Conference Call for 3Q FY3/25

Transcript

- In the third quarter, both consolidated net business profit and bottom-line profit made strong performance due to the steady progress of the Medium-Term Management Plan initiatives amid a favorable business environment and larger gains on stocks. Domestic businesses, in particular, drove the profit growth. In the wealth management business, the AM / foreign currency balances exceeded JPY 19 tn. Credit card sales handled and consumer finance outstanding increased to JPY 30 tn and JPY 2.7 tn respectively. Corporate lending has also increased by 10% YoY for large companies and 6% YoY for mid-sized corporations and SMEs by capturing corporate actions as well as working capital demand, with spreads steadily rising and fee income increasing. Profit in the market business increased steadily by the nimble operations. On the other hand, in overseas, income on loans and deposits and loan-related fees increased, but expenses also rose, mainly due to inflation.
  While G&A expenses increased due to the impact of foreign exchange rates and inflation, the overhead ratio improved significantly due to the implementation of cost control initiatives, such as domestic business reforms. Credit costs were mostly in line with the full-year forecast, despite an increase in overseas banking subsidiaries, including the consolidation of OTO/SOF and costs from large borrowers in overseas.
- For the full year of FY3/25, I am pretty confident that bottom-line profit will exceed the target of JPY 1.16 tn due to the current favorable trend even after considering proactive measures (e.g. forward-looking provisions) and potential losses from the sales of low-profit assets in the fourth quarter, to prepare for future risks and/or volatility.
  We are on pace to surpass an 8% ROE in FY3/25, which was our medium-term outlook, even after implementing these measures to enhance future profitability.
- The policy rate hikes in March and July 2024 had the effect of increasing net interest income by JPY 100 bn, with JPY 70 bn contributing in FY3/25. Furthermore, the latest policy rate hike in January 2025 will increase JPY 100 bn additionally, with JPY 20 bn impacting in FY3/25. In total, previous three rate hikes will increase net interest income by JPY 90 bn in FY3/25 and JPY 200 bn in FY3/26, resulting in a marginal increase of JPY 110 bn in FY3/26.
  Following the rate hike in January, we rose the interest rate on saving deposits to 0.2% with a deposit beta of 40% and the short-term prime rate by 0.25%. Loan spreads have been improving YoY on top of base rate increase and we will continue to focus on further improvement. For JGBs, I believe that it is still too early to build a portfolio at this point, but we will appropriately control the amount of risk to domestic interest rates while assessing monetary policy.
- Equity holdings were reduced by JPY 122 bn by the end of the third quarter, faster than the standard pace, with the consent of sales to JPY 110 bn. I expect to maintain this reduction pace in the fourth quarter. In November 2024, we announced a new plan to reduce JPY 600 bn over five years with JPY 120 bn per year, and we have already exceeded the pace in the first year. This achievement reflects our efforts to reduce ahead of schedule, anticipating that negotiations may become more challenging over time.
- We are currently discussing our FY3/26 plan, taking into account the impact of the interest rate hike in January. I believe we can make a strong profit growth if the current favorable environment continues. As FY3/26 is the final year of the current Medium-Term Management Plan, we aim to pursue both profit growth and ROE improvement, focusing on growth with quality. In the domestic business, the current momentum is expected to continue and the effects of interest rate hikes will be realized. In overseas, we will accelerate the reduction of low-profit assets to further improve

ROE and expect profit contributions from investees in Asia. However, gains on sales of equity holdings are expected to decline, as we sold stocks with relatively larger unrealized gains in FY3/25. There are no significant downside risks for credit costs, but we will closely monitor an increase due to business expansion and overseas, especially if U.S. interest rates remain high. We currently anticipate that the yen will be appreciated beyond the current level due to U.S. interest rate cuts and domestic interest rate hikes, although the pace of U.S. interest rate cuts may slow. We will consider various positive and negative factors to formulate the plan.

- Our capital policy will remain unchanged under the current Medium-Term Management Plan. For shareholder returns, we will maintain a dividend payout ratio of 40% under a progressive dividend policy and allocate excess capital to growth investments and shareholder returns in a well-balanced manner. In FY3/25, we allocated more capital to shareholder returns as there have been fewer opportunities for inorganic investments. However, under the next Medium-Term Management Plan, we should consider growth investments that can generate higher profits than the gains on the sale of equity holdings, which will decline in the near future. We will consider organic growth, and inorganic investment if there is an opportunity, as well as IT investment and human capital investment. While the stock price has recently reached a Price-to-Book Ratio of one, I view this as merely a milestone. Our focus remains on enhancing corporate value by improving both ROE and P/E ratios.

Q&A

Q1. For the potential losses in the fourth quarter, what is the status of the sales of low-profit assets, and what risks do you anticipate regarding forward-looking provisions?

A1. Losses from the sales of low-profit assets announced in November 2024 are expected in the fourth quarter. Given risks such as economic instability and high interest rates, we will consider various measures, including forward-looking provisions, primarily overseas. However, these measures are based on the premise of achieving strong profit growth and exceeding our targets for FY3/25.

Q2. How do you view the upside and downside of the U.S. economy and market under the new administration?

A2: I anticipate the impact should be positive in the short term, but there may also be negative effects in the medium- to long-term. Senior managers who recently visited the U.S. reported that U.S. stakeholders were very optimistic, expecting to ease restrictions soon. In the short term, the market is likely to benefit from this environment, with increased business opportunities for lending and bond issuance. However, we will focus on building resilience and strengthening medium- to long-term management, while paying attention to tail risks such as unexpected geopolitical issues and the potential collapse of an economy nearing a bubble.

Q3. How do you view the deposit beta going forward, considering the strategy of Olive?

A3: Following the policy rate hike in January, we set the deposit rate based on a deposit beta of 40% at the same level as in 2007, when the policy rate was previously 0.5%. We aim to leverage our advantages of Olive to acquire highly sticky, low-cost liquid deposits, thereby pursuing upside potential and improving profitability.

Q4. How do you view the capital policy going forward, considering the rising profit level?

A4: As excess capital may increase, we will prioritize allocating it to organic growth in our domestic businesses in FY3/26, after paying dividends with a 40% payout ratio. The wholesale business has a high ROE and strong loan demand, while the ROE of the retail business is on an upward trend driven by increases in consumer finance outstanding and credit card sales handled. On the other hand, overseas, we will focus on improving ROE through capital reallocation. For inorganic growth, our investment targets remain unchanged: the four countries in our Multi-Franchise Strategy and the CIB business in the U.S. If there is more excess capital, we will conduct share buybacks flexibly.

Q5. How do you plan to address the decline in gains on sales of equity holdings in the future? (e.g. more growth investments including M&A, and/or raising the dividend payout ratio)

A5. In order to generate profit to offset the decline in the gains on the sales of equity holdings, we aim to lay the groundwork for future growth from both organic and inorganic perspectives. M&A is one option, but it is not the only approach to accelerating growth. There are still many challenges in organic growth, such as strengthening the client base for large corporations, enhancing the capabilities of SMBC Nikko, and improving the ROE of overseas businesses. At this time, we are not considering an increase in the dividend payout ratio. Our capital policy remains unchanged: maintaining a dividend payout ratio of 40% under a progressive dividend policy and allocating remaining capital to growth investments and shareholder returns in a well-balanced manner. However, we will reassess the capital policy during discussions for the next Medium-Term Management Plan.

Q6. How sustainable is the growth of domestic and overseas loans?

A6: Domestic loan demand is expected to remain strong in the current environment, especially among large corporations. The +10% YoY increase is inflated due to a temporary rise in working capital demand at the end of the year, but we expect it to continue growing by 5-6%. For mid-sized corporations and SMEs, we believe that the upward trend in loan demand will continue into FY3/26, particularly among supply chain companies.

Overseas, especially in the U.S., corporate activity is expected to increase, driving higher loan demand. However, it is necessary to actively reduce low-profit assets. While loan demand remains strong, we will focus on improving loan spreads while carefully managing loan balances.

Q7. What is the current asset quality in the U.S. and EMEA, where non-performing loans are increasing?

A7: The non-performing loan ratio has declined to 0.68%, and we do not foresee any major downside risks. While some non-performing loans were recorded from borrowers in Europe, we do not anticipate a significant increase in credit costs from large borrowers. The non-performing loan ratio is expected to remain at a low level.

Q8. How do you plan to increase profit in FY3/26, considering the current business momentum?

A8: The decline in gains on sales of equity holdings will be offset by the absence of future measures, while the profit increase from policy rate hikes will contribute throughout the full year, including the latest rate hike in January. I believe that business momentum is accelerating recently, but we will carefully evaluate its magnitude and sustainability as we formulate the plan for FY3/26.

Q9. What is the outlook of Global Market Business Unit, considering its strong performance through 3Q FY3/25?

A9. The nimble operations in the third quarter were very successful, but I expect performance to moderate in the fourth quarter.

Q10. Are there any one-off factors or downside risks in FY3/26?

A10: Gains on sales of equity holdings were a temporary positive factor, as we sold stocks with relatively larger unrealized gains in FY3/25. Profit from the Global Market Business Unit is also expected to be moderate in FY3/26, as its currently strong performance was driven by nimble operations until the third quarter. Additionally, I believe that precautionary measures are necessary to prepare for temporary shocks and tail risks, given the increasing uncertainty.

Q11. What is your view on building yen bond portfolio?

A11: The Bank of Japan has stated that the nominal neutral interest rate is estimated to range between 1% and 2.5%, indicating there is still a considerable gap from the current policy rate of 0.5%. From our perspective as well, corporate capital investment remains active, and there is strong momentum for wage increases, suggesting a gradual progression of inflation. Therefore, we are managing domestic interest rate risks with a highly controlled approach. At this point, we are not considering extending the duration or increasing the balance of our yen bond portfolio.