Conference Call on Strengthening of Strategic Capital and Business Alliance with Jefferies

Transcript

- Since our initial alliance in 2021, Jefferies Financial Group and SMBC Group have jointly marketed in our areas of strength and built a steady track record over the past four years.
- Here are four key points in this project:
    1. Japanese Equities Joint Venture
    We will establish a joint venture in Japan, SMBC Nikko Jefferies Securities, as the core entity overseeing the wholesale Japanese equities business. Ownership will be 60% for SMBC Group and 40% for Jefferies on a voting-rights basis, and 70% and 30% respectively on an economic ownership basis. SMBC Nikko's overseas wholesale Japanese equities business will be migrated to Jefferies. We are also considering establishing an intermediate holding company to ensure cohesive, group-wide management.
    2. Strengthen the Capital Alliance
    We will increase our economic ownership of Jefferies up to 20%. Based on the current share price, the investment amount will be JPY 135 bn and its impact on the CET1 ratio is expected to be (13) bps. We expect the profit contribution of JPY 40 bn with ROE of around 13% in the third year, and JPY 50 bn with ROE of around 17% in the fifth year.
    3. Enhance Collaboration in EMEA
    We will expand the joint coverage of larger sponsors in EMEA.
    4. Credit Facilities
    We will provide new credit facilities of USD 2.5 bn to advance collaboration areas such as EMEA leveraged lending and U.S. pre-IPO lending, receiving fees and growing our collaboration profits while managing profitability with strict discipline.
- SMBC Nikko has a strong presence in the domestic Japanese equities business. However, we see challenges in large-scale global ECM deals and in global deals in secondary business. As deal sizes grow and cross-border activity increases, we will integrate our Japanese equities business with Jefferies to capture these opportunities. By deepening level of collaboration, we will leverage Jefferies' strengths, global fund coverage and sector expertise, to drive SMBC Nikko's next stage of growth.
- Vision for the Japanese Equities Joint Venture: We will combine our respective strengths in investor coverage for retail and wholesale in Japan and worldwide, in research in Japan and globally, and in global equities trading platform. In the service for issuers, this will enable higher-quality insights and proposals, positioning us to win larger, cross-border mandates. In the service for investors, we will broaden our reach and unlock additional opportunities, not only in Japanese equities but also in U.S. equities, such as corporate equity derivatives and synthetic prime brokerage.
- Capital Allocation: Both of our investments, 20% in YES BANK and 5.5% in Jefferies, are included in our initial capital plan. An additional 4.2% investment in YES BANK arose during the year, which consumes (5) bps in CET1 ratio. However, we concurrently sold our stake in Kotak Mahindra Bank and released capital, improving CET1 ratio by +7 bps, to reallocate business portfolio in India.
FY3/26 performance: The JPY 100bn tariff impacts assumed at the start of this fiscal year has only partially materialized and we now expect a reversal of about JPY 80 bn. In addition, the sales of Kotak shares will deliver an after-tax gain of JPY 65 bn. While our business lines remain strong, given strong organic asset growth, especially in Japan and the U.S., we consider accelerating the reduction of low-profit assets, even if that entails some losses.

Shareholder returns: We will consider increasing the dividend forecast if we revise our FY3/26 targets upward. Share buybacks will be decided depending on our capital position while managing organic asset growth. While we are allocating capital to investment for growth this year, we remain committed to enhancing shareholder returns.

Q&A

Q1. How do you view making Jefferies an equity-method affiliate?

A1. It may be a future option, but it will need to meet a stringent threshold in both economics and SMBC Group's governance and capacity.

1. As making equity method affiliate requires to book goodwill, we would compare the earnings after goodwill amortization with the dividend income under the current structure.
2. We do not have sufficient capacity to govern and risk-manage an equities-centric platform like Jefferies now.

We may assess the option taking into account the stance of Jefferies and regulatory approvals if we build the necessary capabilities, but we are not assuming now. Under regulations, increasing ownership above certain thresholds will also make Jefferies to be placed under SMBC Group's U.S. bank holding company. Given our current capital position and capabilities, we do not expect to be in such a position and do not contemplate crossing that threshold.

Q2. What makes up the JPY 50 bn profit contribution in the fifth year?

A2. About JPY 10 bn will come from the Japanese equities business. The remainder will come largely from global businesses, especially in the U.S., and extended joint coverage in EMEA. Jefferies is strong in U.S. high yield and sponsor-related deals but had fewer investment-grade mandates. The bankers hired over the past two years are beginning to contribute to pipeline growth and we expect collaboration to accelerate. We also include dividend income from our Jefferies stake.

Q3. How will the alliance benefits materialize?

A3. Overseas, by partnering in leveraged finance and focusing on sponsor-related deals, we expect higher loan balances and improved spreads, increasing net interest income. We also expect higher fee income as our ECM and M&A client base expands. For the Japanese equities business, integration benefits will begin to materialize after the launch in 2027.

Q4. Beyond the Japanese equities business, is it possible to extend the alliance to the majority of the domestic wholesale securities business, including coverage?

A4. Outside the Japanese equities, coverage and M&A are the area best aligned with the JV. I think the organization should be integrated as early as possible as it is ideal to make M&A and financing proposal together. However, we are reviewing our approach to SME M&A at SMBC Nikko as our focus differs from Jefferies'. For DCM and bond trading, both SMBC Group and Jefferies should prioritize strengthening independently rather than integrating at this stage. Therefore, we will first integrate Japan equities and consider coverage and M&A next.

Q5. With inorganic investments completed under the current Medium-Term Management Plan, can we expect no large investments and stronger shareholder returns in the next plan?

A5. I believe that we filled the missing pieces with our investments in YES BANK and our transaction with Jefferies. While we may consider bolt-on investments and partnerships to strengthen our domestic businesses, we are not planning large-scale investments. As earnings increase, we expect to generate more excess capital. In our discussion on the CET1 ratio target, our stress-buffer analysis does not indicate a need to raise it, but modest increase might be necessary from a liquidity and credit-ratings perspectives. Expanding securities business through alliance with Jefferies may increase volatility in our portfolio, but scaling asset-light businesses, such as asset management and transaction banking, will reduce the necessity for a significant increase. Accordingly, we intend to build capital through retained earnings while also increasing shareholder returns. In the discussion of shareholder returns, we assess various advice from investors. With our PBR now stably above one, I feel that anticipation for share buybacks is not as strong as before. However, as share buybacks are effective method to improve ROE and EPS, we will discuss our policy together with profit level and dividend.