# President's Message

Building on the momentum created by the swift and solid progress in reaping the synergies from business consolidation at Sumitomo Mitsui Banking Corporation (SMBC), SMFG was established as a holding company in December 2002. In February 2003, Sumitomo Mitsui Card Company, Limited, SMBC Leasing Company, Limited, and The Japan Research Institute, Limited became wholly owned subsidiaries along with SMBC to optimize Group management and strengthen strategic businesses. These and other initiatives have fortified the core capital base and earnings capability of the Group.

In the first half of fiscal 2003, we moved aggressively from this reinforced position to strengthen the foundation for achieving higher sustainable profitability.

## Business Environment and Policy

The Japanese economy stagnated in the first half of 2003 as the Iraq war, the outbreak of SARS, and other events led to a heightened sense of economic uncertainty. However, these worries receded and the economy entered a slow recovery trend in the summer, led by improving corporate earnings, resulting from business restructuring and recovering exports. With the gradually rising capital investment, mainly in the manufacturing industries, the deterioration in income and employment and the increase in the number of bankruptcies have been slowing down. Aided by overseas factors, stock prices have been recovering also. The business environment has been improving, but deflation, the overriding factor, continues to prevail.

Against this backdrop, we set decisive targets to rapidly improve asset quality and enhance profitability. We designated fiscal years 2003 and 2004 as the period for halving the non-performing loan ratio and further reducing shareholdings. In the Plan for Strengthening the Financial Base (the Plan), published in September 2003, we outlined our initiatives for enhancing profitability: expand business volume by utilizing the unified Groupwide capabilities to provide higher value-added services that match customers' needs; increase capital efficiency by improving the risk-return profile, and channel resources into high-profit businesses; and strengthen cost efficiency by reinforcing low-cost operation.

In the first half of fiscal 2003, I am pleased to report that significant progress was made in improving asset quality and reinforcing business models with competitive advantage in a number of strategic businesses to enhance profitability. Although we anticipate that the economy will remain in a slow recovery mode in the second half, we are firmly committed to further reinforcing the financial base by improving asset quality and profitability. At the same time, we remain steadfast in our focus on net profit and building up internal reserves.

## Key Issues and Achievements

### 1. Improving Asset Quality

We moved swiftly to achieve the target of reducing the non-performing loan balance to ¥3,900 billion by the end of fiscal 2003 by off-balancing, corporate revitalization, and preventing deterioration of borrowers' financial conditions. As a result, we were able to achieve this target by the end of September 2003, six months ahead of schedule. We will maintain this momentum by utilizing the corporate recovery joint venture established with Goldman Sachs (Japan) Ltd., Daiwa Securities SMBC Principal Investments Co. Ltd., and Development Bank of Japan.

On the shareholdings front, in the first half of fiscal 2003, we achieved nearly 80 percent of the initial aim of selling at least ¥700 billion in cross-shareholdings during the fiscal year. We will continue to reduce our exposure to stock price fluctuations in the second half.

### 2. Enhancing Profitability

We also made steady headway on all fronts of the Plan to bolster profitability by: establishing business models with competitive advantage in several strategic businesses; significantly cutting costs; and utilizing the Groupwide capabilities to provide higher value-added services. We have taken additional steps to maintain this momentum in the second half.

In the middle market banking business, while remaining committed to improving spreads, we focused on loans to small and medium-sized enterprises (SMEs) by expanding and improving risk-taking products. The greater-than-expected number of new originations of *Business Select Loan*, a new-type unsecured loan for small enterprises, and other such unsecured products in the first half reflects the success of our business model. Our capacity to originate unsecured loans will be bolstered in the second half with the standardization of the credit-screening process implemented in the first half, further reducing credit-screening time and cost. Under the deflationary environment, companies are strongly compelled to reduce interest-bearing debt, but we will effect a sweeping reinforcement of the lending business to reverse the downward trend in the loan balance. One such initiative is the change in our strategy for our office network, from streamlining to expansion. For example, sales offices will be newly established in areas with a huge potential SME customer base. For large and medium-sized companies, we will provide a wider range of financing solutions, such as loan syndication and asset securitization, through strengthened cooperation with Daiwa Securities SMBC Co. Ltd.

In the consumer banking business, we have a competitive advantage in marketing investment trusts and pension-type insurance products, and home mortgages. We will continue to establish new business models, such as a financing consultation service through the new delivery channel "SMBC Consulting Plaza," to further strengthen these strategic businesses. We originally set high targets to far surpass the previous fiscal year's results in these strategic businesses, but in fact, we are on course to exceed these targets by even wider margins.

On the cost front, we pushed up our schedule of achieving an annual cost structure of ¥600 billion by one year from fiscal 2004 to fiscal 2003, and made great strides in the first half by further reducing personnel expenses. We are reassessing procurement practices for supplies and imposing other rigorous measures to realize additional cuts in the second half.

Collaborations among Group companies are starting to bear fruit also. In April 2003, we transferred and integrated into JRI the systems-related functions of SMBC. JRI will act as the Group's IT company and be the main cog of the Group's information systems. Another illustration of Group teamwork is "One's Style," a new product jointly developed by SMBC and Sumitomo Mitsui Card, aimed exclusively at people in their 20s and 30s, which we launched in November 2003. Reinforcement of the Group's consumer finance business is next in line. Through these and other initiatives, we will raise the earnings potential Groupwide by capitalizing on the intrinsic strengths of each Group company.

### In Closing

We believe "competitive business models" and "a strong, diversified business portfolio" are necessary to enable us to adapt to changing economic environments and achieve higher sustainable profitability. However, it takes time and fortitude for a huge company such as SMFG, with consolidated banking profit of more than ¥1 trillion, to boost profit 10% or 20%. Nevertheless, speed is of the essence. In strategically important markets with high growth prospects, we will quickly spot and act on opportunities to create new businesses, each of which should have the potential to generate tens of billions of yen in profit. We are firmly committed to seeking and realizing such opportunities.

Underpinning this drive for higher sustainable profitability is our dedication to provide greater value-added products and services to satisfy our customers' needs. The challenge going forward is to realize the opportunities and fulfill our potential, thereby improving our net worth and shareholder value. We respectfully continue to seek your valued support and guidance.

Yoshifumi Nishikawa
*President and Chief Executive Officer*
Sumitomo Mitsui Financial Group, Inc.

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