Investor Relations Meeting for 1H of FY2024
Q&A Summary

Presenters

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Q1: On page 12 of the IR presentation material, the considerable growth seen in the average balance of general corporate lending is illustrated. Please elaborate on what contributed to this growth. Could you also describe the breakdown of capital expenditure-related lending as well as your outlook for funding demand in 2025?

A1: The balance of general lending has steadily expanded due to both internal and external factors. The internal factors include (1) the Group, having entered a phase of capital utilization, focusing on expanding its lending balance as a central investment measure for achieving organic growth and (2) the Group’s ability to accurately accommodate diversifying funding needs among customers thanks to its successful longstanding engagement in consulting-oriented sales. The external factors include (1) full economic recovery from stagnation influenced by the COVID-19 pandemic and (2) the beginning of modest inflation.

Against this background, we have seen the emergence of fresh funding needs among our customers due to evolving social trends, such as those related to DX and decarbonization, in addition to the depreciation of the yen, higher prices for goods, interest rate fluctuations, and other changes in the macro environment. Moreover, although customer need for business and asset succession measures was largely latent prior to the COVID-19 pandemic, the level of need has grown more profound in the post-pandemic era. These are major underlying factors.

As for capital expenditure-related funding, a sector-based breakdown indicates particularly high growth in the transportation, wholesale and retail sectors. Furthermore, it is confirmed that customer needs are strong in other sectors.

We believe that the trends described above will remain ongoing in the second half and beyond. Although we are unsure whether or not the annual growth rate in the lending balance can be kept as high as the present 7% rate through FY2025, we expect it to remain strong going forward. As our customers confront various issues arising from the changes mentioned above, we will stay focused on leveraging a consulting-oriented sales approach to help them resolve such issues via the provision of optimal solutions.

Q2: Regarding the status of reductions in policy-oriented stockholdings as described on page 22 of the IR presentation material, what is your future outlook on this subject, having accomplished greater-than-planned reductions in the balance of these stockholdings and higher gains on sales in the first half?

A2: In the first half, our efforts in this area resulted in a high progress ratio due in part to the reduction of stockholdings associated with a major corporate customer. The successful reduction of our policy-oriented stocks is often dependent on our corporate customer's capital policies. Moreover, the majority of our policy-oriented stockholdings are associated with a handful of major corporate customers. Therefore, it could be quite hard to proceed with divesting them at a steady pace over the course of six years. However, our rationale for reduction is now fully understood by many corporate customers. Accordingly, we believe that there is room for accelerating our reduction plan. In any case, we will continue to engage in in-depth dialogue with corporate customers. We are confident about the likelihood of achieving our final target for reduction.

Q3: Regarding page 11 of the IR presentation material, in which the possible impact on earnings of JPY interest rate hikes is illustrated, the Group suggests that such impact has been stronger than expected as the pass-through rate of term deposits remained below original estimates. Going forward, what is your forecast regarding the customer shift toward term deposits and the pass-through rate of deposit interest rates?

A3: Interest rates on savings accounts increased 0.10%, while the policy rate rose 0.25%. The pass-through rate thus amounted to 40% in line with our estimation. On the other hand, although we had conservatively projected that the pass-through rate for term deposits would amount to 100%, this rate turned out to be around 50%. If the policy rate increases by 0.50% or even 0.75% going forward, more customers will shift toward term deposits at some point. This, in turn, could increase our portfolio's sensitivity to interest rates. We thus need to stay vigilant and quickly respond to changes in customers' financial behavior. This is considered a major objective of our ALM.

Q4: Regarding page 14 of the IR presentation material, which describes the Group's two income sources supported by a strong retail deposit base, could you please name, if any, factors differentiating the Group from other banks in terms of utilizing said retail deposit base and achieving higher net interest income from deposits?

A4: The retail deposits we hold boast strong retention, a factor that gives us an advantage as a bank. Nevertheless, business operations under the negative interest rate environment made it hard for us to achieve higher profit from deposit management. In addition, we have been struggling with an ever-lower ROA and other challenges over the past few years. With the return of a world with interest rates, however, we are now confident that the strength arising from this retail deposit base could be fully leveraged on the back of rises in the ratio of loans and securities to deposits.

At the same time, although we have been able to take full advantage of our locally-rooted physical branch network, we are now focused on promoting the use of digital banking, including among deposit-only customers. For example, the number of app downloads by individual customers has exceeded 10 million. In the area of corporate banking, we have 68,000 customers who name one of our Group banks as their main bank. Backed by these accomplishments, we are quite confident in our ability to capture deposits. We have been able to deliver solutions supporting household financial management and corporate transactions in both face-to-face and digital channels, helping individual and corporate customers stay on trend with the ongoing digital shift in day-to-day finance.

Over the course of the five years from September 2019 to September 2024, our deposit balance grew around JPY10 trillion. Although the business environment is expected to change somewhat in the world with interest rates, we believe that our success hinges on how we steadily integrate face-to-face and digital channels to establish a business structure that involves higher switching costs for customers.

Q5: Regarding page 6 of the IR presentation material, in which the rationale for an upward revision of FY2024 earnings targets is described, please elaborate on your intention behind the revised target, “Aiming for a level of JPY190 billion, excluding MB integration costs.” Is it correct to interpret this as the Group’s intention to draw attention to this target rather than JPY175 billion, which takes these integration costs into account?

A5: We intend to robustly present our actual status as part of stakeholder communications. We believe that actual earnings could turn out to be even higher than the above target in light of such factors as the current pace of growth in the lending balance and the status of credit-related expenses. This projection stands even if positive changes in the interest rate environment are excluded.

Q6: The Group’s medium-term management plan (MMP) target for the lending balance is expected to be met a year ahead of schedule. Taking this and other factors into account, the progress status of the MMP seems to be favorable. Given this, please share your outlook for FY2025 regarding KPIs under the MMP, including ROE (based on total stockholders’ equity).

A6: With regard to operating results for FY2025, we have seen many uncertainties, such as those associated with assumed interest rates and, therefore, are not well-positioned to disclose our outlook. However, if we assume an additional policy rate hike of 0.25%, we could be able to formulate an ambitious, perhaps even unprecedentedly high, ROE target. We have launched internal discussions regarding the formulation of our targets for FY2025 and the next MMP. We intend to disclose our future policies on a separate occasion after robustly discussing these matters.

Q7: Regarding the reduction of policy-oriented stockholdings, it can be assumed that the Group expects the gains on the sale of such stocks in the second half to fall short of those recorded in the first half, based on its FY2024 plan for net gains on stocks (including equity derivatives). If second-half gains on the sale of such stocks are higher than estimated, can we simply expect the Group’s net income to increase with the incorporation of these gains? Or does the above plan take into account the possible recognition of new expense items, like those resulting from the more precise recording of expenses associated with the integration of MB's back-office operations and systems?

A7: We have formulated our plan for the reduction of policy-oriented stockholdings based on certain hypotheses. However, as these endeavors could be affected by customers’ capital policies, it is quite hard for us to predict the timing of reduction. However, we have always allocated surplus funds to forward-looking initiatives to improve the profit and loss status as necessary and whenever an opportunity arises. This remains the same if your possible scenario of greater-then-expected gains on reduction comes to pass. Also, we recognize only a handful of noteworthy items that could involve losses. Going forward, we will discuss and determine in what ways we utilize gains on stocks, employing a broad perspective encompassing our future operations in FY2025 and over the course of the next MMP.

Q8: Regarding gains on the sale of policy-oriented stockholdings to be recorded in FY2025 and later, could you share your thoughts on factoring in these gains when setting performance targets, that is, provided that the Group steadily records a certain volume of gains on reduction annually in line with its plan (i.e., reducing the book value by two thirds or more over the course of the period from April 1, 2024 to March 31, 2030)?

A8: As mentioned earlier, the successful reduction of policy-oriented stocks is dependent on the capital policies of the corporate customers involved. Therefore, the timing of reduction is hardly predictable. We intend to formulate plans for each fiscal year with an eye to steadily achieving our overall reduction target over the six years.

Q9: It is expected that the Group will see ongoing growth in expenses in FY2025 and beyond. Please share your outlook for expenses, taking into account such factors as the effect of the appropriate cost recognition for the integration of MB's back-office operations and systems.

A9: We are about to discuss our FY2025 plan in more depth and, therefore, are not positioned to disclose details. However, we expect the wage increase to remain a central topic meriting public discourse in FY2025. For your reference, in FY2024 we raised wages by around 5% on a Groupwide basis.

With regard to non-personnel expenses, we plan to record approximately JPY20 billion in the collective amortization of expenses associated with the integration of MB's back-office operations and systems. This will help us curb expenses from FY2025 onward. On the other hand, we expect to record a certain amount of amortization costs associated with IT-related investments executed in past fiscal years. Furthermore, we have also pushed ahead with structural reforms as well as the use of AI and other measures to promote the DX of in-house operations. Although these endeavors will result in some degree of growth in costs, we can also expect various positive effects of progress in operational streamlining. Accordingly, we believe that the pace of overall growth in expenses could be contained at a lower level than it was in FY2024.

Q10: Regarding the capital adequacy ratio discussed on page 55 of the IR presentation material, the volume of credit risk weighted assets (RWAs) declined from the level recorded at the end of March 2024. What are the factors contributing to this decrease?

A10: The main factors contributing to the decrease in credit RWAs from March 31, 2024 are (1) a decrease of around JPY300 billion due to the reduction of policy-oriented stockholdings, etc., and (2) a decrease of around JPY150 billion associated with decreases in lending parameters. On the other hand, factors that added to the volume of these assets included (1) an increase of JPY200 billion arising from growth in the loan balance and (2) other factors connected to market operations (e.g., investment trusts and ETF). Thus, the overall volume of credit RWAs declined roughly by JPY140 billion.

Q11: Please provide some details on the proactive balance sheet management stated on page 10 of the IR presentation material.

A11: As presented in the material, the ratio of loans and securities to deposits declined to 77% around the end of March 2022. This resulted in a balance sheet structure characterized by considerable disparity in the loan and deposit balances. However, because the yield curve becomes steeper on the back of changes in the environment, the Group was able to smoothly deliver funding and, therefore, expand the balance of loans, via the full utilization of its deposit base with strong retention while investing in JGBs, especially those with medium-term maturities. At the same time, this shift in the environment is naturally prompting indirect financiers, like ourselves, to effectively employ their Bank of Japan (BOJ) deposits. We currently have BOJ deposits totaling JPY18 trillion. We will thus promote their transition to use in loans and securities. By doing so, we aim to robustly raise our ROA.

Q12: The Group’s current ROE target of 8%, a figure that surpasses the cost of capital, is expected to be met before long. Given this, please describe your views, if any, on the Group’s long-term target. To what extent could the Group raise its ROE target in the future?

A12: We are currently in the process of setting our medium- to long-term ROE target as part of discussions aimed at formulating the next MMP. If the policy rate were to reach the 0.50% upper limit, the achievement of an ROE (based on total stockholders’ equity) of nearly 10% would be in sight. Following on this assumption, we could expect to achieve an ROE of 8% based on the TSE standard. Furthermore, we could, and should, aim for an ROE of more than 8% based on the TSE standard, factoring in such positives as interest rate hikes and future returns on inorganic growth investments. We will strive to achieve an ROE at this level and report it to our stakeholders.

Q13: Looking at page 85 of the IR presentation material, the trend in risk-adjusted return on capital over past 10 years seems to indicate that, in contrast to the constant growth enjoyed by the consumer division, the growth experienced by the corporate division has not been substantial. Is this correct?

A13: In the consumer division, RWA-based capital charges for housing loans, which serve as a major earnings source for the division, have been relatively smaller. I credit the consumer division’s greater degree of growth to this difference. Furthermore, growth in risk-adjusted return on capital is profoundly affected by each division’s deposit spreads. In terms of deposit procurement sources, individual customer deposits account for a high 66% of the overall deposit portfolio, yet another factor supporting growth in its risk-adjusted return on capital.

Q14: According to the Group's capital utilization plan featured on page 21 of the IR presentation material, a goal of the current MMP is to expend a cumulative total of JPY100 billion on inorganic growth investment. The Group already invested around JPY20 billion in the previous fiscal year. Could you touch on the focus of current discussions to determine the usage of the remaining JPY80 billion?

A14: Of the amount budgeted for inorganic growth investment under the current MMP, less than JPY20 billion has been used thus far as part of capital utilization measures. However, we believe that our investments to date will yield robust synergies resulting from the strategic alliances established through this expenditure. Also, we are engaged in wide-ranging discussions aimed at securing alliances outside the Group with an eye to acquiring new customer bases, human and other management resources, and enhancing non-banking functions. Currently, capital utilization is under way in line with progress in balance sheet management on the back of interest rate hikes, though we have yet to proceed sufficiently with inorganic growth investment measures. However, we are determined to work hard to achieve the goals of the MMP in terms of inorganic growth so that we can report good results by the end of its remaining period of one year and four months.

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