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Equity Research
Multinational Banks (Banks(Japan)) / OVERWEIGHT

Major Banks

Research Analysts
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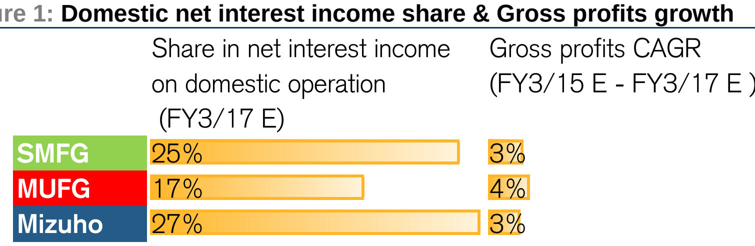
ASSUMING COVERAGE

Maintain OVERWEIGHT; progress reworking profit structures

- **Maintain OVERWEIGHT stance on major banks:** We maintain our OVERWEIGHT stance on Japan's major banks sector because: (1) growth is continuing for peripheral businesses and overseas units, (2) Japan's banks have ample capital from a regulatory perspective, and we believe they have greater potential for growth than their US and European peers, and (3) ROE-based valuations are appealing. From this report, Takashi Miura assumes coverage of the major banks from Takehito Yamanaka.
- **Points to watch:** The major banks' weightings for net interest income from domestic operations have declined to 20−30% of gross business profit because peripheral businesses and overseas units have driven top-line growth. We expect sustained growth for these two areas, allowing banks to offset declines for earnings from domestic banking operations.
- **Risks:** One risk is that investors could focus exclusively on commercial banking operations in Japan and be excessively concerned about narrowing spreads while missing the bigger picture with respect to overall earnings. Another risk is that additional regulations for financial institutions could limit business growth and shareholder returns.
- **Stock calls:** Sumitomo Mitsui Financial Group (SMFG; 8316, TP ¥5,600) is our top pick because we believe its standout growth prospects and profitability give it the greatest potential upside. We reiterate our OUTPERFORM ratings on SMFG and Mitsubishi UFJ Financial Group (MUFG; 8306, TP ¥750) and NEUTRAL rating on Mizuho Financial Group (8411, TP ¥240).

Figure 1: **Domestic net interest income share & Gross profits growth**



Source: Company data, Credit Suisse estimates

Table of contents

Maintain OVERWEIGHT 3
Peripheral businesses and overseas units to drive growth for earnings 3
Using abundant capital to increase overseas lending 4
SMFG our top pick—substantial potential upside 5
Catalysts/risks 6
Valuations 8
Share price declines imply substantial upside 8
Valuations low relative to global peers 9
Shareholder returns 12
Profitability: SMFG still preeminent 14
Growth potential: Peripheral (non-lending) businesses, overseas units continue to expand 15
Securities 15
Non-banking 17
Overseas lending business 19
Business climate surrounding major banks 22
Lending activities overseas covering for weakness in domestic loan business 22
Overseas lending—contributing to profits, via growth in loan balance, stable interest rate spread 22
Domestic lending—marked by lackluster growth, shrinking spreads 24
Marketable securities and cash deposits—growth in cash deposits slowed sharply in 1Q FY3/15 26
Non-performing loans and credit costs remain at healthy levels 27
Topics: government set to lower deposit insurance premiums 29

Sumitomo Mitsui Financial Group (8316 / 8316 JP 30
Mitsubishi UFJ Financial Group (8306 / 8306 JP) 37
Mizuho Financial Group (8411 / 8411 JP) 44

Maintain OVERWEIGHT

Peripheral businesses and overseas units to drive growth for earnings

Expecting sustained growth for peripheral and overseas units

Among the major banks, MUFG has the lowest weighting for domestic net interest income within gross business profit at 22%. Even Mizuho, which has the highest, has brought its weighting down to 33%, and the weighting should continue to decline. Peripheral operations and overseas units have emerged as drivers of top-line growth, and we expect steady growth to continue as a whole at each group.

Peripheral businesses include securities operations, which leverage collaborations between banking and securities, and consumer finance/nonbank lending units, which take advantage of banks' ability to provide steady funding. The major banks aim to set themselves apart from the independents, and we believe there is still substantial room for growth if we anticipate a gradual recovery for Japan's economy and an uptrend for consumer spending.

One driver of growth for overseas business profit and interest income at overseas subsidiaries (overseas interest income) is that Japanese banks have taken over some US and European financial institutions, setting the stage for relationships with non-Japanese clients to grow and unlocking autonomous business growth.

Figure 2: **SMFG gross profits breakdown**

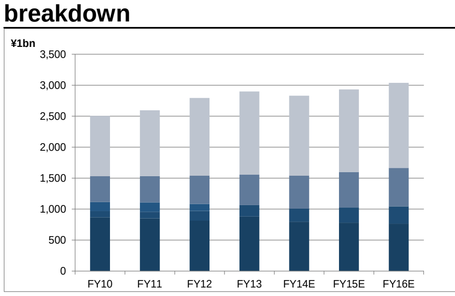


Figure 3: **MUFG gross profits breakdown**

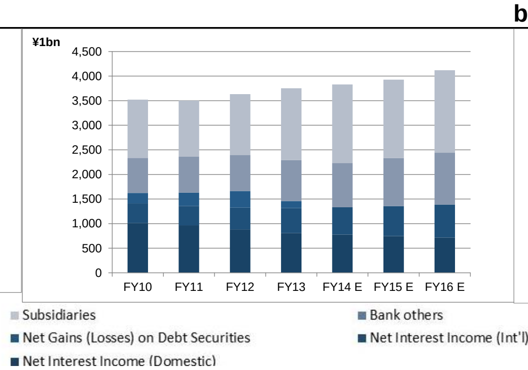
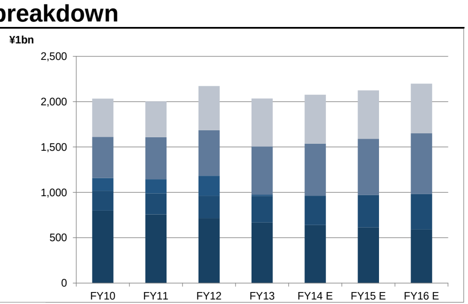


Figure 4: **Mizuho gross profits breakdown**



Source: Company data, Credit Suisse estimates

Expect continued growth for fee and commission income

We expect a temporary lull for some fee income in FY3/15 because of weaker sales of investment trusts. Overall, however, we expect over-the-counter sales of insurance policies, an uptrend for syndicated loan arrangement, and other factors to support sustained growth for fee and commission income.

Excessive focus on domestic spreads

We believe the stock market is paying an undue amount of attention to domestic spreads. Assuming interest rates do not rise further, our view is that peripheral businesses and overseas units can drive growth for overall earnings, even after pricing in additional downside for domestic interest income. Of course, an uptrend for interest rates could mean higher net interest margins and a brisk recovery for interest income.

We maintain our OVERWEIGHT sector view.

Using abundant capital to increase overseas lending

Transitional guidelines for the common equity Tier 1 (CET1) capital ratio will be replaced by more stringent requirements when Basel 3 standards are implemented in full in 2019.

Inputs for CET1 capital will need to be part of equity capital, so institutions may need to raise shareholders equity.

Top class capital allowance globally

Figure 5: **Regulatory capital ratios of global banks**

	G-SIFIs Requirement (%)	Fully Applied (%)	Allowance (%)	Transitional (%)	Updated
SMFG	8.0	10.3	2.3	10.6	3/31/14
MUFG	8.5	11.1	2.6	11.3	3/31/14
Mizuho	8.0	9.1	1.1	8.8	3/31/14
BOA	8.5	9.9	1.4	12.0	6/30/14
Citigroup	9.0	10.6	1.6	13.0	6/30/14
GS	8.5	9.8	1.3	11.4	6/30/14
JPM	9.5	9.8	0.3	9.8	6/30/14
MS	8.5	12.1	3.6	13.8	6/30/14
Barclays	9.0	9.9	0.9	9.8	6/30/14
Deutsche Bank	9.0	11.5	2.5	14.7	6/30/14
HSBC	9.5	11.3	1.8	11.2	6/30/14
RBS	8.5	10.1	1.6	10.1	6/30/14
BNP	9.0	10.0	1.0	10.2	6/30/14

Source: Company data, Credit Suisse estimates

At this point, the major banks already have substantial capital and clear the requirements that will take effect at full implementation. We do not expect any substantial losses, fines, or other events that would have adverse impacts on equity capital.

Figure 6: **Capital ratios of major banks**

(JPY bn)	SMFG FY3/14	MUFG FY3/14	Mizuho FY3/14
CET1	6,551	11,153	5,304
Risk-weighted Assets	61,623	99,084	60,287
(Capital Ratio)			
CET1 Ratio (Minimum Requirement)	8%	8.5%	8%
CET1 Ratio (Transitional)	10.62%	11.25%	8.79%
CET1 Ratio (Full Inplementation)	10.30%	11.10%	9.08%
CET1 Ratio(Full Implementation, excluding net unrealized gains/losses on securities)	9.15%	9.50%	7.88%

Source: Company data

Banks in the US and Europe have been reluctant to increase assets, and recent growth for lending suggests the major banks are at the head of the class.

Figure 7: **Loan balance growth in global major banks**

	Currency (mn)	Loan balance as of latest FY end	CAGR(3yrs)
Mitsubishi UFJ Financial Group	JPY	101,938,907	8.4%
Standard Chartered Plc	USD	294,153	6.6%
HSBC Holdings	USD	1,007,232	1.0%
Sumitomo Mitsui Financial Group	JPY	68,227,688	3.6%
Mizuho Financial Group	JPY	69,301,405	3.4%
UBS	CHF	287,682	2.9%
Wells Fargo & Company	USD	822,286	2.8%
JPMorgan Chase & Co.	USD	734,166	1.9%
Citigroup Inc.	USD	665,472	0.8%
Bank of America Corp.	USD	928,233	-0.4%

Source: Company data

We expect the loan balance of Japanese major banks to continue to grow with a solid increase in overseas assets.

SMFG our top pick—substantial potential upside

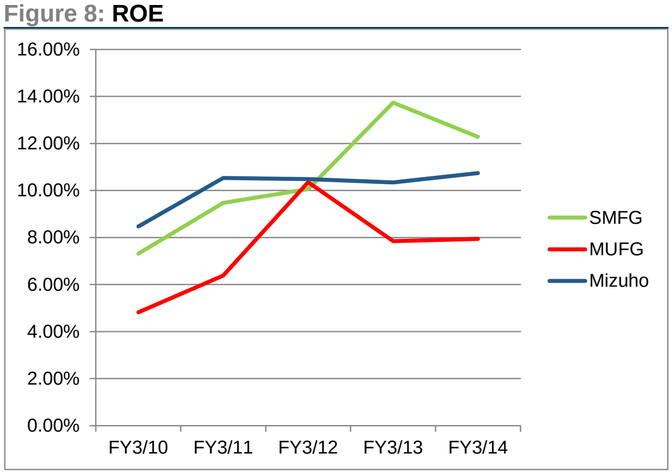
We see SMFG as the most appealing of the three major banks because we believe it has the greatest potential for overseas gross business profit and the best margins. We maintain our OUTPERFORM rating on MUFG in light of the strengths of its overseas operations. Our rating on Mizuho is NEUTRAL, but we could revisit this if integration leads to improvements in cost structures and margins rise.

ROE-based valuations appealing

P/Bs improved temporarily after Abenomics built up a full head of steam in 2013, but valuations have eased since the start of 2014.

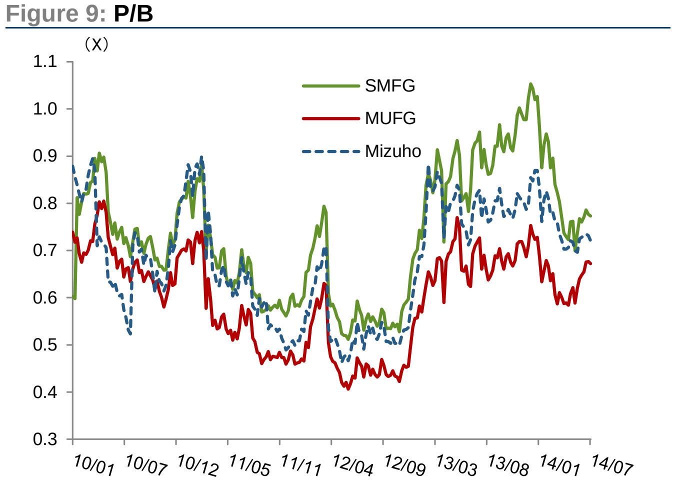
We expect gradual improvements to ROE and believe this will increase the appeal of the major banks' valuations.

Figure 8: **ROE**



Source: Company data

Figure 9: **P/B**



Source: Company data, Thomson Reuters

Catalysts/risks

Factors that could lift sector share prices include yen weakening, stronger-than-anticipated growth for overseas operations, political stability in Thailand (MUFG), expectations for Indonesia now that elections are over (SMFG), higher earnings should US interest rates rise (MUFG), and solid macro numbers that support tapering and, by extension, higher interest rates.

We outline two other potential catalysts/risks for the sector below.

Changes to the BoJ's easing plans

Tapering: Positive impact

If the BoJ were to scale back its easing initiatives, wider spreads could raise expectations of earnings growth. Over the near term, however, higher interest rates could result in valuation losses.

Additional easing: Negative impact

If the BoJ were to go in the opposite direction and pursue additional easing, upside would likely be limited because procurement interest rates cannot go any lower and securities' durations would decline. Spreads would probably contract, with lower interest rates on deposits at the BoJ resulting in lower direct interest income.

New capital guidelines prompting additional capital increases: Negative, but unlikely

In addition to liquidity requirements in effect since 2013, Basel 3 will include three additional requirements. We believe the major banks will clear these requirements easily.

Figure 10: **Regulations set to be implemented but with details TBD**

Regulation	Details	Objective	Target	Date
Liquidity coverage ratio (LCR)	Liquidity/amount needed for 30-day stress scenario	Quantitative liquidity regulation	≤100%	2015
Net stable funding ratio (NSFR)	Stable funding/long-term assets (at least a year to maturity)	Same as above	≤100%	2018
Leverage rule	Common equity Tier 1/exposure	Exposure control	≤3%	2018

Source: Company data, FSA

Three other requirements are in the works, but as of July 2014 details have yet to be determined.

Figure 11: **Regulations that could be implemented**

Regulation	Details	Objective	Target	Date
Interest rate risk in banking book (IRRBB)	Additional risk assets to offset interest risk in banking book	Regulate interest rate risk in banking book	TBD	TBD
Gone-concern loss absorbing capacity (GLAC)	Additional regulatory capital	Additional debt relief during bankruptcies	TBD	TBD
Review of trading account's risk weighting	Additional risk assets to offset credit risk in trading account	Additional capital load for trading account	TBD	TBD

Source: Company data, FSA

The new requirements could raise the need for additional capital, but they will be applied to all financial institutions globally, and at this point, we see relatively little risk of the major banks needing to increase capital.

Figure 12: Financial results and forecasts

					(JPY bln)
		FY3/14	FY3/15 E	FY3/16 E	FY3/17 E
SMFG	Gross Profits	2,898	2,830	2,931	3,038
	(YoY %)	*4%*	*-2%*	*4%*	*4%*
	Ordinary Profits	1,432	1,173	1,160	1,235
	(YoY %)	*33%*	*-18%*	*-1%*	*6%*
	Net Income	835	661	645	689
	(YoY %)	*5%*	*-21%*	*-2%*	*7%*
MUFG	Gross Profits	3,753	3,830	3,927	4,121
	(YoY %)	*3%*	*2%*	*3%*	*5%*
	Ordinary Profits	1,695	1,550	1,545	1,629
	(YoY %)	*26%*	*-9%*	*0%*	*5%*
	Net Income	985	960	951	1,003
	(YoY %)	*15%*	*-2%*	*-1%*	*5%*
Mizuho	Gross Profits	2,035	2,077	2,124	2,198
	(YoY %)	*-6%*	*2%*	*2%*	*3%*
	Ordinary Profits	988	903	860	870
	(YoY %)	*32%*	*-9%*	*-5%*	*1%*
	Net Income	688	500	510	513
	(YoY %)	*23%*	*-27%*	*2%*	*5%*

Source: Company data, Credit Suisse estimates

Valuations

Share price declines imply substantial upside

As before, our TPs use FY3/15E BPS and P/Bs. Our multiples reference our FY3/15E ROE estimates and adjusted betas (two-year betas as a rule, but a five-year beta for Mizuho to minimize noise), the risk-free rate, and an equity risk premium.

Figure 13: **Valuations for the three banks**

(JPY bn)

	SMFG	MUFG	Mizuho
F3/15 Net Income E	661	960	500
F3/14 Net Assets	7,279	13,056	6,457
F3/15 Net Assets E	7,818	13,333	6,866
F3/15 ROE	8.8%	7.3%	7.5%
Stock Volume (1000s)	1,367,273	14,161,471	24,250,067
Dilution			1,099,686
F15/3 BPS	5,717.6	941.5	283.1
Beta	1.200	1.216	1.195
RFR	1.0%	1.0%	1.0%
ERP	6.5%	6.5%	6.5%
Discount Rate (%)	9.0%	9.1%	9.0%
PBR	0.97	0.80	0.84
Target Price	**5,600**	**750**	**240**
Stock Price (8/11)	4,053	583	195
Upside	**38.2%**	**28.7%**	**23.0%**

Source: Company data, Credit Suisse estimates

Higher outlook for comprehensive income lifts BPS, lower beta reduces discount

We raise our BPS estimates relative to forecasts discussed in our 14 May reports (MUFG / SMFG / Mizuho) because: (1) we revise our FY3/15 forecasts; and (2) we raise our net asset outlooks for FY3/15 as we expect share prices to trend higher and boost comprehensive income. At the same time, discount rates applied in generating our multiples have contracted because betas have declined. We raise our TPs in light of these two considerations.

We believe corrections for SMFG and Mizuho and a rally for MUFG mean SMFG has the greatest potential share price upside.

Figure 14: **Difference from previous valuations (14 May)**

(JPY bn)

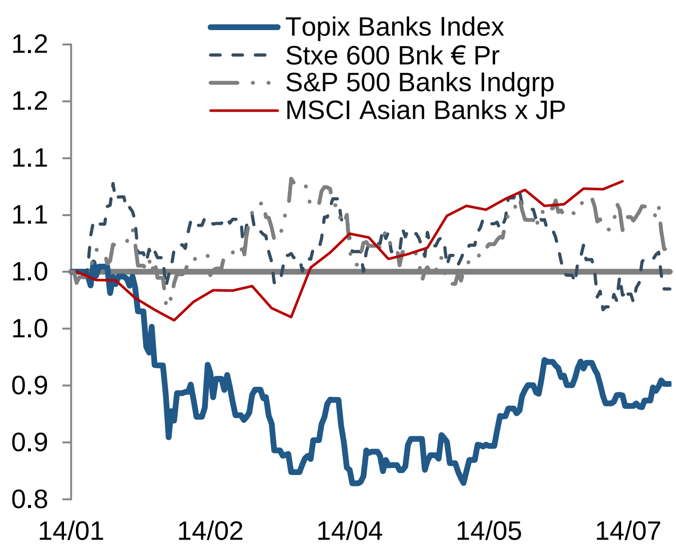
		SMFG	MUFG	Mizuho
Net profit (FY3/15 E)	Current	661	960	500
	Previous (14 May)	671	933	537
ROE (FY3/15 E)	Current	8.8%	7.3%	7.5%
	Previous (14 May)	9.1%	7.3%	8.1%
EPS (FY3/15 E)	Current	5,717.6	941.5	283.1
	Previous (14 May)	5,501.8	908.5	260.2
Beta	Current	1.2	1.216	1.195
	Previous (14 May)	1.263	1.255	1.26
PBR (x)	Current	0.97	0.80	0.84
	Previous (14 May)	0.99	0.80	0.86
Target price	**Current**	**5,600**	**750**	**240**
	Previous (14 May)	5,440	725	225
Share price (8/11)	Current	4,053	583	195
	Previous (14 May)	4,185	574	203
Potential upside	**Current**	**38.2%**	**28.7%**	**23.0%**
	Previous (14 May)	30.0%	26.3%	10.8%

Source: Company data, Credit Suisse estimates

Valuations low relative to global peers

Globally, valuations for Japan's major banks are low relative to those of financial institutions in the US and Europe, and they seem even lower when taking into consideration the potential for additional legal costs at some overseas financial institutions.

Figure 15: **Bank stock indices performance comparison (2014/1/1=1)**



Source: Bloomberg, Credit Suisse

Similarly, a 28 July report by our global equity strategy team entitled ***Global financials: don't give up*** concluded that Japanese banks appear undervalued.

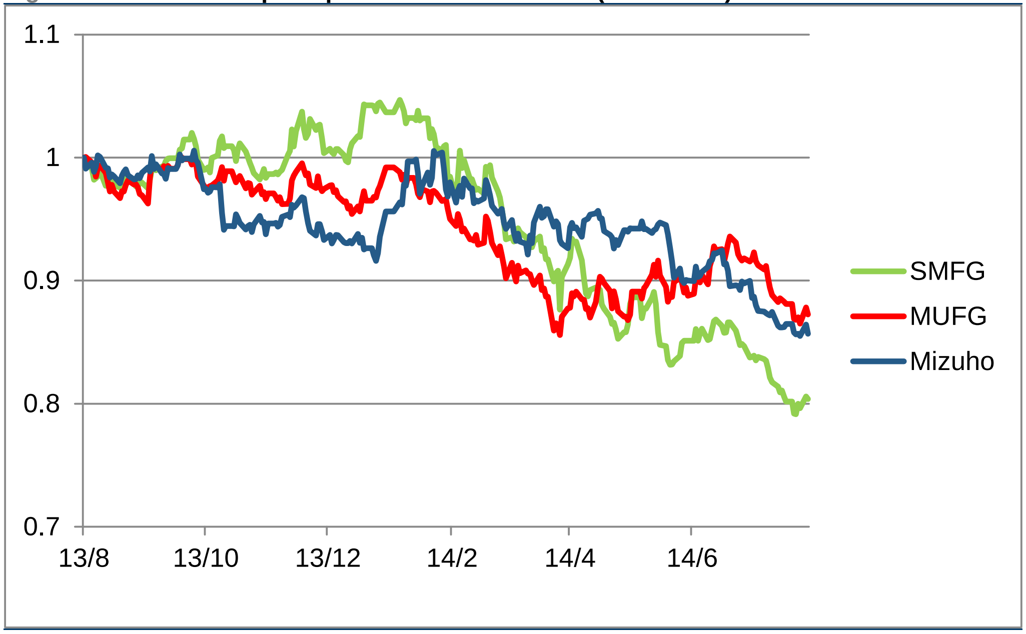
Figure 16: Valuation comparison of global banks

Company	Currency	Price	Rating	BPS			EPS			PBR (X)			PER (X)			ROE (%)		
		8/11/2014		FY14 E	FY15E	FY16E	FY14 E	FY15E	FY16E	FY14 E	FY15E	FY16E	FY14 E	FY15E	FY16E	FY14 E	FY15E	FY16E
SMFG	JPY	4,053.00	O	5,717.6	6,047.9	6,428.3	483.60	472.08	504.20	0.71	0.67	0.63	8.38	8.59	8.04	8.8%	8.0%	8.1%
MUFG	JPY	582.90	O	941.5	992.6	1,047.4	67.82	67.13	70.81	0.62	0.59	0.56	8.60	8.68	8.23	7.3%	6.9%	6.9%
Mizuho FG	JPY	195.10	N	283.3	280.4	295.2	20.61	21.04	21.14	0.69	0.70	0.66	9.47	9.27	9.23	7.5%	7.5%	7.3%
Major bank Average										**0.67**	**0.65**	**0.62**	**8.81**	**8.85**	**8.50**	**7.8%**	**7.5%**	**7.5%**
Bank of America	USD	15.22	N	21.6	22.9	24.4	0.86	1.45	1.60	0.70	0.66	0.63	17.72	10.50	9.49	4.1%	6.8%	7.2%
Citigroup	USD	48.39	O	69.0	73.0	76.8	4.90	5.65	6.10	0.70	0.66	0.63	9.87	8.57	7.93	7.2%	7.9%	8.1%
Goldman Sachs	USD	172.46	O	161.7	168.5	177.6	16.30	16.40	18.25	1.07	1.02	0.97	10.58	10.51	9.45	10.6%	10.6%	11.3%
JPMorgan	USD	56.32	O	57.5	62.4	66.8	5.53	6.20	6.65	0.98	0.90	0.84	10.19	9.08	8.47	9.8%	10.2%	10.2%
Wells Fargo	USD	49.89	N	32.2	34.7	37.5	4.15	4.30	4.65	1.55	1.44	1.33	12.02	11.59	10.74	13.3%	12.9%	12.9%
Morgan Stanley	USD	32.08	N	34.3	36.1	38.3	2.67	2.70	3.20	0.94	0.89	0.84	11.99	11.90	10.03	7.8%	7.5%	8.4%
Barclays	GBP	216.25	N	3.6	3.7	3.9	0.21	0.24	0.26	0.61	0.58	0.55	10.33	9.09	8.40	6.0%	6.5%	6.7%
Credit Suisse	CHF	24.25	-	27.3	28.8	30.7	1.88	2.85	3.22	0.89	0.84	0.79	12.92	8.51	7.52	6.9%	9.9%	10.5%
Deutsche Bank	EUR	24.48	O	47.9	50.4	53.8	4.28	4.14	4.51	0.51	0.49	0.45	5.72	5.92	5.43	8.1%	8.4%	8.5%
UBS	CHF	15.73	N	13.3	13.8	14.7	1.24	1.50	1.78	1.18	1.14	1.07	12.73	10.49	8.82	9.2%	10.9%	12.1%
HSBC	USD	625.90	U	6.0	6.2	6.4	0.53	0.57	0.62	1.05	1.01	0.97	11.76	10.95	10.16	8.9%	9.3%	9.6%
RBS	GBP	339.60	U	4.9	4.7	4.9	0.28	0.23	0.27	0.69	0.72	0.70	12.16	14.56	12.80	5.7%	4.9%	5.5%
Standard Chartered	USD	1,217.50	U	11.8	12.4	13.0	1.03	1.15	1.21	1.04	0.99	0.94	11.83	10.56	10.07	8.8%	9.4%	9.3%
BNP Paribas	EUR	48.03	N	62.8	66.9	71.6	4.94	5.89	7.33	0.77	0.72	0.67	9.72	8.15	6.55	7.9%	8.8%	10.2%
Industrial and Commercial Bank of China	CNY	5.23	O	5.1	5.6	6.3	0.96	0.99	1.08	1.03	0.93	0.83	5.47	5.29	4.82	18.9%	17.6%	17.2%
China Construction Bank	CNY	5.90	O	6.1	6.9	7.8	1.16	1.24	1.30	0.97	0.86	0.76	5.07	4.75	4.54	19.1%	18.0%	16.8%
Bank of China	CNY	3.66	O	4.7	5.2	5.8	0.76	0.81	0.90	0.78	0.70	0.63	4.81	4.49	4.09	16.2%	15.6%	15.5%
Agricultural Bank of China	CNY	3.74	O	3.7	4.2	4.8	0.72	0.79	0.84	1.00	0.88	0.78	5.20	4.75	4.43	19.3%	18.5%	17.6%
Total Average										**0.88**	**0.83**	**0.77**	**9.83**	**8.87**	**8.06**	**10.1%**	**10.3%**	**10.5%**

Source: Company data, Thomson Reuters, Credit Suisse estimates

Recent underperformance relative to TOPIX

Figure 17: **Bank share price performance vs. TOPIX (2013/8/1=1)**



Source: Thomson Reuters, Credit Suisse

Despite improving temporarily toward end-2013, performance of the three major banks relative to TOPIX deteriorated into 2014, and their share prices have underperformed the index on a 12-month basis.

We attribute their soft valuations to the following factors.

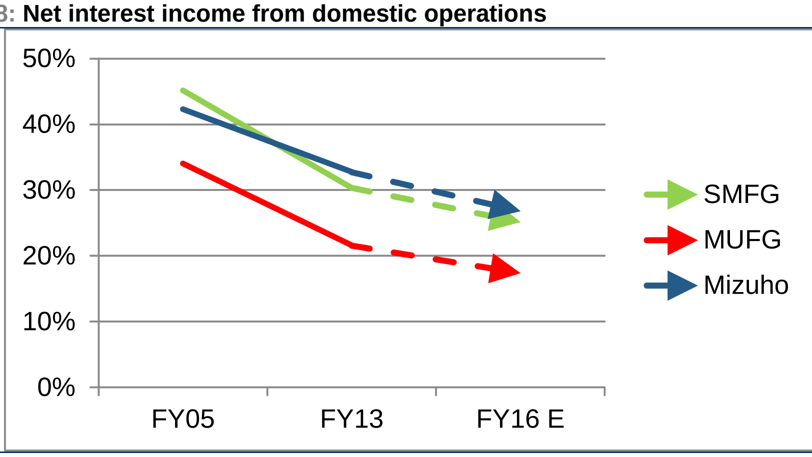
Concerns about growth potential

Concerns that falling domestic interest rates could depress profits are misplaced

Domestic lending is a mature business, and we think it is difficult to expand it profitably unless interest rates rise. Considering the ongoing downtrend for interest rates, we estimate that investors have been concerned that profitability could worsen.

However, the major banks' domestic interest income now accounts for only 20–30% of their gross profits, so the impact of falling interest rates and narrowing margins on broader profits has lessened.

Figure 18: **Net interest income from domestic operations**



Source: Company data, Credit Suisse estimates

At the same time, growth is continuing for peripheral businesses and overseas units, which have become the drivers of earnings growth. The major banks realize differentiation in both areas, and we expect growth to persist.

Irritation concerning shareholder returns

Decisions on shareholder returns could be brought forward

As major Japanese companies become more pro-active regarding shareholder returns, the major banks' returns remain modest at this stage, even though their earnings are firm and their capital exceeds the mandated levels. Their explanation has been that they will act when conditions are in place, so we think investors are likely dissatisfied that no concrete announcements have been forthcoming at this stage.

Although we think final proposals for capital regulations are likely some way off, banks did not need to substantially boost their capital after basic regulations were introduced in the past, and given the lengthy preparatory period until 2019, we believe the major banks could bring forward their decisions on shareholder returns.

Shareholder returns

Cautious on shareholder returns

The major banks have explained that they will act on shareholder returns when conditions are in place. However, they all exceeded the mandated capital adequacy ratios (projected levels) on a full-implementation basis at end-FY3/14, and their targets are even higher: they all aim for a buffer of roughly 1% above the mandated minimum level.

Figure 19: **CET1 target**

	SMFG	MUFG	Mizuho
Minimum Requirement	8%	8.5%	8%
Bank Target	Approx. 10%	9.5%	Upper 9% Level
Base	Full Implementation	Full Inplementation, excluding net unrealized gains/losses on securities	Full Implementation
Deadline	FY3/17	FY3/15	FY3/16
FY3/14 Result	10.3%	9.5%	9.08%

Source: Company data

We think their stance partly reflects previous bad experiences. The major banks were positioned to meet Basel 2 capital requirements in 2007, but had to conduct large-scale capital raisings when Lehman Brothers collapsed just after they had started to implement shareholder returns in earnest. They will likely be keen to avert such conditions this time.

We also think they are cautious on shareholder returns because the Basel 3 framework assigns tougher capital requirement for M&A and asset acquisitions. The major banks are considering large-scale M&A and asset acquisitions to expand their operations. As Basel 3 requires net assets to equal 8.0−8.5% of risk-weighted assets (RWA), we estimate that they need to secure the mandated capital levels to grow.

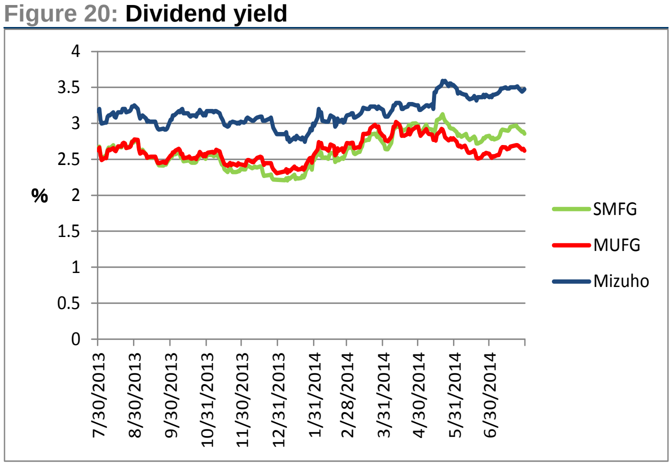
SMFG says that its focus is on ROE and that it wants to achieve high profitability and efficiency by investing in growth, to steadily enhance shareholder value, and to deliver stable dividend growth. It has not stated clearly what the concrete triggers for shareholder returns are, and is keen to wait for banking authorities to clarify mandatory capital adequacy levels. However, it also explains that given its focus on ROE, it will likely be ready to consider allocating surplus funds to shareholder returns after it achieves a capital adequacy ratio of 10%.

MUFG plans to increase its dividend in keeping with its capacity to steadily generate profits. Like SMFG, it explains that it will likely be ready to consider allocating surplus funds to shareholder returns after details of capital adequacy requirements become clear and it is positioned to meet its capital adequacy targets.

Decisions on shareholder returns could be brought forward

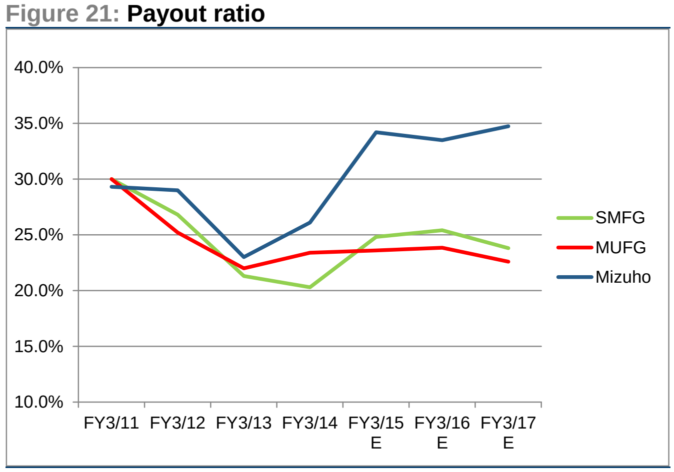
In contrast, Mizuho has announced concrete shareholder returns policies: a ¥0.5 increase for its annual dividend and a 30% consolidated payout ratio. According to anecdotal information, it decided on a dividend increase and dividend levels in response to investor dissatisfaction with opaque shareholder returns policies and because it expects to meet capital adequacy requirements by 2019, even if the authorities introduce additional regulations. Although the dividend increase is limited in value terms and did not have a prolonged impact on the share price, we think the favorable investor reaction following the announcement could prompt the other two major banks to speed up their decisions on shareholder returns.

Figure 20: **Dividend yield**



Source: Bloomberg

Figure 21: **Payout ratio**

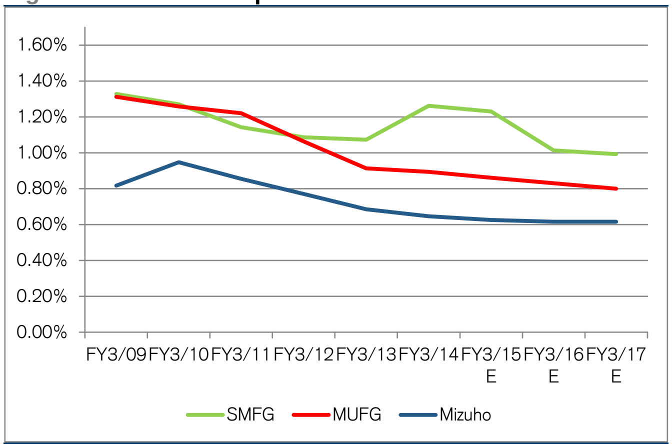


Source: Company data, Credit Suisse estimates

Profitability: SMFG still preeminent

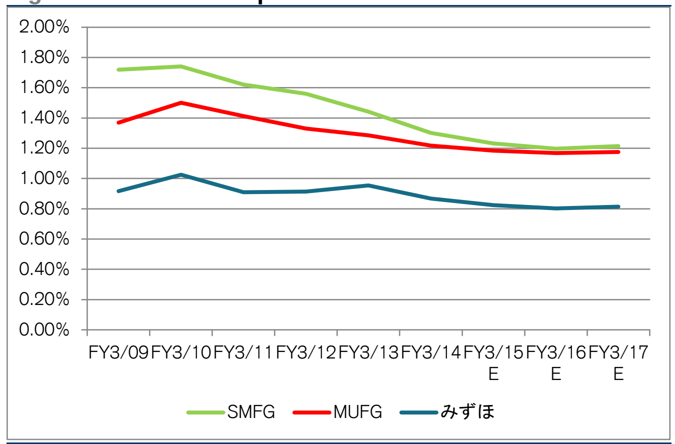
The major banks' consolidated net interest margin (NIM) figures show SMFG's domestic business in the lead.

Figure 22: Domestic operation NIM



Source: Company data, Credit Suisse estimates

Figure 23: Overseas operation NIM



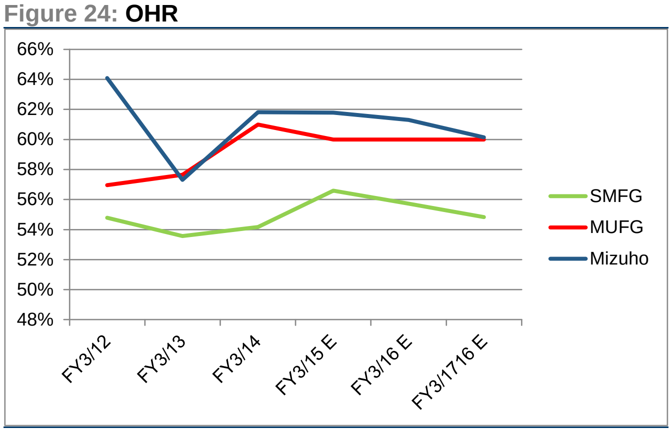
Source: Company data, Credit Suisse estimates

Although SMFG's domestic NIM has increased temporarily in FY3/14–15 because equity index valuation gains are reflected in interest income, it is still well ahead of the other two major banks even after discounting this factor. The gap between MUFG and Mizuho is largely because Mizuho has not consolidated non-banking operations as subsidiaries.

Although domestic NIM has stalled, we expect it to continue shrinking. However, overseas NIM has virtually stopped contracting. Supported partly by contributions from Thailand's Bank of Ayudhya, where spreads are high, we expect MUFG to catch up with SMFG.

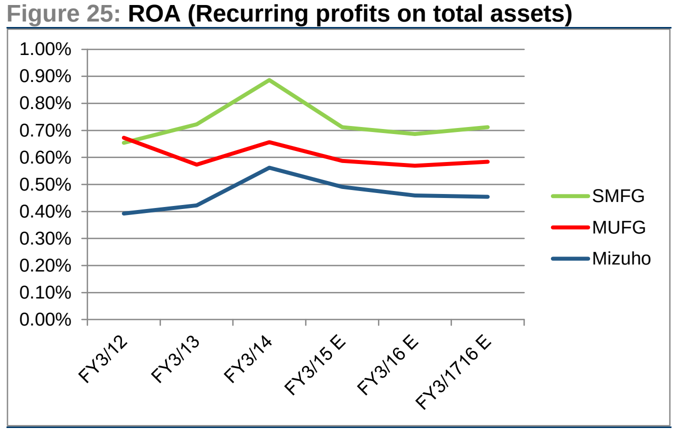
Expense ratios (overhead ratio, or OHR) are high at Mizuho and MUFG. As the major banks are making strategic investments, we do not expect rapid progress for expense reductions. However, we do think investors could change their view of the banks' cost management if their results show signs of drastic expense cuts.

Figure 24: OHR



Source: Company data, Credit Suisse estimates

Figure 25: ROA (Recurring profits on total assets)



Source: Company data, Credit Suisse estimates

Growth potential: Peripheral (non-lending) businesses, overseas units continue to expand

Securities

Growth in large-scale M&A and IPOs involving Japanese companies since the BoJ started monetary easing, together with individuals seeking effective investment vehicles amid prolonged low interest rates and setting up tax-sheltering Nippon Individual Savings Accounts (NISA), has increased profit opportunities for securities companies.

We think the three bank-affiliated securities companies, in particular, have a couple of advantages (outlined below) compared with independent brokerages.

(1) Collaborations between banking and securities

Deals involving large companies are a combination of bank financing, which is mobile, stable and flexible, and brokers' market operations, which provide large-scale, long-term, fixed-rate funds. This link is attractive to companies needing long-term investment.

Collaboration between a bank, which offers settlement accounts, and a broker, which can supply a range of investment products, also remains attractive for individuals in Japan, where banks enjoy considerable trust.

(2) Fund raising, ratings

The three bank-affiliated securities companies are all fully-owned subsidiaries of their banking groups, and thus benefit from their parent banks' strong ratings. "A" ratings for all three are particularly advantageous in terms of fund-raising scale and costs when doing business with foreign financial institutions. They also help to minimize collateral and expand the counterparty base for derivatives and funds settlements.

Figure 26: Five major securities companies

(Bank)	SMBC Nikko				MU Securities				Mizuho			
	Rating for securities company				Rating for securities company				Rating for securities company			
	S&P	Mdy's	R&I	JCR	S&P	Mdy's	R&I	JCR	S&P	Mdy's	R&I	JCR
	A+	A1	AA-	AA	A+	A1	AA-	AA	-	A2	A+	AA-
				¥1bn				¥1bn				¥1bn
	FY3/12	FY3/13	FY3/14	FYQ1/14	FY3/12	FY3/13	FY3/14	FYQ1/14	FY3/12	FY3/13	FY3/14	FYQ1/14
Net operating revenue	229	275	328	68	239	306	451	92	167	257	323	81
Commission earned	119	143	190	38	143	172	243	52	119	143	210	46
Trading profit & loss	102	120	127	27	86	107	210	40	9	68	70	26
Others	7	12	11	2	10	27	(2)	0	40	46	44	9
Recurring profit	45	76	201	15	38	84	163	12	(50)	32	43	11
Net profit	19	46	65	10	17	47	98	9	(96)	29	51	6
Net asset	8,277	6,753	7,205	8,445	22,436	26,506	30,413	28,399	21,164	23,433	22,346	22,604
Debenture bond/loan	3,171	1,974	1,787	1,759	2,417	2,814	3,334	3,345	5,174	3,004	2,290	2,402
Net asset	459	517	589	600	820	924	1,068	973	454	592	652	635
Composition ratio of Trading profit & loss	45%	44%	39%	41%	36%	35%	47%	43%	5%	27%	22%	32%
DER(X)	6.9	3.8	3.0	2.9	2.9	3.0	3.1	3.4	11.4	5.1	3.5	3.8

(self-funding)	Nomura				Daiwa			
	Rating for securities company				Rating for securities company			
	S&P	Mdy's	R&I	JCR	S&P	Mdy's	R&I	JCR
	A-	Baa2	A+	AA-	BBB+	Baa2	A	A+
				¥1bn				¥1bn
	FY3/12	FY3/13	FY3/14	FYQ1/14	FY3/12	FY3/13	FY3/14	FYQ1/14
Net operating revenue	1,536	1,814	1,557	371	336	417	542	122
Commission earned	551	562	733	162	119	143	190	69
Trading profit & loss	273	368	476	159	102	120	127	38
Others	712	883	348	51	114	155	225	16
Recurring profit	85	238	362	52	(12)	95	197	40
Net profit	12	107	214	20	(39)	73	169	34
Net asset	35,697	37,942	43,520	43,931	18,924	19,049	19,481	22,051
Debenture bond/loan	9,690	8,331	8,829	8,788	4,191	3,310	3,393	3,318
Net asset	2,389	2,319	2,553	2,514	952	1,083	1,253	1,260
Composition ratio of Trading profit & loss	18%	20%	31%	43%	30%	29%	23%	31%
DER(X)	4.1	3.6	3.5	3.5	4.4	3.1	2.7	2.6

Source: Company data

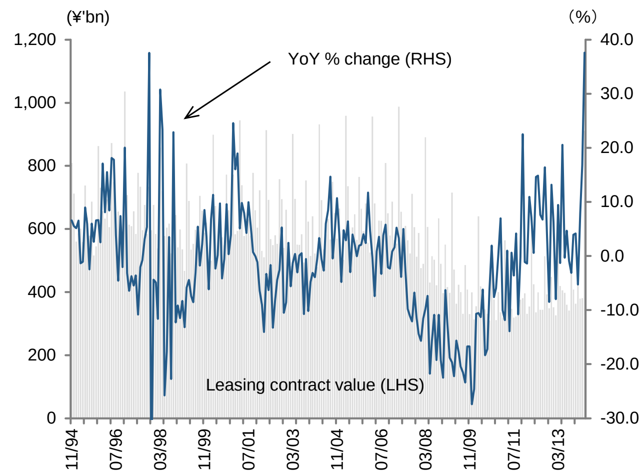
Non-banking

Corporate financing and leasing

Reflecting the rebound in Japan's economy, the value of leasing transactions has trended positive YoY since 2011. Growth has been driven by leasing-based capital spending at SMEs, in particular. Although demand declined in April and May 2014 in reaction to the consumption tax hike, it recovered in June, and we expect growth to continue.

Price competition is stiff in leasing, and low funding costs support competitiveness. Bank-affiliated leasing companies not only can source low-cost funds from their parent banks, but can also target stable fund raising and lower costs by leveraging high ratings and low refinancing risk to access short-term market funds (commercial paper) and long-term fixed-rate funds (corporate bonds).

Figure 27: **Leasing contract value & growth**

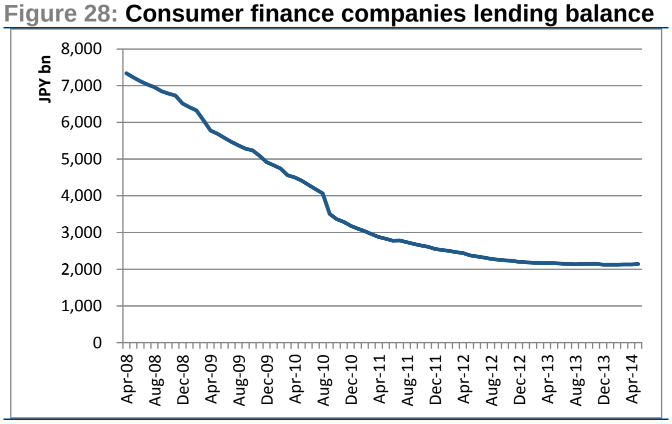


Source: Japan Leasing Association

Consumer finance, credit cards

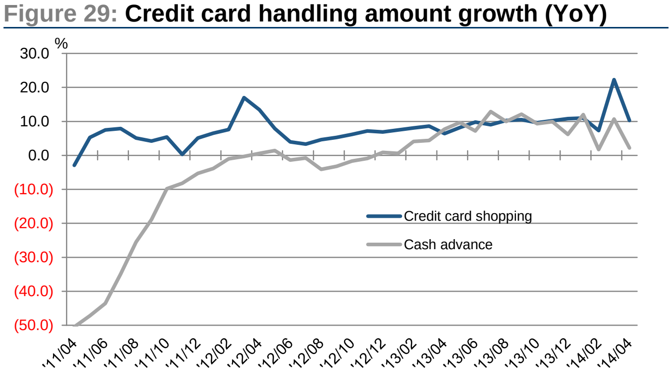
This industry is realigning, and almost all players are bank-affiliated.

Figure 28: **Consumer finance companies lending balance**



Source: Japan Financial Service Association

Figure 29: **Credit card handling amount growth (YoY)**



Source: METI

The decline in the balance of consumer finance outstanding has been slowing steadily since the introduction of quantitative controls, and credit card handling amount continues to rise at a double-digit pace. We forecast further growth in both areas.

The major banks' non-banking operations are leveraging profit scales and funding advantages to steadily grow their assets, and we expect profit contributions to keep increasing.

Figure 30: Subsidiaries charged in peripheral business (non-bank)

SMFG

SMBC Consumer Finance (former PROMIS)

S&P	Mdy's	R&I	JCR
-	-	A	A-

¥1bn	FY3/12	FY3/13	FY3/14	FYQ1/14
Operating revenue	196	187	195	55
Recurring profit	(155)	52	27	18
Net profit	(170)	48	29	16
Total assets	991	882	1,056	1,053
Debenture bond/loan	385	451	649	654
Net assets	109	167	199	217
DER(X)	3.5	2.7	3.3	3.0

Cedyna

S&P	Mdy's	R&I	JCR
-	-	-	A+

¥1bn	FY3/12	FY3/13	FY3/14	FYQ1/14
Operating revenue	176	164	160	
Recurring profit	(28)	14	11	
Net profit	(38)	13	16	
Total assets	1,997	2,134	2,189	
Debenture bond/loan				
Net assets	136	153	173	
DER(X)				

Mitsui Sumitomo Card

S&P	Mdy's	R&I	JCR
-	-	-	-

¥1bn	FY3/12	FY3/13	FY3/14	FYQ1/14
Operating revenue	182	186	192	
Recurring profit	43	45	44	
Net profit	24	28	24	
Total assets	995	1,054	1,218	
Debenture bond/loan				
Net assets	203	226	244	
DER(X)				

Consumer Finance total

¥1bn	FY3/12	FY3/13	FY3/14	FYQ1/14
Operating revenue	555	537	546	
Recurring profit	(140)	110	82	
Net profit	(184)	89	69	
Total assets	3,983	4,069	4,463	
Debenture bond/loan				
Net assets	448	546	616	
DER(X)				

Mitsui Sumitomo Lease

S&P	Mdy's	R&I	JCR
-	-	A+	AA-

¥1bn	FY3/12	FY3/13	FY3/14	FYQ1/14
Operating revenue	952	992	1,037	
Recurring profit	63	59	77	
Net profit	30	31	41	
Total assets	2,907	3,776	4,176	
Debenture bond/loan	2,018	2,709	2,992	
Net assets	536	602	652	
DER(X)	3.8	4.5	4.6	

Nonbank total

¥1bn	FY3/12	FY3/13	FY3/14	FYQ1/14
Operating revenue	1,506	1,529	1,584	
Recurring profit	(77)	169	159	
Net profit	(154)	120	111	
Total assets	6,890	7,845	8,640	
Debenture bond/loan				
Net assets	984	1,148	1,268	
DER(X)				

MUFG

Mitsubishi UFJ NICOS

S&P	Mdy's	R&I	JCR
—	—	AA-	AA-

¥1bn	FY3/12	FY3/13	FY3/14	FYQ1/14
Operating revenue	281	267	266	275
Recurring profit	30	25	20	18
Net profit	29	32	25	17
Total assets	2,316	2,199	2,213	
Debenture bond/loan	720	609	579	
Net assets	161	193	218	
DER(X)	4.5	3.2	2.7	

Acom

S&P	Mdy's	R&I	JCR
BB+	-	BBB	A

¥1bn	FY3/12	FY3/13	FY3/14	FYQ1/14
Operating revenue	210	193	202	53
Recurring profit	32	22	16	15
Net profit	21	21	11	14
Total assets	1,212	1,166	1,155	1,120
Debenture bond/loan	664	633	620	586
Net assets	265	287	307	320
DER(X)	2.5	2.2	2.0	1.8

Total

¥1bn	FY3/12	FY3/13	FY3/14	FYQ1/14
Operating revenue	492	460	468	328
Recurring profit	62	46	35	33
Net profit	50	52	36	31
Total assets	3,528	3,365	3,369	
Debenture bond/loan	1,384	1,241	1,199	
Net assets	426	479	525	
DER(X)				

Source: Company data

Overseas lending business

Major banks' overseas lending has not always been successful. Unlike in Japan, there have been a number of occasions when their non-performing loans expanded and write-downs increased just as their lending businesses started to grow. They have had to lower their credit quality when foreign rivals in good financial health started to expand their lending volumes, and this sometimes resulted in defaults.

In contrast to the past, Japan's major banks are now better positioned than foreign financial institutions in terms of capital and funds, and we think they will likely sustain this advantage for the foreseeable future.

Leeway relative to requisite capital levels

As it now stands, Basel 3's CET1 ratio requirement (e.g., common stock) broadly matches shareholder capital, so banks need shareholder capital to build up income-generating assets.

As the major banks are large operations, have considerable surplus capital and face virtually no likelihood of outflow due to factors such as future costs for settling legal action, we think their capacity to build up risk assets is among the highest in the global industry.

Figure 31: **Room for additional risk weighted assets (RWA)**

	G-SIFIs requirement (%)	CET1 Ratio Fully applied (%)	RWA	Excess CET1	RWA Room	Currency Unit	as of
SMFG	8.0	10.3	61,623	1,417	**17,717**	JPY bn	2014/03/31
MUFG	8.5	11.1	99,084	2,576	**30,308**	JPY bn	2014/03/31
Mizuho	8.0	9.1	60,287	651	**8,139**	JPY bn	2014/03/31
BOA	8.5	9.9	1,282,700	17,958	**211,268**	USD mn	2014/06/30
Citigroup	9.0	10.6	1,274,000	20,384	**226,489**	USD mn	2014/06/30
GS	8.5	9.8	592,000	7,696	**90,541**	USD mn	2014/06/30
JPM	9.5	9.8	1,625,362	4,876	**51,327**	USD mn	2014/06/30
MS	8.5	12.1	422,689	15,217	**179,021**	USD mn	2014/06/30
Barclays	9.0	9.9	429,000	3,861	**42,900**	STG mm	2014/06/30
Deutsche Bank	9.0	11.5	373,000	9,325	**103,611**	EUR mm	2014/06/30
HSBC	9.5	11.3	1,257,700	22,639	**238,301**	USD mn	2014/06/30
RBS	8.5	10.1	414,300	6,629	**77,986**	STG mm	2014/06/30
BNP	9.0	10.0	617,000	6,170	**68,556**	EUR mm	2014/06/30

Source: Company data, Credit Suisse estimates

As leading foreign banks remain cautious on lending, growth in lending value at Japan's major banks is among the industry's strongest. Considering that credit in these situations may also look attractive to borrowers, the major banks' track record raises expectations for business with non-Japanese borrowers, in particular, to expand.

Aggressive M&A

The major banks have also used their ample funds and capital to aggressively acquire and form capital alliances with foreign financial institutions. Some European and US banks are still selling assets as part of their restructuring, and we think Japan's major banks can negotiate from a position of strength.

Figure 32: **M&A activity**

	8316 SMFG				
	Type	Country	Company	Amount	Summary
Mar 2014	Acquisition	Indonesia	PT Bank Tabungan Pensiunan National	approx ¥150bn	Acquisition of 40% equity interest
Jul 2013	Acquisition	France	Societe Generale Private Banking	over ¥10bn	Acquisition of 100% shares
May 2013	Acquisition	Indonesia	PT Bank Tabungan Pensiunan National		Acquisition of 24.26% equity interest
Dec 2012	Investment	Hong Kong	Bank of East Asia	approx ¥35bn	To increase its investment to 9.5% from 4.73%
Apr 2012	Investment	US	China Post & Capital Fund Management	approx ¥10bn	Acquisition of 24% equity interest
Mar 2012	Investment	Indonesia	PT Indonesia Infrastructure Finance		Subscription for 14.9% of total issued shares
Jan 2012	Acquisition	UK	Aircraft leasing business	approx ¥550bn	SMFG, Sumitomo Mitsui Finance and Leasing and Sumitomo Corp acquire RBS's aircraft leasing business

	8306 MUFG				
	Type	Country	Company	Amount	Summary
Dec 2013	Acquisition	Thailand	Bank of Ayudhya	¥536bn	Acquisition of 72% shares
May 2013	Acquisition	US	Services to homeowners associations and community management companies		Union Bank (consolidated subsidiary of BTMU) to acquire First Bank association bank services
Apr 2013	Acquisition	US	Commercial real estate portfolio	approx ¥360bn	Union Bank to acquire from PB Capital which is owned subsidiary of Deutche Bank
Dec 2012	Investment	Vietnam	Vietnam Joint Stock Commercial Bank for Industry and Trade (VietinBank)	approx ¥63.1bn	Acquisition of 20% of ordinary shares and VietinBank became an equity method affiliate of BTMU
May 2012	Acquisition	US	Services to homeowners associations and community management companies	approx ¥10bn	Union Bank to acquire from PNC Bank
Mar 2012	Acquisition	US	Pacific Capital Bancorp	approx ¥120bn	UnionBanCal Corporation and Union Bank to acquire Pacific Capital Bancorp
Mar 2012	Investment	Australia	AMP Capital Holdings	over ¥30bn	Acquisition of 15% equity interest and AMP Capital Holdings became an equity method affiliate of MUTB
Jul 2011	Investment	US	Morgan Stanley		Conversion of convertible preferred stock into common stock. MUFG holds 22.4% of the voting rights and MS becomes an equity method affiliate of MUFG
Apr 2011	Investment	China	SWS MU Fund Management	approx ¥9bn	Acquisition of 33% of the voting rights from BNP Paribas and SWS MU became an equity method affiliate of MUTB

	8411 Mizuho FG				
	Type	Country	Company	Amount	Summary
Jun 2012	Acquisition	Brazil	Banco WestLB do Brasil	approx ¥30bn	Acquisition of 100% shares by Mizuho Corporate Bank
Sep 2011	Investment	Vietnam	Vietcombank	approx ¥45bn	Subscription for 15% (after dilution) of total issued shares by Mizuho Corporate Bank

Source: Company data, Nikkei

The following section discusses the major banks' focused geographical business regions and acquisition criteria.

Figure 33: Major banks acquisition policy

Bank	Core region	Criteria	Schedule from now
SMFG	Asia (Asia-centric)	①Risk controllability ②Profitability–1% RORA target ③Synergies ④Foreign currency funding potential	
MUFG	Americas, ASEAN	①Compatibility with existing operations ②Price–3-year forward hurdle rate	BTMU/UNBC integration (FY7/14) BTMU/BAY integration (within a year)
Mizuho	Asia	①Synergies wih existing businesses ②Price ③Governance check	

Source: Company data

All three major banks are concentrating on Asia, but MUFG also aims to leverage the strength of having operations in the US to grow its US business.

The highest-profile case in value terms has been MUFG acquiring assets via UBCA. We think entrusting operations to local players with detailed knowledge of local conditions offers a strong likelihood of successful integration. In addition, SMFG joining with subsidiaries to acquire assets also offers a broad base for impartial decision-making without regional bias.

We do not think many deals will fit the major banks' criteria. Major potential targets will likely be non-core assets being sold as part of downsizing. However, the three major banks have made synergies a condition of any acquisition, and we do not think they would be attracted to such deals within the framework of their future business growth. We expect them to pursue organic growth for the foreseeable future.

Business climate surrounding major banks

Lending activities overseas covering for weakness in domestic loan business

Breakdown of lending balance

Over the past few years, yen devaluation has contributed to rapid growth in major banks' overseas lending activities, even as domestic loan balances have remained largely unchanged. Overseas loans now account for 33% of the lending balance at MUFG, and 20% at Mizuho.

As a consequence, even though domestic lending has stagnated, loan balances as a whole have increased owing to higher lending overseas, achieving 12% growth at MUFG, and growth of 4% at Mizuho.

Figure 34: **SMFG loan mix**

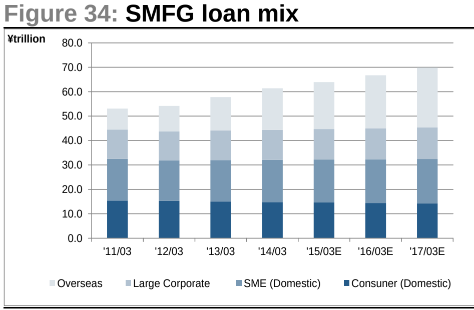


Figure 35: **MUFG loan mix**

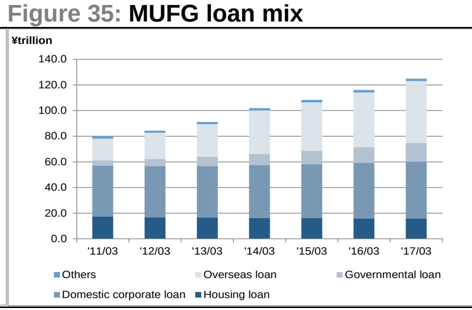
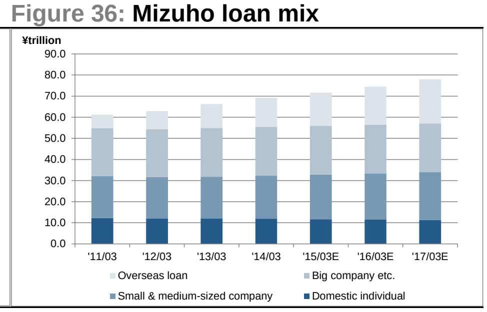


Figure 36: **Mizuho loan mix**



Source: Company data, Credit Suisse estimates

Overseas lending—contributing to profits, via growth in loan balance, stable interest rate spread

The recent increase in overseas lending traces back to 2010, in the aftermath of Europe's sovereign debt crisis, when Japanese major banks took advantage of their European counterparts' downgraded credit ratings. Since that time, however, the lending capacity of European and US financial institutions has improved; from around 2H 2012, growth in the major banks' overseas loan balance has been fueled primarily by the banks' own initiatives.

Figure 37: **SMFG overseas lending**

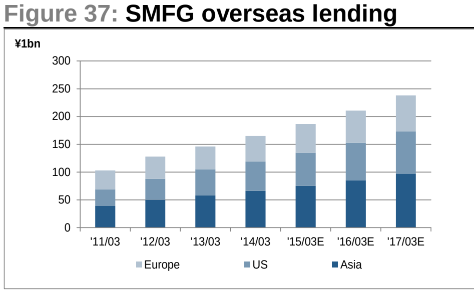


Figure 38: **MUFJ overseas lending**

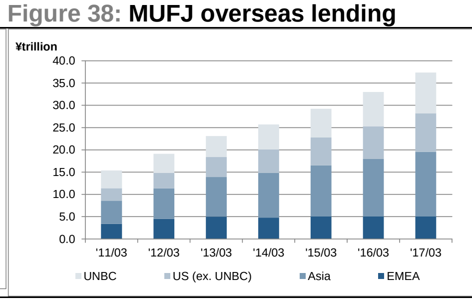
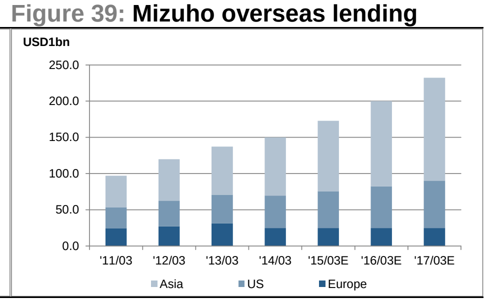


Figure 39: **Mizuho overseas lending**



Note: SMFG, Mizuho – balance at FY-end, MUFG – average balance

Source: Company data, Credit Suisse estimates

(1) Europe

Lending in Europe is growing at a slower rate than that in other regions; not only are local financial institutions regaining competitiveness, but also the underlying demand for funds is not that strong, as the region's economy has yet to recover fully.

(2) Americas

The major banks continue to expand their businesses in the Americas, growing both assets and earnings. MUFG in particular has been adding to its asset base through aggressive acquisitions.

(3) Asia

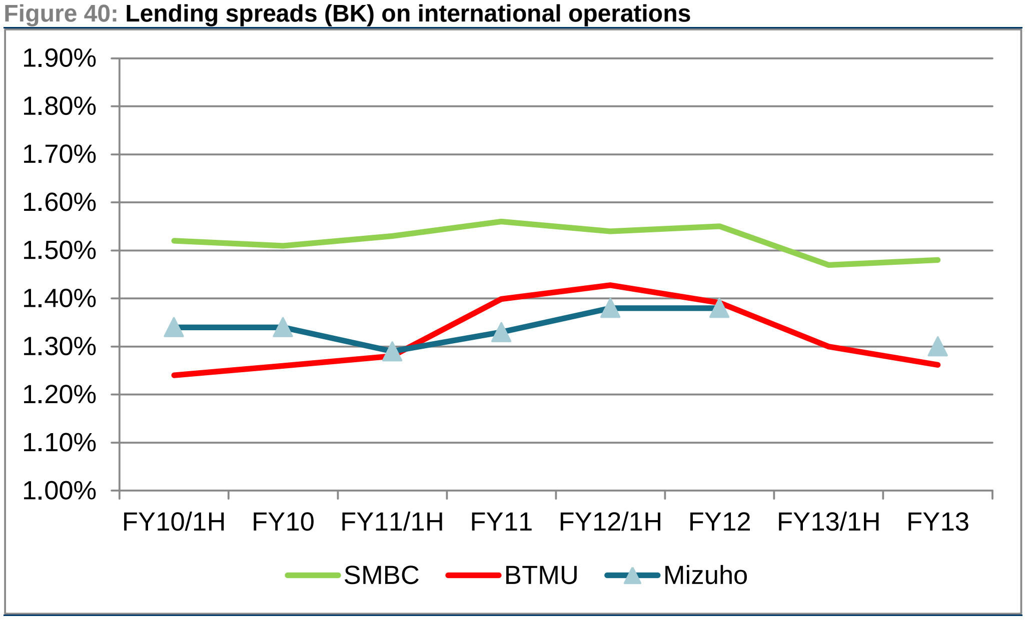
All the major banks are reporting double-digit growth for loan balances in Asia. They are working to capture funding demand in the region through alliances and acquisitions aimed at strengthening their business foundations.

Growth in overseas lending has continued for some years now, with expansion most evident in Asia, an area of particular focus for all three major banks.

Interest-rate spreads on overseas lending activities

Interest rate spreads on overseas lending activities are fatter than those on domestic lending, and moreover have remained stable.

Figure 40: **Lending spreads (BK) on international operations**



Source: Company data

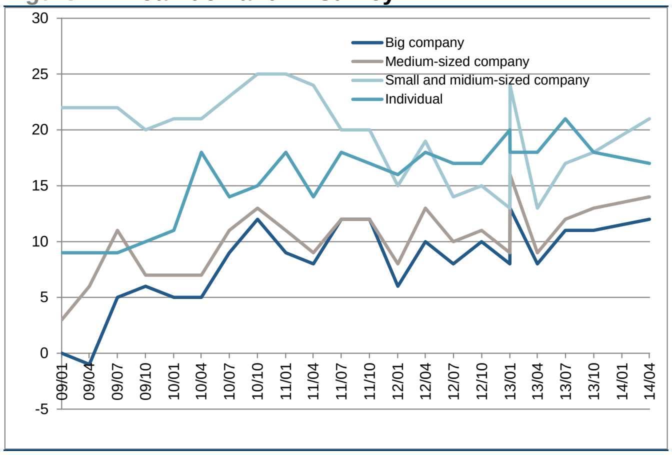
Domestic lending—marked by lackluster growth, shrinking spreads

Domestic funding demand

Ongoing recovery in domestic economy yet to contribute to major banks' earnings

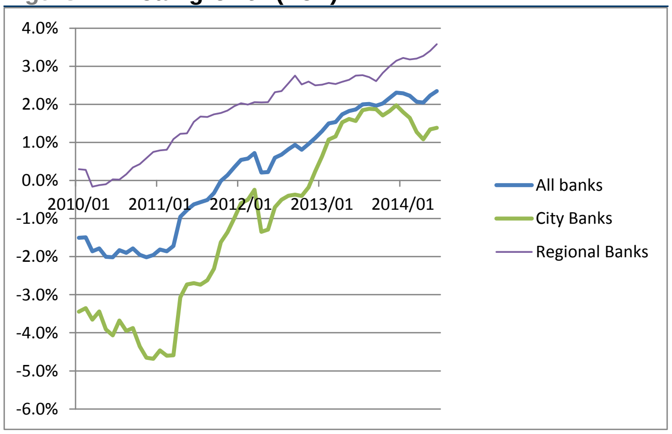
Japan's economy continues to recover modestly, with a smaller-than-expected adverse impact from the consumption tax hike. Judging by the BoJ Tankan's lending diffusion index (DI), overall demand for funding is expected to continue recovering gradually, although demand is evidently quite strong among smaller and local enterprises.

Figure 41: **Loan demand DI survey**



Source: BoJ

Figure 42: **Loan growth (YoY)**



Source: BoJ

Lending growth at major banks lags that of banking sector overall

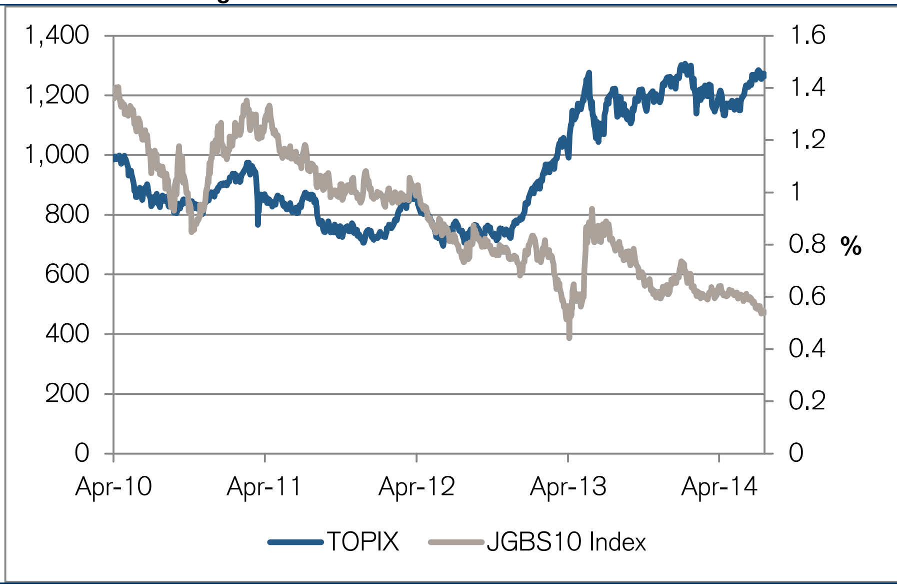
Across the banking sector as a whole, domestic loan balances are now growing at an average annual clip of 2%, however growth in major bank loan balances remains below this pace.

Growth in domestic loan balances is especially strong among regional banks, and is likely being underpinned by increasing demand from regionally-based, small-scale businesses. While comparatively large companies account for much of the lending at city banks, many of these companies already have surplus funds. Moreover, many are choosing to raise funds through corporate bond issuances, taking advantage of the low interest rate and tight credit spread environment. Their demand for funds therefore is comparatively low.

Domestic interest rates

Japan's market interest rates continue to fall; as of 11 August 2014, the yield on 10-year JGBs (i.e., the long-term interest rate) was just over 0.5%. As no exit strategy has been devised as yet for monetary easing, we think interest rates will remain low.

Figure 43: **Domestic long-term interest rate vs. TOPIX**



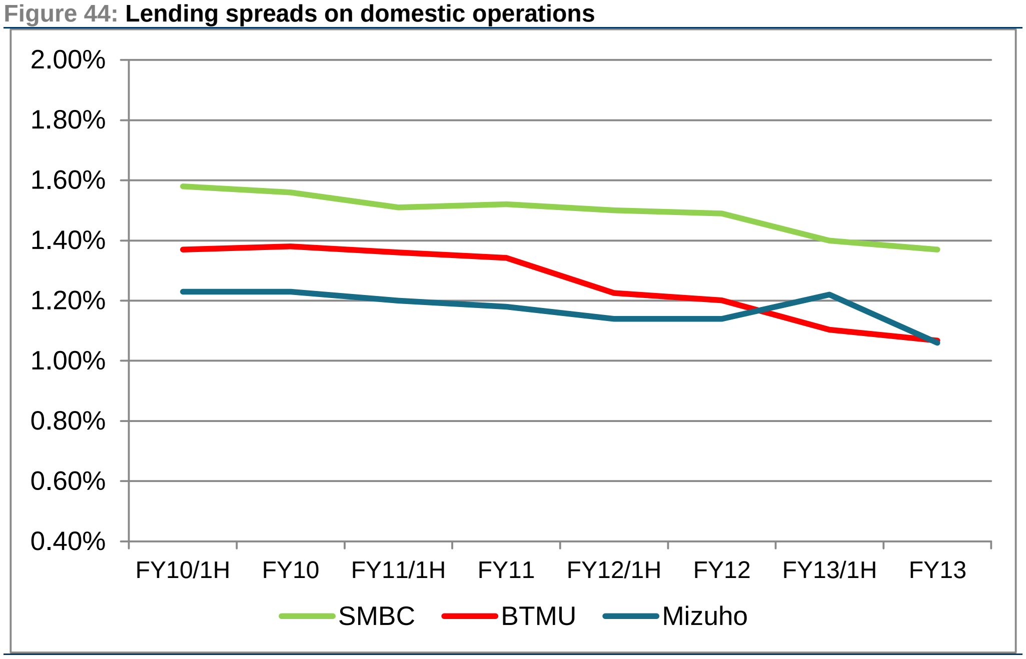
Source: Bloomberg

Ongoing contraction in domestic interest-rate spreads

Loan-deposit spreads at domestic lending operations (average interest rate on loans – average interest rate on deposits) continue to narrow. Deposit interest rates are about as low as they can go, while lending interest rates are still falling.

Spreads also continue to contract at regional banks, which managed to grow lending balances in FY13. In our view, there is still some scope (albeit limited) for contraction in interest-rate spreads.

Figure 44: **Lending spreads on domestic operations**

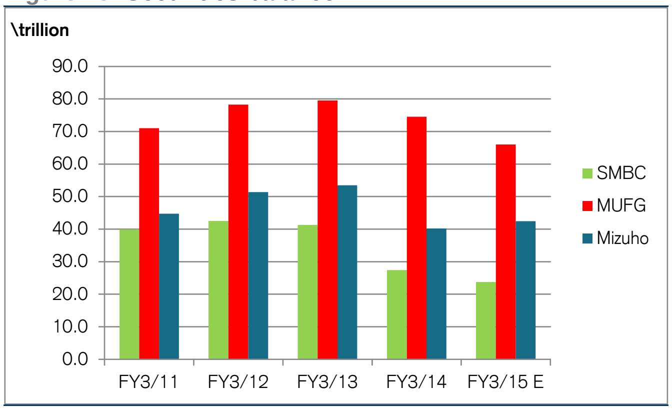


Source: Company data

Marketable securities and cash deposits—growth in cash deposits slowed sharply in 1Q FY3/15

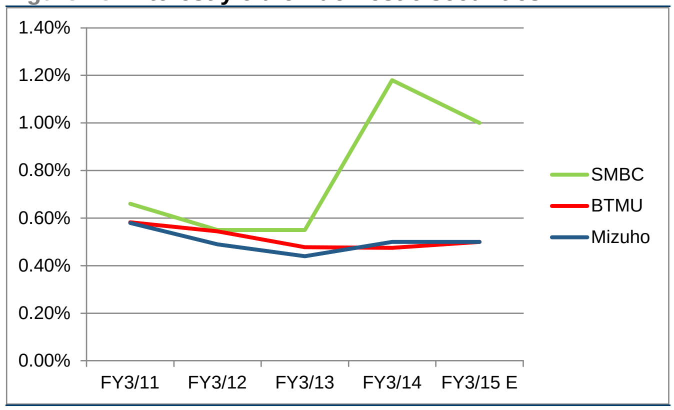
All three major banks reduced their holdings of marketable securities in FY3/14, at the same time piling up cash in BoJ deposits.

Figure 45: **Securities balance**



Source: Company data, Credit Suisse estimates

Figure 46: **Interest yield on domestic securities**

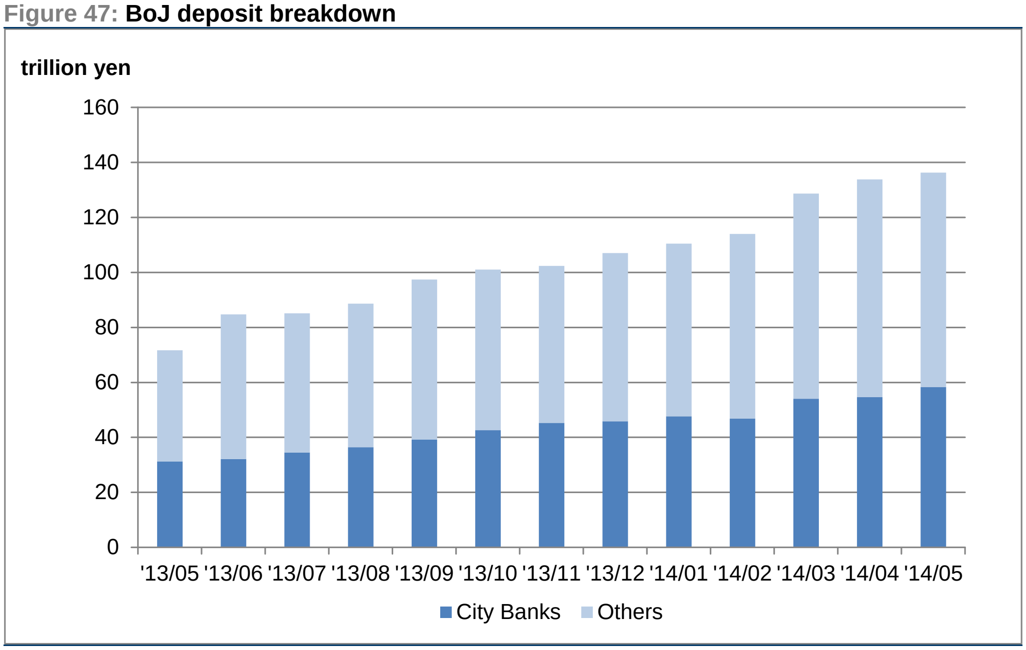


Source: Company data, Credit Suisse estimates

The BoJ has said it aims to grow current deposits to ¥68tn in 2014, to fund further monetary easing. In the main, this money will be deposited by commercial banks. In 2013 the city banks (three major banks plus Resona) contributed a hefty ¥23tn (56% of the total), but judging by the major banks' end-March JGB balances, only MUFG has much room to shift more funds into deposits in 2014.

The major banks' 1Q FY3/15 results suggest that growth in BoJ deposits has slowed markedly at all three. Based solely on remaining holdings of marketable securities, we find it difficult to envision deposits growing at the pace seen last year. This being the case, the BoJ will need to devise some alternative means of raising funds.

Figure 47: **BoJ deposit breakdown**



Source: BoJ

Unrealized gains on JGBs shrinking, while those on shareholdings remain sizable

Aside from MUFG, the major banks have virtually no unrealized gains on JGBs; all three, however, have ample unrealized gains on shareholdings.

With unrealized gains on JGBs in decline, we think banks are realizing gains on shareholdings as a means of shoring up profits. In addition to common stocks, banks have also been increasing their exposure to ETFs, private funds, and so forth.

Figure 48: **SMFG trading (BK account)**

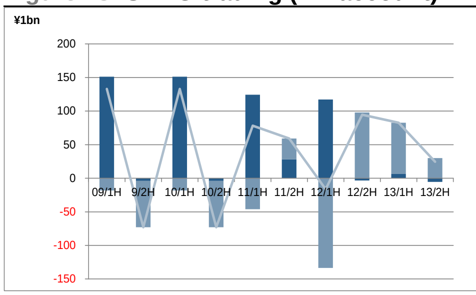


Figure 49: **MUFJ trading (BK account)**

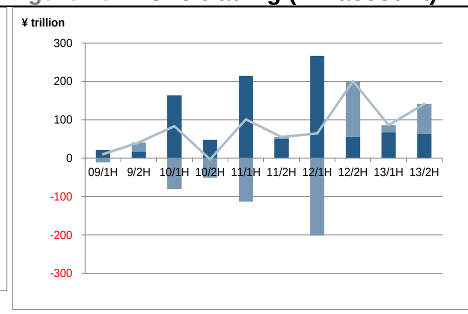
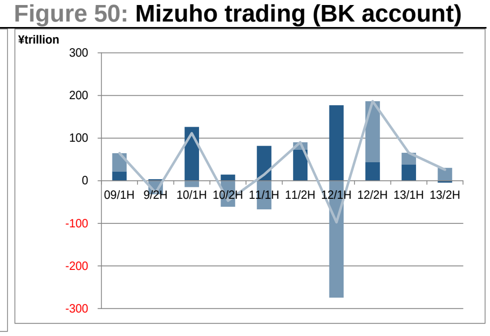


Figure 50: **Mizuho trading (BK account)**



Profit & loss for JGB and other bonds Profit & loss for equity Total

Source: Company data, Credit Suisse estimates

In both FY3/14 and 1Q FY3/15, SMFG booked substantial gains on ETF sales, also realizing gains on equity index-linked investment trusts (booked as dividends under net interest income).

Mizuho intends to reduce equity holdings to around 25% of its Tier 1 capital in FY3/16. To that end, it plans to sell off about ¥100bn this fiscal year, booking estimated gains of around ¥45bn. SMFG also has invested in equity index-linked investment trusts and ETFs, and realized gains on both in FY3/14 and 1Q FY3/15.

Figure 51: **Unrealized gains on marketable securities**

(JPY bn)

	MUFG		SMFG		Mizuho	
	FY3/13	FY3/14	FY3/13	FY3/14	FY3/13	FY3/14
JGB	300	168	120	22	88	13
Domestic Bonds (excluding JGB)	70	55	50	43	25	18
Domestic Stocks	1000	1,560	760	1,131	710	1,107
Others	460	87	154	208	58	(11)

Source: Company data

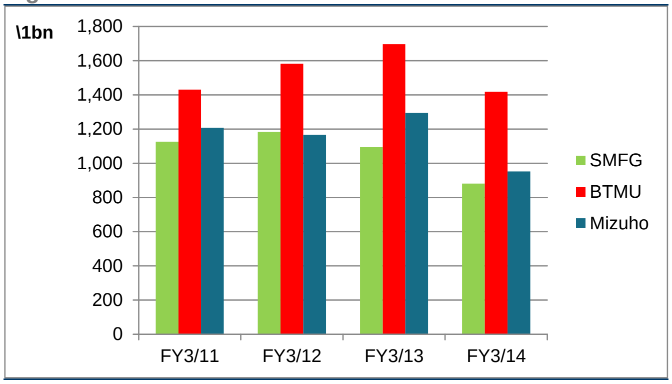
Non-performing loans and credit costs remain at healthy levels

Non-performing loans

The major banks' non-performing loan balances have reached record-low levels, and are still improving. Not only is there a low incidence of new defaults, but also many previously delinquent borrowers have undergone rehabilitation, such that their loans are no longer considered non-performing. Against this backdrop, few market participants now regard bad debt as an issue. For now at least, we expect non-performing loans will have a negligible impact on major banks' operations.

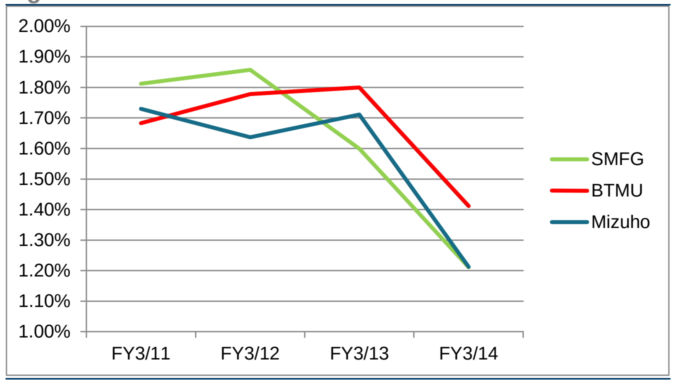
Looking further ahead, there is a possibility that competition from overseas will undermine the business foundations of previously powerful companies, as was the case with Sharp in 2012. In such instances, we would be interested to see how the major banks respond.

Figure 52: **NPLs based on the FRL**



Source: Company data

Figure 53: **NPL ratio**



Source: Company data

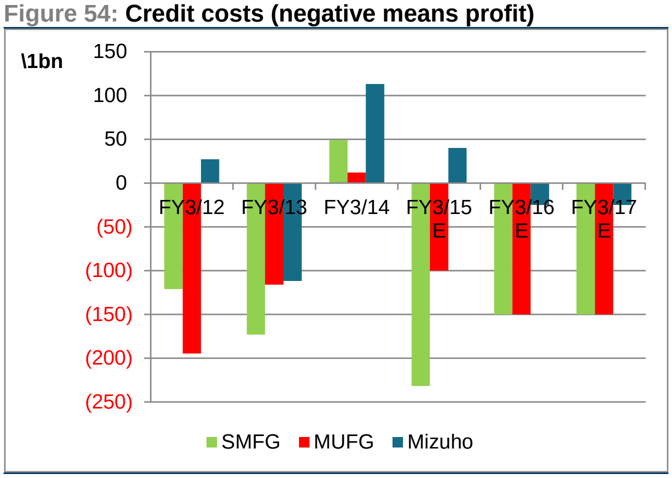
Credit costs

The major banks are now recording net reversals of credit costs, due to the aforementioned rehabilitation of previously delinquent borrowers and low incidence of new defaults, resulting in a reversal of provisions made in previous years, as well as a decline in the reserve ratio.

While all three major banks are still factoring a certain level of credit costs into their guidance, in reality we think such costs will be minimal. MUFG and SMFC both have consumer finance subsidiaries, and as such are likely to see some non-performing loans. That said, there should be limited impact on overall operations.

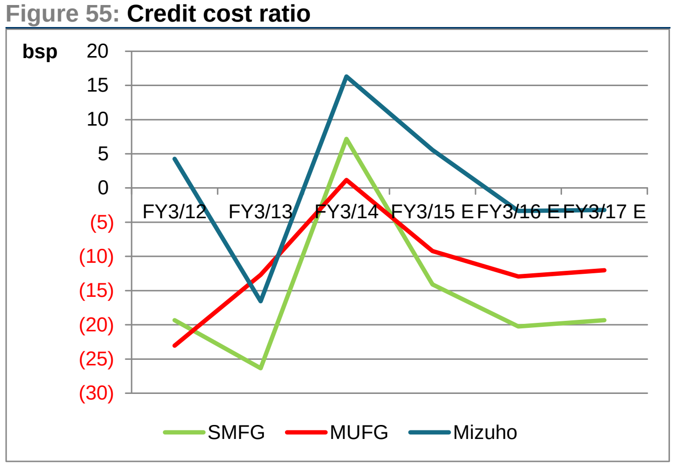
When it comes to corporate finance, the practice at all three major banks is to review internal credit ratings at the end of each fiscal year, then set new discount rates. Most Japanese companies close their books in March, but do not disclose detailed results until several weeks later. Thus the aforementioned review tends to take place in 1–2Q. Amid ongoing improvement in credit quality, we think net reversals of credit costs will be sizable in 1H .

Figure 54: **Credit costs (negative means profit)**



Source: Company data, Credit Suisse estimates

Figure 55: **Credit cost ratio**



Source: Company data, Credit Suisse estimates

Topics: government set to lower deposit insurance premiums

According to the 22 July *Nikkei*, the Japanese government plans to lower deposit insurance premiums in FY3/16.

In FY3/14, Japan's major banks together paid ¥121bn for deposit insurance. If, as reported, the insurance premium for regular deposits is lowered to around 5bps, the three major banks stand to save nearly ¥34.6bn between them.

This same report, though, suggests that the government will require banks to pass the savings on to customers, thereby offsetting some of the boost to earnings.

Figure 56: **Impact from cuts to premiums (cut to 5bps)**

				(JPY bn)
	SMFG	MUFG	Mizuho	Total
Premium paid (FY2013 actual)	47.2	73.5	47.5	121
Average balance of domestic operating deposit	74,665	106,298	71,122	177,420
Rate (bps)	6.32	6.91	6.68	6.82
Impact by reduction	**13.5**	**21.0**	**13.6**	**34.6**

Source: Company data, Credit Suisse estimates

Sumitomo Mitsui Financial Group (8316 / 8316 JP)

Rating	OUTPERFORM*
Price (11 Aug 14, ¥)	4,053
Target price (¥)	(from 5,440) 5,600[1]
Chg to TP (%)	38.2
Market cap. (¥ bn)	5,541.54 (US$ 54.23)
Enterprise value (¥ bn)	5,541.54
Number of shares (mn)	1,367.27
Free float (%)	85.0
52-week price range	5,440 - 3,839

*Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.
[1]Target price is for 12 months.

Research Analysts
Takashi Miura

ASSUMING COVERAGE

Growth potential, profitability underrated

- **Maintain OUTPERFORM; raise TP to ¥5,600:** We adjust our valuation model for Sumitomo Mitsui Financial Group (SMFG) following FY3/14 and 1Q FY3/15 results. We raise our target price from ¥5,440 to ¥5,600 (potential return 38.2%) and maintain our OUTPERFORM rating with the company our top pick in the bank sector. We also introduce our FY3/17 forecasts. From this report, Takashi Miura assumes coverage of SMFG from Takehito Yamanaka.
- **Investment case:** SMFG has achieved the strongest growth in peripheral (non-lending) and overseas business among the major banks. It has also maintained its edge in terms of earnings and looks the most undervalued of the major banks in terms of ROE. We expect it to show the largest reversal when share prices turn around.
- **Catalysts/risks:** Reconfirmation of earnings growth in peripheral and overseas business would be a catalyst. Risks include a slowdown in Asia, which is a key region for the bank, and a fall in the stock market.
- **Valuation:** We base our ¥5,600 TP on a theoretical P/B of 0.97x derived from forecast ROE of 8.8% and a 9.0% discount rate applied to our end-FY3/15 BPS forecast of ¥5,717.6.

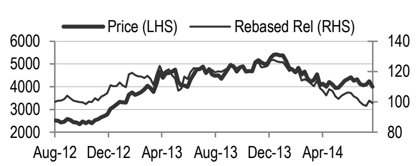
Figure 1: Breakdown of gross profits

(JPY bln)

		FY2010	FY2011	FY2012	FY2013	FY2014 E	FY2015 E	FY2016 E
Gross Profits Breakdown	Net Interest Income (Domestic)	868	849	814	881	796	780	765
	Net Interest Income (Int'l)	100	108	158	184	212	244	280
	Net Gains (Losses) on Debt Securities	147	153	114	1	0	0	0
	Bank others	417	423	455	493	532	574	620
	Bank subtotal	1,532	1,533	1,540	1,558	1,540	1,599	1,666
	Subsidiaries	973	1,062	1,253	1,340	1,290	1,333	1,373
	Total	2,505	2,594	2,793	2,898	2,830	2,931	3,038

Source: Company data, Credit Suisse estimates

Share price performance



The price relative chart measures performance against the TOPIX which closed at 1252.51 on 11/08/14
On 11/08/14 the spot exchange rate was ¥102.19/US$1

Performance Over	1M	3M	12M
Absolute (%)	-1.6	-3.2	-8.9
Relative (%)	-1.4	-9.0	-19.3

Financial and valuation metrics

Year	3/14A	3/15E	3/16E	3/17E
Pre-prov Op profit (¥ bn)	1,328.3	1,228.5	1,297.8	1,372.3
Recurring profit (¥ bn)	1,432.3	1,173.0	1,159.8	1,234.9
Pre-tax profit (¥ bn)	1,422.7	1,173.0	1,159.8	1,234.9
Net profit (¥ bn)	835.4	661.2	645.5	689.4
EPS (¥)	611.0	483.6	472.1	504.2
Change from previous EPS (%)	n.a.	-1.4	-7.9	
IBES Consensus EPS (¥)	n.a.	514.3	520.4	554.5
EPS growth (%)	4.2	-20.8	-2.4	6.8
P/E (x)	7.2	8.4	8.6	8.0
Dividend yield (%)	2.7	3.0	3.0	3.0
BPS (¥)	5,323.9	5,717.6	6,047.9	6,428.3
P/B (x)	0.83	0.71	0.67	0.63
ROE(%)	12.3	8.8	8.0	8.1
ROA (%)	0.54	0.41	0.39	0.40

Source: Company data, Thomson Reuters, IFIS, Credit Suisse estimates.

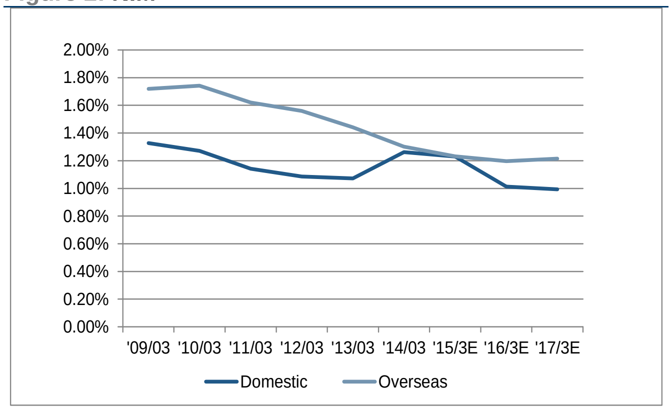
Top pick; maintain OUTPERFORM, raise TP to ¥5,600

SMFG holds top profitability, growth potential among the three major banks.

Profitability

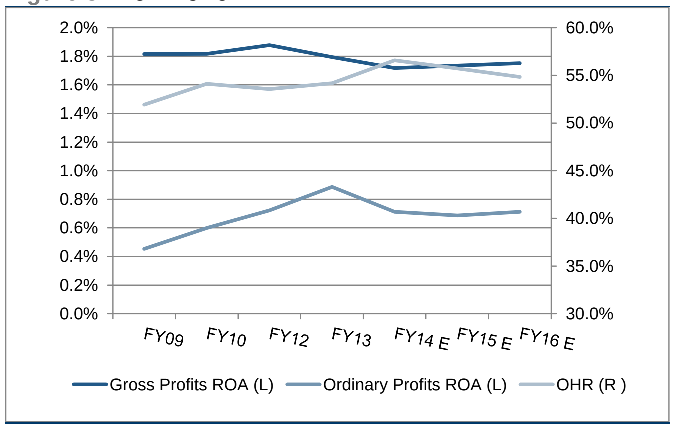
SMFG has the highest net interest margin (NIM) among the major banks. The bank's edge in domestic business, including domestic lending, gives the bank overall competitiveness.

Figure 2: **NIM**



Source: Company data, Credit Suisse estimates

Figure 3: **ROA vs. OHR**



Source: Company data, Credit Suisse estimates

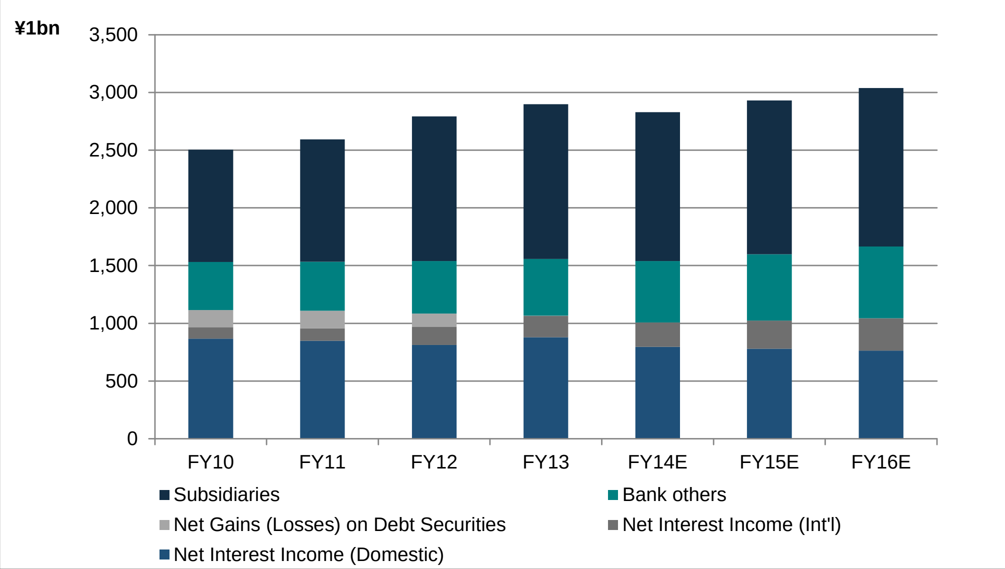
SMFG has achieved the highest top-line profitability (gross business profits ROA) among the three major banks, while its overhead ratio is the lowest. We do not think rapid change in the bank's earnings structure is likely.

In the current financial environment, borrowers do not need to pay high levels of interest to specific financial institutions. We believe disparities in spreads on earnings assets are due largely to differences in terms of loan structure. Individuals and large corporations are interest rate sensitive and therefore opt for the lowest rates, whereas small- and medium-sized enterprises (SME) tend to prefer stable business with banks among their normal transactions. We expect SMFG, which does a large proportion of its business with SMEs, to maintain its edge in terms of domestic profit margins.

Growth potential of peripheral (non-lending), overseas business

Amid sluggish domestic bank investment business (lending, investment in marketable securities), SMFG is benefiting from profit growth at its consolidated subsidiaries, being the only major bank that covers all areas of financial business via its subsidiaries, with SMBC Nikko and SMBC Friend Securities handling securities business, Sumitomo Mitsui Finance and Leasing handling corporate finance, and SMBC Consumer Finance (previously Promise), Cedyna, and Sumitomo Mitsui Card handling consumer finance. In peripheral business, the bank can raise funds at advantageous rates due to its credit position, and we expect continued stable funding.

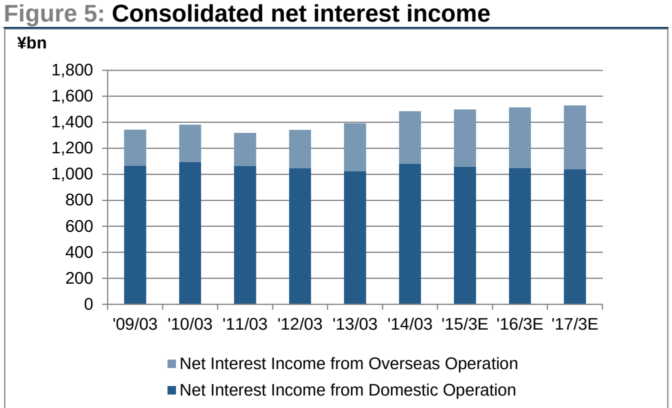
Figure 4: **Breakdown of gross profits**



Source: Company data, Credit Suisse estimates

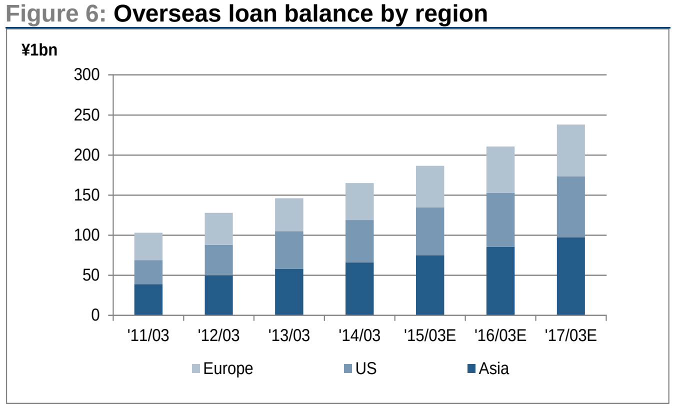
Overseas business

Figure 5: **Consolidated net interest income**



Source: Company data, Credit Suisse estimates

Figure 6: **Overseas loan balance by region**



Source: Company data, Credit Suisse estimates

In overseas business, SMFG has maintained the highest growth among the major banks in terms of both net interest income and loan balance.

We look for strong growth in lending and commission business, especially in Asia, which is a focal point for the bank. In contrast to previously, expansion of business with non-Japanese clients is driving growth and stability is increasing. We also believe that local consolidation, including the bank's 40% stake in BTPN of Indonesia, will lead to future growth.

Valuation

Figure 7: **Target price valuation**

		(JPY bn)
		SMFG
Net Income (F3/15 E)	Current	661
	Previous (14 May)	671
ROE (F3/15 E)	Current	8.8%
	Previous (14 May)	9.1%
BPS (F3/15 E)	Current	5,717.6
	Previous (14 May)	5,501.8
Beta (2yrs)	Current	1.200
	Previous (14 May)	1.263
PBR	Current	0.97
	Previous (14 May)	0.99
Target Price	**Current**	**5,600**
	Previous (14 May)	5,440
Stock Price (8/11)	Current	4,053
	Previous (14 May)	4,185
Potential upside	**Current**	**38.2%**
	Previous (14 May)	30.0%

Source: Company data, Credit Suisse estimates

Although we reduce our NP forecast, we raise our TP due to an increase in BPS due to growth in comprehensive income owing to a rise in equity prices. The share price has fallen since May and potential upside is currently 38.2%.

Outlook

We forecast FY3/15 net profit (NP) of ¥661.2bn, which is slightly below guidance. Our forecasts from 2Q FY3/15 do not reflect gains on securities sales or equity gains/losses.

The bank's CET1 ratio at end-March was 10.62%, far higher than the 8% requirement for G-SIFIs on both transitional & fully-loaded basis. It is also higher than its target (10%).

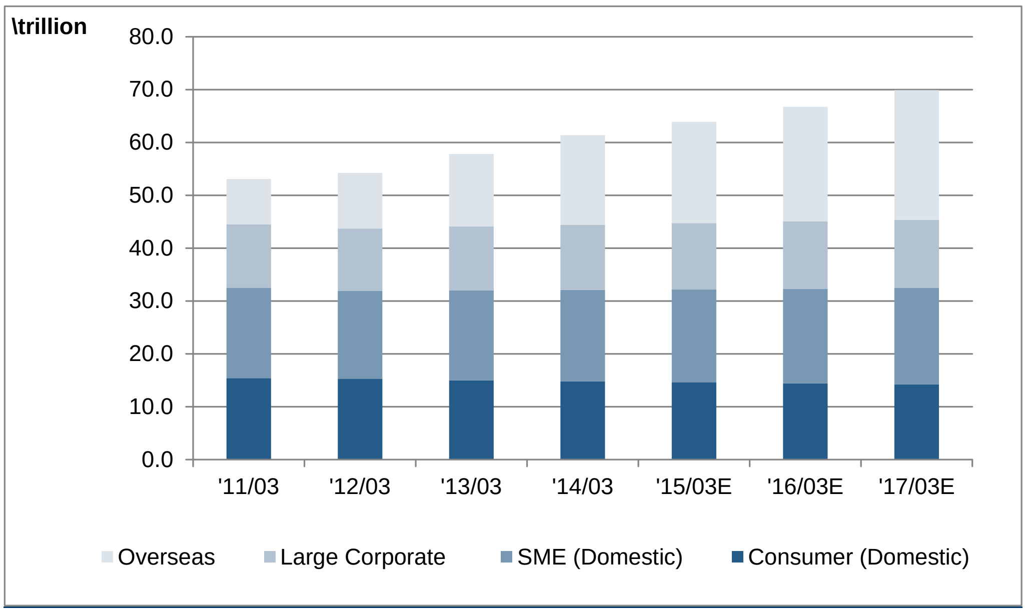
Model assumptions

Domestic lending: slight increase in loan balance, slight contraction in spreads

Home mortgages: Difficult to increase due to sluggish housing demand and tougher competition. With margins also thin, the bank is striving to respond naturally rather than to build up the balance at all costs.

Domestic corporate loans: The bank is striving to make an integrated approach to SMEs and is engaged in restructuring. SMEs are loyal and the source of the bank's high spreads on assets.

Figure 8: **Loan breakdown**



Source: Company data, Credit Suisse estimates

We understand that in 1Q FY3/15, spreads on loans to domestic corporations (loan-deposit margin) stopped falling on loans to both large corporations and other corporations.

Overseas lending: increase in balance, spreads flat

Europe: Balance increasing in comparatively stable fashion

Asia: Aggressively investing resources. The bank is aiming for business expansion opportunities in Indonesia and Vietnam, having acquired a 40% stake in BTPN of Indonesia. It has managed to increase the balance.

Americas: Striving for global franchise expansion, leveraging local bases, including branches and local subsidiaries.

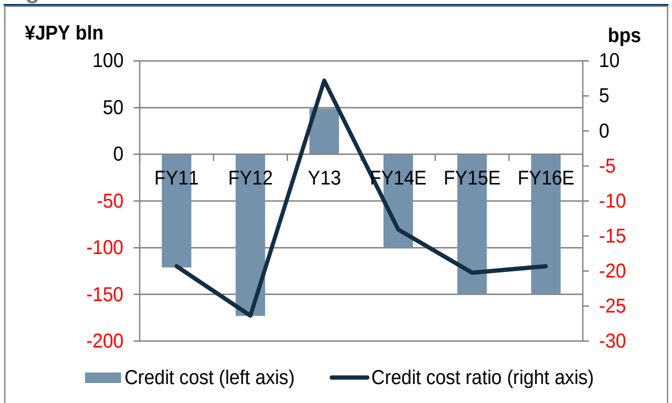
Overseas loan spreads have been stable since 2H FY3/14. The bank plans to secure spreads. Accordingly, we expect it to be able to continue to secure spreads on earnings assets.

Non-performing loans and credit costs

Credit costs will likely increase in theory (cost recognition) as nonbank subsidiaries are expected to generate a certain level of nonperforming loans (NPL). However, as we expect the levels to be low, we see little likelihood that these will be a problem in the near term.

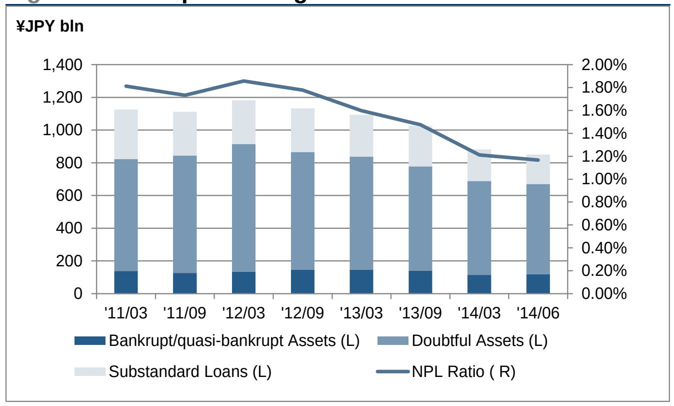
First-quarter FY3/15 credit costs were ¥25.2bn in reversals (profits). The bank revised its provisions in 2Q and 4Q, and costs might change, but we believe we will likely see an improvement from the full-year projection (¥120bn).

Figure 9: **Credit costs**



Source: Company data

Figure 10: **Non-performing loans**



Source: Company data

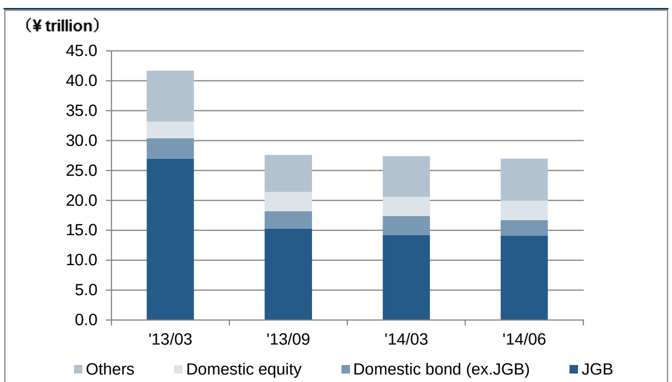
Marketable securities, deposits

Growth in cash and deposits came to a halt at end-1Q FY3/15. As of end-FY3/14, the duration of JGBs had fallen to 1.2 years, unrealized profits on JGBs virtually disappearing.

Unrealized gains on equities increased to ¥1,300bn at end-FY6/14. Valuations of other securities including equity index investment trusts and ETFs held for investment purposes (excluding overseas bonds) also rose, reaching ¥188.6bn at end-FY6/14.

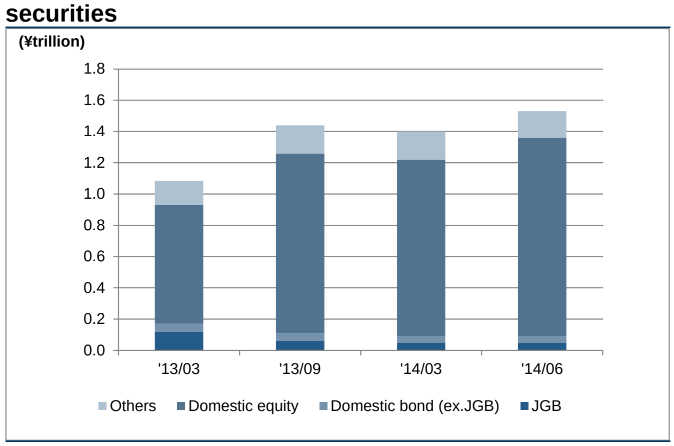
In 1Q FY3/15, the bank booked net interest income of around ¥68bn and equity, etc., gains of ¥32.7bn as equity related investment profits. We believe the bank could book these as earnings by realizing these profits.

Figure 11: **Marketable securities**



Source: Company data

Figure 12: **Unrealized gains/losses on marketable securities**



Source: Company data

Earnings forecasts

Figure 13: Consolidated earnings summary

			Net business profit		Recurring profit		Pre tax profit		Net profit		Diluted EPS		DPS	P/E
			¥mn	YoY (%)	¥mn	YoY (%)	¥mn	YoY (%)	¥mn	YoY (%)	¥	YoY (%)	¥	(x)
Consolidated														
Mar-14	A		1,328,286	2.4	1,432,332	33.4	1,422,694	33.7	835,357	5.2	611.0	4.2	120.0	7.2
Mar-15	**CS E**	**(new)**	**1,228,535**	**-7.5**	**1,173,035**	**-18.1**	**1,173,035**	**-17.5**	**661,214**	**-20.8**	**483.6**	**-20.8**	**120.0**	**8.4**
		(prev)	1,260,501	-5.1	1,259,700	-12.1	1,255,700	18.0	670,600	-19.7	490.5	-19.7	120.0	8.3
	CoE		-		1,110,000	-22.5	-		680,000	-18.6	497.3	45.0	120.0	8.1
	IBES E		-	-	1,158,268	-19.1	-	-	701,517	-16.0	514.3	-15.8	125.5	7.9
Mar-16	**CS E**	**(new)**	**1,297,809**	**5.6**	**1,159,834**	**-1.1**	**1,159,834**	**-1.1**	**645,465**	**-2.4**	**472.1**	**-2.4**	**120.0**	**8.6**
		(prev)	1,362,254	8.1	1,306,400	3.7	1,302,400	3.7	700,700	4.5	512.5	4.5	120.0	7.9
	IBES E		-	-	1,257,134	8.5	-	-	712,798	1.6	520.4	1.2	132.9	7.8
Mar-17	**CS E**	**(new)**	**1,372,292**	**5.7**	**1,234,868**	**6.5**	**1,234,868**	**6.5**	**689,377**	**6.8**	**504.2**	**6.8**	**120.0**	**8.0**

Source: Company data, I/B/E/S, Credit Suisse estimates

Figure 14: Consolidated income statement

(mn yen)	2012/3	2013/3	2014/3	2015/3 E 1Q	2Q E	3Q E	4Q E	2015/3 E	2016/3 E	2017/3 E
Gross profits	2,594,482	2,792,891	2,898,231	708,592	753,540	671,086	696,809	2,829,935	2,931,237	3,038,388
Net interest income	1,341,369	1,392,636	1,484,169	394,602	393,200	348,450	362,590	1,498,840	1,513,828	1,528,967
Trust fees	1,770	1,871	2,472	670	450	1,050	0	2,100	2,205	2,315
Net fees and commissions	823,580	908,168	984,589	218,911	272,570	242,726	253,759	987,955	1,057,112	1,131,110
Net trading profits	198,192	166,617	211,881	43,772	52,300	36,000	37,600	169,600	178,080	186,984
Net other profits	229,568	323,597	215,120	50,635	35,120	42,860	42,860	171,440	180,012	189,013
SGA	1,421,363	1,496,294	1,569,945	397,864	397,800	397,800	408,000	1,601,400	1,633,428	1,666,097
Net business profit	**1,173,119**	**1,296,597**	**1,328,286**	**310,728**	**355,740**	**273,286**	**288,809**	**1,228,535**	**1,297,809**	**1,372,292**
Credit costs (net)	121,255	173,116	-49,072	-25,158	75,100	25,000	25,000	100,000	150,000	150,000
Net gains on equity securities	-27,880	-20,973	89,243	32,654	-32,600	0	33,000	33,000	0	0
Others	-88,411	-28,763	-34,269	-1,092	8,150	2,625	2,625	11,500	12,025	12,576
Recurring profits	**935,571**	**1,073,745**	**1,432,332**	**367,448**	**256,190**	**250,911**	**299,434**	**1,173,035**	**1,159,834**	**1,234,868**
Net extraordinary gains	17,396	-9,712	-9,638	-1,182	1,200	0	0	0	0	0
Profits before tax	**952,966**	**1,064,033**	**1,422,694**	**366,265**	**256,390**	**250,911**	**299,434**	**1,173,035**	**1,159,834**	**1,234,868**
Taxes	311,338	145,968	458,804	107,292	92,061	80,292	95,819	375,371	371,147	395,158
Minority interests	123,090	124,006	128,532	28,152	39,725	33,863	33,863	135,450	142,223	149,334
Net profits	**518,536**	**794,059**	**835,357**	**230,819**	**123,604**	**136,757**	**169,753**	**661,214**	**645,465**	**689,377**
EPS	379.2	586.5	611.0					483.6	472.1	504.2
Dividend per share	100.0	120.0	120.0					120.0	120.0	120.0

Source: Company data, Credit Suisse estimates

Figure 15: Consolidated balance sheet <DOES NOT MATCH THE J VERSION>

(mn yen)	2010/3	2011/3	2012/3	2013/3	2014/3	2015/3 E	2016/3 E	2017/3 E
Cash and due from banks	5,839,672	9,233,906	7,716,291	10,799,291	32,991,113	35,466,200	32,932,900	30,399,600
Receivables under resale agreements	25,226	131,104	227,749	273,217	522,860	522,860	522,860	522,860
Securities	28,623,968	39,952,123	42,529,950	41,306,731	27,152,781	23,759,200	27,247,300	30,551,833
Loans and bills discounted	62,701,033	61,348,355	62,720,599	65,632,091	68,227,688	71,032,232	74,164,481	77,677,895
Tangible fixed assets	1,081,125	1,168,908	1,180,522	1,983,772	2,346,788	2,346,788	2,346,788	2,346,788
Intangible fixed assets	626,248	674,216	799,773	790,860	819,895	819,895	819,895	819,895
Deferred tax assets	728,586	644,736	404,034	374,258	173,180	173,180	173,180	173,180
Other assets	24,601,984	25,708,695	28,440,687	28,465,446	30,047,618	31,377,453	31,519,376	31,664,137
Reserve for possible loan losses	-1,068,329	-1,058,945	-978,933	-928,866	-747,536	-747,536	-747,536	-747,536
Total Assets	**123,159,513**	**137,803,098**	**143,040,672**	**148,696,800**	**161,534,387**	**164,750,272**	**168,979,243**	**173,408,652**
Deposits	78,648,595	81,998,940	84,128,561	89,081,811	94,331,925	95,547,358	99,369,253	103,344,023
Negotiable certificates of deposit	6,995,619	8,366,323	8,593,638	11,755,654	13,713,539	12,519,100	12,519,100	12,519,100
Other liabilities	30,514,494	40,305,761	43,063,497	39,416,117	44,483,904	47,283,400	47,380,912	47,480,374
Total Liabilities	**116,158,708**	**130,671,024**	**135,785,696**	**140,253,582**	**152,529,368**	**155,349,858**	**159,269,265**	**163,343,497**
Shareholders' equity	4,644,677	4,921,419	5,014,313	5,680,626	6,401,215	6,893,014	7,344,579	7,864,755
Valuation and translation adjustments	306,646	173,073	196,087	664,571	877,971	924,500	924,500	924,500
Stock acquisition rights	81	262	692	1,260	1,791	1,900	1,900	1,900
Minority interests	2,049,400	2,037,318	2,043,883	2,096,760	1,724,041	1,581,000	1,439,000	1,274,000
Total net assets	**7,000,805**	**7,132,072**	**7,254,976**	**8,443,218**	**9,005,019**	**9,400,414**	**9,709,979**	**10,065,155**
Total liabilities and net assets	**123,159,513**	**137,803,098**	**143,040,672**	**148,696,800**	**161,534,387**	**164,750,272**	**168,979,243**	**173,408,652**

Source: Company data, Credit Suisse estimates

12 August 2014
Asia Pacific/Japan
Equity Research
Multinational Banks (Banks(Japan)) / OVERWEIGHT

Mitsubishi UFJ Financial Group

(8306 / 8306 JP)

Rating	**OUTPERFORM***
Price (11 Aug 14, ¥)	583
Target price (¥)	(from 725) 750[1]
Chg to TP (%)	28.7
Market cap. (¥ bn)	8,255.88 (US$ 80.79)
Enterprise value (¥ bn)	8,255.88
Number of shares (mn)	14,163.46
Free float (%)	85.0
52-week price range	694 - 530

**Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.*
[1]Target price is for 12 months.

Research Analysts
Takashi Miura

ASSUMING COVERAGE

Undervalued in view of strong overseas growth

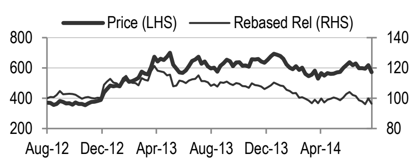
- **Maintain OUTPERFORM; raise TP to ¥750:** We adjust our valuation model for Mitsubishi UFJ Financial Group (MUFG) following FY3/14 and 1Q FY3/15 results. We raise our target price for MUFG from ¥725 to ¥750 (potential return 28.7%) but maintain our OUTPERFORM rating. We also introduce our FY3/17 forecasts. From this report, Takashi Miura assumes coverage of MUFG from Takehito Yamanaka.
- **Investment case:** Growth in MUFG's solid overseas business is being supported by an entrenched local branch network that makes for high stability. MUFG is more than sufficiently capitalized, and we expect the shares to advance as investors rediscover the company's profit potential.
- **Catalysts/risks:** Catalysts include profit growth at local subsidiaries in North America and Asia. Risks include economic reversals and political unrest in MUFG's overseas markets (North America, Asia).
- **Valuation:** We base our ¥750 TP on a theoretical P/B of 0.80x derived from forecast ROE of 7.3% and a 9.1% discount rate applied to our end-FY3/15 BPS forecast of ¥941.5.

Figure 1: **Breakdown of gross profits**

		FY2010	FY2011	FY2012	FY2013	FY2014 E	FY2015 E	FY2016 E
Gross Profits Breakdown	Net Interest Income (Domestic)	101.4	96.7	88.3	81.1	77.8	74.7	71.7
	Net Interest Income (Int'l)	39.8	39.3	44.3	50.5	55.5	61.1	67.2
	Net Gains (Losses) on Debt Securities	21.2	27.0	33.7	14.3	0.0	0.0	0.0
	Bank others	71.4	73.2	73.5	83.6	90.2	97.5	105.2
	Bank subtotal	233.8	236.2	239.8	229.4	223.6	233.2	244.2
	Subsidiaries	118.5	114.0	123.6	145.9	159.4	159.5	167.9
	Total	352.3	350.2	363.4	375.3	383.0	392.7	412.1

Source: Company data, Credit Suisse estimates

Share price performance



The price relative chart measures performance against the TOPIX which closed at 1252.51 on 11/08/14
On 11/08/14 the spot exchange rate was ¥102.19/US$1

Performance Over	1M	3M	12M
Absolute (%)	-2.7	1.6	-3.2
Relative (%)	-2.5	-4.3	-13.6

Financial and valuation metrics

Year	3/14A	3/15E	3/16E	3/17E
Pre-prov Op profit (¥ bn)	1,464.1	1,531.8	1,570.9	1,648.4
Recurring profit (¥ bn)	1,694.8	1,550.4	1,545.4	1,629.0
Pre-tax profit (¥ bn)	1,543.0	1,550.4	1,545.4	1,629.0
Net profit (¥ bn)	984.8	960.4	950.7	1,002.7
EPS (¥)	69.5	67.8	67.1	70.8
Change from previous EPS (%)	n.a.	2.9	-5.3	
IBES Consensus EPS (¥)	n.a.	68.0	71.2	75.8
EPS growth (%)	15.5	-2.5	-1.0	5.5
P/E (x)	8.2	8.6	8.7	8.2
Dividend yield (%)	2.8	2.7	2.7	2.7
BPS (¥)	921.9	941.5	992.6	1,047.4
P/B (x)	0.62	0.62	0.59	0.56
ROE(%)	7.9	7.3	6.9	6.9
ROA (%)	0.40	0.37	0.36	0.36

Source: Company data, Thomson Reuters, IFIS, Credit Suisse estimates.

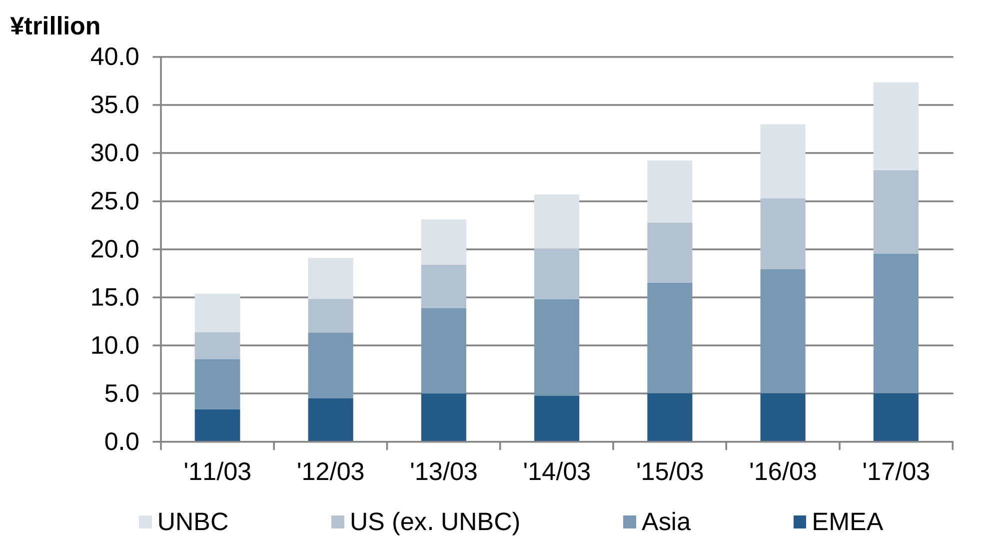
Maintain OUTPERFORM, raise TP to ¥750

MUFG has edge in overseas business expansion

We forecast FY3/15 NP of ¥960.4bn, slightly above guidance due to our more favorable outlook for credit costs. Our forecast excludes capital gains on stock and bond holdings apart from what was actually booked in 1Q.

Growth in MUFG's overseas business is being supported not by an increase in marketable assets but by the solid overseas branch network established in the Bank of Tokyo days and by potent overseas subsidiaries (Union Bank of California, Morgan Stanley, Bank of Ayudhya). We think this gives MUFG an edge over Japan's other two major banks in terms of overseas presence. We expect this local network to give MUFG added stability as it seeks to manage and grow overseas operations that have already taken on considerable scale.

Figure 2: **Overseas loan growth**



Source: Company data, Credit Suisse estimates

MUFG has a consumer finance business overseen by major subsidiaries and a leasing business overseen by affiliates.

In Japan, its brokerage subsidiary is seeing steady profit growth, and the consumer finance segment has also become a stable earner.

MUFG had a CET1 ratio of 11.25% at end-March and should be in the top class among G-SIFIs in terms of headroom when the new capital adequacy rules are fully implemented. We accordingly see little risk of a capital increase, even if regulations are eventually tightened further.

The rapid expansion of MUFG's overseas business is keeping costs high (OHR 61%). MUFG targets a cost ratio of 60% or lower in FY3/15, and we think this is achievable.

Valuation

Figure 3: **Target price valuation**

		(JPY bn) MUFG
Net profit (FY3/15 E)	Current	960
	Previous (14 May)	933
ROE (FY3/15 E)	Current	7.3%
	Previous (14 May)	7.3%
EPS (FY3/15 E)	Current	941.5
	Previous (14 May)	908.5
Revised beta (2yrs)	Current	1.216
	Previous (14 May)	1.255
PBR (x)	Current	0.80
	Previous (14 May)	0.80
Target price	**Current**	**750**
	Previous (14 May)	725
Share price (8/11)	Current	583
	Previous (14 May)	574
Potential upside	**Current**	**28.7%**
	Previous (14 May)	26.3%

Source: Company data, Credit Suisse estimates

We raise our TP because our NP forecast is higher than our previous model. Although the share price has risen since May, potential upside is up slightly to 28.7%.

Model assumptions

Domestic lending: balance edging higher, spreads narrowing

Home mortgages: Growth is unlikely amid weak housing demand and increased competition; margins also under pressure. MUFG prefers profitability and does not chase volume aggressively.

Domestic corporate loans: Loans to large corporations are up slightly amid funding demand centered on M&A. Loans to SMEs are flat despite rebound in funding demand driven by capex expansion due to the weak yen and economic recovery. In both cases, loans are being provided mainly to existing borrowers. This is weighing on profitability as MUFG strives to keep these clients, with margins continuing to narrow although at a slower rate than previously.

Loans to the government: Growth in lending balance slowed in 1Q FY3/15; margins also under pressure.

Overseas lending: balance rising, spreads flat

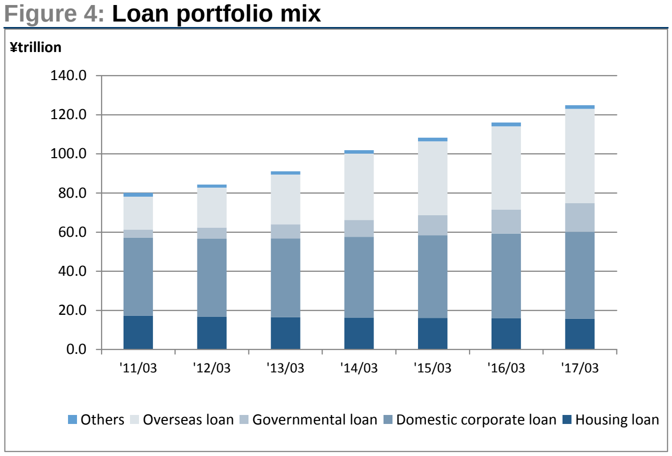
Europe: Loan balance flat amid recovery in European banks' creditworthiness and sluggish demand for funds. MUFG's European loans are profitable.

Asia: Continuing to pursue business with non-Japanese clients via former Bank of Tokyo network and Bank of Ayudhya. Booming demand for funds should support continued growth at current levels, with loans also profitable.

Americas: Sharing business role in North America with alliance partner Morgan Stanley. MUFG seeing higher profits from deal funding and peripheral business. Union Bank of California has over $80bn in assets and is seeing steady growth in both deposits and loans. MUFG also continues to pursue business in Central and South America by leveraging the former Bank of Tokyo's branch network.

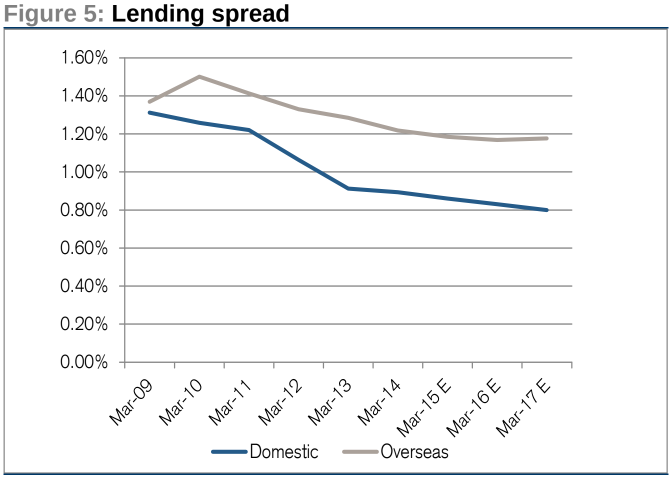
MUFG's local network in Asia and North America gives it an edge over Japan's other two major banks and is contributing to growth overseas.

Figure 4: **Loan portfolio mix**



Source: Company data, Credit Suisse estimates

Figure 5: **Lending spread**



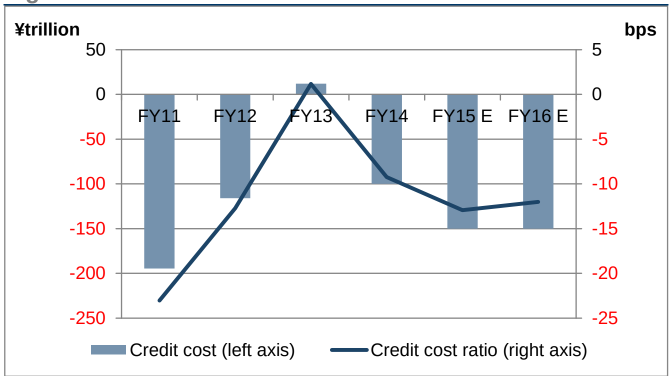
Source: Company data, Credit Suisse estimates

Non-performing loans and credit costs

MUFG has subsidiaries involved in consumer finance and therefore tends to incur a certain amount of bad debt; credit costs are therefore likely. However, credit costs are currently running at historically low levels and unlikely to be a problem for the time being.

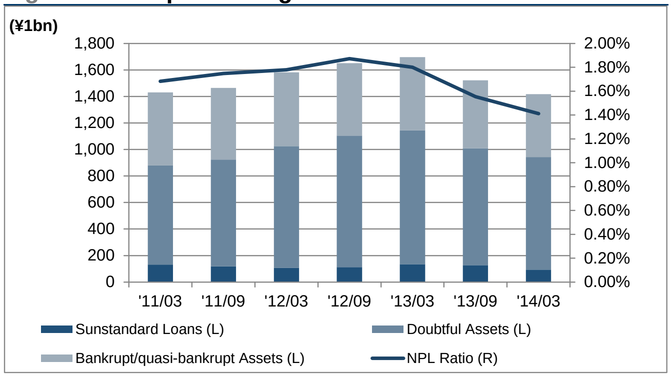
Credit costs totaled ¥7.4bn in 1Q FY3/15. This reflected the addition of credit costs from Bank of Ayudhya, which cancelled out a ¥20.5bn reversal in the domestic bank segment.

Figure 6: **Credit costs**



Source: Company data

Figure 7: **Non-performing loans**



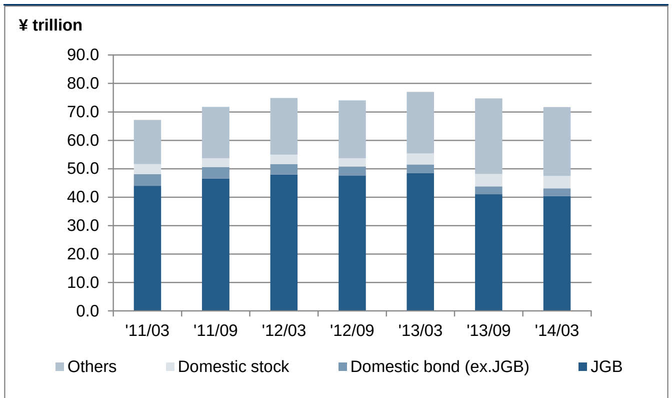
Source: Company data

Marketable securities, BoJ deposits

MUFG is reducing its JGB holdings and increasing its deposits with the Bank of Japan (BoJ) in line with the BoJ's "new dimension" easing initiative. MUFG has more room to shed JGBs than the other two major banks, and we expect BoJ deposits to expand this year in combination with little increase in the balance of marketable securities.

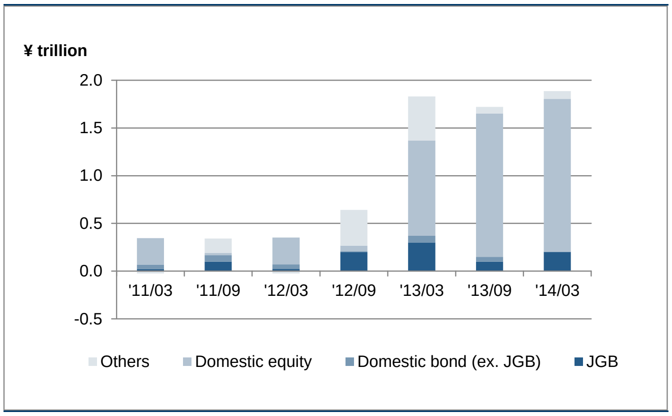
MUFG is alone among the major banks in having ¥168bn in unrealized gains on JGBs. Valuation gains on stockholdings are also substantial.

Figure 8: **Marketable securities**



Source: Company data

Figure 9: **Unrealized gains/losses on marketable securities**



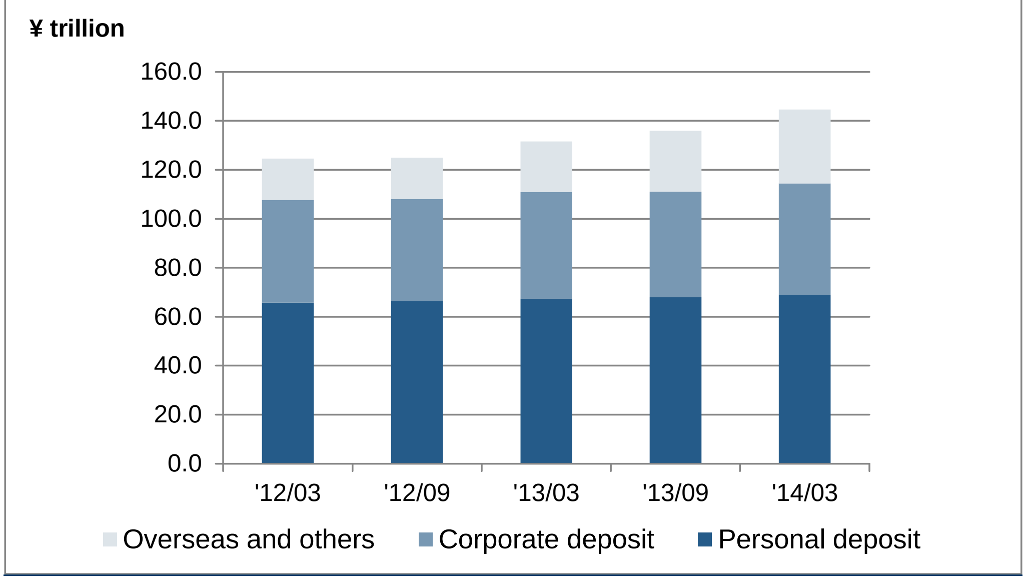
Source: Company data

Deposits

Domestic deposits are rising steadily, and MUFG is also able to consistently raise foreign-denominated funds overseas through its local network.

MUFG can also raise funds at low cost through capital market instruments including corporate bonds and CP.

Figure 10: **Deposit breakdown**



Source: Company data

Earnings forecasts

Figure 11: Earnings summary

		Net business profit		Recurring profit		Pre tax profit		Net profit		Diluted EPS		DPS	P/E
		¥mn	YoY (%)	¥mn	YoY (%)	¥mn	YoY (%)	¥mn	YoY (%)	¥	YoY (%)	¥	(x)
Consolidated													
Mar-14	A	1,464,119	-4.9	1,694,820	26.1	1,543,031	14.0	984,848	15.5	69.5	15.5	16.0	8.2
Mar-15	**CS E (new)**	**1,531,804**	**4.6**	**1,550,404**	**-8.5**	**1,550,404**	**0.5**	**960,383**	**-2.5**	**67.8**	**-2.5**	**16.0**	**8.6**
	(prev)	1,598,948	9.2	1,625,900	-4.1	1,621,900	5.1	932,900	-5.3	65.9	-5.3	16.0	8.8
	CoE	-	-	-	-	-	-	950,000	-3.5	61.2	-12.0	45.0	9.5
	IBES E	-	-	1,552,744	-8.4	-	-	962,805	-2.2	68.0	-2.2	16.5	8.6
Mar-16	**CS E (new)**	**1,570,925**	**2.6**	**1,545,405**	**-0.3**	**1,545,405**	**-0.3**	**950,689**	**-1.0**	**67.1**	**-1.0**	**16.0**	**8.7**
	(prev)	1,728,580	8.1	1,739,900	7.0	1,735,900	7.0	1,004,400	7.7	70.9	7.7	18.0	8.2
	IBES E	-	-	1,620,104	4.3	-	-	1,005,497	4.4	71.2	4.7	17.5	8.2
Mar-17	**CS E (new)**	**1,648,380**	**4.9**	**1,629,034**	**5.4**	**1,629,034**	**5.4**	**1,002,724**	**5.5**	**70.8**	**5.5**	**16.0**	**8.2**

Source: Company data, I/B/E/S, Credit Suisse estimates

Figure 12: Consolidated income statement

(mn yen)	2014/3	2015/3 E 1Q	2Q E	3Q E	4Q E	2015/3 E	2016/3 E	2017/3 E
Gross profits	3,753,023	967,449	913,140	955,100	993,870	3,829,510	3,927,313	4,120,951
Net interest income	1,878,632	490,701	518,290	538,350	500,770	2,048,110	2,109,553	2,172,840
Trust fees	107,935	24,844	28,200	25,000	30,000	108,000	113,400	119,070
Net fees and commissions	1,160,337	284,564	308,750	291,900	332,850	1,218,000	1,315,440	1,420,675
Net trading profits	362,056	59,513	82,900	58,400	88,800	289,600	304,080	319,284
Net other profits	244,062	107,826	-24,900	41,450	41,450	165,800	84,840	89,082
SGA	2,289,375	635,681	496,060	568,153	605,293	2,297,706	2,356,388	2,472,571
Pre-Provision Operating Profits	**1,464,119**	**331,768**	**417,080**	**386,947**	**388,577**	**1,531,804**	**1,570,925**	**1,648,380**
Credit costs (net)	-12,352	7,400	42,600	25,000	25,000	100,000	150,000	150,000
Net gains on equity securities	144,573	22,500	-22,500	0	0	0	0	0
Others	73,776	48,076	19,300	29,400	29,400	118,600	124,480	130,654
Recurring profits	**1,694,820**	**394,944**	**371,280**	**391,347**	**392,977**	**1,550,404**	**1,545,405**	**1,629,034**
Net extraordinary gains	-151,789	-33,987	33,900	0	0	0	0	0
Profits before tax	**1,543,031**	**360,957**	**405,180**	**391,347**	**392,977**	**1,550,404**	**1,545,405**	**1,629,034**
Taxes	439,987	97,707	132,124	117,404	117,893	465,121	463,622	488,710
Minority interests	118,196	22,759	39,250	30,975	30,975	123,900	130,095	136,600
Net profits	**984,848**	**240,491**	**233,806**	**242,968**	**244,109**	**960,383**	**950,689**	**1,002,724**
EPS	69.5					67.8	67.1	70.8
Dividend	16.0					16.0	16.0	16.0

Source: Company data, Credit Suisse estimates

Figure 13: Consolidated balance sheet

(mn yen)	2010/3	2011/3	2012/3	2013/3	2014/03	2015/3 E	2016/3 E	2017/3 E
Cash and due from banks	7,495,050	10,406,053	9,036,116	11,457,999	23,969,883	34,890,600	31,401,540	28,261,386
Receivables under resale agreements	3,559,309	4,997,138	4,552,860	5,635,326	7,237,125	7,237,125	7,237,125	7,237,125
Securities	63,964,461	71,023,637	78,264,735	79,526,850	74,515,573	66,037,700	68,495,480	69,515,835
Loans and bills discounted	84,880,603	79,995,024	84,492,697	91,299,557	101,938,907	108,356,087	115,940,976	124,846,537
Tangible fixed assets	1,357,449	1,333,298	1,343,909	1,404,687	1,540,031	1,540,031	1,540,031	1,540,031
Intangible fixed assets	1,152,606	1,069,317	1,023,834	1,091,392	1,483,352	1,483,352	1,483,352	1,483,352
Deferred tax assets	646,495	780,310	522,886	95,814	130,654	130,654	130,654	130,654
Other assets	42,388,888	37,766,301	40,748,352	45,074,533	48,254,904	45,317,338	46,079,538	46,879,848
Reserve for possible loan losses	-1,337,922	-1,143,997	-1,123,773	-1,087,457	-938,483	-928,500	-928,500	-928,500
Total Assets	**204,106,939**	**206,227,081**	**218,861,616**	**234,498,701**	**258,131,946**	**264,064,387**	**271,380,196**	**278,966,267**
Deposits	123,891,946	124,144,337	124,789,252	131,697,096	144,760,294	150,310,504	156,322,925	162,575,842
Negotiable certificates of deposit	11,019,571	10,961,012	12,980,617	14,855,049	15,548,170	15,548,170	15,304,500	15,304,500
Other liabilities	57,895,962	60,307,306	69,415,962	74,426,900	82,710,587	82,841,130	83,643,400	84,229,930
Total Liabilities	**192,807,479**	**195,412,655**	**207,185,831**	**220,979,045**	**243,019,051**	**248,699,804**	**255,270,825**	**262,110,272**
Shareholders' equity	8,958,783	9,104,973	9,909,575	10,578,356	11,346,299	11,343,183	12,066,972	12,843,096
Valuation and translation adjustments	347,010	-156,025	83,454	1,158,261	1,709,760	1,989,700	1,989,700	1,989,700
Stock acquisition rights	6,451	7,192	7,933	8,884	8,732	8,000	9,000	9,000
Minority interests	1,987,213	1,858,283	1,674,821	1,774,153	2,048,101	2,023,700	2,043,700	2,014,200
Total net assets	**11,299,457**	**10,814,425**	**11,675,784**	**13,519,655**	**15,112,895**	**15,364,583**	**16,109,372**	**16,855,996**
Total liabilities and net assets	**204,106,939**	**206,227,081**	**218,861,616**	**234,498,701**	**258,131,946**	**264,064,387**	**271,380,196**	**278,966,267**

Source: Company data, Credit Suisse estimates

12 August 2014
Asia Pacific/Japan
Equity Research
Multinational Banks (Banks(Japan)) / OVERWEIGHT

Mizuho Financial Group (8411 / 8411 JP)

Rating	**NEUTRAL***
Price (11 Aug 14, ¥)	195
Target price (¥)	(from 225) 240[1]
Chg to TP (%)	23.0
Market cap. (¥ bn)	4,734.02 (US$ 46.37)
Enterprise value (¥ bn)	4,734.02
Number of shares (mn)	24,264.60
Free float (%)	85.0
52-week price range	237 - 194

**Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.*
[1]Target price is for 12 months.

Research Analysts
Takashi Miura

ASSUMING COVERAGE

Poised for progress on earnings restructuring via linkage of banking, trust, securities businesses

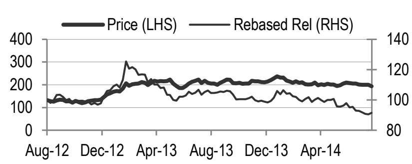
- **Maintain NEUTRAL; raise TP to ¥240:** We adjust our valuation model for Mizuho following FY3/14 and 1Q FY3/15 results. We raise our target price from ¥225 to ¥240 (potential return 23%) but maintain our NEUTRAL rating. We also introduce our FY3/17 forecasts. From this report, Takashi Miura assumes coverage of Mizuho from Takehito Yamanaka.
- **Investment case:** In its 1Q results announcement, Mizuho reported gains from bond sales and the reversal of bad debt reserves, and the company looks to be well on its way to hitting full-FY guidance. Management is also keen on enhancing returns to shareholders, and we think it might take action soon if it appears likely to reach its CET1 target.
- **Risks:** Upside catalysts include margin improvement supported by post-merger cost reductions. Downside risks include a capital shortfall stemming from tighter regulations, and a growth strategy that lags behind those of other major banks due to capital limitations.
- **Valuation:** We base our ¥240 TP on a theoretical P/B of 0.84x derived from forecast ROE of 7.5% and a 9.0% discount rate applied to our end-FY3/15 BPS forecast of ¥283.1 (including dilution). To minimize the effect of past events on our valuation estimate, we use a six-year beta.

Figure 1: Breakdown of gross profits

		FY2010	FY2011	FY2012	FY2013	FY2014 E	FY2015 E	FY2016 E
Gross Profits Breakdown	Net Interest Income (Domestic)	799	757	715	667	640	615	590
	Net Interest Income (Int'l)	218	232	248	293	322	355	390
	Net Gains (Losses) on Debt Securities	141	155	220	14	0	0	0
	Bank others	453	463	503	533	575	621	671
	Bank subtotal	1,611	1,608	1,686	1,507	1,538	1,591	1,651
	Subsidiaries	422	396	486	528	539	534	547
	Total	2,033	2,003	2,172	2,035	2,077	2,124	2,198

Source: Company data, Credit Suisse estimates

Share price performance



The price relative chart measures performance against the TOPIX which closed at 1252.51 on 11/08/14
On 11/08/14 the spot exchange rate was ¥102.1/US$1

Performance Over	1M	3M	12M
Absolute (%)	-2.9	-3.9	-6.7
Relative (%)	-2.7	-10.2	-16.4

Financial and valuation metrics

Year	3/14A	3/15E	3/16E	3/17E
Pre-prov Op profit (¥ bn)	777.1	793.6	822.1	876.2
Recurring profit (¥ bn)	987.6	902.8	859.6	869.5
Pre-tax profit (¥ bn)	985.4	902.8	859.6	869.5
Net profit (¥ bn)	688.4	499.7	511.3	513.7
EPS (¥)	28.4	20.6	21.1	21.2
Change from previous EPS (%)	n.a.	-7.1	-14.9	
IBES Consensus EPS (¥)	n.a.	22.9	23.7	25.0
EPS growth (%)	22.3	-27.4	2.3	0.5
P/E (x)	7.2	9.5	9.3	9.2
Dividend yield (%)	3.2	3.6	3.6	3.6
BPS (¥)	266.3	283.3	280.4	295.2
P/B (x)	0.77	0.69	0.70	0.66
ROE(%)	11.1	7.5	7.5	7.3
ROA (%)	0.39	0.28	0.28	0.27

Source: Company data, Thomson Reuters, IFIS, Credit Suisse estimates.

Maintain NEUTRAL, raise TP to ¥240

Poised for margin improvement through post-merger streamlining and linkage of banking, trust, securities businesses

We forecast FY3/15 NP of ¥500bn, slightly below guidance. We factor in 1Q gains from bond sales as is, and also assume ¥45bn in gains from equity sales over the full year (in line with the company's estimate).

As we expect synergies from the July 2013 merger of Mizuho Bank and Mizuho Corporate Bank to start materializing in earnest.

Regarding overseas business, the key to business portfolio expansion, Mizuho learned from its previous mistake of over-exposure and launched a Super 30 initiative in which it focused on business with the top 30 companies in each of four geographic regions (120 companies total). From FY3/15 the company is taking this a step further, expanding its focus to the top 50 companies in each region under its new Super 50 initiative. With Asia as the priority region, Mizuho is targeting robust growth by expanding business with non-Japanese companies. To date, however, overseas growth through investment has been limited, and we think further growth will require the development of strong local networks.

In contrast with other major banks, Mizuho's consolidated businesses do not include a nonbank unit. Credit Saison and affiliated leasing companies are already expanding on their own, and consolidating these units would therefore likely prove challenging.

As for Mizuho Securities, the company is looking to expand business with banking customers through the integration of banking, trust, and securities services. Meanwhile, supported by the bank's relatively strong credit rating, Mizuho Securities has an advantage over independent firms with respect to raising capital.

The company's CET1 ratio at end-FY3/14 was 8.79%, clear of the 8% requirement for G-SIFIs on both a current- and fully-implemented basis. By FY-end we expect the company to also meet the requirement even after the exclusion of valuation adjustments on other marketable securities. However, Mizuho still has the lowest CET1 ratio of all three major banks, and this could slow the company's expansion in growth businesses that require large capital outlays.

Valuation

Figure 2: **Target price valuation**

		(JPY bn) Mizuho
Net Income (F3/15 E)	Current	500
	Previous (14 May)	537
ROE (F3/15 E)	Current	7.5%
	Previous (14 May)	8.1%
BPS (F3/15 E)	Current	283.1
	Previous (14 May)	260.2
Beta (6yrs)	Current	1.195
	Previous (14 May)	1.26
PBR	Current	0.84
	Previous (14 May)	0.86
Target Price	**Current**	**240**
	Previous (14 May)	225
Stock Price (8/11)	Current	195
	Previous (14 May)	203
Potential upside	**Current**	**23.0%**
	Previous (14 May)	10.8%

Note: ROE includes dilution

Source: Company data, Credit Suisse estimates

Although we reduce our NP forecast, we raise our TP because BPS increased due to an increase in net assets due to growth in comprehensive income owing to a rise in unrealized gains on equity. The share price has fallen since May and potential upside is currently 23%.

Model assumptions

Domestic lending: Modest growth in lending balance, but narrower margins

Home mortgages: Headwinds to growth include stiff competition and sluggish housing demand. We expect Mizuho to remain focused on profitability over volume.

Domestic corporate loans: We assume modest growth in loans to large companies by targeting demand for M&A financing (in some cases may be booked as small-business loans due to the use of SPVs). We assume negligible growth in loans to SMEs despite a recovery in demand for capex financing driven by yen depreciation and improving economic conditions.

In both cases, loans will be primarily to existing customers. Margins are narrowing due to competition, and we expect this trend to continue even if competition eases.

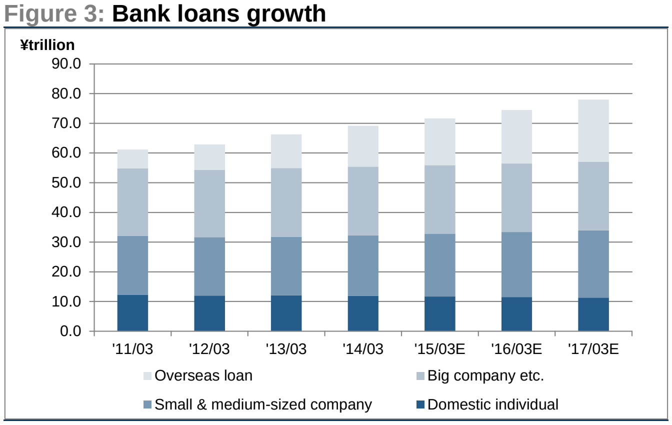
Overseas lending: Growth in lending balance; level margins

Europe: The loan balance has declined due to large repayments by major leveraged financing customers in FY3/14 through 1Q FY3/15, but these loans are now paid off. We expect stagnant growth in the lending balance due to sluggish demand for capital and a recovery in the lending capacity of European financial institutions. Margins narrowed slightly on a decline in high-spread loans, but are basically holding level.

Asia: Mizuho is finding success by leveraging its strength in syndicated loans and cultivating existing customer relationships (Super 30). We expect earnings growth through customer base expansion.

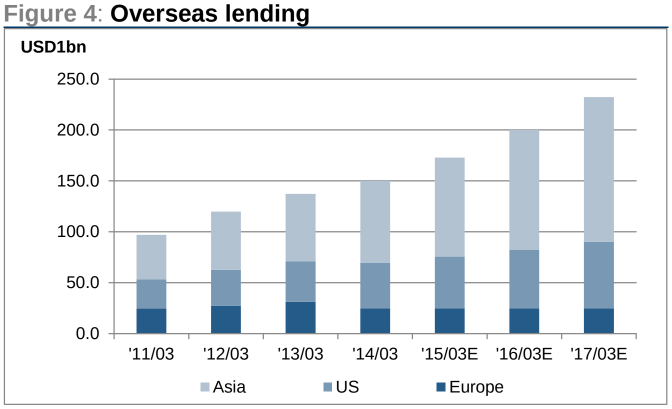
US: Mizuho eyes business growth through new branches, a local subsidiary, and partnerships with leading US financial institutions. Management has interest in M&A and/or asset purchases, but the threshold is high and we think a major asset acquisition is unlikely in the near term.

Figure 3: **Bank loans growth**



Source: Company data, Credit Suisse estimates

Figure 4: **Overseas lending**



Source: Company data, Credit Suisse estimates

Marketable securities and deposits

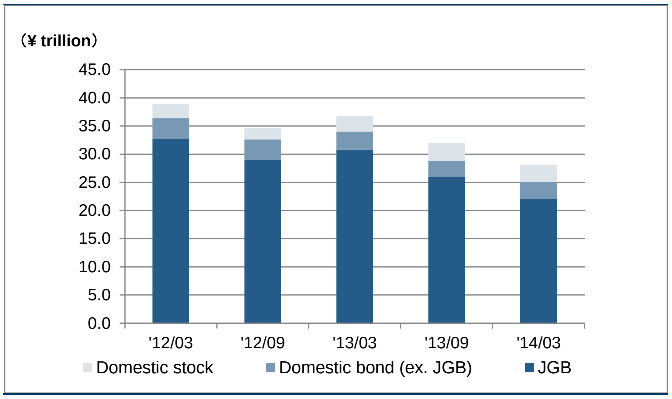
The balance of JGB holdings declined in FY3/14 due to crediting to BoJ deposits, and scope for deposits is therefore limited this year.

Unrealized gains on JGB holdings largely evaporated, but thanks to rising bond prices overseas, the company posted a ¥43.8bn gain from bond sales in 1Q.

Equity sales

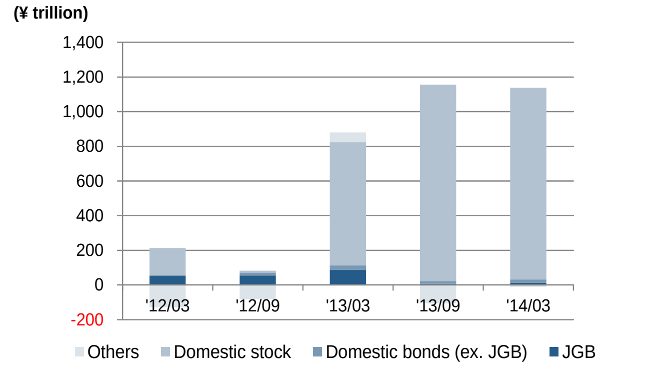
Financial targets for FY3/16 include lowering the ratio of strategic shareholdings to Tier 1 capital to around 25%. Management plans to sell off around ¥100bn worth of shares in FY3/15, producing a gain of ¥45bn. During 1Q FY3/15 the company sold ¥14 billion worth of shares for a gain of around ¥8.5bn. Based on current unrealized gains, we believe both sales and gains targets are attainable by FY-end.

Figure 5: **Marketable securities**



Source: Company data

Figure 6: **Unrealized gains/losses on marketable securities**



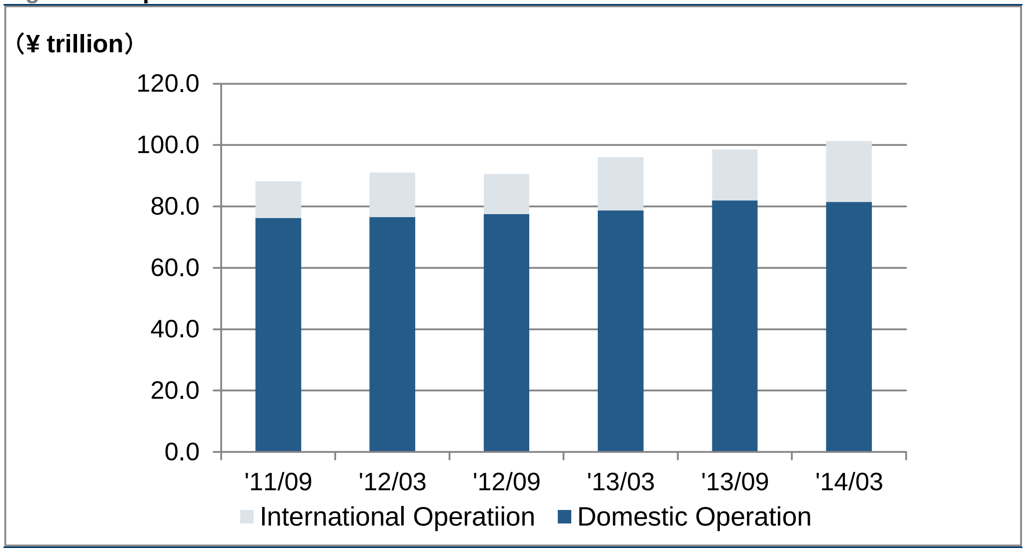
Source: Company data

Deposits

Domestic deposits are increasing steadily, and deposits are increasing overseas as well.

In addition to deposits, Mizuho is also able to procure low-cost funding via market instruments such as corporate bonds and CP.

Figure 7: **Deposit breakdown**



Source: Company data

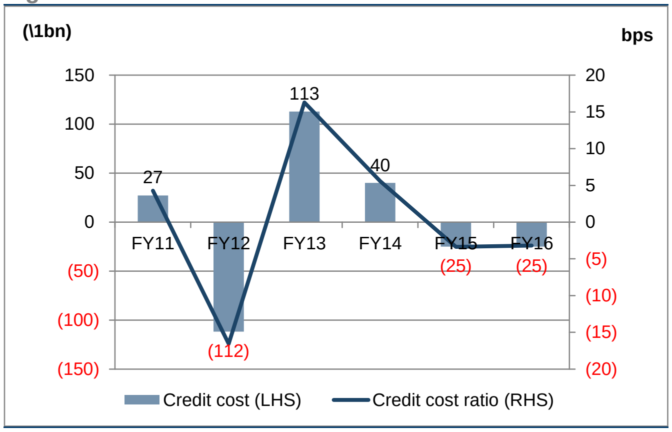
Non-performing loans and credit costs

Because Mizuho does not have a consumer financing unit or other nonbank entity among its consolidated subsidiaries, its credit costs tend to be low relative to those of the other two major banks.

Initial FY guidance conservatively factored in credit costs of ¥60bn, but in 1Q the company actually reported a reversal gain of ¥31.2bn. The company conducted an internal credit rating review during 2Q, and because an overall rating upgrade is expected, we look for a gain for full-FY3/15 as well.

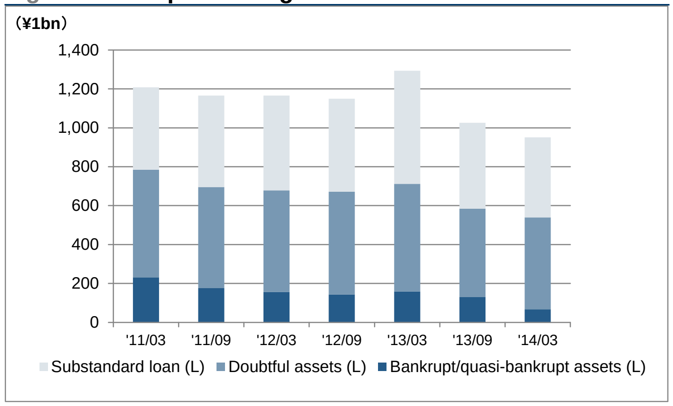
Currently we see no major reason for concern about any of the company's major customers, and credit costs are therefore unlikely to become a significant burden over the next few years.

Figure 8: **Credit costs**



Source: Company data

Figure 9: **Non-performing loans**



Source: Company data

Earnings forecasts

Figure 10: Earnings summary

			Net business profit		Recurring profit		Pre tax profit		Net profit		Diluted EPS		DPS	P/E
			¥mn	YoY (%)	¥mn	YoY (%)	¥mn	YoY (%)	¥mn	YoY (%)	¥	YoY (%)	¥	(x)
Consolidated														
Mar-14	A		777,054	-16.2	987,587	31.6	985,366	37.3	688,415	22.8	28.4	22.3	6.5	7.2
Mar-15	**CS E**	**(new)**	**793,570**	**2.1**	**902,820**	**-8.6**	**902,820**	**-8.4**	**499,733**	**-27.4**	**20.6**	**-27.4**	**7.0**	**9.5**
		(prev)	805,980	3.7	878,800	-11.0	876,400	22.1	536,600	-22.1	22.2	-21.9	6.5	8.8
	CoE		-		-	-	-		550,000	-20.1	22.4	45.0	7.0	8.7
	IBES E		-	-	862,775	-12.6	-	-	571,853	-16.9	22.9	-19.2	7.0	8.5
Mar-16	**CS E**	**(new)**	**822,077**	**3.6**	**859,614**	**-4.8**	**859,614**	**-4.8**	**510,325**	**2.1**	**21.0**	**2.1**	**7.0**	**9.3**
		(prev)	921,972	14.4	963,100	9.6	960,700	9.6	599,500	11.7	24.8	11.7	6.5	7.9
	IBES E		-	-	916,332	6.2	-	-	609,760	6.6	23.7	3.2	7.2	8.2
Mar-17	**CS E**	**(new)**	**876,160**	**6.6**	**869,524**	**1.2**	**869,524**	**1.2**	**512,742**	**0.5**	**21.1**	**0.5**	**7.0**	**9.2**

Source: Company data, I/B/E/S, Credit Suisse estimates

Figure 11: Consolidated income statement

(mn yen)	3/2012	3/2013	3/2014	2015/3 E				3/2015 E	3/2016 E	3/2017 E
				1Q	2Q E	3Q E	4Q E			
Gross profits	2,003,075	2,171,716	2,035,281	504,297	617,529	430,729	524,272	2,076,730	2,124,484	2,198,103
Net interest income	1,088,340	1,075,898	1,108,303	263,964	295,539	280,679	278,962	1,119,080	1,130,271	1,141,574
Trust fees	49,014	48,506	52,014	10,592	16,485	11,235	16,380	54,600	57,330	60,197
Net fees and commissions	458,933	507,378	560,768	112,163	176,965	132,090	167,895	589,050	630,284	674,403
Net trading profits	150,317	215,033	187,421	61,282	35,190	19,800	52,110	168,300	176,715	185,551
Net other profits	256,468	324,899	126,774	56,297	50,350	(13,075)	30,925	123,700	129,885	136,379
SGA	1,283,847	1,244,647	1,258,227	318,736	322,880	320,790	320,790	1,283,160	1,302,407	1,321,944
Net business profit	**719,228**	**927,069**	**777,054**	**185,561**	**294,649**	**109,939**	**203,482**	**793,570**	**822,077**	**876,160**
Credit costs (net)	(27,749)	111,837	(112,879)	31,300	18,700	0	10,000	(40,000)	25,000	25,000
Net gains on equity securities	(38,175)	(82,949)	77,031	15,700	(15,700)	0	52,500	52,500	45,000	0
Others	(60,240)	18,094	20,622	60,078	48,875	3,937	3,937	16,750	17,537	18,364
Recurring profits	**648,561**	**750,376**	**987,587**	**230,039**	**309,124**	**113,877**	**249,920**	**902,820**	**859,614**	**869,524**
Net extraordinary gains	67,888	(32,544)	(2,220)	(1,503)	1,500	0	0	0	0	0
Profits before tax	**716,449**	**717,832**	**985,366**	**228,536**	**309,624**	**113,877**	**249,920**	**902,820**	**859,614**	**869,524**
Taxes	152,826	57,862	214,970	53,197	108,607	34,163	120,117	315,987	257,884	260,857
Minority interests	79,102	99,454	81,980	20,614	22,450	21,525	21,525	86,100	90,405	94,925
Net profits	**484,519**	**560,516**	**688,415**	**154,723**	**178,567**	**58,189**	**108,278**	**499,733**	**510,325**	**512,742**
EPS	20.2	22.9	27.1					20.6	21.0	21.1
Dividend	9.0	6.0	6.5					7.0	7.0	7.0

Source: Company data, Credit Suisse estimates

Figure 12: Consolidated balance sheet

(mn yen)	3/2010	3/2011	3/2012	3/2013	3/2014	3/2015 E	3/2016 E	3/2017 E
Cash and due from banks	5,211,477	9,950,913	7,278,477	12,333,997	20,610,276	25,140,700	23,344,936	21,549,171
Receivables under resale agreements	7,129,676	7,467,309	7,123,397	9,025,049	8,349,528	8,349,528	8,349,528	8,349,528
Securities	43,096,460	44,782,067	51,392,878	53,472,399	43,997,517	42,438,300	44,326,500	46,108,152
Loans and bills discounted	62,164,579	62,777,757	63,800,509	67,536,882	69,301,405	71,764,770	74,596,928	78,093,515
Tangible fixed assets	927,337	947,986	923,907	901,085	925,266	925,266	925,266	925,266
Intangible fixed assets	427,278	442,922	485,995	477,546	531,501	531,501	531,501	531,501
Deferred tax assets	533,030	488,769	359,987	165,299	104,909	104,909	104,909	104,909
Other assets	37,650,808	34,715,045	34,687,111	34,238,795	32,618,790	35,102,696	35,704,871	36,337,155
Reserve for possible loan losses	-887,073	-760,762	-691,760	-739,990	-616,307	-576,400	-576,400	-576,400
Total Assets	**156,253,572**	**160,812,006**	**165,360,501**	**177,411,062**	**175,822,885**	**183,781,270**	**187,308,039**	**191,422,797**
Deposits	76,339,779	79,233,922	78,811,909	84,241,955	89,055,505	90,481,407	94,100,663	97,864,689
Negotiable certificates of deposit	10,287,808	9,650,236	11,824,746	15,326,781	12,755,776	15,821,900	15,821,900	15,821,900
Other liabilities	63,788,932	65,303,849	67,854,551	70,106,096	65,707,055	69,209,150	69,638,758	70,089,845
Total Liabilities	**150,416,519**	**154,188,007**	**158,491,206**	**169,674,832**	**167,518,336**	**175,512,457**	**179,561,320**	**183,776,435**
Shareholders' equity	3,207,219	4,248,209	4,762,749	5,174,601	5,676,215	5,947,833	6,193,238	6,552,882
Valuation and translation adjustments	305,831	80,906	146,687	752,533	781,096	921,500	606,500	606,500
Stock acquisition rights	2,301	2,754	2,158	2,687	3,179	2,080	2,080	2,080
Minority interests	2,321,700	2,292,128	1,957,699	1,806,407	1,844,057	1,397,400	944,900	484,900
Total net assets	**5,837,053**	**6,623,999**	**6,869,295**	**7,736,230**	**8,304,549**	**8,268,813**	**7,746,718**	**7,646,362**
Total liabilities and net assets	**156,253,572**	**160,812,006**	**165,360,501**	**177,411,062**	**175,822,885**	**183,781,270**	**187,308,039**	**191,422,797**

Source: Company data, Credit Suisse estimates

CREDIT SUISSE

Companies Mentioned *(Price as of 11-Aug-2014)*

ACOM (8572.T, ¥394)
Bank of Ayudhya (Unlisted)
Cedyna Financial Corporation (Unlisted)
Daiwa Securities Group (8601.T, ¥832)
Mitsubishi UFJ Financial Group (8306.T, ¥583, OUTPERFORM, TP ¥750)
Mitsubishi UFJ Morgan Stanley Securities (Unlisted)
Mitsubishi UFJ NICOS (Unlisted)
Mizuho Financial Group (8411.T, ¥195, NEUTRAL, TP ¥240)
Nomura Holdings (8604.T, ¥641)
SMBC Consumer Finance (Unlisted)
SMBC Nikko Sec. (Unlisted)
Sharp Corp. (6753.T, ¥310)
Sumitomo Mitsui Card Company (Unlisted)
Sumitomo Mitsui Finance and Leasing Company (Unlisted)
Sumitomo Mitsui Financial Group (8316.T, ¥4,053, OUTPERFORM, TP ¥5,600)
UnionBanCal Corporation (Unlisted)

Other companies mentioned appear in Figures 5, 7, 16, 31, 32

Disclosure Appendix

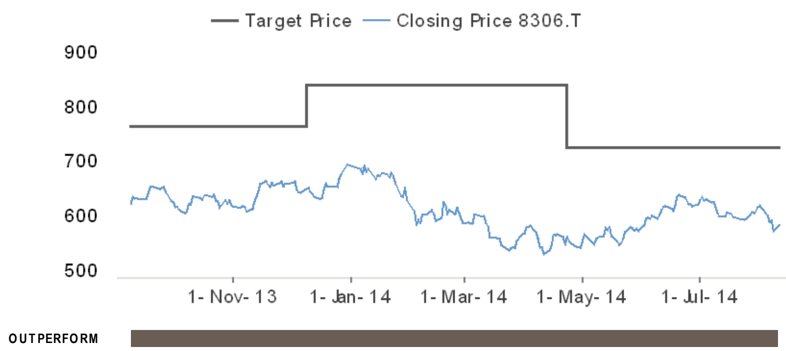
Important Global Disclosures

I, Takashi Miura, certify that (1) the views expressed in this report accurately reflect my personal views about all of the subject companies and securities and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

3-Year Price and Rating History for Mitsubishi UFJ Financial Group (8306.T)

8306.T Date	Closing Price (¥)	Target Price (¥)	Rating
09-Sep-13	623	764	O *
09-Dec-13	650	840	
23-Apr-14	562	725	

** Asterisk signifies initiation or assumption of coverage.*



3-Year Price and Rating History for Mizuho Financial Group (8411.T)

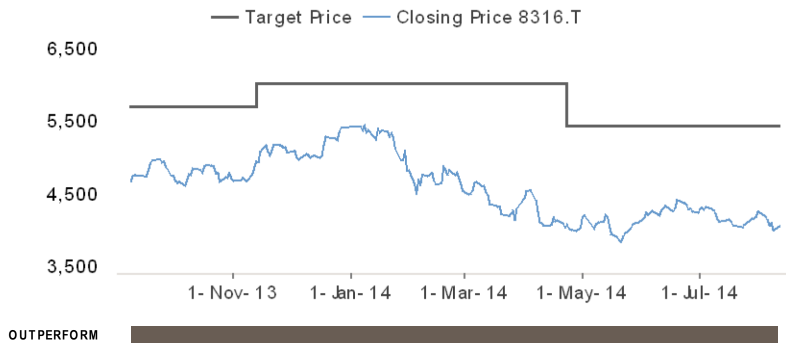
8411.T Date	Closing Price (¥)	Target Price (¥)	Rating
09-Sep-13	212	250	N *
09-Dec-13	214	260	
23-Apr-14	199	225	

** Asterisk signifies initiation or assumption of coverage.*

3-Year Price and Rating History for Sumitomo Mitsui Financial Group (8316.T)

8316.T Date	Closing Price (¥)	Target Price (¥)	Rating
09-Sep-13	4,675	5,700	O *
13-Nov-13	4,945	6,015	
23-Apr-14	4,079	5,440	

** Asterisk signifies initiation or assumption of coverage.*



The analyst(s) responsible for preparing this research report received Compensation that is based upon various factors including Credit Suisse's total revenues, a portion of which are generated by Credit Suisse's investment banking activities

As of December 10, 2012 Analysts' stock rating are defined as follows:

Outperform (O) : The stock's total return is expected to outperform the relevant benchmark*over the next 12 months.

Neutral (N) : The stock's total return is expected to be in line with the relevant benchmark* over the next 12 months.

Underperform (U) : The stock's total return is expected to underperform the relevant benchmark* over the next 12 months.

**Relevant benchmark by region: As of 10th December 2012, Japanese ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. As of 2nd October 2012, U.S. and Canadian as well as European ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. For Latin American and non-Japan Asia stocks, ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark; prior to 2nd October 2012 U.S. and Canadian ratings were based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe. For Australian and New Zealand stocks, 12-month rolling yield is incorporated in the absolute total return calculation and a 15% and a 7.5% threshold replace the 10-15% level in the Outperform and Underperform stock rating definitions, respectively. The 15% and 7.5% thresholds replace the +10-15% and -10-15% levels in the Neutral stock rating definition, respectively. Prior to 10th December 2012, Japanese ratings were based on a stock's total return relative to the average total return of the relevant country or regional benchmark.*

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Restricted	3%	

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Price Target: (12 months) for Mitsubishi UFJ Financial Group (8306.T)

Method: Our ¥750 target price for Mitsubishi UFJ Financial Group is based on a theoretical P/B of 0.80x derived from forecast ROE of 7.3% and a 9.1% discount rate (=1.216 (2 yr beta)*(Rfr 1% + ERP 6.5%)) applied to our end-FY3/15 BPS forecast of ¥941.5.

Risk: Risks that could impede achievement of our ¥750 target price for Mitsubishi UFJ Financial Group include economic reversals and political unrest in MUFG's overseas markets (North America, Asia).

Price Target: (12 months) for Sumitomo Mitsui Financial Group (8316.T)

Method: Our ¥5,600 target price for Sumitomo Mitsui Financial Group is based on a theoretical P/B of 0.97x derived from forecast ROE of 8.8% and a 9.0% discount rate (=1.200 (2yr beta)*(RfR 1% + ERP 6.5%)) applied to our end-FY3/15 BPS forecast of ¥5,717.6.

Risk: Risks to our ¥5,600 target price for Sumitomo Mitsui Financial Group include a slowdown in Asia, which is a key region for the bank, and a fall in the stock market.

Price Target: (12 months) for Mizuho Financial Group (8411.T)

Method: Our ¥240 target price for Mizuho Financial Group is based on a theoretical P/B of 0.84x derived from forecast ROE of 7.5% and a 9.0% discount rate (=1.195 (6yrs beta)*(Rfr 1% + ERP 6.5%)) applied to our end-FY3/15 BPS forecast (including dilution) of ¥283.1. To minimize the effect of past events on our valuation estimate, we use a six-year beta.

Risk: Downside risks to our ¥240 target price for Mizuho Financial Group include a capital shortfall stemming from tighter regulations, and a growth strategy that lags behind those of other major banks due to capital limitations.

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See the Companies Mentioned section for full company names

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