

SUMO-SIZED LENDING

JAPANESE MEGABANKS GO GLOBAL



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QUINLAN
&ASSOCIATES

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EXECUTIVE SUMMARY

The Global Financial Crisis (GFC) severely impacted the manner in which banks carried out their activities. A host of regulatory initiatives aimed at improving the soundness and stability of the financial services industry meant that the 'status quo' was no longer a feasible option for many international players.

Faced with significant write-downs, capital shortfalls and liquidity constraints, a number of European and American banks sought to actively reduce the size of their balance sheets, resulting in a withdrawal from non-core, offshore lending markets. For some, this meant offloading lending portfolios to rival firms.

Mitsubishi UFJ Financial Group (MUFG), Mizuho Financial Group (Mizuho), and Sumitomo Mitsui Financial Group (SMFG) (together the Japanese 'megabanks'), grappling with anaemic domestic loan growth and a rapid deterioration in interest margins, were quick to capitalise on these opportunities, plugging funding gaps left by many of the global banks through a combination of organic and inorganic means. Armed with huge domestic deposit bases and strong balance sheets that had been cleaned up following the Asian Financial Crisis in 1997, the megabanks were in a prime position to pursue an offshore lending-led expansion strategy.

After years of targeted growth, the megabanks have now positioned themselves as major contenders in the global syndicated lending space. They have also captured considerable market share in every country in which they operate, with particular success in emerging markets and cross-border lending. Similar success has been achieved in project financing, where they rank as top-5 players in several of their key operating markets.

Despite solid headline results, this offshore lending-led strategy is now facing a number of challenges. Interest spreads outside of Japan have been declining in line with a global easing in monetary policy. In the search for returns, the megabanks have been shifting down the credit curve, lending to riskier clients and projects. This is having broader implications for the quality of their loan books. Faced with considerable pressure from players such as the Chinese banks, who have been aggressively building their offshore lending business, margins are being hit, impacting the overall profitability of the business.

While we see considerable scope for the megabanks to optimise their current lending platforms and enhance profitability, we believe they need to focus greater attention on growing their fee-based income if they are to remain globally relevant universal banks in years to come. Given the strength of their balance sheet relationships and the ongoing challenges being faced by their international peers, we feel the megabanks are in a prime position to develop their fee-based businesses.

Through rebalancing their interest and non-interest income streams to be more in line with rival global universal banks, we feel each of the megabanks has the potential to earn an additional USD 1.5-2.5 billion in annual revenue within five years. We see this as a realistic target that would transform the megabanks from mere sumo-sized international lenders to credible global players in the corporate and investment banking space.

SECTION 1

THE NEED TO GO GLOBAL

INTRODUCTION

Since the GFC, the megabanks have repositioned themselves as the world's most active cross-border lenders, returning to a position they once held in the 1980s. The Japanese banking crisis that followed the asset bubble of the 1980s had forced a reversal of that earlier cross-border expansion.

Japanese banks continue to face ongoing stagnation in their home economy. Coupled with the Bank of Japan's (BoJ's) introduction of negative interest rates in early 2016, domestic margins have been ruthlessly squeezed. In an effort to counter the slowdown in local lending activity, Japanese banks have looked to offshore markets as a means to pursue their growth ambitions, with the three Japanese megabanks aggressively snapping up assets from select international rivals scaling back their balance sheets.

The move to expand offshore lending activity has been far from secret. In an interview with the Financial Times in December 2014, the president of Mizuho referred to offshore financing as the 'main dish' for Japanese banks, vowing to increase overseas lending in order to benefit from higher net interest margins and diminishing global competition.¹ A few months later in April 2015, Hideyasu Ban, Managing Director of Morgan Stanley MUFG Securities, said Japanese banks are 'being forced to look overseas [because they] face...limited demand in the domestic market,' with offshore growth '[making] up for the low profitability of...domestic lending operations.'²

The increased importance of offshore lending on profitability is clearly evident for the three megabanks, with each reporting compound annual growth rates (CAGR) in overseas lending of more than 20% between 2011 and 2015. International loans now account for over 25% of the total loan books at all three banks, reaching nearly 40% at MUFG. Three underlying forces have driven the aggressive expansion in offshore lending strategy:

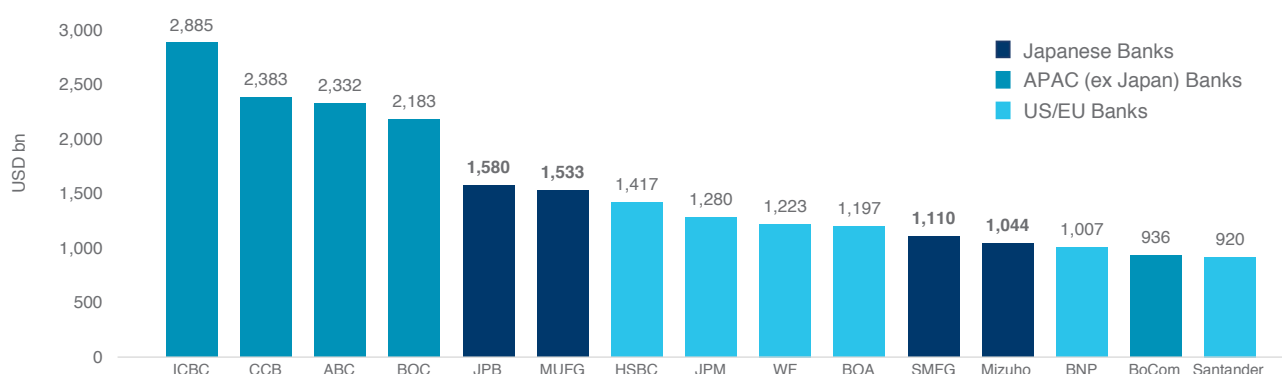
1. STRONG BALANCE SHEETS

Relatively unscathed by the GFC, MUFG, SMFG and Mizuho still possess very strong balance sheets. In fact, all three megabanks rank in the top-15 banks globally by deposit size, providing them with ample liquidity to engage in a lending-led growth strategy (see Figure 1). As the three banks that led the Japanese offshore lending foray in the 1980s, they are also well-versed in deploying excess liquidity generated from a vast local deposit base for offshore lending purposes.

1 Financial Times, 'Mizuho Financial Group focuses on lending beyond Japan blue-chips,' 8 December 2014, available at: <https://www.ft.com/content/4bfeeb12-7ec1-11e4-b83e-00144feabdc0>

2 Global Capital, 'Building Again: The Return of Japan's Banks,' 24 April 2015, available at: <http://www.globalcapital.com/article/r9xfhkx4qrsb/building-again-the-return-of-japans-banks>

FIGURE 1: LARGEST BANKS BY DEPOSIT SIZE



Note: Data as at December 2015

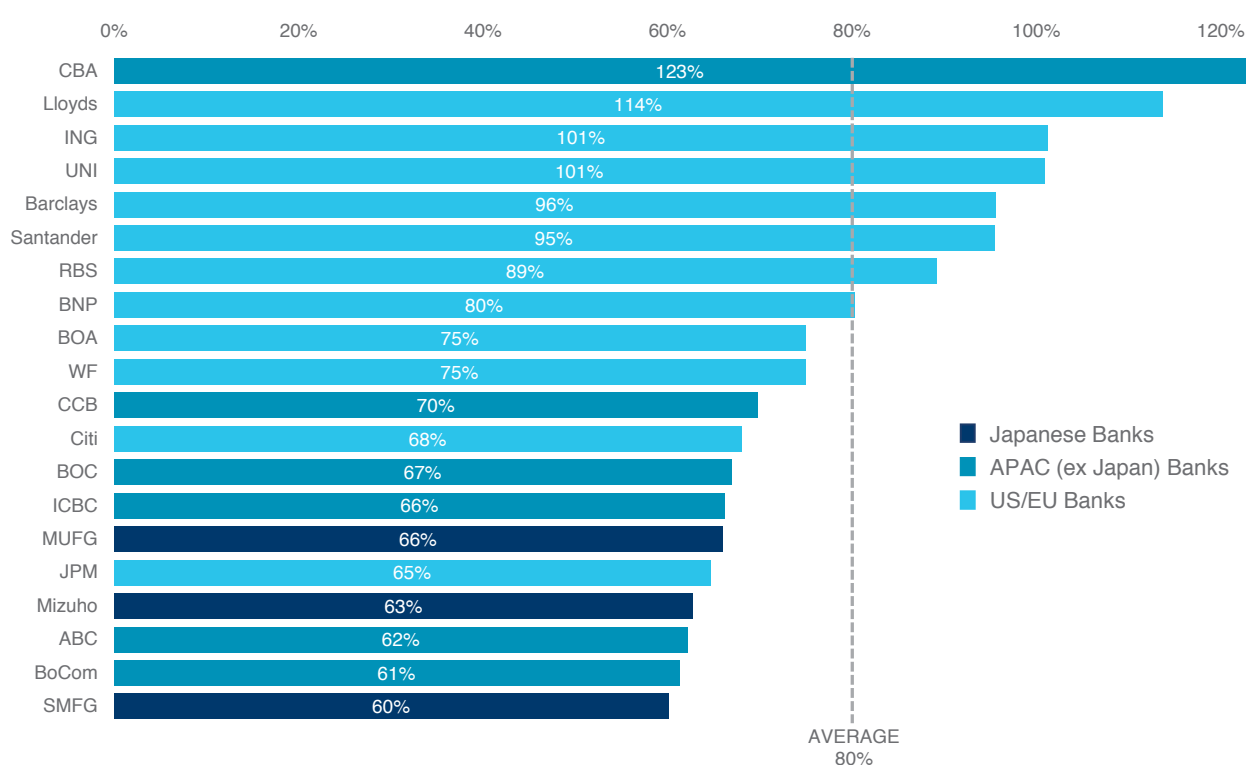
Source: Thomson Reuters Eikon, Quinlan & Associates analysis

In addition to their sizeable home market deposit bases, the Japanese megabanks have among the lowest loan-to-deposit ratios (LDRs) in the world, ranging from 60% to 66%. This compares to an average LDR of 80% for the world's top-20 banks by loan size (see Figure 2). Accordingly, and unlike

many of their global peers, the excess liquidity held by the Japanese megabanks has provided them with considerable firepower to extend their lending books without compromising the underlying health of their balance sheets.

THE EXCESS LIQUIDITY HELD BY THE JAPANESE MEGABANKS HAS PROVIDED THEM WITH CONSIDERABLE FIREPOWER TO EXTEND THEIR LENDING BOOKS

FIGURE 2: LOAN-TO-DEPOSIT RATIOS (TOP-20 BANKS BY TOTAL LOANS)



Note: Data as at December 2015

Source: Thomson Reuters Eikon, Quinlan & Associates analysis

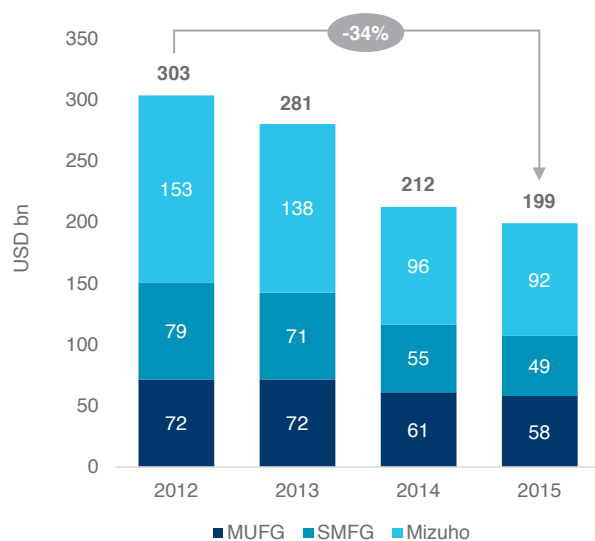
2. DOMESTIC STAGNATION

The excess liquidity of the Japanese megabanks is reflective of their persistently high levels of deposits. The BoJ's implementation of negative interest rates in early 2016 with banks being charged on their excess funds parked with the Japanese central bank is further compelling the megabanks to increase their lending activity.

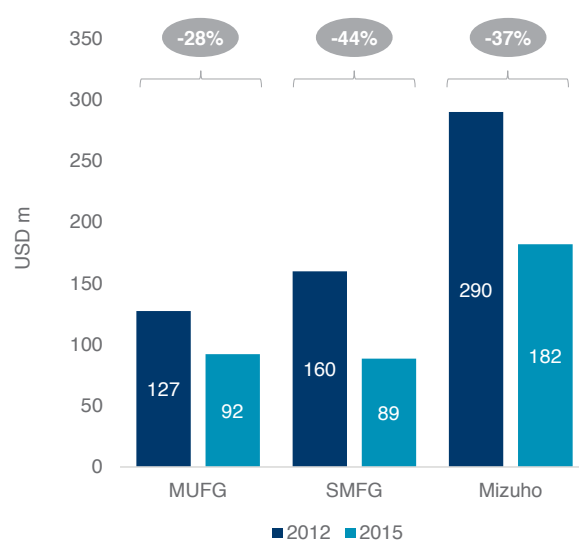
The domestic environment, however, has not been conducive to loan growth, with credit appetite deteriorating on the back of sluggish economic activity. From 2012-15, total Japanese syndicated loan volumes fell by 34% from USD 303 billion to USD 199 billion, with average volumes per deal over the same period falling by 39% from USD 191 million to USD 117 million (see Figure 3).

FIGURE 3: JAPANESE SYNDICATED LOAN VOLUMES (2012-15)

DOMESTIC JAPANESE LOAN VOLUMES
2012-15



DOMESTIC JAPANESE DEAL SIZE (MEGABANKS)
2012 VS. 2015



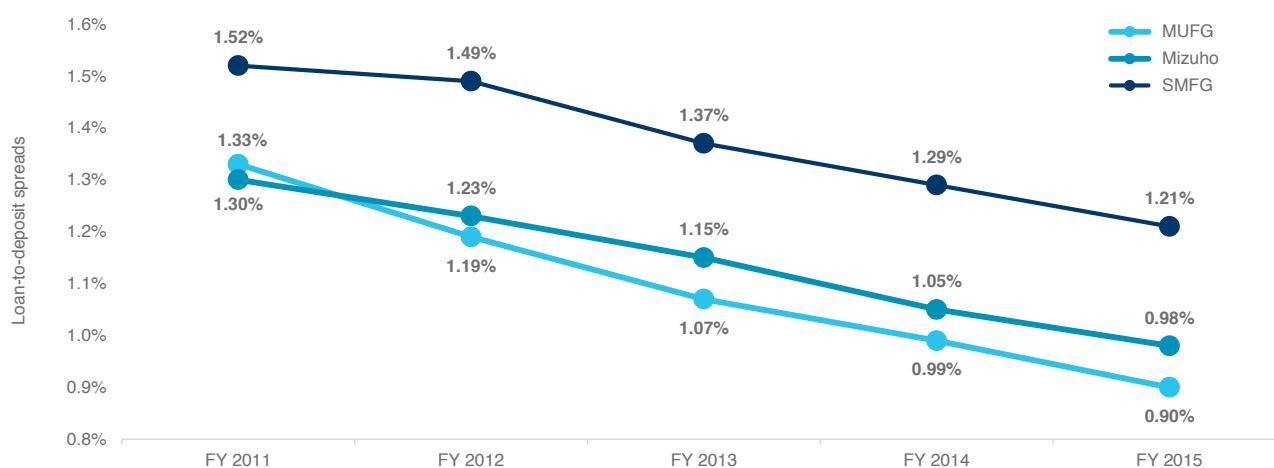
Source: Dealogic, Quinlan & Associates analysis

Aside from failing to stimulate domestic demand, declining interest rates have led to further deterioration in domestic loan-to-deposit spreads for each of the three megabanks, by as much as 43 basis points (MUFG) from 2011-15 (see Figure 4).

As a result, net interest margins (NIMs) for all three megabanks fell below 0.7% in the fiscal year ending March 2016,³ a direct product of the monetary policies undertaken by the BoJ.

3 Fitch, 18 October 2016, available at: <http://asianbankingandfinance.net/lending-credit/news/japanese-banks-margins-hit-record-low-negative-rates-steep-forex-costs-bite>

FIGURE 4: DOMESTIC LOAN-TO-DEPOSIT SPREADS (MUFG, MIZUHO, SMFG)



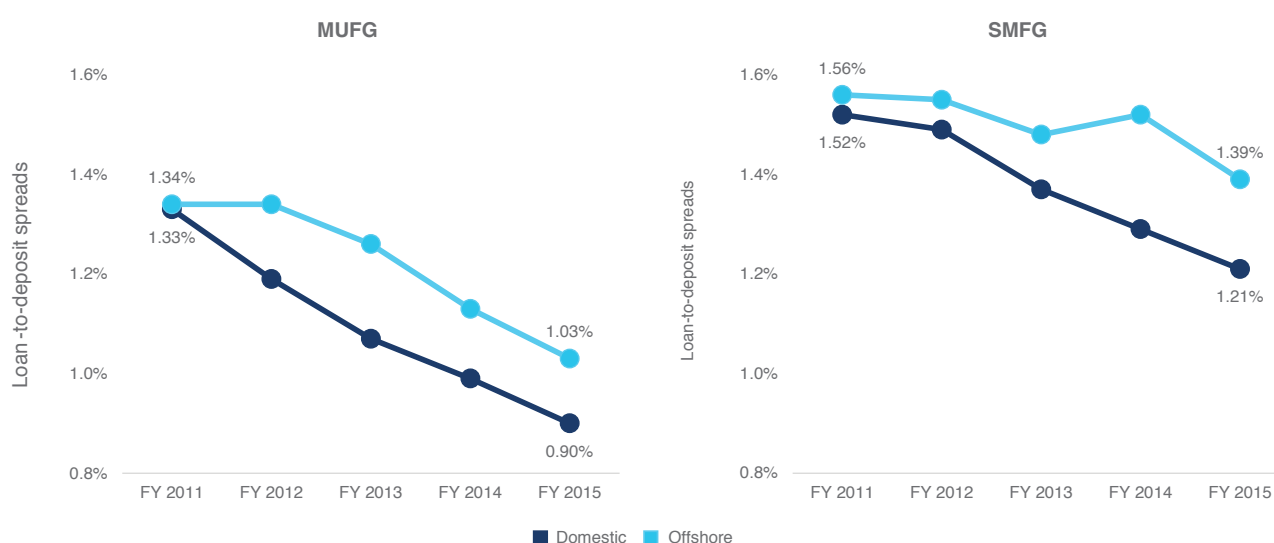
Note: Based on Japanese Banks' financial year-end of 31 March

Source: Banks' Annual Reports, Quinlan & Associates analysis

Offshore lending has consequently appeared increasingly more attractive, especially given the more favourable spreads on offer: while the net difference in domestic and offshore deposit-to-lending spreads at MUFG and SMFG stood at only

1 and 4 basis points respectively in 2011, this had grown to 13 and 18 basis points respectively by 2015 (see Figure 5). With this greater revenue potential offshore, the megabanks sought to actively expand their international loan portfolios.

FIGURE 5: DOMESTIC VS. OFFSHORE LOAN-TO-DEPOSIT SPREADS



Note: Based on Japanese Banks' financial year end of 31 March

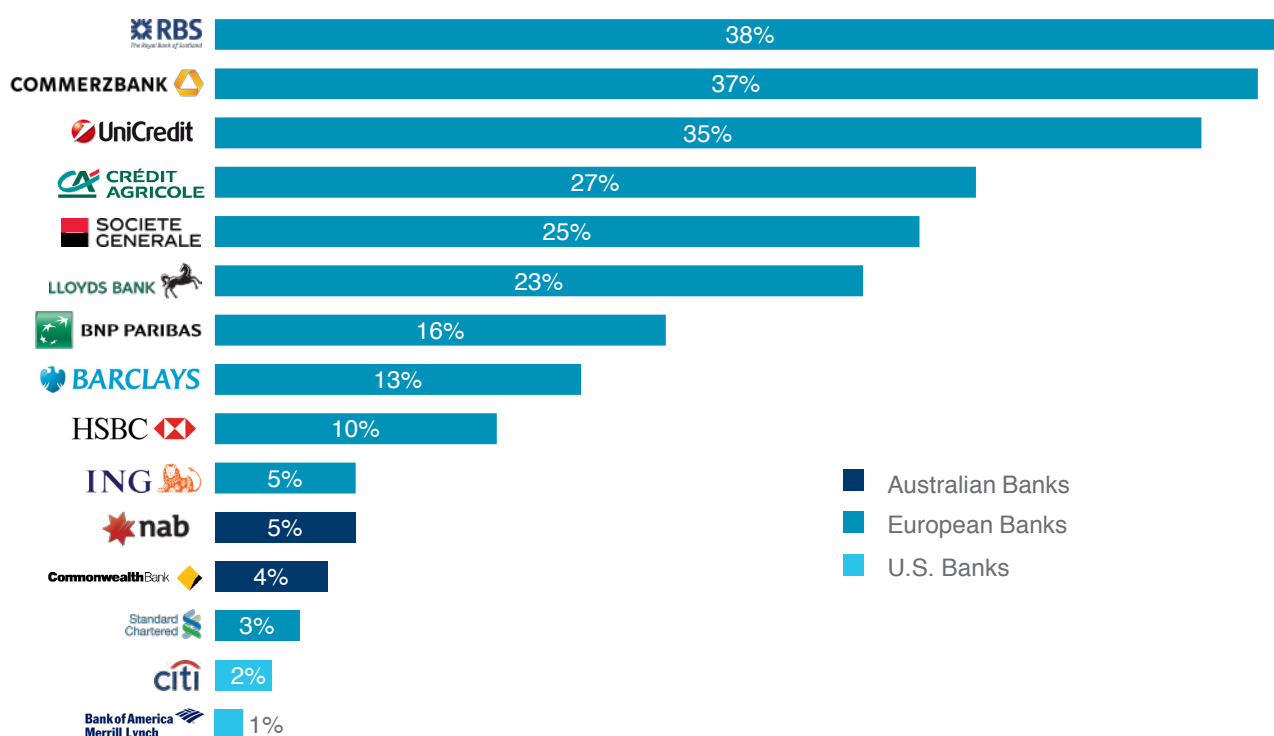
Source: Banks' Annual Reports, Quinlan & Associates analysis

3. GLOBAL PULLBACK

In the aftermath of the GFC, a host of regulatory initiatives such as Basel III, Dodd-Frank, and the European Market Infrastructure Regulation (EMIR), were brought into effect. These regulations were aimed at improving the stability of the global financial system, driving sharp reductions in balance sheet risk: Basel III, for example, requires banks to maintain a 9% tier-1 capital ratio, among other measures. Overall, the regulations had a considerable impact on the manner in which the U.S. and European banks, in particular, conducted their operations.

Following significant write-downs and, in some cases, sizeable net losses, a host of U.S. and European banks were faced with capital shortfalls and liquidity constraints post-2008. In an effort to improve the health of their balance sheets, a number of these banks scaled back their international lending activity. The European banks have been particularly aggressive in scaling back their lending books, with RBS, Commerzbank and UniCredit reducing their loan portfolios by more than 30% since 2011 (see Figure 6). Many of these reductions have been in non-core markets, particularly in Asia and other emerging economies.

FIGURE 6: DECLINE IN LOAN PORTFOLIOS OF SELECTED BANKS (2011-15)



Source: Thomson Reuters Eikon, Quinlan & Associates analysis

These banks' disposal of loan portfolios and general reluctance to write new loans created a funding gap in several offshore markets, which the Japanese megabanks were swift to capitalise on. The fact that

the megabanks had cleaned up their balance sheets post-Asian Financial Crisis also meant they faced little difficulty in adapting to additional regulations.

SECTION 2

MAKING IT HAPPEN

Recent years have seen the Japanese megabanks focus much of their efforts on expanding their offshore lending capabilities. All three megabanks have actively adopted a two-prong approach to their build-outs: (1) inorganic acquisitions and tie-ups; and (2) wide-ranging organic growth tactics.

1. INORGANIC GROWTH

One of the most significant acquisitions post-GFC was MUFG's strategic alliance with Morgan Stanley, following its purchase of a 22% stake in Morgan Stanley in 2008. The alliance allows MUFG to provide additional balance sheet firepower to Morgan Stanley's global advisory business. While various people in the industry have commented on the cultural challenges facing the tie-up, it has been instrumental in driving financing support for Morgan Stanley's cross-border M&A mandates. In January 2014, BTMU, the core banking arm of MUFG, provided financing for Suntory in their USD 16 billion acquisition of Jim Beam, with Morgan Stanley acting as lead financial advisor.

The megabanks have also engaged in selective loan portfolio acquisitions from retreating international banks. For example, in April 2013, MUFG purchased Deutsche Bank's U.S. commercial property loan portfolio for USD 3.7 billion. More recently, Mizuho bought RBS's U.S. and Canadian loan portfolio in a deal worth USD 3 billion in February 2015, with SMFG purchasing General Electric's USD 2.2 billion European buyout loan portfolio a few months later (see Figure 7).

Loan assets have not just been acquired from global banks. In 2013, MUFG purchased a controlling stake in Thailand's Bank of Ayudhya for USD 5.6 billion, increasing its Thai loan portfolio by almost USD 30 billion and its offshore lending portfolio by 13% in the largest banking takeover in Southeast Asia. SMFG and Mizuho have also purchased stakes in several other Southeast Asian banks in order to build their lending footprint across ASEAN.

ONE OF THE MOST SIGNIFICANT [OFFSHORE]
ACQUISITIONS POST-GFC WAS MUFG'S
STRATEGIC ALLIANCE WITH MORGAN STANLEY

FIGURE 7: SELECT LOAN PORTFOLIO ACQUISITIONS

DATE	ACQUIRER	TARGET	VALUE (USD)	DETAILS
Nov 2010	MUFG	RBS	6.4bn	• Project Finance Portfolio Loans
Jan 2012	SMFG	RBS	7.2bn	• Aviation Capital Aircraft Leasing
Apr 2013	MUFG	Deutsche Bank	3.7bn	• US Commercial Property Loan Portfolio
Feb 2015	Mizuho	RBS	3.0bn	• US and Canada Loans
Jun 2015	SMFG	General Electric	2.2bn	• European Buyout Lending Unit

Source: Press releases, Quinlan & Associates analysis

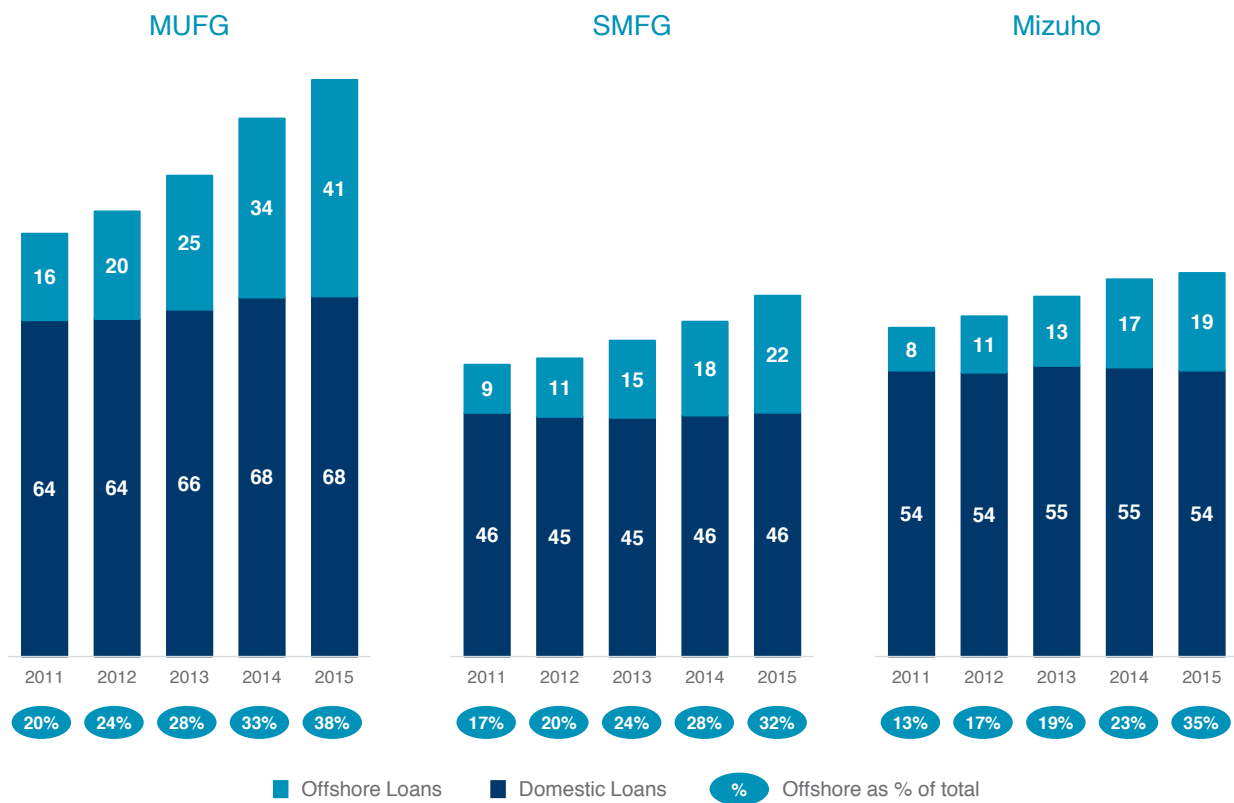
2. ORGANIC GROWTH

In addition to pursuing inorganic growth channels, the Japanese megabanks have adopted an active ‘follow your client’ strategy: in other words, the megabanks followed their domestic clients into offshore markets as those Japanese corporates similarly acquired assets abroad as a means of escaping a lacklustre economic climate at home. All three megabanks were quick to provide funding for these expansion efforts.

However, the balance sheet support provided by the Japanese megabanks has not been limited to Japanese firms. In fact, the megabanks have been increasingly active financing deals involving non-Japanese corporates, particularly on the M&A front. According to Dealogic, banks in Japan had a hand in close to 60% of global M&A financing packages in 2015, up from 46% in 2014.

Through a combination of inorganic and organic growth strategies, offshore lending balances for all three megabanks grew by a CAGR in excess of 20% from 2011-15. This occurred during a time when domestic loan balances remained relatively stagnant. As a result, offshore loans on average now represent one third of the megabanks’ lending portfolios (up from 17% in 2011) (see Figure 8).

FIGURE 8: LOAN PORTFOLIOS OF JAPANESE MEGABANKS (JPY TRN)



Note: Based on Japanese Banks' financial year-end of 31 March

Source: Banks' Annual Reports, Quinlan & Associates analysis

SECTION 3

MOVING UP THE RANKS

After several years of aggressively pursuing an offshore lending-led growth strategy, have the efforts of the Japanese megabanks paid off?

MARKET SHARE

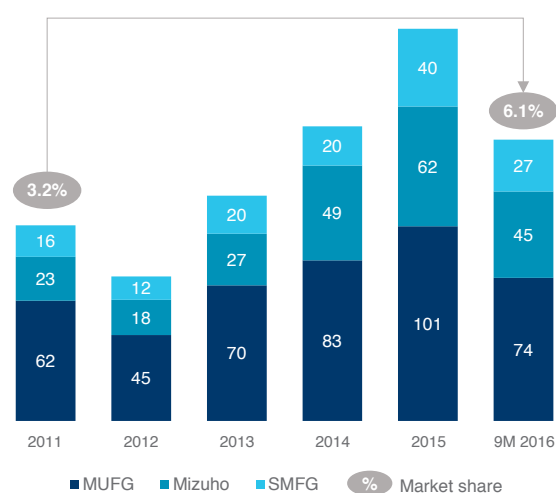
Within the syndicated lending space, all three megabanks have significantly improved their global (ex-Japan) rankings and market shares. MUFG

ranked as the 7th largest player by global syndicated lending volumes in 9M 2016, up from 14th in 2011, while Mizuho and SMFG both climbed 17 spots over the same period to rank 14th and 23rd respectively. Together, the three megabanks have advanced their combined global market share in global syndicated lending from 3.2% in 2011 to 6.1% for 9M 2016 (see Figure 9).

FIGURE 9: GLOBAL SYNDICATED LENDING RANKINGS

9M 2016 RANK	2011 RANK	CHANGE	BANK
1	1	-	JP Morgan
2	2	-	Bank of America Merrill Lynch
3	3	-	Citi
4	4	-	Wells Fargo Securities
5	6	▲ 1	Barclays
6	8	▲ 2	Deutsche Bank
7	14	▲ 7	Mitsubishi UFJ Financial Group
8	9	▲ 1	Credit Suisse
9	5	▼ 4	BNP Paribas
10	11	▲ 1	RBC Capital Markets
11	10	▼ 1	HSBC
12	16	▲ 4	Goldman Sachs
13	12	▼ 1	Morgan Stanley
14	31	▲ 17	Mizuho
15	18	▲ 3	Scotiabank
16	20	▲ 4	BMO Capital Markets
17	17	-	TD Securities
18	19	▲ 1	Unicredit
19	13	▼ 6	Credit Agricole CIB
20	21	▲ 1	ING
21	15	▼ 6	Societe Generale
22	27	▲ 5	US Bancorp
23	40	▲ 17	Sumitomo Mitsui Financial Group
24	25	▲ 1	Suntrust Robinson Humphrey
25	23	▼ 2	CIBC World Markets

SYNDICATED LENDING VOLUME (GLOBAL EX-JAPAN)
MUFG, SMFG, MIZUHO; USD BN



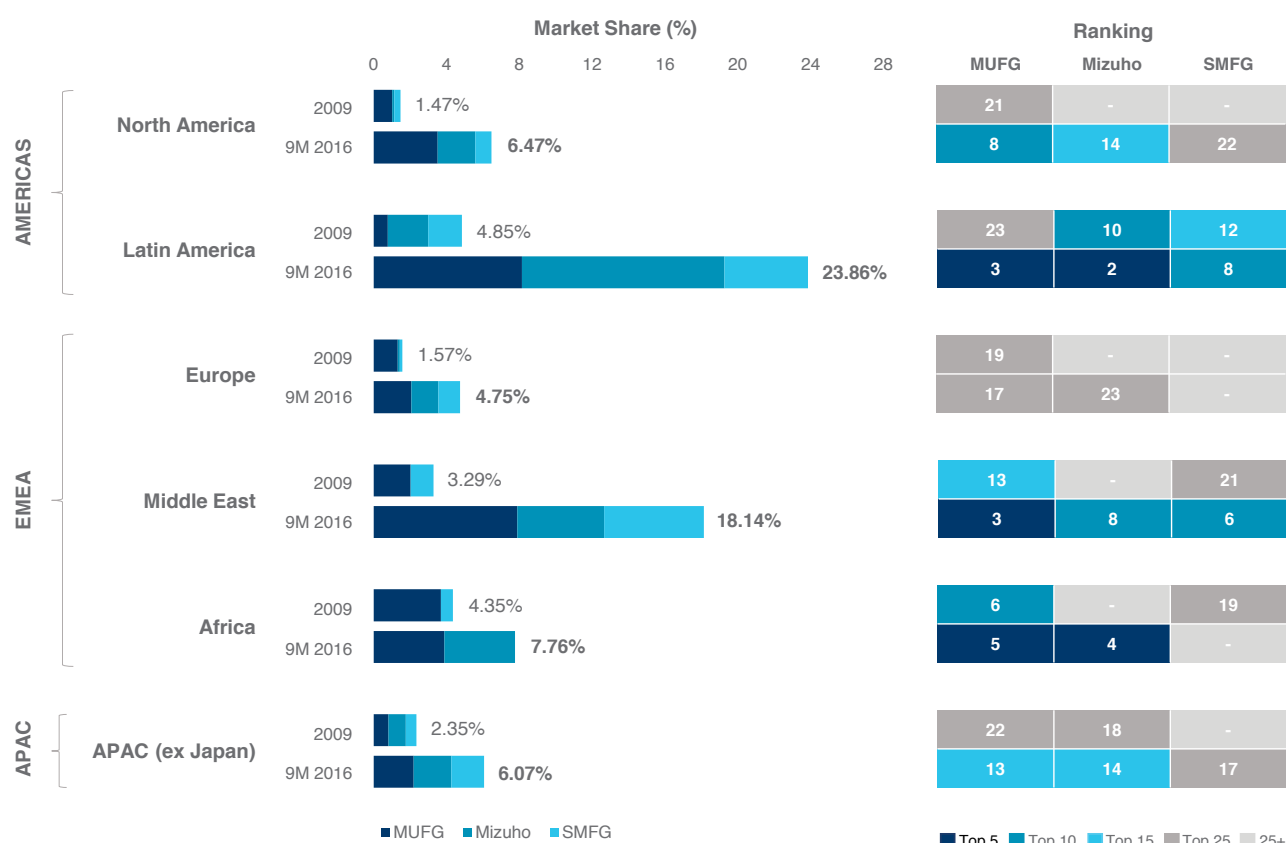
Note: Rankings and market shares based on volume

Source: Thomson Reuters, Quinlan & Associates analysis

The megabanks have also improved their relative position in every key region across the globe. In North America, the largest syndicated lending market in the world, the combined market share for the three megabanks increased from just 1.47% in 2009 to 6.47% for 9M 2016. These market share gains have been even more pronounced in emerging economies: over the same period, the combined

market share for the megabanks in Latin America rose from 4.85% to 23.86%, with strong gains also being made in the Middle East, Africa, Europe and Asia. As a result, the megabanks now feature as top-20 players in almost every region in which they operate, and remain particularly dominant in developing markets (see Figure 10).

FIGURE 10: GEOGRAPHIC SEGMENTATION OF MARKET SHARE & RANKING



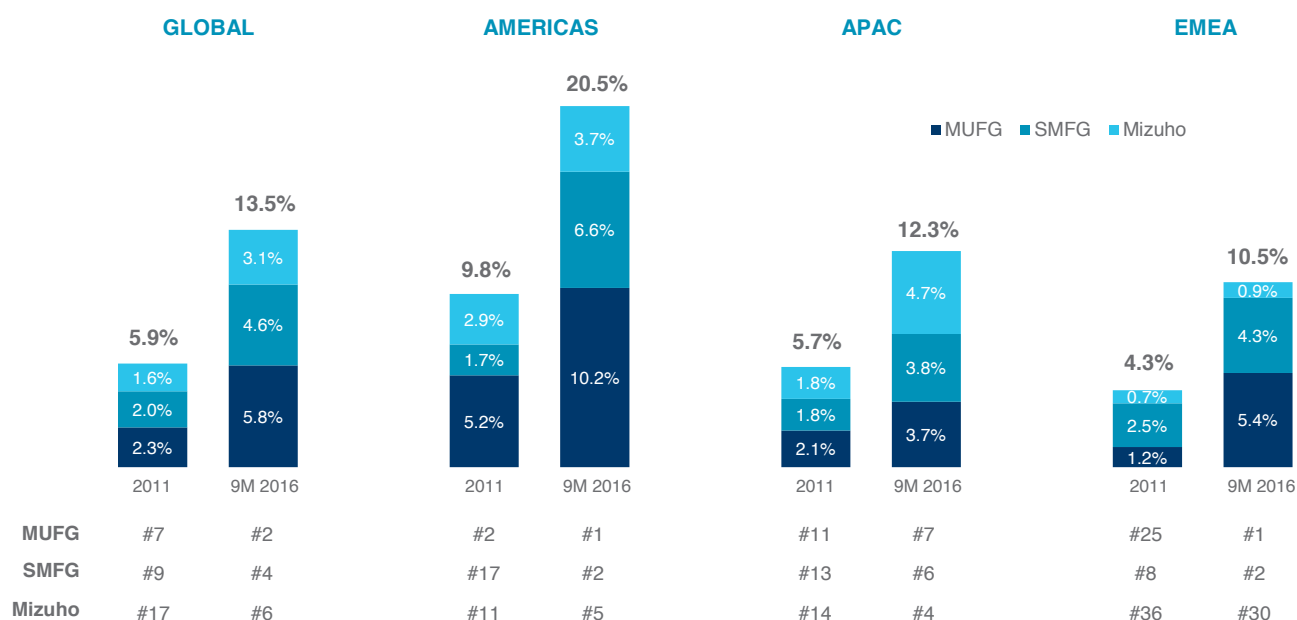
Note: Rankings and market shares based on volume

Source: Dealogic, Quinlan & Associates analysis

The megabanks have also made strong headway in project finance. For 9M 2016, MUFG, SMFG and Mizuho ranked as the 2nd, 4th and 6th largest global initial lead arrangers respectively by volume, with a combined market share of 13.5%, more than double that in 2011 (see Figure 11). Regional rankings have

also improved in the Americas, EMEA and APAC, with combined market share more than doubling over the same period. The megabanks have cornered more than 20% of the market in the Americas, taking out the top two spots over rival U.S. firms.

FIGURE 11: MEGABANK PROJECT FINANCE RANKINGS



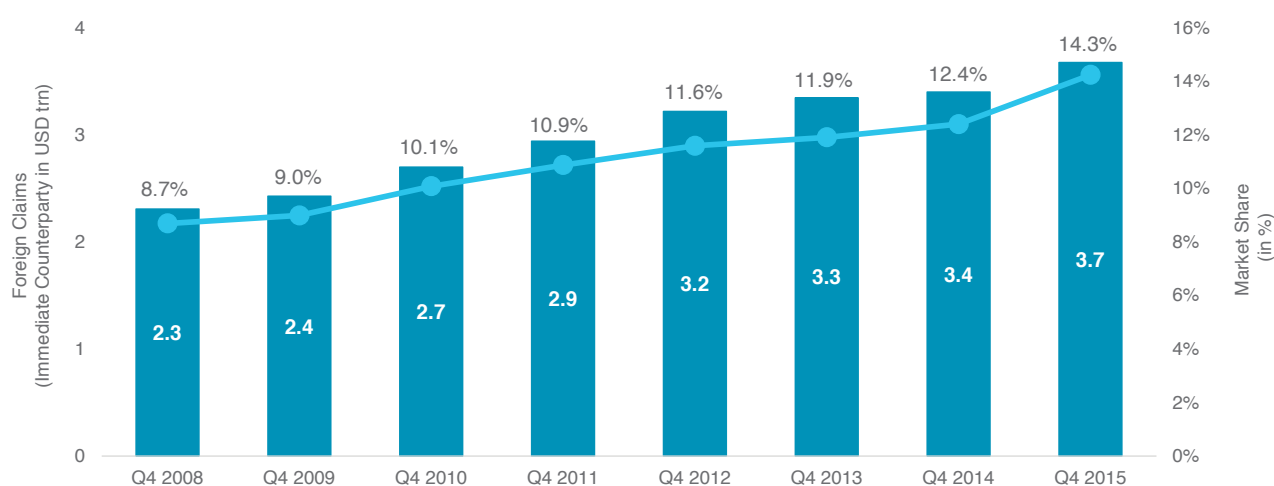
Note: Rankings based on volume

Source: PFIE, Thomson Reuters, Quinlan & Associates analysis

Data from the Bank of International Settlements (BIS) also reveals that Japanese banks have gained significant traction in the cross-border lending space, overtaking Germany in 2015 to become the world's leading cross-border lenders. At the end of 2015, Japanese institutions lent out a total of USD 3.7 trillion in cross-border loans (up from USD

2.3 trillion in 2008), with a combined market share of 14.3% (up from 8.7% in 2008). This compares with a decline of 0.4% faced by reporting countries as a whole (see Figure 12). The Japanese banks have also established themselves as the world's most active lenders to the private sector.

FIGURE 12: JAPANESE BANKS' CROSS-BORDER LENDING VOLUMES



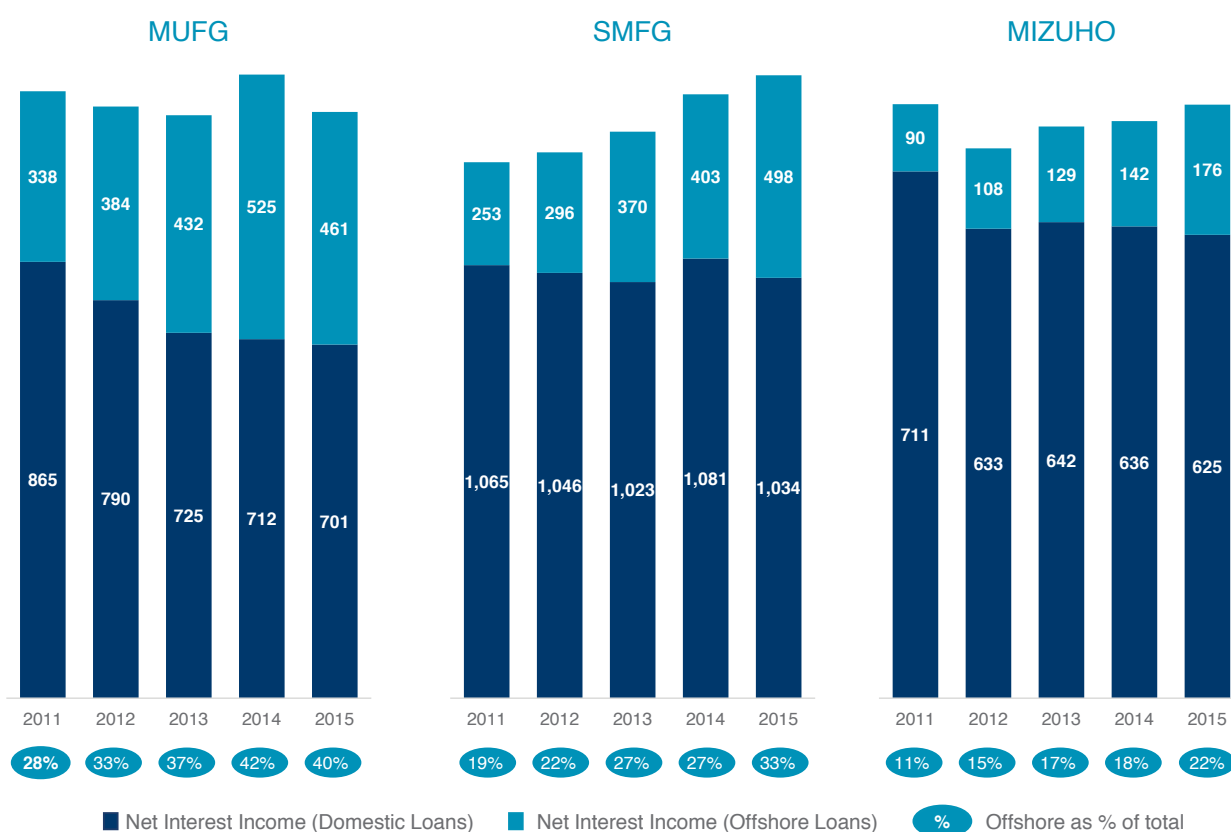
Source: Bank of International Settlements, Quinlan & Associates analysis

REVENUES

From 2011-15, net interest income from the overseas lending operations of MUFG, Mizuho and SMFG grew by a CAGR of 8.1%, 18.1%, and 18.4%

respectively. These revenue gains occurred amidst declines in domestic net interest income for all three megabanks over the same period (see Figure 13).

FIGURE 13: NET INTEREST INCOME AT JAPANESE MEGABANKS (JPY BN)



Note: Based on Japanese Banks' financial year-end of 31 March

Source: Banks' Annual Reports, Quinlan & Associates analysis

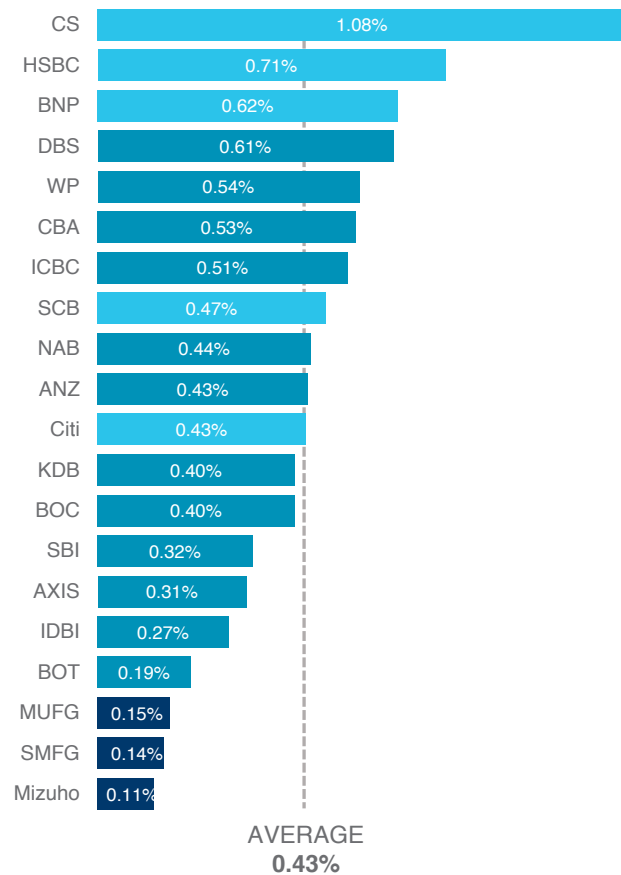
While each of the megabanks has succeeded in growing their offshore interest income, a closer look at the underlying economics of their global lending business paints a more sober story.

Between 1 January 2009 and 30 September 2016, investment banks such as Credit Suisse, Goldman Sachs and Morgan Stanley charged an average

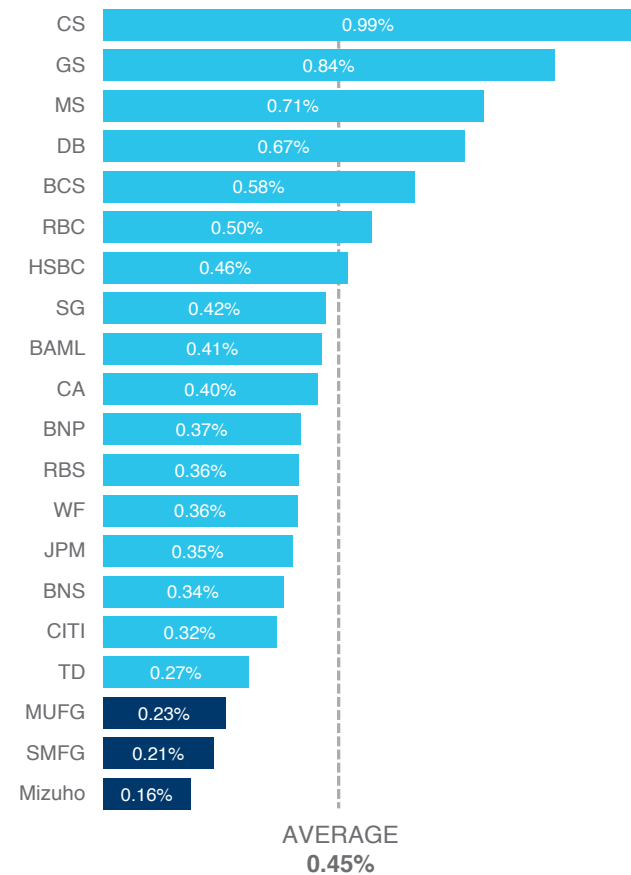
margin of ~1% on their global syndicated loan portfolio, compared with ~0.2% for the Japanese megabanks. Over the same period in Asia Pacific, the best performing bank by margin (HSBC) charged over five times more on its syndicated loans than the best performing Japanese megabank (MUFG) (see Figure 14).

FIGURE 14: SYNDICATED LENDING REVENUE MARGINS FOR TOP-20 LENDERS

TOP 20 APAC SYNDICATED LENDERS



TOP 20 GLOBAL SYNDICATED LENDERS



■ Japanese Banks ■ APAC (ex Japan) Banks ■ US/EU Banks

Note: Data from 1 January 2009 to 30 September 2016

Source: Dealogic, Quinlan & Associates analysis

While this data includes domestic Japanese loans (which are lent out on razor thin margins), the aggressive drive to expand offshore lending has not resulted in meaningfully higher relative returns for the Japanese banks globally. In some instances, this has been exacerbated by an aggressive pricing

strategy; for example, SMFG's average margin on syndicated lending globally halved from ~30bps in 2014 to ~15bps for 9M 2016. This is having broader implications for the overall profitability of SMFG's lending business, raising concerns with respect to underlying profitability.

THE AGGRESSIVE DRIVE TO EXPAND OFFSHORE LENDING HAS NOT RESULTED IN MEANINGFULLY HIGHER RELATIVE RETURNS FOR THE JAPANESE BANKS GLOBALLY

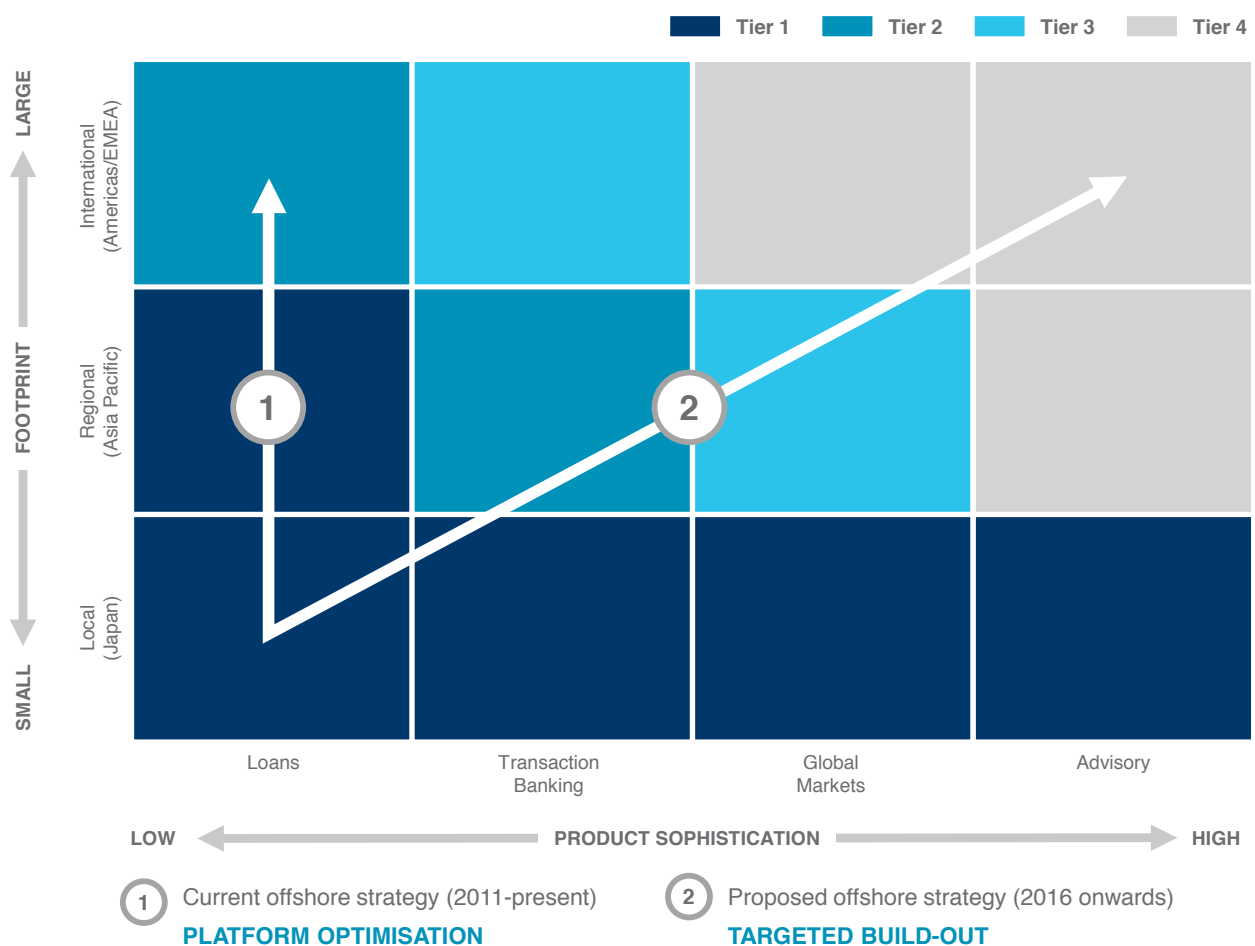
SECTION 4

PRIMED FOR GROWTH

While the megabanks have openly acknowledged the need to grow their non-interest, fee-based income, we feel they still have a long way to go in developing a competitive corporate and investment banking offering outside of Japan. We also see scope for the megabanks to further optimise their existing lending operations.

We believe a two-prong strategy, including platform optimisation and targeted build-out, is needed if the megabanks are to establish themselves as truly global players in years to come (see Figure 15).

FIGURE 15: JAPANESE MEGABANK COMPETITIVE FOOTPRINT



Source: Quinlan & Associates analysis

1. CURRENT GROWTH STRATEGY – PLATFORM OPTIMISATION

The offshore lending-led strategy of the megabanks has no doubt delivered strong market share gains and top-line revenue growth outside of Japan. Notwithstanding impressive headline numbers, there are a number of key risks emerging.

Despite healthier deposit-to-lending spreads outside of Japan, offshore spreads have also declined in line with the global easing in monetary policy in recent years. Moreover, our discussions with various industry sources indicate the megabanks are finding themselves shifting down the credit curve, lending to riskier clients and projects in an effort to boost returns. This is having broader implications around the quality of their loan assets.

At each of the three megabanks, foreign-denominated deposits have not kept pace with growth in overseas loans, which is reflected in considerably higher offshore loan-to-deposit ratios when compared to Japan. Foreign currency funding costs are also on the rise amid expectations that the U.S. Federal Reserve is at the start of an interest rate tightening cycle. Moreover, a number of regional competitors, including the major Chinese banks, have been aggressively building out their offshore lending capabilities, creating considerable pricing pressure. As a result, margins are being squeezed, impacting the underlying profitability of the business.

Faced with such headwinds, we see ample scope for the megabanks to further optimise their lending platforms: Key areas of focus should include:

Credit Risk: given the current uncertainty surrounding the global economic and political climate, we believe the megabanks need to more thoroughly assess their offshore counterparty risks in order to minimise the risk of non-performing loans (NPLs). This will be especially important in light of their recent shift down the credit curve.

Funding: the megabanks will need to develop an effective offshore deposit-gathering strategy in order to avoid relying too heavily on home market funding. This will also help to reduce foreign exchange risk.

Cross-sell: with returns on lending under considerable pressure, the megabanks should look to further leverage their lending relationships to drive cross-sell of related products, particularly interest rate and foreign currency hedging solutions tied to offshore loans. Developing robust cross-selling practices, including automated opportunity identification processes and incentive structures, will be critical in this regard.

Pricing: faced with aggressive competition from Chinese players in the offshore lending space, the megabanks will need to develop a robust pricing strategy that will allow them to defend their recent market share gains while maintaining a healthy level of profitability.

Profitability: the megabanks will need to move from a top-line-driven assessment of performance to a bottom-line, profitability-led evaluation of their offshore lending business. As such, 'cost to serve' will become an increasingly important driver of the credit-approval process. Robust internal management information systems (MIS) will need to be in place in order for profitability metrics to be accurately determined.

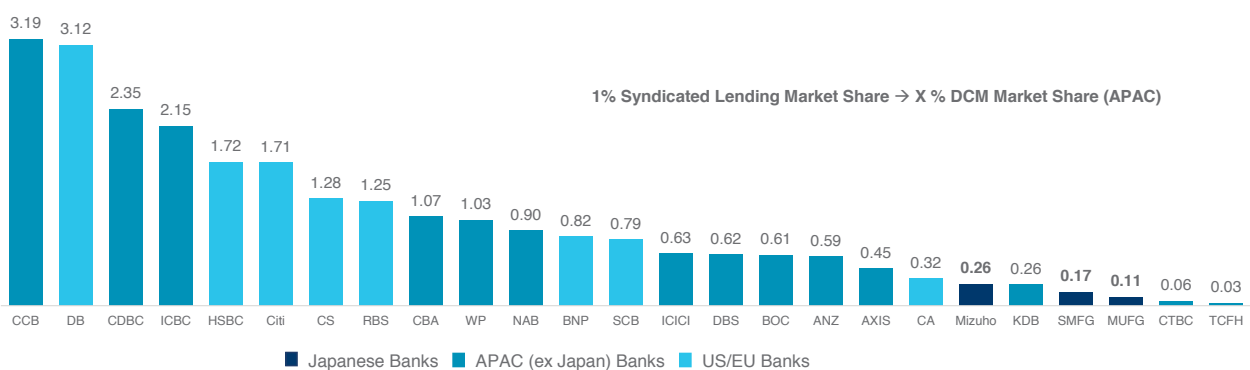
2. PROPOSED GROWTH STRATEGY – TARGETED BUILD-OUT

Although the megabanks remain dominant home market players across lending, transaction banking, global markets and advisory, their success outside of Japan has largely been limited to syndicated lending and project finance. Beyond offering more basic transaction banking and markets capabilities to their Japanese clients offshore, they are largely regarded as 2nd and 3rd-tier players in the international capital markets space.

With interest margins being heavily compressed and funding costs on the rise, we feel the megabanks need to develop a more targeted offshore growth strategy centred on building their fee-based income. Although this is something they are actively committed to pursuing, they still lag their global competitors significantly in converting their balance sheet relationships into new lines of business.

This lack of relationship conversion is particularly evident in debt capital markets (DCM). Between 1 January 2009 and 30 September 2016, for every 1% in syndicated lending market share captured in Asia Pacific, the best performing Japanese bank generated only 0.26% market share in DCM. This syndicated lending-to-DCM 'cross-sell ratio' is among the weakest in the region and trails both global and regional rivals considerably (note: the corresponding ratio for the best performing bank in Asia Pacific over the same period, China Construction Bank, was 3.19%) (see Figure 16).

FIGURE 16: LOAN-TO-DCM MARKET SHARE CONVERSION (APAC)



Note: Data from 1 January 2009 to 30 September 2016

Source: Dealogic, Quinlan & Associates analysis

With global banks continuing to shrink their balance sheets, headcount and geographic footprint, new opportunities are emerging for the megabanks to step in. This is particularly the case in emerging markets – including Southeast Asia, Latin America and Africa – where competition is more nascent, as well as businesses that are more balance sheet-intensive in nature – such as rates and credit trading – where the global banks have been aggressively scaling back.

Any build-out decisions will not only need to take into account wallet sizes and outlooks across target markets, products and client segments, but will also need to reflect the true accessibility of those revenue opportunities. This will be reflective of a combination of external factors, including regulatory and competitive developments, and organisational factors related to the management of a more complex business.

REVENUE POTENTIAL

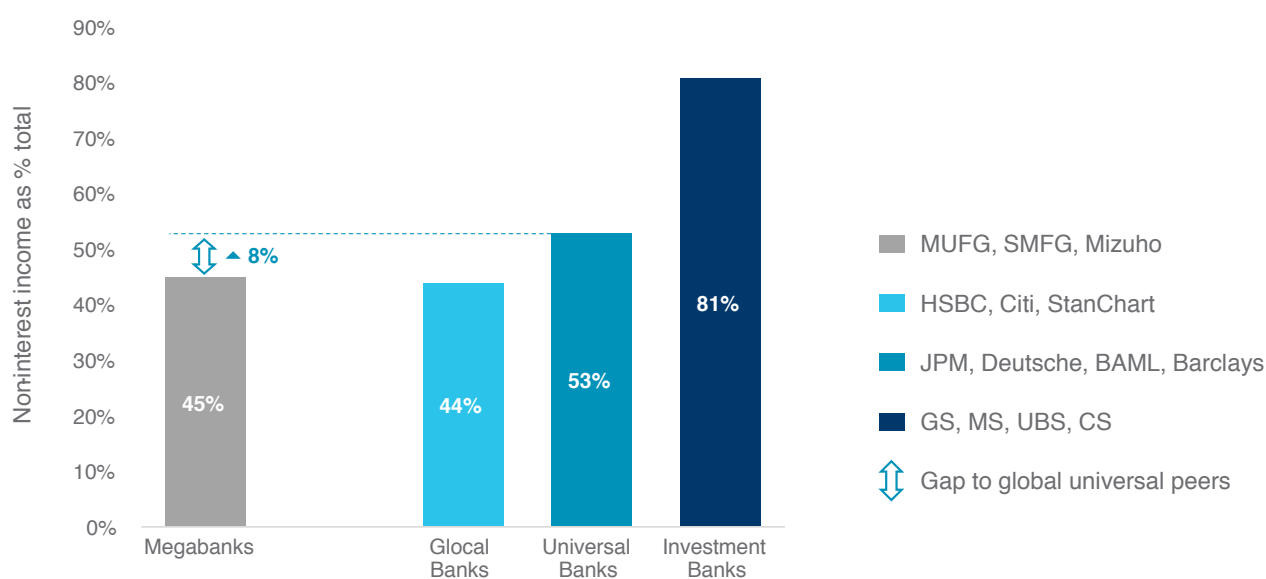
So what is the realistic revenue upside potential for the megabanks from developing their non-interest income sources?

From 2011-15, the megabanks generated, on average, 45% of their total income from non-interest sources. This compared with an average of 44% for glocal banks (global banks with strong local retail and commercial presences in more than one region i.e.

HSBC, Citi and Standard Chartered), 53% for global universal banks, and 81% for global investment banks over the same period (see Figure 17).

As integrated commercial, corporate and investment banking players, we feel the megabanks' revenue mix has the potential to be more comparable to global universal banks. This would suggest the current contribution of non-interest income for the megabanks remains underweight, with a delta of ~8% to their average global universal rival.

FIGURE 17: NON-INTEREST INCOME AS % TOTAL (PEER BENCHMARKING)



Note: Data based on 2011-15 average

Source: Dealogic, Quinlan & Associates analysis

Through rebalancing their income streams to be more in line with their global universal peers, we estimate each of the megabanks has the potential to earn an additional USD 1.5-2.5 billion in annual revenue within five years. Even if these revenues were achieved at a cost-to-income (C/I) ratio of 80%

(significantly higher than the mid-50% C/I ratio of the megabanks at present), this would translate to an incremental USD 300-500 million in underlying profit annually. We see this as a realistic target, but one that can only be achieved if an effective strategic build-out is put in place.

SECTION 5

HOW CAN WE HELP?

Our consultants have worked with a number of regional banks in developing their international growth strategies. The scope typically includes the following:

PHASE 1

Perform a firm-wide, status quo review of the bank's existing international businesses to determine competitive gaps in key operating markets, e.g.:

- Conduct detailed revenue benchmarking by market, product and client segment
- Review organisational processes to evaluate alignment with best practice
- Interview key stakeholders to identify internal roadblocks and obstacles

PHASE 2

Conduct a detailed market and industry assessment to evaluate future growth opportunities, with reference to the bank's own capabilities, e.g.:

- Conduct comprehensive market sizing across markets, products and client segments
- Identify core competencies and internal limitations to determine revenue accessibility
- Outline a roadmap of strategic options, supported by clear and realistic financial and operational targets, as well as key enablers needed to execute shortlisted options

PHASE 3

Provide on-site project management and execution support to facilitate the delivery of all strategic recommendations, e.g.:

- Establish project management office (PMO) governance structure
- Work with key internal sponsor/s to determine responsibilities of team members
- Develop master execution plan around project timetable and workstream deliverables

While we recognise the Japanese megabanks have made some progress in growing their fee-based income streams, we feel they still have some way to go in developing an effective international strategy that will see them transition from mere sumo-sized international lenders to credible players in the global corporate and investment banking market.

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STRATEGY WITH A DIFFERENCE

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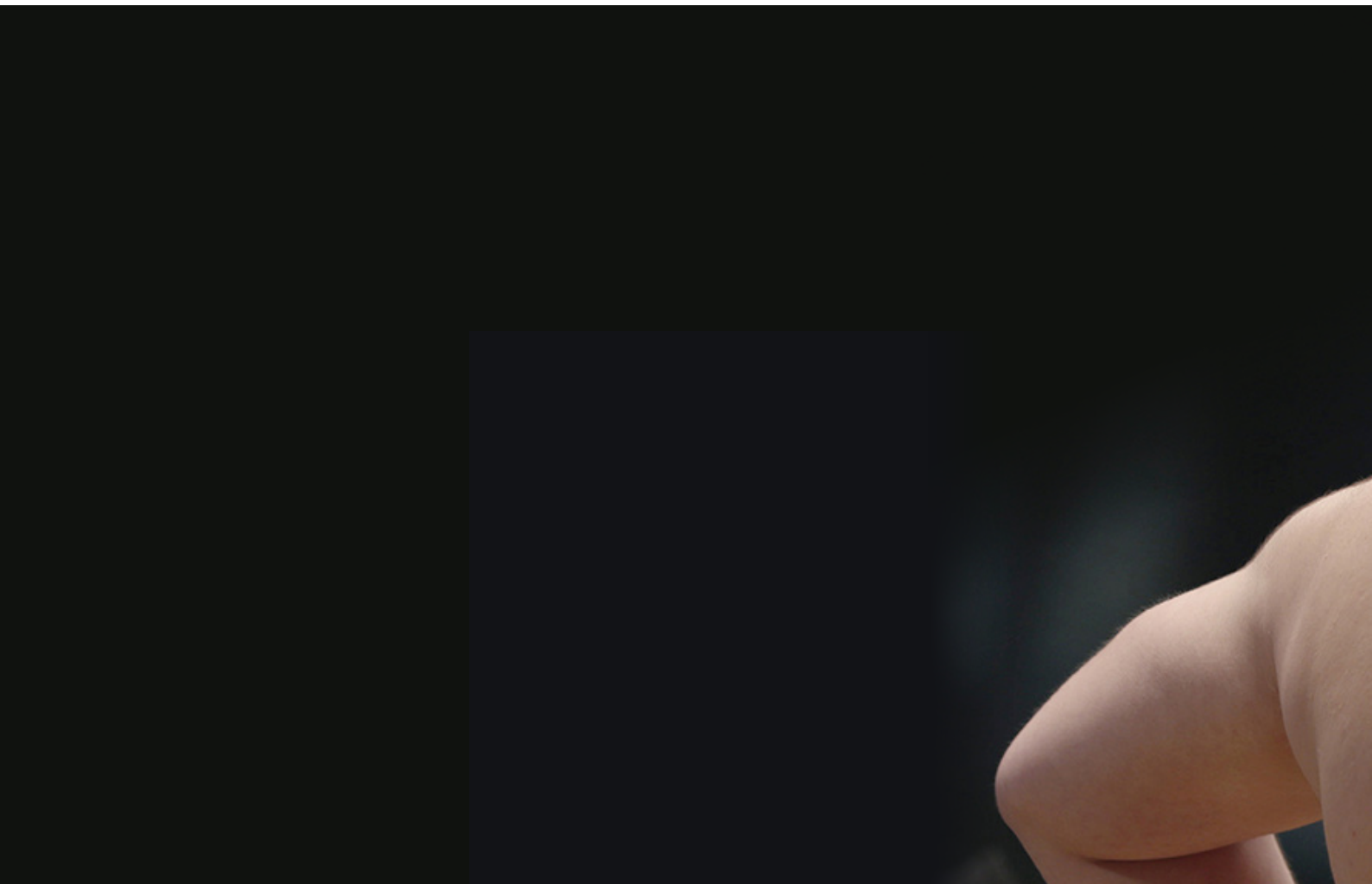
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We are the first firm to offer end-to-end strategy consulting services. From strategy formulation to execution, to ongoing reporting and communications, we translate cutting-edge advice into commercially executable solutions.

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