Rakuten Bank, Ltd.

Transcript of the Q3 FY03/24 Financial Results Presentation

【Slide 2: Number of Accounts Surpassed 15 Million】

Before going through the details of our financial results, as announced today, please note that the number of accounts at Rakuten Bank exceeded 15 million as of February 11, 2024. I would like to thank you for your support.

【Slides 5 and 6: Q1−Q3 Financial Highlights】

In the first nine months of FY03/24, consolidated ordinary income was ¥101.0 billion, up 13.3% year on year, and ordinary profit was ¥35.2 billion, up 23.4%. Non-interest income accounted for 38.8% of the ordinary income; ROE stood at 13.9%. The number of bank accounts, which reached 15 million on February 11, totaled 14.7 million as of end-December, up 10.2% year on year. The main account ratio was 31.4%, and the total deposit balance rose 16.6% year on year to ¥10.3 trillion as of end-December. The G&A expense ratio fell 2.7 percentage points to 42.9%, reflecting improved management efficiency on the back of steady business expansion. The capital adequacy ratio was 11.1%, remaining at a sound level.

The bar graphs illustrate the steady expansion of our operations in terms of both the number of bank accounts and the total deposit balance. Account applications via Rakuten Securities increased substantially in Q3 in anticipation of the new NISA system, which started in January 2024. Meanwhile, the total deposit balance exceeded ¥10 trillion, with its rate of year-on-year growth surpassing that of the number of bank accounts. This means that the per-account deposit balance also increased steadily, alongside the rise in the number of bank accounts.

【Slide 7: Consolidated Statements of Income】

In the first nine months, consolidated ordinary income amounted to ¥101.0 billion, up 13.3% year on year. Gross operating profit rose 15.2% to ¥68.0 billion; ordinary profit increased 23.4% to ¥35.2 billion; and profit attributable to owners of parent grew 23.0% to ¥25.0 billion. Interest income climbed a substantial 20.7% year on year thanks to steady growth of investment assets. Non-interest income associated with daily life—namely customers’ daily activities—marked steady growth, whereas entertainment-related non-interest income fell year on year due to the lasting impact of its strong increase during the pandemic. However, with performance in the daily-life-related category offsetting that in the entertainment-related category, non-interest income was up 3.4% year on year on a net basis.

【Slide 8: Factors Driving Growth in Q1−Q3 Ordinary Profit】

The ¥28.5 billion consolidated ordinary profit logged in the first nine months of FY03/23 grew to ¥35.2 billion in the same period this fiscal year, for a net increase of ¥6.6 billion. The rise in net interest income was a major contributing factor that drove overall growth. Taking advantage of the capital increase accomplished at the time of our IPO, in this fiscal year, we have taken on the challenge of boosting the momentum for interest income growth by expanding our investment assets significantly. We understand that the latest figures are well in line with what we envisioned.

【Slide 9: Ordinary Income, Ordinary Profit, Net Income】

Consolidated ordinary income, ordinary profit, and net Income all delivered double-digit year-on-year growth, fueled by increases in the number of bank accounts and main accounts, along with deposits. The table on the right shows the progress against our forecast for FY03/24. The rate of progress was 74.9% for consolidated ordinary income and 79.0% for ordinary profit; for net Income, the rate was 79.4%, outperforming the Q3 benchmark of 75%. These figures indicate particularly good progress for a constantly growing company, like Rakuten Bank, whose top line and profits tend to rise from Q1 to Q2, from Q2 to Q3, and from Q3 to Q4.

【Slide 10: Revisions to the Consolidated Forecast for FY03/24】

Based on the progress of our business performance on the previous slide, as disclosed today, we upwardly revised our earnings forecast for FY03/24. The estimate for consolidated ordinary income was revised up from the initial projection of ¥134.8 billion to ¥136.1 billion; ordinary profit, from ¥44.5 billion to ¥47.0 billion; and net Income, from ¥31.5 billion to ¥33.4 billion. Calculations based on the revised estimates yield a year-on-year growth rate of 13.0% for ordinary income, 21.4% for ordinary profit, and 20.9% for net Income.

【Slides 11 and 12: Interest Income and Non-Interest Income】

We have stated that, in our business operations, we typically maintain a roughly 6:4 ratio between interest income and non-interest income. During COVID-19 pandemic, non-interest income grew substantially, whereas interest income growth was somewhat sluggish due to a dip in funding needs. From around the IPO, we were able to significantly boost interest income as a result of an accelerated buildup of investment assets; on the other hand, growth of non-interest income was lackluster, reflecting a slowdown following the uptick during the pandemic. Speaking of Q3, the ratio of interest income to non-interest income trended at around 6:4.

For interest income, you can see that loans and monetary claims bought—the two pillars of our investment assets—increased steadily, driving substantial growth of interest on both assets. The overall interest income in the nine months through Q3 also grew at an accelerated pace, rising 19.8% year on year versus 12.6% during the same period in FY03/23.

【Slides 13 and 14: Investment Assets】

Overall, investment assets grew in almost all asset categories. Our basic policy for increasing interest income is twofold: the first is to increase diverse investment assets in a well-balanced manner, and the second is to gradually raise the mix of middle-risk assets to gradually boost the yields. In this table, you can see that the well-balanced accumulation of diverse investment assets is progressing in line with our strategy.

Versus March 2023, housing loans decreased slightly. Interest rates may rise moving forward, and when they rise, loan losses could possibly increase among our housing loans. The margin is extremely thin for housing loans, so a slight uptick in the loan loss ratio could prevent us from securing the expected profit. For this reason, we further reined in the execution of housing loans since the start of FY03/24. The overall balance of housing loans has declined slightly; however, this is in line with our strategy.

Loans to the Ministry of Finance fell slightly. We explained before our intent to maintain these loans at around ¥1 trillion. There is no change to this plan overall, although the loan balance undergoes slight ups and downs from quarter to quarter.

Card loans (personal loans) are expanding steadily post-pandemic. The balance typically declines in December every year, as bonuses are paid during the month. Last December as well, bonus-period repayments reduced the loan balance. Still, you can see that the loan balance has maintained an uptrend compared with the March 2023 and December 2022 figures.

The next slide concerns one of our twofold measures to grow interest income: the progress of our measures to gradually raising the mix of middle-risk assets. The four asset categories of card loans (personal loans), investment property loans, ABL, and monetary claims bought (others) (monetary claims bought, excluding the trust beneficiary rights of Rakuten Card) are considered middle-risk assets. The table shows that the balance has grown steadily in all four asset categories. In addition to expanding diverse investment assets in a well-balanced manner, we are making steady progress in gradually raising the mix of middle-risk assets.

【Slide 15: Balance Sheet】

Characteristically, approximately 78% of our investment assets are based on floating rates, and of these, most are linked to the TIBOR. If and when interest rates rise, especially when short-term interest rates rise, our top line and profits benefit significantly. The Medium- to Long-Term Vision that we have presented to you assumes no change in the interest rates. That said, it is most important for us to firmly accomplish the planned business growth, ordinary income, and ordinary profit, and if there is a change in the policy rate, we expect to see additional top line and profit growth.

【Slide 16: Investment in Marketable Securities】

Historically, we have held marketable securities as collaterals but refrained from acquiring securities for investment purposes. However, after various simulations, we decided to acquire marketable securities for investment and management purposes in addition to our holdings as collaterals. In Q3, as a first step, we purchased ¥138.0 billion worth of bonds, breaking down to ¥7.9 billion in JGBs, ¥112.8 billion in government-guaranteed bonds, and ¥17.3 billion in corporate bonds. Our basic policy is to hold these marketable securities to maturity, aiming to reap the benefits of the difference in long- and short-term interest rates.

【Slide 17: Non-Interest Income】

The pie chart on the right is a breakdown of non-interest income by type. Our non-interest income has three components. The first is commissions received on exchange and settlement transactions, the second is direct debit fees, and the third is card-related fees, which are mostly debit card commissions. The table on the left shows that non-interest income in the nine months through Q3 came to ¥38.0 billion, up 2.9% year on year. Looking at each of the components under fees and commissions income, commissions received on exchange and settlement transactions grew a steady 10.7%. Driving this uptick was an increase in bank accounts, and steady growth of main accounts, which lifted the number of exchange and settlement transactions. Within direct debit fees, the increase in bank accounts and main accounts led to a steady rise in fees from direct debits to pay for water, gas, and electricity, or credit card and mobile phone charges. However, entertainment-related direct debit fees declined slightly year on year, affected by a slowdown following substantial growth during COVID-19 pandemic. With performance in the daily-life-related category offsetting that in the entertainment-related category, direct debit fees increased 2.8% year on year on a net basis.

In card-related fees, debit card transactions have grown steadily, assisted by the gradual spread of cashless payments, but the industry as a whole has seen a decline in the merchant commission rate. As a result, card-related fees which are calculated from multiplying the transaction amount by the merchant fees, have increased by 2.0%. Other fees and commissions income fell year on year, for two reasons. First, the number of executed housing loans declined as we narrowed down our target customers for these loans. Second, our financial instrument brokerage fees were down because Rakuten Securities shifted to zero transaction fees for trading Japanese equities last October.

Other operating income, which includes income from foreign currency deposits, derivatives-embedded time deposits, and FX, was up 3.4% year on year due to some movements in the market.

Please also note that the exchange fees paid and total settlements, shown at the bottom of the table, grew steadily year on year as well.

【Slide 18: Main Accounts】

The number of main accounts as of end-December totaled 4.6 million, up 11.7% year on year, and the main account ratio stood at 31.4%. As total accounts increased 10.2% year on year, the year-on-year growth rate was higher for main accounts. We will make continued efforts to secure more main accounts since these accounts are by far more profitable than non-main accounts, and customers with main accounts tend to maintain large deposit balances.

【Slide 19: New NISA and Bank Accounts】

At the time of the 1H financial results briefing, we used the graph on the lower left to explain that, while new account openings via Rakuten Securities typically decline in Q2 compared to Q1, they grew substantially in Q2 FY03/24 due to the impact of the new NISA system. In Q3, new account openings via Rakuten Securities climbed further, up 45.6% quarter on quarter. This is an extremely good example of group synergy coming to fruition. When customers interested in the new NISA system open accounts with both Rakuten Securities and Rakuten Bank and conduct securities transactions, fund settlement will take place between the two entities. So we expect increasing our bank’s settlement fees.

【Slide 20: Capital Adequacy】

We have maintained a healthy capital adequacy ratio (consolidated basis) at 11.1%. We plan to make effective use of capital, entrusted to us by the shareholders, to expand investment assets, boost interest income, and thereby expand our business and improve profitability. We intend to substantially increase investment assets, expand business, enhance profitability and our corporate value, while keeping the capital adequacy ratio at a healthy level.

【Slide 21: General and Administrative Expenses】

Our non-consolidated G&A expense ratio improved to 42.9%. That said, it is not our objective to reduce expenses for the sake of simply achieving a target expense ratio. In Q3 as well, we made the necessary system investments and marketing expenditures for future growth and expanded our business scale, but as we took advantage of the nature of our business model, the expense ratio fell to 42.9%. Our Medium- to Long-Term Vision targets an expense ratio of 45% in FY03/27, but since we already cleared this target, we now plan to aim for 40% while making the necessary investments and expenditures for growth.

【Slide 22: Credit Costs】

Traditionally, our card loans (personal loans) were guaranteed by Rakuten Card, but we have been working to gradually raise the proportion of non-guaranteed card loans in which we bear the loan loss risk ourselves. As a result, the actual credit cost amount is on a gradual rise. However, the credit cost ratio continues to trend at a low level of 0.04%, so the high quality of our investment assets is maintained.

【Slide 23: ROE】

We thought that the ROE would temporarily dip due in part to the capital increase at the time of our IPO last April. However, our management efficiency improved beyond our expectations, and ROE is now at 13.9%. We keep our current strategy for improving ROE. The details are as follows: ① We will significantly expand non-interest income by boosting the number of main accounts and cross-selling to customers the services of Rakuten Bank and those of the rest of the Rakuten Group. ② We will utilize the unique assets and data of the Rakuten Group to generate investment assets, such as loans and monetary claims bought, with appealing risk-return profiles.③ The current capital adequacy ratio of 11.1% leaves some room, so we will raise ROE by applying some more leverage. ④ The management efficiency of digital banks improves substantially as the business scale grows. We will take full advantage of this characteristic and continue to expand our business scale, thereby improving the ROE. We hope to continue pursuing our strategy along these lines.

【Slide 24: Dividend Policy】

Our dividend policy remains unchanged. We intend to make effective use of the capital entrusted to us by the shareholders to build up our investment assets in a well-balanced manner. At the same time, we will seek to expand interest income substantially by gradually raising the mix of middle-risk assets, while also increasing non-interest income by nurturing our customers to main accounts holders. That is our growth scenario, and we would like to offer returns to our investors in the form of growth and ask for your understanding of our decision not to distribute dividends in the short term.

Rakuten Bank, Ltd.
Summary of Q&A at the Q3 FY03/24 Financial Results Presentation
(February 13, 2024)

Q01. Regarding the upward revisions to the full-year forecast on page 10, to the extent possible, please give us a quantitative explanation of the background. In relation to this, what are the current situation and future outlook regarding the four middle-risk assets on page 14?

A01. First, in terms of our ordinary income, the increase in investment assets, which are the source of our interest income, has been stronger than what we had initially planned. On the other hand, the post-pandemic recovery of non-interest income has been slightly short of our expectations. Our view is that netting out the surplus in interest income against the shortfall in non-interest income will yield a performance of ordinary income slightly above the initial plan.

The improvement in our ordinary profit and net Income is a direct reflection of our structure as a digital bank, where business upsizing leads to better management efficiency and profit generation. We have spent sufficient amount on system investments and marketing; still, the management efficiency improvement from business expansion was greater than our conservative estimates at the beginning of this fiscal year, and profits climbed substantially.

On this basis, I will comment on the four middle-risk assets on page 14, starting with card loans (personal loans). Card loans have been recovering post-pandemic, with the balance increasing even at the end of December in 2023, when repayments typically rise because of bonus payments, compared with both December 2022 and March 2023. We intends to boost the loan balance a notch going forward. Next, in terms of investment property loans, we have explained that we are able to build up the loan balance by approximately ¥100 billion annually, and to this end, we will continue to collaborate with major partners. Market demand remains firm for urban properties near train stations, which we handle, so in this sense as well, we expect stable growth. ABL and monetary claims bought (others) are securitized assets from the securitization of corporates' monetary claims, real estate, or various projects. If we purchases them as the trust beneficiary rights, they will be categorized to monetary claims bought, and if we execute loans to the trust accounts, they will be ABL. Since our competitiveness in securitization is gaining recognition in the market to a certain degree, we see a rise in demand. The balances of ABL and monetary claims bought (others) will not grow constantly every quarter as they are linked to securitization deals, but we believe they will maintain an uptrend.

Q02. I have a question regarding the marketable securities investment on page 16. To confirm, is it correct to say that the latest new purchases worth ¥138.0bn all fall under held-to-maturity securities rather than available-for-sale securities? Also, what types of government-guaranteed bonds have you acquired?

A02. Regarding the investment in marketable securities made for investment purposes in the third quarter, we invested in are held-to-maturity bonds, not available-for-sale securities. In light of the interest rate outlook, we think we can reap the benefits of the difference in long- and short-term interest rates to a certain degree, even if we hold the securities to maturity. We invested based on this assessment and accordingly acquired held-to-maturity securities. As for the government-guaranteed bonds, we purchased bonds issued by public corporations or agencies such as the XYZ Agency. They are guaranteed by the Japanese government, so their credit risks are equivalent to those of JGBs. Yet, the yields on government-guaranteed bonds are now 3−5 basis points higher than those of JGBs. While it is true that JGBs have higher liquidity, since our latest investment targeted held-to-maturity securities, we prioritized the higher yields of government-guaranteed bonds over JGBs' liquidity.

Q03. Looking toward the next fiscal year, what will be the profit growth drivers? We understand that the number of bank accounts was up 10% year on year, but do you envision an ever greater increase once the new NISA system is in full operation?

A03. For Rakuten Bank, it is of prime importance in FY03/25 to achieve solid growth toward the FY03/27 targets outlined in the Medium- to Long-Term Vision. In terms of growth drivers, we intend to expand investment assets and push up interest income, since we continue to have some leeway in capital. Next, non-interest income associated with daily life activities will increase in tandem with the rise in the number of bank accounts and main accounts. Entertainment-related commissions are down year on year in FY03/24, but we expect a turnaround to growth approaching FY03/25. In addition to these factors, as we have seen this fiscal year, we anticipate management efficiency to improve further as the scale of Rakuten Bank's business grows. Improved management efficiency should contribute to profits.

Next, our basic strategy for boosting the number of bank accounts is to win new accounts by effectively utilizing the Rakuten Ecosystem. Within this framework, certain group services could capture consumers' interest at any given time, and referrals from such services could quite possibly push up the number of our bank accounts at some point. Conversely, it is an important for us to seize the moment and ramp up bank account openings via such group services of interest to consumers. Currently, the new NISA system has substantially contributed to the increase in account openings via Rakuten Securities. Thanks to ongoing media coverage, the new NISA has captured the interest of consumers, so it will likely continue to have a positive impact on account openings at Rakuten Bank.

Meanwhile, the new NISA allows only one account per person, so although it will continue to have a positive impact, we believe the impact will gradually wane. In this context, we need to focus on two points. The first is to see how we can secure new account openings by leveraging the growth of Rakuten Mobile, which is currently the area of focus within the Rakuten Group. Second, given the full-scale spread of cashless payments moving forward, we hope to see growth in account openings for the purpose of using Rakuten Bank's cashless services or other cashless services within the Rakuten Group, including Rakuten Card and Rakuten Pay.

Q04. As a medium- to long-term profit target, you have projected an ordinary profit of approximately ¥70.0 billion in FY03/27. Given the possibility of interest rate hikes, what do you see as the upside potential to your medium-term outlook? Additionally, in terms of the use of capital for growth on page 23, could you explain again the areas requiring investment to drive further growth?

A04. Regarding our medium-term profit target, the upward revision conducted at this time is an indication that we have so far managed to perform above our expectations. Still, our first goal is to make sure to achieve an ordinary profit of ¥70.0 billion in FY03/27. This figure does not factor in an increase in interest rates, so the achievement of ¥70.0 billion assumes the current interest rate levels. Meanwhile, the business model of a digital bank is such that when the business scale exceeds a certain threshold, management efficiency improves dramatically in line with the business growth thereafter. We factored in this aspect to a certain degree when we initially formulated our plan. The fact that we did so reflects the possibility of an upside. A rise in interest rates could also provide additional upside, but at present, the promise to you from my position is to accomplish an ordinary profit of ¥70.0 billion in FY03/27. We will strive to achieve this goal firmly.

To answer your question regarding the areas in which to invest for growth, systems are at the base of Rakuten Bank's services. We will be utilizing our systems to improve customer convenience, provide new services, and create new revenue lines by diversifying investment assets and expanding the corporate business (this could be a project for a little later than FY03/27). Therefore, our Investment sector focus will be on system investments.

Q05. I have a question about the credit cost ratio. I believe your asset quality is currently very high and that the risk of the credit cost ratio rising substantially in the future is limited. What is your view on the appropriate credit cost ratio level in the face of future inflation and other changes in the environment?

A05. I am not quite sure whether discussing the credit cost ratio in terms of total assets alone is appropriate. For instance, for housing loans, a 1% loan loss would frankly put us in the red, whereas for card loans (personal loans), our loan loss ratio is about 3% against our interest rate of about 10%. A high-yield business. The loan loss costs and the loan loss cost ratio will change, depending on the mix of our investment assets. Therefore, Rakuten Bank places importance on setting target loan loss ratios based on the profitability of individual assets and adhering to these ratios firmly. In this sense, a gradual rise in the mix of middle-risk assets, including card loans (personal loans), would allow us to sufficiently control risk. Meanwhile, we do not expect low-risk assets to have the exactly same loan loss ratios, so here, credit costs will likely increase gradually. However, at the same time, we should be able to see a far greater increase in interest income.

Q06. I have a question about the relationship with your parent company. I understand that Rakuten Group, Inc. has sold a portion of its shareholdings in Rakuten Bank. Do you expect this to have an impact on your business, if any?

A06. It is true that Rakuten Group, Inc. sold a portion of its shareholdings in Rakuten Bank through a secondary offering last December. Rakuten Bank is a listed company, and we believe it is up to our shareholders to decide whether to hold or sell our shares. On the other hand, at the time of our IPO, Rakuten Group announced that it would maintain our status as its consolidated subsidiary. From this, we understand that our status as a consolidated subsidiary of Rakuten Group will be maintained going forward, although it is up to the parent company to decide on the future shareholding ratio. In this sense, there has been no particular impact on our business because we have remained a consolidated subsidiary. Moving forward, we will continue making maximum use of the Rakuten Ecosystem to achieve our growth. Conversely, Rakuten Bank’s growth and significant top line and profit expansion will naturally have a positive impact on the consolidated financial results of the parent company. As such, please note that there is no particular change in our relationship with our parent company.

Q07. (Follow-on question to Q6) Is there any discussion, for instance, on where you could potentially be impacted on the business front, or is there not even a discussion? Please elaborate a little more on this point.

A07. In terms of impact on business, Initially, there were concerns about the change in status from a 100% subsidiary to no longer being a 100% subsidiary after the IPO, and whether shareholders other than Rakuten Group, Inc. would understand and support our growth strategy utilizing the Rakuten ecosystem. Fortunately, our other shareholders, aside from Rakuten Group, have also shown their support for our directionality, which is to grow and enhance our corporate value by leveraging the Rakuten Ecosystem. In this sense, my answer to you is that, at present, I do not see any potential impact on business.

Q08. I have a question about your outlook on the G&A expense ratio. You mentioned that when the business scale exceeds a certain threshold, management efficiency improves dramatically. Looking at the latest Q3 performance, I think it may have been the first time for you to see this manifest itself as actual results, although you had envisioned it in your mind. In light of the current situation, what is your outlook on management efficiency for the next fiscal year and beyond? What would be your cruising speed?

A08. Regarding the issues of G&A expense ratio and management efficiency, when we formulated the Medium- to Long-Term Vision, we set the target G&A expense ratio for FY03/27 at 45%. You can see that the ratio is currently trending lower than this initial target. In addition, at the time of plan formulation, we factored in considerable investments and expenditures necessary for growth. Moving forward as well, Rakuten Bank does not plan to curb the outlays necessary for growth. Even with such outlays, we should be able to kick off the next fiscal year with a higher level of efficiency versus our initial plan, given that our current management efficiency exceeds the initial expectation. Of course, the possibility of an unexpectedly large growth investment emerging is not zero, but Rakuten Bank has been making system investments every year at an appropriate scale, so in terms of operational efficiency, we anticipate starting from a more efficient level in the next fiscal year than at the time of formulating the medium to long-term vision, and gradually improving from there. As for the expense ratio of 40%, it is not an easily achievable figure, but we believe it is worth challenging within a certain period of time.

(End)