Rakuten Bank, Ltd.
Transcript of the Q1 FY2024 Financial Results Presentation
(August 7, 2024)

【Opening Remarks and Topics】

Before diving into the financial figures, I would like to report that as of July 29, the number of accounts at our bank exceeded 16 million. Additionally, as of the end of July, our deposit balance surpassed ¥11 trillion. This demonstrates that our business is expanding smoothly. With that report, I will now explain the financial figures.

【Q1 FY2024 Financial Highlights】

In Q1 FY2024, ordinary income was ¥40.8 billion, up 25.0% year on year, and ordinary profit was ¥15.2 billion, up 34.2% year on year, showing strong figures.

The non-interest income ratio was 35.5%, slightly down from the usual 40%, as explained in the previous briefing in May. This decrease is due to a significant increase in interest income in a world where interest rates are rising. ROE was 16.4%, which is a very good figure on an annualized basis. The number of accounts was 15.8 million as of the end of June, up 12.9% year on year, with a main account ratio of 31.5%. The deposit balance was ¥10.9 trillion, up 15.3% year on year. The G&A expense ratio decreased to 37.9%, and the capital adequacy ratio remained at a sound level of 11.3%.

【Scale of Operations】

The growth rate of the number of accounts was 12.9% year on year, while the growth rate of the deposit balance was 15.3% year on year, indicating that the growth rate of the deposit balance exceeded that of the number of accounts. This means that not only did the number of accounts increase, but the increase in main accounts also drove the expansion of the deposit balance.

【Consolidated Statement of Income】

Ordinary income was ¥40.8 billion, up 25% year on year, gross operating profit was ¥28.0 billion, up 27.4% year on year, and operating expenses were ¥11.3 billion, up 12.8% year on year. As a result, ordinary profit was ¥15.2 billion, up 34.2% year on year, and net income was ¥10.9 billion, up 35.0% year on year. The increase in ordinary profit was largely due to the increase in interest income, and the growth rate of non-interest income also rose. Costs associated with the FinTech reorganization being discussed with Rakuten Group, Inc. are included in other ordinary income and expenses.

【Summary of Consolidated Financial Results】

The progress rate against this year's financial forecast is 25.1% for ordinary income and 28.6% for ordinary profit. Excluding the ¥638 million in costs associated with the FinTech reorganization this term, ordinary profit would be ¥15.9 billion, with a progress rate of 27.2%, up 39.8% year on year. Net income also has a progress rate of 28.8%, and excluding the FinTech reorganization costs, net income would be ¥11.3 billion, with a progress rate of 27.5%, up 40.5% year on year. The business continues to grow, and both sales and profits tend to increase quarterly. Therefore, the fact that the progress rate for ordinary income and profit exceeded 25% in Q1 indicates that the business is progressing smoothly against this year's performance forecast.

【Interest and Non-Interest Income】

In Q1, interest income increased by 34.7%, and non-interest income increased by 8.9%. As a result, the ratio of interest income to non-interest income is 6.4 to 3.6 when the total is 10.

【Breakdown of Interest Income】

In Q1, interest on loans increased by ¥1.6 billion year on year, interest on monetary claims bought increased by ¥2.1 billion, and others (Interest on due from banks, Interest and dividend on securities, etc.) increased by ¥2.6 billion. Loans, monetary claims bought, and other are becoming the three pillars of our investments.

【Details of Loans and Monetary Claims Bought】

Looking at the breakdown of loans and monetary claims bought, card loans decreased in June due to the usual decline following bonus payments, but the balance increased in April and May, resulting in a net increase in Q1. Card loans, with a yield of 10%, have a significant positive impact on revenue and profit when the balance increases. For housing loans, considering the potential increase in defaults due to future interest rate hikes, we have significantly shifted our target to high-income customers, resulting in a decrease in the balance as repayments exceed new executions. Affiliated loans and investment property loans are growing steadily, and ABL decreased due to the maturity of a large real estate project in Q1, but the overall increasing trend remains unchanged. For monetary claims bought, the balance of trust beneficiary rights of Rakuten Card decreased temporarily due to a surplus in Rakuten Card's cash flow, but Rakuten Card's business continues to expand steadily, and we expect the balance to return to its original increasing trend over time. The combined balance of loans and monetary claims bought increased by 13.1% year on year, continuing to grow steadily. Additionally, in our medium- to long-term vision, we aim to balance the growth of investment assets and gradually increase the proportion of middle-risk assets. The asset categories including middle-risk assets, such as card loans, investment property loans, ABL, and monetary claims bought: others, increased by 15.3% year on year, progressing smoothly in line with our medium- to long-term vision.

【Balance Sheet Summary】

78% of loans and monetary claims bought are based on floating rates, most of which are linked to TIBOR. Therefore, the yield on investment assets will increase quickly when market interest rates rise, including the BOJ's policy rate hike. Almost all cash deposits are in current accounts with the BOJ, and when the BOJ raised the policy rate to 0.25% at the end of July, the interest rate on BOJ current account deposits also increased from 0.1% to 0.25%, increasing the interest earned from cash deposits. On the other hand, it is common for interest paid on deposits to increase with rate hikes. We estimate the pass-through rate of market interest rates to deposit rates to be around 40%. We are currently reviewing our deposit interest rates in response to the BOJ's policy rate hike in July.

【Status of Marketable Securities Investment】

Regarding deposits with the BOJ, we are gradually shifting to securities investments, such as government bonds, government-guaranteed bonds, and corporate bonds. In Q1, we executed new securities investments totaling ¥104.3 billion. For loans to the Ministry of Finance, since the BOJ lifted the negative interest rate policy in March, these loans now bear positive interest rates, often exceeding the interest on BOJ current account deposits, making them one of our investment assets. Under the negative interest rate policy, we maintained a loan balance of about ¥1 trillion to the Ministry of Finance, but if we can secure a yield higher than the interest on BOJ deposits, we will increase loans to the Ministry of Finance beyond ¥1 trillion. In Q1, the balance increased by ¥203.3 billion.

【Non-Interest Income Status】

Non-interest income was ¥14.0 billion, up 8.9% year on year. The three main pillars of non-interest income remain commissions received on exchange and settlement transactions, direct debit fees, and card-related fees. Service transaction income was ¥11.8 billion, up 9.4% year on year. Looking at the breakdown, commissions received on exchange and settlement transactions increased by 12.8% year on year. For direct debit fees, while daily-life-related direct debits showed high growth until FY2024, entertainment-related direct debits experienced negative growth due to the impact of the COVID-19 pandemic. However, in Q1 FY2024, the negative impact on entertainment-related direct debits has almost reached zero, resulting in a total increase of 10.1% in direct debit fees, achieving double-digit growth. Card-related fees increased by 17.2% year on year in Q1, reflecting the increase in card transaction volumes as the decline in merchant commission rates has mostly stopped. Even excluding some one-time income, double-digit growth was achieved.

【Main Accounts Growth Momentum】

In Q1, the total number of accounts increased by 12.9%, while the number of main accounts increased by 13.3%, and non-main accounts increased by 12.8%, indicating progress in main account conversion. The main account ratio is 31.5%.

【Referrals by Customers with an Account】

The number of new account applications introduced by existing account holders is steadily increasing, and this increase has accelerated recently. As the number of accounts increases, we can expect a further increase in new account openings through introductions from existing account holders, and we intend to continue leveraging this as a driver for acquiring new accounts.

【Capital Adequacy】

The capital adequacy ratio remains at a sound level of 11.3%. We aim to expand investment assets while maintaining a sound capital adequacy ratio and improving profitability.

【General and Administrative Expenses】

G&A expense ratio has decreased to 37.9%, but this is an annualized figure based on Q1 numbers. Our goal for this fiscal year is to challenge an G&A expense ratio of 40% throughout the year. Operating expenses themselves increased by 12.7% year on year, indicating that necessary expenses are being incurred. As gross operating profit increased by 27% year on year, G&A expense ratio decreased to 37.9%. We do not intend to run the business with the sole purpose of lowering G&A expense ratio. Instead, we aim to lower G&A expense ratio as a result of expanding the business scale while investing necessary costs for growth.

【Credit Costs】

The credit cost ratio in Q1 remained at an extremely low level of 0.06%. Most of the increase in credit costs is due to the increase in card loan balances, resulting in higher provisions and write-off costs. We operate card loans with a yield of 10%, allowing for credit costs and provisions of up to about 3%, so the increase in credit costs is as expected.

【ROE】

On an annualized basis, ROE is 16.4% in Q1, but it is important to improve ROE throughout the year rather than reacting to quarterly figures. Our goal for FY2024 is to challenge an ROE of 15%.

【Dividend Policy】

As before, we prioritize growth over dividends in the short term, so our policy remains unchanged, and we will not distribute dividends. In the medium term, we will review our capital policy, including dividend payments, based on the progress of our business.

【FinTech Reorganization】

There is no change in the status of discussions with our parent company, Rakuten Group, Inc., regarding the reorganization of the FinTech business. However, as announced on July 29, we have agreed with our parent company to change the effective date of the reorganization from October 2024 to January 2025. There is no change in the premise that Rakuten Bank's shares will remain listed on the Tokyo Stock Exchange Prime Market even if the reorganization is implemented. We are confident that the reorganization will bring significant benefits to Rakuten Bank, but the structure and economic conditions will have a significant impact on the interests of minority shareholders. We are continuing negotiations with Rakuten Group, Inc. to reach an agreement on a structure and economic conditions that minority shareholders can understand and accept.

【Financial Forecasts】

The financial forecasts for FY2024 remain unchanged. The future of the BOJ's monetary policy is very uncertain, making it difficult to reasonably estimate performance based on policy rate fluctuations at this stage. Additionally, the costs associated with the FinTech reorganization are tentatively estimated at ¥5 billion, but as time passes, more concrete figures will become apparent. If it becomes necessary to revise the performance forecast based on reasonable estimates, we will announce it at the appropriate time. With that premise, we have left the performance forecast unchanged this time.

Rakuten Bank, Ltd.

Summary of Q&A at the Q1 FY2024 Financial Results Presentation

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Q01. Regarding the effective date of the FinTech reorganization, which was postponed from October 2024 to January 2025, what are the issues being discussed, and can these issues be resolved within three months? Also, is there any risk that this reorganization could affect the consideration of measures such as raising deposit interest rates?

A01. We believe that the FinTech reorganization will bring significant benefits to Rakuten Bank, but the structure and economic conditions will have a significant impact on the interests of minority shareholders. Since this is a transaction with our parent company, Rakuten Group, Inc., we need to negotiate a structure and economic conditions that minority shareholders can understand and accept. Therefore, we decided to postpone the effective date by three months to allow more time for negotiations. It is uncertain whether the issues can be resolved within three months, but we aim to finalize the reorganization in a way that minority shareholders can understand and accept during this period. As a bank, we set necessary deposit and loan interest rates based on market interest rates, so discussions on the FinTech reorganization will not affect these interest rate settings.

Q02. Regarding the future policy for securities investments, you have slightly increased government bonds and increased loans to the Ministry of Finance to ¥1.2 trillion in Q1. What are your future plans for investments?

A02. Our policy for securities investments is to consider whether we can obtain a higher yield than deposits with the BOJ. Therefore, the issue is not whether to invest in securities or loans to the Ministry of Finance, but rather to choose the more advantageous option based on the investment period and yield. Loans to the Ministry of Finance have started to bear interest since the negative interest rate policy was lifted, and the interest rate has been gradually rising. Additionally, since most loans to the Ministry of Finance have a loan period of six months, the risk of significantly underperforming market interest rates due to changes in the BOJ's monetary policy is low. However, since these loans are subject to bidding, it is uncertain whether we can secure them. On the other hand, securities are generally held to maturity, and we prioritize government-guaranteed bonds, which have slightly higher yields than government bonds, but due to their extremely low circulation, we sometimes purchase government bonds. Our basic policy is to gradually increase securities investments and loans to the Ministry of Finance if we can secure higher yields than deposits with the BOJ.

Q03. Regarding the control of the capital adequacy ratio, it has increased compared to the end of March 2024, even though you are accumulating assets. Do you expect to accelerate asset accumulation to the extent that the ratio significantly decreases, or is the FinTech reorganization itself affecting this control?

A03. We believe that the capital adequacy ratio did not decrease as much as expected due to two main factors. First, the decrease in trust beneficiary rights of Rakuten Card, which reduced risk assets due to a temporary surplus in Rakuten Card's cash flow. Second, the improvement in profitability was better than expected, resulting in an accumulation of capital. Moving forward, we expect to continue expanding investment assets, and the capital adequacy ratio will gradually decrease. It may not decrease as much as initially expected when we created the medium- to long-term vision, but the FinTech reorganization is not causing us to restrain investments to maintain a high capital adequacy ratio.

Q04. Regarding the guidance for FY2024, how much of a positive impact do you expect from the BOJ's additional 15bp rate hike on this year's performance? Is the reason for not revising the forecast related to the FinTech reorganization, and are you not concerned about the recent market turmoil affecting your business model?

A04. The impact of the BOJ's additional 15bp rate hike will increase interest income on ¥4.2 trillion in loans and ¥2.4 trillion in monetary claims bought, totaling ¥6.7 trillion in investment assets, 78% of which are floating rates. Additionally, the yield on BOJ deposits, approximately ¥5 trillion (less than ¥5 trillion on a monthly average), will also increase by 15bp, which is a positive factor. On the deposit side, we estimate a pass-through rate of 40% for market interest rate increases to deposit rates, and we are currently reviewing our deposit interest rates in response to the BOJ's policy rate hike in July. We have seen other banks raise their ordinary deposit rates from 0.02% to 0.1%, which is an 8bp increase, suggesting a higher pass-through rate than 40%. Therefore, the increase in deposit costs may be slightly higher than the logical framework. The recent market turmoil has almost no impact on our business. While a stronger yen may slightly reduce yen-denominated revenue and profit from foreign currency investments, the overall impact is not significant.

Q05. Regarding the growth of assets in Q1, how do you evaluate it compared to the initial plan? What is your outlook for accumulating middle-risk assets, and what is the background of the temporary surplus in Rakuten Card's cash flow?

A05. Card loans, housing loans, and affiliated loans are within the expected range, and investment property loans were slightly stronger than the annual target of ¥100 billion net increase. ABL decreased in Q1 due to the maturity of a large real estate project, but it is growing as planned year on year. Loans to the Ministry of Finance depend on the situation and are not planned in advance. The decrease in trust beneficiary rights of Rakuten Card is due to a temporary surplus in Rakuten Card's cash flow, which is expected to return to normal within a few months. Overall, investment property loans were slightly stronger, and other assets were as expected. We aim to increase middle-risk assets by 10%+ year on year, and there are no major concerns at this time.

Q06. Regarding the costs of the FinTech reorganization, you initially estimated ¥5 billion for the year, but Q1 costs were ¥638 million, which is very low. Do you expect the total cost to be lower than initially estimated?

A06. The costs of the FinTech reorganization were spread out due to the extension of the effective date from October 2024 to January 2025, resulting in lower Q1 costs of ¥638 million. Therefore, the total cost is not expected to decrease or increase significantly. We are considering a maximum of ¥5 billion, and the final cost may be slightly lower or higher.

Q07. Regarding the policy for securities investments, what is your stance on purchasing long-term government bonds?

A07. Given the significant movement in long-term interest rates, we may selectively purchase long-term government bonds if we can obtain benefits based on our medium- to long-term interest rate expectations. However, we are not actively purchasing long-term government bonds as we expect interest rates to rise. This term, we focused on purchasing bonds with maturities of 2-4 years, but we may make exceptions for long-term government bonds depending on interest rate conditions.

Q08. Regarding the outlook for trust beneficiary rights of Rakuten Card, do you

foresee any impact on execution amounts in the context of the FinTech reorganization in the medium to long term?

A08. The increase in trust beneficiary rights of Rakuten Card fundamentally depends on the growth of Rakuten Card's business. While there may be temporary surpluses, as seen this time, if Rakuten Card's business continues to grow in the medium term, the balance will also increase. Rakuten Card has become the No.1 credit card company in Japan and continues to achieve double-digit growth. Therefore, we believe that trust beneficiary rights of Rakuten Card will continue to grow for the foreseeable future.

Q09. Regarding performance progress, the progress rate excluding FinTech reorganization costs is favorable. Are there any one-time factors contributing to this?

A09. We believe that performance progress is on track. From the perspective of whether there are any special factors, there was a slight positive impact from one-time revenue in card-related fees, but this is a small factor overall. There are no significant one-time expenses in sight for this term.

Q10. Regarding the FinTech reorganization, you mentioned discussions with the parent company about the structure and economic conditions. What are the key issues, and what points are being discussed, as far as you can share?

A10. The structure and economic conditions of the FinTech reorganization are intertwined and need to be discussed together. While Rakuten Group, Inc. pursues its own interests, we need to protect the interests of our minority shareholders. Since Rakuten Group, Inc. and our minority shareholders have somewhat conflicting interests, we are continuing negotiations to reach an agreement with the parent company on a structure and economic conditions that our minority shareholders can understand and accept.

Q11. Regarding main accounts, you mentioned that the number of main accounts is increasing at a faster pace than the total number of accounts. What are the growth drivers, and what are the prospects and key points for further growth?

A11. As of the end of June, the number of main accounts has reached 4.9 million, and we believe it will continue to grow steadily. The greatest appeal of our service is its convenience, which encourages customers to shift to using our accounts as their main accounts. Therefore, we will continue to enhance convenience, making customers think, "Rakuten Bank accounts are convenient; let's use them as our main accounts." Additionally, the fact that using Rakuten Bank services earns Rakuten Points is an added incentive.

Q12. Regarding costs, are there any costs that will increase with business expansion, or are there no fundamentally increasing cost items?

A12. Marketing expenses are structured to increase proportionally as the number of customers grows. For example, if a campaign that previously reached 400,000 customers now reaches 500,000 customers, the cost of awarding points will also increase. Therefore, marketing expenses will increase with business expansion. System costs do not double just because the number of accounts doubles, but they may increase slightly with system upgrades or the release of new services. Personnel costs will not double just because the business doubles, but they will increase to some extent as the business expands. In conclusion, the costs that will increase with business expansion are marketing expenses and the personnel costs associated with marketing.

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