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Japan

Deep Dive: Postal privatization in Japan

Ramifications for financial and transport sectors

- **Towards full privatization** — Almost seven years have passed since the post office was privatized in Japan in 2007. Despite the amendment of related laws and other complications, Japan Post Holdings and its two financial units, Japan Post Bank (Japan's largest depositary institution) and Japan Post Insurance (Japan's largest life insurer by total assets), now appear likely to hold their IPOs as early as 2015. Yet the impact of the IPOs and the divestiture of the government's stake on the financial sector and stock market remains difficult to forecast. We therefore thought it would be instructive to analyze a number of scenarios.

- **Limited information available** — The only information available on Japan Post Group's strategy for the future is the medium-term business plan released by the Group in February. We conduct a careful examination of this plan and add our own views in an attempt to get a better handle on future prospects.

- **Impact on financial sector** — Japan Post Bank (JPB) and Japan Post Insurance (JPI) are expected to expand their businesses as Japan Post Holdings (JPH) reduces its stake in the two units. We analyze the likely impact on specific regions and sectors as well as the possibility that privatization might lead to new business opportunities for private firms.

- **Impact on transport sector** — As the market for traditional mail delivery shrinks, we expect the Group will aggressively expand its distribution operations both in Japan and overseas. We analyze the implications for the transport sector, focusing on the home parcel and mail delivery markets.

- **Impact on equity market** — Finally, we consider the potential market impact of the three Japan Post Group firms for which offerings are planned. We also look at similar examples such as Deutsche Postbank, whose IPO weighed on the shares of other German financial institutions.

- **Lessons from past privatizations** — One thing common to the successful privatization examples of Japan Tobacco and Japan Railways was a dramatic shift in awareness among both management and staff. We do not think privatization would have succeeded without bold changes in management's stance and the corporate culture. The results of these changes included overseas M&A deals, the restructuring of domestic operations, and a willingness to pursue innovation that was fostered in the process of resolving labor and financial issues.

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Chapter 1. Overview of postal privatization in Japan

1. Privatization history and timetable

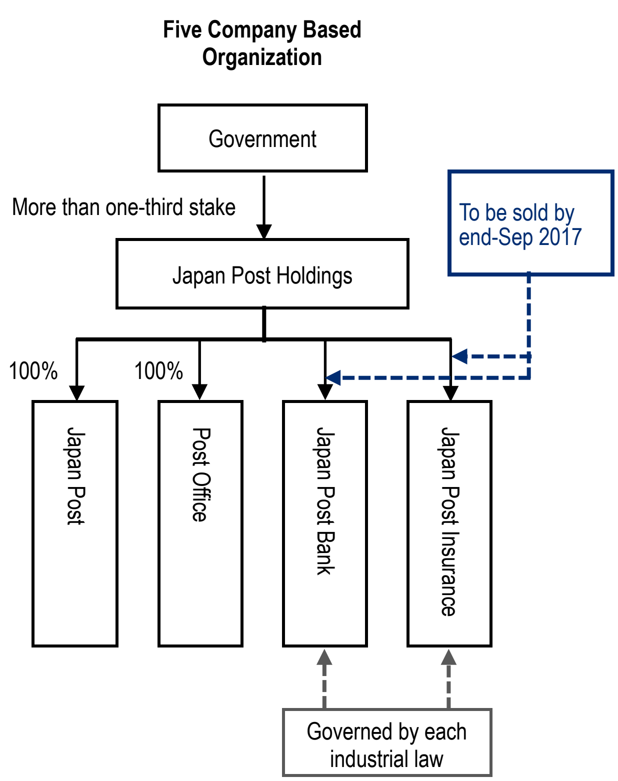
(1) Changes to Postal Service Privatization Act

Reorganization under original Privatization Act

Postal services privatization, the Koizumi administration's showpiece reform, centered on six pieces of related legislation: the Postal Service Privatization Act, the Act on Japan Post Holdings, the Act on Japan Post Service, the Act on Japan Post Network, the Act on the Management Organization for Postal Savings and Postal Life Insurance, and the Act on Preparation of Relevant Acts for Enforcement of the Postal Service Privatization Act.

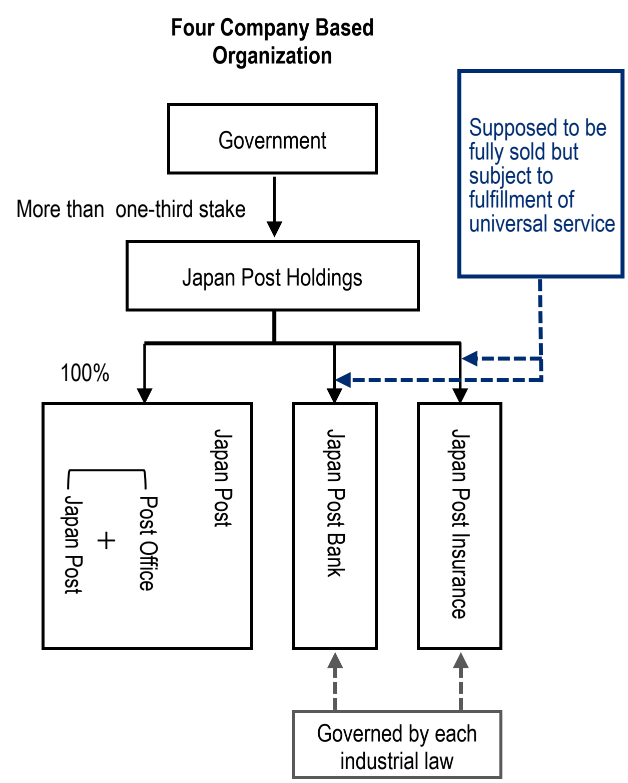
The Postal Service Privatization Act (referred to below as "the Privatization Act") is the basic legislation and authorized the establishment of four business entities under the umbrella of Japan Post Holding in October 2007 to carry on the operations of what was then known as Japan Post: Japan Post Bank, Japan Post Insurance, Japan Post Service, and Japan Post Network. Some of the existing term savings and postal life insurance products guaranteed by the government were transferred to the Management Organization for Postal Savings and Postal Life Insurance (MOPSPLI).

Figure 1. Spin-offs under original Postal Service Privatization Act (as of 2007)



Source: Company data, Citi Research.

Figure 2. Spin-offs under revised Postal Service Privatization Act (today)



Source: Company data, Citi Research.

Group reorganization under amended Privatization Act

The Act to Partially Amend the Postal Service Privatization Act was passed in May 2012, and in October of the same year Japan Post Service and Japan Post Network were merged to form Japan Post, trimming the group from five firms to four.

The amended law also expanded the range of universal service (essential public services that must be provided to everyone fairly, without interruption, and on an equal basis). Limited to postal services under the original Privatization Act, it was widened to include basic savings and insurance services provided via post offices. In effect, the new law requires post offices to provide financial services even in underpopulated and otherwise unprofitable areas.

Public offerings

The original Privatization Act expressly stated that all shares in Japan Post Bank (JPB) and Japan Post Insurance (JPI) were to be sold no later than end-September 2017. This condition was eased significantly under the revised act, which requires only that the shares be sold “as early as possible” while taking into account business conditions at the two firms and the impact on the provision of universal service.

The government is the sole shareholder in Japan Post Holdings (JPH) and is required by the Act on Special Measures for Funding Reconstruction Related to the Great East Japan Earthquake (referred to below as “the Reconstruction Funding Act”) to study ways of divesting its stake as soon as possible while taking into account business conditions and the need to redeem the earthquake reconstruction bonds. The revised Act does not change the fact that the government will continue to own more than one-third of the company’s shares.

The privatization process continues to be carried out as stipulated under the original Act, with the prime minister serving as head of the Cabinet’s Postal Privatization Promotion Headquarters and a Postal Privatization Committee responsible for implementing direct reviews of the process.

The Fiscal System Council’s National Property Committee held its 23rd meeting on April 14 in response to a question from the Minister of Finance and is scheduled to continue discussing how the government should divest its stake in JPH.

(2) Privatization schedule

Already completed

The following measures were carried out during a preparation period from April 2006, when the original Act went into effect, through September 2007:

1. Postal Privatization Promotion Headquarters and Postal Privatization Committee created
2. Postal services expanded to encompass international distribution
3. Holding company and management committee established
4. Postal savings and postal life insurance subsidiaries formed by Japan Post

Future plans

The deadline for divestiture of the government’s stake has been eliminated in the revised Act. However, the privatization process cannot be stopped unless

lawmakers move to reverse the process. We think the JPH IPO will come first, with the autumn 2015 date mentioned by JPH president Taizo Nishimuro the most likely timing. In any case, the situation remains fluid.

1. JPB and JPI to study easing restrictions on business scope, monetary amounts, and holdings in subsidiaries based on views of Postal Privatization Committee
2. JPH IPO, partial sale of shares held by government
3. JPB and JPI IPOs and sale of JPH's shares in both
4. Possible expansion of two financial units' businesses, depending on size of government's indirect holdings
5. Postal Privatization Promotion Headquarters and Postal Privatization Committee to be dissolved after divestiture of JPH's stakes in JPB and JPI
6. "Special measures" for JPB and JPI to be abolished as two firms start operating under Banking Act and Insurance Business Act

2. Key points

(1) Japan Post Holdings (JPH)

Role

The responsibilities of JPH include management of subsidiaries (strategy, risk management, internal controls, capital allocation, and so on), joint administrative management of group firms, and the operation of hospitals, lodging facilities, and so on. It has also been charged with the disposal of assets. Its most important duty in this regard involves holding IPOs for JPB and JPI and selling its shares in both.

Although the government owns 100% of the shares in JPH, it is required by law to make efforts to reduce its stake while continuing to hold more than one-third of the total shares.

Financial profile and workforce

JPH had consolidated assets totaling about ¥292.25trn at end-March 2014, with net assets equal to about ¥13.39trn on a consolidated basis. On a parent-only basis, JPH had total assets of ¥9.74trn, of which shares in subsidiaries—mostly JPB—accounted for more than ¥9.19trn. All of these figures use net asset values for the subsidiaries.

Consolidated NP was ¥526.7bn in FY3/13, ¥479.0bn in FY3/14, and is forecast at ¥330.0bn in FY3/15 (company guidance). The corresponding figures for JPH on a parent-only basis were ¥145.2bn, ¥155.0bn, and ¥127.0bn, respectively. The slide in profits is attributable mainly to a decline in interest income on bonds due to continued low interest rates.

At end-March 2013, JPH had 3,237 employees.

Key points

We see two points to watch in particular: 1) the timing and method of the sale of the government's stake and 2) the group's capital allocation policy, including dividends and the establishment of a fund for the provision of universal service.

(2) Japan Post Bank (JPB)

Role

Current businesses include taking deposits (both demand and term), foreign exchange services, the sale of financial products (investment trusts, JGBs, postal life insurance, and so on), and residential mortgage broking.

Deposits—including any existing postal savings balances—are limited to ¥10mn per person. This ceiling is likely to come under review as privatization proceeds.

For deposits made no later than September 2007, term savings accounts (including the "teigaku" products that can be withdrawn after six months) will continue to carry a government guarantee until they reach maturity or are canceled. Ordinary deposits and other savings deposits made after September 2007 are covered by Japan's deposit insurance program.

New initiatives include utilizing derivatives and a variety of risk management techniques to enable more flexible asset liability management (ALM), broadening the investment universe to include equity investments and participation in loan syndications, selling a wider range of financial products (including foreign currency deposits as well as investment trusts and insurance products not currently offered), and offering loans and credit cards to individuals and small businesses in something approaching a full-line banking model.

Financial profile, organization, and workforce

JPB had assets totaling about ¥202.51trn at the end of March 2014, of which marketable securities accounted for some ¥166.06trn. Liabilities came to about ¥191.05trn. Savings deposits responsible for some ¥176trn of that figure, including ¥26trn in postal savings deposits taken over by MOPSPLI and designated as special deposits. Assets totaled approximately ¥11.46trn.

Consolidated NP was ¥373.9bn in FY3/13, ¥354.6bn in FY3/14, and is forecast at ¥260.0bn in FY3/15 (company guidance).

As of end-March 2013, this arm of the company had, in addition to the head office, 234 directly managed branches, 49 regional centers (which serve as an interface with post offices), 14 administrative centers, and post offices themselves, which serve as bank agents.

As of end-March 2013, JPB had 12,922 employees.

Key points

We see three key points for JPB: 1) the timing and impact of the end of the deposit cap and the expansion of its business, 2) the possibility of working together with other financial institutions to expand its business, and 3) the adoption of ALM with more diversified investments.

(3) Japan Post Insurance (JPI)

Role

Products currently offered by JPI include endowment insurance, whole life insurance, term insurance, education endowment insurance, annuity insurance, accident riders, and hospitalization riders. Services are provided to customers via a network of directly managed branches and life insurance agency contracts signed

with post offices. The value insured is capped at ¥10mn per person, inclusive of existing policies.

Insurance policies written no later than September 2007 will continue to be guaranteed by the government, while policies written after that are covered by the Life Insurance Policyholders Protection Corporation of Japan.

Like JPB, JPI is currently considering developing an ALM system and new products for customers. With ALM, the firm is trying to employ a wider range of investment techniques, assets, and tools to secure investment returns in excess of the guaranteed return on insurance policies. In its new product offerings, the company seeks to provide a wider range of variable annuities and third-sector products such as medical and casualty insurance.

Financial profile, organization, and workforce

JPI had assets of about ¥87.09trn at end-March 2014, with marketable securities accounting for some ¥69.38trn of that figure. Net assets amounted to about ¥1.53trn.

Consolidated NP totaled ¥91.0bn in FY3/13, ¥63.4bn in FY3/14, and is forecast at ¥73.0bn in FY3/15 (company guidance). Core profit was ¥91.0bn in FY3/13 and ¥63.4bn in FY3/14. Investment losses have declined, but a deteriorating expense variance has depressed profits.

As of end-March 2013, the firm's organization consisted of a head office, 79 directly managed branches, five administrative centers, and a call center. It also maintains insurance agency contracts with post offices.

As of end-March 2013, JPI had 6,789 employees.

Key points

We see three key points for JPI: 1) the timing and impact of the end of the insured value cap and the expansion of its business, 2) the possibility of working together with other financial institutions to expand its business, and 3) the adoption of ALM incorporating more diversified investments.

(4) Japan Post

Role

Japan Post is responsible for both postal services and post office network operations. The former involves the universal service of delivering letters, postcards, and so on. The company is required by law to deliver third-class mail (newspapers, magazines, and so on) and fourth-class mail (correspondence course materials, Braille publications, etc.) at lower rates. It also has domestic freight operations similar to those of private freight haulers now that parcel delivery has been removed from postal services. Finally, it has taken over the international distribution operations of the erstwhile Japan Post.

Japan Post is charged with managing and administering the nationwide network of post offices and providing counter services at the same. Most of these services are provided on behalf of (or as an agent for) other Japan Post Group firms. Japan Post handles postal services and parcel counter services for the postal services unit; banking services (such as savings accounts and money transfers) and sales of JGBs and investment trusts for JPB; and sales of life insurance for JPI.

Financial profile, organization, and workforce

Japan Post had assets totaling some ¥4.80trn and net assets of about ¥560.9bn at end-March 2014.

Consolidated NP was ¥83.0bn in FY3/13, ¥32.9bn in FY3/14, and forecast at –¥26.0bn in FY3/15 (company guidance). Factors contributing to the decline in profits include shrinking volumes and rising costs in the postal services business.

At end-March 2013, the firm had a head office in the Japan Post building, 1,093 branch offices (including 13 main branches), and 2,560 delivery centers.

As of end-March 2013, Japan Post had 200,601 employees.

Key points

We see two key points for Japan Post: 1) the expansion of its domestic and overseas distribution and logistics operations and 2) the possibility of working together with outside companies.

(5) Management Organization for Postal Savings and Postal Life Insurance (MOPSPLI)

Role

Of the businesses inherited from the erstwhile Japan Post, MOPSPLI, an independent administrative agency, administers postal savings products and insurance policies still carrying a government guarantee and is charged with faithfully discharging these obligations.

Of these obligations, assets corresponding to postal savings have been entrusted to JPB for investment and designated as "special deposits," and the insurance policies have been reinsured with JPI.

Financial profile

MOPSPLI had assets totaling ¥44.85trn at end-March 2013, with just under ¥30trn of its liabilities consisting of government-guaranteed postal savings. Policy reserves corresponding to the reinsured insurance policies have declined to ¥45.9bn.

Figure 3. Key financial data for Japan Post Group (¥bn, end-FY3/14)

	Japan Post (Consolidated)	Japan Post Holdings	Japan Post	Japan Post Bank	Japan Post Insurance
Revenue	15,240.1	276.3	2,792.4	2,076.3	11,233.9
RP	1,103.6	147.8	52.5	565.0	463.5
NP	479.0	155.0	32.9	354.6	63.4
as a % of Group NP	100.0%	32.4%	6.9%	74.0%	13.2%
Total assets	292,246.4	9,740.1	4,801.7	202,512.8	87,088.6
Net assets	13,388.6	8,719.4	560.9	11,464.5	1,534.4
as a % of Group NP	100.0%	65.1%	4.2%	85.6%	11.5%

Source: Company data, Citi Research.

Key financial indicators for group firms over the last five years are shown in Figures 4–6.

Figure 4. Net profit at Japan Post Group firms (¥bn)

	3/10	3/11	3/12	3/13	3/14
Japan Post (consolidated)	450.2	418.9	468.9	562.8	479.0
Japan Post Holdings	145.4	153.6	151.4	145.2	155.0
Japan Post	-	-	-	83.0	32.9
o/w mail service	-47.5	-35.4	-4.5	31.1	-
o/w post office	33.0	30.7	18.8	28.9	-
Japan Post Bank	296.8	316.3	334.9	373.9	354.6
Japan Post Insurance	70.1	77.3	67.7	91.0	63.4

Source: Company data, Citi Research.

Figure 5. Key financial indicators for JPB (¥bn)

	3/10	3/11	3/12	3/13	3/14
Gross profits	1,710.4	1,718.9	1,670.0	1,624.3	1,568.7
o/w net interest income	1,621.3	1,686.5	1,677.3	1,532.2	1,470.3
Expense	1,221.3	1,210.2	1,173.9	1,110.8	1,096.0
(OHR)	71.4%	70.4%	70.3%	68.4%	69.9%
Net business profits	489.2	508.8	496.1	513.6	472.7
Deposits	175,797.7	174,653.2	175,635.4	176,096.1	176,612.8
o/w special	61,413.3	45,095.2	35,139.2	29,958.7	26,021.9
Securities	178,230.7	175,026.4	175,953.3	171,596.6	166,057.9
o/w JGBs	155,891.6	146,461.0	144,939.8	138,198.7	126,391.1
Tier I ratio	91.6%	74.8%	68.4%	66.0%	56.8%

Source: Company data, Citi Research.

Figure 6. Key financial indicators for JPI (¥bn)

	3/10	3/11	3/12	3/13	3/14
Core profits	427.1	484.5	571.6	570.0	482.1
o/w interest margin	-236.2	-139.3	-61.5	-4.7	54.2
Policies outstanding	127,899.1	120,585.2	113,307.4	107,101.3	101,789.1
Securities	80,341.5	77,173.1	74,587.2	72,558.2	69,379.0
o/w JGBs	67,617.6	64,103.0	59,962.2	56,472.6	52,522.9
Solvency margin	1,664%	1,154%	1,336%	1,468%	1,623%

Source: Company data, Citi Research.

3. IPOs and divestiture of government stake

(1) IPO procedure

Ultimately IPOs will be held for JPH and its two financial units, JPB and JPI. We envision three possible scenarios for listing and treatment of the shares outlined below.

(i) JPH IPO comes first, followed by JPB and JPI

This approach would have the smallest market impact of the three options, but it is difficult to forecast the market's reaction given the uncertain timing, size, and method of the JPB and JPI IPOs. There is also the risk that after selling all its shares in the two financial units, JPH would be viewed as a shell with only the postal services business and post office sales channel remaining. That could potentially discourage long-term investors from investing either in it or in JPB and JPI.

(ii) Simultaneous IPOs for JPH and either JPB or JPI, followed later by the other

This is probably the most realistic option since it would have less impact on the market than simultaneous IPOs for all three firms. However, the problems noted above would still exist to some extent.

(iii) Simultaneous IPOs for all three firms

This approach would probably have the greatest market impact of the three, although it would depend on the scale of the government's divestiture. However, it offers reduced uncertainty regarding the method and timing of the divestiture and also provides investors with three choices. It would also be relatively straightforward for investors to estimate the value of all three companies as the solution to a simultaneous equation.

(2) Divestiture of government's stake

There are two issues regarding the divestiture of the government's stake. One concerns how the proceeds will be transferred to the national treasury, one of the principal reasons for moving ahead with privatization. The other involves business expansion, which will play a role in determining the shares' value.

Government absorption of IPO proceeds

The proceeds from the offering shares in JPB and JPI will go to JPH, and any proceeds from the offering of shares in JPH itself will go to the government.

The question is how the proceeds from the sale of the government's stake in JPB and JPI—both of which are expected to have a large market value—should be transferred to the national treasury. The simplest method would be to use the IPO proceeds to fund a buyback of JPH shares held by the government, thereby diluting the government's stake in the holding company. Another method would be for the government to absorb the proceeds in the form of a special dividend.

A buyback would make it possible to trim the government's share gradually and in line with the sale of shares in JPB and JPI. While this option would probably prompt investors to buy shares in JPH in anticipation of the buyback, there is also the risk that the government could be forced to dispose of its stake at a low price if JPH shares are bid down to reflect the post-divestiture state of the company.

The advantage of a special dividend is that the proceeds for the government would be largely unaffected by JPH's share price, as noted above. To efficiently maximize the revenue received by the national treasury, the size of the stake sold by the government at the IPO should be minimized, and appropriate legal and accounting procedures (e.g., a capital reduction) should be followed. However, we think investors might bid the shares of JPH higher in anticipation of a special dividend.

Business expansion and market impact

Constraints may remain on business expansion depending on the extent of the divestiture. Although selling smaller stakes in JPB and JPI at the IPOs would have less impact on the market, we think the two financial units' operations would remain under heavy constraints unless JPH's stake is cut to less than 50%.

As such, we think JPH needs to dispose of at least 50% of its shares in the two firms in order for them to be able to present a credible outlook for growth with a relatively concrete timeline.

Figure 7. Pros and cons of three divestiture methods

	Listing of holding company, followed by others	Listing of holding company plus one, followed by the other	Simultaneous listing of three entities
Market impact	◎	○	△
Expansion of business scope	△	○	◎
Transparency	△	○	◎
Ease of estimating share value	△	△	○

Note: ◎ = Most positive, ○= Relatively positive, △= Mixed
Source: Citi Research.

Chapter 2. Privatization process

1. Overview of medium-term business plan

(1) Positioning

Plan announced amid uncertainty…

JPH released a medium-term business plan for Japan Post Group on February 26, 2014. The business strategy presentation was largely qualitative in nature since the timing and method of the group's IPOs have yet to be decided and uncertainty surrounds the prospects for business expansion.

A key element of the plan involves the creation of a new postal network, with an emphasis on an organic fusion of the post office network, the bank, and the insurance company. The company envisions itself providing support for "general lifestyle needs." The business plan has three main objectives: bolstering the profitability and operating platforms of the three main businesses, discharging the obligation to provide universal service, and enhancing group value with an eye to an eventual IPO.

The basic approach involves a reaffirmation of the group's commitment to stable profits, local community needs, and the public interest. Although the plan leaves the impression the organization is focused on strengthening infrastructure and operating platforms and increasing business value with an eye to an eventual IPO, it emphasizes that it is too early to discuss specific measures in depth.

And may be revamped

The business plan covers the period from FY3/15 to FY3/17. Given the likelihood that one or more group firms will hold their IPOs during this period, the underlying circumstances may change greatly. We therefore think the plan may be replaced with something more specific before it expires.

(2) Core elements

Overview of the environment

External environment

In compiling the plan, JPH divided the environment into external and internal factors. Aspects of the external environment being monitored include standard factors such as demographics, (low) interest rates, and technological innovation as well as changes in the legal requirements for a share offering and divestiture under the revised Postal Service Privatization Act and the Reconstruction Funding Act.

Internal environment

On the subject of the internal environment, the company reaffirmed both the strengths it seeks to leverage and the issues it faces. The group's strengths as seen by JPH are the size, nationwide networks, and strong brands of its three main businesses: postal services, savings, and insurance. Problems cited include shrinking mail volumes in the internet era, a decline in outstanding savings as term products mature, and a fall in the number of insurance policies in force.

Figure 8. Summary of Japan Post Group's medium-term business plan

Medium-term Group Strategy (Three Pillars)

Enhancement of Three Main Businesses and Reinforcement of Managerial Base

"Total Life Support Company" – Utilizing the Post Office Network

	Stability of Profitability	Diversification/Enhancement of Profits
Mail /Transportation	➢ Sustaining mail/postal profitability ➢ Product development for mail-order businesses ➢ Structural reinforcement of sales force	➢ Enhanced service functions supporting the customer marketing ➢ Expansion and enhancement of logistics businesses and financial services ➢ Entry to international e-commerce
Bank	➢ Sustaining deposit base ➢ Enhancing fee revenue capability ➢ Upgrading sales capability	➢ Diversification of investment under resilient risk management ➢ Expansion of corporate customer base
Agency for Financial Services	➢ Revitalizing business resources ➢ Expansion of network dealing with allied products	➢ Expansion of product lines
Sales	➢ Expansion of product lines ➢ More use of e-channels	➢ Enhancing publicity
Real Estate	➢ Leasing and sales businesses ➢ Redevelopment of properties	➢ Efficient usage of properties

	Reinforcement of managerial base	Profit enhancement
Life Insurance	➢ Enhancement of service quality via strengthening underwriting, payment, processing system ➢ Reinforcement of IT governance ➢ Advanced risk management	➢ Strengthening business promotion capability for 20,000 sales force ➢ Strengthening business capability at JP Insurance branches

Pursuit for USO (Universal Service Obligation)

Co-prosperity of Local Society and JP Group - Utilizing the Post Office Network

Fulfillment of USO for postal services and financial services

Locally committed services via JP Brand

Collaboration with local authorities
- ➢ Issuance of public certificate and sales of public transportation tickets
- ➢ Supporting services for elderly people
- ➢ Security support for children
- ➢ Collaboration with local society for revitalizing the local regions

Providing services linked to local communities
- ➢ Taking care of elderly people via "monitoring" services
- ➢ Extending shopping support services with tie-up with local stores
- ➢ Use as channels for sales of local products using catalogs

Promotion of CSR
- ➢ Supply of information in case of natural disasters (i.e. use of FM)
- ➢ Ecology by use of electric cars

Enhancement of Corporate Value for Future Listing

Organic Combination of Post Office Network with Two Financial Arms

Revitalization of Management
- ➢ Accelerated decision-making
- ➢ Reform of HR management
- ➢ Streamlining of processing via IT

Solid Infrastructure for CoB
- ➢ Enhancement of processing efficiency and reinforcement of infrastructure via renovation/ replacement

Enhanced Governance
- ➢ Reinforcement of compliance and risk control
- ➢ Transparent disclosure
- ➢ Enhancement of financial reporting system

New Services through Collaboration
- ➢ Collaborated business promotion of JP/JP Bank/JP Insurance
- ➢ Leveraged revenue sources through new businesses

Alliance to Take Advantage of JP Network
- ➢ Distribution of allied products through post offices
- ➢ Exploring new alliance fields

Investment for Future Growth
- ➢ Capital investments for CoB

Note: This figure is Citi's translation of Japan Post's business plan.
Source: Compiled by Citi Research based on company data.

Group business plan

Business plan: from vision to realization

JPH sees the three years of the plan as a time for establishing a solid operating platform centering on the Japan Post network. The period from 2017 onward, meanwhile, is viewed as a time for growth and development. In short, the plan is intended to lay the groundwork for future growth.

The three main objectives noted below are intended to reinforce Japan Post's three main businesses while leveraging the post office network noted as one of the firm's strengths in its overview of the environment. By achieving the three objectives, the firm hopes to achieve a successful transition to the next phase.

Three main objectives

Strengthening three main businesses' profitability and operating platforms

The first objective is to establish a corporate group that supports customers' "general lifestyle needs." It will do this by delivering products and services tailored to customers' stage in life via the post office network while leveraging the three main businesses: postal services and distribution, banking, and life insurance.

Individual measures planned for the three main businesses will be discussed below, but they share three common goals: achieving stable profits, diversifying revenue sources, and strengthening operating platforms. The firm also seeks to stabilize earnings and diversify revenue sources for product sales, real estate, and contracted financial services after the three main businesses, perhaps with an eye on a future sale of JPH's stake in JPB and JPI.

Fulfilling the universal service obligation

Under the original Postal Service Privatization Act, Japan Post's only universal service obligation (USO)—a public service that must be provided on an equal basis nationwide—was postal services. The revised Act, however, adds the financial products of postal savings and postal life insurance to this mandate.

As such, the business plan's second main objective is to provide services tailored to local community needs. Specific measures proposed include working with local governments to provide public services—such as the issuance of official documents or services for the elderly—in lieu of local authorities, developing services tailored to local communities (e.g., working with supermarkets to make it easier for the elderly or disabled to do their shopping), and engaging in CSR activities such as providing assistance to victims of natural disasters.

Enhancing group value with eye to eventual IPO

The third objective focuses on market discipline with an eye to an eventual IPO. Basically, it involves enhancing corporate governance and deploying a strategy for increasing business value under that governance.

"Management innovations" related to corporate governance and business infrastructure include HR reforms and training, IT-driven technological innovation, and an acceleration of the decision-making process. Other goals include creating an environment conducive to business continuity and strengthening internal controls and corporate governance.

As a condition for building a business infrastructure, three measures for enhancing business value have been presented: the deployment of new services tapping the group's collective strengths, the promotion of a tie-up strategy utilizing the post office network, and investment aimed at promoting group growth. Boosting revenues will require a larger line of financial products and an expanded network for selling these products. The plan also mentions the more effective utilization of post office space and, more generally, the efficient use of outlets already launched by the private sector.

Infrastructure-related measures

Investment plans

The business plan contains a three-year, ¥1.3trn investment plan that earmarks ¥550bn for facilities, ¥490bn for systems, ¥100bn for real estate development, and ¥160bn for network upgrades.

The plan calls for increasing investment from a typical figure of around ¥160bn a year at present to about ¥430bn a year. Intended as a long-term investment to enhance future earnings stability, the investment plan aims to achieve greater efficiency and sustainability.

Systems development

The primary goal of the planned IT investment is to develop a more sophisticated Postal advanced NETwork system (PNET). This system has been used to connect post offices with the core systems for the group's various businesses, but the plan is to utilize next-generation information terminals to leverage customer information collected by group firms.

Another goal of the plan is to consolidate datacenters and other distributed resources in an attempt to boost efficiency. By centralizing and consolidating data, the group hopes to create a system that helps managers to ascertain relevant information more quickly and accurately.

Real estate operations

Effective utilization of existing properties represents the core of Japan Post's real estate operations. The group plans to revive properties that have effectively fallen into disuse by reorganizing branch networks, consolidating welfare facilities, and developing them into commercial properties (office buildings, commercial facilities, hotels, etc.), residential developments for sale and rent, and parking facilities to boost earnings.

Many of Japan Post's properties, such as the JP Tower in Marunouchi, have prime locations and high market values, and the group is studying ways of monetizing such resources.

HR development

The basic goal of HR development is to help employees develop skills tailored to the needs of the group's businesses. To this end, the group has laid out four main objectives: training people who have 1) the ability to carry out their expected roles, 2) strong marketing skills, 3) specialized expertise, and 4) broad perspectives.

Specific measures include training programs tailored to individual career paths, the use of selective training to bring up leaders within the organization, the hiring and

training of people with specialized expertise, and the broadening of perspectives via personnel exchanges both within the group and with outside organizations.

Key measures by business

Postal services and distribution

The postal services business faces a number of headwinds, including the spread of the internet and corporate efforts to cut communications costs, with the volume of mail delivered falling 28% in the 11 years to FY3/13. On the other hand, the volume of small parcels ("Yu-Pack") has increased as a result of growth in mail-order and online sales.

There are three key goals for the postal services and distribution business: making it more convenient to send and receive mail and parcels, expanding the "Yu-Mail" delivery service for small parcels under 3kg, and expanding distribution services. These will include making it easier for people to receive mail and parcels at convenience stores and post offices and contracting with chain stores to enable sending them from a wider range of locations. The group will also seek to expand the range of financial services on offer, including payment services for mail-order and online businesses.

Numerical targets include increasing Yu-Pack volume from 382mn parcels in FY3/13 to 500mn in FY3/17 and Yu-Mail volume from 3,101mn units in FY3/13 to 4,000mn in FY3/17, thereby lifting NP to ¥28bn in FY3/17.

Banking

The operating environment for the banking business is characterized by a mixture of expectation and concern. Although low interest rates have depressed interest income, there are also some positive developments, including an ongoing shift from savings to investment. Additionally, Japan Post Bank reported that a long-term decline in savings balances had finally reversed in FY3/12.

There are three key goals for the group's banking business: offering service better tailored to customer needs, improving the overall quality of sales and marketing, and broadening the customer base with corporate marketing efforts. Specific measures include offering a wider range of financial products as they are approved, training employees to sell these products, and adopting a globally diversified investment strategy to bolster profitability.

Numerical targets include having ¥183.8trn in savings balances by end-FY3/17 (up ¥6trn from end-FY3/14) and generating ¥220bn in NP by FY3/17.

Life insurance

With birthrates declining and society aging, customer needs are shifting from traditional death benefit insurance to living benefit products. JPI has also expanded the range of its product offerings and has won approval for a new type of educational endowment insurance.

Key goals in the life insurance business include providing products tailored to customer needs, bolstering marketing in the post office channel, and enhancing marketing in the directly managed postal life insurance channel by offering products from affiliated companies. Specific measures include tapping the market of younger consumers by offering a new type of educational endowment insurance for parents saving for their children's education, conducting a sales drive with a group of 20,000

post office liaison officers, and achieving more sophisticated risk management with an enterprise risk management (ERM) system.

Numerical targets for FY3/17 include writing new business with monthly premium revenues of ¥50bn (compared with ¥42.7bn in FY3/14), generating NP of ¥80bn, and recording a return on enterprise value (RoEV) of 8% (based on current assumptions).

Numerical targets

Goals and numerical targets for each business are as indicated above (see table below for a summary). We think the group's profit forecasts are so conservative because of the aggressive investment planned and the need to make conservative assumptions regarding business expansion.

Figure 9. Japan Post Group numerical targets (¥bn)

	FY12 Results	FY16 Target	Change
Consolidated NP	562.8	350.0	-37.8%
Japan Post NP	83.0	28.0	-66.3%
Japan Post Bank NP	373.9	220.0	-41.2%
Japan Post Insurance NP	91.0	80.0	-12.1%
<Other targets>			
Mail/transportation revenue	1,754.4	1,860.0	6.0%
Post office revenue	1,187.9	1,210.0	1.9%
Deposits	176,096.1	+6mn in three years	3.4%
Annualized insurance Premium for new contracts	654.4	520.0	-20.5%
Insurance RoEV	NA	8%	NA

Source: Company data, Citi Research.

2. Assessment of Japan Post's business plan

Business goals and associated measures

Compared with similar business plans released by private financial institutions, the Japan Post Group document lacks specifics and does not provide a full range of targets. However, we think the lack of specificity is to some extent unavoidable inasmuch as group companies have yet to list their shares and it is difficult to come up with a concrete outlook for business expansion until they do. The budget constraint created by the need to provide universal service results in a discount relative to typical listed firms, and this can be confirmed in the business plan's second objective.

Taking into consideration the hints contained in the plan, we think it represents an attempt to maximize utility given a budget constraint line. Specific constraints are listed below:

Budget constraints

1. Universal service → Limited scope for improving efficiency by consolidating inefficient branches

2. Constraints on business expansion → Uncertainty surrounding timing and scope of business expansion due to wait for official approval (personal loans) prevents inclusion in business plan

3. Investment in safe assets → Savings covered by a government guarantee (and transferred to MOPSPLI) can only be invested in JGBs or other safe assets

4. Complete divestiture of shares in subsidiaries → Conflicts of interest may emerge among three listed firms since premise is that all shares in JPB and JPI will be sold (e.g., it might make sense for JPH to open up post office network to companies other than JPB and JPI)

Maximizing utility

1. Fully utilizing network → Taking advantage of inability to squeeze further efficiencies from the network, group intends to develop more sophisticated strategy for supplying enhanced range of services nationwide

2. Ensuring business plan flexibility → Plan will be divided into "foundation" phase (2014–2016) for establishing necessary structures and growth phase (2017 onward), with flexibility ensured by leaving room for transition after questions regarding business expansion, etc., have been answered (i.e., business plan may be revised)

3. Ensuring cooperation between businesses → Investment aimed at promoting closer ties between group businesses (e.g., PNET) and focus on cross-selling should make it possible to minimize uncertainty by leaving few openings for rivals even after shares in JPB and JPI have been fully divested.

4. Expanding efficient frontier → Despite need for minimal allocation to safe assets, company plans investment system that will allow enhancement of returns with global diversification and reorganization of other portfolio elements

Numerical targets

The plan contains key numerical targets, including NP, for each business, as well as a number of targets specific to certain businesses, such as growth in savings balances at JPB. However, it is difficult to assess these targets since the document only contains targets for the final fiscal year and does not provide any hints on how they will be achieved.

For instance, JPB reported NP in excess of ¥370bn in FY3/13, but the plan calls for NP of just ¥220bn in FY3/17. We suspect the decline is attributable to increased investment to bolster infrastructure and to an anticipated fall in interest income due to low long-term interest rates, but the plan's lack of detail precludes a careful analysis.

It also seems odd that while there are no comprehensive targets for profitability, the plan *does* include fairly detailed investment plans.

Investments should be evaluated objectively based on whether they are aligned with shareholder interests. After all, that is one of the primary objectives of introducing market discipline via an IPO. Time may sometimes be ignored (i.e., time value is omitted) when it is determined that making a given investment makes more economic sense than not making it. When an IPO is anticipated, however, it is preferable to estimate a discount rate using the cost of equity capital—shareholders' required return—and to evaluate the project based on present value, as one would if the investment were being made by an ordinary firm.

Although Japan Post Group has yet to list its shares, its investment plans may reflect estimates made based on this assumption. However, it is difficult for us to offer any insight based on the limited information provided in the plan.

Business model and stock characteristics

We think the business strategy being pursued by Japan Post Group is less one of assuming risk to achieve growth than one focusing first and foremost on stability. As such, we envision the shares falling into the category of those promising a stable, attractively high dividend yield.

One reason is the danger that the group will be seen as a Catch 22 proposition, since the timing and scope of business expansion will rely heavily on how and when the government's stake is divested, but the "story" needed to sell the shares will be contingent on the outlook for business expansion. We think a good case for the shares might be made by showing how profits will rise to a certain level and stabilize there based on an extension of current businesses via enhanced HR development and closer group cooperation.

A second reason is that even if an expansion of the group's business is approved, it will take a long time for earnings to benefit substantially, and it is difficult to come to an objective conclusion regarding the likely outcome.

A third reason is the thickness of the group's capital cushion. It currently has a very high capital ratio because the JGBs that constitute the lion's share of its assets carry a risk weight of zero. Accordingly, we think setting a high dividend payout ratio would not create any particular problems in terms of capital management.

3. Lessons from past privatization examples

Japan Tobacco (JT)

JT saw major competitive threats following privatization

JT was formed in April 1985 when the Japan Tobacco & Salt Public Corporation was privatized. The firm's domestic cigarette operations faced substantial competitive threats post-privatization. Imports of cigarettes were liberalized in 1985, and in 1987 Japan became one of the few countries to eliminate import duties on cigarettes. That decision made it possible for overseas cigarette manufacturers to distribute and sell their products within Japan under the same conditions as JT, prompting a sharp decline in the latter's market share.

From 1985 JT entered a variety of new businesses including agriculture, real estate, beverages, engineering, and pharmaceuticals. Unfortunately, most of these operations were heavily reliant on partner firms.

JT listed its shares in October 1994, but its share of the domestic market had fallen to 82.1% in FY3/94, down 15.5ppt from FY3/86. The difficulties faced by the firm at the time are highlighted by the decisions to delay an IPO in the summer of 1992 and again at the end of 1993 because of poor stock market performance, large quantities of forfeited shares, and a steep post-IPO decline in the shares' value.

Sense of urgency fueled restructuring and M&A activity

The turning point for the firm came with the acquisition of tobacco maker R.J. Reynolds International (RJRI) in 1999 and the overhaul of its domestic tobacco business stretching from FY3/04 to FY3/06. The purchase of RJRI was at the time the largest-ever acquisition by a Japanese company, with the investment totaling

$7.79bn (c¥940bn). The restructuring of domestic operations involved eliminating 40% of employees at the parent firm and shutting down 60% of factories as a licensing contract for Marlboro expired. EBITDA rose for eight consecutive years through FY3/09 on domestic cost-cutting efforts and profit growth in the firm's overseas tobacco operations.

JT proceeded to buy British tobacco firm Gallaher in 2007. The total purchase price, including net interest-bearing debt, was £9.4bn (c¥2.25trn). This acquisition made JT the world's third-largest private-sector tobacco company.

Reorganizations and M&A activity are hallmarks of the tobacco industry. As marketing restrictions make it extremely difficult to develop new brands, there are only two ways to expand market share: increase sales of existing brands or acquire other companies' brands.

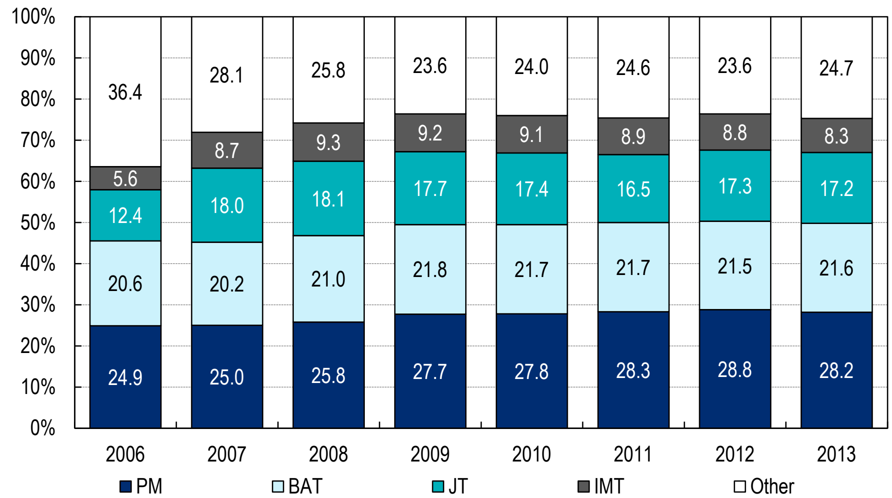
Whether a company owns a leading brand determines whether it acquires other firms or is acquired by them. Companies without a leading brand tend to experience a steady loss of sales share. In particular, the ownership of a leading global brand tends to characterize the winners.

JT was in a relatively weak competitive position prior to the acquisition of RJRI. Its leading brand, Mild Seven, had a large presence in Japan and Taiwan but was little known elsewhere. With its purchases of RJRI and Gallaher, JT acquired both leading global brands and a solid regional portfolio, and it is now one of the winners in the global tobacco industry. In retrospect, privatization gave a strong boost to the firm's globalization.

The tobacco industry has traditionally been characterized by global competition, to the extent that some state-owned firms have experienced a sharp drop in market share after privatization and in some cases have been acquired by global rivals. JT faced the additional handicaps of an end to import duties and the obligation to continue buying expensive domestic tobacco leaf. The result was a strong sense of urgency among the firm's managers that led them to choose the course of action they did.

Naturally, the firm's strong earnings today would not exist without its manufacturing expertise, technology, and management skills. Privatization, however, created a strong sense of urgency and brought out the firm's latent potential.

Figure 10. Global cigarette market share



Note: Excludes China, the US, and duty-free markets.
Source: Company data, Citi Research.

Privatization worked at JT

JT's shares were originally listed at ¥1,438,000 in October 1994. In April 2006 the firm conducted a five-for-one stock split, followed by a 200-for-1 split in July 2012, so that the original listing price was ¥1,438 adjusted for splits. Since March 2013, the shares traded above ¥3,000, which is higher than the price at all four government share offerings. As an economic policy, therefore, we believe privatization worked.

Japan Railways

Issues confronting spin-offs provided incentive

Problems faced by the erstwhile Japan National Railways (JNR) included labor issues, high debt, and unprofitable local rail networks. Privatization was possible because it enabled the creation of a framework for resolving these issues and also because JNR management recognized the need for reforms.

In the privatization process, JNR's freight operations, which were suffering from falling demand and shrinking earnings, were spun off from the company. Staff levels were also cut, and ¥22.6trn of ¥37.1trn in debt—along with the firm's assets—were transferred to the JNR Accounts Settlement Corp. (most of which was funded by taxpayers, with the final bill exceeding initial estimates). Criteria were also established for decisions on whether to continue operating local lines. In short, the issues noted above were not resolved solely by the efforts of JR's management after privatization, but also required the creation of forward-looking frameworks, efforts by management in the lead-up to privatization, and financial support from taxpayers.

After privatization, East Japan Railway Company (JR East) faced labor issues, but in return was given the Tokyo area, which offered the greatest business potential of any area in Japan. Central Japan Railway Company (JR Central) carried heavy debt but was assigned the Tokyo–Osaka shinkansen route, which generated the most cash flow of any route in the country. West Japan Railway Company (JR West) faced the high cost of supporting unprofitable local lines, but shouldered the

least debt. In short, each firm was incentivized by being forced to address a specific issue, and each responded with a variety of initiatives.

The resulting improvements in services and efficiency strengthened their financial positions dramatically. There were also major benefits for users, including wide-ranging improvements to train services, a reduction in the number of accidents due to heavy investments in safety, and far fewer fare increases, in sharp contrast to the latter days of JNR. The companies were also freed up to move into peripheral businesses such as distribution, hotels, and travel, something they would not have been able to do in the JNR era, and these operations have now become an important source of revenue alongside rail operations. When JNR was split up and privatized, there were doubts about when an IPO of JR West shares might be possible, but the firm has subsequently succeeded in increasing market share and raising asset efficiency. JR Central, which was initially feared to be carrying too much debt, has accelerated its debt reductions. By forcing each firm to address a specific issue, it proved possible to achieve the promised gains in service quality and efficiency.

Successful privatization requires framework that promptly addresses problems

The three JR firms are a successful example of privatization because 1) both profits and cash flows have grown, 2) shareholder value was not severely impaired by post-IPO changes to the framework, and 3) as a result, the shares of all three companies are now trading above their original listing prices.

Factors contributing to the successful privatization of JNR and the development of JR group companies into firms with attractive growth potential from an equity investor's perspective included the post-privatization application of market principles, management efforts, and the creation of a forward-looking framework to deal promptly with the issues at hand. Success requires that 1) the assumptions behind the framework remain valid and 2) productivity can be boosted via management efforts.

Lessons from past privatizations

What implications do these examples have for Japan Post?

In the case of JT, privatization enabled a company lacking global competitiveness and domestic diversification to carry out bold acquisitions and restructuring and create value added that it could not have created as a publicly owned business.

At JR, labor and debt problems were resolved with a combination of management efforts and taxpayer support, and privatization was a success inasmuch as both profits and cash flows are up.

One thing common to these successful examples was the dramatic shift in awareness among both management and staff. We do not think privatization would have succeeded without bold changes in management's stance and the corporate culture. The results of these changes included overseas M&A deals, the restructuring of domestic operations, and a willingness to pursue innovation that was fostered in the process of resolving labor and financial issues.

Chapter 3. Postal privatization and the banking, insurance, and transport industries

1. Banking industry

Overview of Japan Post Bank

Scope of operations and comparison with other banks

Low profitability despite large size

At December 31, 2013, Japan Post Bank (JPB) had total assets of over ¥203trn and deposits totaling more than ¥177trn. Its total assets are less than Mitsubishi UFJ Financial Group's total consolidated assets of ¥258trn. Its deposits, however, exceed MUFG's consolidated deposits of ¥158trn, making JPB Japan's largest depository institution.

JPB's profitability is low relative to its total assets. In FY3/13 JPB earned a NP of ¥373.9bn, well below the three megabanks' average FY3/13 NP of ¥735.7bn. Factors behind JPB's low profitability include restrictions on the scope of its operations and legal requirements that mandate investment in safe assets. As a result, JPB's FY3/13 RoA was only 0.19% while the three megabanks' FY3/13 RoA averaged 0.37%.

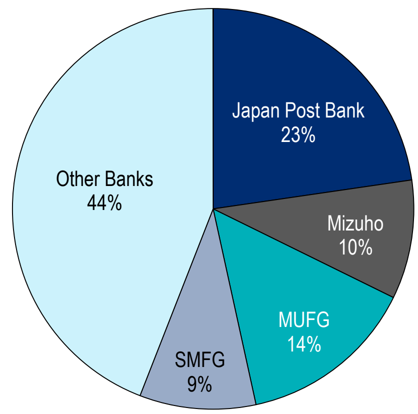
Figure 11. JPB versus private-sector banks (FY3/13, ¥bn)

	JPB	Mizuho	MUFG	SMFG	Resona	SMTH	Shinsei	Aozora	Total	All-bank Total
Total assets	199,840.7	177,411.1	234,498.7	148,696.8	43,110.6	37,704.0	9,029.3	5,016.7	855,307.9	942,006.3
Deposits	176,096.1	99,568.7	146,552.1	100,837.5	36,686.3	27,127.4	5,457.5	3,039.0	595,364.7	868,072.1
(of which special deposits)	29,958.7									
Shareholders' equity	9,237.1	5,174.6	10,578.4	5,680.6	1,803.4	1,711.6	626.4	529.8	35,341.9	41,154.1
Securities	171,596.6	53,472.4	79,526.9	41,306.7	10,181.6	6,346.0	1,842.3	1,305.8	365,578.3	276,885.3
NP	373.9	560.5	852.6	794.1	275.1	133.8	51.1	40.6	3,081.7	3,349.3
RoE	4.05%	10.83%	8.06%	13.98%	15.26%	7.82%	8.15%	7.66%	8.72%	8.14%
RoA	0.19%	0.32%	0.36%	0.53%	0.64%	0.35%	0.57%	0.81%	0.36%	0.36%
Branches	234	523	768	521	378	122	29	20	2,595	12,294
o/w domestic	234	501	731	505	378	118	29	20	2,516	12,199
(Post offices)	23,981	NA	NA	NA	NA	NA	NA	NA	NA	NA
Employee headcount	12,922	27,903	37,488	24,212	12,800	10,343	1,931	1,549	129,148	307,967

Note: Deposits include overseas deposits. Numbers of branches and employee headcount are parent-only figures.
Source: Company data, Citi Research.

JPB accounts for 20% of Japanese banks' aggregate deposits. If counted as a major bank, JPB would account for a hefty 35.5% of the major banks' aggregate deposits.

Figure 12. Share of domestic deposits: JPB versus other major banks (as of March 31, 2013)



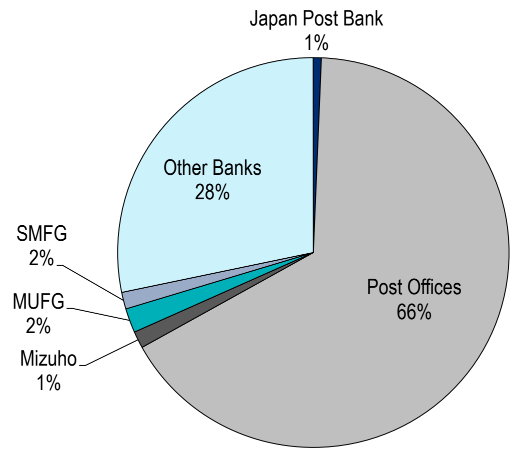
Source: Company data, Citi Research.

By far the most extensive branch network

With 234 directly managed branches and some 24,000 post offices serving as agencies, JPB has by far the most extensive branch network of any Japanese bank.

Because JPB has relatively few directly managed branches, its workforce, at 12,000, is smaller than those of the megabanks and ranks on a par with that of the Resona Group.

Figure 13. Share of domestic bank branches: JPB versus other major banks



Source: Company data, Citi Research.

JPB's financial profile

Figure 14 compares JPB with major banks and leading regional banks in terms of key financial indicators. JPB is distinguished by the following characteristics:

Dependence on securities investment

The vast majority of JPB's total assets are invested in marketable securities—chiefly bonds—due to restrictions on the scope of its operations and legal requirements mandating investment in safe assets.

Low profitability

JPB's RoA is low, largely reflecting its large holdings of safe assets. In addition to low returns on earning assets, JPB has a high overhead ratio, partly due to costs incurred in utilizing the post office network. Additionally, its share of earnings derived from fees and commissions is low even though it is permitted to sell investment trusts and insurance products.

Divergence between simple leverage and risk-based leverage

JPB has a low leverage ratio (shareholders equity ÷ total assets), meaning that it is highly leveraged on a non-risk-adjusted basis. Meanwhile, its Tier 1 ratio, an inverse measure of risk-based leverage, is high. Although JPB's deposit-gathering power results in a large balance sheet, its risk-based leverage is low because it assumes almost no credit risk.

Figure 14. Key financial indicators: JPB versus other major banks (FY3/14, ¥bn)

	Japan Post Bank	Mizuho	MUFG	SMFG	Resona	Chiba	Yokohama	Average
Total assets	202,512.9	175,822.9	258,131.9	161,534.4	44,719.4	12,023.6	13,832.1	124,082.5
Loans	3,076.3	69,301.4	101,938.9	68,227.7	26,701.7	8,061.7	9,453.6	40,965.9
Securities	166,057.9	43,997.5	74,515.6	27,152.8	8,698.5	2,180.2	2,044.7	46,378.2
Deposits	176,612.8	101,811.3	160,308.5	108,045.5	37,695.8	10,495.8	11,878.8	86,692.6
Shareholders' equity	9,498.3	5,676.2	11,346.3	6,401.2	1,543.7	687.3	781.2	5,133.5
Gross profits	1,568.7	2,035.3	3,753.5	2,898.2	608.5	162.6	224.0	1,607.3
o/w NII	1,470.3	1,108.3	1,878.6	1,484.2	430.0	126.5	159.3	951.0
Expense	1,096.0	1,258.2	2,289.4	1,569.9	348.5	88.8	110.3	965.9
PPOP	472.7	777.1	1,464.1	1,328.3	260.0	73.8	113.8	641.4
NP	354.7	688.4	984.8	835.4	220.6	46.4	60.7	455.9
Loans/TA	1.52%	39.42%	39.49%	42.24%	59.71%	67.05%	68.35%	33.02%
Securities/TA	82.00%	25.02%	28.87%	16.81%	19.45%	18.13%	14.78%	37.38%
LDR	1.74%	68.07%	63.59%	63.15%	70.83%	76.81%	79.58%	47.25%
Leverage	4.69%	3.23%	4.40%	3.96%	3.45%	5.72%	5.65%	4.14%
Tier I	56.81%	11.35%	12.46%	12.19%	9.38%	12.85%	12.29%	18.2%
OHR	69.87%	61.82%	60.99%	54.17%	57.27%	54.61%	49.21%	60.09%
PPOP RoA	0.23%	0.44%	0.57%	0.82%	0.58%	0.61%	0.82%	0.52%
RoA	0.18%	0.39%	0.38%	0.52%	0.49%	0.39%	0.44%	0.37%
RoE	3.73%	12.13%	8.68%	13.05%	14.29%	6.76%	7.77%	8.88%

Source: Company data, Citi Research.

Outlook for postal banking business

Existing operations

Depository services

One of the biggest constraints imposed on JPB is the deposit cap. Postal privatization legislation imposed a ceiling on deposits of ¥10mn per depositor (excluding asset-building savings deposits), unchanged from when Japan Post was a public corporation.

Of postal deposits, 10-year postal CDs and other time deposits were transferred to MOPSPLI upon privatization in 2007 and remain guaranteed by the government. Ordinary deposits and deposits made after privatization are covered by the deposit

insurance system but are no longer guaranteed by the government. Deposits transferred to MOPSPLI have been re-deposited with JPB (and designated as special deposits).

JPB's deposits are classified as demand (ordinary) deposits, term deposits (both ordinary time deposits and the "teigaku" product that allows withdrawals after six months), asset-building savings deposits, and non-interest-bearing transfer deposits, which are earmarked for the settlement of transactions (transfer deposits correspond to the former postal remittance account balances and are excluded from the deposit cap).

JPB offers online banking (Yucho Direct) in addition to its bricks-and-mortar channel comprising directly managed branches and post offices serving as agencies.

Settlement services

JPB provides remittance and other funds transfer services like regular banks. When JPB was first privatized in 2007, it was not connected to the Zengin (Japan Bankers Association) payment system. Customers could not transfer funds to other banks until 2009, when JPB finally gained access to the Zengin system.

JPB also offers foreign exchange services such as overseas remittances, currency exchange, and travelers' checks at its directly managed branches.

Financial product sales

Like regular banks, JPB sells investment trusts, JGBs, insurance, and other financial products. Its investment trust sales are steadily growing but still relatively small, amounting to ¥279.1bn in FY3/13. In the investment trust sales rankings, JPB trails far behind not only the megabanks but even Resona Group and Sumitomo Mitsui Trust Holdings.

Figure 15. Investment trust sales: JPB versus other major banks (¥bn)

	3/12	3/13	Share
Japan Post Bank	177.4	279.2	5%
Mizuho	570.0	720.0	13%
MUFG	1,000.0	1,400.0	25%
SMFG	971.8	1,106.5	20%
Resona	690.0	972.7	17%
SMTH	909.8	1163.7	21%
Total	4,319.0	5,642.1	100%

Source: Company data, Citi Research.

Lending services

Lending operations, which began after the Postal Services Agency was reorganized as a public corporation, were initially restricted to loans secured by deposits or JGBs. Upon privatization, however, JPB was granted permission to participate in loan syndications and lend to SPCs. It is awaiting regulatory approval to enter the consumer lending business, but it currently acts as a residential mortgage broker for Suruga Bank.

Credit cards

JPB began issuing JP Bank Cards as a JCB franchisee in 2009. It had issued 2mn cards as of December 31, 2013.

Outlook

Expansion of new businesses is a prerequisite to an IPO and complete privatization. In our opinion, JPB's limited investment options and product offerings and its restrictive ALM framework do not constitute an IPO story compelling enough to attract investors.

However, launching new businesses and raising or eliminating the deposit ceiling would require deliberation by the Postal Privatization Committee and the approval of the Prime Minister and Minister for Internal Affairs and Communications. As noted above, business expansion and the reduction of JPH's ownership stake are largely contingent on each other. Although the timeline is currently uncertain, we think JPB will eventually enter the following new businesses:

Consumer and corporate lending

JPB's lending operations are currently restricted to personal loans secured by deposits or JGBs and to certain business loans (e.g., participation in loan syndications). With JPB currently seeking regulatory approval to offer consumer loans, we believe it will be able to make consumer loans and general corporate loans in the future.

Retail investment products

While JPB currently provides foreign exchange services, it does not offer foreign currency deposits, a product that could be launched relatively easily. The existing ceiling on yen deposits will presumably be progressively raised or eliminated. JPB intends also to expand its existing investment trust offerings and enlarge the scope of its insurance business as its operations are deregulated.

Expansion of investment universe

One initiative that would not require regulatory approval is the expansion of JPB's investment universe. As mentioned above in the context of the medium-term business plan, JPB aims to actively diversify its investments internationally as a means of improving profitability. From a short-term perspective, we think a more realistic option might be to pursue expansion of its efficient frontier by gaining further expertise in asset classes such as domestic and foreign equities, alternative investments, and fixed income.

Business expansion: Options and challenges

Challenges posed by expansion of business scope

With a strategy focused primarily on retail banking, JPB could pursue a full-line banking model targeted mainly at consumers and certain small businesses (e.g., small corporations and sole proprietorships). Under certain circumstances, it may also target large companies. In light of such a strategy's scalability, JPB faces the following challenges in expanding its operations.

Residential mortgages

At first blush, residential mortgages would appear to be a ready addition to JPB's product line, but mortgage lending requires staffing, know-how and infrastructure adequate to surmount the multiple hurdles posed by marketing, product development, loan application screening, back-office processing, and delinquent loan management. Even some private-sector banks have previously found themselves overburdened by loan application volumes that exceeded their back-

office processing capacity. Mortgage lending therefore requires a carefully designed business model.

Business loans

Like residential mortgage lending, business lending also entails challenges, particularly in terms of credit screening and corporate transaction know-how. Additionally, because JPB would generally be extending relatively small loans to businesses, it faces the risk of chronic losses unless its operations are highly efficient. JPB should learn from the example of regional banks lending to businesses through risk-sharing arrangements with major banks or non-bank lenders.

Alternative investments

Some say Norinchukin Bank could serve as a model for JPB. Structurally, Norinchukin Bank is indeed very similar to JPB in that its affiliated financial institutions constitute a nationwide network. In this sense, the investment know-how that Norinchukin Bank has cultivated could be very instructive for JPB as it diversifies its investments going forward. Given the breadth of its prospective investment universe, JPB will need to recruit staff possessing the requisite expertise.

Options for expediting entry into new businesses

Entry into new businesses will require extensive resources in terms of staffing, infrastructure, know-how and back-office processes. As such, we think JPB's options for entering new businesses are as follows:

Build from scratch

The most basic approach is to recruit or train the required human resources, purchase or develop necessary IT systems, and acquire needed know-how. JPB is likely to choose this approach for new businesses it can launch without much difficulty, such as foreign currency deposits and participation in loan syndications. Many of the other businesses mentioned above, however, would likely take considerable time to build from scratch. We therefore believe JPB may consider other approaches for such businesses.

Acquire a company

Acquiring an existing private financial institution would be the fastest way to add new business functions. By acquiring a bank in particular, JPB would gain an existing workforce, IT systems, and a network of directly managed branches. While acquiring a bank is therefore a compelling option, Article 111 of the Postal Privatization Act (restrictions on ownership of subsidiaries) imposes de facto constraints on bank acquisitions. Even after being completely privatized, JPB would likely have difficulty identifying a bank that is large enough, geographically broad enough, and amenable to being acquired (i.e., could be purchased in a friendly deal). Acquisition of a whole company is therefore not necessarily JPB's best option given de facto restrictions on ancillary banking operations.

Acquire business units

Another option is to acquire individual business units. In Europe and the US, it is not unusual for banks to sell business units while restructuring. Although such a spin-off has yet to occur in Japan, the possibility cannot be ruled out. Another possibility is the acquisition of a business that had been launched as a solo or joint venture by a

financial institution or nonfinancial company in the course of business diversification.

Form alliances and/or outsource

The most convenient way to launch a new business is to form an alliance. JPB could expand the scope of its existing mortgage lending alliance with Suruga Bank or form similar alliances with other lenders. In the lending business, JPB could, for example, obtain loan guarantees from other financial institutions or specialize in originating loan applications and loan servicing while outsourcing everything else to another institution. In investment product sales, another approach would be to specialize in selling products developed by other financial institutions. Some regional banks have started offering term deposits with embedded derivatives sourced from major banks (the regional bank only markets the product; the other bank develops the product, hedges the risks, and so on).

Germany's experience

Deutsche Postbank's privatization

Germany initially embarked on reforms to its postal service (Deutsche Bundespost) in 1989, before East-West unification. As part of this process, Deutsche Bundespost was split into three businesses–postal services (Deutsche Post), financial services (Deutsche Postbank), and telecoms (Deutsche Telekom)–and converted into a joint stock company in 1995. Deutsche Post and Deutsche Telekom staged IPOs in 1998. Deutsche Post subsequently acquired a controlling stake in Postbank, making it a subsidiary. Postbank later held an IPO. Although Postbank is now a subsidiary of Deutsche Bank, its privatization story has implications for JPB's full privatization.

Figure 16. Deutsche Postbank's post-privatization growth (€bn)

	FY99	FY13	Change
Customers (mn accounts)	11.5	14.0	21.7%
Deposits	34.0	103.7	205.0%
Loans	3.6	98.0	2,648.9%
o/w mortgages	1.3	70.5	5,448.3%
Total assets	61.5	161.5	162.6%

Source: Company data, Citi Research.

Deutsche Post drastically downsized from over 29,000 post offices in 1990 to around 5,000 today through the mass closure of small, inefficient offices. In place of the closed post offices, it formed operational alliances with over 7,000 partners such as convenience stores and office supply retailers, thereby compensating for the loss of convenience caused by rationalizing its network. Postbank utilizes Deutsche Post's network, providing a full range of banking services at large post offices and enlisting small post offices as cash dispensaries.

Deutsche Post established Deutsche Post World Net and aggressively expanded internationally, most notably by acquiring DHL, an international delivery service. Some analysts speculate that Deutsche Post acquired Postbank partly to fund such expansion. For Postbank, Deutsche Post's branch network was attractive from the standpoint of reducing network-building costs.

Overview of Postbank and its market position

Historically, Postbank was funded with deposits, most of which it invested in marketable securities. Consequently, even after privatization, its loan-to-deposit

ratio was only about 40% despite diversification of its asset portfolio into corporate loans following the acquisition of a government-affiliated financial institution. In 2006, however, Postbank's loan-to-deposit ratio rose sharply to around 80% when it acquired a housing finance company.

After privatization, Postbank succeeded in rapidly gaining new customers. As of 2013 it had 14mn customers, up from 11.5mn in 1999. One factor behind this growth is that other private-sector banks substantially downsized their branch networks when forced to restructure due to nonperforming loan problems. In recent years, however, Postbank's new customer growth has slowed, partly because other banks have completed their restructuring programs and improved their financial positions.

Postbank derives 77% of its earnings from retail banking. Retail loans' share of the firm's loan book has been growing on an annual basis. Figure 17 shows Postbank's operating performance by segment. It shows the retail segment remains Postbank's core business despite having a high overhead ratio.

Figure 17. Deutsche Postbank performance by segment (FY13, €bn)

	Retail	Corporate	Transaction	Financial markets	Others	Group
Balance sheet-related revenues	2,480	302	0	120	-439	2,463
Net fee and commission income	908	89	288	-14	-151	1,120
Total income	3,400	389	288	81	-354	3,804
Allowance for losses on loans and advances	-210	-38	0	-2	-69	-319
Profit before tax	653	162	34	14	-545	318
Cost/income ratio	74.6	50.9	91.3	102.5	-	83.5
Segment assets	NA	NA	NA	NA	NA	NA
Segment liabilities	NA	NA	NA	NA	NA	NA

Source: Company data, Citi Research.

In comparison to postal banking's prominence in Japan, Postbank is not a particularly large bank within Germany. It ranks tenth among German banks in terms of total assets. Note that the figures in Figure 18 represent the number of directly managed branches and Postbank's in-house workforce and do not include Deutsche Post's network.

Figure 18. German banks ranked by total assets (as of June 30, 2013; €bn)

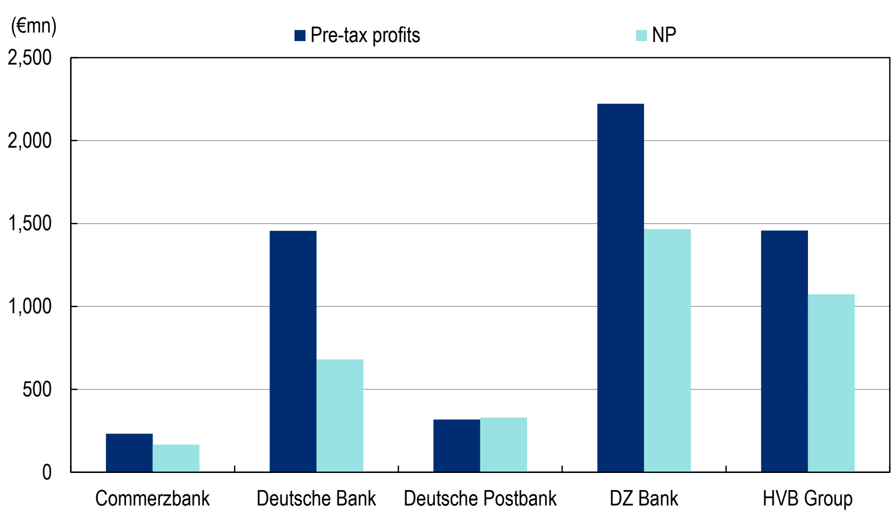
		Total assets	Branches	Employees
1	Deutsche Bank AG	1,611.4	1,924	46,377
2	Commerzbank AG	549.7	1,200	41,113
3	KfW Bankengruppe	464.8	4	5,374
4	DZ Bank AG	387.0	10	28,899
5	HypoVereinsbank Group (HVB)	290.0	933	19,092
6	Landesbank Baden Wurttemberg (LBBW)	273.5	200	11,308
7	Bayerische Landesbank	255.6	4	8,500
8	Norddeutsche Landesbank (Nord LB)	208.2	130	7,000
9	Helaba Bank	161.8	8	3,511
10	Deutsche Postbank	161.5	1,092	18,200
11	Landesbank NRW	145.3	2	1,256
12	Hypothekenbank Frankfurt AG	130.5	8	795
13	ING DiBa	126.0	0	3,178
14	DekaBank Group	116.1	2	4,035
15	HSH Nordbank AG	109.0	7	2,627
16	Landesbank Berlin Holding (LBB)	102.4		5,516
17	Landwirtschaftliche Rentenbank	75.5	1	254
18	Wustenrot & Wurttemburgische	75.0	13	9,605
19	Deutsche Pfandbriefbank	73.9	5	852
20	WGZ Bank	51.6	8	1,243

Source: The Banker, Company data, Citi Research.

Postbank also trails well behind the major German banks in terms of earnings. However, Postbank has a large presence in the retail segment. It has more directly managed branches than any major bank and ranks third in the number of domestic branches. When the post office channel is included, we think Postbank has a competitive advantage in terms of points of contact with retail consumers. By virtue of such broad channels, we think Postbank could capitalize on cross-selling opportunities while expanding its services through M&A. It is therefore a threat to other banks.

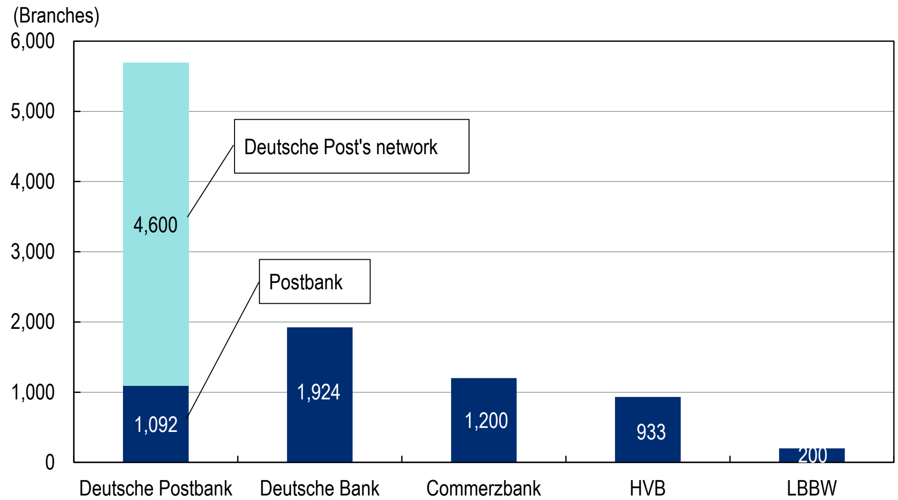
Below we discuss Postbank's post-privatization strategy in the hope of shedding light on JPB's prospective post-privatization strategy.

Figure 19. Comparison of major German banks' earnings (FY13)



Source: Company data, Citi Research.

Figure 20. Comparison of major German banks' branch networks (as of December 31, 2013)



Source: Company data, Citi Research.

Postbank's post-privatization strategy

Merger with government-affiliated financial institution

Postbank's post-privatization strategy was characterized by a combination of M&A-driven business expansion and organic business expansion through Deutsche Post offices as a member of the Deutsche Post Group. Postbank originally specialized in providing retail financial services, but it branched into corporate lending after acquiring DSL Bank, a government-affiliated financial institution active mainly in real estate finance, in 2000. Today, Postbank provides full-line banking services.

International expansion and channel reforms

In July 2001, Postbank acquired BHF (USA) Holdings, a US lender. The acquisition marked the beginning of a push into international logistics finance, mainly in the US, in concert with Deutsche Post's international logistics strategy. In December 2004, Postbank acquired ING-BHF's London branch in the aim of expanding its commercial real estate finance operations in Europe.

In January 2006, Postbank acquired 850 Deutsche Post branches (787 of which were Postbank Centers offering banking services), including 2,000 staff (financial advisors). By doing so, it freed itself from its previous dependence on Deutsche Post for its entire branch network. Postbank estimates that this move reduced its dependence on Deutsche Post's network to around 13%.

Entry into housing finance

Between October 2005 and January 2006, Postbank acquired Beamten-Heimstättenwerk (BHW), a housing finance company (building society), for over €1.7bn to strengthen its retail business. At the time of the acquisition, BHW was Germany's second-ranked specialized housing lender, with an 11.7% market share and €27.5bn of loans outstanding. The acquisition expanded Postbank's loan book by over 50% in one go.

With the BHW acquisition, Postbank added BHW's 800 service centers to its network of 850 Postbank Centers and Deutsche Post's 12,000 post offices. It also

gained BHW's 4,117 salaried employees and 4,200-strong commission sales force. The acquisition rectified both companies' balance sheet imbalances by combining Postbank, which had a surfeit of deposits, with BHW, which was overinvested in residential loans.

Acquisition by Deutsche Bank

In 2008, Deutsche Bank acquired an equity stake in Postbank from Deutsche Post. It increased its stake to 93.7% in 2012, making Postbank its subsidiary in both name and fact.

As Postbank is much smaller than Deutsche Bank in terms of operational scope, its takeover is not necessarily relevant to JPB's future path. Nonetheless, the radical transformation of its business structure over the decade-plus from Deutsche Bundespost's 1995 breakup and privatization through Postbank's 2004 IPO and its 2008 acquisition by Deutsche Bank is an instructive case study.

Implications for Japan

Although Postbank is much smaller in scale than JPB, its history has implications for JPB's future strategy in various respects, including the context of its privatization, its status at the time of privatization, its lopsided deposit-funded financial structure, and channel issues.

First, Postbank underwent a reorganization involving a public entity. As part of its expansion effort, Postbank merged with DSL Bank, a government-affiliated financial institution involved in corporate lending, including real estate finance. Japan also has government-affiliated financial institutions such as the Development Bank of Japan that would be functionally complementary to JPB in terms of business model and asset/liability structure.

Second, Postbank rectified its funding gap. The acquisition of BHW almost instantaneously normalized what had been an extremely low loan-to-deposit ratio. At the same time, the Postbank Group gained a housing finance business with extensive loan-processing capacity, thereby enabling cross-selling to its customer base.

Third, Postbank faced channel problems. Opening a large number of directly managed branches in a short timeframe would have entailed major difficulties. Postbank's acquisition of 850 large branches from Deutsche Post was a very important decision in terms of enhancing its strategy in its proprietary channel. We think JPB could learn from Postbank's example if it is interested in expanding its directly managed branch network.

JPB scenario analysis

Basic approach

Below we present three scenarios with respect to strategies JPB could pursue in the process of full privatization, from the standpoint of financial strategy, regulatory approval for new businesses and challenges in terms of securing management resources.

In terms of business resources, key considerations include that JPB's proprietary channel comprising 234 directly managed branches is small relative to the scale of its assets. JPB is consequently heavily dependent on post offices. Second, recruiting personnel capable of running a full-line banking operation will not be easy.

Third, with JGBs and other low-risk-weight assets accounting for the majority of assets, JPB will enter the private sector with a much higher capital adequacy ratio than other banks. It consequently has both the scope to aggressively increase its risk asset holdings and an ALM mismatch between its long-term JGB holdings and de facto short-term funding.

Scenario analysis

Scenario A: Acquisition of private financial institution

We think one of the most effective options available to JPB would be to acquire a private-sector financial institution, given the spare capital stemming from its high capital ratio, the current constraints on its operational capabilities and know-how, and the need to expand operations prior to an IPO. Postbank's BHW acquisition was a game-changer in that it eliminated Postbank's loan-deposit gap, gave Postbank a back-office platform in the residential lending business, and created opportunities for both companies to cross-sell to each other's customers. Accordingly, acquisition of a bank, the peripheral business of a non-bank institution (e.g., mortgage broking or credit cards), or a portion of another financial institution's operations could conceivably be an option for JPB.

But with Article 111 of the Postal Privatization Act effectively restricting JPH to less than 50% ownership of any subsidiary in a banking-related business, we can safely assume that any opportunities to enter new businesses through acquisitions will take a relatively long time to unfold.

Scenario B: Merger with a government-affiliated financial institution

Postal privatization and reform of government-affiliated corporations were both integral to former Prime Minister Junichiro Koizumi's reform program from a revenue and expenditure standpoint. Consolidation of government-affiliated financial institutions was expected to proceed in parallel with postal privatization as one component of the Koizumi reforms. In Germany, Postbank gained corporate lending capabilities soon after it was privatized by acquiring DSL Bank, a government-affiliated financial institution with corporate lending and real estate finance operations. As such, we think a merger with a government-affiliated financial institution is another option for JPB.

Shoko Chukin Bank has some deposits, but its main source of funding is FILP (Fiscal Investment and Loan Program) agency bonds. The Development Bank of Japan (DBJ) has no deposits at all. In contrast, Japan Post Bank suffers from a dearth of investment opportunities. We think a merger between JPB and Shoko Chukin Bank or DBJ could be mutually beneficial.

Politically, however, the privatization of government-affiliated financial institutions has been de-prioritized, and a government policy decision would probably be required for JPB to pursue such a merger option.

Scenario C: Semi-comprehensive alliance strategy

In our view, an alliance strategy would be the most realistic way for JPB to swiftly enter new businesses with a minimum of difficulty. JPB should, of course, choose between alliances, M&A, and organic growth based on thorough consideration of cost-performance, support resources, and all other relevant factors, but we consider alliances to be its best option for a variety of reasons, including the Postal Privatization Committee's likely reaction and the speed with which JPB could strengthen its business functions through alliances.

The value that JPB adds stems primarily from its network. Its directly managed branches and the post offices that serve as its agencies are ubiquitous throughout Japan. In light of JPB's familiarity to the public and long-standing access to depositors, its product distribution capabilities are its true strength. If JPB sources products through alliances, it could specialize in efficiently selling the products while leaving product development to its alliance partners.

Since 2008, JPB has been partnering with Suruga Bank to offer mortgages and other consumer loans. As of December 31, 2013, Suruga Bank had extended a cumulative total of ¥264.8bn of loans through JPB. Going forward, JPB is likely to utilize the know-how it has gained from this alliance to originate consumer loans on its own books. This example clearly demonstrates how alliances can compensate for a lack of experience.

Looking ahead, we expect JPB to form alliances with other banks in such areas as small-business lending. With its in-branch and external sales force, JPB could act as an intermediary between customers and alliance partners while letting the partners handle credit screening and guarantees. Additionally, alliances in specialty finance businesses (e.g., private equity, real estate finance) may offer opportunities for JPB to accumulate know-how while expanding its range of risk-taking opportunities.

Impact on financial industry

(1) Impact on industry profitability

JPB's most distinctive attribute is its broad, dense network comprising post offices as well as directly managed branches. JPB uses this network to sell various financial products, most notably investment trusts. We expect JPB to leverage the strength of its sales channels while expanding the scope of its operations as JPH divests its stake in JPB.

Such a scenario raises concerns about the intensification of already tough competition among banks. In its current business model, JPB's main source of earnings is investment risk, not credit risk. If JPB goes beyond the operational alliances discussed above and shifts to a business model in which it takes on credit risk, the risk of shrinkage in lending spreads would increase. However, given the constraints on JPB's management resources, we expect any such shift to a credit risk model to take considerable time.

(2) Impact on financial markets

So-called "teigaku" term deposits (including special deposits from MOPSPLI), which can be redeemed after six months, account for over 50% of JPB's total deposits, while demand deposits represent another 30%. The vast majority of JPB's funding is thus of extremely short duration. Its assets, meanwhile, are invested mainly in securities, particularly JGBs and FILP agency bonds, and FILP deposits. Many of its assets have maturities in excess of one year, resulting in a duration mismatch.

Once fully privatized, JPB may seek to rectify this mismatch through its risk management program. It could adjust its interest-rate positioning by engaging in interest-rate swaps as a fixed-rate payer/floating-rate receiver. It may also reduce its bond holdings as it diversifies its asset portfolio away from securities. Either course of action could exert upward pressure on interest rates.

(3) Impact on equity market supply/demand

When JPB shares are sold to the public through an IPO and subsequent secondary-market divestment, we think some investors will probably sell other bank stocks when they purchase JPB shares to keep their overall exposure to the sector constant. Since the price impact of such crowding-out tends to vary greatly depending on market sentiment, timing is important.

2. Insurance industry

Nonlife insurance

Cooperation not competition

Since 1916, when post offices first began selling insurance, the Japan Post Group has been a competitor of the life insurance industry, but it has had little if any relationship with the nonlife insurance industry. Its first contact with the nonlife insurance industry was in 1997, when AIU Insurance proposed utilizing the post office network to sell motorcycle liability insurance. In 2001, a ban on selling nonlife insurance at post offices was relaxed to permit sales of motorcycle liability insurance. One factor behind the decision to ease the ban was that relatively few motorcyclists carried liability insurance even though it was compulsory. Another factor was the small size of the market (about ¥30bn), which meant the impact of post office sales on the nonlife industry would be immaterial.

Increase in postal network's value as sales channel

In 2007, post offices began selling auto insurance on an agency basis. They sell policies jointly underwritten by six insurers (Aioi Nissay Dowa Insurance, Sompo Japan Insurance, Tokio Marine & Nichido Fire Insurance, Nipponkoa Insurance, Fuji Fire and Marine Insurance, and Mitsui Sumitomo Insurance). The Japan Post Group deals with Tokio Marine & Nichido Fire Insurance as its general liaison for auto insurance.

Life insurance

100 years of competition

Having been in competition with the life insurance industry for nearly 100 years, JPI has established a customer base and carved out its own market niche. Hence we do not think its full privatization will have much immediate impact on the life insurance industry, although the expansion of its product offerings may cause friction between a fully privatized JPI and incumbent life insurers.

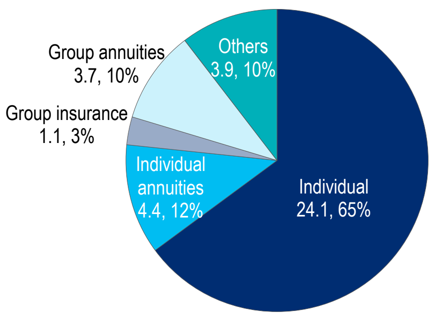
Competition between postal life insurance and private life insurance is one reason for the negative spreads between assumed and actual investment returns that have beset the life insurance industry for well over a decade, although spreads have recently improved substantially, partly because of robust equity market performance. The rates of return offered by postal life insurance products are often cited as a driver of competitive increases in assumed rates of return during the 1980s and 1990s. Then, the postal life insurance business was able to earn high returns by outsourcing asset management to the Ministry of Finance's Fund Management Department and investing assets based on FILP Plans, enabling it to set high assumed rates of return that defied market principles. Postal life insurance was criticized by the private life insurance industry at the time for distorting pricing.

Overview of JPI

JPI's market position

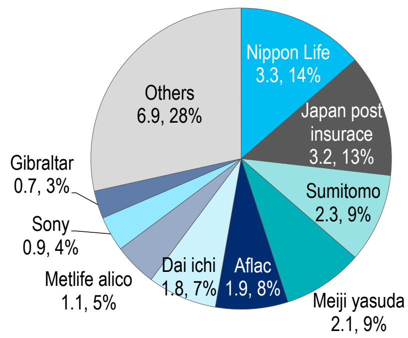
Japan's life insurance market is huge, with annual premium revenues of some ¥37trn (FY3/13). Roughly 80% of this total consists of premiums from individual insurance and individual annuities, JPI's main products. JPI is ranked second in the individual insurance market segment after Nippon Life with annual premium revenues in excess of ¥3trn.

Figure 21. Japanese life insurance premium revenues by product (¥trn)



Note: FY3/13.
Source: *Life Insurance Factbook 2013*, Citi Research.

Figure 22. Individual life insurance premiums by insurer (¥trn)

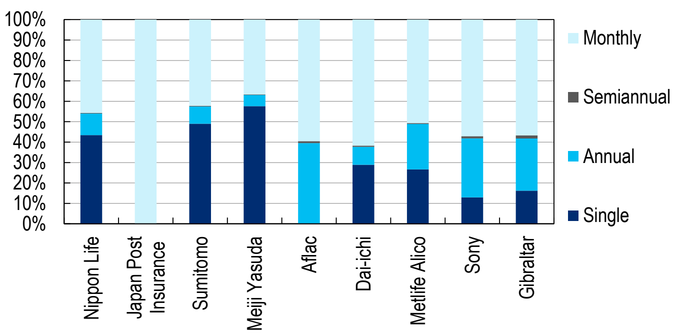


Note: FY3/13.
Source: Company data, Citi Research.

Product attributes

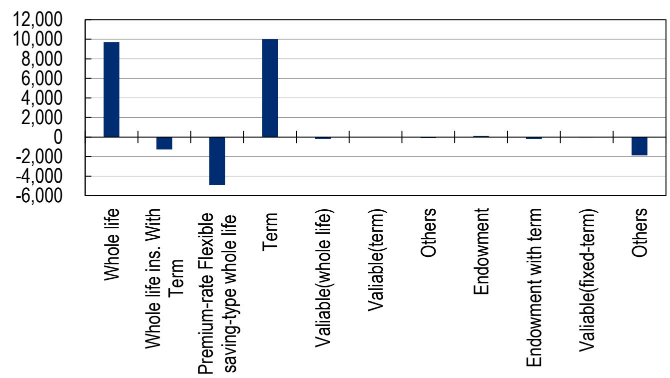
JPI only sells monthly-premium products (Figure 23). For the industry as a whole, sales of whole life and term life insurance increased over the five years through FY3/13 (Figure 24). In the whole-life market segment, single-premium products account for large shares of Mitsui Sumitomo Insurance and Meiji Yasuda Life Insurance's sales, partly reflecting growth in sales of single-premium whole-life insurance through the bank channel. JPI's whole-life insurance sales have also grown, but they account for a tiny share of the industry-wide total. In the term-life market segment, JPI is not experiencing growth in sales of new policies, largely because of restrictions on its policies' coverage.

Figure 23. Breakdown of life insurers' individual insurance premiums (FY3/13)



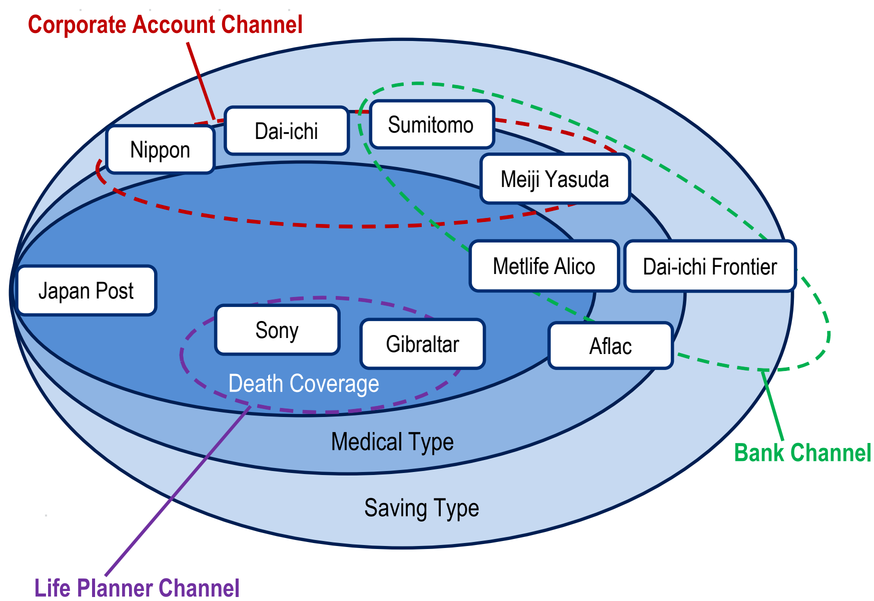
Source: Company data, Citi Research.

Figure 24. Change in new policies written between FY3/09 and FY3/13



Source: *Life Insurance Factbook 2009 and 2013*, Citi Research.

Figure 25. Life insurers' main sales channels



Source: Company data, Citi Research.

With total assets of ¥87trn, JPI is Japan's largest life insurer by assets. At end-FY3/13, it had 6,789 employees and a network of 79 directly managed offices and five service centers. It also utilizes the post office network (20,739 branches, including postal life insurance offices) as an agency channel.

Figure 26. JPI versus private life insurers (FY3/13, ¥bn)

	Japan Post Insurance	Nippon Life	Daiichi Life	Meiji Yasuda	Sumitomo Life	Mitsui Life	T&D	SFH	Total	All Life Insurance
Amount of in-force policies	107,101.3	175,995.7	141,861.6	96,952.8	111,105.8	25,428.2	59,221.2	37,779.0	755,445.6	965,169.5
Annualized premium of in-force policies	2,523.0	3,216.2	2,026.0	2,066.1	2,215.4	527.5	1,447.7	669.9	14,691.8	23,856.1
Total assets	90,462.4	54,882.8	33,072.5	33,000.7	26,464.1	7,229.2	13,586.1	5,952.8	264,650.5	344,998.1
Adjusted net assets value	10,107.4	10,259.2	5,563.3	5,940.5	3,708.6	692.5	1,887.6	1,396.8	39,555.9	50,116.0
Solvency margin ratio	1,467.9	696.4	715.2	930.3	832.8	601.3	943.8	2,281.8	-	861.7
Core OP	570.0	546.5	314.6	394.5	426.2	52.9	182.5	80.0	2,567.3	3,260.0
NP	91.0	210.6	51.5	235.5	113.2	8.8	63.3	42.4	816.5	1,127.4
RoE	9.10%	21.06%	5.15%	23.55%	11.32%	0.88%	6.33%	4.24%	81.65%	112.74%
Core OP/policies	0.53%	0.31%	0.22%	0.41%	0.38%	0.21%	0.31%	0.21%	0.34%	0.34%
Branches	20,739	905	1,346	1,067	1,590	548	1,365	548	28,108	11,711
(Post offices)	24,230								NA	NA
Employee headcount	1,124	11,030	34,898	24,836	25,963	6,700	11,264	4,629	120,444	195,619

Source: Company data, Citi Research.

At end-FY3/13, JPI had ¥107trn of policies in force (individual insurance and individual annuities), making JPI Japan's fourth-ranked life insurer by in-force business. However, insurance policies written by the firm before October 1, 2007 remain guaranteed by the government and were transferred to MOPSPLI. Excluding the JPI-reinsured portion of these transferred policies, JPI had c¥32trn of policies in force at end-FY3/13. Using this figure, JPI is ranked seventh in Japan.

Figure 27. Life insurers ranked by total assets (FY3/13, ¥bn)

	Company name	Total Assets
1	Japan Post Insurance	90,462
2	Nippon Life	54,883
3	Dai-ichi Life	33,072
4	Meiji Yasuda Life	33,001
5	Sumitomo Life	26,464
6	Gibraltar	9,812
7	AFLAC	9,180
8	MetLife Alico	8,720
9	Mitsui Life	7,229
10	Taiyo Life	6,645
11	AXA Life	6,314
12	Fukoku Life	6,007
13	Sony	5,953
14	Asahi Life	5,651
15	Daido Life	5,399
16	TokioMarine & Nichido Anshin	4,599
17	Mitsui Sumitomo Primary	3,766
18	ING Life	3,302
19	Prudential	3,279
20	Hartford	3,089

Source: Company data, Citi Research.

Figure 28. Life insurers ranked by new policies written (FY3/13, ¥bn)

	Company name	Amount of New Business (Individual, Individual annuity)
1	Nippon Life	9,559
2	Dai-ichi Life	7,822
3	Japan Post Insurance	7,149
4	Meiji Yasuda Life	5,008
5	Sumitomo Life	4,687
6	Sony	4,455
7	MetLife Alico	4,024
8	Mitsui Sumitomo Aioi	3,711
9	Daido Life	3,556
10	Gibraltar	3,516
11	TokioMarine & Nichido Anshin	3,402
12	Prudential	3,371
13	NKSJ Himawari	3,043
14	Taiyo Life	2,974
15	AFLAC	2,482
16	ING Life	1,557
17	AXA Life	1,504
18	Fukoku Life	1,496
19	Mitsui Life	1,306
20	Manu Life	1,289

Note: Total for individual life and individual annuity life insurance policies.
Source: Company data, Citi Research.

Figure 29. Life insurers ranked by policies in force (FY3/13, ¥bn)

	Company name	Amount of In-force Policies (Individual, Individual annuity)
1	Nippon Life	175,996
2	Dai-ichi Life	141,862
3	Sumitomo Life	111,106
4	Japan Post Insurance	107,101
5	Meiji Yasuda Life	96,953
6	Sony	37,779
7	Daido Life	36,158
8	Gibraltar	34,886
9	Prudential	30,043
10	Asahi Life	29,206
11	Fukoku Life	27,919
12	MetLife Alico	27,655
13	Mitsui Life	25,428
14	TokioMarine & Nichido Anshin	21,480
15	Taiyo Life	21,023
16	Mitsui Sumitomo Aioi	20,075
17	NKSJ Himawari	19,165
18	AXA Life	15,027
19	AFLAC	14,059
20	ING Life	7,126

Note: Total for individual life and individual annuity life insurance policies.
Source: Company data, Citi Research.

Figure 30. Life insurers ranked by new policies' annualized premium revenues (FY3/13, ¥bn)

	Company name	Ranking of Annualized Premium of New Business (Total)
1	Japan Post Insurance	654
2	Nippon Life	278
3	Meiji Yasuda Life	195
4	Sumitomo Life	173
5	MetLife Alico	151
6	Dai-ichi Life	150
7	AFLAC	128
8	Mitsui Sumitomo Primary	107
9	TokioMarine & Nichido Anshin	81
10	Axa Life	80
11	Gibraltar	79
12	Taiyo Life	78
13	Sony	73
14	Daido Life	72
15	PGF Life	70
16	Prudential	69
17	Mass Mutual	68
18	Manu Life	56
19	ING Life	53
20	Mitsui Sumitomo Aioi	50

Note: Total for individual life and individual annuity life insurance policies.
Source: Company data, Citi Research.

Existing operations

When the privatization process began in 2007, JPI was granted permission to enter two new businesses: contract sales to corporate customers and sales of revised hospitalization riders. Like JPB, it was also granted permission to expand its investable universe by participating in loan syndications and acquiring beneficial interests in trusts.

In terms of its overall scope of operations, JPI is subject to less onerous product-line restrictions relative to private competitors than JPB. However, JPI is subject to a ¥10mn cap on postal life insurance coverage per insured individual, including both pre-existing and new policies, for the time being.

We see a number of products that JPI is currently prohibited from offering but, from a profitability standpoint, is likely to add to its product line as privatization proceeds. These include third-sector insurance products and life insurance with generous death benefits (which the coverage cap currently precludes JPI from offering).

Products JPI can offer

Individual insurance:	Whole life insurance, term life insurance, educational endowment insurance, endowment life insurance, and asset-formation insurance
Annuities:	Term annuities

Products JPI cannot offer

Individual insurance:	Whole life insurance with term-insurance rider, variable insurance, medical insurance, cancer insurance, disability insurance, and variable annuities
Group insurance:	Group insurance and group annuities

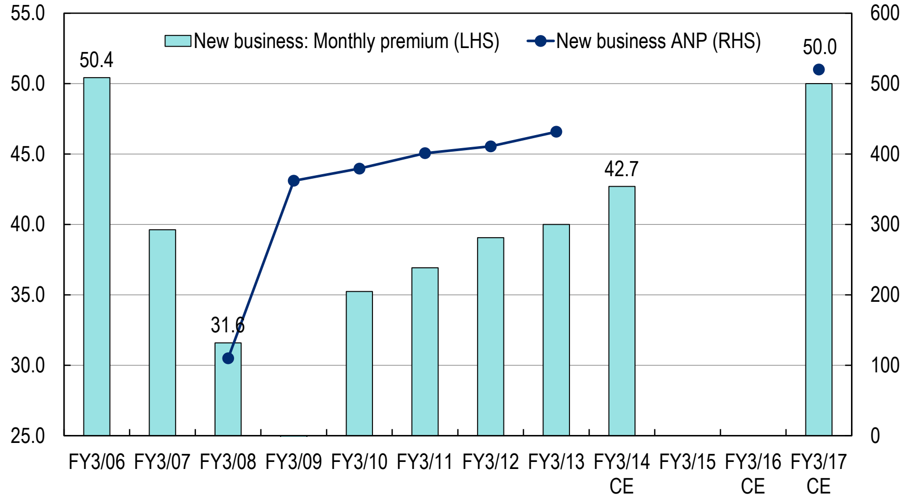
Anticipated future operations

The Japan Post Group's medium-term business plan lists three management goals for JPI: 1) meet the financial security needs of a progressively aging society, 2) build an organization that swiftly and accurately executes all processes from underwriting to claims payment, and 3) establish a sound operating platform.

New products that JPI is likely to add to meet the needs of an aging society include medical insurance and life insurance with more generous death benefits. Improving productivity with new infrastructure, including IT systems, is also an important theme. Another key issue is strengthening asset management capabilities as an institutional investor.

Ways in which JPI could evolve its business model include 1) strengthening earnings by expanding the risk-asset portfolio through diversification, 2) becoming a full-line insurer (excluding group insurance) once restrictions on product /service offerings are eased or eliminated, and 3) entering the workplace market with its directly managed offices' sales force and expanding direct marketing by using call centers in addition to sales through the post office channel. With respect to (2) in particular, JPI began selling upgraded educational endowment insurance from April 2014. It intends to strengthen and diversify its earnings sources by expanding product offerings from alliance partners. By doing so, it aims to earn NP of ¥80bn in FY3/17 by increasing monthly premium revenues from new policies to ¥50bn, roughly 20% above their current level.

Figure 31. JPI: Key performance indicators (¥bn)

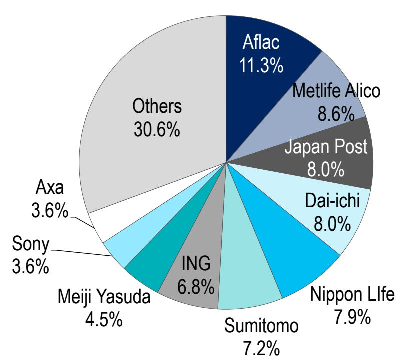


Source: Japan Post Group medium-term plan, Citi Research.

Impact on insurance industry

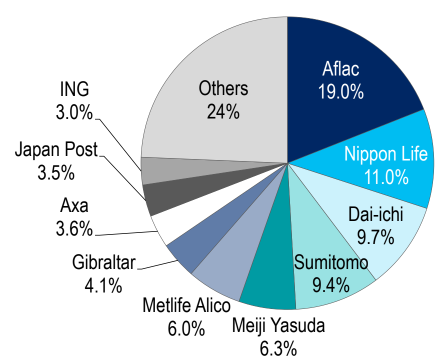
Expectations that JPI will expand sales of Aflac's third-sector insurance products through the post office channel are already emerging. The addition of medical insurance to JPI's product line would immediately lead to competition in the post office channel. In addition to foreign insurers and incumbent Japanese life insurers, nonlife insurers' life insurance subsidiaries are becoming increasingly aggressive in the third-sector insurance market, and competition is likely to heat up further.

Figure 32. Annualized premium revenues from new policies (third-sector products, FY3/13)



Source: *FY13 Life Insurance Statistics*, Citi Research.

Figure 33. Annualized premium revenues from policies in force (third-sector products, FY3/13)



Source: *FY13 Life Insurance Statistics*, Citi Research.

Reference: Estimation of third-sector insurance premium revenues

We forecast the insurance industry's premium revenues from third-sector products, a market with favorable growth prospects. We do so by estimating premium revenues based on insurance benefit payouts. Specifically, we first estimate insurance benefits in the context of national healthcare expenditures. We then estimate insurers' cost of revenues for third-sector insurance by adding asset management expenses and operating expenses, which we assume would both

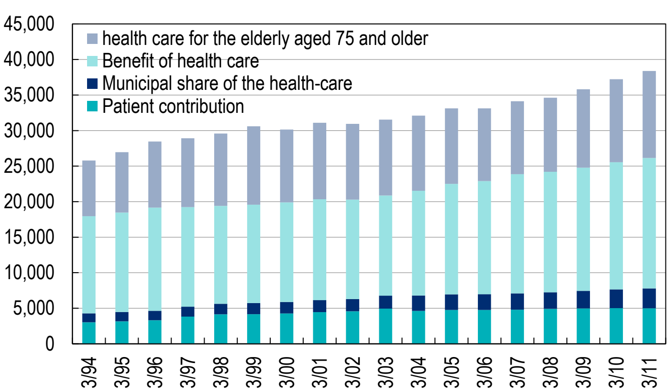
remain constant, to our estimates of insurance benefits. We then estimate cost-of-revenues ratios based on third-sector products' historical and estimated future share of insurers' premium revenues. Lastly, we estimate third-sector premium revenues using these cost-of-revenue ratios.

Estimation of insurance benefit payouts

Japan's national healthcare expenditures are rising every year. Their growth is attributed to growth in healthcare expenditures on late-stage elderly patients due to increased longevity and increases in healthcare unit prices driven by advances in medical technology. Patients' out-of-pocket healthcare expenditures also are increasing in proportion to national healthcare expenditures. When patients are covered by private medical insurance, the insurance benefits paid on their behalf reduce their effective out-of-pocket medical expenses by around 20%.

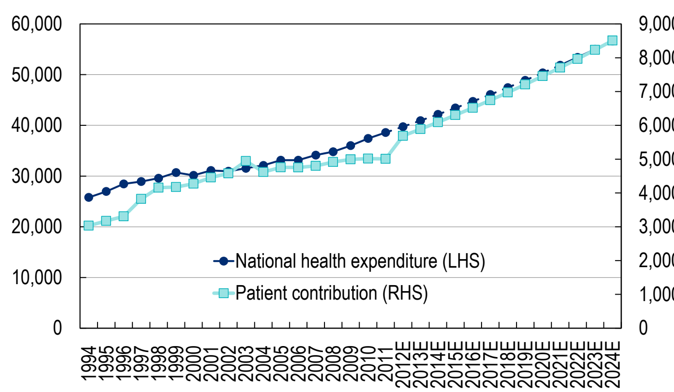
We estimate patients' future out-of-pocket medical expenses using a simple regression model with national healthcare expenditures as the independent variable and patients' share of healthcare expenditures as the dependent variable. National healthcare expenditures have grown at a compound annual rate of roughly 3% over the past five years. We assumed this growth rate would remain constant through FY3/24. Knowing that insurance benefits cover about 20% of patients' share of healthcare expenditures, we were able to estimate both patients' share of healthcare expenditures and future insurance benefit payouts at the same time.

Figure 34. Breakdown of national healthcare expenditures (¥bn)



Source: Citi Research.

Figure 35. National healthcare expenditures and patients' share thereof (¥bn)



Note: From FY3/12 onward, we assumed national healthcare expenditures would grow at a CAGR of 3%, equivalent to their CAGR over the preceding five years. We estimated patients' share of healthcare spending by regressing patients' share of healthcare spending on national healthcare expenditures since 1994. The coefficient of determination was 0.78.
Source: Citi Research.

Estimation of insurers' cost of revenues, premium revenues

Based on the principle of equalization of insurance income and expenses, insurance premium revenues + investment income = insurance claims (referred to in this report as insurance benefits) + operating expenses + asset management expenses.

Premium revenues from third-sector products account for roughly 20% of total premium revenues (Column c in Figure 36). We therefore assume that the same percentage of asset management expenses (Column g) and operating expenses (Column i) is attributable to third-sector insurance. We add the third-sector share of

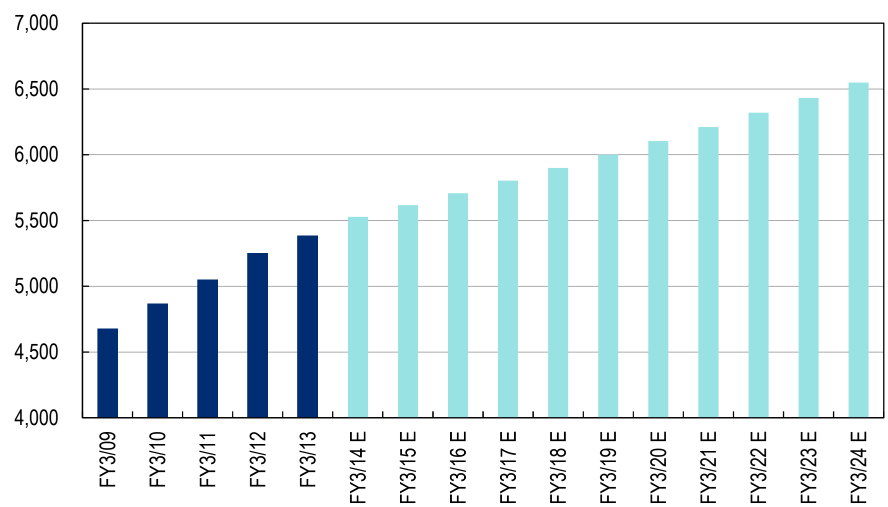
operating expenses and asset management expenses to our estimates of third-sector insurance benefit payouts to arrive at insurers' cost of revenues for third-sector insurance (Column k). This cost of revenues is about 50% of third-sector insurance premium revenues (Column l). We used this ratio to estimate future third-sector insurance premium revenues from the cost of those revenues.

Figure 36. Estimated third-sector insurance premium revenues (¥bn)

	Premium			Investment income		Investment expenses		Operating expenses		Benefit	Prime premium	vs premium
		o/w 3rd sector	3rd sector/ total		o/w 3rd sector		o/w 3rd sector		o/w 3rd sector			
	a	b	c=b/a	d	e	f	g=f*c	h	i=h*c	j	k=g+i+j	l=k/b
FY3/09	19,698.1	4,680.3	24%	5,834.8	*1,386.4*	10,240	2,433	3,776	897	1,068	4,398	94%
FY3/10	21,377.7	4,871.0	23%	10,202.8	*2,324.8*	1,819	415	4,326	986	1,091	2,492	51%
FY3/11	21,781.6	5,053.0	23%	7,679.2	*1,781.5*	2,833	657	4,306	999	1,005	2,661	53%
FY3/12	22,775.4	5,252.7	23%	8,139.5	*1,877.2*	1,890	436	4,353	1,004	*1,142*	2,582	49%
FY3/13	23,856.1	5,384.9	23%	11,835.3	*2,671.5*	1,735	392	4,349	982	*1,182*	2,555	47%
FY3/14 E	-	*5,527.6*	-	-	-	-	*400*	-	*1,000*	*1,223*	*2,623*	*47%*
FY3/15 E	-	*5,616.6*	-	-	-	-	*400*	-	*1,000*	*1,265*	*2,665*	*47%*
FY3/16 E	-	*5,708.4*	-	-	-	-	*400*	-	*1,000*	*1,308*	*2,708*	*47%*
FY3/17 E	-	*5,802.9*	-	-	-	-	*400*	-	*1,000*	*1,353*	*2,753*	*47%*
FY3/18 E	-	*5,900.3*	-	-	-	-	*400*	-	*1,000*	*1,399*	*2,799*	*47%*
FY3/19 E	-	*6,000.5*	-	-	-	-	*400*	-	*1,000*	*1,447*	*2,847*	*47%*
FY3/20 E	-	*6,103.8*	-	-	-	-	*400*	-	*1,000*	*1,496*	*2,896*	*47%*
FY3/21 E	-	*6,210.2*	-	-	-	-	*400*	-	*1,000*	*1,546*	*2,946*	*47%*
FY3/22 E	-	*6,319.8*	-	-	-	-	*400*	-	*1,000*	*1,598*	*2,998*	*47%*
FY3/23 E	-	*6,432.6*	-	-	-	-	*400*	-	*1,000*	*1,652*	*3,052*	*47%*
FY3/24 E	-	*6,548.9*	-	-	-	-	*400*	-	*1,000*	*1,707*	*3,107*	*47%*

Note:Italicized figures are estimates.
Source: Citi Research.

Figure 37. Estimated third-sector insurance premium revenues (¥bn)



Source: Citi Research.

In conclusion, we project that annualized premium revenues from third-sector insurance policies in force have the potential to continue to grow at a CAGR in the vicinity of 2%. The cap on postal life insurance coverage currently precludes JPI from selling life insurance that requires a physical examination. If the cap is raised,

JPI is likely to start selling such insurance in the workplace market in competition with the leading life insurers.

3. Transport industry

Overview of Japan Post

Differences between Japan Post and JPB/JPI

JPH is the sole shareholder of JPB, JPI and Japan Post. While it is slated to sell its entire shareholdings in JPB and JPI, JPH will continue to own all of Japan Post's shares. Additionally, even after JPH's IPO, the government will ultimately continue to own more than one-third of its shares.

In sum, the two financial businesses, the most lucrative of Japan Post Group's operations, will be spun off while the postal service, the least profitable of the group's businesses, and the post office counter business with its large workforce are not ever expected to be fully privatized.

Workforce and post offices

Japan Post has 209,000 employees. Its network consists of 13 branch offices and 24,000 post offices. Under the original Postal Privatization Act, postal services and the post office network were split up into separate legal entities. Under the revised version of the law, these two companies were then merged to form the current Japan Post.

Upon initial privatization, the postal services business—comprising mail collection and delivery and post office counter service outside of regular business hours—was split off from the post office network. The post office business mainly provided counter services. Post offices are classified into two categories: directly managed and contracted. Since Japan Post was established, the post office business mainly handles banking and insurance services on a contract basis because postal services have become a standalone business.

Japan Post is much smaller than JPB and JPI. It has total assets of ¥4.8trn, a mere 1.6% of JPH's total consolidated assets of ¥292.9trn (both as of March 31, 2013). In terms of earnings, the erstwhile Japan Post Service and Japan Post Network, the two companies that were merged to form Japan Post, earned combined FY3/13 NP of ¥60.0bn, more than 10% of JPH's consolidated NP of ¥562.7bn. Real estate and other tangible fixed assets account for ¥2.3trn of Japan Post's ¥4.8trn in total assets. Tangible fixed assets' large share of total assets is a distinctive attribute of Japan Post as operator of the post office network.

Main businesses

Japan Post's main businesses are listed below.

Postal services business: Postal services

Postal service has been Japan Post's core business since it was a public corporation. Japan Post provides basic postal services, including both domestic service and international service pursuant to the Universal Postal Convention. It also sells revenue stamps on behalf of the government, issues New Year's lottery postcards, and provides related services.

Postal services business: Domestic and international distribution and logistics

The main services provided by the domestic distribution business are parcel delivery (Yu-Pack) and letter delivery (Yu-Mail). Incidental services include sales of Yu-Pack packaging supplies and COD services. The erstwhile Japan Post Service acquired Nippon Express's Pelican-bin delivery service in 2010 and merged it into its Yu-Pack operations (discussed below). By market share, Yu-Pack is Japan's third-ranked parcel delivery service behind Yamato Transport and Sagawa Express. Yu-Mail delivers bound printed matter at lower rates than parcel delivery services. Japan Post competes with private mail delivery services in the direct mail market, which includes both Yu-Mail and regular mail. Japan Post's share of the mail delivery market is around 50%.

The international distribution business dates back to before privatization. Japan Post was granted permission to enter the business for several reasons. First, it needed new revenue sources. Second, with Japan Post expanding into the logistics business, meeting customers' growing international logistics needs was important. Third, other countries' postal services had entered the international freight business in addition to international mail delivery. After an aborted joint venture with ANA (ANA & JP Express) and a potential but unrealized alliance with TNT, Japan Post partnered with Sankyu to form a new joint venture, Japan Post Sankyu Global Logistics, a freight forwarder that chiefly handles air cargo. Meanwhile, Japan Post is endeavoring to strengthen its international logistics services, mainly in Asia. It established a local subsidiary in Shanghai in 2013. It is also expanding its services, including small-lot refrigerated transport, in Asian countries. However, the revenue contribution of overseas operations remains extremely small.

Japan Post also runs all of the Japan Post Group's logistics operations on a contract basis and provides third-party logistics (3PL) services to online/mail-order retailers and other corporate customers.

Post office business: Postal, banking and insurance counter services

The post office business's main revenue source is fees from counter services provided on behalf of JPB, JPI and the postal service business. Such fees account for about 98% of its operating revenues. The postal counter services it provides include mail intake and disbursement, sales of postage stamps and revenue stamps, and acceptance of Yu-Pack parcels for delivery. Banking counter services include savings deposits and withdrawals, remittances, payments, and sales of JGBs and other investments. Japan Post provides these banking services as an agent of JPB and receives fees for doing so. Insurance counter services include selling life insurance and paying insurance claims as an agent of JPI. As mentioned above, post offices also sell nonlife insurance and third-sector insurance products on behalf of insurers other than JPI.

Post office business: Real estate

Japan Post operates a high-value-added real estate business by redeveloping properties in prime locations, such as JP Tower adjacent to Tokyo Station. In the medium-term business plan, the real estate business is designated as a key business to be strengthened in the aim of effectively utilizing real estate holdings, including rental office buildings, condominium developments, and parking lots.

Operating environment for postal service business

Figure 38 provides a breakdown of Japan Post's delivery volume. The items that Japan Post delivers can be broadly broken down into 1) letters, postcards and other mail and 2) Yu-Pack and Yu-Mail parcels. The former is the postal service business's main revenue source, accounting for some 85% of total unit volume and an estimated 70% of revenues despite lower postal rates for mail than for parcels. However, the postal service business faces an adverse operating environment as mail volume continues to shrink about 3% annually as a result of corporate direct-mail spending cuts, tougher competition from private mail delivery services, and widespread proliferation of mail-substitute technologies such as the internet. This trend is not unique to Japan. Other developed countries are also experiencing similar declines in mail volumes.

In the parcel delivery (Yu-Pack) market, Japan Post faces intense competition from private parcel delivery services. Although Japan Post's inroads into the market have been delayed by difficulties integrating Nippon Express's Pelican-bin service into its operations, the market is projected to continue growing rapidly, driven largely by e-commerce. Accelerating growth in the parcel delivery business is therefore Japan Post's top priority in terms of earnings growth. The company also faces private-sector competition in the mail delivery market, but it is adapting to the competitive landscape through such means as tightening letter intake standards in response to regulatory problems encountered by Yamato, its biggest rival, in 2011. As such, Japan Post enjoys a competitive advantage in this market.

Below we discuss the operating environment in and outlook for the parcel delivery market, a prospective growth driver for Japan Post, and the mail delivery market, where regulatory reform is a key focal point.

Figure 38. Breakdown of Japan Post's delivery volume (mn units)

	3/2012 Volume	% of total	3/2013 Volume	% of total
Grand total	**22,363**	**100.0%**	**22,346**	**100.0%**
Letter post	**19,108**	**85.4%**	**18,862**	**84.4%**
Domestic mail service	19,058	85.2%	18,814	84.2%
Ordinary mail	18,598	83.2%	18,352	82.1%
First class mail	8,913	39.9%	8,798	39.4%
Second class mail	6,648	29.7%	6,609	29.6%
Third class mail	275	1.2%	253	1.1%
Fourth class mail	24	0.1%	22	0.1%
New Year's cards	2,677	12.0%	2,613	11.7%
Election-related mail	62	0.3%	58	0.3%
Special handling mail	460	2.1%	463	2.1%
International mail service	49	0.2%	48	0.2%
Ordinary mail	40	0.2%	38	0.2%
Small packets	1	0.0%	1	0.0%
EMS	9	0.0%	9	0.0%
Parcel post	**3,255**	**14.6%**	**3,483**	**15.6%**
Yu-Pack	383	1.7%	382	1.7%
Yu-Mail	2,872	12.8%	3,101	13.9%

Source: Company data, Citi Research.

Current state of parcel delivery service

The parcel delivery market was a postal monopoly until the early 1970s. In the latter half of the 1970s, Yamato Transport migrated downstream from the fiercely competitive commercial freight market to the small-parcel delivery market and launched its TA-Q-BIN (express delivery) service. The advent of competition

spurred market growth. In the mid-1970s, small-parcel delivery volume was growing slowly from a small base of around 140mn units. By FY3/13, parcel delivery services' delivery volume had grown to some 3.5bn units. Since privatization, Japan Post has operated its parcel delivery service as part of its distribution business, separate from its mail delivery operations and subject to general freight regulations like other domestic freight carriers.

The parcel delivery market's growth has been driven chiefly by Yamato Transport's TA-Q-BIN service. Originally targeted at the small-parcel market, the TA-Q-BIN service began as a consumer-to-consumer (C2C) freight carrier. The overall parcel delivery market's rapid growth was driven not only by growth in the C2C market segment (since it was more convenient than postal delivery) but also by utilization of the C2C delivery network to capture business-to-consumer (B2C) and business-to-business (B2B) freight traffic. C2C is now a mature market. Yamato's growth is now being driven by freight originating from businesses, with B2C and B2B parcel volume accounting for nearly 90% of parcel delivery volume. C2C accounts for the remaining 10% or so.

Freight shipped in the B2B/B2C market consists mainly of goods purchased by consumers and small commercial shipments of parts, materials and other supplies. The e-commerce market has been growing in recent years in the wake of smartphones' proliferation, increased shipments of gifts directly from merchants to recipients' homes, and rising demand for home delivery of store-bought merchandise. Even in the commercial freight market, where large-lot shipments have historically accounted for the lion's share of cargo volume, there is a trend toward smaller shipment sizes. This trend is a tailwind for growth in the parcel delivery market.

Yamato is the parcel delivery market leader with a 43% share in FY3/13, followed by Sagawa Express with 39% and Japan Post with 11%. Yamato and Sagawa's combined share appears to be even higher in the B2B/B2C market segments. Yamato is highly competitive in the B2C segment in particular. It excels at executing fast, reliable deliveries and handling CoD transactions for online/mail-order retailers. Sagawa has captured a large market share by virtue of strong relationships with corporate customers that have long been its core focus.

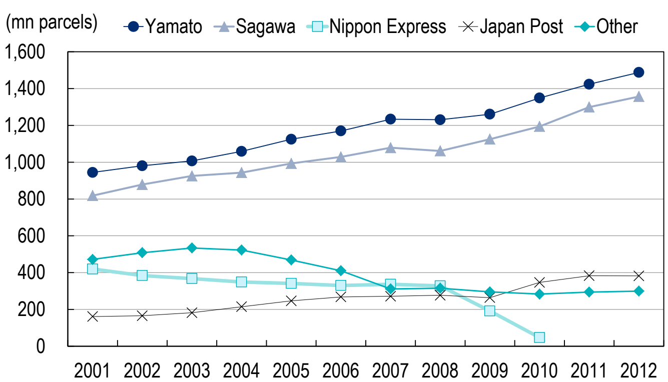
Amid this environment, Yu-Pack's market share has been languishing for two main reasons. First, the product's strength lies in the C2C market. Japan Post must make inroads into the commercial freight market with better marketing. Second, in terms of parcel weight, size and quantity, Japan Post's trucks, terminals and other facilities are ill-suited to handling commercial freight larger than Yu-Pack parcels. Following its privatization, Japan Post partnered with Nippon Express to compete against Yamato and Sagawa. They formed a strategic alliance and merged their parcel delivery operations in the aim of improving service and gaining market share. However, the integration process was very tumultuous internally. Japan Post and Nippon Express ended up not only failing to gain market share but also paying a high price in the form of large financial losses and the loss of customers' trust.

The history of the merger of Japan Post and Nippon Express's parcel delivery operations can be briefly summarized as follows. After being privatized, Japan Post entered into a comprehensive operational alliance with Nippon Express in 2007. In 2008 the two companies established a joint-venture company named JPEX. They planned to merge their respective parcel delivery businesses (Yu-Pack and Pelican-bin) by having JPEX take over their operation, but they encountered difficulties in integrating their IT systems. As a result, only Nippon Express's operations had been transferred to JPEX by the time it commenced operations in April 2009. The Yu-

Pack business was slated to be subsequently integrated into JPEX, but the Minister of Internal Affairs and Communications' approval was not forthcoming, and the merger plan had to be radically revised. JPEX ended up being dissolved and liquidated in August 2010. Its assets were taken over by the erstwhile Japan Post Service.

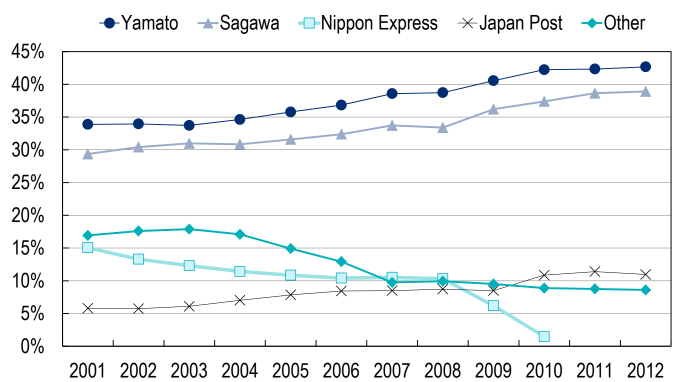
Japan Post booked a large extraordinary loss on the JPEX deal in FY3/10. It incurred another large loss in FY3/11 as a result of 1) higher personnel expenses and higher costs for subcontracted parcel collection and delivery following the takeover of JPEX's operations and 2) increased expenses incurred to rectify Yu-Pack delivery delays immediately after the takeover. Although earnings performance improved in FY3/12– FY3/13, Yu-Pack operations apparently remain in the red even today. Japan Post aims to restore Yu-Pack to profitability in FY3/16. Pelican-bin and Yu-Pack's IT systems were finally integrated in April 2013, but a major failure in the system for managing large customers required an additional two months to fix.

Figure 39. Parcel delivery volumes



Source: MLIT, Citi Research.

Figure 40. Parcel delivery market share



Source: MLIT, Citi Research.

Outlook for parcel delivery business

The parcel delivery market is projected to continue expanding, driven by continued growth in e-commerce and increased utilization of intercompany logistics. In the e-commerce sector, logistics and delivery service competition is anticipated among not only freight carriers but also online/mail-order retailers. However, delivery margins are under pressure in the e-commerce space. With truck rental and personnel expenses rising, all parcel delivery carriers are raising rates to boost profitability. We therefore see little risk of cut-price competition. Instead, we expect the parcel delivery industry to enter an era of competition based on providing high-value-added service to customers.

Yamato has unveiled a "value networking" concept that it calls its third major innovation. It aims to create a high-value-added model by radically improving its cost-competitiveness and reforming its existing network by leveraging Haneda Chronogate, the Okinawa International Air Logistics Hub, and its gateway facilities in Japan's three largest metro areas. Yamato aims to provide customers with superior freight services in terms of speed, cost and quality and expand its operations not only in the parcel delivery business but also in logistics-, finance- and IT-related sectors. It plans to aggressively pursue new customers in both the rapidly growing domestic e-commerce market and the supply-chain logistics market. Additionally, it plans to aggressively capture freight traffic between Japan and other Asian countries. We expect Yamato to steadily gain corporate customers. It is likely

to experience dramatic earnings growth from FY3/17, by which time all of its gateways should be fully operational.

Sagawa Express placed first priority on improving margins in its parcel delivery business in FY3/14. It aggressively raised rates, even at the risk of losing major corporate customers. It appears intent on continuing to prioritize profitability in FY3/15 and beyond. Meanwhile, it plans to create new earnings opportunities by acquiring new corporate customers. It appears to be focusing on manufacturing logistics and 3PL in particular.

By strengthening these functions, Sagawa hopes increased upstream freight volumes will drive growth in its parcel delivery business. Sagawa has also been investing intensively in large distribution facilities in recent years. In addition to recently opened facilities in Kashiwa (Chiba Prefecture) and Yokohama (Kanagawa), Sagawa plans to open distribution facilities in Osaka around May 2014 and in Higashi-Matsuyama (Saitama) around autumn 2015. The new facilities should contribute to strengthening both its parcel delivery and logistics businesses. Another priority is overseas expansion. Sagawa plans to expand its overseas delivery and customs-clearing operations as adjuncts to its core freight-forwarding business, and also intends to actively pursue M&A deals. Over the three years through FY3/16, Sagawa plans to invest a total of ¥100bn in 3PL, manufacturing logistics, and seaborne transport.

Japan Post provides same-day delivery service in urban centers using its existing postal infrastructure. It plans to build 20 “mega distribution centers” throughout Japan and consolidate and relocate 70 regional hub facilities. This plan will entail an investment of some ¥180bn by FY3/19. Japan Post aims to substantially shorten delivery times through centralized processing of mail at mega distribution centers equipped with state-of-the-art automated equipment for performing mail and parcel sorting hitherto done at mail collection and delivery facilities. It also aims to shorten Yu-Pack turnaround times. Many sorting facilities are currently located adjacent to terminal railway stations as a vestige of the rail transport era, but Japan Post plans to relocate them near expressway interchanges. This reorganization will entail the closure and consolidation of sorting facilities, resulting in a more efficient network for Japan Post.

Additionally, Japan Post plans to deploy a specialized sales force and upgrade the sales skills of its delivery personnel, apparently in the aim of acquiring more customers in the e-commerce market, which has promising growth prospects and is characterized by a large volume of small parcels, Japan Post’s forte. In April 2014, Japan Post established a Solutions Planning Department as a sales force targeting mainly online/mail-order retailers. It also plans to set up new organizational units called distribution solutions centers on a regional basis. The distribution solutions centers will comprehensively respond to sales leads and problems reported by local post office personnel. Japan Post also plans to step up IT investment, probably with the goal of upgrading its distribution operations. Through these initiatives, Japan Post aims to overcome its competitive disadvantage vis-à-vis Yamato and Sagawa.

Mail/letter delivery

The Letter Delivery Act, which took effect in April 2003, gave private companies the opportunity to enter the letter delivery business. About 400 companies have since launched “special letter delivery services” that add value through motorcycle delivery, etc. Private companies are also permitted to enter the general letter delivery business, but the barrier to entry is much higher, including a requirement to install at least 100,000 public mailboxes. To date, no private companies have

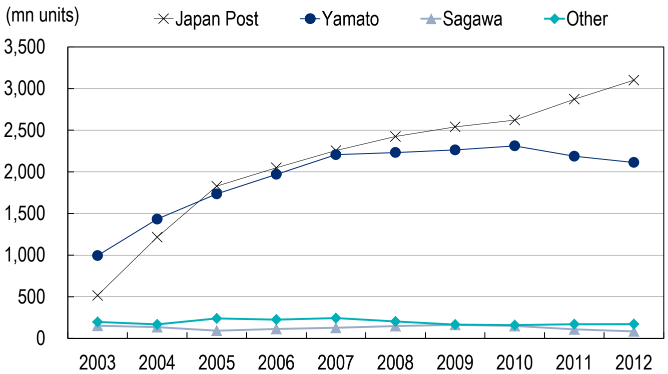
actually entered this business. According to a March 2003 directive issued by the Ministry of Internal Affairs and Communications, “letters” are defined as bills, meeting notices, and government-issued certificates. They do not include other documents or correspondence, catalogs, gift certificates, railway tickets, credit cards, compact discs, or floppy disks. These items can be sent via mail delivery services.

In the mail and bound-printed-matter parcel delivery business, the introduction of flexible pricing through competition and the cultivation of a previously nonexistent market between letter delivery and parcel delivery gave rise to new business opportunities for both Japan Post (and its public predecessor) and private delivery carriers, similar to how TA-Q-BIN’s advent in the 1970s spurred growth in the parcel delivery market. After “letter” was explicitly defined as noted above and Yamato re-launched its mail delivery service in 2003, mail and bound-printed-matter parcel delivery volumes did indeed burgeon as competition flourished. Growth first picked up in the direct mail market. Next, online/mail-order retailers started using mail delivery services instead of parcel delivery services, depending on the size of merchandise being shipped. Mail delivery has thus become an alternative to conventional shipping for certain shippers.

However, the definition of a letter proved to be ambiguous in practice, resulting in confusion among delivery service workers and occasional problems that detracted from user convenience and private delivery carriers’ efficiency. In March 2011, Yamato Transport’s mail service delivered letters sent by an employee of Saitama Prefecture. Legal complaints were filed against both Yamato and the employee who had mistakenly sent the letters via a private mail delivery service. In response to this incident, Yamato tightened its compliance and began to require senders to certify in writing that their outgoing mail did not contain any letters. As a result, delivery of even non-letter mail shifted to Japan Post, partly because the definition of “letter” is so confusing. Yamato’s mail delivery volume has been in decline ever since this incident.

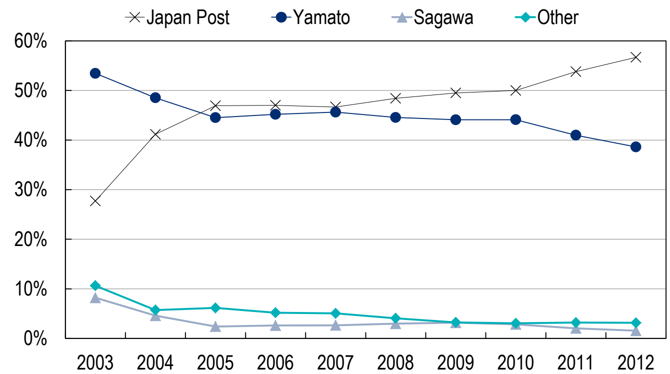
In response to the possibility that customers might also be penalized because of the ambiguous definition of “letter,” Yamato lobbied the Council for Regulatory Reform in April 2013 to repeal or clarify the definition or exempt customers from penalties. However, the Council did not take up the matter. In December 2013, Yamato requested the letter regulations be revised through the adoption of standards based on mail’s external attributes (size, weight, and so on). In Europe and the Americas, postal monopolies’ scope is generally defined based on external criteria. Even in Japan, regulators have previously considered adopting such standards. However, Yamato’s request was not addressed in a March 2014 interim report issued by the Ministry of Internal Affairs and Communications on measures to promote growth in the mail/letter delivery market. Nor did the report mention the possibility of reconsidering the letter regulations. The competitive environment in the mail/letter delivery market thus looks likely to remain advantageous for Japan Post. Meanwhile, Yamato is likely to continue lobbying. In any event, related regulatory developments warrant close monitoring.

Figure 41. Mail delivery volumes



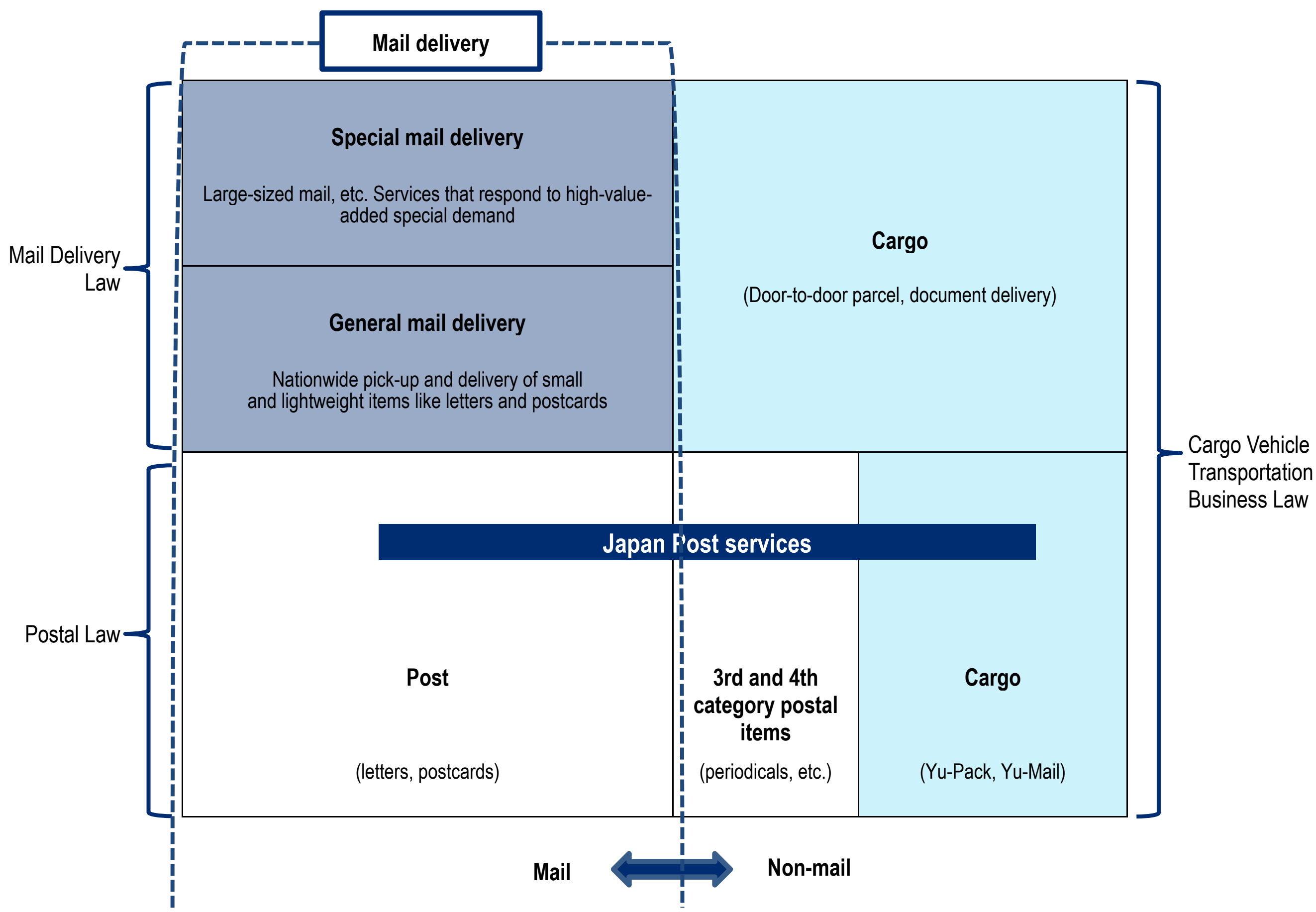
Source: MLIT, Citi Research.

Figure 42. Mail delivery market shares



Source: MLIT, Citi Research.

Figure 43. Legal basis for delivery of letters, non-letter mail, and general mail



Source: MIC, Citi Research.

Challenges facing Japan Post and impact on transport industry

Trend toward higher-added-value logistics services

As noted above, the ongoing decline in mail volume is a structural trend that is expected to continue. For Japan Post, the key to earnings growth is to strengthen domestic parcel delivery, domestic mail delivery, international distribution, and logistics. Of particular importance is the expansion of its parcel delivery business, which is large in scale and operates in a rapidly growing market. Management is likely to focus on expanding the firm's share of the B2B/B2C (e-commerce, etc.) markets in particular.

Japan Post plans to step up investment in distribution facilities and IT systems as mentioned above. Its planned level of investment is very high even in comparison to private competitors. However, with its investment program slated to be completed around FY3/19, Japan Post lags well behind Yamato and Sagawa, both of which already have state-of-the-art distribution centers in operation. Yamato and Sagawa also plan to prioritize the B2B/B2C markets. They are upgrading their networks and investing in IT systems and large logistics facilities. These initiatives should boost the value added by their logistics services. Additionally, Japan Post is not adept at creating new demand, perhaps because it has hitherto enjoyed regulatory protection. With the market demanding increasingly high-value-added logistics services, Japan Post urgently needs to strengthen its service and solutions capabilities in addition to upgrading its infrastructure.

While Japan Post's growth initiatives could pose a threat to Yamato and Sagawa in certain respects, both companies are currently ahead of Japan Post in many respects. Moreover, we expect both to further upgrade their services. Japan Post undeniably faces an uphill challenge in catching up to Yamato and Sagawa and becoming a true competitive threat. Another point that bears noting is that delivery systems that utilize the postal network are basically limited in terms of the size of the goods they are capable of handling. Such limitations could be a constraint on growth. That said, the turmoil that accompanied privatization has finally subsided for Japan Post. It has entered a phase where it will be able to focus on executing its business strategy and strengthening its competitiveness as discussed above. The extent to which Japan Post can gain ground on its leading rivals will be a key focal point going forward.

Improvements in productivity

While mail volume is projected to continue decreasing in its core postal service business, Japan Post is required to provide universal postal service. It will therefore need to achieve further improvements in productivity. Controlling personnel expenses, which account for over 60% of expenses, will be particularly important. In response to the large loss in FY3/11, Japan Post revised its employment practices and wage structure, downsized its workforce, and cut costs. As a result of these measures, its postal service business, which had incurred a large loss after absorbing Pelican-bin, was restored to profitability in FY3/13.

Nonetheless, achieving profitability in the parcel delivery business on a standalone basis still poses a big challenge. In addition to the revenue growth measures discussed above, Japan Post must endeavor to keep cost increases under control even if its parcel delivery volume increases. Although it is likely to increasingly utilize part-time workers as it expands its parcel delivery and other distribution operations, Japan is currently in the midst of a worsening labor shortage, which puts Japan Post at risk of having to raise wages. It therefore must increase its operational efficiency through such means as reshuffling personnel in accord with workloads, installing IT systems, and automating mail/parcel handling processes.

Chapter 4. Equity market impact

1. Impact by business line

Our approach

Getting a picture of the market impact of the three entities that are expected to list from the scale of potential market caps calculated from each business line is important to anticipating the impact on peers' share prices.

Japan Post Bank

Profit levels

Over the past five years JPB has earned net business profits ranging from ¥480.6bn to ¥513.6bn and averaging ¥497.6bn. Of JPB's securities holdings at March 31, 2013, ¥57trn were classified as available for sale while some ¥99trn were classified as held to maturity. JPB has a much larger held-to-maturity portfolio than the typical bank.

Since that means JPB's earnings are fairly well insulated against market fluctuations and since the lending business will take quite a while to move the needle on earnings, we think it is reasonable to assume that JPB will continue to generate its current level of annual pretax profit. Assuming an effective tax rate of 35%, we sense NP is roughly ¥300bn–¥400bn.

Given shareholders' equity of approximately ¥11trn, this equates to an RoE of 2.7% to 3.6%.

A number of methods are available for calculating market cap

Major banks' cost of capital

Major banks' valuations have decreased amid the equity market decline since January. However, we expect the major bank stocks to correct higher from current levels. Our target for major banks' cost of capital is 7.7% (target PER of 13x derived from a no-growth model).

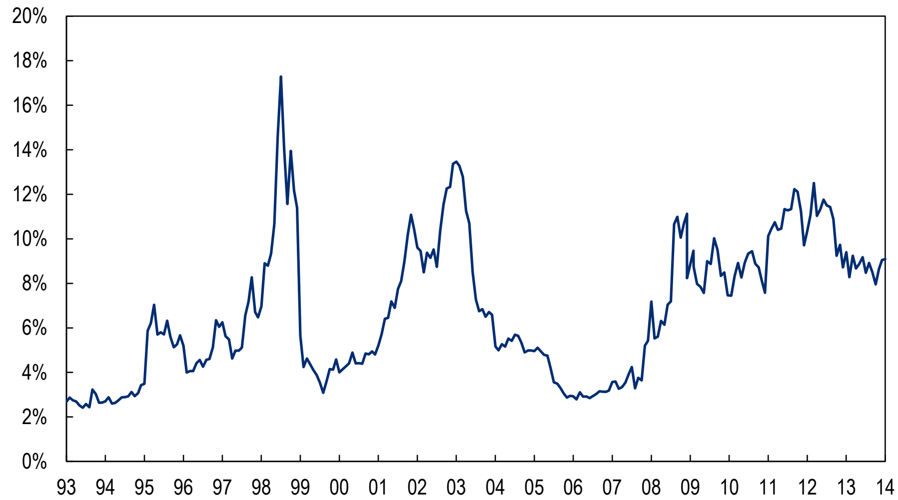
From the standpoint of its operational profile, JPB is more similar to top-tier regional banks than to the major banks. Top regional banks' cost of capital is currently about 6.2%–7.7% and their PER range is 13x–16x.

Figure 44. Market cap matrix according to JPB's profit levels (¥bn)

NP (Horizontal = PER)	10x	11x	12x	13x	14x	15x	16x	17x	18x
300.0	3,000	3,300	3,600	3,900	4,200	4,500	4,800	5,100	5,400
350.0	3,500	3,850	4,200	4,550	4,900	5,250	5,600	5,950	6,300
400.0	4,000	4,400	4,800	5,200	5,600	6,000	6,400	6,800	7,200
450.0	4,500	4,950	5,400	5,850	6,300	6,750	7,200	7,650	8,100
500.0	5,000	5,500	6,000	6,500	7,000	7,500	8,000	8,500	9,000
550.0	5,500	6,050	6,600	7,150	7,700	8,250	8,800	9,350	9,900
600.0	6,000	6,600	7,200	7,800	8,400	9,000	9,600	10,200	10,800
650.0	6,500	7,150	7,800	8,450	9,100	9,750	10,400	11,050	11,700
700.0	7,000	7,700	8,400	9,100	9,800	10,500	11,200	11,900	12,600

Source: Citi Research.

Figure 45. Major banks' cost of capital



Source: Citi Research.

Dividend yield

Because JPB is like a public utility in certain respects (e.g., the universal service requirement), we think management may focus primarily on earning stable profits instead of ambitiously pursuing competition and growth.

Among the banks in our coverage universe, one that seems to attract a high degree of investor interest by virtue of its dividend yield is Aozora Bank. Its stock is priced to yield around 4%–5%.

Figure 46 presents a calculation matrix based on assumed NP of ¥400bn–¥500bn, dividend payout ratios of 30%–70%, and a required dividend yield of 3.5%–5.5%.

Figure 46. Market cap matrix for JPB according to profit levels and dividends (¥bn)

NP	Payout Ratio (Horizontal = Dividend Yield)	3.50%	3.75%	4.00%	4.25%	4.50%	4.75%	5.00%	5.25%	5.50%
400.0	30%	3,429	3,200	3,000	2,824	2,667	2,526	2,400	2,286	2,182
400.0	50%	5,714	5,333	5,000	4,706	4,444	4,211	4,000	3,810	3,636
400.0	70%	8,000	7,467	7,000	6,588	6,222	5,895	5,600	5,333	5,091
500.0	30%	4,286	4,000	3,750	3,529	3,333	3,158	3,000	2,857	2,727
500.0	50%	7,143	6,667	6,250	5,882	5,556	5,263	5,000	4,762	4,545
500.0	70%	10,000	9,333	8,750	8,235	7,778	7,368	7,000	6,667	6,364
600.0	30%	5,143	4,800	4,500	4,235	4,000	3,789	3,600	3,429	3,273
600.0	50%	8,571	8,000	7,500	7,059	6,667	6,316	6,000	5,714	5,455
600.0	70%	12,000	11,200	10,500	9,882	9,333	8,842	8,400	8,000	7,636

Source: Citi Research.

Japan Post Insurance

EV

JPI publicly disclosed its EEV (European embedded value) for the first time last year. With the market pricing life insurers' stocks based more on EV than on profit levels, we consider EV and RoEV to be the most relevant metrics for life insurers.

JPI’s most recently disclosed EV is ¥2,866.2bn as of March 31, 2013. Its RoEV target in the medium-term business plan is 8%.

Matrix of potential business scale

We assume the life insurance industry’s cost of capital is in the 12%–15% range. Figure 47 shows a calculation matrix based on EV of ¥2trn–¥4trn and RoEV.

Figure 47. Market cap matrix for JPI according to EV and cost of capital (¥bn)

EV	RoEV (Horizontal = Cost of Capital)	11.0%	11.5%	12.0%	12.5%	13.0%	13.5%	14.0%	14.5%	15.0%
2,000.0	6%	1,091	1,043	1,000	960	923	889	857	828	800
2,000.0	7%	1,273	1,217	1,167	1,120	1,077	1,037	1,000	966	933
2,000.0	8%	1,455	1,391	1,333	1,280	1,231	1,185	1,143	1,103	1,067
3,000.0	6%	1,636	1,565	1,500	1,440	1,385	1,333	1,286	1,241	1,200
3,000.0	7%	1,909	1,826	1,750	1,680	1,615	1,556	1,500	1,448	1,400
3,000.0	8%	2,182	2,087	2,000	1,920	1,846	1,778	1,714	1,655	1,600
4,000.0	6%	2,182	2,087	2,000	1,920	1,846	1,778	1,714	1,655	1,600
4,000.0	7%	2,545	2,435	2,333	2,240	2,154	2,074	2,000	1,931	1,867
4,000.0	8%	2,909	2,783	2,667	2,560	2,462	2,370	2,286	2,207	2,133

Source: Citi Research.

2. Impact on equity supply and demand

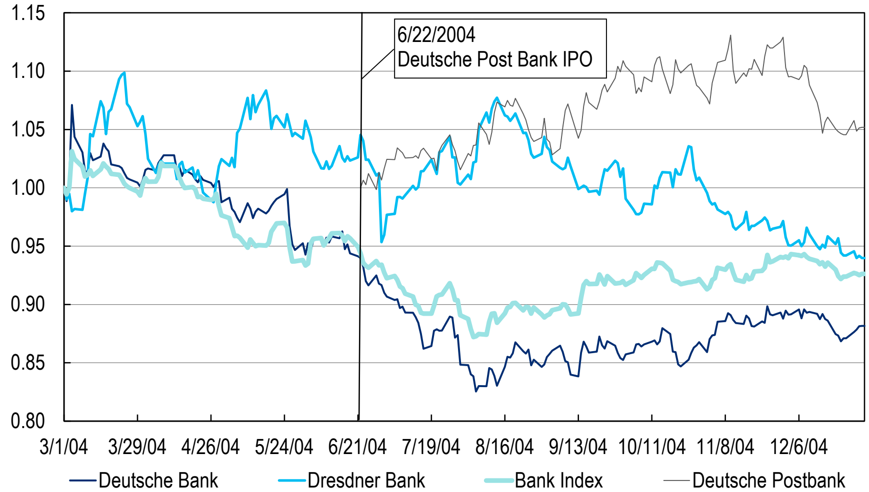
Other financial stocks may be crowded out

From an investment strategy standpoint, investors must anticipate the investment capital flows that will ensue from the IPOs of JPB and JPI, both of which are huge financial institutions. Figure 48 charts German bank stocks’ performance before and after Postbank’s IPO. To factor out the impact of the market environment, Figure 48 plots relative performance benchmarked against the DAX and rebased to a value of 1.0 as of three months before Postbank’s IPO date.

The Bank Index distinctly underperformed the DAX in the three months preceding the IPO. After the IPO, the Bank Index continued to underperform for about two months. Postbank’s stock, meanwhile, received a strong bid during these two months. The Bank Index subsequently traded sideways for the remainder of the timeframe shown.

Even though Postbank’s market cap was only about one-quarter that of Deutsche Bank, its IPO nonetheless triggered a rotation of capital within the banking sector that detracted from the sector’s overall performance.

Figure 48. Impact of Deutsche Postbank's IPO (relative performance vs. DAX)



Source: Citi Research.

Postbank's IPO coincided with a jittery period in German financial markets. Investors consequently may have sought a safe haven in the stock's public-utility characteristics. However, JPB and JPI's market caps are far too large to ignore. We expect their IPOs to crowd out investment in other financial stocks to some extent.

3. Other key points

Industry outlook from regional standpoint

The biggest strength of JPB and Japan Post Insurance is their access to the ubiquitous nationwide post office network. While competition among banks and life insurers has always been intense in economically concentrated urban areas, the major banks have a limited presence outside urban areas.

Assume, for example, that JPB ramps up its lending business in earnest. It probably has little prospect of capturing much business from the major banks' core corporate customer base. Outside urban areas, however, there are regions—particularly those with few bank branches—characterized by less competition. JPB's expansion of its lending business could therefore pose a threat in areas where JPB has a large market share to begin with.

Figure 49. Prefectural deposit shares by bank type (as of March 31, 2013)

	Hokkaido		Aomori		Akita		Yamagata		Iwate		Miyagi		Fukushima		Gunma	
(¥bn)	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share
Major banks	2,378	7.3	59	0.9	47	0.8	62	0.9	98	1.2	1,919	11.6	391	3.0	753	5.2
Regional banks	5,108	15.7	3,900	56.9	3,387	58.2	2,875	40.8	3,809	45.2	7,954	48.0	4,990	37.8	5,374	37.3
2nd tier regional	7,169	22.0	45	0.7	54	0.9	1,032	14.6	1,012	12.0	1,235	7.5	1,336	10.1	821	5.7
Shinkin banks	6,639	20.4	752	11.0	258	4.4	458	6.5	756	9.0	991	6.0	1,533	11.6	2,370	16.4
Shinkumi banks	602	1.8	179	2.6	74	1.3	187	2.7	51	0.6	254	1.5	511	3.9	661	4.6
Rokin banks	875	2.7	139	2.0	138	2.4	309	4.4	279	3.3	356	2.1	391	3.0	469	3.3
JA	3,090	9.5	480	7.0	750	12.9	917	13.0	969	11.5	1,248	7.5	1,558	11.8	1,383	9.6
Japan Post Bank	6,745	20.7	1,296	18.9	1,109	19.1	1,210	17.2	1,456	17.3	2,601	15.7	2,496	18.9	2,593	18.0
Total	32,606	100.0	6,850	100.0	5,816	100.0	7,050	100.0	8,429	100.0	16,556	100.0	13,206	100.0	14,424	100.0

	Tochigi		Ibaraki		Saitama		Chiba		Tokyo		Kanagawa		Niigata		Yamanashi	
(¥bn)	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share
Major banks	784	6.0	1,125	5.8	20,018	42.8	9,455	24.4	204,150	77.4	22,073	35.3	643	3.9	355	6.1
Regional banks	4,580	34.9	8,779	45.2	4,815	10.3	11,764	30.4	9,515	3.6	12,212	19.5	6,432	39.0	2,346	40.0
2nd tier regional	2,040	15.5	324	1.7	1,605	3.4	3,979	10.3	4,435	1.7	2,113	3.4	1,203	7.3	0	0.0
Shinkin banks	1,128	8.6	1,561	8.0	6,569	14.0	2,403	6.2	19,330	7.3	8,292	13.3	1,420	8.6	726	12.4
Shinkumi banks	168	1.3	1,132	5.8	293	0.6	489	1.3	2,570	1.0	304	0.5	886	5.4	622	10.6
Rokin banks	226	1.7	789	4.1	444	0.9	456	1.2	1,805	0.7	971	1.6	727	4.4	58	1.0
JA	1,558	11.9	1,569	8.1	3,884	8.3	2,360	6.1	3,440	1.3	5,759	9.2	2,127	12.9	595	10.2
Japan Post Bank	2,644	20.1	4,157	21.4	9,142	19.5	7,847	20.2	18,454	7.0	10,829	17.3	3,037	18.4	1,155	19.7
Total	13,127	100.0	19,436	100.0	46,771	100.0	38,755	100.0	263,698	100.0	62,553	100.0	16,475	100.0	5,857	100.0

	Nagano		Shizuoka		Gifu		Aichi		Mie		Toyama		Ishikawa		Fukui	
(¥bn)	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share
Major banks	665	4.0	2,420	8.0	764	4.7	21,463	32.5	791	5.8	315	3.5	635	7.2	186	2.8
Regional banks	5,387	32.8	10,399	34.3	5,972	36.4	4,382	6.6	5,121	37.5	3,607	39.6	3,910	44.3	2,448	37.5
2nd tier regional	954	5.8	331	1.1	117	0.7	7,000	10.6	1,420	10.4	880	9.7	30	0.3	372	5.7
Shinkin banks	2,374	14.4	7,014	23.1	3,272	19.9	14,116	21.4	1,186	8.7	1,161	12.7	1,282	14.5	1,133	17.3
Shinkumi banks	872	5.3	69	0.2	562	3.4	616	0.9	50	0.4	145	1.6	54	0.6	103	1.6
Rokin banks	551	3.4	972	3.2	199	1.2	853	1.3	359	2.6	232	2.5	230	2.6	226	3.5
JA	2,866	17.4	4,735	15.6	2,866	17.5	7,372	11.2	2,144	15.7	1,284	14.1	1,110	12.6	824	12.6
Japan Post Bank	2,767	16.8	4,382	14.5	2,668	16.3	10,200	15.5	2,601	19.0	1,492	16.4	1,578	17.9	1,240	19.0
Total	16,436	100.0	30,321	100.0	16,420	100.0	66,002	100.0	13,671	100.0	9,116	100.0	8,831	100.0	6,531	100.0

	Shiga		Kyoto		Osaka		Nara		Wakayama		Hyogo		Tottori		Shimane	
(¥bn)	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share
Major banks	288	3.0	5,197	22.0	46,820	54.7	2,263	20.5	827	9.9	14,779	34.6	60	1.6	29	0.6
Regional banks	3,882	40.0	6,188	26.2	9,033	10.6	3,827	34.7	2,862	34.3	2,509	5.9	1,990	53.1	1,933	41.9
2nd tier regional	950	9.8	258	1.1	3,025	3.5	110	1.0	174	2.1	3,136	7.3	57	1.5	285	6.2
Shinkin banks	1,130	11.6	6,626	28.1	7,338	8.6	1,217	11.0	1,030	12.3	7,962	18.6	367	9.8	405	8.8
Shinkumi banks	190	2.0	187	0.8	2,073	2.4	78	0.7	72	0.9	1,149	2.7	0	0.0	23	0.5
Rokin banks	166	1.7	272	1.2	756	0.9	98	0.9	222	2.7	430	1.0	98	2.6	145	3.1
JA	1,400	14.4	1,196	5.1	4,356	5.1	1,331	12.1	1,508	18.0	5,054	11.8	477	12.7	882	19.1
Japan Post Bank	1,706	17.6	3,658	15.5	12,212	14.3	2,097	19.0	1,661	19.9	7,717	18.1	698	18.6	914	19.8
Total	9,712	100.0	23,582	100.0	85,614	100.0	11,020	100.0	8,355	100.0	42,736	100.0	3,748	100.0	4,616	100.0

	Okayama		Hiroshima		Yamaguchi		Tokushima		Kagawa		Ehime		Kochi		Fukuoka	
(¥bn)	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share
Major banks	1,054	7.6	2,161	9.8	355	3.5	262	3.9	712	7.8	422	3.9	104	2.0	3,365	10.9
Regional banks	5,058	36.4	6,929	31.3	4,185	41.3	2,822	41.7	3,248	35.8	4,428	40.6	1,562	29.8	15,902	51.4
2nd tier regional	1,079	7.8	2,675	12.1	969	9.6	1,185	17.5	1,052	11.6	1,652	15.1	875	16.7	601	1.9
Shinkin banks	1,607	11.6	2,245	10.2	934	9.2	284	4.2	646	7.1	860	7.9	759	14.5	1,602	5.2
Shinkumi banks	366	2.6	958	4.3	93	0.9	0	0.0	124	1.4	5	0.0	51	1.0	386	1.2
Rokin banks	216	1.6	409	1.8	234	2.3	121	1.8	151	1.7	178	1.6	161	3.1	386	1.2
JA	1,653	11.9	2,502	11.3	1,218	12.0	800	11.8	1,566	17.3	1,640	15.0	864	16.5	2,588	8.4
Japan Post Bank	2,868	20.6	4,230	19.1	2,138	21.1	1,286	19.0	1,577	17.4	1,724	15.8	867	16.5	6,131	19.8
Total	13,899	100.0	22,109	100.0	10,126	100.0	6,759	100.0	9,076	100.0	10,908	100.0	5,243	100.0	30,961	100.0

	Saga		Nagasaki		Kumamoto		Oita		Miyazaki		Kagoshima		Okinawa		Overall	
(¥bn)	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share
Major banks	135	2.8	239	3.2	571	5.9	198	2.8	83	1.6	304	3.5	80	1.4	371,853	34.2
Regional banks	1,889	39.9	4,133	54.5	3,717	38.1	2,857	40.8	2,145	40.2	3,154	36.6	3,389	58.1	236,704	21.8
2nd tier regional	206	4.4	212	2.8	1,250	12.8	491	7.0	530	9.9	633	7.3	580	9.9	61,492	5.7
Shinkin banks	306	6.5	175	2.3	670	6.9	587	8.4	462	8.7	869	10.1	151	2.6	124,953	11.5
Shinkumi banks	155	3.3	222	2.9	126	1.3	340	4.9	14	0.3	236	2.7	0	0.0	18,302	1.7
Rokin banks	150	3.2	174	2.3	244	2.5	311	4.4	240	4.5	194	2.2	221	3.8	17,628	1.6
JA	833	17.6	650	8.6	948	9.7	642	9.2	735	13.8	1,203	13.9	759	13.0	89,692	8.3
Japan Post Bank	1,057	22.3	1,776	23.4	2,217	22.8	1,581	22.6	1,131	21.2	2,037	23.6	658	11.3	165,640	15.2
Total	4,731	100.0	7,581	100.0	9,743	100.0	7,007	100.0	5,340	100.0	8,628	100.0	5,837	100.0	1,086,263	100.0

Source: Financial Business Review, Citi Research.

Figure 50. Deposit shares: JPB versus prefectural leaders

		3/2013			3/2008		
Prefecture	Banks	Deposit share (%)	Post Bank share (%)	Difference	Deposit share (%)	Post Bank share (%)	Difference
Miyagi	77	44.0	15.7	28.3	37.7	21.2	16.4
Shimane	Sannin Godo	40.4	19.8	20.6	36.8	23.6	13.1
Yamanashi	Yamanashi Chuo	40.0	19.7	20.3	35.6	22.7	12.9
Ehime	Iyo	35.8	15.8	20.0	33.3	20.1	13.2
Shiga	Shiga	37.5	17.6	19.9	35.5	21.5	14.0
Iwate	Iwate	36.5	17.3	19.2	28.5	22.7	5.9
Okinawa	Ryukyu	30.2	11.3	18.9	28.2	15.3	12.9
Akita	Akita	37.2	19.1	18.1	33.7	23.0	10.7
Okinawa	Okinawa	27.9	11.3	16.6	24.6	15.3	9.3
Toyama	Hokuriku	33.0	16.4	16.6	29.8	19.5	10.3
Yamaguchi	Yamaguchi	37.6	21.1	16.5	34.5	25.7	8.8
Nagano	Hachijuni	32.6	16.8	15.8	30.9	20.6	10.3
Gunma	Gunma	33.7	18.0	15.7	31.6	21.2	10.4
Ishikawa	Hokkoku	32.4	17.9	14.5	30.4	20.5	9.9
Kumamoto	Higo	36.9	22.8	14.2	34.3	26.5	7.7
Nara	Nanto	32.9	19.0	13.9	31.4	23.2	8.2
Aomori	Aomori	32.6	18.9	13.6	29.3	21.7	7.6
Tokushima	Awa	32.6	19.0	13.5	31.1	22.7	8.4
Miyazaki	Miyazaki	34.7	21.2	13.5	30.9	24.9	6.0
Fukushima	Toho	31.6	18.9	12.7	25.2	24.4	0.8
Ibaraki	Joyo	33.7	21.4	12.3	31.9	24.9	7.1
Oita	Oita	34.9	22.6	12.3	33.1	25.5	7.6
Kochi	Shikoku	28.8	16.5	12.3	28.0	21.1	7.0
Wakayama	Kiyo	31.5	19.9	11.6	29.3	24.3	5.0
Kagoshima	Kagoshima	35.1	23.6	11.5	32.5	27.4	5.1
Kagawa	Hyakujushi	28.4	17.4	11.0	26.3	20.7	5.5
Okayama	Chugoku	30.8	20.6	10.2	28.5	24.6	3.9
Yamagata	Yamagata	27.3	17.2	10.1	23.0	21.6	1.4
Tochigi	Ashikaga	30.2	20.1	10.0	26.9	23.7	3.2
Saga	Saga	32.1	22.3	9.8	30.4	25.2	5.1
Mie	Hyakugo	27.9	19.0	8.9	25.6	23.0	2.7
Shizuoka	Shizuoka	23.2	14.5	8.8	22.2	18.2	4.0
Fukui	Fukui	27.5	19.0	8.6	27.0	22.3	4.8
Kyoto	Kyoto	22.7	15.5	7.2	21.4	18.2	3.2
Niigata	Daishi	25.3	18.4	6.9	23.4	21.4	2.0
Gifu	Juroku	22.2	16.3	5.9	18.2	20.0	-1.8
Nagasaki	Juhachi	29.1	23.4	5.7	26.6	26.6	-0.0
Fukuoka	Fukuoka	25.4	19.8	5.6	22.5	23.2	-0.7
Hiroshima	Hiroshima	24.2	19.1	5.0	22.4	23.0	-0.6
Chiba	Chiba	24.3	19.5	4.8	22.9	22.7	0.2
Aomori	Michinoku	22.7	18.9	3.7	22.4	21.7	0.7
Tottori	Tottori	19.9	18.6	1.3	17.2	22.2	-5.1
Akita	Hokuto	19.2	19.1	0.1	18.7	23.0	-4.3
Nagasaki	Shinwa	23.4	23.4	0.0	21.2	26.6	-5.4
Kanagawa	Yokohama	17.0	17.3	-0.3	16.1	20.0	-3.9
Fukuoka	Nishi-Nippon City	19.0	19.8	-0.8	18.6	23.2	-4.6
Gifu	Ogaki Kyoritsu	14.0	16.3	-2.3	12.6	20.0	-7.4
Yamagata	Shonai	12.6	17.2	-4.6	10.5	21.6	-11.1
Niigata	Hokuriku	12.9	18.4	-5.5	12.2	21.4	-9.2
Tokyo	Tokyo Tomin	0.9	7.0	-6.1	0.9	8.1	-7.2
Hokkaido	Hokkaido	13.0	20.7	-7.7	11.7	23.7	-12.1
Shizuoka	Suruga	6.7	14.5	-7.8	5.9	18.2	-12.3
Iwate	Tohoku	7.4	17.3	-9.9	7.8	22.7	-14.9
Shizuoka	Shimizu	4.5	14.5	-10.0	4.2	18.2	-14.0
Osaka	Senshu Ikeda	4.0	14.3	-10.2	3.9	17.0	-13.1
Osaka	Kinki Osaka	3.6	14.3	-10.7	3.8	17.0	-13.2
Mie	Mie	8.2	19.0	-10.9	7.9	23.0	-15.1
Ibaraki	Tsukuba	9.9	21.4	-11.5	6.3	24.9	-18.5
Saitama	Musashino	7.7	19.5	-11.8	7.3	22.7	-15.3
Toyama	Toyama	4.5	16.4	-11.9	4.1	19.5	-15.4
Chiba	Chiba Kogyo	5.5	20.2	-14.7	5.4	23.2	-17.8
Hyogo	Tajima	1.9	18.1	-16.2	1.9	21.8	-19.9
Fukuoka	Kitakyushu	2.2	19.8	-17.6	1.5	23.2	-21.7
Fukuoka	Chikuho	1.8	19.8	-18.0	1.8	23.2	-21.4
Total	Average	21.8	15.2	6.5	20.1	18.2	2.0

Source: Financial Business Review, Citi Research.

Appendix A-1

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