

Summary of Questions and Answers for FY2019

Date of event: May 25, 2020 (Monday)

Attending members from the Company:

Masayuki Mizushima, Representative Director & President

Hirotake Yajima, Director & Executive Vice President

Mitsumasa Matsuzaki, Director & Senior Executive Corporate Officer

Masanori Nishioka, Director & Senior Corporate Officer

Takeshi Tokugawa, Corporate Officer

How do you view the growth rate in the overall market during FY2020? Also, to the extent that is possible, can you tell us your forecasts for FY2021?

Mizushima: Based on the fact that it is extremely difficult to offer a full-year forecast at this time, I would like to speak only in reflection of past trends. Looking back on the impact of such events as the global financial crisis, the advertising market has the potential to fluctuate at a much greater rate than nominal GDP. For that reason, we are seeing very difficult numbers at the moment, and the likelihood of negative growth in the market over the course of FY2020 is high. It is difficult for us as Hakuodo DY Group to measure specific numbers, so I am unable to communicate any.

As for FY2021, growth in the advertising market will largely depend on the impact of COVID-19, but we believe that the business activities of many corporations will return to normal, and, therefore, expect market growth to go back to its previous pace.

In regard to cost reductions, please tell us the current scale you are considering for these efforts as well as their details.

Nishioka: Under the economic environment during the corona calamity, we believe controlling costs will become very important. However, as the path to containing the spread of the virus remains unclear, we are unable to talk about specific numbers in terms of cost reductions. I will, therefore, talk about our policy for controlling costs.

We are conducting various simulations on how long the impact of COVID-19 will last. In addition to using optimistic assumptions in which the impact bottoms out in the first quarter and we see a V-shaped

recovery, we also need to control costs based on the assumption of a prolonged resolution for the issue of COVID-19. To secure funds for the strategic growth investments adopted under the Medium-Term Business Plan to the greatest extent possible, we have already drafted plans at each company for reducing all non-essential and non-urgent costs, centered on expenses related to our operating activities, in the same manner as we did during the global financial crisis. The scale to which we will reduce expenses pertaining to our operating activities will be approximately 15% to 20%, at which point we will examine the need for further reductions in the future. When we say expenses pertaining to our operating activities, we are referring to a part of other expenses, not personnel costs, and are envisioning reductions of several billion yen.

Going forward, we believe it may be necessary for us to reduce costs to an even greater level. We will therefore, consider making adjustments to the timing and speed of strategic investment execution depending on the status of our top line.

Please tell us about the impact of COVID-19 on your overseas businesses, by region, up to March and from April on.

Mizushima: Overseas, the first quarter is from January to March, and during the first quarter, the impact of COVID-19 centered on the Greater China Region and ASEAN Region. In Europe and North America, the spread of COVID-19 became quite serious from April, and since then, we are seeing a genuine impact from the virus on our businesses there. The scale of the Group's business operations in the Greater China Region and ASEAN Region is large. Looking at the status of our offices in these regions, there are locations that saw double-digit declines in revenue in the first quarter. Also, while the scale of *kyu*'s business operations in North America is quite large, revenue in the first quarter was on a par with that of the same period in the previous fiscal year. We anticipate that COVID-19 will have an impact on *kyu*'s performance from the second quarter on, as that is when the virus began to spread extensively in the region. At each overseas office, we have already commenced a broad range of efforts to reduce costs. However, we will promote these efforts while striving to maintain employment to the greatest extent possible so as we do not lose the competitiveness that we have long cultivated overseas.

In terms of the operating status of each office, we have recommenced activities at all locations in China. As social distancing is still required by Chinese authorities for the time being, we are enacting such measures as controlling the number of people in an office at one time. The National People's Congress has re-opened, and there are now high expectations that social activities will start to return to normal. With that said, we believe it will still take a certain amount of time before public events can be held in the same way they were in the past. In China, a great deal of our work pertains to automobiles, and it is still taking time to completely recommence operations at automobile factories. From July on, we

anticipate that factory operations will normalize. We are, therefore, promoting activities based on the assumption that factory operations will gradually start up again from the second quarter. In other locations such as Hong Kong, Taiwan, and South Korea, we have already gotten back to regular working conditions. Particularly in Taiwan, where a large percentage of our businesses are located, performance has been relatively strong as the impact of COVID-19 was limited. However, there is still a great deal of work related to public events that has been suspended. Although restrictions have been lifted in Hong Kong, protests have unfortunately resumed in the area. Lockdowns remain in effect in ASEAN countries and India. We have cautiously started to recommence operations in Europe and the Americas, and our performance should gradually start to recover.

Based on the total of the figures disclosed by the three operating companies, there was growth in billings from Internet media in April. In your explanations on the progress of the Medium-Term Business Plan, you mentioned that the shift from the four mass media services to digital has accelerated. How do you view Internet media during FY2020? Will you continue to face challenging conditions in the four mass media services in May and June?

Mizushima: In regard to the growth in billings from Internet media in April (with billings from programmatic advertising now recognized based on reports of settlement), this growth largely resulted from the impact of the change in the Group's accounting policies. As billings from a large number of advertisements placed in March were recorded in April, from the perspective of advertisement placements we would like you to view billings growth based on the assumptions that the figures are not necessarily in sync with the month.

As a major movement, following the development of technology and devices, we are seeing the diversification of settings in which people interact with advertisements and the decentralization of content. In light of this, we recognize that there has been a trend of shifting from television advertising to Internet advertising. We believe there are several aspects within this trend that have been accelerated due the impact of COVID-19. As people continue to stay at home, the use of digital devices has been firmly established as an integral part of *sei-katsu-sha* behavior, and the trend of prioritizing digital devices is starting to become commonplace. Taking this into consideration, we intend to further utilize digital technologies in our marketing indicators.

Meanwhile, television ratings have increased due to people refraining from going outside, and this has created a positive situation for the television industry. Accordingly, within the impact of COVID-19, we believe there are positive aspects we can find for both mass media and digital media. While we promoted planning that combines television and digital media for a while now, going forward we will

further utilize this kind of planning in order to strengthen our competitiveness. Drawing on this strengthened competitiveness, we aim to increase our market share both in the short term and over the medium term. In particular, online video advertisements have been increasing in recent years, and as such, we will work to reinforce our digital creative structure.

Advertising demand has been stagnant. Under this circumstance, will you prioritize aggressive investment as adopted under the Medium-Term Business Plan, or will you focus your attention on improving operating income before amortization of goodwill (a numerical target of the Medium-Term Business Plan)? Please tell us how you will balance these two aspects.

Matsuzaki: For the time being, we will remain committed to our approach of executing investments to strengthen Group functions, including M&A, in line with the strategies of our Medium-Term Business Plan. However, while closely observing the degree of impact from COVID-19 as well as the extent to which we can recover from this impact over a certain timeline, we aim to strike a balance between these investments and our top-line performance.

IREP Co., Ltd. has been performing extremely well. Could you tell us the story behind this strong performance?

Matsuzaki: IREP competes with companies that specialize in Internet advertising, and it has established a strong reputation for its management capabilities for quite some time. This means that IREP has secured a high level of competitiveness under the current environment in which programmatic advertising is becoming mainstream. IREP also maintains a robust relationship with Google LLC, a media company with a high market share, giving IREP a deep understanding of Google's business, spanning from its media to its solutions. Leveraging this understanding, IREP has continued to reinforce its management capabilities, which is an aspect that has earned a high evaluation by its clients.

Furthermore, since become a wholly owned subsidiary of Hakuholdo DY Holdings, IREP has been taking steps to utilize the resources of the Hakuholdo DY Group, including our data, tools, solutions, extensive product lineups, marketing know-how, and personnel. We believe this has further reinforced IREP's competitiveness. We also believe that IREP has been steadily moving forward with its transformation into a next-generation digital agency as it has started to create highly unique techniques within the creative domain. Going forward, in conjunction with investments to reinforce the digital

infrastructure of integrated advertising companies such as Hakuhodo Inc., we will continue to actively invest Group resources in IREP in an effort to strengthen the company's competitiveness.

Is there anything you would like to mention regarding the performance of Group companies under the umbrella of *kyu* during the previous fiscal year as well as the impact of COVID-19 on these companies?

Matsuzaki: Group companies of *kyu* have also been affected by COVID-19. *kyu* companies primarily operate in the North American market, and we are forecasting an extremely difficult performance in the second quarter (April to June) for these companies due to the impact of lockdowns. In addition, each *kyu* company is actively making efforts to reduce costs.

In the previous fiscal year, the digital agency Kepler Group LLC achieved the best performance out of all *kyu* companies. Regarding the impact of COVID-19, many companies belonging to *kyu* such as IDEO LLC and SYPartners LLC are consulting model companies, and there are current cases of projects for these companies being suspended or delayed. However, there is now a need for proposing innovations with a focus on "with corona" and "after corona," and we believe this need presents a tremendous business opportunity for *kyu*, whose purpose is to be a source of creativity which propels the economy and society forward. Additionally, even amid the corona calamity, the IDEO team, for example, is using its specialty "Design Thinking" for prototyping face masks and is collecting funds, which it then donates to hospitals. In these ways, *kyu* companies are taking steps to contribute to society. While giving consideration first to maintaining employment to ensure our current level of competitiveness, we will enact measures to reduce a variety of costs so that we can keep costs at the lowest possible level. Once the current situation improves, there is an abundance of potential needs to address, and we aim to go on the offensive to make a thorough recovery.

You explained earlier the shift to digitalization is being accelerated due to the impact of COVID-19. In what ways do you believe digitalization will be accelerated going forward, and what is your forecast for media trends as this happens?

Mizushima: In television, as I explained earlier, we recognize that overall there is a trend of a slight market decline due to the decentralization of content. However, the Internet media market has already grown and expanded to the same scale as the television market. We now believe that this market is no longer in a stage where it can achieve tremendous growth and expand regardless of the conditions in the economy, as it had been able to before. Under these circumstances, the lifestyle changes brought

about by the spread of COVID-19 will have an impact on each media. As I mentioned earlier, television ratings have been on the rise. In this stay-at-home lifestyle, people are spending a great deal of time viewing media content or looking forward to viewing media content, which means there has been a significant amount of content consumption. Among this consumption, there is, of course, both content provided by the Internet and content provided by television, and the form of media on which new content will be released is something that will depend on the efforts made by each industry. We also believe that new content will inevitably extend into both forms of media, and from our standpoint, we, therefore, hope that each form of media grows in an extremely positive way. In addition, we will engage in activities so that we can contribute to this growth.

Gross margin was up year on year in Japan, when excluding the impact from Mercari, but declined overseas. Could you please tell us the reasons why this happened? Also, amid the impact from COVID-19, what is your sense of direction for the current fiscal year?

Nishioka: As I touched in my financial results explanation for our domestic businesses, we have been aggressively promoting the shift to handling production work strictly within the Group, which has led to improvement in gross margin. While we will not increase the rate of in-house production without limits, this rate is currently being maintained at a high level. Under these circumstances, both the advertising companies and production companies within the Group are enhancing their profitability, and we continue to see a trend of growth in our consolidated gross margin. I also believe our production companies are starting to focus their attention on cost management and other efforts. Our advertising companies are striving to improve profitability with a strong awareness of their current position and circumstances. In addition, we are seeing some companies make changes to their compensation systems.

Overseas, many companies engage in fee-based work, and we are involved in a large number of businesses that differ from advertising businesses. So, we are focusing our attention more on revenue than gross margin. In that sense, when it comes to our overseas businesses, I would like you to look more at the fact that revenue grew 6% year on year, owing in part to the positive boost provided by M&A carried out in the previous fiscal year.

In regard to the shift in advertising budgets from television advertisements to online ones due to the impact of COVID-19, your domestic clients, to which you excel in responding, will likely further accelerate this shift going forward. What aspects do you feel give you a competitive edge over other companies that specialize in Internet advertising?

Mizushima: In terms of COVID-19, there have been discussions on both “with corona” and “after corona,” but however the scenario may play out, we believe people’s lifestyles will change in a very detailed manner. In regard to the market activities of each company going forward, the way we engage in these activities to respond to the changes among *sei-katsu-sha* will become an extremely important point. Under this environment, the Group will demonstrate its competitive edge through its ability to offer proposals from the viewpoint of *sei-katsu-sha*. We are actually hearing demands for information provision and proposals with a view to “after corona”, and are making use of online meetings and other methods available while working from home to exchange information and propose ideas to many of our domestic clients. When it comes to marketing activities, rather than focusing on a specific domain such as digital and television individually, we believe it is extremely important to promote integrated activities that involve store and product development and innovation. To that extent, our wide range of services and track record with integrated marketing also provide us with a competitive edge. While society at large is being significantly impacted by COVID-19, we aim to contribute to the development of each company in Japan.

Both overseas and domestically, we are hearing that competition with consulting companies, for example, is becoming quite challenging. Could you update us on the current situation and the measures you are taking to address this issue?
--

Mizushima: As for competition with consulting companies, we are starting to compete more often with such companies in terms of client presentations for various advertising campaigns. However, we have yet to see instances where consulting companies undertake marketing activities in their entirety. Recently, corporate activities, including digital transformations, have been entering into a period of significant change. In some cases, we take on marketing activities for clients to which consulting firms renders the services.

In the peripheral activities related to our core business of advertising, we are giving top priority to enhancing our creativity. In terms of output execution, we have confidence in our long-cultivated creativity and in the output of many of our members. To that end, we are stepping up measures to ensure that we maintain our superiority in the advertising business. At the same time, in order to be able to make new proposals, we are currently reinforcing our structures in such ways as enhancing structures in upstream domains and in terms of systems, forming alliance teams, and establishing new companies.