Hakuhodo DY Holdings
Summary of Questions and Answers for 1H of FY2020

Date of event: November 16, 2020 (Monday) 15:30–16:30
(Teleconference)
Attending members of 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

> Could you please comment on gross margin ratio? As we saw in the first quarter, there was an improvement in gross margin ratio in the second quarter as well, as factors that contributed to the improvement in the first quarter continued to make an impact. Do you see this trend of improvement continuing in the second half of FY2020?

There are multiple factors that have contributed to this improvement.

The most significant factor is the efforts each operating company has made to secure profits even amid declines in the top line due to the COVID-19 pandemic.

The second factor is the robust performance of the call center business at a subsidiary company as this business is highly profitable.

The third factor is the benefits we have seen from our client portfolio. In other words, we have been less involved in low-profit projects.

In the second half, we aim to continue efforts to secure profitability, in particular.

> Mr. Mizushima talked earlier about the current strong demand for TV spot advertising and the quick recovery in internet media. By service category, what fields do you believe will see a quick recovery in the second half, and in what fields will a recovery be delayed?

First, looking at client industry, our performance in industries such as Government / Organizations, Games / Sporting goods / Hobby supplies, and Finance / Insurance in the second half should exceed the performance during the same period of the previous fiscal year. We believe that will be the case for approximately half of our clients' industries. Automobiles / Related products is seeing a slow but gradual recovery from the difficult issues they are facing in terms of the supply chain. Also, we can expect a positive impact from the Japanese government's Go To campaigns in Transportation / Leisure, but this service category will continue to face challenging circumstances in the second half. With that said, we anticipate a somewhat decent recovery in Transportation / Leisure compared to our performance in the first half.

By service category, conditions for outdoor media, sales promotions, and PR/events were extremely challenging in the first half as people refrained from gathering together. We are starting to see people become more mobile due to Go To campaigns and other factors, and in the second half we believe we will see a slight recovery in these service categories as sporting events and cultural events start to be held with greater frequency, although not to the extent that they were before the COVID-19 pandemic. However, the situation for these service categories will still remain difficult compared with other categories. For domains such as TV spot advertising and internet media, we believe there will be an increase in orders depending on the circumstances surrounding each client.

In your performance forecasts, you anticipate a 10% decline in billings in the second half compared with the same period of the previous fiscal year. Does this mean that, although you expect to see a higher performance in nearly half of the client industries, the performance in the other half of the industries will lead to a decrease in billings of 10% or more?

There are still client industries in which we cannot engage in marketing activities. Giving consideration of the composition of our clients, compared with the more than 20% decrease in billings in the first half, we expect to see a 10% improvement in billings in the second half, resulting in a 10% decrease in billings for the full year. This forecast is obviously based on the assumption that there will be discrepancies between client industries.

This question is about the degree of impact the COVID-19 pandemic will have on the Company's management strategies. Is the degree of impact small enough that you will be able to continue on the conventional trajectory of your management strategies, meaning you will continue to reduce costs but plan to make aggressive investments to prepare for the next fiscal year? Or, will the degree of impact by so large that the changes you are seeing to business models and to your clients itself will force you to significantly review these strategies themselves? Please tell us about your awareness of this issue from the standpoint of management.

We are closely monitoring reports on the current situation, including the future outlook for the spread of the virus and the development of a vaccine. Based on the situation thus far, we recognize that the impact of the pandemic has been quite significant. Also, in the case that the pandemic resolves in the next fiscal year, it is possible that the domestic economy and advertising market size will recover to the level that it was before the pandemic, numerically speaking. However, we do not believe that the state of the advertising market will return to how it was before the pandemic.

We are in the middle of internal discussions regarding our strategies going forward. However, we have adopted “the shift to complete digitalization” as the basis of our strategies under the Medium-Term Business Plan. During the five years of the plan, we will see a shift from the digitalization of information to the digitalization of lives. Under the plan, we are working to incorporate as part of our business not only advertising but also the peripheral domains of advertising.

The arrival of a completely digitalized era is happening far earlier than expected, as reflected by such factors as the increase in direct and e-commerce purchases of products and the utilization of online meetings and other digital technologies in our daily lives. Accordingly, we will promptly strengthen our response capabilities to data marketing and digital marketing. Furthermore, responding to digital transformation (DX) has become an urgent task as our clients are being pressed to dramatically reform their businesses. In the first half, we increased the number of new solutions teams responsible for responding to DX, and going forward it will be even more important to strengthen these types of domains, including technology. As management, we understand that we must reinforce our structure to respond to the new needs of our clients and media suppliers.

Also, we have been realizing cost reductions amid the restrictions on various activities in the first half. However, we anticipate that in the future another phenomenon similar to the COVID-19 pandemic will occur that will have a major impact on our business. As such, it is imperative that we transform into a company with a more robust corporate structure. We have started to examine cost structure reforms across the entire Group, and we understand that if we do not begin new efforts during the current period then we will not be ready for the next period and beyond. We therefore engage in cost structure reform efforts that go beyond simply a response to an emergency situation. While working to tailor the value we provide on a Groupwide basis to the market, where DX is progressing, we are currently examining ways to further enhance our management efficiency through the DX of the Company itself.

During the COVID-19 pandemic, have you seen changes in the overall mindset of advertisers and partners in terms of procuring (placing orders for) media? Also, with the strong demand for internet advertising, what is the Group’s stance toward this area, including its view and response to the distinctive trends we are seeing during the pandemic?

In terms of media, there is no mistake that the ratio of programmatic advertising has been rapidly increasing, and programmatic advertising for digital advertisements accounts for roughly 75% of the market overall. We believe this trend will have an impact on TV spot advertising and other forms of media as well. There are already numerous companies that have started to make proposals for programmatic TV spot advertising. For video marketing, we believe we will see a further acceleration in the shift we have been seeing from reservation-based advertising to programmatic advertising. In that sense, our stance is to create Group organizations and systems to better respond to programmatic advertising by not only engaging in digital marketing but also video marketing as well (including television).

Additionally, we are considering how to incorporate not only advertising expenses but also sales promotion expenses. We therefore believe we need to strengthen our efforts toward brand fees and sales promotion expenses on a digital basis. The challenges we face in growth markets are considering how to incorporate these expenses as well as how we approach our relationships with platform companies.

Personnel expenses seem to have declined significantly between July and September. As you expect top-line growth to gradually return from the second half onward, what approach will you take toward controlling these expenses going forward?

We saw further declines in personnel expenses in the second quarter compared with the first quarter.

In the first quarter, while there were factors that contributed to increases in personnel expenses, including employees joining the Company at the standard time in April, we also put a substantial freeze on mid-career hires, and this is one of the reasons why we have only seen gradually increases in personnel expenses from the second quarter onward.

Another reason for the decrease in these expenses during the second quarter is that we revised our performance-linked incentives to better correspond with our current performance.

For FY2020, we will essentially maintain our policy of controlling expenses in accordance with our top-line growth. As personnel expenses are naturally part of that policy, we have released a forecast for the second half that anticipates declines in personnel expenses to be at around the same level as they were in the first half. However, there is obviously the possibility that we must reexamine this policy based on upward or downward swings in profitability. Please note that the impact of structural reforms is not included in our performance forecasts.

Furthermore, in terms of next fiscal year, we are currently unable to provide specific levels of cost reductions as the manner in which the current fiscal year will come to a conclusion is still uncertain.

However, we will control costs in a way that corresponds to our performance during the next fiscal year.

Recently, internet media agencies and various other companies have been using the term "DX support." Has the Company been expanding its operations in terms of DX support? Also, by expanding such operations, how do you believe that will impact profits?

E-commerce transactions are increasing tremendously during the COVID-19 pandemic. As the lifestyles of *sei-katsu-sha* change in such ways as increased communication at home, we are seeing various changes in consumption behavior. There is a growing need to promote DX in the businesses of corporations, including within the supply chain. Amid these circumstances, we understand that "DX" has become a "buzzword," and marketing activities in Japan are currently seeing an acceleration of DX, including conventional digitalization.

Each operating company, starting with Hakuhodo, is promoting its business activities while providing DX support to clients through such ways as developing DX-related solutions and forming specialized DX support teams. One example of this is GO-GO-DX, a package of 55 non-contact, non-face-to-face solutions for points of contact with customers. As people are no longer gathering at events, GO-GO-DX provides solutions for holding events online. It also promotes a shift to virtual stores and provides support for remote sales. In these ways, GO-GO-DX represents an undertaking in providing digital solutions for various aspects of business that used to be done in person or through analog means. GO-GO-DX enables digital and online events in place of in-person events, which are now difficult to hold due to the pandemic, and, as such, it is having an impact on our other businesses.

Additionally, we have launched the organization hakuhodo DXD, which is promoting numerous projects such as video production on a digital basis.

DX will continue to progress going forward, and we believe we will see the emergence of various solutions, including those from our competitors. To that end, we will leverage our long-cultivated creativity to prepare new solutions and engage in activities to ensure that DX has a positive impact on our business performance.

I believe you are now starting to gain a certain level of understanding of the current situation surrounding your overseas businesses as there has been a three-month discrepancy in the period for incorporating profits and losses. Compared with the second quarter, it would appear that many other advertising companies are dealing with uncertainty when it comes to their performance in the third quarter. How do you view the current performance trends in your overseas businesses?

Statistics have come out from the International Monetary Fund and other organizations regarding the global economy, and, as you know, the situation varies by region.

Our business development centers on *kyu* in North America and on Hakuhodo in China and the ASEAN region, and there are regions where our performance is good and those where our performance is poor. Based on our latest reports, our overall performance overseas bottomed out in the second quarter (April to June) and, while there has been a trend of improvement in the third quarter (July to September), we are still a ways off from seeing a genuine recovery. While the situation regarding the fourth quarter is still uncertain, on strictly an organic basis, we believe that the downward trend in our performance will be more significant in the second half (July to December) compared with the first half (January to June) as the impact of the COVID-19 pandemic from January to March was extremely small.

By region, our numerical performance is recovering in Greater China as the activities of our clients are becoming reinvigorated. However, as you know, we have been facing an extremely difficult performance in North America, and our performance on an organic basis in ASEAN has been challenging as well. Meanwhile, we are seeing a positive boost in terms of our revenue as, from the second half, we have started to incorporate the profits from companies acquired through M&A (Growww Media Co., Ltd. in Taiwan, Godfrey Dadich Partners LLC under *kyu*, etc.). Our overall overseas revenue declined 8% in the first half, and it would be safe to assume that declines will be a similar level in the second half due to the impact of M&A.

When you talked about structural reforms, you mentioned that you will transition to a more robust cost structure. Could you please tell us the timeframe for this transition?

We are still holding internal examinations regarding cost structure reforms. For now, all we can tell you is that we are pursuing these reforms as quickly as possible and in various areas of our operations.

When decisions are made on these reforms, we will disclose them promptly.