Hakuhodo DY Holdings
Summary of Questions and Answers for 1H of FY2023

Date: November 14, 2023 (Tuesday), 14:00–15:00

Presenters:

Masayuki Mizushima, Representative Director & President

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- What is your view of the advertising market in 2H FY2023 by clients' industry? How about for the Internet media business by service category?

There are signs of recovery for "Beverages/Cigarettes/Luxury foods" following the liquor tax reform and for "Transport/Leisure" thanks to the post-pandemic rebound of customer traffic. The introduction of the invoice system is another driver of new activity among clients.

For "Beverages/Cigarettes/Luxury", in particular, the liquor tax reform led to an extraordinary level of ad spending in October, which also implies buoyant performance for non-alcoholic beverages. Japan Mobility Show, which was successfully held with more than one million attendees, involved a wide variety of industries and not only automobiles. We expect that marketing activities in the car-related industries will be revitalized in the future. Furthermore, we see many other emerging developments including the lifting of the ban on TV commercials for dating apps.

At the same time, we are still facing adverse effects of the rising costs of raw materials and logistics including for "Foodstuffs", "Cosmetics/Toiletries". The "Information/Communications" industry is also cutting back on advertising mainly due to usage fee regulations.

Although our billings from the "Internet Media" business rose 0.8% on the previous year in Q2, the growth rate is slowing down as major platformers curtailed their ad spending.

We expect that the performance of Internet advertising will pick up again in 2H, buoyed by robust demand. At least we believe that the growth rate will exceed the current target of approx. 5%, given the recovery of placement by platformers and the growing volume of new media such as OTT.

- What are the key features of the next Medium-Term Business Plan (MTBP)? ROE before amortization of goodwill is currently listed as a KPI, but are you going to set a more robust target? Do you plan to place a higher priority on capital cost or capital efficiency in your business management?

The greatest challenge at present is to ensure that we achieve earnings estimates as revised. We have started the MTBP process by identifying the challenges and discussing the strategic directions, but we are not yet in a position to communicate anything specific about the plan. We will announce an outline of the plan in our results briefing for Q3 FY2023, timed with the availability of the latest estimates of full-year performance. The detailed plan will be made available along with the announcement of our full-year results.

We still set a target in terms of ROE before amortization of goodwill, but we are also considering other indicators. In any case, we remain committed to maximizing our business value through improved capital efficiency.

- SG&A shows a net increase of ¥11.3 billion year-to-date. Can you break it down into strategic expenses and other costs? It would be necessary to control SG&A to realize the expected operating income of ¥35 billion, but what is your outlook for YoY growth and what are the factors driving that growth?

Upfront investment in infrastructure development under the current MTBP accounts for some ¥2 billion. About ¥1 billion corresponds to the recovery of sales administration activities. The impact of foreign exchange fluctuations is the main factor behind the increase of some ¥2 billion overseas. The remaining balance of over ¥6 billion represents an ordinary increase. In this sense, the year-to-date growth of SG&A is within our expectations.

We expect that full-year SG&A will be slightly reduced on the previous year through cost controls introduced in view of the topline conditions. Investment in infrastructure development will continue in 2H to ensure future growth. The total cost including incentives is expected to be lower than the previous year.

- Why is North America failing to recover? What is the current situation?

The kyu collective is leading our activities in North America, primarily with the consulting business. Partly due to uncertainties in the North American market, clients hesitate to pay for corporate consulting services, which has resulted in some orders being postponed. As it now takes longer than before to win a project, we are struggling to improve overall profitability.

That said, measures to improve business performance have already been taken, including restructuring and business development in new industries. We plan to complete all those measures by the end of March 2024, which should enable us to shift to an aggressive strategy next year.

- The domestic gross margin shows a slight decline in Q2. What are the factors behind it and what is the outlook going forward?

The gross margin declined slightly due to the reduction in BPO projects. Apart from such extraordinary factors, the margin has actually been improving. Profitability has been improving steadily, as attested by the 0.1 point improvement in the year-to-date ratio. Please look at the YTD numbers as the rate fluctuates on a quarterly basis.

We are also seeing progress in contribution to profitability through solution development and service introduction, such as AaaS. We would like to move toward improving the gross margin further including by introducing a non-conventional remuneration scheme.

- What is your full-year outlook for the BPO business? How has it evolved so far this year on a quarterly basis against the previous year's level?

We experience substantial variations in quarterly performance as BPO projects come in various sizes. The volume of the BPO business with the public sector tends to shoot up in Q4 by nature.

In 1H of FY2023, BPO had a negative impact on billings to the tune of ¥24 billion due to the reduction of Covid-related BPO projects as the pandemic subsided. Aside from this extraordinary factor, our domestic billings remains on par with the previous year's level.

For the whole FY2023, we expect a reduction of approx. ¥70 billion in billings from the BPO business.

- The growth target for the "Internet Media" business has been reduced from +10% to +5%. What is the reason for this downward revision? Also, what is the outlook for the profitability of the Hakuhodo DY group's "Internet Media" business?

Expansion of the market scale is one of the reasons. Retail media advertising has been recovering in the US, but the increment is often captured directly by e-commerce media rather than by advertising companies. It will take time for the recovery to stimulate the growth of the latter.

Regarding the profitability of Hakuhodo DY group's Internet media business, IREP and SOLDOUT are currently reforming their business structure to strike a 50:50 balance between collaborative work with Hakuhodo, Daiko or YOMIKO and direct proposals to their clients. Although joint projects are a little less profitable than direct sales at the non-consolidated level, we expect growth at the consolidated level.

DAC is now working with Hakuhodo and other companies to recast its business into a structure prioritizing Group-wide efforts, with improvement in profitability. We understand that profit margins are starting to rise gradually.

- While upfront investment is still ongoing, what is your forecast for the level of operating margin for FY2024 and beyond?

We consider the period of the present MTBP as the period for upfront investment. The upcoming MTBP will be the time for reaping profits. Accordingly, we are proceeding with our planning activities with a view to setting a medium-term course for improving our operating margin starting next year.