Hakuhodo DY Holdings Inc.
Summary of Questions and Answers for 3Q of FY2020

Date: February 10, 2021 (Wednesday), 16:30–17:30
Attending members of the Company:
Masanori Nishioka, Director & Senior Corporate Officer
Hidetaka Tada, Corporate Officer
Takeshi Tokugawa, Corporate Officer

- In regard to the forecasts for domestic advertising demand, the monthly demand in January 2021 was slightly lower than that of December 2020. Was this due to the impact of the state of emergency?
- How do you view the current trend in demand and the trend from next fiscal year onward, including your thoughts on if we will see a significant recovery in advertising demand from advertisers in February, March, April, and after?

We believe that the overall market sentiment in the fourth quarter will be roughly the same as it was in the third. We feel that advertising demand has continued to be relatively steady in January and February, but there is uncertainty regarding demand in March due to the possibility of the state of emergency being extended, among other factors. Advertisers finding themselves with a surplus during their budget period could have a positive impact on demand, but there is still a certain amount of risk related to demand given that we are currently unable to ascertain the impact of the state of emergency. Based on these circumstances, we believe that the year-on-year performance of the domestic advertising market in the fourth quarter will remain at around the same level as it was in the third.

We anticipate that our performance in the fourth quarter will exceed that of the market and be roughly 95% of what it was in the fourth quarter of the previous fiscal year. However, there is a possibility of delays in the recording of work performed by government agencies in response to the COVID-19 pandemic. We view this, as well as the uncertain trends in March, as a risk, and are taking these risks into account as we prepare our forecasts.

It is difficult to make predictions for April and after. We have seen advertisers transition from fixed costs to variable costs, and have heard that this may have an impact on TV ad placements and other advertisements.

- Concerning cost reductions, the Company has been making significant reductions to SG&A expenses on an organic basis. If we separate these based on reductions made as an emergency response and reductions made in a structural manner, how would that breakdown look?
- Taking this breakdown into account, what do you believe your approach to costs will be from the next fiscal year onward?

Cost reductions during the current fiscal year have leaned more toward reductions made as an emergency response. However, we are managing incentives for personnel and other costs in a manner that is linked with our business performance, and therefore the level of such expenses in next year depends upon top-line, which means SG&A expenses do not necessary increase automatically to the levels that they were previously. In addition to incentives, we will continue to control our overall operating expenses in accordance with revenue in the upcoming fiscal year.

From the perspective of structural cost reductions, we are continuing to formulate cost structure reforms. As workstyles are changing due to the COVID-19 pandemic, we are examining how we should maintain costs over the medium to long term, including how we should reform the structure of costs related to personnel, supplies, and offices. Furthermore, as the world shifts to complete digitalization, we recognize the need to reform our business structure and believe that we should pursue such reform in tandem with efforts to strengthen our operational structure. In other words, we are currently at a stage where we need to establish a cycle in which we reduce costs through cost structure reforms while simultaneously investing resources into key business domains. While there is a possibility that we will be able to implement certain cost structure reforms in the fourth quarter, the pursuit of such reforms in tandem with digital transformation efforts will most likely begin from April onward.

- My question is regarding the balance between operating income in the third quarter and the forecast for operating income in the fourth quarter. A 5% decrease in the top line in the fourth quarter is an improvement over the decrease in the third quarter. However, operating income appears to be lower in the fourth quarter than in the third and also lower compared with the fourth quarter of the previous fiscal year. How was this forecast formulated?

- Operating income in the third quarter was on a par with that of the same period in the previous fiscal year. Even amid the “With COVID-19” era, it seems as though operating income is nearing the level that it was prior to the pandemic. In the upcoming fiscal year, do you feel that operating income will reach the level that it was before the pandemic, or do you believe that it will take more time to do so?

First, regarding the balance between operating income in the third quarter and the forecast for operating income in the fourth quarter, one reason why we forecast lower operating income for the fourth quarter is that we took into consideration the risks related to the uncertain outlook for March and the recording of certain work being carried over to FY2021. Additionally, in terms of SG&A expenses, while we have been refraining from making investments to bolster our competitiveness under the current circumstances, we would like to once again start pursuing such investments, to a certain extent, in the fourth quarter with a view toward the upcoming fiscal year. Furthermore, we would like to examine performance-based incentives for our employees as soon as our performance recovers. Our current forecast reflects all of these factors.

In terms of the level of operating income in FY2021, we are currently discussing the composition of our budget for the year, and obviously we aim to restore operating income to the level that it was before the pandemic as quickly as we can. With that said, to bolster our competitiveness over the medium to long term, we feel we need to invest in technologies and digitally savvy human resources in preparation for the shift to the completely digitalized era. To that end, our approach to restoring operating income will give consideration to both short-term and medium- to long-term elements.

- Could you please explain the reasons behind the rise in gross margin in the third quarter? Also, what do you believe to be an appropriate level for gross margin in the fourth quarter and in FY2021?
- Billings from Internet media have seen an increase since October 2020, with an exceptionally good monthly performance in January 2021. Could you please tell us the story behind this growth?

We believe there are several factors that have contributed to the continued growth in gross margin. The most basic factor is our efforts to secure profits on a Groupwide basis in response to the significant decrease in billings. Specifically, we have once again promoted the placing of orders in-house with Group companies. Another factor has been the increase in sales from such businesses as the call center business, which has always been highly profitable. While we cannot say for certain that gross margin will continue to increase in FY2021 and after, we aim to maintain it at a high level similar to the current period.

As for Internet media, the growth in billings over the past several months has been supported by brand advertisers. We believe this support is the result of our proposals geared toward the "new normal" era, which we have continued to make since the first half, including proposals for combining TV and digital advertisements as a form of integrated marketing.

Meanwhile, while we have Group companies with agencies that primarily handle clients focused on internet advertising, we also have companies who deal mainly with clients in the travel and transportation industries. We believe these companies will continue to face challenging conditions. The increase in billings would be greater if we were only dealing with the growth from brand advertisers, but as there are factors that offset this growth, the rate of increase is at the level you currently see.

- Could you comment on overseas trends by region in the fourth quarter?
- In terms of the domestic advertising market in FY2021, the Nikkei Advertising Research Institute forecasts growth in advertising expenses to be slightly over 5%. Taking into account the decline in advertising expenses in the current period, this growth does not seem to be very robust. How does the Company view this forecast?

Greater China is the first region to escape the impact of the COVID-19 pandemic. Projects related to automobiles have been increasing since the second quarter, and we are seeing a recovery on an organic basis as well. Furthermore, we acquired a company in Taiwan through M&A, and, with the impact of incorporating the performance of that company, our performance in Greater China continues to be steady in the fourth quarter. In the ASEAN region, our performance up through the third quarter continued to be impacted by the pandemic. While profit levels fell below what they were in the same period of FY2019, we are starting to see a slight recovery. Meanwhile, in North America, Kepler Group LLC has been performing steadily since the start of the fiscal year. However, other companies in the region have faced challenging conditions, and we have had no choice but to cut costs in order to secure profits. The situation in the region remains the same in the fourth quarter, making for an extremely slow recovery. Amid these circumstances, we have received reports of the success of various proposals, and expect to see the impact of that success emerge from FY2021 onward.

It is difficult to forecast the advertising market, especially ascertaining how much of the market comprises advertising expenses. However, overall, we believe we will see a recovery that is slightly higher than the Nikkei Advertising Research Institute's forecast, particularly in the Internet media domain.

Also, the forecast for growth in the advertising category is between 5% and 10%. If the shift to digitalization continues, then it should be possible for advertising companies to expand their business domains. At Hakuhodo DY Holdings, our stance is to also actively make an entrance into peripheral domains, and we believe that the range to set a benchmark for this kind of expansion is limitless. Taking these possibilities into account, we will establish strategies and targets for the upcoming fiscal year.

- The Company has clients in industries such as Automobiles / Related products, Information / Communications, and Beverages / Cigarettes / Luxury foods. How do you view the situation regarding advertising demand in these three industries?

Demand in the Automobiles / Related products industry has been significantly declining as the industry supply chain has ben hit hard by the pandemic. However, the number of clients resuming marketing activities in the industry has been increasing, and this has led to a trend of recovery in the third and fourth quarters.

There are various types of companies that belong to the Information / Communications industry, including not only cell phone carriers but also platformers. Platformers are a particularly important client, as we also pursue collaboration with them. During the current period, platformers around the world have significantly cut their advertising budgets, and this has had a major negative impact on demand. Meanwhile, it is anticipated that marketing competition between cell phone carriers will intensify going forward, and we view this as an opportunity for us to make a contribution.

Demand in the Beverages industry has been on the rise, and we believe this is due to the invigoration of proposals for e-commerce and D2C (Direct to Consumer) as a means to pursue digital transformation. With regard to how products are sold, we have heard that the industry is seeking proposals for how best to engage in marketing activities amid the shift to digitalization.