SEPTENI HOLDINGS CO., LTD.

Transcript of Questions and Answers for 2Q FY2024 Financial Results Briefing

The transcript of the questions and answers at the financial results briefing for the 2Q of the fiscal year ending December 2024 (for institutional investors, analysts, and the media) held on August 6, 2024 is as follows.

Speakers:

Yuichi Kouno	Representative Director, Group President and Chief Executive Officer
Yusuke Shimizu	Director, Group Executive Vice President and Executive Officer
Tei Go	Group Senior Executive Officer

Q&A 1: Shareholder Return Policy

Questioner: I feel that the update of the shareholder return policy is an excellent decision to significantly enhance it. This time, the Company plans to distribute the full amount of the net profit as dividend for the current term. What will be the amount of the dividend if the final business results are higher or lower? Also, regarding the idea for the next term and beyond, it is said that the dividend payout ratio will be raised to 50% or more. If there are no investment projects for growth, will the payout ratio be 100%?

Kouno: Regarding the dividend for the current fiscal year, the dividend payout ratio is set at 100%, and the total dividend is planned to be ¥6.5 billion on the basis of the full-year forecast. However, the stock market is quite volatile, including the current market sentiment, and accordingly, we believe it may be difficult to forecast client trends. For this reason, we will ultimately make a decision on how to return profits to our shareholders while keeping an eye on our current performance.

For the next fiscal year and beyond, we have set a dividend payout ratio of 50% or more at this time, but we will decide it based on our investment plan and progress in our performance.

Q&A 2: Progress in the Digital Marketing Business

Questioner: Non-GAAP operating profit in the Digital Marketing segment is currently 43% of its full-year forecast. In the same period of the previous fiscal year, the progress rate was 47% compared to the full-year results. Is it possible to see that the progress is steady? What kind of projects and measures are you considering in the plan that the growth rate will increase from the 3Q?

Kouno: As new graduates join in April of the fiscal year from January to December, the plan is weighted toward the second half of the fiscal year. Accordingly, we will increase gear in the future as well in terms of business performance.

In terms of progress, revenue is close to on-line, but Non-GAAP operating profit is a little behind. We intend to build up our operating profit by expanding our top line through putting in place a new management structure since April and strengthening our assets.

Q&A 3: Approach to Shareholder Returns

Questioner: Why did you use shareholder returns for dividends rather than for share repurchases? Considering the future EPS volatility, I think it would be more flexible to fix dividends to some extent and buy back shares if EPS fluctuates. In considering share repurchases, I think the changes in the shareholder composition are taken into account. Please tell us the reasons and background for choosing a dividend payout ratio rather than a total return ratio for the next fiscal year onward.

Go: In the process of deciding to substantially strengthen our shareholder return policy, we have been discussing a variety of options in parallel. As you mentioned, we considered share repurchases among other options, but made a decision based on the percentage ownership of the controlling shareholder and other factors.

We have a long-standing desire to transition to the Prime Market at an appropriate timing from the next fiscal year onward. Based on this desire, and considering the necessary liquidity for this transition, we chose shareholder returns through dividends in order to be as straightforward as possible and to significantly reward shareholders. However, for the next fiscal year and beyond, we intend to maintain a minimum dividend payout ratio of 50% and balance investment and dividends while incorporating flexible measures.

Q&A 4: Measures on Profitability and Future Outlook

Questioner: In order to catch up with the Non-GAAP operating profit forecast, I believe that revenue growth will also accelerate year on year. How do you view the current market environment in terms of anticipating trends in transaction volume? What are your own growth factors?

In this context, the ratio of revenue to net sales has slightly recovered quarter-on-quarter in the 2Q, but is it reasonable to expect further recovery? Please explain the factors behind the year-on-year decline in the ratio of revenue to net sales in the first half of the fiscal year, and the factors behind the recovery in the second half.

Kouno: Demand for the sales promotion budget, which we specialize in, has been returning over the past 1 to 2 years, partly due to the impact of the COVID-19 crisis. And from the end of last year to the beginning of this year, the brand advertising budget has also been recovering.

Looking at past trends, the brand advertising budget tends to be easily controlled by clients and fluctuates in response to market conditions. On the other hand, the sales promotion budgets, which are directly linked to sales, tend to be relatively difficult to reduce, although there are some fluctuations.

Regarding market sentiment moving forward, the stock market is also moving dramatically, and we have yet to fully understand the impact on our clients' situations from last week's movements, but it is likely that any significant fluctuations will result in adjustments to the advertising budget. As a result, as long as we look at the current Japanese market, we do not expect major fluctuations in the sales promotion budgets that we specialize in.

We have two main profit-making strategies in response to this. Currently, the highest growth rate in the digital marketing market is in search advertising. It is necessary to increase our market share of sales through search advertising while also forming a portfolio that is conscious of profitability.

Specifically, as the display advertising and video advertising markets are also growing, we intend to improve our gross profit margin by increasing our handling of advertising media other than search advertising. At the same time, in terms of the efficiency of SG&A expenses, we aim to raise profitability by optimizing costs while also promoting the use of AI.

Second, we are offering our non-advertising services, including our solutions area, and we are seeing a combination of high-margin products. By continuing to strengthen these sales promotions in parallel, we aim to achieve top-line growth and improve profitability.

Q&A 5: Collaboration with the Dentsu Group and M&A Policies in New Areas

Questioner: In addition to advertising, you will invest in consulting and content areas, and in the Marketing Communication Area, you will expand into areas other than advertising. I think this is in line with the Dentsu Group’s strategy. Apart from the collaboration in the existing advertising area, how do you intend to collaborate with the Dentsu Group in such new areas? Also, as a discipline for executing M&A, do you have clear ROI standards, are you going to buy companies that are making a solid profit, or are you going to buy companies that are not generating profits but are likely to generate significant synergies? Please tell us about your approach to growth investments.

Kouno: We believe that the digital marketing market will continue to experience growth over the next 5 to 6 years. However, in order to resolve increasingly complex client issues, we are entering a phase where not only advertising sales but also multiple service offerings are required. In recent years, we have been working together with the Dentsu Group to primarily provide both online and offline solutions to client issues.

From a medium- to long-term perspective, I think that various players are moving towards offering integrated services that combine not only mass and digital advertising areas but also consulting areas, as client issues become increasingly complex. For this reason, it is becoming increasingly necessary to provide one-stop services from consulting to content provision, and synergies in the Marketing Communication Area using content IP, as well as the combined solutions with Data & Solutions Area. We intend to leverage the assets of the Dentsu Group to provide these services.

I think that various companies will move in the same direction, but our greatest strength is the sales promotion area, which is directly linked to the sales of client companies. We believe that our execution capability in this area is highly superior in the market, and we intend to use this strength to establish a position by expanding the scope in which we can add more value.

Go: Until recently, we had not clearly stated the criteria for withdrawal from investments in existing businesses, but we have now clearly defined and begun operating these criteria from this fiscal year. Other investment criteria were also formulated internally at the timing of the establishment of the new management system. This does not mean that there are any different standards, but rather we have internally established standards that incorporate capital-efficiency metrics, such as IRR, in making investment decisions.

In addition, as a major premise, we internally determine how much we can invest, including borrowing capacity, and we are creating our own long-term investment list. Our policy is to strengthen shareholder returns, as we have presented this time, and to focus on investments that will be firmly profitable within our investment capacity. Accordingly, rather than investing in a leap-out as in the past, we would like to carefully examine opportunities that can significantly enhance our existing businesses in the areas presented this time, in light of the investment criteria.

Q&A 6: Progress of Collaboration with the Dentsu Group

Questioner: Please once again tell us why your current track record in alliance with the Dentsu Group was weak. Also, how do you plan to expand this collaboration in the future? Please tell us any measures that you are currently focusing on or are working on.

Kouno: Since the start of the alliance, the collaboration sales have basically been on the rise. In the 2Q, the ratio of Dentsu alliance sales declined, due in part to strong demand from clients in sectors such as information and telecommunications, but the actual figures show year-on-year growth.

Another characteristic of the Dentsu Group's clients is that the ratio of offline brand advertising expenses, mainly television, tends to be high in their advertising budgets, leading to a slightly weaker year-on-year growth compared to other quarters. For such clients, we support digital promotions in brand advertising expenses, but the flow of brand advertising expenses to the digital budget tends to increase from January to March, the 1Q.

In addition to this trend, many companies start their fiscal year from April to June, so the brand advertising budget tends to be relatively smaller. As a result, the growth rate of the Dentsu collaboration has been weaker than organic growth this quarter due to seasonality, but we are also building a system to further increase collaboration, so please continue to look forward to it.

This alliance began with a capital and business alliance in which Dentsu Group Inc. today held approximately 20% of our shares. Over the past few years, Dentsu Group Inc. raised its stake to 52%, and we are proceeding with business collaboration. Over the past 6 years, the collaboration between organizations and management has progressed considerably. In addition to providing our assets to clients of the Dentsu Group companies, particularly Dentsu Inc., we are also delivering offline advertising to our clients, which accounts for around 80% of our sales, as well as offering solutions and other advertising-related services. We intend to further deepen our collaboration with the Dentsu Group through these two pillars.

Q&A 7: Positioning in Cooperation with the Dentsu Group

Questioner: You are considering actively engaged in M&A in the consulting and content areas. Please tell us the positioning and direction of your company, regarding the differentiation or cooperative system with the Dentsu Group or Dentsu Digital.

Kouno: Currently, Dentsu Digital Inc. is our equity-method affiliate. First, I would like to explain how Dentsu Digital's strengths differ from ours. Dentsu Digital has a relatively large brand advertising budget. On the other hand, the Septeni Group tends to manage a large amount of digital budgets for sales promotion expenses.

Rather than focusing on differentiation, we collaborate to make joint proposals to clients, and there are increasing opportunities to present proposals that leverage Dentsu Digital's strength in branding, Septeni's strength in sales promotions, and Dentsu's strength in mass advertising.

Dentsu Digital also has different strengths in the solutions area compared to the Septeni Group. Accordingly, we believe that Dentsu Digital will work together with us to develop the market rather than compete.

Q&A 8: Changes in the Outlook for the Digital Advertising Market

Questioner: Let me ask you about the competitive situation and market environment in the Digital Marketing Business. Looking at the Current Survey of Selected Service Industries, I got the impression that the situation of digital advertising market was weak. According to your explanation, there was no impact from incidents in the food and automotive industries, and there was no perception that the market was slowing down in particular. Is there any change from the initial outlook?

Shimizu: We see no significant changes in the overall market trends from April to June compared to the period from the end of last year to March this year.

On the other hand, regarding the transaction value, which is disclosed as a reference value, the growth rate of our transaction value exceeds the results of the Current Survey of Selected Service Industries. I believe this difference is due to the different industries of the clients we are facing now. As we mentioned earlier, we experienced three months of strong demand from information and telecommunications clients, and we see this gap in relation to the growth rate of the market as a whole.

Q&A 9: Outlook for the Digital Marketing Business for the Second Half

Questioner: What is the degree of certainty that your sales measures will pay off in the Digital Marketing Business in the second half of the fiscal year? Looking at the growth rate of transaction value and the level of take rate in the 2Q, do you think that the second half of the fiscal year will improve respectively? Please tell us about the degree of confidence you have in this, your quantitative targets, and the perspectives you are aiming for.

Shimizu: Considering the trends in the 2Q, I do not think there are any major changes in the current outlook for the second half or beyond, particularly for large clients we are dealing with. Focusing on the take rate, we see that while there has been a downward trend since last year, the decline has bottomed out from the 1Q to the 2Q. At this stage, we do not see any particular downward trend. Therefore, we will continue to maintain our current profitability while building up our highly profitable Direct Business and Data & Solutions Areas.

In addition, we will strike a solid balance between the development of new clients and the portfolio of products in our mainstay Marketing Communications Area. In view of overall market trends, what we can convey at this stage is that we will proceed in the second half of the fiscal year aiming to maintain the current growth rate while improving profitability in this way.

Questioner: Let me confirm, based on the take rate of 18.1% in the 2Q, should we consider flat growth as a base scenario? Or, if the take rate rises as a result of the measures you have just mentioned, please elaborate on what is expected to be most effective.

Shimizu: At this stage, I think it is appropriate to consider the 2Q result as the base scenario. Additionally, from the perspective of increasing the profitability of our overall business, I think that as a business segment, the growth of the revenue in the Data& Solutions Area will be the change in the portfolio that contributes most to the improvement of the take rate.

For the time being, however, the Marketing Communications Area will continue to account for a high percentage of the total, so there are two main strategies for this area. First, we believe that the principle is to increase transactions with higher take rates. Another strategy is to increase transaction volume in the creative, display, and social areas more than in the first half of the fiscal year, even as the number of search ads handled, which tend to have relatively low take rates, increases. We believe that these will lead to an increase in the take rate of the overall business.

Q&A 10: Approach to Growth Investment

Questioner: Regarding the concept of growth investment, do you intend to maintain the target operating profit rate shown in the 3-year plan and invest to achieve this target?

Kouno: We are committed to investing in new areas, including M&A, in our 3-year plan. We intend to prioritize growth investments in areas with higher take rates or profit margin as a new area that we have announced this time, while ensuring growth rates by expanding our Marketing Communications Area.

Q&A 11: Planned Sale of Shares

Questioner: With regard to the sale of shares, which is also a reason for raising the dividend forecast this time, is there any plan left to reorganize the portfolio in the current fiscal year or from the next fiscal year onward? Please tell us whether there are assets you can sell given that your company does not have any strategic shareholdings.

Go: While we refrain from commenting on specific listed companies, we are entering a stage of formulating a growth strategy by narrowing down the focus areas for the new management structure in response to the ideal image of the current portfolio.

Among these, there are occasions when businesses that are not necessarily core are identified. In such cases, we will return profits to shareholders or reinvest in businesses with higher growth rates while maintaining a solid balance after converting them to cash at an appropriate time and under suitable terms. We will disclose any similar items in the future, as appropriate, such as the gain on the sale of COMICSMART INC., which was already recorded in the 1Q.

Q&A 12: Approach to Shareholder Returns

Questioner: Please tell us more details about shareholder returns. The dividend payout ratio for the next fiscal year and beyond is said to be 50% or more. Specifically, what rate are you planning? As a background, from the perspective of Balance Sheet Management, focusing on factors such as the level of cash and the equity ratio, please explain the nuance of the dividend payout ratio for the next fiscal year and beyond.

Go: In terms of the policy we have decided at the present time, the lower limit of the dividend payout ratio for the next fiscal year and beyond is 50%, or 50% or more. We have informed you that this term will be 100%, so we will return more than 75% on average over the two years of this term and next term. As for the total return ratio, a single-year change from 100% to 50% results in a large fluctuation. Therefore, we will continue to internally consider methods to ensure the stability of dividends. Currently, we have announced that dividends alone will account for 50% or more of the payout ratio. However, we still have some options for share repurchases and other measures.

Capital efficiency has declined in our BS due to the fact that capital has become very large since we entered the Dentsu Group. For this reason, we intend to improve this over the next one to two years if we are able to return 100% of profits to shareholders for the current fiscal year and 50% or more for the next fiscal year.

By doing so, we intend to improve our ROE and raise our share price. The appropriate cash position is always monitored internally, so we intend to retain cash within that range and allocate it to investments and returns otherwise.