Interview with the CFO

We will support the execution of the Medium-Term Business Plan through appropriate investment and financial management, and strive to increase corporate value through improved capital efficiency.

Masanori Nishioka

Representative Director & Senior Executive Corporate Officer
CFO

Question

The new Medium-Term Business Plan commenced in fiscal 2024. Could you again share your thoughts on the CFO's role under this plan?

As CFO, it is my role to determine appropriate capital allocation from the perspectives of financial soundness, growth investment, and shareholder returns, in the interest of enhancing corporate value over the medium to long term. I see no significant change in the CFO's role under the new Medium-Term Business Plan.

Various executives have made presentations and explanations that provided detailed information on the new Medium-Term Business Plan. While maintaining financial soundness as our top priority, we will strive to strike a balance between investment for growth in each business area of the new Medium-Term Business Plan and return to our shareholders.

Question

In March 2023, the Tokyo Stock Exchange asked companies to "take action to implement management that is conscious of the cost of capital and stock price." How have you responded to this request?

In our corporate governance report dated July 2024, we provided information on our efforts towards achieving management focused on the cost of capital and our stock price.

As of now (October 2024), actions are still being considered. We intend to disclose our policy and specific initiatives for improvement after thorough discussions within internal deliberative bodies, including the Board of Directors.

We will provide more detailed information at the appropriate time on such items as cost of capital. For now, I will say that we have calculated our cost of capital using various methods, including the commonly used capital asset pricing model (CAPM), and we believe our cost of equity capital to be around 6% to 8%. We acknowledge, however, that recent increases in the risk-free rate have boosted the cost of equity capital calculated using the CAPM.

Furthermore, as the corporate governance report mentions, we have identified return on equity (ROE) before amortization of goodwill as a key performance indicator for improving capital efficiency under the new Medium-Term Business Plan. To increase ROE, one approach is to enhance shareholder returns and reduce the denominator. Instead, we will aim to enlarge the numerator: achieving ROE growth by prioritizing growth investments to expand our business domain.

Question

In June 2024, you made an announcement regarding "capital allocation." Though the concept is understandable, many have asked for explanations supplemented with specific figures.

After announcing our financial results for fiscal 2023, I also received many similar comments in conversations with investors, including shareholders.

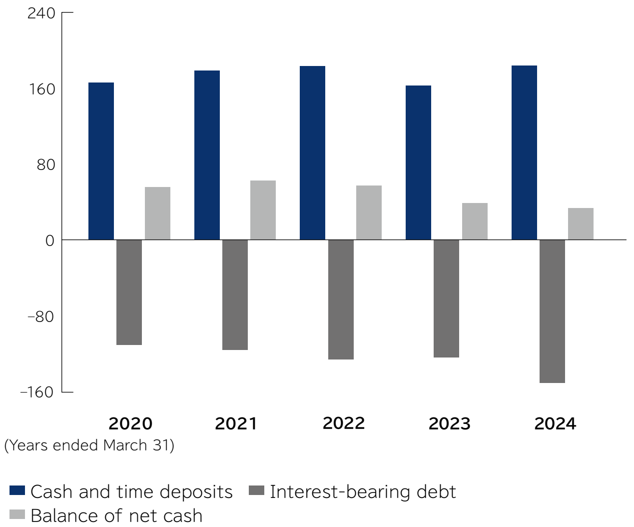
Our current approach is based on maintaining net cash in the medium to long term, while making growth investments and returning value to shareholders within the scope of operating cash flows.

I would like to emphasize that even under the new Medium-Term Business Plan, the Group believes growth investments are necessary to improve corporate value in the medium to long term. I mentioned maintaining net cash in the medium to long term. This is because we prioritize having cash on hand to avoid missing investment opportunities.

The Group is in the process of expanding its scope of operations beyond the advertising business, so we intend to allocate funds primarily toward such growth investments.

Cash and Time Deposits, Interest-Bearing Debt, and Balance of Net Cash as of the Past Five Fiscal Year-Ends

(Billions of yen)



However, operating cash flows may not always be sufficient when making growth investments such as M&A. Also, to improve corporate value we may wish to boost shareholder returns through share buybacks. Maintaining financial soundness is essential for maintaining such flexibility, so we must formulate appropriate capital allocation strategies.

To this end, we will need to actively manage the balance sheet, including by considering the sale of assets such as cross-shareholdings. Meanwhile, we will consider additional shareholder returns if we have surplus cash after prioritizing allocation to growth investments. In any case, we will manage the balance sheet and evaluate shareholder returns based on whether they contribute to capital efficiency and enhance corporate value.

Question

What areas do you envision for growth investments under the new Medium-Term Business Plan? Also, can we assume that these investments will deliver returns during the period of the plan?

Under the new Medium-Term Business Plan, we expect to spend tens of billions of yen on both capital expenditures and M&A. We will invest actively, not just in existing areas but also in new fields—both in Japan and overseas. Of course, before we can invest in M&A we need to find suitable partners, so such investments may not always proceed according to plan.

When investing in new areas, we aim for investments to contribute to the Group's profits during the new Medium-Term Business Plan. In principle, we expect to generate returns that exceed the cost of capital. While we might accept smaller returns initially, our goal is for profits to surpass the cost of capital over the medium to long term.

Under the previous plan, we allocated expenditures strategically, particularly in the field of digital marketing. In fiscal 2024, we expect to begin reaping the rewards of these previous investments.

Question

With regard to shareholder returns, could you please explain the background behind the recent change in your dividend policy?

We remain committed to our policy of stable dividends.

However, in response to investor feedback asking for more clarity about how we define stability and the criteria for adjusting dividends, we have decided to specify a target dividend payout ratio of around 30%.

That said, please note we will determine the dividend payout ratio by looking at figures before amortization of goodwill, not just the disclosed figures. In addition to the fiscal year in question, we intend to make informed decisions on dividend levels by assessing trends over the past few years.

From a practical standpoint, we ask for our shareholders' understanding that dividends may be increased or decreased if the dividend payout ratio before amortization of goodwill deviates significantly from 30%.

We will continue to consider the repurchase of treasury stock based on factors such as performance, financial condition and market trends.

Interview with the CFO

Question

Will there be any change in your approach to fund-raising under the new Medium-Term Business Plan?

We maintain enough interest-bearing debt to ensure sufficient net cash in the medium to long term, and there will be no changes on this front during the period of the new plan. This will ensure a certain level of borrowing capacity and avoid significantly increasing interest-bearing debt.

The Group's business model is not particularly capital-intensive, so our leverage does not need to be high. This stance remains unchanged under the new plan.

On the other hand, in order to diversify future funding risks and not rely solely on bank borrowings, we have established an environment that allows for various funding methods, including issuing corporate bonds. In September 2022, we obtained a credit rating of A+ from R&I, one of Japan's largest credit rating agencies, and as of October 2024 this rating remains unchanged.

Question

You have already discussed items for capital allocation, but could you reiterate your thoughts on cross-shareholdings during the new Medium-Term Business Plan?

As I mentioned before, we monitor the significance and effectiveness of holding each stock on an annual basis. This policy remains unchanged, and we uphold our policy of selling shares when holding them is not rational.

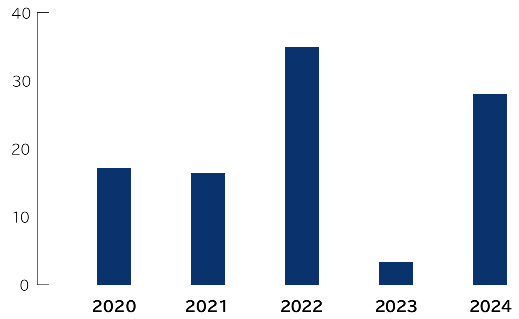
In fiscal 2023, we sold shares worth approximately ¥28.0 billion. Taking into account the impact of the increase in stock prices, as of the end of the fiscal year we had a remaining balance of just over ¥90.0 billion.

Some investors, including many shareholders, have asked us to accelerate our efforts to sell cross-shareholdings. We believe that progressing with these sales will ultimately help provide the financial resources for growth investments during the period of the new Medium-Term Business Plan.

We have not set any KPIs for selling cross-shareholdings, as in some cases we will need to coordinate with counterparties before selling these shares. At the same time, one indicator we recognize is the cross-shareholdings to net asset ratio set by proxy advisory firms.

Results of Sales of Investment Securities Over the Past Five Fiscal Years

(Billions of yen)



(Years ended March 31)

Note: Income from sales of investment securities on the consolidated statements of cash flows

Question

In closing, from your position as CFO, is there anything you would like to convey to readers?

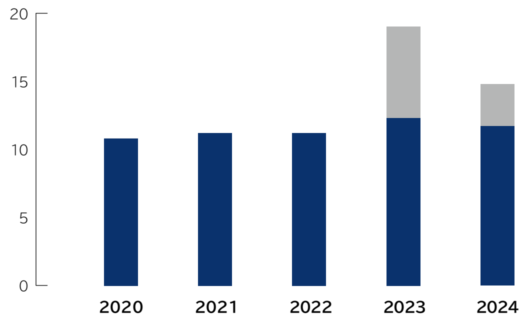
We have allotted a good amount of time to discuss the concept of capital allocation. However, we believe that the Group's more essential assets are intangible and not reflected on the balance sheet. These include *sei-katsu-sha* insight-based creativity and a diverse workforce.

In addition to using the profits or cash generated from goodwill resulting from M&A to contribute to business growth and improve capital efficiency, our first priority is to leverage these intangible assets to generate profits and cash and improve capital efficiency.

With this in mind, I will do my best to fulfill my role as CFO.

Dividends Paid and Purchases of Treasury Shares Over the Past Five Fiscal Years

(Billions of yen)



(Years ended March 31)

■ Dividends paid ■ Purchases of treasury shares