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Q1 FY2025/3 Small Meeting for Sell-side Analysts Q&A Summary

Date & Time : 16:00-16:45 Wednesday, July 31, 2024

Presenters : Takeshi Kamiya, Representative Director, Co-president
Kenichi Ooya, Corporate Senior Officer, Deputy Division Manager of Corporate Strategy Division

[Q]: Q1 operating margin for the Parent Company segment was 2.2%. Compared to Q4 of last year, as well as to your target margin set under the Medium-term Business Plan, Q1 margin seems low. Could you explain why Q1 margin remained low at 2.2%. Also, please provide your outlook for Q2 and after.

[A]: Operating margin for Q1 tends to be lower than Q4 due to seasonality factors such as new graduates joining. However, the margin has improved to a certain degree on a year-over-year basis. We have almost offset the impact of upfront expenses incurred last year for project launches. And the so-called overstaffing issue we had in Q1 of last year has been almost solved in the digital marketing domain. Yet, despite making improvements, overstaffing in the call center services domain remains a challenge. We believe we still have enough room for raising the profitability to a higher level as we grow top-line and increase the utilization rate.

[Q]: So, lower than expected margin is not due to unprofitable deals or extraordinary costs, am I correct?

[A]: Yes, that is correct.

[Q]: Please provide us with your business outlook for Q2 and after.

[A]: Digital marketing and BPO services domains will continue to be on a positive trend, and we expect these domains to achieve high-growth and profits in Q2. Key is the call center business. Q1 growth for regular, or recurring business, was about 2%, making a rebound from Q4 of last year when growth was almost flat. Yet, we still face some challenges such as downsizing of projects. Still, we have sufficient order volume and so, we will continue our efforts for growing top-line and enhancing utilization rate in line with sales growth. We do not see any factor that will drastically drive SG&A expenses. Also, based on the past trend, SG&A expenses decrease from Q1 to Q2, even if not always. So, we are confident that there is plenty of room for operating profit to increase towards Q2.

[Q]: You mentioned that the call center business is on a recovery path. What is your current estimate from Q2 onward?

[A]: There is no drastic change in business conditions. We managed to achieve 2% growth by making a steady effort to build up call center projects one by one. Our sales team is laser-focused on recovering growth. In fact, we are seeing the results in total volume. Now, we want to raise the current 2% growth rate to 3% and higher. We have been proposing clients to utilize AI in many different ways, and seeing an increase in success cases such as enhanced productivity. We will continue this approach.

[Q]: Operating margin for the Parent Company segment in Q2 of last year was 4.4%, the highest quarterly margin in the previous year. What are the differences between last year and this year?

[A]: We don't expect the margin to reach 4% in Q2 this year, the main reason being indirect costs. We have increased indirect expenses from the previous year to achieve growth. So, it is unlikely that Q2 operating margin this year to reach the level of the previous Q2. Still, we believe the margin will grow on a quarter-over-quarter basis.

[Q]: You just mentioned that you are increasing indirect expenses as part of growth investments. Do you see any outcome?

[A]: Yes. We are seeing the impact to a certain level. With the aim of enhancing our proposal planning abilities, we have increased investments in our indirect departments to develop and present new services. Top-line is now growing in BPO services and digital marketing domains, which means we are achieving ROI. Yet, our target growth rate is much higher than the current level and we have not reached the target yet. As a result, the investments are pushing up the SG&A ratio. We need to make efforts to increase top-line to achieve our target growth rate.

[Q]: How much impact do you still get from COVID-related business?

[A]: COVID-related business only has a minor impact on our performance, and so, we have not calculated COVID-related sales separately from this fiscal year. We assume it would be only about several hundred million in a quarter.

[Q]: The Parent Company segment's sales growth excluding COVID-related projects was 3% for Q4 last year, and it has recovered to about 5% in Q1 this year. Can we assume that the growth rate has returned to the previous levels?

[A]: Yes. Growth rate of existing businesses slowed in Q4 last year, but strong performance of digital marketing and BPO services domains have pushed up the level of growth to 5%.

[Q]: Overseas business made a strong showing, and I think it was one of the factors that underpin Q1 profits. Other than managing cost issues that rose in China and South Korea in the previous year, are there any factors that contributed to higher profits overseas? And can we assume that overseas' strong performance will continue from and after Q2?

[A]: In addition to enhanced profitability in China and South Korea, continued growth in ASEAN helped the entire segment achieve significant profit growth. We expect the trend to continue in Q2 and onward.

[Q]: I can understand that overseas profit performed well in Q1 as China and South Korea enhanced year-over-year profit. But could you explain the reason for achieving quarter-over-quarter growth? Are there any areas that became particularly better than Q4 last year?

[A]: Profit growth from Q4 last year is not a one-off event. We have increased profits by making efforts, and the core success factor was the upturn of China's e-commerce business. As you pointed out, overseas performance tends to drop from Q4 to Q1, primarily due to a seasonal factor, specifically, China's largest e-commerce shopping spree, Singles Day. The event takes place in Q4, significantly boosting China's e-commerce sales and profits. Last year, however, orders for China's e-commerce business dipped drastically, and Singles Day's performance was sluggish. At the same time, demand downturn for the business hit bottom and made an upturn, leading to quarter-over-quarter growth from Q4 to Q1 this year.

[Q]: Could you provide us with your outlook for the Domestic Affiliates segment from Q2 onward?

[A]: Key is J-Stream, one of our listed subsidiaries. Downward trends in sales and profits have not completely ended yet, but the company has announced that it expects to achieve both sales and profit growth on a full-year basis. We expect the company to achieve growth as well. Still, we don't expect the segment to make a sharp recovery from Q1 to Q2.

[Q]: Any update on your discussion regarding the disclosures of business plan and dividend plan?

[A]: We are still considering the best approach.

[Q]: How much progress have you made in Q1 towards your internal financial targets?

[A]: Our internal targets are very challenging. Unfortunately, we are slightly behind.

[Q]: How much do foreign exchange rates affect your profit?

[A]: It only has a minor impact on our profit. Although sales have expanded, it also pushed up the costs, therefore, not much impact on profit.

[Note**]**

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