This is an edited version of the English translation of the follow up call with Sell Side Analysts which was conducted in Japanese.

Recruit Holdings Q2 FY2023 Sell-side Analyst Call
November 8, 2023

Shen: Thank you for waiting. Now we would like to begin the sell side analysts call for the second quarter results in the fiscal year ending in March 2024.

UBS securities Fukuyama-san, please go ahead.

Fukuyama: Thank you again.

I have two questions about your capital allocation policy. When I look at your net cash and the financial results, it is above 1 trillion yen so I feel that it is piling up. Is there any policy update regarding capital allocation?

Recently, buyback and I think you addressed the reduction of stake of TOPPAN Holdings. How are you going to allocate this 1 trillion yen cash? Can I have an update on your policy? That's my first question.

And the second question is in the primary market, especially in HR tech-related startups. I think valuation was higher during the pandemic but now it is slowing down. And maybe it is a good timing for making future investments. Is there any update to your general view? Thank you.

Jun: Thank you for your questions. I believe the two questions are co-related. I think the big question is how we are planning to use the money.

We did a share buyback and the process was completed at the end of October.

The order of capital allocation is not going to be changed immediately. We will have the same priority.

But as you mentioned in your second question, if there is a good M&A opportunity, we will place a priority on those opportunities. But maybe the possibility of any gigantic opportunity is not so high. And in the context there is this economic situation. If there is going to be a significant deterioration of the market, then we will need to take advantage of the cash that we have.

But we will not have to use up all 1 trillion yen. We are trying to strike a good balance. There isn't any immediate plan, but obviously, we need to return to our shareholders.

And we will always take that into account when seriously considering how we should allocate our cash. With net cash we could repay the borrowings as well. So yes your understanding is correct.

Fukuyama: Thank you. Are there any developments regarding valuation? It is not really visible from our side.

Jun: Well, it depends on what you're looking at.

In the IPO market in the US, in particular, how much it's going to open when it's going to close. I think that is one of the factors.

For example, maybe some people will face difficulties after filing. The window is closed. Rushing before the window closes and could not go well. The situation will change if exit window becomes narrow. Idekoba has been seeing many people but we're not anticipating any gigantic deal in the near future.

The opportunities are steadily increasing regardless if it is driven by us or our counterparts.

Fukuyama: Thank you

Shen: Citi Yamamura san, please go ahead.

Yamamura: This is Yamamura speaking. Thank you very much.

I have one detailed question. This may not be a right question because you look at each business, but as you explained while the advertising related and personnel related expenses are down, the remaining SG&A after subtracting all these items on a consolidated basis in Q2 seems up by JPY 8 billion from Q1. As adjusted EBITDA margin in each segment seems reasonable, I am assuming this is due to the increase of headquarter expenses. Is this any meaningful expenses or just the one time increase of the miscellaneous costs that we don't need to worry about?

Jun: Thank you. Are you saying it's neither rent nor depreciation? Purely others?

Yamamura: Yes. Subtracting all the other items, “others” seems to be increasing a bit compared to the first quarter.

Jun: Are you comparing it to Q1?

Yamamura: Yes, also “company eliminations” were also slightly increased.

Jun: It's a slight increase. I’m not seeing anything big.The numbers at hand were not much increasing but I would say they are rather much smaller than last year.

Yamamura: I will check them again. Thank you.

Shen: Munakata san from Goldman Sachs please.

Munakata: This is Munakata speaking. Thank you. I have two questions.

One is related to the OPEX breakdown of HR Tech. Thank you for disclosing the breakdown for the first half. In the second half compared against the first half, what is going to be the trend? Basically, drastic change is not something I anticipate but I would like to confirm it with you.

And in the previous briefing, you talked about AI and I attended the session and I felt that AI accounts for a large portion. Can I understand that AI related investments are being done even with discipline? For example, have you been able to hire AI related talent or has it been also subject to freezing?

And the second question is also related to HR Technology. As a simple clarification, the tax burden. There is something related to legal entity restructuring. Is this a tax reduction coming from reorganization last year?

Also, when you look at the number of headcounts as well as the size of the organization, do you feel this is an appropriate size? Thank you.

Jun: Your first question, roughly speaking, it’ll be difficult because FX is moving of course, but If you think in dollar terms, the most standard way to think of it is that it will remain the same. Of course, in the fourth quarter, if the revenue declines more than we expect, we may decide to reduce advertising expenses or other expenses, but basically it is expected to be flat.

Also, opporunities related to AI are what we have been working on. Well, in March, a headcount reduction was announced, but machine learning and AI investments are really at the core of our activities. It is not something we started recently. So we've always worked with people who are specialized in these areas and we increased the number of people and we did the restructuring last March while considering to maintain our organization for the development in the future. We are not hiring immediately to develop something suddenly. I think that's the right way to look at it.

And then, tax. Well, it's not the case. We're disclosing this information, but in HR Technology, M&S, Holdings, and Staffing have many subsidiaries and they have different structures. Some subsidiaries were integrated in a manner that did not affect business operations. That's what we do from time to time. There was a tax benefit by reorganizing and consolidating subsidiaries, which is reflected as a one off element.

So next year, this will be gone. So this tax burden reduction is a special case only for this year. It is not related to the headcount reduction in March. But this is simply a result of reorganization of the company. Did I answer your questions?

Munakata: Thank you, that was very clear. How about the balance of the size of HR Technology and the size of the headcount. Do you think it is appropriate?

Jun: Well, how we define appropriateness is something we need to ask. Well, it depends on the future growth that we aim for. And we discussed that previously. So I'm not sure what is the right balance, but if we only need to have people necessary for today's revenue, then maybe we have an imbalanced size. But when we think about future growth, then we have an adequate number of people needed for future growth.

Munakata: Understood, thank you.

Shen: Mito Securities, Watanabe-san, please?

Watanabe: I have two questions. HR Technology first.

You change to a pricing system that is more favorable to the clients, and you think you can offer high added value to the business volume through this new pricing system closer to PPA.

If that is the case, your market share will rise in the US from this moment. Have you heard voices from the clients? Competitors are cutting budget but you are not cutting budget, which results in the increase in the market share. Are you seeing signs? Or It's still not visible as the demand is declining? That's my first question.

Second question. The adjusted EBITDA margin in HR Technology in the future, you've been controlling your costs for about a year now and you are seeing high margins. If you use creativity, can you grow without spending much costs? If and when the demand recovers in the future, can you leverage what you did in the past 18 months? Or was this an emergency period, so very different from the next growth stage, to achieve growth, and you will enter a phase where you will aggressively invest?

Jun: Let me answer your second question first. If we can grow without spending cost, it will be so easy.

We want to grow by spending wisely and appropriately. So if we start spending when demand recovers, it's too late.

We need to prepare beforehand and when the demand environment comes back, we have to be ready for business clients to spend money on Indeed. Otherwise, we will miss the opportunity.

So, like I said earlier, for us to grow we are preparing and taking various measures. And one of those is the answer to your first question.

We want to be viewed by business clients as a company that offers more added value. So it's not for a short term market share increase, but by shifting from PPC to PPSA, clients can enjoy value with the same amount of money. If clients can feel that then when the demand comes back, it is clear clients will choose where to spend the money.

Watanabe: So you said that you are preparing yourselves. If you start preparing when the growth comes it's too late. You are preparing now with PPSA and others while you are controlling costs?

Jun: Yes, of course. The shift to PPSA is one of those and there are other trials and errors going forward. We are different from competitors by aiming for improving the quality rather than the number of clicks or views.

We are trying to be the platform where the business clients want to spend more money with us and get better results. We hope we can generate more revenue by doing that. I don't know if “preparation” is the best word, but we are trying to make ourselves ready. So this is the business development that does not lead to the revenue today. That's what we're doing.

Watanabe: So you are controlling your costs and you're efficient but also enhancing the quality?

Jun: PPC means we generate revenue with more clicks. But will that really lead to application? Will that lead to final hiring? We don't know. So we want to bring candidates closer to the application or the final stage. We think that has value.

PPSA has already made a rather drastic change in that we will no longer accept clicks that do not lead to applications.

And so it's not our revenue matters, but the key is how to increase the satisfaction of our business clients and how to attract users to us to find jobs. Idekoba is thinking that if we do a matching that satisfies users and clients, we will definitely get results.

Shen: SBI Securities Hosui-san, please go ahead.

Housui: My name is Housui SBI securities. I have two questions. One is on Marketing Solutions in Matching & Solutions. The first half of revenue growth was better than expectation. Which of the categories according to page three of the script, Housing & Real Estate, Beauty, and Travel performed well? Were those the categories that are better than expectations? Can you give us some more color?

The second question is, in the pie chart you are saying that Beauty, Travel, and Dining and SaaS solutions are growing by 17%.

Revenue growth is coming from the introduction of SaaS Solutions resulting in the increased stickiness and revenue increase? Or is it because of the larger investment for advertising? What are the drivers for this increase? I apologize if I missed anything in the script.

Jun: Thank you for your questions. I believe those questions are very much related to each other. So I will respond to it as one question. So as you said, if you subtract the growth in Beauty, other areas would have a higher growth rate. So non-Beauty categories have higher growth rate, especially the Travel continues to have high unit price as well as the volume. There is a large impact. For Dining, there is a rebound from the pandemic and then the SaaS business there is high growth.

This is the context. So for the first half, that is the situation. And the biggest two are Housing & Real Estate and Beauty. We were not expecting drastic growth but they continued to have steady growth.

Did I answer your question?

Housui: Yes. Thank you.

SaaS penetration leading to top line growth. Is that seen in these categories that have high affinity with SaaS solutions?

Jun: Yes, that has been the aim but analyzing how much percentage of the growth comes from those areas is very difficult. In Beauty and Dining, it's internet advertising. It is very similar to SaaS business from the beginning. On top of that, we are adding Air Business Tools as well and they're making great contributions.

Housui: And I have a follow up question. If SaaS introduction penetrates more in these particular categories, without having to spend the same amount of advertising and expenses, will you be able to enjoy steady top line growth?

Jun: How much revenue can we accumulate on top for the mid to long term, and can we acquire new customers and monetize those opportunities who are not in these categories or our verticals? Maybe they would have higher expectations in our view. Of course, maintenance of our customers improving their lifetime value is where SaaS is very effective, so we naturally expect that to be effective in the future.

Housui: Thank you. That's all from my side.

Shen: SMBC Nikko Maeda-san, please.

Maeda: Maeda from SMBC Nikko. Thank you very much.

SaaS business is expanding. Once again let me organize and ask you if Air Business Tool numbers are growing, so which part is growing? For monetizing? Is the revenue from AirREGI or payment of AirPAY? Is the revenue growing for each service or overall revenue of Air Business Tools is big?

You disclose the number of registered accounts. What is the trend of paid accounts? Your revenue is growing, is it because of growth in the number of accounts or the revenue per account?

I could not ask all these details before, so if you could share with us the information.

Jun: There are multiple products, most of them are freemium to improve the client's convenience. That remains unchanged. Among those products, the AirPAY transaction volume is growing and that is contributing to revenue.

So, the Dining clients that use AirPAY or Travel clients that use online AirPAY, we will continue increasing clients that use our AirPAY and also use various measures to encourage more users to use the service.

And like I said in the earlier question, we think the clients outside of our verticals will also increase revenue. We will increase the number of transactions and increase revenue.That is visible in the short term.

And beyond that, we will think of the FinTech related services but at this point growth comes from what I just mentioned.

Maeda: Air BusinessTools revenue is rolling. This is not from the monthly payment, but it's more the transaction commission. Is it growing? So the monetization will not be the direct payment but more from Dining and Beauty will increase the upside by posting the information.

Jun: Yes, of course we have other measures too but that's roughly correct.

Maeda: Understood, thank you.

Shen: JPMorgan Securities, Mori san please.

Mori: Thank you. I have two questions. One is from a short term perspective.

Earlier, Arai san said the HR Technology margin guidance for Q3 was a bit conservative. What is the reason for being conservative? Is it because the Company is being conservative due to the uncertainty of the top line growth? Or is it a buffer for achieving the guidance in case top line growth is not being achieved as expected?

As Q1 result was better than the guidance and Q2 result was in the guidance range, I think the guidance has been improving its accuracy. So, I would like to know your stance for developing the guidance.

Jun: Well, to be honest with you, we announced the guidance of 27% but when we look at the most recent numbers, we think we can go more. That's why I said it's a bit conservative.

Mori: The result of the calculation of the top line and adjusted EBITDA, OPEX seems to be increasing in Q3. It's not like there are any specific reasons for that such as FX?

Jun: I told you that we think it is conservative as of today.

Mori: Alright, understood. Thank you.

The second question is related to Maeda-san's question. Regarding revenue in SaaS solutions you have disclosed and I'm afraid that I am asking for further breakdown. But I am assuming the revenue includes much of AirPAY transaction fees which is the gross payment volume times the fee rate. And I imagine there will be fluctuations between quarters. Is my understanding correct?

Jun: Of course. There is seasonality. Well, I'm not monitoring the degree of fluctuation, but there is a sort of fluctuation, of course.

Mori: And the number of registered accounts is growing at around 30% or higher. But in terms of the gross payment volume, is it growing at a faster pace?

Jun: Well, the reason why I'm not able to give you a straight answer is that I think I responded earlier to someone's question. But we are trying to increase the number of users among our business clients within the existing verticals. And at the same time, we're seeing that business clients outside of the verticals, clients who are smaller in size rather than business clients within the existing verticals, are increasing. The payment volume per client is not necessarily large.

Therefore, compared to the growth of the number of registered accounts, I am not sure if the gross payment volume is growing much faster than that. I don't have the data right now though.

But at the same time we have online AirPAY as well. For example, individual users make online payments with AirPAY online at hotels. In such cases, the payment volume per transaction tends to be large because of the higher unit price. It's really a mixture. So it's difficult to give you a yes or no answer.

Mori: Understand. I think last year you said gross payment volume would exceed 1 trillion yen. So I wondered how much the size would be.

Jun: I believe it's going to be larger than that.

Mori: Yes. I thought so. But the account growth is driven by expansion into SMBs. And that is contributing to the growth momentum, right?

Jun: Yes, SMBs are rather inbound clients. They know the convenience of the service and become our clients. These clients are increasing and we continue to expand those business clients. At the same time, we are trying to increase the use by existing business clients.

Mori: Thank you. This is my last follow up question. I think you have been disclosing the number of cross use accounts. But as of today, what is the service with a higher cross use of AirPAY? Is it still AirREGI?

Jun: Yes, it's AirREGI.

Mori: Then, is AirWORK ATS expanding among different types of business clients?

Jun: Are you talking about AirWORK ATS?

Mori: It is not relevant?

Jun: Right.

Mori: All right. It's not relevant. Well, I thought the pie was larger for AirWORK ATS. If that is true.

Shen: Perhaps the chart in the earnings release was difficult to see but the number was for AirWORK ATS. It's not related to cross use accounts.

Mori: Understand. Thank you

Shen: Nagao san from BofA please.

Nagao: Thank you very much. So let me do that first. So 120 billion yen for Beauty, Travel, and Dining, 53 billion yen for Beauty and I know how much the size of Travel is. How much was Dining revenue in the first half?

Jun: The rest will be very clear. What I can say is it's not back to pre-COVID level yet.

Nagao: OK, understood, That's all that's great. Second question. Maeda-san’s question, maybe I overheard, SaaS solutions, the biggest contributor to revenue was what? Which was it?

Jun: AirPAY.

Nagao: I see. Is this net or gross?

Jun: Net.

Nagao: Okay, thank you very much. Another big question. The big focus of the stock market is, and I know this is a difficult question, can HR Technology recover back to revenue growth in the next fiscal year? Previously I think Deko san said revenue will continue declining for two years. When we look at the snapshot now, is HR technology revenue outlook next year brighter than last time or not? What is your view? This is my last question.

Jun: We are about to develop next year's plan. There is not much we can share with you in terms of timing, and our view. The economy remains harsh. So how much more difficult it will be or not, will be the key. We don't know when recessions will start or end. And the interest rate environment also needs to be taken into account. Given the interest rate environment, we cannot be too optimistic. If we can be optimistic we will start hiring again but that is not what we are thinking yet, not at the moment.

Nagao: A while ago, the Company used to say that EPS of around 10% and adjusted EBITDA of around 10% stable growth was like a guideline. This may be still early to say to turn to that level next year. I’m wondering if you're still not in that sentiment yet. Has your view of growth for the coming year changed between now and the beginning of the fiscal year?

Jun: It is not a business model that goes up steadily and linearly, because sometimes it is flat, sometimes it falls, and sometimes it goes up very high, rather than growing in a single year. It is a company that grows discontinuously.

That is the nature of our business. Looking at a CAGR over a number of years may be the result. We want that to be high, but we don't want to manage it in a single year. We think it is difficult to manage it in a single year.

Nagao: Thank you very much.

Shen: Thank you. It's a bit early, but this is time to conclude the follow up call. Thank you for joining us today. Thank you for your continued support.

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