

Recruit Holdings Q3 FY2021 Earnings Call February 14, 2022

Ito: Welcome to the Recruit Holdings Q3 FY2021 earnings conference call.

I'm Masa Ito, from Investor Relations, and joining me today are Junichi Arai, Executive Officer of Corporate Planning Division and Yasushi Hashimoto, Executive Manager of Disclosure and Individual Investor Relations Department.

Jun will briefly go through the Q3 FY2021 results we announced at 3pm today, then proceed to the Q&A session.

We recommend that you refer to the Highlights on page 5 of the earnings release and the FAQ posted on our IR website.

This call is a simultaneous translation of the original call in Japanese and translation is provided for the convenience of investors only.

Also, please note that all comparisons during this conference call are year over year unless otherwise stated.

Now I'll turn over the call to Jun.

Arai: Thank you for your participation today.

I am Junichi Arai, Executive Officer of the Corporate Planning Division of Recruit Holdings.

Today, I'd like to explain the following four points.

1. Our recently launched self tender offer at a discount price
2. In the third quarter, consolidated revenue increased by 22.0% , consolidated adjusted EBITDA margin was 18.1%, consolidated adjusted EBITDA increased by 54.1%, and adjusted EPS increased by 62.8% .
3. Due to results in the third quarter and progress and trends in the fourth quarter as well as our aggressive investments in hiring and marketing activities aligned with our business strategy, we did not revise our consolidated financial guidance for the second half of the year
4. We have not revised our full-year consolidated guidance range disclosed on November 15, as the business environment remains uncertain due to the potential for future COVID-19 related restrictions in Japan, and globally. However, we expect our full year consolidated financial results will be near the upper end of the guidance range.

I will begin with our recently launched self tender offer before discussing the Q3 results.

On January 28, we announced a share repurchase through a discounted tender offer in which the company will acquire up to 34 million shares at a price of 4,581 yen per share, during the tender offer period from January 31 to March 1.

The total amount is expected to be up to 155.7 billion yen. The tender price represents a 10% discount from the closing price of 5,090 yen on the day before the announcement, which was agreed upon in advance with three Japanese business shareholders that signed the tender offer agreement.

In line with our capital allocation policy, we determined it would be appropriate to buy back our shares from the three Japanese business shareholders in order to alleviate the concerns in the capital markets regarding the impact on our stock price from possible uncoordinated sales by multiple shareholders.

By executing a Self Tender Offer at a discount to the market price, we increase the likelihood that the Japanese business shareholders sell their desired amount of shares and we minimize the cash outflow of buying back shares, while at the same time enhancing shareholder value.

The policy on the disposal of treasury stock acquired through this transaction has not yet been determined at this moment.

However, such treasury stock may be used for stock based compensation for employees, for the delivery of shares upon the exercise of stock acquisition rights, and for strategic M&A using the Company's common stock as consideration.

Next, I will talk about the Consolidated Results of Operations for Q3 of FY2021. Please refer to the FAQ on our website: the appendix for financial results and FAQ number 3 and 4 for consolidated and SBU guidance, respectively.

There were no major changes in the business environment of the HR matching market from the second quarter, which continued to benefit from a tight labor market due to the relatively limited supply of job seekers looking for work combined with significant hiring demand, resulting in increased revenue and adjusted EBITDA for HR Technology and Staffing.

Also, revenue in Media & Solutions increased, excluding revenue from the Rent Assistance Program, which was only in the previous fiscal year, against the backdrop of an economic recovery in Japan since the end of September when COVID-19 related restrictions were lifted. Adjusted EBITDA in Media & Solutions decreased due to strategic marketing activities aligned with its business strategy.

As a result, consolidated revenue was 746.0 billion yen, an increase of 22.0%, consolidated adjusted EBITDA margin was 18.1%, consolidated adjusted EBITDA was 134.8 billion yen, an increase of 54.1%, and adjusted EPS was 55.26 yen, an increase of 62.8%.

Adjusted EBITDA for the nine month period ended December 31, 2021 was 401.1 billion yen. The stock-based compensation expense was 19.3 billion yen during this 9 month period as you can see in the cash flow statement.

This expense is from the stock-based compensation plan for employees of HR Technology, which was implemented in Q4 FY2020, as well as the existing Recruit Group directors' plans.

We expect the stock-based compensation expense for Q4 to be approximately 15 billion yen due to the addition of 2022 grants to HR Technology employees.

Next, I will talk about the results of operations by segment.

First of all, I will talk about HR Technology.

Revenue increased by 81.3% year over year on a US dollar basis to \$1.98 billion. Revenue also increased compared to Q2 driven by continued strong global hiring demand, although the quarter on quarter growth moderated due to the typical holiday seasonality seen in the US and Europe.

The relatively limited supply of job seekers looking for work combined with significant hiring demand continued to create competition for talent on Indeed and Glassdoor.

Due to our auction based, pay for performance pricing model, this competition was a significant driver of revenue growth during the quarter.

On a US dollar basis, revenue in the US increased by 78.9%, supported by both small and medium sized businesses and large enterprises. Revenue outside of the US increased by 88.3%, primarily led by Europe and Canada.

In Japan, revenue growth continued, but at a slower pace than most of the markets in which HR Technology operates, as economic activity recovered after COVID-19 related restrictions were lifted at the end of September.

Adjusted EBITDA for Q3 was 71.9 billion yen, an increase of 168.8%. Revenue growth continued to outpace investments, resulting in adjusted EBITDA margin of 31.9% for Q3, an increase of 8.5% pt from 23.4% for the same period in the previous year.

However, adjusted EBITDA margin for Q3 decreased by 8.4 %pt compared to Q2 of 40.3%.

HR Technology increased investments in strategic sales and marketing, while also increasing investments focused on product and technology initiatives to improve the job seeker experience and simplify hiring, resulting in continued headcount growth across the SBU.

As of November last year, we assumed that the imbalance in the US labor market would lessen gradually over the second half of FY2021.

As such, US dollar based revenue guidance for the second half was approximately 60 to 70% growth year over year.

At this point, however, the business environment for HR Technology hasn't changed significantly from Q3. In the remainder of Q4, we anticipate that the limited supply of job seekers looking for work combined with significant hiring demand will continue to create competition for talent on Indeed and Glassdoor.

Therefore, although the business outlook remains uncertain, we currently expect that our US dollar based revenue for the second half of this year will be near the upper end of the second half guidance range as previously announced in November.

In HR Technology, we continue to significantly increase our investments to grow headcount and plan to continue such initiatives in Q4, in order to support future revenue growth through product and technology innovation.

These investments will be in addition to continued considerable investment in acquiring new users and customers.

As a result, adjusted EBITDA margin for the second half of FY2021 is anticipated to be in the high 20% range as we announced in November.

In the next fiscal year, we plan to continue recruiting top talent aggressively as an upfront investment in order to realize our long term strategy, "Simplify Hiring".

Next, I will talk about the results of Media & Solutions.

Revenue in Media & Solutions decreased by 9.8%.

However, excluding the FY2020 revenue from the Rent Assistance Program, Media and Solutions increased by 7.9% with revenue in Marketing Solutions decreasing 1.3% and HR Solutions increasing 20.5%.

In Q3, after the COVID-19 related preventive measures in Japan were lifted at the end of September 2021, the overall Japanese economy and activities of individuals and business clients improved.

In Marketing Solutions, Housing & Real Estate and Beauty continued to be the primary drivers of revenue growth while revenue in Bridal also increased.

Revenue in Travel and Dining decreased year over year as revenue in Q3 FY2020 had been positively impacted by the temporary Go To campaigns initiated by the Japanese government. However, compared to Q2 of this fiscal year, revenue in both Travel and Dining increased due to the rebound of demand after COVID-19 related restrictions were lifted.

In Travel, in particular, leisure travel recovered to about the same level as Q3 FY2019 before the pandemic.

In Air BusinessTools, the number of AirPAY accounts increased by 39.1% year over year, as of December 31, 2021. Of the approximately 260,000 AirPAY registered accounts as of December 31, 2021, approximately 165,000 accounts also subscribed to other Air BusinessTools solutions.

In HR Solutions, revenue increased by 20.5%, with the year over year comparison benefitting from the significant revenue decline experienced in FY2020.

Revenue in the job advertising business increased year over year as hiring demand for part-time jobs recovered, especially in the restaurant sector. Revenue in the placement service increased year over year, as well as compared to Q3 FY2019 due to the elevated hiring demand in many industries and increasing demand for placement services.

Air BusinessTools aims at improving productivity of clients' business in HR Solutions as well.

SME clients are facing an increasing amount of HR related work due to COVID-19, and the demand for solutions to support them in a simple and easy way has grown rapidly.

The number of accounts for AirSHIFT, a worker shift management service, and AirWORK ATS, a centralized application management service are growing significantly.

The number of AirWORK ATS registered accounts as of December 31, 2021 reached more than 300,000, an increase of over 100% year over year.

As we've mentioned before, we have determined the number of registered SaaS solution accounts in Japan is the most important KPI as Media & Solutions aims to evolve the wide range of solutions offered into an integrated ecosystem to support the operations of our business clients.

Adjusted EBITDA margin in Media & Solutions for Q3 FY2021 was 21.6%.

Adjusted EBITDA decreased by 3.8% year over year as Media & Solutions executed strategic marketing activities aligned with its business strategy.

In Q4, we don't believe the current restrictions will have the same level of impact on daily life in Japan as earlier in the pandemic as daily life has adapted to COVID-19 and the extraordinary suspension and slowdown of economic activities that was seen two years ago is no longer happening.

Looking at the impact COVID-19 has had on previous quarters in Marketing Solutions, the reintroduction of COVID-19 related restrictions is expected to have a limited impact in Housing and Beauty, while Travel and Dining may be negatively impacted.

However, we believe that the negative impact on these businesses will be limited compared to the fourth quarter in FY2020.

Under our guidance announced in November 2021, revenue in Marketing Solutions for the second half of FY2021 was expected to be in the range of approximately a decrease of 8% to an increase of 3% year over year excluding the impact of the Rent Assistance Program in FY2020 as revenue in Q3 FY2020 had been positively impacted by the temporary government travel and dining programs.

Considering the results in Q3 and progress of Q4, we currently expect that revenue in Marketing Solutions for the second half of this year will be similar to revenue excluding the Rent Assistance Program last year.

However, we have not revised our financial guidance in Marketing Solutions for the second half of this year as the impact of COVID-19 related restrictions on the remainder of Q4 is unclear.

Regarding revenue in HR Solutions, although the job advertising business, especially from the restaurant sector, may be impacted by the current COVID-19 related restrictions, based on the revenue growth in the placement service in Q3 and the progress of HR Solutions overall thus far in Q4, we have not revised our financial guidance.

Revenue in HR Solutions for the second half of FY2021 is expected to increase in the range of approximately 17 to 22% year over year.

Q4 is when we invest the most aggressively in marketing activities as it is the most efficient time to capture the demand of individual users in Japan who are looking ahead to the new school year and the traditional start date of work for new graduates from March to May each year.

As in the previous fiscal year, we are investing aggressively in marketing and product development in line with our long-term business strategy for future growth in response to the evolving business environment.

Therefore, we are planning to significantly reduce adjusted EBITDA margin for Q4 compared to Q3 and we expect adjusted EBITDA margin for the second half to be approximately 12% as we announced on November 15, 2021.

In order to implement our long-term business strategy “Help Businesses Work Smarter”, to support further improvement of the performance and productivity of business clients in Japan, we will aggressively continue to focus on investing in strategic product initiatives and recruiting top talents for that, while also streamlining the business management system next fiscal year.

Last but not least, I will talk about the results of Staffing.

Revenue increased by 13.0%, or 9.1% excluding the positive impact of foreign exchange rate movements, primarily driven by the increase in Europe, US, and Australia with additional growth from Japan.

Adjusted EBITDA margin was 8.0%, similar to previous year, due to the decrease in Japan that was partially offset by an increase in Europe, US, and Australia.

Revenue in Japan increased by 9.1% as the number of temporary staff on assignment increased year over year.

Adjusted EBITDA margin was 9.5%, a decrease of 0.4 points, driven by an increase in revenue while costs such as advertising expenses to attract temporary staff increased to a similar extent. Adjusted EBITDA increased by 5.1%.

Revenue in Europe, US, and Australia increased by 16.2%, or 9.1% excluding the positive impact of foreign exchange rate movements, mainly due to increased demand for temporary staff as businesses continued to seek flexible labor to reopen and expand in an uncertain environment.

Along with continued demand for logistics roles to support e-commerce, revenue growth was supported by temporary demand for healthcare roles to support COVID-19 mitigation efforts, particularly in Europe as new variants emerged, which is not expected to be sustainable as COVID-19 recedes.

Adjusted EBITDA margin was 6.8%, an increase of 0.7% points, as revenue increased. Adjusted EBITDA for Q3 FY2021 increased 28.9%.

In the fourth quarter, in Japan, the impact of the recently introduced priority prevention measures on the staffing business is expected to be limited in Q4 FY2021, and the business environment is not expected to change significantly.

In Europe, US, and Australia, the spread of COVID-19 appears to have peaked with cases currently in a declining trend, and we expect demand for temporary staff to continue due to the resumption of economic activities in Q4 FY2021, especially in Europe.

As the outlook for the second half was uncertain as of November 15, we conservatively expected that revenue in Japan for the second half of FY2021 was expected to increase approximately 3% year over year and revenue in Europe, US, and Australia was expected to increase approximately 5% year over year.

Currently, we assume that the second half results will exceed our previous guidance as we anticipate that the trend of the actual results in the third quarter will continue in the fourth quarter.

However, we did not revise our revenue guidance for the second half of FY2021 as the outlook for the sustainability of temporary COVID-19 related demand particularly in Europe remains uncertain.

Adjusted EBITDA margin guidance for the second half of FY2021 is unchanged and is expected to be in the low 6% range, as we plan to execute strategic marketing activities aligned with our business strategy in the fourth quarter.

That concludes my explanation of the financial performance by segment.

We will continue to steadily implement our most important business strategy, "Simplify Hiring" with a long-term perspective, without being constrained by short-term changes in the business environment or business results.

We are grateful for the understanding and support of our shareholders, other capital market participants, and all of our stakeholders.

Please refer to our earnings release and the materials on our website as appropriate, which include the contents of today's presentation.

Question & Answer

Ito: SMBC Nikko Securities, Mr. Maeda, please.

Maeda: Thank you very much. So HR Technology, I have two questions. My first question is a question I asked last time, too. The result, the hiring exceeded supply, and this has been continuing for an extended period of time, so this is not temporary? Mainly in the US, the labor force is in short supply. Maybe this is a structural phenomenon. It's been three months since the last time you announced your results. Have you seen any changes or any indications that you could share with me? Thank you. That's my first question.

Can I ask my second question, too?

Arai: Yes.

Maeda: In the fourth quarter, you expect the increase in expenses. For you, the hiring of talent is a high hurdle for you, too. The third-quarter margin exceeded your anticipation. In the fourth quarter, can you use all your expenses you plan? This is somewhat of a weird question, but do you think you can hire as many talents as you want? And if not, will you delay your hiring to next year?

Arai: Thank you. So the second question is related to HR technology?

Maeda: Yes.

Arai: Understood. So first question. I said this is from the beginning of this fiscal year, the business environment, unprecedented environment is continuing, and we thought that it will stabilize. We said that every quarter. And you may think it will continue more and some say, yes, it will continue, right? At least this ongoing fourth quarter will have the similar trend from what we saw in the second and third quarter in the US and in Europe.

What will happen after that? As Maeda-san just said, the structural problem may not be resolved that easily. That is one view. Another view is for the Company's job hiring demand, the appetite and the environment will change, some say. And some say vice versa. Toward May, when we announce our full-year results, we will watch the situation closely and share the information with you properly.

Including Idekoba-san, we hope we could share with you our view, but we are now looking up to the end of fourth quarter right now.

And to answer your next question, in the third quarter, HR Technology margin, compared to November 15, our projection for the second-quarter margin, if you could project, and I think that was behind your question about the margin and the cost/expenses for the fourth quarter.

It's not that we have to increase costs. Rather, we are hiring talent for the future. On the marketing side and development side, we have to hire talent. That's what we are focusing on now. But as Maeda-san just said, it's not easy. How we can effectively hire is our challenge.

Fortunately, in the fourth quarter and the previous quarter, HR Technology is enjoying a net increase in headcount, so we hope to continue this trend and think of the ideal form of our organization in the future. The fourth-quarter profit and the full-year profit is being considered on that basis. Thank you very much.

Maeda: Thank you.

Ito: Now Jefferies Securities.

Takeuchi: My name is Takeuchi from Jefferies Securities. I have two questions. One is HR Technology revenue from October to December period. Compared to July through September, I see flat performance in the US and other regions are following the previous quarter. It's following the same trend.

Are you seeing a mitigation in the intensive competition over talent in the US? Is it different from other regions?

And the second question is related to labor cost. On a full-year basis in the SG&A, compared to JPY127.3 billion in July to September period, I see there is an increase of JPY143 billion. Can I assume that there is a large proportion of one-time cost of stock-based compensation? Or is this due to a significant increase in the headcount in HR Technology? Can you please elaborate on the breakdown of this increase in the labor cost?

Arai: Thank you. Now let me address your second question first. Share-based compensation is not a one-off expense, but hiring is planned to be increased, especially for HR Tech area. And we are assuming that the performance will continue to improve with increasing headcount. As that expense is expected to continue to increase, it is not something that will be one-off, but we are expecting to hire capable talents and generate performance and be in a positive cycle. So this is not a one-off expense in short answer.

And I also responded to the second question of Mr. Maeda, and this is related to that question. There is a continuing increase in the headcount. And we disclosed the cost structure only on a consolidated basis, not for each segment. But we can say that overall, it is increasing. So that was the response to your second question.

As I mentioned earlier, in terms of correlation with the revenue, we have been sharing a similar story from before COVID, but the revenue and labor cost in a given period do not always match with each other. At times, the increase in labor cost is for our future growth, and we just calculate the profit by subtracting that money from our revenue at that given period.

And to your first question in the overall market, October through December is a holiday season in some countries, and that can lead to a slowdown in activities. On the other hand, we are still facing COVID. We are under extraordinary situations, and there's a balance of being offset by such unique conditions. That is not true for every country, so that is what you're seeing as a difference between regions.

In mid-November, we announced our forecast on revenue growth, and that hasn't been changed. 60% to 70% growth is expected on a global level for the second half. And if the current trend continues, we are expecting to perform at the upper end of the range. The US will be a significant source of revenue. That is the growth you're seeing, and we do see a recovery in some of the markets as well, although at different times, so there is a mixture of different factors.

We do not see that there is a significant gap between the US and other regions.

Takeuchi: Thank you.

Ito: Next Citigroup Securities, please.

Tsuruo: Tsuruo from Citigroup Securities. Thank you. I have two questions; they are both related to capital allocation. With the changes in the financial environment, the stock market is changing dramatically. Based on this, your M&A strategy and your pipeline, and how you plan to build your M&A pipeline, are there any changes?

And second question. About one month ago, 51job privatization offering price changed. What is your current stance and your update and the profit contribution? Any changes there? Thank you very much.

Arai: Thank you for your question. M&A strategy has not changed. We look at our business, our HR Matching business. If there are cases that can contribute much promising companies, we will look for such assets at the appropriate price. And we do not think about large or small size and so no change in our M&A strategy

The share price in the listed companies changed much in the past one month. But the private round, some companies are regarded very highly. And so we will watch the changes closely. We will not be overly optimistic or pessimistic. We want people to be engaged in our company. If we have promising companies that we want to work with, we will look for them. So no change at all in our M&A strategy.

And 51job, the conditions and the schedule changed. And so we hope this will be resolved as soon as possible and will be completed. This is not a consolidated business, so it will be below our profit line. It will hit our bottom line, but in other areas, this is the passive minority investment, no change there. We will continue our collaborative relationship.

Thank you very much.

Takeuchi: Thank you. That's all for me.

Ito: Then Kinoshita-san.

Kinoshita: This is Kinoshita speaking. Thank you. I also have two questions about HR Technology on your mindset. The first question is the situation in the US may be under some seasonality according to your explanation. In the past, figures only for the US market hadn't been disclosed, so I cannot do a comparison. But from the second to third quarter, development in the US, is it in line with your past regular seasonalities? Or has it changed? Has it weakened or strengthened?

Well, I do not get the impression that it has weakened. But is it a regular seasonal adjustment? Or compared to the second quarter, have you done a stronger seasonal adjustment in the third quarter?

And my second question is, in the fourth quarter, you were explaining that you will be spending costs actively to hire people. Compared to how you have been using cost in the past, cost per acquisition, is it planned to be

higher, meaning that it may be less efficient, but you will still be intending to hire? Or would you monitor the cost performance? And if cost per hiring is too high, will you choose to hire at a slower pace? Thank you.

Arai: To your first question about the US market, in 2020 and in FY2021, it is true that we have seen irregular development and it is difficult to look just at the third or the fourth quarter and make comparison, to be honest. If it's in FY2019, revenue in the third quarter was flat QoQ. In FY2020, we saw a strong recovery. Therefore, in the third quarter, we saw more recovery compared to usual times. But this third quarter was more flat.

Excluding certain industries, most industries are in the holiday season and they may pause their hiring activities. That's the same for job seekers as well. In general, the market activities have slowed down. But we do see positive feedback for our products who continue to use our products regardless of negative impact on their businesses in certain industries. I believe that led to this result. Regardless of the normal seasonality, I believe we performed better than usual.

And next, regarding the fourth quarter about recruiting efforts, we are not intending to spend as much cost as possible to hire people. Such activity will not be sustainable. As I've been explaining, online job advertisement business is the main source of income today. And beyond that, in the HR matching market and recruitment automation market are the new battlefield for us to further improve efficiency for our customers. That's where we need additional workforce. We need someone capable of doing new form of marketing.

If the candidate is confident, of course, we will be paying the necessary amount to retain them. That's how we are willing to prepare and that may be linked to the stock compensation system that we've been talking about.

We are focusing on the sustainability of these recruiting activities to secure competent talent so that we can carry out good marketing and develop good products. It is not just about spending money, but we want our recruiting activities to be sustainable. Again, it's not just about using as much cost as possible. Thank you very much.

Kinoshita: Thank you.

Ito: Lastly, Marusan Securities, Harada-san.

Harada: Thank you. I have a question on HR Technology. Last time in Q2, you talked about the labor shortage as well as the increase in unit price as one of the reasons for the EBITDA margin of 40.3%. Did this trend continue in Q3? Did the unit price further increase in Q3 or was it flat?

Arai: The margin increase is not just because of the unit price. The revenue growth led to the profit increase and the margin increase. That is what I said three months ago. Of course, unit price is one factor, but volume is another. These two are intertwined as a multiplier, and this contributes to the top line. And so this leads to revenue increase. As a result, the profit and margin also increased.

As I mentioned earlier, in the fourth quarter, like second and third quarter, the trend is continuing, so basically the same cost structure, the same trend continues. The profit in the fourth quarter will be considered on that basis.

As mentioned in the earlier question, we will continue investing for the future, which will be a cost increase, so margin will be much lower. On that basis, throughout the second half, we will try to keep the margin at the higher half of the 20% range. That is what I can say for now.

Harada: Thank you.

[END]

Forward-Looking Statements

This document contains forward-looking statements, which reflect the Company's assumptions and outlook for the future and estimates based on information available to the Company and the Company's plans and expectations as of the date of this document or other date indicated. There can be no assurance that the relevant forecasts and other forward-looking statements will be achieved.

Please note that significant differences between the forecasts and other forward-looking statements and actual results may arise due to various factors, including changes in economic conditions, changes in individual users' preferences and business clients' needs, competition, changes in the legal and regulatory environment, fluctuations in foreign exchange rates, and other factors.

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