INTEGRATED REPORT PORTAL

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A Message from the CFO

We will achieve sustainable growth by investing in future growth while maintaining financial discipline.

Managing Corporate Officer, EVP,
Group Chief Financial Officer (GCFO)

Ryosuke Sakaue

My Mission as CFO

As CFO, I support group strategies by appropriately controlling risk.

The role of the CFO is to provide support, primarily from a financial perspective, for the implementation of group strategies targeted toward sustainable growth. The Z Holdings Group is currently engaged in a phase of upfront investment that we call our “third founding.” Our mission during this phase is to maintain financial and investment discipline while proactively seizing growth opportunities.

We are steadily expanding our group earnings toward an operating income target of ¥225 billion, a new record for the Group, in fiscal 2023. The Z Holdings Group is evolving into a corporate group that is unique in the world in terms of the scope of its assets, which range from media and search, to Internet and real-world merchandising, payments, finance, and social networking. We are achieving this evolution through initiatives that include the establishment of PayPay Corporation, which has made excellent progress since its launch in 2018, the acquisition of ZOZO, Inc. in the fall of 2019, and a planned business integration with LINE Corporation in March 2021. Going forward, our goal is to become number one in Asia in each of our business areas through the pursuit of increased synergies among our various business operations, leading to further evolution of our group strengths.

Overview of Fiscal 2019

Revenues exceeded ¥1 trillion for the first time, and operating income increased for the first time in three years.

Our consolidated results for fiscal 2019 show that revenues increased by 10.3% year on year to ¥1,05 trillion, exceeding ¥1 trillion for the first time. Operating income was 8.4% higher year on year at ¥152.2 billion. While achieving growth in income, we focused during fiscal 2019 on organizational restructuring and the launch of new services in preparation for a transition in our revenue structure over the medium- to long-term future.

Our top priority in the Commerce business segment is the e-commerce merchandise field. Transaction value in this area grew by ¥270 billion (14.4%) above the previous year's level as a result of the opening of the PayPay Mall in the fall of 2019, and the acquisition of ZOZO, Inc., at the end of that year.

The PayPay business showed encouraging progress thanks to concerted efforts by the entire Z Holdings Group. We have positioned the first three years since the business was launched in October 2018 as a time for upfront investment. Our priorities in this period have been the expansion of the user base and growth in the number of payments. As of June 30, 2020, there were approximately 30 million users, and services were available in around 2.3 million stores nationwide. Brand awareness is also rising steadily. In a survey conducted by PayPay Corporation in May 2020, PayPay was ranked as the number one payment method associated with the word "cashless." Significant amounts were spent on mass-advertising immediately after the launch with the aim of raising recognition levels, but in fiscal 2019 we

expanded the user base and improved retention, while minimizing investment costs by limiting our campaigns in terms of locations, stores, and times. The spread of PayPay as a solution that visualizes consumer behavior is creating important infrastructure for the integrated marketing solutions that the Z Holdings Group aims to provide. Our policy is to move forward strongly with the monetization strategy several years ahead of the initial schedule, especially in the finance business.

The Media business was impacted by anti-tracking in the first quarter, and by COVID-19 in the fourth quarter. However, advertising revenues were higher, and operating income rose for the first time in three years with a 9.5% increase over the previous year's level.

We are pursuing synergies through closer communication with acquired businesses.

Decisions on growth investment in new businesses are based on clearly defined criteria. For example, we have three specific criteria for decisions on M&A. First, the business operations of the company concerned must be compatible with our growth strategies. Second, the company must be number one or the only one in its business area. Third, the company must be suitable for inclusion in our consolidation. We also apply a numerical benchmark, which is an internal rate of return of 10% or higher. If these criteria are met, we will move forward with M&A.

After an investee company has been added to the Z Holdings Group, the next step is post-merger integration (PMI), which is a vital step to ensure that M&A investment results in synergies and profit growth for the Group. I believe that good communication is the key to a successful PMI process. First of all, to ensure that we understand each other's strategies and roles, we create more opportunities for reciprocal communication, including the establishment of a steering committee, and frequent reporting on the company's business situation.

YJ Card Corporation and Ikyu Corporation are examples of companies for which this emphasis on good communication has resulted in extremely successful PMI processes. Both companies are now playing important roles in our Group strategies. Many of the people who today make up the core of our Group management structure were the founders of the companies that we acquired. We aim to apply the lessons that we learned from these successes to our PMI processes for ZOZO, Inc. and, in the future, for LINE Corporation.

Resource Allocation and Future Growth Investment

We will deploy human resources and invest in marketing in strategic areas. We will also step up our ICT investment.

Integrated marketing solutions and scenario finance are both core areas for our future investment strategies. While resources will be allocated preferentially to these areas, we will also continue to invest in e-commerce merchandising as infrastructure for the expansion of our activities in these two areas.

In the short term, our policy is to invest human resources to develop new services in these areas, and to invest in marketing to promote these services. Over the medium- to long-term future, and in preparation for our business integration with LINE Corporation, I believe that we also need to increase the allocation of management resources to investment in ICT, including AI. An analysis of our investment cash flow in fiscal 2019 shows that we invested approximately ¥80 billion in tangible and intangible assets. From fiscal 2020 onward, we plan to increase this to around ¥100 billion per year.

From a geographical perspective, we will prioritize investment in Asian regions where LINE Corporation has high market shares, such as Taiwan, Thailand, and Indonesia. After the business integration with LINE Corporation, we will use their user base to roll out services in Asia based on successes in Japan, which is a forerunner in finding solutions to emerging issues.

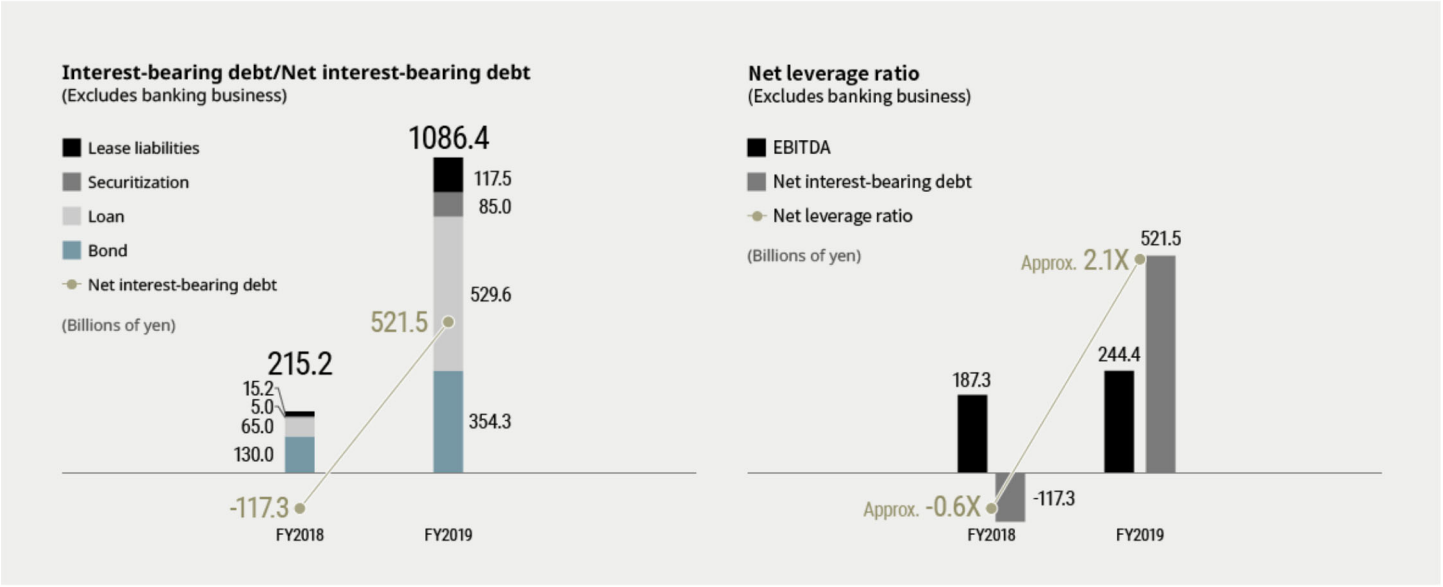
Maintaining Financial Discipline

We rigorously manage our balance sheet with the aim of keeping the ratio of EBITDA to interest-bearing liabilities to around 2.5–3 times.

When I became CFO in 2018, we were a cash-rich company with a surplus of around ¥300 billion. To mark our “third founding,” we have provided returns to shareholders by implementing share buyback schemes totaling ¥290 billion over the past two years. As a result, our net cash position is now almost flat.

Proactive growth investment is essential to our continuing growth. In fiscal 2019, we invested approximately ¥400 billion in the acquisition of ZOZO, Inc. We also invested in businesses that are currently in a growth phase, including credit cards and the merchandising business. While these initiatives caused an increase in interest-bearing liabilities, we see our present net leverage ratio of 2.1 times as an optimum level at which we can maintain our credit rating. We will continue to manage our balance sheet to keep the ratio of interest-bearing liabilities to EBITDA within a range of 2.5 to 3.0 times, which will enable us to maintain our JCR rating of AA- and our R&I rating of A+, so that we can continue to procure funds even during abnormal situations like the present COVID-19 crisis. Going forward, we will continue to prioritize free cash flows and the cash conversion cycle in our cash flow management.

We have been disclosing adjusted free cash flows since the financial results for fiscal 2019. Because we carry out future-oriented upfront investment, our free cash flows are negative. However, we aim to achieve positive free cash flows from fiscal 2020 onward. Because of the upfront cost of working capital in some areas, such as the credit card business, we will improve our capital efficiency by securitizing receivables.



Improving Capital Efficiency

We will maximize profit and improve our capital efficiency by pursuing synergies.

From a capital efficiency viewpoint, we used bridge loans to procure the approximately ¥400 billion required to acquire ZOZO, Inc. in fiscal 2019. In June 2020 we improved our ratio of direct and indirect financing and reduced our capital costs by refinancing ¥200 billion of this amount through a bond issue. The acquisition also added goodwill of approximately ¥212.9 billion and intangible assets of approximately ¥502.1 billion. For this reason, our priority going forward will be to generate synergy benefits. Because Z Holdings has adopted the International Financial Reporting Standards (IFRS), we assess impairment across all group companies engaged in the shopping business, which is a group-level cash-generating unit. This means that a decline in ZOZO's share price will not in itself result in impairment losses.

Because there is a significant overlap of business areas between Z Holdings and LINE Corporation, we need to achieve synergies, including elimination and consolidation of businesses. We have therefore opted for an equal business integration resulting in delisting under the holding company, rather than acquiring shares, maintaining stock market listings, and working to achieve growth while reflecting the views of outside shareholders, which has been our approach with ZOZO, Inc., a company that specializes in a single business area. Based on LINE Corporation's aggregate market value and other factors, we decided to procure the funds required by issuing new shares. This will raise the ratio of total equity to total assets but temporarily lower ROE. However, ROE will naturally improve if the merger generates synergy benefits and expands earnings. This is likely to take several years, but we hope that shareholders will appreciate the vital importance of this step for the future growth of the Z Holdings Group.

We are working to enhance total shareholder returns through sustainable growth.

To achieve sustainable growth in corporate value over the medium- to long-term future, the Z Holdings Group has prioritized proactive upfront investment in future growth. As a listed company, we are also aware of our obligation to provide returns to shareholders, and we aim to improve total shareholder returns, including direct returns in the form of dividends and share buyback schemes, and investment returns resulting from medium- to long-term increases in the share price.

Based on this policy, we have set the dividend for fiscal 2019 at ¥8.86 per share, resulting in total dividend payments of ¥42.1 billion. We will also continue to implement share buyback schemes flexibly when market conditions are appropriate.

Our business integration with LINE Corporation, which is scheduled to occur within fiscal year 2020, will result in our evolution into a highly original and unique Internet business group without parallel in the world. We will maximize these strengths through growth investment, while maintaining financial discipline, so that we can achieve sustainable growth by fulfilling our mission “to unleash the infinite potential of all people, with the power of information technology”.

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