Management's Discussion and Analysis of Financial Position and Operating Results

Dentsu Inc. and Consolidated Subsidiaries
As of March 28, 2019

Any forward-looking statements in the following discussion and analysis are based on the judgment of management as of the date that Dentsu Inc. (hereinafter "Dentsu" or "the Company") filed its securities report for the fiscal year ended December 31, 2018 with regulatory authorities.

Significant Accounting Policies and Estimates

In the preparation of these consolidated financial statements, management discloses the amounts of the reported asset and liability figures as well as those of offbalance sheet transactions such as contingent liabilities, as of the date the accounts are closed.

Management also estimates the impact of these figures on the Company's financial position and operating results during the reporting period. Management continuously evaluates forecasts and assumptions regarding such items as investments, business combinations, retirement benefits and corporate taxes, as well as contingencies and litigation. Management bases its estimates and assumptions on the consideration of several factors, given past performance and conditions. These results underpin asset and liability book values and reported revenue and expense figures. However, uncertainties are inherent in such results and estimates may vary from actual results.

The critical accounting policies described below are those that management considers to have specific potential to affect the financial position and operating results of the Group. Such policies may also include important assumptions and estimates used in creating the Company's consolidated financial statements and therefore have a material impact on these statements.

Revenue Recognition

Starting from the consolidated fiscal year under review, the Group is applying IFRS 15 Revenue from Contracts with Customers (released in May 2014) and Clarifications to IFRS 15 (released in April 2016; both in combination referred to "IFRS 15" below). In accordance with our application of IFRS 15, we recognize revenue using the following five-step approach:

Step 1: Distinguish between contracts with customers
Step 2: Distinguish between contractual obligations
Step 3: Calculate transaction values
Step 4: Allocate transaction values to contractual obligations
Step 5: Recognize revenue once contractual obligations have been fulfilled

The Group offers its customers advertising and information services, in addition to other services.

In our advertising business, we primarily offer advertisement placement services in a wide variety of media, as well as wide-ranging content services and advertising production, which includes creative services. In the case of advertising placement, the Group's contractual obligations are most often fulfilled when ads are actually placed, while, in the case of advertising production and content services, they are primarily fulfilled once finished advertisements have been delivered or the relevant labor has been provided. It is at these times that the Group recognizes the revenue associated with these obligations. In terms of rights businesses, such as marketing rights for sporting events, revenue is recognized based on the rights bestowed upon customers. In cases in which these rights are granted at a certain point in time, revenue is recognized at that point in time. When these rights are conferred over a period of time, revenue is gradually recognized over the duration of the period.

For transactions related to the advertising business, the Group primarily records either the net amount received from customers as remuneration for services, which is calculated by subtracting related costs from considerations received, or certain remunerations and considerations received as commission. In a portion of cases in which customers have been deemed to possess particularly strong attributes, we record the total amount combining considerations with costs.

In our information services business, we primarily conduct the sale of software and other products while offering services that include contracted system development, as well as outsourcing and operation and maintenance services. In the case of software and other product sales, the Group acknowledges the fulfillment of contractual obligations and recognizes revenue at the time of delivery. For contracted software development, we recognize revenue based on the degree of development progress and, in the case of operation and maintenance services, we recognize revenue once contract periods have elapsed. As for transactions related to the information services business, revenue and costs are displayed in their full amounts.

Turnover disclosed on the Group's consolidated income statement represents the total amount that has been billed or can be billed to customers (excluding discounts or related taxes such as consumption tax, etc.) and does not conform to IFRS.

Based on transitional measures related to IFRS 15, the Group is recognizing the cumulative impact of applying these standards from the beginning of the consolidated fiscal year under review and is adopting a policy of not conducting retrospective restatement of comparative information. Accounting policies for fiscal years under comparison to the current consolidated fiscal year are indicated below.

Group revenue primarily comprises commission received from advertisement placement in a wide variety of media and remuneration obtained from advertisers and other customers utilizing services such as wide-ranging content services and advertising production, which includes creative services.

Revenue received through advertising production or other advertising services is recorded as the net amount of remuneration received from advertisers and other clients, which is calculated by subtracting costs from considerations, or as fixed fees or certain remunerations and considerations.

Revenue received through commission is recognized when ads are placed in their corresponding media. Other revenue is recorded after services have been rendered to completion, when the logical measurement of considerations becomes possible and the influx of economic benefit becomes highly possible.

As for transactions related to businesses other than the advertising business, revenue and costs are displayed in their full amounts.

Impairment Loss on Property, Plant and Equipment, Goodwill, Intangible Assets and Investment Property

On the closing date of the fiscal year, the Group judges whether signs of possible impairment of non-financial assets exist, excluding inventories and deferred tax assets. In cases where these signs do exist, we conduct impairment testing based on the recoverable amounts of the assets in question. As for goodwill, we do not conduct amortization. Instead, we conduct impairment testing at a minimum of one time per year, regardless of whether signs of impairment exist or not. However, we also conduct impairment testing in all cases when signs of impairment are discovered. We set the recoverable amount of assets as their fair value or the fair value of their generated capital after subtracting disposal costs, or their utility value, whichever is higher. When the book value of assets or the capital they generate exceeds recoverable amounts, we reduce the value of the asset in question to match the recoverable amount and recognize an impairment loss. When calculating utility value, we utilize predetermined assumptions based on factors including the estimated useful life of the asset, future cash flow, growth and discount rates.

These assumptions are determined based on optimal forecasts and judgements made in reference to past results, business plans approved by management and other factors. However, these assumptions can be impacted by factors such as changes in business strategy or market environment. When assumptions must be changed due to these factors, recognized impairment loss amounts can be significantly affected.

Valuation of Financial Instruments

The Group retains financial assets, including securities and derivatives. When evaluating these financial assets, we utilize pre-determined assumptions. The fair value of these assets is based on market value and calculation procedures such as market approach. Specifically, fair values of shares and other financial assets with trading names for which there are lively markets are calculated based on their market prices. Fair values for those with trading names for which there are no lively markets are primarily calculated with the market approach, using amounts calculated based on observable market data or unobservable input.

The fair values of contingent considerations and share acquisition debt resulting from business combination is calculated through the discounted cash flow method using unobservable input.

Our management has deemed our evaluations concerning the fair values of financial instruments and other matters to be logical. However, the recognized fair values of these financial instruments can be significantly impacted in cases in which forecasts must be updated due to changes in prerequisite assumptions or other unpredictable factors.

Valuation of Defined Benefit Obligations

Defined benefit obligations and retirement benefit expenses are calculated based on preconditions established for use in actuarial calculations. Included among these preconditions are discount rates and future remuneration levels, employee turnover rates and mortality.

Our management has deemed these preconditions logical. However, recognized expenses and recorded obligations can be significantly impacted in cases in which actual results differ from these preconditions or when these preconditions change.

Reserves

The Group currently has legal and constructive obligations resulting from past events. We recognize reserves for these obligations in cases in which demand for their settlement is highly possible and their amounts are reliably predictable. In cases in which the time value of money has a significant impact, we measure reserves using present value, which utilizes a discount rate that reflects the unique risks associated with the liabilities in question.

These reserves are calculated based on optimal forecasts that consider uncertain factors present on fiscal year closing dates. However, recorded obligation amounts can be significantly impacted in cases in which actual results differ from forecasts due to the occurrence of unpredictable events or unforeseeable circumstantial changes.

Recoverability of Deferred Tax Assets

Deferred tax assets are only recognized in cases in which tax credits carried forward or deductible temporary differences are highly likely to be utilized against future taxable earnings. Deferred tax assets are revised on the closing date of each fiscal year and values are reduced for deferred tax assets that are not predicted to product tax benefits.

The Group records deferred tax assets based on future taxable earnings and the continuous review of careful and highly implementable tax planning. We deem the forecasts we make when evaluating recoverability to be logical. However, recognized expenses and recorded assets can be significantly impacted when actual results differ from forecasts due to factors such as unpredictable events or circumstantial changes.

Analysis of the Operating Results for the Consolidated Fiscal Year under Review

Revenue and Revenue Less Cost of Sales

In the consolidated fiscal year under review, the Group's revenue was 1,018,512 million yen (up 9.7% year on year) and gross profit was 932,680 million yen (up 6.3%).

Revenue less cost of sales in the Japan business was up 2.0% year on year, to 369,258 million yen.

Revenue less cost of sales in the Group's international businesses was 563,852 million yen (up 9.3%). The growth rate of organic revenue less cost of sales in the international businesses rose 4.3%. By region, this rate was 7.4% in EMEA, 4.9% in the Americas and -1.7% in APAC.

Selling, General and Administrative Expenses, Other Income and Expenses and Operating Profit

In the consolidated fiscal year under review, SG&A expenses were 820,058 million yen (up 9.1% year on year).

Other income was 11,168 million yen (down 52.2%) and other expenses were 12,151 million yen (up 4.6%). As a result, operating profit for the consolidated fiscal year under review was 111,638 million yen (down 18.7%).

Gains on Equity Method Investment, Gains from the Sale of Affiliate Shares, Financial Gains or Losses and Profit

In the consolidated fiscal year under review, gains on equity method investment were 2,699 million yen (down 36.1% year on year), gains from the sale of affiliate shares were 52,127 million yen and financial income fell to become financial expenses, resulting in financial losses of 17,713 million yen. As a result, profit before tax was 148,751 million yen (down 0.6%).

Out of net profit, which is calculated by subtracting corporate income tax expenses from profit before tax, profit for the year attributable to owners of the parent was 90,316 million yen (down 14.4%).

Management Policy, Management Environment and Issues to Be Addressed

The Dentsu Group has viewed FY2017 and FY2018 as a period of reform in its Japan business. During this time span, we have made the working environment reforms our top priority. In international businesses, the momentum we have maintained since acquiring Aegis Group plc (now "Dentsu Aegis Network Ltd.;" below, "DAN") in 2013 has been recovering thanks to our business portfolio, which is primarily focused on well-balanced regional expansion and growth domains. In the future, we will continue to work toward Group-wide business transformation to secure continuous growth in both our Japanese and international businesses.

All matters relating to the future in this text are based on judgements made by the Group as of the submission date of its Annual Securities Report.

(1) Japanese Business

i. Summary of Working Environment Reforms

In our Japan business, we have been promoting working environment reforms as an integral part of our business transformation efforts for two years by simultaneously shortening working hours and raising work quality and restructuring all functions of our corporate infrastructure.

The three pillars of reform that support our environmental and infrastructural overhauls are thorough time management and enhanced worker protection, business process improvement and Work-Diet through the thorough review of workflows, and smart work styles through enhanced internal infrastructure such as ICT. We have engaged in many related reformative efforts for two years, and, as a result, total working hours per employee fell to 1,952, indicating a steady decline that is mostly in line with our targets. In addition, many of these wide-ranging measures, including our numerous initiatives in the field of RPA, will have increasingly significant positive effects in the future. Value creation starts with our employees, who constantly maintain excellent conditions and are progressively completing infrastructure aimed at maximizing the amount of time invested in creating added value for our customers and client companies. We will continue to work toward creating conditions that allow all Group companies in Japan to demonstrate the results of these efforts.

ii. Enhancing Capabilities in the Japanese Digital Domain

In October 2018, the Group announced a capital and business alliance with SEPTENI HOLDINGS CO., LTD. and business integration with VOYAGE GROUP Inc. and cyber communications inc. The purpose of these moves was to strengthen business foundations in the Japanese digital domain. We will promote collaboration and improvement measures using both the management resources of these groups and the management resources that we have held since before these announcements while we work to provide the highest level of services possible in the digital advertising field.

Furthermore, the Dentsu Group recognizes that is must expand and improve its capabilities to support reforms being implemented by client companies. In the Japanese digital marketing domain, which we consider to be of paramount importance, we have promoted capability enhancement across three fields: solutions, advertising and data technology. By shoring up these collaborative formations, we will work to establish our position as a partner that supports the implementation of reforms promoted by our client companies.

(2) International Businesses

i. Establishment of Business Foundations

The Group actively invested in its international businesses in FY2017 and FY 2018, establishing business foundations in the three categories below. First, we integrated strong common platforms, systems and shared services into our global network and linked them with long-term business reform to raise productivity. While ensuring that our operating model functions effectively, we have aimed to secure top line growth by constructing a growth platform that works as an original system designed to promote internal collaboration. We believe that this platform will help raise the quality of our new business processes by accelerating the sharing of knowledge and experiences gained through business conducted at DAN. At the same time, we actively promoted M&A with the goal of securing access to growth potential and the most advanced services and technologies and to obtain fascinating human resources. Furthermore, we are conducting investment in people to maintain and acquire superior human resources from both inside and outside the Group. These investment efforts include revisions to our incentive system made in FY2018.

ii. Maintenance of Recovering Momentum

Starting in FY2019, we have been focusing on the following three important fields to expand recovering momentum.

- Achievement of further top line growth through the provision of integrated services
  To secure top line growth at DAN, it is important for us to provide solutions through integrated services. As this approach has contributed to recent account acquisitions, we will work to develop related competency levels while working from a level involving more brands and regions than ever before.

- Continuing innovation and developing our uniqueness
  DAN has actively worked to acquire advanced technologies and will continue to promote efforts aimed at strengthening data, analytics and technologies obtained through collaboration with key platform developers, as well as securing digital human resources and new technology through M&A. Additionally, DAN will work to distinguish itself in an increasingly intense competitive environment by enhancing its own uniqueness.

- Raising profitability
  Supported by our previous active investment in areas such as common platforms, we will raise profitability over the next few years while streamlining our business operations. Additionally, we will appoint supervisors with the mission of sustaining recent increases in operational excellence and will also place further emphasis on the importance of raising operational efficiency throughout DAN.

(3) Group-wide Business Transformation

The entire Group will continue to work toward the establishment of common foundations for growth in both the Japanese and international businesses while expanding capabilities and human resources from a Group-wide point of view. From this point of view, we plan to accelerate a variety of efforts, including linkage of external management resources, both in Japan and overseas. Furthermore, we regard the construction of systems that enable swift decision-making from a medium- to long-term perspective as important when facing a rapidly changing environment. Therefore, we are promoting conversion to a holding company system.

(4) Consolidation Guidelines in Place until 2020

The Group has set the following consolidation guidelines in place until 2020:

i. Achieve a gross profit organic growth rate of 3% or more (CAGR over the three years leading up to 2020), providing momentum for all businesses
ii. Improve the operating margin, an indicator of profitability, annually after 2018.
iii. In terms of shareholder return, firmly maintain stable dividends as before and discuss appropriate return of profits to shareholders while considering the future statuses of results and cash flow

Finally, we will also continue to engage in global CSR activities.

During the fiscal year under review, we updated our medium-term CSR strategy. We have selected CSR issues that are important for the Group, including respect for human rights and reducing environmental burdens, and plan to continuously monitor our progress on these issues moving forward.

The Sustainable Development Goals (SDGs) are the subject of increasingly energetic discussion both in Japan and overseas. We are conducting activities aimed at widely spreading awareness regarding the importance of the SDGs throughout society, with a particular focus on Team SDGs that traverse all Japanese Group companies. These activities include conducting consumer SDG surveys and distributing SDGs communication guides. Through Com on Ground, a collaborative campaign involving the world's top five advertising groups, we will continue to support NGO activities aimed at eradicating malaria and tuberculosis on a global scale.

In the future, we will continue to strengthen activities befitting a leading global group in the communications domain and work to raise corporate value.

For more details regarding individual activities, please see the Dentsu Integrated Report (http://www.dentsu.com/csr/).

We will lead the creation of diverse value that will further enrich society while pressing forward with our ceaseless efforts to become a corporate group that opens pathways into a new era.

Analysis of Capital Resources and Cash Liquidity

Assets, Liabilities and Equity

As of December 31, 2018, total assets were up 75,631 million yen year on year, primarily due to an increase in cash and cash equivalents. Total liabilities increased by 115,015 million yen year on year, due mostly to a rise in corporate bonds and borrowings. Total equity fell 39,384 million yen year on year, mainly caused by a decrease in translation adjustment from foreign operations.

Cash Flows

As of December 31, 2018, cash and cash equivalents (below, "cash") were 416,668 million yen (305,760 million yen at the end of the previous fiscal year). This figure was up 110,907 million yen year on year because cash provided by operating activities and cash provided by financing activities were greater than cash used in investing activities.

Cash flows from operating activities

Cash provided by operating activities was 133,049 million yen (provided 141,557 million yen in the previous consolidated fiscal year). This result was primarily due to pretax profit.

Cash flows from investing activities

Cash used in investing activities was 61,382 million yen (used 85,531 million yen in the previous consolidated fiscal year). This was primarily because cash used for the purchase of non-current assets, the acquisition of subsidiaries and the purchase of securities exceeded proceeds from the sale of securities.

Cash flows from financing activities

Cash provided by financing activities was 57,522 million yen (provided 1,226 million yen in the previous consolidated fiscal year). This result was primarily thanks to proceeds from issuance of bonds.

Capital Requirements

The Group's primary working capital requirements are production costs and media fees supporting advertising operations and personnel costs and other SG&A expenses.

In recent years, the Group has developed new capital requirements related to investment in various domains, including global business and digital technology, aimed at expanding existing businesses and discovering and developing new businesses.

Financial Policy

The Group procures working capital through internal funds, corporate bonds, commercial papers and short-term borrowings. The Group has generally had positive working capital (current assets minus current liabilities) on a consolidated basis. In the previous fiscal year and the fiscal year under review, the Group's working capital recorded positive amounts of 94,300 million yen and 149,900 million yen, respectively.

To secure short-term capital liquidity, we have set a maximum bank loan limit of 50,000 million yen, calculated through the syndication method. At Dentsu Aegis Network Ltd., we have set a maximum bank loan limit of 500 million British pounds (about 70,000 million yen) for the purpose of emergency response. To raise capital efficiency within the Group, we have adopted a cash management system (CMS) that allows use to borrow capital from subsidiaries in Japan with a capital surplus and lend capital to Japanese subsidiaries with capital requirements. Dentsu Aegis Network has adopted a global CMS that consolidates overseas capital in London.

In a meeting held on March 15, 2018, our Board of Directors passed a comprehensive resolution concerning the issue of unsecured straight bonds with the goal of securing capital necessary for future business expansion. The total value of these bonds, which will only be publicly offered in Japan, will be under 100,000 million yen. On October 25, 2018, we issued bonds worth 80,000 million yen. The use of funds gained through the issue of these bonds will be used for investment, debt repayment and as working capital.

We have received a long-term credit rating of AA- and a short-term credit rating of a-1+ from Rating and Investment Information, Inc. (R&I), a debt rating agency.

Business and Other Risks

The Group faces the following risks, which have a potential impact on factors such as operating results, stock prices and financial conditions.

All matters relating to the future in the sections below are based on judgements made by the Group as of the filing date of its Annual Securities Report. The Group acknowledges the potential occurrence of these risks and works to avoid them and, in the event that they do occur, to respond appropriately.

Risks related to the advertising industry in general

i. Risks due to economic fluctuation

The performances of advertising companies such as the Group tend to be easily affected by changes in the market or business conditions. This is because many advertisers adjust their advertising expenditures depending on these changes.

The Group is working to form a business structure that is resistant to changes in business conditions by diversifying the content of its services and its regions of business, in addition to other efforts. Despite this, macroeconomic trends in Japan and business environment changes in the main Japanese industrial sector, which spends heavily on advertising, can potentially affect the Group's performance. Additionally, factors such as slumping business conditions overseas and fluctuations in exchange rate can sometimes negatively impact business conditions in Japan.

The Great East Japan Earthquake of March 2011 exerted a major negative impact on the Japanese economy by interrupting supply chains and causing power shortages. The economy and business environment in Japan have since improved, but future earthquakes and other major natural disasters also threaten the business environment with potential negative impact.

In March 2013, we acquired Aegis Group plc, a major advertising agency in the United Kingdom. This acquisition substantially raised the overseas share of our gross profit to 60.4% in FY2018. A higher overseas share means that worsening economic conditions or business environments in major overseas markets in which the Group conducts business can potentially have a further negative impact on the Group's overall performance.

ii. Risks related to technological innovation and structural changes in media

The Group's businesses are impacted by technological innovation and structural changes in media. According to 2018 Advertising Expenditures in Japan (published by Dentsu), the scale of internet advertising medium expenditures has been growing since data collection on it began in 1996, and it has exceeded the combined expenditures of advertising posted for newspapers, magazines and radio, three of the four traditional media (the other being television).

The Group believes that the development of advertising methods that utilize the Internet and other new media will heighten synergy between internet advertising and advertising in the traditional media by linking them together, contributing to future overall expansion in the advertising market. The Group already holds leading positions in the fields of traditional media and internet advertising and is working to unearth and expand further business opportunities.

However, the Group's performance may be negatively affected by situations in which it cannot appropriately respond to rapid technological innovation or structural changes in media.

iii. Risks associated with trade practices, etc.

In Japan, the Group could potentially be required to incur debt from media companies, even in cases in which advertisers are unable to pay advertising fees due to reason such as insolvency. If unpaid fees from advertisers increase, they can potentially impact the Group's performance negatively. Due to a variety of circumstances, sudden changes to advertisement design and content are common in the advertising industry. The Group works to avoid transaction-related trouble before it happens by forming basic transaction agreements with primary customers and through other efforts, but could still possibly face unforeseen accidents or disputes.

Overseas, particularly in the United States and Europe, advertising agencies employ "one industry one company" systems in which they do not assume responsibility for more than one client company in any given industry. However, this practice is not common in Japan, and the Group also counts several leading companies that are in the same industries among its clients. If practices in Japan were to change in this regard and the Group were to fail to respond appropriately, its performance would face potential negative impact.

Risks from competition

i. Competition with advertising agencies

The Group is exposed to intense competition with other advertising agencies both in Japan and overseas.

Business integration and restructuring among Japanese advertising agencies and the increasing participation of foreign agencies could potentially alter the structure of the industry and intensify competition in the Japanese advertising market. If the Group cannot appropriately adapt to intensified competition for customers or to future changes in industry structure or trade practices caused by participation from foreign agencies, it may face potentially negative consequences in terms of performance.

Overseas, the Group is exposed to competition with enormous foreign advertising agencies that conduct business over a wide range of regions and possess abundant financial assets, personnel and other corporate resources, as well as with small advertising agencies that specialize in one or a few countries or regions. If the Group is unable to retain primary customers due to overwhelming competition, its performance could potentially face negative consequences.

ii. Competition with newcomer companies from adjacent industries

As the Group's business domains expand, so do opportunities for competition with entities from adjacent industries, including general trading and consulting companies. Furthermore, many new companies are participating in businesses related to the Internet and social network media, and the Group has a competitive relationship with these companies in realms such as new business development. If, in the future, the Group is unable to appropriately respond to customer demands concerning services and cost in these business fields, or if participation from new companies causes rapid changes in advertising trading practices, the Group's performance may be negatively impacted.

Risks concerning relationships with advertisers and media companies

The Group has business relationships with major advertisers in Japan, most of which it has stably maintained over many years.

The Group has built the cornerstone of its business development by providing business operation and operating activities for mass media companies. Through these activities, it facilitates needs adjustment and smooth transactions between advertisers and media companies.

However, if the Group is unable to services that meet the needs of new or existing advertisers or media companies, it could face the cancellation of its relationships with these entities, falling order numbers or changes in terms and conditions of sale. Its performance could also potentially be negatively impacted by these factors.

In recent years, advertisers have increasingly attempted to cut costs by seeking more efficient advertising services through a variety of methods, including cutting their advertisement suppliers down to one advertising agency. The Group's performance may potentially face negative consequences if the trend of falling profitability in mass media advertising transactions continues.

Risks related to business infrastructure enhancement in the domestic market

i. Risks related to the development of information processing technology, databases, etc.

The Group researches and develops databases and information processing technology that it uses to empirically investigate the effects of advertisers' marketing and advertising expenditures. These activities are aimed at uncovering potential demand and expanding the Group's share of the domestic advertising market. However, the point in time at which the results of this research and development can be commercialized or implemented is uncertain, and it is possible that the Group's research and development activities may not produce their expected results at all, due to future changes in advertiser needs, technological difficulties or other factors.

ii. Risks related to investment in media and internet advertising businesses

To solidify its position in the media advertising market, the Group has been conducting investment in the four traditional media, out-of-home media (transit advertising, outdoor advertising, etc.) and satellite media (BS and CS broadcasting), as well as related research and business development projects. However, in cases including sluggish demand for media advertising or intensified competition, the revenue or results produced may not be commensurate with the investment required for commercialization or research and development.

In the internet advertising domain, the already diverse range of advertising methods and advertisers is expanding, including the obligatory acceleration of cross-media campaign proposals (effective campaign proposals that adapt several media and advertising expressions to the behavior of consumers) and growth in performance-based advertising (an advertising method that automatically and instantly supports advertisement optimization through platforms that process vast amounts of data). To respond to these changes, the Group is proactively investing in alliances with major specialized agencies and other specialized companies, as well as technology. However, the Group may not be able to produce projected results if it cannot appropriately respond to the rapid development of technologies and services in the field of online advertising.

iii. Risks related to promotion business expansion

Promotional measures are becoming more important to advertisers, and the market for them is expanding. The Group is aware of this business opportunity and, in an effort to expand its business in the promotion domain, has established companies specializing in various fields, including in-store marketing, flyer production, direct business and customer access. However, the Group may not be able to reach its projected business expansion targets if advertiser demand does not grow or if it cannot maintain its competitiveness relative to rival companies.

Risks related to the content business

The Group actively invests in acquiring rights related to movies, television programs, sporting events, music and other similar commodities, as well as in their production. It obtains income from the production, distribution and sale of movies and other content, the sale of licensing, sponsorship and broadcasting rights and the sale of advertisements related to movies and other similar content. However, in some cases, business projects related to these investments can extend over many accounting periods, or the investments may involve large acquisition costs or financial commitments. In addition, media providing content have been recently becoming more diverse. Furthermore, reliably estimating consumer reaction, which will influence whether or not the content business succeeds, is difficult. If this business does not progress according to projections or if investment effect falls short of expectations, the Group's performance could potentially suffer.

Risks related to the global business

i. Risks related to international business expansion

With its acquisition of Aegis Group plc, the Group now conducts business in more than 140 foreign countries and regions. As a result, it faces additional risks associated with overseas business operation, the following in particular:

- Difficulty in managing and regulating business in numerous and wide-ranging countries and regions
- Impact from fluctuations in the global economy
- Risks related to foreign laws, regulations and policies, including capital regulation, foreign currency exchange regulations, etc.
- Differences and inconsistencies in tax systems of the various countries and regions in which the Group conducts business
- Tax system changes, including the imposition or increase of withholding taxes on money sent by foreign Group subsidiaries or other forms of payment
- Fluctuations in foreign exchange rate
- Various standards and practices implemented in legislation, regulations and business culture, including restrictions on the ability to enforce agreements or intellectual property rights and constraints on personnel management
- Changes in trade restrictions or tariff systems
- Risks related to political instability and uncertain business environments
- Changes in the political and economic relationships between Japan and the countries and regions in which the Group conducts business
- Acts of terrorism, war, epidemics and other causes of social unrest
- Difficulty in managing labor locally and in preventing inappropriate actions from suppliers

Any of the above risks could raise the Group's costs, reduce its revenue or cause operational obstacles. As a result, they could potentially have seriously negative impacts on the Group's businesses, financial conditions or performance.

ii. Risks related to the impairment of goodwill and intangible assets

The Group recorded large amounts of goodwill and intangible assets when it acquired Aegis Group plc. If, in the future, the value of these assets is damaged to the points where they are considered irrecoverable, the Group may be forced to recognize impairment. This could potentially have serious negative impacts on the Group's businesses, financial conditions or performance.

Risks related to the acquisition and development of human resources

The Group's growth potential and competitiveness largely depend on the acquisition and development of superior human resources. When acquiring human resources, the Group targets stable employment of new graduates, as well as mid-career hires who are immediate assets because of their specialized knowledge and experience. In addition, it aims to conduct human resource development through education and training adapted to fit the functions and abilities of individual employees. However, the Group could potentially face difficulty in acquiring or retaining superior human resources for a variety of reasons. Under such circumstances, the growth potential and competitiveness of the Group could be negatively affected.

Additionally, the Group retains many employees with varied cultural and geographical backgrounds and responds to accompanying personnel management issues. In particular, the Group is facing issues related to the integration of many foreign employees who joined through the acquisition of Aegis Group plc. If the Group secures competent human resources but cannot utilize them adequately or is unable to appropriately respond to these issues, its financial conditions, performance or competitive standing could potentially face negative consequences.

Risks related to information systems

The Group relys on information systems and infrastructure when conducting business management, which includes executing transactions, reporting financial results, handling advertiser marketing and managing information related to advertising. Its information systems can potentially be exposed to system failure, network disruption, illegal intrusion or indiscriminate attacks. Similarly, the Group's confidential information could be revealed to unauthorized individuals or to the public through data security accidents or violations that occur as a result of either authorized or unauthorized system access performed by employees or other parties. Additionally, the Group employs third parties when saving, communicating or processing data. It adopts exhaustive measures to safeguard its data and information systems. However, there is no guarantee that these measures will completely prevent failures, network disruptions or security breaches in the systems of the Group or these third parties. Furthermore, any of these phenomena, could potentially have a negative impact on the Group's performance.

Risks related to legal regulations, etc.

The Group has accepted the application of laws and various regulations, including the Act against Delay in Payment of Subcontract Proceeds, Etc. to Subcontractors and the Act on the Protection of Personal Information. Currently, none of these laws or regulations pose a threat to the Group's businesses. However, the Group's businesses and the advertising industry as a whole could potentially be negatively impacted by the adoption or strengthening of laws and regulations that exert new influences over advertiser activity or the format or content of advertising or by changes in the interpretation of these laws and regulations.

Furthermore, the Group acquires data and personal information from advertisers when conducting business. The Group exhaustively works to ensure the quality of its information management through the acquisition of certifications indicating that its information security management systems comply with international standards and through other methods. However, in the unlikely event that information leaks or other accidents occur, the Group's reliability could suffer significantly, which could, in turn, negatively affect its performance.

Litigation, etc.

The Group may directly or indirectly take part in litigation related to its business practices, including advertisement content and expression, or litigation raised by business partners, various groups, consumers or holders of a variety of intellectual property rights.