COMPANY RESEARCH AND ANALYSIS REPORT

AOI TYO Holdings Inc.

3975

Tokyo Stock Exchange First Section

13-Nov.-2019

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Summary

In 1H FY12/19, the Company posted a decline in both sales and profits due to the shift to printless delivery and the reorganization of unprofitable subsidiaries. The Company downwardly revised the FY12/19 full-year earnings forecasts. Some positive results have emerged with the establishment of joint venture with CCI.

1. Company profile

AOI TYO Holdings Inc. <3975> is a joint holding company established through the management integration of AOI Pro. Inc. and TYO Inc. AOI TYO Group mainly plans and creates TV commercials and also handles Solutions Business that includes direct business with advertisers and video content marketing. It holds a top share in TV commercial production through the management integration of the two leading industry firms.

The decision to proceed with management integration took into account the lack of prospects for major growth in conventional TV commercial production as well as likely expansion of business scope related to advertising, including methodology and structural changes. It comes against a backdrop of diversification of media (primarily through the Internet) and devices (smartphones, tablets, and others) and major shifts in industry landscape with advances in technology, such as communications speed, data analysis, VR*1, and AR*2. This integration aims to realize economies of scale and create synergies and also accelerate the pace of new value creation and business expansion through consolidation and effective utilization of business resources. In addition to external factors such as the impacts of the progress in the shift to printless delivery and work-style reform, and due to the strengthening of the order management system as well as the reorganization of unprofitable subsidiaries, results have temporarily leveled off, but the Company is proactively working on efforts targeting the future, such as collaborations with other companies and investments in new technologies.

*1 VR (virtual reality) refers to the technologies and methods to realize various types of experiences, including in virtual worlds, portraying something like the real world that goes beyond time and space.
*2 AR (augmented reality) refers to the technologies and methods to realize an augmented reality by adding some other information to the information that people can perceive in the real world.

2. 1H FY12/19 financial highlights

In 1H FY12/19, the Company reported lower sales and profits, with net sales of ¥30,636mn (-0.7% YoY) and operating income of ¥816mn (-53.2%). Both sales as well as all profit lines fell short of the Company's initial forecasts. Although sales in the mainstay Video Advertising Business were on par with the same period of the previous year amid the continued decline in print sales, the decline in sales was due to the drop in spot media sales in the strategic Solutions Business, as well as the reorganization of unprofitable subsidiaries in the Overseas Business. Operating income declined significantly, due to the impact of the drop in high-margin print sales, the increase in outsourcing costs associated with work-style reform, as well as higher depreciation in conjunction with the operation of new enterprise systems. On the other hand, qualitatively-speaking, significant progress was made on initiatives targeting future growth, such as the establishment of a joint venture with strategic partner Cyber Communications, Inc. ("CCI").

3. FY12/19 forecast

Based on the 1H results, the Company downwardly revised its forecasts for FY12/19. The revised forecasts are for net sales to decline 1.8% YoY to ¥63,600mn (lowered ¥1,400mn) and operating income to fall 33.0% to ¥2,300mn (lowered ¥300mn). The magnitude of the downward revisions generally reflects the 1H underperformance, while the Company expects 2H performance to be on par with the initial forecasts. The forecast for lower net sales is due to order control in conjunction with work-style reform, the ongoing shift to printless delivery, as well as the reorganization of unprofitable subsidiaries. The forecast for a decline in profit is due to the decline in high-margin print sales, costs to handle work-style reform, as well as up-front investments targeting future growth, particularly with respect to human resources development and hiring. Attention should be paid to the path towards profit growth from next fiscal year onward, when the impacts of the shift to printless delivery will exhaust. We believe that the keys to success will be: 1) video advertising for branding purposes; and 2) handling video content marketing (solutions). The former is an area that the Company can leverage its strengths, so the key points will be to what extent the Company can capture the growing demand and how it can increase profitability (added value).

4. Growth strategy

The Company disclosed a new medium-term business policy in March 2019 in order to address a variety of environment changes two years after the management integration. A key difference with previous policy is the change to management with priority on “quality over quantity.” To ensure that it continues as a powerful group capable of responding to any era, the Company calls for development of businesses that meet needs and changes, full utilization of human resource capabilities, and continuation of healthy profits. It also continues to emphasize sustainability and shareholder return and wants to generate ROE that exceeds COE.

Key Points

- Posted lower sales and profits in 1H FY12/19 due to the shift to printless delivery, the reorganization of unprofitable subsidiaries, and other factors.
- As a result, the Company downwardly revised FY12/19 results forecasts (expects a decline in both net sales and operating income)
- On the other hand, significant progress was made on initiatives targeting the future, such as the establishment of a joint venture with strategic partner CCI
- Based on the new medium-term business policy announced in March 2019, the Company has shifted to a management approach emphasizing “quality over quantity” and is aiming for sustainable growth

Company profile

Joint holding company established for the integration of AOI Pro. and TYO
Holds a top industry share for TV commercial production

1. Business overview

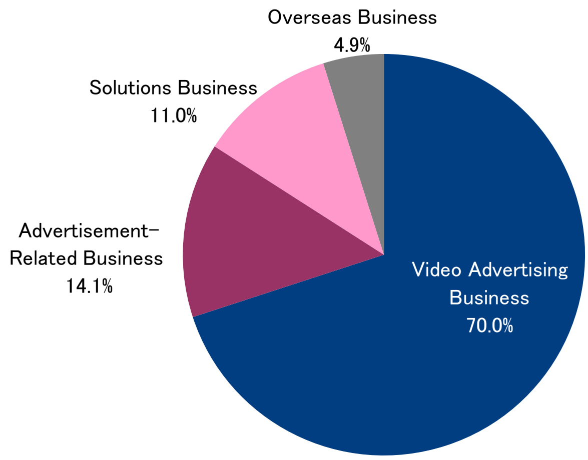
AOI TYO Holdings is a joint holding company that owns AOI Pro. and TYO. AOI TYO Group plans and creates TV commercials and also handles Solutions Business that includes direct business with advertisers and video content marketing. It was founded in January 2017 through management integration of two leading industry firms and holds a top share in TV commercial production.

AOI TYO Group consists of a single Advertising Business segment and four sub-segments (Video Advertising, Advertisement-Related, Solutions, Overseas)*. While the mainstay Video Advertising Business generates about 70% of overall sales, Solutions Business and Overseas Business are attracting attention as a growth driver.

* Changed business categories and names from FY12/19 (details covered below).

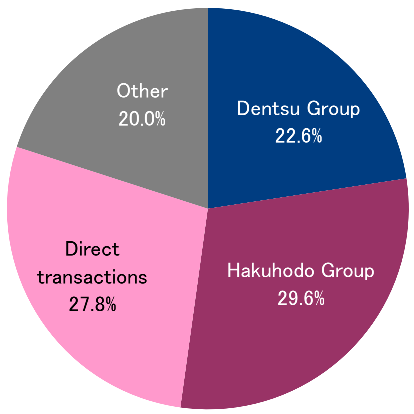
Sales mix by customer was well balanced with 22.6% to the Dentsu <4324> Group, 29.6% to the Hakuhodo (Hakuhodo DY Holdings Inc. <2433>) Group, 27.8% in direct transactions, and 20.0% to others. Direct transactions have been a TYO strength and are still growing after the management integration in correlation with the Solutions Business. Additionally, sales composition by media type is TV commercial production at 58.6%, entertainment contents at 3.4%, digital contents at 20.6%, overseas at 4.8%, and other at 12.6%. “Digital contents” is growing rapidly along with expansion in online video advertising demand as a trend.

Sales composition by business (1H FY12/19 result)



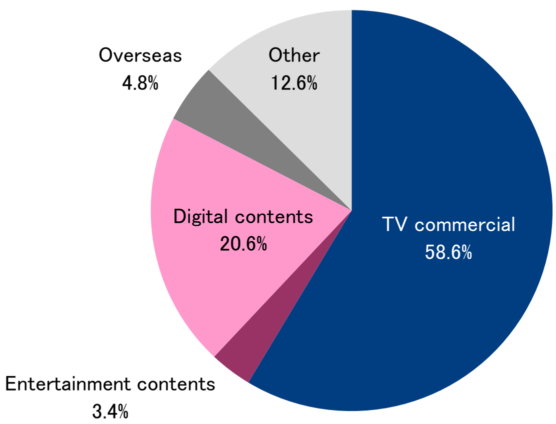
Source: Prepared by FISCO from the Company's results briefing materials

Sales ratio by customer (1H FY12/19 result)



Source: Prepared by FISCO from the Company's results briefing materials

Sales composition ratios by medium (1H FY12/19 results)



Source: Prepared by FISCO from the Company's results briefing materials

Below we review each of these business areas.

(1) Video Advertising Business

The Company plans and produces TV commercials and other advertising video. As for TV commercials, this was the main business for AOI Pro. and TYO, and integration of these two major industry firms established a top market share. Both firms produce numerous excellent works amid continuation of a healthy orders environment. While the Company faces concerns about profitability decline because of changes in media value related to the growing Internet presence and the printless shift as well as the need for income structure reforms and better work efficiency, it aims to establish a dominant position in high-quality video advertising, its strength, including the expanding online video market.

(2) Advertisement-Related Business

This business includes the planning and production of movies, TV dramas, and events; production of digital content, promotional content, and music videos. The Company's strategy is to enclose the market by building up its track record by entering areas that have an affinity with the mainstay business*, and by bolstering peripheral solutions (promotions and content).

* Shoplifters, a movie directed by Hirokazu Koreeda and invested in and produced by AOI Pro, won the Palme d'Or, which is the highest award in the In Competition category at the 71st Cannes Film Festival. The Company intends to continue working on entertainment content and further expand its business in anticipation of an era when entertainment content and advertising video merge together.

(3) Solutions Business

This business provides measures for problem solving for customers. While it currently is roughly equal to results from TYO Offering Management Business Unit*1 and AOI Pro.'s subsidiary Quark tokyo Inc.*2, it also contains SOOTH Inc.*3.

*1 Supplies one-stop solutions mainly through multi-faceted media activities via direct business with advertisers.
*2 Provides services that range from marketing strategy formulation mainly for videos to all PDCA solutions required by communications in the digital era.
*3 Provides experience design solutions using vital sign data and other services.

(4) Overseas Business

The Overseas Business operates sites centered on Southeast Asia (Thailand, Vietnam, Singapore, Indonesia, Malaysia, and India), engaging in business with both Japanese-affiliates and local companies. This business includes video production orders received from overseas. Both AOI Pro. and TYO have been actively engaged in many regions, and this segment is positioned as a future growth driver. AOI TYO Group has also been actively engaging in M&A. In July 2019, K&L ISC, a joint venture with Malaysian advertising company ISC Innovators, was turned into a consolidated subsidiary. Meanwhile, the Company also worked on restructure the business portfolio to better meet future developments. This included the reorganization of the poorly-performing local subsidiary in Beijing.

2. History

(1) AOI Pro.

AOI Pro. goes back to Aoi Advertising Promotion Inc., which was established in 1963 to produce TV commercials, in Tokyo's Minato Ward. It solidified a business base as a video production company focused on TV commercials. In 1990, it listed shares on JASDAQ, taking the lead in this industry, with the aim of making further advances and strengthening social credibility.

It subsequently created numerous videos that attracted substantial interest, fueling healthy growth and listed on the Second Section of the Tokyo Stock Exchange in 1998 and on the First Section in 2000. It established a firm position as one of the major TV commercial production companies.

In September 2011, meanwhile, it launched an overseas site to handle TV commercial production in Indonesia. In October 2014, it added nakamino Co., Ltd.*, which specializes in online video platform effect measurement and operation, to the group (equity-method affiliate) through a capital alliance with the aim of full-fledged ramp-up of video content marketing, a new growth area. These initiatives gave it an edge versus peers in building operations to address diversifying media, growing demand for online videos and other digital contents, and entry by Japanese companies into the fast-growing Asian region.

* It turned this entity into a consolidated subsidiary at the end of December 2015 through an injection of additional capital and changed the company name to Quark tokyo Inc. in April 2016.

(2) TYO

TYO was established as a TV commercial production company in April 1982 in Roppongi, Minato Ward, Tokyo. It was established the latest among other major commercial production companies. Hiroaki Yoshida (Representative Director, Chairman & CEO of AOI TYO Holdings), and together with five other commercial creators, including Kazuyoshi Hayakawa (Representative Director, President and CEO of TYO Inc.) established the company with the dream of "Creating an Ideal Company of Creators, by Creators, for Creators."

The company listed on JASDAQ in 2002. It expanded business by leveraging its creative capabilities of having been involved in the production of numerous TV commercials that left an impression with consumers, notably one promoting travel to Kyoto for Central Japan Railway Company (JR Central) <9022>. Upon changing to the TSE Second Section in October 2013, its listing was reassigned to the First Section in January 2014.

TYO has been involved in various types of content production, including TV commercials, online videos, digital contents and events. Its strength is providing optimal, one-stop solutions for advertisers' advertising promotions and promotional activities. It led the industry with a sales structure and accumulation of knowledge in dealing directly with advertisers* and has focused on building long-term relationships with advertisers, expanding project sizes and capturing sales promotion expenses. Furthermore, it has been actively engaged in overseas expansion.

* Since starting direct business with advertisers in July 2003, the current TYO Offering Management Business Unit has taken charge of the entire group's direct business with advertisers.

(3) Background to the management integration (January 2017)

In the background to the management integration is the diversification of media and devices (such as smartphones and tablets) focused on the Internet, and in addition, the major changes to the industry environment, including communication speeds and data analysis, and also the progress being made in technological innovations, such as VR and AR. In this environment, major growth in TV commercial production, which had been the mainstay up to the present time, is unlikely, but advertising-related business areas will expand, with accompanying changes to their methods and structures.

Based on this sort of awareness of the business environment, the companies judged that integration was to grow in the medium to long term to expand market share, strengthen negotiation power, and maintain robust capital strength. They also want to build a competitive and advanced business model by newly forming a group to lead the industry and concentrating and effectively utilizing management resources.

Financial highlights

Posted lower sales and profits than forecasted in 1H. Impacted by the shift to printless delivery, the reorganization of unprofitable subsidiaries, and other factors

The Company reported lower sales and profits in 1H FY12/19, with net sales of ¥30,636mn (-0.7% YoY), operating income of ¥816mn (-53.2%), ordinary income of ¥637mn (-62.1%), and profit attributable to owners of parent of ¥257mn (-78.0%). Net sales and all profit lines fell short of forecasts.

The mainstay Video Advertising Business recorded net sales on par with the previous year due to an increase in orders from major advertising agencies, even though print sales decreased. The Advertisement-Related Business recorded significantly higher sales year on year, mainly due to the contribution of event-related sales by newly consolidated subsidiaries. However, the overall decline in net sales was the result of the large decline in media sales in the strategic Solutions Business, as well as the reorganization of unprofitable subsidiaries in the Overseas Business. Poor performance by subsidiaries was a major reason why net sales fell short of the Company's forecast.

In terms of net sales by customer, net sales to major advertising agencies increased year on year, as the significant increase in sales to Hakuhodo Group offset the decline in sales to Dentsu Group. The impact of work-style reform in the industry appears to have plateaued. Also, sales from direct transactions grew year on year, excluding the decline in spot media sales (approximately ¥900mn).

Operating income declined significantly, due to the impact of the decline in high-margin print sales, the increase in outsourcing costs associated with work-style reform, as well as higher depreciation in conjunction with the operation of new systems. The main reasons that operating income fell short of the forecast were the fact that net sales were lower expected along with the additional expenses related to new enterprise systems. Also, although the Company posted extraordinary losses (approximately ¥279mn) due to the reorganization of unprofitable subsidiaries, the Company also posted extraordinary income (approximately ¥281mn) in conjunction with the sale of strategic stock holdings with unrealized gains.

In terms of financial conditions, total assets increased 2.0% from the end of FY12/18 to ¥56,717mn, due to an increase in cash and deposits based on long-term loans, despite a decline in non-current assets due to the plateauing in system investment and the start of depreciation. Meanwhile, shareholders' equity fell 2.1% versus end-FY12/18 to ¥24,590 due to the payment of dividends and other factors. Based on this, the equity ratio was roughly flat at 43.4% (versus 45.1% at the end of FY12/18).

1H FY12/19 financial highlights

(¥mn)

	1H FY12/18		1H FY12/19		Change		FY12/19		Difference	
	Result	Ratio	Result	Ratio		Change rate	Initial forecast	Ratio		Achievement rate
Net sales	30,864		30,636		-227	-0.7%	32,000		-1,364	95.7%
Video Advertising Business	21,083	68.3%	21,435	70.0%	352	1.7%		-		-
Advertisement-Related Business	3,944	12.8%	4,322	14.1%	378	9.6%		-		-
Solutions Business	4,072	13.2%	3,385	11.0%	-687	-16.9%		-		-
Overseas Business	1,766	5.7%	1,494	4.9%	-272	-15.4%		-		-
Cost of sales	24,713	80.1%	24,900	81.3%	187	0.8%	-	-		-
SG&A expenses	4,405	14.3%	4,919	16.1%	514	11.7%	-	-		-
Operating income	1,746	5.7%	816	2.7%	-930	-53.2%	1,100	3.4%	-284	74.2%
Ordinary income	1,680	5.4%	637	2.1%	-1,043	-62.1%	1,000	3.1%	-363	63.7%
Profit attributable to owners of parent	1,170	3.8%	257	0.8%	-913	-78.0%	500	1.6%	-243	51.4%
EBITDA	2,357		1,531		825	-35.0%				
Order backlog	14,331		15,119		788	5.5%				
Sales ratio by customer										
Dentsu Group	7,310	23.7%	6,920	22.6%	-390	-5.3%				
Hakuhodo Group	8,311	26.9%	9,066	29.6%	755	9.1%				
Direct transactions	8,699	28.2%	8,517	27.8%	-182	-2.1%				
Other	6,542	21.2%	6,132	20.0%	-410	-6.3%				

Source: Prepared by FISCO from the Company's results briefing materials

Financial position as of the end of June 2019

(¥mn)

	As of the end of December 2018	As of the end of June 2018	Change	
				Change rate
Current assets	35,937	37,290	1,353	3.8%
Cash and deposits	9,836	11,860	2,024	20.6%
Notes and accounts receivable - trade	21,004	20,022	-982	-4.7%
Work in process	4,256	4,583	327	7.7%
Non-current assets	19,693	19,427	-266	-1.4%
Property, plant and equipment	7,235	7,205	-30	-0.4%
Intangible assets	5,772	5,533	-239	-4.1%
Investments and other assets	6,685	6,687	2	0.0%
Total assets	55,631	56,717	1,086	2.0%
Current liabilities	20,114	18,250	-1,864	-9.3%
Accounts payable - trade	8,126	7,035	-1,091	-13.4%
Short-term loans payable	7,936	7,604	-332	-4.2%
Advances received	1,136	1,401	265	23.3%
Non-current liabilities	9,837	13,316	3,479	35.4%
Long-term loans payable	4,549	8,220	3,671	80.7%
Long-term deposits received	3,501	3,501	0	0.0%
Total liabilities	29,951	31,567	1,616	5.4%
Net assets	25,679	25,150	-529	-2.1%
Shareholders' equity	25,114	24,590	-524	-2.1%
Equity ratio	45.1%	43.4%		
Current ratio	178.7%	204.3%		
D/E ratio	0.49	0.64		

Source: Prepared by FISCO from the Company's results briefing materials

Activity results

1. Video Advertising Business

While the production market for TV commercials and other conventional media advertising is roughly flat, the video advertising market (videos on the Internet) is expanding, and the Company's video advertising sales increased 1.7% YoY to ¥21,435mn. The decline in print sales due to the shift to printless delivery*1 (approximately ¥300mn) was within the expected range. While continuing order control related to work-style reforms, a small increase in sales was secured due to the increase in orders/sales from major advertising agencies. Meanwhile, the effective profit margin (just for the CM production division) fell to 33.5% (vs. 36.4% in 1H FY12/18) due the impact of receiving orders for projects with low effective profit margins*2, in addition to the impact caused by the decline in high-margin print sales, despite ongoing efforts to thoroughly control external expenditures.

*1 Historically, television commercial content had been copied to media ("printed") and delivered to broadcast stations. The AOI TYO Group has recognized the sales and profits of this activity in its accounting records. Since October 2017, this content can be delivered via online data transmission, which has resulted in a gradual decline in related sales and profits.

*2 Effective profit is the profit obtained by subtracting external expenditures from sales for CM production.

2. Advertisement-Related Business

Net sales in the Advertisement-Related Business increased significantly by ¥9.6% YoY to ¥4,322mn. Event-related newly consolidated subsidiaries contributed to the increase in sales.

3. Solutions Business

Solutions Business sales declined 16.9% YoY to ¥3,385mn. However, sales are actually increasing steadily if excluded the impact of the decline in spot media sales (approximately ¥900mn decline). In particular, TYO Offering Management Business Unit sales (excluding media costs) rose 14.0% YoY to ¥2,073mn. The increase in orders for television commercials and events for new customers contributed to the increase in sales. Meanwhile, sales at Quark tokyo declined 5.8% YoY to ¥1,032mn. Although sales declined due to the contraction in the size of existing major projects, online video production and promotion planning sales increased. Still, although this is positioned as a growth field, securing personnel with high levels of expertise is a challenge. On August 20, 2019, a joint venture with CCI was established (details discussed below). The collaboration with CCI is expected to help expand the customer base as well as have a positive impact on personnel recruitment going forward.

4. Overseas Business

Net sales in the Overseas Business declined 15.4% YoY to ¥1,494mn. This was due to the reorganization of the underperforming Beijing local subsidiary and other factors, laying the groundwork for profit growth from next fiscal year and beyond.

Main Topics

Progress in collaboration with other companies and other activities targeting the future

1. Joint venture established with Cyber Communications

On February 12, 2019, Quark tokyo created a strategic partnership with CCI, and on August 20, 2019, the joint venture Mediator, Inc.* was established. Mediator provides communications planning and content production for various media attributes, advertising formats, and targets, providing consulting services between clients and media. With the collaboration between CCI, which possesses expertise in digital media, and Quark tokyo, which boasts strengths in digital-age communications planning and creative direction, Mediator aims to become a media communications agency offering one-stop services in communications and creative, ad distribution plan design and implementation for the benefit of both media and clients.

* Ownership ratios: Quark tokyo: 66.6%; CCI: 33.4%

2. Production of Netflix original series Rilakkuma and Kaoru

On April 19, 2019, Netflix began global exclusive distribution of Rilakkuma and Kaoru, the Netflix original series created and produced by TYO's Dwarf Studio. This anime has received a lot of attention as Rilakkuma's first stop-motion anime. Dwarf Studio is a stop-motion animation production studio that is been recognized in Japan and overseas, mainly for its stop-motion animations utilizing advanced skill, and the studio has created numerous characters and content that have become very popular around the world, including the NHK character DOMO-kun, and Komaneko, a long-running movie in France. This Netflix series will do a lot to boost the studio's name recognition and lead to future growth.

3. Capital and business alliance with design incubation team Any Projects

TYO signed a capital and business alliance agreement with AnyProjects Inc., a design incubation team, aiming to create new business value through designs and creative. TYO senior executive officer Shunichi Takano is participating as a partner, and full-scale operations were launched in August 2019. AnyProjects is a design incubation team consisting of five partners. The company's members perform design consulting, new business development, architecture and urban design, communications media strategy, branding strategy, investments, art event production, and more on a global basis, offering integrated consulting and new business support based on cross-discipline expertise. The entities are already working on several joint projects, building synergies through the skills and experience of both companies. In the future, the companies will conduct joint development of design consulting and services supporting business growth and innovation through new methods that extend beyond traditional frameworks and applications of visual communications.

Business performance outlook

Downward revision to FY12/19 results forecasts. Focusing attention on the path to profit growth from FY12/20

Based on 1H results, the Company announced downward revisions to its FY12/19 results forecasts. The revised forecasts are for net sales to decline 1.8% ¥63,600mn (lowered ¥1,400mn), operating income to decline 33.0% to ¥2,300mn (lowered ¥300mn), ordinary income to fall 35.3% to ¥2,150mn (lowered ¥350mn) and for profit attributable to owners of parent to drop 46.2% to ¥1,050mn (lowered ¥250mn). The magnitude of the downward revisions generally reflects the 1H underperformance, while the Company expects 2H performance to be on par with the initial forecasts.

The forecast for lower net sales is due to order control in conjunction with work-style reform, the ongoing shift to printless delivery, the non-recurrence of movie dividend income in the previous fiscal year, as well as the reorganization of unprofitable subsidiaries. In profits, it forecasts profit decline, even with ongoing efforts to improve effective profit margin, due to the decline in high-margin print sales, costs to handle work-style reform, as well as up-front investments targeting future growth, particularly with respect to human resources development and hiring. Results (especially profits) are therefore expected to continue to level off, but this fiscal year should be viewed as a period for the Company to solidify its foundation targeting profit growth in FY12/20 and beyond, including strengthening the internal framework, reorganizing unprofitable businesses, and making up-front investments in new growth fields.

FY12/19 forecast

(¥mn)

	FY12/18		FY12/19				Change	
	Result	Ratio	Initial forecast	Ratio	Revised forecast	Ratio	Revised forecast	Change rate
Net sales	64,792		65,000		63,600		-1,192	-1.8%
Video Advertising Business	43,331	66.9%	43,400	66.8%	-	-	-	-
Advertisement-Related Business	9,836	15.2%	9,100	14.0%	-	-	-	-
Solutions Business	7,585	11.7%	8,000	12.3%	-	-	-	-
Overseas Business	4,038	6.2%	4,500	6.9%	-	-	-	-
Cost of sales	52,052	80.3%	-	-	-	-	-	-
SG&A expenses	9,307	14.4%	-	-	-	-	-	-
Operating income	3,433	5.3%	2,600	4.0%	2,300	3.6%	-1,133	-33.0%
Ordinary income	3,325	5.1%	2,500	3.8%	2,150	3.4%	-1,175	-35.3%
Profit attributable to owners of parent	1,952	3.0%	1,300	2.0%	1,050	1.7%	-902	-46.2%

Source: Prepared by FISCO from the Company's results briefing materials

In order to achieve the results forecasts post-revision, in 2H the Company will need to post net sales of ¥32,964mn (-¥964mn YoY) and operating income of ¥1,484mn (-¥203mn). We think the Company can reach these forecasts based on the fact that it had a healthy order backlog* as of June 30, 2019, the Company's earnings tend to concentrate in fiscal second halves, and the forecasts are at levels that rationally factor in the negative factors that the forecasts are predicated on (progress in the shift to printless delivery, the reorganization of unprofitable subsidiaries, etc.). The path towards profit growth from FY12/20 onward, when the impact of the shift to printless delivery will exhaust out, bears watching. In particular, the surge in advertising right before the 2020 Tokyo Olympics should provide a boost. We think that the keys to success will be: 1) high-quality video advertisements for branding purposes; and 2) handling video content marketing. The former is an area that the Company can leverage its strengths, so the key points will be to what extent the Company can capture the growing demand and how it can increase profitability (added value). Meanwhile, with respect to handling video content marketing, utilizing new technologies and securing personnel with high levels of expertise responsible for this are challenges facing all companies in the industry, so we will keep a close watch on the Company's efforts to bolster its personnel development and hiring, as well as the positive outcomes of collaboration with other companies, including the aforementioned collaboration with CCI, as well as M&A.

* The order backlog as of June 30, 2019 was ¥15,119mn (+5.5% compared to June 30, 2018).

Growth strategy

Based on rapid changes in the environment, the Company is changing to a management with an emphasis on "quality over quantity" targeting sustainable growth

The Company disclosed a new medium-term business policy in March 2019 in order to address a variety of environment changes two years after the merger. A key difference with previous policy is the change to management with priority on "quality over quantity." To ensure that it continues as a powerful group capable of responding to any era, the Company calls for development of businesses that meet needs and changes, full utilization of human resource capabilities, and continuation of healthy profits. Because of the switch from quantity to quality and rapid changes in the environment, the Company decided against using sales, profits, and other numerical goals as KPI. However, it still emphasizes sustainability and shareholder return and wants to generate ROE that exceeds COE*.

* AOI TYO Holdings estimates that the cost of shareholder equity is currently about 9%.

1. Direction of business initiatives

The Company wants to solidify an overwhelming position by deepening its production of high-quality video and movies for branding, its strength, along the lines of existing activities and bolster and "broaden" peripheral solutions (promotions and contents). In particular, for its mainstay video advertising, it hopes to secure market survivor profits as the No.1 firm in the TV commercial production market, the mainstay up now, and acquire market share, mainly for higher-priced video, in the online video market that is growing substantially. Additionally, it outlines a strategy of optimizing video production and distribution (reach) by analyzing and utilizing data and recruiting related market opportunities (including events, public relations, influencer marketing, video distribution, etc.) by strengthening various functions and collaborating with other companies. In peripheral solutions, meanwhile, it aims to realize a high value-added business model by bolstering video as content (developing IP, etc.), strengthening event and PR business through M&A and capital alliances, and developing solutions that utilize video.

2. Human resources

The Company wants to cultivate numerous employees capable of proposing and realizing total communications and recruit professionals in a variety of communication methods. Measures for realizing these goals include hiring people with qualities needed to handle total communications, forming expert teams (total communication expert team, online video expert team, etc.), cultivating human resources through seconding and interaction (utilization of rotation/FA programs, seconding to group companies with different functions, etc.), and strengthening the educational system (classroom lectures and enhancement of on-the-job training for total communication projects).

3. Overseas Business

In fast-growing Asia (Southeast Asia, etc.), the Company intends to strengthen joint efforts through collaboration among multiple sites, rather than just relying on individual sites, and build a potent income structure based on unique "products" and rational capital composition (allocation of capital that reflects individual site profitability, including underperforming reorganization). As examples of "collaboration," it has already formed an overseas strategy division (July 2018), held an Asian meeting, and deployed infrastructure and communication tools. Although the Company recently made the move to reorganize the underperforming Beijing local subsidiary, benefits appear to be gradually emerging in other areas. In development of unique products, it envisions a strategy of packaging IP assets and technology developed and obtained through alliances in Japan as solutions. The Company intends to look at deployment in areas outside of Asia as well.

While the Company currently faces negative impacts from external factors, such as responses to work-style reform and advances in the printless shift, we believe it has significant opportunities over the longer term from various structural changes (media diversification, technology advances, etc.). In particular, its business model based on production of high-quality videos, an important strength, and a strategy that leverages its overwhelming position constitute unique advantages. A key issue is finding ways to capture more of the overall market while bolstering peripheral solutions, such as promotions and contents. We think realization of high added value by leveraging new technology (VR contents, data utilization, etc.) is an important aspect too. The Company's approach to reinforcing operations for business expansion, such as collaboration with external companies, including M&A deals, and recruitment of human resources with robust expertise, hence is likely to strongly influence future growth potential.

Shareholder returns

Aiming for a dividend payout ratio of at least 30%, working on share buybacks too

The Company presented "a dividend payout ratio of at least 30%" as its dividend policy.

For the FY12/19 dividend, the Company plans to pay ¥20 for the full year (¥8 interim, ¥12 period-end), a decline of ¥10 YoY, in light of its outlook for lower profits (the interim dividend of ¥8 has been paid). Furthermore, it announced a share buyback program for 500,000 shares (¥600mn) on February 19, 2019 that extends from March 1, 2019 through February 29, 2020. In addition to increasing shareholder returns and capital efficiency, the aim is to implement a flexible capital policy addressing changes in the business environment. As of August 31, 2019, the Company had purchased a total of 105,000 shares (the total value of shares purchased was approximately ¥79mn).

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