

Aeria Inc.

3758

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<http://www.fisco.co.jp>

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Summary

IP business driving growth

Aeria Inc. <3758> (hereafter, also “the Company”) has three main business areas - IT services, contents, and asset management. The IT services business provides data service, the contents business develops smartphone games, and asset management handles planning and operation of lodging facilities. The Company has leveraged stable earnings in IT services business to fuel M&A and steadily expand contents and asset management businesses. It headed in a new direction in contents business following the hit *A3!* game and purchase of CYBIRD Co., Ltd., which has the Ikemen (*Handsome*) series, with a shift from simple fee-based income to intellectual property (IP) rights business, such as selling goods using characters and stage adaptations, as the main income source. The Company is currently promoting business reorganization via selectivity and focus in order to concentrate business resources in IP business. It aims to fuel growth with IP business.

The Company also earnestly pursues initiatives in new technologies, growth markets, and other new fields, just as it has previously done. In contents business, it is developing contents that apply AI, VR/AR, blockchain, and other new technologies. An example is creating high-quality character appearance images, which could even be mistaken as the face of an actual idol, utilizing AI-based automated generation of character appearance images jointly developed with DataGrid Inc. In asset management, which it entered in 2017, the Company started *minpaku* (short-term rental housing) service to tap into growing accommodations demand from foreign tourists visiting Japan. The *minpaku* experiment through collaboration with its own IP is enjoying a healthy start.

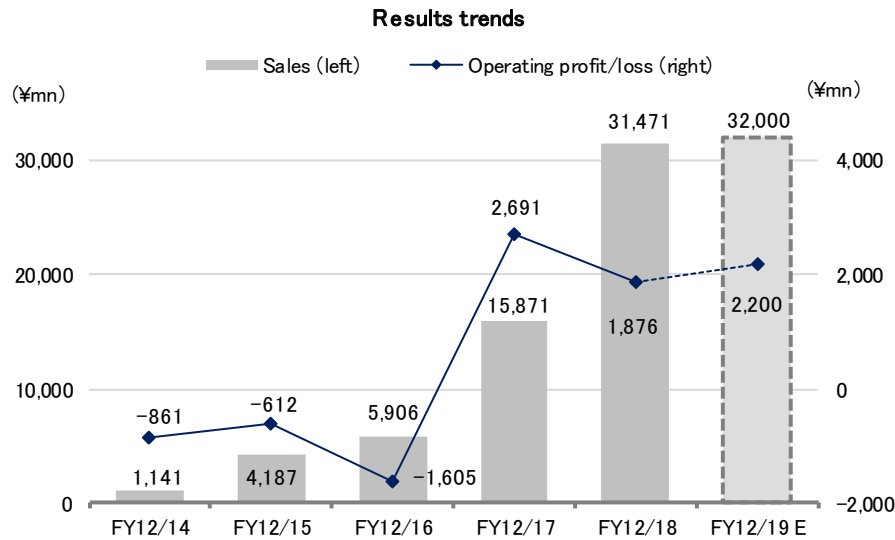
The Company reported FY12/18 results with ¥31,471mn in sales (+98.3% YoY) and ¥1,876mn in operating income (-30.3%). Sales climbed on upbeat *A3!* sales and increase in consolidated subsidiaries, such as CYBIRD. Meanwhile, development costs at consolidated subsidiaries increased due to M&A activity, and SG&A expenses rose too because of higher collection agency fees related to growth in contents business sales and advertising and promotional costs. Based on a determination that its IP offers very high potential, the Company decided to bolster advertising and promotional activities during the fiscal period as an effort to pull away from late arrivals. *A3!* remains highly received because of its impressive game content and has acquired sustainable popularity. We think this was a major turning point for the Company’s IP strategy.

The Company guides for ¥32,000mn in sales (+1.7% YoY) and ¥2,200mn in operating income (+17.3%) in FY12/19. It expects the IT services business to continue stable growth. Contents business is likely to drive consolidated earnings with focus on existing titles and IP expansion and margin improvement as well as full-year contribution by CYBIRD profits. Asset management earnings should settle down with a shift from start-up status to expansion in the *minpaku* service business. We think the outlook seems slightly conservative, despite the Company’s acceleration of activities in its various businesses, because of a strong resolve to avoid lowering guidance.

Key Points

- IP business taking off with the *A3!* hit and CYBIRD acquisition
- Earnings improvement from business reorganization and focus on IP business driving growth
- Steady progress with initiatives in AI technology, *minpaku* demand from foreigners visiting Japan, and other new fields

Summary



Source: Prepared by FISCO from the Company's financial results

Company profile

Promoting three businesses centered around the Internet

1. Company profile

The Company has three main business areas - IT services, contents, and asset management. The IT services business handles an affiliate platform that specializes in online electronic publications, data services, and system development business. The contents business develops, distributes, and operates smartphone and tablet games and sells drama CDs, voice CDs, and character goods. The asset management business consists of real estate business, leasing management business, accommodations facility planning, operation, control, and management business, consulting business related to these areas, and investments in domestic and overseas companies. The Company aims to “become an essential presence, similar to air, in the network society” by moving in the direction of network society advances and harnessing Internet and mobile technologies. With this spirit, it has taken on challenges in many businesses since being founded. The Company utilizes a holding-company format that consists of 27 consolidated subsidiaries and one equity-method affiliated as of end-December 2018.

Company profile

Transition from M&A-driven expansion to pursuit of synergies

2. History

Takayuki Nagashima, chairman and representative director, and Yusuke Kobayashi, president and representative director, founded predecessor Communications Online to deliver Internet-related information provision services in Chiba Prefecture in 1998. The Company entered the game industry (online games) with the acquisition of Game Pot (GMO Group) in 2001, established Aeria in 2002, and listed shares on the Osaka Stock Exchange's Hercules market (now Tokyo Stock Exchange JASDAQ market) in 2004. Leveraging income from IT services business Air Internet Service Co., Ltd. acquired in 2005, it expanded to smartphone games and online sales sites. It launched the asset management business in light of growing *minpaku* demand in 2017. The Company is currently promoting business reorganization from a perspective of selectivity and focus aimed at realizing synergies following exhaustion of M&A activity that targeted future growth and synergies and is cultivating game characters and other intellectual property rights (IP) as a major income source.

History

Date	Event
May 1998	Established Communication Online Ltd.
September 1999	Established internetcom K.K. (merged with US-based Jupitermedia, capitalized at ¥20mn)
May 2001	Established Gamepot Inc. (merged with Gagamel.com (Korea); capitalized at ¥20mn)
October 2002	Established Aeria Inc. (through spin-off)
December 2004	Listed on Osaka Stock Exchange's Hercules Market (stock code: 3758)
November 2005	Acquired 100% of shares in AIR Internet Service Co., Ltd., making it a wholly owned subsidiary
December 2005	Listed Gamepot Inc. on Sapporo Stock Exchange's Ambitious Market
December 2005	Established Aeria Finance Inc. as wholly owned subsidiary to run investment business
April 2006	Acquired 20% stake in Yutaka Shoji Co., Ltd., making it an equity-method affiliate
August 2006	Acquired 50.1% stake in ACQUIRE Corp., making it a subsidiary
August 2006	Established Aeria Games & Entertainment, Inc.
October 2006	Established Aeria IPM, Inc. as wholly owned subsidiary to oversee copyrights
June 2007	Acquired 100% of shares in Kurezo Co., Ltd., making it a wholly owned subsidiary
June 2007	Acquired 41.3% stake in Taiko Holding Co., Ltd. (owner Akatsuki Securities), making it a subsidiary
January 2008	Began offering email delivery ASP services through AIR Internet Service
March 2008	Added vulnerability detection tool (<i>Retina</i>) as part of standard service through AIR Internet Service
April 2008	Transferred all shares in consolidated subsidiary Gamepot Inc. to So-net Entertainment Corp.
July 2008	Acquired Daito Me Co., Ltd. through share exchange, making it a wholly owned subsidiary
July 2008	Began offering carbon offset support program through AIR Internet Service
August 2008	Established European subsidiary as subsidiary of US-based Aeria Games & Entertainment, Inc.
September 2008	Began business partnership with aprecio Corporation
March 2009	Began offering groupware ASP for Cybozu Office 8 through AIR Internet Service
July 2010	Began offering cloud-based service to help prevent misdirected email through AIR Internet Service
December 2012	Removed Aeria Games & Entertainment, Inc. from subsidiaries by establishing AGGP Holdings, Inc. as an intermediary holding company
December 2014	Acquired Gamania Digital Entertainment Inc. through share exchange, making it a wholly owned subsidiary
April 2015	Acquired Infotop Capital Corp. through share exchange, making it a wholly owned subsidiary and making Infotop Corp. (now First Penguin) a second-tier subsidiary
June 2015	Acquired Liber Entertainment Inc. through share exchange, making it a wholly owned subsidiary
October 2015	Acquired ASGARD Co., Ltd. through share exchange, making it a wholly owned subsidiary
December 2015	Acquired GESI Co., Ltd. through share exchange, making it a wholly owned subsidiary
June 2017	Completed transition of Arithmetic Inc. as a wholly owned subsidiary through simple share exchange
July 2017	Acquired GOODVISION CORPORATION through simple share exchange, making it a wholly owned subsidiary
July 2017	Acquired Twist Inc.*, making it a subsidiary
August 2017	Acquired Impression inc. through simple share exchange, making it a wholly owned subsidiary
August 2017	Acquired Sakuragate Inc. as wholly owned subsidiary through simple share exchange
August 2017	Acquired eitarosoft, inc. through simple share exchange, making it a wholly owned subsidiary

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Company profile

Date	Event
September 2017	Acquired Xenoverse Inc. through simple share exchange, making it a wholly owned subsidiary
October 2017	Acquired GG7 Inc. through simple share exchange, making it a wholly owned subsidiary
November 2017	Acquired Total Management Corporation, making it a subsidiary
January 2018	Entered into agreement to establish joint venture company with Wanin International Co., Ltd.
February 2018	Acquired shares of Seisyou Co., Ltd., making it a subsidiary
June 2018	Acquired CYBIRD Co., Ltd., making it a wholly owned subsidiary
January 2019	Sold eitarosoft, Inc. and Seisyou
January 2019	Established Aeria Contents Holdings Inc. as an intermediate holding company in the contents business
January 2019	Established Aeria One Inc. as an external alliance contact point for group company assets

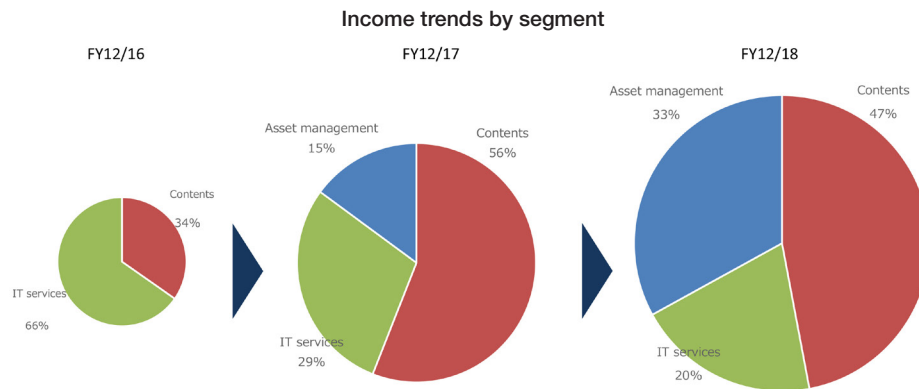
*Twist Inc. was a limited liability company at the time it was acquired but has since been converted to a corporation
 Source: Prepared by FISCO from the Company's website

Business overview

All three segments showing strong growth

1. Business description

Segment sales composition in FY12/18 was IT services business at 20%, contents business at 47%, and asset management business at 33%. In IT services business, mainstay Air Internet Service and First Penguin continue to achieve stable growth. In contents business, *A3!*, a major hit developed by Liber Entertainment, is sustaining healthy momentum and acquired CYBIRD started contributing income too. In asset management business, which began in 2017, existing business is vibrant, and the Company has started initiatives for *minpaku* service. Rapid expansion stands out in contents business and asset management business in recent years.



Source: The Company's results briefing materials

Stable income source, though also takes on challenges

2. IT services

Under the IT services segment there are two main companies, AIR Internet Service and First Penguin. AIR Internet Service operates a data service business while First Penguin operates an affiliate platform business. Other subsidiaries under the IT services segment include Grey Cells, Inc., which offers system solutions and consulting services, and CyberZero Ltd., whose services include social app development and support services for companies uses social media.

(1) AIR Internet Service

AIR Internet Service provides various internet services for businesses, including its cloud-based email solutions service (All in One Mail) and a cloud-based reservations management system (Reserve Keeper) for restaurants. With the bulk of its business stemming from its data center operations, AIR Internet Service generates an exceptionally steady stream of revenues and earnings. It divides its services lines broadly into three areas: business cloud services, managed hosting services, ISP services. Under business cloud services, in addition to All in One Mail and Reserve Keeper, AIR Internet Service offers the popular Cybozu Office (said to be the No. 1 groupware product in Japan). Under managed hosting services, AIR Internet Service offers its proprietary WEBooth hosting services which comes with its own online storage service. ISP services include domain registration and other website-related services.

(2) First Penguin

First Penguin operates diversified businesses, including the affiliate platform business, advertising, content creation/sales, media management, overseas trading, and overseas and domestic employment assistant businesses. This segment covers a wide range of businesses, including affiliate platform, advertising, contents production and sales, media operation, overseas trade, overseas job placement assistance, and domestic job placement assistance. It newly entered payment agency business in 2018. Affiliate platform business is the main area. It operates the infotop portal site, which sells information materials (information reaching materials) *1, and generates strong income on a stable basis. The infotop site has over two million cumulative registered sellers, buyers, and introducers and sells more than 60,000 materials. It is a popular site that covers all types of categories related to daily life. First Penguin serves as a broker for sellers, buyers, and introducers and has a framework for managing sales and compensation payments between sellers and introducers as well as payment and product transfer agent services between sellers and buyers. While the business model has some resemblance to Rakuten Ichiba, infotop differs significantly in just handling the single category of information materials and managing commercial flow and the presence of introducers (affiliate *2 partners).

*1 Information materials: Information that is primarily bought and sold over the internet. The information itself is the product, such as study guides for foreign language, guides on asset management, and self-improvement guides. While some of them are said to be fraudulent, Infotop's careful examination of the materials sold through its website leaves very little room for disreputable operators to sell their wares.

*2 Affiliate: An advertising technique wherein a blogger or magazine receives compensation from the seller if the write-up of the product leads to a sale.

Business overview

Infotop website (left) and business model (right)



Source: The Company's website

Rapid expansion of IP business

3. Contents segment

In contents business, the Company has supplied various games to the market for the platforms of each era, including PCs, Japan-style mobile phones, and smartphones. Smartphone games are currently the most popular offerings. The Company develops smartphone games for women and has achieved major hits with *I★Chu* and *A3!*. It also acquired CYBIRD with the Ikemen Series, a major offering. Furthermore, the Company is shifting this business from simple fee income to an IP business that utilizes characters cultivated in these titles in other areas besides games too.

(1) Liber Entertainment

Liber Entertainment is a core company in the contents business that develops and operates social games, develops consumer games, and operates consulting business for games. It has achieved success by focusing on development of Ikemen training games for women and delivered a hit with the *I★Chu* smartphone game in 2015 and a major hit with *A3!* in the 2017. It is also expanding business scope to peripheral businesses that utilize its IP. Hit products have an effect for three years, and broadening to peripheral businesses can extend the period even more. This is a well-performing subsidiary currently in a growth phase.

a) *I★Chu*

This is a love rhythm adventure game in which the player is a teacher and producer who trains the “Ichu,” an idol egg, to become a full-fledged idol. It began official service in June 2015 and generates income from item charges. Basic play is free. It took off and reached one million downloads by January 2017. Real-world products have done well too because of this success. The Company supplies music CDs, comic anthologies, short stories, fan books, and other items. *I★Chu The Stage* is a 2.5D* version and has been more than 10 times up top now. The game is enjoying a very long run, including collaboration events with Hello Kitty and the possibility of a new series.

* 2.5D: Original works and concepts from “2D” anime and video games converted into “3D” live stage productions.

Business overview

b) A3!

This is an Ikemen training game in which the player assumes the role of director at a run-down theater on the verge of closing and trains new Ikemen actors through rehearsals and makes the production a success. The entire series is dubbed with voices, and minigames have been recorded to generate additional income. Service began with free basic play and item charges in January 2017. Leveraging its success with *I★Chu*, the Company attained a massive hit that was at six million downloads as of February 2019. It has already launched numerous real-world related products, including CDs and comic anthologies. It developed the stage version *MAINSTAGE A3!* and held live events in June to November 2018 and January to March 2019. It is also holding the new *MAINSTAGE A3!* in April-May and August-September 2019. Furthermore, it is promoting overseas rollout, including the start of traditional-Chinese version distribution (Taiwan, Hong Kong, and Macau) and conclusion of a licensing contract for an English version to be distributed globally. We anticipate that it will start distributing in China, where it has lagged thus far, too. The Company has developed *A3!* into a larger business than *I★Chu*, and the game's popularity is unlikely to recede for the time being.

Concept images for A3! (left) and *I★Chu* (right)



Source: The Company's results briefing materials

c) Other products from Liber Entertainment

Soen No Kantai is a full-fledged naval battle game in which the player becomes the general commander of the Soen fleet and battles with a mysterious enemy, the shadow fleet. Service started with free basic play and item charges in September 2017. It is steadily attracting interest and reached 880,000 downloads in March 2019. Other consignment and development cooperation titles include *Kai-ri-Sei Million Arthur*, *Rebellion Run: Dash or Capture!!*, and *One Piece ROMANCE DAWN Boken-no-Yoake*. Management is also considering development of a beautiful girls training game aimed at male players.

(2) CYBIRD

The Company acquired CYBIRD, a longstanding smartphone game provider with the story-type female-oriented romance game Ikemen series that is highly popular with women, as a subsidiary in June 2018. It is also well respected in escape game and fortune-telling segments. The Ikemen series is a blockbuster game with over 20 million cumulative downloads. Following consolidation, we expect CYBIRD to provide not only a large income base in the game market for women, but also synergies in overseas rollout and contents promotion for the Company's other games and characters in light of CYBIRD's robust track record in overseas business and character IP management.

Business overview

Image example from the Ikemen series



Source: CYBIRD web page

(3) Shift to IP business

Besides these, the Company has many other games and contents that have either been released or are currently in development. It owns numerous well-received products, including Arithmetic Inc.'s *DYNAMIC CHORD* and *10 Count* (a boys' love comic) and Sakuragate Inc.'s online casino and land casino slot games. However, the Company's approach to contents business has changed considerably since the *A3!* hit and acquisition of Ikemen series. While games offer appeal as fee-based business, they are even more attractive as IP business utilizing characters because of significant room to expand income beyond just the games to goods, CDs, stage events, and other areas. Furthermore, characters have a longer lifecycle than games and generate high royalties. Platform changes have less impact on IP than games. With new usage styles due to broad adoption of smartphones, interest in characters originating from games has risen and animation developed from games, which previously was not that common, is increasing too. The Company's direction in game development has shifted from high-volume output aimed at obtaining fee income to careful development with emphasis on IP business since the hit with *A3!* and acquisition of the Ikemen series. We think the shift has provided motivation for reorganizing subsidiaries and titles with an approach of focus and selectivity as explained below.

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Business overview

Main smartphone game titles thus far

Date	Producer/Distributor	Description
2003-		Entered the game industry with contents for KDDI <9433> mobile handsets in 2003, mainly grew with PC games and delivered numerous hits, including <i>Shin Megami Tensei: IMAGINE</i>
July 2008		<Launched on iPhone in Japan (SoftBank Mobile)>
July 2009		<Launched on Android OS smartphones in Japan (NTT DoCoMo)>
2013-		Ramped up development of smartphone games from 2013
July 2013	Aeria Games	Officially started service for realistic war fighting game, <i>Battle Rush!</i>
November 2013	Aeria Games	Officially started service for <i>Blacksmith and Dragons</i> RPG
December 2013	Aeria Games	Officially started service for <i>Various Monsters</i> , an exciting new rhythm RPG
April 2014	Aeria Games	Officially started service for <i>Klee: From the Town of Dancing Moon Drops</i> , a classic online RPG
June 2015	Liber Entertainment	Officially started service for <i>I★Chu</i> love rhythm and adventure game
December 2016	Aeria Games	Officially started service for <i>STARLY GIRLS: -Hoshimusume-</i> next-generation training simulation game
January 2017	Liber Entertainment	Officially started service for <i>A3!</i> , <i>Handsome</i> actor training game
May 2017	GESI	Began distributing <i>Secret Inn</i> , a heart-warming RPG where players live with the hero
July 2017	Team-0	Released first game in <i>FuluBeatVR</i> VR rhythm game series
September 2017	Liber Entertainmen	Officially started service for <i>Soen No Kantai</i> realistic naval battle game
December 2017	AGE	Officially started service for <i>Everyone's Casino</i> social casino game for everyone
January 2018	Team-0	Officially released second game in <i>Symphony Line VR</i> VR rhythm game series
March 2018	Arithmetic	Released the Android version of <i>WolfToxic – Ookami Otoko ni Ki wo Tsukero</i>
March 2018	etarosoft	Started distribution of <i>Dance Trips</i> , a romance restaurant game jointly developed with Otomate
March 2018	Team-0	Started puzzle adventure game <i>Two Years' Vacation</i> service (Survival life with friends on an unknown island)
June 2018	Team-0	Officially released <i>HappyTubeVR</i> , the third products in its VR rhythm game series
August 2018	ASGARD	Run second promotional gift campaign for new title <i>DYNAMIC CHORD JAM&JOIN!!!!</i>
August 2018	CYBIRD	Started distribution of music x romance simulation game <i>Ikemen Live: Koi no Uta wo Kimi ni</i>
January 2019	Arithmetic	Began distribution of <i>10 Count</i> for App react (boys' love game)
February 2019	Arithmetic	Released <i>Etokare – Jyunishi ni Neko ga Moreta Rityu</i>
Future plans	Liber Entertainmen	Beautiful girl training program (name undecided) under development, <i>A3!</i> for men Currently developing many other products

*As of the end of February 2019

Source: Prepared by FISCO from the Company's website

Succeeded in a minpaku collaborative experiment

4. Asset management segment

The Company quickly acquired multiple real estate-related companies after the halfway point in 2017 - Twist in July, Impression in August, and Total Management in November. Impression develops investment-purpose condominiums harnessing its strength in investment property sales, sells residence real estate, and handles renovation business. Total Management excels at development of standalone home units and income-earning properties, implements used condominium renovations and property sales, and provides consulting services. It acquires many properties related to inheritance situation, and this business has surprisingly low risk. Companies in the asset management have already been generating solid profits. While income sharply increased in FY12/17, the segment contributed substantially to overall sales and profits in FY12/18 too.

Business overview

Twist is a unique company that offers *minpaku* operation agent service to individuals and others. It provides a one-stop complete agent service for high-income properties mainly in Tokyo and Kyoto that covers from selection of *minpaku* sites with potential to generate high investment return, conversion to *minpaku* specifications with interior design by professional designers, provision of 24-hour multi-language support, property cleaning and management, and placement on Airbnb and Agoda, Asia's largest global online lodging reservations site. It offers excellent affinity with the group as a whole. By collaborating with Twist, other companies in the asset management business can supply properties from their portfolios as *minpaku* sites. The Company combines this service with technology from IT services business to supply highly convenient service known as "real estate tech." It also has an even richer range of ideas utilizing contents business IP.

The Company started a collaborative *minpaku* service with *DYNAMIC CHORD* and *10 Count* in 2018. In a test for two rooms owned by Total Management in Shimo-Kitazawa (Tokyo), room interior utilized characters to create a lively environment with the games and the locations offered limited character goods and limited novelty presents. These steps were very popular. It was possible to charge higher rents and boost profits. The Company intends to continue to actively operate *minpaku* sites that collaborate with games and obtain economies of scale by expanding this business. It is reviewing events and other activities too in light of recent expansion of the 2.5D market. The Company is also looking at utilization of other company IP, not just IP from its own group. Progress realizing various synergies and collaboration with Twist as a key company could enable this business to increasingly contribute to higher added value and growth as a group.

Interior of the collaborative minpaku facility



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

M&A strategy and business reorganization

How to remain an essential presence

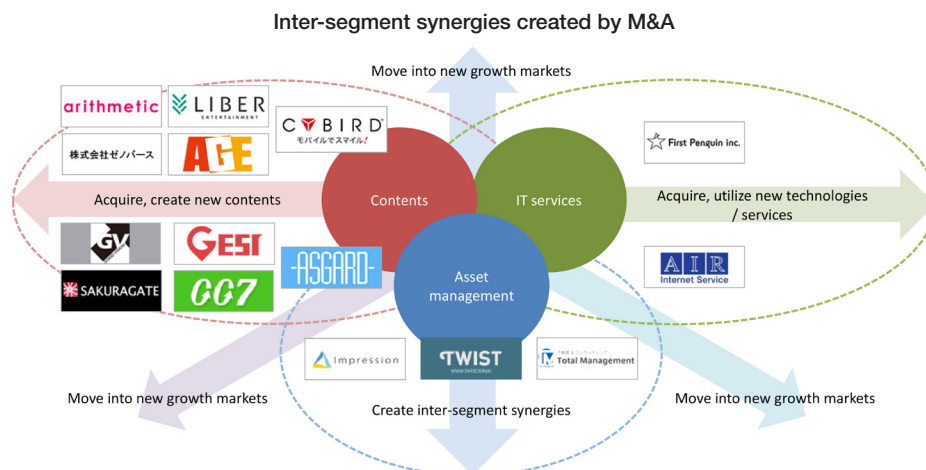
1. Management policy and stage

Since its founding, the Company promoted a concept of “becoming an essential presence, similar to air, in the network society” and “aggressively developing businesses in areas with rapid growth” in order to sustain a position as an essential firm. It aims to develop businesses over the longer term by keeping pace with advances in the network society, including blockchain, AI, VR/AR, and other new technologies, and harnessing new areas, such as growth in lodging demand from foreigners visiting Japan. Active M&A and other investments in growth markets in the Company’s various businesses are a vital component of the business cycle of acquiring business assets that generate stable income, aggressively investing in growth markets, and strengthening the business foundation in growth markets. However, we think the Company has currently entered a stage of reinforcing the business foundation in growth markets.

M&A aimed at acquiring human resources and synergies

2. M&A strategy aims and accelerated M&A

The Company’s M&A strategy aims to acquire management resources and teams and boost their motivation and obtain business assets capable of creating synergies. In particular, the latter seeks to build a robust income foundation that distributes risk in the various businesses and expand scale and also bring the Company into growth markets. We think the Company incurred the most risk with four companies it purchased in 2015 - First Penguin in pursuit of stable income, Liber Entertainment with smartphone games, a growth area, ASGARD, and GESI. However, in the following fiscal year (FY12/16), the Company booked an operating loss of ¥1,605mn (though it reported ¥501mn in EBITDA) because ASGARD and GESI did not reach initial profit expectations, Liber Entertainment incurred substantial costs for new title development expenses and advertising outlays, and it had goodwill depreciation costs and impairment charges due to these difficulties. Yet A3! released by Liber Entertainment in January 2017 was a major hit and income recovered sharply to ¥2,691mn in operating profit in FY12/17. With this success, the Company accelerated M&A activity by purchasing nine companies in FY12/17 and two companies in FY12/18.



Source: Prepared by FISCO from the Company’s management policy briefing materials

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Strengthening synergies and governance through business reorganization

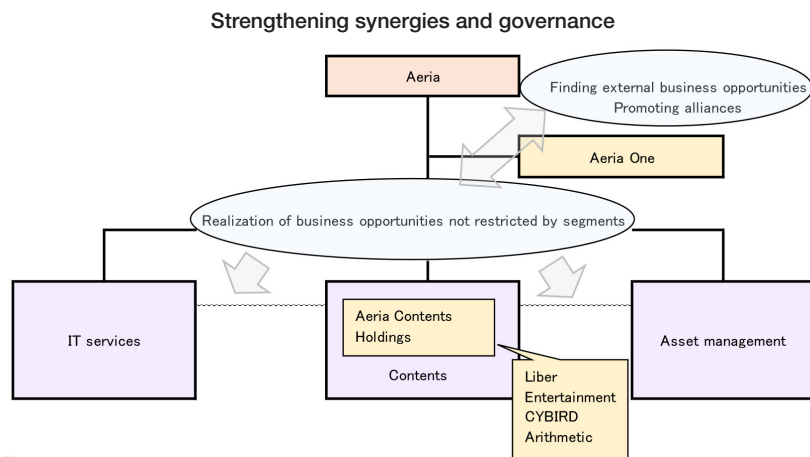
3. Business reorganization

(1) Reorganizing subsidiaries and contents

Thanks to hits with *A3!* and *I★Chu*, the Company acquired IP business as a new business field. We think the purchase of the Ikemen series in 2018 gave the Company confidence to achieve growth in IP business. Therefore, in order to allocate business resources to IP businesses and expand into new technologies and new fields, such as foreign travelers to Japan, it is consolidating business scope that had been broadened and strengthening the business foundation with selectivity and focus. Since 2Q FY12/18, the Company started reorganizing businesses and booked impairment charges on goodwill (¥655mn) for Arithmetic and other investments with insufficient progress toward business plans. It also took goodwill impairment losses due to conservatively revising outlooks for four consolidated subsidiaries (¥686mn) and on software assets at five consolidated subsidiaries (¥659mn). With ASGARD, the Company received debt forgiveness on loans from ASGARD directors (¥657mn; it thus booked ¥657mn in debt forgiveness profit) because ASGARD slipped into a state of excess liabilities on rising development costs and sluggish sales and merged ASGARD into Arithmetic through a spin-off style absorption intended to shore up mutual weaknesses. Additionally, the Company sold shares in eitarosoft, which has extensive IP from other companies, and Seisyuu, on diminished synergy expectations in *minpaku* cleaning, and removed these entities from consolidated scope.

(2) Bolstering synergies and governance through business reorganization

The next step after selectivity and focus is promoting efforts to build an efficient business model as a corporate entity. The Company established Aeria Contents Holdings (ACH), an intermediate holding company, with Chairman Nagashima as the president and Liber Entertainment’s representative director and president Kotaro Hayashida as a director and thereby created a framework to comprehensively manage and supervise the contents business. This scheme facilitates 1) collaboration with the ACH executive team, mainly built around Mr. Hayashida, in development of new game titles at the various companies, 2) sharing of management functions and related curtailment of managing costs, 3) curtailment of hiring costs through optimal allocation of human resources and effective utilization of human resources, and 4) sharing of company information and knowledge with ACH as the hub. The Company also established Aeria One Inc. for the purpose of actively creating synergies through use of group business resources, such as IP, and promoting alliances by finding new business opportunities inside and outside the group without being restricted by concepts in existing business segments.



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

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Incorporating new technologies and growth markets

4. Anticipated new fields

Despite business reorganization, the Company has strived to incorporate new technologies, such as AI, VR/AR, and blockchain, and markets related to the growing number of foreign visitors to Japan as new fields. Both opportunities offer large scale and could make fundamental changes in social structure.

(1) New technology field

In new technology, the Company is developing a trading card service that utilizes blockchain and reviewing use of VR/AR in lodging facilities, but these efforts are still looking ahead to the future. In application of AI to creative areas, the Company invested in DataGrid, a venture firm with AI technology that employs deep learning. DataGrid is engaging in R&D on technology that automatically generates character appearance images using AI. If the Company applies this technology, it could assign not only character appearance image creation, but also scenario creation, automated voice generation, natural language processing, and other aspects to AI software and limit the role of people to training and supervision. This might enable production of global only-one customized games. At the current stage, character appearance automated generation software has succeeded in automatically generating 70,000 characters from data exceeding 200,000 items. The Company could increase income if it becomes possible to endlessly add characters. Replacement of manually drawing characters from scratch with AI should help curtail costs as well. We think this is an attractive project and see applications in other areas besides games, such as *minpaku* reservations and key hand-offs, lodging rights interaction, and blockchain.

Character appearances automatically generated by AI



Source: The Company's results briefing materials

(2) Asset management business in a growth market

The number of foreigners visiting Japan rose by 8.7% YoY to 31.19mn people in 2018 (Source: Japan National Tourist Organization) and continued increasing in January and February 2019. We expect further growth in foreign visitor volume ahead of the 2020 Tokyo Olympics and Paralympics event, including support from national policy aimed at making Japan a major tourist destination. However, Japan faces a significant shortage of lodging facilities and *minpaku* sites have the potential to fill the gap. It implemented the Residential Accommodation Business Act (New *Minpaku* Act), which lifted the ban on *minpaku* practices, in June 2018. The new law aims to cultivate *minpaku* service, but also sets regulations, such as a limit on the number of operating days and notification and lodging party identity confirmation duties. A growing number of local government entities are bolstering their regulations in reaction to concerns expressed by neighboring residents, including noise, garbage disposal practices, and other manner infractions and criminal usage. Nevertheless, we project steady improvement in *minpaku* business health over the longer term because of increase in the number of official registered operators under the New *Minpaku* Act. The Company started its asset management business to target this area and is currently preparing and conducting experiments aimed at expansion of room volume.

Results trends

Major changes in the business structure

1. FY12/18 results trends

The Company reported FY12/18 results with ¥31,471mn in sales (+98.3% YoY), ¥1,876mn in operating income (-30.3%), ¥1,615mn in ordinary income (-41.5%), and ¥1,380mn in net losses attributable to parent shareholders (setback to a loss). In Internet-related business areas where the Company operates, Internet usage and EC (electronic commerce) markets are still expanding and content services have diversified. Competition among companies, meanwhile, has been intensifying, and development costs, personnel costs, and sales promotion outlays are trending upward. In this environment, the Company built a position in the smartphone market by focusing on women and other niche markets with support from stable income in IT services business. Furthermore, it promoted *minpaku* business that taps into foreign tourists visiting Japan and also utilizes the Company's IP and generates synergies.

Sales climbed because of robust income from *A3!* and additions of CYBIRD and other consolidated subsidiaries. While gross margin slipped, this can be attributed to the impact of development costs at consolidated subsidiaries. SG&A expenses rose on higher collection agent fees with increase in contents business sales and larger advertising and promotion costs. In particular, the Company reinforced advertising and promotions to the point of updating guidance during the period because of its recognition of the strong potential of its IP assets. This stance pulled it away from new entrants. *A3!* remains highly received because of its impressive game content and has acquired sustainable popularity. Nevertheless, we think this was a major turning point for the Company's IP strategy. The Company booked ¥722mn in extraordinary profits, including debt forgiveness profits from ASGARD, but ¥2,201mn in extraordinary losses, including impairment charges on goodwill from Arithmetic and some other consolidated subsidiaries and software titles accompanying focus and selectivity. It also booked ¥454mn in 2Q related to correction of the corporate tax and other values related to the purchase of Infotop shares by Infotop Capital in 2015.

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Results trends

FY12/18 results

	FY12/17 (¥mn)	Ratio to sales (%)	FY12/18 (¥mn)	Ratio to sales (%)	Change (%)
Sales	15,871	100.0	31,471	100.0	98.3
Gross profit	8,155	51.4	11,092	35.2	36.0
SG&A expenses	5,463	34.4	9,215	29.3	68.7
Operating profit	2,691	17.0	1,876	6.0	-30.3
Recurring profit	2,760	17.4	1,615	5.1	-41.5
Net profit (loss) attributable to parent company shareholders	2,080	13.1	-1,380	-4.4	Setback

Source: Prepared by FISCO from the Company's financial results

In the results by segment, the IT services business posted ¥6,055mn in sales (+30.2% YoY) and ¥481mn in profit (+9.4%) as the two main subsidiaries (AIR Internet Service and First Penguin) maintained stable income. The contents business reported ¥14,262mn in sales (+59.6%) and ¥922mn in profit (-61.9%). Sales rose on continued robust A3! business and rapid expansion of IP business, including character good sales and stage events, while profits came under pressure from advertising and promotional costs to obtain market position. Asset management business booked ¥10,008mn in sales (+320.4%) and ¥452mn in profit (vs. a ¥94mn loss in FY12/17). Sales and earnings improved substantially, including promotion of IP collaboration with the Company's contents business at Twist and Total Management.

FY12/18 results by segment

Segment sales	FY12/17 (¥mn)	Ratio to sales (%)	FY12/18 (¥mn)	Ratio to sales (%)	Change (%)
IT services	4,616	29.1	6,055	19.2	30.2
Contents	8,874	55.9	14,262	45.2	59.6
Asset management	2,380	14.9	10,008	31.8	320.4
Others	-	-	1,209	3.8	-

Operating profit before adjustment	FY12/17 (¥mn)	Ratio to sales (%)	FY12/18 (¥mn)	Ratio to sales (%)	Change (%)
IT services	440	9.5	481	8.0	9.4
Contents	2,420	27.3	922	6.5	-61.9
Asset management	-94	-3.9	452	4.5	Moved into black
Others*	-	-	-25	-2.1	-

* Others includes cleaning business, chemicals business, etc.

Source: Prepared by FISCO from the Company's financial results

Slightly conservative guidance

2. FY12/19 outlook

For FY12/19, the Company forecasts sales of ¥32,000mn (+1.7% YoY), an operating profit of ¥2,200mn (+17.3%), recurring profit of ¥2,000mn (+23.8%), and net profit attributable to parent company shareholders of ¥1,400mn (vs. a ¥1,380mn loss in FY12/17).

Results trends

FY12/19 outlook

	FY12/18 (mn)	Ratio to sales (%)	FY12/19 E (mn)	Ratio to sales (%)	Change (%)
Sales	31,471	100.0	32,000	100.0	1.7
Gross profit	11,092	35.2	-	-	-
SG&A expenses	9,215	29.3	-	-	-
Operating profit	1,876	6.0	2,200	6.9	17.3
Recurring profit	1,615	5.1	2,000	6.3	23.8
Net profit (loss) attributable to parent company shareholders	-1,380	-4.4	1,400	4.4	Moved into black

Source: Prepared by FISCO from the Company's financial results

In FY12/19, the Company expects continuation of stable income growth in IT services business. It also anticipates improved profitability in contents business driven by focus on expansion of existing titles and IP, enhanced gross margin from business reorganization and sharing knowhow through ACH, and curtailment of development costs due to decline in new titles versus the previous year. Additionally, a full-year contribution from CYBIRD, which was acquired as a subsidiary in June 2018, is likely to make a large contribution to raising market share. There might also be interest in the Company's casino games that offer added value with operational knowhow following passage of Japan's Integrated Resort (IR) Act in July 2018. The Company aims to strengthen *minpaku* service, including collaborative *minpaku* with IP from other companies. While it is beginning to accelerate business activities following reorganization, as described above, the outlook still seems somewhat conservative. We attribute this stance to the Company's strong resolve to avoid lowering guidance in FY12/19.

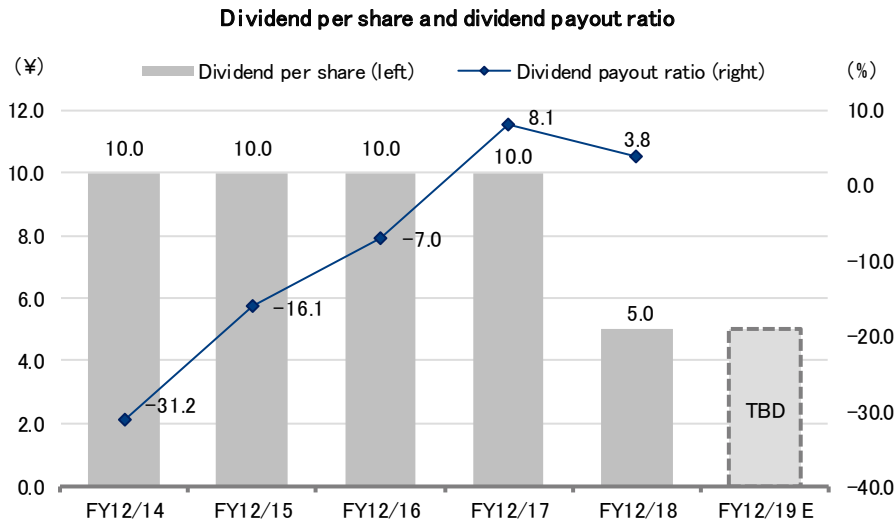
Shareholder return policy

Undecided FY12/19 dividend

1. Dividend

The Company acknowledges that returning profits to shareholders is an important management issue, but wants to expand profit retention in light of efforts to improve and strengthen operations and future business initiatives. It intends to use retained profit funds mainly for M&A and other capital alliances, R&D activities, and new business plans. While the Company had a basic policy of paying a continuous stable dividend from surplus funds in FY12/18, it ended up lowering the annual dividend outlay by ¥5 YoY to ¥5 (no interim dividend), including the impact of lowering profit guidance during the period. In FY12/19, we hope to see recovery to the previous level based on profit trends, but the Company has not reached a decision on the dividend yet.

Shareholder return policy



Note: The Company made a 2-for-1 share split on July 1, 2017.
 Source: Prepared by FISCO from the Company's financial results

QUO cards for the popular A3! title as a shareholder benefit

2. Shareholder benefit program

The Company provides a shareholder benefit each year with the aim of deepening shareholder understanding of its businesses and encouraging share ownership over the longer term. It sends the benefit with notification of resolutions for the general shareholder meeting typically mailed in late March to shareholders on the ledger as of the shareholder benefit standard date (at the end of December). The shareholder benefit in FY12/18 was QUO cards for the popular A3! Title, with expected distribution of ¥300 for 100 shares up to less than 1,000 shares, ¥500 for 1,000 shares up to less than 5,000 shares, ¥700 for 5,000 shares up to less than 10,000 shares, and ¥1,000 for 10,000 shares or more.

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