

KADOKAWA CORPORATION

9468

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FISCO Ltd. Analyst

Yuzuru Sato



FISCO Ltd.

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

■ Index

■ Summary	01
1. FY3/20 results	01
2. FY3/21 outlook	01
3. Medium-Term Management Strategy	01
■ Business overview	02
1. Publication business	03
2. Video and Game business	03
3. Web Services business	04
4. Others	06
■ Results trends	06
1. Overview of the FY3/20 results	06
2. Trends by business segment	07
3. Financial condition and management indicators	10
■ Outlook	12
1. FY3/21 outlook	12
2. Business policies	13
3. Initiatives by business segments	13
■ Medium-Term Management Strategy	15
1. Initiatives addressing changes in the business environment	15
2. Fundamental strategy	16
3. Management numerical goals and individual strategies	18
■ ESG and SDGs initiatives	19
■ Shareholder return policy	20
■ Information security measures	20

Summary

Aiming for further acceleration of business structural reforms driven by past DX efforts and establishment of a growth foundation that responds to changes in the market environment in FY3/21

KADOKAWA CORPORATION <9468> (hereinafter, also “the Company”) is a comprehensive entertainment company that operates Publication, Video and Game, Web Services, and other businesses globally and has an operating holding company format with various group companies, including DWANGO Co., Ltd., which runs one of Japan’s largest video services niconico, game developers FromSoftware, Inc. and Spike Chunsoft Co., Ltd.

1. FY3/20 results

In FY3/20 consolidated results, while revenue fell slightly by 1.9% YoY to ¥204,653mn, operating income climbed significantly with a 198.7% YoY increase to ¥8,087mn. Removal of subsidiary MAGES. Inc. from consolidated scope reduced revenue by about ¥4,700mn, and FY3/20 revenue rose 0.4% excluding this factor. Operating income, meanwhile, primarily increased on robust improvement of DWANGO income following business structural reforms implemented in the previous fiscal year. It missed guidance (¥10,000mn) mainly due to the impact of the Coronavirus disease 2019 (COVID-19) outbreak with a combined setback of ¥1,600mn from lower theater proceeds for the “Fukushima 50” movie released in March 2020, suspended events, and delayed shipments of media mix products from postponement of animation productions.

2. FY3/21 outlook

The Company has not decided the FY3/21 outlook at this point, because of high uncertainty related to expansion of COVID-19 infections and other factors, though intends to release it once disclosure is possible. Main anticipated impacts are the prospect of higher sales of various digital contents on “stay home” demand on the positive side, and closures of bookstores and movie theaters, suspended events, and content production delays on the negative side. Additionally, the Company has postponed the schedule for opening Tokorozawa Sakura Town, which was originally planned for July 2020, to November 2020. The Company plans to further accelerate business structural reforms driven by digital transformation (DX) using rapid changes in the business environment as an opportunity and reinforce its income foundation by bolstering intellectual property (IP) creation and digital-related businesses and reorganizing unprofitable businesses.

3. Medium-Term Management Strategy

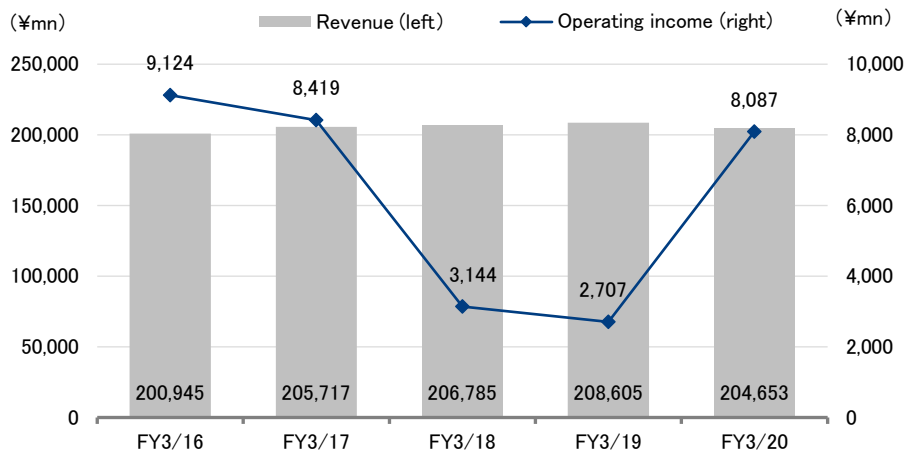
In the medium-term management strategy that lasts through FY3/23, the Company presents a fundamental strategy that targets growth by advancing IP creation capabilities and media mix strategy, which are strengths, in Japan and overseas through promotion of DX. It also intends to promote management with awareness of ESG and SDGs. The Company hopes to curtail consumption of paper resources with manufacturing and logistics reforms from operating the new Tokorozawa plant, bolster online education business, and promote telework and other workstyle reforms. While it fundamentally does not plan to alter this fundamental strategy, management will provide more detailed content at the disclosure of FY3/21 guidance.

Summary

Key Points

- Steep increase in FY3/20 profits thanks to savings from DWANGO business structural reforms
- Promoting DX-led business structural reforms, reinforcement of IP creation and digital-related business, and revisions to unprofitable businesses
- Aims to expand profits with a growth engine of IP “creation x rollout x experiences”

Results trends



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

Business overview

A comprehensive entertainment company group developing three main businesses; Publishing, Video and Game, and Web Services

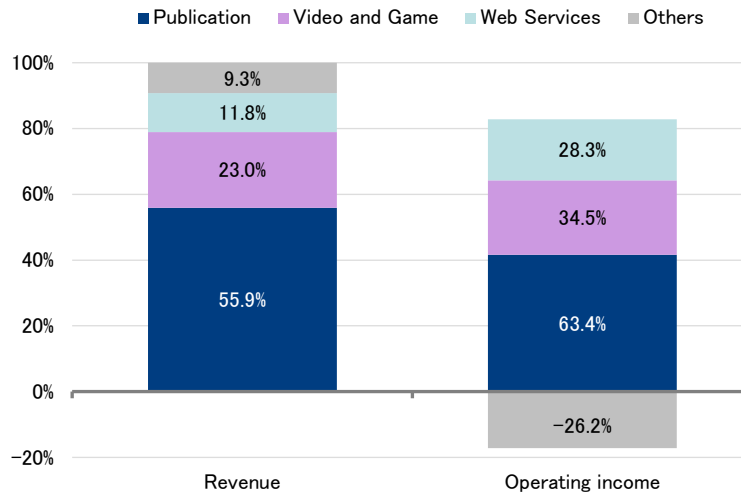
The Company is a comprehensive entertainment company group that handles Publication business, Video business, Rights business, Digital Contents business, network and entertainment services, content planning, development, and operation, and video service operation.

The breakdown of FY3/20 revenue by segment shows Publication business at a majority with 55.9%, Video and Game business at 23.0%, Web Services business at 11.8%, and Others (education, CDs, goods, and other merchandising, and inbound-related business) at 9.3%. In operating income, profits from the Publication business, Video and Game business, and Web Services business offset losses from Others. While Publication business is currently the primary source of sales and profits, the Company hopes to increase sales and improve profitability in the Video & Game business with a media mix strategy utilizing its own IP and achieve renewed growth in Web Services business, which restored profitability in FY3/20, by building the fan community and developing and providing new services.

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Business overview

Composition of revenue and operating income (loss) by business segment (FY3/20)



Note: The composition of operating income is before deductions from internal adjustments.
 Source: Prepared by FISCO from the Company's financial results

1. Publication business

In this business, which is KADOKAWA's main business, the Company publishes and sells paper-based books, separate volumes, light novels, and comics, as well as e-books and magazines. In addition to magazines including "The Television" (TV information), "Famitsu" (game information), and "Lettuce Club" (lifestyle information) and mooks (magazine-style books) in this business, the Company also produces custom media as well as selling advertisements on the Internet.

For sales of paper books, the Company has strength in developing works through its media mix strategy, and it continuously publishes new titles at a rate of 5,000 a year. The Company has worked on optimizing production and shipments based on marketing results from many years and utilization of digital technology. Its book return rate in FY3/20 was in the mid-30% range, which is lower than the industry average.

Conversely, in e-books, the Company sells its own and other companies' works on BOOK☆WALKER, which is its directly managed e-books distribution platform, and also on the e-book stores of other companies, like Amazon <AMZN> and Rakuten <4755>. For e-magazines, it provides and manages content in collaboration with NTT DoCoMo, Inc. <9437> for d magazine, which is an all-you-can-read magazine service. The DWANGO-operated niconico Manga, niconico Books, and Bookmeter have been integrated under the control of BOOK WALKER Co., Ltd., which manages BOOK☆WALKER, in FY3/19 with the aim of strengthening the e-books and e-magazines business Groupwide.

2. Video and Game business

The video business includes planning, production, and distribution of movies; sales of package software; sales of copyrights to overseas versions of anime; and video distribution. In addition, Kadokawa Daiei Studio Co., Ltd. and Glovision Inc. are developing the studio business. The Company is focusing on creating video from the Group IP generated in the Publication and Video and Game businesses and on producing and distributing live-action films and anime titles.

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Business overview

In the game business, KADOKAWA CORPORATION, FromSoftware, Inc., Spike Chunsoft Co., Ltd., and KADOKAWA GAMES, LTD. carry out the planning, development, and sales of packaged game software, network games, and app games. Previous hit titles include “Dark Souls,” “Bloodborne,” “SEKIRO: SHADOWS DIE TWICE” (FromSoftware), “GOD WARS” (KADOKAWA GAMES), “Kenka Bancho,” “Danganronpa,” and “ARK: Survival Evolved” (Spike Chunsoft).

3. Web Services business

DWANGO handles the Web Services business and mainly operates a portal business (running the niconico Douga service, etc.). It also implements live business that plans and manages various events as niconico advertising and promotion as well as mobile business (music distribution service for mobile phones).

The Company provides various services on its mainstay portal business, including the niconico Douga video community, niconico Live, and niconico Channel. Sales include revenue from monthly fees (¥550/month) obtained from niconico premium members, which enables them to watch videos and live broadcasts comfortably; advertising revenue, such as from website banners and video; and revenue from points used to watch pay-to-view videos. At the end of March 2020, the number of valid members*1 had increased to 78.67 million people and among these, the number of premium members continued the downward trend from 2017 with a decline to 1.63 million people (down 170,000 people from end-FY3/19). However, premium members had the first net increase month on month (MoM) in a while in March 2020. The usage conditions from January to March 2020 were that MAU (monthly active users), including non-log-in unique users (UU)*2, was 19.85 million people (up 5.9% YoY).

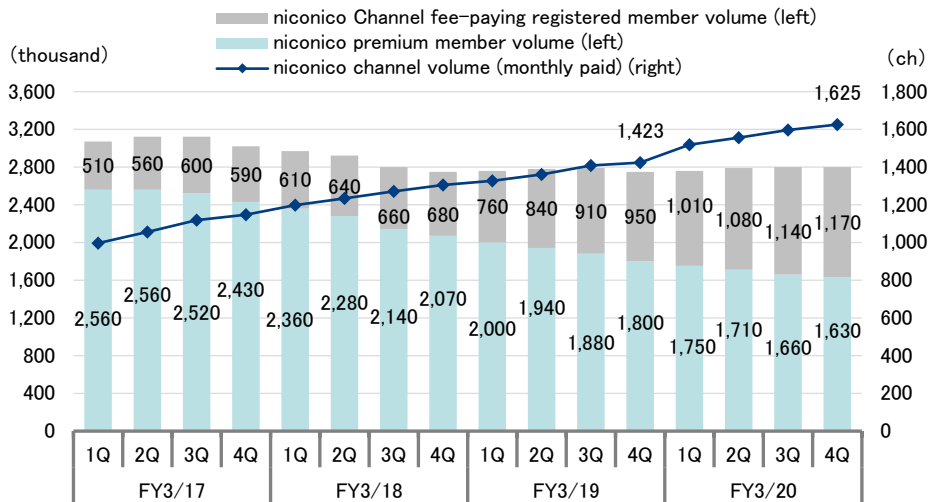
*1 Number of members obtained by subtracting cancellations and unauthorized IDs from ID issuance volume.

*2 From the end of February 2018, it became possible to view without logging-in.

On the other hand, the niconico Channel is a platform where companies, organizations, and users can distribute video and live broadcasts. At the end of March 2020, it had a total of 9,216 channels (up 556 channels from end-FY3/19), 1,625 monthly-fees channels (up 202 channels), and 1,170,000 monthly fee-paying registered members (up 220,000 people), and all of the indicators continue to increase. A growing number of companies and individuals are engaging in business using SNS video, and communications network quality has substantially improved with the version upgrade in 2018. We think the ability to view high-quality video smoothly even on a smartphone is helping increase the number of fee-paying registered members.

Business overview

Volume trends in niconico monthly fee-paying registered members and premium members



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

The live business plans and manages live events, such as niconico Chokaigi*1, Tokaigi*2, Animelo Summer Live*3, and niconico Choparty*4. While the Company had planned joint niconico Chokaigi and Tokaigi events in April 2020, it revised the event to a niconico Internet Chokaigi (April 12–19) in an online-only format because of COVID-19 impact. Total attendees (Internet) rose sharply to about 16.38mn people partly due to extending the event period from two days in the previous year to eight days. The Company halted operations at end-July 2019 for nicofarre (Roppongi), a live house that integrated the network and real world, and niconico Headquarters (Ikebukuro), a niconico promotional shop. It opened Hareza Studio (Ikebukuro) in November 2019 to carry on distribution of live broadcasts handled by the two previous facilities and other activities. The site conducts live performances by virtual characters with a concept of merger real and virtual worlds and distributes anime and game-related stage events.

*1 The largest niconico event held at Makuhari Messe with the concept of "recreating all of niconico onsite." All the participating users are "lead actors" in the various events that integrate the Internet and the real world. niconico Chokaigi 2019 was held on April 27–28, 2019, with approximately 168,000 visitors to the venue and approximately 6.66 million online visitors.

*2 Japan's largest "user participation" game event that features games from analogue to digital and old and new games from the East and West. Tokaigi 2019, which was held at Makuhari Messe on January 26 and 27, 2019, was the first event jointly held with Japan Amusement Expo 2019 and the eSPORTS International Challenge Cup. It had approximately 84,000 site visitors and a total of 4.59 million online visitors, and it is contributing to the expansion of the Japanese games market and the e-sports market.

*3 This is the world's largest Anison live event held during August to September each year. It attracted 84,000 visitors over three days in 2019, an all-time high.

*4 This is the largest niconico live event that brings together users and well-known artists who utilize the "Me singing" and "Me dancing" genres in niconico, which is one of Japan's largest video services. The Company stopped holding it in 2019 (it was held on November 3, 2018, at the Saitama Super Arena, and was attended by approximately 15,000 people).

The mobile business still generates a certain level of profit margin, despite member numbers continuing on a downward trend due to market environment changes. This business operates dwango.jp, which distributes single songs, ring tones, and so forth, as well as animelo mix, which distributes digital contents.

Business overview

4. Others

Others is comprised of businesses including an education business, which involves the management of the Vantan Game Academy and the KADOKAWA Contents Academy schools that provide training to work in creative fields inside and outside of Japan, and N High School (KADOKAWA DWANGO Educational Corporation), which provides education systems characterized by interactivity from the integration of the online and the real worlds, and also merchandising business with planning and sales of character goods and idol CD sales, and inbound-related business. The Company ended its involvement in song production and sales utilizing digital contents and talent management businesses in July 2019 with the removal of MAGES. from consolidated coverage.

Results trends

Step increase in FY3/20 profits thanks to savings from DWANGO business structural reforms

1. Overview of the FY3/20 results

In FY3/20 consolidated results, the Company reported ¥204,653mn in revenue (-1.9%), ¥8,087mn in operating income (+198.7%), ¥8,787mn in ordinary income (+108.9%), and ¥8,098mn in profit attributable to owners of parent (vs. a ¥4,085mn loss in the previous fiscal year). Operating income recovered to the ¥8bn level for the first time in three years following two consecutive setbacks. With improvement of DWANGO income following business structural reforms implemented in FY3/19, Web Services operating income alone added an extra ¥5,364mn.

FY3/20 consolidated results

	FY3/19		Period-start plan	Revised plan (November 2019)	FY3/20			Vs. plan targets
	Results	% of revenue			Results	% of revenue	YoY	
Revenue	208,605	-	217,000	207,000	204,653	-	-1.9%	-1.1%
Cost of sales	151,590	72.7%	-	-	139,793	68.3%	-7.8%	-
Gross profit	57,015	27.3%	-	-	64,860	31.7%	13.8%	-
SG&A expenses	54,307	26.0%	-	-	56,772	27.7%	4.5%	-
Operating income	2,707	1.3%	5,400	10,000	8,087	4.0%	198.7%	-19.1%
Ordinary income	4,205	2.0%	6,200	10,800	8,787	4.3%	108.9%	-18.6%
Profit (loss) attributable to owners of parent	-4,085	-2.0%	3,800	9,500	8,098	4.0%	-	-14.8%
Earnings per share (¥)	-63.94	-	60.07	154.61	130.12	-	-	-

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

While revenue fell slightly YoY, removal of subsidiary MAGES. Inc. from consolidated scope from 2Q was the main setback and reduced revenue by about ¥4,700mn, and FY3/20 revenue rose 0.4% excluding this factor. In operating income, meanwhile, improvement of DWANGO income following business structural reforms implemented in FY3/19 was the primary boost, and Web Services operating income alone added an extra ¥5,364mn.

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Results trends

The unit cost ratio dropped from 72.7% in FY3/19 to 68.3% with improvements of 2.0ppt in outsourcing costs, 0.8ppt in depreciation costs, and 0.4ppt in fees paid. Outsourcing cost savings provided a particularly large contribution (-¥4,442mn YoY). The SG&A expenses ratio, meanwhile, increased by 1.7ppt YoY because of revenue decline and higher advertising and sales promotion costs and personnel costs.

Non-operating income booked an extra ¥117mn in interest income, but forex income slipped by ¥558mn and equity-method investment profits were down by ¥157mn. Thanks to ¥1,606mn in profit from selling fixed assets*1, ¥791mn in profit from selling affiliate company shares, and ¥585mn in settlement income*2 reported as extraordinary profit as well as less corporate tax burden, profit attributable to owners of parent rose substantially.

*1 Mainly profit from selling land and building properties owned by consolidated subsidiary Building Book Center Co., Ltd.

*2 Settlement for damages at a consolidated subsidiary due to contract violation by a business partner

While FY3/20 results had shortfalls of ¥2,346mn in revenue and ¥1,912mn in operating income versus updated guidance announced in November 2019, this mainly reflects the impact of COVID-19. Profit slipped ¥1,100mn from one-time impacts of lackluster theater sales for the “Fukushima 50” movie released on March 6, 2020 because of decline in visitor volume to movie theaters and suspensions of various events and ¥500mn from ongoing impacts through delayed releases in MD business and postponed shipments of media mix product with animation production delays.

Sustained double-digit growth in e-books and e-magazines and upbeat animation overseas-version rights licensing income

2. Trends by business segment

Results by business segment

	FY3/19 Results		FY3/20				Percentage change YoY		Value difference vs. guidance	
			Revised plan (November 2019)		Results					
	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income
Consolidated total	208,605	2,707	207,000	10,000	204,653	8,087	-1.9%	198.7%	-2,346	-1,912
Publication	115,958	7,253	118,000	6,500	117,303	6,248	1.2%	-13.9%	-696	-251
Video and Game	48,295	3,919	50,300	5,100	48,314	3,401	0.0%	-13.2%	-1,985	-1,698
Web Services	25,848	-2,576	24,000	1,900	24,739	2,788	-4.3%	-	739	888
Others	22,143	-2,613	21,700	-2,000	19,497	-2,583	-11.9%	-	-2,203	-583
Eliminations/Corporate	-3,640	-3,274	-7,000	-1,500	-5,200	-1,768	-	-	1,800	-268

Note: The merger of holding company KADOKAWA DWANGO CORPORATION with the Company on July 2019 transferred about ¥0.9bn in costs to the business segments from the eliminations and corporate segment, of which about ¥0.6bn went to the Publication segment.

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

(1) Publication business

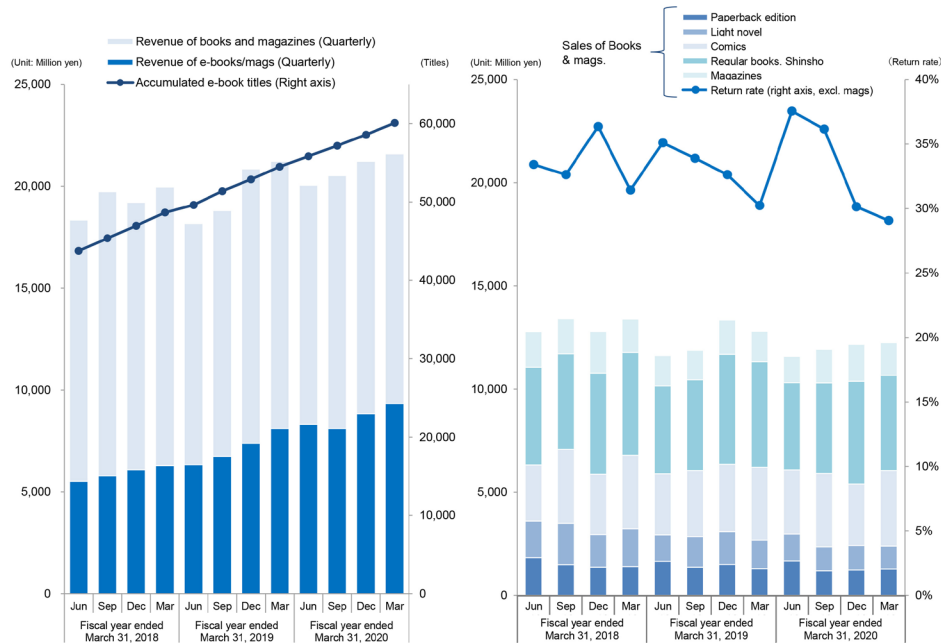
Publication business reported ¥117,303mn in revenue (+1.2% YoY) and ¥6,248mn in operating income (-13.9%). Costs rose by about ¥600mn due to an accounting change that shifted about ¥900mn in overall shared costs to business segments (allocated proportionally by sales share). Real profit decline (excluding this factor) hence was about 5%.

Results trends

Revenue improved on upbeat sales of e-books and e-magazines. External sales through Amazon and other sites rose 50% YoY, and the Company's BOOK☆WALKER store continued upbeat growth at a 30% increase. Dynamic marketing measures that take into account market trends have been successful, and this business climbed as a share of segment revenue from just over 20% in the previous fiscal year to just under 30%. In paper books, meanwhile, revenue modestly declined, similar to the overall market trend, despite healthy growth in comics, on struggling sales of paperbacks, separate volumes, and light novels.

Operating income dropped by about ¥400mn on a real basis, mainly due to upswing in logistic costs for paper books. Shortfall versus guidance occurred due to increase in sales promotion costs accompanying stronger sales of e-books and e-magazines. While the return rate for paper books was high through 2Q, it improved to the 30% level from 3Q. In magazine business, the Company is making healthy progress in conversion of the business model, such as the transition to Web media. The return rate improved, and advertising revenue from Web media is rising.

Publishing business results



Source: The Company's results briefing materials

(2) Video and Game business

Video and Game business booked ¥48,314mn in revenue (+0.04% YoY) and ¥3,401mn in operating income (-13.2%). Video business had robust income from rights licensing in North America and China for animated content and generated income from rights licensing that utilizing IP in collaborations with online games distributed by other companies. Nevertheless, theater income from the "Fukushima 50" movie that had blockbuster potential was sluggish due to COVID-19 impact. The Video business alone delivered higher revenue and profit on upbeat rights licensing.

Results trends

Game business, meanwhile, provided a large income contribution on a major hit with “SEKIRO: SHADOWS DIE TWICE,” which the Company released simultaneously worldwide on March 22, 2019. This title won the Game of the Year award at The Game Awards 2019, which is known as the Academy Awards of the game industry in the US. However, game revenue declined because of sluggish sales of the smartphone app game released in October 2019.

(3) Web Services business

Web Services business reported ¥24,739mn in revenue (-4.3% YoY), continuing a downward trend, and ¥2,788mn in operating income (vs. a ¥2,576mn loss in the previous year), restoring a profit for the first time in three years. Despite an ongoing decline in niconico premium members for mainstay video service to 1.63 million people at end-March 2020 (down by 170,000 people YoY), the pace is modestly easing at the QoQ level and member volume had a net increase (MoM) in March 2020. Nevertheless, fee-paying registered members for niconico Channel service steadily increased to 1.17 million people (up by 220,000 people YoY). Internet events, such as no-audience live shows and official live broadcasts, in particular, performed well in March 2020 amid suspension of real events.

Live business recorded all-time high attendance at niconico Chokaigi 2019 held in April 2019 and narrowed losses with cost controls. Animelo Summer Live 2019 -STORY-, the world’s largest Anison live event held in Aug–Sep 2019 attracted 84,000 people over three days and lifted income. The Company opened satellite studio “Hareza Studio” in Ikebukuro in November and is moving forward with new initiatives, such as holding live performances with virtual characters that employ the latest technologies aimed at realizing integration of Internet, real, and virtual environments and conducting animation and game-related stage events.

In earnings, cost savings from business structural reforms implemented by DWANGO in the previous fiscal year were the main contribution to improved profit. Outsourcing costs, communication costs, and depreciation costs dropped. Other profit boosts came from stronger participation in no-audience live events and Internet events in March than planned and lower new investment costs in video service business than expected.

(4) Others

Others reported ¥19,497mn in revenue (-11.9% YoY) and a ¥2,583mn operating loss (vs. a ¥2,613mn loss in the previous fiscal year).

Despite upbeat momentum in education business driven by income contributions from school operator Vantan Inc. and DWANGO, sales slipped on delayed releases of idol CDs and other content, decline in goods sales in MD business, and removal of subsidiary MAGES.

Earnings were roughly on par with the previous year, including pressure from continued upfront investments in new businesses at Tokorozawa Sakura Town.

Shortfalls versus guidance stemmed not only from suspensions and postponements of CDs and various goods sales under MD business due to COVID-19 impact in revenue but also from lower revenue in MD business and heavy outlays of advertising and promotional costs to recruit students from FY3/21 in education business in earnings.

Results trends

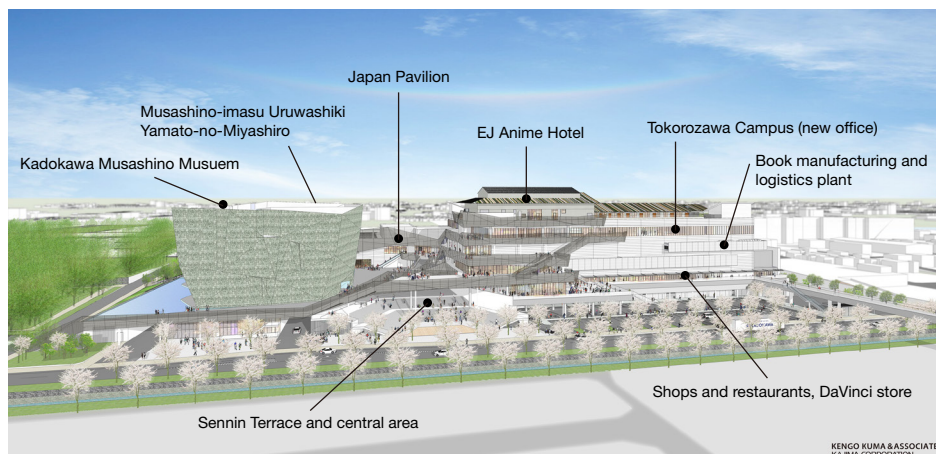
Grand opening of Tokorozawa Sakura Town postponed until November 2020

3. Financial condition and management indicators

Looking at financial conditions at end FY3/20, gross assets were up by ¥2,923mn from end-FY3/19 to ¥242,995mn based on a ¥5,056mn drop in current assets and a ¥7,980mn increase in fixed assets. Current assets had an increase in cash and deposits of ¥1,283mn, but a decline in promissory notes received and accounts receivable of ¥8,421mn. Fixed assets, meanwhile, had a ¥9,582mn rise in tangible fixed assets with progress in the Tokorozawa Project (Tokorozawa Sakura Town*) and a ¥2,588mn decline in investment securities value.

* This is the centerpiece site of the COOL JAPAN FOREST Vision (Joint project between the Company and Tokorozawa city), which aims to generate cutting-edge culture and industry in a location with rich greenery and disseminate them to the world. It includes a book manufacturing and logistics plant, new office space, event space, an anime hotel, shops, restaurants, and commercial facilities operated by the Company, and Kadokawa Musashino Museum, a cultural multifaceted facility, managed and operated by Kadokawa Culture Promotion Foundation. The total budget is ¥39.9bn.

Conceptual image of Tokorozawa Sakura Town



Source: From the Tokorozawa Sakura Town web page

Total liabilities dropped by ¥1,040mn from end-FY3/19 to ¥135,620mn, mainly on decline of ¥2,829mn in promissory notes payable and accounts payable and increases of ¥1,660mn in unpaid amounts, ¥613mn in early payments received, and ¥527mn in deposits under current liabilities and declines of ¥299mn in deferred tax liabilities and ¥321mn in liabilities related to retirement benefits under fixed liabilities. Interest-bearing debt was roughly flat with an increase of just ¥6mn to ¥65,524mn.

Net assets increased by ¥3,964mn from end-FY3/19 to ¥107,375mn. Even with outflow of ¥1,297mn in dividend payments and ¥3,003mn in share buybacks, the Company reported higher retained earnings on ¥8,098mn in profit attributable to owners of parent.

In management indicators, the Company's capital ratio, which reflects soundness, climbed by 1.1ppt from end-FY3/19 to 43.3% and the D/E ratio (interest-bearing debt/capital) modestly improved on a 0.01ppt drop to 0.62x. We think the Company retained financial soundness since it has more than ¥9bn in net cash (cash and deposits – interest-bearing debt). Additionally, in profitability, operating margin shifted to an upturn with a 2.7ppt YoY gain to 4.0% on substantial improvement in Web Services profit, as explained above, and ROE and ROA increased too.

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Results trends

Capital investments totaled ¥15,381mn on a cash basis in FY3/20. Investment outlays for Tokorozawa Sakura Town are scheduled to peak in FY3/21, when the Company completes the new site. Depreciation costs, which temporarily declined in FY3/20, hence should increase from FY3/21. While the Company initially planned the grand opening of Tokorozawa Sakura Town in July 2020, it postponed the timing until November 2020 due to the COVID-19 situation. Depreciation costs might fluctuate depending on the timing of the opening.

Consolidated balance sheet

	FY3/19	FY3/20	Change	Main factor	(¥mn)
Current assets	148,975	143,919	-5,056	Cash and deposits +1,283, Notes and accounts receivable -8,421, Deposits paid +475, Inventory assets -314	
(Cash and deposits)	73,597	74,880	1,283		
Non-current assets	91,096	99,076	7,980	Tangible non-current assets +9,582, Intangible non-current assets -450, Investment securities -2,588, Deferred tax assets +1,574	
Total assets	240,072	242,995	2,923		
Current liabilities	65,325	65,176	-149	Notes and accounts payable-trade -2,829, Unpaid amounts +1,660, Deposits received +527, Advances received +613	
Non-current liabilities	71,335	70,444	-891	Deferred tax liabilities -299, Retirement benefit liability -321	
Total liabilities	136,660	135,620	-1,040		
(Interest-bearing debt)	65,518	65,524	6		
Net assets	103,411	107,375	3,964	Capital surplus -18,296, Retained earnings +25,107, Treasury shares -2,699	

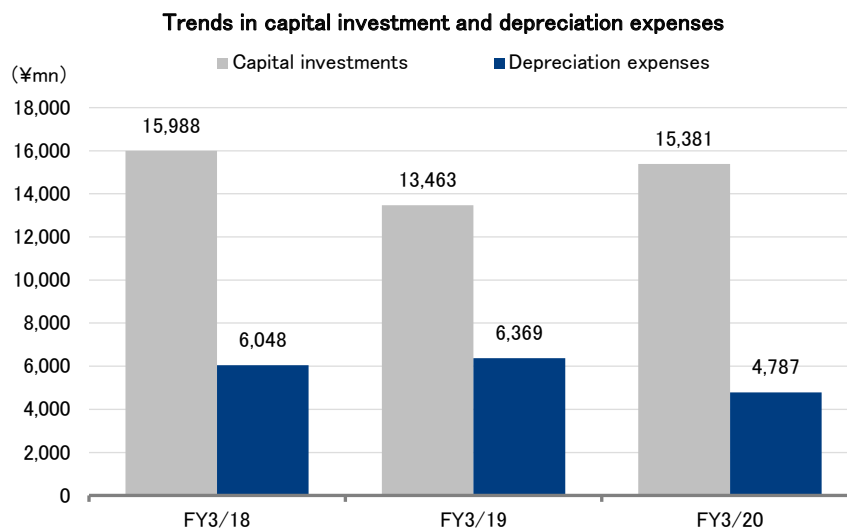
Source: Prepared by FISCO from the Company's financial results

Management indicators

	FY3/19	FY3/20
Financial soundness		
Current ratio	228.1%	220.8%
Equity ratio	42.2%	43.3%
D/E ratio	0.63	0.62
Profitability		
ROE	-3.9%	7.8%
ROA	1.8%	3.6%
Operating margin	1.3%	4.0%

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

Results trends



Cash-basis values for capital investments
 Source: Prepared by FISCO from the Company's results briefing materials

■ Outlook

Plans to promptly disclose FY3/21 guidance after assessing COVID-19 impact

1. FY3/21 outlook

Given uncertainty about when the COVID-19 outbreak might settle down and the need to assess the impact of changes in the business environment on results, the Company plans to promptly disclose FY3/21 consolidated guidance after it clarifies these points. In expenses, while it is likely to incur higher depreciation costs, other expenses (particularly personnel expenses) should be roughly on par with the previous fiscal year.

The Company saw positive and negative aspects to the COVID-19 situation as of late May 2020. Positives include increased utilization of its past contents and improved sales opportunities for digital-related businesses (such as Web Services, e-books and e-magazines, and Game business) due to the “stay home” phenomenon. Negatives, meanwhile, are delays in production and publishing schedules because of interruptions to work that requires real-world interaction in content production (such as studio recording and other final processes), postponement of sales timing accompanying delays in MD product and part procurement that relies on imports, decline in orders related to curtailed sales and restrictions on sales activities, suspension of real-world events, stalled trends in restaurant, travel, and inbound businesses, and temporary sluggishness in overseas markets.

Regarding impact on Tokorozawa Sakura Town, the Company delayed the grand opening until November 2020 and is currently assessing qualitative and quantitative implications. It plans to vacate the No. 3 headquarters building (Iidabashi, Tokyo), which it is leasing, during 2020 once the new Tokorozawa office opens. This change should provide savings of ¥1.2bn annually in leasing fees.

Initiatives include promotion of DX-driven business structural reforms, IP creation, reinforcement of digital-related businesses, and revisions to unprofitable businesses

2. Business policies

(1) Fundamental policies

The Company has presented the following three fundamental policies for FY3/21.

- a) Respond to business situations based on risk of prolonged COVID-19 issues
- b) Rigorously manage business with top priorities on health, reliability, and safety
- c) Approach changes in the environment as opportunities and further promote DX-driven business structural reforms

While the Company was already addressing DX initiatives as a fundamental strategy in the medium-term management plan, it believes that the COVID-19 situation brought the anticipated wave of digitalization forward by 2–3 years and hence intends to accelerate DX-driven business structural reforms, including response to these changes in the market environment.

(2) Priority measures

The Company presented the following five priority measures.

- a) Reinforcement of IP creation business and digital-related businesses (direct digital content distribution, services for digital content distributors, and EC (D-to-C))
- b) More advanced telework and expansion of digital processes in production and logistics operations and preparation operations (launching the new Tokorozawa plant)
- c) Restructuring event business and inbound business (despite difficulty holding conventional events, including shows, this remains a strategic business area)
- d) Exit from unprofitable businesses
- e) Enhanced commitment to SDGs

3. Initiatives by business segments

(1) Publication business

In Publication business, even though some bookstores suspended operations in April (such as bookstores located in commercial facilities) and this affected paper books, the Company expects continued upbeat momentum in e-books and e-magazines and intends to increase the number of Born Digital books*, while steadily cultivating talented authors through the Kakuyomu novel submission site and other efforts in FY3/21. It aims to promote a media mix strategy and creation of new IP and pursue improved profitability via reduction of the return rate and other measures. Additionally, it plans to begin operation of the new Tokorozawa plant in around fall 2020. FISCO expects manifestation of the new plant operation effect in earnings from the latter half of FY3/22 once it exhausts the upturn in depreciation costs, though this depends on the actual operating rate.

| * This refers to contents that are produced as digital data from the outset. |

Outlook

(2) Video and Game business

In Video business, while the COVID-19 situation is not affecting overseas animation rights licensing, the Company anticipates impacts from postponement in release timing of scheduled films and in other areas and also sees near-term pressure on earnings from delays of some titles that are currently in production.

In Game business, meanwhile, negative impact has been minor. The Company is already promoting telework operations for software development. Furthermore, in FY3/21, Spike Chunsoft is slated to release “Cyberpunk 2077” (PS4 package version; developed by Poland-based CD PROJEKT RED) in September 2020. The Company intends to conduct overseas sales of new software that utilizes collaborative IP.

(3) Web Services business

In Web Services business, business structural reforms largely finished in FY3/20, and the Company plans to make new investments to expand revenue in FY3/21. However, it is currently assessing investment timing because of uncertainty about COVID-19 impact. The Company intends to carefully assess investment efficiency in determining whether to ramp up new businesses.

In niconico Douga video community, the Company plans to bolster contents and steadily accumulate fee-paying registered members in light of favorable response to online live events and other content provided in official live broadcasts from mid-March.

(4) Others

In Others business, the Company intends to strengthen education business, rebuild inbound business, and revamp operations, including possible exits from unprofitable businesses.

In education business, the number of students at N High School, which is operated by KADOKAWA-DWANGO Educational Corporation, expanded sharply, doubling to about 14,000 people as of April 2020 over two years (vs. about 7,000 people in April 2018). Recent success by figure skater Rika Kihira, who attends the school, raised awareness of the benefits of correspondence high school that lets people learn without constraints on time and deepened the understanding of guardians. This led to a large rise in students directly entering the school after graduating from middle school. We think steady openings of new school course campuses each year from eight sites in April 2018 to 13 sites in April 2019, and 19 sites in April 2020 helped too. Since N High School results are outside the scope of the Company’s consolidated results and the Company books system usage fees for N High School, increase in student volume provides additional income. Furthermore, provision of high-quality education service that incorporates accretive learning and other techniques contributes to SDGs.

■ Medium-Term Management Strategy

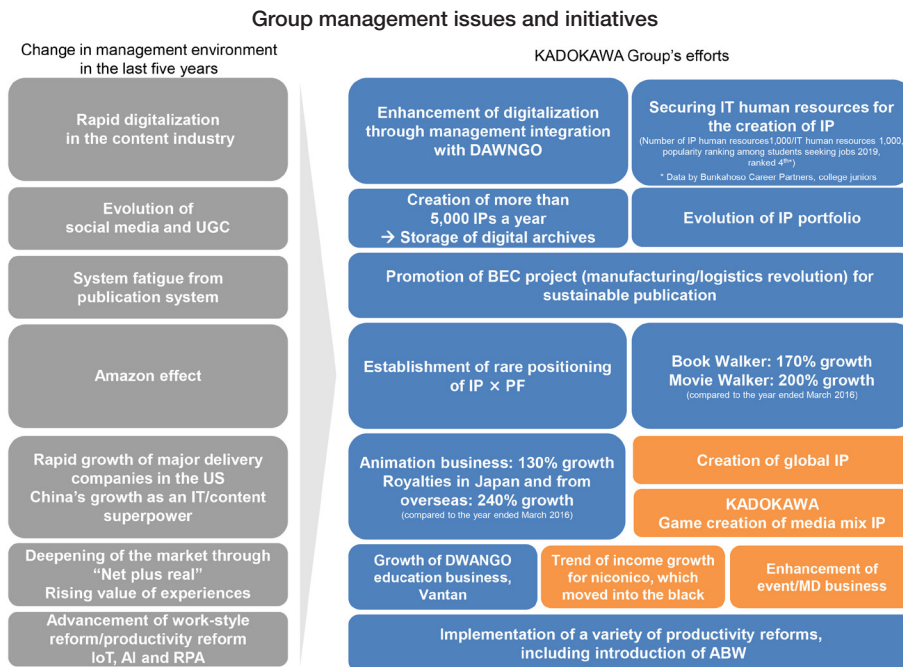
Aims to expand profits with a growth engine of IP “creation x rollout x experiences”

1. Initiatives addressing changes in the business environment

The market environment has changed significantly with rapid inroads by digital conversion of the contents industry, the Amazon effect, growth in video distribution providers utilizing the Internet led by Netflix <NFLX>, expansion of the Chinese market, and system fatigue for the traditional publishing system. The Company’s group is promoting various initiatives to ensure sustainable growth and enhance enterprise value.

Specifically, the Company is striving to bolster its digital platform through integration with DWANGO, acquire IP creative and IT human resources, solidify a sales platform for e-books and e-magazines, and maximize IP income with a media-mix strategy. As DX initiatives, it is promoting productivity reforms in various areas, such as introduction of ABW* as a new work style and implementation of the BEC project in Publishing business (manufacturing and logistics reforms).

* ABW (Activity Based Working) is an approach that selects the space, desk, and other details in accordance with the work content. It refers to flexible selection of locations for work, such as a quiet room for tasks requiring concentration and a sofa for meetings.



Source: The Company's results briefing materials

Through operation of the new Tokorozawa plant, targeting digital short-run in book production and logistics as well as production and shipping at optimal times and in optimal amounts

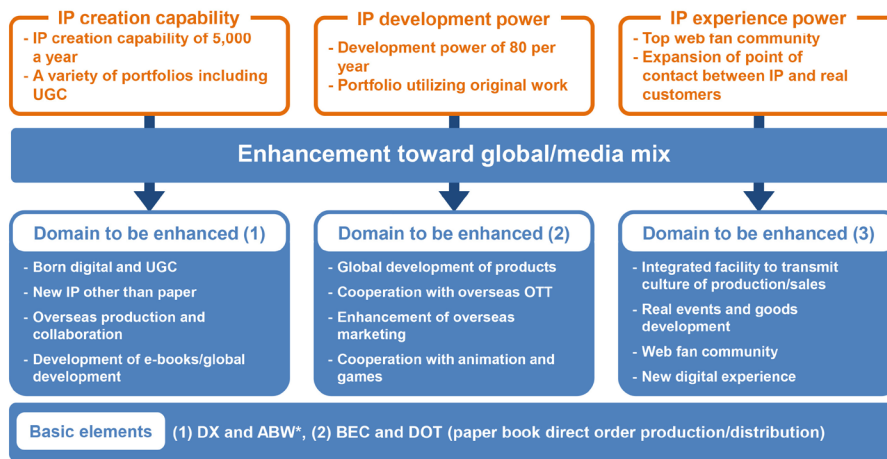
2. Fundamental strategy

The Company aims to integrate creation, rollout, and experiences for IP, its strength, and pursue global rollout under a media mix strategy as its fundamental strategy to realize growth. For example, it aims to offer attractive IP in animated video and game formats, deploy these contents globally, and strengthen collaboration with overseas platform operators (including co-creation of contents). It also wants to broaden contact points through provision of various experience opportunities for the IP worldview, including real events, merchandise, and Web-based fan communities. With promotion of DX initiatives, it hopes to accelerate rollout speed of these activities.

Fundamental strategy for the Company's group: Global media mix

Basic strategy:

- (1) Deliver IP via animation and games globally
- (2) Experience the perspective of the IP world through original work/events/goods/web



* ABW = Activity Based Working

Use DX for acceleration, connecting IP to the world

Source: The Company's results briefing materials

Looking at the Company's growth cycle flow, it creates IP totaling 5,000 publications and 80 video works annually, retains IP contents in its archive (110,000 paper books, 60,000 e-books, and 2,000 video works), and sells contents over its own platform and other company platforms. It aims to expand the digital contents market by advancing these business models (subscription, dynamic pricing, etc.) and promoting global business (international collaborative creation, alliances, etc.). The Company wants to bolster the profitability of its archives and drive platform growth through advances in its platform along with pricing effect, contents exposure effect, and non-inventory sales expansion effect.

(1) DX reforms

The Company formed a DX strategy headquarters and is setting goals and promoting initiatives for specific fields to promote DX. Below we review detailed measures and goals.

Medium-Term Management Strategy

a) ID and data utilization field

The Company aims to “strengthen customer experience” by promoting horizontal collaboration by the marketing division and to improve advertising and sales promotion cost efficiency with digital marketing.

b) Manufacturing and logistics reform field

The Company hopes to lower the return rate to the 20% range in the medium-term (vs. the 30% range in FY3/20) by ramping up a new plant that supports digital short-run and optimized production and shipment timing and volume in the book production and logistics process around the fall of 2020 (warehouse operation scheduled to begin on December 29, 2020).

c) EC and Internet services field

The Company wants to maximize revenue, further expand EC members (from 3.5 million people), and bolster cross-border EC by sharing store operation knowhow and strengthening the fee model.

d) Magazines and Web media field

The Company hopes to improve the magazine return rate and raise MAU by setting and analyzing KPIs and promoting business model reforms. For “The Television,” it achieved an average return rate in the lower half of 20% range and successfully expanded PV volume eightfold for the Web version over two years. Management aims to apply this knowhow horizontally to other areas.

e) ABW and office reform field

The Company wants to enhance labor productivity and increase work efficiency using AI, RPA, and other capabilities through deployment of a satellite office and remote work system and initiatives to assist ICT rule adoption and companywide DX implementation. In labor productivity, it plans to steadily return 5,000 tsubo of existing leased space in Iidabashi and Ginza areas following the launch of its new Tokorozawa office in November 2020 and thereby lower rent and other fixed costs by ¥1.2bn, versus FY3/19, in FY3/23. It also aims to improve system cost and outsourcing cost efficiency by 20%, compared to FY3/19, through application of AI, RPA, and other capabilities.

(2) Global initiatives

The Company wants to raise the overseas sales ratio by rolling out books, animation, games, and other IP contents to countries worldwide, particularly in North America and China. Business strategies include creation of new IP, consolidation and global rollout of promising domestic and overseas IP contents, and promotion of industry-wide DX and global platform deployment. The Company’s animation, games, and other contents are well received globally too, and management wants to conduct not only licensing sales, but also actively promote joint creation and other collaboration with major platform operators.

Promoting “expanded scale of core businesses” x “management approach with emphasis on ESG and SDGs” x “enhanced profitability”

3. Management numerical goals and individual strategies

(1) Management numerical goals

The Company's management numerical goals for FY3/23 are ¥240bn in revenue, ¥15bn in operating income, and 6.3% operating margin. While it is promoting “expanded scale of core businesses” x “management approach with emphasis on ESG and SDGs” x “enhanced profitability” to achieve these goals, the Company might modestly revise goals for the final fiscal year along with its disclosure of FY3/21 guidance, due to COVID-19 impact and delay of the new Tokorozawa plant launch by a few months in FY3/21.

Management numerical goals

	(¥bn)		
	FY3/20 forecast	FY3/20 results	FY3/23 target
Revenue	207.0	204.6	240.0
Operating income	10.0	8.0	15.0
Operating margin	4.8%	4.0%	6.3%

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

The initial medium-term management plan relied on Publication business and Video & Game business for the majority of revenue increase and took a conservative view of Web Services business. It also anticipated build-up of inbound business (event revenue, hotel business, etc.) from the opening of Tokorozawa Sakura Town in November 2020. Earnings, meanwhile, might encounter a temporary dip in FY3/21 because of higher depreciation costs with the new plant launch and the Tokorozawa Sakura Town opening as well as likely impact from COVID-19.

For Publication business, the Company expects cost savings from reduction of the return rate to offset increase in depreciation expenses and factors in growth in e-book and e-magazine business and rights licensing income. It forecasts a rise in operating margin from FY3/20's 5.3% in FY3/23. Similarly, it aims to raise operating margin in Video & Game business from FY3/20's 7.0% through global IP growth, expansion of original games, and gains in animation rights licensing revenue. In Others, it wants to reach profitability in FY3/23 through expansion of educational business, reduced losses with ramp-up of inbound business, and profits in e-sports business.

(2) Individual strategies

a) Publication business

Key strategies in Publication business are strengthening Born Digital and UGC (User Generated Contents) such as Kakuyomu Loyalty Program), creating new IP other than for paper-based contents (Vtuber and WEBTOON* development and original video and game development), promoting overseas local creation and joint creation with overseas companies, and ramping up e-book business and global business (simultaneous global comic launches and BOOK☆WALKER global rollout).

| * WEBTOON is a type of digital comic. |

Medium-Term Management Strategy

b) Video and Game business

Key strategies in Video & Game business are developing global works (invitations to global human resources and collaboration with global companies), collaborating with overseas OTT* (large-scale licensing and joint creation and establishment of and investment in an animation studio), strengthening overseas marketing (establishment of new overseas sites and reinforcement of marketing personnel), and promoting collaboration between animation and games (development of animation IP games, etc.).

| * OTT (Over the Top) refers to a service provider that distributes videos, voice, and other contents over the Internet. |

c) Web Services business, Others

For Others, the Company is launching Tokorozawa Sakura Town, an integrated facility to promote publishing culture, promoting real events & goods (planning and development that factors in global rollout and reinforcement of contact points with customers, including the complex type entertainment shop Anime Deck and Hareza Studio), strengthening the fan community for web services (expansion of the niconico Channel), and offering new digital experiences (educational business growth, subscription service development, etc.).

ESG and SDGs initiatives

The Company also pursues management practices that factor in ESG concepts and SDGs. ESG is an acronym for Environment, Social, and Governance and refers to concepts that companies need to address in order to realize long-term growth. Even institutional investors recently have increasingly placed emphasis on ESG initiatives as a standard in assessing investments in companies. SDGs is the acronym for Sustainable Development Goals that consist of 17 development goals needed to realize a sustainable society adopted at the United Nations Summit in 2015. Themes cover a wide range of issues that include poverty, health, education, energy, and the environment. A growing number of companies are setting goals that apply to their business scope from SDGs and clarifying ways in which they contribute to attainment of these development goals.

The Company is promoting SDG-related activities too. As initiatives in existing businesses that factor in sustainability, it is curtailing consumption of paper resources through production and logistical reforms (thereby reducing waste and cutting forest and water resource consumption) and expanding N High School and other online studying programs (provision of educational opportunities and severing of the poverty cycle). The new Tokorozawa plant, which is scheduled to begin operating from November 2020 should substantially advance curtailment of paper resource consumption through production and logistical reforms. This is because digitalization of production and logistical processes at this plant should enable manufacturing of the optimal amounts at the optimal times.

New initiatives to accommodate SDGs include enlisting women and people with overseas backgrounds as directors (promoting leadership by women and equal opportunity) and opening Tokorozawa Sakura Town with the new Tokorozawa office and cultural facilities (giving consideration to diverse work styles, local economies, and the natural environment). The Company aims to build a seamless work style as a diverse approach to work. At the Tokorozawa campus slated to open in November 2020, it has arranged unique office space for Japan with 2,600 tsubo per floor that offers anticipated benefits of deepening creativity and contributing to sustainability and the BCP (business continuation plan). It hopes to deepen creativity through provision of a relaxed office and nearby environment and fostering interaction with visitors to Tokorozawa Sakura Town and promote development of contents for a global audience. The Company plans to define priority issues related to SDGs during FY3/21 and then promote achievements in these areas.

■ Shareholder return policy

Plans to disclose the FY3/21 dividend along with guidance

The Company sees returning profits to shareholders as an important management issue while also bolstering corporate capabilities and retaining profits to fund future business initiatives. It has continuously distributed profits in light of earnings in each period and appropriately implemented share buybacks, as necessary, too. It acquired 1.89mn shares (2.99% of shares excluding treasury shares) for about ¥3bn in an off-auction own share repurchase (ToSTNeT-3) in August 2019 and paid a ¥30.0 dividend (+¥10.0 YoY) in FY3/20, putting the dividend payout ratio at 23.1%, because of profit recovery. This was the first dividend hike since the merger with DWANGO in FY3/15. The Company plans to disclose the FY3/21 dividend along with guidance.

The Company's shareholder gift program covers shareholders who own 100 or more shares for at least a year (recorded in the shareholder register at least three straight times under the same shareholder number). Qualified shareholders select one of the gift items from a catalog*. The program offers additional gifts to shareholders for three years or longer (recorded in the shareholder register at least seven straight times under the same shareholder number) as a long-term special incentive.

* Choices for shareholder gifts at end-FY3/19 were a book and other publication, a DVD, a movie advance ticket gift card, a BOOK☆WALKER gift card, or a tote bag.

■ Information security measures

The Company is developing web services as one of its main services, and to ensure information security, it is implementing sufficient information security measures, including protecting personal information and conducting employee training. It implements various measures, both for software and hardware, to prevent unauthorized access of the in-Company network. In addition, it has established internal regulations for organizational, human, physical, and technical safety measures, and it is implementing and managing the necessary and appropriate measures. Also, to protect personal information, it has established a privacy policy and is working to ensure compliance with it. Moreover, when the handling of personal information is outsourced, the Company conducts the necessary and appropriate monitoring of the relevant outsourcer.



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■ For inquiry, please contact: ■

FISCO Ltd.

5-11-9 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062

Phone: 03-5774-2443 (Financial information Dept.)

Email: support@fisco.co.jp