

# **KADOKAWA DWANGO CORPORATION**

**9468**

Tokyo Stock Exchange First Section

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

## ■ Index

■ <b>Summary</b> .....	<b>01</b>
1. Revenue increased and profits decreased in FY3/17, although the results exceeded the Company forecasts .....	01
2. Outlook is for higher sales but lower profits in FY3/18 from the increase in strategic investment costs .....	01
3. Announced a new medium-term vision .....	02
■ <b>Company profile</b> .....	<b>03</b>
1. Company profile .....	03
2. History .....	03
3. Strengths and business risks .....	04
■ <b>Business overview</b> .....	<b>05</b>
1. The Web Services business .....	06
2. The Publication business .....	07
3. The Video and Game business .....	08
4. Others .....	08
■ <b>Results trends</b> .....	<b>08</b>
1. Overview of the FY3/17 results .....	08
2. Trends by business segment .....	10
3. Financial condition and business indicators .....	13
■ <b>Business outlook</b> .....	<b>16</b>
1. The FY3/18 results outlook .....	16
2. Outlook by business segment .....	16
■ <b>The new medium-term vision and the “Tokorozawa Sakura Town     (tentative name)” project</b> .....	<b>18</b>
1. New medium-term vision .....	18
2. Tokorozawa Sakura Town (tentative name) project .....	19
■ <b>Shareholder return policy</b> .....	<b>20</b>

## Summary

### Focusing on the new Web services scheduled for release in October 2017

KADOKAWA DWANGO CORPORATION <9468> (hereafter, also “the Company”) was formed in October 2014 from the merger of major publishing house KADOKAWA CORPORATION and DWANGO Co., Ltd., which manages one of Japan’s largest video community services, “niconico.” The Company is a comprehensive media provider with capability of both a mega-content publisher and a digital content platformer. The Company is developing a wide range of businesses, including books and e-books; magazines and advertisements; motion picture planning, production, and distribution; video community services; mobile content distribution; game software planning, development, and sales; online learning services; and the operation of vocational schools.

#### 1. Revenue increased and profits decreased in FY3/17, although the results exceeded the Company forecasts

In the FY3/17 consolidated results, revenue rose 2.4% year on year (YoY) to ¥205,717mn, while operating income fell 7.7% to ¥8,419mn, for an increase in revenue and a decrease in profits. There was a major increase in revenue in the Publication business, as in addition to the increase in sales of e-books and e-magazines, in the paper books business also, sales of books related to the movie “Your Name (Japanese title, Kimi no na wa)” and media-mix titles were strong. But the new investment in the Web Services business had an effect on profits. However, both revenue and profits exceeded the revised forecasts that the Company had announced in November 2016, as results in the Publication business trended favorably in 2H also.

#### 2. Outlook is for higher sales but lower profits in FY3/18 from the increase in strategic investment costs

The outlook for the FY3/18 consolidated results is for revenue to increase 3.1% YoY to ¥212,000mn and operating income to decrease 31.1% to ¥5,800mn, for higher revenue but lower profits. In October 2017, the Company plans to release a new version of niconico, of niconico (crescendo), including new services for smartphones. Due to the costs of its development and also investment in the Publication business toward the start of operations of its books manufacturing and distribution base, it expects to record strategic investment costs of ¥1,700mn. In addition, the Company is forecasting a decline in profits of ¥900mn in its existing businesses mainly because the positive effects from “Your Name” will have run their course, and revenue from the music distribution service will decrease due to a fall in the number of mobile members in the Web Services business.

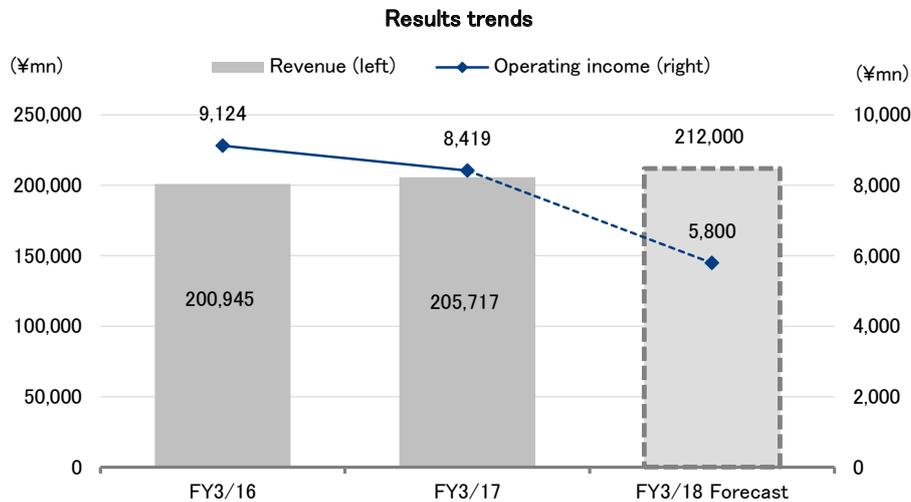
Summary

**3. Announced a new medium-term vision**

The Company has recently announced a new medium-term vision. Its policy is to expand its businesses while developing a media-mix strategy that fuses the Internet and the real world. What is in the spotlight at the current time is the release of niconico (crescendo) in October 2017. The Company is aiming for revenue growth from niconico by installing the world’s most advanced functions and providing attractive services. Also, in the Publication business, it intends to conduct test production and to optimize distribution toward the start of operations at the books manufacturing and distribution base in Tokorozawa-city, Saitama Prefecture, which is expected to contribute to strengthened profitability after it becomes operational in 2020. The Company did not announce medium- to long-term management numerical targets in the new medium-term vision, due to the difficulty in predicting the extent of the impact of the new Web services at the current stage. So the Company decided not to announce targets that would be highly uncertain. At FISCO, we expect that current upfront investment will lead to steady growth in the medium to long term because 1)the Company’s media-mix strategy will generate steady revenue, and it has accumulated related know-how, 2) in the Publication business, the start of operations of the books manufacturing and distribution base from 2020 will improve profitability to the next level, and 3) it has new growth potential from launching new Web services.

**Key Points**

- Focusing on the new Web services scheduled for release in October 2017
- Pursuing increased growth in the medium term through strengthening its media-mix strategy



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

## ■ Company profile

### Integration of a major publisher and a video service operating company

#### 1. Company profile

The Company is a joint holding company established on October 1, 2014, through a share transfer. It aims to create and grow new businesses in the fields of games, e-books, and the education business through leveraging synergies with the major publisher KADOKAWA and DWANGO, which is the operator of the leading Japanese video service “niconico.” It is developing a wide range of businesses, mainly books and e-books; magazines and advertisements; motion picture planning, production, and distribution; video community services; mobile content distribution; game software planning, development, and sales; online learning services; and the operation of vocational schools.

#### 2. History

The history up to the management integration goes back to October 2010, when KADOKAWA GROUP HOLDINGS, INC. and DWANGO Co., Ltd. formed a comprehensive business alliance for e-books and the distribution of various contents. In May 2011, the relationship progressed to a capital alliance, and in November 2011, they began providing the “KADOKAWA niconico A” service. The relationship between the two companies quickly became closer and they established an advertising joint venture, smileedge Co., Ltd. in March 2013 (liquidated in July 2015) and went as far as the integration in October 2014. In October 2015, the Company name was changed to Kadokawa Kabushiki-kaisha\* to emphasize management integration both internally and externally (but the English name remains KADOKAWA DWANGO CORPORATION).

\* KADOKAWA is a combination of the Japanese sounds in the names of the Group’s constituent companies, KADOKAWA and DWANGO (“KA” from KADOKAWA, followed by “DO” from DWANGO, which is pronounced “Do-wan-go” in Japanese, followed by “KA” from KADOKAWA, and “WA” from DWANGO.)

In May 2016, the Company acquired equity of 51% in Yen Press, LLC (hereafter, Yen Press)\*, which publishes translations of Japanese manga and graphic novels, and made it a consolidated subsidiary, with the aim of maximizing the growth potential of Japanese content in the North American market.

\* Yen Press is the English language publishing business of manga, graphic novels, and other publications that was spun-off by the Hachette Book Group, a major North American publishing company, in order to establish a joint venture with the Company.

#### History

Month and year	Major event
October 2010	DWANGO and KADOKAWA GROUP HOLDINGS entered into a comprehensive business alliance relating to e-books and the distribution of various contents.
May 2011	A capital alliance was concluded between KADOKAWA GROUP HOLDINGS and DWANGO.
November 2011	The KADOKAWA niconico A comic service, a collaboration between niconico Douga and BOOK ☆ WALKER, was launched.
March 2013	The advertising joint venture smileedge Co., Ltd. was established.
October 2014	KADOKAWA and DWANGO established the joint holding company KADOKAWA DWANGO through a joint share transfer.
October 2015	The Company changed its name in Japanese to Kadokawa Kabushiki-kaisha
May 2016	Yen Press, LLC (Delaware, the United States) was consolidated (the Company’s investment ratio, 51%)

Source: Prepared by FISCO from the Company website

Company profile

**History of KADOKAWA**

Month and year	Major event
November 1945	Kadokawa Shoten was founded.
September 1982	The magazine Weekly the Television was launched.
March 1990	The magazine Tokyo Walker was launched.
November 1998	KADOKAWA SHOTEN was listed on the Second Section of the Tokyo Stock Exchange.
April 2003	KADOKAWA HOLDINGS was established by an incorporation-style company split through the holding-company method.
September 2004	KADOKAWA HOLDINGS was listed on the First Section of the Tokyo Stock Exchange.
July 2006	KADOKAWA HOLDINGS changed its corporate name to KADOKAWA GROUP HOLDINGS.
October 2010	Entered a comprehensive business alliance with DWANGO for e-books and the distribution of various contents.
June 2011	Received a third-party allocation of shares of DWANGO for a capital increase.
June 2013	KADOKAWA GROUP HOLDINGS changed its corporate name to KADOKAWA CORPORATION.
May 2014	Concluded an integration agreement with DWANGO.

Source: Prepared by FISCO from the securities report

**History of DWANGO**

Month and year	Major event
August 1997	DWANGO was established to plan, develop, operate, and support network game systems, as well as to provide consultations.
April 2001	Established Composite Inc. with the objective of planning, developing, and managing content services for mobile phones.
November 2002	Made Composite Inc. a wholly owned subsidiary to strengthen the cooperation framework for content services for mobile phone users.
July 2003	Listed on the Tokyo Stock Exchange Mothers Market.
September 2004	Listing was transferred to the Tokyo Stock Exchange First Section.
April 2005	Made CHUNSOFT Co., Ltd. a subsidiary.
February 2006	Entered into a business and capital alliance with Avex Group Holdings Inc. <7860>
May 2008	Collaborated with Yahoo Japan Corporation <4689> on "niconico Douga," a video community service.
October 2010	Entered into a comprehensive business alliance with KADOKAWA GROUP HOLDINGS, INC. for e-books and the distribution of various contents.
June 2011	Conducted a third party allocation of new shares to KADOKAWA GROUP HOLDINGS, INC.
July 2013	Entered a business alliance with Nippon Telegraph and Telephone Corporation <9432>.
May 2014	Concluded an integration agreement with KADOKAWA.
December 2014	Made the education business operator Vantan Inc. a wholly owned subsidiary.

Source: Prepared by FISCO from the securities report

## Strengths are in maximizing earnings through accumulating expertise in developing IP in multimedia formats

### 3. Strengths and business risks

#### (1) Strengths

The Company's strengths include its ability to create unique services, including editing capabilities honed in the fields of publishing and videos, expertise in developing intellectual property (IP) across multimedia formats to maximize earnings, the generation of original network services based on advanced networking technologies, and the integration of these services with real-world events.

In the Web Services business, the Company is creating various UGC (User Generated Content) on niconico, and its contents-centered community is always active, focused on the users. In addition, in recent years it has been using the niconico Channel to enhance its content-development capabilities.

## Company profile

In the Publication business, the Company has a production system able to issue 5,000 new titles a year based on the editing capabilities accumulated over many years and its precise marketing and promotion capabilities. In e-books, it is achieving growth to the extent that “BOOK ☆ WALKER,” which it manages itself, has been positioned as the industry platform. Further, the novel posting site “Kakuyomu” has a total number of page views (PV) of more than 210 million\*, and the number of titles posted on it is trending upwards. Of these titles, in FY3/17, 55 were turned into books, which can be said to be one example of the actualization of the synergies from the management integration of IP and IT companies.

\* As of the end of March 2017

In overseas development also, the Company is actively creating overseas bases and conducting local businesses with translated publications and character merchandising business.

## (2) Business risks

Business risks can be considered to include shrinkage of the paper-based book market or slowdown of rapid growth of e-book market may exceed the Company's expectations in the Publication business, currently its largest earnings pillar.

In addition, if the Company were to lose market share due to the entry of new players in the Web Services business, which is expected to be an earnings driver in the future, it could have a negative impact on its earnings. Also, in the Video and Game business, there is the risk that profits will fluctuate greatly depending on if there will be hit titles or not.

## Business overview

### It is focusing on its Publication business, Web Services business, and Video and Game business

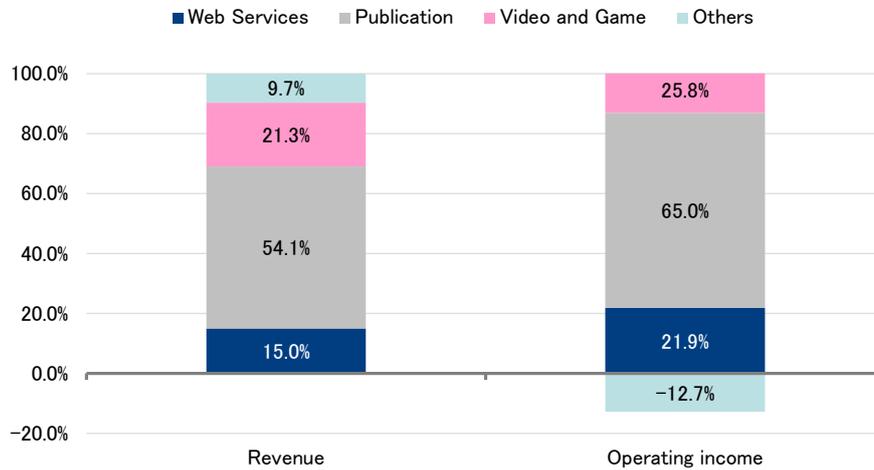
As of the end of March 2017, the Company Group was comprised of 46 consolidated subsidiaries, including KADOKAWA and DWANGO that conduct their businesses under the Company, which is the holding company, and 12 equity-method affiliates. The Group has three business segments, the Web Services business conducted by DWANGO, which mainly involves the provision of the “niconico” video service; the Publication business conducted by KADOKAWA for books, magazines, and other publications; and the Video and Game business for package sales of DVDs and other goods; the planning, production, and distribution of movies and other broadcasting programs; and also the development and sales of games. It also classifies its operations into the Others business segment that includes product sales and the education business\*. In FY3/17, the percentages of total revenue by segment (to external customers) were Web Services 15.0%, Publication 54.1%, Video and Game 21.3%, and Others 9.7%. The percentages of operating income were Web Services 21.9%, Publication 65.0%, Video and Game 25.8%, while Others recorded a loss. Currently, the majority of both revenue and operating income is provided by the Publication business, but going forward, it is forecast that the percentages provided by the Web Services business, which has high growth potential, will rise.

\* In order to clearly indicate the main business pillars in the Group, from FY3/17 the Company changed its reporting segments to “Web Services” (formerly Portal Business, Live Business, and Mobile Business), “Publication” (Books and IP Business, Information Media Business), “Video and Game” (Video and IP Business, and Game Business), and “Others” (Others and some businesses in Information Media).

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Business overview

**Percentages of revenue and operating income by business segment (FY3/17)**



Note: The percentages for revenue and operating income are before the deductions from internal adjustments.  
Source: Prepared by FISCO from the Company's financial results

**1. The Web Services business**

Setting DWANGO's video service "niconico" as the core, this business is comprised of live business of planning and operating various kinds of events and leasing event venues, often as a way to promote "niconico," and also a music distribution business for mobile devices.

The Company provides various services on its mainstay "niconico" website, including niconico Video Community, niconico Live, and niconico Channel. Sales include revenues from premium memberships that enable members to watch videos and live feeds comfortably, advertising revenues from website banners and so forth, and also revenues from points used to watch pay-to-view videos. As of the end of March 2017, it had issued IDs to 64.3 million people (up 8.89 million YoY) and it had 2.43 million premium members (down 130,000). Usage conditions in Q4 (January to March) were that there were 9.13 million MAU (monthly active users) and 3.30 million DAU (daily active users). In addition, the "niconico Channel," which is a platform on which companies, organizations, and users can deliver video and live broadcasts, had a total of 7,863 channels, of which 1,147 were monthly-fee channels, and the number of monthly fee-paying members had reached 590,000 people.

Business overview

In businesses other than “niconico,” the Company plans and manages live events, such as “niconico Chokaigi,”\*1 “Game Party”\*2, “Animelo Summer Live,” and “niconico Choparty”\*3. It also operates the live music venue “nicofarre,” a new entertainment format that realizes a fusion of the Internet and the real world, and the niconico showroom “niconico Honsha”\*4, which had its grand renewal opening in Ikebukuro, Tokyo, in October 2014, operating collaboration cafes for limited periods and live game events.

\*1 The largest “niconico” event held at Makuhari Messe with the concept of “recreating everything of ‘niconico’ on site.” All the participating users are the “lead actors” in the various events that integrate the Internet and the real world. The “2017 niconico Chokaigi” event was held on April 29 and 30, 2017, with 154,000 visitors to the venue and approximately 5 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. It was held on February 11 and 12, 2017, at Makuhari Messe, and it had 68,000 site visitors and 4,126,000 online visitors, and it is contributing to the expansion of the Japanese game market.

\*3 A large-scale stage event for niconico, which is Japan’s premium video service. It is niconico’s largest live event where users active on niconico in genres such as “This is me singing” and “This is me dancing,” and also famous artists, gather together and perform. It was held for the fifth time on Nov. 3, 2016, at the Saitama Super Arena, and was attended by approximately 15,000 people.

\*4 The “niconico” pilot shop is a complex facility comprising nicocafe, an event space, the nicobukuro studio, and the niconico shop. The grand opening was in Harajuku in April 2011, then transferred to Ikebukuro and renewed.

In the music distribution business, although member numbers are trending downward due to the decline in feature phone users and the shift to smartphones, it remains a highly profitable business for the Company. This business operates “dwango.jp,” which distributes single songs, ring tones(r), and so forth, as well as “animelo (songs from popular anime).”

**2. The Publication business**

In this business, which is KADOKAWA’s mainstay business, the Company publishes and sells paper-based books, including separate volumes, pocket editions including graphic novels, and comics, as well as e-books. In addition to magazines including “Weekly the Television (TV information magazine),” “the Walker Series (town information magazine),” “Weekly Famitsu (game information magazine),” and “Lettuce Club (lifestyle information magazine),” and mooks (magazine style books), in this business, the Company also produces custom media such as “Hikari TV Guide”, as well as selling magazine and Internet advertising.

The paper-based book business provides a strong background for developing related products through its media-mix strategy, and the Company is an industry leader in graphic novels. It has considerable experience in working to achieve appropriate production and shipping based on marketing, and the rate of product returns in FY3/17 Q4 (January to March) was less than 30%, which was lower than the industry average\* of around 35%.

\* The sources of the industry indicators are the Publishing Monthly Report and Publishing Yearbook published by the All Japan Magazine and Book Publisher’s and Editor’s Association and Research Institute for Publications.

At the same time, the Company sells e-books directly on BOOK ☆ WALKER, its own e-book distribution platform, and at external e-book stores, including Amazon Kindle and Rakuten Kobo. It also conducts sales promotions, such as the “niconico Kadokawa Festival\*.”

\* It was first held in October 2014 to commemorate the management integration of KADOKAWA and DWANGO, and it has been held every fall since then.

It conducts various promotions linking KADOKAWA’s contents and niconico’s services, and in addition in 2016 (from Oct. 1 to Oct. 31), it carried out a large scale campaign linked to the online shop.

## Business overview

Advertising revenue from magazines and mooks has continued to slump because mainstay advertisement media is changing from paper-based to digital, and the current profit environment is harsh. Therefore, to deal with this environment, the Company is currently streamlining its operations while actively taking steps to digitization.

### 3. The Video and Game business

This business includes sales of package software; the planning, production, and distribution of movies; sales of the copyrights to overseas versions of anime; and video distribution. In addition, Kadokawa Daiei Studio Co. and Glovision Inc. are developing the studio business. The Company is focusing on visualizing the Group IP generated in the Publication business and the Video and Game business and on producing and distributing live-action films and anime titles. It has also recently been working on video distribution and sales of anime copyright overseas.

In this business, the Company's five consolidated subsidiaries, FromSoftware, Inc., Spike Chunsoft Co., Ltd., KADOKAWA GAMES, LTD., MAGES. Inc., and KADOKAWA CORPORATION carry out the planning, development, and sales of packaged game software, network games, and app games. Previous hit titles include "Dark Souls", "Bloodborne (FromSoftware)", "Kantai Collection", "Derby Stallion GOLD (KADOKAWA GAMES)", "Kenka Bancho", "Danganronpa", "Shiren the Wanderer (Spike Chunsoft)", and "STEINS;GATE (MAGES)".

### 4. Others

Others comprises businesses such as e-commerce sales of character merchandise and pop idol CDs, copyright revenues and sales of CDs featuring content created from anime or "niconico." It also includes an education business involving the operation of Vantan which provides training to work in creative fields inside and outside of Japan, and also online learning services at N High School and other educational facilities.

## Results trends

### Revenue increased and profits decreased in FY3/17, although the results exceeded the Company forecasts

#### 1. Overview of the FY3/17 results

In the FY3/17 consolidated results, revenue increased 2.4% YoY to ¥205,717mn, operating income decreased 7.7% to ¥8,419mn, ordinary income declined 27.3% to ¥7,407mn, and profit attributable to owners of parent fell 15.8% to ¥5,767mn, for an increase in revenue but a decrease in profits.

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## Results trends

**Overview of the FY3/17 consolidated results**

(¥mn)

	FY3/16		Initial forecast	Revised forecasts (Nov. 2016)	FY3/17			
	Results	% of revenue			Results	% of revenue	YoY change rate	% of revised forecasts
Revenue	200,945	-	200,000	202,000	205,717	-	2.4%	1.8%
Cost of sales	141,144	70.2%	-	-	145,676	70.8%	3.2%	-
Gross profit	59,801	29.8%	-	-	60,040	29.2%	0.4%	-
SG&A expenses	50,676	25.2%	-	-	51,621	25.1%	1.9%	-
Operating income	9,124	4.5%	3,100	6,000	8,419	4.1%	-7.7%	40.3%
Ordinary income	10,189	5.1%	3,300	5,800	7,407	3.6%	-27.3%	27.7%
Profit attributable to owners of parent	6,845	3.4%	1,750	4,000	5,767	2.8%	-15.8%	44.2%

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

**Results by segment**

(¥mn)

	FY3/16		FY3/17		YoY	FY3/16	FY3/17
	Results	Revised forecasts	Results	Operating margin		Operating margin	
Revenue	Web services	33,136	32,000	31,275	-5.6%		
	Publication	105,199	109,000	113,012	7.4%		
	Video and Game	44,284	44,000	44,402	0.3%		
	Others	21,340	20,000	20,209	-5.3%		
	Eliminations/Corporate	-3,015	-3,000	-3,182	-		
	Consolidated total	200,945	202,000	205,717	2.4%		
Operating income	Web services	4,638	2,500	2,815	-39.3%	14.0%	9.0%
	Publication	6,282	6,900	8,342	32.8%	6.0%	7.4%
	Video and Game	3,614	3,200	3,312	-8.4%	8.2%	7.5%
	Others	-1,011	-1,600	-1,635	-	-4.7%	-8.1%
	Eliminations/Corporate	-4,399	-5,000	-4,415	-	-	-
	Consolidated total	9,124	6,000	8,419	-7.7%	4.5%	4.1%

Note: The revised forecasts were announced in November 2016

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

Revenue increased overall, as despite a fall in revenue from the Web Services business and Others, revenue in the Publication business rose 7.4% YoY from the continued growth of e-books and e-magazines and strong sales of media-mix titles. Operating income fell overall, reflecting declines in the Web Services business, the Video and Game business, and Others, despite rising significantly in the Publication business by 32.8%. Ordinary income declined sharply, mainly reflecting a loss of ¥535mn as equity in losses of affiliates recorded in FY3/17 after recording equity in income of affiliates of ¥675mn in the previous fiscal year under non-operating income and losses. A further factor was a ¥597mn YoY increase in donations. Nevertheless, as results in the Publication business also trended strongly in 2H, both revenue and profits exceeded the Company's initial plan and its upwardly revised forecasts of November 2016.

Results trends

## Profits in the Publication business increased significantly from the growth in e-books and e-magazines and the low product return rate

### 2. Trends by business segment

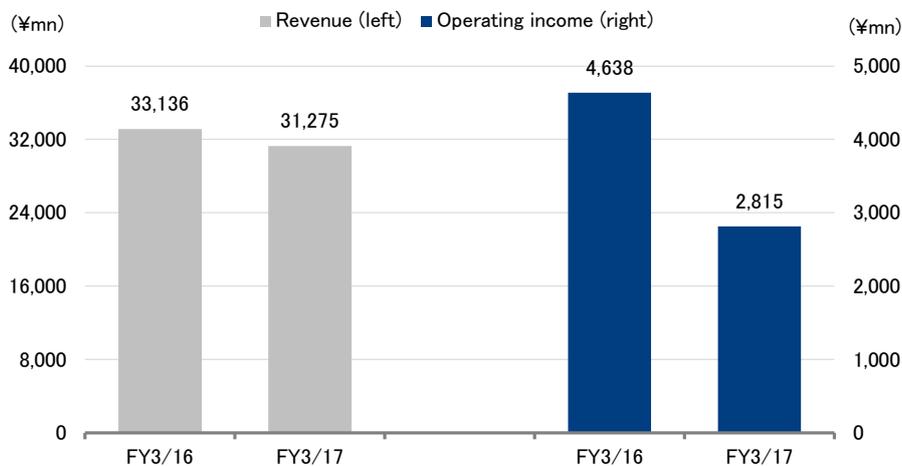
#### (1) Web Services business

In the Web Services business, revenue decreased 5.6% YoY to ¥31,275mn and operating income fell 39.3% to ¥2,815mn. In the mainstay portal business, the number of fee-paying “premium members” declined (down 130,000 on the end of the previous fiscal year to 2.43 million people), while advertising revenue also fell slightly due to the delay in responding to smartphones. But this was covered by the increase in the number of monthly fee-paying members (up 140,000 on the end of the previous fiscal year to 590,000 people), and revenue remained at basically the same level as the previous fiscal year. However, profits declined due to the higher costs from the renewal investment\* toward improving the niconico video services and for the costs of developing apps.

\* From Aug. 18, 2016, the Company increased the maximum size of the video file that could be posted onto the “niconico Douga” site from the previous 100MB (premium members) to a maximum of 1.5GB. From Oct. 27, it launched “HTML5 (β)” as a new page from which to watch videos that reduces the video playback waiting time. On Nov. 1, it began offering the “New Delivery (β)” service, in which users can distribute and view high definition videos of niconico live broadcasts at 1Mbps. In addition, it released the niconico live broadcast (delivery only) as a smartphone app (from October) and the “niconico ch” app (from November).

The Company has positioned the live business as a cost item due to its positioning as an advertising tool for the portal business. It held numerous events during this fiscal year, including “niconico Chokaigi 2016,” “niconico Machikaigi 2016,” “niconico Choparty 2016,” and “Game Party 2017.” Revenue declined only slightly YoY, but in profits, the loss increased because of the rise in production costs for “niconico Chokaigi 2016.” In the mobile business, the number of members of the music distribution service continued to decline for double-digit in revenue and profits, which accounted for the majority of the fall in profits in this business segment. In November 2016, the Company released “RPG Atsumaru,” as a posting community service for self-made games using “RPG Maker MV,” which was developed and is sold by the Company Group. “RPG Atsumaru” has proved very popular, with the total number of plays reaching 3 million times since the launch of the service.

The Web Services business revenue and segment operating income



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

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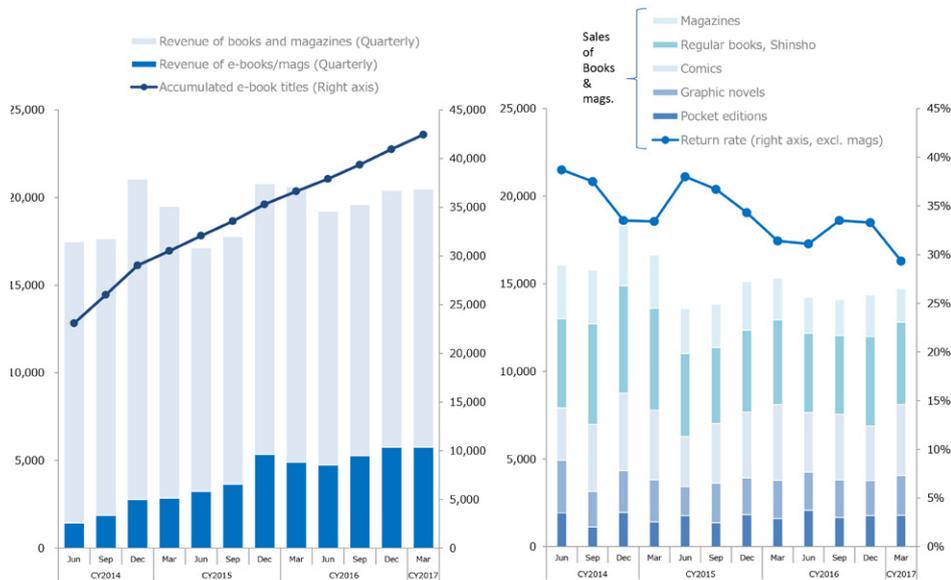
Results trends

**(2) The Publication business**

In the Publication business, revenue increased 7.4% YoY to ¥113,012mn and operating income rose 32.8% to ¥8,342mn, making it the Company's only segment to record both higher revenue and profits. Structural changes to the markets are occurring, as while the paper-books market is gradually contracting, the e-books and e-magazines markets are expanding. For the Company also, its e-books and e-magazines business continued to perform strongly and achieved its forecast of YoY double-digit increases in revenue and profits, and it is the driving force in this business segment.

Conversely, for paper books, while sales of books related to "Your Name" trended strongly and above forecast, popular media-mix titles, like "Sword Art Online", "Re:Zero –Starting Life in Another World", and "Kono Subarashii Sekai Ni Shukufuku Wo! (KonoSuba: God's Blessing on this Wonderful World!)," also performed well. Further, in terms of the genres of the hit titles, they have also spread to non-fiction and children's books in addition to those strong from the past like graphic novels, comics, and literature. The Company is building a mechanism to earn profits steadily while maintaining the number of new releases without depending on spontaneous major hits. Moreover, in addition to having established smooth coordination between the sales and editing teams, it grasps sales conditions at books stores and carries out the production and shipping based on highly accurate demand forecasts. As a result, in the current Q4, it kept down the product return rate to the low level of below 30%, which, alongside its efforts to reduce inventory, is contributing to the improvement in profitability.

The Publication business

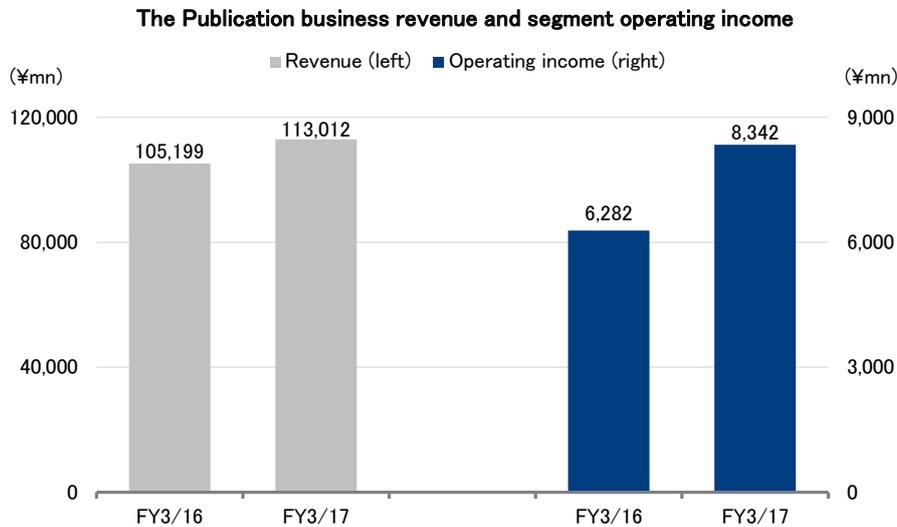


\*Revenue (quarterly) was the results for KADOKAWA CORPORATION before September 2014 and for KADOKAWA DWANGO CORPORATION after October 2014.

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

On the other hand, paper magazines have continued to record a loss due to the decline in advertising revenue, which is the source of earnings, and the Company has coped with the situation by changing its business structure. Specifically, it has been turning the mainstay Weekly the Television and Walker series to digital media, and tried to recover advertising revenue by introducing additional value. As a result, the size of loss made by paper magazines was made smaller.

Results trends



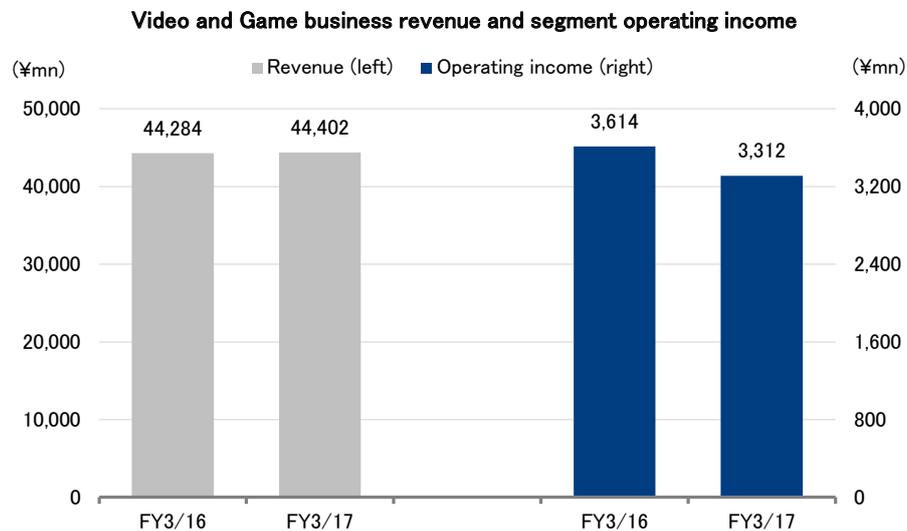
Source: Prepared by FISCO from the Company's results briefing materials

**(3) The Video and Game business**

In the Video and Game business, revenue increased 0.3% YoY to ¥44,402mn and operating income decreased 8.4% to ¥3,312mn. In the Video business, the distribution of revenue from the production committee of “Your Name” made a huge contribution, while domestic sales of video packages, particularly anime titles, performed strongly. Also, sales of licenses overseas, like “Bungo Stray Dogs” and “Handshaker,” enlarged profits to exceed the forecasts.

In the Game business, among the media-mix titles, sales were strong from series titles, like “Re:Zero –Starting Life in Another World -DEATH OR KISS-,” “Danganronpa,” and “Witcher.” Sales were also supported by download content of “DARK SOULS III,” and other royalty revenue, but revenue from social game titles slumped. Other factors driving the decline in profits are; 1)YoY contribution of “DARK SOULS III” became smaller, and 2)the launch timing of new social game titles was delayed to FY3/18 while the associated development costs were recorded in advance.

Results trends



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

**(4) Others**

In Others, revenue decreased 5.3% YoY to ¥20,209mn and the operating loss was ¥1,635mn (compared to an operating loss of ¥1,011mn in the previous fiscal year). Revenue fell from the decline in product sales, while in profits, research and development costs for inbound business, and investment costs for the education business made the loss bigger.

**Raising funds from borrowing for the construction of “Tokorozawa Sakura Town (tentative name)”**

**3. Financial condition and business indicators**

Looking at the financial condition at the end of March 2017, total assets were up ¥45,340mn on the end of the previous fiscal year to ¥246,949mn. Breaking this down, current assets increased ¥43,053mn and non-current assets rose ¥2,287mn. The increase in current assets was mainly due to the rise in cash and deposits of ¥44,738mn from implementing long-term borrowing. In non-current assets, tangible non-current assets and intangible non-current assets increased by ¥1,213mn and ¥1,845mn respectively, while other investment assets decreased by ¥770mn.

Total liabilities were up ¥38,142mn on the end of the previous fiscal year to ¥135,224mn. Current liabilities decreased ¥300mn, but non-current liabilities increased significantly, by ¥38,442mn. This is because long-term debt rose ¥37,899mn on the end of the previous fiscal year following the implementation of long-term borrowing\* in August 2016. The objective of the long-term borrowing is to supplement the funds for the construction of “Tokorozawa Sakura Town (tentative name)” (it will include a books manufacturing and distribution base, offices, and commercial facilities), which is a new project that the Company is progressing in Tokorozawa City, Saitama Prefecture.

\* The Company utilized the low interest rate environment, in which interest payments are lower than the fees for the borrowing commitment line, to conduct borrowing of ¥15,000mn (loan period, 7 years, interest rate: base rate + spread) so that it could secure long-term working capital. In addition, KADOKAWA also reviewed its existing borrowing of ¥10,000mn and commitment line agreement (upper-limit amount, ¥15,000mn), and with the aim of reducing monetary expenses, carried out prepayment and cancellation of the commitment line agreement and conducted borrowing of ¥25,000mn (same conditions as the Company).

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## Results trends

Net assets were up ¥7,198mn on the end of the previous fiscal year to ¥111,724mn. This was due to the increase in retained earnings of ¥5,541mn following the recording of profit attributable to owners of parent, and also a rise in accumulated other comprehensive income of ¥1,758mn, including from an increase in the market capitalization of shares held.

Looking at cash flow conditions, at the end of March 2017, cash and cash equivalents were up ¥38,965mn on the end of the previous fiscal year to ¥91,140mn. Cash flow from operating activities was ¥11,968mn, as an income tax payment of ¥2,362mn was absorbed by income before income taxes of ¥7,375mn and reductions in depreciation of ¥5,258mn and of accounts receivable of ¥3,444mn. Cash used in investing activities was ¥10,394mn from the expenditure to acquire tangible non-current assets (¥3,656mn) and intangible non-current assets (¥2,507mn), the increase in fixed deposits (¥4,560mn), and expenditure to acquire equity in a subsidiary following a change to the scope of consolidation (¥1,039mn). Cash flow from financial activities was ¥37,200mn from the long-term borrowing.

Looking at the management indicators, the equity ratio, which indicates financial soundness, fell from 51.4% at the end of the previous fiscal year to 44.5% from the increase in interest-bearing debt, while the current ratio rose from 214.5% to 285.9% due to the increase in cash and deposits from the long-term borrowing. The D/E ratio also rose from 0.28 to 0.61 because of the effects of the increase in interest-bearing debt. Compared to the previous fiscal year, the financial condition has worsened slightly, but net cash (cash and deposits minus interest-bearing debt) is a surplus of ¥37,962mn, and it can be judged that the Company is sufficiently maintaining financial soundness. Meanwhile, in the indicators of profitability, the operating margin fell from 4.5% to 4.1% and ROE from 6.6% to 5.4% due to the costs of upfront investment. Profitability is expected to continue to decline in FY3/18 also as the Company will continue to increase investment costs, but in the medium- to long-term, profitability is forecast to improve, particularly in the Web Services business and the Publication business.

**KADOKAWA DWANGO CORPORATION** | 3-Jul.-2017

 9468 Tokyo Stock Exchange First Section | <http://info.kadokawadwango.co.jp/english/index.html>

## Results trends

**Balance sheet, cash flow statement, and management indicators**

(¥mn)

	FY3/15	FY3/16	FY3/17	Change	Main change factor
<b>Current assets</b>	131,200	131,827	174,880	43,053	Cash and deposits +44,738, Inventory assets +762, Accounts receivable -3,444
(Cash and deposits)	63,207	60,804	105,542	44,738	
<b>Non-current assets</b>	74,473	69,781	72,068	2,287	Tangible non-current assets +1,213, Intangible non-current assets +1,845, Other investment assets -770
<b>Total assets</b>	205,673	201,609	246,949	45,340	
<b>Current liabilities</b>	63,316	61,459	61,159	-300	Short-term debt +445, Provision for returned products -870
<b>Non-current liabilities</b>	38,108	35,623	74,065	38,442	Long-term debt +37,899
<b>Total liabilities</b>	101,425	97,082	135,224	38,142	
(Interest-bearing debt)	31,598	29,376	67,580	38,204	
<b>Net assets</b>	104,248	104,526	111,724	7,198	Retained earnings +5,541, Capital surplus -1,077, Accumulated other comprehensive income +1,758

**Cash flow statement**

Cash flow from operating activities	7,765	6,733	11,968	
Cash flow from investing activities	-9,049	-4,673	-10,394	
Cash flow from financial activities	24,385	-8,775	37,200	
Cash and cash equivalents	59,201	52,175	91,140	38,965

**Management indicators**

## &lt;Financial soundness&gt;

Current ratio	207.2%	214.5%	285.9%
Capital adequacy ratio	50.2%	51.4%	44.5%
D/E ratio	0.3	0.28	0.61

## &lt;Profitability&gt;

ROE	22.5%	6.6%	5.4%
ROA	2.1%	5.0%	3.3%
Operating margin	1.4%	4.5%	4.1%

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

## Business outlook

### Focusing on the new Web services scheduled for release in October 2017

### By segment, revenue and profit are forecast to increase in the Video and Game business

#### 1. The FY3/18 results outlook

The outlook for the FY3/18 consolidated results is for higher revenue but lower profits, with revenue to increase 3.1% YoY to ¥212,000mn, but operating income to fall 31.1% to ¥5,800mn, ordinary income to decline 16.3% to ¥6,200mn, and profit attributable to owners of parent to decrease 39.3% to ¥3,500mn. The Company is forecasting that profits in existing businesses will decline ¥900mn following the end of the contribution to profits of the hit movie “Your Name”, and due to the slump in the mobile business. It also expects strategic investments costs for growth in the future to increase ¥1,700mn. The main reasons for the increase in investment costs will be 1)the upfront costs relating to the launch of the books manufacturing and distribution base that is scheduled to become operational in the spring of 2020, including the cost of test production and distribution optimization, 2)the cost of developing Web services, and 3)investment in the inbound business. The amount of the strategic investment costs that will affect P/L are ¥4,600mn in FY3/17 and ¥6,300mn in FY3/18. The same as in the previous period, results may be higher than forecast if hit titles appear among the books, videos, and games exceeding expectations.

#### Overview of the FY3/18 Company forecasts

	FY3/17				FY3/18			(¥mn)
	Results	% of revenue	YoY change rate	Compared to revised forecast	Forecast	% of revenue	YoY change rate	
Revenue	205,717	-	2.4%	1.8%	212,000	-	3.1%	
Operating income	8,419	4.1%	-7.7%	40.3%	5,800	2.7%	-31.1%	
Ordinary income	7,407	3.6%	-27.3%	27.7%	6,200	2.9%	-16.3%	
Profit attributable to owners of parent	5,767	2.8%	-15.8%	44.2%	3,500	1.7%	-39.3%	

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

#### 2. Outlook by business segment

##### Revenue and operating income forecasts by segment

	FY3/17 results		FY3/18 full year forecast		YoY		(¥mn)
	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	
Consolidated results	205,717	8,419	212,000	5,800	3.1%	-31.1%	
Web Services	31,275	2,815	32,000	1,600	2.3%	-43.2%	
Publication	113,012	8,342	114,400	6,100	1.2%	-26.9%	
Video and Game	44,402	3,312	46,500	3,700	4.7%	11.7%	
Others	20,209	-1,635	22,300	-1,200	10.3%	-	
Eliminations/Corporate	-3,182	-4,415	-3,200	-4,400	-	-	

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

## Business outlook

**(1) The Web Services business**

In the Web Services business, revenue is forecast to increase 2.3% YoY to ¥32,000mn and operating income to fall 43.2% to ¥1,600mn. This fiscal year's results can be said to be dependent on the effects of niconico (crescendo), which is the new version of niconico scheduled to be released in October 2017 that includes new services for smartphones. The Company has not clarified the details of the services, but based on its statement of "planning to include several state-of-the-art functions never before seen in streaming services anywhere in the world," it is considered that through the introduction of these services, it plans to once again increase the number of premium members, which has somewhat hit a ceiling since the last fiscal year, and it will also incorporate measures to raise ARPU. For the fees structure, it seems to be preparing multiple plans, including a subscription model (monthly fixed-fees plan) and a pay-as-you-go plan. Also, it is thought that one factor behind the recent sluggish performance of niconico is the delay in meeting needs of smartphone users, so another point will be whether or not it can create attractive services and functions by introducing new services for smartphones.

In the portal business, the number of fee-paying members is forecast to increase from 2H onwards and for revenue to rise for the full fiscal year, but for profits to decrease due to the higher development costs. In the live business, the Company will continue to actively hold events, but the same as in the previous fiscal year, revenue is expected to decrease slightly and this business will continue to record a loss. The outlook for the mobile business is for lower revenue and profits from the decline in the number of members of the music distribution service, which in this fiscal year will again account for more than half of the decline in profits in this business segment.

**(2) The Publication business**

In the Publication business, the forecasts are for revenue to increase 1.2% YoY to ¥114,400mn and for operating income to decrease 26.9% to ¥6,100mn. Sales are expected to continue to grow for books, including e-books and e-magazines. However, in addition to the end of the positive effects from the hit book titles relating to "Your Name", the main factors behind the decline in profits will include the higher costs from test production for the launch of the books manufacturing and distribution base, system investment for the e-books distribution platform "BOOK ☆ WALKER" and the "Kakuyomu" platform, and also strategic investment in "Live TV" and "Magazine Walker," which are businesses currently being developed.

**(3) Video and Game business**

In the Video and Game business, the forecasts are for revenue to increase 4.7% YoY to ¥46,500mn and for operating income to increase 11.7% to ¥3,700mn. In the Video business, profits will decline on the end of revenue distribution from "Your Name", but the Company plans to strengthen license sales, including popular anime and movies for the overseas market. Both revenue and profits are expected to increase in the Game business as a reaction to results in the previous fiscal year.

**(4) Others**

In Others, revenue is forecast to increase 10.3% YoY to ¥22,300mn, while the operating loss will be ¥1,200mn (compared to a loss of ¥1,635mn in the previous fiscal year). Revenue is expected to increase from the strengthening of development and sales for character products utilizing content that the Company itself owns, while stable revenue is also expected from the education business. As of April 2017, N High School (KADOKAWA DWANGO educational corporation), which opened in April 2016, had a total of 3,782 students (of whom, 2,002 were new students). This school provides "N Preparatory School," an original learning application, and system usage fees are expected to increase alongside the rise in the number of students. Vantan also is set to maintain a certain level of earnings. In profits, the effects of the increase in products sales are expected to reduce the amount of the loss.

## ■ The new medium-term vision and the “Tokorozawa Sakura Town (tentative name)” project

### Promoting medium-term growth through strengthening the media-mix strategy further

#### 1. New medium-term vision

The Company announced its new medium-term vision at the same time it announced its FY3/17 results. Within the expansion of the Internet age, its policy is to enlarge its businesses by developing a media-mix strategy that fuses the Internet and the real world. To achieve growth, it is aiming not only to fulfill its function as a catalyst for the creation of IP, but also to maximize value through multiplexing IP using the media mix expertise. In addition, having interfaces of contact with users through the various channels will provide it with opportunities to acquire revenue.

At the current time, the point to focus on is niconico (crescendo), which is the new version of niconico including services for smartphones that will be released in October 2017. The Company is aiming to grow revenue from the niconico Douga by providing attractive services. Also, in the Publication business, its policy is to conduct test production and to optimize distribution toward the start of operations of the books manufacturing and distribution base in Tokorozawa, which is expected to contribute to strengthened profitability after it becomes operational in 2020.

The Company did not announce medium- to long-term management numerical targets in the new medium-term vision, but this is because of the difficulty in predicting at the current stage the extent of the impact of new Web services. So it decided that it was preferable not to announce targets that would be highly uncertain. At FISCO, we expect that current upfront investment will lead to steady growth in results in the medium to long term. The reasons why we think this are that 1) it is steadily generating revenue from the media-mix strategy it is promoting and accumulating expertise in it, and leveraging synergies in each business segment, 2) in the Publication business, in the context of the improving and stabilizing profitability from the one-company system, profitability will also improve to the next level from the start of operations of the books manufacturing and distribution base from 2020, and 3) it can be expected to have new growth potential from launching new Web services.

The new medium-term vision and the “Tokorozawa Sakura Town (tentative name)” project

**Specific policies in the medium-term vision**

Web Services business
<ul style="list-style-type: none"> <li>• Launching services in the new version of niconico crescendo</li> </ul>
Plans to include several state-of-the-art functions never before seen in streaming services anywhere in the world
<ul style="list-style-type: none"> <li>• Expanding entertainment services</li> </ul>
It will increase user ARPU by providing high-value-added entertainment services utilizing AI, etc.
<ul style="list-style-type: none"> <li>• Strengthening collaboration between platforms</li> </ul>
It will strengthen collaboration between niconico, BOOK ☆ WALKER, and ComicWalker
The Publication business
<ul style="list-style-type: none"> <li>• Maintain 5,000 newly published titles</li> </ul>
As the source of IP creation, it will utilize its marketing capabilities to open-up new genres and expand market share while maintaining the foundation of a diversified portfolio that includes literary books, graphic novels, practical lifestyle books, and comics.
<ul style="list-style-type: none"> <li>• Building a new books manufacturing and distribution structure</li> </ul>
It is conducting test production and the optimization of the production system and distribution base toward the start of operations at the new Tokorozawa plant
<ul style="list-style-type: none"> <li>• The full digitization of information magazines</li> </ul>
For the TV information magazine Weekly the Television, it is creating a database (DB) of talent information, and in the Walker series, which is a regional information magazine, it is also continuing to build a DB to utilize the information and expertise it has accumulated for the inbound business.
It is further enhancing the online sales function of “Mainichi ga Hakken”, a lifestyle information magazine
Video and Game business
<ul style="list-style-type: none"> <li>• Further strengthening the media mix</li> </ul>
Taking advantage of its enhanced lineup, particularly in anime, it is strengthening the secondary development of product sales (MD) and events, in addition to video distribution domestically and overseas.
It is advancing joint production with overseas partners in the live-action area.
<ul style="list-style-type: none"> <li>• Establishing a strategy for the game business</li> </ul>
It is strengthening profitability from the creation of game content fully utilizing IP and aiming to bolster the strategic development of game subsidiaries that possess individuality.
Others
<ul style="list-style-type: none"> <li>• Strengthening the MD business</li> </ul>
It is strengthening profitability through integrated manufacturing and sales-type management, and it will start the systems integration of the EC websites.
It will enhance niconico's MD functions, which will result in the maximization of revenue.
<ul style="list-style-type: none"> <li>• Linking content and events</li> </ul>
It is accumulating management expertise in anime tourism that use contents as the theme and in Tokorozawa Sakura Town (tentative name), it will hold its own events using content toward achieving profitability in the event business.
Overseas business
Utilizing its domestic strengths, it is expanding license sales and overseas sales bases to stimulate demand for visits to Japan and to develop the inbound business.
Revenue is currently ¥10bn and it is aiming to exceed ¥20bn by FY3/21

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

## Profitability set to increase with the start of operations at the new books plant

### 2. Tokorozawa Sakura Town (tentative name) project

In December 2016, the Company announced the cost of the non-current assets scheduled to be acquired in the future for the Tokorozawa Sakura Town (tentative name) project. Tokorozawa Sakura Town (tentative name) will be the foundation of the “COOL JAPAN FOREST Concept” that aims at creating a cultural complex and for town planning that is being advanced by KADOKAWA in collaboration with Tokorozawa City. In the project, KADOKAWA will construct a books manufacturing and distribution base, the Tokorozawa Campus (offices), and new business facilities (an event venue and commercial facilities) on the site of the former Tokorozawa Purification Center (approximately 37,000m<sup>2</sup>).

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The new medium-term vision and the “Tokorozawa Sakura Town (tentative name)” project

The cost of the acquisition of the non-current assets will be ¥39.9bn (¥24.6bn for the books manufacturing and distribution plant, ¥6.4bn for the Tokorozawa Campus, and ¥8.9bn for the new business facilities), with construction scheduled to begin in February 2018 and to be completed in April 2020. The Company has already procured the funds for the construction costs in the long-term borrowing conducted in the previous fiscal year, and it plans to cover all the costs from its own funds. Within these facilities, it will introduce into the books manufacturing and distribution plant the latest digital equipment that integrates manufacturing and distribution, enabling on-demand printing. Once this plant becomes operational, the Company will be able to manufacture small lots of books and conduct just-in-time manufacturing and distribution, which can be expected not only to reduce printing costs and material costs, but also to lower the return rate of books, which will in turn contribute to an improvement in the profit margin.

The Company currently orders printing to major printing companies, but production of books can be profitable only when a certain number is printed. However, once the new plant becomes operational, the Company will be able to manufacture even small lots of books and realize a flexible manufacturing system easy to meet the demand. Of course, offset printing can still have cost advantages in some cases and not all books will be printed at the new plant. But when this plant becomes operational, the return rate of books may fall to around 25%. In the event that the Company has excess production capacity, it may accept printing orders from other companies in the same industry, which will further solidify its profitability. At the start of the plant's operations, the depreciation expense will have a negative effect on profits, but in the medium to long term, the plant will contribute to the Company's profits.

## ■ Shareholder return policy

### **Considers returns to shareholders to be an important management issue and pays dividends in consideration of results in the fiscal period**

The Company considers it important to make sustainable distributions of profits to shareholders and other stakeholders while ensuring continuity of its business management by building up internal reserves to strengthen the corporate constitution and to prepare for future business development. In addition, it also recognizes that returning profits to shareholders is a key management priority, and takes into account the business performance of each period when deliberating on shareholder returns.

The Company plans to continue to pay a dividend of ¥20 per share in FY3/18, the same as in FY3/17 (for a dividend payout ratio of 38.8%). It has also introduced a shareholder reward system. Shareholders who hold 100 shares or more continuously for 1 year or more (shareholders listed at least 3 consecutive times in the shareholders' register) are given a gift of either 3 paperbacks, 3 comics, 2 separate volumes, 2 movie tickets, 3,000 e-book purchase points, 1 DVD or Blu-ray Disc, or 1 niconico item. It has also introduced a system to reward long-term shareholders, with shareholders who have held their shares for 3 years or more (shareholders listed at least 7 consecutive times in the shareholders' register) able to receive an additional gift of either 2 paperbacks, 2 comics, 1 separate volume, 1 movie ticket, or 1,500 e-book purchase points.



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