

KADOKAWA DWANGO CORPORATION

9468

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21-Jun.-2018

FISCO Ltd. Analyst

Yuzuru Sato



FISCO Ltd.

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

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Summary

Aiming for a V-shaped recovery in FY3/19 by reforming the profit structure through upgrading the version of niconico and launching new services

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. In addition to its Publication business, the Company is expanding its business through pursuing a media mix strategy that is centered on the Web Services business, which is focused on “niconico,” and on the Video and Game business.

1. FY3/18 results

In the FY3/18 consolidated results, revenue increased 0.5% year-on-year (YoY) to ¥206,785mn, while operating income decreased 62.6% to ¥3,144mn, for higher revenue but lower profits. The results were below the initial Company forecasts (revenue of ¥212,000mn and operating income of ¥5,800mn). The main decrease factors were the fall in the number of fee-paying members in the Web Services business, the delays to the launches of the niconico (crescendo) and nicocas services, the increase in strategic investment costs in the Publication business, and the decline as a reaction to the fact that the movie “Your Name” was a major hit in FY3/17. Also, compared to the Company forecasts, in the Web Services business the number of fee-paying members decreased more than was initially anticipated, and this decrease, together with the delay in the launch of a new service for smartphones that was scheduled to be launched in October 2017, and also the slump in some live-action films in the video business, were the reasons why results were less than the initial Company forecasts.

2. FY3/19 outlook

The outlook for the FY3/19 consolidated results is for a V-shaped recovery, with revenue to increase 11.7% year-on-year (YoY) to ¥231,000mn and operating income to rise 154.4% to ¥8,000mn. The majority of the increase in profits will be from the higher profits in the Web Services business and the Video and Game business. In the portal business within the Web Services business, the Company intends to launch the niconico (crescendo) and nicocas services before the summer vacation in 2018 and thereby halt the decline in the number of fee-paying members. It also plans to launch original games, games collaborated with niconico, and so-called social tipping for distributors, such as VTuber. Through these measures, the Company will strengthen the earnings components in the portal business that are not dependent on the number of premium members, and a substantial increase in profits is expected. In the Video and Game business, for video, the profitability of video works is expected to improve, while for games also, a significant increase in profits is forecast, including from the contributions of original games. At FISCO, we think that there are two key points for FY3/19. The first point is whether or not the niconico (crescendo) service, which it has announced will be launched on June 28, will receive major support from users. It is likely that to a certain extent, the answer to this question will be clarified in the Q1 results. The second point is whether or not the contributions to profits of original games and pay-as-you-go fees, whose profits are expected to increase significantly, will trend as expected by the Company. We shall be focusing on the timing on which it introduces the original games and the pay-as-you-go fees.

Summary

3. The future growth strategy

The Company's policy is to grow its businesses by developing domestically and overseas a media-mix strategy that fuses the Internet and the real world. The Group's IP strategy is to realize an integrated, synergy-type media mix that utilizes not only a conventional media mix whose starting point is publications, but also a starting point of original works created outside of publishing, such as on niconico. It is also strengthening its IP creation and training, and in terms of specific measures, it established companies including vaka, Inc.*1 and ENGI, Inc.*2, while from April 25, it test-launched N Anime*3. In the Publication business, it has started test operations of a new book manufacturing and distribution system able to respond to requests for small-lot production runs with short delivery times, which will be fully fledged operations at the Tokorozawa book manufacturing and distribution base to be completed in the spring of 2020. Through the introduction of this system, the Company will be able to realize small-lot production runs tailored to demand at low costs, and it expects to improve profitability by reducing the product return rate. In addition, sales in the e-books business are forecast to continue to increase at an annual rate of double digits. At FISCO, we think that as a result of the current stage of upfront investment, it will steadily achieve growth in the medium to long term from these measures it is progressing.

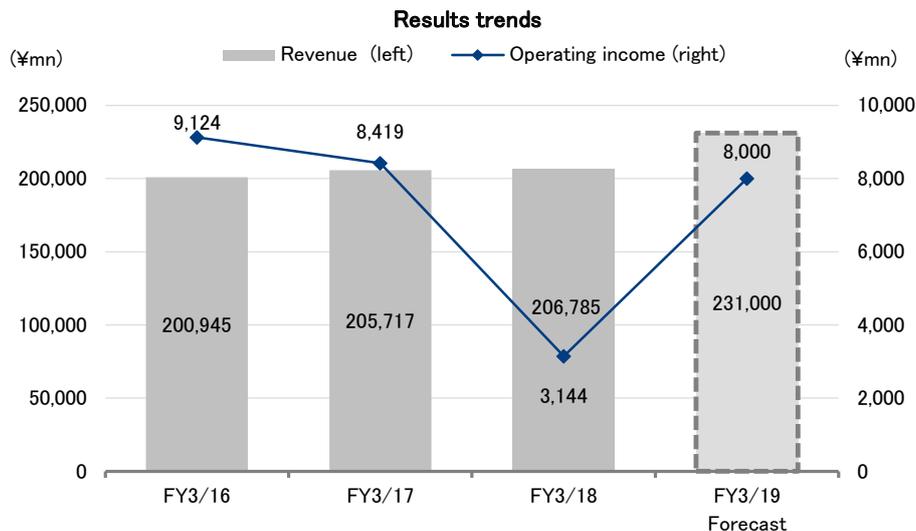
*1 A joint-venture company established in February 2018 with khara, Inc., which is overwhelmingly strong in anime. It aims to secure the secondary usage rights to the works of individual creators and to accelerate the creation of IP.

*2 A hybrid digital animation production studio co-founded by KADOKAWA CORPORATION, Sammy Corporation, and Ultra Super Pictures. It was established in April 2018 and began operations from June of the same year. Hybrid digital animation is animation using new image expressions that combines the two digital image technologies of "digital drawing" and "3DCG," which are familiar to Japanese anime fans. It is considered that the studio is aiming to create content through new image expressions that utilize the latest technologies.

*3 An anime portal site that brings together anime contents and information that are distributed across various websites, such as videos, illustrations, and news. It enables anime fans to navigate the anime contents on niconico, and it is expected to lead to an increase in the site's user numbers.

Key Points

- Outlook is for a V-shaped recovery in results in FY3/19 from the launches of new niconico services and newly produced games
- Profits are expected to increase substantially in the Web Services business and the Video and Game business
- Pursuing expansion and growth in the medium term through promoting its media-mix strategy



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

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■ Business overview

A comprehensive media company that is deploying Publication, Web Services, and Video and Game businesses

The Company is a holding company that was established in October 2014 following the management integration of KADOKAWA, which operates the Publication business, and DWANGO, which operates niconico, one of Japan's largest video services. The business segments are divided into the Web Services business that is focused on niconico, the Publication business, the Video and Game business, and the Others business, which includes sales of goods and an education business.

Looking at the percentages of revenue by segment in FY3/18, the Web Services business contributed 13.8%, the Publication business 53.7%, the Video and Game business 22.6%, and the Others business 9.9%. In terms of the percentages of operating income, the Web Services and Others businesses both recorded operating losses, which were covered by the profits of the Publication business and the Video and Game business. Currently, the Publication business contributes more than half of both sales and operating income. Going forward, it is expected that the Video and Game business will continue to grow its top line performance based on an IP strategy, and that its profitability will improve. In the Web Services business also, it is considered that the Company is aiming to establish a profit structure that is not dependent on fixed-rate fee services through introducing pay-as-you-go fees and original games.

1. Web service business

Setting the portal business (DWANGO's video service niconico) as the core, this business is comprised of the live business which plans and operates various kinds of events and leases event venues, often as a way to promote niconico, and the music distribution business for mobile devices.

The Company provides various services on its mainstay portal business, including the niconico Douga 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 revenues from points used to watch pay-to-view videos. As of the end of March 2018, it had issued IDs to 72.22 million people (up 7.92 million people YoY), while there were 2.07 million premium members (down 360,000 people). The usage conditions from January to March 2018 were that the log-on MAU (monthly active users) was 8.81 million people (down 320,000 people) and the log-in DAU (daily active users) was 2.98 million people (down 320,000 people), so both continue to trend downward following their respective peaks in FY3/17 1H. However, through the responses at the end of February 2018 to "Viewing without membership registration and login," the March usage conditions greatly improved. Specifically, the MAU combined with the number of non-log-in UU was 17.54 million people and the DAU was 3.28 million people. Also, with regards to the niconico channel platform, on which companies, organizations, and users can deliver video and live broadcasts, at the end of March 2018, in total it had 8,182 channels (up 319 channels on the end of the previous fiscal year), 1,305 monthly-fees channels (up 158 channels), and 680,000 monthly fee-paying members (up 90,000 people), so all of the indicators increased.

Business overview

In the live business, 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 Honsha showroom*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 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 2018 was held on April 29-30, 2018, with 161,000 visitors to the venue and approximately 6.12 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. Game Party 2018 was held on February 10-11, 2018, at Makuhari Messe, had 72,000 site visitors and 5,130,000 online visitors, and contributed to the expansion of the Japanese game market. Also, as a result of holding the recent e-sports event, the Company is advancing measures toward developing the e-sports market, such as newly issuing the Japan e-sports Pro License to 15 people.

*3 A large-scale stage event for niconico, which is one of the Japanese largest video service. It is niconico's largest live event where users active on niconico in various genres, such as "This is me singing" and "This is me dancing," and famous artists gather together and perform. It was held for the sixth time on November 3, 2017, at the Saitama Super Arena, and was attended by approximately 15,000 people.

*4 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 the facility was relocated and reopened in Ikebukuro.

The music distribution business remains a highly profitable business for the Company, despite member numbers trending downward due to market environment changes. This business operates dwango.jp, which distributes single songs, ring tones, and so forth, as well as animelo (songs from popular anime).

2. Publication business

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

The paper-based book business provides a strong foundation 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 FY3/18 was under 35%, which was lower than the industry average of under 40%.

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 and Rakuten. For e-magazines, it provides and manages content for d magazine, which is an all-you-can-read magazine service operated by NTT DoCoMo, Inc. The DWANGO-operated niconico Manga, niconico Books, and Bookmeter have been integrated under the control of BOOK WALKER Co., Ltd., which manages BOOK☆WALKER, and together with the collaboration with ComicWalker, which is KADOKAWA's comprehensive manga site, the aim is to strengthen the e-books and e-magazines business.

For magazines and mooks, advertising revenue from paper media, which is the source of earnings, continues to decrease alongside the advance of digitization, and currently the profit conditions are tough. Therefore, to deal with this environment, the Company is currently streamlining its operations while actively pursuing digitization.

Business overview

3. Video and Game business

The video business includes sales of package software; planning, production, and distribution of movies; 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.

In the game 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), "GOD WARS" (KADOKAWA GAMES), "Kenka Bancho," "Danganronpa," "ARK:Survival Evolved" (Spike Chunsoft), and "STEINS;GATE" (MAGES.).

4. Others

This business is comprised of businesses such as the e-commerce 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, which involves the operation of the Vantan Game Academy and KADOKAWA Contents Academy schools that provide training to work in creative fields inside and outside of Japan; the online learning services of N High School, through which students can obtain a qualification equivalent to a high school diploma online and other educational facilities; and the planning and management of the inbound business.

Results trends

Profits fell in FY3/18 due to the lower profits in the portal business and from the decrease due to the effects of "Your Name"

1. Overview of the FY3/18 results

In the FY3/18 consolidated results, revenue increased 0.5% YoY to ¥206,785mn, operating income decreased 62.6% to ¥3,144mn, ordinary income declined 49.8% to ¥3,716mn, and profit attributable to owners of parent fell 82.0% to ¥1,038mn, for an increase in revenue but a decrease in profits.

Overview of the FY3/18 consolidated results

	FY3/17		Initial forecasts	FY3/18			
	Results	% of revenue		Results	% of revenue	YoY	vs. forecast
Revenue	205,717	-	212,000	206,785	-	0.5%	-2.5%
Operating income	8,419	4.1%	5,800	3,144	1.5%	-62.6%	-45.8%
Ordinary income	7,407	3.6%	6,200	3,716	1.8%	-49.8%	-40.1%
Profit attributable to owners of parent	5,767	2.8%	3,500	1,038	0.5%	-82.0%	-70.3%

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

Results trends

Revenue trended strongly in the Video and Game business, increasing 6.8% YoY, and in the Others business also, rising 3.0%. But it slumped in the Web Services business, declining 7.2% due to the fall in the number of fee-paying members, and it was also sluggish in the Publication business, decreasing 0.3%. Therefore overall, revenue increased slightly. While the operating loss contracted in the Other business, operating income was affected by the decline in profits in the three main businesses taken together. In particular, in addition to the decline in the number of fee-paying members, the Web Services business was affected by the delay in the launches of new services and recorded an operating loss. In the Publication and Video and Game businesses also, profits declined as a reaction to the fact that “Your Name” was a major hit in the previous fiscal year. Non-operating income improved by ¥1,584mn YoY, with the main factors being the improvement in the gain/loss on equity-method investment (¥1,221mn) and the decrease in donations (¥379mn).

Also, looking at the increase-decrease factors in the comparison with the initial Company forecasts, the main reason why revenue was below the forecast was the results of the portal business, and for operating income, the results of the portal business and the video business. The portal business was affected by the fact that the number of fee-paying members declined at a pace greater than expected, and also by the delays until before the summer of 2018 of the launches of new services that had been planned for October 2017, including niconico (crescendo) and nicocas. Another factor behind profits failing to meet their forecast was that in the video business, revenue from live-action films other than from “Legend of the Demon Cat” and “Miracles of the Namiya General Store” was less than forecast, overall.

Higher sales and profits in the e-books business and game business

2. Trends by business segment

(1) Web Services business

In this business, revenue decreased 7.2% YoY to ¥29,023mn and the operating loss was ¥1,067mn (compared to operating income of ¥2,815mn in the previous fiscal year).

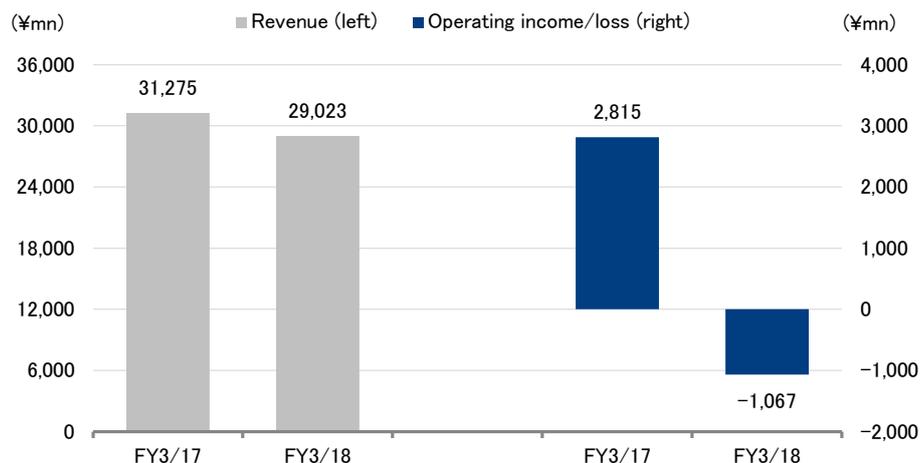
In the mainstay portal business, the number of niconico fee-paying members, which is the main source of earnings, was 2.07 million people at the end of FY3/18, which is a decline of 360,000 people on the end of the previous fiscal year and the main reason for the lower revenue. In addition to the decline in revenue, the main reasons for the decline in profits were that the Company postponed the launches of the new version of niconico called niconico (crescendo), and of nicocas, a new service for smartphones, which were scheduled to be launched in October 2017, and also the increases in the development costs related to these services and the system-improvement costs for existing services.

Results trends

In the live business, the Company continues to hold various kinds of events that fuse the Internet and the real world in order to differentiate itself from the other video services that it competes with. There were a record number of visitors, of 154,000 people, to niconico Chokaigi 2017 in April, while 81,000 people attended Animelo Summer Live 2017 –THE CARD–, which is the world’s largest live anime song event, held in August 2017. These visitor numbers confirm that interest is rising in entertainment that fuses the Internet and the real world. There were also 72,000 visitors to Game Party 2018, which is Japan’s largest user participation-type game event, held in February 2018, and moreover for the first time it issued pro-licenses for an e-sports event. In such ways, the Company is advancing measures toward developing the e-sports market in Japan in the future. In addition, in this business, there were contributions to profits from #Compass – Combat Providence Analysis System –, which is a game app from a joint project with NHN PlayArt Corp. that is involved with a popular creator team on niconico, and also in relation to the live tour of a live-broadcasting distributor of a popular game. Overall in the live business, revenue increased YoY, while the extent of the operating loss was reduced.

In the mobile business, the number of members of the dwango.jp music distribution service continued to decrease, and once again revenue and profits declined by double digits YoY. However, the Company also made similar progress in reducing costs and profitability was maintained.

Web Services business revenue and operating income/loss



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

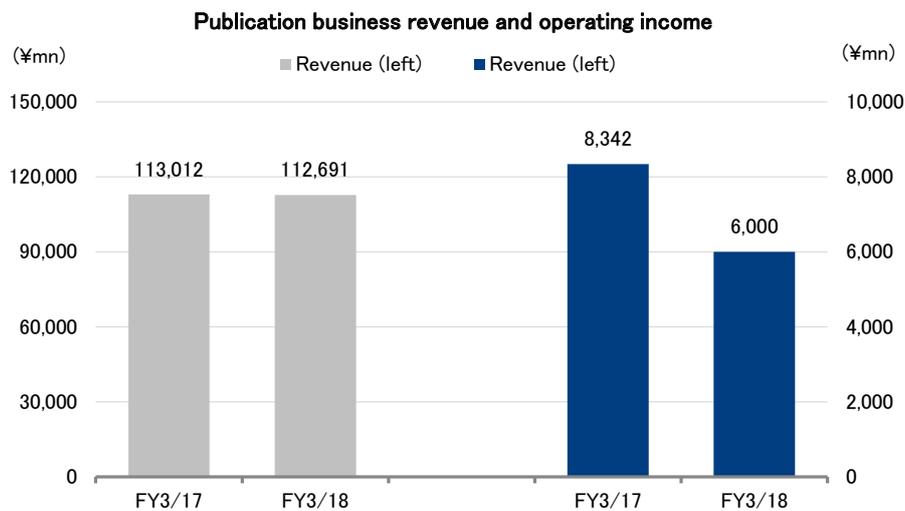
(2) Publication business

In this business, revenue decreased 0.3% YoY to ¥112,691mn and operating income declined 28.1% to ¥6,000mn. In the books business, although the publishing market in Japan as a whole is contracting, the Company has launched works and aimed to expand the genres of the children’s books and learning reference books markets, which are expected to grow. Although it released hit books, including graphic novels, comics, and literary books, sales declined as a reaction to the previous strong performance of books related to “Your Name”, which was a major hit in the previous fiscal year. Profits also fell due to the decline as a reaction to “Your Name” and also from the rise in costs to prepare the Tokorozawa manufacturing and logistics base, which has begun test operations toward full-scale operations from April 2020, and also in investment costs for a digital-related new business in the publishing field.

Results trends

In the e-books and e-magazines business, sales trended strongly for each of d magazine, which is NTT DoCoMo's all-you-can-read magazine service; BOOK☆WALKER, which is the comprehensive e-book store operated by the Company's Group, and for the e-book stores of other companies. The percentage of revenue provided by e-books and e-magazines in this business segment exceeds 20%.

Within the context of the contracting market, revenue continued to decline in the magazine business. But the Company is making progress in converting the business model, including transitioning to Web media, and the website's page views are increasing.



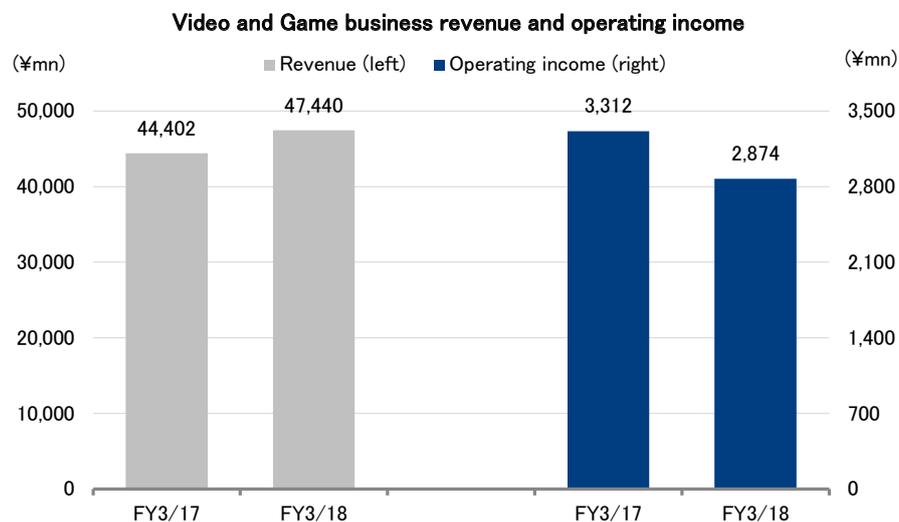
Source: Prepared by FISCO from the Company's results briefing materials

(3) Video and Game business

In this business, revenue increased 6.8% YoY to ¥47,440mn, while operating income decreased 13.2% to ¥2,874mn. In the video business, distribution revenue was strong, from literary books through to the large-scale media-mix works of "Legend of the Demon Cat" and the "Miracles of the Namiya General Store". In addition, results were favorable from distribution revenue for anime works, sales of package software, and license revenue, and therefore as a whole, revenue increased. However, operating income declined, including due to the impact of the slump for live-action works overall, and also the decline as a reaction to the fact that "Your Name" was a major hit in the previous fiscal year.

Conversely, in the game business, the app games "Tenka Hyakken -Zan-" and "Yuki Yuna is a Hero: A Sparkling Flower", and the console game "DARK SOULS III", performed well across the fiscal year, while some new games also became hits, and revenue and profits increased.

Results trends



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

(4) Others

In this business, revenue increased 3.0% YoY to ¥20,821mn and the operating loss was ¥1,356mn (compared to a loss of ¥1,635mn in the previous fiscal year). Revenue rose due to the steady increase in student numbers at the N High School, which is a correspondence high school that utilizes the Internet, and at the vocational schools specializing in the creative field. In terms of profits, even though the inbound business continues to record a loss, which is expected to become profitable in 2020, the education business contributed to reduce the loss.

The Tokorozawa Project, which has total construction costs of ¥39.9bn, is progressing as planned, and financial soundness is being maintained

3. Financial condition and management indicators

Looking at the financial condition at the end of FY3/18, total assets were down ¥4,159mn on the end of the previous fiscal year to ¥242,790mn. Breaking this down, current assets decreased ¥14,501mn and non-current assets increased ¥10,343mn. In current assets, cash and deposits declined ¥19,580mn, which was mainly due to the reduction in interest-bearing debt and the allocation of funds to acquire treasury shares and for capital investment. Also, because the end of March was a bank holiday, notes and accounts receivable-trade increased ¥4,527mn. In non-current assets, tangible non-current assets rose ¥10,099mn, mainly due the construction of Tokorozawa Sakura Town (provisional name; hereafter, the Tokorozawa Project), while intangible non-current assets grew ¥416mn.

Total liabilities were down ¥1,562mn on the end of the previous fiscal year to ¥133,662mn. Within this amount, current liabilities increased ¥13,123mn, but the majority of it was due to the shifting of some long-term borrowing to short-term borrowing. Total interest bearing debt declined ¥2,181mn. In addition, notes and accounts payable-trade rose ¥751mn from the effects of the bank holiday, while advances received increased ¥475mn.

Results trends

Net assets were down ¥2,596mn compared to the end of the previous fiscal year to ¥109,128mn. This was due to the increase in retained earnings of ¥1,038mn following the recording of profit attributable to owners of parent, and also a rise in accumulated other comprehensive income of ¥243mn, including from an increase in the market capitalization of shares held. Capital surplus decreased ¥1,490mn, mainly due to dividend payments, while the acquisition of treasury shares was also a decreasing factor of ¥2,563mn.

Looking at the cash flow conditions, at the end of FY3/18, cash and cash equivalents were down ¥23,733mn compared to the end of the previous fiscal year to ¥67,407mn. Cash flow from operating activities was ¥1,608mn, as although the accounts receivable recovered amount declined because the last day of March was a bank holiday, the Company recorded items including net income before income taxes and depreciation expenses. Cash flow used in investing activities was ¥18,765mn from the expenditure to acquire tangible non-current assets (¥13,310mn) and intangible non-current assets (¥2,678mn), and expenditure for time deposits (¥4,195mn). Cash flow used in financial activities was ¥6,421mn from the repayments of long-term loans payable (¥2,152mn), expenditure to acquire treasury shares (¥3,001mn), and dividend payments (¥1,391mn).

Looking at the management indicators, the equity ratio, which indicates financial soundness, declined slightly, from 44.5% at the end of the previous fiscal year to 44.1%, due to the reduction in shareholders' equity following the acquisition of treasury shares. Each of the profitability indicators declined compared to the previous fiscal year, ROE by 1.0%, ROA by 1.5%, and the operating income margin by 1.5%. This was mainly due to the deterioration of profits in the Web Services business. It can be said that going forward, recovering this business will be the key to recovering profitability as a whole.

On a cash basis, the outlook for the FY3/19 capital investment plan is for ¥19.1bn, which is a further increase on the ¥15.9bn in the previous fiscal year. This is mainly for the rise in payments for the Tokorozawa Project construction costs. In FY3/19, the plan is for depreciation expenses of ¥6.5bn and profit attributable to the owners of the parent of ¥5.4bn, so free cash flow will continue to be negative in FY3/19 as well, and it is highly possible that the cash and deposits balance will decrease. However, it would seem that cash-out will peak in FY3/19, and if results recover steadily, the financial position can be expected to also improve from FY3/20 onwards.

KADOKAWA DWANGO CORPORATION

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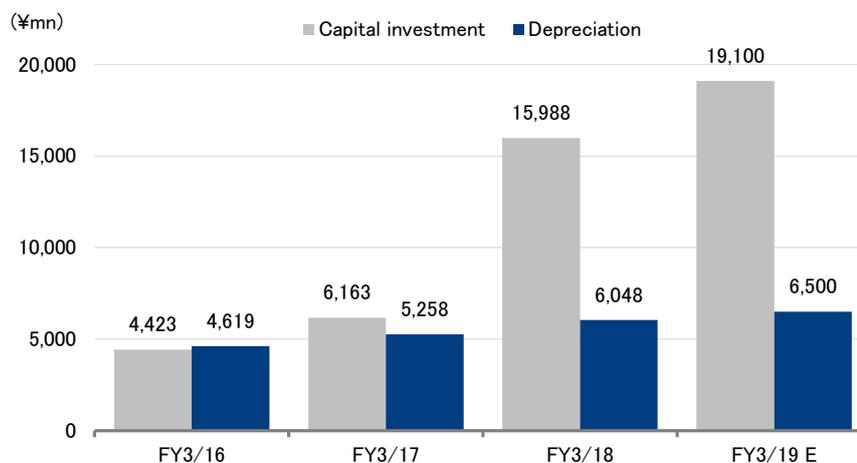
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Results trends

Balance sheet, cash flow statement, and management indicators

	FY3/15	FY3/16	FY3/17	FY3/18	Change	Main factor
	(¥mn)					
Current assets	131,200	131,827	174,880	160,379	-14,501	Cash and deposits -19,850, notes and accounts receivable +4,527, inventory assets +472
(Cash and deposits)	63,207	60,804	105,542	85,962	-19,580	
Non-current assets	74,473	69,781	72,068	82,411	10,343	Tangible non-current assets +10,099, intangible non-current assets +416, investment and other assets -173
Total assets	205,673	201,609	246,949	242,790	-4,159	
Current liabilities	63,316	61,459	61,159	74,282	13,123	Notes and accounts payable-trade +751, short-term loans payable and current portion of long-term loans payable +12,710
Non-current liabilities	38,108	35,623	74,065	59,380	-14,685	Long-term loans payable -14,891
Total liabilities	101,425	97,082	135,224	133,662	-1,562	
(Interest-bearing debt)	31,598	29,376	67,580	65,399	-2,181	
Net assets	104,248	104,526	111,724	109,128	-2,596	Retained earnings +1,038, capital surplus -1,490, treasury shares -2,563, accumulated other comprehensive income +243
Cash flow statement						
Cash flow from operating activities	7,765	6,733	11,968	1,608		
Cash flow from investing activities	-9,049	-4,673	-10,394	-18,765		
Cash flow from financing activities	24,385	-8,775	37,200	-6,421		
Cash and cash equivalents at end of period	59,201	52,175	91,140	67,407	-23,733	
Management indicators						
<Financial soundness>						
Current ratio	207.2%	214.5%	285.9%	215.9%		
Equity ratio	50.2%	51.4%	44.5%	44.1%		
D/E ratio	0.3	0.28	0.61	0.61		
<Profitability>						
ROE	22.5%	6.6%	5.4%	1.0%		
ROA	2.1%	5.0%	3.3%	1.5%		
Operating margin	1.4%	4.5%	4.1%	1.5%		

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

Trends in capital investment and depreciation expenses


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

■ Outlook

Outlook is for a V-shaped recovery in results in FY3/19 from the launches of new niconico services and newly produced games

1. FY3/19 outlook

The outlook for the FY3/19 consolidated results is for a rapid recovery, of revenue to increase 11.7% YoY to ¥231,000mn, operating income to rise 154.4% to ¥8,000mn, ordinary income to grow 144.8% to ¥9,100mn, and profit attributable to the owners of the parent to climb 420.1% to ¥5,400mn. The Company will launch the niconico (crescendo) and nicocas services, whose launches it postponed until summer vacation period in 2018, and thereby halt the downward trend in the number of fee-paying members. In addition, it will launch new original games and games collaborated with niconico, and also so-called social tipping for niconico distributors and increase revenue from pay-as-you-go fees. This is expected to lead to higher profits in the portal and game businesses, which will be the main factors behind the improved results.

Therefore, while results in Q1 in this fiscal year are forecast to continue to remain at a low level, it is expected that the recovery in the results will become apparent from the second half of Q2 due to the growth of the portal and game businesses. Conversely, if the decline in the number of fee-paying members is not halted even after the launches of niconico (crescendo) and nicocas, and if profits from the new games and pay-as-you-go fees do not grow as much as expected, there is the risk that the results will fall below the forecasts. Therefore, these developments will be the biggest points to focus on in the FY3/19 results.

FY3/19 outlook

	FY3/18			FY3/19		
	Results	% of revenue	YoY	Forecast	% of revenue	YoY
Revenue	206,785	-	0.5%	231,000	-	11.7%
Operating income	3,144	1.5%	-62.6%	8,000	3.5%	154.4%
Ordinary income	3,716	1.8%	-49.8%	9,100	3.9%	144.8%
Profit attributable to owners of parent	1,038	0.5%	-82.0%	5,400	2.3%	420.1%
Earnings per share (¥)	15.53			82.13		

(¥mn)

	FY3/18 results		FY3/19 forecast		YoY	
	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income
Consolidated total	206,785	3,144	231,000	8,000	11.7%	154.5%
Web Services	29,023	-1,067	34,800	1,000	19.9%	-
Publication	112,691	6,000	119,400	6,400	6.0%	6.7%
Video and Game	47,440	2,874	56,300	7,000	18.7%	143.6%
Others	20,821	-1,356	24,200	-2,200	16.2%	-
Eliminations/Corporate	-3,191	-3,306	-3,700	-4,200	-	-

(¥mn)

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

Outlook

Profits are expected to increase substantially in the Web Services business and the Video and Game business

2. Outlook by business segment

(1) Web Services business

In this business, the forecasts are for revenue to increase 19.9% YoY to ¥34,800mn and for operating income of ¥1,000mn (compared to a loss of ¥1,067mn in the previous fiscal year).

In the portal business, the Company intends to launch the new version of niconico called niconico (crescendo) and the nicocas service for smartphones before the summer vacation in 2018. The features of nicocas include that it was developed in-house by the Company using world-leading streaming technology to realize an interface that integrates video, live broadcast, bi-directional communication, and image synthesis, and that based on live user broadcasting, it offers rich new functions to enhance its bi-directionality and collaborative capability. It makes possible more exciting programs by facilitating more active communication between live-broadcast distributors and viewers.

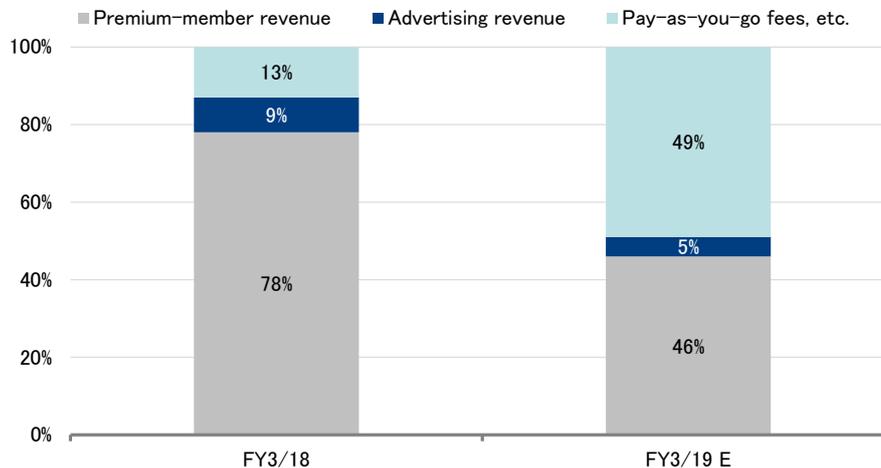
The Company also plans to launch games unique to niconico through using its bi-direction functionality, and thereby grow revenue from pay-as-you-go fees. The new games that it will launch in the near future are being developed in-house, so they will feature the Company's original game content, such as collaborations with niconico live broadcasts. For sales-promotion activities, it plans to conduct digital promotions centered on the niconico platform, so sales-promotion expenses are not expected to be large. If these games are hit, profits in the Company's game business will grow.

Also, the VTuber (virtual YouTuber) market was launched in earnest in 2017 and user creators and Internet companies have entered-into it one after another, and in this situation, the Company is increasing its opportunities to profit from this market. Specifically, it is aiming to enhance VTuber programs and to acquire revenue (social tipping) from creators and fans who support the VTubers and also through the management of VTuber.

Through these measures, the Company is aiming to convert the revenue model in the portal business from a conventional model of fixed-rate-fees services based on monthly revenue from paying members, to a hybrid-type model in which revenue is divided into from pay-as-you-go fees, such as from games and social tipping, and from monthly fees. In terms of revenue growth, it is forecast to increase 51% YoY.

Outlook

Percentages of revenue in the portal business



Note: includes the change of categories
Source: Prepared by FISCO from the Company's results briefing materials

The Company is aiming to expand the user groups, particularly to teenage users, by improving the usability and functionality for smartphone users of niconico (crescendo) as the new version of niconico Douga, which in the past were insufficient. It is considered that it is also aiming for re-growth in the number of fee-paying members (premium members) by aiming to “provide opportunities for IP creation and to enhance monetization by offering new playgrounds.” The number of fee-paying members is expected to bottom-out (at around 1.90 million people) in June 2016 before the launch of niconico (crescendo), and then to recover moderately after that to 2.01 million people by March 2019. Therefore, monthly-fees revenue is also expected to decrease by around 10% in FY3/19.

Also, a reason for users leaving niconico is considered to be the relative decline in the quality of its services due to the aging of the system infrastructure. So from FY15, the Company has been working to reconstruct the distribution system. Currently, it has established a schedule for the system improvements and after the launch of the new services, it expects to be able to realize high-quality streaming distribution at low cost. In terms of the specific measures, in order to make possible the distribution of high-quality images, it is advancing the transition from software to dedicated hardware for the transcoding of video and live broadcasts, which is scheduled to be completed by the end of June 2018. Through the use of dedicated hardware, it will be able to distribute all live broadcast programs in HD image quality (720p), and 4K distribution will also become possible. Moreover, in order to cope with the increase in the volume of communication traffic in the future, it will expand the network bandwidth by nearly two times, from the previous 730Gbps to 1,400Gbps. Although there are concerns that infrastructure costs will increase due to these measures, the Company considers that it will be able to reduce total costs by advancing the virtualization of its infrastructure, while the failure rate will also be reduced. Infrastructure costs are expected to decline from ¥5bn in FY3/18 to ¥4.2bn in FY3/19 and to as low as ¥3.3bn in FY3/20, which will contribute to improving the profitability of the portal business.

In addition, the Company plans to actively hold events in the live business, so it is possible that the extent of the loss in this business will increase slightly YoY. Also, in the mobile business, the decline in sales and profits will continue alongside the fall in member numbers for the music distribution service, although a high level of profitability is expected to be maintained through cost controls.

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Outlook

(2) Publication business

In this business, revenue is forecast to increase 6.0% YoY to ¥119,400mn and operating income to rise 6.7% to ¥6,400mn. In the e-books and e-magazines business, the Company intends to grow revenue and profits through deploying its own value-added strategy, which includes conducting advanced sales of the Group's works on BOOK☆WALKER, its own distribution platform, and offering various types of benefits. In addition, it will strengthen cooperation with content distributors to external sites and other platforms, including d magazine, to continue to realize double-digit growth. Also, as of April 1, 2018, DWANGO's e-books business has been consolidated into BOOK WALKER Co., Ltd., and it is expected that efficiency and sales will be maximized in this business through the construction of an integrated service, from promotions through to sales.

In the book business, in the context of the contracting paper publications market, the Company is aiming to increase revenue through focusing on creating powerful IP, such as strengthening the discovery of original works on the Internet, like Kakuyomu. It is also aiming to maximize profits through improving the efficiency of the Production Department by using content-data management on the cloud and improving the efficiency of the Sales Department by utilizing AI (improving the accuracy of decision marking on re-prints and reducing the returns rate).

The state-of-the-art system, which is an integrated system from manufacturing through to logistics and that is scheduled to become fully operational from April 2020, in April 2018 began Print On Demand production, in which it can produce small-lot orders, and also started the commercial production of paperback books. A system is in place in which the original printing plates are managed on the cloud, and if there is inventory in the online connected warehouse, the product is quickly loaded with other goods and shipped. Traditionally in the supply chain in the publishing industry, it would take 7-10 days for the ordered product to be delivered to the book store, but this new system greatly shortens the delivery time to just 24-48 hours. All of the functions, from the ordering system through to production and inventory management, are unified with IoT, and the product return rate is reduced through optimization of the production and delivery. The Company thinks that it will be able to reduce its current returns rate of around 35% to as low as approximately 20% to 25% in the future, and when considering the possibility of expanding its solutions services (outsourced manufacturing) to other companies in the same industry, profits in the book business can be expected to increase from 2020 following the start of full-scale operations at the new Tokorozawa plant.

(3) Video and Game business

In this business, revenue is forecast to increase 18.7% to ¥56,300mn and operating income to rise 143.6% to ¥7,000mn. In the video business, the Company will advance its media-mix strategy, centered on movies and anime, while it is also aiming to increase revenue through strengthening license sales in the overseas markets. Further, in order to respond to the expansion of the anime market, it will make a subsidiary of the production studio ENGI Inc. (ENTertainment Graphic Innovation), and thereby strengthen its production functions.

In the game business, the forecasts are for substantial increases in revenue and profits, as in addition to the effects of the launches of original games in Web services, it is also expected that FromSoftware will launch powerful, major titles.

Outlook

(4) Others

In the Others business, revenue is forecast to increase 16.2% YoY to ¥24,200mn, while the operating loss will be ¥2,200mn (compared to a loss of ¥1,356mn in the previous fiscal year). In the education business, as of April 2018, N High School (KADOKAWA DWANGO educational corporation), which opened in April 2016, had a total of 6,512 students (an increase of 2,730 students YoY), and students numbers are steadily increasing. The usage fees and other revenue from the original learning system of this school and from the N Preparatory School learning app are recorded in the Company's consolidated results. The profit-loss breakeven point is considered to be a level of around 7,000 to 8,000 students, and it may become profitable in FY3/20 at the earliest.

In the inbound business, which is being treated as a new business, the Company is aiming to increase profits by creating business opportunities, such as events utilizing KADOKAWA content and the sales of goods, and disseminating information on Japan, via information magazines and online. In terms of the state of the current measures, it collaborates with expressway bus company Willer, Inc., and working on the commercialization of travel experience services that are highly entertaining, mainly for inbound customers. However, the current stage is one of upfront investment and it is expected to become profitable from FY3/21 onwards.

Growth strategy

Pursuing expansion and growth in the medium term through promoting its media-mix strategy

As its medium-term vision, the Company has set-out a policy of expanding its business while 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 through its media mix. In addition, having interfaces of contact with users through various channels will provide it with opportunities to acquire revenue. As its media-mix strategy, its policy is to advance an integrated, synergy-type media-mix strategy that starts from the original works (IP) created in various media, including on niconico and games and comics, and to develop them for other media.

In manufacturing and logistics also, the Company expects that the state-of-the-art Tokorozawa plant, which will become fully operational in April 2020, will strengthen the profitability of the Publication business. For the development of overseas markets also, the aim is for revenue to increase from the current scale of slightly more than ¥10bn to in excess of ¥20bn by FY3/21. In particular, its strategy for the large-scale Chinese market is to expand sales through using local subsidiaries to develop the "original proposals and original works" parts of IP, to which foreign capital regulations do not apply.

At FISCO, we expect that current upfront investment will lead to growth in the medium to long term. The reasons why we think so are that 1) it is steadily generating revenue through promotion of its media-mix strategy and accumulating expertise while leveraging synergies in each business segment, 2) in the context of improving and stabilizing profitability from the one-company system, the Publication business will see profitability improve to the next level from the start of operations of the book manufacturing and distribution base from 2020, and 3) new growth potential from launching new web services can be expected.

■ Shareholder return policy

Returns profits to shareholders through shareholder dividends, acquisition of treasury shares, and a shareholder-rewards system

The Company considers returning profits to shareholders, at the same time as aiming to supplement internal reserves to strengthen the corporate constitution and to prepare for future business development, to be an important management issue, and its policy is to pay dividends after considering the business performance in each fiscal period. It also returns profits to shareholders through acquiring treasury shares, depending on the share-price level. It plans to pay a dividend per share in FY3/19 of ¥20.0 (dividend payout ratio, 24.4%), the same as in the previous fiscal year. For the acquisition of treasury shares, continuing on from FY3/18, in which acquired 2.28 million treasury shares for ¥2,999mn, it has announced that in FY3/19 also, it will acquire 2.60 million treasury shares (upper limit) for ¥3bn (upper limit) (the acquisition period is May 14 to September 28, 2018).

The Company has also introduced a shareholder-rewards 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 books, 1 DVD or Blu-ray, a set of 2 movie tickets, a set of 2 BOOK☆WALKER ¥1,500 gift card, or an item of niconico merchandise. Long-term shareholders who have held shares for 3 years or more (shareholders listed at least 7 consecutive times in the shareholders' register) can receive an additional gift of either 2 books, 1 movie ticket, or 1 BOOK☆WALKER ¥1,500 gift card.

■ 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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