

KADOKAWA CORPORATION

9468

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Summary

The Company expects to achieve a V-shaped recovery for profits in FY3/20 due to the effects of improved profits in the Web Services business and the continued growth of the e-books and e-magazines business

KADOKAWA 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. Following the transition in July 2019 from a pure holding company structure to an operating holding company structure, the Company name was changed from KADOKAWA DWANGO CORPORATION to KADOKAWA CORPORATION (the name of the former KADOKAWA CORPORATION was changed to KADOKAWA FUTURE PUBLISHING and it became an intermediate holding company that manages the production and distribution subsidiaries of print publication businesses).

1. FY3/19 results

In the FY3/19 consolidated results, sales increased but profits decreased, with revenue rising 0.9% year-on-year (YoY) to ¥208,605mn, but operating income falling 13.9% to ¥2,707mn. The high growth of e-book and e-magazine continued, and the expansion of sales of overseas licenses for anime and other products as well as “SEKIRO: SHADOWS DIE TWICE” (hereafter, SEKIRO), an action adventure game released simultaneously worldwide in March 2019 that became a major hit contributed to higher earnings. However, profits declined mainly due to the deterioration of earnings in the Web Services business, which is centered on niconico. Also, loss attributable to owners of parent was ¥4,085mn (compared to a profit of ¥1,038mn in the previous fiscal year) due to the recording of an impairment loss on the non-current assets of DWANGO.

2. FY3/20 outlook

For FY3/20, the Company is forecasting revenue to increase 4.0% YoY to ¥217,000mn, operating income to rise 99.4% to ¥5,400mn, ordinary income to climb 47.4% to ¥6,200mn, and profit attributable to owners of parent to be ¥3,800mn, for a return to profitability. The main reason for this rapid recovery will be that in the Web Services business, operating income will be ¥300mn (compared to a loss of ¥2,576mn in FY3/19) from the effects of the earnings structural reforms implemented in DWANGO. Also, sales of SEKIRO continue to be strong at the present time, while in July 2019, the Company will launch the original book of the feature length animated movie “Weathering With You” * to coincide with its theatrical release.

* The latest work of the director Makoto Shinkai, who made the movie “Your Name” that was a record hit in 2016. This time, the plan is to quickly release the movie and translated publications overseas, so if the movie is a hit, it expects earnings contribution from the media mix strategy as well.

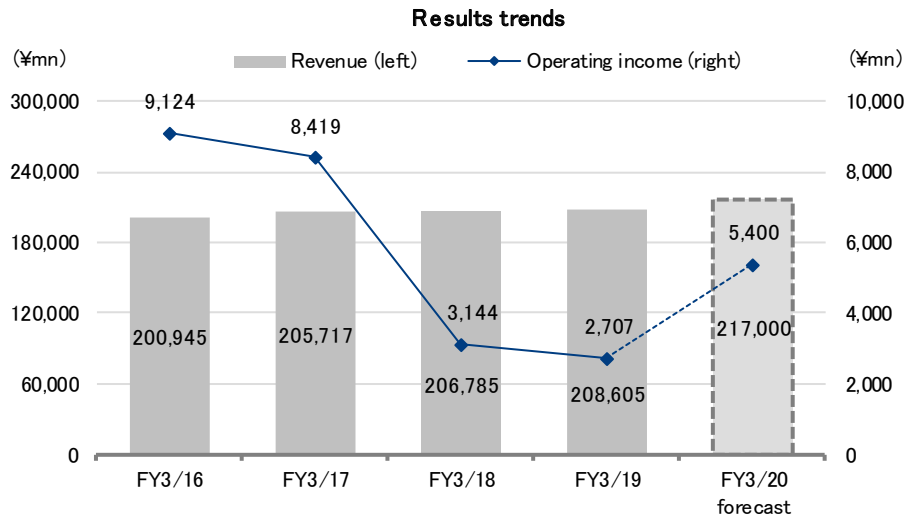
Summary

3. The future growth strategy

As its business strategy for the future, the measures the Company is working on include 1) reconstructing DWANGO, which continues to record a loss, 2) improving business efficiency by implementing a digital transformation for the Group as a whole, and improving cost competitiveness and productivity through strengthening digital CRM, 3) strengthening the ability to create IP, which is the source of competitiveness, and enhancing media mix development capabilities, 4) and reforming the production and distribution platforms. Among these, its policy for DWANGO is to conduct business concentration and selection and reorganize the organization, and going forward, it is aiming to generate earnings from niconico by working on an alliance strategy and diversifying the earnings portfolio. In addition to rebuilding DWANGO, it will strengthen the global development and profitability of the IP business through advancing the creation of IP, which is one of the Company's strengths, and developing the media mix.

Key Points

- Achieved record high revenue in FY3/19, but recorded loss attributable to owners of parent due to the deterioration of earnings at DWANGO
- Aiming to return to profitability in FY3/20 for the first time in three fiscal years by continuing the media mix strategy with its IP and conducting business structural reforms in the Web Services business



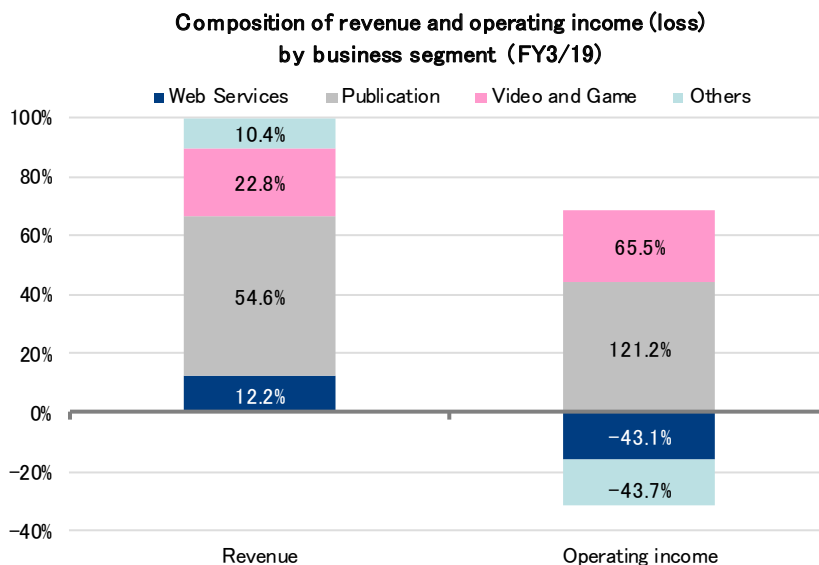
Source: Prepared by FISCO from the Company's financial results

Business overview

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

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 businesses are divided into the three main business segments, of the Publishing business, the Video and Game business, and the Web Services business, and also Others, which includes sales of goods, an education-related business, and an inbound business.

Looking at the percentages of revenue by segment in FY3/19, the Publishing business provided the majority at 54.6%, followed by the Video and Game business at 22.8%, the Web Services business at 12.2%, and Others at 10.4%. Also, for operating income, operating losses in the Web Services business and Others were covered by the operating income in the Publishing business and the Video and Game business. The main business is currently the Publishing business, but going forward the Company intends to grow the topline of the Video and Game business and improve earnings through a media mix strategy with its IP. In the Web Services business also, it is implementing measures to recover earnings from its mainstay services niconico and it is expected to be profitable in FY3/20.



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

1. Publication business

In this business, which is KADOKAWA's main business, the Company publishes and sells paper-based books, separate volumes, pocket editions including graphic novels, and comics, as well as e-books and magazines. 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 as well as selling advertisements on the Internet.

Business overview

For sales of paper books, the Company has strength in developing works through its media mix strategy, and it has established an industry-leading position for graphic novels. To create hit works, it continuously publishes new titles at a rate of 5,000 a year. The Company has been working to optimize production and shipping through its track record of marketing and digital technologies that it has accumulated over many years, and in FY3/19, the book return rate was in the range of 30% to 34%, below the industry average (in the range of 35% to 39%).

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 in collaboration with NTT DoCoMo, Inc.<9437> for d magazine, which is an all-you-can-read magazine service. The DWANGO-operated niconico Manga, niconico Books, and Bookmeter have been integrated under the control of BOOK WALKER Co., Ltd., which manages BOOK•WALKER, with the aim of strengthening the e-books and e-magazines business Groupwide.

For magazines and mooks, advertising revenue from paper media, which is the source of earnings, has been on a declining trend 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.

2. 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 consolidated subsidiaries, KADOKAWA CORPORATION, FromSoftware, Inc., Spike Chunsoft Co., Ltd., KADOKAWA GAMES, LTD., and MAGES. Inc. 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.).

3. Web Services business

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

Business overview

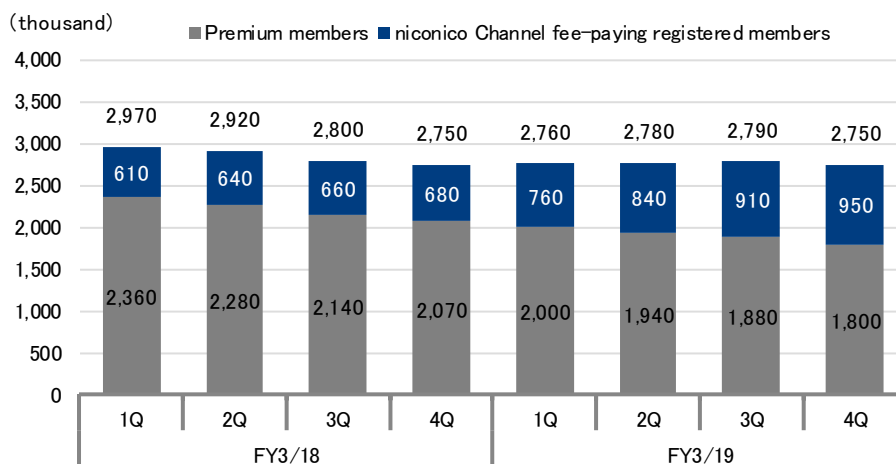
The Company provides various services on its mainstay portal business, including the niconico Douga video community, niconico Live, and niconico Channel. Sales include revenue from monthly fees (¥540/month) obtained from niconico premium members, which enables them to watch videos and live broadcasts comfortably; advertising revenue, such as from website banners and video; and revenue from points used to watch pay-to-view videos. At the end of March 2019, the number of IDs issued had increased to 77.09 million people (an increase of 4.87 million people from the end of the previous fiscal year), but the number of premium members continued to decline to 1.8mn people (down 270,000 people). The usage conditions from January to March 2019 were that MAU (monthly active users), including non-log-in UU*, was 18.74 million people, and DAU (daily active users) was 3.02 million people. It seems that the main factors behind the increase in UU were that by upgrading to niconico (crescendo) and greatly improving the network environment, general users can now watch the content on niconico Douga much more comfortably, and also that even non-log-in users can watch it.

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

The niconico Channel is a platform where companies, organizations, and users can distribute video and live broadcasts. At the end of March, it had a total of 8,660 channels (up 478 channels from the end of the previous fiscal year), 1,423 monthly-fees channels (up 118 channels), and 950,000 monthly fee-paying registered members (up 270,000 people), and all of the indicators continue to increase.

In August 2018, the Company released a live-streaming app for smartphones, nicocas (test broadcast), as a new live broadcast service. It also newly launched the Gift (social tipping function) service, which supports broadcasters by enabling users to send them gift items during live broadcasts. Further, in the nicocas app (Android/iOS), even non-members can watch videos and live broadcasts, and broadcast themselves (but they are unable to post videos). The Company integrated the interactive function in nicocas (test broadcast) into niconico Live in April 2019, and it intends to further expand the Gift service and to enhance the service's interactive functionality. Its strategy is to increase the number of viewers through these measures, and thereby raise the number of fee-paying members and revenue from pay-as-you-go fees.

Trends in the number of fee-paying members



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

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 2019 was held on April 27-28, 2019, with 168,000 visitors to the venue and approximately 6.66 million online visitors. This was a record high attendance for Chokaigi after it had been separated from the Tokaigi (Game Party Japan) event.
- *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 2019, which was held at Makuhari Messe on January 26 and 27, 2019, was the first event jointly held with Japan Amusement Expo 2019 and the eSPORTS International Challenge Cup. It had approximately 84,000 site visitors and a total of 4.59 million online visitors, and it is contributing to the expansion of the Japanese games market and the e-sports market.
- *3 A large-scale stage event for niconico, which is one of the Japanese largest video services. 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 seventh time on November 3, 2018, 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 mobile business remains a highly profitable business for the Company, despite member numbers continuing on a downward trend due to market environment changes. This business operates dwango.jp, which distributes single songs, ring tones, and so forth, as well as animelo mix, which distributes digital contents.

4. Others

Others is comprised of businesses including an education business, which involves the management of the Vantan Game Academy and the KADOKAWA Contents Academy schools that provide training to work in creative fields inside and outside of Japan, and N High School (KADOKAWA DWANGO Educational Corporation), which provides education programs characterized by interactivity from the integration of the online and the real worlds, and also the planning and management of the inbound-related business. In June 2018 as part of its measures to promote the inbound business, KADOKAWA opened its first restaurant, INUA*, at lidabashi in Tokyo.

- * KADOKAWA, formed a partnership with Mr. Rene Redzepi, who is the head chef at the famous restaurant noma in Copenhagen, Denmark. INUA opened on June 29, 2018, welcoming Mr. Thomas Frebel, who formerly worked at noma, as its head chef.

Results trends

Despite achieving record high revenue in FY3/19, recorded a final loss due to the deterioration of earnings at DWANGO

1. Overview of the FY3/19 results

In the FY3/19 consolidated results, revenue increased 0.9% YoY to ¥208,605mn, operating income decreased 13.9% to ¥2,707mn, ordinary income rose 13.2% to ¥4,205mn, and loss attributable to owners of parent was ¥4,085mn (compared to a profit of ¥1,038mn in the previous fiscal year). Due to the slump in the results of the niconico service and the poor performance of the game business, the impairment loss on non-current assets, mainly at DWANGO, was ¥4,174mn, while business structural improvement costs of ¥261mn were posted as an extraordinary loss, and therefore a final loss was recorded. Conversely, the Video and Game business expanded steadily due to the growth of the e-books and e-magazines business and sales of overseas anime licenses, and also from hit titles, such as SEKIRO.

Overview of the FY3/19 results

	FY3/18		FY3/19		FY3/19		YoY	% of revised forecasts
	Results	% of revenue	Initial forecast	Revised forecast	Results	% of revenue		
Revenue	206,785	-	231,000	207,000	208,605	-	0.9%	0.8%
Operating income	3,144	1.5%	8,000	1,900	2,707	1.3%	-13.9%	42.5%
Ordinary income	3,716	1.8%	9,100	2,900	4,205	2.0%	13.2%	45.0%
Profit (loss) attributable to owners of parent	1,038	0.5%	5,400	-4,300	-4,085	2.3%	-	-

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

Results by business segment

	FY3/18		FY3/19				YoY			
	Results		Initial forecast		Revised forecast (Feb. 2019)		Results			
	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income		
Consolidated total	206,785	3,144	231,000	8,000	207,000	1,900	208,605	2,707	0.9%	-13.9%
Publication	112,691	6,000	119,400	6,400	116,900	6,700	115,958	7,253	2.9%	20.9%
Video and Game	47,440	2,874	56,300	7,000	47,000	3,300	48,295	3,919	1.8%	36.4%
Web Services	29,023	-1,067	34,800	1,000	25,500	-1,800	25,848	-2,576	-10.9%	-
Others	20,821	-1,356	24,200	-2,200	21,400	-3,000	22,143	-2,613	6.3%	-
Eliminations/Corporate	-3,191	-3,306	-3,700	-4,200	-3,800	-3,300	-3,640	-3,274	-	-

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

Revenue declined 10.9% YoY in the Web Services business, but they increased in each of the Publishing business, the Video and Game business, and Others, and therefore overall revenue was once again a record high. Operating income rose in the Publishing business and the Video and Game business, but the losses grew in the Web Services business and Others, so operating income declined for the third consecutive fiscal year. Conversely, ordinary income increased for the first time in three fiscal years due to the absence of donations of ¥610mn that were recorded in non-operating income in the previous fiscal year, and the improvements to the foreign exchange gain-loss and the financial balance.

Results trends

In February 2019, the Company announced downwardly revised results forecasts for FY3/19, mainly due to the deterioration of earnings at DWANGO. Compared to these revised forecasts, revenue was 0.8% and operating income was 42.5% above forecast. Factors for these results include exceeded expectations in sales for SEKIRO in the game business, which was released in March and became a bestseller. There were also favorable performance of e-books and e-magazines in addition to the sales effects of SEKIRO, despite that DWANGO incurred additional structural improvement costs in terms of operating income. The Company also pursued full-scale cost control.

e-books and e-magazines, and license revenue for overseas were strong, but niconico continued to slump

2. Trends by business segment

(1) Publication business

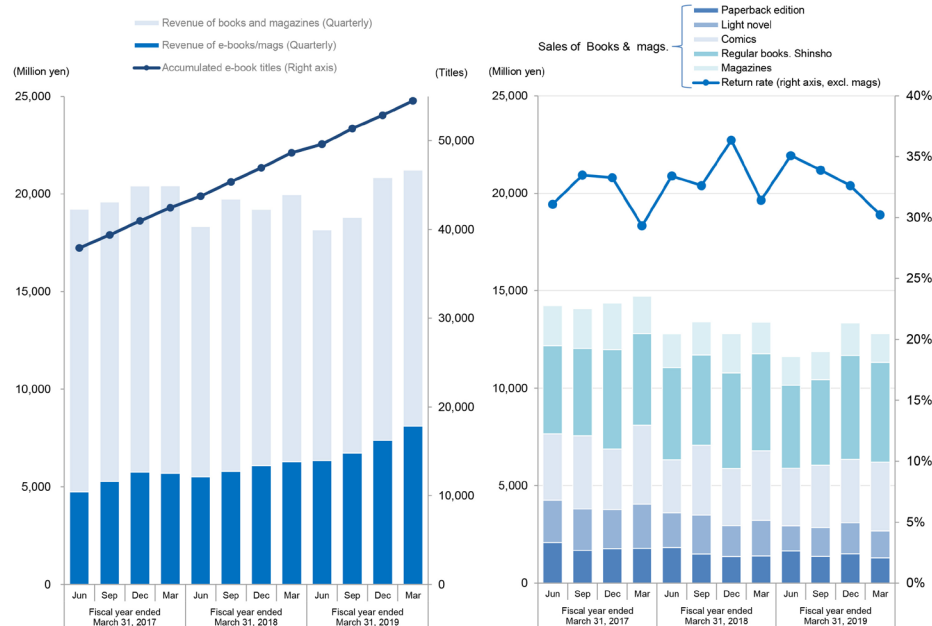
In the Publishing business, revenue increased 2.9% YoY to ¥115,958mn and operating income rose 20.9% to ¥7,253mn, the first-time profits had increased in two fiscal periods. This was mainly due to the continued strong sales of e-books and e-magazines with both sales and profits rising YoY, higher revenue for commercialization licenses in rights sales for gaming machines contributed to the higher profits.

The e-books and e-magazines business performed well. On BOOK☆WALKER, which is the comprehensive e-book store operated by the Company's Group, sales increased 46% YoY. In the external sales business also, sales rose 45% following the start of a sales license for a new external e-book store. In particular, the Company implemented the 8th anniversary campaign for BOOK☆WALKER, and in September 2019, it expanded the lineup of works through integrating it with the niconico Book app, and the resulting increase in MAU and the rise in the monthly purchase amount per user were the main reasons for the strong sales. Also, BOOK☆WALKER Global for the overseas market and Taiwan BOOK☆WALKER both maintained high growth. The percentage of revenue provided by e-books and e-publishing in the Publishing business is around 25%.

In the books business, in comics, sales were strong of large-scale works like Yotsubato! and Delicious in Dungeon, and also the series, The Rising of the Shield Hero and Overlord. In graphic novels, sales were solid of popular series, such as Sword Art Online and The Irregular at Magic High School. In general books, educational manga for elementary school students contributed to earnings, while in general paperbacks, sales of original books of movies such as Laplace's Witch and You Shine in the Moonlit Night, and The Castle of Kingdom Gone, were strong. The main reasons for the decline in profits were the high level of profits in the previous fiscal year and also the rise in the freight burden relating to return operations in the second half of the fiscal year. For the Tokorozawa production and distribution base, which is scheduled to start full operations in FY3/20, the construction of the plant and the establishment of systems are progressing on schedule, and it is currently conducting commercial production of some paperback books and graphic novels.

Results trends

Publishing business results



Source: The Company's results briefing materials

In the magazines business, the Company is at the stage of transitioning its business model to one that incorporates Web media, and as for website page views and advertising, revenue is increasing. Also, although the number of magazines sold continues to decline, the actual sales rate is improving, and the profit-loss balance is beginning to show signs of improvement.

(2) Video and Game business

In the Video and Game business, revenue increased 1.8% YoY to ¥48,295mn and operating income rose 36.4% to ¥3,919mn. In the video business, overseas license sales were strong, including for STEINS; GATE ZERO and Angels of Death, and anime distribution revenue and commercialization license revenue increased. Sales from Movie Ticket, which is a service to pre-purchase reserved-seat movie tickets operated by Movie Walker Co., Ltd., also grew, and the strong results were maintained.

In the game business, SEKIRO, which was released simultaneously worldwide on March 22, became a hit with more than 2 million copies sold in 10 days, and it contributed significantly to earnings. In addition, DARK SOULS REMASTERED continued to sell strongly in Japan and overseas, and overseas royalty revenue also increased. Earnings contribution from Teku Teku Teku Teku, a location-information game, launched by DWANGO at the end of November 2018 was greatly below the expected amount, so it was decided to end this service in June 2019, and to record the app development costs in a lump sum. Looking only at the DWANGO game business, which was impacted by these factors, the operating loss was approximately ¥1.1bn.

(3) Web Services business

In this business, revenue decrease 10.9% YoY to ¥25,848 and operating loss was ¥2,576 (compared to ¥1,067 in the previous fiscal year.)

Results trends

In the portal business, at the end of FY3/19 the number of niconico fee-paying premium members, which is the main source of earnings, was 1.8 million people, down 270,000 people from the end of the previous fiscal year, and this seems to be the main reason why sales declined approximately ¥2bn. Although communication costs and other costs decreased due to the network infrastructure improvement measures implemented since the previous fiscal period, promotions were actively conducted for the previously mentioned Teku Teku Teku Teku, while expenses relating to reviewing and withdrawing from the business were recorded, and these were the main reasons why the operating loss grew. For the Gift (social tipping) service in nicocas also, it seems that a little more time is required for its use to spread among users.

In the live business, the Company continues to hold various events on the theme of “fusing the Internet and the real world” in order to differentiate itself from other competing video services. At niconico Chokaigi 2018 held in April 2018, the number of site visitors was 161,000 people (compared to 154,000 people in the previous year), which was a new record high. Moreover, in August 2018, 81,000 people, same as in the previous year, attended Animelo Summer Live 2018 “OK!”, which is the world’s largest live anime song event. The Company previously positioned the live business as for advertising and publicity purposes to strengthen the niconico brand, but for the future, it has changed its policy to develop the business considering the profitability of the various events.

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 YoY. However, the Company also made progress in reducing costs at the same time and profitability was maintained.

(4) Others

In Others, revenue increased 6.3% YoY to ¥22,143mn and the operating loss was ¥2,613mn (compared to ¥1,356mn in the previous fiscal year). Sales rose because of the steady increase in student numbers at N High School, which is a correspondence high school that utilizes the Internet, and at the vocational schools specializing in the creative field. It was also because the product-sales business, which includes e-commerce for character goods and pop idol CDs, performed well. However, the operating loss grew, mainly due to the increase in preparation expenses for the inbound business, toward the goal of it becoming profitable by FY3/20.

At N High School, a KADOKAWA DWANGO Educational Corporation, the number of students has increased rapidly, from about 7,000 in April 2018 to about 10,000 in April 2019. N High School opened six attendance-course campuses in April 2018, at Tokyo (Ochanomizu), Omiya, Yokohama, Chiba, Nagoya, and Fukuoka, to give it a total of eight campuses, and the activities of one of its current students, the figure skater Rika Kihira, has contributed greatly to its improved name recognition. In the past, there were many high school students who re-entered a correspondence high school only because they had to leave the school they were attending, but it is said that an increasing number of students are choosing themselves to enter N High School. It seems that in the background to this is that the advantages of attending a correspondence high school without time constraints are once again being recognized, and that the level of understanding among parents and guardians has also deepened. New campuses will be opened in April 2019 at five locations in Sendai, Tachikawa, Kashiwa, Kyoto and Esaka, and the number of students is expected to grow even more.

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 FY3/19, total assets were up ¥190mn from the end of the previous fiscal year to ¥240,072mn. Breaking this down, current assets had declined ¥6,337mn, while non-current assets had increased ¥6,527mn. In current assets, there were increases of notes and accounts receivable of ¥2,794mn and inventory assets of ¥1,987mn, but cash and deposits declined ¥12,365mn due to the acquisition of treasury shares. In non-current assets, tangible non-current assets increased ¥4,917mn, mainly due to the progress made in the Tokorozawa Project, while investments and other assets rose ¥3,933mn, primarily because of the rise in the market values of shares held. However, intangible non-current assets decreased ¥2,323mn, mainly due to the impairment loss on non-current assets, such as software, at DWANGO.

Total liabilities were up ¥5,907mn from the end of the previous fiscal year to ¥136,660mn. The main increase items included income taxes paid of ¥1,838mn, advanced received of ¥986mn, and notes and accounts payable-trade of ¥793mn. Interest-bearing debt increased ¥119mn to ¥65,518mn, mainly due to the refinancing of bank borrowing.

Total net assets were down ¥5,716mn from the end of the previous fiscal year to ¥103,411mn. The main decrease factors include a ¥5,434mn decline in retained earnings due to the recording of loss attributable to owners of parent of ¥4,085mn and dividends paid of ¥1,348mn, as well as the decline in shareholders' equity from the acquisition of treasury shares of ¥3,000mn. On the other hand, other comprehensive income rose ¥2,534mn, including due to the increase in the total market value of shares held.

Looking at the cash flow conditions, at the end of FY3/19, cash and cash equivalents were down ¥11,284mn from the end of the previous fiscal year to ¥56,123mn. Cash flow provided by operating activities was ¥5,864mn. Cash flow used in investing activities was ¥13,058mn, mainly due to purchase of property, plant and equipment of ¥10,485mn and purchase of intangible assets of ¥2,978mn. Cash flow used in financing activities was ¥4,236mn due to purchase of treasury shares of ¥3,000mn and dividends paid of ¥1,348mn.

Looking at the management indicators, the equity ratio, which indicates financial soundness, declined 2.5 percentage points (PP) from the end of the previous fiscal year to 42.2%. The D/E ratio (interest-bearing debt / shareholders equity) rose 0.04 from the end of the previous fiscal year to 0.65. Although cash and deposits decreased due to the investment in the Tokorozawa Project and the acquisition of treasury stock, net cash (cash and deposits – interest-bearing debt) is a surplus of more than ¥8bn, so the Company can be judged to be securing its financial soundness. Conversely, for profitability, mainly due to the previously mentioned deterioration of earnings in the Web Services business, the operating income margin is 1.3%, ROA is 1.8%, and ROE is -3.9% and the low levels of each of these indicators will be a management issue in the future.

The FY3/19 capital investment plan on a cash basis was ¥13,463mn, which was a reduction from the initial plan of ¥19,100mn. But this was mainly due to reviewing the investment plans of individual projects and working on reducing costs, and the Tokorozawa Project is being progressed in accordance with the initial investment plan of a total of ¥39.9bn. The capital investment plan for FY3/20 is ¥13,000mn and investment will peak in FY3/21, which is when the new base will be completed through the Tokorozawa Project. Therefore, it is expected that free cash flow will become positive from FY3/22 onwards.

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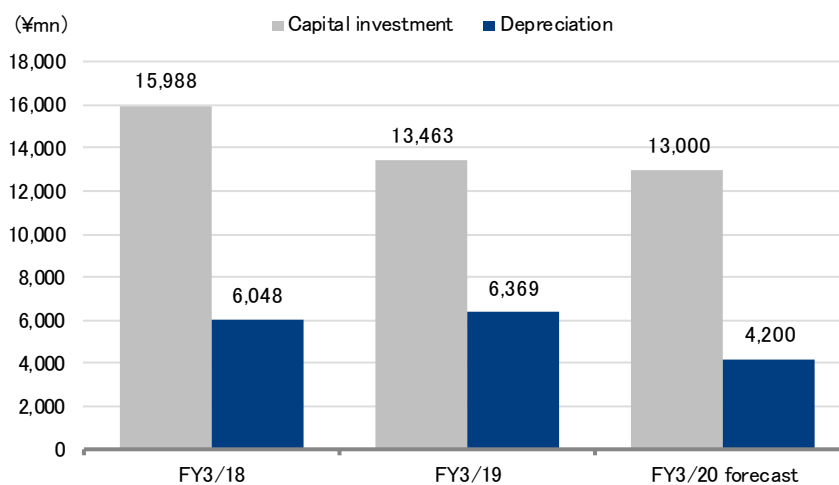
Results trends

Consolidated balance sheet, cash flow statement and management indicators

	FY3/16	FY3/17	FY3/18	FY3/19	Change	Main factor
	(¥mn)					
Current assets	131,827	174,880	155,312	148,975	-6,337	Cash and deposits-12,365, Notes and accounts receivable+2,794, Inventory assets+1,987
(Cash and deposits)	60,804	105,542	85,962	73,597	-12,365	
Non-current assets	69,781	72,068	84,569	91,096	6,527	Tangible non-current assets+4,917, Intangible non-current assets-2,323, Investments and other assets+3,933
Total assets	201,609	246,949	239,881	240,072	190	
Current liabilities	61,459	61,159	74,266	65,325	-8,941	Notes and accounts payable-trade+793, Short-term loans payable and current portion of long-term loans payable-14,869, Income taxes payable+1,838, Advances received+986
Current liabilities	35,623	74,065	56,487	71,335	14,848	Long-term loans payable+14,988
Total liabilities	97,082	135,224	130,753	136,660	5,907	
(Interest-bearing debt)	29,376	67,580	65,399	65,518	119	
Net assets	104,526	111,724	109,128	103,411	-5,716	Retained earnings-5,434, Treasury shares -2,894, Other comprehensive income +2,534
Cash flow statement						
Cash flow from operating activities	6,733	11,968	1,608	5,864		
Cash flow from investing activities	-4,673	-10,394	-18,765	-13,058		
Cash flow from financing activities	-8,775	37,200	-6,421	-4,236		
Cash and cash equivalents at end of period	52,175	91,140	67,407	56,123		
Management indicators						
<Financial Soundness>						
Current ratio	214.5%	285.9%	209.1%	228.1%		
Equity ratio	51.4%	44.5%	44.7%	42.2%		
D/E ratio	0.28	0.61	0.61	0.65		
<Profitability>						
ROE	6.6%	5.4%	1.0%	-3.9%		
ROA	5.0%	3.3%	1.5%	1.8%		
Operating margin	4.5%	4.1%	1.5%	1.3%		

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 financial results

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■ Outlook

Sales of SEKIRO will continue to be strong in FY3/20 Attention will focus on the progress made in DWANGO's business structural reforms

1. FY3/20 outlook

The outlook is for the FY3/20 consolidated results to recover sharply, with forecasts of revenue to increase 4.0% YoY to ¥217,000mn, operating income to rise 99.4% to ¥5,400mn, ordinary income to climb 47.4% to ¥6,200mn, and profit attributable to owners of parent of ¥3,800mn (compared to a loss of ¥4,085mn in FY3/19). The main factors will be the continued growth of e-book and e-magazine sales and license revenue, and recording operating income of ¥300mn in the Web Services business, which recorded a loss of about ¥2,500mn in FY3/19. The impairment loss recorded in FY3/19 will also end, and the outlook is for the final loss to become a final profit for the first time in two fiscal years.

In the game business, if the strong sales of SEKIRO continue in the future, results may exceed the forecasts. Also, on July 19, Weathering With You is scheduled to be released, which is the new movie by director Makoto Shinkai who directed Your Name, a record breaking hit in 2016 that contributed greatly to the Company's results. Attention on it is high as KADOKAWA books will release the original book of this movie. This time, the plan is to quickly release the movie and translated publications overseas, and sales of original books and related goods can be expected to increase worldwide depending on the response to the movie. So this could also be a factor causing results to exceed the forecasts.

FY3/20 outlook

	FY3/19		FY3/20		
	Results	% of revenue	YoY	% of revenue	YoY
Revenue	208,605	-	217,000	-	4.0%
Operating income	2,707	1.3%	5,400	2.5%	99.4%
Ordinary income	4,205	2.0%	6,200	2.9%	47.4%
Profit (loss) attributable to owners of parent	-4,085	2.3%	3,800	1.8%	-
Earnings per share (¥)	-63.94	-	60.07	-	-

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

Outlook

Aiming to return to profitability for the first time in three fiscal years by continuing the media mix strategy with its IP and conducting business structural reforms in the Web Services business

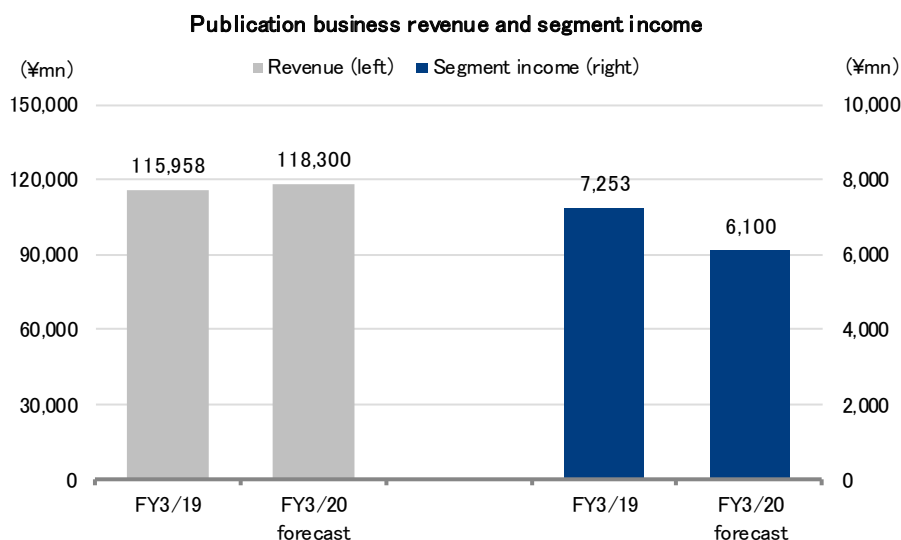
2. Outlook by business segment

(1) Publication business

In the Publishing business, the forecasts are for revenue to increase 2.0% YoY to ¥118,300mn and operating income to decrease 15.9% to ¥6,100mn. In the book business, the Company will work to strengthen nurturing new authors and discovering high-quality original books by developing new authors and supporting the creation of works posted online through Kakuyomu, its novel posting website. At the same time, it will aim to maximize earnings by working to optimize production numbers and to reduce the return rate through detailed marketing activities utilizing digital technologies. New publications will be maintained at a rate of 5,000 a year, and sales of e-books and e-magazines are expected to continue to grow, so the outlook is for the higher sales to continue. However, profits are expected to decrease because the investment burden is forecast to rise, including due to the active investment in the Tokorozawa Project.

In the magazines business, the Company is at the stage of transitioning its business model to one that incorporates Web media, and it intends to increase revenue from Web advertisements while also keeping down costs.

The outlook for the e-books and e-magazines business is for sales and profits to increase. The Company will expand sales through strengthening external sales and distribution overseas and promoting its own value-added strategy such as conducting various campaigns for its distribution platform BOOK☆WALKER.



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

(2) Video and Game business

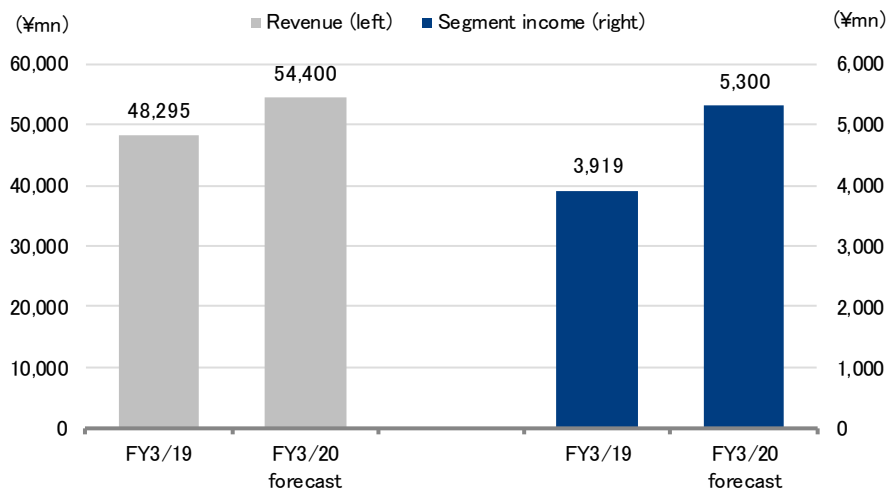
In the Video and Game business, the forecasts are for revenue to increase 12.6% YoY to ¥54,400mn and operating income to grow 35.2% to ¥5,300mn. The loss of ¥1.1bn recorded in the DWANGO game business in FY3/19 will end, and also sales and profits are expected to increase in both the video business and the game business.

Outlook

In the video business, the Company will continue to progress its media mix strategy that utilizes its strength of having original works, centered on movies and anime. Therefore, revenue is expected to increase, including anime distribution revenue for the overseas market and license sales revenue.

In the game business, steady growth is expected for SEKIRO developed by FromSoftware and for the series titles, such as DARK SOULS developed by a Group subsidiary. As for SEKIRO, 2 million copies were sold in 10 days after its release on March 22, and this is about the same high pace as the worldwide hit DARK SOULS III, which sold 3 million copies in about 1 month following its release. SEKIRO is an action game that omits multiplayer functions and RPG elements, and it has high-definition, three-dimensional, powerful character movement with a high level of difficulty, and it seems that these mechanics are being widely praised among gamers. At FISCO, we think that its contribution in the results forecasts is conservative, so it is highly likely that results will exceed the forecasts.

Video and Game business revenue and segment income



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

(3) Web Services business

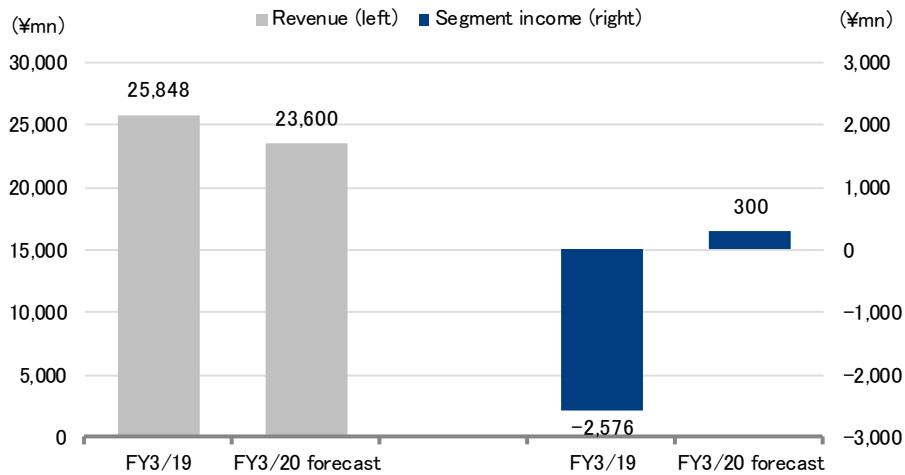
In the Web Services business, the forecasts are for revenue to decrease 8.7% YoY to ¥23,600mn, but operating income of ¥300mn (compared to a loss of ¥2,576mn in FY3/19) for profits for the first time in three fiscal years.

In the portal business, the Company is working to improve the earnings structure through selection and concentration in niconico, and to increase the number of fee-paying subscribers to channels through enhancing the content on niconico Channel. Its policy is also to work to secure earnings in the VR business area. It is aiming to halt the decline in the number of fee-paying members of niconico Douga. The current situation is that the withdrawal rate of existing members has settled down, but the decline in the number of newly acquired members is an issue. Therefore, as the measures to recover earnings, it is considering to diversify its earnings portfolio by expanding the revenues from pay-as-you-go fees and advertisement and shift from a business model that is dependent on monthly revenue, which currently provides nearly 80% of revenue.

In the live business, sales are forecast to decrease but profits are expected to improve through reviewing earnings structure of various events. In the mobile business also, the fall in sales and profits will continue, but the profit margin will be maintained through cost controls.

Outlook

Web Services business revenue and segment income



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

DWANGO appointed Mr. Takeshi Natsuno as President and Representative Director on February 13, 2019, the day it announced its FY3/19 Q3 financial results. It is renewing its management structure and progressing structural reforms, including “business withdrawals” “organizational reform,” and “alliance promotion.” For “business withdrawals,” it had decided to withdraw from services it judges to have no future potential or that will take time to become profitable. In the game business, it ended the Teku Teku Teku Teku and ARTILIFE services in June 2019, while it ended the SNS service friend.nico (Mastodon instances) in April of the same year. It also closed the DWANGO Artificial Intelligence Research Institute (AI research) and DWANGO CG Research (CG research) at the end of March 2019.

For “organizational reform,” as of April 1, 2019, the organization was changed to a services-based business headquarters system to clarify profit-loss balance management and at the same time, to reduce the number of managers to one third and to streamline the organization. In “alliance promotion,” it is actively building partnerships for niconico and aiming for it to become a hub for video-related sites in Japan. Recently, it entered-into a partnership with AbemaTV and in April 2019, it started distribution of it on niconico Live, focusing on the original content distributed by AbemaTV, such as dramas and variety shows, while it also established the AbemaTV Channel on niconico Channel. Users can view content on Live while posting comments, while they can view program-archive videos on Channel. Going forward, the strategy is to improve the value of niconico as a medium by expanding similar alliances.

As the business plan for the future, the Company is aiming for the Web Services business to be profitable in FY3/20; to expand the niconico peripheral businesses in FY3/21, particularly the education business; and by FY3/22, to build a management structure able to realize sustainable growth and for DWANGO, including the VR business and the education business, to achieve profitability on a stand-alone basis.

Outlook

(4) Others

In Others, the forecasts are for revenue to increase 26.9% YoY to ¥28,100mn and an operating loss of ¥2,100mn (compared to ¥2,613mn in FY3/19). The sales-increase rate appears high, but this will be mainly due to the increase in internal transactions. In profits, a loss is once again expected as the Company will continue with preparations in the inbound business toward the opening of Tokorozawa Sakura Town in FY3/20. For the education business, which is steadily growing to become one of the earnings businesses, its policy is to develop content for interactive programs and expand the schools to train human resources to work in the creative fields.

■ Strategy for the entire Group

Promote digital transformation and expand the IP business

1. Group reorganization

Based on the significant deterioration of DWANGO's results in FY3/19, the Company recognized that reconstructing DWANGO's management structure was a pressing issue, and it announced that it would implement a Group reorganization on April 1, with a further reorganization on July 1. The previous organization structure consisted of the Company and its four subsidiaries, KADOKAWA, DWANGO Co., Ltd., Gzbrain Inc., and Daihyakka NEWS, Inc. But through the reorganization on April 1, KADOKAWA was placed as a subsidiary of the Company, and under it, in addition to the previous KADOKAWA subsidiaries, were placed DWANGO, Gzbrain, and Daihyakka NEWS. So based on the leadership of KADOKAWA, a structure has been established that aims to accelerate the utilization of DWANGO's technological capabilities and vast user base across the Group, to promote the optimal allocation of management resources, to establish a solid management foundation as a group, and to realize sustainable growth and an increase in enterprise value over the medium- to long-term.

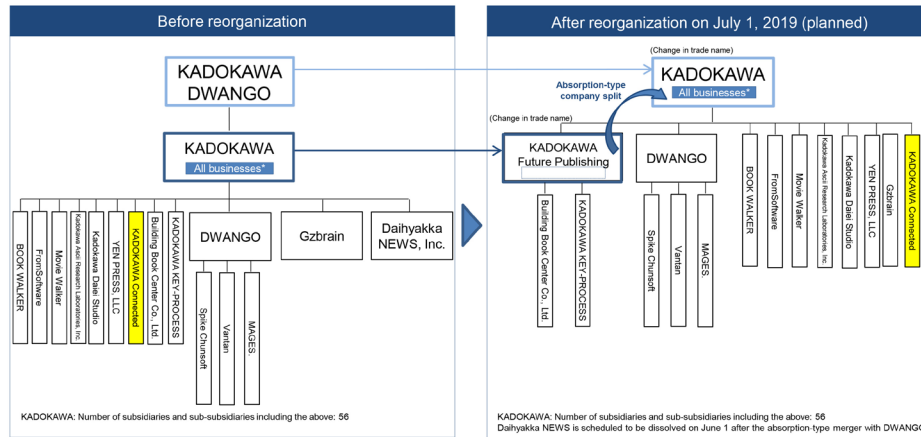
In the reorganization announced in May, it was clarified that the Company would shift from its pure holding company structure at that time to an operating holding company structure on July 1, and that it intended to enhance its IP business capabilities, which is one of its strengths, and to progress measures to strengthen the governance structure and to improve management efficiency. Specifically, the Company has taken over the KADOKAWA CORPORATION business and changed the company name from KADOKAWA DWANGO CORPORATION to KADOKAWA CORPORATION. Also, the company name of KADOKAWA CORPORATION, which was a subsidiary of KADOKAWA DWANGO CORPORATION, was changed to KADOKAWA FUTURE PUBLISHING, and it became an intermediate holding company that manages the production and distribution subsidiaries of print publication businesses.

Strategy for the entire Group

Purposes of the reorganization

Purposes of the reorganization

Reinforcement of IP business capability, governance, and streamlined corporate management through becoming an operating holding company



Source: The Company's results briefing materials

2. Specific measures

(1) Make the DWANGO businesses profitable

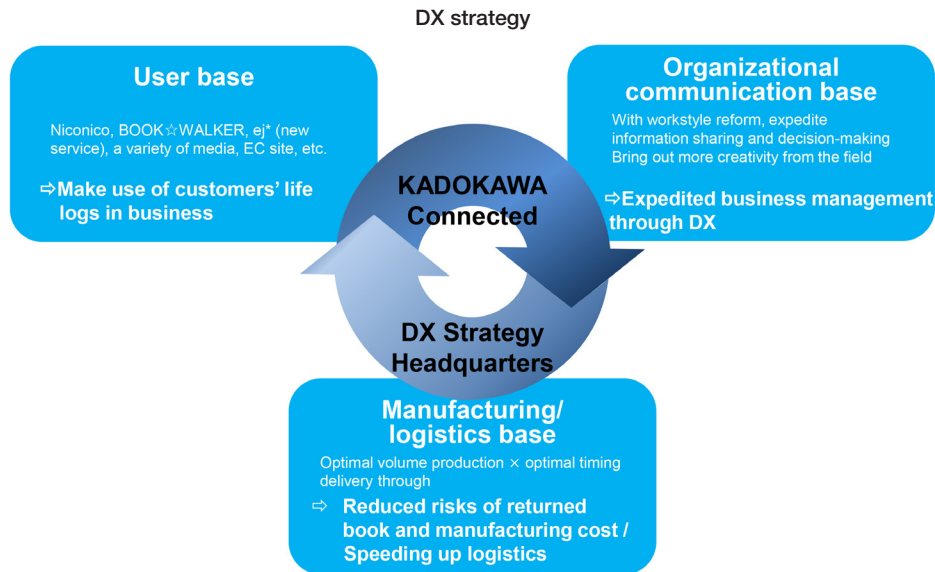
For the DWANGO businesses, it intends to advance business selection and concentration and implement the above-described measures, and to restructure them to the profitable video distribution portal business.

(2) Implement digital transformation (DX) for all Group departments and businesses

The Company is reorganizing the KADOKAWA organization structural and placing the DX Strategy Headquarters as the central axis of the entire organization in order to optimize DX as a whole. Also, in order to accelerate the implementation of DX, in April 2019, a total of 120 engineers from the ICT departments of KADOKAWA and DWANGO were gathered, and a new company, KADOKAWA Connected Inc., was established. It is thought that at the new company, by providing a work and personnel environment that is easy for IT engineers to work in, it will not only reform and advance the ICT (Information Communication Technology) work of the Group as a whole, but also provide the industry's highest level of ICT services inside and outside of the Group. The plan is to increase the number of IT engineers in this subsidiary to 200 people at an early stage.

Going forward, the Company will reform its three foundations (user base, organizational communication base, and manufacturing and logistics base) based on DX, and reform the businesses from the users' point of view, with the aim of creating an organization with strengthened costs competitiveness and improved productivity. In particular, there are many labor-intensive work flows in KADOKAWA, whose main business is the Publishing business, so it seems that there remains plenty of room to improve their productivity through conducting sweeping reforms using DX.

Strategy for the entire Group



Source: The Company's results briefing materials

(3) Enhance the ability to create foundation IP

In order to further enhance the ability to create IP, which is one of the Company's strengths, it has established the IP Creation (IPC) Business Headquarters, and it is working to optimize the organization and further develop human resources. In particular, the number of hit works from novels posted on the Internet has been increasing recently, and discovering and developing such authors has become an important skill for editors. So it is thought that the Company will enhance its ability to create IP through developing many human resources who possess this skill.

(4) Strengthening media mix development capabilities

The Company has established the IPEx Business Headquarters, whose responsibilities include movies and anime, games, rights, MD, and overseas businesses, and it is aiming to optimize the media mix management organization. The new organization will proceed with turning original source material into games and movies as well as global expansion as required by the mixed media strategy to carry out initiatives effectively and increase corporate value.

(5) Reforming the production and logistics platforms

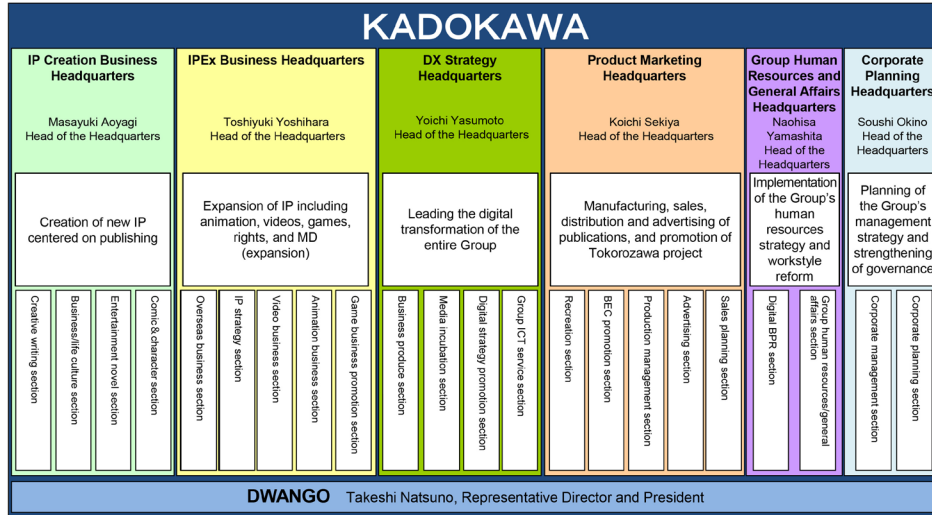
The Company has established the Product Marketing Headquarters. By developing book store transactions and the total digitization of the publishing work flow through establishing digital printing and logistics systems and shifting to online, it is aiming to maximize earnings through realizing production of the optimal amounts at the optimal times, and by reducing the product return rate.

(6) Others

In addition, in order to strengthen the management system of the entire Group, the Group Human Resources and General Affairs Headquarters and the Corporate Planning Headquarters have been newly organized. They are working to achieve the further growth of the Group companies and to generate earnings from new businesses, including the inbound business.

Strategy for the entire Group

KADOKAWA Corporate Structure



Source: The Company's results briefing materials

3. Management targets

By progressing these measures, the Company is working to build a diverse and highly profitable business portfolio and to strengthen the management structure. Also, in order to improve enterprise value, it has stated that it is working on various measures, such as to expand businesses, including with an eye to M&A, to strengthen corporate governance, and to enhance returns to shareholders.

ESG initiatives

It seems that the Company will also strengthen its measures for ESG in the future. ESG stands for Environmental, Social and Governance, and awareness is spreading among companies both in Japan and overseas that they must conduct measures from the three viewpoints of ESG in order to realize long-term growth. In addition, recently an increasing number of institutional investors are setting the status of ESG measures as an evaluation standard when deciding to invest in a company. These efforts mainly involve reforms to ways of working, contributions to the environment and society, and checks on the corporate government system.

The Company will promote work-style reforms, mainly by the Group Human Resources and General Affairs Headquarters, while KADOKAWA Connected has been newly established to provide an environment that is easy to work in for IT engineers. In addition, the new Tokorozawa office that is scheduled to be completed in 2020 will be the largest in Japan, of about 9,917m² (3,000 tsubo) per floor, which indicates the Company's intention to take on the challenge of conducting advanced work-style reforms. In a creative environment equipped with the latest office functions, it will advance content development for the world, at the same time as aiming to realize diverse work styles and a work-life balance.

ESG initiatives

From an environmental perspective, the new manufacturing and logistics base at Tokorozawa will become operational from FY3/21, which will enable books to be produced of the optimal amounts at the optimal times. This is expected to reduce the consumption of paper through reducing the return rate, and thereby reduce the burden on the environment. In addition, some departments in the Head Office have already become paperless.

From the perspective of social contribution, the focus is on the education business. In April 2019, the N Junior High Department was newly opened, and it is utilizing the educational expertise of N High School to provide exploratory learning and programming learning. Also, in May 2019, it was announced that the N High School Investment Department would be newly established in N High School as part of its efforts for financial education. Mr. Yoshiaki Murakami has been appointed as a special adviser, and in addition to conducting classes necessary for stock investment, each student will be provided with ¥200,000 from the Murakami Foundation he created, and the students will actually buy and sell stocks to learn about investments. The Department is scheduled to be active for 9 months, from June 2019 to February 2020, with a capacity for 50 students.

For its corporate governance initiatives, the Company has shifted to an operating holding company structure and enhanced internal controls. It has also appointed four independent outside directors (there are eight in-house directors) and newly established the Nomination and Evaluation Remuneration Committee.

■ 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, while 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 acquires treasury shares if necessary. In FY3/20, the Company is planning a dividend per share of ¥20.0 (for a dividend payout ratio of 33.3%), which is the same as in the previous fiscal year.

The Company has introduced a shareholder-rewards system. Shareholders who hold 100 shares or more continuously for 1 year or more (shareholders listed at least three consecutive times in the shareholders' register) are sent a shareholder-reward catalog and an application form to receive a gift. It has also established a long-term shareholder-rewards system, in which long-term shareholders who have held shares for three years or more (shareholders listed at least seven consecutive times in the shareholders' register) receive an additional gift product.

■ 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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