COMPANY RESEARCH AND ANALYSIS REPORT

KADOKAWA CORPORATION

9468

Tokyo Stock Exchange First Section

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Index

Summary

The Company will invest management resources in books, animation, games, and the education businesses, and aims for ¥16,000mn in operating income in FY3/23

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

1. 1H FY3/21 results

In 1H FY3/21 consolidated results, while revenue fell 2.9% YoY to ¥97,553mn, operating income increased 22.8% YoY to ¥7,847mn, setting a new record high for a half-year basis. Due to the impact of COVID-19, the Video business and Web Services business accounted for approximately ¥4,300mn and ¥1,800mn of the decline in revenue, respectively. On the other hand, the increase in operating income was driven by the significant increase in profit in the Publication business based on the acceleration of growth in the high-profit-margin e-books segment, continued strong performance for both new and existing games in the Game business, and an improvement in the Company's overall operating efficiency attributable to the digital transformation (DX).

2. FY3/21 outlook

In terms of the outlook for FY3/21, the Company is forecasting revenue to increase 1.6% YoY to ¥208,000mn, and operating income to grow 29.8% YoY to ¥10,500mn, as the Company forecasts revenue to increase for the first time in two years and expects a new record high in operating income. While the third wave of COVID-19 is setting in, the Company believes that the four growth businesses (books, animation, games, and education) will continue to perform strongly without any negative impacts from the pandemic, and that these segments will drive results. 1H operating income was 74.7% of the full-year forecast, but the factors for smaller profit in 2H include the increase in depreciation as well as start-up fees for Tokorozawa Sakura Town, which celebrated its Grand Opening in November 2020, as well as an expected increase in costs in the Web Services business, including investment targeting a recovery in sales for niconico Douga services. However, the Company believes that there is a possibility for operating income to exceed its forecast depending on the sales of "Cyberpunk 2077" and other titles the Company has high hopes for, in the Game business.

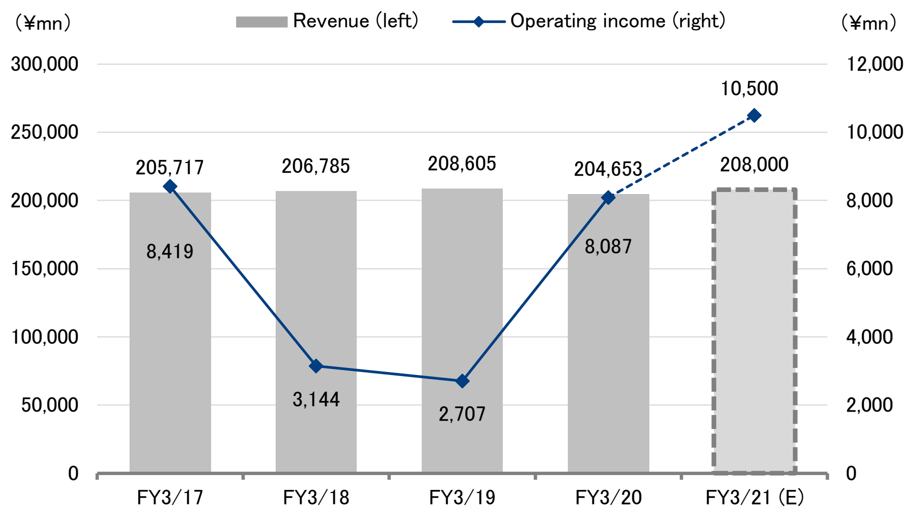
3. Medium-Term Management Strategy

In the Company's medium-term management strategy covering the period through FY3/23, the Company laid out its strategy for accelerating growth by promoting a global/media mix strategy and through DX, based on its IP creation capabilities, IP rollout power, and its IP experience power. The Company's numerical management targets for FY3/23 are revenue of ¥240bn and operating income of ¥16bn. The Company will aim to achieve these targets by investing management resources in its four businesses positioned as growth businesses (books, animation, game, education). In books, the Company will expand earnings by promoting growth in e-books as well as through manufacturing and distribution reforms. In animation and games, the Company will employ a media mix strategy for its own IP as well as capture the Publishing business. In the education business (EdTech), the number of students continues to increase at N High School (KADOGAWA DWANGO Campus), which offers an educational system provided by DWANGO, while in April 2021 the S High School will be established and the Company will begin offering an educational system utilizing VR technology. The number of students enrolled in N High School was 15,000 as of October 2020, representing a 50% increase from April 2019. Going forward, the Company expects this business to enjoy strong growth, as it believes the number of students will increase and it will provide new added-value through the use of VR courses.

Key Points

- 1H FY3/21 operating income was a record high on a six-month basis amid the COVID-19 pandemic.
- The four growth businesses (books, animation, games, education) are driving earnings
- The Company is aiming for operating income of ¥16bn in FY3/23 based on a three-pronged approach of expanding the scale of core businesses, practicing ESG/SDG-conscious management, and enhancing earnings power

Results trends



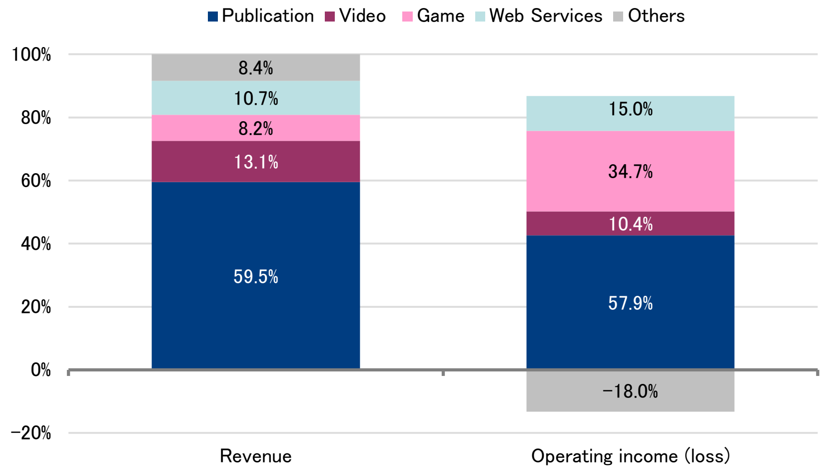
Source: Prepared by FISCO from the Company's financial results

Business overview

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

The Company is a comprehensive entertainment corporate group that operates both in Japan and overseas, with four main businesses: the Publication business, the Video business, the Game business, and the Web Services business. The breakdown of 1H FY3/21 revenue by segment shows the Publication business at a majority with 59.5%, Video business at 13.1%, Web Services business at 10.7%, Game business at 8.2%, and Others (education, CDs, goods, and other merchandising, and inbound-related business) at 8.4%. The operating loss in the Others business was covered by operating income in the four main businesses, particularly the Publication business. While Publication business is currently the primary source of sales and profits, the Company hopes to increase sales and improve profitability in the Video and Game businesses with a media mix strategy utilizing its own IP and achieve renewed growth in Web Services business, which restored profitability in FY3/20, by building the fan community and developing and providing new services.

Composition of revenue and operating income (loss) by business segment (1H FY3/21)



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

1. Publication business

In this business, which is KADOKAWA's main business, the Company publishes and sells paper-based books, separate volumes, light novels, and comics, as well as e-books and magazines. A wealth of title archives (110,000 paper-based books and 60,000 e-books) is a driving force of the KADOKAWA Group's growth. In addition to magazines including "The Television" (TV information), "Famitsu" (game information), and "Lettuce Club" (lifestyle information) and mooks (magazine-style books) in this business, the Company also produces custom media as well as selling advertisements on the Internet.

For sales of paper books, the Company has strength in developing works through its media mix strategy, and it continuously publishes new titles at a rate of 5,000 a year. The Company has worked on optimizing production and shipments based on marketing results from many years and utilization of digital technology. Its book return rate in 1H FY3/21 was in the 30% range, which is lower than the industry average.

Conversely, in e-books, the Company sells its own and other companies' works on BOOK☆WALKER, which is its directly managed e-books distribution platform, and also on the e-book stores of other companies, like Amazon <AMZN> and Rakuten, Inc. <4755>. For e-magazines, it provides and manages content in collaboration with NTT DoCoMo, Inc. <9437> for d magazine, which is an all-you-can-read magazine service. In 1H FY3/21, sales of e-books and e-magazines as a percentage of overall sales of books and magazines increased to just under 50%, as annualized growth in the segment remained above 10%, which is a high level.

2. Video business

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

3. Game business

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

4. Web Services business

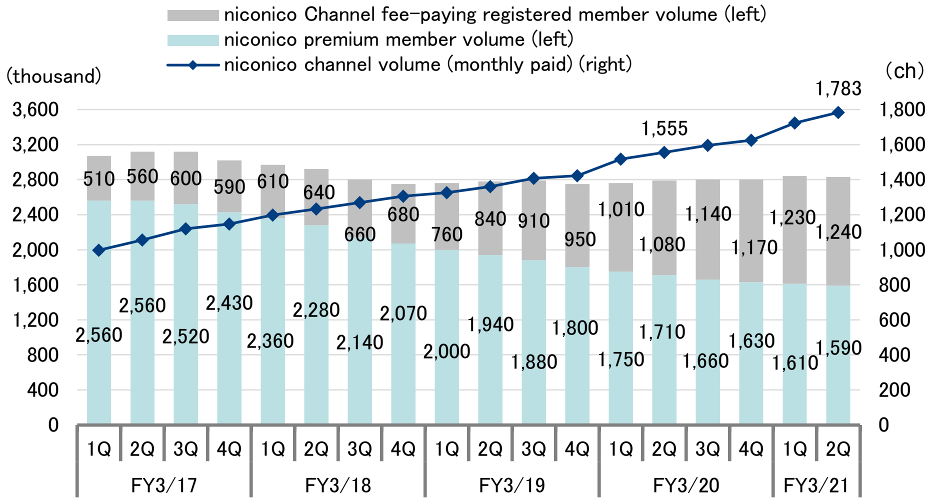
DWANGO handles the Web Services business and mainly operates a portal business (running the niconico video services, etc.). It also implements live business that plans and manages various events as niconico advertising and promotion as well as mobile business (music distribution service for mobile phones).

The Company provides various services on its mainstay portal business, including the niconico Douga, niconico Live, and niconico Channel. Sales include revenue from monthly fees (¥550/month) obtained from niconico premium members, which enables them to watch videos and live broadcasts comfortably; advertising revenue, such as from website banners and video; and revenue from points used to watch pay-to-view videos. As of September 30, 2020, the number of valid members*1 was 83 million people, while 1.59 million of these were premium members (down 120,000 people from September 30, 2019), as the downward trend since 2017 continues. However, since March 2020, the number of premium members started showing a net increase on a month-over-month basis in some months. The usage conditions from July to September 2020 were that MAU (monthly active users), including non-log-in unique users (UU)*2, was 20 million people.

*1 Number of members obtained by subtracting cancellations and unauthorized IDs from ID issuance volume.
*2 From the end of February 2018, it became possible to view without logging-in.

On the other hand, the niconico Channel is a platform where companies, organizations, and users can distribute video and live broadcasts. At the end of September 2020, it had a total of 9,553 channels (up 593 cannels from September 30, 2019), 1,783 monthly-fees channels (up 228 channels), and 1,240,000 monthly fee-paying registered members (up 160,000 people), and all of the indicators continue to increase. A growing number of companies and individuals are engaging in business using SNS video, and communications network quality has substantially improved with the version upgrade in 2018. We think the ability to view high-quality video smoothly even on a smartphone is helping increase the number of fee-paying registered members.

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



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

The live business plans and manages live events, such as niconico Chokaigi*1, Tokaigi*2, and Animelo Summer Live*3. While the Company had planned joint niconico Chokaigi and Tokaigi events in April 2020, it revised the event to a niconico Internet Chokaigi (April 12–19) in an online-only format because of COVID-19 impact. Total attendees (Internet) rose sharply to about 16.38mn people partly due to extending the event period from two days in the previous year to eight days. Also, Animelo Summer Live was canceled and instead Animelo Summer Night in Billboard Live was streamed online. In addition, at the Heresta Studio (Ikebukuro) which opened in November 2019, the site conducted live performances by virtual characters based on the concept of "merging the real and virtual worlds," and offers wide-ranging contents including anime and game-related stage events.

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

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

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

The mobile business operates dwango.jp, which distributes single songs, ring tones, and so forth, as well as animelo mix, which distributes digital contents. The mobile business still generates a decent level of profit margin, despite the continuing downward trend in the number of members due to changes in the market environment in the music distribution business.

5. Others

The Others business is comprised of businesses including the education business, the MD business and the inbound-related business. The education business is centered on Vantan Inc., which operates multiple schools focused on creative fields, and DWANGO Co., Ltd., which provides educational systems characterized by interactivity from the integration of the online and real worlds, to schools including N High School (KADOGAWA DWANGO Campus), an online-based, distance-learning high school. In the MD business, Chara-Ani Corporation engages in the planning and sales of character goods and idol music CDs and DVDs.

Results trends

1H FY3/21 operating income was a record high on a six-month basis amid the COVID-19 pandemic

1. Overview of the 1H FY3/21 results

In 1H FY3/21 consolidated results, revenue fell 2.9% YoY to ¥97,553mn, operating income increased 22.8% YoY to ¥7,847mn, ordinary income rose 19.6% YoY to ¥8,140mn, and profit attributable to owners of parent declined 16.1% to ¥5,206mn. Operating income was a new record high for a half-year basis. Despite the decline in revenue due to the impact of COVID-19, the increase in operating income was driven by the acceleration of growth in the high-profit-margin e-books segment, strong performance in the Game and education businesses, and an improvement in the operating efficiency while maintaining a high teleworking ratio (approximately 70%) due to the ongoing promotion of DX.

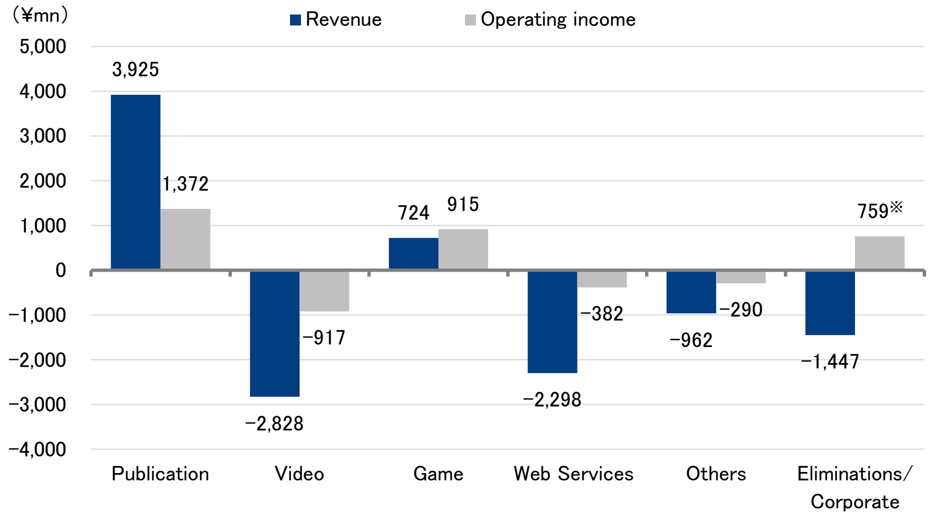
1H FY3/21 consolidated results

(¥mn)

	1H FY3/20		1H FY3/21			
	Results	% of revenue	Results	% of revenue	YoY	Amount of change
Revenue	100,439	-	97,553	-	-2.9%	-2,886
Cost of sales	67,574	67.3%	62,125	63.7%	-8.1%	-5,449
SG&A expenses	26,476	26.4%	27,580	28.3%	4.2%	1,104
Operating income	6,389	6.4%	7,847	8.0%	22.8%	1,457
Ordinary income	6,805	6.8%	8,140	8.3%	19.6%	1,335
Extraordinary income/loss	1,768	1.8%	-451	-	-	-2,219
Profit (loss) attributable to owners of parent	6,202	6.2%	5,206	5.3%	-16.1%	-996

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

Change in results by business segment (YoY)



* In conjunction with the integration of KADOKAWA CORPORATION into the KADOKAWA CORPORATION holding company in July 2019, for the 3-month period (April – June 2020), there was a cost transfer from the Corporate/Eliminations segment to business segments of approximately ¥300mn (of this, approximately ¥200mn to the Publication segment). As a result, there was an actual increase in profit of approximately ¥459mn.
Source: Prepared by FISCO from the Company's results briefing materials

Looking at the business segments, growth in the Publication business and the Game business made up for the decline in the Video business and the Web Services business which suffered large impacts from COVID-19. Looking at the amount of the negative impact of COVID-19 on revenue, in the Video business there was a minus ¥4.3bn impact due to the closure of movie theaters in conjunction with the government's emergency declaration and the seat restrictions put in place after the emergency declaration was lifted. Meanwhile, in the Web Services business, there was a minus ¥1.8bn impact due to the cancelation of live events such as niconico Chogikai and Animelo Summer Live.

In 1H FY3/20, the Company posted extraordinary income including ¥1,604mn for gain on sales of non-current assets and ¥585mn in settlement received, while in 1H FY3/21 the Company posted ¥434mn in business restructuring expenses.* As a result, profit attributable to owners of parent declined YoY.

* The Company booked losses in conjunction with the withdrawal from unprofitable businesses, and penalties associated with the termination of lease agreements due to the COVID-19 pandemic.

Acceleration in growth in e-books and strong performance centered on repeat titles in games

2. Trends by business segment

Results by business segment

(¥mn)

	1H FY3/20		1H FY3/21		Percentage change YoY		Amount change YoY	
	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income
Consolidated total	100,439	6,389	97,553	7,847	-2.9%	22.8%	-2,886	1,457
Publication	56,204	3,308	60,129	4,680	7.0%	41.5%	3,925	1,372
Video	16,060	1,760	13,232	842	-17.6%	-52.1%	-2,828	-917
Game	7,576	1,888	8,301	2,804	9.6%	48.5%	724	915
Web Services	13,159	1,591	10,861	1,209	-17.5%	-24.0%	-2,298	-382
Others	9,489	-1,167	8,527	-1,457	-10.1%	-	-962	-290
Eliminations/Corporate	-2,050	-992	-3,498	-232	-	-	-1,447	759

* In conjunction with the integration of KADOKAWA CORPORATION into KADOKAWA CORPORATION holding company in July 2019, for the 3-month period (April – June 2020), there was a cost transfer from the Corporate/Eliminations segment to business segments of approximately ¥300mn (of this, approximately ¥200mn to the Publication segment).

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

(1) Publication business

The Publication business performed well, with revenue increasing 7.0% YoY to ¥60,129mn, and operating income growing 41.5% to ¥4,680mn. In 1Q (April – June 2020), approximately ¥300mn of costs were transferred from the Corporate/Eliminations segment to business segments (allocated proportionally to the share of sales). This had the effect of increasing costs in the Publication segment by approximately ¥200mn. As a result, the increase in operating income on real basis was even higher than the reported amount.

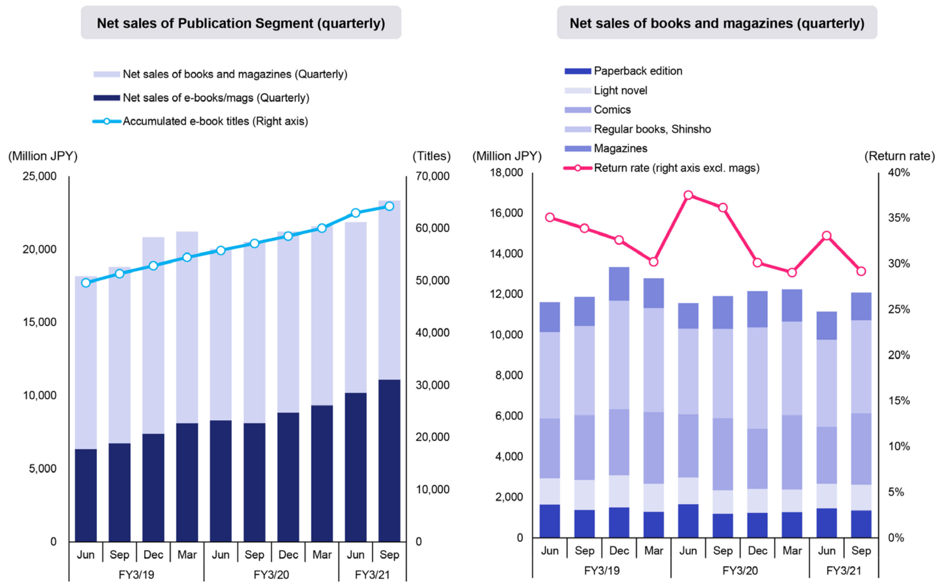
Revenue of e-books and e-magazines increased by ¥4,868mn, or a 30% YoY increase. There was a further acceleration of the market growth, which had already been growing due to the fact that COVID-19 was making people refrain from going out. Revenue in 1Q was 23% higher than the same quarter of the previous year, but this revenue growth increased to 37% YoY in 2Q. Looking at sales by sales channel, the ratio of sales via BOOK☆WALKER was approximately 20%, with revenue increasing 29% YoY. Meanwhile, sales through Amazon and other external sites increased by 49% YoY, and accounted for approximately 60% of revenue. The remaining sales were through d Magazine, a service operated in collaboration with NTT DoCoMo. In addition, both the number of members increased and average monthly spend per member grew.

In printed books, in continuation from 1Q, sales increased in 2Q due to strong sales at suburban stores and e-commerce bookstores. Titles that sold well included "Delicious in Dungeon, Vol. 9" (comic), "Sword Art Online (24) Unital Ring III" (light novel), "Aokute Itakute Moroi" (paperback edition), and Animal Crossing: New Horizons – The Complete Guide (regular book).

In terms of profits, in addition to strong sales of e-books and e-magazines, which have high profit margins, profits were aided by an improvement in return rates from bookstores. Profits were also buoyed by licensing resulting from turning IP into products and games.

Results trends

Publishing business quarterly results



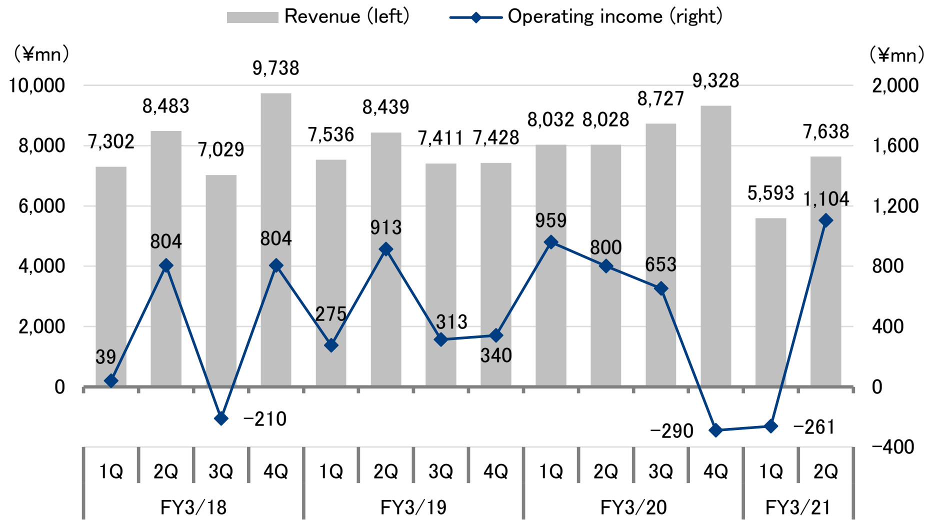
Source: The Company's results briefing materials

(2) Video business

The Video business booked ¥13,232mn in revenue (-17.6% YoY) and ¥842mn in operating income (-52.1%). The decline in revenue was caused by the closure of movie theaters and restrictions on the number of seats used after reopening, resulting in a decline in movie distribution sales, and sales of Movieticket, an electronic ticket service for movie theaters, along with other factors. Meanwhile, since the start of 2Q FY3/21 (July – September), the studio business, animation creation, and international rights sales recovered to the level of the year-earlier period. In international rights sales, titles distributed in North America and China, such as "Re:ZERO -Starting Life in Another World-," and "DECA-DANCE," contributed to revenue. Also, licensing revenue in conjunction with collaboration with online games distributed by other providers using the Company's IP continued to contribute to profits.

In terms of profits, profit declined by double digits due to the decline in revenue, but looking only at 2Q, profit increased 38.0% YoY to ¥1,104mn in conjunction with the recovery of the creation business and the licensing business. This marked the highest profit level since FY3/18.

Video business quarterly results



Source: Prepared by FISCO from the fact sheet

(3) Game business

The Game business revenue increased 9.6% YoY to ¥8,301mn, and operating income grew 48.5% YoY to ¥2,804mn. The increase in revenue was due to the strong performance of "Pokémon Mystery Dungeon: Rescue Team DX" released in March by Spike Chunsoft, as well as strong repeat sales of "SEKIRO: SHADOWS DIE TWICE" and the "DARK SOULS" series by From Software.

(4) Web Services business

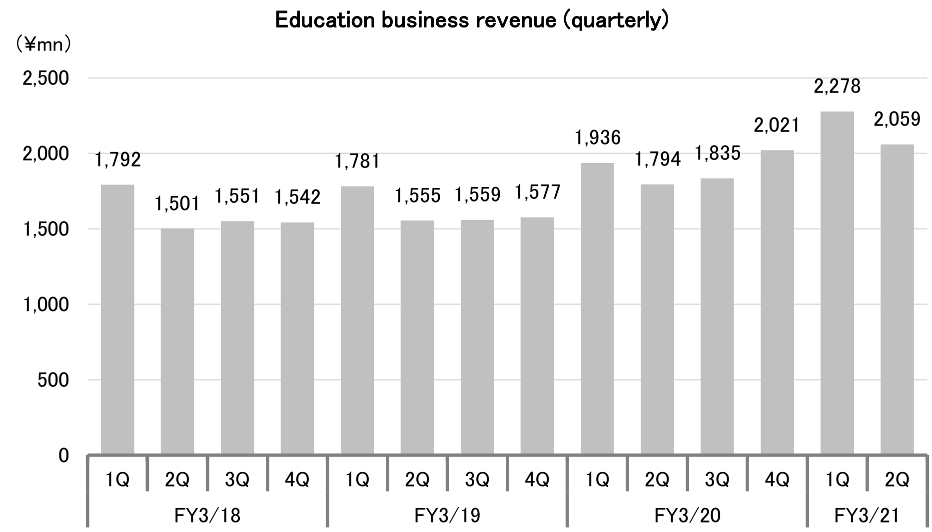
The Web Services business reported ¥10,861mn in revenue (-17.5% YoY) and ¥1,209mn in operating income (-24.0% YoY). The number of nicinico premium members declined (down 120,000 people YoY as of September 30, 2020), leading to a decline in revenue in the portal business, and sales in the live concert business fell due to the cancellation of key live events such as the niconico Chokaigi and Animelo Summer Live and the shift to holding them online. This had a negative ¥1,800mn impact on revenue.

Although there was a decline in profit due to the revenue drop in the portal business, the profit margin only fell slightly from 12.1% in the year-earlier period to 11.1%, as the impact on profit in the live concert business was minor.

(5) Others

The Others business reported ¥8,527mn in revenue (-10.1% YoY) and a ¥1,457mn operating loss (vs. a ¥1,167mn loss in the same period in the previous fiscal year).

The education business reported revenue of ¥4,337mn (+16.3% YoY). This increase was due to the steady increase in the number of students for both Vantan, the creative field school, and N High School, the online-based distance-learning high school. In particular, N High School has been growing rapidly, as the school has 15,803 students as of October 2020, which is more than 50% more than the 10,339 students as of April 2019. Meanwhile, the MD business saw a decline in sales, reflecting a delay in launching sales of idol music CDs and the cancellation of events amid the COVID-19 pandemic. In terms of profit, profit increased in the education business, but the overall loss widened due to the weak performance in the MD business and the struggles in the inbound-related business.



Source: Prepared by FISCO from the Company's fact sheet

Tokorozawa Sakura Town had grand opening in November 2020, the Company expects to recover investment amount in approximately 11 years

3. Financial condition and management indicators

Looking at financial conditions at the end of 1H FY3/21, total assets have decreased by ¥1,822mn from the end of previous fiscal year to ¥241,173mn. Breaking this down, there was a ¥13,870mn decrease in current assets and a ¥12,048mn increase in non-current assets. Looking at the main change factors, in current assets, cash and deposits declined ¥13,882mn due to the construction of Tokorozawa Sakura Town* and the acquisition of some non-current assets, while notes and accounts receivable - trade declined ¥3,086mn. In non-current assets, property, plant and equipment increased ¥8,597mn and intangible fixed assets increased ¥532mn, while investment securities increased ¥5,526mn due to a rise in the market value of shares held. On the other hand, deferred tax assets declined ¥2,580mn.

* This is the centerpiece site of the COOL JAPAN FOREST Vision (Joint project between the Company and Tokorozawa city), which aims to generate cutting-edge culture and industry in a location with rich greenery and disseminate them to the world. It includes a book manufacturing and logistics plant, new office space, event space, an anime hotel, shops, restaurants, and commercial facilities operated by the Company, and Kadokawa Musashino Museum, a cultural multifaceted facility, managed and operated by Kadokawa Culture Promotion Foundation. The total budget is ¥39.5bn.

Total liabilities declined ¥9,069 from the end of previous fiscal year, to ¥126,551mn. In current liabilities, notes and accounts payable - trade declined ¥3,366mn, advances received fell ¥2,302mn, and provision for sales returns declined ¥1,218mn. Also, interest-bearing debt increased ¥47mn to ¥65,571. The repayment deadline for ¥10,000mn booked in non-current liabilities as long-term borrowings is now less than a year away, so this amount was moved to current liabilities.

Net assets increased by ¥7,246mn from the end of previous fiscal year to ¥114,621mn. Retained earnings increased ¥3,318mn due to factors including ¥1,888mn of dividend payments and the booking of ¥5,206mn in profit attributable to owners of parent. In addition, valuation difference on available-for-sale securities increased ¥4,054mn due to the increase in the aggregate market value of shares held.

In management indicators, the Company's equity ratio, which reflects soundness, climbed by 3.4pp from the end of previous fiscal year to 46.7%, and the D/E ratio (interest-bearing debt/capital) declined by 0.04pp to 0.58x, as the financial condition of the Company improved a bit. Net cash (cash and deposits – interest-bearing debt) declined from positive ¥9.3bn at the end of FY3/20 to minus ¥4.5bn, mainly due to the increase in construction cost outlays for Tokorozawa Sakura Town, but based on the fact that large investment has already peaked, net cash is expected to improve from FY3/22 onward.

Consolidated balance sheet

(¥mn)

	FY3/18	FY3/19	FY3/20	1H FY3/21	Change
Current assets	155,312	148,975	143,919	130,049	-13,870
(Cash and deposits)	85,962	73,597	74,880	60,998	-13,882
Non-current assets	84,569	91,096	99,076	111,124	12,048
Total assets	239,881	240,072	242,995	241,173	-1,822
Current liabilities	74,266	65,325	65,176	66,034	858
Non-current liabilities	56,487	71,335	70,444	60,517	-9,927
Total liabilities	130,753	136,660	135,620	126,551	-9,069
(Interest-bearing debt)	65,399	65,518	65,524	65,571	47
Net assets	109,128	103,411	107,375	114,621	7,246

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

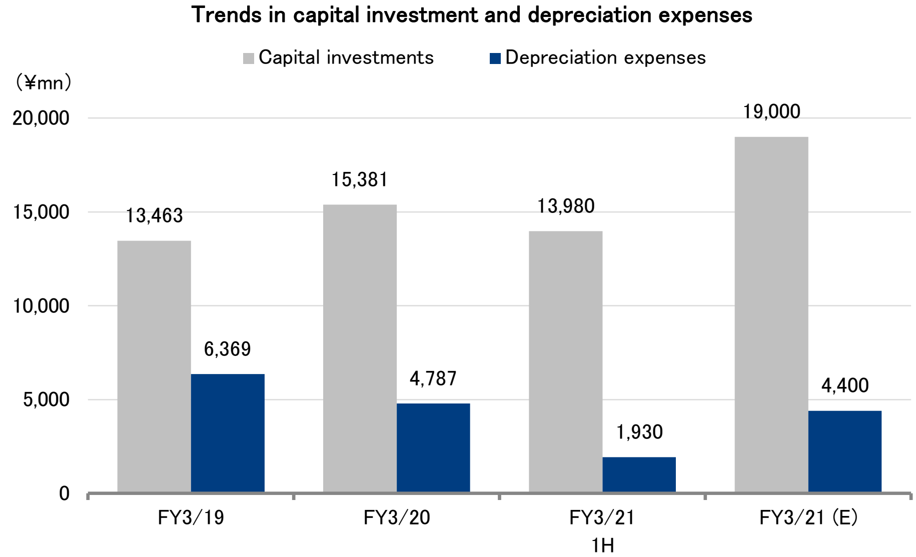
Management indicators

(¥mn)

	FY3/18	FY3/19	FY3/20	1H FY3/21
Financial soundness				
Current ratio	209.1%	228.1%	220.8%	196.9%
Equity ratio	44.7%	42.2%	43.3%	46.7%
D/E ratio	0.61	0.63	0.62	0.58

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

The amount of capital investment in FY3/21 on a cash basis is forecast to be ¥19bn. Tokorozawa Sakura Town had its grand opening in November 2020, and this concluded the large investments. From FY3/22 onward, the amount of capital investment is expected to be much lower than the level in FY3/21. Depreciation related to Tokorozawa Sakura Town is expected to be ¥1.2bn in FY3/21, and ¥2.3 in FY3/22 and beyond. As a result, FY3/22 depreciation is expected to be approximately ¥1.1bn higher than the ¥4.4bn of depreciation forecast for FY3/21.



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

Outlook

Expecting record high operating income in FY3/21, driven by the growth businesses amid the COVID-19 pandemic

1. FY3/21 outlook

In terms of the consolidated results outlook for FY3/21, the Company is forecasting revenue to increase 1.6% YoY to ¥208,000mn, operating income to grow 29.8% YoY to ¥10,500mn, ordinary income to increase 25.2% to ¥11,000mn, and profit attributable to owners of parent to decline 9.9% to ¥7,300mn. Profit attributable to owners of parent will decline due to the non-recurrence of the extraordinary profit on gains on sales of non-current assets posted in FY3/20, but the Company is forecasting record high operating income.

FY3/21 results outlook

(¥mn)

	FY3/20		FY3/21			Progress rate through 1H
	Results	% of revenue	Forecast	% of revenue	YoY	
Revenue	204,653	-	208,000	-	1.6%	46.9%
Operating income	8,087	4.0%	10,500	5.0%	29.8%	74.7%
Ordinary income	8,787	4.3%	11,000	5.3%	25.2%	74.0%
Profit (loss) attributable to owners of parent	8,098	4.0%	7,300	3.5%	-9.9%	71.3%
EBITDA	12,948	6.3%	15,000	7.2%	15.8%	65.4%
Profit per share (¥)	130.12		118.52			

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

While the third wave of COVID-19 is setting in, the Company believes that the four growth businesses (books, animation, games, and education) will continue to perform strongly in 2H and drive overall results. In terms of costs, the opening of the new Tokorozawa office and the 70% teleworking rate system are expected to reduce office rental costs.

The progress rate through 1H compared to full-year FY3/21 forecasts are 46.9% for revenue, and 74.7% for operating income. Factors include the increase in depreciation costs in 2H (+¥540mn versus 1H), the plans for aggressive investment in order to realize earnings growth in the Web Services business, and the expectations for increased costs in the Game business. However, we believe that these forecasts are conservative overall, and we think that the Company has a good chance of achieving its forecasts.

The four growth businesses (books, animation, games, education) are driving earnings

2. Outlook by business segment

Results outlook by business segment

(¥mn)

	FY3/20		FY3/21		YoY		Forecast Progress rate through 1H	
	Results		Forecast					
	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income
Consolidated total	204,653	8,087	208,000	10,500	1.6%	29.8%	46.9%	74.7%
Publication	117,303	6,248	127,500	8,300	8.7%	32.8%	47.2%	56.4%
Video	34,116	2,122	30,000	2,200	-12.1%	3.6%	44.1%	38.3%
Game	14,237	1,278	16,000	3,100	12.4%	142.4%	51.9%	90.5%
Web Services	24,739	2,788	20,900	1,400	-15.5%	-49.8%	52.0%	86.4%
Others	19,497	-2,583	21,700	-3,600	11.3%	-	39.3%	-
Eliminations/Corporate	-5,240	-1,768	-8,100	-900	-	-	-	-

* In conjunction with the integration of KADOKAWA CORPORATION into KADOKAWA CORPORATION holding company in July 2019, for the three-month period (April – June 2020), there was a cost transfer from the Corporate/Eliminations segment to business segments of approximately ¥300mn (of this, approximately ¥200mn to the Publication segment).
Source: Prepared by FISCO from the Company's results briefing materials

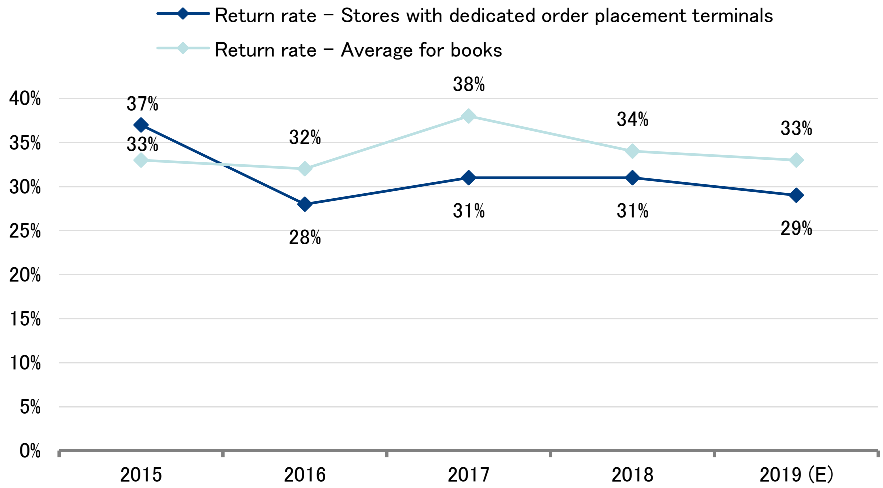
(1) Publication business

In the Publication business, the Company expects revenue to increase 8.7% YoY to ¥127,500mn, and operating income to increase 32.8% to ¥8,300mn. In the high-growth area of e-books and e-magazines, the Company will aggressively incorporate content into story sales and subscription services (all-you-can-read) services, to grow the profit base even further.

In printed books, in light novels, the Company plans to add many influential IP, including "The Intuition of Haruhi Suzumiya," a very popular series with more than 20 million copies in print, which will get its first new novel in 9.5 years (released November 2020), and "The Irregular at Magic High School: Magian Company," the sequel to "The Irregular of Magic High School," which has more than 15 million copies in print (released October 2020). With these and other IP, the Company expects revenue to increase in 2H FY3/21.

The Company expects operating income to increase due to the increase in revenue as well as cost reductions due to an improvement in the return rate for printed books. Since dedicated order placement terminal integrations with bookstores will help improve the return rate to be lower than the return rate at other stores, the Company plans to increase the number of stores using such terminals in 2020.

Change in return rates at stores with dedicated order placement terminals and stores without such terminals



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

(2) Video business

In the Video business, the Company is forecasting revenue to decline 12.1% YoY to ¥30,000mn, and operating income to increase 3.6% to ¥2,200mn. Although box office revenue will decline in 2H FY3/21 due to ongoing seat restrictions at movie theaters, the Company is expecting an expansion of the highly-profitable animation business and an increase in licensing revenue for online games distributed to other providers using the Company's IP. For 2H, IP expectations include the theater animation "Josse, the Tiger and the Fish" (due to be released on December 25, 2020) and TV animation "Love Live! Nijigasaki High School Idol Club" (started being broadcast in October 2020).

(3) Game business

In the Game business, the Company is forecasting revenue to increase 12.4% YoY to ¥16,000mn, and operating income to increase 142.4% YoY to ¥3,100mn. In terms of influential titles in 2H FY3/21, Spike Chunsoft will release "Cyberpunk 2077"*1 localized for Japan (due to be released December 10, 2020), and "Re: Zero – Starting Life in Another World – The Prophecy of the Throne,"*2 based on a very popular original light novel (due to be released on January 28, 2021).

*1 Developed by CD PROJEKT RED from Poland. An open world-style RPG set in a future world. The platform is compatible with PS4/Xbox One/PC. Also compatible with free upgrade to PS5 version expected in the future.

*2 A tactical adventure game developed in an original story fully supervised by the original author. Platforms are PS4/Nintendo Switch/Steam.

Looking at operating income on a six-month basis, the Company expects operating income to decline from ¥2,804mn in 1H to ¥296mn in 2H. This is because, in addition to the fact that sales of high-profit repeat products were strong in 1H, the Company is expecting an increase in costs in 2H. However, at FISCO we feel that there is a strong possibility that game sales will increase in 2H as well, and believe that there is a solid possibility that results in the Game business could exceed the Company's forecast.

(4) Web Services business

In the Web Services business, the Company forecasts revenue to decrease 15.5% YoY to ¥20,900mn, and operating income to decline 49.8% to ¥1,400mn. In the portal business, although the decline in the number of niconico premium members is leveling off, revenue is expected to continue to decline. Also, in the live concert business, in-person events continue to be shifted to online events, so the Company expects revenue to decline in 2H FY3/21.

In terms of operating profit, the Company expects operating profit to decline from ¥1,209mn in 1H to ¥191mn in 2H. This decline in operating profit is expected due to aggressive investment aimed at increasing premium membership and expanding various niconico services in the portal business with the goal of recovering to a growth phase. Specifically, the Company aims to increase the number of premium members by acquiring attractive content available only to premium members, investing in development to improve UI functions, and investing promotion costs. In addition, on niconico Channel, the Company will expand content using KADOKAWA Group's IP to approximately 40 channels and improve customers' LTV.

(5) Others

The Company expects revenue in Others to increase 11.3% YoY to ¥21,700mn, but is forecasting an operating loss of ¥3,600mn (compared to a loss of ¥2,583mn in FY3/20). The expected increase in revenue is due to the continued growth of the education business backed by the increase in the number of students, as well as new businesses in conjunction with the opening of Tokorozawa Sakura Town (hotel business, events business, restaurant/bar business, etc.)

The widening of the operating loss will be due to the increase in up-front investment associated with the opening of Tokorozawa Sakura Town, while the education business is expected to see an increase in profit. Also, the Company plans to individually examine unprofitable businesses, and decide whether to withdraw from them or work to rebuild them.

Medium-Term Management Strategy

Group's content business to enter new growth phase through "DX × ABW"

1. Current business environment and future direction

As corporate activities and the living environment change drastically due to COVID-19, companies need to come up with growth strategies compatible with the era of the new normal. As mentioned above, the strengths of KADOGAWA Group, such as IP creation and deployment capabilities, are considered to be the driving force for business performance growth from April 2020. KADOGAWA Group is aiming to enter a new growth phase by further promoting the content business's "DX × ABW*."

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

The Company's plan for future initiatives are as follows.

a) With 5,000 + α newly published book titles/year, and continuing to produce original game/anime IPs (= base content), the Company will build a foundation for multi-dimensional and stable business growth.
b) Increase the room for business growth through direct deployment of the original IP by the Company, as well as by taking in the Publishing business which has plenty of room to grow.
c) Raise the level of both the business and management infrastructure by advancing DX.
d) Expedite the expansion of the real (physical) business eyeing the end of the COVID-19 pandemic.
e) View the value of ABW/ABT (Activity Based Teams) in the real workplace in a fresh light and promote ABW/ABT.

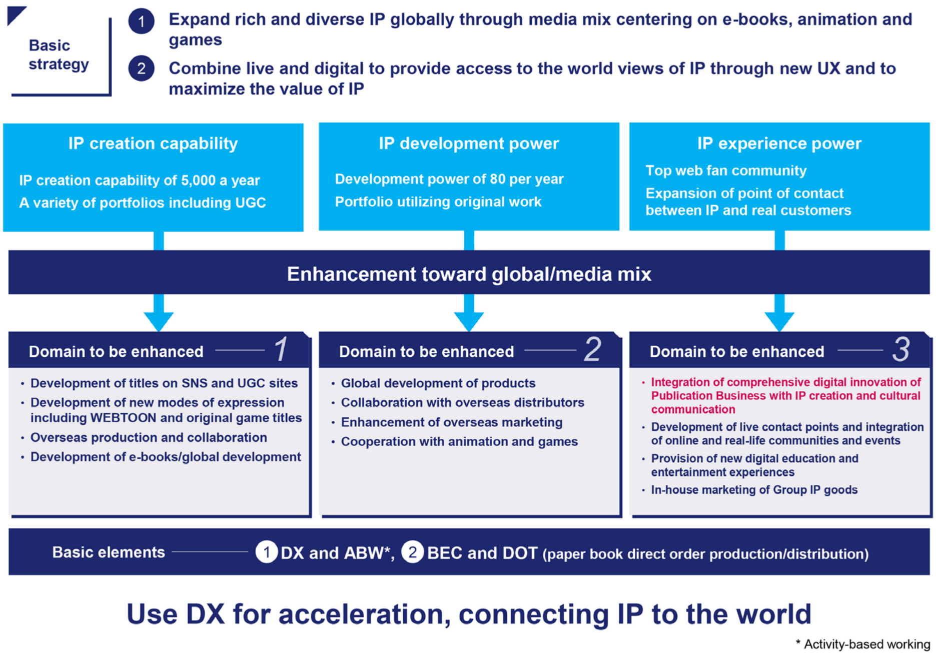
Globally deploy rich and diverse IP through media mix strategy, combine live and digital to maximize IP value

2. Fundamental strategy and changes in the business environment

(1) Fundamental strategy

The Company aims to integrate creation, rollout, and experiences for IP, its strength, and pursue global rollout under a media mix strategy as its fundamental strategy to realize growth. For example, it aims to offer attractive IP in animated video and game formats, deploy these contents globally, and strengthen collaboration with overseas platform operators (including co-creation of contents). In addition, by having people experience the world views of IP at live events, goods development, and the fan community online, the Company aims to expand contact points with customers, and by promoting DX initiatives, the Company's strategy aims to accelerate the speed of rollout and maximize the value of IP.

KADOKAWA Group's fundamental strategy – Global/media mix



Source: The Company's results briefing materials

(2) Changes in the business environment

Due to the COVID-19 pandemic, there has been a delay in the experience-based business and face-to-face services. However, on the other hand, the market environment has changed significantly since the spring of 2020, including an increase in demand for IP via the Internet, and the Company has been successful in capturing IP demand by responding to flexibly to changes with upfront investment in ABW and DX.

In terms of negative impacts, in addition to the aforementioned cancellation or postponement of live events and the postponement of broadcasts and releases of video works, there has been a delay in the manufacturing and distribution reform project being advanced at the new Tokorozawa plant. Due to delays in the arrival of overseas engineers needed to build the production lines and the collection of product and technical information from overseas, full-scale operation at the plant may be delayed by about one year.

On the other hand, in terms of positive impacts, online events attracted a record-high number of attendees (17.74mn visitors to niconico Internet Chogikai), sales of e-books grew 38% YoY (January – August 2020) and overseas monthly sales exceeded ¥100mn, video subscription sales grew, and the number of games sold surged along with a general increase in IP demand mainly online. Many of these positive aspects are not temporary phenomena, but rather it is believed that that the phenomena that should have arrived several years from now arrived ahead of schedule, and at FISCO we believe that the basic trend will not change even in the era of the new normal in the future.

The Company is aiming for operating income of ¥16bn in FY3/23 based on a three-pronged approach of expanding the scale of core businesses, practicing ESG/SDG-conscious management, and enhancing earnings power

3. Numerical management targets and business strategy

In terms of numerical management targets for FY3/23, the Company is targeting revenue of ¥240bn, operating income of ¥16bn, and EBITDA of ¥25bn. The revenue amount is the same as the initially-announced amount, but the Company has increased the operating income target by ¥1bn, likely based on the outlook for strong results in FY3/21. The Company looks to achieve these targets by expanding the scale of its core businesses, practicing ESG/SDG-conscious management, and enhancing earnings power, and over the medium to long term the Company aims to achieve sustainable growth enhance its corporate value.

Management numerical goals

(¥bn)

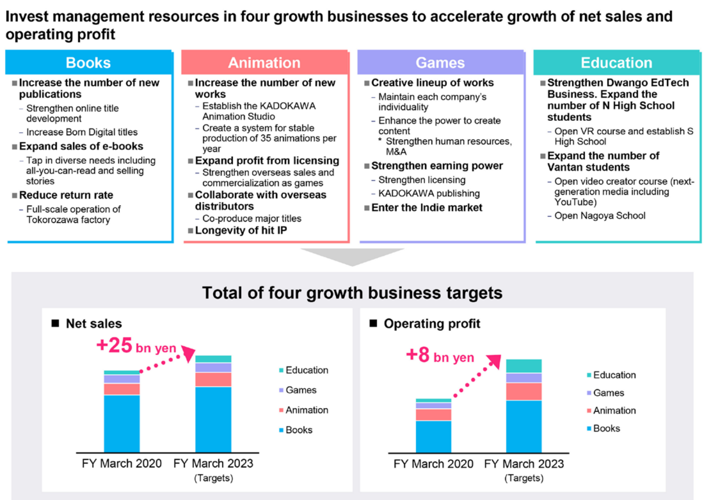
	FY3/20 Results	FY23/3 Initial target	FY23/3 Revised target	Annualized average growth rate
Revenue	2,046	2,400	2,400	5.5%
Operating income	80	150	160	25.5%
EBITDA	129	-	250	23.4%
EBITDA margin	6.3%	-	10.4%	

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

(1) Aggressive investment in growth businesses

The Company has announced its plan to invest management resources in the four growth businesses (books, animation, games, education) and accelerate their growth in order to achieve its targets. The Company expects total revenue in these four businesses to increase by ¥25bn over the three years that started in FY3/20. This would account for approximately 70% of the entire increase in revenue for the Company. Similarly, the Company forecasts operating income from these four businesses to increase by a total of ¥8bn, which is the same as the companywide increase over a three-year period.

Aggressive investment in growth businesses



Source: The Company's results briefing materials

In the books business, the Company aims for revenue growth based on an increase in the number of new publications (strengthen online title development, increase Born Digital titles*) and measures to bolster sales of e-books (capture diverse needs including all-you-can-read service and story selling) and reduce the return rate by expanding the cooperative system with partnering bookstores.

* On the Company's Kakuyomu novel submission site, in FY3/20 there were 122 submissions that were turned into books, as well as some submissions turned into dramas and animations. This activity is expected to pick up even more momentum, partially due to the Company's introduction in October 2019of a program to return advertisement expenses to authors.

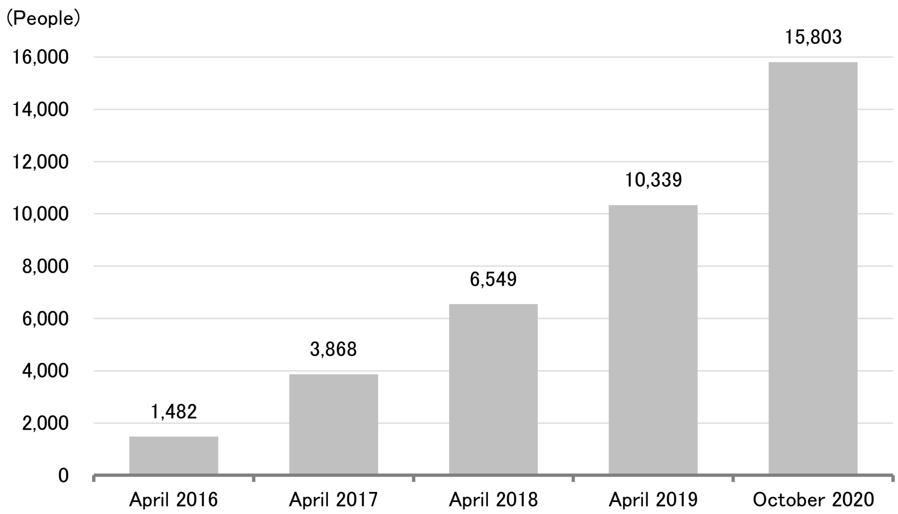
In the animation business, the Company will expand earnings through a number of efforts, including increasing the number of new works, increasing profits from licensing (overseas sales and licensed sales based on commercialization as games, etc.), collaboration with overseas distributors (co-produce major titles), and increasing the longevity of hit IP. In particular, Japanese animation are popular overseas, and there seems to be significant room for growth through licensing revenue.

In the Game business, the Company will maintain the individuality of each of the Group companies and enhance their ability to create content, as well as bolster earnings power by enhancing license sales and through the full-fledged development of KADOKAWA Publishing, and enter the UGC/indie game market*, thereby seeking additional growth. The Company has been selling the game creation tool "RPG Maker" series for the UGC/indie game market for 30 years, and has sold a total of 3.5 million units mainly to overseas users. In order to further strengthen this business, in September 2020 the Company established Gotcha Gotcha Games Inc. through a stock split. Going forward, the Company will aim to secure stable earnings through the sale of its abundant games as well as by offering a new service using a subscription model. Also, the Company plans to develop business on a global scale, with an eye towards business tie-ups with partners in Japan and overseas.

* Games developed by individuals or a small number of developers.

In the education business, the Company will bolster the initiatives in the Dwango EdTech business. Specifically, in conjunction with the increase in the number of students in N High School, KADOGAWA DWANGO Campus plans to establish "S High School" in April 2021. From April 2021, N High School and S High School will start offering a premium version of the general academic course using VR technology, and DWANGO will provide the VR education system. With the continued increase in the number of students, the Company expects a high growth rate going forward.

Number of students in N High School



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

(2) Further evolution of work style

With the opening of the Tokorozawa office, the Company will shift to a new work style with ABT,* in which the office evolves into a co-creation space and merges with teleworking. The upgrading of infrastructure is also resulting in improved operational efficiency. In editing operations, paper proofreading is the last hurdle for teleworking, but by resolving technical issues such as PDF proofreading and tablet color proofing, the Company aims to realize 100% teleworking for editing by FY3/23.

* As of March 2020, the Company had made the decision to return approximately 16,528 m2 of office space, but with the increase in teleworking due to COVID-19, the Company plans to return more office space and warehouses by FY3/23.

(3) Agile manufacturing and sales systems

By having the book production line operate in earnest in the Tokorozawa plant, the Company will shift from forecast-based production to on-demand production, this will improve the net shipment rate and reduce the return rate through a high-speed order reception and shipping cycle, and the Company aims to reform manufacturing and distribution in the books business. This system will cover the replicas of publications (comics, paperback books, etc.), excluding hardcover books which is approximately 25% of all products. According to the Company's estimates, it will be possible to reduce costs by approximately 10% on a net shipment count basis, so it is being seen as an initiative that will lead to an improvement in profitability. As noted above, full-scale operation is expected to start about one year later than initially planned due to the impacts of COVID-19.

(4) Strengthen data marketing

The Company is building a marketing automation base that will be shared among the Group. Specifically, the Company will build a data management platform that integrates customer data held by each group company, which will lead to improved advertising accuracy and improved services. Furthermore, by constructing its original machine learning system, the Company will work to improve the efficiency of marketing costs by optimizing advertisements and automating cross-selling promotion, and to improve the LTV of the entire Group.

(5) Bolster IP deployment capabilities

The Company is working to build its global marketing strategy and enhance its risk management system in order to capture the increasing global IP needs. In particular, IP such as animation and games are being received well overseas, and the Company can expect an increase in licensing revenue, an expansion of cross-border EC, and an expansion of the distribution platforms. In addition, the Company plans to focus on local IP development.

In terms of the marketing strategy, the Company will deploy a business field x region matrix strategy, and in terms of development, the Company will transition from a product-out type of development to a market-in style of development with an emphasis on user perspective. In terms of risk management, the Company will first figure out the risks in each region (legal, cultural), and upgrade the risk management system for each risk.

(6) Tokorozawa Project investment recovery plan and effect on improving profit

As a part of the Tokorozawa Project, in August 2020 the Company opened a new office, and opened a new business base in November 2020. The total investment amount for the Tokorozawa Project is expected to be ¥39.5bn, which is slightly less than the initial projection of ¥39.9bn. However, impacted by the COVID-19 pandemic, the timing of full-scale operations for the digital manufacturing and distribution plant has been delayed, so the investment recovery plan (if starting with 2H FY3/21) is expected to lengthen from the initial forecast of 9.9 years to 11.6 years.

In addition, under the assumption that full-scale operation will start from FY3/24, total EBITDA for the 10 years through FY3/33 is estimated to be ¥28.3bn for the digital manufacturing and distribution plant, ¥7.6bn for new businesses, and ¥10.3bn for economic effects of the office/ABW promotion effects. The impact on profit by the operation of the digital manufacturing and distribution plant in the Publication and book business will be minus ¥200mn in FY3/21 and minus ¥400mn in FY3/22 as a result of up-front depreciation, but the plant is expected to have an impact of positive ¥1,100mn in FY3/25 when the plant is fully operational (depreciation is expected to be ¥700mn in FY3/21, and ¥1,400mn in subsequent fiscal years.) As a result, the Company expects profitability in the Publication and books business to improve from no later than FY3/25.

Positioning of the Tokorozawa Project

Book manufacturing & distribution factory, new office and new business base opened in Tokorozawa, Saitama

Tokorozawa Sakuratown

1 Construction of book manufacturing & distribution factory that dramatically innovates the Publication Business infrastructure	2 Construction of new office to enhance global content development	3 Reinforcement of the Intangible Goods Business as an important element in the media mix strategy	4 Base for important initiatives for the environment and SDGs in the Publication Business
Realize small-lot and timely manufacturing by introducing a cutting-edge digital printer and introduce the most-advanced distribution equipment. Reduce the return rate, curb manufacturing costs and improve profit margin	Realize work style reform and efficient office strategy	Established as an IP dispatching base of the KADOKAWA group with digital solutions, including live distribution and the Internet event. Provide the users with new IP experiences	Reduce waste and decrease consumption of forest and water resources by restraining consumption of paper resources for the sake of sustainability

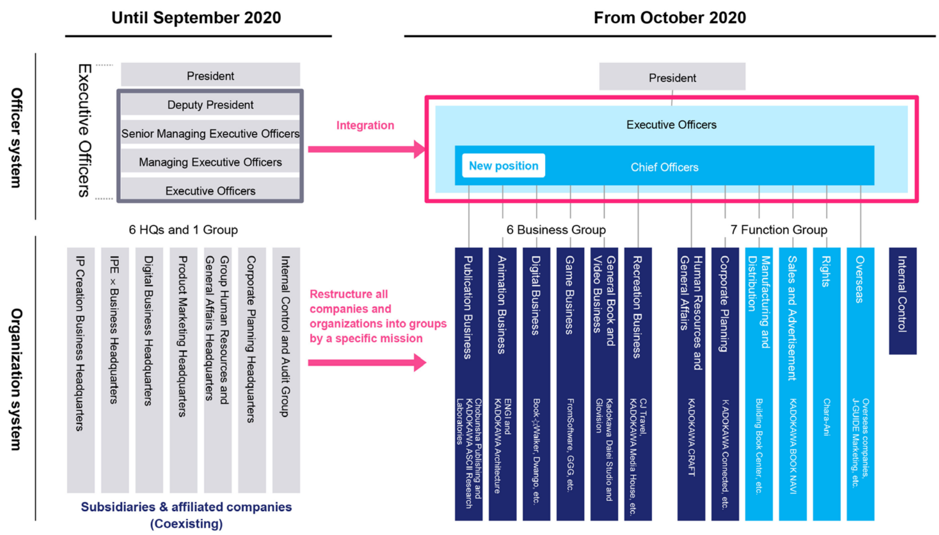
Source: The Company's results briefing materials

(7) Revision to organizational structure aimed at speeding up management decisions

In October 2020, the Company made significant changes to its organizational structure in order to accelerate the speed of management decisions by transferring decision-making authority in each business. Specifically, the positions of Deputy President, Senior Managing Executive Officer and Managing Executive Officer were abolished, and integrated into the position of Executive Officer. Additionally, manufacturing and distribution, sales and advertising, rights, and overseas were established as independent groups as strategic organizations. By subdividing the organizational structure into six business groups and seven function groups and assigning COs, the Company will be better equipped to develop businesses quickly with the aim of accelerating future growth.

Change in execution framework

- **Abolish the positions of Deputy President, Senior Managing Executive Officer and Managing Executive Officer and integrate them into Executive Officers and eradicate the Headquarters system**
- **Restructure all companies and organizations into groups by mission managed by Chief Officers (CO)**
- **Strategic organizations for manufacturing and distribution, sales and advertisement, rights, and overseas are established as independent groups**



Source: The Company's results briefing materials

SDGs initiatives

The Company also pursues management practices that factor in SDGs. SDGs is the acronym for Sustainable Development Goals that consist of 17 development goals needed to realize a sustainable society adopted at the United Nations Summit in 2015. Themes cover a wide range of issues that include poverty, health, education, energy, and the environment. The Company's SDGs-related efforts are consistent with the Company's management philosophy of "Continuity and Change."

In terms of the Company's initiatives considering sustainability in existing businesses, two examples are curbing paper resource consumption through manufacturing/distribution reforms (reduce waste and consumption of forest/water resources), and expanding the initiatives of N High School, where students can learn online (provide educational opportunities, eliminate the chain of poverty). New initiatives include enlisting women and people with overseas backgrounds as directors (promoting leadership by women and equal opportunity) and opening Tokorozawa Sakura Town with the new Tokorozawa office and cultural facilities (giving consideration to diverse work styles, local economies, and the natural environment). The Company plans to define priority issues during FY3/21 and then promote achievements in these areas.

Shareholder return policy

Plans to pay a FY3/21 dividend of ¥30.0 per share, the same as in FY3/20, and considering further expanding the shareholder gift program

The Company's basic policy is to continuously distribute profits to shareholders while at the same time bolstering internal reserves to strengthen the corporate structure on the assumption of business longevity and to prepare for unforeseen situations and future business expansion. In addition, the Company will continue to execute share buybacks, as necessary. In terms of the per share dividend for FY3/21, the Company is expecting solid operating results, so it plans to pay a dividend of ¥30.0 per share (dividend payout ratio of 25.3%), the same amount as the dividend in the previous fiscal year.

The Company's shareholder gift program covers shareholders who own 100 or more shares for at least a year*1. Qualified shareholders select one of the gift items from a catalog*2. The program offers additional gifts to shareholders for three years or longer (recorded in the shareholder register at least seven straight times under the same shareholder number) as a long-term special incentive. The Company is also considering enhancing the shareholder gift program.

*1 For example, the requirement for shareholders to receive the shareholder gift as of March 31, 2021, is to, at a minimum, have their shares recorded in the shareholder registry under the same shareholder number at the end of March 2020, September 2020, and March 2021.

*2 Choices for shareholder gifts at the end of FY3/20: books (three books), a DVD or BD (one), movie advanced ticket gift cards (two cards), BOOK☆WALKER gift card (two gift cards), Kadogawa paperback/light novel all-you-can-read card that can be used at BOOK☆WALKER (three months' worth), Kadogawa Shinjigen – revised edition (one copy), Animalium (one copy), and a Terebichan cushion (one).

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.

FISCO

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