TYO Inc.

4358 Tokyo Stock Exchange First Section

12-Nov.-15

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FISCO Ltd. Analyst
Ikuo Shibata

In addition to its recent strong results, TYO Inc. is making steady progress in its growth strategy

TYO <4358> (hereafter, "the Company") is a creative agency handling the planning and production of every type of advertising content, including TV commercial planning and production, and also areas such as digital advertising and smartphone apps, centered on branding and the Web. Within a favorable ordering environment, it is steadily expanding its results, using as a weapon the creativity that it has demonstrated in many commercial productions that have left an impression on consumers and its provision of one-stop solutions for a wide range of advertising productions.

The Company is progressing its Mid-Term Management Plan with FY7/14 as its first year. In addition to continuing to strengthen transactions with advertising agencies, by significantly expanding direct transactions with advertisers and newly developing overseas operations, in FY7/17 the Company is targeting sales of ¥40,000mn and operating profit of ¥2,700mn, for a three-year average annual sales growth rate of 14.6%, and it is also forecasting a high operating profit growth rate of 16.4%. In particular, its strategy for direct transactions with advertisers, which it has positioned as a growth field, is for the Group to capture growth by targeting every advertising production market, while continuing to leverage its competitive advantages and customer contacts in conventional TV commercial production and Web production. In addition, it is advancing preparations toward realizing overseas business developments and strategic M&As, focused on ASEAN and India.

As a result of these efforts, in March 2015 it established a supervising management company in Singapore for its overseas operations, and in July 2015 launched a joint-venture company (PT TYO FIRST EDITION) in Indonesia as the first stage of its strategic M&As in Asia. This company has launched activities by inheriting the operations from Indonesia's largest domestic capital affiliated advertising company (The First Edition) group. In addition, in August 2015, the Company made a consolidated subsidiary of K&L Inc., which is strong in the graphics field and possesses an overseas network centered on the Asia region. So in addition to its recent strong results, the Company's growth strategy would also seem to be progressing smoothly.

In the FY7/15 results, sales increased 6.9% year on year (yoy) to ¥28,393mn and operating profit rose 10.0% to ¥1,884mn. This meant sales increased for the fourth consecutive year and operating profit for the sixth consecutive year, and moreover it was a record high for profits. Compared to the initial forecasts, sales were basically the same as targeted, while each profit item exceeded its target. In particular, direct transactions with advertisers, which the Company is focusing on, significantly improved and drove the growth in results.

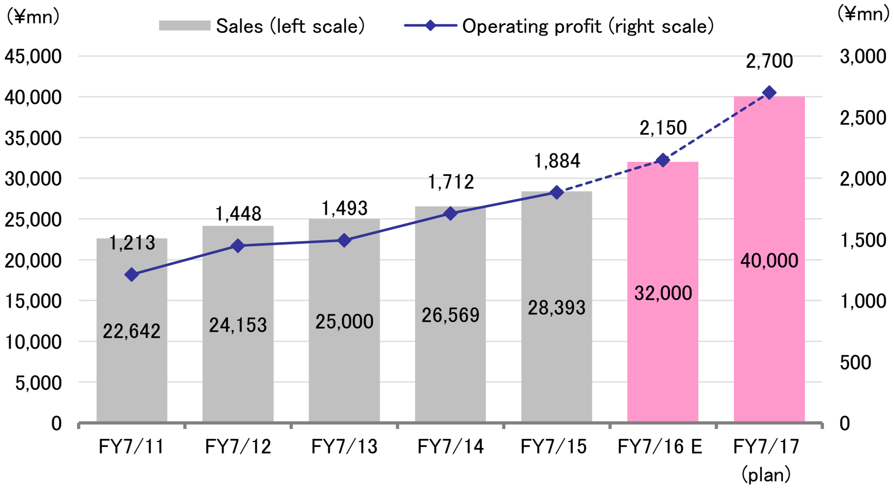
For its FY7/16 results forecasts, in accordance with its Mid-Term Management Plan the Company is forecasting continued increases in sales and profits, with sales climbing 12.7% yoy to ¥32,000mn and operating profit rising 14.1% to ¥2,150mn.

When considering not only the favorable ordering environment, but also the contributions to results of the consolidation of the Indonesian subsidiary and K&L, at FISCO we think that the Company's forecasts are at a conservative level. Therefore, including the possibility of upside for the results, we intend to pay attention to how results trend in the near future, while also keeping a watch on the progress made in the growth strategy, such as the measures for growth from the next fiscal year (FY7/17) onwards.

Check Point

- Entered a new growth stage centered on its core operations
- Each profit item exceeded targets
- Plenty of room to improve the dividend payout ratio and raise dividends alongside the growth in profits

Trends in full-year results



Company Profile

Creative agency handling the planning and production of every type of advertising content

(1) Description of operations

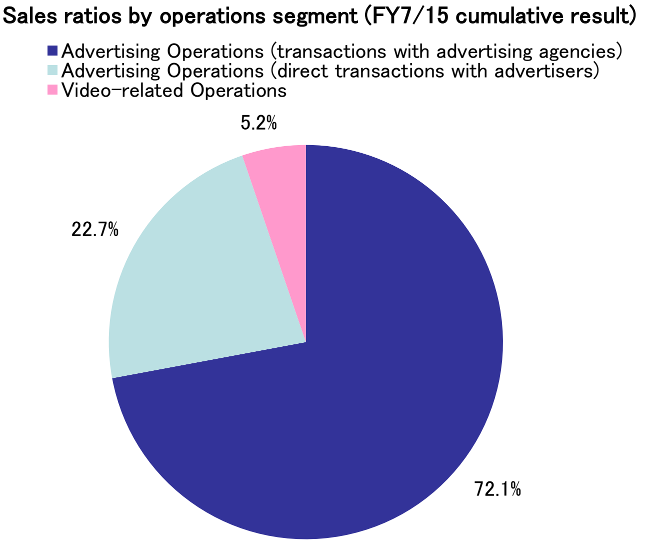
The Company is a creative agency handling the planning and production of every type of advertising content, including TV commercial planning and production, and also areas such as digital advertising and smartphone apps, centered on branding and the Web.

Within the solid growth seen in the TV commercial production market, the Company is steadily expanding its results, using as a weapon the creativity that it has demonstrated in many commercial productions that have left an impression on consumers, such as the "So da Kyoto, Iko (Let's go to Kyoto)" CM for JR Central <9022> and for Uniqlo <9983> and other clients.

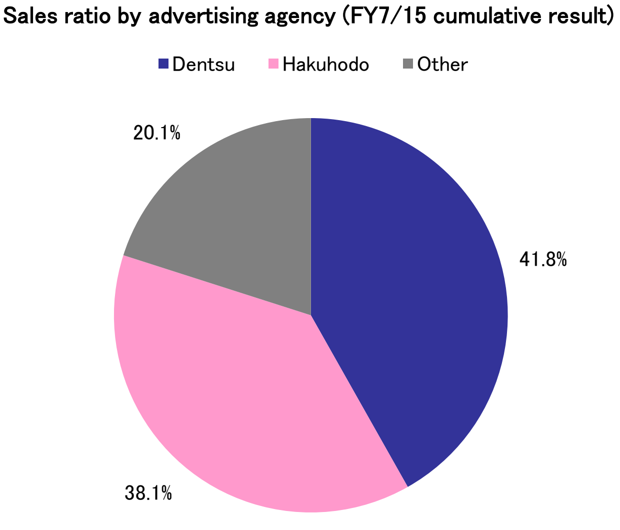
In the past, the Company tried to expand its area of operations into the entertainment business, including game software and animation, but combined with the impact of the economic recession, this expansion became a factor keeping down its results. However, it succeeded in reorganizing its operations by liquidating unprofitable segments and returning to its main operations, and it has achieved a certain level of results in terms of strengthening its financial base and improving profitability and can be said to have entered a phase of pursuing further growth.

The Company changed its operations segments in FY7/15. Previously, it had three operations segments of "TV Commercial Operations," which including the planning and production of TV commercial for advertising agencies; "Marketing Communications Operations," which carried out the planning and production of Web advertising and promotional media advertising for direct advertisers; and "Other Operations" which included the production of music videos and animation by the subsidiaries. But in order to correct distortions in profit and loss due to transactions between operations and also to reflect the actual conditions of operational activities in the segment information, the "TV Commercial Operations" and "Marketing Communications Operations" segments were integrated to create the "Advertising Operations" segment, and "Other Operations" was renamed "Video-related Operations."

In FY7/15, the main segment of Advertising Operations contributed 94.8% of sales, within which transactions with advertising agencies provided 72.1% and the growth field of direct transactions with advertisers 22.7%.



The ratios according to advertising agency were 41.8% for the Dentsu Group <4324> and 38.1% for the Hakuhodo DY Holdings Group <2433>, so the combined total for these two groups was 79.9%. Also, in the ratios according to industry, “Electrical and telecommunications,” “Vehicles, transportation equipment, and industrial machinery,” “Beverages,” and “Entertainment and amusement” ranked in the top positions.



Sales by industry TOP10

	FY7/14 (cumulative total)	FY7/15 (cumulative total)
No. 1	Beverages	Electrical and telecommunications
No. 2	Electrical and telecommunications	Vehicles, transportation equipment, and industrial machinery
No. 3	Vehicles, transportation equipment, and industrial machinery	Beverages
No. 4	Apparel, textiles, and accessories	Entertainment and amusement
No. 5	Entertainment and amusement	Education, publishing, and information
No. 6	Distribution-related and restaurants	Apparel, textiles, and accessories
No. 7	Education, publishing, and information	Cosmetics, sanitary, and medical
No. 8	Cosmetics, sanitary, and medical	Distribution-related and restaurants
No. 9	Real estate and construction	Real estate and construction
No. 10	Foods	Foods

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Has progressed operational reorganization and achieved a V-shaped recovery in results, and its listing was reassigned to the TSE 1st Section in 2014

(2) Company history

The Company was established as a commercial production company in April 1982 in Roppongi, Minato Ward, Tokyo. It was the last of the three major commercial production companies to be established. President and Representative Director Hiroaki Yoshida, together with five other commercial creators including Kazuyoshi Hayakawa (current Senior Executive Director), established the Company with the dream of "Creating an Ideal Company of Creators, by Creators, for Creators."

Since its establishment, the Company has leveraged its creativity, which is one of its strengths, to steadily put its operations on a growth track, and a commercial it produced in 1987 won the Gold Prize at the Cannes International Advertising Festival (winning it again in 1992). In 1989, it won the All-Japan CM Grand Prize, the most coveted honor in Japan's TV commercial production industry (winning it again in 1990).

Conversely, aiming for further growth the Company attempted to enter into the entertainment video field (including games, music, and TV programs) and expanded its operations. In 1994, it launched computer graphics production operations, in 1995 game software operations, and in 2000 music-related video production operations. Then in 2002, it listed on JASDAQ.

Subsequently, the Company expanded its area of operations through actively conducting M&As and establishing group companies, launching Web production operations in 2002, character production operations and animation operations in 2003, and broadcast programs production operations in 2006. In 2007, Tsuburaya Productions Co., Ltd., which had fallen into management difficulties, was incorporated into the Group (however, it was deconsolidated following the sale of all 51.0% holdings of shares to Fields <2767> in 2010).

However, compared to the stable advertising production operations, entertainment is a high-risk, high-return business and combined with the impact of the economic recession, the expansion was a factor that kept down results. The Company has continued in rapid succession to reorganize its operations by pulling out of unprofitable segments and returning to its main operations, including withdrawing from game software operations in 2009. These measures have proven successful and it has strengthened its financial base, improved profitability, and achieved a V-shaped recovery in results, and upon changing to the TSE 2nd Section in October 2013, its listing was reassigned to the 1st Section.

The Company's name came from the city code of Tokyo, TYO, used by the International Air Transport Association (IATA). The name conveys the Company's hope that talented creators will work their way to this creative business city, TYO, and its determination to become a creative agency in Tokyo representing Japan and sending out messages to the world.

New development of overseas operations is one of the pillars of its strategy

(3) Realizing strategic M&As (first stage) in Asia

In addition to continuing to strengthen transactions with advertising agencies, the main pillars of the strategy described in the "TYO Group 2013 Mid-term Management Plan" are a significant expansion in direct transactions with advertisers and the new development of overseas operations. As part of its growth strategy, the Company established a joint-venture company (PT TYO FIRST EDITION) in July 2015 in Indonesia as the first stage of its strategic M&As in Asia. In addition, in August 2015 it made a consolidated subsidiary of K&L, which is strong in the graphics field and possesses an overseas network centered on the Asia region, through a subscription to a third party allocation of shares.

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PT TYO FIRST EDITION was established as a joint-venture company with the representatives of The First Edition Group, which is the largest domestic-capital affiliated advertising company in Indonesia, and essentially it has been operational since August by inheriting the operations of The First Edition. The initial plan was for it to be established in FY7/16, but this was achieved a year ahead of schedule. The First Edition has a track record within Indonesia of providing services in various areas, including branding consulting and event, as well as creative, strategic planning and research, and events. Going forward, the aim is to expand the share of the Indonesian advertising market, which is growing remarkably, by training human resources recruited locally in the creativity, techniques, and expertise that are the Company's strengths. The policy is also to try to increase transactions with Japanese companies in Indonesia. The Company's capital contribution ratio is 51.0% (acquisition cost of approximately ¥76mn), while the cost of acquiring goodwill was the same amount of around ¥76mn (amortized straight line over 5 years).

Conversely, K&L is a creative agency with a track record of achievements in projects for major advertisers and other clients over a long period of time, particularly in the graphics field. It launched overseas operations, including in China, India, and other parts of Asia, ahead of many other Japanese companies. The abundance of achievements and expertise possessed by the K&L Group, including in its overseas operations, will be leveraged by the Group to expand its direct transactions with advertisers and for the fully fledged development of its overseas operations. In addition, by mutually and effectively utilizing the management resources and sales networks of both groups, which span domestic and foreign markets, it would seem the aims are to expand the scale and improve the efficiency of operations. Through the subscription to the third-party allocation of new shares, the Company's percentage of voting rights became 68.0% (the acquisition cost was not disclosed), while goodwill was not recorded. In addition, sales of K&L in the most recent fiscal year (FY6/15) were ¥1,499mn and its total assets were ¥388mn. Following this acquisition, K&L Advertising (Shanghai) and InterStudio Co., Ltd became consolidated subsidiaries and K&L ARMS COMMUNICATION PRIVATE LIMITED became an equity-method affiliate.

■ Characteristics of the Company

Its strengths are its sales force and creativity and it is taking an independent path of direct transactions with advertisers

The Company can be described as having four strengths; a) a rich track record of achievements and a sales force deployed as multiple brands b) creativity, as demonstrated by the many awards it has received c) provision of one-stop solutions through diverse content production, d) promotion of direct transactions with advertisers.

a) A rich track record of achievements and a sales force deployed as multiple brands
The Company's strong sales force is supported of course by have the reliability of it being a listed company, but also by its wide-ranging planning and proposal capabilities from the deployment of multiple brands that utilize their respective characteristics for their advertising production achievements for leading advertisers and other clients (more than 2,000 annual productions). In particular, the deployment of multiple brands, based on a thorough firewall (the separation of information) serves as a competition measure for the advertiser side (to dispel the harmful effects and sense of resistance from ordering from the same production company as competitors). Each respective brand has a company-like existence, which has the effect of maintaining high levels of motivation based on the transfer of significant authority and independent profitability. This is a factor differentiating the Company from the other major production companies.

The main brands of transactions with advertising agencies

TYO Productions 1	TV commercial planning and production, Video production
TYO Productions 2	TV commercial planning and production, Video production
Monster	TV commercial planning and production, Video production
Camp KAZ	TV commercial planning and production
M1 Productions	TV commercial planning and production
Creative Center	TV-CM planning and direction
TYO Technical Ranch Inc.	Video post-production operations, video photography-related operations, and lighting equipment-related operations
Ludens Co., Ltd.	CG and digital content planning and production

The main brands of direct transactions of advertisers

ID	Planning and production of Interactive contents, smartphone applications	
Dwarf	Character planning and development	
Zero3	Media-free creative planning and direction	
Zeo Corporation	Marketing communication	
Com Co., Ltd	WEB production	
Camp Draft Co., Ltd.	Brand communication design	
MIURA & Co.,Ltd.	Ideas development and direction of advertising communication	NEW
K&L, Inc.	Advertising communication business	NEW
PT TYO FIRST EDITION 【Indonesia】	Branding and consulting, creative, strategic planning and research, and event services	NEW
K&L Advertising (Shanghai) 【Shanghai】	Advertising communication business	NEW

b) Creativity, as demonstrated by the many awards it has received

In addition to being a company that was founded by creators, among the Company's 800 employees, about 90% are creators forming the creator group, and they particularly focus on quality in production. Reflecting this, the Company was responsible for many commercial productions that left an impression on consumers, such as JR Central's "So da, Kyoto, Iko" commercial which is in its 17th year and for Uniqlo and other clients. In addition, the many awards that the Company has received testifies to its unsurpassed creativity.

Awards (2014)

2014

in the World

17th Asia Pacific Advertising Festival	Grande	★★
	Gold	★★
	Silver	★★
	Bronze	★
	Finalist	★★
Cannes Lions International Festival of Creativity	Bronze	★
Spikes Asia	Silver	★
	Bronze	★

in Japan

54th ACC CM Festival	Silver	★★
	Bronze	★★★★
	Finalist	★★★★★★★★★★★
67th Dentsu Television Advertising Dentsu Award	Excellence Award	★★
Fujisankei Communications Group Advertising Award	Excellence Award	★★
51th Galaxy Awards	Galaxy Honors for Programs Recommended	★
CODE Awards	Good Campaign	★
VFX-Japan Awards	Top Excellence Award	★

c) Provision of one-stop solutions through diverse content production
The Company is involved in a wide range of advertising content production for every type of media, including TV commercial planning and production, but also sales promotion using digital media (Web, etc.) and events. Its strength is its ability to propose the optimum product mix for each advertiser's advertising publicity and sales-promotion activities. Its wide ranging planning and proposal capabilities through the provision of one-stop solutions are contributing significantly to the growth of its direct transactions with advertisers.

d) Promotion of direct transactions with advertisers
One of the characteristics of the Company is that it is promoting direct transactions with advertisers. Generally, the business practice in this industry is for advertising agencies to receive bulk orders from advertisers and production companies to play a sub-contractor role for these orders. But in contrast, in direct transactions with advertisers, the advertisers directly order projects from production companies like the Company. The background to this development are the changes starting to be seen on the advertisers' side (a movement of ordering media and production separately), and in addition, the start of a trend for a new form of mutually complementary relationship between production companies and advertising agencies, of mutually concentrating their management resources into their respective areas of specialization.

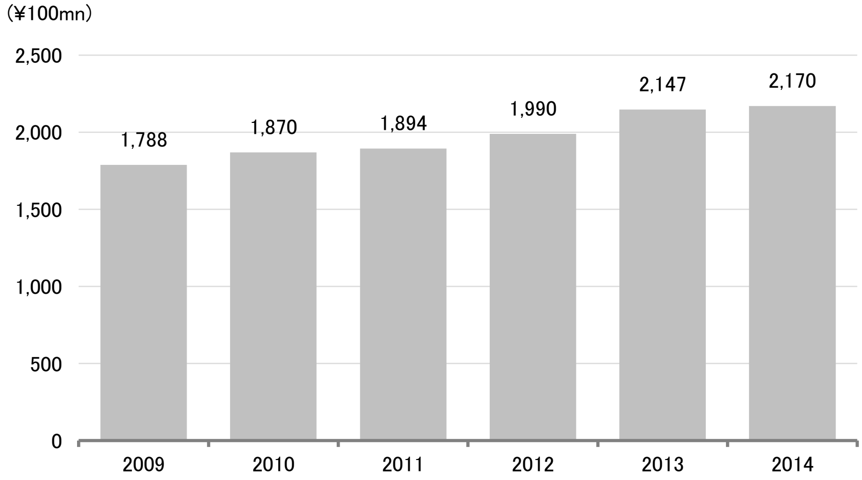
Through promoting direct transactions with advertisers, the Company is able to pursue a number of benefits, including improving profitability, building long-term relations with advertisers (a direct dialogue with the advertisers makes possible proposals from a long-term perspective), expanding the scale of projects (improving the unit price by acquiring projects that straddle media and segments), and acquiring sales promotion expenses (targeting sales promotion expenses in addition to advertising and promotion expenses).

■ Industry environment

TV commercial production, its core area, is a stable market not sensitive to economic trends

According to a survey by Dentsu, the advertising market (TV commercial market) is comprised of approximately 90% media costs and 10% production costs. Compared to media transactions the scale of the TV commercial production market is small, but in contrast to media prices that are susceptible to economic fluctuations, a characteristic of this market is that it is stable and not easily influenced by economic conditions, and this point is the biggest difference with advertising agencies as the subjects of media transactions. Over the last few years, the TV commercial production market has grown steadily and in the future, toward the holding of the 2020 Tokyo Olympics, it is anticipated that companies will become more active in their publicity and advertising activities and consequentially, the TV commercial production market is expected to expand.

Trends in TV commercial production costs

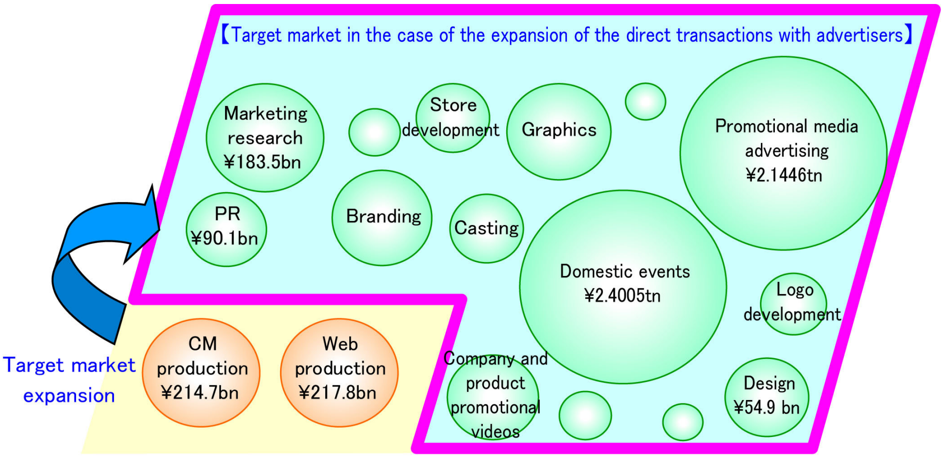


Source: Dentsu "Advertising costs in Japan"

Further, for direct transactions with advertisers, which the Company has positioned as a strategic field, it is targeting every market peripheral to advertising, including domestic events, promotions media, marketing research, PR, brands and consulting, and store development, in addition to conventional TV commercial production and Web production. The scales of the main target markets for its current operations of TV commercial production and Web production are each approximately ¥200bn, but for example, the domestic events market and the promotional media advertising market are each enormous markets with a scale of around ¥2tn. So by advancing into peripheral areas by promoting direct transactions with advertisers, the scale of the Company's market can be expected to expand onto the next level.

The Company's advance into these fields clearly distinguishes it from the other major commercial production companies, and it is precisely because it is promoting direct transactions with advertisers that it can be regarded as having tremendous potential to capture transactions in peripheral areas.

Target market for direct transactions with advertisers



With regard to the competitive environment, the three major companies, led by Tohokushinsha Film Corporation <2329>, which is the veteran of the industry, and followed by the Company and AOI Pro. Inc. <9607> account for about 30% of the total market (the Company's market share is 9.0%). On the other hand, looking at the trend in the number of members of the Japan Ad Contents Production Companies Association (JAC), we see that the number is declining, peaking at 143 companies in 1992 but falling to 96 companies by 2014. So in the context of this decline and the expanding market share of the three major companies, the industry is considered to be developing into an oligopoly. In the background to this development is thought to be the fact that it has become difficult for small operators to win projects due to the increasing awareness of compliance on the advertisers' side, including for information management, and also an operational structure of utilizing scale merits.

On the other hand, in terms of the changes on the advertisers' side, up to the present time generally they have placed bulk orders with the advertising agencies, but recently a development of ordering media and production separately has begun. It seems that the aim of this is to improve cost performance by them selecting for themselves the optimum transaction partner in each respective field. By clearly segregating advertising agencies and production companies, the complementary relationship of the co-existence and co-prosperity of both parties is being further strengthened, and this can be considered to be an excellent opportunity for the Company, which is aiming to increase its direct transactions with advertisers, to expand its operations.

Financial highlights

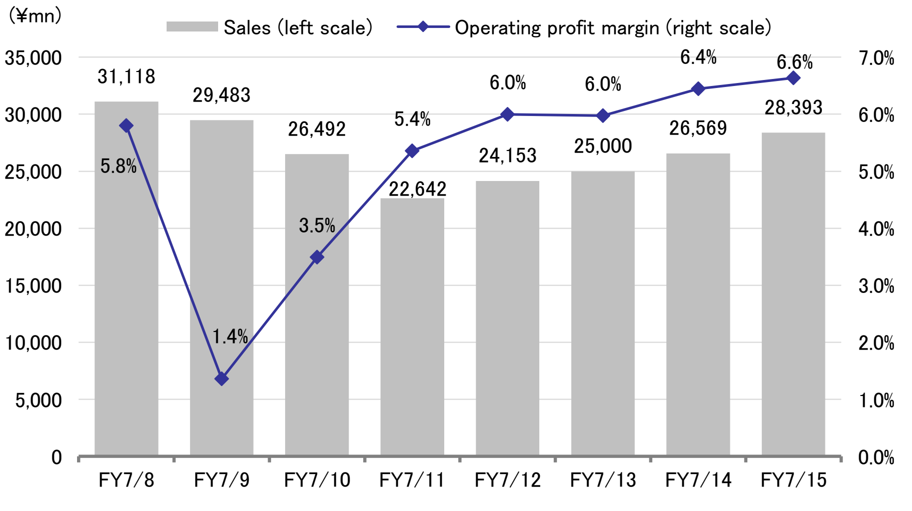
Entered a new growth stage, centered on its core operations

(1) Trends in past results

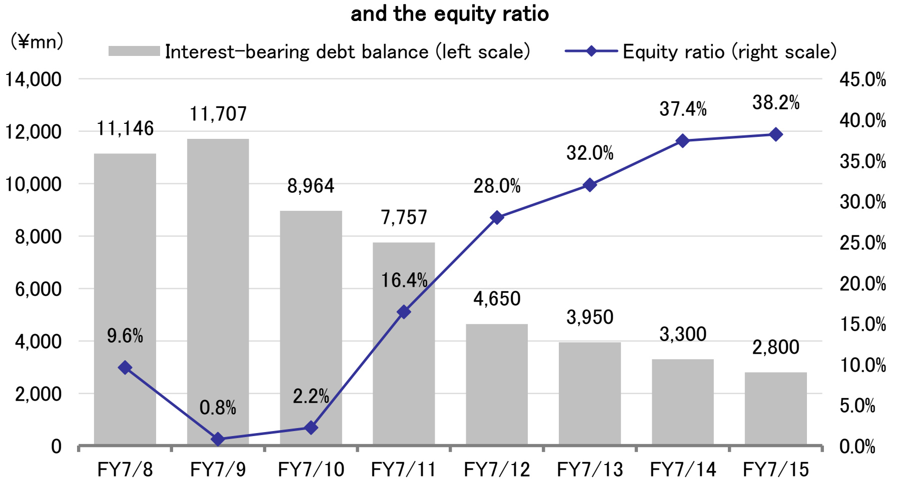
Looking at the trends in the Company's past results, we see that following the sales peak in FY7/08, they traced a downward curve as it liquidated unprofitable segments generated by the expansion of the area of operations in the past. However, it successfully reorganized operations by returning to its main operations, and after bottoming-out in FY7/11, sales increased for 4 consecutive years and the Company seems to have entered a new growth stage, centered on its core operations. On the operating profit side also, after it fell significantly in FY7/09 due to the recording of a loss by pulling out of unprofitable departments, it achieved a V-shaped recovery and increased for 6 consecutive years (achieving record highs).

In terms of finance, together with the growth of the interest-bearing debt balance alongside the expansion of the area of operations in the past, in FY7/09 the equity ratio fell significantly to 0.8% due to the liquidation of unprofitable segments. But subsequently, following the accumulation of internal funds from the recovery of results and the implementation in December 2010 of a third-party allocation of new shares (that raised approximately ¥1.3bn), the FY7/15 equity ratio had recovered to the level of 38.2%. The Company is also steadily repaying its interest-bearing debt. The FY7/15 interest-bearing debt balance was ¥2,800mn, but the net interest-bearing debt balance, calculated by subtracting the cash and deposits balance, has been zero since FY7/14.

Trends in sales and the operating profit margin



Trends in interest-bearing debt (borrowing and corporate bonds) and the equity ratio



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Each profit item exceeded targets

(2) FY7/15 financial results highlights

In the FY7/15 results, sales increased 6.9% yoy to ¥28,393mn, operating profit rose 10.0% to ¥1,884mn, ordinary profit climbed 19.7% to ¥1,806mn, and net income increased 87.8% to ¥1,119mn. This meant sales increased for the fourth consecutive year and operating profit for the sixth consecutive year, and moreover it was a record high for profits. Also, compared to the initial forecasts, sales were basically as targeted, while each profit item exceeded its target.

In sales, the favorable ordering environment is proving to be a fair wind, and in Advertising Operations, transactions with advertising agencies and direct transactions with advertisers both performed strongly, while results also grew in Video-related Operations. In particular, direct transactions with advertisers increased significantly and drove the growth in results.

On the profit side also, the operating profit margin rose to 6.6% (compared to 6.4% in the previous fiscal year) due to the reduction in fixed costs following the increase in sales and the thorough implementation of cost management, and also from the elimination of transient expenses (listing-related expenses) from the previous fiscal year.

On the balance sheet, total assets rose to ¥14,590mn (up 13.3% yoy) due to the increases in notes and accounts receivable and work in progress in conjunction with the strong orders performance. But exceeding this increase, shareholders' equity rose to ¥5,572mn (up 15.8%) from the accumulation of internal reserves, and as a result, the equity ratio improved to 38.2%. In addition, interest-bearing debt was reduced to ¥2,800mn (down 15.2% compared to the end of the previous fiscal year) from the progress made in scheduled repayments.

FY7/15 financial highlights

(unit: ¥mn)

	FY7/14 results		FY7/15 results		Change		FY7/15 Company forecasts		Achievement rate
		Ratio		Ratio		Change rate		Ratio	
Sales	26,569		28,393		1,823	6.9%	28,500		99.6%
Transactions with advertising agencies	19,789	74.5%	20,461	72.1%	672	3.4%	-	-	-
Direct transactions with advertisers	5,362	20.2%	6,444	22.7%	1,082	20.2%	-	-	-
Video-related Operations	1,417	5.3%	1,487	5.2%	70	5.0%	-	-	-
Cost	21,875	82.3%	23,425	82.5%	1,549	7.1%	-	-	-
SG&A expenses	2,981	11.2%	3,084	10.9%	102	3.4%	-	-	-
Operating profit	1,712	6.4%	1,884	6.6%	171	10.0%	1,850	6.5%	101.8%
Transactions with advertising agencies	3,344	16.9%	3,340	16.3%	-4	-0.1%	-	-	-
Direct transactions with advertisers	99	1.8%	309	4.8%	210	209.8%	-	-	-
Video-related Operations	172	12.1%	151	10.2%	-21	-12.1%	-	-	-
Ordinary profit	1,509	5.7%	1,806	6.4%	297	19.7%	1700	6.0%	106.3%
Net income	596	2.2%	1,119	3.9%	523	87.8%	900	3.2%	124.4%

The conditions in each of the main operations are as follows.

Within Advertising Operations, transactions with advertising agencies sales rose 3.4% yoy to ¥20,461mn, but operating profit fell 0.1% to ¥3,340mn, meaning profit declined despite the increase in sales. Sales can be seen to be growing stably within the gradual development in the industry of an oligopoly of the major production companies, including the Company. Also, sales to the Dentsu and Hakuhodo groups steadily grew to reach a total of ¥16,354mn for the two groups (up 0.8% yoy). The background to this increase was the strong acquisition of large-scale projects and the expansion of the video advertising market, such as for Web movies. However on the profit side, operating profit declined slightly following an increase in the number of staff and higher outsourcing costs in conjunction with the growth in sales.

Conversely, in direct transactions with advertisers, which has been positioned as a growth field, both sales and profits greatly increased, with sales rising 20.2% yoy to ¥6,444mn and operating profit 209.8% to ¥309mn. As a result of the expansion in the number of staff and the improvement in the sales force through them becoming more "battle hardened," the scale of the projects ordered expanded, which contributed to the increase in sales. On the profit side also, the shift to larger projects and the implementation of thorough cost management absorbed the prior costs from promoting new sales activities, and profits greatly increased. The operating profit margin also improved greatly to 4.8% (1.8% in the previous fiscal year). Essentially, these operations should be highly profitable as the transactions are direct. But compared to the scale of sales up to the present time, the area covered has expanded and so the structure has a heavy burden of fixed costs. Therefore, profitability can be expected to improve in the future alongside the expansion in the scale of sales.

In Video-related Operations, sales rose 5.0% yoy to ¥1,487mn, but operating profit fell 12.1% to ¥151mn, for an increase in sales but a decrease in profits. In addition to the major increases in video projects for companies and in projects such as for highly profitable live footage, the rise in the project unit cost for anime production projects contributed to the higher sales. However on the profit side, the increase in outsourced work due to the rise in anime production projects meant profits declined.

Increases in sales and profits expected to continue in this fiscal year

(3) FY7/16 results forecasts

In its FY7/16 results forecasts, in accordance with its Mid-Term Management Plan the Company is forecasting continued increases in sales and profits, with sales increasing 12.7% yoy to 32,000mn, operating profit rising 14.1% to ¥2,150mn, ordinary profit growing 10.7% to ¥2,000mn, and net income climbing 7.2% to ¥1,200mn.

The Company does not disclose sales forecasts for each respective operations, but in the continued favorable ordering environment, the assumption is that Advertising Operations will drive the growth in results. In particular, it is anticipated that direct transactions with advertisers will grow significantly based on expectations for the contributions from the consolidation of K&L and the Indonesian joint-venture company.

On the profit side also, the increase in sales is expected to result in an increase in profits. However, despite the major increase in sales, the operating profit margin is forecast remain unchanged year-on-year. The reason for this is thought to be that it reflects the Company's conservative view on the firming-up of the contribution to profits of K&L and the Indonesian joint-venture company, and also on prior investment costs.

At FISCO, we think that the consolidation of K&L and the Indonesia joint-venture company will add in the region of \2bn as the total for the 2 companies and that the order balance at the end of FY7/15 of ¥6,452mn (up 15.2% yoy) will steadily accumulate, so we view the Company's sales forecasts as being at a defensive level. For its profit forecasts too, we must be aware of the possibility of upside from its conservative assumptions. In addition, it will be necessary to pay attention to the progress made in the growth strategy, including the measures it will take from the next fiscal year (FY7/17) onwards for growth toward realizing the targets in its Mid-Term Management Plan (including strategic M&As) .

FY7/16 results forecasts

(unit: ¥mn)

	FY7/15 results		FY7/16 company forecasts		Change	
		Ratio		Ratio		Change rate
Sales	28,393		32,000		3,607	12.7%
Transactions with advertising agencies	20,461	72.1%	-	-	-	-
Direct transactions with advertisers	6,444	22.7%	-	-	-	-
Video-related Operations	1,487	5.2%	-	-	-	-
Cost	23,425	82.5%	-	-	-	-
SG&A expenses	3,084	10.9%	-	-	-	-
Operating profit	1,884	6.6%	2,150	6.7%	266	14.1%
Ordinary profit	1,806	6.4%	2,000	6.3%	194	10.7%
Net income	1,119	3.9%	1,200	3.8%	81	7.2%

Progress made so far in the Mid-Term Management Plan

Set a FY7/18 sales targets of ¥50bn and is further accelerating growth

The Company is advancing the “TYO Group 2013 Mid-Term Management Plan ” with FY7/14 as the first year.

Over the last five years, the Company has revived and rebuilt its operations by returning to its main operations and has made a rapid recovery both in terms of profitability and strengthening its financial base. Therefore, the content of the plan is of aiming to shift to a phase of pursuing further growth. From the continued strengthening of transactions with advertising agencies, the dramatic expansion of direct transactions with advertisers, and the new development of overseas operations, in FY7/17 the Company is targeting sales of ¥40,000mn (3 year average annual growth rate of 14.6%) and operating profit of ¥2,700mn (operating profit margin of 6.8%). Also, the FY7/18 sales target is ¥50,000mn (4 year average annual growth rate of 17.1%) and its policy is to further accelerate growth.

Financially, in FY7/14 the Company achieved the target of a net interest-bearing debt balance of zero, while it has also achieved a certain level of results in strengthening its financial base, and its policy going forward it to actively expand operations while prioritizing growth. Therefore, regardless of the initial target of raising the equity ratio to 50% or more by FY7/16, the focus is being placed on efficiently utilizing capital for growth.

(1) Continuing to strengthen transactions with advertising agencies

The measures aiming to continue to strengthen transactions with advertising agencies are as follows. a) Focusing on expanding the “surface” (such as by strengthening personnel and enhancing brands), b) expanding the area for upstream (including through strengthening collaborations by aiming to supplement the creative function for advertising agencies), and c) strengthening the influence on downstream (for example, by strengthening collaborations with outsourcers and industry peers). The sales target for transactions with advertising agencies in FY7/18 is ¥26,000mn (average annual growth rate of 7.1%).

(2) Dramatic expansion of direct transactions with advertisers

Conversely, the measures for direct transactions with advertisers, which has been positioned as a growth field, include the following. a) Strengthen the sales force (such as by strengthening personnel and enhancing brands), b) enhancing functions (enhancing the branding and marketing functions), c) acquire new advertisers, and d) expand the projects of existing advertisers. In particular, in addition to conventional commercial production and Web production, the target for direct transactions with advertisers is the enormous market that includes the domestic events market and the promotions media market. The FY7/18 sales target for direct transactions with advertisers is ¥18,000mn (average annual growth rate of 35.4%) and the aim is to raise the current sales ratio (FY7/15) of 22.7% to 36.0%.

The Company is aiming to improve its sales force, including by increasing personnel numbers and making its sales force actively recruited in recent years more “battle hardened,” and batch orders of large-scale projects from upstream are steadily increasing. Domestically also, its policy is to actively carry out M&As to accelerate the growth of operations and it is investigating as candidates companies above a certain size, including in the areas of PR and sales promotions that will lead to an expansion of direct transactions with advertisers.

In March 2015, the Company decided to support the revival of the brand of Skymark Airlines Co., Ltd, which was undergoing civil rehabilitation proceedings. It first provided a service free of charge as this provided an excellent opportunity to publicize its branding capabilities (the upstream area of brand design and communications strategy), and in terms of sales, it seems to be aiming for prior investment-type effects.

Also, as was previously explained, in August 2015 the Company made a consolidated subsidiary of K&L, which is strong in the graphics field and also possesses an overseas network. In addition, in September 2015 it established MIURA&Co., Ltd. (hereafter, “MIURA&CO)” as a creative boutique that develops ideas and directs advertising communications. Takehiko Miura, who has created a number of works for the Company Group over many years, including the JR Central “Cinderella Express” series, was appointed as its representative. It will fully utilize the functions of all of the segments in the Group, and in addition to the planning and production of video content, the plan is for it to provide one-stop support, from brand design through to practice, with the aim of further strengthening the Company Group’s creativity and branding capabilities.

(3) The new development of overseas operations

The Company is investigating overseas operations with an eye to acquiring local independent agencies. As it assumes it will acquire companies already up and running locally that are generating profits, the initial business development will be centered on the continuation of services to local clients. But for the future, it is aiming to build a network of creative companies in the 10 ASEAN countries and in India, and to build a structure in the relevant areas able to provide services to Japanese companies and local companies that are looking to develop inter-regional operations. The sales target for overseas operations in FY7/18 is ¥4,000mn.

In August 2014, the Company newly established an Asia Strategy Department and began fully fledged preparations to realize strategic M&As. In March 2015, it established a supervising management company (TYO-ASIA PTE.LTD) in Singapore for its overseas operations and also in FY7/15, as mentioned above, an Indonesian joint-venture company (PT TYO FIRST EDITION) as the first stage of its strategic M&As in Asia. In addition to aiming to capture increased share in the Indonesian advertising market, which is growing remarkably, its goal is to expand its share of transactions with Japanese companies in Indonesia. Through the current strategic M&As in combination with the operations of K&L, which possesses an overseas network centered on Asia, including Shanghai, it is on the brink of achieving ¥2,000mn of the overseas sales target of ¥4,000mn. Going forward, in order to accumulate the remaining amount of ¥2,000mn, it is investigating and selecting M&A candidates for the second stage and onwards.

Mid-Term Management Plan numerical targets

(unit: ¥mn)

	FY7/14 results		FY7/15 results		FY7/16	FY7/17	Three-year annual growth rate	FY7/18		Four-year annual growth rate
		Ratio		Ratio					Ratio	
Sales	26,569	-	28,393	-	32,000	40,000	14.6%	50,000	-	17.1%
(growth rate)	6.3%	-	6.9%	-	12.7%	25.0%		25.0%	-	
Transactions with advertising agencies	19,789	74.5%	20,461	72.1%	-	-	-	26,000	52.0%	7.1%
Direct transactions with advertisers	5,362	20.2%	6,444	22.7%	-	-	-	18,000	36.0%	35.4%
Video-related Operations	1,417	5.3%	1,487	5.2%	-	-	-	1,500	3.0%	1.4%
(overseas operations)	0	0.0%			-	-	-	4,000	8.0%	-
Operating profit	1,712	-	1,884	-	2,150	2,700	16.4%	-		-
(profitability)	6.4%	-	6.6%	-	6.7%	6.8%		-		-

When considering the external factors (including the favorable ordering environment and the development of an oligopoly) and the internal factors (such as the recovery of the financial base and profitability, differentiation through creativity, and the fully fledged operations of direct transactions with advertisers), we consider that it is fully possible for the Company to achieve the targets in its Mid-Term Management Plan. But on the other hand, it can be said that an issue it faces is that within the anticipated favorable external environment, it needs to create a system to avoid lost opportunities through making sure to secure all projects. The Company is increasing staff through prior investment, but as it focuses on creativity, it is possible that it will face a dilemma in terms of balancing quality and profitability.

Also, as the Company is targeting direct transactions with advertisers as its growth driver in the medium term, it will be necessary to watch carefully the progress it makes in this area. In particular, in addition to the progress made for sales targets, it is considered that the important points will be what changes will occur in the Company’s relationship with advertising agencies and to its profit structure alongside its expansion of scale, and what progress will it make in capturing demand from peripheral areas.

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The strategy for the development of overseas operation is to build relations with local media through acquiring local advertising agencies, as well as capturing advertisers. But its biggest challenges would seem to be integrating them with the Company's creativity (localization) and managing these local subsidiaries.

Comparison with industry peers

Focusing on the trend in the sales growth rate in the future

We have compared the Company's growth potential, profitability, and financial soundness to the other two major commercial production companies, using the content of their most recent financial results as the standard.

Looking at growth potential based on performance over the last three years, the sales of AOI Pro. Inc. stand out. Considering the Company over the same period, as it has achieved a high growth rate since FY7/14, it seems that we should pay attention to how its sales growth rate trends in the future. On the other hand, its operating profit growth rate as on the same level as that of AOI Pro. Inc. In the case of the Company, this can be considered to be the result of its efforts to improve profitability through pulling out of unprofitable segments and returning to its main operations.

With regards to profitability, Tohokushinsha Film Corporation, which handles video and broadcast operations that have a low cost ratio, boasts a high operating profit margin, while the Company has taken steps to improve its profitability and its operating profit margin is about at the same level as that of AOI Pro. Inc. In addition, the Company's ROE, which shows capital efficiency, is superior to those of the other companies from its high total assets turnover ratio and financial leverage.

Looking at financial soundness, while the Company's equity ratio is inferior to those of the other companies, it is not at a level to cause concerns about the stability of its financial base. Also, from its current ratio and interest coverage ratio, it can be judged that there are no concerns for its short-term payment capability and interest payment capability.

Comparison of financial indicators

(unit: ¥mn)

	Tohokushinsha Film Corporation 2329 FY3/15	AOI Pro.Inc. 9607 FY3/15	The Company 4358 FY7/15
Scale			
Sales (¥mn)	58,098	28,817	28,393
Operating profit (¥mn)	5,403	1,952	1,884
Profitability			
Operating profit margin	9.3%	6.8%	6.6%
(cost ratio)	75.0%	80.9%	82.5%
(SG&A expenses ratio)	15.7%	12.7%	10.9%
ROE	5.4%	11.3%	21.6%
Growth potential (based on last three years)			
Sales	-2.5%	10.0%	5.5%
Operating profit	-4.3%	9.2%	9.2%
Soundness			
Equity ratio	69.4%	45.8%	38.2%
Current ratio	257.1%	172.9%	192.8%
Interest coverage ratio	90.0	13.8	32.7
Total assets turnover ratio	0.61	1.13	1.95
Financial leverage	1.44	2.18	2.62

With regards to the Company's share price valuation, compared to its industry peers, its PER (forecast) and PBR (result) are both at high levels, and in particular its high PBR reflects the height of its capital efficiency (ROE). However, when considering that the Nikkei Average PER (forecast) is 14.46 times, for each of the three companies it can be said that their share price valuation assumes a mature market (that does not incorporate market growth and changes to market share). Therefore, in terms of the factors that will push up the share price, in addition to of course profit growth from the achievement of the targets in the Company's Mid-Term Management Plan, if it shows results that can convince that it has growth potential exceeding that of the domestic TV commercial production market, such as by improving market share and capturing share from peripheral areas, and advancing into overseas markets, then there is still plenty of room for a review of the Company's share price valuation.

Comparative share price valuation

	Tohokushinsha Film Corporation 2329 FY3/15	AOI Pro.Inc 9607 FY3/15	The Company 4358 FY7/15
Closing share price, October 19 (¥)	886	877	202
Number of shares outstanding (1,000 shares)	46,735	13,335	62,389
Market capitalization (¥mn)	41,408	11,694	12,603
EPS (forecast)	72.35	80.48	19.24
BPS (result)	1,482.31	943.52	89.31
Dividend (forecast)	14.00	25.00	5.00
PER (forecast)	12.2	10.9	10.5
PBR (result)	0.6	0.9	2.3
Dividend yield (forecast)	1.58%	2.85%	2.48%

■ Returns to shareholders

Plenty of room to improve the dividend payout ratio and raise dividends alongside the growth in profits

In FY7/15, the Company paid an annual dividend of ¥5 per share, which in actual terms was an increase of ¥2 when excluding the listing commemorative dividend paid in FY7/14. In FY7/16 also, it plans to pay an annual dividend of ¥5 per share (for a dividend payout ratio of 26.0%). Within its Mid-Term Management Plan, the Company describes its policy of prioritizing returns to shareholders, who are the owners of the Company, in order to strengthen its financial base, and that it is targeting a dividend payout ratio of 25% or more. Therefore, assuming that the Company realizes the targets in its Mid-Term Management Plan, we can expect that there remains plenty of room for it to improve the dividend payout ratio and to increase dividends alongside the growth in profits.

Moreover, together with the year-end dividend, the Company continues to implement a Shareholder Special Benefit Plan for interim returns to shareholders. The shareholder special benefits in FY7/15 (reference date, January 31, 2015) were a present of a QUO card, depending on the number of shares held, and in addition it implemented the “Shareholders! You are the artists!” competition for the production of original music videos following the drawing of lots for three pairs of winners. Its policy is to continue to provide these sorts of creative benefits to shareholders as befitting its position as a creative company.

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