COMPANY RESEARCH AND ANALYSIS REPORT

AOI TYO Holdings Inc.

3975

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Summary

In the first fiscal year following the integration, both sales and profits increased more than forecast In addition to the improvement in profitability, performance was aided by the slow start in the shift to printless

AOI TYO Holdings Inc. <3975> is a joint holding company established through the management integration of AOI Pro. Inc. and TYO Inc. AOI TYO Group mainly plans and creates TV commercials and also handles Solutions Business that includes direct transactions with advertisers, online videos and other digital contents. It holds a top share in TV commercial production through the management integration of the two leading industry firms.

The decision to proceed with management integration took into account the lack of prospects for major growth in conventional TV commercial production as well as likely expansion of business scope related to advertising, including methodology and structural changes. It comes against a backdrop of diversification of media (primarily through the Internet) and devices (smartphones, tablets, and others) and major shifts in industry landscape with advances in technology innovations, such as communications speed, data analysis, VR*1, and AR*2. This integration aims to realize economies of scale and create synergies and also accelerate the pace of new value creation and business expansion through consolidation and effective utilization of business resources.

*1 VR (virtual reality) refers to the technologies and methods to realize various types of experiences, including in virtual worlds, portraying something like the real world that goes beyond time and space.
*2 AR (augmented reality) refers to the technologies and methods to realize an augmented reality by adding some other information to the information that people can perceive in the real world.

In FY12/17, net sales increased 8.5% YoY*1 to ¥70,473mn, while operating income increased 35.0% to ¥4,619mn, both of which were much higher than initial forecasts. The Advertising Video Production Business performed solidly, while the Solutions Business, positioned as a growth area, saw significant growth. The major increase in operating income was the result of higher net sales as well as the improvement in profitability in the Advertising Video Production Business. The combination of the improvement in profitability and the slow start in the shift to printless*2 led to profits in particular being much higher than the forecast. With respect to progress with the integration effect, positive results were achieved in relation to proactive investment in growth areas, improvements in business efficiency, and other areas.

*1 Previous-year results use combined amounts for consolidated results of AOI Pro. and TYO on a calendar-year basis (pro forma; 12-month basis).
*2 TV commercial materials have traditionally been copied to a memory media (printed) for delivery to various broadcast media and sales and profits from such copies were booked. AOI TYO Group expects decline in printing sales due to the transition to online data submissions. This transition began in October 2017, but thus far the pace has been slow.

For FY12/18, AOI TYO Group's net sales are forecast to decline 0.7% YoY to ¥70,000mn, while operating income is expected to fall 17.7% YoY to 3,800mn, as earnings are projected to temporarily decrease in conjunction with the impact of the shift to printless and upfront investment in growth areas. The expectation for a drop in net sales is primarily due to a decline in sales in the Advertising Video Production Business caused by the acceleration of the shift to printless and efforts to address work style reforms (controlling orders received). Meanwhile, the Solutions Business, which is a growing field, and the Overseas Business, which pursues M&A, are expected to grow. In terms of profits, a decline in operating income is expected due to upfront investment in growth areas as well as the fact that profitability improvement will not be as large as in the previous fiscal year, and thus the impacts of the shift to printless will not be completely covered by profitability improvements.

AOI TYO Group envisions longer-term growth driven by Solutions Business and Overseas Business (China and Southeast Asia). In the existing mainstay Advertising Video Production Business, meanwhile, it targets steady growth by promoting heightened emphasis on profitability and efficiency and a lean organization that adapts to a printless model. The outlook sets FY12/21 goals of at least 12% in ROE and ¥8bn EBITDA (based on 17.0% average growth over three years with FY12/18 target of ¥5bn as the starting point).

We think the Solutions Business field, which AOI TYO Group aims to expand, offers a market with large potential. We also expect AOI TYO Group's experience and knowhow cultivated in video production to provide a differentiating factor and see a large advantage from its credibility (brand strength) and financial clout. Improvements started to be seen in profitability and other areas, but we will be particularly focusing on new value creation, such as VR technology and data utilization, in the context of specific results obtained from management integration and aggressive investments in growth fields.

Key Points

- Joint holding company established through the management integration of AOI Pro. and TYO and holds a top share in TV commercial production
- In FY12/17, the first fiscal year following the integration, both sales and profits increased more than expected
- In addition to the improvement in profitability, performance was aided by the slow start in the shift to printless
- The outlook for FY12/18 is for performance to temporarily decline, due to factors including the acceleration of the shift to printless and upfront investment
- The Solutions Business and the Overseas Business will be drivers of earnings growth over the medium to long term

Company profile

Joint holding company established through the management integration of AOI Pro. and TYO and holds a top share in TV commercial production

1. Business overview

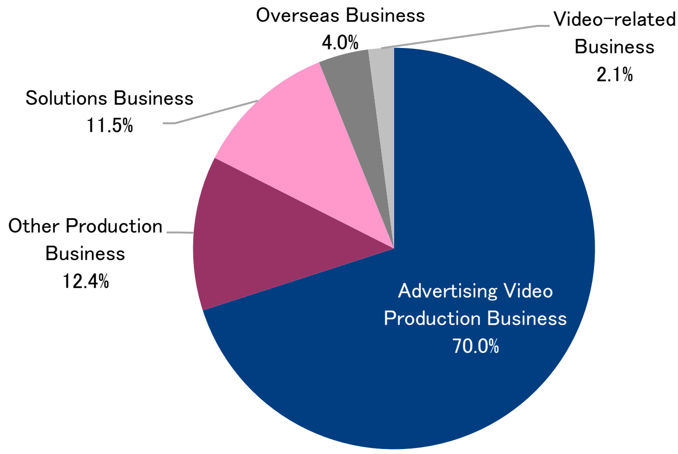
AOI TYO Holdings is a joint holding company that owns AOI Pro. and TYO. AOI TYO Group plans and creates TV commercials and also handles solutions business that includes direct transactions with advertisers, online videos and other digital contents. It was founded in January 2017 through management integration of two leading industry firms and holds a top share in TV commercial production*.

* The industry's three major firms controlled a combined 30-40% share with Tohokushinsha Film Corporation <2329> as the leader and then AOI Pro. and TYO for many years. This management integration moved AOI TYO Group into the top position.

AOI TYO Group has Advertising Business and Video-related Business segments and five sub-segments (Advertising Video Production, Other Production, Solutions, Overseas, and Video-Related). While the conventional mainstay Advertising Video Production Business generates approximately 70% of overall sales, Solutions Business, a growth area, has been expanding substantially recently and is attracting attention as a growth driver.

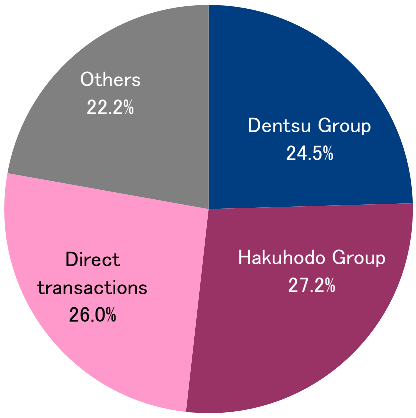
Sales mix by customer in FY12/17 was well balanced with 24.5% to the Dentsu Group, 27.2% to the Hakuhodo Group, 26.0% in direct transactions, and 22.2% to others. Direct transactions have been a TYO strength and is still growing after the management integration in correlation with the Solutions Business.

Sales composition by business (FY12/17 result)



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

Sales ratio by customer (FY12/17 result)



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

Below we review each of these business areas.

(1) Advertising Video Production Business

This business plans and produces TV commercials and other advertising videos. It was also the primary segment at AOI Pro. and TYO and holds a top share now thanks to integration of the two leading firms. Both companies have created many excellent TV commercials amid continuation of a robust orders environment. However, this business is confronting concerns about decline in profitability due to changes in media value amid advances by the Internet and other technologies and the printless shift. It needs earnings structure reforms and improved efficiency.

(2) Other Production Business

Production business besides advertising videos includes movies and dramas, event planning and production, web production, and sales promotional material production.

(3) Solutions Business

This business provides measures for problem solving for customers. While it currently is roughly equal to results from TYO Offering Management Business Unit*1 and AOI Pro.'s subsidiary Quark tokyo Inc.*2, it also contains SOOTH Inc.*3, which was established as a growth area on February 1, 2018.

*1 Renamed from TYO General Business Division Headquarters, the division supplies one-stop solutions mainly through multi-faceted media activities via direct transactions with advertisers.
*2 Provides PDCA solutions for online content strategy formulation, planning, production, data analysis, and media distribution, centered on videos.
*3 This company seeks to evolve into a business that greatly expands the future of content production by engaging in planning and production of contents such as VR that incorporate the latest technologies, consulting that utilizes the accumulation of knowledge including emotion data obtained especially by dramatically evolving devices and AI, both of which were started by the AOI Pro. Experience Design Department, and turning the experiences cultivated through these into services.

(4) Overseas Business

The Overseas Business operates sites in China and Southeast Asia (Thailand, Vietnam, Singapore, Indonesia, Malaysia, and India) and seeks to expand transactions with local companies, including Japanese affiliates. Both AOI Pro. and TYO have been actively engaged in many regions, and this segment is positioned as a growth driver. AOI TYO Group has also been actively engaging in M&A. In October 2017, AOI TYO Group purchased minority shares of VIEWFINDER MEDIA JOINT STOCK COMPANY (hereinafter, "VF MEDIA"), a leading video production company in Vietnam, a group company (equity-method affiliate). Following this, in March 2018, AOI TYO Group acquired majority shares of RESERVE TANK SDN. BHD. (hereinafter, "Reserve Tank"), the parent company of leading Malaysian TV commercial production companies DIRECTORS THINK TANK SDN. BHD., THE TANKERS SDN. BHD., and DIRECTORS THINK TANK PTE. LTD. (Singapore), a consolidated subsidiary.

(5) Video-related Business

This business covers activities besides advertising, including photo studios for general consumers* and music video production.

* Operated by AOI Pro.'s subsidiary Hollyhock Inc. This business started with the first store at Tokyo Midtown in Roppongi and has been adding other sites. It currently has four stores.

2. History

(1) AOI Pro.

AOI Pro. goes back to Aoi Advertising Promotion Inc., which was established in 1963 to produce TV commercials, in Tokyo's Minato Ward. It solidified a business base as a video production company focused on TV commercials. In 1990, it listed shares on JASDAQ, taking the lead in this industry, with the aim of making further advances and strengthening social credibility.

It subsequently created numerous videos that attracted substantial interest, fueling healthy growth and listed on the Second Section of the Tokyo Stock Exchange in 1998 and on the First Section in 2000. It established a firm position as one of the major TV commercial production companies.

In September 2011, meanwhile, it launched an overseas site to handle TV commercial production in Indonesia. In October 2014, it added nakamino Co., Ltd.*, which specializes in online video platform effect measurement and operation, to the group (equity-method affiliate) through a capital alliance with the aim of full-fledged ramp-up of video contents marketing, a new growth area. These initiatives gave it an edge versus peers in building operations to address diversifying media, growing demand for online videos and other digital contents, and entry by Japanese companies into the fast-growing Asian region.

* It turned this entity into a consolidated subsidiary at the end of December 2015 through an injection of additional capital and changed the company name to Quark tokyo Inc. in April 2016.

(2) TYO

TYO was established as a TV 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. Hiroaki Yoshida (Representative Director of AOI TYO Holdings), together with four other commercial creators, established the company with the dream of "Creating an Ideal Company of Creators, by Creators, for Creators."

The company listed on JASDAQ in 2002. It expanded business by leveraging its creative capabilities of having been involved in the production of numerous TV commercials that left an impression with consumers, notably one promoting travel to Kyoto for Central Japan Railway Company (JR Central) <9022>. Upon changing to the TSE Second Section in October 2013, its listing was reassigned to the First Section in January 2014.

TYO has been involved in various types of content production, including TV commercials, online videos, digital contents and events. Its strength is providing optimal, one-stop solutions for advertisers' advertising promotions and promotional activities. It led the industry* with a sales structure and accumulation of knowledge in dealing directly with advertisers and has focused on building long-term relationships with advertisers, expanding project sizes and capturing sales promotion expenses. Furthermore, it has been actively engaged in overseas expansion.

* Since starting direct transactions with advertisers in July 2003, the current TYO Offering Management Business Unit has taken charge of the entire group's direct transactions with advertisers.

Management integration

Aims to tackle changes in the business environment and build a competitive, advanced business model

As discussed above, AOI TYO Holdings is a joint holding company established in January 2017 through the management integration of AOI Pro. and TYO. This management integration of two major TV commercial production companies has the following background, objectives, and anticipated effects.

1. Background

In the background to the management integration is the diversification of media and devices (such as smartphones and tablets) focused on the Internet, and in addition, the major changes to the industry environment, including communication speeds and data analysis, and also the progress being made in technological innovations, such as VR and AR. In this environment, major growth in TV commercial production, which has been the mainstay up to the present time, is unlikely, but advertising-related business areas will expand, with accompanying changes to their methods and structures. Based on this sort of awareness of the business environment, the companies judged that integration was to grow in the medium to long term to expand market share, strengthen negotiation power, and maintain robust capital strength. They also want to build a competitive and advanced business model by newly forming a group to lead the industry and concentrating and effectively utilizing management resources.

2. Objectives

The management integration seeks to create new sensations worldwide by pursuing an advanced business model ahead of changes in the environment and merging creativity cultivated from many years of advertising video production with the latest technologies and diverse data.

3. Anticipated effects

(1) Strengthening the advertising video production operations

In the Advertising Video Production Business, which is the core operations, AOI TYO Group is pursuing integration effects in the areas of brand competitiveness, operational efficiency, new technological developments, and cost competitiveness. In other words, while on the one hand it is aiming to maximize sales opportunities by preserving the previous competitive relations between the brands, on the other hand it intends to improve operational efficiency through the sharing of personnel and business streamlining measures, and also to promote cost competitiveness by joint procurement and mutual utilization of the filming equipment rental departments.

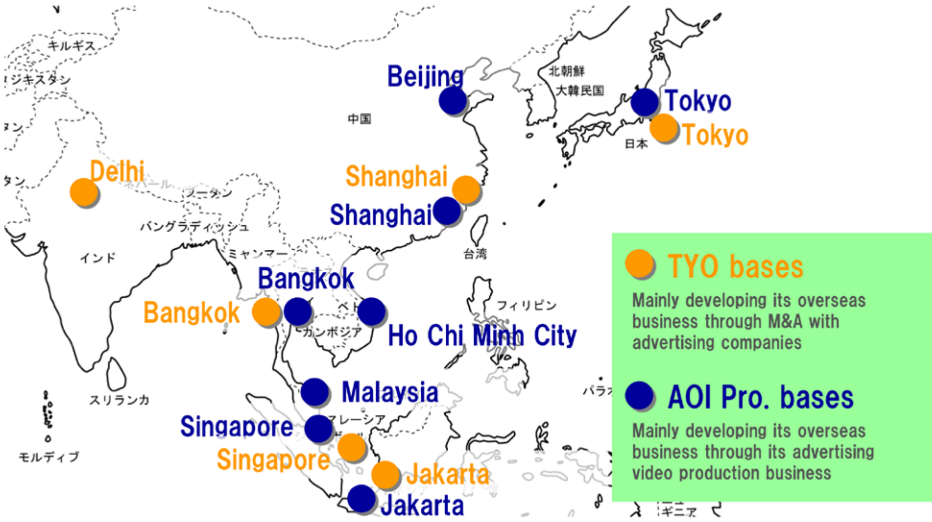
(2) Promoting strategic business areas

AOI TYO Holdings is aiming to collaborate TYO's direct transactions with advertisers, which it had been working on strategically, with the video content marketing that AOI Pro. has been focusing on in the same way. Specifically, TYO's strength is in direct transactions with advertisers, for which it has established a sales system and accumulated expertise, but it needs to be also able to provide the solutions that advertisers require for the web and online video. Conversely, AOI Pro.'s strength is in video content marketing and it is able to provide solutions in the online video market, which will continue to expand, but it also needs the sales capabilities necessary for direct transactions with advertisers. It is considered that the two companies will be able to generate synergies by mutually utilizing each other's respective strengths.

(3) Accelerating the development of the Overseas Business

For the Overseas Business, AOI Pro. has been developing its video production business while TYO has been pursuing M&A with advertising companies, so there are no overlapping functions. Furthermore, from the fact that their policies, of expanding clients from Japanese companies to local companies located overseas, are consistent, they are aiming to accelerate their Asia strategy through the mutual use of both companies' bases.

Locations of overseas bases



Source: Company materials

In addition, it will become possible to efficiently allocate both companies' management resources in growth fields, based on a shared management strategy, through utilizing the joint holding company system. It is considered that in addition to increasing the management agility and efficiency, this will increase their risk tolerance and enhance their ability to adapt to changes to the industry.

Financial highlights

In AOI TYO Group's first fiscal year, both sales and profits increased more than forecast In addition to the improvement in profitability, performance was aided by the slow start in the shift to printless

In the results for FY12/17, the first year after the management integration, net sales increased 8.5% YoY* to ¥70,473mn, operating income increased 35.0% to ¥4,619mn, ordinary income rose 48.3% to ¥4,394mn, and profit attributable to owners of parent rose 154.0% to ¥2,781mn, for a significant increase in sales and profits and above the initial forecast.

* Previous-year results use combined amounts for consolidated results of AOI Pro. and TYO on a calendar-year basis (pro forma; 12-month basis).

Net sales increased in all businesses. The Advertising Video Production Business saw solid sales in particular, while the Solutions Business, positioned as a growth area, saw a large increase in sales. In terms of net sales by customer, there was significant growth in direct transactions with advertisers in conjunction with the expansion of the solutions business.

Meanwhile, in terms of profits, although there was a large increase in SG&A expenses due to costs associated with the integration and other factors, AOI TYO Group achieved a significant increase in operating income as a result of the increase in sales and improved profitability in the Advertising Video Production Business. The operating income margin grew considerably to 6.6% (versus 5.3% in previous fiscal year). Furthermore, one factor behind the big increase in final profit (profit attributable to owners of parent) was the tax losses (decline in tax expenses) associated with the reorganization of group businesses.

AOI TYO Holdings achieved earnings growth exceeding forecasts due to the fact that it had already made progress on profitability improvements in advance of the shift to printless which began in October 2017, but relatively little progress was actually made in the shift to printless. The overlapping of these two positive factors led to profit in particular being much higher than the forecast.

Regarding the financial situation, total assets are ¥59,737mn, and shareholders' equity is ¥24,675mn. We are not concerned about the stability of the financial base given the robust 41.3% equity ratio and 164.2% current ratio. Additionally, interest-bearing debt is ¥16,238mn, resulting in a low D/E ratio of 0.64. Meanwhile, ROE, indicating capital efficiency, is a high 11.3%, but one must keep in mind the fact that there was a positive impact from the aforementioned special factors (the delay in the shift to printless and tax effect accounting). Of the total assets, goodwill (an intangible asset)* is ¥4,106mn, or 6.9% of total assets.

* Approximately ¥4,000mn of goodwill was posted in conjunction with the integration (at the time of integration), and this is scheduled to be amortized over 20 years (¥200mn per year).

FY12/17 financial highlights

(¥mn)

	FY12/16		FY12/17		Change		FY12/17		Achievement rate
	Result	Ratio	Result	Ratio		Change rate	Initial forecast	Ratio	
Achievement rate	64,928	100.0%	70,473	100.0%	5,545	8.5%	65,000	100.0%	108.4%
Advertising Video Production Business	48,750	75.1%	49,339	70.0%	589	1.2%	-	-	-
Other Production Business	8,608	13.3%	8,773	12.4%	165	1.9%	-	-	-
Solutions Business	3,610	5.6%	8,071	11.5%	4,461	123.6%	-	-	-
Overseas Business	2,558	3.9%	2,842	4.0%	284	11.1%	-	-	-
Video-related Business	1,401	2.2%	1,446	2.1%	45	3.2%	-	-	-
Cost of sales	-	-	56,788	80.6%	-	-	-	-	-
SG&A expenses	-	-	9,065	12.9%	-	-	-	-	-
Operating income	3,422	5.3%	4,619	6.6%	1,197	35.0%	3,500	5.4%	132.0%
Ordinary income	2,963	4.6%	4,394	6.2%	1,431	48.3%	3,200	4.9%	137.3%
Profit attributable to owners of parent	1,095	1.7%	2,781	3.9%	1,686	154.0%	1,400	2.2%	198.7%
EBITDA	4,389	6.8%	5,755	8.2%	1,366	31.1%	4,630	7.1%	124.3%
Sales ratio by customer									
Dentsu Group	18,566	28.6%	17,299	24.5%	-1,267	-6.8%			
Hakuhodo Group	18,814	29.0%	19,182	27.2%	368	2.0%			
Direct transactions	14,891	22.9%	18,357	26.0%	3,466	23.3%			
Other	12,658	19.5%	15,635	22.2%	2,977	23.5%			

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

Financial position as of the end of December 2017 (financial ratio)

(¥mn)

	As of the end of December 2017	Comment
Current assets	41,503	
Cash and deposits	12,573	
Notes and accounts receivable – trade	17,813	
Work in process	3,629	
Electronically recorded monetary claims	6,208	
Non-current assets	18,234	
Property, plant and equipment	7,679	
Intangible assets	5,269	Goodwill ¥4,106mn
Investments and other assets	5,285	
Total assets	59,737	
Current liabilities	25,275	
Accounts payable – trade	7,341	
Short-term loans payable	12,772	
Advances received	758	
Non-current liabilities	8,756	
Long-term loans payable	3,465	
Long-term deposits received	3,501	
Total liabilities	34,031	
Net assets	25,706	
Shareholders' equity	24,186	
Equity ratio	41.3%	
Current ratio	164.2%	
D/E ratio	0.64 times	

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

Activity results

Significant outcome from the improvement in profitability and aggressive investment in growth areas

1. Mainstay business conditions and primary initiatives

(1) Advertising Video Production Business

Advertising Video Production Business sales were firm, rising by 1.2% YoY to ¥49,339mn amid a flat (or declining) trend in the TV commercial and other conventional media advertising production market. A key point is that the establishment of an operational management framework with a heightened emphasis on profitability (stricter review and selection from the orders stage, rigorous production cost management, etc.) contributed to an effective profit margin* of 33.4% (vs. 31.2% in the previous year), despite the modest growth in net sales. This contributed greatly to overall profit. Although printing sales declined 9.6% YoY to ¥2,654mn, this resulted in operating performance exceeding forecasts due to the sluggish start in the shift to printless, which began in October 2017.

* Effective profit is the value obtained by subtracting external spending and production costs from net sales.

(2) Solutions Business

Net sales in the Solutions Business, which is an area of focus as a growth field, rose significantly by 123.6% YoY to ¥8,071mn. This included a large 108.6% YoY increase in TYO General Business Division Headquarters' (currently TYO Offering Management Business Unit) sales to ¥5,577mn, and a significant 234.6% YoY increase in sales by AOI Pro.'s subsidiary Quark tokyo to ¥2,416mn. The former benefitted from large project orders from new advertisers in direct transactions with advertisers, a core area, as well as growth in projects from existing advertisers. The latter started ramping up project orders in the second year of full-fledged operations. Direct transactions with large companies, in particular, are growing as a result of efforts including the differentiation of production capabilities, which is a strength, amid the increase in demand for PDCA video contents marketing. Furthermore, a specialized team* dedicated to new marketing strategies was established, and in December 2017 this team launched the vertical video media Q16GiRL. The first content project was a collaboration with Lotte Co., Ltd.'s Fit's chewing gum.

* A specialized team that develops optimal marketing strategies for clients needing new marketing communication with a focus on millennials (the generation born from 1980 to 2000), while providing creative direction and production. Millennials overlap with the digital native generation, a generation for which communication through social media and other methods is well entrenched. Millennials tend to value experiences, as well as being understood and respected by others, more than material possessions, and have a strong affinity for the sharing economy, in which places and possessions are shared among people. This generation is attracting a lot of attention for the influence it has on society and consumption.

Also, on February 1, 2018, the business activities started by the AOI Pro. Experience Design Department were spun off into a newly-founded company SOOTH Inc. Up until now, progress has been made on: 1) Planning and production of content that incorporates the newest technologies, such as VR, AR and MR; and 2) Accumulating knowledge including new data and emotion data. Going forward, SOOTH Inc. will aim to: 3) Develop an integrated marketing business (provide comprehensive solutions for marketing stages from brand strategy development to effect measurement and analysis); and 4) Create a high value-added business through data applications. This move can be seen as proof that AOI TYO Group is confident about future business growth. Significant contributions to earnings will be a medium- to long-term issue, but the company has considerable potential, including the scope of applications.

(3) Overseas Business

Sales in the Overseas Business generally grew as forecast, increasing 11.1% YoY to ¥2,842mn. In October 2017, AOI TYO Group added VF MEDIA, Vietnam's largest video production company, to the group as an equity-method affiliate*. VF MEDIA is highly trusted by both clients and advertising companies in Vietnam based on its size and experience. By working with VF MEDIA, AOI TYO Group aims to further grow its business in Vietnam, where the advertising market is growing. Also, in March 2018, AOI TYO Group turned Reserve Tank, with leading Malaysian TV commercial production companies under its umbrella (known as DTT group), into consolidated subsidiaries. This group receives a lot of orders for projects not only in Malaysia, but also in Indonesia, China, and other neighboring countries with large advertising markets. Through this move, AOI TYO Group aims to further expand its business in the Southeast Asian market.

* AOI TYO Group acquired 36% of the stock of VF INVESTMENT JOINT STOCK COMPANY, the holding company of VIEWFINDER MEDIA JOINT STOCK COMPANY, turning both companies into Group companies.

2. Progress with the integration effect

Aiming to quickly realize the integration effect, AOI TYO Group has worked to reorganize the corporate division, is aggressively investing in growth areas, and is reducing external spending, among other initiatives. In addition to seeing positive results in investment in growth areas (particularly VR-related and venture investment, etc.) and improved business efficiency, the following initiatives are being implemented.

(1) Group business reorganization

With the objective of restructuring AOI TYO Group's businesses in conjunction with changes in the business environment, since November 2017 AOI TYO Group has divested from subsidiaries TYO Animations, REAL-T, and Business Architects, as well as consolidated the lighting equipment rental business, which is expected to see a stable increase in demand, thereby strengthening the business.

(2) Consolidation of the corporate division

In January 2018, the functions of the administrative divisions of AOI Pro. and TYO were consolidated.

(3) Relocation of head offices, office merger

In March 2018, the head offices moved from Shirokane to Osaki in conjunction with the consolidation of the corporate division functions, and TYO's head office (Meguro) was sold in order to optimize assets.

(4) Venture investment

The Ad Hack Ventures*1 fund targeting venture companies was launched in August 2017. This fund invests in venture companies that are in stages with relatively high exit (IPO, etc.) probabilities and which have ongoing advertising needs. The fund is expected to have total assets under management of ¥1.8bn (several hundred million yen per deal). So far, the fund has invested a total of just over ¥700mn in three companies*2 with strong growth potential.

*1 Established jointly by TYO and FIELD MANAGEMENT.
*2 Logbar Inc. (develops and sells "ili," the world's first wearable voice translation device), every, Inc. (provides "DELISH KITCHEN," one of Japan's largest video recipe sites, and other contents), and Sumally (provides "Sumally Pocket," a cloud storage service).

In addition, in January 2018, AOI TYO Group invested $5mn in SPIRAL VENTURES ASIA FUND I, managed by Singapore-based Spiral Ventures Pte. Ltd. The investment is positioned as a part of the growth strategy for both the Solutions Business and the Overseas Business. By building relationships with Asian venture companies with high growth potential in the early stages, and by developing cooperative frameworks with investee companies, AOI TYO Holdings aims to further expand its presence in overseas markets. Also, through this process, AOI TYO Group anticipates business expansion utilizing AOI TYO Group's knowledge and experience in the fields of advertising and video production.

Business performance outlook

For FY12/18, AOI TYO Group is forecasting a decline in profits The shift to printless, upfront investments, and other factors will result in a temporary decline in earnings

For FY12/18, AOI TYO Group's net sales are forecast to decline 0.7% YoY to ¥70,000mn, operating income is expected to fall 17.7% YoY to 3,800mn, ordinary income is projected to decline 15.8% YoY to ¥3,700mn, and profit attributable to owners of parent is expected to fall 17.3% YoY to ¥2,300mn. Earnings are expected to temporarily decline due to the impact of the shift to printless and upfront investment in growth areas.

The expectation for a drop in revenue is primarily due to a decline in sales in the Advertising Video Production Business caused by the impact of the shift to printless (a pickup in pace is expected from around April 2018) as well as addressing work style reforms (controlling orders received). Elsewhere, a decline in sales in the Other Production Business is expected, mainly due to the reorganization of group businesses. Meanwhile, sales in the Solutions Business, which is a growing field, and the Overseas Business, which promotes M&A, are expected to grow.

In terms of profits, operating income is expected to decline by approximately ¥800mn. This is due to the fact that profitability improvement will be smaller than in the previous fiscal year, and thus the impacts of the shift to printless (a roughly ¥900mn decline in operating income) will not be completely covered by profitability improvements, along with upfront investments in growth areas (R&D-related personnel expenses, system costs, etc.) and other factors. Meanwhile, a gain on transfer of approximately ¥334mn in association with the sale of TYO's head office will be posted as extraordinary income.

FY12/18 forecast

(¥mn)

	FY12/17		FY12/18		Change	
	Result	Ratio	Forecast	Ratio	Amount	% change
Net sales	70,473	100.0%	70,000	100.0%	-473	-0.7%
Advertising Video Production Business	49,339	70.0%	45,300	64.7%	-4,039	-8.2%
Other Production Business	8,773	12.4%	7,900	11.3%	-873	-10.0%
Solutions Business	8,071	11.5%	11,200	16.0%	3,129	38.8%
Overseas Business	2,842	4.0%	4,500	6.4%	1,658	58.3%
Video-related Business	1,446	2.1%	1,100	1.6%	-346	-23.9%
Cost of sales	56,788	80.6%	-	-	-	-
SG&A expenses	9,065	12.9%	-	-	-	-
Operating income	4,619	6.6%	3,800	5.4%	-819	-17.7%
Ordinary income	4,394	6.2%	3,700	5.3%	-694	-15.8%
Profit attributable to owners of parent	2,781	3.9%	2,300	3.3%	-481	-17.3%
EBITDA	5,755	8.2%	5,000	7.1%	-755	-13.1%
ROE	11.3%		8.8%		-2.5pt	-

Source: Prepared from the Company's results briefing materials

The earnings forecasts for the main businesses as well as assumptions behind the forecasts are discussed below.

(1) Advertising Video Production Business

In the Advertising Video Production Business, net sales are expected to decline 8.2% YoY to ¥45,300mn. It must be noted that the approximately ¥4,000mn decline in sales includes the impacts of the shift to printless and the transfer to the Solutions Business. Other factors for the decline in net sales are the impact of profitability-oriented operational management and addressing the work style reforms (order control).

(2) Solutions Business

In the Solutions Business, net sales are expected to increase 38.8% YoY to ¥11,200mn. Of this, the TYO General Business Division Headquarters' net sales are forecast to increase 43.4% YoY to ¥8,000mn (this includes transfers from the Advertising Video Production Business), while Quark tokyo's net sales are expected to increase 11.8% YoY to ¥2,700mn. The relatively modest growth in net sales for Quark tokyo compared to the previous year is the result of prioritizing the buildup of the framework targeting future business growth (adding personnel working on data analysis, etc.).

(3) Overseas Business

In the Overseas Business, net sales are forecast to increase 58.3% YoY to ¥4,500mn. In addition to business growth in Southeast Asia, DTT group, which were acquired as consolidated subsidiaries in March 2018, is expected to contribute to sales.

We think that AOI TYO Group has reasonably reflected adverse factors into its net sales forecast, while its assumptions for positive factors are well grounded. Therefore, we feel that AOI TYO Group's net sales forecasts are sufficiently achievable. As with the previous year, it should be noted that the timing and pace of the shift to printless will have an impact on operating performance. Meanwhile, AOI TYO Group's profit forecasts reflect strategic decisions (aggressive upfront investments, etc.), and we believe that how funds are used and the underlying objectives (anticipated effects) should be the focus of attention, rather than exploring the possibility of the forecasted figures being achieved.

Growth strategy

Longer-term growth drivers are the Solutions Business and Overseas Business supplying new value

AOI TYO Group depicts a longer-term growth image with Solutions Business (including related production business) and Overseas Business (China and Southeast Asia) driving stronger performance. In the existing mainstay Advertising Video Production Business, meanwhile, it targets steady growth by promoting heightened emphasis on profitability and efficiency and a lean organization that adapts to a printless model. The outlook sets FY12/21 goals of at least 12% in ROE and ¥8bn EBITDA (based on 17.0% average growth over three years with FY12/18 target of ¥5bn as the starting point).

We attribute use of EBITDA as the goal to emphasis on earnings growth and the prospect of M&A activities (since EBITDA does not count amortization of goodwill). AOI TYO Group aims to realize EBITDA growth by investing aggressively in projects likely to deliver profitability exceeding the cost of shareholders' equity and also improve shareholder returns (dividend payout ratio) and capital efficiency (ROE).

1. Solutions Business

It aims to expand orders from new and existing advertisers in direct transactions with advertisers, which it has already been handling. Also, it hopes to provide the general public with new experiences by developing and producing contents that incorporate the latest technologies, such as VR, AR, MR, IoT, and AI. It also seeks to accumulate knowledge, including new data and emotion data obtained from these experiences, for application in the integrated marketing business (supplying solutions that integrate from brand strategy formulation to effect measurement and analysis). Furthermore, it intends to make advances to high value-added businesses utilizing data (such as DMP and strategic consulting). The approach seeks to foster a solutions-proposal business model and shift to knowledge-intensive business while harnessing experiences, knowledge, networks, and other resources from past Advertising Video Production Business. To achieve this, it will focus on reinforcement of operations and personnel (communication designers, data specialists, and others), including external people. Additionally, it will pursue aggressive investments to gather and accumulate data, integrate with external data, and develop and build schemes for effect measuring and analysis and IT services.

2. Overseas Business

AOI TYO Group plans to continue bolstering sites in China and Southeast Asia that the two companies pursued thus far. In Southeast Asia, it plans to strengthen production capabilities and expand business via M&A. Additionally, it intends to leverage collaboration and mutual utilization of human networks and resources.

We do not see the EBITDA goal (¥8bn) as an easy level in light of decline in profitability from the printless shift and burden from investments in new growth areas amid slim prospect of growth in demand for mainstay TV commercial production (Advertising Video Production Business). Nevertheless, we think the “experience design” business field, which AOI TYO Group aims to expand through promotion of a solutions-type business model, offers a market with large potential. We also expect AOI TYO Group’s experience and knowhow cultivated in video production to provide a differentiating factor and see a large advantage from its credibility (brand strength) and financial clout (especially for expansion of business with clients having a nationwide reach and investment strategy including M&A). Improvements started to be seen in profitability and other areas, but we will be particularly focusing on new value creation (such as VR content and data utilization) in the context of specific results obtained from management integration and aggressive investments in growth fields.

Shareholder returns

Aiming for at least 30% consolidated payout ratio

AOI TYO Holdings has presented a dividend policy of targeting at least 30% consolidated dividend payout ratio and dividend hikes accompanying a higher effective profit level. Furthermore, it is adopting DOE (dividend on equity ratio) as an indicator (with a goal of 4% in FY12/21) and seeks to raise this value from the standpoint of supplying a continuous and steady dividend.

For FY12/17, the annual dividend was ¥30 per share (including a ¥10 commemorative dividend), which was ¥2 higher than the initial forecast due to the stronger-than-forecast operating results. The consolidated dividend payout ratio was 25.6%, but the actual payout ratio after deducting the impact of the decline in taxes paid, primarily due to the reorganization of group businesses (a transient, special factor) was 30.5%, securing the 30% level.

For FY12/18, AOI TYO Holdings expects to pay an ordinary dividend of ¥30 per share (interim dividend = ¥8 per share, fiscal year-end dividend = ¥22 per share). This dividend would result in a payout ratio of 31.4% and DOE of 2.8%. The final dividend amount would be the same as the previous year, but it can be viewed as a dividend increase if one excludes the commemorative dividend, and we see AOI TYO Holdings as maintaining a high dividend level.

Concerning share buybacks during the period from May 16, 2017 through May 15, 2018*1, buybacks were suspended in conjunction with the adoption of an earnings-linked stock compensation system in February 2018*2. AOI TYO Holdings bought back a cumulative total of 261,400 shares through February 27, 2018 (total purchase amount of ¥289,631,200).

*1 The initial plan was to purchase 400,000 shares (upper limit), ¥400mn in total purchase amount (upper limit).
*2 The purchase of AOI TYO Holdings' own shares was discontinued in order to avoid infringement of insider trading regulations.

Furthermore, it provides benefits to shareholders listed or registered in the shareholder register as of June 30 (with ownership of 500 or more shares) with an original QUO card* and original photo collection with a photo shooting (40 people selected from applicants in a lottery).

* ¥3,000 for 500 or more shares, ¥5,000 for 1,000 or more shares, and ¥10,000 for 2,000 or more shares.

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