COMPANY RESEARCH AND ANALYSIS REPORT

AOI TYO Holdings Inc.

3975

Tokyo Stock Exchange First Section

21-May-2019

FISCO Ltd. Analyst

Ikuo Shibata

FISCO Ltd.

http://www.fisco.co.jp

Index

Summary

Sales and profits declined in FY12/18 due to the printless shift and work style reforms
Disclosed a medium-term business policy with stronger emphasis on quality that targets sustainable growth

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, 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.

The Company reported lower sales and profits in FY12/18 with net sales at ¥64,792mn (-8.1% YoY) and operating profit at ¥3,433mn (-25.7%). Sales fell substantially in the mainstay advertising video production business. Yet this outcome was not surprising because it reflected the impact of advances in the printless shift, income management with emphasis on profitability, and orders control related to work style reforms. Profits, meanwhile, slipped due to earnings pressure from weaker sales and higher depreciation costs with operation of a new system. The Company's efforts to improve effective profit margin* through stricter management of external expenditures limited the size of decline in operating profit. The Company also made some progress in future business initiatives, including promotion of an investing and alliance strategy and preparation for video advertising in the 5G era.

* Effective profit is profit obtained by subtracting external expenditures from net sales (details covered below).

The Company's FY12/19 targets are ¥65,000mn in sales (+0.3% YoY) and ¥2,600mn in operating profit (-24.3%). It aims to secure sales on par with the previous fiscal year amid likely continuation of the printless shift and other trends. In profits, it forecasts decline in a second straight year because of responses to work style reforms and investments in future growth mainly to cultivate and hire personnel. From FY12/20, however, the Company expects bottoming out of the profit decline and improvement, thanks to exhausting impact from the printless shift.

The Company disclosed a new medium-term business policy in order to address a variety of environment changes two years after the merger. A key difference with previous policy is the change to management with priority on “quality over quantity.” To ensure that it continues as a powerful group capable of responding to any era, the Company calls for development of businesses that meet needs and changes, full utilization of human resource capabilities, and continuation of healthy profits. It also continues to emphasize sustainability and shareholder return and wants to generate ROE that exceeds COE.

Key Points

- Posted lower sales and profits in FY12/18 due to work style reform responses and impact from the printless shift
- Though lifted effective profit margin and made progress with the investing and alliance strategy and preparations for video advertising in the 5G era
- Profit likely to continue declining through FY12/19 because of the ongoing printless shift and investments in growth
- Disclosed a new medium-term business policy that switches to management with priority on “quality over quantity” and sustainable growth

Company profile

Joint holding company established for the integration of AOI Pro. and TYO
Holds a top industry share for TV commercial production

1. Business overview

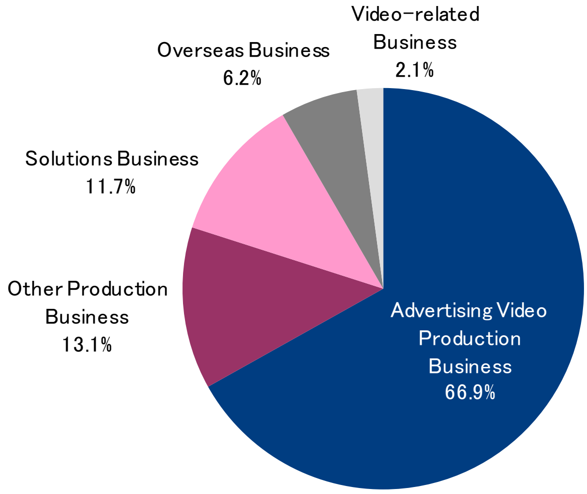
AOI TYO Holdings is a joint holding company that owns AOI Pro. and TYO. AOI TYO Group plans and creates TV commercials and also handles Solutions Business that includes direct transactions with advertisers, online videos and other digital contents. It was founded in January 2017 through management integration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

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 about two-thirds of overall sales, Solutions Business and Overseas Business have been expanding substantially recently and is attracting attention as a growth driver.

* Changed business categories and names as part of the new medium-term business policy from FY12/19 (details covered below).

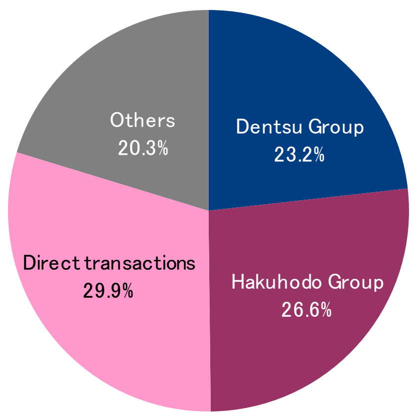
Sales mix by customer was well balanced with 23.2% to the Dentsu <4324> Group, 26.6% to the Hakuhodo (Hakuhodo DY Holdings Inc. <2433>) Group, 29.9% in direct transactions, and 20.3% to others. Direct transactions have been a TYO strength and are still growing after the management integration in correlation with the Solutions Business. Additionally, sales competition by media type is TV commercial production at 58.9%, entertainment contents at 4.7%, digital contents at 15.7%, overseas at 6,5%, and other at 14.2%. “Digital contents” is growing rapidly along with expansion in online video advertising demand as a trend.

Sales composition by business (FY12/18 result)



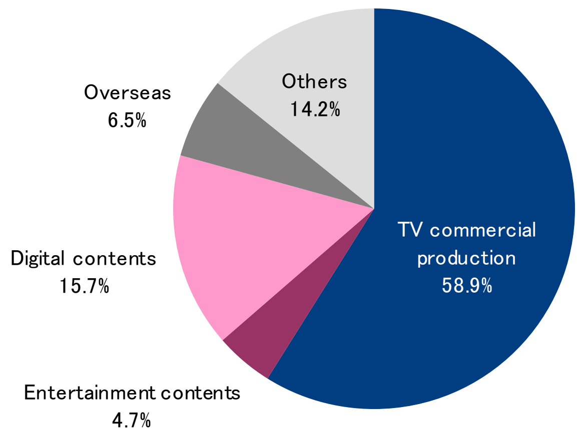
Source: Prepared by FISCO from the Company's results briefing materials

Sales ratio by customer (FY12/18 result)



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

Sales composition ratios by medium (FY12/18 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

The Company plans and produces TV commercials and other advertising video. This was the main business for AOI Pro. and TYO, and integration of these two major industry firms established a top market share. Both firms produce numerous excellent TV commercials amid continuation of a healthy orders environment. While the Company faces concerns about profitability decline because of changes in media value related to the growing Internet presence and the printless shift as well as the need for income structure reforms and better work efficiency, it aims to establish a dominant position in high-quality video advertising, its strength, including the expanding online video market. The new business categories changed the mainstay segment name to "Video Advertising Business."

(2) Other Production Business

Production business other than advertising videos includes movies, dramas, and event planning and production, Web production, and promotional goods production. In the new segment framework, these activities are combined with Video-related Business as the Advertising-related Business.

(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 on February 1, 2018 as a strategic move for the growth area. No change in new Business segments.

*1 Supplies one-stop solutions mainly through multi-faceted media activities via direct transactions with advertisers.
*2 Provides services that range from marketing strategy formulation mainly for videos to all PDCA solutions required by communications in the digital era.
*3 Provides experience design solutions using vital sign data and other services.

(4) Overseas Business

The Overseas Business operates sites in Southeast Asia (Thailand, Vietnam, Singapore, Indonesia, Malaysia, and India) and China, 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 Pro. purchased minority shares of VIEWFINDER MEDIA JOINT STOCK COMPANY, a leading video production company in Vietnam, which became a group company (equity-method affiliate). Following this, in March 2018, AOI Pro. acquired majority shares of Directors Think Tank (DTT) Group, a leading Malaysian TV commercial production company group, which became consolidated subsidiaries. No change in new Business segments.

(5) Video-related Business

This is business other than advertising and includes production of music videos. In the new segment framework, these activities are combined with other production business as the Advertising-related Business.

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 established the latest among other major commercial production companies. Hiroaki Yoshida (Representative Director, Chairman & CEO of AOI TYO Holdings), and together with five other commercial creators, including Kazuyoshi Hayakawa (Representative Director, President and CEO of TYO Inc.) 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.

(3) Background to the management integration (January 2017)

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 had 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.

Financial highlights

Posted lower sales and profits in FY12/18 due to printless shift and work style reforms
Though achieved some improvement in effective profit margin

The Company reported lower sales and profits in FY12/18 with net sales at ¥64,792mn (-8.1% YoY), operating profit at ¥3,433mn (-25.7%), recurring profit at ¥3,325mn (-24.3%), and net profit attributable to parent shareholders at ¥1,952mn (-29.8%). Compared to its revised guidance (from August 10, 2018), sales reached the target, but profits missed.

Sales dropped in all businesses other than Overseas Business. Mainstay Advertising Video Production Business sales fell considerably. Yet this outcome was not surprising because it reflected the impact of advances in the printless shift (reducing sales by about ¥730mn), income management with emphasis on profitability, and orders control related to work style reforms. Solutions Business, which is positioned as a growth area, also slumped on removal of major projects. Overseas Business moved in a positive direction, posting a large increase on acquisition of a major Malaysian advertising production firm as a consolidated subsidiary.

In the breakdown of sales by customer category, as explained above, while sales to advertising agencies weakened due to work style reforms, direct transactions with advertisers steadily increased, including video production, events, and public relations.

Profits, meanwhile, slipped because of earnings pressure from weaker sales (particularly decline in high-margin print sales) and higher depreciation costs with operation of a new system. The Company's efforts to improve effective profit margin* through stricter management of external expenditures limited the size of the decline in operating profit. Nevertheless, the plan had been expecting further improvement in effective profit margin and this was a reason for missing the outlook. We think this portion could be viewed as room for improvement from the next fiscal year. Sales of property and strategic stock holdings aimed at streamlining assets after the merger resulted in ¥509mn in extraordinary profits, but the Company also booked ¥351mn in extraordinary losses related to reorganization of underperforming subsidiaries.

* Effective profit is the profit obtained by subtracting external expenditures from sales for CM production. The effective profit margin rose to 35.5% in FY12/18 (vs. 33.4% in FY12/17).

In fiscal conditions, total assets declined 6.9% from the end of FY12/18 to ¥55,634mn, despite an increase in non-current assets (mainly "investments and other assets") from aggressive investment activities* and creation of new systems, because of even larger declines in current assets (such as "cash and deposits" and "notes and accounts receivable – trade"). Furthermore, shareholders' equity posted a 1.8% gain versus end-FY12/18 to ¥25,114mn as retained earnings build-up and other items offset a reduction from share buybacks. The equity ratio improved to 45.1% (vs. 41.3% at the end of FY12/18) with these changes. While "cash and deposits" fell, the liquidity ratio stayed at a high level of 180.5% and financial soundness is not a concern.

* The increase reflects a ¥500mn investment in Panair, Inc. via a venture fund jointly established by TYO and Field Management, acquisition of DTT Group, as major advertising production company in Malaysia, as a consolidated subsidiary, and a purchase of shares in Tagpic Inc. (making it an equity-method affiliate), one of the largest influencer marketing companies in Asia.

FY12/18 financial highlights

(¥mn)

	FY12/17		FY12/18		Change		FY12/18 revised guidance (August 10)		Achievement rate
	Result	Ratio	Result	Ratio		Change rate		Ratio	
Net sales	70,473		64,792		-5,681	-8.1%	64,000		101.2%
Advertising Video Production Business	49,270	69.9%	43,331	66.9%	-5,939	-12.1%	-	-	-
Other Production Business	8,774	12.5%	8,463	13.1%	-311	-3.5%	-	-	-
Solutions Business	8,072	11.5%	7,585	11.7%	-487	-6.0%	-	-	-
Overseas Business	2,912	4.1%	4,038	6.2%	1,126	38.7%	-	-	-
Video-related Business	1,446	2.1%	1,372	2.1%	-74	-5.1%	-	-	-
Cost of sales	56,788	80.6%	52,052	80.3%	-4,736	-8.3%	-	-	-
SG&A expenses	9,065	12.9%	9,307	14.4%	241	2.7%	-	-	-
Operating income	4,619	6.6%	3,433	5.3%	-1,186	-25.7%	3,800	5.9%	90.3%
Ordinary income	4,394	6.2%	3,325	5.1%	-1,068	-24.3%	3,700	5.8%	89.9%
Profit attributable to owners of parent	2,781	3.9%	1,952	3.0%	-829	-29.8%	2,300	3.6%	84.9%
Sales ratio by customer									
Dentsu Group	17,299	24.5%	15,053	23.2%	-2,246	-13.0%			
Hakuhodo Group	19,182	27.2%	17,225	26.6%	-1,957	-10.2%			
Direct transactions	18,357	26.0%	19,366	29.9%	1,009	5.5%			
Other	15,633	22.2%	13,146	20.3%	-2,487	-15.9%			

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

Financial position as of the end of December 2018

(¥mn)

	As of the end of December 2017	As of the end of December 2018	Change	Change rate
Current assets	41,503	36,307	-5,195	-12.5%
Cash and deposits	12,573	9,836	-2,737	-21.8%
Notes and accounts receivable – trade	24,021	21,004	-3,016	-12.6%
Work in process	3,629	4,256	626	17.3%
Non-current assets	18,234	19,327	1,092	6.0%
Property, plant and equipment	7,679	7,235	-444	-5.8%
Intangible assets	5,269	5,772	503	9.6%
Investments and other assets	5,285	6,319	1,033	19.6%
Total assets	59,737	55,634	-4,102	-6.9%
Current liabilities	25,275	20,114	-5,161	-20.4%
Accounts payable – trade	7,341	8,126	785	10.7%
Short-term loans payable	12,772	7,936	-4,835	-37.9%
Advances received	758	1,136	378	49.9%
Non-current liabilities	8,756	9,840	1,084	12.4%
Long-term loans payable	3,465	4,549	1,084	31.3%
Long-term deposits received	3,501	3,501	-	-
Total liabilities	34,031	29,954	-4,076	-12.0%
Net assets	25,706	25,679	-26	-0.1%
Shareholders’ equity	24,675	25,114	439	1.8%
Equity ratio	41.3%	45.1%		
Current ratio	164.2%	180.5%		
D/E ratio	0.63	0.49		

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

Activity results

Pursuing improvements in effective profit margin, though continuing robust investments in new areas

1. Advertising Video Production Business

While the production market for TV commercials and other conventional media advertising is roughly flat, the Company's advertising video production sales fell substantially with a 12.1% YoY decline to ¥43,331mn. Sales were down on stricter income management because of emphasis on profitability, orders control related to work style reforms*1, and impact from advances in the printless shift*2. Looking at the quarterly sales trend, however, while the Company considerably slowed momentum in 1Q, the trend remained roughly flat from 2Q and we think pressure from intended action (such as orders control) largely finished. In profits, effective profit margin (just for the CM production division) rose substantially to 35.5% (vs. 33.4% in FY12/17) thanks to construction of a sales management operation with emphasis on profitability (rigorous assessment and selection at the orders acceptance stage, thorough management of external spending, etc.). We think this is an important point.

*1 Work style reforms are affecting business in two ways – 1) work style reform (cutbacks in working hours) at major advertising agents (customer side) and 2) orders control (deal curtailment) from AOI TYO Group's own work style reform. While the latter impact might result in projects that AOI TYO Group did not accept going to other businesses (mid-sized and smaller firms), temporary market distortion is likely to disappear (be absorbed) because work style reforms are taking place throughout the industry.

*2 Print sales totaled ¥1,924mn (down ¥730mn YoY). We believe it is necessary to see the remaining portion as a source of downward pressure on sales as the printless shift advances.

2. Other Production Business

Other production business sales eased 3.5% YoY to ¥8,463mn. While there was a large setback from selling a web production subsidiary (lowering sales by about ¥800mn), the Company curtailed the actual sales decline to about ¥300mn because of strong growth in events and public relations income and dividend income from a movie* that the group invested in and produced (about ¥200mn).

* "Shoplifters," which was funded and produced by AOI Pro. and directed by Hirokazu Kore-eda, won the Palme D'Or award (top prize) in the competition division at the 71st Annual Cannes Film Festival. It also received the ARRI/Osram award (grand prize) in the Cinema Masters competition at the 36th Munich International Film Festival in Germany (the first time for a Japanese film to win this award). In Japan, it won the Grand Prize in a total of eight divisions, including the best movie award, and received the most awards at eight for the 42nd Japan Academy Awards. AOI TYO Group intends to continue its initiatives with entertainment content and pursue further growth in this business on the prospect of a coming era that fuses entertainment content and advertising videos. *

3. Solutions Business

Solutions Business sales declined 6.0% YoY to ¥7,585mn. However, segment sales were roughly flat excluding TV commercial media costs from sales. While TYO's offering management division sales (excluding media costs) rose by a healthy 6.9% YoY to ¥3,717mn, AOI Pro.'s subsidiary Quark tokyo sales slumped 7.8% to ¥2,226mn. Video advertising production increased, but non-recurrence of a major project (including planning and consulting) from the previous fiscal year undercut sales. The Company sees this as a growth area. However, it needs to strengthen operations, such as recruiting personnel with strong expertise.

In new business initiatives, the Company achieved some progress, including the establishment of SOOTH*1, a new company that provides experience design solutions using vital sensing data and other services, and a business alliance (overall assistance in planning, public relations, and advertising strategy, etc.) with Panair*2, which manages electricity using big data. Additionally, Quark tokyo concluded a strategic partnership with Cyber Communications Inc. (CCI) on February 12, 2019. By combining Quark tokyo, which has extensive results in digital promotion targeted to young people, and CCI's media solutions, the Company aims to develop new media contents and bolster services that build engagement between companies and consumers.

*1 AOI TYP Group established this company on February 1, 2018 to carry on business handled by the AOI Pro. Experience Design Department. While the division handled 1) planning and production of contents that incorporates VR, AR, MR, and other latest technologies and 2) knowledge accumulation including new data and emotion data, the new company creation (spin-off) aims to go further in 3) pursuing comprehensive marketing business (solution provision covering from brand strategy proposal to effect measuring and analysis) and 4) developing high value-added business through data utilization. This move confirms existence of a basis for business expansion. Although full-fledged earnings contributions need substantial time, the business has large potential, including the application scope.

*2 Panair supplies the Panair Cloud, which is Japan's first cloud platform for electric power distribution using AI and big data researched and developed on its own. It established a new company with TEPCO Energy Partner, Inc. via joint investment in April 2018 and is pursuing development of energy-related services that harness IT. Panair has attracted interest in the electric power industry and throughout the energy industry. Along with the alliance, Ad Hack Ventures, a venture fund jointly established by TYO and FIELD MANAGEMENT, invested ¥500mn in Panair. We think the stake targets investment return, including from an IPO, based on evaluation of robust business potential and development of a stronger partnership.

4. Overseas Business

Sales in the Overseas Business grew significantly with a 38.7% increase to ¥4,038mn from the previous year. Positive factors were organic growth in Southeast Asia amid expansion of the advertising market and acquisition of DTT Group, a major Malaysia-based advertising production company group, as consolidated subsidiaries*.

* AOI Pro. purchased shares of holding-company Reserve Tank Sdn. Bhd., which owns the DTT Group, in March 2018. In 10 years from its establishment, DTT Group expanded video production business to a level that puts it in the top five firms in Malaysia. It has offices in Kuala Lumpur (Malaysia) and Jakarta (Indonesia) and receives many orders from China and other neighboring countries. We believe this acquisition aims for entry into Indonesia and other neighboring countries, in addition to expansion of business with Japanese and local companies in Malaysia.

Business performance outlook

Profit decline likely to last through FY12/19 on continuation of the printless shift and investments in growth

The Company's FY12/19 targets*1 are ¥65,000mn in sales (+0.3% YoY), ¥2,600mn in operating profit (-24.3%), ¥2,500mn in recurring profit (-24.8%), and ¥1,300mn in net profit attributable to parent shareholders (-33.4%). It aims to secure sales on par with the previous fiscal year amid likely continuation of the printless shift*2 and other trends. In profits, it forecasts decline in a second straight year because of investments in future growth and other factors.

*1 The Company changed business categories and names as part of formulating the new medium-term business policy from FY12/19. Specifically, it renamed "Advertising Video Production Business" as "Video Advertising Business", combined "Other Production Business" and "Video-related Business" as "Advertising-related Business", and retained "Solutions Business" and "Overseas Business" in existing formats.

*2 Projects a sales setback of about ¥900mn from printless shift (roughly ¥700mn in profit downside).

In sales, the Company expects to match the FY12/18 level, despite continued orders control related to promotion of work style reforms and printless shift, non-recurrence of movie dividend income from FY12/18, and reorganization of underperforming subsidiaries, because of steady sales growth in solution and overseas businesses that it is promoting. In profits, it forecasts profit decline in a second straight year, even with ongoing efforts to improve effective profit margin, due to decline in high-margin print sales, costs from responses to work style reforms, and investment in future growth mainly to cultivate and hire human resources. From FY12/20, however, the Company expects bottoming out of the profit decline and improvement, thanks to exhausting impact from the printless shift.

FY12/19 forecast

(¥mn)

	FY12/18		FY12/19		Change	
	Result	Ratio	Initial forecast	Ratio		Change rate
Net sales	64,792		65,000		207	0.3%
Advertising Video Production Business	43,331	66.9%	43,400	66.8%	69	0.2%
Advertising-related Business	9,836	15.2%	9,100	14.0%	-736	-7.5%
Solutions Business	7,585	11.7%	8,000	12.3%	415	5.5%
Overseas Business	4,038	6.2%	4,500	6.9%	462	11.4%
Cost of sales	52,052	80.3%	-	-	-	-
SG&A expenses	9,307	14.4%	-	-	-	-
Operating income	3,433	5.3%	2,600	4.0%	-833	-24.3%
Ordinary income	3,325	5.1%	2,500	3.8%	-825	-24.8%
Profit attributable to owners of parent	1,952	3.0%	1,300	2.0%	-652	-33.4%

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

We think the Company should attain FY12/19 targets, despite the ongoing printless shift and investment costs, because the plan conservatively factors in impact values, demand for high-quality video advertising, its strength, is robust, and Solutions and Overseas businesses, which are growth areas, are likely to expand. In particular, we are closely monitoring trends in Solutions Business because the Company's reinforcement of broad proposal activities (digital video, event production and operation, public relations, etc.) is likely to expand direct advertiser transactions with not only new companies but a wide range of clients and demand for video contents marketing is growing. While the extent of progress by the printless shift, an external factor, might affect income, it is important to note that this portion is not an indicator of whether the Company's results are fundamentally healthy or not.

Growth strategy

Disclosed a new medium-term business policy in light of rapid changes in the environment
Switching to management that emphasizes "quality over quantity" aimed at realizing sustainable growth

The Company disclosed a new medium-term business policy in order to address a variety of environment changes two years after the merger. A key difference with previous policy is the change to management with priority on "quality over quantity." To ensure that it continues as a powerful group capable of responding to any era, the Company calls for development of businesses that meet needs and changes, full utilization of human resource capabilities, and continuation of healthy profits. Because of the switch from quantity to quality and rapid changes in the environment, the Company retracted numerical goals that it had been promoting*1 and decided against using sales, profits, and other numerical goals as KPI. However, it still emphasizes sustainability and shareholder return and wants to generate ROE that exceeds COE*2.

*1 The growth strategy disclosed in December 2016 (just before integration) set FY12/21 goals at ¥8bn EBITDA, at least 12% ROE, and 4% DOE.
*2 AOI TYO Holdings estimates that the cost of shareholder equity is currently about 9%.

1. Direction of business initiatives

The Company wants to solidify an overwhelming position by deepening its production of high-quality video and movies for branding, its strength, along the lines of existing activities and bolster and "broaden" related solutions (promotions and contents). In particular, for its mainstay video advertising, it hopes to secure market survivor profits as the No.1 firm in the TV commercial production market, the mainstay up now, and acquire market share, mainly for higher-priced video, in the online video market that is growing substantially. Additionally, it outlines a strategy of optimizing video production and distribution (reach) by analyzing and utilizing data and recruiting related market opportunities (including events, public relations, influencer marketing, video distribution, etc.) by strengthening various functions and collaborating with other companies. In peripheral solutions, meanwhile, it aims to realize a high value-added business model by bolstering video as content (developing IP, etc.), strengthening event and PR business through M&A and capital alliances, and developing solutions that utilize video.

2. Human resources

The Company wants to cultivate numerous employees capable of proposing and realizing total communications and recruit professionals in a variety of communication methods. Measures for realizing these goals include hiring people with qualities needed to handle total communications, forming expert teams (total communication expert team, online video expert team, etc.), cultivating human resources through seconding and interaction (utilization of rotation/FA programs, seconding to group companies with different functions, etc.), and strengthening the educational system (classroom lectures and enhancement of on-the-job training for total communication projects).

3. Overseas Business

In fast-growing Asia (China, Southeast Asia, etc.), the Company intends to strengthen joint efforts through collaboration among multiple sites, rather than just relying on individual sites, and build a potent income structure based on unique "products" and rational capital composition (allocation of capital that reflects individual site profitability, including underperforming reorganization). As examples of "collaboration," it has already formed an overseas strategy division (July 2018), held an Asian meeting, and deployed infrastructure and communication tools. These efforts appear to be producing results as well. In development of unique products, it envisions a strategy of packaging IP assets and technology developed and obtained through alliances in Japan as solutions. The Company intends to look at deployment in areas outside of Asia as well.

While the Company currently faces negative impacts from external factors, such as responses to work style reforms and advances in the printless shift, we believe it has significant opportunities over the longer term from various structural changes (media diversification, technology advances, etc.). In particular, its business model based on production of high-quality videos, an important strength, and a strategy that leverages its overwhelming position constitute unique advantages. A key issue is finding ways to capture more of the overall market while bolstering peripheral solutions, such as promotions and contents. We think realization of high added value by leveraging new technology (VR contents, data utilization, etc.) is an important aspect too. The Company's approach to reinforcing operations for business expansion, such as collaboration with external companies, including M&A deals, and recruitment of human resources with robust expertise, hence is likely to strongly influence future growth potential.

Shareholder returns

Aiming for a dividend payout ratio of at least 30%, planning share buybacks too

The Company presented "a dividend payout ratio of at least 30%" as its dividend policy.

In FY12/18, it paid a ¥30 ordinary dividend for the full year (¥8 interim, ¥22 period-end), in line with the period-start outlook (36.4% payout ratio). It also advocates buybacks as part of a dynamic capital policy aimed at improving shareholder return and capital efficiency and purchased 400,000 shares (for ¥531,200,000) on June 7, 2018.

For the FY12/19 dividend, the Company plans to pay ¥20 for the full year (¥8 interim, ¥12 period-end), a decline of ¥10 YoY, in light of its outlook for lower profits (this stance keeps the dividend payout ratio at the same level as FY12/18 at 36.4%). Furthermore, it announced a share buyback program for 500,000 shares (¥600mn) on February 19, 2019 that extends from March 1, 2019 through February 29, 2020.

The Company is planning gifts too for shareholders listed or registered on the shareholder ledger as of June 30, 2019 (who own 500 or more shares), including an original QUO card, original gift selection catalog*, and tickets to a tour of their animation studio (random selection among applicants).

* ¥3,000 QUO card for 500 shares or more, ¥5,000 QUO card for 1,000 shares or more, and ¥10,000 gift selection catalog for 2,000 shares or more.

Disclaimer

FISCO Ltd. (the terms "FISCO", "we", mean FISCO Ltd.) has legal agreements with the Tokyo Stock Exchange, the Osaka Exchange,and Nikkei Inc. as to the usage of stock price and index information. The trademark and value of the "JASDAQ INDEX" are the intellectual properties of the Tokyo Stock Exchange, and therefore all rights to them belong to the Tokyo Stock Exchange.

This report is based on information that we believe to be reliable, but we do not confirm or guarantee its accuracy, timeliness,or completeness, or the value of the securities issued by companies cited in this report. Regardless of purpose,investors should decide how to use this report and take full responsibility for such use. We shall not be liable for any result of its use. We provide this report solely for the purpose of information, not to induce investment or any other action.

This report was prepared at the request of its subject company using information provided by the company in interviews, but the entire content of the report, including suppositions and conclusions, is the result of our analysis. The content of this report is based on information that was current at the time the report was produced, but this information and the content of this report are subject to change without prior notice.

The final selection of investments and determination of appropriate prices for investment transactions are decisions for the recipients of this report.

FISCO Ltd.