COMPANY RESEARCH AND ANALYSIS REPORT

KADOKAWA CORPORATION

9468

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Summary

Targets ¥240bn in revenue and ¥15bn in operating income in FY3/23 as medium-term management goals

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

1. FY3/20 1H results

In 1H FY3/20 (Apr-Sep) 2019 consolidated results, while revenue fell slightly by 1.7% YoY to ¥100,439mn, operating income climbed significantly with a 123.1% YoY increase to ¥6,389mn, mainly on robust improvement of DWANGO income following business structural reforms implemented in the previous fiscal year, and upbeat overseas rights licensing income for anime content and sales of games, e-books, and e-magazines. In game business, the Company received a boost from a major hit with cumulative shipments of more than 4 million copies as of end-September 2019 with SEKIRO: SHADOWS DIE TWICE (below, SEKIRO), an action adventure game released simultaneously worldwide in March 2019.

2. FY3/20 outlook

The Company updated FY3/20 guidance to ¥207,000mn in revenue (-0.8% YoY) and ¥10,000mn in operating income (+269.3%), versus period-start targets of ¥217,000 and ¥5,400mn respectively). Despite lowering the revenue target by ¥10bn from the period-start level due to the revenue of consolidated subsidiary MAGES. Inc. in July 2019 and other factors, the new operating income outlook reflects stronger recovery in DWANGO income than expected, upbeat activity in e-book, anime, and game businesses, and overall cost reduction. The Company aims to reach all-time high operating income for the first time since FY3/15 when it merged with DWANGO. While it projects an HoH decline in 2H operating income, this view stems from planned reinforcement of promotions and other efforts to expand sales in Web services business and conservative guidance for the Publication and Video & Game businesses. Nevertheless, we think it might beat updated earnings guidance considering the 63.9% fulfillment rate for the full-year operating income target through 1H.

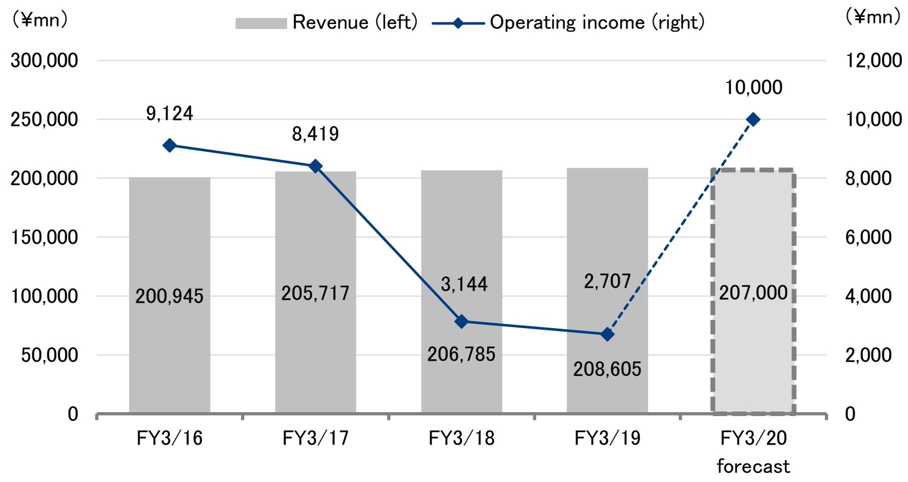
3. Medium-Term Management Strategy

The Company targets ¥240bn in revenue and ¥15bn in operating income in FY3/23 as medium-term management goals. It aims to accelerate the growth engine from an ability to create new IP at a pace of 5,000 items per year in Publication business and domestic and overseas rollout capabilities utilizing a mixture of media through promotion of digital transformation (below, DX). It also pursues management with awareness of ESG and SDGs. The Company has scheduled the grand opening of Tokorozawa Sakura Town, which is currently being built with a total investment of ¥39.9bn, in July 2020 and includes a book manufacturing and logistics plant and the Tokorozawa Campus (new office space) too. It hopes to contribute to establishment of one of Japan's largest pop culture dissemination sites. While earnings might temporarily slow or even decline from FY3/21 because of higher depreciation costs from launching this site, we expect healthier profitability from FY3/22 with full-year operation of the book manufacturing and logistics plant that facilitates timely production of hardcover books in the right amounts.

Key Points

- Earnings rose significantly in 1H FY3/20 mainly on cost savings at DWANGO from business restructuring reforms
- Management lifted FY3/20 profit guidance and expects to post all-time high operating income since the DWANGO merger
- Targets ¥15bn in FY3/23 operating income fueled by the growth engine of IP "creation x rollout x experiences"

Results trends



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

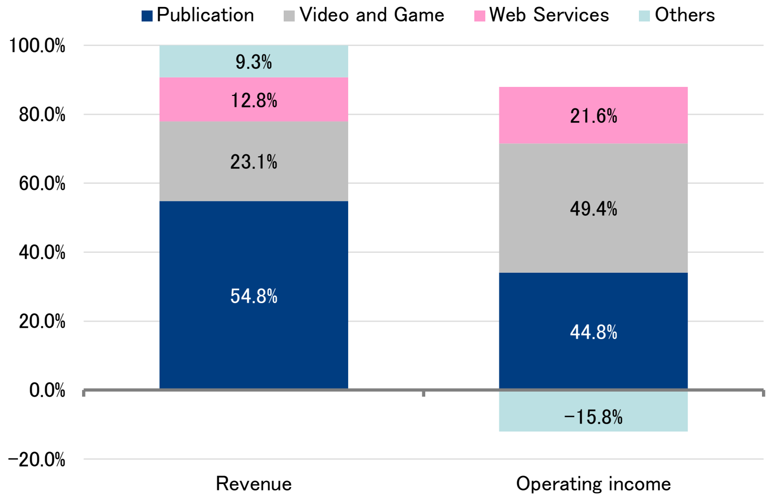
Business overview

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

The Company is a comprehensive media company with subsidiaries that handle Publication business, Video business, Rights business, Digital Contents business, network and entertainment services, content planning, development, and operation, and video service operation.

The breakdown of 1H FY3/20 net sales by segment shows Publication business at a majority with 54.8%, Video and Game business at 23.1%, Web Services business at 12.8%, and Others (merchandising, education, and inbound-related business) at 9.3%. In operating income, profits from the Publication business, Video and Game business, and Web Services business offset losses from Others. While Publication business is currently the primary source of sales and profits, the Company hopes to increase sales and improve profitability in the Video & Game business with a media mix strategy utilizing its own IP and achieve renewed growth in Web Services business, which restored profitability in 1Q FY3/20, by building the fan community and developing and providing new services.

Composition of revenue and operating income (loss) by business segment (FY3/20 1H)



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

1. Publication business

In this business, which is KADOKAWA's main business, the Company publishes and sells paper-based books, separate volumes, light novels, graphic novels, and comics, as well as e-books and magazines. In addition to magazines including "The Television" (TV information), "Walker" (regional information), "Famitsu" (game information), and "Lettuce Club" (lifestyle information) and mooks (magazine-style books) in this business, the Company also produces custom media as well as selling advertisements on the Internet.

For sales of paper books, the Company has strength in developing works through its media mix strategy, and it continuously publishes new titles at a rate of 5,000 a year. The Company has worked on optimizing production and shipments based on marketing results from many years and utilization of digital technology. Its book return rate in 1H FY3/20 was in the mid-30% range.

Conversely, in e-books, the Company sells its own and other companies' works on BOOK•WALKER, which is its directly managed e-books distribution platform, and also on the e-book stores of other companies, like Amazon and Rakuten. For e-magazines, it provides and manages content in collaboration with NTT DoCoMo, Inc.<9437> for d magazine, which is an all-you-can-read magazine service. The DWANGO-operated niconico Manga, niconico Books, and Bookmeter have been integrated under the control of BOOK WALKER Co., Ltd., which manages BOOK•WALKER, in FY3/19 with the aim of strengthening the e-books and e-magazines business Groupwide.

2. Video and Game business

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

In the game business, the Company's consolidated subsidiaries, KADOKAWA CORPORATION, FromSoftware, Inc., Spike Chunsoft Co., Ltd., and KADOKAWA GAMES, LTD. carry out the planning, development, and sales of packaged game software, network games, and app games. Previous hit titles include "Dark Souls," "Bloodborne," "SEKIRO" (FromSoftware), "GOD WARS" (KADOKAWA GAMES), "Kenka Bancho," "Danganronpa," and "ARK:Survival Evolved" (Spike Chunsoft). The Company sold shares in subsidiary MAGES. in July 2019, removing it from consolidated coverage.

3. Web Services business

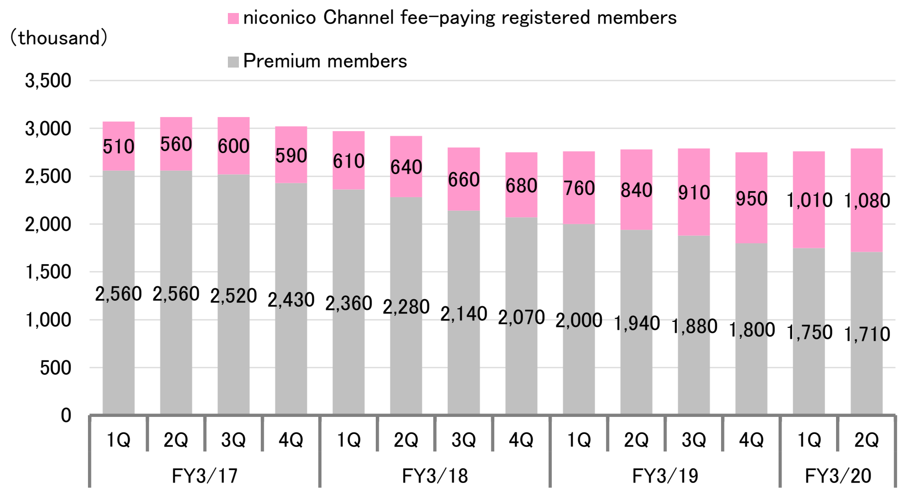
DWANGO handles the Web Services business and mainly operates a portal business (running the niconico Douga service, etc.). It also implements live business that plans and manages various events as niconico advertising and promotion and rents out event spaces as well as mobile business (music distribution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

The Company provides various services on its mainstay portal business, including the niconico Douga video community, niconico Live, and niconico Channel. Sales include revenue from monthly fees (¥550/month) obtained from niconico premium members, which enables them to watch videos and live broadcasts comfortably; advertising revenue, such as from website banners and video; and revenue from points used to watch pay-to-view videos. At the end of September 2019, the number of valid members*1 had increased to 74.66 million people and among these, the number of premium members continued declining from the peak at end-September 2016 to 1.71 million people (down 230,000 people from the end of September 2018). The usage conditions from July to September 2019 were that MAU (monthly active users), including non-log-in UU*2, was 22.45 million people, and DAU (daily active users) was 3.07 million people. MAU has been increasing at a moderate pace because general users can now watch the content on niconico Douga much more comfortably, following substantial improvement in the communications network environment since the upgrade in 2018, and even non-log-in users can watch it.

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

On the other hand, the niconico Channel is a platform where companies, organizations, and users can distribute video and live broadcasts. At the end of September 2019, it had a total of 8,960 channels (up 533 channels from the end of September 2018), 1,555 monthly-fees channels (up 194 channels), and 1,080,000 monthly fee-paying registered members (up 240,000 people), and all of the indicators continue to increase.

Trends in the number of fee-paying members



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

The live business plans and manages live events, such as niconico Chokaigi*1, Tokaigi*2, Animelo Summer Live*3, and niconico Choparty*4. The Company halted operations at end-July 2019 for nicofarre (Roppongi), a live house that integrated the network and real world, and nicinico Headquarters (Ikebukuro), a nicinico promotional shop. It opened Hareza Studio (Ikebukuro) in November 2019 to carry on distribution of live broadcasts handled by the two previous facilities and other activities. The site conducts live performances by virtual characters with a concept of merger real and virtual worlds and promotes anime and game-related stage events.

*1 The largest niconico event held at Makuhari Messe with the concept of "recreating all of niconico onsite." All the participating users are "lead actors" in the various events that integrate the Internet and the real world. niconico Chokaigi 2019 was held on April 27-28, 2019, with approximately 168,000 visitors to the venue and approximately 6.66 million online visitors. This was a record high attendance for Chokaigi after it had been separated from the Tokaigi (Game Party Japan) event.

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

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

*4 A large-scale stage event for niconico, which is one of the Japanese largest video services. It is niconico's largest live event where users active on niconico in various genres, such as "This is me singing" and "This is me dancing," and famous artists gather together and perform. The Company stopped holding it in 2019 (it was held on November 3, 2018, at the Saitama Super Arena, and was attended by approximately 15,000 people).

The mobile business still generates a certain level of profit margin, despite member numbers continuing on a downward trend due to market environment changes. This business operates dwango.jp, which distributes single songs, ring tones, and so forth, as well as animelo mix, which distributes digital contents.

4. Others

Others is comprised of businesses including an education business, which involves the management of the Vantan Game Academy and the KADOKAWA Contents Academy schools that provide training to work in creative fields inside and outside of Japan, and N High School (KADOKAWA DWANGO Educational Corporation), which provides education programs characterized by interactivity from the integration of the online and the real worlds, and also merchandising business with planning and sales of character goods and idol CD sales, and inbound-related business. The Company ended its involvement in song production and sales utilizing digital contents and talent management businesses in July 2019 with the removal of MAGES. from consolidated coverage.

Results trends

Earnings rose significantly in 1H FY3/20 mainly on cost savings at DWANGO from business restructuring reforms

1. Overview of the FY3/20 1H results

In 1H FY3/20 (Apr-Sep) 2019 consolidated results, the Company reported ¥100,439mn in revenue (-1.7%), ¥6,389mn in operating income (+123.1%), ¥6,805mn in ordinary income (+72.9%), and ¥6,202mn in net income attributable to parent shareholders (+192.7%). Earnings increased more than expected. Furthermore, the setback of just over a billion yen in revenue due to removal of MAGES. results from consolidated coverage in 2Q FY3/20 only had a minor impact on profits.

FY3/20 1H results

(¥mn)

	FY3/19 1H		FY3/20 1H			
	Results	% of revenue	Results	% of revenue	% change	Change
Revenue	102,129	-	100,439	-	-1.7%	-1,690
Cost of sales	73,765	72.2%	67,574	67.3%	-8.4%	-6,191
Gross profit	28,364	27.8%	32,865	32.7%	15.9%	4,501
SG&A expenses	25,500	25.0%	26,476	26.4%	3.8%	976
Operating income	2,864	2.8%	6,389	6.4%	123.1%	3,525
Ordinary income	3,934	3.9%	6,805	6.8%	72.9%	2,870
Profit (loss) attributable to owners of parent	2,119	2.1%	6,202	6.2%	192.7%	4,083

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

Results by business segment

(¥mn)

	FY3/19 1H		FY3/20 1H		% change		Change	
	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income
Consolidated total	102,129	2,864	100,439	6,389	-1.7%	123.1%	-1,690	3,525
Publication	55,079	3,003	56,204	3,308	2.0%	10.1%	1,125	304
Video and Game	23,809	2,532	23,620	3,648	-0.8%	44.1%	-189	1,116
Web Services	13,828	-100	13,159	1,591	-4.8%	-	-668	1,692
Others	11,276	-999	9,489	-1,167	-15.8%	-	-1,787	-168
Eliminations/Corporate	-1,863	-1,571	-2,033	-992	-	-	-170	579

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

In revenue, e-books and e-magazines performed well and Publication business posted an increase. In operating income, Publication business, Video and Game business, and Web Services business booked higher profits, including strong contributions to improved earnings from Web Services business and Video and Game business.

Major boosts were manifestation of business restructuring reforms implemented by DWANGO in the previous fiscal year for Web Services business and upbeat overseas rights licensing income for animation in video business and a large hit with cumulative sales of more than four million copies by SEKIRO, which started sales in March 2019, in game business for Video and Game business. The Company's overall cost-cutback efforts lifted profits too.

The unit cost ratio dropped by 4.9ppt YoY. Cost savings on a total basis were ¥216.9bn YoY in outsourcing costs, ¥1,050mn in depreciation costs, and ¥212mn in communication costs. We think these cutbacks mainly came from restructuring reforms at DWANGO. The SG&A expenses ratio, meanwhile, increased by 1.4ppt YoY because of revenue decline and higher personnel costs.

Non-operating income booked interest income, dividend income, and equity-method investment profits. In forex income, the Company posted a ¥295mn profit in the previous year, but had a ¥331mn loss this year because of forex-related impact. Thanks to ¥1,604mn in profit from selling fixed assets*1 and ¥585mn in settlement income*2 reported as extraordinary profit, the growth rate in net income attributable to parent shareholders was even larger than for other profit items.

*1 Mainly profit from selling land and building properties owned by consolidated subsidiary Building Book Center Co., Ltd.
*2 Settlement for damages at a consolidated subsidiary due to contract violation by a business partner

Profits increased substantially in the Web Services business and the Video and Game business

2. Trends by business segment

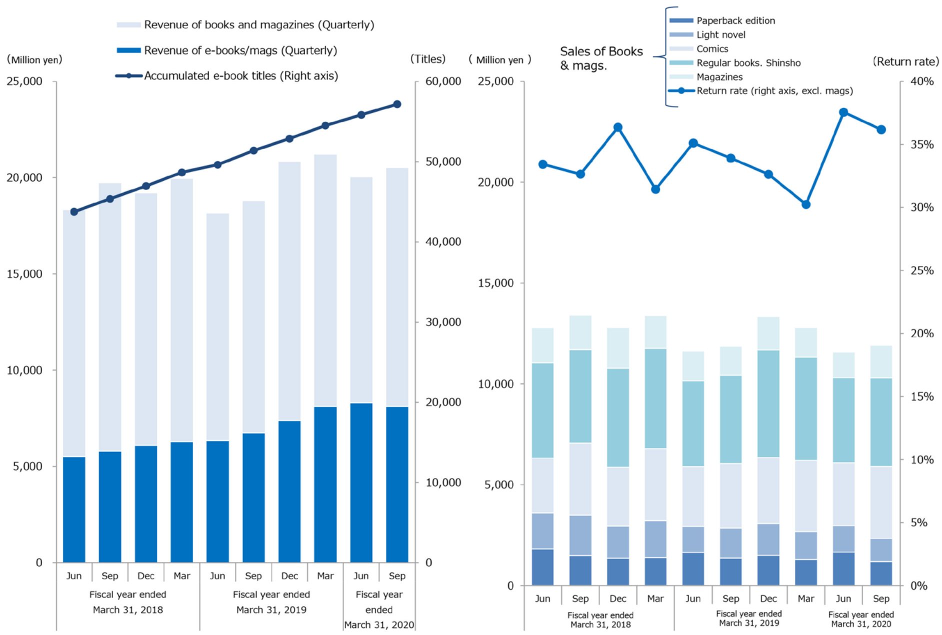
(1) Publication business

Publication business reported ¥56,204mn in revenue (+2.0% YoY) and ¥3,308mn in operating income (+10.1%) with support from upbeat sales of e-books and e-magazines as sales measures with strong emphasis on market trends paid off. And lifted the sales ratio in this segment from just over 20% a year earlier to just under 30%.

For book business, the Company generated healthy sales from Dungeon Meshi in comics, The Irregular at Magic High School in light novels, Weathering With You in general short books, and Sekai-ichi Oishii Tenuki Gohan – Saisoku! Yaruki-no-Iranai 100 Recipes in general books. For magazine business, the Company achieved smooth progress in revamping the business model, such as a transition to Web media, lowered the return rate, and increased advertising income from Web media.

Results trends

Publishing business results



Source: The Company's results briefing materials

(2) Video and Game business

Video and Game business booked ¥23,620mn in revenue (-0.8% YoY) and ¥3,648mn in operating income (+44.1%). We think sales expanded on a real basis excluding the impact of selling the MAGES. business. Video business had robust income from overseas rights licensing mainly in North America and China for animated content, such as Overload 3, Isekai Cheat Magician, and The Rising of the Shield Hero. Game business, meanwhile, provided a large income contribution on a major hit with cumulative shipment of more than 4 million copies by September of SEKIRO, which the Company released simultaneously worldwide on March 22, 2019 (it sold 2 million copies in the first ten days after the release).

(3) Web Services business

Web Services business reported ¥13,159mn in revenue (-4.8% YoY) and ¥1,591mn in operating income (vs. a ¥100mn loss in the previous year), restoring a profit for the first time in two years. Despite a decline in niconico premium members for mainstay video service to 1.71 million people at end-September 2019 (vs. 1.75 million at end-June), the pace is modestly easing at the QoQ level. Nevertheless, paid members for niconico Channel service steadily increased to 1.08 million people (vs. 1.01 million at end-June).

Live business recorded all-time high attendance at niconico Chokaigi 2019 held in April 2019 and narrowed losses with cost controls. Animelo Summer Live 2019 -STORY-, the world's largest Anison live event held in Aug-Sep 2019 attracted 84,000 people over three days and lifted income.

In earnings, cost savings from business restructuring reforms implemented by DWANGO in the previous fiscal year were the main contribution to improved profit. Outsourcing costs, communication costs, and depreciation costs dropped.

(4) Others

Others reported ¥9,489mn in revenue (-15.8% YoY) and a ¥1,167mn operating loss (vs. a ¥999mn loss in the previous fiscal year). Despite continued upbeat momentum in education business driven by income contributions from school operator Vantan Inc., sales slipped on weaker revenue in MD business with backlash from non-recurrence of idol CDs sold in 1Q FY3/19 and the revenue of MAGES. (removing this business). Inbound business contributed negatively to earnings due to ongoing investments in future growth for the inbound business.

The number of students at N High School, which is operated by KADOKAWA-DWANGO Educational Corporation, expanded sharply to about 11,000 people as of September 2019 (vs. about 7,000 people in April 2018). Recent success by figure skater Rika Kihira, who attends the school, raised awareness of the benefits of correspondence high school that lets people learn without constraints on time and deepened the understanding of guardians. This led to a large rise in students directly entering the school after graduating from middle school. We think openings of five new school course campuses in April 2019 in Sendai, Tachikawa, Kashiwa, Kyoto, and Esaka (bringing the total number to 13 sites) helped too. The Company plans to open another six sites in April 2020. It books system usage fees for N High School, and we expect increase in student volume to provide additional income for educational business.

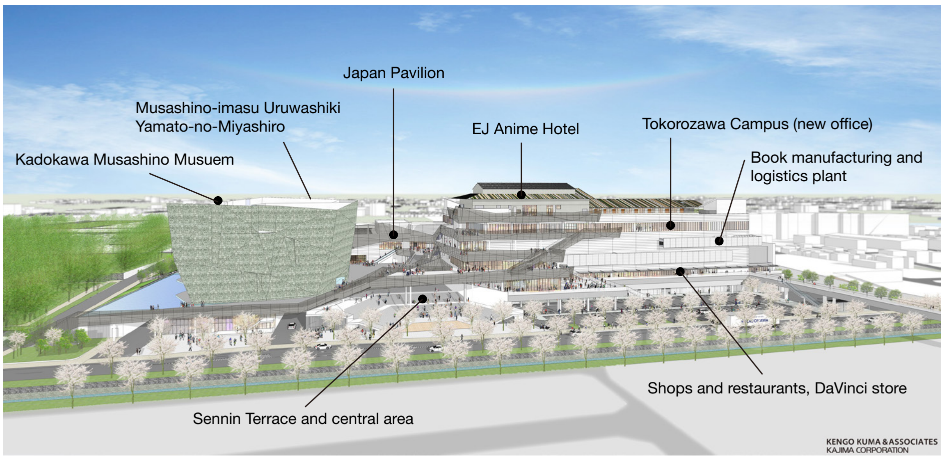
Grand opening of Tokorozawa Sakura Town scheduled in July 2020

3. Financial condition and management indicators

Looking at financial conditions at end-1H FY3/20, gross assets were down by ¥4,286mn from end-FY3/19 to ¥235,785mn based on a ¥17,065mn drop in current assets and a ¥12,779mn increase in fixed assets. Current asset declines were promissory notes received and accounts receivable by ¥11,862mn and cash and deposits by ¥4,828mn. Fixed assets, meanwhile, climbed with a ¥9,103mn rise in tangible fixed assets with progress in the Tokorozawa Project (Tokorozawa Sakura Town*) and a ¥3,494mn increase in investment securities value with gains in the market value of stocks held by the Company.

* This is the centerpiece site of the COOL JAPAN FOREST Vision that aims to generate cutting-edge culture and industry in a location with rich greenery and disseminate them to the world. It includes a book manufacturing and logistics plant, new office space, event space, an anime hotel, shops, restaurants, and commercial facilities operated by the Company and Kadokawa Musashino Musuem, a cultural multifaceted facility, managed and operated by Kadokawa Culture Promotion Foundation. The total budget is ¥39.9bn.

Conceptual image of Tokorozawa Sakura Town



Source: From the Tokorozawa Sakura Town web page

Total liabilities dropped by ¥8,463mn from end-FY3/19 to ¥128,197mn, mainly on declines under current liabilities of ¥4,514mn in promissory notes payable and accounts payable, ¥1,060mn in unpaid amounts, ¥755mn in unpaid corporate taxes, and ¥1,454mn in return reserves. Interest-bearing debt was roughly flat with a decline of just ¥47mn to ¥65,471mn.

Net assets increased by ¥4,176mn from end-FY3/19 to ¥107,588mn. Even with outflow of ¥1,297mn in dividend payments and ¥3,000mn in share buybacks, the Company added ¥6,202mn in net income attributable to parent shareholders and ¥2,288mn from a rise in other negotiable securities valuation change.

In management indicators, the Company's capital ratio, which reflects soundness, climbed by 2.5ppt from end-FY3/19 to 44.7% and the D/E ratio (interest-bearing debt/capital) modestly improved on a 0.03ppt drop to 0.62x, mainly due to progress in streamlining through DWANGO's business restructuring reforms and substantial income recovery. While cash and deposits fell because of outlays for Tokorozawa Project capital investments and share buybacks, we think the Company retained financial healthy since it still has more than ¥3bn in net cash (cash and deposits – interest-bearing debt).

Capital investments totaled ¥11,325mn on a cash basis in 1H FY3/20, and the Company budgets ¥13,000mn for the full fiscal year, mainly going into the Tokorozawa Project. Investment outlays are scheduled to peak in FY3/21, when the Company completes the new site with the Tokorozawa Project, at an estimated roughly ¥18,000mn (including ¥15,000mn for the Tokorozawa Project). Depreciation costs, which are temporarily headed lower in FY3/20, hence should increase to about ¥7,000mn in FY3/21. We think it will take until FY3/22 to restore positive free cash flow.

Consolidated balance sheet

(¥mn)

	FY3/19	FY3/20 1H	Change	Main factor
Current assets	148,975	131,910	-17,065	Cash and deposits -4,828, Notes and accounts receivable -11,862, Inventory assets +949
(Cash and deposits)	73,597	68,769	-4,828	
Non-current assets	91,096	103,875	12,779	Tangible non-current assets +9,103, Intangible non-current assets -249, Investment securities +3,494
Total assets	240,072	235,785	-4,286	
Current liabilities	65,325	55,940	-9,385	Notes and accounts payable-trade -4,514, Current portion of long-term borrowings -1,060, Income taxes payable -755, Provision for sales returns -1,454
Non-current liabilities	71,335	72,256	921	Deferred tax assets +986
Total liabilities	136,660	128,197	-8,463	
(Interest-bearing debt)	65,518	65,471	-47	
Net assets	103,411	107,588	4,176	Capital surplus -18,300, Retained earnings +23,208, Treasury shares -2,832, Other comprehensive income +2,016

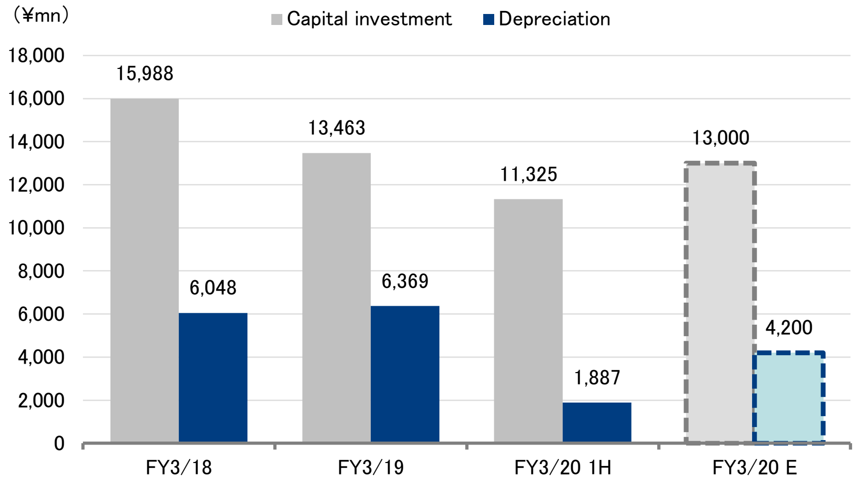
Source: Prepared by FISCO from the Company's financial results

Management indicators

	FY3/19	FY3/20 1H
<Financial Soundness>		
Current ratio	228.1%	235.8%
Equity ratio	42.2%	44.7%
D/E ratio	0.65	0.62

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

Trends in capital investment and depreciation expenses



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

Outlook

Raised FY3/20 profit guidance, expects all-time high operating income since the merger with DWANGO

1. FY3/20 outlook

The Company revised FY3/20 consolidated guidance with increases from period-start targets other than for revenue to ¥207,000mn in net sales (-0.8% YoY), ¥10,000mn in operating income (+269.3%), ¥10,800mn in ordinary income (+156.8%), and ¥9,500mn in net income attributable to parent shareholders (vs. a ¥4,085mn loss in the previous year) and expects to post all-time high for the first time in four years since FY3/15 when it merged with DWANGO in operating income and ordinary income. While the sale of MAGES. removes a few billion yen in revenue (split about evenly between the Video and Game business and Others), main source of profit improvement are income contributions from e-book, animation, and game businesses and cost savings on business restructuring reforms at DWANGO.

FY3/20 outlook

(¥mn)

	FY3/19		FY3/20				
	Results	% of revenue	Initial forecast	Revised forecasts (Nov. 2019)	% of revenue	YoY	Revised amount
Revenue	208,605	-	217,000	207,000	-	-0.8%	-10,000
Operating income	2,707	1.3%	5,400	10,000	4.8%	269.3%	4,600
Ordinary income	4,205	2.0%	6,200	10,800	5.2%	156.8%	4,600
Profit attributable to owners of parent	-4,085	-2.0%	3,800	9,500	4.6%	-	5,700
Earnings per share (¥)	-63.94		60.07	154.61			

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

Outlook by business segment for FY3/20

(¥mn)

	FY3/19 results		FY3/20				YoY		Revisions versus period-start guidance	
			Initial forecast		Revised forecast					
	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income
Consolidated total	208,605	2,707	217,000	5,400	207,000	10,000	-0.8%	269.3%	-10,000	4,600
Publication	115,958	7,253	118,300	6,100	118,000	6,500	1.8%	-10.4%	-300	400
Video and Game	48,295	3,919	54,400	5,300	50,300	5,100	4.2%	30.1%	-4,100	-200
Web Services	25,848	-2,576	23,600	300	24,000	1,900	-7.1%	-	400	1,600
Others	22,143	-2,613	28,100	-2,100	21,700	-2,000	-2.0%	-	-6,400	100
Eliminations/ Corporate	-3,640	-3,274	-7,400	-4,200	-7,000	-1,500	-	-	400	2,700

Note: The merger of holding company KADOKAWA DWANGO CORPORATION with the Company transferred about ¥1bn in costs to the business segments from the eliminations and corporate segment.
Source: Prepared by FISCO from the Company's results briefing materials

Viewed by business segment, improved income in Web Services Business provides the majority of anticipated profit gains. Other contributions are higher profits in Video and Game business, smaller losses in Others, and progress in lowering companywide costs. In profit upside versus period-start guidance too, recovery in Web Services business income delivers the largest boost. Upward revisions also come from cutbacks in companywide shared costs and increased profit in Publication business. Regarding companywide shared costs, the merger of holding-company KADOKAWA DWANGO CORPORATION with the Company distributed a total of roughly ¥1bn in costs to the business segments in accordance with sales levels (hence these costs mainly went to Publication business).

While the Company expects HoH decline in 2H operating income, following 1H's ¥6,389mn, this guidance primarily reflects planned measures that aim to expand sales in Web Services business, a conservative sales outlook for new titles in Video and Game business, and a rise of a few hundred million yen HoH in depreciation costs due to progress with the Tokorozawa project. Nevertheless, we think it might beat updated earnings guidance considering the 63.9% fulfillment rate for the full-year operating income target through 1H.

Healthy progress in media mix strategy with proprietary IP, moving into a phase of implementing sales expansion measures in Web Services business

2. Outlook by business segment

(1) Publication business

For Publication Business, the Company targets ¥118,000mn in revenue (+1.8% YoY) and ¥6,500mn in operating income (-10.4%), trimming ¥300mn from revenue and adding ¥400mn to operating income versus period-start guidance. It expects flat profit on a real basis because of increase in cost distribution to Publication business from revising companywide shared cost allocation as explained above. Despite larger investment burden accompanying progress in the Tokorozawa Project, the Company believes it is capable of offsetting this impact with expansion of e-book and e-magazine business and improved income in magazine business. It uses a conservative sales outlook for new titles.

(2) Video and Game business

For Video and Game business, the Company targets ¥50,300mn in revenue (+4.2% YoY) and ¥5,100mn in operating income (+30.1%), trimming ¥4,100mn from revenue and ¥200mn from operating income versus period-start guidance due to a large impact from the MAGES. sale and revision of companywide shared cost distribution respectively. The projected roughly ¥1.2bn YoY rise in operating income includes ¥1.1bn from non-recurrence of a loss of about ¥1.1bn in DWANGO's game business in the previous fiscal year.

The Company prepared a conservative sales plan for new videos, games, and other content. Key IP released in 2H includes the animated movie Seven Days War (theater release on December 13, 2019) and the movie Fukushima 50 (slated for theater release on March 6, 2020). Management's cautious stance in game business takes into account the absence of a global hit along the lines of SEKIRO that contributed to higher profits in 1H. Given this situation, the Company forecasts slightly weaker profit HoH in 2H at ¥1,452mn in operating income, versus 1H's ¥3,648mn.

(3) Web Services business

For Web Services business, the Company targets ¥24,000mn in revenue (-7.1% YoY) and ¥1,900mn in operating income (versus a ¥2,576mn loss in the previous year), adding ¥400mn to revenue and ¥1,600mn to operating income versus period-start guidance. It projects restoration of a profit for the first time in three years. While the outlook projects HoH decline in 2H operating income to ¥309mn, versus 1H's ¥1,591mn, this reflects a shift to implementation of measures aimed at increasing sales after restoration of profitability through restructuring reforms in the portal business.

In portal business, despite continued decline in the number of premium members for niconico Douga service, the Company is sustaining an upward trend in paid members for niconico Channel and plans to implement measures to revive the number of premium members.

In live business, the Company expects to improve profits through its efforts to revise the income structure for various events. In mobile business, while sales and profits continue to weaken, the Company wants to ensure a certain amount of profit with cost controls.

(4) Others

For Others, the Company targets ¥21,700mn in revenue (-2.0% YoY) and a ¥2,000mn operating loss (versus a ¥2,613mn loss in the previous year), trimming ¥6,400mn from revenue and adding ¥100mn to operating income versus period-start guidance. The sales reduction mainly reflects the MAGES. sale. In education business, the Company expects to sustain upbeat momentum with contributions from Vantan. In inbound business, it plans to continue moving forward with preparations for opening Tokorozawa Sakura Town in July 2020.

Medium-Term Management Strategy

Targets ¥240bn in revenue and ¥15bn in operating income in FY3/23 fueled by the growth engine of IP “creation x rollout x experiences”

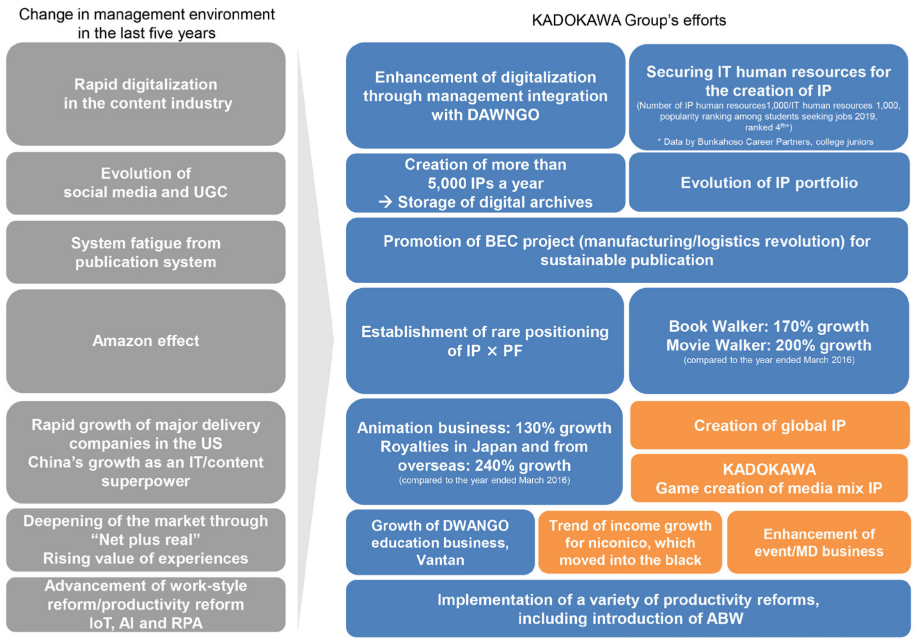
1. Initiatives addressing changes in the business environment

The market environment has changed significantly with rapid inroads by digital conversion of the contents industry and SNS services, the Amazon effect, growth in video distribution providers utilizing the Internet led by Netflix <NFLX>, expansion of the Chinese market, and system fatigue for the traditional publishing system. The Company’s group is promoting various initiatives to ensure sustainable growth and enhance enterprise value.

Specifically, the Company is striving to bolster its digital platform through integration with DWANGO, acquire IP creative and IT human resources, solidify a sales platform for e-books and e-magazines, and maximize IP income with a media-mix strategy. As DX initiatives, it is promoting productivity reforms in various areas, such as introduction of ABW* as a new work style and implementation of the BEC project in Publishing business (manufacturing and logistics reforms).

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

Group management issues and initiatives

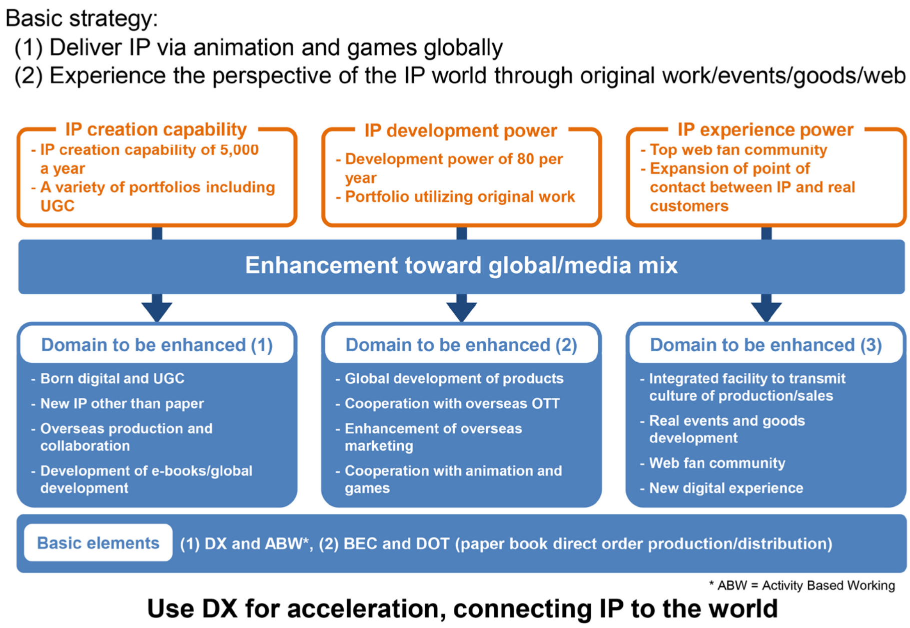


Source: The Company's results briefing materials

2. Fundamental strategy

The Company advocates global media mix that combines creation, rollout, and experiences capabilities for IP, an important strength, as its fundamental strategy. For example, it aims to offer attractive IP in animated video and game formats, deploy these contents globally, and strengthen collaboration with overseas platform operators (including co-creation of contents). It also wants to broaden contact points through provision of various experience opportunities for the IP worldview, including real events, merchandise, and Web-based fan communities. With promotion of DX initiatives, it hopes to accelerate rollout speed of these activities.

Fundamental strategy for the Company's group: Global media mix



Source: The Company's results briefing materials

Looking at the Company's growth cycle flow, it creates IP totaling 5,000 publications and 80 video works annually, retains IP contents in its archive (110,000 paper books, 60,000 e-books, and 2,000 video works), and sells contents over its own platform and other company platforms. It aims to expand the digital contents market by advancing these business models (subscription, dynamic pricing, etc.) and promoting global business (international collaborative creation, alliances, etc.). The Company wants to bolster the profitability of its archives and drive platform growth through advances in its platform along with pricing effect, contents exposure effect, and non-inventory sales expansion effect.

(1) DX reforms

The Company formed a DX strategy headquarters and is setting goals and promoting initiatives for specific fields to promote DX. Below we review detailed measures and goals.

a) ID and data utilization field

The Company aims to "strengthen customer experience" by promoting horizontal collaboration by the marketing division and utilize digital marketing to improve advertising and sales promotion cost efficiency by 10% compared to FY3/19 (related divisions: sales/marketing).

b) Manufacturing and logistics reform field

The Company hopes to lower the return rate to the 20% range in FY3/23 (vs. the 30% range in FY3/19) by ramping up a new plant that supports digital short-run and optimized production and shipment timing and volume in the book production and logistics process in July 2020 (warehouse operation scheduled to begin on December 29, 2020) (related divisions: book business/production management).

c) EC and Internet services field

The Company wants to maximize revenue, further expand EC members (from 3.5 million people), and bolster cross-border EC by sharing store operation knowhow and strengthening the fee model (related divisions: MD business, PF business, book business, Web media business, video and anime business).

d) Magazines and Web media field

The Company hopes to improve the magazine return rate and raise MAU by setting and analyzing KPIs and promoting business model reforms. For "The Television," it achieved an average return rate in the lower half of 20% range and successfully expanded PV volume eightfold for the Web version over two years. Management aims to apply this knowhow horizontally to other areas (related divisions: magazine business and Web media business).

f) ABW and office reform field

The Company wants to enhance labor productivity and increase work efficiency using AI, RPA, and other capabilities through deployment of a satellite office and remote work system and initiatives to assist ICT rule adoption and companywide DX implementation. In labor productivity, it plans to steadily return 5,000 tsubo of existing leased space in Iidabashi and Ginza areas following the launch of its Tokorozawa campus in July 2020 and thereby lower rent and other fixed costs by ¥1.2bn, versus FY3/19, in FY3/23. It also aims to improve system cost and outsourcing cost efficiency by 20%, compared to FY3/19, through application of AI, RPA, and other capabilities (related divisions: system/back office).

(2) Global initiatives

The Company hopes to boost the overseas revenue ratio from less than 10% currently to more than 10% in FY3/23 through rollout of books, animation, games, and other IP contents in North America, China, and other locations. Business strategies include creation of new IP, consolidation and global rollout of promising domestic and overseas IP contents, and promotion of industry-wide DX and global platform deployment. The Company's animation, games, and other contents are well received globally too, and management wants to conduct not only licensing sales, but also actively promote joint creation and other collaboration with major platform operators.

3. Medium-term management targets and individual strategies

(1) Management targets

Medium-term goals for FY3/23 are ¥240bn in revenue, ¥150bn in operating income, and 6.3% operating margin and work out to average annual growth rates versus the FY3/20 outlook of 5.1% in revenue and 14.5% in operating income. The Company intends to attain these goals by expanding scale in core businesses, managing business with sensitivity to ESG and SDGs, and boosting profitability.

Management targets

(¥bn)

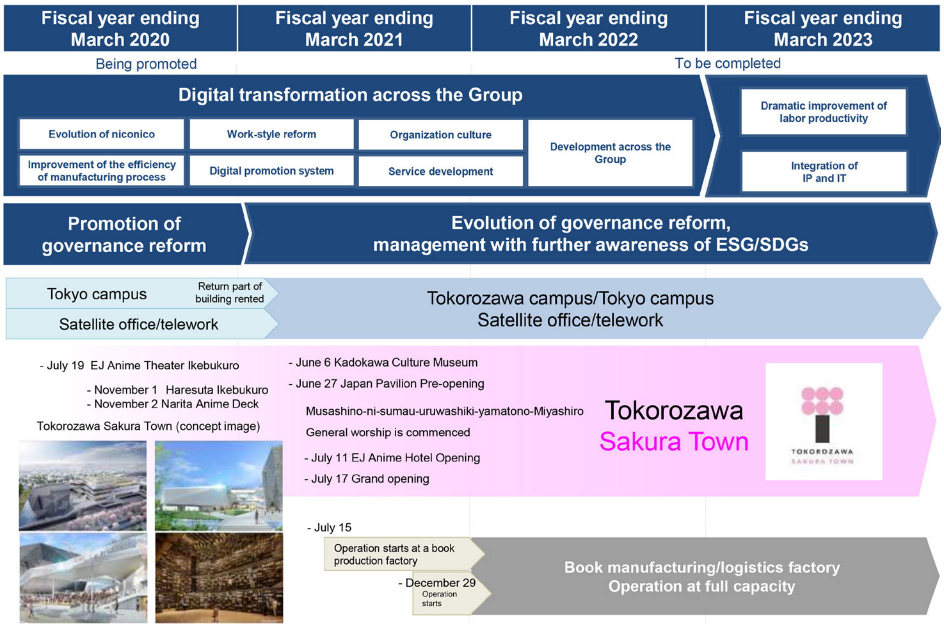
	FY3/20 forecast	FY3/23 target	Average annual growth rates
Revenue	207	240	5.1%
Operating income	10	15	14.5%
Operating margin	4.8%	6.3%	

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

In revenue, the Company expects the Publication business and Video & Game business to drive growth, but has a conservative view of the Web Services business. Additionally, it projects full-fledged ramp-up of inbound business (event income, hotel business, etc.) after the opening of Tokorozawa Sakura Town in July 2020 and a few billion yen in annual sales in FY3/23. In earnings, meanwhile, higher depreciation costs accompanying operation of a new plant and the Tokorozawa Sakura Town opening might temporarily weaken results in FY3/21.

For Publication business, the Company expects cost savings from reduction of the return rate to offset increase in depreciation expenses and factors in growth in e-book and e-magazine business and rights licensing income. It forecasts a rise in operating margin from FY3/20's anticipated 5.5% in FY3/23. For Video & Game business, it thinks operating margin should be stronger than FY3/20's anticipated 10.1% due to growth in global IP income, expansion of original games, and increase in animation rights licensing income. For Others, it projects a smaller loss thanks to top-line gains driven by expansion of educational business and pick-up in inbound business and monetization of e-sports business.

Roadmap



Source: The Company's results briefing materials

(2) Individual strategies

a) Publication business

Key strategies in Publication business are strengthening Born Digital and UGC (Kakuyomu Loyalty Program, etc.), creating new IP other paper-based contents (Vtuber and WEBTOON* development and original video and game development), promoting overseas local creation and joint creation with overseas companies, and ramping up e-book business and global business (simultaneous global comic launches and BOOK*WALKER global rollout).

* WEBTOON is a type of digital comic.

b) Video and Game business

Key strategies in Video & Game business are developing global works (invitations to global human resources and collaboration with global companies), collaborating with overseas OTT* (large-scale licensing and joint creation and establishment of and investment in an animation studio), strengthening overseas marketing (establishment of new overseas sites and reinforcement of marketing personnel), and promoting collaboration between animation and games (development of animation IP games, etc.).

* OTT (Over the Top) refers to a service provider that distributes videos, voice, and other contents over the Internet.

c) Web Services business, Others

For Others, the Company is launching Tokorozawa Sakura Town, an integrated facility to promote publishing culture, promoting real events & goods (planning and development that factors in global rollout and reinforcement of contact points with customers, including Anime Deck and Hareza Studio), strengthening the fan community for web services (expansion of the niconico Channel and promotion of the authors' salon), and offering new digital experiences (educational business growth, subscription service development, etc.).

ESG and SDGs initiatives

The Company also pursues management practices that factor in ESG concepts and SDGs. ESG is an acronym for Environment, Social, and Governance and refers to concepts that companies need to address in order to realize long-term growth. Even institutional investors recently have increasingly placed emphasis on ESG initiatives to a standard in assessing investments in companies. Main ESG topics are work style reforms, contributions to the environment and society, and the corporate governance framework. SDGs is the acronym for Sustainable Development Goals that consist of 17 development goals needed to realize a sustainable society adopted at the United Nations Summit in 2015. Themes cover a wide range of ranges that include poverty, health, education, energy, and the environment. A growing number of companies are clarifying ways in which they contribute to attainment of these development goals.

The Company aims to build a seamless work style as part of work style reforms. At the Tokorozawa campus slated to open in July 2020, it has arranged unique office space for Japan with 2,600 tsubo per floor that offers anticipated benefits of deepening creativity and contributing to sustainability and the BCP (business continuation plan). It hopes to deepen creativity through provision of a relaxed office and nearby environment and fostering interaction with visitors to Tokorozawa Sakura Town and promote development of contents for a global audience. It also wants to support diverse work styles and work-life balance by setting up collaboration with the Tokyo campus (Iidabashi, Ginza, and Ichigaya) and building a telework environment that deliver an environment for working from and holding meetings anywhere in the world.

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

The Company focuses on educational business as social contributions, including educational services that specialize in creative fields at Vantan, provision of the N High School system (correspondence course high school) and launch of N Middle School in April 2019, and start of discovery-oriented learning and programming education utilizing N High School's educational knowhow.

For its corporate governance initiatives, the Company has shifted to an operating holding company structure in July 2019 and enhanced internal controls. It has also appointed four independent outside directors (there are eight in-house directors) and newly established the Nomination and Evaluation Remuneration Committee.

Shareholder return policy

Intends to pay a ¥30.0 dividend (+¥10.0 YoY)

The Company sees returning profits to shareholders as an important management issue while also bolstering corporate capabilities and retaining profits to fund future business initiatives. It has continuously distributed profits in light of earnings in each period and implemented share buybacks too. It plans to pay a ¥30.0 dividend (+¥10.0 YoY) in FY3/20, putting the dividend payout ratio at 19.4%. Despite setting the dividend at ¥20.0 in period-start guidance, it now expects to raise the dividend following upward revision of the earnings outlook. This is the first dividend hike since the merger with DWANGO in FY3/15.

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

* Choices for shareholder gifts at end-FY3/19 were a book and other publication, a DVD, a movie advance ticket gift card, a BOOK*WALKER gift card, or a tote bag.

Information security measures

The Company is developing web services as one of its main services, and to ensure information security, it is implementing sufficient information security measures, including protecting personal information and conducting employee training. It implements various measures, both for software and hardware, to prevent unauthorized access of the in-Company network. In addition, it has established internal regulations for organizational, human, physical, and technical safety measures, and it is implementing and managing the necessary and appropriate measures. Also, to protect personal information, it has established a privacy policy and is working to ensure compliance with it. Moreover, when the handling of personal information is outsourced, the Company conducts the necessary and appropriate monitoring of the relevant outsourcer.

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