

# **KADOKAWA DWANGO CORPORATION**

**9468**

Tokyo Stock Exchange First Section

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<http://www.fisco.co.jp>

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## Summary

### The e-books and e-magazines business continues to perform well, while the aim is for a major increase in profits in FY3/19, including from the effects of the releases of original games in the 2H

KADOKAWA DWANGO CORPORATION <9468> (hereafter, also “the Company”) was formed in October 2014 from the merger of major publishing house KADOKAWA CORPORATION and DWANGO Co., Ltd., which manages one of Japan’s largest video community services, niconico. In addition to its Publication business, the Company is expanding its business through pursuing a media mix strategy that is centered on the Web Services business, which is focused on “niconico,” and on the Video and Game business.

#### 1. FY3/19 1H results

In the FY3/19 1H (Apr-Sept 2018) consolidated results, revenue increased 0.6% year on year (YoY) to ¥102,129mn and operating income increased 0.2% to ¥2,864mn.

Revenue and profits declined in the Web Services business, as the number of fee-paying members continues to trend downwards. But revenue and profits rose in the Publication business due to the strong performances of e-books and e-magazines, while revenue and profits also increased in the Video and Game business from the favorable overseas license sales for anime and overseas royalty revenue for games, which covered for the declines in the Web Services business. The Company worked to improve the niconico service, including by strengthening communication lines and improving image quality. It was also enhanced with new functions, including releasing nicocas (test broadcast) as a new broadcasting service in August 2018, and introducing Gift (a social tipping function), which allows viewers to support distributors by sending them gift items. At the end of September 2018, the number of premium members had continued to trend downward, to 1.94 million people, but the numbers of viewers and views of niconico have been increasing since the previous year due to these measures, and their effects are steadily starting to appear.

#### 2. FY3/19 outlook

The initial forecast for the FY3/19 consolidated results has been left unchanged, with revenue to increase 11.7% year-on-year (YoY) to ¥231,000mn and operating income to rise 154.4% to ¥8,000mn. The main change factors will be the increases in profits in the Web Services and Video and Game businesses, as the four original game titles, which are scheduled to be released from November 2018 onwards, are expected to contribute to earnings. Among them, the title in which expectation is the highest is “Teku Teku Teku Teku,” which is a location-information game using Augmented Reality (AR) technology released on November 29, 2018. From the initial release of the game, the Company entered into large-scale collaborations to raise the appeal of the game. Among the other game titles, there are games that are premised on the participation of the viewer in the broadcast, such as niconico Live and nicocas, which may lead to an increase in fee-paying members. Other than these, in the VR business, which provides users with a one-stop service for the elements necessary for a VTuber (Virtual YouTuber), revenues are expected to increase from the launch of a subscription model service, and in addition, from pay-as-you-go fees from parts sales for Gift and Custom Cast (VTuber creation + niconico Live broadcast app). The points for the FY3/19 results are whether and to what extent these measures will contribute to earnings.

## Summary

**3. The future growth strategy**

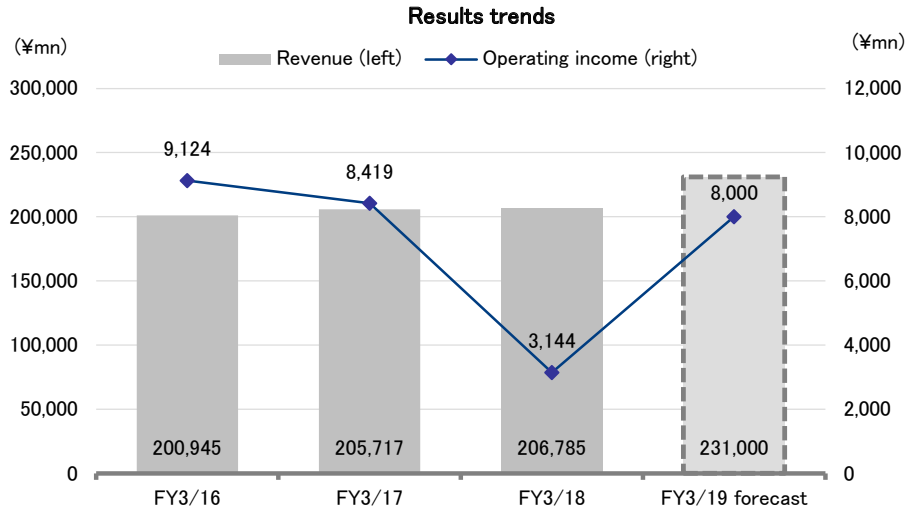
The Company's policy is to grow its businesses by developing domestically and overseas a media-mix strategy that fuses the Internet and the real world. The Group's IP strategy is to realize an integrated, synergy-type media mix that utilizes not only a conventional media mix whose starting point is publications, but also a starting point of original works created outside of publishing, such as on niconico. It is also strengthening its IP creation and training. The anime comprehensive information website N Anime,\* which started services from April 2018, has been increasing its monthly Unique User (UU) numbers in every fiscal quarter through a variety of measures, including free broadcasts and multiple-episode broadcasts of previously produced anime and holding campaigns collaborating with newly produced anime. In Q2 (July to September 2018), its monthly average UU increased to as high as 7 million, and made a fully-fledged start from October. In the Publication business, it has started test operations of a new book manufacturing and distribution system to enable responses to requests for small-lot production runs with short delivery times, which will be fully fledged operations at the Tokorozawa book manufacturing and distribution base to be completed in the spring of 2020. Through the introduction of this system, the Company will be able to realize small-lot production runs tailored to meet demand at low costs, and it expects to improve profitability by reducing the product return rate. In addition, sales in the e-books business are forecast to continue to increase at an annual rate of double digits. At FISCO, we think that as a result of the current stage of upfront investment, it will steadily achieve growth in the medium to long term from these measures the Company is progressing.

\* An anime portal site that brings together anime contents and information that are distributed across various pages in niconico, such as videos, manga, news, and illustrations. It enables anime fans to navigate the anime contents on niconico, and it is expected to lead to an increase in the site's user numbers. Since October 2018, the Company has made a fully-fledged start in providing the services. The services include introducing broadcast information on newly produced anime (paid-for and free), and information on works, such as the day on which they will be broadcast on TV, as well as collaboration projects to newly produce anime.

**Key Points**

- The outlook for FY3/19 is for profits to increase for the first time in three fiscal periods from the growth in earnings in the Web Services and Video and Game
- In addition to enhancing new services, the Company is aiming for the re-growth of niconico from the synergies with original games and measures to strengthen the VR business
- Aiming for a medium-term growth by creating and developing IP and strengthening the exit strategy

Summary



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

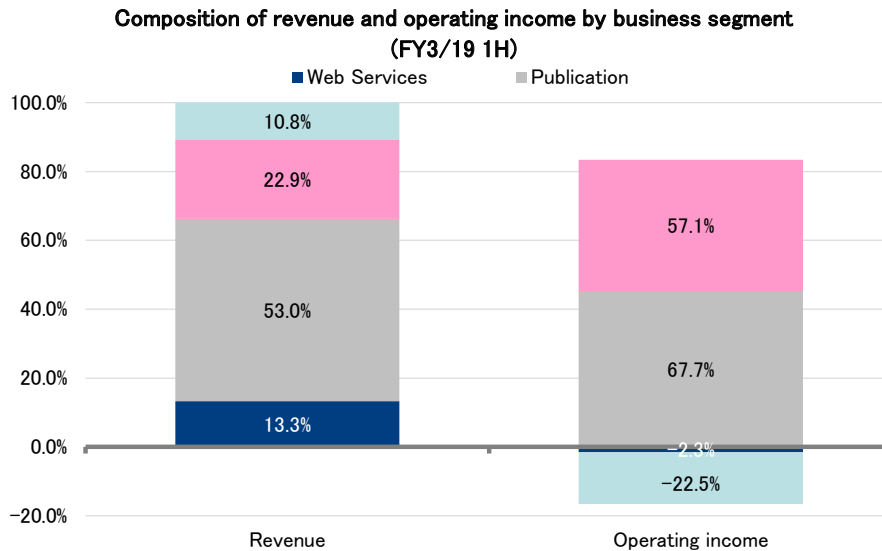
## Business overview

### A comprehensive media company that is deploying Publication, Web Services, and Video and Game businesses

The Company is a holding company that was established in October 2014 following the management integration of KADOKAWA, which operates the Publication business, and DWANGO, which operates niconico, one of Japan's largest video services. The business segments are divided into the Web Services business that is focused on niconico, the Publication business, the Video and Game business, and the Others business, which includes sales of goods and an education business.

Looking at the percentages of revenue by segment in FY3/19 1H, the Web Services business contributed 13.3%, the Publication business 53.0%, the Video and Game business 22.9%, and the Others business 10.8%. In terms of the percentages of operating income, the Web Services and Others businesses both recorded operating losses as the two businesses are at the upfront investment stage, which were covered by the profits of the Publication business and the Video and Game business. Currently, the Publication business contributes more than half of both sales and operating income. Going forward, the Company will aim to improve the profitability of the Video and Game business through the growth of its top line performance based on an IP strategy. In the Web Services business also, the Company is aiming to establish a profit structure that is not dependent on fixed-rate fee services through introducing original games and "gifts" to expand revenue from pay-as-you-go fees.

Business overview



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

**1. Web Services business**

Setting the portal business (DWANGO's video service niconico) as the core, this business is comprised of the live business, which plans and operates various kinds of events as a way to promote niconico and leases event venues, and the music distribution business for mobile devices.

The Company provides various services on its mainstay portal business, including the niconico Douga video community, niconico Live, and niconico Channel. Sales include revenues from the fees of niconico premium membership that enables members to watch videos and live broadcast comfortably, advertising revenues from website banners and so forth, and revenues from points used to watch pay-to-view videos. As of the end of September 2018, it had issued IDs to 74.53 million people (up 2.31 million people YoY), while premium members continued to decrease with 1.94 million people (down 130,000 people). The usage conditions from July to September 2018 were that the MAU (monthly active users) including non-log-in UU\* was 19.42 million people (up 1,180,000 people) and the log-in DAU (daily active users) was 3.19 million people (up 30,000 people). Incidentally, in the same period in the previous fiscal year, log-in MAU was 9.1 million people and DAU was 3.09 million people, so the number of viewers has become an increase if including non-log in UU.

\* From the end of February 2018, it became possible to view without logging-in.

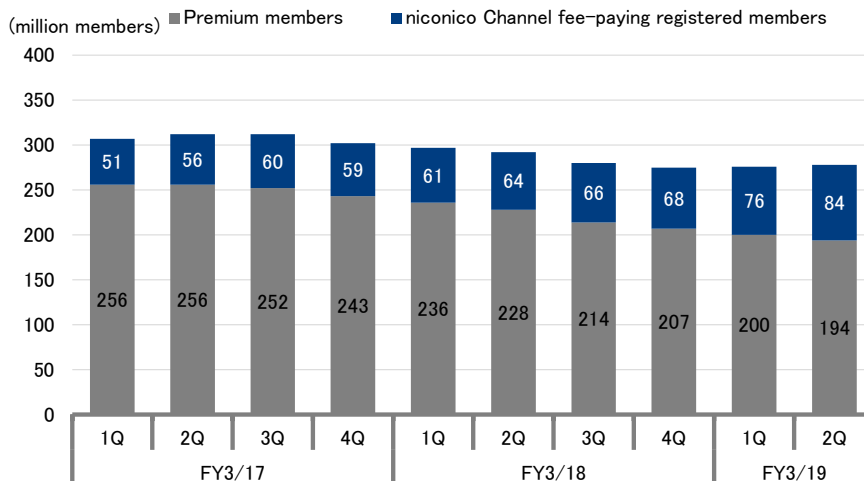
Also, the niconico Channel platform, on which companies, organizations, and users can deliver video and live broadcasts, at the end of September 2018 had in total 8,427 channels (up 245 channels on the end of the previous fiscal period), 1,361 monthly-fees channels (up 56 channels), and 840,000 monthly fee-paying registered members (up 160,000 people), so all of the indicators increased. The total number of niconico premium members and niconico Channel fee-paying members at the end of FY3/19 1H was 2.78 million people, which was a decrease of 140,000 people on the end of the previous fiscal year. But it is an increase of 20,000 people when compared to the previous fiscal quarter, which is the second consecutive quarter in which it has increased, so positive signs have started to appear for the future.

We encourage readers to review our complete legal statement on "Disclaimer" page.

Business overview

In August 2018, the Company released nicocas (test broadcast) as a new live broadcast service. It also newly launched the Gift (social tipping function) service, which supports broadcasters by enabling users to send them gift items during live broadcasts. Further, in the nicocas app (Android/iOS), even non-members can watch videos and live broadcasts, and broadcast themselves. The Company plans to integrate the interactive function in nicocas (test broadcast) into niconico Live by the end of March 2019, and it intends to further expand the Gift service and to enhance the service's interactive functionality. Its strategy is to increase the number of viewers through these measures, and thereby raise the number of fee-paying members and revenue from pay-as-you-go fees.

**Trends in the number of fee-paying members**



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

In the live business, the Company plans and manages live events, such as niconico Chokaigi\*1, Game Party\*2, Animelo Summer Live, and niconico Choparty\*3. It also operates the live music venue nicofarre, a new entertainment format that realizes a fusion of the Internet and the real world, and the niconico Honsha showroom\*4, which had its grand renewal opening in Ikebukuro, Tokyo, in October 2014, operating collaboration cafes for limited periods and live game 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 2018 was held on April 29-30, 2018, with 161,000 visitors to the venue and approximately 6.12 million online visitors.

\*2 Japan's largest "user participation" game event that features games from analogue to digital and old and new games from the East and West. Game Party 2018 was held on February 10-11, 2018, at Makuhari Messe, had 72,000 site visitors and 5,130,000 online visitors, and contributed to the expansion of the Japanese game market. Also, as a result of holding the recent e-sports event, the Company is advancing measures toward developing the e-sports market, such as newly issuing the Japan e-sports Pro License to 15 people.

\*3 A large-scale stage event for niconico, which is one of the Japanese largest video service. 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. It was held for the seventh time on November 3, 2018, at the Saitama Super Arena, and was attended by approximately 15,000 people.

\*4 A complex facility comprising nicocafe, an event space, the nicobukuro studio, and the niconico shop. The grand opening was in Harajuku in April 2011, then the facility was relocated and reopened in Ikebukuro.

The music distribution business remains a highly profitable business for the Company, despite member numbers trending downward 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.

## Business overview

## 2. Publication business

In this business, which is KADOKAWA's main business, the Company publishes and sells paper-based books, separate volumes, pocket editions including graphic novels, and comics, as well as e-books. 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 in magazines and on the Internet.

The paper-based book business provides a strong foundation for developing related products through its media-mix strategy, and the Company is an industry leader in graphic novels. It has considerable experience in working to achieve appropriate production and shipping based on marketing, and the product return rate in FY3/18 was under 35%, which was lower than the industry average of under 40%.

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, with the aim of strengthening the e-books and e-magazines business Groupwide.

For magazines and mooks, advertising revenue from paper media, which is the source of earnings, continues to decrease alongside the advance of digitization, and currently the profit conditions are tough. Therefore, to deal with this environment, the Company is currently streamlining its operations while actively pursuing digitization.

## 3. 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, DWANGO Co., Ltd., FromSoftware, Inc., Spike Chunsoft Co., Ltd., KADOKAWA GAMES, LTD., and MAGES. Inc. carry out the planning, development, and sales of packaged game software, network games, and app games. Previous hit titles include "Dark Souls," "Bloodborne" (FromSoftware), "GOD WARS" (KADOKAWA GAMES), "Kenka Bancho," "Danganronpa," "ARK:Survival Evolved" (Spike Chunsoft), and "STEINS;GATE" (MAGES.).



## Business overview

#### 4. Others

This business is comprised of businesses such as the e-commerce of character merchandise and pop idol CDs, copyright revenues, and sales of CDs featuring content created from anime or niconico. It also includes an education business, which involves the operation of the Vantan Game Academy and KADOKAWA Contents Academy schools that provide training to work in creative fields inside and outside of Japan; the online learning services of N High School, through which students can obtain a qualification equivalent to a high school diploma online and other educational facilities; and the planning and management of the inbound business. In June 2018 as part of its measures to promote the inbound business, KADOKAWA opened its first restaurant, INUA\*, at Iidabashi in Tokyo.

\* KADOKAWA Corporation, formed a partnership with Mr. Rene Redzepi, who is the head chef at the famous restaurant noma in Copenhagen, Denmark. INUA opened on June 29, 2018, welcoming Mr. Thomas Frebel, who formerly worked at noma, as its head chef.

## Results trends

### Revenue and profits increased in FY3/19 1H from the growth of the Publication and Video and Game businesses

#### 1. Overview of the FY3/19 1H results

In the FY3/19 1H consolidated results, the Company recorded increases in revenue and profits. Revenue increased 0.6% YoY to ¥102,129mn, operating income increased 0.2% to ¥2,864mn, ordinary income increased 29.4% to ¥3,934mn, and profit attributable to owners of parent increased 21.1% to ¥2,119mn.

#### Overview of the FY3/19 1H results

	FY3/18 1H		FY3/19 1H				(¥mn)
	Results	% of revenue	Results	% of revenue	YoY	Full-year forecast	Progress rate
Revenue	101,473	-	102,129	-	0.6%	231,000	44.2%
Cost of sales	73,480	72.4%	73,765	72.2%	0.4%	-	-
Gross profit	27,992	27.6%	28,364	27.8%	1.3%	-	-
SG&A expenses	25,133	24.8%	25,500	25.0%	1.5%	-	-
Operating income	2,858	2.8%	2,864	2.8%	0.2%	8,000	35.8%
Ordinary income	3,039	3.0%	3,934	3.9%	29.4%	9,100	43.2%
Profit attributable to owners of parent	1,749	1.7%	2,119	2.1%	21.1%	5,400	39.2%

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

## Results trends

Revenue decreased 10.2% YoY in the Web Services business, increased 1.2% in the Publication business, increased 3.2% in the Video and Game business, and increased 11.2% in the Others business. Therefore, overall, the Company maintained a trend for increased revenue. For operating income, the Web Services and Others businesses recorded losses, but these were covered by the increases in operating income in the Publication business and the Video and Game business, which meant that profits increased for a 1H for the first time in two fiscal years. Ordinary income increased by double-digits, as non-operating income improved by ¥890mn YoY. The main factors were the absence of ¥610mn in donations recorded in the same period in the previous fiscal year and a ¥288mn increase in foreign-exchange gain. The Company does not disclose their original forecasts for the 1H, but it seems progress was made basically as planned for revenue and operating income.

## The e-books business and the overseas license revenue performed well

### 2. Trends by business segment

#### (1) Web Services business

In this business, revenue decreased 10.2% YoY to ¥13,828mn and the operating loss was ¥100mn (compared to operating income of ¥393mn in the same period of the previous fiscal year).

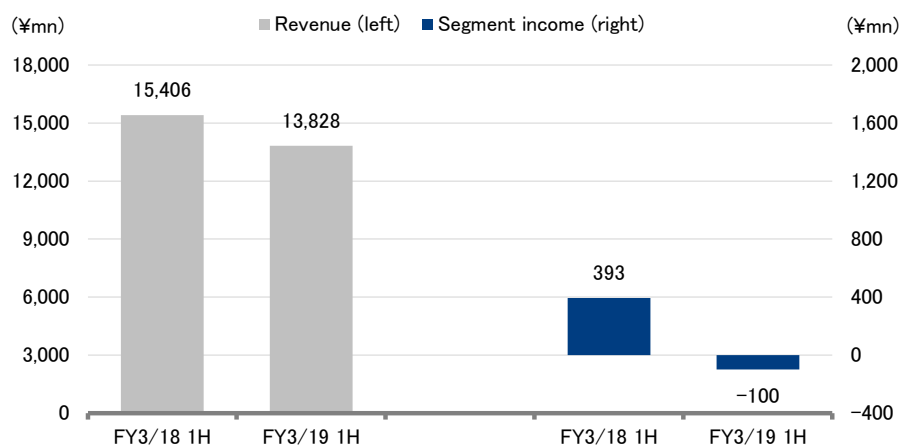
In the mainstay portal business, the number of niconico fee-paying members, which is the main source of earnings, was 1.94 million people at the end of FY3/19 1H. This is a decline of 340,000 people on the end of the previous fiscal year and the main reason for the lower revenue. The extent of the operating loss grew alongside the decline in revenue. But due to the effects of the infrastructure-improvement measures that the Company has been working on since the previous fiscal period, cost-improvements effects, including a reduction in communication costs, have started to appear, and the operating loss amount in Q2 (July to September) was reduced compared to in the previous fiscal period, so profitability is improving. As the re-growth strategy for niconico, the Company worked to improve the viewing environment for video and live broadcasts by improving service quality (enhancing communication lines, and compliance with the shift to high image quality). In addition, in June 2018, it started providing niconico (crescendo) as the new version. Also, in August 2018 it released nicocas (test broadcast), a new live broadcasts service, and it worked to enhance service functions, including introducing Gift (a social tipping function), in which users can support broadcasters by giving them gift items during live broadcast programs. Further, with the aim of cultivating and developing the VR market, in April 2018 it released Virtual Cast\*, which is a VR communications service.

\* A service in which anyone can broadcast as a VTuber via a broadcast service, such as niconico Live.

In the live business, the Company is continuing to hold various types of events that fuse the Internet and the real world in order to differentiate its services from the other video services of its competitors. Niconico Chokaigi 2018 held in April 2018 had 161,000 visitors to the venue (154,000 in the previous year), which was a new record high. Moreover, in August 2018, 81,000 people attended Animelo Summer Live 2018 "OK!", which is the world's largest live anime song event, and it contributed to earnings.

In the mobile business, the number of members of the dwango.jp music distribution service continued to decrease, and once again revenue and profits declined by double digits YoY. However, the Company also made similar progress in reducing costs and profitability was maintained.

## Results trends

**Web Services business revenue and segment income**


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

**(2) Publication business**

In the Publication business, revenue increased 1.2% YoY to ¥55,079mn and operating income rose 25.1% to ¥3,003mn. The number of new publications of books and magazines trended downward compared to in the same period in the previous fiscal year. But revenue and profits still increased, with the main factors being growth in sales of e-books and e-magazines at a double-digit pace, and copyright revenue with the recording of license revenue for game machines and for overseas.

In the e-books and e-magazines business, sales were strong on BOOK☆WALKER, which is the comprehensive e-book store operated by the Company's Group. In the external sales business, the start of new sales licenses on external e-book stores also contributed. In particular, for BOOK☆WALKER, the Company implemented effective sales promotion measures, completed the integration with the niconico Book app in September, and expanded the lineup of works. As a result, in the 1H revenue increased 32% YoY (up 39% in September after the completion of the app integration), and it recorded operating income compared to the previous operating loss. As a new measure for BOOK☆WALKER, it started the Bookmeter\*1 and the API review collaboration, and since June 2018, it has become possible to trial read and trial review works before purchasing them. In addition, the collaboration with Kakuyomu\*2 started in May of this year, enabling authors to sell on BOOK☆WALKER the works that they wrote on Kakuyomu. BOOK☆WALKER handles the books and magazines of more than 1,000 publishing companies, and it is expected to grow in the future from the expansion of the product lineup and the enhancement of the various support and service functions. On the other hand, in the external sales business, revenue increased 39% YoY from the expansion of the sales channels and also that some Isekai (fantasy world) genre works become hits. The percentage of revenue provided by the e-books and e-magazines in the Publication business segment is growing, rising to more than 20%.

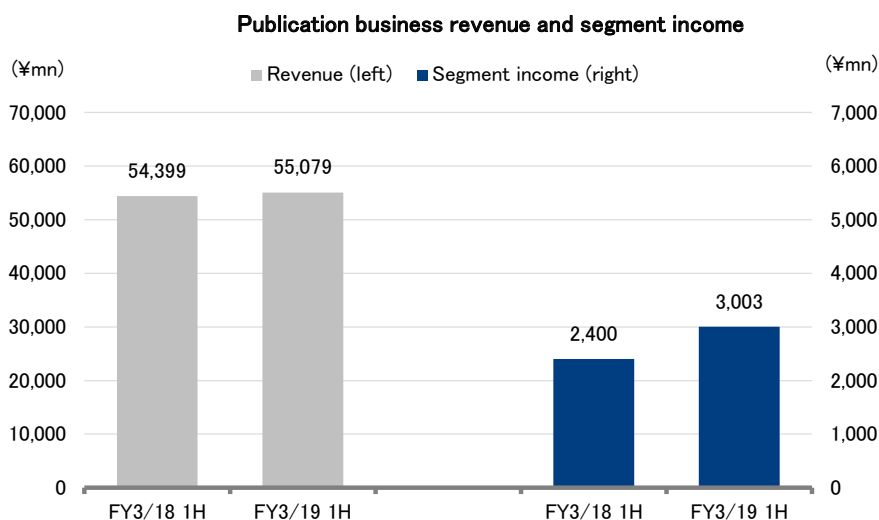
\*1 One of Japan's largest reading community website managed by TRISTA Co., Ltd. It started services in 2008, was made a subsidiary of DWANGO in 2014, and all its shares were transferred to BOOK WALKER\_CO.,LTD. in April 2018 and was made its subsidiary.

\*2 A novel posting website provided by KADOKAWA. Following author registration, anyone can publish a novel on the Internet for free.

Results trends

On the other hand, in the books business, in comics, sales were strong of the major works of “Yotsubato!” and “Delicious in Dungeon” and also of the “Overlord” and “Angels of Death” series. In general books, educational manga for elementary school students performed well and contributed to earnings. In media mix-related, sales were strong of the original books of “Laplace’s Witch” and “Biblia Koshodo no Jiken Techo”, and also books related to the movie “Mirai”. Therefore, revenue increased, but profits declined. The main reason for this is the fact that the establishment of manufacturing and production bases for the Tokorozawa Project, which has started test production toward full-scale operations from April 2020, is progressing according to schedule, so expenses related to this are increasing.

In the magazine business, the decline in revenue and the operating loss are continuing under the context of the contracting market. The Company is currently at the stage of converting the business model, such as transferring to Web media, and website’s page views and advertising revenue are increasing.



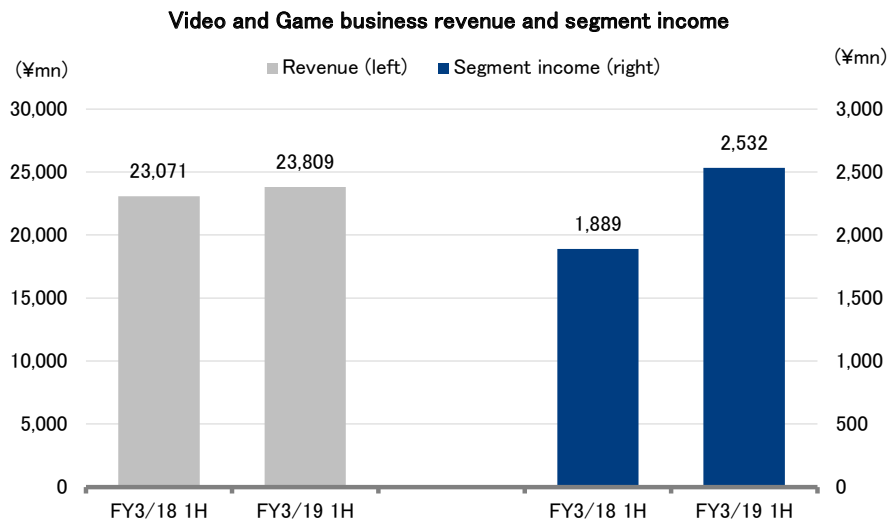
Source: Prepared by FISCO from the Company's results briefing materials

**(3) Video and Game business**

In the Video and Game business, revenue increased 3.2% YoY to ¥23,809mn and operating income rose 34.0% to ¥2,532mn. Within these amounts, in the video business, revenue was basically unchanged YoY and operating income increased. Overseas license sales were strong, including for “STEINS; GATE ZERO”, “Angels of Death”, and “Overlord”, while Movie Ticket, which is a service to pre-purchase reserved-seat movie tickets operated by Movie Walker Co., Ltd., also grew steadily and contributed to earnings. The main factor behind the higher profits was the increase in overseas license sales, which are highly profitable.

On the other hand, revenue and profits increased in the game business. Sales of “DARK SOULS REMASTERED” were strong in Japan and overseas, and overseas royalty revenue continued to increase. Also, packaged games, such as “METAL MAX Xeno” and “Conan Outcasts”, performed well overall and contributed to the higher profits.

## Results trends



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

#### (4) Others

In the Others business, revenue increased 11.2% YoY to ¥11,276mn and the operating loss was ¥999mn (compared to a loss of ¥212mn in the same period in the previous fiscal year). Revenue rose because of the steady increase in student numbers at the N High School, which is a correspondence high school that utilizes the Internet, and at the vocational schools specializing in the creative field, and in addition because the product-sales business, which includes e-commerce for character goods and pop idol CDs, performed well. But in profits, the main factor behind the higher loss was the increase in preparation expenses for the inbound business toward the goal of becoming profitable by 2020. The N High School opened six campuses in April 2018, at Tokyo (Ochanomizu), Omiya, Yokohama, Chiba, Nagoya, and Fukuoka, to give it a total of eight campuses. Also, the figure skater Rika Kihira, who won the NHK Trophy, an international figure skating competition, in November 2018, is a first year student of N High School, and she is enjoying success while utilizing the merits of a correspondence-system school without time constraints.

## The Tokorozawa Project, which has total construction costs of ¥39.9bn, is progressing as planned, and financial soundness is being maintained

### 3. Financial condition and management indicators

For the financial condition at the end of FY3/19 1H, total assets were down ¥1,808mn on the end of the previous fiscal year to ¥238,073mn. Looking at the breakdown, current assets decreased ¥3,680mn, while non-current assets increased ¥1,871mn. In current assets, inventory assets rose ¥965mn, but cash and deposits decreased ¥1,364mn and notes and accounts receivable declined ¥2,556mn. The notes and accounts receivable amount was a reaction, as an increase from the effects of March 31, 2018, being a bank holiday. In non-current assets, the main factor was the rise in the market values of shares held, with investment securities increasing ¥2,687mn.

## Results trends

Total liabilities were down ¥1,138mn on the end of the previous fiscal year to ¥129,614mn. Within this amount, interest-bearing debt increased ¥3,974mn on the end of the previous fiscal year, including due to refinancing by banks. However, there were declines in notes and accounts payable-trade of ¥1,675mn, outstanding payments of ¥2,042mn, and advances received of ¥1,207mn.

Total net assets were down ¥669mn on the end of the previous fiscal year to ¥108,458mn. Retained earnings increased ¥771mn from the recording of profit attributable to the owners of parent of ¥2,119mn and dividend payments of ¥1,348mn, while accumulated other comprehensive income rose ¥1,453mn, including due to the increase in the aggregate market value of shares held. Conversely, the main decrease factor was the acquisition of treasury shares of ¥3,000mn.

Looking at the cash flow conditions, at the end of FY3/19 1H, cash and cash equivalents were up ¥6,513mn compared to the end of the previous fiscal year to ¥73,921mn. Cash flow from operating activities was ¥3,189mn, due to recording net income before income taxes and depreciation expenses. Cash flow from investing activities was ¥3,521mn due to the recording of net decrease in time deposits (¥7,792mn), despite the expenditure to acquire tangible non-current assets (¥2,202mn) and intangible non-current assets (¥1,600mn). Cash flow used in financial activities was ¥349mn due to expenditure to acquire treasury shares (¥3,000mn) and dividend payments (¥1,348mn), that offset proceeds from refinancing long-term loans payable (¥3,962mn).

Looking at the management indicators, the equity ratio, which indicates financial soundness, was unchanged on the end of the previous fiscal year at 44.7%. The D/E ratio (interest-bearing debt / shareholders equity) rose 0.04 on the end of the previous fiscal year to 0.65 due to the increase in interest-bearing debt. However, the Company holds an abundance of cash and deposits, of more than ¥80bn, so it can be judged to be securing its financial soundness.

The FY3/19 capital investment plan on a cash basis increased ¥3,112mn YoY to ¥19,100mn, which was in accordance with the initial forecast. The spending up to 1H was ¥3,803mn, while in the 2H, spending is scheduled on construction costs and other costs for the Tokorozawa Project. Spending relating to the Tokorozawa Project is scheduled in the future also and the investment phase will continue, with cash-out expected to peak in FY3/21. However, free cash flow is forecast to be in surplus from FY3/22 onwards.

## Consolidated balance sheet

	FY3/18	FY3/19 1H	Change	Main factor
				(¥mn)
<b>Current assets</b>	155,312	151,632	-3,680	Cash and deposits -1,364, notes and accounts receivable -2,556, inventory assets +965
<b>(Cash and deposits)</b>	85,962	84,598	-1,364	
<b>Non-current assets</b>	84,569	86,440	1,871	Tangible non-current assets +78, intangible non-current assets -156, investments and other assets +1,949
<b>Total assets</b>	239,881	238,073	-1,808	
<b>Current liabilities</b>	74,266	58,147	-16,119	Notes and accounts payable-trade -1,675, short-term loans payable and current portion of long-term loans payable -11,029
<b>Non-current liabilities</b>	56,487	71,466	14,979	Long-term loans payable +15,003
<b>Total liabilities</b>	130,753	129,614	-1,138	
<b>(Interest-bearing debt)</b>	65,399	69,373	3,974	
<b>Net assets</b>	109,128	108,458	-669	Retained earnings +771, treasury shares -2,978, accumulated other comprehensive income +1,453

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

## Results trends

**Cash flow statement**

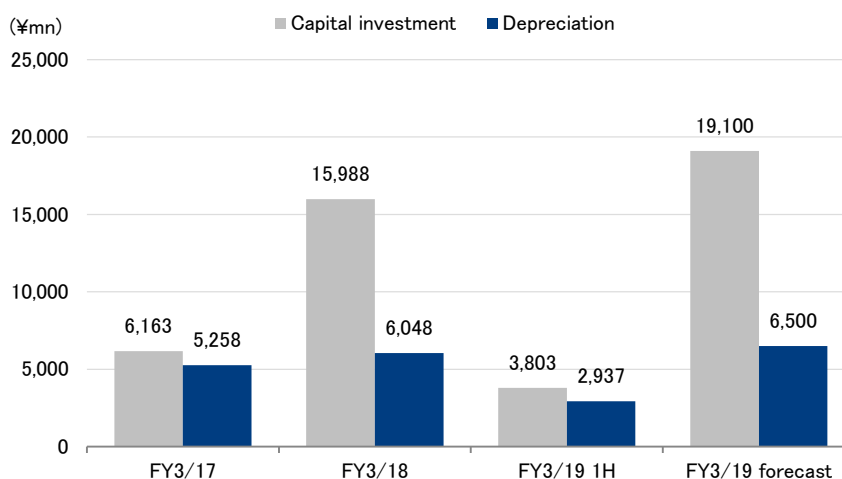
	(¥mn)	
	FY3/18 1H	FY3/19 1H
Cash flow from operating activities	-5,119	3,189
Cash flow from investing activities	-6,074	3,521
Cash flow from financing activities	-4,003	-349
Cash and cash equivalents at end of period	75,903	73,921

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

**Management indicators**

	FY3/16	FY3/17	FY3/18	FY3/19 1H
<b>&lt;Financial Soundness&gt;</b>				
Current ratio	214.5%	285.9%	209.1%	260.8%
Equity ratio	51.4%	44.5%	44.7%	44.7%
D/E ratio	0.28%	0.61%	0.61%	0.65%

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

### The outlook for FY3/19 is for profits to increase for the first time in three fiscal periods from the growth in earnings in the Web Services and Video and Game businesses

#### 1. FY3/19 outlook

The initial forecast for the FY3/19 consolidated results have been left unchanged, with revenue to increase 11.7% YoY to ¥231,000mn, operating income to rise 154.4% to ¥8,000mn, ordinary income to grow 144.8% to ¥9,100mn, and profit attributable to the owners of the parent to climb 420.1% to ¥5,400mn and it expects to record higher profits for the first time in three fiscal years. The key point toward achieving the forecasts is what the responses will be to the four original games scheduled to be released from November 2018 onwards. Within them, expectations are particularly high for “Teku Teku Teku Teku”, which is a location-information game utilizing AR technology released at the end of November 2018.

If these games are hits, not only will this lead to an increase in earnings in the portal business from pay-as-you-go fees, they will also contribute to earnings growth in the game business. The number of niconico viewers has already changed direction and is increasing following the release of niconico (crescendo) and the improvements to the service quality. So if these original games play a hook role for viewers to shift to fee-paying members, it would seem that a scenario in which the portal business becomes profitable and achieving re-growth will become a more realistic one. Conversely, if these original games fail to catch on or cannot stop the decline in fee-paying members, a downside risk would increase.

#### FY3/19 consolidated outlook

	FY3/18			FY3/19		
	Results	% of revenue	YoY	Forecast	% of revenue	YoY
Revenue	206,785	-	0.5%	231,000	-	11.7%
Operating income	3,144	1.5%	-62.6%	8,000	3.5%	154.4%
Ordinary income	3,716	1.8%	-49.8%	9,100	3.9%	144.8%
Profit attributable to owners of parent	1,038	0.5%	-82.0%	5,400	2.3%	420.1%
Earnings per share (¥)	15.53			82.13		

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



## Outlook

## In addition to enhancing new services, the Company is aiming for the re-growth of niconico from the synergies with original games and measures to strengthen the VR business

### 2. Outlook by business segment

#### Outlook by business segment for FY3/19

	FY3/18 results		FY3/19 forecast		YoY	
	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income
<b>Consolidated total</b>	206,785	3,144	231,000	8,000	11.7%	154.5%
<b>Web Services</b>	29,023	-1,067	34,800	1,000	19.9%	-
<b>Publication</b>	112,691	6,000	119,400	6,400	6.0%	6.7%
<b>Video and Game</b>	47,440	2,874	56,300	7,000	18.7%	143.6%
<b>Others</b>	20,821	-1,356	24,200	-2,200	16.2%	-
<b>Eliminations/Corporate</b>	-3,191	-3,306	-3,700	-4,200	-	-

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

#### (1) Web Services business

In this business, the forecasts are for revenue to increase 19.9% YoY to ¥34,800mn and for operating income of ¥1,000mn (compared to a loss of ¥1,067mn in the previous fiscal year). As 1H revenue was ¥13,828mn, revenue and profits are expected to increase significantly in the portal business in the 2H.

For niconico, the Company has released nicocas (test broadcast) as a new live broadcast service, and it has developed in-house an interface that uses the world's most advanced streaming technologies to integrate video, live broadcasts, interactive communication, and video synthesis. In addition, the number of viewers has changed direction to a recovery trend, as the Company has responded to the shift to high image quality through establishing a wide-area communications infrastructure. The number of premium members is also expected to change direction and increase, if moderately, in the future, and to recover to 2.01 million people by the end of FY3/19 (down 60,000 people on the end of the previous fiscal year, but up 70,000 on the end of the 1H). Also, in the 2H, we will see an expansion in earnings from pay-as-you-go fees, including due to the launches of original games, Gift in nicocas, and parts sales from Custom Cast.

Within the original games currently being launched, the title for which expectations are particularly high is "Teku Teku Teku", which was launched on November 29, 2018. This game uses location information, and when the player 'paints' a district (an area surrounded by roads) while walking, that district is transformed into a fantasy world in which treasure chests, gold, and monsters appear. In this game, by defeating these monsters, players gain experiences points and items and while growing their character as the hero of the story, they can kill "rank bosses" that will appear in famous places throughout the country. Also, the Depth AR function, which is an AI technology, is used as the camera mode, making it possible to take photos of the monsters that appear while feeling a real sense of the monsters' sizes against the actual background from the AI determining the size and proximity of the monster. In terms of the characters, collaboration characters from movies, including "Godzilla" "Resurgence", "Pop Team Epic", "Neon Genesis Evangelion", and "Sachiko Kobayashi", make appearances. In future updates, the plan is to add a "ranch," where players can nurture monsters that had become their friend, and also "raid battles" in which everyone will fight the deca-boss. The business model is that it is free to download and the Company will acquire earnings from pay-as-you-go fees from in-game purchases of important items.

Outlook

“ARTILIFE”\*, which is scheduled to be released in December, is a game to observe and develop “artificial life” that act autonomously in a virtual space. Through self-learning using AI technology, the artificial life grows and evolves while adapting to its environment, and it is also possible for users to exchange artificial lives or to create a family tree through combining their artificial lives. Live broadcasts will also be possible in the Web browser version, which can be viewed on the nicocas app, and as a game assuming the participation of viewers in the live broadcasts, it may lead to an increase in fee-paying members. It was developed at Dwango Media Village, which is the DWANGO’s machine-learning technologies R&D department.

\* The plan is to release the Web browser version and the iOS version for smartphones in December 2018, and then the Android version for smartphones at the start of 2019.

In addition, “PicoPico”, which enables retro games to be played on a smartphone, is scheduled to be released in early 2019. The prices are scheduled to be ¥550 a month (tax included) for the iOS version and ¥540 a month (tax included) for the Android version. Its features include that players can freely save and download games that have no save or password functions, and also that by posting saved data, other users can continue to play their game. Other than these, the PC browser game “Engage Princess” is scheduled to be released in April 2019. Within the media mix strategy of the KADOKAWA Group, this is a work planned to commemorate the 25th anniversary of the “Dengeki Bunko” entertainment novel label, and its genre will be a love comedy RPG.

Original Games

<p><b>RPG for walking through life “Teku Teku Teku Teku”</b></p>  <p>[Service start date] November 29, 2018 [Price] Free (except charging in app) [Platform] iPhone/Android [Official website] <a href="https://www.teku4.jp/">https://www.teku4.jp/</a> ©DWANGO Co., Ltd.</p>	<p><b>Observation/development project of artificial life equipped with artificial intelligence “ARTILIFE”</b></p>  <p>[Service start date] December 2018 **“ARTILIFE” for Android smartphone is to be released at the beginning of 2019 [Price] Free (except charging in app) [Platform] * “ARTILIFE” for smartphone (observation and development of life) &gt; iOS/Android (Android ver. is to be released at the beginning of 2019) * “ARTILIFE” for Web browser and livestreaming (observation and development of life; Customization for livestreaming is available) &gt; Windows - nicocas (able to view/involve in livestreaming of ARTILIFE) &gt; iOS/Android/Web browser [Official website] <a href="https://artilife.net">https://artilife.net</a></p>
<p><b>“PicoPico” makes it possible to play retro games paid members can play retro games as much as they like</b></p>  <p>[Service start date] Beginning of 2019 [Price] iOS: 550 yen/month (including tax) planned Android: 540 yen/month (including tax) planned [Official website] <a href="https://site.nicovideo.jp/picopico/">https://site.nicovideo.jp/picopico/</a></p> <p><small>*Copyright © 1985-2018 Terepita, © 2018-2018 Terepita, Inc. All rights reserved. Terepita and Terepita Game is a trademark of Terepita, Inc. registered or protected in the US and other countries. ©2018 Interscope Co., Ltd. ©2018 ProjectGG</small></p>	<p><b>Presented by Dengeki Bunko x niconico PC browser game “Engage Princess”</b></p>  <p>[Service start date] End of 2018 [Official website] <a href="http://engageprincess.nicovideo.jp">http://engageprincess.nicovideo.jp</a> [Original/Main story] Tsukasa Fushimi [Main character design/illustration] Hiro Kanzaki</p> <p><small>© 2018 Studio Fushimi / Dengeki Bunko © 2018 DWANGO CORPORATION/2018 © 2018 INTERSCOPE CO., LTD. All rights reserved. * The screens shown are their own under development.</small></p>

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

## Outlook

The Company's policy is to focus on measures to cultivate and develop the VR market, and it plans to use a subscription model to provide users with a one-stop service for the elements necessary for a VTuber. It currently provides several individual services. For example, Custom Cast, which it started providing in October 2018 as an app for the creation of VTuber 3D avatars and broadcasting, has been attracting an unprecedented amount of attention, including that it achieved 1 million downloads in just 11 days after its release, even without any promotional measures being conducted. Currently, many people are using it to create a 3D avatar and to post that image on Twitter and other SNS, and the plan going forward is to obtain earnings from pay-as-you-go fees through parts sales. Also, niconicosolid, which was officially opened in 2014, has acquired the No.1 position for the number of postings as a 3D model posting UGC platform. In addition, in April 2018, the Company started providing the Virtual Cast service, in which anyone can become the virtual character of their choice and communicate in a VR space via its broadcasting service, including for live broadcasts. It expects to provide these services through a subscription model as tools for VTubers. VTubers can also broadcast live on niconico and nicocas, and they can obtain revenue from viewers from the Gift (social tipping) function.

Through these measures, it is expected that in the future, the revenue model in the portal business will shift from the conventional model of fixed-rate-fees services based on monthly revenue from paying members (which provided 78% of total revenue in FY3/18) to a hybrid-type model in which revenue is divided into from pay-as-you-go fees, such as from games and Gift (social tipping), and from monthly fees.

As the measures toward improving service quality, since the start of the new version niconico (crescendo), it has become possible to broadcast live programs in HD image quality (720p). Also, in order to respond to the increase in the volume of communication traffic in the future, the Company has nearly doubled the network bandwidth, from the previous 730Gbps to 1,400Gbps. These measures enable videos to be viewed comfortably. Going forward, the Company will continue to work to improve service quality at the same time as reducing infrastructure costs. Progressing the virtualization of the information system is expected to lead to reductions in the failure-occurrence rate and total costs. Specifically, through the reduction in communication costs and other costs, infrastructure costs are forecast to decline from ¥5bn in FY3/18, to ¥4.2bn in FY3/19, and to ¥3.3bn in FY3/20, which is expected to contribute to the profitability of the portal business in the future.

The Company plans to actively hold events in the live business, so it is possible that the extent of the loss in this business will increase slightly YoY. Also, in the mobile business, the decline in sales and profits will continue alongside the fall in member numbers for the music distribution service, although a high level of profitability is expected to be maintained through cost controls.

**(2) Publication business**

In this business, revenue is forecast to increase 6.0% YoY to ¥119,400mn and operating income to rise 6.7% to ¥6,400mn. In the 2H, revenue is expected to increase 10.3% YoY, which is a rise of 16.8% compared to the 1H, so it will be a high hurdle to clear. However, it seems that it can be achieved, including through accelerating the growth of e-books and e-magazines, and the increase in copyright revenue in the overseas market. For e-books and e-magazines, the Company completed the app integration of BOOK☆WALKER, its own broadcast platform, and niconico Book in September 2018, and we can expect further improvements to business efficiency and the maximization of sales. Moreover, the outlook for the external sales business is that the effects of the acquisition of new sales channels will continue in the 2H as well.

## Outlook

In the book business, in the context of the contracting paper publications market, the Company is aiming to increase revenue through focusing on creating powerful IP, such as strengthening the discovery of original works on the Internet, like Kakuyomu. It is also aiming to maximize profits through improving the efficiency of the Production Department by using content-data management on the cloud and improving the efficiency of the Sales Department by utilizing AI (improving the accuracy of decision marking on re-prints and reducing the returns rate).

The Tokorozawa Project state-of-the-art system, which is an integrated system from manufacturing through to logistics and that is scheduled to become fully operational from April 2020, in April 2018 began part of the commercial production of paperback books and graphic novels. A system is in place in which the original printing plates are managed on the cloud, and if there is inventory in the online connected warehouse, the product is quickly loaded with other goods and shipped. Traditionally in the supply chain in the publishing industry, it would take 7-10 days for the ordered product to be delivered to the book store, but this new system greatly shortens the delivery time to just 2-4 days. All of the functions, from the ordering system through to production and inventory management, are unified with IoT, and the product return rate would be reduced through optimization of the production and delivery. The Company thinks that it will be able to reduce its current returns rate of around 35% to as low as approximately 20% to 25% in the future, and when considering the possibility of expanding its solutions services (outsourced manufacturing) to other companies in the same industry, profits in the book business can be expected to increase from FY3/21 following the start of full-scale operations at the new Tokorozawa plant.

**(3) Video and Game business**

In this business, revenue is forecast to increase 18.7% to ¥56,300mn and operating income to rise 143.6% to ¥7,000mn. Revenue in the 2H is forecast to increase significantly, up 33.3% YoY and 36.5% compared to the 1H. However, in the game business, the previously mentioned original games will contribute to achieving this. In the video business also, the Company will progress its media mix strategy, centered on movies and anime, while license sales in the overseas market are expected to increase. It also intends to strengthen production functions in order to respond to the expansion of the anime market.

In the game business, in addition to the effects from the original games, sales of “SEKIRO: SHADOWS DIE TWICE”, which is a new game produced by FromSoftware, are scheduled to start from March 2019.

**(4) Others**

In the Others business, revenue is forecast to increase 16.2% YoY to ¥24,200mn, while the operating loss will be ¥2,200mn (compared to a loss of ¥1,356mn in the previous fiscal year). The outlook for the education business is for the higher revenue to continue from the increase in student numbers in N High School (KADOKAWA DWANGO educational corporation). The usage fees and other revenue from the original learning system of this school and from the N Preparatory School learning app are recorded in the Company's consolidated results.

In the inbound business, which is being treated as a new business, by collaborating within and outside of the KADOKAWA Group content, it is creating business opportunities such as events and the sales of goods, as well as with expressway bus company Willer, Inc., and working on the commercialization of travel experience services that are highly entertaining, mainly for inbound customers. However, the current stage is one of upfront investment and it is expected to become profitable from FY3/21 onwards.

## ■ Growth strategy and ESG initiatives

### Pursuing expansion and growth in the medium term through promoting its media-mix strategy

As its medium-term vision, the Company has set-out a policy of expanding its business while developing a media-mix strategy that fuses the Internet and the real world. To achieve growth, it is aiming not only to fulfill its function as a catalyst for the creation of IP, but also to maximize value through multiplexing IP through its media mix. In addition, having interfaces of contact with users through various channels will provide it with opportunities to acquire revenue. As its media-mix strategy, its policy is to advance an integrated, synergy-type media-mix strategy that starts from the original works (IP) created in various media, including on niconico and games and comics, and to develop them for other media.

In manufacturing and logistics also, the Company expects that the state-of-the-art Tokorozawa plant, which will become fully operational in April 2020, will strengthen the profitability of the Publication business. For the development of overseas markets also, the aim is for revenue (total of sales at overseas bases and license sales) to increase from the current scale of slightly more than ¥10bn to in excess of ¥20bn by FY3/21. In particular, its strategy for the large-scale Chinese market is to expand sales through using local subsidiaries to develop the “original proposals and original works” parts of IP, to which foreign capital regulations do not apply.

At FISCO, we expect that current upfront investment will lead to growth in the medium to long term. The reasons why we think so are that 1) it is steadily generating revenue through promotion of its media-mix strategy and accumulating expertise while leveraging synergies in each business segment, 2) in the context of improving and stabilizing profitability from the one-company system, the Publication business will see profitability improve to the next level from the start of operations of the book manufacturing and distribution base from 2020, and 3) new growth potential from launching new web services can be expected.

It seems that the Company will also strengthen its measures for ESG in the future. ESG stands for Environmental, Social and Governance, and awareness is spreading among companies both in Japan and overseas that they must conduct measures from the three viewpoints of ESG in order to realize long-term growth. In addition, recently an increasing number of institutional investors are setting the status of ESG measures as an evaluation standard when deciding to invest in a company. These efforts mainly involve reforms to ways of working, contributions to the environment and society, and checks on the corporate government system. Within them, the main items for the reforms to ways of working include the status of the active participation of women (the percentage of women in executive and managerial positions) and reforms to work styles (reduction in the total number of work hours per year and the status of introducing teleworking and flextime systems). For contributions to the environment, the main items include measures to reduce CO2 emissions and for recycling.

## Growth strategy and ESG initiatives

Looking at the Company from the points of its reforms to work styles and contributions to the environment, we see that the Tokorozawa Project, which will be completed in 2020, will be a major change. Through the operations of Tokorozawa's new manufacturing and distribution bases, it will be possible for it to produce books in a timely manner and in appropriate quantities, which will make it possible to reduce the consumption of paper, including from reducing the return rate, which will in turn lead to a reduction in its environmental impact. In addition, the Tokorozawa new office will be the largest in Japan, of about 9,917 m<sup>2</sup> (3,000 tsubo) per floor, which indicates the Company's intention to take on the challenge of conducting advanced work-style reforms. In a creative environment equipped with the latest office functions, it will advance content development for the world. At the same time, it is aiming to realize diverse work styles and a work-life balance. Specifically, it will realize "reforms to work styles" by establishing an environment in which the best work style and work place can be selected according to "the objective" without restricting the workplace or the way of working. In addition, the Company will create next-generation competitiveness with the aim of improving productivity, and in order to take a leap forward to become a world-class global entertainment company, it will secure excellent human resources through cultivating a corporate culture that feels appealing to employees.

From the viewpoint of social contribution also, the Company has announced that it will newly open the N Junior High Department in April 2019 as part of its education business. In order to realize a new choice in learning for junior high school students, it will utilize the educational expertise of N High School to provide inquiry-type learning and programming learning and nurture the students' creativity. It will be a commuter-type school and will open campuses in Tokyo (Shinjuku) and Osaka (Esaka).

## ■ Shareholder return policy

### Returns profits to shareholders through shareholder dividends, acquisition of treasury shares, and a shareholder-rewards system

The Company considers returning profits to shareholders, while aiming to supplement internal reserves to strengthen the corporate constitution and to prepare for future business development, to be an important management issue, and its policy is to pay dividends after considering the business performance in each fiscal period. It again acquired treasury shares in FY3/19 1H, which meant that the ratio of treasury shares acquired to the total number of shares issued rose to 10.8% (7.2% at the end of the previous fiscal period). In FY3/19, the Company is planning a dividend per share of ¥20.0 (for a dividend payout ratio of 24.4%), which is the same as in the previous fiscal year.

The Company has also introduced a shareholder-rewards system. Shareholders who hold 100 shares or more continuously for 1 year or more (shareholders listed at least 3 consecutive times in the shareholders' register) are given a gift of either 3 books, 1 DVD or Blu-ray, a set of 2 movie tickets, a set of 2 BOOK•WALKER ¥1,500 gift card, or an item of niconico merchandise. Long-term shareholders who have held shares for 3 years or more (shareholders listed at least 7 consecutive times in the shareholders' register) can receive an additional gift of either 2 books, 1 movie ticket, or 1 BOOK•WALKER ¥1,500 gift card.

## ■ 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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