TYO Inc.
4358 Tokyo Stock Exchange First Section

17-May-16

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FISCO Ltd. Analyst
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Inheriting operations from Indonesia's largest domestic capital affiliated advertising company group

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

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

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

However, in the results for the FY7/16 1H period, while sales increased 9.5% y-o-y to ¥13,791mn, operating profit declined 43.4% to ¥408mn, for an increase in sales but a decline in profits. But both sales and profits were below the initial forecasts. With the favorable ordering environment proving to be a fair wind, Advertising Operations grew, but in addition to a slow start due to the low profit margin projects in Q1, the slumps in the Indonesian subsidiary and Video-related Operations had an adverse impact on the results.

For its FY7/16 revised results forecasts, following the downward revision of the forecasted amounts upon taking into account the 1H results, the Company is forecasting increases in sales and decreases in profits, with sales increasing 5.7% y-o-y to ¥30,000mn and operating profit decreasing 20.4% to ¥1,500mn.

At FISCO, we expect results to somewhat draw to a halt in this period due to an accumulation of unexpected factors. But as a certain level of results have started to appear in direct transactions with advertisers, which the Company is focusing on, and in addition as it is aiming to strengthen personnel through upfront investment, we evaluate that its measures to expand its business in the future are progressing steadily. We will be focusing on the progress made in the growth strategy, such as measures for growth from the next fiscal year (FY6/17), including the M&A second stage.

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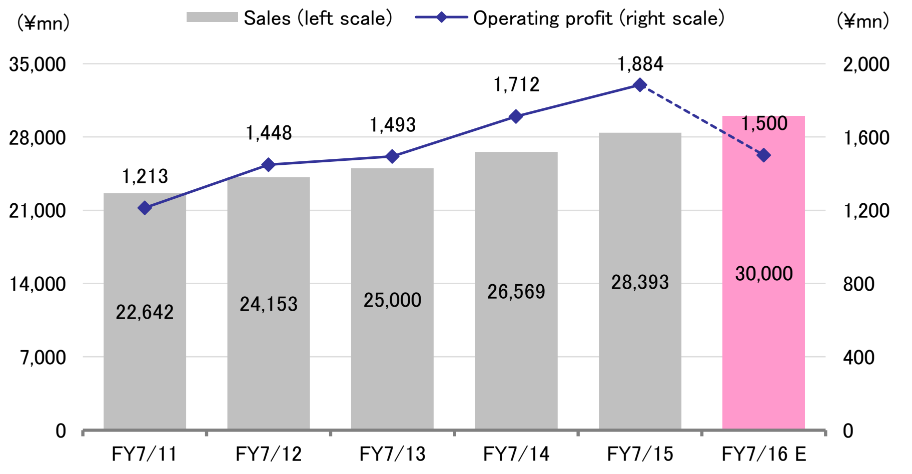
Check Point

- Made a consolidated subsidiary of K&L, which is strong in the graphics area and has an overseas network
- The results forecasts are conservative based on the effects of the stricter selection of projects
- ROE is superior to those of other companies from its high total assets turnover ratio and financial leverage

Trends in full-year results



Business overview

Made a consolidated subsidiary of K&L, which is strong in the graphics area and has an overseas network

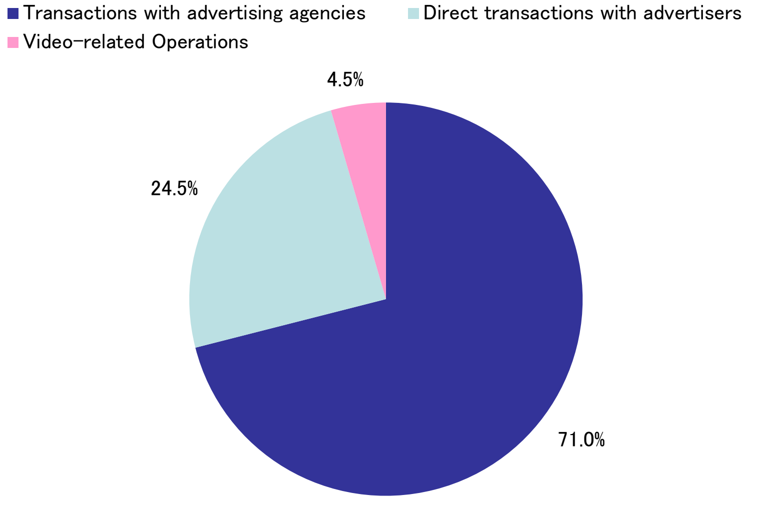
(1) Description of operations

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

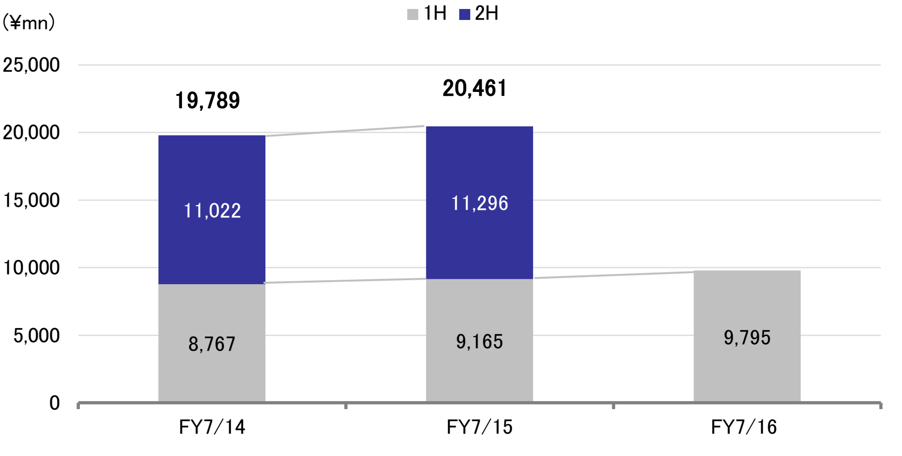
Within the solid growth seen in the TV commercial production market, the Company is steadily expanding its results, using as a weapon the creativity that it has demonstrated in many commercial productions that have left an impression on consumers, such as the “So da Kyoto, Iko (Let’s go to Kyoto)” CM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

There are two operations segments; the mainstay Advertising Operations, and also Video-related Operations, which involves the production of music videos and animation by subsidiaries. In addition, Advertising Operations is further divided into “transactions with advertising agencies,” which includes the planning and production of TV commercials for advertising agencies, and “direct transactions with advertisers,” which involves the planning and production of Internet advertising and promotional media advertising directly for advertisers. Recently, the Company has been focusing on “direct transactions with advertisers” and these operations are growing significantly. Advertising Operations provides 95.5% of all sales, while within this percentage, 71.0% are sales from transactions with advertising agencies and 24.5% are from direct transactions with advertisers (FY7/16 1H results).

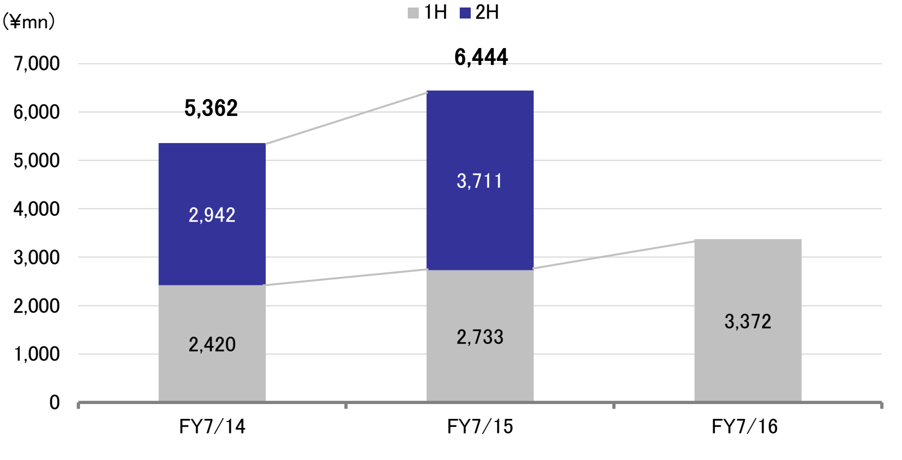
Sales ratios by operations segment (FY7/2016 1H result)



Trends in transactions with advertising agencies

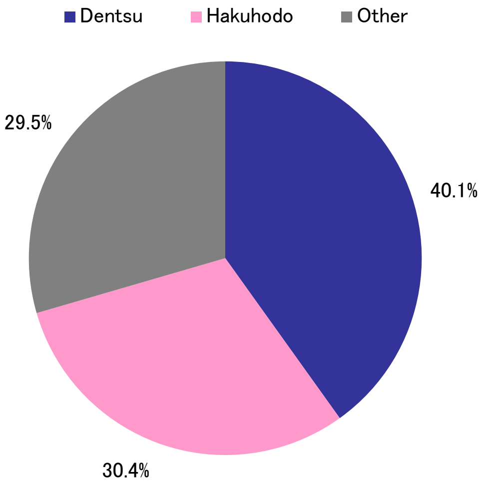


Trends in direct transactions with advertisers



The ratios according to advertising agency were 40.1% for the Dentsu Inc. <4324> and 30.4% for the Hakuhodo Inc., so the combined total for these two groups was 70.5%. Also, in the ratios according to industry, “Electrical and telecommunications,” “Vehicles, transportation equipment, and industrial machinery,” “Beverages,” “Apparel, textiles, and accessories,” and “Entertainment and amusement” ranked in the top positions.

Sales ratio by advertising agency (FY7/2016 1H result)



Sales by industry TOP10

	FY7/15 1H	FY7/16 1H
No. 1	Electrical and telecommunications	Electrical and telecommunications
No. 2	Vehicles, transportation equipment, and industrial machinery	Vehicles, transportation equipment, and industrial machinery
No. 3	Beverages	Beverages
No. 4	Apparel, textiles, and accessories	Apparel, textiles, and accessories
No. 5	Entertainment and amusement	Entertainment and amusement
No. 6	Distribution-related and restaurants	Education, publishing, and information
No. 7	Education, publishing, and information	Cosmetics, sanitary, and medical
No. 8	Cosmetics, sanitary, and medical	Finance and insurance
No. 9	Foods	Distribution-related and restaurants
No. 10	Real estate and construction	Foods

(2) Company history

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

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

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

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

However, compared to the stable advertising production operations, entertainment is a high-risk, high-return business and combined with the impact of the economic recession, the expansion was a factor that kept down results. The Company has continued in rapid succession to reorganize its operations by pulling out of unprofitable segments and returning to its main operations, including withdrawing from game software operations in 2009. These measures have proven successful and it has strengthened its financial base, improved profitability, and achieved a V-shaped recovery in results, and upon changing to the TSE 2nd Section in October 2013, its listing was reassigned to the 1st Section in January 2014.

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

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

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

PT TYO FIRST EDITION (FE) was established as a joint-venture company with the representatives of The First Edition Group, which is the largest domestic-capital affiliated advertising company in Indonesia, and essentially it has been operational since August 2015 by inheriting the operations of The First Edition. The initial plan was for it to be established in FY7/16, but this was achieved a year ahead of schedule. The First Edition has a track record within Indonesia of providing services in various areas, including branding consulting as well as creative, strategic planning and research, and events. Going forward, the aim is to expand the share of the Indonesian advertising market, which is growing remarkably, by training human resources recruited locally in the creativity, techniques, and expertise that are the Company's strengths. The policy is also to try to increase transactions with Japanese companies in Indonesia. The Company's capital contribution ratio is 51.0% (acquisition cost of approximately ¥76mn), while the cost of acquiring goodwill was the same amount of around ¥76mn (amortized using the straight line method over 5 years).

Conversely, K&L is a creative agency with a track record of achievements in projects for major advertisers and other clients over a long period of time, particularly in the graphics field. It launched overseas operations, including in China, India, and other parts of Asia, ahead of many other Japanese companies. The abundance of achievements and expertise possessed by the K&L Group, including in its overseas operations, will be leveraged by the Group to expand its direct transactions with advertisers and for the fully fledged development of its overseas operations. In addition, by mutually and effectively utilizing the management resources and sales networks of both groups, which span domestic and foreign markets, it would seem the aims are to expand the scale and improve the efficiency of operations. Through the subscription to the third-party allocation of new shares, the Company's percentage of voting rights became 68.0% (the acquisition cost was not disclosed), while goodwill was approximately ¥9mn (amortized using the straight line method over 5 years).In addition, sales of K&L in the most recent fiscal year (FY6/15) were ¥1,499mn and its total assets were ¥388mn. Following this acquisition, K&L Advertising (Shanghai) became a consolidated subsidiary and in December 2015, K&L CREATIVE ASIA PTE. LTD. was established.

Characteristics of the Company

It has 4 strengths, including creativity, as demonstrated by the many awards it has received

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

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

The main brands of transactions with advertising agencies

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

The main brands of direct transactions of advertisers

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

b) Creativity, as demonstrated by the many awards it has received
In addition to being a company that was founded by creators, among the Company's 850 employees, about 90% are creators forming the creator group, and they particularly focus on quality in production. Reflecting this, the Company was responsible for many commercial productions that left an impression on consumers, such as JR Central's "So da, Kyoto, Iko" commercial which is in its 18th year and for Uniqlo and other clients. In addition, the many awards that the Company has received testifies to its unsurpassed creativity.

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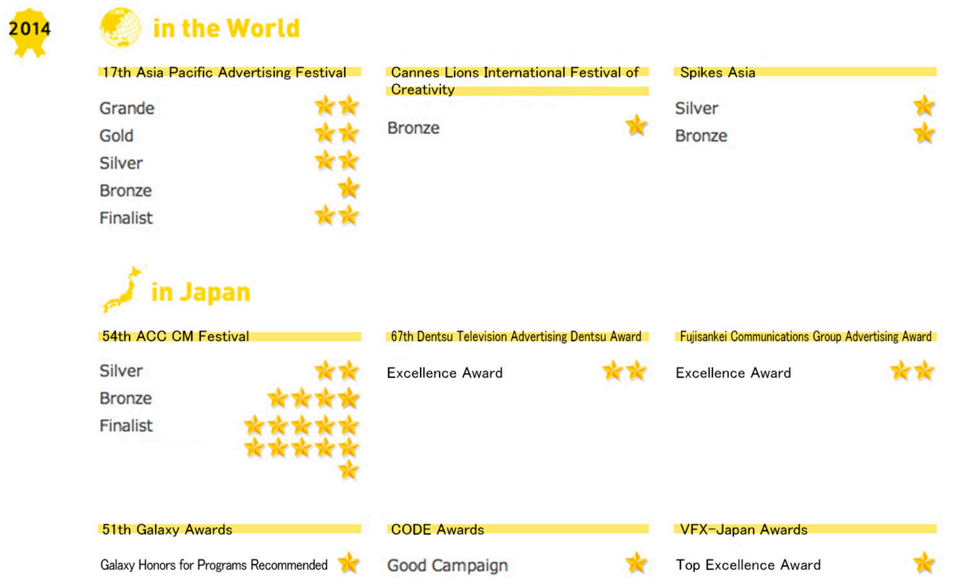
Awards (2014)



c) Provision of one-stop solutions through diverse content production

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

d) Promotion of direct transactions with advertisers

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

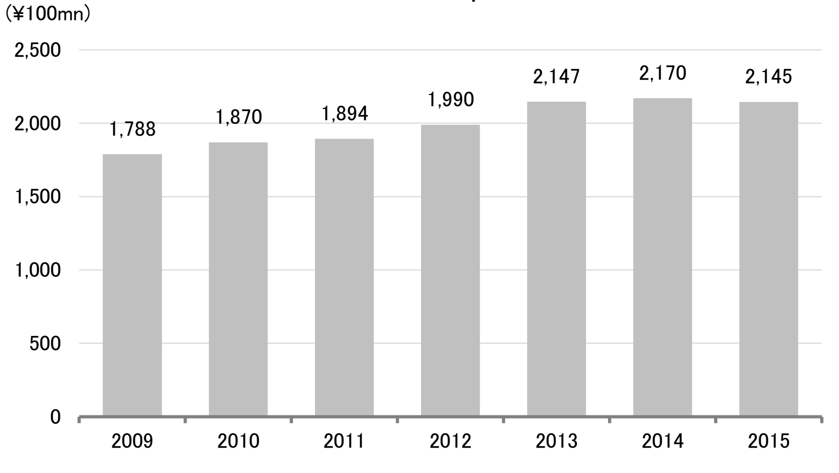
Through promoting direct transactions with advertisers, the Company is able to pursue a number of benefits, including improving profitability, building long-term relations with advertisers (a direct dialogue with the advertisers makes possible proposals from a long-term perspective), expanding the scale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

Industry environment

Expanding market scale through progressing the advertiser direct sales model and advancing into peripheral areas

According to a survey by Dentsu, the advertising market (TV commercial market) is comprised of approximately 90% media costs and 10% production costs. Compared to media transactions the scale of the TV commercial production market is small, but in contrast to media prices that are susceptible to economic fluctuations, a characteristic of this market is that it is stable and not easily influenced by economic conditions, and this point is the biggest difference with advertising agencies as the subjects of media transactions. Over the last few years, the TV commercial production market has grown steadily. However, the reasons for its somewhat weak growth in 2015 were the reaction to the rush in demand in the previous fiscal year in advance of the hike in the consumption tax rate and following the holding of the FIFA World Cup in Brazil, as well as the slowdown of overseas economies and the sluggish growth in consumer spending. Due to the impact of these factors, spending on advertising as a whole slumped. However, toward the holding of the 2020 Tokyo Olympics, it is anticipated that companies will become more active in their publicity and advertising activities and consequentially, the TV commercial production market is expected to expand.

Trends in TV commercial production costs



Source: Dentsu "Advertising costs in Japan"

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

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

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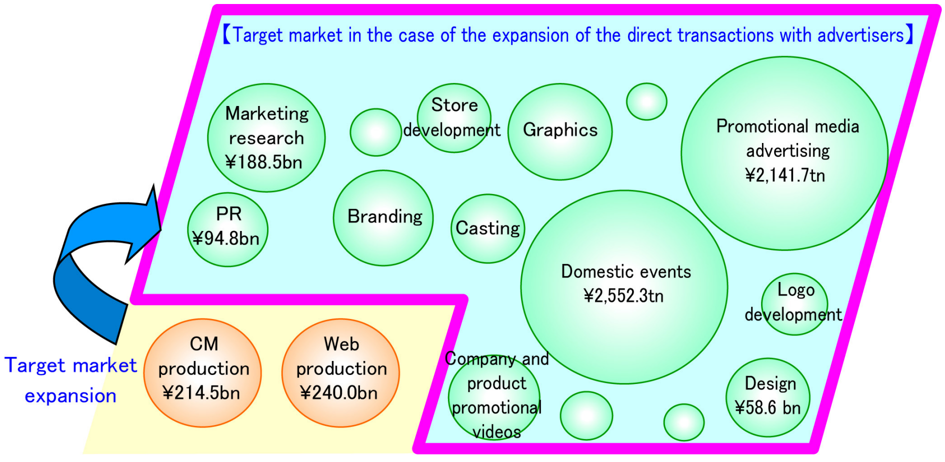
Target market for direct transactions with advertisers



With regard to the competitive environment, the three major companies, led by Tohokushinsha Film Corporation <2329>, which is the veteran of the industry, and followed by the Company and AOI Pro. Inc. <9607> account for about 30% of the total market (the Company's market share is approximately 9.0%). On the other hand, looking at the trend in the number of members of the Japan Ad Contents Production Companies Association (JAC), we see that the number is declining, peaking at 143 companies in 1992 but falling to 94 companies by 2015. So in the context of this decline and the expanding market share of the three major companies, the industry is considered to be developing into an oligopoly. In the background to this development is thought to be the fact that it has become difficult for small operators to win projects due to the increasing awareness of compliance on the advertisers' side, including for information management, and also an operational structure of utilizing scale merits.

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

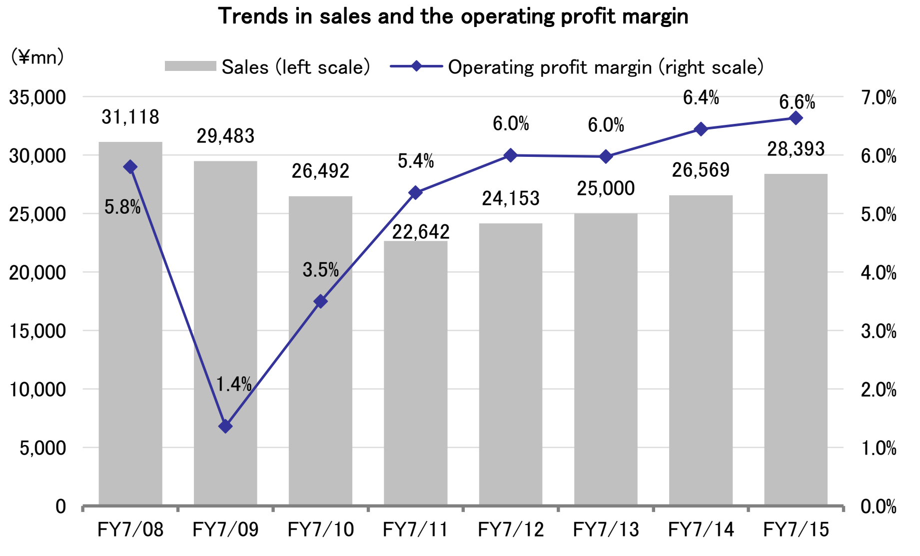
■ Financial highlights

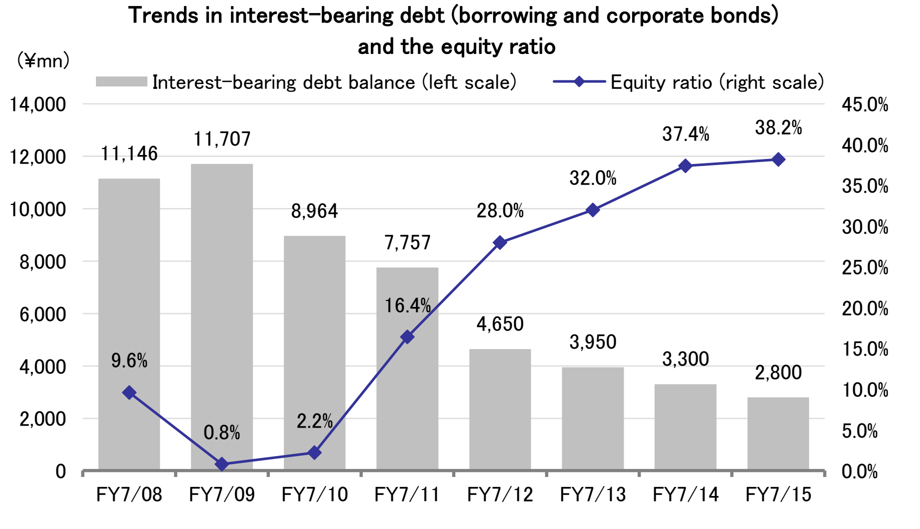
After results fell greatly from FY7/09, they achieved a V-shaped recovery with 6 consecutive fiscal years of higher profits

(1) Trends in past results

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

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





(2) FY7/16 1H financial results highlights

In the results for FY7/16 1H, sales increased 9.5% y-o-y to ¥13,791mn, operating profit decreased 43.4% to ¥408mn, ordinary profit declined 48.3% to ¥366mn, and net income attributable to owners of the parent fell 69.9% to ¥132mn, for an increase in sales but a decline in profits. However, both sales and profits were below the initial forecasts.

With the favorable ordering environment proving to be a fair wind, sales from transactions with advertising agencies trended strongly, and in addition, sales from direct transactions with advertisers also grew significantly following the consolidation of FE and K&L. However, the main reasons why sales fell below the initial forecast was that FE's contribution to results was below expectations, and also that sales from Video-related Operations were sluggish.

In terms of profits, the gross profit ratio fell greatly due to the impact of factors including the occurrence of low profit margin projects in Q1. Further, in addition to the increase in expenses associated with the consolidations of FE and K&L, SG&A expenses rose because of upfront expenses for business expansion (including for personnel expenses and M&A-related expenses). As a result, profits declined and the operating profit margin fell to 3.0% (compared to 5.7% in the same period in the previous fiscal year). The increase in SG&A expenses was basically as expected, so the reasons why operating profit fell greatly below the initial forecast were that sales failed to reach their target and the fall in the gross profit ratio.

Financially, while total assets increased slightly to ¥14,868mn (up 1.9% y-o-y), shareholders' equity decreased to ¥5,361mn (down 3.8%) due to the payment of dividends and other factors, and therefore the equity ratio fell marginally, to 36.1% (compared to 38.2% at the end of the previous fiscal period). The interest bearing debt balance also increased to ¥3,025mn (up 8.0%), but the current ratio maintained a high level of 203.3%, and there are no concerns about the Company's financial stability.

FY7/16 1H financial highlights

(¥mn)

	FY7/15 1H results		FY7/16 1H results		Change		FY7/16 initial forecasts		Difference with target
		Ratio		Ratio		Change rate		Ratio	
Sales	12,596		13,791		1,194	9.5%	14,500		95.1%
Advertising Operations	11,899	94.5%	13,167	95.5%	1,268	10.7%	-	-	-
Video-related Operations	696	5.5%	623	4.5%	-73	-10.6%	-	-	-
Cost of sales	10,417	82.7%	11,625	84.3%	1,207	11.6%	-	-	-
SG&A expenses	1,457	11.6%	1,757	12.7%	300	20.6%	-	-	-
Operating profit	721	5.7%	408	3.0%	-313	-43.4%	900	6.2%	45.4%
Advertising Operations	1,540	12.9%	1,383	10.5%	-157	-10.2%	-	-	-
Video-related Operations	52	7.6%	-1	-	-54	-	-	-	-
Adjustment	-872	-	-973	-	-101	-	-	-	-
Ordinary profit	709	5.6%	366	2.7%	-342	-48.3%	830	5.7%	44.2%
Net income attributable to owners of the parent	439	3.5%	132	1.0%	-307	-69.9%	500	3.4%	26.5%

	End of July 2015	End of January 2016	Change	
				Percentage change
Total assets	14,590	14,868	277	1.9%
Shareholders' equity	5,572	5,361	-210	-3.8%
Equity ratio	38.2%	36.1%	-2.1	

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

Within Advertising Operations, in transactions with advertising agencies, sales increased 6.9% y-o-y to ¥9,795mn, while operating profit decreased 4.3% to ¥1,472mn*. Results got off to a slow start in Q1 due to the accumulation of factors, of low profit margin projects and projects with changed acceptance-inspection periods. But increase in sales was still achieved thanks to the stronger sales performance in Q2 from collecting income from those projects whose acceptance-inspection period had been delayed. Total sales from transactions with two companies, Dentsu and Hakuhodo, grew steadily to ¥ 6,914mn (up 18.1%). But the higher sales were not enough to offset the impact of the low profit margin projects, and as a result profits declined. One factor behind this was that within the favorable ordering environment, the fact that the Company had many projects invited it having a number of low profit margin projects due to insufficient management of profit margins after the orders. But from the Q2 onwards, the profit margin has been improving as the Company is more strictly investigating and selecting projects at the ordering stage and implementing a more thorough profit management system.

* In results according to transaction, sales are the total for external customer sales, and operating profit is the total according to segment (before adjustment).

On the other hand, in direct transactions with advertisers, which the Company has positioned as a growth field, sales increased 23.4% y-o-y to ¥3,372mn, but operating profit fell 24.7% to ¥50mn. Despite the major growth in sales from the contributions of FE and K&L following their consolidation, not only profits but also sales fell below the initial forecast because of factors such as the sluggish sales from FE. The three main reasons for the poor sales performance of FE were 1) the sluggish local economy, 2) the impact of temporary circumstances (including a change of system) at a customer on which it is highly dependent for transactions, and 3) the lack of progress in acquiring new customers. However, the profit margin in the Sales Head Office, which plays a central role in direct transactions with advertisers, seems to be improving steadily, thanks to the larger scale of projects and the improved proficiency in carrying out operations.

In Video-related Operations, sales fell 10.6% y-o-y ¥623mn, while the operating loss was ¥1mn (compared to operating profit of ¥52mn in the same period in the previous fiscal year). This poor performance was because in addition to the reduction in the scale of orders for some anime production projects, there were no orders for large-scale music video projects as there were in the same period in the previous fiscal year. Moreover, the reason profits declined and an operating loss recorded was that as well as the lower sales pushing down profits, work has been prolonged for some anime production projects and profitability worsened compared to the same period in the previous fiscal year, in which there were orders for highly profitability music video production projects.

The results forecasts are conservative based on the effects of the stricter selection of projects

(3) FY7/16 results forecasts

In its FY7/16 results forecasts, the Company has downwardly revised the initial forecasts to take into account the 1H results and other factors. The revised forecasts are for sales to increase 5.7% y-o-y to ¥30,000mn (extent of revision : down ¥2,000mn), operating profit to decrease 20.4% to ¥1,500mn (extent of revision : down ¥650mn), ordinary profit to decline 25.3% to ¥1,350mn (extent of revision : down ¥650mn), and net income to fall 35.7% to ¥720mn (extent of revision : down ¥480mn).

Within the continued favorable ordering environment, Advertising Operations is expected to grow, including from the contributions of FE and K&L following their consolidation. However, the reason for the downward revision to the sales forecast is to reflect in the full-year forecasts the sluggish performances of FE and Video-related Operations, which adversely impacted the 1H results, and also that the estimates are conservative due to the effects of the Company's more strict criteria for selecting projects in order to eliminate those with low profit margins.

For profits also, even though profitability is expected to improve in 2H, the profit forecasts were downwardly revised to reflect the delayed projects in 1H and the slumping performances of FE and Video-related Operations, and the forecast is now for a decline in profits, compared to the initial forecast of an increase in profits.

In order to achieve the revised results forecasts, in 2H the Company must record sales of ¥16,208mn (up 2.6% y-o-y) and operating profit of ¥1,091mn (down 6.1%). At FISCO, we think that the Company's forecasts are slightly conservative, based on the order balance of ¥15,263mn (up 3.6%) at the end of January 2016, and the fact that the projects' acceptance-inspection periods (particularly projects with high profit margins) are concentrated in the 2H. It also cannot be denied that an upside in results is possible from the realization of the M&A second stage, which the Company is currently preparing for through the inspection and selection of candidates.

We expect results to somewhat draw to a halt in this period because of an accumulation of unexpected factors, including the impact of low profit margin projects and the slumping performances of FE and Video-related Operations. But as a certain level of results have started to appear in direct transactions with advertisers, which the Company is focusing on, and in addition, as confirmed orders and inquiries are steadily piling-up and it is aiming to strengthen personnel through upfront investment, we evaluate that its measures to expand its businesses in the future are progressing steadily.

FISCO

TYO Inc.
4358 Tokyo Stock Exchange First Section

17-May-16

FY7/16 results forecast

(¥mn)

	FY7/15 results		FY7/16 forecast				Change			
			Initial		Revised		Initial		Revised	
		Ratio		Ratio		Ratio		Percentage change		Percentage change
Sales	28,393		32,000		30,000		3,607	12.7%	1,607	5.7%
Operating profit	1,884	6.6%	2,150	6.7%	1,500	5.0%	266	14.1%	-384	-20.4%
Ordinary profit	1,806	6.4%	2,000	6.3%	1,350	4.5%	194	10.7%	-456	-25.3%
Net income	1,119	3.9%	1,200	3.8%	720	2.4%	81	7.2%	-399	-35.7%

Progress made so far in the Mid-Term Management Plan

Aiming to shift to a phase of pursuing further growth in the Mid-Term Management Plan that is currently in progress

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

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

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

(1) Continuing to strengthen transactions with advertising agencies

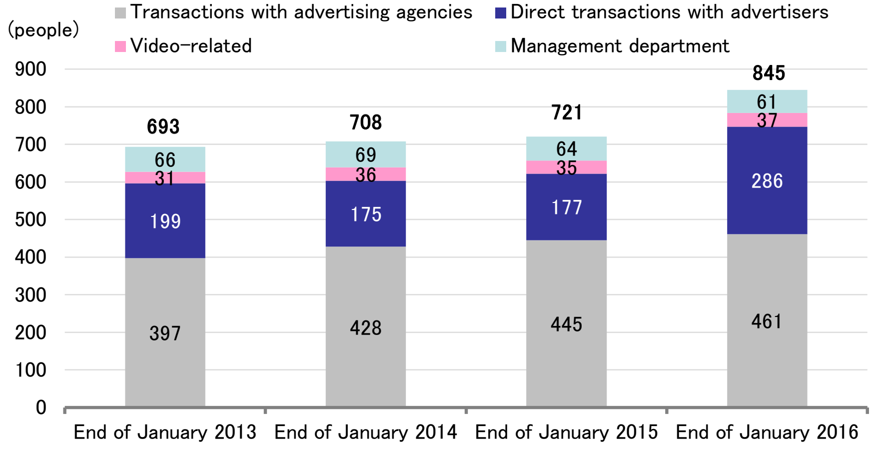
The measures aiming to continue to strengthen transactions with advertising agencies are as follows.1) Focusing on expanding the “surface” (such as by strengthening personnel and enhancing brands), 2) expanding the area for upstream (including through strengthening collaborations by aiming to supplement the creative function for advertising agencies), and 3) strengthening the influence on downstream (for example, by strengthening collaborations with outsourcers and industry peers). The sales target for transactions with advertising agencies in FY7/18 is ¥26,000mn (average annual growth rate of 7.1%).

(2) Dramatic expansion of direct transactions with advertisers

Conversely, the measures for direct transactions with advertisers, which has been positioned as a growth field, include the following. 1) Strengthen the sales force (such as by strengthening personnel and enhancing brands), 2) enhance functions (enhancing the branding and marketing functions), 3) acquire new advertisers, and 4) expand the projects of existing advertisers. In particular, in addition to conventional commercial production and Web production, the target for direct transactions with advertisers is the enormous market that includes the domestic events market and the promotions media market. The FY7/18 sales target for direct transactions with advertisers is ¥18,000mn (average annual growth rate of 35.4%) and the aim is to raise the current sales ratio (FY7/15) of 22.7% to 36.0%.

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

Trends in personnel



Note: Direct transactions with advertisers at the end of January 2016 includes the increases following the consolidation of FE and K&L.

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

(3) The new development of overseas operations

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

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

Mid-Term Management Plan Targets

(¥mn)

	FY7/14 results		Mid-Term Management Plan Targets					Three year annual growth rate	Image after 4 years		
			FY7/15 results		FY7/16		FY7/17		FY7/18		Four year annual growth rate
		Ratio		Ratio	Initial forecasts	Revised forecast	Targets			Ratio	
Sales	26,569	-	28,393	-	32,000	30,000	40,000	14.6%	50,000	-	17.1%
(growth rate)	6.3%	-	6.9%	-	12.7%	5.7%	33.3%		25.0%	-	
Transactions with advertising agencies	19,789	74.5%	20,461	72.1%	-	-	-	-	26,000	52.0%	7.1%
Direct transactions with advertisers	5,362	20.2%	6,444	22.7%	-	-	-	-	18,000	36.0%	35.4%
Video-related Operations	1,417	5.3%	1,487	5.2%	-	-	-	-	1,500	3.0%	1.4%
(overseas operations)					-	-	-	-	4,000	8.0%	-
Operating profit	1,712	-	1,884	-	2,150	1,500	2,700	16.4%			
(profitability)	6.4%	-	6.6%	-	6.7%	5.0%	6.8%				

When considering the external factors (including the favorable ordering environment and the development of an oligopoly) and the internal factors (such as the recovery of the financial base and profitability, differentiation through creativity, and the fully fledged operations of direct transactions with advertisers), we consider that it is fully possible for the Company to achieve the targets in its Mid-Term Management Plan. However, a cause for concern is that the contribution of FE following its launch has not been as was initially expected. Therefore, we will be paying attention to the path taken toward improving FE's results, including progress made in acquiring new customers.

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

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

■ Comparison with industry peers

ROE is superior to those of the other companies from its high total assets turnover ratio and financial leverage

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

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

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

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

Comparison of financial indicators

(¥mn)

	Tohokushinsha Film Corporation	AOI Pros Inc.	TYO Inc.
	2329	9607	4358
	FY3/15	FY3/15	FY7/15
Scale			
Sales	58,098	28,817	28,393
Operating profit	5,403	1,952	1,884
Profitability			
Operating profit margin	9.3%	6.8%	6.6%
Sales cost ratio	75.0%	80.9%	82.5%
SG&A expenses ratio	15.7%	12.7%	10.9%
ROE	5.4%	11.3%	21.6%
Growth potential (based on last 3 years)			
Sales	-2.5%	10.0%	5.5%
Operating profit	-4.3%	9.2%	9.2%
Soundness			
Equity ratio	69.4%	45.8%	38.2%
Current ratio	257.1%	172.9%	192.8%
Interest coverage ratio	90.0	13.8	32.7
Total assets turnover ratio	0.62	1.17	2.65
Financial leverage	1.47	2.24	2.07

Returns to shareholders

Can expect plenty of room for dividends to increase alongside the growth in profits

In FY7/15, the Company paid an annual dividend of ¥5 per share (payout ratio, 27.8%), which in actual terms was an increase of ¥2 when excluding the listing commemorative dividend paid in FY7/14. In FY7/16 also, it has left its initial forecast unchanged and plans to pay an annual dividend of ¥5 per share (for a revised dividend payout ratio of 43.3%). Within its Mid-Term Management Plan, the Company describes its policy of prioritizing returns to shareholders who are the owners of the Company, in order to strengthen its financial base, and that it is targeting a dividend payout ratio of 25% or more. Therefore, assuming that the Company realizes the targets in its Mid-Term Management Plan, we can expect that there remains plenty of room for it to improve the dividend payout ratio and increase dividends alongside the growth in profits.

Moreover, together with the year-end dividend, the Company continues to implement a Shareholder Special Benefit Plan for interim returns to shareholders. The shareholder special benefits in FY7/16 (reference date, January 31, 2016) were a present of a QUO card, depending on the number of shares held, and in addition it implemented the "Shareholders! You are the heroes of the anime!" competition for the production of original animation following the drawing of lots for two pairs of winners. Its policy is to continue to provide these sorts of creative benefits to shareholders as befitting its position as a creative company.