TYO Inc.
4358 Tokyo Stock Exchange First Section

14-Nov.-16

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FISCO Ltd. Analyst
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Sales will exceed those of the leading company following the management integration with AOI Pro.

TYO <4358> (hereafter, also "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.

On July 11, 2016, the Company announced its management integration with AOI Pro. <9607> from the same industry. A joint holding company is scheduled to be established (by stock transfer) on January 4, 2017*[1]. In the background to this integration is the diversification of media and devices (such as smartphones and tablets) that are focused on the Internet, and in addition, the major changes to the industry environment, including to communication speeds and data analysis, and also the progress being made in technological innovations like virtual reality (VR)*[2], and augmented reality (AR)*[3]. In this environment, it is anticipated that while on the one hand major growth in TV commercial production, which has been the mainstay up to the present time, is unlikely, on the other hand the advertising-related business areas will expand with accompanying changes to their methods and structures. By concentrating and effectively utilizing management resources, the Company is aiming to "expand market share," "strengthen negotiation power," and "enhance capital strength," and going forward, its policy is to evolve to become the No.1 advertising-related service provider, mainly for video, in Asia. Up until now, Tohokushinsha Film Corporation <2329> has been the leading company in the TV commercial production industry, and a structure continued in which it, along with the other 2 major companies in the industry of the Company and AOI Pro., held market shares of around 30% to 40%. But following the integration, the Company's TV commercial production sales will exceed those of Tohokushinsha Film Corporation.

In the FY7/16 results, sales increased 5.3% year-on-year (y-o-y) to ¥29,898mn, while operating profit fell 22.3% to ¥1,464mn, for an increase in sales for the fifth consecutive fiscal year but decline in profit. Supported by the favorable ordering environment, sales trended positively in transactions with advertising agencies, and they also grew significantly in the mainstay business of direct transactions with advertisers due to the effects of consolidation (of FE*[4] and K&L*[5]), despite the delay to the acceptance period. However, profits declined, as it was not possible to recover from the adverse effects of the low profit margin projects in 1Q, and also the slump in results at an overseas subsidiary (FE) because of factors including the stagnation of the local economy.

In conjunction with the establishment of the new holding company, the Company has changed its fiscal period (to a fiscal period ending in December). Accordingly, as the current fiscal year will have an irregular fiscal period of 5 months, from August 1 to December 31, at the current time the Company has not determined its results forecasts (it is expected to announce them promptly at the stage when an announcement becomes possible). The order balance at the end of the FY7/16 had been accumulating steadily, reaching ¥7,404mn (up 14.8% y-o-y), including the previously described delay portion in direct transactions with advertisers. In terms of profits also, the profit margin has been improving through the Company strictly investigating and selecting projects and thoroughly establishing a system to manage profits. Therefore at FISCO, at the very least we expect the results to surpass those in the same period in the previous fiscal year.

*1 The stock transfer ratio is 0.18 of the new company's stock for 1 common stock of the Company.

*2 Virtual reality (VR) refers to the technologies and methods to realize various types of experiences, including in virtual worlds, portraying something like the real world that goes beyond time and space.

*3 Augmented reality (AR) refers to the technologies and methods to realize an 'augmented' reality by adding 'some other information' to the information that people can perceive in the real world.

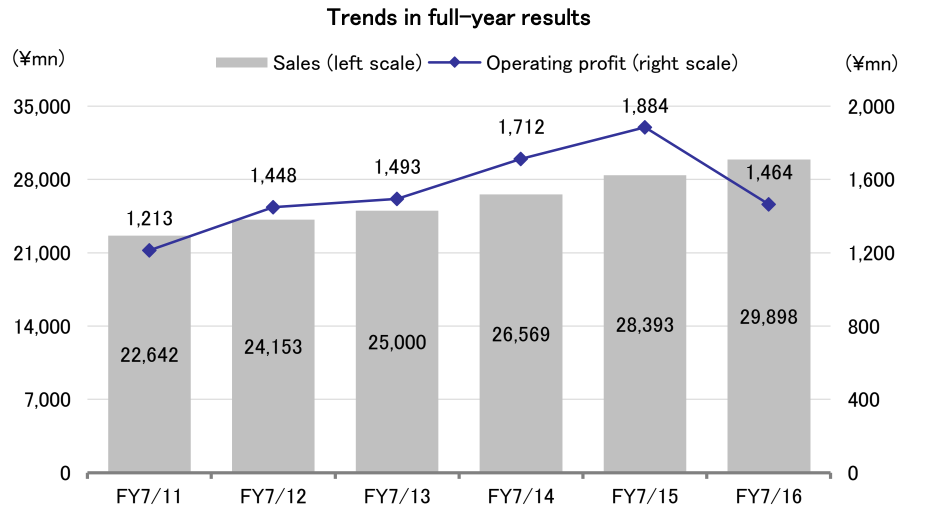
*4 PT TYO FIRST EDITION (an Indonesian corporation; hereafter, FE) was established in July 2015 as a joint venture company with The First Edition Group, which is one of Indonesia's largest domestic capital affiliated advertising company.

*5 K&L (Chiyoda Ward, Tokyo) was made a consolidated subsidiary in August 2015 through a subscription to a third party allocation of shares (percentage of voting rights, 68.0%). It is strong in the graphics field and possesses an overseas network centered on the Asia region.

The Company has not yet announced any specific details about its post-integration business strategy. But up to the current time, its growth strategy has been focused on 1) continuing to strengthen transactions with advertising agencies, 2) dramatically expanding its direct transactions with advertisers, and 3) the new development of overseas operations, and no major changes are expected to these strategies. Rather, it is considered that in order to realize each of these directions, it will aim to speed up while increasing added value (competitiveness). In particular, the affinity between the Company's strength, of direct transactions with advertisers, and AOI Pro.'s strength, of video content marketing, is high, so it is very likely that synergies will be generated from both companies utilizing each other's strength. In addition, there are no overlapping functions in their development of overseas operations, which is a priority of both companies, and they can be expected to aim to accelerate their Asia strategy by promoting the networking of both companies' bases.

Check Point

- Through the management integration, aiming to become the leading Japanese and Asian providers of video-focused advertisement-related services
- Expanding market scale through progressing the advertiser direct sales model and advancing into peripheral areas
- High affinity between direct transactions with advertisers and video content marketing



Business overview

Uses as a weapon the creativity that it has demonstrated in many commercial productions that have left an impression on consumers

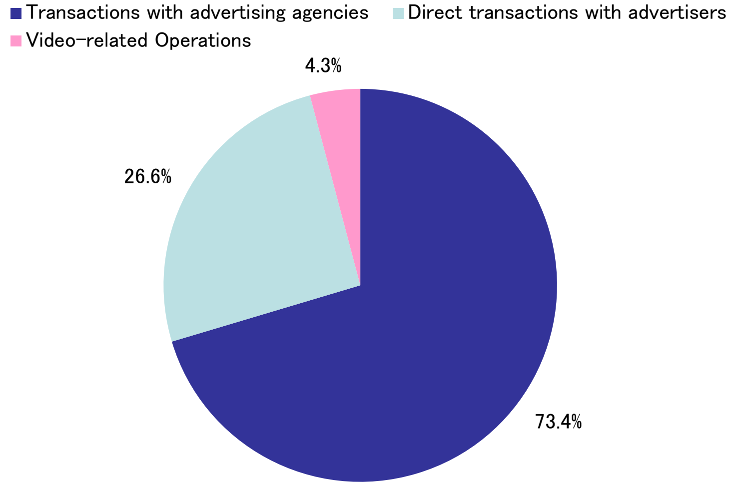
(1) Description of operations

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>), for Uniqlo (Fast Retailing Co., Ltd. <9983>) and for other clients.

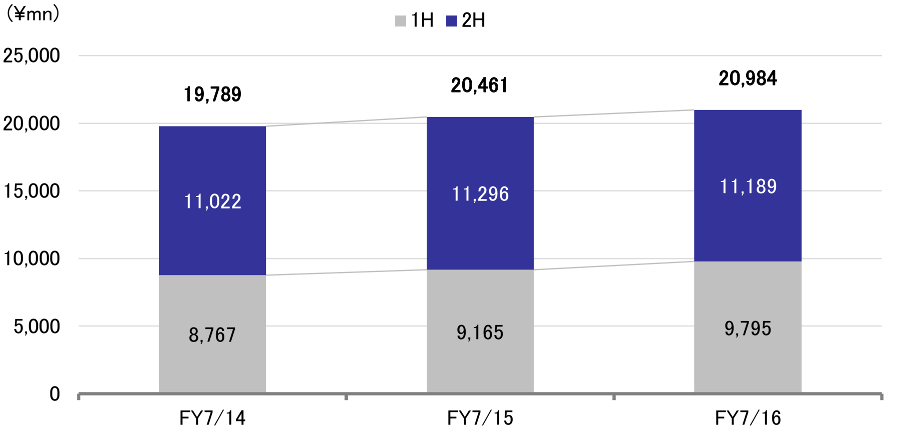
There are two operations segments; the mainstay Advertising Operations, and also Video-related Operations, which involves the production of music videos and animation by subsidiaries. In addition, Advertising Operations is further divided into “transactions with advertising agencies,” which includes 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 95.7% of all sales, while within this percentage, 73.4% are sales from transactions with advertising agencies and 26.6% are from direct transactions with advertisers (FY7/16 results).

Sales ratios by operations segment (FY7/16 results)



Source: the Company's financial results briefing materials

Trends in transactions with advertising agencies



Source: the Company's financial results briefing materials

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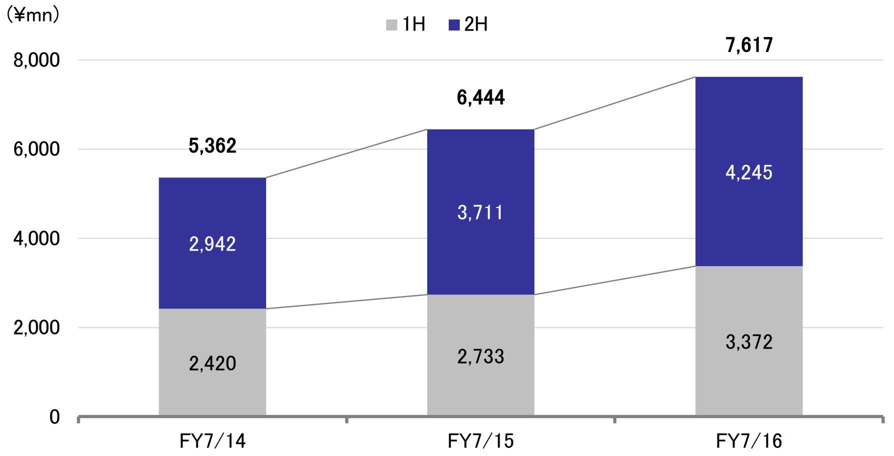
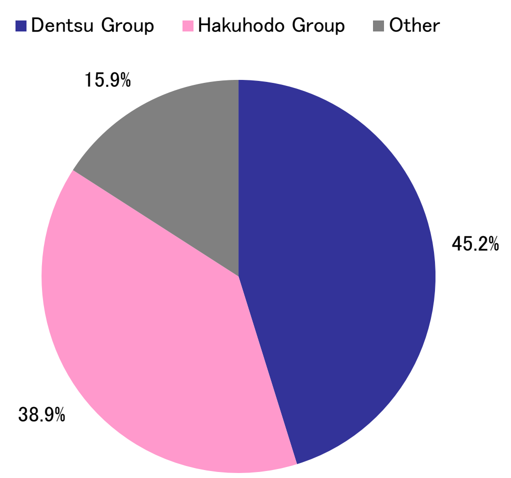
Trends in direct transactions with advertisers



Source: the Company's financial results briefing materials

The sales ratios by advertising agency were 45.2% for the Dentsu Group <4324> and 38.9% for the Hakuhodo Group, so the combined total for these two groups was 84.1%. Also, in the sales by industry, "Electrical and telecommunications," "Beverages," "Vehicles, transportation equipment, and industrial machinery," "Entertainment and amusement," and "Apparel, textiles, and accessories," and ranked in the top positions (FY7/16 results).

Sales ratio by advertising agency (FY7/16 results)



Source: the Company's financial results briefing materials

Sales by industry TOP 10

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

Source: the Company's briefing materials

(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. Hiroaki Yoshida (current Chairman), together with five other commercial creators including Kazuyoshi Hayakawa (current President and Representative 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 CORPORATION <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 Tokyo Stock Exchange Second Section in October 2013, its listing was reassigned to the First 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.

■ Characteristics of the Company

Pursing improved profitability and other benefits by promoting direct transactions with advertisers

The Company can be described as having four strengths: 1) a rich track record of achievements and a sales force deployed as multiple brands; 2) creativity, as demonstrated by the many awards it has received; 3) provision of one-stop solutions through diverse content production; and 4) promotion of direct transactions with advertisers.

(1) 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 having 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.

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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, video production	Creative Center Advertising 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	

Source: the Company materials

The main brands of direct transactions with advertisers

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

Source: the Company materials

(2) 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 890 employees, the majority 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.

* In 2016 also, several works in whose production the Company was involved have received awards, including at the 19th Asia Pacific Advertising Festival (held March 16 to 19) and the 63rd Cannes Lions International Festival of Creativity (held June 18 to 25).

(3) 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. The Company's 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.

(4) 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).

■ The management integration with AOI Pro.

Through the management integration, aiming to become the leading Japanese and Asian providers of video-focused advertisement-related services

On July 11, 2016, the Company announced its management integration with AOI Pro. <9607> through the establishment of a joint holding company (by stock transfer). The joint holding company, AOI TYO Holdings Inc., will be established on January 4, 2017, with both companies coming underneath its umbrella. In conjunction with this, the Company will be delisted within the year and the newly established holding company is scheduled to be listed from 2017 (the stock transfer ratio is 0.18 of the new company's stock for 1 common stock of the Company).

The form of the management integration

- One of the largest companies in the TV commercial production industry
- Established in 1963
- Listed on the Tokyo Stock Exchange First Section
- Annual sales: ¥32bn
- No. of employees (consolidated): 902

- One of the largest companies in the TV commercial production industry
- Established in 1982
- Listed on the Tokyo Stock Exchange First Section
- Annual sales: ¥29.8bn
- No. of employees (consolidated): 891

Source: the Company's briefing materials

Overview of the joint holding company

Trade name	AOI TYO Holdings Inc.
Date of registration of establishment	January 4, 2017 (scheduled)
Stock exchange listing	Tokyo Stock Exchange First Section / January 4, 2017 (scheduled)
Address	Minato Ward, Tokyo
Names of Directors	Representative Director Hiroaki Yoshida (currently TYO Representative Director & President) Yasuhito Nakae (currently AOI Pro. Representative Director & President and Group CEO) Executive Director Satoshi Yuzurihara (currently AOI Pro. Representative Director & Vice President and Group CFO) Managing Director Hiroaki Uekubo (currently TYO Managing Director) Director Satoru Yaegashi (Audit and Supervisory Committee Member) (currently AOI Pro. Director, Audit and Supervisor Committee Member) External Director Takashi Kokubo (Audit and Supervisory Committee Member) (currently TYO External Director) Kazuki Takada (Audit and Supervisory Committee Member) (currently AOI Pro External Director, Audit and Supervisory Committee Member) Yoshiharu Hagiwara (Audit and Supervisory Committee Member) (currently TYO Executive Auditor)
Capital	¥5 billion
Capital reserve	¥1,250 million
Fiscal year-end	December 31

Source: the Company's briefing materials

(1) Background

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

(2) Objective

As a new corporate group that will lead the industry, the objective of the integration is to build an advanced business model, and in addition, to evolve to become the leading Japanese and Asian providers of video-focused advertisement-related services.

(3) Effects

a) Strengthening of the video advertising and video production operations area
In the video advertising and video production operations, which are the core operations, the Company is pursuing integration effects in the areas of "brand competitiveness," "operational efficiency," "new technological developments," and "cost competitiveness." In other words, while on the one hand it is aiming to maximize sales opportunities by preserving the previous competitive relations between the brands, on the other hand it intends to improve operational efficiency through the sharing of personnel and business streamlining measures, and also to promote cost competitiveness by joint procurement and mutual utilization of the post production (editing) departments and the filming equipment rental departments. Moreover, it is considered that the integration will significantly improve its development capabilities for new video production technologies, such as VR and AR, through the joint development of these new technologies and the creation of investment opportunities for them.

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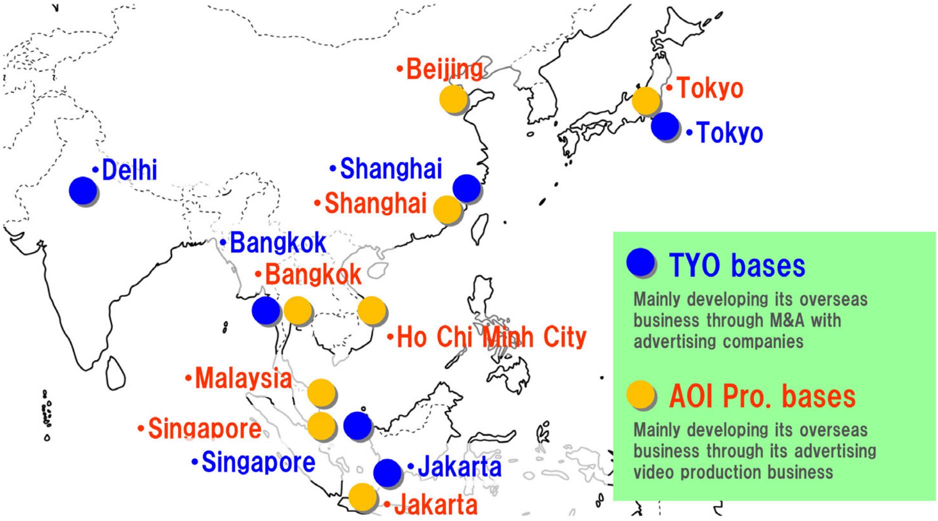
b) Promoting strategic business areas

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

c) Accelerating the development of the overseas business

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

Status of overseas bases



Source: the Company's briefing materials

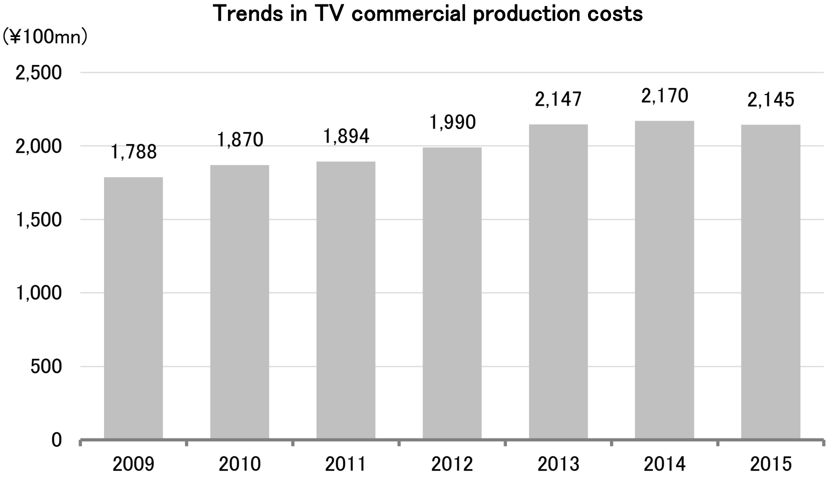
In addition, it will become possible to efficiently allocate both companies' management resources in growth fields, based on a shared management strategy, through utilizing the joint holding company system. It is considered that in addition to increasing the management agility and efficiency, this will enable them to positively take risks like never before and enhance their ability to adapt to changes to the industry.

Industry environment

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

According to a survey by Dentsu Inc., 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, companies will become more active in their publicity and advertising activities and consequentially, the TV commercial production market is expected to expand. However, the Company also has a view that from a long-term perspective, it is difficult to envisage major growth based on the impact of environmental changes, including the diversification of media and devices focused on the Internet, and the progress being made in technological innovation.

Trends in TV commercial production costs

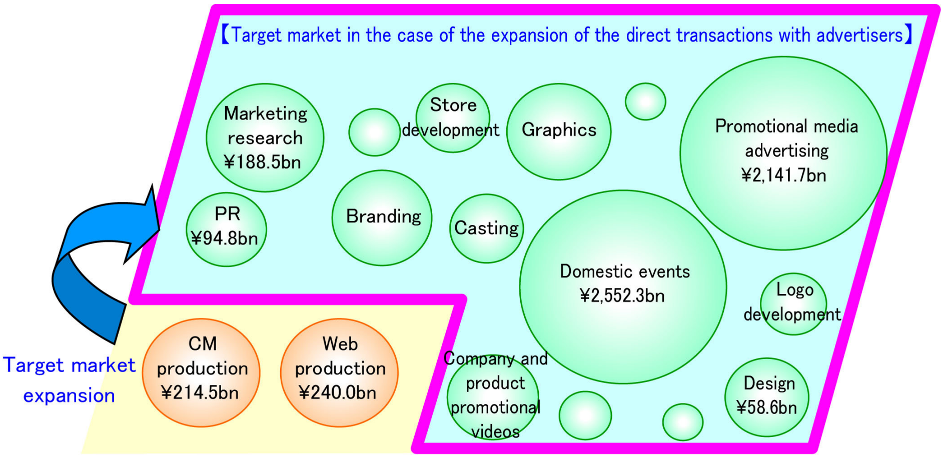


Source: prepared by FISCO from Dentsu Inc. "Advertising costs in Japan"

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 ¥2 tn. 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.

Target market for direct transactions with advertisers



With regard to the competitive environment, the three major companies, led by Tohokushinsha Film Corporation, which is the veteran of the industry, and followed by the Company and AOI Pro. Inc. account for about 30% to 40% of the total market. Through the current integration with AOI Pro., the Company's TV commercial production-related sales will surpass those of Tohokushinsha Film Corporation. 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 93 companies by 2016. 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

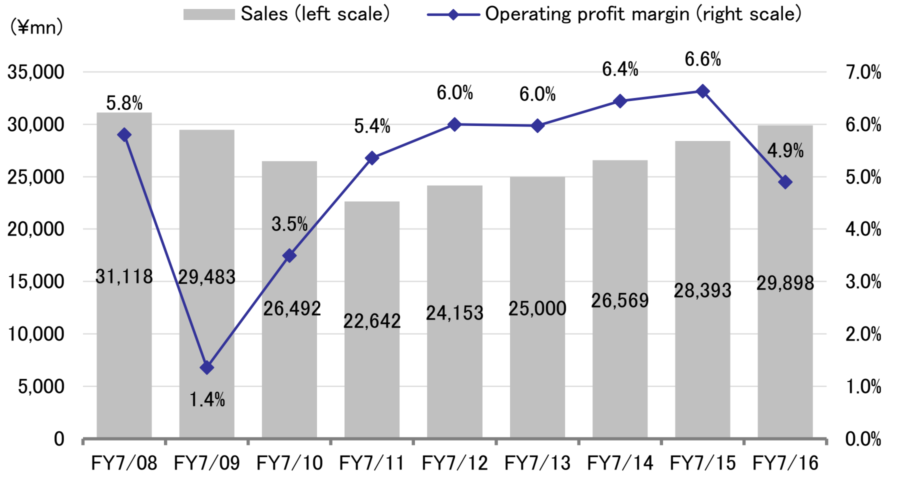
Improving the equity ratio by accumulating internal funds and a third party allocation of shares

(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 5 consecutive fiscal 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 fiscal years up to FY7/15. However, the decline in profits in FY7/16 was due to the impact of the slump in results at an overseas subsidiary and projects with low profit margins.

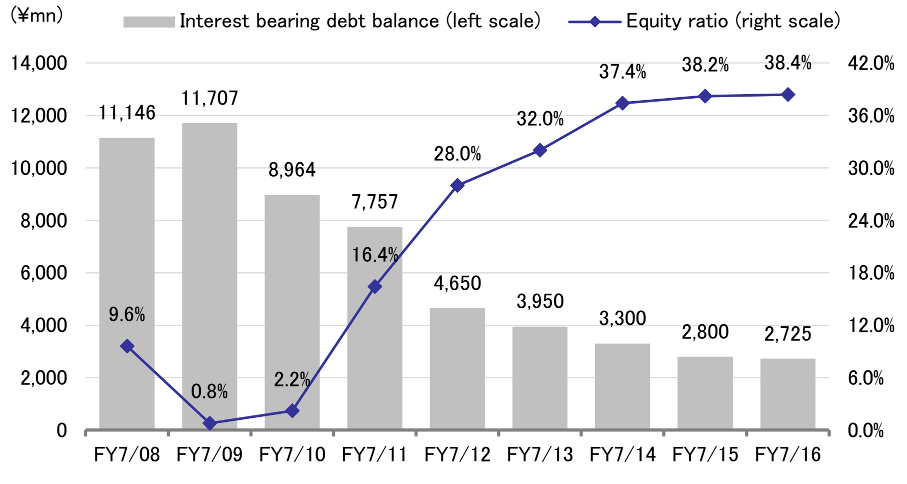
In terms of finance, together with the growth of the interest-bearing debt balance alongside the expansion of the area of operations in the past, in FY7/09 the equity ratio fell significantly to 0.8% due to the liquidation of unprofitable segments. But subsequently, following the accumulation of internal 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 FY7/16 equity ratio had recovered to the level of 38.4%. The Company is also steadily repaying its interest-bearing debt. The FY7/16 interest-bearing debt balance was ¥2,725mn, but the net interest-bearing debt balance, calculated by subtracting the cash and deposits balance, has been zero since FY7/14.

Trends in sales and the operating profit margin



Source: the Company's financial results summary

Trends in interest-bearing debt (borrowing and corporate bonds) and the equity ratio



Source: the Company's financial results summary

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In FY7/16, sales increased for the fifth consecutive fiscal year, but profits declined

(2) FY7/16 financial results highlights

In the FY7/16 results, sales increased 5.3% y-o-y to ¥29,898mn, operating profit declined 22.3% to ¥1,464mn, ordinary profit fell 28.3% to ¥1,296mn, and net income attributable to the owners of the parent decreased 53.9% to ¥516mn, so although sales increased for the fifth consecutive fiscal year, profits declined. These results can be said to be basically in line with the revised results forecasts (announced February 26, 2016) after excluding the effects of a special factor (the extraordinary loss).

Supported by the favorable ordering environment, sales from transactions with advertising agencies trended strongly, while sales from direct transactions with advertisers also grew significantly from the effects of consolidation (of FE and K&L), despite the delay to the acceptance period. Conversely, sales from Video-related Operations were down, due to a reduction in the scale of projects and other factors.

In terms of profits, in 1H the cost ratio rose from the impact of projects with low profit margins, and in addition, SG&A expenses increased significantly due to acquisitions and other factors, and as result, operating profits declined. The deterioration of profits in direct transactions with advertisers was particularly due to the slump in results at FE, and the operating profit margin fell to 4.9% (from 6.6% at the end of the previous fiscal year). The significant declines in ordinary profit and net income attributable to the owners of the parent were because of the effects of an exchange loss from the appreciation of the yen (non-operating expenses) and the recording of an allowance following the abolition of the retirement benefits system for directors (extraordinary loss).

Financially, total assets increased 1.9% compared to the end of the previous fiscal year to ¥14,873mn, and shareholders' equity rose 2.4% to ¥5,708mn. As a result, the equity ratio trended basically unchanged at 38.4% (compared to 38.2% at the end of the previous fiscal year). In addition, interest-bearing debt fell to ¥2,725mn (down ¥75mn from the end of the previous fiscal year) due to scheduled repayments, and there were no major changes to the stability of the financial base. However, ROE, which indicates capital efficiency, declined to 9.2% (from 21.6% at the end of the previous fiscal year) due to the deterioration in the profit margin, including because of the special factors (the recording of an exchange loss and expenses relating to directors' retirement benefits).

FY7/16 financial highlights

(¥mn)

	FY7/15 result		FY7/16 result		Change		FY7/16 revised forecast		Achievement rate
		Ratio		Ratio		Change rate		Ratio	
Sales	28,393		29,898		1,504	5.3%	30,000		99.7%
Transactions with advertising agencies	20,461	72.1%	20,984	70.2%	523	2.6%	-	-	-
Direct transactions with advertisers	6,444	22.7%	7,617	25.5%	1,172	18.2%	-	-	-
Video-related Operations	1,487	5.2%	1,295	4.3%	-191	-12.9%	-	-	-
Cost of sales	23,425	82.5%	24,835	83.1%	1,410	6.0%	-	-	-
SG&A expenses	3,084	10.9%	3,598	12.0%	513	16.7%	-	-	-
Operating profit	1,884	6.6%	1,464	4.9%	-419	-22.3%	1,500	5.0%	97.6%
Transactions with advertising agencies	3,340	16.3%	3,468	16.5%	127	3.8%	-	-	-
Direct transactions with advertisers	309	4.8%	147	1.9%	-161	-52.2%	-	-	-
Video-related Operations	151	10.2%	80	6.2%	-70	-46.6%	-	-	-
Adjustment	-1,777	-	-1,917	-	-140	-	-	-	-
Ordinary profit	1,806	6.4%	1,296	4.3%	-510	-28.3%	1,350	4.5%	96.0%
Net profit attributable to the owners of the parent	1,119	3.9%	516	1.7%	-603	-53.9%	720	2.4%	71.7%

	FY7/15 result	FY7/16 result	Change	
				Change rate
Total assets	14,590	14,873	283	1.9%
Shareholders' equity	5,572	5,708	136	2.4%
Equity ratio	38.2%	38.4%	0.2	-

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

Results in transactions with advertising agencies trended steadily, with sales increasing 2.6% y-o-y to ¥20,984mn and operating profit rising 3.8% to ¥3,468mn. Supported by the favorable ordering environment (including the growth of the advertising market and the development of an oligopoly in the industry), sales increased mainly from transactions with Dentsu Group and Hakuhodo Group. In terms of profits, there was a delay in their recording due to the impact of factors including the low profit margin projects in 1Q, but from 2Q onwards, the Company secured rising profits through strictly investigating and selecting projects and thoroughly establishing a system to manage profits, and as a result the profit margin improved compared to FY7/15. Total transactions with Dentsu Group and Hakuhodo Group, continued to grow steadily, reaching ¥17,641mn (up 7.9% y-o-y).

In direct transactions with advertisers, sales increased 18.2% y-o-y to ¥7,617mn, but operating profit decreased 52.2% to ¥147mn, for lower profits despite the higher sales. The consolidation of FE and K&L contributed to the increase in sales, while the slump in results at FE had an adverse impact on profits. 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. Accordingly, although results in direct transactions with advertisers were somewhat sluggish, this can be understood to be because of the slump in results at FE and the delay in recording profits for a large project.

In Video-related Operations, sales decreased 12.9% y-o-y to ¥1,295mn and operating profit fell 46.6% to ¥80mn. In addition to the reduction in the scale of orders for some anime production projects, sales fell because the number of orders for corporate video projects and concert video projects declined compared to the previous fiscal year. In addition, although profits fell compared to the previous fiscal year, in which there was a large-scale live music project with a high profit margin, in anime production, the work on a project with a low profit margin has been completed and the profit margin seems to be improving.

(3)Current fiscal year (FY12/16) results forecasts

In conjunction with the establishment of the new holding company, the Company has changed its fiscal period. Accordingly, as the current fiscal year will have an irregular fiscal period of 5 months, from August 1 to December 31, at the current time it has not determined its results forecasts (it is expected to announce them promptly at the stage when an announcement becomes possible).

The order balance at the end of the FY7/16 had accumulated steadily and reached ¥7,404mn (up 14.8% compared to the end of FY7/15), including the previously-described delayed portion in direct transactions with advertisers. In terms of profits also, the profit margin has been improving through the Company strictly investigating and selecting projects and thoroughly establishing a system to manage profits. Therefore at FISCO, at the very least we expect the results to surpass those in the same period in the previous fiscal year.

Future direction

High affinity between direct transactions with advertisers and video content marketing

The Company has not yet announced any specific details about its post-integration business strategy. But up to the current time, its growth strategy has been focused on 1) continuing to strengthen transactions with advertising agencies, 2) the dramatic expansion of direct transactions with advertisers, and 3) the new development of overseas operations, and no major changes are expected to these strategies. Rather, it is considered that in order to realize these directions, it will aim to speed up while increasing added value (competitiveness). In particularly, the affinity between the Company's strength, of direct transactions with advertisers, and AOI Pro.'s strength, of video content marketing, is high, so it is very likely that synergies will be generated from both companies utilizing each other's strength. In addition, there are no overlapping functions in their development of overseas operations, which is a priority of both companies, and they can be expected to aim to accelerate their Asia strategy by promoting the networking of both companies' bases.

At FISCO, we are focusing on the effects that the current management integration will have on a variety of aspects, including 1) the Company's positioning within the industry, and also its relations with 2) advertising agencies, 3) advertisers 4) sellers, and 5) (potential) business partners including overseas. In particular, in addition to competitiveness for 1), by improving negotiation power not only in 2), 3), 4), but also in 1), in the context of the progress of selection and concentration within the industry, it is considered that the Company might become a receptacle for projects and human resources. For 5) also, establishing a position as the industry leader and constructing an advanced business model can be expected to increase opportunities to capture new business. Whatever the case, we will be paying attention to its announcements on its specific business strategy (business plan) in the future.

Returns to shareholders

Decided on a dividend of ¥5 per share, the same as in FY7/15

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. While final profits were down in FY7/16, including due to special factors (such as the recording of an allowance on the abolition of the retirement benefits system for directors), the Company has still decided to pay a dividend of ¥5 per share, the same as in FY7/15 (for a dividend payout ratio of 60.4%).

At the current point in time, the Company has not disclosed results forecasts for FY12/16 because of the irregular fiscal period of 5 months due to the management integration, but it plans to pay a year-end dividend of ¥2 per share.

It has also not yet published a specific policy on returns to shareholders for after the management integration.

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