Voltage Inc.
3639 Tokyo Stock Exchange First Section

14-Dec.-16

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Announced the Three-Year Strategy. Aiming for results to leap forward in FY6/19, is embarking on drastic reforms to its business model

Voltage Inc. <3639> (hereafter, "the Company") is a supplier of mobile content. Based on its corporate philosophy of "Art & Business," it has established a new genre of story-based entertainment called "Drama Apps" that are different from both games and manga. It has narrowed down its content themes to "Drama on Love and Challenge" and has an overwhelming presence in the field of Romance Apps.

In July 2016, Mr. Yuzi Tsutani, the Company founder and Chairperson and CEO, returned to the Company as President, and the Three-Year Strategy, which is the plan to reform its business model, was formulated based on his leadership. The background to this would seem to be the Company's recognition that, despite having opened up a new frontier for Romance Apps and achieved rapid growth, it needed to reform its business model to escape from the period of stagnation it had experienced over the previous two years. Toward implementing the reforms, the Company had previously clarified the outline of the reforms in the June 2016 full fiscal year financial results announcement, and then in the current 1Q FY6/17 financial results announcement, its explanation took the form of rewording a series of stories about the Three-Year Strategy, including course corrections for implementing the reforms.

The starting point for the formulation of the Three-Year Strategy was the sense of crisis arising from the current situation, of a slowdown in the sales growth rate from the business model that had been the pillar of the Company, and also the forecast that it will decrease in the future. In terms of the changes to the business environment in the future, the Company envisages "fierce competition in the entertainment industry" and the "globalization of competition" So within a rapidly changing external environment, even the Company, which up to the present time has achieved a high growth rate as a pioneer in the mobile contents market for females, is presently being required to transform its business.

The entry point to the Three-Year Strategy was the decision to rearrange the business segments and to reconstruct the organization. The number of business segments was changed from the former two to three, and their management methods are also to be separated into forms appropriate for each. The organization will promote growth in the form of multiple autonomous organizational units, focused on the next generation of leaders. For this, it is expected that improvements to the production process and operational efficiency will be progressed at the same time as the development of leaders.

With regard to the names of the business segments, below, based on the names to be adopted from FY6/17, "core model (existing development)" shall be written as "existing development" and "core model (new development)" as "new development," while "new model" remains unchanged as "new model."

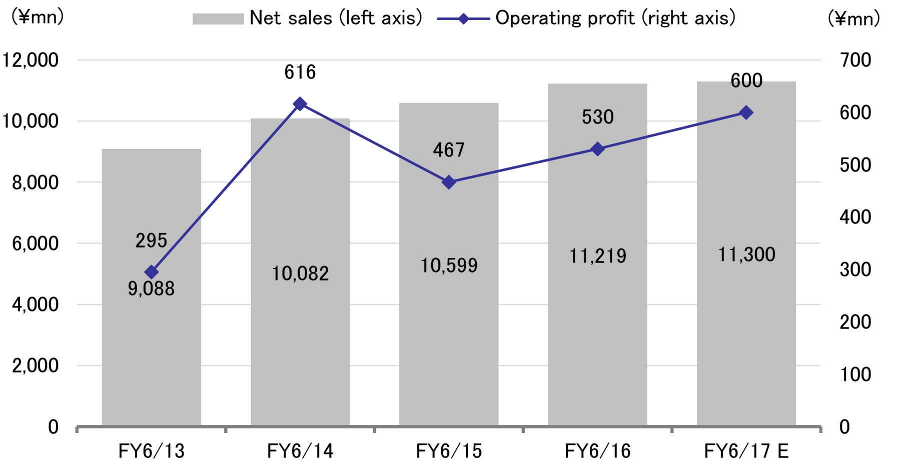
Also, in the current financial results announcement, the Company described the specific business policies for "new development" and "new model," and also for "new location," which is a new business area. For the product series for the "new development" and "new model" business segments that the Company intends to generate profits, while keeping the previous keywords of "minimum" and "little by little," it clarified its approach for policies to create the mechanism to generate profits in the future. Furthermore, in the business area that it has named "new location," the Company presented a direction to search for businesses in completely different fields than in the past, including to develop contents utilizing high-tech technologies like Virtual Reality (VR), and for the real business, in which its content assets will be deployed in real venues, such as for stage.

In the Three-Year Strategy, the Company will spend the next two years on the sweeping reforms of its business model, aiming to make a leap forward in its FY6/19 results. At FISCO, we evaluate the following three points of the Three-Year Strategy as effective and for which effects can be expected; 1) the various measures are consistent and they are logically connected, 2) the measures are strongly focused on "profits" (not sales), and 3) the reforms extend not just to organizational restructuring and business-process improvements, but to the entire Company, including to the personnel evaluation system.

Check Point

- The entry point to the Three-Year Strategy was the decision to rearrange the business segments and restructure the organization
- It is implementing measures to generate profits from “new development” and “new model” and seeking business possibilities in “new location”
- It will not prioritize only earnings in FY6/17, but also advancing the business restructuring

Results trends

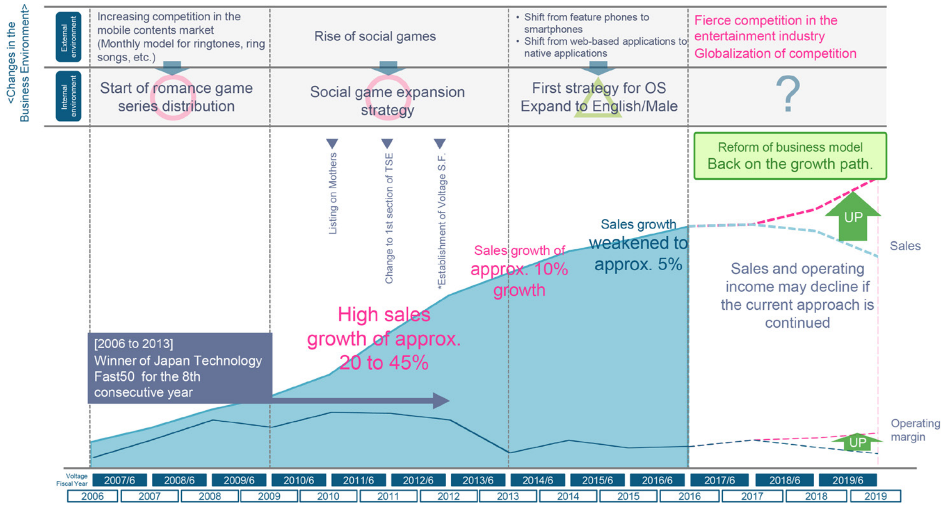


Source: Prepared by FISCO from Company materials

Announcement of the Three-Year Strategy, the plan to reform the business model

Reform of business model in line with changes to the environment. Back on the growth path.

(1) Review of results and the background to the formulation of the Three-Year Strategy



Source: 1Q FY6/17 financial results briefing materials

As explained above, since its foundation the Company has steadily achieved growth, but during this period environmental changes have occurred that have weeded-out many mobile content manufacturers. Specifically, these changes include the rise of social games and that the main device has changed from the feature phone to the smartphone. In particular, the appearance and rapid spread of the smartphone has caused the distribution platforms (PF) to shift from social-only PF to OS-based PF (App Store and Google Play), and in addition, it has accelerated the transition from app-type Web applications to native applications.

In the three year period up to FY6/16, the Company has been progressing content for smartphones based on its slogan of “OS-based First.” For a mobile contents supplier like the Company, the impact of changes to the delivery PF and app technologies are enormous, and there have been quite a few suppliers that have been unable to respond to the wave of changes and have been weeded-out of the industry. Yet even in such a situation, although its growth rate has slowed, the Company has still been able to somehow respond to the environmental changes and has continuously achieved higher sales.

Conversely in terms of profits, a situation has continued in which it has been unable to set a new high for profits since they peaked in FY6/12. Also, on the point of the extent to which it has achieved its initial forecasts, in FY6/14 the results exceeded the target, but in the two fiscal years after that, of FY6/15 and FY6/16, the results were below the initial forecasts. The reason why the Company’s profit growth has stagnated in the last few years is that it has found hits harder to come by in its Japanese-version Romance Apps, and that in this situation, the Suspense Apps and English-version Romance Apps business, which are expected to become the next generation sources of growth, have made sluggish starts.

Mr. Yuzi Tsutani, who returned to the Company as President in July 2016, reached the conclusion that the cause of the slow starts of the new businesses in terms of generating profits could be traced back to the timing of the public offering. In June 2010, the Company was listed on the Tokyo Stock Exchange (TSE) Mothers market, and then one year later, its listing was reassigned to the TSE First Section. The timings of these listings were during a period in which the new market of Romance Apps was rapidly expanding, which for the Company as the leader of this market, created a situation in which “if it released a romance app, it would sell well.” Based on this success experiences, it had applied the same production and sales methods to its new businesses of English-version Romance Apps and Suspense Apps, which Chairman Tsutani analyzed to be the biggest reason why these new businesses have not taken off. Moreover, he also concluded that the cause of their slow starts was the Company’s lack of expertise in developing and launching these businesses and that it lacked human resources with the experience of launching new businesses.

Reviewing the business segments and aiming for organizational restructuring toward a further leap forward in FY6/19

(2) Overview of the Three-Year Strategy

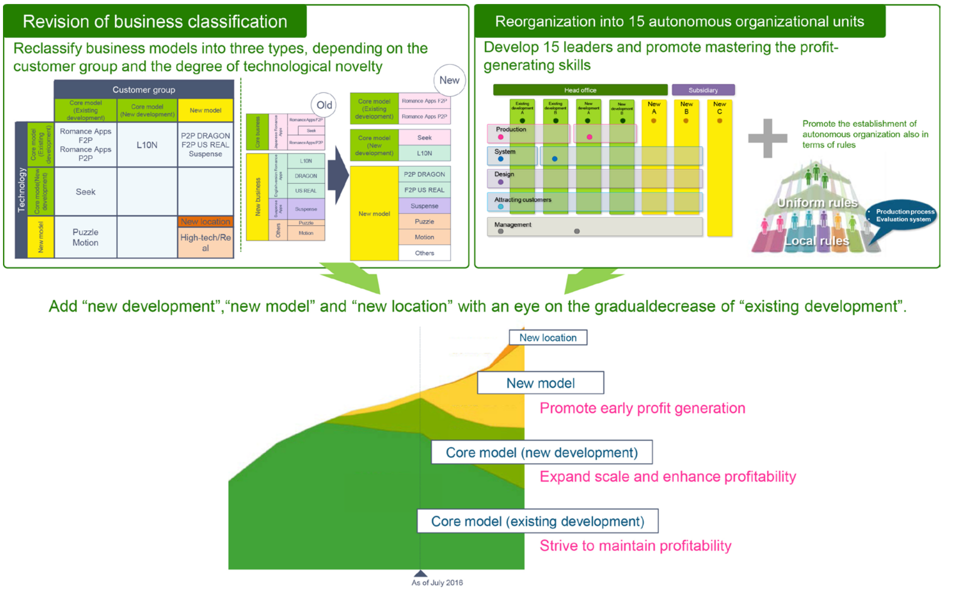
What President Tsutani was first aiming for was to rearrange the businesses, which up to that time had been categorized by target market, and also to develop leaders to be responsible for the next-generation businesses. Until recently, the Company had two business segments, which it has rearranged into three segments according to customer group and the degree of technological novelty. It resolved on various measures, such as to address the fact that the organization had become rigid and for the segmentation of product development, and took the decision to create 15 autonomous organizational units and to develop 15 employees to serve as the heads of these units as the leaders of the next-generation businesses.

Based on the leadership of President Tsutani, the Company formulated the Three-Year Strategy, the plan to reform the business model, as the entry point to realize these aims. This strategy covers a wide area, including product development and the methods of managing these developments, the approaches for the teams and organizational units that will implement these methods, the internal key performance indicators (KPI), and the personnel evaluation system. The Three-Year Strategy name is derived from the fact that the 2 year period of FY6/17 and FY6/18 will be used to steadily achieve structural reforms, and that in the third year of FY6/19, the aim is to achieve a leap forward in results in a form that can be clearly seen.

The Three-Year Strategy covers a wide range of areas, and so the Company first outlined the strategy in the FY6/16 full fiscal year financial results announcement, and then following that in the 1Q FY6/17 financial results, it announced an image of the reforms as a whole and also details of the reforms relating to the “new development” and “new model” segments. Furthermore, it is expected to continue to explain any course corrections and additional items in its financial results announcements from 2Q onwards.

(3) Details of the Entry Point to the Three-Year Strategy

While there are specific measures for each business that directly affect the recovery of profitability and growth potential, the Company still needs to takes steps for that part that will serve as the foundation of these measures in order that they may function efficiently. Also, if this foundation part is not properly created, then its essential strength as an organization will not be realized. The reforms of this foundation part in the Three-Year Strategy correspond to two reforms; the rearrangement of the business segments and the restructuring of the organization into 15 autonomous organizational units.

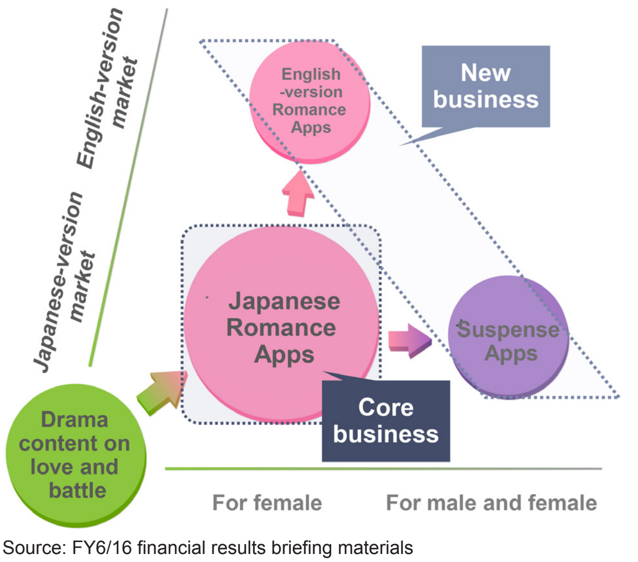


Source: 1Q FY6/17 financial results briefing materials

a) Rearranging the business segments

Up until recently, the Company kept the markets in mind as the targets and developed its business in a two-segment system, of Japanese-version Romance Apps as the “core business” and English-version Romance Apps and Suspense Apps as the “new business.” This reflects its adoption of a strategy in which, after establishing Romance Apps as the source of earnings in the “Japanese-version market for females,” in order to expand the market it selected the “English-version market” and the “market for males” as the new targets, and aimed to develop for each of these respective targets with English-version Romance Apps and Suspense Apps, respectively.

Previous market expansion image for Voltage



Source: FY6/16 financial results briefing materials

In contrast to this, in the Three-Year Strategy the business model has been reformed into three models depending on the customer group (horizontal axis) and the degree of technological novelty (vertical exist) of the “core model (existing development),” the “core model (new development)” and the “new model,” with each being allocated into nine cells in a matrix. Looking at the customer group, we see that as a result of rearranging the business segments, positioned in the “new model” is mixture of titles, of US REAL and DRAGON titles that target the “English-version and females” groups, and Suspense titles that targets the “Japanese-version and males” groups. But conversely, although targeting the same groups of “English-version and females,” L10N, which is closer to generating profits, is positioned in “new development.”

In technological terms, Romance Apps, which previously have been the mainstay product, have been positioned in “existing development”, while romance drama titles like “Doubt – Who is the Liar” (hereafter, “Doubt”) which includes investigative and judgment elements, have been made independent as a new series known as Seek and categorized in “new development.” Also, Puzzle Action Games like “LOVE☆Scramble” and titles such as Motion which is scheduled to be launched in the future, have been categorized in “new model.” In addition, in the 1Q FY6/17 financial results announcement, the cell with the highest level of novelty was filled with the new business areas of “high-tech” and “real” that belong to “new location.”

At first glance, these changes to the business segments do not appear to be very significant and seem to be nothing more than a confirmation of the current situation and changes to the wording, but this is absolutely not the case. The new business segments comprised of nine cells can be said to condense various elements, – such as the Company’s recognition of the current situation for its markets and each of its products, its outlook and direction for the future, and its business strategy – into a single reform. Starting with the structural reforms described below, all of the Company’s Three-Year Strategy is based on these business segments. In other words, understanding the changes to the business segments is the first step toward analyzing and understanding the Company in the future.

With regard to the business segments, it is considered that the nine-cell framework itself does not change under the Three-Year Strategy, but that the contents of each cell are expected to change. Indeed, at FISCO we think that they must be changed. In this sense, each of the businesses in the “new model” cell are expected to generate profits at an early stage and be moved to the “new development” cell, and therefore new businesses and product series will have to be added to the “new model” cell.

b) Restructuring the organization into 15 autonomous organizational units

For the organization also, the Company presented its restructuring of the organization into 15 autonomous organizational units according to the previous described business segments, operations processes, and functions (including production, design, and attracting customers). Its policy is to launch new products and services and strengthen the generation of earnings through optimizing the management of these organizational units. The number 15 has two meanings; it is the number extracted from the needs for business and product classifications, operations processes, and functions, and it is also the number of leaders that the Company considers it requires in order to realize sustainable growth in the future. The 15 leaders will manage teams of from 10 to a maximum of 100 people. The Company, which has many young employees (the average age of its employees is in the late twenties), expects its employees to acquire work skills through their experiences of launching businesses.

What is required of each autonomous organizational unit is to set and establish the optimum “local rules” for each business segment. The opposing concept to local rules are “Uniform rules.” As previously stated, from the public offering up until FY6/12, which is when the Company recorded its record-high profits, was a period when in actual terms, the Japanese-version Romance Apps was the only source of earnings, and at the same time, when this business achieved remarkable growth. At that time, the Company used an approach of conducting the series of tasks, including production, launch, management, and publicity, in accordance with its “Uniform rules.” But presently, based on its analysis of the past, it has concluded that the reason for its recent stagnation is that it has continued to adopt unchanged unified rules for its new products and new businesses. Therefore, in the Three-Year Strategy, while retaining the unified rules for those parts of its business that still need them, it requires that the 15 autonomous organizational units establish local rules that are to be applied in light of the content of their respective businesses. “The word “autonomous” is derived from this point.

At FISCO, we evaluate the organizational restructuring into 15 autonomous organizational units to be an effective policy that conceals great possibilities. The establishment of the previously mentioned local rules will be the most fundamental part of the launches of new businesses and products, and it is an extremely important point in terms of profit and loss management. Therefore, the significance of clarifying this point is great. But on the other hand, it is a fact that the establishment of local rules is an extremely difficult task (for precisely this reason, it can be said that up to the present time the Company has relied on unified rules). Each of the leaders of the 15 autonomous organizational units will be tasked with setting and establishing the local rules, and at FISCO we think this will lead to them accumulating practical experience that will facilitate their development as leaders, and therefore we will be paying close attention to the Company's organizational reforms.

Also, based on this approach, the figure shows what the Company thinks about the growth potential of the businesses in the future. With regards to "existing development" that is currently the source of earnings, it is clearly extremely interesting that it is anticipating negative growth. It seems likely that the answers to the question of why the Company considers this to be the fate of "existing development" in the future and what steps it will take in response will be clarified when it updates the Three-Year Strategy in the future. "New development" and "new model" are the two business segments for which it has the greatest expectations to become the next generation sources of earnings. The growth from both is expected to compensate for the negative growth in "existing development" and to grow the Company as a whole. As is explained below, here are the reasons why the specific measures for both have been presented first.

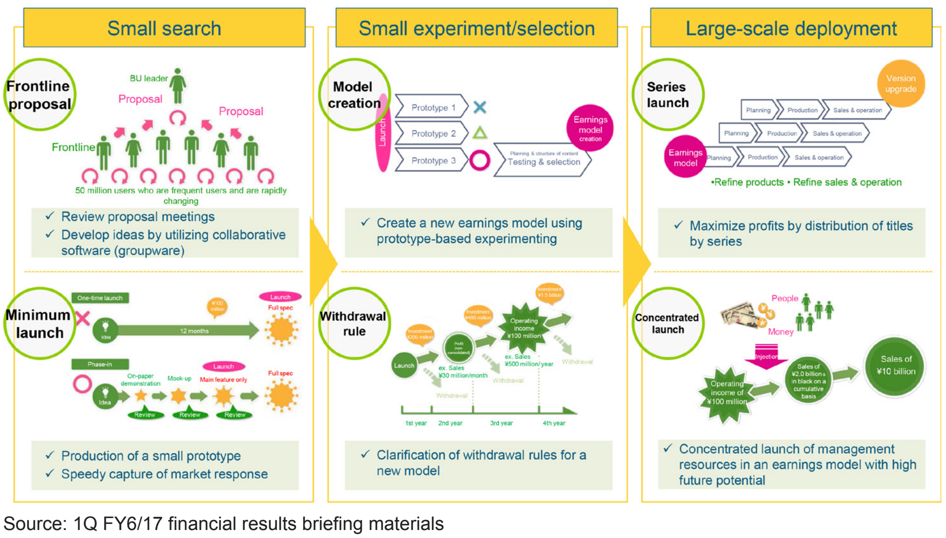
Creating a mechanism to generate profits from "new development" and "new model"

(4) The specific measures to strengthen "new development" and "new model"

In the 1Q FY6/17 financial results announcement, the Company described the specific measures to strengthen "new development" and "new model." The current situation in "new development" is that there are two corresponding products; L10N, which is a Japanese-version Romance Apps that is being translated unchanged for the North American market, and Seek, which, based on the specifications of "Doubt," adds investigative and judgment elements to the story. These titles have months in which they are profitable on a single-month basis and have been positioned as the titles that will be generate profits the soonest.

"New model" includes DRAGON that the Company has been working on for the last few years, the US REAL series for the North American market, and Suspense intended for males in Japan. In addition, it includes the Puzzle Action Games that was newly launched in Q4 FY6/16, and Motion, which is scheduled to be launched in the future. Compared to "new development," it will still take some time before these titles are generating profits.

A point shared by both "new development" and "new model" would seem to be the delay in them generating profits due to the Company adopting the same methods as it did for "existing development," in which the success pattern for the way of conducting the business was established. Therefore, the Company has considered up to the point of the final generation of profits, adopted a policy of "small search" and "small experiment/selection," and based on the keywords of "large-scale deployment," is thoroughly implementing an approach to business management that keeps down risk.



Source: 1Q FY6/17 financial results briefing materials

Specifically, in "small search," up to the present time it has not been unusual for the initial production costs for the launch of new contents to be close to ¥100mn. Instead, first this amount is kept down and the contents launched onto the market, and then they are updated and improved while observing the responses of users. In other words, the style has been changed so that instead of producing and launching a product with a score of 90 out of a possible 100, it is launched on the level of around 50 to 60 points, and then improved up to 90 points by observing the responses to it. "Small experiment/selection" means judging the business potential of prototypes produced for small amounts, and from within them, selecting and developing those that will become profit models. It also indicates that at the development stage, thorough rules will be clearly set, and that the businesses will be developed and managed while keeping down risks that would cause losses to swell unnecessarily. This approach does not stop only at production, and the Company intends to thoroughly apply it to all of the series of processes, including advertising and publicity. Finally, "large-scale deployment" aims to maximize profits by developing the series of profit models created up to the present time, and in addition, through the concentrated investment of the management resources of money and people into models that will be highly profitable in the future, advancing the generation of earnings at a single stroke.

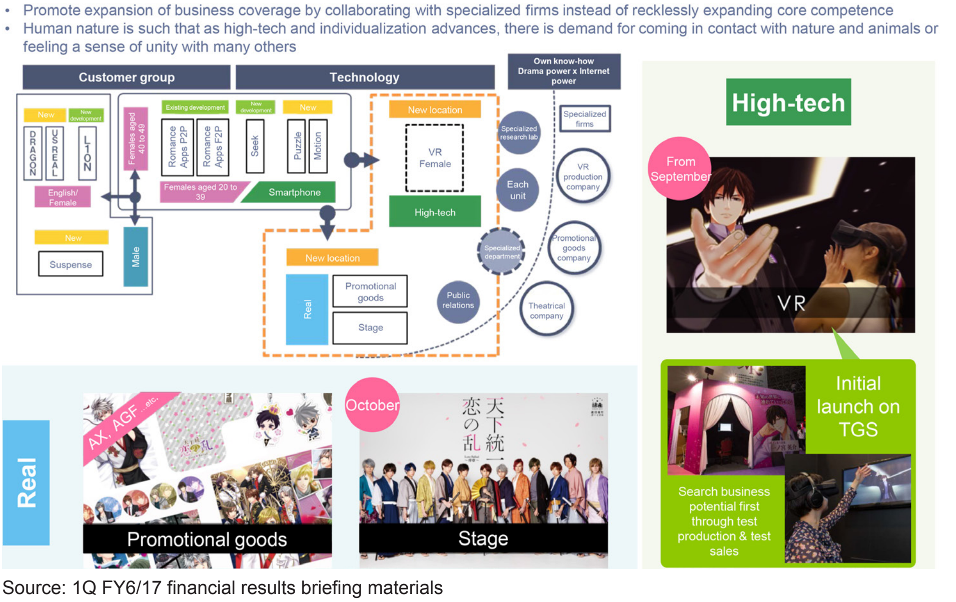
At FISCO, we expect the measures for "new development" and "new model" to be extremely effective. One reason we think this is that we highly evaluate the fact that these measures have been precisely matched to the analysis of the causes of past failures. In addition, a second reason is that the Company is conducting the organizational reforms as previously explained, of further segmenting the business segments and establishing 15 autonomous organizational units, as the mechanisms that will serve as the basis for implementing these measures. We think the greater the reform, the more consistent the layers need to be. For these reasons, we are optimistic about the reforms that will be carried out in the Three-Year Strategy in the future.

In order to take on this difficult challenge, the Company may feel it is moving in the direction of risk on the point that it must develop its human resources at the same time is implementing the reforms. But at FISCO, we think that a young enterprise like the Company must at some point invest in (or bear the risk of) developing its human resources, and for precisely this reason, we evaluate as effective its business-promotion measures based on the concepts of "minimum" and "Phase-in," which assumes a trial-and-error approach up to the point that profits are generated.

Embarking on business development defined as a "new location"

(5) Specific measures to search for potential businesses in "new location"

As a new topic in the 1Q FY6/17 financial results announcement, the Company defined "new location" as a new business area and explained that it had begun measures to search for potential businesses in this area.



Source: 1Q FY6/17 financial results briefing materials

In addition to the previously described three segments, the Company has defined a new business area it calls "new location." In the Company's business-segment matrix, this area corresponds to the "new model" from both the aspects of customer group and technologies. In terms of its specific business content, it is aiming to generate profits from two areas; a business to advance into fields fusing high-tech technologies, including VR, and a real business, of using the company's drama apps in real venues, such as for stage. Within the Company, the former is called "high-tech" and the latter "real."

The Company made a fully fledged start on the "new location" businesses of "high-tech" and "real" in FY6/17. The details are as yet unclear, but in "high-tech," it has already attracted attention for the VR contents using its own titles that it exhibited for the first time at the Tokyo Game Show in September 2016. In "real" also, it has been searching for and considering several business developments, and already some of its contents have been used in a stage performance in October 2016. For goods sales also, it exhibited at Anime Expo 2016, an overseas event in July 2016, and in Japan, in November 2016, at the Anime Girls Festival 2016. With regard to these fields, the Company, instead of attempting to recklessly expand the core competence that it currently possesses, is aiming to broaden its business scope by collaborating with specialized companies, and its plans to create prototypes and conduct test marketing toward exploring the possibilities for the business itself.

At FISO, we think that while it will take a little more time and information before the "new location" business can be evaluated in detail and incorporated into the results forecasts, it constitutes one important part of the Three-Year Strategy and that its contribution to profits can be expected to be materialized in FY6/19, the final year of the strategy. The concepts of "minimum" and "Phase-in" in "new development" and "new model" can be replaced with the keywords of "test production" and "test-sales" in "high-tech." This reduces the risk while verifying the business potential, and also incorporates the awareness of the objective of "try it out first (at low cost) and accumulate expertise." While the Company has clarified its attitude of "taking the necessary risks" for new business development, within the situation in which it is strengthening its awareness of internal income-and-expenditure management, our evaluation at FISCO is that its attitude of taking risk is greater than its anxiety about doing so.

In the real business, we are paying attention to the point that it is expected to be based on collaborations with other companies. The Company's hit title "Tenka Toitsu Koi no Ran - Love Ballad" was performed on stage by the Bancho Boys theater company (performed October 13 to 16, 2016). As this symbolizes, the Company's drama app contents are appealing to be developed over a wide range of areas, including for stage. There is also the possibility of unexpected hits being created by its partners, so will be paying attention to developments in this area in the future.

Strengthening internal income-and-expenditure management

(6) "Time profit" and strengthening income-and-expenditure management

From the interview conducted by FISCO, we understand that the Company is taking steps to strengthen internal income-and-expenditure management in relation to the Three-Year Strategy. The concept of "time profit" has been introduced as the core aspect of this. Previously, it prioritized increasing sales and its awareness of profits was low. To say this in an easy to understand way, in some cases it would spend more than 10 to achieve 10 sales. This particularly occurred in existing development in which higher sales leads directly to profits, so to a certain extent it was tolerated.

To correct this point, the Company is requiring that all employees act with a clear awareness of the input costs, the anticipated sales, and the resulting operating profit. At the same time, it is seeking that employees change their awareness about ways of working and of using time, aiming to reduce working hours and to improve efficiency compared to the past. The concept of "time profit" was created from this approach, and the Company's policy is to strengthen income-and-expenditure management with this as the slogan.

In order to make this policy effective, the Company is also reforming its personnel system and personnel evaluation system. For the personnel system, it has created a mechanism to allocate employees to levels of seniority, functions, and positions, and to enable them to be appointed to managerial positions within the Company once they reach a certain level of seniority. For the personnel evaluation system, there has been a major change of course, from evaluations based on sales to evaluations based on profits. Our understanding at FISCO is that the combination of these two changes is essentially a transition to a personnel system that prioritizes abilities, and it can be expected to support the Company's recovery of profitability and growth potential.

FISCO

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Aiming to achieve both the optimization of the approach to targets and expansion of scale

(7) The Goal of the Three-Year Strategy: the Evolution of the Group Structure

Source: 1Q FY6/17 financial results briefing materials

The Three-Year Strategy is still at the stage in which the overall picture is being clarified, and the form that the Company will take once the reforms to the business model have been completed remains uncertain. However, we will next briefly touch on the “Evolution of Group Structure” that the Company presented as one direction it will take in the FY6/16 full year financial results announcement, and in addition, the events that seem likely to occur as part of this.

The Company plans to “Evolve of Group Structure” prior to reforming the organizational structure, developing leaders, creating businesses, and producing a framework for generating profits. The explanation for this is that it is “Aiming to achieve both the optimization of the approach to targets and expansion of scale by establishing several strategic subsidiaries for different target groups and contents expertise.” That is to say, it has conceived a business structure that will be easier to steer by segmenting the organization according to business segment and product series.

In terms of the development to support this, in July 2016 the Company established Volmo, Inc, as a strategic subsidiary responsible for producing motion-type contents. In addition, in November 2016, it inherited the business relating to the puzzle action game “LOVE☆Scramble” through a company split, and it established Volsta, Inc., to be responsible for the production of collecting-and-nurturing-type contents for females.

At FISCO, we cannot judge at the current point in time whether group management by a holding company is optimal for the Company. But we feel that there is a strong sense of awareness among the management team of a standalone profitability system for each business and product series or autonomous organizational unit. There is no doubt that this is one of the most essential tasks for the Company. The “Evolution of Group structure” needs to be closely related to the 15 autonomous organizational units’ ways of working, and we think that changes to the organization structure in the future will be an important point that we will need to pay attention to.

Business results trends

Sales fell in 1Q FY6/17 due to a decline in “existing development,” but the loss was lessened by cost reductions

(1) 1Q FY6/17 results

In the 1Q FY6/17 results, net sales were ¥2,469mn (down 11.2% YoY), the operating loss was ¥51mn (compared to an operating loss of ¥75mn in the same period in the previous fiscal year), the recurring loss was ¥62mn (recurring loss of ¥83mn), and the net loss attributable to the owners of the parent company was ¥57mn (net loss of ¥75mn).

Net sales declined YoY due to the impact of sales in “existing development,” which is the source of earnings, falling 25.5% to ¥1,752mn. Sales increased in both “new development” and “new model,” but not enough to compensate for the decline in “existing development.”

In terms of profits, based on Three-Year Strategy that began from this fiscal period, the Company worked to minimize costs and succeeded in reducing the loss from each profit item, including the operating loss, compared to in the same period in the previous fiscal year. By cost item, advertising costs were reduced by 54.0% YoY, which contributed greatly to the overall reduction in costs.

Breakdown of net sales and operating profit by business segment (management-accounting basis)

(Unit: ¥mn)

		FY6/16	FY6/17	
		Q1 results	Q1 results	YoY
Net sales	Core model (existing development)	2,351	1,752	-25.5%
	Core model (new development)	414	530	27.9%
	New model	16	187	1051.3%
	Total	2,782	2,469	-11.2%
Operating profit	Core model (existing development)	188	204	8.5%
	Core model (new development)	-122	-125	-
	New model	-141	-130	-
	Total	-75	-51	-

Source: Prepared by FISCO from the 1Q FY6/17 financial results briefing materials

The background to the decline in sales in “existing development” includes that in “F2P,” although it introduced in this Q1 new horizontal measures to replace the horizontal measures terminated in Q4 FY6/16, they were not picked-up as far as the anticipated line. Another factor behind the decrease was that in “P2P” also, sales from titles that the Company has stopped updating declined to an extent greater than expected. Conversely, operating profit increased YoY due to factors including costs, such as for TV commercials, being kept down.

In “new development,” “Doubt” maintained its strong performance, which absorbed the slump in some of the L10N titles and ensured an increase in sales YoY. The operating loss was due to an increase in costs, including for TV commercials for “Doubt,” and this loss was basically the same as in the same period in the previous fiscal year.

In “new model,” sales increased significantly YoY due to the higher sales from “Suspense” and also the accumulation of sales from “LOVE☆Scramble,” a Puzzle Action Games launched in Q4 FY6/16. In profits, the operating loss was about the same as in the same period in the previous fiscal year because of the higher costs associated with the launch of “LOVE☆Scramble.”

Will not actively pursue higher earnings in FY6/17 and instead will advance the business-model reforms

(2) Outlook for the FY6/17 full year

For FY6/17, the Company is forecasting net sales of ¥11,300mn (up 0.7% YoY), operating profit of ¥600mn (up 13.0%), recurring profit of ¥600mn (up 22.9%), and net profit attributable to the owners of the parent company of ¥340mn (up 61.6%).

The Company is formulating and executing its business strategy in accordance with the new business segments from FY6/17. The outlook by business segment from 1Q FY6/17 and beyond is as follows.

In FY6/17, "existing development" will correspond to "F2P" and "P2P" Japanese-version Romance Apps, and currently it is the source of earnings for the Company. "F2P" is distributed on the OS-based PF and the social-only PF, and "P2P" is distributed on the OS-based PF and official carrier PF, but earnings from both are mainly from the OS-based PF. In terms of the steps taken to increase earnings, the Company's policy for "F2P" is to aim to improve ARPPU through the horizontal dissemination of successful measures and to prepare for the next IP titles, and for P2P, to enhance ARPPU and strengthen the customer-attracting model through implementing new events.

In FY6/17, "new development" corresponds to Seek and L10N, both of which are close to generating profits. The Company is aiming to serialize Seek by utilizing "Doubt" to produce new titles, while it intends to maximize sales by improving L10N based on existing titles and launching "Liar!" (title in Japan, "Doubt") in October 2017.

"New model," is a series group with a different target group and production technologies to "core model," and in FY6/17 it will correspond to the English-version Romance Apps DRAGON and US REAL, and also "Suspense," "Puzzle Action Game," and "Motion". For the time being, the Company is aiming to generate profits at an early stage through various measures, while continuing in a situation of spending on upfront costs.

Important tasks from Q2 FY6/17 onwards

Classification		Important tasks
Core model (Existing development)	Romance Apps F2P	Improve ARPPU through dissemination of successful measures to other BUs and prepare next IP titles
	Romance Apps P2P	Enhance ARPPU and strengthen customer-attracting model through implementation of new events
Core model (New development)	Seek	Develop new titles and introduce the series through improvement of "Doubt"
	L10N	Make partial improvement of existing title base and maximize sales of "Liar!"
New model	P2P DRAGON	Further attract customers through the AmeMix series
	F2P US REAL	Strengthen the operation of "Curses" events and consider the introduction of its series
	Suspense	Implement improvement measures by "Roppongi" user segment
	Puzzle	Expand MAU through reinforcing promotional activities
	Motion	Start with minimum launch

Source: 1Q FY6/17 financial results briefing materials

FISCO

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First Section

14-Dec.-16

In FY6/17, the outlook is for a situation of spending on upfront costs in the two business segments of “new development” and “new model”. As “existing development” will continue to remain the source of earnings in a one-pillar earnings structure, the net sales growth rate will be 0.7%. For profits, the Company is aiming to keep down costs by thoroughly implementing “small search” and “small experiment/selection” described in the Three-Year Strategy, and it expects to maintain the increase in profits YoY, if only a small one.

FY6/17 is the first fiscal year of the Three-Year Strategy and it will be difficult for the Company to prioritize increasing earnings during this period of various reforms. It will simultaneously carry out major reforms since its foundation in a number of areas, including organizational reforms, developing leaders, reforms to the ways of conducting businesses, and moreover changes to the personnel evaluation system. This may have an adverse impact in terms of improving results, but the Company itself anticipated this point from the time it formulated the strategy. Therefore at FISCO, we think that rather than focusing on the results’ numerical values, the important point for FY6/17 is the progress made in reforming the business model.

Simplified Income Statement & Major Management Indicators

(Unit: ¥mn)

	FY6/14	FY6/15	FY6/16	1Q FY6/17	FY6/17 E
Net sales	10,082	10,599	11,219	2,469	11,300
YoY	10.9%	5.1%	5.8%	-11.2%	0.7%
Gross profit	6,699	6,697	6,855	1,431	-
Gross margin	66.4%	63.2%	61.1%	57.9%	-
SG&A cost	6,083	6,229	6,324	1,482	-
SG&A ratio	60.3%	58.8%	56.4%	60.0%	-
Operating profit	616	467	530	-51	600
YoY	108.7%	-24.2%	13.6%	-	13.0%
Operating profit margin	6.1%	4.4%	4.7%	-2.1%	5.3%
Recurring profit	646	485	488	-62	600
YoY	88.1%	-24.9%	0.6%	-	22.9%
Net profit attributable to owners of the parent company	291	232	210	-57	340
YoY	107.0%	-20.3%	-9.5%	-	61.6%
EPS (¥)	57.37	45.31	40.66	-11.27	66.61
Dividend (¥)	19.00	15.00	15.00	-	未定
BPS (¥)	701.00	731.67	744.49	-	-

Simplified Balance Sheet

(Unit: ¥mn)

	FY6/14	FY6/15	FY6/16	1Q FY6/17
Current assets	4,123	3,687	3,705	3,464
Cash and deposits	2,201	1,820	2,237	2,060
Accounts receivable	1,836	1,722	1,290	1,197
Other current assets	85	144	177	205
Fixed assets	908	1,311	1,199	1,203
Tangible fixed assets	241	343	209	223
Intangible fixed assets	364	555	473	463
Investments and other fixed assets	302	412	516	516
Total Assets	5,031	4,999	4,905	4,667
Current liabilities	1,445	1,209	1,037	1,038
Accounts payable	155	194	188	207
Other current liabilities	1,289	1,015	848	830
Fixed liabilities	-	-	-	-
Shareholders' equity	3,545	3,707	3,868	3.633
Capital	908	922	936	936
Capital surplus	874	887	901	901
Retained earnings	1,762	1,897	2,031	1,895
Accumulated other comprehensive income	17	63	0	0
Existing share options	23	18	-	-
Total Net Assets	3,586	3,789	3,868	3.629
Total Net Assets & Liabilities	5,031	4,999	4,905	4.667

Statements of Cash Flow

(Unit: ¥mn)

	FY6/14	FY6/15	FY6/16
Cash flow from operating activities	894	424	920
Cash flow from investment activities	-414	-763	-372
Cash flow from financing activities	-74	-90	-69
Cash and deposits translation adjustment, etc.	11	48	-61
Change in cash and deposits	417	-380	417
Cash and deposits at start of fiscal year	1,783	2,201	1,820
Cash and deposits at end of fiscal year	2,201	1,820	2,237

Distribution of profits

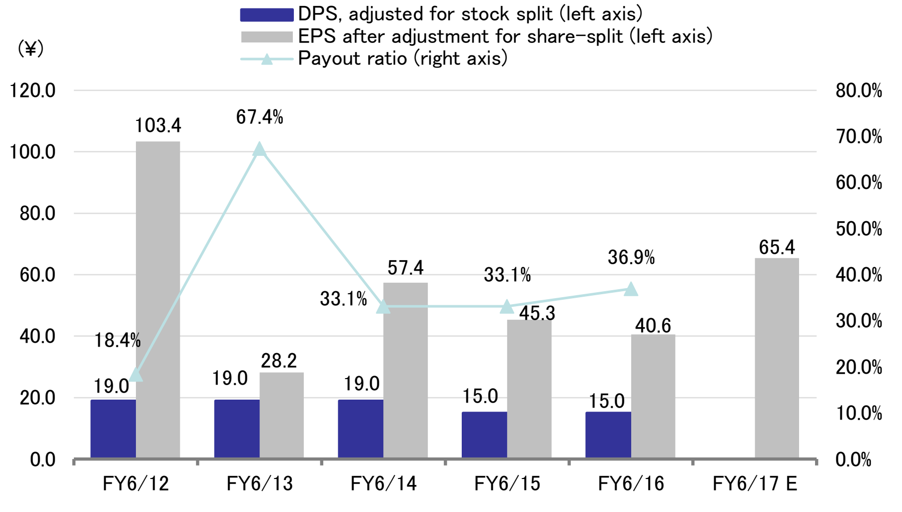
In addition to dividends from surplus, the Company acquires treasury stock

(1) Dividends from surplus

The Company's basic dividend policy is to aim to achieve a balance between securing sufficient internal reserves to develop its businesses in the future and to strengthen its financial position, while also returning profits to shareholders

The Company paid a dividend of ¥15 in FY6/16, the same as in the previous fiscal year. As net profit attributable to the owners of the parent company declined 9.5% YoY, the dividend payout ratio increased from 33.1% in the previous fiscal year to 36.9%. At this initial stage, the Company has not yet determined the dividend for FY6/17, and going forward it is expected to determine it in accordance with the above-described basic policy, while also taking into consideration progress made in results and other factors.

Trends in earnings per share, dividends and dividend payout ratio



Source: Prepared by FISCO from the Company's FY6/16 financial results summary

(2) Acquisition of treasury stock

The Company acquired treasury stock from August 19 to 26, 2016. Its reasons for doing so are considered to be to improve capital efficiency, to return profits to shareholders, and also to facilitate a capital policy that is able to respond flexibly to changes to the business environment.

Status of acquisition of treasury stock

Type of stock acquired	The Company's common stock
Total number of shares acquired	91,300 shares
Total price of shares acquired	¥99,942,800
Period	August 19 to 26, 2016 (contract base)
Acquisition method	Purchased on the market based on a discretionary investment contract concluded with a securities company

Source: Prepared by FISCO based on the Company press release of August 26, 2016

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