

# **KADOKAWA DWANGO CORPORATION**

**9468**

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## Summary

### From February, the focus will be on the response to niconico (crescendo)

KADOKAWA DWANGO CORPORATION <9468> (hereafter, also “the Company”) was formed in October 2014 from the merger of major publishing house KADOKAWA CORPORATION and DWANGO Co., Ltd., which manages one of Japan’s largest video community services, niconico. The Company is a comprehensive media provider that develops a wide range of businesses, including books; e-books and e-magazines; magazines and advertisements; motion picture planning, production, and distribution; video community services; mobile content distribution; game software planning, development, and sales; online learning services; and the operation of vocational schools.

#### 1. FY3/18 1H results were basically as planned

In the FY3/18 1H consolidated results, revenue increased 1.7% year on year (YoY) to ¥101,473mn and operating income declined 35.3% to ¥2,858mn, for higher sales but lower profits. Revenue declined in the Web Services business due to the fall in the number of fee-paying members in the portal and mobile businesses, but this was covered by the increases in the Publication, Video and Game, and Others businesses. Despite the double-digit increase in profits in the Video and Game business, operating income declined mainly because of the fall in revenue in the Web Services business and the increases in upfront investment for the new version of niconico (crescendo) and for new businesses in the Publication business, including for the manufacturing and distribution plant scheduled to become fully operational in April 2020. The Company did not disclose forecasts for 1H, but it would appear that the results were basically as planned in all of its business segments.

#### 2. Forecasts are for revenue to increase and profits to decrease in FY3/18 due to upfront investment

For the FY3/18 full-year consolidated forecasts, the initial Company forecasts of revenue to increase 3.1% to ¥212,000mn and operating income to decrease 31.1% to ¥5,800mn have been left unchanged. The reasons for this decrease forecast are strategic upfront investment of ¥1,700mn, including for investment relating to niconico (crescendo) and for the start of operations of the book manufacturing and distribution base in the Publication business, and a decrease of ¥900mn in existing businesses, such as because the effects on the Publication business and Video and Game business from the movie “Your Name” have run their course and a fall in revenue from music distribution services in the Web Services business. However, since the timing for the start of the niconico (crescendo) service was postponed to February 28, 2018, from its initial planned start in October, operating results in the Web Services business are expected fall below initial forecasts. The content of the niconico (crescendo) service, which was the subject of much attention, was announced by the Company on November 28. The Company will launch a new service, “nicocas,” as a third interface to follow niconico Douga video community and niconico Live. “nicocas” realizes an interface that integrates video, live broadcast, bidirectional communication, and image synthesis. Based on live user broadcasting, it features rich new functions to enhance its bidirectionality and collaborative capability. By enabling more active communication between the live broadcast distributor and the viewers, the interface enables fun, engaging programs. Furthermore, the interface offers greater convenience such as allowing users to view on smartphones without logging on niconico for the first time. The Company is enhancing content and functions that are enjoyable for smartphone users and thereby aiming to expand the number of fee-paying members, particularly teenage users. It is also aiming for regrowth of its Web Services business by increasing revenue from pay-as-you-go fees and other fees. The number of fee-paying members peaked in September 2016 at 2.56 million people and had fallen to 2.28 million people at the end of September 2017, and the Company’s current target is to reach 2.56 million people again.

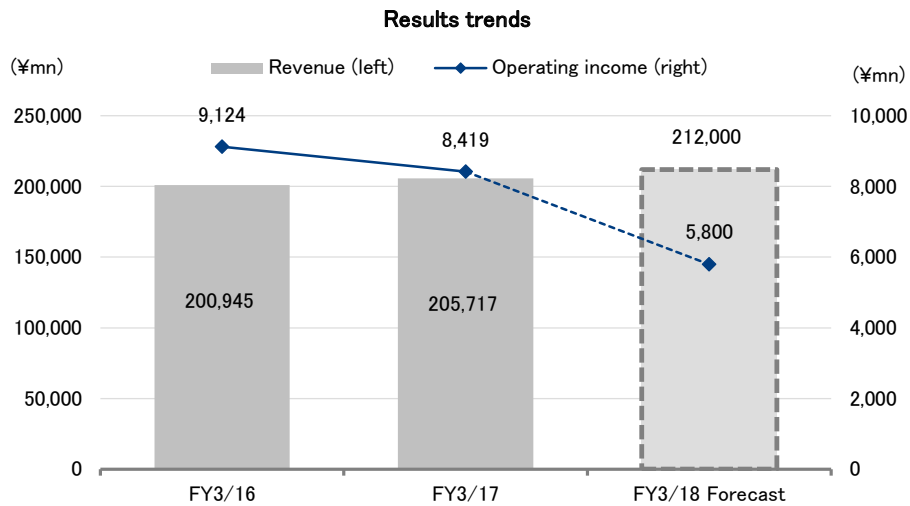
Summary

**3. Profitability is expected to improve from the media-mix strategy and the introduction of a new book manufacturing and distribution system in the Publication business**

Going forward, the Company's policy is to grow its businesses by developing domestically and overseas a media-mix strategy that fuses the Internet and the real world. In the Web Services business, it is aiming for a recovery with niconico (crescendo), while in the Publication and Video and Game businesses, it is working to improve profitability and maximize profits from IP content through its media-mix strategy. Also, in the Publication business, it has started test operations of a new book manufacturing and distribution system that is able to respond to requests for small-lot production runs with short delivery times, and fully fledged operations will began at the Tokorozawa book manufacturing and distribution base that will be completed in the spring of 2020. Through the introduction of this system, the Company will be able to realize small-lot production runs tailored to demand at low costs, and it expects to improve profitability by reducing the product return rate. In addition, it is possible that the business scale will expand by developing this system as a solution service for other domestic and overseas publication companies. At FISCO, we think that as a result of the current stage of upfront investment, it will steadily achieve growth in the medium to long term from these measures it is progressing.

**Key Points**

- Strengths are in maximizing earnings through accumulating expertise in developing IP in multimedia formats
- The initial forecasts for FY3/18 results have been left unchanged, while the focus will be on niconico (crescendo), which is New service from February 2018
- Pursuing expansion and growth in the medium term through promoting its media-mix strategy



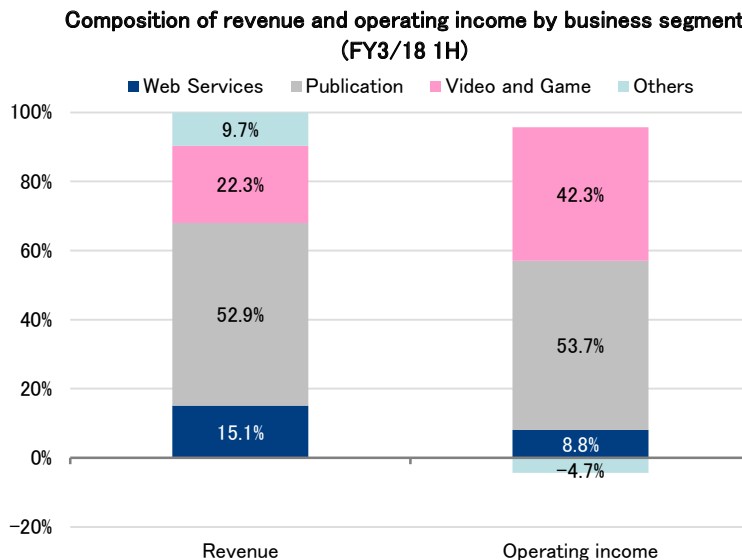
Source: Prepared by FISCO from the Company's financial results

## Business overview

### Focusing on the Publication, Web Services, and Video and Game businesses

As of the end of September 2017, the Group was comprised of 48 consolidated subsidiaries, including KADOKAWA and DWANGO, that conduct business under the Company, which is the holding company, and 13 equity-method affiliates. The Group has three business segments, the Web Services business conducted by DWANGO, which mainly involves the provision of the niconico video service; the Publication business conducted by KADOKAWA for books, magazines, and other publications; and the Video and Game business for the planning, production, and distribution of movies and other broadcasting programs; package sales of DVDs and other goods; and also the development and sales of games. It also classifies operations in the Others business segment that includes product sales and the education business\*. In FY3/18 1H, the composition of total revenue by business segment was Web Services 15.1%, Publication 52.9%, Video and Game 22.3%, and Others 9.7%. The composition of operating income was Web Services 8.8%, Publication 53.7%, Video and Game 42.3%, while Others recorded a loss due to investment in education and preparation costs related to inbound businesses. Currently, the majority of both revenue and operating income is provided by the Publication business, but going forward, it is forecast that contribution from the Web Services business, which has high growth potential, will increase.

\* In order to clearly indicate the main business pillars in the Group, from FY3/17, the Company changed its reporting segments to Web Services (formerly Portal business, Live business, and Mobile business), Publication (Books and IP business and Information Media business), Video and Game (Video and IP business and Game business), and Others (Others business and some businesses in the Information Media business).



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

Business overview

**1. Web Services business**

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

The Company provides various services on its mainstay niconico website, including the niconico Douga video community, niconico Live, and niconico Channel. Sales include revenues from premium memberships that enable members to watch videos and live feeds comfortably, advertising revenues from website banners and so forth, and revenues from points used to watch pay-to-view videos. As of the end of September 2017, it had issued IDs to 68.32 million people (up 8.26 million YoY) and it had 2.28 million premium members (down 280,000). In Q2 (July-September) there were 9.10 million MAU (monthly active users) and 3.09 million DAU (daily active users). niconico Channel, which is a platform on which companies, organizations, and users can deliver video and live broadcasts, had a total of 8,244 channels, of which 1,233 were monthly fee channels, and the number of monthly fee-paying members had reached 640,000 people.

In businesses other than niconico, the Company plans and manages live events, such as niconico Chokaigi\*<sup>1</sup>, Game Party\*<sup>2</sup>, Animelo Summer Live, and niconico Choparty\*<sup>3</sup>. It also operates the live music venue nicofarre, a new entertainment format that realizes a fusion of the Internet and the real world, and the niconico Honsha showroom\*<sup>4</sup>, which had its grand renewal opening in Ikebukuro, Tokyo, in October 2014, operating collaboration cafes for limited periods and live game events.

\*1 The largest niconico event held at Makuhari Messe with the concept of "recreating all of niconico onsite." All the participating users are "lead actors" in the various events that integrate the Internet and the real world. niconico Chokaigi 2017 was held on April 29-30, 2017, with 154,000 visitors to the venue and approximately 5 million online visitors.

\*2 Japan's largest "user participation" game event that features games from analogue to digital and old and new games from the East and West. It was held on February 11-12, 2017, at Makuhari Messe, had 68,000 site visitors and 4,126,000 online visitors, and is contributing to the expansion of the Japanese game market.

\*3 A large-scale stage event for niconico, which is one of the Japanese largest video service. It is niconico's largest live event where users active on niconico in various genres, such as "This is me singing" and "This is me dancing," and famous artists gather together and perform. It was held for the sixth time on November 3, 2017, at the Saitama Super Arena, and was attended by approximately 15,000 people.

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

The music distribution business remains a highly profitable business for the Company, despite member numbers trending downward due to market environment changes. This business operates [dwango.jp](http://dwango.jp), which distributes single songs, ring tones, and so forth, as well as animelo (songs from popular anime).

**2. Publication business**

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

The paper-based book business provides a strong foundation for developing related products through its media-mix strategy, and the Company is an industry leader in graphic novels. It has considerable experience in working to achieve appropriate production and shipping based on marketing, and the rate of product returns in FY3/18 1H was 32.8%, which was lower than the industry average of 39.4%.

## Business overview

At the same time, the Company sells e-books directly on BOOK☆WALKER, its own e-book distribution platform, and at external e-book stores, such as Amazon Kindle and Rakuten Kobo. It also conducts sales promotions, such as the niconico Kadokawa Festival\*.

\* It was first held in October 2014 to commemorate the management integration of KADOKAWA and DWANGO, and it has been held every fall since then. It conducts various promotions linking KADOKAWA's content and niconico's services.

Advertising revenue from magazines and mooks has continued to slump because mainstay advertisement media is changing from paper-based to digital, and the current profit environment is harsh. Therefore, to deal with this environment, the Company is currently streamlining its operations while actively pursuing digitization.

### 3. Video and Game business

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

In the game business, the Company's five consolidated subsidiaries, FromSoftware, Inc., Spike Chunsoft Co., Ltd., KADOKAWA GAMES, LTD., MAGES. Inc., and KADOKAWA CORPORATION carry out the planning, development, and sales of packaged game software, network games, and app games. Previous hit titles include "Dark Souls," "Bloodborne" (FromSoftware), "Kantai Collection," "Derby Stallion GOLD" (KADOKAWA GAMES), "Kenka Bancho," "Danganronpa," "Shiren the Wanderer" (Spike Chunsoft), and "STEINS;GATE" (MAGES.).

### 4. Others

The Others business comprises businesses such as e-commerce of character merchandise and pop idol CDs, copyright revenues and sales of CDs featuring content created from anime or niconico. It also includes an education business involving the operation of schools that provide training to work in creative fields inside and outside of Japan, and also online learning services at N High School, through which students can obtain qualification equivalent to a high school diploma online and other educational facilities.

## Results trends

### Revenue increased and profits decreased in FY3/18 1H, although results were in line with the Company forecasts

#### 1. Overview of the FY3/18 1H results

In the FY3/18 1H consolidated results, revenue increased 1.7% YoY to ¥101,473mn, operating income decreased 35.3% to ¥2,858mn, ordinary income declined 24.2% to ¥3,039mn, and profit attributable to owners of parent fell 42.1% to ¥1,749mn, for an increase in revenue but a decrease in profits.

## Results trends

**Overview of the FY3/18 1H consolidated results**

(¥mn)

	FY3/17		FY3/18		YoY	FY3/18		YoY	Progress rate
	1H results	% of revenue	1H results	% of revenue		Full-year forecast	% of revenue		
Revenue	99,795	-	101,473	-	1.7%	212,000	-	+3.1%	47.9%
Cost of sales	70,591	70.7%	73,480	72.4%	4.1%	-	-	-	-
Gross profit	29,203	29.3%	27,992	27.6%	-4.1%	-	-	-	-
SG&A expenses	24,783	24.8%	25,133	24.8%	1.4%	-	-	-	-
Operating income	4,419	4.4%	2,858	2.8%	-35.3%	5,800	2.7%	-31.1%	49.3%
Ordinary income	4,011	4.0%	3,039	3.0%	-24.2%	6,200	2.9%	-16.3%	49.0%
Profit attributable to owners of parent	3,020	3.0%	1,749	1.7%	-42.1%	3,500	1.7%	-39.3%	50.0%

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

**Results by business segment**

(¥mn)

	FY3/17 1H results		FY3/18 1H results		Change		FY3/18 full-year forecast		Progress rate	
	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income
Consolidated total	99,795	4,419	101,473	2,858	1.7%	-35.3%	212,000	5,800	47.9%	49.3%
Web Services	16,088	1,744	15,406	393	-4.2%	-77.4%	32,000	1,600	48.1%	24.6%
Publication	53,744	3,884	54,399	2,400	1.2%	-38.2%	114,400	6,100	47.6%	39.3%
Video and Game	21,555	1,311	23,071	1,889	7.0%	44.1%	46,500	3,700	49.6%	51.1%
Others	9,925	-587	10,140	-212	2.2%	-	22,300	-1,200	45.5%	-
Eliminations/Corporate	-1,517	-1,933	-1,544	-1,612	-	-	-3,200	-4,400	-	-

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

Revenue decreased in the Web Services business due to the declines in the number of fee-paying members in the portal and mobile businesses. But this was covered by the higher revenues in the Publication, Video and Game, and Others businesses, and as a whole, revenue increased 1.7% YoY. Despite the strong performance of the video business, operating income decreased, mainly due to the fall in revenue in the Web Services business and the increases in upfront investment for the new version of niconico (crescendo) and for new businesses in the Publication business. The Company did not disclose forecasts for 1H, but it appears that, on an operating income basis, the results were basically as planned in all of the business segments.

## Upfront investment increased in the Web Services and Publication businesses

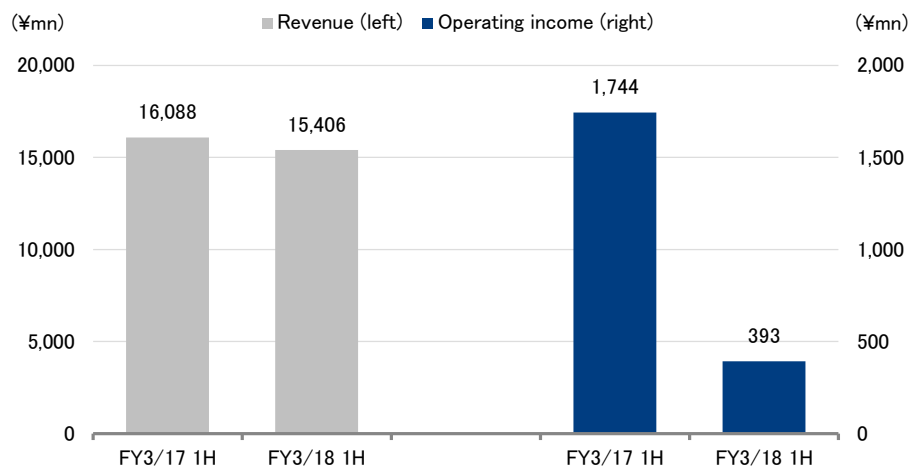
### 2. Trends by business segment

#### (1) Web Services business

In this business, revenue decreased 4.2% YoY to ¥15,406mn and operating income fell 77.4% to ¥393mn. Revenue increased in the live business, but decreased in the portal and mobile businesses due to the continuing decline in the number of fee-paying members. In profits also, in addition to the lower sales from the fall in the number of fee-paying members in the portal and mobile businesses, the main factor behind the lower operating income was that upfront investment increased YoY for the renewal of niconico and for its new version (crescendo). Profits fell by little more than ¥1.3bn, which seems to be mainly from the decline in profits in the portal business, which recorded a loss.



## Results trends

**Web Services business revenue and operating income**


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

Looking at the number of fee-paying members in the portal business at the end of FY/18 Q2, there were 2.28 million premium members (down 280,000 people YoY), and the downward trend continued. But the number of fee-paying registered members of niconico Channel steadily increased to 640,000 people (up 80,000 people).

The Company positions the live business as an advertising and publicity tool for the portal business, so fundamentally it is not viewed as a business to generate profits. But in FY3/18 1H, revenue in this business increased from the merchandise sales of a live broadcasting game group and the sales of “#Compass – Combat Providence Analysis System –,” which is an app game from a joint project with NHN PlayArt Corp., and the size of the loss shrunk YoY. There were a record number of visitors, 154,000 people, to niconico Chokaigi 2017 in April, while 81,000 people attended Animelo Summer Live 2017 –THE CARD–, which is the world's largest live anime song event, over three days in August. These events were favorably received with all the tickets sold-out, which confirms that there continues to be strong demand for entertainment that fuses the Internet and the real world.

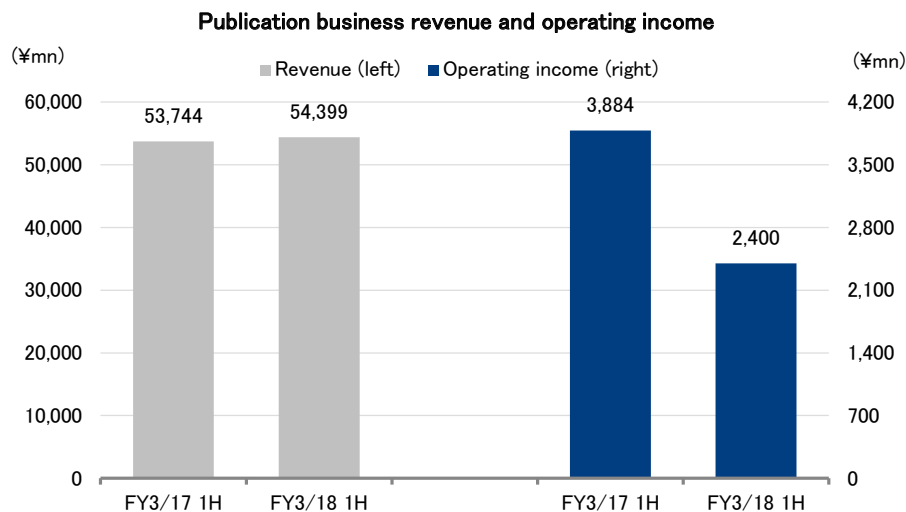
In the mobile business, the number of members of the dwango.jp music distribution service continued to decrease, and once again revenue and profits declined by double digits YoY. However, sales steadily increased of dwango.jp for Sugotoku, which was launched in June 2017 for Sugotoku Contents®, which is managed by NTT DOCOMO, INC. <9437>.

**(2) Publication business**

In this business, revenue increased 1.2% YoY to ¥54,399mn, but operating income decreased 38.2% to ¥2,400mn. Revenue grew because the decline in sales of books and magazines was covered by the strong performances of e-books and e-magazines. Operating income decreased mainly because there were few major hits compared to the same period of the previous fiscal year, and also due to the little more than ¥1bn increase in upfront investment for new businesses in the Publication business, including for the book manufacturing and distribution plant.

Results trends

For books, a framework in which they do not rely on small number of major hits and profits steadily increase from the continuous production of hits is being established. Specifically, an organization that smoothly coordinates sales and production has been established and sales conditions at bookstores are being ascertained in real time, which is making manufacturing and shipping based on highly precise demand forecasts possible. As a result, the product return rate is improving. For e-books and e-magazines, revenue and profit exceeded the forecasts for d magazine, which is an all-you-can-read magazine service managed by NTT DOCOMO. Also, for BOOK☆WALKER, sales were strong for graphic novels as well as comics and other publications in the e-book stores managed by other companies. The percentage of total book and magazine sales provided by e-books and e-magazines has increased to slightly less than 30%. In the context of the paper-based magazine market, the Company is ending or suspending publication of unprofitable magazines, and at the same time, investing in order to convert its business to online media.



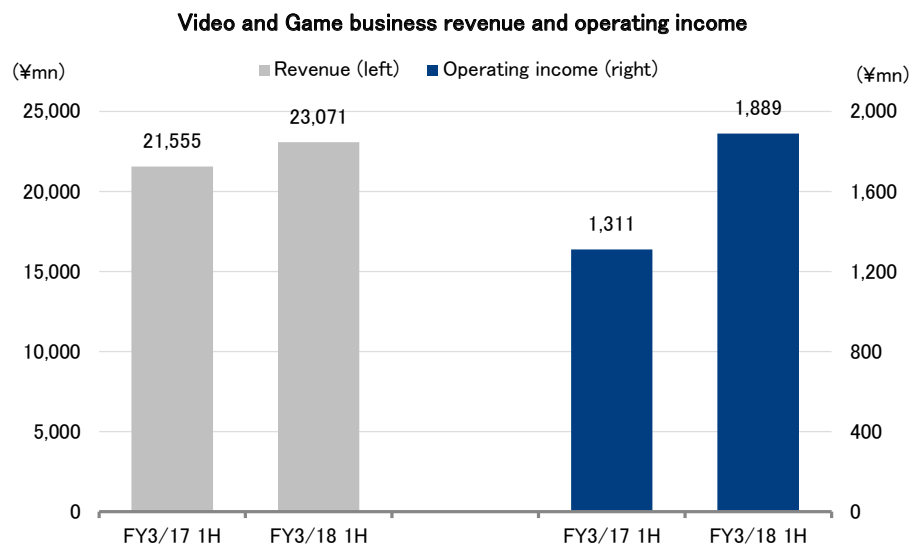
Source: Prepared by FISCO from the Company's results briefing materials

**(3) Video and Game business**

In this business, revenue increased 7.0% YoY to ¥23,071mn and operating income grew 44.1% to ¥1,889mn. Revenue grew because in addition to the strong performance of app games, results were driven by multiple anime works, including the theatrical releases of “No Game No Life Zero” and “Fate/kaleid liner Prisma☆Illya: Oath Under Snow,” revenue from overseas copyrights for “Akashic Records of Bastard Magic Instructor” and “Made in Abyss,” and package sales of “KonoSuba: God’s Blessing on This Wonderful World!,” “Kantai Collection KanColle,” and “Saga of Tanya the Evil.” In addition, online movie ticket sales trended favorably.

Operating income increased because, in addition to the effects of the higher sales in the video business, the strong performance of anime media-mix works contributed to the rise in the profit margin. It was also because of the progress made in improving profits in the studio business, which had worsened due to the high production costs in the same period in the previous fiscal year. While the video business provided the majority of the increase in profits in this business, the strong results in the game business from app games also contributed to the higher profits.

## Results trends



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

#### (4) Others

In the Others business, revenue increased 2.2% YoY to ¥10,140mn and operating loss was ¥212mn (compared to a loss of ¥587mn in the same period in the previous fiscal year). Revenue trended strongly including from e-commerce sales of character products and pop idol CDs, and from the sales and copyright usage fees from content created from anime and niconico. Revenue from the management of schools to train human resources who will be active in the creative field also trended stably.

In profits, the Company recorded business development, research, and other costs relating to inbound demand, which is expected to contribute to growth in the future. However, the extent of the loss was reduced due to the end of effects that occurred in the same period in the previous fiscal year, the inventory appraisal loss that was incurred for some trading card games.

## Within the total cost of the Tokorozawa project of ¥39.9bn, investment of ¥10bn is planned in FY3/18

### 3. Financial condition and management indicators

Looking at the financial condition at the end of FY3/18 Q2, total assets were down ¥6,882mn compared to the end of the previous fiscal period to ¥240,067mn. Breaking this down, current assets decreased ¥7,826mn and non-current assets rose ¥944mn. In current assets, cash and deposits fell ¥11,960mn, but within this amount, approximately ¥3,600mn was the effects of a lag in the deposit of funds because the last day of September was a holiday for banks. Notes and accounts receivable-trade increased ¥1,620mn. Also, in non-current assets, due to the increase in capital investment, tangible non-current assets rose ¥231mn, while intangible non-current assets and investments and other assets increased ¥195mn and ¥517mn, respectively.

## Results trends

Total liabilities were down ¥6,654mn compared to the end of the previous fiscal year to ¥128,570mn. Within this amount, current liabilities decreased ¥6,045mn. This was mainly due to decreases in notes and accounts payable-trade of ¥1,763mn, accounts payable-other of ¥1,676mn, advances received of ¥915mn, and provision for sales returns of ¥878mn. In non-current liabilities, long-term borrowing fell ¥1,121mn.

Net assets were down ¥228mn compared to the end of the previous fiscal year to ¥111,496mn. This was due to the increase in retained earnings of ¥1,750mn following the recording of profit attributable to owners of parent, and also a rise in accumulated other comprehensive income of ¥755mn, including from an increase in the market capitalization of shares held. Capital surplus decreased ¥1,489mn, mainly due to dividend payments, while the acquisition of treasury shares was also a decreasing factor of ¥1,326mn.

Looking at the cash flow conditions, at the end of FY3/18 Q2, cash and cash equivalents were down ¥15,236mn compared to the end of the previous fiscal year to ¥75,903mn. Cash flow used in operating activities was ¥5,119mn due to the decline in the accounts receivable recovered amount, which was because the final day of September was a holiday for banks, and also due to the decrease in notes and accounts payable. Cash flow used in investing activities was ¥6,074mn from the expenditure to acquire tangible non-current assets (¥1,805mn) and intangible non-current assets (¥1,094mn), and expenditure for time deposits (¥4,375mn). Cash flow used in financial activities was ¥4,003mn from the repayments of long-term loans payable (¥1,078mn), expenditure to acquire treasury shares (¥1,742mn), and dividend payments (¥1,391mn).

Looking at the management indicators, the equity ratio, which indicates financial soundness, rose from 44.5% at the end of the previous fiscal year to 45.7% from the decrease in interest-bearing debt, while the D/E ratio also improved somewhat compared to the end of the previous fiscal period, falling from 61.5% to 60.7%. Construction of the Tokorozawa Sakura Town (tentative name) (Tokorozawa Project) began in the previous fiscal year, and as the funds for the capital investment, the Company procured long-term borrowing of ¥40bn, which caused the equity ratio and D/E ratio to worsen. But the net cash (cash and deposits - interest-bearing debt) level at the end of September was ¥27,026mn, and it can be judged that the Company is sufficiently maintaining its financial soundness.

On a cash basis, the FY3/18 capital investment plan is for ¥14bn (of which, ¥10bn\* is for the Tokorozawa Project). Within this amount, up to the end of Q2, the Company had spent around ¥3.0bn, and it plans to spend the remaining around ¥11bn during 2H. So it is possible that at the end of FY3/18, the level of cash and deposits will be slightly lower than at the end of FY3/18 Q2.

\* The forecasted capital investment for the Tokorozawa Project is for approximately ¥1bn in FY3/19, around ¥10bn in FY3/20, and approximately ¥19bn in FY3/21.

## Results trends

**Consolidated balance sheet**

	FY3/15	FY3/16	FY3/17	FY3/18 1H	Change	Main factor
						(¥mn)
<b>Current assets</b>	131,200	131,827	174,880	167,054	-7,826	Cash and deposits -11,960, notes and accounts receivable +1,620, inventory assets +901
<b>(Cash and deposits)</b>	63,207	60,804	105,542	93,582	-11,960	
<b>Non-current assets</b>	74,473	69,781	72,068	73,012	+944	Tangible non-current assets +231, intangible non-current assets +195, investments and other assets +517
<b>Total assets</b>	205,673	201,609	246,949	240,067	-6,882	
<b>Current liabilities</b>	63,316	61,459	61,159	55,114	-6,045	Notes and accounts payable-trade -1,763, accounts payable-other -1,676, advances received -915, provision for sales returns -878
<b>Non-current liabilities</b>	38,108	35,623	74,065	73,456	-609	Long-term loans payable -1,121
<b>Total liabilities</b>	101,425	97,082	135,224	128,570	-6,654	
<b>(Interest-bearing debt)</b>	31,598	29,376	67,580	66,556	-1,024	
<b>Net assets</b>	104,248	104,526	111,724	111,496	-228	Retained earnings +1,750, capital surplus -1,489, treasury shares -1,326, accumulated other comprehensive income +755

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

**Cash flow statement**

	FY3/15	FY3/16	FY3/17	FY3/18 1H
				(¥mn)
<b>Cash flow from operating activities</b>	7,765	6,733	11,968	-5,119
<b>Cash flow from investing activities</b>	-9,049	-4,673	-10,394	-6,074
<b>Cash flow from financial activities</b>	24,385	-8,775	37,200	-4,003
<b>Cash and cash equivalents at end of period</b>	59,201	52,175	91,140	75,903

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

**Management indicators**

	FY3/15	FY3/16	FY3/17	FY3/18 1H
<b>&lt;Financial soundness&gt;</b>				
<b>Current ratio</b>	207.2%	214.5%	285.9%	303.1%
<b>Capital adequacy ratio</b>	50.2%	51.4%	44.5%	45.7%
<b>D/E ratio</b>	30.6%	28.3%	61.5%	60.7%
<b>&lt;Profitability&gt;</b>				
<b>ROE</b>	22.5%	6.6%	5.4%	
<b>ROA</b>	2.1%	5.0%	3.3%	
<b>Operating margin</b>	1.4%	4.5%	4.1%	

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

## Business outlook

### The initial forecasts for FY3/18 results have been left unchanged, while the focus will be on niconico (crescendo), which is new service from February 2018

#### 1. FY3/18 outlook

The initial forecasts for the FY3/18 consolidated results of revenue to increase 3.1% YoY to ¥212,000mn, operating income to decrease 31.1% to ¥5,800mn, ordinary income to decline 16.3% to ¥6,200mn, and profit attributable to the owners of parent to fall 39.3% to ¥3,500mn have been left unchanged. The progress made up to Q2 has basically been as planned, but the launch of the niconico (crescendo) service, which was initially scheduled to be launched in October, has been postponed to February 28, 2018, so it is forecast that the result will be below the full-year target of ¥1,600mn for the Web Services business.

The Company is forecasting that profits in existing businesses will decline ¥900mn following the end of the contribution to profits of the FY3/17 major hit movie "Your Name," and due to the business environment in the mobile business. It also expects strategic investment costs for growth in the future to increase ¥1,700mn. Main investments will be 1) the upfront costs relating to the launch of the book manufacturing and distribution base that is scheduled to become operational in the spring of 2020, including the cost of test production and distribution optimization, 2) the cost of developing new web services, and 3) investment in the inbound business. As planned, the amount of the strategic investment costs that will affect P/L are ¥4,600mn in FY3/17 and ¥6,300mn in FY3/18 (of which ¥3,000mn around in 1H). The same as in the previous period, results may be higher than forecast if hit titles appear among the books, videos, and games and exceed expectations.

#### FY3/18 consolidated outlook

	FY3/17			FY3/18			(¥mn)
	Results	% of revenue	YoY change	Company forecast	% of revenue	YoY change	
Revenue	205,717	-	2.4%	212,000	-	3.1%	
Operating income	8,419	4.1%	-7.7%	5,800	2.7%	-31.1%	
Ordinary income	7,407	3.6%	-27.3%	6,200	2.9%	-16.3%	
Profit attributable to owners of parent	5,767	2.8%	-15.8%	3,500	1.7%	-39.3%	
Earnings per share (¥)	85.03			51.60			

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

## By business segment, revenue and profit are forecast to increase in the Video and Game business

### 2. Outlook by business segment

#### Outlook by business segment

	FY3/17 results		FY3/18 forecast		YoY	
	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income
Consolidated total	205,717	8,419	212,000	5,800	3.1%	-31.1%
Web Services	31,275	2,815	32,000	1,600	2.3%	-43.2%
Publication	113,012	8,342	114,400	6,100	1.2%	-26.9%
Video and Game	44,402	3,312	46,500	3,700	4.7%	11.7%
Others	20,209	-1,635	22,300	-1,200	10.3%	-
Eliminations/Corporate	-3,182	-4,415	-3,200	-4,400	-	-

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

#### (1) Web Services business

In this business, revenue is forecast to increase 2.3% YoY to ¥32,000mn and operating income to decrease 43.2% to ¥1,600mn. However, since the timing for the start of the niconico (crescendo) service was pushed back to February 28, 2018, from its initial planned start in October, operating results in the Web Services business are expected fall below initial forecasts.

The content of the niconico (crescendo) service, which was the subject of much attention, was announced by the Company on November 28. The Company will launch a new service, "nicocas," as a third interface to follow niconico Douga video community and niconico Live. nicocas was developed by the Company using world-leading streaming technology to realize an interface that integrates video, live broadcast, bidirectional communication, and image synthesis. Based on live user broadcasting, it features rich new functions to enhance its bidirectionality and collaborative capability. By enabling more active communication between the live broadcast distributor and the viewers, the interface enables fun, engaging programs. Furthermore, the interface allows users to view on smartphones without logging on niconico for the first time, and offers various fun functions such as games that make use of bidirectionality functions (nicowari Game). By achieving convenience for smartphone users, which had been a weak point, and enhancing its functions, (crescendo) aims to expand its user base, mainly in the teenage segment, and "enhance IP creation opportunities and monetization through the provision of new leisure spaces." The impact of these efforts will attract interest going forward.

The target at the present time is to quickly recover the number of premium members, which had declined to 2.28 million people at the end of September 2017, to as high as the previous peak of 2.56 million people (at the end of September 2016). In the 1H results briefing, the Company showed its ambition by stating that there were no examples in the past among community services of a service recovering after it had peaked out, and if it achieved it, that this would be the first ever case. The aims for the launch of niconico (crescendo) include to enhance the content provided to smartphone users to play and enjoy and increase MAU/DAU by expanding user groups, to create new content (proper IP), to raise ARPU (average revenue per user) through the addition of a billing axis for fixed fee-paying members, and to grow revenue from pay-as-you-go fees.

## Business outlook

The new version of niconico (crescendo) was initially scheduled to be launched in October, but due to a delay in its development, the launch was postponed until February 28, 2018. Therefore, approximately four months' worth of the effects of its introduction have also been postponed, which will be a downside factor in the results. In terms of the investment-recovery period of (crescendo), it is estimated to be around three years, a general assumption for Internet services.

In the portal business, the number of fee-paying members is expected to recover from the launch of new services, and according to the Company forecast, revenue is set to increase YoY for the full fiscal year. However, the outlook is for the decline in profits to continue due to the increase in development costs, so profits are forecast to change direction and increase from FY3/19 at the earliest. It is necessary to be aware of the risk that if the number of fee-paying members does not recover even after the launch of the new services, the decline in profits will continue.

In the live business, the Company will continue to actively hold events, but just as in the previous fiscal year, revenue is expected to decrease slightly and this business will continue to record a loss. The outlook for the mobile business is for lower revenue and profits from the decline in the number of members of the music distribution service, which in FY3/18 will again account for more than half of the decline in profits in this business segment.

**(2) Publication business**

In this business, the forecasts are for revenue to increase 1.2% YoY to ¥114,400mn and for operating income to decrease 26.9% to ¥6,100mn. Revenue is expected to continue to grow for books, including e-books and e-magazines. However, in addition to the end of the positive effects from the hit book titles relating to "Your Name," the main factors behind the decline in profits will include the higher costs from test production for the launch of the book manufacturing and distribution base, system investment for the Kakuyomu platform, and strategic investment in Live TV, Magazine☆Walker and ComicWalker, which are businesses currently being developed.

It seems that steady progress is being made toward the start of operations at the book manufacturing and distribution plant. Currently, the Company has started the construction of the manufacturing system and test production. The features of this plant are that it will be capable of "short runs" in which it can flexibly respond to small-lot orders of only tens to thousands of items, and a print-on-demand production line that can produce orders from single items. A system is being established in which the original printing plate is managed on the cloud, and if there is stock in the online connected warehouse, the product is quickly loaded with other goods and shipped. Traditionally, in the supply chain in the publishing industry, it would take 7-10 days for the ordered product to be delivered to the store, but this new system greatly shortens the delivery time to just 24-48 hours. All of the functions, from the ordering system through to production and inventory management, are unified with IoT, and the product return rate is reduced through optimization of the production and delivery. Such system is unprecedented in the publishing industry and is expected to attract a lot of attention in the future.



## Business outlook

Already, the product return rates of some bookstores where demand trends are visible online have fallen by several points compared to previously, so the effects of this system have already been confirmed. The Company will start commercial production from FY3/19, and it is considered that the new Tokorozawa manufacturing base, which will become operational from the spring of 2020, will be able to handle the majority of the re-print production. So the Company is aiming to improve profitability by reducing the product return rate, which is currently in a range of 30-35%, to the 20% level. It is positioning the new system as an open platform for the publishing industry as a whole and is considering utilizing it for solution services (manufacture on assignment) for publication businesses in Japan and overseas. However, the new system will not replace the existing system for all publications, because for books that are expected to sell in large numbers from the beginning, costs will be lower on the conventional production line. Therefore, going forward, the production system that is optimal for the order volume will be used on a case-by-case basis, and the Company expects that the launch of the new system will not only improve profitability, but also expand the business scale through manufacture on assignment from 2020 onwards, which is when the new Tokorozawa manufacturing base becomes operational.

**(3) Video and Game business**

In this business, revenue is forecast to increase 4.7% YoY to ¥46,500mn and operating income to rise 11.7% to ¥3,700mn. In the video business, profits will decline with the end of the distribution of income from the movie “Your Name,” but sales of copyrights to overseas markets of popular anime, video content and other IP is expected to increase. Also, in 2H, there will be advanced screenings in China of the movie “Legend of the Demon Cat,” which is a joint Japan-China production. It is an ambitious work directed by a famous Chinese film director with total production costs of ¥15bn. Only the distribution income from China is scheduled to be recorded in the FY3/18 results, and following its official opening in Japan on February 24, 2018 (distributors: Toho/KADOKAWA), the domestic portion of income will be recorded during FY3/19.

In the game business, while there are no major titles scheduled, revenue and profits are still expected to increase from the higher sales of existing titles, and also as sales via Steam\* are trending strongly, particularly of the previously produced “Danganronpa” series.

\* Steam is a DRM (digital rights management) and download-sales platform for PC games managed by Valve Corporation. Regardless of whether domestically or overseas, it handles various PC games, apps, video titles, and other works. It is the world's largest PC game download content provider, and as of 2017, it provides more than 70,000 items of content.

**(4) Others**

In the Others business, revenue is forecast to increase 10.3% YoY to ¥22,300mn, while the operating loss will be ¥1,200mn (compared to a loss of ¥1,635mn in the previous fiscal year). Revenue is expected to increase from the strengthening of development and sales of character products utilizing content that the Company itself owns, while stable revenue is also expected from the education business. As of October 2017, N High School (KADOKAWA DWANGO educational corporation), which opened in April 2016, had a total of 4,313 students, an increase of about 2,300 students in a year. This school provides N Preparatory School, an original learning application, and system usage fees are recorded in the Company's consolidated results. The profit-loss breakeven point is considered to be a level of around 7,000-8,000 students, and it has targeted profitability in around 1-2 years' time. In profits, the effects of the increase in revenue and the absence of the loss in trading cards that were recorded in the previous fiscal year are expected to reduce the amount of the loss.

In the inbound business, which is being treated as a new business, the Company is aiming to increase profits by creating business opportunities, such as events utilizing KADOKAWA content and the sales of goods, and disseminating information on Japan, via information magazines and online. In terms of the state of the current measures, it collaborates with expressway bus company Willer, Inc., and working on the commercialization of travel experience services that are highly entertaining, mainly for inbound customers. In terms of specific results, it has commercialized so-called “anime pilgrimage tours” to the locations where anime are set through a collaboration with the Anime Tourism Association.

## Growth strategy

### Promoting medium-term growth through the media-mix strategy

#### 1. New medium-term vision

The Company announced its new medium-term vision at the same time it announced its FY3/17 results. Amid the expansion of the Internet age, its policy is to enlarge its businesses by developing a media-mix strategy that fuses the Internet and the real world. To achieve growth, it is aiming not only to fulfill its function as a catalyst for the creation of IP, but also to maximize value through multiplexing IP through its media-mix expertise. In addition, having interfaces of contact with users through various channels will provide it with opportunities to acquire revenue.

At the current time, the point to focus on is niconico (crescendo), which is the new version of niconico including services for smartphones that will be released in February 2018. The Company is aiming to grow revenue from niconico Douga once again by providing attractive services. Also, in the Publication business, test production toward the start of operations is making smooth progress at the book manufacturing and distribution base in Tokorozawa, which is expected to contribute to strengthened profitability after it becomes operational in 2020.

The Company did not announce medium- to long-term numerical targets in the new medium-term vision, but this is because of the difficulty in predicting at the current stage the extent of the impact of new web services, niconico (crescendo). So it decided that it was preferable not to announce targets that would be highly uncertain. At FISCO, we expect that current upfront investment will lead to steady growth in results in the medium to long term, even though earnings have slumped at the moment. The reasons why we think so are that 1) it is steadily generating revenue through promotion of its media-mix strategy and accumulating expertise while leveraging synergies in each business segment, 2) in the context of improving and stabilizing profitability from the one-company system, the Publication business will see profitability improve to the next level from the start of operations of the book manufacturing and distribution base from 2020, and 3) new growth potential from launching new web services can be expected.

Growth strategy

**Specific policies in the medium-term vision**

Web Services business
<ul style="list-style-type: none"> <li>· Launch services in the new version of niconico (crescendo)</li> </ul> <p>It has plans to include several state-of-the-art functions never before seen in streaming services anywhere in the world.</p>
<ul style="list-style-type: none"> <li>· Expand entertainment services</li> </ul> <p>It will increase user ARPU by providing high-value-added entertainment services utilizing AI, etc.</p>
<ul style="list-style-type: none"> <li>· Strengthen collaboration between platforms</li> </ul> <p>It will strengthen collaboration between niconico, BOOK☆WALKER, and ComicWalker.</p>
Publication business
<ul style="list-style-type: none"> <li>· Maintain 5,000 newly published titles</li> </ul> <p>As the source of IP creation, it will utilize its marketing capabilities to open up new genres and expand market share while maintaining the foundation of a diversified portfolio that includes literary books, graphic novels, practical lifestyle books, and comics.</p>
<ul style="list-style-type: none"> <li>· Build a new book manufacturing and distribution structure</li> </ul> <p>It is conducting test production and optimization of the production system and distribution base toward the start of operations at the new Tokorozawa plant.</p>
<ul style="list-style-type: none"> <li>· Full digitization of information magazines</li> </ul> <p>For the TV information magazine "The Television," it will create a database of talent information, and for regional information magazine "Walker," it will also continue to build a database to utilize the information and expertise it has accumulated for the inbound business. It will further enhance the online sales function of "Mainichi ga Hakken," a lifestyle information magazine.</p>
Video and Game business
<ul style="list-style-type: none"> <li>· Further strengthen the media-mix</li> </ul> <p>Taking advantage of its enhanced lineup, particularly in anime, it will strengthen the secondary development of merchandise (MD) sales and events, in addition to video distribution domestically and overseas. It will also advance joint production with overseas partners in the live-action area.</p>
<ul style="list-style-type: none"> <li>· Establish a strategy for the game business</li> </ul> <p>It will strengthen profitability from the creation of game content fully utilizing IP and aim to bolster the strategic development of game subsidiaries that possess individuality.</p>
Others business
<ul style="list-style-type: none"> <li>· It will strengthen profitability through integrated manufacturing and sales-type management, and will start systems integration of EC websites.</li> </ul> <p>It will enhance niconico's MD functions, which will result in the maximization of revenue.</p>
<ul style="list-style-type: none"> <li>· Link content and events</li> </ul> <p>It will accumulate management expertise in anime tourism that uses themes based on owned content and in Tokorozawa Sakura Town (tentative name), where it will hold its own events using owned content, to achieve profitability in the event business.</p>
Overseas business
<p>Utilizing its domestic strengths, it will expand revenue from license sales and sales at overseas bases while stimulating demand for visits to Japan and developing the inbound business.</p> <p>Revenue is currently ¥10bn and it is aiming to exceed ¥20bn by FY3/21.</p>

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

## Aiming for revenue of ¥20bn in the overseas business in FY3/21

### 2. Overseas business strategy

The Company's policy is to strengthen its overseas business as the value of Japanese content rises overseas. It is aiming to more than double overseas revenue, including license revenue, from less than ¥10bn in FY3/17 to approximately ¥20bn in FY3/21. In terms of current overseas sales, its overseas bases acquire revenue from books, goods, and other products, while it also obtains license revenue for publications and video content. In terms of the composition of total overseas sales in FY3/17, sales revenue from overseas bases provided approximately 50%, while the remainder was divided between license fees for publications and video content.

In particular, alongside the development of digital technologies in the last few years, inquiries about video content from overseas video distributors, such as Netflix, have become active, and the media-mix overseas is expanding. In the same way, opportunities to expand sales of game content are increasing thanks to the introduction of game content developed by the Group's subsidiaries on Steam.

Going forward, the Company's strategy is to expand the overseas business by utilizing the strength of the KADOKAWA brand and its abundance of IP, and constructing a production system from collaborations with local partners and alliances. In particular, there are expectations for expansion of the game business through collaboration with Tencent Holdings Limited, which is the largest provider of Internet services in China. In September 2016, Tencent implemented a capital participation for Guangzhou Tianwen Kadokawa Animation and Comics Co., Ltd., which is a joint venture between the Company and a state-owned Chinese company established in 2010 (Tencent acquired some of the shares of the joint-venture partner, for an ownership ratio of 41%). In the future, they will accelerate the development of manga and graphic novels on Tencent's digital distribution platform. They are also expected to collaborate on game content and the media-mix strategy, and we shall be paying attention to developments in the future.

## ■ Shareholder return policy

### **Considers returns to shareholders to be an important management issue and pays dividends in consideration of results in the fiscal period**

The Company considers it important to make sustainable distributions of profits to shareholders and other stakeholders while ensuring continuity of its business management by building up internal reserves to strengthen the corporate constitution and to prepare for future business development. In addition, it also recognizes that returning profits to shareholders is a key management priority, and takes into account the business performance of each period when deliberating on shareholder returns.

The Company plans to continue to pay a dividend of ¥20 per share in FY3/18, the same as in FY3/17 (for a dividend payout ratio of 38.8%). It has also introduced a shareholder reward system. Shareholders who hold 100 shares or more continuously for 1 year or more (shareholders listed at least 3 consecutive times in the shareholders' register) are given a gift of either 3 paperbacks, 3 comics, 2 separate volumes, 2 movie tickets, 3,000 e-book purchase points, 1 DVD or Blu-ray disc, or 1 niconico item. It has also introduced a system to reward long-term shareholders, those who have held shares for 3 years or more (shareholders listed at least 7 consecutive times in the shareholders' register), by offering an additional gift of either 2 paperbacks, 2 comics, 1 separate volume, 1 movie ticket, or 1,500 e-book purchase points.

## ■ Information security measures

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



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