KADOKAWA DWANGO CORPORATION

9468 Tokyo Stock Exchange First Section

17-Aug.-16

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In this fiscal year, active investment to launch new businesses and to change the categories of existing businesses

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 both a mega-content publisher and digital content platformer. It has a wide range of businesses, including books and e-books; magazines and advertising; motion picture planning, production, and distribution; video services; mobile content distribution; game software planning, development, and sales; and the operation of vocational schools.

The Company achieved positive consolidated results in FY3/16, of net sales of ¥200,945mn, operating income of ¥9,124mn, ordinary income of ¥10,189mn, and net income attributable to the owners of the parent company of ¥6,845mn. These results were driven by a higher than anticipated growth in e-books to constitute more than one fifth of the mainstay Books and IP Business, materialization of structural reforms and the integration of the paper book business companies under KADOKAWA CORPORATION in April of last year.

For FY3/17, the Company is targeting net sales of ¥200,000mn (down 0.5% year-on-year (y-o-y)), operating income of ¥3,100mn (down 66.0%), and net income attributable to the owners of the parent company of ¥1,750mn (down 74.4%), so while net sales are expected to remain basically unchanged, profits are set to fall significantly. This is because the Company has determined to invest in order to launch new businesses and to change the styles of existing businesses supported by recovery of profitability in the Books and IP Business and stabilization of its management foundation. The forecasts also incorporate the decline in profits in some existing businesses such as Game Business and Mobile Business.

Breaking down the specific investments, the Company will invest in the following seven areas: 1) renewing "niconico" (to comply with the shift to high image quality and to rebuild the infrastructure), 2) new services for smartphones, 3) conversion of the revenue model of magazine business, 4) an inbound business, 5) a game information portal, 6) learning services on the Internet, and 7) enhancing the UGC* posting website. Among these, "niconico" renewal and launch of new services for smartphones in the Web Services Business, conversion of revenue model of magazine business in the Publishing Business, and the investment in inbound business seem to make up a large proportion.

* Stands for "User Generated Content" and contents created in Consumer Generated Media. It corresponds to the content generated on the "Kakuyomu" novel posting website launched in February 2016.

Through implementing these investments, the Company has positioned FY3/17 as a year to actively and continuously invest in launching new businesses and in existing businesses which is the same as FY3/16 although the year was formerly announced as a year to develop new businesses in the Medium-term Management Plan (FY3/16 to FY3/18) in May 2015. Therefore, the targeted year to earn operating income of ¥18,000mn to ¥20,000mn has been postponed by one fiscal year, from FY3/18 to FY3/19.

At FISCO, we think that there is room for the expected results to exceed the targets, based on the fact that the Company's forecast of lower profits from its existing businesses is largely due to its conservative outlook. In addition, when considering that it succeeded in recovering the profitability of the Books and IP Business around one and a half years after the integration, we can expect further increase of the Company's profitability in the medium term by its implementation of the current round of active investments, strengthening the foundations of its existing businesses such as the Portal Business, the Information Media Business and launch of new businesses. Therefore, we will be paying attention to the progress made in these investments.

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KADOKAWA DWANGO CORPORATION

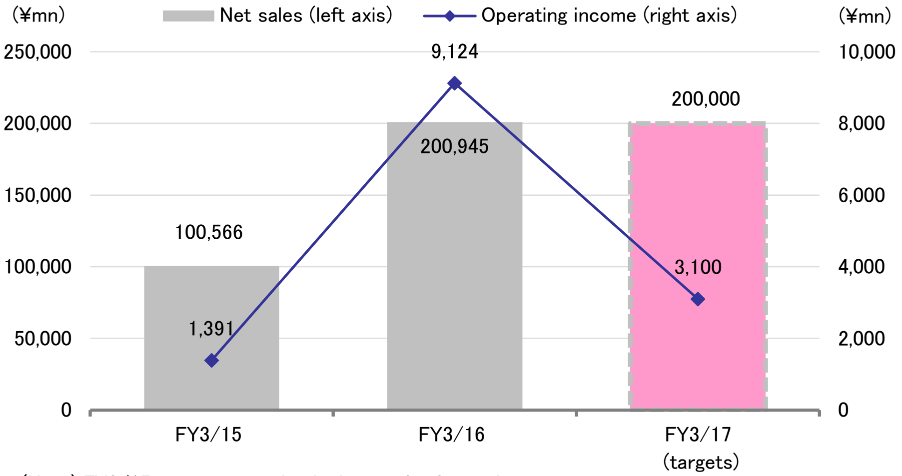
9468 Tokyo Stock Exchange First Section

17-Aug.-16

Check Point

- In FY3/16, the profitability of the mainstay Books and IP Business recovered and the management foundations were stabilized
- Direct and external sales of e-books were positive and this business grew in weight to constitute more than one fifth (22%) of the Books and IP Business sales
- FY3/17 will be a period of active investment to launch new businesses and to change the styles of existing businesses

Business Performance Trend



(Note) FY3/15 are provisional calculations for 6 months

Company Profile and History

Integration of a major publisher and a video community service operating company

(1) Company profile

KADOKAWA DWANGO is a joint holding company established on October 1, 2014, through a share transfer. The Company aims to create and grow new businesses in the fields of game information portals, e-books, and the education business through leveraging synergies with the major publisher KADOKAWA and DWANGO, which is the operator of the leading Japanese video service "niconico." The Company's strengths lie in its ability to create unique services, including editing capabilities honed in the fields of publishing and videos, expertise in developing unique content across multimedia formats to maximize earnings, the generation of original network services based on advanced networking technologies, and the integration of these services with real-world events. It has a wide range of businesses, including books and e-books; magazines and advertising; motion picture planning, production, and distribution; video services; mobile content distribution; game software planning, development, and sales; and operation of vocational schools.

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KADOKAWA DWANGO CORPORATION

9468 Tokyo Stock Exchange First Section

17-Aug.-16

* KADOKAWA is a combination of the Japanese sounds in names of the Group's constituent companies, KADOKAWA and DWANGO ("KA" from KADOKAWA, followed by "DO" from DWANGO, which is pronounced "Do-wan-go" in Japanese, followed by "KA" from KADOKAWA, and "WA" from DWANGO.)

(2) Company history

The history of the management integration goes back to October 2010, when KADOKAWA GROUP HOLDINGS, INC. and DWANGO Co., Ltd. formed a comprehensive business alliance for e-books and the distribution of various contents. In May 2011, the relationship progressed to a capital alliance, and in November 2011, they began providing the "KADOKAWA niconico A" service. The relationship between the two companies quickly became closer and they established an advertising joint venture, smiledge Co., Ltd. in March 2013 (liquidated in July 2015) and went as far as the integration in October 2014. On October 1, 2015, the Company name was changed to Kadokawa Kabushiki Kaisha* to emphasize management integration both internally and externally (but the English name remains KADOKAWA DWANGO CORPORATION).

History

	Event
October 2010	DWANGO and KADOKAWA GROUP HOLDINGS entered into a comprehensive business alliance relating to digital books and the distribution of various contents.
May 2011	A capital alliance was concluded between KADOKAWA GROUP HOLDINGS and DWANGO.
November 2011	The KADOKAWA niconico A comic service, collaboration between niconico Douga and BOOK ☆ WALKER was launched.
March 2013	The advertising joint venture smiledge Co., Ltd. was established.
October 2014	KADOKAWA and DWANGO established the joint holding company KADOKAWA DWANGO through a joint share transfer.
October 2015	The Company name was changed in Japanese to Kadokawa Kabushiki Kaisha.

History of KADOKAWA

	Event
November 1945	Kadokawa Shoten was founded.
September 1982	The magazine Weekly the Television was launched.
March 1990	The magazine Tokyo Walker was launched.
November 1998	KADOKAWA SHOTEN was listed on the Second Section of the Tokyo Stock Exchange.
April 2003	KADOKAWA HOLDINGS was established by an incorporation-style company split through the holding-company method.
September 2004	KADOKAWA HOLDINGS was listed on the first section of the Tokyo Stock Exchange.
July 2006	KADOKAWA HOLDINGS changed its corporate name to KADOKAWA GROUP HOLDINGS.
October 2010	Entered a comprehensive business alliance with DWANGO for e-books and the distribution of various contents.
June 2011	Received a third-party allocation of shares of DWANGO for a capital increase.
June 2013	KADOKAWA GROUP HOLDINGS changed its corporate name to KADOKAWA CORPORATION.
May 2014	Concluded an integration agreement with DWANGO.

History of DWANGO

	Event
August 1997	DWANGO was established to plan, develop, operate, and support network game systems, as well as to provide consultations.
April 2001	Established Composite Inc. with the objective of planning, developing, and managing content services for mobile phones.
November 2002	Made Composite Inc. a wholly owned subsidiary to strengthen the cooperation framework for content services for mobile phone users.
July 2003	Listed on the Tokyo Stock Exchange Mothers Market.
September 2004	Listing was transferred to the Tokyo Stock Exchange First Section.
April 2005	Made CHUNSOFT Co., Ltd. a subsidiary
February 2006	Entered into a business and capital alliance with Avex Group Holdings Inc.
May 2008	Collaborated with Yahoo Japan Corporation on "niconicoDouga " a video community service.
October 2010	Entered into a comprehensive business alliance with KADOKAWA GROUP HOLDINGS, INC. for digital books and the distribution of various contents.
June 2011	Conducted a third party allocation of new shares to KADOKAWA GROUP HOLDINGS, INC.
July 2013	Entered a business alliance with Nippon Telegraph and Telephone Corporation.
May 2014	Concluded an integration agreement with KADOKAWA.
December 2014	Made the education business operator Vantan Inc. a wholly owned subsidiary.

Strengths and Business Risks

Maximizing profits by developing unique content across multimedia formats

The Company's strengths include its ability to create unique services, including editing capabilities honed in the fields of publishing and videos, expertise in developing unique content across multimedia formats to maximize earnings, the generation of original network services based on advanced networking technologies, and the integration of these services with real-world events.

Specifically, within the Internet services, various UGC are created within "niconico," and a community centered on content is always active, focused on the users. In addition in recent years, the ability to develop content has been expanded through the "niconico channel" service. In publishing, it has a system of efficient production through the capabilities of editing, detailed marketing, and promotion accumulated over many years. In e-books, BOOK ☆ WALKER, which the Company itself manages, has grown to establish a position as the industry platform. The Company establishes oversea bases aggressively, and publishes translated Japanese contents locally and develops character businesses there.

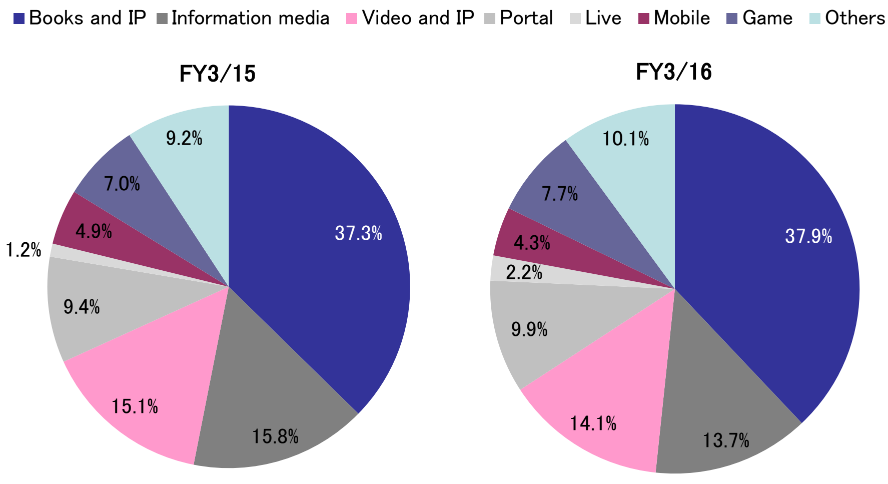
Business risks include the fact that the shrinkage of the paper-based book market or slowdown of rapid growth of e-book market may exceed the Company's anticipation in the Books and IP Business, currently its largest earnings pillar. In addition, if the Company were to lose market share due to the market entry of new players in the Portal Business, expected to be an earnings driver in the future, it could have a negative impact on its earnings.

Business Operations

Core operations are the Books and IP Business and the Portal Business

The KADOKAWA DWANGO Group comprises of 42 consolidated subsidiaries, including KADOKAWA and DWANGO, and 13 equity-method affiliates (as of March 31, 2016). The Group had eight business segments: the Books and IP (Intellectual Property) Business, the Information Media Business, the Video and IP Business, the Portal Business, the Live Business, the Mobile Business, the Game Business, and Others. The percentages of total net sales of each segment in FY3/16 (external net sales) were as follows: the Books and IP Business 37.9%, the Information Media Business 13.7%, the Video and IP Business 14.1%, the Portal Business 9.9%, the Live Business 2.2%, the Mobile Business 4.3%, the Game Business 7.7%, and Others 10.1%.

Percentages of Net Sales by Segment



(Note) The percentages are calculated using sales to external customers

(1) Books and IP Business

In this business, the Company publishes and sells paper-based books, including separate volumes, pocket editions including graphic novels, and comics, as well as e-books. The paper-based book business is a strong background for developing related products through its media mix, 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 FY3/16 was 35.0%, which was lower than the industry average*1 of 36.9%.

In e-books, the Company carries out direct sales through its e-book distribution platform BOOK ☆ WALKER and is also focusing on expanding sales in external e-book stores, such as Amazon, by conducting the "niconico Kadokawa Festival" sales promotion*2, and simultaneously releasing new publications in paper and e-book formats. Incidentally, in the Annual Sales Ranking by Publishing Company 2015 announced by Amazon Japan, Co., Ltd., KADOKAWA ranked first in e-books for the second consecutive year (it also ranked first in paper books). The cumulative number of books converted to the digital format as of March 31, 2016, stood at 39,580, with almost all current publications now converted.

In the Books and IP Business in FY3/16, net sales were ¥77,848mn (before the elimination of internal sales between segments) and operating income was ¥7,429mn (before the adjustment for inter-segments profits). Within this sales total, net sales of e-books were ¥17,139mn, and their ratio of the Books and IP Business sales increased significantly, from 14.9% in FY3/15 (fiscal half year results), to 22.0%.

(2) Information Media Business

In addition to magazines including Weekly the Television (TV information magazine), Walker Series (Town information magazine), Weekly Famitsu (Game information magazine), and Lettuce Club (Lifestyle Information magazine), and mooks (magazine style books), in this business, the Company also produces custom media such as Weekly Georgia and Hikari TV Guide, as well as selling magazine and Internet advertising.

With the conversion of existing paper media to Internet and digital formats, revenue from magazine sales has slumped, and the associated decline in advertising sales continues. To deal with this harsh environment, the Company is eliminating and rationalizing unprofitable departments while actively taking steps to transition media from paper-based to digital, such as the launch of the game information portal service. Net sales in the Information Media Business in FY3/16 were ¥28,080mn (the operating loss was ¥1,650mn). The magazine return rate is 32.7%, lower than the industry average of 41.8%, the same as with books.

(3) Video and IP Business

In this business, the Company sells packaged software such as DVDs and Blu-ray discs, as well as conducting the planning, production, and distribution of movies. It is focusing on visualizing the Group IP generated in the Books and IP Business and the Game Business, and on producing and distributing live-action films and animation products. It has also recently been working on picture distribution via the Internet and sales of anime copyright overseas. Net sales in the Video and IP Business for FY3/16 were ¥28,817mn (operating income of ¥1,346mn).

(4) Portal Business

This business is the core earnings pillar alongside the Books and IP Business. The Company provides various "niconico" video community services, such as "niconico Douga," "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 also revenues from points used to watch pay-to-view videos. As of March 31, 2016, there were 2.56 million premium members and 55.41 million registered members. Net sales in the Portal Business in FY3/16 were ¥20,117mn (operating income of ¥2,122mn).

*1 The sources of the industry indicators are the Publishing Monthly Report and Publishing Yearbook published by the All Japan Magazine and Book Publisher's and Editor's Association and Research Institute for Publications.

*2 The promotion ran from October 1 to November 30, 2015, and offered special programs linking DWANGO services with KADOKAWA content. For example, they issued coupons for their e-book store with purchases at ordinary book stores, broadcasted special programs on the "niconico Live" service, and held special in-store events to emphasize the cooperation of the two companies.

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KADOKAWA DWANGO CORPORATION

9468 Tokyo Stock Exchange First Section

17-Aug.-16

*1 The largest “niconico” event held at Makuhari Messe with the concept of “recreating everything of ‘niconico’ on site.” All the participating users are the “lead actors” in the various events that integrate the Internet and the real world. The “niconico Chokaigi” event was held on April 25 and 26, 2015, with 151,115 visitors to the venue and a total of 7,940,495 online visitors.

*2 At the “niconico” pilot shop, a facilities complex of nicocafe, an event space, the nicobukuro studio, and the niconico shop. The grand opening was in Harajuku in April 2011, then transferred to Ikebukuro and renewed.

(5) Live Business

In this business, the Company plans and operates various kinds of events, leases event venues, and so forth, and the business is often positioned as a way to promote “niconico.” The Company plans and operates “niconico Chokaigi”*1, “Game Party”, and “Animelo Summer Live”. It also operates the live music venue “nicofarre”, a new entertainment format that realizes a fusion of the Internet and the real world. It additionally operates the niconico showroom “niconico Honsha”*2, which had its grand renewal opening in Ikebukuro, Tokyo, in October in 2014, collaboration cafes for limited periods, and live game events. Net sales in the Live Business in FY3/16 were ¥4,464mn (operating loss of ¥790mn).

(6) Mobile Business

This business has made a significant contribution to DWANGO’s earnings with its core operation of music distribution to mobile phones and smartphones. While the overall scale of the business is shrinking due to a decline in the number of feature phone members, which is associated with the recent shift from feature phones to smartphones, it is still an important cash cow business. In this business, the Company operates “dwango.jp,” which distributes single songs, ring tones®, and so forth, as well as “animelo (songs for popular anime).” Net sales in the Mobile Business in FY3/16 were ¥8,619mn (operating income of ¥3,305mn).

(7) Game Business

In this 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 and network games. Previous hit titles include Dark Souls, Bloodborne (FromSoftware), Kantai Collection, Derby Stallion (KADOKAWA GAMES), Kenka Bancho, Danganronpa, Shiren the Wanderer (Spike Chunsoft), and Steins;Gate (MAGES). Net sales in the Game Business in FY3/16 were ¥15,599mn (operating loss of ¥2,268mn).

(8) Others

Others comprises businesses such as e-commerce sales of character merchandise and pop idol CDs, copyright revenues, sales of CDs featuring content created from anime or “niconico,” and revenues from the operation of schools providing training to work in creative fields inside and outside of Japan. Net sales in Others in FY3/16 were ¥21,337mn (operating loss of ¥469mn). In addition to the opening of N High School on April 1, 2016, it established N Cram School as a boarding school specializing in preparing students for the exam to enter into the University of Tokyo. Other than this, in April it partnered with Yoyogi Seminar to open Yozemi N School, a preparatory school for N High School students.

Results Trends

Results were driven by recovering profitability in the Books and IP Business, and a high level of operating income was secured

(1) FY3/16 results trends

●Results overview

The Company recorded positive consolidated results in FY3/16, of net sales of ¥200,945mn, operating income of ¥9,124mn, ordinary income of ¥10,189mn, and net income attributable to the owners of the parent company of ¥6,845mn.

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KADOKAWA DWANGO CORPORATION

9468 Tokyo Stock Exchange First Section

17-Aug.-16

FY3/16 consolidated results overview

(¥mn)

	FY3/15		FY3/16			
	Result	Sales ratio	Company targets	Result	Sales ratio	vs. target
Net sales	100,566	-	200,500	200,945	-	0.2%
Cost of sales	72,682	72.3%	-	141,144	70.2%	-
Gross profit	27,884	27.7%	-	59,801	29.8%	-
SG&A expenses	26,493	26.3%	-	50,676	25.2%	-
Operating income	1,391	1.4%	7,000	9,124	4.5%	30.4%
Ordinary income	2,472	2.5%	6,800	10,189	5.1%	49.8%
Net income before income taxes	13,428	13.4%	-	10,512	5.2%	-
Net income	14,100	14.0%	-	6,954	3.5%	-
Net income attributable to the owners of the parent company	14,055	14.0%	4,000	6,845	3.4%	71.1%

Source: prepared by FISCO based on the Company's financial results summary

Net sales were secured at a level above the Company target. In addition to the strong performance of the Books and IP Business, the results in the Live Business and the Mobile Business also contributed. The gross margin was 29.8%, up 2.1 percentage points compared to 27.7% in the previous fiscal year (fiscal half year results), due to factors such as the business expansion of e-books, which has a high profit margin, and the strong performance of the Mobile Business. Furthermore, for SG&A expenses, the Company succeeded in realizing more efficient management, supported by the structural reforms implemented by KADOKAWA and keeping down advertising expenses in the Mobile Business. Consequently, the SG&A expenses ratio was 25.2%, falling 1.1 percentage points compared to the previous fiscal year. As a result, the operating income margin rose 3.1 percentage points to 4.5%.

Compared to the Company targets (net sales of ¥200,500mn, operating income of ¥7,000mn, ordinary income of ¥6,800mn and profit attributable to owners of the parent of ¥4,000mn), while net sales were secured at the same level as the target, each of the profit items greatly exceeded their respective targets. Breaking down the main factors behind this, the e-books business performed better than expected and in addition, the Mobile Business and the Live Business both exceeded their targets.

Company Targets by Segment and Differences with Results

(¥mn)

	FY3/16 full-year forecasts		FY3/16 full-year results		Difference Full-year results－forecasts	
	Net sales	Operating income	Net sales	Operating income	Net sales	Operating income
Consolidated total	200,500	7,000	200,945	9,124	445	2,124
Books and IP	70,000	4,900	77,848	7,429	7,848	2,529
Information Media	34,200	-1,200	28,080	-1,650	-6,119	-450
Video and IP	28,500	1,300	28,817	1,346	317	46
Portal	21,000	2,100	20,117	2,122	-882	22
Live	3,500	-1,000	4,464	-790	964	209
Mobile	7,900	2,600	8,619	3,305	719	705
Games	18,200	2,500	15,599	2,268	-2,600	-231
Others	20,500	800	21,337	-469	837	-1,269
Corporate / eliminations	-3,300	-5,000	-3,940	-4,437	-640	562

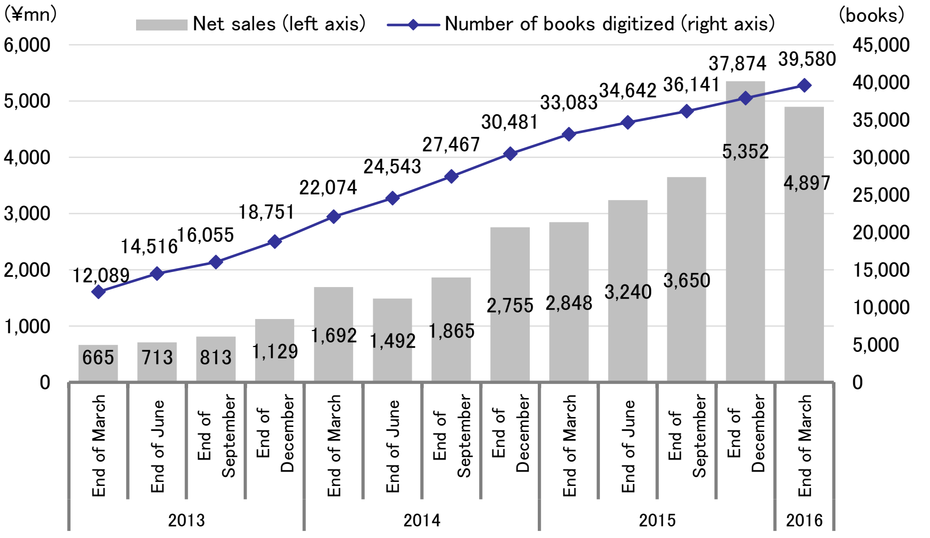
Source: the Company's financial results briefing materials

●Conditions by segment a) Books and IP Business

Net sales (before the elimination of internal sales between segments) were ¥77,848mn, and operating income (before adjustment for inter-segments profits) was ¥7,429mn, and both net sales and operating income exceeded the Company targets (net sales of ¥70,000mn and operating income of ¥4,900mn).

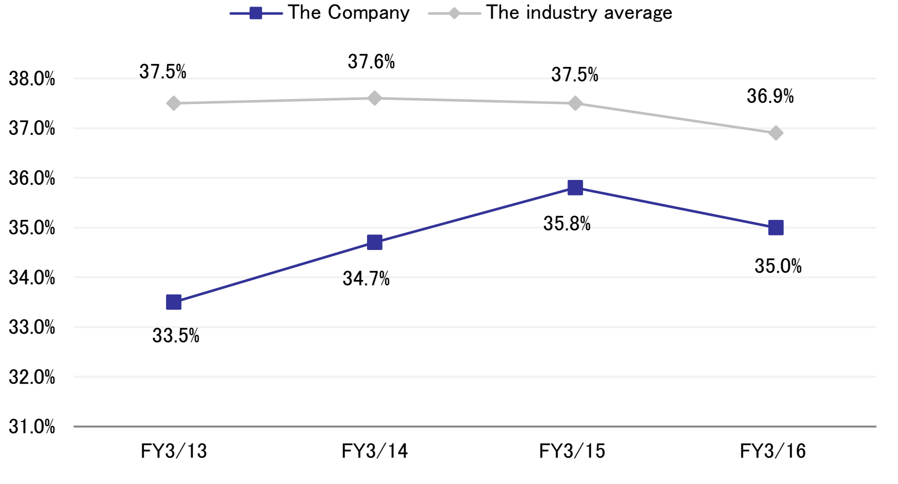
In the e-books business, positive results were achieved in both direct sales and external sales supported by the "niconico Kadokawa Festival" held from October to November in the previous year. For BOOK ☆ WALKER, the Company developed an original value-added strategy, including pre-sales of Group works and original appendices. In addition, the effects from strengthening cooperation with other platforms, such as delivering contents to external websites, and collaborating with NTT DOCOMO's "d magazine," came to fruition. As a result, net sales steadily increased and operating income greatly exceeded the target (¥2,800mn above the target).

Trends in e-Book Net Sales and in the Number of Books Digitized (cumulative)



On the other hand, although the market for paper books is shrinking, creation of various hit works supported the results. Shika no Ou which won the Japan Booksellers' Award, and Overload and Boku dake ga inai Machi which gained popularity through reinforced media mix techniques. Other factors were the effects of the structural reforms by KADOKAWA, improvement in the return rate (FY3/15 35.8%→FY3/16 35.0%) as a result of strengthened marketing and the optimization of the number of copies produced, and strong performance of overseas copyright sales of graphic novels and comics. As a result, profitability recovered and operating income was kept at a level only slightly lower than the target, of ¥300mn. When considering that the Company accumulated an allowance for doubtful accounts of ¥300mn for subscription agencies, we can confirm that thanks to the management integration, the transition to digital-related, copyright-related and EC-related products in KADOKAWA has been accelerated.

Trends in the Book Return Rates



b) Information Media Business

Net sales were ¥28,080mn and the operating loss was ¥1,650mn. Net sales were smaller and the operating loss was larger than planned (net sales of ¥34,200mn and operating loss of ¥1,200mn). Revenue from sales of magazines and mooks, and advertising revenue were below their forecasts due to the impact from market shrinking, while Internet advertising revenue rose from the transition to digital. In addition, sales from customized magazines declined following the end of a large-scale contract. The reason for a larger than expected loss was that large-scale part-work planning (mooks with DVDs) performed sluggishly in addition to the major decline in net sales. Also, the accumulation of an allowance for doubtful accounts of ¥100mn for medium- to small-sized subscription agencies had a negative impact as the same as in the Books and IP Business.

c) Video and IP Business

Net sales were ¥28,817mn and operating income was ¥1,346mn, and the Company achieved its targets for both net sales and operating income (net sales of ¥28,500mn and operating income of ¥1,300mn). In package video sales, DVD and Blu-ray sales trended positively, particularly for anime works such as Kantai Collection - KanColle, Overload, and High School D X D. For operating income, the anime copyright sales business for the overseas market expanded greatly and contributed positively to results.

d) Portal Business

Net sales were ¥20,117mn and operating income was ¥2,122mn, so although net sales were below target, operating income was as planned (net sales of ¥21,000mn and operating income of ¥2,100mn). Net sales fell below the target due to the negative impact from the delay in launching a new service. However, the reason for the achievement of meeting the operating income target was that the number of premium members increased as planned, and that increase of niconico channel members raised the revenue from point sales and other items . The implementation of cost controls was another reason.

At the end of FY3/16, the number of premium members was 2.56 million people (up 120,000 from the end of the previous fiscal year), while the number of registered members was 55.41 million (up 8.38 million).

e) Live Business

Net sales were ¥4,464mn and the operating loss was ¥790mn. Net sales were above the Company target and the operating loss was less than expected (net sales of ¥3,500mn and operating loss of ¥1,000mn). The results were from the better-than-expected performance of “Animelo Summer Live 2015-THE GATE-,” which was held in August of last year (from the 28th to 30th, with a total of 81,000 visitors over the 3 days), and also the number of visitors to “niconico Chokaigi 2015” (151,000 visitors) and “Game Party2016” (47,000 visitors) both exceeded the numbers in the previous year. In addition, strong results from event sponsorships and exhibitors contributed to the reduction in the operating loss.

f) Mobile Business

Net sales were ¥8,619mn and the operating income was ¥3,305mn, both exceeding the Company targets (net sales of ¥7,900mn and operating income of ¥2,600mn). This was because the declines in member numbers for both smartphones and feature phones were more moderate than anticipated, and in addition, the Company kept down advertising expenses and implemented cost controls, enabling it to secure better-than-expected profits.

g) Game Business

Net sales were ¥15,599mn and operating income was ¥2,268mn, and while both were slightly below the targets (net sales of ¥18,200mn and operating income of ¥2,500mn), the Company succeeded in rebuilding this business. Launches of the big titles of KanColle Kai and DARK SOULS Ⅲ in Q4, and sales of Witcher 3: the Wild Hunt all enabled the Company to come close to the targeted operating income which seemed a high hurdle to clear.

h) Others

Net sales were ¥21,337mn and the operating loss was ¥469mn. Net sales exceeded plan, but operating income was significantly below the target (net sales of ¥20,500mn and operating income of ¥800mn). This was due to the sluggish performance of trading card games withdrawing from some titles, and the struggle in sales of goods.

●Indicators of financial stability are being kept at a sound level

At the end of FY3/16, total assets were ¥201,609mn, down by ¥4,063mn from the end of the previous fiscal year. Current assets increased by ¥627mn, because the increase in accounts receivable due to the business expansion was larger than the decrease in cash and deposits from the acquisition of treasury stock and payments of expenses for structural improvements. Non-current assets fell ¥4,692mn from the sale of investment securities and the depreciation of tangible non-current assets.

Liabilities were ¥97,082mn, down ¥4,342mn from the end of the previous fiscal year because of a decline in current liabilities of ¥1,857mn following a reduction in other current liabilities from the payment of expenses for business structural improvements, and also a fall in non-current liabilities of ¥2,485mn, including the repayment of long-term debt.

Net assets were ¥104,526mn, up ¥278mn from the end of the previous fiscal year. Retained earnings increased by ¥6,137mn on the recording of net income attributable to the owners of the parent company, although shareholders' equity declined by ¥4,700mn following the acquisition of treasury stock.

Looking at the cash flow conditions, at the end of FY3/16, cash and cash equivalents had decreased to ¥52,175mn due to expenditure of ¥7,026mn, including foreign currency translation adjustment. Cash flow generated from operating activities was reduced to ¥6,733mn from net income before adjustment for incomes taxes of ¥10,512mn because of a payout for business structural improvements, income taxes, and others. Cash flow used in investing activities was ¥4,673mn with as a result of expenses for time deposits and for acquiring tangible and intangible non-current assets. Cash flow used in financial activities was ¥8,775mn due to the repayment of long-term debt, expense for the acquisition of additional shares in a subsidiary and treasury stock.

Looking at the management indicators, the equity ratio, which indicates financial soundness, rose to 51.4%, while the current ratio also improved to 214.5% because liabilities decreased from the repayment of long-term debt and the payment of expenses for business structural improvements, and the improved results increased retained earnings. On the other hand, for the indicators of profitability, the operating income margin, which had been at the low level of 1.4% in the previous fiscal year, improved to 4.5% from the recovery of profitability in the Books and IP Business supported by the realization of the effects of the structural reforms, and also from the strong performance of e-books.

Balance Sheet, Cash Flow Statement, and Management Indicators

(¥mn)

	FY3/15	FY3/16	Change	Change factor
Current assets	131,200	131,827	627	Accounts receivable +2,632 Cash and deposits -2,403
Non-current assets	74,473	69,781	-4,692	Intangible non-current assets +537 Tangible non-current assets -1,763 Other investment assets -3,465
Total assets	205,673	201,609	-4,063	
Current liabilities	63,316	61,459	-1,857	Trade debt +728 Others -3,467
Non-current liabilities	38,108	35,623	-2,485	Long-term debt -2,298
Total liabilities	101,425	97,082	-4,342	
Net assets	104,248	104,526	278	Retained earnings +6,137 Capital surplus -724 Treasury stock -4,700 Non-controlling shareholders' equity -195
Total liabilities and net assets	205,673	201,609	-4,063	
Cash flow from operating activities	7,765	6,733		
Cash flow from investing activities	-9,049	-4,673		
Cash flow from financing activities	24,385	-8,775		
Cash and cash equivalents	59,201	52,175		
Management indicators				
Stability				
Current ratio	207.2%	214.5%		
Equity ratio	50.2%	51.4%		
Profitability				
ROE	22.5%	6.6%		
ROA	2.1%	5.0%		
Operating income margin	1.4%	4.5%		

Source: prepared by FISCO based on the Company's securities report

(2) The Company has set FY3/17 as a year for active investment to launch new businesses and to change the styles of existing businesses

●Overview of the Company targets

The Company has positioned FY3/17 as a year to actively invest in order to achieve continuous growth in the future, and it is targeting net sales of ¥200,000mn (down 0.5% y-o-y), operating income of ¥3,100mn (down 66.0%), ordinary income of ¥3,300mn (down 67.6%), and net income attributable to the owners of the parent company of ¥1,750mn (down 74.4%). So although net sales will be basically unchanged, profits are expected to decline significantly because of the implementation of new investment.

Overview of the FY3/17 Company Targets

(¥mn)

	FY3/16		FY3/17		
	Result	Sales ratio	Company targets	Sales ratio	y-o-y
Net sales	200,945	-	200,000	-	-0.5%
Operating income	9,124	4.5%	3,100	1.6%	-66.0%
Ordinary income	10,189	5.1%	3,300	1.7%	-67.6%
Net income attributable to the owners of the parent company	6,845	3.4%	1,750	0.9%	-74.4%

Source: prepared by FISCO based on the Company's financial results summary

The reason for the slight decline in net sales is that every business is forecast to fall slightly other than the Publishing Business. Conversely, there are two main factors behind the anticipated major reduction in profits; that profits are expected to fall substantially in some of the existing businesses, such as the Game and Mobile Businesses (reduction of ¥2,640mn), and the anticipated negative effects from the increase of new investment (reduction of ¥3,380mn).

Firstly, the reduction in profits in some of the existing businesses will be from a decline in the Game Business due to the release of major titles, such as DARK SOULS Ⅲ, in the previous fiscal year not being matched; a downward trend in member numbers is expected to continue in the Mobile Business; and a decline in profits is forecast in the Live Business, in which event sponsorship performed better than expected in the previous fiscal year. In the Game Business, the profit level was high in the previous fiscal year compared to a normal year, and similarly the Mobile Business and Live Business both achieved better-than-expected results. However, in this fiscal year the Company does not expect these positive trends to continue and its forecasts are based on this conservative outlook. Therefore, it is necessary to be aware that the Company is not expecting a major deterioration of the business environments for its existing businesses.

As for the specific investments of ¥4,650mn (increased by ¥3,380mn from the previous fiscal year) for future growth, the Company will invest in the following seven areas: 1) renewing "niconico" (to comply with the shift to high image quality and to rebuild the infrastructure), 2) new services for smartphones, 3) conversion of the magazine business revenue model, 4) an inbound business, 5) a game information portal, 6) learning services on the Internet, and 7) enhancing the UGC* posting website. Among these, the weight is considered to be the largest for the investment in the "niconico" renewal in the Web Services Business, the new service for smartphones, and to convert the magazine business revenue model in the Publishing Business, and also the investment in the related inbound business.

●Company targets and initiatives by segment

From FY3/17, the Company will change its reporting segments to "Web Services" (formerly Portal Business, Live Business, and Mobile Business), "Publication" (Books and IP Business, Information Media Business), "Video and Game" (Video and IP Business, and Game Business), and "Others" (Others and Some Businesses in Information Media), which will be businesses not included in any of the other segments. The aim of renewed segmentation is to clearly indicate the main pillars of its Group businesses. Below, we look specifically at the situations by segment upon applying the new segments to the FY3/16 result.

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9468 Tokyo Stock Exchange First Section

17-Aug.-16

Change of Business Segments

Before change

Former segment	FY3/16 results Net sales	FY3/16 results Operating income
Books and IP	77,848	7,429
Information Media	28,080	-1,650
Video and IP	28,817	1,346
Portal	20,117	2,122
Live	4,464	-790
Mobile	8,619	3,305
Game	15,599	2,268
Others	21,337	-469
Corporate / eliminations	-3,940	-4,437

After change (¥mn)

New segment	FY3/16 results* Net sales	FY3/16 results* Operating income	Former segment
Web Services	33,136	4,638	Portal, Live, Mobile
Publication	105,200	6,314	Books and IP, Information Media
Video and Game	44,284	3,614	Video and IP, game
Others	21,337	-1,011	Others, Some businesses in Information Media
Corporate / eliminations	-3,013	-4,431	Corporate / eliminations

*The values changed from the FY3/16 results from the former segments to for the new segments are approximated values from the time the materials were published.

Source: the Company's financial results briefing materials

a) Web Services Business

Net sales are forecast to decline 3.4% y-o-y to ¥32,000mn and operating income to fall 41.8% to ¥2,700mn, for a reduction in sales and a double-digit decline in operating income. The factors behind these declines are that in order to improve usability, the Company will strengthen the functions of "niconico" by significantly strengthening the line server, which has lagged behind its competitors, and in addition, it plans to invest in the development of a new service for smartphones. Further, the Company's conservative outlook for the Live Business and the Mobile Business, which performed better than expected in the previous fiscal year, is a factor behind the forecast declines.

b) Publication Business

Net sales are forecast to increase 1.7% y-o-y to ¥107,000mn and operating income to decline 30.3% to ¥4,400mn, for an increase in sales but a double-digit decline in operating income. In terms of the specific measures in this business, the Company plans to proceed with executing structural reforms of its magazine business, including digitization. In addition, as an initiative to strengthen the affinity between the Internet and Publication Business, it is aiming to strengthen its ability to create works on the novel posting site "Kakuyomu" (launched February 2016) and the online comic service "ComicWalker" (launched March 2014), as well as bolstering online promotions. Furthermore, it will implement initiatives to actively develop its overseas business using Cool Japan content through expanding and enhancing its overseas business. Specifically, it will develop Guangzhou in China, Hong Kong, and Taiwan to be bases for the inbound business, and also, as indicated by the establishment of a base in Malaysia, expand the content business for Southeast Asia. Moreover, for English-speaking countries, particularly in the United States whose comic market is growing, the Company's policy is to maximize the value of its content by linking it to animation delivery with the technique of the media mix, and the development of goods, not limited to translation publishing.

c) Video and Game Business

While net sales are forecast to remain basically unchanged, declining 0.6% y-o-y to ¥44,000mn, operating income is expected to fall significantly, down 30.8% to ¥2,500mn. As the specific initiatives in this business, the Company is aiming to promote and actively develop video production through collaborations with overseas companies, and in the Game Business, to stably develop best-selling titles with the goal of securing profits from sales. As there will be no major title launches in this fiscal year, in contrast to the previous fiscal year, namely DARK SOULS Ⅲ and KanColle Kai, it is thought that sales will fall significantly as a result.

d) Others

Net sales are forecast to decrease by 6.3% y-o-y to ¥20,000mn and an operating loss of ¥1,300mn, which will be slightly larger than the loss of ¥1,011mn recorded in the previous fiscal year. This is because of the expected costs to advance into the inbound business; to strengthen the planning, production and promotion of online learning services; and to launch a new service for game-community users (building a game information portal).

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9468 Tokyo Stock Exchange First Section

17-Aug.-16

Net Sales and Operating Income Targets by Segments

(¥mn)

	FY3/16 full-year results		FY3/17 full-year forecasts		Change	
	Net sales	Operating income	Net sales	Operating income	Net sales	Operating income
Web Services	33,136	4,638	32,000	2,700	-1,136	-1,938
Publication	105,200	6,314	107,000	4,400	1,800	-1,914
Video and Game	44,284	3,614	44,000	2,500	-284	-1,114
Others	21,337	-1,011	20,000	-1,300	-1,337	-289
Corporate / eliminations	-3,013	-4,431	-3,000	-5,200	13	-769
Net sales total	200,945	9,124	200,000	3,100	-945	-6,024

Source: the Company's financial results briefing materials

At FISCO, we think that there is room for the expected results to exceed the targets based on the fact that the Company's forecast of lower profits from its existing businesses is largely from its conservative outlook. In addition, when considering that it succeeded in recovering the profitability of the Books and IP Business around one and a half years after the management integration, by implementing the current round of active investments, it will proceed with strengthening the foundations of its existing businesses, such as the Portal Business and the Information Media Business, and launch new businesses, which can be expected to further increase the Company's profitability in the medium term. Therefore, we will be paying attention to the progress made in these investments.

■ Medium-Term Management Strategy

Postponed the period to achieve the targets by one year, to FY3/19

In May 2015, the Company announced its Medium-term Management Plan (FY3/16 −FY3/18 Medium-term Vision - Toward New Challenges and Growth Markets). In the plan, it positioned FY3/16 as a year to actively invest in new businesses and services, FY3/17 as a year to develop these investments, and FY3/18 as the year to recoup the investment, setting targets for this fiscal year of net sales of ¥230,000mn and operating income of ¥18,000mn to ¥20,000mn. Specifically, the plan has four basic strategies for business expansion; (1) growth of the Books and IP Business, (2) growth of the game information portal business, (3) growth of the Portal Business, and (4) entry into the educational business.

While the active investment in FY3/17 will fundamentally be in line with the basic strategy described in the Medium-term Management Plan, due to the current increase in the spending on new investments, the Company has changed FY3/17, which it had positioned as a year to develop the investments, to a year to continuously and actively invest in new businesses and services, the same as FY3/16. As a result, the investment recoup period has been postponed by one fiscal year, from FY3/18 to FY3/19.

Returns to Shareholders

The Company recognizes returning profits to shareholders as an important management issue and implemented share buybacks

The Company's first priority is to ensure the continuity of its business management by building up internal reserves to strengthen the corporate constitution and to prepare for future business development. It also considers it important to sustainably distribute profits to shareholders and other stakeholders, and recognizes that returning profits to shareholders is an important management issue. It takes into account the business performance of each period when deliberating on shareholder returns.

The dividend for FY3/16 was ¥20 per share (for a dividend payout ratio of 20.2%). For FY3/17, the Company plans to continue to pay a dividend of ¥20. It also has a shareholder reward system. Shareholders who hold 100 shares or more continuously for one year or more (shareholders listed at least three consecutive times in the shareholders' register) are given a gift of either three pocket editions, two separate volumes, two movie tickets, 3,000 e-book purchase points, or a set of DVDs or Blu-ray Discs from one of the Company's subsidiaries. Shareholders who have held their shares for three years or more (shareholders listed at least seven consecutive times in the shareholders' register) receive an additional gift of either two pocket editions, one separate volume, one movie ticket, or 1,500 e-book purchase points from one of the Company's subsidiaries.

Based on a resolution of the Board of Directors in a meeting held on August 6, 2015, the Company implemented a market buyback of treasury shares between August 10 and October 15, 2015, on the Tokyo Stock Exchange, and acquired treasury shares, of 3,000,000 Company common shares, for a total acquisition price of ¥4,712,098,500.

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