

AOI TYO Holdings Inc.

3975

Tokyo Stock Exchange First Section

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Summary

Sales and profit declines in 1H FY12/18 went beyond guidance Faced setbacks from the printless shift and work style reforms, but improved effective profit margin*¹ and achieved progress in future- oriented initiatives

AOI TYO Holdings Inc. <3975> is a joint holding company established through the management integration of AOI Pro. Inc. and TYO Inc. AOI TYO Group mainly plans and creates TV commercials and also handles Solutions Business that includes direct transactions with advertisers, online videos and other digital contents. It holds a top share in TV commercial production through the management integration of the two leading industry firms.

The decision to proceed with management integration took into account the lack of prospects for major growth in conventional TV commercial production as well as likely expansion of business scope related to advertising, including methodology and structural changes. It comes against a backdrop of diversification of media (primarily through the Internet) and devices (smartphones, tablets, and others) and major shifts in industry landscape with advances in technology, such as communications speed, data analysis, VR*², and AR*³. This integration aims to realize economies of scale and create synergies and also accelerate the pace of new value creation and business expansion through consolidation and effective utilization of business resources.

*1 Effective profit is the value obtained by subtracting external spending and production costs from net sales.

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

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

AOI TYO Group posted sales and profit declines in 1H FY12/18 that went beyond forecast at ¥30,864mn in net sales (decreased 8.5% year on year (YoY)) and ¥1,746mn in operating income (decreased 26.0%). While the printless shift had less impact than expected, Advertising Video Production Business shrank considerably due to stricter income management with emphasis on profitability, orders control as part of the response to work style reforms, and delayed sales recognition for some deals. Nevertheless, Solutions Business, which is seen as a growth area, delivered solid performance and Overseas Business grew substantially thanks to the acquisition of a major Malaysia-based advertising production company as a consolidated subsidiary. In earnings, meanwhile, downside from lower sales caused profit decline, but improvement in effective profit margin through stricter income management with emphasis on profitability enabled AOI TYO Group to limit the setback. AOI TYO Group made progress toward future business expansion as well in promotion of investment and business alliance strategies and initiatives in online video advertising for the 5G era.

Summary

AOI TYO Group lowered its FY12/18 forecast from the period-start stance (only net sales). The updated outlook projects sales and profit declines at ¥64,000mn in net sales (-9.2% YoY; a reduction of ¥6,000mn) and ¥3,800mn in operating income (-17.7%). While AOI TYO Group already anticipated declines due to impact from the printless shift, responses to work style reforms, and other factors, further reduction of the sales outlook reflected shortfall in 1H results and a conservative assumptions for 2H too based on a policy of not overly pursuing sales expansion (instead selectively accepting deals with emphasis on profitability). The earnings outlook, however, stayed the same because of improved effective profit margin and the prospect of dividend income from movie investments* that was not expected at the period-start stage.

* This income includes the film Shoplifters (directed by Hirokazu Kore-eda) that won the Palme D'Or award in the competition division at the 71st Annual Cannes Film Festival.

AOI TYO Group envisions longer-term growth driven by Solutions Business and Overseas Business (China and Southeast Asia). In the existing mainstay Advertising Video Production Business, meanwhile, it targets steady growth by promoting heightened emphasis on profitability and efficiency and a lean organization that adapts to a printless shift model. The outlook sets FY12/21 goals of at least 12% in ROE and ¥8bn EBITDA (based on 17.0% average growth over three years with FY12/18 target of ¥5.23bn as the starting point).

We think the Solutions Business field, which AOI TYO Group aims to expand, offers a market with large potential. We also expect AOI TYO Group's experience and knowhow cultivated in video production to provide a differentiating factor and see a large advantage from its credibility (brand strength) and financial clout. Improvements started to be seen in effective profit margin and future-oriented initiatives, but we will be particularly focusing on new value creation, such as VR technology and data utilization, in the context of specific results obtained from management integration and aggressive investments in growth fields.

Key Points

- Sales and profit declines in 1H FY12/18 went beyond forecast
- Faced setbacks from the printless shift and work style reforms, but improved effective profit margin and achieved progress in future-oriented investment and business alliance strategies
- Lowered FY12/18 forecast (only net sales)
- Growth image of the Solutions Business and the Overseas Business will be drivers of earnings growth over the medium to long term

■ Company profile

Joint holding company established through the management integration of AOI Pro. and TYO and holds a top share in TV commercial production

1. Business overview

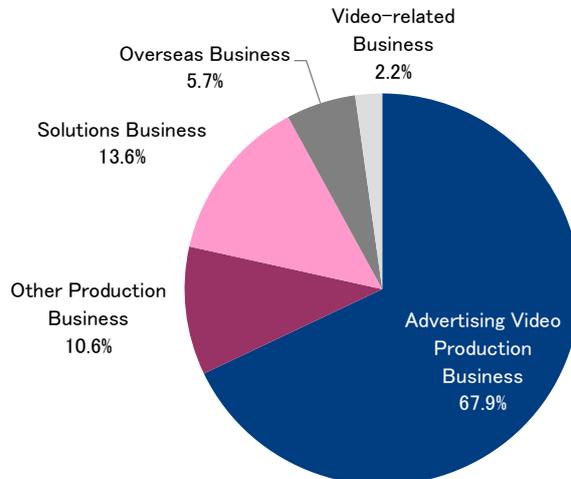
AOI TYO Holdings is a joint holding company that owns AOI Pro. and TYO. AOI TYO Group plans and creates TV commercials and also handles Solutions Business that includes direct transactions with advertisers, online videos and other digital contents. It was founded in January 2017 through management integration of two leading industry firms and holds a top share in TV commercial production*.

* The industry's three major firms controlled a combined 30-40% share with Tohokushinsha Film Corporation <2329> as the leader and then AOI Pro. and TYO for many years. This management integration moved AOI TYO Group into the top position.

AOI TYO Group has Advertising Business and Video-related Business segments and five sub-segments (Advertising Video Production, Other Production, Solutions, Overseas, and Video-Related). While the conventional mainstay Advertising Video Production Business generates nearly 70% of overall sales, Solutions Business, a growth area, has been expanding substantially recently and is attracting attention as a growth driver. (1H FY12/18 result)

Sales mix by customer in 1H FY12/18 was well balanced with 23.7% to the Dentsu Group, 26.9% to the Hakuhodo Group, 28.2% in direct transactions, and 21.2% to others. Direct transactions have been a TYO strength and are still growing after the management integration in correlation with the Solutions Business. Additionally, sales competition by media type is TV commercial production at 61.2%, entertainment contents at 4.4%, digital contents at 17.2%, overseas at 3.2%, and other at 13.9%. "Digital contents" is growing rapidly along with expansion in online video advertising demand.

Sales composition by business (1H FY12/18 result)

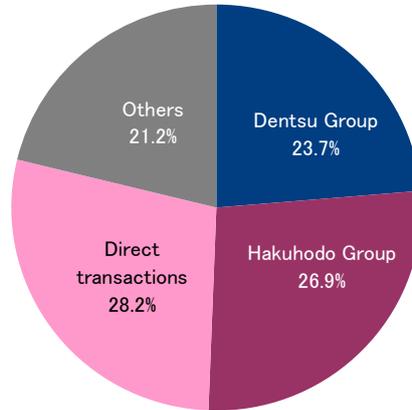


Source: Prepared by FISCO from the Company's results briefing materials

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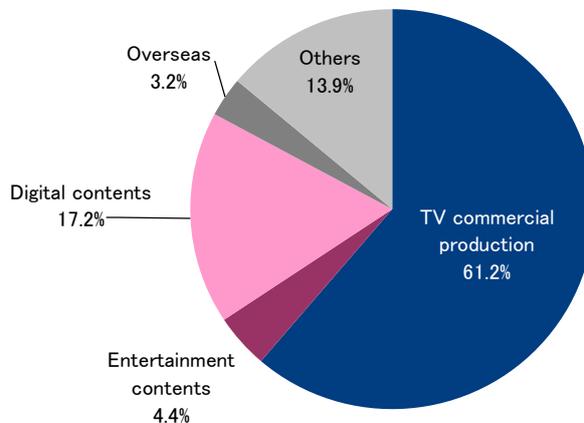
Company profile

Sales ratio by customer (1H FY12/18 result)



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

Sales composition ratios by medium (1H FY12/18 results)



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

Below we review each of these business areas.

(1) Advertising Video Production Business

This business plans and produces TV commercials and other advertising videos. It was also the primary segment at AOI Pro. and TYO and holds a top share now thanks to integration of the two leading firms. Both companies have created many excellent TV commercials amid continuation of a robust orders environment. However, this business is confronting concerns about decline in profitability due to changes in media value amid advances by the Internet and other technologies and the printless shift. It needs earnings structure reforms and improved efficiency.

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Company profile

(2) Other Production Business

Production business besides advertising videos includes movies and dramas, event planning and production, web production, and sales promotional material production.

(3) Solutions Business

This business provides measures for problem solving for customers. While it currently is roughly equal to results from TYO Offering Management Business Unit*1 and AOI Pro.'s subsidiary Quark Tokyo Inc.*2, it also contains SOOTH Inc.*3, which was established as a growth area on February 1, 2018.

*1 Renamed from TYO General Business Division Headquarters, the division supplies one-stop solutions mainly through multi-faceted media activities via direct transactions with advertisers.

*2 Provides services that range from marketing strategy formulation mainly for videos to all PDCA solutions required by communications in the digital era.

*3 Provides experience design solutions using vital sign data and other services.

(4) Overseas Business

The Overseas Business operates sites in China and Southeast Asia (Thailand, Vietnam, Singapore, Indonesia, Malaysia, and India) and seeks to expand transactions with local companies, including Japanese affiliates. Both AOI Pro. and TYO have been actively engaged in many regions, and this segment is positioned as a growth driver. AOI TYO Group has also been actively engaging in M&A. In October 2017, AOI TYO Group purchased minority shares of VIEWFINDER MEDIA JOINT STOCK COMPANY, a leading video production company in Vietnam, a group company (equity-method affiliate). Following this, in March 2018, AOI TYO Group acquired majority shares of Directors Think Tank (DTT) Group, a leading Malaysian TV commercial production company a consolidated subsidiary.

(5) Video-related Business

This business covers activities besides advertising, including photo studios for general consumers* and music video production.

* Operated by AOI Pro.'s subsidiary Hollyhock Inc. This business started with the first store at Tokyo Midtown in Roppongi and has been adding other sites. It currently has four stores.

2. History

(1) AOI Pro.

AOI Pro. goes back to Aoi Advertising Promotion Inc., which was established in 1963 to produce TV commercials, in Tokyo's Minato Ward. It solidified a business base as a video production company focused on TV commercials. In 1990, it listed shares on JASDAQ, taking the lead in this industry, with the aim of making further advances and strengthening social credibility.

It subsequently created numerous videos that attracted substantial interest, fueling healthy growth and listed on the Second Section of the Tokyo Stock Exchange in 1998 and on the First Section in 2000. It established a firm position as one of the major TV commercial production companies.

Company profile

In September 2011, meanwhile, it launched an overseas site to handle TV commercial production in Indonesia. In October 2014, it added nakamino Co., Ltd.*, which specializes in online video platform effect measurement and operation, to the group (equity-method affiliate) through a capital alliance with the aim of full-fledged ramp-up of video contents marketing, a new growth area. These initiatives gave it an edge versus peers in building operations to address diversifying media, growing demand for online videos and other digital contents, and entry by Japanese companies into the fast-growing Asian region.

* It turned this entity into a consolidated subsidiary at the end of December 2015 through an injection of additional capital and changed the company name to Quark tokyo Inc. in April 2016.

(2) TYO

TYO was established as a TV commercial production company in April 1982 in Roppongi, Minato Ward, Tokyo. It was the last of the three major commercial production companies to be established. Hiroaki Yoshida (Representative Director of AOI TYO Holdings), together with four other commercial creators, established the company with the dream of “Creating an Ideal Company of Creators, by Creators, for Creators.”

The company listed on JASDAQ in 2002. It expanded business by leveraging its creative capabilities of having been involved in the production of numerous TV commercials that left an impression with consumers, notably one promoting travel to Kyoto for Central Japan Railway Company (JR Central) <9022>. Upon changing to the TSE Second Section in October 2013, its listing was reassigned to the First Section in January 2014.

TYO has been involved in various types of content production, including TV commercials, online videos, digital contents and events. Its strength is providing optimal, one-stop solutions for advertisers' advertising promotions and promotional activities. It led the industry* with a sales structure and accumulation of knowledge in dealing directly with advertisers and has focused on building long-term relationships with advertisers, expanding project sizes and capturing sales promotion expenses. Furthermore, it has been actively engaged in overseas expansion.

* Since starting direct transactions with advertisers in July 2003, the current TYO Offering Management Business Unit has taken charge of the entire group's direct transactions with advertisers.

Financial highlights

Sales and profit declines in 1H FY12/18 went beyond forecasts Improved effective profit margin and progressed in investment and alliance strategies

AOI TYO Group posted lower sales and profits in 1H FY12/18 at ¥30,864mn in net sales (-8.5% YoY), ¥1,746mn in operating income (-26.0%), ¥1,680mn in ordinary income (-27.1%), and ¥1,170mn in profit attributable to owners of parent (-1.6%). While it expected sales and profit declines in initial forecast because of advances in the printless shift, responses to work style reforms, and other impacts, actual results were even weaker.

Financial highlights

Sales fell considerably in mainstay Advertising Video Production Business. While the printless shift had less impact than expected, there was a heavy toll from stricter income management with emphasis on profitability, orders control as part of the response to work style reforms, and delayed sales recognition for some deals. Nevertheless, Solutions Business, which is seen as a growth area, delivered solid performance and Overseas Business grew substantially thanks to acquisition of a major Malaysia-based advertising production company as a consolidated subsidiary. Main reasons for the shortfall in sales (versus forecast) were delayed recognition of sales on some deals, priority on improving the effective profit margin over sales expansion, a larger impact from the response to work style reforms than anticipated, and modest lagging of the ambitious full-year plan in Solutions Business.

According to the sales breakdown by customer category, advertising agent sales declined due to the impact of work style reforms and other factors, as explained above, but direct transactions with advertisers expanded on growth in solutions business.

In earnings, meanwhile, downside from lower sales caused profits to decline, though improved effective profit margin from stricter income management with emphasis on profitability (such as selectivity in accepting deals and rigorous cost management) enabled AOI TYO Group to limit the setback.

In fiscal conditions, total assets declined 6.8% from the end of FY12/17 to ¥55,672mn, despite an increase in non-current assets (mainly “investments and other assets”) from aggressive investment activities*, because of even larger declines in current assets (“cash and deposits” and “notes and accounts receivable – trade”). Furthermore, shareholders’ equity posted a slight 0.5% gain versus end-FY12/17 to ¥24,788mn as retained earnings build-up and other items offset a reduction from share buybacks. The equity ratio improved to 44.5% (vs. 41.3% at the end of FY12/17) with these changes. While “cash and deposits” fell, the liquidity ratio stayed at a high level of 187.7% and financial soundness is not a concern.

* The increase reflects a ¥500mn investment in Panair, Inc. via a venture fund jointly established by TYO and Field Management, acquisition of DTT Group, as major advertising production company in Malaysia, as a consolidated subsidiary, and a purchase of shares in Tagpic Inc. (making it an equity-method affiliate), one of the largest influencer marketing companies in Asia.

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Financial highlights

1H FY12/18 financial highlights

| | 1H FY12/17 | | 1H FY12/18 | | Change | | (¥mn) | | |
|---|------------|-------|------------|-------|--------|-------------|------------------|-------|------------------|
| | Result | Ratio | Result | Ratio | Change | Change rate | 1H FY12/18 | | Achievement rate |
| | | | | | | | Initial forecast | Ratio | |
| Net sales | 33,729 | | 30,864 | | -2,865 | -8.5% | 35,000 | | 88.2% |
| Advertising Video Production Business | 24,723 | 73.3% | 20,962 | 67.9% | -3,761 | -15.2% | - | - | - |
| Other Production Business | 3,533 | 10.5% | 3,264 | 10.6% | -269 | -7.6% | - | - | - |
| Solutions Business | 3,721 | 11.0% | 4,194 | 13.6% | 473 | 12.7% | - | - | - |
| Overseas Business | 1,056 | 3.1% | 1,766 | 5.7% | 710 | 67.2% | - | - | - |
| Video-related Business | 697 | 2.1% | 678 | 2.2% | -19 | -2.7% | - | - | - |
| Cost of sales | 26,885 | 79.7% | 24,713 | 80.1% | -2,172 | -8.1% | - | - | - |
| SG&A expenses | 4,484 | 13.3% | 4,405 | 14.3% | -79 | -1.8% | - | - | - |
| Operating income | 2,358 | 7.0% | 1,746 | 5.7% | -612 | -26.0% | 2,000 | 5.7% | 87.3% |
| Ordinary income | 2,305 | 6.8% | 1,680 | 5.4% | -625 | -27.1% | 1,900 | 5.4% | 88.5% |
| Profit attributable to owners of parent | 1,189 | 3.5% | 1,170 | 3.8% | -19 | -1.6% | 1,300 | 3.7% | 90.0% |
| EBITDA | 2,932 | | 2,357 | | -575 | -19.6% | 2,690 | | 87.6% |
| Sales ratio by customer | | | | | | | | | |
| Dentsu Group | 8,473 | 25.1% | 7,310 | 23.7% | -1,163 | -13.7% | | | |
| Hakuhodo Group | 10,258 | 30.4% | 8,311 | 26.9% | -1,947 | -19.0% | | | |
| Direct transactions | 8,243 | 24.4% | 8,699 | 28.2% | 456 | 5.5% | | | |
| Other | 6,754 | 20.0% | 6,542 | 21.2% | -212 | -3.1% | | | |

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

Financial position as of the end of June 2018 (financial ratio)

| | As of the end of | | Change | | (¥mn) |
|---------------------------------------|------------------|------------|-------------|--------|-------|
| | | | Change rate | | |
| | December 2017 | June 2018 | | | |
| Current assets | 41,503 | 36,216 | -5,287 | -12.7% | |
| Cash and deposits | 12,573 | 10,462 | -2,111 | -16.8% | |
| Notes and accounts receivable – trade | 24,021 | 19,469 | -4,552 | -19.0% | |
| Work in process | 3,629 | 5,083 | 1,453 | 40.1% | |
| Non-current assets | 18,234 | 19,455 | 1,221 | 6.7% | |
| Property, plant and equipment | 7,679 | 7,291 | -387 | -5.1% | |
| Intangible assets | 5,269 | 5,784 | 515 | 9.8% | |
| Investments and other assets | 5,285 | 6,379 | 1,094 | 20.7% | |
| Total assets | 59,737 | 55,672 | -4,065 | -6.8% | |
| Current liabilities | 25,275 | 19,291 | -5,983 | -23.7% | |
| Accounts payable – trade | 7,341 | 5,990 | -1,351 | -18.4% | |
| Short-term loans payable | 12,772 | 8,209 | -4,563 | -35.7% | |
| Advances received | 758 | 1,350 | 592 | 78.1% | |
| Non-current liabilities | 8,756 | 10,699 | 1,942 | 22.2% | |
| Long-term loans payable | 3,465 | 5,480 | 2,015 | 58.2% | |
| Long-term deposits received | 3,501 | 3,501 | - | - | |
| Total liabilities | 34,031 | 29,991 | -4,040 | -11.9% | |
| Net assets | 25,706 | 25,680 | -25 | -0.1% | |
| Shareholders' equity | 24,675 | 24,788 | 112 | 0.5% | |
| Equity ratio | 41.3% | 44.5% | | | |
| Current ratio | 164.2% | 187.7% | | | |
| D/E ratio | 0.63 times | 0.53 times | | | |

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

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Activity results

Promoting initiatives in online video advertising for the 5G era

1. Mainstay business conditions and primary initiatives

(1) Advertising Video Production Business

Advertising Video Production Business sales were down 15.2% YoY to ¥20,962mn amid a roughly flat (to modest decline) trend in the advertising production market for TV commercials and other conventional media. While the printless shift had less impact than expected*1, stricter income management with emphasis on profitability, orders control as part of the response to work style reforms *2, and delayed sales recognition for some deals weighed heavily on sales. In earnings, however, the substantial improvement in effective profit margin (only the CM production division) to 36.4% (vs. 33.8% in the previous year), which was achieved by building sales management operations that focus on profitability (such as strict scrutiny and selection from the project orders stage and rigorous sales unit cost control), deserves notice.

*1 While the AOI TYO Group expected the printless shift to accelerate from around April 2018 in initial forecast, the actual pace has been slower. Print sales dropped 20.7% YoY to ¥1,061mn, but the decline margin appears to have been less than anticipated. Nevertheless, it is necessary to recognize remaining impact from printless shift as a factor incrementally lowering sales as this shift advances.

*2 Work style reforms are affecting business in two ways – 1) work style reform (cutbacks in working hours) at major advertising agents (customer side) and 2) orders control (deal curtailment) from AOI TYO Group's own work style reform. While the latter impact might result in projects that AOI TYO Group did not accept going to other businesses (mid-sized and smaller firms), temporary market distortion is likely to disappear (be absorbed) because work style reforms are taking place throughout the industry.

(2) Solutions Business

Sales in the Solutions Business, which is viewed as a growth area, climbed 12.7% YoY to ¥4,194mn. The TYO Offering Management Business Unit had robust sales growth with a 24.4% YoY increase to ¥2,965mn.

However, it is modestly trailing in progress toward the ambitious full-year plan. Sales at Quark Tokyo, a subsidiary of AOI Pro., fell 14.9% YoY to ¥1,095mn. While online video advertising production increased thanks to a trend of growing demand, the overall result was lower because of the presence of a major planning and consulting deal in the previous year.

Efforts in future business expansion, meanwhile, included the establishment of SOOTH*1, a new company that provides experience design solutions using vital sign data and other services, a business alliance (full support in branding, public relations, and advertising strategy) with Panair*2, which realizes electric power management using AI and big data, and some results in “initiatives in online video advertising for the 5G era” explained below.

*1 AOI TYP Group established this company on February 1, 2018 to carry on business handled by the AOI Pro. Experience Design Department. While the division handled 1) planning and production of contents that incorporates VR, AR, MR, and other latest technologies and 2) knowledge accumulation including new data and emotion data, the new company creation (spin-off) aims to go further in 3) pursuing comprehensive marketing business (solution provision covering from brand strategy proposal to effect measuring and analysis) and 4) developing high value-added business through data utilization. This move confirms existence of a basis for business expansion. Although full-fledged earnings contributions need substantial time, the business has large potential, including the application scope.

*2 Panair supplies the Panair Cloud, which is Japan's first cloud platform for electric power distribution using AI and big data researched and developed on its own. It established a new company with TEPCO Energy Partner, Inc. via joint investment in April 2018 and is pursuing development of energy-related services that harness IT. Panair has attracted interest in the electric power industry and throughout the energy industry. Along with the alliance, Ad Hack Ventures, a venture fund jointly established by TYO and FIELD MANAGEMENT, invested ¥500mn in Panair. We think the stake targets investment return, including from an IPO, based on evaluation of robust business potential and development of a stronger partnership.

Activity results

(3) Overseas Business

Sales in the Overseas Business grew significantly with a 67.2% YoY increase to ¥1,766mn. Positive factors were organic growth in Southeast Asia amid expansion of the advertising market and acquisition of DTT Group, a major Malaysia-based advertising production company, as a consolidated subsidiary*.

* AOI TYO Group purchased shares of holding-company Reserve Tank Sdn. Bhd., which owns the DTT Group, in March 2018. In 10 years from its establishment, DTT Group expanded video production business to a level that puts it in the top five firms in Malaysia. It has offices in Kuala Lumpur (Malaysia) and Jakarta (Indonesia) and receives many orders from China and other neighboring countries. We believe this acquisition aims for entry into Indonesia and other neighboring countries, in addition to expansion of business with Japanese and local companies in Malaysia.

2. Initiatives in online video advertising for the 5G era

Given the prospect of rapid expansion in the video advertising market from 2020 driven by 5G*, AOI TYO Group has presented three directions and achieved some results toward its aim of establishing a business model that meets the needs of high-quality video and providing new value.

* This refers to new technology for realization of a larger-capacity network system capable of handling anticipated traffic growth for the information society of the 2020s at low cost and low power consumption. R&D efforts are moving forward to satisfy requirements of ultra high-speed communications, low latency, and simultaneous connection to a large number of terminals needed for wider adoption of IoT and IoE.

(1) Fusion of commercials and entertainment

“Shoplifters,” which was funded and produced by AOI Pro. and directed by Hirokazu Kore-eda, won the Palme d’Or award (top prize) in the competition division at the 71st Annual Cannes Film Festival. It also received the ARRI/Osram award (grand prize) in the Cinema Masters competition at the 36th Munich International Film Festival in Germany (the first time for a Japanese film to win this award). AOI TYO Group intends to continue its initiatives with entertainment content and pursue further growth in this business on the prospect of a coming era of fusion of entertainment content and advertising videos*.

* Advertising videos are undergoing a functional shift from being a tool to communicate brand information to being a tool that connects brands and consumers. As a result, video producers need to be content creators capable of handling the full range from developing to producing high-quality scenes that emotionally move consumers.

(2) Online videos and influencer marketing

In July 2018, AOI Pro. concluded a capital and business alliance with Tagpic, one of the largest influencer marketing companies in Asia, and adopted it as an equity-method affiliate in August. This move strengthened its presence in the video and influencer marketing field. With more companies utilizing social media in video marketing in recent years, the alliance hopes to expand business areas and achieve business growth at both companies by combining Tagpic’s knowhow in influencer casting and utilization and knowledge in the area of Internet video distribution using the PICFEE branding video distribution network, and AOI Pro.’s video production skills. It also aims to provide new value leveraging video and influencer marketing in client branding strategies.

(3) Response to creator demand

AOI TYO Group established “MovieBox,” a human resources solution service, in the TYO Offering Management Business Unit, in order to respond to rapidly growing corporate needs for in-house creators. This strategy aims to acquire business from the tail portion (with smaller project scale) in the long-tail online video advertising market not addressed in the past, with cultivation of a business model that emphasizes efficiency. AOI TYO Group has already started provision of group resources (mainly personnel and video production assistance tools) and knowhow via monthly retainer contracts.

Activity results

3. Progress in 1H FY12/18

Looking at 1H FY12/18 progress in trends described above, despite pressure on earnings from the external environment (printless shift and work style reform responses), we think the AOI TYO Group had successes in improving effective profit margin, promoting investment and alliance strategies, and preparing for the 5G era. Improved effective profit margin (leaner organization) and investments in new growth areas demonstrate progress in the management integration effect (economies of scale).

■ Business performance outlook

Lower FY12/18 period-start forecast (only net sales)

AOI TYO Group lowered its FY12/18 forecast from the period-start stance (only net sales). The updated outlook projects sales and profit declines at ¥64,000mn in net sales (-9.2% YoY; a reduction of ¥6,000mn), ¥3,800mn in operating income (-17.7%), ¥3,700mn in ordinary income (-15.8%), and ¥2,300mn in profit attributable to owners of parent (-17.3%).

In sales, while AOI TYO Group should books gains in Solutions Business as a growth area, Overseas Business with an acquisition effect, and Other Production Business from dividend income on movie investments (about ¥200mn), it forecasts a substantial decline in Advertising Video Production Business, just as in 1H, because of advances in the printless shift (likely to accelerate from 2H 2018), responses to work style reforms, and other factors. It reduced the period-start net sales target to reflect the 1H shortfall (about ¥4bn) and use a conservative assumption for 2H based on a policy of not overly pursuing sales expansion (instead selectively accepting deals with emphasis on profitability).

AOI TYO Group projects lower earnings (YoY), despite targeting higher effective profit margin (just as in 1H), owing to profit setback from lower sales and investments in growth areas. Nevertheless, it maintained the existing earnings outlook because of factoring in dividend income from movie investments (about ¥200mn) not included initially.

To reach FY12/18 targets, AOI TYO Group needs to deliver ¥33,136mn in net sales (-9.8% YoY) and ¥2,054mn in operating income (-9.2%) in 2H. We think it is capable of attaining the outlook in light of likely growth in online video advertising demand, steady improvement in effective profit margin, dividend income not included in the period-start view, and additions from the acquisition effect (Malaysian subsidiary).

Business performance outlook

FY12/18 forecast

(¥mn)

| | FY12/17 | | FY12/18 | | FY12/18 | | YoY | |
|---|---------|-------|------------------|-------|------------------|-------|------------------|------------------|
| | Result | Ratio | Initial forecast | Ratio | Revised forecast | Ratio | Initial forecast | Revised forecast |
| Net sales | 70,473 | | 70,000 | | 64,000 | | -0.7% | -9.2% |
| Advertising Video Production Business | 49,339 | 70.0% | 45,300 | 64.7% | - | - | -8.2% | - |
| Other Production Business | 8,773 | 12.4% | 7,900 | 11.3% | - | - | -10.0% | - |
| Solutions Business | 8,071 | 11.5% | 11,200 | 16.0% | - | - | 38.8% | - |
| Overseas Business | 2,842 | 4.0% | 4,500 | 6.4% | - | - | 58.3% | - |
| Video-related Business | 1,446 | 2.1% | 1,100 | 1.6% | - | - | -23.9% | - |
| Cost of sales | 56,788 | 80.6% | - | - | - | - | - | - |
| SG&A expenses | 9,065 | 12.9% | - | - | - | - | - | - |
| Operating income | 4,619 | 6.6% | 3,800 | 5.4% | 3,800 | 5.9% | -17.7% | -17.7% |
| Ordinary income | 4,394 | 6.2% | 3,700 | 5.3% | 3,700 | 5.8% | -15.8% | -15.8% |
| Profit attributable to owners of parent | 2,781 | 3.9% | 2,300 | 3.3% | 2,300 | 3.6% | -17.3% | -17.3% |
| EBITDA | 5,755 | 8.2% | 5,230 | 7.5% | 5,230 | 8.2% | -9.1% | -9.1% |
| ROE | 11.3% | | 8.8% | | 8.8% | | - | - |

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

Growth strategy

Longer-term growth drivers are the Solutions Business and Overseas Business supplying new value

1. Background to the management integration (January 2017)

In the background to the management integration is the diversification of media and devices (such as smartphones and tablets) focused on the Internet, and in addition, the major changes to the industry environment, including communication speeds and data analysis, and also the progress being made in technological innovations, such as VR and AR. In this environment, major growth in TV commercial production, which has been the mainstay up to the present time, is unlikely, but advertising-related business areas will expand, with accompanying changes to their methods and structures.

Based on this sort of awareness of the business environment, the companies judged that integration was to grow in the medium to long term to expand market share, strengthen negotiation power, and maintain robust capital strength. They also want to build a competitive and advanced business model by newly forming a group to lead the industry and concentrating and effectively utilizing management resources.

Growth strategy

2. Longer-term growth image

AOI TYO Group depicts a longer-term growth image with Solutions Business (including related production business) and Overseas Business (China and Southeast Asia) driving stronger performance. In the existing mainstay Advertising Video Production Business, meanwhile, it targets steady growth by promoting heightened emphasis on profitability and efficiency and a lean organization that adapts to a printless shift. The outlook sets FY12/21 goals of at least 12% in ROE and ¥8bn EBITDA (based on 17.0% average growth over three years with FY12/18 target of ¥5.23bn as the starting point).

We attribute use of EBITDA as the goal to emphasis on earnings growth and the prospect of M&A activities (since EBITDA does not count amortization of goodwill). AOI TYO Group aims to realize EBITDA growth by investing aggressively in projects likely to deliver profitability exceeding the cost of shareholders' equity and also improve shareholder returns (dividend payout ratio) and capital efficiency (ROE).

(1) Solutions Business

It aims to expand orders from new and existing advertisers in direct transactions with advertisers, which it has already been handling. Also, it hopes to provide the general public with new experiences by developing and producing contents that incorporate the latest technologies, such as VR, AR, MR, IoT, and AI. It also seeks to accumulate knowledge, including new data and emotion data obtained from these experiences, for application in the integrated marketing business (supplying solutions that integrate from brand strategy formulation to effect measurement and analysis). Furthermore, it intends to make advances to high value-added businesses utilizing data (such as DMP and strategic consulting). The approach seeks to foster a solutions-proposal business model and shift to knowledge-intensive business while harnessing experiences, knowledge, networks, and other resources from past Advertising Video Production Business. To achieve this, it will focus on reinforcement of operations and personnel (communication designers, data specialists, and others), including external people. Additionally, it will pursue aggressive investments to gather and accumulate data, integrate with external data, and develop and build schemes for effect measuring and analysis and IT services.

(2) Overseas Business

AOI TYO Group plans to continue bolstering sites in China and Southeast Asia that the two companies pursued thus far. In Southeast Asia, it plans to strengthen production capabilities and expand business via M&A. Additionally, it intends to leverage collaboration and mutual utilization of human networks and resources.

We do not see the EBITDA goal (¥8bn) as an easy level in light of decline in profitability from the printless shift and burden from investments in new growth areas amid slim prospect of growth in demand for mainstay TV commercial production (Advertising Video Production Business). Nevertheless, we think the "experience design" business field, which AOI TYO Group aims to expand through promotion of a solutions-type business model, offers a market with large potential. We also expect AOI TYO Group's experience and knowhow cultivated in video production to provide a differentiating factor and see a large advantage from its credibility (brand strength) and financial clout (especially for expansion of business with clients having a nationwide reach and investment strategy including M&A). Improvements started to be seen in effective profit margin and future-oriented initiatives, but we will be particularly focusing on new value creation (such as VR content and data utilization) in the context of specific results obtained from management integration and aggressive investments in growth fields.

■ Shareholder returns

Policy targeting at least 30% consolidated dividend payout Implementing share buybacks too

AOI TYO Holdings has presented a dividend policy of targeting at least 30% consolidated dividend payout ratio and dividend hikes accompanying a higher effective profit level. Furthermore, it is adopting DOE (dividend on equity ratio) as an indicator (with a goal of 4% in FY12/21) and seeks to raise this value from the standpoint of supplying a continuous and steady dividend.

For FY12/18, AOI TYO Holdings expects to pay an ordinary dividend of ¥30 per share (interim dividend = ¥8 per share, fiscal year-end dividend = ¥22 per share). This dividend would result in a payout ratio of 31.4% and DOE of 2.8%.

AOI TYO Group purchased 400,000 shares (¥531,200,000 purchase cost) on June 7, 2018 as part of dynamic capital policy aimed at raising shareholder return and capital efficiency.

Furthermore, it provides benefits to shareholders listed or registered in the shareholder register as of June 30 (with ownership of 500 or more shares) with an original QUO card* and original photo collection with a photo shooting (40 people selected from applicants in a lottery).

| * ¥3,000 for 500 or more shares, ¥5,000 for 1,000 or more shares, and ¥10,000 for 2,000 or more shares. |



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