Actively Tackling Challenges and Aiming for Sustainable Growth Utilizing KOEI TECMO's Sound Financial Structure as a Foundation

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Achieving record-high net sales and non-operating income and expenses in FY2023 despite results falling short of targets

For the fiscal year that ended in March 2024 (FY2023), the second year of our Third Medium-Term Management Plan, KOEI TECMO recorded consolidated net sales of 84.5 billion yen, an increase of 7.9% from the previous year, and operating profit of 28.4 billion yen, a decrease of 27.2%. Net sales reached an all-time high thanks to repeat sales of existing titles and the launch of multiple new mobile titles. In contrast, sales of new console/PC and mobile titles were below targets. Operating profit fell short of our initial target for a few reasons: our inability to reach sales targets for new titles, an increase in variable costs like sales commissions resulting from the concentrated release of new in-house-developed mobile titles, and a rise in employment and outsourcing costs.

On the other hand, non-operating income and expenses reached an all-time high due to the recording of interest income and gain on the sale of investment securities as we carried out fund management while monitoring financial markets. As a result, profit attributable to parent company shareholders increased 9.2% from the previous year to 33.7 billion yen.

Returning to profit growth trajectory and preparing for our next growth phase

KOEI TECMO's management policy in the current year is to create and develop global IPs. In implementing this policy, we have commenced a variety of measures to strengthen our growth potential and profitability after reflecting upon why we fell short of our targets in FY2023.

First, as a growth strategy, we will strive to meet challenges in genres with growing markets like open world games and will expand our global business. To build a development system capable of consistently releasing new major titles, we have established a new AAA Games Studio, have launched a large-scale project that transcends the boundaries of brands, and are developing new titles. We will also invest in human resources through active recruiting and training focused mainly on new graduates and will also promote innovation in production processes by utilizing new technologies such as generative AI. At the same time, we are reviewing our in-house quality control and review systems to raise our AAA-level quality. We are also directing efforts toward cost management and reduction by enhancing the efficiency of CG production management and checking systems, and utilizing AI in some processes.

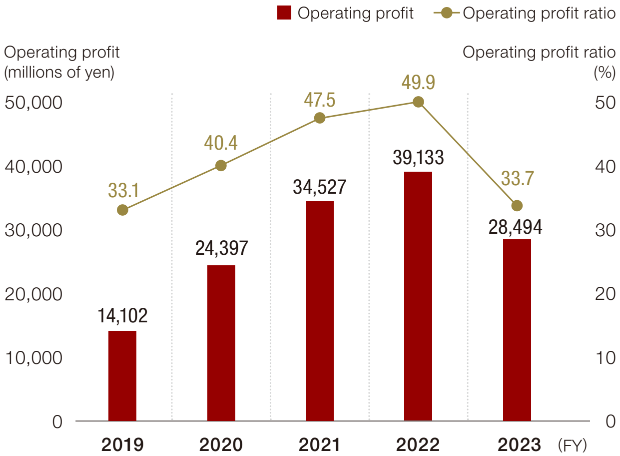
I am confident that these measures will enable profits to return to an upward trajectory from FY2024. That said, recent years have witnessed increasingly longer development times for each title. This means that more time could be needed for growth potential to rebound. Mindful of this, we have revised our FY2024 sales target downward from 100 billion yen to 90 billion yen. We are currently starting preparations for the next Medium-Term Management Plan and beyond. I hope that everyone will anticipate further growth in our business results over a slightly longer time span.

KOEI TECMO's basic financial management policy: Using a multi-layered profit cycle to generate stable profits in a volatile industry

The game industry is characterized by wide fluctuations in sales that make forecasting difficult. Generally speaking, developing a new game requires an investment of at least 2 to 3 billion yen. A major title can cost more than 10 billion yen, with development spanning several years. During this time, development costs are incurred upfront, resulting in significant negative cash flows. For this reason, it is crucial to establish a system capable of generating stable profits in gaming businesses with such volatility in sales.

The KOEI TECMO Group has six brands that can develop games in a diverse range of genres. At the same time, we have established a multi-layered revenue cycle in which we (1) create new IP, (2) develop hit titles into series, (3) develop collaborative titles, and (4) license out IP. This cycle serves as the foundation that allows us to continuously take on challenges for the future by steadily securing balanced profits as a company.

Operating profit and operating profit ratio



Three key points of financial management

Against this background, KOEI TECMO thoroughly executes a conservative and safety-oriented financial management policy. Specifically, we focus on 1) implementing thorough profit management for individual titles, 2) recording game development costs upfront as they are incurred, and 3) securing stable available funds.

1) Thorough profit management for individual titles: Ensuring an operating profit ratio of 30%

In undertaking profit management for individual titles, we strictly adhere to the standard of attaining a 30% operating profit ratio for in-house projects. We make assessments at each milestone, from the planning stage to release, and discontinue the development of any titles with little prospect of attaining an operating profit ratio of 30%. Therefore, we rarely extend development periods or suddenly cancel titles immediately before release. Managing the profit of individual titles allows us to develop titles while skillfully devising ways to deliver high-quality titles to customers within a fixed budget.

2) Recording game development costs upfront as they are incurred: A profit structure that incorporates future costs

In general, development costs of games and other software products under development are frequently recorded as work in progress assets and then amortized as expenses after release. In that case, if a game does not sell as expected or is discontinued midway through development, it can end up remaining on the balance sheet as a non-performing asset.

However, in KOEI TECMO's case, development costs incurred during the current fiscal year are recognized as expenses for that year. This prevents the risk of asset impairment losses even if sales hypothetically fall short of our plan or development is canceled. Even though incurring increasing development costs upfront reduces our current profitability, we have adhered to this policy since our founding to maintain a profit structure that continually generates profits and to be fully prepared for any future volatility.

KOEI TECMO's M&A and PMI

M&A: Emphasis on 1) valuable IP and outstanding human resources, 2) creating synergy, and 3) specific PMI plans
PMI: Our successful PMI was the result of continuously communicating shared values to employees

When considering M&A, we emphasize three points: whether the other company has valuable IP and outstanding human resources, whether we can expect synergy commensurate with the premium we will pay, and to what extent we can concretely draw a vision for PMI (Post Merger Integration). We focus on these points because M&A requires exhaustive verification and analysis of post-acquisition management and the creation of synergy.

Following the business integration of Koei Co., Ltd. and TECMO, LTD. in 2009, we were able to proceed with PMI in one fell swoop by completely unifying the personnel system, including salary levels, and project management methods. Similarly, Gust Co., Ltd., which became a wholly owned subsidiary in 2011, was absorbed and branded.

The basis of this PMI was management's belief that it would be unnatural to not collaborate in the same businesses given that the two companies integrated their management and that it is far easier to create synergy within a single company. Both companies had independently achieved solid results and cultivated their own distinct corporate culture, and there was a sense that they resisted changing their cultures. For these reasons, top management explained the background of the M&A and the direction of the PMI, continuously transmitted messages to employees encouraging them to do their best, and focused on conveying our cherished values to earn the empathy of employees. Thanks to these efforts, brands with different origins are now collaborating to create game titles (such as "Atelier Resleriana: Forgotten Alchemy and the Polar Night Liberator" by Team NINJA and Gust, and the "Nioh" series by KOU SHIBUSAWA and Team NINJA).

3) Securing stable available funds: A solid financial foundation for creating major titles

KOEI TECMO is taking on the challenge of creating major titles for global markets, and securing ample available funds is essential for achieving this objective.

We maintain a policy of securing funds to continue paying our employees' salaries so that they can continually take on new challenges even if we are unable to produce a hit title for several years.

Focusing on content industries other than games: Considering M&A that create synergy through IP and outstanding human resources

We proactively consider M&A as one of our future growth strategies. In FY2023, KOEI TECMO entered into a capital and business alliance with Akatsuki Inc. We will increase the effectiveness of our business alliance with the launch of "Atelier Resleriana: Forgotten Alchemy and the Polar Night Liberator," jointly developed by Akatsuki Games of the Akatsuki Group and KOEI TECMO GAMES. We regard the formation of this alliance with a smartphone game company to be a major achievement.

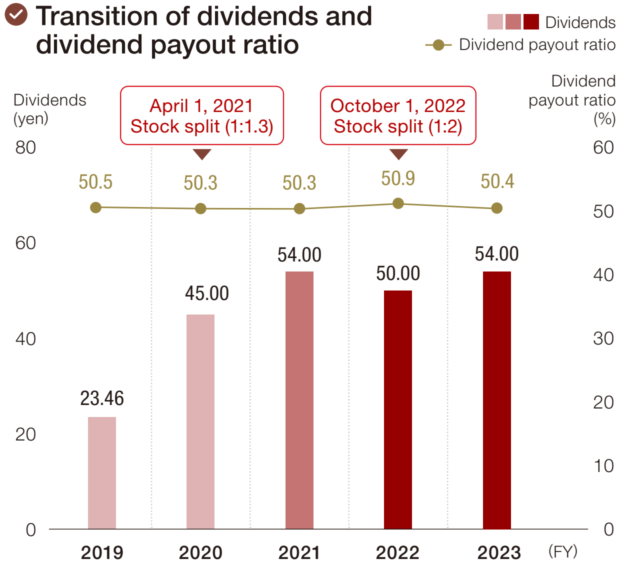
The chief points that serve as a basis when considering M&A are whether the partner company has intellectual property (IP) and reliable human resources. It is extremely important to consider the post-M&A structure from the perspective of whether we can increase and utilize the appeal of the IP and raise the skills and morale of outstanding human resources to ensure we can create synergy. For example, even if a company uses its original IP only for mobile games, there is a possibility that the same IP can also be utilized in multifaceted ways. In addition to the game industry, we continuously focus on other content industries such as anime, manga, and movies that are compatible with games.

Undertaking management with an awareness of cost of capital and stock price, and aiming to further increase our stock value

We will continue working toward ensuring that management is aware of the cost of capital and stock price. Our ROE for FY2023 was 21.3%, exceeding 20% for the fourth consecutive year. In this way, we maintain our ROE at a level significantly higher than the cost of capital as calculated by the Company. Furthermore, we position the return of profits to our shareholders as one of our most important management policies. Our basic policy for returning profits to shareholders is to realize "a consolidated annual total payout ratio of 50%, including dividends and share buybacks, or an annual dividend of 50 yen per share" (the actual results at the end of FY2023 were an annual dividend of 54 yen per share and a total payout ratio of 50.4%).

Under our Group vision of becoming "The World's No. 1 Digital Entertainment Company," KOEI TECMO aims to realize growth potential and profitability and has overcome numerous hurdles to achieve its targets. In the future, we will continue to work in unison to take on the challenge of attaining high targets and aim to further increase our stock value along with the advance of the Group to meet even greater expectations of our stakeholders.

Transition of dividends and dividend payout ratio



(Note) The Company implemented a 1.3-for-1 common stock split on April 1, 2021, and a 2-for-1 common stock split on October 1, 2022. Dividends per share (after stock split adjustment) are calculated on the assumption that the said stock split was implemented at the beginning of fiscal 2019.

Continuity, flexibility, and soundness as the keys to successful non-operating investments: Undertaking fund management without losses after a merger

The game industry is a business in which making forecasts is difficult. Accordingly, we maintain ample available funds that allow us to proactively pursue future development and business regardless of short-term shifts in business results. Rather than holding idle funds, we manage our funds efficiently while balancing risk and return. Surplus fund management is positioned solely as a means of supporting our core businesses. Accordingly, we adhere to the following basic principles.

1) Continuity

We aim to achieve continuity by managing surplus funds after investing in our core businesses from each fiscal year's profits and by being able to record stable profits from a medium- to long-term perspective.

2) Flexibility

We maintain the flexibility to review our portfolio in response to changes in the financial environment.

3) Soundness of our asset portfolio

We ensure a healthy balance sheet, which includes ascertaining the unrealized gains and losses of our managed assets.

The state of fund management is reported to the Board of Directors monthly and undergoes detailed checks to ensure proper governance. Additionally, in FY2023 we shifted to a bond-centered portfolio, which significantly improved non-operating income and expenditures, along with the unrealized gains and losses of managed assets.

The balance of fund management has been consistently positive since our business integration. Profits earned through fund management support the growth of KOEI TECMO as future funds.