SQUARE ENIX HOLDINGS CO., LTD.
3Q FY2017/3 Financial Results Briefing (Teleconference) Notes

Date/Time: February 6, 2017 (Mon); 10:00-11:00pm (JST)
Presenter: Yosuke Matsuda, President and Representative Director
Interpretation: Japanese-English

Overview

For the nine-month period ended December 31, 2016 (“1-3Q FY2017/3”), the Company booked net sales of ¥190.1 billion, operating income of ¥21.5 billion, recurring income of ¥22.1 billion, and profit attributable to owners of parent of ¥17.1 billion.

Net sales rose YoY, while operating income fell. The declines at the operating and recurring income lines were roughly equal, while profit attributable to owners of parent rose by ¥3.5 billion.

The Digital Entertainment segment saw a sharp rise in net sales, but operating income declined ¥1.4 billion. In the HD Games sub-segment, the newly released “FINAL FANTASY XV” (“FFXV”) and the PS4 version of “Rise of the Tomb Raider “contributed to earnings, but the MMO sub-segment sold fewer expansion disks than it had a year earlier, resulting in lower profits.

The Amusement segment was helped in part by the popularity of “Love Live! School Idol Festival,” an arcade game launched in early December. However, in the absence of a contributor on the scale of the previous year’s “DISSIDIA FINAL FANTASY,” profits fell by ¥700 million.

The Publication segment saw slight declines in both net sales and operating income. FY2017/3 is a period of preparation we are using to cultivate new titles for FY2018/3.

The Merchandising segment saw increases in both net sales and operating income. Major HD title releases have driven growth in sales of tie-in merchandise.

For the three-month period ended December 31, 2016 (“3Q”), the Company booked net sales of ¥83.7 billion and operating income of ¥10.4 billion. The release of “FFXV” drove a sharp YoY rise in sales, but the amortization of development costs resulted in a decline in profits. The development costs for “FFXV” have been fully amortized in 3Q, so we expect downloads and other repeat sales to contribute to earnings going forward.

In the Smart Device sub-segment, we launched “STAR OCEAN” in 3Q and “DISSIDIA FINAL FANTASY” in 4Q. Based on their strong start, we have high hopes for the way forward.

At the non-operating line, we booked approximately ¥500 million in foreign exchange gains in 1-3Q FY2017/3. We had initially anticipated a strong yen, but since the yen weakened instead, sales of “FFXV” and other titles resulted in gains on our foreign currency-denominated receivables.

We see no need to revise our full-year guidance at present.

Q&A

Q: What is the status of Machine Zone’s development of a mobile version of “FFXV” and what business model is being applied to this deal?

A: We have entered a license agreement with Machine Zone that enables them to engage in development and publishing efforts based on the “FFXV” IP. NDA prevents us from disclosing information on the details of the agreement or the launch timing, but we have been told the development effort is going well.

Q: What will drive earnings in FY2018/3?

A: HD: We are slated to launch “DRAGON QUEST XI.” We also look for repeat sales of “FFXV”, which was released in FY2017/3, and are preparing to offer premium downloadable contents (PDLC) for that title as well.

MMO: We plan to launch expansion disks for “FINAL FANTASY XIV” and “DRAGON QUEST X.”

Smart Devices: We are hard at work on development efforts leveraging both new and existing IP ahead of launches slated for FY2018/3. We will also continue to bolster our overseas offerings, including to China and the Western markets.

Q: How have sales of “FFXV” been and how have PDLC been contributing to earnings?

A: Initial shipments of “FFXV” exceeded 5 million units, and that figure reached 6 million units in early 4Q. The pace of sales exceeds our plan. Going forward we intend to use PDLC and free updates to continue to build interest in the title and to grow sales of the primary title over the long term.
Sales prices are lower for PDLC than for the primary title, but PDLC margins are high. We focus on PDLC more from the perspective of user retention than from the earnings that the PDLC themselves generate.

Q: Do rising development costs not suggest greater asset risk for your work in progress?

A: We see the level of development costs for both HD and Smart Device titles in our current pipeline as appropriate. We intend to maximize earnings from titles slated for launch in FY2018/3 and beyond by picking optimal release dates that reflect competition from peers and other considerations of the market landscape. While some uncertainty is involved in the performance of Smart Device titles that leverage new IP, we on the whole anticipate no major asset risk at this time.

Q: Will you be leveraging self-developed game engines to engage in efficient game development efforts going forward?

A: We do intend to engage in efficient game development efforts by selecting game engines to use based on the attributes of the title in question, with one option being our self-developed engine, which was completed via the development of “FFXV”, and another being Unreal Engine 4, which is used widely in the industry.