We would now like to begin the Financial Results Briefing Session of SQUARE ENIX HOLDINGS (the “Company”) for the nine-month period ended December 31, 2018 (“1-3Q FY2019/3”).

Today’s presenters are:
Yosuke Matsuda, President and Representative Director
Kazuharu Watanabe, Chief Financial Officer.

First, Mr. Watanabe will give an overview of the Company’s financial results for 1-3Q FY2019/3, and then Mr. Matsuda will discuss the progress made by each of the Company’s business segments.

Good afternoon. I’m Kazuharu Watanabe. I will be presenting an overview of the Company’s financial results for 1-3Q FY2019/3.

In 1-3Q FY2019/3, the Company booked net sales of ¥179 billion (-4.8% YoY), operating income of ¥11.7 billion (-65.3%), ordinary income of ¥15.9 billion (-54.1%), and net income attributable to parent company shareholders of ¥8.9 billion (-60.1%).
I will next break our results down by segment.

The Digital Entertainment segment booked net sales of ¥130.4 billion (-¥13.1 billion YoY) and operating income of ¥14.8 billion (-¥21.5 billion).

The HD Games sub-segment saw net sales rise YoY thanks to the launch of major new titles such as “SHADOW OF THE TOMB RAIDER” and “JUST CAUSE 4.” Meanwhile, operating income declined YoY due to greater amortization of development costs and increased advertising spending.

The MMO sub-segment saw both net sales and operating income decline YoY due to the release of expansion packs for “FINAL FANTASY XIV” and “DRAGON QUEST X.”

In the Games for Smart Devices/PC Browsers sub-segment, many of the titles launched since the previous fiscal year have performed below our expectations and failed to add to the revenues generated by existing games. A decrease in licensing income and an increase in advertising spending also contributed to a YoY decline in net sales and operating income. “Romancing SaGa Re;universe,” which was launched in December, is off to a good start, but its sales only began to hit our books as of 4Q.

The Amusement segment posted net sales of ¥34.2 billion (+¥2.7 billion YoY) and operating income of ¥1.4 million (-¥1.1 billion). Net sales rose YoY thanks to solid arcade operations and the launch of new amusement machines, but operating income declined, in part due to greater amortization charges associated with changing out machines installed in arcades.

The Publication segment posted net sales of ¥9.9 billion (+¥1.7 billion YoY) and operating income of ¥2.8 billion (+¥1.0 billion). Sales of printed comic books were on par with the same period of the prior fiscal year, but sales in digital formats grew sharply, resulting in higher net sales and operating income YoY.
The Merchandising segment posted net sales of ¥5.1 billion (-¥700 million YoY) and operating income of ¥500 million (-¥1 billion). The YoY declines in net sales and operating income are owed to the high hurdle set in the same period of the prior fiscal year by the release of merchandise based on characters in the Group’s IP portfolio.

This concludes my overview of our financial results.

I am Yosuke Matsuda. I will be discussing the progress we made in each business segment in 1-3Q and our outlook for 4Q.

Our 3Q plan was premised on the HD Games sub-segment offsetting sluggishness in the Games for Smart Devices/PC Browsers sub-segment, but results were disappointing as we sold fewer copies of the HD game “JUST CAUSE 4” on launch than we had expected.

Both net sales and operating income declined YoY at the Digital Entertainment segment.

3Q at the HD Games sub-segment was marked by growth in the holiday season of digital sales, especially of “SHADOW OF THE TOMB RAIDER,” and by the launch of “DRAGON QUEST BUILDERS 2.” Meanwhile, while we released “JUST CAUSE 4,” we sold fewer units on launch than we had anticipated and were therefore unable to offset charges such as the amortization of development costs.
We released multiple new titles in the Games for Smart Devices/PC Browsers sub-segment in 3Q, but many of them have got off to a lackluster start.

Under our current accounting policy, we post sales on smart device titles with a one-month lag. As such, we did not start to post sales of “Romancing SaGA Re;universe,” which was launched in December, until 4Q. We are currently exploring the possibility of revising our accounting policy so as to rectify this one-month lag as of FY2020/3.
The Amusement segment saw net sales rise YoY on the launch of “Starwing Paradox,” but operating income fell due to sizeable initial amortization charges associated with the game’s development. We want to grow the game’s sales by working to make it a long-runner.

Both net sales and operating income rose YoY at the Publication segment thanks to brisk sales in digital formats. Rather than relying on major hit titles, we have established a library of smaller titles on “MANGA UPI!” and “GANGAN pixiv,” which has helped to stabilize earnings. We have high hopes that digital sales will continue to provide a foundation for stable earnings in FY2020/3 and beyond.

The Merchandising segment saw both net sales and operating income decline YoY. We intend to bolster earnings by forming a new business unit combining e-commerce, animation, stage productions, and music as of FY2020/3 to enable us to better leverage our content.

I will next discuss our full-year outlook. In 4Q, we expect to achieve significant improvement in earnings with the help of titles such as “KINGDOM HEARTS III” and “Romancing SaGa Re;universe.”

Global shipments (including digital downloads) of “KINGDOM HEARTS III” have already exceeded 5 million units, and we expect sales volume to grow even further by the end of the fiscal year. In addition, “Romancing SaGa Re;universe,” which we launched in December, is outperforming our expectations.
Moreover, given the thorough review we conducted of our content production account in 2Q, we see lower risk of incurring significant additional valuation losses in 4Q.

Because we need to keep a close eye on such conditions, we have left our full-year guidance unchanged as of the end of 3Q.
Q: Do the sales thus far of “SHADOW OF THE TOMB RAIDER” and “JUST CAUSE 4” change your outlook for additional sales in FY2020/3? If so, does that impact your medium-term target for operating income of ¥40-50 billion in FY2020/3?

A: While “SHADOW OF THE TOMB RAIDER” got off to a weak start, we had shipped a total of 4.12 million units as of the end of 3Q, and we look for sales to grow further in FY2020/3. Initial sales of “JUST CAUSE 4” were below our expectations, but we intend to grow sales in FY2020/3 by offering updates and through other initiatives. As such, any adverse impact on the achievement of our medium-term target should be limited.

Q: Operating income at the Games for Smart Devices/PC Browsers sub-segment dropped off sharply versus 2Q. With sales down, could you not do something to control advertising spending and other costs?

A: TV commercials are especially expensive, but we do not advertise all of our titles. We are selective about which titles we advertise based on the return we can expect from our investment. In terms of the comparison versus 2Q, we ran advertising campaigns toward the year-end, but since December sales are not posted until 4Q, that prior spending hit the books first and depressed our profits.

Q: Do you believe you can achieve operating income of ¥30 billion in FY2019/3, or have you maintained full-year guidance because you believe you’re in the clear so long as you don’t undershoot guidance by more than 30% based on the Tokyo Stock Exchange’s disclosure rules [which say no guidance revision is required if a company expects a profit result that deviates no more than 30% from published guidance]?

A: We see some uncertainty in terms of the extent to which we will be able to make up for ground lost in 3Q and because we could incur valuation losses depending on the timing at which we release new major titles in FY2020/3 and beyond. That said, we also see some potential upside factors, so we intend to work hard to achieve our ¥30 billion target.
Q: Could you tell us approximately how much you booked in advertising costs in 3Q for titles to be launched in 4Q?

A: We don’t disclose our advertising costs for individual titles, but we spent a reasonable amount.

Q: What can you tell us about the timeline for your FY2020/3 releases?

A: I cannot go into any detail at the moment, but I believe we will be able to make various announcements in the lead-up to this year’s E3.

Q: How likely are you to reach your operating income target of ¥40-50 billion with the lineup you have planned for FY2020/3?

A: We believe operating income of ¥40-50 billion will be attainable in FY2020/3 with the lineup we currently have planned, but we still see risk of deviating from our target depending on when we release new titles and on how our development efforts progress.

Q: At your 2Q earnings briefing, you discussed changing your policy to developing smart device titles, but how has that gone?

A: The titles we launched in 3Q were already set for release prior to the change in our approach, so they are not reflective of any change. As of FY2020/3, we plan on reorganizing and consolidate the 11 existing business divisions within SQUARE ENIX JAPAN (SQUARE ENIX CO., LTD.) into four business units in order to increase the efficiency of our workflows, make more effective use of our resources, and consolidate our expertise with the aim of improving profitability.

Q: What were the main reasons you posted an operating loss of ¥1.7 billion at the HD Games sub-segment?

A: The main reason is that we launched “JUST CAUSE 4” in December 2018, but it got off to a sluggish start, so we were not able to offset the amortization charges on the development costs. Additional sales of “SHADOW OF THE TOMB RAIDER” during the holiday season and the launch of “DRAGON QUEST BUILDERS 2” were also not enough to compensate for the shortfall of “JUST CAUSE 4.”
Q: Why did “SHADOW OF THE TOMB RAIDER” and “JUST CAUSE 4” get off to a weak start? If initial sales volumes are lower than they traditionally have been but digital sales are extending the lifetimes of games, don’t you need to change the timing of your advertising efforts?

A: We think the main reason is that we were unable to provide an experience that was novel enough that players would choose to buy them before any of the other numerous major titles on the competitive landscape. Also, while it is true that we are seeing a shift away from sales of boxes to digital downloads, with this many titles competing with one another, initial sales are definitely an important element in increasing user awareness. For that reason, we do need to engage in a certain amount of advertising just ahead of a new title’s launch.