We would now like to begin the Financial Results Briefing Session of SQUARE ENIX HOLDINGS (the “Company”) for the fiscal year ended March 31, 2019 (“FY2019/3”).

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

First, Mr. Watanabe will give an overview of the Company’s financial results for 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 FY2019/3.

In FY2019/3, the Company booked net sales of ¥271 billion (+8.2% YoY), operating income of ¥24.5 billion (-35.7%), ordinary income of ¥28.3 billion (-21.6%), and net income attributable to parent company shareholders of ¥18.4 billion (-28.5%).

The year recorded higher sales but lower profits YoY.
The plans, forecasts, strategies and ideas described in this material are descriptions of forecasts of future results. These descriptions rely on information available as of the date of production of this material and are based on assumptions and judgment made by the Company’s management. Readers are advised not to rely solely on these forecasts. Readers should not assume that these forecasts are accurate or valid information, even after the date of public release. There are many factors that may cause actual results to vary considerably from the forecasts, and in some cases actual results may be inferior to forecasts.

I will next break down our results by segment.

The Digital Entertainment segment booked net sales of ¥204.5 billion (+¥13.1 billion YoY) and operating income of ¥29 billion (-¥14.4 billion).

The HD Game sub-segment saw YoY growth in net sales thanks to the release of the major titles “KINGDOM HEARTS III,” “SHADOW OF THE TOMB RAIDER,” and “JUST CAUSE 4.” However, a rise in costs associated with the release of the new titles resulted in a YoY decline in operating income.

Both net sales and operating income fell YoY at the MMO sub-segment due to the high hurdle set in the previous year, which saw the release of expansion packs for “FINAL FANTASY XIV” and “DRAGON QUESTX.” However, recurring subscription revenue remained brisk.

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. This, combined with a decrease in licensing revenue, led to a YoY decrease in net sales and operating income.

The Amusement segment posted net sales of ¥46.2 billion (+¥4.5 billion YoY) and operating income of ¥1.9 billion (-¥500 million). Net sales rose YoY thanks to solid arcade operations and the launch of new amusement machines, but operating income fell YoY due to an increase in depreciation charges related to the replacement of arcade machines.

The Publication segment booked net sales of ¥14 billion (+¥3 billion YoY) and operating income of ¥3.9 billion (+¥1.5 billion). Sales of printed comic books were on par with those of the previous fiscal year, but sales in digital formats grew sharply. A strong performance by the “MANGA UP!” manga application also contributed to the YoY rise in net sales and operating income.
The Merchandising segment posted net sales of ¥7.3 billion (-¥200 million YoY) and operating income of ¥900 million (-¥900 million). The YoY decline in net sales and operating income was the result of a high hurdle set in the previous year by the release of new merchandise based on popular characters and of strategic investments in developing new businesses.

This concludes my overview of our financial results.

I am Yosuke Matsuda. I will be discussing the progress we made in each of our business segments and our outlook for the next fiscal year and beyond.

We saw a strong performance in 4Q thanks to the launch of major new titles, but this was not enough to compensate for the shortfalls of 1Q-3Q, and our full-year operating income undershot our initial plan.

In addition, we booked an extraordinary loss of ¥680 million in 4Q due to valuation losses on stock in an affiliate company. This owed to the suspension of development projects at our wholly owned subsidiary STUDIO ISTOLIA CO., LTD. and to the discontinuation of that firm’s operations.

In the HD Game sub-segment, the 4Q release “KINGDOM HEARTS III” performed well. “NieR: Automata” sales also remained brisk and sold more than 1 million additional units in FY2019/3. Its cumulative units sold surpassed 4 million as of May 13, 2019.

We have reviewed our FY2020/3 assumptions for additional sales of existing games conservatively given the FY2019/3 performances of titles such as “JUST CAUSE 4” and “SHADOW OF THE TOMB RAIDER.”
The value of digital sales of HD games is growing year by year. The portion of sales generated from physical disks rises when we launch major new titles due to campaigns aimed at securing substantial initial sales, but digital downloads form the bulk of later sales. Maintaining digital sales of existing titles over the long term is key and should continue to have a significant impact on our earnings in FY2020/3 and beyond.

The MMO sub-segment saw a YoY decline due to the high hurdle set by the release of expansion packs in the previous year, but paying subscriber numbers remained strong. In particular, we have seen marked growth in subscriber numbers since we announced our plan for a July 2 release of the ‘FINAL FANTASY XIV: SHADOWBRINGERS’ expansion pack. We look for the expansion pack to bolster earnings.

This slide shows our units sold. The sharp YoY growth in the number of physical disks sold in Western markets in FY2019/3 owes primarily to the launch of ‘KINGDOM HEARTS III,’ ‘SHADOW OF THE TOMB RAIDER,’ and ‘JUST CAUSE 4.’ Physical disks account for the majority of sales of new titles on launch, with later sales contributing to profits as digital downloads come to account for the bulk.

This slide tracks the performance of the Games for Smart Devices/PC Browsers sub-segment. Net sales rose sharply QoQ in 4Q with help from ‘Romancing SaGa Re;univerSe’ and due to strong performance in the new year’s sales period, but this was not enough to offset the shortfall versus our plan in 1Q-3Q. A recent release called ‘LAST IDEA’ has gotten off to a decent start. In terms of future launches, we have announced the release of a smartphone version of ‘OCTOPATH TRAVELER.’ Beta testing has yielded positive feedback, and we hope to make the
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The Amusement segment saw higher net sales but a decline in operating income YoY. Our new arcade game machine “Starwing Paradox” proved popular with players, but its earnings contribution was limited by significant depreciation charges.

The Publication segment delivered a brisk performance in FY2019/3 with both net sales and operating income rising YoY, but we take a conservative view on FY2020/3 earnings. “MANGA UP!” has begun producing benefits, giving rise to new titles and generating sales, and we will work to develop synergies between it and our games. We see the Publication segment as a promising business that we want to continue to grow.

Both net sales and operating income fell YoY at the Merchandising segment. The segment holds a key position in our portfolio as a stable revenue generator, and we enhanced the organizational structure that supports it as of April 1. We want to grow it into a business with more than ¥10 billion in sales going forward.
In keeping with our initial FY2019/3 shareholder return plan for a consolidated dividend payout ratio of 30%, we will pay a year-end dividend of ¥37 per share, which, combined with the interim dividend of ¥10 we already paid, makes for an annual dividend of ¥47.

We look for FY2020/3 earnings to be in line with those of FY2019/3, forecasting net sales of ¥270 billion and operating income of ¥24 billion. There are two primary reasons that our plan anticipates a FY2020/3 performance on par with the previous year’s. The first is that it will be challenging for the Games for Smart Devices/PC Browsers sub-segment to be able to generate the earnings that we had initially anticipated given sluggish performances from titles we launched in 3Q FY2019/3.

We had looked for FY2020/3 earnings contributions in FY2020/3 from multiple titles that we had released in FY2019/3. However, we find ourselves in challenging circumstances as the only new title capable of contributing to earnings is “Romancing SaGA Re;univerSe.” The second reason is that we have been forced to review our outlook for additional sales of titles conservatively we released in FY2019/3, including “SHADOW OF THE TOMB RAIDER” and “JUST CAUSE 4,” given the way they have performed to date.
At E3, we plan to unveil the details of our major new HD games for FY2020/3, but due to the progress of our development efforts and out of consideration of competitor release schedules, our major launches will take place after midyear of FY2020/3. As such, the FY2020/3 earnings contribution will be limited. We had initially anticipated to grow up and to the right between FY2019/3 and FY2020/3, but we now look to trend flat given that we will be “rewinding” one year in our earnings trajectory. In light of our forthcoming lineup of titles, we believe that it is FY2021/3 and beyond when we can expect major growth and think we have the potential to generate operating income of ¥40-50 billion.

When you see the lineup we will be unveiling at E3, I believe that you will understand why we now expect a sharp growth curve between FY2020/3 and FY2021/3 rather than the gradual curve that we had originally anticipated. In addition to our major titles, we also have FY2020/3 releases planned for some unique and promising games, including some for smartphones. As such, we hope that our earnings will overshoot our initial targets for sales of ¥270 billion and operating income of ¥24 billion.
Our strategy for achieving our medium-term earnings targets is to expand stable recurring earnings while also sustaining investment in new IP. Once our new HD titles have been fully depreciated, additional sales will contribute significantly to our profits. Expansion of the stable recurring earnings will enable us to attain our medium-term earnings targets with our current pipeline.

We are already undertaking initiatives aimed at sustaining growth beyond the achievement of our medium-term targets, but it will still take some time for those initiatives to produce results.

We may be announcing smartphone game titles using the technologies listed here going forward, so please look out for them.

In summary, we look to “rewind” one year, forecasting a performance in FY2020/3 on par with that of FY2019/3, and as a result plan to catch up in FY2021/3.
Q&A highlights

Q: What level of profits do you look for from the Games for Smart Devices/PC Browsers sub-segment in your FY2021/3 earnings forecast?
A: We expect sales of at least ¥100 billion and a margin in line with that of FY2019/3.

Q: How sales of your major titles trend swings your earnings. Do you take any measures to mitigate your risk of earnings volatility?
A: We reduce volatility risk by expanding our base of stable recurring revenue from sources such as digital downloads, e-commerce and the publication businesses.

Q: What specific moves are you taking to expand additional sales? Also, what does your FY2020/3 plan anticipate in terms of additional sales of the major titles you released in FY2019/3?
A: We are working to grow additional sales by engaging in sales and marketing efforts based on regional sales trends and customer preferences and by our sales and development teams coordinating to execute a variety of promotional initiatives. Our FY2020/3 plan takes a conservative view of additional sales of the major titles we released in FY2019/3. This view represents a significant reduction versus our original expectations.

Q: Is there any correlation between print sales and digital sales in the Publication segment?
A: The proportion of digital sales is on the rise in the Publication segment, but print sales are also growing. Readers are increasingly choosing to purchase the print version after having bought the digital version, so we do see a complementary relationship between the two.

Q: Could you tell us about the progress of your strategic alliance with the Tencent Group?
A: We are holding regular meetings. I have nothing I can announce at present, but once we reach agreement on a major project, we will make an announcement on it and brief to you.
Q: At the end of FY2019/3, the balance of your content production account was in excess of ¥50 billion. What do you think of the soundness of your assets?
A: We have determined them to be sound based on a careful examination of the asset value of each individual title. We also see our content production account as a driver necessary to our future growth. A rich content production account is the key to our growth.

Q: What do you think of the potential of new platforms that have been announced such as Google’s STADIA and Apple’s Apple Arcade? Also, how much of an earnings contribution do you expect from these services in FY2021/3?
A: While we see significant potential from game streaming, we believe the FY2021/3 earnings contribution will be limited. Streaming will enable us to deliver our products and services to casual game players and players in regions where home consoles are not commonplace, so we initially look for growth in customer numbers, but we anticipate that achieving that in FY2020/3 will be impractical.

Q: Could you share your breakdown for your FY2020/3 outlook for the Digital Entertainment segment?
A: We take a conservative view on additional sales of HD games released in FY2019/3. For the MMO sub-segment, we look for growth in both sales and profits given the release of expansion packs. We are also targeting sales and profit growth for the Games for Smart Devices/PC Browsers sub-segment, which we hope to achieve through the full-year earnings contribution by last December’s launch “Romancing SaGA Re;univerSe” and through added earnings from new FY2020/3 releases such as “LAST IDEA.”

Q: Did you post any licensing revenue in 4Q FY2019/3 in the Games for Smart Devices/PC Browsers sub-segment? Do you believe that you will likewise be posting licensing revenue in FY2020/3?
A: Licensing revenue was recognized in 4Q FY2019/3 as result of the receipt of the fee. We also look to book it in FY2020/3.