



Integrity & Sustainability

May 13, 2021

Sector: IT / Telecom

Drecom (3793)

FY2020 Full Year Result
April 1, 2020 – March 31, 2021

GIR Earnings View

1

Summary of Financial Results for the Fiscal Year 2020, Ended March 31, 2021

- For FY2020, the company posted net sales of 11.84 billion yen, operating income of 2.05 billion yen, and net income attributable to shareholders of the parent company of 1.62 billion yen. Operating income and net income attributable to parent company exceeded the company's guidance, announced on January 28, 2021, of 11.70 billion yen, 1.90 billion yen, and 1.40 billion yen, respectively; and posted record high profit.
- Results surpassed company guidance because IP titles performed better than expected. The only title that was in the red for Q3 broke into the black in Q4, but another title that was in the black for Q3 slid into the red in Q4. Therefore, total number of titles in the red was one, unchanged QOQ. Both titles are expected to rebound during FY2021 H1

- By April 2023, Drecom aims to transform itself into a comprehensive entertainment company. The company plans to use the stable cash flow from its gaming business to fuel growth to (1) continue expansion of its gaming business, (2) diversification of IP owned by the company, and (3) apply know-how acquired in the gaming business to other areas.

(1) Continue expansion of its gaming business

The number of development projects in the gaming business increased by three during Q4, as 12 full-scale and prototype development are in-progress. Six new games in total are scheduled for release in FY2022.

(2) Diversification of IP owned by the company

As for the original IP¹ *Evil Prince and the Puppets*, development of a new game is underway, and e-commerce has also started, making it an IP.

(3) Apply know-how acquired in the gaming business to other areas

"AKROGLAM", a service in the music domain, and "root", a twitter marketing service, have seen increases in fan communities and in the number of companies using their services – which also appear to be expanding.

Operational Progress

2

¹ Intellectual Property



GIR Earnings View (cont.)

3

Outlook for FY2021 Q1

- The company's guidance for FY2021 Q1 (April-June 2021) for sales of 2.70 billion yen and operating profit of 350 million yen, reflect the absence of new releases, weakening of tailwinds from FY2020's "stay home" demand, and completion of cost efficiency improvements. The company expects YOY revenue and profit declines. Among other reasons for expected revenue declines are the withdrawal from the advertising business and the closing of some titles.
- The stock price has already factored-in stable fundamentals and is looking for new growth catalysts. Therefore, the stock price could fluctuate depending on developments related to new titles, and it is entering a phase where expectations for earnings growth in FY2021 and beyond are leading the way.

Performance Index (Consolidated, Quarterly)

Income statement															(JPY mn)
Year Ending	FY03/19					FY 03/20					FY03/21				
	1Q	2Q	3Q	4Q	1Q-4Q	1Q	2Q	3Q	4Q	1Q-4Q	1Q	2Q	3Q	4Q	1Q-4Q
Accounting Standard	Japanese GAAP														
Sales	2,865	2,695	2,387	2,773	10,720	2,254	2,235	2,483	3,178	10,150	3,303	2,882	2,971	2,685	11,841
YoY	11.4%	-25.7%	-38.5%	-10.8%	-18.7%	-21.3%	-17.1%	4.0%	14.6%	-5.3%	46.6%	28.9%	19.7%	-15.5%	16.7%
Gross Profit	363	220	290	561	1,434	570	556	587	479	2,192	1,067	889	1,120	921	3,997
YoY	-54.5%	-77.7%	-64.6%	14.1%	-53.7%	57.0%	152.3%	102.7%	-14.6%	52.9%	87.1%	60.1%	90.8%	92.0%	82.3%
Gross Profit Margin	12.7%	8.2%	12.1%	20.2%	13.4%	25.3%	24.9%	23.6%	15.1%	21.6%	32.3%	30.9%	37.7%	34.3%	33.8%
SG&A	781	381	416	434	2,012	442	352	389	393	1,575	443	461	488	552	1,944
YoY	2.2%	-55.3%	-35.5%	-32.5%	-30.8%	-43.4%	-7.8%	-6.6%	-9.4%	-21.7%	0.3%	31.1%	25.7%	40.4%	23.4%
Operating income	-418	-161	-126	128	-577	128	204	198	86	617	624	428	632	369	2,053
YoY	-	-	-	-	-	-	-	-	-32.2%	-	386.4%	110.1%	218.3%	326.8%	232.7%
Operating income margin	-14.6%	-6.0%	-5.3%	4.6%	-5.4%	5.7%	9.1%	8.0%	2.7%	6.1%	18.9%	14.9%	21.3%	13.7%	17.3%
Ordinary income	-513	-311	-458	-67	-1,349	152	144	219	121	636	609	423	622	366	2,019
YoY	-	-	-	-69.9%	-	-	-	-	-	-	301.4%	194.6%	183.8%	200.8%	217.5%
Net income	-505	-151	-717	-340	-1,713	122	92	177	321	711	467	359	473	326	1,625
YoY	-	-	-	21.8%	739.6%	-	-	-	-	-	282.4%	291.7%	167.3%	1.6%	128.4%
Net income margin	-17.6%	-5.6%	-30.0%	-12.3%	-16.0%	5.4%	4.1%	7.1%	10.1%	7.0%	14.1%	12.5%	15.9%	12.1%	13.7%

Source: Global IR, Inc. based on company's annual securities report

Note: Rounded under JPY mn. Rounded to one decimal place.

*Calculated by Global IR, Inc.



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Performance Index (Consolidated, Full year)

Per-Share Data

Year Ending	2017/3	2018/3	2019/3	2020/3	2021/3
Total No. of Shares outstanding (,000)	14,371	28,742	28,819	28,894	28,976
EPS	29.7	-7.2	-60.5	25.0	57.0
Adjusted EPS	29.67	-	-	24.98	56.85
BPS	113.2	106.7	47.9	74.2	132.91
DPS	0	0	0	0	0

Cash Flow

(JPY mn)

Year Ending	2017/3	2018/3	2019/3	2020/3	2021/3
Depreciation	214	299	462	382	626
Sales Cash Flow	846	-79	78	691	3,196
Investment Cash Flow	-456	-1,958	-123	-101	-1,140
Financial Cash Flow	1,345	2,288	-271	-1,188	968

Financial data

(%)

Year Ending	2017/3	2018/3	2019/3	2020/3	2021/3
ROA	11.9	-2.2	-24.7	11.1	19.1
ROE	35.5	-6.6	-78.3	41.0	44.8
Equity Ratio	47.0	33.2	19.6	32.9	39.5

Source: Global IR, Inc. based on company's annual securities report

Note: Rounded under JPY mn. Rounded to one decimal place.

*Calculated by Global IR, Inc.

Drecom (3793)

Initiation Report

GIR View



Japan's mobile gaming market – consisting mainly of games played on smartphones – is huge, valued at more than ¥1.3 trillion. Globally, the mobile gaming market is thought to have been worth about ¥8 trillion in 2020. The Japanese market is the third largest in the world after those in China and the US, and is not significantly smaller than either. With the wide uptake of smartphones, the Japanese mobile gaming market grew rapidly until 2017, to over ¥1 trillion. Since then it has continued to expand, at a slower pace, driven by the enjoyable gaming experiences offered by companies in the sector. Market growth is likely to have accelerated with the coronavirus pandemic.

In the fiscal year to March 31 2021, more than 90% of Drecom's revenue will come from mobile gaming, and the company expects to achieve record sales and operating profit. The company was founded in 2001 and was listed on the Tokyo Stock Exchange's Mothers market in 2006. Several times in the past it has run at a loss, but Global IR, Inc. (GIR) believes that this has given it the knowledge of how to be profitable and to manage itself in a way that controls its profitability. One of Drecom's strengths is that since the era of feature phone games (on traditional mobile phones) nearly a decade ago, it has had a distinctive game management style that emphasises continuous usage by players. It has also built a relationship of trust with leading IP¹ holders. Drecom's game management style fits well with IP, which emphasizes long-term value such as brand and user engagement.



Aiming at a stock-based business model, Drecom has set up a revenue structure that grows sales and profits through having multiple game titles. In particular, it releases IP-based games, on a Free-to-Play basis but in which players choose to make in-game payments, over long periods, with good game management in place. Games that sell less well point to the timing of reductions in operating costs and the termination of operations, allowing preparation for the release of new titles. The Japanese mobile gaming market has increasing barriers to entry, but Drecom is one of the companies able to clear them. The market continues to grow, and the mobile gaming business has become the company's cash cow. In our view, Drecom is entering a period in which it will be able to create new revenue streams.



¹ Intellectual Property



GIR View (continued)

4

The first reason for the increasing barriers to entry is rising development costs. These have risen to more than ¥100 million per title, and sometimes more than ¥1 billion. **The second issue is finding personnel with the right skills.** The mobile gaming business involves two different functions: development, and also management, because the revenue that players are charged comes from post-release game management. These two functions require different skills and mindsets. Game companies have to develop and retain the right human resources.

Third, there is a barrier to entry in the form of IP-centric inner circles within the industry, known as 'value circles,' based on abilities and relationships. IP has been adopted for most game titles as the mobile gaming market has expanded. Intellectual Property (IP) in a game refers to well-known game titles or characters. The use of this kind of IP extends across magazines, merchandise, games, and industries, further enhancing its value. Companies that use the IP therefore have to be part of the circle to be able to contribute to the improvement in the IP's value, and the interests of each industry stakeholder must be carefully taken into consideration.

5

6

As mobile games have become cash cows, on a consolidated basis there is the prospect of retained earnings moving into positive territory. Medium-term, Drecom aims to build new revenue streams in entertainment by deploying the management skills it has acquired in the gaming business and making the most of its management strengths.

Financial Data

Share price: ¥872 (as of February 12, 2021)

Fiscal Year	Sales (¥m)	YoY (%)	Operating Profit (¥m)	YoY (%)	Net Profit (¥m)	YoY (%)	Recurring Profit (¥m)	YoY (%)	EPS (¥)	PER (x)
2017/3	8,388	28.3	932	NA	844	NA	814	NA	29.7	-
2018/3	13,192	57.2	190	-79.7	-29	NA	-204	NA	-7.2	-
2019/3	10,720	-18.8	-577	NA	-1,349	NA	-1,712	NA	-60.5	-
2020/3	10,150	-5.4	617	NA	635	NA	711	NA	25.0	32.6
2021/3 (Co. est.)	11,700	15.3	1,900	207.9	1,800	183.1	1,400	96.8	49.1	16.6

in Millions of JPY



FAQs from Meetings with Investors

Drecom holds meetings with overseas institutional investors on an ongoing basis. Below we reproduce some common questions and responses from these meetings. The responses are based on the company's answers and include GIR commentary and additional information. The questions are ordered according to issues that were of particular interest. For more information on the answers, click "Answer" at the end of the question.

Drecom's Financial Performance

Q1: Why was there a loss in the year to March 31, 2019? -----<Answer>

Q2: However, Drecom turned a profit of ¥690 million in the fiscal year to March 31, 2020. What was the background to this turnaround?

-----<Answer>

Q3: In the fiscal year to 31 March, 2021, sales and operating profit are expected not just to have turned up, but to be at record highs. Can you explain why? -----<Answer>

Q4: Please share your thoughts on the possible financial results for the fiscal year ending March 31, 2022, and beyond -----<Answer>

About Drecom

Q5: Please tell us about the trends in revenue contribution from each title -----<Answer>

Q6: Are trends in billing and ARPU much affected by seasonal factors or entertainment events? -----<Answer>

Q7: What is the difference between the revenue structure of in-house IP and third-party IP? -----<Answer>

Q8: Can you explain why the billing amount and sales are different? -----<Answer>

Q9: Please tell us how the differences between the Apple, Google and enza platforms impact your earnings-----<Answer>

Q10: Please tell us about your relationship with Bandai Namco Entertainment (7832)-----<Answer>

Q11: Please give your thoughts on new businesses, investment such as M&A, etc. -----<Answer>

Q12: Please explain your views on shareholder returns -----<Answer>

About the Gaming Market

Q13: How large is the market?-----<Answer>

Q14: Please outline the trends in the market. -----<Answer>

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*Integrity & Sustainability***CHART AND TABLES**

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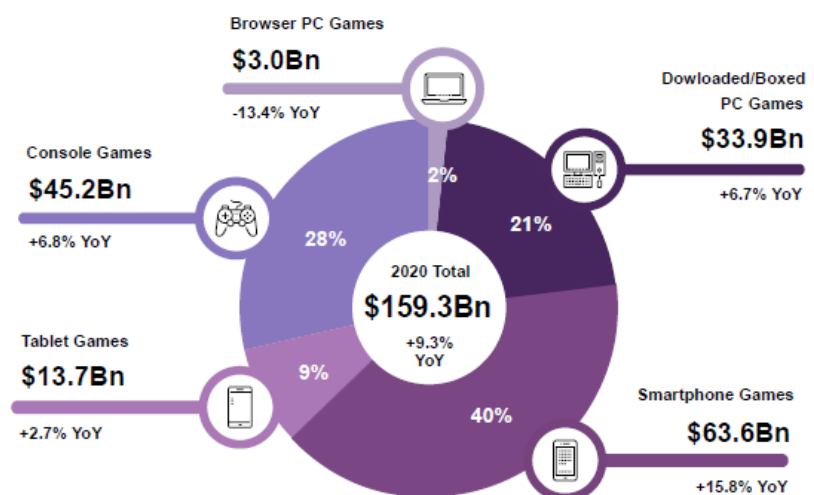
The Mobile Gaming Market

Trends in the Mobile Gaming Market

The domestic mobile gaming market expanded rapidly until about 2017

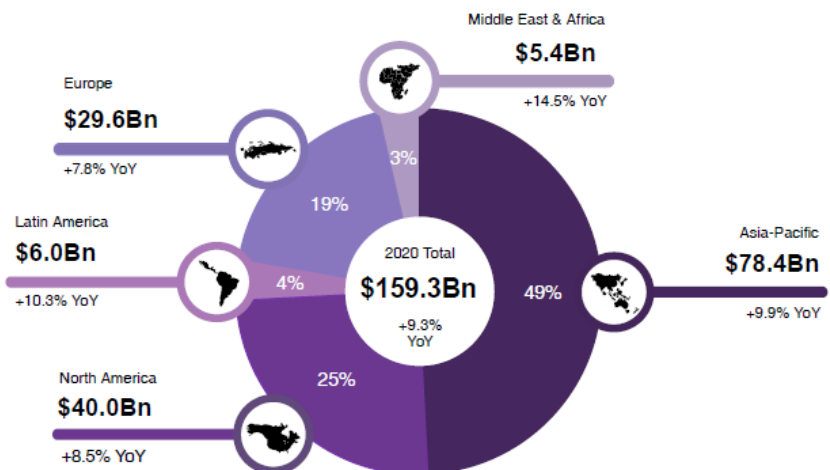
The global mobile gaming market is estimated to have been worth about ¥8 trillion in 2020, and the Japanese market about ¥1.3 trillion, making it the third-largest in the world after China and the United States. However, the difference in size is relatively small: Japan's mobile gaming market is huge.

Figure 1. 2020 Global Gaming Market By Segment, 2020



Source: Newzoo

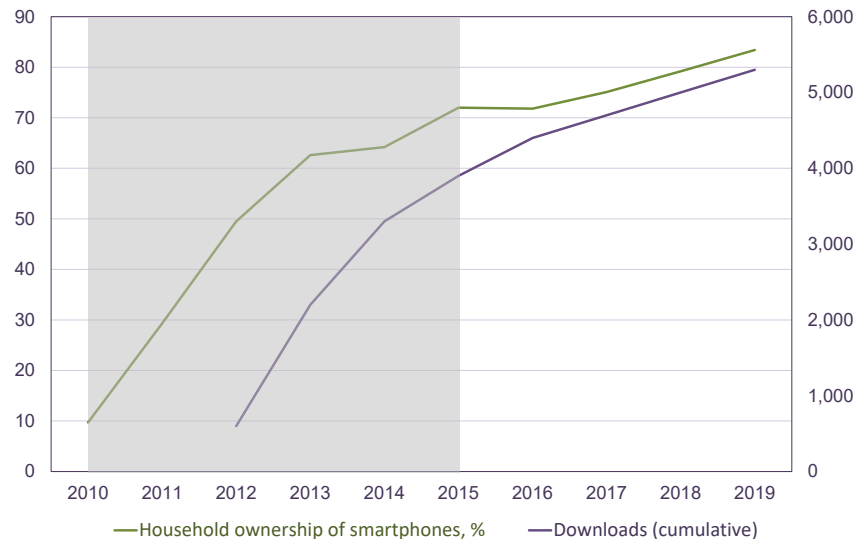
Figure 2. 2020 Global Gaming Market By Region, 2020



Source: Newzoo

The domestic mobile gaming market expanded rapidly until around 2017 with the uptake of smartphones. Since then, although growth has slowed, the market has continued to expand moderately. According to the *Famitsu Game White Paper*, the domestic mobile gaming market exceeded ¥1 trillion yen in value in 2017, and has continued to grow moderately since then.

Figure 3. Smartphone Gaming Market Grew with the Uptake of smartphones

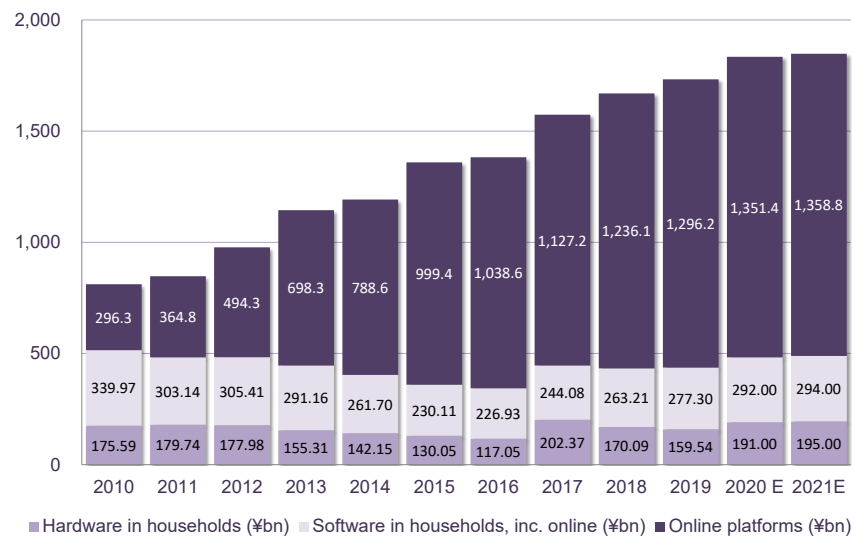


Source: GungHo Online Entertainment Co.; Survey of Trends in Communications Usage (通信利用動向調査), Ministry of Internal Affairs and Communications

Downloads of *Puzzle & Dragons* (Pazdora), a game released by GungHo in January 2012, rose almost in line with the increase in the number of smartphones, and the overall market for smartphone games in the early 2000s expanded with the uptake of smartphones.

Figure 4. Growth of the Domestic Gaming Market (Household & Online Platforms)

Unit: ¥bn



Source: *Famitsu Game White Paper*, 2020

Note: Data period: Dec 28, 2009 to Dec 29, 2019 Accurate figures for 2020 and 2021 are unavailable; from May 2020 they are estimates.



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There are three factors driving continued moderate growth:

(1) Improvement of the appeal of games, through the efforts of game companies.

(2) Coronavirus accelerating changes in life and work trends.

(3) The expansion of the base of users who have gaming experience, and the gaming generations' transitioning into adulthood.

Continued Moderate Growth in 2017 and Beyond

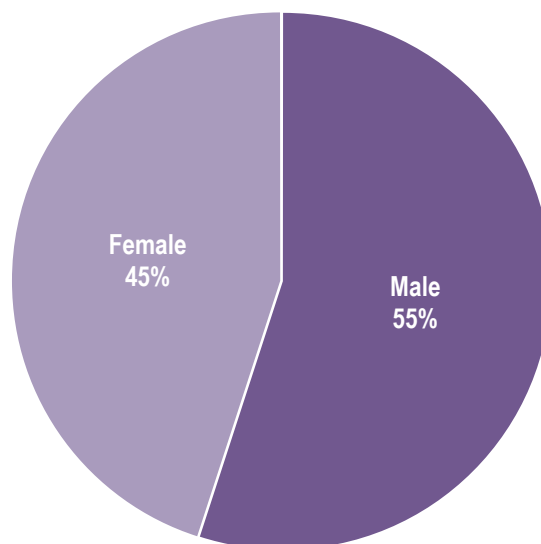
As noted above, the mobile gaming market continues to expand, albeit at a more moderate pace. This is for a number of reasons, including: (1) the appeal of a variety of mobile gaming experiences, as a result of game companies' efforts; (2) the acceleration of existing trends in life and work, as a result of the coronavirus pandemic, and thus an increase in the number of gaming hours played; (3) the expansion of the base of users who have gaming experience, and the gaming generations' transitioning into adulthood.

As smartphones became more widespread, users grew accustomed to using them for various functions, and they became a familiar gadget in everyday life – that is, they became commoditized. At the same time, gaming companies have optimized their smartphones for screen use, resolution, operability, and behavior when games are played, while providing users with a variety of gaming experiences. In this way, as the appeal of smartphone games is improved, a virtuous cycle is generated in which these games attract more users.

Figures 5 and 6 show that there is little difference in the gender and age composition of players. Overall, it can be inferred that the market of mobile game players is growing.

Figure 5. Gender Balance of Players

Unit:%



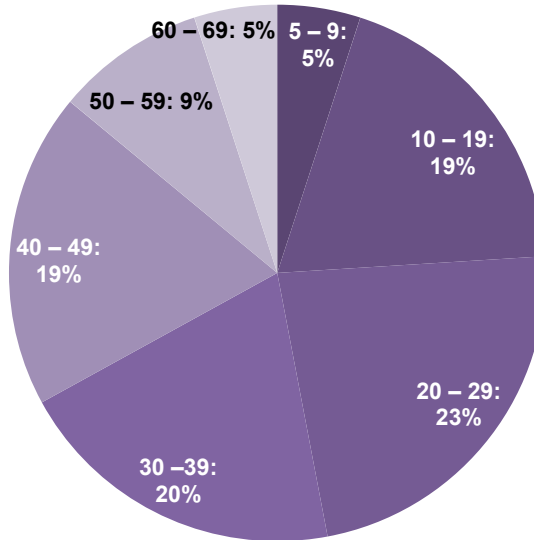
Source: Famitsu Game White Paper, 2020

Note: Data period: Dec 31, 2018 – Nov 3, 2019



Figure 6. Age Breakdown of Game Players, in Years (Japan)

Unit:%



Source: Famitsu Game White Paper, 2020

Note: Data period: 31 Dec, 2018 – 3 Nov, 2019

Figure 7. Game Apps in Japan: Players, Time and Revenues (weekly averages)

Average no. of players weekly (million)	Average weekly playing time (million hrs)	Average weekly billing (¥m)	ARPU / week (¥)
2.563	8.485	719.718	280.80

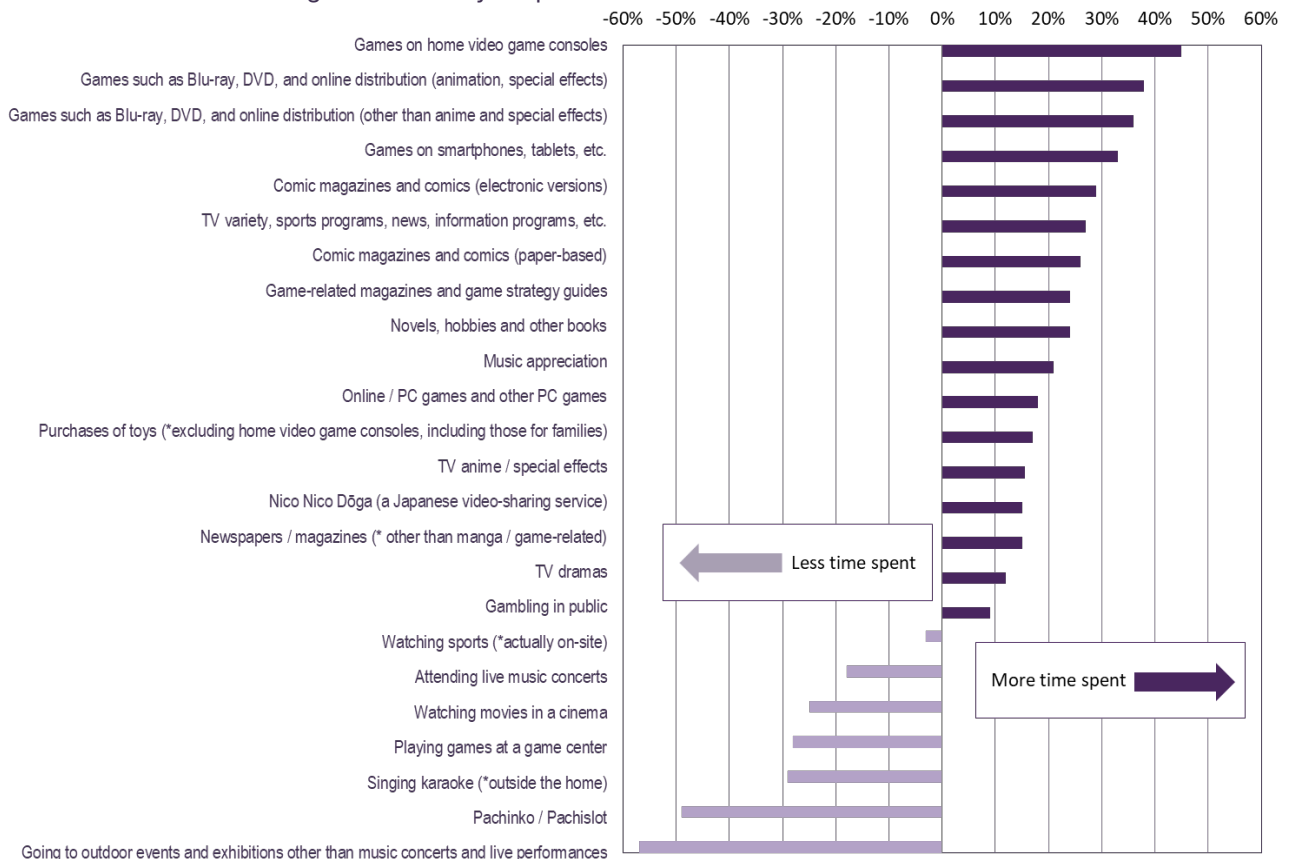
Source: Famitsu Game White Paper, 2020

Note: Data period: 31 Dec, 2018 – 3 Nov, 2019

Furthermore, the constraints resulting from the coronavirus since Spring 2020 have accelerated changes in life and work patterns that were already occurring. As a result, it appears that more time is being spent on playing games (see Figure 8 below). This is increasingly driving the mobile gaming market.

Figure 8. Changes in entertainment activity due to the effects of the coronavirus

Q. Please tell us about changes in the time you spent on entertainment activities in March.



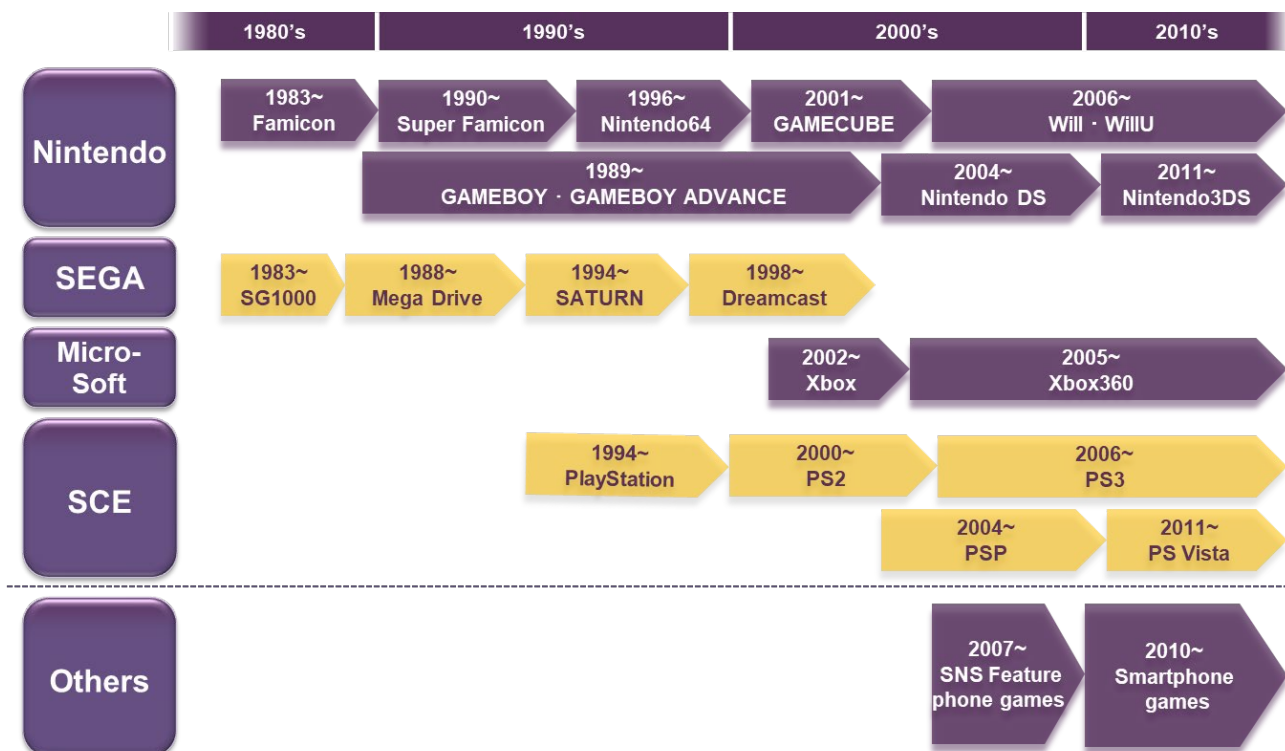
Source: Famitsu Game White Paper, 2020

Note: Percentage of respondents who answered that they had increased their activity. Video items include recording and viewing.

Eb-i Survey; survey date: April 6, 2020. n = 7,801

3) Concerning point 3 above, as shown in Figure 9, Nintendo's Family Computer was launched in Japan in 1983. Following this, in 1989 came the Gameboy. The Playstation, which appeared in 1994, appealed to an older user base, and in recent years these players have become more interested in mobile gaming. In addition, many users started to become familiar with games for the first time around 2010, through social network service (SNS) mobile games. The commoditization of smartphones and the increase in disposable income as players became adult members of society also helped to establish a lifestyle in which interaction with mobile games became part of everyday leisure. The younger generation now own smartphones from an early age, become paying users from about high-school age, and start to take part in the mobile game market.

Figure 9. History of the Domestic and Home Video Game Market



Source: Global IR, Inc.

Features of the mobile gaming market, high barriers to entry

(1) High development costs; (2) The need to find personnel with different skill sets; (3) The existence of 'value circles' based on capabilities and relationships

Features of the mobile gaming market:

(1) High development costs:
More personnel needed, long lead times.

(2) Development and management in the mobile game business are completely different functions, requiring personnel ...

(3) The existence of 'value circles' in the industry, consisting of abilities and relationships.

Developing mobile games is increasingly expensive. Development costs for feature phone games typically ran to a few tens of millions of yen, but for mobile games they are usually in excess of ¥100 million, and for some titles are estimated to be more than ¥1 billion. The reason is that users have been used to high graphics performance, 3D images, etc. since the days of packaged software for home video-game consoles, so user expectations are high.

To give a clearer picture of the increase in development costs: developing feature phone games required 10 to 20 people and took about six months to complete. For mobile games, it requires 50 to 100, and the lead time from planning to completion rises to 1.5 to 2 years. During this period, labor costs are very high.

Mobile games are first developed, then – after release – managed. Sales are realized through users choosing to make in-game payments. Game



management involves planning in-game events, promoting engagement through interesting features or additions, responding to users' requests and complaints, and addressing problems such as defects and bugs.

Development and management of games being completely different types of business, mobile gaming companies need to nurture personnel with different mental and other skill sets. Games are developed by specialized personnel – game creators – who design the games and add sound, graphics, etc. Knowledge is built up not only by individual creators, but also as a team. By contrast, game management requires close communication with users, focusing on engagement through dialogue.

Mobile games have become a huge, ¥1 trillion-plus market, and the use of IP has become standard. Intellectual Property in a game means the inclusion of a well-known game title or character. The addition of IP to mobile games increases the value of that IP, and at the same time brings in users and gets them involved. For mobile games, the key to success is how long the player can continue to enjoy a game after it has been released – that is, whether the players will continue to choose to make in-game payments.

The same IP might be used across a number of media other than games, including magazines, videos, etc., so there are many stakeholders involved. Companies that use the IP have to be able to contribute to the value of that IP, so there is an informal inner circle of IP users known as a 'value circle'. Membership requires IP users not only to contribute to raising the value of the IP, but also to consider the other stakeholders in each industry.

The requirements for being in the game industry have expanded to encompass not just development capabilities, but also successful management and marketing, as well as being in a 'value circle' based on abilities and human relationships. The requirements not only for financial strength, but also a track record and credibility as a member of the circle, form barriers that make it hard for prospective new entrants to the market

Mobile gaming moving towards a stock-based business model

As tangible and intangible barriers to entry arise in the mobile gaming market, companies are increasingly adopting one of the following strategies to increase revenue:

- (1) Trying to create games that are big hits, using their own IP;
- (2) Building up billing revenue in multiple layers by releasing multiple titles using other companies' IP, without focusing too much on one's own.

With the second option, the release of a new game is very likely to secure a certain amount of sales over a given period of time through the use of IP. And

Cleared barriers to entry, stock-type business model point to stable and rising earnings.



in addition to the release of new games as appropriate, billing sales will be accumulated for each title. We believe that in this way it has become possible to build a stock-type business model in the mobile game business.

In other words, while barriers to entry have risen in the mobile gaming market, business models have been shifted to stocking. Companies that can clear the barriers to entry and optimize stock-based business models are therefore more likely to achieve relatively stable revenue growth.

**Drecom (3793)****Clears the barriers to entry, allied with
'value circles'****Company Profile**

Founded in 2001; entered the gaming market in 2009

Drecom is a gaming company that clears the high barriers to entry in the current mobile gaming market. The company is now expected to achieve record operating profit in the fiscal year to March 31, 2021, which we believe testifies to its recognition in the mobile gaming market and its experience over the past few years, as well as its ability to control the market duration of its game titles and to optimize its revenue.

Drecom was founded by Yuki Naito, the current president. While attending Kyoto University, he set up Drecom with a group of university students centered on Kyoto University, and in November 2001 established it as a company.

Ever since it was founded, the company has been involved with entertainment services based on people-to-people connections on the Internet. In 2003 it developed a blog service, and in 2006 it was listed on the Tokyo Stock Exchange 'Mothers' section, with business development centered on this service. At that time, Web 2.0, which allows users to create and collaborate online, was a major new trend. Drecom's IPO was in tune with the times.

The number of users of the blog service rose, but it proved hard to make profitable. The business fell significantly short of Drecom's expectations, and it was forced to rebuild from its management foundations. Rakuten (4755) provided support, and after a capital and business alliance in 2008, including a third-party allotment, Drecom expanded into mobile phone-related business.

On the other hand, entertainment services based on interpersonal connections – the focus of Drecom's business since its inception – emerged from several social networking platforms, such as Facebook and Mixi, around 2007-2008. These typically had an open-door policy on the provision of games – that is, anyone could become a game provider. In 2009, Drecom offered games on social media. The following year, it also started offering games for mobile phones. Onmyoji Heian Yokitan and Chokoto Farm won acclaim and established a position in the social game market. Chokoto Farm was launched in January 2011, has been on the market for 10 years and is still available.

2009: Moved into games on social network services. 2010: Offered games for mobile phones; established its position.

During this period, the social gaming market expanded rapidly by providing new gaming experiences using people-to-people connections on the more popular feature phones. However, with the use of 'Gacha', which is a way of making purchases within games through paid electronic draws, sometimes in sequence, some game providers were viewed as having caused a social problem by unduly raising the expectations of players in games requiring payments. In 2013, the Consumer Affairs Agency alerted game providers to potential violations of the Act against Unjustifiable Premiums and Misleading Representations. The event is commonly referred to as the 'Illegal Kompu Gacha problem'. The effect was to dampen the rapid market growth, but lowering the risks arising from gamers' highs and high billing turned into a pathway to more smartphone-based gaming. In other words, the 'Illegal Kompu Gacha problem' prompted the industry to accelerate its move into the smartphone gaming market.

Revenue structure

The revenue structure of mobile game sales at Drecom differs for in-house and third-party titles.

For in-house games (in-house IP), as shown in Figure 10, billed sales are accounted as Drecom sales. From these are deducted fixed costs, and also variable costs in the form of fees paid to platforms and copyright fees. The remainder is operating income.

Sales are handled differently in the revenue structure of IP distributed by third parties. In this case, billed sales are revenue-shared with the partner company, and Drecom's share is accounted as its sales. In this case there are no variable costs in the form of fees paid to platforms and copyright fees. Drecom's operating income from this source is calculated by deducting its fixed costs.

The operating profit margin on IP distributed by third parties is therefore high, but the actual billed sales of the company's titles distributed by third parties are larger than the sales recorded by Drecom. GIR estimates that actual billed revenue from Drecom's IP distributed by third parties is approximately four to five times higher.

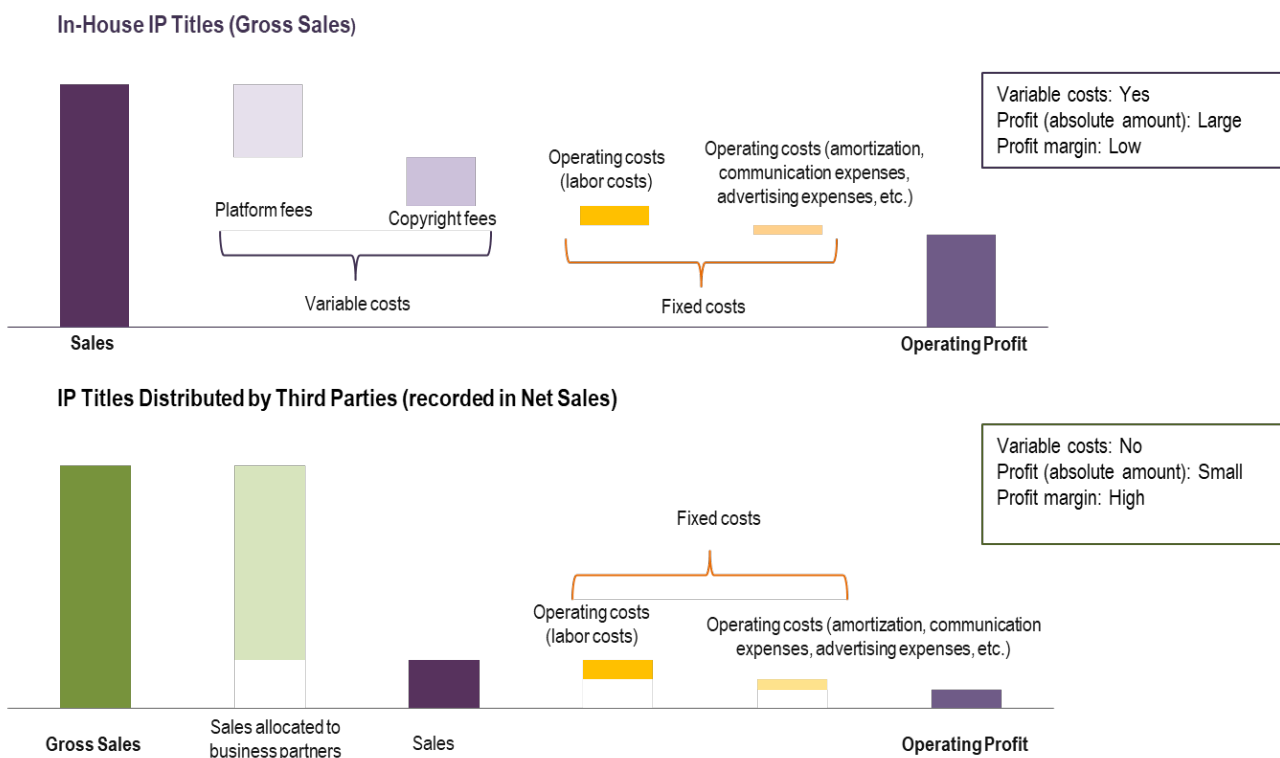
Third-party platforms distributing Drecom's IP include Bandai Namco Entertainment (BNE)'s enza. Drecom has been involved with BNE since the launch of the enza platform (details on Page 19), and we believe it is responsible for managing both the platform and games. This means that Drecom may effectively have two sources of income from its distribution via enza. If so, the company's profit margins from this relationship may be higher than those from other platforms.

The business models for in-house (owned) IP and third-party (other



companies' IP are different. In-house IP is a high-risk, high-return product for which it is relatively hard to acquire users, because it does not have the name recognition of other companies' IP. However, once it has been adopted by players and becomes a hit, it is profitable because there are no copyright fees to be paid out. On the other hand, while other IPs are low-risk, low-return, powerful IPs have a number of stakeholders, and unpredictable events can incur intangible costs in the short term. For example, if the title does not become a hit, but cannot be terminated easily, this is regarded as a hidden cost.

Figure 10. Comparison of Revenue Structures: In-House versus Third-Party IP



Source: Global IR, Inc.



Drecom's strengths

Strengths nurtured since the company's inception

1. Management experience with IP and a relationship of trust with its users;
2. Building an organization that can successfully develop and manage multiple games, and establishing a stock-based business model;
3. Sustainable and reproducible management practices gained from experience, including setbacks;
4. Potential for further business development, not only in the game business.

1. Management experience with powerful IP and a relationship of trust with its users

Drecom's strengths:

- (1) Managing IP, relationships with IP holders
- (2) Establishing a stock-based business model that can develop and manage multiple titles.
- (3) Sustainable and reproducible management practices gained from experience, including setbacks.
- (4) Potential for development in other business areas.

In the gaming market nearly 10 years ago, Drecom offered several games, mainly for feature phones, including the aforementioned Onmyoji Heian Yokitan and Chokoto Farm, along with powerful IP. From the beginning the company's games were not intended to persuade people to gamble; rather, the focus was on continuous use. This meant that Drecom was not the kind of company that would grow so fast that its revenues would shoot up tenfold in a short period. But in addition to gaining a solid financial base to develop games for smartphones, the company has established a track record in business, and strong relationships with leading IP holders such as Bandai Namco Entertainment (BNE).

In game management, the focus on continuous use is player-oriented, but it also fits with IP that emphasizes increases in value long-term, such as brand and royalties. In our view it was this that gave Drecom its strengths and competitive advantages in a mobile game market that was heading for rapid expansion

In managing games using third-party IP, it is essential to have certain types of knowledge that can only be obtained from experience – such as maintaining appropriate communication across industries. It is also vital that individual skills and abilities be shared with the organization or community as a whole.

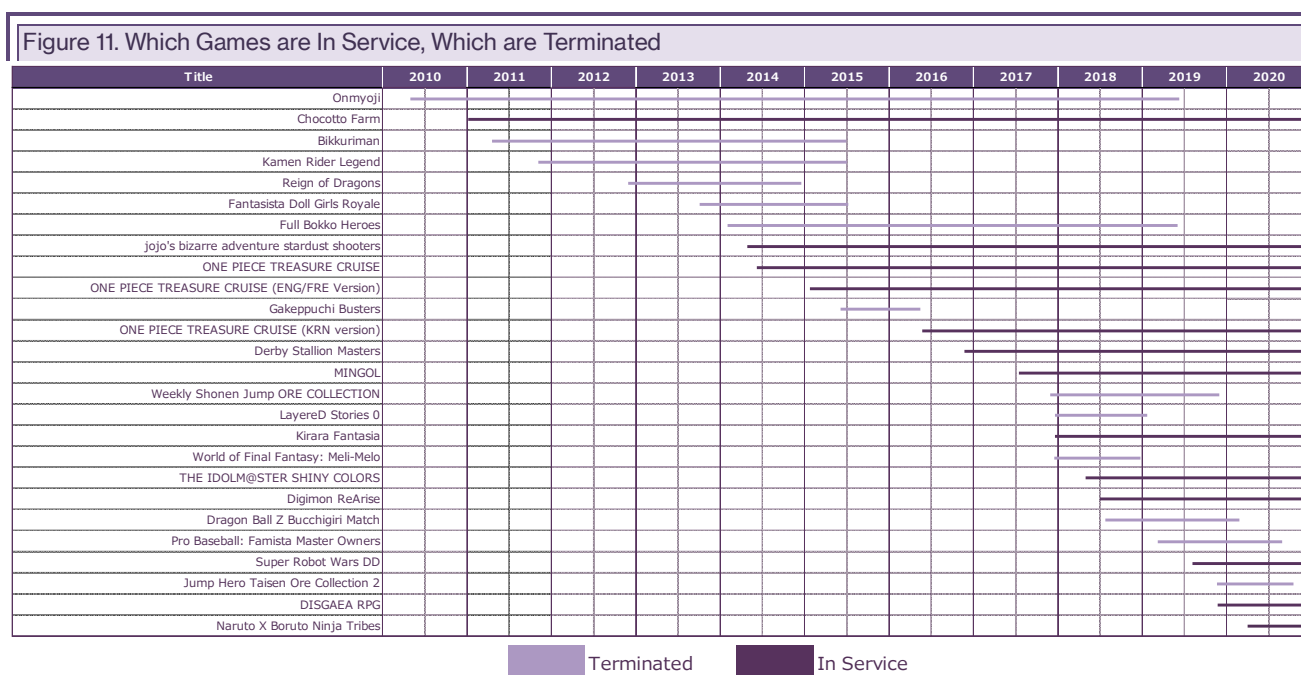
Drecom began full-scale support for mobile games for smartphones in 2012. After several transitional products, in 2014, *Full Bokko Heroes*, as well as *JoJo's Bizarre Adventure Stardust Shooters* (from BNE), and *ONE PIECE Treasure Cruise* (from BNE) were released and successfully converted for smartphones.

2. Building an organization that can successfully develop and manage multiple games, and establishing a stock-based business model

During the emergence of smartphone games, the game market featured blockbuster titles by other companies, such as *Puzzle & Dragons* (GungHo Online Entertainment (3765); released in February 2012) and *Monster Strike* (Mixi (2121); released in October 2013). Drecom followed this by working on games using both its own and third-party IP. Fifteen smartphone games were developed and released, under titles including *Derby Stallion Masters* and *Mingol* (now distributed by ForwardWorks). Three of these are Drecom's own games, while 12 use other companies' IP (not including the enza titles mentioned below).

Many of these games proved disappointing in terms of revenue. However, the process brought Drecom a wealth of experience and learning and resulted in an organization that can develop and manage multiple games. This point can now be identified as a factor in the company's strengths and competitive advantages.

Figure 11 shows how Drecom is accumulating sales from multiple games using a series of revenue optimization methods, including cost control, careful timing of withdrawal from service, and, based on the sales situation after a release, preparation for releases of new games. GIR believes that Drecom is putting together a stock-type business model.



Source: Global IR, Inc. from company materials

Drecom has relationships with leading companies, including Bandai Namco (BNE)

Drecom has good relationships with leading companies such as BNE, ForwardWorks, and Aniplex, a wholly-owned subsidiary of Sony Music Entertainment, which itself is 100% owned by Sony (6758). In addition to developing and managing multiple games, including *ONE PIECE Treasure Cruise*, Drecom was involved in the launch of a joint venture on the game platform 'enza', which was started in April 2018. While the joint venture will become 100% owned by BNE in March 2020, Drecom's involvement with enza will continue.

So far, 12 games using BNE's IP have been developed and managed by Drecom, and five are still in service. Bandai Namco Holdings (7832), the holding company of BNE, held 19.1% of Drecom's shares (as of September 30, 2020), making it the company's second largest shareholder; these shares were transferred from Rakuten in September 2018. The shareholding demonstrates the good relationship between Drecom and BNE, and is likely to strengthen it.

ForwardWorks is responsible for the mobile business under Sony Interactive Entertainment, a multinational video game and digital entertainment company that is a 100% subsidiary of Sony. Drecom is involved in ForwardWorks' *Mingol* and *Makai War Record Disgaea RPG*. *Mingol* is a mobile version of *Minnan no Golf*, the main game on the Playstation, and for *Makai War Record Disgaea RPG*, Drecom was involved in repairing defects and improving game management. Both games are good examples of the relationship of trust between the two companies.

Drecom is also responsible for developing and managing *Ira Fantasia*, distributed by Aniplex, and has a track record of more than three years since this game was released. Drecom was also in charge of *World of Final Fantasy Merimero*, distributed by Square Enix (9684), though the service of this game has now been terminated.

These specific development and management results – (1) managing powerful IP and the relationship of trust with its holders, and (2) creating an organization that can develop and manage multiple titles, and with this the establishment of a stock-based business model – function as strengths and competitive advantages for Drecom.

3. Sustainable and reproducible management practices gained from experience, including setbacks

The first setback that Drecom faced was the failure of its blogging business immediately after the IPO. In addition the company was faced with the effects



of its financial difficulties, as well as organizational challenges due to employees being insecure about their futures.

Drecom recovered from these difficulties with the help of a capital injection from Rakuten. The company's various responses to the crises it went through seem to have become transmuted into management expertise. Even after focusing on the game business, the company was confronted with operating losses – during the market transition from feature phones to smartphones (2013); the failure of its original titles (2015); and in the rush to release multiple IP titles (2018) – but deficits did not become the norm, and the company quickly recovered its profitability.

The upside of not having much cash is that financial constraints force an early response to any crisis. Drecom is very conscious of optimizing revenue by accurately gauging timing, monitoring failures, cutting costs by controlling outsourcing costs, withdrawing if it cannot keep up, and preparing to launch new titles.

Drecom's experience in developing and managing multiple game titles has enabled it to build a rich outsourcing network. It has effectively set up a system that enables it to double its development and game management capacity just by using outsourcing, or shrink it in the same way. With timely use of this system, Drecom can stay in control of costs and link these to demand.

4. Potential for further business development, not only in the game business.

Drecom's history is generally described with a focus on gaming, but the company has not limited itself to this business. In addition to the blog business it was working on at the time of the IPO, other major examples are ringtones for feature phones and the educational content business that led to a joint venture with Rakuten. The company has also worked on music distribution, anime distribution, SNS services using location information, and other areas. Given the size of the company, this is a wide variety of activities. Drecom does not yet have a business with continuity in addition to its game business, but it refers to itself as "an Internet shop before it is a game shop," so can be expected to work on some kind of new business in the future. It is likely to apply the strengths it acquired in the game business to other fields in the entertainment industry, with the potential to create a second strong revenue stream.

For new businesses, risk control tighter, investment initially limited.

Although developing new businesses is always a risk, we believe that risk controls are in place more than they were for the game businesses described above. Until the growth potential is confirmed, the scale of any investment is likely to be limited. As with the game business, the company will be looking to start small and grow from there.

Drecom's Business Performance

Through conscious optimization of revenue, record profits likely for the fiscal year to March 31, 2021

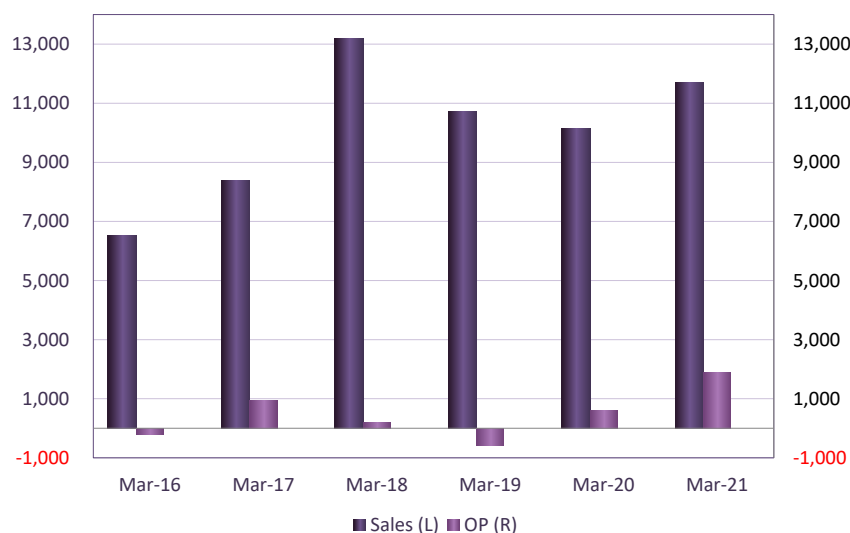
In 2016–2018, as the rapid growth in the mobile gaming market was coming to an end, the company released 10 titles with the aim of expanding its market share. However, competition was fierce, and sales of many games fell short of expectations. At this period in mobile gaming, gamers were looking for a new type of experience in addition to IP.

Drecom acknowledged this error and after 2018, withdrew titles that would not monetize. For this reason, it recorded a net loss of ¥1.96 billion in the fiscal year to March 31, 2019, but posted a net profit of ¥690 million in the fiscal year to March 31, 2020.

Withdrew non-monetizing titles, became profitable the following year.

Figure 12. Financial performance

Unit: ¥m



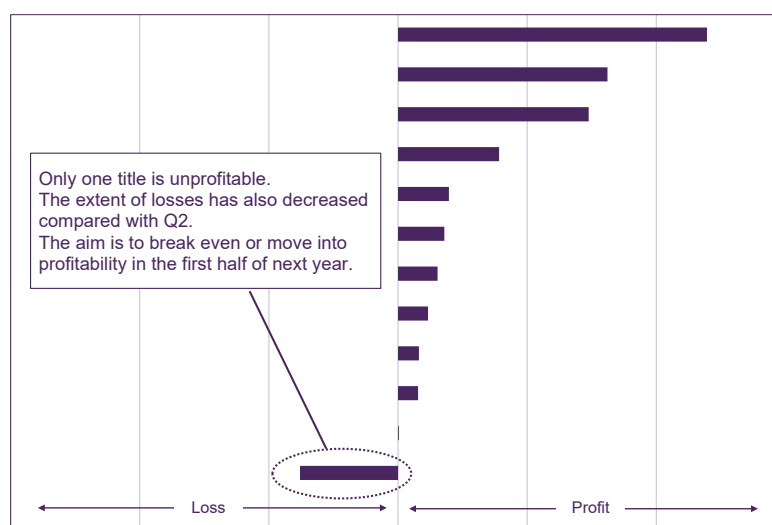
Source: Global IR, Inc. from company materials

Note: Mar-21 figures are Drecom forecasts

Profitability differs by title; cost control is tight, based on experience.

Drecom outlines the earnings situation for each title in its results briefing materials, though the exact details are not disclosed. In the third quarter of the fiscal year to March 31, 2021 (October–December), 11 of the 12 games in service were in profit, and operating profits piled up.

Figure 13. Profitability of games in service



Source: Global IR, Inc. from company materials

Note: Series games are counted under one title. The 3 enza titles are under *Boku & Dragons*.

In addition, billings tend to increase during the New Year, when users in the entire market have more time to play games, while they tend to decrease in March and April, in July and August, during the summer vacation, and toward the end of the year, when people are busier with life and leisure activities related to the end of school terms and to company activities. On the other hand, for Drecom, the release anniversaries of games currently in service are concentrated in the April-July and October-December quarters. Holding anniversary and half-year anniversary events at these times makes it possible to increase billings, and thus to smooth out fluctuations in sales to some extent.

As a result, we expect sales and OP to reach record highs in the fiscal year to March 2021.

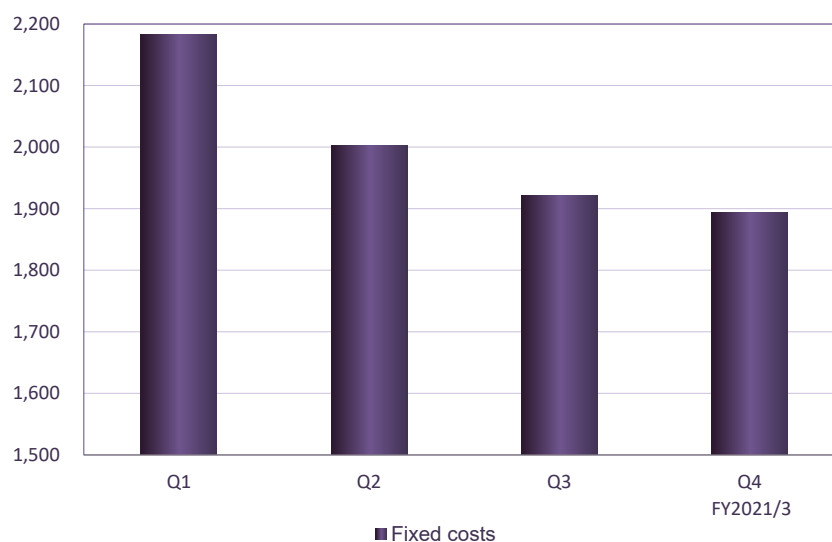
In addition to there being relatively few sales days in the January-March quarter, there were no major events other than New Year's events. Furthermore, user in-game payments will not be made until April and May for the anniversary events of the flagship titles. Therefore, January-March quarter sales are expected to have fallen compared with those in the October-December quarter. October-December quarter sales were in any case strong, driven by the anniversary and year-end events of the game *Davimus*.

On the other hand, costs have continued to decline since the April-June quarter, as shown in Figure 14. This is due to management with an emphasis on efficiency and efforts to review and control costs – mainly in the administration department – as the development of multiple game titles takes off and the capitalization of development costs progresses. Therefore, costs in the January-March are also expected to decline compared with those in the October-December quarter.

Drecom releases its earnings outlook only for the following quarter. This is because of factors that cannot be determined, such as the timing of game title releases. The company announced its full-year earnings forecast for the year to March 2021 when it released its October-December figures on January 28. It expects full-year sales to increase 15.3% to ¥11.7 billion and operating profit to be up 307.9%, to ¥1.9 billion. Although revenue is expected to have declined quarter-on-quarter from the October-December quarter to the January-March quarter, it had already grown 31.3% in the nine months through the October-December quarter. Both Drecom and GIR therefore expect sales and operating profit to reach record highs in the fiscal year to March 31, 2021.

Figure 14. Trend in fixed costs, FY to March 2021

Unit: ¥m



Source: Global IR, Inc. from company materials

Higher profits likely in the next fiscal year by new title release.

In the fiscal year to March 31, 2022, GIR believes that Drecom is likely to achieve higher profits. First, looking at the sales side: 11 of the 12 titles already in service in the fiscal year to March 31, 2021 have contributed to earnings, and it is almost inevitable that sales from aging existing game titles will fall in the next fiscal year. However, according to the earnings briefing on January 28, Drecom's pipeline has 10 titles under development through to March 2023. If so, at least one title can be expected to be released in the fiscal year to March 31, 2022. There is a good chance that this will compensate for the aging of existing titles and lead to a net increase in sales. Moreover, on the cost side, the company will continue to focus on operational efficiency and cost optimization. In addition, the amortization of goodwill generated by the acquisition of the BlasTrain game development company ends during the current fiscal year. GIR believes that the costs in the fiscal year to March 31, 2022 are likely to be flat or less than those on a quarterly basis in the January-March quarter of the current fiscal year.



Integrity & Sustainability

Stable profit growth likely over the medium term through stock-based business model.

Possibility of dividends within a few years.

Drecom's Growth Strategy:

- (1) Moving into other entertainment fields using the know-how acquired through game management.
- (2) Expanding in-house IP.
- (3) Domestic hit titles to be made available overseas.
- (4) Introducing a subscription business model in areas other than mobile gaming.

Although there are differences in the profit contribution from each title, Drecom takes its risk management very seriously. By accumulating multiple titles, the company appears to be putting into place a stock-type business model.

Consequently, it is therefore very likely that the company will be able to maintain a relatively stable trend of increasing sales and profits over the medium term.

Though retained earnings posted a loss of ¥1.47 billion as of March 31, 2020, as noted, the company is likely to post record high profits in the period to March 31, 2021. If it does, in GIR's view the deficit in retained earnings is on course to be eliminated and the company will be in a position to consider paying dividends within a few years.

Drecom's Growth Strategy

In the results meeting materials for the July-September quarter of 2020 Drecom gave an indication of its future direction. In addition to further increasing its strengths in developing and managing IP games, and expanding its core game business, the company set out the following four areas to focus on in terms of growth:

1. Moving into entertainment fields other than mobile games
2. Acquisition, creation and development of IP
3. Taking existing titles into overseas markets
4. Diversification of the revenue model

1. Moving into entertainment fields other than mobile games

Over the next three years, Drecom aims to transform itself from a "mobile gaming company with strengths in developing and managing IP games" to a "comprehensive entertainment content company centered on IP." Currently, the company's offering consists mainly of mobile games, but it has announced that it intends to develop and provide entertainment services in other fields, such as music, comics, and light novels, utilizing its own IP. In addition to being able to utilize its know-how from IP game management to acquire fans and form fan communities in each field, in the past it has developed and provided music streaming apps and manga apps, so it has long experience of business development in these areas. In September 2020 it released *AKROGLAM*, IP in the form of a musical drama, developed in-house. The service is growing – it had more than 10,000 followers on Twitter by the end of September – and sales of CDs and other related items started in January 2021.

2. Acquisition, Creation and Development of IP

To become a "comprehensive entertainment company", Drecom needs to increase its in-house IP. The company has worked with other IP holders in the past to develop and provide content, but in the future, in addition to creating and developing its own IP in-house, it plans to increase the number of IPs it owns by means including acquisitions from other companies. In the fiscal year to March 31, 2020, Drecom acquired *Boku & Dragons* (and other properties) from Ignis Co. (3989). When Ignis was choosing a company to sell to, Drecom's development and management of IP games, and its attitude regarding IP, were rated highly. Drecom's integrity in matters concerning IP and the recognition of its value are well-known within the industry, and this reputation can be expected to work in its favor when it acquires IP from other parties. In November 2020, it won a part of the copyright and trademark of the pioneering role-playing game *Wizardry*, and the music drama IP *AKROGLAM* mentioned earlier was released. Titles utilizing the company's in-house IP are currently under development in mobile games, and in addition to games that utilize IP owned by other companies, the number of Drecom mobile games using its in-house IP can be expected to increase.

3. Taking existing titles into overseas markets: increased revenue from overseas

Drecom currently obtains most of its revenue from the domestic market, but in future it aims to increase revenue from abroad by offering successful Japanese titles in overseas markets, particularly the rapidly growing Chinese market. *ONE PIECE Treasure Cruise* (distributed by Bandai Namco), developed and managed by Drecom, has been distributed worldwide since 2015, and the company has an excellent track record in management for overseas users. Worldwide distribution of *Derby Stallion Masters* and *Makai War Record Disgaea RPG* (distributed by ForwardWorks) has already been announced for the fiscal year to March 31, 2022. In addition to this previous experience, Drecom has close relationships with leading marketing companies overseas. These should prove to be strengths in the company's overseas expansion.

4. Diversification of the Revenue Model: Moving Away from Dependency on Free-to-Play

Drecom will also focus on diversifying its revenue model. Currently, almost all revenue comes from in-game purchases within games that follow a Free-to-Play (F2P) model, but in future the company intends to introduce a subscription model for areas other than mobile gaming. This should increase revenue stability by moderating the volatility inherent in the F2P model. In addition to a subscription model being expected to be introduced for the augmented reality (AR) app construction platform 'AROW', mail-order sales of

related goods such as CDs have also started for the music drama IP *AKROGLAM* mentioned above. Drecom aims to generate the same level of revenue as F2P in the next five years from business models other than the F2P model.

Drecom and ESG

With respect to ESG, Drecom is improving its non-financial disclosures to help improve corporate value in the future. Its current initiatives are set out below.

S: Social

Creating a working environment that takes into account human rights, diversity and flexibility

In addition to prohibiting discrimination in the workplace and implementing appropriate labor management measures, Drecom is focusing on maintaining the health of its employees, respecting employee life events and life stages – such as introducing remote working – and recommending that male employees take parental leave.

Promoting employees' health and nurturing their skills

The company tries to ensure that the working environment is one that enables employees to stay healthy and fulfil their potential.

- For example, it has rooms where employees can receive a low-cost massage:
<<https://newswitch.jp/p/17425>>
- ...and a café space, run in partnership with a popular café chain:
<https://www.wantedly.com/companies/drecom/post_articles/173575>
- ...as well as support for events that share knowledge and disseminate technical information
<<https://tech.drecom.co.jp/>>

Promoting an entrepreneurial community

Drecom seeks to be a pioneer of student entrepreneurship and IT-related ventures. The company is working on initiatives to contribute to the development of younger entrepreneurs and the further revitalization of entrepreneurship in Japan. These include:

- Free lending of office space for study sessions and seminars
"Shea Spe" (Share Space!)
<<https://drecom.co.jp/recruit/room/>>



Integrity & Sustainability

President is the founder, CFO worked at major securities companies.

G: Governance

The founding president is Yuki Naito. He has steered the business and management since it was founded. Drecom's CFO is Hideki Goto, who has experience as an analyst and investment banker at major securities companies. Both the CFO and Hiroyuki Kono, a former investment banker in foreign securities and Head of the IR Office, can communicate with overseas investors in English without the need for interpreters. In addition, around half the company's employees are entitled to participate in a corporate share ownership scheme. This has proved a success in that they are very keen to participate in the improvement of operations and corporate value.

Further, to ensure that management functions soundly from a governance perspective, Drecom is focusing on appointing a number of independent outside directors from different professional backgrounds, on appointing women as directors, and on holding regular meetings of the Board of Directors, along with lively discussions.

- Appointment of female directors – Female directors: 20%
- Inside directors vs. independent external directors – External directors: 60%
- Independent directors have diverse expertise – Backgrounds in accountancy, law, academia
- Frequency of Board of Directors meetings – 28 meetings in the year to March 2020; 24 in the year to March 2019



Figure 15. Comparable companies

Company	Country	Stock code	Market Cap (\$bn)
Drecom	Japan	3793	231
Sony	Japan	6758	144,560
Nintendo	Japan	7974	81,007
Konami Holdings	Japan	9766	10,134
Capcom	Japan	9697	9,307
Square Enix Holdings	Japan	9684	8,349
DeNA	Japan	2432	2,608
GungHo Online Entertainment	Japan	3765	2,431
Mixi	Japan	2121	1,937
Colopl	Japan	3668	1,186
Akatsuki	Japan	3932	587
Klab	Japan	3656	346
Gumi	Japan	3903	282
Drecom	Japan	3793	231
Microsoft	US	MSFT	1,843,996
Activision Blizzard	US	ATVI	79,789
Electronic Arts	US	EA	42,375
Zynga	US	ZNGA	12,926
Tencent	China	700_HKG	936,841
NetEase	China	9999_HKG	457,699
Nexon	Korea (Japan)	3659	28,058
NCSOFT	Korea	A036570_XKRX	20,313
Netmarble	Korea	A251270_XKRX	10,677

Source: Global IR, Inc. from interviews with Drecom

Note: As of 12 February, 2021



Performance Index

Profit and loss statement							(Consolidated, ¥m)
Year Ending	Mar-2015	Mar-2016	Mar-2017	Mar-2018	Mar-2019	Mar-2020	Mar-2021 Co. est.
Accounting Standard	Japanese GAAP						
Sales	7,298	6,534	8,389	13,193	10,720	10,150	11,700
YoY	-	-10.5%	28.4%	57.3%	-18.7%	-5.3%	15.3%
Gross profit	2,274	1,796	3,056	3,096	1,434	2,192	-
YoY	-	-21.0%	70.2%	1.3%	-53.7%	52.9%	-
Gross profit margin	31.2%	27.5%	36.4%	23.5%	13.4%	21.6%	-
Operating income	301	-206	932	191	-577	617	1,900
YoY	-	-	-	-79.6%	-	-	207.9%
Operating income margin	4.1%	-3.2%	11.1%	1.4%	-5.4%	6.1%	16.2%
Ordinary (Pre-Tax) income	279	-218	844	-29	-1,349	636	1,800
YoY	-	-	-	-	-	-	183.1%
Net Income	-1	-618	810	-200	-1,717	713	1,400
YoY	-	-	-	-	-	-	96.2%
Net income margin	-	-9.5%	9.7%	-1.5%	-16.0%	7.0%	12.0%
Per-Share Data							(Consolidated)
(	Mar-2015	Mar-2016	Mar-2017	Mar-2018	Mar-2019	Mar-2020	Mar-2021 Co. est.
Total No. of Shares outstanding (,000)	13,883	13,901	14,371	28,742	28,819	28,894	-
EPS	1.3	-39.4	29.7	-7.2	-60.5	25.0	49.1
Adjusted EPS	-	-	29.67	-	-	24.98	-
BPS	139.6	101.8	113.2	106.7	47.9	74.2	-
DPS	0	0	0	0	0	0	0
Balance Sheet							(Consolidated, ¥m)
Year Ending	Mar-2015	Mar-2016	Mar-2017	Mar-2018	Mar-2019	Mar-2020	Mar-2021 Co. est.
Current Assets	3,486	2,326	5,661	6,192	5,191	4,572	-
Cash and Cash Equivalents	2,360	1,310	3,003	3,303	2,866	2,268	-
Tangible Fixed Assets	102	91	108	300	252	172	-
Intangible Fixed Assets	633	353	666	1,017	773	907	-
Investment and Other Assets	458	530	385	1,588	731	774	-
Total Fixed Assets	1,194	974	1,158	2,905	1,756	1,852	-
Total Assets	4,680	3,300	6,819	9,097	6,946	6,424	-
Current Liabilities	1,866	1,336	3,202	3,240	3,873	3,595	-
Long-term Liabilities	600	311	252	2,596	1,650	661	-
Total Debt	2,466	1,647	3,455	5,836	5,523	4,255	-
Net Assets	2,214	1,653	3,365	3,261	1,423	2,169	-
Interest-bearing Debt*	1,391	800	1,192	3,591	3,348	2,194	-



Integrity & Sustainability

Cash Flow							(Consolidated, ¥m)
Year Ending	Mar-2015	Mar-2016	Mar-2017	Mar-2018	Mar-2019	Mar-2020	Mar-2021 Co. est.
Depreciation	542	460	214	299	462	382	-
Sales Cash Flow	944	54	846	-79	78	691	-
Investment Cash Flow	-680	-549	-456	-1,958	-123	-101	-
Financial Cash Flow	638	-574	1,345	2,288	-271	-1,188	-

Financial data							(Consolidated, %)
Year Ending	Mar-2015	Mar-2016	Mar-2017	Mar-2018	Mar-2019	Mar-2020	Mar-2021 Co. est.
ROA	0.0	-18.7	11.9	-2.2	-24.7	11.1	-
ROE	1.0	-32.6	35.5	-6.6	-78.3	41.0	-
Equity Ratio	40.7	42.1	47.0	33.2	19.6	32.9	-

Source: Global IR, Inc. based on company's annual securities report

Note: Rounded under ¥m. Rounded to one decimal place.

*Calculated by Global IR, Inc.



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