

Augmenting Our Strategy in Light of Changes in the Consumer Market and the Online Market, Our Core Business, Respectively. We Aim to Maximize Profitability With Additional Multiple Usage.



Haruhiro Tsujimoto

President and
Chief Operating Officer (COO)

In the fiscal year ended March 31, 2013, although the expanding online business caused sales to increase, an important point of our growth strategy, major games that either missed their sales targets or were postponed caused profits to decline.

The following is an explanation of Capcom's strategy to achieve medium-term business goals, including improvements to the Consumer business in response to rapid changes in the market environment and enhancements to the online business.

Capcom's Strength

1 Advanced Ability to Develop Original Game Content

In the contents industry, generation of new content is the source of a company's competitiveness. One of the reasons Capcom has continued to grow is due to the core Consumer business "ability to provide original content" through the utilization of strong development capabilities for creating a large amount of superior game content.

Capcom's superior development capabilities possess "developer creativity" and an "organizational structure that enables developers to hone their skills"; two factors successfully realized a number of times through structural reforms.

Capcom's Strength

2 Extensive Collection of Leading Global Content

The originality of content created by Capcom using the world-class development capability is, naturally, held in high esteem by users. We attempt to secure stable earnings by creating new million-seller titles once every two or three years, and introducing the sequels of these titles regularly, such as "Street Fighter" and "Resident Evil", which have sold over one million copies worldwide. We possess the most popular contents among Japanese game software manufacturers, and development capabilities continue to be one of our biggest strengths.

Furthermore, "possessing scores of content with universal market" appeal enables us to develop our Single Content Multiple Usage strategy worldwide. Based on our success in the Consumer business, we have engaged in the multiple development of popular content for various forms of media, which has led to success in other businesses, and we are now creating a business model to realize multiple profits in the contents market as well. [Diagram 15](#)

Three Growth Strategies for Achieving New Medium-Term Business Goals

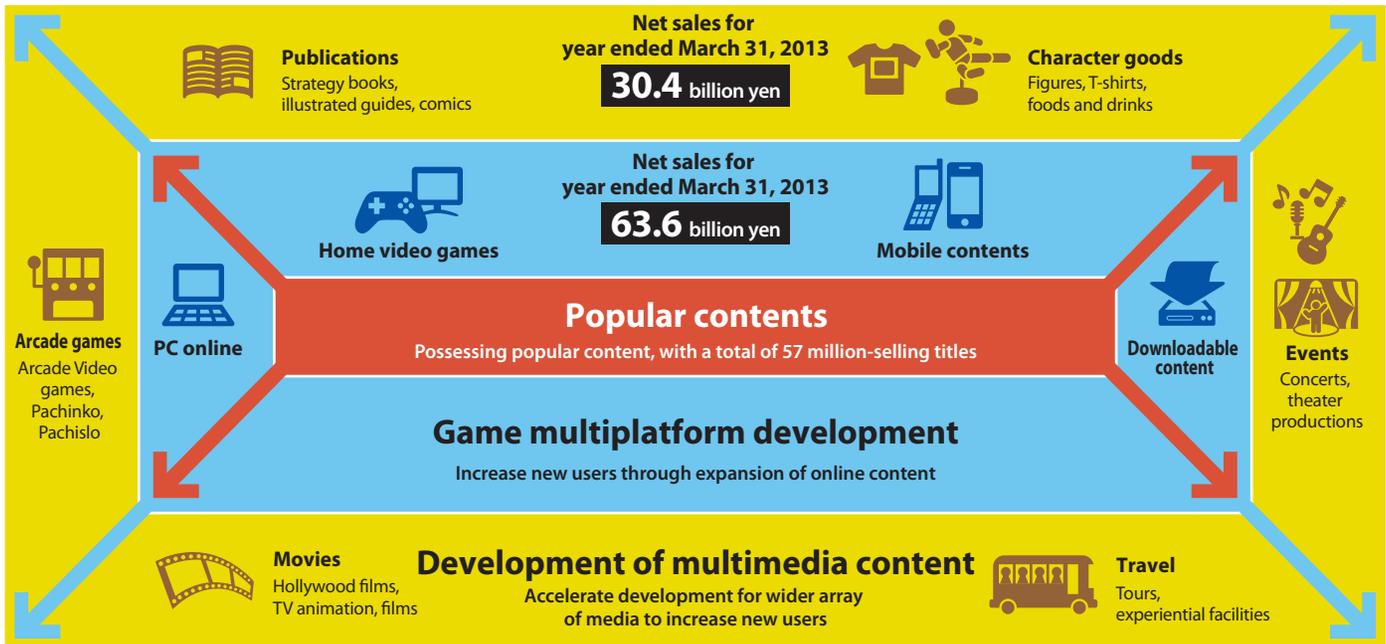
The 2012 game market was worth 61.4 billion dollars (up 7.0% from the previous year) due to platform expansion, and is expected to increase to 86.6 billion dollars in 2017.

There was significant growth in the mobile content and PC online market, which was worth 35.9 billion yen (up 20.9% from the previous

Total as of March 31, 2013

Diagram 15 Single Content Multiple Usage

94.0 billion yen



Our Strategy for Growth

year) in 2012. The main reasons for this include (1) the spread of smartphones and tablets, (2) the spread of social games and (3) high-speed PC and mobile phone communications that enables online game platforms connecting high-performance devices such as PC, smartphone, iPad and a wide range of other consoles to the home video games. As a result, the online game market is expected to grow steadily to 58.6 billion dollars in 2017 (up 63.2% from 2012). **Diagram 16**

At the same time, the consumer market was worth 25.5 billion dollars (down 7.9% from the previous year) in 2012, although it is expected to continue growing steadily to 28.0 billion dollars (up 9.8% from 2012) in 2017. Following online market compartmentalization, five years from now, we anticipate it will continue to be a cornerstone of the market.

In response to the changing market environment, and to achieve our medium-term business goals, Capcom has outlined three major strategies for growth: "improving the Consumer business", "strengthening the online business", and "expanding Single Content Multiple Usage",

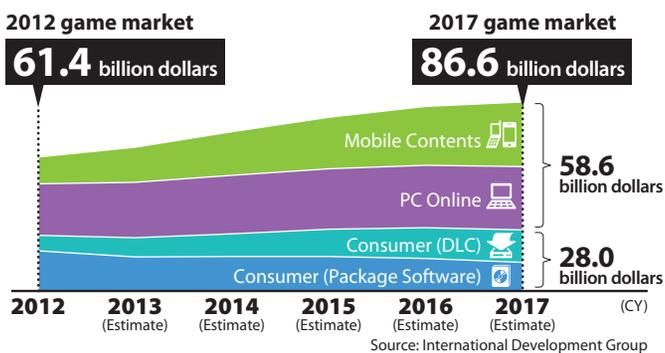
and will allocate 80% of management resources to the Digital Contents businesses promoting these strategies.

Please see "CEO's Discussion on the Summary of This Year's Performance and New Medium- and Long-Term Business Goals", Q4, on page 20.

Next fiscal year (ending March 31, 2014), an enhanced title lineup will be a contributing factor toward our goal of increased sales and profits, but we have to realize our growth strategy to stabilize performance. Accordingly, to ensure our medium-term business goals are achieved, we will enhance digitally distributed content (DLC) within the Consumer business, and make development more efficient and shorten the sales cycle of major titles by transitioning outsourced work in-house. Furthermore, in the online business, we will promote development for a variety of platforms and regions, while continuing to focus efforts on the development of Single Content Multiple Usage, which is at the core of our business development.

On the following pages, I will explain each of our three growth strategies.

Diagram 16 Game Market Size



Growth Strategy

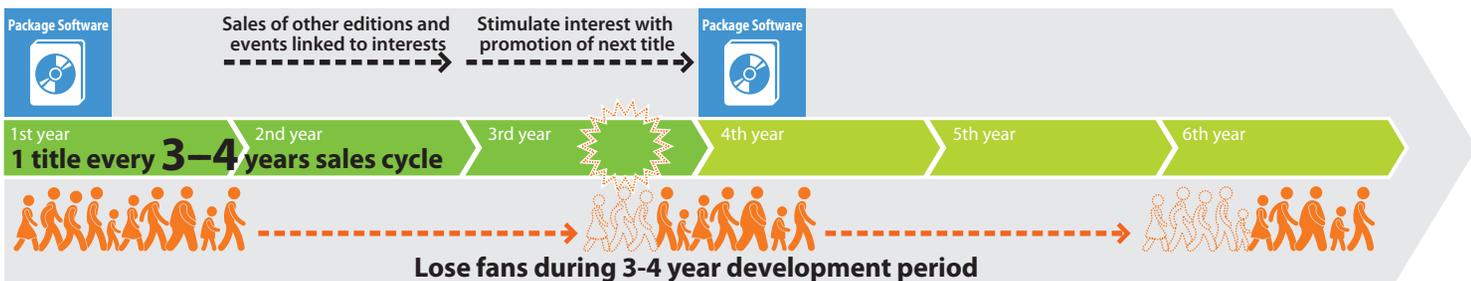
- Development Strategy P25**
Improving the Consumer Business
- Market Strategy P27**
Strengthening the High-Growth Online Business
- Media Strategy P29**
Expanding Single Content Multiple Usage Development

Development Strategy

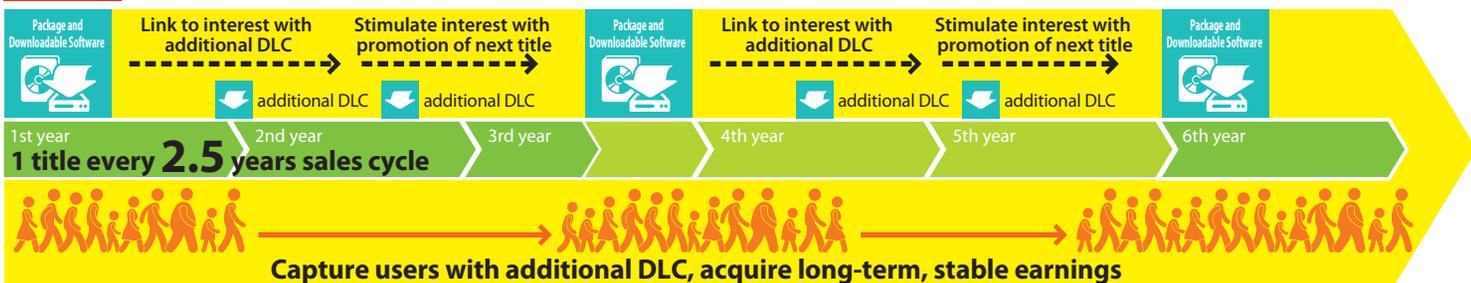
Improving the Consumer Business

Diagram 17 Strengthening Digital Strategy (DLC)

At present Package game focused business model



In future Enhanced digital strategy (DLC) business model



Revised Strategy in Response to a Changing Market

Here, I'd like to explain "improving the Consumer business," the first of our growth strategies for achieving our medium-term business goals. As stated in the CEO Message (see Q2 on page 18), the consumer market is currently going through major changes due to DLC market expansion and market oligopolization by certain titles. Capcom was late responding to the rise of DLC and we had quality issues with titles outsourced overseas, all of which has impacted earnings.

We will continue to create popular content for the consumer market, a major market that will continue to represent one-third of the overall game market in 2017, positioned as a core business able to ensure an operating margin of 15% or higher. Hence, with a slight shift in the strategy we have pursued up to now, we will create a structure better able to generate stable growth conforming to the rapidly changing market.

To this end, we will (1) strengthen our digital strategy (DLC), (2) improve development efficiency and product quality by transitioning outsourced work in-house and (3) shorten the sales cycle of popular series titles to create a portfolio of titles enabling sustainable growth over the medium- to long-term.

1 Strengthening Our Digital Strategy (DLC)

Looking at "strengthening our digital strategy (DLC)," [Diagram 17](#) DLC accounts for 27.8% of the consumer market. We will expand DLC sales

to improve the DLC ratio, currently 11.3% of Capcom's business. [Diagram 18](#)

The merits of improving the DLC ratio include (1) the reduced production costs of digital distribution and the ability to avoid inventory risks and (2) the ability to realize long-term, stable additional sales by capturing users with the ongoing distribution of DLC. This is one strategy for responding to concerns over the volatility associated with hit titles and the rising development costs in the Consumer business indicated by investors.

Specifically, we will (1) provide additional content strategically after the launch of major titles like "Resident Evil" and "Street Fighter" to lengthen the product lifetime and (2) expand download only titles like "Dungeons & Dragons: Chronicles of Mystara." [Diagram 19](#) We will also establish a development and marketing structure conform to the DLC business.

2 Improving Development Efficiency and Product Quality by Transitioning Outsourced Work In-House

We will "improve development efficiency and product quality by transitioning outsourced work in-house" by shifting to a structure focused on in-house development from our aggressive use of overseas outsourcing since fiscal 2009. This is because striking technological innovations in the market resulted in an inability to appropriately sell titles conforming to market needs due to time required to change specification and other agreements with foreign outsourcers, as well

Diagram 18 DLC Ratio (Capcom and Market Average Comparison)

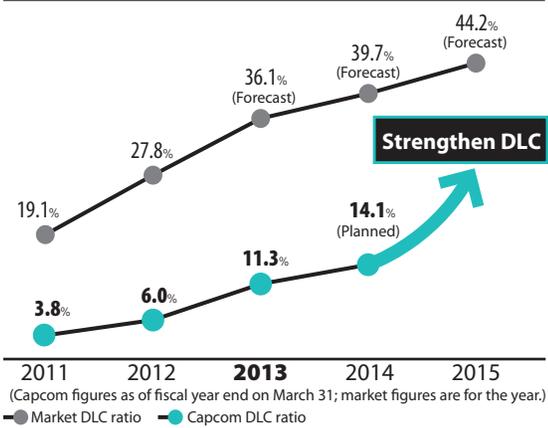
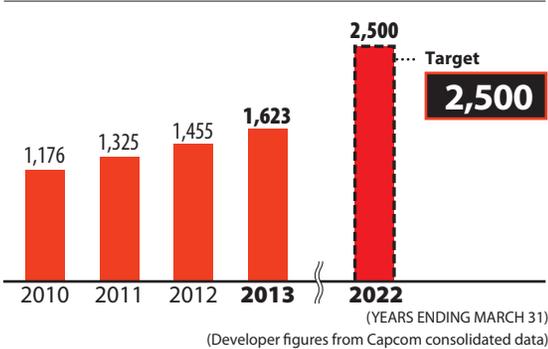


Diagram 20 Number of Developers



as an increased number of development companies that could not keep up with the technology.

For Capcom, the current drastic changes in the marketplace, such as the arrival of next-generation consoles and the expansion of the DLC market, shifting our development structure to one focused in-house will improve quality through the internal accumulation of expertise on next-generation consoles and other new technologies. We will observe sales schedules with flexible staff organization.

Furthermore, shifting in-house will increase our internal production ratio (percent of development investment amount allocated to in-house production) to 60% (this fiscal year it was 50%) and we will continue to increase it over the medium-term. Also, there is concern over worsening profitability associated with staff allocation and rising costs. In response, Capcom thinks it possible to (1) hire 100 development employees, mainly new graduates, every fiscal year, growing to a structure of 2,500 people by fiscal 2021, (2) strengthen development personnel allocation management with a 52-week map and improve operating rates and (3) keep costs (of sales) down and reduce overseas outsourcing expenses.

3 Shortening the Sales Cycle of Popular Series Titles

In terms of "shortening the sales cycle of popular series titles", we launch sales of popular series titles held by the Company approximately every 2.5 years. This is because the development of a single major title usually

Diagram 19 Digitally Distributed Content Examples

Full title distribution

"Dungeons & Dragons: Chronicles of Mystara"
Same content as package game sold over the Internet

©1974, 1993, 1996, 2013 Wizards of the Coast LLC. Dungeons & Dragons, Chronicles of Mystara, Wizards of the Coast, their respective logos, and character likenesses are property of Wizards of the Coast LLC. All rights reserved. Distributed by CAPCOM CO., LTD.

Item distribution

"Resident Evil: Revelations"
Distribution of equipment and parts to proceed through game advantageously

DLC

New costume distribution

"Street Fighter X Tekken"
Providing new fun with distribution of additional character costumes

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Additional scenario distribution

"DmC Devil May Cry"
Lengthening the title lifecycle through distribution of additional scenarios

requires 3–4 years; in the event that there are few hits, it will be difficult to create a series title every year and earnings will be adversely impacted. For this reason, it is important either to maintain a large number of popular titles or shorten the sales cycle to ensure stable earnings. **Diagram 17**

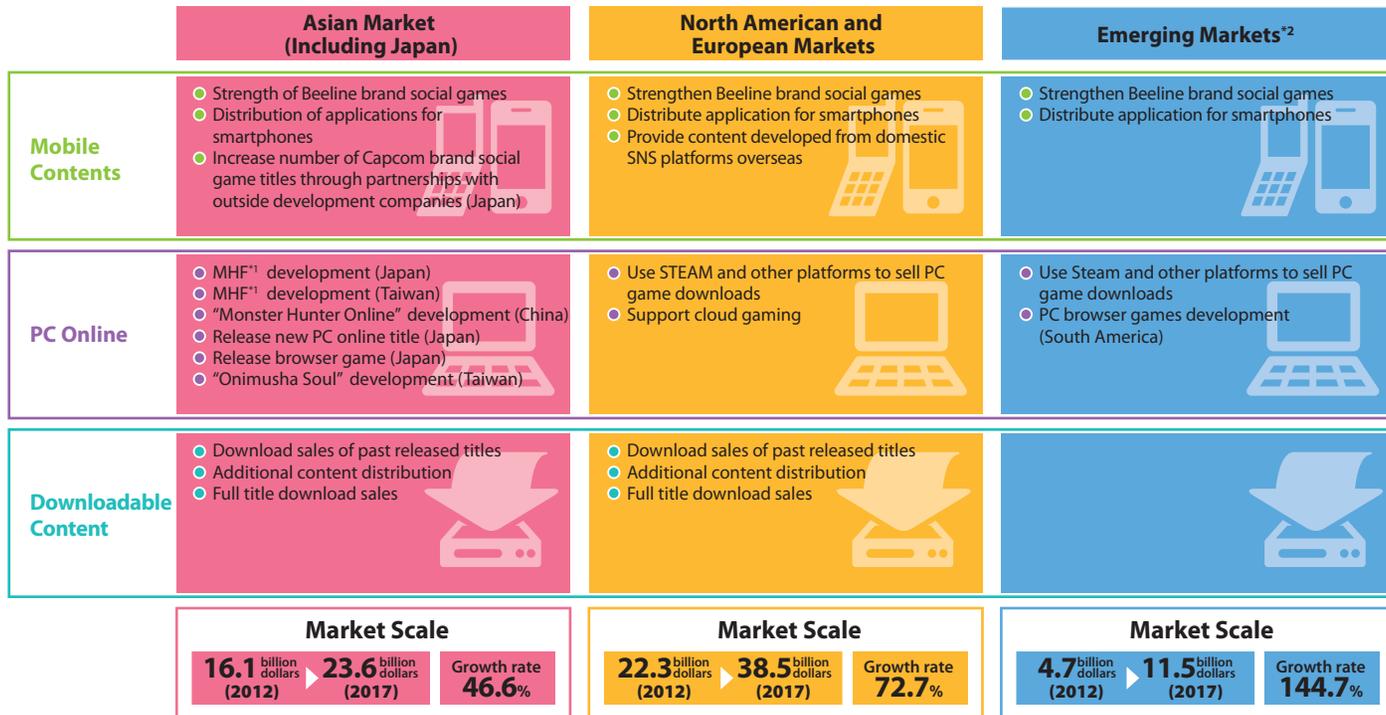
Although Capcom owns many major titles such as "Monster Hunter" and "Resident Evil", to pursue both stable performance and growth, we will promote shortening of the sales cycle to increase the number of titles released in a single fiscal year and expand earnings.

Moreover, we will also make development more efficient through the use of "Panta Rhei", our proprietary new integrated development environment. "Panta Rhei" brings out next-generation console performance, enabling further improvements to game quality, while optimizing game development with support for the latest graphics and an improved workflow that we expect will make development more efficient. In conjunction with the integrated development environment "MT Framework" for current game consoles, Capcom will launch multiple popular titles for various consoles.

With these three overlapping growth strategies and a development structure enabling a flexible response to rapid changes in the market, we will create popular titles for various consoles sold in a 2.5 year cycle. Furthermore, during times when there are no title launches, we will continuously offer new item and scenario downloads to attract users and solidify our fan base in an attempt to attain revenue from the sale of additional items and improve profitability.

Strengthening the High-Growth Online Business

Diagram 21 Capcom Online Strategy (Matrix)



*1: "Monster Hunter Frontier G"

*2: South America, Africa, Middle East, etc.

Online Business as Our Growth Engine

Now, I'm going to explain the second growth strategy for achieving medium-term business goals, "strengthening our online business." [Diagram 21](#)

In terms of online business measures, Capcom is (1) developing social games for mobile and PC on many platforms, (2) strengthening overseas development and (3) enhancing development staff. These measures will enable us to grow online business sales to 28 billion yen (up 22.3% from the previous fiscal year) in the fiscal year ending March 31, 2014 and to 30 billion yen in the fiscal year ending March 31, 2015. [Diagram 22](#) There are three points to these measures. The first is to augment the number of social game titles that make thorough use of the Capcom brand developed for a variety of platforms. The second, to strengthen the Beeline brand management structure and create a next hit to follow "Smurf's Village". The third is to establish a presence overseas with respect to PC online games. Through these measures, we aim to further entrench existing users and cultivate new user segments.

1 Augmenting Capcom Brand Social Games

The Capcom brand develops content making use of popular title brand power at development bases in Tokyo and Osaka and attempts to realize a synergy effect with home video games. We will upgrade and expand the number of social games launched, aggressively

distribute native app content optimized for smartphones and original content for LINE games on multiple platforms. [Diagram 23](#)

2 Cultivating the Light User Segment with the Beeline Brand

We are also strengthening social games for smartphones under the Beeline brand. The reason for creating a second brand is because Capcom brand games have an image of difficulty and complexity about them, creating high barriers preventing light users from casually purchasing a download. Developing a new brand circumvents these obstacles

Diagram 22 Online Market and Capcom Online Sales Growth Rate Forecast

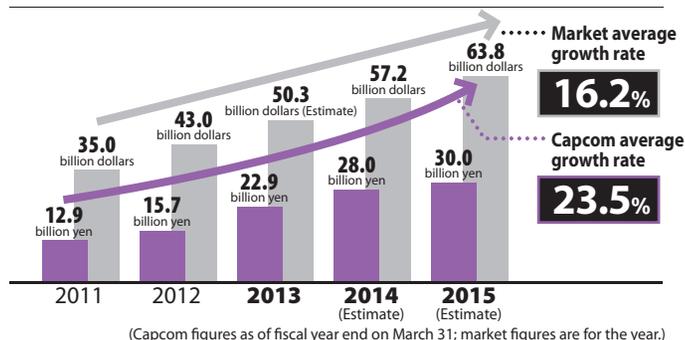


Diagram 23 Mobile Contents and Two Brand Strategy

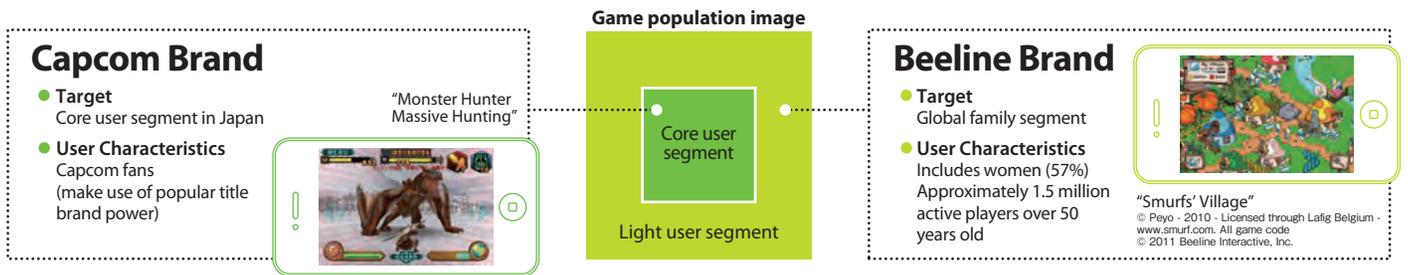
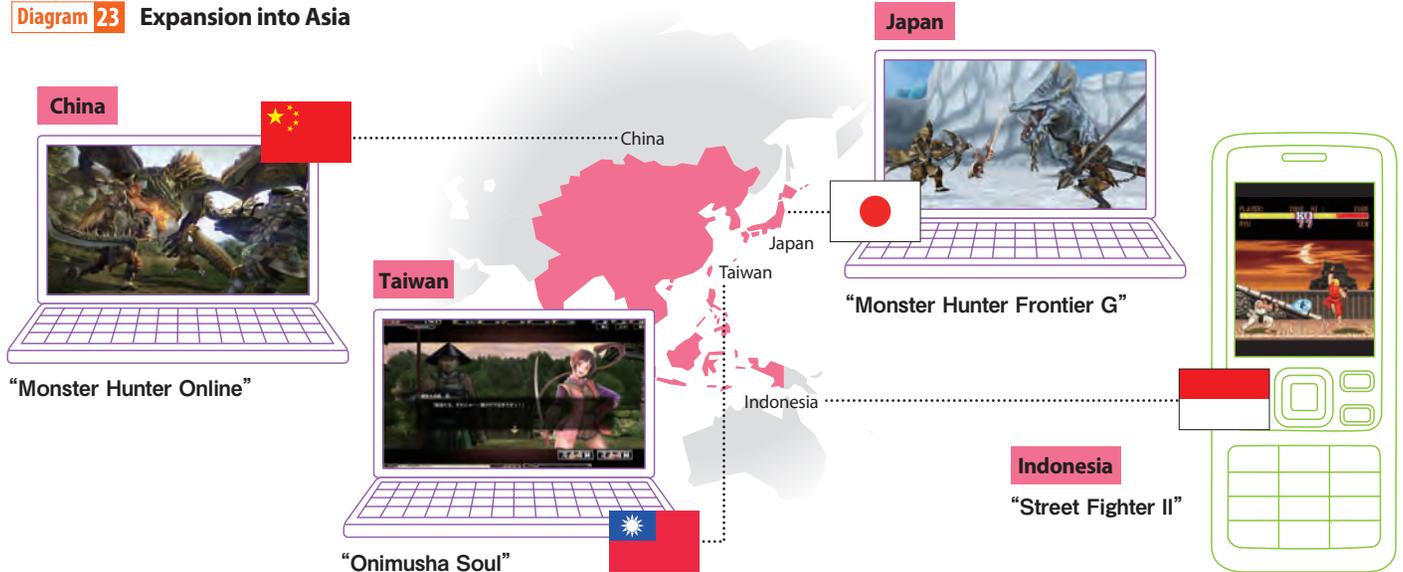


Diagram 23 Expansion into Asia



altogether. We will develop social games that conform to each of the various regional characteristics of our four development bases located in North America, Europe, Japan and Thailand, while acquiring users in developing regions where home video games have not been adopted. **Diagram 23**

Our growth strategy up to now is already paying off; major title "Smurf's Village" became the "top-selling app" in the App Store sales rankings in 80 countries and downloads of Beeline titles in Japan and overseas have exceeded 100 million. However, in the second half of CY 2012, competition in overseas markets intensified, causing a lull in the creation of new hits.

In terms of our overseas title lineup next fiscal year (ending March 31, 2014), we will erect the next pillar of earnings following "Smurf's Village" by launching titles that make use of globally popular brands, including "Snoopy 2" (tentative title) featuring this popular Western character licensed from a third-party company. Our target for Mobile Contents sales is 12.5 billion yen (up 13.6% from the previous fiscal year).

3 Launching Online Development in the Asia Region

Regarding PC online overseas business, Capcom will focus on the massive Asia market **Diagram 24** and growth potential of South America. Specifically, in China, the world's largest online game market, we have begun beta testing "Monster Hunter Online" through a collaboration

with Tencent. In Taiwan, we are distributing "Onimusha Soul" and will upgrade and expand the development line at our subsidiaries in Taiwan and South Korea. Our collaboration with Tencent has been determined to be an effective means of mitigating country risks associated with China and gaining expertise.

In Japan, we will strengthen earnings power by distributing a major update to "Monster Hunter Frontier G" (for PC and Xbox 360) for the new PlayStation 3 and Wii U, and develop browser game "Onimusha Soul" on a new platforms. Next fiscal year, we are targeting sales of 9.5 billion yen (up 41.8% from the previous fiscal year).

Up to now, Capcom's business focused mainly on package game software sold by retailers (sellout model, B to B), but going forward, we will switch to an operations business (operational model, B to C) where, after distributing software, updates are provided as appropriate based on user movement, and in-game events are held. Capcom will attempt to achieve its medium-term business goals by ensuring stable earnings each month and improving the operating margin.

Furthermore, to implement the above measures, we plan to hire 170 people for our development and sales management divisions next fiscal year.

Expanding Single Content Multiple Usage Development

Diagram 25 Making Use of Multiple Popular Contents



Developing Popular Multimedia Content to Expand Earnings

This section will explain the "expansion of Single Content Multiple Usage" in terms of the aforementioned three growth strategies formulated to achieve the medium-term business goals.

A "home video game" is an artistic media product that consists of highly creative, multi-faceted elements such as images, storyline, a worldview, music and interactive game play. This is exactly why each of these constituent elements can be individually developed into an attractive product through different facets of media.

Therefore, we can expect the following four effects by developing each of these elements into different business fields: (1) creating new profit opportunities other than the Consumer business; (2) creating heightened excitement through increased exposure by simultaneous multiple-field development (promotional effects); (3) absorbing customers obtained from other business segments as home video game users; and (4) reducing profit fluctuations through business portfolio creation (risk hedge).

We own scores of intellectual properties based on popular content. We are now creating a business model to enjoy multiple profits by promoting

Single Content Multiple Usage strategy in several applications. **Diagram 25**

This strategy will allow us to leverage the success of our Consumer business with the aim of maximizing profits and achieving success in other businesses (Mobile, Pachinko & Pachislo, Arcade Games, Movies, Publishing, Character Goods, etc.).

Promoting Multiple Usage Development to Achieve a Synergy Effect with Games

This fiscal year (ended March 31, 2013), we maximized profits by promoting the Single Content Multiple Usage development of popular content. First, Hollywood film "Resident Evil: Retribution" based on the "Resident Evil" series was released worldwide earning 0.24 billion dollars at the box office. In Japan, the CG animated film "Resident Evil: Damnation" was released. Also, we collaborated with Universal Studios Japan (USJ) to hold "Halloween Horror Night", part of the "Universal Surprise Halloween" event, as well as with Shibuya PARCO to open a "Resident Evil Café" inside that department store. These initiatives contributed to sales of the "Resident Evil" series consumer software in our attempt to maximize profits.

Other examples of multiple usage development involve the

*1 Source: "Licensed Character Business 2011" by Yano Research Institute Ltd.
 *2 Source: Amusement Industry Survey Report
 *3 Source: Manufacturer sales base compiled by Capcom using Pachinko Maker Trends (2010,2011,2012); Yano Research Institute Ltd.
 *4 ©CAPCOM developed by gloops ©CAPCOM CO., LTD.
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Diagram 26 Examples of Single Content Multiple Usage



Our Strategy for Growth

"Monster Hunter" series. With the upcoming launch of "Monster Hunter 3G HD Version" and current distribution of social games "Monhan Tankenki Maboroshi no Shima" and "Minna to Monhan Card Master", we held "Monster Hunter Orchestra Concert: Hunting Music Festival 2012" with the Tokyo Philharmonic Orchestra in six cities across Japan in addition to holding "Monster Hunter The Real 2012" at USJ, all in an effort to realize a synergy effect with games. **Diagram 26**

Regarding "Sengoku BASARA", in connection to the release of home video game "Sengoku BASARA 3 Utage PlayStation 3 The Best" we broadcast the TV animation "Sengoku BASARA The Moon Light Party" and produced stage performances "Sengoku BASARA 2" and "Sengoku BASARA 3 Setouchi Kyoran".

As for "Ace Attorney", since the fiscal year in which "Professor Layton VS. Phoenix Wright: Ace Attorney" was launched, we have made efforts to create a buzz and expand this fan base, including the "Ace Attorney" film and collaboration with the Takarazuka Revue Company on the production "Prosecutor Miles Edgeworth: Ace Attorney 3".

In terms of multiple usage developments next fiscal year, we will (1) continue to make use of popular content, mainly "Monster Hunter",

"Sengoku BASARA" and "Ace Attorney", (2) engage in major project development with new game "Gaist Crusher" and (3) develop projects around Capcom's 30th anniversary in an attempt to realize ongoing multimedia development that appeals to a wide customer segment to improve brand value and profitability, as well as contribute to regional promotion.

In particular, with respect to (2) "Gaist Crusher", as a new project focused on kids, we will engage in large-scale cross-media development in collaboration with major companies in the manga, animation, music and toy areas to coincide with release of new games for the Nintendo 3DS in December 2013.

Specifically, we will be placing stories in "Saikyo Jump" and "V Jump", which are comic published by Shueisha Inc., promoting a television animation project produced by Pierrot Co., Ltd., developing music in collaboration with Avex Entertainment Inc., and with Bandai Co., Ltd., we plan to develop a "Gaimetal" toy from the game "Gaist Crusher". By launching a wide variety of ongoing content, despite the falling birthrate in recent years, we will attempt to grab the attention of our target, elementary school aged boys, to establish a new brand.

Targeting Sustainable and Stable Growth Through the Creation of a New Business Model

With the environment surrounding the game industry in the midst of a great transformation, what strategies will Capcom employ to target sustainable growth? Game industry analyst Yusuke Tsunoda discusses the future of package games and digitally distributed content, as well as Capcom's response to the mobile game market, with President and Chief Operating Officer Haruhiro Tsujimoto.



Haruhiro
Tsujimoto

President and
Chief Operating Officer (COO)
Capcom Co., Ltd.

Conversation

Yusuke
Tsunoda

Analyst, Corporate Research Division
Tokai Tokyo Research Center Co., Ltd.



From Unit Sales of Package Games Toward a More Sustainable Earnings Model

Tsunoda With the environment surrounding the game industry going through major changes, such as the rapid expansion of the mobile content market, what kind of business development is Capcom targeting?

Tsujimoto In the traditional package games business model, we used to recoup our investment by selling as many products at a few thousand yen each as possible. But now, even after game sales, the provision of digitally distributed content (DLC) facilitates longer enjoyment of each title, resulting in a business model with the potential for earnings on a continuous basis. An example of the success of this business model is already evident with the PC online game "Monster Hunter Frontier Online" (MHF). Compared to the consumer games market, the PC online games market is smaller and has fewer users. However, in the past five years since MHF was released, its fan base is still growing and providing support to Capcom's earnings. Going forward, I want to establish a sustainable earnings model similar to this for all our games.

Tsunoda I see. However, overseas markets have already embraced the DLC business, which I have to say, makes Capcom's download strategy response appear to be lagging behind somewhat. Moreover, what about the potential for new liabilities and risks associated with providing content on a continual basis?

Tsujimoto That's exactly right. I regret to say that, up to now, we had few plans for the full-scale implementation of DLC. From here on out, we need to focus on the long-term provision of content starting at the earliest stages of development. Furthermore, in terms of user response, if the additional related content we are providing continually to users online is deemed uninteresting from the start, there will be no ongoing business to pursue. This means that, more than ever before, the creation of underlying content is the key to success.

Transforming a Project-Based Development Structure to One Focused on Series

Tsunoda Aren't changes to your development structure necessary to create the kind of earnings model you propose?

Tsujimoto Yes, that's right. We are transforming our development structure from one that has traditionally focused on projects where work on new content begins after a title is released, to a development structure focused on creating a series of content for well-known titles such as "Monster Hunter" and "Resident Evil". However, our basic approach to content creation has not changed. Popular Capcom games continue to be loved more than a decade after their initial release, but we now engage in a variety of measures to maintain user interest until the release of the next title. We make an effort to engage fans through user events, feature films, animation and other media developments. Maintaining customer satisfaction in this way enables us to heighten brand loyalty for each title.



Tsunoda Yes, but given that, in the package game era, new titles were released every couple of years, you not only need to develop even more content for release, you also need to step-up the frequency of DLC to prevent users from losing interest. I think Capcom's aggressive hiring strategy of employing nearly 100 new developers each year makes the deployment and management of human resources even more difficult. What are your thoughts regarding resource allocation?

Tsujimoto We approach this issue flexibly. For example, even in the event we have plans to create a new version of a game two years down the road, if the previous version continues to provide users with enjoyment, we see no reason to disrupt the flow by investing in more staff and moving forward with development of a new version. From here on out, we will monitor the feedback on and status of current titles in real time, regardless of genre, with the intention of maintaining and strengthening these communities through the flexible allocation of management resources. This is possible as long as the current environment enables us to connect with users directly.

To Survive, Companies Must be Able to Continue Providing Customer Satisfaction with Creative Content

Tsunoda Regarding mobile content, although you were successful with "Smurf's Village", the impression is that subsequent developments have been a step behind that of other companies. Going forward, what is your strategy in this area?

Tsujimoto There is no doubt that the smartphone and tablet device user segment is large and attractive. However, with "Smurf's Village", we learned that there are not as many core users in this market as there are in the consumer market. Outside of Japan, people spend

less money on mobile games, particularly in Europe and North America, making it a low-margin, high turnover business. That being said, even in this area, we will continue aggressively releasing interesting titles under both the Capcom and Beeline brands. Our recognition of the high-growth potential of mobile contents and the pivotal role they play in our online strategy remains unchanged. Nevertheless, the consumer business is still the primary driver of new intellectual property creation. Our view is that mobile content developed from content created for the consumer segment is linked to sustainable and stable growth.

Tsunoda I see, so Capcom remains steadfast in its focus on the Consumer business?

Tsujimoto Today's mobile game industry is a world apparently full of dreams about making a fortune off a hit game. But if the hit is just a one-off, success is transient. For Capcom, it is crucial to maintain and deepen the user support we have worked so hard to earn up to now. We believe we can outperform other companies as long as we are able to continue this approach. This kind of strategy is already beginning to be implemented in Europe and North America, and we don't intend to be left behind. I keep coming back to this point, but the essence of a game's value is derived from its content—its worldview and characters, etc. Only companies that understand this and are able to continue providing customer satisfaction will be able to survive.

We have applied various aspects of this new business model approach to the development of "Monster Hunter 4", which goes on sale in September, and I look forward to seeing how the market reacts. We will strive to incorporate your assessment of us here into future developments.

After the Conversation

President Tsujimoto conveyed a clear vision for "enhancing profitability via a business model with more continuity focused on consumer games". However, I had hoped to hear a reasoned and easily understood story along the lines of "smash hit apps in the booming smartphone market giving rise to business amounting to several hundred million yen per month" in today's stock market amid unavoidable concerns over the high-risk consumer segment. That being said, I concur with the view that, 5–10 years down the road, only companies able to create content will survive, and I commend the management of such an unshakable leader. Nevertheless, in light of performance revisions last year as each business was at an inflection point, investor sentiment will surely be linked to Capcom's ability to achieve results through the realization of this vision. (Tsunoda)

Yusuke Tsunoda (Profile)

Bachelor of Business Administration, Risho University
2006 April: Joined Tokai Tokyo Securities Co., Ltd.
2008: Began working as an analyst covering the game, amusement and telecom sectors.

