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1. Operating results

(1) Qualitative information and consolidated financial statements

Operating results of the fiscal year ended March 31, 2014

During the fiscal year ended March 31, 2014, the Japanese economy has got on the road to recovery owing to steady consumer spending, the yen's depreciation and brisk exports, plus the improvement in the employment/income environment and rises in stock prices, as well as Tokyo being selected to host the 2020 Olympic Games.

In the industry, the home video game market entered a transition period with weak performance, due in part to next-generation home video game consoles not yet being released in Japan even as such were already released in other areas including North America and Europe simultaneously in November last year.

Meanwhile, the social game market saw native app games surge amid the shift from feature phones (conventional mobile phones) to smartphones (high-function mobile phones) as the mainstream platform. Additionally, the market environment has been rapidly changing with the spread of tablet devices (multi-functional mobile terminals) and the rise of LINE, an app that allows users to call and chat for free, which promoted multi-polarization of business structures and led to increased presence of social game market.

Under such circumstances, the long-awaited flagship title "Monster Hunter 4" which Capcom released in September 2013 displayed explosive popularity with long lines forming at major retailers across the nation since the release date. With more than four million units sold, the game was a smash hit, and the total number of units sold in the series exceeded 28 million.

In addition, in order to adapt to the changes of external business environments, Capcom worked on improvement of the development process and earnings management by clarifying the operational chain and responsibility through reorganization of the development structure and speeding up of decision making, as well as by increasing the ratio of in-house development through such measures as progressively reducing the outsourcing of development, especially those to overseas developers.

In addition, "Monster Hunter Festa '13", which Capcom held in five cities in Japan including Tokyo and Osaka last fall, turned out to be a success bringing in nearly 50,000 fans being participated in total.

Furthermore, our branding development gained further momentum through the event "Monster Hunter The Real 2014" held this February in collaboration with Universal Studios Japan, a theme park in Osaka, as it was popular with visitors.

Given the above, net sales increased to 102,200 million yen (up 8.6% from the previous fiscal year).

In terms of earnings, operating income leveled off at 10,299 million yen (up 1.5% from the previous fiscal year) and ordinary income, however, decreased to 10,946 million yen (up 0.0% from the previous fiscal year) due to such factors as loss on closing stores.

Net income amounted to 3,444 million yen (up 15.9% from the previous fiscal year) despite the recording of special losses including restructuring charges primarily due to the slump of mobile content.

Capcom is fully recognizing the importance of diversity of human resources in recent years while actively utilizing female workers and making evaluations according to performance and not based on gender, age and such. As part of such efforts, we are promoting executive positions of female employees, and so far we have two female corporate officers and 20 female employees in management positions such as general managers and senior managers.

Status of each operational department

① Digital Contents business

In the Digital Contents business, the featured title “Monster Hunter 4” (for Nintendo 3DS) was supported by overwhelming popularity, as mentioned above, and created a huge buzz even comparable to a sort of social phenomenon. Moreover, sales of “Dead Rising 3” (for Xbox One) that has been geared toward the European and U.S. markets, and “Resident Evil Revelations” (for PlayStation 3, Xbox 360, Wii U and PC) exceeded a million titles each and so three titles have become million-sellers.

In addition, “Dragon’s Dogma: Dark Arisen” (for PlayStation 3 and Xbox 360) showed firm sales while projected sales were basically achieved for “Phoenix Wright: Ace Attorney Dual Destinies” (for Nintendo 3DS).

Furthermore, full-game digital titles, which respond to changes in forms of distribution, contributed to the expansion of sales by growing significantly both at home and overseas in line with the progress in diversification of business models. This included the over-performance of “DuckTales: Remastered” for overseas in addition to the aforementioned “Monster Hunter 4” showing strong sales.

Sales of “Lost Planet 3” (for PlayStation 3, Xbox 360 and PC), were below expectations due in part to intensifying competition in the European and U.S. markets.

Meanwhile, the online game “Monster Hunter Frontier G” (for PC, Xbox 360, PlayStation 3 and Wii U) performed lower than anticipated, but the browser game “Onimusha Soul” which was distributed in Taiwan with the aim of expanding Capcom’s business fields, garnered a great deal of attention and ranked first in popularity. This thereby marked the beginnings of gaining a foothold in the market for the local corporation, which was established two years ago.

However, mobile contents underperformed as a whole due in part to a lack of major titles and the fiercely competitive environment even though “Monster Hunter Hunting Quest” performed steadily.

As a result, net sales were 65,824 million yen (up 3.4% from the previous fiscal year), and operating income was 4,489 million yen (down 36.4% from the previous fiscal year).

② Arcade Operations business

In the Arcade Operations business, under the continuous stagnant market circumstances, Capcom has been working to expand customer base. In an effort to reach potential customers, Capcom developed elaborate activities such as conducting “free game experiencing tours” for middle-aged and seniors, and setting up “kids’ corners” for pre-school children, while it endeavored to capture a wider range of customers including core customers, repeat customers and families by renovating arcades and holding various events.

However, the lack of high-performing game machines, intensification of competition with other entertainment and bad weather adversely impacted efforts to attract customers.

With the promotion of a scrap-and-build policy in accordance with changes in the environment, Capcom opened an arcade in Shizuoka City and closed two unprofitable arcades during the period under review, bringing the total number of arcades to 33 as of the end of the period under review.

As a result, net sales were 10,620 million yen (down 3.0% from the previous fiscal year), and operating income was 1,617 million yen (down 5.4% from the previous fiscal year).

③ Amusement Equipments business

In the Pachinko & Pachislo business, “Monster Hunter: Gekka Raimei”, in which the motif is a title for which Capcom is known, served to lead the increase of sales and support earnings as it showed a good start due to its synergy with home video game software. In addition, “Devil May Cry 4”, which was released last September, realized better-than-expected sales, contributing to the increase of sales.

On the other hand, in the Arcade Games Sales business, the new coin-operated game machines “Monster Hunter Medal Hunting Compact” and “Mario Party Fushigi no Korokoro Catcher 2” performed solidly.

As a result, net sales were 23,160 million yen (up 38.0% from the previous fiscal year), and operating income was 7,131 million yen (up 45.8% from the previous fiscal year).

④ Other Businesses

In Other Businesses, which is mainly the publication of game guidebooks, etc. and selling of character and other goods, net sales were 2,594 million yen (down 4.3% from the previous year), and operating income was 1,001 million yen (up 35.2% from the previous year).

Prospects for the next fiscal year

As for future prospects, the transition of business models is expected to accelerate in the home video game market due to the emergence of next-generation machines with diverse networking functions in light of the rise of online games thanks to the proliferation of smartphones and such.

On the other hand, we expect that the burden on software makers will increase further as the surge of development costs, due to the higher-spec hardware, will be unavoidable.

Furthermore, with the rise of the social gaming market, which has a low barrier to entry, a major transformation is in progress as the struggle to take initiative among gaming consoles, smartphones and such intensifies further. It is expected that the overall market size will increase due to the expansion of the user base caused by the synergy between the two, and the landscape may transform rapidly due to the intensification of competition between companies.

Under the circumstances of drastic changes in the business environment, Capcom will focus on increasing the corporate value of the whole group with agile management development through selection and concentration, such as by inputting management resources in focused businesses and growth areas through the review of earnings structures and business models as well as by withdrawing from unprofitable businesses.

For this, Capcom will focus on marketing of digital download contents and PC online games for which continued growth is expected. Also, Capcom will enhance the Pachislo business which has been growing steadily in the last few years, while aiming for the early rebuilding of Mobile Contents business. Furthermore, taking with utmost seriousness the fact that extraordinary losses were recorded for the second consecutive fiscal year following the previous fiscal year, Capcom recognizes that in order to break through this situation the important issue in management is the establishment of a corporate structure that secures stable earnings without being influenced by changes in the environment.

(2) Analysis of the consolidated financial position

① Analysis of assets, liabilities and net assets

(Assets)

Total assets as of the end of the current fiscal year decreased by 7,754 million yen from the end of the previous fiscal year to 96,611 million yen. The primary increase was 6,446 million yen in notes and accounts receivable, trade. The primary decreases were 8,533 million yen in work-in-progress for game software, 1,801 million yen in cash on hand and in banks, 595 million yen in raw materials and supplies and 564 million yen in merchandise and finished goods.

(Liabilities)

Total liabilities as of the end of the current fiscal year decreased by 8,801 million yen from the end of the previous fiscal year to 32,735 million yen. The primary decreases were 7,144 million yen in short-term borrowings, 3,000 million yen in long-term borrowings.

(Net assets)

Net assets as of the end of the current fiscal year increased by 1,047 million yen from the previous fiscal year to 63,875 million yen. The primary increases were 3,444 million yen in net income for the current fiscal year and 2,333 million yen in cumulative translation adjustments which related to foreign exchange translation of the net assets of foreign consolidated subsidiaries. The primary decrease was 2,286 million yen in treasury stock and 2,283 million yen in cash dividends.

② Analysis of cash flow

Cash and cash equivalents as of the end of the current fiscal year decreased by 5,404 million yen from the end of the previous fiscal year to 26,118 million yen. Cash flow positions of each activity and their factors are described below.

(Cash flows from operating activities)

Net cash gained from operating activities was 13,201 million yen (6,647 million yen in the previous fiscal year).

The primary items increasing cash flows were 6,010 million yen decrease in work-in-progress for game software (increase of 2,837 million yen in the previous fiscal year), 5,315 million yen in net income before income taxes (3,719 million yen in the previous fiscal year) and 4,806 million yen increase in notes and accounts payable, trade (decrease of 474 million yen in the previous fiscal year). The primary item decreasing cash flows was 6,351 million yen increase in accounts receivable, trade (decrease of 5,760 million yen in the previous fiscal year).

(Cash flows from investing activities)

Net cash used in investing activities was 6,155 million yen (1,375 million yen in the previous fiscal year).

The primary items used were 3,517 million yen in payments into time deposits (no payments in the previous fiscal year) and 2,203 million yen in payment for acquisition of tangible fixed assets (3,086 million yen in the previous fiscal year).

(Cash flows from financing activities)

Net cash used in financing activities was 15,099 million yen (1,162 million yen provided in the previous fiscal year).

The primary items used were 10,000 million yen net decrease in short-term borrowings (4,290 million yen net increase in the previous fiscal year), 2,286 million yen in payment for repurchase of treasury stock (1 million yen in the previous fiscal year) and 2,283 million yen in dividends paid by parent company (2,298 million yen in the previous fiscal year).

(Reference) Trends of cash flow indicators

	Year ended March 2010	Year ended March 2011	Year ended March 2012	Year ended March 2013	Year ended March 2014
Shareholders' equity ratio to total assets	62.3	64.2	60.4	60.2	66.1
Shareholders' equity ratio to total assets based on fair market value	120.5	103.9	110.8	81.4	114.0
Debt amortization ratio to cash flows	122.7	32.8	-	258.7	53.4
Interest coverage ratio	86.9	155.8	-	62.4	136.8

Shareholders' equity ratio to total assets: Shareholders' equity / Total assets

Shareholders' equity ratio to total assets based on fair market value : Total of the capital stock at market price / Total assets

Debt amortization ratio to cash flows: Interest-bearing debt / Cash flows from operating activities

Interest coverage ratio: Cash flows from operating activities / Interest payments

(Note 1) Percentage figures are calculated on a consolidated basis.

(Note 2) Total market value of shares is calculated based on the number of shares as of the end of the fiscal year excluding treasury stock.

(Note 3) Cash flows are used for cash flows from operating activities.

(Note 4) The interest-bearing debt refers to the debts posted in the consolidated balance sheets for which we are paying interests.

(Note 5) As the cash flows from operating activities fell into red in fiscal year ended March 2012, we have omitted debt amortization ratio to cash flows from operating activities and interest coverage ratio.

(3) Basic policy for profit distribution and dividend for the current and next fiscal year

Capcom considers returning profits to the shareholders be one of the most important management issues. Its fundamental dividend policy is to provide a stable and continued dividend to the shareholders, taking into account the future business development and changes in operating circumstances.

Our surplus dividend is basically paid twice a year, that is, at the end of mid-term and fiscal year.

Dividend payment amount is decided by a competent corporate body, which is the board of directors for the mid-term, and during the shareholders meeting for the fiscal year.

Regarding internal reserves, Capcom will enhance its corporate value through investment for development of game software, Arcade Operations and growing business.

Capcom plans to pay a year-end dividend for the current fiscal year be 25 yen per share. The annual dividend for the current fiscal year under review is 40 yen per share, since the Company paid an ordinary dividend 15 yen per share as an interim dividend.

We set regulations up to be able to pay interim dividend.

2. Business policy

(1) Management principle

Our principle is to be a creator of entertainment culture. Through development of highly creative software contents that excite people and stimulate their senses, we have been aiming to offer an entirely new level of game entertainment. Our management objectives are also on strengthening relationships with shareholders, clients and our employees to satisfy demands and to bring about prosperous benefits.

(2) Business targets

We believe “Cash-Flow Management” (real management that generates cash) has become an important factor - more important than to make up financial statements utilizing changes in accounting standards. We do not set actual target figures on specific fields because we understand “Cash-Flow Management” as a very important factor for business status.

(3) Medium and long term business strategy

① Reorganization of the development processes

- a. Through the reform of development processes based on the medium-term strategy map, Capcom will engage in the reinforcement of the development system so that the reduction of development costs and shortening of development time can be promoted and stable earnings will be secured for every fiscal year.
- b. Capcom will cope with the rapid expansion of the online gaming market while enhancing and strengthening development of mobile contents and others that require lower development costs than home video game software and that can avoid inventory risk and piracy.
- c. Capcom will secure competitive advantages by developing diverse contents responsive to market demands. To this end, Capcom will exercise thorough earnings management as well as suppress development costs that are rising each year and improve the quality of products through the increase in the in-house development ratio and the reduction of outsourcing of development.
- d. Capcom will endeavor to promote multi-platform development by supplying same software to multiple game consoles, etc. through the utilization of “MT framework” and “Panta Rhei” which are Capcom’s unique game engines (integrated development environment) that can standardize development tools of different hardware such as next-generation machines and PCs, while suppressing development costs and shortening development time.

② Increase download sales

Capcom will focus on marketing of digital download contents given the diversification of forms of distribution of home video games with the full-game digital titles of home video game software growing compared to retail package versions (similar to how in recent years download sales of music is most common rather than CD sales).

As such, Capcom will aim to increase earnings through business development that unifies development, marketing and promotion.

③ Enhance online games

- a. While free-to-play is most common for digital content such as social games, profits from such are leveling compared to package software for sale because in addition to the fact that development costs are cheaper, there is no inventory risk or piracy and it is possible to charge for items and supply additional content in line with the response of users. As such, Capcom will dedicate itself to secure stable profits on a sustainable basis through accurate management after the supply of content and the accumulation of management knowhow.
- b. Capcom has an abundance of popular titles that have become major hits in the package software business such as “Monster Hunter” and “Resident Evil”. Capcom will endeavor to strengthen online games to regain ground in mobile contents by creating synergy among the prime content mentioned above and enhanced game management (accurate understanding of user trends, application to content supply, etc.).

④ Promote Single Content Multiple Usage strategy

Capcom has many well-known characters since it has many million-selling titles such as “Monster Hunter” and “Resident Evil”, and popular content are being used on many fronts including television, cartoons, publications, movies, theaters, toys, foods, drinks and such. Since the licensing business that utilizes the copyrights of such secures stable earnings and has the capacity for growth going forward, Capcom will actively execute this strategy.

⑤ Focus on expanding overseas sales

The development of the large-scale overseas market is essential in promoting a growth strategy under an environment where the domestic market is maturing and the decreasing birthrate and aging population is advancing. Capcom has many million-selling titles that are popular overseas, such as “Resident Evil” and “Street Fighters” which have been made into movies by Hollywood, and is one of the world’s leading content holders. As such, Capcom will endeavor to increase earnings with proactive measures such as deepening the Capcom brand by advertising “made in Capcom”.

⑥ Enhance Pachislo development

In recent years, the Pachislo business has been growing steadily with the positive cycles of popular titles and has grown to become a strong source of earnings. Going forward, in order to make it a pillar of earnings after the digital contents business, Capcom will focus on increasing business opportunities through increased customer satisfactions, by such means of expansion of development staff and stable release of Capcom units for several machines each year.

(4) Issues to be addressed

Major issues to be addressed taking in consideration surrounding business environments and future market trends:

① Consolidation of the critical strategic divisions

We will concentrate our management resources in the home video game software segment, which is our core business, especially in its development and marketing divisions in order to strengthen the competitive edge.

② Expansion of the business field

We will focus on growing the content-related business to expand our business fields in response to changes in the managerial environments, through the distribution of games to other platform that are not game consoles including mobile phones and smartphones and the enhancement of Pachinko & Pachislo business. Additionally we will push for the expansion of download sales in response to diversified form of distribution.

③ Focus on the overseas operations

Making strong efforts in developing overseas markets is the key to the future business growth as the Japanese domestic market matures. We are determined to execute the strategic overseas operation deployment through the group-wide global business restructuring. One such effort will be to conduct corporate reforms of overseas subsidiaries including Capcom U.S.A., Inc., one of our crucial subsidiaries.

④ Selection and concentration of business

We are focused on setting a clear vision for the future by harnessing our corporate strength through the effective use of our research and development resources. In addition, we are pushing through a strategy that concentrates management resources on selected business to make the most of the collective power of the entire Capcom group, thus increasing our corporate value. Investment in growth field and the decision to close down unprofitable businesses are examples of such activities.

⑤ Enhancement of the corporate quality

We are trying to realize flexible business operations and to improve our operation efficiency through the management innovation. At the same time we are building a framework that enhances our revenue base. As part of such efforts to enhance our business foundation, we are pursuing the strategic group operation and financial structure reformation by reinforcing the management system of both domestic and foreign subsidiaries.