

## Special Feature

# A Viable Business Model for Video Content Distribution

Evolving Internet functionality continues to bring new heights of convenience to the everyday lives of a growing number of people around the globe. Advanced Internet search capabilities enable users to quickly retrieve essential information and locate hard-to-find items for online purchase. With a few clicks of the mouse, it's possible to book a table for lunch, or even launch a new career, all from the comfort of home. Although for the most part a great boon to all concerned, the Internet's convenience-enhancing functionality, if abused, can also be the source of undesirable, far-reaching social consequences. One particularly vexing example of such abuse is copyright infringement resulting from the unauthorized posting of video content.

Video-sharing sites have enjoyed surging popularity since their appearance on the Internet in 2005. Essentially platforms enabling users to upload and share video content with other users, video-sharing sites embody the interactive quality of Internet usage, arguably one of the medium's chief points of popular appeal. While the vast majority of users upload content that conforms to the stated policies and guidelines of video-sharing sites, an alarming upward trend in unauthorized postings of television and film content has become increasingly apparent in recent years. Users who upload copyrighted content on video-sharing sites act in flagrant disregard both of the law and of the legitimate interests of content producers and other copyright holders. Users who view such unauthorized content do so entirely free of charge, but at the considerable expense of the legitimate owners of the content. As long as the current situation persists, content producers will be denied their rightful earnings, effectively limiting the funds available for the production of new content. For this reason, some observers are concerned about potential deterioration in both the quality and the quantity of new video content in coming years.



Sharing fully in these concerns about the future of video content production, the Group took an initial step toward rectifying this situation with its April 2009 acquisition and consolidation of video-streaming service provider GyaO CORPORATION and subsequent full-scale entry into the video-streaming service market. By offering Internet users a legitimate means of freely accessing popular video content, the Group sharply reduces the incentive for illegal uploading of video content. And by leveraging an integrated distribution platform that generates revenues both from advertising and pay content, the Group is well placed to fairly compensate copyright holders in return for the usage of their content, thereby facilitating the ongoing production and distribution of fresh video content. Positioning the video distribution business as an integral component of our open network initiative, we intend to work with partners in building a video distribution platform that satisfactorily balances the needs of producers, distributors, and viewers of video content.

### Consolidation of GyaO CORP., and Equity Participation by Major Players in the TV and Advertising Industries

The Group acquired 51% of the outstanding shares of GyaO CORP., a wholly owned subsidiary of USEN CORPORATION, in April 2009 and subsequently converted it into a consolidated subsidiary. This was a natural move, given the Group's active involvement in the video-streaming area via the Yahoo! Streaming service. Combining GyaO CORP.'s brand power, subscriber base, and content-procuring prowess with the Group's technological expertise and user base, we have created GyaO!, Japan's largest official video content distribution site. From its inception, GyaO! has attracted the attention of numerous companies both within and outside the Group. As of April 2010, Japan's five major television networks—TV Asahi, TOKYO BROADCASTING SYSTEM HOLDINGS, NIPPON TELEVISION NETWORK, Fuji Television Network, and TV TOKYO—and two large advertising agencies—DENTSU INC. and HAKUHODO DY MEDIA PARTNERS INCORPORATION—had each taken an equity stake in GyaO CORP. We view such broad-based equity participation as a clear endorsement of the Group's rationale and objectives with regard to the GyaO! launch. In addition to the equity partnership arrangements outlined above, we intend to cooperatively partner with content providers and advertising agencies in providing content as well as jointly developing and marketing advertising products. Looking ahead, the Group also expects to promote and participate in a wide variety of collaborative campaigns, such as free distribution of an episode of a popular television drama, offered on a special limited-period preview basis, to groups of randomly selected subscribers.

Interactive vision



### Launch of GyaO!, including GyaO! Store

In September 2009, the Group launched GyaO!, an official free video content distribution site. GyaO! Store, a pay video content distribution platform, is an integral part of the GyaO! site. With the cooperation of television broadcasters, film distributors, and other copyright holders, GyaO! offers approximately 1,100 video programs and GyaO! Store around 1,400 programs as of March 2010. Whether to provide content on a free of charge or pay basis is decided by copyright holders, in principle, based on expectations regarding viewer audience scale. For newer content expected to attract a large viewership and, as a result, appeal to advertisers, services are generally provided free of charge. For older content expected to attract a more limited viewing audience, services are generally provided on a pay basis.

## Advertising Products

Taking mainstream commercial television advertising as a model, Internet video advertising by convention used to be broadcast immediately before the start of each video program segment. Because Internet video program segments of only a few minutes in duration are fairly common, a 15- or 30-second advertisement broadcast before each start of brief video program segments can tend to annoy viewers. With this in mind, we are taking steps to design and market innovative branding advertising products that depart from convention in viewer-friendly directions.

Currently, our two most popular branding advertising products are top jack, which occupies GyaO!'s entire top page, and sponsor category. While GyaO!'s top page employs thumbnails to introduce video content and to guide users, the backdrop of the entire top page is designed to project the corporate brand image of the sponsoring advertiser. This is referred to as top jack advertising. Showa TV, a theme-based collection of video content on the GyaO! site, offers an example of sponsor category advertising. Here, the video content and advertising share a common corporate-sponsored theme. Leveraging the high visibility of the GyaO! site, these products address advertisers' principal goal of achieving a strong branding impact.

In addition, the Group has developed interactive vision, a high-impact video advertising product that is broadcast on peripheral screen space simultaneously with the video program under way. Compared with advertising broadcast immediately prior to each video program segment, interactive vision is less annoying to viewers.

GyaO!'s portfolio of advertising products employ cutting-edge audiovisual techniques to achieve impact and effectiveness levels comparable to those of television advertising. Thanks to the targeting capabilities unique to Internet advertising, moreover, all of these products can be fine-tuned to address the specific needs of each advertiser. Going forward, the Group intends to develop increasingly effective, viewer-friendly advertising products geared to maximizing advertising revenues.

## Pay Content

Although currently offering approximately 1,400 video programs, GyaO! Store's pay content sales are limited. Looking forward, we expect that pay content revenues will rise to approximately the same level as advertising revenues, assuming that we (1) continuously add new high-demand content to GyaO! Store's video offerings, (2) price the content appropriately, and (3) simplify the purchase process. Through partnerships with content providers, we expect to offer a steadily expanding and increasingly varied selection of video programs in the future. Purchases made through GyaO! Store can be settled using the Group's Yahoo! Wallet online settlement service. Requiring only a one-time initial registration, with no monthly membership fee, Yahoo! Wallet is a simply structured, easy-to-use service offering users wide-ranging benefits. Through collaborations between GyaO! and GyaO! Store, we plan to carry out a variety of promotional activities. One such collaboration might consist of free broadcasts of season-opening episodes of popular television dramas via GyaO!, with subsequent episodes broadcast only via GyaO! Store on a pay basis. With the goal of expanding pay content revenues, we will exploit all possible means of promoting increased usage of GyaO! Store services.

GyaO! official Web site top page



Note: Programming details and other information appearing above as of June 2010

### Other Earnings

In addition to revenues from advertising and pay content, we anticipate a third source of revenues in the form of commissions on transactions initiated via affiliate advertising links. Placed to the right of the video screen, affiliate advertising will primarily feature products related to the content of the video being viewed, including DVDs and promotional goods, with embedded links that lead viewers to Yahoo! Shopping and other e-commerce sites where transactions can be executed. Products sold in this manner generate affiliate commissions, paid by sellers, which are expected to be a stable revenue stream looking forward.

### Cost-Reduction Measures

Prior to Group consolidation, GyaO CORP. recorded an operating loss of approximately ¥2.7 billion on net sales of around ¥5.3 billion for the fiscal year ended August 31, 2008. Thanks to successful cost-reduction efforts, the company entered the black and registered an operating income for the month of December 2009 as well as the fourth quarter of fiscal 2009, the three-month period ended March 31, 2010. Cost-reduction efforts focused chiefly on two areas, as discussed below.

The distribution of video data entails far greater expenditures than does the distribution of still-image data. Furthermore, additional expenses accrue when a single program is viewed simultaneously by many users. With the goal of minimizing costs associated with distribution and simultaneous viewing, we integrated the independent video distribution systems previously employed in the Yahoo! Streaming service with GyaO CORP.'s video distribution systems, marshalling our diverse know-how and expertise to build more cost-effective video distribution operations. As a result, both GyaO! and GyaO! Store are optimally configured for efficient, low-cost distribution of high-quality video content.

In addition, we undertook a comprehensive review of GyaO CORP.'s cost structure, which in turn led to a renegotiation of the terms and conditions of content purchase agreements. While still under the umbrella of the USEN Group, GyaO CORP. had agreed to pay a fixed minimum amount to copyright holders regardless of the revenues generated from usage of their content. The company therefore had incurred losses in cases where content-related sales failed to exceed the fixed minimum amount paid to secure the content. Our renegotiation concluded with agreement on a revenue-sharing scheme with copyright holders, a change that locks in cost-containment benefits for GyaO CORP.

### Future Developments

The estimated number of GyaO! viewers in March 2010 was 11 million, based on Nielsen Online channel level data, including home and office access and excluding Internet application use. Including GyaO! Store's inventory, GyaO! offers some 2,500 video programs covering a wide range of categories including feature movies, foreign-language dramas, animations, comedy acts, and sports features. Working in cooperation with television broadcasters and other copyright holders, the Group intends to offer users access to video programs not viewed when originally broadcast. In promoting the secondary and tertiary use of video content, we aim to increase revenues both for copyright holders and for the Group.

GyaO! Store official Web site top page

