

Financial Management Report on Nintendo

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Nintendo is a Japanese based video game hardware and software development company. Nintendo originally started in 1886 making playing cards. They continued to sell playing cards and other toy products until they began to shift focus in the 1970s and 80s to the new emerging video game and arcade products. Nintendo would first gain its popularity with its Donkey Kong arcade cabinet. Video games would become a booming industry in Japan but die off in the western markets in the early 80s due to a massive influx of poor quality products developed for systems such as the Atari 2600. In 1986 Nintendo would release worldwide the Nintendo Entertainment System, a video game system marketed as a full entertainment package and not as a video game console due to the stigma in western markets. The system launched with copies of the first Super Mario Bros game and Duck Hunt. The Nintendo Entertainment System was met with high praise and is considered to be responsible for bringing video games back to the mainstream market, and responsible for the video game industry that we have today. Nintendo would continue to develop new and improved hardware and software and eventually meet with its long time competitor Sony who would release the first Playstation in the mid 90s.

Over the past five years Nintendo has struggled with a number of issues concerning the company's direction. In July of 2015 the president Satoru Iwata suddenly passed away leaving the company with an uncertain future. In 2015 – 2017 sales had reached the lowest they had been in over a decade. Their latest console the Wii U had severely underperformed, and with Nintendo's main products being hardware gaming systems this would not instill confidence in investors.

During this uncertain three year period however there would be a moment of hope. In the summer of 2016 a mobile game called "Pokemon Go" released as was met with instant success and drove Nintendo stocks up by 50%. Later that fall two more Pokemon games would be released for the Nintendo 3DS called Pokemon Sun and Pokemon Moon.

Pokemon is the second most profitable gaming franchise in history with a lifetime revenue of \$18.5 billion as of 2019. The Pokemon Company which handles the merchandising, tv shows, and everything else related to Pokemon, and Game Freak the video game studio which handles the production of the video game development are both owned by Nintendo. However even with the success of Pokemon Go, and the Sun and Moon games Nintendo would not see a growth in sales until 2018. Sun and Moon sold 1.5 Million copies in its first week in Europe, and since has gone on to sell more than 16 million copies worldwide. Even with 2016's Pokemon games performing well, Nintendo's Net Profit would only be \$4.4 billion. A steady decline since 2009's Net Profit of \$18.7 billion

In the early 2000s Nintendo was in direct competition with Sony and Microsoft in the video gaming hardware sector, and remains in competition with them today. The significance of this being that early in the 2000s Nintendo released a gaming platform called the Nintendo Gamecube competing directly with Sony's Playstation 2 and Microsoft's Xbox. The Gamecube performed well but was unable to keep up with the number of units sold compared to the Playstation 2 and Xbox. From 2005 to 2006 the next round of video gaming hardware would be

released. Microsoft releasing the Xbox 360, and Sony releasing Playstation 3. Nintendo would release a new console but one that would be very different from the competition and other consoles that came before it, the Nintendo Wii.

The Nintendo Wii was the first gaming console to almost entirely use motion controls to play its games, differing greatly from the traditional controller used to play games. The motion controls and ease of access, combined with a strong marketing campaign got the attention of many people who had never played games before and soon many people not originally in this niche market at the time were buying the Wii. Due to the Wii's success outside the normal target market that Sony and Microsoft had capitalized on Nintendo would peak at \$18.7 billion earned in the year 2009. Unfortunately for companies operating in the video game sector gaming hardware has an average lifespan on the market of four to six years, 2009 being the fourth year on the Market for the highly profitable Wii console. The following years would see a steady decline in net sales with 2010 Nintendo earning \$15.4 billion in net sales. It was clear a new product needed to be put out onto the market. In 2011 Nintendo would release the newest platform in its line of handheld gaming devices the Nintendo 3DS. The Nintendo 3DS would not perform quite as well as its predecessor but still performed very well and would be a supported device till 2018. With the release of the Nintendo 3DS Sony would compete with Nintendo in the handheld gaming sector releasing the Sony PS Vita. Competing with Nintendo and the rise of mobile gaming on Apple and Android smartphone devices the PS Vita would be considered an outright failure. "For gamers, the Vita failed to provide the sort of innovation that players found in Nintendo's more popular handhelds, the DS and the 3DS. Despite launching with much weaker hardware than the Vita, the 3DS had a large library and innovative use of dual-screen technology that captivated adults and children alike." "As media players, the Vita and the PSP were mediocre at best, and as smartphones became more present Sony's handhelds lagged behind other devices in utility." (Business Insider, 2019.) In 2011 Nintendo would go on to earn 12.2 billion, even with the launch and success of a new handheld gaming device net sales would still show a decline after the 2009 peak. The growth in the mobile gaming on apple and android devices would take a deep cut into the mobile gaming sector that Nintendo had controlled since the mid 90s.

In November of 2012 Nintendo would finally release a new home console to succeed the Nintendo Wii, and this time the console would debuted long before Sony and Microsoft's newest iterations of their gaming platforms. Nintendo's newest console was called the Wii U and was met with much criticism as the platform did not innovate near as much as the previous Wii console. The system was considered a minor updated Wii console, and had very little to offer as far as new games within the launch window. The Wii was considered a highly innovative platform and companies such as Sony and Microsoft would attempt to emulate that success with products of their own. However, the new Nintendo Wii U brought nothing new to the table. It was merely a Wii console with HD capabilities and a new controller which contained a touch screen. Over the lifespan of the Wii console from 2006 to 2012 dedicated Nintendo customers felt that Nintendo had abandoned them. People who grew up in the 80s, 90s, and early 00s did not feel that Nintendo was making products for them anymore. This created an alienation from Nintendo's early adaptors and die-hard fans, the people who had

been with Nintendo from the start now felt the company had abandoned them in favor of market share with pushing a new type of gaming platform with the Wii console. This trend lines up with the net sales shown over the course of 2006 to 2012, as Nintendo picked up a new target market, the market that Nintendo had earned over the years since 1986 moved on to Sony and Microsoft's platforms as their platforms catered more to their interests in the video gaming sector.

The importance in bringing up this demographic of Nintendo consumers is that this disconnect was a direct cause of Nintendo's falling net sales and underperforming Wii U sales. As the Wii targeted people who did not play games to entice them to play games, Nintendo would try to continue with traditional video game sales practices which did not continue to entice the new target market Nintendo had acquired. Nintendo realized they had alienated their core market and marketed the Wii U to be more appealing to "gamers" and classic Nintendo fans. At the time of the Wii U's release Nintendo's original core market had moved on and showed little to no interest in the new product and Nintendo's new market of Wii adaptors did not see the point in owning a second "Wii" console. Nintendo's net sales in 2012 would only reach \$7.8 billion. Yearly net sales would continue to decline through to the end of fiscal year 2017. Even with sales picking up for the Nintendo 3DS and Wii U consoles over the five year period with games like Pokemon X and Y for the 3DS and Super Smash Bros for the Wii U and 3DS Nintendo would have a lot of work to do to regain the trust and support of their original core market.

During this time, a new video game franchise would attempt to take the number two spot away from Pokemon as second most successful video game franchise, that franchise being Call of Duty. As of 2019 Call of Duty is the third most successful video game franchise in history at \$18.1 billion earned in lifetime revenue. Call of Duty comes behind Pokemon at \$18.5 billion, and Mario at \$30.25 billion. In 2009 Call of Duty Modern Warfare 2 broke the highest grossing launch in entertainment history selling more than \$4.7 million copies of the game in 24 hours. Call of Duty was released on Sony's Playstation 3 and Microsoft's Xbox 360 gaming consoles. Highly popular games such as Call of Duty would be key factors in luring customers away from the Nintendo platform, this marking the start in the net sales decline.

Nintendo learned the hard way that they will not be able to compete by just releasing an updated version of an already operating gaming system, the company has always been one to seek innovation and finding a new way to innovate would be what would drive sales back up. However, to achieve this Nintendo would spend a great deal on research and development.

As Research and development was underway at Nintendo on its next home console, Nintendo would invest heavily once again on its software development. Releasing updated HD versions of older popular games for the Wii U in the Legend of Zelda series, and releasing new titles in highly popular franchises such as Mario Kart 8 and Super Smash Bros both of which were sequels to classic Nintendo 64 titles from the late 90s. The refocus on gaming software would move more Wii U systems through the years of 2014 and 2015, but net sales would

continue to drop through the end of fiscal year 2017 reporting net sales of only 4.3 billion, this being the lowest point of the decade.

Throughout 2016 Nintendo would continue to focus on its growing library of software attempting to revitalize older popular franchises to bring back its core market it lost during the Wii days. Titles such as Star Fox Zero, a sequel to a 1998 title, would be released. The insanely popular Pokemon Go would give Nintendo a footing on the mobile gaming scene, and two Pokemon titles would release on the 3DS. Nintendo would also through make major announcements of major upcoming titles demoing them at the Electronic Entertainment Expo in Los Angeles, The Tokyo Game Show, and Gamescon in Berlin. Both titles being brand new installments in the highly popular Zelda and Mario franchises. People from the original Nintendo audience was taking notice again and Nintendo's future seemed very bright. Then in October of 2016 Nintendo unveiled its new upcoming gaming hardware, the Nintendo Switch. The product would marry the technologies of handheld gaming and at home console gaming. The system essentially being a tablet with two controllers that could be attached to the sides and played as a handheld device, or attached to a docking station connected to a TV and played at home. It was also announced that the game would launch the highly anticipated title The Legend of Zelda: Breath of the Wild. The Nintendo Switch release March 3rd 2017 with high praise and selling out worldwide selling over 1.5 million units in its first week. The success of Nintendo's newest hardware and software would win back its previously lost core market and in 2019 reported net sales of 10.9 billion.

"For Nintendo Switch hardware, we not only launched a special hardware edition but also made such efforts as developing a function adapted to Nintendo Switch Online—a paid service that enhances online functionality—and updated the hardware's operating system. We released a total of 14 titles of compatible software including evergreen series, namely: Super Smash Bros. Ultimate, the latest installment of Super Smash Bros. whose popularity dates back to the Nintendo 64 software era; Pokémon: Let's Go, Pikachu! and Pokémon: Let's Go, Eevee!, which were among the first Pokémon Series titles designed for a home gaming system; and Super Mario Party, the latest title in the Mario Party series." (Nintendo Annual Report, 2019)

The Nintendo Switch and its software titles continue to sell well and sales continue to increase. Learning that it cannot compete directly with the massive power houses of Sony and Microsoft they will continue to innovate in unique gaming platforms to stay ahead of the curve. 2020 will be a very interesting year as Sony plans to unveil its newest gaming platform the Playstation 5. Nintendo will continue to forge its own path in video games as it always has done, and the lessons it has learned over the decade should prove that Nintendo will not be beaten down any time soon.

Part C Investment Appraisal

Year	Projected Cash Flows	
	A	B
0	-103	-115
1	10	60
2	30	40
3	50	60
4	65	5

Cost of Capital 8.73%

Payback Period (PBP)

Project A = Year 4

Project B = Between Year 2 and Year 3

Accounting Rate of Return (ARR)

Project A = 0.37

Project B = 0.35

Net Present Value

Project A = 388.76

Project B = 73.45

1. After calculating and comparing the two projects I would choose to go with Project A. By observing the Net Present Value I can see that its value is worth significantly more than Project B's. While the Pay back period for Project B is much better than Project A's, being returned between the 2nd and 3rd year. There is a massive drop off in value after the 3rd year. So this model shows that while you will recoup your cost with project B and sooner than project A taking into consideration the Accounting Rate of Return, Project B does not look to be profitable over the long term projections. While Project A, indeed taking longer to recoup costs, will yield a much higher profit in the long term. Other factors of this project and company would need to be taken into serious consideration to judge whether or not the company could handle a long term investment such as Project A, but judging only by the information presented here Project A is the one I would choose to adopt.
2. As I mentioned in the previous paragraph, taking into consideration the Pay pack Period, Accounting Rate of Return, and Net Present Value are not the only factors I would take into consideration when selecting a project to adopt. While this is all incredibly helpful information to have I would need to consider other factors of the company as well. What is the size of the company, is it a new startup, how much capital is available to the

company at the time of selecting these projects, will selecting a project like this at this time do financial harm to the company in the short term? The company may have other plans or projects in the pipeline that the payback period of projects A or B could influence. In which case Project B may be the better option if you need short term gains rather than long term gains. Yes, Project A looks to be the most profitable, but what if there is another project that needs to occur that is on your timeline in year 3? By going with Project A you would not have recouped your cost at that point and could potentially delay the next project or venture for your company, in which case Project B would be the ideal choice for this scenario. My background is primarily in film, so I know when producing a film project if I intend on producing other film projects in the future that need to be in keeping with certain timelines for production to occur effectively and smoothly I may not be able to afford the time it takes to recoup from Project A to be able to have my money back to fund a new project, so if I have plans for future projects I need a certain capital for then Projects like Project B may be in my best interest. But if I can afford the long-term investment, in a similar manner to stock trading for example, then Project A is the one I would choose were the continuation of my company and other projects not solely dependent upon the recouped cost of the projects in question.

Appendix

Fiscal Year ends on March 31. Figures represented as millions of USD

Nintendo	2015	2016	2017	2018	2019	Activision 2019*
Net Sales	4,581	4,464	4,366	9,959	10,914	6,489
Gross Profit		1,955	1,775	3,806	4,556	1,503
Operating Profit	206	290	262	1,675	2,270	1,607

Cash and cash equivalents at end of period	2,346	2,284	2,955	4,570	5,321	5,794
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*Millions of Dollars

Fiscal Year ends on March 31. Figures represented as millions of USD

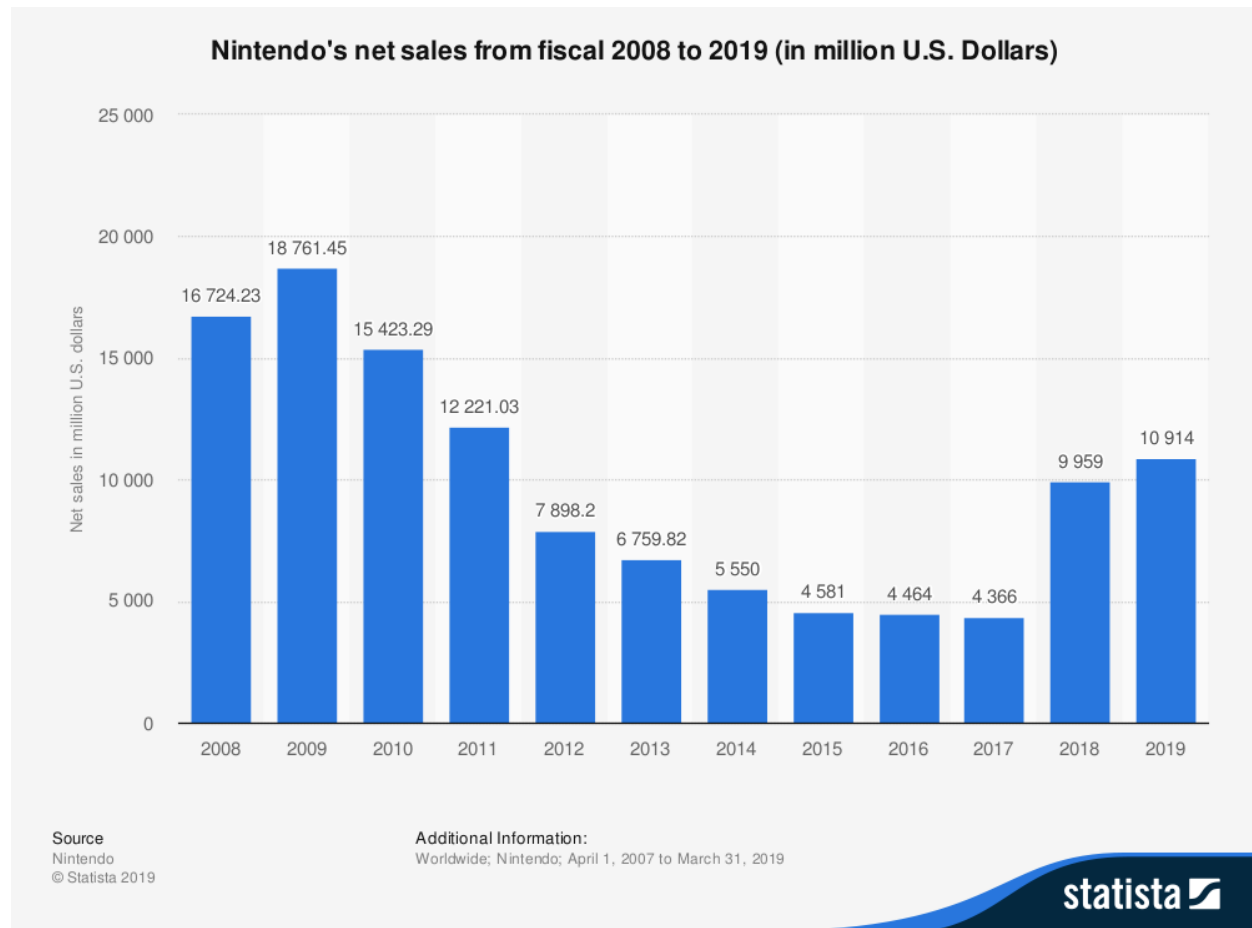
Nintendo	2015	2016	2017	2018	2019	Activision 2019*
Net Assets	9,729	10,273	11,169	12,486	12,861	7,292
Total Assets	11,274	11,477	13,115	15,412	15,366	19,845
Net Assets Per Share	82.18	85.51	92.96	103.58	107	
Profit Per Share	2.94	1.21	7.62	10.96	14	

*Millions of Dollars

Fiscal Year ends on March 31. Figures represented as millions of YEN ¥

Nintendo	2015	2016	2017	2018	2019
Capital adequacy ratio	86.29	89.50	85.15	80.75	83.40

Return on equity (ROE)	3.66	1.42	8.51	10.86	14.22
Price earnings ratio (PER)	50.00	116.45	30.26	40.32	19.54



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