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TSE2

AQ INTERATIVE, Inc.

Towards the Launch of Marvelous AQL, Inc.

On June 23, 2011, AQI INTERACTIVE Inc. (hereafter AQI or the Company) announced that the merger agreement involving AQI, Marvelous Entertainment, Inc. (hereinafter MMV; 7877/TSE2) and Liveware, Inc. (hereinafter LW; unlisted) had been approved at the Company's 12th Ordinary Shareholders Meeting. Following this approval, the three firms will execute the terms of the agreement (with MMV as the merging company) and the launch of Marvelous AQL, Inc. (hereinafter MAQL) as of October 1, 2011.

The objectives of the merger is to position MAQL's game divisions as its core business, while pursuing ways to develop synergies with a broad array of media in order to become a provider of content "that can astonish the world." Trias Corporation interviewed the two listed companies, AQI and MMV, which will form the core of MAQL, and report on its future direction, as well as follow up on AQI's FY3/11 business results. The following is a summary of the Company's Business Results Meeting and relevant interviews.

Background to the Merger

AQI's share value has remained depressed since the merger announcement made on May 10, 2011. This is due to concerns among equity market players over MMV, the merging company which has reported operating losses over the past few years and hurt shareholders' equity (¥1,902 million in retained losses in FY3/11). As seen in Table 1 below, compared to AQI's FY3/11 net assets of ¥6,878 million, MMV has just ¥325 million. AQI also posts a BPS of ¥123,194.46 versus MMV's ¥2,665.21, and an EPS of ¥9,872.84 versus ¥1,075.82. As for the merger ratio, MMV has a ratio of 1.0 compared to 7.0 for AQI and 6.2 for LW, meaning one AQI share equals seven MAQL shares—indicating MMV's business valuation is somewhat overvalued.

Astute management was the reason why MMV was chosen as the merging company, despite its book value and profitability both being lower than AQI. One of the ideas that were examined was to position AQI as the merging company due to its balance sheet strength and significant income improvement posted by its Network Game Business. But the management teams of the three enterprises chose to exploit MMV's accumulated losses for tax purposes, rather than opt for outward appearances when launching the new entity. Although the Network Content Business has been performing well, all three firms are battling to survive in the immensely competitive entertainment content industry. The management teams not only realized that survival would depend on the adoption of strategic initiatives that integrate the business resources of the three firms, but were united in their shared perception of the imperative to develop businesses aimed at the global market over a mid- to long-term basis.

● 【Table 1】Summary of Consolidated Business Results and Combined Pre-Merger Totals of 3 Firms

(¥ million)	AQI	MMV	LW	Total
Sales	7,239	6,965	696	14,900
Operating Income	1,070	202	43	1,315
Ordinary Income	1,041	148	69	1,258
Net Income	537	131	54	722
Net Assets	6,878	325	446	7,646
Total Assets	8,235	4,092	517	12,844
Loss Carried Forward	0	3,561	0	3,561
Interest-Bearing Liabilities	74	1,820	0	1,894
Stock Indicators per Share				
EPS	9,872.84	1,075.82	--	--
BPS	126,194.64	2,665.21	--	--

※Tables prepared by Trias based on AQ INTERACTIVE's disclosed data

Consequence of Launching Marvelous AQL, Inc.

The three-firm merger will have a profoundly positive impact, particularly in developing game content, in that their respective strengths help augment their respective weaknesses. For instance, AQI had previously attempted to develop proprietary games for the home, but found that performance of its Consumer Game Business stalled as a result of such marketing weaknesses as the inability to acquire copyrights and product planning deficiencies. On the other hand, MMV—despite boasting ample marketing strength, including the ability to produce content based on leading copyrights and having accumulated a body of intellectual property (IP) rights—failed to capitalize on its advantages due to weak financial fundamentals, which prevented it from investing in large title projects, which new game content are difficult to develop and incur significant marketing costs. MMV thus failed to exploit its strengths to secure future growth on a strategic basis. The integration of AQI and MMV will enable the new company to develop consumer games across the entire breadth of the development process, from downstream to upstream, entirely in-house.

As the merging company, MMV currently has three major businesses—the Music Video Business, which includes planning, development and DVD production; the Digital Content Business, which engages in game development; and Stage Performance Business. Its roots hark back to Back in

Video set up in 1970, a company that marketed video-, laser disc-, VHS-format software and game software for Tokyo Hoso, the national TV network now known as Tokyo Broadcasting System (TBS). Back in Video would later merge with Victor Entertainment Inc., which was established in 1983 and formerly named Victor Music Industries, but then changed its name to Victor Interactive Software (hereinafter VIS). MMV acquired VIS in 2003 and, after integrating the former's game development unit with VIS, changed its name to Marvelous Interactive, Inc. In June 2007, MMV absorbed Marvelous Interactive, Inc. in order to organize its current digital content operation.

● Post-Merger Synergy in Game Content Development

	Project Management System	Contents IP	Marketing	Planning	Develop– ment	Sales Promotion
AQI	○	–	–	–	○	–
MMV	–	○	○	○	–	○
MAQL	○	○	○	○	○	○

As the predecessor of MMV, VIS originally developed and produced animated film programs (Japanese anime), then sold them as DVDs for additional income—a traditional business model relying on "single-source, multiple-use" content to create several business lines from a single source. Thus, a major characteristic of MMV's digital content production is that anime lies at the core of its IP library. The same formula applies for MMV's Music Video and Stage Performance Businesses, which depend primarily on revenues generated from content—including marketing/sales and copyright acquisition—that they plan and produce based on famous anime titles, which already have a sizeable fan base. Because anime lends itself to numerous series and spinoffs, marketing activities can be conducted on a pre-planned basis and it is easier to control hit-or-miss risks when the anime are translated into game software because of their established fan base.

Diversifying Business Portfolio and Reinforcing the Domestic Online Game Business

By merging into a single entity, AQI and MMV will be able to upgrade MAQL's game software business, which AQI could not maximize, into a robust core business by incorporating AQI's strengths in game development and sound financials with MMV's ample IP library, as well as strengths in copyright acquisition and marketing muscle, which includes the product planning and development. Upon MAQL's launch, the company plans to create and offer even more new, proprietary content not only for consumer games, which was a core AQI business, but also for online games, which AQI had been developing as a core growth business, at an even faster pace to achieve greater growth. MAQL will also aim to diversify its business portfolio by providing content for a broad array of platforms, including PCs and mobile systems.

For MAQL's online game business, AQI and MMV presently combine for a PC membership base of some 2.4 million users. Meanwhile, LW, which is strong in the mobile domain, has a mobile membership base of 3.1 million and boasts some 800 titles available as content on its website. The three partners estimate that, in addition to the some 5 million online game members, MAQL's client base could reach nearly 10 million when users of MMV's entertainment-related operations, which include music, video and stage performances, are included. Once MAQL is launched, the new company will reinforce its marketing database capabilities by capitalizing on its sizeable membership base and aims to tap the expanding online game market with even greater speed.

● Present Operating Infrastructure of Online Games

(thousand people)

	AQI		MMV		LW	
PC	"Browser Sangokushi"	2,000	"Minna de Bokujo"	200		
	"Browser Puroyakyu"	130	"Browser Ikkitousen"	60		
Mobile					"Bokujo Monogatari"	2,300
					"Sanmondo-no Hiyoko	800

MAQL's vision over the next several years and beyond is to position its game divisions as core businesses, while pursuing ways to develop synergies with a broad array of media in order to become a provider of content "that can astonish the world." But its final goal is to challenge the global market with totally new concepts and next-generation technologies. As such, the newly merged firm will be placing a priority on technological initiatives with the global market in mind, while accelerating growth in its domestic online game business.

FY3/11 Business Results Summary and FY3/12 Earnings Forecast

FY3/11 Consolidated Business Results Summary

As seen in Table 2, AQI's Network Content Business outperformed projections this quarter on the back of its "Browser Sangokushi (Romance of the Three Kingdoms)" game, contributing significantly to consolidated profit. On the other hand, in its Consumer Game Business, the Company instituted such structural reforms as voluntary retirement and other initiatives in Q1, while downsizing its product development regime and reducing costs to correspond with changes in its operating environment and sales trends. In addition, it posted a ¥406 million loss from amortized development costs for titles under development, as well as a ¥81 million provision for bad debt arising from its U.S. subsidiary.

●【Table 2】Summary of FY3/11 Consolidated Business Results and Forecast for FY3/12

(¥ million)	FY3/11 (Actual) 1H	2H	FY	% to Net Sales	FY3/12 (Forecast) 1H	2H	FY	% to Net Sales	YoY Chg
Sales	**3,598**	**3,640**	**7,239**	**100.0%**	**3,080**	**4,720**	**7,800**	**100.0%**	**7.7%**
Consumer Game	1,063	1,394	2,457	33.9%	880	1,260	2,140	27.4%	-12.9%
Network Content	1,594	1,661	3,255	45.0%	1,700	3,000	4,700	60.3%	44.4%
Arcade Game	939	587	1,526	21.1%	500	460	960	12.3%	-37.1%
Gross profit	**2,005**	**1,637**	**3,644**	**50.3%**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
SG&A Expenses	**1,266**	**1,305**	**2,573**	**35.5%**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Operating Income	**739**	**331**	**1,070**	**14.8%**	**350**	**650**	**1,000**	**12.8%**	**-6.5%**
Consumer Game	-34	-81	-115	-1.6%	85	246	331	4.2%	--
Network Content	922	755	1,677	23.2%	532	612	1,144	14.7%	-31.8%
Arcade Game	154	29	182	2.5%	87	70	157	2.0%	-13.7%
Adjustments	-302	-371	-673	-9.3%	-354	-278	-632	-8.1%	--
Ordinary Income	**696**	**344**	**1,041**	**14.4%**	**350**	**650**	**1,000**	**12.8%**	**-3.9%**
Extraordinary Income	**3**	**238**	**241**	**3.3%**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Extraordinary Loss	**228**	**34**	**263**	**3.6%**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Net Income	**237**	**300**	**537**	**7.4%**	**200**	**380**	**580**	**7.4%**	**8.0%**

In the Arcade Game Business, AQI divested MICRO CABIN, INC. in January 2011, a subsidiary involved in the development of systems used for pachinko and pachisuro slot machines. In doing so, the Business will be concentrating its resources on its core Pokemon business. While the power blackouts caused by electricity shortages resulting from the post-March 11 calamity had a moderate impact on net sales and profit, the division managed to sustain profitability.

As a result of the division-level structural reforms mentioned above, R&D and content development costs were kept to ¥458 million, a decrease of ¥150 million from the previous year. Capex also fell by ¥126 million on a year-on-year basis, to ¥220 million, as there were fewer platforms to invest in, while ¥116 million was spent on advertising, a y-o-y decline of ¥220 million.

The Company posted a one-time income of ¥236 million from the divestiture of MICRO CABIN, INC., but also booked a one-time loss of ¥157 million from a cancelled title development project in its Consumer Game Division. It also paid out ¥66 million as a special retirement expense and a lump-sum amortization of goodwill of ¥34 million.

FY3/12 Consolidated Financial Forecast

The impact of AQI's merger with MMV and LW is not accounted for in the financial forecasts of 2H and FY3/12. Given the ongoing uncertainty in its operating environment since March 11, the forecast for the Consumer Game Business has been calculated on a particularly conservative basis.

However, because dividends from the division-level structural reforms are expected to kick in, the Company expects to maintain a profit-generating regime.

Its Network Content Business is continuing to outperform projections. While the forecast for net sales sees a slight decline, income is expected to fall on a y-o-y basis. Of the ¥3,255 million in net sales that was reported in 1H, more than ¥3,000 million was generated from the PC version of the “Browser Sangokushi” game. For this fiscal year, the Company is planning to aggressively roll out new titles, including their mobile versions, and thus believes net sales of “Browser Sangokushi” will fall by 50% on a y-o-y basis.

Because “Browser Sangokushi” is managed through such websites as AQI’s original site and mixi, no platform fee is required. While this factored to create a business regime with a high profit margin in fiscal 2010, the operating income margin for fiscal 2011 is expected to fall significantly, from 23.2% to 14.7%, due to two facts: first, the Company will be aggressively launching new titles that require platform fees and because net sales of the PC version of “Browser Sangokushi” is expected to decrease by half.

As for the Arcade Game Business, the Company will step up its focus on its Pokemon business, which boasts high profitability, because the market for such general arcade game machines as “Minna de Derby” and “Cubic Mall” AQI has sold up until fiscal 2010 has suffered even more dramatically than the consumer game market. As a result, the forecast is that net sales will fall significantly, but that the operating income margin is likely to remain at a decent level nearing that posted in the previous fiscal year.

While AQI is planning to announce its financial forecasts for 2H and the full year at its first-half results meeting, because MMV will be carrying forward a ¥3.5 billion loss, MAQL will see its pre-tax income equal net income.

Reference

Key Stock Indicators/Financial Data and Business Results (Consolidated)

No. of Shares Issued	Mar. 2011	54,505
No. of Treasury Stock	Mar. 2011	0
Market Value (¥million)	Aug.25, 2011	3,941
BPS (¥)	Mar. 2011	126,194.64
ROE (%)	Mar. 2011	7.8
ROA (%)	Mar. 2011	6.5
PER (times)	FY3/11 est.	7.3
PCFR (times)	Mar. 2011	4.7
PBR (times)	Mar. 2011	0.6
Share Price (¥)	Aug.25, 2011	72,300
Unit Share (shares)	Aug.25, 2011	--
Average Daily Volume (shares)	Aug.25, 2011	601

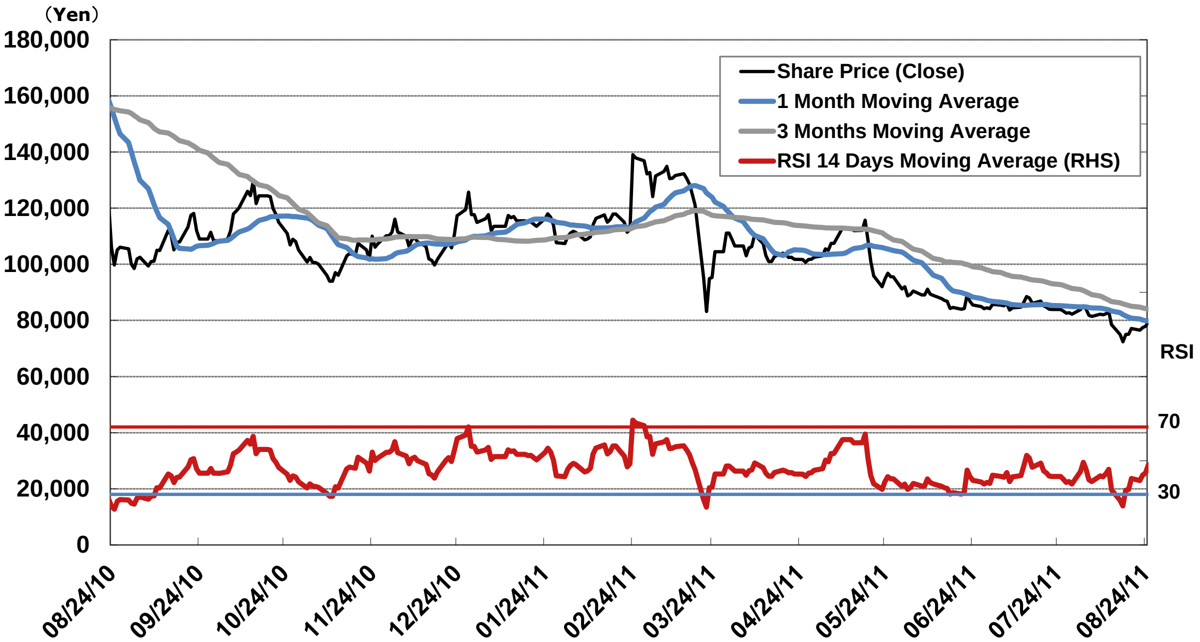
Total Assets (¥million)	Mar. 2011	8,235
Shareholders' Equity (¥million)	Mar. 2011	6,878
Interest-Bearing Debts (¥million)	Mar. 2011	74
Equity Ratio (%)	Mar. 2011	83.5
Ratio of Interest-Bearing Debts (%)	Mar. 2011	1.1
Free Cash Flows (¥million)	Mar. 2011	142

ROE=Current Net Income÷Shareholders' Equity
ROA=Current Net Income÷Total Assets
PCFR=Maket Value÷(Current Net Income+Depreciation)
Average Daily Volume=Ave. Daily Vol. for previous 12 m/s
Interest-Bearing Debts Ratio=I.B.D.÷Shareholders' Equity
Free Cash Flows=Operating CF+Investment CF

Consolidated (¥million)	Net Sales	Operating Income	Ordinary Income	Net Income	EPS (¥)	DPS (¥)
FY3/08	5,666	766	759	517	10,110	2,000
FY3/09	6,180	-7	13	-468	-8,625	0
FY3/10	7,197	58	63	58	1,076	1,500
FY3/11	7,239	1,070	1,041	537	9,873	3,700
1H FY3/12 fcst.	3,080	350	350	200	3,669	1,200
FY3/12 fcst.	7,800	1,000	1,000	580	10,641	--

Note: FY3/12 forecasts announced on May 10, 2011

Stock Price Charts and RSI



Source: Prepared by Trias Corp. with Bloomberg data
Note: RSI, Relative Strength Index, is the index representing the ratio of overbought or oversold share prices.
In general, over 70 in RSI shows overbought share price range, while below 30 shows oversold share price range.
RSI = averaged share price appreciation for N days÷(averaged share price appreciation for N days + averaged share price decline for N days) x100