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Change in the method for recording revenue from JAFCO's US subsidiary and its exclusion from the scope of consolidation

JAFCO Co., Ltd. (hereinafter "we" or "JAFCO") hereby announces that from the first quarter of FY2019/3 onward, the method for recording revenue from management fees that JAFCO America Ventures Inc. (a wholly owned subsidiary; "JAV") receives has been changed, and JAV has been excluded from the scope of consolidation accordingly.

1. Overview

As the fund management style whereby a parent company controls overseas investment activity does not fit with the highly localized nature of the venture capital ("VC") business, our investment activity in the US has been conducted by a team of local venture capitalists, which operates its own funds and makes its own investment decisions.
Previously, fundraising for these funds was entirely dependent on capital contributions from JAFCO and its domestic funds, but in 2013, the US team started raising funds by themselves in response to a trend in larger fund sizes in the US VC industry. As a result, the ratio of funds raised from external investors is increasing. Also, to strengthen its brand presence in the US, the team changed its name to Icon Ventures.
Under such circumstances, we adopted the new Japanese GAAP Standard No. 29 Accounting Standard for Revenue Recognition ("Revenue Recognition Standard") and decided to offset JAV's expenses with JAV's revenues. Due to the resultant decrease in JAV's materiality in our consolidated financial statements, we decided to exclude JAV from the scope of consolidation.
Please note that JAFCO's position as GP of the funds managed by Icon Ventures ("Icon Funds") remains unchanged after JAV's exclusion form consolidation and we will continue to commit to US investment as a major investor of Icon Funds.

2. The background and impact of the changes

The background of the changes in the revenue recording method and the scope of consolidation is as follows:

(1) JAV's position in our investment activity in the US

VC investment is a highly localized business. In the US, our investment team made up of highly experienced local venture capitalists makes its own investment decisions. It has adopted a management style generally used by VC firms in the US to improve fund performance.

i. VC management style in the US and JAFCO group's investment activity

In the US, a VC firm generally sets up an LLC (Limited Liability Company) for each fund to carry out investment decision making and other duties as General Partner ("GP"). A separately established management company ("Management Company") carries out the back-office work (fund accounting, salary payment to venture capitalists, etc.) for all LLCs established by a VC firm. Management fees from funds are centralized at the Management Company and will be used to pay fund management expenses.

For the management of Icon Funds (Icon I-VI), six LLCs have been set up for each fund to carry out investment decision making and other GP duties, as in the case with other VC firms in the US, while JAV has consistently been the Management Company of Icon Funds. JAV receives management fees from Icon Funds, from which it pays expenses incurred in investment activity in the US.

ii. Successful fundraising from external investors
Icon Funds were launched in 2003 by Joe Horowitz, managing general partner of the US investment team, and several other members. New investment activity for the sixth fund is currently underway. In 2013, the US investment team took the initiative in achieving successful fundraising for Icon V from external investors in response to a trend in larger fund sizes in the US VC industry. It has also raised funds for the succeeding Icon VI from external investors. In total, it has now raised a sizable amount of funds from external investors.

iii. New brand name
In 2015, the US investment team rebranded its name from Jafco Ventures to Icon Ventures to step up its investment activity. Icon Ventures has been increasing its presence in the US VC market.

iv. Expenses for US investment activity
As seen from the above, the US investment team has come to carry out fundraising in addition to investment decision making. Accordingly, the proportion of business expenses sourced from Icon Funds' management fees that are consumed by the US investment team at its discretion has increased than before.

(2) Change in the method for recording revenues and exclusion from consolidation
Amid such changes in our US investment activity through Icon Funds, the Revenue Recognition Standard was issued in March 2018. Following discussions on how to apply the new standard, we decided to make the following changes from the first quarter of FY2019/3.

i. Until the end of FY2018/3, gross management fees that JAV received from Icon Funds were recorded as income from partnership management under net sales in our consolidated statements of income, and total expenses incurred for JAV's business activity in the US were recorded under selling, general and administrative (SG&A) expenses.
Following the release of the Revenue Recognition Standard, we discussed how Icon Funds' management fees should be recorded in our consolidated statements of income when applying the new standard to JAV. Considering JAV's function and operation as the Management Company of Icon Funds, we deemed that it would better represent JAV's actual status if we only recorded net management fees received by JAV, offsetting its SG&A expenses, instead of recording the gross amount as before.

ii. Exclusion from the scope of consolidation
As mentioned previously, the fund management style whereby a Japanese parent company (i.e. JAFCO) controls investment activity in the US does not fit with the highly localized nature of the VC business. Moreover, the US investment team is building up its own fundraising track record. Due to the above reasons, the consolidation of JAV, which plays a part in the US investment activity as the Management Company of Icon Funds, has come to contradict with the nature and the actual status of our VC business.
As JAV's materiality in our consolidated financial statements has diminished following the net amount presentation of management fees, and in consideration of JAV's qualitative materiality, we have decided to exclude JAV from the scope of consolidation.

3. Impact of the change

Due to the above changes in the revenue recording method and the scope of consolidation, "Net sales" and "Selling, general and administrative expense" in the Consolidated Statement of Income decreased by ¥285 million and ¥309 million respectively, while "Cost of sales" increased by ¥79 million.
The above changes have no material impact on the items that reflect the status and results of our US

investment activity, including the balance of operational investment securities, capital gains and success fees in the consolidated financial statements, and operating profit, ordinary profit and profit before income taxes in the consolidated statement of income.
The current US investment team continues to carry out JAFCO's investment activity in the US through Icon Funds regardless of the change in the scope of consolidation, and JAV will continue to operate as the Management Company of Icon Funds.