COMPANY RESEARCH AND ANALYSIS REPORT

DYNAM JAPAN HOLDINGS

06889

Hong Kong Stock Exchange

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FISCO Ltd. Analyst
Yuzuru Sato

FISCO Ltd.
http://www.fisco.co.jp

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Summary

After thoroughly implementing infection-prevention measures, has restarted the business and is working to strengthen the profitability of halls through productivity reforms

DYNAM JAPAN HOLDINGS Co., Ltd. (HK06889; hereinafter, the Company) is one of Japan's top operators of pachinko halls with the largest number of halls operated. Its strength and characteristics lie in low-cost operations based on the "chain store theory." In addition, the Company is a pioneer as the first in its industry to be listed on a stock market, aided by recognition of its high-quality management with implementation of a customer-first approach, information disclosure, compliance management, and other measures.

1. Revenue declined in FY3/20, but secured an increase in profits through thoroughly implementing low-cost operations

Amid the continuing severe environment in the pachinko hall industry, revenue declined in the Company's FY3/20 consolidated results, down 3.0% year-on-year (YoY) to ¥141,919mn, but it secured an increase in profits, with profit before income taxes rising 0.7% to ¥19,506mn. The main reason for the decline in revenue was that, in a situation in which the market as a whole continues to contract, the number of customers decreased due to the spread of the novel coronavirus across the end of the period. However, the Company succeeded in measures to reduce personnel costs through reviewing hall operations and to keep down advertising costs. In the aircraft leasing business, which it has started as a new business, it began leasing three aircrafts and recorded lease revenue of ¥564mn.

2. Restarted the business while thoroughly implementing novel coronavirus infection-prevention measures, and worked to minimize the business loss

After the Japanese government issued a declaration of a state of emergency due to the spread of the novel coronavirus, the Company voluntarily closed practically all its halls from late April to early May. But following the lifting of the declaration of a state of emergency, it reopened them for business in stages and by June, it had reopened practically every hall. However, as they are open for business while infection-prevention measures are being implemented, it is expected that some time will be required before the operating rate returns to its normal level. Therefore, the Company is aiming to achieve profitability for the full fiscal year by thoroughly implementing cost reductions, including postponing purchases of new machines. The deadline for removals of models under the former regulations, which had been at the end of January 2021, has been extended by one year following the National Police Agency's revision to the regulations, which is good news for pachinko hall operators.

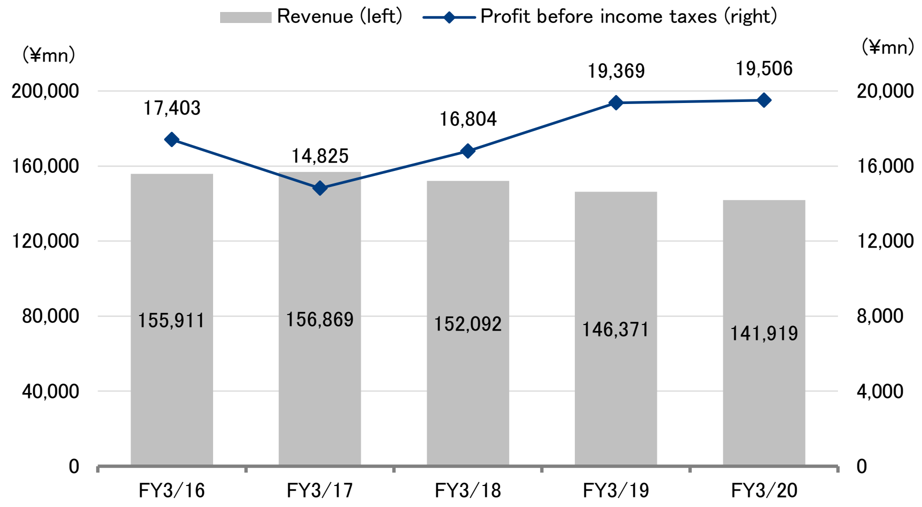
3. Aiming to strengthen profitability by increasing the efficiency of hall operations

The Company is aiming for growth on two axes, of "increasing the number of halls" and "growing revenue at existing halls." But in the current severe environment, its policy is to focus on building a structure that can secure stable earnings, and therefore it is working to increase the efficiency of hall operations through productivity and structural reforms. Currently at some halls, it is conducting an experiment to reduce working hours through the division of labor, and if its effects are verified, it intends to extend this approach to all halls. In the future in the industry as whole, due to the severity of the earnings environment, it is highly possible that small- and medium-sized halls will be weeded-out and halls will be further consolidated into the major capital players. The Company is the largest player in terms of number of halls, but even so, it has only around a 5% share. Therefore, even if the market contracts, at FISCO we think there is still plenty of room for it to grow through increasing its market share.

Key Points

- In FY3/20, revenue declined due to the impact of the spread of the novel coronavirus, but achieved an increase in profits for the third consecutive period through increasing the efficiency of hall operations
- Was unable to avoid the severe earnings environment in FY3/21 1H, but is working to secure profitability for the full fiscal year
- The market continues to contract, but even in this situation, there remains plenty of room to grow through increasing market share

Trends in operation results



Source: prepared by FISCO from the Company's financial-statements announcement

Company profile

Expanded business scope by implementing innovative measures premised on "chain store theory", first pachinko hall operator to list shares

1. History

The Company was founded as Sawa Shoji Co., Ltd. in 1967 by Yohei Sato, the father of Yoji Sato, a current senior corporate advisor. When the founder passed away in 1970, his eldest son, Yoji, who was then aged 24 and working at The Daiei, Inc., took over the business, and steadily expanded operations.

The Company was a pioneer in the pachinko hall industry by acting on new initiatives ahead of peers, including hiring new university graduates, opening suburban halls and low-cost halls, forming a labor union, and spreading low-fee ball rental nationwide. Yoji Sato's leadership was an important factor in the Company's adoption of a progressive corporate culture. He joined Daiei due to interest in the chain store theory that was still a novel concept in Japan. Subsequently, following the death his father, the founder, he succeeded his father for the Company's management, and within this management, he expanded business by consistently applying the chain store theory to pachinko hall operations. The chain store theory is the source of low-cost operations, the Company's largest strength.

His logical approach rooted in the chain store theory took hold as the corporate culture and served as a fundamental force lifting the Company to the position of being the top company in the industry. The Company also moved quickly in embracing the most important concepts for modern management of a customer-first approach, information disclosure, and compliance, providing a foundation for its listing on the Hong Kong Stock Exchange in August 2012.

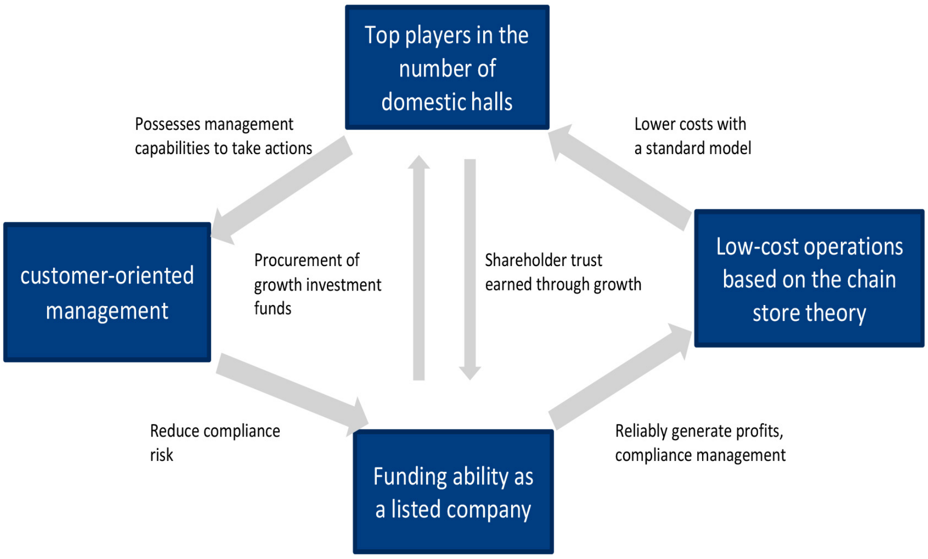
Chairman of the Board, President and Chief Executive Officer Kohei Sato resigned as Director and Executive Office, and on April 27, 2020, it was announced that he would become a non-executive director (advisor). However, there will be no changes to management policy or other matters in the future.

Established a robust management foundation that leverages four strengths, differentiates itself from other companies

2. DYNAM JAPAN HOLDINGS Group's features and strengths

We focus on four points as the Company's attributes and strengths – 1) top player in terms of the number of halls in Japan, 2) low-cost operations, 3) customer-oriented management, and 4) fund-raising capabilities. Importantly these strengths are mutually interactive. We think it is difficult for other companies to realize the same combined strength seen at the Company.

Relationship among the four strengths of the Dynam Japan Holdings Group

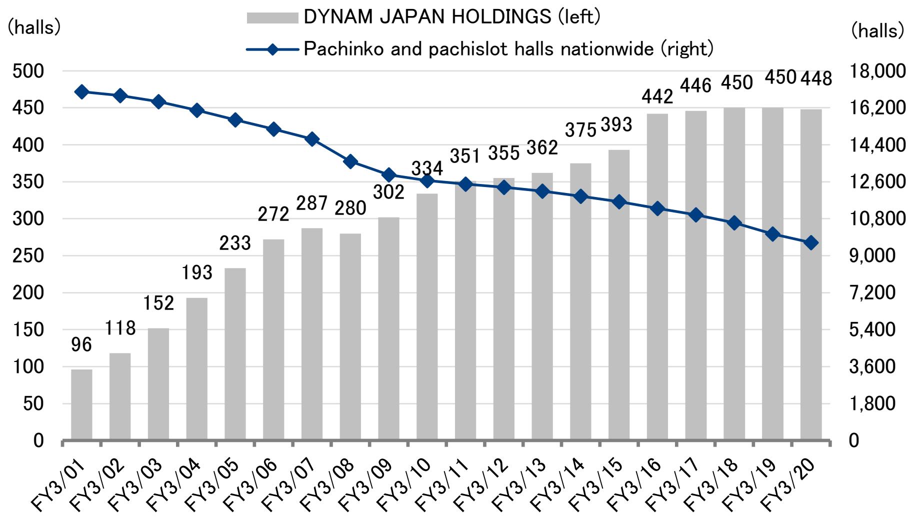


Source: Prepared by FISCO from interviews

(1) The domestic leader with 448 group halls

The Company is the domestic leader with 448 group halls (as of the end of March 2020). While it is not possible to make precise comparisons due to differences in compilation timing, the Company's domestic shares for the number of halls and machine installations are both at around 5%. It exceeded 1% of industry share in 2003, and since then, it has increased the number of halls, including through M&A, and expanded its share in a situation in which hall numbers in the industry as a whole are declining.

Trend in number of group halls



Source: Prepared by FISCO from the Company's materials and National Police Agency materials

The Company's large number of halls provides it with economies of scale that appear in new hall openings, renovations, amusement machine purchases, prize procurement, logistics, and other areas. Benefits in amusement machine purchases and hall operations, which account for a large portion of expenses, are particularly important. The large number of halls obviously means ownership of a high volume of pachinko and pachislot machines and stronger buying power toward amusement equipment manufacturers. The Company also develops and deploys private-brand machines (in FY3/20, 9.5% of installed pachinko machines were private-brand machines) and realizes economies of scale in this respect too. Furthermore, it has built operations that attract more customers and lower costs by leveraging its large hall network to move models among halls.

(2) Low-cost operations based on the chain store theory

Low-cost operations are a vital source of the Company's competitiveness. Our understanding is that this aspect is tremendous support in enabling the Company to secure the feasibility and effectiveness of various measures, including the growth strategy.

The chain store theory provides the theoretical backdrop as a pillar to low-cost operations. Costs of personnel and machines constitute a large portion of the total cost of operating a pachinko hall. Yet it takes more than just direct cost cutbacks. The Company is succeeding with low-cost operations as an overall group by deploying hall designs and hall operating systems (such as ball counters at each machine) that facilitate operations with a small number of employees and by standardizing new halls. The chain store theory plays an important role in a variety of ways and is enabling low-cost operations for the Group.

The Company is the industry leader in Japan, as mentioned earlier, with 448 halls. Aggressive hall network expansion supports this position, but the driving force of low-cost operation know-how has been an essential enabler. Hall network expansion has created a virtuous cycle of cost reductions through economies of scale that has put the Company in its strong position. We think the customer-oriented management explained below is an outcrop from low-cost operations as well.

The history section explained the background to the Company's utilization of the chain store theory in its management. The Company established the Pachinko Chain Store Association (PCSA), an industry group in 2003 (as of March 2020, 20 companies were full members and 34 companies were supporting members) with peers who have a similar view, and this entity has been researching application of the chain store theory to pachinko hall management. By promoting the activities of PCSA, the Company is contributing to strengthening the management foundations of its industry peers, and this leads to Yume Corporation Co., Ltd. joining the Group in November 2015.

(3) Implementing management from a customer perspective

The Company advocates a customer-first approach as one of its five business policies and has been practicing it. This stands out because we think few peers who promote a similar policy are actually seeing actions through.

Among the Company's business policies, we have a favorable view of a) low ball rental fees and b) operations that do not rely on gambling appeal. These are also key words for understanding the Company's business policy and growth strategy.

a) Low ball rental fee operations

Pachinko is a game that is played with rented balls. The fee for renting balls (halls lend the balls) had been ¥4 per ball. Low ball rental fee operations take a cheaper approach that lowers the fee to ¥1 or ¥2. Customers can rent more balls for the same amount, extending their playing time in accordance with the additional balls. For the Company, whose goal is for everyone to be able to easily enjoy pachinko as part of the infrastructure of a region, it can be said that increasing low ball rental fee halls is a rational measure. At the end of March 2020, it had 274 low ball rental fee halls, which is 60.9% of its total halls and seems to be greatly above the industry average.

Data shows that halls offering low ball rental fees have attracted more customers than halls charging higher fees. Yet it takes substantial company wherewithal to adopt this type of strategy. A measure to offset this aspect is growth through expansion of hall numbers. The Company has followed this path.

b) Operations that do not rely on gambling appeal

The Company does not position models with strong gambling appeal as a central strategy. Pachinko machines range from ones with high probability of major wins to ones with low probability. Machines with lower probability give a larger number of balls in a major win and are preferred by pachinko fans. Many pachinko halls hence attract customers by operating halls with a high ratio of machines with strong gambling features.

However, based on the strengthening of measures to address gambling addiction and related, the regulatory authorities have been revising the regulations in stages in order to suppress the gambling aspect, and the current situation is that a style of managing pachinko halls by attracting customers through "selling" gambling is coming to an end. The Company, meanwhile, has a lower ratio of gambling-type machines than the industry and conversely the share of machines with the lowest gambling features at 1/100 probability is 20 percentage points higher than the industry average. While the Company cannot avoid an impact from stricter gambling appeal regulations, we think the negative impact is relatively minor due to its existing pursuit of operations that do not rely on gambling appeal.

(4) Fund-raising capabilities that leverage strength as a listed company

The Company became the first in the pachinko hall industry to list its shares with its IPO on the Hong Kong Stock Exchange in 2012. Only three companies, including the Company, out of the pachinko hall industry's roughly 3,000 companies are listed on stock markets as of the end of March 2020. The industry is projected to face realignment going forward. An important point for a buyer in this environment is obviously whether it has fund-raising capabilities. The Company capitalized on its strength as a listed company to acquire Yume Corporation in November 2015 through a stock swap for all of its shares. We anticipate very strong benefits for the Company as a listed company in non-M&A areas too because of the likely need for a variety of funds in the future for hall investment, new business development and other initiatives.

FY3/20 results conditions

Revenue declined in FY3/20 due to the impact of the spread of the novel coronavirus, but profits rose for the third consecutive period through increasing the efficiency of hall operations

1. Summary of FY3/20 results

In the FY3/20 consolidated results, revenue decreased 3.0% YoY to ¥141,919mn, operating profit increased 11.2% to ¥21,514mn, profit before income taxes rose 0.7% to ¥19,506mn, and net profit attributable to owners of the Company grew 1.2% to ¥12,748mn. So, while revenue declined, the Company secured an increase in profits for the third consecutive period.

Summary of FY3/20 results

(¥mn)

	FY3/19 Full-year	FY3/20			Remark
		Full-year	YoY	Change	
Ball rental fee revenue	768,857	732,862	-4.7%	-35,995	High ball rental fee halls 410,270 (-31,034), low ball rental fee halls 322,592 (-4,961)
Cost of prizes	622,486	590,943	-5.1%	-31,543	High ball rental fee halls 340,651 (-27,539), low ball rental fee halls 250,292 (-4,004)
Revenue	146,371	141,919	-3.0%	-4,452	High ball rental fee halls 66,919 (-3,495), low ball rental fee halls 72,300 (-957)
Operating expenses	128,024	121,912	-4.8%	-6,112	Machine costs 2,433 Personnel costs -2,011 Decrease in hall operating expenses, etc. -4,451 Change amount due to the new lease accounting standards -2,086 (rent, etc.)
SG&A expenses	5,023	5,020	-0.1%	-3	
Other income (including vending machine fee income)	8,971	9,010	0.4%	39	Insurance income for disasters in the previous fiscal period -470 Aircraft lease revenue 564
Other expenses	2,953	2,483	-15.9%	-470	Loss due to disasters in previous fiscal period -616 Aircraft lease expenses 399
Total expenses	127,029	120,405	-5.2%	-6,624	
Operating profit	19,342	21,514	11.2%	2,172	
Financial income	471	461	-2.1%	-10	
Financial expenses	444	2,469	456.1%	2,025	Change amount due to new lease accounting standards 1,880 (interest on leased assets)
Profit before income taxes	19,369	19,506	0.7%	137	
Net profit attributable to owners of the Company	12,596	12,748	1.2%	152	
EBITDA	31,136	33,151	6.5%	2,015	

Source: prepared by FISCO from the Company's financial-statements announcement

In FY3/20, the Company newly opened one low ball rental fee hall and closed three halls, following a review of the commercial areas. Therefore, at the end of the period, the number of group halls had decreased by two on the end of the previous fiscal period to 448 halls.

Due to the impact of the revision to the regulations to suppress the gambling aspect, the decrease in the pachinko-player population and the contraction of market scale are continuing. In this situation, the Company worked to maintain and improve customer attraction, including promoting the shift from pachinko machines to pachislot machines. But since February 2020, the number of customers has been falling due to the impact of the spread of the novel coronavirus as well, so ball rental fee revenue, which corresponds to gross sales, declined 4.7% YoY to ¥732,862mn. Breaking this down, it decreased 1.5% to ¥322,592mn in low ball rental fee halls and declined 7.0% to ¥410,270mn in high ball rental fee halls.

Prize issuance value, which reflects unit costs, meanwhile, declined 5.1% YoY to ¥590,943mn. The difference between ball rental fee revenue and prize issuance value is gross profit and represents net sales (revenue). As mentioned earlier, revenue decreased 3.0% YoY in FY3/20.

The percentage of total revenue from ball rental fee revenue is the gross margin, and in FY3/20, the gross margin increased 0.4% of a percentage points (pp) YoY to 19.4%. This was because it was 22.4% in low ball rental fee halls, the same level as in the previous fiscal period, while it rose 0.4 pp to 17.0% in high ball rental fee halls, and also as the percentage of low ball rental fee halls, which have a high gross margin, increased. Gross margin is the inverse of the payout rate to customers (percentage of prize issuance value to ball rental fee revenue), and when this value is too high, it might lead to customer losses. Since past trends show gross margin in the 18% range to 19% range, we think the FY3/20 result was within the normal range.

Operating expenses decreased 4.8% YoY (down ¥6,112mn) to ¥121,912mn. This was because although machine costs rose ¥2,433mn YoY, mainly due to the increase in purchases of pachislot machines, personnel costs declined ¥2,011mn following the review of hall operations, and as hall operating expenses, including advertising and promotional costs, fell ¥4,451mn. Also, the changes to the lease accounting standards in the IFRS (International Financial Reporting Standards) from FY3/20 were a costs-decrease factor of ¥2,086mn. Rent expenses on real estate are now deemed lease assets and recorded in assets, so from the aspect of profit-loss, rather than cost processing of rent expenses as previously, they are now recorded as the licensing assets amortization amount. The effects of this were to increase profits by ¥2,086mn at the operating profit stage, but interest on leased assets of ¥1,880mn were recorded in financing expenses.

Impact of new lease accounting standards on the income statement

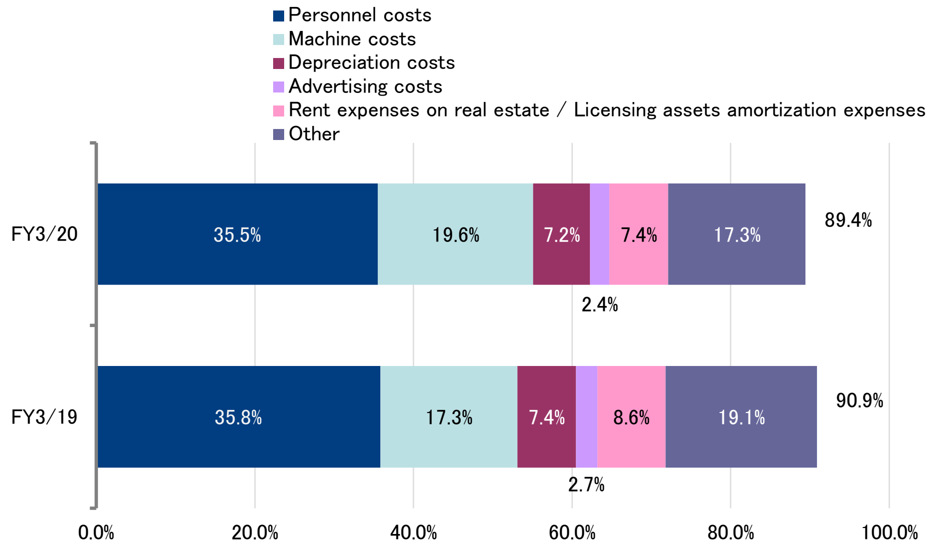
(¥mn)

Factors	Costs	FY3/19	FY3/20	Change	Remark
Operating expenses	Rent expenses on real estate	12,604	169	-12,435	
	Licensing assets amortization amount	-	10,349	10,349	
	Total	12,604	10,518	-2,086	Factors boosting operating profit
Operating profit		19,342	21,514	2,172	¥2,086mn impact from change of lease accounting standards
Financial expenses	Interest on leased assets	-	1,880	1,880	Factors pressuring profit before income taxes
Profit before income taxes		19,369	19,506	137	

Source: prepared by FISCO from the financial-results announcement and interviews

For the FY3/20 results, the severe market environment continued, and as sales measures in this situation, the Company promoted the shift to low ball rental fee halls and also increased purchases of pachislot machines, which are expected to attract customers. It also worked to keep down hall-operations costs, so although revenue declined, it secured an increase in profits. Looking at the ratio of costs to revenue, after excluding the effect of the changes to the lease accounting standards (rental expenses on real estate and licensing asset amortization expenses), it declined 0.3pp YoY. Machine costs rose 2.3pp, but there were declines in personnel costs of 0.3pp, advertising costs of 0.3pp, and other operating expenses of 1.8pp, which can be read as the effects of reducing operations costs.

Ratio of costs to revenue



Source: prepared by FISCO from the Company's financial-statements announcement

Total assets increased greatly following the adoption of the new lease accounting standards

2. Financial condition

At the end of FY3/20, total assets were up ¥91,907mn on the end of the previous fiscal period to ¥277,239mn. Within this amount, as the change amount due to the adoption of the new lease accounting standards, licensing assets (the total amount of future rent) of ¥79,048mn were recorded. For your reference, if calculated using the same standards as previously, it would have been an increase of ¥6,756mn. Looking at the main change factors, cash and deposits decreased ¥5,727mn, while inventory assets and prizes grew ¥2,212mn and property, plant and equipment rose ¥9,761mn. The increase in property, plant and equipment was from the recording in assets of aircrafts (three aircrafts worth ¥16,337mn) following the start of the aircraft leasing business, and if excluding this factor, property, plant and equipment also decreased.

Total liabilities were up ¥98,975mn on the end of the previous fiscal period to ¥142,507mn. In this amount, as the change amount due to the adoption of the new lease accounting standards, lease liabilities increased ¥93,642mn. Compared to the previous standard, interest-bearing debt increased ¥10,602mn, while accounts payable and accrued expenses decreased ¥4,496mn and income taxes payable declined ¥1,009mn. The increase in interest-bearing debt was due to bank loans of ¥11,221mn to raise funds for the aircrafts. The Company's policy is cover 70% of the fund raising for the aircrafts from loans from financial institutions. The relevant loans are full-amount nonrecourse loans, while for their repayment, it will use the cashflow from the aircraft leasing business as the source of funds. With the aim of reducing loan-related risk, the Company has concluded loan contracts in which it does not have repayment obligations outside of this range.

Total equity was down ¥7,068mn from the end of the previous fiscal period to ¥134,732mn. As the change amount due to the adoption of the new lease accounting standards, the decrease factor was a surplus, etc. of ¥9,443mn, and compared to the previous standard, the decrease factors were dividend payments of ¥9,192mn from the recording of net profit of ¥12,747mn, and other comprehensive income of ¥1,180mn.

The capital ratio declined from 76.5% at the end of the previous period to 48.6%. But this was due to the impact of the adoption of the new lease accounting standards, and when calculated using the previous standards, it continued to be maintained at the high level of 74.6%. So, it can be judged that the Company is maintaining its financial soundness.

Statement of consolidated financial position using the previous standard (non-application of new lease accounting standards)

[Statement of consolidated financial position]

(¥mn)

	End-FY3/19 previous standards (3)	End-FY3/20			Differences between the previous standards and the new standards (1-2)	Increase/decrease on the end of the previous fiscal period on using the previous standards (2-3)
		New standards (1)	Previous standards (2)	Change (2-3)		
Total assets	185,332	277,239	192,088	85,151	Licensing assets 79,048	Cash and cash equivalents -5,727 Inventory assets and prizes 2,212 Property, plant and equipment 9,761 (aircrafts 16,337)
Total liabilities	43,532	142,507	48,865	93,642	Lease liabilities 93,642	Interest-bearing debt 10,602 Accounts payable and accrued expenses -4,496 Income taxes payable -1,009
Share capital	15,000	15,000	15,000	-		
Surplus, etc.	126,800	119,732	128,223	-8,491	Revision to surplus due to the adoption of IFRS16 (discount processing for the current value of the future-rent total amount)	Net profit for the year 12,747 Dividend payments -9,192 Other comprehensive income -1,180
Total equity	141,800	134,732	143,223	-8,491		
Liabilities and net worth	185,332	277,239	192,088	85,151		
Capital ratio	76.5%	48.6%	74.6%	-	Decline in the capital ratio due to the adoption of IFRS16	

Source: Prepared by FISCO from the Company's materials

[Cash and deposits and interest-bearing debt]

(¥mn)

	End-FY3/19	Ratio	End-FY3/20	Ratio
Cash and cash equivalents	47,537	25.7%	41,810	15.1%
Interest-bearing debt (Pachinko business)	2,626	1.4%	2,007	0.7%
Interest-bearing debt (Aircraft leasing business)	-	-	11,221	4.0%
Total assets	185,332	100.0%	277,239	100.0%

Note: The Company funded the purchases of the aircrafts 30% from its own funds and 70% from bank loans
Source: Prepared by FISCO from the Company's materials

In DYNAM's FY3/20 results, revenue and profits declined due to the impact of the novel coronavirus

3. Situation at DYNAM Co., Ltd.

In the FY3/20 results (Japanese standards) of DYNAM, which is the Group's core company, revenue decreased 2.8% YoY to ¥132,714mn, operating profit declined 6.3% to ¥17,016mn, ordinary profit fell 4.6% to ¥18,193mn, and net profit was down 5.1% to ¥11,758mn.

Up to 3Q, the decline in revenue from pachinko machines was covered by the increase in deployments of pachislot machines, which have high customer-attraction capabilities. But due to the impact of the spread of the novel coronavirus, on entering March the number of customers fell considerably, and as a result, revenue declined for the full fiscal year.

In costs, due to the active deployments of popular pachislot machines, machine costs increased ¥1,715mn YoY. But DYNAM worked to reduce hall-operating costs other than machine costs, including advertising and promotional costs and personnel costs, and as a result, total costs declined ¥2,724mn. However, this was not enough to cover for the decline in revenue, and therefore operating profit decreased ¥1,144mn.

DYNAM's management situation

(¥mn)

	FY3/19	Vs. revenue	FY3/20	Vs. revenue	Change	Summary
Revenue	136,584	-	132,714	-	-3,870	Decrease in the number of customers due to the impact of the novel coronavirus Decline in the operating rate due to the removal of strong gambling-appeal amusement machines
Machine costs	22,898	16.8%	24,612	18.5%	1,715	Purchases of new slot machines (up 9,488 machines YoY)
Advertising and promotional costs	3,578	2.6%	3,129	2.3%	-448	Kept down promotional materials within halls by introducing digital signage
Personnel costs	44,702	32.7%	43,081	32.5%	-1,621	Kept down total personnel costs alongside the changes to hall operations
Other costs	47,246	34.6%	44,873	33.8%	-2,372	Reduced utilities costs and repair costs
Total expenses	118,423	86.7%	115,699	87.2%	-2,724	
Operating profit	18,161	13.3%	17,016	12.8%	-1,144	
Ordinary profit	19,078	14.0%	18,193	13.7%	-884	
Net profit	12,388	9.1%	11,758	8.9%	-629	
Total assets	120,399	-	117,324	-	-3,074	Current assets 1,641 Non-current assets -4,716
Total liabilities	33,783	-	28,168	-	-5,615	Accounts payable -2,190 Accrued expenses -1,659
Net assets	86,615	-	89,156	-	2,541	Net profit 11,758 Dividend payments to the Company -9,116
KPIs						
No. of halls	406	-	405	-	-1 hall	New hall openings: Yamagata AEON Town Sakata Hall Closed halls: Sakata Izumi Hall and Azuma Town Hall
Pachinko machine operating rate	43.0%	-	41.4%	-	-1.6pt	+9.5pt vs. rival halls
Pachislot machine operating rate	40.0%	-	38.2%	-	-1.8pt	+4.6pt vs. rival halls
No. of machines	188,699	-	189,140	-	441 machines	Installed machine share 4.5%
No. of private-brand machines	10,084	-	12,658	-	2,574 machines	Private-brand machine installation rate 9.5% (difference on previous period, 2.0pt)

Source: Prepared by FISCO from the Company's materials

Within the KPI (Key Performance Indicators), on looking at the operating rate, it declined 1.6pp YoY to 41.4% for pachinko machines and it fell 1.8pp to 38.2% for pachislot machines, so it decreased for both types of machines. This was because, due to the revision to the regulations on amusement machine installation standards in February 2018, the Company has been required to remove machines deemed to have a high gambling appeal under the former regulations, and the operating rate of the machines newly deployed under the new regulations is low. This is a problem faced by the entire industry, not just the Company. In fact, from the Company's own survey to compare the operating rates of its halls with those of competitor halls, its own rates are higher by 9.5%pp for pachinko machines and 4.6%pp for pachislot machines, so there has been no change to the superiority of its customer-attraction capabilities.

The main details of the regulation revisions for pachinko and pachislot (from application models since February 2018)

• Review of maximum ball output	The maximum ball output per jackpot reduced to around 60% of previously (pachinko 2,400 balls → 1,500 balls, pachislot 465 medals → 285 medals)
• Review of ball output rate test	Lowered the upper limit of the ball output rate and set a new lower limit (setting a new lower limit = necessary to ensure a ball output rate above a certain level)
• Add a setting function to pachinko machines	Makes it possible to set "probability of jackpot" (maximum of 6 levels) in pachinko machines

Source: Prepared by FISCO from National Police Agency materials

For the changes to halls in FY3/20, 2 halls were closed (Sakata Izumi Hall and Ibaraki Azuma Town Hall) and one hall was opened (Yamagata AEON Town Sakata Hall), for a total of 405 halls. The Sakata Izumi Hall was closed due to the situation on the real estate lender side, so in its place, the Company opened Yamagata AEON Town Sakata Hall. Also, the Azuma Town Hall is being rebuilt and it was scheduled to be re-opened by March 2020, but due to the impact of the novel coronavirus, its opening is now scheduled for July.

Since FY3/18, the Company's opening of halls has leveled-off. This is because, following the revisions to the regulations on the gambling aspect, by January 2021 it has to replace all the models under the old regulations with models under the new regulations, which in the short term is increasing the investment burden for model replacements, while it is also possible that earnings will deteriorate due to the loss of customers from the replacement of machines under the new regulations. So, at the current point in time, it has judged that it is more important to increase the profitability of existing halls rather than actively open new halls. Moreover, the novel coronavirus is dealing a major blow to management in the pachinko hall industry at the present time, and in recent years, it can be said that the Company has been successful in temporarily postponing decisions on hall openings after more precisely analyzing hall-opening standards.

Impact of the novel coronavirus and the measures in response

Could not avoid the severe earnings conditions in FY3/21 1H, but is working on securing profits for the full fiscal year

Due to the spread of the novel coronavirus, on April 7, 2020, the Japanese government issued a declaration of a state of emergency. Within it, pachinko halls were among the industries subject to a request for voluntary closures, so the Group implemented voluntary closures and it seems that it closed practically all of its hall from the end of April to early May. Subsequently, from mid-May in those regions where there were no concerns about the spread of the infection, and then based on the lifting of the declaration of a state of emergency on May 25 for all prefectures, including Metropolitan Tokyo, it re-opened the Group's halls for business in stages after thoroughly implementing infection-prevention measures, and it is estimated that practically all the halls were open for business from June onwards. Going forward, if there is no second wave of the spread of the infection, at FISCO we forecast that the operating rate will gradually recover and that it may have returned to the normal level by FY3/21 2H.

Looking at the impact on results of this situation, halls were voluntarily closed in April and May, so it seems that revenue declined greatly compared to in the same months in the previous fiscal year.

While saying that the halls were reopened for business from mid-May onwards, they were reopened only after thoroughly implementing infection-prevention measures (reduction in opening hours, thorough disinfecting, etc.), so the operating rate may remain at a low level for the time being. Assuming that there is no second wave in the spread of the infection from July onwards, at FISCO we forecast that earnings will gradually rebound from the recovery of revenue due to the rise in the operating rate and the measures to keep down various costs.

As its measures in response to the decline in revenue, the Company plans to reduce machine costs, personnel costs, variable costs, and fixed costs by 20%, 10%, 15%, and 10% respectively YoY (total reduction of more than ¥10bn), while it has in sight even greater reductions, depending on the circumstances.

The deadline for replacing models under the new regulations was initially the end of January 2021, but due to the spread of the novel coronavirus, the National Police Agency has extended the effective period of models under the former regulations by one year by revising the regulations on May 20. Based on this, the amusement machine industry group also announced that it has formulated its own rules to sequentially progress the removal of the models under the former regulations. According to the details of this announcement, some pachislot machines with strong gambling appeal will be removed by the end of December 2020, while all other models will be sequentially removed and replaced with models under the new regulations. At the end of FY3/20, the percentage of models replaced with models under the new regulations was only slightly less than 40%, so there were concerns about an increase in machine costs in FY3/21. But the current decision to extend the deadline has greatly reduced the risk of incurring this burden.

Summary of the extension of the deadline for the removal of models under the former regulations

• Amusement machines whose testing and certification was scheduled to expire by the end of December 2020 Pachislot machines with strong gambling appeal → Removal by the initial testing and certification expiration date Pachinko models Hane Mono, Choi Pachi, and Ama Deji (jackpot probability, less than 1/100), pachislot model normal A type → To be sequentially removed within 7 months (210 days) from the initial testing and certification expiration date Other amusement machines → For their removal by December 31, 2020, as of May 20, 2020, removal of 15% of installed machines every month
• Amusement machines whose testing and certification expiration is scheduled from January 2021 onwards Pachislot machines with strong gambling appeal → Removal by the initial testing and certification expiration date Other amusement machines → For their removal by November 30, 2021, as of January 31, 2021, removal of 15% of installed machines every month

Source: The Pachinko and Pachislot Industries 21st Century Association (content of resolution on May 20, 2020)

In response to the spread of the novel coronavirus, going forward the Company's policy is to implement measures for the following three points, based on the idea that "Once safety has been ensured, it is most important to continue in business to protect people's lives and the economy and to contribute to the local community."

(1) Respond to the crisis in which the highest priority is given to the lives and safety of customers, employees, and business partners

- Implement business self-restraint in response to the requests of each local government (the prefectural governors)
- Voluntarily implement infection-prevention measures for the 27 set items

(2) Realize both measures to prevent the infection spreading and for business activities (economy)

- Thoroughly implement infection-prevention measures after reopening for business
- Transition in stages from the start of busines to normal business activities in accordance with the infection-prevention guidelines

(3) In light of the deterioration of the business environment, minimize the business loss

- Maintain employee hiring and implement measures for subsidy strengthening and economic-support expansion
- Reduce costs through productivity reforms and structural reforms in indirect departments
- Review operating activities (cost and investment plans) prioritizing cash flow

Developments in the new business

The aircraft leasing business started leasing three aircrafts, but is now waiting until the market environment settles down

1. Aircraft leasing business

The new aircraft leasing business was launched in FY3/20. In terms of the specific scheme, it is being conducted by Dynam Aviation Ireland Limited (DAIL), a subsidiary established in Ireland in December 2018 that was wholly funded by the Company (capital of ¥100mn, fiscal year ending in March). The reason for establishing it in Ireland is that the Irish government supports the aircraft leasing business as a national policy and has set a low corporate tax rate, and among the world's top 15 aircraft leasing business companies (based on the number of aircrafts), 14 companies have bases in Ireland.

As the business model, it plans to mainly lease mid-sized "narrow model" aircrafts, a segment with high transaction activity, including the Boeing 737-model series and the Airbus A319, A320, and A321 models. This category greatly outweighs other aircraft sizes in the number of aircrafts in operation by airlines and orders and order backlogs of aircraft firms and truly holds the position of a "volume zone." Focusing on this market makes it possible for the Company to ensure market liquidity while also conducting business management that keeps down management risk.

In FY3/20, the Company purchased a total of three aircrafts (one newly manufactured and the other two used) and started leasing them to Vueling Airlines (Spain) and IndiGo (India). Both are LCC (low-cost-carrier) airline companies, and IndiGo is India's largest airline company. In FY3/20, this business recorded lease revenue of ¥564mn and operating expenses and depreciation of ¥399mn, and in costs, interest payments relating to bank loans (¥11,221mn).

Deal income in leasing business is determined through finalization of three main aspects – initial purchase price, lease fee income during the lease period, and selling price after the lease finishes. The industry uses internal rate of return (IRR) to measure investment return because of these characteristics. We believe the Company has realized the IRR it anticipated in the three deals (estimated at about 5-6% based on recent interest rate conditions) at this point.

Results for aircraft lease contracts

Leasing party	Contract period	Model	Assets (net worth)	Average age	Average remaining lease period
Vueling Airlines (Spain)	July 2019	Airbus A320	US$150.12mn	1.2 years	5.5 years
IndiGo (India)	October 2019	Airbus A320			
IndiGo (India)	March 2020	Airbus A321			

Source: Prepared by FISCO from the Company's materials

However, the Company's initial plan for the future was to purchase a total of 20 aircrafts by FY3/22, with the aim of leasing them to the world's airline companies. But the airline industry has been dealt a major blow by the novel coronavirus, so for the time being it is adopting a cautious stance for aircraft purchases. However, global aircraft demand is expected to recover at some time, so going forward, after paying attention to developments in airline companies, the Company's policy is to progress sales discussions by focusing on the popular narrow-model aircrafts with stable prices.

Started deployments of video slot machines in casinos, but will take time to launch due to the impact of the novel coronavirus

2. Progress in the video slot machine business for casinos

The Company has been working on the planning and development of mass-market video slot machines for the Macau casino market as a new business. The development concept is a straightforward approach of time-consumption games that incorporates pachinko elements.

The Company worked on development of this video slot machine jointly with WEIKE GAMING TECHNOLOGY (S) PTE. LTD. (below, WEIKE), which holds a license for manufacturing and selling casino machines in Macau. So far, it has obtained approval for four models from the Macau casino regulatory authorities, while it is also applying for approval for these four models in Singapore.

In addition, in September 2019 the Company concluded a sales agreement with a Macau casino operator and in November of the same year, it deployed on a test basis one of each of three models (total of three machines) into Legend Palace Casino. Moreover, it deployed 10 machines into a different casino hall from January 2020. It had also planned deployments into one other hall, but this had to be postponed due to the impact of the novel coronavirus.

Installations of casino-use video slot machines and status of development approval

Time	No. of machines	Trial location
From November 2019	3	Legend Palace Hotel Casino
From January 2020	10	Word-Class Casino in Ponte 16 Resort Macau

Name of model	Conditions
Pachinko Bonus Series No.1 Machine	Has obtained approval in Macau and Singapore
Pachinko Bonus Series No.2 Machine	Has obtained approval in Macau and Singapore
Pachinko Bonus Series No.3 Machine	By March 2020, had obtained approval in Macau and is applying for approval in Singapore

Source: Prepared by FISCO from the Company's materials

The current sales agreements are on a trial basis, so if the models had been evaluated as being "earning machines" when looking at the operating conditions in the future, it was possible that the number of machines deployed would have increased dramatically. But that was before the impact of the novel coronavirus. In the casino halls in Macau on entering May 2020, due to the effects of restricting the entrance to halls of non-residents and operations only of every other machine, the number of visitors decreased greatly, down 90% YoY, and the situation was that it was not possible to evaluate the models deployed on a trial basis. Therefore, depending on when the number of customers is normalized, the Company has decided to start operations on a trial basis after replacing the software, and to wait for the evaluations of the casino operators.

At FISCO, we think that for the time being, some time will be required before the video slot machines business makes a fully-fledged contribution to earnings. Even when deploying models on a trial basis, they will not subsequently be deployed on a fully fledged basis if they do not obtain the support of the customer. Also, in terms of the business model, the Company only conducts planning and development and it depends on WEIKE for manufacturing and sales licenses. Therefore, even if it succeeds with fully fledged deployments, there are unknown factors to determine the extent to which these deployments will contribute to earnings. The ideal would be to realize revenue sharing agreements with the casino operators, but as there are various regulations, at FISCO we think that some time will also be required for this point. Whatever the case, what is most important is that the Company's new products become "earning machines," and it will be necessary to pay attention to the operating and sales conditions of the initial-number models.

Business outlook

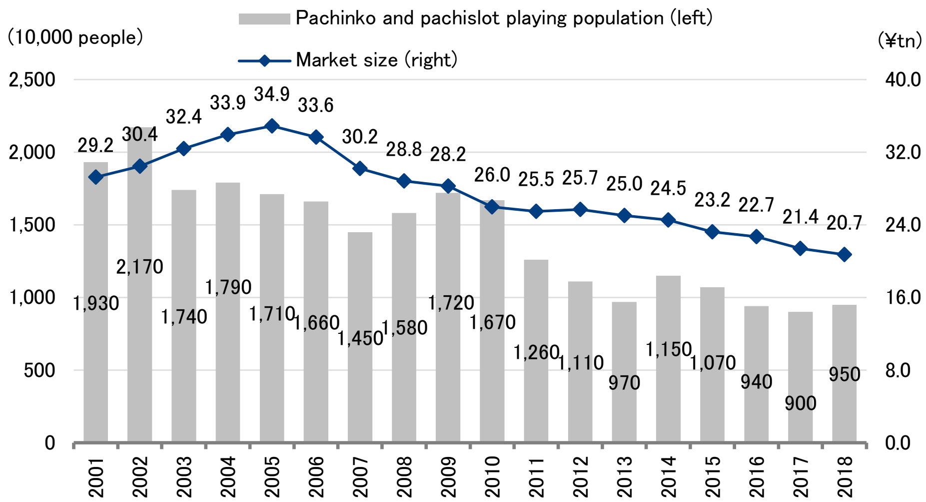
Spurred-on by the spread of the novel coronavirus, the consolidation of the pachinko hall industry into the major capital players may progress even more

1. Pachinko hall industry conditions and growth strategy

(1) Market trends

The pachinko market continues to experience a long-term shrinkage trend. According to "White Paper on Leisure 2019" by the Japan Productivity Center, while Japan's pachinko and pachislot playing population rebounded by about 500,000 people (5.6%) to 9.5mn people in 2018, from 9.0mn people in the previous year, the pachinko hall market (total ball rental fee revenue) fell 3.3% YoY to ¥20.7tn. It has declined to a level of around 60% of its peak in 2005.

Trends in the pachinko and pachislot playing population and pachinko hall market size



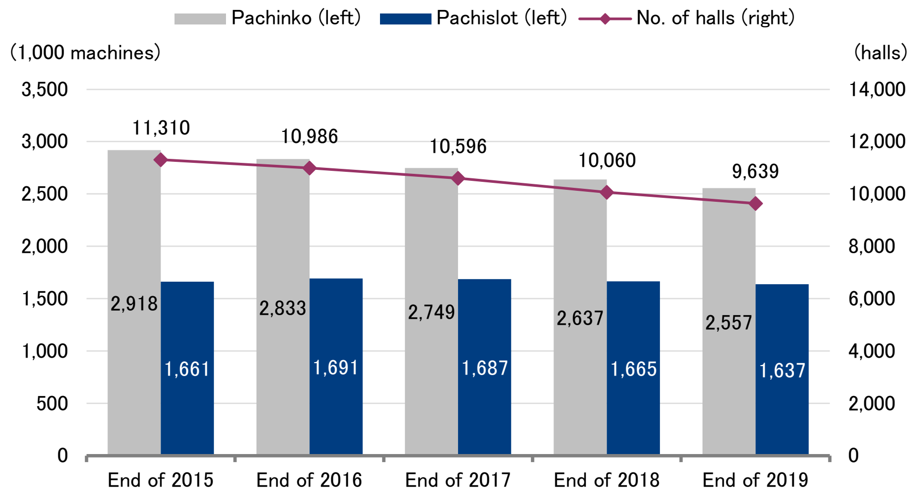
Source: Prepared by FISCO from the Japan Productivity Center's "White Paper on Leisure"

Reflecting these conditions, the number of pachinko and pachislot halls continues to decrease, and at the end of 2019, the number of halls was down 4.2% on the end of the previous year to 9,639 halls (according to the National Police Agency research), falling below the important benchmark of 10,000 halls. In terms of the number of machines installed also, the number of pachinko machines decreased 3.0% on the end of the previous year to 2,557,000 machines, and the number of pachislot machines declined 1.6% to 1,637,000 machines, so both continue to trend downward. At FISCO, we think that it is possible that the weeding-out of small- and medium-sized halls with no management strength will be progressed even further because of the deterioration of earnings following the voluntary business closures due to the spread of the novel coronavirus, and as even through the deadline has been postponed by one year, due to the concerns about the increased investment burden and the loss of customers from transitioning from models under the former regulations to models under the new regulations.

Looking at the numbers of pachinko and pachislot machines installed per hall, the number at the end of 2019 was 435.3 machines, and it has been increasing in the last few years. This seems to indicate the decrease in the number of small- and medium-sized halls. Conversely, the ball rental fee revenue per hall is continuing at around the same level YoY, at slightly more than ¥2bn. It seems a factor for ball rental fee revenue is the increase in low ball rental fee halls, but for earnings per hall, it can be said that the current situation is that even the large-sized halls are struggling.

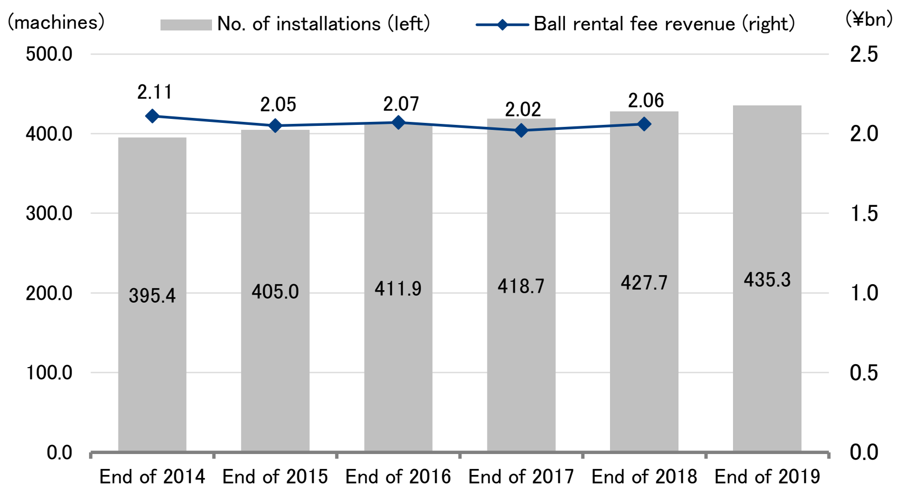
Incidentally, for the Group in FY3/20, the number of pachinko and pachislot machines installed per hall was 470 machines, and the ball rental fee revenue was slightly more than ¥1.6bn. The reason why its ball rental fee revenue is low despite the fact that the number of machines installed is above the industry average is considered to be the high percentage of its halls that are low ball rental fee halls, at 60.9%. As previously stated, the Company has positioned pachinko as daily entertainment that anyone can enjoy, and it has worked on implementing low-cost operations that can secure profitability even with low ball rental fees. Therefore, our understanding at FISCO is that the current strengthening of regulations on models with gambling appeal will have a comparatively small impact on the Company.

No. of halls and no. of installations of amusement machines



Source: Prepared by FISCO from National Police Agency materials

Trends in number of installations and ball rental fee revenue per hall



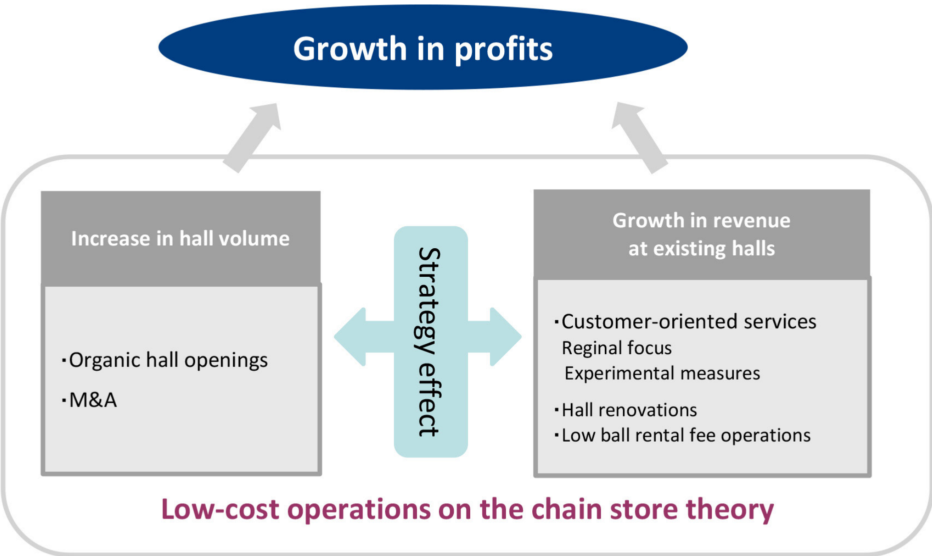
Source: Prepared by FISCO from National Police Agency materials

(2) Growth strategy

The Company's growth strategy in the pachinko hall business is to pursue growth along two tracks, "increase in the number of halls" and "growth in revenue at existing halls". While its choices for increasing the number of halls is organic (self) openings and acquisitions, we think organic openings are more efficient due to the Company's strength in low-cost operations. In acquisitions, we expect the Company to assess each opportunity individually and proceed in cases that offer clear benefits. However, for its strategy of increasing the number of halls, for the time being the Company's policy is to maintain a cautious stance due to the severity of the market environment, and at FISCO, we think that it will re-start this strategy only when the market environment and the profitability of existing halls recover.

For the growth in revenue at existing halls, the Company focuses on securing customer traffic, more than average spend. This approach fits with the Company's strategy of getting pachinko to take hold as a leisure activity for spending time. While the Company has steadfastly worked to attract more customers through localized measures that leverage characteristics of individual halls as explained in the section on results trends, customer traffic growth has been fluctuating due to strong headwinds confronting the entire industry.

Image of the two-pronged growth strategy – increase in the number of halls and growth in revenue at existing halls



Source: Prepared by FISCO from interviews

For pachinko machines, the operating rate is low (weak ability to attract customers) for models under the new regulations in which the gambling appeal is kept down. As a result, this is factor behind the lack of progress in transitioning from models under the former regulations to models under the new regulations. But in January 2020, the Safety Division of Community Safety Bureau of National Police Agency amended the Standards to Interpret the Technical Standards, so the operating rate is expected to recover. This revision relaxes the restrictions on time-shortening modes and it newly adds one function called “play time.” Specifically, at the stage in which the number of rotations reaches a certain number within low probability, the machine enters short-time mode. On entering short-time mode, the player can substantially reduce the balls they hold, which makes is possible to play the jackpot lottery a certain number of times. Other than this, it has also become possible to abolish the upper limit on the number of times for entering-into short-time mode and to set up to two patterns for the number of times for the probability variator limiter, and these sorts of relaxations of the technological regulations is making it possible for manufacturers to develop models with higher gaming appeal than previous amusement machines, so the models that are enjoyable to play on will increase. Initially, the plan was to introduce models of various manufacturers with the “play time” function added by April, but this has been delayed slightly due to the impact of the novel coronavirus. We shall be paying attention to operating conditions in the future.

Conversely, for pachislot machines, it has been decided that machines with strong gambling appeal shall be completely removed by the end of December 2020, which is the same as before. For pachislot machines as well, there are expectations for developments of models with strong gaming appeal in the future. But a trend has been observed in which their operating rate depends more on their gambling appeal than it does for pachinko machines, so there are concerns about the loss of customers from 2021 onwards. As measures to increase the operating rate, the Company’s policy is to continue to strengthen sales of low medal rental fee machines, the same as for pachinko machines (in normal operations, the ¥20 low medal rental amount is ¥10). The Company’s ratio of pachislot machines to the total number of amusement machines installed per hall was 30.4% in FY3/20, which is a lower level than the industry average of 39.0%. Therefore, it is possible that its ratio of pachislot machines will increase in the future, but it is thought that the Company will determine this while looking at the operating rate and profitability.

(3) Measures toward recovering profitability

As new measures toward recovering the profitability of halls, the Company is progressing an experiment to reduce the working time at some halls through division of labor. Specifically, in order to establish an environment that makes possible “halls concentrated on hall services,” the operations and functions that are respectively the responsibilities of the venues (halls) and the head office are defined, and tasks other than those which can be done by the halls are transferred to the head office supervisory function. The effects of this are expected to be an improvement in productivity (=lowering the personnel costs ratio) from reducing the work burden at halls and improving customer satisfaction (=improving ability to attract customers) by enhancing services.

If the effects of the above-described experiment are confirmed, it will be extended to all halls, which is thought will further solidify the earnings structure. The Company is also working on workstyle reforms, of utilizing its diverse human resources according to their aptitudes (creating places of work that are rewarding and satisfying to work in) and promoting diversity and inclusion.

Amid the continuing market contraction, there remains plenty of room for growth by increasing share

2. Approach to results from FY3/22 onwards

The spread of the novel coronavirus has reaffirmed the enormity of the impact and risk an unknown disease presents to economic activities. Looking to the future also, treatments and vaccines are still only at the development stage. So it is difficult to predict the future in this situation, as it is possible that a second wave of the spread of the infection will occur. Going forward, assuming that a further spread of the infection does not occur and that conditions return to normal, it is highly likely that revenue and profits will increase in FY3/22.

If the number of halls remain at the same level, the change factors will be the operating rate, machine costs, and hall costs including personnel costs. The outlook for the operating rate is that it will bottom-out in April to June 2020 and then recover. It will rise comparatively in FY3/21, but the point is whether or not it will recover to the level of FY3/20. Even if business conditions return to normal, if the operating conditions of the models under the new regulations trend at the same low level as previously, the strength of the recovery will be weak. It is difficult to be optimistic about a market environment that is characterized by factors such as the decline in the pachinko population and the aging of the population, but there are expectations for the appearance of hit models supported by the young generation and female customers.

Also, machine costs will change depending on the pace of replacements with models under the new regulations. In April and May 2020, purchases had also stopped, and when considering the operating-rate conditions, it is inevitable that for the time being the Company will be cautious and refrain from purchases. Therefore, it is fully possible that machines costs in FY3/22 will increase from purchases of these machines it previously refrained from purchasing. On the other hand, hall costs, which include personnel costs, will change depending on the extent to which the next-generation operations, which it is currently working on experimentally, will have an effect. It seems that there remains room to further decrease the personnel costs rate through allocating functions and promoting the use of IT.

Looking in the medium-term, even though the contraction of the pachinko and pachislot industry will continue in the future, at FISCO we think that there remains plenty of room for the Company to grow through increasing its share. This is because, as previously explained, even when saying that it has the largest share in the industry in terms of the number of halls, this share is still no more than around 5%. Also, the direction of the Company, which is aiming to make pachinko something everyone can easily enjoy in their daily lives as part of the infrastructure of a region, is in accordance with the changes to the times, and in the future, it is forecast that an industry restructuring and consolidation into the major capital players will progress. In this situation, we think that it is highly possible that the Company will increase its share as one of the winners in this scenario.

Simplified income statement and key indicators

(¥mn)

	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20
Revenue	155,911	156,869	152,092	146,371	141,919
YoY	0.9%	0.6%	-3.0%	-3.8%	-3.0%
Operating expenses	138,326	142,142	136,727	128,024	121,912
YoY	2.7%	2.8%	-3.8%	-6.4%	-4.8%
SG&A expenses	5,798	5,622	5,049	5,023	5,020
YoY	6.3%	-3.0%	-10.2%	-0.5%	-0.1%
Other income	8,184	9,224	9,458	8,971	9,010
Other expenses	1,805	2,430	2,425	2,953	2,483
Total expenses	137,745	140,970	134,743	127,029	120,405
YoY	1.9%	2.3%	-4.4%	-5.7%	-5.2%
Operating profit	18,166	15,899	17,349	19,342	21,514
YoY	-6.1%	-12.5%	9.1%	11.5%	11.2%
Financial income	311	233	236	471	461
Financial expenses	1,074	1,307	781	444	2,469
Profit before income taxes	17,403	14,825	16,804	19,369	19,506
YoY	-10.8%	-14.8%	13.3%	15.3%	0.7%
Income taxes	6,864	5,520	5,879	6,778	6,759
Net profit for the year	10,539	9,305	10,925	12,591	12,747
YoY	-6.4%	-11.7%	17.4%	15.2%	1.2%
Net profit attributable to owners of the Company	10,544	9,360	10,870	12,596	12,748
YoY	-6.7%	-11.2%	16.1%	15.9%	1.2%
EBITDA	30,494	28,469	29,524	31,136	33,151
YoY	-0.5%	-6.6%	3.7%	5.5%	6.5%
EPS (¥)	13.9	12.2	14.2	16.4	16.6
Dividend per share (¥)	13	12	12	12	9

Source: prepared by FISCO from the Company's financial-statements announcement

Statement of consolidated financial position

(¥mn)

	End-FY3/16	End-FY3/17	End-FY3/18	End-FY3/19	End-FY3/20
Current assets	43,240	63,072	53,145	59,875	55,798
Cash and cash equivalents	28,134	48,499	40,533	47,537	41,810
Trade receivables	459	563	469	614	554
Non-current assets	145,944	142,043	131,826	125,457	221,441
Property, plant and equipment	109,532	106,687	98,794	95,445	105,206
Licensing assets	-	-	-	-	79,048
Intangible assets	3,991	3,833	3,545	3,112	3,623
Total assets	189,184	205,115	184,971	185,332	277,239
Current liabilities	30,838	38,496	39,643	36,452	44,028
Trade and other payables	17,786	18,282	19,220	19,297	14,801
Borrowings	2,369	7,281	7,351	2,124	3,008
Lease liabilities	-	-	-	-	12,185
Non-current liabilities	25,727	29,738	7,813	7,080	98,479
Borrowings	18,394	22,768	1,221	502	10,220
Lease liabilities	-	-	-	-	81,611
Equity attributable to owners of the Company	132,645	136,953	137,532	141,821	134,753
Share capital	15,000	15,000	15,000	15,000	15,000
Capital reserve	12,883	12,741	12,741	12,741	12,741
Retained profits	110,253	112,403	114,106	115,204	109,317
Other component of equity	-5,202	-3,191	-4,315	-1,124	-2,305
Non-controlling interests	-26	-72	-17	-21	-21
Total equity	132,619	136,881	137,515	141,800	134,732
Liabilities and net worth	189,184	205,115	184,971	185,332	277,239

Source: prepared by FISCO from the Company's financial-statements announcement

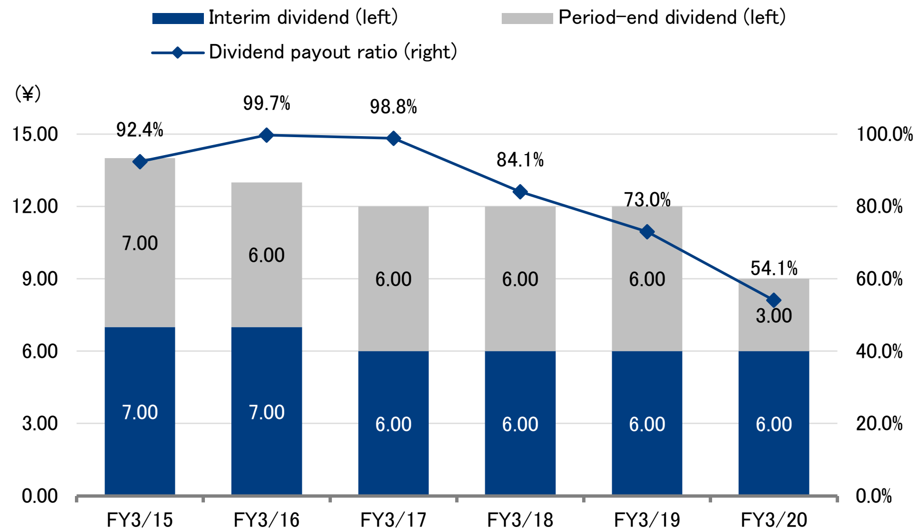
Returns to shareholders

In light of the current earnings environment, has decided a dividend per share of ¥9 for FY3/20

The Company is highly conscious of the significance of returns to shareholders because it recognizes the importance of raising shareholder value in order to achieve sustainable growth. Based on this view, its policy is to pay stable dividends.

For FY3/20, the Company has decided on an annual dividend per share of ¥9 (interim dividend of ¥6, period-end dividend of ¥3). It is thought that it has reduced the period-end dividend in light of the current earnings conditions. Compared to net profit attributable to owners of the Company of ¥12,748mn, the dividend total amount is ¥6,894mn, for a dividend payout ratio of 54.1%.

Trends in dividend per share and dividend payout ratio



Source: prepared by FISCO from the Company's financial-statements announcement

CSR/ESG initiatives

Aiming to enhance long-term enterprise value as "regional infrastructure" in dealing with working style reforms, fostering and appointing women managers, and other important themes

1. CSR initiatives and enhancement of long-term enterprise value

As a listed company, the Company conducts compliance management in line with the laws and seeks to maximize profits. It also aims to build "regional infrastructure" (being a presence that is vital to local areas) and possesses strong CSR (corporate social responsibility) awareness.

Refer our report issued on December 25, 2018 for details. The Company conducts internal discussions and also interacts with external parties (other companies, local society, etc.) and engages in other activities to address social themes, such as work style reforms, training female managers, and efforts to prevent second-hand smoke. It aims to enhance long-term corporate value.

Disclosed an enhancing non-financial (ESG) information and provision of tools for dialogue with long-term investors

2. ESG activities

The Company made a major revision to the CSR section on its website on February 25, 2019, and it became the ESG section. The Hong Kong Stock Exchange requires companies listed on the exchange to disclose ESG information since 2017, and listed companies are ramping up their disclosure of non-financial information. The Company's website also added to information disclosure on its views of and initiatives with the environment (E) and society (S) and governance (G).

Pursuit of improvements in enterprise value from a long-term perspective, including ESG, is gaining recognition as a common theme among long-term investors and companies in an environment that encourages closer dialogue between investors and companies. We have a positive view of the Company's information disclosure on its website as evidence of its openness to dialogue with global long-term investors. The Company also disclosed an ESG report (ESG Report 2019) in August. We expect steady enhancement of tools for dialogue with long-term investors to broaden opportunities for appropriate assessment of the Company in the stock market.

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■ For inquiry, please contact: ■
FISCO Ltd.
5-11-9 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (Financial information Dept.)
Email: support@fisco.co.jp