

# Daikoku Denki Co., Ltd.

6430

Tokyo Stock Exchange First Section and Nagoya Stock Exchange First Section

25-Aug.-2021

FISCO Ltd. Analyst

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FISCO Ltd.

<https://www.fisco.co.jp>

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## Summary

**In the FY3/21 results, sales and profits decreased significantly, mainly due to the impact of COVID-19, but recovered from the 2H. In FY3/22, a recovery is expected toward the 2H alongside the market's revitalization.**

### 1. Business overview

Daikoku Denki Co., Ltd. <6430> (hereafter, "the Company") has two main businesses: one that develops, manufactures and sells computer systems for pachinko (Japanese slot machines) parlors and halls, and the other that develops, produces and sells display and control units for pachinko and pachislot machines. The Company holds the leading market share, approximately 36.6%, of the Japanese market for hall computers, reflecting an information management method that is the de facto standard for the industry. Furthermore, the industry's leading membership-based information provision service Daikoku Denki Strategic Information System (DK-SIS) to support the operations of pachinko hall associations forms a network of 3,337 pachinko halls and supports the Company's business foundation.

Japan's pachinko market has been shrinking over the years. In response, the Company has been working to reform its businesses over the medium to long term. Reforms include developing a next-generation hall computer and shifting to a business model more reliant on services that provide recurring revenue. However, with the series of revisions to regulations (including controlled ball payouts, measures against gambling addiction, and replacement with machines complying with the new regulations) having brought the industry to a major turning point, earnings right now remain difficult due to the impact of future uncertainty, along with the impact of the COVID-19 pandemic. Meanwhile in June 2019, the Company released the AI hall computer "X (Kai)," the first of its kind in the industry, as it started in earnest on its efforts targeting future business expansion. Toward a new era with machines complying with the new regulations, the Company is aiming to increase its market share and boost profitability while helping hall operators improve efficiency, save labor and halls' ability to attract customers.

### 2. Overview of FY3/21 results

In the FY3/21 results, sales and profits decreased significantly due to the impact of COVID-19, with net sales declining 29.4% year-on-year (YoY) to ¥23,228mn and operating income falling 65.7% to ¥490mn. During the COVID-19 pandemic, pachinko halls' management conditions have become even more severe, including due to the effects of having to temporarily close halls and reduce opening hours. In addition, as the schedule for the removal of machines compliant with the old regulations has been pushed back, which has invited an extreme fall in the desire to conduct capital investment and the postponement of capital investment. Therefore, results in the Information System Segment fell greatly. In the Control System Segment as well, against the backdrop of factors including various game machine manufacturers postponing sales of new titles due to the impact of COVID-19, sales of display and control units declined YoY. Profits decreased alongside the major decline in sales, but they were supported by the Company-wide review of costs and so were higher than forecast.

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## Summary

**3. FY3/22 forecasts**

For the FY3/22 results, the Company is forecasting increases in sales and profits, with net sales to rise 11.9% YoY to ¥26,000mn and operating income to grow 73.2% to ¥850mn. The severe business environment will continue due to the prolonging of COVID-19 and the shortage of semiconductors, but sales are expected to recover to a certain extent from the recovery of pachinko hall capital investment from the 2H. In particular, in advance of the installation deadline of the end of January 2022 for machines compliant with the old regulations, the outlook is their replacements with machines compliant with the new regulations will contribute to the revitalization of the game machines market. Therefore, it is necessary to be aware that the forecasts are for results to be concentrated in the 2H. For profits, the Company plans to actively invest (upfront investment) in the Information System Segment, but the forecast is still for operating income to increase significantly from the effects of the higher sales and the improvement to the earnings structure.

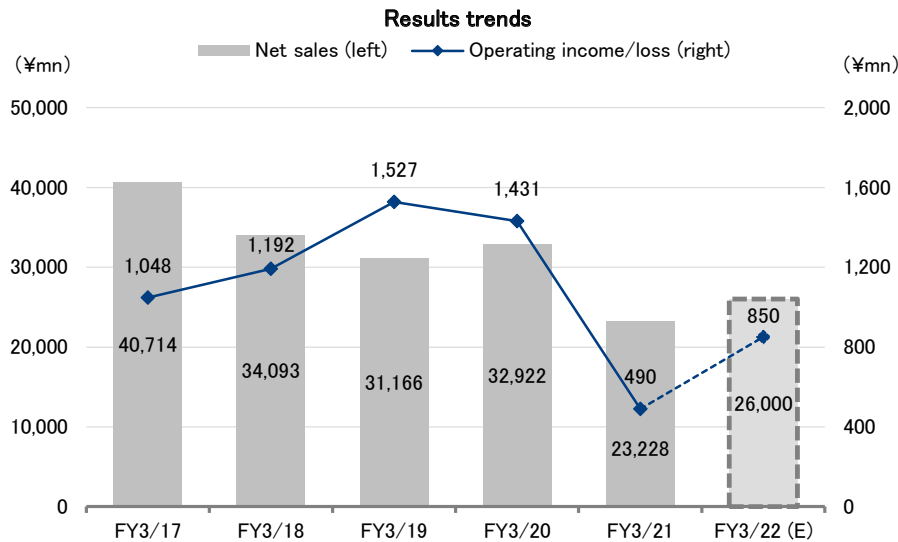
**4. Future strategic direction**

In the Company's view, regulatory revisions and other changes in conditions surrounding the pachinko industry will, in the medium to long term, represent a good opportunity for the industry to evolve into one that enjoys even wider public support. The Company's policies are focused particularly on expanding market share with its industry-first AI hall computer "X (Kai)" and other next-generation products, as well as on creating new value through its data analytics and planning and development capabilities, which will contribute to industry growth while also leading to improved growth and profitability for the Company itself. In the medium- to long-term view, we at FISCO are also keeping a close watch on the Company's efforts to revitalize the industry as a whole, and its M&A action both in and outside the industry.

**Key Points**

- Sales and profits decreased in FY3/21 due to the continuation of a severe industry environment, which overlapped with the strong impact of COVID-19, but profits were still higher than forecast and maintained the annual dividend of ¥40.
- In FY3/22, sales and profits are forecast to increase from the anticipated recovery of pachinko hall capital investment from the 2H
- In advance of the installation deadline of the end of January 2022 for machines compliant with the old regulations, the outlook is their replacements with machines compliant with the new regulations will contribute to the market's revitalization
- In anticipation of a new era with machines complying with the new regulations, the Company aims to increase its market share and improve profitability by helping pachinko halls improve their operating efficiency and save labor, as well as by providing new value leveraging data

Summary



Source: Prepared by FISCO from the Company's financial results

## Description of businesses

### Focuses on hall computers and peripheral equipment for pachinko halls. Aims to further expand its top market share in the industry by promoting the industry's first AI hall computer

While emphasizing development, production and sales of computer systems for pachinko halls, the Company also develops, manufactures and sells display and control units for pachinko and pachislot machines.

As a pioneer in the development of hall computers, which assist in the management of pachinko halls, and holder of the top market share in the Japanese market, the Company won halls' trust and satisfied pachinko players by proposing a management method which puts emphasis on data management, introducing innovative peripheral equipment for its hall computers and providing the industry's leading membership-based information provision service.

The Company's share of the hall computer market is 36.6%, and in particular, its market share of large-scale halls with at least 501 machines is 59.2%.

The Company's two main businesses are the Information System Segment and Control System Segment, but the Information System Segment provided 75.1% of its net sales (FY3/21 results) and has been the main source of stable profit in the past few years.

Description of businesses

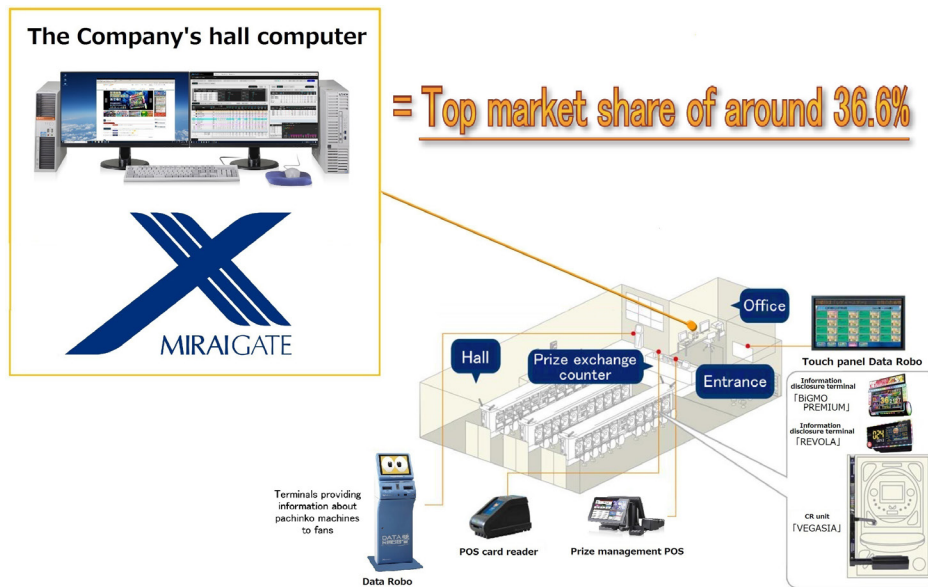
1. Information System Segment

The Information System Segment offers a complete line of information equipment and services necessary to support operational management at pachinko halls. It sells hall computers, which are the core of the system used at pachinko halls, and peripheral equipment, such as prize management and information disclosure systems. The segment also offers MIRAIGATE Service (MG Service), a hall management support service, through a server, and the membership-based information provision service DK-SIS, which is the leading service in Japan that provides strategic information about associated halls.

Hall computers are the core systems for supporting pachinko hall operations. These computers display the operating conditions and sales of each machine in a hall. These computers are supported by peripheral equipment, such as prize management and information disclosure systems, and also serve as the foundation of the MG Service. Introducing a hall computer provides the advantage that peripheral equipment and support services can be sold as a package deal. The Company has been aiming to transition to a business model that provides recurring revenue by collecting membership fees for the MG Service after sales in addition to information equipment sales.

In June 2019, the Company released industry-first AI hall computer “X (Kai),” its first launch in 12 years since the release of the hall computer “CII”. Based on the concept of a “hall computer that teaches,” the main feature of this AI hall computer is that it will guide pachinko hall operators to the optimal solutions by utilizing the Company’s big data and having AI automatically analyze the data. By helping pachinko hall operators improve their operating efficiency, save labor and halls’ ability to attract customers, it aims to expand its market share and increase its profitability.

Hall computers and main peripheral equipment



Source: Prepared by FISCO from the Company's results briefing materials

## Description of businesses

## 2. Control System Segment

The Control System Segment produces and sells displays and control units, as well as components used for pachinko and pachislot machines for game machine manufacturers. Applying the knowledge obtained from analyzing data from pachinko machines as a hall computer manufacturer for many years, the segment serves as a development partner for the content as well, moving beyond the scope of a machine manufacturer by proposing specs based on the trends of popular models and acquiring copyrights for popular characters. In particular, from 2H FY3/21, the Company plans to leverage the hardware and software technologies it has cultivated to advance bundled contract development of pachislot machines and expand the business domain of the products it sells, thereby ramping up the pachislot business in earnest.

# ■ Company strengths

## Track record of creating new opportunities for the industry and provides added value for hall management in various aspects

### 1. Growth model based on market expansion through innovation

Since its establishment, the Company has consistently planned and developed new categories of goods and services, thereby cultivating the pachinko market and achieving growth. It has not just developed machines with superior functions but emphasized the importance of data management and the necessity for information disclosure. Thus, it has been able to provide added value to various aspects of pachinko hall management.

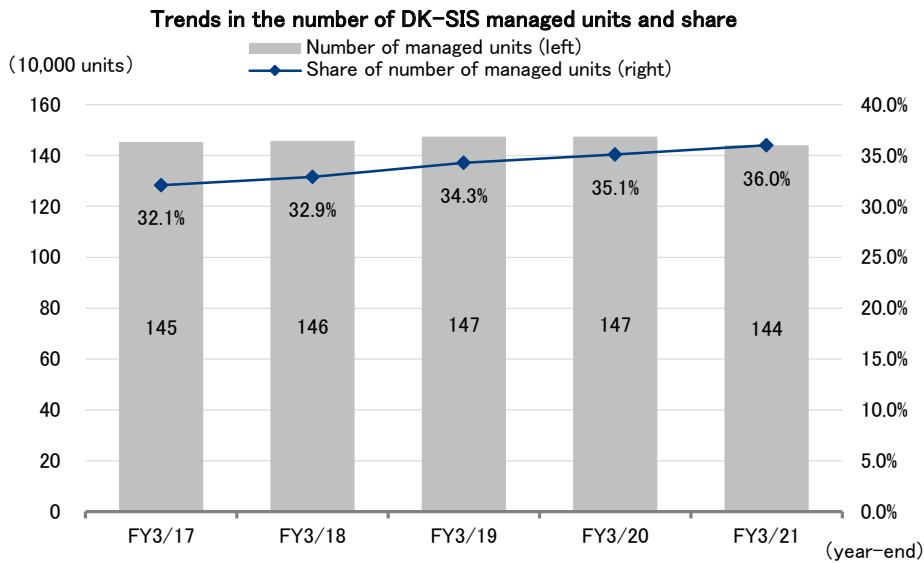
Launched in 1974, the Company's first hall computer enabled the managers of pachinko halls to introduce a hall management method based on data management. Previously, pachinko halls accumulated only basic data, but with the introduction of hall computers, data-based hall management became the de facto standard. In subsequent years, the Company has been consecutively introducing industry-first information equipment with revolutionary functions in the pachinko industry. One such piece of equipment was the Data Robo terminal, which provides information about different models of pachinko and pachislot machines to the players of these machines. This equipment has increased the satisfaction of pachinko players and the efficiency of pachinko hall management, and hereby improved the profitability of pachinko halls.

In June 2019, the Company released the industry's first AI hall computer, "X (Kai)." This AI hall computer will greatly help pachinko hall operations, for which shortage of manpower is an issue, by improving operating efficiency and reducing necessary labor by having AI automatically analyze big data that the Company possesses.

Company strengths

2. Strong network of pachinko halls

Another advantage the Company has is its membership-based information provision service, DK-SIS. This service creates an information network connecting the Company and member pachinko halls, and processes and analyzes the daily operational information of pachinko halls recorded by hall computers and gives feedback to hall managers to help their operations. It enables the managers to conduct effective hall operation utilizing valuable external information, including nationwide pachinko machine information and operational data broken down by machine model. At the same time, this strong network made up of members also supports the Company's business foundation. Additionally, it occupies an industry think-tank role, contributing to improving the Company's brand as a leading company, and is utilized in strategic proposals and sales activities to game machine manufacturers. Membership totaled 3,337 halls at the end of March 2021 with 1.44mn managed machines (36.0% share in managed machines). While member volume has peaked amid a recent decline in overall pachinko halls, DK-SIS enjoys a large share in managed machines, mainly at large sites. Also, recently it has been focusing on spreading the use of Market-SIS, which is a commercial area analysis service that analyzes from various angles factors such as customer numbers, operating rates, occupancy rates, and support rates of halls and machines managed within commercial areas. It is being highly evaluated as a tool to ascertain the flow of people (player trends) and that contributes to improving halls' ability to attract customers.



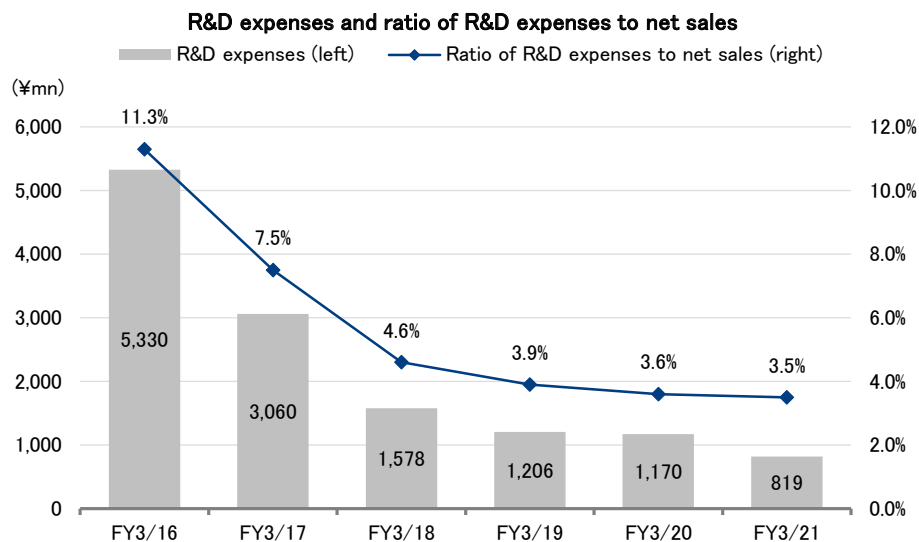
Source: Prepared by FISCO from the Company's results briefing materials



Company strengths

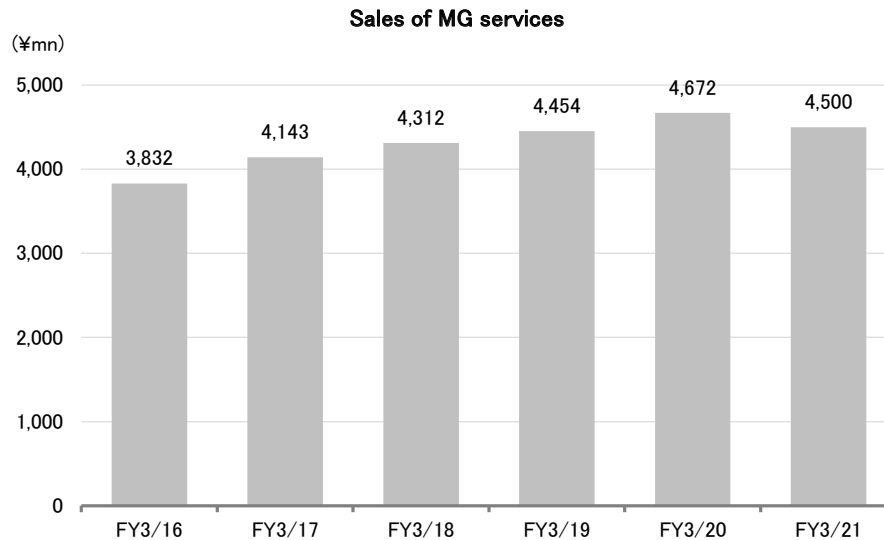
3. Stable profit base that supports investment for the future

The Company’s main source of competitiveness is its proactive upfront investment eyeing future growth, including its R&D expenses. Over the past few years, it has developed unique pachislot machines, a next-generation hall computer (and peripheral equipment), and other products to drive its sales and profit growth hereafter. The stable revenue stream provided by the high-margin Information System Segment makes this investment possible. In particular, MG services promoted by the Company as a recurring revenue business model have grown and enabled funding of R&D at a high level while maintaining stable segment income, and investment risk has been limited. The Company’s ability to balance large profits from its existing businesses with heavy investment in businesses for future growth allows it to produce value on a continuing basis. Since FY3/18, the ratio of R&D expenses to net sales has been trending at roughly 3.5% because of a lull in major investment in the next-generation hall computer, etc. Going forward, the Company intends to proactively invest its R&D expenses in fields including data analysis features related to AI hall computer “X (Kai),” which has already been introduced in the market.



Source: Prepared by FISCO from the Company’s financial results

## Company strengths



Note: The FY3/21 values are the Company's forecasts

Source: Prepared by FISCO from the Company's results briefing materials and other materials

## Industry environment

### The sense of uncertainty remains due to COVID-19, but with the approach of the installation deadline for machines compliant with the old regulations, the outlook is for the gradual revitalization of the market

Japan's pachinko industry has been experiencing a challenging environment over the past few years, reflecting the decline in the overall number of pachinko players, a trend toward playing games with low rental costs for balls, increases in Japan's consumption tax, and other factors. The self-regulatory action taken by the industry in 2015 (tightening restrictions on both pachinko and pachislot machines with strong gambling elements) left the whole industry in a slump in 2016 as it started to grapple with the problem of collecting and removing all pachinko machines that may perform differently from certified standards. Since the official announcement on September 4, 2017, of the Regulations Regarding the Certification of Game Machines and Examination of Models (enforced on February 1, 2018; hereafter, "new regulations") \*, the situation has remained in a state of flux due to a pessimistic view and uncertainty toward the industry. As for pachislot machines in particular, the certification of mainstay models with strong gambling elements which had been the breadwinners for the management of pachinko halls had expired at the end of December 2019 (deadlines for removal), and this will have a considerable impact on pachinko halls' business. This, combined with the impacts of the COVID-19 pandemic (business suspensions, shortened operating hours, etc.) since the start of 2020, has led to a continually difficult environment.

\* Among the new regulations are restrictions on the maximum number of balls that can be paid out and clearly defined standards for "controlled machines." However, although more than three years have passed since the enforcement of the new regulations, there is still a large number of machines conforming to the previous regulations that continue to operate. Pachinko hall operators are worried that their earnings will decline and they will be faced with difficult decisions about the timing of equipment replacement and other matters. This has likely prolonged their diminished investment appetite (cautious stance).

Industry environment

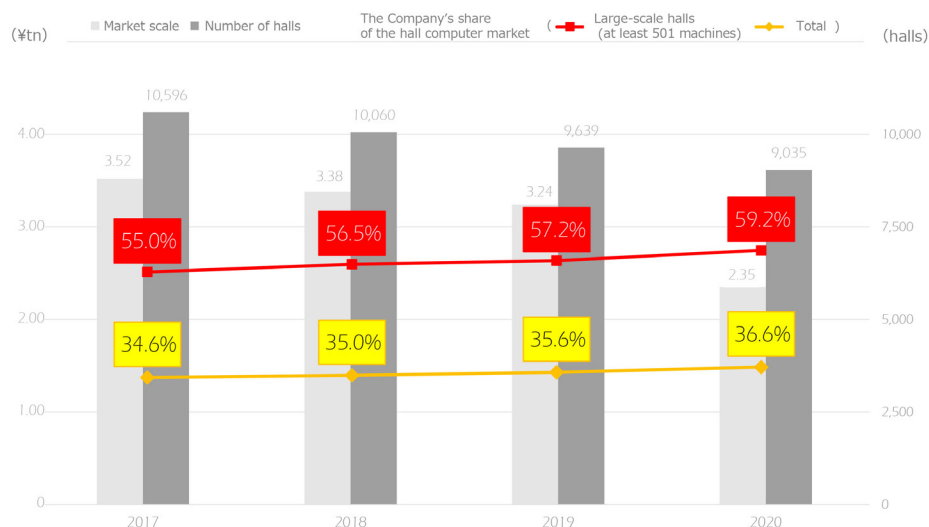
On the other hand, the deadline for completely removing machines conforming to the previous regulations was extended for one year (until the end of January 2022) due to the COVID-19 pandemic, and the replacement of machines with those complying with the new regulations is expected to progress gradually in stages. As game machines with new game features (“play time,” etc.)\* are being released based on the revisions to the Criteria for Interpretation of Technological Standards enacted in January 2020 and consequent internal regulations of the Japan Pachinko Machine Industry Association, many popular models of pachinko machines are appearing, so it is expected that the replacement of these machines will lead to activation of the market. With this, there are hopes that the market will be revitalized by the demand for replacement of game machines. Alongside this, by the end of March 2021, 65% of pachinko machines had been replaced with machines compliant with the new regulations, but only 50% of pachislot machines had been replaced (from a survey by the Company). Going forward, as machines conforming to the previous regulations are removed and machines complying with the new regulations are introduced to the market in the future, it is believed that investment (to draw in customers) as pachinko halls compete to survive will be sparked, and it is also expected that the efforts to save labor will be activated to resolve the labor shortage in the operation of pachinko halls and that there will also be investments made to address the move to eliminate smoking in pachinko halls as a part of the Health Promotion Law that went into full effect in April 2020.

\* “Play time” is a system (rescue measure) whereby the machine enters a shortened time mode (a function that efficiently rotates balls without reducing the number of balls up to a certain number of times) if the player does not have a big win in a specified number of rotations during normal play (low probability). With the recent industry regulations, new functions such as “play time” have been added, and the breadth of game features of game machines has expanded significantly.

According to surveys by the National Police Agency, the number of pachinko halls in Japan declined at an average annual rate of 3.6% from 2012 to 2020. In particular, there is a noticeable decline in new hall openings due to the impact of the new regulations and other factors. In the end of December 2020, the number of halls was 9,035 (-604 YoY), and the Company served 36.6% of these halls. Its customer halls are often high-end, large pachinko halls that are the top performers in their respective local markets, which exceed the market average in size\*. The customer base hence is fairly resilient to economic fluctuations and possesses healthy investment resources. As the Company moves toward a new era with machines complying with the new regulations, we expect an excellent opportunity for it to expand business once investment appetites recover, mainly at large halls.

\* The Company’s share of the large-scale halls (at least 501 machines) market is even higher at 59.2%.

Market scale, the number of halls, and the Company’s share of the hall computer market



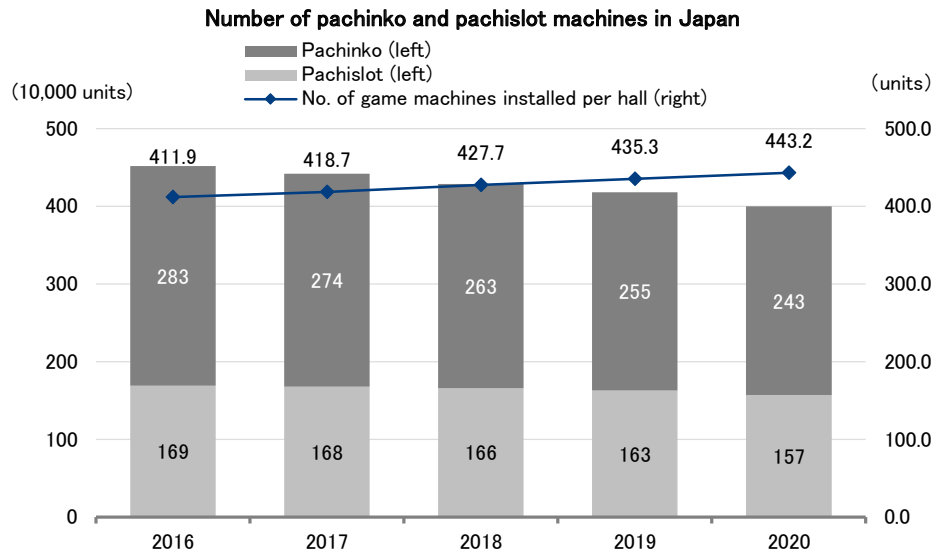
※Market scale (total gross profit) is the value estimated from DK-SIS actual data.  
 ※The number of halls is from data in the National Police Agency’s Current Status of Entertainment and Amusement Businesses, etc., and the Status of Measures for Crimes relating to Entertainment and Amusement Businesses, etc.

Source: The Company’s results briefing materials

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Industry environment

Meanwhile, although the number of game machines is on a downward trend (the decline in pachinko machines is particularly striking), the number of machines per hall is increasing, indicating that halls are becoming larger. As discussed above, larger pachinko halls that command economies of scale are the Company's main segment, therefore this trend should benefit the Company with its ability to realize robust investment return through advanced functionality and added value.



Source: Prepared by FISCO from the Current Status of Entertainment and Amusement Businesses, etc., and the Status of Measures for Crimes relating to Entertainment and Amusement Businesses, etc., 2020, by the Public Security Division of the Security Bureau, the National Police Agency, and from Company materials

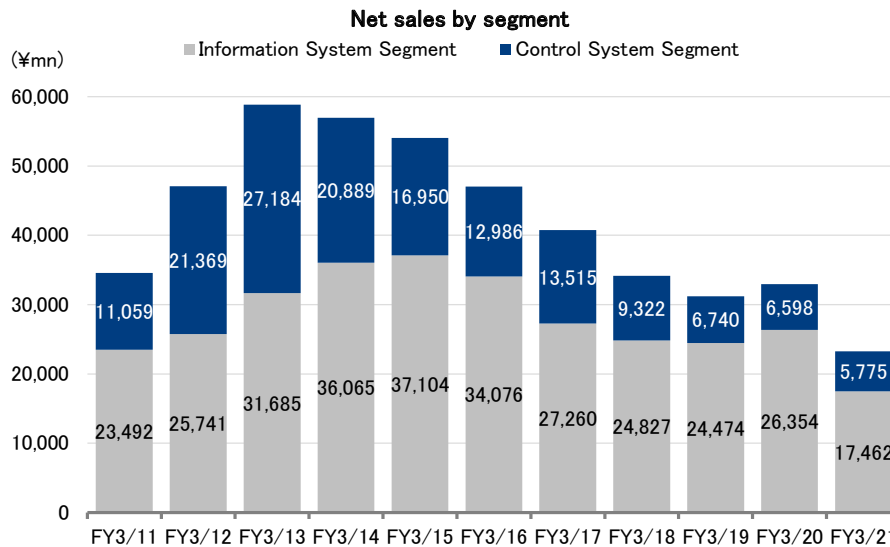
## Financial results trends

**As the industry enters a period of transition, earnings have been on a downward curve, but the Company is establishing a foundation for sustainable growth eyeing the future**

### 1. Performance over the past fiscal years

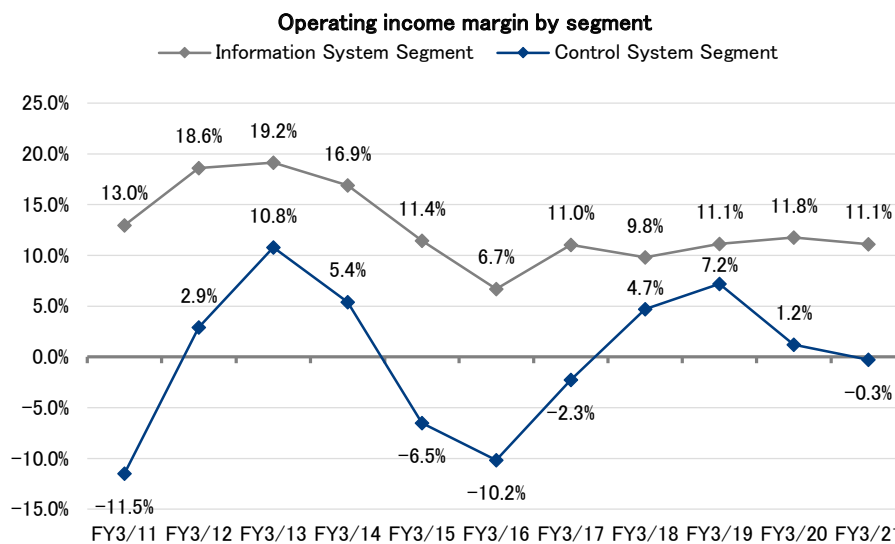
Looking back at past results, the Company's sales shrank YoY because of restrained consumer spending and the impact of the Great East Japan Earthquake in FY3/11. Its results rebounded afterwards, even though the pachinko industry continued to contract. This recovery was mainly led by the Information System Segment, which holds high market shares for its products. Net sales in this segment reached consecutive record highs from FY3/13 to FY3/15, supporting the Company's overall performance. However, net sales have been weak since FY3/16 due to the impacts of negative factors in the industry (self-regulatory action, collecting and removing of machines, and uncertainty related to new regulations), as well as the impacts of the COVID-19 pandemic and other factors since the start of 2020.

Financial results trends



Source: Prepared by FISCO from the Company's results briefing materials

The Information System Segment has become the source of profits, and has maintained high profit margins as the Company's performance recovered. Reflecting increasing investment in R&D for next-generation products from FY3/14 to FY3/17, profit margins have declined, but considering the size of the investment, margins are still high. However, although R&D for next-generation products has run its course for the meantime since FY3/18, profit margins have not completely returned to the previous high levels due to factors including the stagnation in net sales. Meanwhile, steady progress in the conversion to a recurring revenue business model, including growth in MG services, has been supporting income.



Source: Prepared by FISCO from the Company's financial results briefing materials

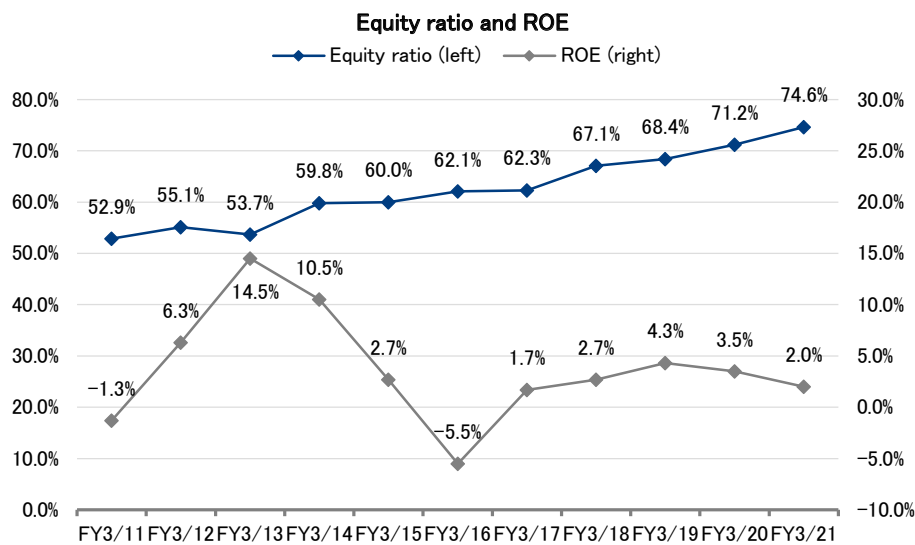
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## Financial results trends

In terms of financial indicators, the Company's equity ratio, a measure of financial stability, has been rising, reflecting the accumulation of retained earnings, reaching a high level of 74.6% in FY3/21. The current ratio, which indicates the ability to make payments in the short term, was 267.1%, mainly due to large holdings of cash and deposits, as the Company's robust financial base is a strength not only for business continuity, but also as a source for powering future growth. ROE, a measure of capital efficiency, has been low since FY3/15 due to a deterioration of net income. The Company suffered losses in FY3/15 due to the bankruptcy of a manufacturer customer and in FY3/16 due to the devaluation of parts and materials for its pachislot machines as industry restrictions were placed on risky machines.



Source: Prepared by FISCO from the Company's financial results

## The FY3/21 results declined significantly, mainly due to the impact of COVID-19, but they recovered from the 2H and profits were higher than forecast

### 2. Overview of FY3/21 results

In the FY3/21 results, sales and profits decreased significantly due to the impact of COVID-19, with net sales declining 29.4% YoY to ¥23,228mn, operating income falling 65.7% to ¥490mn, ordinary income decreasing 41.1% to ¥986mn, and net income attributable to owners of the parent declining 42.3% to ¥612mn. However, results recovered from the 2H and profits were higher than forecast.

Management conditions for pachinko halls become even more severe with the ongoing severe market environment overlapped with the impact of COVID-19 (including halls' temporary closures and reduced opening hours). In addition, the schedule for the removal of machines compliant with the old regulations was pushed back, which invited an extreme fall in the desire to conduct capital investment and the postponement of capital investment. Therefore, results in the Information System Segment fell greatly. In the Control System Segment as well, against the backdrop of factors including various game machines manufacturers postponing sales of new titles due to the impact of COVID-19, sales of display and control units declined YoY.

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## Financial results trends

Profits decreased alongside the major decline in sales, but they were higher than forecast supported by the Company-wide review of costs. In particular, the Company significantly reduced SG&A expenses with a completion of a round of R&D expenses (down ¥350mn YoY), reductions in personnel expenses (down ¥280mn) and business trip expenses because of COVID-19 (down ¥150mn).

Financially, total assets were down 3.8% on the end of the previous fiscal period to ¥41,084mn, mainly due to the decreases in accounts receivables and other trade receivables because of the lower sales, and in depreciation expenses of property, plant and equipment. Conversely, shareholders' equity increased slightly, up 0.8% to ¥30,662mn, due to the accumulation of retained earnings, so the equity ratio rose to 74.6% (71.2% at the end of the previous period). The Company has also secured cash and deposits of ¥15,739mn and its current ratio is 267.1%, so there are no concerns about its financial soundness.

**Overview of FY3/21**

	FY3/20		FY3/21		Change		(¥mn)			
	Results	Ratio to sales	Results	Ratio to sales	% change	FY3/21		vs. forecast		
						Initial forecast	Ratio to sales	Achievement rate		
<b>Net sales</b>	32,922		23,228		-9,693	-29.4%	28,000		-4,771	83.0%
Information System Segment	26,354	80.0%	17,462	75.1%	-8,892	-33.7%	21,000	75.0%	-3,537	83.2%
Control System Segment	6,598	20.0%	5,775	24.9%	-822	-12.5%	7,000	25.0%	-1,224	82.5%
Adjustment	-31	-	-9	-	21	-	-	-	-	-
<b>Gross profit</b>	12,040	36.6%	9,388	40.4%	-2,652	-22.0%	10,500	37.5%	-1,111	89.4%
<b>SG&amp;A expenses</b>	10,608	32.2%	8,897	38.3%	-1,711	-16.1%	10,100	36.1%	-1,202	88.1%
<b>Operating income (loss)</b>	1,431	4.3%	490	2.1%	-941	-65.7%	400	1.4%	90	122.7%
Information System Segment	3,104	11.8%	1,939	11.1%	-1,164	-37.5%	1,700	8.1%	239	114.1%
Control System Segment	78	1.2%	-15	-0.3%	-93	-	600	8.6%	-615	-
Adjustment	-1,751	-	-1,433	-	317	-	-1,900	-	466	-
<b>Ordinary income (loss)</b>	1,674	5.1%	986	4.2%	-688	-41.1%	500	1.8%	486	197.4%
<b>Net income (loss) attributable to owners of the parent</b>	1,061	3.2%	612	2.6%	-448	-42.3%	300	1.1%	312	204.2%
<b>Depreciation</b>	2,212	6.7%	1,967	8.5%	-244	-11.1%	2,119	7.6%	-151	92.8%

	End of FY3/20	End of FY3/21	YoY	
				% change
<b>Total assets</b>	42,702	41,084	-1,617	-3.8%
<b>Total equity</b>	30,406	30,662	255	0.8%
<b>Equity ratio</b>	71.2%	74.6%	3.4pt	-

Source: Prepared by FISCO from the Company's financial results and results briefing materials

## Financial results trends

The results by segment were as follows.

### (1) Information System Segment

Results decreased significantly, with net sales declining 33.7% YoY to ¥17,462mn and segment income falling 37.5% to ¥1,939mn. The Company focused on introductions of the “X (Kai)” AI hall computer (system upgrade from existing hall computers) and on sales of the latest products linked to it. But during the COVID-19 pandemic, the impact of halls’ temporary closures and reduced opening hours and players refraining from visiting halls caused pachinko halls’ management conditions to become even more severe, and this overlapped with the extreme fall in the desire to conduct capital investment and the postponement of capital investment following the schedule for the removal of machines compliant with the old regulations being pushed back by one year. Therefore, sales declined significantly. In particular, while the impact of COVID-19 was basically within the expected scope, it seems that the impact of pushing back the removal schedule was greater than anticipated. In addition, sales of MG services, which have contributed to improving earnings, declined slightly YOY due to the temporary suspension of services (approximately 1 month) during the periods when halls were temporarily closed. But even so, they can be highly evaluated on the point of supporting earnings\*. Additionally, as “play time” machines have become more common, sales of information-disclosure terminals compliant with “play time” machines (REVOLA, IL-X3) have trended steadily since the year-end sales competition through proposals at the MIRAIGATE 2020 Web Exhibition & Seminar. In addition, the number of introductions of “X (Kai),” the AI hall computer useful for managing data from “play time” machines, has recovered up to 90% compared to the previous year, which can be viewed as a good sign of things to come. Profits decreased alongside the decline in sales, but they were still significantly higher than forecast as they were supported by highly profitable MG services, and also from the holding of online exhibitions and seminars, the utilization of mobile, and the reductions of various costs. The segment income margin was maintained at the high level of 11.1% (11.8% in the previous period).

\* In particular, it is aiming to steadily increase the shares of the “X (Kai)” AI hall computer and of Market-SIS (a part of MG services), which is a commercial area analysis service that will become a mainstay service in the future and that is being highly evaluated as a tool to ascertain the flow of people (player trends) and that contributes to halls’ ability to attract customers in commercial zones.

Regarding the operating status of pachinko halls (4 yen pachinko, 20 yen pachislot), although it was sluggish at around 50% YoY in April–May 2020 when the state of emergency was declared, it recovered thereafter, and has been around 80% since July. Although there is a sense that the recovery trend is plateauing at the moment, demand for replacement of game machines is expected to be energized going forward, as game machines with new game features (“play time,” etc.) are gradually introduced to the market and high-capacity pachinko machines begin to appear.

### (2) Control System Segment

Net sales decreased 12.5% YoY to ¥5,775mn and the segment loss was ¥15mn (income of ¥78mn in the previous period). Various game machines manufacturers postponed sales of new titles due to the impact of COVID-19, which included halls’ temporary closures and reduced opening hours. But even in this situation, the Company was still able to secure sales at a certain level, including sales of parts and from contracted small-scale development projects, but infrastructure sales (display and control units), which are the core sales, declined YoY. Profits were pushed down by the decline in sales and also as highly profitable infrastructure sales slumped, so a segment loss was recorded. However, the restrictions on activities due to COVID-19 are gradually being eased and the various game machine manufacturers are conducting fully fledged development of new game machines, including of “play time” machines. The Company is progressing measures in line with these developments, including reallocating resources and reviewing processes, while at the same time it is progressing measures for the future, including expanding the business areas for the outsourced development of pachislot machines and sales products, and conducting survey research toward reducing the costs of display units.

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### 3. Summary of FY3/21

Based on the above and to summarize FY3/21, the challenging industry environment combined with the impact of the COVID-19 pandemic resulted in a continuation of weak operating results. To restate the current situation, there has not been a recovery in willingness to make capital investments in pachinko halls, nor significant progress in the shift to pachinko and pachislot machines that comply with the new regulations. Amid this, the Company has not been able to introduce the AI hall computer “X (Kai)” in earnest or sell the latest related equipment. However, if we look at the Company’s activities, it has been working towards market penetration of the AI hall computer “X (Kai)” and “Market-SIS” (commercial area analysis service), as well as promoting contracted development of pachislot machines. These efforts appear to be going well, so the groundwork laid by the Company can be seen as a positive heading into the future. In particular, at the MIRAIGATE 2020 Web Exhibition & Seminar discussed below, the number of attendees was double that of a normal year, and the Company was able to confirm large potential demand for its services. Also, in the market there has been gradual progress with the development and introduction of “play time” machine models. These developments represent an opportunity for business expansion in the Company’s Information System Segment and Control System Segment, and we view the recovery of its operating results as only a matter of time.

## ■ Main activities

### **MIRAIGATE 2020 Web Exhibition & Seminar had twice the usual number of attendees, the Company confirmed large potential demand**

#### 1. Held the MIRAIGATE 2020 Web Exhibition & Seminar

Each year, the Company participates in various exhibitions and seminars held nationwide to provide proposals, such as on new products and on services that are useful for hall management (data utilization, etc.) For the Company, these events are important places for conducting sales and building relations. In 2020, it held an online event (September 1st to 15th) on a trial basis for the first time from the viewpoint of measures for COVID-19, and it had a total of 5,508 participants, which is twice the scale of a typical year. Participation was likely facilitated by being held online, but even so, within the ongoing severe industry environment, this can be understood as showing the great expectations and potential demand for the Company’s products and proposals. The themes of this event were “play time,” “reduce personnel and save labor,” and “with COVID-19,” and it made proposals for the industry’s new normal. Also, at the same time it held the DK-SIS seminar and made proposals such as for market analysis during COVID-19 and methods to recover results in the future. In March 2021, it held the second online seminar, which had 4,370 participants.

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Main activities

## 2. Proposals of new products in line with the times, such as combatting the COVID-19 pandemic

The Company also released new products and services in line with the times one after another. These included measures to help halls prevent COVID-19 infections\*1, reduce personnel and save labor\*2, and handle the prohibition of smoking in halls\*3. These efforts have not only supported hall business management, but have also built a base for sales of information disclosure equipment and penetration of the AI hall computer “X (Kai).”

\*1 To help prevent the spread of the COVID-19, the Company has added a function to call lamps to notify players of the machines that have been cleaned and disinfected and lights up the lamps to notify staff of the machines that need to be disinfected.

\*2 The Company released wearable device WW-01 for hall staff to use. With a large LCD screen, it conveys various information, such as call notices from players, abnormalities or unauthorized access to game machine data, etc., via vibration and on-screen display for every instance.

\*3 When leaving machines to smoke, players can use the seat-leaving operation on machines, such as the BiGMO PREMIUM, REVOLA and VEGASIA machines. They can smoke with peace of mind while keeping track of their smoking time on the “DiSMO” signage installed in the “Smoking Ark” smoking booth. Staff can respond quickly with an incoming voice notification from a game machine when a player has exceeded the smoking time limit.

## ■ Outlook

### The outlook for FY3/22 is for sales and profits to increase from the market’s revitalization due to replacements with machines compliant with the new regulations and the recovery of pachinko hall capital investment

#### 1. FY3/22 forecast

For the FY3/22 results, the Company is forecasting sales and profits to increase, with net sales to rise 11.9% YoY to ¥26,000mn, operating income to grow 73.2% to ¥850mn, ordinary income to increase 1.3% to ¥1,000mn, and net income attributable to owners of the parent to rise 6.1% to ¥650mn.

The severe business environment is continuing due to the prolonging of COVID-19 and the shortage of semiconductors, but sales are forecast to recover to a certain extent due to the recovery of pachinko hall capital investment from the 2H. In particular, in advance of the installation deadline of the end of January 2022 for machines compliant with the old regulations, the outlook is that their replacements with machines compliant with the new regulations will contribute to the revitalization of the game machines market. Therefore, it is necessary to be aware that the forecasts are for results to be concentrated in the 2H. Also, based on the prolonging of COVID-19, it seems that the Company’s policy is to further improve the earnings structure so it is able to generate profits even if hall operations do not return to their former level.

For profits, the Company plans to actively invest (upfront investment) in the Information System Segment, but the forecast is still for operating income to increase significantly from the effects of the higher sales and the improvement to the earnings structure. The operating income margin is also expected to improve to 3.3% (2.1% in the previous period).

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## Outlook

**FY3/22 forecast**

	FY3/21		FY3/22		YoY change	
	Result	Ratio to sales	Forecast	Ratio to sales	% change	
Net sales	23,228		26,000		2,771	11.9%
Information System Segment	17,462	75.1%	19,500	75.0%	2,037	11.7%
Control System Segment	5,775	24.9%	6,500	25.0%	724	12.5%
Adjustment	-9	-	-	-	-	-
Gross profit	9,388	40.4%	10,400	40.0%	1,011	10.8%
SG&A expenses	8,897	38.3%	9,550	36.7%	652	7.3%
Operating income	490	2.1%	850	3.3%	359	73.2%
Information System Segment	1,939	11.1%	1,850	9.5%	-89	-4.6%
Control System Segment	-15	-0.3%	600	9.2%	615	-
Adjustment	-1,433	-	-1,600	-	-166	-
Ordinary income	986	4.2%	1,000	3.8%	13	1.3%
Net income attributable to owners of the parent	612	2.6%	650	2.5%	37	6.1%

Source: Prepared by FISCO from the Company's financial results and results briefing materials

**2. Policy for main activities**

The Company's policy is to aim to recover results at an early stage and also to focus on activities with an eye to the future, while responding expediently to changes of conditions.

**(1) Information System Segment**

It will continue to promote introductions of the "X (Kai)" AI hall computer and to spread the use of Market-SIS, a commercial area analysis service, that will be a mainstay service in FY3/22. At the same time, it is thought that it will also work to enhance maintenance services and on further strengthening relations with halls.

**(2) Control System Segment**

Its policy is to shift the main axis of sales from pachislot machines to pachinko machines, which are currently performing favorably. Future measures include expanding the business areas, such as through sales of the Company's own pachislot housing\* (a sales strategy focusing on hardware) and strengthening the profitability of outsourced software development projects (improve work efficiency, etc.)

| \* With the aim of effectively utilizing (OEM), the molds, etc., owned by the Company |

## Outlook

### 3. FISCO analyst's opinion

The FISCO analyst's opinion is that while it will be necessary to continue to pay attention to the impact of COVID-19, with the approaching deadline for installations of machines compliant with the old regulations, we can expect the market to be revitalized. In particular, from the steady spread of "play time" machines and the large potential demand for the Company's products (and services), we think it is highly likely that the Company's results will enter a fully-fledged recovery process. We also judge that the Company's results forecasts are at fully achievable levels, when considering its conservative view on the operations rate of halls. The points to focus on will be the progress made in the spread of the "X (Kai)" AI hall computer and the Market-SIS service, and also the measures with an eye to the future, such as launching new MG services and expanding the business areas in the Control System Segment. In particular, its developments for specific products (and services) would seem worthy of attention as showing the direction it is aiming for in the future. Also, assuming that the COVID-19 pandemic is approaching its end, alongside the normalization of the market, we estimate that investment and M&A in order to be one of the survivors in the pachinko halls industry will accelerate and the movement toward an industry reorganization will rapidly advance, which could be an important turning point for the Company. Therefore, it will be necessary to follow-up on developments in the future from these kinds of viewpoints.

## Future strategic direction

### In addition to increasing market share with the AI hall computer "X (Kai)," the Company aims to generate new value utilizing its data analytics and planning and development capabilities

In the Company's view, regulatory revisions and other changes in conditions surrounding the pachinko industry will, in the medium to long term, represent a good opportunity for the industry to evolve into one that enjoys even wider public support. The Company's policies are focused particularly on expanding market share with its AI hall computer "X (Kai)" and other next-generation products, as well as creating new value through its data analytics and planning and development capabilities, which will contribute to industry growth while also leading to improved growth and profitability for the Company itself.

#### 1. Information System Segment

The Company's policy is to promote introduction of the "X (Kai)" AI hall computer, and at the same time, to contribute to the earnings of pachinko halls by market launching products installed with various content compatible with new styles of playing, such as the "play time" machines. Moreover, by progressing MG services (in particular, the Market-SIS commercial area analysis service), it will support pachinko halls' improved competitiveness and labor saving, and realize both customer acquisitions and the stabilization of results.

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Future strategic direction

## 2. Control System Segment

In addition to the growing demand for reduced development costs for pachinko and pachislot machines, demand for new proposals to address future changes in the market environment is rising, and as planning capabilities have become increasingly important, the Company intends to closely coordinate the efforts of its Control System Segment and Information System Segment in order to further differentiate itself from competitors, assure rapid response to changes in the market environment, and raise operating efficiency. In particular, the Company will revise its development system, further improve operating efficiency, and use the hardware and software technologies it has cultivated over the years to advance bundled contract development of pachislot machines and expand the business domain of the products it sells (start the pachislot business in earnest), as well as utilize the Information System Segment's DK-SIS data and Fan-SIS data\* to promote project proposals that generate new gaming value.

\* A service to collect data of player trends using the CII FACE authentication system from halls that have introduced it nationwide, which enables player trends for the market as a whole to be ascertained.

## 3. Strengthening the R&D system

On April 1, 2020, the Company newly established the R&D Department (changed to the R&D Office from 2021) to conduct tasks including basic research into new technologies and investigations of new businesses from a medium- to long-term perspective. With the goal of providing technological support for business expansion in the future, it is responsible for building a technological foundation for introductions of the latest technologies within the Company, including AI technologies. It is also progressing open innovation and working on accumulating technologies and building alliances outside of the Company.

## 4. Points of focus for the FISCO analyst

Even though the pachinko industry is approaching a major turning point that renders the Company's surrounding profit conditions uncertain from a medium- to long-term perspective, the successful launch of AI hall computer "X (Kai)" aimed at future growth, in addition to its high-value-added next-generation products, will give it a major advantage over its competitors. In particular, we see the Company's MG services and value proposals leveraging its unique services and data analysis putting it in a strong position to meet the changing needs of the industry. Even assuming the pachinko market continues to contract for a while longer, we believe it will be possible for the Company to sustain growth with the help of a full-scale rollout of a high-value-added lineup of next-generation products that will capture replacement demand among existing pachinko hall operators. Additionally, polarization is likely to proceed further in the pachinko hall industry with firms with extensive capital resources surviving. These conditions are likely to work favorably for the Company in its efforts to increase market control with the AI hall computer "X (Kai)" and raise market share.

We believe that for the time being, it is necessary to cautiously assess net sales growth, which is readily affected by the external environment, but we should also focus on improvement in profitability through development of products and services that respond to changes in market conditions and expansion of MG services. From a medium- to long-term perspective, we also anticipate results from the Company's efforts to revitalize the industry as a whole, as it faces a new age with the complete transition to machines complying with the new regulations. We will also keep watch on the Company's efforts to engage directly with pachinko and pachislot players, amusement fans and new fan segments (including provision of member information via a smartphone app and initiatives that bring people to halls) as well as with pachinko halls and game machine manufacturers. Furthermore, as the Company completes a round of major investment in next-generation hall computers and begins collecting on that investment, we need to also monitor its M&A moves, including those outside the industry. Because the Company's expertise in utilizing data can be extended in other areas, we believe M&A will be an important strategy, both for securing a new source of profits and distributing risk.

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## ■ Shareholder returns

### **Plans to continue to pay a ¥40 annual dividend in FY3/22, likely to have room to raise the dividend over the future accompanying profit growth**

Due to the impact of COVID-19, profits decreased significantly in FY3/21, but even so the Company maintained the dividend per share at ¥40 (interim dividend ¥10, period-end dividend ¥30). In FY3/22 as well, it plans to once again pay an annual dividend per share of ¥40. Its policy is to determine a dividend increase in line with results, so we can expect there to be plenty of room for it to increase the dividend in the future alongside the growth of profits.

The Company had introduced a shareholder benefits program with the aims of increasing the appeal of investing in its shares and promoting shareholders holding them over the medium- to long term. However, as the business environment is expected to continue to be uncertain in the future and as profits have decreased significantly due to the impact of COVID-19, it abolished this program in FY2020. Going forward, its policy is to prioritize dividends in order to return profits to shareholders.



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