

Daikoku Denki Co., Ltd.

6430

Tokyo Stock Exchange Prime Market and Nagoya Stock Exchange Premier Market

27-Feb.-2024

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FISCO Ltd.

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

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Summary

In 1H FY3/24, with the steady spread of smart pachislot gaming machines, major increases in revenue and profit. Full-year forecasts upwardly revised and expecting to set new record high for profit

1. Business overview

Daikoku Denki Co., Ltd. <6430> (hereafter, “the Company”) has two main businesses: the Information System Segment that develops, manufactures and sells computer systems for pachinko (Japanese slot machines) parlors and halls, and the Amusement Segment that develops, produces and sells display and control units for pachinko machines. The Company holds the leading market share, approximately 38.7%, of the Japanese market for hall computers, reflecting an information management method, etc. 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) facilitating the operations of pachinko hall associations forms a network of 3,257 pachinko halls and supports the Company’s business foundation.

With the pachinko market on a trend of steady annual shrinkage, the Company is striving to increase market share at large halls and promoting business reforms, including a shift to a business model with recurring revenue that continues over time, from a medium to long term perspective. Over the past several years, controlled ball payouts, measures against gambling addiction, and amended regulations on game machines (enforced on February 1, 2018; hereafter, “new regulations”) have brought the pachinko hall industry to a major turning point. This has been compounded by impact from the COVID-19 pandemic, and earnings have been lackluster for some time due to uncertainty about the future. However, with the steady increase in utilization of the closely-watched smart gaming machines*, which emerged in November 2022, the business performance of pachinko halls has expanded rapidly along with the recovery of capital investment, and the Company is entering a new phase of growth.

* This refers to smart pachinko and smart pachislot, types of smart gaming machines, which enable users to play without directly touching the balls and medals in contrast to the past format. Key points are elimination of facilities related to balls and medals at pachinko halls and enhancement of gaming performance compared to existing gaming machines. Future developments should be closely monitored considering support from gaming machine manufacturer organizations (Nikkoso and Nichidenkyo). Smart pachislot machines were introduced into the market from November 21, 2022, and smart pachinko machines were rolled out on April 3, 2023.

2. Overview of 1H FY3/24 results

In the Company’s results for 1H FY3/24, net sales increased by 158.4% YoY to ¥29,168mn and operating income rose by 953.6% to ¥7,899mn, as the Information System Segment rapidly expanded to account for the major increases in revenue and profit. With operation of smart pachislot machines introduced on the market in November 2022 performing well, pachinko halls upped their capital investment to accommodate smart gaming machines, and in accord with this, system upgrades to the AI hall computer X (Kai), optimal for data management of smart gaming machines, made progress, and sales volume of dedicated card units for smart gaming machines and information disclosure terminals, etc., exceeded plans by a large margin. On the profit front as well, expansion in the Information System Segment bolstered earnings and led to an operating income margin of 27.1%, a major improvement (6.6% a year ago).

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Summary

3. FY3/24 forecasts

With regard to results for FY3/24, the Company made upward revisions in light of the progress of first half results and recent conditions. It is expecting net sales to increase 60.3% YoY to ¥51,000mn and operating income to rise by 61.2% to ¥10,500mn, so for the full year as well major increases in revenue and profits are expected. For net sales, the Information System Segment is expected to continue to grow substantially. Regarding smart pachislot machines, there are many hit models and models operating at a high level, and in the second half as well, they are expected to spread. With respect to profits, the Company continues to actively invest in cloud development and development toward the market launch of smart pachislot machines under its own brand, but growth in the Information System Segment is boosting earnings and the operating income margin is expected to improved greatly from 12.6% last year to 20.6%.

4. Medium-term management plan

The Company started a medium-term management plan (three years) now in its second year and seeing a path to more active conditions in the gaming machine market and pachinko hall capital investments as the new era of smart gaming machines emerges. The Company will capture demand from the spread of smart gaming machines and continue to promote the uptake of the AI hall computer X (Kai). It is also aiming to shift to a recurring revenue business by enhancing its MIRAIGATE Services ("MG Services"), a business that uses cloud servers, and building a platform that will be unique in the industry. Further, as a gaming machine manufacturer, it will work to develop smart pachislot machines under its own brand (aiming for a market launch in FY3/25). Its numerical goals (post-revision) for FY3/25, the last year of the plan, are net sales of ¥40,000mn and operating income of ¥4,500mn (operating income margin of 11.3%). In its forecasts for FY3/24 (following revision of the increased amounts), the Company expects to exceed its plan one year ahead of schedule.

Key Points

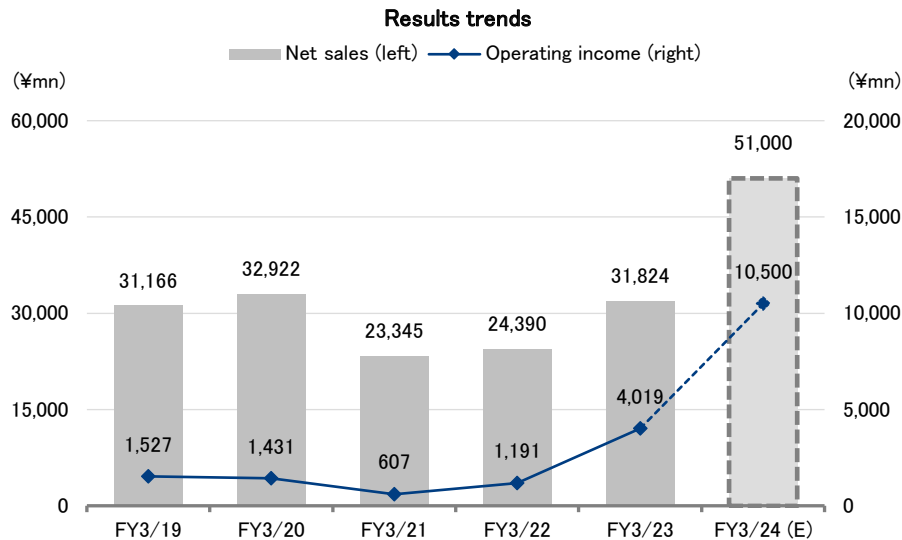
- In 1H FY3/24, major revenue and profit growth thanks to the steady spread of smart pachislot machines
- The introduction of smart pachislot machines operating at a high level has led to ramped up capital investment demand at pachinko halls, and card units and mainstay products are experiencing growth
- Results forecasts for FY3/24 have been upwardly revised, and for the full year as well major increases in revenue and profit are expected (record-high results)
- Medium-term management plan sees the advent of the era of smart gaming machines, aiming to strengthen cloud development and shift to a recurring revenue model and to quickly develop smart pachislot machines

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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 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, etc.

The Company's share of the hall computer market is 38.7%, and in particular, its market share of large-scale halls with at least 501 machines is 60.9%. (as of FY3/23).

The Company's two main businesses are the Information System Segment and Amusement Segment*, but the Information System Segment provided over 80% of its net sales and has been the main source of stable profit in the past few years

* As of FY3/24, the Control System Segment name has also been changed to the Amusement Segment.

Description of businesses

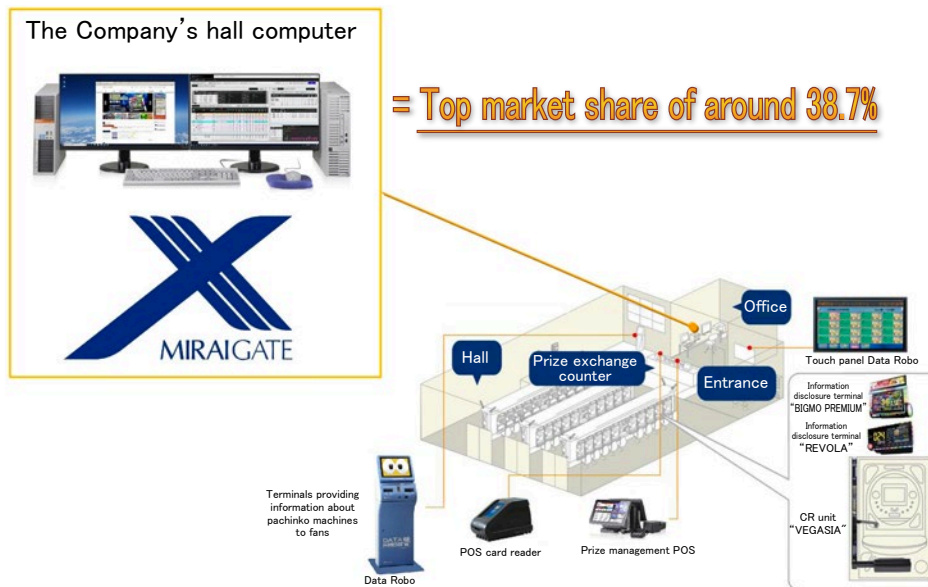
1. Information System Segment

The Company sells hall computers (machine management systems), which serve as core systems at pachinko halls, and peripheral equipment, such as prize and customer management systems, information disclosure systems and card units, and offers MG Services that provide various services on hall computers and over the internet via a server. DK-SIS, a membership information provision service and the industry's foremost strategic information tool, is the pillar of MG Services.

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, are supported by peripheral equipment such as prize management and information disclosure systems and card units, and serve as the foundation of MG Services. Introducing a hall computer provides the advantage that peripheral equipment and support services can be sold as a package deal.

In June 2019, the Company released the AI hall computer X (Kai), the first of its kind in the industry and the first upgrade in 12 years since the CII hall computer. 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 optimal solutions by utilizing the Company's big data and having AI automatically analyze the data. By using AI's ability to prepare forecasts utilizing big data that cannot be processed by people to instantaneously generate analyses that previously required significant time and assist personnel with limited experience in making assessments expected of highly experienced personnel, the Company will enhance efficiency and reduce labor resources in hall management, contribute to further customer attraction and improve profitability. With the spread of smart gaming machines introduced in November 2022, the computer is also spurring system upgrades as a hall computer optimal for data management.

Hall computers and main peripheral equipment



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

Description of businesses

2. Amusement Segment

The Control System Segment develops, produces and sells displays and control units, as well as components used for gaming machines (mainly pachinko) 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 plans based on the trends of popular models and sales of copyrights for popular characters. In particular, the Company is ramping up pachislot business from FY3/22 by leveraging hardware and software technologies cultivated up to now. As a gaming machine manufacturer,* the Company intends to focus on manufacturing and selling smart pachislot machines under its own brand, with a view to market launch in FY3/25. As of FY3/24, the Company has merged its Control System Division (amusement division) and Manufacturing Division (supply division) and renamed the department the AMS (Amusement & Supply) Management Department. The segment name has also been changed to the Amusement Segment.

| * Handled by subsidiaries DAXEL Co., Ltd. and ALOFT Co., Ltd. as well as LAIRI Inc., consolidated in April 2023. |

■ Company features

Track record of creating new product opportunities for the industry and provides added value for hall operations in various ways

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.

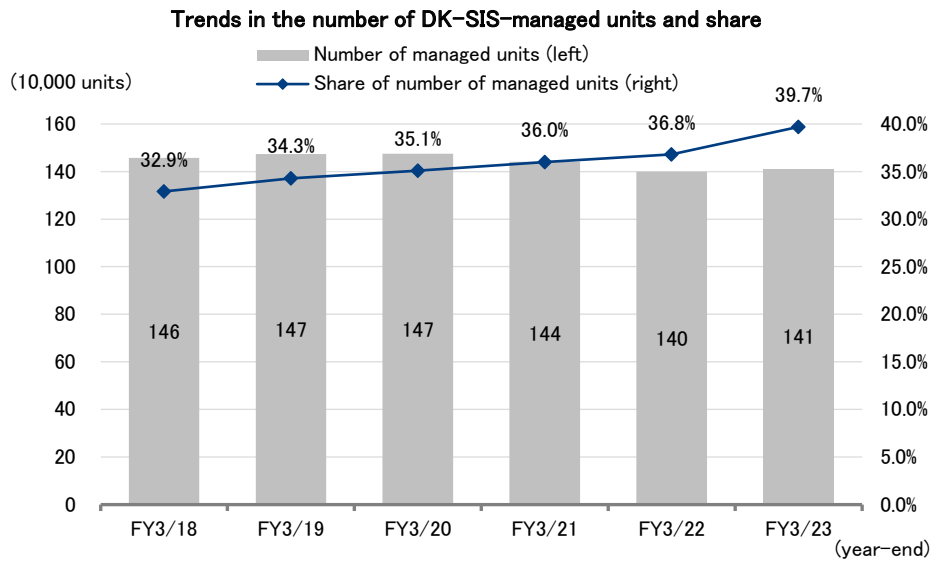
Launched in 1974, the Company's first hall computer enabled managers of pachinko halls to introduce a hall management method based on data management. Previously, pachinko halls accumulated only basic data, but with the introduction of hall computers, data-based hall management became the de facto standard. Ever since then, it has been steadily rolling out industry-first information equipment that contains innovative functions, such as the Data Robot information disclosure terminal that provides operational information about gaming machines at pachinko halls to fans. It has contributed to healthier hall results by boosting the efficiency of hall management and supplying added value that raises fan satisfaction.

In June 2019, the Company released the industry's first AI hall computer, X (Kai). This AI hall computer not only helps the performance of pachinko halls, but also improves operating efficiency, thus reducing labor necessary for hall management already undergoing labor shortages.

Company features

2. Strong network of pachinko halls

Another one of the Company’s strengths is that it has built a robust network with member pachinko halls through an array of services based on hall computers (MG Services), and evolved it into the industry’s only platform. Launched in 1990, DK-SIS is a service offering feedback in the form of information that is useful in hall operations after processing and analyzing the daily operational information of pachinko and pachislot machines received from pachinko halls. Simulations based on nationwide gaming machine sales data support forecast management, and a strong network of member halls underpins the Company’s business foundation. Additionally, the service takes on a role as a sort of think tank in the industry, helping to enhance the Company’s brand power as a leading company, and it is apparently being utilized in strategic proposals and sales activities to game machine manufacturers. Membership totaled 3,257 halls at the end of FY3/23 with 1.41mn managed machines (39.7% share in managed machines). Recently, the Company has been focusing on promoting widespread use from various angles of its Market-SIS market area analysis service, which analyzes customer numbers, utilization rates, market share, and support rates of pachinko hall rivals operating in the commercial sphere. Market-SIS is being well received as a tool that grasps mobility (player) trends and helps halls improve their ability to attract customers. Moreover, the Company launched the cloud-based chain store management system ClarisLink in 2021. The new system is its first using the cloud. Its unparalleled data and response speed have drawn rave reviews, and the number of contracting halls has grown in excess of forecasts.

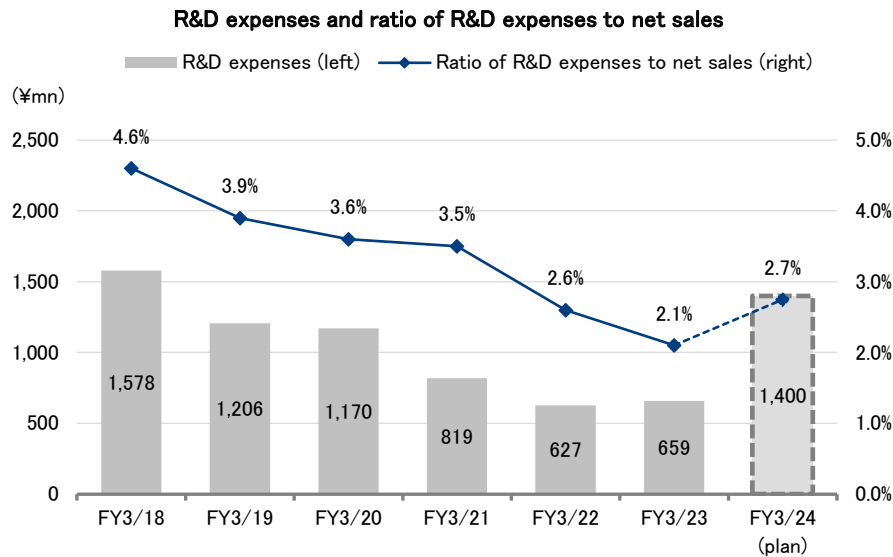


Source: Prepared by FISCO from the Company’s materials

Company features

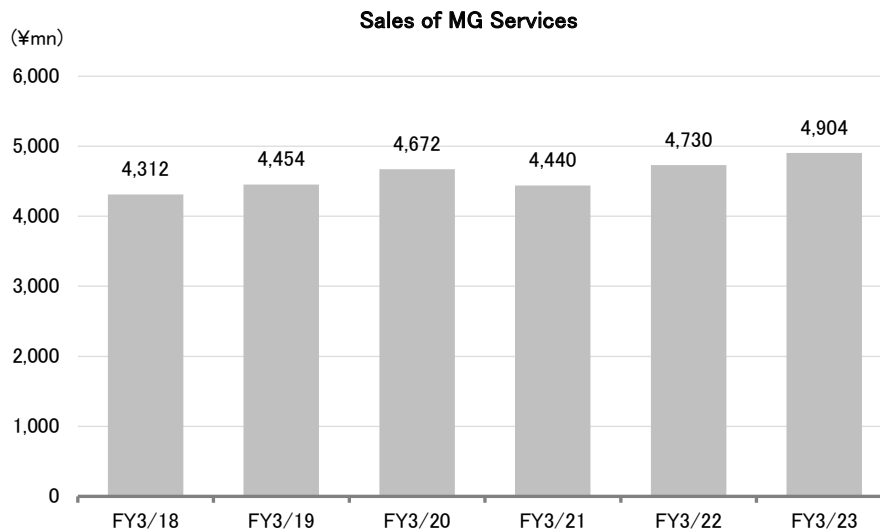
3. Stable profit base that supports investment for the future

The Company’s main source of competitiveness is its proactive upfront investment eyeing future growth, including its R&D expenses. Development of a next-generation hall computer (and peripheral equipment) and start of a new MG Services are evidence of continued aggressive investment in areas expected to become its growth driver. 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. While exhaustion of large-scale investments in the next-generation hall computer and other outlays have kept R&D expenses at roughly 3% of net sales since FY3/18, the Company intends to aggressively allocate R&D expenses, mainly for central components of its strategy such as the cloud and smart pachislot, in the medium-term management plan.



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

Company features



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

Financial results trends

In 1H FY3/24, with smart pachislot gaming machines spreading steadily, mainstay products necessary for smart gaming machines greatly exceeding forecasts

1. Overview of 1H FY3/24 results

The Company posted 1H FY3/24 results expanding significantly, with net sales of ¥29,168mn (up 158.4% YoY), operating income of ¥7,899mn (up 953.6%), ordinary income of ¥7,938mn (up 810.9%) and net income attributable to owners of parent of ¥5,502mn (up 864.6%).

Major expansion in the Information System Segment drove results growth. With smart pachislot machines introduced on the market in November 2022 operating at a high level, at pachinko halls, capital investment to handle smart gaming machines is ramping up, and with this, they are upgrading their systems to AI hall computer X (Kai), which is optimal for data management for smart gaming machines. In addition, product sales volumes for the card unit VEGASIA, which includes cards for dedicated use with smart gaming machines, and the information disclosure terminals REVOLA and BiGMO PREMIUM, etc. increased beyond forecasts. In addition, regrading service sales, MG services performed solidly. At the same time, in the Amusement Segment, impacted by stagnation in the pachinko sales volume in the market overall, display units and control units for gaming machines along with sales of parts fell short of the previous fiscal year.

As for profits, earnings increased greatly on expansion in the Information System Segment. In particular, growth in mainstay products with high profit margins led to significant growth in operating income, and the operating income margin also improved greatly, from 6.6% a year ago to 27.1%.

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Financial results trends

Looking at financial conditions, total equity increased 13.8% compared to the end of the previous fiscal year to ¥38,016mn from the accumulation of retained earnings. Cash and deposits and accounts receivable – trade increased with the increase in revenue, and product inventory was bolstered to prepare for increased capital investment demand. As a result, total assets increased by 16.9% from the end of FY3/23 to ¥56,477mn, and the equity ratio declined slightly to 67.3% (69.2% at the end of FY3/23).

Overview of 1H FY3/24

	1H FY3/23		1H FY3/24		YoY	
	Results	Share	Results	Share		% change
Net sales	11,289		29,168		17,878	158.4%
Information System Segment	8,505	75.3%	27,286	93.5%	18,780	220.8%
Amusement	2,788	24.7%	1,890	6.5%	-897	-32.2%
Adjustment	-4	-	-7	-	-3	-
Gross profit	5,233	46.4%	13,701	47.0%	8,467	161.8%
SG&A expenses	4,483	39.7%	5,801	19.9%	1,318	29.4%
Operating income	749	6.6%	7,899	27.1%	7,149	953.6%
Information System Segment	1,406	16.5%	8,964	32.9%	7,558	537.4%
Amusement	48	1.7%	-105	-5.6%	-153	-
Adjustment	-704	-	-959	-	-254	-
Ordinary income	871	7.7%	7,938	27.2%	7,067	810.9%
Net income attributable to owners of the parent	570	5.0%	5,502	18.9%	4,931	864.6%
Depreciation	795		787		-8	-1.0%

	End of FY3/23	End of FY3/24	Change	
				% change
Total assets	48,298	56,477	8,178	16.9%
Total equity	33,399	38,016	4,616	13.8%
Equity ratio	69.2%	67.3%	-1.9pt	-

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

Financial results trends

The results by segment were as follows.

(1) Information System Segment

Net sales increased by 220.8% YoY to ¥27,286mn, and segment income increased 537.4% to ¥8,964mn, a major increase that set an all-time record high (for a half). Smart pachislot machines introduced on the market in November 2022 operated at a high level, which stimulated capital investment by pachinko halls, the Company's customers, to accommodate smart gaming machines, and with this, systems were upgraded to AI hall computer X (Kai), and sales volumes for products like VEGASIA*¹, a card unit that includes units exclusively for smart gaming machines, and the information disclosure terminals REVOLA and BIGMO PREMIUM came in well above expectations. In addition, regarding service sales as well, MG Services increased the number of franchises in connection with responding to market changes caused by the introduction of smart gaming machines, and exceeded the previous fiscal year. In particular, the Company worked to strengthen three management support services: Market-SIS, a market area analysis service, ClarisLink, a chain store management system, and the labor-saving tool Raku Raku Replacement Operation Option (settings are replaced on gaming machines in just one minute).*² As for profits, upfront expenditures in cloud and other technology increased, but growth in high profit-margin mainstay products and accumulation of recurring revenue from MG Services resulted in a major profit gain, and the segment income margin increased greatly to 32.9% from 16.5% a year ago.

*¹ Regarding the release of the card unit VEGASIA, since its late entry on the market in 2013, it has steadily expanded its share (16.7% as of September 30, 2023), but going forward FISCO believes there is a strong possibility that its share expansion will be spurred on by the shift to smart gaming machines.

*² Market-SIS, which was released in April 2019, is in use at 4,238 gaming halls as of September 30, 2023 (increase of 1,209 halls from September 30, 2020), and ClarisLink, released in November 2021, is contracted by 661 halls (increase of 530 halls from September 30, 2022), so both products are growing steadily.

Looking at trends in the overall market, a total of 20 models of smart pachislot machines were introduced as of September 30, 2023, and the Company's smart pachislot machines account for 23.8% of overall pachislot machines installed (8.2% as of March 31, 2023), so they are spreading at a high pace*¹. Pachislot machine sales volume in 1H FY3/24 (April to September) grew to approximately 400,000 units (approx. 240,000 units the previous term), of which around 60% were smart pachislot machines*². In addition, overall gaming machine operation was 106.1% of the previous fiscal year in 1Q (April to June) and 106.4% in 2Q (July to September), so they performed well, but looking only at pachislot machines, the arrival of smart pachislot drove growth in overall operations, which were 132.5% of the previous fiscal year in 1Q and 123.3% in 2Q, a factor for why capital investment demand is rising at pachinko halls*³.

*¹ At the same time, regarding smart pachinko machines introduced on the market since April 2023, a total of seven models were introduced as of September 30, 2023, but they still account for only 3.0% of overall installations of pachinko machines.

*² Pachinko machine sales volume in 1H FY3/24 slowed to around 500,000 units (around 530,000 units last year), as there were no new types to drive operations and priority was placed on the shift to smart pachislot machines.

*³ Operating status (YoY) is from data comparisons by the company DK-SIS.

(2) Amusement Segment

Net sales declined 32.2% YoY to ¥1,890mn, and segment loss was ¥105mn (profit of ¥48mn in the previous fiscal year), so revenue declined significantly and a segment loss was posted. With the impact of stagnating sales volume for pachinko machines on the market overall, sales of display units and control units for gaming machines and parts sales declined YoY. On the profit front, profit was held down by the major decrease in revenue, and the segment posted a loss as a result of development expenditures for smart pachislot machines (aiming for a market launch in FY3/25) under the Company's own brand.

2. Summary of 1H FY3/24

Summarizing 1H FY3/24, there are two key points: major growth in results was from smart pachislot machines driving the overall growth of gaming machine operations while there was steady growth in installation volume (external factors), and the Company steadily captured capital investment demand associated with the spread of smart gaming machines (internal factors). With regard to the latter in particular, entering the era of smart gaming machines, it could be said to be proof the Company is again raising its competitiveness. In addition, it is also commendable that mainstay products necessary for smart gaming machines are growing and contributing to increased profitability. At the same time, smart pachinko machines have not yet spread on a full-fledged basis, but recently, there are starting to be models with good operations, and the Company sees this as a potential growth area going forward. With regard to activities, the Company has made steady progress in cloud development, the basis of new services that utilize the latest technologies, and in the market launch of smart pachislot machines under its own brand (aiming for market launch in FY3/25).

■ Outlook

Major upward revision to FY3/24 results forecasts; expecting new record-high profit

1. FY3/24 forecast

The Company has revised its FY3/24 forecast upward, taking into account such matters as the progress of 1H results and current conditions. The Company forecasts significant increases to sales and profits, including a projection of record high profits, with ¥51,000mn in net sales (up 60.3% YoY and revised upward by ¥13,000mn), ¥10,500mn in operating income (up 161.2% and ¥6,300mn), ¥10,600mn in ordinary income (up 148.8% and revised upward by ¥6,250mn), and ¥7,200mn in net income attributable to owners of the parent (up 145.9% and revised upward by ¥4,200mn).

For net sales, there is expected to be continued major growth in the Information System Segment. Regarding smart pachislot machines, there are many hit models and models operating at a high level, and in the second half as well, their further spread is expected. At the same time, in the Amusement Segment (formerly the Control System Segment), the Company is predicting a decline in revenue due to a decrease in display and control unit development models.

In terms of profit as well, the Company is spending on promoting DX and developing internal systems and continuing active development investment*, but Information System Segment growth is boosting earnings, and the operating income ratio is expected to improve substantially to 20.6% (from 12.6% a year ago).

* R&D expenses are projected to increase 112.2% YoY to ¥1,400mn and capital investment to rise 131.1% to ¥2,900mn, so both are expected to more than double.

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Outlook

FY3/24 forecast

(¥mn)

	FY3/23		FY3/24				Change (revised forecast)	
	Results	Share	Initial forecast	Share	Revised forecast	Share	% change	
Net sales	31,824		38,000		51,000		19,175	60.3%
Information System Segment	26,209	82.4%	33,000	86.8%	46,500	91.2%	20,290	77.4%
Amusement	5,639	17.7%	5,000	13.2%	4,500	8.8%	-1,139	-20.2%
Adjustment	-24	-	-	-	-	-	-	-
Gross profit	14,507	45.6%	-	-	23,800	46.7%	9,292	64.1%
SG&A expenses	10,487	33.0%	-	-	13,300	26.1%	2,812	26.8%
Operating income	4,019	12.6%	4,200	11.1%	10,500	20.6%	6,480	161.2%
Information System Segment	5,490	20.9%	5,900	17.9%	12,700	27.3%	7,219	131.3%
Amusement	140	2.5%	30	0.6%	-350	-7.8%	-490	-
Adjustment	-1,615	-	-1,730	-	-1,850	-	-234	-
Ordinary income	4,260	13.4%	4,350	11.4%	10,600	20.8%	6,339	148.8%
Net income attributable to owners of the parent	2,927	9.2%	3,000	7.9%	7,200	14.1%	4,272	145.9%

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

2. FISCO's view

In order to achieve the full-year forecast (after upward revisions), the Company needs second half net sales of ¥21,831mn and operating income of ¥2,600mn. Regarding the spread of smart pachislot machines at a high pace and the speed of the concomitant expansion of capital investment demand, while it is necessary to take a somewhat cautious view, 1) there is still room for expansion in the number of smart pachislot machines*, and hit models have increased, 2) hit models are emerging, too, for smart pachinko machines, which have been slow to spread, and 3) an increase in overall operations have increased the latitude of pachinko hall investment and the willingness to invest, etc., so FISCO believes that the Company's results forecasts are fully achievable. In particular, with regard to 2), a multitude of high models of smart pachinko machines have emerged, and by getting on top of this trend earlier than expected, it's possible that it will be a factor for beating forecasts. In judging the growth of the Company's results in FY3/25 and beyond, this can be understood as a key point to focus on. In this sense, an issue in the industry as a whole is how to differentiate from existing machines (with smart pachislot machines' functionality, gameplay, and production results, etc.), and it could be said the Company will play a large role. In February 2024, the Company is planning to hold an exhibition and what kind of value it will propose with its new showpiece products and the reaction they receive bear watching. In addition, in results for FY3/25, growth in smart pachislots could slow along with the rise in their installation ratio, and to that extent investment can be expected in smart pachinko machines, and also because the issue of paper money expected in 2024 will spur demand for replacement machines, FISCO believes that continued high growth is possible.

* We believe the ratio of smart pachislot machines to overall pachislot machines has the latitude to expand to around 40% for the time being (it was 23.8% as of September 30, 2023), and that this will be achieved in another year or two.

■ Medium-term management plan

Advancing the medium-term management plan for an era of smart gaming machines.

Aims to build the industry's only platform on a cloud server

Seeing a path to livelier conditions in the gaming market and pachinko hall capital investments as the switch to the new era of smart gaming machines emerges, the Company launched its medium-term management plan (three years) starting in FY3/23 and it is now in its second year. Based on the corporate philosophy of “we will continue to achieve sustainable growth consistently from now on through the creation of new value based on innovation,” the Company intends to redefine business domains as a way of addressing future changes in the market environment. Specifically, it outlined a strategy of capturing demand related to inroads from the spread of smart gaming machines, continuing promotion of AI hall computer X (Kai) uptake, and carrying on building the industry's only platform through rollout of business utilizing a cloud server (reinforcement of new MG Services).

1. Market environment

The gaming machine market and pachinko hall industry are anticipating the arrival of a new era accompanying full transition to machines that meet the new regulations and new rollout of smart gaming machines. The switch to smart gaming machines significantly affects fan growth and the format of hall management by broadening convenience and “game” aspects. In particular, manifestation of differences in customer draw by individual pachinko halls is accelerating the trend of industry reorganization driven by leading companies. The Company envisions a scenario of significant income expansion alongside advances in the shift to smart gaming machines as pachinko halls ramp up capital investments (including new site openings) for survival.

2. Priority measures (redefining business domains)

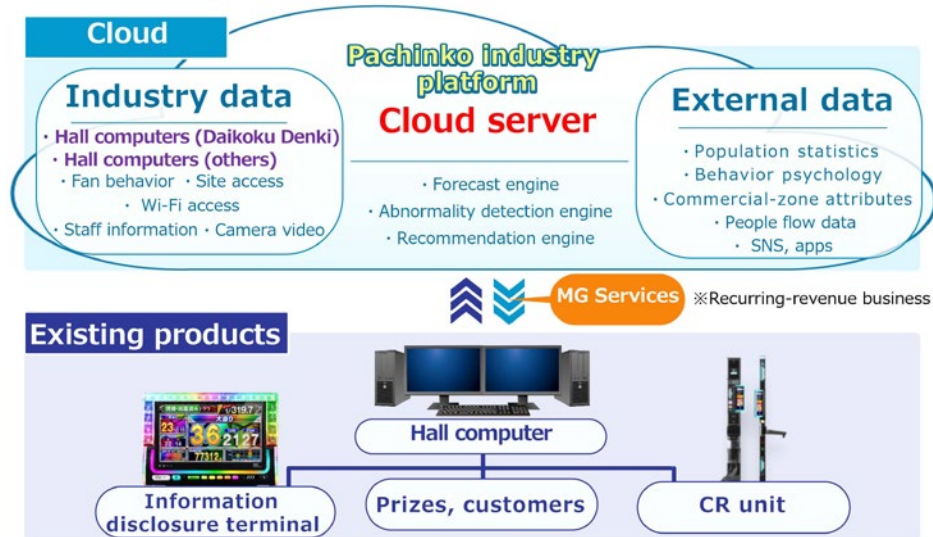
(1) Information System Segment

The centerpiece of the strategy is its aim to build the industry's only platform through reinforcement of new MG Services that apply a cloud server in anticipation of future market changes, and thereby lock in customers (primarily major hall operators) and effectively assist hall management and contribute to industry reforms. This requires continued promotion of AI hall computer X (Kai), provision of products and services that flexibly address machines that meet the smart gaming machines, further progression of labor and headcount savings, and improvement in the market shares of all products through timely launch of products that transform the way hall staff work and the strategy for attracting fans. It also involves launching a platform that consolidates and utilizes industry and external data on a cloud server* and raising stable income through reinforcement of new MG Services.

* The platform consolidates industry data (hall computers of Daikoku Denki and others, fan behavior, site access, Wi-Fi access, staff information, and surveillance video, etc.) and external data (population statistics, behavior psychology, trading area attributes, people flow data, and SNS and apps, etc.) on a cloud server, and effectively utilizes and analyzes it with engines focused on forecasting, abnormality detection, and recommendations, among other functions.

Medium-term management plan

Target image for FY3/25



Source: The Company's results briefing materials

(2) Amusement Segment

The Company advocates a policy of transitioning from “pachinko” to “smart pachislot” as the main business driver. It plans to further pursue consignments for comprehensive development of pachislot gaming machines that it started in 2H FY3/21. It is also working on developing its own brand of pachislot machines as a gaming machine manufacturer, targeting launches in FY3/25.

3. Investment plan

In the three-year investment plan, the Company intends to cumulatively spend ¥4.0bn in R&D expenses (¥2.8bn in the previous three years) and ¥6.2bn in capital investments (¥4.1bn in the previous three years), exceeding combined outlays in the previous three years. It also plans to mainly allocate R&D expenses to smart pachislot machines (Amusement Segment) and capital investments to server development (Information System Segment).

4. Numerical goals

The Company upwardly revised its numerical goals (announced in May 2023) as a reflection of the fact that 1) results in FY3/23, the first fiscal year of the Company's medium-term management plan, exceeded forecasts, 2) market activation from the introduction of smart gaming machines is happening at a quicker pace than expected, and 3) model replacement demand can be expected from the issue of a new Japanese bills (banknotes) scheduled for 2024. Specifically, the numerical goals for FY3/25, the final year of the plan, were raised for net sales from ¥34,000mn to ¥40,000mn and for operating income from ¥2,200mn to ¥4,500mn. (However, the revised forecast for FY3/24 is expected to exceed the plan by one year ahead of schedule, and is likely to be revised upward again.) What is characteristic is how the Company will work to raise the added value of its products and convert to an income structure pivoting on recurring revenue business via MG Services (to increase income) while also actively spending on R&D and making capital investments.

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Medium-term management plan

Medium-term management plan

	(¥mn)								
	FY3/22		FY3/23 (First year of the medium-term management plan)		FY3/24 (Second year of the medium-term management plan)		FY3/25 (Third year of the medium-term management plan)		Annual average growth rate (Three years)
	Results	Share	Results	Share	Revised forecast	Share	Revised forecast	Share	
Net sales	24,390		31,824		38,000		40,000		17.9%
Information System Segment	18,647	76.5%	26,209	82.4%	33,000	86.8%	-	-	-
Amusement	5,759	23.6%	5,639	17.7%	5,000	13.2%	-	-	-
Gross profit	10,143	41.6%	14,507	45.6%	15,200	40.0%	-	-	-
SG&A expenses	8,952	36.7%	10,487	33.0%	11,000	28.9%	-	-	-
Operating income	1,191	4.9%	4,019	12.6%	4,200	11.1%	4,500	11.3%	55.8%
Ordinary income	1,367	5.6%	4,260	13.4%	4,350	11.4%	4,650	11.6%	50.4%
Net income attributable to owners of the parent	1,228	5.0%	2,927	9.2%	3,000	7.9%	3,200	8.0%	37.6%

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

5. Medium- to long-term focus points

To reinforce MG Services premised on tapping into its strength in data for the arrival of a new era driven by smart gaming machines, FISCO agrees that the Company's strategy to advance from hall computers to business utilizing a cloud server makes sense to leverage its advantages. Furthermore, the platform business it targets is likely to reinforce the Company's overwhelming position by fueling a beneficial cycle (networking effect) wherein members are drawn to places with extensive data and data accumulates in places with more members. We also intend to focus on the extent of new value realized through innovation and sustainability initiatives as its exercise of leadership in the industry contributes substantially to its own continuation and the sustainability of the industry and society as an industry leader. Further, pachinko halls need to make considerable capital investments to introduce smart gaming machines, so industry reorganization will quickly accelerate and gameplay will evolve, and pachinko and pachislot fans, who have been decreasing, are expected to begin to recover, including by capturing new user types.* These sorts of structural changes will likely provide excellent opportunities for the Company to expand its share and raise its profitability. Accordingly, how much of a central role it will play toward activating the industry will be an important point with respect to accelerating its own growth. In working to capture new earnings sources and engage in risk disbursement, M&A and business alliances aimed at entering different sectors will also be worth watching.

* According to the Japan Productivity Center's "Leisure White Paper 2023," provided in documents submitted by the Company, the population participating in pachinko, which has been decreasing, began rising again in 2021 at 7.2 million after 7.1 million in 2020 and was 7.7 million in 2022, so two consecutive years of increases. (Japan Productivity Center's "Leisure White Paper 2023").

Industry environment

The industry overall faces a difficult environment, but it is entering a new era with demand for replacing gaming machines, and there are signs the market is activated

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. Furthermore, promulgation of "new regulations" on September 2017 fueled pessimistic views of the industry and uncertainty about the future. This disarray persisted for a while, and additional impact by COVID-19 (temporary hall closures and shorter operating hours) since the start of 2020 accelerated the harsh environment.

In 2021, however, the market was enlivened by replacement demand for gaming machines, driven by progress in gradually replacing gaming machines with those meeting the new regulations ahead of the deadline at the end of January 2022, in contrast with the emergence of several popular gaming machine models with new amusement features (such as "play time"*) following revisions to the Criteria for Interpretation of Technological Standards adopted in January 2020, and in accordance with related Nikkoso internal stipulations. In addition, the phased introduction of smart gaming machines started in November 2022 and the gaming machine market and pachinko hall industry are approaching a new era, with attention focusing on the deployment of smart gaming machines going forward.

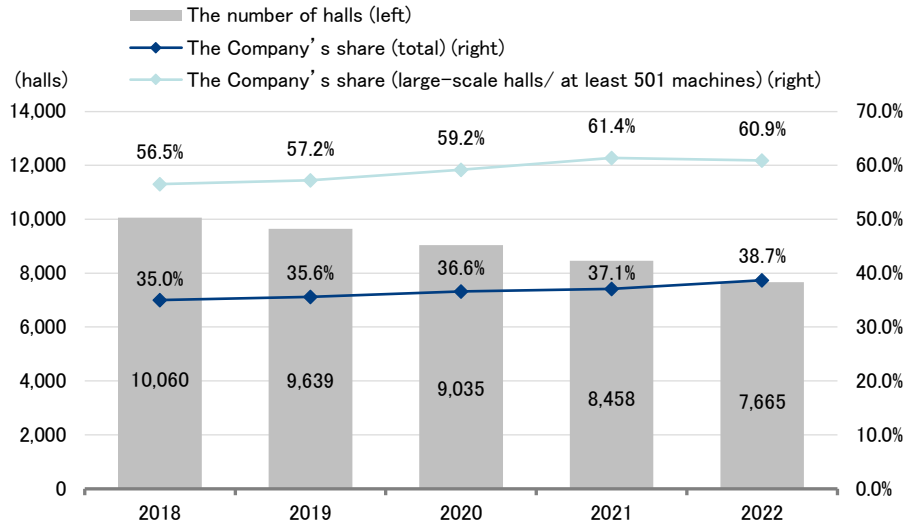
* "Play time" is a system (rescue measure) whereby the machine enters a shortened time mode (a function that efficiently rotates balls without reducing the number of balls up to a certain number of times) if the player does not have a big win in a specified number of rotations during normal play (low probability). With the 2020 industry regulations, new functions such as "play time" have been added, and the breadth of game features of game machines was expanded.

According to surveys by the National Police Agency, the number of pachinko halls in Japan declined at an average annual rate of 4.8% over 10 years from 2013 to 2022. In particular, in recent years there has been a noticeable decline in new hall openings due to the impact of the new regulations and other factors. However, at the end of December 2022, the number of halls was 7,665 (down 793 YoY), and the Company share of hall computer customers rose to 38.7% continuing the trend to increase year by year. Its customer halls are often high-end, large pachinko halls that are the top performers in their respective local markets and 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 new smart gaming machines, 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 60.9%.

Industry environment

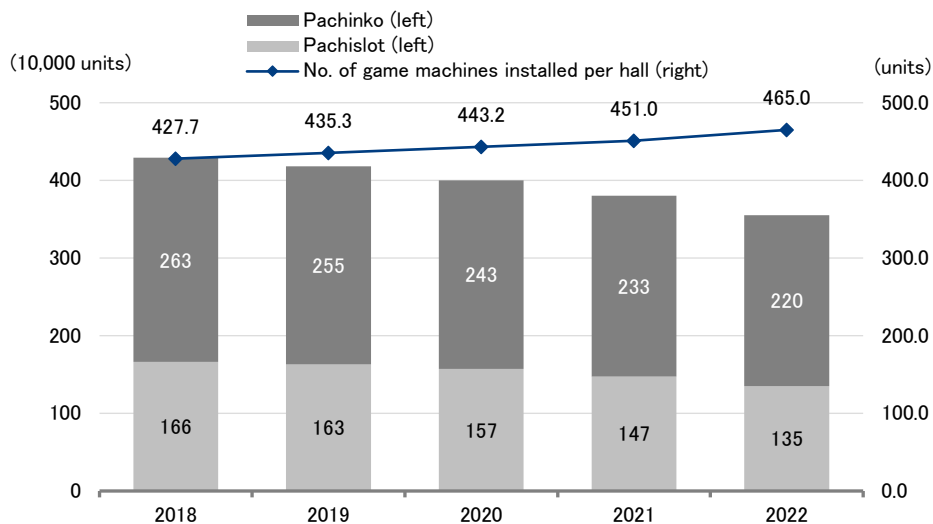
Trends in the number of halls and the Company's share of the hall computer



Source: Prepared by FISCO from the Current State of Amusement and Entertainment Business, etc., and State of Control of Offenses Related to Amusement and Entertainment Business, etc. 2022 by the Safety Division of the Community Safety Bureau, the National Police Agency, and the Company's results briefing materials

Although the number of game machines installed and running in the market is on a downward trend, 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 a main segment, therefore this trend should benefit the Company with its ability to realize robust investment return through advanced functionality and added value.

Trends in the number of installed units in the gaming machine market



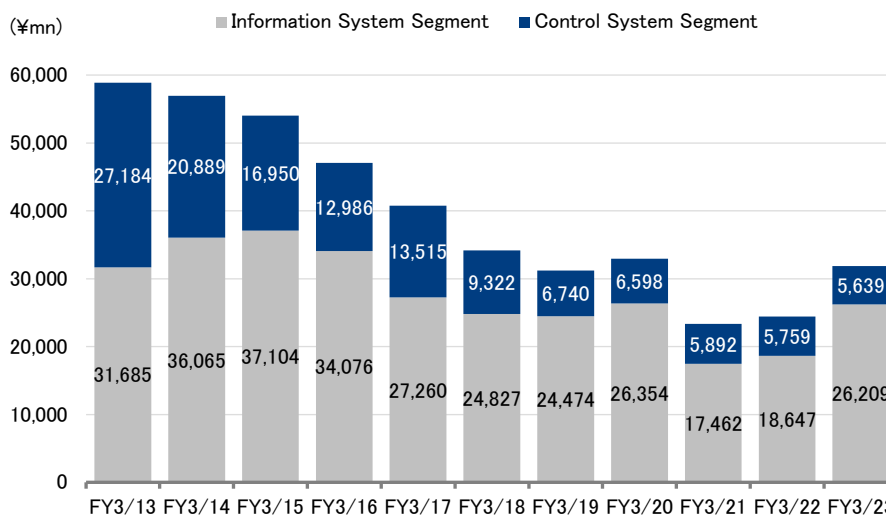
Source: Prepared by FISCO from the Current State of Amusement and Entertainment Business, etc., and State of Control of Offenses Related to Amusement and Entertainment Business, etc. 2022 by the Safety Division of the Community Safety Bureau, the National Police Agency, and the Company's results briefing materials

■ Performance over the past fiscal years

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 based on earnings recovery and expansion through the emergence of smart gaming machines

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 three 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. However, in FY3/23, in addition to the recovery from the pandemic, the market environment changed with the introduction of smart pachislot machines in November 2022, and with this the Company's results have been recovering and expanding pivoting on the Information System Segment.

Net sales by segment

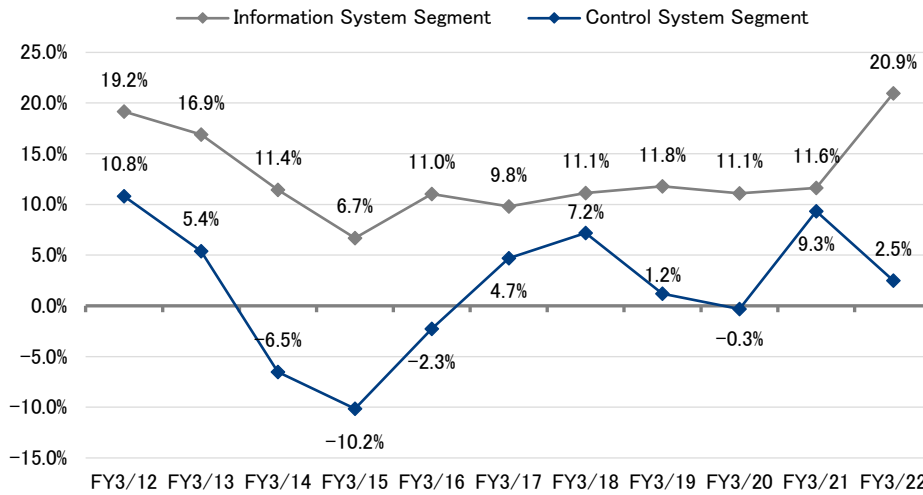


Source: Prepared by FISCO from the Company's financial results

The Information System Segment has become the source of profits, and has maintained high profit margins. Margins fell from FY3/14 to FY3/16 due in part to an increase in R&D expenses for next-generation products. During the period from FY3/18 to FY3/22, these expenses ran their course, but a slump in net sales and other factors prevented the profit margin from returning to its previous high level. In FY3/23, however, the profit margin of the Information System Segment improved greatly thanks to a recovery in net sales and increased sales of high added-value products. The Company is also steadily converting to a recurring revenue business model through the growth of its MG Services, and this is also a factor underpinning profit.

Performance over the past fiscal years

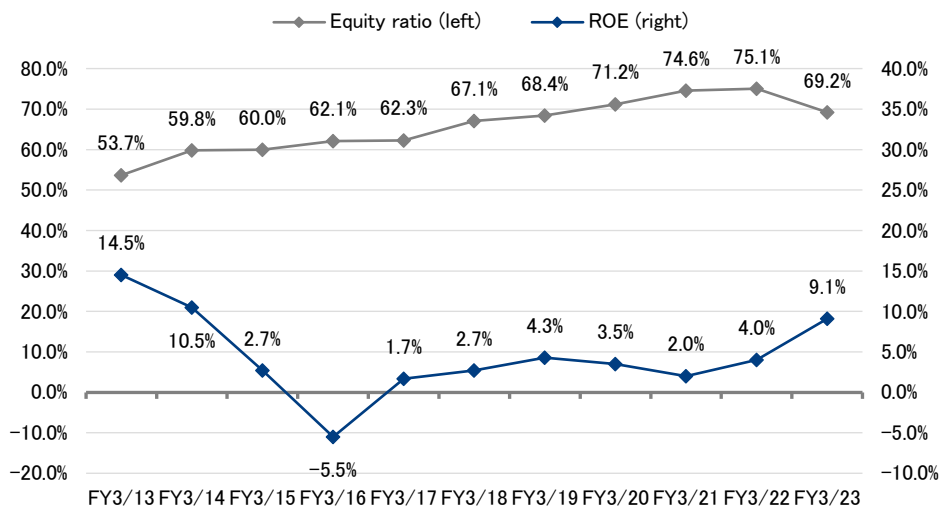
Operating income margin by segment



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

In terms of financial indicators, the Company's equity ratio, a measure of financial stability, has risen, reflecting an accumulation of retained earnings, etc. In FY3/23, the Company maintained its equity ratio at a high level of 69.2% despite a slight decrease as assets such as accounts receivable – trade increased due to the rapid expansion of net sales. The current ratio, which indicates the ability to make payments in the short term, was around 240%, mainly due to large holdings of cash and deposits, as the Company's robust financial base can be said to be a strength 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. In FY3/23, however, profit recovered and ROE also improved greatly.

Equity ratio and ROE



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

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Initiatives in sustainability

Announced its sustainability policy aiming to realize a sustainable society and aim for Group growth

To pursue the Group’s own growth and realize a sustainable society through business activities based on its corporate philosophy of “we will continue to achieve sustainable growth consistently from now on through the creation of new value based on innovation,” the Company again resolved at the Board of Directors matters pertaining to the sustainability policy and identification of materiality (important issues) and disclosed the information (March 2022). The Company is advancing specific initiatives in line with materiality, including raising awareness through games to check gambling addiction, holding parent-child programming experience classes, promoting telecommuting and other workstyle reforms as well as human resource engagement, and installing solar panels. It has also established the Sustainability Committee as part of its building of frameworks to promote sustainability activities in a continuous and organized manner, and is disclosing information regarding climate change based on the Task Force on Climate-related Financial Disclosures (TCFD) recommendations. In December 2022, the Company achieved a high, “B-” management level rating for its climate control efforts from the CDP, an international non-profit organization headquartered in London, England that evaluates and certifies companies and other entities’ environmental-related strategies, initiatives, and so forth.

Initiatives in sustainability

<p>Corporate philosophy</p> <p>Sustainability Policy</p>	<p>We will continue to achieves sustainable growth consistently from now on through the creation of new value based on innovation</p> <p>The Daikoku Denki Group solves social issues through business activities based on its management philosophy, and will aim for the realization of a sustainable society and the growth of the group together with stakeholders.</p>
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ESG	Materialities	SDGs
E	Contributions to the global environment	
S	Promotion of activities by human resources	
	Provision of solutions based on innovation	
G	Handling of addiction	
	Strengthening of governance and compliance	

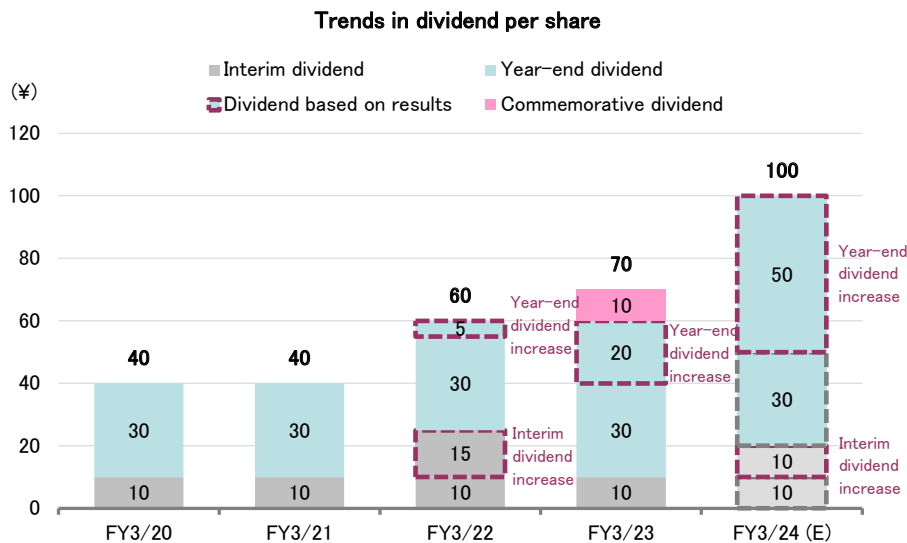
Source: The Company's results briefing materials

Shareholder returns

The Company has upwardly revised its dividend forecast for FY3/24, planning an annual dividend of ¥100 per share (¥20 interim dividend already paid and ¥80 year-end dividend)

The Company’s policy is to maintain a stable dividend and to provide a special dividend depending on its business results. Regarding FY3/24, with results forecasts being upwardly revised, the dividend forecast was also raised. The year-end dividend was revised from ¥30 to ¥80 and the annual dividend per share is scheduled to rise by ¥30 to ¥100 (¥20 interim, ¥80 year-end). FISCO believes there is a sufficient likelihood that the dividend will be increased with profit growth going forward.

Additionally, the Company resumed the shareholder benefit program, which seeks to enhance the investment appeal of its stock and promote medium- to long-term ownership, in FY3/22. The benefit program gives QUO cards to shareholders with the value calibrated to the number of shares owned and the period of sustained ownership at the end of September each year.



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



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