

DYNAM JAPAN HOLDINGS

06889

Hong Kong Stock Exchange

5-Jul.-2022

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FISCO Ltd.

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

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Summary

Expectations of medium-term growth through market share expansion amid the ongoing weeding out of the pachinko hall industry

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

1. In FY3/22 results, returned to increase in profit for first time in two years

In FY3/22 consolidated results, revenue increased 6.6% year on year (YoY) to ¥105,141mn, while operating profit rose 58.4% YoY to ¥10,654mn, securing increased revenue and profit during the COVID-19 pandemic. The main factor behind the increase in revenue was that the Company did not close halls in the pachinko business as it had in April and May 2020 following the government's declaration of a state of emergency, resulting in an increase in the number of days of operation. However, despite a record high number of COVID-19 cases in 4Q, there was no impact on the operation rate. Meanwhile, the Company reduced business expenses by 2.7% YoY, as it worked to reduce personnel costs by making changes to hall operations, and there was a change* in accounting treatment. With this, operating profit increased significantly.

* Due to the fact that the average useful life of pachinko and pachislot machines exceeds two years, the Company changed from booking the cost as a lump sum when purchasing a machine costing ¥0.1mn or more to booking the machine as an asset and depreciating it over two years using the straight-line method. As a result, machine-related costs including depreciation declined ¥586mn YoY to ¥15,903mn.

2. FY 3/23 business strategy

For FY3/23 results, the Company's policy is to focus on the recovery in the number of customers in the pachinko business as its top priority issue. Although the Company has built up a tolerance toward COVID-19, the number of customers is still at about 80% of pre-pandemic levels, and senior customers in particular have not been recovered. To bring back the number of customers to pre-pandemic levels, the Company plans to improve the quality of its services and strengthen customer attraction capabilities by making pachinko halls into comfortable leisure spaces. Meanwhile, operating expenses are expected to increase YoY due to the increase in depreciation of pachinko and pachislot machines and the near completion of initiatives to reduce expenses at halls. Furthermore, the machine industry will start introducing smart pachislot machines from November 2022 and smart pachinko machines from January 2023. These machines will be more game-oriented than conventional machines and aid in the prevention of spreading infections, so they are attracting attention as an effort to energize the entire industry.

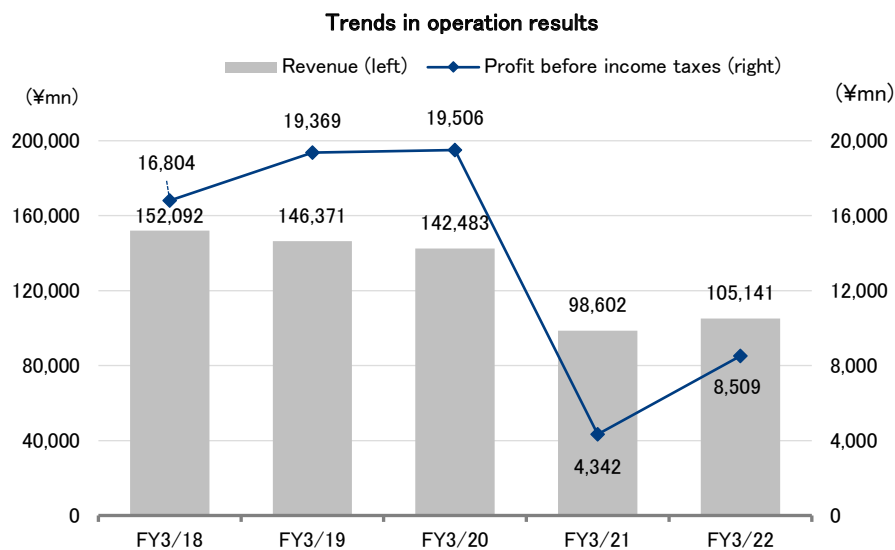
Summary

3. Pachinko business growth strategy

With the aim of achieving growth in the pachinko business, the Company will work on five different fronts: multiple-hall development, low playing cost operations, product development, data-driven approach, and cost management. The Company will take a wait-and-see approach to multiple-hall development as the industry continues to face headwinds, but will resume when halls return to profitability. While the Company is the industry leader in terms of the number of halls, its market share is around 5%, and there is considerable room for growth. It will work to bolster hall profitability by raising operational efficiency by standardizing operations, increasing the ratio of private-brand machines, and advancing a strategy of putting in place pachinko and pachislot machines using a data-driven process, along with other measures. It also has a positive approach toward moving ahead with installation of smart pachislot and pachinko. At FISCO, we think that over the next couple of years the elimination and consolidation process in the pachinko hall industry will gain more steam, and the companies that survive will have a road towards growth open up to them through an increase in market share.

Key Points

- In FY3/22, returned to increased revenue and profit for first time in two years due increased revenue from the increase in the number of operating days and cost management
- In FY3/23, the policy is to cover burden of increased depreciation of pachinko and pachislot machines through greater revenue from larger number of customers to ensure profits
- Possibility of increasing market share with the start of introductions of smart pachislot and smart pachinko



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

■ Company profile

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

1. History

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

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

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

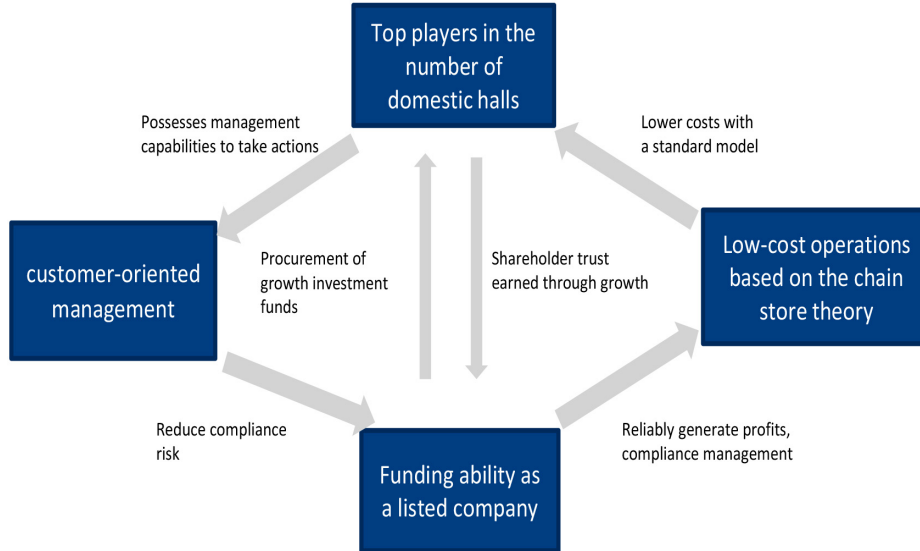
Established a robust management foundation that leverages four strengths, differentiates itself from other companies

2. DYNAM JAPAN HOLDINGS Group's features and strengths

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

Company profile

Relationship among the four strengths of the Dynam Japan Holdings Group

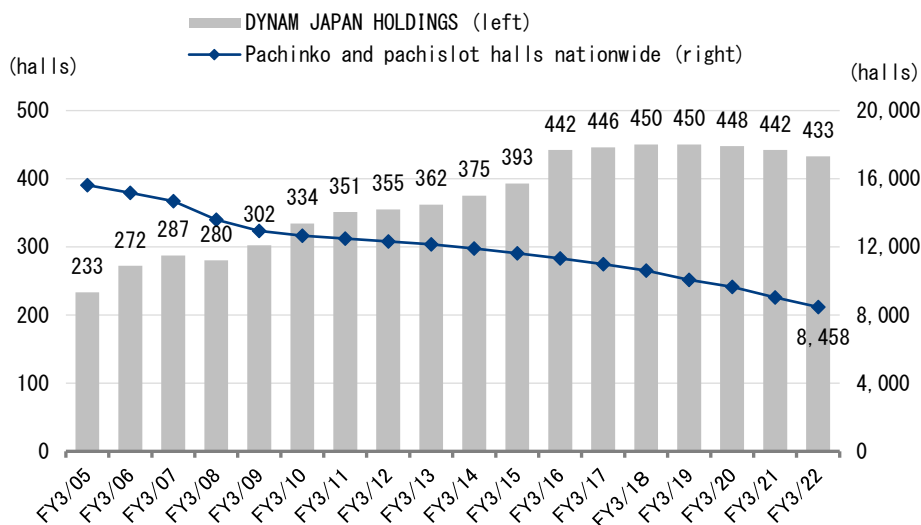


Source: Prepared by FISCO from interviews

(1) Domestic leader with 433 group halls

The Company is the domestic leader with 433 group halls (as of the end of March 2022). While it is not possible to make precise comparisons due to differences in compilation timing, its domestic shares for the number of halls and machine installations are both at around 5%. Its market share exceeded 1% in 2003, and since then it has increased its number of halls, including through M&A, and maintained its market share amid the decrease in the overall number of halls in the industry. Since FY3/20, the number of halls has been declining slightly, partially due to the deterioration in the industry environment because of the COVID-19 pandemic, but the Company’s market share has been steadily expanding.

Trend in number of group halls



Source: Prepared by FISCO from the Company’s financial statements announcement and the National Police Agency’s “Current Situation with Amusement and Entertainment Business and Situation with Policing Amusement and Entertainment-related Crime, etc. in 2021”

We encourage readers to review our complete legal statement on “Disclaimer” page.

Company profile

In promoting multi-hall operations, the Group uses a standardized format when opening stores and mainly focuses on large population centers in rural areas (commercial areas with populations of 30,000 to 50,000 people) where rents can be kept down. By increasing the number of halls and leveraging economies of scale, the Company is able to keep down the costs for purchasing pachinko and pachislot machines, prizes, and other items. The large number of halls means it buys more machines, and thus has stronger buying power with amusement equipment manufacturers. The Company also proactively develops and deploys private-brand machines*, and realizes economies of scale in this respect as well. Furthermore, it has established logistics centers that cover around 30 halls in 16 locations nationwide, and is curbing machine costs (costs related to purchasing amusement machines) and reducing logistics costs by having halls flexibly lend machine models to one another. In doing so, the Company is managing halls in an agile manner, including adjusting machine model lineups according to customer needs, and it has built a system enabling it to both increase the number of customers and reduce costs.

* As of the end of March 2022, 15.2% of its installed pachinko machines were private-brand machines (DYNAM standalone basis)

(2) Chain store theory

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

Costs of machines and personnel constitute a large portion of the total cost of operating a pachinko hall. In addition to direct cost cutbacks, the Company is deploying hall designs and hall operating systems (such as ball counters at each machine) that facilitate operations with a small number of employees and standardizing new halls. The chain store theory plays an important role in a variety of ways and is enabling low-cost operations for the Group overall.

The Company is the industry leader in Japan, as mentioned earlier, with 433 halls. Aggressive hall network expansion supports this position, but the driving force of the chain store theory know-how has been an essential enabler. Hall network expansion has created a virtuous cycle of cost reductions through economies of scale that has put the Company in its strong position. We think the customer-oriented management explained below is an outcrop from the chain store theory as well.

(3) Implementing management from a customer perspective

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

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

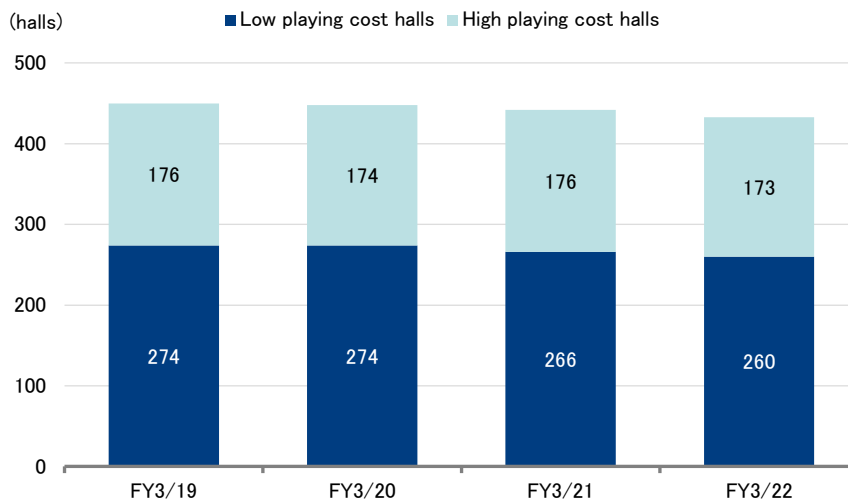
a) Low playing cost operations

Pachinko is a game played with rented balls, and low playing cost operations refer to a format in which ball rental fees has been lowered to ¥1 or ¥2 per ball, which is cheaper than the standard price of ¥4. Customers can rent more balls for the same amount, extending their playing time in accordance with the additional balls. For the Company, whose goal is for everyone to be able to easily enjoy pachinko as part of the infrastructure of a region, it can be said that increasing low playing cost halls is a rational measure.

Company profile

At the end of March 2022, the Company had 260 low playing cost halls, which is 60.0% of its total halls. From FY3/21 onward, the Company continued closing unprofitable halls during the COVID-19 pandemic due to a decrease in the number of customers in the elderly demographic, which is the main target, but it has seen a recovery in this number, and therefore has made no changes to its plans to increase the ratio of low playing cost halls over the medium to long term. Continuing this strategy requires considerable company wherewithal, and the strategy for this lies in multiple-hall development and low-cost operations.

Number of low playing cost halls and high playing cost halls



Source: Prepared by FISCO based on the Company's annual report, news releases and materials provided by the Company

b) Operations that do not rely on gambling appeal

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

However, based on the strengthening of measures to address gambling addiction and related issues, the regulatory authorities have been revising the regulations in stages in order to suppress the gambling aspect, and the current situation is that a style of managing pachinko halls by attracting customers through "selling" gambling is coming to an end. The Company, meanwhile, has a lower ratio of gambling-type machines than the industry average, and conversely its share of machines with the lowest gambling features at 1/100 probability is 20 percentage points higher than the industry average. It cannot avoid the impact of stricter regulations on gambling appeal, but given the fact that it has been working on sales operations that do not rely on gambling appeal for some time now, we at FISCO feel that the negative impact on the Company will be comparatively minor.

Company profile

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

The Company became the first in the pachinko hall industry to list its shares with its IPO on the Hong Kong Stock Exchange in 2012. Only three companies, including the Company, out of the pachinko hall industry's roughly 2,500 companies are listed on stock markets as of the end of March 2022. The industry is projected to face realignment going forward. An important point for a buyer in this environment is obviously whether it has fund-raising capabilities. The Company capitalized on its strength as a listed company to acquire Yume Corporation in November 2015 through a stock swap for all of its shares. With respect to the demand for funds due not only to M&A but also investment in halls and new business development, the advantage of being a listed company is significant and will likely work in its favor in terms of procuring funds.

FY3/22 results conditions

In FY3/22, returned to increased revenue and profit for first time in two years due increased revenue from the increase in the number of operating days and cost management

1. Summary of FY3/22 consolidated results

In the FY3/22 consolidated results, revenue and profit rebounded. Revenue increased 6.6% to ¥105,141mn, operating profit rose 58.4% to ¥10,654mn, profit before income taxes increased 96.0% to ¥8,509mn, and net profit rose 111.7% to ¥4,977mn. Still, the number of customers did not fully recover, and results remain at a low level compared to before the COVID-19 pandemic (revenue was ¥142,483mn and operating profit was ¥21,514mn in FY3/20).

Summary of FY3/22 consolidated results

	FY3/21		FY3/22		Remark
	Results	Results	YoY	Change	
Revenue	98,602	105,141	6.6%	6,539	
Revenue from pachinko business	97,141	103,588	6.6%	6,447	High playing cost halls 51,293 (+3,638), low playing cost halls 52,295 (+2,809)
Revenue from aircraft leasing business	1,461	1,553	6.3%	92	3 aircraft continue to be leased
Operating expenses	97,564	94,911	-2.7%	-2,653	
Pachinko business expenses	96,673	93,950	-2.8%	-2,723	Machine costs -13,260, depreciation of pachinko and pachislot machines +12,674, personnel costs -1,746
Aircraft leasing business expenses	891	961	7.9%	70	Personnel costs
SG&A expenses	4,340	4,279	-1.4%	-61	
Other income	11,561	9,114	-21.2%	-2,447	Vending machine fee income +101, Employment adjustment subsidy, etc. from the government -3,088
Other operating expenses	1,531	4,411	188.1%	2,880	Impairment loss on fixed assets +2,215
Operating profit	6,728	10,654	58.4%	3,926	
Financial income	286	426	49.0%	140	
Financial expenses	2,672	2,571	-3.8%	-101	
Profit before income taxes	4,342	8,509	96.0%	4,167	
Pachinko business	9,878	13,113	32.7%	3,235	
Aircraft leasing business	224	252	12.5%	28	
Company-wide expenses	5,760	4,856	-15.7%	-904	
Tax expenses	1,991	3,532	77.4%	1,541	
Net profit	2,351	4,977	111.7%	2,626	
EBITDA	16,781	19,709	17.4%	2,928	

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

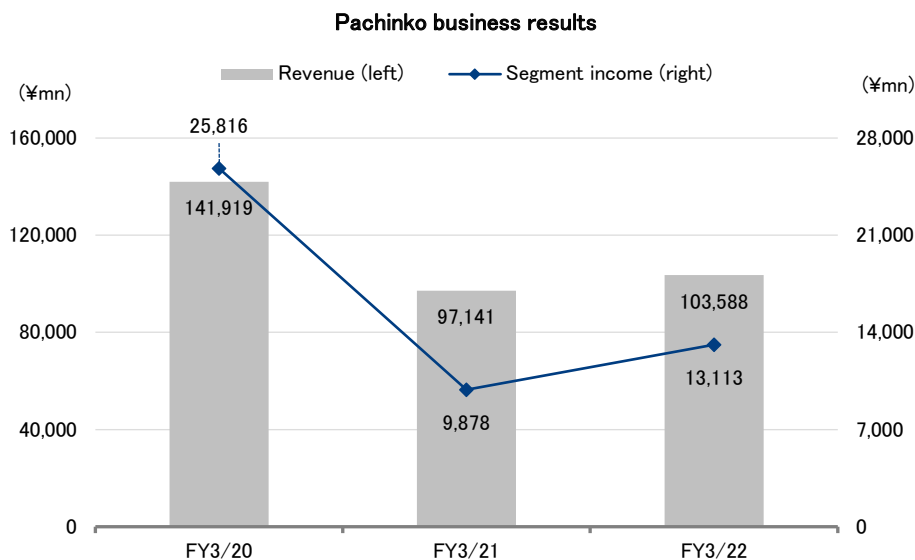
FY3/22 results conditions

With respect to revenue, a factor behind the increase in revenue in the pachinko business was the increase in the number of operating days as the entire industry did not close halls as it had in April and May 2020 in response to the Japanese government's declaration of a state of emergency. In addition to the effect of increased revenue, a factor in increasing operating income was a 2.7% YoY reduction in operating expenses. Looking at the factors behind the decrease in operating expenses, the main factors were a ¥1,746mn decrease in hall personnel costs in the pachinko business, and a combined ¥586mn decrease in machine purchases and depreciation. In other income, vending machine fee income increased by ¥101mn due to the recovery in the number of operating days at halls, while the employment adjustment subsidy, etc. from the government due to the COVID-19 pandemic decreased by ¥3,088mn. In other expenses, the Company booked hall-related impairment losses of ¥2,215mn. The number of employees at the end of FY3/22 was 13,420, a YoY decrease of 2,684 people.

(1) Pachinko business

In the pachinko business, revenue increased 6.6% YoY to ¥103,588mn, while segment profit rose 32.7% to ¥13,113mn, returning to increased revenue and profit. Of revenue, revenue from high playing cost halls increased 7.6% to ¥51,293mn, while revenue from low playing cost halls rose 5.7% to ¥52,295mn, as the recovery in low playing cost halls was comparatively tepid. The main factor for this is believed to have been the fact that elderly customers, who tend to visit low playing cost halls, were more hesitant to return to halls amid the ongoing pandemic and the closure of unprofitable halls moved ahead.

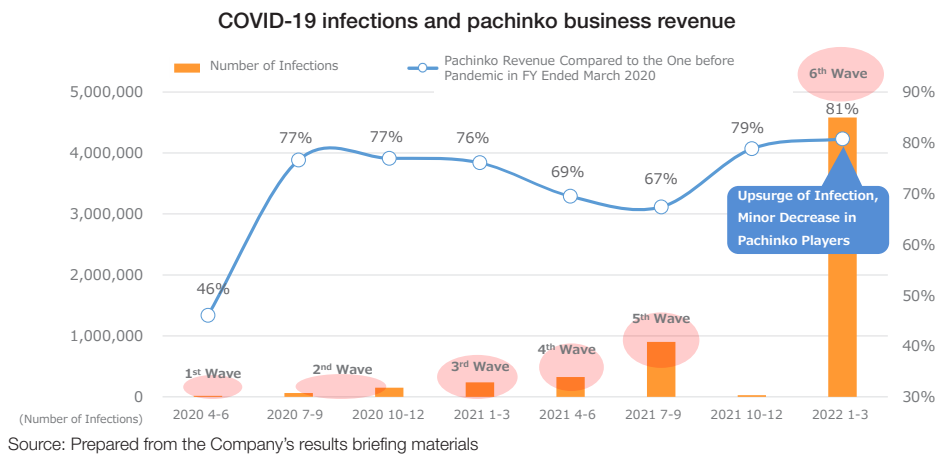
According to the Company's member data, the rate of return of customers by age group from before the pandemic (February 2019) to since the pandemic (September 2021) is 80.8% for members age 20-29 and approximately 75% for members age 30-69, but only 71.9% (the lowest) for members age 70-79 and the trend appeared to have continued in 2H. The number of halls decreased by 9 compared to March 31, 2021, falling to 433 halls.



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

Meanwhile, a positive sign is that the Company has established a system to continue hall operations while living with COVID-19 by implement rigorous infection control measures and improving services to work recovering customer traffic even in the COVID-19 pandemic. COVID-19 infections hit a record high in Q4 FY3/22 and the Company faced stronger headwinds due to factors such as state of emergency declarations in major cities, but the impact on pachinko business revenue was negligible.

FY3/22 results conditions



In FY3/22, in conjunction with the revised Act on Control and Improvement of Amusement Business, etc., the Company must, by January 31, 2022, replace its pachinko machines and pachislot machines with machines complying with the new regulations that limit gambling appeal, so more machines are being replaced than in a normal year. At the end of January 2021, approximately 51% of installed machines, or 105,000 machines, were under the former regulations. All of these machines needed to be either replaced with machines complying with the new regulations, or simply removed, by the end of January 2022. As a result, purchase costs increased significantly YoY from ¥16.4bn to over ¥40bn, but due to the change in accounting for expenses based on two-year depreciation as mentioned above, ¥15.9bn was recorded as expenses including depreciation and ¥28.9bn of undepreciated amount was recorded as property, plant and equipment.

Looking at other major changes in operating expenses, they included a ¥1,746mn decrease in hall personnel costs through the implementation of hall operation reforms, a ¥621mn decrease in depreciation of right-of-use assets (land rent), and a ¥695mn decrease in cleaning expenses. Meanwhile, advertising expenses increased by ¥1,056mn due partly to the resumption of measures to attract customers and an increase in the number of machine replacements, while repair expenses increased by ¥530mn and utilities expenses increased by ¥429mn, resulting in a ¥2,723mn decrease in total business expenses. Despite a decrease in the employment adjustment subsidy from the government, etc. and booking of impairment losses, segment income increased by ¥3,235mn due to higher operating revenue and lower operating expenses.

Looking at the results for DYNAM Co., Ltd., which is the Group's core company, revenue increased 7.4% YoY to ¥97,730mn, while operating profit was ¥5,745mn (compared to an operating loss of ¥2,521mn in the same period of the previous fiscal year). The employment adjustment subsidy, etc. from the government booked in non-operating profit declined, but ordinary profit increased 161.7% YoY to ¥8,749mn and net profit increased 174.5% to ¥4,892mn.

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FY3/22 results conditions

DYNAM's results (using Japanese accounting standards)

	FY3/21		FY3/22		Summary
	Results	Results	YoY	Change	
Revenue	90,993	97,730	7.4%	6,737	Amusement business revenue +6,633, vending machine fee income +104
Total expenses	93,515	91,984	-1.6%	-1,531	
Machine costs	14,719	14,527	-1.3%	-192	Switched from lump-sum cost accounting to two-year depreciation
Personnel costs	38,084	36,428	-4.3%	-1,656	Control of part-time employee personnel costs
Other costs	40,712	41,029	0.8%	317	Increase in capital investment for advertising expenses and to improve the gaming environment
Operating profit	-2,521	5,745	-	8,266	
Ordinary profit	3,343	8,749	161.7%	5,406	Decrease in the employment adjustment subsidy, etc. from the government
Extraordinary profit	1	0	-	-1	
Extraordinary loss	384	1,276	232.3%	892	Recorded an impairment loss in property, plant and equipment
Net profit	1,782	4,892	174.5%	3,110	
[Main KPIs (key performance indicators)]					
No. of halls	401	396		-5	Closed 2 halls in Gunma Prefecture and 1 each in Ehime, Tochigi and Miyazaki prefectures
Pachinko machine operating rate*1	28.2%	29.9%		1.8pt	Gap with competitors +3.0pt*2
Slot machine operating rate*1	27.0%	24.1%		-2.8pt	Gap with competitors -1.8pt*2
No. of machines	187,843	185,971	-1.0%	-1,872	Installed machine share 4.9%
Number of private-brand machines	16,742	19,840	18.5%	3,098	Private-brand machine installation rate 15.2% (difference from previous period: +2.5pt)*3

*1 Operating rate: The average number of customers/installed machines at peak times (average at 3 p.m. and 7 p.m.) from April 1, 2021 to March 31, 2022

*2 Figures for competitors are calculated based on customer count surveys conducted at 1,200 halls located near DYNAM halls nationwide

*3 Installation ratio is the ratio of all installed pachinko machines

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

As of March 31, 2022, the Group had 396 halls, a decline of 5 halls from March 31, 2021, and the number of installed machines also declined slightly by 1.0% to 185,971 machines. However, the number of private-brand machines increased 18.5% to 19,840 machines, as the Company raised the ratio of private-brand machines purchased as a way to manage costs. The machine operating rate for pachinko machines rose 1.8pp YoY, but the operating rate for pachislot machines declined 2.8pp, suggesting the impact on the operating rate of a lack of a hit pachislot machine.

(2) Aircraft leasing business

In the aircraft leasing business, revenue increased 6.3% YoY to ¥1,553mn, while segment profit rose 12.5% to ¥252mn. The Company has limited its scope of business to narrow-body aircraft, which are highly liquid and for which demand is expected to be stable. It is continuing the leases of three aircraft purchased in FY3/20, and revenue and profits increased due to the depreciation of the yen against the U.S. dollar. The fleet value for the three aircraft is ¥17,000mn, and the annualized gross rate of return was 8.8%.

Results for aircraft lease contracts (as of March 2022)

Leasing party	Contract period	Model	Fleet value	Average age	Average remaining lease period	Annualized gross rate of return
Vueling Airlines (Spain)	July 2019	Airbus A320				
IndiGo (India)	October 2019	Airbus A320N	¥17,000mn	3.1 years	3.6 years	8.8%
IndiGo (India)	February 2020	Airbus A321N				

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

FY3/22 results conditions

Capital ratio increased despite increase in interest-bearing debt to meet capital demand for the purchase of pachinko and pachislot machines, etc.

2. Financial condition

At the end of FY3/22, total assets decreased ¥7,652mn compared to the end of the previous fiscal period to ¥293,421mn. The main factor for the change was the ¥18,153mn decline in cash and deposits to ¥56,508mn, mainly due to the purchase of non-current assets centered on pachinko and pachislot machines and payment of income tax payable. Right-of-use assets, deferred tax assets, and stock holdings decreased by ¥3,687mn, ¥2,448mn and ¥1,150 million yen, respectively, while recording amusement machines as a fixed asset of ¥28,958mn was a factor in the increase.

Total liabilities decreased ¥6,662mn compared to the end of the previous fiscal period to ¥162,439mn. This was mainly due to borrowing from a financial institution to meet the capital demand for the purchase of pachinko and pachislot machines, etc., and an increase of ¥9,174mn in interest-bearing debt, despite decreases of ¥5,371mn in income tax payable, ¥7,685mn in trade and other payables, and ¥2,677mn in lease liabilities, respectively.

Total equity decreased ¥990mn compared to the end of the previous fiscal period to ¥130,982mn. Retained earnings increased by ¥1,736mn due to recording ¥4,997mn in net profit and ¥3,261mn in dividend payments. Capital reserve decreased ¥3,152mn due to conducting a share buyback. In FY3/22, the Company acquired 30,135,800 shares of treasury share (approximately 4.0% of outstanding shares), of which 29,838,400 was retired, and as of the end of FY3/22 held 297,400 shares of treasury share.

The capital ratio increased slightly from 43.8% at the end of FY3/21 to 44.6% due to the decrease in liabilities. However, net cash (cash and deposits - interest-bearing debt) is still in a downward trend at ¥13,367mn, a decrease of ¥27,327mn from the end of the previous year and showing that the Company's financial position yet to enter a recovery phase. The cause of this was a significant increase in the purchase of new machines as replacements accompanying the introduction of new regulations in FY3/22. Actually, there was a negative free cash flow of ¥10,291mn as cash flow from operating activities was ¥32,719mn and cash flow from investing activities was ¥43,010mn. However, the net cash situation is expected to improve in FY3/23 if operating revenue remains steady, as the number of machines purchased is forecast to decrease.

Consolidated financial condition

	End-FY3/21	End-FY3/22	Change	Change items
Total assets	301,073	293,421	-7,652	
(cash and cash equivalents)	74,661	56,508	-18,153	Cash and cash equivalents (-18,153), booked as property, plant and equipment for pachinko and pachislot machines (+28,958), right-of-use assets (-3,687), deferred tax assets (-2,448), stock holdings (-1,150)
Total liabilities	169,101	162,439	-6,662	
(interest-bearing debt)	33,967	43,141	9,174	Interest-bearing debt (+9,174), lease liabilities (-2,677), income tax payable (-5,371), trade and other payables (-7,685)
Total equity	131,972	130,982	-990	
(Capital ratio)	43.8%	44.6%	0.8pt	Net profit (4,997), dividend payments (-3,261), acquisition and retirement of treasury shares (-35), other comprehensive income (461)
(Net cash)	40,694	13,367	-27,327	

Source: Prepared by FISCO from the Company's financial statements announcement, results briefing materials and materials provided by the Company

FY3/22 results conditions

Cash flow statement

	FY3/21	FY3/22	Details
Cash flow from operating activities	29,441	32,719	Profit before income taxes (8,509), depreciation (21,859), income taxes paid (-3,756)
Cash flow from investing activities	-1,188	-43,010	Payments for property, plant and equipment (-42,940)
Free cash flows	28,253	-10,291	
Cash flow from financing activities	4,457	-8,565	Dividends paid (-3,261), payments for acquisition of treasury stock (-3,187)
Cash and cash equivalents	74,661	56,508	

Source: Prepared by FISCO from the Company's financial statements announcement, results briefing materials and materials provided by the Company

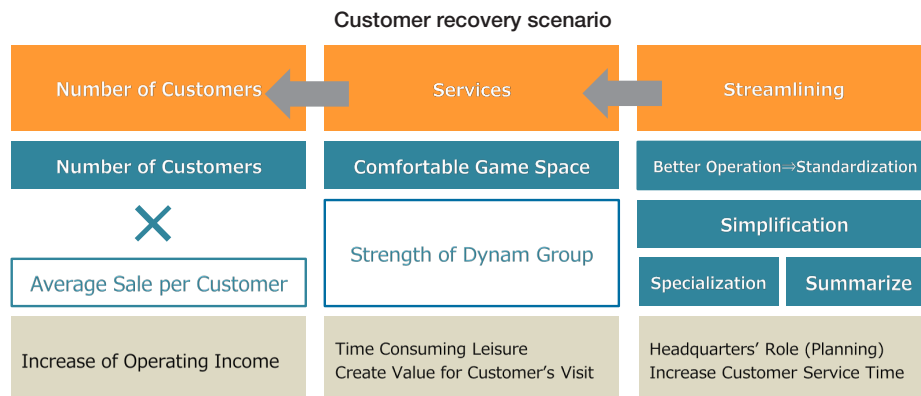
FY3/23 business strategy

In FY3/23, the policy is to cover burden of increased depreciation of pachinko and pachislot machines through greater revenue from larger number of customers to ensure profits

1.Pachinko business

(1) Business strategy

In FY3/23, the Company operational system for the COVID-19 pandemic is almost in place, so its policy is to strengthen initiatives to recover the number of customers. Specifically, the Company will increase the amount of time hall staff have to respond to customer service needs by standardizing and consolidating operations, and will improve customer satisfaction by restructuring training programs and quality control methods to improve service quality. By improving customer satisfaction, the Company intends to increase the number of customers and lengthen playing time (= raise the price per customer), which will lead to higher operating revenues. To recover numbers, in addition to capturing younger customers from competing neighboring halls, the key will be enticing the return of older customers, whose numbers continue to be sluggish.



Source: From materials provided by the Company

FY3/23 business strategy

In addition, smart pachislot and smart pachinko will be introduced as a new industry-wide initiative. Smart pachislot is scheduled to be introduced to halls in November 2022 and smart pachinko in January 2023 or later, which could trigger a recovery in customer numbers. The difference between these and existing pachislot and pachinko machines is that players can play without having to come into contact with pachinko machines or pachinko balls or medals, which helps prevent COVID-19 infection and allows players to enjoy the game with peace of mind. In addition to providing an opportunity for elderly customers to return to halls, it may also increase the number of female customers because it improves cleanliness and eliminates the need to carry output balls to counting machines. For hall staff as well, this has the benefit of reducing workload as it will no longer be necessary to perform tasks such as resupplying medals, carrying output balls or counting winnings.

Regarding smart pachinko and smart pachislot, deregulation that is expected to raise the maximum jackpot probability and improve game play is planned, which is expected to increase the number of new customers. On the other hand, smart pachinko and smart pachislot machines require the installation of a dedicated unit that transmits ball output information and other data to an external control center to prevent fraud, which generates a need for new capital investment.

Due to the difficult market environment, it is unlikely that industrywide replacements will occur at once. There is also a shortage of semiconductors and production of pachinko machines and other machines has not proceeded as planned, which is believed will cause further delays in the supply of smart pachinko and smart slot machines. The Company is upbeat about the introduction of these machines as they could provide an opportunity for a recovery in customer traffic, but it is not expected to have a full-scale impact on results until FY3/24 at the earliest.

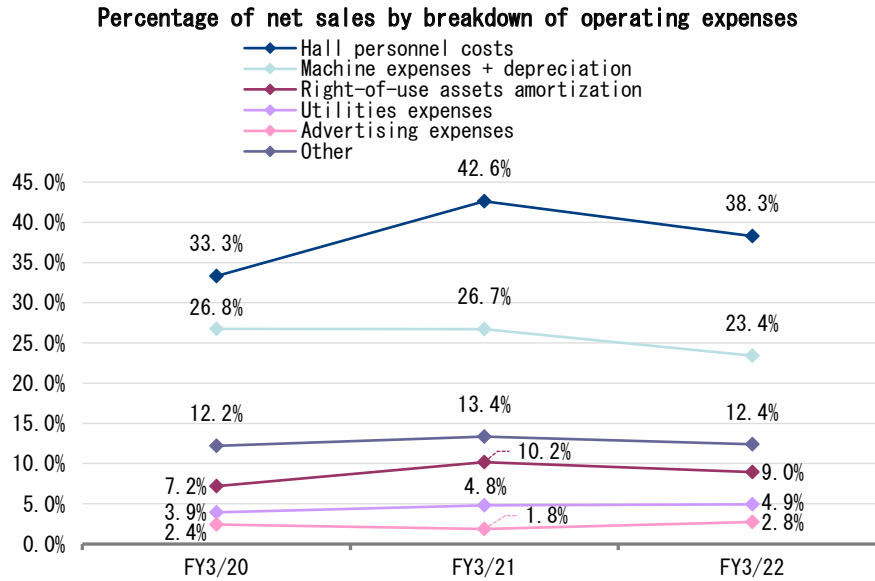
Then, regarding hall opening strategy, the Company has reached a reasonable level of closing unprofitable halls and is planning multiple openings in FY3/23 (one hall each opened in Kagoshima Prefecture and Shizuoka Prefecture in April). Regarding the ratio of private-brand machines, the Company conceives a level on a par with FY3/22. Regarding original DYNAM, the Company is planning the launch of two amadeji high jackpot probability machines, and several models with changed specifications for manufacturers' national brand machines.

(2) Outlook for expenses

Regarding the outlook for operating expenses, the Company is forecasting an increase in machine-related costs. Purchases in FY3/23 are expected to decrease significantly YoY, depreciation of pachinko and pachislot machines booked as an asset will increase. Meanwhile, personnel costs, which account for about 40% of operating expenses, were reduced in the previous fiscal year, including for part-time workers, and it is believed the best that can be done in FY3/23 will be to keep them on similar level. Utilities expenses are expected to rise on the back of an increase in electricity charges. Advertising expenses are viewed to be lowerable YoY due to the decrease in replacement models, but overall operating expenses are forecast to increase.

Regarding factors changing other revenue and expenses, a large part of the ¥2,456mn employment adjustment subsidy, etc. from the government recorded in the previous fiscal year will be eliminated, but there is expected to be a significant decrease in impairment loss of ¥2,430mn, and these are viewed as almost offsetting each other.

FY3/23 business strategy



Source: Prepared by FISCO from the Company's financial statements announcement and materials provided by the Company

In the aircraft leasing business, purchased three new aircraft and plans to start leasing

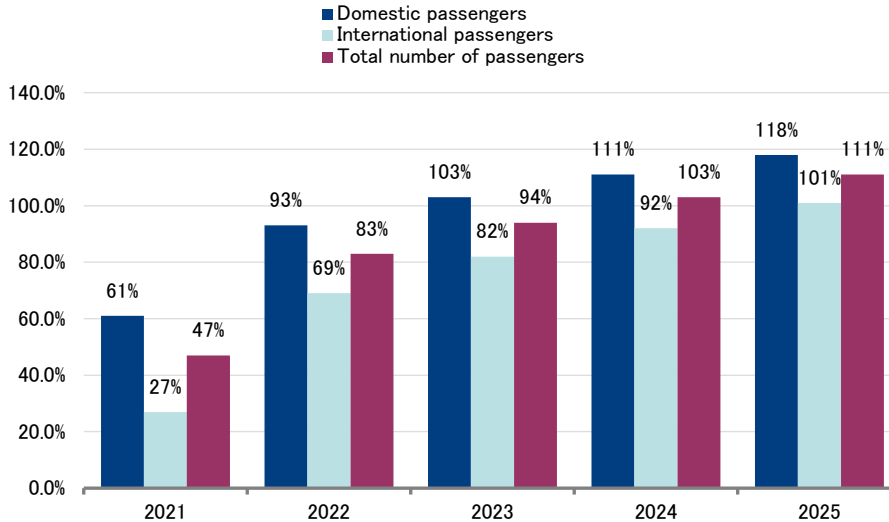
2. Aircraft leasing business

In the aircraft industry, conditions remain challenging amid the COVID-19 pandemic, but demand, centered on domestic routes, is slowly starting to return. According to data released by the International Air Transport Association, international passenger volume will not return to 2019 levels until around 2025, but domestic passenger volume is expected to recover around 2023 as deregulation moves ahead in Europe and the U.S., and overall passenger volume is forecast to recover to 2019 levels by 2024.

In addition, The Boeing Company<BA> forecasts that by 2040 there will be demand for 43,610 new aircraft, primarily narrow-body aircraft used for short-haul flights (25,900 in operation as of 2019). As a result, it is believed there will be no change in the Company's view that stable growth will continue in the medium- to long-term for the aircraft leasing business.

FY3/23 business strategy

Future passenger volume projection (2019=100%)



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

Against this backdrop, the Company announced in October 2021 that Dynam Aviation Ireland Limited, the subsidiary that operates this business, signed an agreement with Wizz Air Hungary Ltd., a Hungarian LCC, to buy three aircraft (Airbus A321Neo) through a sale and leaseback transaction. After completion of the aircraft purchase agreement, each aircraft will be leased to Wizz or a Wizz affiliate. Deliveries of the aircraft are expected to be slightly later than initially planned, with two aircraft forecast to be delivered between July and September 2022 and one between October and December 2022.

Lease revenue from the additional three aircraft will be added to results in FY3/23, and the forecast is for increase revenue and profits. Although the situation in Ukraine is still chaotic, the impact on existing lease customers and Wizz Air is expected to be minimal due to the small number of flights to Russia.

For video slot machines, sales activities and conversion for online use will be considered not just for Macao, but for all of the Southeast Asian region as the COVID-19 pandemic continues

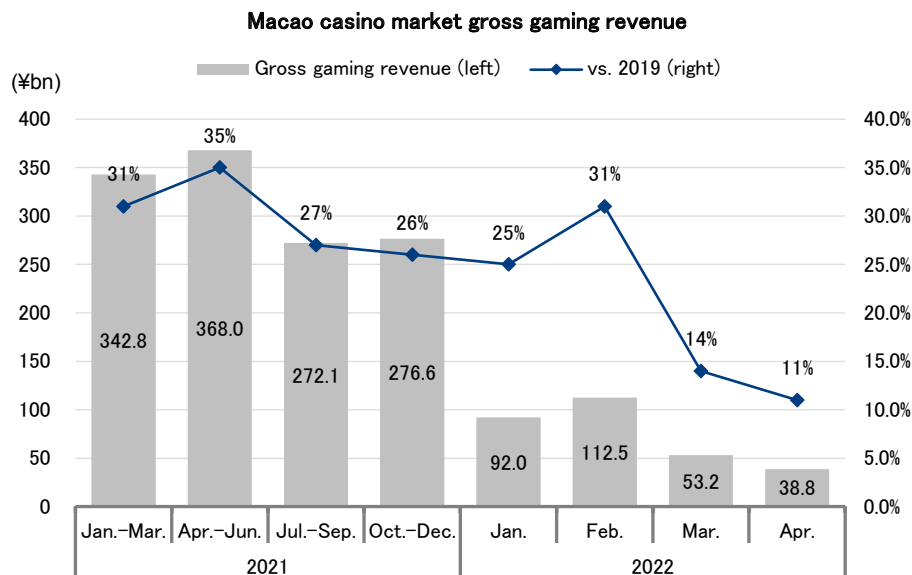
3. Video slot machine business for casinos

The Company has been working on planning and development with the aim of deploying video slot machines in the Macau casino market as a new business. These video slot machines are more targeted to the mass-market than other types of machines, and the development concept is to make straightforward games that incorporate elements of pachinko.

FY3/23 business strategy

The Company jointly developed the plan for the game software in Japan with a developer, and then outsourced the manufacturing and sales of the games for casinos to WEIKE GAMING TECHNOLOGY (S) PTE. LTD. (WEIKE), a Singapore-based company that holds a license for manufacturing and selling casino machines in Macau. As of March 2022, the Company has obtained approval for six models from the Macau casino regulatory authorities and five models in Singapore. In addition, since November 2019, one of each of the three models of machines that incorporate the developed game (total of three machines) were deployed on a test basis in Legend Palace Casino, and from January 2020, a total of ten machines representing three machine models were deployed on a test basis in Casino Ponte16.

Macao's GGR (gross gaming revenue) for April-June 2021 recovered to approximately 35% of the same quarter in pre-COVID-19 pandemic 2019, but restrictions on overseas travel and the COVID-19 pandemic in the Chinese mainland halted recovery, and the situation in April 2022 had fallen to 11% of the 2019 level.



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

Amid these conditions, the Company is in regular contact with casino operators and has begun preparations to resume sales activities of video slot machines, including trials, with the expectation of a recovery to a certain level by the latter half of 2022. At the same time, it is considering sales activities in the Asian region, where markets such as Malaysia are recovering, and moving ahead on examination of converting games it has developed, such as social games, for online use.

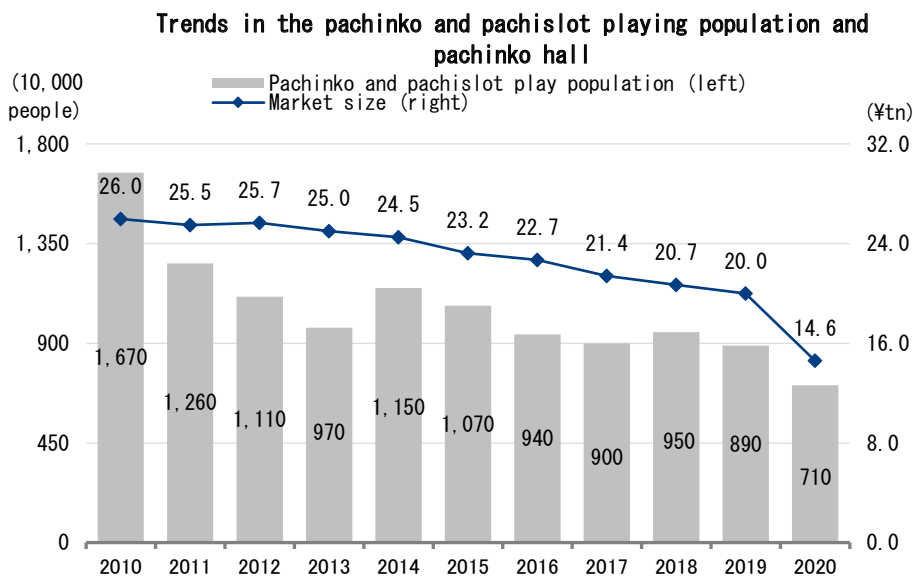
The amount of time needed from the trial until the full-scale introduction of video slot machines and the scale (number of units) are still undecided, but if there is strong support from customers, it is believed this business could contribute a certain amount to earnings. In any case, the most important thing is that customers and casino operators feel the Company's new products are attractive. Future trends, including initiatives to convert social games and other games to online will be worth watching.

Future growth strategy

Possibility of increasing market share with the start of introductions of smart pachislot and smart pachinko

1. Market trends

The pachinko market continues to experience a long-term contraction trend. According to the “White Paper on Leisure 2021” issued by the Japan Productivity Center, Japan’s pachinko and pachislot playing population in 2020 was 710 million, a 20% YoY decline, and the pachinko hall market size (total ball rental fee revenue) contracted 27% YoY to ¥14.6tn.



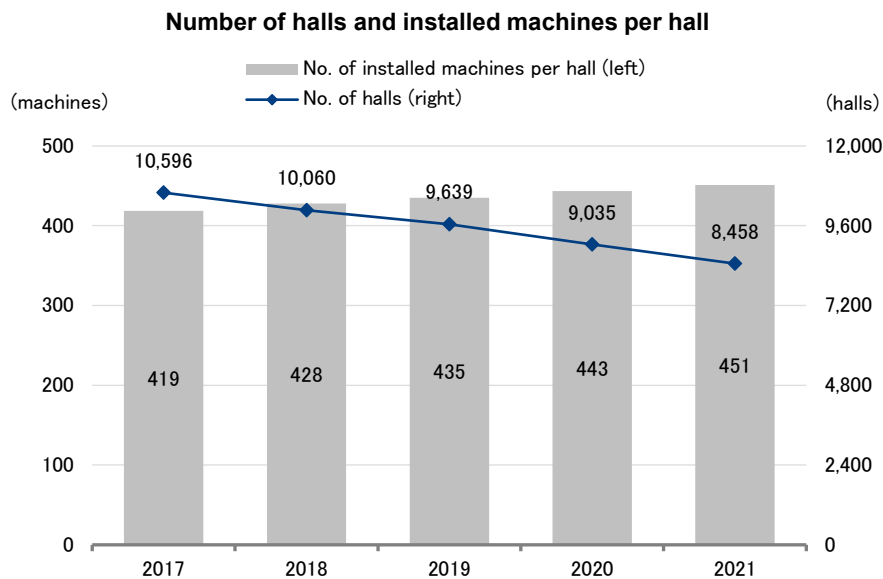
Source: Prepared by FISCO from the Japan Productivity Center’s “White Paper on Leisure”

Reflecting these conditions, the number of pachinko and pachislot halls continues to decrease, and at the end of 2021, the number of halls was down 6.4% versus the end of the previous year to 8,458 halls (according to the National Police Agency’s “Current Situation with Amusement and Entertainment Business and Situation with Policing Amusement and Entertainment-related Crime, etc. in 2021”), the 26th consecutive year of decreases. Moreover, in terms of the number of machines installed at the end of 2021, pachinko machines decreased 3.9% compared to the end of the previous year to 2,338,000 machines, and pachislot machines declined 6.1% to 1,475,000 machines, so both continue to trend downward.

Hall closures appear to have passed their peak following the deadline for the removal of old regulation machines at the end of January 2022, we at FISCO believe that the environment will continue to be harsh for small and medium-sized halls with a weak management structure. The introduction of smart pachinko and smart pachislot machines from November 2022 onward will present an opportunity. There is a considerable possibility that these machines will have improved gameplay compared to conventional models, and their introduction is forecast to increase the ability to attract customers, but halls without financial resources may not be able to make proactive investment, which could result in a further decrease in the ability to attract customers.

Future growth strategy

Over the past few years, the number of pachinko and pachislot machines installed has continued its tendency to rise, and as of December 31, 2021, there were 451 machines installed, 8 more than at the end of the previous year. This shows that the elimination of small- and medium-sized halls is underway. Incidentally, as of March 31, 2022, DYNAM installed 470 pachinko or pachislot machines per hall, slightly above the industry average. If the introduction of the smart pachinko and pachislot machines leads to further consolidation of major capital, it could present a good opportunity for the Company to expand its market share, so we will focus on upcoming movements.



Source: Prepared by FISCO from materials provided by the Company and the National Police Agency's "Current Situation with Amusement and Entertainment Business and Situation with Policing Amusement and Entertainment-related Crime, etc. in 2021"

2. Growth strategy

As its growth strategy in the pachinko business, the Company will work going forward on five themes: multiple-hall development, low playing cost operations, product development, data-driven approach, and cost management.

(1) Multi-hall operations

As the effects of the COVID-19 pandemic are being prolonged and the elimination of pachinko halls is moving ahead, the Company's policy is to prioritize securing profit from existing halls for the time being. Having said that, the Company will resume openings for the first time in two years in FY3/23 and is planning to open halls in locations where there is an expectation of generating earnings. Openings will take place following purchase of unoccupied properties or through M&A and other efforts, while also keeping costs under control. Targeted properties must be medium-sized halls able to accommodate 400-500 pachinko and pachislot machines, and there must be no other Group halls nearby to avoid cannibalism (encroaching on another hall's customer base).

(2) Low playing cost operations

In general, the Company's new halls will have low playing costs. It has stated a vision of making pachinko and pachislot a form of daily entertainment that everyone can enjoy freely as a part of the community infrastructure, and will increase the number of low playing cost halls to achieve this vision because it makes sense. An advantage of focusing on low playing cost halls is that the Company can open halls in small commercial areas thanks to its wide-ranging customer base.

Future growth strategy

(3) Product development

The Company will strengthen its product development of private-brand machines. Developing and introducing products matching customer needs will help with cost management, and will be positioned as an important strategy in terms of differentiating its halls from those of competitors.

(4) Data-driven approach

In its hall operations, the Company will advance efforts taking advantage of big data. Specifically, it will analyze customer needs based on playing data and customer data, and reflect the findings in pachinko and pachislot machine lineups and carry out sales promotion measures to raise the operating rate.

(5) Cost management

The Company will continue its efforts to standardize and improve efficiency in hall operations, effectively share information across all halls and strengthen hall earnings capabilities.

At FISCO, we believe that the consolidation in the pachinko hall industry by large capital will proceed, spurred by the COVID-19 pandemic. As a part of this, we forecast that this will be a good opportunity to rekindle growth based on market share expansion for the Company, which has a wide range of customers as a result of its low playing cost business and due to the fact that it has firmly established low-cost operations. Although the Group currently is the leader in the industry in terms of its number of halls, its market share is approximately only 5%, and we feel there is ample room for growth through an expansion of its market share.

Simplified income statement and key indicators

	(¥mn)				
	FY3/18	FY3/19	FY3/20	FY3/21	FY3/22
Revenue	152,092	146,371	142,483	98,602	105,141
YoY	-3.0%	-3.8%	-2.7%	-30.8%	6.6%
Operating expenses	136,727	128,024	122,311	97,564	94,911
YoY	-3.8%	-6.4%	-4.5%	-20.2%	-2.7%
SG&A expenses	5,049	5,023	5,020	4,340	4,279
YoY	-10.2%	-0.5%	-0.1%	-13.5%	-1.4%
Other income	9,458	8,971	8,446	11,561	9,114
Other operating expenses	2,425	2,953	2,084	1,531	4,411
Operating profit	17,349	19,342	21,514	6,728	10,654
YoY	9.1%	11.5%	11.2%	-68.7%	58.4%
Financial income	236	471	461	286	426
Financial expenses	781	444	2,469	2,672	2,571
Profit before income taxes	16,804	19,369	19,506	4,342	8,509
YoY	13.3%	15.3%	0.7%	-77.7%	96.0%
Income taxes	5,879	6,778	6,759	1,991	3,532
Net profit	10,925	12,591	12,747	2,351	4,977
YoY	17.4%	15.2%	1.2%	-81.6%	111.7%
EBITDA	29,524	31,136	33,151	16,781	19,709
YoY	3.7%	5.5%	6.5%	-49.4%	17.4%
EPS (¥)	14.2	16.4	16.6	3.1	6.8
Dividend per share (¥)	12.00	12.00	9.00	5.00	5.00

Source: Prepared by FISCO from the Company's financial statements announcement, results briefing materials and materials provided by the Company

Future growth strategy

Statement of consolidated financial position

	(¥mn)				
	FY3/18	FY3/19	FY3/20	FY3/21	FY3/22
Current assets	53,145	59,875	55,798	91,790	67,487
Cash and cash equivalents	40,533	47,537	41,810	74,661	56,508
Trade receivables	469	614	554	361	332
Other	12,143	11,724	13,434	16,768	10,647
Non-current assets	131,826	125,457	221,441	209,283	225,934
Property, plant and equipment	98,794	95,445	105,206	96,415	118,648
Right-of-use assets	-	-	79,048	77,537	73,850
Intangible assets	3,545	3,112	3,623	3,348	3,440
Investments, other	29,487	26,900	33,564	31,983	29,996
Total assets	184,971	185,332	277,239	301,073	293,421
Current liabilities	39,643	36,452	44,028	59,812	47,324
Accounts payable	19,220	19,297	14,801	19,997	12,312
Short-term borrowings, etc.	7,351	2,124	3,008	11,380	12,945
Lease liabilities	256	227	12,185	12,040	11,245
Other	12,816	14,804	14,034	16,395	10,822
Non-current liabilities	7,813	7,080	98,479	109,289	115,115
Long-term borrowings	1,221	502	10,220	22,587	30,196
Lease liabilities	326	353	81,611	79,899	78,017
Other	6,266	6,225	6,648	6,803	6,902
Total liabilities	47,456	43,532	142,507	169,101	162,439
Total equity	137,515	141,800	134,732	131,972	130,982
Total liabilities and equity	184,971	185,332	277,239	301,073	293,421

Source: Prepared by FISCO from the Company's Annual Report

Returns to shareholders

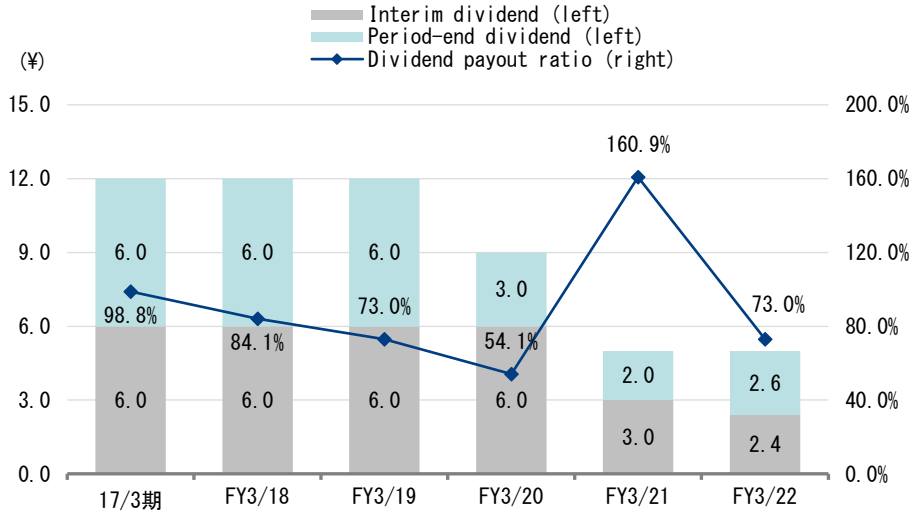
To pay a FY3/22 dividend of ¥2.6 per share

The Company is highly conscious of the significance of returns to shareholders because it recognizes the importance of raising shareholder value in order to achieve sustainable growth. Based on this view, its policy is to not only pay stable dividends, but also to acquire treasury shares.

In light of the current situation with earnings, the Company decided on a FY3/22 dividend of ¥2.6 per share to pay a full-year dividend of ¥5.0 per share, the same as the previous fiscal year, and total dividend payments of ¥3,634mn. Furthermore, in the FY3/22, the Company carried out ¥3,187mn in stock buybacks (30,135,800 shares; approximately 4.0% of its outstanding shares), resulting in a total return to shareholders of ¥6,821mn and a total payout ratio of 137.1%.

Returns to shareholders

Trends in dividend per share and the dividend payout ratio



Source: Prepared by FISCO from the Company's financial statements announcement, news releases and materials provided by the Company

ESG initiatives

1. Through ESG activities, the Company aims to grow sustainably and to maximize corporate value

The Company is earnestly continuing initiatives to increase value for all of its stakeholders, including investors, and has formulated clear policies from each of the perspectives of environment (E), social (S) and governance (G).

Based on its Group Philosophy of "A centurial commitment to building trust and encouraging dreams," the Group is advancing ESG initiatives with the ideal of achieving perpetual growth, and it discloses information in accordance with the latest international guidelines and the listing rules of the Hong Kong Stock Exchange for each category (Environment, Social, Governance). Furthermore, details about the Company's initiatives can be found on its website and in ESG Report 2022. Amid the attention being focused on ESG investing, this is expected to fulfill an important role as a tool for dialogue with investors.

2. Environmental initiatives

Based on its recognition that global environmental problems are shared by all humans, the DYNAM Group works proactively to address environmental issues, centered on climate change, and aims to reduce its environmental impact. In addition, the Company complies with environmental laws, regulations and ordinances and practices continuous environmental management.

ESG initiatives

Economic activities are one of the causes of global environmental problems such as climate change, energy consumption, and pollution, and international targets have been set for global warming. The DYNAM Group is addressing business operations in a decarbonizing society by striving to reduce CO₂ emissions caused by excessive energy consumption by using halls made from wood, which has a lower impact on the environment, appropriately managing energy consumption, advancing green IT and creating systems that do not generate waste or properly dispose of it if they do.

3. Social initiatives

The Group engages in initiatives aimed at “enhancing social value” through efforts targeting all stakeholders, including customers, communities, business partners, employees, and shareholders and investors.

The Company is carrying out a diverse range of initiatives aimed at “enhancing social value.” Such initiatives include providing services from the perspective of customers to make “pachinko a form of daily entertainment,” addressing pachinko addiction, engaging in activities to promote pachinko as “local infrastructure,” developing private-brand machines with pachinko and pachislot machine manufacturers, developing human resources (including active participation by women), and holding more briefings for investors.

Activities under the slogan of “local infrastructure” include supporting the independence of the elderly, promoting employment in the community, responding to natural disasters and backing recovery, as well as supporting sports.

4. Governance initiatives

The DYNAM Group has selected to be a “Company with a Nomination Committee, Etc.” and has established the three committees of the Nomination Committee, Remuneration Committee and Audit Committee. This Company with a Nomination Committee, Etc. assumes the role of executing decision-making and auditing functions for management decision-making, and to clarify supervisory functions and execution of duty functions.

The latest information about the DYNAM Group’s corporate governance is noted in detail in Annual Report issued every year. This information can also be found on the Company’s website.



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