

Daikoku Denki Co., Ltd.6430 Tokyo Stock Exchange
First Section

2-Feb.-17

Important disclosures
and disclaimers appear
at the end of this document.FISCO Ltd. Analyst
Ikuo Shibata**■ Reforming businesses over the medium to long term in a shrinking market, targeting further growth**

Daikoku Denki Co., Ltd. <6430> (hereafter, "the Company") has two main segments, the Information System Segment, which develops, manufactures and sells computer systems for pachinko (Japanese pinball) parlors or halls, and the Control System Segment, which develops, produces and sells display and control units for pachinko and pachislot machines, as well as pachislot machines. The Company holds the leading share of the Japanese market for hall computers, of approximately 35%, reflecting an information management method that is the de facto standard for the industry. The Daikoku Denki Strategic Information System (DK-SIS) supplies information to support the operations of pachinko hall associations. It is the only such system in Japan and was used by 3,704 pachinko and pachislot halls at September 30, 2016, i.e., at the end of 1H FY3/17. It has also made a fully fledged entry into the manufacture and sales of in-house developed pachislot machines.

Japan's pachinko market has been shrinking for several years. In response, the Company seeks to reform its businesses over the medium to long term. Reforms include developing a next-generation hall computer, shifting to a business model more reliant on services that provide recurring revenues and developing and commercializing pachislot machines. These reforms have produced results to a certain extent. In particular, the next-generation hall computer, on which the Company has invested heavily, is in its final stage of development. This hall computer will operate on a cloud server and be capable of advanced analysis of large quantities of data. It will be far superior to any competing computer and should allow the Company to increase its share of the Japanese market for these machines. Recently, however, business performance has remained under pressure due to the inception of specific measures to address the industry's policy of collecting and removing "all the pachinko game machines whose performance may differ from the models that were submitted for format inspection" in the current fiscal year, in addition to the adoption last year of industry restrictions on risky machines.

For 1H FY3/17, the Company posted lower net sales and operating income year on year (YoY), with consolidated net sales declining by 16.7% YoY to ¥20,187mn and operating income decreasing by 25.7% to ¥605mn. Notably, net sales were lower than the Company had originally forecast. (Profits were above forecasts at every level.) In a persistently challenging market environment, the Information System Segment saw product sales drop sharply due to fewer new and remodeled pachinko halls in line with weaker investment sentiment among pachinko hall operators. In the Control System Segment, the main reason for the lower-than-forecast sales was the postponement of several models to 2H FY3/17 due to changes in the product launch schedules of pachinko machine manufacturers. However, profits in both segments were above their respective earnings forecasts. In the Information System Segment, the main reasons were relatively firm sales of new products and the postponement of certain SG&A expenses to 2H FY3/17. In the Control System Segment, the main contributing factor was the strong sales volumes of models that the Company worked on.

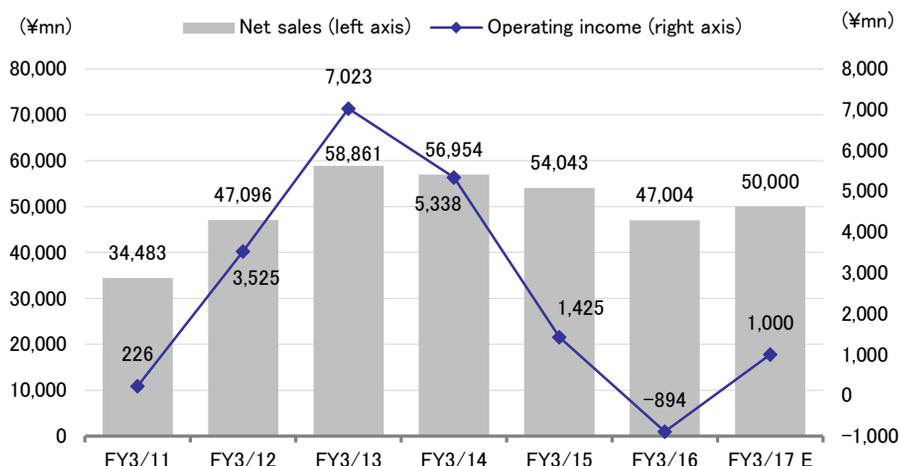
For FY3/17, the Company has maintained its initial forecasts. It projects a 6.4% YoY rise in consolidated net sales to ¥50.0bn and operating income of ¥1.0bn. It thus expects to achieve top-line growth and restore profitability. Taking into account the Company's 1H FY3/17 performance and the persistently severe market environment, FISCO believes that it will not be easy for the Company to meet those forecasts. However, investment trends among pachinko halls after the end of the industry's "collection and removal" policy will have a significant bearing on the Company's business performance in FY3/17. Therefore, progress toward a recovery in investment sentiment on the part of pachinko hall operators, including the impact on business performance in the next fiscal year, must be watched closely.

The Company is pushing ahead with its new medium-term plan, called "Next 50 Chapter One," with FY3/17 being the first year of the plan. The plan intends to increase the Company's share of the market for hall computers by implementing the next-generation hall computer in FY3/18. It also aims to promote sales growth and profitability by applying the Company's capability to analyze data and plan and develop products to add value to its products and services. From a medium- to long-term perspective, FISCO expects the Company to achieve its growth targets based on its dominant market position. We also expect the Company to contribute to a revival of Japan's pachinko industry.

Check Point

- Established a top industry position primarily through the industry's only membership information service (DK-SIS)
- Projected to attain sales growth and restore profitability on a full-year basis in FY3/17
- Aiming to enhance growth and profitability by expanding market share through the next-generation hall computer and the creation of new added value

Trends in Full-year Results



Description of Businesses

Established a top industry position primarily through the industry's only membership information service (DK-SIS)

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

As the pioneer in the development of hall computers, which assist the management of pachinko halls, the Company won hall's trust and pachinko fans' satisfaction by providing a management system which puts emphasis on data management, introduction of innovative peripheral equipment for its hall computers, and utilization of the leading membership information service in the pachinko industry; and it holds the top share of the Japanese market for hall computers.

In FY3/16, the Company held an approximately 35% share of the Japanese market for hall computers, indicating that it served about 3,900 halls.

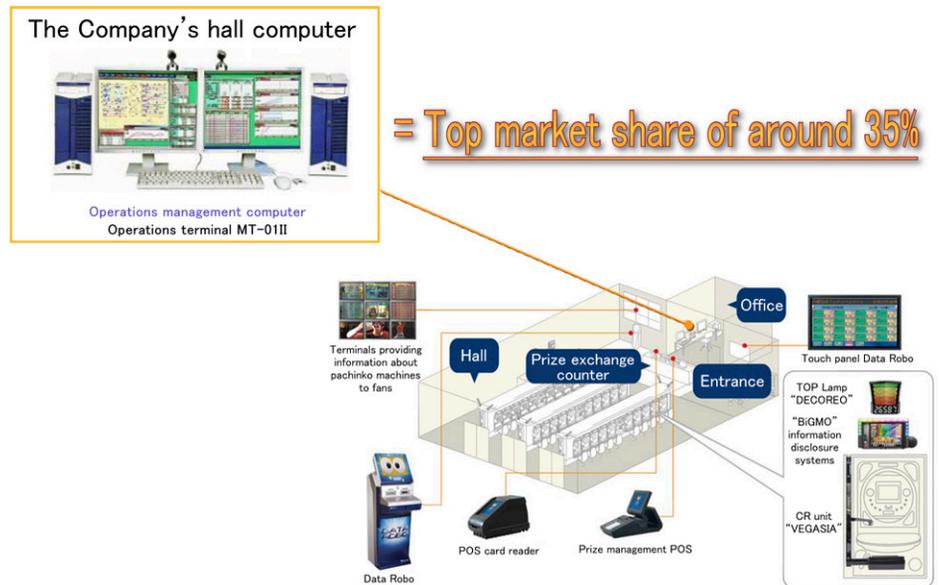
The Company's two main businesses are the Information System Segment and the Control System Segment, but the Information System Segment provided approximately 72.4% of its total sales in FY3/16 and was the main source of stable profit.

(1) Information System Segment

The Information System Segment offers a complete line of information equipment and services to support sales and operational management at pachinko halls. Hall computers are the core of the system used at halls, and these computers are supported by peripheral equipment, such as prize management systems and information display systems. For consolidating and analyzing the data recorded by this equipment, the segment offers services such as its unique DK-SIS system, which is the leading service in Japan that provides strategic information about associated halls.

Hall computers are the core systems for supporting pachinko hall operations. These personal computers display the operating condition and sales of each machine in a hall. As mentioned above, these computers are supported by peripheral equipment, such as prize management systems and information display systems. They also serve as the foundation of the DK-SIS system. Peripheral equipment and support services are often sold with hall computers as a package deal. The Company has been strengthening the sale of services for its information system equipment, such as prize management systems and information display systems, because it earns regular fee income from these services.

Hall Computers and Main Peripheral Equipment



Source: The Company's financial results briefing materials

(2) Control System Segment

The Control System Segment produces LCD display units, control units, switches, and motors for pachinko and pachislot machines. Applying the knowledge obtained during many years of analyzing data from pachinko machines through its DK-SIS, the Segment analyzes trends in the popularity of pachinko machines and presents ideas to makers of these machines for the manufacture of hit machines. It also serves as a partner to machine manufacturers in developing appealing content for their machines and helps the manufacturers obtain the rights to use animation characters in their machines.

Since FY3/14, the Company's consolidated subsidiary Daxel Inc. has been producing and selling pachislot machines developed by Daikoku Denki under the Daxel brand name. The first such machine, called "Magical Suite Prism Nana", sold 4,000 units. The second machine, "Sasamisan@Gambaranai Slot", sold 6,000 units. The third, "Pachislot Hyakkaryoran Samurai Girls", sold 5,100 units. The success of these machines demonstrates the Company's ability to develop products with great appeal as games. The Company has established a high-quality brand image specializing in animation characters. In FY3/17, the Company launched "Milky Holmes TD" in April and has sold 8,800 units of this machine. On November 14, the Company launched "Witch Craft Works" as its second new model for FY3/17. This model appears to be achieving an industry-leading operating performance.

New product



Launch of pachislot game machine "Witch Craft Works"

- The Company continues to work on the genre of "Anislo," which combines animation and pachislot machines, based on the Company's strong determination to acquire next-generation fans.
- Installation of the pachislot machine "Witch Craft Works" has started in pachinko halls across the country from November 14, 2016.

<Selling Points>

1. A large amount of new animation and original music was also installed as entertainment features.
2. A system (periodic drawing and 1G Ren, etc.) that received a favorable reception through "Hyakka Ryoran: Samurai Girls" was adopted as a game amusement feature.

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Source: The Company's financial results briefing materials

■ Company Strengths

Advocating the importance of data management and the necessity of information disclosure

(1) Growth model based on market expansion through innovation

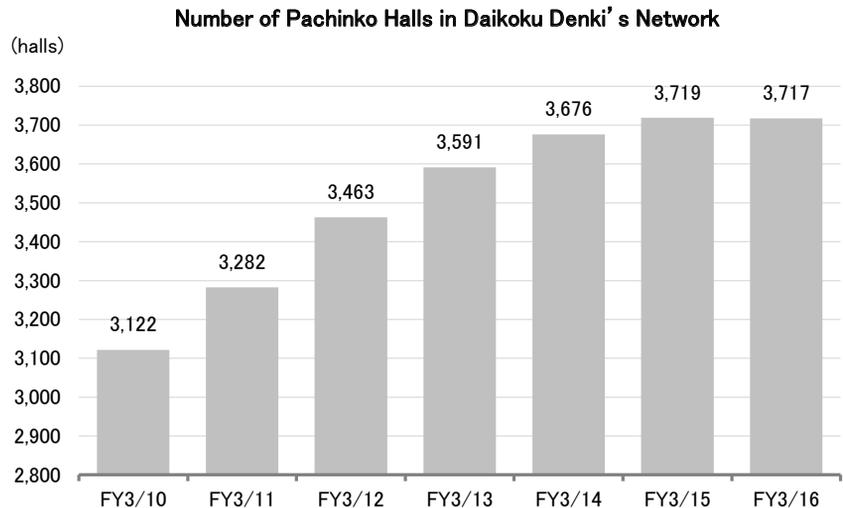
Since its establishment, the Company has consistently planned and developed new categories of goods and services, thereby developing the pachinko market and achieving growth. It has not just developed machines with superior functions but emphasized the importance of data management and the need for information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

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

A newer business being pursued by the Company is the development, production, and sale of pachislot machines that differ from previous pachinko and pachislot machines, which tended to be chosen based on the desire to gamble. The Company's pachislot machines display original characters produced by popular illustrators in anime using original voices. These high-quality machines have won accolades from fans of anime, and the Company has again established a new market for amusement equipment.

(2) A strong network of pachinko halls

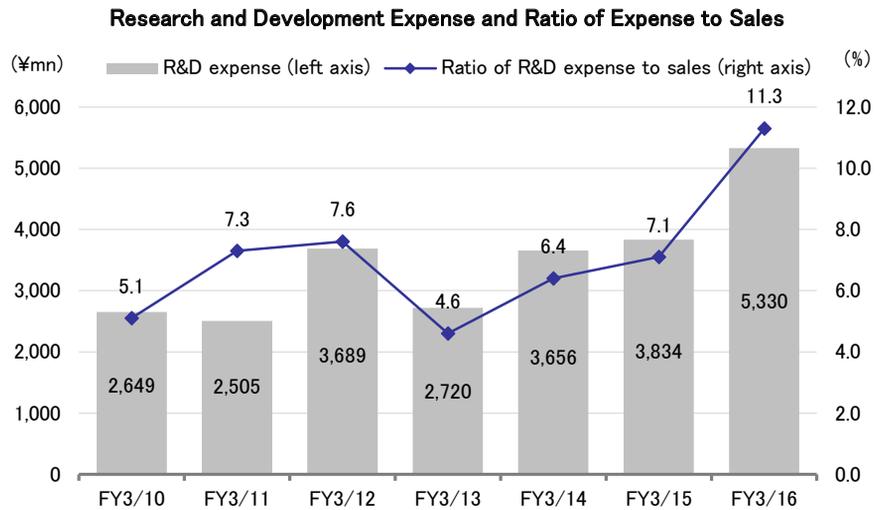
Another advantage the Company has is the DK-SIS, hall computer based membership information service. This service connects the Company and member pachinko halls through networks, and gathers, processes and analyzes the daily operational information of pachinko halls recorded by hall computers and gives feed-back to the managers of these halls to improve their operations. The managers of halls in which Daikoku Denki's hall computers are installed receive operational data daily on all the pachinko machines in Japan equipped with the Company's hall computers. They also receive operational data broken down by the model of pachinko machine. This information enables them to improve the running of their businesses. At the same time, the Company maintains firm ties with the halls using its equipment, which supports the Company's business. The Company's DK-SIS allows it to serve as a think tank on the pachinko industry and elevates the Company's brand name. At the end of September 2016, the DK-SIS service was used by 3,704 pachinko and pachislot halls which operated approximately 1.42mn machines, or 31.0% of all the machines installed in Japan, and gathered data on ¥10.2tn worth of annual sales.



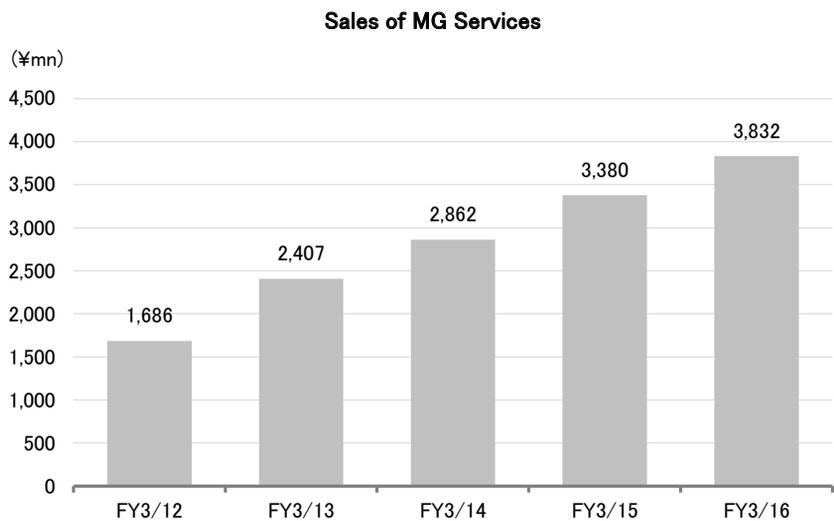
Source: Prepared by FISCO from Company's financial results briefing materials

(3) Stable profit base that supports investment for the future

The Company's main source of competitiveness is its proactive upfront investment in goods and services, including its R&D expenditure. Over the past few years, the Company has developed unique pachislot machines, a next-generation hall computer, and other products to drive its sales and profit growth hereafter. The stable revenue stream or Cash Cow provided by the high-margin Information System Segment makes this investment possible. In particular, the management support services (MG services) nurtured by the Company provide enough profit to fund the investment in R&D for the next-generation hall computer, greatly limiting investment risk. The Company's ability to balance large profits from its existing businesses with heavy investment in businesses of the future allows it to produce value on a continuing basis.



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



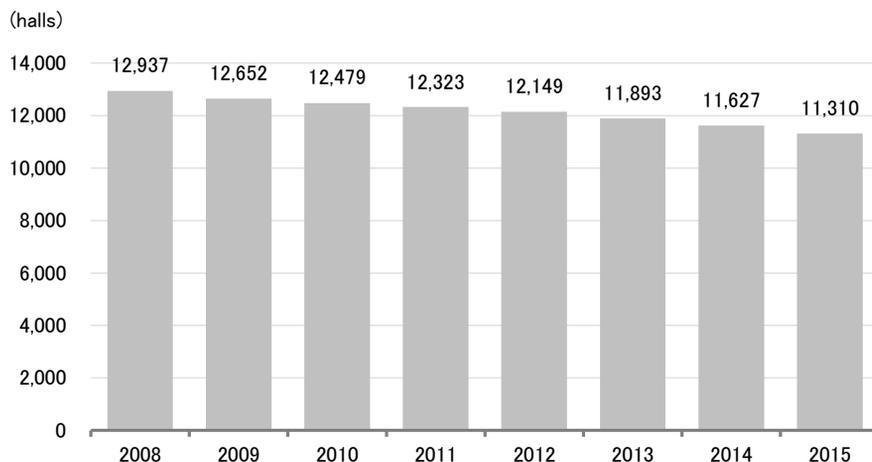
Source: Prepared by FISCO from Company's financial results briefing materials

■ Industry Environment

A shrinking pachinko market year after year

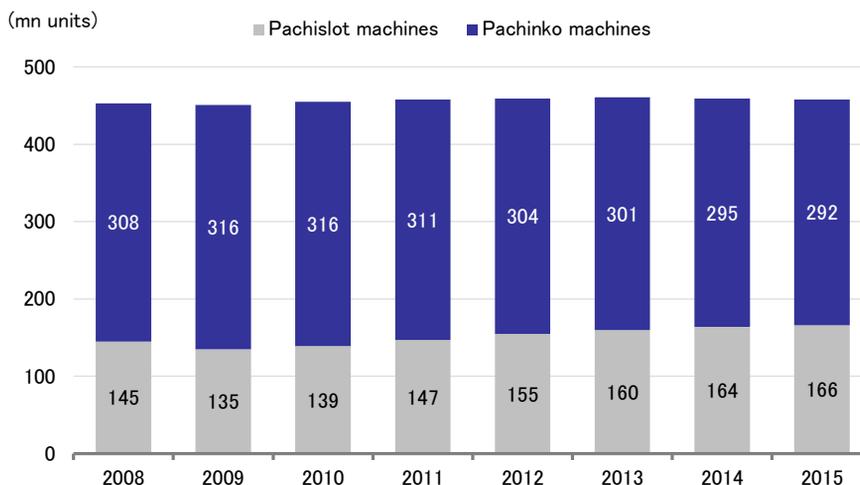
Japan's pachinko industry has been shrinking for years, reflecting a decline in the overall number of pachinko players, a trend toward playing games with low rental costs for balls, increases in Japan's consumption tax, and other factors. According to surveys by the National Police Agency, the number of pachinko and pachislot halls in Japan declined at an average annual rate of 2.1% from 2011 to 2015. In 2015, the number of halls was 11,310 (down 317 halls YoY). It is estimated that the Company served about 3,900 of these halls based on the fact that it held approximately 35% of the Japanese market for hall computers in FY3/16 according to Company estimates. Most of the Company's customers are high-end, large pachinko halls that are the top performers in their respective local markets, averaging 519.1 machines per hall, or about 30% more than the average number of machines per hall, according to the National Police Agency. Therefore, the business of these customer halls is relatively insensitive to economic cycles, and the halls can invest in new businesses.

Number of Pachinko and Pachislot Halls in Japan



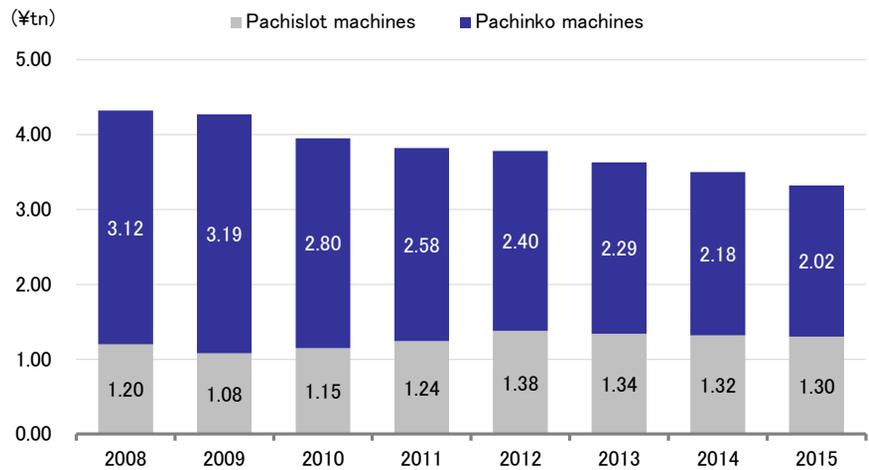
However, the National Police Agency reports that, while the number of pachinko machines in Japan has declined since 2010, the number of pachislot machines has increased, so the combined number of pachinko and pachislot machines has remained fairly constant. Since the number of pachinko and pachislot halls decreased over the same period, the average number of machines per hall has increased. This trend toward larger pachinko and pachislot halls that command merits of scale benefits the Company, which invests effectively in developing equipment with advanced functions and services with added value.

Number of Pachinko and Pachislot Machines in Japan



According to the Company, the value of Japan's combined market for pachinko and pachislot games, as measured by the gross profit earned by all halls nationwide, has fallen each year, similar to the decline in the number of halls. This value has also declined on a per-machine basis. Thus, even though pachinko halls and pachislot halls are increasing in average size, they continue to operate in a challenging business. The pachinko industry has been especially hurt by its adoption last year of new restrictions on the gambling aspect of pachinko and pachislot machines, along with specific measures to address the industry's policy of collecting and removing "all the pachinko game machines whose performance may differ from the models that were submitted for format inspection". Similar restrictions have impaired the profitability of halls in the past by temporarily turning off some players from pachinko and pachislot games, and the new restrictions are likely to have the same impact. On the other hand, the new restrictions may motivate hall managers to convert their operations to less risky machines. If the industry can rebound from the impacts of these new restrictions and of increases in Japan's consumption tax, and if Japan's economy can generate some inflation as the country prepares to host the Olympic Games in Tokyo in 2020, the Company believes that the combined market for pachinko and pachislot games could recover to about ¥4tn per year.

Value (Gross Profit) of Japanese Markets for Pachinko and Pachislot Games



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

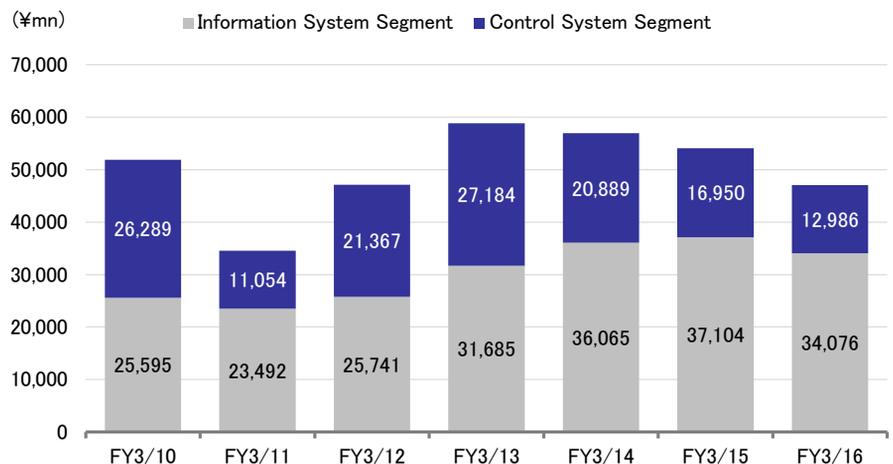
■ Financial Results Trends

Company's business has held firm as the industry has shrunk as a whole

(1) Performance over the past seven fiscal years

In FY3/11, the Company's sales shrank YoY because of restrained consumer spending and the impact of the Great East Japan Earthquake. Its total sales rebounded in FY3/12– FY3/13, even though the pachinko industry continued to consolidate. This recovery was led by the Information System Segment, which holds high market shares for its products. Sales in this segment reached consecutive record highs in FY3/13–FY3/15, supporting the Company's overall performance. In FY3/16, sales in the Information System Segment and overall sales contracted YoY, reflecting the impact of industry restrictions on risky machines.

Consolidated Net Sales by Segment



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

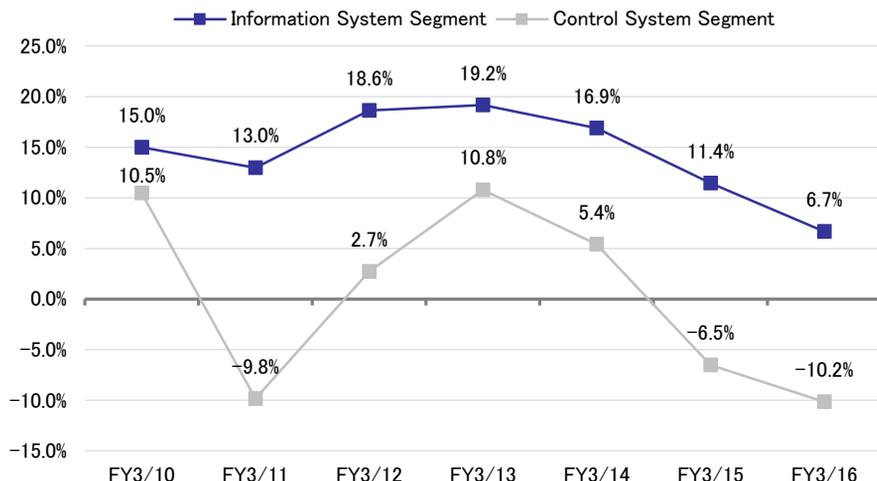
The Information System Segment provides steady profits, and has maintained high profit margins as the Company's performance recovered. Reflecting increasing investment in the development of the next-generation hall computer since FY3/14, profit margins have declined since FY3/13, but considering the size of the investment, margins are still high.

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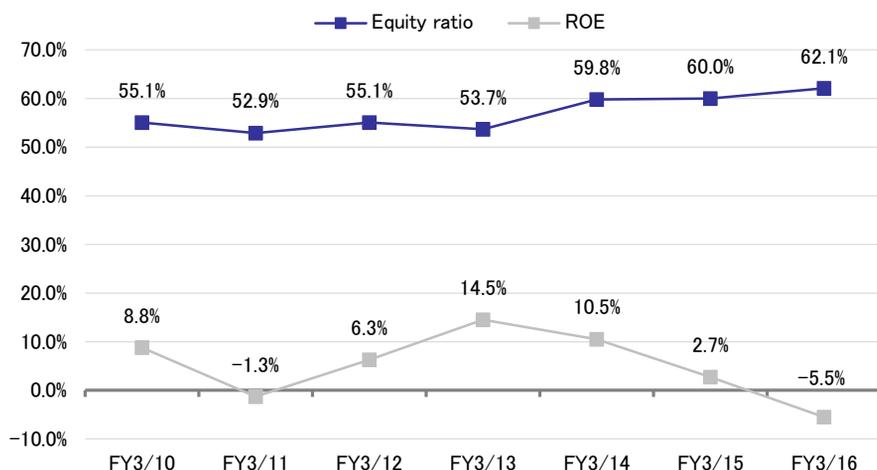
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Operating Profit Margins by Segment



The Company's equity ratio, a measure of financial stability, has risen, reflecting large retained earnings, reaching 62.1% in FY3/16. The current ratio, which indicates the ability to make payments in the short term, was 177.4% in FY3/16, mainly due to large holdings of cash and deposits. The ROE, a measure of capital efficiency, has been low since FY3/15 due to a deterioration of net income. In FY3/15, the Company suffered a loss due to the bankruptcy of a manufacturer customer. In FY3/16, because of the industry restrictions on risky machines, the Company launched fewer new pachislot machine models than planned, and its sales volume of these machines were far below the planned level. As a result, the Company suffered a loss due to the devaluation of parts and materials for its pachislot machines.

Equity Ratio and ROE





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Sales and profits declined YoY in 1H FY3/17 due to the impact of the challenging market environment

(2) 1H FY3/17 results

In 1H FY3/17, the Company posted declines in sales and profits. Consolidated net sales decreased by 16.7% YoY to ¥20,187mn, operating income declined by 25.7% YoY to ¥605mn, ordinary income decreased by 22.0% YoY to ¥706mn, and profit attributable to owners of parent decreased 21.9% YoY to ¥329mn. Notably, net sales were lower than the Company had originally forecast. (Profits were above forecasts at every level.)

The pachinko market environment remained under pressure primarily because of the inception of specific measures to address the industry's policy of collecting and removing "all the pachinko game machines whose performance may differ from the models that were submitted for format inspection" by the end of December 2016. Another factor was the impact of industry restrictions that weighed down performance in the previous fiscal year. In this environment, sales were sluggish in both the Information System Segment and the Control System Segment. In particular, the Information System segment saw product sales drop sharply due to fewer new and remodeled pachinko halls in line with weaker investment sentiment among pachinko hall operators. In the Control System Segment, the main reason for lower-than-forecast sales was the postponement of several models to 2H FY3/17 in line with changes in the product launch schedules of pachinko machine manufacturers.

Meanwhile, on the earnings front, profits declined mainly due to the negative impact of lower sales on profits, and an increase in SG&A expenses, including higher costs related to the sale of pachislot machines developed in-house. However, profits in both the Information System Segment and the Control System Segment far surpassed forecasts. In the Information System Segment, the main reasons were relatively firm sales of new products and the postponement of certain SG&A expenses to 2H FY3/17. In the Control System Segment, the main contributing factor was the steady growth in sales volume of models that the Company worked on. R&D expense decreased 33.2% YoY to a combined ¥1,711mn for both segments, but was largely in line with expectations.

In terms of financial condition, there were no notable changes in total assets or total equity. The equity ratio rose to 63.0% at the end of 1H FY3/17 from 62.1% at the end of FY3/16, remaining at a high level. Interest-bearing debt stood at ¥3,300mn at the end of 1H FY3/17, a decrease of ¥2,200mn from the end of FY3/16.

Overview of the 1H FY3/17 results

	1H FY3/16 Result		1H FY3/17 Result		YoY change		1H FY3/17 Initial Co. forecast		vs. Plan	
		Ratio to sales		Ratio to sales		YoY rate of change		Ratio to sales		%
Sales	24,225		20,187		-4,037	-16.7%	21,500		-1,313	93.9%
Information Systems	16,089	66.4%	13,126	65.0%	-2,963	-18.4%	14,000	65.1%	-874	93.8%
Control Systems	8,144	33.6%	7,093	35.1%	-1,050	-12.9%	7,500	34.9%	-407	94.6%
Adjustment	-8	-	-31	-	-23	-	0	-	-31	-
Gross profit	7,966	32.9%	7,532	37.3%	-433	-5.4%	7,300	34.0%	232	103.2%
SG&A expenses	7,150	29.5%	6,926	34.3%	-223	-3.1%	7,100	33.0%	-174	97.6%
Operating income	815	3.4%	605	3.0%	-209	-25.7%	200	0.9%	405	303.0%
Information Systems	1,320	8.2%	1,414	10.8%	93	7.1%	1,200	8.6%	214	117.8%
Control Systems	350	4.3%	95	1.3%	-255	-72.9%	-100	-1.3%	195	-
Adjustment	-854	-	-903	-	-48	-	-900	-	-3	-
Ordinary income	905	3.7%	706	3.5%	-199	-22.0%	200	0.9%	506	353.0%
Profit attributable to owners of parent	421	1.7%	329	1.6%	-92	-21.9%	120	0.6%	209	274.3%
Depreciation cost	585		792		207	35.4%	850		-58	
R&D expense	2,562		1,711		-851	-33.2%	1,500		211	
Information Systems	1,925		1,093		-832	-43.2%	1,000		93	
Control Systems	636		618		-17	-2.7%	500		119	

Breakdown of segment sales

Information System Segment				
Equipment	10,734		7,911	-2,823
Service	5,355		5,215	-140
Control System Segment				
Units and components	7,734		3,825	-3,909
Pachislot machines and other equipment	410		3,268	2,858



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1H FY3/16 results by segment were as follows.

a) In the Information System Segment, profits rose YoY despite lower net sales. Net sales decreased by 18.4% YoY to ¥13,126mn, while segment operating income rose by 7.1% YoY to ¥1,414mn. Against forecasts, net sales were below forecast, but profits were above forecast. The drop in product sales was triggered by fewer new and remodeled pachinko halls. This, in turn, reflected weaker investment sentiment among pachinko hall operators because of the inception of specific measures to address the industry's policy of collecting and removing non-compliant machines. In light of this challenging industry environment, the Company had set conservative forecasts, but net sales ended up falling below even this forecast. Notably, the sales volume of hall computers was only 30 units, down 24 units YoY and below the initial forecast of 50 units. In parallel, sales of peripheral equipment as a whole remained weak.

Meanwhile, segment operating income was far above forecast mainly because of relatively firm sales of the new REVOLA information display terminal, which were 10.6% above forecast, and the postponement of certain SG&A expenses to 2H FY3/17. R&D expense in the Information System Segment decreased by 43.2% YoY to ¥1,093mn, but was largely in line with expectations.

Sales of MG services grew steadily by 9.4% YoY to ¥2,044mn. The Company has been promoting MG services as a stable source of sales and profits as part of its transition to a profit structure more dependent on recurring revenue.

b) In the Control System Segment, net sales and profits both decreased YoY. Net sales contracted by 12.9% YoY to ¥7,093mn and segment operating income declined by 72.9% YoY to ¥95mn. Against forecasts, net sales were below forecast while profits were above forecast. Business performance was weighed down by the postponement of several models to 2H FY3/17 in line with changes in the product launch schedules of pachinko machine manufacturers. The segment marketed four models of display units in 1H FY3/17, which was three less than the number of models marketed in 1H FY3/16, compared with six models planned, and the number of display units sold dropped by 61.5% YoY to 32,054 units, which was 49.3% of the forecast. As a result, sales of display units and other products for core pachinko machines dropped sharply. On the other hand, the Control System Segment launched one new model of pachislot machine developed in-house as planned, selling 8,800 units. There were no sales of this model in 1H FY3/16.

Meanwhile, segment profit surpassed initial forecast mainly because of steady growth in the sales volume of models that the Company worked on. R&D expense in the Control System Segment decreased slightly by 2.7% YoY to ¥618mn, but was largely in line with expectations.

Sales Volumes in 1H FY3/17

Sales Volumes (Information Systems Segment)

	1H FY3/16 Result	1H FY3/17 Result	YoY change	FY3/16 Initial Co. forecast
Hall computers	54 units	30 units	-24 units	50 units
Call lamps				
BiGMO Series	6,820 units	- units	-6,820 units	- units
BiGMO PREMIUM	21,619 units	12,674 units	-8,945 units	17,500 units
REVOLA	- units	19,583 units	19,583 units	17,500 units
IL-X Series	41,189 units	10,757 units	-30,432 units	22,000 units
VEGASIA CR unit	44,094 units	30,327 units	-13,767 units	30,600 units
Face recognition system	6 halls	3 halls	-3 halls	7 halls

Sales Volumes (Control Systems Segment)

	1H FY3/16 Result	1H FY3/17 Result	YoY change	FY3/16 Initial Co. forecast
Display unit models	7 models	4 models	-3 models	6 models
Units sold	83,272 units	32,054 units	-51,218 units	65,000 units
Pachislot machine models	0 models	1 models	1 models	1 models
Units sold	0 units	8,800 units	8,800 units	9,000 units

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



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Projected to attain sales growth and restore profitability on a full-year basis in FY3/17

(3) Company forecasts for FY3/17

For FY3/17, the Company has maintained its initial forecasts. It is projected to attain sales growth and restore profitability. The Company forecasts a 6.4% YoY increase in consolidated net sales to ¥50.0bn, an operating income of ¥1.0bn, reversing the ¥894mn operating loss in FY3/16, an ordinary income of ¥1.0bn versus an ordinary loss of ¥749mn in FY3/16, and profit attributable to owners of parent of ¥600mn, after a loss of ¥1,676mn in FY3/16.

The outlook for the market environment remains uncertain. With this in mind, the Company foresees a YoY decline in sales in the Information System Segment in FY3/17 based on an anticipated decline in sales of hall computers and peripheral equipment. However, the Company expects sales in the Control System Segment to contribute positively to sales growth, mainly based on anticipated sales of three pachislot machine models developed in-house and planned for launch in FY3/17.

The Company projects a YoY rise in its SG&A expenses in FY3/17, reflecting increases in sales commissions and advertising and sales promotion costs accompanying greater sales of pachislot machines. However, it sees sales growing enough to more than offset this increase in SG&A expenses, leading to a return to profitability. The Company plans to invest ¥4.4bn in R&D in FY3/17, which is 17.4% less than it invested in R&D in FY3/16.

Company Forecasts for FY3/17 versus FY3/16 Results

	FY3/16 Result		FY3/17 Forecast		YoY change	
		Ratio to sales		Ratio to sales		YoY rate of change
Sales	47,004		50,000		2,996	6.4%
Information Systems	34,076	72.5%	31,000	62.0%	-3,076	-9.0%
Control Systems	12,986	27.6%	19,000	38.0%	6,014	46.3%
Gross profit	14,279	30.4%	17,200	34.4%	2,921	20.5%
SG&A expenses	15,174	32.3%	16,200	32.4%	1,026	6.8%
Operating income	-894	-1.9%	1,000	2.0%	1,894	-
Information Systems	2,277	6.7%	2,300	7.4%	23	1.0%
Control Systems	-1,319	-10.2%	600	3.2%	1,919	-
Adjustment	-1,852	-	-1,900	-	-	-
Ordinary income	-749	-1.6%	1,000	2.0%	1,749	-
Profit attributable to owners of parent	-1,676	-3.6%	600	1.2%	2,276	-
Depreciation cost	1,360		1,700		340	25.0%
R&D expense	5,330		4,400		-930	-17.4%
Information Systems	3,965		2,700		-1,265	-31.9%
Control Systems	1,365		1,700		335	24.5%

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

Sales in 1H FY3/17 were below forecast and the market environment remains under pressure in 2H FY3/17. Despite these factors, the Company has maintained its sales forecast for FY3/17. We believe there are two main reasons: 1) the Company has determined that it must determine investment trends among pachinko hall operators after the industry's "collection and removal" policy for non-compliant machines ends on December 31, 2016; and, 2) the Company has posted stronger-than-anticipated sales of component and related products in the Control System Segment. In regard to the first reason above, there is a view that the need to address the industry's "collection and removal" policy for non-compliant machines has exhausted the surplus investment capacity of many pachinko hall operators. Meanwhile, there are signs that pachinko hall operators with relatively strong finances are looking for opportunities to make new investments. For these reasons, the Company seems to believe that pachinko hall operators could resume positive investment activity after the start of 2017.

On the other hand, although profits in 1H FY3/17 were above forecasts, we believe the Company has maintained its profit forecasts for FY3/17 mainly because profits in 1H FY3/17 included the impact of the postponement of certain SG&A expenses to 2H FY3/17. Naturally, this will not impact full-year forecasts for FY3/17.



Daikoku Denki Co., Ltd.

6430 Tokyo Stock Exchange
First Section

2-Feb.-17

The Company's forecasts by segment for FY3/17 are as follows.

a) Information System Segment

For the Information System Segment, profits are projected to increase slightly despite a decline in sales. The Company forecasts a 9.0% YoY decline in net sales to ¥31.0bn, but a 1.0% rise in segment operating income to ¥2.3bn. It expects the new REVOLA information display terminal to contribute positively to sales, but it expects sales of peripheral equipment and other products to fall, leading to a drop in overall segment sales. On the earnings front, the Company will reduce its investment in the development of a next-generation hall computer, now in its final stage. This should lift operating income, albeit slightly. It appears that although sales in 1H FY3/17 were below forecast, the Company will determine whether or not to revise forecasts, as well as the extent of any revisions, once it has identified investment trends among pachinko hall operators following the end of the industry's "collection and removal" policy for non-compliant machines.

b) Control System Segment

For the Control System Segment, the Company expects to return to profitability on the back of a large increase in sales. The Company projects a 46.3% YoY jump in sales to ¥19.0bn and an operating income of ¥600mn, after an operating loss of ¥1,319mn in FY3/16. It anticipates large FY3/17 sales from the three models of pachislot machines that it was unable to sell in FY3/16. On the earnings front, the Company aims to enhance profitability through the large increase in sales, despite a YoY increase in segment R&D expense. The postponement of sales to pachinko machine manufacturers, which caused sales to fall short of forecast in 1H FY3/17, is expected to have a continuing impact on sales forecasts in 2H. However, it appears that the Company has determined that it can adequately make up for any impact based on continued solid sales of components and other products, which were favorable in 1H FY3/17.

Sales Targets in FY3/17

Information System Segment

	FY3/16 Result	FY3/17 Target	YoY change
Hall computers	113 units	100 units	-13 units
Call lamps			
BiGMO Series	13,412 units	- units	-13,412 units
BiGMO PREMIUM	54,987 units	40,000 units	-14,987 units
REVOLA	- units	40,000 units	40,000 units
IL-X Series	73,020 units	50,000 units	-23,020 units
VEGASIA CR unit	98,009 units	70,000 units	-28,009 units
Face recognition system	12 halls	15 halls	3 halls

Control System Segment

Display unit models	13 models	9 models	-4 models
Units sold	124,770 units	122,054 units	-2,716 units
Pachislot machine models	1 models	3 models	2 models
Units sold	5,100 units	17,800 units	12,700 units

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

Taking into account the Company's 1H FY3/17 performance, the persistently severe market environment and other factors, FISCO believes that it will not be easy for the Company to meet its forecasts. However, as with the Company, FISCO believes investment trends among pachinko halls after the end of the industry's "collection and removal" policy will have a significant bearing on the Company's business performance in FY3/17. Therefore, progress toward a recovery in investment sentiment on the part of pachinko hall operators, including the impact on business performance in the next fiscal year, must be watched closely.

■ Growth Strategy

Aiming to enhance growth and profitability by expanding market share through the next-generation hall computer and the creation of new added value

The Company is pushing ahead with its new medium-term plan, called “Next 50 Chapter One,” with FY3/17 being the first year of the plan.

The previous medium-term plan was positioned as an investment period through to the completion of the next-generation hall computer. Under the plan, the Company implemented measures such as the development of the next-generation hall computer, in which approximately ¥10.0bn was invested in R&D over three years, the shift to a business model more reliant on services that provide recurring revenues and developing and commercializing pachislot machines. The Company has produced results to a certain extent.

Under the current medium-term plan, the Company assumes that the environment for Japan’s pachinko and pachislot market will gradually improve, and based on this assumption, will strengthen its business base to help customers to respond effectively to market changes (i.e., to attract customers that want to play on machines resembling games) and to reform the management of pachinko halls (by basing strategic decisions on data analysis). The Company intends to increase its share of the market for hall computers with the launch of its next-generation hall computer in FY3/18 and to promote sales growth and profitability by applying its capability to analyze data and plan and develop products to add value to its products and services. The plan targets consolidated net sales of ¥57.0bn (a compound average growth rate of 4.9% over four years) and operating income of ¥4.0bn for an operating income margin of 7.0% and an ROE of at least 7% for FY3/20. The plan envisages four-year R&D investment of ¥10bn on a cumulative basis from FY3/18 to FY3/20, capital investment of ¥4bn (same basis), and depreciation cost of ¥5bn (same basis). While investing and spending for future growth, the Company aims to increase its profitability.

Targets of Current Medium-Term Plan

	FY3/16 Result		FY3/17 Co. Target		FY3/20 Co. Target		Compound average growth rate (from FY3/16)
		Ratio to sales		Ratio to sales		Ratio to sales	
Sales	47,004		50,000		57,000		4.9%
Information Systems	34,076	72.5%	31,000	62.0%	38,000	66.7%	2.8%
Control Systems	12,986	27.6%	19,000	38.0%	19,000	33.3%	10.0%
Operating income	-894		1,000	2.0%	4,000	7.0%	-
Information Systems	2,277	6.7%	2,300	7.4%	5,000	13.2%	21.7%
Control Systems	-1,319	-	600	3.2%	1,000	5.3%	-
Adjustment	-1,852	-	-1,900	-	-2,000	-	-
ROE		-5.5%		2.1%		7.0% and more	-
Sales of MG Services		3,832		4,200		7,300	17.5%

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

Although FISCO also assumes that Japan’s pachinko and pachislot industry is likely to recover gradually from the short-term business decline due to the industry’s restrictions on machine specifications, the industry’s prospects remain uncertain due to possible structural changes in its external environment. However, the Company’s ability to invest ¥10bn in the next-generation hall computer gives it a great advantage over other companies in the industry. Thus, even if the industry or market were to contract further, the Company could maintain growth by increasing its share of the market. The pachinko and pachislot hall industry is likely to polarize further depending on capital availability and to consolidate, which would benefit the Company.

The Company has considerable scope to demonstrate its competitive edge in terms of its ability to devote ample time and funds to develop in-house pachislot machines compared with other pachislot machine makers, and its ability to analyze data to develop machines that offer appealing game features. However, rather than fight for share in the current market, we believe that the key to success for the Company is to use its ability to create original value to target new submarkets, such as fans of anime, thereby supporting the growth of the overall market for pachislot machines.

Current business performance remains under pressure due to the impact of the rapid onset of restrictions on models with strong gambling aspects. The outlook is highly uncertain for FY3/18 based on several factors, including the possibility of additional industry restrictions and user responses to the replacement of models (including the impact of temporarily turning off certain customers) along with investment trends among pachinko hall operators based on those factors. In addition, we have assumed that the Company will begin sales of the next-generation hall computer within FY3/18 at the earliest. However, depending on market conditions, it would be prudent to consider the possibility that the Company may push back the launch schedule. Therefore, although we must take a cautious view of the Company's short-term business performance, from a medium- to long-term perspective, the current challenging situation will encourage a shift to game play based on a stronger emphasis on game features and the consolidation of the pachinko hall industry, thereby helping to lay the groundwork for the Company to demonstrate its competitive advantages still further. Going forward, from a medium-to long-term perspective, FISCO expects the Company to achieve its growth targets based on its dominant market position. We will also be closely watching the Company's initiatives to help reinvigorate Japan's pachinko industry.

■ Shareholder Returns

Supplementing minimum dividends with dividends dependent on profits

For FY3/16, the Company paid interim dividends of ¥10 per share and term-end dividends of ¥40 per share, for full-year dividends of ¥50 per share. It plans to pay the same dividends for FY3/17.

Through FY3/15, the Company paid minimum dividends of ¥40 per share and supplemented these dividends with special dividends depending on its profits. However, from FY3/16, the Company raised its minimum annual dividends to ¥50 per share.

Given the Company's policy of supplementing its minimum dividends with dividends dependent on profits, FISCO foresees the likelihood of increases in annual dividends as the Company's profits grow over the medium term.

To make its shares more attractive to investors and to encourage shareholders to keep their holdings over the medium-to-long term, the Company has just adopted a system of awarding gifts to shareholders. According to this system, all shareholders registered at the end of September will be awarded points that vary depending on the number of shares held (the minimum holding is 100 shares) and the length of time they have been held. These points can be exchanged for food, electronic goods, gifts, and the Company's original goods.

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