

**Dynam Japan Holdings**06889 Hong Kong Stock  
Exchange

7-Aug.-14

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and disclaimers appear  
at the end of this document.FISCO Ltd. Analyst  
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## ■ Expanding by promoting low playing cost machines and low-cost operations

Dynam Japan Holdings is the top operator of pachinko and pachinko slot (pachislot) halls in Japan in terms of the number of halls operated and the second largest operator in terms of operating revenue. Japan's market for pachinko and pachinko slot entertainment has been shrinking for years, but the company has maintained high sales and earnings by increasing the number of its halls. The company's promotion of low playing cost halls has supported its sales growth, and its reliance on the chain store business model for opening new halls, plus its low-cost hall operations, have underpinned profit growth. These strategies have allowed the company to expand its market share and establish a basis for growth over the medium-to-long term.

By the end of the fiscal year ending in March 2023, i.e., by the end of FY3/23, the company aims to have 1,000 halls in operation and to hold a 10% share of the Japanese market. The company has grown by stressing the quality of its halls more than their number, and it values efficiency. We believe that it should be assessed based on the quality of its halls, rather than their number.

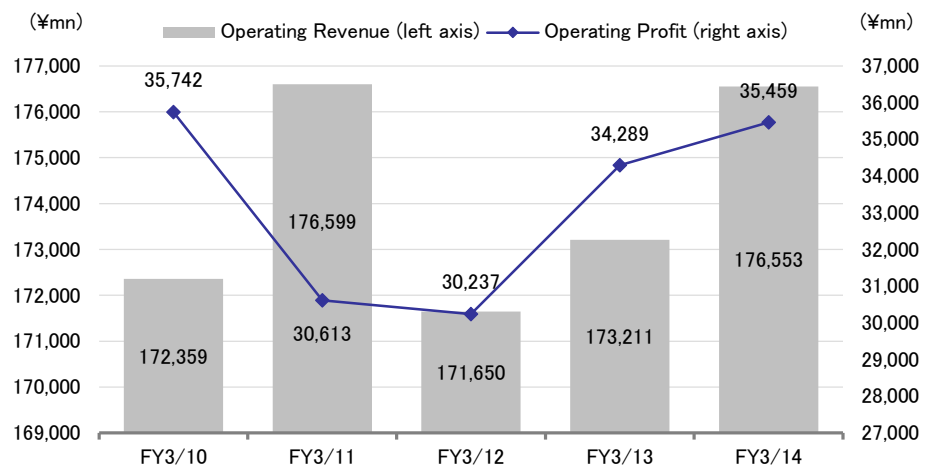
Dynam Japan Holdings is anxious to enter the casino business, but it intends to do so carefully, based on an analysis of its properties and strengths. This is a realistic approach, given the size of the company and the risks inherent in the casino business. The casino business is still not legal in Japan, although a bill is pending in the Diet to legalize it at some point in the future.

A proposal has been made to tax pachinko and pachislot entertainment. Dynam Japan Holdings supports this proposal because it believes that such a tax would be more beneficial than detrimental. It might transform the public perception of the pachinko industry from being at risk of regulation to being entitled to operate. As a result, the company's share price might rise.

## ■ Check Point

- The only listed operator of pachinko and pachislot halls in Japan, although listed in Hong Kong
- Invested in a casino operator in Macao and gaining valuable know-how from the company
- Maintaining a high dividend payout ratio of 45-50%, despite heavy investment in growth

Operating Revenue and Operating Profit (¥mn), FY3/10–FY3/14



## ■ Company Overview

### The only listed Japanese operator of pachinko and pachislot halls

#### (1) Corporate history and business description

At the end of March 2014, Dynam Japan Holdings operated 375 pachinko and/or pachislot halls in Japan, the highest number of any operator. In FY3/14, the company's revenue from renting pachinko balls and pachislot tokens totaled ¥922.2bn, which was the second largest such revenue in the industry. This revenue is also called gross revenue. Dynam Japan Holdings is the only listed Japanese operator of pachinko halls. Its shares were listed on the Hong Kong Stock Exchange in August 2012.

In 2012, the pachinko industry generated sales of ¥19.1trn, which was about 80% of the revenue generated by all gaming industries in Japan. Thus, the pachinko industry far surpassed in size other gaming industries, such as horse racing, bicycle racing, boat racing, auto racing, and the lottery. Nonetheless, the pachinko industry had shrunk steadily since at least 1995, when it generated sales of ¥30.9trn.

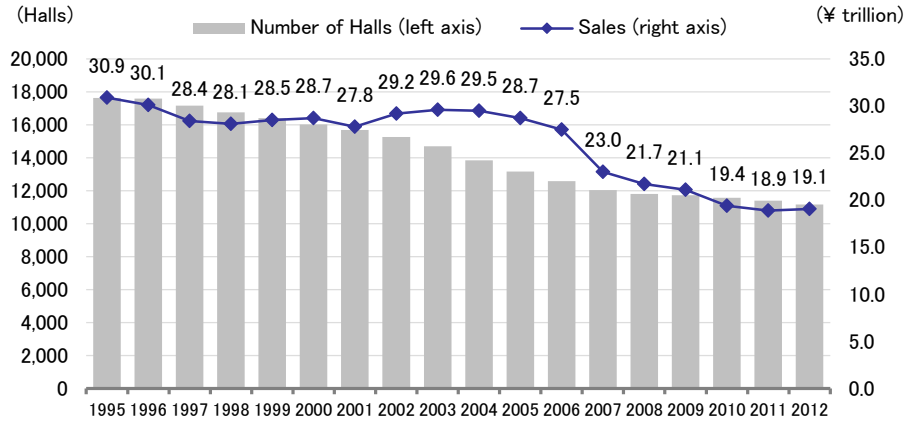


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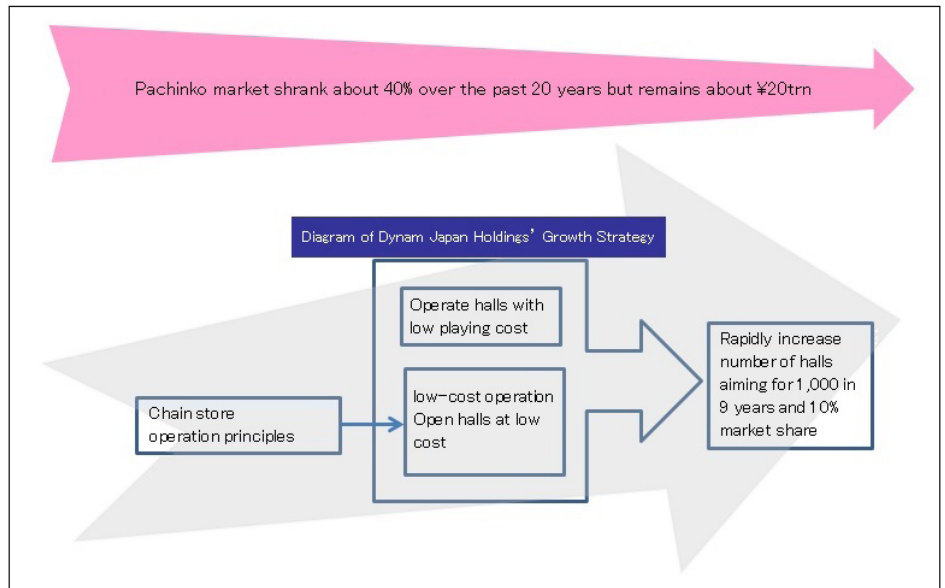
### Japan's Pachinko Hall Market in Terms of Sales and Number of Halls in Operation, 1995-2012



Source: compiled by Fisco based on the Leisure White Paper by the Japan Productivity Center and materials from Nichiyukyo (Japan Association of Recreation Businesses) and Japan's National Police Agency

Japan's pachinko market is shrinking for many reasons: games played on mobile devices have become popular, Japan's population is shrinking, and real personal income has been dropping for years. In other words, the causes of industry contraction are structural, not cyclical. However, the pachinko market is still close to ¥20trn in size, and to prosper in a shrinking industry, Dynam Japan Holdings' strategy is to increase its market share. To do that, it is opening more halls offering machines with low playing cost, thereby attracting more customers. In opening more halls, the company applies the low-cost principles of chain store management. It uses the same principles to manage its halls, thereby insuring profitability.

#### Diagram of Dynam Japan Holdings' Growth Strategy



To understand the company’s strategy, it is helpful to know its history and the management style of its chairman, Mr. Yoji Sato. When Mr. Sato graduated from university, he took a job with the supermarket company Daiei (8263), a pioneer in the chain store business. At Daiei, Mr. Sato absorbed the principles of chain store management. Shortly thereafter, Mr. Sato’s father, who had founded Sawa Shoji, the predecessor of Dynam Japan Holdings, passed away. Therefore, Mr. Sato left Daiei and assumed the leadership of Sawa Shoji at the age of 24. Mr. Sato then introduced the principles of chain store operation to the business of operating pachinko halls and steered the company to the top of the industry as a result. At the same time, he introduced modern business concepts, such as putting the customer first, publically corporate information disclosure, and compliance management, earlier than most other Japanese companies. In summary, he created a company with low operational risk.

**Company History**

July 1967	Established as Sawa Shoji Co., Ltd., with pachinko halls in Kameari and Kanamachi, Tokyo
November 1987	Company name changed to Dynam Co.
April 1989	Hired first employees who had just graduated from universities
October 1989	Opened company’s first suburban pachinko hall in Shinhatsuda, Niigata Prefecture
October 1993	Became a corporate member of the Pegasus Club, an organization that analyzes chain store operations
August 1994	Opened company’s first low playing cost pachinko hall made of wood, in Kobetsu, Hokkaido
July 1997	Held first business results meeting with securities analysts
December 1997	Received the first investment rating ever awarded to a pachinko hall operator in Japan
April 1998	Established a labor union called Dynam Union, the first such union in the industry
December 2006	Opened the first pachinko hall offering low playing costs (¥2 per pachinko ball and ¥10 per pachislot token), in Kobetsu, Hokkaido. Established Dynam Holdings Co., Ltd.
May 2007	Began full-scale development of Dynam Yuttari Kan pachinko halls, which rent pachinko balls at a price of ¥1 each
March 2009	Announced the concept of Shinrai no Mori pachinko halls and opened the first such hall in Takanosu, Akita Prefecture
September 2011	Dynam Japan Holdings established through a split up of Dynam Holdings
August 2012	Shares listed on the Hong Kong Stock Exchange
January 2013	Established subsidiary Dynam Hong Kong Co., Ltd.
May 2013	Announced investment in the Erin Town Project, a real estate development in Mongolia
June 2013	Announced the investment of US\$35mn in Macao Legend Development Ltd.
October 2013	Announced the investment of US\$15mn in IGG Inc., of Singapore
January 2014	Invested US\$50mn more into Macao Legend Development Ltd.

**Number of Yuttari Kan halls matches number of traditional Dynam halls**

**(2) Promotion of low playing cost halls**

A main component of Dynam Japan Holdings’ growth strategy is to aggressively increase the number of its pachinko/pachislot machines that can be played at low cost and thereby attract more customers. Competitors are doing the same thing, but Dynam Japan Holdings is leading the industry in this change. For traditional pachinko machines, the standard rental fee is ¥4. Low-cost machines charge rental fees of only ¥1-2 per pachinko ball.

At the end of FY3/14, 371 of the company’s 375 pachinko halls, or 98.9% of all halls, were equipped with at least one low-cost machine and 65% of all its machines were low-cost machines, compared to an industry average proportion of 40.5%.

Dynam Japan Holdings operates three kinds of pachinko halls, traditional Dynam halls offering high playing cost machines, i.e., machines charging a rental fee of ¥4 per pachinko ball and ¥20 per pachislot token, Yuttari Kan halls, which specialize in low playing cost machines, and Shinrai no Mori halls, which are based on the concept of time consuming leisure and offer mainly low playing cost machines. The Yuttari Kan halls allow smoking anywhere, whereas the Shinrai no Mori halls strictly segregate smoking areas. In FY3/14, the company opened 13 new pachinko halls, all being Yuttari Kan halls. It also converted one traditional Dynam hall and four Shinrai no Mori halls into Yuttari Kan halls. Thus, at the end of FY3/14, the company operated 173 traditional Dynam halls and 172 Yuttari Kan halls, as summarized in the table below.

**Breakdown by Type of Pachinko Halls Operated by  
Dynam Japan Holdings at the end of FY3/14**

Type	Rental cost per ball for most machines	Smoking policy	Number of halls
Traditional Dynam	¥4	open	173
Yuttari Kan	¥1-2	open	172
Shinrai no Mori	¥1-2	segregated	30

**Installation Rates of Machines With Low Playing Costs for  
Dynam Japan Holdings and the Japanese Pachinko Industry at the end of FY3/14**

	Dynam Japan Holdings	Industry
% of halls with at least 1 low-cost machine	98.9%	–
Ratio of low-cost pachinko machines to total machines	65.0%	40.5%
Ratio of low-cost pachislot machines to total machines	50.0%	21.1%

The average revenue per pachinko/pachislot hall has been declining for some time for Dynam Japan Holdings and the pachinko industry. The company aims to reverse this trend by rapidly introducing more machines with low playing cost, hoping to increase the number of its customers enough to offset the decline in rental charge. The industry has been slower to adopt machines with low playing cost, apparently because hall operators doubt that they can offset the impact of lower rental charges with an increase in the number of customers.

**Dynam Japan Holdings' Revenue from Renting Pachinko Balls (Gross Revenue),  
Net Revenue, and Operating Profit by Type of Pachinko Hall, FY3/13 – FY3/14**

(¥mn)

			FY3/13			FY3/14			
			H1	H2	Total	H1	H2	Total	Ratio
Gross Revenue	Total	Ammount	467,263	461,895	929,158	470,532	451,640	922,172	100.0%
	Traditional Dynam	Ammount	364,457	352,385	716,842	343,925	324,661	668,586	72.5%
	Yuttari Kan	Ammount	80,575	87,668	168,243	107,249	108,578	215,827	23.4%
	Shinrai no Mori	Ammount	22,231	21,842	44,073	19,358	18,401	37,759	4.1%
Net Revenue	Total	Ammount	82,060	81,901	163,961	82,159	83,595	165,754	100.0%
		% of gross revenue	17.6%	17.7%	17.6%	17.5%	18.5%	18.0%	
	Traditional Dynam	Ammount	53,823	53,485	107,308	51,598	52,523	104,121	62.8%
		% of gross revenue	14.8%	15.2%	15.0%	15.0%	16.2%	15.6%	
	Yuttari Kan	Ammount	22,433	23,006	45,439	25,889	26,489	52,378	31.6%
		% of gross revenue	27.8%	26.2%	27.0%	24.1%	24.4%	24.3%	
	Shinrai no Mori	Ammount	5,804	5,411	11,215	4,671	4,584	9,255	5.6%
		% of gross revenue	26.1%	24.8%	25.4%	24.1%	24.9%	24.5%	
Hall Operating Profit	Total	Ammount	15,489	14,568	30,057	14,003	15,860	29,863	100.0%
		% of net revenue	18.9%	17.8%	18.3%	17.0%	19.0%	18.0%	
	Traditional Dynam	Ammount	12,113	13,726	25,839	11,019	15,043	26,062	87.3%
		% of net revenue	22.5%	25.7%	24.1%	21.4%	28.6%	25.0%	
	Yuttari Kan	Ammount	3,158	1,435	4,593	2,745	761	3,506	11.7%
		% of net revenue	14.1%	6.2%	10.1%	10.6%	2.9%	6.7%	
	Shinrai no Mori	Ammount	218	-592	-374	239	56	295	1.0%
		% of net revenue	3.8%	-10.9%	-3.3%	5.1%	1.2%	3.2%	

## Hall operations made more efficient with personal systems

### (3) Low-cost operations

The strategy that Dynam Japan Holdings is pursuing to increase its revenue may be contributing to a decline in the average revenue per hall. In order to maintain hall profitability, the halls must be operated at low cost, in line with chain store operating principles.

The company operates and opens halls at low cost. For example, the business model for a new Yuttari Kan hall is as follows. There are two standard sizes for these halls, those equipped with 480 machines and one with 560 machines. They are located in smaller cities or suburbs with one hall per area containing 50,000 potential customers. The land on which to build a hall is leased for 20 years, and a hall is made of wood, resulting in a total initial cost at about ¥452mn. The pachinko and pachislot machines for the hall cost about ¥150mn, and this cost is not booked as a fixed asset at the balance sheet but is entirely expensed in the first year of operations, so a new hall is invariably unprofitable in its first year. However, it turns profitable in its second year, and the company aims for an average annual return on its investment of 28.9% over the first 10 years.



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To operate halls at low cost, the company controls its personnel and machine costs, which together comprise about 60% of the total cost of operating a hall. It lowers its machine cost by installing used machines and private brand machines, and by negotiating low machine installation costs. Dynam Co., the main operational company of the group, develops private brand machines, as does Dynam Business Support Co. The company keeps its personnel cost low by using personal systems and by managing uniformly, based on an information system. Personal systems are particularly effective in lowering personnel cost.

Personal systems include magnetic memory cards that record the number of pachinko balls or pachislot tokens purchased, used and won. They allow customers to change pachinko machines without carrying their pachinko balls. Thus, hall corridors remain uncluttered with boxes for carrying balls, and it is easier to monitor the number of balls outstanding, enabling the company to reduce the number of employees per hall. Ordinarily, 10 regular employees and 10 part-time employees are needed to operate a pachinko hall over three shifts. By using personal systems, Dynam Japan Holdings can operate a hall over three shifts with 6-7 part-time employees. The company has introduced these systems into 217 of its halls and into more than 90% of its Yuttari Kan and Shinrai no Mori halls. It plans to install these systems into all new halls opened in the future.

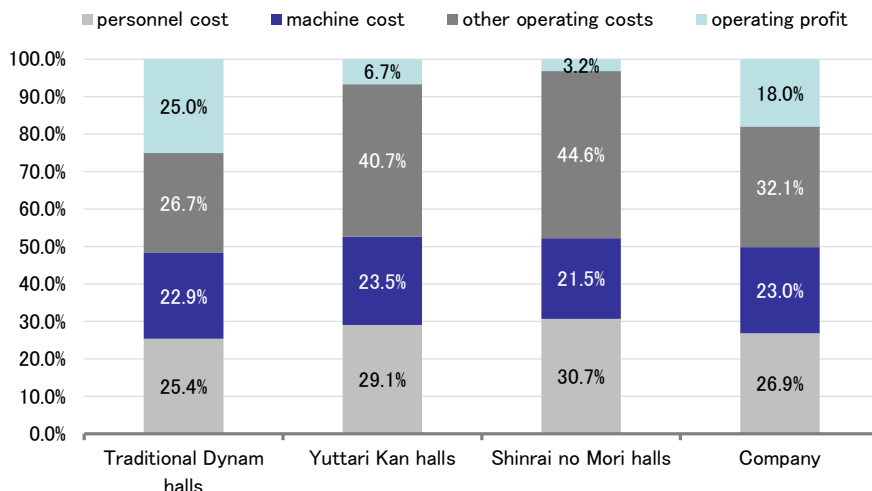
Summary of Measures to Expand Revenue and Control Operating Costs

Purpose	Main Measures	Details	Impact
Expand Revenue	Open mainly halls with low-cost machines	Open <i>Yuttari Kan</i>	Increase scale of halls operations
	Modify machines to accommodate changing customer desires		Raise revenues
Expand Profit	<b>Standardize new hall Formats</b>	<b>Initial cost ¥452mn, excluding machine cost</b>	<b>Minimize initial investment cost</b>
	Wood structures	Serve a customer population of 50,000	
	20-year land lease	Reap 10-year average ROI of 28.9%	
	480 or 560 machines	Machine cost ¥150mn expensed in first year	
Expand Profit	<b>Control operating costs</b>	<b>Costs of personnel and machines comprise 60% of total operating costs</b>	<b>Lower hall operating costs</b>
	Install used machines	Used machines to account for 20.3% of total machine cost in H1 FY3/15	Reduce machine cost
	Install private brand machines	Introduced in Feb. 2014; aims to install 2,000 machines ultimately	
	Store machines at distribution centers	With 14 centers nationwide, use lowers machine installation cost	
	Introduce personal systems	Installed in 217 halls at end FY3/14; in 90.1% of all <i>Yuttari Kan</i> and <i>Shinrai no Mori</i> halls	Raise employee productivity
Uniform management based on information system	System comprises six subsystems for managing halls, operations, machines, prizes, personnel, and accounts	Lower employee costs per hall	
			Raise administrative efficiency

The company's policy of maintaining low-cost operations appears reasonable, and it is quite persuasive. For example, we calculate that a private brand machine is about ¥100,000, or 20-30%, cheaper than a national brand machine. However, a private brand machine may not attract as many customers as a national brand machine. The company can select used machines based on its appraisal of their popularity, so the installation of used machines should have the desired impact. The storage of machines at distribution centers should also lower costs, given the frequency of machine replacement and the flexibility this practice allows to satisfy local variations in types of machines considered attractive.

The company's model for opening new halls seems to be working. The profitability of the 20 halls opened during the past two years varies, but on average, it is in line with the company's target. This should give the company self confidence about its approach.

**Breakdown of Operating Costs and Profit by Type of Pachinko Hall in FY3/14**



To improve the profitability of its unprofitable halls, the company could strictly implement its low-cost operations. It has already installed personal systems in many of its halls, but it can install them in more halls and thereby reduce the number of its employees. It has just begun to install used and private brand machines, so it could install either or both in unprofitable halls. To increase the revenues of unprofitable halls, it could replace machines that rent balls for ¥1 per ball with machines charging ¥2 per ball. Machines that charge ¥4 per ball remain popular, attesting to the price insensitivity of demand for pachinko machine entertainment.

An effective marketing strategy may be to attract more elderly customers, particularly people who have never played pachinko. The elderly are becoming an increasingly important customer segment for game centers in Japan during the daytime. The elderly tend to prefer to play games with metal tokens. Pachislot halls have managed to keep elderly customers longer period of time by lowering their rental fee for tokens, thereby increasing their revenues. In this respect, they are identical to pachinko halls equipped with machines that charge low rental fees.

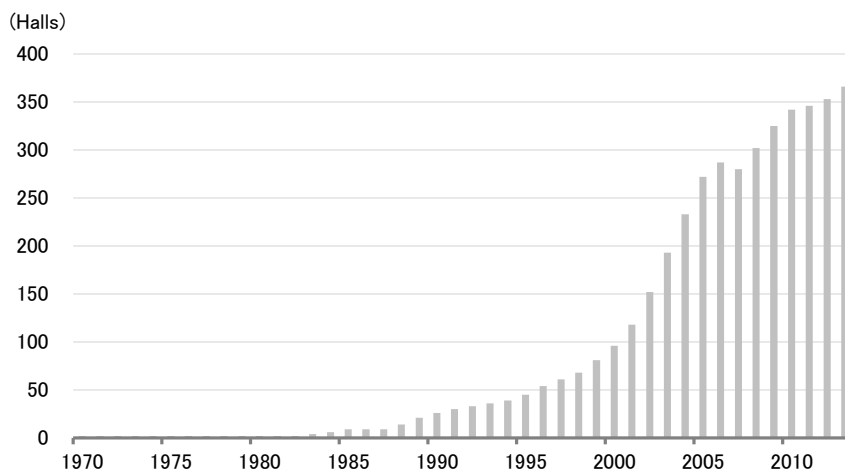
### The company targets 1,000 halls in operation and a 10% market share in 9 years

#### (4) Mid-term Hall Opening Plan

For the business of operating pachinko halls, Dynam Japan Holdings aims to operate 1,000 halls and to hold a 10% share of the Japanese market 9 years from now. In other words, it aims to almost triple the current number of its halls. To do this, it plans to open an average of about 40 halls per year and to acquire other pachinko hall operators.



**Number of Pachinko/pachislot Halls Operated by Dynam Co.**



However, Dynam opened only seven new halls in FY3/13 and 13 in FY3/14, and we believe it will be difficult to open 40 new halls per year while maintaining the strict criteria it has set for new halls. We believe that the company should only open new halls that meet its criteria, rather than opening them just to expand. Therefore, we applaud the company for limiting its new hall openings to 20 over the past two fiscal years. The company’s criteria for setting up a new hall are demanding but well-conceived, enabling a hall to earn an operating profit of about ¥130mn in its second year of operation, which is a sizable profit.

However, the company should have enough cash to open 40 new halls per year. Investing ¥452mn per new hall, the company would need about ¥18.1bn per year. If it maintained its dividend at FY3/14’s level of ¥14 per share, it would need about ¥10.4bn per year to pay dividends. Against these cash requirements, in FY3/14, the company earned a net profit of ¥21,310mn and claimed a depreciation expense of ¥10,234mn.

**Statement of Simplified Free Cash Flow, FY3/10–perpetuity**

	FY3/10	FY3/11	FY3/12	FY3/13	FY3/14	Future years	(¥mn) assumptions
net profit (A)	20,214	16,191	15,898	20,925	21,310	21,300	same as FY3/14
depreciation expense (B)	11,402	11,462	10,804	10,507	10,234	10,200	same as FY3/14
cash inflow (A) + (B)	31,616	27,653	26,702	31,432	31,544	31,500	
dividend payments (D)	7,242	4,295	4,885	4,271	10,586	10,400	¥14 DPS for 742.85mn shares outstanding
investment in new halls (E)	11,133	6,152	7,471	10,723	9,292	18,080	40 halls at ¥452mn per hall
cash outflow (D) + (E)	18,375	10,447	12,356	14,994	19,878	28,480	

## ■ Topics

### The company invested in Macao's casino operator

#### (1) Basic stance towards casino business

Dynam Japan Holdings wants to enter the casino business as both an operator of pachinko halls and a casino operator. To prepare for this business, the company set up a subsidiary in Hong Kong in January 2013.

#### ○ Overseas activity

In June 2013, Dynam Japan Holdings invested US\$35mn in casino operator Macao Legend Development Ltd., and in January 2014, it invested another US\$50mn in this company. Dynam Japan Holdings also concluded a contract with Macao Legend Development to install a new generation of pachinko machine in the casinos operated by Macao Legend. Instead of containing pins onto which pinballs drop, the new machines have LCD screens. To develop this new type of machine and games for the machine, Dynam Japan Holdings signed a memorandum of understanding with IGG Inc., of Singapore, and invested US\$15mn in that company in October 2013. No other Japanese operator of pachinko halls has invested in and concluded a business contract with a casino operator in Macao.

Since Dynam Japan Holdings invested in Macao Legend Development Ltd. and IGG Inc., the share prices of both these companies have risen. Thus, at the end of FY3/14, Dynam Japan Holdings held valuation gains of ¥2.3bn on its investment in IGG and of about ¥5.6bn on its investment in Macao Legend Development. Dynam Japan Holdings is under no obligation to maintain its stakes in these companies. It may sell them whenever it wishes to.

#### ○ Possible casino business in Japan

The Japanese government is trying to make Japan more attractive to international tourists. Tokyo will host the Olympic Games in 2020, and many parties are promoting the development of integrated resorts that include casinos, which are currently banned in Japan. A multi-party commission in the Diet is preparing a bill to legalize casinos. Full debate on this bill is likely at the extraordinary session of the Diet this autumn, but it appears that the bill will ultimately become law. Details of the bill remain fluid, so it is premature to speculate about its commercial potential. However, several local governments have expressed interest in hosting an integrated resort, including the governments of Hokkaido, Chiba, Kanagawa, Osaka, Nagasaki, Miyazaki, and Okinawa.

No Japanese company has the knowhow to operate a casino, and several companies are trying to acquire such knowhow, but this will take quite a bit of time. It may be necessary to obtain the cooperation of a US casino operator. Furthermore, many non-Japanese casino operators are interested in establishing business in Japan. Therefore, competition for sites for integrated resorts in Japan's larger cities is likely to be intense. Given this probability, Dynam Japan Holdings apparently intends to set up an integrated resort on its own land using its competitive strengths.

It is impossible to predict whether Dynam Japan Holdings or any other Japanese company could compete successfully in the casino business, but Dynam Japan Holdings believes that its participation in this business would benefit its stakeholders. The initial investment in an integrated resort would be huge. Probably, it would surpass ¥1trn for a resort in the Greater Tokyo area. The company plans to avoid such a large initial investment and to base its decision on entering the casino business on the optimal use of its land, capital, and work force. This is a down-to-earth stance.

Another unknown is whether casinos in Japan could attract serious global gamblers as do Las Vegas and Macao. If the casino business were overly regulated, it may not be competitive internationally. Thus, it would be prudent to await the details of the anticipated law and its application before committing significant resources to the business.

## The company supports Pachinko tax

### (2) Company stance on the tax

#### ○ Background of pachinko tax

The imposition of a tax on pachinko entertainment has been promoted often in the past by some Japanese politicians. The current administration of Prime Minister Shinzo Abe is advocating such a tax to partially offset the decline in tax revenue resulting from a proposed drop in corporate income tax rates. A 1% tax on the ¥20trn pachinko industry would yield tax revenue of ¥200bn.

The government has not decided whether to impose a pachinko tax, but mass media have reported that it is considering imposing such a tax as a commission on the conversion of prizes won at pachinko halls into cash. This conversion takes place at shops near pachinko halls that are separate from the pachinko industry. If such a scheme were implemented, the current legal framework for the pachinko industry may have to be amended.

Regardless of the legal arguments, the pachinko industry generally imposes any tax on its business because it fears that the tax would adversely affect the business. If pachinko hall customers were taxed, the number of customers may decline.

#### ○ Company stance

Dynam Japan Holding supports the imposition of a tax on pachinko/pachislot entertainment because it believes that paying such a tax would convey the positive impression of an industry contributing to society and that this image would support the stable growth of the industry over the long term.

We believe that Dynam Japan Holdings' stance toward a pachinko/pachislot tax is the most realistic and forward-looking stance because this tax seems likely, as does the legalization of the casino industry. A bill combining the imposition of a pachinko tax as a new source of tax revenue with the legalization of the casino industry would have a good chance of passing.

A pachinko tax may hurt the company's earnings in the short term, but we think that opposition to the tax would be more effective when other taxes are being raised than when the tax is being introduced. Opposition at such times, when many consumers are opposed to tax increases, might help the company attract more customers.

Moreover, the taxation of pachinko entertainment might allow Japanese operators of pachinko halls to list their shares in Japan. They have been unable to list in Japan because the securities industry has not recognized the legitimacy of the structure of the pachinko industry, in which prizes are converted into cash at shops that are supposedly independent of the pachinko industry. The share price valuations of listed operators of pachinko halls might then reflect the image of such operators as providers of entertainment, rather than as likely targets of regulation.

## Financial Analysis and Business Trends

### Recording high, stable profits

#### (1) Financial analysis

In FY3/14, the company's return on equity (ROE) remained high at 15.9%, but this was about five percentage points lower than the ROE of 20.6% in FY3/11.

ROE is the product of a company's return on assets (ROA) and financial leverage. In FY3/14, the company's ROA was 19.6%, higher than its ROE, partly because the company had low financial leverage. Dynam Japan Holdings has been reducing its interest-bearing debt, which fell to ¥4,324mn at the end of FY3/14. The large contribution of the company's ROA to its ROE attests to the high quality of its ROE. However, if the company continues to reduce its interest-bearing debt while earning large net profits, its ROE will decline.

As detailed in the table below, the company's operating revenue and operating profit have changed little over the past four fiscal years, but its operating profit margin has remained high, recovering to more than 20% in FY3/14.

We suspect that Dynam Japan Holdings maintains a large amount of cash in order to open new pachinko halls and enter the casino business. As discussed below, the company keeps a dividend payout ratio of close to 50%, a high level which demonstrates an unusual concern for its shareholders.

**Financial Figures for Dynam Japan Holdings, FY3/10–FY3/14**

			FY3/10	FY3/11	FY3/12	FY3/13	FY3/14
Main results	Operating revenue	¥mn	172,359	176,599	171,650	173,211	176,553
	SGA costs	¥mn	642	934	1,754	3,112	4,075
	Operating profit	¥mn	35,742	30,613	30,237	34,289	35,459
	Net profit	¥mn	20,214	16,191	15,898	20,925	21,310
	Total assets	¥mn	166,958	166,927	156,461	167,877	185,732
	Equity	¥mn	71,929	85,370	93,474	125,827	142,817
	Interest-bearing debt	¥mn	54,269	38,017	23,237	5,583	4,324
	Depreciation cost	¥mn	11,402	11,462	10,804	10,507	10,234
Profitability & Efficiency	EBITDA	¥mn	47,144	42,075	41,041	44,796	45,693
	Equity ratio	%	–	20.6%	17.8%	19.1%	15.9%
	Ratio of operating profit to total assets	%	–	18.3%	18.7%	21.1%	20.1%
	Asset turnover rate	x/year	–	1.06	1.06	1.07	1.00
	Gross profit margin	%	21.1%	17.9%	18.6%	21.6%	22.4%
	SGA cost ratio	%	0.4%	0.5%	1.0%	1.8%	2.3%
	Operating profit margin	%	20.7%	17.3%	17.6%	19.8%	20.1%
	EBITDA margin	%	27.4%	23.8%	23.9%	25.9%	25.9%
Growth	Operating revenue growth	%	4-year average rates				0.6%
	Operating profit growth	%					–0.2%
	Net profit growth	%					1.3%

### Gross and net revenue from Yuttari Kan halls grew y-o-y

#### (2) Consolidated Financial Results for FY3/14

In FY3/14, Dynam Japan Holdings increased its operating revenue (net revenue plus other revenue) by 1.9% y-o-y to ¥176,553mn, its operating profit by 3.4% y-o-y to ¥35,459mn, its pretax profit by 3.7% to ¥34,678mn, and its net profit by 1.8% y-o-y to ¥21,310mn.



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Revenue from renting pachinko balls or pachislot tokens, or gross revenue, declined by 0.8% y-o-y to ¥922,172mn, but the cost of prizes decreased by 1.1% y-o-y to ¥756,418mn, so net revenue rose by 1.1% y-o-y to ¥165,754mn. Other revenue increased by 16.7% y-o-y to ¥10,799mn, primarily because the company recorded its first valuation gain on its investment in IGG Inc., of ¥2,301mn. The main component of other revenue, commissions on sales of vending machines, was essentially unchanged y-o-y at ¥4,084mn.

Gross revenue from traditional Dynam pachinko halls fell by 6.7% y-o-y to ¥668,586mn in FY3/14. This decline was partially due to the reduction in the number of these halls by one, but the main reason for the drop was a decline in the number of customers, as consumers shifted to pachinko halls equipped with machines of low operating cost.

Gross revenue from Yuttari Kan pachinko halls grew by 28.3% y-o-y to ¥215,827mn, reflecting two factors: 1) demand for this kind of hall equipped with low playing cost machines and allowing open smoking, and 2) the addition of 18 halls, of which 13 were new, one resulted from the conversion of a traditional Dynam hall, and four came about from the conversion of Shinrai no Mori halls.

Gross revenue from Shinrai no Mori pachinko halls dropped by 14.3% y-o-y to ¥37,759mn, primarily because four of these halls were converted into Yuttari Kan halls.

Net revenue from traditional Dynam halls decreased by 3.0% y-o-y to ¥104,121mn, net revenue from Yuttari Kan halls increased by 15.3% y-o-y to ¥52,378mn, and net revenue from Shinrai no Mori pachinko halls fell by 17.5% y-o-y to ¥9,255mn. The Yuttari Kan halls reduced the profit earned by shops converting prizes into cash to increase returns to customers, effectively raising its cost of prizes, but it increased its gross revenue enough to greatly offset this impact.

**Dynam Japan Holdings' Gross Revenue, Cost of Prizes, and Net Revenue by Type of Pachinko Hall, FY3/13 – FY3/14**

(¥mn)

			FY3/13			FY3/14			
			H1	H2	Total	H1	H2	Total	Ratio
Gross Revenue	Total	Amount	467,263	461,895	929,158	470,532	451,640	922,172	100.0%
	Traditional Dynam	Amount	364,457	352,385	716,842	343,925	324,661	668,586	72.5%
	Yuttari Kan	Amount	80,575	87,668	168,243	107,249	108,578	215,827	23.4%
	Shinrai no Mori	Amount	22,231	21,842	44,073	19,358	18,401	37,759	4.1%
Cost of Prizes	Total	Amount	385,203	379,994	765,197	388,373	368,045	756,418	100.0%
		% of gross revenue	82.4%	82.3%	82.4%	82.5%	81.5%	82.0%	–
	Traditional Dynam	Amount	310,634	298,900	609,534	292,327	272,138	564,465	74.6%
		% of gross revenue	85.2%	84.8%	85.0%	85.0%	83.8%	84.4%	–
	Yuttari Kan	Amount	58,142	64,662	122,804	81,360	82,089	163,449	21.6%
		% of gross revenue	72.2%	73.8%	73.0%	75.9%	75.6%	75.7%	–
	Shinrai no Mori	Amount	16,427	16,431	32,858	14,687	13,817	28,504	3.8%
		% of gross revenue	73.9%	75.2%	74.6%	75.9%	75.1%	75.5%	–
Net Revenue	Total	Amount	82,060	81,901	163,961	82,159	83,595	165,754	100.0%
		% of gross revenue	17.6%	17.7%	17.6%	17.5%	18.5%	18.0%	–
	Traditional Dynam	Amount	53,823	53,485	107,308	51,598	52,523	104,121	62.8%
		% of gross revenue	14.8%	15.2%	15.0%	15.0%	16.2%	15.6%	–
	Yuttari Kan	Amount	22,433	23,006	45,439	25,889	26,489	52,378	31.6%
		% of gross revenue	27.8%	26.2%	27.0%	24.1%	24.4%	24.3%	–
	Shinrai no Mori	Amount	5,804	5,411	11,215	4,671	4,584	9,255	5.6%
		% of gross revenue	26.1%	24.8%	25.4%	24.1%	24.9%	24.5%	–

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### Aiming to increase its profits by carrying out its growth strategy

#### (3) Prospects for FY3/15

The company has not announced its forecasts for FY3/15. Although Japan's economy has picked up, the operating environment for the pachinko industry is likely to remain challenging. Individual income is rising somewhat, but the clientele of pachinko halls is aging as hall use by young people declines.

The company aims to increase its profits by carrying out its growth strategy of opening new Yuttari Kan Halls and converting traditional Dynam halls and Shinrai no Mori halls into Yuttari Kan halls to expand revenues while thoroughly applying low-cost operations to lower costs.

Dynam Japan Holdings has stated that it plans to open about 40 new halls per year, but we believe 13, the number opened in FY3/14, is more realistic. To lower costs, the company will probably continue to install more private brand and used machines, as well as more personal systems.

The pachinko industry claims to have been unaffected by the rise in Japan's consumption tax rate from 5% to 8% as of April 1, 2014, mainly because the industry did not raise its fees following the tax rise. However, the industry is being hurt by a rise in its cost of prizes.

#### Summary Income Statement, FY3/10 – FY3/14

(¥mn)

	FY3/10		FY3/11		FY3/12		FY3/13		FY3/14	
	Results	Results	y-o-y	Results	y-o-y	Results	y-o-y	Results	y-o-y	
Gross revenue	862,023	859,882	-0.2%	908,309	5.6%	929,158	2.3%	922,172	-0.8%	
Cost of prizes	696,562	690,245	-0.9%	743,231	7.7%	765,197	3.0%	756,418	-1.1%	
Net revenue	165,461	169,637	2.5%	165,078	-2.7%	163,961	-0.7%	165,754	1.1%	
Other revenue	6,898	6,962	0.9%	6,572	-5.6%	9,250	40.7%	10,799	16.7%	
Operating revenue	172,359	176,599	2.5%	171,650	-2.8%	173,211	0.9%	176,553	1.9%	
Pachinko hall operating costs	134,787	144,239	7.0%	138,785	-3.8%	133,904	-3.5%	135,891	1.5%	
SGA costs	642	934	45.5%	1,754	87.8%	3,112	77.4%	4,075	30.9%	
Other operating costs	1,188	813	-31.6%	874	7.5%	1,906	118.1%	1,128	-40.8%	
Total operating costs	136,617	145,986	6.9%	141,413	-3.1%	138,922	-1.8%	141,094	1.6%	
Operating profit	35,742	30,613	-14.4%	30,237	-1.2%	34,289	13.4%	35,459	3.4%	
Net financial cost	2,442	2,137	-12.5%	1,833	-14.2%	853	-53.5%	781	-8.4%	
Pretax profit	33,300	28,476	-14.5%	28,404	-0.3%	33,436	17.7%	34,678	3.7%	
Tax expense	13,086	12,285	-6.1%	12,506	1.8%	12,511	0.0%	13,368	6.8%	
Net profit	20,214	16,191	-19.9%	15,898	-1.8%	20,925	31.6%	21,310	1.8%	



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Summary Balance Sheet, 3/10 – 3/14

	(¥mn)				
	3/10	3/11	3/12	3/13	3/14
Current assets	32,971	34,766	36,871	50,568	50,946
Cash & deposits	22,087	17,460	28,524	41,466	34,830
Sales receivable	374	352	381	359	563
Other	10,510	16,954	7,966	8,743	15,553
Long-term assets	133,987	132,161	119,590	117,309	134,786
Tangible fixed assets	101,191	98,004	95,033	93,853	94,605
Intangible fixed assets	1,775	1,678	1,489	1,411	1,408
Long-term investments, others	31,021	32,479	23,068	22,045	38,773
Total assets	166,958	166,927	156,461	167,877	185,732
Current liabilities	55,747	45,020	33,384	30,694	33,666
Accounts payable	1,459	1,232	1,148	905	1,722
Short-term borrowings, etc.	26,335	15,439	1,654	1,258	1,265
Others	27,953	28,349	30,582	28,531	30,679
Long-term liabilities	39,282	36,537	29,603	11,356	9,249
Long-term borrowings	27,934	22,578	21,583	4,325	3,059
Other	11,348	13,959	8,020	7,031	6,190
Equity	71,929	85,370	93,474	125,827	142,797
Capital stock	5,540	6,100	5,000	15,000	15,000
Additional paid-in capital	0	0	0	0	0
Retained earnings	66,389	79,270	88,474	110,827	127,797
Treasury stock	0	0	0	0	0
Translation gains or losses	0	0	0	0	0
Total equity	71,929	85,370	93,474	125,827	142,817
Liabilities & equity	166,958	166,927	156,461	167,877	185,732
Interest-bearing debt	54,269	38,017	23,237	5,583	4,324

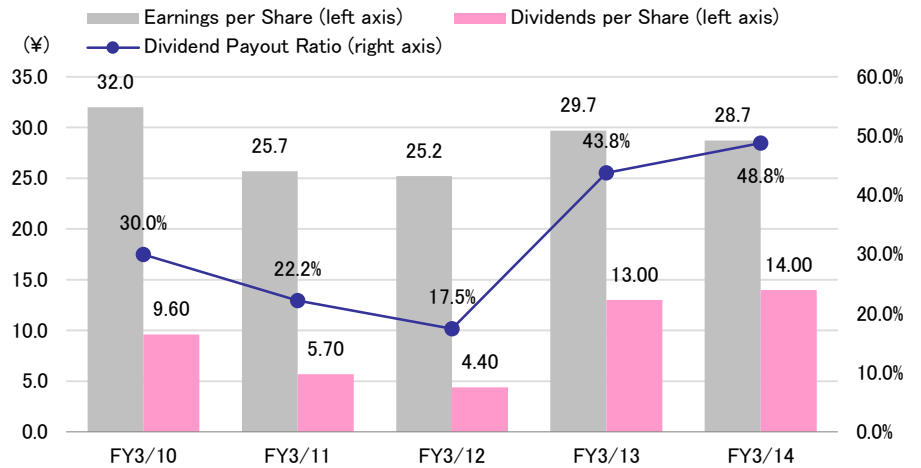
Summary Cash Flow Statement, FY3/10 – FY3/14

	(¥mn)				
	FY3/10	FY3/11	FY3/12	FY3/13	FY3/14
Cash flow from operations	19,229	33,399	31,906	28,330	27,455
Cash flow from investing	-10,053	-17,248	10,998	-10,899	-22,470
Cash flow from financing	-7,560	-20,778	-31,840	-8,028	-13,102
Translation adjustments to cash and deposits	0	0	0	3,539	1,481
Y-o-y change in cash and deposits	1,616	-4,627	11,064	12,942	-6,636
Cash and deposits at start of the year	20,471	22,087	17,460	28,524	41,466
Cash and deposits at end of the year	22,087	17,460	28,524	41,466	34,830

### Company to maintain high dividend payout ratio while investing aggressively in growth

As a listed company, Dynam Japan Holdings is mindful of its obligations to its shareholders. Consequently, it intends to maintain a dividend payout ratio of at least 35%. For FY3/14, the company paid a dividend of ¥14 per share, for a dividend payout ratio of 48.8%. A payout ratio this high is a generous return to shareholders. It is even more praiseworthy given the company's need for funds to open new halls and to enter the casino business.

**Earnings per Share, Dividends per Share and Dividend Payout Ratio, FY3/10 – FY3/14**





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