DYNAM JAPAN HOLDINGS

06889

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FISCO Ltd. Analyst
Yuzuru Sato

FISCO Ltd.
https://www.fisco.co.jp

Index

Summary

The Company aims to rekindle growth by bolstering earnings power through reforming hall operations

DYNAM JAPAN HOLDINGS Co., Ltd. (HK06889; hereinafter, the Company) is the 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 FY3/21 consolidated operating profit remained positive despite the novel coronavirus (COVID-19) pandemic

In FY3/21 consolidated results, revenue declined 30.8% year-on-year (YoY) to ¥98,602mn, while operating profit declined 68.7% YoY to ¥6,728mn. The main factors for the decline in both revenue and profit were that the Company had no choice but to temporarily close halls from April to May 2020 following the government's declaration of a state of emergency in conjunction with the COVID-19 pandemic, as well as the fact that, even after the resumption of operations, customers' return to halls was tepid, and the level of revenue from July onward on a monthly basis was only 70-80% that of the previous year. The Company has worked to thoroughly reduce costs, including curbing machine purchases and reviewing hall operating and personnel costs, and the Company also booked ¥5,544mn in subsidy income from the government. As a result, the Company was able to achieve positive operating profit, which was its initial target. As the entire industry was forced to deal with a challenging business environment, the Company's ability to quickly respond to the changes in the environment and post a profit is worthy of praise. In the aircraft leasing business, which was launched as a new business in FY3/20, the Company continued to lease three aircraft, and posted revenue of ¥1,461mn in FY3/21 (versus ¥564mn in FY3/20).

2. Aims to post an increase in both revenue and a profit in FY3/22

The Company will aim to secure higher revenue and another year of positive profit in FY3/22. In Japan, despite the continued difficulty in predicting when the COVID-19 pandemic will come under control, progress is being made on vaccine administration, so from July 2021 onward the Company is planning to gradually start activities to bring in customers, and implement measures to increase customers while taking infection risks into consideration. Even if the same operating as in 2H FY3/21 continues, pachinko business revenue is expected by be 12-13% higher than in FY3/21. Meanwhile, the factors behind the increase in costs include the rise in machine purchasing costs. Among the pachinko and pachislot machines in halls, machine models under the former regulations (approximately 105,000 machines) must all be removed by the end of January 2022, and replaced with machines under the new regulations. Also, regarding the subsidies received from the government that were posted in FY3/21, given the fact that all halls continue to operate normally in FY3/22, it is highly likely that these subsidies will decrease significantly in FY3/22. Based on this point, the Company will carry out its hall operational reforms at all halls as a measure to reduce costs, and the Company also plans to increase the number of low-cost, private-brand machines in halls.

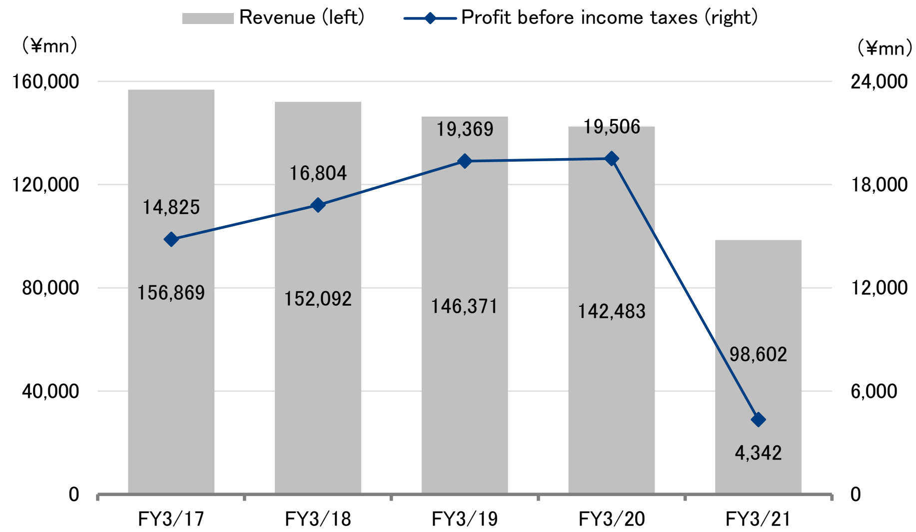
3. Pachinko business growth strategy

With the aim of achieving growth in the pachinko business, the Company will work on five different fronts: multiple-hall operation, low playing cost operation, product development, data-driven operations, and cost management. Amid the prolonged COVID-19 pandemic, a total of 666 pachinko halls closed, one of the largest number of closures ever. Looking at it another way, it is a good opportunity to purchase pachinko halls. If the terms are right, the Company will consider targeting halls that hold 400-500 machines and that will not eat into the business of other Group halls. Also, the Company will work to bolster hall profitability by reviewing operations, advancing a strategy of putting in place machines using a data-driven process, increasing the ratio of private-brand machines, and other measures. At FISCO, we think that over the next year or two the weeding out 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 FY3/21, revenue and operating profit declined by double digits due to the impact of the COVID-19 pandemic, but an operating profit was secured as a result of thorough cost reductions
- In the pachinko business, the Company worked to reduce costs by reforming hall operations and introducing private-brand machines, and the Company is aiming for an operating profit again in FY3/22.
- As the COVID-19 pandemic has led to weeding out and consolidation in the pachinko hall industry, the Company will advance initiatives targeting growing again

Trends in operation results



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 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 was a pioneer in the pachinko hall industry by acting on new initiatives ahead of peers, including hiring new university graduates, opening suburban halls and low-cost halls, forming a labor union, and spreading low-fee ball rental 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 his father, the founder, he succeeded his father for the Company's management, and within this management, he 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.

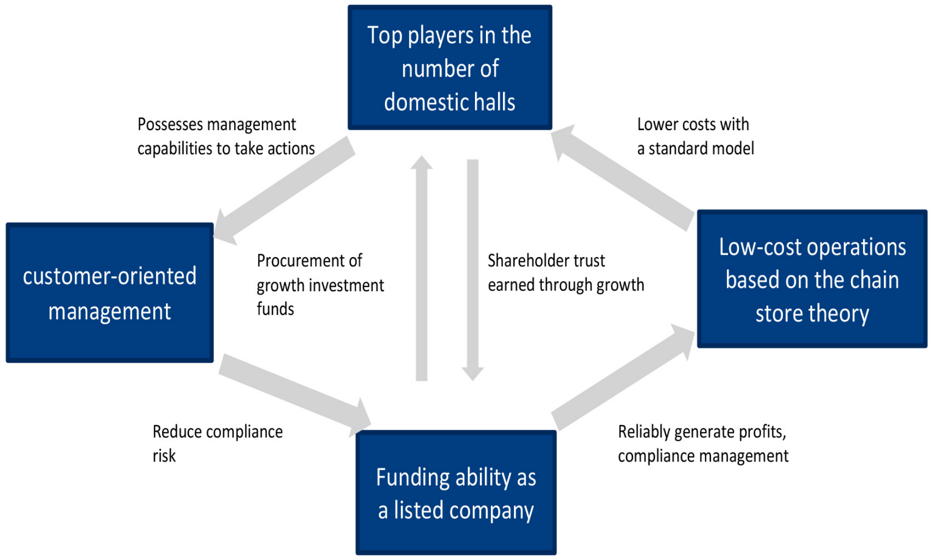
His logical approach rooted in the chain store theory took hold as the corporate culture and served as a fundamental force lifting the Company to the position of being the top company in the industry. The Company also moved quickly in embracing the most important concepts for modern management of a customer-first 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.

Relationship among the four strengths of the Dynam Japan Holdings Group

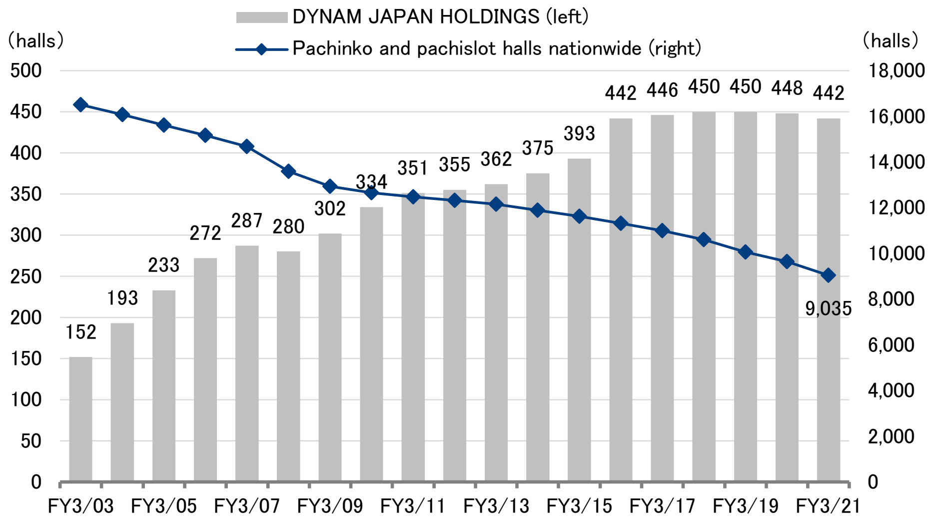


Source: Prepared by FISCO from interviews

(1) The domestic leader with 442 group halls

The Company is the domestic leader with 442 group halls (as of the end of March 2021). While it is not possible to make precise comparisons due to differences in compilation timing, the Company's domestic shares for the number of halls and machine installations are both at around 5%. The Company's market share exceeded 1% in 2003, and since then it has increased its number of halls, including through M&A, and the Company has maintained its market share amid the decrease in the overall number of halls in the industry.

Trend in number of group halls



Source: Prepared by FISCO from the Company's website, 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 2020"

The Company's large number of halls provides it with economies of scale that appear in new hall openings, renovations, pachinko and pachislot machine purchases, prize procurement, logistics, and other areas. Benefits in pachinko and pachislot machine purchases and hall operations, which account for a large portion of expenses, are particularly important. The large number of halls obviously means ownership of a high volume of pachinko and pachislot machines and stronger buying power toward amusement equipment manufacturers. The Company also develops and deploys private-brand machines (as of the end of March 2021, 12.7% of installed pachinko machines were private-brand machines) and realizes economies of scale in this respect too. Furthermore, the Company has established logistics centers that cover 20-30 halls in 16 locations nationwide, and the Company is curbing machine costs (costs related to purchasing pachinko and pachislot machines) and reducing shipping costs by having halls flexibly lend machine models to one another. In addition, the Company is managing halls in an agile manner, including adjusting machine model lineups according to customers' needs, and has built a system enabling it to both increase the number of customers and reduce costs.

(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. Yet it takes more than just direct cost cutbacks. The Company is succeeding with low-cost operations as an overall group by deploying hall designs and hall operating systems (such as ball counters at each machine) that facilitate operations with a small number of employees and by 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.

The Company is the industry leader in Japan, as mentioned earlier, with 442 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.

The history section explained the background to the Company's utilization of the chain store theory in its management. The Company established the Pachinko Chain Store Association (PCSA), an industry group in 2003 with peers who have a similar view. By promoting the activities of PCSA, the Company is contributing to strengthening the management foundations of its industry peers, and this leads to Yume Corporation Co., Ltd. joining the Group in November 2015. In October 2020, PCSA merged with the Japan Association of Pachinko Industry Executives, with the new, post-merger entity named the Mirai Pachinko Industry Federation.

(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.

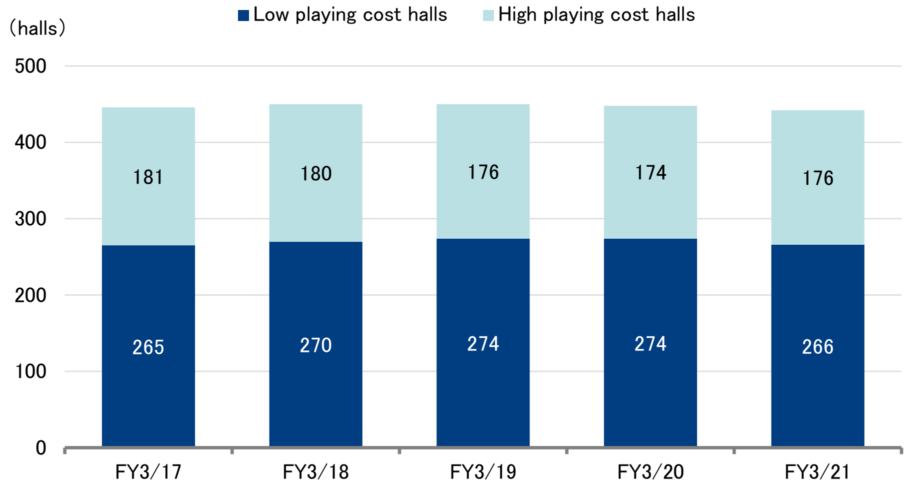
Among the Company's business policies, we have a favorable view of a) low playing cost and b) operations that do not rely on gambling appeal. These are also key words for understanding the Company's business policy and growth strategy.

a) Low playing cost operations

Low playing cost (Pachinko is a game that is played with rented balls) operations refer to a type of operation in which the ball fee 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. At the end of March 2021, it had 266 low playing cost halls, which is 60.2% of its total halls. In terms of the ratio of machines installed, the ratio of pachinko machines that are low playing cost machines is 71.8% (compared to an industry average of 42.7%) and the ratio of low playing cost pachislot machines is 57.3% (compared to an industry average of 16.6%), so both ratios greatly exceed the industry averages.

Data shows that halls offering low playing cost have attracted more customers than halls charging higher fees. Yet it takes substantial company wherewithal to adopt this type of strategy. The strategy for covering this is the multiple-hall operation and low-cost operations, and that it exactly what the Company has been doing.

Number of low playing cost halls and high playing cost halls



Source: Prepared by FISCO based on the Company's annual report, website, 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, 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 the share of machines with the lowest gambling features at 1/100 probability is 20 percentage points higher than the industry average. The Company cannot avoid the impact of stricter regulations on gambling appeal, but given the fact that the Company has been developing halls 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.

(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 2,600 companies are listed on stock markets as of the end of March 2021. 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 strong demand for potential capital through not only M&A but investment in halls and new business development, etc., it is likely that the Company's advantage of being a listed company will work tremendously in its favor.

FY3/21 results conditions

Double-digit declines in both revenue and profit due to the impacts of the COVID-19 pandemic, but profit achieved through thorough cost-cutting efforts

1. Summary of FY3/21 results

In the FY3/21 consolidated results, revenue and profit declined by double digits. Revenue declined 30.8% to ¥98,602mn, operating profit fell 68.7% to ¥6,728mn, profit before income taxes decreased 77.7% to ¥4,342mn, and net profit attributable to owners of the Company fell 81.5% to ¥2,363mn.

Summary of FY3/21 interim results

(¥mn)

	FY3/20 Results	FY3/21			Remark
		Results	YoY	Change	
Revenue	142,483	98,602	-30.8%	-43,881	
Revenue from pachinko business	141,919	97,141	-31.6%	-44,778	High playing cost halls 47,655 (-21,964), low playing cost halls 49,486 (-22,814)
Revenue from aircraft leasing business	564	1,461	159.0%	897	Acquired during FY3/20, full operation in FY3/21
Operating expenses	122,311	97,564	-20.2%	-24,747	
Pachinko business expenses	121,912	96,673	-20.7%	-25,239	Machine costs -11,264mn, personnel costs -5,880mn, advertising costs -1,626mn
Aircraft leasing business expenses	399	891	123.3%	492	
SG&A expenses	5,020	4,340	-13.5%	-680	
Other income	8,446	11,561	36.9%	3,115	Vending machine fee income -1,694, government subsidy income +5,544
Other operating expenses	2,084	1,531	-26.5%	-553	
Operating profit	21,514	6,728	-68.7%	-14,786	
Financial income	461	286	-38.0%	-175	
Financial expenses	2,469	2,672	8.2%	203	
Profit before income taxes	19,506	4,342	-77.7%	-15,164	
Net profit attributable to owners of the Company	12,748	2,363	-81.5%	-10,385	

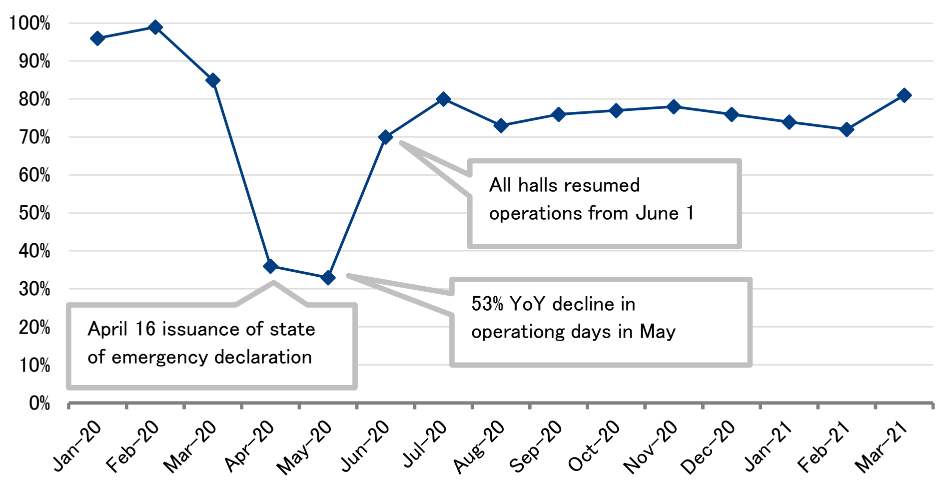
Source: Prepared by FISCO from the Company's financial statements announcement and results briefing materials

Following the Japanese government's declaration of a state of emergency due to the COVID-19 pandemic, in the pachinko business the Company had no choice but to temporarily close approximately 97% of its halls in the April through May 2020 period. The halls were then reopened from June after conducting thorough infection prevention measures, but customers were slow to return due to caution about COVID-19, and from July onward revenue from the pachinko business was only 70-80% of the same month of the previous year. This was the main reason for the decline in revenue. However, the Company worked to thoroughly reduce costs, including the curbing of machine purchases, narrowing personnel costs, and reviewing other expenses, as well as booked an employment adjustment subsidy, etc. of ¥5,544mn from the government in other income. All of this led to the Company securing an operating profit, which was the initial goal.

(1) Pachinko business

Looking at trends in the pachinko industry from April 2020 onward, following the Japanese government's state of emergency declaration on April 16, local governments asked pachinko halls in their respective areas to suspend operations. In response to these requests, 436 of the 448 pachinko halls in the Group had no choice but to temporarily suspend operations. From the beginning of May, the Group's pachinko halls resumed operations sequentially, with infection control measures in place, in regions where the state of emergency had been lifted, but pachinko business revenue in the April – May period fell to approximately 30-40% of the level of the same month of the previous year. While all halls were re-opened from June 1, customers were hesitant to return due to concerns about infections, and since July revenue has remained at 70-80% of the level of the same month in the previous year. Looking by customer segment, it appears that elderly customers have been the most hesitant to return to halls.

Pachinko business revenue (Yo Y)



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

Amid this difficult environment, ball rental fee revenue, which corresponds to gross sales, declined 35.2% YoY to ¥475,163mn. Breaking this down, it fell 34.3% YoY to ¥211,826mn in low playing cost halls, and declined 35.8% YoY to ¥263,337mn in high playing cost halls. Meanwhile, prize issuance value, which represents the cost of goods, declined 36.0% YoY to ¥378,022mn. The difference between ball rental fee revenue and prize issuance value is pachinko business revenue, and this declined 31.6% YoY to ¥97,141mn.

The ratio of ball fee revenue to pachinko business revenue is the gross profit margin, and in FY3/21 the gross margin increased 1.0pp YoY to 20.4%. Breaking it down, the gross margin for low playing cost halls increased 1.0pp YoY to 23.4%, while the gross margin for high playing cost halls increased 1.1pp YoY to 18.1%. Gross margin is the inverse of the payout rate to customers (percentage of prize issuance value to ball rental fee revenue), so if that is too high, it might lead to losing customers. Since past trends show gross margin generally at 18% - 20%, the payout rate in FY3/21 was a bit low.

The Company also thoroughly tightened down on business costs in order to put a stop to the deterioration in earnings. Specifically, the Company reduced machine costs by ¥11,264mn YoY, personnel costs by ¥5,880mn, and other costs including advertising and utilities by ¥8,095mn. Total costs in the pachinko business declined 20.7% YoY to ¥96,673mn. As a result, the operating profit of the pachinko business, which is the difference between revenue and business costs, declined 97.7% YoY to ¥468mn, so the initial target of an operating profit was achieved. As the entire industry faced a business environment more challenging than ever experienced before, the Company's ability to post a profit by swiftly managing the business is worthy of praise. Additionally, the Company booked an employment adjustment subsidy, etc. of ¥5,544mn from the government in other income.

As of March 31, 2021, the Group had 442 halls, a decrease of six halls from March 31, 2020. One hall was newly opened (renovated hall), while seven halls were closed.

Looking at the results for DYNAM Co., Ltd., which is the Group's core company, revenue decreased 31.4% YoY to ¥90,993mn, while operating loss was ¥2,522mn (compared to operating profit of ¥17,016mn in the previous fiscal year). While consolidated results are presented based on International Financial Reporting Standards (IFRS), DYNAM Co., Ltd.'s results are presented based on Japanese accounting standards, and employment adjustment subsidy, etc. from the government was booked in non-operating profit. As a result, ordinary profit declined 81.6% YoY to ¥3,343mn.

DYNAM's results

(¥mn)

	FY3/20 Results	FY3/21			Summary
		Results	YoY	Change	
Revenue	132,713	90,993	-31.4%	-41,720	Temporary hall closures due to impacts of the COVID-19pandemic, slow recovery in customers
Machine costs	24,613	14,719	-40.2%	-9,893	Suppression of pachinko and pachislot machine purchases
Personnel costs	43,082	38,084	-11.6%	-4,997	Suppression of part-time workers' wages, reduction of salaries and bonuses
Other costs	48,003	40,712	-15.2%	-7,291	Reduction of hall operating costs
Total expenses	115,698	93,516	-19.2%	-22,182	
Operating profit	17,016	-2,522	-	-19,538	
Ordinary profit	18,193	3,343	-81.6%	-14,850	Booked employment adjustment subsidy, etc. from the government
Net profit	11,758	1,782	-84.8%	-9,976	
Main KPI (key performance indicators)					
No. of halls	405	401		-4	New hall openings: Ibaraki Inashiki Hall Closed halls: Gunma Isesaki Hall, Nishi-nippori Pachinko Hall, Hitachi Hall, Saga Kanzaki Hall, Tottori Yasunaga Hall
Pachinko machine operating rate	41.4%	28.2%		-13.2pt	Decline in number of customers due to COVID-19
Pachislot machine operating rate	38.2%	27.0%		-11.2pt	Decline in number of customers due to COVID-19
No. of machines	189,140	187,843		-1,297	Installed machine share 4.7%
No. of private-brand machines	12,658	16,742		4,084	Private-brand machine installation rate 12.7% (difference on previous period, +3.2pt)*

*Private-brand machine installation rate is the percentage of total installed pachinko machines
Note: Accounting method is based on Japanese standards
Source: Prepared by FISCO from the Company's results briefing materials and materials provided by the Company

Looking operating rate, one KPI (key performance indicator), the operating rate for pachinko machines declined 13.2pp YoY to 28.2%, while the operating rate fell 11.2pp to 27.0% for pachislot machines, so the operating rate fell significantly for both types of machines due to the decline in customers caused by COVID-19. Additionally, with respect to pachinko machines, the ratio of private-brand machines increased 3.2pp YoY to 12.7%. This shows how the Company raised the ratio of low-cost private-brand machines in the purchase of new machine models, as a part of its effort to reduce costs.

* The number of actual customers / number of machines at the peak time (around 3:00pm)

(2) Aircraft leasing business

In the aircraft leasing business, which was launched in FY3/20, 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. The Company is refraining from purchasing new aircraft given the ongoing headwinds, including the major blow suffered by airlines around the world caused by the COVID-19 pandemic. Currently, the Company is continuing the leases of the three aircraft purchased in FY3/20.

Revenue in FY3/21 was ¥1,461mn, an increase of 159.0% YoY. The rise was due to the full-year contribution in FY3/21 of lease revenue from the three aircraft purchased during FY3/20.

Meanwhile, business expenses increased 123.3% YoY to ¥891mn. As a result, operating profit, including financial costs and other expenses in order to purchase aircraft, increased 39.1% YoY to ¥224mn. The fleet value for the three aircraft is ¥15,999mn, and the annualized gross rate of return was 8.8%.

Results for aircraft lease contracts

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	¥15,999mn	2.2 years	4.5 years	8.8%
IndiGo (India)	October 2019	Airbus A320NEO				
IndiGo (India)	March 2020	Airbus A321NEO				

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

Increasing borrowings in order to secure cash on hand given the uncertain outlook for the business environment

2. Financial condition

At the end of the FY3/21 period, total assets increased ¥23,834mn versus the end of the previous fiscal period to ¥301,073mn. The main factor for the change was the ¥32,851mn increase versus the end of the previous fiscal period resulting from improved cash flow due to bank borrowings and deferrals in the timing of tax payments. These tax payment deferrals were due to special extensions given to companies that were hard hit by the COVID-19 pandemic. Meanwhile, by keeping down machine purchasing costs and by closing unprofitable halls, property, plant and equipment fell ¥8,791mn, and licensing assets declined ¥1,511mn.

Total liabilities were up ¥26,594mn on the end of the previous fiscal period to ¥169,101mn. This was mainly due to the increase in interest-bearing debt, and there was a ¥21,622mn increase in the pachinko business. In addition, accounts payable and accrued expenses increased ¥5,196mn and lease liabilities declined ¥1,857mn.

Total equity was down ¥2,760mn from the end of the previous fiscal period to ¥131,972mn. While the Company posted net profit attributable to owners of the Company of ¥2,363mn, dividend payments were ¥4,576mn, and ¥1,437mn was used on the acquisition and retirement of treasury shares.

Mainly due to the increase in interest-bearing debt, the capital ratio declined from 48.6% at the end of FY3/20 to 43.8%. However, net cash, which is the difference between cash and deposits and interest-bearing debt, was ¥40,694mn, a ¥12,112mn increase from the end of the previous period. However, approximately ¥10bn in deferred tax payments were paid at the end of May 2021, so net cash effectively increased slightly versus the end of the previous period. As a result of the thorough cost-cutting efforts countering the large decline in revenue, the Company maintained its financial soundness, and the Company demonstrated its strength of being able to adroitly handle changes in the environment. This ability is praiseworthy.

Consolidated financial condition

(¥mn)

	End-FY3/20	End-FY3/21	Change	Changed items
Total assets	277,239	301,073	23,834	Cash and cash equivalents (+32,851), property, plant, and equipment (-8,791), licensing assets (-1,511), deferred tax assets (-1,294)
(Cash and cash equivalents)	41,810	74,661	32,851	
Total liabilities	142,507	169,101	26,594	Interest-bearing debt (+20,739), lease liabilities (-1,857), accounts payable and accrued expenses (+5,196)
(Interest-bearing debt from pachinko business)	2,007	23,629	21,622	
(Interest-bearing debt from aircraft leasing business)	11,221	10,338	-883	
Total equity	134,732	131,972	-2,760	Net profit attributable to owners of the Company (+2,363), dividend payments (-4,576), acquisition and retirement of treasury shares (-1,437), other comprehensive income (+890)
(Capital ratio)	48.6%	43.8%	-4.8pt	
(Net cash)	28,582	40,694	12,112	

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

FY3/22 Business Strategy

Will work to reduce costs in the pachinko business by reforming hall operations and installing private-brand machines as it aims to secure an operating profit for FY3/22

1. Pachinko business

(1) Business Strategy

FY3/22 revenue in the pachinko business is expected to increase 12-13% YoY even if the pachinko hall operating rate stays at the same level as it has been since 2H FY3/21. However, this would be only about 80% the level compared to FY3/20.

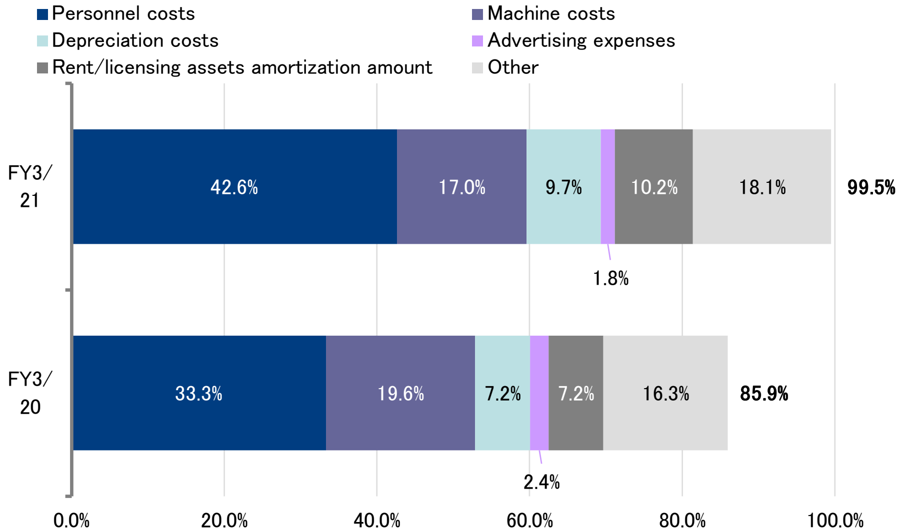
Therefore, as a business policy, the Company will gradually start activities to attract customers from July 2021, when the elderly people are expected to have finished receiving their COVID-19 vaccines. From the fall, with an eye on the infection situation, the Company will push its efforts to attract customers into high gear, and aim to recover the number of customers and pachinko business revenue, with a goal of recovering pachinko business revenue to the level seen before the COVID-19 pandemic by around March 2022.

(2) Cost management

With respect to its business plan for FY3/22, the Company will advance initiatives to secure an operating profit, even assuming that the 2H FY3/21 operation rate continues throughout all of FY3/22. Even though the pachinko business revenue is expected to increase YoY, pachinko business profit will not grow smoothly, as there are actually several things that should be cleared. First of all, the employment adjustment subsidy, etc. (¥5,544mn) received in FY3/21 may decline significantly.

Secondly, there is expected to be a big increase in the number of purchased machines from FY3/22. This is because a 2018 amendment to the Act on Control and Improvement of Amusement Business, etc. led to regulation changes aimed at curbing the gambling appeal of pachinko and pachislot machines, and these changes require hall operators to remove all machines under the former regulations and replace them with machines under the new regulations by the end of January 2022. In the Company's case, at the end of FY3/21, approximately 51%, or 105,000 machines, were machines under the former regulations, and the Company must either replace all of these with machines under the new regulations or simply remove them during FY3/22.

Ratio of expenses to pachinko business revenue



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

The Company plans to work on the two initiatives of reforming hall operations and increasing the installation of private-brand machines. The two major costs involved in hall operations are personnel costs and machine purchasing costs, and reducing these costs will directly lead to strengthening the earnings power of halls. The ratio of hall personnel costs to pachinko business revenue increased from 33.3% in FY3/20 to 42.6% in FY3/21, and the Company will work to lower this personnel cost ratio by carrying out hall operational reforms at all halls.

Hall operational reforms will involve reducing out-of-hall operations and reviewing operations, thereby reducing the total number of hours worked by hall staff and reducing the ratio of personnel costs to hall expenses. The main out-of-hall operations include the ordering and correction of sales promotion materials, and work related to the handling of prizes. The Company will work to lessen the work load related to prizes by reducing the number of items. Specific examples of operational revisions include improving work methods (in-hall meeting bodies, pre-distribution of plans, etc.) and internal rule revisions (reduction of e-mail/text message confirmation time through centralized distribution of information distribution rules, etc.)

In FY3/20, the Group implemented operational reforms on a trial basis at 50 halls (just over 10% of the Group's total number of halls), and these reforms resulted in a roughly 20% decline in personnel costs. The Company plans to start similar reforms at all halls from FY3/22, and a decrease in the personnel cost ratio is expected.

Also, to increase the installation ratio of private-brand machines, the Company plans to strengthen product development. The Company has built cooperative relationships with manufacturers, and has sold 79 types of private-brand machines so far. Over the past three years, the price of private-brand machines has become approximately 15% lower than the price of national brand machines. The machine types are centered on types of Ama Deji (jackpot probability, less than 1/100). Because the Company can provide the Company's own halls with machine types that match customers' needs and it leads to a reduction in machine purchasing costs, there is a large advantage to introducing private-brand machines.

For DYNAM Co., Ltd., the ratio of private-brand machines to the total number of installed pachinko machines was 9.5% in FY3/20 and then increased to 12.7% in FY3/21. In terms of the number of machines, there was a 32.3% increase from the end of the previous period to 16,742 machines, as the slight decline in the overall number of machines resulted in an increase in the ratio. In FY3/22, the number of installed machines will be increased, thereby reducing costs. Also, in the future, the target will be to lower the price of private-brand machines to one-half the current price.

In the aircraft leasing business, the Company plans to maintain the status quo until the external environment improves

2. Aircraft leasing business

In the aircraft leasing business, the situation remains challenging, and in the industry, it is being said that it will take until 2023 or 2024 for things to return to pre-COVID-19 levels. Domestic flights will likely gradually recover first, followed by short-distance international flights, and then long-distance international flights. Also, there is no change to the outlook that over the medium- to long-term horizon global demand for aircraft will continue to expand, especially for narrow body aircraft.

Going forward, the Company has indicated its plan to proceed cautiously with business talks on aircraft, centered on narrow-body models that are no more than five years old, while keeping a close eye on the financial conditions of airlines, and the Company aims to build a stable and highly-profitable portfolio. In FY3/22, the Company is expected to continue the leases for its three existing aircraft.

The Company is preparing to restart sales activities for video slot machines from the fall of 2021

3. Progress in the video slot machine business for casinos

The Company has been working on the planning and development of mass-market video slot machines for the Macau casino market as a new business. Video slot machines are time-consumption-type games, and the development concept is to make straightforward games that incorporate elements of pachinko.

The Company worked on development of this video slot machine jointly with WEIKE GAMING TECHNOLOGY (S) PTE. LTD. (WEIKE), which holds a license for manufacturing and selling casino machines in Macau. So far, the Company has obtained approval for six models from the Macau casino regulatory authorities, and approval for five models in Singapore. In addition, in September 2019 the Company concluded a sales agreement with a Macau casino operator and in November 2019 the Company deployed on a test basis one of each of the three models (total of three machines), and deployed 10 machines in a different casino hall from January 2020. The Macau market was hit hard by the impacts of the COVID-19 pandemic, but currently the Company is using web meetings and other means to confirm with key operators that sales activities will restart after the market recovers.

Status of development approval of casino-use video slot machines

Name of model	Conditions
Pachinko Bonus Series No.1 Machine	Has obtained approval in Macau, and has obtained approval in Singapore in May 2020
Pachinko Bonus Series No.2 Machine	Has obtained approval in Macau, and has obtained approval in Singapore in May 2020
Pachinko Bonus Series No.3 Machine	Has obtained approval in Macau, and has obtained approval in Singapore in November 2019
Pachinko Bonus Series No.4 Machine	Has obtained approval in Macau, and has obtained approval in Singapore in January 2021

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

The Macau casino market is gradually recovering as the restrictions on entry from mainland China, which accounts for about 70% of the number of visitors, have been lifted since September 2020. Although the total revenue in April 2021 was still low at 36% compared to two years ago, it is expected to recover to a certain level after the fall of 2021, and the Company is preparing to start business talks with a third casino operator. Depending on the situation with the COVID-19 pandemic going forward, the Company would like to start negotiations around the fall of 2021.

At FISCO, we think that for the time being, some time will be required before the video slot machines business makes a fully-fledged contribution to earnings. It is unclear how long it will take from the trial introduction to the full-scale introduction and the scale (number of units), but if the machines are liked by a lot of customers, it should lead to a decent contribution to profits. In any case, the most important thing is that the Company's new products become attractive machines for customers and casino operators, and we would like to monitor the operation and sales status of the machines that will be introduced on a trial basis in the future.

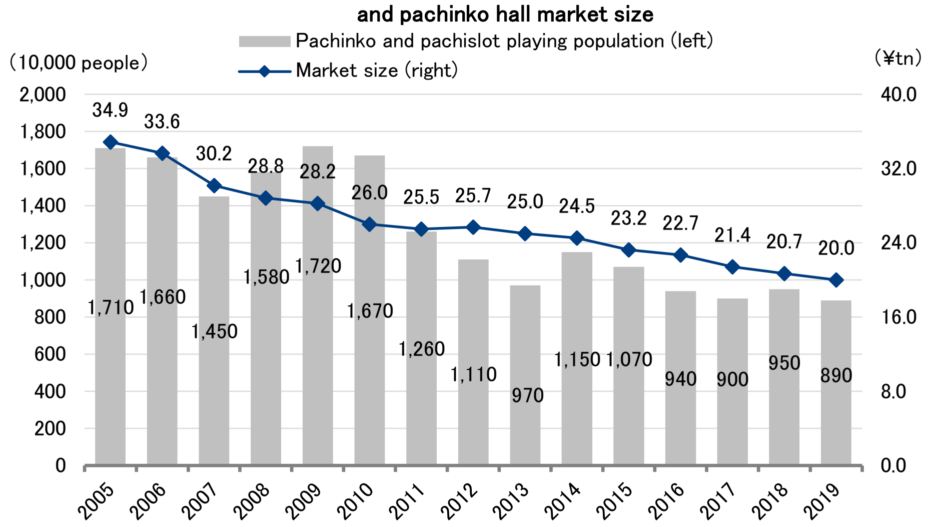
Business outlook

The Company will work towards achieving growth again amid consolidation in the pachinko hall industry spurred by the COVID-19 pandemic

1. Market trends

The pachinko market continues to experience a long-term contraction trend. According to the "White Paper on Leisure 2020" issued by the Japan Productivity Center, Japan's pachinko and pachislot playing population in 2019 was 8.9 million, a 600,000 person decline from 9.5 million in the previous year, and the pachinko hall market size (total ball rental fee revenue) fell 3.4% YoY to ¥20.0tn, marking the seventh consecutive year of decline. Data for 2020 have yet to be released, but it is clear from the Company's earnings that the market contracted significantly due to the COVID-19 pandemic.

Trends in the pachinko and pachislot playing population and pachinko hall market size

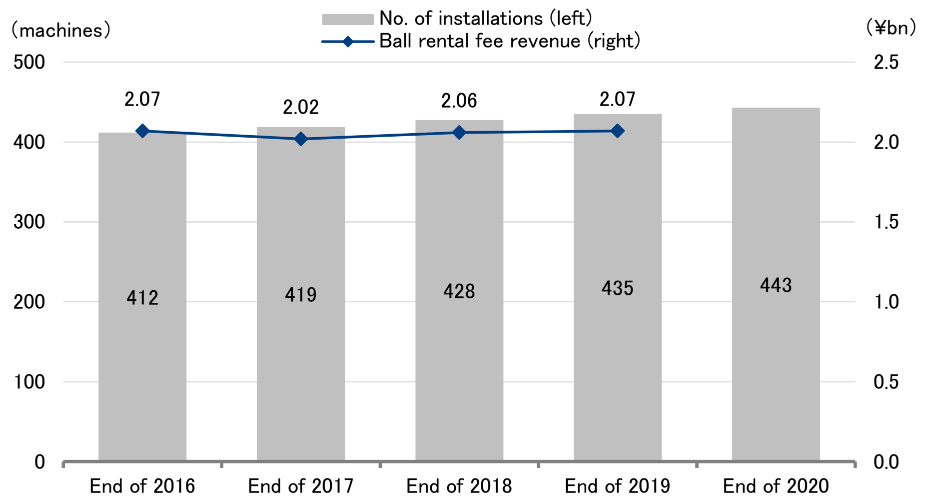


Source: Prepared by FISCO from the Japan Productivity Center's "White Paper on Leisure"

Reflecting these conditions, the number of pachinko and pachislot halls continues to decrease, and at the end of 2020, the number of halls was down 6.3% versus the end of the previous year to 9,035 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 2020"). Also, in terms of the number of machines installed at the end of 2020, the number of pachinko machines decreased 4.9% on the end of the previous year to 2,432,000 machines, and the number of pachislot machines declined 4.0% to 1,572,000 machines, so both continue to trend downward.) At FISCO, we think there is a possibility of further weeding out of weaker, small- and medium-sized halls in 2021 because of the ongoing sluggish operating rate amid the COVID-19 pandemic as well as the increase in investment burden in conjunction with the transition from machine models under the former regulations to machine models under the new regulations. In fact, looking at the numbers of pachinko and pachislot machines per hall, the number has been increasing in the last few years, and stood at 443 (+8 YoY) machines at the end of 2020. Incidentally, for the Group, the number of pachinko and pachislot machines installed per hall as of March 31, 2021, was 471 machines.

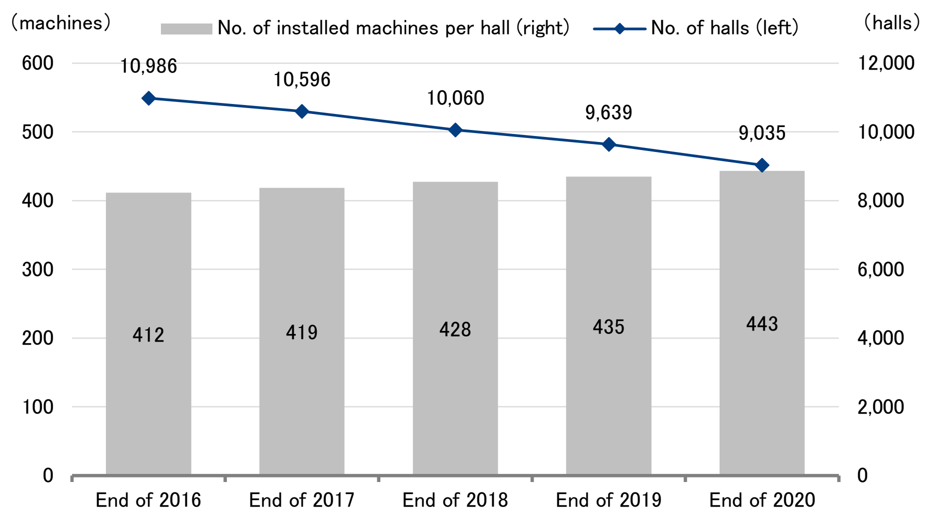
The ball rental fee revenue per hall in FY3/20 was slightly more than ¥1.6bn, which was lower than the industry average of ¥2.07bn. The reason why its ball rental fee revenue is low despite the fact that the number of machines installed is above the industry average is because the percentage of low playing cost pachinko machines for the Company is slightly above 71%, which is much higher than the industry average of just over 42%. As previously stated, the Company has positioned pachinko as a form of daily entertainment that anyone can enjoy, and it has worked on implementing low-cost operations that allow it to secure profitability even with low playing costs, and this has allowed it to expand business. At FISCO, we think that the low-cost operation know-how that the Company has cultivated up until this point will be put to good use amid the headwinds created by the COVID-19 pandemic.

Trends in number of installations and ball rental fee revenue per hall



Source: Prepared by FISCO from the Japan Productivity Center's "White Paper on Leisure" and the National Police Agency's "Current Situation with Amusement and Entertainment Business and Situation with Policing Amusement and Entertainment-related Crime, etc. in 2020"

Number of installed machines per hall and number of halls



Source: Prepared by FISCO from the National Police Agency's "Current Situation with Amusement and Entertainment Business and Situation with Policing Amusement and Entertainment-related Crime, etc. in 2020"

2. Growth strategy

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

(1) Multiple-hall operation

The effects of the COVID-19 pandemic have been prolonged, and the weeding out and consolidation of pachinko halls is accelerating, including the closing of 666 halls in the industry in 2020. Amid this, backed by its abundant funding strength, the Company will advance multiple-hall operation by purchasing unoccupied properties, as well as through M&A and other measures. Properties targeted by the Company must be able to accommodate 400-500 machines, which is medium-sized hall of the same scale as the Group, and there must be no other Group halls nearby so that halls do not eat into one another's customer base. However, it seems that the Company will not actually proceed with multiple-hall operation efforts until the stage when the profits of Group halls can be expected to be stable.

(2) Low playing cost operation

In general, the Company's new halls will have low playing costs. The Company has stated its vision of "making pachinko and pachislot a daily entertainment that everyone can enjoy freely" as a part of the community infrastructure, and will increase the number of low-fee ball rental halls in order to achieve this vision. An advantage of focusing on low playing cost halls is that the Company can open halls in small commercial areas due to the wide range of customer types that enjoy such halls.

(3) Product development

The Company will strengthen its product development of private-brand machines. As stated earlier, developing and introducing products matching customers' needs will reduce costs and differentiate the Company's halls from those of its competitors.

(4) Data-driven approach

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

(5) Cost management

As discussed above, the Company will improve hall profitability by applying its hall operation revisions to all of its halls.

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 the number of Group halls, its market share is approximately 5%, and we feel there is ample room for growth through an expansion of its market share.

Simplified income statement and key indicators

(¥mn)

	FY3/17	FY3/18	FY3/19	FY3/20	FY3/21
Revenue	156,869	152,092	146,371	142,483	98,602
YOY	0.6%	-3.0%	-3.8%	-2.7%	-30.8%
Business expenses	142,142	136,727	128,024	122,311	97,564
YOY	2.8%	-3.8%	-6.4%	-4.5%	-20.2%
SG&A expenses	5,622	5,049	5,023	5,020	4,340
YOY	-3.0%	-10.2%	-0.5%	-0.1%	-13.5%
Other income	9,224	9,458	8,971	8,446	11,561
Other expenses	2,430	2,425	2,953	2,084	1,531
Operating profit	15,899	17,349	19,342	21,514	6,728
YOY	-12.5%	9.1%	11.5%	11.2%	-68.7%
Financial income	233	236	471	461	286
Financial expenses	1,307	781	444	2,469	2,672
Profit before income taxes	14,825	16,804	19,369	19,506	4,342
YOY	-14.8%	13.3%	15.3%	0.7%	-77.7%
Income taxes	5,520	5,879	6,778	6,759	1,991
Net profit for the year	9,305	10,925	12,591	12,747	2,351
YOY	-11.7%	17.4%	15.2%	1.2%	-81.6%
Net profit attributable to owners of the Company	9,360	10,870	12,596	12,748	2,363
YOY	-11.2%	16.1%	15.9%	1.2%	-81.5%
EBITDA	28,469	29,524	31,136	31,151	16,781
YOY	-6.6%	3.7%	5.5%	0.0%	-46.1%
EPS (¥)	12.2	14.2	16.4	16.6	3.1
Dividend per share (¥)	12.00	12.00	12.00	9.00	5.00

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

Statement of consolidated financial position

(¥mn)

	End-FY3/17	End-FY3/18	End-FY3/19	End-FY3/20	End-FY3/21
Current assets	63,072	53,145	59,875	55,798	91,790
Cash and cash equivalents	48,499	40,533	47,537	41,810	74,661
Trade receivables	563	469	614	554	361
Non-current assets	142,043	131,826	125,457	221,441	209,283
Property, plant and equipment	106,687	98,794	95,445	105,206	96,415
Licensing assets	-	-	-	79,048	77,537
Intangible assets	3,833	3,545	3,112	3,623	3,348
Total assets	205,115	184,971	185,332	277,239	301,073
Current liabilities	38,496	39,643	36,452	44,028	59,812
Trade and other payables	18,282	19,220	19,297	14,801	19,997
Borrowings	7,281	7,351	2,124	3,008	11,380
Lease liabilities	302	256	227	12,185	12,040
Non-current liabilities	29,738	7,813	7,080	98,479	109,289
Borrowings	22,768	1,221	502	10,220	22,587
Lease liabilities	575	326	353	81,611	79,899
Total liabilities	68,234	47,456	43,532	142,507	169,101
Total equity	136,881	137,515	141,800	134,732	131,972
Total liabilities and equity	205,115	184,971	185,332	277,239	301,073

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

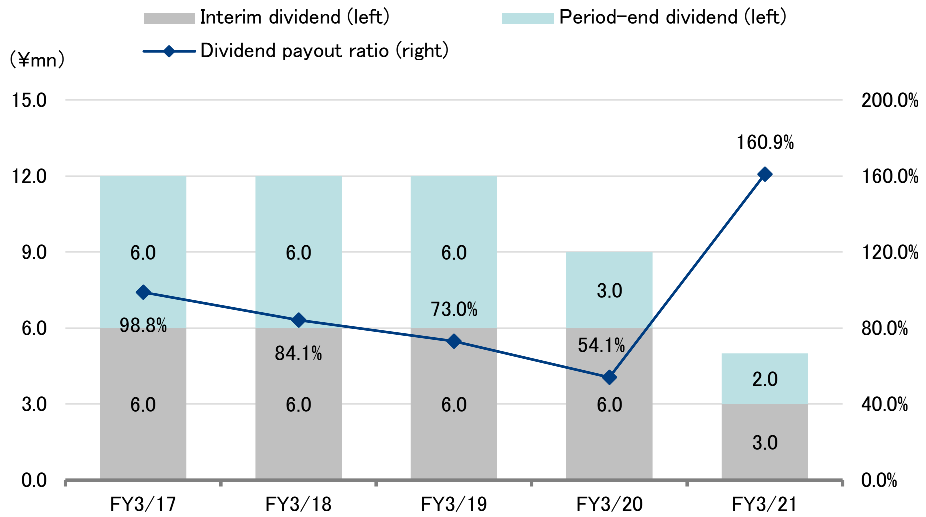
Returns to shareholders

FY3/21 period-end dividend of ¥2.0 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 pay stable dividends.

In light of the current situation with earnings, the Company decided on a FY3/21 period-end dividend of ¥2.0 per share. The full-year dividend is ¥5.0 per share, and the full-year dividend payout ratio is 160.9%. Also, in FY3/21, the Company carried out ¥1,437mn in stock buybacks (13,284,600 shares; approximately 1.7% of outstanding shares).

Trends in dividend per share and dividend payout ratio



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

CSR/ESG initiatives

Carrying out workplace reforms and developing and appointing women managers among other measures with the aim of enhancing long-term corporate value

1. Enhancement of long-term corporate value through CSR

As a listed company, the Company not only conducts compliance management in line with the laws and regulations and seeks to maximize profits, but also possesses strong awareness of CSR (Corporate Social Responsibility) while positioning its aim of building "regional infrastructure" as the axis of management.

Details can be found in its "ESG Report 2020." The Company conducts internal discussions and also interacts with external parties (other companies, local communities, etc.) about a variety of topics, including work style reforms, training women managers, and efforts to prevent second-hand smoking, all with the aim of enhancing long-term corporate value.

Actively disclosing information on ESG initiatives, and enhancing tools for dialogue with long-term investors

2. ESG activities

Pursuit of improvements in enterprise value from a long-term perspective, including ESG, is gaining recognition as a common theme among long-term investors and companies in an environment that encourages closer dialogue between investors and companies.

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 about its ESG philosophy and initiatives on the Company website. Also, the detailed content of its initiatives is found in the Company's ESG Report 2020, which is also available on the website. This is also expected to fulfill an important role as a tool for dialogue with investors.

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■ For inquiry, please contact: ■
FISCO Ltd.
5-13-3 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (IR Consulting Business Division)
Email: support@fisco.co.jp