COMPANY RESEARCH AND ANALYSIS REPORT

DYNAM JAPAN HOLDINGS Co., Ltd.

06889

Hong Kong Stock Exchange

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FISCO Ltd. Analyst
Yuzuru Sato

FISCO

FISCO Ltd.

https://www.fisco.co.jp

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Summary

Revenue to enter new growth trajectory with installation of smart gaming machines the catalyst

DYNAM JAPAN HOLDINGS Co., Ltd. <HK06889> is one of Japan's top operators of pachinko halls with the largest number of halls operated. Its strength and characteristics lie in low-cost operations based on the chain store theory. The Company's vision is to "transform pachinko into a 'daily entertainment' of local infrastructure that anybody can enjoy easily." 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. Revenue increased for second consecutive year in FY3/23, EBITDA continues increasing

In the FY3/23 consolidated results, revenue increased for the second consecutive year, increasing by 11.5 % year-on-year (YoY) to ¥117,206mn. In a situation in which novel coronavirus (hereafter COVID-19) infections have been repeatedly calming down and then re-occurring, the number of customers visiting halls gradually recovered with the thoroughly implementation of infection prevention measures. Another factor in increased revenue was the introduction of smart pachislot gaming machines (hereafter, smart pachislot) in November 2022, resulting in the creation of popular machines. Operating profit decreased by 36.5% YoY to ¥6,764mn due to the impact of increases in gaming machine depreciation (up ¥16,057mn YoY) and also in utilities expenses (up ¥2,169mn). However, EBITDA*, which has traditionally expressed the Company's earnings power, increased by 35.0% YoY to ¥43,729mn for the second consecutive year of gains, indicating that the Company has begun to recover despite the headwinds caused by the COVID-19 pandemic. The number of halls was 429, a decrease by 4 compared to the end of the previous fiscal year.

* EBITDA = profit + income taxes + financial expenses + depreciation (excluding depreciation for right-of-use assets) + foreign exchange gain or loss

2. FY3/24 business strategy

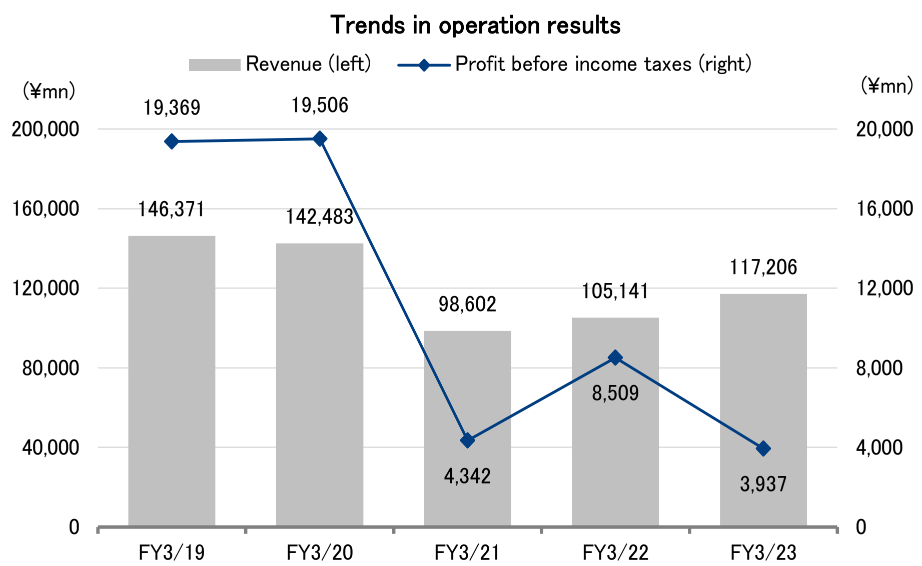
In FY3/24, the Company's strategy is to aim for increased revenue and profits by actively installing smart gaming machines with high customer attraction capabilities and move forward on attracting a new customer base. Installation of smart pachinko gaming machines (hereafter, smart pachinko) started in April, following on from the earlier introduction of smart pachislot machines, but has not resulted in significant changes in regard to attracting customers compared to conventional pachinko machines. Overall gaming machine purchase costs are planned to be reduced by about 10%-15% YoY through effective use of secondhand machines, and gaming machine depreciation is also forecast to peak in FY3/24 1H. Utilities expenses will continue to increase, but this will be absorbed by cost containment through standardization of operations. The Company also plans to expand the number of halls through new openings and M&A.

3. Pachinko business growth strategy

The growth strategy of the pachinko business is to aim to return to a growth trajectory by addressing four growth strategies: increasing revenues by investing in smart gaming machines; developing new customers through large-scale renovations of existing halls; optimizing costs through strategic use of in-house secondhand machines; and establishing new hall opening patterns. In terms of new store opening patterns, as construction costs continue rising, the Company will acquire unoccupied properties that were formerly pachinko halls and halls acquired through M&A, as well as developing new business formats that take advantage of the characteristics of smart gaming machines. Since the onset of the COVID-19 pandemic hall closures have proceeded at a pace of about 800-900 halls per year, mainly small- to medium-sized halls that lacked corporate strength in the gaming machine industry, and it is predicted that concentration on major companies will continue even further amid the spread of smart gaming machines in the future. The Company believes it has an opportunity to bring its pachinko business back onto a growth trajectory through an increased share of the market and we at FISCO expect that it will also make a strong recovery on an operating profit basis from FY3/24 2H onward.

Key Points

- Operating profits decreased due to an increase in depreciation, but revenue and EBITDA increased for the second consecutive year in FY3/23
- Expand revenue through active installation of smart gaming machines and turn from defense to going on the attack
- The appearance of smart game machines has triggered further strengthening of the oligopoly by major players, providing an opportunity to expand market share



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," became first pachinko hall operator to list shares

1. History

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

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

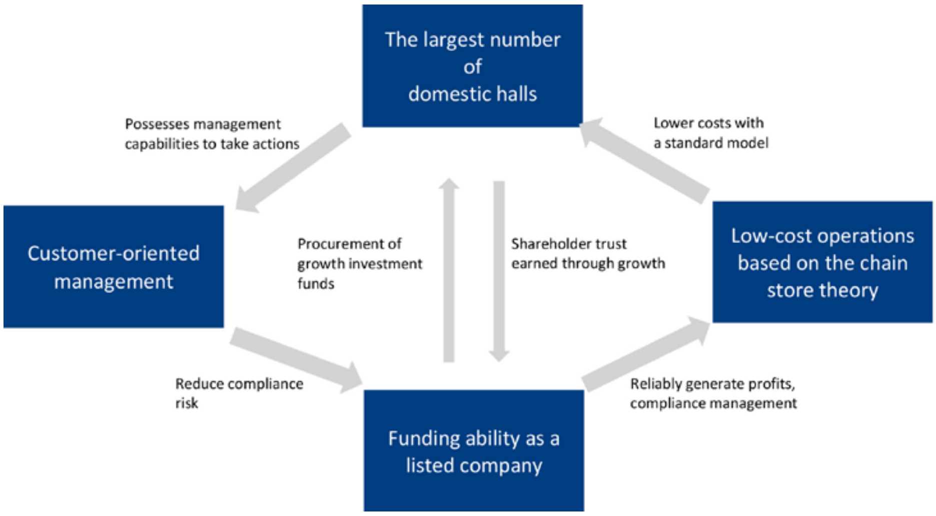
His logical approach rooted in the chain store theory took hold as the corporate culture and served as a fundamental force lifting the Company to the top position in the industry. It was also quick to incorporate the most important concepts of modern management, such as a customer-first approach, information disclosure, and compliance, into its management philosophy, 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

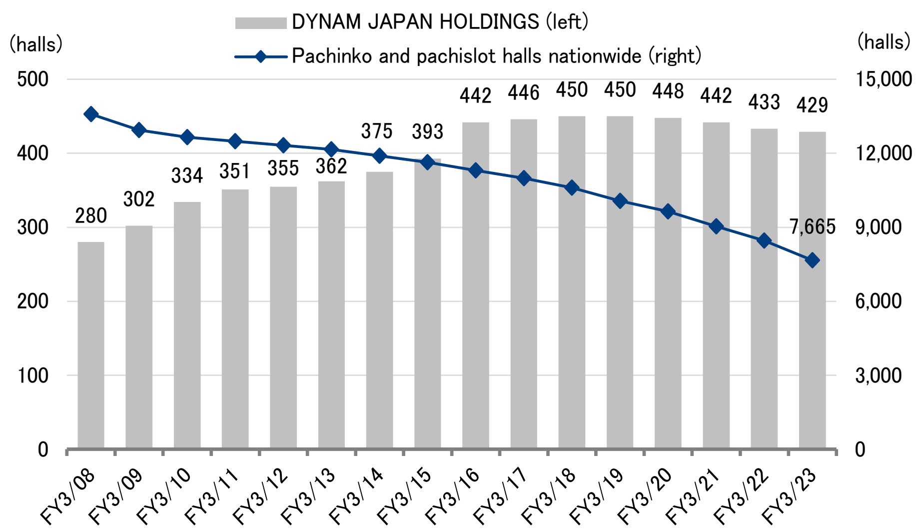


Source: Prepared by FISCO from interviews

(1) Domestic leader with 429 group halls

There were 7,665 pachinko and pachislot halls in Japan as of December 31, 2022 (down 793 YoY), according to National Police Agency materials. Of these halls, the Company is the domestic leader with 429 group halls (as of the end of March 2023). While it is not possible to make precise comparisons due to differences in compilation timing, its domestic shares for the number of halls and machine installations both trended at around 5%. Its market share exceeded 1% in 2003, and since then it has increased its number of halls, including through M&A, and maintained its market share amid the decrease in the overall number of halls in the industry. From FY3/20 onward, the number of halls declined slightly, partially due to the deterioration in the industry environment because of the COVID-19 pandemic, but the Company's market share has been steadily expanding.

Trend in number of group halls



Source: Prepared by FISCO from the Company's financial statements announcement and the National Police Agency's "Current Situation with Amusement and Entertainment Business and Situation with Policing Amusement and Entertainment-related Crime, etc. in 2022"

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

* As of the end of March 2023, 10.1% of its installed pachinko machines were private-brand machines (DYNAM standalone basis)

(2) Chain store theory

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

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

The Company is the industry leader in Japan, as mentioned earlier, with 429 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 is an outcrop from the chain store theory as well (explained below).

(3) Implementing management from a customer perspective

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

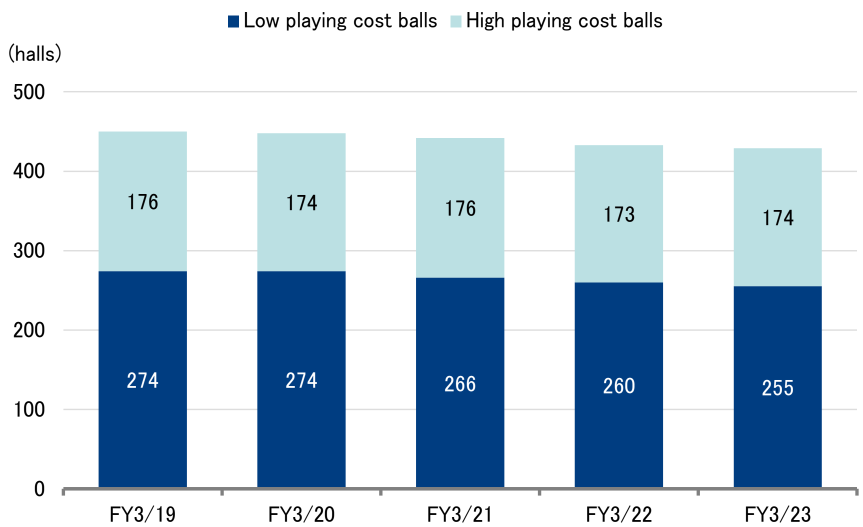
Among the Company's business policies, we have a favorable view of a) low playing cost operations and b) operations that do not rely on gambling appeal. These are also key words for understanding its business policy and growth strategy.

a) Low playing cost operations

Pachinko is a game played with rented balls, and low playing cost operations refer to a format in which ball rental fees have 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 2023, the Company had 255 low playing cost halls, which is 59.4% of its total halls. From FY3/21 onward, the downward trend continued as the Company continued closing unprofitable halls during the COVID-19 pandemic due to a decrease in the number of customers in the elderly demographic, which is the main target. Although in the short-term the Company will take a cautious stance in regard to opening low playing cost halls, in the medium- to long-term it expects an increase in the elderly demographic, therefore has made no changes to its plans to increase the ratio of low playing cost halls. Continuing this strategy requires considerable corporate strength, and the strategy for this lies in multiple-hall development and low-cost operations.

Number of low playing cost halls and high playing cost halls



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

b) Operations that do not rely on gambling appeal

The Company does not position models with strong gambling appeal as a central strategy. Pachinko machines range from ones with high probability of major wins to ones with low probability. Machines with lower probability give a larger number of balls in a major win and are preferred by pachinko fans. Many pachinko halls hence attract customers by operating halls with a high ratio of machines with strong gambling features. However, based on the strengthening of measures to address gambling addiction and related issues, the regulatory authorities have been revising the regulations in stages in order to suppress the gambling aspect, and the current situation is that a style of managing pachinko halls by attracting customers through "selling" gambling is coming to an end.

The Company, meanwhile, has a lower ratio of gambling-type machines than the industry average, and conversely its share of machines with the lowest gambling features at 1/100 probability is 20 percentage points higher than the industry average. It cannot avoid the impact of stricter regulations on gambling appeal, but given the fact that it has been working on sales operations that do not rely on gambling appeal for some time now, we at FISCO feel that the negative impact on the Company will be comparatively minor.

Senior customers have been slow to return to halls since the onset of the COVID-19 pandemic and younger- to middle-aged customers have increased markedly since the introduction of smart pachislot machines. Therefore, the policy for the future is to create halls supporting a wide range of customer demographics.

(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 2,000 companies are listed on stock markets as of the end of March 2023*. 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 Co., Ltd. in November 2015 through a stock swap for all of its shares. With respect to the demand for funds due not only to M&A but also investment in halls and new business development, the advantage of being a listed company is significant and will likely work in its favor in terms of procuring funds.

* NIRAKU GC HOLDINGS, INC.<HK1245> and Okura Holdings Limited<HK1655> are listed on the Hong Kong Stock Exchange.

Status of FY3/23 results

In FY3/23, operating profit decreased due to an increase in depreciation, but EBITDA continued to increase by double-digits

1. Overview of FY3/23 results

In the FY3/23 consolidated results, revenue increased by 11.5% YoY to ¥117,206mn, operating profit decreased by 36.5% to ¥6,764mn, profit before income taxes decreased by 53.7% to ¥3,937mn, and net profit for the year decreased by 63.9% to ¥1,798mn, resulting in increased revenue and decreased profit, but EBITDA, which has traditionally indicated earning power, increased by 35.0% to ¥43,729mn, the second consecutive year to increase and continuing the recovery trend.

Summary of FY3/23 consolidated results

(¥mn)

	FY3/22	FY3/23			Remark
	Result	Result	YoY	Change	
Revenue	105,141	117,206	11.5%	12,065	
Revenue from pachinko business	103,588	114,331	10.4%	10,743	High playing cost halls 55,993 (+4,700), low playing cost halls 58,338 (+6,043)
Revenue from aircraft leasing business	1,553	2,875	85.1%	1,322	Total number of owned aircraft increased from 3 to 6
Operating expenses	94,911	112,318	18.3%	17,407	
Pachinko business expenses	93,950	110,484	17.6%	16,534	Depreciation of pachinko and pachislot machines +16,057, utilities expenses +2,169, hall management personnel costs -2,243
Aircraft leasing business expenses	961	1,834	90.8%	873	Depreciation +654
SG&A expenses	4,279	4,309	0.7%	30	
Other income	9,114	8,663	-4.9%	-451	Subsidy income -1,917, compensation for removal of halls +817
Other operating expenses	4,411	2,478	-43.8%	-1,933	Loss on the disposal of property, plant and equipment +477, property, plant and equipment impairment loss -2,173
Operating profit	10,654	6,764	-36.5%	-3,890	
Financial income	426	450	5.6%	24	
Financial expenses	2,571	3,277	27.5%	706	Exchange-rate loss 232
Profit before income taxes	8,509	3,937	-53.7%	-4,572	
Tax expenses	3,532	2,139	-39.4%	-1,393	
Profit	4,977	1,798	-63.9%	-3,179	

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

Revenue increased for the second consecutive fiscal year due to the continued recovery trend in the number of customers in the pachinko business. Conversely, operating profit decreased by double digits, because although hall management personnel costs decreased by ¥2,243mn, machine depreciation increased by ¥16,057mn and utilities expenses rose by ¥2,169mn due to surges in energy prices.

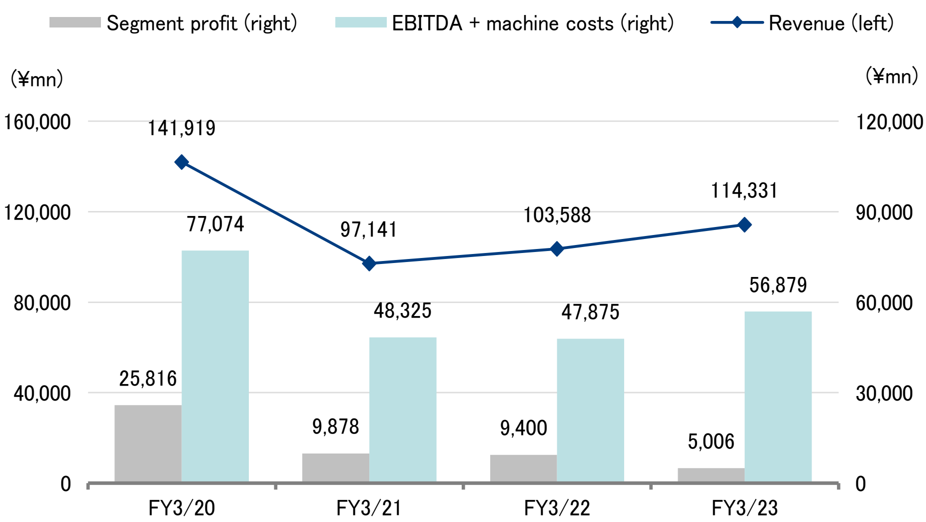
Other income decreased in total by ¥451mn due to a ¥1,917mn decrease in subsidy income (employment adjustment subsidy related to COVID-19), while recording ¥817mn in compensation for removal of halls. Other operating expenses decreased by ¥1,933mn in total due mainly to a ¥2,173mn decrease in impairment loss related to halls. As a result of efforts to standardize hall operations and increase efficiency, the number of consolidated employees at the end of the period was 12,722, a decrease by 698 YoY.

(1) Pachinko business

In the pachinko business, revenue increased but profit decreased, with revenue increasing by 10.4% YoY to ¥114,331mn and segment profit decreasing by 46.7% to ¥5,006mn. From FY3/22, the method for recording machine purchasing expenses has been changed from being recorded as a lump sum to a two-year, straight line depreciation method, and profits declined because of the resulting significant increase in depreciation.

However, when looking at actual profitability excluding the effects of this change of accounting standard, we see that profits are steadily recovering. Specifically, EBITDA (segment profit + depreciation + impairment loss + financial expenses) plus one-time machine costs, as measured from FY3/20 onward, rose by 18.8% YoY to ¥56,879mn in FY3/23, the second consecutive year of increasing, and its ratio of revenue also turned around, increasing by 3.5p.p YoY to 49.7%. Compared to the level in FY3/20, before the COVID-19 pandemic, revenue is at 80.6% and EBITDA + machine costs at 73.8%, so they are still on the way to recovery, but the Company should be commended for the recovery in its earnings when the entire industry is under extremely harsh conditions and many companies are being forced to downsize. We will touch on the factors behind the recovery in profitability later, but it was mainly due to an improvement in the labor cost ratio, which was a commendable effect of the Company's efforts to review hall operations.

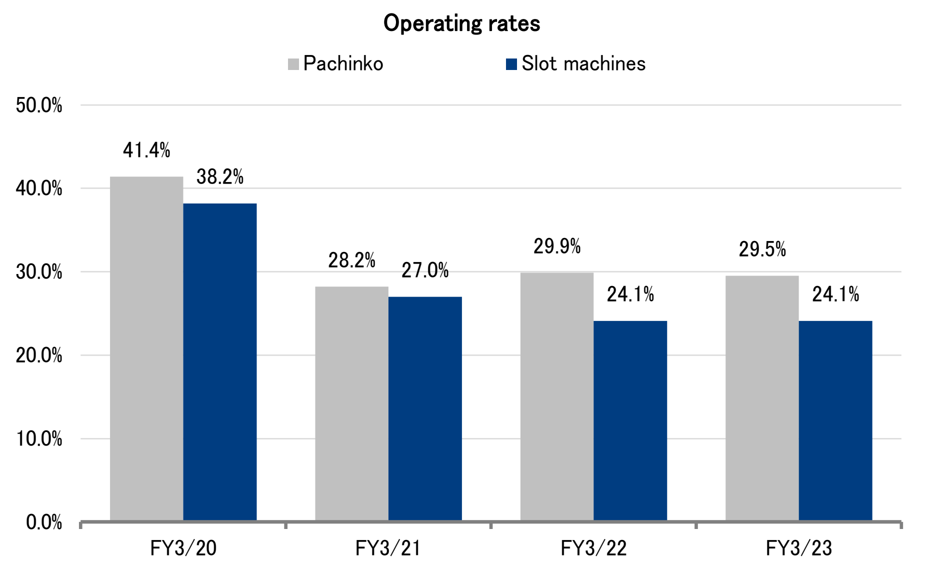
Pachinko business results



Note: EBITDA (segment profit + depreciation + impairment loss + financial expenses)
Source: Prepared by FISCO from the materials provided by the Company and an annual report

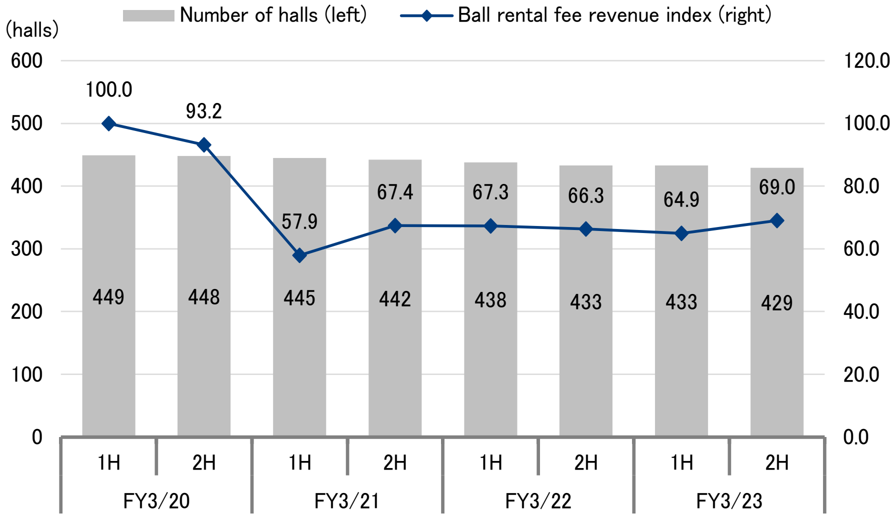
Breaking down revenue in pachinko business, in high playing cost halls, it increased by 9.2% to ¥55,993mn, while in low playing cost halls, it rose by 11.6% to ¥58,338mn, so revenue increased for both types of halls. Revenue from pachinko machines increased from the effect of creating several hit machines, and revenue from pachislot machines that had been continuously sluggish reverted to increase due to the creation of hit smart pachislot machines that started being introduced from November 2022.

Looking at ball rental fee revenue, which corresponds to gross sales, there was a marginal increase by 0.2% YoY to ¥507,852mn. On a half-year basis,1H decreased by 3.7% YoY to ¥245,981mn and 2H transitioned to an increase by 4.1% to ¥261,871mn. This was due to the effects of introducing smart pachislot machines, which was a factor in increasing the operating rate of pachislot machines. This can also be seen in the operating rate of pachislot machines in DYNAM halls, which was 22.0% in 1H but recovered to 24.1% over the full year. Having said that, though, ball rental fee revenue is still at a level just below 70% of that from the standard of three periods earlier. Viewed by customer demographics, this appears to show the impact of the ongoing slow return to halls by senior customers. To address this situation, the Company's policy is to strive to increase the number of younger customers. The number of halls at the end of FY3/23 was 429, a decrease by 4 compared to the end of the previous fiscal year.



Note: Data are for DYNAM halls. Operating rate = Actual number of customers / number of machines at peak time (average at 3:00 p.m. and 7:00 p.m.)
Source: Prepared by FISCO from the materials provided by the Company and the Company's results briefing materials

Trends in the number of halls and the ball rental fee revenue index



Note: The standard for the ball rental fee revenue index is for FY3/20 1H to be set as 100
Source: Prepared by FISCO from the materials provided by the Company and an annual (interim) report

Pachinko business expenses increased by 17.6% YoY to ¥110,484mn. The main change factors were that hall management personnel costs decreased by ¥2,243mn, but that depreciation of pachinko and pachislot machines increased by ¥16,057mn and utilities expenses rose by ¥2,169mn. This is the second period since the start of the machines' depreciation, so the extent of the increase is large. Also, the increase in utilities expenses was due to the sharply rising electricity charges. The reason for the decrease in hall management personnel costs was that, while maintaining the time spent on customer services, the Company realized a reduction in total work hours by standardizing various types of backyard operations.

Looking at the trend of the ratio of various expense items to pachinko business revenue, in total it rose by 5.9pp YoY to 96.6%. Breaking this down, it rose by 11.4pp for depreciation and by 1.4pp for utilities expenses, but the ratio declined by 5.6pp for hall operation personnel costs, and by keeping other expenses under control, the effects could be seen in the recovery of profitability. In particular, it is notable that the hall personnel costs ratio fell to 32.7%, which is close to its level of three periods before (33.3% in FY3/20). Hall operation efficiency has improved and profit margins are expected to increase as the operation rate rises going forward.

Breakdown of pachinko business expenses

	FY3/20	FY3/21	FY3/22	FY3/23	YoY
Total expenses	85.9%	99.5%	90.7%	96.6%	5.9%
Advertising expenses	2.4%	1.8%	2.8%	2.6%	-0.1%
Depreciation	7.2%	9.7%	20.3%	31.7%	11.4%
Hall personnel expenses	33.3%	42.6%	38.3%	32.7%	-5.6%
Machine costs	19.6%	17.0%	3.1%	3.4%	0.2%
Depreciation of right-of-use assets	7.3%	10.2%	9.0%	7.8%	-1.1%
Repair expenses	2.4%	1.8%	2.2%	2.3%	0.1%
Utilities expenses	3.9%	4.8%	4.9%	6.3%	1.4%
Cleaning expenses	2.7%	3.2%	2.4%	2.1%	-0.2%
Other	7.1%	8.4%	7.9%	7.6%	-0.2%

Note: Ratios to pachinko business revenue
Source: Prepared by FISCO from the annual report

Looking at the results of DYNAM Co., Ltd., which is the Group's core company, revenue increased but profit decreased, with revenue increasing by 10.0% YoY to ¥107,500mn, operating profit decreasing by 75.6% to ¥1,426mn, ordinary profit declining by 79.1% to ¥1,827mn, and profit falling by 81.4% to ¥910mn. The increase and decrease factors were basically the same as for the consolidated results.

DYNAM's results (using Japanese accounting standards)

(¥mn)

	FY3/22	FY3/23			Summary
	Results	Results	YoY	Change	
Revenue	97,730	107,500	10.0%	9,770	Amusement business revenue +9,912, vending machine fee income -142
Total expenses	91,893	106,074	15.4%	14,181	Machine costs +14,672, utilities expenses +2,024, personnel costs -2,148
Machine-related expenses	14,435	29,107	101.6%	14,672	Increase in pachinko and pachislot machine depreciation +14,586
Utilities expenses	4,588	6,612	44.1%	2,024	
Personnel costs	36,428	34,280	-5.9%	-2,148	
Other costs	36,441	36,076	-1.0%	-365	
Operating profit	5,837	1,426	-75.6%	-4,411	
Ordinary profit	8,749	1,827	-79.1%	-6,922	Decrease in the employment adjustment subsidy, etc. from the government -1,741
Extraordinary profit	0	912	-	912	Nagano Iida Hall evacuation compensation +817
Extraordinary loss	1,277	1,143	-10.5%	-134	Recorded a loss on retirement of non-current assets and impairment loss
Profit	4,893	910	-81.4%	-3,983	
[Main KPIs (key performance indicators)]					
No. of halls	396	392			3 halls were opened (including 1 hall through M&A), 7 halls were closed
Pachinko machine operating rate*1	29.9%	29.5%		-0.4pt	Slot machine operating rate +2.5pt*2
Slot machine operating rate *1	24.1%	24.1%		0.0pt	Gap with competitors -2.9pt*2
No. of machines	185,971	185,433	-0.3%	-538	Installed machine share 5.3% (+0.6pt YoY)
Number of private-brand machines	19,840	13,127	-33.8%	-6,713	Private-brand machine installation rate 10.1% (difference from previous period: -5.1pt)*3

*1 Operating rate: The average number of customers / installed machines at peak time (average at 3 p.m. and 7 p.m.) (average from April 1, 2022 to March 31, 2023)
*2 Figures for competitors are calculated based on customer count surveys conducted at 1,200 halls located near DYNAM halls nationwide
*3 Installation ratio is the ratio of all installed pachinko machines
Source: Prepared by FISCO from the materials provided by the Company and the Company's results briefing materials

At the end of March 2023, the number of halls had decreased by 4 YoY to 392 halls. There were 7 unprofitable halls closed and 2 new openings, while 1 more hall was acquired through M&A. In conjunction with the decrease in the number of halls, the number of installed machines had also decreased slightly, down by 0.3% YoY to 185,433 units, but the number of installed machines per hall rose slightly from 470 units to 473 units. Private-brand machines decreased significantly by 33.8% to 13,127 units, but this decline was due to the timing of machine replacements and there has been no change to the Company's policy of continuing to focus on private-brand machines. For the operating rate, for pachinko machines it declined by 0.4pp YoY to 29.5%, while for pachislot machines it remained on a par YoY at 24.1%. The number of smart pachislot machines at the end of the fiscal year was just under 5,000 units, accounting for about 9% of all pachislot machines.

(2) Aircraft leasing business

In the aircraft leasing business, revenue increased by 85.1% YoY to ¥2,875mn and segment profit rose by 75.4% to ¥442mn. The Company has limited its scope of business to narrow-body aircraft, which are highly liquid and for which demand is expected to be stable. It is continuing the leases of three aircraft purchased in FY3/20. Also, in October 2021, Dynam Aviation Ireland Limited (DYNAM Aviation), which is the subsidiary that operates this business, concluded an agreement with Wizz Air Hungary Ltd., a Hungarian LCC, to buy three aircraft (Airbus A321neo) through a sale and leaseback transaction, and delivery of these three aircraft was completed during FY3/23. This led to having six leased aircraft in the fleet and was a factor in increased revenue and profits.

The fleet value of the six aircraft is ¥41,130mn (up ¥24,130mn from the end of the previous period), the average remaining lease period is 5.3 years, and the annualized growth rate of return is 8.1%. This rate is down slightly from 8.8% at the end of the previous period, but this is due to the rising price of newly purchased aircraft because of inflation.

Results for aircraft lease contracts

<table>
<tr><th>Leasing party</th><th>Delivery period</th><th>Model</th><th>Assets (net value)</th><th>Average age</th><th>Average remaining lease period</th><th>Annualized gross rate of return</th></tr>
<tr><td>Vueling Airlines (Spain)</td><td>FY3/20</td><td>Airbus A320</td><td rowspan="5">¥41,130mn</td><td rowspan="5">2.1 years</td><td rowspan="5">5.3 years</td><td rowspan="5">8.1%</td></tr>
<tr><td rowspan="2">IndiGo (India)</td><td rowspan="2">FY3/20</td><td>Airbus A320neo</td></tr>
<tr><td>Airbus A321neo</td></tr>
<tr><td rowspan="2">Wizz Air (Hungary)</td><td>FY3/22</td><td rowspan="2">Airbus A321neo</td></tr>
<tr><td>FY3/23</td></tr>
</table>

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

Financial position slightly worsened by increased interest-bearing debt

2. Financial condition

At the end of FY3/23, total assets had increased by ¥32,187mn compared to the end of the previous period to ¥325,608mn. The main change factors were increases in cash and deposits by ¥3,097mn, property, plant and equipment by ¥28,228mn and right-of-use assets by ¥2,891mn, respectively, and a decrease in deferred tax assets by ¥1,153mn. The main factor in the increase in property, plant and equipment was the purchase of three new aircraft. Regarding the amount for acquisition of gaming machines there was a YoY decrease from ¥42,247mn to ¥38,095mn due to replacement demand generated by new regulations in the previous period, while the undepreciated balance increased to ¥36,281mn from ¥28,958mn at the end of the previous fiscal year.

Total liabilities increased by ¥34,742mn from the end of the previous period to ¥197,181mn. This was mainly due to increases in interest-bearing debt by ¥29,026mn, lease liabilities by ¥2,435mn and accounts payable and accrued expenses by ¥2,420mn. The increase in interest-bearing debt was mainly due to expenses for the purchase of aircraft.

Total equity decreased by ¥2,555mn from the end of the previous period to ¥128,427mn. The main reasons for the decrease were dividend payments of ¥3,669mn, and ¥993mn to acquire treasury shares, despite recording profit of ¥1,806mn.

The equity ratio declined to 39.4% from 44.6% at the end of the previous period, mainly due to an increase in interest-bearing debt, and net cash (cash and deposits – interest-bearing debt) turned negative at ¥12,562mn, indicating a slight deterioration in the Company's financial position. Regarding cash flow conditions, cash flows from operating activities increased from ¥32,719mn in the previous fiscal year to ¥54,660mn, but cash flows from investing activities also increased by about the same amount, so free cash flow was minus ¥10,334mn, and negative for the second year in succession as the Company financed its business investments with interest-bearing debt. In addition, the aircraft leasing business plans to purchase two new aircraft in FY3/24, so the projection is for interest-bearing debt to increase in FY3/24 as well. However, the pachinko business is expected to get back onto an earnings recovery trajectory, so we at FISCO think the financial condition will gradually improve over the medium term.

Consolidated financial condition

(¥mn)

	FY3/22 End	FY3/23 End	Change	Change items
Total assets	293,421	325,608	32,187	Cash and deposits (+3,097), property, plant and equipment (+28,228), right-of-use assets (+2,891), deferred tax assets (-1,153)
(Cash and deposits)	56,508	59,605	3,097	
Total liabilities	162,439	197,181	34,742	Interest-bearing debt (+29,026), lease liabilities (+2,435), accounts payable and accrued expenses (+2,420)
(Interest-bearing debt)	43,141	72,167	29,026	
(Interest-bearing debt/Japanese companies)	32,945	47,090	14,145	
(Interest-bearing debt/Overseas companies)	10,196	25,077	14,881	
Total equity	130,982	128,427	-2,555	
(Equity ratio)	44.6%	39.4%	-5.2pt	
(Net cash)	13,367	-12,562	-25,929	

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

Cash flow statement

(¥mn)

	FY3/22	FY3/23
Cash flows from operating activities	32,719	54,660
Cash flows from investing activities	-43,010	-64,994
Free cash flows	-10,291	-10,334
Cash flows from financing activities	-8,565	12,712
Cash and cash equivalents	56,508	59,605

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

FY3/24 business strategy

Expand revenue through active installation of smart gaming machines and turn from defense to going on the attack

1. Pachinko business

(1) Business strategy

In FY3/24, the Company's strategy is to increase revenue and profits by actively installing smart gaming machines with high customer attraction power and rolling out promotions to draw a wide range of customers.

After the introduction of smart pachislot machines in November 2022, there was a shortage of semiconductors and delays in type approval*, etc. While the industry as a whole was expected to supply 150,000 units in FY3/23, only slightly more than 80,000 units were available, and even major halls continued to have difficulty procuring these machines. In FY3/24, manufacturers are planning to sell 310,000 units in 1H and 800,000 units for the full year, but this will depend on the procurement of parts and acquisition of type approval going forward. If the installation of smart pachislot machines moves forward steadily, the installation rate across the entire industry is expected to grow and the Company intends to raise the ratio of its installations as well.

* Before a pachinko or pachislot machine can be installed in a hall, it must pass a type approval test (a test to confirm that the machine is manufactured in accordance with the regulations) conducted by the Security Communications Association of Japan (SCAJ) and be approved by the SCAJ.

Installation of smart pachinko machines began in April 2023. As there is currently no significant difference in the operation rate compared to conventional models, manufacturers are forecast to plan for only about 100,000 units for the industry as a whole in FY3/24 1H. However, this may change depending on parts procurement and the status of type approval. For this reason, the Company's policy is to prioritize installation of smart pachislot machines in FY3/24.

The introduction of smart gaming machines is expected to have the following three benefits for the gaming machine industry. First, the gaming machines will not need balls or medals, which will improve convenience and will be a measure to prevent infection, while the improved specifications of the gaming machines (currently limited to smart pachislot machines) will increase the game-playing experience, which is expected to increase the number of players.

Secondly, by not needing balls or medals there is no need for island facilities (equipment to replenish the rented balls, etc.), which means there is no need to exchange or maintain them, helping to advance low-cost hall operation. Some competitors have already opened smart gaming machine specialty halls, and if this initiative is successful, the number of small specialty halls that take advantage of low-cost operations may increase.

Thirdly, there is the health of the industry. Game data from smart gaming machines (ball data, installation data, etc.) will be sent to the "machine information center," which is a third-party organization. This is expected to have the effects of strengthening security, eradicating illegal games and helping to prevent addiction. If the industry is healthier, it is expected that the number of participants will increase and the customer base will expand further.

In terms of hall opening strategy, as construction costs continue to remain high, the Company will consider new hall openings, including those in unoccupied properties that were formerly pachinko halls, and also aim to increase the number of halls by focusing on acquisitions of halls that meet its criteria for M&A. It will consider liquidating halls that it judges to be unlikely to recover. Overall, the Company plans a net increase over the previous fiscal year, which would be the first increase in seven years since FY3/18. This is partly because the external environment has calmed down and the operation rate of existing halls is headed toward recovery due to the effects of smart pachislot machines, while the number of competing halls that do not have the funding capabilities have continued to close in 2023, which is seen as a good opportunity for the Company to expand its share.

(2) Outlook for pachinko business expenses

Regarding pachinko business expenses, the Company is poised to continue moving ahead with cost controls. The Company plans to reduce the number of machines purchased by 10%-15% from the previous fiscal year by making effective use of secondhand machines owned by the Group, although it will actively install smart gaming machines. As a result, depreciation of machines is forecast to peak in 1H and decrease in 2H.

Hall personnel expenses account for just over 30% of pachinko business expenses and by continuing low-cost operation initiatives, the Company expects to further reduce total working hours, but utility expenses are set for a higher YoY increase than the previous fiscal year. Advertising expenses are also expected to rise slightly due to the roll out of promotional measures combined with the expansion of the number of smart gaming machines units installed.

In the aircraft leasing business, has newly concluded contracts for two aircraft and the forecast is for double-digit growth to continue in FY3/24

2. Aircraft leasing business

In the airline industry the total number of passengers is trending toward recovery as restrictions on travel are being lifted, mainly in Europe and the U.S. Air traffic volume is expected to return to pre-COVID-19 levels in 2023 and then continue their expansion trend going forward. With the prospect of expansion in short-haul traffic, demand for long-body aircraft such as the Airbus A321neo and Boeing B-737 MAX 10 is expected to increase as long-body aircraft has a longer fuselage and can set more passengers.

In this situation, Dynam Aviation Ireland Limited concluded a contract with Wizz Air to newly purchase two aircraft through a sale and leaseback contract in October 2022. The delivery of these aircraft is scheduled for October to December 2023.

The Company is forecasting double-digit increases in revenue and profits for FY3/24 due to the full-year contribution of the lease fees from the three aircraft delivered to Wizz Air in the previous fiscal year, in addition to the lease fees from the two aircrafts scheduled for delivery in the latter half of 2023. Despite the chaotic situation in Ukraine, the impact on existing leased carriers and Wizz Air is expected to be minimal due to the small number of flights to Russia.

In addition, the Company employed a person responsible for technical, lease management and legal affairs at a subsidiary in FY3/23, and built its own system to manage leases. Going forward, the Company will accumulate expertise in lease management operations with a view to not only providing lease management services to other companies engaged in the aircraft leasing business, but also to conducting joint purchases to expand business.

Video slot machine business resumes contact with local operators for trial negotiations on lifting Macau entry restrictions

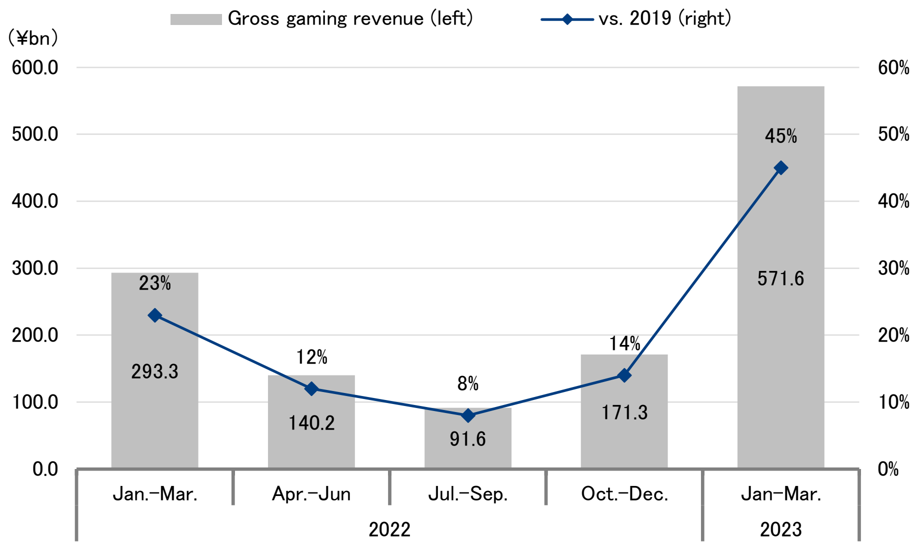
3. Video slot machine business for casinos

The Company has been working on planning and development of video slot machines for casinos as a new business. These video slot machines are more targeted to the mass-market than other types of machines, and development is ongoing to make straightforward games that incorporate elements of pachinko.

Game software is jointly developed with a Japanese company, and manufacturing and sales for casinos is outsourced to WEIKE GAMING TECHNOLOGY (S) PTE. LTD., a Singapore company that has a manufacturing and sales license for casino machines in Macau, where the Company's main target market is located. As of March 2023, it had obtained approval for 6 machines in Macau and 5 machines in Singapore. Also, for machines installed with the developed games, since November 2019 it has test installed 1 unit each of 3 machine models (3 units in total) in Legend Palace Casino, and in addition, since January 2020, it has test installed a total of 10 units of 3 machine models in Casino Ponte16.

The situation of Macau casinos' gross gaming revenue (GGR) is that it is slumping partly because of the restrictions on travel by foreign visitors due to the impact of China's zero-COVID-19 policy, but in January to March 2023, recovered to a level of 45% of 2019 due to Macao lifting entry restrictions following a sluggish year in 2022. The Company has resumed contact with operators to gather information ahead of trial negotiations. Compliance with Macau EGM Technical Standards Version 2.0, which is required for the trial, has already been verified by the Gaming Inspection and Coordination Bureau (DICJ) in September 2022, and further progress is expected.

Macao casino market gross gaming revenue



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

In other regions, the Company has installed a casino machine on a trial basis, which is still ongoing, in one casino in Malaysia. Also, it is at the stage of concluding an NDA and progressing negotiations with the relevant companies in order to convert its developed game software, such as social games, to online.

Although the business plan has been significantly delayed by COVID-19, if the developed products are appealing and can win a lot of support from customers, it is considered that they will contribute to earnings to a certain extent. We shall be paying close attention to developments in the future, including efforts to convert social games and other games to online.

Future growth strategy

The appearance of smart game machines has triggered further strengthening of the oligopoly by major players, providing an opportunity to expand market share

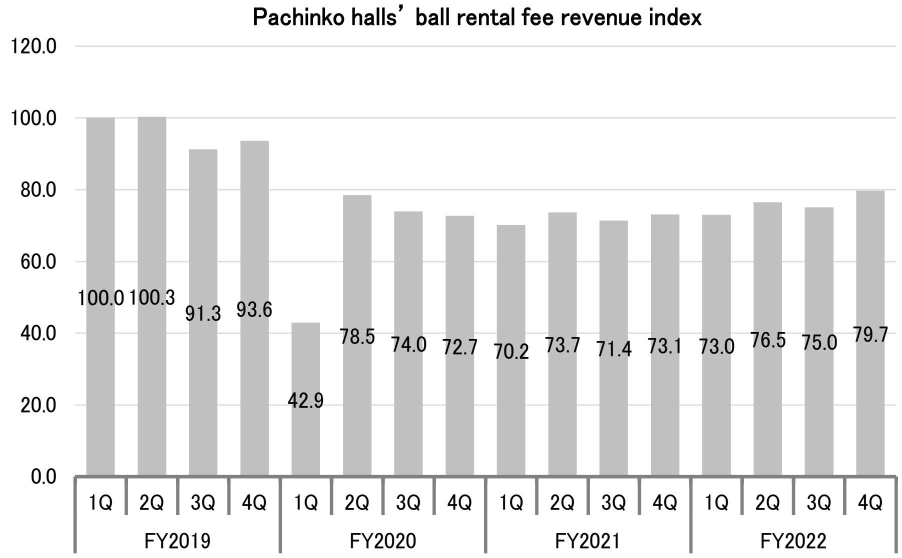
1. Market trends

The pachinko market's long-term contraction trend is continuing. According to the "Leisure White Paper 2022" compiled by the Japan Productivity Center, in 2021 the pachinko and pachislot participation population was 7.2 million people, including due to the effects of COVID-19, while the market scale (ball rental fees) was ¥14.6 trillion. Compared to 2002 (21.7 million people, ¥30.4 trillion), the participation population has fallen to slightly more than 30% and the market scale to slightly less than 50%.

Reflecting this situation, the number of pachinko and pachislot halls is also trending downward with the onset of the COVID-19 pandemic having made management conditions even harsher, with closures increasing, mainly of small- to medium-sized halls. At the end of 2022, the number of halls had declined by 9.4% compared to the end of the previous year to 7,665 halls, which is a decline to less than 50% of the level of 20 years ago*. For the number of machines installed as well, pachinko machines declined by 5.7% compared to the end of the previous year to 2,205,000 units, while pachislot machines decreased 7.9% to 1,358,000 units, so the downward trend is continuing for both types of machines.

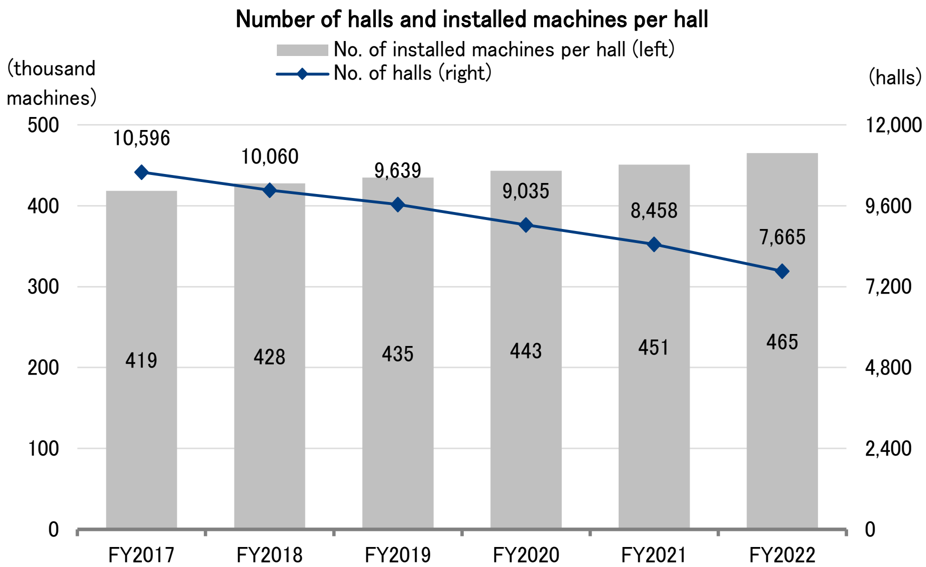
* Source: The National Police Agency's "Current Situation with Amusement and Entertainment Business and Situation with Policing Amusement and Entertainment-related Crime, etc. in 2022"

According to statistics from the Ministry of Economy, Trade and Industry, pachinko hall sales bottomed-out in FY2020 1Q (April to June), which is when the halls were forced to close due to COVID-19, and recovered from FY3/22 onwards, but due to the intermittent waves of the disease, full recovery has not yet been achieved. However, as mentioned above, the installation of smart gaming machines has begun to attract customers back to the halls, especially among the young and middle-aged, and there are some positive signs for the future. With that said, companies that don't have the capital strength needed to install the smart gaming machines which hold the key to sales recovery will continue to find conditions to be harsh. As a result, even into 2023, closures have continued at a pace that will be about 800 to 900 halls annually.



Note: FY2019 1Q (April to June) as the standard (=100.0)
Source: prepared by FISCO from the Ministry of Economy Trade and Industry's "Current Survey of Selected Service Industries"

As a result, an oligopoly of the market by major companies with financial strength is predicted to become even stronger. In fact, the market share of the top five companies by number of halls increased from about 10% at the end of 2017 to about 14% at the end of 2022. Moreover, looking at the trend in the number of installed machines per hall, the industry appears to be becoming more of an oligopoly, recording year by year growth from 419 at the end of 2017 to 465 at the end of 2022, which suggests that halls are becoming larger. Incidentally, DYNAM Group halls had an average of 477 machines per hall at the end of March 2023, slightly exceeding the industry average.



Source: Prepared by FISCO from materials provided by the Company and the National Police Agency's "Current Situation with Amusement and Entertainment Business and Situation with Policing Amusement and Entertainment-related Crime, etc. in 2022"

The current installations of smart gaming machines are expected to revitalize the market, and for the industry, this is the biggest innovation since the installation of CR machines (installation of machines compatible with pre-paid cards) in 1992. Installations of the CR machines at that time caused the market to grow, so the industry has great expectations for smart gaming machines. However, it is also true that the market environment is different today from that of those days, with a variety of entertainment options and the widespread use of the Internet for social games, etc. It remains to be seen how much the market will be stimulated by the installation of smart gaming machines. Ultimately, the key to growth will be whether manufacturers can develop attractive machines that draw in enough customers, and whether halls can maintain and improve service quality, including hospitality, to increase repeat customers.

Secure a competitive advantage by actively installing smart gaming machines and building halls to attract a new customer base with an aim for renewed growth

2. Growth strategy

The Company's growth strategy for the pachinko business is to address four growth strategies as themes for the time being to achieve growth from FY3/24 onward: increasing revenues by investing in smart gaming machines; developing new customers through large-scale renovations of existing halls; optimizing costs through strategic use of in-house secondhand machines; and establishing new hall opening patterns.

(1) Increasing revenues by investing in smart gaming machines

The key to recovery in customer numbers and operating revenue will be the introduction of smart gaming machines, especially the popular smart pachislot machines, and how many of them can be installed. The Company plans to use its ample capital strength to actively introduce these models. In addition, due to the semiconductor shortage, supply of machine bodies and specialized units and peripheral parts is not keeping up with demand, so the Company will secure the number of machines it needs by asking for increased production.

(2) Developing new customers through large-scale renovations of existing halls

The Company aims to restore profitability in its flagship halls by renovating them to attract new customer segments. The introduction of the smart pachislot machines, in particular, has drawn back dormant younger and middle-aged customers, and the Company will work to find a new, broad customer base, not just seniors. Specific measures include better provision of information on how to play and enjoy gaming machines, ensuring priority for smart gaming machines and providing a product lineup that meets customer needs, improving the environment through renovations, proposing new game environments, reviewing universal design and making other investments to attract new customer segments.

(3) Optimizing costs through strategic use of in-house secondhand machines

The Company has long sought to control gaming machine purchase expenses and will bolster that initiative while utilizing various types of data.

(4) Establishing new hall opening patterns

New store-opening patterns include the acquisition of unoccupied properties that were formerly pachinko halls and the acquisition of some halls through M&A, as mentioned above. When opening a new low playing cost hall, the return-on-investment period is prolonged considering the considering the initial capital investment and the number of customers, so the Company launches halls acquired as unoccupied properties or through M&A at a low cost. Moreover, smart gaming machines do not need island facilities, so there is a greater degree of freedom in terms of interior layout, and they can be installed in halls with a small installation space and can help to keep hall staff down to the absolute minimum, so going forward, it is considered that developments will include opening halls in small commercial areas and opening small-sized halls with dedicated smart gaming machines within buildings. The Company's vision is to transform pachinko into "daily entertainment," and the introduction of smart gaming machines is expected to promote the development of new forms of pachinko halls that will bring the Company closer to realizing this vision.

Income statement and key indicators

(¥mn)

	FY3/19 Full year	FY3/20 Full year	FY3/21 Full year	FY3/22 Full year	FY3/23 Full year
Revenue	146,371	142,483	98,602	105,141	117,206
YoY	-3.8%	-2.7%	-30.8%	6.6%	11.5%
Operating expenses	128,024	122,311	97,564	94,911	112,318
YoY	-6.4%	-4.5%	-20.2%	-2.7%	18.3%
SG&A expenses	5,023	5,020	4,340	4,279	4,309
YoY	-0.5%	-0.1%	-13.5%	-1.4%	0.7%
Other income	8,971	8,446	11,561	9,114	8,663
Other operating expenses	2,953	2,084	1,531	4,411	2,478
Operating profit	19,342	21,514	6,728	10,654	6,764
YoY	11.5%	11.2%	-68.7%	58.4%	-36.5%
Financial income	471	461	286	426	450
Financial expenses	444	2,469	2,672	2,571	3,277
Profit before income taxes	19,369	19,506	4,342	8,509	3,937
YoY	15.3%	0.7%	-77.7%	96.0%	-53.7%
Income taxes	6,778	6,759	1,991	3,532	2,139
Profit	12,591	12,747	2,351	4,977	1,798
YoY	15.2%	1.2%	-81.6%	111.7%	-63.9%
EBITDA	31,136	31,151	16,781	32,383	43,729
YoY	5.5%	0.0%	-46.1%	93.0%	35.0%
EPS (¥)	16.4	16.6	3.1	6.8	2.5
Dividend per share (¥)	12.00	9.00	5.00	5.00	5.00

Source: Prepared by FISCO from the Company's annual report

Statement of consolidated financial position

(¥mn)

	FY3/19	FY3/20	FY3/21	FY3/22	FY3/23
Current assets	59,875	55,798	91,790	67,487	69,166
Cash and cash deposits	47,537	41,810	74,661	56,508	59,605
Trade receivables	614	554	361	332	407
Other	11,724	13,434	16,768	10,647	9,154
Non-current assets	125,457	221,441	209,283	225,934	256,442
Property, plant and equipment	95,445	105,206	96,415	118,648	146,876
Right-of-use assets	-	79,048	77,537	73,850	76,741
Intangible assets	3,112	3,623	3,348	3,440	3,730
Investment, other	26,900	33,564	31,983	29,996	29,095
Total assets	185,332	277,239	301,073	293,421	325,608
Current liabilities	36,452	44,028	59,812	47,324	53,840
Accounts payable	19,297	14,801	19,997	12,312	14,732
Short-term borrowings, etc.	2,124	3,008	11,380	12,945	16,629
Lease liabilities	227	12,185	12,040	11,245	10,749
Other	14,804	14,034	16,395	10,822	11,730
Non-current liabilities	7,080	98,479	109,289	115,115	143,341
Long-term borrowings	502	10,220	22,587	30,196	55,538
Lease liabilities	353	81,611	79,899	78,017	80,948
Other	6,225	6,648	6,803	6,902	6,855
Total liabilities	43,532	142,507	169,101	162,439	197,181
Total equity	141,800	134,732	131,972	130,982	128,427
Total liabilities and equity	185,332	277,239	301,073	293,421	325,608

Source: Prepared by FISCO from the Company's annual report

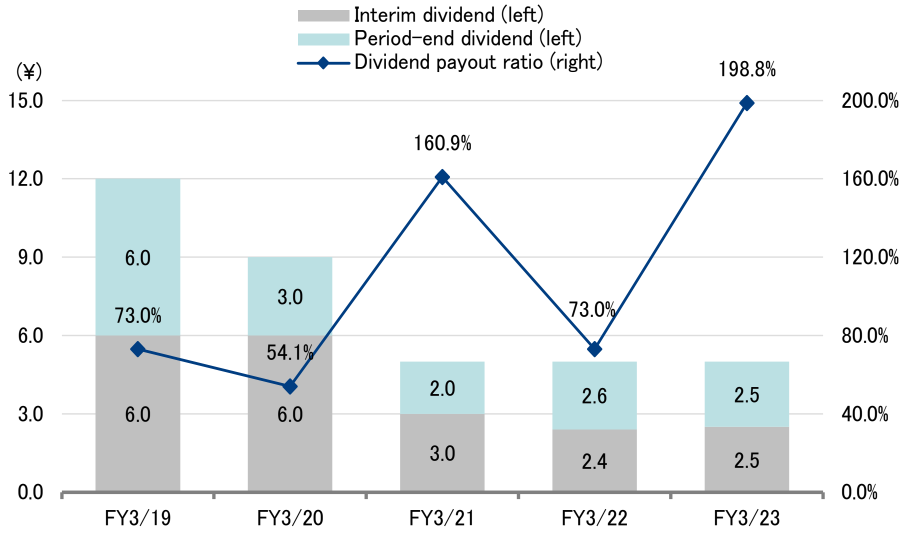
Returns to shareholders

Decided to pay a FY3/23 full-year dividend of ¥5 per share on a par with the previous fiscal year

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

For FY3/23, the Company decided pay a dividend of ¥5 per share, the same as the previous fiscal year. The dividend payout ratio will be 198.8%, but the Company maintained the same level as it wanted to emphasize a stable dividend and that earnings are looking up. Also, in FY3/23 the Company purchased on the market 9,079,000 treasury shares (approximately 1.3% of all issued shares) and retired 8,588,000 treasury shares.

Trends in dividend per share and the dividend payout ratio



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

ESG initiatives

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

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

Based on its Group Philosophy of "A centurial commitment to building trust and encouraging dreams," the Group is advancing ESG initiatives with the ideal of achieving perpetual growth, and it discloses information in accordance with the latest international guidelines and the listing rules of the Hong Kong Stock Exchange for each category (Environment, Social, Governance). Furthermore, details about the Company's initiatives can be found on its website and in ESG Report 2023. Amid the attention being focused on ESG investing, this is expected to fulfill an important role as a tool for dialogue with investors.

1. Environmental initiatives

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

Economic activities are one of the causes of global environmental problems such as climate change, energy consumption, and pollution, and international targets have been set for global warming. The Group is addressing business operations in a decarbonizing society by striving to reduce CO_2 emissions caused by excessive energy consumption by using halls made from wood, which has a lower impact on the environment, appropriately managing energy consumption, advancing green IT and creating systems that do not generate waste or properly dispose of it if they do.

2. Social initiatives

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

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

Activities under the slogan of "local infrastructure" include supporting the independence of the elderly, promoting employment in the community, responding to natural disasters and backing recovery, as well as supporting sports and schools, such as donating photocatalytic sprays to coat equipment in schools.

3. Governance initiatives

The Group has selected to be a "Company with a Nomination Committee, Etc." and has established the three committees of the Nomination Committee, Remuneration Committee and Audit Committee. This Company with a Nomination Committee, Etc. assumes the role of executing decision-making and auditing functions for management decision-making, and to clarify supervisory functions and execution of duty functions. Also, in order to strengthen risk management throughout the Group, it has also established the Group Crisis Management Committee, and should a crisis occur, it has established a structure able to implement rapid decision making, information dissemination, and appropriate measures in response.

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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