

Daikoku Denki Co., Ltd.

6430

Tokyo Stock Exchange Prime Market and Nagoya Stock Exchange Premier Market

8-Sept.-2023

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FISCO Ltd.

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

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Summary

In FY3/23, the market was activated by the introduction of smart gaming machines, leading to major increases in sales and profits that exceeded forecasts. Medium-term management plan targets also upwardly revised in anticipation of a new era

1. Business overview

Daikoku Denki Co., Ltd. <6430> (hereafter, “the Company”) has two main businesses: one that develops, manufactures and sells computer systems for pachinko (Japanese slot machines) parlors and halls, and the other that develops, produces and sells display and control units for pachinko machines. The Company holds the leading market share, approximately 38.7%, of the Japanese market for hall computers, reflecting an information management method that is the de facto standard for the industry. Furthermore, the industry’s leading membership-based information provision service Daikoku Denki Strategic Information System (DK-SIS) facilitating the operations of pachinko hall associations forms a network of 3,257 pachinko halls and supports the Company’s business foundation.

With the pachinko market on a trend of steady annual shrinkage, the Company is striving to increase market share at large halls and promoting business reforms, including a shift to a business model with recurring revenue that continues over time, from a medium to long term perspective. Over the past several years, controlled ball payouts, measures against gambling addiction, and amended regulations on game machines (enforced on February 1, 2018; hereafter, “new regulations”) have brought the pachinko hall industry to a major turning point. This has been compounded by impact from the COVID-19 pandemic, and earnings have been lackluster for some time due to uncertainty about the future. However, machines complying with the former regulations at the end of January 2022 are being replaced in stages, the gaming machine market is showing signs of an upswing driven by pachinko machines that meet the new regulations, and results have recovered, particularly those from pachinko machines. Operations of the closely-watched smart gaming machines*, which emerged in November 2022, have steadily increased, and alongside the market’s recovery, the Company is entering a new phase. On December 20, 2022, the Company made the cloud service system developer GLOBAL WISE Co. a consolidated subsidiary, and on April 1, 2023 it consolidated LAIRI Inc., a pachislot development company, as the Company made a full-fledged move toward cloud utilization and entry into the smart pachislot business, which are pivotal to its medium-term strategy.

* This refers to smart pachinko and smart pachislot, types of smart gaming machines, which enable users to play without directly touching the balls and medals in contrast to the past format. Key points are elimination of facilities related to balls and medals at pachinko halls and enhancement of gaming performance compared to existing gaming machines. Future developments should be closely monitored considering support from gaming machine manufacturer organizations (Nikkoso and Nichidenkyo). Smart pachislot machines were introduced into the market from November 21, 2022, and smart pachinko machines were rolled out on April 3, 2023.

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Summary

2. Overview of FY3/23 results

The Company posted FY3/23 results, with net sales of ¥31,824mn (up 30.5% YoY) and operating income of ¥4,019mn (up 237.4%). Sales and profits both increased substantially and came in above forecasts (announced February 9, 2023). Growth in the Information System Segment contributed to the increase in net sales. Sales volumes for certain products had to be adjusted because of the difficulty of procuring electronic components and other items, but the Company's results improved as smart pachislot machines were launched on the market in November 2022 and received strong support from fans, which led pachinko halls to bolster their capital investment. In particular, the VEGASIA card unit, which includes a dedicated unit for smart gaming machines, sold briskly, and sales of system upgrades to the AI hall computer X (Kai) and of BiGMO PREMIUM, large LCD information terminals for fans, exceeded forecasts. Meanwhile, in the Control System Segment, component sales were strong, but gaming machine sales volume in the overall market declined in reaction to replacement demand the previous year for machines meeting the new regulations and because of a general stance toward exploring trends in smart gaming machines. Sales of display units and control units both declined because of this. On the profit front, growth in the Information System Segment provided a big boost to revenue, which led to a major increase in profit. The operating income margin was 12.6%, returning to double digits (4.9% the previous year).

3. FY3/24 forecasts

The Company forecasts net sales of ¥38,000mn (up 19.4% YoY) and operating income of ¥4,200mn (up 4.5%), envisioning higher sales and profits. With regard to net sales, growth is expected in the Information System Segment, a continuation of the previous year. Smart pachinko machine operation (four models as of March 31, 2023) is at a high level and smart pachislot machines were launched on the market in April 2023, so demand rooted in capital investment by pachinko halls is expected to continue. At the same time, in the Amusement Segment (former Control System Segment),* revenue is forecast to decline due to a decrease in display and control unit development models. In terms of profits, the Company will see higher profit from growth in the Information System Segment, but is planning to actively invest in development, so it is projecting a slight decrease in the operating income margin to 11.1% (12.6% the previous year).

* The segment name was changed as of FY3/24.

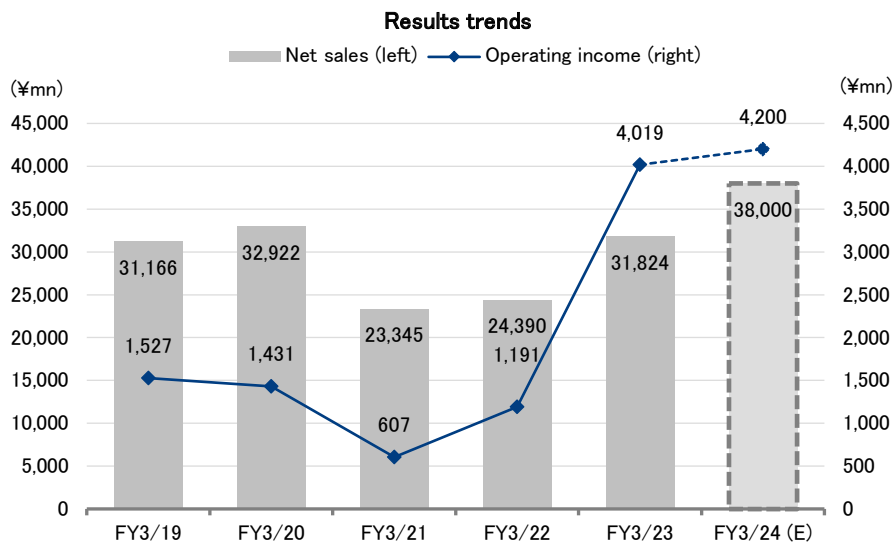
4. Medium-term management plan

The Company started a medium-term management plan (three years) starting from FY3/23 with full transition to machines in anticipation of meeting the new regulations and seeing a path to livelier conditions in the gaming machine market and pachinko hall capital investments as the new era of smart gaming machines emerges. The Company upwardly revised its medium-term management plan in May 2023 in light of the market launch of smart gaming machines and the fact that its recent results have trended above forecasts. There has been no change, however, in the Company's general direction. The Company will capture demand from the spread of smart gaming machines and continue to promote the uptake of the AI hall computer X (Kai). It is also aiming to shift to a recurring revenue business by enhancing its MIRAIGATE Services ("MG Services"), a business that uses cloud servers, and building a platform that will be unique in the industry. Further, as a gaming machine manufacturer, it will work to develop smart pachislot machines under its own brand (planning a market launch in fiscal 2024). Its numerical goals (post-revision) for FY3/25, the last year of the plan, are net sales of ¥40.0bn (17.9% average annual growth rate over three years) and operating income of ¥4.5bn (operating income margin of 11.3%).

Summary

Key Points

- In FY3/23, the Company achieved increases to both sales and profits that largely exceeded the plan
- Growth in the VEGASIA card unit and key products on a tailwind of market activation caused by the introduction of smart gaming machines
- Forecasting higher sales and profits in FY3/24 as well even while making active development investment
- Medium-term management plan upwardly revised. With the advent of the era of smart gaming machines, aiming to strengthen cloud development and shift to a recurring revenue model and to quickly develop smart pachislot machines



Source: Prepared by FISCO from the Company's financial results and releases

■ Description of businesses

Focuses on hall computers and peripheral equipment for pachinko halls. Aims to further expand its top market share in the industry by promoting the industry's first AI hall computer

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

As a pioneer in the development of hall computers, which assist in the management of pachinko halls, and holder of the top market share in the Japanese market, the Company won halls' trust and satisfied pachinko players by proposing a management method which puts emphasis on data management, introducing innovative peripheral equipment for its hall computers, and providing the industry's leading membership-based information provision service.

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Description of businesses

The Company's share of the hall computer market is 38.7%, and in particular, its market share of large-scale halls with at least 501 machines is 60.9%. (as of FY3/23).

The Company's two main businesses are the Information System Segment and Control System Segment*, but the Information System Segment provided around 80% of its net sales and has been the main source of stable profit in the past few years

* As of FY3/24, the Control System Division and Manufacturing Division have been merged and renamed the AMS (Amusement & Supply) Management Department. The segment name has also been changed to the Amusement Segment.

1. Information System Segment

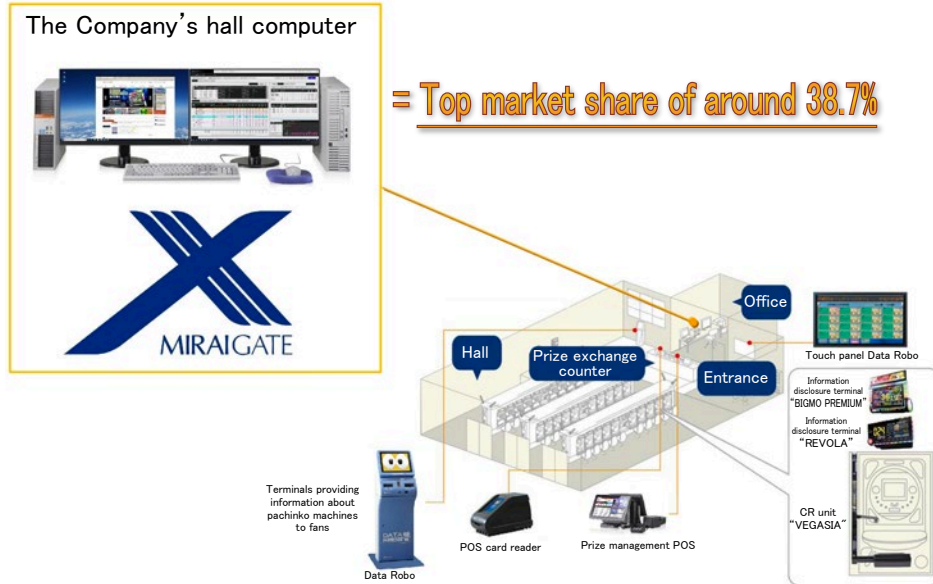
The Company sells hall computers (machine management systems), which serve as core systems at pachinko halls, and peripheral equipment, such as prize and customer management systems, information disclosure systems and card units, and offers MG Services that provide various services on hall computers and over the internet via a server. DK-SIS, a membership information provision service and the industry's foremost strategic information tool, is the pillar of MG Services.

Hall computers are the core systems for supporting pachinko hall operations. These computers display the operating conditions and sales of each machine in a hall, are supported by peripheral equipment such as prize management and information disclosure systems and card units, and serve as the foundation of MG Services. Introducing a hall computer provides the advantage that peripheral equipment and support services can be sold as a package deal.

In June 2019, the Company released the AI hall computer X (Kai), the first of its kind in the industry and the first upgrade in 12 years since the CII hall computer. Based on the concept of a "hall computer that teaches," the main feature of this AI hall computer is that it will guide pachinko hall operators to optimal solutions by utilizing the Company's big data and having AI automatically analyze the data. By using AI's ability to prepare forecasts utilizing big data that cannot be processed by people to instantaneously generate analyses that previously required significant time and assist personnel with limited experience in making assessments expected of highly experienced personnel, the Company will enhance efficiency and reduce labor resources in hall management, contribute to further customer attraction and improve profitability. With the spread of smart gaming machines, which were introduced in November 2022, the computer is also spurring system upgrades as a hall computer optimal for data management.

Description of businesses

Hall computers and main peripheral equipment



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

2. Control System Segment

The Control System Segment develops, produces and sells displays and control units, as well as components used for pachinko and pachislot machines for game machine manufacturers. Applying the knowledge obtained from analyzing data from pachinko machines as a hall computer manufacturer for many years, the segment serves as a development partner for the content as well, moving beyond the scope of a machine manufacturer by proposing plans based on the trends of popular models and sales of copyrights for popular characters. In particular, the Company is ramping up pachislot business from FY3/22 by leveraging hardware and software technologies cultivated up to now. As a gaming machine manufacturer,* the Company intends to focus on manufacturing and selling smart pachislot machines under its own brand, with a view to market launch in fiscal 2024. As of FY3/24, the Company has merged its Control System Division (amusement division) and Manufacturing Division (supply division) and renamed the department the AMS (Amusement & Supply) Management Department. The segment name has also been changed to the Amusement Segment.

* Consolidated subsidiary Daxel Co., Ltd. and ALOFT Co., Ltd. are taking on that role.

■ Company strengths

Track record of creating new product opportunities for the industry and provides added value for hall management in various aspects

1. Growth model based on market expansion through innovation

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

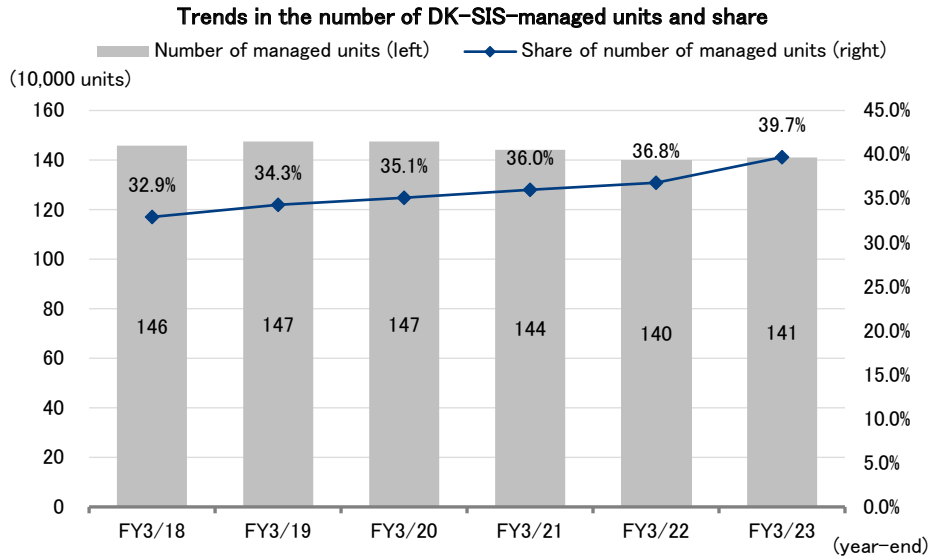
Launched in 1974, the Company's first hall computer enabled managers of pachinko halls to introduce a hall management method based on data management. Previously, pachinko halls accumulated only basic data, but with the introduction of hall computers, data-based hall management became the de facto standard. Ever since then, it has been steadily rolling out industry-first information equipment that contains innovative functions, such as the Data Robot information disclosure terminal that provides operational information about gaming machines at pachinko halls to fans. It has contributed to healthier hall results by boosting the efficiency of hall management and supplying added value that raises fan satisfaction.

In June 2019, the Company released the industry's first AI hall computer, X (Kai). This AI hall computer not only helps the performance of pachinko halls, but also improves operating efficiency, thus reducing labor necessary for hall management already undergoing labor shortages.

2. Strong network of pachinko halls

Another one of the Company's strengths is that it has built a robust network with member pachinko halls through an array of services based on hall computers (MG Services), and evolved it into the industry's only platform. Launched in 1990, DK-SIS is a service offering feedback in the form of information that is useful in hall operations after processing and analyzing the daily operational information of pachinko and pachislot machines received from pachinko halls. Simulations based on nationwide gaming machine sales data support forecast management, and a strong network of members underpins the Company's business foundation. Additionally, the service takes on a role as a sort of think tank in the industry, helping to enhance the Company's brand power as a leading company, and it is apparently being utilized in strategic proposals and sales activities to game machine manufacturers. Membership totaled 3,257 halls at the end of March 2023 with 1.41mn managed machines (39.7% share in managed machines). Recently, the Company has been focusing on promoting widespread use of its Market-SIS market area analysis service, which analyzes customer numbers, utilization rates, market share, and support rates of pachinko hall rivals operating in the commercial sphere. Market-SIS is being well received as a tool that grasps mobility (player) trends and helps halls improve their ability to attract customers. Moreover, the Company launched the cloud-based chain store management system ClarisLink in 2021. The new system is its first using the cloud. Its unparalleled data and response speed have drawn rave reviews, and the number of contracting halls has grown in excess of forecasts.

Company strengths

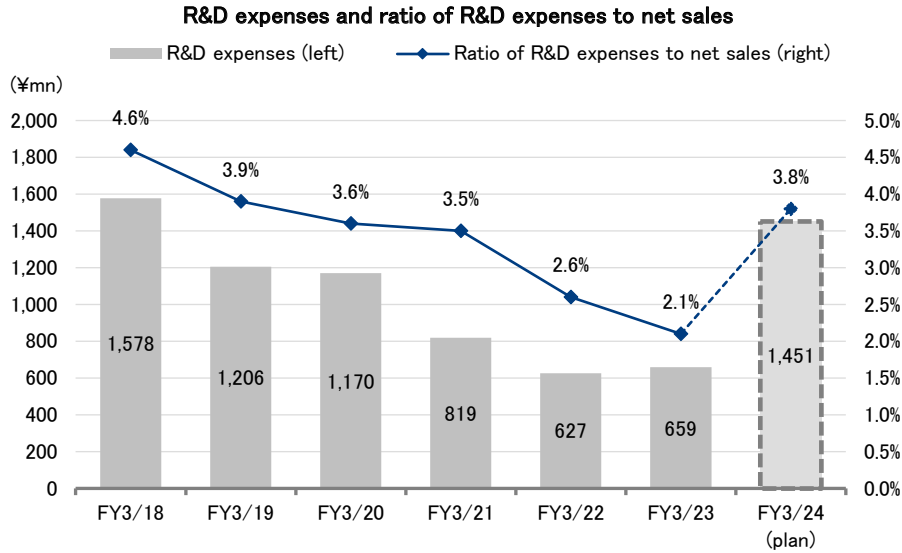


Source: Prepared by FISCO from the Company's materials

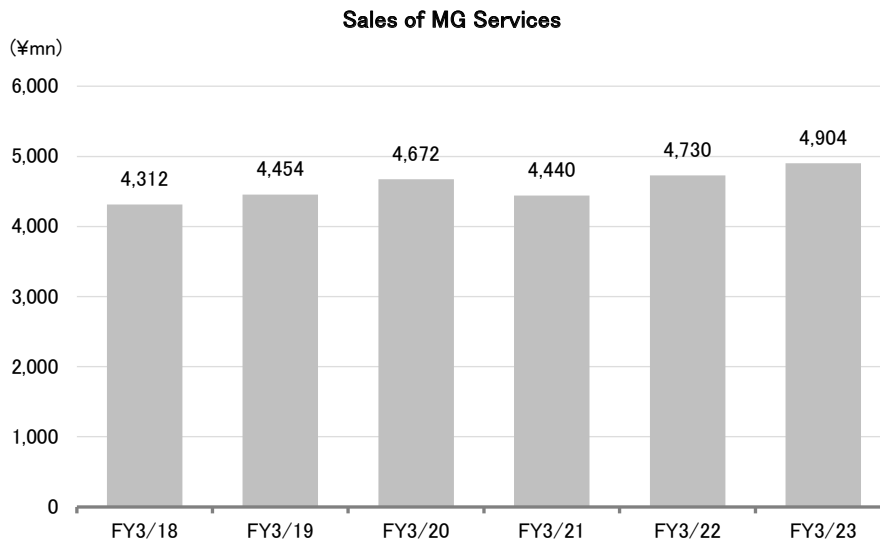
3. Stable profit base that supports investment for the future

The Company's main source of competitiveness is its proactive upfront investment eyeing future growth, including its R&D expenses. Development of a next-generation hall computer (and peripheral equipment) and start of a new MG Services are evidence of continued aggressive investment in areas expected to become its growth driver. The stable revenue stream provided by the high-margin Information System Segment makes this investment possible. In particular, MG Services promoted by the Company as a recurring-revenue business model have grown and enabled funding of R&D at a high level while maintaining stable segment income, and investment risk has been limited. The Company's ability to balance large profits from its existing businesses with heavy investment in businesses for future growth allows it to produce value on a continuing basis. While exhaustion of large-scale investments in the next-generation hall computer and other outlays have kept R&D expenses at roughly 3% of net sales since FY3/18, the Company intends to aggressively allocate R&D expenses, mainly for central components of its strategy such as the cloud and smart pachislot, in the medium-term management plan (Details below).

Company strengths



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



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

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Financial results trends

In FY3/23, sales and profits increased by large margins, exceeding forecasts. Market activation caused by the introduction of smart gaming machines led to strong sales of the AI hall computer X and key products.

1. Overview of FY3/23 results

The Company posted FY3/23 results, with net sales of ¥31,824mn (up 30.5% YoY), operating income of ¥4,019mn (up 237.4%), ordinary income of ¥4,260mn (up 211.5%) and net income attributable to owners of parent of ¥2,927mn (up 138.2%). Sales and profits increased by large margins, enough to exceed forecasts that had been upwardly revised three times (announced February 9, 2023).

Capital investment by pachinko halls was limited through the first half as the halls refrained from opening new halls or making major renovations as a result of exploring trends in smart gaming machines, whose introduction (in November 2022) was drawing near, but as expectations for smart gaming machines grew, upfront capital investment was ramped up ahead of their introduction. Under this environment, in the Information System Segment, production volume had to be adjusted for certain products because supply of electronic components and other items could not keep pace due to the impact of the global semiconductor shortage, but the Company made preparations to be able to fully meet demand. In 3Q, smart pachislot machines were introduced in November 2022. The new machines were strongly supported by fans, so pachinko halls further upped their capital investment to accommodate smart gaming machines and this gave a large boost to the Company's results. In particular, sales of VEGASIA, a card unit that includes a dedicated unit for smart gaming machines, were brisk, and sales of system upgrades to the AI hall computer X (Kai) and of BiGMO PREMIUM, large LCD information terminals for fans, came in above forecasts, so the Information System Segment saw significant growth. With regard to service sales as well, the Company was able to steadily raise their level centering on MG Services.

In the Control System Segment, component sales were strong, but gaming machine sales volume in the overall market declined in reaction to replacement demand the previous year for machines meeting the new regulations and because of a general stance toward exploring future trends in smart gaming machines. Sales of display units and control units both declined because of this.

With regard to profits as well, the growth in the Information System Segment gave a major boost to profit. In particular, system upgrades to X (Kai) and key products, which have high profit margins, performed well, and cost controls were also implemented, resulting in an improved gross margin. Recording bad debt expenses in SG&A expenses* put downward pressure on profits, but this was offset by revenue growth, and the operating income margin returned to double digits at 12.6% (4.9% the previous year).

* Due to bad debt expenses for receivables due to customer gaming machine manufacturers under civil rehabilitation proceedings and subsidiaries' uncollected receivables.

Looking at financial conditions, total equity increased 7.3% YoY to ¥33,399mn from the accumulation of retained earnings. Accounts receivable – trade and related items increased with the increase in revenue, and product inventory and other items were bolstered to prepare for increased demand from investment related to the market launch of smart gaming machines. As a result, total assets increased by 16.4% from the end of FY3/22 to ¥48,298mn, and the equity ratio declined slightly to 69.2% (75.1% at the end of FY3/22).

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Financial results trends

Overview of FY3/23

	FY3/22		FY3/23		YoY		FY3/23			
	Results	Share	Results	Share	Change	% change	Initial forecast	Share	Revised forecast	Share
Net sales	24,390		31,824		7,434	30.5%	26,000		30,000	
Information System Segment	18,647	76.5%	26,209	82.4%	7,562	40.6%	19,500	75.0%	-	-
Control System Segment	5,759	23.6%	5,639	17.7%	-120	-2.1%	6,500	25.0%	-	-
Adjustment	-17	-	-24	-	-7	-	-	-	-	-
Gross profit	10,143	41.6%	14,507	45.6%	4,364	43.0%	-	-	13,500	45.0%
SG&A expenses	8,952	36.7%	10,487	33.0%	1,535	17.2%	-	-	10,500	35.0%
Operating income	1,191	4.9%	4,019	12.6%	2,828	237.4%	850	3.3%	3,000	10.0%
Information System Segment	2,171	11.6%	5,490	20.9%	3,318	152.8%	1,950	-	-	-
Control System Segment	537	9.3%	140	2.5%	-396	-73.8%	450	-	-	-
Adjustment	-1,518	-	-1,611	-	-93	-	-1,550	-	-	-
Ordinary income	1,367	5.6%	4,260	13.4%	2,892	211.5%	950	3.7%	3,200	10.7%
Net income attributable to owners of the parent	1,228	5.0%	2,927	9.2%	1,698	138.2%	650	2.5%	2,100	7.0%
Depreciation	1,762		1,589		-173	-9.8%				

(¥mn)

	End of FY3/22	End of FY3/23	Change from year-end	
			Change	% change
Total assets	41,489	48,298	6,808	16.4%
Total equity	31,141	33,399	2,258	7.3%
Equity ratio	75.1%	69.2%	-5.9pt	-

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

The results by segment were as follows.

(1) Information System Segment

The segment reported increased sales and profits that exceeded the plan, with net sales at ¥26,209mn (up 40.6% YoY) and segment income at ¥5,490mn (up 152.8%). Sales volumes for certain products had to be adjusted because of the difficulty of procuring electronic components and other items, but the Company's results improved as smart pachislot machines were launched on the market in November 2022 and received strong support from fans, which led pachinko halls to bolster their capital investment.* In particular, the VEGASIA card unit, which includes a dedicated unit for smart gaming machines, sold briskly, and sales of system upgrades to the AI hall computer X (Kai) and of BiGMO PREMIUM, large LCD information terminals for fans, exceeded forecasts. With regard to service sales as well, key services performed well, and the number of halls subscribing to MG Services, including ClarisLink, a cloud-based chain store management system, and Market-SIS, a market area analysis service, increased as the halls responded to market changes driven by the introduction of smart gaming machines. The Company was able to steadily increase sales as a result. On the profit front as well, growth in key products with high profit margins and an increase in service sales resulted in a large increase in profit, and the segment margin also returned to a high level at 20.9% (11.6% the previous year). In terms of activities, the Company consolidated GLOBAL WISE, a cloud service system developer, through a stock acquisition with a view to cloudifying existing services at an early date.

* Since the introduction of smart pachislot machines in November 2022, operation of 20-yen pachislot machines was 110.6% of the previous year in November, 114.8% in December, 114.8% in January 2023, 118.1% in February, and 122.0% in March, so the machines have performed well. In addition, smart pachislot machines grew to account for 8.2% of all pachislot machines installed as of March 31, 2023.

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Financial results trends

(2) Control System Segment

The segment reported lower sales and profits, with net sales at ¥5,639mn (down 2.1% YoY) and segment income at ¥140mn (down 73.8%). Component sales were strong, but gaming machine sales volume in the overall market declined in reaction to replacement demand the previous year for machines meeting the new regulations and because of a general stance toward exploring future trends in smart gaming machines. Sales of display units and control units both declined because of this. At the same time, the substantial decline in profit was due to profit being held down by lower revenue and to the major impact of recording bad debt expenses (approx. ¥0.37bn). The segment margin also declined, to 2.5% (9.3% the previous year). Regarding activities, the Company consolidated (as a second-tier subsidiary) LAIRI Inc., which develops pachislot machines, with a view toward early entry into the smart pachislot business. With regard to contract development (OEM) as well, along with existing pachinko machines, the Company worked to strengthen its pachislot development system and re-establish a manufacturing environment, and it manufactured one model of pachislot machine.

2. Summary of FY3/23

To sum up FY3/23, there continued to be negative factors, among them sales adjustments caused by the semiconductor shortage and lower sales volumes of gaming machines in the market overall, but with market activation from the introduction of smart gaming machines providing a tailwind, the fact that the Company ultimately increased its sales and profits well beyond forecasts is a positive development that bodes well for the future. In particular, the profit margin of the Information System Segment returning to its previous high level is commendable as evidence that the Company's competitive advantages will be further demonstrated in the new era of smart gaming machines. With regard to activities for the future, along with steady growth from MG Services, which include Market-SIS and the cloud-based chain store management system ClarisLink, the Company successfully executed M&As to strengthen cloud services and enter the smart pachislot business. It might be said that the Company has finally begun moving full-scale toward the realization of its medium-term strategy.

■ Main activities

Two strategic M&A deals for strengthening cloud services and entering the smart pachislot business

1. Consolidation of a cloud service system developer

On December 20, 2022, the Company made the cloud service system developer GLOBAL WISE* into a consolidated subsidiary through a stock acquisition. This can be seen as a move to further strengthen cloud services, which is part of the Company's medium-term management plan. GLOBAL WISE is a company that provides the full gamut from cloud construction to system development and system operation and maintenance. For the Company, which is working to utilize cloud technology to build a platform for services in support of pachinko hall management, there are major benefits in terms of being able to acquire human resources and expertise. For GLOBAL WISE as well, it can expect to see higher business value, which includes employee motivation, when becoming independently involved in projects as a member of the Group, whose strengths are its financial resources and business foundation.

* The Company acquired 5,677 shares (acquisition price: ¥191mn, goodwill: ¥833mn), bringing its percentage of voting rights to 98.3%. GLOBAL WISE has about 50 employees. As for GLOBAL WISE's most recent results (FY3/22), net sales were ¥422mn and operating income was ¥8mn, and, in terms of its financial position, net assets were ¥188mn and total assets were ¥960mn.

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Main activities

2. Consolidation of a pachislot developer

On April 1, 2023, through its subsidiary ALOFT Co., Ltd., the Company made LAIRI Inc., which develops pachislot machines, a consolidated subsidiary (second-tier subsidiary) via a stock acquisition. This can be seen as a move to enter the smart pachislot business, which is stated in the Company's medium-term management plan. LAIRI has been involved in the development of pachislot machines since its founding and by making it a subsidiary the Company acquires an in-house manufacturing system for pachislot development and will work to quickly build a development system.

* The Company acquired 200 shares, 100% of outstanding shares (the acquisition price was not disclosed). Financial information has not been disclosed, but the impact on results for FY3/24 is thought to be negligible.

■ Outlook

For FY3/24, the Company is expecting continued increases in sales and profits and is also planning to make active investments in development

1. FY3/24 forecast

For FY3/24, The Company forecasts continual increases to sales and profits with ¥38,000mn in net sales (up 19.4% YoY), ¥4,200mn in operating income (up 4.5%), ¥4,350mn in ordinary income (up 2.1%), and ¥3,000mn in net income attributable to owners of the parent (up 2.5%).

Regarding net sales, the Company is expecting to see major growth from the Information System Segment, a continuation from the previous year. Smart pachislot machines launched on the market (four models as of March 31, 2023) are operating at a high level, and smart pachinko machines were introduced starting in April 2023, so it is assumed that demand associated with capital investment by pachinko halls will continue. The Company appears to be taking a cautious approach to smart pachinko machines, including with respect to the timing of having a lineup of models, because so little time has passed since their launch. At the same time, in the Amusement Segment (formerly the Control System Segment), the Company is predicting a decline in revenue due to a decrease in display and control unit development models.

Regarding profits, the Company expects to secure higher profits on the boost provided by growth in the Information System Segment, just as in the previous year, but the operating income margin is projected to decline slightly to 11.1% (12.6% the previous year) as a result of active investment in development*.

* R&D expenses are projected to increase 120.0% YoY to ¥1,451mn and capital investment to rise 134.4% to ¥2,941mn, so both are expected to more than double.

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Outlook

FY3/24 forecast

	FY3/23		FY3/24		Change (revised forecast)	
	Result	Share	Initial forecast	Share		% change
Net sales	31,824		38,000		6,175	19.4%
Information System Segment	26,209	82.4%	33,000	86.8%	6,790	25.9%
Control System Segment	5,639	17.7%	5,000	13.2%	-639	-11.3%
Operating income	4,019	12.6%	4,200	11.1%	180	4.5%
Information System Segment	5,490	20.9%	5,900	17.9%	409	7.5%
Control System Segment	140	2.5%	30	0.6%	-110	-78.7%
Adjustment	-1,611	-	-1,730	-	-118	-
Ordinary income	4,260	13.4%	4,350	11.4%	89	2.1%
Net income attributable to owners of the parent	2,927	9.2%	3,000	7.9%	72	2.5%

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

2. FISCO focus

We at FISCO believe that it will be necessary to continue to monitor the impact of the external environment, which has a high degree of uncertainty due to semiconductor shortages, surging raw material prices and other factors, but that the Company's results forecasts are sufficiently achievable on the assumption that demand related to capital investment by pachinko halls continues and is ramped up further in this new era of smart gaming machines. Of course there is no denying the possibility that the willingness of pachinko halls to make capital investments could be temporarily impacted by current uncertainties, including the timing of future model deployment and their operating level after being introduced, and that the extent of this impact will need to be carefully watched, but whatever the case may be, for pachinko halls, introducing smart gaming machines (replacement) and cloudification are essential elements to their survival, so trends going forward will need to be monitored from the perspective of how much demand is captured over the next several years. We will also continue keeping an eye on the Company's progress toward realization of its medium-term strategy, which includes strengthening cloud services and trends in the development of smart pachislot machines.

Medium-term management plan

Started the medium-term management plan for an era of smart gaming machines. Aims to build the industry's only platform on a cloud server

Seeing a path to livelier conditions in the gaming market and pachinko hall capital investments as the switch to the new era of smart gaming machines emerges, the Company launched its medium-term management plan (three years) starting in FY3/23. Based on the corporate philosophy of "continuing to consistently deliver sustainable growth in the future by creating new value through innovations," the Company intends to redefine business domains as a way of addressing future changes in the market environment. Specifically, it outlined a strategy of capturing demand related to inroads from the introduction of smart gaming machines, continuing promotion of AI hall computer X (Kai) uptake, and carrying on building the industry's only platform through rollout of business utilizing a cloud server (reinforcement of new MG Services).

Medium-term management plan

1. Market environment

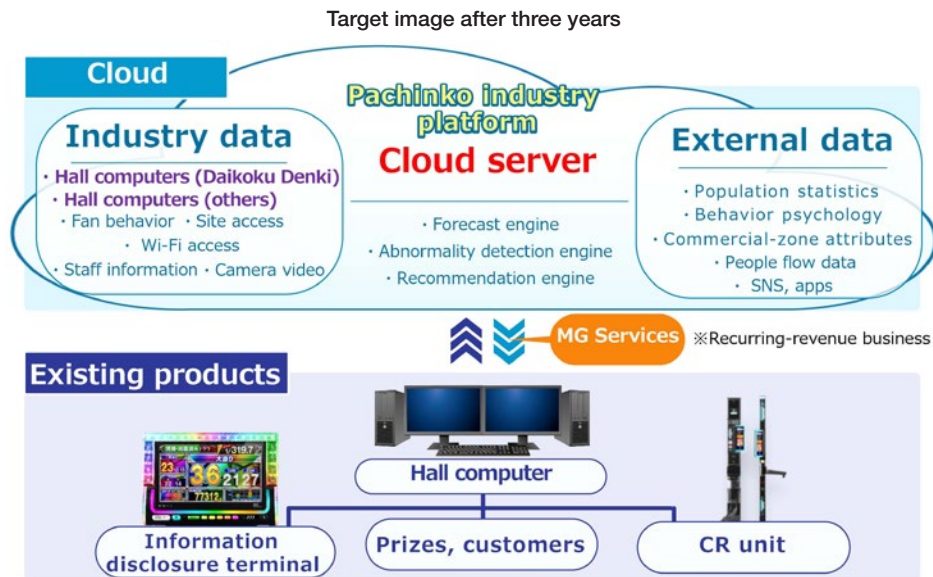
The gaming machine market and pachinko hall industry are anticipating the arrival of a new era accompanying full transition to machines that meet the new regulations and new rollout of smart gaming machines. The switch to smart gaming machines significantly affects fan growth and the format of hall management by broadening convenience and “game” aspects. In particular, manifestation of differences in customer draw by individual pachinko halls is accelerating the trend of industry reorganization driven by leading companies. The Company envisions a scenario of significant income expansion alongside advances in the shift to smart gaming machines as pachinko halls ramp up capital investments (including new site openings) for survival.

2. Priority measures (redefining business domains)

(1) Information System Segment

The centerpiece of the strategy is its aim to build the industry’s only platform through reinforcement of new MG Services that apply a cloud server in anticipation of future market changes, and thereby lock in customers (primarily major hall operators) and effectively assist hall management and contribute to industry reforms. This requires continued promotion of AI hall computer X (Kai), provision of products and services that flexibly address machines that meet the smart gaming machines, further progression of labor and headcount savings, and improvement in the market shares of all products through timely launch of products that transform the way hall staff work and the strategy for attracting fans. It also involves launching a platform that consolidates and utilizes industry and external data on a cloud server* and raising stable income through reinforcement of new MG Services.

* The platform consolidates industry data (hall computers of Daikoku Denki and others, fan behavior, site access, Wi-Fi access, staff information, and surveillance video) and external data (population statistics, behavior psychology, trading area attributes, people flow data, and SNS and apps) on a cloud server, and effectively utilizes and analyzes it with engines focused on forecasting, abnormality detection, and recommendations, among other functions.



Source: The Company's results briefing materials

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Medium-term management plan

(2) Amusement Segment

The Company advocates a policy of transitioning from “pachinko” to “smart pachislot” as the main business driver. It plans to further pursue consignments for comprehensive development of pachislot gaming machines that it started in 2H FY3/21. It is also working on developing its own brand of pachislot machines as a gaming machine manufacturer, targeting launches in FY2024.

3. Investment plan

In the three-year investment plan, the Company intends to cumulatively spend ¥4.0bn in R&D expenses (¥2.8bn in the previous three years) and ¥6.2bn in capital investments (¥4.1bn in the previous three years), exceeding combined outlays in the previous three years. It also plans to mainly allocate R&D expenses to smart pachislot machines (Amusement Segment) and capital investments to server development (Information System Segment).

4. Numerical goals

The Company upwardly revised its numerical goals as a reflection of the fact that 1) results in the previous period, the first fiscal year of the Company's medium-term management plan, exceeded forecasts, 2) market activation from the introduction of smart gaming machines is happening at a quicker pace than expected, and 3) model replacement demand can be expected from the issue of a new Japanese bills (banknotes) scheduled for 2024. Specifically, the numerical goals for FY3/25, the final year of the plan, were raised for net sales from ¥34.0bn to ¥40.0bn (average annual growth rate for three years increases from 11.7% to 17.9%) and for operating income from ¥2.2bn to ¥4.5bn (operating income margin increases from 6.5% to 11.3%). What is characteristic is how the Company will work to raise the added value of its products and convert to an income structure pivoting on recurring revenue business via MG Services (to increase income) while also actively spending on R&D and making capital investments.

Medium-term management plan

(¥mn)

	FY3/22		FY3/23 (First year of the medium-term management plan)		FY3/24 (Second year of the medium-term management plan)		FY3/25 (Third year of the medium-term management plan)		Annual average growth rate (Three years)
	Results	Share	Results	Share	Revised forecast	Share	Revised forecast	Share	
Net sales	24,390		31,824		38,000		40,000		17.9%
Information System Segment	18,647	76.5%	26,209	82.4%	33,000	86.8%	-	-	-
Control System Segment	5,759	23.6%	5,639	17.7%	5,000	13.2%	-	-	-
Gross profit	10,143	41.6%	14,507	45.6%	15,200	40.0%	-	-	-
SG&A expenses	8,952	36.7%	10,487	33.0%	11,000	28.9%	-	-	-
Operating income	1,191	4.9%	4,019	12.6%	4,200	11.1%	4,500	11.3%	55.8%
Ordinary income	1,367	5.6%	4,260	13.4%	4,350	11.4%	4,650	11.6%	50.4%
Net income attributable to owners of the parent	1,228	5.0%	2,927	9.2%	3,000	7.9%	3,200	8.0%	37.6%

Source: Prepared by FISCO from the Company's financial results and medium-term management plan

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Medium-term management plan

5. Medium- to long-term focus points

To reinforce MG Services premised on tapping into its strength in data for the arrival of a new era driven by smart gaming machines, FISCO agrees that the Company's strategy to advance from hall computers to business utilizing a cloud server makes sense when considering changes in the industry environment as opportunities to leverage its advantages. Furthermore, the platform business it targets is likely to reinforce the Company's overwhelming position by fueling a beneficial cycle (networking effect) wherein members are drawn to places with extensive data and data accumulates in places with more members. We also intend to focus on the extent of new value realized through innovation and sustainability initiatives as its exercise of leadership in the industry contributes substantially to its own continuation and the sustainability of the industry and society as an industry leader. In addition, we will keep our eyes trained on the Company's M&A activities aimed at entering different sectors and its reinforcement of business alliance initiatives to enable it to acquire new revenue sources and disperse risk.

Furthermore, we believe the upwardly revised medium-term management plan (numerical goals) is well within reach with smart gaming machines gaining solid traction so far. There are currently about 3.5mn pachinko and pachislot machines installed in total. The Company expects that the changeover to smart gaming machines will go smoothly, and therefore, how quickly smart gaming machines gain traction over the next few years will be key. Also, new Japanese bills (new banknotes) scheduled to be issued in July 2024 are expected to underpin replacement demand. At any rate, pachinko halls need to make considerable capital investments for the introduction of smart gaming machines. Therefore, there is a strong possibility that industry realignment could suddenly accelerate, and the evolution of game features is likely to be accompanied by a turn to recovery from the downturn to date in pachinko and pachislot fan numbers, including by capturing new users. Such structural changes can also be regarded as offering excellent opportunities for the Company to expand its market share and strengthen its earnings capabilities. As such, whether the Company is able to play a central role in revitalizing the industry will probably be an important point for accelerating its own growth too.

■ Industry environment

A challenging industry environment has remained in place for some time, but there are signs of market activation from the introduction of smart gaming machines

Japan's pachinko industry has been experiencing a challenging environment over the past few years, reflecting the decline in the overall number of pachinko players, a trend toward playing games with low rental costs for balls, increases in Japan's consumption tax, and other factors. The self-regulatory action taken by the industry in 2015 (tightening restrictions on both pachinko and pachislot machines with strong gambling elements) left the whole industry in a slump in 2016 as it started to grapple with the problem of collecting and removing all pachinko machines that may perform differently from certified standards. Furthermore, promulgation of "new regulations" on September 4, 2017 fueled pessimistic views of the industry and uncertainty about the future. This disarray persisted for a while, and additional impact by COVID-19 (temporary hall closures and shorter operating hours) since the start of 2020 accelerated the harsh environment.

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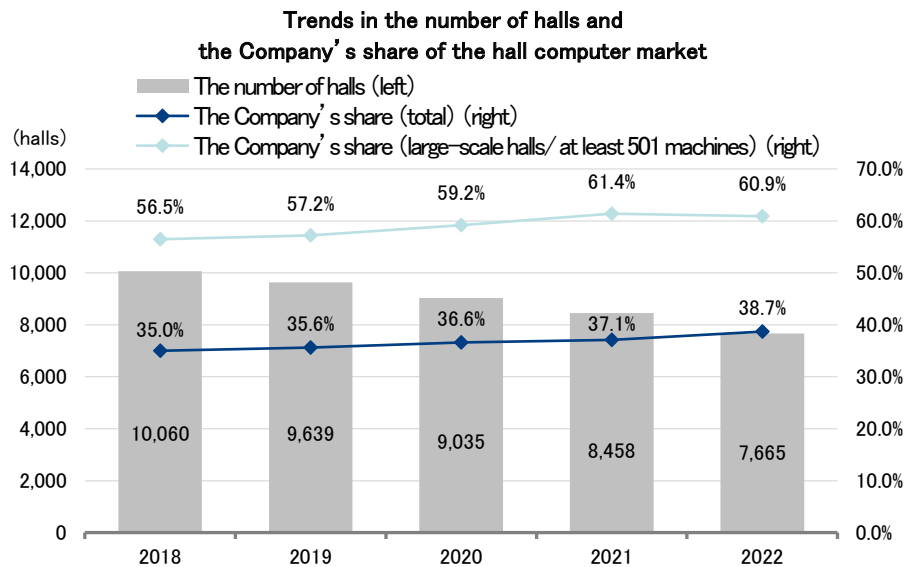
Industry environment

In 2021, however, the market was enlivened by replacement demand for gaming machines, driven by progress in gradually replacing gaming machines with those meeting the new regulations ahead of the deadline at the end of January 2022, in contrast with the emergence of several popular gaming machine models with new amusement features (such as “play time”*) following revisions to the Technology Format Interpretation Standards adopted in January 2020, and in accordance with related Nikkoso internal stipulations. In addition, the phased introduction of smart gaming machines started in November 2022 and the gaming machine market and pachinko hall industry are approaching a new era, with attention focusing on the deployment of smart gaming machines going forward. At the same time, in terms of risk factors, there are concerns about the impact of semiconductor shortages and sharp increases in costs caused by rising prices.

* “Play time” is a system (rescue measure) whereby the machine enters a shortened time mode (a function that efficiently rotates balls without reducing the number of balls up to a certain number of times) if the player does not have a big win in a specified number of rotations during normal play (low probability). With the recent industry regulations, new functions such as “play time” have been added, and the breadth of game features of game machines was expanded.

According to surveys by the National Police Agency, the number of pachinko halls in Japan declined at an average annual rate of 4.8% over 10 years from 2013 to 2022. In particular, in recent years there has been a noticeable decline in new hall openings due to the impact of the new regulations and other factors. However, at the end of December 2022, the number of halls was 7,665 (down 793 YoY), and the Company share of hall computer customers rose to 38.7% continuing the trend to increase year by year. Its customer halls are often high-end, large pachinko halls that are the top performers in their respective local markets and exceed the market average in size*. The customer base hence is fairly resilient to economic fluctuations and possesses healthy investment resources. As the Company moves toward a new era with new smart gaming machines, we expect an excellent opportunity for it to expand business once investment appetites recover, mainly at large halls.

* The Company's share of the large-scale halls (at least 501 machines) market is even higher at 60.9%.



Source: Safety Division, Community Security Bureau, National Police Agency

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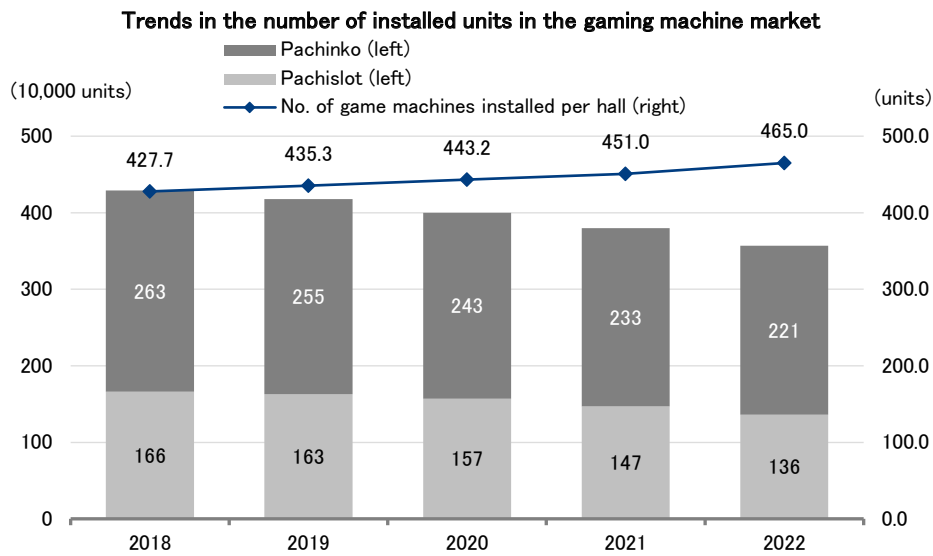
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Industry environment

Prepared by FISCO from the Current Status of Entertainment and Amusement Businesses, etc. and the Status of Measures for Crimes relating to Entertainment and Amusement Businesses, etc. 2022 and the Company's results briefing materials Although the number of game machines installed and running in the market is on a downward trend (the decline in pachislot machines is particularly striking), the number of machines per hall is increasing, indicating that halls are becoming larger. As discussed above, larger pachinko halls that command economies of scale are a main segment, therefore this trend should benefit the Company with its ability to realize robust investment return through advanced functionality and added value.

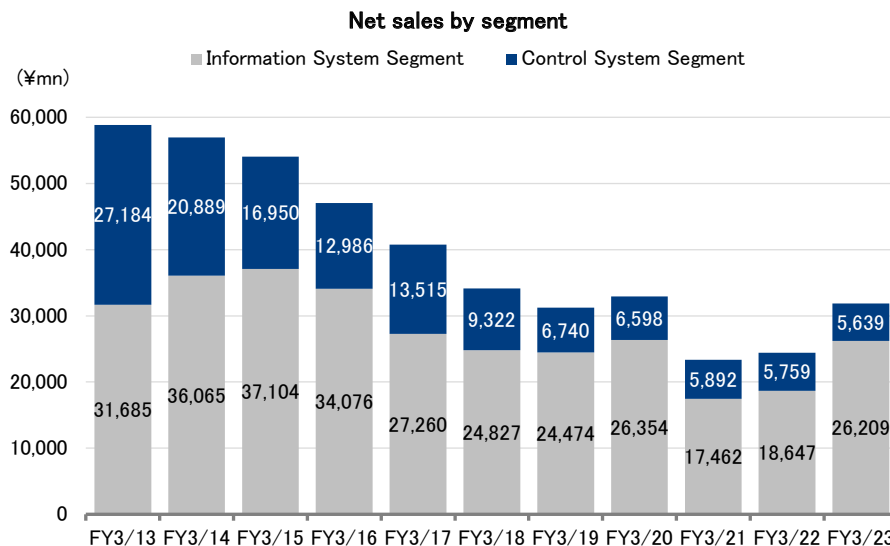


Source: Safety Division, Community Security Bureau, National Police Agency

■ Performance over the past fiscal years

Prepared by FISCO from the Current Status of Entertainment and Amusement Businesses, etc. and the Status of Measures for Crimes relating to Entertainment and Amusement Businesses, etc. 2022

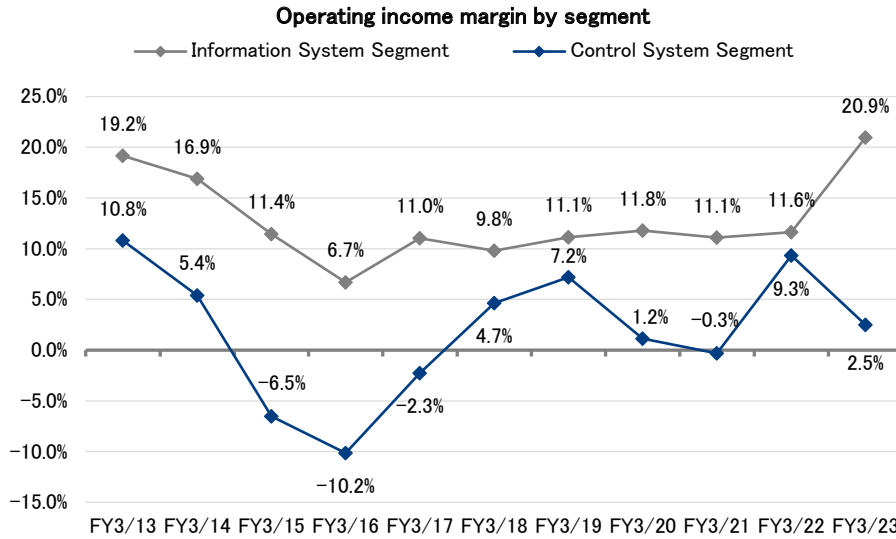
As the industry enters a period of transition, earnings have been on a downward curve, but the Company is establishing a foundation for sustainable growth eyeing the future based on earnings recovery and expansion through the emergence of smart gaming machines. Looking back at past results, the Company's sales shrank YoY because of restrained consumer spending and the impact of the Great East Japan Earthquake in FY3/11. Its results rebounded afterwards, even though the pachinko industry continued to contract. This recovery was mainly led by the Information System Segment, which holds high market shares for its products. Net sales in this segment reached three consecutive record highs from FY3/13 to FY3/15, supporting the Company's overall performance. However, net sales have been weak since FY3/16 due to the impacts of negative factors in the industry (self-regulatory action, collecting and removing of machines, and uncertainty related to new regulations), as well as the impacts of the COVID-19 pandemic and other factors since the start of 2020. However, in FY3/23, in addition to the recovery from the pandemic, the market environment changed with the introduction of smart pachislot machines in November 2022, and with this the Company's results have been recovering and expanding pivoting on the Information System Segment.



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

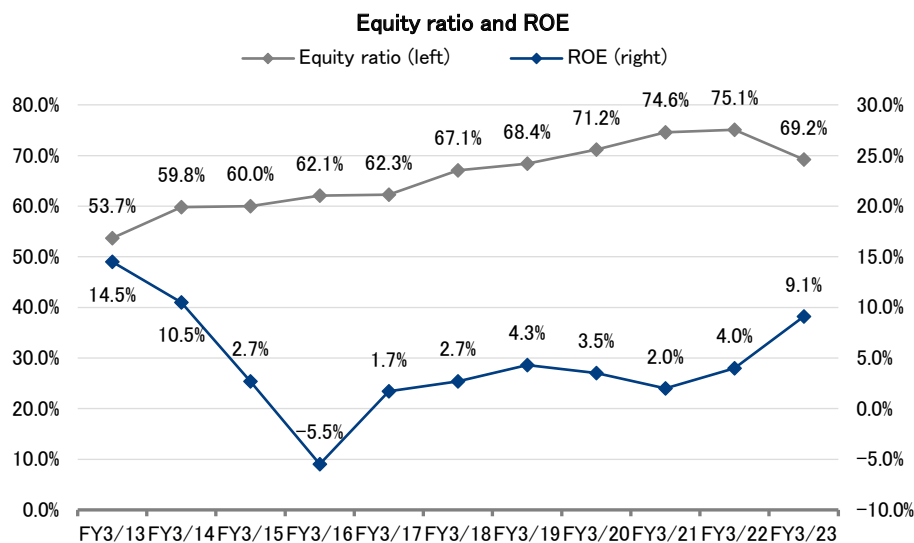
The Information System Segment has become the source of profits, and has maintained high profit margins. Margins fell from FY3/14 to FY3/16 due in part to an increase in R&D expenses for next-generation products. During the period from FY3/18 to FY3/22, these expenses ran their course, but a slump in sales and other factors prevented the profit margin from returning to its previous high level. In FY3/23, however, the profit margin of the Information System Segment improved greatly thanks to a recovery in sales and increased sales of high added-value products. The Company is also steadily converting to a recurring revenue business model through the growth of its MG Services, and this is also a factor underpinning profit.

Performance over the past fiscal years



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

In terms of financial indicators, the Company's equity ratio, a measure of financial stability, has risen, reflecting an accumulation of retained earnings. In FY3/23, the Company maintained its equity ratio at a high level of 69.2% despite a slight decrease as assets such as accounts receivable – trade increased due to the rapid expansion of net sales. The current ratio, which indicates the ability to make payments in the short term, was around 240%, mainly due to large holdings of cash and deposits, as the Company's robust financial base is a strength as a source for powering future growth. ROE, a measure of capital efficiency, has been low since FY3/15 due to a deterioration of net income. The Company suffered losses in FY3/15 due to the bankruptcy of a manufacturer customer and in FY3/16 due to the devaluation of parts and materials for its pachislot machines as industry restrictions were placed on risky machines. In FY3/23, however, profit recovered and ROE also improved greatly.



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

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Initiatives in sustainability

Announced its sustainability policy aiming to realize a sustainable society and aim for Group growth

To pursue the Group’s own growth and realize a sustainable society through business activities based on its corporate philosophy of “continuing to consistently deliver sustainable growth in the future by creating new value through innovations,” the Company again resolved at the Board of Directors matters pertaining to the sustainability policy and identification of materiality (important issues) and disclosed the information (March 2022). The Company is advancing specific initiatives in line with materiality, including raising awareness through games to check gambling addiction, holding parent-child programming experience classes, promoting telecommuting and other workstyle reforms as well as human resource engagement, and installing solar panels. It has also established the Sustainability Committee as part of its building of frameworks to promote sustainability activities in a continuous and organized manner, and is disclosing information regarding climate change based on the Task Force on Climate-related Financial Disclosures (TCFD) recommendations. In December 2022, the Company achieved a “B-” management level rating for its climate control efforts from the CDP, an international non-profit organization headquartered in London, England that evaluates and certifies companies and other entities’ environmental-related strategies, initiatives, and so forth.

Initiatives in sustainability

<p>Corporate philosophy</p> <p>Sustainability Policy</p>	<p>We will continue to achieves sustainable growth consistently from now on through the creation of new value based on innovation</p> <p>The Daikoku Denki Group solves social issues through business activities based on its management philosophy, and will aim for the realization of a sustainable society and the growth of the group together with stakeholders.</p>
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ESG	Materialities	SDGs
E	Contributions to the global environment	
S	Promotion of activities by human resources	
	Provision of solutions based on innovation	
	Handling of addiction	
G	Strengthening of governance and compliance	

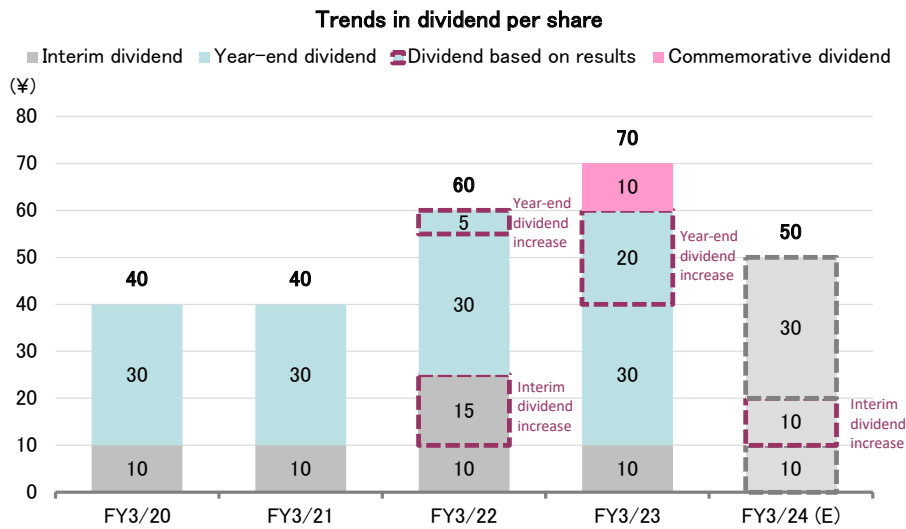
Source: The Company's results briefing materials

Shareholder returns

For FY3/24, the Company is planning an annual dividend of ¥50 per share. Leeway to increase the dividend is expected with profit growth

The Company’s policy is to maintain a stable dividend and to provide a special dividend depending on its business results. In FY3/23, it paid an annual dividend of ¥70 per share (¥10 interim, ¥60 year-end), a ¥10 increase from the previous year, that included a special dividend (¥20) owing to its good results and a commemorative dividend for its 50th anniversary (¥10). Because the Company’s recent results have been solid, for FY3/24 it is planning an annual dividend of ¥50 per share (¥20 interim, ¥30 year-end), with a special dividend (¥10) added to the interim dividend. FISCO believes there is a sufficient likelihood that the dividend will be increased with profit growth going forward.

Additionally, the Company resumed the shareholder benefit program, which seeks to enhance the investment appeal of its stock and promote medium- to long-term ownership, in FY3/22. The benefit program gives QUO cards to shareholders with the value calibrated to the number of shares owned and the period of sustained ownership at the end of September each year.



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



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