

DYNAM JAPAN HOLDINGS Co., Ltd.

06889

Hong Kong Stock Exchange

12-Jan.-2024

FISCO Ltd. Analyst

Yuzuru Sato



FISCO Ltd.

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

■ Index

■ Summary	01
1. Double digit growth in revenue and profit in FY3/24 1H	01
2. FY 3/24 business strategy	01
3. Pachinko business outlook	02
■ Company profile	03
1. History	03
2. DYNAM JAPAN HOLDINGS Group's features and strengths	03
■ Status of FY3/24 1H results	07
1. Overview of FY3/24 1H results	07
2. Financial condition	16
■ FY3/24 business strategy	17
1. Pachinko business	17
2. Aircraft leasing business	19
3. Video slot machine business for casinos	20
■ Future growth strategy	21
1. Market trends	21
2. Growth strategy	23
■ Returns to shareholders	26
■ ESG initiatives	27
1. Environmental initiatives	27
2. Social initiatives	27
3. Governance initiatives	28

Summary

Recovery in revenue due to impact of smart slot machines, number of halls to grow once again based on M&A strategy

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. Double digit growth in revenue and profit in FY3/24 1H

In the FY3/24 1H (April – September 2023) consolidated results, revenue increased by 14.6% year-on-year (YoY) to ¥64,375mn, while operating profit grew 13.4% to ¥4,400mn, as both revenue and profit increased by double digits. In the industry, smart slot machines, which were introduced from November 2022, are popular and customer numbers have recovered, mainly among young and middle-aged people. The Company increased the number of smart slot machines in its halls in order to capture the demand for smart slot machines, and operating revenue from the pachinko business was strong, increasing 12.8% year on year to ¥62,187mn. Although there was an increase in depreciation costs in the pachinko business (up ¥6,030mn), this was offset by the effects of increased revenue, and operating income for the entire Company increased by double digits. In addition, in the pachinko business, depreciation has increased significantly due to changes in accounting standards* from FY3/22, but they are expected to peak in FY3/24 1H and decrease from 2H. Operating revenue for this business is still recovering, at around 84% of the FY3/20 1H level before COVID-19, but in terms of profitability excluding gaming machine-related expenses, efforts have been made to improve hall productivity and reduce costs, and as a result, operating revenue has recovered to a level close to pre-pandemic levels. The number of group halls increased by 5 halls from the end of the previous fiscal year to 434 halls as of the end of September 2023, the first increase since March 2018, due to the acquisition of five halls through M&A.

* The Company had been booking expenses for the purchase of gaming machines on a single year basis, but then it changed to a method of recognizing them as depreciating assets and booking depreciation expenses (2 year straight line depreciation) (some machines are expensed in single year).

2. FY3/24 business strategy

In FY3/24, the Company is working to increase hall revenue by installing smart gaming machines with high customer attraction capabilities, to improve the earnings capability by performing renovations of flagship halls, acquiring new users (cultivation of a wide range of age groups) and expanding the number of halls by continuing active M&A. Among the smart gaming machines, smart pachinko gaming machines, which started to be introduced in April 2023, are being introduced cautiously due to the fact that there is not much difference in customer attraction capability as the specs are similar to those of conventional models (1.7% as of the end of FY3/24 1H → 3% range at end of FY3/24), while the plan is to proactively introduce smart slot machines (20.8% → low 30% range). The growth rate of operating revenue is expected to slow down compared to the 1H period as the effects of introducing smart slot machines, which started in the 2H of the previous fiscal year, will fade. However, on the other hand, depreciation costs are also expected to decrease, so the profit growth rate might further increase. The Company also announced that it had acquired the business rights for two halls in December 2023.

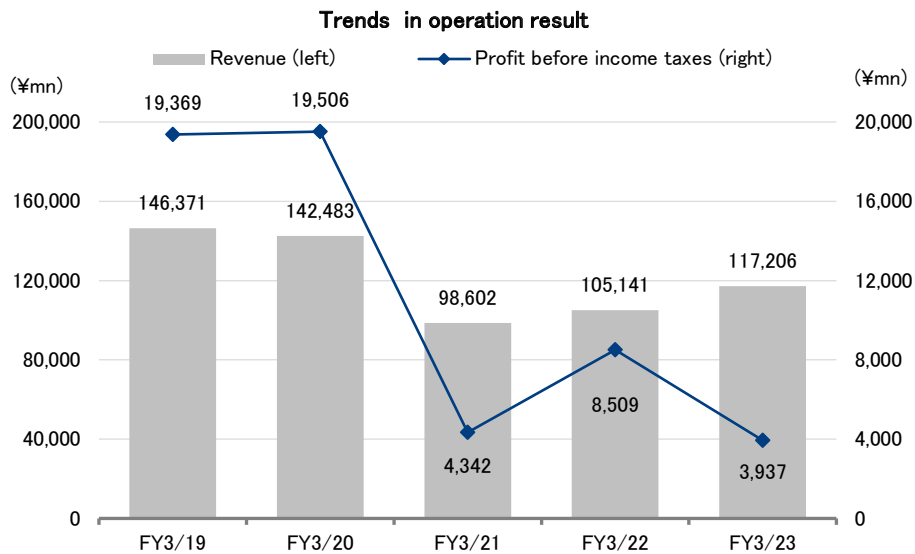
Summary

3. Pachinko business outlook

The pachinko industry, which continued to face a severe market environment due to the COVID-19 pandemic, is finally recovering based on the introduction of smart slot machines. The speed of the spread of smart gaming machines is more modest than initially expected, but at FISCO we think that going forward specs will be revised in order to promote the spread of smart pachinko machines. At that time, the number of customers will likely increase, including senior customers (age 60+) who have not completely come back to playing at pachinko halls, and halls will become even more profitable. In particular, seniors account for just over 40% of the Company's customer base, so if attractive models of smart pachinko machines emerge, that will have a large impact on increasing the number of customers. It seems that the overall industry will further progress towards an oligopoly for large companies that have the financial means to invest in smart gaming machines, and at FISCO we think this will be a good opportunity for the Company to increase its hall count through an M&A strategy over the next few years and grow its pachinko business.

Key Points

- Customer traffic recovered alongside the introduction of smart slot machines, and there was double-digit growth in revenue and profit in FY3/24 1H
- Expecting depreciation burden to decline and revenue growth rate to further increase in FY3/24 2H
- Aiming for renewed growth by bolstering investment in smart gaming machines and creating halls to attract a new customer base, as well as through proactive M&A



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.

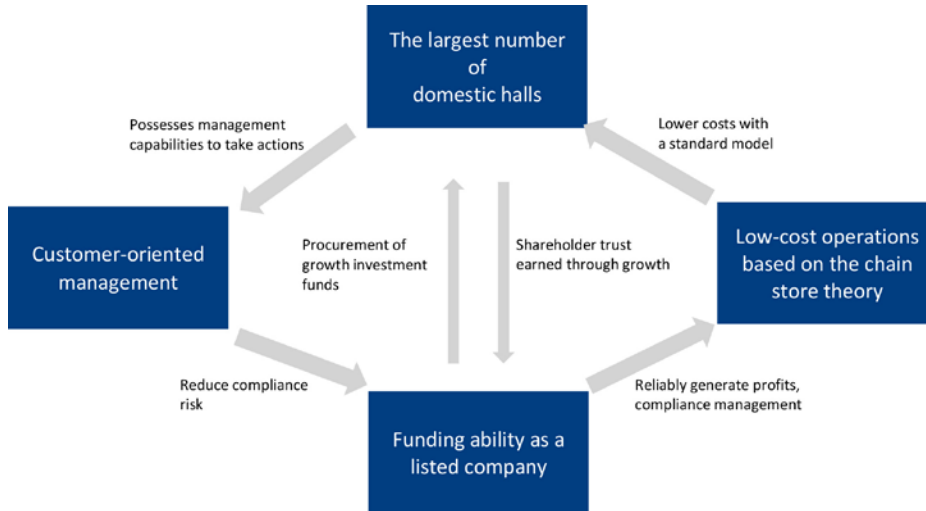
Established a robust management foundation that leverages four strengths, differentiates itself from other companies

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.

Company profile

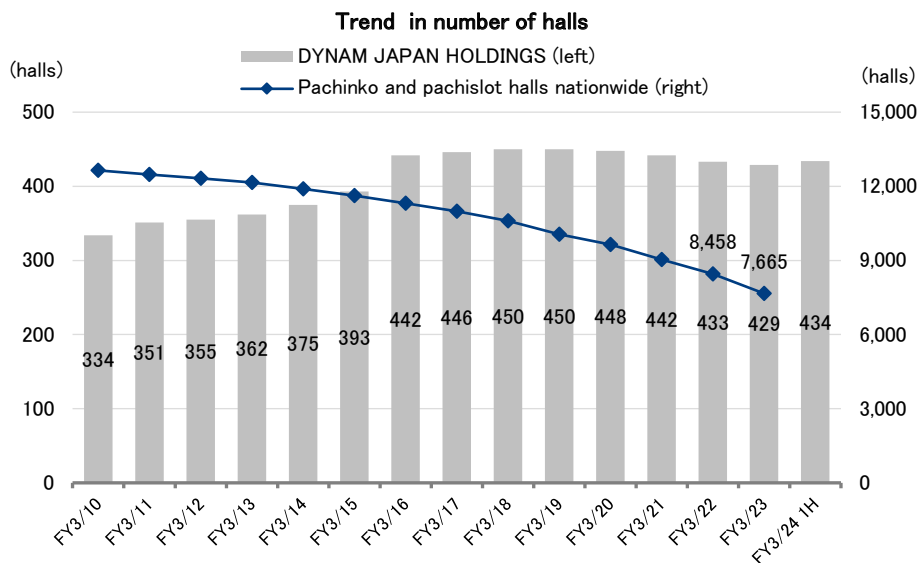
Relationship among the four strengths of the Dynam Japan Holdings Group



Source: Prepared by FISCO from interviews

(1) Domestic leader with 434 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, down to roughly half of the peak level in 1995. Of these halls, the Company is the domestic leader with 434 group halls (as of the end of September 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 seem to be around 6%. Its market share exceeded 1% in 2003, and the Company has increased its number of halls, including through M&A, and increased its market share amid the decrease in the overall number of halls in the industry. From FY3/20 onward, the number of halls declined for four straight fiscal years due to the closing of unprofitable halls caused by the deterioration in the market environment because of the COVID-19 pandemic, but in FY3/24 1H the Company acquired 5 halls through M&A, leading to an increase of 5 halls versus the end of FY3/23 to 434 halls, as the number of halls increased for the first time in a long time.



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"

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DYNAM JAPAN HOLDINGS Co., Ltd.

12-Jan.-2024

06889 Hong Kong Stock Exchange

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Company profile

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 September 2023, 9.6% of its installed pachinko machines were private-brand machines (DYNAM stand-alone 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 434 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.

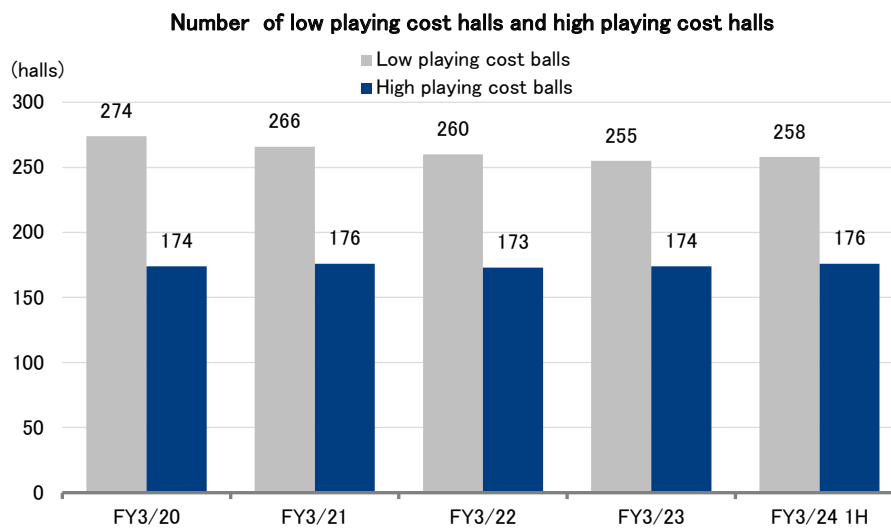
Among the Company's business policies, we have a favorable view of a) low playing cost operations and b) operations that do not rely on gambling appeal. These are also key words for understanding its business policy and growth strategy.

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.

Company profile

At the end of September 2023, the Company had 258 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 senior demographic, which is the main target, but as of the end of September 2023 had returned to increasing. 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.



Source: Prepared by FISCO based on the Company's 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 20pt 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, while younger- to middle-aged customers have increased markedly since the introduction of smart slot machines in November 2022. In the Company's case, slightly over 40% of customers are seniors, just under 40% of customers are in their 40s to 50s, while just under 20% are in their 10s to 30s. Therefore, the policy for the future is to create halls supporting a wide range of customer demographics.

DYNAM JAPAN HOLDINGS Co., Ltd.

06889 Hong Kong Stock Exchange

12-Jan.-2024

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Company profile

(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 1,500 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.

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

Status of FY3/24 1H results

Customer visits recovered triggered by the introduction of smart slot machines, with double-digit increases in both revenue and profit in FY3/24 1H

1. Overview of FY3/24 1H results

In the FY3/24 1H results, revenue increased by 14.6% YoY to ¥64,375mn, operating profit increased by 13.4% to ¥4,400mn, profit before income taxes increased by 26.1% to ¥2,924mn, and net profit for the interim period rose by 58.4% to ¥1,874mn. Revenue increased for the third straight interim period, while all profit lines turned higher for the first time in two fiscal periods.

As the COVID-19 pandemic moved towards a closing, there was a recovery in customer visits, especially among younger- and middle-age customers, based on the popularity of smart slot machines which began to be introduced in November 2022, and pachinko revenue rose 12.8%, and was the main reason for the increase in overall revenue. In the aircraft leasing business, the number of aircraft being leased increased from four a year earlier to nine, and due to this the revenue roughly doubled year-on-year, contributing to the increase in revenue. It seems as if the recovery in operating profit is dull compared to the earnings before the COVID-19 pandemic (revenue = ¥74,052mn, operating profit = ¥14,042mn), but this is due to the change in accounting treatment since FY3/22, resulting in a significant increase in depreciation costs of machines by ¥5,990mn, to ¥18,033mn. Looking at the operating profit before deducting machine-related expenses (depreciation + purchase costs), the operating profit has recovered to 89% the level before the COVID-19 pandemic, and it is clear that the profit-earning capability has steadily recovered.

Status of FY3/24 1H results

FY3/24 1H consolidated results

	FY3/23 1H	FY3/24 1H	YoY		Remark
			%	Change	
Revenue	56,195	64,375	14.6%	8,180	
Revenue from pachinko business	55,150	62,187	12.8%	7,037	High playing cost halls 29,246 (+2,187), low playing cost halls 32,941 (+4,850)
Revenue from aircraft leasing business	1,045	2,188	109.4%	1,143	The number of owned aircraft increased from 4 to 9
Operating expenses	52,915	60,530	14.4%	7,615	
Pachinko business expenses	52,246	59,208	13.3%	6,962	Machine-related expenses (depreciation + purchase costs) +5,769, utilities expenses +320, repair expenses +687, personnel costs -209
Aircraft leasing business expenses	669	1,322	97.6%	653	Depreciation +559
SG&A expenses	2,048	2,144	4.7%	96	Company management expenses other than in the pachinko business and the aircraft leasing business
Other income	4,950	3,963	-19.9%	-987	Prior 1H: Received compensation for the removal of the Nagano-Iida Hall 817
Other operating expenses	2,301	1,264	-45.1%	-1,037	Impairment losses -651, Loss on the disposal of property, plant and equipment -340
Operating profit	3,881	4,400	13.4%	519	
Financial income	173	419	142.2%	246	
Financial expenses	1,736	1,895	9.2%	159	
Profit before income taxes	2,318	2,924	26.1%	606	
Tax expenses	1,135	1,050	-7.5%	-85	
Profit	1,183	1,874	58.4%	691	

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

Other income decreased in total by ¥987mn due to the non-recurrence of ¥817mn in compensation for removal of halls posted in the year-earlier period, while other expenses decreased by ¥1,037mn. Impairment losses on property, plant and equipment related to halls declined by ¥651mn, while loss on the disposal of property, plant and equipment declined by ¥340mn. The number of halls in the Company as of the end of FY3/24 1H increased by 1 hall versus the end of FY3/23 1H to 434 halls (up 5 halls compared to the end of FY3/23). As a result of efforts to standardize hall operations and increase efficiency, the number of consolidated employees at the end of the period was 12,679, a decrease by 216 YoY (down 43 compared to the end of FY3/23).

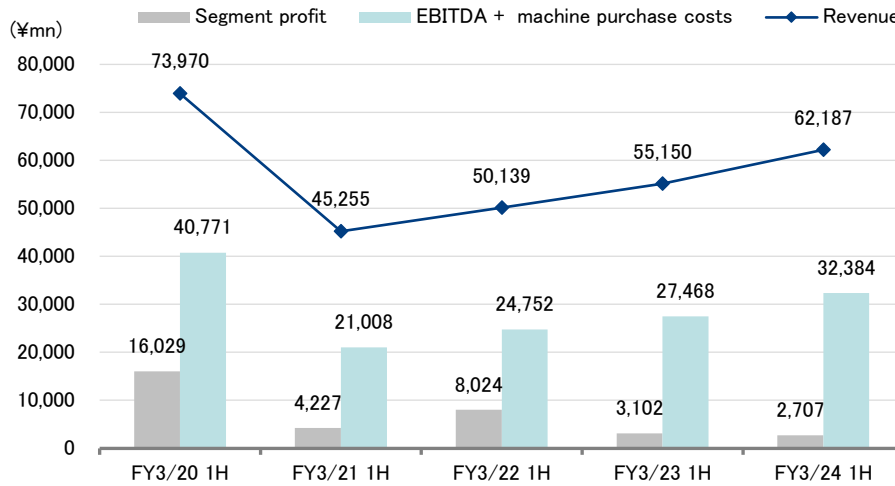
(1) Pachinko business

In the pachinko business, revenue increased but profit decreased, with revenue increasing by 12.8% YoY to ¥62,187mn and segment profit decreasing by 12.7% to ¥2,707mn. As mentioned earlier, 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, which resulted in a significant increase in depreciation and amortization expenses by ¥6,035mn to ¥26,427mn, causing decreased profit.

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 17.9% YoY to ¥32,384mn in FY3/24 1H, the third consecutive year of increasing, and its ratio of revenue also turned around, increasing by 2.3pt YoY to 52.1%. Compared to the level in FY3/20 1H, before the COVID-19 pandemic, revenue has recovered to 84.1% of the level, and EBITDA + machine costs to 79.4%. Profitability ((EBITDA + machine costs) ÷ revenue) has recovered to 52.1% of the level prior to the pandemic. The entire industry is under extremely harsh conditions and many companies are being forced to downsize the number of halls, but the Company should be commended for the outcome from its efforts to review hall operations and reduce costs.

Status of FY3/24 1H results

Pachinko business results



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

Breaking down revenue in the pachinko business, pachinko revenue decreased by 0.1% YoY to ¥39.73bn, but slot revenue increased 45.9% to ¥22.45bn. With the emergence of multiple hit smart slot machine models in compliance with new regulations, in addition to the return of customers centered on younger and middle-aged customers, the Company installed more smart slot machines in order to respond to the popularity of smart slot machines. In terms of the number of installed gaming machines at the end of FY3/24 1H, the number of pachinko machines declined 0.6% YoY to 142,000, while the number of slot machines increased 10.5% to 68,000, increasing by around 6,000 machines. Of these, looking at smart machines, there were 2,351 smart pachinko machines, which the Company started installing from April 2023, with the ratio only at 1.7%, while there were 14,312 smart slot machines, for an installation ratio of 20.8%. Looking at the ball fee revenue ratio, this movement was clearer, with the ratio of revenue from smart slot machines reaching 29.5% as of September 2023.

Installations of smart slot machines and smart pachinko machines

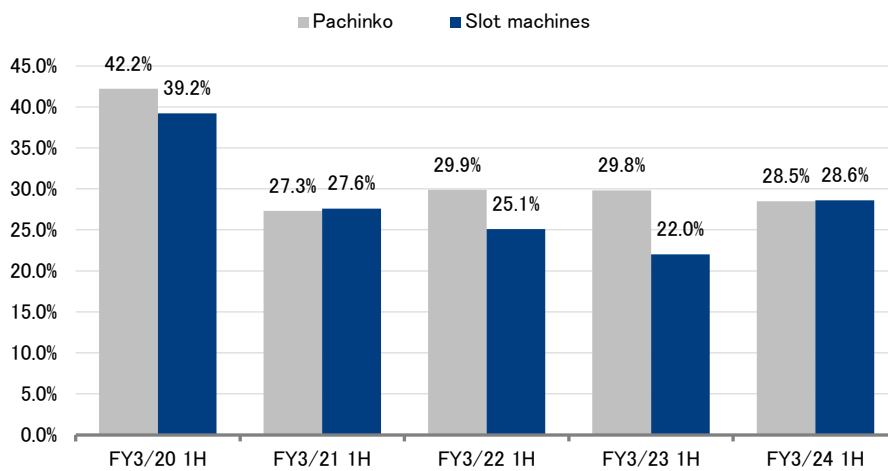


Source: Prepared by FISCO from materials provided by the Company and the Company's results briefing materials

Status of FY3/24 1H results

The reason why the introduction of smart pachinko machines did not progress was that the specs were almost the same as previous models and could not be differentiated, and the manufacturing cost increased due to the need to install a new ball circulation system inside the machine. Thus, there was limited activity on the part of the manufacturers to proactively release main titles, and with limited investment capacity on the part of the halls, the Company prioritized the introduction of smart slot machines, which are expected to see an increase in operating rates. In fact, looking at the operating rates at DYNAM halls, while slot machines increased by 6.6pt YoY to 28.6%, pachinko machines fell by 1.3pt to 28.5%, reflecting these trends.

Operating rates

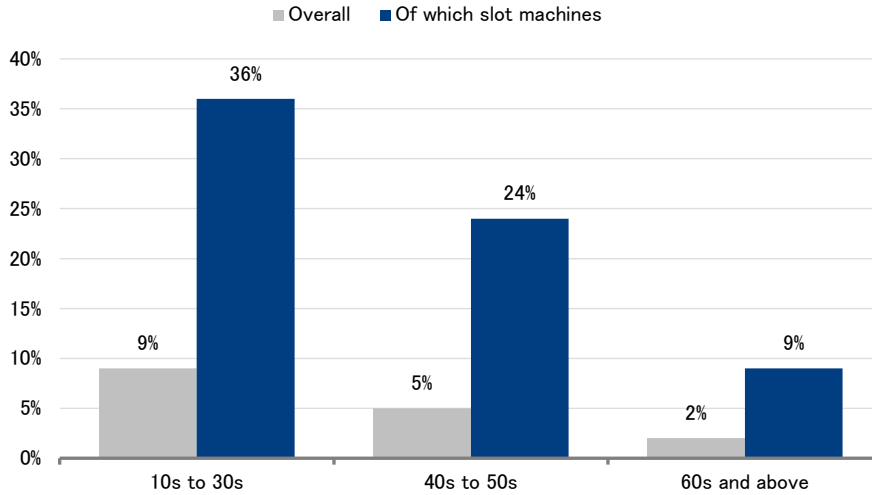


Note: Data are for DYNAM halls. Operating rate = Actual number of customers / number of machines at peak time (average at 3:00 p.m. and 7:00 p.m.)
Source: Prepared by FISCO from the materials provided by the Company and the Company's results briefing materials

Looking at trends in the number of customers by age group, there has been a noticeable recovery among young and middle-aged people who prefer slot machines, while growth is still sluggish among seniors, who tend to play pachinko. Data as of September 2023 show that the number of customers in their 10s to 30s has increased by 9% overall, and when looking at slot machines alone, it has increased greatly by 36%. The number of customers in their 40s to 50s has also increased by 5% overall, of which slot machines increased by 24%. For seniors in their 60s and above, the recovery has been slow, with an overall increase of 2% and a 9% increase in slot playing customers. For seniors, the return in customer numbers is still slow since the COVID-19 pandemic, but for young and middle-aged customers, it seems that they have returned to near pre-COVID-19 levels. Seniors account for over 40% of the Company's customer base, so for the time being the Company's halls will continue to operate with the aim of attracting young and middle-aged customers.

Status of FY3/24 1H results

YoY growth rate in customers by age (September 2023)

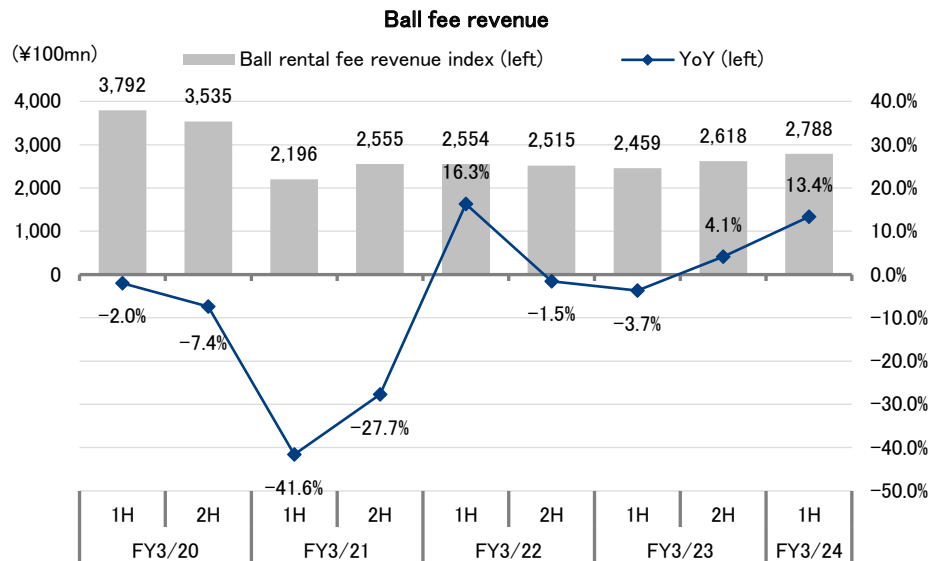


Source: Prepared by FISCO from the materials provided by the Company and the Company's results briefing materials

Breaking down revenue by hall type, in high playing cost halls, it increased by 8.1% to ¥29,246mn, while in low playing cost halls, it rose by 17.3% to ¥32,941mn, so revenue increased more for low playing cost halls. Revenue from slot machines was solid for both types, while revenue from pachinko machines declined significantly for high playing cost halls.

Looking at ball rental fee revenue, which corresponds to gross sales, there was an increase by 13.4% YoY to ¥278,822mn, turning to an increase trend from the previous 2H. In addition to the fact that in May 2023 the activity restrictions were lifted alongside the reclassification of COVID-19 in the Infectious Diseases Control Law being lowered from Class 2 to Class 5, which is the same as seasonal influenza, multiple smart slot machine models emerged as hit models, and as a business strategy the Company increased the number of slot machines at existing halls and implemented a large-scale renovation at aging flagship halls. As a result of these efforts, the level of hospitality was raised.

Status of FY3/24 1H results



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

At existing DYNAM halls, the number of slot machines was increased during FY3/24 1H at 104 halls. In addition to adding a total of 3,716 machines, the Company carried out major renovations of three flagship halls, and added a total of 156 slot machines. Comparing the YoY growth rate in ball revenue as of September 2023 to non-renovated halls, the growth rate at non-renovated halls was 7.6%, versus an increase of 15.3% at halls where slot machines were increased, compared to an increase of 25.9% at halls where major renovations were made. Therefore, the effects of these actions were evident.

Operating measures through renovations of existing halls (DYNAM's existing halls)

	Number of halls	Number of slot machines added	Investment amount (¥bn)
Increase in slot machines	10.4	371.6	3.3
Major renovations	0.3	15.6	0.3

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

September 2023 increase in ball fee revenue (per hall)

	YoY difference (¥thousands)	YoY comparison
Halls that added slot machines	13,163	115.3%
Halls that performed major renovations	40,756	125.9%
Halls that did not perform renovations	5,552	107.6%

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

Status of FY3/24 1H results

Pachinko business expenses increased by 13.3% YoY to ¥59,208mn. The main change factors were that hall management personnel costs decreased by ¥209mn, but that game machine-related costs (depreciation + purchase costs) increased by ¥5,769mn, utilities expenses rose by ¥320mn, and repair costs rose ¥687mn. 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. On game machine-related costs, this was the third period since the start of the machines' depreciation, and the extent of the increase was large, partially due to the increase in the number of installed smart slot machines. The increase in utilities expenses was due to the impact of high electricity rates, while the rise in repair costs was due to the renovations of many halls in conjunction with the increase in smart slot machines.

Looking at the trend of the ratio of various expense items to pachinko business revenue, in total it rose by 0.5pt YoY to 95.2%. Breaking this down, it declined by 4.3pt for hall operation personnel costs to 30.3%, while it rose by 6.4pt for depreciation to 35.0%, centered on game machines. The introduction of smart slot machines required investment in peripheral equipment such as dedicated units, which increased depreciation, but excluding the impact of the increase in depreciation, the business expense ratio would have decreased. Compared to FY3/20 1H before the COVID-19 pandemic, the business expense ratio before the pandemic was 82.6%, which was 12.6pt lower than FY3/24 1H, but hall personnel expenses were successfully reduced to a ratio of 30.3%, compared to 33.2% before the COVID-19 pandemic. Cleaning costs and other costs have also improved, and excluding game machine-related expenses, the operating expense ratio is at a slightly lower level than before the COVID-19 pandemic, and the Company's effective earnings ability has almost returned to the level of before the pandemic. Regarding game machine-related expenses, although the initial cost of introducing smart game machines increases the burden, depreciation expenses are expected to peak out from 2H onwards, and if the number of customers can increase, profitability will also likely further increase.

Ratio of pachinko business expenses to revenue

	FY3/20 1H	FY3/23 1H	FY3/24 1H	YoY	vs. FY3/20 1H
Total expenses	82.6%	94.7%	95.2%	0.5pt	12.6pt
Hall personnel expenses	33.2%	34.6%	30.3%	-4.3pt	-2.9pt
Depreciation	6.8%	28.6%	35.0%	6.4pt	28.2pt
Machine costs	17.8%	3.4%	2.7%	-0.7pt	-15.1pt
Depreciation of right-of-use assets	6.9%	8.1%	7.2%	-0.9pt	0.3pt
Repair expenses	2.3%	2.2%	3.0%	0.8pt	0.7pt
Utilities expenses	4.1%	6.6%	6.3%	-0.3pt	2.2pt
Cleaning expenses	2.6%	2.0%	2.0%	0.0pt	-0.6pt
Advertising expenses	2.3%	2.5%	2.4%	-0.1pt	0.1pt
Other	6.7%	6.8%	6.2%	-0.6pt	-0.5pt

Note: Ratios to pachinko business revenue

Source: Prepared by FISCO from the materials provided by the Company and the Company's interim report

Looking at the results of DYNAM Co., Ltd., which is the Group's core company, revenue increased by 12.7% YoY to ¥58,513mn, operating profit increased by 38.1% to ¥1,574mn, ordinary profit grew 28.0% to ¥1,698mn, and interim profit declined by 15.3% to ¥1,038mn. While there were slight differences due to Japanese accounting standards, the factors for the increases and decreases were basically the same as for the consolidated results.

DYNAM JAPAN HOLDINGS Co., Ltd.

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12-Jan.-2024

<https://www.dyjh.co.jp/english/ir/index.html>

Status of FY3/24 1H results

DYNAM's FY3/24 1H results (using Japanese accounting standards)

(¥mn)

	FY3/23	FY3/24	YoY		Summary
	1H	1H	%	Change	
Revenue	51,905	58,513	12.7%	6,608	Pachinko +52 (+0.1%), slot machines +6,312 (+46.1%), Revenue from vending machines, etc. +243
SG&A expenses	50,765	56,939	12.2%	6,174	
Machine-related expenses	12,318	17,942	45.7%	5,624	Increase in pachinko and pachislot machine depreciation
Utilities expenses	3,289	3,611	9.8%	322	Reduction in hall operation personnel costs
Personnel costs	17,469	17,005	-2.7%	-464	Persistently high electricity rates
Repair expenses	1,029	1,712	66.4%	683	
Other costs	16,660	16,669	0.1%	9	
Operating profit	1,140	1,574	38.1%	434	
Ordinary profit	1,327	1,698	28.0%	371	
Extraordinary profit	818	-	-	-818	Posting of compensation for removal of halls in previous interim period (+817)
Extraordinary loss	242	20	-91.7%	-222	
Interim profit	1,226	1,038	-15.3%	-188	
Main KPIs (key performance indicators)					
No. of halls	396	397		1	1 hall opened in previous 2H, 1 hall acquired (M&A), 6 halls closed. 5 halls acquired (M&A) in FY3/24
Pachinko machine operating rate*1	29.8%	28.5%		-1.3pt	Gap with competitors 2.9pt*2
Slot machine operating rate *1	22.0%	28.6%		6.6pt	Gap with competitors -2.7pt*2
No. of machines	186,113	191,577	2.9%	5,464	Installed machine share 5.4%
Smart pachinko machines		2,283			Ratio of total installed pachinko machines: 1.8%
Smart slot machines		13,064			Ratio of total installed slot machines: 21.2%
Number of private-brand machines	15,741	12,430	-21.0%	-3,311	Private-brand machine installation rate 9.6% (difference from previous period: -2.5pt YoY)*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, 2023 to September 30, 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 September 2023, the number of halls had increased by one YoY to 397 halls. In the previous 2H, one hall was opened and one hall was acquired via M&A, while six unprofitable halls were closed, while five new halls were acquired via M&A in FY3/24 1H. The number of installed machines had increased by 2.9% YoY to 191,577 units, and the main reason for the increase was the addition of smart slot machines. The number of installed smart machines was 2,283 smart pachinko machines (1.8% of installed pachinko machines), while there were 13,064 smart slot machines (21.2%). Private-brand pachinko machines decreased significantly by 21.0% to 12,430 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.

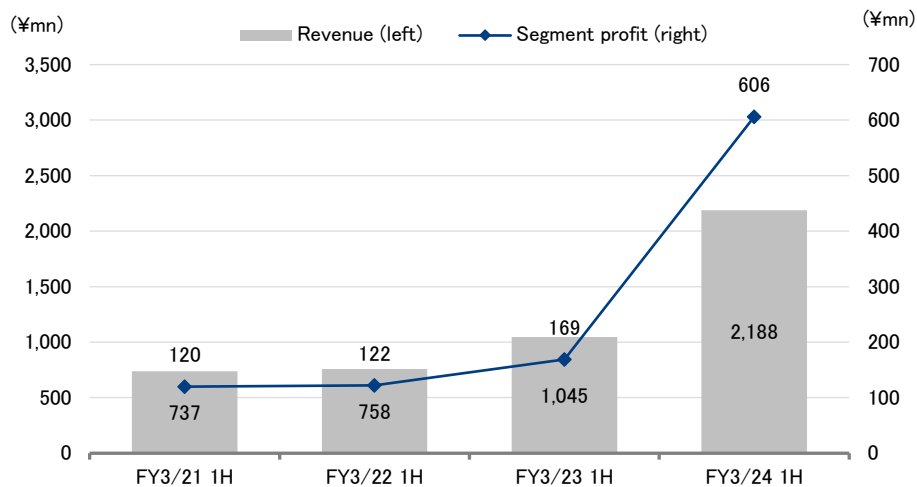
(2) Aircraft leasing business

In the aircraft leasing business, revenue increased by 109.4% YoY to ¥2,188mn and segment profit rose by 258.6% to ¥606mn. The business operates subsidiary Dynam Aviation Ireland Limited (DYNAM Aviation), which has limited its scope of business to narrow-body aircraft (AIRBUS A320 series and The Boeing Company's B737 series, etc.), which are highly-liquid and for which demand is expected to be stable. From FY3/24 1H, the Company also started providing an aircraft lease management service.

Status of FY3/24 1H results

The main factors for the increase in revenue were the purchase of three new aircraft through sale and leaseback transactions and the start of new leases, while leased aircraft increased from four aircraft to nine aircraft (increase of three aircraft from end of previous fiscal year). In July 2023, the Company completed the delivery of two aircraft to Indian LCC IndiGo, while in September the Company completed the delivery of one aircraft to Hungarian LCC Wizz Air Hungary Ltd. In the newly offered aircraft lease management service, the Company was entrusted with management service for four aircraft owned by other companies. Business expenses rose 97.6% YoY to ¥1,322mn, mainly due to the increase in depreciation (up ¥559mn) accompanying the purchase of new aircraft.

Results for aircraft leasing business



Source: Prepared by FISCO from the materials provided by the Company and the Company's interim report

The fleet value of the aircraft is ¥72,437mn, a 156.4% YoY increase (up ¥44,188mn YoY), the average remaining lease period is 5.8 years, and the annualized growth rate of return is 8.2%.

Ownership of aircraft assets

	FY3/23		FY3/24 1H-end
	1H-end	End of fiscal year	
Aircraft owned/managed	4	6	13
Owned	4	6	9
Managed	0	0	4
Average age	2.5	2.1	1.7
Average lease period (years)	4.5	5.3	5.8
Average yield (%) (*)	8.3	8.1	8.2
Aircraft asset balance (¥mn)	28,249	41,130	72,437

*Gross rate of return, annualized

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

Increase in interest-bearing debt due to purchase of new aircraft

2. Financial condition

At the end of FY3/24 1H, total assets had increased by ¥28,509mn compared to the end of the previous period to ¥354,117mn. The main change factors were a decrease in cash and deposits by ¥15,515mn in conjunction with new purchases of aircraft, along with a ¥31,307mn increase in aircraft assets, a ¥7,125mn increase in right-of-use assets, and a ¥1,032mn increase in deferred tax assets. The increase in right-of-use assets was an increase due to M&A and leased real estate contract renewals. The balance of assets for gaming machines decreased from ¥36,281mn at the end of the previous fiscal year to ¥35,814mn. Regarding the amount for acquisition of gaming machines there was a YoY increase of ¥3,995mn to ¥18,334mn due to the purchase of smart slot machines, however the asset balance turned lower as a result of the depreciation of gaming machines purchased in bulk in FY3/22 to deal with replacement demand to comply with new regulations. In 2H, the Company plans to narrow its machine purchase amount, so the asset balance is expected to decline further.

Total liabilities increased by ¥24,501mn from the end of the previous period to ¥221,682mn. This was mainly due to increases in interest-bearing debt by ¥15,440mn for the purpose of purchasing aircraft, while lease liabilities increased ¥7,070mn due to M&A and leased real estate contract renewals.

Total equity increased by ¥4,008mn from the end of the previous period to ¥132,435mn. There were dividend payments of ¥1,783mn, but in addition to recording 1H profit attributable to owners of parent of ¥1,873mn, there was a ¥4,761mn increase in foreign currency translation adjustments due to the depreciation of the yen.

Regarding cash flow conditions, cash flows from operating activities increased by ¥5,904mn from the previous fiscal year to positive ¥32,659mn, while cash flows from investing activities were outflows of ¥52,775mn (¥18,334mn from the purchase of game machines, ¥25,823mn from the purchase of aircraft). As a result, free cash flow was negative ¥20,116mn. Also, cash flows from financing activities was positive ¥4,252mn due to bank borrowings.

The equity ratio declined from 39.4% at the end of FY3/23 to 37.4%, mainly due to an increase in interest-bearing debt, and net cash (cash and deposits – interest-bearing debt) turned negative at ¥43,517mn, indicating a slight deterioration in the Company's financial position, but the main reason was the purchase of aircraft aimed at expanding the aircraft leasing business. However, all borrowings related to the aircraft leasing business are in the form of non-recourse loans (non-recourse financing). For this reason, the risk associated with borrowing is reduced by using cash flow from the aircraft leasing business as the source of funds for repayment, and by the contracts that do not obligate repayments beyond that amount. As yields in this business are stable and an earnings recovery can be expected in the mainstay pachinko business, the financial situation is unlikely to deteriorate further in the future. From a medium- to long-term perspective, we at FISCO expect the financial situation to gradually improve.

Status of FY3/24 1H results

Consolidated financial condition

	FY3/23 end	FY3/23 1H-end	Change	Change items
Total assets	325,608	354,117	28,509	Cash and deposits (-15,515), aircraft (+31,307), game machines (-467), other property, plant and equipment (+1,863), right-of-use assets (+7,125)
(Cash and deposits)	59,605	44,090	-15,515	
Total liabilities	197,181	221,682	24,501	Interest-bearing debt (+15,440), lease liabilities (+7,070), accounts payable and accrued expenses (-342)
(Interest-bearing debt)	72,167	87,607	15,440	
(Interest-bearing debt/ Recourse loans)	47,090	43,733	-3,357	
(Interest-bearing debt/ Non-recourse loans)	25,077	43,874	18,797	
Total equity	128,427	132,435	4,008	1H profit attributable to owners of parent 1,873, dividend payments -1,783, foreign currency translation adjustment +4,761
(Equity ratio)	39.4%	37.4%	-2.0pt	
(Net cash)	-12,562	-43,517	-30,955	

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

Cash flow statement

	FY3/23 1H	FY3/24 1H
Cash flows from operating activities	26,755	32,659
Cash flows from investing activities	-23,379	-52,775
Free cash flows	3,376	-20,116
Cash flows from financing activities	-4,382	4,252
Cash and cash equivalents	56,927	44,090

Source: Prepared by FISCO from the materials provided by the Company and the Company's interim report

FY3/24 business strategy

FY3/24 2H outlook is for a further rise in profit growth rate due to a decline in depreciation and an increase in revenue

1. Pachinko business

(1) Business strategy

For FY3/24, the business strategy is to proactively introduce smart gaming machines that have a high ability to attract customers, while at the same time increasing the profitability of existing halls by acquiring new users (cultivating a wide range of age groups) through renovations of existing halls, while also working to expand the number of halls through M&A. These efforts are showing results through FY3/24 1H, and the Company is on a steady recovery trend, for which it can be commended. Although the Company's plan is to reduce hall investment and gaming machine purchases in 2H slightly compared to 1H, the Company will continue to move forward with hall acquisitions through M&A. In December 2023, the Company acquired the business rights to two halls operated by Hawaii Co., Ltd. in Mie Prefecture.

FY3/24 business strategy

In order to acquire new users, the Company will bolster its provision of information on how to play and enjoy pachinko and slot machines so that even beginners can easily start playing, as well as prioritize securing smart gaming machines and continue to offer a product lineup that meets customer needs. Also, in the future, the Company will look into proposing new gaming environments that take advantage of the characteristics of smart gaming machines as well as carrying out major renovations.

Based on these efforts, the recovery trend in revenue is expected to continue in FY3/24 2H, but the revenue growth rate will be slightly lower than the 12.8% increase in 1H, as the impact of smart slot machines, which started to be introduced from November of the previous year, will weaken.

(2) Characteristics and advantages of introducing smart gaming machines

The features and benefits of smart gaming machines, which started to be introduced from November 2022, are summarized below. A feature of smart gaming machines is that you can play without directly touching the medals or balls. Pachinko balls circulate within the machine, while slot machines do not use medals and all information about the balls paid out is stored as electronic information. In addition, information on gaming machine installations and balls paid out is sent and centrally managed by a gaming machine information center, thereby promoting the industry's soundness.

The advantages of smart gaming machines for users are that due to deregulation, the degree of freedom in developing gaming machines has increased, and the specifications have been significantly improved, increasing expectations for winning balls and medals, as well as game playability, and that machines do not require balls or medals. With this, users feel an increased sense of convenience as well as feel more secure in preventing the spread of infectious diseases. At present, the deregulation of smart slot machines has led to the introduction of popular models, which have become the driving force behind the recovery in customer numbers, but deregulation has not been implemented for smart pachinko machines that would significantly improve specifications, and as a result, the introduction of smart pachinko machines has been delayed. At FISCO, we believe that the current business environment of the pachinko hall industry is the reason why deregulation to promote the introduction of smart pachinko machines has not been implemented. In 2023, with the introduction of smart slot machines, halls with investment capacity are seeing a recovery in customer traffic and higher profits, but small and medium-sized halls without investment capacity went bankrupt one after another, leading to further polarization. Under these circumstances, if deregulation were to take place for smart pachinko machines, this trend could further accelerate, and it is speculated that the regulatory authority will be monitoring the situation for a while to determine the best timing for deregulation. In fact, from March 2024, halls will be able to add a function called "Lucky Trigger*" for light-mid-range machines and high jackpot probability machines with a jackpot winning probability of 1/200 or more, but it will be applicable not only to smart pachinko machines but also to conventional machines. Introducing smart pachinko machines requires investment in peripheral equipment such as a dedicated unit, which is difficult for halls without sufficient investment capacity. It is believed that it is for this reason that conventional machines were also included. Although the installed ratio of light-mid-range machines and high jackpot probability machines is said to be around 30% in the industry as a whole, and they are not mainstream, the development of attractive models will lead to a recovery in customer traffic, which has been stagnant. This is attracting significant attention.

| * Function that raises the expectation for the winning balls to that on par with a middle machine |

In terms of merits for halls, carrying and washing balls and medals will be unnecessary, which will lead to a reduction in work for hall staff, and island equipment (equipment to replenish the rented balls, etc.) will be unnecessary. As a result, new halls' initial investment costs will decline, and existing halls' running costs will be reduced. Furthermore, because hall layouts will become freer, it will be possible to create innovative halls unbound by existing concepts, which will create room to cultivate new types of customers.

FY3/24 business strategy

For the overall gaming industry, winning ball data will be centrally managed by an external third-party organization. This will enhance security, eradicating illegal games and helping to prevent addiction. By the industry becoming healthier, it is expected that the game-playing population will increase.

As of September 2023, for the industry as a whole, the ratio of smart slot machines was in the 20% range, while the ratio of smart pachinko machines was just under 3%. The speed of spread has been a little slower than initially expected, but there has been no change to the direction for the replacement of all machines with smart gaming machines going forward. As a result, the Company plans to progress with proactive investment in smart gaming machines going forward.

(3) Outlook for expenses

Regarding pachinko business expenses, the Company is poised to continue moving ahead with cost controls. Regarding the number of gaming machines purchased, the plan is to reduce the number of gaming machines purchased in 2H compared to 1H, due to a rebound from the increase in the number of slot machines installed at halls in 1H, as well as efforts to make effective use of used machines owned by the Group. As a result, depreciation for gaming machines will peak in 1H and then decline in 2H, and are expected to remain at around ¥36bn for the full fiscal year, roughly the same level as the previous year.

Hall personnel expenses account for just over 30% of pachinko business expenses. Efforts to improve hall operation efficiency have mostly run their course, so hall personnel expenses are expected to increase slightly along with the recovery in revenue. Repair costs are expected to decline slightly in 2H following the increase in renovation expenses in 1H due to the addition of slot machines units. The Company plans to continue to keep other expenses down.

Based on the above, if revenue continues to grow steadily in 2H, we at FISCO think that operating profit will grow to roughly double the level of 1H, due to the decline in depreciation and repair costs.

In the aircraft leasing business, the Company will have 10 leased aircraft and 7 managed aircraft as of the end of FY3/24

2. Aircraft leasing business

The airline industry continues to recover in conjunction with the COVID-19 pandemic coming to an end, and in 2023 the total number of passengers is returning to pre-pandemic levels and is expected to continue to grow going forward. With the prospect of expansion in short-haul traffic, demand for long-body, narrow aircraft (such as the Airbus A321 series and Boeing B-737 series) is expected to increase as long-body aircraft have a longer fuselage and can seat more passengers.

In this situation, in December 2023 Dynam Aviation Ireland Limited is planning to deliver one aircraft to Wizz Air through a sale and leaseback transaction. With respect to the management service, the Company plans to assume management for the 3 remaining aircraft owned by another company, and expects to have 10 aircraft for lease (up 4 compared to the end of March 2023) and 7 managed aircraft as of the end of FY3/24, and is expecting a significant increase in revenue and profit for the full fiscal year.

DYNAM JAPAN HOLDINGS Co., Ltd.

12-Jan.-2024

06889 Hong Kong Stock Exchange

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FY3/24 business strategy

As its business strategy going forward, the Company will increase profits by purchasing aircraft, mainly next-generation narrow-body aircraft with good fuel economy, and leasing them to blue-chip airlines, as well as diversify and control the risk of its portfolio in terms of aircraft type, age, lease period, lessee airlines, and regions, as it increases the number of aircraft it owns. Furthermore, the Company's strategy is to utilize in-house aircraft lease management functions to provide various services (aircraft procurement, lease management, re-leasing, advice/proposals, market trends and know-how) to other companies and earn fee income. In the medium term, the Company aims to increase the number of aircraft it leases and manages to 30 aircraft.

Currently negotiating with Macao casino operators for trials for video slot machines, chance for trials to restart in 2024

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 September 2023, it had obtained approval for six machines in Macau and five machines in Singapore. Also, for machines installed with the developed games, since November 2019 it has test installed one unit each of three machine models (three units in total) in Legend Palace Casino, and in addition, since January 2020, it has test installed a total of 10 units of three machine models in Casino Ponte16.

The situation of Macau casinos' gross gaming revenue (GGR) is that it has rapidly recovered to roughly four times YoY in the January - September 2023 period with the lifting of China's zero-COVID-19 policy, as well as Macao completely lifting entry restrictions. Compared to the level of 2019 before COVID-19, the GGR is 58.5% and is still on a recovery track, but this is because the recovery of GGR from VIP remains limited due to enhanced restrictions by the authorities against junkets*. As a result, casino operators have been bolstering their services for general customers, and in the most recent quarter (July - September), the general customer GGR was 93.3% of the pre-COVID year, so it is almost back to the same level.

* Business operators that provide loans at casinos, aiming to attract high-net-worth customers.

For the Company, which is oriented towards the mass market, this market development shows that the environment is getting ready for market entry. The Company is currently negotiating detailed terms for starting trials with major casino operators in Macau, and there is a chance that trials could begin as early as 2024. Compliance with Macau EGM Technical Standards Version 2.0, which is required for the trial, has already been approved by the Gaming Inspection and Coordination Bureau (DICJ) in September 2022, and further progress is expected.

FY3/24 business strategy

Macau market

	Jan – Sep 2022	Jan – Sep 2023	Change	YoY	Vs. 2019
Casino gross gaming revenue	589.9	2,390.6	1,800.7	405.2%	58.5%
Breakdown					
VIP	148.0	602.3	454.3	407.0%	31.6%
General customers	441.9	1,788.3	1,346.4	404.7%	82.2%

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

In addition, the Company has concluded NDAs with related companies and is advancing negotiations, with the aim of using already developed game software for social games and other online applications.

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 conversion of developed products for social games.

Future growth strategy

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

1. Market trends

The pachinko market's long-term contraction trend is continuing, due to the diversification of leisure and stronger restrictions to suppress gambling attractiveness to address addiction. According to the "Leisure White Paper 2023" compiled by the Japan Productivity Center, in 2022 the pachinko and slot participation population was 7.7 million people, rising for the second straight year, but still not recovered to 8.9 million people in 2019, prior to the COVID-19 pandemic. The market scale (ball rental fees) was ¥14.6tn, staying flat for the second consecutive year. Compared to 2002 (21.7 million people, ¥30.4tn), the participation population has fallen to 35%, and the market scale to slightly less than 48% of the 2002 levels.

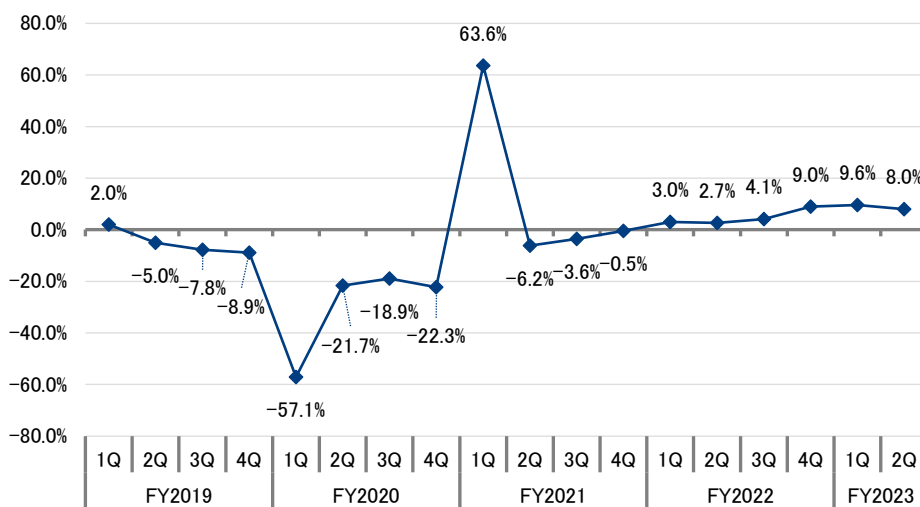
Reflecting this situation, the number of pachinko and pachislot halls is also trending downward with the onset of the COVID-19 pandemic having made management conditions even harsher, with a trend continuing for closures increasing, mainly of small- to medium-sized halls without ability to invest in smart slot machines. 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"

Future growth strategy

According to statistics from the Ministry of Economy, Trade and Industry, pachinko hall net sales (ball fee revenue) have been modestly increasing since FY2022 1Q (April to June). In particular, since 4Q (January-March 2023) when the full-scale introduction of smart slot machines began, the rate of increase in sales has risen to the low single-digits level, giving the impression that it has finally gotten off the bottom. It can be said that smart slot machines are the driving force for this, but the introduction of “Lucky Trigger” to pachinko machines from March 2024 is expected to lead to a recovery in customer numbers among seniors, and the relaxation of regulations aimed at promoting the spread of smart pachinko machines is also expected.

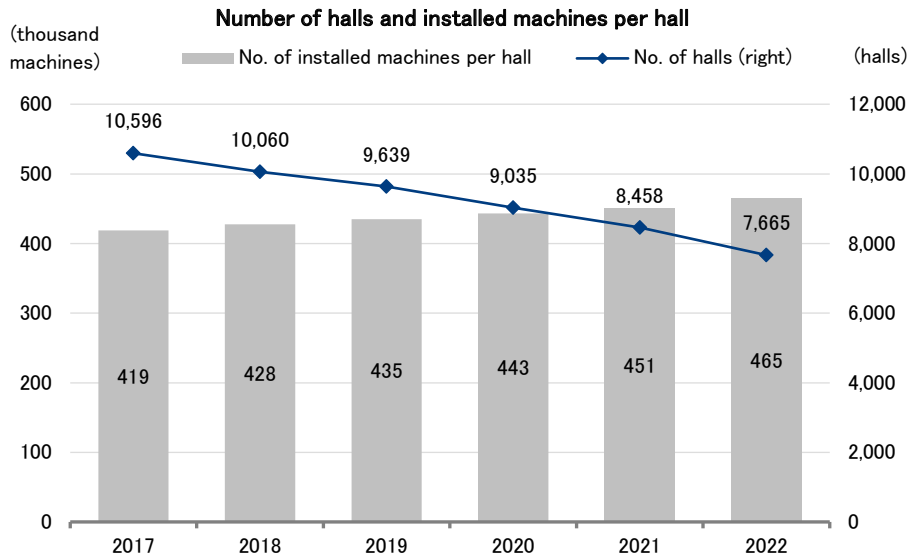
Pachinko hall ball fee revenue growth rate (YoY)



Source: Prepared by FISCO from the Ministry of Economy Trade and Industry's "Current Survey of Selected Service Industries"

Amid these circumstances, 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 in the industry, the industry appears to be becoming more of an oligopoly dominated by large companies operating large halls, recording year by year growth from 419 units at the end of 2017 to 465 units at the end of 2022. Incidentally, DYNAM Group halls had an average of 486 machines per hall at the end of September 2023, slightly exceeding the industry average. In addition, in October 2023, Gaia Co., Ltd., one of the major companies in the industry, went bankrupt, but at FISCO we believe that this was due to long-standing management problems and that this will not spread to other major companies.

Future growth strategy



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 help the market recover, and bright signs are starting to be seen. 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 revitalize, 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 revitalized 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 secure repeat customers and acquire new customers.

Aiming for renewed growth by bolstering investment in smart gaming machines, creating halls to acquire new customers, and through proactive M&A

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 strengthening investing in smart gaming machines; improving earning power through large-scale renovations of existing halls; acquiring new users (cultivation of a wide range of age groups); and expanding the number of halls by continuing active M&A.

Future growth strategy

(1) Increasing revenues by strengthening 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 slot machines, and how many of them can be installed. The Company plans to use its ample capital strength to actively introduce these models, and plans to achieve increased revenue while raising investment efficiency. Regarding smart pachinko machines, the Company will continue to introduce them while keeping an eye on the situation since the specs are almost the same as the previous models, but if an attractive model is developed due to deregulation, the Company will actively introduce it.

(2) Improving earning power through large-scale renovations of existing halls

As discussed above, the Company carried out large-scale renovations of its aging flagship halls during FY3/24 1H, and saw the effect of increasing revenue. Based on this, the Company plans to carry out renovations of halls that have aged, in light of the future market environment and revenue. By updating equipment, etc., the Company aims to improve customer satisfaction and raise hall profitability by increasing repeat rates and acquiring new customers.

(3) Acquisition of new users (cultivation of a wide range of age groups)

The customer base of the Company's halls is characterized by a high age group, with over 40% being seniors and just under 40% being in their 40s to 50s. Because the recovery of seniors has been slow since the COVID-19 pandemic, the Company believes it is important to expand its customer base to a wide range of age groups, so it has strengthened its product lineup, including smart slot machines, which have a high play rate among young and middle-aged people, and the Company will cultivate customers in the 10s to 30s age range. The Company will also work to acquire new users by strengthening the provision of information on how to play and enjoy pachinko and slot machines. In the future, it is expected the development of next-generation halls will provide innovative and new entertainment experiences based on free layouts that take advantage of the features of smart gaming machines.

(4) Expanding the number of halls by continuing active M&A

Regarding the Company's hall opening strategy, for the time being the strategy is to efficiently increase the number of halls by continuing M&A. When opening a new hall amid rising construction costs, the investment recovery period will be longer if you consider the initial costs of gaming machines and peripheral equipment, and thus increasing the number of halls through M&A has a higher investment efficiency. In fact, in FY3/24, through December 2023 the Company has completed two M&As and acquired seven halls. As competing halls continue to close, the Company plans to actively carry out M&A for deals that satisfy its conditions and thereby increase the number of halls.

Future growth strategy

Simplified income statement and key indicators

	(¥mn)				
	FY3/20	FY3/21	FY3/22	FY3/23	FY3/24 1H
Revenue	142,483	98,602	105,141	117,206	64,375
YoY	-2.7%	-30.8%	6.6%	11.5%	14.6%
Operating expenses	122,311	97,564	94,911	112,318	60,530
YoY	-4.5%	-20.2%	-2.7%	18.3%	14.4%
SG&A expenses	5,020	4,340	4,279	4,309	2,144
YoY	-0.1%	-13.5%	-1.4%	0.7%	4.7%
Other income	8,446	11,561	9,114	8,663	3,963
Other operating expenses	2,084	1,531	4,411	2,478	1,264
Operating profit	21,514	6,728	10,654	6,764	4,400
YoY	11.2%	-68.7%	58.4%	-36.5%	13.4%
Financial income	461	286	426	450	419
Financial expenses	2,469	2,672	2,571	3,277	1,895
Profit before income taxes	19,506	4,342	8,509	3,937	2,924
YoY	0.7%	-77.7%	96.0%	-53.7%	26.1%
Income taxes	6,759	1,991	3,532	2,139	1,050
Profit	12,747	2,351	4,977	1,798	1,874
YoY	1.2%	-81.6%	111.7%	-63.9%	58.4%
EBITDA	31,151	16,781	32,383	43,729	26,763
YoY	0.0%	-46.1%	93.0%	35.0%	34.2%
EPS (¥)	16.6	3.1	6.8	2.5	2.6
Dividend per share (¥)	9.00	5.00	5.00	5.00	2.50

Source: Prepared by FISCO from the materials provided by the Company and the Company's interim report

Statement of consolidated financial position

	(¥mn)				
	FY3/20	FY3/21	FY3/22	FY3/23	FY3/24 1H
Current assets	55,798	91,790	67,487	69,166	53,947
Cash and cash deposits	41,810	74,661	56,508	59,605	44,090
Trade receivables	554	361	332	407	437
Other	13,434	16,768	10,647	9,154	9,420
Non-current assets	221,441	209,283	225,934	256,442	300,170
Property, plant and equipment	105,206	96,415	118,648	146,876	179,579
Right-of-use assets	79,048	77,537	73,850	76,741	83,866
Intangible assets	3,623	3,348	3,440	3,730	6,466
Investment, other	33,564	31,983	29,996	29,095	30,259
Total assets	277,239	301,073	293,421	325,608	354,117
Current liabilities	44,028	59,812	47,324	53,840	58,394
Accounts payable	14,801	19,997	12,312	14,732	14,390
Short-term borrowings, etc.	3,008	11,380	12,945	16,629	19,417
Lease liabilities	12,185	12,040	11,245	10,749	10,901
Other	14,034	16,395	10,822	11,730	13,686
Non-current liabilities	98,479	109,289	115,115	143,341	163,288
Long-term borrowings	10,220	22,587	30,196	55,538	68,190
Lease liabilities	81,611	79,899	78,017	80,948	87,866
Other	6,648	6,803	6,902	6,855	7,232
Total liabilities	142,507	169,101	162,439	197,181	221,682
Total equity	134,732	131,972	130,982	128,427	132,435
Total liabilities and equity	277,239	301,073	293,421	325,608	354,117

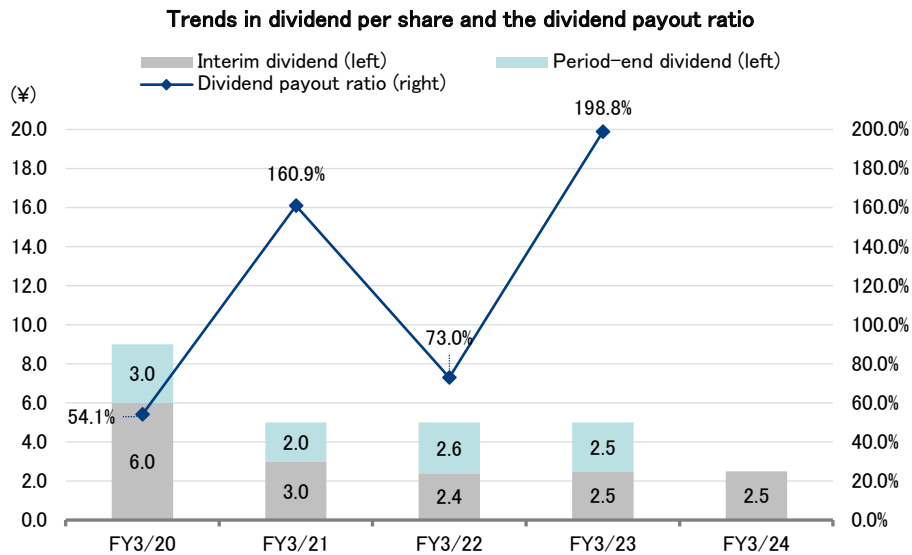
Source: Prepared by FISCO from the materials provided by the Company and the Company's interim report

Returns to shareholders

Planning to pay a FY3/24 1H dividend of ¥2.5 per share, flat YoY

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 continue to pay stable dividends with a consolidated dividend payout ratio above 35%, while it is also continuing to acquire treasury shares as a part of its basic policy.

For FY3/24 1H, the Company decided pay a dividend of ¥2.5 per share, the same as a year earlier. Also, in FY3/24 1H the Company purchased on the market 7,688,000 treasury shares (approximately 1.1% of all issued shares) and retired 7,746,000 treasury shares.



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. With respect to business operations in a decarbonized society, the Group aims to reduce CO₂ emissions caused by excessive energy consumption by building wooden halls with a low environmental impact, and appropriately managing energy consumption (including energy-saving measures, the use of eco-friendly cars, installation of water-saving toilets, etc.), promoting green IT (digitization of documents, promotion of online meetings, etc.), systems to prevent waste and appropriately dispose of it (effective use and recycling of used gaming machines, wooden halls, recycling of general waste). As an energy-saving initiative, as of the end of March 2023, all group halls have installed LED lighting, and 99.1% of halls have installed air conditioning control devices.

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, optimizing work-life balance and working styles and health management, as well as 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 horizontally across companies 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