

Daikoku Denki Co.6430 Tokyo Stock Exchange First
Section

23-Aug.-16

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at the end of this document.

FISCO Ltd. Analyst

Ikuro Shibata

■ New medium-term plan, called “Next 50 Chapter One”, aims to lift growth and profitability

Daikoku Denki Co., Ltd. <6430> (hereafter, “the Company”) has two main segments, the Information System Segment, which develops, manufactures and sells computer systems for pachinko (Japanese pinball) parlors or halls, and the Control System Segment, which develops, produces and sells display and control units for pachinko and pachislot game machines. The Company holds the leading share of the Japanese market for hall computers, of approximately 35%, reflecting an information management method that is the de facto standard for the industry. The Daikoku Denki Strategic Information System (DK-SIS) supplies information to support the operations of pachinko hall associations. It is the only such system in Japan and was used by 3,717 pachinko and pachislot halls at the end of the fiscal year through March 2016, i.e., at the end of FY3/16. For the past three fiscal years, the Company has also manufactured and sold pachislot machines developed in-house on a large scale.

As Japan’s pachinko market has been shrinking for several years, the Company aims to reform its businesses over the medium-to-long term. Although the Company’s sales and profits have contracted year on year (YoY) for the past three fiscal years, reflecting the impact of industry restrictions on risky machines, it has made progress in its three main reforms: 1) developing a next-generation hall computer, 2) shifting to a business model more reliant on services that provide recurring revenues, and 3) developing and commercializing pachislot game machines. In particular, the next-generation hall computer, on which the Company has invested heavily, is in its final stage of development and should contribute to sales from FY3/18. This hall computer will operate on a cloud server and be capable of advanced analysis of large quantities of data. It will be far superior to any competing computer and should allow the Company to increase its share of the Japanese market for these machines.

In FY3/16, the Company’s consolidated net sales declined by 13.0% YoY to ¥47,004mn and the Company suffered an operating loss of ¥894mn, reversing an operating income of ¥1,425mn in FY3/15. Both figures were lower than the Company had originally forecast. The Company’s operating environment was severe in FY3/16 due to increased restrictions on machines adopted by the pachinko industry. Thus, sales and profits in both the Information System Segment and the Control System Segment decreased YoY. Sales of pachislot machines developed in-house were much weaker than the Company had foreseen because three of the four models the Company had intended to sell in FY3/16 had to be modified to comply with the new industry limitations. Thus, sales of these three models will not be realized until FY3/17.

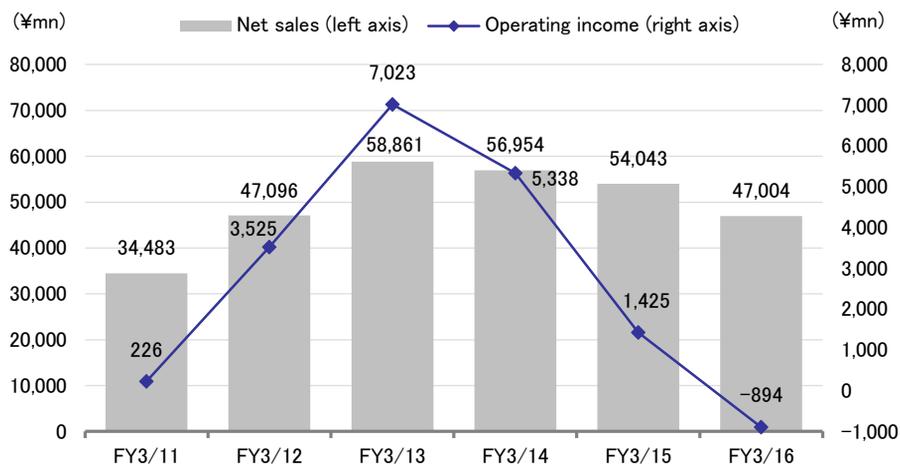
For FY3/17, the Company projects a 6.4% YoY rise in consolidated net sales to ¥50.0bn and an operating income of ¥1.0bn. It expects a challenging operating environment to lead to a continuous YoY drop in sales of peripheral equipment, resulting in YoY falls in sales in the Information System Segment. However, the recovery of results in the Control System Segment is expected to contribute significantly to the overall performance of the company. FISCO believes that these forecasts are achievable because the Company’s sales of equipment for pachinko machines should normalize as appropriate standards for this equipment are adopted and the three models of pachislot machines developed in-house in FY3/16 but not sold until FY3/17 should contribute to sales and profit growth. However, the Company expects most of the sales and profit improvement it projects for FY3/17 in the second half of the fiscal year. Furthermore, its results could be adversely affected by external factors, such as the prolongation of the impact of industry controls, as they were in FY3/16.

FY3/17 is the first year of the Company’s new four-year plan, called “Next 50 Chapter One”. This plan intends to increase the Company’s share of the market for hall computers by implementing next-generation hall computer in FY3/18. It also aims to promote sales growth and profitability by applying the Company’s capability to analyze data and plan and develop products to add value to its products and services. The plan targets consolidated net sales of ¥57.0bn and operating income of ¥4.0bn for an operating income margin of 7.0% and an ROE of at least 7% for FY3/20. FISCO expects the Company to achieve its growth targets based on its dominant market position. We also expect the Company to contribute to a revival of Japan’s pachinko industry.

Check Point

- Stressing the development, production and sale of computer systems for pachinko halls
- Control System Segment to lead growth of overall sales and profits in FY3/17
- Next-generation hall computer in the final stage of development

Trends in Full-year Results



Description of Businesses

Stressing the development, production and sale of computer systems for pachinko halls

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

As the pioneer in the development of hall computers, which assist the management of pachinko halls, the Company won hall's trust and pachinko fan's satisfactions by providing the management system which put emphasis on data management, introduction of innovative peripheral equipment for its hall computers, and utilization of the only membership information service in the pachinko industry; and it holds the top share of the Japanese market for hall computers.

In FY3/16, the Company held an approximately 35% share of the Japanese market for hall computers, indicating that it served about 3,900 halls.

The Company's two main businesses are the Information System Segment and the Control System Segment, but the Information System Segment provided 72.4% of its total sales in FY3/16 and was the main source of stable profit.

(1) Information System Segment

The Information System Segment offers a complete line of information equipment and services to support sales and operational management at pachinko halls. Hall computers are the core of the system used at halls, and these computers are supported by peripheral equipment, such as prize management systems and information display systems. For consolidating and analyzing the data recorded by this equipment, the segment offers services such as its unique DK-SIS system, which is the only service in Japan that provides strategic information about associated halls.

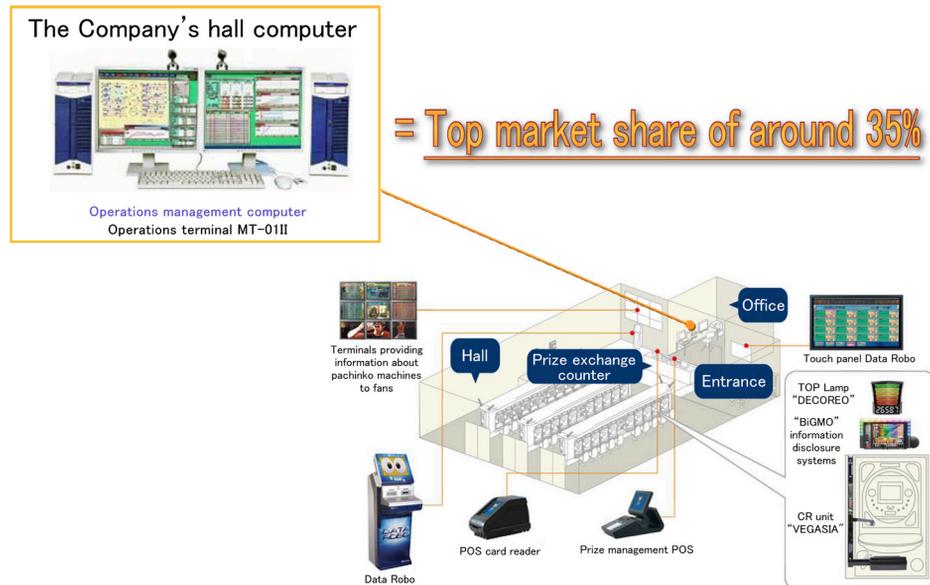
Hall computers are the core systems for supporting pachinko hall operations. These personal computers display the operating condition and sales of each machine in a hall. As mentioned above, these computers are supported by peripheral equipment, such as prize management systems and information display systems. They also serve as the foundation of the DK-SIS system. Peripheral equipment and support services are often sold with hall computers as a package deal. The company is promoting the sale of services for its information system equipment, such as prize management systems and information display systems, because it earns regular fee income from these services.

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Hall Computers and Main Peripheral Equipment



Source: Company materials

(2) Control System Segment

The Control System Segment produces LCD display units, control units, switches and motors for pachinko and pachislot machines. Applying the knowledge obtained during many years of analyzing data from pachinko machines through its DK-SIS, the Segment analyzes trends in the popularity of pachinko machines and presents ideas to makers of these machines for the manufacture of hit machines. It also serves as a partner to machine manufacturers in developing appealing content for their machines and helps the manufacturers obtain the rights to use animation characters in their machines.

Since FY3/14, the Company's consolidated subsidiary Daxel Inc. has been producing and selling pachislot game machines developed by Daikoku Denki under the Daxel brand name. The first such machine, called "Magical Suite Prism Nana", sold 4,000 units. The second machine, "Sasamisan@Gambaranai Slot", sold 6,000 units. The third, "Pachislot Hyakkaryoran Samurai Girls", sold 5,100 units. The success of these machines demonstrates the Company's ability to develop products with great appeal as games. The Company has established a high-quality brand image specializing in animation characters. In April 2016, it started selling its latest pachislot machine, called "Milky Holmes TD". As of May 25, 2016, it had sold 8,800 units of this machine.

“Detective Opera Milky Holmes TD”



Bushiroad x Daxel superiority combined in the final completion of the ultimate machine!

This is the culmination of anime character slot machine technology!

This pachinko machine was jointly developed by Bushiroad Inc., which deals in a range of media mix content, including trading card games, anime, comics and smartphone applications, and Daxel Inc., which generates new demand for entertainment with its proprietary “ANIME × SLOT” system, which distinguishes it from other machine makers, releasing high-end models contributing to the improvement of operation rates.

It is a completely new system in which users can watch anime at normal game times. New anime stories and songs are added weekly utilizing the RTC function incorporated in the system, which has not been widely introduced in Japan’s pachislot industry. Compared to other games, Detective Opera Milky Holmes TD offers the players more enjoyable content.

From the viewpoint of specifications, it is designed to operate with coins of smaller value than normal machines and return pinballs frequently enough to satisfy the user. Please look forward to the culmination of anime slot machine technology with next-generation specifications that prioritize pleasure and ease of use.

©Milky TD Production Committee
 ©Theater-use Milky Holmes Production Committee
 ©bushiroad/Project MILKY HOLMES
 ©Futari wa Milky Holmes Production Committee
 ©DAXEL
 Nendoroid cooperation/GOOD SMILE COMPANY

Source: Company materials

■ Company Strengths

Advocating the importance of data management and the necessity of information disclosure

(1) Growth model based on market expansion through innovation

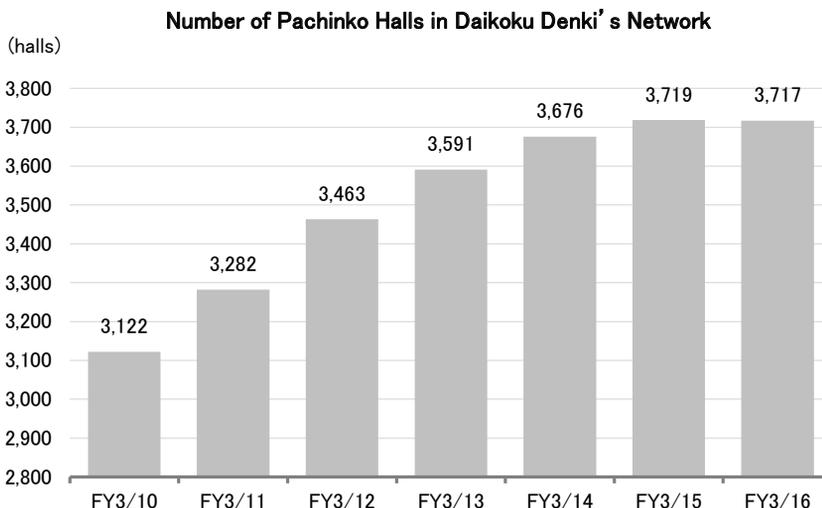
Since its establishment, the Company has consistently planned and developed new categories of goods and services, thereby developed the pachinko market and achieved growth. It has not just developed machines with superior functions but emphasized the importance of data management and the need for information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

Launched in 1974, the Company’s first hall computer enabled the managers of pachinko halls to introduce a hall management method based on data management. Previously, pachinko halls accumulated only basic information, but with the introduction of hall computers, data-based hall management became the de facto standard. In subsequent years, the Company developed other kinds of information equipment with revolutionary functions. One such piece of equipment was the Data Robo terminal, which provides information about different models of pachinko and pachislot game machines to the users of these machines. This equipment has increased the satisfaction of pachinko machine users and the efficiency of pachinko hall management, as well as the profitability of pachinko halls.

A newer business being pursued by the Company is the development, production, and sale of pachislot game machines that differ from previous pachinko and pachislot game machines, which tended to be chosen based on the desire to gamble. The Company’s pachislot game machines display original characters produced by popular illustrators in anime using original voices. These high-quality machines have won accolades from fans of anime, and the company has again established a new market for amusement equipment.

(2) A strong network of pachinko halls

Another advantage the Company has is the DK-SIS, hall computer based membership information service. This service connects the Company and member pachinko halls through networks, and gathers, processes and analyzes the daily operational information of pachinko halls recorded by hall computers and gives feed-back to the managers of these halls to improve their operations. The managers of halls in which Daikoku Denki's hall computers are installed receive operational data daily on all the pachinko machines in Japan equipped with the company's hall computers. They also receive operational data broken down by the model of pachinko machine. This information enables them to improve the running of their businesses. At the same time, the Company maintains firm ties with the halls using its equipment, which supports the company's business. The Company's DK-SIS allows it to serve as a think tank on the pachinko industry and elevates the Company's brand name. At the end of FY3/16, the DH-SIS service was used by 3,717 pachinko and pachislot halls which operated approximately 1.42mn machines, or 31.0% of all the machines installed in Japan, and generated annual sales of ¥10.2 trillion.

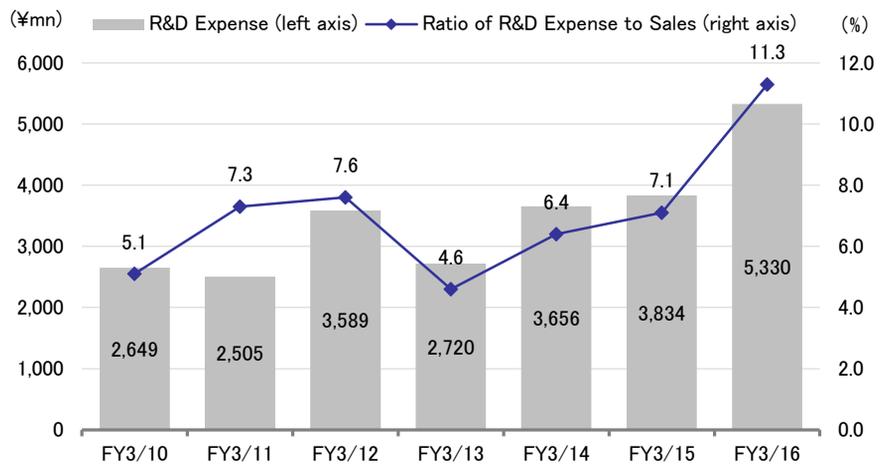


Source: Compiled by FISCO based on Company materials

(3) Stable profit base that supports investment for the future

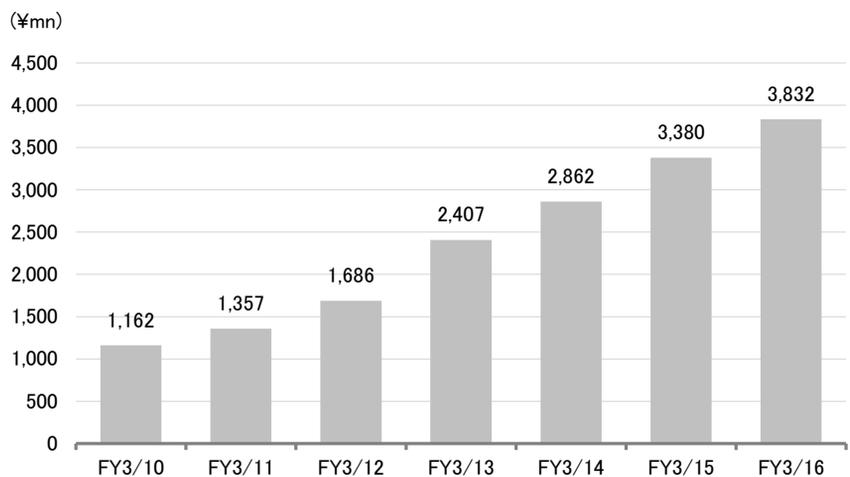
The Company's main source of competitiveness is its investment in goods and services, including its R&D expenditure. Over the past few years, the company has developed unique pachislot machines, a next-generation hall computer, and other products to drive its sales and profit growth hereafter. The stable revenue stream or Cash Cow provided by the high-margin Information System Segment make this investment possible. In particular, the management support services (MG services) nurtured by the Company provide enough profit to fund the investment in R&D for the next-generation hall computer, greatly limiting investment risk. The company's ability to balance large profits from its existing businesses with heavy investment in businesses of the future allows it to produce value on a continuing basis.

Research and Development Expense and Ratio of Expense to Sales



Source: Compiled by FISCO based on Company materials

Sales of MG Services



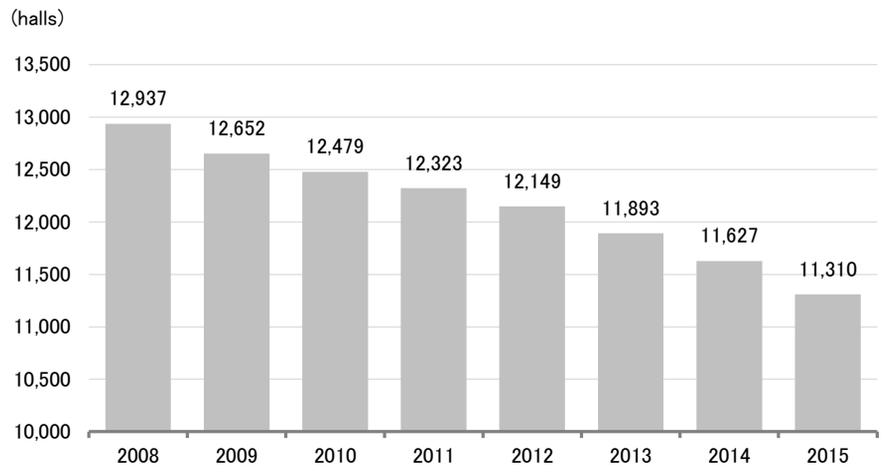
Source: Compiled by FISCO based on Company materials

■ **Industry Environment**

Pachinko market could recover if deflation were curtailed

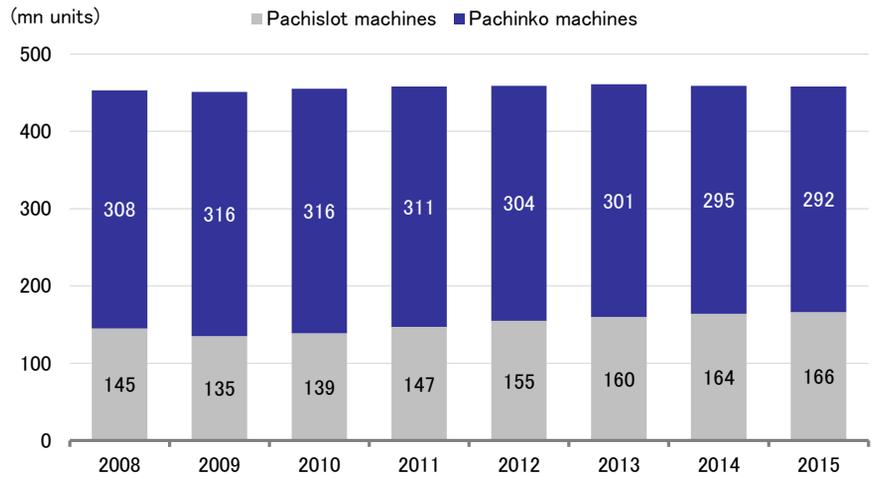
Japan's pachinko industry has been shrinking for years, reflecting a decline in the overall number of pachinko players, a trend toward playing games with low rental costs for balls, increases in Japan's consumption tax, and other factors. According to surveys by the National Police Agency, the number of pachinko and pachislot halls in Japan declined at an average annual rate of 2.1% from 2011 to 2015. In 2015, the number of halls was 11,310 (down 317 halls YoY). It is estimated that the Company served about 3,900 of these halls based on the fact that it held approximately 35% of the Japanese market for hall computers in FY3/16. Most of the Company's customers are high-end, large pachinko halls, averaging 519.1 machines per hall, or about 30% more than the average number of machines per hall, according to the National Police Agency. Therefore, the business of these customer halls is relatively insensitive to economic cycles, and the halls can invest in new businesses.

Number of Pachinko and Pachislot Halls in Japan



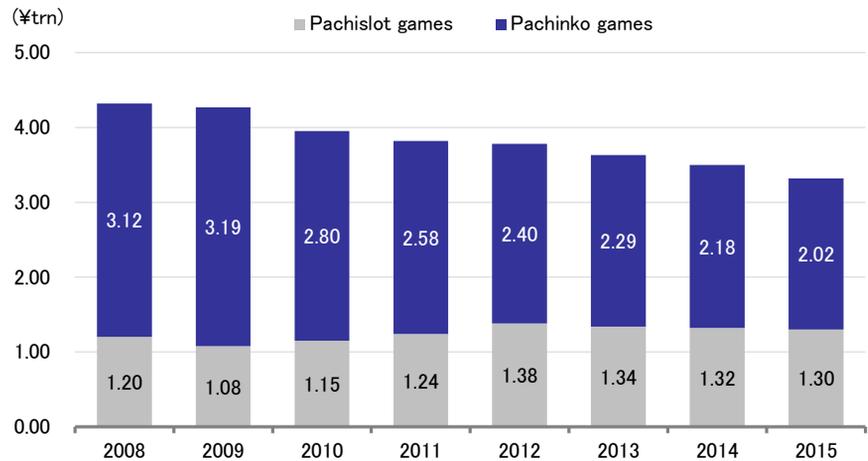
However, the National Police Agency reports that, while the number of pachinko machines in Japan has declined since 2010, the number of pachislot machines has increased, so the combined number of pachinko and pachislot machines has remained fairly constant. Since the number of pachinko and pachislot halls decreased over the same period, the average number of machines per hall has increased. This trend toward larger pachinko and pachislot halls that command merits of scale benefits the Company, which invests effectively in developing equipment with advanced functions and services with added value.

Number of Pachinko and Pachislot Machines in Japan



According to the Company, the value of Japan's combined market for pachinko and pachislot games, as measured by the gross profit earned by all halls nationwide, has fallen each year, similar to the decline in the number of halls. This value has also declined on a per-machine basis. Thus, even though pachinko halls and pachislot halls are increasing in average size, they continue to operate in a challenging business. The pachinko industry has been especially hurt by its adoption last year of new restrictions on the gambling aspect of pachinko and pachislot machines. Similar restrictions have impaired the profitability of halls in the past, and the new restrictions are likely to have the same impact. On the other hand, the new restrictions may motivate hall managers to convert their operations to less risky machines. If the industry can rebound from the impacts of these new restrictions and of increases in Japan's consumption tax, and if Japan's economy can generate some inflation as the country prepares to host the Olympic Games in Tokyo in 2020, the Company believes that the combined market for pachinko and pachislot games could recover to about ¥4trn per year.

Value (Gross Profit) of Japanese Markets for Pachinko and Pachislot Games



Source: Compiled by FISCO based on Company materials

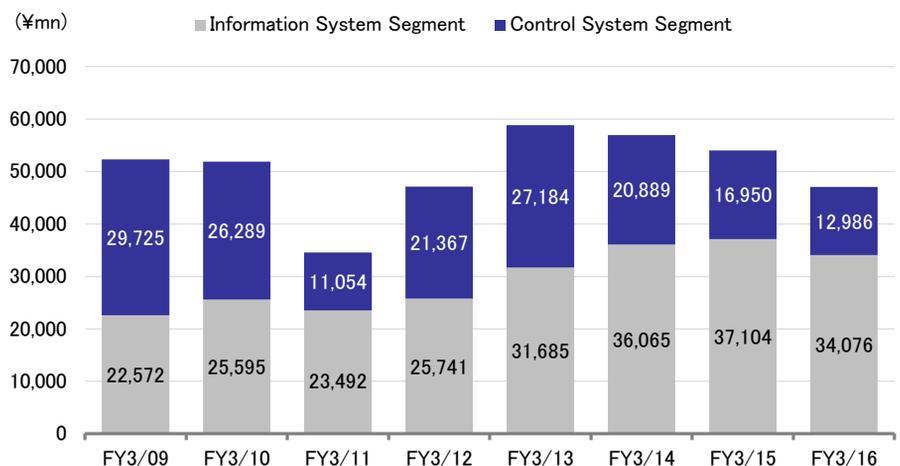
■ Financial Results Trends

Company's business has expanded as the pachinko industry has shrunk

(1) Performance over the past seven fiscal years

In FY3/11, the Company's sales shrank YoY because of restrained consumer spending and the impact of the Great East Japan Earthquake. Its total sales rebounded in FY3/12– FY3/13, even though the pachinko industry continued to consolidate. This recovery was led by the Information System Segment, which holds high market shares for its products. Sales in this segment reached consecutive record highs in FY3/13–FY3/15, supporting overall sales. In FY3/16, sales in the Information System Segment and overall sales contracted YoY, reflecting the impact of industry restrictions on risky machines.

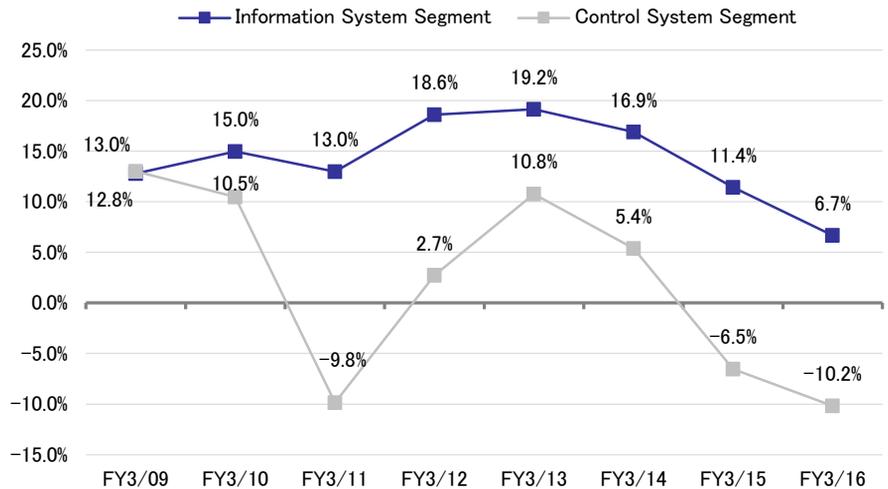
Consolidated Net Sales by Segment



Source: Compiled by FISCO based on Company materials

The Information System Segment provides steady profits, so the segment has supported high overall profitability for the Company as it has also supported sales. Reflecting increasing investment in the development of the next-generation hall computer since FY3/14, profit margins have declined since FY3/13, but considering the size of the investment, margins are still high.

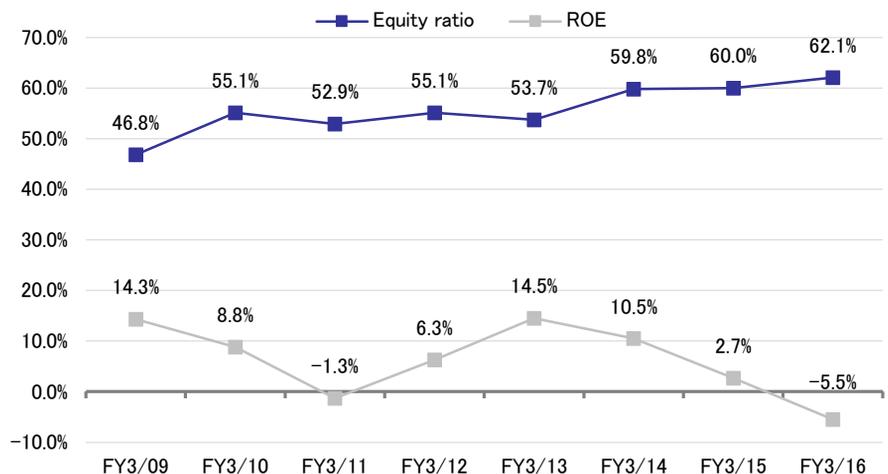
Operating Profit Margins by Segment



Source: Compiled by FISCO based on Company materials

The Company's equity ratio, a measure of financial stability, has risen, reflecting large retained earnings, reaching 62.1% in FY3/16. The current ratio, which indicates the ability to make payments in the short term, was 177.4% in FY3/16, mainly due to large holdings of cash and deposits. The ROE, a measure of capital efficiency, has been low since FY3/15 due to a deterioration of net income. In FY3/15, the Company suffered a loss due to the bankruptcy of a manufacturer customer. In FY3/16, because of the industry restrictions on risky machines, the Company was able to launch only one new model of pachislot machine, instead of the four planned, and its sales of these machines were far below the planned level. As a result, the company suffered a loss due to the devaluation of parts and materials for its pachislot machines.

Equity Ratio and ROE



Source: Compiled by FISCO based on Company materials



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Sales and profits declined YoY in FY3/16 due to the impact of industry restrictions

(2) FY3/16 results

In FY3/16, consolidated net sales dropped by 13.0% YoY to ¥47,004mn, and the Company suffered an operating loss of ¥894mn, reversing an operating income of ¥1,425mn in FY3/15, an ordinary loss of ¥749mn, versus an ordinary income of ¥1,566mn a year earlier, and a net loss accruing to Company shareholders of ¥1,676mn, against a net income of ¥874mn in FY3/15. On October 26, 2015, the Company lowered its forecasts for FY3/16, but the FY3/16 results were worse than the revised forecasts.

The pachinko market environment remained challenging in FY3/16, primarily due to the additional restrictions on risky machines adopted by the pachinko industry. Therefore, sales and profits deteriorated YoY in both the Information System Segment and the Control System Segment. Performance in the Information System Segment fell short of the Company's forecasts mainly because the industry restrictions eroded the pachinko halls' desire to invest. The difficult market environment caused YoY drops in the number of models of display units and in the number of display units sold by the Control System Segment. Sales of pachislot machines developed in-house fell far short of the Company's plan in FY3/16 because the industry restrictions forced the Company to modify its machines. Thus, it sold only one new model of these machines in FY3/16, although it had planned to sell four new models. The three models not marketed in FY3/16 will be marketed in FY3/17.

Although investment in R&D on the next-generation hall computer and other products was kept within the planned amount, the Company suffered an operating loss because of the drop in its sales and because of valuation losses on parts and materials for the pachislot machines developed in-house that will not be sold until FY3/17.

Because of the net loss suffered in FY3/16, total equity decreased by 8.9% during the fiscal year to ¥29,291mn. However, total assets fell by 11.9% YoY to ¥47,139mn for two main reasons: accompanying the YoY drop in sales, sales credits and cash and deposits declined YoY, and 2) deferred tax assets contracted YoY as the Company reappraised their recoverability. As a result of these YoY declines in equity and total assets, the equity ratio rose to 62.1% at the end of FY3/16 from 60.0% at the end of FY3/15.



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Overview of the FY3/16 results

(¥mn)

	FY3/15 Result		FY3/16 Result		YoY change		FY3/16 Initial Co. forecast		FY3/16 Revised Co. forecast (as of November 26, 2015)	
		Ratio to sales		Ratio to sales		YoY rate of change		Ratio to sales		Ratio to sales
Sales	54,043		47,004		-7,039	-13.0%	60,000		53,000	
Information Systems	37,104	68.7%	34,076	72.5%	-3,028	-8.2%	35,000	58.3%	35,000	66.0%
Control Systems	16,950	31.3%	12,986	27.6%	-3,964	-23.4%	25,000	41.7%	18,000	34.0%
Adjustment	-11	-	-58	-	-	-	-	-	-	-
Gross profit	15,659	29.0%	14,279	30.4%	-1,380	-8.8%	20,000	33.3%	18,000	34.0%
SG&A expenses	14,233	26.3%	15,174	32.3%	941	6.6%	18,000	30.0%	17,000	32.1%
Operating income	1,425	2.6%	-894	-1.9%	-2,319	-	2,000	3.3%	1,000	1.9%
Information Systems	4,244	11.4%	2,277	6.7%	-1,967	-46.4%	2,900	8.3%	2,900	8.3%
Control Systems	-1,105	-6.5%	-1,319	-10.2%	-214	-	1,000	4.0%	0	0.0%
Adjustment	-1,713	-	-1,852	-	-	-	-1,900	-	-1,900	-
Ordinary income	1,566	2.9%	-749	-1.6%	-2,315	-	2,000	3.3%	1,000	1.9%
Net profit attributable to owners of parent	874	1.6%	-1,676	-3.6%	-2,550	-	1,400	2.3%	550	1.0%
Depreciation cost	1,409		1,360		-49	-3.5%	1,700		1,700	
R&D expense	3,834		5,330		1,496	39.0%	5,600		5,800	
Information Systems	2,710		3,965		1,255	46.3%	3,700		3,900	
Control Systems	1,124		1,365		241	21.4%	1,900		1,900	

Breakdown of segment sales

Information Systems						
Equipment	26,531		23,088		-3,443	-13.0%
Service	10,573		10,988		415	3.9%
Control Systems						
Units and components	14,217		10,279		-3,938	-27.7%
Pachislot machines and other equipment	2,733		2,707		-26	-1.0%

	FY3/15-end Result	FY3/16-end Result	YoY change	
				YoY rate of change
Total assets	53,528	47,139	-6,388	-11.9%
Total equity	32,138	29,291	-2,847	-8.9%
Equity ratio	60.0%	62.1%	2.1%	-

Source: Compiled by FISCO based on Company materials

FY3/16 results by segment were as follows.

a) In the Information System Segment, net sales weakened by 8.2% YoY to ¥34,076mn, and segment operating income decreased by 46.4% to ¥2,277mn. Sales of peripheral equipment declined as the Company had foreseen, because sales of newer products, such as new CR units, peaked in FY3/15. However, sales of hall computers fell by 18 units YoY to 113 units in FY3/16, although the company had originally projected sales of 150 units for FY3/16. The additional restrictions adopted by the industry on the risks of winning for machines caused replacement demand for hall computers to weaken from the second half of FY3/16. Sales of services by the Information System Segment grew YoY in FY3/16, led by a 13.4% rise in sales of MG services to ¥3,832mn. The Company has been promoting MG services as a stable source of sales and profits as part of its transition to a profit structure more dependent on recurring revenue.

Even though sales in the Information System Segment fell by more than planned in FY3/16, the segment invested the amount originally planned in R&D on the next-generation hall computer. Consequently, segment operating income dropped sharply YoY.

b) In the Control System Segment, net sales contracted by 23.4% YoY to ¥12,986mn in FY3/16, and the segment operating loss expanded to ¥1,319mn from ¥1,105mn in FY3/15. The segment marketed 13 models of display units in FY3/16, which was one less than the number of models marketed in FY3/15, and the number of display units sold dropped by 49.6% YoY in FY3/16 to 124,770 units, led by a large fall in sales of display units for pachinko machines. An increase in the component reuse rate* at makers of pachinko machines also contributed to the drop in sales of display units. At the start of FY3/16, the Control System Segment planned to sell four new models of pachislot machines, aiming for sales of 30,000 units. However, these new models had to be modified to comply with the tighter industry restrictions, so only one new model was marketed in FY3/16, selling 5,100 units. The other three new models will be sold in FY3/17.

* An increase in the reuse rate (the rate of using used parts) by makers of pachinko and pachislot machines forces the Company to lower its sales prices.



The significant sales decline and losses stemming from the devaluation of parts and materials for the pachislot machines to be sold next fiscal year led to the increase in the operating loss in the Control System Segment.

Sales Volumes of Information Systems and Control Systems

Sales Volumes (Information Systems)

	FY3/15 Result	FY3/16 Result	YoY change	FY3/16 Initial Co. forecast	FY3/16 Revised Co. forecast (as of November 26, 2015)
Hall computers	131 units	113 units	-18 units	150 units	150 units
Call lamps					
BiGMO series	17,125 units	13,412 units	-3,713 units	20,000 units	20,000 units
BiGMO PREMIUM	58,587 units	54,987 units	-3,600 units	60,000 units	60,000 units
iL-X Series	82,747 units	73,020 units	-9,727 units	85,000 units	85,000 units
VEGASIA CR unit	109,561 units	98,009 units	-11,552 units	90,000 units	90,000 units
Face recognition systems	11 halls	12 halls	1 halls	30 halls	30 halls

Sales Volumes (Control Systems)

Display unit models	14 products	13 products	-1 products	14 products	12 products
Units sold	247,649 units	124,770 units	-122,879 units	238,000 units	148,000 units
Pachislot machine models	2 products	1 products	-1 products	4 products	3 products
Units sold	7,000 units	5,100 units	-1,900 units	30,000 units	19,000 units

Source: Compiled by FISCO based on Company materials

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Control System Segment to lead growth of overall sales and profits in FY3/17

(3) Company forecasts for FY3/17

For FY3/17, the Company projects a 6.4% YoY increase in consolidated net sales to ¥50.0bn, an operating income of ¥1.0bn, reversing the ¥894mn operating loss in FY3/16, an ordinary income of ¥1.0bn versus an ordinary loss of ¥749mn in FY3/16, and a profit attributable to owners of parent of ¥600mn, after a net loss of ¥1,676mn in FY3/16.

The Company foresees another YoY decline in sales in the Information System Segment in FY3/17, reflecting the continuation of a difficult market environment, but it projects a YoY recovery in sales in the Control System Segment, due in particular to sales of the three models of pachislot machines partially developed in FY3/16.

The Company projects a YoY rise in its SG&A expenses in FY3/17, reflecting increases in sales commissions and advertising and sales promotion costs accompanying greater sales of pachislot machines. However, it sees sales growing enough to more than offset this increase in SG&A expenses, leading to a return to an operating income. The Company plans to invest ¥4.4bn in R&D in FY3/17, which is ¥930mn less than it invested in R&D in FY3/16.



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Company Forecasts for FY3/17 versus FY3/16 Results

(¥mn)

	FY3/16 Result		FY3/17 Forecast		YoY change	
		Ratio to sales		Ratio to sales		YoY rate of change
Sales	47,004		50,000		2,996	6.4%
Information Systems	34,076	72.5%	31,000	62.0%	-3,076	-9.0%
Control Systems	12,986	27.6%	19,000	38.0%	6,014	46.3%
Gross profit	14,279	30.4%	17,200	34.4%	2,921	20.5%
SG&A expenses	15,174	32.3%	16,200	32.4%	1,026	6.8%
Operating income	-894	-1.9%	1,000	2.0%	1,894	-
Information Systems	2,277	6.7%	2,300	7.4%	23	1.0%
Control Systems	-1,319	-10.2%	600	3.2%	1,919	-
Adjustment	-1,852	-	-1,900	-	-	-
Ordinary income	-749	-1.6%	1,000	2.0%	1,749	-
Profit attributable to owners of parent	-1,676	-3.6%	600	1.2%	2,276	-
Depreciation cost	1,360		1,700		340	25.0%
R&D expense	5,330		4,400		-930	-17.4%
Information Systems	3,965		2,700		-1,265	-31.9%
Control Systems	1,365		1,700		335	24.5%

Information System Segment Sales Breakdown

	FY3/16	FY3/17	YoY change
Hall computers	113 units	120 units	7 units
Call lamps			
BiGMO Series	13,412	-	-13,412
BiGMO PREMIUM	54,987	40,000	-14,987
REVOLA	-	40,000	40,000
IL-X Series	73,020	50,000	-23,020
VEGASIA CR unit	98,009	70,000	-28,009
Face recognition system	12	15	3

Control System Segment Sales Breakdown

	FY3/16	FY3/17	YoY change
Display unit models	13	12	-1
Units sold	124,770	156,000	31,230

	FY3/16	FY3/17	YoY change
Pachislot machines			
Number of models sold	1	3	2
Units sold	5,100	22,500	17,400

Source: Compiled by FISCO based on Company materials

The Company's forecasts by segment for FY3/17 are as follows.

a) For the Information System Segment, the Company forecasts a 9.0% YoY decline in net sales to ¥31.0bn but a 1.0% rise in segment operating income to ¥2.3bn. It projects a slight YoY increase in sales of hall computers and expects initial sales of the new REVOLA information display terminal, but it expects sales of peripheral equipment, such as CR units, to fall, leading to a drop in overall segment sales. It will reduce its investment in the development of a next-generation hall computer, which should lift operating income somewhat.

b) For the Control System Segment, the Company projects a 46.3% YoY jump in sales to ¥19.0bn and an operating income of ¥600mn, after an operating loss of ¥1,319mn in FY3/16. It assumes that the Japanese market for control systems for pachinko and pachislot machines normalizes in FY3/17 as appropriate standards for these machines are adopted. It also expects to increase the number of customers for its control systems. Finally, it anticipates large FY3/17 sales from the three models of pachislot machines that it was unable to sell in FY3/16. Although the Company projects a YoY increase in segment R&D costs, it expects the large sales jump to more than offset the impact of this increase on profit.



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Sales Targets in FY3/17

	FY3/16 Result	FY3/17 Target	YoY change
Hall computers	113 units	120 units	7 units
Call lamps			
BiGMO Series	13,412 units	-	-13,412 units
BiGMO PREMIUM	54,987 units	40,000 units	-14,987 units
REVOLA	-	40,000 units	40,000 units
IL-X Series	73,020 units	50,000 units	-23,020 units
VEGASIA CR unit	98,009 units	70,000 units	-28,009 units
Face recognition system	12 halls	15 halls	3 halls

Control System Segment

Display unit models	13 products	12 products	-1 products
Units sold	124,770 units	156,000 units	31,230 units
Pachislot machine models	1 products	3 products	2 products
Units sold	5,100 units	22,500 units	17,400 units

FISCO finds the Company's FY3/17 forecasts feasible. Although the environment in the pachinko market is likely to remain difficult, the Company should be able to attain its targets for the number of display unit models and unit sales of display units. Based on the sales contributions of new models of pachislot machines in the past, the three new models to be marketed in FY3/17 should boost sales and profits in the Control System Segment. However, most of the sales and profit improvement projected by the Company is scheduled for the second half of FY3/17. Furthermore, the Company's sales and profits remain subject to external factors, such as a prolongation of the additional industry restrictions on machines. Developments that will affect the Company's sales and profit growth from FY3/18, such as the cementing of firm ties with new customers and preparations to sell the next-generation hall computer, should be monitored closely.

■ Growth Strategy

Next-generation hall computer in the final stage of development

(1) Progress made through previous medium-term plan

In the Company's previous medium-term plan, which was intended to cover the three years from FY3/15 through FY3/17, the Company pursued three business reforms to promote its growth and the growth of its industry over the medium-to-long term. As detailed below, the primary reform was to develop the next-generation hall computer.

a) Developing the next-generation hall computer

Since FY3/14, the Company has been developing the next-generation hall computer, which will operate on a cloud server and be capable of advanced analysis of large amounts of data. Unlike previous hall computers, the next-generation computer will be able to gather and analyze data on customer behavior and to recommend actions to improve sales and profits, thereby contributing to the growth of the pachinko hall industry. This capability could also be applied to other business areas. From FY3/15 to FY3/17, the Company planned to invest about ¥10bn in R&D to develop the next-generation hall computer and peripheral equipment for the computer. This development is in the final stage, and the new computer is scheduled to be marketed from FY3/18. By launching sales of this computer, which will be far superior to any other such machine, the Company aims to raise its share of the Japanese market for hall computers to 50% over the medium-to-long term.

In September 2014, the Company bought land adjacent to its Kasugai plant in Aichi Prefecture to expand the plant and help it increase its market share in information systems. In October 2015, the additional plant began operations, increasing production capacity. Hereafter, the Company plans to integrate its production facilities, develop a department to guarantee product quality, and build an environment for development testing at the Kasugai plant.

b) Converting business model to stock type revenue model

The Company is changing its business model from a dependency on sales of information system equipment to a dependency on services provided after the sale of such equipment. This change allows the Company to sell its hall computers and peripheral equipment at low prices, thereby increasing its price competitiveness and its market shares while stabilizing its profit growth with service usage fees. As noted above, in FY3/16, sales of MG services in the Information System Segment grew by 13.4% YoY to ¥3,832mn.

c) Expanding sales of pachislot machines developed in-house

Pachislot game machines developed in-house are another growth driver planned by the Company. The first commercially successful model, “Magical Suite Prism Nana”, was the first such machine in the industry incorporating original characters. Launched in FY3/14, this model sold 4,000 units. A hit model marketed in FY3/15 was the “Sasamisan@Gambaranai Slot” machine, which emphasized the conveyance of an interesting story and established a new concept of pachislot entertainment. With the launch of this machine, the Company established a high-quality brand image specializing in animation characters. In FY3/16, the Company marketed its “Pachislot Hyakkaryoran Samurai Girls” pachislot machine, which sold 5,100 units and became a source of sustained contribution to operations. In the field of pachislot machines, the Company has forged a pattern of success based on data application.

To cater to the generation that grew up with anime, the Company will concentrate on the development of “anislo” (animation collaborated slot machines) that offer stories, not just balls, to help convert the pastime to a form of amusement.

(2) New medium-term plan “Next 50 Chapter One”

FY3/17 is the first year of the Company's new four-year plan, called “Next 50 Chapter One”. The Company assumes that the environment for Japan's pachinko and pachislot market will gradually improve. By implementing this four-year plan, the Company aims to strengthen its business base to help customers to respond effectively to market changes (i.e., to attract customers that want to play on machines resembling games) and to reform the management of pachinko halls (by basing strategic decisions on data analysis). The Company intends to increase its share of the market for hall computers with the launch of its next-generation hall computer in FY3/18 and to promote sales growth and profitability by applying its capability to analyze data and plan and develop products to add value to its products and services. The plan targets consolidated net sales of ¥57.0bn (a compound average growth rate of 4.9% over four years) and operating income of ¥4.0bn for an operating income margin of 7.0% and an ROE of at least 7% for FY3/20. The plan envisages four-year R&D investment of ¥10bn, capital investment of ¥4bn, and depreciation cost of ¥5bn. While investing and spending for future growth, the Company aims to increase its profitability.

Targets of Current Medium-Term Plan

	FY3/16		FY3/17		FY3/20		Compound average growth rate (from FY3/16)
	Result	Ratio to sales	Target	Ratio to sales	Target	Ratio to sales	
Sales	47,004		50,000		57,000		4.9%
Information Systems	34,076	72.5%	31,000	62.0%	38,000	66.7%	2.8%
Control Systems	12,986	27.6%	19,000	38.0%	19,000	33.3%	10.0%
Operating income	-894		1,000	2.0%	4,000	7.0%	-
Information Systems	2,277	6.7%	2,300	7.4%	5,000	13.2%	21.7%
Control Systems	-1,319	-	600	3.2%	1,000	5.3%	-
Adjustment	-1,852	-	-1,900	-	-2,000	-	-
ROE		-5.5%		2.1%		7.0% and more	-
Sales of MG Services		3,832		4,200		7,300	17.5%

Source: Compiled by FISCO based on Company materials



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The objectives and strategies for each segment are detailed below.

a) Information System Segment

The Company plans to create new value in the Information System Segment and to raise its share of the Japanese market for hall computers by launching its next-generation hall computer. It also intends to increase the number of pachinko fans by expanding its social networking service (SNS) and developing new services. Thus, it targets segment sales of ¥38.0bn and operating income of ¥5.0bn for FY3/20. By accelerating the conversion of this segment's profit model to one more dependent on recurring revenues, the Company expects segment sales of services to grow to ¥7.3bn in FY3/20.

The next-generation hall computer will be adjustable to accommodate regional traits, so it will probably replace current hall computers, which are not adjustable. The Company will continue to encourage changes in the management of pachinko halls to base management decisions more on data. Through these efforts, the Company hopes to contribute to and benefit from a recovery of sales and profits in Japan's pachinko hall industry.

Also, regarding the fan service, comprehensive content providing information on pachinko and pachislot is available via the Pachi-Robo SNS application. Payout information and techniques for playing new machines at participating pachinko halls can be accessed by PC, cell phone or smartphone via the Site Seven website. About 420,000 fans now subscribe to these services, but by adding new content to these services and by offering new services, the Company aims to increase the number of its service subscribers to 1 million by FY3/20 and to strengthen the ties between these fans and the halls served by the Company.

b) Control System Segment

In the Control System Segment, the Company intends to create new amusement value, support the activities of the pachinko industry, and apply its ability to plan and develop new products to respond to market changes. Through these efforts, the Company targets segment net sales of ¥19.0bn and operating income of ¥1.0bn for FY3/20. In the pachinko machine business, the Company will strengthen its base through several measures. It will pursue a strategy of product differentiation by strengthening its ability to propose plans that take advantage of its ability to amass information (the DK-SIS system) and analyze data. It will shorten its product development time by specializing in some development processes and by improving its development technology, thereby lowering the cost of development and commercializing products faster. In the pachislot machine business, the Company will refine the pattern of success it has built based on anime character machines, thereby contributing to the operations of pachislot machine halls and attracting new customers to these halls.

Although FISCO also assumes that Japan's pachinko and pachislot industry is likely to recover gradually from the short-term business decline due to the industry's restrictions on machine specifications, the industry's prospects remain uncertain due to possible structural changes in its external environment. However, the Company's ability to invest ¥10bn in the next-generation hall computer gives it a great advantage over other companies in the industry. Thus, even if the industry or market were to contract further, the Company could maintain growth by increasing its share of the market. The pachinko and pachislot hall industry is likely to polarize further depending on capital availability and to consolidate, which would benefit the Company.

With the sale in FY3/17 of three new models of pachislot machine developed in-house and originally scheduled for sale in FY3/16, the Company's business in the development, manufacture and sale of these machines should advance on a full scale. We believe that this business could drive sales and profit growth hereafter. Compared with other makers of pachislot machines, the Company could gain superiority because it has ample time and funds to develop these machines and it can use its ability to analyze data to develop machines that offer game attraction. However, rather than fight for share in the current market, we believe that the key to success for the Company is to use its ability to create original value to target new submarkets, such as fans of anime, thereby supporting the growth of the overall market for pachislot machines.

■ Shareholder Returns

Providing returns through dividends and gifts

For FY3/16, the Company paid interim dividends of ¥10 per share and term-end dividends of ¥40 per share, for full-year dividends of ¥50 per share. It plans to pay the same dividends for FY3/17.

Through FY3/15, the Company paid minimum dividends of ¥40 per share and supplemented these dividends with special dividends depending on its profits. However, from FY3/16, the Company raised its minimum annual dividends to ¥50 per share.

Given the Company's policy of supplementing its minimum dividends with dividends dependent on profits, FISCO foresees the likelihood of increases in annual dividends as the Company's profits grow over the medium term.

To make its shares more attractive to investors and to encourage shareholders to keep their holdings over the medium-to-long term, the Company has just adopted a system of awarding gifts to shareholders. According to this system, all shareholders registered at the end of September will be awarded points that vary depending on the number of shares held (the minimum holding is 100 shares) and the length of time they have been held. These points can be exchanged for food, electronic goods, gifts, and the Company's original goods.

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