

3. Amusement Business (37:12-56:04)

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I am Fukuda, the manager of the Amusement Business Division.

I would like to talk to you today about what kind of business development and sales activities we are conducting in line with trends in pachinko hall industries.

Amusement Business

■ Trends in the Pachinko Hall Industry

First of all, regarding trends in the pachinko hall industry, please look at the graph on the left. Industry sales are the sum of pachinko hall sales. The figure for 2023 was 15.7 trillion yen. This term, based on the financial statements of the pachinko halls I manage and discussions with the respective managers during visits, most of the halls are reporting increased revenue. From this, we expect that overall sales will probably increase by around 3%. We expect the market size in 2024 to be a little over 16 trillion yen.

Also, regarding the number of stores, it is true that the number of stores closing is greater than the number of stores opening. I think there are about 6,000 stores.

Since the COVID-19 pandemic in 2020, the market size initially shrank. However, as opportunities for going out increased after the pandemic, the industry as a whole has started to recover, with many businesses seeing a general bottoming-out of losses. It was a huge story, but the start of Smart Slot machines in November 2022 has led to an increase in the operation of high-priced slot models. Slots have been driving growth, while pachinko has seen slight stagnation or a small decline. However, the overall trend seems to be moving in a positive direction as the gains from slots offset the minor losses in pachinko.

In terms of the number of stores, my sense is that for those living in the Tokyo metropolitan area, there are probably about five or six pachinko halls within walking distance or a short drive. However, among these, stores with low utilization and unprofitable operations are generally closing down. Popular stores are very profitable. As I will explain later using the store's profit and loss statement (PL), when a store reaches a size of 1,000 machines, the revenue typically amounts to around 6 billion yen annually, with operating profit in the range of 200 to 300 million yen. With such figures, it is unlikely that such stores would close. Of course, even the leading stores are considered key earners, so I believe that strong pachinko halls with solid financial performance will continue to survive in the long run.

Also, for the top pachinko halls in each prefecture. I visit pachinko halls every week, and in the Tokai-Osaka-Kanto region, for the top 10 operators, for example in Osaka, Aichi, and Tokyo, their net assets are typically around 10 billion yen.

To give you an idea of how high this standard is, there are around 4,000 listed companies, but only 2,500 of these have net assets of 10 billion yen or more. Pachinko halls are not generally listed in Japan, but if they were, it would feel as if there are halls with strong financial resources across the country, particularly in each prefecture. These halls would be comparable to mid-sized or larger companies in terms of financial strength, and many such halls exist in each region. When visiting such companies, rather than hearing about closures, they often mention plans to expand by opening new locations, especially as things are returning to normal after the pandemic.

Therefore, our company plans to continue sourcing properties that meet the needs of these halls, or introduce such opportunities, as part of our ongoing strategy.

■ Pachinko Business - Reasons for the continued acceleration of M&A in the future -

There are two main reasons for the acceleration of M&A in the pachinko business in the future. The first point is that if new construction is done, it is becoming unprofitable due to the rising cost of construction.

As you can see in the document on the left, construction costs are rising year by year. I visit various halls and speak with many operators, and it seems that building from scratch is only something they'd consider when they find a truly desirable location. Essentially, they are focusing primarily on M&A as their main strategy moving forward.

The next point is the increasing cost of capital investment and the approaching expiration of fixed-term lease agreements, which are creating pressure for decision-making.

When you try to introduce smart machines, it costs about 500,000 yen per machine. There is a unit next to it where money is deposited, and the surrounding machines typically cost between 200,000 to 300,000 yen. Therefore, it costs about 800,000 yen to introduce one machine. If a store with 1,000 machines were to replace all its equipment, an investment of around 800 million yen would be required. However, there are fewer halls now that are confident they can recover that investment, which is becoming a significant challenge.

On the other hand, local strong halls are thinking, "If we do it, we might be able to achieve even more." This is the case with the need for buying and selling, and M&A is accelerating.

Also, although the number of machines has been increasing recently, 2004 was the year with the most pachinko machines installed in Japan. There are many halls that opened at this time, and most of them have a real estate contract period of 20 years, but many of them have been around for about 20 years in this year. For these halls, the time has come to be forced to make a choice: whether to continue leasing the hall for another 20 years, or whether to sell it if there is someone else who can take over.

Including such cases, consolidation or acquisition will be carried out through M&A. We think that cases like this will increase in the future.

■ Real Estate Owned and Business Strategy

Next, I will talk about our real estate holdings and business strategy. The profit and loss statement for the store on the left shows the scale as small, medium, and large, corresponding to 300 machines, 500 machines, and 1,000 machines, respectively.

70% of our real estate holdings consist of medium and large-sized properties, which account for 70% of the total. Even in smaller stores, for example, in unique markets such as mountain areas where there may be no other pachinko halls, it might actually be the case that installing 1,000 machines would exceed the demand due to population limitations, considering the local capacity. In some cases, having around 300 or 400 machines might actually be more profitable. Therefore, we do have some smaller and more specialized locations in our portfolio.

As you can see from the table on the left, I'll explain the annual sales first, before talking about the gross profit. This is an example of a store selling 15 thousand yen per unit per day. We multiplied the sales by 360 days of operation. Gross profit is

17% of sales. This is about the average gross profit of the industry, but when calculated by gross profit, if you look at the final operating profit, it is about 1.9% for small stores and 4.4% for large stores. Therefore, even if the gross profit margin remains constant, the amount of SG&A expenses that can be incurred is larger than the amount of gross profit. In this sense, profitability is likely to increase in terms of structure. Therefore, when it comes to top-performing halls, they generally aim for 800 to 1,000 machines. If the number is below that, there is a significant amount of hesitation when it comes to opening a new location. Accordingly, in light of this market environment, we will actively acquire real estate as we anticipate strong demand for new store openings as part of our JALCO business strategy. However, it is important to note that in markets like Nagoya, there are areas where there is an oversaturation of halls with around 1,000 machines. Therefore, it's not simply a matter of opening new locations everywhere. However, we believe that, in principle, larger stores have the potential to succeed, so we will actively pursue opportunities to acquire them.

As for the smaller stores, as I mentioned earlier, they are located in unique markets such as islands or mountain areas. There are companies in Japan that operate in areas where other businesses are unlikely to enter, and they manage their operations with low costs and steady profitability. Therefore, when it comes to the real estate of such halls, we consider the market conditions or asset value if they are located in urban areas. However, we also assess the overall management capabilities of the pachinko halls and continue to acquire them based on that comprehensive evaluation.

■KPI: Trends in Contacts with Targeted Companies Nationwide

Next, regarding our sales activities, we place great importance on the number of sales interactions, or the frequency of contact. As of May, we had met and made contact with 100 companies out of the top 300. By October, we increased that number by approximately 30 companies, bringing the total to 130.

From my experience, I believe we are now at a point where we can quickly reach out to the top pachinko halls in each prefecture. Specifically, I can immediately contact the owners of those companies or the heads of store development, and reach out with a simple "How's it going?" via phone.

Therefore, moving forward, we plan to dive deeper into the specific needs of each company and find solutions that match those needs. On the flip side, we will also ensure that we properly represent the corporate clients who could potentially become sellers, and increase the number of sales interactions to ensure we don't miss any opportunities. This is the direction we're currently aiming for.

■Specific Example in Sales Activities (1)

A specific example at a sales site. There were M&A deals in western Japan. In this regard, we plan to acquire real estate and have JALCO handle the sales rights and mediation. Through this, we anticipate generating long-term rental income and M&A fees.

I often travel for business to visit large pachinko halls every week, and when I sense that a deal might be possible, it's important to quickly determine whether the potential buyer hall has a need for it. Without this, there is a risk of moving forward based on a misunderstanding, which happens quite often. We continue to focus on understanding customer needs and conducting thorough sales activities.

■Specific Example in Sales Activities (2)

Next, regarding this, when I was on a business trip in the western Japan area, I visited a hall that I had never met before. I had spoken with them a few times over the phone and wanted to meet in person, but there had been no prior appointment. However, I decided to visit without an appointment, and I was able to meet with the sales manager. After that, through several exchanges, I was able to get an introduction to the chairman of the company. During that meeting, we made various proposals. While we will continue with those proposals, the chairman, who is on good terms with the owner of another company, introduced us to a hall because they expressed an intention to sell.

As with the example below, particularly with the Osaka deals from last year and the year before, our industry recognition has increased, and as a result, more people have become familiar with our name. This has led to a growing level of trust in JALCO, with properties being introduced to us. I believe that, intuitively, our trustworthiness has been steadily increasing.

The next point is the synergistic effect of such things. Since our company owns real estate, we are the first to receive information when there are opportunities for expansion or when a property needs renovation. For the companies that supply equipment to pachinko halls, being able to quickly grasp renovation needs is crucial, as it directly leads to securing orders. Our company and the equipment companies related to pachinko halls mutually introduce clients to each other. Specifically, when there is an equipment-related opportunity, we introduce it to the equipment company. On the other hand, there are still some pachinko halls that we have not been able to contact directly. The equipment companies have installed their products in pachinko halls all across the country, so they often have connections with hall managers and owners. Therefore, we plan to continue actively exchanging introductions with them going forward.

■ Characteristics and Advantages of Our Business

Our business characteristics and advantages. In terms of the size of the market, I think that pachinko will probably be around 15 trillion yen in the fiscal year under review and around 16 trillion yen in 2024. In the restaurant industry, there is a very large market.

We can calculate rent income as about 120 billion yen if we take a 20% share at the maximum. In that case, it may be possible to accumulate up to 2 trillion yen as assets. There is a very large market.

In addition, although there are several competitors, we are the only listed company that actively acquires pachinko hall real estate. Basically, information is coming into us, and it continues to be easy to operate.

Regarding operational efficiency, based on last year's performance, the EBITDA and labor productivity, when divided by the number of employees from operating profit, are very high. We plan to maintain these metrics while continuing our sales activities.

When compared to other companies, our strength can be summarized simply: we handle everything related to opening new halls. There are no other companies that offer such a comprehensive business approach, and many of the services we provide are unique to our company.

JALCO provides real estate introductions and also offers financing services. In terms of financing, for example, we provide funds for capital investment or when goodwill arises during M&A transactions involving sales rights. In these cases, we help facilitate the funding through loans, allowing the payment to be received accordingly. Additionally, we offer machine rentals, and one of the methods for funding is off-balance sheet financing. By providing a combination of these services, along with the necessary real estate and capital for opening new locations, JALCO stands out as the only company capable of handling all aspects. While M&A brokers and real estate companies may have specific areas or categories they work within, there are limitations to what

they can do. JALCO's strength lies in being able to manage everything when entrusted with the task.

This concludes the explanation of the semi-annual financial results. Thank you very much.