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## BUSINESS

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### OVERVIEW

We operate pachinko halls in Japan where customers can play pachinko and pachislot, which are recreational arcade games characterised by an element of chance. We were the fourth largest pachinko hall operator in Japan in 2013 (based on gross pay-ins<sup>1</sup>), according to EBI. The pachinko industry is highly fragmented, with over 3,800 operators running 11,893 halls as at 31 December 2013. In 2013, our market share based on gross pay-ins was 1.3%, while our market share based on the number of halls in Japan was 0.5%. Ever since we opened our first pachinko hall in 1950, all our operations have been focused in Northeast Honshu (本州島東北), Japan, covering ten prefectures that have a total population of approximately 47.4 million (representing 37.7% of the total population in Japan), as at 31 December 2013, according to EBI.

Pachinko is one of the most popular forms of entertainment for adults in Japan and has a long history, dating back to the early twentieth century. **Pachinko** is similar in appearance to a pinball machine and is played by firing pachinko balls in rapid succession into a playing field, with the aim of firing them into designated pockets that release bonus pachinko balls. Playing costs range from ¥0.5 to ¥4 per ball (before consumption tax). **Pachislot** is similar in appearance to a traditional slot machine and is played by inserting pachislot tokens to spin its image reels, with the aim of stopping the reels at a winning matching combination, which will release bonus pachislot tokens. Playing costs range from ¥2 to ¥20 per token (before consumption tax).

Generally, players aim to collect the most number of balls and tokens, which can either be saved for subsequent visits, or more notably, exchanged for prizes. At our halls, customers can exchange two types of prizes, namely: (1) **general prizes** (including our private brand products), which are generally the types of goods sold in convenience stores, including cigarettes, food and snacks, household goods and drinks; and (2) **G-prizes**, which are decorative cards with a small embedded piece of metal (such as gold) or coin-shaped pendants of metal (such as gold), that can be subsequently sold by customers to independent G-prize buyers for cash. Our Japan Legal Adviser has confirmed that our pachinko and pachislot hall operations do not constitute “gambling” under, and do not violate, the Penal Code.

Our halls can be categorised into suburban halls and urban halls.

1. **Suburban halls** are our primary business focus, representing 91.5%, 91.9%, 92.3% and 91.9% of our revenue from pachinko and pachislot business for the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014. They are typically located in suburban areas (such as the suburbs of Fukushima Prefecture (福島県)), require car access and provide parking spaces (including for the disabled). Generally, customers are the self-employed (such as farmers and fishermen), factory workers and retirees, and these halls are generally larger with around 400 to 700 machines. Gross pay-ins from peak operation hours (which are typically from 12:00 noon to 5:00 p.m.) on average accounted for approximately 45% of the daily gross pay-ins of our suburban halls during the Track Record Period.

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<sup>1</sup> Represents the amount received from customers for rented pachinko balls and pachislot tokens.

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2. **Urban halls** are typically located in urban areas (such as Tokyo (東京都)) and within walking distance of train stations. Generally, customers are full-time employees of urban areas and these halls are generally smaller with around 200 to 300 machines. Gross pay-ins from peak operation hours (which are typically from 5:00 p.m. to 10:00 p.m.) on average accounted for approximately 41% of the daily gross pay-ins of our urban halls during the Track Record Period.

We first opened our door to pachinko players in 1950. Our corporate slogan is “*Happy Time Creation*” and we place our primary focus on customer experience and goodwill. We have strived to adapt to changing industry trends and customer preferences throughout our operating history and have developed into an operator of 55 pachinko halls, consisting of 46 suburban halls and 9 urban halls, as at the Latest Practicable Date.

Fukushima Prefecture (福島県) is our most important strategic location, in which our headquarters are located and we have the most number of halls (namely, 20 halls as at the Latest Practicable Date), machines and also revenue generation, accounting for over 40% of our total revenue during the Track Record Period. We will continue to leverage our strengths and expand our operations in Northeast Honshu (本州島東北) (especially Fukushima Prefecture (福島県) and its neighbouring and conjoining prefectures) in a cost-efficient and strategic manner. In particular, we expect to open a new hall in Fukushima Prefecture (福島県) by December 2015 with over 1,000 machines, which will become our largest hall and is expected to become one of the largest halls in Fukushima Prefecture (福島県).

The pachinko industry has a dominant presence in the gaming sector in Japan (which, as defined by our independent industry consultant, EBI, consists of pachinko, bicycle-racing, auto-racing, horse-racing and lottery), having comprised 78.0% or ¥18.8 trillion (in terms of gross revenue) of the gaming sector in Japan in 2013. Even though the industry has been shrinking since the early 2000’s, it still remains relatively favourable to large hall operators (such as ourselves) due to the resulting consolidation. According to EBI, small hall operators (that operate less than ten halls) have been dropping out of the industry and are expected to continue to do so, while large hall operators (that operate at least ten halls) have greater financial and other resources and are able to benefit from economies of scale, including operational cost efficiencies, and have been benefiting by absorbing the freed up market share. The opportunities for us from this consolidation are compounded by the high industry fragmentation and the fact that there are very few hall operators that are of our size. As at 31 December 2013, there were over 3,800 operators, of which 95.8% were small hall operators with less than 10 halls and we were one of the only eight hall operators with over 50 halls in Japan.

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### STRENGTHS

We believe that we have a number of key strengths that differentiate our business from that of our competitors, including the following:

**Strong market position (especially in Fukushima Prefecture (福島県)), largely due to economies of scale and brand recognition gained from our strategic geographical focus in Northeast Honshu (本州島東北) and our centralised management strategy**

We were the fourth largest pachinko hall operator in Japan (based on gross pay-ins) in 2013 and the largest pachinko hall operator in Fukushima Prefecture (福島県) (based on the total number of halls) as at 31 December 2013, according to EBI. The pachinko industry is highly fragmented and there are very few pachinko hall operators that are of our size. As at 31 December 2013, there were over 3,800 operators, of which 95.8% were small hall operators with less than 10 halls and we were one of the only eight hall operators with over 50 halls. As at the Latest Practicable Date, we operated 55 pachinko halls, all of which are strategically located in Northeast Honshu (本州島東北). Since we opened our first hall in 1950, our strategy has always been to focus hall openings exclusively in Northeast Honshu (本州島東北), specifically Fukushima Prefecture (福島県), Tokyo (東京都) and their neighbouring and adjoining prefectures.

Through our centralised management strategy, we centralise and standardise processes throughout our hall operations, including overall management, new hall development, machine procurement, prize procurement, IT systems, marketing, recruitment and training of full-time employees, internal audit and daily operations. Our centralised management strategy, together with our strategic geographical focus, has allowed us to benefit from economies of scale via significant operational efficiencies and cost savings, especially as our fixed overhead is shared among our 55 operating halls, resulting in a substantially lower fixed overhead per hall compared to our smaller competitors. Ultimately, these have greatly contributed to our strong market position.

For example, we are able to source general prizes in large volumes and variety at relatively lower costs. As a market leader, we are also able to gain priority from machine suppliers over smaller hall operators for purchases of new machines. This allows us to remain highly competitive by consistently being able to be among the first to acquire the newest machine models, which is essential to maintaining high player traffic as new machine models typically generate the most player interest. Further, our geographical focus has allowed our 55 halls to be managed efficiently, as we are readily able to: (1) conduct regular physical internal meetings among managers based in different business locations; (2) rotate our area managers and hall managers to other areas and halls in order to boost their management skills; and (3) transfer our machines between our halls and warehouses in a cost and time efficient manner and in response to changing consumer preferences.

In addition, our centralised management strategy and tactical geographic focus have helped us establish strong brand recognition, thus, further improving our player traffic and customer loyalty. For example, we are able to ensure the consistency of the key features of all of our halls (thus, reinforcing our brand image), while our operational efficiencies and cost savings allow us

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to operate relatively large halls, which are generally more attractive to players. Also, we believe we are able to consistently provide a professional level of hospitality and better gaming experience for customers, as we centralise training for our full-time employees through the use of our training facilities located near our headquarters in Fukushima Prefecture (福島県) and structured training and rotation programs.

Also, as mentioned above, despite the pachinko industry having been shrinking since the early 2000's, the industry remains economically favourable to large hall operators (such as ourselves). Small hall operators have been dropping out of the industry and are expected to continue to do so. Large hall operators (such as ourselves) have greater financial and other resources and are able to benefit from economies of scale, including operational cost efficiencies, and have been benefiting by absorbing the freed up market share. The opportunities for us from this consolidation are compounded by the high industry fragmentation and the fact that there are very few hall operators whose operations are as big as ours. We believe we will particularly benefit from this trend in Fukushima Prefecture (福島県) and its neighbouring prefectures, where our leading position has also served as an increasingly effective barrier of entry.

### **Efficient management structure supported by sophisticated information technology systems that enable us to anticipate and respond quickly to changes and trends in customer preferences**

We have implemented a multi-layered hierarchical management structure for our hall operations, consisting of our 55 hall managers (each responsible for overseeing the daily operations of one particular hall), our 13 area managers (each responsible for overseeing the daily operations of three to six halls), our division manager (based in our headquarters and generally oversees the operations of all our halls) and our Directors. Generally, each manager reports directly to the relevant manager in the next higher rank.

Since customer preferences and trends vary among different areas, our area and hall managers' on-site presence in each area and hall allows us to collect localised market information, such as approximate payout ratios achieved by competing operators, and player acceptance towards new machines, enabling us to make timely business decisions which are responsive to changing conditions in each geographical market. We also utilise sophisticated information technology systems to provide us with real-time data regarding useful business metrics such as machine utilisation for each type of machine as well as the business performance of each machine in our halls. They have allowed us to closely monitor our hall performances and also to perform timely analyses on our operational efficiency. For example, by utilising our information technology systems, we are able to assess the popularity of each machine and to adjust our procurement strategy accordingly. We also monitor the daily business performance of machines and use this information to determine the pin angle maintenance and adjustment required for our pachinko machines and also the ideal adjustments of payout settings for our pachislot machines, in order to ensure full compliance with the required ranges on payout ratios under law. See “— Pachinko and Pachislot Hall Operations — Pachinko halls — Machine maintenance and the business performance of our halls” in this section below for details.

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### **Effective internal controls and procedures to ensure our compliance with applicable laws and regulations and to detect and prevent fraud, cheating and money laundering activities**

We have implemented internal controls and procedures to ensure that our pachinko and pachislot hall operations are conducted professionally and in full compliance with applicable laws and regulations, especially the Amusement Business Law and its ancillary prefectural local regulations. Our internal control measures enable us to detect irregularities and unusual activities or trends in the transactions that take place in our pachinko halls which, if detected, are reported to our Directors and senior management for investigation, remediation and, if necessary, reporting to the relevant authorities in Japan.

We believe that money laundering risks associated with our pachinko and pachislot hall operations are inherently low, due to the stringent laws and regulations and machine limitations pertaining to the number of pachinko balls or pachislot tokens that can be played as well as won at our pachinko and pachislot machines. Even though there are currently no specific obligations imposed on pachinko hall operators under the AML laws of Japan, we have voluntarily established various policies and procedures designed to identify and mitigate money laundering in our pachinko and pachislot hall operations. Such policies and procedures have been designed, implemented and operating with reference to the guidance letter titled “International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation” issued by the Financial Action Task Force in 2012, and also the Amusement Business Law. See “Internal Controls and Anti-Money Laundering” and “Appendix IV — Summary of the Review of Anti-Money Laundering Procedures, Systems and Controls” for details.

In particular, the Japanese government has been continuously regulating the pachinko industry for compliance with the Amusement Business law or its ancillary prefectural local regulations, through direct enforcement. Every year, the Japanese government (through the National Police Agency) announces a list of administrative dispositions imposed on pachinko halls (including suspensions or even revocations of operating licences) due to discovered breaches of the Amusement Business Law or its ancillary prefectural local regulations. For example, in 2010, 2011 and 2012, there were a total of 705, 696 and 817 administrative dispositions imposed on pachinko halls, of which five, four and six were for suspensions of operating licences, and seven, five and seven were for revocations of operating licences, respectively. Most of the administrative dispositions (especially the suspensions and revocations of operating licences) were imposed against halls owned by small hall operators who generally have fewer resources to establish effective internal controls and procedures. This creates opportunities for larger hall operators (such as ourselves) that have implemented proper internal controls, as: (1) our smaller competitors are being pushed out, thus, freeing up additional market share for us and our expansion; and (2) an overall improved compliance by hall operators with applicable laws and regulations will ultimately improve the overall reputation of the pachinko industry as a whole, thus, potentially attracting new customers.

We believe our internal controls and procedures are effective, as: (1) our Japan Legal Adviser has confirmed that we have been in compliance in all material respects with all applicable Japan laws, rules and regulations during the Track Record Period and up to the Latest

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Practicable Date. See “— Legal Proceedings and Compliance” for details on our compliance with applicable laws and regulations, as confirmed by our Japan Legal Adviser; and (2) our AML Consultant has confirmed that nothing has come to their attention that causes them to believe that the AML controls put in place by us were not designed, implemented and operating in all material respects to achieve the internal control objectives for the period as stated in their report as set out in “Appendix IV — Summary of the Review of Anti-Money Laundering Procedures, Systems and Controls”.

### **Experienced and well-qualified management team with a strong track record in operating pachinko halls**

Our Executive Director and senior management team (including our Executive Officers) have extensive experience in operating pachinko halls in Japan. Mr. Taniguchi, our Chairman, Chief Executive Officer and Executive Director, is a son of our Founder, Mr. Tetsuyoshi TANIGUCHI (谷口哲義)<sup>#</sup> (also known as Mr. JEONG Bokyoung (鄭福鎔)) and has been with our Group for over 27 years, having previously headed a number of departments across our operations, such as human resources, hall development and sales. Mr. Taniguchi is also a director of the Pachinko-Trusty Board\* (一般社団法人パチンコ・トラスティ・ボード) and also the vice president, and the head of the Tohoku branch, of Nihon Yugi-kanren Jigyo Kyokai (Japan Amusement Business Association)\* (一般社団法人 日本遊技関連事業協会). Mr. Taniguchi has acquired extensive knowledge in a wide array of aspects in pachinko and pachislot hall operations.

Our business execution and day-to-day management are undertaken by our four experienced Executive Officers (which includes Mr. Taniguchi), who collectively possess expertise across the sales, corporate affairs, legal matters, financial control and general management functions in pachinko and pachislot hall operations. Our Executive Officers have an average of over 15 years of experience in pachinko and pachislot hall operations and have considerable experience and knowledge in their respective areas of responsibilities.

We have also appointed four Independent Non-executive Directors with extensive knowledge in finance and accounting, compliance and corporate governance. They will be invaluable to our future development as a listed company on the Stock Exchange.

See “Directors and Senior Management” for more details.

### **STRATEGIES**

We are one of the leaders in the pachinko industry and we aim to continue to strengthen our market position and further grow our business by pursuing the following strategies:

#### **Continue to leverage our strengths and expand our suburban halls network in Northeast Honshu (本州島東北) and to extend our leading market position**

Our suburban halls have always been our primary business focus and we currently expect them to continue to be so, primarily because we have a proven track record, as shown by our leading market position, in successfully operating and expanding our suburban hall operations in

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Northeast Honshu (本州島東北) (especially Fukushima Prefecture (福島県) and its neighbouring prefectures) in a cost-efficient and strategic manner in line with our centralised management strategy. For the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, our suburban halls generated revenue of ¥27,113 million, ¥29,342 million, ¥30,452 million and ¥13,968 million from pachinko and pachislot business, representing 91.5%, 91.9%, 92.3% and 91.9% of our revenue from pachinko and pachislot business, respectively. Also, according to EBI: (1) land costs (whether for acquisitions or leases) in suburban areas are lower than urban areas (which has allowed us to open relatively large halls which are usually more attractive to customers); (2) there are significantly more entertainment options in urban areas, such as cinemas, horse-racing and nightlife entertainment, which increases competition for urban pachinko halls; (3) the customer base in suburban areas is generally more stable as customers are typically self-employed (such as farmers and fishermen), factory workers and retirees, whose free time is more evenly dispersed throughout the day, while customers in urban areas are typically full-time employees, who have more choices in hall selection as halls in urban areas and usually in close proximity to each other; and (4) companies in Japan are increasingly looking to build industrial parks in less populated areas of Japan (such as suburban areas), mainly because there is sufficient land to construct larger buildings with ample parking space, which is ultimately expected to increase the working population (one of our target demographics for suburban halls) in these suburban areas. Therefore, we intend to exploit our competitive strengths to continue to improve the performance of, and to expand, our suburban hall network in Northeast Honshu (本州島東北) and ultimately to add to our leading market position.

In particular, we plan to open a total of seven suburban halls over the next three years. We believe that many opportunities for pachinko hall expansion continue to exist in Northeast Honshu (本州島東北), particularly in suburban areas. We believe this is so, despite the shrinking pachinko industry, because the resulting consolidation has pushed out smaller pachinko hall operators (thus, freeing up market share for us) due to competition from larger hall operators, such as ourselves, that have greater financial and other resources and are able to benefit from economies of scale, including operational cost efficiencies. This has especially been the case in Fukushima Prefecture (福島県) and its neighbouring prefectures, where our leadership position has also served as an increasingly effective barrier of entry. Our operational efficiencies and cost savings also allow us to successfully operate relatively large halls, which are generally more attractive to players and has helped capture the market share of smaller hall operators. See “— New Hall Development” in this section below for details.

These seven new suburban halls will share the same key features as our existing profit-making suburban halls, but will be even larger, typically featuring around 560 to 800 machines per hall. In particular, we expect to open a new hall in Fukushima Prefecture (福島県) by December 2015 with over 1,000 machines, which will become our largest hall and is expected to become one of the largest halls in Fukushima Prefecture (福島県). These new halls will be larger than the industry average and our Directors believe such large-scale halls will significantly help attract new player traffic, especially from our competitors' halls, due to such halls being spacious with an opulent atmosphere and increased choice of machines. Such halls will also allow us to reduce our overhead per machine. We will be able to utilise our economies of scale to operate such large halls in a cost-efficient manner.



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Breakeven period and investment payback period are useful indicators of the performance of a new hall. Breakeven period refers to the time required for the hall's monthly revenue (from pachinko and pachislot hall operations) to equal its monthly direct expense, while investment payback period refers to the time required for the hall's accumulated net profit to cover its opening costs and operating expenses incurred so far. Based on our past experience with opening new halls, the breakeven period is typically around four to ten months and investment payback period is around seven years. We expect the breakeven period and investment payback period for these seven new suburban halls to be similar. We plan to open these seven new suburban halls ourselves (as opposed to acquiring our competitors' halls), and we will lease the properties for these seven new suburban halls on terms similar to our existing leases, which last for around 10 to 20 years (being longer than the expected investment payback period of seven years).

### **Improve the performance of our urban halls**

As at the Latest Practicable Date, we operated nine urban halls. During the three years ended 31 March 2014, our revenue from pachinko and pachislot business per urban hall decreased at a CAGR of 5.2% while our revenue from pachinko and pachislot business per suburban hall increased at a CAGR of 3.5%. Also, during the year ended 31 March 2014, our revenue per machine for our suburban halls was 20.9% higher than that of our urban halls. The decrease of our revenue per urban hall was mainly due to the following reasons: (1) property space is limited and land acquisition and rental costs are much higher in urban areas, which have restricted us to opening relatively small urban halls (with only around 200 to 300 machines per hall, compared with our much larger suburban halls that currently have around 400 to 700 machines per hall) and are generally less welcoming to pachinko and pachislot players due to less choices of machines; (2) the entertainment industry in urban areas (especially Tokyo (東京都)) is much more competitive, with a higher concentration of not only our competitors' halls but also alternative forms of entertainment (such as cinemas, horse-racing and nightlife entertainment); and (3) the customer base is relatively unstable as customers are typically full-time employees, thus, their free time to play at our halls is generally limited to after office hours and may retreat to suburban areas during weekends and holidays.

Going forward, we intend to improve the performance of our urban hall network. First, we intend to close down two of our urban halls in Tokyo (東京都) by the end of 2015. These two halls have been loss-making, primarily due to low player traffic caused by their below-average hall size and the intense competition in the urban areas of Tokyo (東京都). To close these two halls, we expect to incur costs of ¥327 million (subject to negotiation), consisting of: (1) rent for the remaining term of the lease (being ¥289 million); and (2) restoration fees (being ¥38 million). Nevertheless, we expect the Group's financial performance to improve in the long run as these two halls show insufficient potential in generating positive financial results in the future. We will consider using the existing staff and machines for these halls (that are expected to be closed down) for either our existing halls or our new suburban halls to be opened in the next three years.

Second, for our remaining urban halls (which all have a positive cash flow), we believe there is strategic and financial value in continuing their operations, and we intend to improve their financial results through more effective marketing strategies, fine-tuning of the machine mixes



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and also minor hall renovations, in order to ultimately revitalise player interest and provide better playing experiences. We also intend to reduce these halls' operational costs by purchasing second-hand machines, which are significantly cheaper than new machines. Ultimately, our Directors expect to see improved results after the abovementioned steps are taken to enhance the performance of our urban halls.

### **Launch an online general prize redemption system**

We are currently considering launching an online system (through a potential joint venture), where customers can exchange balls or tokens obtained at our halls for general prizes. We believe that this online general prize redemption system will significantly help us in attracting more pachinko customers and also the pachinko industry as a whole. Primarily, we expect it to greatly improve the redemption rate of general prizes, which has historically been very low (as compared to G-prizes). For the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, the amount of redeemed general prizes was 1.0%, 0.9%, 0.9% and 1.3% of the total amount of redeemed prizes, respectively. We believe this low redemption rate of general prizes is due to the fact that G-prizes are much more flexible, as they can be sold by customers to independent G-prize buyers for cash. General prizes, on the other hand, are very limited in variety as their offerings are restricted by the actual physical space of our halls. For example, our halls currently only offer around 280 to 1,400 types (depending on the size of the hall) of daily convenience store goods.

Through an online system, our range of general prizes will no longer be limited to the physical space of our halls. This means we will be able to offer a significantly wider range in terms of both quantity and variety of goods (and significantly, not just the traditionally offered daily convenience store goods). The online system may also offer a delivery service for exchanged general prizes, providing high level of convenience for our customers. The selling price of such prizes will be within the maximum value stipulated under the Enforcement Ordinance (being ¥9,600 before consumption tax). Our Japan Legal Adviser has confirmed that this online general prize redemption system (as conceptualised so far) and our involvement with it are in compliance with applicable Japan laws and regulations.

### **Achieve greater cost savings through our centralised management strategy**

With our centralised operational and management structure, we will continue to strive for greater operational efficiencies and cost savings by standardising our pachinko halls in terms of branding, construction and procurement. Together with our strategy to expand within Northeast Honshu (本州島東北), we expect to benefit further from economies of scale in respect of cost savings through bulk purchases and efficient allocation of human resources. We believe that this strategy would help enhance our strong market position and eventually lead us to an even more dominant position in Northeast Honshu (本州島東北).

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### Continue to invest in our information technology system

We plan on consolidating certain software systems into an advanced integrated software system, with improved data-analysis functions and increased efficiency in information sharing and communication among our various departments. For example, an advanced integrated system will more efficiently circulate operational data collected in each hall to our purchasing department for making procurement decisions, and also simultaneously to our sales strategy department for analysis and budgeting. Further, we intend to upgrade our current Hall Management System in order to enhance our internal control by adding a new function that detects instances when a machine suddenly pays out an exceptionally high amount for our immediate attention. We will also consider adding a face-recognition function to our hall surveillance systems to detect previously caught or suspected cheaters.

### PACHINKO AND PACHISLOT HALL OPERATIONS

Our primary business has always been our pachinko and pachislot hall operations<sup>2</sup>. As at the Latest Practicable Date, we operated 55 pachinko halls in ten prefectures of Japan, all within Northeast Honshu (本州島東北), especially Fukushima Prefecture (福島県), Tokyo (東京都) and their neighbouring and conjoining prefectures. We have achieved growth in the number of our pachinko halls during the Track Record Period and up to the Latest Practicable Date. The table below shows the number of our operating halls as at the indicated dates:

	As at 31 March			As at	As at the
	2012	2013	2014	30 September	Latest
				2014	Practicable
					Date
Suburban .....	42	43	44	44	46
Urban .....	8	9	9	9	9
<b>Total</b> .....	<b>50</b>	<b>52</b>	<b>53</b>	<b>53</b>	<b>55</b>

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<sup>2</sup> Our revenue from our pachinko and pachislot business constituted almost all of our total revenue, namely 97.6%, 97.5%, 97.5% and 97.6% of our total revenue during the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014. Other than our core business of pachinko and pachislot hall operations (including vending machine income), we also have two other businesses, namely our hotel operations and also our "LIZARRAN" restaurant. See "— Other Businesses" in this section below for details of these other businesses.

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Our revenue from our pachinko and pachislot hall operations consists of: (1) revenue from our pachinko and pachislot business, which in turn represents gross pay-ins less gross payouts; and (2) vending machine income. The table below shows our revenue from our pachinko and pachislot hall operations during the Track Record Period:

	Year ended 31 March						Six months ended 30 September			
	2012		2013		2014		2013		2014	
	¥	%	¥	%	¥	%	¥	%	¥	%
	(in millions, except for percentages)									
	(unaudited)									
Revenue from pachinko and pachislot business . . . . .	29,628	97.6	31,919	97.7	32,994	97.9	15,992	97.8	15,191	98.1
Vending machine income . . . . .	724	2.4	748	2.3	704	2.1	362	2.2	301	1.9
<b>Revenue from pachinko and pachislot hall operations . . . . .</b>	<b>30,352</b>	<b>100.0</b>	<b>32,667</b>	<b>100.0</b>	<b>33,698</b>	<b>100.0</b>	<b>16,354</b>	<b>100.0</b>	<b>15,492</b>	<b>100.0</b>

The table below shows our revenue from pachinko and pachislot business during the Track Record Period:

	Year ended 31 March			Six months ended 30 September	
	2012	2013	2014	2013	
				(unaudited)	2014
	(¥, in millions)				
Gross pay-ins <sup>(1)</sup> . . . . .	224,968	242,217	236,449	120,674	90,989
Less: Gross payouts <sup>(2)</sup> . . . . .	(195,340)	(210,298)	(203,455)	(104,682)	(75,798)
<b>Revenue from pachinko and pachislot business<sup>(3)</sup> . . . . .</b>	<b>29,628</b>	<b>31,919</b>	<b>32,994</b>	<b>15,992</b>	<b>15,191</b>

(1) Represents the amount received from customers for rented pachinko balls and pachislot tokens.

(2) Represents the aggregate cost of G-prizes and general prizes exchanged by customers.

(3) Represents gross pay-ins less gross payouts.

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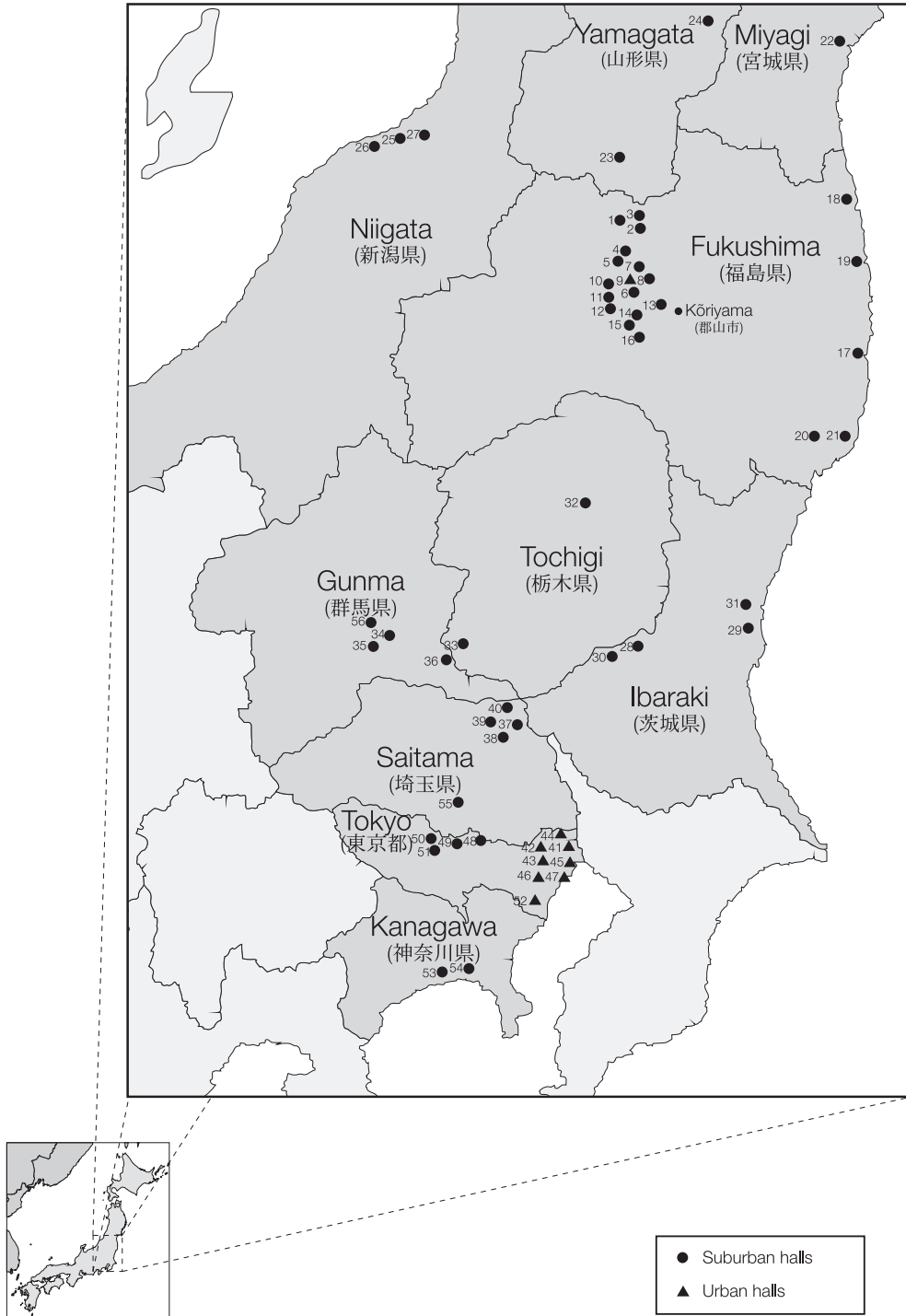
### Geographical Focus in Northeast Honshu (本州島東北)

All of our halls are located in Northeast Honshu (本州島東北). Our halls are spread across ten prefectures, namely:

1. in the Tōhoku Region (東北地方): Fukushima Prefecture (福島県), Miyagi Prefecture (宮城県) and Yamagata Prefecture (山形県);
2. in the Kantō Region (関東地方): Tokyo (東京都), Ibaraki Prefecture (茨城県), Gunma Prefecture (群馬県), Kanagawa Prefecture (神奈川県), Tochigi Prefecture (栃木県) and Saitama Prefecture (埼玉県); and
3. in the Chūbu Region (中部地方): Niigata Prefecture (新潟県).

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The below map shows the number of our pachinko halls as at the Latest Practicable Date:



*Note:* Hall number 17 in Fukushima Prefecture (福島県) has been permanently closed since the Great East Japan Earthquake as it is located within the exclusion zones implemented by the Japanese government in March 2011. See “— Pachinko and Pachislot Hall Operations — Fukushima Prefecture (福島県) and the Great East Japan Earthquake” in this section below for details.

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The table below shows a breakdown of our halls by type in each of these ten prefectures as at the Latest Practicable Date:

Prefecture	Number of operating halls		
	Suburban	Urban	Total
<b>Tōhoku Region (東北地方)</b>			
Fukushima Prefecture (福島県) . . . . .	19	1	20
Miyagi Prefecture (宮城県) . . . . .	1	—	1
Yamagata Prefecture (山形県) . . . . .	2	—	2
<b>Kantō Region (関東地方)</b>			
Tokyo (東京都) . . . . .	4	8	12
Gunma Prefecture (群馬県) . . . . .	4	—	4
Ibaraki Prefecture (茨城県) . . . . .	4	—	4
Kanagawa Prefecture (神奈川県) . . . . .	2	—	2
Saitama Prefecture (埼玉県) . . . . .	5	—	5
Tochigi Prefecture (栃木県) . . . . .	2	—	2
<b>Chūbu Region (中部地方)</b>			
Niigata Prefecture (新潟県) . . . . .	3	—	3
<b>Total</b> . . . . .	<b>46</b>	<b>9</b>	<b>55</b>

These ten prefectures had a total population of 47.4 million as at 31 December 2013 and a real GDP of ¥202.9 trillion in 2013, representing 37.7% and 38.6% of the total population as at 31 December 2013 and real GDP of Japan in 2013, respectively. The table below shows certain economic data with respect to the ten prefectures for the indicated dates and periods:

	2009	2010	2011	2012	2013	2014E	2015E	2016E	2017E	2018E	CAGR	
											2009 - 2013	2014E - 2018E
<b>Total population of the ten prefectures as at 31 December (thousands)</b> . . . . .	46,906	47,395	47,367	47,358	47,380	47,384	47,389	47,376	47,360	47,352	0.3%	0.0%
Percentage of total population of the ten prefecture out of that of Japan (%) . . . . .	37.3	37.5	37.5	37.6	37.7	37.8	37.8	37.9	38.0	38.0	N/A	N/A
<b>Total real GDP of the ten prefectures (¥ billion)</b> . . . . .	194,571	195,846	196,528	199,395	202,918	203,836	206,042	208,810	212,231	216,697	1.1%	1.5%
Growth rate of the total real GDP of the ten prefectures (%) . . . . .		0.7	0.3	1.5	1.8	0.5	1.1	1.3	1.6	2.1	N/A	N/A

Source: Japan Statistics Bureau and EBI

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As shown above, the total population of these ten prefectures has increased slightly. Further the total population of these ten prefectures has been taking up an increasingly larger proportion of the total population of Japan.

### **Fukushima Prefecture (福島県) and the Great East Japan Earthquake**

Fukushima Prefecture (福島県) is our most important strategic location, in which our headquarters, hotel and 20 of our halls (as at the Latest Practicable Date) are located. In particular, it is the prefecture with the most number of our halls and machines. Our halls in Fukushima Prefecture (福島県) accounted for 40.1%, 40.7%, 40.5% and 42.7% of our total revenue for the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, respectively.

In March 2011, the Great East Japan Earthquake struck the Tōhoku Region (東北地方), northeast of Japan. This earthquake triggered tsunami waves that struck the northeastern coast of Japan, and caused (among others) the nuclear power plant incident in Fukushima Prefecture (福島県), causing the lingering public concern over radiation levels.

As a result of the Great East Japan Earthquake, we recorded earthquake losses (namely, property damage) of ¥653 million for the year ended 31 March 2011. It caused us to temporarily suspend the operations of a majority of our halls, namely 32 halls, of which 11 halls were reopened within two weeks, 17 halls were reopened within four weeks, one hall was reopened within six weeks, two halls were reopened within eight weeks and one hall was reopened within 13 weeks. We also had to permanently close one hall (that was located within the exclusion zone in Fukushima Prefecture (福島県) implemented by the Japanese government). For this one permanently closed hall, we entered into alternative dispute resolution (namely, mediation of settlement before the Nuclear Damage Compensation Dispute Resolution Center\* (原子力損害賠償紛争解決センター), an administrative alternative dispute resolution institution established by the Japanese government specifically to deal with nuclear damage compensation claims arising from this nuclear power plant incident) with the operator of the affected nuclear plants, Tokyo Electric Power Company, Incorporated\* (東京電力株式会社), which compensated us ¥590 million (recorded as other income for the six months ended 30 September 2014), mainly for our loss of profits incurred during the one-year period after the Great East Japan Earthquake and also related property damages (including loss of all movables such as machines and islands). Our Directors are considering the most appropriate method to obtain compensation for loss of profits for subsequent years. Aside from this permanently closed hall, none of our halls is within the exclusion zones implemented by the Japanese government.

Further, our Directors have confirmed that we have not experienced any casualties or injuries as a result of the Great East Japan Earthquake.

On 22 December 2014, the Tokyo Electric Power Company, Incorporated\* (東京電力株式会社) announced the on-schedule completion of the first major advancement towards the decommissioning of the relevant nuclear power plant. All fuel assemblies had been removed from one of the four damaged reactor buildings, resulting in a significantly safer environment for workers and surrounding communities, according to the operator's president and chief executive



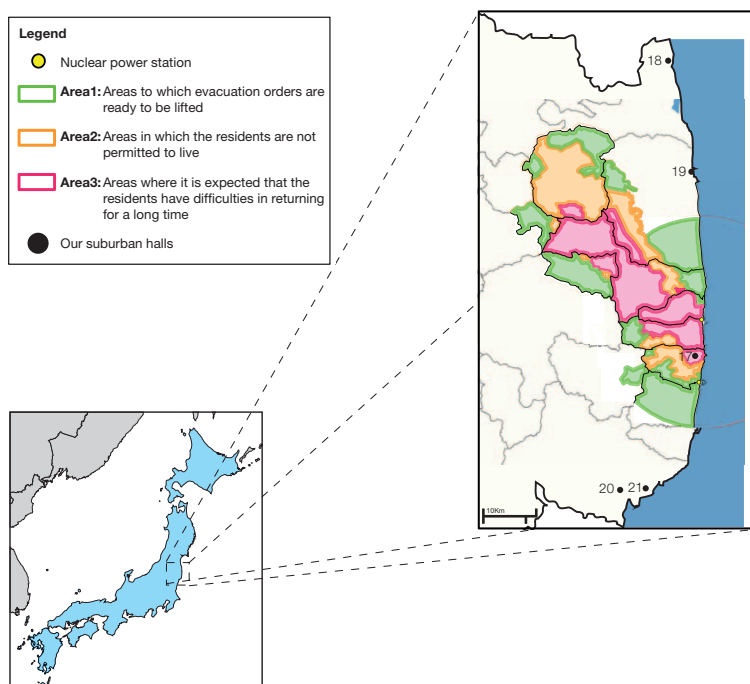
officer. Fuel removal operations have shifted towards the remaining three damaged reactor buildings. Further, a reputable scientific journal published a report in early 2014 on the radiation in certain areas neighbouring the exclusion zones. The average radiation dose rate in 2012 and the projected average radiation dose rate in 2022 are both similar to the average background radiation exposure in Japan. Further, a detectable increase in cancer risk from 2012 onwards is unlikely.

**Exclusion zones stipulated by the Ministry of Economy, Trade and Industry of Japan (経済産業省)**

In response to the Great East Japan Earthquake, the Ministry of Economy, Trade and Industry of Japan (経済産業省) stipulated exclusion zones on 22 April 2011 with three degrees of severity, namely areas where (from most severe to least severe): (1) it is expected that residents will have difficulties in returning for a long time; (2) the residents are not permitted to live; and (3) evacuation orders are ready to be lifted. Since the implementation of such exclusion zones, the Ministry of Economy, Trade and Industry of Japan\* (経済産業省) has gradually reduced the size of such zones twice, namely on 1 April 2014 and 1 October 2014.

We only own one hall that is located within these exclusion zones, which, as mentioned above, has been permanently closed since the Great East Japan Earthquake. Our next closest hall (to these exclusion zones) is already located at least five kilometres outside of the least severe exclusion zone (areas where evacuation orders are ready to be lifted).

The below map shows the coverage of these three exclusion zones as at the Latest Practicable Date, including the location of our halls in Fukushima Prefecture (福島県):



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### ***Effect of the Great East Japan Earthquake on the working population and financial results of our halls in Fukushima Prefecture (福島県)***

According to statistics published by the Fukushima Prefectural Government (福島県庁), the working population (including part-time employees) in Fukushima Prefecture (福島県) as at 31 December 2011 recorded a decrease of 6.6% to 598,006 as compared to 31 December 2010. This was mainly due to a decrease in women with part-time jobs as many chose to leave the prefecture in order to avoid the aftermath of the earthquake. However, by 31 December 2012, the working population had already sharply rebounded, increasing by almost 10% to 652,725 as compared to the same time last year. In fact, by 31 December 2012, the working population had already exceeded the level preceding the Great East Japan Earthquake by 2.0%, and by 31 December 2013, the working population had increased to 655,479. The increase in working population was mainly due to a surge in male workers (primarily in the manufacturing, construction and logistics industries) and also female workers (primarily in welfare and catering service) as part of the post-earthquake recovery efforts.

	<b>Before the Great East Japan Earthquake</b>	<b>After the Great East Japan Earthquake</b>		
	<b>31 December 2010</b>	<b>31 December 2011</b>	<b>31 December 2012</b>	<b>31 December 2013</b>
Working population of Fukushima Prefecture (trailing 12-month average) . . . . .	640,221	598,006	652,725	655,479
Percentage change of working population of Fukushima Prefecture since 31 December 2010 (%) . . . . .	N/A	-6.6	2.0	2.4

*Source: Fukushima Prefectural Government (福島県庁)*

Ultimately, the increases in working population have improved the business performance of our halls located in Fukushima Prefecture (福島県) by increasing our player traffic. For the three years ended 31 March 2012, 2013 and 2014, the revenue from pachinko and pachislot business of these halls amounted to ¥11.9 billion, ¥13.0 billion and ¥13.4 billion, respectively, and represented a CAGR of 6.0%. In fact, our halls located in Fukushima Prefecture (福島県) have become increasingly important to our financial results since the earthquake, having represented 40.1%, 40.7%, 40.5% and 42.7% of the total revenue from pachinko and pachislot business of all our halls for the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, respectively. Further, operating profit attributable to our halls located in Fukushima Prefecture (福島県) also increased over the Track Record Period, having represented 51.1%, 54.6%, 55.9% and 59.7% of our total operating profit for the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, respectively. Ultimately, as a result of the Great East Japan Earthquake, our revenue was not negatively impacted (and actually improved compared to the financial year preceding the earthquake), while our profit was

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negatively impacted only for the year ended 31 March 2011 (being the year of the earthquake), after which it had already rebounded to levels exceeding that of the financial year preceding the earthquake.

### Gaming Experience

Our pachinko halls provide a venue for customers to play two types of recreational arcade games, namely pachinko and pachislot. These games are played as follows:

#### **1. Obtaining pachinko balls or pachislot tokens**

Pachinko balls are used to play pachinko games, while pachislot tokens are used to play pachislot games.

Our pachinko and pachislot games may be played for different ball or token rental rates. We have pachinko machines with playing costs of ¥0.5, ¥1, ¥1.25, ¥2 and ¥4 and pachislot machines with playing costs of ¥2, ¥5, ¥10 and ¥20 in our halls<sup>3</sup>. For example, for ¥1,000, a customer may obtain 250 ¥4 pachinko balls to play or 50 ¥20 pachislot tokens to play.

To obtain pachinko balls or pachislot tokens, a player initially inserts cash into the game machine. The player can then purchase pachinko balls in ¥500 blocks or pachislot tokens in ¥1,000 blocks out of such cash balance and put the balls or tokens into play.

When the player finishes playing that particular machine, any unutilised cash, balls or tokens can be stored either in: (1) an IC card, which will be ejected from the machine; or (2) a membership card inserted by the player at the beginning of play. See “— Marketing and Market Research — Membership system” in this section below for details on our membership cards.

These IC and membership cards can then be: (1) re-inserted into machines in the same hall to utilise any stored cash, balls or tokens; (2) inserted into the cash changer to redeem any remaining cash balance before such card's expiry; or (3) handed over to our staff in the same hall to exchange the remaining balance of balls or tokens into prizes.

For IC cards, any stored balls or tokens can only be used on the same day the card is issued, while any cash balance will be forfeited 21 days after the card is issued (in line with market practice). Unutilised cash stored in IC cards are accounted for as other payables and is recognised as gross pay-ins when the player uses it to purchase balls or tokens. Any forfeited

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<sup>3</sup> Some of our halls may require the customer to absorb the consumption tax. For these halls, playing costs for pachinko machines are ¥0.54, ¥1.08, ¥2.16 and ¥4.32, while playing costs for pachislot machines are ¥5.4, ¥10.8 and ¥21.6. Our Japan Legal Adviser has confirmed that such arrangements are in compliance with the Amusement Business Law and the Enforcement Ordinance.

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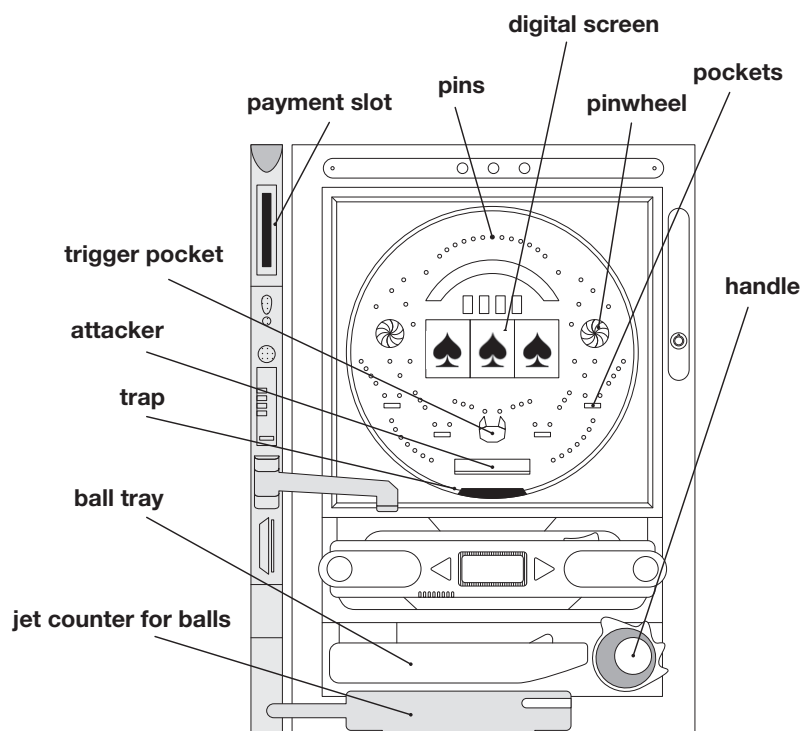
cash balance is recognised as other income, which accounted for less than 0.02% of our gross pay-ins during the Track Record Period. See “Financial Information – Results of Operations of our Group – Description of Components of Results of Operations – Gross pay-ins” for details on unused amounts on IC cards.

The number of our pachinko halls has grown during the Track Record Period, which also meant a corresponding increase in the number of our pachinko and pachislot machines. The table below shows the number of our pachinko and pachislot machines as at the indicated dates:

	As at 31 March						As at 30 September	
	2012		2013		2014		2014	
	(number of machines, except for percentages)							
		%		%		%		%
Pachinko . . . . .	16,551	69.3	17,160	68.3	17,575	67.9	17,562	67.3
Pachislot . . . . .	<u>7,321</u>	<u>30.7</u>	<u>7,981</u>	<u>31.7</u>	<u>8,313</u>	<u>32.1</u>	<u>8,542</u>	<u>32.7</u>
<b>Total . . . . .</b>	<b><u>23,872</u></b>	<b><u>100.0</u></b>	<b><u>25,141</u></b>	<b><u>100.0</u></b>	<b><u>25,888</u></b>	<b><u>100.0</u></b>	<b><u>26,104</u></b>	<b><u>100.0</u></b>

### 2. *Playing pachinko or pachislot*

#### *Pachinko*



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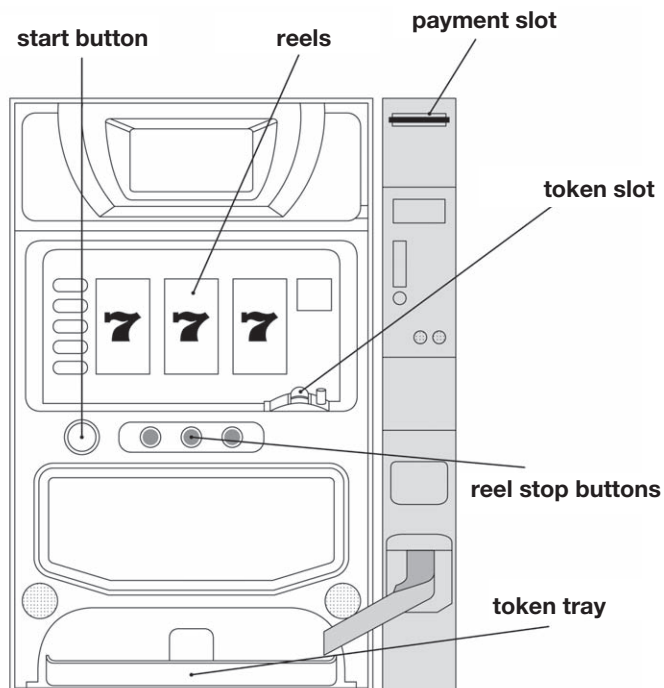
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A pachinko machine resembles a vertical pinball machine (but without pinball flippers and with a large number of playing balls). The objective is to collect as many pachinko balls as possible, in order to exchange them for prizes in our halls. Upon inserting cash, an IC card or the membership card into the payment slot adjacent to the machine, a number of small metal pachinko balls is dispensed into the ball tray located near the bottom of the machine. The player fires the balls into the playing field in rapid succession, while controlling the velocity of the pachinko balls by turning a handle located next to the tray. The key is to find the proper shooting strength, as turning the handle too far sends the pachinko balls straight into the exit chute and the balls will be forfeited, while not turning the handle far enough will not cause the balls to launch into the playing field.

Once shot into play, the pachinko balls cascade down through the dense array of pins in the playing field. Pachinko balls will either fall into: (1) the single trap at the bottom of the playing field and such pachinko balls will be lost; or (2) the pockets located along the bottom of the playing field, which in turn trigger the release of more pachinko balls into the ball tray, that can be placed back into play or exchanged for prizes.

There is typically one pocket near the bottom of the playing field, a “trigger” pocket, which causes images arranged in multiple columns on the digital screen in the centre of the playing field to spin, similar to the reels in a slot machine. Each spin pays out a small number of balls. If the spins produce a winning combination of images on-screen, the “jackpot” mode commences that opens a larger pocket in the playing field (the “attacker”) for a limited time. Each ball that lands in the “attacker” during this “jackpot” mode pays out a large predetermined number of pachinko balls.

### *Pachislot*



A pachislot machine is similar to a traditional slot machine, with three reels of different images in playing field. The objective of pachislot is to collect more tokens by stopping the spinning reels such that the images on each reel match up to form a winning combination. To play, as with pachinko machines, a player inserts cash, an IC card or a membership card into the payment slot adjacent to the machine, and a number of tokens to be used in the game will be dispensed into the tray near the bottom of the machine. The player inserts tokens into the machine presses the start button, which causes the three reels to begin to spin. While the reels are spinning, the player presses the stop button under each reel to stop the corresponding reel. If, after the three reels have been stopped, two or more of the pictures match up, the player wins more tokens that are dispensed into the token tray. If none of the pictures on the three reels matches up, the tokens played are lost.

### 3. *Redeeming Prizes*

Both games end when the player either runs out of pachinko balls or pachislot tokens, or simply stops playing. Each machine may have its own theme or enhancing features such as a display screen that shows short video clips during play for added entertainment, in order to provide the player with a more entertaining gaming experience.

Once a customer has finished playing, the pachinko balls or pachislot tokens collected by them must be returned to the pachinko hall and cannot be used in other halls. The pachinko hall will count such balls or tokens and issue a receipt to the player showing the number collected. The player may then take this receipt to claim prizes at the prize exchange counter within the pachinko hall (and operated by the hall operator), similar to exchanging tickets won at a carnival for prizes. The number of balls or tokens required to exchange for prizes vary by location and the market value of such prizes. Generally, prizes must be claimed on the same day the receipt is issued as the receipt is only valid on its issue date. See “— Marketing and Market Research — Membership system” in this section below for information on carrying over unused balls for subsequent visits.

Prizes provided by our pachinko halls consist of:

- a. **General prizes.** These are typically the types of daily goods sold in convenience stores, including cigarettes, food and snacks, household goods and drinks. Our halls offer a selection of around 280 to 1,400 types of general prizes, with the number and variety varying based on the size of the hall. Our suburban halls are larger (and offer more types of general prizes) than our urban halls. The dominant category of our general prizes on offer is food and snacks, which includes an array (namely, 22 items) of our private brand products manufactured by our private label manufacturers.

The value of pachinko balls or pachislot tokens required to redeem general prizes is determined with reference to suggested retail prices from the prize supplier. Regulations set the upper limit of the value of all prizes at ¥9,600 (before consumption tax). For more information, see “Applicable Laws and Regulations D. Other Regulations on Pachinko Businesses — 5. Playing Costs, Prize Offerings and Prize Value”. We realise a margin on general prizes where the monetary value of the number of balls or

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tokens required to collect a general prize exceeds that of our purchase price for such general prize. During the Track Record Period, our general prize (excluding our private brand products) mark-up ranged from 18% to 25%, while our private brand product mark-up was higher, ranging from 43% to 46%. Our Directors have confirmed that there was no material change in our general prize mark-ups (including our private brand products) during the Track Record Period and up to the Latest Practicable Date.

Our Japan Legal Adviser has confirmed that such mark-ups on our general prizes are legal and valid under applicable Japan laws and regulations.

- b. **G-prizes.** These are decorative cards with a small embedded piece of metal (such as gold) or coin-shaped pendants of metal (such as gold), and can be subsequently sold by players to independent G-price buyers for cash.

The value of pachinko balls or pachislot tokens required to redeem G-prizes varies depending on location as well as the playing cost of the machine played, generally corresponding to a mark-up over the price (paid by us to our G-prize wholesalers for the G-prizes). Therefore, similar to general prizes, we sometimes realise a margin on G-prizes due to the G-prize mark-up, where the monetary value of the number of balls or tokens required to exchange a G-prize exceeds that the cost we paid for such G-prize. During the three years ended 31 March 2014, our G-prize mark-up was nil, while during the six months ended 30 September 2014 (specifically, since 1 April 2014), our G-prize mark-up ranged from 4% to 20% (with an average of 10%). See “Financial Information — Results of Operations of Our Group — Description of Components of Results of Operations — Gross payouts” for details on the material changes in our G-prize mark-ups during the Track Record Period and up to the Latest Practicable Date, and also the expected impact on our operational and financial results.

G-prizes make up virtually all of the value of prizes exchanged by customers. The table below shows the value of G-prizes and general prizes exchanged by customers during the indicated periods:

	Year ended 31 March						Six months ended 30 September			
	2012		2013		2014		2013		2014	
	(in millions, except for percentages)									
	¥	%	¥	%	¥	%	¥	%	¥	%
G-prizes . . . . .	193,351	99.0	208,288	99.1	201,708	99.1	103,706	99.1	74,508	98.3
General prizes. . . . .	1,950	1.0	1,989	0.9	1,852	0.9	961	0.9	994	1.3
Others <sup>(Note)</sup> . . . . .	39	0.0	21	0.0	(105)	0.0	15	0.0	296	0.4
<b>Total . . . . .</b>	<b>195,340</b>	<b>100.0</b>	<b>210,298</b>	<b>100.0</b>	<b>203,455</b>	<b>100.0</b>	<b>104,682</b>	<b>100.0</b>	<b>75,798</b>	<b>100.0</b>

Note:

Others mainly represent the movements of balances of unutilised balls and tokens during the year/period. See “Financial Information — Financial Metrics of our Business”.



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Our Japan Legal Adviser has confirmed that such exchange of G-prizes and such G-prize mark-ups are legal and valid under applicable Japan laws and regulations.

In accordance with the Amusement Business Law and its ancillary prefectural local regulations, we strictly do not exchange any pachinko balls or pachislot tokens for cash or securities in any of our halls. However, customers are free to further sell their G-prizes to an independent G-prize buyer (not located in our halls) for cash.

Further, as advised by our Japan Legal Adviser, Japan laws or regulations do not restrict customers from purchasing balls or tokens and then directly exchanging them for prizes without playing. However, such acts are prohibited under our internal AML policies and procedures. Our hall staff perform regular monitoring of customers during operation hours to identify (among others) customers exchanging prizes without playing. Further, at the end of each day, our hall managers compare the ratio of the number of balls played to the number of balls rented at the pachinko hall with historical figures. If abnormal values are detected, our hall manager will instruct hall staff to review surveillance camera footage of the day to identify any customers that exchanged prizes without playing. Hall staff will also pay special attention to customers on the next day to identify such suspicious activity. If a customer is identified to be exchanging prizes without playing and does not cease to do so after being asked, such act will immediately be reported to the police. We may also request such customer to immediately leave the premises and refuse the exchange of balls or tokens earned without playing. No such incident was discovered during the Track Record Period and up to the Latest Practicable Date. In any event, customers should have no (or less) incentive to exchange balls or tokens for prizes without playing, as they will suffer immediate monetary losses due to the various prize mark-ups imposed by us.

### **Three Party System**

Under the Amusement Business Law (and its ancillary prefectural local regulations), pachinko hall operators must not be involved in the exchange of prizes for cash or securities by either: (1) providing cash or securities as prizes; or (2) repurchasing from customers the prizes provided to them for cash or securities. In order to ensure compliance with (among others) these restrictions, we operate our pachinko and pachislot hall operations (regarding the sale and purchase of G-prizes exchanged by a customer by playing at our halls) in accordance with an established industry practice commonly referred to as the “Three Party System”. For a detailed description of the laws and regulations relating to pachinko and pachislot hall operations, see “Applicable Laws and Regulations”.

### **Parties**

The parties under the “Three Party System” consist of:

1. **Pachinko hall operators.** These operate pachinko halls that provide pachinko and pachislot games, and also purchase G-prizes from G-prize wholesalers. Customers can play these games and exchange their balls or tokens in these halls for prizes, such as G-prizes;

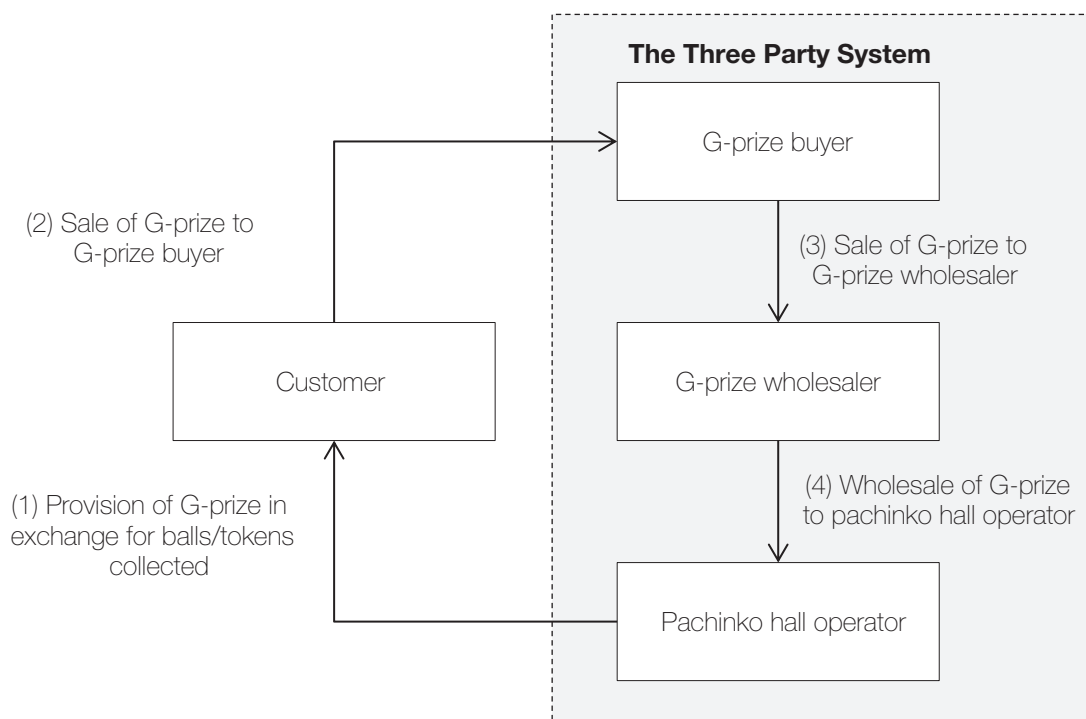
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2. **G-prize buyers.** These are typically companies or sole proprietorships. Customers can, but are not obliged to, sell their G-prizes (that they obtained from pachinko halls) to them for cash. G-prize buyers will then further sell these G-prizes to G-prize wholesalers; and
3. **G-prize wholesalers.** These are typically companies and they purchase G-prizes from G-prize buyers, and then further sell them to pachinko hall operators.

The diagram below shows the general flow of G-prizes within the Three Party System and with customers:



While the purchase price for transactions marked (2), (3) and (4) in the above diagram are generally similar, our G-prize wholesalers also typically receive a monthly fee from us and G-prize buyers also typically receive a monthly fee from the relevant G-prize wholesaler, for their respective services rendered for such relevant transactions. Consistent with industry practice, the monthly fee paid by us to G-prize wholesalers is greater than that paid by G-prize wholesalers to their G-prize buyers. See “— Pachinko and Pachislot Hall Operations — Three Party System — Agreements between us and G-prize wholesalers” and “— Pachinko and Pachislot Hall Operations — Three Party System — Agreements between G-prize wholesalers and G-prize buyers” in this section below. As for transaction (1), depending on the location of the hall and competition in that area, a mark-up on the G-prizes (set by the pachinko hall operator) may be added over the purchase price of the G-prize paid by the pachinko hall operator to the G-prize wholesaler, when the customer exchanges his balls or tokens for G-prizes. For instance, assuming a 10% G-prize mark up, a customer will need 1,100 ¥1 balls to exchange a G-prize with a cost of ¥1,000 from the operator.

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Further, G-prize wholesalers may purchase G-prizes from various G-prize buyers, and they may also sell G-prizes to various pachinko hall operators if the G-prize is of the same type in design and appearance. As such, all the G-prizes purchased by the wholesaler from multiple G-prize buyers are commingled, meaning that the G-prizes that are sold to the pachinko hall by the wholesaler are not necessarily the same G-prizes provided by the pachinko hall to its customers.

### ***Independence***

Under the Three Party System, pachinko hall operators (such as ourselves), must be independent of each of the: (1) G-prize wholesalers engaged by them; and (2) G-prize buyers engaged by their G-prize wholesalers. This ensures that, from the pachinko hall operators' perspective, G-prize wholesalers and G-prize buyers are unrelated third parties from the pachinko hall operator.

#### *Independence between pachinko hall operators and G-prize wholesalers*

A G-prize wholesaler is independent and an unrelated third party to the pachinko hall operator if:

1. neither party may have the ability to exercise control, whether directly or indirectly, over the other, through (i) any relationship or connection between the personnel of the pachinko hall operator and the G-prize wholesaler, (ii) any equity holding or any other capital relationship or connection between the pachinko hall operator and the G-prize wholesaler, or (iii) any contract or other agreement between the pachinko hall operator and the G-prize wholesaler; and
2. G-prizes to be purchased are of market value, meaning that G-prizes must have intrinsic value (which can be satisfied by the metal (such as gold) embedded in the G-prize).

Each of these factors is satisfied with respect to all of our pachinko halls.

Our Japan Legal Adviser, after conducting due diligence as described in “— Pachinko and Pachislot Hall Operations — Three Party System — Independence — Due diligence conducted by our Japan Legal Adviser and the Sole Sponsor” in this section below, has also determined that each of our pachinko halls is independent as evaluated under the factors listed above from each of our G-prize wholesalers.

#### *Independence between pachinko hall operators and G-prize buyers*

A G-prize buyer is independent and an unrelated third party to the pachinko hall operator if:

1. neither party may have the ability to exercise control, whether directly or indirectly, over the other, through (i) any relationship or connection between the personnel of the

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G-prize buyer and the pachinko hall operator, (ii) any equity holding or any other capital relationship or connection between the G-prize buyer and the pachinko hall operator, or (iii) any contract or other agreement between the G-prize buyer and the pachinko hall operator;

2. G-prizes to be purchased are of market value, meaning that G-prizes must have intrinsic value (which can be satisfied by the metal (such as gold) embedded in the G-prize); and
3. G-prizes are not directly returned from or sold by the G-prize buyer to the pachinko hall operator (but, for example, are instead sold by the G-prize buyer to a G-prize wholesaler who in turn commingles the G-prizes that it has purchased from multiple sources (including other G-prize buyers), thus, making it impossible to identify which hall the G-prizes came from).

Each of these factors is satisfied with respect to all of our pachinko halls.

Our Japan Legal Adviser, after conducting due diligence as described in “— Pachinko and Pachislot Hall Operations — Three Party System — Independence — Due diligence conducted by our Japan Legal Adviser and the Sole Sponsor” in this section below, has confirmed that each of our pachinko halls is independent as evaluated under the factors listed above from each of the G-prize wholesalers (engaged by us) G-prize buyers (engaged by such G-prize wholesalers).

### *Our internal control procedures to ensure our independence*

We have obtained written confirmations issued to us and the Sole Sponsor from all our current G-prize wholesalers regarding their independence (based on criteria even stricter than that set out above) from: (1) us; and (2) any G-prize buyers engaged by them who have G-prize buying shops near our halls. These confirmations also covered the following matters:

- a complete and accurate list of all G-prize buyers engaged by them who have G-prize buying shops near our halls;
- to the best of their knowledge, the content of the confirmations issued by such G-prize buyers (as described below) to us and the Sole Sponsor is true and accurate;
- written undertakings to conduct their own regular background checks against any G-prize buyers engaged by them in order to monitor any independence issues between such G-prize buyers and themselves, and if these G-prize wholesalers become aware of any such independence issues, they will inform us and resolve such issues immediately in order to ensure compliance with the Three Party System;

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- written undertakings to report to us in a timely manner any change in their shareholding structure and composition of their board of directors, or if they become aware of any change in the shareholding structure or composition of the board of directors of any G-prize buyers engaged by them or any other matters that may affect their independence or the independence of such G-prize buyers within the Three Party System; and
- to the best of their knowledge, they are not aware that any such G-prize buyers are anti-social forces, or are or will be involved in any actions or activities using, or jointly associate with, any anti-social force. Further, neither they nor any of their representatives, directors, statutory auditors, executive officers or shareholders are anti-social forces, or are or will be involved in any actions or activities using, or jointly associate with, any anti-social force.

We have obtained written confirmations issued to us and the Sole Sponsor from all such G-prize buyers regarding their independence (based on criteria even stricter than that set out above) from: (1) us; and (2) any G-prize wholesalers engaged by us. These confirmations also covered the following matters:

- neither they nor any of their representatives, directors, statutory auditors, executive officers or shareholders are anti-social forces, or are or will be involved in any actions or activities using, or jointly associate with, any anti-social force;
- to the best of their knowledge, they are not aware that any such G-prize wholesalers are anti-social forces, or are or will be involved in any actions or activities using, or jointly associate with, any anti-social force; and
- they have undertaken to the G-prize wholesaler that engages them that they shall report to such G-prize wholesaler in a timely manner any change in their shareholding structure or composition of board of directors or any other matters that may affect their independence within the Three Party System.

We have also obtained through our current G-prize wholesalers a list of the shareholders of the G-prize buyers engaged by them.

We will require our G-prize wholesalers to re-issue, and to request their G-prize buyers to re-issue, these confirmations to us every year.

In addition, we have also adopted the following internal control procedures to ensure the independence of our pachinko halls from each of our G-prize wholesalers and G-prize buyers engaged by them:

- we regularly obtain from each of our G-prize wholesalers a list of the shareholders (or ultimate owners) and directors of both themselves and the G-prize buyers engaged by them;

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- we will annually obtain commercial registers of all our G-prize wholesalers and the G-prize buyers engaged by them (provided that they are legal corporate entities) to review the composition of their board of directors;
- we will engage independent third parties to perform annual searches on the shareholding structure and list of directors (if available) for all of our G-prize wholesalers and G-prize buyers engaged by them;
- we require our Directors, senior management and Shareholders to confirm that they are independent of our G-prize wholesalers and such G-prize buyers (based on the criteria set out above), and to notify us immediately if they become aware of any potential independence issues;
- we will provide training on the Three Party System to our employees on a regular basis to ensure that they do not engage with G-prize wholesalers or G-prize buyers engaged by them, and to prevent them from unknowingly establishing a relationship with them. For example, all our Directors and senior management attended a training conducted by our Japan Legal Adviser in December 2014 on the legal, regulatory and practice requirements under the Penal Code, the Amusement Business Law and the Third Party Local Regulation, including the independence requirements within the Three Party System;
- we require that none of our management, Directors or staff are engaged in the G-prize buying business; and
- as our pachinko and pachislot hall operations are monitored by the Prefectural Public Safety Commission\* (都道府県公安委員会) in each relevant prefecture, in order to prevent any conflicts of interest that might otherwise arise and for improved corporate governance, none of our Directors or senior management has been, or is, a police officer in Japan and we require them to confirm so to us.

For our internal control procedures in relation to potential new G-prize wholesalers, see “— Pachinko and Pachislot Hall Operations — Three Party System — Risk management” in this section below.

### *Due diligence conducted by our Japan Legal Adviser and the Sole Sponsor*

Our Japan Legal Adviser and Sole Sponsor has conducted the following due diligence regarding our independence from each of our G-prize wholesalers and the G-prize buyers engaged by them:

- hosted a training session conducted by our Japan Legal Adviser in December 2014 for all our Directors and senior management on the legal, regulatory and practice requirements under the Penal Code, the Amusement Business Law and the Third Party Local Regulations, including the independence requirements within the Three Party System;

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- obtained confirmations issued to us and the Sole Sponsor from our Directors and senior management regarding (among others) their attendance and understanding of the relevant legal, regulatory and practice requirements (including on independence) explained at the above training session;
- obtained confirmations issued to the Sole Sponsor from our Company, Directors, Shareholders and senior management regarding (among others) the Group's and their independence from each of our G-prize wholesalers and the G-prize buyers (engaged by our G-prize wholesalers);
- interviewed all our Directors and senior management regarding (among others) their understanding of the relevant legal, regulatory and practice requirements (including on independence) explained at the above training session, their relationship(s) with our G-prize wholesalers and also the G-prize buyers (engaged by our G-prize wholesalers), and ultimately to confirm the Group's and their independence from each such party;
- interviewed our G-prize wholesalers (through their legal representative, a director or other responsible management personnel), regarding (among others) their relationship(s) with our Group and also the G-prize buyers (engaged by them), and ultimately to confirm their independence from each such party;
- interviewed the G-prize buyers (engaged by our G-prize wholesalers) (through their legal representative, a director or other responsible management personnel) regarding (among others) their relationship(s) with our Group and also our G-prize wholesalers, and ultimately to confirm their independence from each such party;
- reviewed all agreements between us and our G-prize wholesalers, namely purchase agreements for G-prizes, lease agreements and purchase agreements for miscellaneous goods and services. See “— Agreements between us and G-prize wholesalers” above for details on such agreements, including our Japan Legal Adviser's confirmation that such agreements do not affect our independence;
- reviewed the confirmations issued to us and the Sole Sponsor from all of our G-prize wholesalers and the G-prize buyers (engaged by our G-prize wholesalers) (except for those engaged in relation to our one hall that has been permanently closed due to the Great East Japan Earthquake) regarding (among others) their independence within the Three Party System. See “— Pachinko and Pachislot Hall Operations — Three Party System — Our internal control procedures to ensure our independence” for details of these confirmations;
- reviewed all commercial registers of our G-prize wholesalers and such G-prize buyers (engaged by our G-prize wholesalers) that are corporations in order to identify (among others) to identify any overlap of directors; and
- obtained a list of the Group's representatives, directors, statutory auditors, executive officers and shareholders through the Group's commercial registers and share registers.



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### ***Legality of our pachinko and pachislot hall operations and the Three Party System***

Our Japan Legal Adviser, having conducted due diligence described above and reviewed the relevant court cases, governmental statements and practices, has advised us that:

1. the National Police Agency has never taken any action against the legality of the pachinko industry, as a whole, under the Penal Code, the Amusement Business Law, the Third Party Local Regulations or otherwise;
2. as long as our pachinko and pachislot hall operations are conducted under the Three Party System, in accordance with prevailing standard industry practices in the pachinko industry, and the independence factors described above are satisfied, our pachinko and pachislot hall operations will not violate the Penal Code, the Amusement Business Law or the Third Party Local Regulations;
3. our pachinko and pachislot hall operations (as carried out in the context of the Three Party System) do not contravene the Penal Code, the Amusement Business Law, the Third Party Local Regulations or any of the operating licences of our halls; and
4. as at the Latest Practicable Date, we have not been found to be in any material breach of the Penal Code, the Amusement Business Law, the Third Party Local Regulations or any of the operating licences of our halls.

### ***Agreements between us and G-prize wholesalers***

Our business with the G-prize wholesalers is generally based on: (1) a purchase agreement for G-prizes; and (2) for around half of our suburban halls, a lease agreement for certain premises on the parcel of land where the relevant pachinko hall is located. For a few G-prize wholesalers, we may also enter into other purchase agreements for miscellaneous matters such as general prizes and vending machines.

***Purchase agreements for G-prizes.*** We enter into one master continuous purchase and supply agreement with each G-prize wholesaler, and also generally memorandum(s) as ancillary agreement(s) to such master agreement which will include separate commercial terms (such as the cost of G-prizes) for each hall. These agreements are generally valid for one year and automatically renewed on an annual basis. Under these agreements, we generally purchase G-prizes daily from the G-prize wholesaler for cash (typically settled upon delivery). In addition, we typically pay them a fixed monthly fee and/or a variable monthly fee calculated at around 1% of the total cost of the G-prizes purchased that month.

***Lease agreements.*** We enter into lease agreements for around half of our suburban halls. Under these, the G-prize wholesaler is restricted to use of the premises as office space and may not, without our prior approval, change the existing buildings or construct new buildings. We

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lease multiple premises under separate lease agreements with the same G-prize wholesaler. These leases generally last for a term of one year, with automatic annual renewals unless we or the G-prize wholesaler objects. We may also terminate the agreement at our option upon any breach by the G-prize wholesaler of any provisions of the agreement.

***Purchase agreements for miscellaneous goods/services.*** For a few of our G-prize wholesalers, we also enter into purchase agreements for general prizes, such as foods, and also vending machines.

According to our Japan Legal Adviser, the various agreements that we have entered into with our G-prize wholesalers do not contravene the Amusement Business Law or the various relevant local regulations established by prefectural governments that prohibit pachinko hall operators from causing third parties to repurchase G-prizes from customers, as these arrangements do not affect our independence (i.e. do not allow us and the G-prize wholesalers either direct or indirect control over each other).

### ***Agreements between G-prize wholesalers and G-prize buyers***

To the best of our Directors' knowledge and belief, G-prize wholesalers and G-prize buyers also typically agree between themselves two similar agreements: (1) a purchase agreement for G-prizes; and (2) a lease agreement for a portion of the same parcel of land leased by us (for around half of our suburban halls) to the G-prize wholesaler.

***Purchase agreements for G-prizes.*** Each G-prize wholesaler and G-prize buyer also enters into an arrangement under which the G-prize wholesaler purchases G-prizes from the G-prize buyer for cash on a daily basis, at a price equivalent to that paid for G-prizes by the G-prize buyer to playing customers, and also by the hall operator (such as ourselves) to the G-prize wholesaler. In addition, the G-prize wholesalers also pay a fixed monthly fee to the G-prize buyers for their prize buying services, which allows the G-prize buyers to sustain their operations and to earn a profit.

***Lease agreements.*** These allow the G-prize buyer to establish a presence on the property leased from us (for around half of our suburban halls) by the G-prize wholesaler, where customers may sell their G-prizes for cash. These arrangements between the G-prize wholesaler and G-prize buyer are common in the pachinko industry. To the best of our Directors' knowledge and belief, for some of our halls, G-prize buyers enter into lease agreements directly with the relevant landlord.

We have no arrangements, relationships or agreements with G-prize buyers, and no ability to exercise control, whether directly or indirectly, over them, nor they over us, through (i) any equity holding or capital relationship or connection, (ii) any relationship or connection between personnel, or (iii) any contract or other agreement. Nor do the arrangements between G-prize wholesalers and G-prize buyers create any relationship between us and the G-prize buyer.

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### **Risk management**

We have a detailed internal policy and procedures in place for the selection of our G-prize wholesalers. Our purchasing department handles and oversees this selection and background check process. Our G-prize wholesalers are selected based on the transparency of their operations, distribution network, logistics and inventory control capabilities and availability of supplies, by inspecting (among others) their commercial registers, financial statements, seal certificate and corporate brochure(s). There has been no change in our G-prize wholesalers during the Track Record Period and up to the Latest Practicable Date, and our Directors currently expect to continue using the same G-prize wholesalers in the foreseeable future.

Before engaging a G-prize wholesaler, we will conduct background checks, with a focus on: (1) independence; and (2) anti-social forces.

We will conduct anti-social forces checks on potential counterparties through a private investigation company, an independent third party, that has access to a database of information collected from newspapers and other publicly available sources. We will also, to the extent possible, inspect the commercial registers of our G-prize wholesalers to cross-check their directors to review their independence from us. If it is found that any potential G-prize wholesaler belongs to or is related to the Japanese mafia or other anti-social force, or is not independent of us, we will not engage with that G-prize wholesaler.

If we really do engage a new G-prize wholesaler, we will require them to deliver written declarations stating (among others) that they are independent of us and the G-prize buyers with whom they contract, and that they (including their shareholders, directors and prize buyers they contract with) do not have any connections to the Japanese mafia or other anti-social forces. We will also request our G-prize wholesalers to conduct regular background checks against any G-prize buyers engaged by them to review any anti-social force or independence issues between themselves. Ultimately, we will also subject them to the same ongoing independence controls that apply to our existing G-prize wholesalers. See “Applicable Laws and Regulations – C. Legality of Pachinko Businesses and the Three Party System – 3. Three Party System – Our internal control procedures to ensure our independence”. The same will apply to any new G-prize buyer.

### **Pachinko Halls**

We operate all of our halls under our *NIRAKU* brand and our halls can be identified by our *NIRAKU* logos as depicted below:



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Our halls can be categorised into suburban halls and urban halls.

1. **Suburban halls** are our primary business focus, representing 91.5%, 91.9%, 92.3% and 91.9% of our total revenue for our pachinko and pachislot business for the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014. They are typically located in the suburbs (areas with relatively low population density, such as the suburbs of Fukushima Prefecture (福島県)), require car access and provide parking spaces (including for the disabled). Generally, customers are the self-employed (such as farmers and fishermen), factory workers and retirees, and these halls are generally larger with around 400 to 700 machines. Gross pay-ins from peak operation hours (which are typically from 12:00 noon to 5:00 p.m.) on average accounted for approximately 45% of the daily gross pay-ins of our suburban halls during the Track Record Period.
2. **Urban halls** are typically located in urban areas (areas with relatively high population density, such as Tokyo (東京都)) and within walking distance of a train station. Generally, customers are full-time employees of urban areas and these halls are generally smaller with around 200 to 300 machines. Gross pay-ins from peak operation hours (which are typically from 5:00 p.m. to 10:00 p.m.) on average accounted for approximately 41% of the daily gross pay-ins of our urban halls during the Track Record Period.

Some additional typical characteristics of our halls are:

- feature a mix of pachinko and pachislot machines and a mix of low and high playing cost machines (within which there can be a mix of high and low jackpot probability);
- feature a general prize display section where customers can select general prizes, and also a prize exchange counter where customers exchange balls or tokens for such general prizes or G-prizes;
- offer both G-prizes and general prizes (with a broad selection of approximately 280 to 1,400 types of general prizes, including our private brand products, depending on the size of our halls);
- smoking on the premises is permitted;
- provide snack and beverage vending machines (which are installed and maintained by independent vending machine operators); and
- many of our suburban halls feature a noodle shop or cafe (whose operations are outsourced to independent third parties).

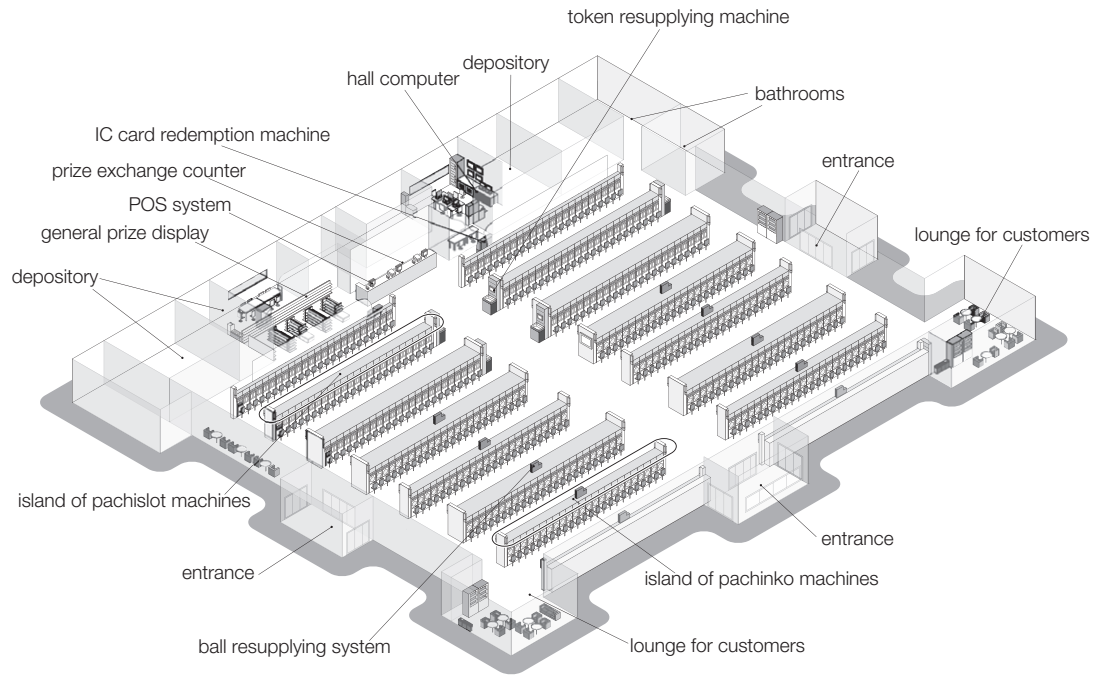
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Also, for our suburban halls, we are dedicated to ensuring that their external architecture is in harmony with their surroundings, through the use of minimalistic designs (featuring basic geometry) and softer earth-tone colours. As for the interior design of our suburban and urban halls, it is bright and neat with a standardised layout. All in all, we believe the external and internal design of our halls create a welcoming and relaxing gaming experience for our customers.

A typical layout for our pachinko halls is shown below:



The exact number and proportion of pachinko and pachislot machines in each hall are determined by population and mix of machines provided by competitors in the area and also customer preferences. All of our halls have a standardised layout featuring many “islands”, or rows of around 10-24 machines each, separated by aisles. Each island features machine of the same playing cost (e.g. only ¥1 pachinko machines or only ¥20 pachislot machines). The vast majority (around 90% of our halls) of our machines have an automatic calculation function to count the number of balls or tokens collected. For those machines that do not have such function, there are jet counters at the end of the islands that can perform the same function. There are also IC card machines in our halls.

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We utilise a centralised management strategy, which leverages the economies of scale of our significant presence and strategic geographical focus in Northeast Honshu (本州島東北), to centralise and standardise processes throughout our business, from branding and construction to management, new hall development, machine procurement, prize procurement recruitment and training of full-time employees, internal audit and daily operations. This strategy has resulted in significant cost savings and operational efficiencies. Therefore, in accordance with our centralised management strategy, the general features of our halls remain constant regardless of their location, which in turn helps us establish strong brand recognition, thus, further improving our player traffic and customer loyalty.

The number of our halls has increased (with no closures) during the Track Record Period and up to the Latest Practicable Date as a result of our ongoing strategy to continually expand (especially our suburban hall network) in Northeast Honshu (本州島東北). The table below shows the movement of each type of our operating halls during the indicated periods:

	Year ended 31 March			Six months ended 30 September	From 1 October 2014 to the Latest Practicable Date
	2012	2013	2014	2014	
<b>Halls at the beginning of the period</b>					
Suburban halls . . . . .	40	42	43	44	44
Urban halls . . . . .	8	8	9	9	9
<b>Total . . . . .</b>	<b>48</b>	<b>50</b>	<b>52</b>	<b>53</b>	<b>53</b>
<b>Halls newly opened during the period</b>					
Suburban halls . . . . .	2	1	1	—	2
Urban halls . . . . .	—	1	—	—	—
<b>Total . . . . .</b>	<b>2</b>	<b>2</b>	<b>1</b>	<b>—</b>	<b>2</b>
<b>Halls at the end of the period</b>					
Suburban halls . . . . .	42	43	44	44	46
Urban halls . . . . .	8	9	9	9	9
<b>Total . . . . .</b>	<b>50</b>	<b>52</b>	<b>53</b>	<b>53</b>	<b>55</b>

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The table below shows a breakdown of the average number of pachinko and pachislot machines for each type of hall during the Track Record Period:

	As at 31 March			As at 30 September
	2012	2013	2014	2014
<b>Suburban halls</b>				
Pachinko .....	357	360	361	361
Pachislot .....	162	170	174	178
<b>Total</b> .....	<b>519</b>	<b>529</b>	<b>534</b>	<b>539</b>
<b>Urban halls</b>				
Pachinko .....	196	188	188	185
Pachislot .....	64	75	75	79
<b>Total</b> .....	<b>260</b>	<b>264</b>	<b>264</b>	<b>264</b>

The table below shows a breakdown of the percentage of low and high playing cost machines at each type of hall as at 30 September 2014:

	Suburban halls	Urban halls	All halls
	%	%	%
<b>Pachinko<sup>(1)</sup></b>			
High playing cost <sup>(2)</sup> .....	57.9	50.9	57.2
Low playing cost <sup>(3)</sup> .....	42.1	49.1	42.8
<b>Total</b> .....	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Pachislot<sup>(1)</sup></b>			
High playing cost <sup>(4)</sup> .....	83.5	89.5	84.0
Low playing cost <sup>(5)</sup> .....	16.5	10.5	16.0
<b>Total</b> .....	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

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(1) The playing costs of our pachinko machines are ¥0.5, ¥1, ¥1.25, ¥2 and ¥4, while the playing costs of our pachislot machines are ¥2, ¥5, ¥10 and ¥20. Some of our halls may require the customer to absorb the consumption tax. For these halls, playing costs for pachinko machines are ¥0.54, ¥1.08, ¥2.16 and ¥4.32, while playing costs for pachislot machines are ¥5.4, ¥10.8 and ¥21.6. Our Japan Legal Adviser has confirmed that such playing costs are in compliance with the Amusement Business Law and the Enforcement Ordinance.

(2) Comprises pachinko machines with playing costs of ¥4 per ball or above.

(3) Comprises pachinko machines with playing costs below ¥4 per ball.

(4) Comprises pachislot machines with playing costs of ¥20 per token or above.

(5) Comprises pachislot machines with playing costs below ¥20 per token.

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The table below shows the gross pay-ins and revenue for our pachinko and pachislot business by type of hall for the indicated periods:

	Year ended 31 March						Six months ended 30 September			
	2012		2013		2014		2013		2014	
	¥	%	¥	%	¥	%	¥	%	¥	%
(in millions, except for percentages)										
(unaudited)										
<b>Gross pay-ins<sup>(1)</sup></b>										
Suburban halls . . . . .	206,437	91.8	224,493	92.7	219,455	92.8	111,650	92.5	84,175	92.5
Urban halls . . . . .	18,531	8.2	17,724	7.3	16,994	7.2	9,024	7.5	6,814	7.5
<b>Total . . . . .</b>	<b>224,968</b>	<b>100.0</b>	<b>242,217</b>	<b>100.0</b>	<b>236,449</b>	<b>100.0</b>	<b>120,674</b>	<b>100.0</b>	<b>90,989</b>	<b>100.0</b>
<b>Revenue from pachinko and pachislot business<sup>(2)</sup></b>										
Suburban halls . . . . .	27,113	91.5	29,342	91.9	30,452	92.3	14,727	92.1	13,968	91.9
Urban halls . . . . .	2,515	8.5	2,577	8.1	2,542	7.7	1,265	7.9	1,223	8.1
<b>Total . . . . .</b>	<b>29,628</b>	<b>100.0</b>	<b>31,919</b>	<b>100.0</b>	<b>32,994</b>	<b>100.0</b>	<b>15,992</b>	<b>100.0</b>	<b>15,191</b>	<b>100.0</b>

(1) Represents the amount received from customers for rented pachinko balls and pachislot tokens.

(2) Represents gross pay-ins less gross payouts.

The table below shows the revenue margin (namely, our revenue from pachinko and pachislot business divided by gross pay-ins) for our pachinko and pachislot business by type of hall, type of machine and by playing cost for the indicated periods:

	Year ended 31 March			Six months ended 30 September	
	2012	2013	2014	2013	2014
	%	%	%	%	%
<b>Suburban halls</b>					
Pachinko machines . . . . .	12.3	12.4	13.4	12.6	15.4
High playing cost . . . . .	10.5	10.7	11.8	10.9	13.4
Low playing cost . . . . .	24.3	23.2	22.7	22.0	26.3
Pachislot machines . . . . .	15.1	14.4	14.8	14.5	18.9
High playing cost . . . . .	14.7	14.1	14.5	14.2	18.6
Low playing cost . . . . .	27.5	23.2	20.6	20.6	27.2
Overall for suburban halls . . . . .	13.1	13.1	13.9	13.2	16.6



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	Year ended 31 March			Six months ended 30 September	
	2012	2013	2014	2013	2014
	%	%	%	%	%
<b>Urban halls</b>					
Pachinko machines . . . . .	13.0	14.3	14.8	13.9	17.8
High playing cost . . . . .	11.5	12.5	12.5	11.5	15.0
Low playing cost . . . . .	24.5	23.1	23.5	23.0	28.0
Pachislot machines	15.6	15.3	15.5	14.5	18.4
High playing cost . . . . .	15.6	15.4	15.3	14.3	18.3
Low playing cost . . . . .	N/A <sup>(Note)</sup>	2.7	20.8	19.3	21.9
Overall for urban halls . . . . .	13.6	14.5	15.0	14.0	17.9
<b>Overall revenue margin for our Group . . . . .</b>	13.2	13.2	14.0	13.3	16.7

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*Note:* Low playing cost pachislot machines were only introduced to urban halls in March 2013. The revenue margin was low compared to other periods as the payout ratio of such machines were set at a higher level for promotion purpose.

For the three years ended 31 March 2014, the revenue margin for high playing cost machines was generally stable, while the revenue margin for low playing cost machines generally decreased, especially for our suburban halls. There was a decrease in the utilisation rate for all of our machines, meaning that players were spending less time playing our machines. For example, the utilisation rate decreased from 34.4% to 27.9% for high playing cost pachinko machines and from 39.6% to 35.8% for low playing cost pachinko machines. For our high playing cost machines, the payout ratio slightly decreased during these three years, which helped offset the negative effect on revenue of the fall in utilisation rate and ultimately led to a stable revenue margin. However, for our low playing cost machines, since they only accounted for less than 20% of our revenue, we maintained a similar payout ratio, which, coupled with the slight reduction in utilisation rate, ultimately resulted in a decrease in the revenue margin.

For the six months ended 30 September 2014, we imposed G prize mark-ups (effective from 1 April 2014), ranging from 4% to 20% (with an average of around 10%). This helped to raise the revenue margin for both high playing cost and low playing cost machines, despite the drop in our overall pachinko machine utilisation rate from 34.5% to 27.5% compared to the corresponding period of the previous year.

For further details of utilisation rate, see “Financial Information — Results of Operations of Our Group — Description of Components of Results of Operations — Gross pay-ins”.

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Regarding revenue contribution, for the years ended 2012, 2013 and 2014, our top five halls (all being suburban halls) contributed 18.0%, 17.6% and 17.2%, while our top ten halls (all being suburban halls) contributed 33.0%, 32.0% and 31.5%, of the revenue from our pachinko and pachislot business, respectively.

### ***Machine maintenance and the business performance of our halls***

We conduct regular maintenance for our pachinko and pachislot machines, which in turn can affect the business performance of our halls.

As stated above, our revenue from pachinko and pachislot business represents gross pay-ins (amount received from balls and tokens rented to customers) less gross payouts (aggregate cost of prizes exchanged by customers).

Gross pay-ins is primarily affected by the level of customer spending in our halls, which is in turn largely affected by: (1) G-prize mark-ups; (2) payout ratios; (3) number, types and mixes of machines; (4) number and types of halls; (5) number and playing time of customers; (6) competitors' behavior and the general trend of the pachinko industry; and (7) macroeconomic factors (such as tax and inflation). On the other hand, gross payouts is to a large extent affected by G-prize markups and payout ratios of our machines. Payout ratios is affected by the mix of machines with various specifications, which include matters such as playing costs (as usually low playing cost machines are preset with a lower payout ratio), jackpot probability (including the jackpot size, i.e. the number of balls or tokens won from hitting a jackpot during the jackpot mode, which is randomly fixed by the machine's in-built computer chip) and, significantly, pin angles (for pachinko machines only) and the machine's payout setting (for pachislot machines only).

Among the financial and operational metrics mentioned above, payout ratios is one of the factors that hall operators can most readily influence, namely through maintenance and adjustments of pin angles (for pachinko machines) and adjusting the payout setting (for pachislot machines), both while ensuring full and consistent compliance with the legally required ranges on payout ratios. See "Financial Information" for details on each of the financial metrics mentioned above.

### *Pachinko machines — pin angle maintenance and adjustments*

Pin angles impact the distance between the ends of each pin, which in turn directly influences the likelihood that balls fall into the designated pockets that release bonus balls, trigger jackpots, or conversely, fall into the trap and become lost. Therefore, pin angles have a direct impact on payout ratios and ultimately gross payouts and revenue. However, pin angles often shift during the normal course of play on a pachinko machine as the pachinko balls cascade down, through and collide into the pins in the playing field, which consequentially changes payout ratios of pachinko machines. There are required ranges under law for payout ratios.

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Therefore, consistent with industry practice, we generally perform regular maintenance and adjustments on the angle of the pins of our pachinko machines in order to ensure full and consistent compliance with such required ranges on payout ratios. For example, the number of balls that a pachinko machine may pay out must be between 0.5 to 2.0 times the number of balls put into play over a continuous 10-hour period. Our Japan Legal Adviser has advised us of the three criteria that must be satisfied in respect of such pin angle maintenance and adjustments, namely: (1) such pin angle maintenance and adjustments do not involve any bending or other modification of the shape of the pins; (2) the purpose of such pin angle maintenance and adjustments is to ensure compliance with the relevant required ranges and to maintain an average payout ratio for each pachinko machine that is in compliance with the relevant required ranges; and (3) the payout ratio of the pachinko machine for which the Maintenance and Adjustment of Pins has been completed remains within the required range. Our Japan Legal Adviser has also advised us that: (1) provided that the above three criteria are satisfied, we may conduct such pin angle maintenance and adjustments anytime; (2) we have strictly complied with such criteria; and (3) ultimately, the pin angle maintenance and adjustments conducted by our Group are in full compliance with the Amusement Business Law and the Enforcement Ordinance. See “Applicable Laws and Regulations” for details on the required ranges for payout ratios of pachinko machines.

### *Pachislot machines – adjustments of payout settings*

A player wins bonus pachislot tokens if the images on the reels form a winning combination. The amount of payouts for a particular winning combination may differ from machine to machine, as each pachislot machine has adjustable payout settings. These settings are designed and preset solely by the machine manufacturer, come in-built into the machine and can only be adjusted by our hall operations staff. There are a range of payout settings, all of which must fall within the range required under the Enforcement Ordinance. For example, the number of tokens that a pachislot machine may pay out must be between 0.55 to 1.2 times the number of tokens put into play over 17,500 continuous plays. The machine manufacturer must ensure such payout settings are in full compliance with these required ranges in order for the machine to pass the examination on specifications etc. as required under the Amusement Business Law. See “Applicable Laws and Regulations” for details on the required ranges for payout ratios of pachislot machines.

Consistent with industry practice, we regularly adjust these payout settings of our pachislot machines in order to improve the business performance of our halls. Our Japan Legal Adviser has advised us that our adjustments of payout settings for our pachislot machines are in full compliance with the Amusement Business Law and the Enforcement Ordinance.

### *Commercial aim*

While ensuring such full and consistent compliance with the required ranges on payout ratios under law, we also determine our target payout ratio from a commercial standpoint mainly based on: (1) our understanding of local customer preferences; (2) the cost structure of our halls; and (3) the competitive landscape in the vicinity of each of our halls (including market intelligence on the payout ratios of our competitors). Ultimately, our commercial aim is to adjust the payout

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setting (for pachislot machines) or maintain the pins (for pachinko machines) in strict compliance with applicable laws (for pachinko machines) in such a way that maximises our revenue from pachinko and pachislot business by striking the optimal balance between gross pay-ins and revenue margin. For example, we believe players that prefer low playing cost machines are generally more attracted to the entertainment element of pachinko and pachislot, which means they are less sensitive to movements in payout ratio and are more prepared to accept a lower payout ratio. On the other hand, we believe players that prefer high playing cost machines are generally more attracted to the chance element of pachinko and pachislot (to win a larger amount of prizes), which means they are more sensitive to payout ratios and are more prepared to accept a higher payout ratio.

### ***Centralised hall management strategy***

We utilise a centralised management strategy, which leverages the economies of scale of our significant presence and strategic geographical focus in Northeast Honshu (本州島東北), to centralise and standardise processes throughout our business, from branding and construction to management, new hall development, machine procurement, prize procurement recruitment and training of full-time employees, internal audit and daily operations. This strategy has resulted in significant cost savings and operational efficiencies. Therefore, in accordance with our centralised management strategy, the general features of our halls remain constant regardless of their location, which in turn helps us establish strong brand recognition, thus, further improving our player traffic and customer loyalty.

### **NEW HALL DEVELOPMENT**

In conjunction with our expansion strategy, we continually strive to identify potential locations for new suburban halls. When selecting a location for opening a new suburban hall, we consider the following characteristics of the targeted region: (1) its proximity to Fukushima Prefecture (福島県) and Tokyo (東京都) (and most preferably being located in Northeast Honshu (本州島東北)); (2) its proximity to our own halls; (3) the population density and demographic, (4) the number of competing halls, (5) the number of machines in the competing halls; and (6) the average number of players per machine. As a general rule, for our suburban halls, there must be commercial areas within a 15 minute drive radius, and such radius must cover at least 50,000 people and have at least 18 people (above 18 years old) per machine (owned by all operators). The investment payback period should be no more than seven years.

Our process for hall openings is also centralised and based on the following steps: (1) our hall development department selects a potential location; (2) our hall development department conducts a primary property survey to judge the suitability of the target property, taking into account its location, accessibility, economic conditions, customer flow and competitive environment; (3) if results of the primary property survey are satisfactory, our sales department, corporate planning department and sales strategy department will then conduct a secondary location survey to provide a second opinion on the location; (4) both survey results will be presented to our Directors for approval; (5) our hall development department will prepare an

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investment plan; and (6) such investment plan will be approved by a management committee consisting of our Directors, and our Board will make the final decision. This process typically takes about two months. Subsequent construction and design of an acquired property will take about six months.

Currently, we plan on opening new suburban halls (by leasing the relevant properties) in the following regions and closing three urban halls in Tokyo (東京都) during the three years ending 31 March 2018 as set out in the table below:

Prefecture	Number of operating halls as at the Latest Practicable Date	Expected net hall openings during the year ending 31 March			Expected number of operating halls by 31 March 2018 <sup>1</sup>
		2016	2017	2018	
<b>Tohoku region (東北地方)</b>					
Fukushima Prefecture (福島県) . . . . .	20	1	1	1	23
Miyagi Prefecture (宮城県) . . . . .	1	—	—	—	1
Yamagata Prefecture (山形県) . . . . .	2	—	—	—	2
<b>Kantō region (関東地方)</b>					
Tokyo (東京都) . . . . .	12	-3*	—	—	9
Gunma Prefecture (群馬県) . . . . .	4	1	—	—	5
Ibaraki Prefecture (茨城県) . . . . .	4	1	1	—	6
Kanagawa Prefecture (神奈川県) . . . . .	2	—	—	—	2
Saitama Prefecture (埼玉県) . . . . .	5	—	—	—	5
Tochigi Prefecture (栃木県) . . . . .	2	—	—	1	3
<b>Chūbu region (中部地方)</b>					
Niigata Prefecture (新潟県) . . . . .	3	—	—	—	3
<b>Total</b> . . . . .	<b>55</b>	<b>0</b>	<b>+2</b>	<b>+2</b>	<b>59</b>

\* We intend to close down three of our urban halls in Tokyo (東京都) by the end of 2015. Two of these are loss-making and will be closed down by us as part of our strategy to improve the performance of our urban hall network. See “Business — Strategies — Improve the performance of our urban halls”. As for the third hall, it has been profit-making but will also be closed down by the end of 2015 purely due to city planning by the government of Tokyo (東京都) and we do not expect such closure to cause any negative financial impact as we expect to receive full compensation (including loss of income) from such government. We will consider using the existing staff and machines for these three halls (that are expected to be closed down) for either our existing halls or our new suburban halls to be opened in the next three years.

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Our plans for expansion are based on various assumptions, including: (1) industry trends continuing to develop as we anticipate, including the favourable market opportunities arising from the industry consolidation (as a result of the shrinking industry) and high industry fragmentation, as well as growing hall size; (2) our ability to respond to changes in the competitive landscape, both with respect to other pachinko hall operators as well as other types of entertainment; (3) our ability to respond to changes in the regulatory environment for pachinko in Japan if any; (4) favourable economic, political and other conditions in Japan and elsewhere in Asia; and (5) our future financial condition, results of operations and cash flows. Further, the estimated cost of setting up a new suburban hall (with around 640 machines) is on average around ¥1,200 million, including initial machine costs and land costs.

### CUSTOMERS

Our revenue from pachinko and pachislot hall operations consists of: (1) revenue from pachinko and pachislot business, which in turn represents gross pay-ins less gross payouts; and (2) vending machine income.

The vast majority of our customers consist of customers of our pachinko and pachislot business, being members of the general population who play at our pachinko halls. We believe that our customers cover a relatively broad range of players in terms of age demographic and income group. Customers for our suburban halls are usually the self-employed (such as farmers and fishermen), factory workers and retirees, while customers for our urban halls are usually full-time employees.

As a pachinko hall operator, we have a large and diversified customer base across Japan. We did not rely on any single customer.

Regarding our vending machine business, we enter into service agreements with various vending machine operators, which are major manufacturers of drinks or food. They will install and maintain various vending machines at our halls, while we in turn receive from such vending machine operators a concession for each machine: (1) ranging from approximately ¥2 million to ¥10 million, payable upon the commencement of the installation period; and (2) ranging from approximately ¥0.3 million to ¥7 million, payable upon the renewal of each installation period. The installation period is usually three years. Also, we share approximately 30% to 50% of the gross proceeds from these vending machines. These vending machine operators are responsible for stocking, repairing and maintaining their machines.

All of our vending machine operators are independent third parties.

### SUPPLIERS

Our major suppliers consist of: (1) machine suppliers; (2) G-prize wholesalers; and (3) general prize suppliers.

All of our suppliers are independent third parties. None of our Directors, their associates or any person who, to the knowledge of our Directors, owns more than 5% of our issued share capital or of any of our subsidiaries, had any interest in any of our five largest suppliers during the Track Record Period.

#### 1. Machines

In conjunction with sourcing, transferring and disposal of the pachinko and pachislot machines in our halls, we operate a centralised system to: (1) gather information on machine utilisation in our halls and necessary market information for planning purposes; (2) confirm with manufacturers and dealers the availability of machines; (3) procure new machines; (4) procure second-hand machines; and (5) manage, schedule and coordinate the allocation, disposal or replacement of machines.

#### ***New and second-hand machines***

Machine procurement is very important to our business as it is critical to boosting player traffic. We do not manufacture any of our playing machines. Instead, we purchase pachinko and pachislot machines regularly for installation in our new halls, or to replace older machines in our existing halls, in order to boost player traffic and to keep up with changing customer preferences and modern trends (by acquiring the latest machine models which we believe appeal to customers). The number of machines we purchase each year is typically similar to the number of all machines in our halls, which means that almost all machines are replaced once a year.

In order to purchase machines, we either purchase: (1) new machines from machine manufacturers; or (2) second-hand machines from dealers.

Most of our machine purchases are for new machines from machine manufacturers. The main reason is to boost player traffic by acquiring the latest machine models, which are typically more popular than older models. This is especially so for high playing cost machines, which constitute the majority of our machines. Selection of new machines is also highly dependent on the machine manufacturers, who generally conduct their own market research to design new machines and marketing. As such, player interest in specific new models is largely influenced by machine manufacturers.

We sometimes also purchase second-hand machines from dealers. This is because there is a portion of machines (already introduced into the market) that remain popular for a relatively long time and continue to generate sufficient revenue. However, machine manufacturers typically only sell a particular model for a limited time and with a limited supply, after which new production will be discontinued. As such, for these older yet still popular models, we need to rely on dealers.

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Also, when we purchase new machines to replace existing machines, such replaced machines are often transferred to one of our warehouses for storage or even potential further use. We may later transfer such replaced machines to another hall for further use based on customer preferences in that area, which will result in cost savings.

The table below shows a breakdown of the total cost and number of pachinko and pachislot machines purchased from machine suppliers or second-hand dealers during the Track Record Period:

	Year ended 31 March						Six months ended 30 September	
	2012		2013		2014		2014	
	¥	%	¥	%	¥	%	¥	%
	(in millions, except for percentages)							
<b>Cost of machine</b>								
New . . . . .	7,072	98.8	7,858	98.9	8,124	98.9	4,452	99.3
Second hand . . . . .	54	0.7	51	0.6	54	0.7	17	0.4
Storage charges . . . . .	35	0.5	39	0.5	38	0.5	13	0.3
<b>Total . . . . .</b>	<b><u>7,161</u></b>	<b><u>100.0</u></b>	<b><u>7,948</u></b>	<b><u>100.0</u></b>	<b><u>8,216</u></b>	<b><u>100.0</u></b>	<b><u>4,482</u></b>	<b><u>100.0</u></b>
	(number of machines, except for percentages)							
		%		%		%		%
<b>Number of machines purchased</b>								
New . . . . .	19,784	95.1	21,550	93.3	21,549	91.4	11,900	96.5
Second hand . . . . .	1,021	4.9	1,544	6.7	2,030	8.6	427	3.5
<b>Total . . . . .</b>	<b><u>20,805</u></b>	<b><u>100.0</u></b>	<b><u>23,094</u></b>	<b><u>100.0</u></b>	<b><u>23,579</u></b>	<b><u>100.0</u></b>	<b><u>12,327</u></b>	<b><u>100.0</u></b>

Our area managers reviews and makes decisions for each pachinko hall regarding its mix of machines on a weekly basis. Our area managers will place any requests to the manager of our sales department for new or second-hand pachinko and pachislot machines using our Machine Management System. We negotiate the relevant sales agreements with manufacturers or dealers, specifying the number and type of machines, price, payment method and the hall(s) in which the machines are to be installed. The manager of our sales department decides how many and which machines to purchase, arranges the purchase, places the order with the manufacturer or dealer, obtains confirmation from the manufacturer or dealer and arranges for delivery of the machines directly to the appropriate hall. Our sales department also determines the annual budget for machine purchases for each hall based on a percentage of each hall's revenue, subject to a maximum amount.

### **Machine suppliers**

Our sales support department maintains a list of approved machine suppliers. We generally settle our payments in full with our machine suppliers in the month following the date of purchase of the machines.



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For the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, our five largest machine suppliers accounted for 56.5%, 48.4%, 54.4% and 53.8%, of our total purchases of pachinko machines and pachislot machines, while our single largest machine supplier accounted for 20.2%, 15.3%, 17.5% and 12.5%, of our total purchases of machines, respectively.

### ***Removal and disposal of machines***

We arrange for removal and disposal of old machines from the pachinko halls. Old machines may be: (1) transferred to one of our warehouses for storage and potential future use; (2) traded in to a machine supplier for a discount on a new machine; or (3) sold to second-hand dealers through an auction process to the highest bidder. Sometimes we might only sell certain parts of an old machine. If a machine is traded in for a new machine to the original manufacturer, the manufacturer purchases the entire machine in order to reuse certain components.

### ***Compliance***

Our machine purchase agreements require us and our counterparty to comply with the Amusement Business Law. In addition, we generally undertake and warrant in the agreements that we are not in violation of the laws regarding adjustment or remodelling of machines and that we will permit the Organisation for Sound Development of Pachinko & Pachislot Industry\* (遊技産業健全化推進機構), a third party self-regulatory organisation in Japan, to inspect our machines.

There are several regulations governing pachinko and pachislot machines. See “Applicable Laws and Regulations – D. Other Regulations on Pachinko Businesses” for details.

According to the Amusement Business Law and National Public Safety Commission regulation, pachinko and pachislot machines must meet certain technical standards. The Amusement Business Law also requires each pachinko hall to obtain prior permission from the Prefectural Public Safety Commission\* (都道府県公安委員会) before increasing or changing its number of machines (including the transfer for a machine to a different hall). Before a new or second-hand machine is shipped to us, the prefectural police must certify the eligibility and compliance of the machine or replacement part, which is evidenced by a “notice of inspection” issued to the manufacturer (for new machines) or dealer (for second-hand machines) who then provide the Notice of Inspection to us. In addition, the machines are inspected at the pachinko hall where they are to be installed. The manufacturer (for new machines) or the dealer (for second-hand machines) also provides us with certificates of guarantee certifying that the machines they provide to us, which are individually identified by a unique serial number, have been inspected by the local police authorities. A similar notice and certificate are issued when machine parts are replaced. In addition, prior to operation of a new or second-hand machine, the pachinko hall must submit an application to the local police authority to request an inspection, upon completion of which an approval is granted and operation of the machine may begin. The police may inspect the machines at random after installation in the pachinko hall.

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A person who intends to manufacture or import a pachinko or pachislot machine or to install it may, but is not legally required to, apply for an inspection of the machine by the Security Communications Association\* (保安通信協会) for specifications of such imported or manufactured pachinko or pachislot machine. A machine manufacturer typically submits its machine prototypes to testing by the Security Communications Association\* (保安通信協会). Machine prototypes that pass such testing receive certificates. Each machine subsequently manufactured according to that prototype will also have a certificate showing its compliance with such testing. Purchasing machines from manufacturers that have received this approval reduces the risk of installing machines that do not comply with the legal requirements. A pachinko operator that intends to increase or change its number of machines, including the transfer of a machine to a different pachinko hall, must obtain prior written permission from the Prefectural Public Safety Commission\* (都道府県公安委員会).

As we only purchase machines from manufacturers that submit their machine prototypes for testing by the Security Communications Association\* (保安通信協会), our pachinko and pachislot machines each have a certificate demonstrating compliance with those tests and have passed all inspections conducted by the relevant Prefectural Public Safety Commission\* (都道府県公安委員会) during the Track Record Period.

The license, approval or permit requirements under Japan law and regulations for dealing in pachinko and pachislot machines are limited to a permit for dealing in second-hand goods under the Used Goods Dealer Act. This permit is issued by the Prefectural Public Safety Commission\* (都道府県公安委員会).

The pachinko and pachislot machines we purchase are pre-programmed by the manufacturer to comply with legal and technical specifications, such as payouts and probabilities of triggering certain modes of play (e.g. “jackpot” mode for pachinko or “bonus rounds” for pachislot).

The payouts of pachinko balls and pachislot tokens resulting from “jackpot” or “bonus” modes as a percentage of total balls or tokens played is limited by law so as to discourage playing with the sole purpose of winning or “gambling”. These required ranges include: (1) the number of pachinko balls that the machine may pay out to between 0.5 to 2.0 times the number of balls put into play over a continuous 10-hour period; and (2) the number of pachislot tokens that the machine may pay out to between 0.55 to 1.2 times the number of tokens played during the course of 17,500 consecutive plays. These restrictions are contained in the Amusement Business Law, or its subordinate regulations, and are fully available to the public. For further information, see “Applicable Laws and Regulations — D. Other Regulations on Pachinko and Pachislot Businesses”. See “— Pachinko and Pachislot Hall Operations — Pachinko Halls — Machine maintenance and the business performance of our halls” for details on our regular maintenance on our pachinko and pachislot machines and its effect on payout ratios and ultimately the business performance of our halls.

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By collecting data from our machines through our numerical analysis system on every 15 minutes, we are able to monitor the performance of our machines and determine whether they remain in compliance with applicable regulations. In the event that we detect significant fluctuations in this data, we are able to use this data to locate the machines that are not performing properly and instruct our hall managers to make the appropriate daily maintenance to ensure compliance. See “— Information Technology” in this section below for more on the types of data collected from our machines.

### **2. General Prizes**

We currently purchase our general prizes from 26 general prize suppliers. Our purchasing department is responsible for general prize procurement (typically twice a week), which is facilitated by the daily inventory checks conducted via our Prize Management System. See “— Information Technology” in this section below for further details about our Prize Management System. Each hall manager is also responsible for conducting daily inventory checks of general prizes at their hall. Generally, the same types of general prizes are offered at each of our halls though larger halls (such as suburban halls) will offer more types.

To select our general prize suppliers, our purchasing department submits a written request for approval with our corporate planning section (which oversees compliance matters), our finance department and our Executive Director. Our general prize suppliers are selected based on the transparency of their operations, distribution network, logistics and inventory control capabilities and availability of supplies. In particular, we conduct anti-social forces checks through a private investigation company, an independent third party, that has access to a database of information collected from newspapers and other publicly available sources. If it is found that any of a potential general prize supplier’s representatives, officers, executive officers or main shareholders (if they are listed companies) belongs to or is related to any anti-social force, we do not engage with that entity.

We enter into continuous purchase agreements with some of our general prize suppliers, pursuant to which we place orders based on our inventory needs. These purchase agreements are typically valid for a year, and are automatically renewed on a yearly basis. We have long-term relationships with almost all of our general prize suppliers. Payments to our suppliers are typically made within 60 days or on a monthly basis in the month following the month during which the goods are received. For our most popular general prizes, we utilise our POS system, through which our hall managers will place orders when the inventory of a certain prize in our Prize Management System falls below a predetermined level.

We engage several private label manufacturers (namely, local manufacturers and suppliers of foods and drinks) to produce our private brand products, which consist of foods and drinks. We believe our private brand products help attract more customers by providing a unique and additional range of general prizes.

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For the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, our five largest general prize suppliers accounted for 88.9%, 89.9%, 90.8% and 91.3%, of our total purchases of general prizes, while our single largest general prize supplier accounted for 39.8%, 42.0%, 44.4% and 43.9%, of our total purchases of general prizes, respectively.

### 3. G-prizes

We currently purchase our G-prizes from 12 G-prize wholesalers. Our headquarters appoints our G-prize wholesalers and enters into a standardised master agreement with each G-prize wholesaler who satisfies our background check criteria. Our headquarters assign one approved G-prize wholesaler for each of our halls. Day-to-day G-prize procurement is handled by hall staff and overseen by the hall manager at each individual hall. These duties include:

- deciding the quantity of G-prizes to be purchased each day subject to the limits set by our headquarters;
- placing purchase orders;
- checking the G-prizes delivered against the relevant purchase order;
- handling cash payments for G-prizes;
- maintaining the inventory of G-prizes; and
- counting and reconciling the number of G-prizes on a daily basis.

For information on internal control measures relating to G-prize procurement, see “Internal Controls and Anti-Money Laundering – Internal Controls Relating to Cash and G-prizes”.

For the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, our five largest G-prize wholesalers (which have, on average, been established in Japan for over 40 years and whose primary business includes the supply of G-prizes to pachinko hall operators) accounted for 92.8%, 91.2%, 89.7% and 89.5%, of our total purchases of G-prizes, while our single largest G-prize wholesaler accounted for 72.8%, 72.1%, 70.4% and 70.2%, of our total purchases of G-prizes, respectively.

## MARKETING AND MARKET RESEARCH

Our sales and marketing department engages in a variety of marketing activities to promote our pachinko and pachislot business. For the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, we spent ¥939 million, ¥1,231 million, ¥1,362 million and ¥680 million on advertising, representing 3.9%, 4.7%, 5.0% and 4.7% of our total expenses (the total of hall operating expenses and administration and other expenses), respectively.

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### Membership system

We have implemented a voluntary membership system, which is open to all our customers. Our membership system is designed to enhance customer loyalty, by providing them the convenience of carrying over any unused pachinko balls or pachislot tokens for their subsequent visits. This also increases customers' spending and our cash flow, as customers are more likely to purchase a larger amount of balls or tokens with each purchase.

The key terms of our membership system are: (1) if a member has any unused balls or tokens, these will be stored on our IT systems and can be carried over for use or prize exchange at their subsequent visits; (2) such carried-over balls or tokens can only be used in the hall where such membership was registered; (3) there are no expiry for such carried-over balls or tokens; (4) customers may carry over a maximum of 999,999 balls and 199,999 tokens; and (5) customers may also store up to ¥10,000 in cash on the membership card, which will be forfeited if the membership card is unused for 90 consecutive days.

Each of our halls maintains its own register of members and each customer can only apply for one membership card per hall. To register as a member and to receive such membership card, a customer must provide age proof and their identification card. Members need to enter a password or present their identification card whenever they wish to use their membership card, thus, helping to ensure the non-transferability of any carried-over balls or tokens.

The Amusement Business Law prohibits the issuance of valuable papers to customers. Any carried-over balls or tokens are strictly not stored on our membership cards themselves, but only on our IT systems. Such membership cards only store personal information of our members. Therefore, our Japan Legal Adviser has confirmed that our membership cards shall not be construed to be "valuable papers" and that our membership system is in compliance with applicable Japan laws and regulations. See "Applicable Laws and Regulations — D. Other Regulations on Pachinko and Pachislot Businesses — 6. Membership Systems" for details.

Our membership system also allows us to collect statistical information regarding our customers' identities, age, frequency of visits, locations of halls visited, amounts of purchases (including breakdown of tokens and balls), number of balls or tokens exchanged for prizes and preferences for various types of machines. Our sales and marketing team regularly analyses such information and uses it to design appropriate marketing strategies and activities, as well as to help our hall managers better plan the overall mix of machines at each of our halls, to better encourage recurring visits from such customers.

As at 30 September 2014, we had 226,848 members.

### Advertising

We conduct advertising, sales promotion activities to support our pachinko and pachislot hall operations. Our sales and marketing team designs and conducts our advertising media and sales promotion activities.

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Most of our advertising activities are designed to raise awareness for our pachinko and pachislot games (especially new machines and new halls) and attract them to visit our halls. We have multiple advertising streams, including television, radio, flyers, direct mail, newspaper and also signboards inside and outside our halls. In particular, when customers join our membership system, they are asked whether they wish to receive specific advertisements. If they choose so, we will send such members direct mail containing information of new machines or seasons' greetings.

Also, we are the official sponsor for a local professional basketball team in Fukushima Prefecture (福島県), whose uniforms display our "NIRAKU" logo, as a means to further improve our brand awareness.

In Japan, the Amusement Business Law requires a pachinko hall operating licence holder to advertise or promote their business in such a way that it will not likely interfere with the peace and quiet surrounding the place of business. Under the Standards for the Interpretation and Operation of the Amusement Business Law published by the National Police Agency, the following methods of advertisement are likely to constitute an "interference with peaceful and quiet surroundings":

- displaying sexually explicit or other adult material;
- advertising or promoting the illegal maintenance and adjustments of pin angles, illegal alterations of payout probabilities or otherwise encouraging customers' "passion for gambling"; or
- noise levels beyond prescribed limits in public areas.

Failure to comply with such restrictions may result in various penalties, the most severe being a cancellation of the Operating Licence. In order to ensure our compliance with these regulations on advertising and promotional activities, our sales support department has adopted an internal guideline that strictly controls the choice of words allowed to be used in our advertising activities. Our sales support department monitors these activities, and sometimes may even consult the relevant police office to ensure compliance. For information on regulation of the pachinko industry and related advertising, see "Applicable Laws and Regulations — D. Other Regulations on Pachinko Businesses — 9. Advertising and Promotion Regulations". Our Japan Legal Adviser has confirmed that, as at the Latest Practicable Date, our Group had complied with the applicable laws and regulations concerning such advertising-related activities.

### **Corporate Social Responsibility**

We also believe it is important for us to fulfil our corporate social responsibility by continuously contributing to the society. We engage in charity activities from time to time. While charity is the primary goal, such charity activities still provide valuable exposure of our brand and enhances the public image of our brand as a socially responsible enterprise. During the years

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ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, our expenses on corporate social responsibility related activities (which consisted of donations to charities for supporting the Japan earthquake reconstruction and regional events)<sup>4</sup> was ¥19.1 million, ¥10.8 million, ¥32.5 million and ¥29.9 million, respectively.

For example, after the Great East Japan Earthquake, we sponsored music festivals to raise funds for relief efforts. Also, we offered a free daily shuttle bus service for over a year, which was open to anyone wishing to travel to and from Tokyo (東京都) and Fukushima Prefecture (福島県).

In addition, in 2010, we established a wholly-owned special subsidiary\* (特定子会社), Merrist, for the purpose of hiring employees that are handicapped persons. Under the Act on Employment Promotion etc. of Persons with Disabilities\* (障害者の雇用の促進等に関する法律) (Act No. 123 of 1960), at least 2% of the employees of a Japanese company, that has at least 50 employees, must be handicapped persons. The number of handicapped persons employed by Merrist can be counted for the purpose of its ultimate holding company, our Company. As at 30 September 2014, we have hired 61 employees that are handicapped persons, which is more than double the legal requirement. Such employees are mostly stationed in our halls and responsible for relatively basic tasks such as gardening and cleaning of our halls and training facilities. In recognition of our efforts to employ handicapped persons, we have received multiple awards. See “— Awards and Accreditations” in this section below for details.

### Market Research

Every year, we purchase a market research report prepared by an independent market researcher regarding the pachinko industry. We also pay close attention to potential new machines (by both monitoring the industry trend and maintaining close contact with our machine suppliers) and customer feedback, which allows us to make better decisions for machine allocation.

Another useful market research tool is our membership system, which allows us to collect statistical information regarding our customers' identities, age, frequency of visits, locations of halls visited, amounts of purchases (including breakdown of tokens and balls), number of balls or tokens exchanged for prizes and preferences for various types of machines. Our sales and marketing team regularly analyses such information and uses it to design appropriate marketing strategies and activities, as well as to help our hall managers better plan the overall mix of machines at each of our halls, to better encourage recurring visits from such customers.

Further, for new hall openings, we follow a detailed layered process involving various surveys conducted by our hall development department, sales department, corporate planning department and sales strategy department, to determine (among others) the suitability of the

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<sup>4</sup> Such expenses formed part of the advertising expenses as included in administrative and other operating expenses.

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target property, taking into account its location, accessibility, economic conditions, customer flow and competitive environment. Such survey results will be reviewed by the head of our sales department, our hall development department and ultimately our Executive Director. See “— New Hall Development” in this section above for details.

### INFORMATION TECHNOLOGY

Our corporate management office oversees our IT system, which plays a crucial role in our Company’s business operations and streamlines the collection and preparation of financial and operational information.

Our IT system consists of a network of software systems, of which, centralised systems such as the accounting, human resources and payroll, and budget management systems are installed throughout our Company. Hall level information and data in relation to hall management, machine management, and prize management are generated and collected at each individual hall, and then transferred to the centralised systems for further analysis on a company level.

#### Centralised Systems

##### 1. *Accounting System*

Cash revenue data calculated based on the number of pachinko balls played are collected on a daily basis by the responsible officer of each individual hall after the close of business, other information on cash inflows and outflows, and goods purchase are generated and saved in the daily business report system. Each hall manager reviews and compares data collected in the daily business report system against the cash revenue data collected based on the pay-ins for the day in order to verify and ensure correspondence and accuracy of the information collected. Upon confirmation from each hall manager, such verified data is transmitted to the Accounting System at our headquarters.

Our accounting system is used to extract accounting information such as purchase and payment data, which are processed using the liabilities management function of the accounting system. Monthly depreciation and amortisation is calculated based on the information collected by the noncurrent assets management system, which stores acquisition, disposal and sales of noncurrent assets data. Such data allows the accounting system to formulate ledger sheets such as the tentative calculation sheet, balance sheet and income statement.

##### 2. *Human Resource and Payroll System*

Our Human Resource and Payroll System administers and manages personnel information of employees of our Group according to the allocation of authority in each system. Employment information, including the authority allotted to each employee in each system, is determined based on the organisation and position; therefore it is subject to change due to personnel transfers. The system manages log-in accounts on company-owned computers which employees use for executing their daily duties. Our human resources and payroll system also administers and manages salary calculation and clock-in/clock-out, as well as work hours.



### 3. ***Budget Management System***

The budget management system sets out the scope of responsibility related to each aspect of our business to clearly identify the specific measures to be adopted for each fiscal year. Based on the scope of responsibility set by our budget management system, a budget for the following fiscal year is formulated. Relevant personnel who are responsible for carrying out the scopes of responsibilities and execution of expenses are required to apply for a managerial decision through the budget management system by stating the reasons to justify such execution of expenses. After the application, those approved are executed as expenses and orders are placed. The relevant personnel are also required to analyse the budgeted expenses and the actual expenses tallied in the budget management system at the end of the month after the expenses are settled, in order to evaluate the executions of their scope of responsibilities and identify any issues arising from such executions.

### 4. ***Purchase Administration System***

Where order placements were requested through the budget management system and are subsequently approved, such order placement data will then be transmitted to the purchase administration system. Our purchase administration system administers the order placement status. Through the order confirmation process at the time of delivery of goods, details of the order confirmation is linked to the liabilities management in our accounting system as payment request data.

Based on the data transmitted through our purchase administration system from each hall, hall managers are able to formulate the pay-in rate and the projection of the number of customers who will play on each machine model. The projection of the number of customers for each machine model is tallied as monthly sales plans for each hall and area, as well as for all halls of our Company. Authorised personnel are allowed to access such sales plans, namely “52-week Sales Plans,” depending on the authority allotted to each position.

### 5. ***Security System***

Our security system records and maintains highly confidential information and data of company-wide accounting transactions, thus access is only limited to selective authorised staff who are provided with an encrypted password. Our security system is overseen by the system support division manager and security settings of the system may not be altered without the approval of the system support division manager. Our networks are protected by firewalls and anti-virus software. Access to our networks by our employees is also limited by those with password authorisation. For more information on control over these systems, see “Internal Controls and Anti-Money Laundering — Internal Controls Relating to Information Technology and Computer Systems”.

### **Hall Level Systems**

#### **1. *Hall Management System***

We have installed a computerised data processing system, generally known as “hall computer” developed by third-party manufacturers, in our pachinko halls. The system collects real-time information on the number of pachinko balls or pachislot tokens rented, played and paid out at each pachinko and pachislot machine and transmit data to our data analysis system every hour via a decrypted line so that hall managers can effectively monitor the performance of machines. If any unusual activity is detected by the system, the system would record it and alert management for a status check.

Each hall manager is granted access to view this data within their respective hall for the purpose of monitoring hall operations. The system also allows managers to quickly detect irregular activities in our pachinko halls. However, only our headquarters management team is granted access to the data collected from all of our pachinko halls for monitoring the overall performance and machine utilisation of our hall operations.

#### **2. *Machine Management System***

As a part of the operation administration system, our machine management system determines the types and numbers of pachinko and pachislot machines to be purchased at each hall. Our area managers are responsible for assessing the types and quantities of machines to be purchased, and our headquarters staff are responsible for execution of order placement. We also have in place the layout administration system, which records machine installation status, machine layout in each hall and the history of repositioning such machines. Further, the layout administration system manages other information based on the master ID of each pachinko and pachislot machine purchased. Through utilising the information maintained by the system, the application documents necessary for the administrative procedures for replacing pachinko and pachislot machines can be easily retrieved, and thus substantially reduces time and expenses.

#### **3. *Prize Management System***

Through our POS system installed in each hall, we centrally manage the procurement of our general prizes and G-prizes, including ordering, acceptance, delivery and inventory control. This information is transmitted to our prize administration system which allows us to maintain up-to-date and accurate inventories of our various prizes, consolidate orders of general prizes, and when appropriate, arrange for periodic, automatic purchases of products with a high turnover rate. This system also provides a reference point for estimating the volume of future prize redemptions based on cumulative historic data.

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### AWARDS AND ACCREDITATIONS

Our achievements over the years have been recognised by numerous awards and accreditations, including the following:

Award / Accreditation	Year of Grant	Issuer of Award
Won top award in pachinko hall section for activity of contribution to society	2014	All Japan Organisation of Social Contribution (全日本社会貢献団体機構)
Awarded as an excellent office for employment of persons with disabilities	2012	Chairman of Japan Organisation for Employment of the Elderly, Persons with Disabilities and Job Seekers (独立行政法人高齢・障害・求職者雇用支援機構理事長)
Certified as a company actively supporting child care under the Act on Advancement of Measures to Support Raising Next-Generation Children	2010 and 2012	Ministry of Health, Labour and Welfare of Japan (厚労省)
Merrist is acknowledged as a special subsidiary* (特定子会社) for the purpose of hiring handicapped persons under the Act on Employment Promotion etc. of Persons with Disabilities	2010	Ministry of Health, Labour and Welfare of Japan (厚労省)

### COMPETITION

According to EBI, the pachinko industry in Japan is highly fragmented with over 3,800 operators as at 31 December 2013. Our major competitors are pachinko hall operators located nearby our halls. See “Industry Overview” for further information on this industry.

We also compete with other types of entertainment and gaming activities, including web-based gaming, potentially interactive gaming channels, and other public racing in Japan. We may also face competition from other gaming venues, particularly casinos if legislation is eventually passed to legalise the operation of casinos in Japan. See “Risk Factors — Risks Relating to the Pachinko Industry — We face intense competition in Japan”. We compete on the basis of variety and type of pachinko and pachislot games offered, types of prizes offered at our halls and players’ other personal preferences.

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### EMPLOYEES

As at 30 September 2014, we had a total of 1,409 employees, all of whom were based in Japan, of which 1,223 were stationed in our pachinko halls. The table below shows a breakdown of the number of our employees by function as at 30 September 2014:

Function	As at 30 September 2014
Management . . . . .	14
Customer service . . . . .	2
Sales support . . . . .	16
Sales and marketing . . . . .	24
Area sales management . . . . .	13
Hall management . . . . .	53
Hall attendants . . . . .	1,177
Procurement . . . . .	4
Finance and accounting . . . . .	11
IT . . . . .	7
Others . . . . .	88
<b>Total</b> . . . . .	<u>1,409</u>

We have implemented a multi-layered management structure for our hall operations, consisting of (from highest rank): our Directors, our division manager (based in our headquarters), our 13 area managers (each responsible for overseeing the daily operations of three to six pachinko halls) and our 55 hall managers (each responsible for overseeing the daily operations of one specific pachinko hall). Generally, each manager reports directly to the relevant manager in the next higher rank. For example, hall managers regularly report to area managers, area managers report weekly to our division manager, and the entire management team meets monthly at our headquarters. Managers in the Kantō Region (関東地方) also meet weekly, as do managers in the Tōhoku Region (東北地方).

A typical pachinko hall employs 22 employees, with around 8 employees present at any time per shift. These include 1 hall manager, 4 assistant managers and the rest being full-time or part-time operational staff.

Our full-time employees may be relocated to other pachinko halls of ours, while part-time employees are typically fixed to one particular hall.

Full-time employees receive performance evaluations on an annual basis. We enter into formal written employment contracts with all our full-time staff. Consistent with common practice in Japan, such employees are subject to working regulations which we establish and keep on file with the labour standards inspection office. These working regulations covers various matters, including but not limited to hiring, compensation, insurance, annual vacation policy, duties of the employee and disciplinary measures. We provide our staff with a copy of these working

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regulations and an employee booklet upon commencement of employment. In the event of disputes regarding terms of the employment, dismissal or other related matters, we will first try resolving such disputes by way of mediation, and if it fails, the working regulations, as well as other applicable laws and regulations, will determine the respective duties and rights of us and our staff.

We also enter into employment contracts with our part-time staff. As stipulated in their contracts, the part-time or temporary staffs are subject to a 14-day probation period, salary raises but are not entitled to bonuses or retirement allowances. The employment contracts with our part-time or temporary staff also set out terms and matters such as position, term of contract, status of contract renewal, work location, work hours, annual leave and whether social insurance or employment insurance are included subject to the number of work hours per week.

Our staff costs include all salaries and benefits payable to all our employees and staff, including our Directors. Our staff costs remained relatively stable during the Track Record Period and amounted to 20.3%, 19.8%, 17.6% and 24.1% of our total revenue in the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, respectively.

### **Labour union**

In 2005, we established a labour union, of which all of our employees (including hall managers), other than management and certain employees with access to management-level information (such as our area managers and finance, accounting and IT staff), are members. Our labour union collectively bargains on behalf of our employees for remuneration and welfare-related issues, participates in labour-management consultations and handles other consultations and investigations as necessary for the welfare of our employee members. Our labour union is also a member of UA Zensen (The Japanese Federation of Textile, Chemical, Food, Commercial, Service and General Workers' Unions)\* (全国繊維化学食品流通サービス一般労働組合同盟), which is the largest industrial union in Japan and provides guidance to our labour union on related issues, such as the proper method in communicating and bargaining with their pachinko hall operator. We have not experienced any strikes or other labour disturbances which have interfered with our operations in any material respect or any other material labour disputes with our employees. Our directors meet members of this labour union once every month to discuss any labour-related issues.

We believe that we have established good relationships and loyalty with our employees. For example, our hall managers stay with us on average for 13 years, while area managers and our senior management stay with us on average for 15 years. Also, we have also voluntarily adopted an internal policy which adheres to a guideline issued by the Ministry of Health, Labour and Welfare (厚労省), which allows all employees with children to take parental holidays. This is a voluntary higher standard than that stipulated by relevant labour laws, and the Ministry of Health, Labour and Welfare (厚労省) has issued a certificate to us in recognition of such internal policy.

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Our Japan Legal Adviser has confirmed that, as at the Latest Practicable Date, our Group was in compliance with all applicable labour and employment regulations. We currently have in place internal control systems and risk management procedures to monitor compliance with labour, employment and other applicable regulations. Going forward, our Company, through our compliance department, will continue to monitor all labour issues to ensure compliance with all applicable labour and employment regulations.

### Recruitment

Our success, to a considerable extent, depends upon our ability to attract, motivate and retain a sufficient number of qualified employees, including area managers, hall managers, sales managers and staff. We believe high-quality customer service and effective management is a key attribute of our success. Our headquarters is responsible for hiring our full-time employees, while part-time employee recruitment is typically handled by our hall managers depending on the operational needs of specific halls.

Primarily, we recruit, place and train our full-time employees with a focus on fresh graduates through our annual recruitment program. We believe this allows us to hire high-quality employees in the market by offering competitive wages and benefits, focused training and internal promotion opportunities. The majority of our staff (excluding operational staff) are university graduates. We have adopted a variety of initiatives to facilitate recruitment of our staff, such as recruitment fairs, online recruitment, flyers and posters. We believe our continuous efforts will help us attract suitable personnel.

In addition, in 2010, we established a wholly-owned special subsidiary\* (特定子会社), Merrist, for the purpose of hiring employees that are handicapped persons. Under the Act on Employment Promotion etc. of Persons with Disabilities\* (障害者の雇用の促進等に関する法律) (Act No. 123 of 1960), at least 2% of the employees of a Japanese company, that has at least 50 employees must be handicapped persons. The number of handicapped persons employed by Merrist can be counted for the purpose of its ultimate holding company, our Company. As at 30 September 2014, we have hired 61 employees that are handicapped persons, which is more than double the legal requirement. Such employees are mostly stationed at our halls and responsible for relatively basic tasks such as gardening and maintenance of our halls and training facilities (including sanitisation). In recognition of our efforts to employ handicapped persons, we have received multiple awards. See “— Awards and Accreditations” in this section above for details.

### Training

During the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, we spent approximately ¥16 million, ¥60 million, ¥46 million and ¥35 million to train our staff, respectively. We own training facilities in Fukushima Prefecture (福島県) where our personnel development department conducts training sessions for both new and existing employees.

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For fresh graduate employees, they must attend our one-week orientation training, which mainly focuses on the pachinko industry history and also our history, centralised management strategy and management philosophy. Subsequent training will be on-the-job, typically consisting of operational training at a range of our halls (where they will receive field training from our hall management team) and managerial, sales management and compliance training in the relevant departments at our headquarters, coupled with periodic promotion as experience is accumulated.

For our existing employees, we provide trainings and career guidance (tailored depending on such employee's ranking and job position), including training on the Three Party System to ensure that our employees do not engage with G-prize wholesalers or G-prize buyers engaged by them, and to prevent them from unknowingly establishing a relationship with them. For example, all our Directors and senior management attended a training conducted by our Japan Legal Adviser in December 2014 on the legal, regulatory and practice requirements under the Penal Code, the Amusement Business Law and the Third Party Local Regulation, including the independence requirements within the Three Party System.

Employees that are selected for potential promotion must pass a test, after which they will be given specific training to prepare them for their promoted job position.

We also require our hall managers and area managers to rotate approximately every two years. This ensures they gain a fuller understanding of their managerial roles by having to manage multiple areas or halls.

We believe our training programmes also help to promote internal upward mobility (by helping us identify promising promotion candidates), which not only increases employee retention rates, but also produces the type and quality of management personnel needed for our expanding hall network. Another objective of our training programmes is to provide a sufficient number of well-trained employees for newly opened pachinko halls. We also send our employees to lectures hosted by the Prefectural Public Safety Commission\* (東京都公安委員会), which are designed to promote compliance with the Amusement Business Law.

## HEALTH, WORK SAFETY, SOCIAL AND ENVIRONMENTAL MATTERS

Our business is subject to relevant Japan national and prefectural laws, ordinance and regulations regarding health, work safety, social and environmental matters.

Regarding environmental matters, the Amusement Business Law and the prefectural ordinances sets out restrictions on noise and vibration levels in the areas surrounding our pachinko halls. These specify the acceptable noise levels for certain areas and times of the day. See "Applicable Laws and Regulations – D. Other Regulations on Pachinko Businesses – 8. Environmental Regulations" for further information on laws regulating noise and vibration. Each pachinko hall shall also have equipments necessary to keep illumination in the hall more than 10 lux.

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To ensure compliance with such laws and regulations, we have appointed a manager to supervise and monitor our compliance and also our internal standards regarding such matters, and we keep a record of any relevant incidents. Our Directors are of the view that the annual cost of compliance with applicable health, work safety, social and environmental laws, regulations and policies was not material during the Track Record Period and is also not expected to be material going forward.

During the Track Record Period and as at the Latest Practicable Date: (1) there had been no violation of the health, work safety, social and environmental laws, rules and regulations applicable to our operations; (2) all the required permits and environmental approvals for construction had been obtained; and (3) there had been no claim or penalty imposed upon our Group as a result of violation of health, work safety, social and environmental laws, rules and regulations. Our Japan Legal Adviser is of the opinion that our Group has complied with all applicable Japan health, work safety, social and environmental laws, rules and regulations during the Track Record Period and up to the Latest Practicable Date.

## PROPERTIES AND FACILITIES

### Overview of property interests

Our self-owned and leased property interests comprise a gross floor area of approximately 823,258 sq.m. in aggregate. Among these property interests, approximately 88,100 sq.m. of which are considered directly relevant to our operations as they are buildings housing our operational pachinko halls, supporting facilities and premises used for property activities (within the meanings of the Listing Rules) (the “Operational Premises”). The remaining approximately 735,158 sq.m. are non-operational and include land on which our Operational Premises are located and parking lots adjacent to our pachinko halls.

### Pachinko halls

Approximately 88.1% of our Operational Premises are used as pachinko halls. As at the Latest Practicable Date, we operated 55 pachinko halls, all of which were located in Northeast Honshu (本州島東北), Japan. We also have on-site offices and ancillary facilities located within the premises of our pachinko halls to ensure efficient and smooth operations.

### Supporting facilities

We also own the properties housing our headquarters and training facilities, both located in Koriyama City (郡山市) of Fukushima Prefecture (福島県). Our offices in Tokyo (東京都) and Hong Kong, as well as the premises housing our “LIZARRAN” restaurant are leased properties.



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### Property activities

Our property activities (within the meanings of the Listing Rules) include a hotel and an office building for lease to third party tenants, both located in Koriyama City (郡山市) of Fukushima Prefecture (福島県), as well as a three-storey building of residential apartments for lease to third party tenants located in Tokyo (東京都). All of them are operated on self-owned properties. See “Appendix III – Valuation Report on Selected Property Interests” for the full-text valuation report prepared by our Property Valuer on these properties.

Our Directors have confirmed that as at 30 September 2014, being the last day of the Track Record Period, no single property interest of ours that forms part of our non-property activities had a carrying amount of 15% or more of our total assets.

Further, our Directors have confirmed that as at the Latest Practicable Date, no single property interest of ours was material to our Group’s total assets as a whole, and none of our property interests was individually material to us in terms of turnover contribution or rental expenses.

### Self-owned properties

As at the Latest Practicable Date, approximately 55.4% of our Operational Premises were self-owned properties. The table below sets forth a summary of our self-owned Operational Premises:

Hall Numbers <sup>4</sup>	Pachinko halls		Approximate Gross Floor Area <sup>1 and 2</sup>
	Location	Usage	Total (sq.m.)
1	Sasakino, Fukushima-shi . . . . .	Pachinko hall	1,629
2	Toyano, Fukushima-shi . . . . .	Pachinko hall	1,664
3	Senouemachi, Fukushima-shi . . . . .	Pachinko hall	1,641
6	Asakamachi, Koriyama-shi . . . . .	Pachinko hall	1,579
8	Mukaigawaramachi, Koniya-shi . . . . .	Pachinko hall	1,929
9	Ekimae, Koniya-shi <sup>3</sup> . . . . .	Pachinko hall	3,273
10	Namiki, Koriyama-shi . . . . .	Pachinko hall	1,774
12	Otsukimachi, Koriyama-shi . . . . .	Pachinko hall	602
13	Zukei, Koriyama-shi . . . . .	Pachinko hall	1,450
15	Asakamachi, Koriyama-shi . . . . .	Pachinko hall	1,301
16	Emochi, Sukagawa-shi . . . . .	Pachinko hall	1,531
20	Taira, Iwaki-shi . . . . .	Pachinko hall	1,493

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Hall Numbers <sup>4</sup>	Pachinko halls		Approximate Gross Floor Area <sup>1 and 2</sup>
	Location	Usage	Total (sq.m.)
21	Tairashio, Iwaki-shi . . . . .	Pachinko hall	1,934
23	Banseicho, Yonezawa-shi . . . . .	Pachinko hall	835
24	Wakamiya, Yamagata-shi . . . . .	Pachinko hall	1,381
26	Minami-ku, Niigata-shi . . . . .	Pachinko hall	1,391
27	Kita-ku, Niigata-shi . . . . .	Pachinko hall	1,391
30	Odabayashi, Yuki-shi . . . . .	Pachinko hall	957
31	Higashikanesanacho, Hitachi-shi . . . . .	Pachinko hall	1,794
32	Ikkucho, Nasushiobara-shi . . . . .	Pachinko hall	1,454
33	Fukuicho, Ashikaga-shi . . . . .	Pachinko hall	1,625
35	Itahana, Annaka-shi . . . . .	Pachinko hall	1,657
36	Oizumimachi, Oura-gun . . . . .	Pachinko hall	1,768
40	Kamikawasaki, Hanyu-shi . . . . .	Pachinko hall	2,810
42	Nakano-ku, Tokyo . . . . .	Pachinko hall	887
45	Ota-ku, Tokyo . . . . .	Pachinko hall	479
53	Kurobeoka, Hiratsuka-shi . . . . .	Pachinko hall	1,675

**Total: 27**

### Supporting facilities

Hohaccho, Koriyama-shi . . . . .	Training facilities	1,460
Hohaccho, Koriyama-shi . . . . .	Headquarters	2,457

### Property activities (within the meanings of the Listing Rules)

Ekimae, Koriyama-shi . . . . .	Hotel and Ekimae hall <sup>3</sup>	3,273
Ekimae, Koriyama-shi . . . . .	Offices for lease	2,699
Oomorinishi, Tokyo . . . . .	Apartment units for lease	264

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Note:

1. Includes Operational Premises only.
2. The attributable interests of our Group in the properties listed above are 100%.
3. We operate a hotel above our Ekimae hall in Koriyama City (郡山市) of Fukushima Prefecture (福島県). The said hotel and pachinko hall are located in the same building.
4. The hall numbering follows the map of our pachinko halls set out in “– Pachinko and Pachislot Hall Operations – Geographical Focus in Northeast Honshu (本州島東北)” in this section above.

For details of the securities being secured to our self-owned Operational Premises, see “Financial Information – Indebtedness”.

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### Leased properties

As at the Latest Practicable Date, approximately 44.6% of our Operational Premises were leased properties, which have a lease term generally ranging from 3 to 20 years. The table below sets forth a summary of our leased Operational Premises:

Hall Numbers <sup>3</sup>	Location	Usage	Approximate Gross	
			Floor Area <sup>1 and 2</sup>	
			Total (sq.m.)	Expiry Date
4	Jotake, Nihonmatsu-shi. . . . .	Pachinko hall	1,523	February 2022
5	Motomiya, Motomiya-shi . . . . .	Pachinko hall	1,301	June 2030
7	Hiwadamachi, Koriyama-shi. . . . .	Pachinko hall	1,422	March 2017
11	Shima, Koriyama-shi . . . . .	Pachinko hall	959	March 2019
14	Minami, Koriyama-shi. . . . .	Pachinko hall	1,172	October 2021
18	Babano, Soma-shi . . . . .	Pachinko hall	1,389	February 2023
19	Haramachi-ku, Minamisoma-shi . . . . .	Pachinko hall	1,513	December 2029
22	Taihaku-ku, Sendai-shi. . . . .	Pachinko hall	2,161	August 2021
25	Higashi-ku, Niigata-shi. . . . .	Pachinko hall	1,393	April 2023
28	Tomado, Chikusei-shi . . . . .	Pachinko hall	1,398	June 2022
29	Edakawa, Hitachinaka-shi . . . . .	Pachinko hall	1,464	October 2021
34	Amagawaoshimamachi, Maebashi-shi . . . . .	Pachinko hall	1,932	November 2027
37	Atago, Kazo-shi . . . . .	Pachinko hall	1,839	July 2026
38	Fukai, Kitamoto-shi . . . . .	Pachinko hall	1,606	February 2025
39	Nakai, Konosu-shi . . . . .	Pachinko hall	2,055	March 2027
41	Nakano-ku, Tokyo . . . . .	Pachinko hall	852	Automatic renewal at a three-year interval
43	Nakano-ku, Tokyo . . . . .	Pachinko hall	385	Automatic renewal at a three-year interval
44	Nakano-ku, Tokyo . . . . .	Pachinko hall	628	June 2018
46	Ota-ku, Tokyo. . . . .	Pachinko hall	434	May 2015
47	Ota-ku, Tokyo. . . . .	Pachinko hall	362	July 2015
48	Tateno, Higashiyamato-shi. . . . .	Pachinko hall	1,951	April 2016
49	Kamikitadai, Higashiyamato-shi . . . . .	Pachinko hall	1,470	April 2019
50	Mizuhomachi, Nishitama-gun, Tokyo. . . . .	Pachinko hall	1,262	February 2020
51	Inadaira, Musashimurayama-shi, Tokyo . . . . .	Pachinko hall	1,465	January 2024

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Hall Numbers <sup>3</sup>	Location	Usage	Approximate Gross Floor Area <sup>1 and 2</sup>	
			Total (sq.m.)	Expiry Date
52	Ota-ku, Tokyo . . . . .	Pachinko hall	884	April 2022
54	Hongo, Ebina-shi . . . . .	Pachinko hall	2,103	August 2033
55	Shinkou, Iruma-shi . . . . .	Pachinko hall	2,467	November 2034
56	Arima Shibukawa-shi . . . . .	Pachinko hall	1,309	December 2034
<b>Total<sup>1</sup>: 28</b>				

### Others

Minato-ku, Tokyo . . . . .	Restaurant	308	July 2017
Minato-ku, Tokyo . . . . .	Office	243	Automatic renewal at a two-year interval
Central, Hong Kong . . . . .	Office	67	December 2017

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*Note:*

- Includes Operational Premises only and excludes a pachinko hall grossing 1,619 sq.m. which has been permanently closed since the Great East Japan Earthquake as it is located within the exclusion zones implemented by the Japanese government in March 2011. Both the land and building of that pachinko hall are leased properties expiring in 2027. See “— Pachinko and Pachislot Hall Operations — Fukushima Prefecture (福島県) and the Great East Japan Earthquake” in this section above for details.
- The attributable interest of our Group in the above listed properties is 100%.
- The hall numbering follows the map of our pachinko halls set out in “— Pachinko and Pachislot Hall Operations — Geographical Focus in Northeast Honshu (本州島東北)” in this section above.

The two leased Operational Premises that will expire by 2015<sup>5</sup> accounted for, in aggregate, approximately, 1.8%, 1.7%, 1.5% and 1.6%, respectively, of our revenue for the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014.

We own and/or rent the land on which our pachinko halls are located, and lease and/or have constructed the buildings that house our pachinko and pachislot hall operations. Under the Civil Code and the Leases Act and in accordance with the terms of our lease agreements, while the lessor owns the title of the land we lease, we own the title of the premises we constructed on such land. Our Japan Legal Adviser has confirmed that these arrangements of title ownership are in compliance with the Civil Code, the Leases Act and all applicable laws and regulations in Japan.

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<sup>5</sup> These are for the halls numbered 46 and 47 as indicated in the map in “Business — Pachinko and Pachislot Hall Operations — Geographical Focus in Northeast Honshu (本州島東北)”.

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We are generally required pursuant to the terms of our lease agreements to return the land to the lessor in its original condition as a vacant site upon expiry or termination of lease. Thus, if we do not renew all of our leases, we will be required to demolish the pachinko halls that we have constructed on the parcels of land we have leased as and when each such lease expires. Our Directors currently estimate that the maximum potential demolition costs for each pachinko hall premise shall be approximately ¥127.7 million excluding other costs. During the Track Record Period, we did not have any significant difficulty in securing location for our new pachinko halls, nor did we fail to renew any of our lease agreements for pachinko hall sites. See “Risk Factors — Risks Relating to our Business — We may not be able to renew leases or other contractual arrangements for the use of existing pachinko halls, or to obtain desirable sites for the expansion of our operations, on satisfactory terms or at all” for details.

The table below indicates how the properties housing our operational pachinko halls are held as at the Latest Practicable Date:

	Number of Pachinko Halls <sup>1</sup>				
	Self-owned Operational Premises			Leased Operational Premises	
	Owned building and partially owned (and partially leased) land			Leased building and partially owned (and partially leased) land	
	Owned building and owned land	Owned (and partially leased) land	Owned building and leased land	Leased building and leased land	Leased building and partially leased land
Pachinko halls. . . . .	6	13	8	27	1

*Note:*

- Includes our operational halls only and excludes a hall which has been permanently closed since the Great East Japan Earthquake as it is located within the exclusion zones implemented by the Japanese government in March 2011. Both the land and building of that pachinko hall are leased properties expiring in 2027. See “— Pachinko and Pachislot Hall Operations — Fukushima Prefecture (福島県) and the Great East Japan Earthquake” in this section above for details.

The lease contacts for our pachinko halls operated on leased land consist of two types, namely (1) fixed term lease contract and (2) standard lease contract.

In a fixed term lease contract, the lessee must return the land as a vacant lot upon expiry or termination of the relevant lease contract. The lessee under a standard lease contract enjoys security of tenure because the contract may be automatically renewed unless the lessor has justifiable reasons for re-entry upon expiry of the lease contract. Our Directors currently intend to use our best endeavours to negotiate for the renewal of our fixed term contracts on commercially viable terms and conditions that are in the interests of our Company and Shareholders as a whole. We are in negotiation with the relevant landlords of the three pachinko halls with lease land components expiring by 2015 and our Directors believe that, based on the current negotiation status, it is highly likely that we will be able to continue occupying the Operational Premises and land components housing these three pachinko halls.

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The earliest expiration date of the lease contracts for 49 of our pachinko halls with leased land components is in 2015. The table below summarises the type of lease contracts for the 49 pachinko halls as at the Latest Practicable Date:

Year of expiry of land lease contract	Number of pachinko halls <sup>1</sup>			
	Fixed term lease (land components)	Fixed term leases (land and building components)	Standard lease	Total
By 2015 .....	—	—	3	3
2016-2020 .....	—	1	11	12
2021-2025 .....	4	4	12	20
2026-2030 .....	3	—	5	8
2031-2035 .....	1	1	2	4
Automatic renewal .....	—	—	2	2
Total .....	<u>8</u>	<u>6</u>	<u>35</u>	<u>49</u>

*Note:*

- Includes our operational halls only and excludes a hall which has been permanently closed since the Great East Japan Earthquake as it is located within the exclusion zones implemented by the Japanese government in March 2011. Both the land and building of that pachinko hall are leased properties expiring in 2027. See “— Pachinko and Pachislot Hall Operations — Fukushima Prefecture (福島県) and the Great East Japan Earthquake” in this section above for details.

The three lease contracts with leased land components that will expire by 2015<sup>6</sup> accounted for, in aggregate, approximately 4.3%, 4.2%, 4.2% and 4.4% of our revenue for the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, respectively.

As at the Latest Practicable Date, save as disclosed in this Prospectus, none of our Operational Premises (i) was subject to any restriction on use; (ii) was subject to encumbrances, liens, pledges and mortgages; or (iii) involved any breach of law and regulation (including environmental regulation), title defect, investigation, notice or pending litigation, nor did we have any plan to (a) construct, renovate, improve or develop any Operational Premise; or (b) dispose of or change the use of any Operational Premise.

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<sup>6</sup> These are for the halls numbered 10, 46 and 47 as indicated in the map in “Business — Pachinko and Pachislot Hall Operations — Geographical Focus in Northeast Honshu (本州島東北).”

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### INTELLECTUAL PROPERTY

Our Group's brand name, particularly our traditional "NIRAKU" brands, are valuable assets for our Company and operations.

As at the Latest Practicable Date, our Group had 24 registered trademarks in Japan and ten of which are material to our pachinko and pachislot hall operations. These material trademarks are our "NIRAKU (ニラク)" brand, ,  and **NIRAKU** or variations of them, under which all of our Group's pachinko halls in Japan are operated. These material trademarks have been registered by our Group in Japan and are each valid for ten years from the date of registration. The material trademarks have commencement dates ranging from April 2003 to August 2012 and will expire between August 2018 and May 2024. These trademarks are of material importance to our business operations, financial position and prospects. As at the Latest Practicable Date, our Japan Legal Adviser has confirmed that we own and have valid and enforceable rights to use our intellectual property rights as set forth here.

We have also been granted exclusive use of the "LIZARRAN" trademark, a Spanish restaurant. See "— Other Business" in this section below for details.

During the Track Record Period, no material claims or disputes were brought against us in relation to any infringement of trademarks, patents or other intellectual property. Our Directors are also not aware of any use by any third party of our logo or brand and believe that there has been no infringement that would result in a significant potential impact to our business.

See "Appendix VI — Statutory and General Information — 2. Our material intellectual property rights" for details of intellectual property rights that are material to our business.

### INSURANCE

We believe that our insurance coverage is consistent with the industry standard and is adequate for our business operations. From time to time, we review and assess our risks and adjust our insurance coverage as appropriate.

We maintain fire insurance for our pachinko halls and operating properties from fire damage. We also maintain movable property insurance, which insures our movable property (such as cash in our halls) from theft and burglary, and public liability insurance for third party physical injuries and property damage, and labour and health insurance for our employees. Each policy contains certain customary exclusions. In addition, certain events such as nuclear events, labour strikes, acts of war or terrorism, and other disasters are excluded from coverage by these insurance policies. We do not carry business interruption insurance resulting from natural disasters such as droughts, floods, earthquakes or severe weather conditions, any suspension or cessation in the supply of utilities and other calamities. We plan to purchase similar policies for our future properties. However, our insurance coverage may not be adequate to cover all losses that may

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occur. See “Risk Factors — Risks Relating to Our Business — Our insurance coverage may not be adequate to cover all possible operational losses that we could suffer. In addition, our insurance costs may increase and we may not be able to obtain the same level of insurance coverage in the future”.

### OTHER BUSINESSES

Our primary business has always been our pachinko and pachislot hall operations. Our revenue from pachinko and pachislot hall operations constituted almost all of our total revenue, namely 97.6%, 97.5%, 97.5% and 97.6% of our total revenue during the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014. Other than our core business of pachinko and pachislot hall operations (including vending machine income), we also have two other businesses, namely our hotel operations and also our “LIZARRAN” restaurant.

#### 1. Hotel Operations

We have been operating a hotel called Koriyama City Hotel (郡山シティホテル), which is a business hotel with basic amenities, since 1979. It is situated in the centre of Koriyama City (郡山市), Fukushima Prefecture (福島県), being in front of the Koriyama railway station. It is a 11-storey hotel with a gross floor area of 2,944.38 sq m and has 84 guest rooms.

Our Property Valuer, DTZ Debenham Tie Leung Limited, an independent property valuer, has valued (among others) our hotel as at 31 January 2015 and is of the opinion that its value was ¥728 million, with the entire value attributable to us. See “Appendix III— Valuation Report on Selected Property Interests” for the full text of their letter, summary of valuation and valuation certificates.

Our revenue from our hotel operations has been relatively insignificant, namely nil, ¥84 million, ¥149 million and ¥80 million, representing only nil, 0.3%, 0.4% and 0.5% of our total revenue, for the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, respectively. Revenue from our hotel operations was nil in the year ended 31 March 2012 because our hotel had been closed for renovation since the Great East Japan Earthquake and reopened in August 2012. For the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, our hotel’s average occupancy rate was nil, 70.3%, 79.9% and 82.2%, respectively. As our Group’s hotel operation is not our major business focus, we have no intention to expand (i.e. increasing the number of hotels) our hotel operation. For the years ended 31 March 2012, 2013 and 2014 and the six months ended 30 September 2014, our hotel’s net profit / (loss) before tax amounted to (¥138 million), (¥12 million), ¥1 million and ¥6 million, respectively. As our hotel is a budget hotel with limited facilities, our expected capital expenditures on the maintenance and refurbishment of the hotel shall not be significant.



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### 2. “LIZARRAN” Restaurant

On 16 December 2013, we (through our subsidiary, Niraku Corporation) and Comess Group De Restauración S.K. (“**Comess Group**”), an independent third party, entered into a franchise agreement, whereby Comess Group granted Niraku Corporation the exclusive rights to open a network of “LIZARRAN” restaurants in Japan. Comess Group is a reputable restaurant group that has over 10 years’ experience in operating and franchising multiple restaurant brands (such as “LIZARRAN”, “Cantina Mariachi”, “Pasta City”, “Rock & Ribs” and “China Boom”) and over 300 restaurant establishments across the world (especially in Europe, and also the Middle East, China and now Japan). The material terms of this franchise agreement are:

<b>Parties</b>	(1) Comess Group, as franchisor and legal owner of the “LIZARRAN” trademark (a Spanish restaurant); and  (2) Niraku Corporation, as franchisee
<b>Licence</b>	Comess Group grants Niraku Corporation the exclusive rights to open a network of “LIZARRAN” restaurants in Japan, which must always operate in accordance with the instructions of Comess Group. Such exclusivity even precludes Comess Group from opening any such restaurant in Japan
<b>Restaurant openings</b>	Niraku Corporation will open at least 20 restaurants by 2028, with at least one new restaurant per year
<b>Term</b>	20 years (renewable for an additional 20 years by Niraku Corporation upon six months’ written notice and Niraku Corporation’s compliance with this franchise agreement)
<b>Fees/Royalties</b>	Niraku Corporation shall pay to Comess Group: <ul style="list-style-type: none"><li>• initial licence fee - €250,000 (equivalent to approximately HK\$3.04 million)</li><li>• royalties - 2.25% of Niraku Corporation’s net sales, payable monthly</li></ul>

We entered into this franchise agreement in order to diversify our business and because our Directors viewed this as a sound business opportunity. A side benefit is also an added level of hospitality training for our employees, as we will periodically rotate selected employees to serve at our restaurants.

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As at the Latest Practicable Date, we had opened one restaurant on 15 October 2014 (thus, no revenue for our restaurant business was recorded during the Track Record Period) as our first and flagship “LIZARRAN” restaurant (with a seating capacity of 82) and is situated in Tokyo (東京都). In each of 2015, 2016 and 2017, we plan to open one new restaurant in Tokyo (東京都). The estimated costs of opening each new restaurant is approximately ¥40 million to ¥50 million.

For the six months ended 30 September 2014, pre-operating costs for setting up our restaurant (including costs for staff recruitment and rental) of ¥10 million were recorded. As a result, our Group’s “other business” recorded a loss of ¥4 million, taking into account our hotel operation’s net profit before tax of ¥6 million for the six months ended 30 September 2014.

The strategy of our restaurant business is to capture the taste of the younger generation (as we believe Spanish cuisine is particularly appealing to them as it is a relatively social cuisine that is served in a relatively casual and relaxing environment) by: (1) serving authentic Spanish cuisine at affordable prices (as opposed to other European cuisines); (2) providing attentive services (all restaurant staff will receive extensive training); (3) strategically placing our restaurants in locations with high customer traffic; and (4) learning from the proven track record of Lizzaran restaurant’s chain restaurant management experience (with a network of over 300 restaurants worldwide, including in Asia). We expect our restaurants will breakeven within approximately 12 months from opening. Further, due to the relatively low investment cost of our restaurant operation (as the opening cost of a restaurant amounts to approximately ¥40 to ¥50 million) and the fact that restaurant operation is more of a cashflow business and does not require much working capital (i.e. debtor turnover days is relatively short), we do not expect any significant risk to arise from our restaurant operation.

### LEGAL PROCEEDINGS AND COMPLIANCE

From time to time, we have been (and may in the future occasionally be) involved in routine legal proceedings or disputes in the ordinary course of our business that are common for our industry, which are primarily disputes with our customers, suppliers and employees regarding minor employment disputes, customer complaints and contract disputes with our suppliers. During the Track Record Period, we were not involved in any legal proceedings. We are also subject to regular investigation by the relevant government regulatory bodies (including police personnel) regarding our licenses and operations. We have not incurred significant legal costs and expenses in connection with these legal proceedings and investigations.

Under the Amusement Business Law, we, as a pachinko hall operator, must, prior to establishing each pachinko hall, obtain an operating licence from the relevant Prefectural Public Safety Commission\* (都道府県公安委員会). Once granted, the operating licence will remain effective unless and until it is cancelled by the Prefectural Public Safety Commission\* (都道府県公安委員会) pursuant to the Amusement Business Law. As at the Latest Practicable Date, we owned 56 halls and had obtained and directly hold a licence (through Niraku Corporation) for each of these halls, each of which is currently valid.

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Our Japan Legal Adviser has confirmed that, during the Track Record Period and up to the Latest Practicable Date: (1) we have not been the subject of any administrative proceedings (including administrative dispositions) and have not been imposed any fines or penalties (including suspensions or revocations of operating licences) by regulatory authorities; (2) none of our Directors or senior management has been, or are, the subject of any regulatory inquiry or investigation in Japan; (3) we have also been, and currently are, in compliance in all material respects with all applicable laws, rules and regulations; (4) we have obtained and currently maintain all necessary approvals, certificates, permits or licenses that are material to our operations; (5) our Company was in compliance with the applicable laws and regulations in any and all conditions imposed on it under licences granted by the relevant Prefectural Public Safety Commission\* (都道府県公安委員会) in all material respects; (6) the Prefectural Public Safety Commission\* (都道府県公安委員会) has not imposed any non-standard conditions on or suspended or revoked any of the licenses held by our Group; (7) none of our pachinko hall operations have been suspended due to violations of the Amusement Business Law or other applicable laws and regulations; and (8) we were not involved in any litigation or arbitration proceedings pending or, to our knowledge, threatened against us or any of our Directors that could have a material adverse effect on our business, financial condition or results of operations.