18 October 2024

GENDA（9166 JP）

A High-Quality M&A Compounder with Strong Cash Flow Generation

Executive Summary

GENDA is a rapidly growing holding company in the entertainment industry, operating amusement arcades and karaoke boxes. At CGS, we believe that GENDA’s greatest strength lies in its robust cash flow (CF) generation, fueled by M&A as a key growth driver. Notably, GENDA has achieved an incremental ROI of approx. 25% - a key metric for CGS in assessing the quality of a company’s CF generation, measuring the return of operating CF increase relative to invested capital growth. This performance is exceptionally high, even compared to global companies with M&A-driven growth strategies, and CGS expects this level to be maintained over the long term. When we compare GENDA against global companies in mature industries pursuing roll-up M&A strategies, however, GENDA’s EV/EBITDA multiple per 1% of expected profit growth (0.3x as of October 2024) currently trades at an approx. 70-80% discount. This suggests a strong sense of undervaluation per growth, from an objective standpoint.

In this report, we examine GENDA’s equity story from three key perspectives. We also explore the underlying business model, M&A strategy, and potential risk factors. Finally, to give investors a deeper understanding of the company's equity story, we have included interviews with CEO Ms. Shin and CFO Mr. Watanabe.

The three key points of the company’s equity story are as follows:

1. GENDA’s M&A Strategy Shows Strong Potential for Success

GENDA's M&A strategy is well-supported by a clear vision, skilled professionals, an effective roll-up model, and robust post-acquisition initiatives. Also in Japan, several structural factors further enhance the feasibility of high-return M&A: a significant demand for business succession due to the aging population, the ability to acquire businesses at relatively low multiples due to tax incentives, and the low interest rates.

2. FY27 EBITDA Projected at ¥44.7bn, a 5.5x Increase Over FY23

For this report, CGS has modeled GENDA’s financial performance through FY27, based on specific assumptions including future M&A. Notably, the U.S. segment is expected to generate substantial synergies, representing a major area of growth.

3. Significant Upside Potential in GENDA’s Valuation Multiple per 1% Growth

CGS analyzed GENDA's valuation per 1% profit growth through four key drivers: capital efficiency, CF conversion, profit growth volatility, and quality of capital allocation. When comparing these to the global companies that also leverage roll-up M&A within mature industries, GENDA stands out as undervalued from an objective point of view, with a potential room for valuation growth.

CGS believes that GENDA's goal of becoming the world’s leading entertainment company by 2040 is well-supported by its current strategy as the first step. We look forward to seeing GENDA’s future as a physical platform championing Japan's renowned anime culture on a global scale.

Capital Growth Strategies Co., Ltd.

Team Research
research@capital-gs.co.jp

GENDA（9166 JP）

Share Price (as of 17 Oct 2024)	JPY 2,498
Market Cap.	US$ 1.3bn

FY(Jan.-end)	F24E	F25E	F26E	F27E
Cash EPS	70	102	152	219
Cash P/E	36x	25x	16x	11x
P/E	48x	37x	25x	17x
P/B	6x	5x	4x	3x
ROE	15%	14%	17%	21%
EV/EBITDA	14x	11x	8x	6x
Dividend Yield	0%	0%	0%	0%
Cash ROIC	14%	12%	12%	13%
OCF Conversion	58%	64%	67%	68%
Incremental ROI*	5%	20%	22%	27%

* Incremental ROI: OCF Growth/Invested Capital Growth

Contents

*CGS estimates

Equity Story ①: GENDA’s M&A Strategy Shows Strong Potential for Success

Summary:

GENDA’s M&A strategy is supported by a solid management foundation—skilled professionals in M&A, business operations, and digital transformation (DX); a clear roll-up-focused vision; and well-established systems for deal sourcing, integration, and synergy realization. This foundation is complemented by Japan’s favorable structural conditions, including an aging population, tax policies, and low interest rates, all of which create an environment for sustained success in M&A. Notably, post-acquisition synergies have already demonstrated strong performance, and the DX team is expected to further contribute to the development of a differentiated model.

Here we summarize the key rationales:

I. Gathering of M&A Professionals
GENDA is composed of experts, including management team with deep knowledge of the entertainment industry, as well as finance, legal, and accounting professionals adept in the M&A process, and DX specialists. This internal expertise leads to high performance, with minimal reliance on external resources. Consequently, decision-making and execution speed are faster, and acquisition costs are kept lower.

II. Favorable External Environment
Japan offers a unique environment with an unprecedented demand for business succession due to the aging business-owner demographic, along with relatively low M&A multiples. These conditions are rare globally and highly favorable for GENDA. Additionally, Japan’s low-interest rates further enhance the investment landscape.

III. Focus on a Roll-Up Model in the Amusement and Karaoke Industries
With the roll-up model as the primary approach, GENDA benefits from reduced management risk while achieving economies of scale. This also helps to keep acquisition costs low.

IV. Post-Merger Integration (PMI) Synergies Are Successfully Materializing
The synergies resulting from PMI efforts are emerging as planned, driving additional value from acquisitions.

V. Track Record and Credibility in M&A
Having completed 34 acquisitions to date, GENDA is well-regarded among potential acquisition targets. In addition to direct-sourcing through the group’s internal network, GENDA partners with over 100 of M&A brokerage firms and achieves approx. 200 sourcing leads. CGS thinks his success is resulted from GENDA's credibility and extensive network.

VI. GENDA’s Acquisition Strategy
GENDA's EV/EBITDA is currently at 14x (based on FY24 CGS est.). Acquiring companies with significantly lower EV/EBITDA multiples and realizing post-acquisition synergies facilitate higher corporate value. Using its own shares for acquisitions is also feasible, enabling quicker capital recovery and leveraging low-interest rates (GENDA’s borrowing cost is in the 1% range).

Now we take a deeper look at some of the important rationales above.

I. Gathering of M&A Professionals

○ Out of 105 employees at headquarters, 34 are management personnel, and 71 are tech specialists. Within the management team, approx. 20 are part of the M&A team (excluding executive management), with the rest in roles such as HR and general administration. The M&A team includes diverse professionals from global investment banks (with CEO Ms. Shin and CFO Mr. Watanabe both formerly with Goldman Sachs), consulting firms, FAS, former M&A finance bankers, legal experts, and certified public accountants.

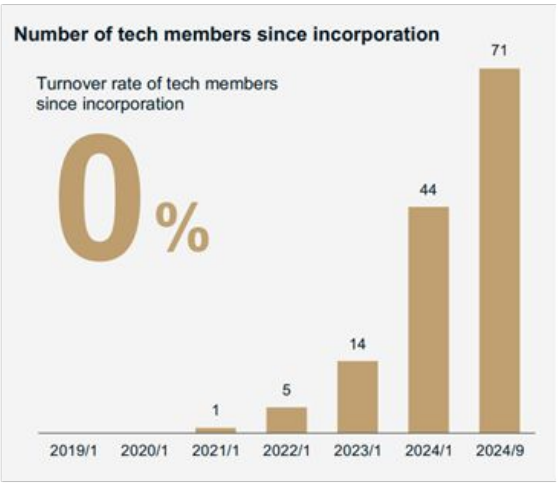
Equity Story ①: GENDA’s M&A Strategy Shows Strong Potential for Success

○ This robust team allows GENDA to handle the entire M&A process in-house, from sourcing (identifying and researching acquisition targets) and conducting due diligence (evaluating a target's operational, financial, and risk factors) to post-merger integration (PMI). With a dedicated specialist team, GENDA can manage multiple projects simultaneously, ensuring smooth and efficient execution.

○ In the M&A process, proposals are reviewed by the “Investment Committee” before final approval by the Board of Directors. The Investment Committee consists of five key members: Chairman Mr. Kataoka, CEO Ms. Shin, CFO Mr. Watanabe, CSO Mr. Hahara, and Executive Officer Mr. Ninomiya. Together, these five members hold approx. 20% of the total shares, and they carefully assess each opportunity to ensure it contributes to an increase in “per-share value.” Additionally, Chairman Mr. Kataoka dedicates significant time to M&A activities, including sourcing acquisition targets.

○ The company actively recruits tech talent and leverages DX in PMI. They are integrated into acquired companies to support system upgrades and streamline operations. DX is also used proactively to address on-the-ground challenges. While day-to-day operations at arcade and karaoke venues are not highly visible to outsiders, many tasks rely on spreadsheet and manual labor, resulting in inefficiencies, which present significant opportunities for DX improvement. The company also plans to enhance digital marketing efforts via its own app and other platforms. In recent earnings briefings, some of the examples have been shared, such as using app-based coupons for customer acquisition and digitalizing the prize game supply chain.

Ex. 1: Growth of Tech Professionals at GENDA



Source: GENDA

II. Favorable External Environment

○ The following external factors strongly support GENDA’s ability to execute continuous M&A:

1. **Rising Demand for Business Succession Due to Aging Demographics**
   A critical factor behind GENDA’s consistent M&A activities is Japan’s unprecedented need for business succession. Many well-performing businesses are seeking buyers due to a lack of successors, presenting ample acquisition opportunities.

2. **Rationally Justified, Relatively Low Acquisition Valuations**
   In business succession M&As, valuations can be relatively lower than in traditional M&A. Many business-owners prefer selling their business at a slightly lower valuation over retaining it due to significant tax benefits. For instance, future profits would incur corporate and income taxes, and retaining the business until the owner’s passing could lead to inheritance tax rates as high as 55%. However, choosing to sell now allows owners to capture future profits only at a 20.3% capital gains tax, securing funds while they’re still in good health. The entertainment industry typically has a FCF/EBITDA conversion of around 50% (the remainder is primarily taxes and CapEx). Therefore, selling at 6-10 years of future FCF equates to approx. 3-5 years of EBITDA, justifying EV/EBITDA multiples of 3-5x.

Equity Story ①: GENDA's M&A Strategy Shows Strong Potential for Success

3. **Low-Interest Rates Enhance Investment Returns**
   Japan's low-interest rates significantly benefit GENDA's M&A strategy from a ROI perspective for shareholders. Practically, 3-5 year EBITDA payback model translates to an EBITDA yield of around 20-30%, and FCF yield of around 10-15%. This effectively allows for funding at an interest rate of 1% and generating a FCF return of 10-15%, making for highly favorable investment returns. Additionally, the low-interest environment in Japan enables a strong leverage effect, leading to a further increase in shareholders return. For example, consider acquiring a company with ¥1bn of EBITDA and ¥500mn of FCF at an EV of ¥4bn yen (EV/EBITDA multiple of 4x), using ¥3.8bn of debt and ¥200mn of equity (GENDA typically finances M&A with 100% debt). Quick math suggests that in this case, shareholders' internal rate of return (IRR) could reach 32% assuming that GENDA equally repays debt through 8 years (a typical borrowing term for GENDA) with annual interest rate of 1%. This does not take post-acquisition synergies into account.

   If post-acquisition synergies increase EBITDA by 30% only in the first year, the IRR could reach 100% meaning invested shareholders equity is expected to double every year (see Example 1 under IV. Expected Synergies). Alternatively, assuming a 10% cost of capital and a perpetual growth rate of 0%, the company's value would be ¥5bn (¥500mn FCF/10%), minus ¥3.8bn in debt, resulting in ¥1.2bn in equity value. Thus, there is a potential for them to achieve M&A that can turn ¥200mn investment into ¥1.2bn through financial leverage. CGS thinks this is one of their advantages as a corporate where it can fully leverage M&A with debt.

III. Focus on a Roll-Up Model in the Amusement and Karaoke Industries

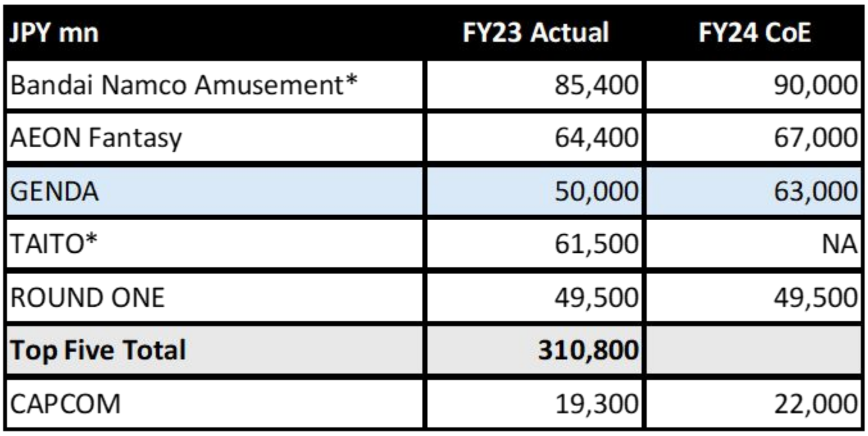
○ A roll-up M&A strategy involves acquiring multiple companies within the same industry, typically where smaller players dominate, to achieve consolidation. GENDA has effectively implemented this approach in the arcade market, fueling rapid growth. Out of 34 acquisitions, 16 have been domestic arcades.

○ The advantages of a roll-up M&A strategy include: 1) achieving scale economies by consolidating redundant functions to reduce costs; 2) enhancing synergy creation through GENDA's support, knowledge transfer, and group collaboration; 3) enabling rapid growth; 4) strengthening brand presence and market visibility; 5) acquiring at lower valuations; and 6) promoting industry restructuring, which helps alleviate competitive pressures.

○ There is still ample room for roll-up M&A in the domestic arcade market. GENDA holds a little over 10% market share, placing it third in the industry. While the top five companies account for about 50% of the market (in terms of revenue), the remaining 50% consists of roughly 100 small and medium-sized companies. Acquiring these smaller players offers substantial growth potential. Other arcade operators are not as proactive in M&A and likely lack the execution capabilities that GENDA possesses.

Equity Story ①: GENDA’s M&A Strategy Shows Strong Potential for Success

Ex. 2: Sales of Key Players in Domestic Amusement Arcades



JPY mn	FY23 Actual	FY24 CoE
Bandai Namco Amusement*	85,400	90,000
AEON Fantasy	64,400	67,000
GENDA	50,000	63,000
TAITO*	61,500	NA
ROUND ONE	49,500	49,500
Top Five Total	**310,800**	
CAPCOM	19,300	22,000

Note: Bandai Namco Amusement’s figure includes overseas sales.
TAITO’s figure includes equipment sales.
Source: CGS – Based on Company Data

IV. Post-Merger Integration (PMI) Synergies Are Successfully Materializing

○ Acquired companies have been growing steadily, with synergy effects contributing to overall performance expansion. In non-manufacturing acquisitions, PMI synergies primarily include: (1) revenue growth, (2) cost reductions through purchasing scale, improved product mix, and margin enhancement via price adjustments, and (3) reductions in SG&A costs through functional integration and productivity gains.

○ Synergies are managed through monthly "GENDA Group Management Meetings," where leaders from each group company participate. Under a give-and-take approach, synergy initiatives are presented and decisions are made on the spot, ensuring prompt execution.

Ex. 3: Structure to maximize synergies led by GENDA Group Management Meetings

Measures to Maximize Synergies

GENDA

Manage synergies at monthly GENDA Group Management Meetings

- Top executives from each company physically gather to discuss measures to realize synergies
- Embodying “Speed is King”, one of the GENDA Values, we immediately execute management decisions that generate synergies “on the spot” (specific examples are shown on the following pages)

(Seating chart at the February 2024 Group Management Meeting)

Source: GENDA

Equity Story ①: GENDA's M&A Strategy Shows Strong Potential for Success

○ Examples of Successful Post-Merger Integration (PMI)

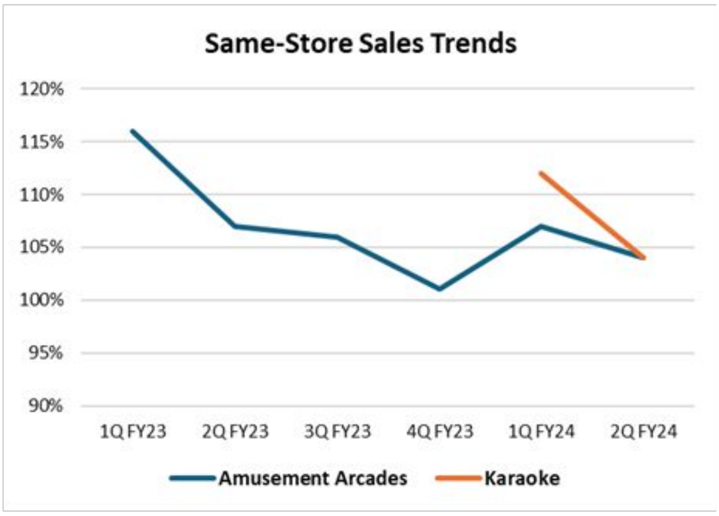
(Example 1) Achieving Fast Payback

In arcades where prize games are a main attraction, economies of scale offer significant advantages. For instance, an exclusive campaign featuring TWICE merchandise, which generated remarkable sales, would be unfeasible for a smaller chain of five locations, but is accessible once arcades join the GENDA Group. As a result, post-acquisition, all acquired arcades have seen substantial growth in EBITDA. According to GENDA's disclosures, Takarajima's 20 locations achieved payback in just over two years, while Sugai Tinos' 18 locations and Avis' 4 locations were just about 1.5 years payback, demonstrating impressively quick returns.

(Example 2) Sales Growth in Arcades and Karaoke Boxes

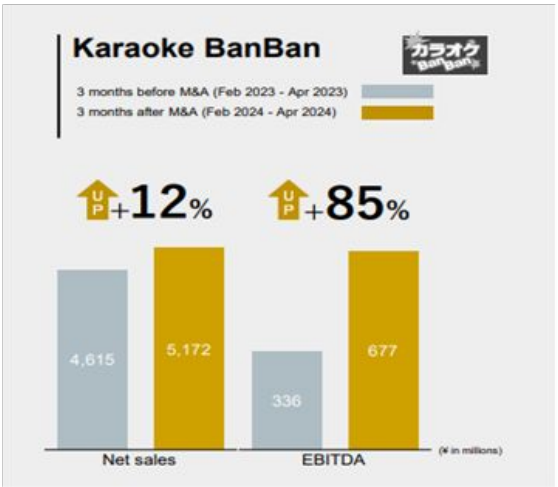
In FY24, same-store sales growth has been strong, with arcades achieving a 7% increase in Q1 and 4% in Q2, and karaoke boxes posting 12% in Q1 and 4% in Q2. Given the high contribution margins—70% for arcades and 90% for karaoke boxes—this sales growth has a significant impact. EBITDA for karaoke boxes surged by 85% within three months of the acquisition. In arcades, initiatives include sharing high-quality GiGO prizes, introducing anime and other IP-based campaigns, remodeling with a focus on prize games, and app-based promotions. In karaoke boxes, growth strategies include optimizing pricing, collaborating with arcades for joint promotions, and IP partnerships. These efforts not only improve profitability but boost employee morale.

Ex. 4: GENDA's Same-Store Sales Growth Trends



Source: CGS – Based on Company Data

Ex. 5: Example of Synergy Creation by GENDA (Shin Corporation)



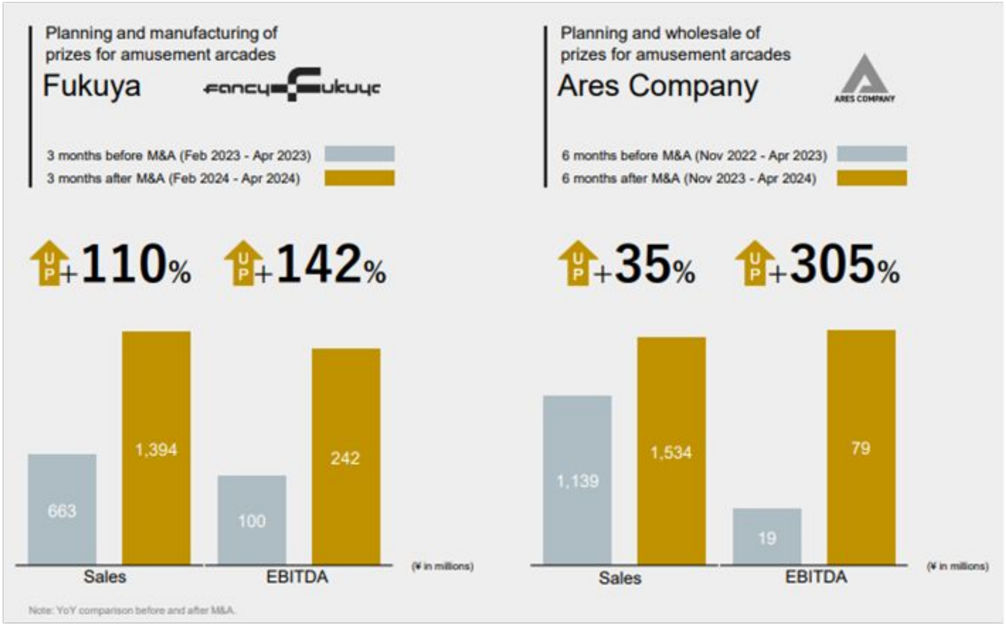
Source: Company Data

Equity Story ①: GENDA's M&A Strategy Shows Strong Potential for Success

(Example 3) Growth in Prize Companies (Suppliers for Arcade Prizes)

In October 2023, GENDA acquired Ales Company, followed by Fukuyaho Holdings in January 2024. Post-acquisition, both companies experienced strong sales growth and improved profitability. Sales to the GENDA Group increased, and cross-selling opportunities with other clients contributed to the revenue growth. Additionally, cost reductions from shared procurement and functionality integration helped enhance profitability.

Ex. 6: Example of Synergy Creation by GENDA (Prize Companies)



Source: Company Data

Equity Story ②: FY27 EBITDA Projected at ¥44.7bn, a 5.5x Increase Over FY23

***Projections Based on CGS Performance Model Forecasts**

Summary:

Based on certain assumptions on M&A and other factors, CGS simulated a financial model that projects EBITDA of ¥44.7bn (5.5x growth vs FY23), EBITA of ¥27.6bn (5.0x growth), and cash EPS of ¥219 (3.5x growth) by FY27. EBITA growth is primarily driven by contributions from M&A and synergy effects from the US business. For the US segment, CGS expects a ¥3.7bn increase in EBITA by FY27, largely due to the store refurbishment impact on the newly acquired NEN locations (with an assumption that store sales increase by 80% through refurbishment). If the store refurbishment impact exceeds expectations, additional profit gains may be realized.

***Note:** The company has not disclosed medium-term management targets due to the inherent uncertainties of future M&A activities. At CGS, we have attempted to forecast performance through FY27 based on certain assumptions, including M&A and subsequent synergies. Please note that there is a risk that M&A outcomes and synergies may not proceed exactly as assumed, and these projections are intended to provide an illustrative image of potential future performance.*

○ M&A Assumptions in CGS Forecast:

1. **M&A Investment Amounts**: FY24 M&A investments are projected at ¥18bn (Only publicly announced deals. ¥21.2bn if stock-deals are included.). From FY25 onward, we assumed annual M&A investments to be ¥30bn, all financed through debt with no equity financing assumed.
2. **Acquisition Valuation**: From FY25 onward, M&A investments are assumed to have an acquisition valuation of EV/EBITDA at 5x on our base case.
3. **Returns and Assets from ¥30bn M&A Investment**: Expected returns and assets acquired from a ¥30bn M&A investment are assumed as follows: revenue of ¥36bn, EBITDA of ¥6bn yen, EBITA of ¥3.6bn, total assets of ¥30bn yen, and goodwill of ¥15bn yen. However, in the first year, only half of this impact (six months) is assumed.
4. **Annual M&A Advisory Costs**: Annual advisory fees for M&A are assumed to be ¥1bn (treated as non-tax-deductible similar to goodwill).
5. **PMI Effects and Capital Expenditures**: Post-acquisition, EBITDA is projected to increase by 20% over three years due to PMI effects and capital investments.

○ Additional Key Assumptions (Organic):

1. **Annual Capital Expenditures**: Targeted at 8-10% of sales (including investments in both new and existing stores).
2. **Sales Growth in Existing Business**: Expected to grow at an annual rate of 7% (5% from new stores and 2% from existing stores).
3. **U.S. Subsidiary NEN's Projected Growth**: Expected to reach 1.6x sales growth by FY27 (compared to FY23) with an EBITDA margin of 20% (19% for overall North American operations).

○ Simulated CGS Forecast Model Based on Assumptions Above:

- **Revenue**: ¥249.5bn, representing a 31% CAGR from FY24.
- **EBITDA**: ¥44.7bn, achieving a 45% CAGR from FY24.
- **EBITA (Operating Profit ex. Goodwill Amortization)**: ¥27.6bn, with a 43% CAGR from FY24.
- **Cash EPS (EPS Excluding Goodwill Amortization)**: ¥219, reflecting a 46% CAGR from FY24.

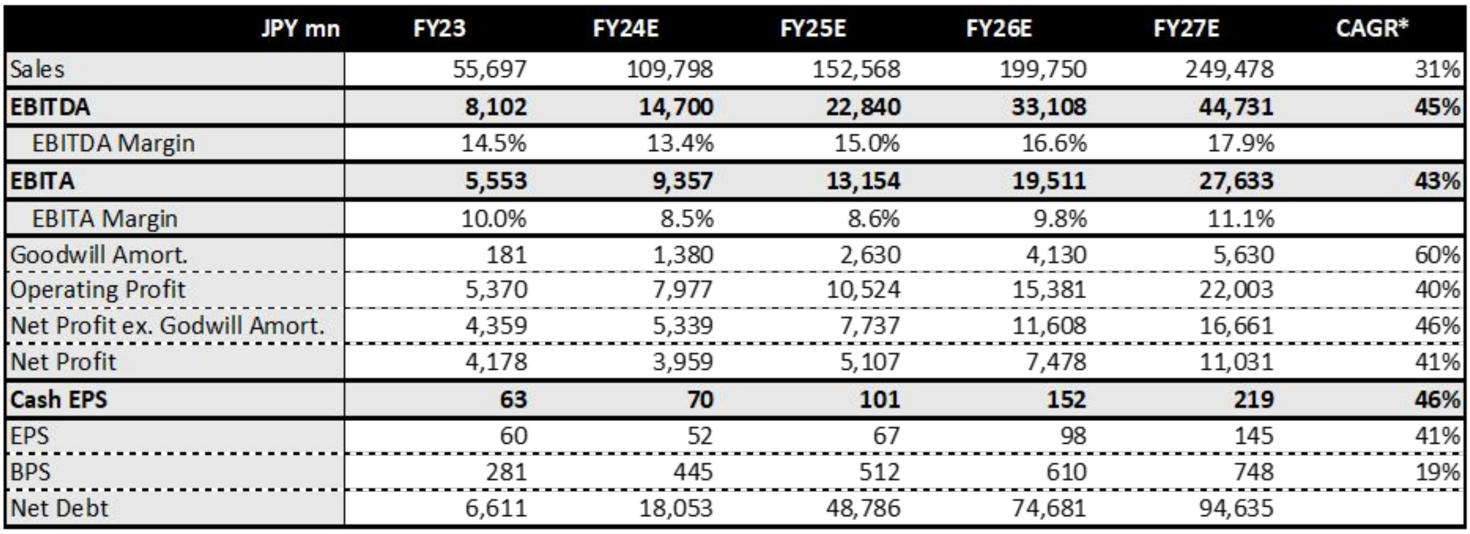
For further details, please refer to Tables 7–12.

Equity Story ②: FY27 EBITDA Projected at ¥44.7bn, a 5.5x Increase Over FY23

***Projections Based on CGS Performance Model Forecasts**

○ CGS places an importance on EBITDA, EBITA (operating profit before goodwill amortization), and cash EPS, similar to the company's focus. Given that M&A is a key growth driver for the company, metrics that exclude goodwill amortization should be seen as a closer reflection of its actual cash flow performance.

Ex. 7: GENDA's Mid-term Financials Forecast (CGS est.)



JPY mn	FY23	FY24E	FY25E	FY26E	FY27E	CAGR*
Sales	55,697	109,798	152,568	199,750	249,478	31%
EBITDA	**8,102**	**14,700**	**22,840**	**33,108**	**44,731**	**45%**
EBITDA Margin	14.5%	13.4%	15.0%	16.6%	17.9%	
EBITA	**5,553**	**9,357**	**13,154**	**19,511**	**27,633**	**43%**
EBITA Margin	10.0%	8.5%	8.6%	9.8%	11.1%	
Goodwill Amort.	181	1,380	2,630	4,130	5,630	60%
Operating Profit	5,370	7,977	10,524	15,381	22,003	40%
Net Profit ex. Godwill Amort.	4,359	5,339	7,737	11,608	16,661	46%
Net Profit	4,178	3,959	5,107	7,478	11,031	41%
Cash EPS	**63**	**70**	**101**	**152**	**219**	**46%**
EPS	60	52	67	98	145	41%
BPS	281	445	512	610	748	19%
Net Debt	6,611	18,053	48,786	74,681	94,635	

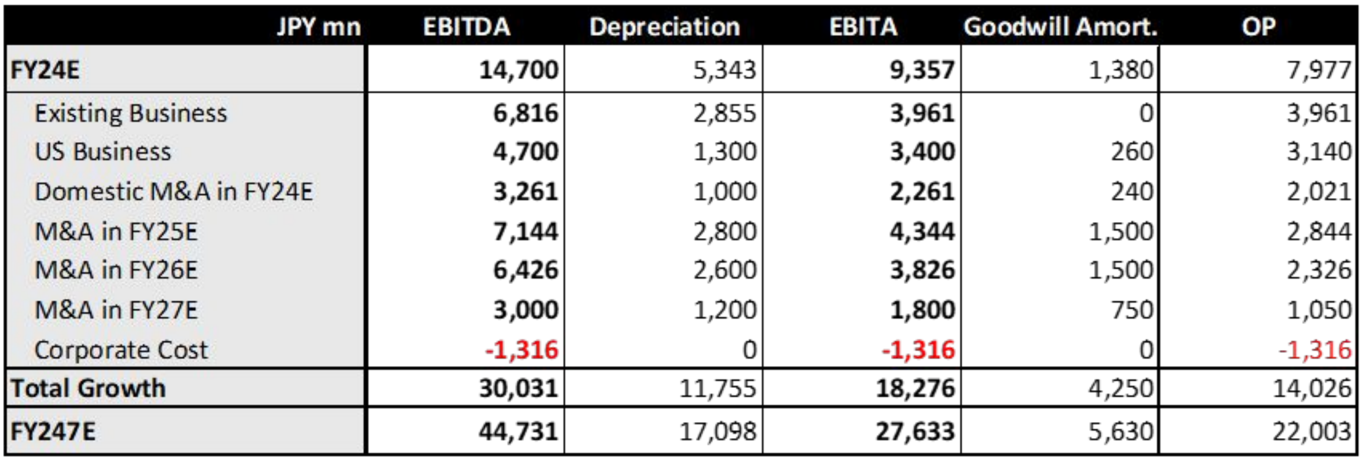
*CAGR from FY24E through FY27E

Source: CGS

○ In Ex. 8, we compare FY24 forecasts with FY27 projections for EBITDA, EBITA, and operating profit, showing the increase in each by contributing factor. EBITA is expected to increase by ¥18.3bn, broken down as follows:

1. **M&A Contributions from FY25 Onward**: ¥10bn
2. **US Business**: ¥3.4bn
3. **Domestic M&A Contributions in FY24**: ¥2.3bn (including ¥1.3bn from PMI effects)
4. **Profit Growth from Existing Domestic Businesses (mainly arcades)**: ¥4bn
5. **Increase in Corporate Expenses**: -¥1.3bn

Ex. 8: GENDA's Mid-term Growth Driver Forecast (CGS est.)



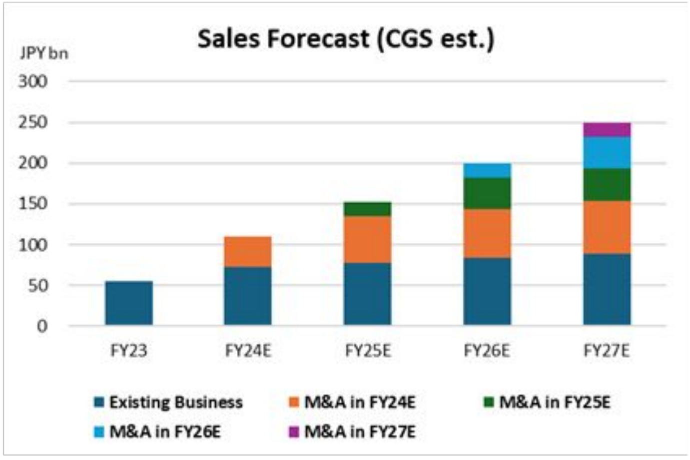
JPY mn	EBITDA	Depreciation	EBITA	Goodwill Amort.	OP
FY24E	**14,700**	5,343	**9,357**	1,380	7,977
Existing Business	**6,816**	2,855	**3,961**	0	3,961
US Business	**4,700**	1,300	**3,400**	260	3,140
Domestic M&A in FY24E	**3,261**	1,000	**2,261**	240	2,021
M&A in FY25E	**7,144**	2,800	**4,344**	1,500	2,844
M&A in FY26E	**6,426**	2,600	**3,826**	1,500	2,326
M&A in FY27E	**3,000**	1,200	**1,800**	750	1,050
Corporate Cost	**-1,316**	0	**-1,316**	0	-1,316
Total Growth	**30,031**	11,755	**18,276**	4,250	14,026
FY247E	**44,731**	17,098	**27,633**	5,630	22,003

Source: CGS

Equity Story ②: FY27 EBITDA Projected at ¥44.7bn, a 5.5x Increase Over FY23

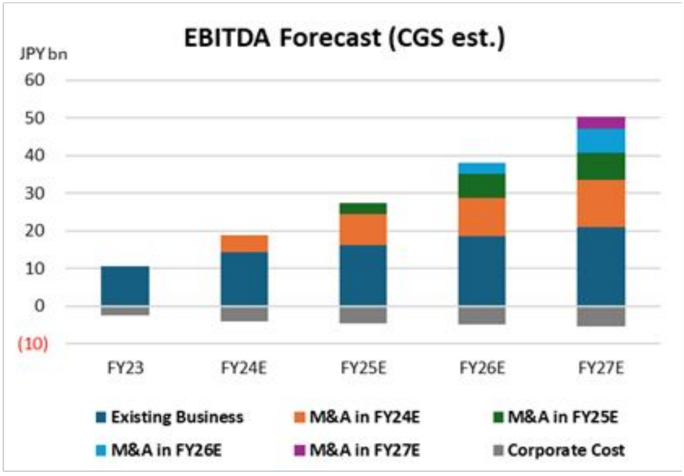
***Projections Based on CGS Performance Model Forecasts**

Ex. 9: Sales Forecast and Growth Drivers



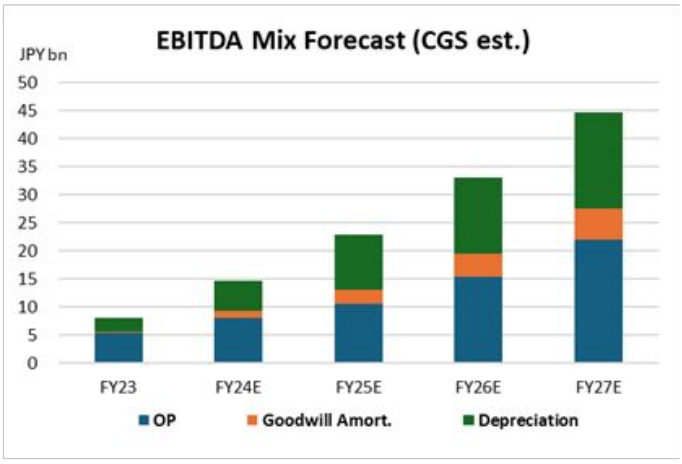
Source: CGS

Ex. 10: EBITDA Forecast and Growth Drivers



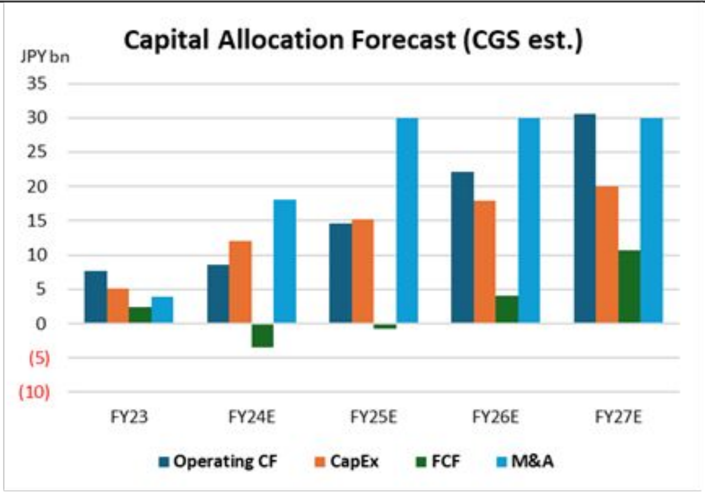
Source: CGS

Ex. 11: EBITDA Mix Forecast



Source: CGS

Ex. 12: Capital Allocation Forecast



*Note: FCF＝OCF - CapEx Source: CGS

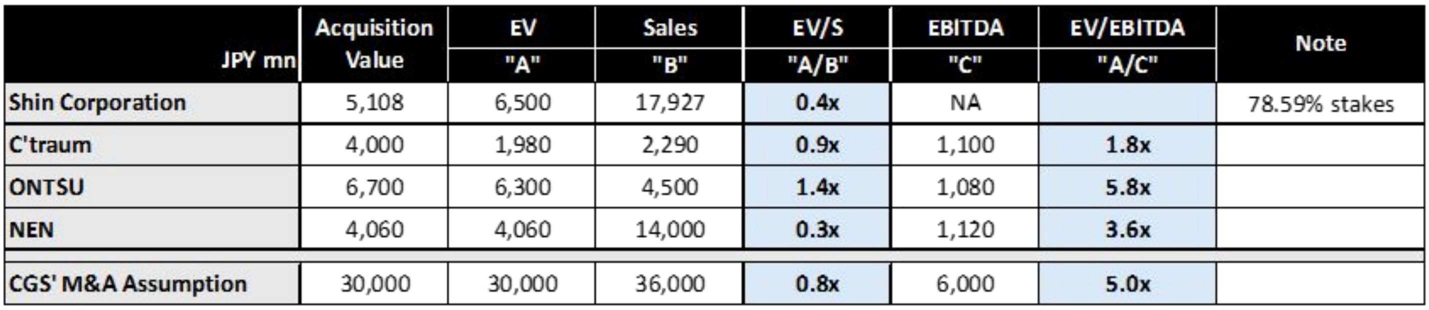
○ The assumption of 5x EV/EBITDA multiple for M&A from FY25 onward is based on past results. Among the transactions where both acquisition price and EBITDA were disclosed, C’traum, ONTSU, and NEN had acquisition EV/EBITDA multiples of 1.8x, 5.8x, and 3.6x, respectively. Shin Corporation's acquisition was disclosed with a purchase price of ¥5.1bn (for a 78.59% stake) in financial reports. CGS estimates Shin Corporation’s FY24 EBITDA at ¥2bn, resulting in an EV/EBITDA of 3.3x including some synergies.

Additionally, the 13 M&A transactions executed in FY23 are estimated to have a combined investment amount of ¥7.2bn (per financial disclosures), with an expected combined FY24 EBITDA of ¥1.4bn (based on a 2x annualized forecast from ¥700mn EBITDA for the first half of FY24), giving an implied EBITDA multiple of about 5x. However, the acquired companies held substantial cash reserves (¥3.1bn), adjusting the actual EV/EBITDA multiple to around 3x. Based on these considerations, the 5x EV/EBITDA assumption on M&A by CGS should be viewed as reasonable.

Equity Story ②: FY27 EBITDA Projected at ¥44.7bn, a 5.5x Increase Over FY23

***Projections Based on CGS Performance Model Forecasts**

Ex. 13: GENDA's Past M&A Valuation and CGS' Model Assumption (CGS est.)



JPY mn	Acquisition Value	EV	Sales	EV/S	EBITDA	EV/EBITDA	Note
		"A"	"B"	"A/B"	"C"	"A/C"	
Shin Corporation	5,108	6,500	17,927	0.4x	NA		78.59% stakes
C'traum	4,000	1,980	2,290	0.9x	1,100	1.8x	
ONTSU	6,700	6,300	4,500	1.4x	1,080	5.8x	
NEN	4,060	4,060	14,000	0.3x	1,120	3.6x	
CGS' M&A Assumption	30,000	30,000	36,000	0.8x	6,000	5.0x	

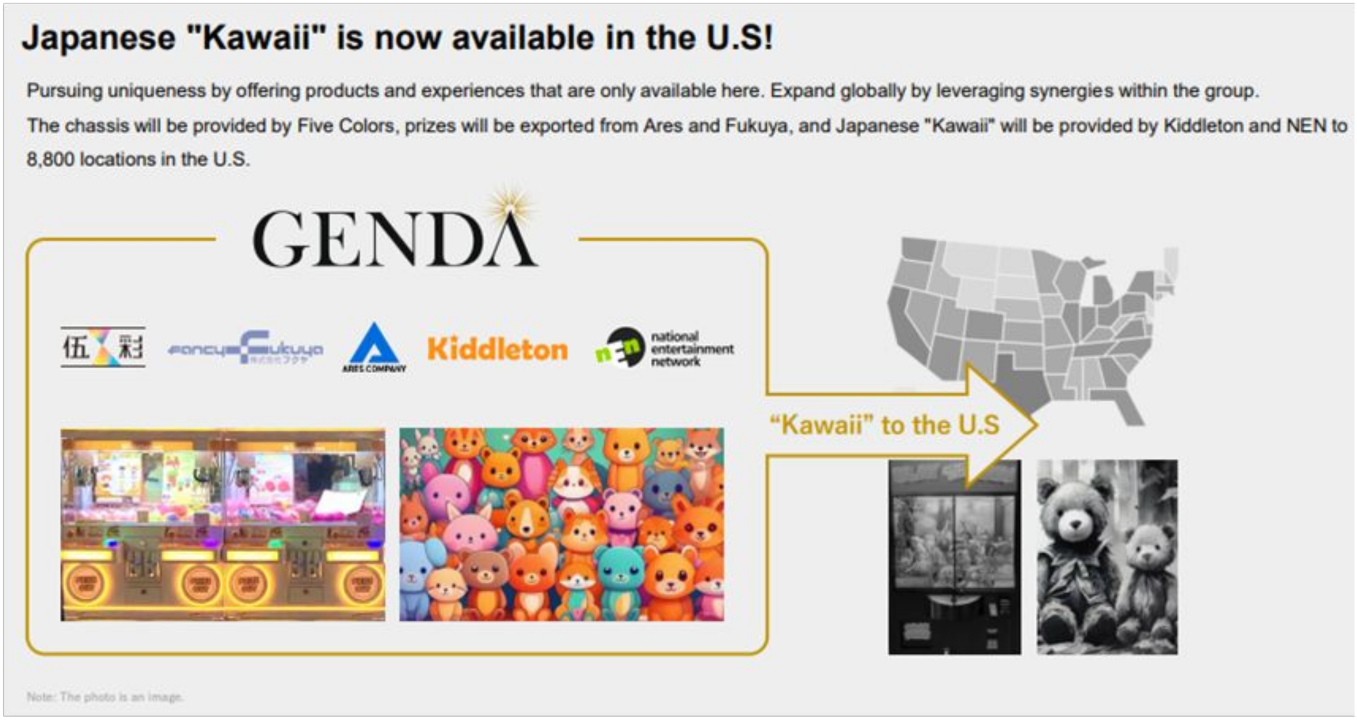
Source: Company Data, CGS

High Expectations for Synergy Effects in the US Business

○ CGS is particularly excited about the potential growth opportunity in the U.S. business. FY24 revenue for the U.S. operations (Kiddleton) is projected at ¥4bn, with EBITDA of ¥600mn (in line with company forecasts). However, the impact of acquiring NEN (National Entertainment Network), including PMI effects, is expected to be substantial, with revenue forecasted to expand to ¥28.4bn and EBITDA to ¥5.3bn by FY27.

○ The main driver behind this anticipated rapid expansion and success in the U.S. business is the planned acquisition of NEN by the end of FY24. By rebranding NEN's equipment and prizes with Japan's popular "Kawaii" style, CGS expects a significant impact, with a projected 80% increase in sales per location.

Ex. 14: GENDA expands the US Business with offering Japanese "Kawaii"



Japanese "Kawaii" is now available in the U.S!

Pursuing uniqueness by offering products and experiences that are only available here. Expand globally by leveraging synergies within the group.
The chassis will be provided by Five Colors, prizes will be exported from Ares and Fukuya, and Japanese "Kawaii" will be provided by Kiddleton and NEN to 8,800 locations in the U.S.

Note: The photo is an image.

Source: Company Data

Equity Story ②: FY27 EBITDA Projected at ¥44.7bn, a 5.5x Increase Over FY23

***Projections Based on CGS Performance Model Forecasts**

NEN's Extensive Mini-Location Amusement Network Driving Growth

○ Overview of NEN and Synergy Potential with GENDA's "Kawaii" Style

NEN operates approx. 8,000 mini-location amusement facilities across the U.S., primarily within Walmart, Denny's, and similar venues. Mini-location amusement facilities are small, unattended entertainment setups. GENDA entered the U.S. amusement market in 2019 through a joint venture with Round One (Kiddleton) and expanded primarily in the mini-location format, fully acquiring Kiddleton in 2022. CGS believes the successful "Kawaii" style prize games used in Kiddleton's operations will also appeal at NEN's locations. Initial renewal tests at several NEN locations have shown promising results.

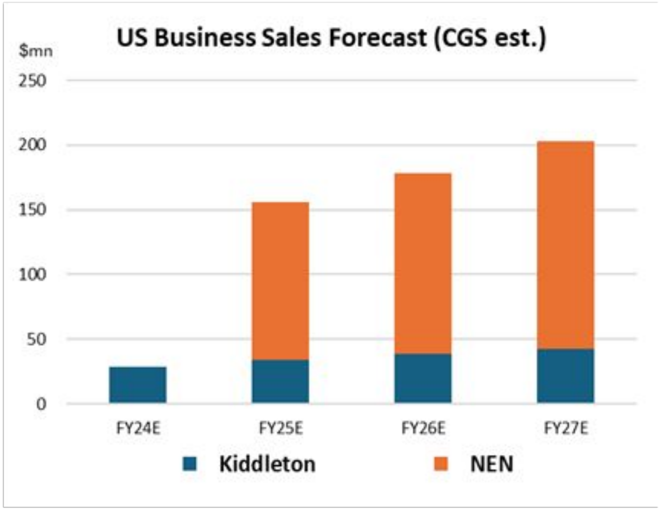
○ Projected Revenue for the US Business in FY27

CGS forecasts revenue for the US business at ¥28.4bn in FY27. This projection assumes that approx. 6,000 of NEN's 8,000 locations will be renewed over three years (FY25-FY27), with each renovated location achieving an 80% increase in revenue. NEN's FY23 revenue is expected to be $100mn, with projections of $160mnn (¥22.4bn, assuming ¥140/$) by FY27. The assumption of an 80% sales increase per renovated location is derived from the fact that Kiddleton's "Kawaii" mini-locations generate three times the revenue per location compared to NEN's. However, this projection is conservative due to some unknown variables.

○ Projected EBITDA for the US Business in FY27

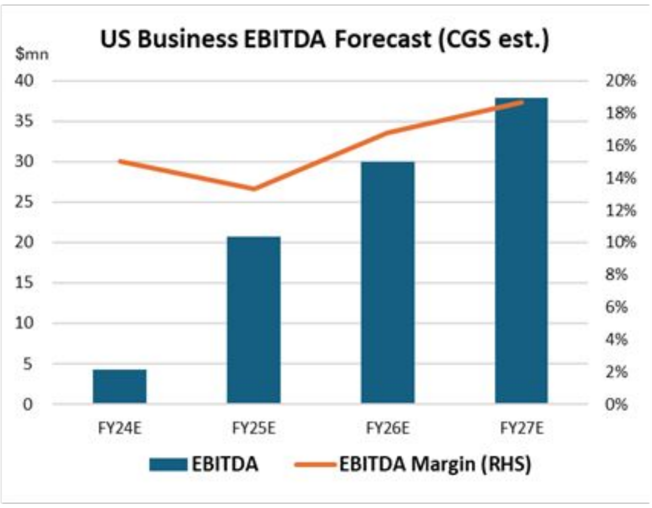
US EBITDA is projected at ¥5.3bn by FY27. Kiddleton's FY24 EBITDA is expected to be ¥600mn, and NEN's FY23 EBITDA is approx. ¥1.1bn (based on ¥140/$), resulting in a combined EBITDA growth scenario of over threefold. EBITDA margin for the US business is projected at 19% in FY27. This is a substantial increase from the current margins: Kiddleton's FY24 forecasted margin is 15%, and NEN's FY23 margin is 8%. The revenue gains from the Kawaii-style renewals are expected to significantly boost margins.

Ex. 15: US Business Sales Forecast & Growth Driver



Source: CGS

Ex. 16: US Business EBITDA Forecast



Source: CGS

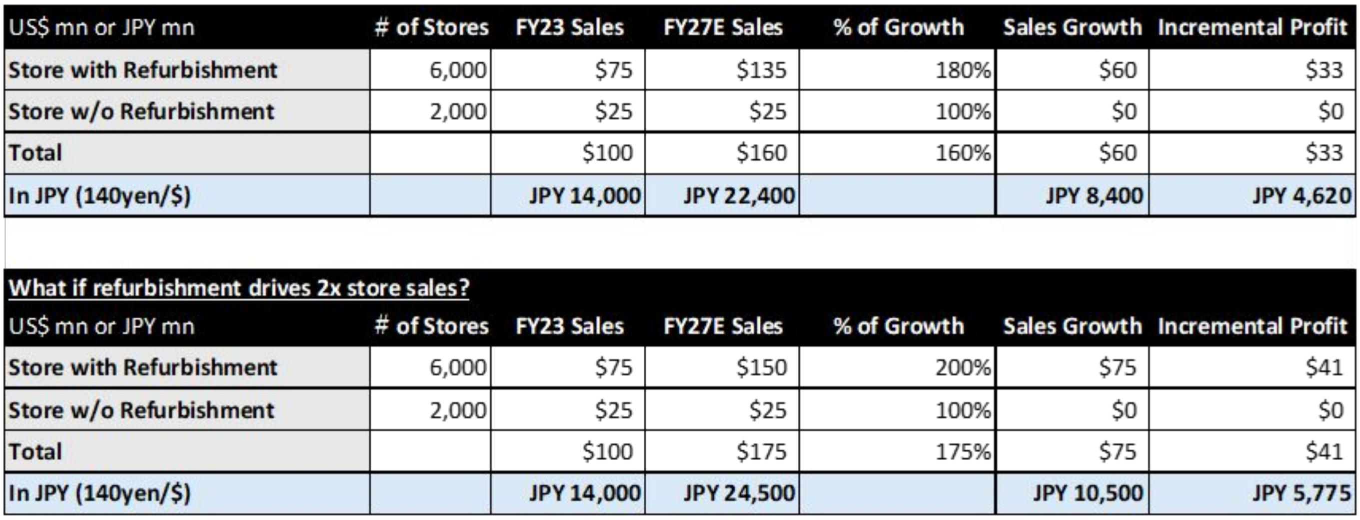
Equity Story ②: FY27 EBITDA Projected at ¥44.7bn, a 5.5x Increase Over FY23

***Projections Based on CGS Performance Model Forecasts**

○ Expected Increase in EBITDA Margin Due to High Contribution Margins of Prize Games

The projected significant rise in EBITDA margin in the US is based on the high contribution margin of prize games, which exceeds 50%, making revenue growth highly impactful. A model of these projections is shown in Ex. 17. If sales at 6,000 NEN locations (representing 75% of total locations) increase by 80%, revenue would grow by ¥8.4bn, resulting in a contribution margin increase of ¥4.6bn. Accounting for an estimated ¥1.3bn increase in fixed costs, such as depreciation linked to revenue growth and baseline increases, this translates to an EBITDA increase of ¥3.3bn. Additionally, if sales at renovated locations were to double, an extra ¥1.2bn in contribution margin beyond CGS forecasts could be achieved

Ex. 17: Prize Game's High Incremental Margin is Expected to Drive EBITDA Margin Expansion



US$ mn or JPY mn	# of Stores	FY23 Sales	FY27E Sales	% of Growth	Sales Growth	Incremental Profit
Store with Refurbishment	6,000	$75	$135	180%	$60	$33
Store w/o Refurbishment	2,000	$25	$25	100%	$0	$0
Total		$100	$160	160%	$60	$33
In JPY (140yen/$)		JPY 14,000	JPY 22,400		JPY 8,400	JPY 4,620

What if refurbishment drives 2x store sales?

US$ mn or JPY mn	# of Stores	FY23 Sales	FY27E Sales	% of Growth	Sales Growth	Incremental Profit
Store with Refurbishment	6,000	$75	$150	200%	$75	$41
Store w/o Refurbishment	2,000	$25	$25	100%	$0	$0
Total		$100	$175	175%	$75	$41
In JPY (140yen/$)		JPY 14,000	JPY 24,500		JPY 10,500	JPY 5,775

Source: CGS

○ Quick Payback Period for Mini-Locations

Another key advantage of mini-locations is their quick payback period. The planned investment for renovations over three years is around ¥5bn, with an estimated cost of ¥800,000 per location (assuming two units per location, each set with four cranes). With an expected EBITDA increase of ¥3.3bn over three years, the renovation investment is projected to be recouped within 1.5 years, highlighting a major advantage of mini-locations. Furthermore, the amortization period for prize machines in the U.S. is 12 years (compared to 10 years in Japan), resulting in lower depreciation costs and a significant contribution not only to EBITDA but also to operating profit (nearly 90% of the EBITDA increase is expected to translate to operating profit growth).

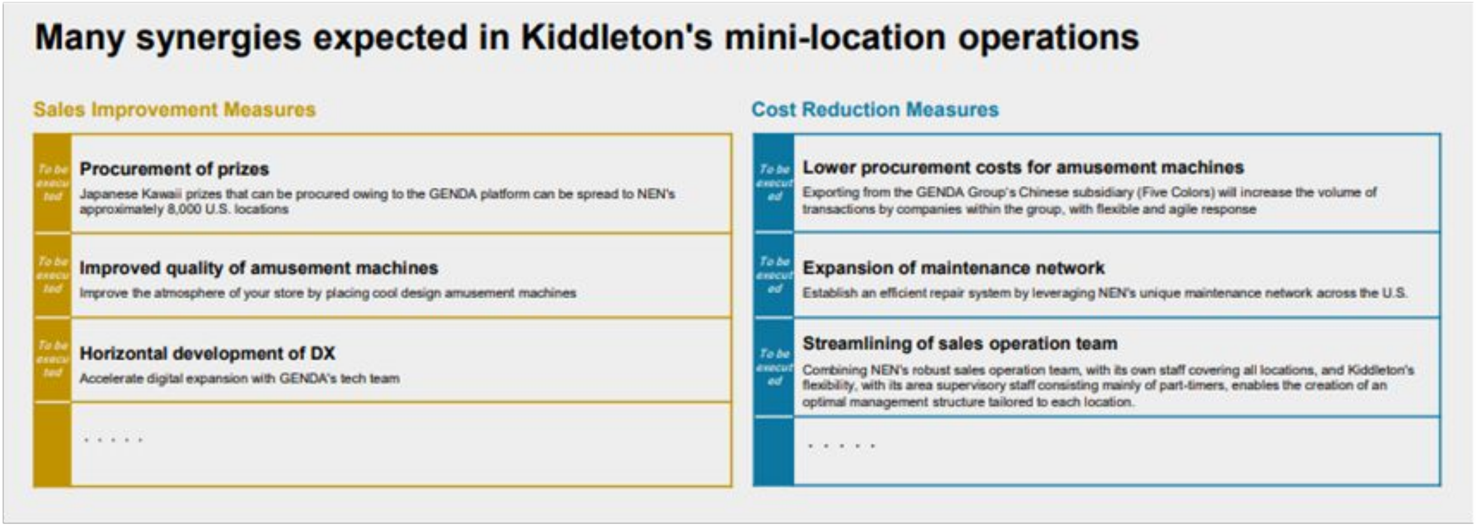
Equity Story ②: FY27 EBITDA Projected at ¥44.7bn, a 5.5x Increase Over FY23

***Projections Based on CGS Performance Model Forecasts**

○ Additional Initiatives in the US Business

Beyond revenue growth strategies, plans for the US business also include expanding DX initiatives and implementing cost-saving synergies.

Ex. 18: Many Ways to Drive Synergies Exist in Addition to Sales Growth



Many synergies expected in Kiddleton's mini-location operations

Sales Improvement Measures

- To be executed — **Procurement of prizes**
  Japanese Kawaii prizes that can be procured owing to the GENDA platform can be spread to NEN's approximately 8,000 U.S. locations
- To be executed — **Improved quality of amusement machines**
  Improve the atmosphere of your store by placing cool design amusement machines
- To be executed — **Horizontal development of DX**
  Accelerate digital expansion with GENDA's tech team
- . . . . .

Cost Reduction Measures

- To be executed — **Lower procurement costs for amusement machines**
  Exporting from the GENDA Group's Chinese subsidiary (Five Colors) will increase the volume of transactions by companies within the group, with flexible and agile response
- To be executed — **Expansion of maintenance network**
  Establish an efficient repair system by leveraging NEN's unique maintenance network across the U.S.
- To be executed — **Streamlining of sales operation team**
  Combining NEN's robust sales operation team, with its own staff covering all locations, and Kiddleton's flexibility, with its area supervisory staff consisting mainly of part-timers, enables the creation of an optimal management structure tailored to each location.
- . . . . .

Source: Company Data

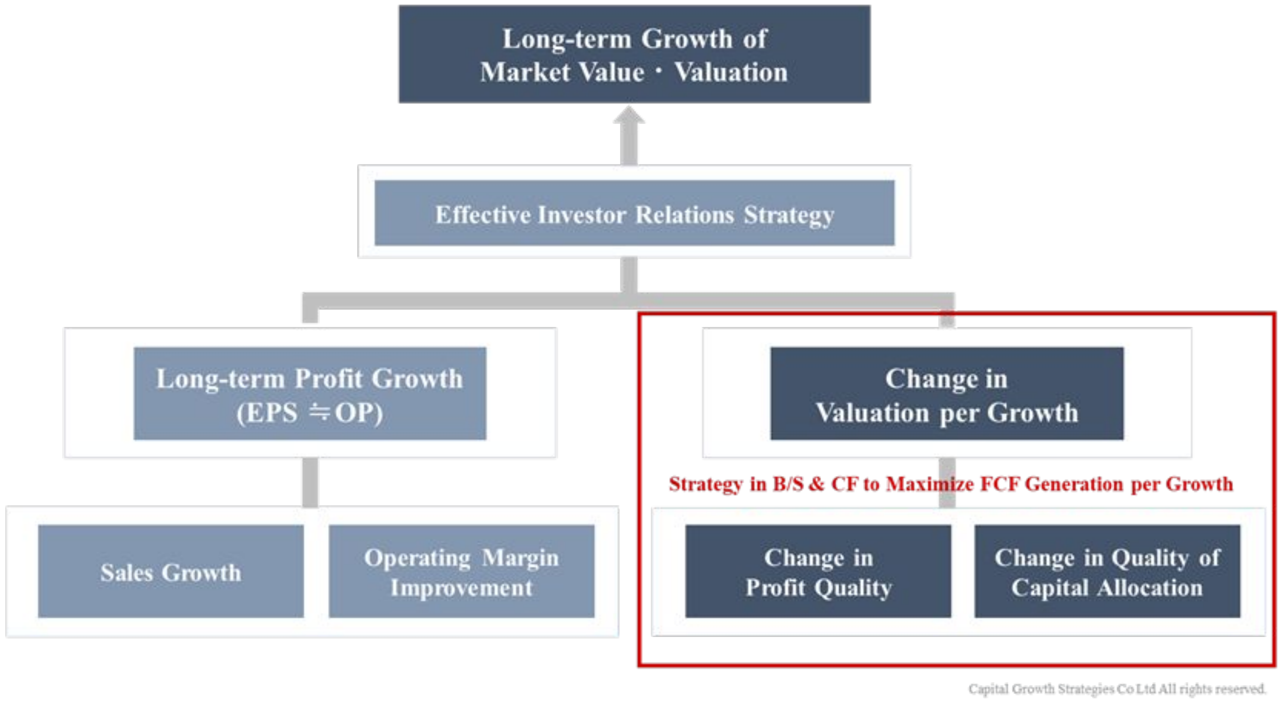
Equity Story ③: Significant Upside Potential in Multiples per 1% Growth

Summary:

The key drivers for valuation per 1% of profit growth is analyzed based on four indicators: capital efficiency, CF conversion, volatility of profit growth, and the quality of capital allocation. Although their future CF conversion is expected to see a sight deterioration, the CF generation capability through capital allocation focused on M&A remains strong and highly efficient. When compared to global companies that also pursue growth through roll-up M&A strategies, there is a significant room for GENDA's EBITDA multiple per growth to catch up the comparable peers.

So far, we've outlined GENDA's growth story and our forecast. Now we turn to consider how the stock market might evaluate GENDA's anticipated growth rate in terms of multiples over the long term. A critical point in this evaluation, as prioritized by CGS's leadership based on their extensive investment experience, is the multiple the stock market is willing to assign per 1% of profit growth rate. This perspective allows for a deeper understanding of how market expectations align with GENDA's growth trajectory.

Ex. 19: CGS' Approach to Analyze Long-term Equity Valuation



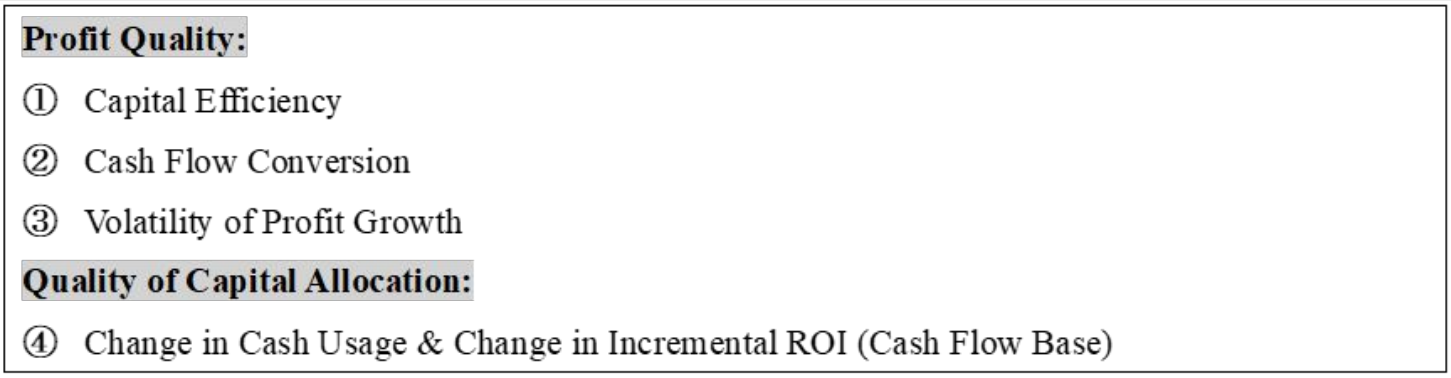
Source: CGS

Even among companies with an expected long-term profit growth rate of 10% per year, some may be valued at an EV/EBITDA multiple of 15x, while others may only achieve a multiple of 7x. This difference stems from the varying multiples that the stock market assigns per 1% of profit growth rate, and these multiples can change over time even for the same growth rate. Simply focusing on the anticipated profit growth rate when evaluating investments can obscure valuation logic when comparing historical or comps/benchmarks. CGS believes that this valuation per 1% of profit growth is a primary factor in understanding market valuations and is a crucial analysis point for long-term investors.

Equity Story ③: Significant Upside Potential in Multiples per 1% Growth

At CGS, we define the drivers of valuation per 1% profit growth rate as follows (Ex. 20). These drivers, in essence, represent the drivers of FCF generation per 1% of profit growth. In other words, even with an annual profit growth rate of 10%, companies with stronger FCF-generating abilities are granted higher multiples by the stock market. CGS uses this approach to analyze the fair multiples that the stock market may be willing to pay for each target company's long-term growth within the current interest rate environment. It should be noted that this analysis is based solely on CGS' independent perspective as long-term investors, without input or influence from the management of the companies analyzed on any of the valuation drivers or financial models.

Ex. 20: Key Criteria that CGS focuses on to Analyze Equity Valuation per 1% of Profit Growth



Profit Quality:

① Capital Efficiency

② Cash Flow Conversion

③ Volatility of Profit Growth

Quality of Capital Allocation:

④ Change in Cash Usage & Change in Incremental ROI (Cash Flow Base)

Source: CGS

Now we analyze the valuation drivers per 1% profit growth for GENDA moving forward:

1. Capital Efficiency

We begin by examining capital efficiency, specifically ROIC and ROE. ROIC, in particular, is crucial for CGS, as it reflects how much of the future operating CF will need to be reinvested into capital to generate expected profits. This allows us to gauge how much FCF can be retained, making it a key measure of FCF generation per profit growth.

Typically, ROIC is calculated with NOPAT (net operating profit after tax) as the numerator. However, under Japanese accounting standards, GENDA's NOPAT includes amortization costs for goodwill, which requires adjustment. Thus, CGS defines Cash NOPAT as the after-tax operating profit excluding goodwill amortization. Using this Cash NOPAT, we analyze GENDA's Cash ROIC (ROIC adjusted for goodwill amortization).

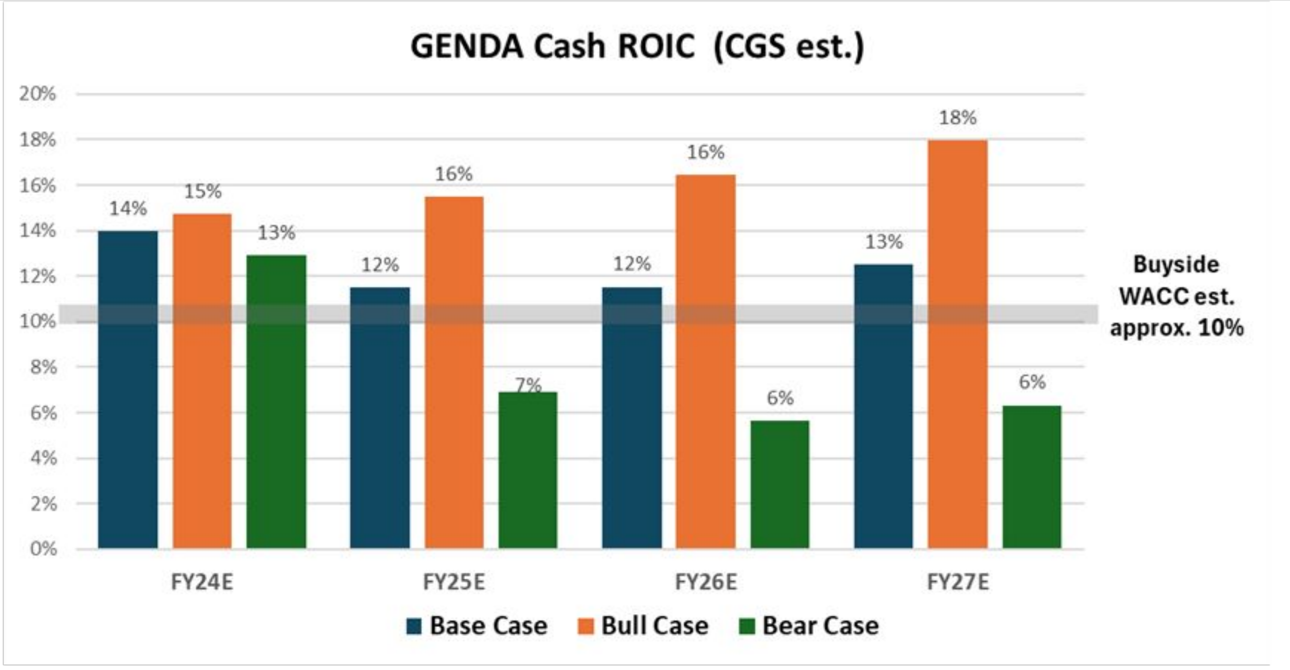
Recall that our base case projection assumes that GENDA will make acquisitions with an average EV/EBITDA of 5x, investing ¥30bn annually over the next three years (our bull case assumes ¥40bn in acquisitions at an average EV/EBITDA of 4x). Furthermore, we expect that synergies from these acquisitions will enable the acquired businesses to improve their EBITDA margins to around 20% within three years, aligning with the EBITDA margin of GENDA's existing entertainment platform business (excluding acquisition impact).

Equity Story ③: Significant Upside Potential in Multiples per 1% Growth

Based on these financial models, GENDA's Cash ROIC is projected to sustain steady profit growth at around 12–13%, through slightly decreasing from approx. 14% in the current fiscal year (our bull case suggests an improvement to around 18%). The primary drivers of Cash ROIC for GENDA are average acquisition valuation and synergy realization post-acquisition. As shown in the differences between CGS' base and bull cases, the effectiveness of these two factors will significantly influence GENDA's future Cash ROIC.

The anticipated slight decline of Cash ROIC to 12–13% may look somewhat negative for valuation per growth. However, given an estimated buy-side WACC of 10% (WACC based on global interest rates rather than Japan's almost zero risk-free rate), we note that the ROIC-WACC spread remains positive. CGS thinks this positive spread supports market cap growth through ongoing capital allocation. Conversely, if Cash ROIC falls below 10% or if global interest rates increase considerably (thereby raising the buy-side WACC), it would be possible that their profit growth may not drive market cap expansion due to de-rating of valuation per growth.

Ex. 21: GENDA's Cash ROIC Forecast



Source: CGS

2. CF Conversion

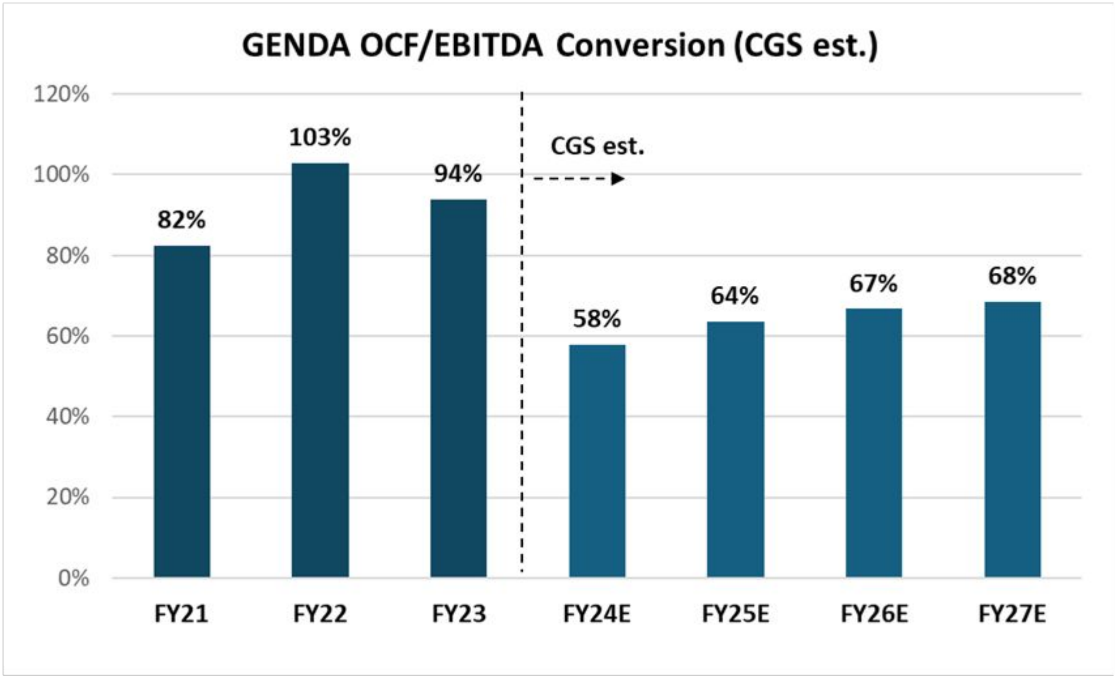
Profit on the income statement includes non-cash items such as depreciation and goodwill amortization, which means that it does not directly equate to cash flow. The CF conversion rate is an indicator of how effectively accounting profits on the income statement are converted into cash flow, and this measure is especially critical for long-term investors assessing FCF generation per profit growth. Specifically, we evaluate the conversion rate from EBITDA to operating CF (OCF/EBITDA conversion) and also the conversion rate from net income to FCF (FCF conversion). The primary driver of these metrics is the cash conversion cycle (CCC). For our analysis, CGS defines FCF as operating CF minus capital expenditures.

Equity Story ③: Significant Upside Potential in Multiples per 1% Growth

For GENDA, FCF is highly influenced by organic CapEx, so to gauge the company's underlying CF conversion, we examine the OCF/EBITDA conversion rate before CapEx impact. Until FY23, GENDA's OCF/EBITDA conversion rate showed a strong average of 93%, attributed to both a low effective tax rate and minimal impact from working capital increases tied to acquisitions. However, with the effective tax rate normalizing from FY24, CGS projects that while there may be no material shifts in CCC, the conversion rate may deteriorate to a mid-term range of 60–70%. This projected decline could weaken FCF generation per profit growth, posing a negative factor for ongoing equity valuation per 1% of growth.

On a normalized tax rate, the key focus for long-term investors is how the CCC of acquired entities might impact GENDA's consolidated CCC and whether the company's post-acquisition PMI initiatives can improve CCC enough to partially offset the working capital increases that come with acquisitions. While CGS' model currently assumes no impact on CCC relative to GENDA's existing operations, these two factors could present both upsides and risks to the future CF conversion. Thus, observing how management executes in these areas should be essential for investors going forward.

Ex. 22: GENDA's OCF/EBITDA Conversion Forecast



Source: CGS

3. Volatility of Profit Growth

The next factor is earnings growth volatility. Even if a company doubles its operating profit over five years, the aggregate FCF in the same period varies significantly depending on whether the growth is achieved linearly or through volatility. This volatility in earnings growth directly affects capital costs due to less consistent CF generation per 1% of expected growth. Consequently, industries with cyclical earnings are generally valued at a discount compared to non-cyclical industries even on a similar expected long-term growth rate. Thus for valuation, earnings growth volatility is one of the critical elements in analyzing FCF generation and assessing the sustainable equity multiple that investors are willing to pay per 1% growth.

Equity Story ③: Significant Upside Potential in Multiples per 1% Growth

Typically, CGS analyzes volatility in sales and contribution margin. However, since GENDA's growth is primarily driven by M&A, our standard analytical approaches for organic growth companies are not applicable here. That said, we think GENDA's non-linear growth story through M&A is relatively well-known in the stock market. Therefore, unless unexpected earnings volatility such as profit decline arises, we believe that the volatility in profit growth from future M&A is unlikely to significantly impact the company's valuation (i.e. already well-known volatility).

4. Change in Cash Usage & Change in Incremental ROI

Finally, we will examine the quality of capital allocation. Here CGS focuses on how cash utilization evolves and how efficiently the CF could increase relative to the incremental invested capital (i.e. incremental ROI).

For GENDA, in FY23, 57% of cash was allocated to organic investments, with the remaining 43% directed toward M&A. In FY24, the M&A portion is expected to increase to approx. 60%, though organic CapEx are also expected to increase as the business expands. CGS projects that this allocation structure, with about 40% directed toward organic investments, will persist over the next few years.

From an investor's perspective, the key consideration is the incremental return generated by these future investments. To assess this, we analyze how the company's incremental ROI on CF-base has evolved from the past and how it may change going forward.

Ideally, we would compare GENDA's incremental ROI over a long-term period (e.g. 10 years) against projections for the next 3–5 years. However, since the company has only disclosed financials for the past three years since going public, we must rely on these three year figures. From FY21 to FY23, GENDA's invested capital has increased by approx. ¥15.5bn, with cumulative operating CF over the same period totaling around ¥2.9bn (¥3.8bn if including FY24 estimates by CGS). This results in their incremental ROI of 20–25%, which CGS considers an impressive figure based on our long-time investment experience.

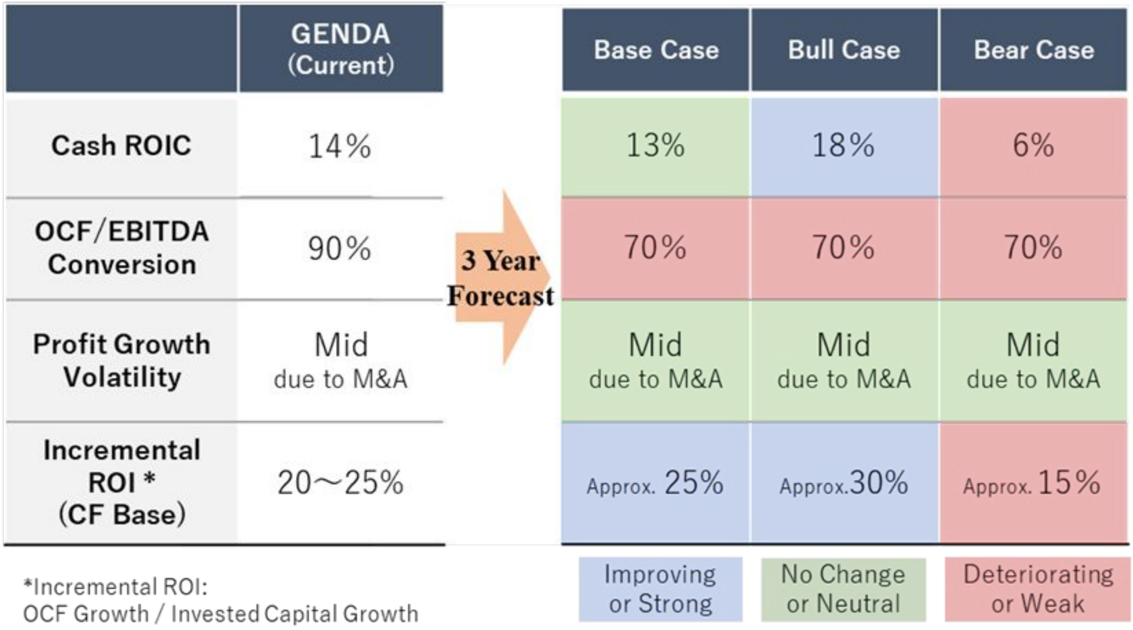
From a valuation perspective, the key question is how this incremental ROI could evolve going forward. In CGS's forecast, GENDA's invested capital is expected to grow by about ¥30–34bn annually starting in FY25, driven by continued M&A and CapEx. The incremental ROI on this additional capital invested is expected to contribute to annual operating CF increase of ¥7.5–8.5bn through FY27. This results in an estimated average incremental ROI of around 25% per year. This expected performance compares favorably with global companies in other sectors following a roll-up M&A growth strategy (see Ex. 24), suggesting that GENDA's high-quality capital allocation is likely to be sustained over the mid-term.

Key risk factors that could prevent GENDA's incremental ROI from meeting CGS' projected levels include acquisition valuations, realization of post-acquisition synergies through PMI (including impact on cash conversion cycle), and the degree of increase in organic CapEx. Notably, the expected ROI on organic investments, based on past performance analysis, tends to be lower than that of M&A. This means that how much GENDA allocates capital toward organic investments could play a critical role in the quality of its capital allocation. Long-term investors should continue monitoring how GENDA's management executes in this regard.

Equity Story ③: Significant Upside Potential in Multiples per 1% Growth

Based on the prior analysis, our forecast for GENDA's future FCF generation per 1% profit growth (i.e., the valuation driver per 1% profit growth) is as follows (Ex. 23).

Ex. 23: GENDA's Mid-term Change in Key Drivers of Valuation per Growth (CGS est.)



	GENDA (Current)	Base Case	Bull Case	Bear Case
Cash ROIC	14%	13%	18%	6%
OCF/EBITDA Conversion	90%	70%	70%	70%
Profit Growth Volatility	Mid due to M&A	Mid due to M&A	Mid due to M&A	Mid due to M&A
Incremental ROI * (CF Base)	20～25%	Approx. 25%	Approx.30%	Approx. 15%

*Incremental ROI: OCF Growth / Invested Capital Growth

Improving or Strong | No Change or Neutral | Deteriorating or Weak

Source: CGS

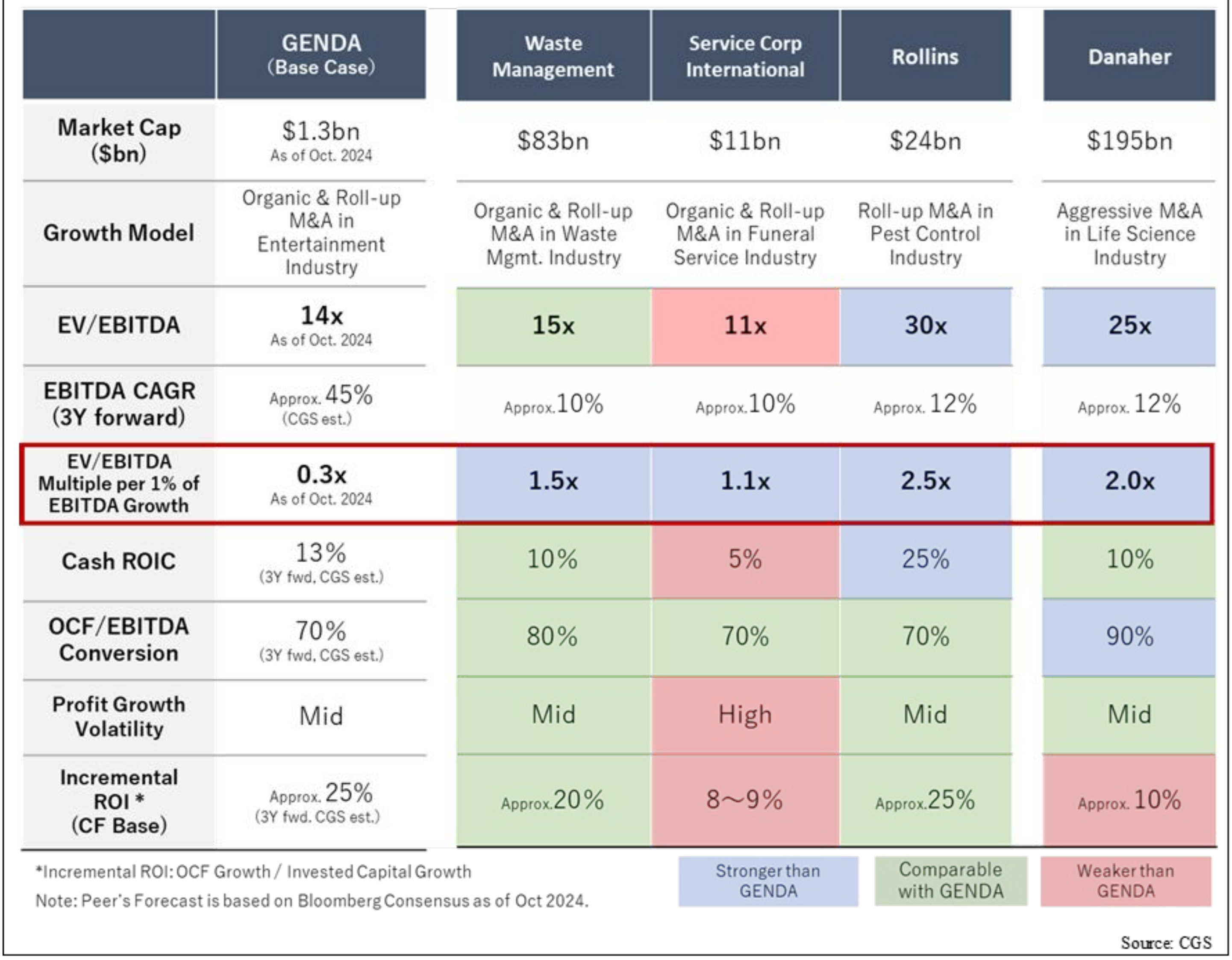
Lastly, we will analyze to gauge the fair multiple that the stock market may be willing to pay for GENDA's FCF generation per profit growth in the current interest rate environment. Typically, the ideal approach is to identify companies within the same industry that share common growth story and FCF generation characteristics per growth similar to GENDA's projections. From there, we would gauge the multiples that the market currently assigns to these companies to analyze a reasonable comps valuation.

However, given that GENDA's equity story is less about a traditional gaming and entertainment industry in Japan and more focused on a unique, roll-up M&A strategy, we've selected comparable companies from a broader range of industries that similarly employ roll-up M&A strategies within mature markets as growth model. Specifically, we pick up Waste Management (WM US) in the waste services sector, Service Corp International (SCI US) in funeral services, and Rollins (ROL US) in pest control. Additionally, though not strictly focused on roll-up M&A within a mature market, we included Danaher (DHR US) from life sciences as a longer-term benchmark for GENDA due to its highly regarded, aggressive M&A strategy.

Among these peers, the proportion of cash allocated toward M&A over the past 5–10 years varies: Waste Management and Service Corp International have dedicated about 30% of cash investments to M&A (like GENDA, both companies have high levels of organic CapEx), while Danaher and Rollins allocated around 85–90% (particularly Rollins has a capital light business model). Each company views M&A as a core growth driver. In Ex. 24, we summarize how these peers' current valuation drivers—focused on FCF generation per 1% profit growth—compare with CGS' projections for GENDA.

Equity Story ③: Significant Upside Potential in Multiples per 1% Growth

Ex. 24: Comparison between GENDA and Selected Global M&A Focused Companies



	GENDA (Base Case)	Waste Management	Service Corp International	Rollins	Danaher
Market Cap ($bn)	$1.3bn As of Oct. 2024	$83bn	$11bn	$24bn	$195bn
Growth Model	Organic & Roll-up M&A in Entertainment Industry	Organic & Roll-up M&A in Waste Mgmt. Industry	Organic & Roll-up M&A in Funeral Service Industry	Roll-up M&A in Pest Control Industry	Aggressive M&A in Life Science Industry
EV/EBITDA	14x As of Oct. 2024	🟩 15x	🟥 11x	🟦 30x	🟦 25x
EBITDA CAGR (3Y forward)	Approx. 45% (CGS est.)	Approx.10%	Approx.10%	Approx. 12%	Approx. 12%
EV/EBITDA Multiple per 1% of EBITDA Growth	**0.3x** As of Oct. 2024	🟦 **1.5x**	🟦 **1.1x**	🟦 **2.5x**	🟦 **2.0x**
Cash ROIC	13% (3Y fwd. CGS est.)	🟩 10%	🟥 5%	🟦 25%	🟩 10%
OCF/EBITDA Conversion	70% (3Y fwd. CGS est.)	🟩 80%	🟩 70%	🟩 70%	🟦 90%
Profit Growth Volatility	Mid	🟩 Mid	🟥 High	🟩 Mid	🟩 Mid
Incremental ROI * (CF Base)	Approx. 25% (3Y fwd. CGS est.)	🟩 Approx.20%	🟥 8～9%	🟩 Approx.25%	🟥 Approx. 10%

*Incremental ROI: OCF Growth / Invested Capital Growth

Note: Peer's Forecast is based on Bloomberg Consensus as of Oct 2024.

🟦 Stronger than GENDA

🟩 Comparable with GENDA

🟥 Weaker than GENDA

Source: CGS

In this comparison, the three companies employing roll-up M&A growth models in mature markets, along with Danaher, all maintain an expected profit growth rate within the 10–12% range, yet the EV/EBITDA multiples that the stock market grants vary significantly. Notably, the pest control giant Rollins is attributed the highest multiple due to its strong FCF generation per profit growth, even at similar expected growth rates with others.

Based on the CGS forecast, GENDA's expected FCF generation per profit growth may not reach the level of Rollins (given differences in organic CapEx requirements and Cash ROIC) but is relatively comparable to Waste Management's figure. In practice, when evaluating the multiple difference between GENDA and Waste Management, we need to think about the considerable difference in liquidity between their stocks by applying a liquidity discount to GENDA. Even considering this discount, however, the EBITDA multiple currently assigned to GENDA per 1% projected growth (0.3x) appears undervalued in light of GENDA's long-term FCF generation potential. Given GENDA's expected growth rate, CGS thinks there is considerable upside potential in its current EV/EBITDA multiple from an objective standpoint.

Company Overview and Business Model

Company Overview

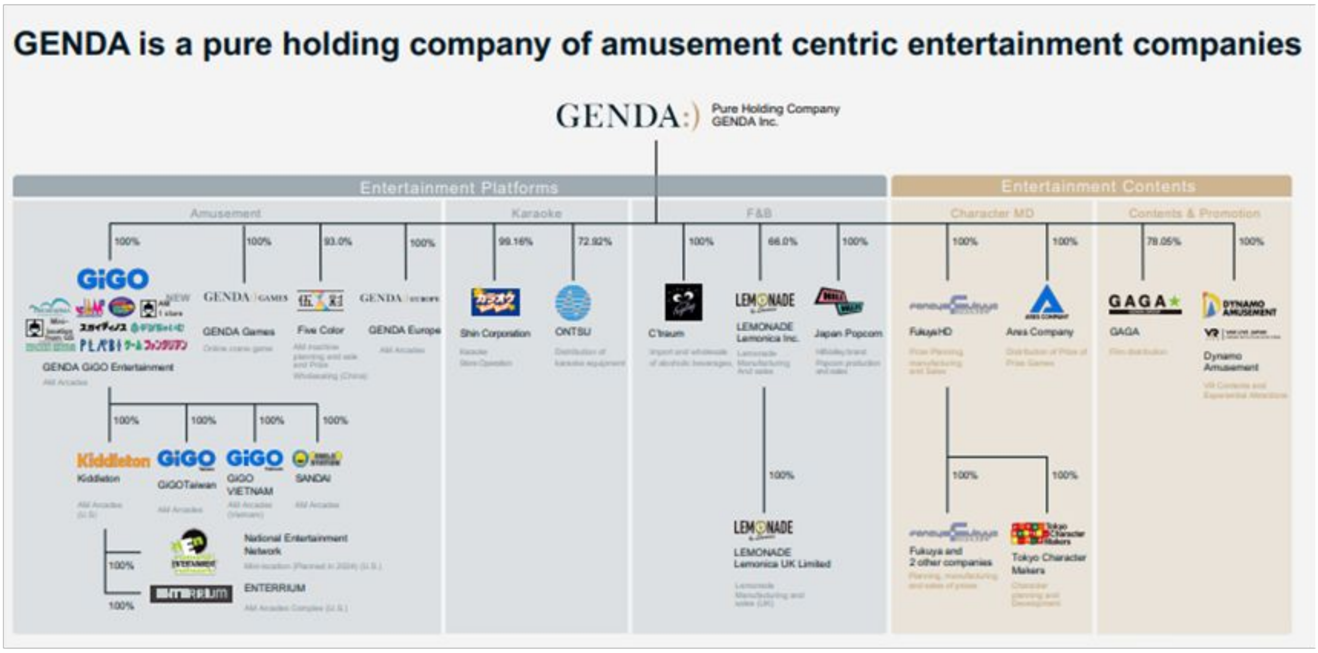
○ GENDA is a rapidly growing holding company in the entertainment sector, operating amusement facilities (arcades) and karaoke boxes. The company's name stands for the "Global Entertainment Network for Dreams and Aspiration," reflecting its mission to "spread joyful moments worldwide" and its vision to become the world's leading entertainment company by 2040. To achieve this mission and vision, GENDA aims to acquire and integrate platforms that connect consumers with popular IP content such as anime and movies, including arcades and karaoke facilities.

Ex. 25: GENDA's Business Foundation

Source: Company Data

○ GENDA originated as Midas Entertainment, founded in 2018 with support from Midas Capital, a private equity fund in Japan. It was co-founded by Nao Kataoka, former President of Aeon Fantasy and current Chairman, and Mai Shin, former Goldman Sachs executive and current President. In August 2020, the company rebranded to its current name. In December of the same year, it established a strong growth foundation by acquiring Sega Entertainment from Sega Sammy Holdings.

Ex. 26: GENDA's Business Structure as a Holding Company (as of Sept. 2024)



Source: Company Data

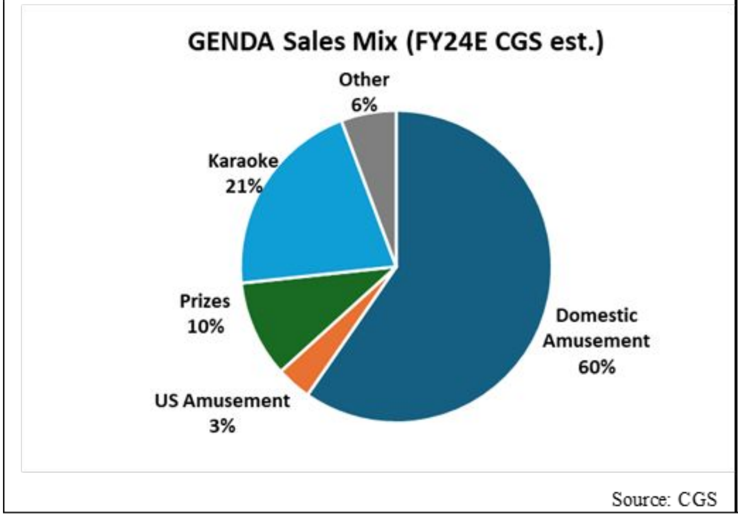
Company Overview and Business Model

Business Model

○ GENDA's revenue and EBITDA composition for FY24 are outlined in Ex. 27 and 28. Approx. 60% of revenue and 64% of EBITDA derive from the domestic amusement segment, predominantly through the "GiGO" brand of amusement arcades. As of the end of Sep 2024, there are 333 arcade locations, with one-third of sales each from urban, shopping center, and suburban locations, respectively. Currently, growth is driven by urban locations, with prize games (mainly crane games) as the central focus. Prize games are expected to generate strong revenue based on the following factors:

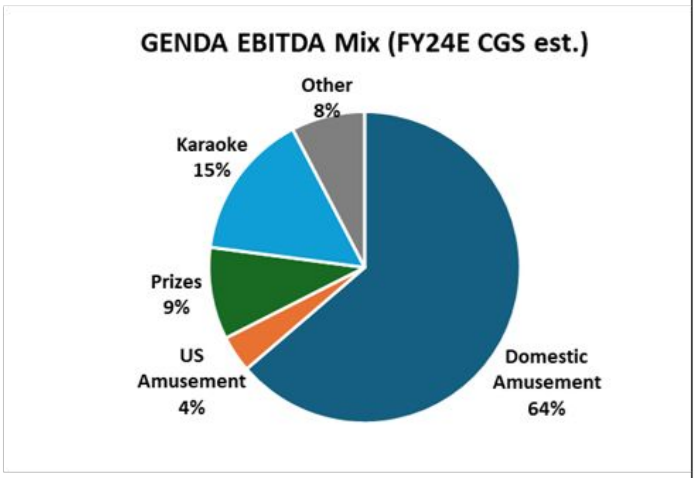
1. **Stable Revenue Model**: Diverse prizes help keep customers engaged, reducing fatigue and encouraging repeat visits, and equipment can be used for over ten years.
2. **Adaptability to Diverse Markets and Users**: A wide range of prizes appeals to a broad demographic, from young people to families.
3. **Low Inventory Risk and High Margin**: Many prizes are small, low-cost items, resulting in low inventory risk and high margins, with a contribution margin of approx. 70%.
4. **Synergies with Entertainment IPs**: The games easily integrate with popular IPs like anime, enhancing their appeal and potential revenue.

Ex. 27: GENDA's Sales Mix (CGS est.)



Source: CGS

EX. 28: GENDA's EBITDA Mix (ex. M&A Cost, CGS est.)

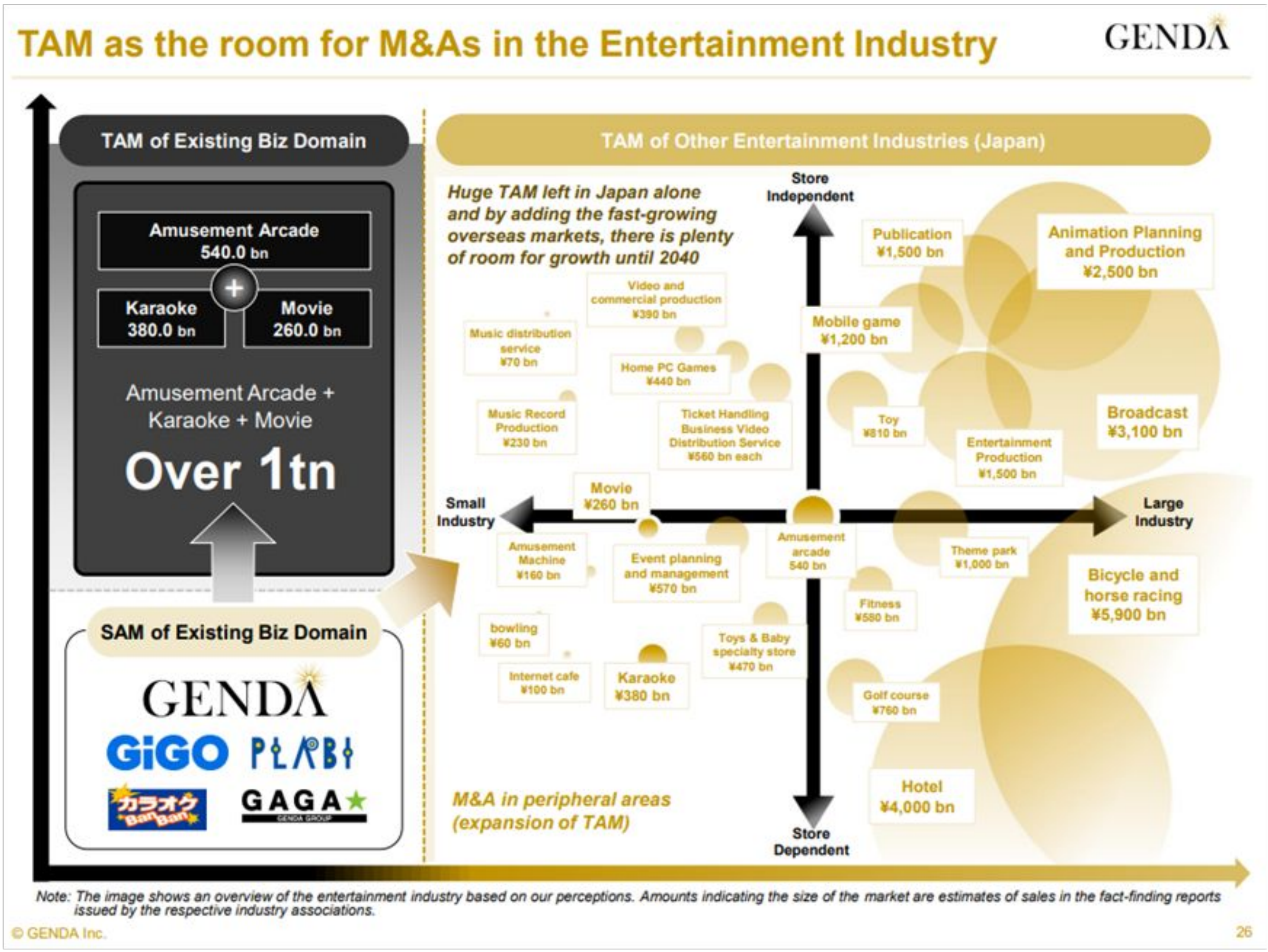


Source: CGS

Analysis of TAM (Total Addressable Market) ～ Still room for growth in the karaoke market

○ TAM (Total Addressable Market) refers to the maximum market size each company or business could potentially achieve. For GENDA, in alignment with its vision to become the world's leading entertainment company, TAM represents the target markets for M&A with respective market sizes. Ex. 29 illustrates GENDA's perspective on the domestic TAM for its M&A targets. Additionally, SAM, also shown in the Ex. 29, stands for Serviceable Available Market, which indicates the maximum market size realistically achievable by the company.

Ex. 29: GENDA's TAM Definition & Domestic Amusement Industry's Market Size



TAM as the room for M&As in the Entertainment Industry

GENDA

TAM of Existing Biz Domain

Amusement Arcade 540.0 bn
Karaoke 380.0 bn
Movie 260.0 bn

Amusement Arcade + Karaoke + Movie

Over 1tn

SAM of Existing Biz Domain

TAM of Other Entertainment Industries (Japan)

Huge TAM left in Japan alone and by adding the fast-growing overseas markets, there is plenty of room for growth until 2040

M&A in peripheral areas (expansion of TAM)

Note: The image shows an overview of the entertainment industry based on our perceptions. Amounts indicating the size of the market are estimates of sales in the fact-finding reports issued by the respective industry associations.

© GENDA Inc. 26

Source: Company Data

○ Within this broad scope, predicting which sectors GENDA will likely target on future M&A is challenging at this stage. However, we understand that the regulated industries such as pachinko are not areas of their interest. On the other hand, as suggested in Equity Story ②, should the PMI efforts for NEN prove successful, we expect the M&A potential within the U.S. amusement market to increase significantly. Additionally, GENDA has announced plans to establish a European base, indicating potential for M&A in Europe as well. Here, additional comments will focus on the karaoke box market, which falls within GENDA's SAM (Serviceable Available Market) scope.

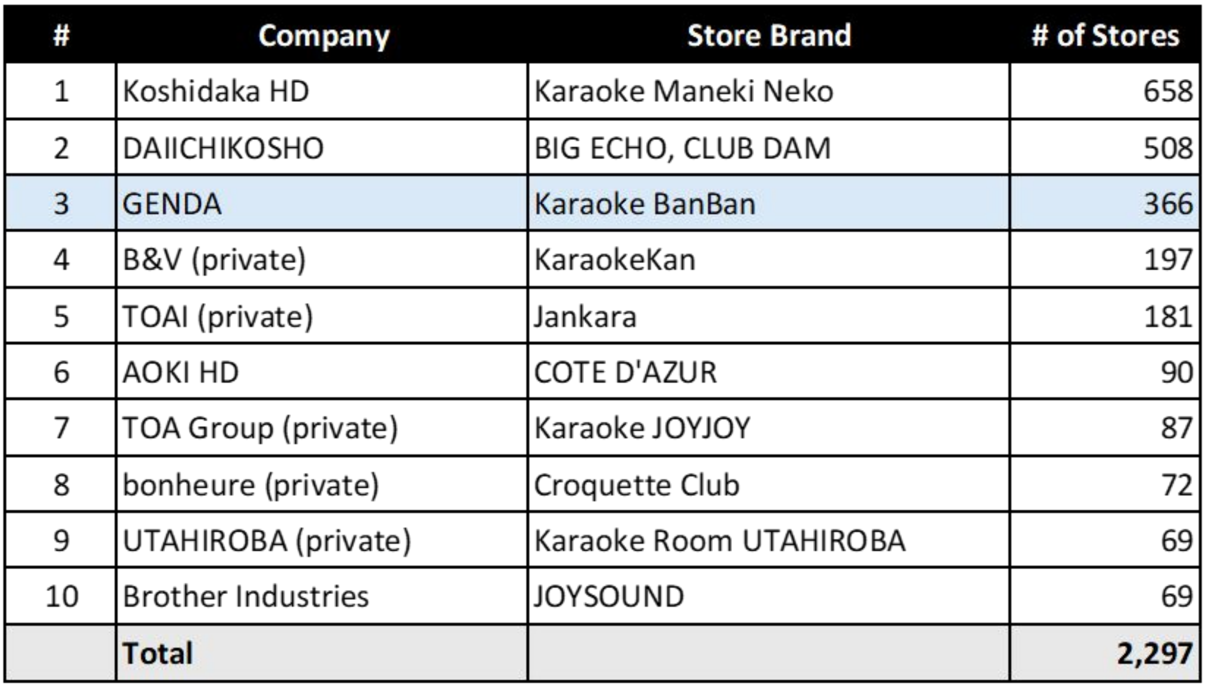
Analysis of TAM (Total Addressable Market) 〜 Still room for growth in the karaoke market

○ GENDA entered the karaoke box market in 2024 through the acquisition of Shin Corporation, recognizing a significant potential for roll-up-style M&A in this sector, much like in the arcade business. GENDA is estimated to hold roughly a 5% market share, ranking the third in the industry (based on a total market size of ¥380bn as estimated by the company). Ex. 30 lists the number of stores for each major competitor. Chains ranked sixth and below have fewer than 100 locations, predominantly run by unlisted small and mid-sized enterprises. According to the "Karaoke White Paper 2024" issued by the National Karaoke Business Association, there are 8,298 karaoke box facilities (defined as locations with two or more vocal rooms) across Japan. The top 10 companies collectively operate 2,298 stores, with the top five accounting for 2,000, suggesting a large presence of smaller operators.

○ In GENDA's karaoke business, the EBITDA margin for FY24 is projected to be around 10% (based on CGS estimates), compared to the industry leader Koshidaka Holdings, whose margin was 21% for FY23. This suggests that there is room for the profitability improvements in GENDA's karaoke business.

○ The "Karaoke White Paper 2024" also estimates the karaoke equipment manufacturing market at ¥54bn, with the distributor market approx. ¥150bn. Beyond karaoke box operations, other segments within the broader karaoke industry may offer additional entry opportunities for GENDA (notably, the company acquired ONTSU in August 2024).

Ex. 30: Key Players in Domestic Karaoke Box



#	Company	Store Brand	# of Stores
1	Koshidaka HD	Karaoke Maneki Neko	658
2	DAIICHIKOSHO	BIG ECHO, CLUB DAM	508
3	GENDA	Karaoke BanBan	366
4	B&V (private)	KaraokeKan	197
5	TOAI (private)	Jankara	181
6	AOKI HD	COTE D'AZUR	90
7	TOA Group (private)	Karaoke JOYJOY	87
8	bonheure (private)	Croquette Club	72
9	UTAHIROBA (private)	Karaoke Room UTAHIROBA	69
10	Brother Industries	JOYSOUND	69
	Total		**2,297**

Source: CGS – Based on Company Data

Risk Factors

Risks of Increasing Acquisition Valuation

○ As acquisition targets grow, there is potential for GENDA acquisition EV/EBITDA multiples to rise. CGS' financial model (base case) is based on M&A transactions executed at an EV/EBITDA multiple of 5x. While it is unlikely that GENDA will engage in acquisitions exceeding an EV/EBITDA of 10x, there could be an increase in transactions in the range of 6-8x.

Risk of Ineffective Post-Merger Integration (PMI)

○ There is a possibility of operational issues arising in sectors outside of the amusement facility business. While GENDA has extensive expertise and resources in managing arcades, this may not be as readily available for businesses acquired in other areas, including the karaoke business acquired in FY23. These sectors could be more susceptible to external factors, a common challenge in M&A, especially if external environments worsen post-acquisition. Although GENDA is focusing on strategic areas such as sales planning, procurement, and DX, less information is available on core administrative functions like human resources, finance, and internal controls. As acquisitions continue to scale up, there is potential for administrative challenges to emerge due to misalignment between management capacity and operational scale.

Risk of Deteriorating Cash Flow (CF) Conversion

○ Acquiring companies with weaker cash conversion cycles (CCC) could lead to increased working capital needs, potentially reducing total cash flow conversion and impacting overall valuation.

Interview with the CEO and CFO

Summary:

GENDA focuses on M&A as a core growth strategy while maintaining a balance with organic growth. For both types of investments, the company adheres to a high IRR hurdle rate, with numerous promising investment opportunities available.

Future M&A candidates will primarily be within adjacent areas of existing business. However, GENDA is open to exploring opportunities across the broader entertainment industry, excluding sectors with insufficient legal frameworks. Regarding the acquisition of NEN in the US, GENDA possesses the necessary expertise and human resources, and expects to achieve substantial synergies. In the medium to long term, a roll-up M&A strategy could also be feasible in the U.S. market.

GENDA places a strong emphasis on cash flow generation in its M&A activities. While optimizing the cash conversion cycle (CCC) is important, the company assesses overall performance CF generation based on balance sheet impact and PMI synergies. Although synergy effects are not included in the initial investment valuation at the time of acquisition, significant synergies have been achieved in many cases post-acquisition, ultimately resulting in substantial returns on CF basis.

CGS: Today, we are pleased to welcome Ms. Shin, CEO of GENDA, and Mr. Watanabe, CFO, for a discussion. In addition to our report, this interview aims to incorporate direct insights from the leadership on key topics that long-term investors may consider when evaluating potential investments.

Photo of Mgmt. Meeting with GENDA; From Right, Watanabe (CFO, GENDA), Shin (President, GENDA), and Nobuzane (CEO, CGS)

CGS : GENDA has continued its growth by making M&A a central driver, acquiring various companies in sectors like arcades and karaoke. At the same time, you're also planning significant capital investment for organic growth, with about ¥12bn allocated in FY23 (approx. 11% of the company's sales guidance of ¥110bn). Could you share your approach to evaluating investment opportunities and discipline when it comes to prioritizing organic growth investments and M&A?

Interview with the CEO and CFO

Ms. Shin: We view both M&A and organic growth, including new store openings, as investments under the same framework. For each, we set the same IRR hurdle rate. If we encounter a situation where one must be prioritized over the other, we may have to make a choice. However, our current financial position allows us to invest actively without limitations, and we see very attractive opportunities in both M&A and organic new store openings. That said, in terms of scale, the business size that can be acquired through a single M&A transaction is generally larger than what we achieve with new openings. As a result, M&A may take precedence in certain situations based on its absolute scale potential.

CGS : In terms of investment discipline, how do you differentiate between the two types of investments? At CGS, we see capital allocation as a crucial driver of equity valuation. Given the limited financial and human capital available, how do you prioritize between these two types of investments?

Ms. Shin: We see numerous opportunities that comfortably exceed our IRR hurdle rate for both types of investments. Therefore, there are no constraints or financial limitations that force us to choose one over the other. Each investment we make is expected to generate sufficient returns.

Mr. Watanabe: When considering capital allocation between M&A and organic growth, M&A allows us to deploy larger amounts of capital, while organic investments provide more control. In M&A, we need to carefully consider the intentions of the acquisition target until the final stage. We believe that both of these approaches are essential.

CGS : Regarding M&A, I'd like to ask another question. In your IR disclosures, you’ve defined the TAM (Total Addressable Market) to include various entertainment fields such as theme parks, cinemas, and fitness centers. Could you share more about the characteristics of industries that you consider for investment, and if there are any industries you would exclude?

Ms. Shin: We consider the entire entertainment field as potential targets. However, priority is naturally higher for industries closer to our existing operations. Since nearly 70% of GENDA's revenue comes from amusement arcades, related fields have a higher priority. Regarding sectors we exclude, we avoid those that lack adequate legal frameworks.

CGS : It seems that your M&A strategy focuses on roll-up acquisitions in somewhat saturated industries, targeting smaller companies repeatedly. Would you consider investing in more consolidated industries as well?

Ms. Shin: In our main arcade roll-up strategy, as you noted, this is a market with many smaller players. Consolidating them provides significant benefits and remains a priority. However, we’re not limited to just this approach. We maintain a broad perspective, learning from various companies, and aim to adopt the optimal strategy for each situation.

CGS : In June of this year, you announced the acquisition of NEN (National Entertainment Network), a company operating a mini-location business in the United States. How do you plan to prioritize future M&A investment decisions between domestic and international opportunities?

Interview with the CEO and CFO

Ms. Shin: For international M&A, we understand that post-merger integration (PMI) costs are naturally higher compared to domestic deals. This means adjustments or considerations in acquisition multiples are necessary. That said, I find NEN's valuation quite reasonable, especially when taking into account the high level of clarity in their operations and the substantial benefits we foresee. NEN's business is closely aligned with what we have been developing organically for the past five years, making it a natural extension of our existing activities.

CGS : Regarding the investment discipline for domestic versus international M&A, you mentioned that PMI costs are higher for overseas deals. How different are these costs? And when setting the hurdle rate, do you adjust the WACC differently for domestic and international investments?

Ms. Shin: There isn't a predetermined difference in WACC between domestic and international deals, but when conducting due diligence, we incorporate additional management costs directly into the valuation before making investment decisions. This means that, although we apply the same hurdle rate for both domestic and international investments, we account for these management costs as part of the business plan for each investment.

Mr. Watanabe: For overseas investments, we set a higher hurdle rate to match the expected return needed. In the case of NEN, we believe it will yield returns well above those expectations.

CGS : Great. Regarding the U.S. mini-locations business you acquired, could you share your strategy for further expansion? Will you focus on organic growth through new openings, or do you see a potential for additional M&A, possibly through a roll-up strategy?

Ms. Shin: NEN already operates around 8,000 locations, so rather than adding more sites, our immediate focus is on increasing profitability at existing ones. We plan to replicate some aspects of our U.S. business model—for example, incorporating Japanese-style game machines and prize offerings—to drive significant increases in both revenue and profit.

As for further M&A and roll-up opportunities in the U.S., we are actively exploring possibilities. Given the nature of our industry, smaller acquisitions of a few locations are feasible and aligned with our strategy.

CGS : You mentioned that your immediate focus on NEN after the acquisition is to increase profitability at existing stores. How do you manage the PMI process for both domestic and overseas acquisitions?

Ms. Shin: Domestically, our approach is to consolidate each business under one core company, as we do with our arcade business. For other businesses, we operate them under the holding company framework.

Internationally, PMI costs are typically high when entering a new country, including substantial recruiting costs. However, in the U.S., we already have a five-year business track record, experienced personnel, and market knowledge, making it very different from an entirely new market entry.

CGS : So, you have an experienced foundation for PMI in the U.S. Going forward, how do you see the potential of investments outside the U.S. from a long-term perspective?

Ms. Shin: We believe that crane games and the culture of Japanese-style arcades have a large market potential globally. However, given the significant size and growth opportunities within the U.S., our current focus remains on this market.

Interview with the CEO and CFO

CGS : Mr. Watanabe, I'd like to hear your thoughts as well on PMI strategy from CFO's perspective. GENDA places a strong emphasis on cash EPS, aligning well with the perspective of global investors. While it is indeed important that cash EPS growth contributes to the P&L, I believe it's equally vital to consider the other drivers of free cash flow. This involves factors like capital efficiency on the balance sheet and the impact on consolidated cash flow generation capability due to differences in the CCC model of acquired companies. When consolidating an acquired company, I think it's essential to evaluate whether the overall CF generation model will improve, remain stable, or worsen. Could you share any PMI initiatives regarding balance sheet management, the CCC model, cash flow conversion, or other metrics beyond the P&L?

Mr. Watanabe: : As you pointed out, in our M&A strategy, the ability to generate free cash flow is critical for financing and investment discipline. This is where we focus most of our attention. In terms of P&L, we use cash EPS as a simple metric. As we grow through M&A, the total free cash flow increases, and theoretically, this should lead to proportional growth in enterprise value. However, if the number of shares exceeds the cash flow growth rate, the stock price may decreases even though the overall free cash flow grows. This is why we manage through cash EPS - the "per share" metrics.

I think the ability to generate cash flow should increase through the synergies we've disclosed. Let us provide a few examples of PMI success stories. In the arcade business, all the six companies that joined us through M&A have seen a significant growth in EBITDA. In karaoke, EBITDA has increased by 85% year over year. For upstream businesses like Fukuya, a prize supplier, and its distributor Ares Company, EBITDA of both have increased by 150% and 300% year over year, respectively. Based on this track record, we believe we can replicate these synergies to some extent across our group's entertainment businesses. That said, when we make investment decisions, we don't factor in post-acquisition synergies when determining whether we meet our hurdle rate.

On the topic of capital allocation, we think there are two points where practical realities may differ from the world of finance theory.

First, on the M&A side, each deal is evaluated on a deal-by-deal basis, but it's crucial to maintain a favorable balance between the acquisition costs and the resulting cash flow. If the acquired company has net cash on its balance sheet, that provides a benefit beyond just cash flow generation, as it reduces the overall investment.

Second, on the organic side, morale on the ground is vital. For instance, our team at the arcade business is working daily towards becoming the top operator in Japan, and they're getting close to reaching that goal. This high level of morale is critical. So, restricting investment in organic growth may not always lead to optimal outcomes. As long as an investment exceeds a certain hurdle rate, we believe we should allocate capital, aiming to maximize overall capital allocation.

CGS : That's really helpful. As an example, say you acquire a business with a high inventory business model. How do you approach optimizing the acquired company's CCC post-acquisition?

Interview with the CEO and CFO

Mr. Watanabe: : Naturally, we aim to make improvements where possible. However, one key principle at our company is that we approach mergers and acquisition differently. With mergers, there are usually many areas we can improve. However, with acquisitions, we tend to operate the acquired business as part of holding company structure, granting it higher operational freedom, so we generally avoid making major changes. Within that framework, though, we will make improvements where feasible.

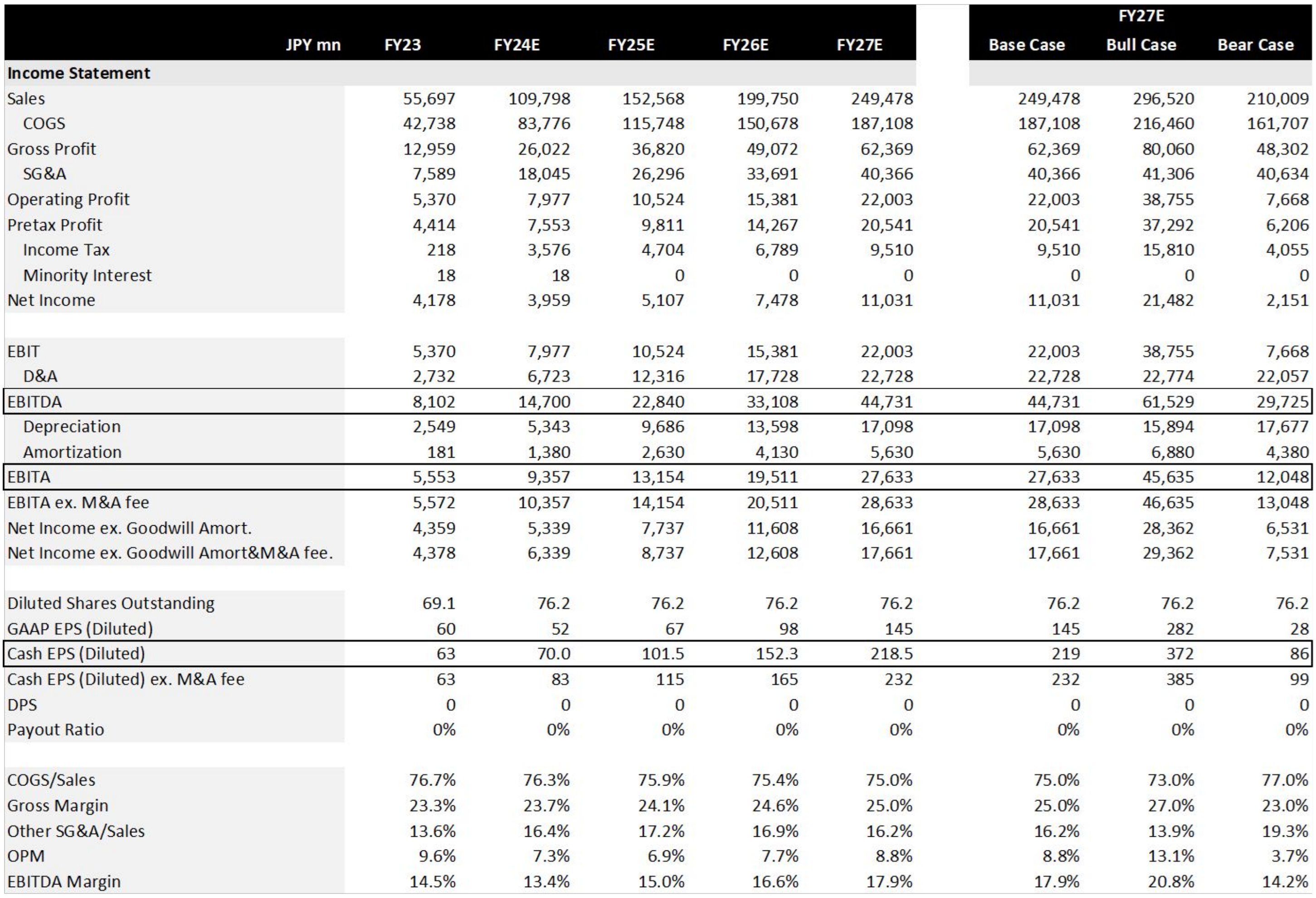
Even if an acquired company's CCC is relatively worse than our overall cycle, we proceed with the acquisition if we believe the investment returns will more than offsetting this. Take Ares Company, for example. Post-acquisition, its EBITDA increased fourfold year over year. While the exact acquisition price is undisclosed, if we acquired it at an EV/EBITDA multiple of 4x, then, factoring in synergies, it's as if we acquired it at 1x EV/EBITDA. In this way, improvements in cash flow indicators post-acquisition can effectively reduce the overall acquisition cost, and this approach works well for us.

CGS : In other words, it sounded to me that as long as overall cash flow generation improves, you're willing to accept a temporary decline in some cash flow indicators like CCC, all in pursuit of maximizing enterprise value. We believe that's the strategic approach you're taking.

We've discussed various points from a long-term investors' perspective that may influence investment decisions. Lastly, if there's any key messages you'd like to leave us with, please feel free to share.

Ms. Shin: Thank you very much for today. At GENDA, we are growing with M&A as our key driver, and we intend to continue leveraging M&A for a long-term growth. The nature of our M&A-driven growth strategy makes it difficult for us to offer a clear long-term outlook, but we are personally very excited about what's coming. We hope our investors are as excited and look forward to the future alongside us.

CGS’ Financial Model



						FY27E		
JPY mn	FY23	FY24E	FY25E	FY26E	FY27E	Base Case	Bull Case	Bear Case
Income Statement								
Sales	55,697	109,798	152,568	199,750	249,478	249,478	296,520	210,009
COGS	42,738	83,776	115,748	150,678	187,108	187,108	216,460	161,707
Gross Profit	12,959	26,022	36,820	49,072	62,369	62,369	80,060	48,302
SG&A	7,589	18,045	26,296	33,691	40,366	40,366	41,306	40,634
Operating Profit	5,370	7,977	10,524	15,381	22,003	22,003	38,755	7,668
Pretax Profit	4,414	7,553	9,811	14,267	20,541	20,541	37,292	6,206
Income Tax	218	3,576	4,704	6,789	9,510	9,510	15,810	4,055
Minority Interest	18	18	0	0	0	0	0	0
Net Income	4,178	3,959	5,107	7,478	11,031	11,031	21,482	2,151
EBIT	5,370	7,977	10,524	15,381	22,003	22,003	38,755	7,668
D&A	2,732	6,723	12,316	17,728	22,728	22,728	22,774	22,057
EBITDA	8,102	14,700	22,840	33,108	44,731	44,731	61,529	29,725
Depreciation	2,549	5,343	9,686	13,598	17,098	17,098	15,894	17,677
Amortization	181	1,380	2,630	4,130	5,630	5,630	6,880	4,380
EBITA	5,553	9,357	13,154	19,511	27,633	27,633	45,635	12,048
EBITA ex. M&A fee	5,572	10,357	14,154	20,511	28,633	28,633	46,635	13,048
Net Income ex. Goodwill Amort.	4,359	5,339	7,737	11,608	16,661	16,661	28,362	6,531
Net Income ex. Goodwill Amort&M&A fee.	4,378	6,339	8,737	12,608	17,661	17,661	29,362	7,531
Diluted Shares Outstanding	69.1	76.2	76.2	76.2	76.2	76.2	76.2	76.2
GAAP EPS (Diluted)	60	52	67	98	145	145	282	28
Cash EPS (Diluted)	63	70.0	101.5	152.3	218.5	219	372	86
Cash EPS (Diluted) ex. M&A fee	63	83	115	165	232	232	385	99
DPS	0	0	0	0	0	0	0	0
Payout Ratio	0%	0%	0%	0%	0%	0%	0%	0%
COGS/Sales	76.7%	76.3%	75.9%	75.4%	75.0%	75.0%	73.0%	77.0%
Gross Margin	23.3%	23.7%	24.1%	24.6%	25.0%	25.0%	27.0%	23.0%
Other SG&A/Sales	13.6%	16.4%	17.2%	16.9%	16.2%	16.2%	13.9%	19.3%
OPM	9.6%	7.3%	6.9%	7.7%	8.8%	8.8%	13.1%	3.7%
EBITDA Margin	14.5%	13.4%	15.0%	16.6%	17.9%	17.9%	20.8%	14.2%

CGS’ Financial Model

						FY27E		
JPY mn	**FY23**	**FY24E**	**FY25E**	**FY26E**	**FY27E**	**Base Case**	**Bull Case**	**Bear Case**
Cash Flow Statement								
Net Income	4,178	3,959	5,107	7,348	10,641	10,641	21,092	1,761
D&A	2,549	6,723	12,316	17,928	23,328	23,328	23,374	22,657
Changes in Working Capital	184	-2,179	-2,899	-3,193	-3,360	-3,360	-4,496	-2,329
OCF	7,602	8,504	14,524	22,083	30,609	30,609	39,970	22,089
CAPEX	-5,132	-12,000	-15,257	-17,978	-19,958	-19,958	-17,791	-21,001
FCF	2,470	-3,496	-733	4,105	10,651	10,651	22,178	1,088
Acquisitions	-3,861	-18,000	-30,000	-30,000	-30,000	-30,000	-40,000	-20,000
Cash Dividends Paid	0	0	0	0	0	0	0	0
FCF III (OCF - ICF -Div)	-2,732	-21,496	-30,733	-25,895	-19,349	-19,349	-17,822	-18,912
Share Issuance (Repurchase)	4,084	10,054	0	0	0	0	0	0
Issuance (Reduction) of Debt - Net	3,912	15,000	27,000	26,500	20,000	20,000	20,000	20,000
Net Change in Cash	5,242	3,558	-3,733	605	651	651	2,178	1,088
Conversion								
OCF/EBITDA	93.8%	57.8%	63.6%	66.7%	68.4%	68.4%	65.0%	74.3%
FCF/NI	59.1%	-88.3%	-14.3%	55.9%	100.1%	100.1%	105.2%	61.8%
Balance Sheet								
Cash & Cash Equivalents, ST Inv	12,379	15,937	12,204	12,809	12,855	12,855	9,298	18,044
Accounts Receivable	4,126	6,317	8,778	11,492	14,354	14,354	17,872	11,507
Inventories	4,373	5,738	7,928	10,320	12,816	12,816	13,047	12,405
Total Current Assets	23,567	30,681	31,599	37,311	42,713	42,713	42,906	44,645
Net PP&E	12,581	22,738	43,308	62,488	79,749	79,749	91,804	66,916
LT Investments	135	135	135	135	135	135	135	135
Intangible/Goodwill	5,698	19,318	31,688	42,558	51,928	51,928	64,678	39,178
Total LT Assets	28,574	52,351	85,291	115,341	141,972	141,972	166,777	116,389
Total Assets	52,141	83,032	116,890	152,653	184,685	184,685	209,683	161,034
ST Debt & Curr. Portion LT Debt	7,620	7,620	7,620	7,620	7,620	7,620	7,620	7,620
Accounts Payable	3,213	4,590	6,342	8,256	10,253	10,253	11,861	8,861
Total Current Liabilities	16,892	18,269	20,021	21,935	23,932	23,932	25,540	22,540
LT Debt	11,370	26,370	53,370	79,870	99,870	99,870	99,870	99,870
Total LT Liabilities	15,585	30,585	57,585	84,085	104,085	104,085	104,085	104,085
Total Liabilities	32,477	48,854	77,606	106,020	128,017	128,017	129,625	126,625
Total Equity	19,664	34,177	39,284	46,632	56,668	56,668	80,058	34,410
Total Liabilities & Shareholder's Equity	52,141	83,032	116,890	152,653	184,685	184,685	209,683	161,034
CCC								
Days of Sales Outstanding (DSO)	21	21	21	21	21	21	22	20
Days of Inventory Outstanding (DIO)	28	25	25	25	25	25	22	28
Days of Payables Outstanding (DPO)	20	20	20	20	20	20	20	20
Cash Conversion Cycle (Days)	29	26	26	26	26	26	24	28
ROE	27%	15%	14%	17%	21%	21%	31%	5%
ROIC	15%	9%	8%	8%	9%	9%	15%	3%
Cash ROIC	18%	10%	8%	9%	9%	9%	15%	4%
Net Debt / EBITDA	0.7	0.8	1.5	1.9	1.9	1.9	1.5	2.6

Disclaimer

This report was prepared by Capital Growth Strategies Co., Ltd. (hereinafter "CGS") at the request of the subject company (hereinafter "the Subject Company"). CGS has received compensation from the Subject Company for preparing this report, and may receive compensation for services other than report preparation as well .

This report is intended to provide reference information on the Subject Company and does not constitute, nor is it intended as, an invitation, recommendation, or advice for investment. Investment decisions should be made at the investor's own discretion and responsibility. The hypotheses, views, analyses, performance forecasts, etc., contained in this report are based on information obtained through public sources and interviews, and have been created by CGS, not by the Subject Company. CGS does not guarantee the accuracy or completeness of the information in this report. Any use of the information in this report is at the reader's discretion and responsibility, and CGS assumes no liability for any damages resulting from such use.

Intellectual property rights, including copyrights of this report, belong to CGS, and reproduction, modification, processing, sale, display, transmission, or distribution without prior written consent from CGS is strictly prohibited. Directors and employees of CGS may hold securities of the Subject Company. The content of this report is subject to change without notice.