

**07/02/2020: Nihon Falcom (3723.JP)**

**Business Description:** Nihon Falcom Corporation engages in the development and production of title game software in Japan. It also produces music and video titles; plans game software; sells game software and related products; and provides various licenses. The company was founded in 1981 and is based in Tachikawa, Japan. - *TIKR.com*

**Thesis:** Nihon Falcom (3723) is one of the oldest game developers in existence. Boom/bust revenue cycles cloud the company's operating excellence. Falcom is small and often overlooked as a member of the Mother's Index (reserved for emerging companies). Over the last decade, Nihon's expanded gross margin 21%, increased EBIT margin 36% and sport near 50% FCF margins. They have \$55M in net cash on the balance sheet and trade ~14x its 5YR normalized EBIT. **We think the company's worth ~\$21/share (70% upside) based on conservative growth estimates.**

**Main Business Segments:** Nihon operates two segments: game software/game music development (33% of rev.) and licensing (67% of rev.). The company's game development arm produces both PC and hard-console RPG-centered games. Their latest games include [Ys IX](#), [Trails of Cold Steel IV](#) and [Trails of Cold Steel III](#). The licensing segment monetizes Nihon's IP through US-based releases, game character toys and smartphone applications. Licensing is an **incredible** business. With zero incremental costs, the company recognized 100% of its licensing revenue towards its gross profit. Falcom's entry into smartphones increases their market exponentially (similar to Nintendo). They generate 75% of their revenue from Japan.

**CEO Living His Dream:** The coolest part about Nihon is the company's CEO, Toshihiro Kondo. You couldn't script Kondo's story any better. Kondo *loved* video games as a child and from an early age wanted to own an arcade. At 14 Kondo played his first Nihon game, *YsIII*. During college, Kondo created a Nihon fanbase website. Before graduating, Kondo applied for a job in Falcom's accounting department. From there he worked his way up. Gradually taking more responsibility. He even started writing scripts for games. Kondo's passion was soon recognized by Falcom's founder, Masayuki Kato. In 2007, Kato *hand-picked* Kondo to be his successor as CEO.

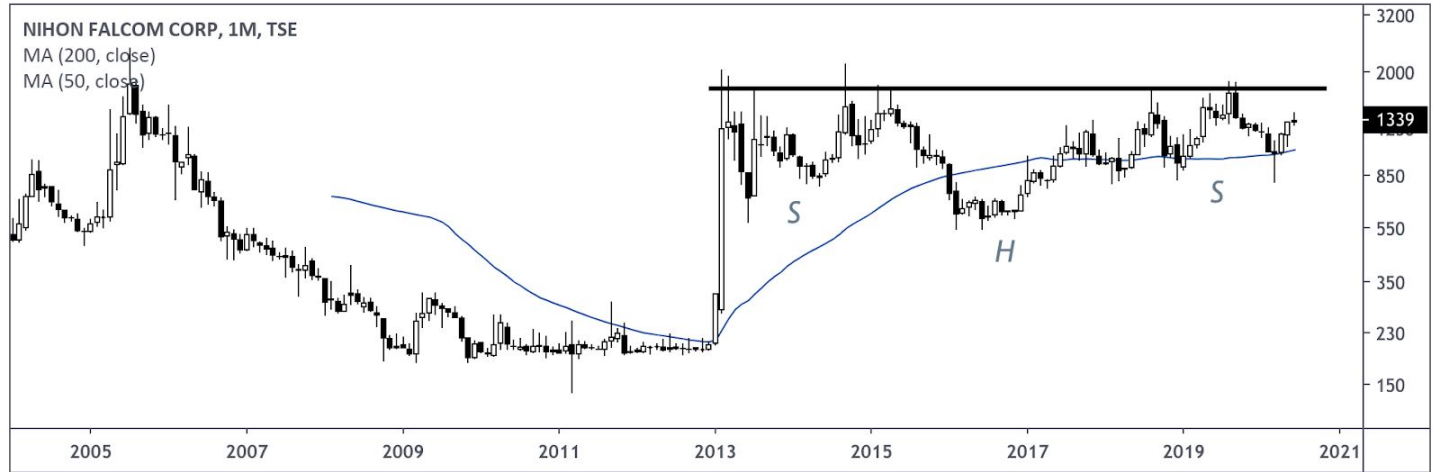
**What's It Worth:** Including cash, Falcom's reasonably cheap. Back out the \$55M in cash and things get very attractive. You can buy Falcom's business today, ex-cash for 8x 5YR normalized EBIT. That's 8x for a 90% GM business with near 50% FCF margins and no debt. Our base case assumes 3.72% annual revenue growth, 90% GM, 59% EBIT margins and 46% FCF margins over the next five years.

	EBIT		
EV/EBIT Mult.	\$15	\$16	\$17
10	\$150	\$160	\$170
11	\$165	\$176	\$187
12	\$180	\$192	\$204

Given our assumptions, we end 2024 with \$27M in revenue, \$16M in EBIT and \$12M in FCF. **This gives us \$156M in EV. Add back cash and you get \$211M in market cap (\$20/share equity value).**

## Chart Analysis: Nihon Falcom (3723.JP)

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TSE\_DLY:3723, 1M 1339 ▼ -10 (-0.74%) O:1320 H:1426 L:1284 C:1339



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