



AB Hotel

TSE (JASDAQ) Standard

6565

Industry: Leisure and amusement

Early turnaround to be achieved by focusing on business demand; initiating coverage with a Buy

Initiating coverage with a target price of 1,400 yen and a Buy rating

We initiate coverage of AB Hotel Co., Ltd. (6565, AB Hotel, the company) with a target price of 1,400 yen and a Buy rating. The company has maintained a policy of running hotels to meet purely business demand, rather than relying on inbound tourists, and as a result, the COVID-19 pandemic has caused relatively little impact to the company's earnings. The company already returned to profitability in 2Q FY3/21. While many of its competitors have been struggling with persistent losses and damage to their equity capital, the company has not suffered any particular damage to its store network or balance sheet, and we believe it will be able to outperform its competitors in the recovery phase. On the other hand, the company's stock price has weakened relative to its peers, and we expect that the stock has significant upside going forward.

Low-cost management and an aggressive and healthy store opening policy

AB hotel is a consolidated subsidiary of Tosho Co., Ltd. (8920). Based in Aichi Prefecture, the company operates 31 business hotels under direct management. The company has unique expertise in reducing initial investment and low-cost operations, and as such has maintained an OPM of over 25% for a long time before the COVID-19 pandemic. The number of stores has more than doubled from 14 at the end of FY3/17, as the company aggressively opened new stores in locations where business demand is strong, rather than being carried away by the inbound travel boom.

Turned profitable in Jul-Sep period. Weakening of competition is progressing.

Since 4Q FY3/20, the company's earnings have been strongly affected by the COVID-19 pandemic, and in 1Q FY3/21, it fell into an operating loss of 156m yen. However, the company posted a profit of 12m yen in 2Q and 222m yen in 3Q, reflecting its business-focused locations and cost competitiveness. On the other hand, many of its competitors are unable to get out of the red and are suffering from damage to their equity capital.

Earnings forecast by Mita Securities

We forecast OP of 141m yen for FY3/21 (-89.4% YoY; company guidance 104m yen), 681m yen for FY3/22 (+383.7% YoY), and 1.355bn yen in FY3/23, expecting recovery to the level before the COVID-19 pandemic. We believe there is ample room for new store openings in the medium to long term.

Valuations and risk factors

In calculating our target price, we used a residual income model (RIM) with a cost of equity of 7.5% and a terminal growth rate of 1.5%, based on our earnings forecasts for FY3/21-FY3/26. Our target price is equivalent to 23.6x our FY3/23 EPS forecast of 59.30 yen.

Risk factors to our view include: 1) a request from the national or local government to refrain from business travel; 2) a significant decline in hotel room occupancy rates and room rates; and 3) significant conflicts among major shareholders and management of Tosho and AB Hotel.

MITA SECURITIES Co., Ltd.

Junichi Shimizu

Chief Analyst, Head of Research

Initiation of coverage

Rating

Buy

Target price (JPY)	1,400
Stock price (JPY) (Apr 20)	1,034
Market cap (JPYbn)	14.7

Key changes

Rating	New
Target price	New
Earnings forecast	New

Stock price (JPY)



Source: Bloomberg Finance LP

Earnings

		3/19	3/20	3/21E	3/22E	3/23E
Sales	JPYbn	5.5	6.3	4.8	6.1	7.0
OP	JPYbn	1.4	1.3	0.1	0.7	1.4
RP	JPYbn	1.4	1.3	0.1	0.6	1.3
NP	JPYbn	0.9	0.9	0.1	0.4	0.8
EPS	JPY	62.6	62.9	5.0	28.9	59.3
BPS	JPY	371	428	431	456	509
DPS	JPY	6.0	6.0	2.0	4.0	6.0
PER	x	32.0	14.4	228.8	35.8	17.4
PBR	x	5.4	2.1	2.7	2.3	2.0
Div. yield	%	0.3	0.7	0.2	0.4	0.6
ROA	%	5.6	4.9	0.4	1.9	3.8
ROE	%	18.3	15.7	1.2	6.5	12.3

Source: Company data, Mita Securities

Company profile

AB Hotel is based in Aichi Prefecture and operates 31 business hotels specializing in lodging under the AB Hotel brand. The company is actively involved in the store design stage to reduce initial investment, and achieves low-cost front desk operations through the outsourcing method. AB Hotel is a consolidated subsidiary of Tosho (8920).

Investment Thesis

Outlook

Recovery ahead of the competition

We initiate coverage of AB Hotel Co., Ltd. (6565, AB Hotel, the company) with a target price of 1,400 yen and a Buy rating.

Initiating coverage with a TP of 1,400 yen and a Buy rating

The company is a consolidated subsidiary of Tosho Co., Ltd. (8920). Based in the Mikawa area of Aichi Prefecture, the company operates 31 business hotels nationwide under direct management system. Before the COVID-19 pandemic, the company achieved an OPM of over 25% for eight consecutive fiscal years (including the period when it was the hotel division of Tosho), thanks to its unique expertise in low initial investment and low-cost operations. In addition, the company has been expanding its business by aggressively opening new stores on the back of high profitability.

Since 4Q of FY3/20, the hotel industry has been strongly affected by the COVID-19 pandemic, with many operators falling into significant losses, especially in 1Q FY3/21 when the first state of emergency was declared. The company also posted an operating loss of 156m yen in 1Q. However, the company posted a profit in 2Q and 3Q, reflecting its business-focused locations and cost competitiveness. While many of its competitors are stuck in the red and are suffering from damages to their equity capital (some have recapitalized), the company has not suffered any particular damage to its store network or balance sheet and should be able to outperform its competitors in the recovery phase.

Excellent cost competitiveness. Quick recovery from the COVID-19 pandemic is expected

We forecast OP of 141m yen (-89.4% YoY; company guidance 104m yen) in FY3/21 and 681m yen (+383.7% YoY) in FY3/22. We expect the company's profits to recover to the pre-COVID-19 levels in FY3/23 (OP forecast of 1.355bn yen). In the medium to long term, we expect the company to expand by opening new stores again. With the withdrawal of competitors, it may become easier to secure properties with low budgets.

We expect the company's profits to return to the pre-COVID-19 levels in FY3/23. Large room for new store openings in the medium to long term

Catalysts

The catalysts we envision for an upturn in the stock price include an increase in hotel room occupancy rates, a significant decrease in the number of new cases of the COVID-19 infection, the generalization of vaccinations, and the resumption of the Go To Travel campaign by the Japanese government.

Figure: Summary of Mita Securities' earnings forecast (non-consolidated)

JPYm	3/18	3/19	3/20	Mita E 3/21	Mita E 3/22	Mita E 3/23	Mita E 3/24	Mita E 3/25	Mita E 3/26	CoE 3/21
Earnings										
Sales	4,420	5,515	6,296	4,783	6,090	7,021	7,702	8,451	9,370	4,790
YoY, %	25.9	24.8	14.2	-24.0	27.3	15.3	9.7	9.7	10.9	
Operating profit	1,193	1,410	1,333	141	681	1,355	1,840	2,239	2,721	104
YoY, %	21.4	18.2	-5.4	-89.4	383.7	98.8	35.8	21.7	21.5	
OPM, %	27.0	25.6	21.2	2.9	11.2	19.3	23.9	26.5	29.0	
Recurring profit	1,146	1,398	1,297	107	640	1,314	1,799	2,198	2,680	90
YoY, %	18.3	22.0	-7.2	-91.7	496.6	105.1	37.0	22.2	21.9	
Net profit	723	887	891	71	410	841	1,151	1,407	1,715	55
YoY, %	12.3	22.7	0.5	-92.0	474.6	105.1	37.0	22.2	21.9	
Depreciation	403	518	643	702	776	795	808	844	892	
Capital expenditure	2,055	2,335	2,393	2,597	930	930	1,130	1,560	1,560	
Free CF	-720	-941	1,077	-2,269	270	691	822	713	1,078	
Per share indicators										
EPS (JPY)	51.01	62.57	62.86	5.03	28.91	59.30	81.22	99.25	121.00	3.89
BPS (JPY)	313.23	370.80	427.66	430.69	455.60	508.90	582.12	672.37	783.36	
DPS (JPY)	5.00	6.00	6.00	2.00	4.00	6.00	8.00	9.00	10.00	2.00
Valuation, profitability, etc.										
PER (x)	51.1	32.0	14.4	228.8	35.8	17.4	12.7	10.4	8.5	
PBR (x)	8.3	5.4	2.1	2.7	2.3	2.0	1.8	1.5	1.3	
Dividend payout ratio (%)	9.7	9.6	9.5	39.8	13.8	10.1	9.8	9.1	8.3	
Dividend yield (%)	0.2	0.3	0.7	0.2	0.4	0.6	0.8	0.9	1.0	
ROA (%)	5.9	5.6	4.9	0.4	1.9	3.8	5.0	5.8	6.6	
ROE (%)	18.8	18.3	15.7	1.2	6.5	12.3	14.9	15.8	16.6	
Financial soundness indicators										
Capital ratio (%)	31.8	30.0	31.7	29.0	29.8	32.0	34.8	38.0	41.4	
Debt/Equity (x)	0.5	0.5	0.6	0.5	0.5	0.6	0.6	0.7	0.9	

Source: Company data, Mita Securities

Valuations

Stock valuation based on the residual income model (RIM)

In calculating our target price of 1,400 yen, we used a residual income model (RIM) with a cost of equity of 7.5% and a terminal growth rate of 1.5%, based on our earnings forecasts for FY3/21-FY3/26. Our target price is equivalent to 23.6x our FY3/23 EPS forecast of 59.30 yen.

TP of 1,400 yen based on RIM

Figure: Residual Income Model (RIM)

JPYbn	Y0 MitaE 3/21	Y1 MitaE 3/22	Y2 MitaE 3/23	Y3 MitaE 3/24	Y4 MitaE 3/25	Y5 MitaE 3/26	Y6~ MitaE 3/27
Shareholders' equity (EOP)	6.1	6.5	7.2	8.3	9.5	11.1	
Net profit		0.4	0.8	1.2	1.4	1.7	
Cost of equity		0.5	0.5	0.5	0.6	0.7	
Residual income		0.0	0.4	0.6	0.8	1.0	
PV of residual income		0.0	0.3	0.5	0.6	0.7	
PV of terminal value							11.8
Beta	1.40						
Risk free rate (%)	0.50						
Risk premium (%)	5.00						
Cost of equity (%)	7.50						
Terminal growth rate (%)	1.50						
Total equity value						19.9	
Number of shares O/S (m)						14.176	
Target share price						1,400	

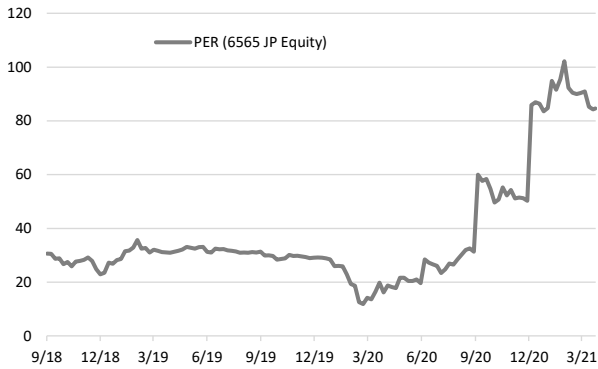
Source: Company data, Mita Securities

Figure: Sensitivity of target price to terminal growth rate

Terminal growth rate	0.50	0.70	0.90	1.10	1.30	1.50	1.70	1.90	2.10	2.30	2.50	2.70	2.90
Target price	1,300	1,300	1,350	1,350	1,400	1,400	1,450	1,450	1,500	1,550	1,600	1,650	1,650

Source: Mita Securities

Figure: AB Hotel's historical PER (reference)



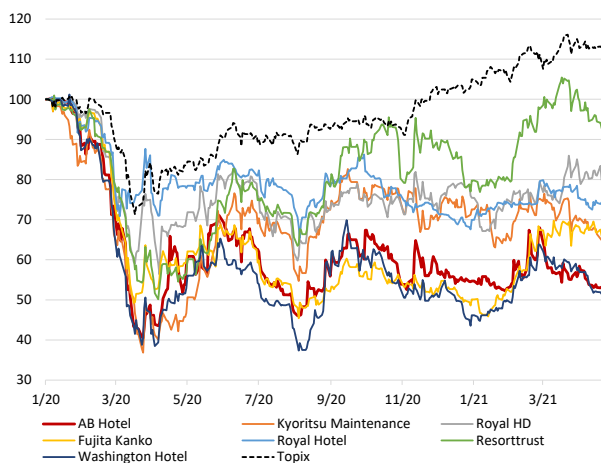
Source: Bloomberg Finance LP data, Mita Securities

Comparison of valuations with peers

AB Hotel was already profitable in 2Q FY3/21, recovering earnings ahead of its competitors and not suffering any damage to its equity capital. However, the recovery of the company's stock price compared to the pre-COVID-19 level has been comparable to, or even behind, its more severely damaged competitors. In our view, differences in fundamentals may be taking longer to be reflected in the stock price due to the relatively small market capitalization of many stocks in this sector and the limited coverage by sell-side analysts.

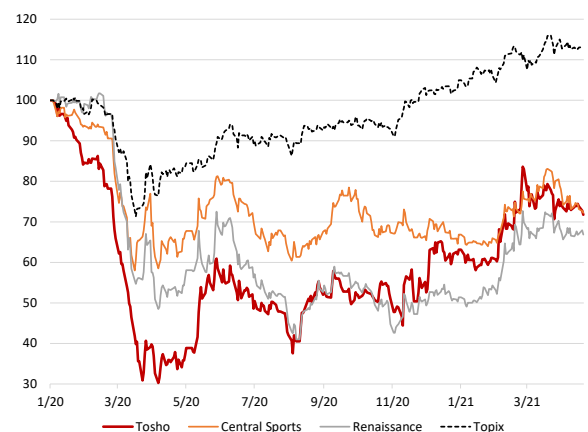
Stock price does not fully reflect the strength of fundamentals, in our view

Figure: Stock price trends for hotel operators



Source: Bloomberg Finance LP data, Mita Securities Note: Indexed to 100 at the end of 2019

Figure: Stock price trends for fitness club operators (reference)



Source: Bloomberg Finance LP data, Mita Securities Note: Indexed to 100 at the end of 2019

Figure: Comparison of valuations for hotel operators

Company	Ticker	Share price 20-Apr	Mkt cap JPYbn	PER Last	PER LTM	PER Current E	PER Next E	PBR Last	EV/EBITDA Next E	EV/Sales Next E	ROE LTM	Sales growth LTM	EBITDA Mgn LTM	Div Yield Current E	1M Change	3M Change	1YR Change
RESORTTRUST INC	4681	1,721	186.8	25.8	19.0	30.1	17.3	1.4	9.7	1.5	7.3	-11.7	15.8	1.8	-11.3	14.9	65.2
WASHINGTON HOTEL CORP	4691	685	8.3	18.5	18.5	NA	NA	0.6	NA	NA	3.1	-7.6	9.4	NA	-14.8	5.5	-0.6
AMAZE CO LTD	6076	861	13.1	54.7	NA	NA	NA	1.2	NA	NA	-2.6	-28.7	14.0	NA	-3.6	6.4	28.3
GREENS CO LTD	6547	520	6.7	NA	NA	NA	650.0	2.8	NA	0.5	-128.2	-50.3	-55.9	0.0	-18.4	14.3	27.8
ABHOTEL CO LTD	6565	1,034	14.7	16.4	83.5	NA	NA	2.4	NA	NA	2.9	-23.6	21.9	0.0	-7.3	-1.4	-14.9
ROYAL HOLDINGS CO LTD	8179	1,917	87.0	NA	NA	NA	98.6	3.4	14.6	1.1	-76.8	-41.2	-25.3	0.5	-7.3	5.5	12.8
KYORITSU MAINTENANCE CO	9616	3,375	132.4	19.0	NA	NA	29.4	1.8	17.6	1.3	-11.1	-25.6	-3.3	0.7	-14.0	-1.0	44.6
IMPERIAL HOTEL LTD	9708	1,850	109.9	45.6	NA	NA	NA	2.1	54.1	2.0	-16.5	-51.7	-15.3	0.2	-12.2	-5.2	-5.0
ROYAL HOTEL LTD/THE	9713	1,205	12.4	17.0	NA	NA	NA	NA	NA	NA	NA	-50.6	-25.8	NA	-6.2	-1.2	-7.3
FUJITA KANKO INC	9722	1,847	22.5	NA	NA	1.0	NA	18.7	22.3	1.4	-163.4	-61.4	-68.6	0.0	-5.3	29.4	10.5
KYOTO HOTEL LTD/THE	9723	616	7.4	NA	NA	NA	NA	12.0	NA	NA	-126.8	-54.8	-19.8	NA	-1.1	7.7	10.4
Average				28.2	40.3	15.6	198.8	4.6	23.6	1.3	-51.2	-37.0	-13.9	0.5	-9.2	6.8	15.6

Source: Bloomberg Finance LP data, Mita Securities

Note: Forecasts are based on Bloomberg consensus

Figure: Comparison of valuations for fitness club operators (reference)

Company	Ticker	Share price 20-Apr	Mkt cap JPYbn	PER Last	PER LTM	PER Current E	PER Next E	PBR Last	EV/EBITDA Next E	EV/Sales Next E	ROE LTM	Sales growth LTM	EBITDA Mgn LTM	Div Yield Current E	1M Change	3M Change	1YR Change
RENAISSANCE INC	2378	1,132	24.2	13.4	NA	NA	61.2	1.4	NA	1.0	-24.8	-30.9	-1.1	0.2	-9.4	20.2	21.9
RIZAP GROUP INC	2928	201	111.8	NA	NA	NA	NA	4.4	NA	NA	-20.4	-13.5	2.7	NA	-14.8	36.7	67.5
CENTRAL SPORTS CO LTD	4801	2,351	27.0	12.3	NA	NA	NA	1.2	NA	NA	-10.3	-29.1	8.9	NA	-13.2	10.2	12.2
CURVES HOLDINGS CO LTD	7085	960	90.1	110.0	110.0	NA	NA	11.1	NA	NA	9.6	-10.5	11.3	NA	-5.1	22.8	101.0
FAST FITNESS JAPAN INC	7092	4,160	64.8	30.7	30.7	137.5	35.7	15.1	15.7	4.6	64.6	41.2	33.1	0.1	6.7	5.6	NA
TOSHO CO LTD	8920	1,743	66.8	11.5	24.0	197.6	34.9	1.9	13.4	3.7	8.4	-8.0	30.4	0.1	-11.5	13.2	91.5
Average				35.6	54.9	167.6	43.9	5.9	14.5	3.1	4.5	-8.5	14.2	0.1	-7.9	18.1	58.8

Source: Bloomberg Finance LP data, Mita Securities

Note: Forecasts are based on Bloomberg consensus

Risk factors

Risk factors to our view include: 1) a request from the national or local government to refrain from business travel; 2) a significant decline in hotel room occupancy rates and room rates; and 3) significant conflicts among major shareholders and management of Tosho and AB Hotel.

Company overview

Company and business overview

Overview of AB Hotel

AB Hotel is based in Anjo City, Aichi Prefecture, and as of the end of 3Q FY3/21, it had 31 AB Hotels (4,101 rooms), a business hotel chain. The number of stores in Aichi Prefecture is the largest, accounting for 13 stores. The company has been opening hotels in locations where there is strong business travel demand near manufacturers' manufacturing bases.

Focuses on pure business use

Figure: Regional distribution of hotels

	Stores	Main regions
Hokkaido	0	
Tohoku	0	
Kanto	2	
Chubu	20	Aichi 13; Gifu 3
Kinki	7	Shiga 3
Shikoku	0	
Chugoku	1	
Kyushu	1	
Total	31	

Source: Company data, Mita Securities

Latest financial results

Parent sales for FY3/20 were 6.296bn yen (+14.2% YoY), OP was 1.333bn yen (-5.4% YoY), and NP was 891m yen (+0.5% YoY). The main reason for the decline in OP was the adverse impact of the COVID-19 pandemic in 4Q.

OP declined in FY3/20 due to the COVID-19 pandemic; FY3/21: Loss in 1Q but turned profitable in 2Q

Parent sales for 1-3Q FY3/21 were 3.508bn yen (-29.2% YoY), OP was 78m yen (-93.8% YoY), and NP was 44m yen (-94.2% YoY). Quarterly OP was already in the black in 2Q, with -1.56bn yen in 1Q, 12m yen in 2Q, and 222m yen in 3Q. While many of the major players in the industry were stuck in the red, the company was able to quickly return to profitability, demonstrating the strength of its business-focused store locations and low-cost operations.

Company History

AB Hotel started out as a division of the parent company, Tosho. The predecessor of Tosho was Towa Construction, which was established in 1979 by Toshihiro Kutsuna, the current Chairman and Representative Director of Tosho. By utilizing their experience in the civil engineering and construction industry, Tosho and AB Hotel were able to build a highly profitable business model. As for the hotel business, Tosho entered the market in 1999 (initially as a franchisee) and started to develop multiple stores in 2005.

Realizing a highly profitable business model by applying experience in civil engineering and construction to the company's current business

In October 2014, Tosho spun off its hotel business through a company split and established AB Hotel Co., Ltd. In December 2017, AB Hotel was listed on the JASDAQ Standard of the Tokyo Stock Exchange.

Figure: History of Tosho Group

Date	Events
Mar-79	Toshihiro Kutsuna (currently Chairman and Representative Director of Tosho) established Towa Construction (currently Tosho). Started civil engineering and construction business.
Dec-86	Started condominium sales business and management of own rental condominiums.
Aug-89	Started administration of condominiums for sale and rent.
Dec-89	Opened the first golf driving range in Anjo City, Aichi Prefecture.
Mar-95	Started construction of rental condominiums on order.
May-96	Entered the sports club business. The first store, Holiday Sports Club Mikawa Anjo, was opened.
Apr-99	Four group companies merged and changed the company name to Tosho Co., Ltd.
Nov-99	Entered the hotel business. The first hotel, Hotel Sunroute Mikawa Anjo, was opened in Anjo City, Aichi Prefecture, as a franchisee (the current AB Hotel Mikawa Anjo Main Tower).
Dec-00	Began opening multiple stores in the sports club business.
Feb-04	Tosho was registered over-the-counter stock in the Japan Securities Dealers Association.
Mar-04	Began development of the "A-City" series of company-owned rental condominiums.
Dec-04	Tosho was listed on the JASDAQ stock exchange.
Sep-05	Changed the name of Hotel Sunroute Mikawa Anjo to AB Hotel Mikawa Anjo Main Tower. Opened the second hotel, AB Hotel Mikawa Anjo New Tower, in Anjo City, Aichi Prefecture, and began to open multiple hotels.
Apr-10	Tosho was listed on the Osaka Securities Exchange JASDAQ following the merger of the JASDAQ Securities Exchange and the Osaka Securities Exchange.
May-12	Opened the first Holiday Sports Club store in the Kanto region in Funabashi, Chiba Prefecture.
Mar-13	Tosho was listed on the Second Section of the Tokyo Stock Exchange.
May-13	Tosho was listed on the Second Section of the Nagoya Stock Exchange.
Jun-13	Tosho was delisted from JASDAQ (Standard) of Osaka Securities Exchange.
Mar-14	Tosho was listed on the First Section of the Tokyo Stock Exchange and the First Section of the Nagoya Stock Exchange. Opened Tokyo Office.
Oct-14	The hotel business was spun off into a separate company, AB Hotel Co., Ltd. (now a consolidated subsidiary). Toshihiro Kutsuna assumed the position of President and Representative Director.
Jun-16	Yuichiro Kutsuna assumed the position of President and Representative Director of Tosho.
Sep-16	Kazuki Kutsuna assumed the position of President and Representative Director of AB Hotel.
Dec-17	AB Hotel was listed on the JASDAQ Standard Market of the Tokyo Stock Exchange and the Second Section of the Nagoya Stock Exchange.
Feb-18	Established Tosho Asset Management Co., Ltd. as a wholly owned consolidated subsidiary of Tosho. Mayumi Kutsuna was appointed as President and Representative Director.
Jan-20	Tosho REIT Inc., for which Tosho Asset Management manages assets, completes registration as an investment corporation.
Mar-20	Tosho and AB Hotel transferred a part of sports clubs, rental condominiums and hotels to Tosho REIT.
Oct-20	Opened the 100th store of the Holiday Sports Club.
Mar-21	Tosho issued the 1st unsecured bond of 5bn yen (JCR rating: BBB+/Stable).

Source: Company data, Mita Securities

Major shareholders/Management

The largest shareholder of AB Hotel is Tosho, which holds about 53%. AB Kaihatsu, the second largest shareholder, is the asset management company of Kazuki Kutsuna (President and Representative Director of AB Hotel). Kazuki Kutsuna is the second son of Toshihiro Kutsuna (Chairman and Representative Director of Tosho), the founder of the Tosho Group, and the younger brother of Yuichiro Kutsuna (President and Representative Director of Tosho). Thus, in the Tosho Group, the founding family has a great deal of control in terms of both capital and human resources.

The founding family has a great deal of influence

Figure: Major shareholders of AB Hotel (end-FY3/20)

Major shareholders	Shares held (%)
Tosho	52.77
AB Kaihatsu GK	35.55

Source: Company data, Mita Securities

Figure: Major shareholders of Tosho (end-FY3/20) (reference)

Major shareholders	Shares held (%)
Toshihiro Kutsuna	41.21
Yuichiro Kutsuna	11.00
Custody Bank of Japan (trust account)	8.71
The Master Trust Bank of Japan (trust account)	3.64
Kazuki Kutsuna	3.17
Rasset LLC	2.98
Ai Kikuchi	2.72
Mayumi Kutsuna	1.74

Source: Company data, Mita Securities

Hotel business

Outlook for the hotel business

Rapidly expanding business with a highly unique business model (before COVID-19)

The company operates business hotels under the AB Hotel brand name, with 31 stores and 4,101 rooms as of the end of 3Q FY3/21. All stores are directly managed. The number of stores has more than doubled from 14 at the end of FY3/17. The company maintained an OP margin of over 25% for a long time, before the COVID-19 pandemic, which is extremely high for a hotel operator.

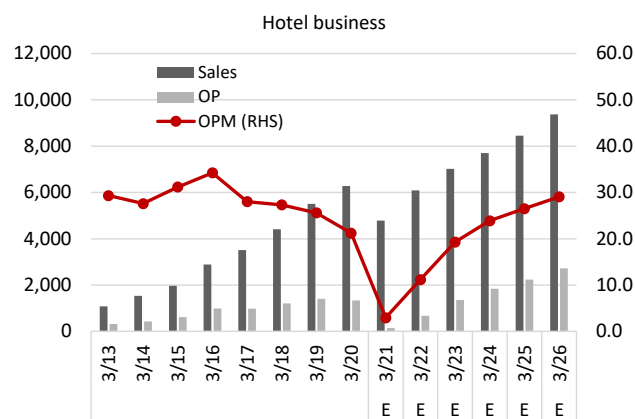
Rapidly expanding store network backed by high profit margins

Relatively high occupancy rate even after the COVID-19 pandemic. Early recovery is expected

Our forecast for the FY3/21 is for sales of 4.783bn yen (-24.0% YoY) and OP of 141m yen (-89.4% YoY). The company posted an operating loss of 156m yen in the 1Q. However, due to the characteristics of the regions and locations where the company's hotels are located, the recovery of business customers is progressing steadily, and the company has already returned to profitability in 2Q. 69% occupancy rate for 1-3Q is a relatively high level for a business hotel. We forecast OP of 681m yen for FY3/22 (+383.7% YoY). In addition, the company plans to resume store openings, albeit on a limited basis, at the beginning of FY3/23, and we assume that it will return to the profit level before the COVID-19 pandemic in FY3/23.

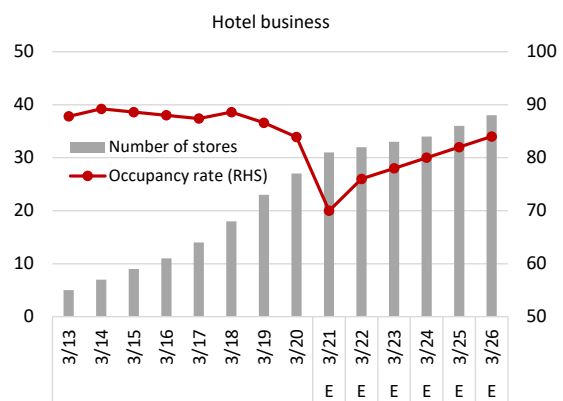
We expect OP to recover to pre-COVID-19 level in FY3/23

Figure: Sales, OP, OPM



Source: Company data, Mita Securities Note: JPYm. Forecasts are by Mita Securities

Figure: Number of stores, occupancy rate



Source: Company data, Mita Securities Note: Forecasts are by Mita Securities

AB Hotel

Pure business use hotel

AB Hotel is a hotel chain that pursues to meet pure business demand. In the past, many business hotel operators actively marketed to the growing number of inbound customers and functioned as budget hotels for tourism purposes, but many of them have fallen on hard times due to oversupply and the loss of inbound demand caused by the COVID-19 pandemic. Even in the heyday of inbound tourism, AB Hotel did not follow the latest trends and operated hotels with an emphasis on repeat customers for business use. As a result, the company has been able to maintain a relatively high occupancy rate as a business hotel operator even in the wake of the COVID-19 pandemic.

Focuses on pure business use, not on the inbound boom

Areas and locations

The company has a nationwide network of hotels, although the largest number of hotels are located in Aichi Prefecture, where it is based. The locations are mainly in front of train stations and near interchanges, where manufacturers' manufacturing bases are located nearby and there is demand for accommodation from business travelers. Aichi Prefecture is a region where many manufacturers, mainly in the automotive industry, have their manufacturing bases, and there is strong demand for business travel.

Opens stores in close proximity to manufacturers' manufacturing facilities

Figure: List of hotels (end-3Q FY3/21)

Region	Prefecture	Hotel	Region	Prefecture	Hotel	Region	Prefecture	Hotel
Chubu	Aichi	AB Hotel Mikawa-Anjo Main Tower	Chubu	Gifu	AB Hotel Gifu	Kanto	Gunma	AB Hotel Isesaki
		AB Hotel Mikawa-Anjo New Tower			AB Hotel Kagamihara		Saitama	AB Hotel Fukaya
		AB Hotel Mikawa-Anjo South Tower			AB Hotel Kani			
		AB Hotel Toyota-Motomachi		Shizuoka	AB Hotel Iwata	Kinki	Osaka	AB Hotel Osaka Sakaisuji-Honmachi
		AB Hotel Okazaki			AB Hotel Fuji			AB Hotel Sakai-Higashi
		AB Hotel Nagoya-Sakae		Nagano	AB Hotel Shiojiri		Kyoto	AB Hotel Kyoto Shijo-Horikawa
		AB Hotel Komaki		Ishikawa	AB Hotel Kanazawa		Shiga	AB Hotel Omi-Hachiman
		AB Hotel Ichinomiya						AB Hotel Hikone
		AB Hotel Toyohashi						AB Hotel Konan
		AB Hotel Mikawa-Toyota					Nara	AB Hotel Nara
		AB Hotel Tokai-Otagawa				Chugoku	Yamaguchi	AB Hoel Ube-Shinkawa
		AB Hotel Tahara						
		AB Hotel Gamagori				Kyushu	Fukuoka	AB Hotel Yukuhashi

Source: Company data, Mita Securities

Unique business model

The standard business model of AB Hotel is to secure a 35% recurring profit margin on a store-by-store basis, assuming a total investment of around 600 to 700m yen, a room count of around 130 rooms, and an occupancy rate of 80%. It is a hotel specializing in lodging and does not have banquet halls. As in the case of the sports club business of Tosho, the parent company, the company's knowledge of the construction industry is helping to reduce the initial investment.

In terms of operations, the company uses the unique outsourcing method for store management. The front desk of each hotel is operated not by the company's employees, but by married couples (or other combinations of couples) who live and work in the hotel under an outsourcing contract. The company has introduced a system of incentives linked to room occupancy rates to increase the efficiency of operations.

The sales channels include Rakuten Travel and other online travel agencies, as well as the company's own website. In general, the pricing seems to be slightly lower than other business hotels with the same specifications. We expect that the company will continue to be competitive in pricing due to its low initial investment and low-cost outsourcing system.

Strict policy to open stores only when the recurring profit margin can be assumed to be 35% at the store level. Controls investment amount with unique construction know-how. Utilizes an outsourcing method for front desk work

Figure: Exterior of hotel



Source: Company data

Figure: Single room



Source: Company data

Figure: Large bath



Source: Company data

Figure: Buffet for breakfast



Source: Company data

Figure: Dining room for breakfast



Source: Company data

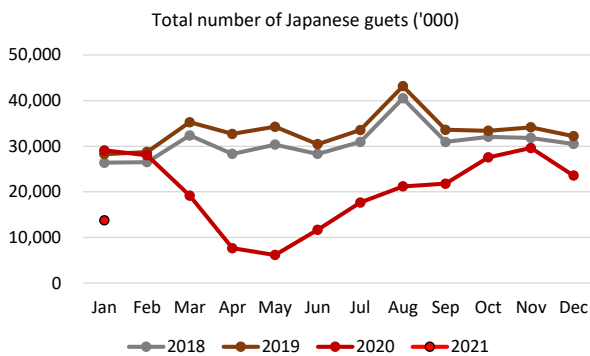
Trends in the hotel market

Fierce headwind from the COVID-19 pandemic (Japan Tourism Agency data)

The COVID-19 pandemic has been a fierce headwind for the hotel market, as foreign guests have almost disappeared since March 2020, while the number of Japanese guests has also plummeted. Although the Japanese government’s Go To Travel campaign helped boost demand for a while after the summer, the campaign was suspended at the end of the year, and demand has slumped again.

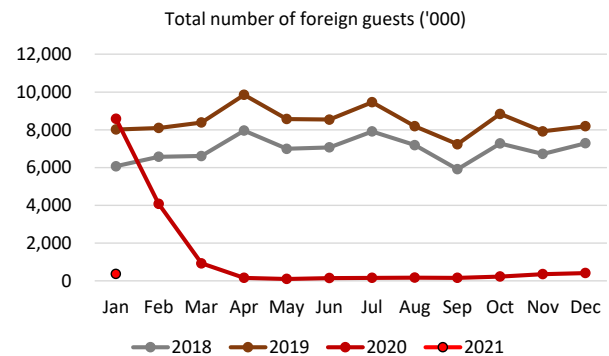
Inbound demand disappeared. The number of domestic travelers has also dropped sharply

Figure: Total number of Japanese guests



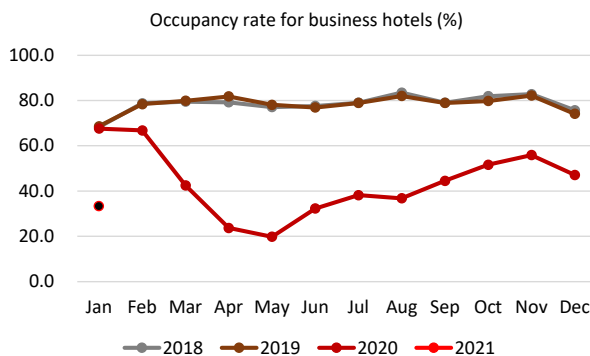
Source: Japan Tourism Agency, Mita Securities

Figure: Total number of foreign guests



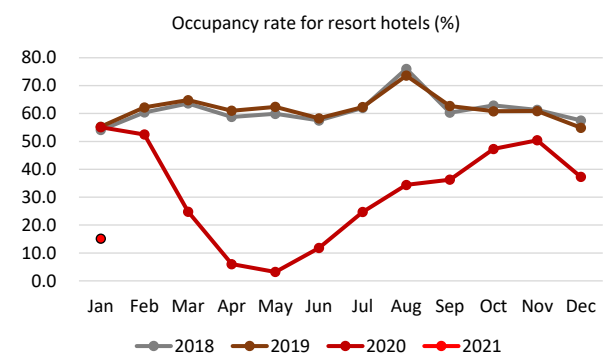
Source: Japan Tourism Agency, Mita Securities

Figure: Business hotel occupancy rate



Source: Japan Tourism Agency, Mita Securities

Figure: Resort hotel occupancy rate



Source: Japan Tourism Agency, Mita Securities

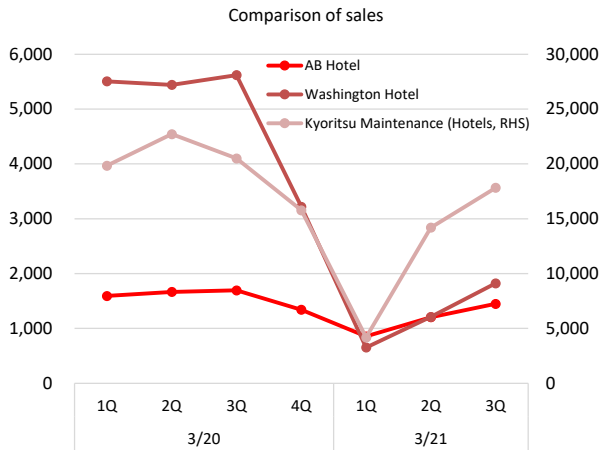
AB Hotel’s situation after the COVID-19 pandemic

In 1Q FY3/21, when the first emergency declaration was made, hotel companies were forced to suffer a sharp decline in sales and fell into the red, and AB Hotel was no exception, posting sales of 855m yen (-46.3% YoY), an operating loss of 156m yen, and an OPM of -18.3%. However, the damage to the company’s earnings was considerably less severe than other hotel operators, and the company posted a small OP in 2Q (12m yen) and posted an OP for 1-3Q. The reasons behind this are: 1) the company’s hotels are often located near local manufacturers’ manufacturing bases and have strong business demand; 2) the company has long had a management policy of not relying on inbound customer demand; and 3) the company has a high profit margin due to low initial investment and low-cost operations, and is highly resistant to declines in occupancy rates and room rates.

Damage from the COVID-19 is relatively minor, and early recovery is expected

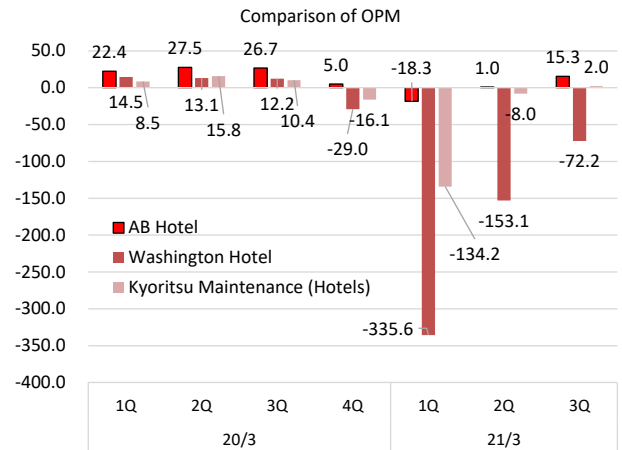
There are many hotel operators that have posted large losses and suffered significant damage to their equity capital. Some of them were forced to increase their capital. We believe that the possibility of such risks occurring in AB Hotel is limited, and that AB Hotel is in a position to take measures for early recovery ahead of the industry.

Figure: Quarterly sales for hotel operators (JPYm)



Source: Companies data, Mita Securities

Figure: Quarterly OPM for hotel operators (%)



Source: Source: Companies data, Mita Securities

Figure: Comparison of listed hotel operators

Company name	Ticker	FY	Consolidated/parent		Shareholders' equity			Hotel-related business segment				Segment name
			Sales	YoY (%)	OP	OPM (%)	Sales	YoY (%)	OP	OPM (%)		
Resorttrust	4681	1-3QFY3/21	130,572	5.9	15,350	11.8	134,383	45,710	-28.1	-2,650	-5.8	Hotel & restaurants
		FY3/20	159,145	-11.4	11,652	7.3	127,798	80,659	0.3	92	0.1	
Washington Hotel	4691	1-3QFY3/21	3,686	-77.8	-5,358	-145.4	8,553					
		FY3/20	19,786	-7.6	1,269	6.4	14,445					
Amaze	6076	FY11/20	11,343	-23.5	1,525	13.4	11,604					
		FY11/19	14,837	0.9	3,652	24.6	11,898					
Greens	6547	1-2QFY6/21	8,223	-48.2	-3,637	-44.2	2,358					
		FY6/20	22,909	-25.9	-3,456	-15.1	6,003					
AB Hotel	6565	1-3QFY3/21	3,508	-29.2	77	2.2	6,021					
		FY3/20	6,295	14.2	1,333	21.2	6,062					
Royal HD	8179	FY12/20	84,304	-40.0	-19,269	-22.9	20,896	13,906	-53.9	-6,996	-50.3	Hotel business
		FY12/19	140,578	2.1	4,648	3.3	50,824	30,185	5.6	3,622	12.0	
Kyoritsu Maintenance	9616	1-3QFY3/21	91,343	-31.4	-3,744	-4.1	75,130	36,208	-42.6	-6,392	-17.7	Hotel business
		FY3/20	169,770	4.3	11,205	6.6	83,954	78,831	0.8	4,853	6.2	
Imperial Hotel	9708	1-3QFY3/21	16,632	-61.6	-8,439	-50.7	51,523					
		FY3/20	54,558	-6.6	3,160	5.8	60,627					
Royal Hotel	9713	1-3QFY3/21	11,879	-60.0	-7,249	-61.0	12,419					
		FY3/20	37,601	-8.0	-257	-0.7	20,132					
Fujita Kanko	9722	FY12/20	26,648	-61.4	-20,611	-77.3	1,182					
		FY12/19	60,960	-0.5	280	0.5	26,263					
Kyoto Hotel	9723	1-3QFY3/21	2,993	-62.9	-1,849	-61.8	567					
		FY3/20	9,625	-9.0	89	0.9	2,106					

Source: Companies data, Mita Securities

Mita Securities' earnings forecast

Earnings forecast for FY3/21

We expect sales of 4.783 bn yen (-24.0% YoY), OP of 141m yen (-89.4% YoY), and NP of 71m yen (-92.0% YoY) for FY3/21, slightly above the company's OP/NP guidance (company guidance: 4.790bn yen in sales, 104m yen in OP, and 55m yen in NP). OP for 4Q (three months) is expected to be 63m yen (222m yen in 3Q). We believe the company remained in the black in 4Q despite the impact of the declaration of a state of emergency.

We expect OP of 141m yen for FY3/21

Earnings forecast for FY3/22

For FY3/22, we forecast sales of 6.090bn yen (+27.3% YoY), OP of 681m yen (+383.7% YoY), and NP of 410m yen (+474.6% YoY). We assume that RevPAR will increase by 15%, with both occupancy rate and room rate improving. The company is likely to see a relatively quick recovery in earnings as the company's hotels are mainly used for business purposes. The company has not developed hotels based on inbound demand, and many of the company's hotels are located near the manufacturing bases of local manufacturers.

We expect OP to increase by 384% to 681m yen for FY3/22

Our view on FY3/23 and beyond

We forecast OP of 1.355bn yen (+98.8% YoY) in FY3/23, 1.840bn yen (+35.8% YoY) in FY3/24, and 2.239bn yen (+21.7% YoY) in FY3/25. We expect profits to recover to the pre-COVID-19 pandemic level in FY3/23. The company has not yet entered many regions, and in the medium to long term, we expect it to expand by opening new stores again. With competitors withdrawing from the market, it may become easier for the company to secure properties with low budgets.

We expect profits to recover to the pre- COVID-19 levels in FY3/23. There is a lot of room for growth in the medium to long term due to the large number of regions where the company has not yet entered

Figure: Mita Securities' earnings forecast (parent, various indicators)

Key indicators	3/18	3/19	3/20	3/21	3/22	3/23	3/24	3/25	3/26	5y ave growth
	A	A	A	MitaE	MitaE	MitaE	MitaE	MitaE	MitaE	(CAGR, %)
Sales growth (%)	25.9	24.8	14.2	-24.0	27.3	15.3	9.7	9.7	10.9	
Operating profit growth (%)	21.4	18.2	-5.4	-89.4	383.7	98.8	35.8	21.7	21.5	
Recurring profit growth (%)	18.3	22.0	-7.2	-91.7	496.6	105.1	37.0	22.2	21.9	
Net profit growth (%)	12.3	22.7	0.5	-92.0	474.6	105.1	37.0	22.2	21.9	
Gross profit margin (%)	36.7	35.1	30.1	12.4	19.6	27.3	31.6	33.8	36.0	
SG&A/Sales (%)	9.6	9.6	8.9	9.4	8.4	8.0	7.7	7.3	7.0	
Operating profit margin (%)	27.0	25.6	21.2	2.9	11.2	19.3	23.9	26.5	29.0	
Recurring profit margin (%)	25.9	25.4	20.6	2.2	10.5	18.7	23.4	26.0	28.6	
EBITDA margin (%)	36.1	35.0	31.4	17.6	23.9	30.6	34.4	36.5	38.6	
Number of stores (EOP)	18	23	27	31	32	33	34	36	38	4.2
Number of rooms (EOP)	2,342	3,029	3,586	4,099	4,227	4,331	4,461	4,721	4,981	4.0
Sales/Ave number of rooms (JPY/day)	5,561	5,564	5,176	3,430	3,952	4,446	4,800	5,043	5,292	
(YoY, %)	-2.2	0.1	-7.0	-33.7	15.2	12.5	8.0	5.1	4.9	

Source: Company data, Mita Securities

Figure: Mita Securities' earnings forecast (parent, PL, JPYm)

PL	3/18	3/19	3/20	3/21	3/22	3/23	3/24	3/25	3/26	5y ave growth
Parent (JPYm)	A	A	A	MitaE	MitaE	MitaE	MitaE	MitaE	MitaE	(CAGR, %)
Sales	4,420	5,515	6,296	4,783	6,090	7,021	7,702	8,451	9,370	14.4
COGS	2,799	3,577	4,402	4,192	4,896	5,104	5,270	5,590	5,997	
Gross profit	1,621	1,938	1,894	591	1,193	1,918	2,431	2,860	3,373	
SG&A	424	528	560	450	512	563	591	621	652	
Operating profit	1,193	1,410	1,333	141	681	1,355	1,840	2,239	2,721	80.8
Non-operating income	29	78	55	65	70	75	80	85	90	
Non-operating expense	76	90	91	99	111	116	121	126	131	
Recurring profit	1,146	1,398	1,297	107	640	1,314	1,799	2,198	2,680	90.3
Extraordinary gains	0	76	312	17	0	0	0	0	0	
Extraordinary losses	2	77	188	0	0	0	0	0	0	
Pre-tax profit	1,144	1,398	1,421	124	640	1,314	1,799	2,198	2,680	84.8
Corporate taxes	421	511	530	53	231	473	648	791	965	
Net profit	723	887	891	71	410	841	1,151	1,407	1,715	88.9
EBITDA	1,595	1,927	1,976	843	1,457	2,150	2,648	3,083	3,613	33.8
Shares O/S (m)	7.1	14.2	14.2	14.2	14.2	14.2	14.2	14.2	14.2	
EPS	102.02	62.57	62.86	5.03	28.91	59.30	81.22	99.25	121.00	
DPS	10.00	6.00	6.00	2.00	4.00	6.00	8.00	9.00	10.00	
BPS	626.47	370.80	427.66	430.69	455.60	508.90	582.12	672.37	783.36	
Payout ratio (%)	9.7	9.6	9.5	39.8	13.8	10.1	9.8	9.1	8.3	
ROA (%)	5.9	5.6	4.9	0.4	1.9	3.8	5.0	5.8	6.6	
ROE (%)	18.8	18.3	15.7	1.2	6.5	12.3	14.9	15.8	16.6	

Source: Company data, Mita Securities

Figure: Mita Securities' earnings forecast (parent, BS, JPYm)

BS	3/18	3/19	3/20	3/21	3/22	3/23	3/24	3/25	3/26	5y ave growth
Parent (JPYm)	A	A	A	MitaE	MitaE	MitaE	MitaE	MitaE	MitaE	(CAGR, %)
Assets										
Total current assets	2,850	3,632	4,234	4,305	4,560	5,136	5,929	6,995	8,370	
Cash and deposits	2,587	3,223	3,903	3,683	3,925	4,560	5,297	5,897	6,847	
Accounts receivable	189	261	219	310	395	455	499	548	607	
Inventories	11	25	18	25	26	27	28	29	30	
Other	63	122	93	287	214	94	105	522	886	
Total fixed assets	11,129	13,893	14,872	16,750	17,079	17,414	17,755	18,103	18,458	
PP&E, net	10,580	13,243	14,115	16,000	16,320	16,646	16,979	17,319	17,665	
Intangibles	13	20	20	30	32	33	34	35	36	
Investments and other	536	631	737	720	727	734	742	749	757	
Deferred assets	5	3	1	0	0	0	0	0	0	
Total assets	13,985	17,528	19,107	21,055	21,639	22,550	23,684	25,098	26,828	5.0
Liabilities										
Total current liabilities	2,066	2,771	3,250	3,000	3,100	3,147	3,184	3,256	3,347	
Short-term debt	1,202	1,672	1,852	2,000	2,000	2,000	2,000	2,000	2,000	
Other	864	1,098	1,398	1,000	1,100	1,147	1,184	1,256	1,347	
Total long-term liabilities	7,478	9,501	9,795	11,950	12,081	12,189	12,248	12,311	12,376	
Long-term debt	7,062	8,900	9,014	11,000	11,000	11,000	11,000	11,000	11,000	
Other	416	601	781	950	1,081	1,189	1,248	1,311	1,376	
Total liabilities	9,544	12,272	13,044	14,950	15,181	15,336	15,432	15,567	15,724	1.0
Net assets										
Net assets	4,440	5,256	6,062	6,105	6,458	7,214	8,252	9,531	11,105	12.7
Shareholders' equity	4,440	5,256	6,062	6,105	6,458	7,214	8,252	9,531	11,105	12.7
Warrants	0	0	0	0	0	0	0	0	0	
Debt										
Debt	8,264	10,573	10,866	13,000	13,000	13,000	13,000	13,000	13,000	0.0
Debt/Equity (x)	0.5	0.5	0.6	0.5	0.5	0.6	0.6	0.7	0.9	
Net Debt/Equity (x)	1.3	1.4	1.1	1.5	1.4	1.2	0.9	0.7	0.6	
Shareholders' capital ratio (%)	31.8	30.0	31.7	29.0	29.8	32.0	34.8	38.0	41.4	
Debt/EBITDA (x)	5.2	5.5	5.5	15.4	8.9	6.0	4.9	4.2	3.6	

Source: Company data, Mita Securities

Figure: Mita Securities' earnings forecast (parent, CF, JPYm)

CF	3/18	3/19	3/20	3/21	3/22	3/23	3/24	3/25	3/26	5y ave growth
Parent (JPYm)	A	A	A	MitaE	MitaE	MitaE	MitaE	MitaE	MitaE	(CAGR, %)
Cashflow from operations										
Cashflow from operations	1,412	1,464	1,714	279	1,200	1,621	1,952	2,273	2,638	
Net profit	723	887	891	71	410	841	1,151	1,407	1,715	
Depreciation and amortization	403	518	643	702	776	795	808	844	892	
Other	286	59	180	-495	14	-15	-8	22	31	
Cashflow from investing										
Cashflow from investing	-2,132	-2,405	-637	-2,547	-930	-930	-1,130	-1,560	-1,560	
Capital expenditure	-2,055	-2,335	-2,393	-2,597	-930	-930	-1,130	-1,560	-1,560	
Disposal of fixed assets	0	0	1,846	0	0	0	0	0	0	
Other	-77	-70	-91	50	0	0	0	0	0	
Cashflow from financing										
Cashflow from financing	1,900	1,577	-397	2,049	-28	-57	-85	-113	-128	
Dividends paid	-22	-71	-85	-85	-28	-57	-85	-113	-128	
Share capital issuance / (buy-back)	507	0	0	0	0	0	0	0	0	
Debt issuance / (repayment)	1,415	1,648	-312	2,134	0	0	0	0	0	
Other	0	0	0	0	0	0	0	0	0	
Cash and cash equivalents	2,587	3,223	3,903	3,683	3,925	4,560	5,297	5,897	6,847	
Free cashflow	-720	-941	1,077	-2,269	270	691	822	713	1,078	

Source: Company data, Mita Securities

APPENDIX

[Analyst Certification]

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The target price and ratings are based on our views for the next 12 months or so.

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Hold: Stocks whose total return (percentage change in share price from current price to projected target price plus projected dividend yield), as of the time the target price is set or changed, is expected to be between -15% and +15%.

Sell: Stocks whose total return (percentage change in share price from current price to projected target price plus projected dividend yield), as of the time the target price is set or changed, is expected to be -15% or less.

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