Zenkoku Hosho

MITA SECURITIES Co., Ltd.
Junichi Shimizu
Chief Analyst, Head of Research

TSE 1st Section 7164 Industry: Other financials

Entering a new growth stage. Initiating coverage with a Buy rating

Initiating coverage with a TP of 6,400 yen and a Buy rating
We initiate coverage of Zenkoku Hosho Co. Ltd. with a target price of 6,400 yen and a Buy rating. The company is entering a new growth stage, backed by M&A, full-scale operation of a servicer subsidiary, and improved yields on surplus funds, in addition to organic growth due to stronger relationships with partner financial institutions. We expect that the COVID-19 pandemic will not have a noticeable negative impact on the creditworthiness of mortgage borrowers, and that credit costs will remain at a low level.

Guarantee business enters a new growth stage
Taking advantage of its independent status, the company has partnerships with 742 financial institutions nationwide. In recent years, the company has been strengthening its relationships with major banks and top regional banks, and the balance of its guarantee exposure has been growing at an annual rate of around 8%. In addition, credit costs have been kept at a low level, supporting steady profit growth. Furthermore, the company's M&A initiatives, which it has been preparing for several years (e.g., underwriting guarantee exposure from partner financial institutions), have begun to bear fruit. We believe that inorganic growth can be expected to begin in earnest going forward, given that regional financial institutions have a need to withdraw from inefficient guarantee operations and that the company has already strengthened its financial base in preparation for M&A.

Dawn of Akebono Servicer
The company changed the name of the servicer company it acquired to Akebono Servicer and began transferring the collection of its own NPLs. In the past, NPLs after disposal of collateral were sold in bulk to external servicers at a low price, but with the start of operations of Akebono, the company has established a collection system within its own group. In the future, the company will be able to cross-sell mortgage loan guarantees and debt collection to partner financial institutions.

Profit growth expected to exceed the medium-term plan
We forecast OP of 37.5bn yen (+5.9% YoY) in FY3/21, 39.7bn yen (+6.0% YoY) in FY3/22, and 42.4bn yen (+6.8% YoY) in FY3/23, exceeding the 40.25bn yen target in the company's medium-term management plan (announced in March 2020). We expect the balance of guarantee exposure at the end of FY3/23 to be 16.7trn yen, without factoring in future M&A, which would enable the company to substantially exceed its plan of 16.8trn yen.

Valuations and risk factors
In calculating our target price, we used a residual income model (RIM) with a cost of equity of 6.5% and a terminal growth rate of 0.2%, based on our earnings forecasts for FY3/21-FY3/26. Our target price is equivalent to 15.7x our FY3/22 EPS forecast of 408.86 yen, which represents a premium of 15% to the average PER of comparable companies of 13.7x.

Risk factors to our view include a sharp rise in the default rate due to a significant deterioration in the employment situation, a significant decline in the recovery rate due to a significant drop in housing prices, and the occurrence of large-scale fraudulent mortgage applications.

Initiation of coverage

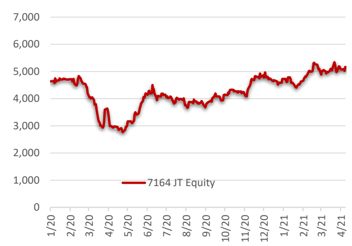
Rating
Buy

Target price (JPY)	**6,400**
Stock price (JPY) (Apr 7)	5,170
Market cap (JPYbn)	356.1

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
Revenue	JPYbn	43.2	45.2	47.2	50.3	53.9
OP	JPYbn	34.2	35.4	37.5	39.7	42.4
RP	JPYbn	35.2	35.8	38.1	40.6	43.4
NP	JPYbn	24.1	24.4	26.4	28.1	30.1
EPS	JPY	350.9	355.2	384.0	408.9	437.1
BPS	JPY	1,846	2,109	2,382	2,656	2,940
DPS	JPY	87.0	95.0	111.0	135.0	153.0
PER	x	11.0	9.6	13.5	12.6	11.8
PBR	x	2.1	1.6	2.2	1.9	1.8
Div. yield	%	2.2	2.8	2.1	2.6	3.0
ROA	%	7.8	7.0	6.9	6.8	6.8
ROE	%	20.5	18.0	17.1	16.2	15.6

Source: Company data, Mita Securities

Company profile
Zenkoku Hosho is an independent mortgage guarantee company with guarantee exposure of 14.2trn yen (end-3Q FY3/21). It has partnerships with 742 financial institutions nationwide. Stock revenue has been growing due to the increase in the guarantee exposure, whereas credit costs have remained at a low level. The company has made it clear that it aims to grow through M&A.

Investment Thesis

Outlook

New growth drivers emerging in addition to organic growth

Initiating coverage with a TP of 6,400 yen and a Buy rating

We initiate coverage of Zenkoku Hosho Co. Ltd. (Zenkoku Hosho, or the company) with a target price of 6,400 yen and a Buy rating.

Zenkoku Hosho is a mortgage guarantee company with outstanding guarantee exposure of 14.2trn yen (as of the end of 3Q FY3/21). Historically, the majority of mortgage guarantee companies in Japan are subsidiaries or affiliates of financial institutions and their guarantee coverage has been limited to the group. The company has been able to increase its market share and grow by building a unique position as an independent guarantee company. Most recently, the company has been providing mortgage guarantees to 742 partner financial institutions (banks, shinkin banks, credit cooperatives, JA (Japan Agricultural Cooperatives), JF (Japan Fisheries Cooperatives), etc.) nationwide. Mortgage guarantees are a business where economies of scale come into play, and the company's competitive advantage is growing. In recent years, the company has been growing its stock revenue by increasing the utilization rate among its partner financial institutions in the banking sector (major banks, top regional banks, etc.), which have high loan amounts per person. In addition, new growth drivers have emerged in recent years, such as the expansion of guarantee exposure through M&A, the start of operations at a servicer subsidiary, and an improvement in the yield on the surplus funds.

Expansion of guarantee exposure through M&A

In 4Q FY3/20, the company acquired Towa Shinyo Hosho (guarantee exposure 90.3bn yen), a subsidiary of Towa Bank (8558) (a second-tier regional bank in Gunma Prefecture), making it a subsidiary (currently Minori Guarantee). In 4Q FY3/21, the company acquired Tsukuba Shinyo Hosho (guarantee exposure 290bn yen), a subsidiary of Tsukuba Bank (8338) (a regional bank in Ibaraki Prefecture). Behind the increase in M&A activity are the needs of regional financial institutions to withdraw from the mortgage guarantee business and to reduce their risk-weighted assets. Zenkoku Hosho has been working to build a mortgage screening system that can withstand M&A due diligence, strengthen its financial base by borrowing subordinated loans, and obtain credit ratings (JCA: A-/Stable). The company has made practical and financial preparations to meet the needs of financial institutions.

Servicer subsidiary began operations. Preparations are underway to realize cross-selling

In addition, Akebono Servicer, a servicer subsidiary, has started operations and is strengthening its collection of NPLs. This is expected to be a new growth driver for the company, given that it can improve the collection rate of its own NPLs, and in the future, it will be able to cross-sell mortgage guarantees and servicing by taking on the collection of NPLs held by partner financial institutions.

Expanding opportunities for surplus funds management

Since the company accepts guarantee fees in a lump sum at the time of mortgage loan execution, it always has a huge surplus of funds and can increase its profitability by improving the yield of these funds. In the past, subordinated bonds of financial institutions were the main investment product, but after the introduction of Basel III, the issuance of subordinated bonds by regional banks plummeted and investment opportunities were scarce. Recently, however, the company has been expanding its investment portfolio in line with the increasing number of subordinated debt issues by general business companies. In our view, the company has entered a phase where it can expect profit growth not only from its core business but also from higher yields on surplus funds.

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

JPYm	3/19	3/20	Mita E 3/21	Mita E 3/22	Mita E 3/23	CoE 3/21	Consensus 3/21	Consensus 3/22
Earnings								
Revenue	43,204	45,203	47,186	50,290	53,881	47,580	47,574	50,555
YoY, %	9.1	4.6	4.4	6.6	7.1	5.3	5.2	6.3
Operating expense	8,975	9,823	9,736	10,578	11,474	11,230		
YoY, %	6.6	9.4	-0.9	8.7	8.5	14.3		
General expense	6,248	7,091	6,800	7,100	7,689	7,530		
Credit cost	2,727	2,732	2,936	3,478	3,785	3,700		
vs. guarantee exposure (bp)	2	2	2	2	2			
Pre-provision OP	36,956	38,111	40,386	43,190	46,192	40,050		
YoY, %	10.1	3.1	6.0	6.9	6.9	5.1		
Operating profit	34,229	35,379	37,451	39,713	42,407	36,350	37,403	39,368
YoY, %	9.8	3.4	5.9	6.0	6.8	2.7	5.7	5.3
Recurring profit	35,169	35,760	38,122	40,587	43,392	36,870	38,054	40,168
YoY, %	10.0	1.7	6.6	6.5	6.9	3.1	6.4	5.6
Net profit	24,134	24,430	26,419	28,127	30,071	25,480	26,324	27,795
YoY, %	9.4	1.2	8.1	6.5	6.9	4.3	7.8	5.6
Guarantee exposue								
Guarantee exposure (parent+subsidiaries)	12,717,625	13,706,420	14,741,872	15,627,467	16,671,273	14,840,000		
YoY, %	7.9	7.8	7.6	6.0	6.7	8.3		
Guarantee exposure (parent)	12,717,625	13,616,023	14,361,872	15,266,467	16,328,323			
YoY, %	7.9	7.1	5.5	6.3	7.0			
Amount of new guarantee granted	1,722,629	1,732,416	1,533,029	1,734,386	1,943,821			
YoY, %	3.4	0.6	-11.5	13.1	12.1			
Number of new guarantee granted	68,311	67,003	58,963	65,449	71,993	71,000		
YoY, %	0.3	-1.9	-12.0	11.0	10.0	6.0		
Amount of subrogation (default)	11,709	12,036	11,066	11,165	11,777	13,420		
vs. guarantee exposure (bp)	10	9	8	8	7			
Per share indicators								
EPS (JPY)	350.88	355.15	384.03	408.86	437.12	370.42	382.66	404.03
BPS (JPY)	1,846.41	2,108.65	2,381.94	2,655.88	2,940.00			
DPS (JPY)	87.00	95.00	111.00	135.00	153.00	111.00	113.98	127.32
Valuation, profitability, etc.								
PER (x)	11.0	9.6	13.5	12.6	11.8			
PBR (x)	2.1	1.6	2.2	1.9	1.8			
Dividend payout ratio (%)	24.8	26.8	28.9	33.0	35.0			
Dividend yield (%)	2.2	2.8	2.1	2.6	3.0			
ROA (%)	7.8	7.0	6.9	6.8	6.8			
ROE (%)	20.5	18.0	17.1	16.2	15.6			
Financial soundness indicators								
Capital ratio (%)	39.5	38.9	41.3	42.7	43.8			
Capital ratio (adjusted for subordinated loans, %)	39.5	44.9	47.0	48.0	48.7			
shareholders' equity/total assets+guarantee exposure (%)	1.0	1.0	1.1	1.2	1.2			
shareholders' equity/total assets+guarantee exposure (adjusted for subordinated loans, %)	1.0	1.2	1.3	1.3	1.3			

Source: Company data, QUICK, Mita Securities Note: Consensus forecasts are by QUICK consensus

Profit growth expected to exceed the medium-term management plan

Our FY3/23 OP forecast of 42.4bn yen exceeds the medium-term plan

We forecast OP of 37.5bn yen (+5.9% YoY) in FY3/21, 39.7bn yen (+6.0% YoY) in FY3/22, and 42.4bn yen (+6.8% YoY) in FY3/23. We expect OP to be higher than the FY3/23 OP guidance of 40.25bn yen in the company's medium-term management plan (announced in March 2020).

We expect the number of new guarantees to reduce to 58,963 (-12.0% YoY) in FY3/21, given the impact of the COVID-19 pandemic. However, we expect the number to normalize to 65,449 (+11.0% YoY) in FY3/22 and 71,993 (+10.0% YoY) in FY3/23.

We assume that the COVID-19 pandemic is unlikely to have a negative impact on the creditworthiness of Japanese mortgage borrowers, and that the credit cost ratio (vs. guarantee exposure) will remain at the current level of 2bp.

As for the balance of guarantee exposure, we forecast 14.7trn yen (+7.6% YoY) at the end of FY3/21 and 16.7trn yen at the end of FY3/23, without factoring in future M&A. Considering the possibility of future M&A, it is highly likely that the company's medium-term management plan (16.8trn yen at the end of FY3/23) will be substantially exceeded.

Catalysts

Our expected catalysts include a recovery in the number of new guarantees granted, M&A announcements, and the acceptance of servicing projects from partner financial institutions.

Valuations

Stock valuation based on the residual income model (RIM)

In calculating our target price of 6,400 yen, we used a residual income model (RIM) with a cost of equity of 6.5% and a terminal growth rate of 0.2%, based on our earnings forecasts for FY3/21-FY3/26. Our target price is equivalent to 15.7x our FY3/22 EPS forecast of 408.86 yen, which represents a premium of 15% to the average PER of comparable companies of 13.7x.

Figure: Residual Income Model (RIM)

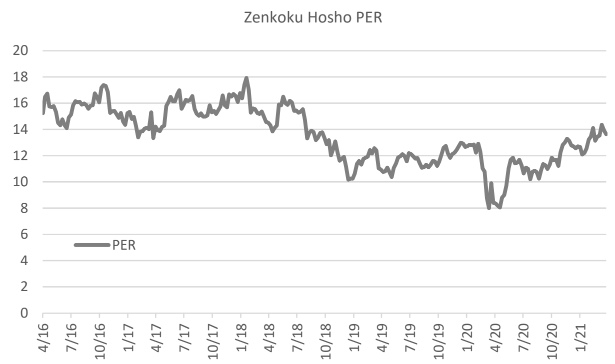
	Y0	Y1	Y2	Y3	Y4	Y5	Y6~
	MitaE	MitaE	MitaE	MitaE	MitaE	MitaE	MitaE
JPYbn	3/21	3/22	3/23	3/24	3/25	3/26	3/27
Shareholders' equity (EOP)	163.7	182.5	202.1	221.3	239.8	257.7	
Net profit		28.1	30.1	31.0	31.8	33.1	
Cost of equity		10.6	11.9	13.1	14.4	15.6	
Residual income		17.5	18.2	17.9	17.5	17.6	
PV of residual income		16.4	16.1	14.8	13.6	12.8	
PV of terminal value							203.9

Beta	1.20
Risk free rate (%)	0.50
Risk premium (%)	5.00
Cost of equity (%)	6.50
Terminal growth rate (%)	0.20

Total equity value	441.2
Number of shares O/S (m)	68.793
Target share price	6,400

Source: Company data, Mita Securities

Figure: Zenkoku Hosho's PER (reference)



Source: Bloomberg Finance LP data, Mita Securities

Comparison of valuations with similar companies

There are no listed mortgage loan guarantee companies in Japan similar to Zenkoku Hosho. For reference, the following chart shows valuation comparisons with Japanese nonbanks and overseas mortgage guarantee companies.

Figure: Comparison of valuations (reference)

Company	Ticker	Curncy	Share price 7-Apr	Mkt cap Bn	PER Last	PER LTM	PER Current E	PER Next E	PBR Last E	EV/EBITDA Next E	EV/Sales Next E	ROE LTM	Sales growth LTM	EBITDA Mgn LTM	Dividend yield Current E	1M Change	3M Change	1YR Change
ZENKOKU HOSHO CO LTD	**7164**	**JPY**	**5,170**	**356.1**	**14.6**	**13.9**	**NA**	**NA**	**2.3**	**NA**	**NA**	**17.7**	**5.2**	**80.5**	**NA**	**5.0**	**9.8**	**74.9**
MORTGAGE SERVICE JAPAN LTD	7192	JPY	1,125	16.5	15.6	17.0	NA	NA	2.9	NA	NA	18.6	6.0	20.5	NA	-1.8	-6.3	43.8
ARUHI CORP	7198	JPY	1,847	66.6	13.1	13.6	13.4	11.8	2.3	12.7	4.0	17.5	4.6	43.6	2.7	12.3	4.9	55.1
PREMIUM GROUP CO LTD	7199	JPY	2,800	37.3	24.9	26.9	16.6	17.0	5.4	NA	2.4	21.2	25.0	22.3	1.6	17.4	11.9	92.7
CREDIT SAISON CO LTD	8253	JPY	1,370	254.1	9.6	9.6	6.7	7.0	0.4	56.3	8.5	4.3	-8.4	34.4	3.3	0.2	11.3	26.5
AIFUL CORP	8515	JPY	318	154.1	110.4	26.5	8.2	8.1	1.1	NA	4.2	4.2	6.4	13.2	0.6	2.3	25.7	37.7
AEON FINANCIAL SERVICE CO LT	8570	JPY	1,491	322.1	NA	NA	20.6	11.0	0.8	NA	NA	NA	NA	NA	2.6	5.0	14.9	42.8
ACOM CO LTD	8572	JPY	508	810.9	13.4	13.0	10.8	11.6	1.7	14.7	5.2	13.7	-2.6	34.3	1.2	0.2	10.9	14.7
JACCS CO LTD	8584	JPY	2,279	79.9	7.3	7.0	9.7	9.5	0.5	NA	10.8	7.0	3.5	26.0	3.9	6.9	18.3	36.1
ORIENT CORP	8585	JPY	151	259.5	13.9	16.4	16.2	12.9	1.2	NA	6.3	7.3	-2.7	23.0	2.0	0.7	23.8	25.8
EGUARANTEE INC	8771	JPY	2,096	95.2	38.7	45.3	46.0	34.3	6.3	19.2	9.1	15.4	11.1	58.7	0.8	9.5	-8.6	19.7
Average					**26.1**	**18.9**	**16.5**	**13.7**	**2.3**	**25.7**	**6.3**	**12.7**	**4.8**	**35.6**	**2.1**	**5.2**	**10.6**	**42.7**
MGIC INVESTMENT CORP	MTG	USD	13.97	4.7	10.7	10.6	8.2	7.5	1.0	NA	4.6	9.9	-1.2	NA	1.7	12.7	5.1	116.3
ESSENT GROUP LTD	ESNT	USD	48.57	5.5	12.5	12.5	9.1	7.9	1.4	NA	5.1	12.1	10.0	NA	1.3	14.9	3.2	77.6
GENWORTH MORTGAGE INSURANCE	GMA AU	AUD	2.54	1.0	NA	NA	13.5	11.5	0.8	NA	NA	-7.4	-8.3	NA	3.7	3.7	10.9	27.0
Average					**11.6**	**11.5**	**10.3**	**9.0**	**1.1**	**NA**	**4.8**	**4.9**	**0.2**	**NA**	**2.3**	**10.4**	**6.4**	**73.6**

Source: Bloomberg Finance LP data, Mita Securities   Note: Forecasts are based on Bloomberg consensus

Risk factors

Risk factors for our view include: 1) a sharp rise in the default rate due to a significant deterioration in the employment situation; 2) a significant decline in the collection rate due to a significant drop in housing prices; 3) the occurrence of large-scale fraudulent applications for housing loans; 4) a decline in guarantee rates due to the emergence of competition; 5) a deterioration in group credit life insurance-related income due to the occurrence of large-scale disasters; 6) the occurrence of large-scale losses in the management of surplus funds; and 7) downward pressure on the guarantee exposure due to a sharp decline in new guarantee executions and a sharp increase in prepayment.

Company overview

Company and business overview

Overview of Zenkoku Hosho

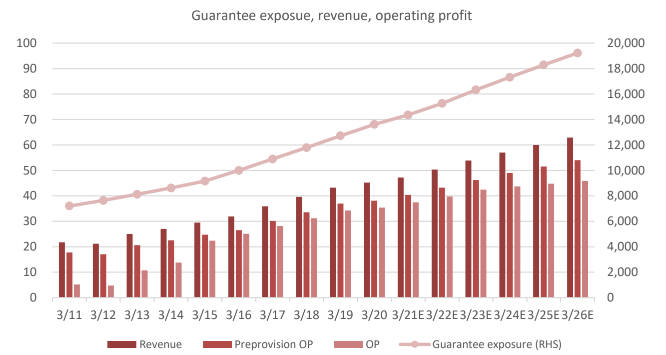
Zenkoku Hosho, as an independent guarantee company, has tie-ups with 742 financial institutions nationwide. Its guarantee exposure is 6.7% of the outstanding mortgage loans in Japan

Zenkoku Hosho is a nationwide provider of mortgage credit guarantee services. While most of the mortgage guarantee companies in Japan are group companies of financial institutions, the company is unique in that it is an independent company. The company's balance of guarantee exposure is 14.2trn yen (as of the end of 3Q FY3/21). As of the end of FY3/20, the company had a 6.7% share of Japan's total housing loan balance of approximately 202trn yen. The company has 13 sales offices nationwide and 257 employees (full-time, as of FY3/20).

The company has partnerships with 742 financial institutions (banks, shinkin banks, credit cooperatives, JA, etc.) (as of end of 3Q FY3/21). Its partnership share by type of financial institution is 88% for banks, 96% for shinkin banks, 96% for credit cooperatives, and 48% for JA.

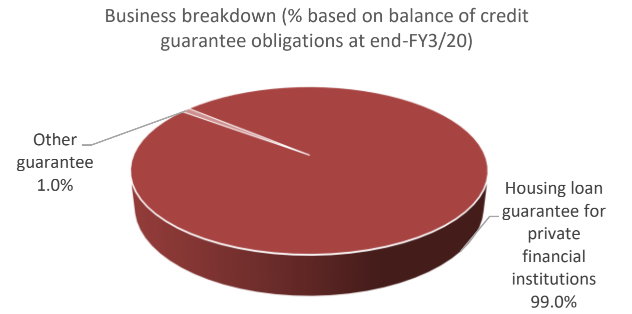
In FY3/20, the company posted non-consolidated revenue of 45.2bn yen, OP of 35.4bn yen, and NP of 24.4bn yen. Credit costs were 2.7bn yen, a low level of 2bp relative to the guarantee exposure. The five-year CAGR for OP was 9.6%.

Figure: Guarantee exposure, revenue, OP



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

Figure: Business breakdown



Source: Company data, Mita Securities

Mortgage loan guarantee business

Business model based on stock revenue. Default risk and collection risk are low

The mortgage loan guarantee business is a stock revenue model that primarily receives guarantee fees based on the balance of the guarantee exposure. However, if a mortgage borrower becomes unable to repay the loan, the company is required to make a lump-sum repayment of the remaining loan balance to the lender on behalf of the borrower (subrogation). As a result of the subrogation, the company acquires the right to claim the remaining loan balance from the borrower (reimbursement claim rights) and collect the debt through voluntary sale or auction of the collateral.

Zenkoku Hosho guarantees recourse-type mortgage loans (a common type of mortgage loan in Japan) that are secured by the borrower's own residential property. This type of loan is characterized by a high willingness of the borrower to repay, low credit risk, and a high recovery rate. In assessing the risks of recourse-type loans, the company carefully examines the borrowers' repayment ability.

Group Companies

The number of subsidiaries is increasing, but results are reported on a non-consolidated basis

Zenkoku Hosho has a servicer (Akebono Servicer), credit guarantee companies (Minori Guarantee and Tsukuba Shinyo Hosho), and an administrative agency (Zenkoku Business Partner) as subsidiaries. So far, the company has been reporting its financial results on a non-consolidated basis, but with the expansion of its subsidiaries' performance and additional M&A, we believe that the company may move to consolidated financial reporting in the near future.

Figure: Subsidiaries

Subsidiary name	Overview	Shares held (%)	Note
Zenkoku Business Partner, K.K.	Zenkoku Business Partner provides administrative services for Zenkoku Hosho.	100.0	Non-consolidated
Akebono Servicer Co., Ltd.	Zenkoku Hosho acquired the former Yutori Servicer Co., Ltd. in December 2018 and made it a subsidiary. Akebono acts as an agent for a portion of the debt collection operations for claims for reimbursement held by Zenkoku Hosho. Going forward, it aims to provide debt collection services to partner financial institutions.	100.0	Non-consolidated
Minori Guarantee Co., Ltd.	Zenkoku Hosho acquired the former Towa Shinyo Hosho Co., Ltd. in February 2020 and made it a subsidiary. Minori continues to provide credit guarantee services for Towa Bank's housing loans (approximately 90bn yen). Gowing forward, it will cover niche and growing loan market as a second brand guarantee company for Zenkoku Hosho. It has entered into a partnership with Tokyo Star Bank to provide mortgage guarantee services for compact and renovated condominiums. It has moved head office from Maebashi City, Gunma Prefecture to Chuo-ku, Tokyo.	100.0	Non-consolidated
Tsukuba Shinyo Hosho Co., Ltd.	Zenkoku Hosho acquired Tsukuba Shinyo Hosho Co., Ltd. in March 2021 and made it a subsidiary. The company continues to provide credit guarantee services for Tsukuba Bank's housing loans (approximately 290bn yen). Head office is located in Tsukuba City, Ibaraki Prefecture.	100.0	Non-consolidated

Source: Company data, Mita Securities

Company History

Zenkoku Hosho was established in 1981. The company was initially engaged in the credit guarantee business for public housing loans. In 1997, it started providing mortgage guarantee services to private financial institutions, and since then it has expanded its partnerships to include financial institutions nationwide. Under the previous management, the company aimed to become a financial conglomerate, but since Eiji Ishikawa (current President and Representative Director) took over as President in 2006, it has concentrated its resources on the mortgage guarantee business. In December 2012, the company was listed on the First Section of the TSE. In 2018, it acquired a servicer company and began operating a debt collection business. In recent years, the company has focused on acquiring guarantee subsidiaries of financial institutions that are exiting the business and the guarantee contracts they hold through M&A. Its recent M&A deals have consisted of those specializing in areas where it can leverage its strengths and easily realize synergies.

Figure: Zenkoku Hosho's history

Date	Event
Feb-81	Established Zenkoku Hosho Co., Ltd.
Jul-97	Started mortgage loan guarantee business for private financial institutions
May-98	Achieved a guaranteed balance of 1 trillion yen
Jul-06	Eiji Ishikawa appointed President and Representative Director (current position)
Mar-07	Achieved a guaranteed balance of 5 trillion yen
Dec-12	Listed on the First Section of the Tokyo Stock Exchange
Mar-16	Achieved a guaranteed balance of 10 trillion yen
Dec-18	YUTORI Servicer Co., Ltd. made a subsidiary (currently Akebono Servicer Co., Ltd.)
Feb-20	Acquired Towa Shinyo Hosho Co., Ltd. from Towa Bank and made it a subsidiary (currently Minori Guarantee Co., Ltd.)
Mar-21	Acquired Tsukuba Shinyo Hosho Co., Ltd. from Tsukuba Bank and made it a subsidiary

Source: Company data, Mita Securities

Major shareholders

As of the end of FY3/20, three of the four major shareholders holding more than 5% of the company were life insurance companies. Zenkoku Hosho is a major customer of life insurance companies because it takes out group credit life insurance to cover the risk of death of mortgage borrowers.

Eiji Ishikawa, President and Representative Director, owns less than 0.07% of the company.

Figure: Major shareholders (end-FY3/20)

Shareholders	Shares held (%)
Fukoku Mutual Life Insurance Company	9.01
Meiji Yasuda Life Insurance Company	9.01
The Master Trust Bank of Japan (trust account)	6.26
Taiyo Life Insurance Company	6.20

Source: Company data, Mita Securities

Details of business

Mortgage Loan Guarantee Business

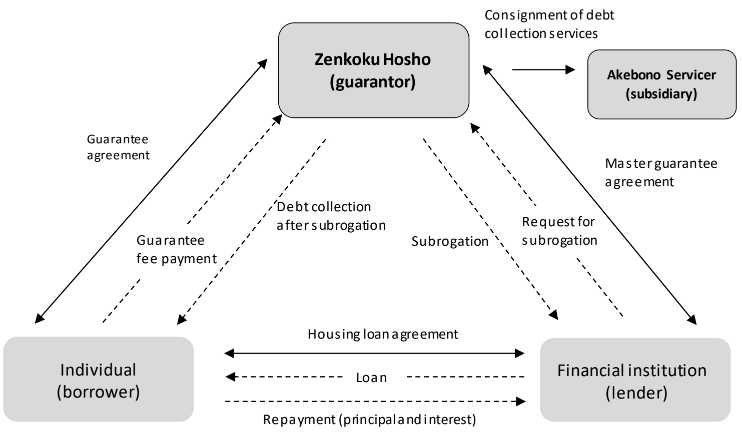
Structure of the guarantee business

A business that provides credit guarantees for mortgage loans by financial institutions and earns stable guarantee fees

Mortgage borrowers apply to Zenkoku Hosho for a credit guarantee when taking out a loan from a financial institution. Zenkoku Hosho examines the borrower (annual income, place of work, length of service, etc.) and the subject property, and determines whether or not to provide the guarantee. The company receives a guarantee fee as compensation for providing the guarantee. The majority of the company's guarantee fee income is linked to the balance of its guarantee exposure, but a portion is linked to the number of new guarantees granted. Over the past few years, the company's annual guarantee fee income has been around 34-35bp of the guarantee exposure.

In the event that a mortgage borrower becomes unable to repay the loan, the company repays the remaining loan balance in a lump sum to the lender on behalf of the borrower (this is called "subrogated repayment"). As a result of the subrogated repayment, it acquires the right to claim the remaining loan balance from the borrower (this is called a "reimbursement claim rights"). The company collects the claim through voluntary sales or auctions of the collateral, and outsources part of its debt collection activities to its subsidiary, Akebono Servicer. The company's final loss will be the amount it is unable to collect through these debt collection activities. The ratio of subrogation payments to guarantee exposure (equivalent to a default ratio) has been on a long-term downward trend and is currently below 0.1%. In addition, the company's collection rate on reimbursement claim rights has been improving over the long term and is currently above 70%.

Figure: Structure of the mortgage loan guarantee business



Source: Company data, Mita Securities

Characteristics of mortgage loans covered by the guarantee

Handles only recourse-type loans for self-residential properties with low credit risk

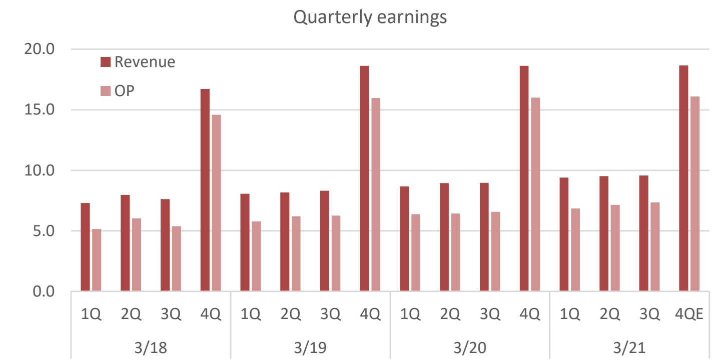
The mortgage loans guaranteed by Zenkoku Hosho are only recourse-type loans that cover properties for personal residence. Loans for investment properties (such as so-called "investment condominium loans") and non-recourse loans that rely on the value of real estate properties (such as so-called "apartment loans") are not included. Recourse-type loans are those in which the remaining debt is not discharged even after disposal of the collateral. In general, borrowers have a high willingness to repay recourse-type loans for the house they are living in, and payment priority is high. For this structural reason, mortgages on self-residential properties in Japan are perceived as an asset class with low credit risk.

Seasonality of guarantee fee income

Seasonality exists in guarantee fee income, with a sharp increase in 4Q

Guarantee fee income, which accounts for the majority of the company's operating revenue, is seasonal, with the amount in 4Q being outstanding. This is because the company receives the majority of group credit life insurance dividends, which are included in guarantee fee income, in 4Q. Group credit life insurance is used to cover the mortality risk of mortgage borrowers.

Figure: Quarterly earnings



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

Partnerships with financial institutions

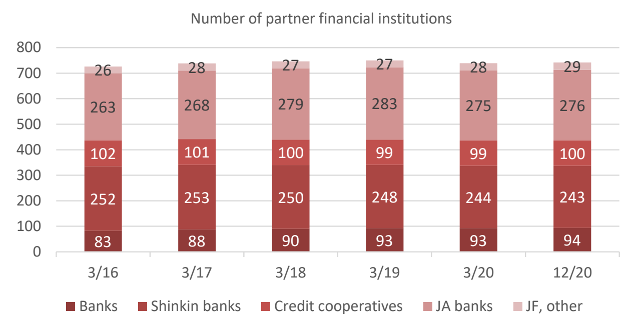
Number of financial institutions and share of partnerships

Established partnerships with the majority of financial institutions

As of Q3 FY3/21, Zenkoku Hosho had 742 partner financial institutions, including 94 banks, 243 shinkin banks, 100 credit cooperatives, 276 JAs, and 29 JFs and others. The number has been decreasing in some categories due to mergers among financial institutions.

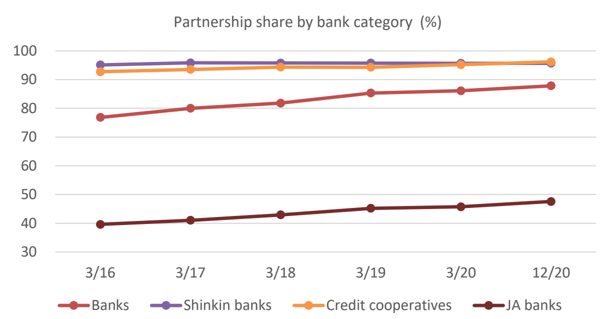
The share of partnerships by type of business (number of partner financial institutions by type of business / number of financial institutions by type of business) is 88% for banks, 96% for shinkin banks, 96% for credit cooperatives, and 48% for JA, indicating that the majority of financial institutions have already tied up with Zenkoku Hosho.

Figure: Number of partner financial institutions



Source: Company data, Mita Securities

Figure: Partnership share by business type



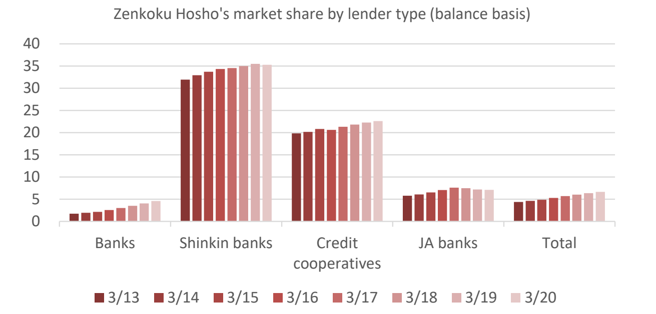
Source: Company data, Mita Securities

Market share by business type

Strengthening relationships with the banking sector

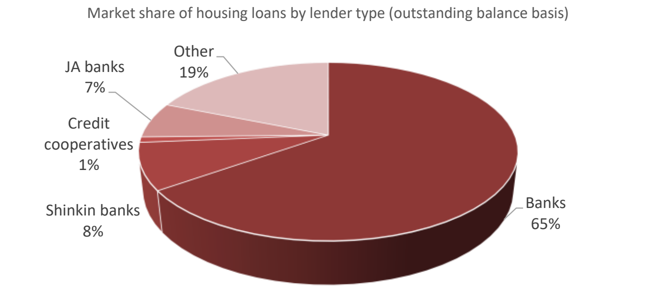
The market share by type of business is based on our estimate of Zenkoku Hosho's share of outstanding mortgage loans by type of business. The two categories with the highest market shares are shinkin banks (35%) and credit cooperatives (23%). The share of the banking sector is still low at 5%, but has been growing significantly over the past few years. The banking sector is extremely important in the mortgage loan market. In recent years, Zenkoku Hosho's growth has been supported by stronger relationships with the banking sector.

Figure: Market share of Zenkoku Hosho by business type



Source: JHF data, Company data, Mita Securities

Figure: Market share for mortgage loans by lender type



Source: JHF data, Mita Securities

Strengths of Zenkoku Hosho

Screening System

150 experts examine 300,000 cases per year. Rich examination experience is the source of its risk assessment capability

The cornerstone of the credit guarantee business is the screening system. Zenkoku Hosho has approximately 150 examiners, and is capable of handling 300,000 applications per year. In addition to building up in-house screening know-how based on its extensive experience in managing mortgage loans, the company conducts detailed screening by referring to external personal credit information data (CIC and JICC) used for screening by credit card and consumer finance companies. In general, financial institution-affiliated guarantee companies tend to overestimate risk by placing too much emphasis on formal requirements, but by assessing substantive risk from a variety of angles, the company minimizes the number of cases it misses (for financial institutions, this means expanding the customer base that can obtain a mortgage). In addition, the company has created a manual on how to detect fraudulent cases, which is shared among examiners.

Strengths of being an independent company

Unique positioning as an independent company encourages growth

Because of their historical background, many mortgage guarantee companies in Japan are group companies of financial institutions. Most of them are regional financial institutions operating in a limited area, which limits the room for growth for guarantee companies and makes it impossible to escape the risk of regional concentration. In addition, the use of subsidiary guarantees does not reduce risk for the financial institution group as a whole. For financial institutions that adopt consolidated reporting, the effects of subsidiary guarantees cannot be incorporated in the consolidated accounts.

Zenkoku Hosho does not belong to any particular group and can provide guarantees in partnership with various financial institutions, which gives it a lot of room for growth and diversifies its regional risk. By using an external guarantee company such as Zenkoku Hosho, financial institutions can essentially transfer risk outside the group.

Strengths of being a listed company

"Quality guarantee"

If a financial institution receives a guarantee from a guarantee company that is 1) a listed company and 2) a dividend-paying company, the guarantee will be treated as a "quality guarantee," and the financial institution will not be required to make provisions for the mortgage loans covered by the guarantee. Since listing on the First Section of the Tokyo Stock Exchange in December 2012, Zenkoku Hosho has been stably paying dividends and meets the requirements for a quality guarantee. We believe that one of the main reasons why the company, which has little need to raise funds to operate its business, has remained listed is because it is able to offer the benefits of a quality guarantee to its partner financial institutions.

Strength in obtaining credit ratings

Provides financial institutions with options to reduce RWAs

Zenkoku Hosho has an "A-/Stable" credit rating from Japan Credit Rating Agency (JCR). Under capital adequacy regulations, financial institutions apply a 75% risk weighting to mortgage loan portfolios with LTVs of 100% or more, but if Zenkoku Hosho takes over such mortgage guarantee obligations, the financial institutions can apply the 50% risk weighting of Zenkoku Hosho (A-) instead. This will enable financial institutions to reduce risk-weighted assets, while Zenkoku Hosho will be able to increase the balance of its guarantee exposure.

Mortgage loan market in Japan

Size of the mortgage loan market (balance basis)

Japan's outstanding mortgage balance is 202trn yen, with a 5-year CAGR of 2.1%

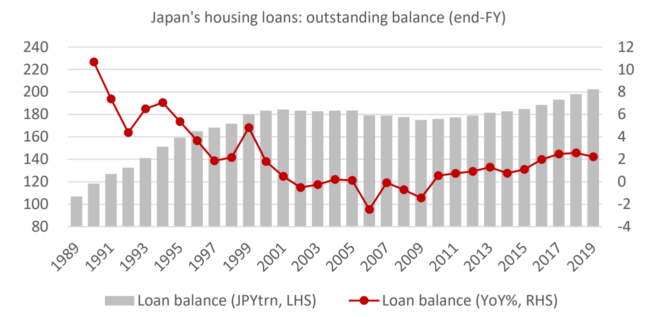
According to data from the Japan Housing Finance Agency (JHF), the outstanding balance of mortgage loans in Japan at the end of FY2019 (end of March 2020) was 202.5trn yen (+2.2% YoY). The breakdown by business type is as follows: domestic banks 132.0trn yen (65.2% share), JHF (total of direct loans and purchased loans) 22.3trn yen (11.0% share), shinkin banks 17.1trn yen (8.5% share), JA 13.1trn yen (6.5% share), and credit cooperatives 2.0trn yen (1.0% share). The five-year average growth rate of outstanding loans is 2.1% (CAGR).

Size of the mortgage loan market (new loan basis)

New loans in FY3/20 were 21.4 trn yen. Banking sector accounts for nearly 70%

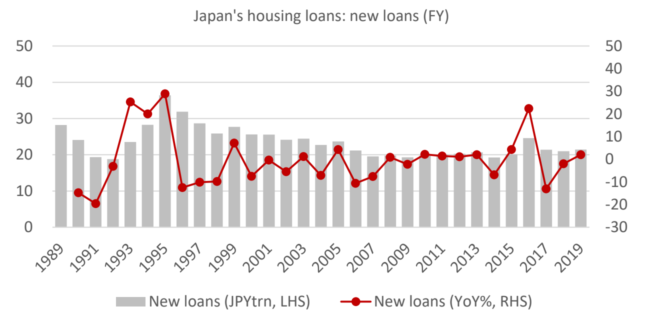
According to JHF data, new mortgage lending in Japan in FY2019 (April 2019-March 2020) was 21.4trn yen (+2.0% YoY). By type of business, domestic banks accounted for 14.8trn yen (69.2% share), JHF 2.4trn yen (11.0% share), and shinkin banks 1.6trn yen (0.9% share). The five-year average growth rate of new loans is 2.1% (CAGR).

Figure: Mortgage loan balance in Japan



Source: JHF data, Mita Securities

Figure: New mortgage lending in Japan



Source: JHF data, Mita Securities

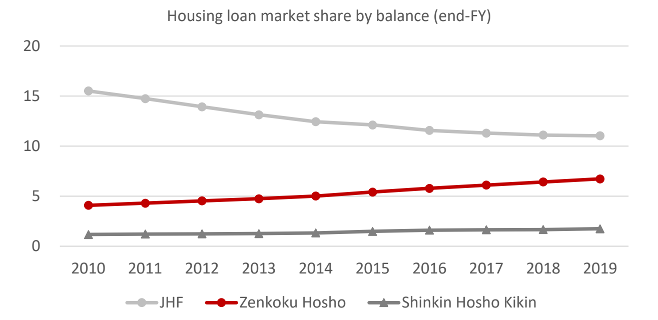
Positioning of Zenkoku Hosho in the mortgage loan market

Market share is 6.7% for outstanding loans and 8.1% for new loans. Growth far outpacing the market

Since Zenkoku Hosho does not provide loans on its own, it does not appear in the JHF data above. The relationship is that Zenkoku Hosho's guarantee is attached to a part of the outstanding balance of mortgage loans and new loans of the private financial institutions mentioned above.

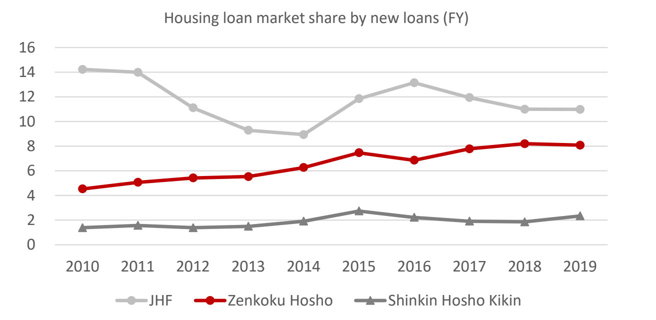
The share of outstanding and new loans guaranteed by Zenkoku Hosho is 6.7% and 8.1%, respectively, as estimated from the above data. The five-year average growth rate of Zenkoku Hosho is 8.3% for the loan balance and 7.5% for the new loans (both CAGRs). Both the balance of guarantee exposure and the amount of newly granted guarantees are growing at a much faster rate than the overall mortgage loan market.

Figure: Market share for loan balance



Source: JHF data, Shinki Kikin data, Company data, Mita Securities

Figure: Market share for new loans



Source: JHF data, Shinki Kikin data, Company data, Mita Securities

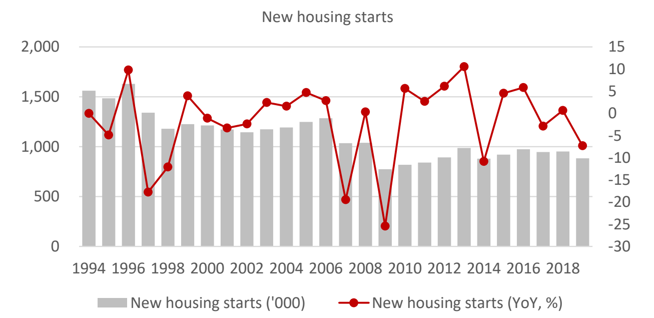
JHF's "Flat 35"

The Japan Housing Finance Agency (JHF) is the successor of the former Government Housing Loan Corporation. Currently, JHF provides long-term fixed mortgage loans under the product name "Flat 35" and transfers the risk to MBS (mortgage-backed securities) investors using a securitization scheme. Flat 35 loans do not require a guarantee, and as such JHF can be regarded as one of the competitors for Zenkoku Hosho. However, since JHF provides only long-term fixed-rate loans, it is difficult to increase its market share in a low interest rate environment. Flat 35 is offered by financial institutions and mortgage banks nationwide. Of these, Aruhi (7198) is the largest.

Shinkin Hosho Kikin

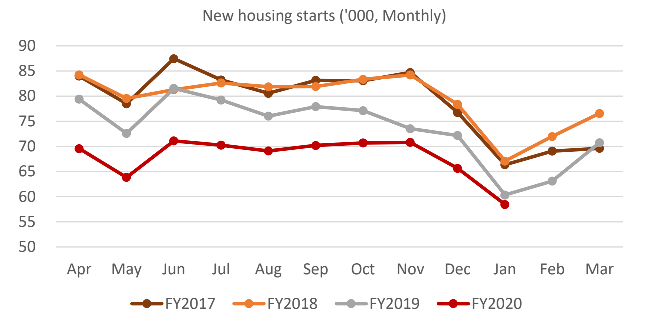
Shinkin Hosho Kikin is a non-profit institution whose members are the Shinkin Central Bank and shinkin banks throughout Japan. It is similar to Zenkoku Hosho in that it provides guarantees to a large number of financial institutions, and as such it can be regarded as one of the competitors for Zenkoku Hosho. However, the balance of guarantees provided to shinkin banks was only 3.6trn yen in FY3/20, compared to 6.0trn yen for Zenkoku Hosho. In our view, the existence of Shinkin Hosho Kikin is unlikely to have a significant negative impact on the growth potential of Zenkoku Hosho, given that the shinkin bank category accounts for only about 8% of the housing loan market.

Figure: New housing starts (reference)



Source: MLIT data, Mita Securities

Figure: New housing starts (reference)



Source: MLIT data, Mita Securities

Risks and mitigating factors in the mortgage guarantee business

Mortgage loan default risk and debt collection risk

Default rates worsened after the Lehman crisis. At present, the impact of COVID-19 is limited

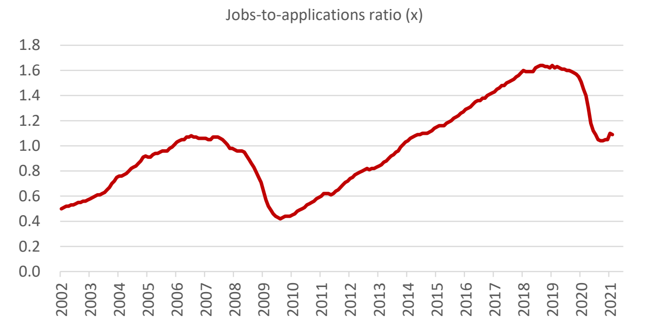
The biggest risks for mortgage guarantee companies would be an increase in the default rate (an increase in subrogation payments) and a decrease in the collection rate of reimbursement claim rights. The former is brought about by the worsening employment situation and the latter by falling real estate prices. For Zenkoku Hosho, the default rate reached a record high of 0.34% in FY3/10 after the Lehman crisis, and the collection rate reached a record low of 58.8% in FY3/05.

In recent years, the default rate (the rate of subrogation payments) has hovered around 0.1%, and there was no increase in FY3/21, when the COVID-19 pandemic hit. The delinquency ratio, a leading indicator, has also been stable at around 0.2%. Employment-related indicators, such as the unemployment rate and the ratio of job openings to applications, deteriorated slightly, but the degree of deterioration was limited compared to the Lehman crisis. The collection rate of reimbursement claim rights remains high at over 70%.

Figure: Unemployment rate

Source: MIC data, Mita Securities

Figure: Effective job openings-to-applications ratio



Source: MHLW data, Mita Securities

Risk of falsification of examination documents

Zenkoku Hosho does not provide guarantees for loans for investment properties, which are prone to fraud risks

There is a risk of various irregularities in the field of mortgage lending. In recent years, the following cases have become problematic in the mortgage loan market. There is a possibility that some of the real estate agents who broker investment properties are malicious. The following two cases are not related to Zenkoku Hosho.

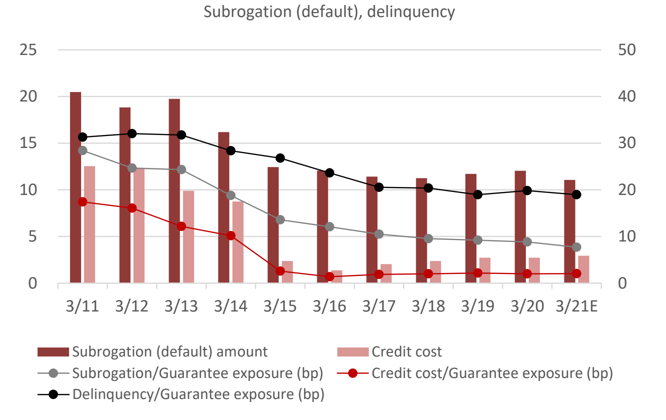
- A case of falsification of income certificates in order to make it easier to pass the screening process for investment-purpose condominium loans.
- A case in which an investment property was falsified as one's own residence, and the "Flat 35" loan, which can only be used for one's own residence, was used for investment purposes.

Zenkoku Hosho is implementing various measures to prevent fraudulent use in the guarantee screening process. The company has a thorough understanding of the methods of fraud and the tendencies of fraudulent companies, and has created a manual to share information among the examiners. In addition, the company does not guarantee loans for investment properties.

Risks related to group credit life insurance

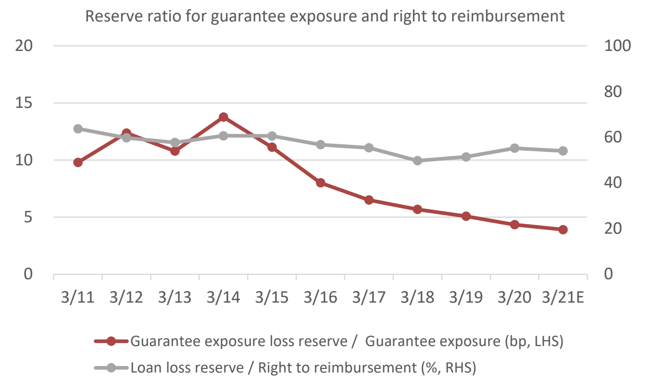
The revenue of Zenkoku Hosho includes dividend income from group credit life insurance. In the event of a major disaster or epidemic and a higher-than-expected increase in the mortality rate, dividends from group credit life insurance could be reduced.

Figure: Subrogation (default) and credit costs



Source: Company data, Mita Securities Note: LHS JPYbn, RHS bp, Forecasts are by Mita Securities

Figure: Reserve ratio



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

Growth strategy

Zenkoku Hosho has entered a new stage of profit growth. In addition to organic growth through the strengthening of relationships with partner financial institutions, the company is likely to step up its efforts to achieve inorganic growth through M&A. Furthermore, by strengthening the operation of its servicer subsidiary, the company will not only improve the collection rate, but will also be able to take on debt collection operations from third parties. The investment environment is expected to improve for its surplus funds with the expansion of the market for subordinated bonds by general corporations.

Mortgage loan guarantees

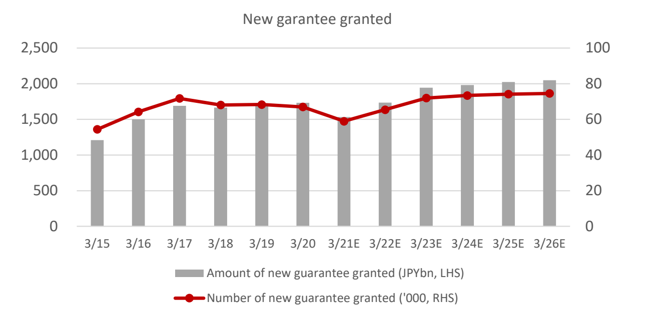
Organic growth by strengthening relationships with financial institutions and improving the mix

Increase in the utilization rate of Zenkoku Hosho's products at partner financial institutions, especially in strengthening relationships with the banking

The five-year CAGR of new guarantees through FY3/20 is 7.5%. Although we expect a decline in FY3/21 due to the impact of COVID-19, medium- to long-term growth is likely to continue.

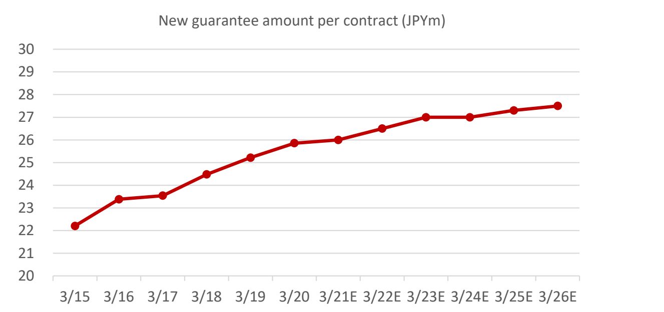
By strengthening relationships with its partner financial institutions, there is room to increase the utilization rate and increase the amount of new guarantees granted. For partner financial institutions, the inclusion of Zenkoku Hosho's products will increase their chances of attracting customer segments that they have previously missed. To date, the percentage of loans originated by metropolitan banks, which have higher loan amounts per loan, has increased, leading to an increase in the amount of new guarantees granted per loan. The company's relationship with the banking sector has strengthened in recent years, and we expect this trend to continue.

Figure: Amount and number of new guarantees granted



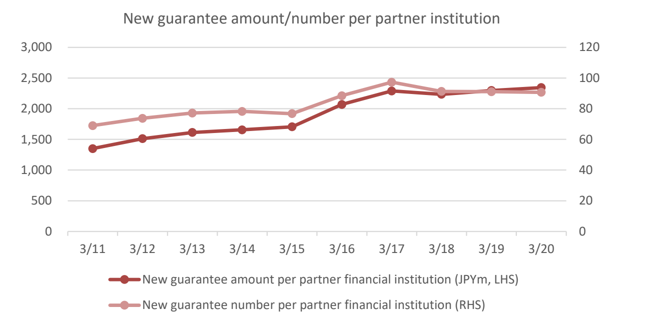
Source: Company data, Mita Securities Note: Forecasts are by Mita Securities

Figure: Amount of new guarantees granted per loan



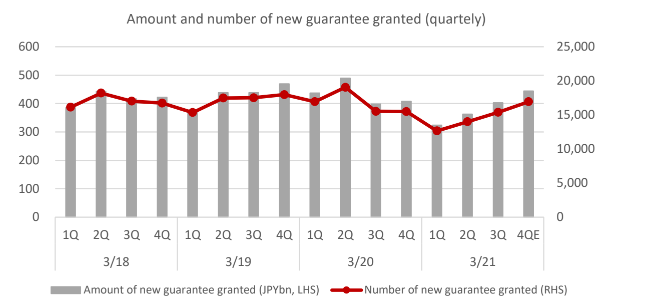
Source: Company data, Mita Securities Note: Forecasts are by Mita Securities

Figure: Amount and number of new guarantees per institution



Source: Company data, Mita Securities

Figure: Amount and number of new guarantees granted (Q)



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

Approaching the existing mortgage loan market (inorganic growth)

Stock acquisition, absorption-type splits, and RMBS purchases for inorganic growth. Provides risk reduction tools to partner financial institutions

In its "new medium-term management plan 2020-2022" announced in March 2020, Zenkoku Hosho commented on its growth strategy through an "approach to the existing mortgage loan market," and we believe this approach will play an important role in the company's growth going forward. This approach involves Zenkoku Hosho taking over existing guarantee exposure held by other guarantee companies through a stock acquisition or corporate split (absorption-type split). For the company, this would allow it to expand its balance of guarantee exposure in one fell swoop.

In February 2020, the company received an A-range credit rating (JCR: A-/Stable), which means that partner financial institutions that accept this approach will benefit from a reduction in the risk weighting of their mortgage portfolios under capital adequacy regulations. For example, a risk weight of 75% is applied to mortgage loans with an LTV of 100% or more, but by allowing Zenkoku Hosho to take over the guarantee exposure, a risk weight of 50% (corresponding to Zenkoku Hosho's A-range rating) can be applied. Capital adequacy measures are extremely important as a management issue for regional financial institutions, and we believe that many financial institutions will show interest.

Since the succession of guarantee exposure is done on a portfolio basis, it may include high-risk mortgage loans. The company examines each mortgage loan and adjusts the transaction risk by requiring a higher guarantee fee for higher-risk mortgages. The company's large number of examiners makes it possible for it to use this M&A method.

The company has been preparing to acquire deals in the existing mortgage market for several years and has already accumulated a number of successful cases: in FY3/19, it purchased RMBS; in FY3/20, it purchased RMBS and Towa Shinyo Hosho (stock acquisition); in FY3/21, it purchased Settsu Suito Sogo Shinyo (company split) and Tsukuba Shinyo Hosho (stock acquisition).

RMBS purchase means that the company assumes credit risk by purchasing trust beneficiary rights backed by mortgages held by financial institutions. The balance of RMBS is recorded as investments and other assets (fixed assets) on the company's balance sheet, and dividend income is recorded as non-operating income (a factor increasing recurring profit).

As the company does not adopt consolidated accounting, the P/L does not reflect the profit and loss of the subsidiaries. Given the company's stance on strengthening M&A, we believe there is a good chance that the company will move to consolidated accounts in the near future.

Figure: Succession of guarantee exposures through mergers and acquisitions

Succession of guarantee obligation

Date	Approach	Counterparty/acquired company	Guarantee obligation (JPYbn)
4Q FY3/12	Individual contract transfer	Subsidiary of shinkin bank (name not disclosed)	11.0
3Q FY3/16	Company split (absorption-type)	Seishin Shinyo Hosho	43.3
4Q FY3/20	Acquisition of shares (making it a subsidiary)	Towa Shinyo Hosho (currently Minori Guarantee)	90.3
1Q FY3/21	Company split (absorption-type)	Cedyna (currently SMBC Finance Service)	2.8
4Q FY3/21	Company split (absorption-type)	SMBC Finance Service	5.0
4Q FY3/21	Company split (absorption-type)	Settsu Suito Sogo Shinyo	5.8
4Q FY3/21	Acquisition of shares (making it a subsidiary)	Tsukuba Shinyo Hosho	290.0

Source: Company data, Mita Securities

Figure: Substantial succession of guarantee exposures through RMBS purchase

RMBS purchase scheme

Date	Approach	Outline of initiatives
2Q FY3/19	Purchase of RMBS	Purchased subordinated tranches of RMBS backed by housing loans held by a financial institution (approx. 1.3bn yen)
3Q FY3/20	Purchase of RMBS	Purchased RMBS backed by housing loans held by a financial institution (no tranche split, approx. 3bn yen)

Source: Company data, Mita Securities

Strengthening the servicer business to improve collection rates and realize cross-selling

Expect to improve the collection rate for the time being. Expect to take on external projects in the future

Zenkoku Hosho has changed the trade name of YUTORI Servicer, which it acquired in FY3/19, to Akebono Servicer, and has sent the necessary personnel to start loan servicing operations. In addition to improving the collection rate by bringing the servicing operations that had been outsourced to the company in-house, the company will be able to receive servicing contracts from partner financial institutions in the future, in our view.

Previously, the company disposed of its reimbursement claim rights, after disposing of collateralized properties, through bulk sales to outside servicers, which forced the company to sell the claims at a low price. With the start of operations at Akebono Servicer, the company is now able to achieve a higher collection rate.

At present, Akebono Servicer only collects claims from Zenkoku Hosho, but Zenkoku Hosho intends to expand the scope of Akebono's business. The company is working on sales activities in order to contract debt collection services from partner financial institutions. We have high expectations for the company in terms of its ability to cross-sell its existing guarantee products and debt collection services. Although it will take a few years for this business to become fully operational, it is an important field that could become one of the long-term growth drivers.

Figure: Entry into new business

Entry into new business

Date	Approach	Outline of initiatives
3Q FY3/19	Acquisition of shares (making it a subsidiary)	Acquired all shares of Yutori Servicer (currently Akebono Servicer), making it a subsidiary. Entered the servicing business, which requires a business license from the Ministry of Justice

Source: Company data, Mita Securities

Surplus fund management

The hybrid bond market is booming, providing a good opportunity to expand investment income

Expansion of the corporate hybrid bond market is a factor for improving investment yields

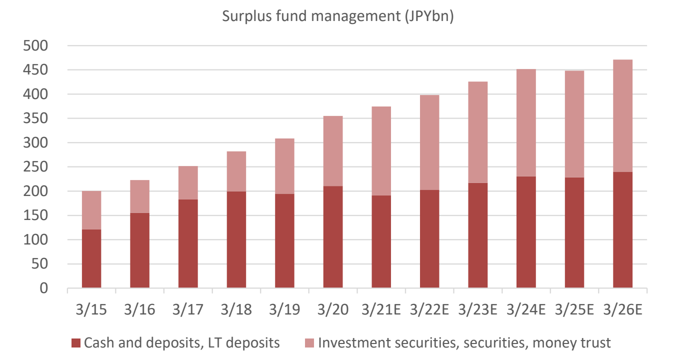
Zenkoku Hosho holds a large amount of surplus funds because it receives a lump-sum guarantee fee when a financial institution executes a mortgage loan. The company is investing some of its surplus funds for the long term, while ensuring sufficient liquidity in case of subrogation or cancellation of guarantee contracts.

As of the end of FY3/20, the company had 210.6bn yen in cash and deposits (including long-term deposits) and 144.4bn yen in marketable and investment securities. The cash and deposits are equivalent to about 17.6 times the company's subrogation payments (12.0bn yen in FY3/20), and as such the company has sufficient liquidity, in our view.

Marketable and investment securities are long-term investments consisting mainly of highly rated corporate bonds, government bonds, and municipal bonds. Subordinated bonds issued by financial institutions and general corporations is the main component. In the past, subordinated debt of financial institutions was the main investment target, but after the introduction of Basel III, the issuance of subordinated debt by regional banks plummeted and investment opportunities were scarce. In recent years, however, there has been an increase in the issuance of ultra-long-term subordinated debt (hybrid bonds) by general corporations to finance M&A and maintain credit ratings, and the company has been expanding its investment targets. In our view, the company has entered a phase where it can expect profit growth not only from its core business but also from higher yields on invested assets.

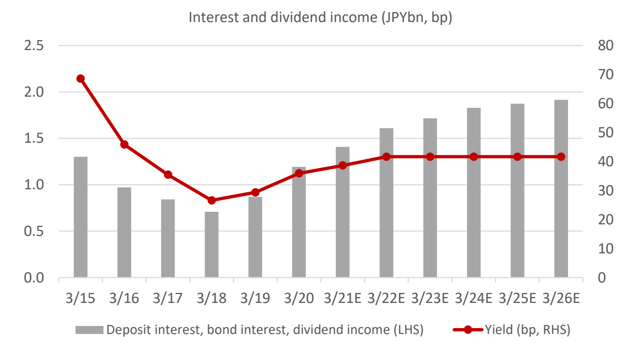
To ensure the safety of the company's corporate bond portfolio, the company has established internal regulations that include rating requirements for issuers and a maximum holding limit per issuer.

Figure: Breakdown of surplus funds management



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

Figure: Interest and dividend income



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

Earnings forecast

Our earnings forecast

Earnings forecast for FY3/21

We expect OP for FY3/21 to be 37.5bn yen, exceeding the guidance. Credit costs and general expenses are expected to be lower

We expect non-consolidated revenue of 47.2bn yen (+4.4% YoY), OP of 37.5bn yen (+5.9% YoY), and NP of 26.4bn yen (+8.1% YoY) for FY3/21. Compared to the company's guidance (revenue of 47.58bn yen, OP of 36.35bn yen, and NP of 25.48bn yen), our forecast for revenue is almost the same level, and our forecasts for OP and NP are about 1bn yen higher.

We expect credit costs s and general expenses to be the main reasons for exceeding the guidance. We believe that credit costs of 2.9bn yen (vs. 2.7bn yen in FY3/20) will be better than the company's guidance of 3.7bn yen, as the COVID-19 pandemic has not had a significant negative impact on the employment situation in Japan and the mortgage borrowers appears to be sound. We assume that the credit cost ratio (vs. guarantee exposure) will be 2bp (vs. 2bp in FY3/20). In addition, we expect general expenses to be 6.8bn yen (vs. 7.1bn yen in FY3/20), lower than the company's guidance of 7.5bn yen, as the COVID-19 pandemic is expected to have curbed operating costs for sales activities with reduction of travels and etc.

We expect guarantee exposure (including subsidiaries) as of the end of FY3/21 to be 14,741.9bn yen (+7.6% YoY; company guidance 14,840bn yen) and the number of new guarantees granted to be 58,963 (-12% YoY; company guidance 71,000). The company's guidance is in line with its medium-term management plan announced in March 2020, which does not fully incorporate the impact of the COVID-19 pandemic, so the market is likely to assume that these KPIs will be missed.

Earnings forecast for FY3/22

We expect OP to increase 6% to 39.7bn yen in FY3/22. Company guidance is assumed to be more conservative than our forecast

We forecast non-consolidated revenue of 50.3bn yen (+6.6% YoY), OP of 39.7bn yen (+6.0% YoY), and NP of 28.1bn yen (+6.5% YoY) for FY3/22. We assume that credit costs will be 3.5bn yen, 2bp of the guarantee exposure (unchanged from FY3/21). The company's profit growth should continue to be supported by the favorable performance of mortgage loans. We expect the number of new guarantees granted to recover to 65,449 (+11.0% YoY), slightly below the FY3/20 level.

We assume that the company's guidance for FY3/22, which will be announced at the time of the announcement of FY3/21 results, is likely to be slightly more conservative than our forecast. The company tends to present conservative estimates for credit costs, in our view.

Our view on the medium-term management plan

Our view on the results for FY3/23, the final year of the medium-term management plan

We expect Zenkoku Hosho to exceed its OP target in FY3/23. Guarantee exposure target can be exceeded by accumulating M&A

We expect the balance of guaranteed exposure to be 16,671.3bn yen (+6.7% YoY), revenue to be 53.9bn yen (+7.1% YoY), and OP to be 42.4bn yen (+6.8% YoY) for FY3/23. The company's medium-term management plan announced in March 2020 calls for 16,834bn yen in guarantee exposure, 53bn yen in revenue, and 40.25bn yen in NP for FY3/23. Although this plan was formulated before the negative impact of the COVID-19 was fully factored in, we believe that it is possible to exceed these targets in terms of revenue and OP. Our forecast for the guaranteed exposure does not factor in the impact of additional M&A. If we take into account the increase in M&A, we believe that the company will be able to substantially exceed its forecast of 16.8trn yen.

Strengthening shareholder returns

The nature of Zenkoku Hosho's business requires it to have sufficient equity capital, and its high creditworthiness is a source of competitive advantage. The company has already secured sufficient equity capital by steadily accumulating profits over the long term, in our view. Over the past five years, the company's capital adequacy ratio (i.e., shareholders' equity/total guaranteed exposure + total assets) has improved significantly from 0.72% to 1.11%, in our estimate (based on our forecast for FY3/21). The capital adequacy ratio, after adjusting for subordinated loans, is 1.26% (our estimate) (treating 75% of subordinated loans as equity). We believe that the company's profitability and financial strength have increased sufficiently to reach a stage where it can both maintain its creditworthiness and enhance shareholder returns. In its medium-term management plan, the company plans to achieve a payout ratio of 35% in FY3/23 (FY3/21 guidance: 30%), a target that we believe the company can meet without difficulty.

Zenkoku Hosho has reached a stage where it can both maintain its creditworthiness and enhance shareholder returns. Dividend payout ratio is expected to increase year by year

Figure: Mita Securities' earnings forecast (non-consolidated, PL, JPYm)

JPYm	3/18 A	3/19 A	3/20 A	3/21 MitaE	3/22 MitaE	3/23 MitaE	3/24 MitaE	3/25 MitaE	3/26 MitaE	5y growth (CAGR)
Revenue	39,599	43,204	45,203	47,186	50,290	53,881	56,994	60,010	62,897	5.9
Guarantee fee income	39,461	43,038	45,056	47,039	50,140	53,728	56,839	59,854	62,739	5.9
Other income	138	166	147	147	150	153	155	156	158	
Operating expense	8,419	8,975	9,823	9,736	10,578	11,474	13,295	15,212	17,028	
SG&A	6,045	6,248	7,091	6,800	7,100	7,689	8,056	8,511	8,851	
Credit costs	2,374	2,727	2,732	2,936	3,478	3,785	5,240	6,702	8,178	
Provision for guarantee loss reserves	3,090	3,034	2,547	2,705	3,230	3,480	4,324	5,290	6,062	
Provision for loan loss reserves	-716	-307	185	230	248	305	916	1,412	2,116	
Pre-provision operating profit	33,553	36,956	38,111	40,386	43,190	46,192	48,938	51,499	54,047	6.0
Operating profit	31,179	34,229	35,379	37,451	39,713	42,407	43,698	44,797	45,869	4.1
Non-operating income	795	947	1,249	1,470	1,674	1,785	1,900	1,951	1,995	
Interest income	96	115	126	100	98	105	112	115	117	
Interest on securities	539	667	910	1,244	1,436	1,531	1,631	1,672	1,708	
Dividend income	75	86	157	65	75	80	86	88	90	
Non-operating expenses	1	7	868	798	799	799	800	800	32	
Recurring profit	31,974	35,169	35,760	38,122	40,587	43,392	44,798	45,948	47,832	4.6
Extraordinary gains	79	0	0	0	0	0	0	0	0	
Extraordinary losses	83	324	518	0	0	0	0	0	0	
Pre-tax profit	31,971	34,844	35,241	38,122	40,587	43,392	44,798	45,948	47,832	
Corporate taxes	9,919	10,710	10,811	11,703	12,460	13,321	13,753	14,106	14,684	
Net profit	22,052	24,134	24,430	26,419	28,127	30,071	31,045	31,842	33,148	4.6
Shares O/S (m)	68.762	68.781	68.788	68.793	68.793	68.793	68.793	68.793	68.793	
EPS	320.70	350.88	355.15	384.03	408.86	437.12	451.28	462.86	481.84	4.6
BPS	1,572.47	1,846.41	2,108.65	2,381.94	2,655.88	2,940.00	3,219.80	3,488.26	3,748.45	9.5
Dividend	5,508	5,991	6,542	7,636	9,282	10,525	11,797	13,374	15,248	14.8
DPS	80.00	87.00	95.00	111.00	135.00	153.00	171.00	194.00	222.00	14.9
Payout ratio (%)	25.0	24.8	26.8	28.9	33.0	35.0	38.0	42.0	46.0	
Tax rate (%)	31.0	30.7	30.7	30.7	30.7	30.7	30.7	30.7	30.7	
ROA (%)	7.9	7.8	7.0	6.9	6.8	6.8	6.5	6.4	6.4	
ROE (%)	22.3	20.5	18.0	17.1	16.2	15.6	14.7	13.8	13.3	

Source: Company data, Mita Securities

Figure: Mita Securities' earnings forecast (non-consolidated, various indicators)

	3/18 A	3/19 A	3/20 A	3/21 MitaE	3/22 MitaE	3/23 MitaE	3/24 MitaE	3/25 MitaE	3/26 MitaE	5y growth (CAGR)
Revenue growth (%)	10.2	9.1	4.6	4.4	6.6	7.1	5.8	5.3	4.8	
Operating expense growth (%)	8.2	6.6	9.4	-0.9	8.7	8.5	15.9	14.4	11.9	
SG&A growth (%)	5.2	3.4	13.5	-4.1	4.4	8.3	4.8	5.7	4.0	
Credit cost growth (%)	16.9	14.9	0.2	7.4	18.5	8.8	38.4	27.9	22.0	
Pre-provision OP growth (%)	11.2	10.1	3.1	6.0	6.9	6.9	5.9	5.2	4.9	
Operating profit growth (%)	10.8	9.8	3.4	5.9	6.0	6.8	3.0	2.5	2.4	
Recurring profit growth (%)	10.3	10.0	1.7	6.6	6.5	6.9	3.2	2.6	4.1	
Net profit growth (%)	12.9	9.4	1.2	8.1	6.5	6.9	3.2	2.6	4.1	
SG&A/Revenue (%)	15.3	14.5	15.7	14.4	14.1	14.3	14.1	14.2	14.1	
Credit-related costs / Revenue (%)	6.0	6.3	6.0	6.2	6.9	7.0	9.2	11.2	13.0	
Pre-provision OP / Revenue (%)	84.7	85.5	84.3	85.6	85.9	85.7	85.9	85.8	85.9	
Operating profit / Revenue (%)	78.7	79.2	78.3	79.4	79.0	78.7	76.7	74.7	72.9	
Recurring profit / Revenue (%)	80.7	81.4	79.1	80.8	80.7	80.5	78.6	76.6	76.0	
Guarantee fee income / Guarantee exposure (bp)	34.8	35.1	34.2	33.6	33.8	34.0	33.8	33.6	33.5	
SG&A / Guarantee exposure (bp)	5.3	5.1	5.4	4.9	4.8	4.9	4.8	4.8	4.7	
Credit costs / Guarantee exposure (bp)	2.1	2.2	2.1	2.1	2.3	2.4	3.1	3.8	4.4	
Pre-provision OP / Guarantee exposure (bp)	29.6	30.2	28.9	28.9	29.2	29.2	29.1	28.9	28.8	
Operating profit / Guarantee exposure (bp)	27.5	27.9	26.9	26.8	26.8	26.8	26.0	25.2	24.5	
Interest income / Cash and deposits (%)	0.05	0.06	0.06	0.05	0.05	0.05	0.05	0.05	0.05	
Securities yield (%)	0.90	0.79	0.83	0.80	0.80	0.80	0.80	0.80	0.80	

Source: Company data, Mita Securities

Figure: Mita Securities' earnings forecast (non-consolidated, guarantee exposure, JPYm)

JPYm	3/18 A	3/19 A	3/20 A	3/21 MitaE	3/22 MitaE	3/23 MitaE	3/24 MitaE	3/25 MitaE	3/26 MitaE	5y growth (CAGR)
Number of new guarantees granted	68,073	68,311	67,003	58,963	65,449	71,993	73,433	74,168	74,538	4.8
Change (YoY, %)	-5.2	0.3	-1.9	-12.0	11.0	10.0	2.0	1.0	0.5	
Amount of new guarantees granted	1,666,315	1,722,629	1,732,416	1,533,029	1,734,386	1,943,821	1,982,698	2,024,775	2,049,807	6.0
Change (YoY, %)	-1.4	3.4	0.6	-11.5	13.1	12.1	2.0	2.1	1.2	
New guarantee amount per transaction	24.48	25.22	25.86	26.00	26.50	27.00	27.00	27.30	27.50	1.1
Change (YoY, %)	4.0	3.0	2.5	0.6	1.9	1.9	0.0	1.1	0.7	
Guarantee exposure	11,789,304	12,717,625	13,616,023	14,361,872	15,266,467	16,328,323	17,318,192	18,288,429	19,222,313	6.0
Change (YoY, %)	8.3	7.9	7.1	5.5	6.3	7.0	6.1	5.6	5.1	
Guarantee exposure (parent+subsidiaries)	11,789,304	12,717,625	13,706,420	14,741,872	15,627,467	16,671,273	17,643,994	18,597,941	19,516,349	5.8
Change (YoY, %)	8.3	7.9	7.8	7.6	6.0	6.7	5.8	5.4	4.9	

Source: Company data, Mita Securities

Figure: Mita Securities' earnings forecast (non-consolidated, asset quality, credit costs, JPYm)

JPYm	3/18 A	3/19 A	3/20 A	3/21 MitaE	3/22 MitaE	3/23 MitaE	3/24 MitaE	3/25 MitaE	3/26 MitaE	5y growth (CAGR)
Delinquencies, defaults										
Guarantee exposure	11,789,304	12,717,625	13,616,023	14,361,872	15,266,467	16,328,323	17,318,192	18,288,429	19,222,313	6.0
Delinquent loan amount	24,010	24,095	26,990	27,232	28,724	30,533	35,922	43,295	45,721	10.9
Delinquency ratio (vs. EOP guarantee exposure, %)	0.20	0.19	0.20	0.19	0.19	0.19	0.21	0.24	0.24	
Change (YoY, %)	7.4	0.4	12.0	0.9	5.5	6.3	17.7	20.5	5.6	
Subrogation repayments (default amount)	11,237	11,709	12,036	11,066	11,165	11,777	13,129	15,447	18,617	11.0
Subrogation repayments / Delinquent loan amount (%)	50.3	48.8	50.0	41.0	41.0	41.0	43.0	43.0	43.0	
Subrogation repayments / Guarantee exposure (%)	0.10	0.10	0.09	0.08	0.08	0.07	0.08	0.09	0.10	
Change (YoY, %)	-1.6	4.2	2.8	-8.1	0.9	5.5	11.5	17.7	20.5	
Reserves										
Guarantee loss reserves (EOP)	6,691	6,453	5,905	5,601	5,954	6,531	7,793	9,144	10,572	
Guarantee loss reserves / Guarantee exposure (%)	0.06	0.05	0.04	0.04	0.04	0.04	0.05	0.05	0.06	
Guarantee loss reserves / Delinquent loan amount (%)	27.9	26.8	21.9	20.6	20.7	21.4	21.7	21.1	23.1	
Loan loss reserves (EOP)	5,737	6,302	7,533	8,963	9,211	9,716	10,832	12,743	15,359	
Loan loss reserves / Reimbursement claim rights (%)	49.7	51.4	55.2	54.0	55.0	55.0	55.0	55.0	55.0	
Credit costs										
Total credit costs	2,374	2,727	2,732	2,936	3,478	3,785	5,240	6,702	8,178	
Provision for guarantee loss reserves	3,090	3,034	2,547	2,705	3,230	3,480	4,324	5,290	6,062	
Provision for loan loss reserves	-716	-307	185	230	248	305	916	1,412	2,116	
vs. guarantee exposure (bp)	2.1	2.2	2.1	2.1	2.3	2.4	3.1	3.8	4.4	

Source: Company data, Mita Securities

Figure: Mita Securities' earnings forecast (non-consolidated, BS, JPYm)

JPYm	3/18	3/19	3/20	3/21	3/22	3/23	3/24	3/25	3/26	5y growth
	A	A	A	MitaE	MitaE	MitaE	MitaE	MitaE	MitaE	(CAGR)
(Assets)										
Total current assets	206,161	188,741	204,500	196,235	215,105	234,492	256,012	261,006	281,434	7.5
Cash and deposits	184,518	175,742	191,595	175,703	186,770	199,761	211,871	210,233	220,968	
Reimbursement claim rights	11,536	12,266	13,652	16,599	16,748	17,665	19,694	23,170	27,926	
Securities	6,921	6,334	5,731	9,175	9,752	10,431	11,063	10,978	11,538	
Money held in trust	5,023	0	0	0	0	0	0	0	0	
Other	3,900	701	1,055	3,722	11,046	16,351	24,215	29,369	36,361	
Loan loss reserves	-5,737	-6,302	-7,533	-8,963	-9,211	-9,716	-10,832	-12,743	-15,359	
Total fixed assets	87,976	132,490	168,468	200,069	212,075	226,667	239,799	238,093	250,237	4.6
Tangible fixed assets	194	235	275	287	306	328	347	365	383	
Intangible fixed assets	395	583	657	686	731	783	828	872	914	
Investments and other assets	87,385	131,671	167,535	199,096	211,038	225,556	238,624	236,856	248,940	
Total assets	294,137	321,232	372,968	396,305	427,180	461,160	495,811	499,099	531,671	6.1
(Liabilities)										
Total current liabilities	29,351	30,406	29,910	30,514	32,381	34,736	37,536	40,317	43,293	7.2
Unearned revenue	15,578	16,264	16,687	16,997	17,999	19,194	20,440	21,631	22,788	
Guarantee loss reserves	6,691	6,453	5,905	5,601	5,954	6,531	7,793	9,144	10,572	
Other	7,082	7,689	7,318	7,916	8,428	9,011	9,303	9,541	9,933	
Total long-term liabilities	156,658	163,826	198,008	201,929	212,092	224,171	236,774	218,814	230,510	2.7
Long-term borrowings	0	0	30,000	30,000	30,000	30,000	30,000	0	0	
Long-term unearned revenue	156,597	163,767	167,944	171,854	181,992	194,071	206,674	218,714	230,410	
Other	61	59	64	75	100	100	100	100	100	
Total liabilities	186,010	194,233	227,919	232,443	244,473	258,907	274,310	259,130	273,802	3.3
(Net assets)										
Total net assets	108,127	126,998	145,049	163,862	182,707	202,253	221,501	239,969	257,869	9.5
Shareholders' equity	108,002	126,880	144,901	163,684	182,529	202,075	221,323	239,791	257,691	9.5
Warrants	124	117	148	178	178	178	178	178	178	
Total liabilities and net assets	294,137	321,232	372,968	396,305	427,180	461,160	495,811	499,099	531,671	6.1

Source: Company data, Mita Securities

Figure: Mita Securities' earnings forecast (non-consolidated, CF, JPYm)

JPYm	3/18	3/19	3/20	3/21	3/22	3/23	3/24	3/25	3/26	5y growth
	A	A	A	MitaE	MitaE	MitaE	MitaE	MitaE	MitaE	(CAGR)
Cashflow from operations	34,911	32,812	29,778	27,042	33,219	39,120	38,024	40,316	39,077	
Net profit	22,052	24,134	24,430	26,419	28,127	30,071	31,045	31,842	33,148	
Depreciation	212	230	280	292	312	334	353	372	390	
Increase / (decrease) in unearned revenue (ST+LT)	12,078	7,856	4,600	4,220	11,140	13,274	13,849	13,231	12,853	
Other	569	592	468	-3,889	-6,360	-4,558	-7,223	-5,128	-7,313	
Cashflow from investing	-29,176	-34,182	2,714	-23,726	-20,949	-25,087	-22,958	2,615	-20,930	
Sale / (purchase) of tangilbe and intangible fixed assets	-244	-423	-408	-333	-376	-408	-417	-434	-448	
Inflows / (outflows) from term deposits	-14,200	-2,100	39,900	15,322	-9,041	-10,613	-9,893	1,338	-8,770	
Sale and redemption / (purchase) of investment securities	-19,572	-40,559	-34,925	-35,617	-10,980	-12,888	-12,015	1,625	-10,651	
Other	4,840	8,900	-1,853	-3,099	-553	-1,178	-632	86	-1,061	
Cashflow from financing	-4,269	-5,505	23,260	-6,542	-7,636	-9,282	-10,525	-41,797	-13,374	
Dividends paid	-4,268	-5,508	-5,992	-6,542	-7,636	-9,282	-10,525	-11,797	-13,374	
Share capital issuance / (buy-back)	0	3	0	0	0	0	0	0	0	
Debt issuance / (redemption)	0	0	29,250	0	0	0	0	-30,000	0	
Other	-1	0	2	0	0	0	0	0	0	
Cash and cash equivalents at end of period	77,868	70,992	126,745	123,518	128,152	132,903	137,445	138,579	143,353	

Source: Company data, Mita Securities

APPENDIX

[Analyst Certification]
We hereby certify that the views on securities and issuers expressed in this report accurately reflect the personal views of the analyst(s) listed on the cover page of this report. The analyst(s) also certifies that the analyst(s) has not been compensated, directly or indirectly, or promised to be compensated, for expressing any particular view in this report.

[Ratings]
Ratings are based on the following definitions.
The target price and ratings are based on our views for the next 12 months or so.
Buy: 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 more.
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.
RS: Rating Suspended - Stocks for which the target price and rating have been temporarily suspended.
NR: No Rating - Stocks for which no target price or rating is assigned.

[Potential Conflicts of Interest]
Mita Securities Co., Ltd. and its affiliates have or may in the future have transactions with the companies mentioned in this report, such as providing investment banking services to them. Therefore, investors viewing this report should be aware that Mita Securities Co., Ltd. and its affiliates may have conflicts of interest that could affect the objectivity of this report. Mita Securities Co., Ltd. may in the future hold or trade shares of the stocks listed in this report. Mita Securities Co., Ltd. may also take positions to sell or buy in a manner that conflicts or is inconsistent with the investment decisions and views expressed in this report. Please refer to this report only as one factor for reference in making investment decisions.

[Important Disclosures]
1. Mita Securities Co., Ltd. has a parent company, subsidiary, affiliated company or related company relationship with the company covered by this report: N/A
2. An officer of Mita Securities Co., Ltd. is concurrently an officer of the company covered by this report: N/A
3. Mita Securities Co., Ltd. owns 5% or more of the total number of issued common shares, etc. of the company covered by this report (as of the end of the previous month): N/A
4. Mita Securities Co., Ltd. has acted as lead manager or joint lead manager for the public offering of securities of the company covered by this report in the past 12 months: N/A
5. The analyst(s) listed on the cover of this report is a director or advisor of the company covered by this report: N/A
6. Any family member of the analyst(s) listed on the cover of this report is a director or an advisor of the company covered by this report: N/A
7. The analyst(s) listed on the cover of this report or their family members hold securities (common stock, corporate bonds, convertible bonds, etc.) of the company covered by this report: N/A

[Disclaimer for the English version of the report]
The Japanese version of this report is the official version, and the English version is a translation of the Japanese version. In the event of any discrepancy between the Japanese and English versions, the Japanese version shall always take precedence. Mita Securities Co., Ltd. makes no guarantee as to the accuracy and completeness of the content of the English version of this report.

[Important notes concerning the Financial Instruments and Exchange Act]
When conducting transactions in accordance with the contents of this report, the customer may be required to bear the prescribed fees and expenses for each service or product. In addition, there is a possibility that each service or product may incur losses due to price fluctuations, etc. Since each service or product has different fees, etc. and risks, please read carefully the documents for listed securities, etc., pre-contract documents for the relevant service or product, etc., or materials for customers.

Company Name
Mita Securities Co., Ltd. / Financial Instruments Business Operator, Director-General of the Kanto Local Finance Bureau (Kinsho) No. 175
Memberships
Japan Securities Dealers Association