



Koshidaka Holdings

TSE 1st Section 2157

Industry: Leisure and amusement

Turning a pinch into an opportunity; initiating coverage with a Buy rating

Initiating coverage with a target price of 650 yen and a Buy rating

We initiate coverage of Koshidaka Holdings Co., Ltd. (2157, Koshidaka HD, the company) with a target price of 650 yen and a Buy rating. In the wake of the COVID-19 pandemic, karaoke companies have been requested to close their stores or shorten operating hours, and we expect the company to post operating losses in the FY8/21-FY8/22 period. However, we believe that the impact on the company's balance sheet will be minimal and that the company will be in a position to continue aggressive investment with an eye to the post-COVID-19 era. The company sees the retreat of izakaya (Japanese-style pubs) and competitors' karaoke stores as an opportunity to open new stores in locations where rents were previously too high for its criteria for new store opening. In addition, the company has not changed its stance of aggressively pursuing M&A and new businesses from a long-term perspective. In our view, the company will be able to increase its competitive advantage in the karaoke room market over the medium to long term.

Demand for karaoke is strong. Progress in vaccination is the key to recovery in supply

Every time the number of new infections increased, the government asked karaoke companies to close their stores or shorten operating hours. In particular, restrictions on nighttime hours, when the majority of sales are generated, have prevented the company from improving its earnings. On the other hand, when the requirement for shorter hours was eased in the fall of last year, we saw a large number of customers returning to the karaoke stores, which confirms that there is a strong latent demand for karaoke as a form of entertainment. We believe that progress in vaccination will be the key to recovery on the supply side. Although there are many unknowns about the vaccination schedule, we believe that if the vaccination actually goes ahead, the operating hours of karaoke stores will start to normalize, resulting in recovery of the company's earnings.

Mita Securities' earnings forecast

We forecast OP of -5.5bn yen in FY8/21 (1.1bn yen in FY8/20) and -1.3bn yen in FY8/22, as we are not confident about the vaccination schedule in the near future. Nevertheless, we expect the company to return to profitability in FY8/23 (our OP forecast: 1.5bn yen) due to the normalization of operating hours at karaoke stores starting in around 4Q FY8/22. We expect the company to recover to pre-COVID-19 profitability in FY8/24-FY8/25.

Valuations and risk factors

In calculating our target price, we used a residual income model (RIM) with a cost of equity of 6.0% and a terminal growth rate of 1.2%, based on our earnings forecasts for FY8/21-FY8/26. Our target price is equivalent to 32.4x our FY8/23 EPS forecast of 20.07 yen and 17.3x our FY8/24 EPS forecast of 37.59 yen.

Risk factors to our view include 1) prolonged requests for store closures and expansion of target areas due to the significant increase in the number of new infections, 2) significant delays in vaccination schedules, and 3) failures in large M&A.

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

Initiation of coverage

Rating Buy

| | |
|---------------------------|------|
| Target price (JPY) | 650 |
| Stock price (JPY) (May 6) | 562 |
| Market cap (JPYbn) | 46.3 |

Key changes

| | |
|-------------------|-----|
| Rating | New |
| Target price | New |
| Earnings forecast | New |

Stock price (JPY)



Source: Bloomberg Finance LP

Earnings

| | | 8/19 | 8/20 | 8/21E | 8/22E | 8/23E |
|------------|-------|-------|-------|-------|-------|-------|
| Sales | JPYbn | 65.8 | 43.3 | 23.5 | 29.7 | 38.8 |
| OP | JPYbn | 9.5 | 1.1 | -5.5 | -1.3 | 1.5 |
| RP | JPYbn | 9.6 | 1.7 | -3.1 | -0.5 | 1.8 |
| NP | JPYbn | 6.2 | -0.2 | -3.1 | -1.0 | 1.6 |
| EPS | JPY | 76.6 | -2.8 | -37.9 | -12.8 | 20.1 |
| BPS | JPY | 391.2 | 281.0 | 231.0 | 214.2 | 230.2 |
| DPS | JPY | 12.0 | 12.0 | 4.0 | 4.0 | 6.0 |
| PER | x | 23.1 | NA | NA | NA | 28.0 |
| PBR | x | 4.5 | 1.6 | 2.4 | 2.6 | 2.4 |
| Div. yield | % | 0.7 | 2.6 | 0.7 | 0.7 | 1.1 |
| ROA | % | 8.9 | -0.4 | -7.0 | -2.4 | 3.6 |
| ROE | % | 21.7 | -0.8 | -14.8 | -5.8 | 9.0 |

Source: Company data, Mita Securities

Company profile

Koshidaka HD is a major karaoke room operator that operates "Karaoke Manekineko" stores nationwide. The total number of stores as of the end of February 2021 was 546. In March 2020, it spun off the Curves business and is concentrating its management resources on the karaoke business.

Investment thesis

Outlook

Expanding possible locations for new stores. Turning a pinch into an opportunity

We initiate coverage of Koshidaka Holdings Co., Ltd. (2157, Koshidaka HD, the company) with a target price of 650 yen and a Buy rating.

The company operates karaoke rooms nationwide under the brand "Karaoke Manekineko." It has the third largest market share in the industry. The total number of stores is 546 (end-2Q FY8/21). The company has achieved growth by differentiating itself in the matured karaoke market based on its policy of "new business models in existing industries." Originally, the company was strong in roadside stores in rural areas, and in recent years it has been aggressively opening stores in downtown areas in front of railway stations, resulting in a net increase of over 100 stores over the past five years. Before the COVID-19 pandemic, the karaoke business segment's OP was 4.5bn yen in FY8/19, with a five-year CAGR of 23.4%.

Since 3Q FY8/20, the company's earnings have been strongly affected by the COVID-19 pandemic. In particular, when the first emergency was declared in 3Q FY8/20, all stores were closed for a period of time, and the company fell into a significant loss. Thereafter, sales gradually recovered, but in 2Q FY8/21, when the second emergency was declared, the number of stores with shortened hours increased and the rate of sales decline and operating loss widened. Currently, stores in Tokyo and other areas are closed due to the third emergency declaration, and the operating loss is expected to increase further. We forecast OP of -5.5bn yen and NP of -3.1bn yen for FY8/21.

However, the company continues to be aggressive in opening new stores, even in the face of the COVID-19 pandemic. The company sees the closing of izakaya (Japanese-style pubs) and competitors' karaoke stores as an opportunity to open new stores in locations where rents were previously too high for its criteria for new store opening. In addition, the company has been maintaining aggressive stance for M&A, and in April 2021, it acquired the karaoke business of Daisyo (9979), a major operator of izakaya, with 43 stores. The company has the know-how to open new stores at low cost, and we are not concerned about excessive investment leading to deterioration of its balance sheet. Although the company's OP has been in the red for some time, the subsidies by the local governments should provide some financial relief.

Vaccinations are expected to be promoted in Japan in the near future, and the business hours of karaoke stores are expected to gradually normalize. According to the government's announcement, the distribution of vaccines for the elderly (65 and over) is planned to be completed by the end of June. However, we are not sure when the vaccinations for the general public will start, and we assume that the company will post an operating loss of -1.3bn yen for FY8/22. That said, we expect the karaoke stores' operating hours will start to normalize in around 4Q FY8/22, and that the company will return to profitability in FY8/23. We expect the company to recover to pre-COVID-19 profitability in FY8/24-FY8/25.

Catalysts

The catalysts we envision for an upturn in the stock price include significant decrease in the number of new infections, progress in normalizing operating hours of karaoke stores, progress in vaccination schedule, new M&A, and early profitability of new businesses.

Initiating coverage with a TP of 650 yen and a Buy

Differentiation is the engine of growth

Significant revenue reduction and loss continue due to requests for closure and shorter hours

Continues aggressive stance in new store openings. Retreat of izakaya and competitors' karaoke stores is an opportunity to expand its store network

As vaccination progresses, operating hours of karaoke stores should start to normalize

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

| JPYm | 8/18 | 8/19 | 8/20 | 8/21 | 8/22 | 8/23 | 8/24 | 8/25 | 8/21 | 8/21 | 8/22 | 8/23 |
|---------------------------------------|---------|--------|--------|--------|--------|--------|--------|--------|------|-----------|-----------|-----------|
| | A | A | A | Mita E | Mita E | Mita E | Mita E | Mita E | CoE | Consensus | Consensus | Consensus |
| Earnings | | | | | | | | | | | | |
| Sales | 61,771 | 65,840 | 43,304 | 23,510 | 29,724 | 38,827 | 41,294 | 44,811 | NA | 36,300 | 36,950 | 37,700 |
| (YoY, %) | 11.7 | 6.6 | -34.2 | -45.7 | 26.4 | 30.6 | 6.4 | 8.5 | | | | |
| Operating profit | 7,858 | 9,508 | 1,148 | -5,531 | -1,304 | 1,530 | 2,958 | 4,674 | NA | 1,700 | 1,800 | 2,000 |
| (YoY, %) | 27.8 | 21.0 | -87.9 | NA | NA | NA | 93.4 | 58.0 | | | | |
| OPM (%) | 12.7 | 14.4 | 2.7 | -23.5 | -4.4 | 3.9 | 7.2 | 10.4 | | | | |
| Recurring profit | 8,208 | 9,562 | 1,700 | -3,116 | -496 | 1,837 | 3,165 | 4,881 | NA | 1,700 | 1,800 | 2,000 |
| (YoY, %) | 29.2 | 16.5 | -82.2 | NA | NA | NA | 72.3 | 54.2 | | | | |
| Net profit | 4,427 | 6,227 | -232 | -3,091 | -1,047 | 1,637 | 3,065 | 3,346 | NA | 870 | 1,010 | 1,150 |
| (YoY, %) | 36.0 | 40.7 | NA | NA | NA | NA | 87.3 | 9.2 | | | | |
| Depreciation | 3,582 | 4,096 | 4,493 | 4,540 | 4,555 | 4,572 | 4,595 | 4,617 | | | | |
| Capital expenditure | 4,822 | 8,049 | 5,983 | 5,500 | 5,000 | 5,000 | 5,500 | 6,000 | | | | |
| Free CF | -15,079 | 3,845 | -4,746 | -5,906 | -1,464 | 2,133 | 2,304 | 2,367 | | | | |
| Segment earnings | | | | | | | | | | | | |
| Karaoke business | | | | | | | | | | | | |
| Sales | 31,936 | 35,732 | 27,157 | 21,828 | 27,928 | 36,905 | 39,180 | 42,486 | | | | |
| (YoY, %) | 7.8 | 11.9 | -24.0 | -19.6 | 27.9 | 32.1 | 6.2 | 8.4 | | | | |
| Operating profit | 3,153 | 4,519 | -839 | -4,502 | -559 | 2,214 | 3,605 | 5,311 | | | | |
| OPM (%) | 9.9 | 12.6 | -3.1 | -20.6 | -2.0 | 6.0 | 9.2 | 12.5 | | | | |
| Curves business | | | | | | | | | | | | |
| Sales | 27,933 | 28,037 | 14,302 | | | | | | | | | |
| (YoY, %) | 17.8 | 0.4 | NA | | | | | | | | | |
| Operating profit | 5,345 | 5,679 | 3,006 | | | | | | | | | |
| OPM (%) | 19.1 | 20.3 | 21.0 | | | | | | | | | |
| Bath house business | | | | | | | | | | | | |
| Sales | 1,587 | 1,640 | 1,207 | 1,045 | 1,098 | 1,152 | 1,268 | 1,394 | | | | |
| (YoY, %) | -3.0 | 3.3 | -26.4 | -13.4 | 5.0 | 5.0 | 10.0 | 10.0 | | | | |
| Operating profit | 72 | 109 | -70 | -121 | -88 | -46 | 27 | 59 | | | | |
| OPM (%) | 4.5 | 6.6 | -5.8 | -11.6 | -8.0 | -4.0 | 2.1 | 4.2 | | | | |
| Real estate management business | | | | | | | | | | | | |
| Sales | 314 | 432 | 637 | 636 | 699 | 769 | 846 | 931 | | | | |
| (YoY, %) | 0.5 | 37.6 | 47.7 | -0.2 | 10.0 | 10.0 | 10.0 | 10.0 | | | | |
| Operating profit | 134 | 59 | -78 | -208 | 42 | 62 | 77 | 104 | | | | |
| OPM (%) | 42.6 | 13.8 | -12.2 | -32.7 | 6.0 | 8.0 | 9.1 | 11.2 | | | | |
| Per share indicators | | | | | | | | | | | | |
| EPS (JPY) | 54.44 | 76.57 | -2.84 | -37.91 | -12.84 | 20.07 | 37.59 | 41.04 | NA | 10.67 | 12.39 | 14.10 |
| BPS (JPY) | 315.51 | 391.24 | 281.01 | 230.99 | 214.15 | 230.23 | 261.82 | 296.86 | | | | |
| DPS (JPY) | 25.00 | 12.00 | 12.00 | 4.00 | 4.00 | 6.00 | 6.00 | 8.00 | NA | | | |
| Valuation, profitability, etc. | | | | | | | | | | | | |
| PER (x) | 21.5 | 23.1 | NA | NA | NA | 28.0 | 14.9 | 13.7 | | | | |
| PBR (x) | 3.7 | 4.5 | 1.6 | 2.4 | 2.6 | 2.4 | 2.1 | 1.9 | | | | |
| Dividend payout ratio (%) | 18.6 | 15.9 | NA | NA | NA | 29.9 | 16.0 | 19.5 | | | | |
| Dividend yield (%) | 2.1 | 0.7 | 2.6 | 0.7 | 0.7 | 1.1 | 1.1 | 1.4 | | | | |
| ROA (%) | 7.9 | 8.9 | -0.4 | -7.0 | -2.4 | 3.6 | 6.3 | 6.5 | | | | |
| ROE (%) | 18.7 | 21.7 | -0.8 | -14.8 | -5.8 | 9.0 | 15.3 | 14.7 | | | | |
| Financial soundness indicators | | | | | | | | | | | | |
| Capital ratio (%) | 37.5 | 44.1 | 51.4 | 42.6 | 39.4 | 39.9 | 42.7 | 45.3 | | | | |
| Debt/Equity (x) | 0.9 | 0.7 | 0.6 | 1.0 | 1.1 | 1.0 | 0.9 | 0.8 | | | | |

Source: Company data, QUICK, Mita Securities

Note: Consensus forecasts are by QUICK consensus

Valuations

Stock valuation based on the residual income model (RIM)

In calculating our target price, we used a residual income model (RIM) with a cost of equity of 6.0% and a terminal growth rate of 1.2%, based on our earnings forecasts for FY8/21-FY8/26. Our target price is equivalent to 32.4x our FY8/23 EPS forecast of 20.07 yen and 17.3x our FY8/24 EPS forecast of 37.59 yen.

TP of 650 yen based on RIM

Figure: Residual Income Model (RIM)

| | Y0 | Y1 | Y2 | Y3 | Y4 | Y5 | Y6~ |
|----------------------------|------|-------|-------|-------|-------|-------|-------|
| | A | MitaE | MitaE | MitaE | MitaE | MitaE | MitaE |
| JPYbn | 8/20 | 8/21 | 8/22 | 8/23 | 8/24 | 8/25 | 8/26 |
| Shareholders' equity (EOP) | 22.9 | 18.8 | 17.5 | 18.8 | 21.3 | 24.2 | |
| Net profit | | -3.1 | -1.0 | 1.6 | 3.1 | 3.3 | |
| Cost of equity | | 1.4 | 1.1 | 1.0 | 1.1 | 1.3 | |
| Residual income | | -4.5 | -2.2 | 0.6 | 1.9 | 2.1 | |
| PV of residual income | | -4.2 | -1.9 | 0.5 | 1.5 | 1.5 | |
| PV of terminal value | | | | | | | 32.5 |

| | | | | | | | |
|--------------------------|------|--|--|--|--|------------|--|
| Beta | 1.10 | | | | | | |
| Risk free rate (%) | 0.50 | | | | | | |
| Risk premium (%) | 5.00 | | | | | | |
| Cost of equity (%) | 6.00 | | | | | | |
| Terminal growth rate (%) | 1.20 | | | | | | |
| Total equity value | | | | | | 52.9 | |
| Number of shares O/S (m) | | | | | | 81.533 | |
| Target share price | | | | | | 650 | |

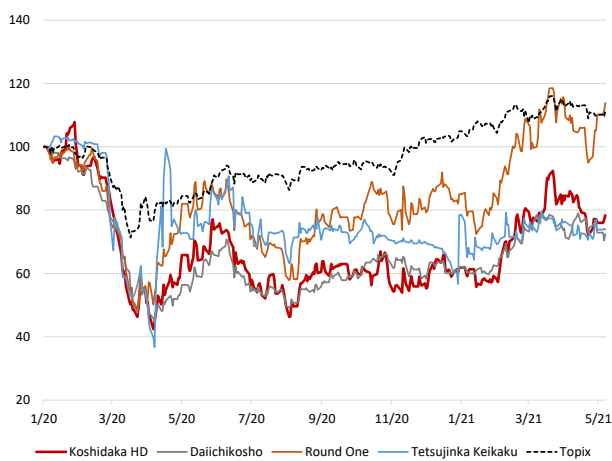
Source: Company data, Mita Securities

Figure: Sensitivity of target price to terminal growth rate

| Terminal growth rate | 0.20 | 0.40 | 0.60 | 0.80 | 1.00 | 1.20 | 1.40 | 1.60 | 1.80 | 2.00 |
|----------------------|------|------|------|------|------|------------|------|------|------|------|
| Target price | 580 | 590 | 600 | 620 | 630 | 650 | 670 | 690 | 710 | 730 |

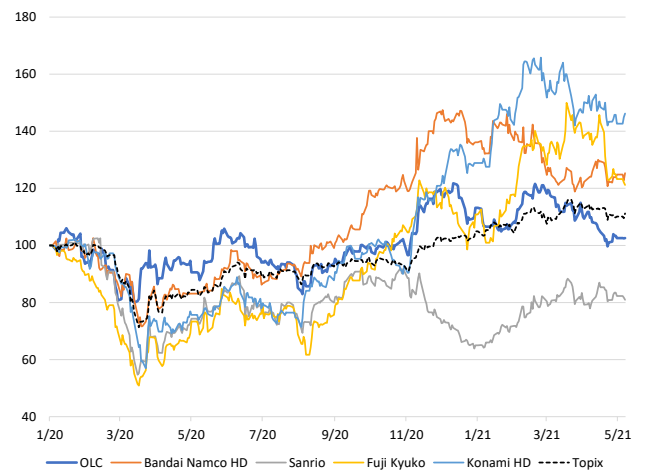
Source: Mita Securities

Figure: Stock price trends for karaoke companies



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

Figure: Stock price trends for amusement companies (reference)



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

Figure: Comparison of valuations for karaoke companies

| Company | Ticker | Share price 6-May | 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 |
|---------------------------|--------|----------------------|------------------|-------------|------------|------------------|---------------|-------------|---------------------|--------------------|------------|---------------------|-------------------|------------------------|--------------|--------------|---------------|
| KOSHIDAKA HOLDINGS CO LTD | 2157 | 562 | 46.3 | NA | NA | NA | NA | 2.2 | NA | NA | -19.1 | -68.1 | -18.3 | NA | -7.9 | 12.2 | 28.9 |
| TETSUJIN INC | 2404 | 271 | 3.7 | NA | NA | NA | NA | 115.1 | NA | NA | -832.4 | -42.5 | -47.0 | NA | -1.8 | 3.0 | 4.2 |
| ROUND ONE CORP | 4680 | 1,234 | 117.8 | 24.5 | NA | NA | 31.3 | 2.7 | 7.6 | 1.6 | -29.1 | -36.2 | -4.8 | 1.6 | 4.2 | 21.3 | 46.6 |
| DAIICHIKOSHO CO LTD | 7458 | 4,185 | 239.5 | 18.9 | NA | NA | 49.2 | 1.9 | 11.1 | 1.8 | -1.8 | -28.5 | 18.1 | 2.7 | -2.8 | 6.2 | 33.5 |
| Average | | | | 21.7 | NA | NA | 40.3 | 30.5 | 9.4 | 1.7 | -220.6 | -43.8 | -13.0 | 2.2 | -2.1 | 10.7 | 28.3 |

Source: Bloomberg Finance LP data, Mita Securities

Note: Forecasts are based on Bloomberg consensus

Figure: Comparison of valuations for amusement companies (reference)

| Company | Ticker | Share price 6-May | 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 |
|---------------------------|--------|----------------------|------------------|-------------|------------|------------------|---------------|-------------|---------------------|--------------------|------------|---------------------|-------------------|------------------------|--------------|--------------|---------------|
| ORIENTAL LAND CO LTD | 4661 | 15,485 | 5,631.7 | NA | NA | 109.2 | 52.8 | 6.7 | 29.6 | 10.6 | -6.9 | -63.3 | 2.1 | 0.2 | -6.7 | -10.4 | 16.8 |
| BANDAI NAMCO HOLDINGS INC | 7832 | 8,190 | 1,818.2 | 31.2 | 32.5 | 36.8 | 23.7 | 3.7 | 12.4 | 2.1 | 11.8 | -0.2 | 13.7 | 1.3 | 1.0 | -7.9 | 50.0 |
| SANRIO CO LTD | 8136 | 1,753 | 156.1 | 775.7 | NA | NA | 165.0 | 3.9 | 41.7 | 3.3 | -8.6 | -26.1 | -5.9 | 0.0 | 1.8 | 3.0 | 11.7 |
| FUJI KYUKO CO LTD | 9010 | 5,180 | 284.3 | 173.9 | NA | NA | 104.3 | 11.2 | NA | 7.1 | -11.6 | -39.1 | 13.8 | 0.1 | -12.9 | -9.6 | 76.3 |
| KONAMI HOLDINGS CORP | 9766 | 6,580 | 944.2 | 44.7 | 28.7 | 29.3 | 20.9 | 3.0 | 9.7 | 2.9 | 10.9 | -0.5 | 25.1 | 1.0 | -0.8 | -5.7 | 95.8 |
| Average | | | | 256.4 | 30.6 | 58.4 | 73.4 | 5.7 | 23.3 | 5.2 | -0.9 | -25.8 | 9.8 | 0.5 | -3.5 | -6.1 | 50.1 |

Source: Bloomberg Finance LP data, Mita Securities

Note: Forecasts are based on Bloomberg consensus

Risk factors

Risk factors to our view include 1) prolonged requests for store closures and expansion of target areas due to the significant increase in the number of new infections, 2) significant delays in vaccination schedules, and 3) failures in large M&A.

Company overview

Company and business overview

Overview of Koshidaka HD

Koshidaka HD is engaged in the karaoke business, the bath house business, and the real estate management business. The main format of the karaoke business, which accounts for the majority of sales, is “Karaoke Manekineko,” with 516 stores in 43 prefectures nationwide as of the end of 2Q FY8/21 (end of February 2021). In addition, the company has six “1 Kara” solo karaoke stores in the domestic market. In Japan, the company is the third largest karaoke room operator after Daiichikoshō (7458, operator of “Big Echo”) and B&V (operator of “Karaoke Kan”).

The company has expanded overseas, with 5 stores in Singapore, 5 stores in South Korea, 6 stores in Malaysia, 1 store in Thailand, and 1 store in Indonesia (only Singapore and South Korea are consolidated; the company has already announced its withdrawal from Singapore).

The total number of stores, including non-karaoke stores (such as Karaage no Tensai), was 546 (excluding unconsolidated overseas stores).

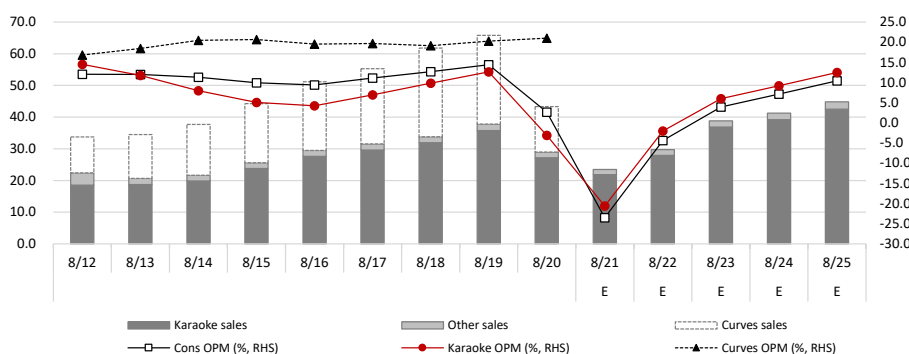
In the bath house business, the company operates five natural hot spring facilities in Tokyo, Gunma, Fukushima, and Oita. In the real estate management business, the company manages real estate owned by the Group, and one of its representative properties is “AQERU Maebashi” in front of Maebashi Station.

The Curves business, which operates fitness clubs for women, was completely spun off as of March 1, 2020. The Curves business was consolidated until 2Q FY8/20 with a significant contribution to the earnings, so it is important to keep this in mind when evaluating the company's past results.

Operating over 500 karaoke “Manekineko” stores nationwide. The third largest share of the karaoke room industry

Completely separated the Curves business

Figure: Sales, OPM



Source: Company data, Mita Securities

Note: JPYbn. Forecasts are by Mita Securities

Latest financial results

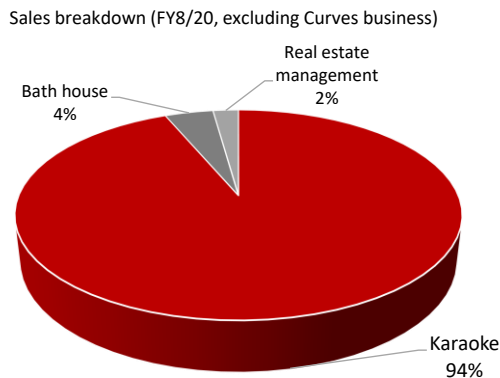
Consolidated sales for FY8/20 were 43.3bn yen (-34.2% YoY), OP was 1.1bn yen (-87.9% YoY), and NP was -0.2bn yen (6.2bn yen in FY8/19). The main reasons for the large YoY decline in OP were: 1) the adverse impact of the COVID-19 pandemic in 2H (Mar-Aug), and 2) the exclusion of the Curves business from consolidated results from 3Q. The karaoke business segment fell into the red with sales of 27.2bn yen (-24.0% YoY) and OP of -0.8bn yen (4.5bn yen in the previous year).

Operating loss has been continuing since 3Q FY8/20 due to the impact of the COVID-19 pandemic

Consolidated sales for 1H FY8/21 were 12.1bn yen (-64.3% YoY), OP was -2.6bn yen (4.9bn yen profit in 1H FY8/20), and NP was -1.7 bn yen (3.4 bn yen profit in 1H FY8/20). As mentioned above, the Curves business was consolidated in 1H FY8/20. Karaoke business segment sales for 1H FY8/21 were 11.3bn yen (-39.0% YoY) and OP was -2.1bn yen (2.3bn yen profit in 1H FY8/20).

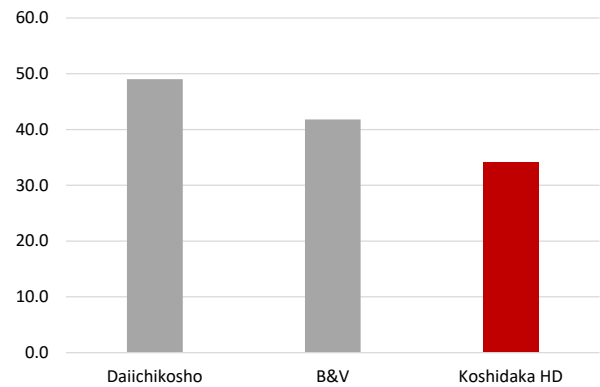
On a quarterly basis, both the consolidated and karaoke business segment results have been in the red for four consecutive quarters since 3Q FY8/20 (Mar-May 20).

Figure: Sales breakdown (FY8/20)



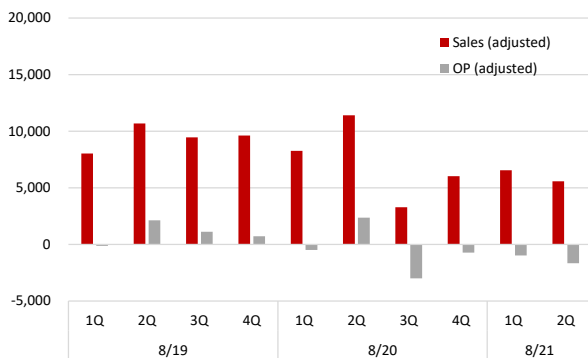
Source: Company data, Mita Securities Note: Excludes sales for Curves business

Figure: Sales of the three major karaoke room companies



Source: Companies data, Mita Securities Note: JPYbn. FY3/19 for Daiichikoshoh and B&V, FY8/19 for Koshidaka. Room business for Daiichikoshoh, domestic karaoke business for Koshidaka

Figure: Quarterly earnings (excluding the Curves business)



Source : Company data, Mita Securities Note: JPYm

Figure: Signboard of Manekineko (Shinjuku Nishi-guchi Store)



Source: Company data

Group companies

Koshidaka HD is a pure holding company, and each business is operated by a subsidiary. The domestic karaoke and bath house businesses are operated by Koshidaka Co., Ltd., the real estate business by Koshidaka Products Co., Ltd., and the overseas karaoke businesses by the subsidiaries in the respective countries (only Singapore and South Korea are consolidated). The company has already announced its withdrawal from Singapore, and KOSHIDAKA SINGAPORE PTE. LTD. will be dissolved.

Figure: Main subsidiaries

| Subsidiary name | Shares held (%) | Location | Overview |
|--------------------------------------|-----------------|-------------|--|
| KOSHIDAKA Co., Ltd. | 100.0 | Gunma | Karaoke and bath house businesses |
| KOSHIDAKA Products Co., Ltd. | 100.0 | Tokyo | Real estate business |
| KOSHIDAKA Business Support Co., Ltd. | 100.0 | Tokyo | Group administration |
| KOSHIDAKA KOREA Co., Ltd. | 100.0 | South Korea | Karaoke business in South Korea |
| KOSHIDAKA INTERNATIONAL PTE. LTD. | 100.0 | Singapore | Intermediate holding company overseeing karaoke business in Southeast Asia |
| KOSHIDAKA SINGAPORE PTE. LTD. | 100.0 | Singapore | Karaoke business in Singapore |

Source: Company data, Mita Securities

Company history

The predecessor of Koshidaka HD was a Chinese restaurant in Maebashi, Gunma Prefecture, which operated ramen stores under the name "Joshu Ramen." In 1990 the company entered the karaoke business, and in 1993 it opened its first "Karaoke Manekineko" store in Maebashi City. The company began opening multiple stores using the "inuki" method (opening new stores utilizing the old tenant's facilities), opening its 100th store in 2004 and its 500th store in 2017.

In 2007, the company was listed on the JASDAQ Securities Exchange. The company was listed on the Osaka Securities Exchange JASDAQ market in 2010 and on the Tokyo Stock Exchange JASDAQ (Standard) in 2013, and was listed on the First Section of the Tokyo Stock Exchange in 2016.

In 2008, the company acquired Curves Japan which had the exclusive rights to operate the Curves business in Japan, and in 2018 it acquired Curves International Holdings, the global franchisor of the Curves business. In March 2020, the company completely separated the Curves business through a stock-distribution spin-off, in order to promote corporate values of both the karaoke and the Curves businesses.

The company grew from a ramen store in Gunma to a nationwide karaoke company. The Curves business was spun off, and the business structure became centered on karaoke again

Figure: History

| Date | Events |
|--------|--|
| Mar-67 | Established Shinseiken, a Chinese restaurant in Maebashi, Gunma Prefecture (now Koshidaka Holdings Co., Ltd.). Expanded the chain under the name "Joshu Ramen". |
| Aug-90 | Started operation of karaoke stores. |
| Dec-93 | Opened the first "Karaoke Manekineko" store in Maebashi City. |
| Aug-95 | Hiroshi Koshidaka was appointed as the President and Representative Director. |
| Mar-00 | Company name and organization changed to Koshidaka Co., Ltd. |
| Oct-04 | Opened the 100th "Karaoke Manekineko" store. |
| Mar-06 | Opened the first Curves store as a franchisee in Sapporo, Hokkaido. |
| Jun-07 | Listed on the JASDAQ stock exchange. |
| Oct-08 | Acquired shares of Curves Japan Co, Ltd. |
| Apr-10 | Listed on the JASDAQ market of the Osaka Securities Exchange following the merger of the JASDAQ Securities Exchange and the Osaka Securities Exchange |
| Sep-10 | Company name and organization changed to Koshidaka Holdings Co., Ltd. |
| Jun-11 | Opened the first "Karaoke Manekineko" overseas store in Seoul, South Korea. |
| Nov-11 | Opened the first "1 Kara" solo karaoke store in Chiyoda-ku, Tokyo. |
| Jul-13 | Listed on the Tokyo Stock Exchange JASDAQ (Standard) following the merger of the Tokyo Stock Exchange and the Osaka Securities Exchange. |
| Feb-14 | Acquired the shares of K BOX ENTERTAINMENT GROUP PTE. LTD. and made it a subsidiary (changed the company name to KOSHIDAKA SINGAPORE PTE. LTD.). Started operation of karaoke stores in Singapore. |
| Apr-15 | Acquired the shares of Moon Co., Ltd. which operates karaoke facilities mainly in Kanagawa Prefecture. Merged with Koshidaka Co., Ltd. |
| Nov-16 | Changed its market to the First Section of the Tokyo Stock Exchange. |
| Jul-17 | Opened the 500th "Karaoke Manekineko" store. |
| Mar-18 | Acquired shares of Curves International Holdings, Inc. (global franchiser of Curves business) |
| Oct-19 | Number of Curves business stores exceeded 2,000. |
| Mar-20 | Curves business became a non-consolidated subsidiary through a stock-distribution-type spin-off. Complete separation of Curves business |
| Apr-21 | Announced the dissolution of KOSHIDAKA SINGAPORE PTE. LTD. |
| Apr-21 | Acquired the karaoke business (43 stores) of Daisy Corporation. |

Source: Company data, Mita Securities

Major shareholders

Mr. Hiroshi Koshitaka, President and Representative Director, and his asset management companies (Yozan and Fukuru) own a total of approximately 37% of the company's shares. Former Senior Managing Director Osamu Koshitaka (younger brother of Hiroshi Koshitaka) and his asset management company (IMO) own a total of approximately 7%, and Managing Director Miwako Koshitaka (spouse of Hiroshi Koshitaka) owns approximately 1%. In total, the founding family owns at least 46% of the company's shares.

The largest shareholder is the president. The founding family owns 46% of the shares

Figure: Major shareholders (end-FY8/20)

| Major shareholders | Shares held (%) |
|--|-----------------|
| Youzan KK | 25.92 |
| Fukuru | 8.54 |
| Northern Trust Co., (AVFC) Re Fidelity Funds | 7.26 |
| IMO KK | 4.60 |
| Hiroshi Koshidaka | 2.84 |
| Osamu Koshidaka | 2.69 |
| The Chase Manhattan Bank 385036 | 2.26 |
| The Master Trust Bank of Japan (trust account) | 2.23 |
| Miwako Koshidaka | 1.17 |

Source: Company data, Mita Securities

Karaoke business

Outlook for the karaoke business

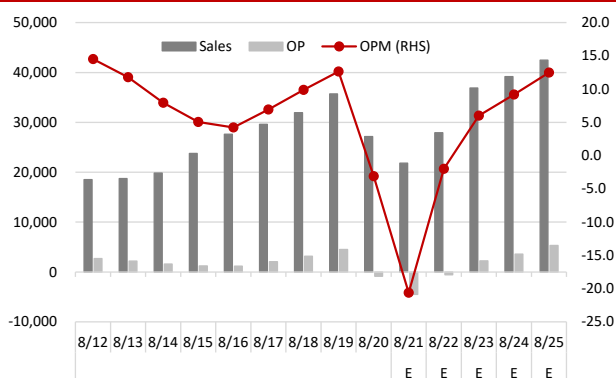
The company was in a profit growth phase, but fell into the red due to the COVID-19 pandemic

The company's karaoke stores used to be mainly roadside facilities in regional areas. In recent years, as the brand recognition of "Karaoke Manekineko" increased, the company aggressively opened new stores in downtown areas in front of railway stations and increased the size of its facilities, resulting in significant growth in sales and profits. The five-year CAGR of the karaoke business through FY8/19, before the impact of the COVID-19 pandemic, was 12.5% for sales and 23.4% for OP. The total number of stores expanded 1.4 times in the five years to the end of FY8/19.

In FY8/20, affected by the COVID-19 pandemic, sales declined sharply from the 3Q (Mar-May 20), and full-year OP fell into the red at -0.8bn yen. On a quarterly basis, the company has posted operating losses for four consecutive quarters from 3Q FY8/20 to 2Q FY8/21. In response to government requests to close stores and shorten hours, many of its stores were not able to operate fully during the highest sales hours of the day (around 7-11pm).

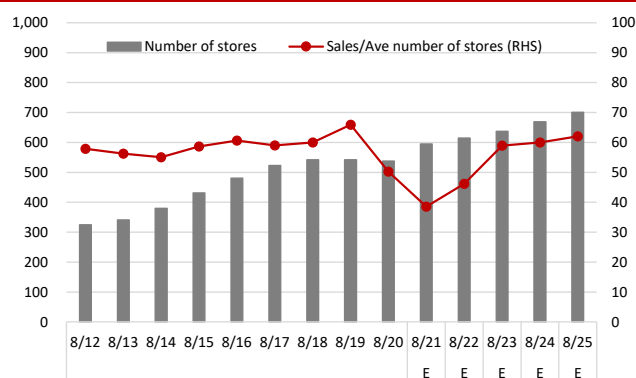
Achieved profit growth by aggressively opening new stores. Suffering from sales decline and loss due to requests for closure and shorter hours in the wake of the COVID-19 pandemic

Figure: Karaoke business sales, OP, OPM



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

Figure: Number of stores, sales per store



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

Operating loss forecast for this and next fiscal year

For FY8/21, we forecast sales of 21.8bn yen (-19.6% YoY) and OP of -4.5bn yen (-0.8bn yen in FY8/20) for the karaoke business segment, with OP of -2.1bn yen in 1H (Sep-Feb) and -2.4bn yen in 2H (Mar-Aug).

In Tokyo and other areas, the company continued to shorten business hours in March and April, and following the third emergency declaration, many of its stores went on temporary closure after April 25 (130 stores were announced as closed on April 26). This time, four prefectures under the emergency declaration, including Tokyo, have asked restaurants and entertainment facilities that serve alcoholic beverages or karaoke facilities to close, instead of shortening their hours. This is an extremely harsh measure for izakaya and karaoke stores. On May 7, the morning edition of the Nikkei reported that the emergency period would be extended to May 31, and that Fukuoka and Aichi prefectures would be added to the list (we have not confirmed the accuracy of the report). We believe that an operating loss in 3Q (Mar-May) is inevitable, and that sales recovery in 4Q (Jun-Aug) is unlikely to be sufficient to return to profitability.

Strong headwinds continue for alcoholic beverages and karaoke; operating loss expected in 3Q and 4Q for FY8/21

Nevertheless, the company is expected to receive subsidies from the local governments by responding to requests for shorter hours and store closure. The amount of the subsidy may change from time to time, but we have included 2.2bn yen of subsidy income in non-operating income for FY8/21 in our forecast (note that it is not included in segment OP).

Subsidy Income will be incorporated as non-operating income

Our forecast for the karaoke business segment for FY8/22 is for sales of 27.9bn yen (+27.9% YoY) and OP of -0.6bn yen, the third consecutive year of operating loss. In Japan, the vaccination has just started for some elderly people, and there is no certainty about the schedule for the general public. According to the government's announcement, the distribution of the vaccine for the elderly (65 years old and above) will be completed by the end of June, and the distribution and vaccination for the general public is expected to follow. Therefore, it is difficult to make an optimistic assumption that the number of newly infected people will decrease in one direction, especially in 1H FY8/22 (Sep 21-Feb 22). While the number of newly infected people is increasing and decreasing, we believe that the government's request for karaoke stores to shorten their operating hours and restrictions on the serving of alcoholic beverages will not be fully dispelled. We assume, however, that as the effect of vaccination becomes evident, the operating hours of karaoke stores will start to normalize in around 4Q FY8/22.

Vaccination schedule is uncertain. We assume OP to turn to profitability in FY8/23

We expect the karaoke business segment to return to profitability in FY8/23, assuming OP of 2.2bn yen in FY8/23 and 3.6bn yen in FY8/24.

Karaoke is a culture. Latent demand is strong in the domestic market

For FY8/25, we forecast OP of 5.3bn yen and an OP margin of 12.5% for the karaoke business segment. We believe that the OP margin will return to the level of FY8/19, before the COVID-19 pandemic. Karaoke is firmly rooted in Japanese culture among men and women of all ages, and it will regain its position as an important means of entertainment in the post-COVID-19 era, in our view. Our observation is that there was sufficient demand for karaoke during operating hours, even in the period when shorter hours were requested.

Karaoke culture is firmly rooted in Japan. The market is highly likely to recover

The way people enjoy karaoke may change in the post-COVID-19 era. We assume that the groups of users will become smaller and younger, and that the use of after-parties by business people will decrease due to the spread of working from home. The company, which has been attracting younger customers with its low prices, may find it easier to trigger a recovery. This could be a chance for the company to strengthen its position in the market.

Overseas business needs to be redesigned

The company's overseas karaoke business is smaller in scale than its domestic business, and the demand for karaoke as a means of entertainment is not as well established overseas as it is in the domestic market. We assume that the company will continue to post losses in the overseas.

Overseas sales are expected to remain in the red. A turnaround is needed

The company already announced its withdrawal from the Singapore market as it has been banned to operate stores for a long time following the COVID-19 pandemic. The decision to withdraw before the damage became too deep was a sound one. Other regions will no longer be positioned as growth areas as they used to be, in our view. Although it is important for the company to maintain its know-how on overseas business, it needs to redesign the overseas business as a whole as the recovery is not expected in the near future, in our opinion.

Characteristics of “Karaoke Manekineko”

Location of stores

Koshidaka HD was originally based in Maebashi City, Gunma Prefecture (the company is registered in Maebashi City, but its real headquarters is in Minato-ku, Tokyo), and many of its stores are roadside stores in eastern Japan. In recent years, the company has been aggressively opening stores in the downtown area in front of railway stations, and the number of stores in Tokyo is increasing. As a result, over 45% of the company's stores are located in the Kanto region (based on the number of Manekineko stores).

The company's competitors, such as Big Echo (Daiichikosho) and Karaoke Kan (B&V), have highly visible locations in the downtown area. We often find a Karaoke Kan in the immediate vicinity of a Big Echo. This is a strategy to capture the demand for after-parties among business people.

We have the impression that many Manekineko stores are located in buildings that do not have good visibility in the area. It seems that the company is focused on saving store opening costs and rents to offer low rates to its repeat customers, and generating sales through high turnover. Manekineko is a latecomer to the downtown market and has needed to build its position by differentiating itself from the major players. The company uses the term “new business models in existing industries” to describe its strategy, and this is also reflected in its choice of locations.

Kanto region accounts for over 45%. Expanded stores from roadside to downtown areas in front of stations

Differentiation from peers based on the policy of “new business models in existing industries”

Figure: Distribution of karaoke stores

| Store format | Region | | Breakdown by prefecture | | | | | | | | | |
|------------------------|----------|-----------|-------------------------|----------|-----------|-----------|----------|----------|----------|-----------|--|--|
| | Region | Share (%) | | | | | | | | | | |
| | Hokkaido | | Hokkaido | | | | | | | | | |
| Manekineko | 41 | 7.9 | 41 | | | | | | | | | |
| Daisyo's karaoke store | 0 | 0.0 | | | | | | | | | | |
| Total | 41 | 7.3 | 41 | | | | | | | | | |
| | Tohoku | | Niigata | Miyagi | Fukushima | Aomori | Yamagata | Iwate | Akita | | | |
| Manekineko | 52 | 10.1 | 17 | 13 | 12 | 4 | 3 | 2 | 1 | | | |
| Daisyo's karaoke store | 3 | 7.0 | 1 | | 1 | 1 | | | | | | |
| Total | 55 | 9.8 | 18 | 13 | 13 | 5 | 3 | 2 | 1 | | | |
| | Kanto | | Tokyo | Kanagawa | Saitama | Chiba | Gunma | Ibaraki | Tochigi | Yamanashi | | |
| Manekineko | 235 | 45.5 | 81 | 38 | 36 | 27 | 21 | 15 | 15 | 2 | | |
| Daisyo's karaoke store | 34 | 79.1 | 14 | 10 | 2 | 6 | | 2 | | | | |
| Total | 269 | 48.1 | 95 | 48 | 38 | 33 | 21 | 17 | 15 | 2 | | |
| | Chubu | | Shizuoka | Aichi | Nagano | Toyama | Ishikawa | Gifu | Fukui | | | |
| Manekineko | 71 | 13.8 | 22 | 15 | 12 | 7 | 6 | 5 | 4 | | | |
| Daisyo's karaoke store | 6 | 14.0 | 3 | | 2 | 1 | | | | | | |
| Total | 77 | 13.8 | 25 | 15 | 14 | 8 | 6 | 5 | 4 | | | |
| | Kinki | | Hyogo | Osaka | Mie | Shiga | Nara | Kyoto | Wakayama | | | |
| Manekineko | 31 | 6.0 | 13 | 10 | 3 | 2 | 2 | 1 | | | | |
| Daisyo's karaoke store | 0 | 0.0 | | | | | | | | | | |
| Total | 31 | 5.5 | 13 | 10 | 3 | 2 | 2 | 1 | 0 | | | |
| | Chugoku | | Hiroshima | Okayama | Yamaguchi | Tottori | Shimane | | | | | |
| Manekineko | 28 | 5.4 | 17 | 7 | 4 | | | | | | | |
| Daisyo's karaoke store | 0 | 0.0 | | | | | | | | | | |
| Total | 28 | 5.0 | 17 | 7 | 4 | 0 | 0 | | | | | |
| | Shikoku | | Kagawa | Ehime | Tokushima | Kochi | | | | | | |
| Manekineko | 19 | 3.7 | 7 | 7 | 4 | 1 | | | | | | |
| Daisyo's karaoke store | 0 | 0.0 | | | | | | | | | | |
| Total | 19 | 3.4 | 7 | 7 | 4 | 1 | | | | | | |
| | Kyushu | | Fukuoka | Saga | Miyazaki | Kagoshima | Oita | Nagasaki | Kumamoto | | | |
| Manekineko | 30 | 5.8 | 8 | 5 | 5 | 5 | 4 | 3 | | | | |
| Daisyo's karaoke store | 0 | 0.0 | | | | | | | | | | |
| Total | 30 | 5.4 | 8 | 5 | 5 | 5 | 4 | 3 | 0 | | | |
| | Okinawa | | Okinawa | | | | | | | | | |
| Manekineko | 9 | 1.7 | 9 | | | | | | | | | |
| Daisyo's karaoke store | 0 | 0.0 | | | | | | | | | | |
| Total | 9 | 1.6 | 9 | | | | | | | | | |
| | Total | | | | | | | | | | | |
| Manekineko | 516 | 100.0 | | | | | | | | | | |
| Daisyo's karaoke store | 43 | 100.0 | | | | | | | | | | |
| Total | 559 | 100.0 | | | | | | | | | | |

Source: Company data, Mita Securities Note: Number of stores at end-2QFY8/20 for Manekineko. Daisyo's karaoke stores are the number of stores acquired from Daisyo. Definition of region is by Koshidaka

Profit structure

Sales in the karaoke business consist of 1) room usage fees x number of users and 2) additional food and beverage charges. Room usage fees are charged in 30-minute increments or free time (a fixed fee for customers who use the room for a long time). The room usage fee may or may not include a drink bar, depending on the store. Manekineko stores allow customers to bring in their own drinks and food, without charging a fee. In addition, the stores are open 24 hours a day, and they actively strive to attract customers outside of their main nighttime hours (around 7-11pm). Before the COVID-19 pandemic, the company's monthly sales per store were around 5 million yen.

The main cost items are store rent, depreciation (karaoke equipment, kitchen, and other facilities), labor costs (employees and part-time workers), foodstuff costs, and sales promotion costs. The ratio of fixed costs seems to be reasonably high. Stores are mostly rented, and karaoke equipment are mostly owned.

Just before the COVID-19 pandemic, the gross profit margin in the karaoke business was around 22%, and the OPM was around 12%. This is a high level, equivalent to around twice the general OPM of major food service providers. However, since 3Q FY8/20, the gross profit margin has been negative due to a significant decline in sales.

Stores and facilities

In the past, the company's stores were mainly roadside in regional areas, but in recent years, it increased the number of stores in downtown areas in front of railway stations. In many of the latter cases, the company rents one or two large floors on floors other than the first floor of the building to save on rent and reduce the operational burden (and labor costs). The karaoke rooms are somewhat simpler than those of the major companies in the industry (Big Echo and Karaoke Kan), and the lighting is brighter in the rooms.

The karaoke machines installed in the rooms are the LIVE DAM series by Daiichikoshō and the JOYSOUND series by Exing. Therefore, Daiichikoshō is both a competitor in karaoke rooms and a supplier of karaoke equipment. In the past, the company developed its own "Sukitto" karaoke machine, but it was not able to promote the product and has already withdrawn from the business.

Pre-COVID-19 OPM was around 12%. Currently, the company is unable to cover its fixed costs due to the significant decline in sales

Facilities that focus on operational efficiency

Figure: Exterior of the store (Ueno Chuo-dori Store)



Source: Company data

Figure: Reception



Source: Company data

Figure: Karaoke room



Source: Company data

Figure: Self-service drink bar



Source: Company data

Figure: Manekineko set



Source: Company data

Figure: Gin-dako



Source: Company data

Figure: Manekineko salad



Source: Company data

Figure: Chocolate parfait



Source: Company data

Characteristics in pricing strategy

As shown below, there does not appear to be a significant difference among the karaoke companies in the room usage fees on Friday nights, which are the peak hours for karaoke stores.

However, unlike other stores, Manekineko allows customers to bring in their own drinks and food. Obviously, the cost performance for the user is overwhelmingly higher when using the bring-your-own service. Since there are few karaoke stores that allow customers to bring their own food and drinks, it should be easier to secure repeat customers. For the store side, while it is difficult to increase sales related to food and beverage, it has the advantage of lightening the burden of operation, in our opinion.

The company also offers the following discount services to stimulate demand among students and seniors.

- “Mafu” (Manekineko Free Time): For groups of college students, junior college students, and vocational students, the service offers unlimited singing and unlimited drinks for 550 yen (including tax) per person from 6:00 p.m. to the following morning from Sunday to Thursday.
- “ZERO Kara”: For high school groups. No charge for karaoke rooms, regardless of the day or time. One-order system.
- “Asa Uta (Morning song)”: From morning until 12:00 noon, the room charge is 11 yen per person for 30 minutes (tax included). One-order system. There is no age limit, but the target audience is mainly seniors.

**Unbeatable cost performance
with bring-your-own system and
low rates for students**

Figure: Price comparison (Shibuya Station area, Shibuya-ku, Tokyo)

| Manekineko Shibuya Main Store (Koshidaka HD) | | | | Big Echo Shibuya (Daiichikoshoh) | | | | | Karaoke Kan Shibuya Main Store (B&V) | | | Uta Hiroba Shibuya Center Gai Main Store (Criax) | | | | | | | |
|--|---------|---------------------|------------------|----------------------------------|---------------------|--------|--------|---------|--------------------------------------|---------------------|-------------------|--|---------------------|---------|--------------|-----|-----|-----|-----|
| Price per person for 30 minutes | | | | Price per person for 30 minutes | | | | | Price per person for 30 minutes | | | Price per person for 30 minutes | | | | | | | |
| 1 order system | | 1 order system | | 1 order system | | | | | 1 order system | | | With drink bar | | | | | | | |
| Member | Member | Member | Member | Member | Member | Member | Member | Member | Member | Member | Member | General | General | General | General | | | | |
| Every day | Mon-Thu | Fri, before holiday | Sat, Su, holiday | Mon-Thu | Fri, before holiday | Sat | Sun | holiday | Mon-Thu | Fri, before holiday | Sat, Sun, holiday | Mon-Thu | Fri, before holiday | Sat | Sun, holiday | | | | |
| 7:00-12:00 | 11 | | | | | | | | | | | | | | | | | | |
| 11:00-18:00 | | 187 | 187 | 220 | Open-19:00 | 200 | 200 | 270 | 270 | 270 | 11:00-19:00 | 99 | 99 | 143 | Open-18:00 | 270 | 270 | 270 | 270 |
| 18:00-7:00 | | 429 | 539 | 539 | 19:00-Close | 440 | 540 | 540 | 440 | 440 | 19:00-Close | 440 | 539 | 539 | 18:00-Close | 500 | 550 | 550 | 500 |

Source: Companies data, Mita Securities

Note: Prices are as of April 23, 2021 on the website

Figure: Price comparison (Sangenjaya station area, Setagaya-ku, Tokyo)

| Manekineko Sangenjaya (Koshidaka HD) | | | | Big Echo Sangenjaya Ekimae (Daiichikoshoh) | | | | Karaoke Kan Sangenjaya (B&V) | | | | |
|--------------------------------------|---------|---------------------|-------------------|--|---------------------|-------------------|---------|---------------------------------|-------------------|---------|-----|-----|
| Price per person for 30 minutes | | | | Price per person for 30 minutes | | | | Price per person for 30 minutes | | | | |
| 1 order system | | With drink bar | | 1 drink system | | | | 1 drink system | | | | |
| Member | Member | Member | Member | Member | Member | Member | Member | Member | Member | Member | | |
| Every day | Mon-Thu | Fri, before holiday | Sat, Sun, holiday | Mon-Thu | Fri, before holiday | Sat, Sun, holiday | Mon-Thu | Fri, before holiday | Sat, Sun, holiday | Mon-Thu | | |
| 7:00-12:00 | 11 | | | | | | | | | | | |
| 11:00-19:00 | | 275 | 275 | 385 | Open-19:00 | 200 | 200 | 240 | 11:00-19:00 | 99 | 99 | 143 |
| 19:00-7:00 | | 440 | 550 | 550 | 19:00-Close | 400 | 400 | 500 | 19:00-Close | 407 | 495 | 495 |

Source: Companies data, Mita Securities

Note: Prices are as of April 23, 2021 on the website

Impact of the COVID-19 on karaoke room market

Supply restrictions due to closures and shortened hours hurt

Below are the quarterly results for the karaoke business segment of Koshidaka HD and the karaoke and restaurant business segment of Daiichikoshō. It is obvious that the impact of the COVID-19 pandemic on the karaoke room market has been enormous.

Kosidaka HD's YoY revenue decline was -66.2% in the Mar-May 20 period, -37.6% in the Jun-Aug 20 period, -21.0% in the Sep-Nov 20 period, and -52.1% in the Nov 20-Feb 21 period. OPs have all been in the red since the Mar-May 20 period. The results are more severe in the period when the company had to comply with requests from local governments for closures or shorter hours for a long time in a wide range of areas. Sales and OP deteriorated in the most recent quarter because many stores were asked to close earlier based on the second emergency declaration. Karaoke stores have a high percentage of sales in the evening hours, and are therefore susceptible to the impact of shorter hours.

Nevertheless, we observe a strong latent demand for karaoke, given that 1) sales tended to recover when requests for shorter hours were eased, and 2) even during the most recent period when nighttime hours were severely restricted, sales were maintained at about 50% of the previous year. In our view, it is mainly the supply factor that has caused the recent sharp decline in sales.

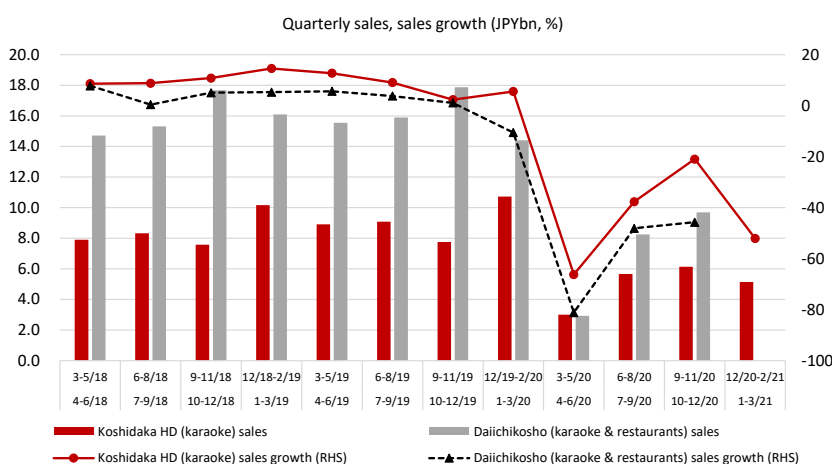
Of the two companies, Koshidaka HD's earnings has deteriorated to a slightly lesser extent, probably due to the difference in the store locations (many of them are located in regional roadside areas) and the difference in the degree of dependence on demand from businesspeople during the evening hours. Another reason might be that Daiichikoshō's karaoke and restaurant business reflects the earnings of its restaurants other than karaoke rooms. The degree of deterioration in restaurants appears to be more significant because the profit margins of restaurants are originally lower than those of karaoke rooms, and Daiichikoshō's restaurants include a large number of izakaya, which have been heavily hit by the COVID-19 pandemic.

A significant decrease in revenue and a fall into the red due to requests for closure and shorter hours

Demand is there, but supply is limited

Koshidaka HD was relatively less affected

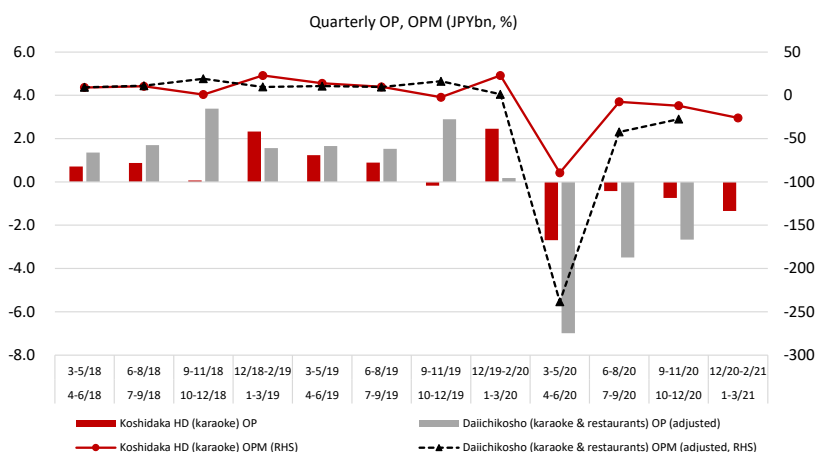
Figure: Quarterly sales



Source: Companies data, Mita Securities

Note: JPYbn. Upper row fiscal term shows Koshidaka HD, lower row shows Daiichikoshō

Figure: Quarterly OP, OPM



Source: Companies data, Mita Securities Note: JPYbn. Upper row fiscal term shows Koshidaka HD, lower row shows Daiichikoshi. Daiichikoshi's 4-6/20 OP (adjusted) incorporates fixed costs posted in the extraordinary loss account

Growth strategy

Continue to aggressively open new stores and increase sales per store

Despite the COVID-19 pandemic, the company's basic strategy remains unchanged: to pursue sales growth by expanding the number of stores and increasing sales per store. The company plans to continue opening new stores in downtown areas in front of railway stations. The company is positive that as more izakaya and karaoke stores close their doors, there will be more opportunities to open new stores in locations where rents were previously too high for the company to open new stores. In October 2020, the company opened a large-scale store (Shibuya Main Store) in Shibuya THE PRIME (next to SHIBUYA 109) (previously occupied by a restaurant bar but withdrawn). The company is also active in M&A, and in April 2021, it took over the karaoke business (43 stores) of Daisy, a major operator of izakaya. The company is also increasing the size of existing stores by renting additional space.

In addition to opening new stores in downtown areas and increasing floor space, the company has been aggressively pursuing the following new initiatives in order to increase sales per store. While there are issues with the feasibility and profitability of these businesses, we believe that the company's willingness to take on new challenges is positive.

Live viewing business

The company has started a new live viewing business. Live performances by artists held in the Shibuya Main Store are transmitted to Manekineko karaoke rooms throughout Japan (3,000 rooms can receive this service). In addition to the karaoke room fee and food and beverage charges, the company will receive a portion of the ticket and merchandise revenues. It is also expected that the regular live viewing will help attract repeat customers to the karaoke rooms. The company expects this business to be one of the ways to raise sales per room.

Artists who mainly perform live are finding it difficult to perform live in real life due to the COVID-19 pandemic. The demand for live streaming of events is already increasing, and web-based streaming has already become common.

Positive attitude toward opening new stores with more opportunities

Ticket and merchandise sales revenue

However, compared to real live performances, it is difficult to earn income from sales of goods and additional services (CDs, goods, photos, chatting, and taking pictures with “cheki” camera), and there is room for innovation in service provision and billing methods. The key point is whether the company can create a system where artists can use the company's live viewing services to attract more customers and generate more revenue from sales of goods and additional services.

Figure: Live room

Source: Company data

Figure: Recording room

Source: Company data

KARASTA×ONEREC

The company, in collaboration with Mixi, has developed a service that allows users to record “I tried singing” videos and post them on YouTube, etc., and has begun test operations in a recording room set up in the Shibuya Main Store. The service has the advantage of being able to use high-quality accompaniment, microphones, high-definition cameras, and lighting systems, as well as clearing up copyright issues. After the test operation, the company is planning to expand the service nationwide.

The company has a strong spirit of challenge when it comes to new businesses, and this new business has the potential to create a lot of buzz. If the company can get YouTubers with a large number of subscribers to use the service on a regular basis, it could be useful in stimulating demand for karaoke among general consumers.

However, our impression is that there are many issues that need to be resolved, such as scalability, in order to make this service profitable, as the demand of potential users of this service seems to be limited.

Services for YouTubers

Mita Securities' earnings forecast

Earnings forecast for FY8/21

For 8/21, we forecast consolidated sales of 23.5bn yen (-45.7% YoY), OP of -5.5bn yen (1.1 bn yen in FY8/20), and NP of -3.1bn yen (-0.2 bn yen in FY8/20). On an OP basis, we expect the loss to increase from -2.6bn yen in 1H to -2.9bn yen in 2H. On a NP basis, we expect the loss to shrink from -1.7bn yen in 1H to -1.4bn yen in 2H. We assume that the company will post subsidy income, from cooperating with the local governments' request for the closure and shortening of operating hours, as non-operating income. The total number of stores at end-FY8/21 is assumed to be 595 (+57 YoY). The succession of Daisy's karaoke business (43 stores) is expected to make a significant contribution.

Forecast FY8/21 OP of -5.5bn yen

Earnings forecast for FY8/22

For FY8/22, we forecast sales of 29.7bn yen (+26.4% YoY), OP of -1.3bn yen, and NP of -1.0bn yen. The reason for assuming a loss is that it is difficult to be certain at this point how much progress will be made in the 1H (Sep 21-Feb 22) with vaccinations against the COVID-19. We believe that there will still be a request for shorter hours in some areas. However, we assume that the operating hours of karaoke stores will start to normalize in around 4Q due to progress in vaccination. We assume that the total number of stores at end-FY8/22 will be 615 (+20 YoY).

FY8/22 OP is expected to improve to -1.3bn yen

Outlook for FY8/23 and beyond

We forecast OP of 1.5bn yen in FY8/23, 3.0bn yen in FY8/24, and 4.7bn yen in FY8/25, and believe that the company will be able to recover to its pre-COVID-19 profit level, excluding the Curves business, in the FY8/24-FY8/25 period. We assume that the total number of stores will be 637 at end-FY8/23, 669 at end-FY8/24, and 701 at end-FY8/25. We have not factored in the acquisition of stores through M&A in our earnings forecasts, but we see it as an additional growth factor.

We expect profitability in FY8/23. Profit is expected to recover to the pre-COVID-19 level in FY8/24-FY8/25 period

Points to note: Curves business spin-off

The spinoff of the Curves business was executed on March 1, 2020, and the 1H results of the Curves business are reflected in the consolidated PL and CF for FY8/20; the Curves business is not included in the consolidated BS as of end-FY8/20, but is included in the consolidated BS as of end-FY8/19.

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

| | 8/18 | 8/19 | 8/20 | 8/21 | 8/22 | 8/23 | 8/24 | 8/25 | 5-yr ave growth (CAGR, %) |
|-------------------------|------|------|-------|--------|--------|--------|--------|--------|------------------------------|
| | A | A | A | Mita E | Mita E | Mita E | Mita E | Mita E | |
| Sales growth (%) | 11.7 | 6.6 | -34.2 | -45.7 | 26.4 | 30.6 | 6.4 | 8.5 | |
| OP growth (%) | 27.8 | 21.0 | -87.9 | NA | NA | NA | 93.4 | 58.0 | |
| RP growth (%) | 29.2 | 16.5 | -82.2 | NA | NA | NA | 72.3 | 54.2 | |
| NP growth (%) | 36.0 | 40.7 | NA | NA | NA | NA | 87.3 | 9.2 | |
| Gross profit margin (%) | 27.0 | 30.0 | 19.1 | -8.2 | 8.5 | 15.4 | 18.5 | 21.6 | |
| OP margin (%) | 12.7 | 14.4 | 2.7 | -23.5 | -4.4 | 3.9 | 7.2 | 10.4 | |
| EBITDA margin (%) | 19.7 | 22.7 | 14.6 | -3.8 | 11.6 | 16.2 | 18.8 | 21.2 | |
| ROA (%) | 7.9 | 8.9 | -0.4 | -7.0 | -2.4 | 3.6 | 6.3 | 6.5 | |
| ROE (%) | 18.7 | 21.7 | -0.8 | -14.8 | -5.8 | 9.0 | 15.3 | 14.7 | |

Source: Company data, Mita Securities

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

| PL | 8/18 | 8/19 | 8/20 | 8/21 | 8/22 | 8/23 | 8/24 | 8/25 | 5-yr ave growth (CAGR, %) |
|-----------------------|--------|--------|--------|--------|--------|--------|--------|--------|------------------------------|
| Consolidated, JPYm | A | A | A | Mita E | Mita E | Mita E | Mita E | Mita E | |
| Sales | 61,771 | 65,840 | 43,304 | 23,510 | 29,724 | 38,827 | 41,294 | 44,811 | 0.7 |
| COGS | 45,065 | 46,078 | 35,049 | 25,428 | 27,185 | 32,830 | 33,664 | 35,128 | |
| Gross profit | 16,706 | 19,762 | 8,255 | -1,918 | 2,540 | 5,997 | 7,630 | 9,683 | |
| SGA | 8,848 | 10,254 | 7,107 | 3,613 | 3,844 | 4,467 | 4,672 | 5,010 | |
| Operating profit | 7,858 | 9,508 | 1,148 | -5,531 | -1,304 | 1,530 | 2,958 | 4,674 | 32.4 |
| Non-operating income | 600 | 621 | 904 | 2,514 | 914 | 414 | 314 | 314 | |
| Non-operating expense | 250 | 566 | 352 | 99 | 106 | 107 | 107 | 107 | |
| Recurring profit | 8,208 | 9,562 | 1,700 | -3,116 | -496 | 1,837 | 3,165 | 4,881 | 23.5 |
| Extraordinary gains | 381 | 3 | 21 | 200 | 0 | 0 | 0 | 0 | |
| Extraordinary losses | 520 | 737 | 1,533 | 1,500 | 1,000 | 200 | 100 | 100 | |
| Pre-tax profit | 7,688 | 8,829 | 188 | -4,416 | -1,496 | 1,637 | 3,065 | 4,781 | 91.1 |
| Corporate taxes | 2,897 | 2,432 | 419 | -1,325 | -449 | 0 | 0 | 1,434 | |
| Minority interests | 365 | 170 | 0 | 0 | 0 | 0 | 0 | 0 | |
| Net profit | 4,427 | 6,227 | -232 | -3,091 | -1,047 | 1,637 | 3,065 | 3,346 | NA |
| EBITDA | 12,155 | 14,925 | 6,330 | -891 | 3,451 | 6,302 | 7,753 | 9,490 | |
| Shares O/S | 81.318 | 81.318 | 81.533 | 81.533 | 81.533 | 81.533 | 81.533 | 81.533 | |
| EPS | 54.44 | 76.57 | -2.84 | -37.91 | -12.84 | 20.07 | 37.59 | 41.04 | |
| DPS | 25.00 | 12.00 | 12.00 | 4.00 | 4.00 | 6.00 | 6.00 | 8.00 | |
| Payout ratio (%) | 18.6 | 15.9 | NA | NA | NA | 29.9 | 16.0 | 19.5 | |
| BPS | 315.51 | 391.24 | 281.01 | 230.99 | 214.15 | 230.23 | 261.82 | 296.86 | |

Source: Company data, Mita Securities

Figure: Mita Securities' earnings forecast (consolidated, segment earnings, JPYm)

| Segment earnings | 8/18 | 8/19 | 8/20 | 8/21 | 8/22 | 8/23 | 8/24 | 8/25 | 5-yr ave growth |
|--|--------|--------|--------|--------|--------|--------|--------|--------|-----------------|
| Consolidated, JPYm | A | A | A | Mita E | Mita E | Mita E | Mita E | Mita E | (CAGR, %) |
| Karaoke business | | | | | | | | | |
| Sales | 31,936 | 35,732 | 27,157 | 21,828 | 27,928 | 36,905 | 39,180 | 42,486 | 9.4 |
| (YoY, %) | 7.8 | 11.9 | -24.0 | -19.6 | 27.9 | 32.1 | 6.2 | 8.4 | |
| Operating profit | 3,153 | 4,519 | -839 | -4,502 | -559 | 2,214 | 3,605 | 5,311 | NA |
| (YoY, %) | 53.8 | 43.3 | NA | NA | NA | NA | 62.8 | 47.3 | |
| OP margin (%) | 9.9 | 12.6 | -3.1 | -20.6 | -2.0 | 6.0 | 9.2 | 12.5 | |
| Number of stores | 542 | 542 | 538 | 595 | 615 | 637 | 669 | 701 | |
| (YoY, %) | 3.6 | 0.0 | -0.7 | 10.6 | 3.4 | 3.6 | 5.0 | 4.8 | |
| Sales/Ave number of stores | 60 | 66 | 50 | 39 | 46 | 59 | 60 | 62 | |
| (YoY, %) | 1.7 | 9.9 | -23.7 | -23.4 | 19.8 | 27.7 | 1.8 | 3.4 | |
| Curves business | | | | | | | | | |
| Sales | 27,933 | 28,037 | 14,302 | | | | | | |
| (YoY, %) | 18 | 0 | NA | | | | | | |
| Operating profit | 5,345 | 5,679 | 3,006 | | | | | | |
| (YoY, %) | 14 | 6 | NA | | | | | | |
| OP margin (%) | 19 | 20 | 21 | | | | | | |
| Bath house business | | | | | | | | | |
| Sales | 1,587 | 1,640 | 1,207 | 1,045 | 1,098 | 1,152 | 1,268 | 1,394 | 2.9 |
| (YoY, %) | -3.0 | 3.3 | -26.4 | -13.4 | 5.0 | 5.0 | 10.0 | 10.0 | |
| Operating profit | 72 | 109 | -70 | -121 | -88 | -46 | 27 | 59 | NA |
| (YoY, %) | -41.2 | 51.0 | NA | NA | NA | NA | NA | 120.0 | |
| OP margin (%) | 4.5 | 6.6 | -5.8 | -11.6 | -8.0 | -4.0 | 2.1 | 4.2 | |
| Real estate management business | | | | | | | | | |
| Sales | 314 | 432 | 637 | 636 | 699 | 769 | 846 | 931 | 7.9 |
| (YoY, %) | 0.5 | 37.6 | 47.7 | -0.2 | 10.0 | 10.0 | 10.0 | 10.0 | |
| Operating profit | 134 | 59 | -78 | -208 | 42 | 62 | 77 | 104 | NA |
| (YoY, %) | 5.8 | -55.6 | NA | NA | NA | 46.7 | 25.1 | 35.4 | |
| OP margin (%) | 42.6 | 13.8 | -12.2 | -32.7 | 6.0 | 8.0 | 9.1 | 11.2 | |

Source: Company data, Mita Securities

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

| BS | 8/18 | 8/19 | 8/20 | 8/21 | 8/22 | 8/23 | 8/24 | 8/25 | 5-yr ave growth |
|--------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|-----------------|
| Consolidated, JPYm | A | A | A | Mita E | Mita E | Mita E | Mita E | Mita E | (CAGR, %) |
| Assets | | | | | | | | | |
| Total current assets | 19,963 | 20,762 | 13,753 | 7,621 | 6,809 | 8,508 | 9,891 | 11,791 | |
| Cash and deposits | 11,926 | 12,582 | 9,890 | 5,760 | 4,970 | 6,776 | 8,591 | 10,469 | |
| Accounts receivable | 3,824 | 3,870 | 197 | 125 | 282 | 250 | 316 | 298 | |
| Inventories | 1,123 | 1,112 | 283 | 187 | 407 | 369 | 456 | 440 | |
| Other | 3,089 | 3,198 | 3,383 | 1,549 | 1,151 | 1,112 | 528 | 584 | |
| Total fixed assets | 48,394 | 51,325 | 30,803 | 36,562 | 37,486 | 38,512 | 40,051 | 41,589 | |
| Tangible assets | 17,552 | 22,193 | 22,568 | 24,959 | 25,798 | 26,721 | 28,063 | 29,405 | |
| Intangible assets | 24,628 | 22,536 | 351 | 2,500 | 2,320 | 2,142 | 1,975 | 1,807 | |
| Investment and other | 6,214 | 6,596 | 7,884 | 9,103 | 9,368 | 9,649 | 10,013 | 10,377 | |
| Total assets | 68,357 | 72,087 | 44,556 | 44,184 | 44,295 | 47,020 | 49,942 | 53,380 | 3.7 |
| Liabilities | | | | | | | | | |
| Total current liabilities | 14,828 | 15,023 | 10,468 | 10,450 | 12,654 | 13,309 | 13,406 | 13,575 | |
| Accounts payable | 2,431 | 2,477 | 235 | 350 | 374 | 452 | 463 | 484 | |
| Short-term debt | 4,808 | 4,153 | 7,396 | 7,500 | 9,500 | 9,500 | 9,500 | 9,500 | |
| Other | 7,588 | 8,393 | 2,837 | 2,600 | 2,780 | 3,357 | 3,442 | 3,592 | |
| Total long-term liabilities | 26,833 | 25,249 | 11,176 | 14,900 | 14,181 | 14,940 | 15,190 | 15,601 | |
| Long-term debt | 19,541 | 18,098 | 7,248 | 10,500 | 9,500 | 9,500 | 9,500 | 9,500 | |
| Other | 7,292 | 7,152 | 3,928 | 4,400 | 4,681 | 5,440 | 5,690 | 6,101 | |
| Total liabilities | 41,660 | 40,272 | 21,646 | 25,350 | 26,835 | 28,249 | 28,595 | 29,176 | 6.2 |
| Net assets | | | | | | | | | |
| Shareholders' equity | 25,657 | 31,815 | 22,912 | 18,834 | 17,460 | 18,771 | 21,347 | 24,204 | 1.1 |
| Warrants | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| Minorities | 1,041 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| Total net assets | 26,697 | 31,815 | 22,912 | 18,834 | 17,460 | 18,771 | 21,347 | 24,204 | 1.1 |
| Debt | | | | | | | | | |
| Debt/EBITDA | 2.0 | 1.5 | 2.3 | -20.2 | 5.5 | 3.0 | 2.5 | 2.0 | 5.3 |
| D/E (x) | 0.9 | 0.7 | 0.6 | 1.0 | 1.1 | 1.0 | 0.9 | 0.8 | |
| Shareholders' equity ratio (%) | 37.5 | 44.1 | 51.4 | 42.6 | 39.4 | 39.9 | 42.7 | 45.3 | |

Source: Company data, Mita Securities

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

| CF | 8/18 | 8/19 | 8/20 | 8/21 | 8/22 | 8/23 | 8/24 | 8/25 | 5-yr ave growth |
|----------------------------------|---------|--------|--------|--------|--------|--------|--------|--------|-----------------|
| Consolidated, JPYm | A | A | A | Mita E | Mita E | Mita E | Mita E | Mita E | (CAGR, %) |
| Cashflow from operations | | | | | | | | | |
| Cashflow from operations | 8,327 | 12,578 | 4,378 | 1,594 | 3,536 | 7,133 | 7,804 | 8,367 | |
| Net profit | 4,427 | 6,227 | -232 | -3,091 | -1,047 | 1,637 | 3,065 | 3,346 | |
| Depreciation and amortization | 4,297 | 5,417 | 5,182 | 4,640 | 4,755 | 4,772 | 4,795 | 4,817 | |
| Other | -397 | 934 | -573 | 45 | -172 | 724 | -56 | 204 | |
| Cashflow from investing | | | | | | | | | |
| Cashflow from investing | -23,406 | -8,732 | -9,124 | -7,500 | -5,000 | -5,000 | -5,500 | -6,000 | |
| Capital expenditure | -4,822 | -8,049 | -5,983 | -5,500 | -5,000 | -5,000 | -5,500 | -6,000 | |
| Disposal of fixed assets | 0 | 6 | 43 | 0 | 0 | 0 | 0 | 0 | |
| Other | -18,584 | -689 | -3,184 | -2,000 | 0 | 0 | 0 | 0 | |
| Cashflow from financing | | | | | | | | | |
| Cashflow from financing | 13,276 | -3,193 | 5,785 | 2,369 | 674 | -326 | -489 | -489 | |
| Debt issuance/repayment | 14,449 | -2,099 | 6,925 | 3,356 | 1,000 | 0 | 0 | 0 | |
| Share issuance/buyback | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| Dividend paid | -773 | -895 | -1,140 | -987 | -326 | -326 | -489 | -489 | |
| Other | -400 | -200 | 0 | 0 | 0 | 0 | 0 | 0 | |
| Cash and cash equivalents | | | | | | | | | |
| Cash and cash equivalents | 11,889 | 12,530 | 9,297 | 5,760 | 4,970 | 6,776 | 8,591 | 10,469 | |
| Free cashflow | -15,079 | 3,845 | -4,746 | -5,906 | -1,464 | 2,133 | 2,304 | 2,367 | |

Source: Company data, Mita Securities

APPENDIX

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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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