



Skylark Holdings

TSE 1st Section 3197 Industry: Food service, retail

Top priority is credit improvement; initiating coverage with a Hold rating

Initiating coverage with a TP of 1,550 yen and a Hold rating

We initiate coverage of Skylark Holdings Co., Ltd. (3197, Skylark HD, the company) with a target price of 1,550 yen and a Hold rating.

The company is the largest family restaurant operator in Japan, with 3,126 stores at end-FY12/20, down 132 YoY. In recent years, the company has been expanding “Shabu-Yo” and “Musashino Mori Coffee” stores, but the COVID-19 pandemic has forced it to close a large number of other stores, including “Jonathan’s,” which has most of the stores in the Tokyo metropolitan area. The company posted a net loss of -17.2bn yen in FY12/20 (IFRS). It violated the financial covenants on its loans, but this has been resolved by amending the contract. 1Q FY12/21 also saw a net loss of -1.9bn yen. In order to restore its damaged balance sheet and secure funds for growth, the company raised funds through a public offering in June. For now, the company's top priority is to improve and stabilize its creditworthiness, and we believe it is unlikely to pursue an aggressive growth strategy.

Mita Securities' earnings forecast

Our FY12/21 OP forecast (IFRS) is 5.3bn yen (-23.0bn yen loss in FY12/20; company guidance 5bn yen), which we believe will be supported by subsidy income from local governments. We expect OP to recover to 7.5bn yen (+40.4% YoY) in FY12/22, assuming no subsidies. We forecast FY12/23 OP to be 20.7bn yen (+177.5% YoY), recovering to FY12/19 level (20.6bn yen). We expect a moderate increase in the number of stores, from 3,126 at end-FY12/20 to 3,171 at end-FY12/23. Net debt/EBITDA ratio is expected to be 4.0x at end-FY12/21, 3.9x at end-FY12/22, and 3.0x at end-FY12/23, which should allow the company to comply with the financial covenants under the revised contract.

Valuations and risk factors

In calculating our target price, we used a residual income model (RIM) with a cost of equity of 4.0% and a terminal growth rate of 0.3%, based on our earnings forecasts for FY12/21-FY12/25. Our target price is equivalent to 29.5x our FY3/23 EPS forecast of 52.57 yen.

Upside risk factors to our view include an unexpectedly early recovery in earnings and dividend payments. Downside risk factors include prolonged requests for shorter hours due to rapid increase in COVID-19 cases, unexpected deterioration in same-store sales, large goodwill impairment, violation of financial covenants, and customer defection due to food poisoning.

Special topics: Shareholder benefits

At the end of this report, we have included a list of shareholder benefit yields for food service companies. In some cases, the share prices of food service companies, which have a large number of small investors, rise just before the granting of benefits and fall afterwards. It is also important to note that there are cases where stock prices drop significantly after a reduction in shareholder benefits.

MITA SECURITIES Co., Ltd.

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Initiation of coverage

Rating

Hold

Target price (JPY)	1,550
Stock price (JPY) (Jun 30)	1,543
Market cap (JPYbn)	351.0

Key changes

Rating	New
Target price	New
Earnings forecast	New

Stock price (JPY)



Source: Bloomberg Finance LP

Earnings

IFRS		12/19	12/20	12/21E	12/22E	12/23E
Sales	JPYbn	375.4	288.4	282.0	332.4	362.1
OP	JPYbn	20.6	-23.0	5.3	7.5	20.7
Pre-tax Profit	JPYbn	16.7	-26.4	1.5	4.6	17.9
NP	JPYbn	9.5	-17.2	0.5	2.7	12.0
EPS	JPY	48.0	-87.2	2.2	11.8	52.6
BPS	JPY	672	576	699	711	759
DPS	JPY	19.0	0.0	0.0	4.0	16.0
PER	x	44.4	-18.3	697.8	130.2	29.4
PBR	x	3.2	2.8	2.2	2.2	2.0
Div. yield	%	0.9	0.0	0.0	0.3	1.0
ROA	%	2.4	-3.8	0.1	0.6	2.5
ROE	%	7.2	-14.0	0.4	1.7	7.2

Source: Company data, Mita Securities

Company profile

Skylark HD is Japan's largest operator of family restaurants, including “Gusto,” and “Bamiyan.” The company had 3,115 stores at the end of March 2021. FY12/20 sales were 288.4bn yen.

Investment Thesis

Outlook

Top priority is credit improvement

We initiate coverage of Skylark Holding Co., Ltd. (3197, Skylark HD, the company) with a target price of 1,550 yen and a Hold rating.

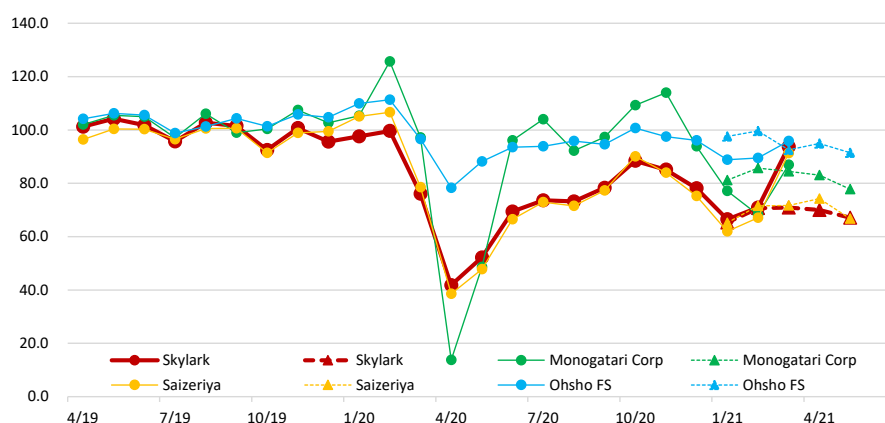
The company is Japan's largest operator of family restaurants, with a five-year average sales growth rate of 2.0% (CAGR) through FY12/19 and an average OPM of 7.3% over the five-year period from FY12/15 to FY12/19, before the impact of COVID-19.

In FY12/20, sales fell to 288.4bn yen (-23.2% YoY) and OP fell to -23.0bn yen (20.6bn yen profit in FY12/19) due to the strong impact of COVID-19. As a result of the sharp decrease in EBITDA and the resulting spike in the net leverage ratio (net debt/adjusted EBITDA), the company violated the financial covenants on its loans. The company escaped defaulting on its debt as the financial institutions did not demand forfeiture and agreed to change the financial covenants, but in 2Q FY12/21, the company raised capital to restructure its balance sheet. In our view, the company's top priority is to improve its creditworthiness as financial institutions will continue to closely monitor the company's credit standing for some time.

Initiating coverage with a TP of 1,550 yen and a Hold rating

Significant loss in FY12/20. Deteriorating balance sheet with violation of financial covenants. Recently raised capital. Near term priority is to improve creditworthiness

Figure: Monthly same-store sales



Source: Companies data, Mita Securities

Note: Same month last year or year before last =100. Solid line vs last year, dotted line vs year before last. Partially estimated by Mita Securities

Our consolidated earnings forecast for FY12/21 is 282.0bn yen in sales (-2.2% YoY) and 5.3bn yen in OP (-23.0bn yen loss in FY12/20), roughly in line with the company's guidance (285.0bn yen in sales and 5.0bn yen in OP). However, we believe that the OP for this fiscal year will be supported by subsidy income from local governments. We expect same-store sales to decline 24.5% from FY12/19, slightly below the company's guidance of a 23.0% decline. Our estimate for the number of stores at the end of the fiscal year is 3,131 (+0.2% YoY).

We expect the company to return to profitability in FY12/22 without subsidies, and to return to the pre-COVID-19 OP level of FY12/19 in FY12/23. By this time, the company's creditworthiness should have improved to the point where it can consider more proactive strategies.

We expect a return to positive OP in FY12/21 thanks to subsidy income, positive OP in FY12/22 without subsidy, and full recovery to the pre-COVID-19 level in FY12/23

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

JPYm	12/18	12/19	12/20	12/21	12/22	12/23	12/21	12/21	12/22	12/23
IFRS	A	A	A	Mita E	Mita E	Mita E	CoE	Consensus	Consensus	Consensus
Earnings										
Sales	366,360	375,394	288,434	281,986	332,399	362,139	285,000	310,686	325,765	330,456
(YoY, %)	1.9	2.5	-23.2	-2.2	17.9	8.9				
Operating profit	22,857	20,562	-23,031	5,310	7,455	20,689	5,000	6,714	13,081	14,807
(YoY, %)	-18.7	-10.0	NA	NA	40.4	177.5				
OPM (%)	6.2	5.5	-8.0	1.9	2.2	5.7				
Pre-tax profit	18,596	16,729	-26,433	1,490	4,622	17,856	1,000	3,490	9,078	10,644
(YoY, %)	-20.9	-10.0	NA	NA	210.2	286.3				
Net profit	11,438	9,487	-17,214	503	2,696	11,959	400	1,692	5,974	6,845
(YoY, %)	-26.4	-17.1	NA	NA	435.9	343.6				
Depreciation and amortization	14,075	51,061	51,168	47,075	47,122	47,169				
Capital expenditure	19,020	20,386	15,770	17,500	17,500	19,250				
Free CF	11,904	47,379	20,982	26,182	29,811	46,117				
KPI										
Number of stores	3,200	3,258	3,126	3,131	3,146	3,171				
(YoY, %)	1.7	1.8	-4.1	0.2	0.5	0.8				
Sales per store	115	116	90	90	106	115				
(YoY, %)	-0.2	0.7	-22.3	-0.3	17.5	8.3				
Per share indicators										
EPS (JPY)	58.04	48.03	-87.16	2.21	11.85	52.57	2.03	8.58	30.26	34.64
BPS (JPY)	661.92	672.48	576.00	698.92	710.77	759.34				
DPS (JPY)	38.00	19.00	0.00	0.00	4.00	16.00	NA			
Valuation, profitability, etc.										
PER (x)	29.9	44.4	NA	697.8	130.2	29.4				
PBR (x)	2.6	3.2	2.8	2.2	2.2	2.0				
Dividend payout ratio (%)	65.5	39.6	0.0	0.0	33.8	30.4				
Dividend yield (%)	2.2	0.9	0.0	0.0	0.3	1.0				
ROA (%)	3.5	2.4	-3.8	0.1	0.6	2.5				
ROE (%)	8.9	7.2	-14.0	0.4	1.7	7.2				
Financial soundness indicators										
Capital ratio (%)	39.5	29.3	25.8	34.0	33.7	34.9				
Debt/Equity (x)	1.1	1.9	2.3	1.6	1.5	1.4				
Net debt/EBITDA (x)	3.3	3.3	8.8	4.0	3.9	3.0				

Source: Company data, Bloomberg Finance LP data, Mita Securities

Note: Consensus forecasts are by Bloomberg consensus. Net profit stands for net profit attributable to owners of the company

Valuations

Stock valuation based on residual income model (RIM)

In calculating our target price of 1,550 yen, we used a residual income model (RIM) with a cost of equity of 4.0% and a terminal growth rate of 0.3%, based on our earnings forecasts for FY12/21-FY12/25. Our target price is equivalent to 29.5x our FY12/23 EPS forecast of 52.57 yen.

TP of 1,550 yen based on RIM

Figure: Residual Income Model (RIM)

	Y0	Y1	Y2	Y3	Y4	Y5	Y6~
	A	Mita E	Mita E	Mita E	Mita E	Mita E	Mita E
JPYbn	12/20	12/21	12/22	12/23	12/24	12/25	12/26
Shareholders' equity (EOP)	158.5	159.0	161.7	172.8	182.9	193.8	
Net profit		0.5	2.7	12.0	13.7	15.5	
Cost of equity		6.3	6.4	6.5	6.9	7.3	
Residual income		-5.8	-3.7	5.5	6.8	8.2	
PV of residual income		-5.6	-3.4	4.9	5.8	6.7	
PV of terminal value							182.3
Beta	0.70						
Risk free rate (%)	0.50						
Risk premium (%)	5.00						
Cost of equity (%)	4.00						
Terminal growth rate (%)	0.30						
Total equity value							349.3
Number of shares O/S (m)							228
Target share price							1,550

Source: Company data, Mita Securities

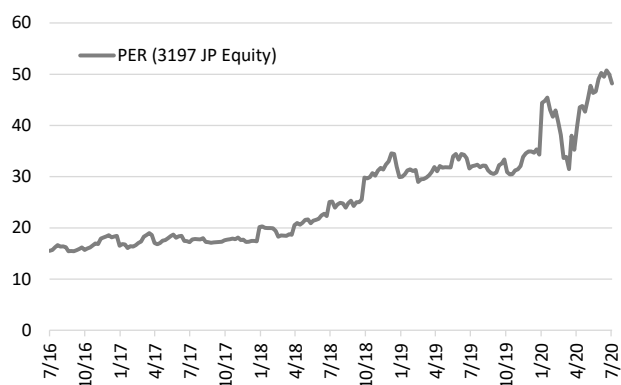
Note: Shareholders' equity at end-FY12/20 includes additional equity raised in June 2021

Figure: Sensitivity of target price to terminal growth rate

Terminal growth rate (%)	0.0	0.1	0.2	0.3	0.4	0.5	0.6	0.7	0.8	0.9	1.0
Target price	1,500	1,500	1,500	1,550	1,550	1,600	1,600	1,650	1,650	1,700	1,750

Source: Mita Securities

Figure: Skylark HD's PER (reference)



Source: Bloomberg Finance LP data, Mita Securities

Comparison of valuations with similar companies (reference)

Figure: Comparison of valuations for food service companies

Company name	Ticker	PX 6/30	Mkt cap JPYbn	Net D/E Last	Sales YoY LTM	EBITDA Mgn LTM	ROE LTM	ROE Cur E	ROE Nxt E	PER LTM	PER Cur E	PER Nxt E	PBR Last	EV/EBITDA Cur E	EV/Sales Cur E	Div yield Cur E	1M Chg	3M Chg	1YR Chg
KURA SUSHI INC	2695	4,650	192.5	-0.1	7.4	4.6	3.1	8.3	12.3	134.7	48.1	30.1	4.1	16.2	1.3	0.5	19.5	26.2	81.3
MCDONALD'S HOLDINGS CO JAPAN	2702	4,900	651.5	-0.2	2.4	14.8	12.7	11.4	10.9	30.6	30.5	28.7	3.7	13.1	2.0	0.8	-1.5	-3.5	-13.4
OOTOYA HOLDINGS CO LTD	2705	2,670	19.3	0.2	-34.3	-24.0	-203.9	NA	NA	NA	NA	NA	13.8	NA	NA	NA	-2.8	0.3	20.2
FUJIO FOOD GROUP INC	2752	1,247	55.6	3.6	-33.9	-12.3	-81.6	11.5	NA	NA	119.9	32.8	15.5	NA	2.1	0.0	-7.5	-8.2	-8.2
AMIYAKI TEI CO LTD	2753	2,916	20.0	-0.2	-30.6	-9.8	-7.0	3.5	NA	NA	28.5	28.5	1.0	NA	0.4	0.0	1.6	-0.1	-5.0
HIRAMATSU INC	2764	211	10.3	4.1	-36.6	-32.0	-79.3	NA	NA	NA	NA	NA	2.9	NA	NA	NA	15.9	36.1	21.3
PEPPER FOOD SERVICE CO LTD	3053	475	18.6	2.4	NA	NA	NA	NA	NA	NA	NA	NA	31.4	NA	NA	NA	22.4	57.3	-5.8
ARCLAND SERVICE HOLDINGS CO	3085	2,196	72.7	-0.6	18.8	12.9	14.5	13.8	12.7	23.0	22.0	21.3	3.2	10.4	1.4	1.1	-4.1	-0.6	19.8
CHOUSHIMARU CO LTD	3075	1,142	16.6	NA	-1.6	1.2	-0.5	NA	NA	NA	NA	NA	2.3	NA	NA	NA	5.4	-8.9	3.6
DOUTOR NICHIREI HOLDINGS CO	3087	1,714	78.2	-0.3	-26.7	-4.8	-11.0	4.9	2.9	NA	16.1	27.1	0.8	7.2	0.4	1.4	4.6	1.0	0.7
BRONCO BILLY CO LTD	3091	2,375	35.8	-0.3	-27.8	0.2	-3.5	NA	NA	NA	NA	NA	2.1	NA	NA	0.7	2.5	0.9	1.7
MONOGATARI CORP (TP 9,100 Buy)	3097	7,470	90.2	0.2	-8.4	8.5	7.8	15.4	NA	59.1	30.1	25.0	4.5	14.5	1.4	0.9	14.6	3.9	86.1
CHIMNEY CO LTD	3178	1,369	26.5	0.8	-67.8	-38.2	-94.9	NA	NA	NA	NA	NA	5.3	NA	NA	NA	2.5	6.7	-0.3
TORIKIZOKU HOLDINGS CO LTD	3193	1,796	20.9	0.0	-40.8	-9.9	-39.3	NA	NA	NA	NA	28.9	4.3	NA	1.0	0.0	0.1	10.1	21.7
HOTLAND CO LTD	3196	1,325	28.5	0.6	-12.3	2.8	-8.1	15.3	NA	NA	25.9	25.5	3.9	NA	1.0	0.4	-5.6	3.0	19.6
SKYLARK HOLDINGS CO LTD (TP 1,550 Hold)	3197	1,543	351.0	2.1	-27.6	6.9	-15.9	1.0	4.4	NA	179.9	51.0	2.7	8.8	1.6	0.2	0.1	-5.4	-5.3
SFP HOLDINGS CO LTD	3198	1,450	37.4	-0.1	-56.7	-17.8	-41.7	NA	NA	NA	NA	22.7	3.5	NA	1.5	0.0	8.0	3.3	-2.6
CREATE RESTAURANTS HOLDINGS	3387	912	172.8	3.5	-46.6	-0.8	-82.7	12.6	NA	NA	68.1	68.1	10.0	NA	2.3	0.0	15.9	7.7	33.7
SAINT MARC HOLDINGS CO LTD	3395	1,594	36.3	-0.2	-36.2	-9.7	-19.1	3.7	2.6	NA	24.3	36.9	0.9	6.4	0.5	2.8	2.7	-4.4	-2.1
TORIDOLL HOLDINGS CORP	3397	1,884	164.4	3.0	-13.9	5.4	-18.5	4.0	7.9	NA	107.9	36.5	5.7	12.0	1.9	0.3	11.1	16.4	60.2
KOMEDA HOLDINGS CO LTD	3543	2,070	95.5	1.5	-7.6	20.9	10.6	13.9	14.1	26.6	19.0	17.4	2.7	16.8	4.5	2.6	1.8	3.7	15.8
KUSHIKATSU TANAKA HOLDINGS C	3547	1,824	17.0	0.3	-35.8	-11.2	-38.4	6.5	30.6	NA	67.5	26.1	12.2	61.5	1.9	0.3	0.6	-1.1	15.4
CHIKARANOMOTO HOLDINGS CO LT	3561	609	16.5	3.7	-43.2	-13.9	-93.5	NA	NA	NA	NA	NA	11.1	NA	NA	NA	-2.2	-1.1	-8.1
FOOD & LIFE COMPANIES LTD	3563	4,795	556.6	2.4	2.4	14.6	17.1	22.6	23.7	60.6	43.6	38.0	9.6	17.9	2.7	0.5	-2.2	-1.5	107.9
ATOM CORP	7412	774	149.8	0.2	-35.2	-4.1	-21.6	NA	NA	NA	NA	NA	18.0	NA	NA	NA	0.5	2.9	-2.6
KAPPA CREATE CO LTD	7421	1,453	71.8	0.4	-13.3	0.7	-10.0	NA	NA	NA	NA	NA	6.6	NA	NA	NA	-0.7	-2.0	2.7
WATAMI CO LTD	7522	931	39.7	3.5	-33.1	-17.1	-132.0	NA	NA	NA	NA	NA	11.7	NA	NA	NA	1.3	-6.1	2.6
ZENSHO HOLDINGS CO LTD	7550	2,853	441.8	2.2	-5.6	5.4	2.6	12.6	13.2	190.5	38.0	34.5	5.1	13.4	1.0	0.7	4.8	0.1	35.3
KOURAKUEN HOLDINGS CORP	7554	1,541	25.9	1.1	-30.5	-3.3	-23.7	NA	NA	NA	90.6	NA	7.3	NA	1.0	0.0	-2.1	-8.5	3.8
ANRAKUTEI CO LTD	7562	5,420	11.6	1.3	73.0	-2.1	-22.3	NA	NA	NA	NA	NA	2.6	NA	NA	NA	2.8	5.4	11.8
SAIZERIYA CO LTD	7581	2,665	139.3	-0.3	-28.6	0.1	-7.5	0.6	5.1	NA	151.5	30.0	1.6	14.2	0.9	0.7	9.4	19.1	32.1
HIDAY HIDAKA CORP	7611	1,802	68.7	-0.3	-30.0	-7.9	-12.2	NA	NA	NA	NA	NA	3.1	NA	NA	0.0	2.2	2.0	13.0
COLOWIDE CO LTD	7616	1,981	149.1	3.6	-28.5	3.0	-56.1	NA	NA	NA	NA	NA	9.0	NA	NA	NA	2.1	8.0	40.1
UKAI CO LTD	7621	3,110	16.3	1.5	-35.5	-14.5	-45.4	NA	NA	NA	NA	NA	5.7	NA	NA	NA	2.8	2.3	-1.3
GLOBAL-DINING INC	7625	601	6.2	0.9	-33.5	-15.3	-34.0	NA	NA	NA	NA	NA	2.8	NA	NA	NA	19.0	104.4	285.3
ICHIBANYA CO LTD	7630	5,090	162.5	-0.5	-8.3	7.7	9.2	11.4	NA	59.3	45.4	51.6	5.5	NA	3.0	1.6	7.3	6.0	9.9
ASAKUMA CO LTD	7678	1,577	8.5	-0.4	-27.9	-23.0	-51.6	NA	NA	NA	NA	NA	3.8	NA	NA	NA	1.3	-0.1	9.9
MOS FOOD SERVICES INC	8153	3,035	97.2	-0.2	4.3	7.4	2.2	3.7	NA	93.9	55.1	46.8	2.1	NA	1.2	0.8	-2.4	-5.3	4.7
KISOJI CO LTD	8160	2,340	60.6	0.0	-29.3	-7.0	-18.3	NA	NA	NA	NA	NA	2.5	NA	NA	NA	0.7	-0.3	-0.5
SRS HOLDINGS CO LTD	8163	810	29.7	0.5	-2.1	-5.4	-36.3	NA	NA	NA	NA	NA	3.0	NA	NA	NA	-1.3	-3.8	-7.6
ROYAL HOLDINGS CO LTD	8179	2,175	98.7	2.3	-45.2	-26.7	-71.9	-15.8	-0.1	NA	NA	68.5	3.3	27.6	1.3	0.2	6.0	11.0	22.1
RINGER HUT CO LTD	8200	2,381	62.1	1.0	-28.1	-14.9	-62.4	NA	NA	NA	NA	NA	6.2	NA	NA	NA	6.9	6.2	4.5
GIFT INC	9279	2,524	25.1	0.2	19.6	6.0	9.1	23.0	NA	84.6	29.8	21.9	7.4	NA	1.8	0.6	8.1	21.2	80.0
GENKI SUSHI CO LTD	9828	2,516	22.3	0.6	-11.9	3.7	-5.3	NA	NA	NA	NA	NA	2.7	NA	NA	NA	-5.5	-2.4	13.0
GINZA RENOI CO LTD	9853	830	5.2	0.1	-48.1	-52.4	-53.3	NA	NA	NA	NA	NA	1.6	NA	NA	NA	1.3	1.2	-1.2
GOURMET KINEYA CO LTD	9850	964	21.8	1.5	-43.1	-15.2	-46.7	NA	NA	NA	NA	NA	2.6	NA	NA	NA	-0.1	0.4	1.2
YOSHINOYA HOLDINGS CO LTD	9861	2,123	138.3	0.8	-21.2	0.5	-17.2	6.3	3.2	NA	67.1	64.4	3.5	16.0	1.1	0.3	5.7	-1.6	-0.5
KFC HOLDINGS JAPAN LTD	9873	2,826	63.4	-0.8	12.6	8.6	12.3	NA	NA	22.5	22.8	23.3	2.7	NA	0.5	1.8	1.5	-3.6	-2.6
MATSUVAFOODS HOLDINGS CO LTD	9887	3,525	67.2	0.3	-11.4	-0.2	-5.7	NA	NA	NA	28.1	17.9	1.7	NA	0.8	0.7	1.1	1.6	-0.1
SAGAMI HOLDINGS CORP	9900	1,021	29.2	-0.2	-23.0	-9.2	-20.7	NA	NA	NA	NA	NA	2.5	NA	NA	NA	-1.1	-8.9	-15.6
OHSO FOOD SERVICE CORP (TP 7,250 Buy)	9936	5,600	130.4	-0.2	-5.8	10.3	8.3	210.0	NA	24.5	19.9	18.7	2.0	NA	1.3	1.8	0.0	-2.9	-3.8
JOYFULL CO LTD	9942	775	24.7	37.9	-33.1	-11.1	-110.8	NA	NA	NA	NA	NA	8.8	NA	NA	NA	7.9	10.6	-8.9
DAISYO CORP	9979	1,057	22.4	0.3	-40.1	-12.5	-57.6	NA	NA	NA	NA	NA	1.8	NA	NA	NA	6.9	9.0	-14.1
Average				1.6	-21.2	-5.4	-31.8	17.4	10.3	67.5	79.5	34.2	5.6	17.1	1.5	0.7	3.6	5.8	18.3
Median				0.3	-28.0	-3.7	-18.8	11.4	9.4	59.2	38.0	28.9	3.5	14.2	1.3	0.6	1.8	1.0	3.6

Source: Bloomberg Finance LP data, Mita Securities

Note: Forecasts are based on Bloomberg consensus. Shading indicates stocks covered by Mita Securities

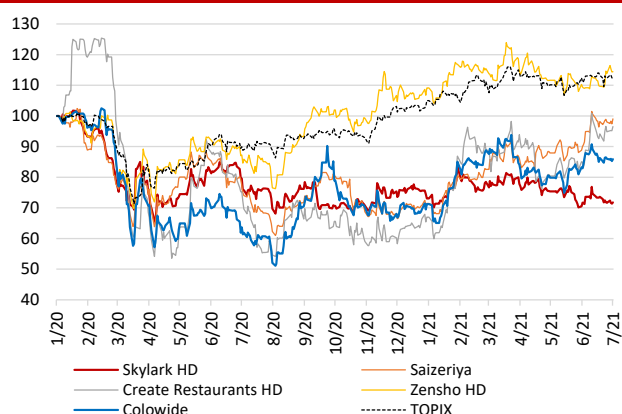
Figure: Comparison of valuations for food service companies (family restaurants, general type)

Company name	Ticker	PX 6/30	Mkt cap JPYbn	Net D/E Last	Sales YoY LTM	EBITDA Mgn LTM	ROE LTM	ROE Cur E	ROE Nxt E	PER LTM	PER Cur E	PER Nxt E	PBR Last	EV/EBITDA Cur E	EV/Sales Cur E	Div yield Cur E	1M Chg	3M Chg	1YR Chg
SKYLARK HOLDINGS CO LTD (TP 1,550 Hold)	3197	1,543	351.0	2.1	-27.6	6.9	-15.9	1.0	4.4	NA	179.9	51.0	2.7	8.8	1.6	0.2	0.1	-5.4	-5.3
CREATE RESTAURANTS HOLDINGS	3387	912	172.8	3.5	-46.6	-0.8	-82.7	12.6	NA	NA	68.1	68.1	10.0	NA	2.3	0.0	15.9	7.7	33.7
ZENSHO HOLDINGS CO LTD	7550	2,853	441.8	2.2	-5.6	5.4	2.6	12.6	13.2	190.5	38.0	34.5	5.1	13.4	1.0	0.7	4.8	0.1	35.3
SAIZERIYA CO LTD	7581	2,665	139.3	-0.3	-28.6	0.1	-7.5	0.6	5.1	NA	151.5	30.0	1.6	14.2	0.9	0.7	9.4	19.1	32.1
COLOWIDE CO LTD	7616	1,981	149.1	3.6	-28.5	3.0	-56.1	NA	NA	NA	NA	NA	9.0	NA	NA	NA	2.1	8.0	40.1
ROYAL HOLDINGS CO LTD	8179	2,175	98.7	2.3	-45.2	-26.7	-71.9	-15.8	-0.1	NA	NA	68.5	3.3	27.6	1.3	0.2	6.0	11.0	22.1
JOYFULL CO LTD	9942	775	24.7	37.9	-33.1	-11.1	-110.8	NA	NA	NA	NA	NA	8.8	NA	NA	NA	7.9	10.6	-8.9

Source: Bloomberg Finance LP data, Mita Securities

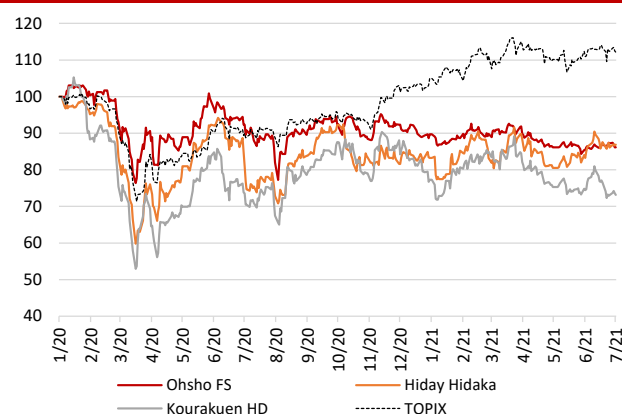
Note: Forecasts are based on Bloomberg consensus. Shading indicates stocks covered by Mita Securities

Figure: Stock price trends (family restaurants, general type)



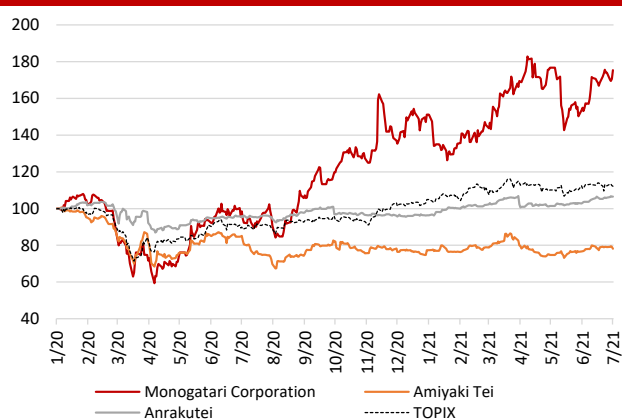
Source: Bloomberg Finance LP data, Mita Securities Note: Indexed 100 at the end of 2019

Figure: Stock price trends (Chinese restaurants)



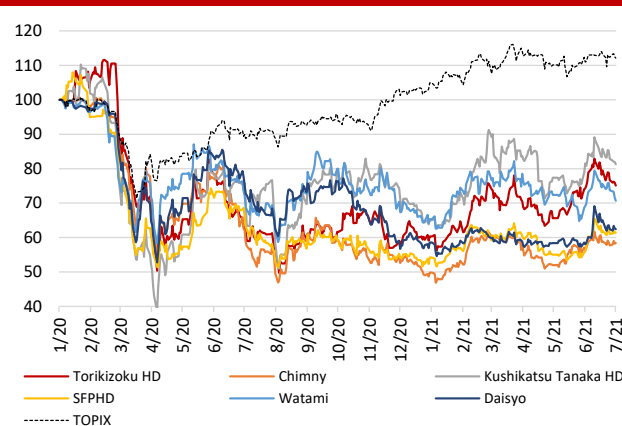
Source: Bloomberg Finance LP data, Mita Securities Note: Indexed 100 at the end of 2019

Figure: Stock price trends (Japanese BBQ)



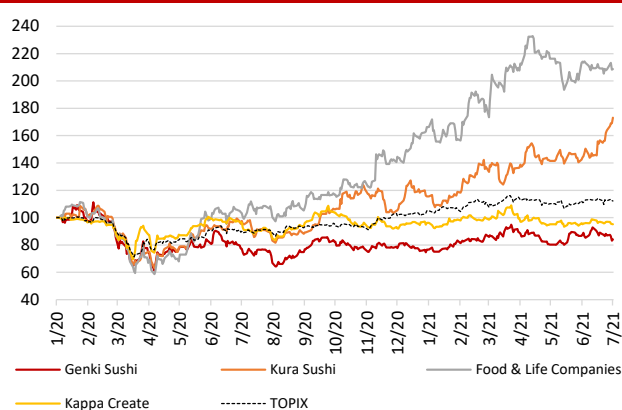
Source: Bloomberg Finance LP data, Mita Securities Note: Indexed 100 at the end of 2019

Figure: Stock price trends (Japanese style pubs)



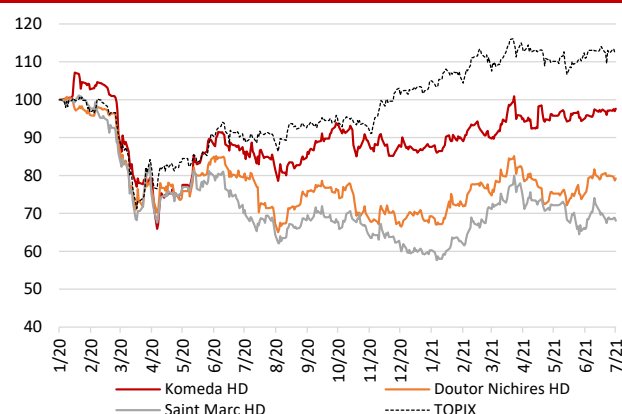
Source: Bloomberg Finance LP data, Mita Securities Note: Indexed 100 at the end of 2019

Figure: Stock price trends (sushi restaurants)



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

Figure: Stock price trends (coffee shops)



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

Risk factors

Upside risk factors to our view include an unexpectedly early recovery in earnings and dividend payments. Downside risk factors include prolonged requests for shorter hours due to rapid increase in COVID-19 cases, unexpected deterioration in same-store sales, large goodwill impairment, violation of financial covenants, and customer defection due to food poisoning.

Company overview

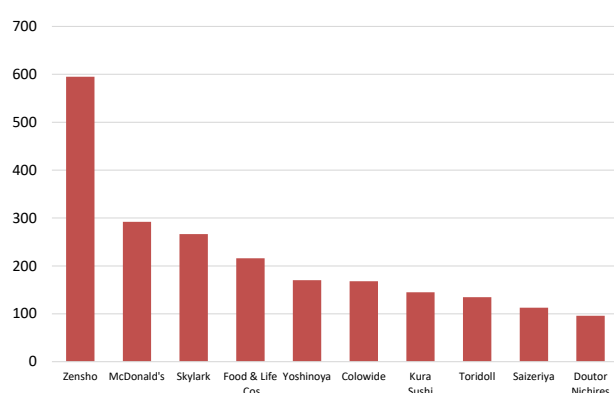
Company overview

Overview of Skylark HD

Skylark HD is a major restaurant company based in Musashino City, Tokyo, and has the largest network of family restaurants in Japan, with 3,115 stores as of March 31, 2021, most of which are directly managed. Its main formats include "Gusto," "Bamiyan," "Shabu-Yo," "Jonathan's," "Yumean," "Steak Gusto," "Karayoshi," and "Musashino Mori Coffee." The largest format, "Gusto," accounts for 43% of the total number of stores. In recent years, the number of specialty stores such as "Shabu-Yo" (all-you-can-eat shabu-shabu), "Karayoshi" (fried chicken set meals), and "Musashino Mori Coffee" (full-service coffee shop) has been growing.

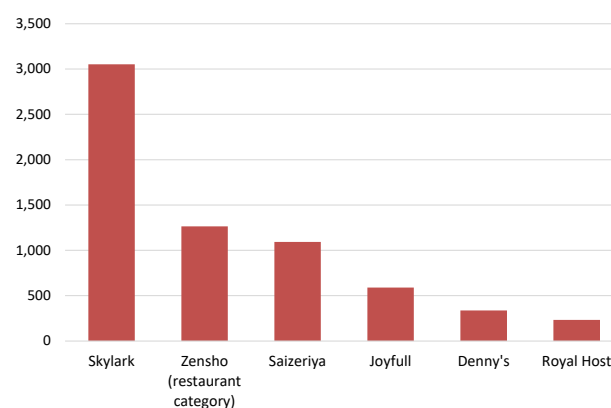
Japan's largest family restaurant chain under direct management system

Figure: Sales for food service companies (LTM, JPYbn)



Source: Bloomberg Finance LP data, Mita Securities

Figure: Number of domestic stores for family restaurants



Source: Companies data, Mita Securities

Note: End-Feb 21 for Saizeriya and Denny's, end-Mar 21 for others

Figure: Major competitors by format

Category	Skylark's main format(s)	Competitor(s)	Operating company for competitor (or its parent)
General family restaurant (mainly western style)	Gusto Jonathan's	Saizeriya Joyfull Coco's Denny's Royal Host	Saizeriya Joyfull Zensho HD Seven & i HD Royal HD
Chinese cuisine	Bamiyan	Gyoza no Ohsho Hidakaya Kourakuen	Ohsho Food Service Hiday Hidaka Kourakuen HD
Shabu-shabu & sushi	Shabu-Yo	Yuzuan Shabusai On-Yasai Dontei	Monogatari Corporation Create Restaurants HD Colowide Anrakutei
Japanese cuisine	Yumean, Aiya	Hanayayohei	Zensho HD
Steak	Steak Gusto	Ikinari! Steak Steak Don, VOLKS Steak Miya Bronco Billy	Pepper Food Service Anrakutei Atom (Colowide group) Bronco Billy
Fried chicken (kara-age)	Karayoshi	Karayama Karaage no Tensai	Arcland Service HD Watami
Full-service coffee shop	Musashino Mori Coffee	Hoshino Coffee Komeda's Coffee	Doutor Nichires HD Komeda HD

Source: Companies data, Mita Securities

Group companies

The group transitioned to a holding company structure in 2016. Skylark HD is the holding company, and each subsidiary operates its own restaurant businesses. Of these, Skylark Restaurants operates major restaurant formats such as “Gusto” and “Bamiyan,” and accounts for about 90% of consolidated sales.

Figure: Subsidiaries

Subsidiary name	Voting right (%)	Location	Overview
Skylark Restaurants Co., Ltd.	100.0	Tokyo	Operates family restaurants
NILAX Inc.	100.0	Tokyo	Operates buffet restaurants in shopping centers
Tomato and Associates Co., Ltd.	100.0	Hyogo	Operates Juju Karubi, etc.
Taiwan Skylark Co., Ltd.	100.0	Taiwan	Operates Café Grazie, Shabu-Yo, etc. in Taiwan
Skylark Malaysia Sdn. Bhd.	100.0	Malaysia	Operates a Shabu-Yo restaurant in Malaysia
FLO Japon Co., Ltd.	100.0	Tokyo	Sells Western-style confectionery and side dishes
Japan Cargo Co., Ltd.	100.0	Saitama	Logistics services for group companies
Skylark D&M Co., Ltd.	100.0	Tokyo	Provides cleaning and maintenance services for group companies' stores, deliveries of store products, and linen supply services

Source: Companies data, Mita Securities

Strengths and challenges

Strengths

The company's strengths include: (1) overwhelming brand power as a pioneer in the family restaurant business; (2) an integrated supply chain that includes large-scale central kitchens, logistics functions, and store operations; (3) store and product development capabilities that enable it to identify trends in the restaurant market and develop multiple stores in popular formats ahead of its competitors; (4) ease of format conversion due to its large number of restaurant formats; and (5) a well-developed take-out and delivery system.

Strengths include brand power, integrated supply chain, store and product development capabilities, multi-format operations, and take-out/delivery system

While many of the company's competitors operate a large number of restaurant formats, they are often a collection of businesses acquired through M&A, and our impression is that few of them have succeeded in creating synergies among their formats as Skylark HD has.

Also, it is a relief that the company has not entered the izakaya (Japanese style pub) business, where competition is fierce and COVID-19 has a large impact.

Figure: Central kitchens

MD centers and factories	Location	MD centers and factories	Location
Sendai Merchandising Center	Miyagi	Gifu Merchandising Center	Gifu
Higashi Matsuyama Merchandising Center	Saitama	Nishinomiya Merchandising Center	Hyogo
Shisui Merchandising Center	Chiba	Kita Kyushu Merchandising Center	Fukuoka
Akishima Merchandising Center	Tokyo	Fujioka Factory	Gunma
Sagamihara Merchandising Center	Kanagawa	Maebashi Factory	Gunma

Source: Companies data, Mita Securities

Challenges

The company's group is so large, with stores in urban areas and roadside locations across the country, that it is affected by COVID-19 in the same way as restaurant operators in general. The company was forced to close a large number of unprofitable stores last year, mainly in the Tokyo metropolitan area. The pace of store network expansion is likely to be moderate in the near future.

By type of format, the company has not been able to establish a sufficient presence in areas such as yakiniku (Japanese BBQ) and sushi, which are popular among consumers, in our view.

With the exception of Taiwan, the company has not been active in overseas expansion to date. The company is now becoming slightly more active by opening new restaurants in Malaysia.

On the balance sheet, the company still has a large amount of debt and goodwill as a negative legacy from past LBOs. In FY12/20, the company violated the financial covenants on its debt due to deterioration in earnings, but was able to avoid default due to the flexible support by financial institutions.

Challenges include difficulty in expanding scale, presence in the yakiniku and sushi categories, overseas expansion, and creditworthiness

Company history

The predecessor of Skylark HD was Kotobuki Foods established in 1962, which opened its first "Skylark" family restaurant in 1970. In 1974, the company changed its name to Skylark Co., Ltd.

The company registered its stock on the over-the-counter market in 1978, was listed on the Second Section of the Tokyo Stock Exchange in 1982, and was listed on the First Section of the Tokyo Stock Exchange in 1984.

The company opened its first "Jonathan's" store in 1980 and its first "Bamiyan" store in 1986, and reached the 1,000 store mark in 1992. The company opened its first low-priced "Gusto" store in 1992 and subsequently converted a number of unprofitable stores into "Gusto" stores. The company continued to aggressively open new stores, reaching the 1,000 store mark for "Gusto" in 2003.

Meanwhile, as a side effect of the company's expansion-oriented strategy, an increase in unprofitable stores and cannibalization among its own businesses emerged as issues. In 2006, the company carried out an MBO and delisted its shares with the support of Nomura Principal Finance and other investors, and worked to restructure its business. In 2009, the company completed its withdrawal from the "Skylark" format.

In 2011, the company was acquired by Bain Capital. In October 2014, the company was re-listed on the First Section of the Tokyo Stock Exchange. Bain Capital completed the sale of its stake by 2017. The company's 146.0bn yen of goodwill is an internally generated goodwill booked at the time of the Bain Capital acquisition.

The company transitioned to a holding company structure in January 2016, and changed its name to Skylark Holdings Co., Ltd. in July 2018.

Entered the family restaurant business in 1970. Opened the first Gusto restaurant in 1993. MBO and de-listing in 2006. Relisted in 2014. Bain Capital has already completed its exit

Figure: History

Date	Event
Apr-62	Established Kotobuki Foods Ltd. with the aim of developing a comprehensive food retail chain.
Jul-69	Kotobuki Foods Ltd. reorganized as Kotobuki Foods Co., Ltd.
Jul-70	Kotobuki Foods opened its first family restaurant, "Skylark," in Fuchu City, Tokyo.
Nov-74	Kotobuki Foods changed its trade name to Skylark
Dec-77	Central kitchen opened in Higashi Matsuyama City, Saitama Prefecture (currently Higashi Matsuyama MD Center)
Jul-78	Registered as an over-the-counter stock with the Japan Securities Dealers Association.
Aug-82	Listed on the Second Section of the Tokyo Stock Exchange.
Jun-84	Listed on the First Section of the Tokyo Stock Exchange.
Mar-87	Kansai Factory (currently Nishinomiya MD Center) established in Nishinomiya City, Hyogo Prefecture.
Mar-92	Opened the first "Gusto" family restaurant in Kodaira City, Tokyo.
Sep-06	SNC Investment acquired shares of Skylark via MBO. Delisted from the First Section of the Tokyo Stock Exchange. Became a wholly owned subsidiary of SNC Investment through a share exchange.
Jul-07	SNC Investment merged with Skylark, with SNC Investment as the surviving company. Company name changed to Skylark.
Oct-09	Completely closed the family restaurant "Skylark."
Nov-11	Became a subsidiary of BCJ Holdings 6. Acquired by Bain Capital.
Apr-12	Became a wholly owned subsidiary of BCJ Holdings 6.
Jun-12	BCJ Holdings 6 merged with Skylark, with BCJ Holdings 6 as the surviving company, and changed its name to Skylark.
Jul-14	BCJ Holdings 5 merged with Skylark, with BCJ Holdings 5 as the surviving company, and changed its name to Skylark.
Oct-14	Listed on the First Section of the Tokyo Stock Exchange.
Sep-15	Established Skylark Restaurants.
Jan-16	Transitioned to a holding company structure to enhance the competitiveness of the group.
Nov-17	Bain Capital completed the sale of Skylark shares.
Jul-18	Company name changed to Skylark Holdings.

Source: Company data, Mita Securities

Major shareholders/management team

Bain Capital completed the sale of its shareholding by November 2017, and the current top shareholders consist of institutional investors and supplier companies.

Makoto Tani, the company's top executive, was appointed President and Representative Director in August 2008; in March 2018, he was appointed Chairman & President and Representative Director following the retirement of former Chairman Ralph Alvarez. He holds less than 0.03% of the company's shares as of the end of FY12/20.

Chairman and President Tani has served as the top management for a long time

Figure: Major shareholders (end-FY12/20)

Major shareholders	Shares held (%)
The Master Trust Bank of Japan, Ltd. (trust account)	4.01
Custody Bank of Japan, Ltd. (trust account)	2.33
Custody Bank of Japan, Ltd. (trust account 5)	1.77
Asahi Breweries	1.73
Kirin Brewery Company	1.69

Source: Company data, Mita Securities

Shareholder benefit program

As part of its shareholder benefit program, the company offers meal coupons to shareholders registered at the end of June and December. However, as part of structural reforms in response to the impact of COVID-19, the company changed its shareholder benefit program and reduced the amount of meal coupons given to shareholders from the end of December 2020. Under the new system, shareholders holding 100 shares receive meal coupons worth 4,000 yen (2,000 yen x 2 times) per year (6,000 yen per year under the old system). This is equivalent to a yield of 2.6% if the stock price is 1,550 yen.

We recognize that the shareholder benefit program is one of the important criteria for individual investors in selecting restaurant operator stocks. The company's stock is popular among individual investors because the yield on its shareholder benefits is slightly higher than that of other companies in the restaurant industry, and because the company's restaurants are located throughout Japan, making it easy to use the benefit meal coupons.

The shareholder benefit program has influenced the company's share price to some extent. In general, stocks with high shareholder benefit yields tend to rise and fall around the time of vesting, and the company's share price has tended to do so in the past. The company announced the change to its shareholder benefit plan on September 10, 2020, and on the following day (September 11, 2020) the company's share price fell by about 10%.

Reduced shareholder benefits in response to deteriorating earnings

Figure: Skylark HD's shareholder benefit program

Applicable until end-June 2020

Number of shares		Annual gift amount (JPY)	Annual gift per share (JPY)	
			End-June	End-December
100 - 299		6,000	3,000	3,000
300 - 499		20,000	9,000	11,000
500 - 999		33,000	15,000	18,000
1,000 -		69,000	33,000	36,000

Applicable from end-December 2020

Number of shares		Annual gift amount (JPY)	Annual gift per share (JPY)	
			End-June	End-December
100 - 299		4,000	2,000	2,000
300 - 499		10,000	5,000	5,000
500 - 999		16,000	8,000	8,000
1,000 -		34,000	17,000	17,000

Source: Company data, Mita Securities

Figure: Skylark HD's stock price and vesting date



Source: Bloomberg Finance LP data, Mita Securities

Details of business

Breakdown of sales and store count

Breakdown of consolidated sales

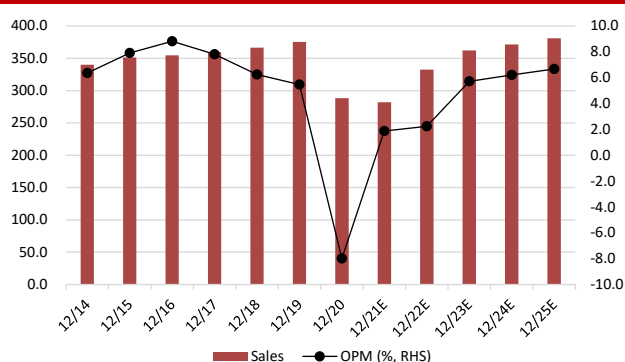
Consolidated sales for FY 12/20 were 288.4bn yen (-23.2% YoY). Sales by restaurant format were as follows: "Gusto" 120.4bn yen (42% share of total sales), "Bamiyan" 31.2bn yen (11% share), "Shabu-Yo" 29.4bn yen (10% share), and "Jonathan's" 26.4bn yen (9% share). "Jonathan's," which posted the second highest sales after "Gusto" in FY12/19, has a store network centered in the Tokyo metropolitan area, and has been strongly affected by COVID-19. Its sales share declined from 11% in FY12/19 to 9% in FY12/20 as it became the focus of store reductions.

Of the FY12/20 sales, delivery rose sharply to 33.2bn yen (+38% YoY, 12% share of sales) and take-out to 17.2bn yen (+110% YoY, 6% share). In-store dining and other sales were 238.0bn yen (-31% YoY, 83% share). Delivery and take-out combined accounted for 17.5% of consolidated sales. Delivery services cover a wide area, with 94% of households in Tokyo and three prefectures. The majority of deliveries were made by the company itself.

"Gusto" accounts for 42% of sales. Share of "Jonathan's" declined

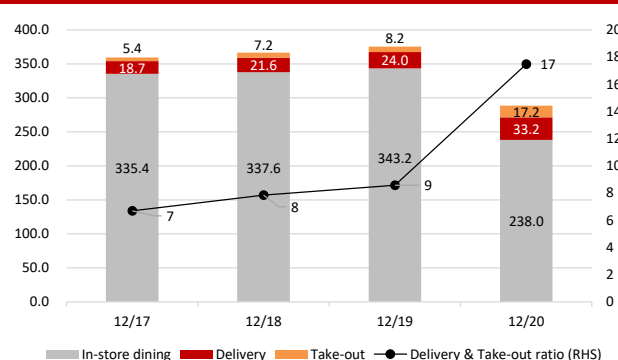
Take-out / delivery accounts for 17.5% of sales

Figure: Sales (JPYbn), OPM (%)



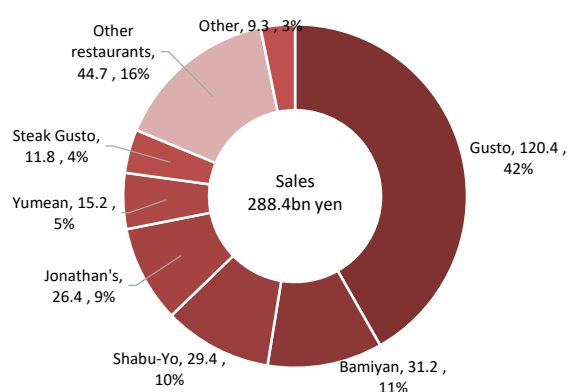
Source: Company data, Mita Securities Note: Forecasts are by Mita Securities

Figure: Breakdown of sales (JPYbn)



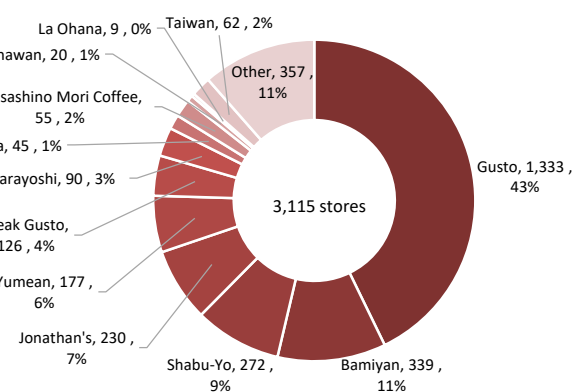
Source: Company data, Mita Securities

Figure: Breakdown of sales (FY12/20, JPYbn, %)



Source: Company data, Mita Securities

Figure: Breakdown of store count (end-Mar 21, stores, %)



Source: Company data, Mita Securities

Breakdown of stores by format

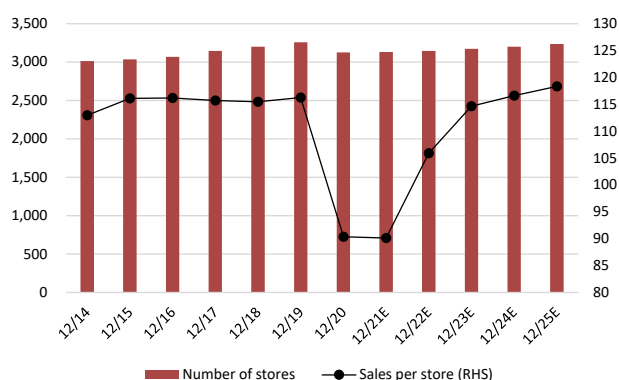
The number of stores at end-1Q FY 12/21 (end of March 2021) was 3,115. This includes 1,333 “Gusto” (43% share), 339 “Bamiyan” (11% share), 272 “Shabu-Yo” (9% share), and 230 “Jonathan's” (7% share).

Most of the stores of “Jonathan's” are located in the Tokyo metropolitan area, with the majority in Tokyo, Kanagawa, Saitama, and Chiba prefectures, and were hit hard by COVID-19, which was the main reason for the company's store reduction from FY12/20 onward. The number of “Jonathan's” stores declined from 299 at end-FY12/18 to 230 at end-1Q FY12/21.

On the other hand, there are three formats that have been growing stores in recent years: “Shabu-Yo” (from 202 stores at end-FY12/18 to 272 stores at end-1Q FY12/21), “Karayoshi” (from 41 stores to 90 stores), and “Musashino Mori Coffee” (from 23 stores to 55 stores). In addition, the “Karayoshi” menu (karaage set meal, etc.) has already been offered at all “Gusto” stores.

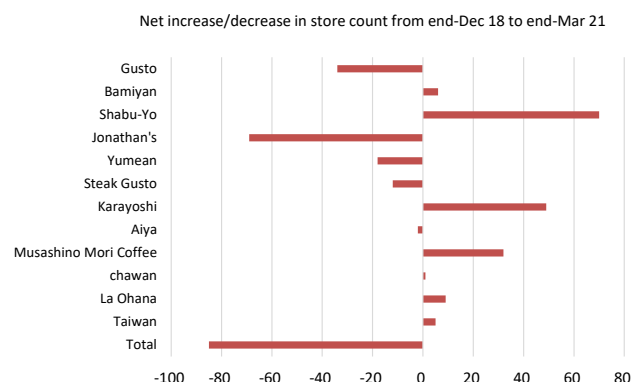
“Jonathan's” has been drastically reduced. “Shabu-Yo,” “Karayoshi,” and “Musashino Mori Coffee” are growing in store count

Figure: Store count, sales per store (JPYm)



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

Figure: Changes in store count (Dec 18 through Mar 21)



Source: Company data, Mita Securities

Main restaurant formats with growth potential

Shabu-Yo

“Shabu-Yo” is an all-you-can-eat shabu-shabu restaurant with 272 stores at end-1Q FY12/21. It is the fastest growing restaurant format in recent years. The company has opened stores in suburban roadside areas as well as near stations in central Tokyo. The main target is families in their 30s and 40s, and it is also popular among students in the city (lunch is served until 16:00, a time when high school students can stop by after school). At one time, it was popular to post pictures of meat plates stacked high like a tower on SNS, which helped raise the profile of “Shabu-Yo.” The average spend per customer is about 1,700 yen, which is lower than the typical level for all-you-can-eat shabu-shabu restaurants. The menu is divided into several courses depending on the type of meat available. In addition to meat, all-you-can-eat vegetables, desserts, rice, curry, and noodles are available. Depending on the course, you can also choose sushi. The meat and sushi are brought to each table by the staff, while the other ingredients are displayed for customers to pick up. Although the restaurant uses many ingredients with a high cost of goods ratio, such as meat, the burden of cooking in the kitchen is small, and the labor cost ratio appears to be low.

All-you-can-eat shabu-shabu with reasonable pricing. Popular among families and students. Highest growth potential restaurant format

Figure: Exterior view of store



Source: Company data

Figure: Interior view of store



Source: Company data

Figure: Shabu-shabu



Source: Company data

Figure: Shabu-shabu



Source: Company data

Figure: Vegetables buffet



Source: Company data

Figure: Sushi



Source: Company data

Musashino Mori Coffee

“Musashino Mori Coffee” is a full-service coffee shop with 55 stores at end-1Q FY12/21, an increase of 10 stores during the quarter (8 of which were converted). The stores are mainly located in suburban roadside areas, but are also located near stations in central Tokyo. The main targets are groups of women in their 30s-50s, single customers, and couples. The interior, menu, and tableware have a more stylish image than that of a typical family restaurant. It offers a wide variety of drinks, including coffee, tea, soft drinks, and alcohol, as well as desserts and light meals. There is no drink bar, and food and drinks are brought to the table by a wait staff upon receiving the order. During breakfast hours, the restaurant offers a morning service where customers who order a single drink are offered a free slice of toast. There are also a variety of take-out menus. The average spend per customer for eat-in is estimated to be around 1,200 yen.

Full-service coffee shops are an area that many food service companies have attempted to enter, following the success of “Komeda’s Coffee” and “Hoshino Coffee.” “Musashino Mori Coffee” is a latecomer to the market, having opened its first store in March 2015, but the business is growing steadily and we have high expectations for the business going forward.

Although a latecomer as a full-service coffee shop, it is growing steadily. Stylish image distinguished from typical family restaurants

Figure: Exterior view of store



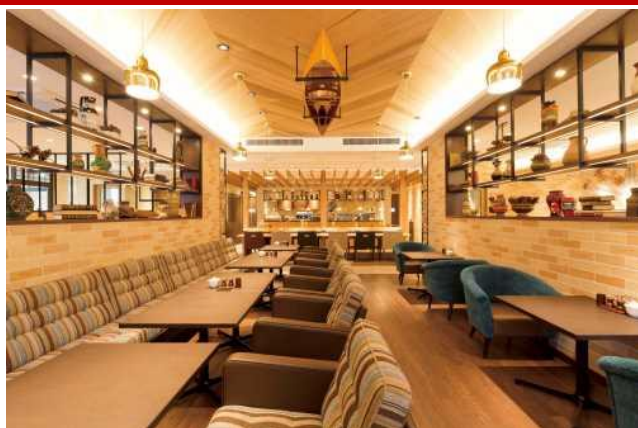
Source: Company data

Figure: Interior view of store



Source: Company data

Figure: Interior view of store



Source: Company data

Figure: Hand drip coffee



Source: Company data

Figure: Pancake



Source: Company data

Figure: Ham sandwich



Source: Company data

Business performance in the wake of the COVID-19 pandemic

Same-store sales

The company's same-store sales for FY12/20 declined 24.3% YoY, strongly affected by COVID-19. The breakdown shows a 28.1% decline in the number of customers and a 5.3% increase in average spend per customer. The increase in average spend per customer was mainly due to a large increase in the delivery/take-out ratio.

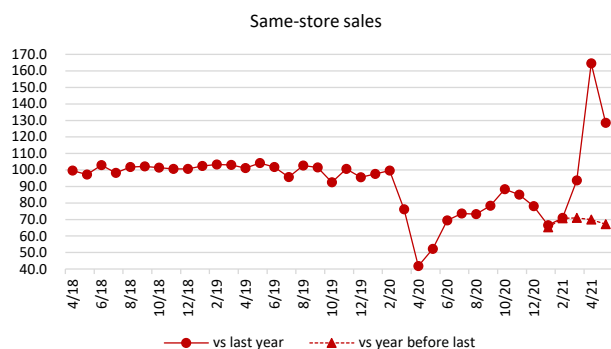
Same-store sales in 1Q FY12/21 declined 23.4% YoY, broken down by a 29.6% decline in number of customers and an 8.7% increase in average spend per customer. Monthly same-store sales YoY were down 33.5% in January, 29.1% in February, and 6.3% in March. Compared to 2019, it was down 34.7% in January, down 29.3% in February, and down 29.1% in March.

As for 2Q, same-store sales in April were up 64.6% YoY, broken down into a 54.6% increase in number of customers and a 6.5% increase in average spend per customer. The significant YoY increase was due to a rebound from a sharp drop in sales in April 2020 due to COVID-19. Compared to the same month in 2019, the sales declined by 30.0%, still stuck in a very difficult situation.

Since January, sales have been down around 30% compared to 2019

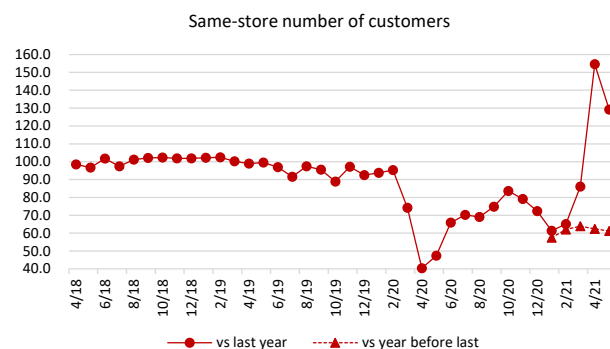
Same-store sales in May increased 28.6% YoY, broken down by a 29.1% increase in number of customers and a 0.4% decrease in average spend per customer. Compared to the same month in 2019, sales were down 32.9%. The situation remains severe due to the impact of about 2,300 stores shortening their opening hours.

Figure: Same-store sales



Source: Company data, Mita Securities Note: Same month last year or year before last = 100

Figure: Same-store number of customers



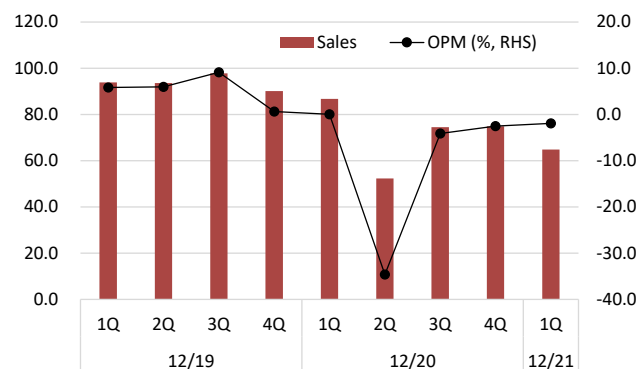
Source: Company data, Mita Securities Note: Same month last year or year before last = 100

Figure: Same-store average spend per customer



Source: Company data, Mita Securities Note: Same month last year or year before last = 100

Figure: Quarterly earnings (JPYbn)



Source: Company data, Mita Securities

Credit improvement and growth strategy

Outline and background of the capital increase

Use of funds for new stock issue

On May 21, one week after the announcement of 1Q FY12/21 results, the company announced the issuance of new shares. The total proceeds of 42.6bn yen will be used for factories capital expenditures of 3.0bn yen, IT investments of 6.0bn yen, capital expenditures for new store openings in Japan and overseas of 6.0bn yen, and capital expenditures for conversion of existing stores and store renovations of 10.0bn yen. The remaining amount (approximately 17.6bn yen) will be used to repay loans.

Raised 42.6bn yen through a capital increase in June

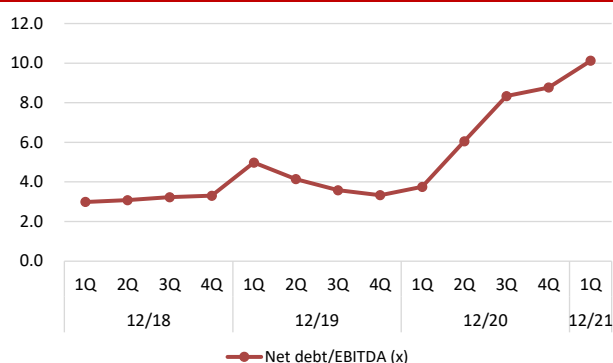
Violation of financial covenants on loans and amendment of contracts

The reason for the capital increase is that the company posted a net loss of -17.2bn yen in FY12/20 and a net loss of -1.9bn yen in 1Q FY12/21, resulting in a decline in equity capital from 132.8bn yen at end-FY12/19 (before COVID-19) to 112.2bn yen at end-1Q FY12/21.

Background: loss of equity capital due to large losses, significant deterioration in net leverage ratio

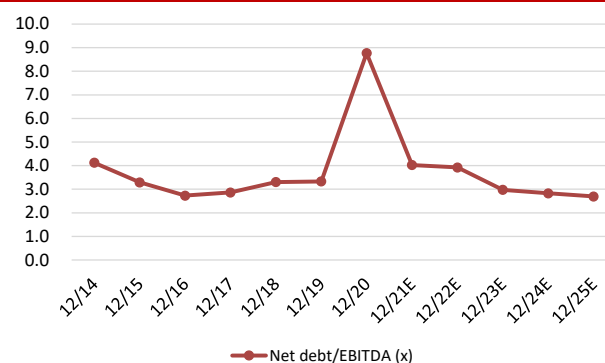
It is also important to note that the company has experienced LBOs in the past and has a large amount of debt with financial covenants; in 2Q FY12/20, the company violated one of the financial covenants related to the net leverage ratio (net debt/adjusted EBITDA). The risk of the company defaulting was eliminated when the financial institutions agreed not to pursue claims for forfeiture and subsequently agreed to relax the financial covenants. Going forward, the company needs to respond to the assistance of financial institutions by improving its credit quality. It is our understanding that the capital increase was an important first step toward improving the company's creditworthiness.

Figure: Net debt/EBITDA (quarterly basis)



Source: Company data, Mita Securities

Figure: Net debt/EBITDA (FY basis)



Source: Company data, Mita Securities

Note: Forecasts are by Mita Securities

Implications

Balance between credit improvement and growth strategies

In general, a breach of financial covenants is a financial crisis for a company. In Japan, there have been many cases where financial institutions have taken a flexible approach to companies in breach of financial covenants, instead of taking hard-line measures such as claiming forfeiture of the benefit of time. However, it is natural to assume that in return for the compromises, there will be more stringent monitoring by financial institutions. In this context, the top priority for the company in the near term should be to improve its creditworthiness. The company's growth strategy is likely to center on strengthening the competitiveness of existing stores. This will include changing the format of underperforming stores and renovating existing stores. We expect the ratio of "Shabu-Yo" and "Musashino Mori Coffee" to increase. On the other hand, we do not think the company is in a phase where it will aggressively open new stores. We expect the number of stores to be 3,131 (+0.2% YoY) at end-FY12/21, 3,146 (+0.5% YoY) at end-FY12/22, and 3,171 (+0.8% YoY) at end-FY12/23, compared to 3,126 at end-FY12/20. In order to start aggressively opening new stores, the company needs to first improve its creditworthiness and significantly lower its net leverage ratio.

Top priority for the time being will be to improve creditworthiness. Growth strategy is expected to focus on strengthening existing stores

Direction of dividends and shareholder benefits

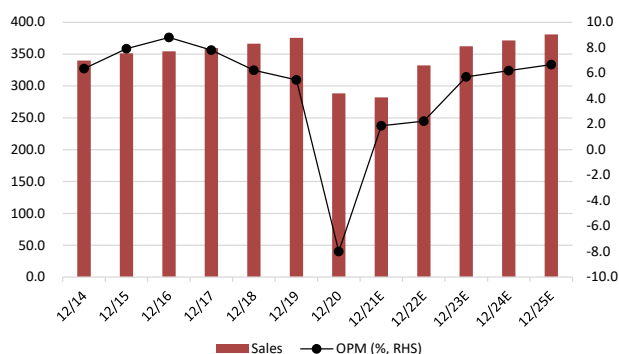
The company did not pay a dividend in FY12/20 due to losses, and plans to pay no dividend in 1H FY12/21, with 2H undecided. We expect the company to pay no dividend for FY12/21.

The company's basic policy on dividends is to target a payout ratio of 30% (based on adjusted net profit). In the past, the company's basic policy was to have a payout ratio of 40%, but due to the need to fund growth, it lowered the ratio to 30%. Going forward, it will be difficult for the company to raise its dividend payout ratio target due to increasing financial constraints, in our view.

As long as creditworthiness remains a constraint, expectations for dividends are low

With regard to shareholder benefits, the company reduced the amount of meal coupons to be given to shareholders from the end of December 2020. We believe this is due to the company's increased financial constraints. We expect the company to maintain the current level of shareholder benefits in the future.

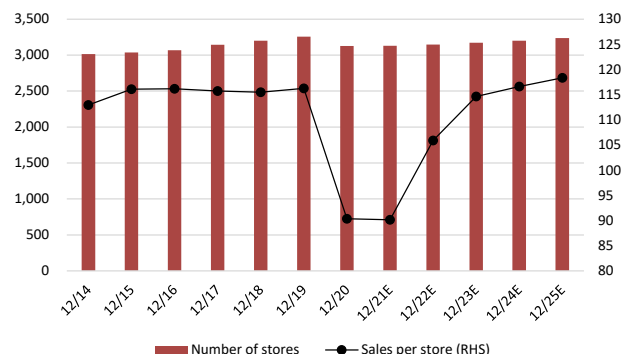
Figure: Sales (JPYbn), OPM (%)



Source: Company data, Mita Securities

Note: Forecasts are by Mita Securities

Figure: Store count, sales per store (JPYm)



Source: Company data, Mita Securities

Note: Forecasts are by Mita Securities

Figure: Skylark HD's growth strategies

Phase	Time period	Initiatives
Phase 1	-2022	Cost reduction, expansion of delivery and take-out sales, conversion of formats, productivity improvement of existing stores
Phase 2	2022-2025	Full-scale entry into mail-order, external sales and meal delivery services, overseas store openings
Phase 3	2025-	Expansion of market share through M&A

Source: Company data, Mita Securities

Figure: Examples of capital increase by food service companies (including subordinated loans)

Announcement	Company name	Ticker	Funding method	Funding amount (JPYm)	Note
07/28/20	Colowide	7616	Preferred shares	9,000	Dividend 3.5% per annum. No conversion right to common shares
07/31/20	Pepper Food Service	3053	Warrants	6,740	Exercise price 415 yen (initial), with downward adjustment clause (last closing price x 90%, minimum exercise price 208 yen)
			Warrants	2,883	Exercise price 415 yen (initial), with downward adjustment clause (minimum exercise price 312 yen)
					Maximum dilution of the above total 99.96%
11/11/20	Joyfull	9942	Treasury share sale	1,000	
11/11/20	SRS HD	8163	Warrants	6,186	Exercise price 922 yen (initial), with downward adjustment clause (last closing price x 92%, minimum exercise price 646 yen). Maximum dilution 19.27%
11/19/20	Sagami HD	9900	Warrants	4,910	Exercise price 1,291 yen (initial), with downward adjustment clause (last closing price x 92%, minimum exercise price 904 yen). Maximum dilution 14.34%
12/24/20	Ootoya HD	2705	Preferred shares	3,000	With conversion right to common shares
01/26/21	Ringer Hut	8200	Subordinated loans	5,000	
			Warrants	2,359	Exercise price 2,363 yen (initial), with downward adjustment clause (last closing price x 92%, minimum exercise price 1,655 yen). Maximum dilution 3.84%
02/02/21	Create Restaurants HD	3387	Undated subordinated loans	15,000	Recorded as equity under IFRS
02/05/21	Zensho HD	7550	Subordinated loans	10,000	JCR recognizes 50% as equity
02/08/21	Monogatari Corporation	3097	CB	6,120	Conversion price of 12,500 yen (initial, before 1:2 stock split), with downward adjustment clause (minimum conversion price of 11,250 yen). Maximum dilution 8.69%
02/15/21	Royal HD	8179	Common shares	10,000	Issue price 1,718 yen
			Warrants	7,847	Exercise price 1,908 yen (initial), with upward and downward adjustment clauses (minimum exercise price 1,431 yen)
			Preferred shares	3,000	Dividend 8.5% per annum. No conversion right to common shares
			Preferred shares	3,000	Dividend 8.5% per annum, with conversion right to common shares
					Maximum dilution of the above total 29.69%
05/14/21	Chikaranomoto HD	3561	Common shares	1,646	Issue price 558 yen
			Warrants	1,182	Exercise price 587 yen (fixed)
			Warrants	765	Exercise price 764 yen (fixed)
					Maximum dilution of the above total 24.71%
05/20/21	Fujio Food Group	2752	Subordinated loans	3,700	
			Treasury share sale	851	Sale price 1,216 yen
			Warrants	1,919	Exercise price 1,399 yen (fixed). Maximum dilution 3.21%
05/20/21	Saint Marc HD	3395	Warrants	967	Exercise price 1,662 yen (initial), with downward adjustment clause (minimum exercise price 1,280 yen)
			CB	6,057	Conversion price 1,662 yen (initial), with downward adjustment clause (minimum conversion price 1,280 yen)
					Maximum dilution of the above total 23.09%
05/21/21	Skylark HD	3197	Common shares	42,610	Public offering of new shares. Issue price 1,495 yen. Dilution 15.19%
05/24/21	Watami	7522	Preferred shares	12,000	Dividend 4% per annum. No conversion right to common shares
06/25/21	Zensho HD	7550	Subordinated loans	20,000	
06/28/21	Chimny	3178	Subordinated loans	1,000	

Source: Companies data, Mita Securities

Mita Securities' earnings forecast

Earnings forecast for FY12/21

We forecast consolidated sales of 282.0bn yen (-2.2% YoY), OP of 5.3bn yen (-23.0bn yen loss in FY12/20), OPM of 1.9% (-8.0% in FY12/20), and NP of 0.5bn yen (-17.2bn yen loss in FY12/20). We expect these figures to be roughly in line with the company's guidance of 285.0bn yen in sales, 5.0bn yen in OP, and 0.4bn yen in NP. We expect the number of stores at the end of the fiscal year to be 3,131 (+0.2% YoY). We assume same-store sales to decline 0.3% YoY (number of customers: -5.0%, average spend per customer: +5.0%). Compared to FY12/19, same-store sales are expected to decline 24.5%, which is slightly below the company's guidance of 23.0%.

Going forward, we can expect a further easing of requests by local governments for restaurants to close or shorten their hours, and a recovery in demand for food service due to progress in vaccinations. As in-store dining recovers, take-out demand is likely to peak out. On the other hand, in the delivery business, the company seems to be succeeding in attracting new customers, and a certain level of demand can be expected to take hold.

As the company adopts IFRS, OP reflects subsidy income from local governments (a positive item) and impairment losses on non-financial assets (a negative item). Our forecast incorporates subsidy income of 18.0bn yen and impairment loss of 5.0bn yen. The company's guidance incorporates 10.0bn yen in subsidy income generated in Jan-Mar.

We assume that the net debt/EBITDA ratio at the end of the fiscal year will be 4.0x (it does not match the company definition), below the limit of financial covenants of 5.5x.

We expect a turnaround in the black with an OP of 5.3bn yen. However, the profit should be supported by subsidy income from local governments

Outlook for FY12/22 and beyond

For FY 12/22, we forecast sales of 332.4bn yen (+17.9% YoY), OP of 7.5bn yen (+40.4% YoY), and an OPM of 2.2%. There is no significant difference in the OPM from the FY 12/21 forecast, but while the FY 12/21 forecast incorporates a large amount of subsidy income, the FY 12/22 forecast does not. We believe that FY 12/22 will be the start of a full-fledged recovery. We assume that the number of stores at the end of the fiscal year will be 3,146 (+0.5% YoY). We assume that the net debt/EBITDA ratio at the end of the fiscal year will be 3.9x, which is below the upper limit of the financial covenants of 4.5x.

We forecast OP 20.7bn yen (+177.5% YoY) and an OPM of 5.7% in FY12/23. This is comparable to the FY12/19 OP of 20.6bn yen and OPM of 5.5%. We assume that the number of stores at the end of the fiscal year will be 3,171 (+0.8% YoY), and that the pace of store openings will recover, albeit slightly. We assume that the company's net debt/EBITDA ratio at the end of the fiscal year will improve to 3.0x, below the upper limit of the financial covenant of 4.0x. By this time, financial constraints should have been eased, making it easier for the company to aggressively pursue growth strategies.

We expect the company to achieve profitability on its own in FY 12/22 and to post an OP on par with FY 12/19 in FY 12/23. Financial constraints should be eased, making it easier to pursue growth strategies

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

Various indicators	12/17	12/18	12/19	12/20	12/21	12/22	12/23	12/24	12/25	5-yr ave growth
Consolidated	A	A	A	A	Mita E	Mita E	Mita E	Mita E	Mita E	(CAGR, %)
Sales growth (%)	1.4	1.9	2.5	-23.2	-2.2	17.9	8.9	2.6	2.5	
Same-store sales growth (%)	0.0	0.4	0.3	-24.3	-0.3	17.6	8.3	1.7	1.5	
Store count growth (%)	2.5	1.7	1.8	-4.1	0.2	0.5	0.8	0.9	1.1	
OP growth (%)	-10.1	-18.7	-10.0	NA	NA	40.4	177.5	11.5	10.2	
Pre-tax profit growth (%)	-18.8	-20.9	-10.0	NA	NA	210.2	286.3	14.3	12.3	
NP growth (%)	-14.6	-26.4	-17.1	NA	NA	435.9	343.6	14.9	12.8	
GPM (%)	69.9	69.6	69.6	68.4	69.2	69.5	69.7	69.7	69.7	
OPM (%)	7.8	6.2	5.5	-8.0	1.9	2.2	5.7	6.2	6.7	
EBITDA margin (%)	11.6	10.2	19.2	9.8	18.6	16.4	18.7	19.0	19.3	
ROA (%)	4.9	3.5	2.4	-3.8	0.1	0.6	2.5	2.8	3.2	
ROE (%)	12.9	8.9	7.2	-14.0	0.4	1.7	7.2	7.7	8.2	

Source: Company data, Mita Securities

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

PL	12/17	12/18	12/19	12/20	12/21	12/22	12/23	12/24	12/25	5-yr ave growth
Consolidated, JPYm	A	A	A	A	Mita E	Mita E	Mita E	Mita E	Mita E	(CAGR, %)
Sales	359,445	366,360	375,394	288,434	281,986	332,399	362,139	371,480	380,877	5.7
Cost of sales	108,293	111,401	114,045	91,288	86,852	101,382	109,728	112,558	115,406	
Gross profit	251,152	254,959	261,348	197,146	195,134	231,017	252,411	258,922	265,472	
Other operating income	602	881	899	2,394	18,900	1,000	1,000	1,000	1,000	
SG&A	221,814	230,538	236,930	212,637	203,724	222,062	230,222	234,350	238,557	
Other operating expenses	1,837	2,445	4,755	9,935	5,000	2,500	2,500	2,500	2,500	
Operating profit	28,103	22,857	20,562	-23,031	5,310	7,455	20,689	23,071	25,415	NA
Interest income	17	14	12	14	15	15	15	15	15	
Other income	2	7	2	2	2	2	2	2	2	
Interest expense	4,496	4,214	3,816	2,813	2,837	2,750	2,750	2,585	2,420	
Other expenses	107	68	31	605	1,000	100	100	100	100	
Pre-tax profit	23,519	18,596	16,729	-26,433	1,490	4,622	17,856	20,403	22,912	NA
Corporate taxes	7,970	7,158	7,242	-9,219	987	1,927	5,897	6,661	7,414	
NP attributable to non-controlling interests	0	0	0	0	0	0	0	0	0	
NP attributable to owners of the company	15,549	11,438	9,487	-17,214	503	2,696	11,959	13,742	15,498	NA
EBITDA	41,835	37,226	71,941	28,384	52,385	54,577	67,858	70,712	73,532	
Shares outstanding (m)	197	197	198	198	228	228	228	228	228	
EPS (JPY)	78.96	58.04	48.03	-87.16	2.21	11.85	52.57	60.41	68.12	
BPS (JPY)	646.57	661.92	672.48	576.00	698.92	710.77	759.34	803.74	851.87	
DPS (JPY)	38.00	38.00	19.00	0.00	0.00	4.00	16.00	20.00	24.00	
Payout ratio (%)	48.0	65.5	39.6	0.0	0.0	33.8	30.4	33.1	35.2	

Source: Company data, Mita Securities

Figure: Mita Securities' earnings forecast (store count)

Assumptions for store count	12/17	12/18	12/19	12/20	12/21	12/22	12/23	12/24	12/25	5-yr ave growth
	A	A	A	A	Mita E	Mita E	Mita E	Mita E	Mita E	(CAGR, %)
New openings	97	89	86	46	50	50	55	60	65	
Number of stores	3,145	3,200	3,258	3,126	3,131	3,146	3,171	3,201	3,236	0.7
(YoY, %)	2.5	1.7	1.8	-4.1	0.2	0.5	0.8	0.9	1.1	
Sales/Ave number of stores (JPYm)	116	115	116	90	90	106	115	117	118	5.5
(YoY, %)	-0.4	-0.2	0.7	-22.3	-0.3	17.5	8.3	1.7	1.5	

Source: Company data, Mita Securities

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

BS	12/17	12/18	12/19	12/20	12/21	12/22	12/23	12/24	12/25	5-yr ave growth
Consolidated, JPYm	A	A	A	A	Mita E	Mita E	Mita E	Mita E	Mita E	(CAGR, %)
Total current assets	32,960	37,736	36,658	36,317	59,424	58,060	63,373	36,874	40,064	
Cash and cash equivalents	15,094	18,908	18,949	17,030	39,063	35,874	48,081	20,047	21,975	
Trade and other receivables	8,691	9,714	10,689	13,588	12,679	14,641	7,186	7,062	9,634	
Inventories	4,677	4,282	4,899	4,304	5,950	6,137	7,032	5,351	4,171	
Other	4,158	4,522	1,798	1,350	1,682	1,353	1,019	4,354	4,225	
Total non-current assets	285,243	292,935	417,321	405,354	408,694	421,467	432,033	440,373	449,884	
Tangible fixed assets	102,277	104,447	230,040	210,530	215,004	219,253	224,791	231,551	239,474	
Goodwill	146,140	146,098	146,072	146,059	146,016	146,016	146,016	146,016	146,016	
Other intangible assets	3,461	6,602	5,835	4,726	4,620	5,446	5,934	6,087	6,241	
Other	33,365	35,788	35,373	44,039	43,055	50,752	55,293	56,719	58,154	
Total assets	318,203	330,671	453,979	441,672	468,118	479,528	495,405	477,247	489,948	2.1
Total current liabilities	54,881	157,277	97,588	203,726	98,743	106,088	110,307	105,157	106,597	
Short-term debt	10,859	111,379	18,459	125,845	25,000	25,000	25,000	22,000	22,000	
Trade and other payables	25,264	26,299	26,349	24,435	23,248	27,137	29,371	30,128	30,891	
Other financial liabilities	3,682	3,487	32,757	31,735	29,838	29,838	29,838	26,258	26,258	
Other	15,076	16,112	20,022	21,712	20,657	24,113	26,098	26,771	27,448	
Total non-current liabilities	135,998	42,941	223,574	124,185	210,369	211,738	212,347	189,236	189,550	
Long-term debt	115,588	21,675	110,859	20,000	110,552	102,936	99,547	74,413	72,666	
Other financial liabilities	4,777	5,364	96,511	88,311	84,609	92,225	95,614	97,329	99,076	
Other	15,633	15,902	16,204	15,873	15,208	16,577	17,186	17,494	17,808	
Total liabilities	190,879	200,218	321,162	327,911	309,112	317,826	322,654	294,393	296,147	-2.0
Total equity	127,324	130,453	132,817	113,761	159,006	161,702	172,751	182,853	193,802	11.2
Equity attributable to owners of the company	127,324	130,453	132,817	113,761	159,006	161,702	172,751	182,853	193,802	11.2
Non-controlling interests	0	0	0	0	0	0	0	0	0	
Total liabilities and equity	318,203	330,671	453,979	441,672	468,118	479,528	495,405	477,247	489,948	
Debt	134,906	141,905	258,586	265,891	250,000	250,000	250,000	220,000	220,000	-3.7
Net debt/EBITDA (x)	2.9	3.3	3.3	8.8	4.0	3.9	3.0	2.8	2.7	
D/E (x)	1.1	1.1	1.9	2.3	1.6	1.5	1.4	1.2	1.1	
Shareholders' equity ratio (%)	40.0	39.5	29.3	25.8	34.0	33.7	34.9	38.3	39.6	

Source: Company data, Mita Securities

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

CF	12/17	12/18	12/19	12/20	12/21	12/22	12/23	12/24	12/25	5-yr ave growth
Consolidated, JPYm	A	A	A	A	Mita E	Mita E	Mita E	Mita E	Mita E	(CAGR, %)
Operating CF	31,510	31,571	67,825	36,724	42,697	55,008	69,908	61,032	63,663	
NP attributable to owners of the company	15,549	11,438	9,487	-17,214	503	2,696	11,959	13,742	15,498	
Depreciation and amortization	13,464	14,075	51,061	51,168	47,075	47,122	47,169	47,640	48,117	
Other	2,497	6,058	7,277	2,770	-4,880	5,191	10,780	-350	48	
Investing CF	-19,606	-19,667	-20,446	-15,742	-16,516	-25,197	-23,791	-22,426	-24,185	
Capital expenditure	-18,254	-19,020	-20,386	-15,770	-17,500	-17,500	-19,250	-21,000	-22,750	
Disposal of fixed assets	9	0	1,062	8	0	0	0	0	0	
Other	-1,361	-647	-1,122	20	984	-7,697	-4,541	-1,426	-1,435	
Financing CF	-13,078	-8,049	-47,350	-22,921	-4,149	-33,000	-33,910	-66,640	-37,550	
Dividends paid	-7,609	-7,470	-6,110	-1,986	0	0	-910	-3,640	-4,550	
Share capital issuance/buyback	1,329	93	209	0	44,742	0	0	0	0	
Debt issuance/repayment	-3,500	1,512	-3,175	16,107	-15,891	0	0	-30,000	0	
Other	-3,298	-2,184	-43	-565	0	0	0	0	0	
Cash and cash equivalents	15,094	18,908	18,949	17,030	39,063	35,874	48,081	20,047	21,975	
Free CF	11,904	11,904	47,379	20,982	26,182	29,811	46,117	38,606	39,479	

Source: Company data, Mita Securities

Special topics: Shareholder benefits

Shareholder benefit yield for food service companies

Figure: Comparison of shareholder benefit yield

	Company name	Ticker	Vesting month	Shareholder benefit/share (JPY)	Shareholder benefit yield (%)	PBR (x)
1	WATAMI CO LTD	7522	Mar, Sep	80.0	8.6	11.7
2	DAISYO CORP	9979	Feb, Aug	60.0	5.7	1.8
3	SFP HOLDINGS CO LTD	3198	Feb, Aug	80.0	5.5	3.5
4	ATOM CORP	7412	Mar, Sep	40.0	5.2	18.0
5	FUJIO FOOD GROUP INC	2752	Dec, Jun	60.0	4.8	15.5
6	ANRAKUTEI CO LTD	7562	Mar, Sep	260.0	4.8	2.6
7	CREATE RESTAURANTS HOLDINGS	3387	Feb, Aug	40.0	4.4	10.0
8	CHIMNEY CO LTD	3178	Mar, Sep	60.0	4.4	5.3
9	PEPPER FOOD SERVICE CO LTD	3053	Jun, Dec	20.0	4.2	31.4
10	KAPPA CREATE CO LTD	7421	Mar, Sep	60.0	4.1	6.6
11	COLOWIDE CO LTD	7616	Mar, Sep	80.0	4.0	9.0
12	TORIDOLL HOLDINGS CORP	3397	Sep, Mar	60.0	3.2	5.7
13	OTOYA HOLDINGS CO LTD	2705	Mar, Sep	80.0	3.0	13.8
14	SRS HOLDINGS CO LTD	8163	Mar, Sep	24.0	3.0	3.0
15	YOSHINOYA HOLDINGS CO LTD	9861	Feb, Aug	60.0	2.8	3.5
16	SKYLARK HOLDINGS CO LTD	3197	Jun, Dec	40.0	2.6	2.7
17	ASAKUMA CO LTD	7678	Mar	40.0	2.5	3.8
18	HOTLAND CO LTD	3196	Jun, Dec	30.0	2.3	3.9
19	GOURMET KINEYA CO LTD	9850	Mar, Sep	20.0	2.1	2.6
20	BRONCO BILLY CO LTD	3091	Jun, Dec	40.0	1.7	2.1
21	RINGER HUT CO LTD	8200	Feb, Aug	33.0	1.4	6.2
22	AMIYAKI TEI CO LTD	2753	Mar	40.0	1.4	1.0
23	KISOJI CO LTD	8160	Mar, Sep	32.0	1.4	2.5
24	KOURAKUEN HOLDINGS CORP	7554	Mar	20.0	1.3	7.3
25	GINZA RENOIR CO LTD	9853	Mar	10.0	1.2	1.6
26	GENKI SUSHI CO LTD	9828	Mar, Sep	30.0	1.2	2.7
27	TORIKIZOKU HOLDINGS CO LTD	3193	Jan, Jul	20.0	1.1	4.3
28	HIDAY HIDAKA CORP	7611	Feb, Aug	20.0	1.1	3.1
29	KUSHIKATSU TANAKA HOLDINGS C	3547	Nov	20.0	1.1	12.2
30	ARCLAND SERVICE HOLDINGS CO	3085	Jun, Dec	22.0	1.0	3.2
31	KOMEDA HOLDINGS CO LTD	3543	Feb, Aug	20.0	1.0	2.7
32	UKAI CO LTD	7621	Sep	30.0	1.0	5.7
33	MONOGATARI CORP	3097	Jun, Dec	70.0	0.9	4.5
34	CHOUSHIMARU CO LTD	3075	May, Nov	10.0	0.9	2.3
35	SAIZERIYA CO LTD	7581	Aug	20.0	0.8	1.6
36	OHSO FOOD SERVICE CORP	9936	Mar, Sep	40.0	0.7	2.0
37	ZENSHO HOLDINGS CO LTD	7550	Mar, Sep	20.0	0.7	5.1
38	MOS FOOD SERVICES INC	8153	Mar, Sep	20.0	0.7	2.1
39	DOUTOR NICHIRETS HOLDINGS CO	3087	Feb	10.0	0.6	0.8
40	KURA SUSHI INC	2695	Apr	25.0	0.5	4.1

Source: Companies data, Bloomberg Finance LP data, Mita Securities

Note 1: Shareholder benefit yield = Meal coupon amount per share (minimum purchase unit basis)/Stock price (June 30, 2021)

Note 2: Watami (7522) offers 4,000 yen worth of meal coupons every half year. However, use is limited to 500 yen per person per occasion

APPENDIX

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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.

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