

TENPO INNOVATION | 3484

Profitability rising on structural growth drivers

Margins rising on increase in successor contracts and guarantee fees

SUMMARY

◆ TENPO INNOVATION announced 9M FY23/3 results at 15:30 on Thursday 2/2. Headline numbers were net sales increased +17.1% YoY, OP increased +59.5% YoY, GPM rose from 17.6% → 19.7%, and OPM rose from 7.6% → 10.4%. Profits increased significantly mainly due to several large and profitable sales in real estate transactions. Along with 3Q cumulative results, the Company also revised up full-term guidance after achieving 97% of OP in the first 9 months (see table below and on P5). New full-term forecasts are for net sales +13.9% YoY and OP +30.3% YoY. Net sales were only revised up slightly as the assumption for active subleased contracts at the end of the fiscal year is effectively unchanged and the target for signed contracts is up only marginally. The upward revision to profits reflects growth in profits is accelerating due to two structural drivers.

◆ ① The difficult environment for the restaurant industry overall is actually a favorable opportunity for the Company as more properties become available to procure for subleasing, and turnover in existing contracts increases the number of profitable successor contracts (no acquisition costs such as key money), and ② newly established store rent guarantee business has no cost of sales or operating expenses such as personnel cost, so net sales are basically equivalent to operating profit (nearly 100% OPM), and revenue is linked directly to the number of signed contracts each quarter, so profits are set to grow at a faster pace than net sales going forward thanks to these two structural drivers boosting margins.

◆ On Friday 2/10 at 16:30, the Company announced that the Board of Director resolved at its meeting held on 2/10 to repurchase up to 3.65% of shares outstanding (up to 650,000 shares) on Monday 2/13 at 08:45 at Friday's closing price of 1,240, through off-hours trading on ToSTNeT-3 of the Tokyo Stock Exchange, pursuant to Article 156 of the Companies Act as applied pursuant to Article 165, Paragraph 3 of said Act. The reason given for the repurchase of its own shares is to improve capital efficiency and enable the execution of a flexible capital policy.

TENPO INNOVATION: Company revises up full-term FY23/3 guidance

FY23/3 Full-term Consolidated Financial Forecasts

JPY mn, % [J-GAAP]	Net Sales	Operating Profit	Ordinary Profit	Profit ATOP*	Basic EPS (¥)	FY-end DPS (¥)
Previous Forecast [A] 2022.05.11	12,655	1,059	1,074	733	41.37	TBD
Revised Forecast [B] 2023.02.02	13,000	1,185	1,235	846	47.91	16.00
Increase/decrease AMT (B - A)	345	126	161	113	—	—
Increase/decrease PCT (B / A - 1) * 100	2.7	11.9	15.0	15.4	—	—
(Ref) FY22/3 Results (non-consolidated)	11,415	909	986	662	37.36	12.00

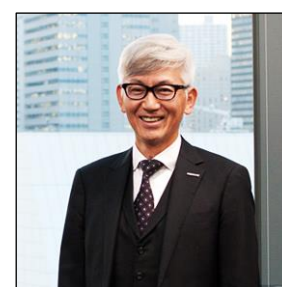
Source: Company press release. Note: FY22/3 non-consolidated results for reference only. *attrib to owners of parent.

Q3 Follow-up

Financial Indicators

Share price (2/27)	1,272
YH (23/2/27)	1,272
YL (22/1/27)	790
10YH (23/2/27)	1,272
10YL (20/4/6)	477
Shrs out. (mn shrs)	17.674
Mkt cap (¥ bn)	21.916
EV (¥ bn)	17.740
Equity ratio (12/31)	29.4%
23.3 P/E (CE)	25.9x
23.3 EV/EBITDA (CE)	14.5x
22.3 ROE (act)	21.1%
22.3 ROIC (act)	18.6%
22.12 P/B (act)	5.70x
23.3 DY (CE)	1.29%

6M weekly share price



Representative Director
Yasuo Hara



Chris Schreiber CFA
Company Specialist

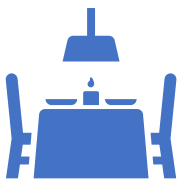
This report has been prepared at the request of TENPO INNOVATION. For details, please refer to the Disclaimer on the last page.

PART ① RESTAURANT INDUSTRY UPDATE



Japan Foodservice Assoc.

JF was established in 1974 under approval of the Ministry of Agriculture, Forestry and Fisheries. The number of regular and supporting member companies has reached 800, representing an estimated market size of approx. ¥25 trillion with 5 million workers.



No. of stores

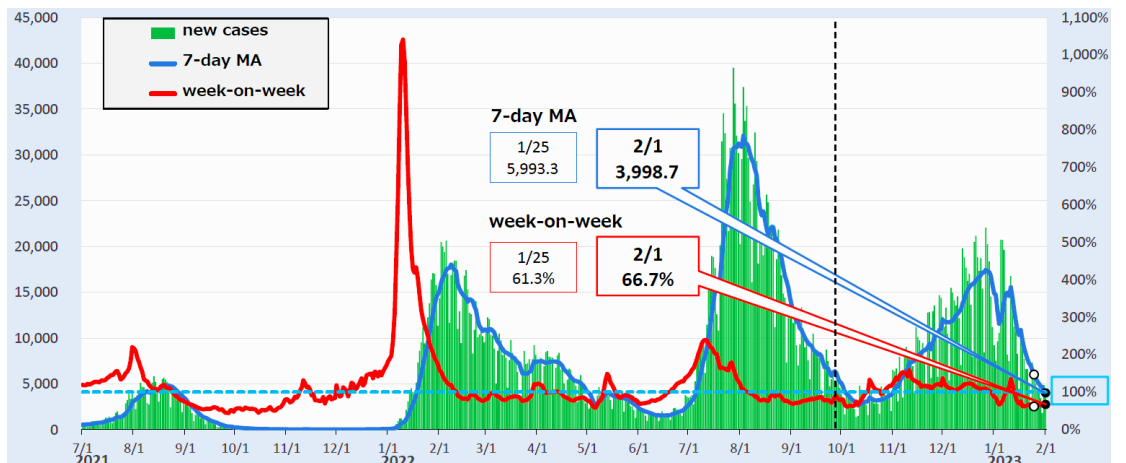


Sales

Net store closures of restaurants in the all-stores data on the right is clearly a lagging indicator relative to sales. The middle graph on the right suggests the impact from the global pandemic *appears* to be mitigating. However, YoY figures, by definition, are versus the same month in the previous year, which can be deceptive after large declines.

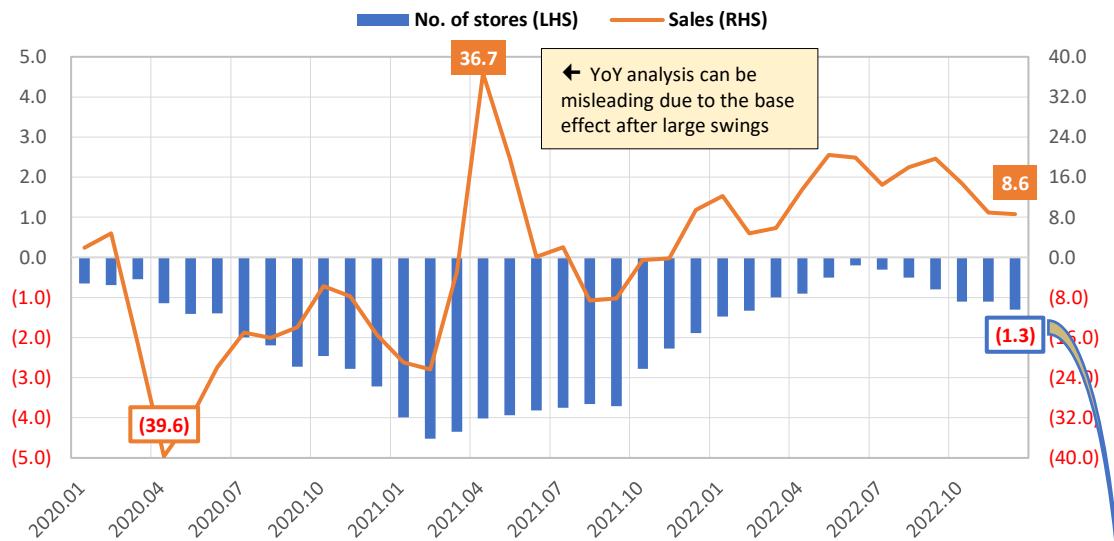
In order to strip out the base level effect, from Mar-2021, the JF monthly survey results report added two new columns to include sales and no. of stores comparisons versus the corresponding month in 2019 (see lower graph on the right).

Greater Tokyo number of new positive cases, compared to previous week (as of 2023.02.02)

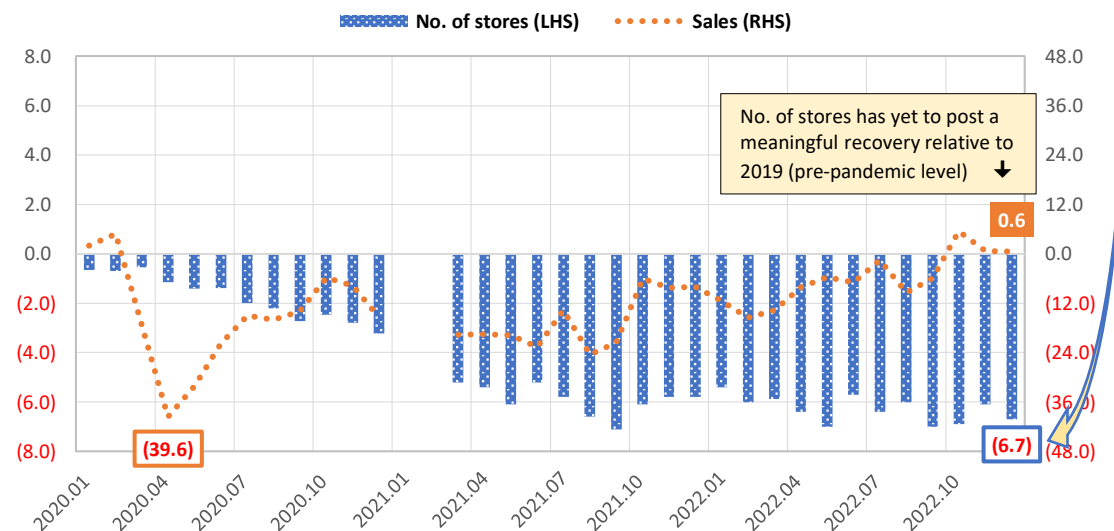


Source: Bureau of Social Welfare and Public Health, Tokyo Metropolitan Government COVID-19 monitoring website

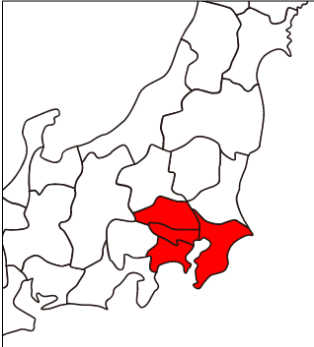
JF Food Service Industry Market YoY Trend Survey – Monthly Results Reports



JF Food Service Industry Market Monthly Trend Survey – adjusted vs. 2019 same month*



Source: Japan Foodservice Association (JF). Note: data for all stores incl. new opens. http://www.jfnet.or.jp/data/data_c.html

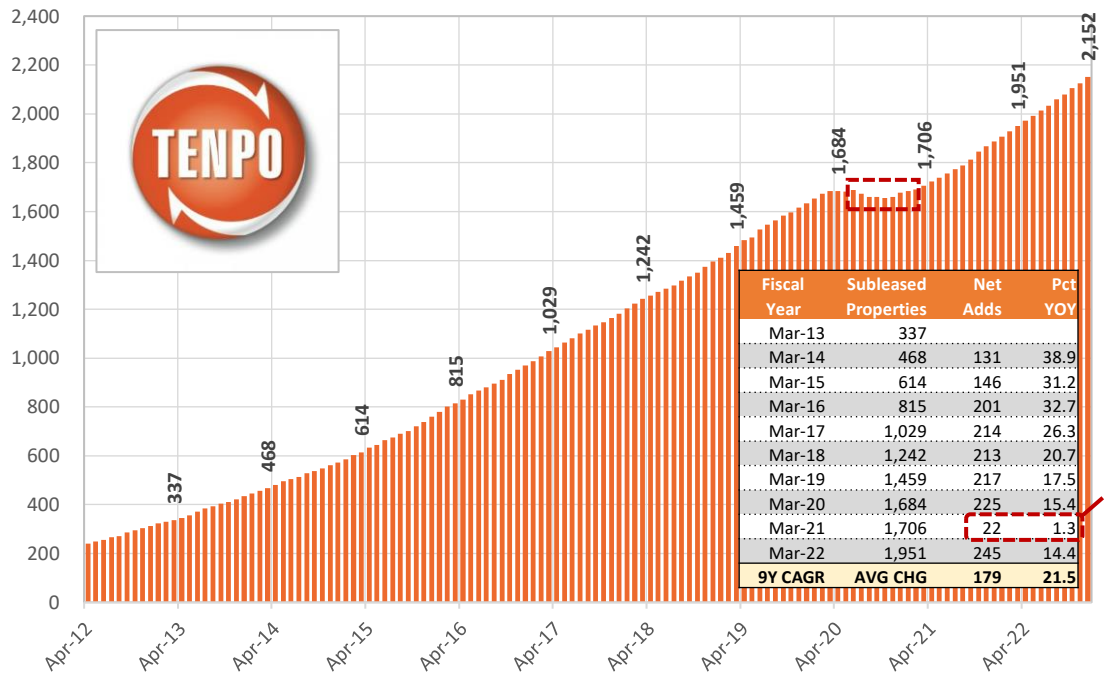


Expertise in finding and subleasing relatively small, low rent, vacated-furnished restaurant store properties, many in central Tokyo.

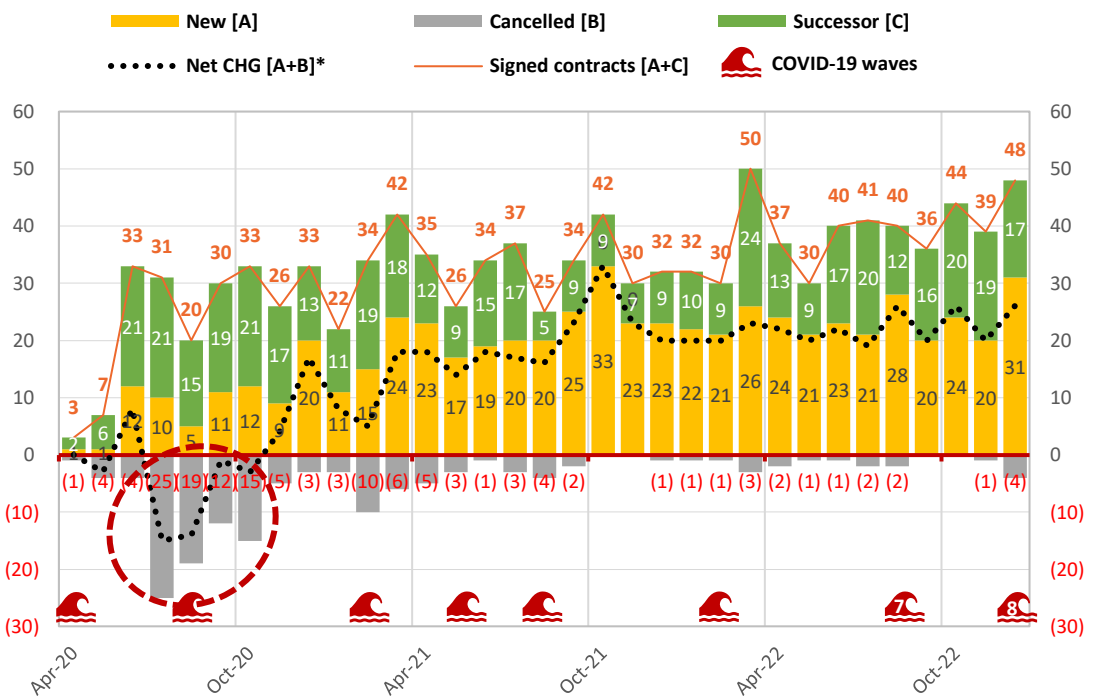


TENPO INNOVATION subleased store properties are uncorrelated with the market. According to the JF Food Service Industry Market YoY Trend Survey for December 2022, **total stores declined -1.3% YoY, but relative to December 2019, declined -6.7%**, yet to post a meaningful recovery. For the same period, **subleased restaurant store properties for TENPO INNOVATION increased +14.0% YoY, and relative to December 2019, increased +31.7%**. In other words, there is no correlation between TENPO INNOVATION subleased restaurant store properties and the underlying market trend for total stores. They are uncorrelated. The graph below shows the long-term monthly trend of the Company's subleased restaurant store properties.

Monthly trend of subleased store properties: textbook definition of stable high growth



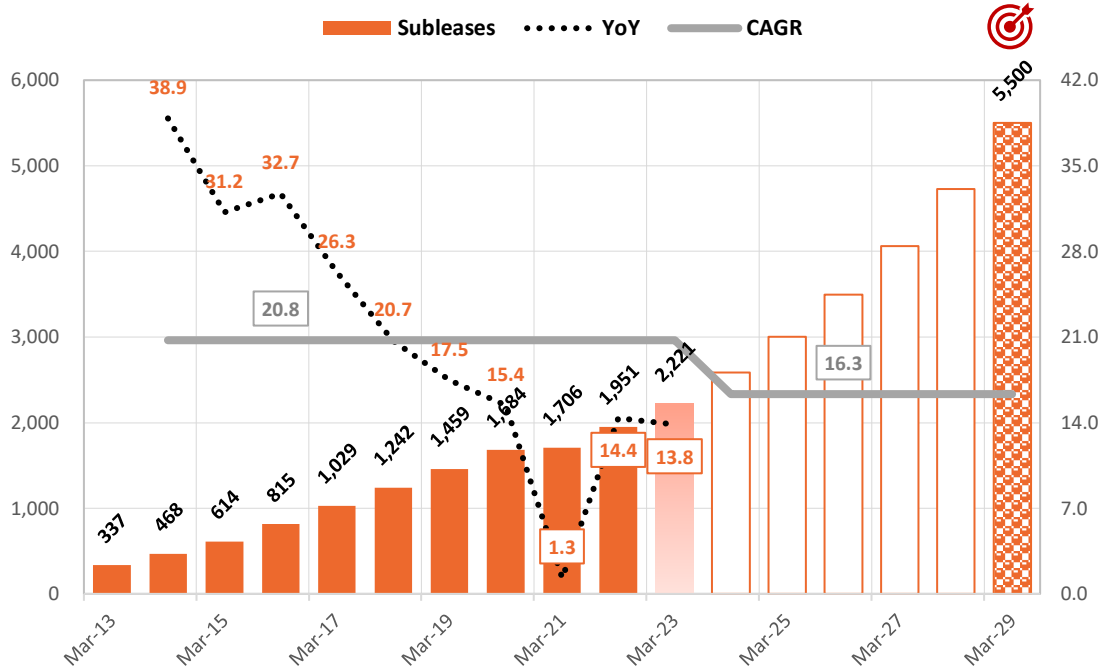
Monthly trend of sublease contract transactions during the pandemic



Source: compiled by Omega Investment from company IR results briefing materials. *Note: net change = "New - Cancelled" as well as reflects transfer from "sublease to leasehold" and "leasehold to sublease" (Dec 2021: -2; Jan 2022: -1; Oct 2021: +2; Nov 2022: +1; Dec 2022: -1).



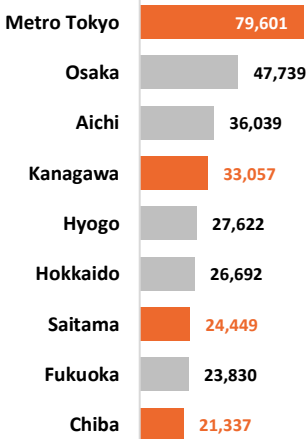
TENPO INNOVATION: Sustainable double-digit growth with high stability



Source: compiled by Omega Investment from company IR FY22/3 Q4 results briefing materials.

The graph above shows the Company's medium-term target for 5,500 subleased properties by the end of FY3/29, implying 6-year CAGR of +16.3% per year. This target was not randomly formulated by simply assigning a certain CAGR growth rate, rather, it is equivalent to a roughly 5% market share of the estimated 110,000 viable candidate restaurant store property universe in Tokyo and the three surrounding prefectures, based on the total number of 160,000 restaurants from the 2016 Economic Census of Business Activity. In order to achieve this target, a key initiative in the Company's Medium-Term Management Plan is to boost its salesforce from the current 40 professionals (14 store procurement, 26 finding subleasing tenants) to 100 (30 store procurement, 70 finding subleasing tenants). Please refer to P10 in the REFERENCE section for details of initiatives in the MTP.

Ranking of No. of Restaurants by Prefecture



Note: 4 Tokyo area = roughly 159K
Source: 2016 Economic Census of Business Activity (METI)

TOKYO × TENPO INNOVATION

Grab Tokyo.

The world's largest number of passengers
The world's largest number of restaurants
The world's top gastronomic city

Shinjuku Station: 3.59 million
Metropolitan Tokyo: 79,601
No. of Michelin-star restaurants: 226

We compete in this city with the highest potential.

The world's most traversed pedestrians
The world's best subculture district

Shibuya
Akihabara

There is more we can do.

99% untapped market.
We will not stop and will keep pushing forward.
It will become a big swell and envelop this city.

From because we can do it → so we will do it.

PART ② EARNINGS RESULTS

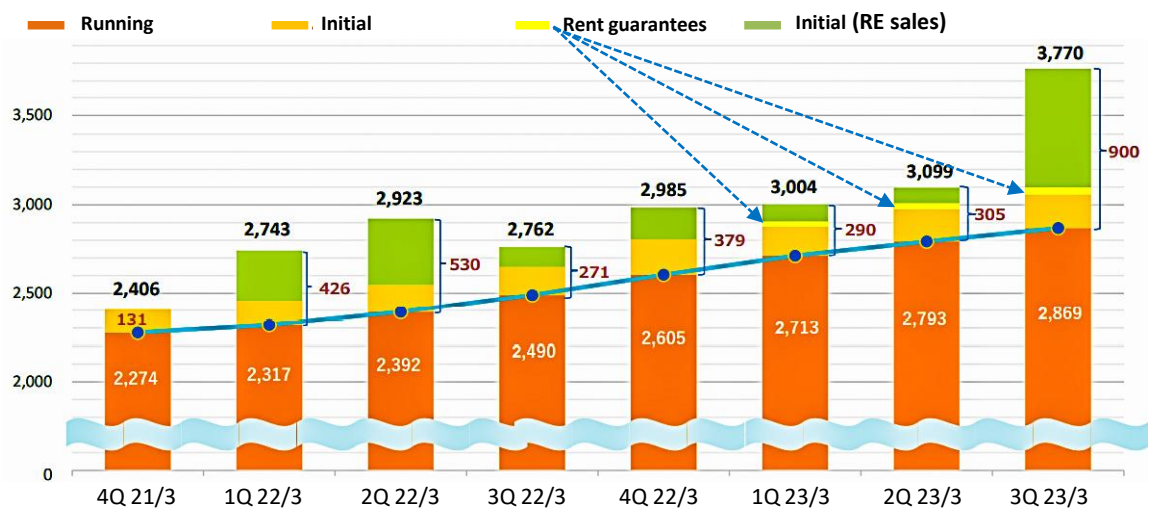


Company revises up full-term guidance after achieving 97% of OP in the first 9M

3Q cumulative (9M) results are summarized in the table below. Net sales increased +17.1% YoY, OP increased +59.5% YoY, GPM rose from 17.6% → 19.7%, and OPM rose from 7.6% → 10.4% (see margins graph on P8). In addition to the contribution from new high margin rent guarantee business, margins got a strong boost from the sale of 5 properties which included several large-scale profitable properties (see below). The number of signed contracts topped 100 for the fifth consecutive quarter at 131 (new record), and the number of profitable successor contracts also increased to 56. Total active restaurant store sublease properties reached 2,152 (+14.0% YoY).

The current business environment is extremely favorable for the business model given active turnover in restaurant openings and closings. TENPO INNOVATION specializes in properties having 1) relatively small scale and reasonable rent, 2) good location and 3) vacated furnished, and as such, are always in high demand. While the quarterly sales amount for RE sales fluctuates from quarter to quarter, it is achieving its target of one property sale and one procurement each quarter (3Q 5 sales and 5 acquisitions, 3Q-end inventory 3 properties). Although the primary objective of this business is to maintain a good relationship with RE brokers by paying meaningful commissions in return for good information on sublease candidates, the Company has recently also received interest from existing owner landlords to purchase properties, enhancing a stable supply pipeline without referrals. New store rent guarantee business is summarized on the next page.

Quarterly Trend of Sales Breakdown by Income Category (JPY mn)



Note: initial income includes one-time payments of key money, contract-related fees and proceeds from the sale of fixtures from vacated-furnished store properties. Running income includes rent income and contract renewal fees from sublease tenants. Store sublease rent guarantees include some running income. Figures for 1Q FY23/3 are consolidated; figures for 4Q FY22/3 and earlier are non-consolidated. Source: excerpt from IR results briefing materials.

TENPO INNOVATION FY23/3 3Q cumulative (9M) Consolidated Financial Results Summary

[J-GAAP] JPY mn, %	FY22/3 9M act NC	ratio to sales	FY23/3 9M act consol	ratio to sales	AMT CHG YoY*	PCT CHG YoY *	23/3 9M ACH ratio vs init CE	FY23/3 init CE consol	FY23/3 rev CE consol	AMT CHG YoY*	PCT CHG YoY*
Net sales	8,429	100.0%	9,874	100.0%	1,445	17.1	78.0%	12,655	13,000	1,585	13.9
Gross profit	1,486	17.6%	1,950	19.7%	463	31.2					
SG&A expenses	845	10.0%	927	9.4%	82	9.7					
Operating profit	641	7.6%	1,023	10.4%	382	59.5	96.6%	1,059	1,185	275	30.2
Ordinary profit	689	8.2%	1,066	10.8%	377	54.7		1,074	1,235	248	25.2
Profit ATOP	468	5.6%	731	7.4%	263	56.2	99.7%	733	846	184	27.7
Signed contracts* ¹	295		355		60	20.3		450	460	53	13.0
Sublease properties* ²	1,888		2,152		264	14.0		2,221	2,222	271	13.9

*YOY comparisons are provided as reference values versus the previous year's non-consolidated figures.

Note: *1 = new plus successor contracts signed. *2 = number of active sublease contracts at FY end.

Source: compiled by Omega Investment from IR results briefing materials.

PART ③
TOPICS



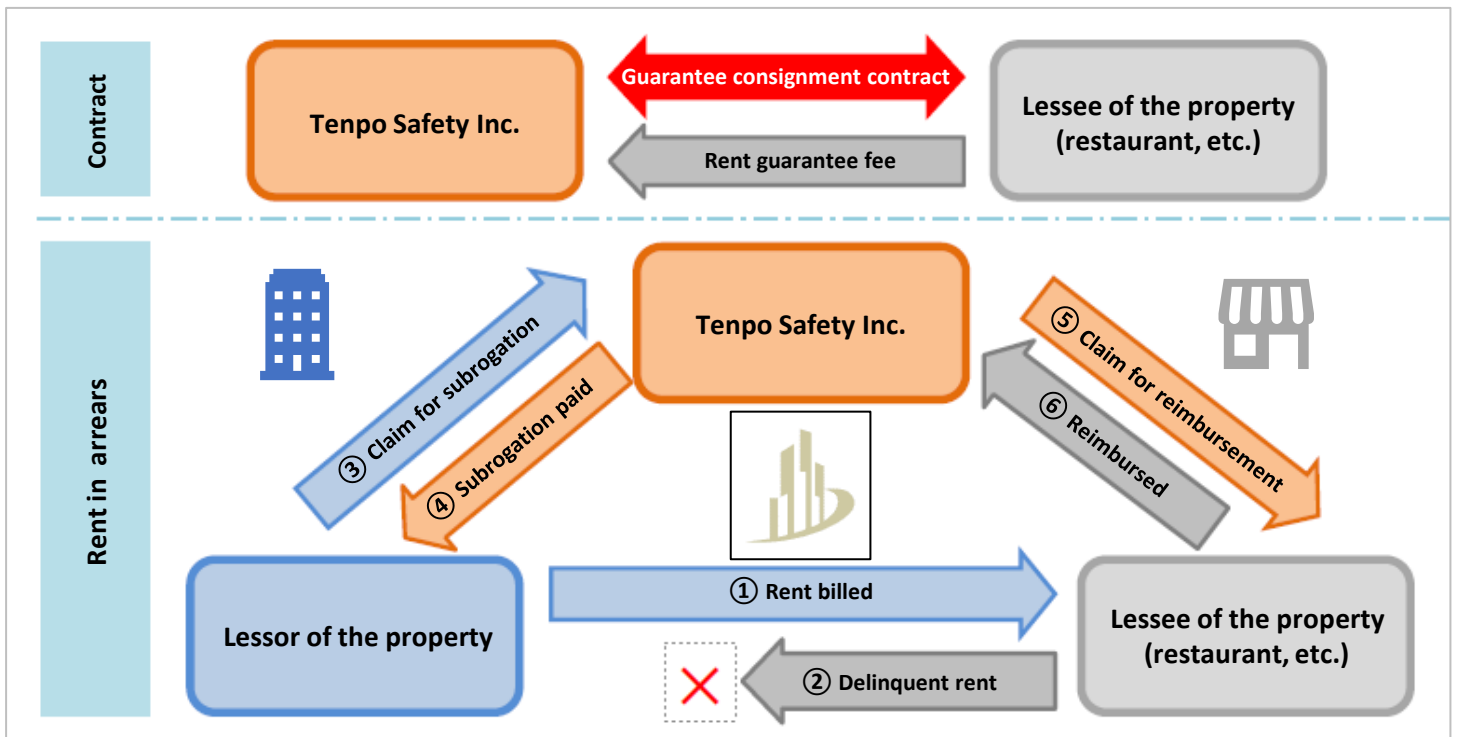
Tenpo Safety Inc.

Store rent guarantee business of Tenpo Safety Inc. commenced on April 1, 2022

Since the Revised Civil Code went into effect from April 2020, rent guarantees for store lease properties are expanding socially as a system that benefits both property landlords and tenants. In the past, the Company had tenants enter a rent guarantee contract automatically upon application, and the business was consigned to outside providers of rent guarantees. However, with over 17 years experience in subleasing over 2,000 restaurant store properties, and unique screening know-how, the Company is fully capable of assessing the risk of its subleased properties. The Board of Directors resolved on March 24, 2022 to establish a wholly-owned subsidiary with the aim of keeping this income stream in-house.

According to the Company, every contract signed requires entering a rent guarantee agreement, and the rent guarantee fee is equivalent to roughly 1 month's rent. The newly established Tenpo Safety Inc. handles 70-80% of these contracts, the remainder deemed to carry a higher level of risk are outsourced. Therefore, with signed contracts running at over 100 per quarter, roughly 80 contribute directly to Group profits each quarter. As described on the cover page, this business carries a virtual 100% OPM, and growth is linked directly to signed contracts. Along with the rise in profitable successor contracts, store rent guarantee business will be a structural driver of margins going forward.

Tenpo Safety Inc. Store Rent Guarantee Business Overview



Source: FY22/3 4Q IR results briefing materials, restaurant store image from Tenpo Safety Inc. website.

PART ④
SHARE PRICE



Key takeaways:

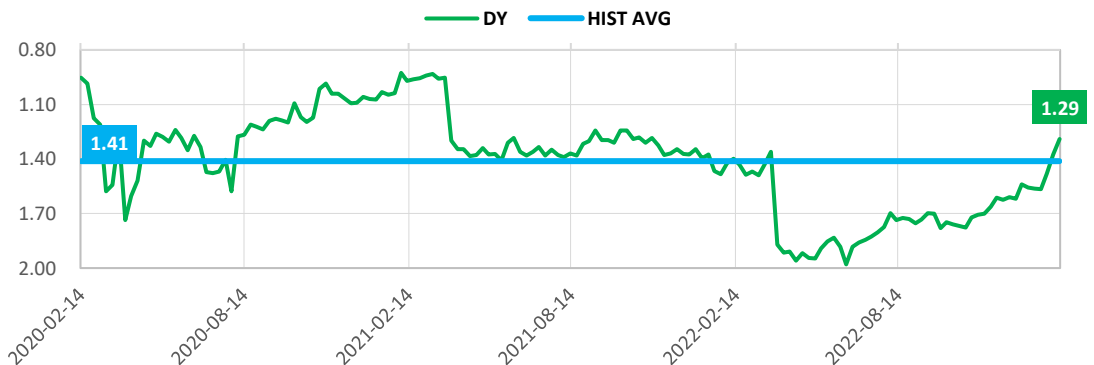
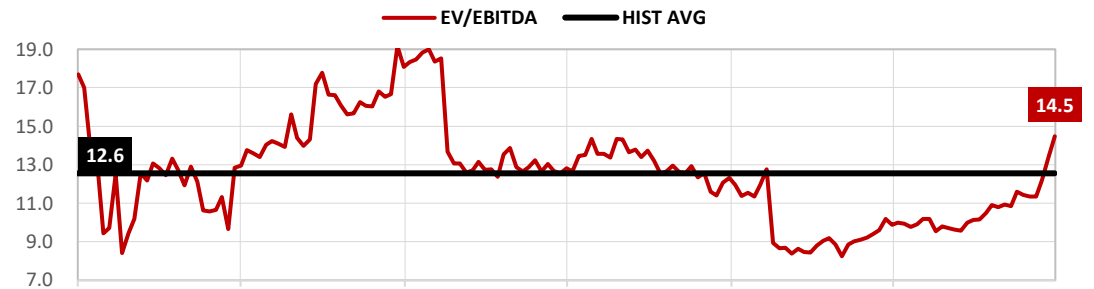
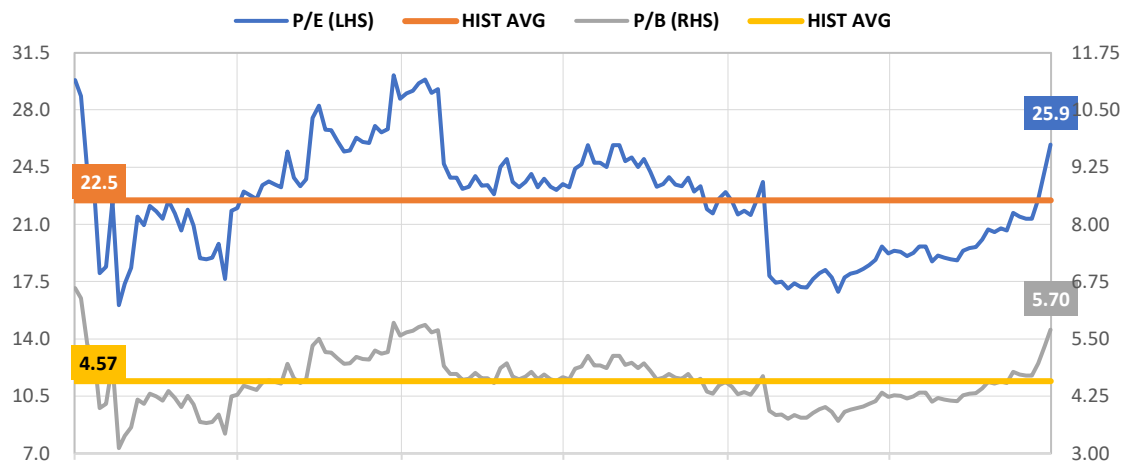
❶ The current P/E and EV/EBITDA are trading on 15% premiums, each to their respective historical averages. As previewed in our previous note, based on H1 progress ratios for OP and profit ATOP, full-term guidance was revised up on 3Q results.

❷ The equity ratio on the surface may appear low at 29.4%, however this reflects the fact that the B/S is comprised of a large amount of deposits paid and received. The Company is debt-free, and the B/S is extremely healthy.

❸ The company disclosed guidance for FY-end DPS of ¥16.00 per share, a dividend hike of ¥4.00 per share versus FY22/3.

❹ Short-term technical indicators have now become slightly overbought: 14d RSI 91.5, MACD 62.7 (signal 38.0, histogram 24.8), 26W divergence +26.8%, 52W +35.5%, Bollinger band +2.6 std. deviations (+2.6σ), fast stochastics %K 97.0, %D 88.2.

3Y Share Price Chart, 13W/26W/52W MA, Volume and Trend of Valuations



Source: compiled by Omega Investment from historical price data. Forecast values based on current Company estimates.

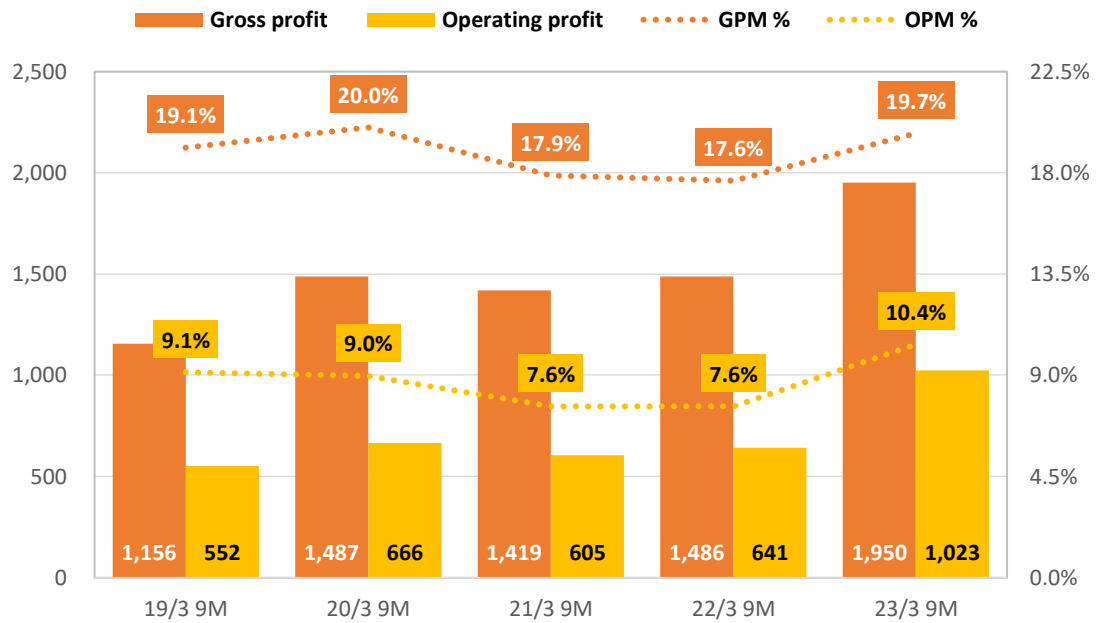
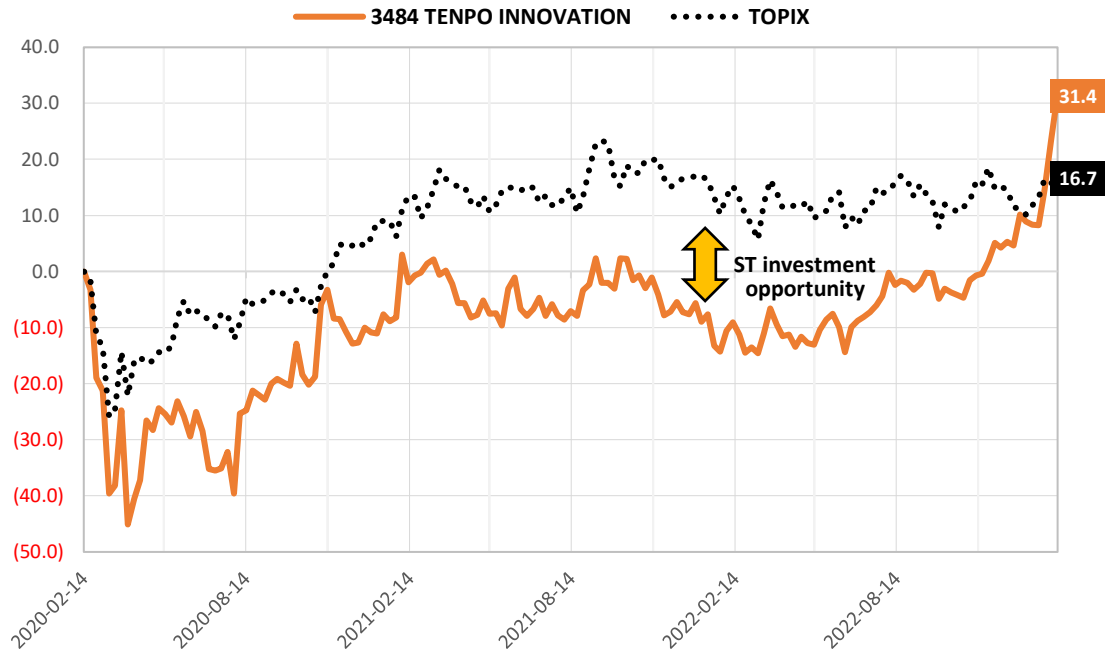


The share price had underperformed TOPIX over the last 2½ years, largely due to misperception from association with the struggling restaurant industry under COVID-19.

Not only has the Company resumed double-digit growth in net sales, **growth in profits is accelerating due to the structural drivers of rising successor contracts and the new addition of extremely high margin rent guarantee business.**

✦ While the short-term investment opportunity due to underperformance based on market misperception about COVID-19 has been achieved, **Omega Investment believes the long-term opportunity from the graph on P4 still offers large upside potential on a medium-term horizon.**

3Y Relative Share Price Performance and 5Y Trend of GP/OP and GPM/OPM



REFERENCE

TENPO INNOVATION Medium-Term Management Plan

JPY mn, %	FY3/22 act	FY3/23 init. CE	YoY pct	FY3/24 MTP	YoY pct	FY3/25 MTP	YoY pct
Net sales	11,415	12,655	10.9	14,437	14.1	16,417	13.7
Operating profit	910	1,059	16.4	1,257	18.7	1,471	17.0
OPM	8.0%	8.4%	—	8.7%	—	9.0%	—
Signed contracts	407	450	10.6	510	13.3	580	13.7
Sublease properties	1,951	2,221	13.8	2,527	13.8	2,879	13.9

Source: compiled by Omega Investment from IR results briefing materials.

Priority initiative to strengthen and enhance the sales force

The Company has the following medium-term and long-term targets.

By FY3/25, **increase the Sales Dept. from 40 professionals to 100** (currently 14 in charge of property procurement → 30, 26 in charge of finding tenants → 70)

- ▶ Subleased store property net adds to 600 per year (by FY3/26)
- ▶ Contracts signed to 1,000 per year (by FY3/27)

By FY3/29, **increase the number of active subleased store properties to 5,500**

- ▶ Net sales ¥30 billion
- ▶ Operating profit ¥3 billion
- ▶ OPM 10.0%

As TENPO INNOVATION is the only specialist firm engaged in this restaurant store property subleasing business, this is no easy task, and cannot be accomplished by simply directing a headhunting firm to find the required personnel (they simply do not exist). Management fully recognizes that the way forward is to find suitable personnel and provide advanced level on-the-job training by existing professional staff. The point is that there is a lot of technical background knowledge required about property specifications such as the correct amperage requirements for electricity supply, drainage pipe diameter, etc., as well as expertise and know-how in retail properties, the restaurant industry, the city, restaurant facilities, and legal matters.

The Company summarizes its HR strategy for the Sales Dept. in a 3-point plan: ① increase staff, ② provide advanced OTJ training and ③ transfer capable sales staff to property procurement. Management envisions this extensive training for sales staff to find tenants for subleasing will take one year. Specifically, it will try to develop a standard method of passing on the expert knowledge involving the 237 items/steps from introduction of the property to concluding a subleasing agreement. Then, recognizing that procurement has a high level of difficulty and strategically holds the highest importance to future growth, it will optimize transfer and assignment of capable sales staff.

Then, in order to achieve the second long-term goal above of increasing the number of active subleased store properties to 5,500 by FY3/29, management will employ a strategy of ④ procurement area focus. Specifically, roughly 30 procurement staff will cover approximately 1,000 station areas and 2,000 real estate agents. For terminal stations with more than 1 million passengers and major real estate agencies, multiple procurement staff will be assigned. The target is to achieve procuring roughly 600 store properties per year (or 50 per month) by FY3/26.



Shareholder Return Policy

The Company's basic policy is to pay stable dividends while strengthening its management base. The dividend per share (DPS) for the fiscal year ending March 31, 2023 was disclosed on February 2, 2023, marking a second consecutive dividend hike.

Trend of Dividends Paid and Payout Ratio

JPY thou., %	FY3/19 act	FY3/20 act	FY3/21 act	FY3/22 act	FY3/23 rev CE
Net profit	509,698	564,272	575,606	662,386	846,000
Total dividends	124,767	160,414	160,414	212,086	TBD
Dividend payout	23.6%	28.4%	27.9%	32.1%	TBD
DOE	6.7%	6.9%	5.8%	6.8%	—

DPS (yen)	7.00*	9.00	9.00	12.00	16.00
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Source: compiled by Omega Investment from IR results briefing materials.

*Note: adjusted to reflect the stock split.

Div. hike

Div. hike



Major Shareholders (as of March 31, 2022)

Shareholder Name	Shares Owned	Pct Ownership
CROPS Corporation	10,044,400	56.83%
The Master Trust Bank of Japan, Ltd. (trust account)	1,139,800	6.44%
UNION BANCAIRE PRIVEE	784,000	4.43%
Yasuo Hara	750,000	4.24%
Yohei Shimura	504,000	2.85%
Nomura Trust & Banking Co. (trust account)	364,700	2.06%
Custody Bank of Japan, Ltd. (trust account)	178,900	1.01%
TENPO INNOVATION Employee Stock Ownership Plan	159,200	0.90%
Yuji Kondo	34,400	0.19%
Kentaro Mamiya	33,800	0.19%
Top 10 total	13,993,200	79.14%
Total number of shares authorized to be issued	64,000,000	
Total number of shares issued and outstanding (including 514 treasury shares)	17,674,400	
Number of shareholders	13,372	

Source: Notice of the 16th Ordinary General Meeting of Shareholders.





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