MIRAI Corporation (3476)

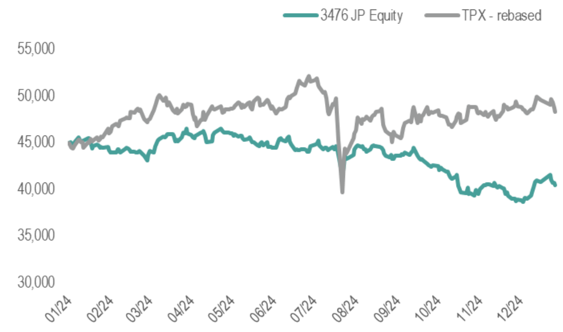
Stringent cost control and expansion of variable rents for hotels

13 January 2025

FP10/24 results update

Share price: ¥40,500 **Market cap: ¥77.3bn**

- **Results beat company guidance –** FP10/24 results exceeded company guidance for net operating income (NOI) and dividend per unit (DPU). The notable improvement of NOI (+11.6% vs. FP10/23, +4.8% vs FP4/24) is attributable to a lower expense ratio than initial expectations (actual 32.5%, guidance 34.0%) due to lower rental business expenses and repair costs, higher variable rent on the back of a strong tailwind in the hotel sector (actual ¥173 million vs. guidance ¥149 million), and other one-off rental income. Other expenses such as outsourcing costs and utility bills were well controlled, reflecting MIRAI's asset management ability. As a result, DPU came in at ¥1,257 exceeding the FP10/24 DPU target of ¥1,185.



Source: Bloomberg

Adjusting our estimates

- **Downgrading our earnings estimates –** We have downgraded our earnings estimates for FY10/25 and beyond, reflecting weaker FP4/25 and FP10/25 company guidance and slower property acquisitions than we had initially estimated. However, we continue to believe the company will be able to maintain high NOI margins with stringent cost control with a steady expense ratio of 33% between FY10/25 and FY10/27. We remain bullish on operating revenue and NOI expansion in the medium-to-long term, leading to higher DPU, reflecting an increase in variable rent in the hotel sector driven by growing inbound demand, the termination of free rent periods and rent holidays in office and certain commercial properties, and the strategy of replacing low-yield properties with high-yield assets.

- **Valuations** – On our revised estimates, the shares are trading on P/NAV FY10/25 of 0.67x and a dividend yield of 6.1%.

Year-end	FY10/23	FY10/24	FY10/25E	FY10/26E	FY10/27E
Operating revenue (¥bn)	12.05	12.09	12.72	13.40	14.11
NOI (¥bn)	7.43	8.18	8.52	8.98	9.45
NP (¥bn)	4.60	4.64	4.88	5.14	5.42
EPU (¥)	2,597	2,434	2,559	2,696	2,840
DPU (¥)	2,520	2,407	2,487	2,621	2,760
Sales growth YoY (%)	+10.2	+0.3	+5.2	+5.4	+5.3
NOI growth YoY (%)	-0.1	+10.1	+4.2	+5.4	+5.3
NP growth YoY (%)	+0.7	+0.9	+5.1	+5.4	+5.3
EPU growth YoY (%)	+0.7	-6.3	+4.5	+5.4	+5.3
DPU growth YoY (%)	-2.3	-4.5	+3.3	+5.4	+5.3
P/NAV (x)	0.77	0.69	0.67	0.65	0.61
PER(x)	15.6	16.6	15.8	15.0	14.3
Distribution yield (%)	6.2	5.9	6.1	6.5	6.8
AFFO yield (%)	7.2	7.9	7.7	8.0	8.6
FFO/Unit	3,149	3,260	3,109	3,276	3,450
FFO payout (%)	80.0	73.8	80.0	80.0	80.0
AFFO payout (%)	80.0	73.8	80.0	80.0	80.0

Source: Company, Astris Advisory (estimates)

Price Performance

	YTD	1M	3M	12M
Abs (%)	-0.7	+4.1	-4.9	-8.9
Rel (%)	+1.9	+5.4	-5.2	-16.3

Company sector

REITS-Diversified
Office REITs (GICS)

Stock data

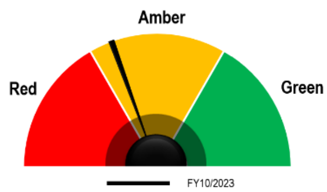
Price (¥)	40,500
Mkt cap (¥bn)	77.3
Mkt cap ($m)	490.9
52-week range (¥)	38,650-46,650
Shares O/S (m)	1.9
Average daily value ($m)	1.5
Free float (%)	99.0
Foreign shareholding (%)	14.6
Ticker	3476
Exchange	Tokyo Stock Exchange
Net Debt/Equity (x)	1.0
FFO leverage (x)	13.8
BBG BUY | HOLD | SELL	0 | 0 | 0

Source: Bloomberg

Business Overview

MIRAI Corporation is a mid-sized, diversified J-REIT jointly owned by Mitsui & Co. and IDERA Capital Partners.

Astris-Sustainability ESG rating



Reference Ratings	
MSCI	N/A
Sustainalytics	N/A
Refinitiv	N/A
S&P Global	1.0
Bloomberg	1.28
CDP	N/A

Next events

FP4/25 results June 2025

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Recent results

FP10/24 NOI exceeded the company's expectations due to continuous cost control with effective asset management skills

Key financials

(¥bn)	15th FP 10/23	17th FP 10/24	YoY (%)	17th FP 10/24 Guidance	18th FP 4/25 Guidance	19th FP 10/25 Guidance
Operating revenue	**5.74**	**6.20**	**+8.0**	**6.15**	**6.08**	**6.19**
Real estate expenses	1.99	2.02	+1.2	2.09	1.93	1.99
Net operating income (NOI)	**3.75**	**4.18**	**+11.6**	**4.06**	**4.15**	**4.20**
Other expenses - total	1.60	1.79	+11.9	1.80	1.84	1.90
Net income	**2.15**	**2.40**	**+11.4**	**2.26**	**2.31**	**2.31**
DPU	1,215	1,257	+3.5	1,185	1,210	1,210
FFO payout ratio (%)	75.2	74.9		73.8	73.8	73.3

Source: Company

Hotel revenue grew significantly, reflecting the expansion of variable rent

Per business segment

(¥bn)	15th FP 10/23	17th FP 10/24	YoY (%)	17th FP 10/24 Guidance	18th FP 4/25 Guidance	19th FP 10/25 Guidance
Operating revenue	**5.74**	**6.20**	**+8.0**	**6.15**	**6.08**	**6.19**
Lease business revenue						
Office	2.31	2.37	+2.7	2.37	2.40	2.43
Retail	1.27	1.34	+5.5	1.34	1.27	1.32
Hotel	0.64	0.92	+42.5	0.89	0.95	0.92
Residential	0.07	0.07	-	0.07	0.07	0.07
Others	0.45	0.46	+0.2	0.46	0.46	0.46
Other lease business revenue	1.00	1.05	+5.1	1.03	0.93	1.00
Gain on sales of real estate properties	0.00	0.00	-	0.00	0.00	0.00

Source: Company

Key highlights

FP10/24 results highlighted an increase of variable rent for hotels and continuous cost management, leading to higher NOI than guidance. The notable improvement of NOI is attributable to a lower expense ratio than management's initial expectation (actual 32.5%, guidance 34.0%). Compared to guidance, other rental business expenses came out lower (actual ¥304 million, guidance ¥341 million), which was mainly because of the reduction of a one-off marketing cost for Mi Nara, which opened in FP10/23. Furthermore, repair costs were also lower (actual ¥111 million, guidance ¥130 million). The improvement in utility cost efficiency through the switch of an electricity supplier at the Kawasaki Tech Center also contributed. Outsourcing costs were well controlled as well. Property and other taxes were in line with initial guidance.

DPU came in at ¥1,257 exceeding the FP10/24 DPU target of ¥1,185, reflecting the expansion of variable rents from hotels, the reduction of expenses, one-off other rental income. The company conservatively sets its DPU targets at ¥1,210 for FP4/25 and FP10/25 respectively, taking into account lower rents from some properties due to seasonality, the reversal effect of one-off rental income incurred in FP10/24, and cost increases including higher interest payments. It is also worth noting that the company expects limited positive impacts in FP4/25 and FP10/25 compared to FP10/24 when MIRAI enjoyed rent increases, a positive impact from new property acquisitions, and some costs fading away (i.e. one of the impacts associated with tax burden and costs related to a change of hotel operator). Furthermore, one-time income such as restoration fees associated with the departure of large-block tenants also boosted NOI.

The following are highlights by asset type:

- **Office – Improving market environment**

  Larger offices located in the seafront area such as Shinagawa Seaside Parktower and Tokyo Front Terrace continued to see occupancy rates trending above the average for the area. One large tenant is due to leave most of the tenancy at Shinjuku Eastside Square in July 2025 but most of the space is set to be filled with new tenants under more favorable terms for MIRAI than the departing tenant, ensuring minimal underutilization. The company has also identified prospective tenants for the remaining space. MIRAI expects an improving market environment with lower vacancy rates and rents bottoming out in the Tokyo metropolitan area. As for mid-sized offices, occupancy rates continued to remain high and enjoy rent hikes.

- **Commercial properties – Positive momentum continues**

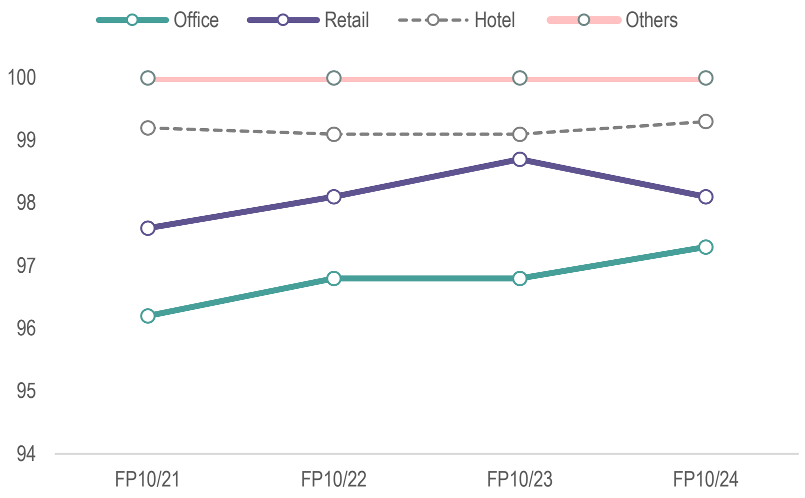
  Profitability remains stable, supported by the recovery in foot traffic and the expansion of strong inbound demand, with some properties generating variable rent linked to sales revenue. Commercial properties are expected to enjoy steady consumption and inbound demand, leading to upward pressure on rents.

- **Hotels – Room for expansion of variable rent**

  Smile Hotel Hakataeki-Mae experienced strong inbound demand in particular. In addition, the properties in Kyoto and Osaka enjoyed an increase in rental income by the switch from fixed-rent-only contracts to contracts including variable rent as a result of a change in a hotel operator. The market environment continued to trend positively. Construction costs continued to increase, reflecting a limiting new supply of budget-type hotels offering lower price points, and inbound demand. We believe such a positive environment will enable MIRAI to increase revenue from variable rents for hotels including two properties that have already implemented variable rent contracts.

Occupancy rates temporarily declined for Office due to Shinagawa Seaside Parktower and Tokyo Front Terrace but those of other asset types continue to remain high

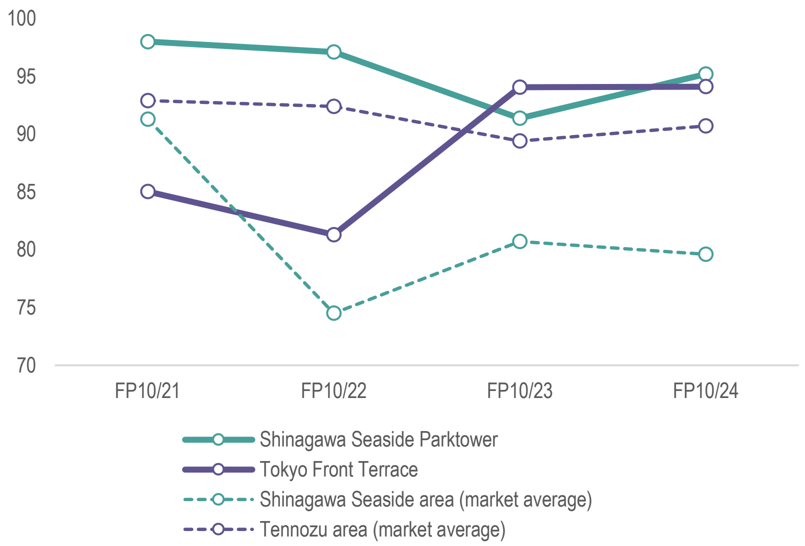
Occupancy rates by asset type (%)



Source: Company

MIRAI's occupancy rates continued to trend higher than comparable office buildings in the seafront areas

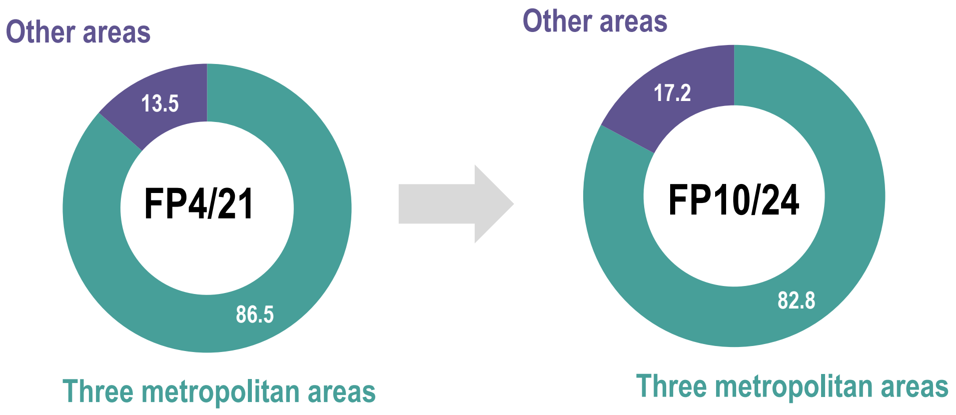
Occupancy rates of MIRAI's larger office buildings (%)



Source: Company
Notes: The occupancy rates in the Shinagawa Seaside and Tennozu areas were computed based on Astris' estimates.

MIRAI's portfolio is getting more benefits from geographical diversification

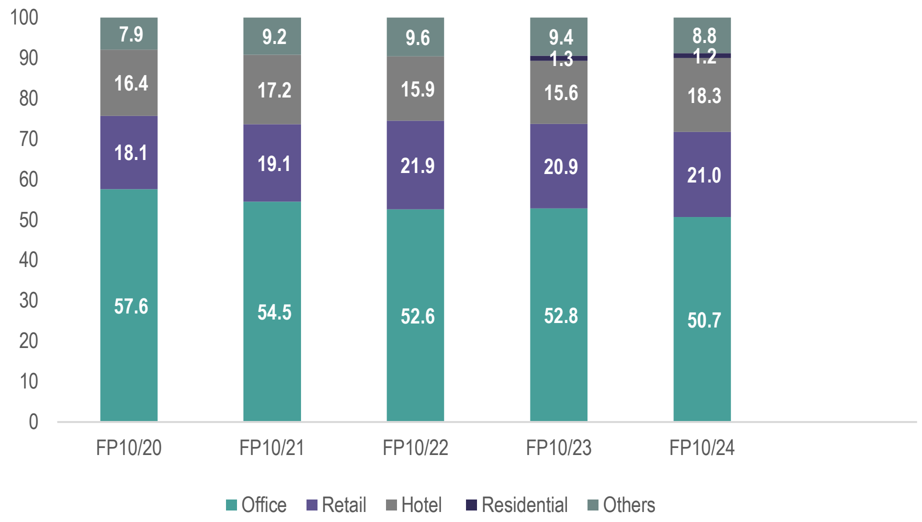
MIRAI's portfolio by location (%)



Source: Company

Portfolio weighting shifted to Hotels

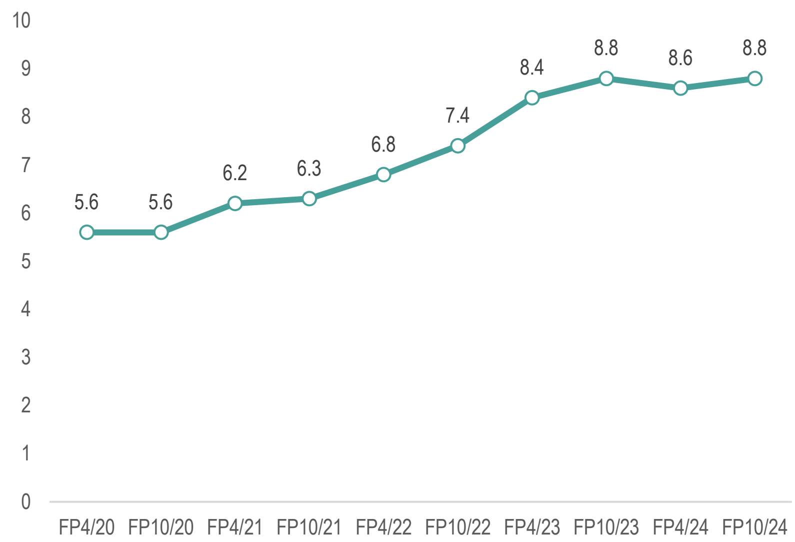
MIRAI's portfolio by asset type (%)



Source: Company

Unrealized gain margins remain high after the acquisition of new assets

Unrealized gain margins (%)



Source: Company

Astris earnings estimates and key assumptions

We have revised our earnings estimates reflecting the following:

- New company guidance for FY4/25 and FY10/25, which came out more conservatively than we had initially expected
- Slower progress in asset acquisitions than our initial expectations

Our key earnings forecasts are as follows:

Astris Advisory earnings estimates

Year-end	FY10/25E OLD	FY10/25E NEW	FY10/26E OLD	FY10/26E NEW	FY10/27E
Revenue (¥bn)	**13.25**	**12.72**	**14.67**	**13.40**	**14.11**
YoY (%)	+3.1	+5.2	+10.7	+5.4	+5.3
NOI (¥bn)	**8.88**	**8.52**	**9.83**	**8.98**	**9.45**
YoY (%)	+3.1	3.1	+10.7	3.1	3.1
NOI Margin (%)	67.0	67.0	67.0	67.0	67.0
NP (¥bn)	**5.09**	**4.88**	**5.63**	**5.14**	**5.42**
YoY (%)	+3.1	+5.1	+10.7	+5.4	+5.3
EPU (¥)	**2,667**	**2,559**	**2,952**	**2,696**	**2,840**
YoY (%)	+3.1	+4.5	+10.7	+5.4	+5.3
DPU (¥)	**2,667**	**2,487**	**2,952**	**2,621**	**2,760**
YoY (%)	+4.2	+3.3	+10.7	+5.4	+5.3

Source: Astris Advisory

The core assumptions for our estimates are as follows:

- **Revenue growth –** mid-single-digit revenue growth expectations in FY10/25-FY10/27. We believe internal growth from office operations will be the most important driver for growth given more than 50% of the portfolio is offices.
- **Profitability –** NOI margin will be maintained high with effective expense control
- **DPU –** We believe DPU will expand primarily through internal growth combined with external growth.

Summary

MIRAI Corporation ("MIRAI") is a **diversified J-REIT jointly sponsored by Mitsui & Co. (8031) and IDERA Capital Management (majority owned by the Fosun Group (0656 HK)).** Almost half of the assets consist of B-class office properties in three metropolitan areas (Tokyo, Osaka, and Nagoya), which have limited supply and will face a smaller risk of rental reductions than the larger A-class office buildings.

The four largest B-class office buildings with more than ¥10bn acquisition prices make up 36% of the portfolio as of the end of October 2024. The rest of the properties are smaller with acquisition prices below ¥10bn. The variations in size and property type provide asset diversification.

More than 80% of the portfolio comprises properties in major metropolitan areas in Tokyo, Osaka, and Nagoya. The company plans to expand AUM to ¥200bn during the current medium-term plan, which will bring more diversification to the portfolio. Five properties have been added in FP4/24 through the fifth PO as part of a post-COVID reversal. There was limited AUM expansion during the pandemic when the market was stagnant because the company's focus was more on portfolio reconstruction to enhance the stability of the portfolio rather than expansion of assets.

As part of its external growth strategy, MIRAI will focus on properties that can benefit from structural changes such as domestic inflation and further improvement in inbound demand from overseas, rather than being confined to investment ratios by asset type alone. Specifically, this may involve introducing variable rents in hotels, including those with expiring fixed-rent contracts, as well as considering urban commercial facilities that are more likely to benefit from inflation, commerical facilities whose rents are linked to sales and mid-sized offices, in which MIRAI has expertise, and a track record in rasing rents. Furthermore, there is an expectation that opportunities for external growth through M&A, backed by the creditworthiness of sponsor Mitsui & Co., will also be pursued.

Major Japanese credit agency JCR has an A+ credit rating for MIRAI but revised its outlook from stable to positive in February 2024. The reasoning was based on an expectation of stable cash flows driven by MIRAI's efforts to add more defensiveness to its portfolio. As it continues to expand AUM, the likelihood of a credit rating upgrade will increase, in our view. Any upgrade would open up investment in MIRAI to regional financial institutions that invest in J-REITs, but only those with credit ratings of AA or higher. The Rating and Investment Information, Inc. (R&I) also upgraded its rating outlook in July 2024 from "Stable" to "Positive" under the long-term issuer rating of A.

The company has embarked on a medium-term strategy (2022-25) based on the following (all increases are compared to FP4/21):

- **DPU: ¥1,300 (vs. ¥1,247 in FP4/21)**
- **NAV/U: Over ¥53,000 (CAGR about +2%)**
- **AUM: ¥200bn (CAGR about +6%)**

Astris Advisory estimates MIRAI Corporation will drive medium-term growth via the following factors:

- **Termination of free rent periods and rent holidays –** The main driver for internal growth in our view as more than 50% of the portfolio consists of offices and some commercial facilities that will benefit from the termination of free rent periods (a period of rent exemption after occupancy begins), which were offered to tenants after COVID-19 and rent holidays (a period of rent exemption during a certain period of the contract term) in future.
- **Increasing variable rent for hotels –** A shift towards tenancy contracts with variable rents for hotels will expand NOI and DPU on the back of increasing inbound demand from overseas, a strong appetite for domestic travel, and domestic inflation.
- **Improving profitability through portfolio reconstruction –** MIRAI currently holds a pipeline of six highly profitable properties with significant potential for internal growth, worth a total of ¥22bn, which exceeds the average yield of the existing portfolio. The company plans to enhance portfolio profitability by selling low-yield properties or those with limited potential for future rent increases, and replacing them with these pipeline properties.
- **Acquisition of properties –** We believe external growth through property acquisitions with POs will be a key driver once the capital market environment recovers.

The Tokyo office market faced concerns over the impact of a significant supply of new S and A-class office spaces in 2024. However, these concerns have proven unfounded, as both occupancy rates and rental prices have remained stable and are currently showing signs of improvement. Meanwhile, medium-sized offices, a strong area for MIRAI, continued to see limited new supply, resulting in steady occupancy rates and rents. Profitability has also improved across MIRAI's managed properties. Based on this operational performance, MIRAI plans to continue focusing on the acquisition of medium-sized offices.

Company description

Overview

MIRAI is a diversified J-REIT jointly sponsored by Mitsui & Co. and IDERA Capital Management. Listing on the Tokyo Stock Exchange in 2016, it was added to the FTSE/EPRA Nareit Global Index in 2021. Its investment fund is classified as a diversified REIT with more than **50% invested in offices, about 21% in retail, and about 18% in hotels** as of the end of October 2024. Regionally the focus has been on three metropolitan areas (Tokyo, Osaka, and Nagoya) with high population concentrations. Properties in these areas make up more than 80% of the portfolio. **Most properties are classified as B-class** which is defined as buildings older than 15 years and below 30,000 m^2 in size. Unlike A-class offices which target a smaller number of large domestic and foreign corporates, it is relatively easier for B-class office buildings to maintain more stable occupancy rates and more sustainable cash flows over time because of a broader tenant base and limited new supply.

Assets under management totaled ¥178.2bn as of the end of October 2024 with an appraisal value of ¥196.2bn and an occupancy rate of 98.3%. Appraisal NOI yield (based on appraisal value) is 4.7% based on purchase value.

A key competitive strength lies in credit enhancement opportunities backed by Mitsui & Co.'s creditworthiness. The credit rating by JCR is already A+ but given a credit rating upgrade in February 2024 from Stable to Positive, a potential improvement towards AA- or higher could further expand the investment universe to include local financial institutions that can only invest in J-REITs above an AA credit rating.

Timeline summary

Key dates	Details
November 2015	Establishment of MIRAI Corporation by Mitsui & Co. & IDERA Partners
December 2016	**IPO**
May 2018	**1st PO (public offering)**
October 2018	**2nd PO**
July 2019	Attempt to rescue Sakura Sogo REIT Investment as a white knight from Star Asia Group's TOB. The acquisition would have expanded MIRAI's AUM above ¥200bn, facilitating inclusion into a global index. This was the first TOB in the J-REIT sector.
August 2019	The attempt of the white knight fell short. Sakura Sogo was acquired by Star Asia at the end
December 2019	**3rd PO**
December 2021	**Inclusion into the FTSE/EPRA Nareit Global Index**
December 2021	**4th PO**
November 2023	**5th PO**
February 2024	**JCR improved MIRAI's outlook from stable to positive on an A+ credit rating**
July 2024	**R&I has upgraded its issuer rating outlook from stable to positive under the long-term issuer rating of A.**

Source: Company

ASTRIS CORPORATE ADVISORY JAPAN

Financial Summary

Income statement (¥bn)	FY 10/23	FY 10/24	FY 10/25E	FY 10/26E	FY 10/27E
Operating revenue	**12.05**	**12.09**	**12.72**	**13.40**	**14.11**
Real estate expenses	4.00	3.91	4.20	4.42	4.66
Net operating income (NOI)	**7.43**	**8.18**	**8.52**	**8.98**	**9.45**
NOI margin (%)	61.6	67.7	67.0	67.0	67.0
Depreciation expense	1.39	1.58	1.46	1.54	1.62
Other expenses	1.43	1.96	2.18	2.29	2.42
Net income	**4.60**	**4.64**	**4.88**	**5.14**	**5.42**
Sales growth YoY (%)	+10.2	+0.3	+5.2	+5.4	+5.3
NOI growth YoY (%)	-0.1	+10.1	+4.2	+5.4	+5.3
NP growth YoY (%)	+0.7	+0.9	+5.1	+5.4	+5.3
EPU growth YoY (%)	+0.7	-6.3	+4.5	+5.4	+5.3
DPU growth YoY (%)	-2.3	-4.5	+3.3	+5.4	+5.3

Cash flow statement (¥bn)	FY 10/23	FY 10/24	FY 10/25E	FY 10/26E	FY 10/27E
FFO	5.37	6.22	5.93	6.25	6.58
Capital expenditure	(11.22)	(13.76)	(7.63)	(10.72)	(4.23)
Cash from investing	**(11.13)**	**(13.28)**	**(7.63)**	**(10.72)**	**(4.23)**
Dividends paid	(4.64)	(4.35)	(4.74)	(5.00)	(5.26)
Cash from financing	**(3.14)**	**7.58**	**0.75**	**3.00**	**(2.26)**
Net cash flow	**(1.49)**	**0.69**	**(0.34)**	**0.69**	**0.57**
Free cash flow	1.56	(7.37)	(1.10)	(2.31)	2.83
EBITDA	6.68	6.83	7.44	7.68	8.09

Source: Company, Astris Advisory (estimates)

Balance sheet (¥bn)	FY 10/23	FY 10/24	FY 10/25E	FY 10/26E	FY 10/27E
Real estate portfolio	164.67	167.80	174.03	180.45	187.56
Cash and cash equivalents	4.51	3.00	3.52	2.63	5.25
Accounts &notes receivables	0.26	0.26	0.27	0.28	0.31
Other long-term assets	0.72	1.05	1.05	1.05	1.05
Restricted assets	2.63	2.64	2.64	2.64	2.64
Total assets	**172.79**	**174.75**	**181.52**	**187.06**	**196.82**
Accounts payables	0.71	0.74	0.96	0.99	1.04
Short-term liabilities and deposit	7.06	7.00	7.50	8.00	9.70
Unsecured debt	84.00	85.50	91.38	96.04	103.86
Secured debt	0.00	0.00	00.00	00.00	0.00
Other long-term liabilities	0.00	0.12	0.12	0.12	0.12
Total liabilities	**91.76**	**93.35**	**99.88**	**105.14**	**114.72**
Minority interest	0.00	0.00	0.00	0.00	0.00
Shareholder equity	81.03	81.39	81.63	81.92	82.10
Total equity	81.03	81.39	81.63	81.92	82.10
Total liabilities & equity	**172.79**	**174.75**	**181.52**	**187.06**	**196.82**

Key metrics	FY 10/23	FY 10/24	FY 10/25E	FY 10/26E	FY 10/27E
P/NAV (x)	0.77	0.69	0.67	0.65	0.61
P/E (x)	15.6	16.6	15.8	15.0	14.3
Dividend yield (%)	6.2	5.9	6.1	6.5	6.8
AFFO yield (%)	7.2	7.9	7.7	8.0	8.6
EPU	2,597	2,434	2,559	2,696	2,840
DPU	2,520	2,407	2,487	2,621	2,760
FFO Payout ratio (%)	80.0	73.8	80.0	80.0	80.0
AFFO Payout ratio (%)	80.0	73.8	80.0	80.0	80.0
FFO per unit	3,149	3,260	3,109	3,276	3,450

Source: Company, Astris Advisory (estimates)

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