September 1, 2020

Invincible Investment Corporation

Q&A regarding Financial Results for the Fiscal Period Ended June 2020

Q: We understand that INV will amend the lease agreement with MyStays Hotel Management (MHM) by mid-September. What kind of discussion has been held until now?

A: As announced in the monthly performance disclosure dated August 25, 2020, GOP for the 73 hotels managed by MHM in July was about 20% of the contracted fixed rent for the month. July is the peak season and the fixed rent is set high. Although the hotels' occupancy rate and GOP have improved significantly compared to April and May, they have not yet recovered to meet the contracted fixed rent amount. Therefore, we must do something about the lease agreement with MHM, and we plan to conclude an agreement and announce the result by mid-September. However, unlike the measures taken for the March-June 2020 period, INV does not plan to support MHM by funding its deficits. While the hotel GOP for July and onwards are expected to be in the black, INV does not intend to bear the burden even if GOP turns to GOL.

Q: Are you planning any radical revisions to the lease agreement with MHM? In other words, are you going to change the current lease agreement in which MHM cannot accumulate retained earnings into a new lease agreement in which MHM will be able to improve the financial foundation over the medium-to-long term?, Or, are you going to maintain the current lease agreement because you believe MHM will be able to pay the rent as it used be once the COVID-19 situation is gone?

A: Although there is the possibility of a radical revision, it is not in the best interest for INV and its investors to decide on a medium-to long-term lease structure when the environment surrounding the hotel market is so bad and the outlook for the future is uncertain. We take it very seriously that we have imposed a heavy burden on unitholders in the March to June 2020 period, and we are currently considering various options. However, in a situation where forecasting future earnings is extremely difficult, we think it is important to take a step-by-step approach. We also believe that we should adopt a cautious approach to accumulate internal reserves for MHM, because the flip side of this is that it will reduce the profit for INV and thus the distribution to its unitholders.

Q: What is your perspective on the appraisal value over the next year?

A: It is difficult to forecast the outlook for the next year, but the factors that caused the hotels' appraisal value to decline at the end of June will serve as a reference. For the June 2020 fiscal period, the appraisal value for the domestic hotels fell by JPY 21.4 billion, or 4.9%, from the previous fiscal period. Of this, about 60% was due to a cash flow (CF) factor, and the remaining 40% was due to an increase in cap rates. For CF, the estimated CF for July 2020 to June 2021, the first year of the appraisal, was reduced by about 40-50% of the assumption due to the COVID-19 factor. The cap rates have increased by 0.1 to 0.3pt, but this is attributable to the adjustment due to the deviation between the DCF evaluation and the direct capitalization method evaluation based on the increase in the base rate and the decrease in the CF estimate (the appraisal standards require that there is no significant deviation between the DCF value and the direct capitalization method value). The appraisal level at the end of the December 2020 fiscal period will depend on the estimated CF for Jan.-Dec. 2021, the first year of the appraisal, compared to the estimated CF for July 2020 to June 2021 of the current appraisal. It is highly probable that the CF estimates for Jan.-Dec. 2021 will be better than July 2020-June 2021, though this will depend on the progress of stamping out COVID-19. It is unlikely that the appraisal will further decrease due to the CF factor. Rather, we believe that there is a possibility that appraisal values will increase due to the improvement of CF and the possibility of a decline in cap rates resulting from the shrinking gap between the DCF value and the direct capitalization method value.

Q: Is there possibilities of property sales?

A: We are considering various options, including property sales. For the sale of hotel property, it is highly likely that the sale price will be significantly lower than the appraisal value in the current market. On top of that, we will lose the income from the hotel which is expected to recover in the future. Therefore, selling a hotel property in the current market is not necessarily a reasonable option.

Q: In P2 of the presentation, the hotels recovered to positive GOP from negative GOP in June. Is this underpinned by the support from INV?

A: This is purely a result of increased sales and cost reductions, and without support from INV. In the same manner, the outlook of positive GOP in July and onwards does not count on support from INV

Q: You mentioned that INV is not considering to support MHM any longer. Is it OK to assume that INV does not need to support MHM so long as the current level of RevPAR continues?

A: That's right.

Q: According to P2 of the presentation, the hotel GOP has not recovered to the level at which fixed rents can be paid. Does it mean that INV is not in the red but is not likely to receive the fixed rents set forth in the lease contract?

A: The hotel GOP is in the black, but has not yet recovered to the level of fixed rents contracted, making it difficult for MHM to pay fixed rents in full. Based on this, measures against MHM are under discussion.

Q: What is break-even point (BEP) of RevPAR where fixed rents can be paid?

A: BEP of fixed rent payment is estimated to be at around 60% of RevPAR for the 73 hotels operated by MHM in the December 2019 fiscal period (JPY8,877). In other words, if RevPAR decreases by about 40% from JPY8,877, MHM will not be able to pay the fixed rent. Previously in May 2020, we explained that if RevPAR decreases by 30% MHM will not be able to pay the fixed rent. Therefore, it is fair to say that the BEP has improved due to cost reductions and other efforts by MHM.

Q: What is BEP of RevPAR where MHM Hotels' GOP falls into the red?

A: BEP of GOP/GOL is estimated to be at around 30% of RevPAR for the 73 hotels operated by MHM in December 2019 fiscal period. Please note that the correlation between RevPAR and GOP is becoming increasingly complex due to diversification of hotel types and increases in non-room revenues, and that these BEP simulations are rough estimates based on certain assumptions.

Q: Is your portfolio benefitting from the "Go To Travel" campaign? What are your

expectations regarding this campaign?

A: It seems that the travel demand is more affected by peoples' sentiment and behavior in response to news headlines reporting the number of Covid-19 infectious people, rather than the “Go To Travel” campaign itself. For example, MS Yokohama Kannai recorded a high occupancy rate of 80% in July. This is partly due to telework demand, but it may be capturing a portion of increasing accommodation demand in Yokohama due to the exclusion of Tokyo from the campaign. This may be useful for measuring the effects of the campaign and the impact of the exclusion of Tokyo. The occupancy rates of resort hotels in rural areas, such as Hotel Epinard Nasu, are also recovering, and the campaign seems to have a certain positive effect. It should be noted that the effects of the inclusion of Tokyo, if at all, will be affected by the remaining level of money in the government's budget at that time and the situation of the cities receiving travelers from Tokyo.

Q: Have hotel earnings bottomed out in May 2020?

A: Based on the assumption that the COVID-19 problem will not worsen further, both the occupancy rate and GOP seem to have bottomed out in May. However, the pace of recovery appears to be slower than expected.

Q: Do you have improvement measures to raise the occupancy rate?

A: Measures taken by MHM are described in the presentation materials. In addition to the 3C’s (Closed spaces, Crowded places and Close-contact settings) avoidance proposals, follow-up of cancellations, and demand recovery measures such as acquiring new educational travel, the company is also working to create new demand by providing telework environments and accepting voluntary quarantine.

Q: Regarding financial status, are there any problems in lender negotiations, such as interest rates and borrowing periods for the refinancing?

A: Although there was a major refinancing in June and July, the interest rate hike was curbed by shortening the borrowing period, giving priority to ensuring the smooth implementation of refinancing. In this market environment, spreads were somewhat wider than usual, but refinancing was carried out in a very reasonable way.

Q: What about the status of fixed rent payments for the hotels other than MHM?

A: One operator requested a rent reduction or exemption for a portion of the rent, but we did not accept and we are not going to. Even if a reduction or exemption is required in the future, we have taken deposits equivalent to 6 to 12 months' rent or more from the fixed rent hotel operators, and there should be no impact on INV's profits.