create restaurants holdings inc.

3387 Tokyo Stock Exchange First Section

6-Jun.-16

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Realizing Higher Growth Potential by Engaging in "Group Federation Management", Entering a New Growth Phase

create restaurants holdings inc. <3387> focuses mainly on the operation of restaurants and food courts inside shopping centers, while also developing izakaya (traditional Japanese eating and drinking establishments) and restaurant formats acquired though M&A. One characteristic is that the company carefully selects locations that attract large numbers of customers, and employs a distinctive multi-brand, multi-location strategy, which involves developing a variety of restaurant formats attuned to specific locations (regional characteristics, customer attributes, competition status, etc.). This strategy has supported the company's main business. Currently, the company has 795 restaurants in approximately 190 formats (as of end-February 2016). Moreover, the company is achieving higher growth by engaging in "group federation management,"*1 which involves incorporating formats with high growth potential into the company's own growth profile through M&A, such as the seafood izakaya chain "ISOMARU SUISAN"*2, that has been gaining popularity with its 24-hour operation in convenient station-front locations. In this way, the company appears to have entered a new growth phase.

In its FY2/16 results the company recorded significant growth in both revenue and earnings, with net sales of ¥103,271mn (+49.0% YOY) and ordinary income of ¥7,340mn (+67.4% YOY), setting a new record high for ordinary income while at the same time surpassing ¥100bn in sales for the first time since establishment. In addition to expansion in store numbers centered on the solidly performing ISOMARU SUISAN izakaya format, acquisition of KR FOOD SERVICE CORPORATION, the developer of the Kagonoya Japanese restaurant chain, which boasts high visibility in the Kansai region, drove results growth. Further, from a profit and loss perspective, while profitability declined in some CR suburban commercial facilities, ordinary income growth was secured as a result of sound performance in urban and high-end formats, contributions from SFP and KR, and overseas operations becoming profitable.

In respect of its FY2/17 results outlook, the company expects net sales up 14.3% YOY to ¥118,000mn and ordinary income up 7.6% YOY to ¥7,900mn. It is supposed that expansion in store numbers at the soundly performing ISOMARU SUISAN and in specialty brands will again be the drivers of operational growth, with no allowance currently for any contribution to results from M&A. Accordingly, it is important to note that M&A which the company is proactively taking into consideration may be a source of outperformance in results.

The company is promoting its 3-year medium-term management plan, and as well as leaving the plan unchanged until FY2/18 given sound progress in FY2/16 results and the fact that group federation management is now on track, publicly announced its new FY2/19 plan. The FY2/19 targets (including M&A) aim for net sales of ¥175bn and ordinary income of ¥13bn. Further, particulars of its VISION2020, which is a growth snapshot in four years' time, call for sales to ¥200bn in FY2/20 as a result of: 1) organic store openings, 2) domestic M&A, and 3) further development overseas.

We feel that hurdles to achieving these targets (envisaged growth) are by no means low, however, given that there is still ample room for suburban store openings for the soundly performing izakaya format, the M&A environment serves as a tailwind for the company, and that we may expect a boost from the know-how it has accumulated and the popularity of Japanese cuisine overseas, we assess them as attainable. Of course, it is necessary to note that factors such as delays in uncovering new M&A deals and creating synergies may give rise to potential underperformance versus targets. Further, we would draw attention to the fact that this is not simply the aggregation of sales, but also to value-adding trends and specific results unique to the company's group federation management in the further evolution of its strategy by crossing location diversity and brand specialization, expressing cost synergies and other features.

*1 Through the group management being promoted by the company, growth is fostered by achieving a balance between "cohesion" from the holding company and "autonomy" at each group operating entity.

*2 Developed by SFP Dining Co., Ltd. <3198> that was acquired in April 2013.

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create restaurants holdings inc.

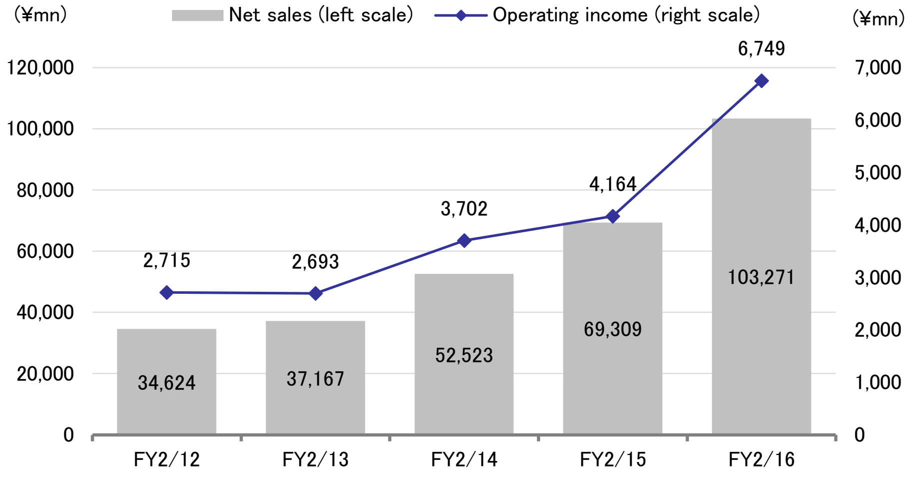
3387 Tokyo Stock Exchange First Section

6-Jun.-16

Check Point

- Incorporating a range of formats with growth potential into corporate expansion through proactively engaging in M&A
- Achieved significant revenue and earnings growth in FY2/16, surpassing ¥100bn in sales for the first time
- Aiming for FY2/20 sales of ¥200bn via measures including further overseas development

Results Trends



Business Overview

Tackling corporate expansion through proactively engaging in M&A in a range of formats with growth potential

(1) Business Details

As well as the operation of restaurants and food courts in shopping centers being a core focus, the company is also rolling out izakaya and eatery formats acquired through M&A. As a holding company it comprises 13 consolidated subsidiaries (of which four are overseas), one non-consolidated subsidiary (Taiwan)*, and four affiliates (Shanghai, Dalian, Thailand), as of end-February 2016.

* Its Taiwanese subsidiary is scheduled to become a consolidated subsidiary from this period (FY2/17).

The company carefully selects locations that attract large numbers of customers, and employs a distinctive multi-brand, multi-location strategy, which involves developing a variety of restaurant formats attuned to specific locations (regional characteristics, customer attributes, and competition status, etc.). This strategy has supported the company's main business. Further, recently, the company is achieving a high growth rate by promoting "group federation management," which involves incorporating various formats with high growth potential into the company's own growth profile through aggressive M&A activities. Currently, as of end-February 2016, the company has 795 restaurants in approximately 190 formats.

The company's operating formats may be categorized into four formats: 1) the CR Category operating restaurants and food courts within shopping centers, 2) the SFP Category operating izakaya, 3) the Specialty Brand Category operating a variety of restaurants and 4) the Overseas Category operating Japanese restaurants in Singapore and Hong Kong, etc. The composition shows that the flagship CR Category represents 37.8% of sales, the SFP Category 34.9%, the Specialty Brand Category 24.4% and the Overseas Category 2.7% (FY2/16 actual results).

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create restaurants holdings inc.

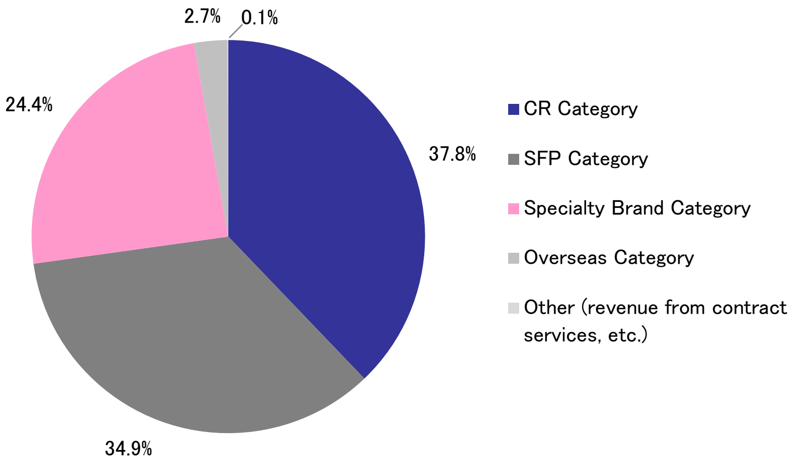
3387 Tokyo Stock Exchange First Section

6-Jun.-16

Overview of Business Categories (as of end-February 2016)

CR Category	Comprising stores operated by create restaurants (CR). Operating multi-brand restaurants and food courts, mainly within suburban shopping centers 381 stores as of end-February 2016 Major formats include Harvest, Shabu Sai and Dessert Okoku.
SFP Category	Comprising stores operated by SFP Dining, which the company entered into a capital tie-up, in April 2013 Operating izakaya in urban downtown districts 176 stores as of end-February 2016 Major formats include seafood izakaya ISOMARU SUISAN and fried chicken wing specialty stores Toriyoshi.
Specialty Brand Category	Comprised of KR Food Service (KR), Create KISSHO (CK), LE MONDE DES GOURMET (LG), eatwalk (EW), YUNARI (YNR), Shanghai Bishoku Chushin (SBC), Gourmet Brands Company (GBC), and RC Japan (RCJ). The companies are developing their respective specialty brands, focusing on Kagonoya mainly for roadside locations and urban commercial facilities. The total number of stores as of end-February 2016 was 192. The main brands in this category are Kagonoya Japanese restaurants, KISSHO specialty Japanese cuisine outlets, TANTO TANTO Italian restaurants, predominantly vegetable-based AWKitchen Italian restaurants, Tsukemen TETSU, Nanxiang Mantou Dian Nanxiang steamed soup dumpling restaurant, JEAN FRANCOIS bakery and café.
Overseas Category	Comprising stores operated by the company's Singaporean, Hong Kong and Chinese subsidiaries. The total number of stores as of end-February 2016 was 46. Shabu Sai, MACCHA HOUSE and others form the main formats.

Net sales ratio by category (FY2/16 actual results)



Further, the breakdown of store numbers by location shows 29.6% for suburban SC, 19.0% for urban SC, 26.3% for station-front and urban downtown districts, 12.8% for roadside, 6.1% in station buildings, 3.3% for department stores, and 3.0% overseas; having achieved a good, balanced distribution from the previous concentration in commercial facilities (as of the end of FY2/16).

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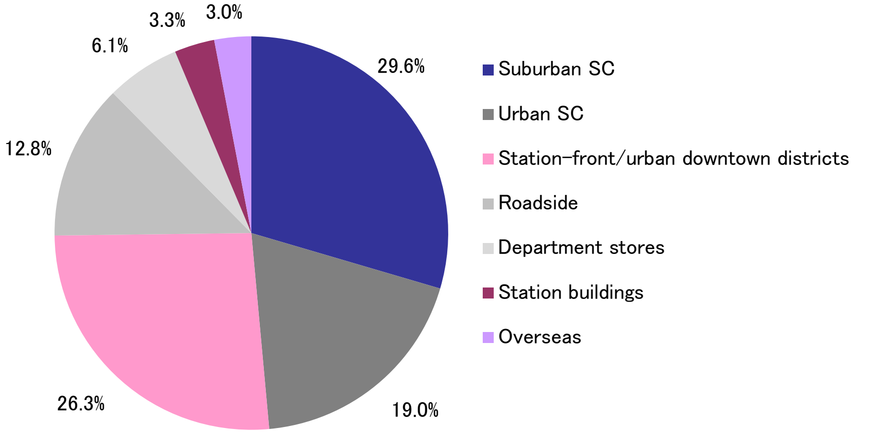
create restaurants holdings inc.

3387 Tokyo Stock Exchange First Section

6-Jun.-16

Composition of store numbers by location (as of end-February 2016)



(2) Corporate history

The company was established in 1997 as the Yokosuka Brewing Company K.K. (the trading name was changed to create restaurants inc. in 1999) by Tokuju, K.K., the family business of the company's current chairman, Hitoshi Gotoh. However, its actual foundation was in 1999, when it took over the operation of five western-style restaurants from Tokuju and started the restaurant business in earnest. In 2000, then employee of Mitsubishi Corporation <8058> and current representative director, president and CEO Haruhiko Okamoto engaged with the company through an in-house venture scheme, with the company also receiving a capital investment from Mitsubishi (the capital relationship with Mitsubishi was terminated in 2012). Thereafter, backed by Mitsubishi's credit capabilities and other resources, the company accelerated its growth by increasing its number of restaurants, mainly opening them in commercial facilities and similar locations. In 2005, the company listed on the Tokyo Stock Exchange Mothers market, changing to the First Section of the Tokyo Stock Exchange in 2013.

The company has also been aggressive in M&A, bringing the Japanese cuisine chain KISSHO under its umbrella in 2007 and shifting to a holding company structure in 2010 to establish a platform for group federation management. Subsequently, the company has acquired LE MONDE DES GOURMET in 2012, SFP Dining and eatwalk in 2013, YUNARI and Shanghai Bishoku Chushin Co., Ltd. (trading name changed from R21 Cuisine) in 2014, KR Food Service and RC Japan in 2015, successively bring them into the Group. SFP Dining was listed on the Second Section of the Tokyo Stock Exchange in December 2014 (a subsidiary listing).

In overseas development, the company started in 2008 by establishing a joint venture with a local company in Shanghai, and among other initiatives went on to establish wholly-owned subsidiaries in mainland China in 2010, Singapore in 2011, Hong Kong in 2012, and Taiwan in 2014. While the company's overseas development is still considered to be in the experimental stage, it is preparing the groundwork for a full-fledged expansion in the future. In February 2016 it established a subsidiary in New York also aimed at a US rollout.

Corporate characteristics

Developing a range of formats, optimally utilizing the ability to attract customers at favorable sites

(1) Multi-brand, multi-location strategy

The special characteristics of the company's main business are: 1) opening restaurants in commercial facilities that attract large numbers of customers (shopping centers, station buildings, etc.), and 2) operating diverse formats attuned to their local environments (regional characteristics and customer attributes, competitive circumstances, etc.). The diversity of these formats, including Japanese, western, and Chinese cuisine, as well as ethnic food and cafes, enables the company to open multiple restaurants within a single commercial facility, and this and its ability to respond to various needs of the facility owner (developers, etc.) have worked to the company's advantage in opening restaurants inside commercial facilities, which typically have higher barriers to entry. Naturally, there is also a cost factor involved in creating multiple formats attuned to their local environments; however, the capacity to open formats that use the customer drawing power of favorable sites to maximum advantage is the company's true worth. It has accumulated format development and operational know-how that are the source of its value creation.

On the other hand, the seafood izakaya ISOMARU SUISAN, developed by SFP Dining which was acquired in 2013, has as a special characteristic in its 24-hour operation in station-front locations populated with convenience stores and drug stores. In challenging fierce competition with street-level stores the chain deliberately selected high-cost station-front sites due to its insistence on locations that attract large numbers of customers. This may be cited as one reason why the chain has a strong affinity with the strategy employed by the company thus far. Therefore, it can be seen as an extension of the scope of the multi-location strategy to include the street-level store domain, and it could pave the way for future full-scale development of diverse formats among street-level stores in urban downtown districts, in addition to the existing commercial facilities. Further, the Kagonoya Japanese restaurant chain by KR Food Service has been developed focused on roadside locations, and via aggressive M&A including other specialty brands, the company will strive to further expand location diversity and brand specialization.

(2) Growth model based on the group federation management

In addition to organic (internal) growth, the company's growth model is one which through supporting additional growth by, as well as engaging with high growth potential formats via M&A, creating various synergies and providing a platform (support from a funding and management perspective etc.), leads ultimately into its own growth. In the past the company expanded its operational base through operating restaurants in commercial facilities and food courts. However, given that it was a growth model that was readily influenced by the commercial facility's circumstances, as well as shifting to a holding company structure, the company sought to transition to a strategy that aims for autonomous growth via group federation management. Understandably, it is felt that success also came from the fact that for the company, which was established from an internal Mitsubishi Corporation venture, it was a management style that was familiar from a management resource (with staff etc. that were skilled in business management) and cultural perspective, and further, the recognition that it was a partner with which a relationship could be readily formed with relatively little resistance also from capital tie-up partners.

Given that we may see many operators that, while establishing extremely attractive formats, from a business management perspective hit a wall as they aim to expand in scale, we feel that what will determine the company's future growth potential is how it can discover the optimal group management model, develop a relationship of trust between group companies and support each company's growth.

Earnings overview

Achieved significant revenue and earnings growth in FY2/16, surpassing ¥100bn in sales for the first time

(1) Progress in group federation management and results trends

Looking back at results over the past five years, expansion in store numbers, via new store openings and M&A, has been the driver of results growth. In particular, the turning point was from FY2/13 with a shift to a new growth strategy through group federation management. As well as bringing a range of formats with growth potential into the group, while realizing high growth potential by supporting further store expansion, the company sought to enhance location diversity and specialty branding. Looking at the composition of store numbers by location, at end-February 2012 commercial facilities (the total of suburban SC and urban SC) represented 78.4% of overall numbers. However, at end-February 2016 while representation by commercial facilities had shrunk to 48.6%, a balanced portfolio had been established with station-front stores and those in urban downtown districts (26.3%) and roadside stores (12.8%) having been newly added.

Store openings and closings (including M&A) and period end store number trends

	New store openings	Store closures	Acquired via M&A	Period end store numbers
FY2/12	14	-33	0	356
FY2/13	45	-29	7	381
FY2/14	61	-36	108	514
FY2/15	102	-42	26	616
FY2/16	108	-38	109	795

* From FY2/15 period end store numbers record total store numbers including stores where outsourced operations are provided, FC stores, non-consolidated stores and overseas J/V stores.

Historical M&A track record

Date acquired	Company name	Main brand (s)	Acquisition cost (¥ mn)
March 2012	LE MONDE DES GOURMET	TANTO TANTO	Undisclosed
April 2013	SFP Dining	ISOMARU SUISAN, Toriyoshi Shoten etc.	6,573
April 2013	eatwalk	AWkitchen, Yasaiya Mei etc.	858
April 2014	YUNARI	Tsukemen TETSU etc.	1,506
November 2014	Shanghai Bishoku Chushin	Nanxiang Mantou Dian	180
June 2015	KR Food Service	Kagonoya etc.	14,979
August 2015	RC Japan	Rainforest Café etc.	65

From a financial perspective, despite the owned capital ratio, which represents the stability of the financial platform, achieving a level that exceeded 35% by FY2/12, in FY2/13 the shares held by Mitsubishi Corporation were acquired by way of TOB, and as a result of around 80% of those shares being retired it declined to 19.7%. In FY2/14 owned capital was strengthened through the sale of treasury shares and the owned capital ratio improved to 32.4% temporarily due to a new share issuance in line with the listing (subsidiary listing) of SFP Dining in FY2/15. However, last year (FY2/16) it declined again to 24.1% due to the acquisition of KR Food Service. Net interest bearing debt rose significantly to ¥18,265mn.

The cash flow status up to FY2/13 shows cash flow from investment activities trended within stable cash flows from operating activities, however, from FY2/14, due to aggressive new store opening and M&A, cash flows from investment activities has expanded significantly.

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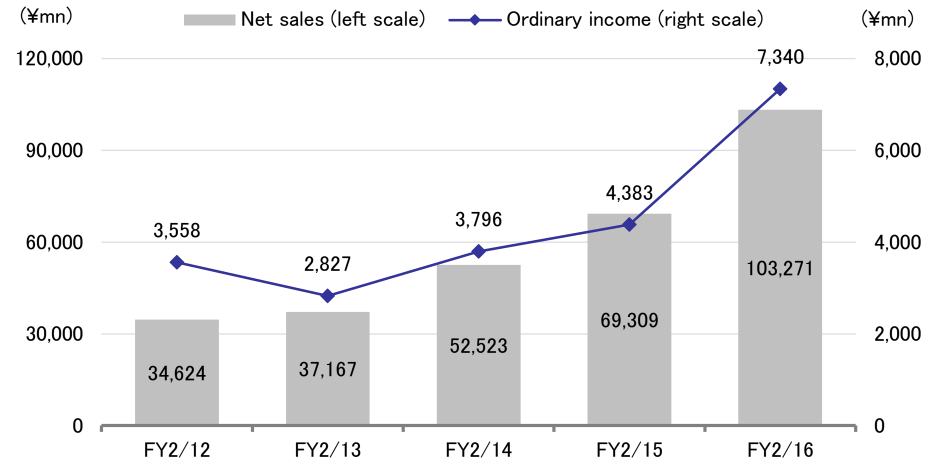
create restaurants holdings inc.

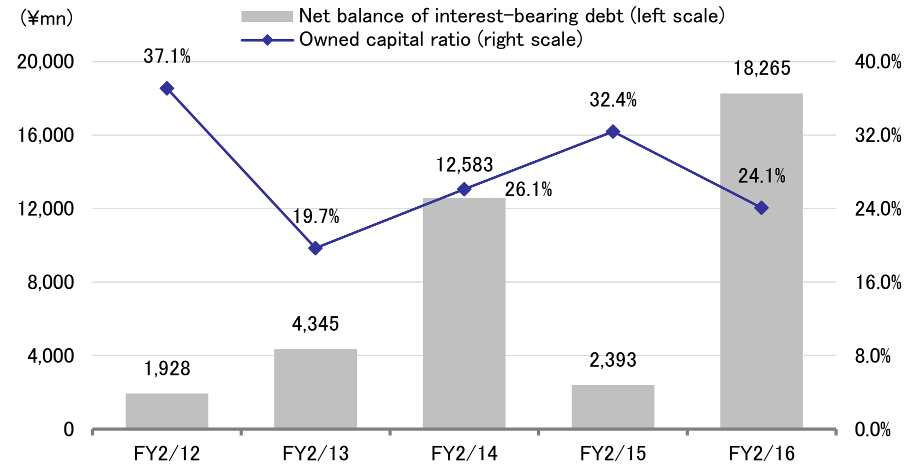
3387 Tokyo Stock Exchange First Section

6-Jun.-16

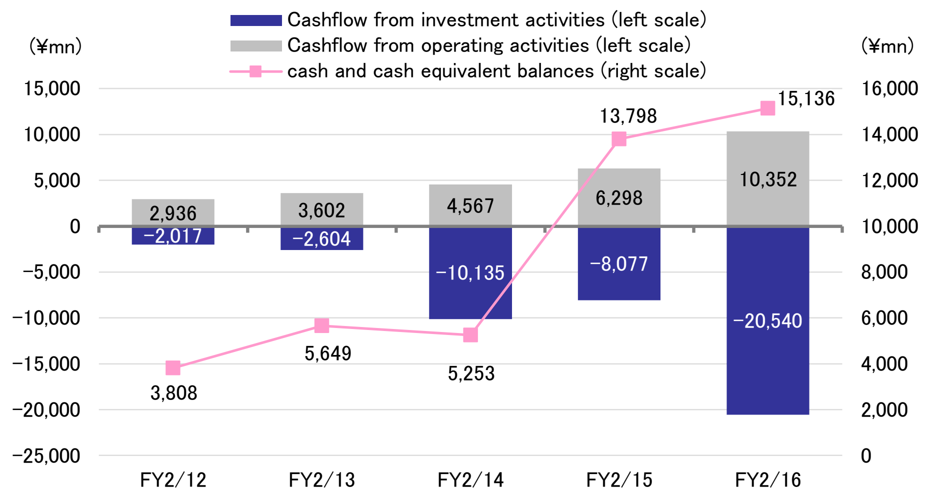
Full-year Business Results



Owned capital ratio and net balance of interest-bearing debt trends



Cash flows from operating activities and cash flows from investing activities, cash and cash equivalent balance trends



For the company, which aims to aggressively engage in M&A going forward also, it is felt that strengthening the financial platform is one issue, however, having secured a net D/E ratio of 1.04*1 and net interest bearing debt to cash flow ratio of 1.76*2, it is thought that for the time being there are no concerns regarding financing capabilities judging from its past track record and ample operating cash flows.

(2) FY2/16 results overview

The FY2/16 results showed net sales of ¥103,271mn (+49.0% YOY), operating income of ¥6,749mn (+62.1% YOY), ordinary income of ¥7,340mn (+67.4% YOY) and net income of ¥3,321mn (+48.9% YOY), being a significant rise in revenue and ordinary income, and as well as being the first time sales have surpassed ¥100bn, set a record high also for ordinary income.

Further, the company twice revised its full-year outlook upwards, however, net sales, operating income and ordinary income all managed to exceed plan versus even the second upwardly revised results outlook. However, as discussed below, net income, due to temporary extraordinary factors, saw a decline and was below plan.

In sales, amidst sound performance in the CR Category, via the steady expansion in store numbers and consolidation of KR Food Service, those from the SFP Category and the Specialty Brand Category also increased significantly. Further, factors behind exceeding the plan included sound performance in same-store sales of 100.7% (versus 99.4% in the plan) and new store openings exceeding plan mainly in the SFP Category. Moreover, with 108 (versus 99 in the plan) new store openings for the group overall, with 109 openings via M&A, 38 closings and total period-end store numbers reached 795 (an increase of 179 over the previous period end).

From a profit and loss perspective, while profitability declined at some suburban CR facilities, urban and high-end stores performed soundly, with increased ordinary income due to consolidated contributions from SFP Dining, KR Food Service and overseas operations turning profitable; with the ordinary income ratio also improving to 7.1% (from 6.3% in the previous period). The decline in net income was in addition to 1) pared earnings at SFP Dining in line with its listing (giving rise to changes in the company's holding), due to 2) the recording of impairment losses (at KR Food Service's Thai J/V, the CR Category's Okinawa stores etc.), 3) increased corporate taxes resulting from changes in the recording of sponsorship fees from beer companies, and 4) increased minority interests due to a higher than expected contribution (weighting) from the SFP Category. Of these 2)-4) were unexpected factors.

From a financial perspective, while total assets rose significantly to ¥72,530mn (up 54.2% over the previous period end) due to the consolidation of KR and expansion in store numbers, with owned capital rising to ¥17,501mn (+14.8% YOY) as a result of increased retained earnings, the owned capital ratio declined to 24.1% (from 32.4% at the previous period end). The balance of net interest bearing debt also increased to ¥18,265mn (+663.3% from the previous period end).

Results by category are as set out below.

CR Category sales rose 8.0% YOY to ¥39,084mn, while category profits declined 1.9% YOY to ¥3,469mn resulting in increased revenues but decreased earnings. Compared to the plan sales were basically in line, but category profits were slightly below expectations. In addition to a full-year contribution from stores opened in the previous period and 45 new store openings, existing store sales being 101.5% (versus 99.9% in the plan) contributed to increased revenues. However, while urban stores (in particular high-end stores) performed soundly due to factors including increased inbound demand, stores in suburban and regional areas apparently struggled with stagnant consumer demand. While it secured sales in line with the plan by introducing a low cost buffet for weekday lunches as a countermeasure, as this precipitated lower margins, from a profit perspective they were below plan with reduced earnings. Store numbers at the end of the period expanded to 381 (up 17 from the previous period end) as a result of 45 new store openings (and 20 closures).

*1 Net D/E ratio is calculated as net interest-bearing debt / owned capital. Generally, a multiple of less than 1x is rated as having no safety concerns.

*2 Net interest-bearing debt to cash flow ratio is calculated as net interest bearing debt / cash flows from operating activities. It is an indicator determining how many years of cash flows from operating activities are required to repay interest bearing debt, with it generally regarded as of concern if repayment capability exceeds 10x.

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create restaurants holdings inc.

3387 Tokyo Stock Exchange First Section

6-Jun.-16

*1 A (casual) poultry cuisine format with the average customer spend lower than Toriyoshi, which is a specialty fried chicken-wing restaurant.

*2 Shares acquired from Oriental Land on August 31, 2015. It operates four eateries in the Ikspiari commercial facility within Tokyo Disney Resort, including the popular Rain Forest Café. The aim was seen to be enhancing its brand line-up by acquiring a famous overseas brand and strengthening operations in tourist locations.

*3 A character-themed café in collaboration with Sanrio Co., Ltd. <8136>. In the CR Category it has rolled-out three stores domestically (Harajuku, Umeda, Yokohama).

SFP Category sales rose 61.9% YOY to ¥36,091mn, with category profit up 104.6% YOY to ¥4,349mn representing a significant increase in revenues and earnings. Compared to the plan sales were basically in line, while category profit exceeded expectations. In addition to a full-year contribution from stores opened in the previous period and proactive opening of 44 new stores, the fact that 14 months were consolidated due to a change in the accounting period was a factor contributing (approximately ¥4.4bn) to increased revenues. Moreover, in respect of new store openings, apart from the soundly performing ISOMARU SUISAN, these included six Toriyoshi Shoten*1 stores, established as a new format. Further, with the increase from new stores also performing well, from a profit perspective also the profit increases exceeded plan. As a result of 44 new store openings (zero closures), total store numbers at the period end reached 176 (39 greater than the previous period end).

Specialty Brand Category sales rose 203.9% YOY to ¥25,198mn while category profits rose 248.5% to ¥1,739mn, representing significant growth in both revenue and earnings. Compared to the plan both sales and category profit were basically in line with expectations. Apart from the additional contribution from KR Food Service which was consolidated in July 2015 (estimated at ¥15.5bn over the eight month period), results grew significantly due to the consolidation of YUNARI in June 2014 and contributed from the beginning of the period (estimated at ¥500mn per quarter), and also the consolidation of RC Japan*2 in September 2015. In particular, KR Food Service, in addition to its flagship Kagonoya operations performing well, saw steady expansion in its service (and parking) area operations outsourcing provision. Store numbers at the end of the period reached 192 (110 stores more than the end of the previous period) as a result of 13 new store openings (and 9 closures) and the addition of 98 stores via M&A.

The Overseas Category showed sales of ¥2,832mn (+14.1% YOY), and category profits of ¥164mn (versus a loss of ¥147mn a year earlier), representing increased revenue and a shift to profitability. In addition to Singapore and Hong Kong performing soundly, by closing unprofitable stores in China (Shanghai) in line with the company's plan, improvement in profitability was achieved. Tackling the creation of group synergies with, amongst other things, the opening in Hong Kong in November 2015 of Tsukemen TETSU (YUNARI's first overseas store), and in December of the Pom Pom Purin Café*3, as a result of 11 new store opening (with 9 closings) and 11 stores added by M&A (including stores obtained from the acquisition of KR Food Service), period end store numbers reached 46 (13 more than at the end of the previous period).

Expecting a third consecutive period revenue and ordinary income growth in FY2/17

(3) FY2/17 results outlook

In FY2/17 the company expects a third consecutive period of net sales and ordinary income growth, with net sales of ¥118,000mn (+14.3% YOY), operating income of ¥7,600mn (+12.6% YOY), ordinary income of ¥7,900mn (+7.6% YOY) and net income of ¥4,200mn (+26.4% YOY). These are almost at the same levels as the target values (not including M&A) in the medium-term management plan.

While the number of months subject to consolidation at SFP Dining will normalize (returning from 14 to 12 months), in addition to KR Food Service contributing from the start of the period (adding a further four months), it is expected that expansion in store numbers, with 99 new store openings (and 30 closures) will be among factors contributing to higher revenues. Further, same-store sales are expected to be 97.8% compared to the previous period. However, as contributions from M&A are a highly uncertain factor, they have not been included at this point.

From a profit and loss perspective, while apart from hikes in raw material and personnel costs, continuing to remain high, costs including store opening costs in line with proactive new store opening, and goodwill amortization are expected to remain at high levels, increased profits are expected due to factors including profit boosts from increased revenues and improved profitability in overseas operations.

The outlook for sales by category is as set out below.

CR Category sales are expected to be up 3.6% YOY to ¥40,503mn, with category profits up 12.0% YOY to ¥3,885mn. Despite 20 store closures being planned (including 16 stores in one tranche from a food court operation in line with the expiration of a contract) revenues are expected to increase as a result of the full-year contribution from stores opened in the previous period and 27 new store openings. Also, it is felt that the pace of new store openings becoming slightly slower reflects their policy of making store replacements with specialty brands, the characteristics of which suit the location. Further, in respect of CR stores also, the direction appears to be to proactively roll out the roast beef donburi specialty stores that were smoothly established last period. Taking into consideration that existing store sales are struggling in suburban and regional areas, the company assumes a conservative level of 98.2% compared to the previous period.

SFP Category sales are expected to rise 6.1% YOY to ¥38,300mn and category profit to decline 5.7% YOY to ¥4,100mn. Despite normalization of the number of months subject to consolidation for SFP (as it returns from 14 to 12 months) being a negative factor, revenues are expected to increase as a result of the full-year contribution from stores opened in the previous period and 41 new store openings. In respect of brands to be rolled out, continuing from last period ISOMARU SUISAN and Toriyoshi Shoten appear to form the pivotal players. Further, in addition to the metropolitan terminal stations to date, the direction is to roll them out to major railway stations in commuting zones also. Given a conservative estimate of the impact of erosion of the effects of the boost gained from a grand opening, the company expects same store sales to be 96.0% compared to the previous period.

It is expected that Specialty Brand Category sales will rise 42.1% YOY to ¥35,816mn and category profit by 19.7% YOY to ¥2,081mn. In addition to KR Food Service contributing from the start of the period (estimated as adding ¥9bn over four months), the outlook calls for increased revenue as stores opened last year make a full-year contribution and from the 23 new store openings (with 6 closures). Apart from KR Food Service it appears the plan is for YUNARI (Tsukemen TETSU etc.) to play a pivotal role.

It is expected that Overseas Category sales will rise 19.4% YOY to ¥3,380mn and category profit by 49.6% YOY to ¥246mn. In addition to Taiwan being newly consolidated (with an estimated ¥400mn increase in revenue), as a result of Singapore and Hong Kong performing soundly it is expected that revenues will rise. Further, the first North American store (New York) is also planned to be opened, targeting a start within this year. Thus, eight new store openings (and four closures) are planned.

At FISCO we feel that given there is ample room for new stores, including suburban areas (rollout to major train stations in commuting zones etc.) focusing on izakaya format ISOMARU SUISAN and others that maintain solid performance, and as the Specialty Brand Category centered on KR Food Service is also sound, we assess the company’s results outlook to be attainable. Further, attention must be paid to the fact that M&A, which is being aggressively considered, may potentially be a factor for results to outperform.

■ Growth strategies

Targeting ¥200bn in sales in FY2/20, through further overseas expansion etc.

(1) Medium-term management plan

The company is promoting its 3-year medium-term management plan (which is a rolling plan). It plans to accelerate growth by: 1) organic store openings, 2) effecting domestic M&A, and 3) further overseas expansion; based on group federation management; embracing formats with growth potential into its own growth profile via proactive M&A.

Given that the last period’s results progressed well versus the plan and group federation management is now on track, as well as leaving the FY2/18 numerical targets unchanged, it has newly announced its FY2/19 targets. The FY2/19 targets cite as goals net sales of ¥17,500mn, ordinary income of ¥13,000mn and net income of ¥7,600mn. Based on FY2/16 actual results this implies 3-year average growth rates of 19.2% for net sales, 21.0% for ordinary income and 31.8% for net income.

create restaurants holdings inc.

3387 Tokyo Stock Exchange First Section

6-Jun.-16

Medium-term management plan (including M&A)

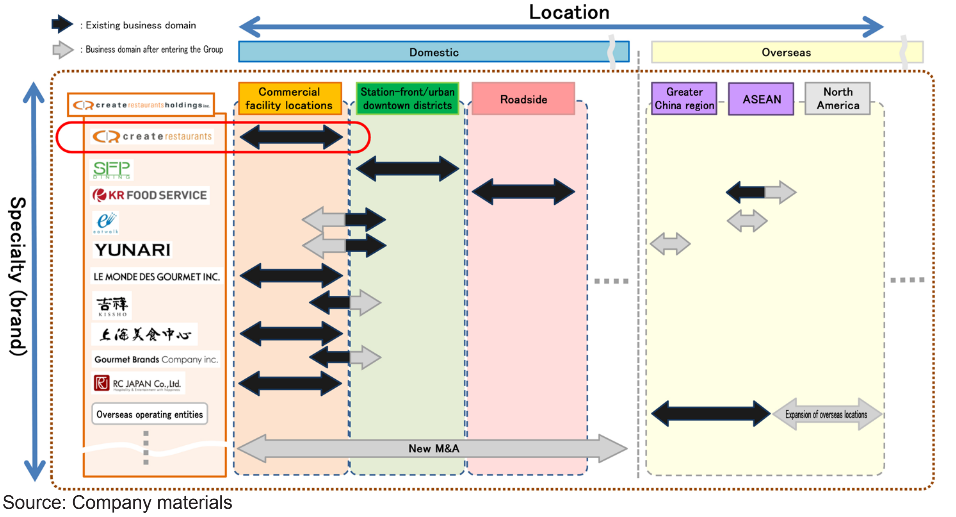
(Unit: ¥mn)

	FY2/16 (actual results)	FY2/17 (plan)	FY2/18 (plan)	FY2/19 (plan)	Average growth rate
Net sales	103,271	118,000	150,000	175,000	19.2%
(Growth rate)	49.0%	14.3%	27.1%	16.7%	
Ordinary income	7,340	7,900	10,700	13,000	21.0%
(margin)	7.1%	6.7%	7.1%	7.4%	
Net income	3,321	4,200	6,100	7,600	31.8%
(margin)	3.2%	3.6%	4.1%	4.3%	

(2) VISION2020 the growth snapshot in 4 years' time

Also, the VISION2020 growth snapshot in 4 years' time has been announced, aiming for continuous growth through building a strong portfolio by further developing group federation management. Given that through M&A to date, it has sought to attain location diversity including, in addition to commercial facility locations, and apart from business precinct and station front locations (SFP) and roadside locations (KR), overseas locations (Greater China region, ASEAN etc.), and expanded the variety of formats (specialty brands), the result has produced new growth opportunities by seeking further combinations of location diversity and brand specialization.

Group federation management growth picture



Source: Company materials

Moreover, 1) organic store openings, 2) domestic M&A and 3) additional overseas expansion are cited among the core growth engines, with the goal of ¥200bn in sales in FY2/20.

The sales growth image for each of the growth engines and basic policies are as set out below.

1) Organic store openings

In operations currently being rolled out growth is promoted by store openings, aiming for ¥60bn in increased sales over four years from around 90 new store openings per annum. Soundly performing izakaya format ISOMARU SUISAN and the flagship CR Category form the focus. In addition to these, the company's direction is to also strengthen Specialty Brand Category store openings. In particular, in a recent trend we can see cases of specialty brands Tsukemen TETSU (YUNARI) and AWkitchen (eatwalk) store openings within commercial facilities, and we feel that in the future store openings of this sort will increase.

2) Domestic M&A

Through the implementation of group federation management, which supports M&A, the company is aiming for ¥30bn in increased sales over three years. Based on previously executed deals, the company is engaged in uncovering new deals divided into three patterns: 1) exits by fund and other investors (SFP Dining, KR Food Service), 2) acquiring noncore operations (LE MONDE DES GOURMET, RC Japan) and 3) alliances with founders (eatwalk, YUNARI). The track record over the past four years is of adding around ¥38bn in sales via M&A, and taking into account the plethora of deals currently on the table, it is judged to be eminently achievable. Further, the company emphasizes four evaluation criteria: 1) continued sales and profit growth potential, 2) high profitability based on competitive superiority, 3) multi-store "brandability", and 4) management's passion.

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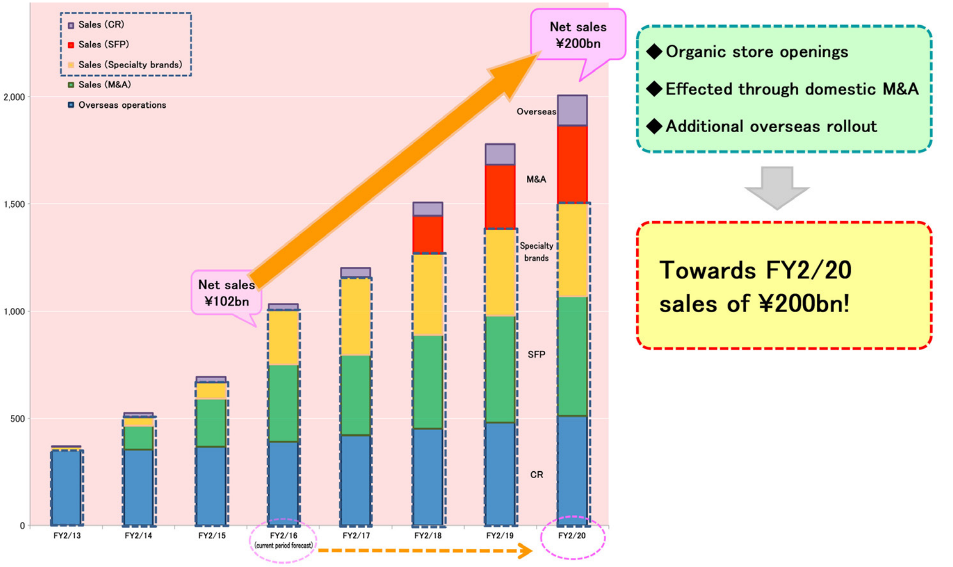
3387 Tokyo Stock Exchange First Section

6-Jun.-16

3) Additional overseas rollout

Utilizing know-how from Singapore and Hong Kong, in this period (FY2/17) the company through expansion, starting with Taiwan which is to be consolidated, into North America, where Japanese cuisine is very popular, and the ASEAN region (Indonesia, Malaysia, Vietnam etc.), is aiming for increased sales of ¥10bn over four years. Further, it is also considering joint ventures, where operational expansion may be expected with relatively little capital, and expansion via franchise structures.

Sales growth snapshot



Source: Company materials

At FISCO, while we feel that the hurdles the company faces in achieving the medium-term management plan and VISION2020 are by no means low, due to, amongst other things, there being ample room for new store openings for the soundly performing izakaya format, the M&A environment providing a tailwind, and a boost able to be expected from the know-how the company has accumulated and Japanese cuisine popularity overseas also, we deem them to be eminently achievable. In particular, in respect of the M&A environment, as restructuring progresses in the food service industry, we see factors such as opportunities to meet operators developing unique, attractive formats, while still immature in terms of management resources, are increasing and the trend amongst large corporations to divest themselves of noncore operations (e.g. food service subsidiaries etc.), as was the case in RCJ acquisition from Oriental Land, as having strong potential to act a tailwind for the company. Of course, it is essential to pay attention to the potential for delays in uncovering deals in M&A and promoting the creation of synergies to be factors for underperformance compared to targets.

On the other hand, in respect of ISOMARU SUISAN, which carries a large weighting in the store opening plan, while in addition to it performing soundly at present, and there remaining ample room for store openings, as a measure for diversifying risk and anticipating further future prospects, it will be raised as a topic for the future to unearth and nurture new core store opening candidates. We would like to draw attention to the future development of Toriyoshi Shoten that was established as a new format.

Further, we would draw attention to the fact that this is not simply the aggregation of sales, but also one of value-adding trends and specific results unique to the company’s group federation management in the further evolution of its strategy by crossing location diversity and brand specialization, expressing cost synergies and other features.

Shareholder returns

Medium-term room for increased dividends is also large in line with profit growth

The company's basic policy is to pay stable dividends targeting a consolidated payout ratio of around 30%, taking into consideration factors such as operating results and future business development. For FY2/16, the company has announced it will pay an annual dividend of ¥11.7 per share (representing a 33.2% payout ratio), a YOY increase of ¥4.1 (after adjustment for the stock split). Also, in FY2/17, the company plans to pay an annual dividend of ¥13.0 per share, a YOY increase of ¥1.3 (after adjustment for the stock split). Based on the company's medium-term management plan, as it is forecasting a high growth rate driven by continued aggressive business development, there is ample room for increased dividends in line with profit growth over the medium term also.

Aiming to enhance liquidity, the company undertook a 3-for-1 stock split with February 29, 2016 as the date of record. Further, it announced accordingly an expansion of its shareholders' benefits program, with August 31, 2016 as the date of record. Twice a year, in February and August, it distributes meal vouchers to the value of ¥3,000 (¥6,000 annually) to shareholders with 100-499 shares, ¥6,000 (¥12,000 annually) to shareholders with 500-1,499 shares, ¥15,000 (¥30,000 annually) to shareholders with 1,500-4,499 shares, and ¥30,000 (¥60,000 annually) to shareholders with 4,500 or more shares.

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