COMPANY RESEARCH AND ANALYSIS REPORT

create restaurants holdings inc.

3387

Tokyo Stock Exchange First Section

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Index

Summary

Profits decreased in FY2/19, although sales increased
A temporary increase in the impairment loss following the adoption of IFRS kept down profits
Is aiming to accelerate growth, centered on the M&A strategy

create restaurants holdings inc. <3387> (hereafter, also "the Company") 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 through 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 925 restaurants*1 in approximately 200 brands (as of the end of February 2019). Moreover, the Company is achieving higher growth by incorporating brands with high growth potential into the Company's own growth profile through aggressive M&A, such as the seafood izakaya chain Isomaru Suisan*2, which has been gaining popularity with its 24-hour operation in favorable station-front locations, by engaging in "Group Federation Management."*3 In this way, the Company appears to have entered a new growth phase.

*1 Including all business consignment outlets and franchise outlets (same below)
*2 Developed by SFP Holdings Co., Ltd. <3198> that was acquired in April 2013
*3 The Group's management being advanced by the Company. Up to the present time, it has taken a solar system-type approach to creating synergies between members of the Group, but going forward, it is aiming to evolve to a star cluster-type approach, in which the various companies in the Group pursue synergies with each other.

In the FY2/19 results (based on IFRS) *, sales increased but profits decreased, with revenue rising 2.4% year-on-year (YoY) to ¥119,281mn and operating profit falling 34.9% to ¥3,975mn. Both sales and profits were below the initial forecasts, and furthermore, profits were also below the revised forecasts announced on January 11, 2019. The factors behind the higher sales were the full fiscal year contributions of the outlets opened in the previous fiscal year and the openings of 89 new outlets (of which, an increase of 29 outlets through M&A, etc.) However, the reasons why revenue was below the initial forecast included that, in addition to the effects of the earthquakes and the unseasonable weather, the Company strategically kept down some new outlet openings, and also that the performance-improvement effects in some of the outlets that underwent brand conversions fell short of expectations. In profits also, although it was able to control the cost rate within the expected range, profits decreased due to the slump in revenue and also as personnel costs rose more than expected. In addition, as the impairment loss temporarily increased following the adoption of IFRS, profits fell even below the revised forecasts. But in terms of activities, it can be said that the Company achieved a certain level of results for the establishment of a foundation on which to accelerate growth in the future, including adopting IFRS and realizing M&A.

* Transitioned to IFRS (International Financial Reporting Standards) from the FY2/19 full-year results.

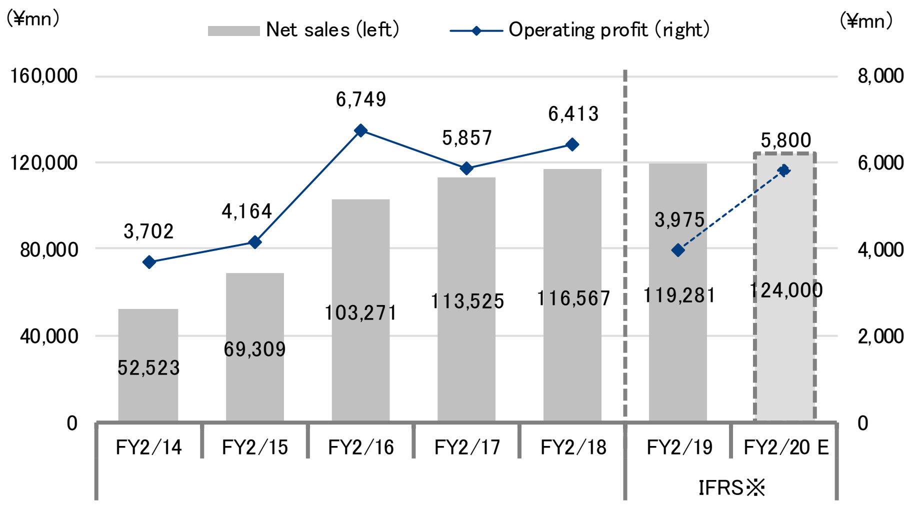
For the FY2/20 results (based on IFRS), the Company is forecasting higher sales and profits, with revenue to increase 4.0% YoY to ¥124,000mn and operating profit to rise 45.9% to ¥5,800mn. Revenue is expected to grow in every category. The main reasons for the higher sales and profits will be the openings of 77 new outlets (of which, an increase of 26 outlets through M&A) and also the full fiscal year contributions of the outlets opened in the previous fiscal year. Conversely, it plans to exit from 38 outlets, such as unprofitable ones. Also, for sales at existing outlets, it expects to secure sales of 98.2% of the result in the previous fiscal year, including due to the brand conversions and the measures that will contribute to improving productivity. For profits, the Company will continue to work on controlling costs and it expects to realize a major improvement through eliminating the temporary impairment loss that kept down profits in the previous fiscal year. Adjusted EBITDA, which it prioritizes, is also expected to increase 1.7% YoY to ¥11,000mn.

The important management issues for the Company including the diversification of customer needs, the intensification of competition, and securing quality human resources, but on the other hand, the M&A environment has become advantageous. Based on these and other factors, it has once again indicated the direction it will take for its medium-term growth strategy; namely, it will steer a course to realize strong, sustainable growth by 1) progressing the M&A strategy in Japan and overseas, 2) further strengthening its ability to create brands, and 3) further developing the Group Federation Management. Also, alongside this course, it has announced its new three-year medium-term management plan. For the plan's final fiscal year (FY2/22), it is aiming for revenue of ¥152,000mn and adjusted EBITDA of ¥16,100mn, which it will achieve from opening 50 to 60 new outlets each year and also from the increase in the number of outlets from M&A (around 200 outlets over the three years).

Key Points

- In FY2/19, profits decreased although sales increased, while both were below the initial forecasts
- Profits were kept down by the temporary increase in the impairment loss following the adoption of IFRS
- The forecasts for FY2/20 are for sales to increase and profits to improve significantly
- Is aiming to accelerate growth through progressing the M&A strategy in Japan and overseas and further evolving Group Federation Management

Results trends



*Adopted IFRS from FY2/19
Source: Prepared by FISCO form the Company's financial results

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Company profile

Implements "Group Federation Management" that pursues a variety of brands utilizing aggressive M&A

1. Business description

The Company mainly have operated restaurants and food courts at shopping centers and has moved into izakaya and other type restaurants acquired through M&A. As a holding company, it brings together 18 consolidated subsidiaries (including 5 overseas companies) (as of end of FY2/19).

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 brands attuned to specific locations (regional characteristics, customer attributes, and competition status, etc.). This strategy has supported the Company's main business. Further, in recent years, the Company is promoting "Group Federation Management," which involves incorporating various brands with high growth potential into the Company through aggressive M&A activities. As of the end of February 2019, the Company has 925* restaurants in approximately 200 brands.

The Company's businesses are divided into four categories: (1) the CR Category, involving the operation of restaurants and food courts with multiple brands mainly at commercial facilities, (2) the SFP Category, involving the operation of izakaya brands, (3) the Specialty Brands Category, involving the operation of various restaurant brands, and (4) the Overseas Category, which involves operation of Japanese restaurants in Singapore, Hong Kong, Taiwan, and so forth. The mainstay CR Category makes up 37.9% of the Company's sales, while the SFP Category makes up 31.4%, the Specialty Brands Category 28.0%, and the Overseas Category 2.7% (as of the end of FY2/19).

Overview of business categories

CR Category	It is comprised of the outlets operated by create restaurants (CR), Create Dining (CD) and Create Bayside (CB). There were 444 outlets at the end of February 2019. The main brands include Harvest, shabu SAI, Rio Grande Grill, Roast Beef Hoshi, and Desert Okoku.
SFP Category	It is comprised of the restaurants operated by SFP Holdings, with which the Company entered-into a capital tie-up in April 2013. It operates izakaya outlets in urban downtown districts. There were 239 outlets at the end of February 2019. The main brands include seafood izakaya Isomaru Suisan and fried chicken wing specialty restaurants Toriyoshi and Toriyoshi Shoten. The new brands, of izakaya of gyoza "dumplings" Ichigoro and Go no Go bars, are making steady starts.
Specialty Brand Categories	It is comprised of KR HOLDINGS (KR), LE MONDE DES GOURMET (LG), eatwalk (EW), YUNARI (YNR), Gourmet Brands Company (GBC), Route 9g(RN), and YUZURU (YZ). It is mainly focusing on Kagonoya and Gomasoba YUZURU outlets for roadside locations, developing their respective specialty brands for urban commercial facilities. There were 208 outlets in total at the end of February 2019. The main brands include Japanese restaurants Kagonoya, Italian restaurants TANTO TANTO, primarily vegetable-based Italian restaurants AW kitchen, Tsukemen TETSU, Café Boulangerie JEAN FRANÇOIS, Singaporean cuisine Hainan Jeefan Restaurants, and Gomasoba YUZURU.
Overseas Category	It is comprised of restaurants operated by the Company's overseas subsidiaries in Singapore, Hong Kong, Taiwan, and the United States. There were 34 outlets in total at the end of February 2019. The main brands include shabu SAI and MACCHA HOUSE. an outlet specializing in matcha green tea. In December 2018 in North America (New York), it opened 2 Japanese food restaurants, Aburiya Kinnosuke and SOBA TOTTO , and is currently operating 3 restaurants.

Source: Prepared by FISCO from Company materials and interviews

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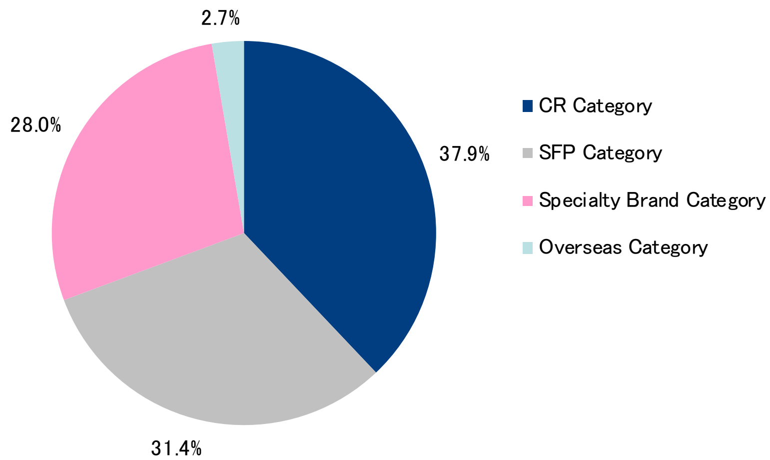
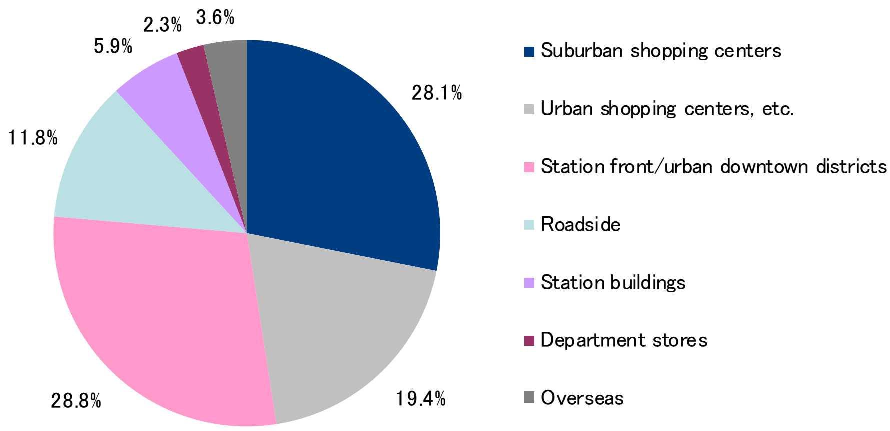
Net sales by category (FY2/19 results)



Source: Prepared by FISCO from Company materials

Further, the breakdown of restaurant numbers by location shows 28.1% for suburban SC, 19.4% for urban SC, 28.8% for station front and urban downtown districts, 11.8% for roadside, 5.9% in station buildings, 2.3% for department stores, and 3.6% overseas; having achieved a good, balanced distribution from the previous concentration in commercial facilities (as of the end of FY2/19).

Composition of restaurant numbers by location
(as of the end of February 2019)



Source: Prepared by FISCO from Company materials

2. History

The Company was established in 1997 as the Yokosuka Brewing Company K.K. (the company 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 reputation 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 Mothers market of the Tokyo Stock Exchange, changing to the First Section in 2013.

The Company has also been aggressive in M&A, acquiring the Japanese cuisine chain KISSHO 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*1 and eatwalk in 2013, YUNARI and Shanghai Bishoku Chushin Co., Ltd. (company name changed from R21 Cuisine) in 2014, KR Food Service*2 and RC Japan (now Create Dining inc.) in 2015, successively bring them into the Group. SFP Dining was listed on the TSE Second Section in December 2014 (a subsidiary listing). (Its listing was changed to the TSE 1st Section on February 28, 2019).

*1 SFP Dining Co., Ltd. changed its name to SFP Holdings Co., Ltd. in June 2017
*2 KR Food Service Co., Ltd., changed its name to KR Holdings Co., Ltd., in December 2018.

In overseas deployment, 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 expansion 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, and in July 2017, it opened NAOKI TAKAHASHI* in New York. The Company completed the exit of all restaurants from China (Shanghai) at the end of August 2017.

* The restaurant name was changed and is currently Sushi Nao.

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Corporate characteristics

Possesses a strong brand portfolio with industry development capabilities and robust M&A results

1. Multi-brand, multi-location strategy

The 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 brands attuned to their local environments (regional characteristics and customer attributes, status of competition, etc.). The diversity of these brands, 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 respond to various needs of the facility owner (developer, etc.). This has worked to the Company's advantage in opening restaurants inside commercial facilities, which typically have a higher barrier to entry. Naturally, there is also a cost factor involved in creating multiple brands attuned to their local environments; however, the capacity to develop brands that use the customer drawing power of favorable locations to maximum advantage is the Company's true worth. The source of its value creation is accumulation of know-how in brand development and operations.

On the other hand, the seafood izakaya ISOMARU SUISAN, developed by SFP which was acquired in 2013, has as a special characteristic in its 24-hour operation in station-front locations populated with convenience stores and drugstores. In challenging fierce competition with street-level locations, 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 domain, and it could pave the way for future full-scale development of diverse brands among street-level locations in urban downtown districts, in addition to the existing commercial facilities. Further, the Kagonoya Japanese restaurant chain by KR Food Service has been developed focusing 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 "Group Federation Management"

In addition to organic (internal) growth, the Company's growth model is one where growth arises by supporting growth through engagement with high growth potential brands via M&A, creating various synergies and providing a platform (support from a funding and management perspective etc.). 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, along with the shift 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 recognized the Company succeeded because it had been established from an internal Mitsubishi Corporation venture. Additionally, it was a management style familiar in terms of management resources (with staff etc. that were skilled in business management) and corporate cultural perspective. Furthermore, it was recognized as a partner with which a relationship could be readily formed, and done so with relatively little resistance from capital tie-up partners. For the growth strategy going forward, M&A and "Group Federation Management" (maximizing Group synergies) will be the mainstay in a growth model clearly to the Company's advantage in a tough operating environment where the domestic market is contracting and affected by labor shortages.

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Financial results

Realizing high growth potential and profitability through aggressive additions including M&A

1. "Group Federation Management" progress and results trends

Looking back at results, expansion in restaurant numbers, via new openings and M&A, has been the driver of growth. In particular, the turning point was from FY2/13 with a shift to a new growth strategy through "Group Federation Management." By realizing high growth potential through bringing a range of formats with growth potential into the Group, while supporting further additions, the Company sought to enhance location diversity and specialty branding. Looking at the composition of restaurants by location, at the end of February 2012, commercial facilities (the total of suburban SC and urban SC) represented 78.4% of overall numbers. However, at the end of February 2019 while representation by commercial facilities had shrunk to 47.5%, a balanced portfolio had been established with station-front locations and those in urban downtown districts (28.8%) and roadside locations (11.8%) having been newly added.

Openings and closings (including M&A) and total at the end of period

	New openings	Closures	Acquired via M&A	Total at the end of the period
FY2/13	45	-29	7	381
FY2/14	61	-36	108	514
FY2/15	102	-42	26	616
FY2/16	108	-38	109	795
FY2/17	116	-54	0	857
FY2/18	68	-62	2	865
FY2/19	60	-29	29	925

Note: From FY2/15, total at the end of the period includes restaurants where outsourced operations are provided, FC locations, non-consolidated locations and overseas J/V locations.
Source: Prepared by FISCO from Company materials

M&A track record

Date acquired	Company name	Main brand(s)	Acquisition price (¥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, Yasaiyamei, 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	Rain Forest Café, etc	65
January 2018	ROUTE9G	Hainan Jeefan Restaurants	Undisclosed
March 2018	Create Bayside	Developing restaurants, etc., under the IKSPIARI brand	Undisclosed
December 2018	YUZURU	Gomasoba YUZURU	Undisclosed
March 2019	Kiya Foods	Ginza Kiya	Undisclosed
March 2019	Joh Smile (M&A by SFP)	Maekawa Suigun, etc.	Undisclosed

Source: Prepared by FISCO from Company materials

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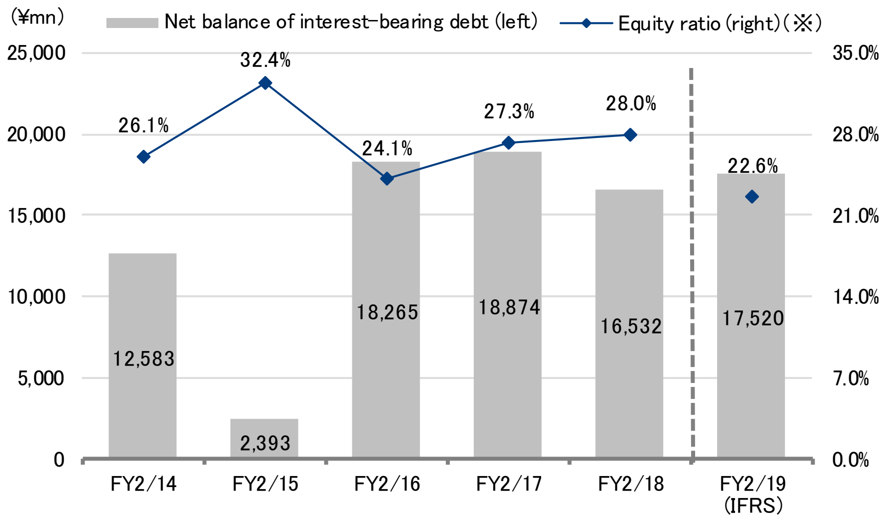
From a financial perspective, the equity ratio, which represents the stability of the financial foundation, achieved a level exceeding 35% by FY2/12. Mitsubishi Corporation's shares were acquired by way of TOB, and as a result of around 80% of those shares being retired, the equity ratio declined to 19.7% at end-FY2/13. In FY2/14, equity was strengthened through the sale of treasury shares and the equity ratio improved to 32.4% temporarily at the end of FY2/15 due to a new share issuance in line with the listing (subsidiary listing) of SFP Dining. However, it declined again to 24.1% at the end of FY2/16 due to the acquisition of KR Food Service. Net interest-bearing debt also rose significantly to surpass the ¥18bn level.

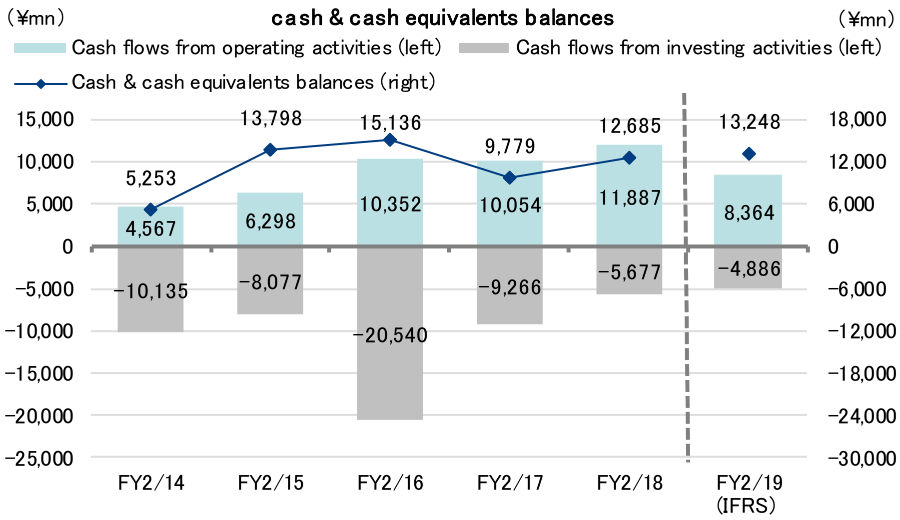
For the cash flow conditions, up to FY2/13, investment cash flow trended within the range of stable operating cash flow, but it grew significantly from FY2/14 to FY2/17 due to the active investment in new outlet openings and in M&A. Since FY2/18, the Company has once again reduced the amount of cash flow used for investment, including by keeping down new outlet openings.

Equity ratio and net balance of interest-bearing debt



*Following the adoption of IFRS, "the equity ratio" was changed to "the ratio of equity attributable to the owners of the parent company".
Source: Prepared by FISCO from the Company's financial results

Cash flows from operating activities and cash flows from investingactivities, cash & cash equivalents balances



Source: Prepared by FISCO from the Company's financial results

For the Company, which aims to continue to engage in M&A aggressively, strengthening the financial foundation is an issue. However, having secured a net D/E ratio of 1.07*1 as of February 28, 2019, (based on IFRS) and net interest-bearing debt to cash flow ratio of 2.09*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.

*1 Net D/E ratio is calculated as net interest-bearing debt / equity. Generally, a multiple of less than 1x is rated as having no stability 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 the rate exceeds 10x.

In FY2/19, profits decreased although sales increased The impairment loss temporarily increased following the adoption of IFRS

2. FY2/19 results overview

In the FY2/19 results (based on IFRS)*1, revenue increased 2.4% YoY to ¥119,281mn, operating profit decreased 34.9% to ¥3,975mn, profit before tax declined 37.4% to ¥3,688mn, and profit attributable to owners of parent fell 51.8% to ¥1,321mn, so sales increased but profits decreased. Both revenue and profits were below the initial forecasts, and moreover, profits were also below the revised forecasts announced on January 11, 2019.

*1 Transitioned to IFRS from the FY2/19 full-year results.
*2 The initial forecasts were downwardly revised due to factors including the effects of the earthquakes and the unseasonable weather, and also because of the increase in personnel costs. Specifically, revenue was revised from ¥125,000mn to ¥120,000mn, operating profit from ¥7,600mn to ¥5,700mn, profit before tax from ¥7,400mn to ¥5,600mn, and profit attributable to owners of parent from ¥4,000mn to ¥2,900mn.

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The factors behind the higher sales were the full fiscal year contributions of the outlets opened in the previous fiscal year (70 outlets, of which, an increase of 2 outlets from M&A) and from the openings of 89 new outlets (of which, an increase of 29 outlets from M&A, etc.) However, the reasons why revenue was below the initial forecast included the effects of the earthquakes (in the Kansai and Hokkaido areas) and the unseasonable weather (including the large typhoons that hit Japan, and heatwaves), and also because some openings of new outlets were strategically kept down and as the performance-improvement effects in some of the outlets that underwent brand conversions fell below expectations. Sales in existing outlets were also only 96.7% of the result in the previous fiscal year (98.1% of the initial forecast). For outlet openings, exits and related, 89 outlets were newly opened (of which, an increase of 29 outlets through M&A, etc.), while the Company exited from 29 outlets, conducted brand conversions of 37 outlets, and renovated 18 outlets. As a result, at the end of February 2019, the Group's total number of outlets exceeded 900, reaching 925.

In profits, although the Company was able to control the cost rate within the expected range, profits decreased due to the slump in revenue and as personnel costs rose more than expected. In addition, the reason why profits fell further below the revised forecasts was that the impairment loss temporarily increased following the adoption of IFRS*. However, the increase in the impairment loss was because the impairment loss standard became stricter on the adoption of IFRS, and it is not the case that the profitability of assets has changed significantly.

* Adjusted EBITDA, which excludes the impact of the impairment loss and other factors, decreased 12.1% YoY to ¥10,814mn, but it was above the revised forecast. The Company's policy is to use adjusted EBITDA as a priority indicator in the future. It is calculated as follows; adjusted EBITDA = operating profit + other operating expenses – other operating revenue (excluding funding revenue) + depreciation expenses + non-recurring expense items (such as advisory expenses for share acquisitions).

Overview of FY2/19 results

(¥mn)

	FY2/18 Results IFRS basis		FY2/19 Results IFRS basis		Change		FY2/19 Initial forecasts based on IFRS		FY2/19 Revised forecasts based on IFRS	
		% of total		% of total		Change rate		% of total		% of total
Revenue	116,522		119,281		2,759	2.4%	125,000		120,000	
CR Category	43,735	37.5%	45,633	37.9%	1,897	4.3%	-	-	-	-
SFP Category	36,841	31.6%	37,751	31.4%	909	2.5%	-	-	-	-
Specialty Brand Category	33,177	28.5%	33,659	28.0%	481	1.5%	-	-	-	-
Overseas Category	2,834	2.4%	3,237	2.7%	402	14.2%	-	-	-	-
Cost of sales	33,524	28.8%	34,314	28.8%	790	2.4%	-	-	-	-
SG&A expenses	75,638	64.9%	79,116	66.3%	3,478	4.6%	-	-	-	-
Operating profit	6,110	5.2%	3,975	3.3%	-2,135	-34.9%	7,600	6.1%	5,700	4.8%
Profit before tax	5,889	5.1%	3,688	3.1%	-2,201	-37.4%	7,400	5.9%	5,600	4.7%
Profit attributable to owners of parent	2,743	2.4%	1,321	1.1%	-1,422	-51.8%	4,000	3.2%	2,900	2.4%
Adjusted EBITDA	12,306	10.6%	10,814	9.1%	-1,492	-12.1%	-		10,506	
CR Category CF	4,971	11.4%	5,417	11.9%	446	9.0%				
SFP Category CF	5,345	14.5%	4,538	12.0%	-807	-15.1%				
Specialty Brand Category CF	2,953	8.9%	2,205	6.6%	-747	-25.3%				
Overseas Category CF	240	8.5%	-89	-	-330	-				

*The percentages of the total for the category CF (cash flow) are from the percentages of sales per category.
*Category CF = operating profit (Japanese standards) + depreciation expenses + amortization of goodwill + funding revenue + non-recurring expenses items
*The percentages of FY2/19 revenue are before adjustments.
Source: Prepared by FISCO from Company materials

Category results are set out as below.

(1) In the CR category, revenue increased 4.3% YoY to ¥45,633mn and category CF*1 increased 9.0% to ¥5,417mn, for higher sales and profits (CF increased). So overall, it can be said that the results were steady. The main factors behind the higher sales were the full fiscal year contributions of the outlets opened in the previous fiscal year (31 outlets) and the openings of 38 new outlets (of which, an increase of 17 outlets from M&A, etc.) In particular, there were major contributions from the consolidation of create bayside, which acquired the directly operated restaurant business (17 outlets) of IKSPIARI Co., Ltd.*2, and the acceptance of full business operations of Tokyo Midtown Hibiya Food Hall (HIBIYA FOOD HALL). In addition, the Company actively opened outlets in tourist destinations, such as in the Japanese-style café format. However, for sales from existing outlets, although sales were strong from outlets such as the highly popular Shabu-shabu style brands and Desert Okoku due to the tapioca boom, some BEEF RUSH outlets struggled, and therefore sales were only 97.0% of the result in the previous fiscal year (97.1% of the initial forecast and 97.6% of revised forecast). Profits (CF) increased, as the efforts to control costs and personnel expenses were successful.

*1 For the management of figures by category, previously the Company disclosed "category income" that was calculated based on ordinary income according to Japanese standards. But following the adoption of IFRS, it changed it to "category cash flow (category CF)" that is calculated based on adjusted EBITDA.

*2 On March 1, 2018, the Company acquired the directly operated restaurant business of IKSPIARI and acquired 100% of the shares of Create Bayside Inc. which was newly established from a company-split with IKSPIARI. Create Bayside manages restaurants (9 restaurants) and food courts (8 booths) within IKSPIARI, a commercial complex, and in terms of M&A, it has been positioned as targeting the separation of non-core businesses.

(2) In the SFP category, revenue increased 2.5% YoY to ¥37,751mn and category CF decreased 15.1% to ¥4,538mn, for increased sales but decreased profits (CF decreased). Revenue and profits (CF) were both below the initial forecasts. However, this was because for the second consecutive period, the Company strategically kept down new outlet openings and conducted strategic investment, including actively conducting brand conversions (26 outlets). So, these results were in line with expectations, of a slight increase in sales and a decline in profits. The main reasons for the higher sales were the full fiscal year contributions of the outlets opened in the previous fiscal year (20 outlets) and the openings of 18 new outlets (including 3 franchise outlets). In particular, it opened new outlets in downtown areas, including of the mainstay Isomaru Suisan brand and a new brand, Go no Go. At the same time, it actively opened outlets through brand conversions to Toriyoshi Shoten, which has become the second earnings pillar. On the other hand, the reasons why revenue was below the initial forecast were that the Company kept down openings of some new outlets, that the performance-improvement effects from the brand conversions fell below expectations, and also because sales from existing outlets were only 97.0% of the result in the previous fiscal year (99.5% of initial forecast and 97.0% of the revised forecast). In profits (CF), although the cost rate was kept down to basically the same level as in the previous fiscal year, profits still decreased (CF decreased) and were below the initial forecast. This was mainly because brand conversion costs were higher than expected, while there were also increases in personnel costs, including due to the rise in hourly wages, and in other costs.

(3) In the Specialty Brand Category, revenue increased 1.5% YoY to ¥33,659mn and category CF decreased 25.3% to ¥2,205mn, for higher sales but lower profits (CF decreased). Both revenue and profits (CF) were below the initial forecasts. The main reasons for the higher sales were the full fiscal year contributions of the outlets opened in the previous fiscal year (15 outlets, of which, an increase of 2 outlets from M&A), and the openings of 25 new outlets (of which, an increase of 10 outlets through M&A). In particular, the Company opened outlets in the HIBIYA FOOD HALL for Mr. FARMER (EW) and the bakery JEAN FRANÇOIS (GBC), while it also opened outlets with highly specialized formats in excellent locations, including of Azusa Coffee (KR) and TANTO TANTO (LG). The results included the additions from RN (2 outlets), which was consolidated in January 2018, and YZ (10 outlets), which was consolidated in December 2018. Conversely, the main reasons why revenue was below the initial forecast was that KR, which is based on Kansai, struggled due to the effects of the natural disasters, including the earthquake and the major typhoons, and also because sales from existing outlets were only 95.0% of the result in the previous fiscal year (98.0% of the initial forecast and 95.6% of the revised forecast). Profits decreased (CF decreased) and were below the initial forecasts due to the decline in revenue because of the effects of factors such as the earthquakes and the typhoons, and also as it became difficult to control the various costs, particularly KR costs and personnel costs.

(4) In the Overseas Category, revenue increased 5.4% YoY to ¥2,987mn and category CF was negative ¥89mn, for higher sales but lower profits (CF decreased), and a category loss was recorded. In addition to the openings of 6 new outlets, the 2 outlets acquired from the business transfer*1 contributed to the higher sales. The Company opened shabu SAI outlets and the Japanese café format Momiji Chaya outlets in Singapore, Hong Kong, and Taiwan. The outlets in Singapore performed particularly well, and sales from existing outlets were also 96.5% of the result in the previous year (94.3% of the initial forecast and 96.8% of the revised forecast), which was higher than initially expected. On the other hand, profits decreased (CF decreased), mainly due to the costs arising from the consolidation of Create Restaurants NY Inc. (CRNY)*2 following the adoption of IFRS and from the business transfer of 2 outlets.

*1 The Japanese restaurants SOBA TOTTO and Aburiya Kinnosuke in New York joined the Group in December 2018.
*2 CRNY, the New York subsidiary, recorded a loss because its outlets struggled.

Main topics

Adoption of IFRS, realization of M&A, etc. Building the foundation on which to accelerate growth in the future

1. Conditions for outlet openings, exits, and related

The number of openings of new outlets in the Group as a whole was 89 outlets. But when excluding M&A, it was 60 outlets, which reflects the policy for the second consecutive period of somewhat keeping down the pace of new outlet openings. Also, the Company exited from 29 outlets, mainly unprofitable ones and those whose contracted period had ended, while at the same time, it actively conducted brand conversions (37 outlets) and renovations (18 outlets) with the aim of improving the results at existing outlets. In particular, in the SFP category, it conducted brand conversions from Isomaru Suisan to Toriyoshi Shoten, including with experimental intentions, for 26 outlets. As a result of these measures, although overall the performance-improvement effect fell below expectations, it is considered that the empirical rules obtained from them, including the aspects for which there had been misconceptions, will become important expertise when the Company advances its growth strategy in the future.

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The numbers of outlet openings, exits, etc.

	as of the end of February 2018	New openings	Exits	as of the end of February 2019	Brand conversions	Renovations
CR Category	418	38 (17)	12	444	11	9
SFP Category	225	18	4	239	26	6
Specialty Brand Category	191	25 (10)	8	208	0	3
Overseas Category	31	8 (2)	5	34	0	0
Total number of group stores	865	89 (29)	29	925	37	18

* Figures in parentheses are from M&A
Source: Prepared by FISCO from Company materials

2. Adoption of IFRS

The Company transitioned to IFRS from the FY2/19 full-year results. The aims of its introduction are to establish an infrastructure toward progressing M&A in Japan and overseas, to improve its international comparability in the capital markets, and to optimize business management by unifying the accounting standards within the Group. Following the adoption of IFRS, the impairment loss standard became stricter, which meant that the impairment loss temporarily increased compared to in the previous fiscal year. But on changing the perspective, this can also be evaluated as indicating that the Company has become more financially sound by immediately progressing the processing of impairment. It is also necessary to be aware of the differences in standards within Japan up to the present time, such as the change to the depreciation method (changed from the declining balance method to the straight line method) and the non-recording of the periodic amortization of goodwill.

3. Results for M&A, etc.

The Company has so far completed 4 M&A, which will also be the main axis of its growth strategy in the future. In December 2018, it acquired YUZURU Inc. (YZ), which is a major provider of gomasoba sesame noodles in Hokkaido that manages 10 Gomasoba YUZURU outlets (sales scale, about ¥960mn). Also, in December 2018, its New York subsidiary CRNY acquired 2 Japanese restaurants, Aburiya Kinnosuke and SOBA TOTTO in New York (sales scale, approximately ¥680mn). Furthermore, on entering this fiscal period, in March 2019 it consolidated Kiya Foods Co., Ltd., which manages 7 outlets, including the long-established soba and udon noodle outlet of Ginza Kiya in Ginza, while the subsidiary SFP acquired Joh Smile Restaurant System Inc. (JS), which manages 19 outlets (sales scale ¥1.48bn), mainly izakaya in Kumamoto.

4. SFP's listing changed to the TSE 1st Section

On February 28, 2019, the listing of the listed subsidiary SFP Holdings Co., Ltd., was changed from the Tokyo Stock Exchange (TSE) 2nd Section to the 1st Section. SFP (SFP category) plays an important role as the growth engine for the Company's Group, including through the popular Isomaru Suisan brand. Going forward also, it has set out the direction of aiming to utilize M&A to increase the number of outlets in regional cities. Therefore, SFP itself is progressing a growth strategy, and as a result, the enterprise value of the Company's entire Group will increase, which can be evaluated as being extremely meaningfully in terms of improving its presence in the capital markets.

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Outlook

Forecasts for FY2/20 are for sales to increase and profit-loss to improve greatly
Is also focusing on measures to accelerate growth from the next period onwards

For the FY2/20 results (based on IFRS), the Company is forecasting higher sales and profits, with revenue to increase 4.0% YoY to ¥124,000mn, operating profit to rise 45.9% to ¥5,800mn, profit before tax to grow 51.8% to ¥5,600mn, and profit attributable to owners of parent to increase 134.6% to ¥3,100mn.

Revenue is expected to grow in every category. In particular, the main factors behind the higher sales will be the full fiscal year contributions of the 89 outlets opened in the previous fiscal and in addition, that the Company plans to open 77 new outlets (of which, an increase of 26 outlets from M&A*1). On the other hand, it plans to exit from 38 outlets, mainly unprofitable ones. It is also anticipated that sales from existing outlets will be maintained at 98.2% of the result in the previous fiscal year, including from the brand conversions of 15 outlets and the measures to contribute to productivity improvements*2.

*1 7 Kiya Foods (KF) outlets and 19 Joh Smile (JS) outlets.
*2 They include preparing multilingual outlet manuals with a view to the enforcements of Work Style Reform legislation and in response to the new foreigner residence status system; promoting mechanization and the shift to IT, such as introducing automatic change machines; and the development of business formats with high levels of investment efficiency.

In profits, the profit-loss situation is expected to improve significantly, as the Company will continue to work to control costs, and also due to the elimination of the temporary impairment loss that kept down profits in the previous fiscal year. The outlook for adjusted EBITDA, which is a priority indicator, is that it will increase 1.7% YoY to ¥11,000mn. However, for the SFP category, the Company will keep down openings of new outlets to 7 outlets from its policy of aiming to improve its financial structure to a more robust one. But on the other hand, it will exit from 12 unprofitable outlets and conduct upfront investment, so due to these and other reasons, profits are forecast to decline.

FY2/20 results forecasts (based on IFRS)

(¥mn)

	FY2/19 (IFRS) Results		FY2/20 (IFRS) Forecast		Change	
		% of total		% of total		Change rate
Revenue	119,281		124,000		4,718	4.0%
CR Category	45,633	37.9%	47,300	37.9%	1,667	3.7%
SFP Category	37,751	31.4%	39,000	31.2%	1,249	3.3%
Specialty Brand Category	33,659	28.0%	34,200	27.4%	541	1.6%
Overseas Category	3,237	2.7%	4,400	3.5%	1,163	35.9%
Operating profit	3,975	3.3%	5,800	4.7%	1,824	45.9%
Profit before tax	3,688	3.1%	5,600	4.5%	1,911	51.8%
Profit attributable to owners of parent	1,321	1.1%	3,100	2.5%	1,778	134.6%
Adjusted EBITDA	10,814	9.1%	11,000	8.9%	185	1.7%
CR Category CF	5,417	11.9%	5,700	12.1%	283	5.2%
SFP Category CF	4,538	12.0%	4,300	11.0%	-238	-5.2%
Specialty Brand Category CF	2,205	6.6%	2,300	6.7%	95	4.3%
Overseas Category CF	-89	-	400	9.1%	489	-

*The percentage of category CF is relative to sales by category
*Revenue is before adjustments
Source: Prepared by FISCO from Company materials

At FISCO, we think that the Company's results forecasts are at levels that are fully achievable. It is worth noting that, in the context of the fact that the sales-increase rate is expected to be only moderate for the third consecutive period, it can be said that it will work to accelerate growth from the next fiscal period onwards. In particular, the progress made in M&A, which will be the main axis of the growth strategy in the future, will not only be an upside factor for results in the current fiscal period, but it will also be an important point for results bottoming-out and improving from the next fiscal period onwards and for acquiring momentum to progress the growth strategy.

Growth strategy

Aiming to accelerate growth through M&A and by further evolving the Group Federation Management

1. The medium-term growth strategy

The Company has once again indicated the direction of its medium-term growth strategy, which is based on the one hand on its important management issues, which include responding to diversifying customer needs, the intensification of competition including from ready-to-eat meals, and securing high-quality human resources, but also on the other hand, on an environment in which candidates for M&A are increasing, mainly for business succession and fund projects. In other words, its policy is to steer a course for sustainable, strong growth through 1) progressing an M&A strategy in Japan and overseas, 2) further strengthening its ability to create brands, and 3) further evolving the Group Federation Management. So, while there will be no major changes to the direction it has taken up to the present time, this policy depicts growth that is particularly centered on the M&A strategy and Group Federation Management (maximizing synergies between Group members).

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(1) Progressing an M&A strategy in Japan and overseas

In Japan, the Company's policy is to target companies that possess cutting-edge brands that will enable it to diversify its outlets, and it is aiming to acquire individual assets from a project, regardless of its scale. In particular, in the SFP category, based on the SFP Food Alliance concept, it will work to open outlets of popular brands like ISOMARU SUISAN by progressing M&A for outlets in regional cities. Conversely, for overseas, it is actively progressing the discovery of projects, particularly in North America, centered on the North America Business Investment Promotion Department, which was opened in February 2019. In Asia also, in addition to M&A, its policy is to also consider developments through franchises (FC) and joint ventures (JV).

(2) Further strengthening its ability to create brands

In a situation in which customer needs are diversifying and the pace of change is becoming increasingly fast, we have entered an age in which a company's "ability to respond to change" is being tested more and more. But the Company is constructing a portfolio rich in expertise and diversity and creating a strategy to make it a winner in this age through combining the brand-development capabilities it has cultivated up to the present time with a spirit of taking on challenges.

(3) Further evolving the Group Federation Management

The intention is to evolve from the solar system-type approach taken up to the present time, in which the Company played the central role in creating synergies within the Group, to a star cluster-type approach, in which the various Group companies pursue synergies with each other. Specifically, the measures will include 1) developing franchises among Group members, 2) conducting brand conversions across the Group companies, 3) expanding joint purchasing, 4) promoting cooperation between the holding companies, and 5) newly establishing the Group Business Strategy Headquarters*. Also, in advance of the 20th anniversary of its establishment, the Company has set out a new Group mission statement, "Unlimited excitement! Create a surprising future together by combining all our individuality. "

* Some examples of achievements up to the present time include 1) the management of Mr. FARMER (EW) by CR (Kisarazu outlet), 2) the brand conversions from the desert café brand (CD) to a character café brand (CR), and from the Kagonoya brand (KR) to the shabu SAI brand (CR), and 3) joint purchasing of pork (KR and CR) and of wasabi (CR, KR, and SFP). So, a certain level of results has been achieved. Also, the Group Business Strategy Headquarters is scheduled to be newly established in June 2019, and further synergies are expected to be created within the Group in the future.

2. Medium-term management plan

The Company has once again indicated the direction for its medium-term growth strategy, and alongside this, it also announced its new three-year, medium-term management plan. The targets for the plan's final fiscal year, FY2/22, are revenue of ¥152,000mn and adjusted EBITDA of ¥16,100, which it will achieve by increasing the number of outlets through M&A (around 200 outlets over the three years) and also by opening 50 to 60 new outlets each year. In FY2/20, there is the strong aspect of building the foundations on which to progress the growth strategy in the future (particularly in the SFP category), and it is planning to return to a growth track and once again achieve annual growth in excess of 10% from FY2/21. The profit margin is also expected to gradually improve alongside the growth of revenue.

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Medium-term management plan

(¥mn)

	FY2/20	FY2/21	FY2/22
Revenue	124,000	137,000	152,000
(Growth rate)	4.0%	10.5%	10.9%
Operating profit	5,800	7,500	9,600
(Profit margin)	4.7%	5.5%	6.3%
Profit attributable to owners of parent	3,100	3,700	5,000
(Profit margin)	2.5%	2.7%	3.3%
Adjusted EBITDA	11,000	13,500	16,100

Source: Prepared by FISCO from the Company's financial results

In addition to the strong performance of the CR category, there remains plenty of room to open outlets, including by entering-into regional cities through M&A for the izakaya formates (the SFP category), which is the main axis of growth, and the M&A environment within Japan is advantageous for the Company's Group. Therefore, at FISCO we think that the assumption in the medium-term management plan (an increase in the number of outlets from new outlet openings and M&A) will not be difficult to achieve. On the other hand, what can be said to be an issue is how it will get on the growth tracks that it has not been on up to the present time, including by further evolving the Group Federation Management (pursuing synergies from changing from a solar system-type approach to star cluster-type approach) and conducting overseas M&A. In particular, for M&A of overseas companies, there are few companies in the Japanese food-services industry that have the strength to take on the challenge this entails and also few examples of successes, and the hurdles that have to be cleared for an M&A to be successful are high, including how to find a good deal at a reasonable price and how to effectively manage an overseas company, such as by conducting PMI (performance improvement after the acquisition) and risk management. In other words, in order to achieve sustainable growth in a situation of a contracting domestic market, there are only two major choices; increase share of the domestic market or enter-into overseas markets. If the Company can accumulate aspects such as systems, expertise, and networks to enable it to be successful in overseas M&A, it is considered that the Group will have the opportunity to take a major leap forward. It should also be noted that the speed of completing an M&A and the size of the deal may have a major impact not only on the Company's results, but also on its financial condition.

Shareholder returns

Plans an annual dividend of ¥12 for FY2/20, the same as FY2/19
Plenty of room for the dividend to increase alongside profit growth in the future

For FY2/19, the Company decided to pay a dividend per share of ¥12 (¥6 interim, ¥6 period-end), which was an increase of ¥2 YoY, in line with the initial forecast. For FY2/20, it also plans to pay a dividend per share of ¥12 (¥6 interim, ¥6 period-end), the same as FY2/19.

At FISCO, we think that there is plenty of room for the dividend to increase for FY2/21 onwards when profit starts to grow again.

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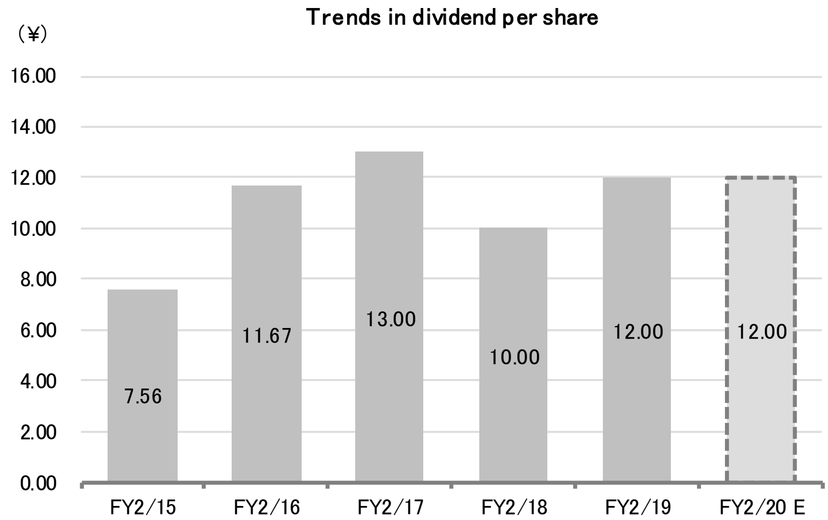

*Dividend per share after adjusting for the stock split.
*In FY2/15, the consolidated dividend payout ratio decreased because gain on change in equity was recorded under extraordinary income following the IPO of SFP.
Source: Prepared by FISCO from the Company's financial results

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