COMPANY RESEARCH AND ANALYSIS REPORT

KENKO Mayonnaise Co., Ltd.

2915

Tokyo Stock Exchange First Section

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Summary

Continued to achieve record-high results, benefiting from the expansion of the restaurant and HMR markets

KENKO Mayonnaise Co., Ltd. <2915> (hereafter, "KENKO Mayo" or "the Company") is a manufacturer of foods for commercial-use engaged in the production and sale of salads and delicatessen items, mayonnaise and dressings, as well as processed egg and other products. It holds a leading position in the commercial-use market and the leading market share in the "long-life salads" category at 42.3%. It has a 15.2% share of the mayonnaise and dressings market, second behind the market leader, and omelet products at 9.5%, third place behind the market leader.

1. Continued to achieve record-high results in FY3/17

In the FY3/17 consolidated results, net sales increased 5.8% year-on-year (YoY) to ¥70,812mn and recurring profit rose 17.2% to ¥4,017mn, for the sixth consecutive fiscal year of higher sales and the third consecutive fiscal year of higher recurring profit. Moreover, the Company achieved record highs for net sales for the fifth consecutive fiscal year and for recurring profit for the second consecutive fiscal year. As a result of focusing on menu-proposal activities by field and by business format, and also on product development, sales increased for all of the products of salads, mayonnaise and dressings, and egg products. In particular, there was significant growth in sales, mainly for convenience stores (hereafter, CVS), of egg salads for delicatessen bakery products and of long-life salads from the strategy of miniaturization for commercial-use. In addition to the effects of the higher sales, the factors behind the increase in profits were the improved productivity at the factories and the progress made in reducing the costs of logistics and the main raw materials, and the recurring profit margin rose 0.6 of a percentage point to 5.7%.

2. Forecasts are for the higher sales and profits to continue in FY3/18 also

The forecasts for the FY3/18 consolidated results are for the higher sales and profits to continue, with net sales to increase 5.9% YoY to ¥75,000mn and recurring profit to rise 2.1% to ¥4,100mn.While profits are expected to decline in 1H due to the impact of the soaring price of potatoes, the Company will continue to implement measures by field and by business format, and it is it is aiming for net sales of ¥75,000mn and a consolidated recurring profit margin of 5%, which are the initial targets for this fiscal year as the final year of the current Mid-term Management Plan.

3. Conducting large-scale investment from the concept for the Group's production bases

For its domestic bases, the Company plans to expand facilities at two factories and build two new factories towards growth from FY3/19 onwards. In addition to expanding production facilities at its Shizuoka Fujisan Factory, which is the production base from processed egg products, and at its Nishi-Nihon Factory, which is its production base for long-life salads and dressings, it will build two new factories for its consolidated subsidiaries that produce fresh delicatessen items. The total investment amount is expected to be more than ¥15,000mn and production capacity will increase by the equivalent of sales of more than ¥10,000mn annually, with the construction at all the factories to be completed by March 2019. Therefore, net sales are forecast to expand from FY3/20 onwards. Conversely, the depreciation burden will also increase, but it is considered that the aim is to continuously expanding earnings from further strengthening the development and sales of high value-added products, in addition to from the higher sales.

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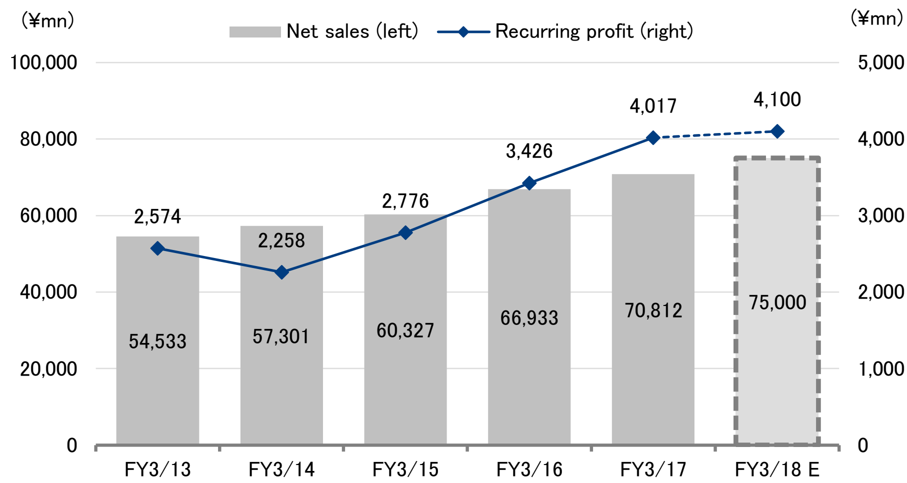
4. Stably pays dividends with a dividend payout ratio of 20% as the benchmark, and also provides special gifts to shareholders

The Company's shareholder returns policy is based on stable dividends, with a payout ratio of 20% as the benchmark. It plans to raise dividends by ¥2 y-o-y to ¥37.0 in FY3/18, which represents a dividend payout ratio of 21.2%, about the same as the previous fiscal year. Also, as a further shareholder incentive, the Company awards shareholders registered at the end of March of each fiscal year with (¥1,000 or ¥2,500 worth of) its own products according to the number of shares held.

Key Points

- Has the top market share in the industry for long-life salads and is increasing its share for omelet products
- In FY3/18, the forecast is for a decline in profits in 1H due to the soaring prices of a raw material, but for a recovery in 2H
- The four new and expanded factories will become operational in FY3/19 and the aim is to further expand earnings through large-scale investment

Results trends (consolidated)



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

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Company overview

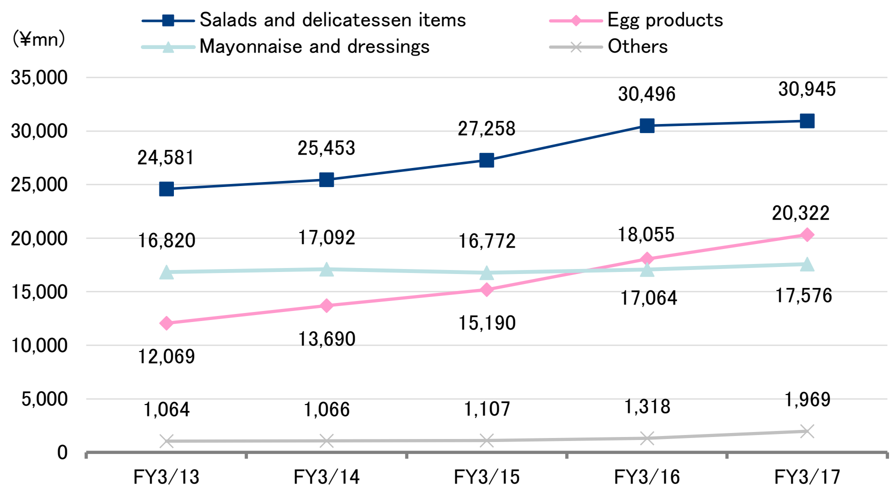
Has the top market share in the industry for long-life salads and is increasing its share for omelet products

1. Scope of Business

KENKO Mayo is engaged in the production and sale of salads and delicatessen items, mayonnaise and dressings, as well as processed egg products and other products for commercial-use. It also undertakes operations such as the production and sale of fresh delicatessen items (daily grocery delicatessen products) and retail store operations through its consolidated subsidiaries.

Looking at the percentages of total net sales (consolidated) by product in the last five fiscal periods, sales of salads and delicatessen products, which provide more than 40% of total sales, have been steadily expanding, and in addition the major growth in processed egg products is noteworthy. The main factors behind this are the start of operations in FY3/14 of the Shizuoka Fujisan Factory, which specializes in processed egg products, and the subsequent expansion of its production capacity, and also the acquisition of a series of customers in the restaurant industry, including conveyer belt sushi chains, and CVS, thanks to customers' favorable assessments of the quality of the processed egg products produced at this factory. The percentage of total net sales provided by processed egg products rose from 22.1% in FY/13 to 28.7% in FY3/17. Conversely, sales of mayonnaise and dressings trended basically the same way as the trends in their markets as a whole and have moved within a flat range in the last few years.

Trends in net sales by product (consolidated)



Source: Prepared by FISCO from the Company's results briefing materials

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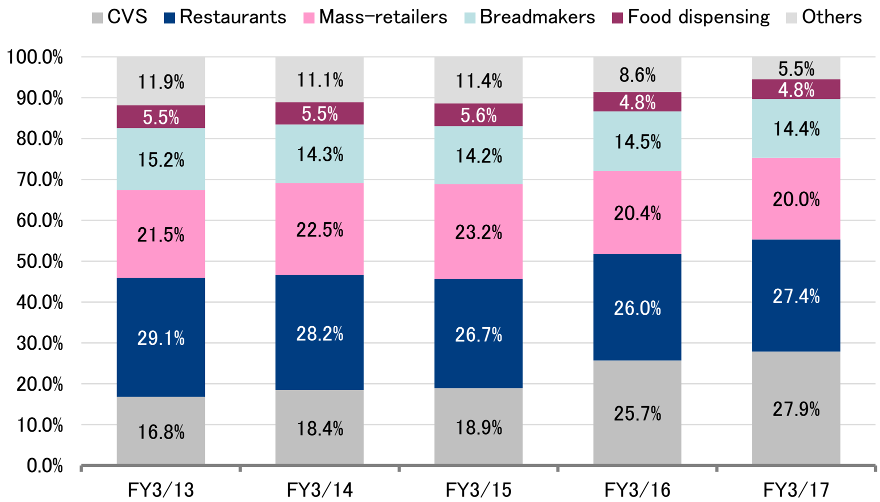
Looking at the percentages of total net sales (consolidated) by field (customer industry), they are 27.9% for CVS, 27.4% for restaurants and 20.0% for mass retailers, and these 3 fields provide more than 70% of total sales. In particular, a point to pay attention to is that CVS has overtaken restaurants to provide the highest percentage of total net sales. The background to this is the expansion of the home meal replacement (HMR) market in the context of the increase in the number of CVS, the trend toward more "solitary meals" with the rise in single-person households and the "simplification" of cooking at home due to changes such as the shift to nuclear families and the greater participation of women in society, including more working women. As the products for CVS, in addition to egg salads for sandwiches and atsuyaki (thick omelet) for lunch boxes, sales of products like small-package, long-life salads are also growing significantly.

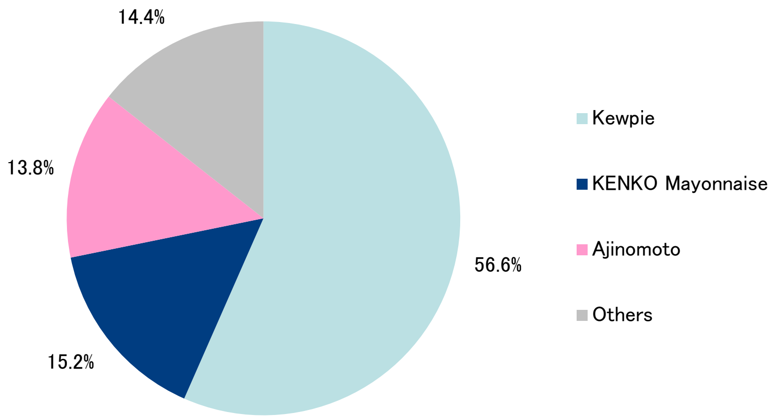
Trends in sales contributions by business category



Source: Prepared by FISCO from the Company's results briefing materials

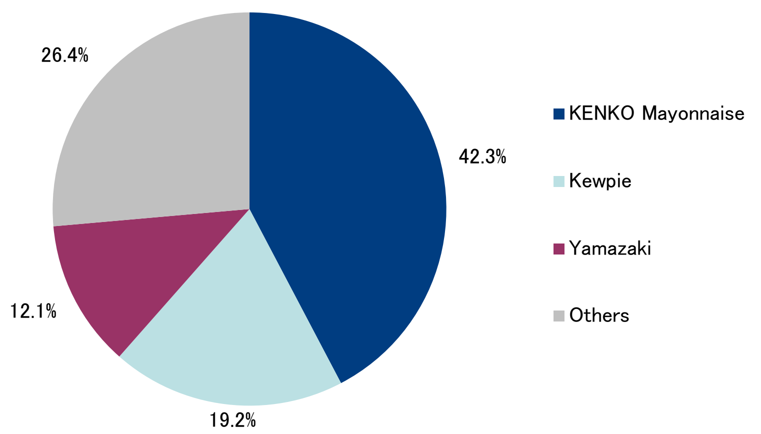
Looking at the market shares in the Company's industries, its share for mayonnaise and dressings has trended stably over the last few years at around 15% and it has maintained its second-ranking position in the industry. As it virtually specializes in commercial-use, its products are not very familiar to general consumers, but in the commercial-use field it competes for the top position with Kewpie, which is the leading manufacturer, and it has a track record of supplying many major restaurants and hotel chains. Meanwhile, the Company, which is a pioneer of long-life salads, has established an industry-leading market share of over 40% for this product. Recently, sales of small-package, long-life salads for CVS have grown significantly, and it has also been expanding its market share of this product. The Company ranks third in the industry for omelet products with a market share of around 9%. Until the completion of the Shizuoka Fujisan Factory this was around 5%, but its share has expanded in the last few years and it is expected to grow further in the future.

Mayonnaise and dressings market shares (2016)



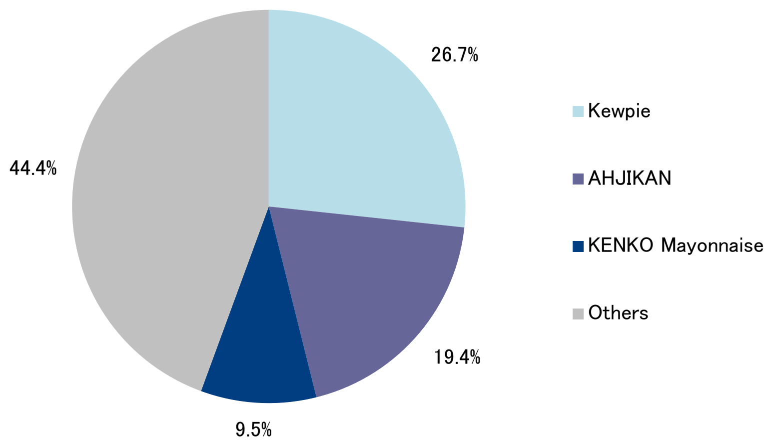
Source: Prepared by FISCO from NIKKAN KEIZAI TSUSHINSHA, Inc.'s "The Beverage & Food Statistics Monthly"

Long-life salads market shares (estimations for 2016)



Source: Prepared by FISCO from FUJI Keizai's "Foodstuff Marketing Handbook"

Omelet products market share (estimations for 2016)



Source: Prepared by FISCO from FUJI Keizai's "Foodstuff Marketing Handbook"

2. The Company Strengths

The Company's feature is its collective strength of integration between the production, development and sales departments; namely, its nationwide production system that supplies high-quality products on a stable basis, and product development capabilities that meet customer needs as well as its meticulous sales response capabilities.

High quality means not only good taste, as safety and security are also important elements. Further, for the Company, which is focused on commercial-use sales, the question of how it can offer added value to customers is an important key in order for it to grow its business. Therefore, it is taking steps to offer added value through its meticulous response to customers, involving the detailed segmentation of industry fields by business format, with the sales, product development, production and menu development teams acting in concert. Seemingly as a result of these efforts, since 2011 the Company's sales growth rate has continued to outpace the growth rate of the restaurants and HMR markets.

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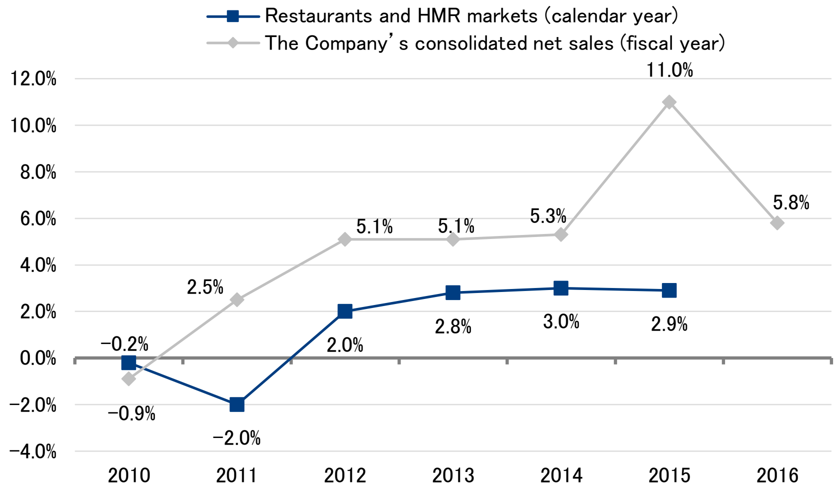
Broad product line-up

Source: The Company's results briefing materials

Growth rate of the restaurants and HMR markets and the sales growth rate



Source: Prepared by FISCO from the Company's financial results and data from the Foodservice Industry Research Institute

3. Production structures, consolidated subsidiaries

Currently, the Company's nationwide production system comprises seven factories operated by the parent company and nine factories operated by seven consolidated subsidiaries. Subsidiary production bases are closely linked to their operating areas because they produce delicatessen-related products for daily deliveries to supermarkets. Above all, a just-in-time (JIT) response capability is essential for CVS, which operate 24 hours a day, 7 days a week. Some of the factories therefore operate 365 days-a-year, with flexible production systems that can quickly respond to changes in order volumes.

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Also, the Company's subsidiary Salad Cafe Co., Ltd. operates specialty salad shops. As of the end of March 2017, there were 18 shops, an increase of 1 store YoY, mainly opened in department stores and shopping malls in the metropolitan Tokyo and Kansai areas.

In terms of overseas operations, the Company established a joint venture (49% equity stake) in Indonesia with a local food producer in 2012, which began production of mayonnaise and sauces in the fall of 2013 (annual capacity of about 4,000 tons). This factory has obtained Halal certification, and apart from local home and commercial-use sales of these products, it is engaged in the sale of liquid eggs. From February 2015, the joint venture commenced exports to Japan of its "Omayo" brand mayonnaise, which has received Halal certification, while domestically it is in the process of expanding its sales channels on a number of fronts, such as for hotels and restaurants.

As its overseas businesses operate as equity-method affiliates, their sales are not reflected in the Company's consolidated sales, but are recorded in non-operating profit and expenses as equity in net profit (loss) of affiliates. They are included in Other Businesses in the consolidated business segments.

Affiliates (scope of operations, investment ratio)

Consolidated subsidiaries	Investment ratio (%)	Main business
DIETCOOK SHIRAOI Co., Ltd.	100.0	Delicatessen-related production and sales
Lilac FOODS Co., Ltd.	100.0	Delicatessen-related production and sales
KANTOH DIETCOOK Co., Ltd.	100.0	Delicatessen-related production and sales
KANTOH DIET EGG Co., Ltd.	100.0	Delicatessen-related production and sales
KANSAI DIETCOOK Co., Ltd.	100.0	Delicatessen-related production and sales
DIETCOOK SUPPLY Co., Ltd.	100.0	Delicatessen-related production and sales
KYUSHU DIETCOOK Co., Ltd.	100.0	Delicatessen-related production and sales
Hello Delica Co., Ltd.	100.0	Delicatessen-related sales
Salad Cafe Co., Ltd.	100.0	Operation of shops specializing in salads
(equity-method affiliates)		
PT. Intan Kenkomayo Indonesia	49.0	Mayonnaise, dressings, and sauces production and sales

* Shows Group investment ratio, including indirect investments from wholly-owned subsidiaries
Source: Prepared by FISCO from the Company's securities report

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Results trends

Achieved record highs for net sales for the fifth consecutive fiscal year and for recurring profit for the second consecutive fiscal year

1. Overview of the FY3/17 results

In the FY3/17 consolidated results announced on May 12, net sales increased 5.8% YoY to ¥70,812mn, operating profit rose 16.0% to ¥3,987mn, recurring profit grew 17.2% to ¥4,017mn, and net profit attributable to parent shareholders increased 37.5% to ¥2,867mn, for higher sales and profits. Net sales increased for the sixth consecutive fiscal year and achieved a record high for the fifth consecutive fiscal year, while recurring profit rose for the third consecutive fiscal year and achieved a record high for the second consecutive fiscal year. In comparison to the revised Company forecasts announced in November 2016, operating profit and recurring profit were slightly below forecast, but this was due to the effects of the soaring market price of potatoes due to a poor harvest and a rise in procurements costs, and also due to factors including the deterioration of yield and an increase in the disposal loss. The impact of the poor harvest of potatoes is thought to have been on a scale of several hundreds of millions of yen, and it seems that without this impact, both operating profit and recurring profit would have exceeded their revised forecasts.

FY3/17 consolidated results

(¥mn)

	FY3/16		FY3/17					
	Results	% of sales	Initial forecast	Revised forecast	Results	% of sales	YoY	vs. revised forecast
Net sales	66,933	-	70,000	70,800	70,812	-	+5.8%	+0.0%
Cost of sales	49,689	74.2%	-	-	52,433	74.0%	+5.5%	-
SG&A expenses	13,807	20.6%	-	-	14,391	20.3%	+4.2%	-
Operating profit	3,436	5.1%	3,450	4,100	3,987	5.6%	+16.0%	-2.8%
Share of loss of entities accounted for using equity method	-81	-	-	-	-32	-	-	-
Recurring profit	3,426	5.1%	3,500	4,200	4,017	5.7%	+17.2%	-4.4%
Extraordinary income/losses	-660	-	-	-	4	-	-	-
Net profit attributable to parent shareholders	2,085	3.1%	2,130	2,680	2,867	4.0%	+37.5%	+7.0%

Note: Revised forecast is as of November 2016.
Source: Prepared by FISCO from the Company's financial results

Looking at the trends in the restaurant, CVS, and supermarket industries, which are the Company's main target markets, in the restaurant industry, the fast food market has recovered, while sales to family restaurants continue to be strong. The cafe business format is trending favorably and the number of these stores is increasing, and overall it grew by around 3% YoY. Also, sales of daily items for CVS rose only slightly on an existing stores basis, but on an all-stores basis it is estimated they grew by around 3% due to the increase in the number of stores. Demand for products such as lunch boxes, sandwiches, and salads continued to expand because of the proliferation of "solitary meals" and the "simplification of cooking" following the increase in single-person households and the greater participation of women in society, including more working women. For the same reason, sales of delicatessen items for supermarkets increased by approximately 4%, and the underlying expansion of the HMR market is continuing alongside that of the restaurant market.

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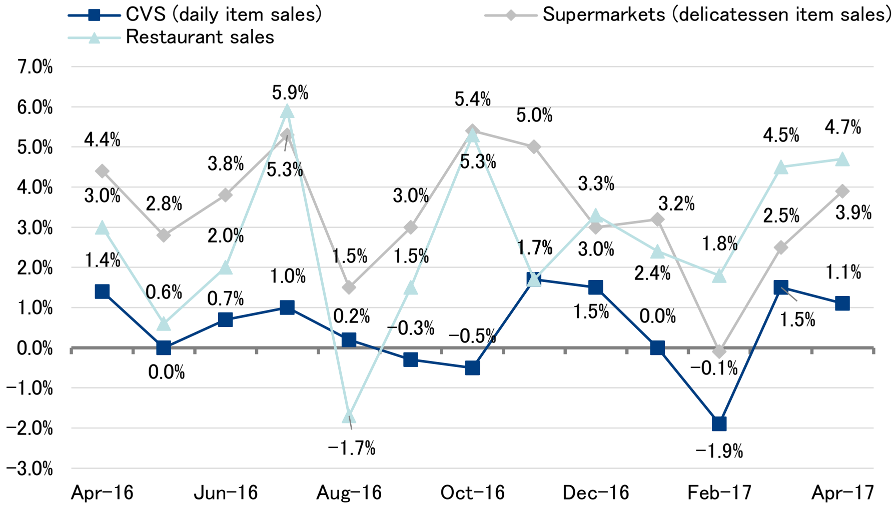
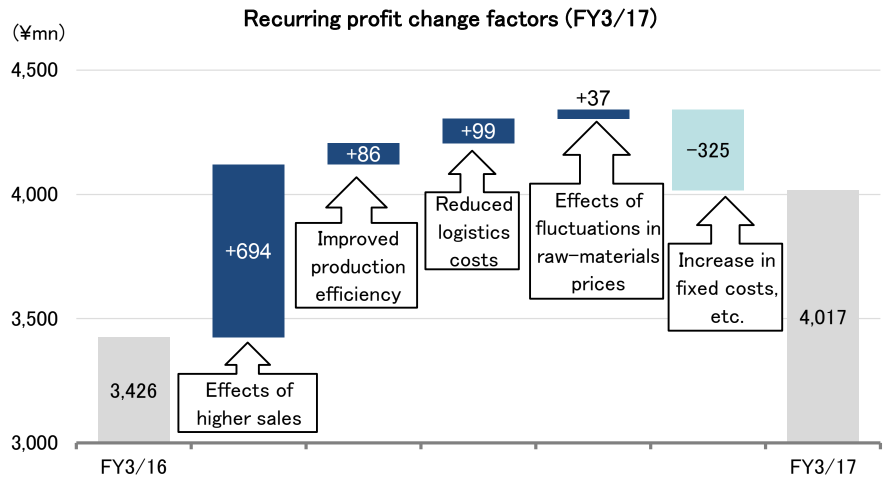
Major markets' monthly sales trends (YoY)



Source: Prepared by FISCO from data from Japan Food Service Association, Japan Supermarket Association and Japan Franchise Association

In this sort of market environment, the Company's net sales increased 5.8% YoY and grew at a pace above the growth of the restaurant and HMR markets. Looking at net sales by field, they grew significantly for CVS, by 15% YoY, while they increased 11% for restaurants and 3.7% for mass retailers, so sales rose for all of the main markets. Sales trended particularly favorably for CVS thanks to the increased adoption of processed egg products for items such as lunch boxes, sandwiches, and noodles. Another factor behind the increase in sales was the performance of small-package, long-life salads that have been adopted as PB products and become long-running hits. Further, for the restaurant industry, sales of sauces grew following the recovery of a major hamburger chain that is a main customer, while sales of processed egg products for CVS continued to trend strongly. In addition, sales rose of fresh delicatessen daily items for mass-retailers, while sales of cut vegetables sold exclusively in Hokkaido also trended strongly. However, there were restrictions on the delivery of potato salads and related products due to the impact of the fall in the supply volume of potatoes in Q4, and the sales increase rate was around 4%, which is lower than the Company-wide average.

Looking at the factors causing recurring profit to increase and decrease, the increase factors were the effects of the higher sales of ¥694mn, the improvement in production efficiency, mainly at a consolidated subsidiary, of ¥86mn, and the reduction in logistics costs of ¥99mn, which absorbed the fluctuation in raw-materials prices of ¥37mn and the increase in fixed costs of ¥325mn, including for personnel costs and IT investment. In the prices of raw materials, while the price of potatoes soared in 2H, the impact of this was exceeded by the effects of cost reductions from the fall in prices in the egg and cooking-oil markets.



Source: Prepared by FISCO from the Company's results briefing materials

Also, in non-operating profit, the loss in the equity in net profit (loss) in affiliates shrunk to ¥32mn (compared to a loss of ¥81mn in the previous fiscal year). The main reason for this was the higher sales of liquid eggs and commercial-use mayonnaise following a rise in the number of Japanese restaurants entering-into Indonesia. The net profit increase rate grew, but this was mainly due to the reduction in the amount of the extraordinary loss recorded in this fiscal year, which in the previous fiscal year was ¥885mn as the total of a loss on the disposal of fixed assets and an impairment loss.

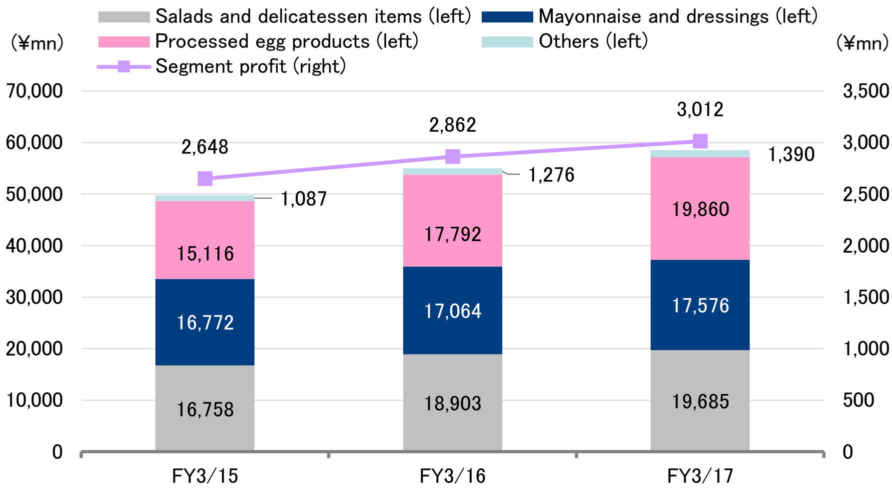
The growth drivers are processed egg products among the products and the CVS market among the markets

2. Trends by business segment

(1) Seasoning and processed food business

In this business, net sales increased 6.3% YoY to ¥58,511mn and the segment profit rose 5.2% to ¥3,012mn, continuing the trend for increases in both revenues and profits.

Results in the seasoning and processed foods business



Source: Prepared by FISCO from the Company's results briefing materials

Looking at the sales trends by product, sales of salads and delicatessen items increased 4.1% to ¥19,685mn (sales volume, up 2.3%), mayonnaise and dressings rose 3.0% to ¥17,576mn (up 3.6%), and processed egg products grew 11.6% to ¥19,860mn (up 14.0%), meaning sales of every product increased.

In salads and delicatessen products, sales of small-package long-life salads, mainly for CVS, trended strongly, up 20% YoY. In Japanese side dishes, the Company enhanced the WASAI BANSAI® series product lineup from 6 items at the end of the previous fiscal year to 11 items, and these products are being adopted by an increasing number of mass retailers and restaurants. It also announced a new brand of MAGOKORO SHOKUSAI® that targets the hospital- and nursing-meals market, and although still small scale, its sales grew, mainly for hospitals.

In mayonnaise and dressings, sales of 1kg mayonnaise packages grew for mass retailers, bread manufacturers, and for exports. Sales also grew of 500ml dressing packages and nugget sauce for the fast food market, and of small-package products for the CVS market. In World Traveler Dressings®, which was launched as a new series in the previous fiscal year, the Company announced three new products, including from the information collected and developed into products at the Vancouver Research Office in Canada, which was opened in July 2015, for a total of four products. In addition, responding to the demand for high-value added and health-conscious products, it released three items in the Triple Balance® series of non-oil dressings that have the keywords of low calorie, low sugar, and reduced salt, and these products have been favorably received by restaurants and other customers.

The growth in processed egg products was mainly for the CVS market, from egg salads for sandwiches and for delicatessen bakery products, Atsuyaki (thick omelet) for sushi rolls, and Kinshi-tamago, thin omelet cut into string-like strips, for noodles. In boiled egg products also, the Company continued to adopt various products, including for restaurants and for bread with filling, and the double-digit growth continued.

(2) Delicatessen-related business

Net sales in this business increased 3.8% YoY to ¥11,062mn, while on a profit basis, segment profit grew significantly, up 58.5% to ¥1,023mn.

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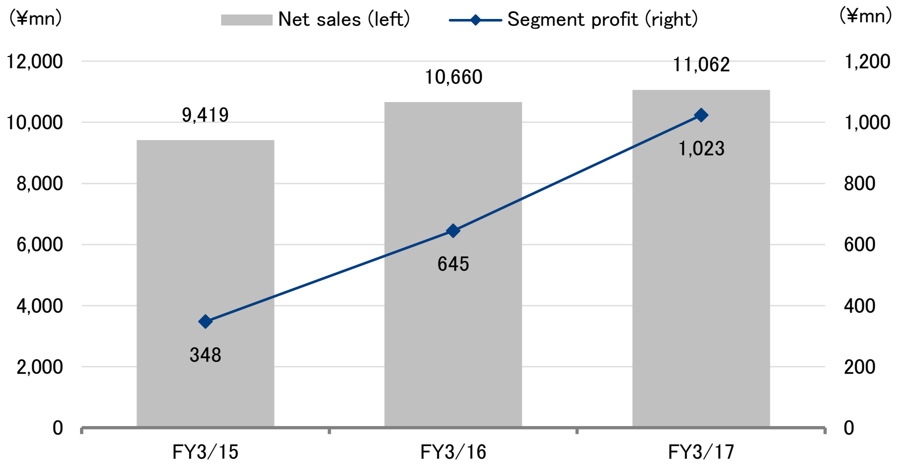
Results in the delicatessen-related business



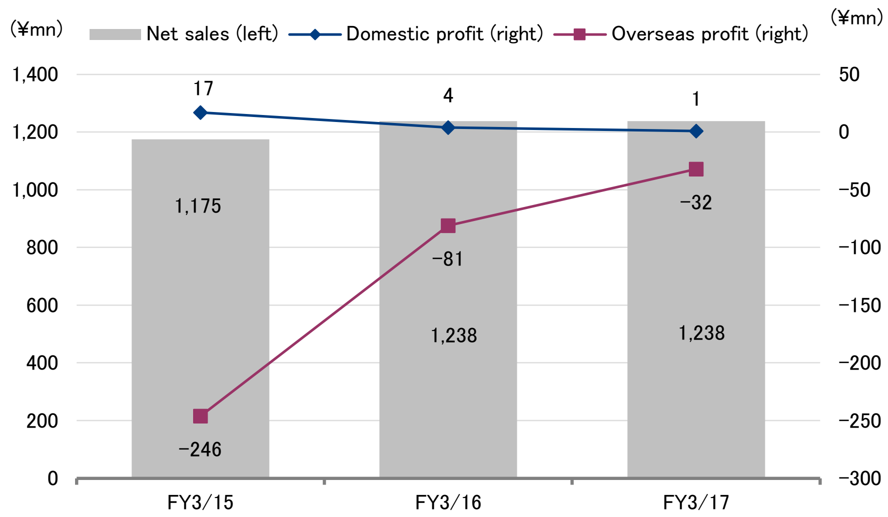
Source: Prepared by FISCO from the Company's results briefing materials

Due to the impact of the poor potato harvest, sales of the basic product of potato salad slumped, and if looking only at Q4, growth became sluggish with net sales increasing only 1.1% YoY and segment profit rising 6.9%. However, this was covered by the growth in other products, including macaroni salads using ham, seasoned cod roe, and eggs; spaghetti salads using 10 vegetables; and Japanese delicatessen items. Sales of cut vegetables limited to the Hokkaido area also trended favorably. The segment profit margin rose from 6.1% in the previous fiscal year to 9.2%, with the main factors including the measures to improve productivity carried out at a consolidated subsidiary. Specifically, progress was made in improving the food-disposal loss (improving the yield) and also in increasing production efficiency through reviewing the production lines.

(3) Other businesses

Other businesses includes in its results the equity in net profit (loss) of affiliates from overseas operations, in addition to revenue from the Company's specialty salad shops operated by its consolidated subsidiary Salad Cafe Inc. Sales were flat YoY at ¥1,238mn and the segment loss was ¥31mn (compared to a loss of ¥77mn in the same period in the previous fiscal year).

Other businesses results



Source: Prepared by FISCO from the Company's results briefing materials

For Salad Cafe, the number of stores increased by 1 on the end of the previous fiscal year to 18. A store was newly opened in March 2016 under the new brand WaSaRa Kintetsu Abeno Harukas, which provides "Japanese-style salads" with an emphasis on Japanese ingredients and tastes. Its sales are growing on the back of the boom in Japanese food, so in March 2017 the Company also opened Imotamaya Isetan Shinjuku Cafe, which specializes in Japanese side dishes, mainly made of potato and egg, as foods familiar to a wide range of age groups. Profits decreased slightly due to the rise in store-opening costs.

On the other hand, in the overseas business, as previously mentioned the loss in the equity in net profit (loss) in an affiliate in Indonesia was reduced.

Raised ¥6,400mn in a capital increase through a public offering in preparation for large-scale capital investment

3. Financial position and management indicators

Looking at the financial condition at the end of March 2017, total assets were up ¥9,136mn on the end of the previous fiscal year to ¥51,442mn. The main increase factors were that in current assets, cash and deposits rose ¥6,366mn due to a capital increase through a public offering carried out in February 2017, while accounts receivable rose ¥524mn. In fixed assets, tangible fixed assets increased ¥1,599mn following the investment to strengthen the production capacity.

Total liabilities were down ¥8mn on the end of the previous fiscal year to ¥22,985mn. In current liabilities, accounts payable increased ¥717mn, while equipment-related notes payable decreased ¥672mn. In fixed liabilities, on the one hand long-term loans payable fell ¥695mn, but on the other hand long-term accounts payable rose ¥536mn, and in total, interest-bearing debt increased ¥34mn. Also, net assets were up ¥9,144mn on the end of the previous fiscal year to ¥28,456mn. This was due to an increase in retained earnings of ¥2,527mn following the recording of net profit attributable to parent shareholders, and also as the capital and capital surplus increased ¥6,487mn on the implementation of the capital increase through a public offering.

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Looking at the management indicators, the shareholders' equity ratio rose by 9.7 percentage points on the end of the previous fiscal year to 55.3%, which exceeds the level of 50% targeted in the Mid-term Management Plan. In addition, the interest-bearing debt ratio fell by 12.5 points to 26.9%, so it can be said that the Company has greatly strengthened its financial base. However, it is aiming to further expand the Group's production capacity and plans to spend a total of ¥15,900mn up to March 2019 at 4 domestic bases to expand the production capacity of its existing factories and to build new factories. The level of cash and deposits at the end of FY3/17 was ¥13,700mn, so the Company plans to cover the shortfall from borrowing from banks, and therefore the shareholders' equity ratio may again fall in the future. But in the context of the continuing ultra-low interest rates, it is expected to be able to maintain its financial soundness.

In the indicators of profitability, ROE was 12.0% and the consolidated recurring profit margin was 5.6%, and both increased for the third consecutive fiscal year. Profitability is continuing to improve from the effects of the higher sales, mainly of processed egg products. The forecast for FY3/18 is that the consolidated recurring profit margin will fall to 5.5%, because the rise in the price of raw materials and in personnel costs and other fixed costs will overlap with the costs to prepare for the construction of the new factories. However, it will still be maintained at above the 5% level, which is the target in the Mid-term Management Plan.

Consolidated balance sheet

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17	Change
Current assets	18,095	18,704	21,836	29,196	7,360
Cash and deposits	3,884	4,778	7,412	13,779	6,366
Inventories	2,135	2,309	2,601	2,817	216
Fixed assets	21,590	20,744	20,469	22,245	1,775
Total assets	39,686	39,448	42,306	51,442	9,136
Current liabilities	14,860	14,422	16,313	16,487	173
Fixed liabilities	9,015	7,058	6,680	6,498	-182
Interest-bearing debt*	9,943	8,584	7,617	7,651	34
Total liabilities	23,876	21,481	22,994	22,985	-8
Total net assets	15,810	17,967	19,311	28,456	9,144
Stability					
Current ratio	121.8%	129.7%	133.9%	177.1%	
Shareholders' equity ratio	39.8%	45.5%	45.6%	55.3%	
Interest-bearing debt ratio	62.9%	47.8%	39.4%	26.9%	
Profitability					
ROE (return on equity)	8.3%	9.6%	11.2%	12.0%	
Recurring profit/net sales	4.2%	5.0%	5.1%	5.6%	

*Interest-bearing debt includes long-term accounts payable
Source: Prepared by FISCO from the Company's financial results and results briefing materials

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Future outlook

In FY3/18, profits will decline in 1H due to the soaring prices of a raw material, but will recover in 2H

1. Outlook for the FY3/18

The forecasts for the FY3/18 consolidated results are for the higher sales and profits to continue, with net sales to increase 5.9% YoY to ¥75,000mn, operating profit to grow 2.3% to ¥4,080, recurring profit to rise 2.1% to ¥4,100mn, and net profit attributable to parent shareholders to increase 0.1% to ¥2,870mn, so the outlook is once again for record-high results. While profits are expected to decline in 1H due to the impact of the soaring price of potatoes, they will recover from 2H onwards and the growth in profits will be maintained for the full fiscal year. A return to a single-digit increase in sales is expected for Q1.

The FY3/18 consolidated outlook

(¥mn)

	FY3/17		FY3/18			
	Full-year result	YoY	1H forecast	YoY	Full-year forecast	YoY
Net sales	70,812	+5.8%	37,880	+5.2%	75,000	+5.9%
Operating profit	3,987	+16.0%	2,200	-11.2%	4,080	+2.3%
Recurring profit	4,017	+17.2%	2,210	-11.3%	4,100	+2.1%
Net profit	2,867	+37.5%	1,550	-8.3%	2,870	+0.1%
Earnings per share (¥)	194.88		94.08		174.20	

*Net profit: Net profit attributable to parent shareholders
Source: Prepared by FISCO from the Company's financial results

In terms of the factors causing recurring profit to increase and decrease, the increase factors will be the effects of the higher sales of ¥375mn, the improvement in production efficiency of ¥90mn, and the reduction in logistics costs of ¥58mn, while the decrease factors will be the fluctuation in raw-materials prices of ¥80mn and the increase in fixed costs of ¥360mn.These forecasts assume that the price of eggs, which are a main raw material, will stay at around the same level of the previous fiscal year of ¥205/kg, and that the price of potatoes will fall 6.7% to ¥180/kg due to the recovery of the harvest yield. However, the reasons why despite this, profits are forecast to decline ¥80mn are the expected rise in the market price of cooking oil and the increase in costs for the import of tuna and other raw materials. The impact from cooking oil will be kept down as the Company concludes forward contracts from more than half of its annual amount, so it is not considered that there will be a major fluctuation. Therefore, the market conditions for eggs and potatoes may be the factors causing profits to change in the future.

In April and June, the price of eggs rose by more than 5% compared to the same period in the previous fiscal year, which seems to have been due to the impact of the avian influenza that occurred in Miyagi Prefecture and Chiba Prefecture in March. However, currently this situation has settled down, so it seems that going forward the price will trend around the same level YoY. Also, potatoes planted in the spring are harvested in the fall, but due to the unseasonable weather in 2016, the harvest yield declined greatly, by 9% YoY, so the average wholesale price rose sharply, up 21% (¥159/kg in 2015 → ¥193/kg in 2016). Therefore, the wholesale price in 2017 will depend on the harvest yield and the Company is assuming a recovery of 2% YoY and so expects the wholesale price to fall. If the weather is good and the harvest yield recovers to the level of two years ago, it is possible that the wholesale price will fall more than the Company expects.

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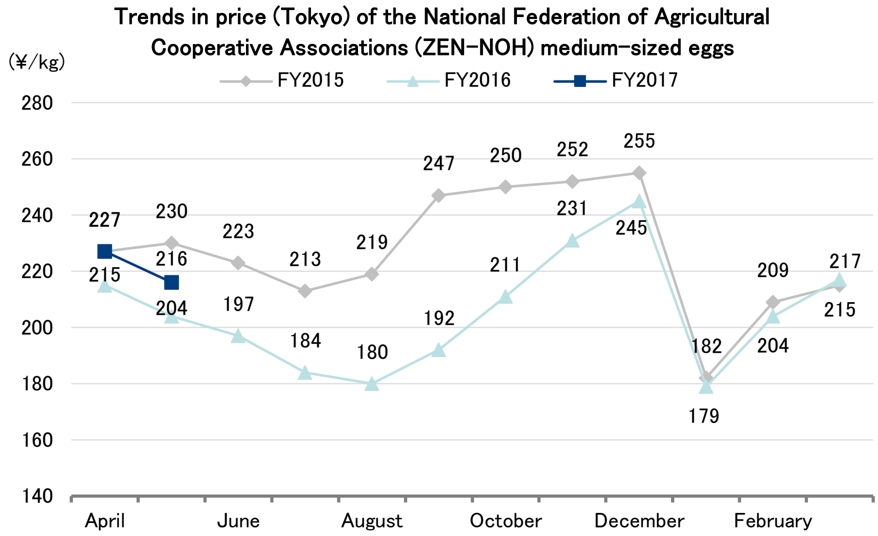
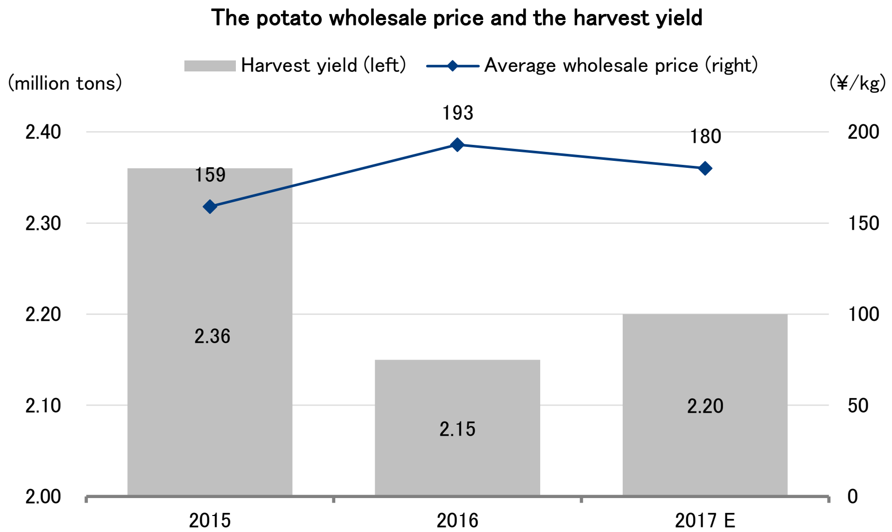


Source: Prepared by FISCO from data from ja-z-tamago. Co., Ltd.



Source: Prepared by FISCO from the Company's results briefing materials

2. Sales outlook by segment

In the sales forecasts by segment, in the seasoning and processed food business, sales are expected to increase 5.1% YoY to ¥61,477mn; in the delicatessen-related business, to rise 10.4% to ¥12,210mn, and in others, to increase 6.1% to ¥1,313mn. As the measures for this fiscal year, the Company is developing products in response to the changes in the markets and in customer needs, including for health-conscious products and for labor shortages. Its policy is to expand sales by developing new products from novel concepts without being constrained by existing concepts, while also expanding sales channels through conducting further market directing.

Net sales by segment

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	Growth rate
Seasonings & processed foods	49,733	55,035	58,511	61,477	5.1%
Salads & delicatessen	16,758	18,903	19,685	20,729	5.3%
Mayonnaise & dressings	16,772	17,064	17,576	18,298	4.1%
Processed egg products	15,116	17,792	19,860	21,075	6.1%
Others	1,087	1,276	1,390	1,375	-1.1%
Delicatessen-related business	9,419	10,660	11,062	12,210	10.4%
Other business	1,175	1,238	1,238	1,313	6.1%
Total	60,327	66,933	70,812	75,000	5.9%

Source: Prepared by FISCO from the Company's results briefing materials

In the seasoning and processed food business, sales of salads and delicatessen products are forecast to increase 5.3% YoY. 2017 marks the 40th anniversary of the launch of the long-life salads Fashion Delica Foods®, so the Company plans to launch new products and to implement various measures to unify and improve the brand image in conjunction with the Group's comprehensive fairs that it holds in Tokyo and Osaka every fall. As the product strategy, it intends to continue to grow sales of small-package, long-life salads, as well as strengthening the product lineup, including of new material-related potato products.

Sales of mayonnaise and dressings are forecast to increase 4.1% YoY. The Company is aiming to increase sales by developing high value-added products using new manufacturing methods with an awareness of health consciousness, launching new commercial-use products for the seasoning (sauces) market, and expanding its business areas.

Sales of processed egg products are forecast to increase 6.1% YoY. The Company will continues to expand domestic and overseas sales of the Sozaitei® series, which grew rapidly by 2.3 times following many inquiries in the previous fiscal year. For egg salads also, it is responding to the increase in demand and since March 2017 it has strengthened production capacity at the Atsugi Factory and it plans to actively expand sales channels.

Sales are also forecast to increase in others from the rise in the number of Salad Cafe stores, while the aim is to change the loss in the equity in net profit (loss) in an affiliate in Indonesia to a profit in this fiscal year.

Longer-term management strategy

The four new factories will become operational in FY3/19 and the aim is to further expand earnings through large-scale investment

1. The concept for the Group's production bases

For its domestic bases, the Company plans to expand facilities at two factories and build two new factories towards growth from FY3/19 onwards. Specifically, it plans to increase production facilities at the Shizuoka Fujisan Factory (main products: omelet products) and the Nishi-Nihon Factory (long-life salads and dressings) and build new factories at its consolidated subsidiaries of KANTOH DIETCOOK Co., Ltd. (fresh delicatessen items) and DIETCOOK SHIRAOI Co., Ltd. (fresh delicatessen items and long-life salads). Once these construction projects are completed, it will add production capacity equivalent to sales of more than ¥10,000mn a year.

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The concept for the Group's production bases

Factory / subsidiary	Main product	Construction start date	Scheduled completion date	Capital investment (unit: ¥mn)	Increase in capacity on completion (forecast)
Shizuoka Fujisan Factory (Fuji City, Shizuoka Prefecture)	Omelet products	July 2017	February 2019	4,167	Processed egg products will increase by approximately 3,020t a year
Nishi-Nihon Factory (Maizuru City, Kyoto Prefecture)	Long-life salads and dressings	February 2018	March 2019	5,636	Salads and delicatessen products will increase by approximately 4,300t a year
KANTOH DIETCOOK (Odawara City, Kanagawa Prefecture)	Fresh delicatessen items	June 2017	June 2018	3,550	Sales of salads and delicatessen products will increase by approximately ¥6,000mn a year
DIETCOOK SHIRAOI (Shiraoi-gun, Hokkaido)	Fresh delicatessen items and long-life salads	July 2017	April 2018	2,547	Salads and delicatessen products will increase by approximately 3,000t a year

Source: Prepared by FISCO from the Company's results briefing materials

Shizuoka Fujisan Factory is a facility dedicated to the production of processed egg products that was newly opened in March 2014, and in the last few years it has been one of the driving forces behind the Company's growth. It had an annual production capacity of about 6,000 tons, but since the space in the existing factory has been almost entirely filled, the Company decided to expand the factory facilities within the same site. The capital investment will be more than ¥4,000mn and the construction is scheduled for completion in February 2019, after which the annual production capacity will increase by around 3,020 tons. It is considered that the Company is aiming to expand its share of the omelet market, in which it is currently ranked third, and become the second-ranked company.

The Nishi-Nihon Factory produces long-life salads and dressings. The annual production capacity of the existing factory is approximately 18,000 tones and it is the Company's main base in the West Japan area. The current construction work will increased its annual production capacity by around 4,300 tons. It is scheduled for completion by March 2019 and this expansion in production capacity is expected to result in higher sales of long-life salads.

Since KANTOH DIETCOOK's existing factory in Tokorozawa had become too small, the Company newly purchased land in Odawara City, Kanagawa Prefecture, as the site to build a new factory to produce fresh delicatessen items. Its construction is scheduled for completion in June 2018 and it is expected to increase sales by approximately ¥6,000mn.

DIETCOOK SHIRAOI's existing factory has become obsolete, so the Company decided to construct a new factory within Ishiyama Industrial Park in Shiraoi Town, which is scheduled for completion in April 2018. In addition to fresh delicatessen items, the plan is to increase the production capacity for new material-related potato products, and the annual production capacity will increase by around 3,000 tons.

The completion of the construction at these four factories will further expand the Group's production capacity. As they will become operational from FY3/19 onwards, deprecation expenses are forecast to increase. But if the start of operations at the factories goes smoothly, then it is expected that this increase will be fully absorbed by the effects of the higher sales, so the outlook is for the recurring profit margin to be maintained at above 5%.

The capital investment amount in FY3/18 will be ¥600mn and no particularly large investments are planned. Depreciation expenses are forecast to be ¥1,700mn, a slight decrease YoY.

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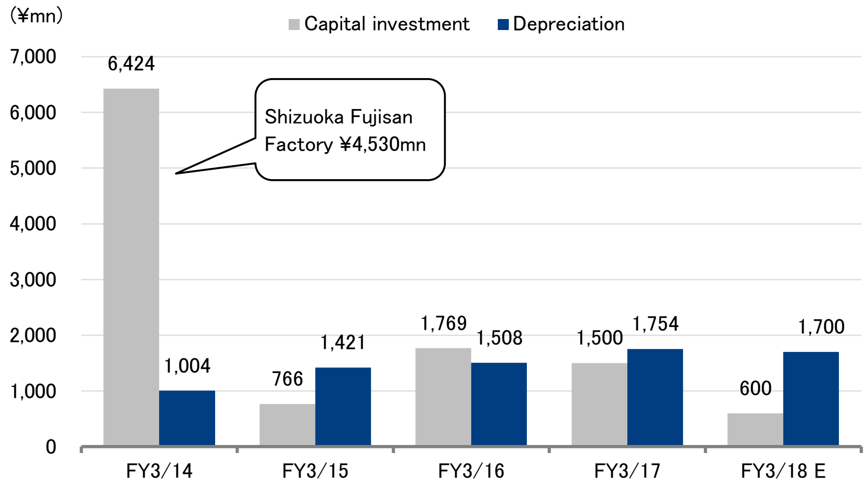
Change in capital expenditure and depreciation



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

Is making steady progress with the Mid-term Management Plan and it can achieve all of its targets

2. The progress made in the Mid-term Management Plan

FY3/18 is the final year of the Mid-term Management Plan KENKO Five Code 2015-2017. The Plan's management targets are consolidated sales of ¥75,000mn, a consolidated recurring profit margin of 5%, a shareholders' equity ratio of 50%, and to maintain ROE at 8% or above. The Company made excellent progress up to the previous fiscal year and it has already achieved the targeted levels for the recurring profit margin, shareholders' equity ratio and ROE. If it achieves net sales of ¥75,000mn in FY3/18, it is highly likely that it will have achieved all of these numerical targets.

KENKO Five Code 2015-2017

(¥mn)

	FY3/15 result	FY3/16 result	FY3/17 result	FY3/18 Mid-term Plan targets	FY3/18 Current forecasts
Net sales	60,327	66,933	70,812	75,000	75,000
Recurring profit	2,776	3,426	4,017	3,750	4,100
Recurring profit margin	4.6%	5.1%	5.6%	5.0%	5.5%
Shareholders' equity ratio	45.5%	45.6%	55.3%	50.0%	-
ROE	9.6%	11.2%	12.0%	At least 8%	9.7%

Source: Prepared by FISCO from the Company's results briefing materials

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There are three main reasons why results are trending favorably. The first reason is the steady expansion of the restaurants and HMR markets, which are the Company's main markets, due to factors such as the increase in single-person households and the greater participation by women in society, for example more working women. The second reason is that the Company continues to propose detailed menus and conduct sales activities tailored to specific industries and formats in order to respond to the issues in the restaurant industry, that it requires products and menus that contribute to the "simplification" of cooking due to its chronic shortage of labor, and also the development of menus that reflect the rising awareness of health among consumers. This is enabling the Company to expand its share of business with existing customers and also develop new customers. The third reason is that results have improved at a pace faster than expected due to the strong sales of processed egg products for CVS and of small-package long-life salads as PB products.

Further, within business strategies aimed at achieving the mid-term management plan, the Company is tackling the following three major initiatives – "Establishing our position as the 'Leading Company in Salads,'" "Further evolving Salad Cuisine," and "Strengthening the management platform to proactively promote expansion into global markets." In order to establish its position as the 'Leading Company in Salads,' the Company's policy is to expand the scope of sales in its various existing businesses. To further evolve Salad Cuisine, it intends to strengthen information provision through the media and its own website, strengthen branding, and promote its Salad Cuisine cooking schools and Salad Cafe shops. On its own website, the Company has posted more than 1,200 recipes, including by business format and by season, and it disseminates information on trends on its "salads information specialty site" that is visited by people interested in salads. The Company has set August 24 as "Dressings Day" and his registered it with the Japan Anniversary Association.

As part of its strengthening of the management platform to proactively promote expansion into global markets, the Company newly established a research office in Vancouver, Canada, in July 2015. Specific results have already started to appear from the information collected by this base, including the early launch of new products in the World Traveler Dressings® series. It is difficult for the Company to expand its export business quickly due to the various hurdles that must be cleared, such as meeting each country's import restrictions, but it intends to expand profits centered on exports of mayonnaise and dressings, aiming for net sales of ¥1,000mn in FY3/18 (they were about ¥700mn in FY3/17).

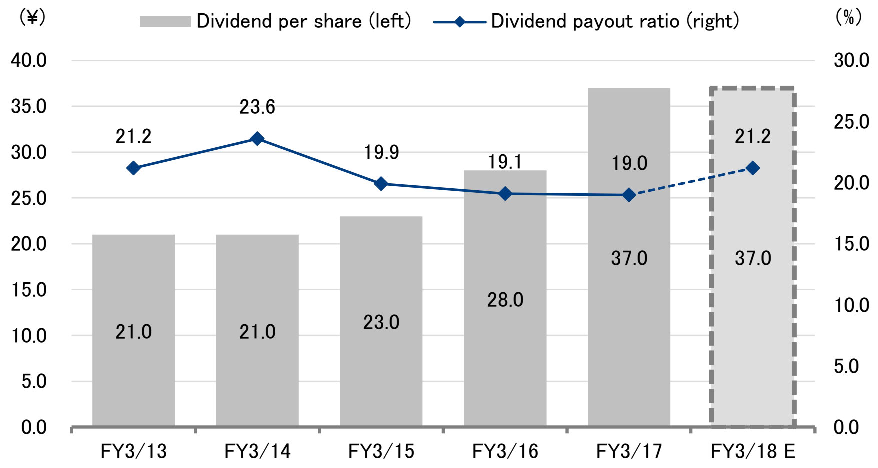
Shareholder return policy

Benchmark is a dividend payout ratio of 20% and it also provides gifts to shareholders

As its policy to return profits to shareholders, the Company pays dividends and provides gifts to shareholders. Its dividend policy is to raise dividends to a high level in line with earnings growth based on a benchmark consolidated dividend payout ratio of 20%, while also taking into consideration the continuity of dividends. In FY3/18, it plans to leave the dividend per share unchanged YoY at ¥37.0 (payout ratio, 21.2%), while we can expect dividend growth in the future if earnings continue to increase.

At the same time, the Company gives its products as gifts to shareholders registered on March 31 of each fiscal year. A present with a value of ¥1,000 is given to shareholders with 100 to 999 shares, while a present with a value of ¥2,500 is given to shareholders with 1,000 or more shares.

Dividend per share and dividend payout ratio



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

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