COMPANY RESEARCH AND ANALYSIS REPORT

KENKO Mayonnaise Co., Ltd.

2915

Tokyo Stock Exchange First Section

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Index

Summary

Prices of raw materials have fallen further and the results outlook is for higher profits from 2H

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, processed egg products, as well as mayonnaise and dressings, 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 9.5% in the omelet products market, third behind the market leader.

1. FY3/18 1H results

In the FY3/18 1H consolidated results, net sales increased but profits decreased, with net sales increasing 2.8% YoY to ¥37,021mn and recurring profit decreasing 12.3% to ¥2,184mn. Factors decreasing profit were the rise in vegetable prices, particularly of potatoes, due to typhoon damage in the previous year, and higher fixed costs, including personnel costs and systems investment. The growth in net sales slowed, including for convenience stores (CVS) due to continued unseasonable weather during the summer. But as a result of its meticulous proposal activities tailored to industries and business formats, the Company once again achieved a record high on a fiscal half-year basis. The results were slightly below the initial Company forecasts (net sales of ¥37,880mn and recurring profit of ¥2,210mn).

2. FY3/18 outlook

Initial forecasts have been left unchanged for the FY3/18 consolidated results. The Company projects for net sales to increase 5.9% YoY to ¥75,000mn and recurring profit to rise 2.1% to ¥4,100mn. The outlook for net sales is for the increasing trend to continue, although there remains a risk that the result will be slightly below forecast because of the part that it was below forecast up to 1H. Conversely, in profits, the Hokkaido potato yield was about 10% higher than in the previous year, so a reduction in raw material prices can be expected in 2H. Therefore, at FISCO, we think that it is possible that the full fiscal year recurring profit will be around the same level as the Company's forecast. FY3/18 is the final year of the mid-term management plan, and it seems the Company will be able to maintain a recurring profit margin at the 5% level.

3. Progress made on 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 with a focus on growth from FY3/19 onwards. In addition to expanding production facilities at its Shizuoka Fujisan Factory, which is the production base for processed egg products, and Nishi-Nihon Factory, which is the 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 ¥15bn and production capacity will increase by an equivalent of sales of more than ¥10bn in sales annually with a single operating team working in a day, compared to the previous structure. The subsidiaries' new factories are scheduled to become operational in FY3/19 Q1, and the Shizuoka Fujisan Factory and Nishi-Nihon Factory in Q4. Therefore, depreciation expenses are forecast to increase from FY3/19 to FY3/20. But despite this, it is considered that the Company is aiming to maintain or improve the recurring profit margin of 5% through the effects of higher sales and from strengthening the development of high-value-added products and improving production efficiency.

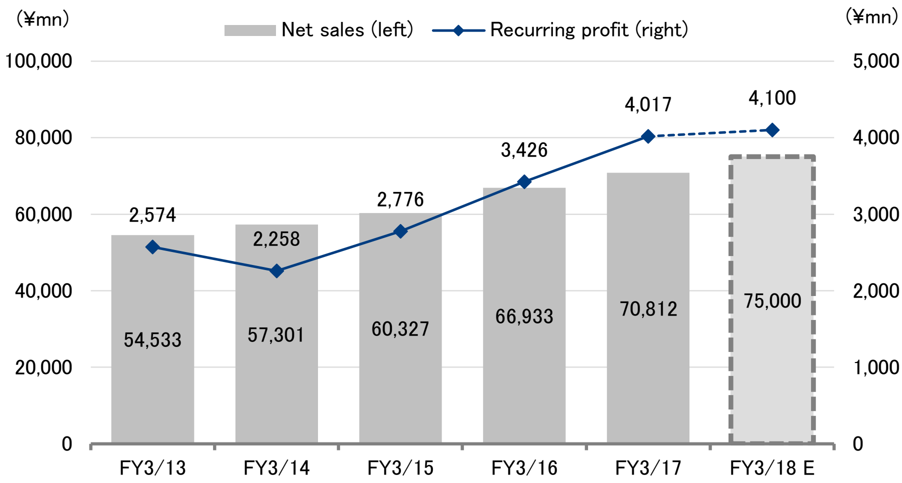
4. Shareholder return policy

The Company's shareholder return policy is based on stable dividends, with a payout ratio of 20% as the bench¬mark. It plans to pay ¥37 in FY3/18 as it did in FY3/17, which represents a dividend payout ratio of 21.2%. Also, as a shareholder incentive, the Company awards shareholders registered at the end of March of each fiscal year with its own products (worth ¥1,000 or ¥2,500) according to the number of shares held.

Key Points

- Due to meticulous proposal activities tailored to industries and business formats, the outlook is for record high results again in FY3/18
- The sales capacity is scheduled to increase by around ¥10bn with two new factories and expanded facilities at two existing factories becoming operational in FY3/19
- Aiming for stable growth, while maintaining the recurring profit margin at a level above 5%

Results trends (consolidated)



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

Company overview

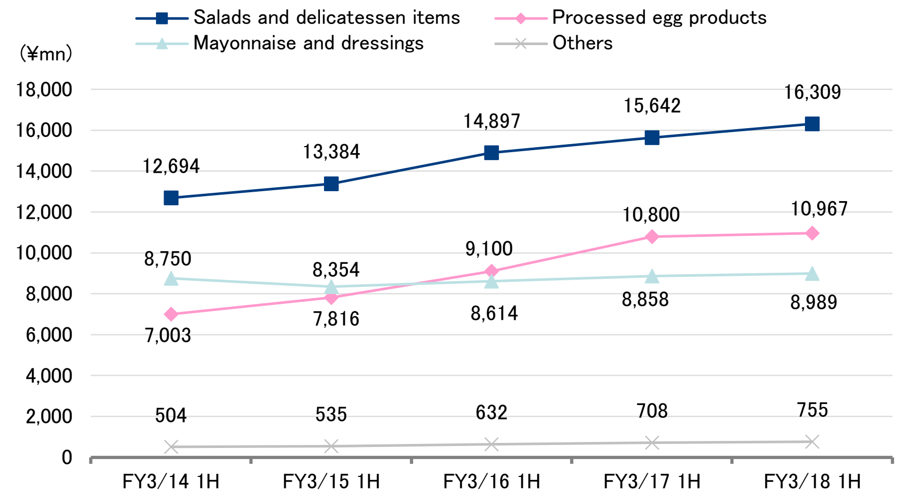
Has the top market share in the industry for long-life salads and is increasing its share for processed egg products

1. Scope of business

KENKO Mayo is engaged in the production and sale of salads and delicatessen items, processed egg products, including mayonnaise and dressings, and other products for commercial use. It also undertakes operations such as the production and sale of delicatessen items that are delivered daily 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 items, which provide more than 40%, have been steadily expanding, and major growth in processed egg products is noteworthy. Main supporting factors 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, in addition to 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. In addition, egg salad for sandwiches and breads with fillings that are being newly adopted, mainly by CVS, is supporting growth. The percentage of total net sales provided by processed egg products rose from 24.2% in FY/14 1H to 29.6% in FY3/18 1H. Conversely, sales of mayonnaise and dressings followed market trends on the whole and have moved within a flat range in the last few years.

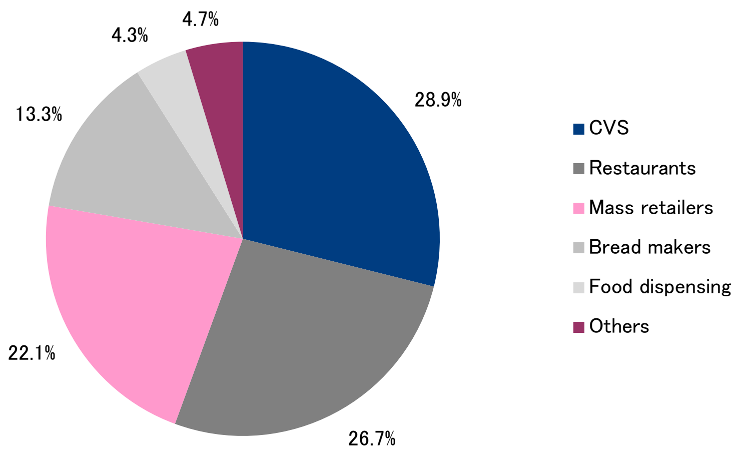
Trends in net sales by product (consolidated)



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

Looking at the composition of total net sales (consolidated) by industry in FY3/18 1H, the highest was to CVS at 28.9%, next was restaurants at 26.7%, and then mass retailers at 22.1%, so these three fields provided more than 70% of total net sales. In the last few years, the home meal replacement (HRM) market has been expanding in the context of 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. Demand from CVS and mass retailers is growing for products such as egg salad for sandwiches and atsuyaki (thick omelets) for lunch boxes, while demand for small packaged long-life salads and dressings are also increasing.

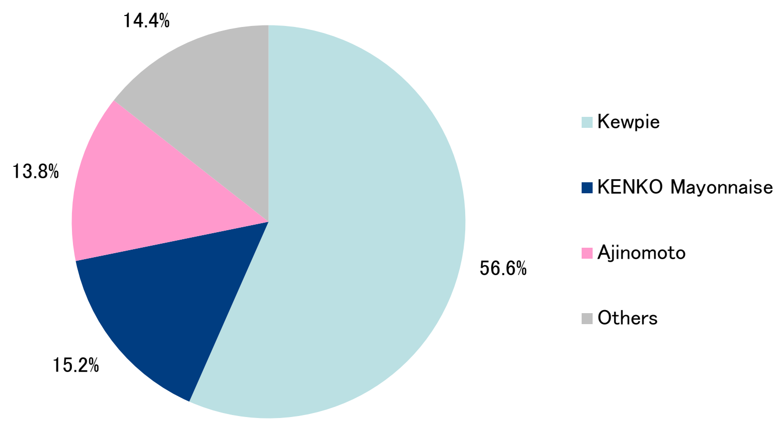
Sales contributions by industry (consolidated, FY3/18 1H)



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

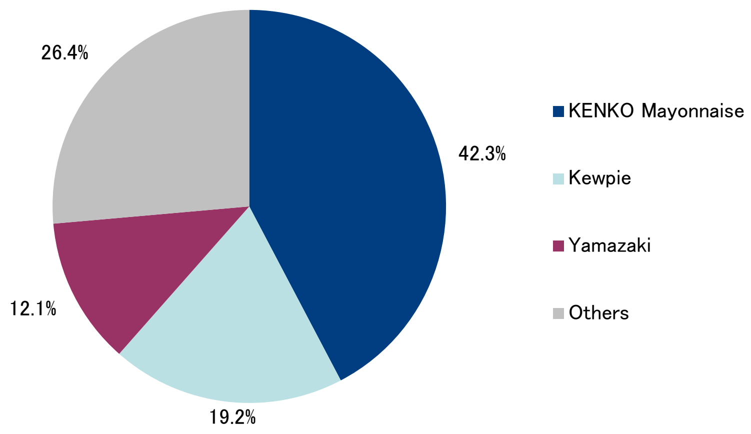
Looking at market share by industry, the Company's share in the mayonnaise and dressings market has trended stably at around 15% over the last few years and it has maintained its second-ranking position. As it virtually specializes in commercial use, its products are not very familiar to general consumers, but in the commercial-use field it competes for the top position with Kewpie Corporation <2809>, 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 packaged long-life salads to 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 6%, 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)



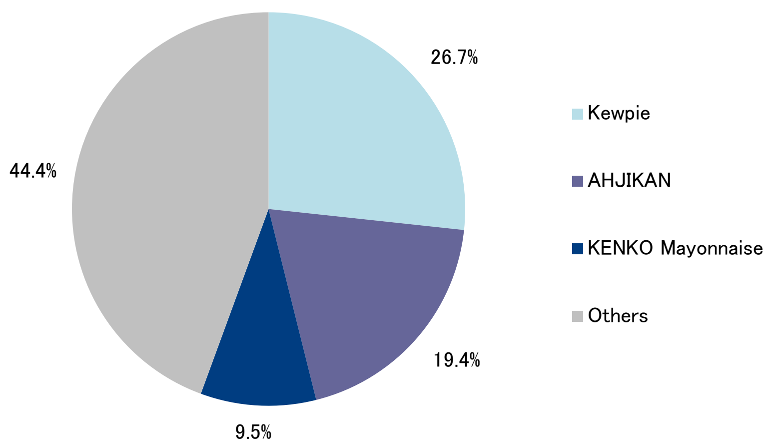
Source: Prepared by FISCO from NIKKAN KEIZAI TSUSHINSHA, Inc.'s "The Beverage & Food Statistics Monthly"

Long-life salads market shares (estimations for 2016)



Source: Prepared by FISCO from FUJI Keizai Management Co., Ltd.'s "Foodstuff Marketing Handbook"

Omelet products market share (estimations for 2016)



Source: Prepared by FISCO from FUJI Keizai Management Co., Ltd.'s "Foodstuff Marketing Handbook"

2. Company strengths

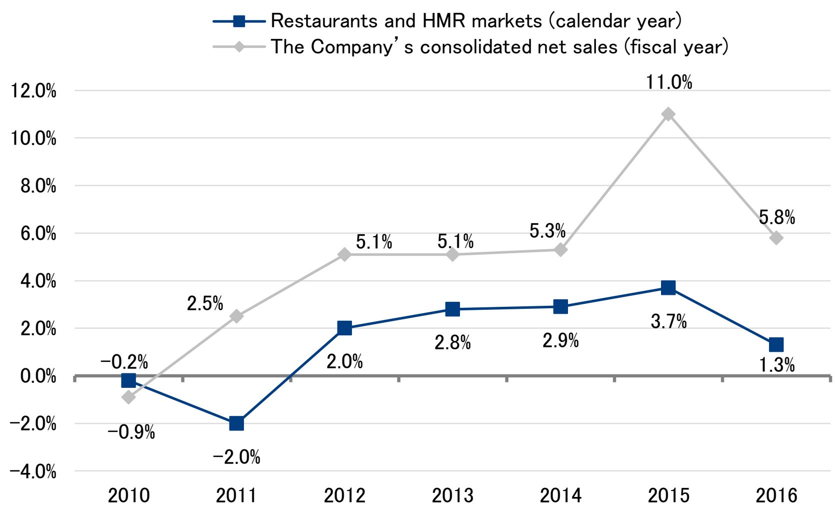
The Company's strength lies in its integration of the production, development and sales departments, namely, its nationwide production system that stably supplies high-quality products, product development capabilities that meet customer needs, and its meticulous sales response capabilities.

High quality means not only good taste, as safety and security are also important elements. Further, for the Company, which is focused on sales in the commercial-use field, 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 industries and business formats, with the sales, product development, production and menu development teams acting in concert. Seemingly as a result of these efforts, the Company has continued to outpace the restaurants and HMR markets in terms of sales growth rate since 2011.

Broad product lineup

* Figures for KENKO Mayonnaise are on a standalone basis
Source: The Company's results briefing materials

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



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

3. Production structures and 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 items that are delivered daily 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.

Also, the Company's subsidiary Salad Cafe Co., Ltd. operates specialty salad shops. As of the end of September 2017, there were 18 shops, mainly opened in department stores and shopping malls in the metropolitan Tokyo and Kansai areas. The shops also play the role of disseminating information, such as on new proposals for salad menus.

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 sales of these products for home and commercial use, it is engaged in the sale of liquid eggs. Sales of Halal-certified mayonnaise to supermarkets selling Japanese food products and other customers in Indonesia have begun. Going forward, the company will actively implement sales activities to raise awareness and expand sales by developing local mayonnaise markets and culture and introducing products for commercial use by Japanese companies. 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 and 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

Results trends

Profits declined due to higher raw material prices, but once again achieved a record high for net sales

1. Overview of FY3/18 1H results

In the FY3/18 1H consolidated results announced on November 9, sales increased but profits decreased, with net sales increasing 2.8% YoY to ¥37,021mn, operating profit decreasing 13.1% to ¥2,152mn, recurring profit falling 12.3% to ¥2,184mn, and net profit attributable to parent shareholders declining 11.9% to ¥1,489mn. The initial Company forecasts were for higher sales and lower profits due to the impact of the rising prices of raw materials, with the main factor being the soaring price of potatoes, although net sales and operating profit were both slightly under these forecasts by 2.3% and 2.2%, respectively. This was due to significant impacts caused by continued unseasonable weather during the summer and sluggish growth of sales to CVS.

FY3/18 1H consolidated results

(¥mn)

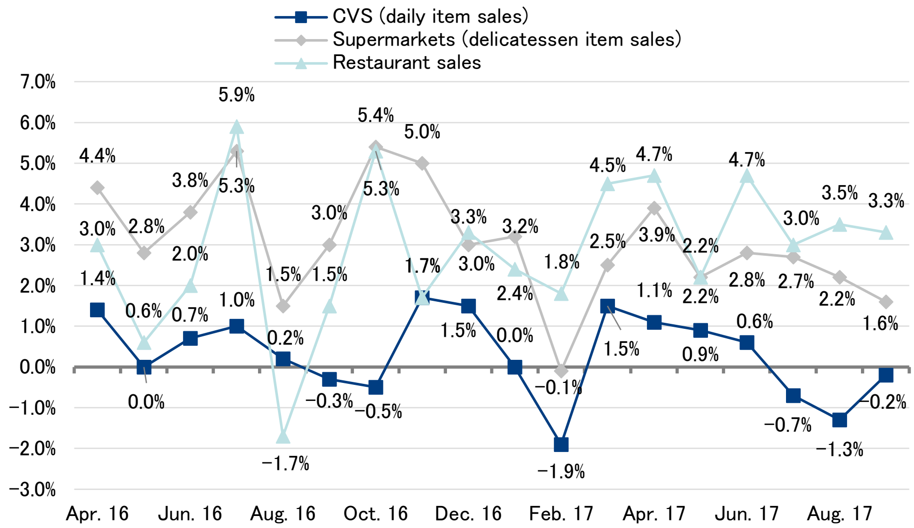
	FY3/17 1H		FY3/18 1H				
	Results	% of sales	Initial forecast	Results	% of sales	YoY	vs. forecast
Net sales	36,009	-	37,880	37,021	-	+2.8%	-2.3%
Gross profit	9,573	26.6%	-	9,576	25.9%	+0.0%	-
SG&A expenses	7,097	19.7%	-	7,423	20.1%	+4.6%	-
Operating profit	2,476	6.9%	2,200	2,152	5.8%	-13.1%	-2.2%
Recurring profit	2,490	6.9%	2,210	2,184	5.9%	-12.3%	-1.2%
Net profit attributable to parent shareholders	1,690	4.7%	1,550	1,489	4.0%	-11.9%	-3.9%

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

Looking at the respective trends in the Company's main target markets of restaurants, CVS, and mass retailers (supermarkets), net sales for the restaurant market as a whole trended steadily, up approximately 3% YoY. By business format, they increased 5% for fast food restaurants, which had the highest growth among the main business formats. It is considered that the reason for this was that sales promotion measures, including campaigns and seasonal menus, were favorably received. Family restaurants also continued to perform strongly, up 2%, while sales stopped falling and remained around the same level YoY despite the continued decrease in the number of locations in the izakaya (Japanese taverns) and pub business format. This was due to the increase in customer numbers within the ongoing economic recovery.

As for sales of daily items to CVS, it is estimated that sales at existing stores remained flat YoY, but sales grew approximately 2% overall as a result of the increase in the number of stores. Alongside the rise in health consciousness and growth in demand in the HMR market, the Company is enhancing its product lineup of salads and delicatessen items and strengthening sales floors. As previously mentioned, due to the impact of continued unseasonable weather in the summer, growth has slightly slowed compared to the previous fiscal year, although it remained steady. In addition, against the backdrop of growth in sales of delicatessen items for supermarkets and demand in the HMR market, net sales were strong overall, up around 3% YoY.

Major markets' monthly sales trends (YoY)

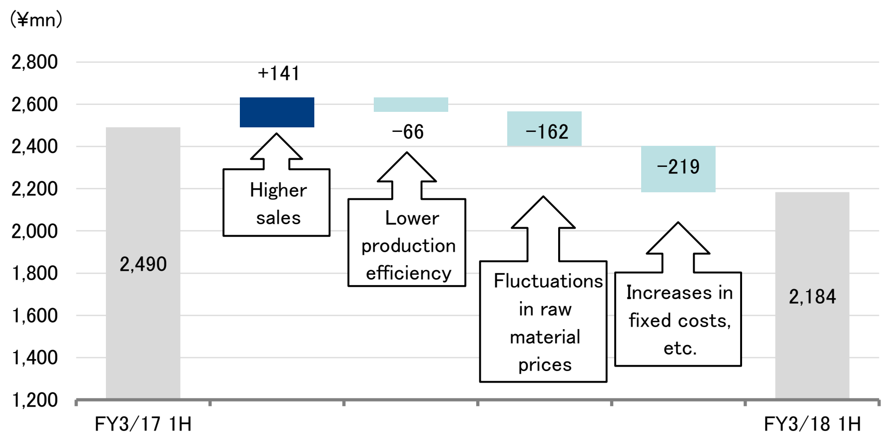


Source: Prepared by FISCO from data from the Japan Food Service Association, Japan Supermarket Association and Japan Franchise Association

In this market environment, the Company's net sales grew 2.8% YoY, which is roughly the same growth rate as in the restaurant and HMR market. It is considered that this is due to positive effects from the Company's meticulous proposal and sales activities tailored to industries and business formats.

In terms of the factors causing recurring profit to increase and decrease,, higher sales was an increasing factor of ¥141mn, while decrease factors were ¥162mn from the impact of higher raw material prices, particularly for potatoes, and ¥66mn from lower production efficiency, which was mainly due to a decline in the quality of vegetables. Another decreasing factor was the rise in fixed costs and other costs of ¥219mn (including personnel costs, systems investment, and exhibition costs). Within the raw materials, the prices of eggs and cooking oil trended at around the same level YoY.

Factors affecting recurring profit (FY3/18 1H)



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

Also, in non-operating profit, the equity in net loss in affiliates shrunk from ¥14mn in FY3/17 1H to ¥7mn. Although it is taking slightly longer than initially planned, the profit-loss performance of the equity-method affiliate in Indonesia is improving from the higher sales of liquid eggs and commercial-use mayonnaise, mainly for local Japanese restaurants. The company is aiming to become profitable in FY3/18 2H and to achieve the profit-loss breakeven point for the full fiscal year.

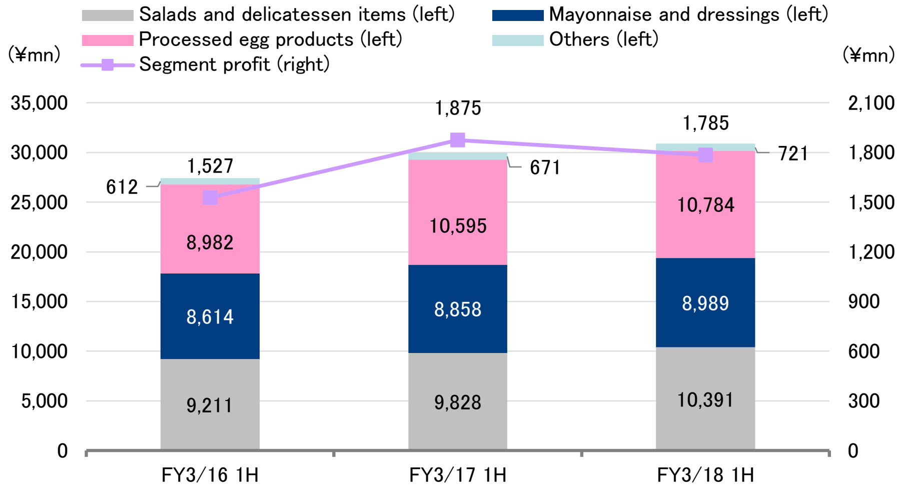
Achieved higher sales for all products, particularly salads and delicatessen items

2. Trends by business segment

(1) Seasoning and processed food business

In this business, net sales increased 3.1% YoY to ¥30,885mn and segment profit decreased 4.8% to ¥1,785mn. Profits fell on a half fiscal year basis, but on looking only at Q2 (July-September 2017), net sales increased 3.3% and segment profit grew 3.7%, marking the first increase in profits in four fiscal quarters. Also, the segment profit margin was 6.5%, which was above its most recent peak in the previous Q2.

Results in the seasoning and processed food business



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

Looking at sales trends by product, sales of salads and delicatessen items increased 5.7% to ¥10,391mn (sales volume up 6.2%), processed egg products grew 1.8% to ¥10,784mn (up 4.0%), and mayonnaise and dressings rose 1.5% to ¥8,989mn (up 1.0%), meaning sales of every product increased.

In salads and delicatessen items, sales grew of the mainstay products of long-life salads and Japanese-style delicatessen items to CVS and restaurants. In particular the WASAI BANSAI® series is meeting customer needs for high value-added, simplicity, and waste reduction, and the Company has also expanded its product lineup from 11 items at the end of the previous fiscal year to 13 items. As a result, it has been increasingly adopted by izakaya and hotels for buffet menus and it performed strongly. For potato salads also, against the backdrop of the shortage of workers in the restaurant industry, demand is increasing for products with preprocessed ingredients that can be cooked easily, so sales to CVS and mass retailers of the Salads made by Pros series grew steadily.

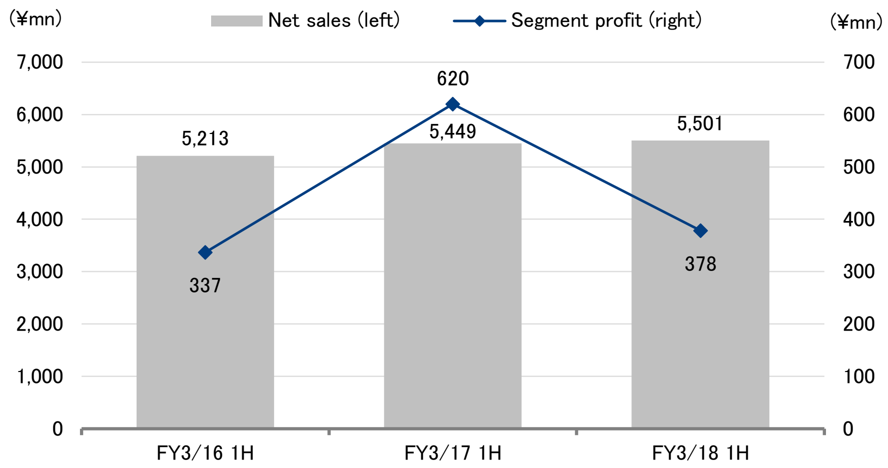
In processed egg products, egg salads for sandwiches and breads with fillings, atsuyaki for lunch boxes, and kinshi-tamago (thin omelets cut into strips) for noodles for the CVS market were newly adopted, which contributed to higher sales. The unit price per weight fell slightly, but this was due to changes in the sales composition ratio. Also, the Company is actively developing and selling products to respond to customers' needs, such as for simplification in restaurants and other places where meals are prepared by commercializing Range-Easy Eggs and also by launching egg white sheets in response to the needs of health-conscious customers.

In mayonnaise and dressings, 10kg mayonnaise packages for bread makers were newly adopted, while other products, including small-packaged dressings for CVS, and nugget sauces for fast food restaurants, and 500ml packages of dressings, also performed well. The Company expanded the lineup of its mainstay World Traveler Dressings® series by one item from the end of the previous fiscal year to five items. In addition, the Company continued to diversify the Triple Balance® series, which includes low calorie, low sugar, and reduced salt non-oil dressings sold in 20ml, 200ml, 500ml, and 1L packages, and added three items to the lineup for a total of six. Higher sales of these products contributed to the results of this business.

(2) Delicatessen-related business

In this business, net sales increased 1.0% YoY to ¥5,501mn and segment profit decreased 39.1% to ¥378mn. The main reason for this decrease was the higher prices of vegetables, particularly potatoes. However, products for mass retailers, including those using seasoned cod roe, shrimp, and burdock, were newly adopted, while rolled omelet and soup-related products were also adopted, and net sales continued on an upward trend.

Results in the delicatessen-related business

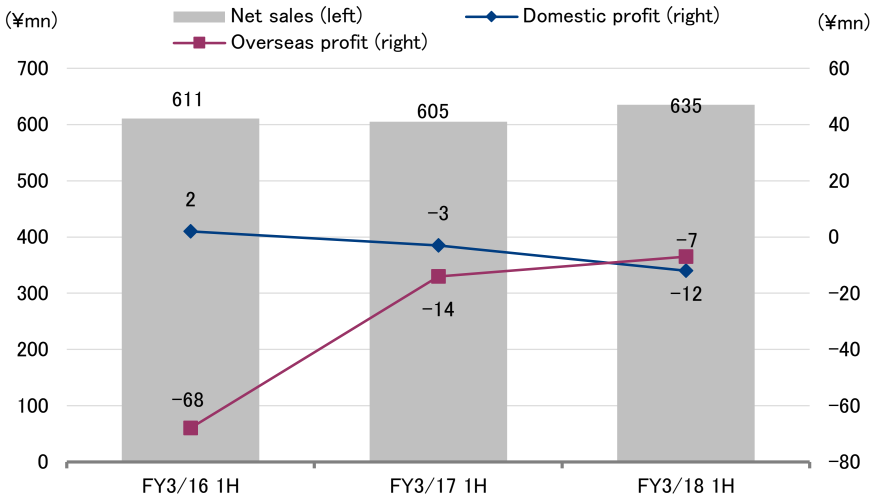


Source: Prepared by FISCO from the Company's results briefing materials

(3) Other businesses

Results for other businesses include 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. Net sales rose 4.9% YoY to ¥635mn and segment loss was ¥19mn (compared to a loss of ¥17mn in FY3/17 1H).

Other businesses results



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

The number of Salad Cafe stores increased by 1 from the end of the previous fiscal year to 18 stores, which contributed to higher sales. The Japanese-style salad specialist store Wasara Sogo Yokohama Store opened in April 2017 as the second store following on from the opening of the Wacara Kintetsu Abeno Harukas Store in Osaka. Against the backdrop of the boom in Japanese foods, the Company is strengthening its Japanese-style salad menu proposals. Also, in March 2017, the Company opened Imotamaya Isetan Shinjuku Cafe, which specializes in Japanese side dishes using ingredients that are familiar to a wide range of age groups, mainly potatoes and eggs.

On the other hand, in the overseas business, as previously mentioned equity in net loss of affiliates in Indonesia was reduced.

Due to the concept for the Group's production bases, interest-bearing debt increased, but it maintained its financial soundness

3. Financial position and management indicators

Looking at the financial position at the end of FY3/18 1H, total assets increased ¥6,006mn from the end of the previous fiscal year to ¥57,448mn. The main increasing factors in current assets were increases in cash and deposits of ¥661mn and note and accounts receivable-trade of ¥2,979mn due to the last day of September falling on a holiday for financial institutions. In fixed assets, construction in progress grew ¥3,649mn due to the construction carried out in line with the concept for the Group's production bases.

Total liabilities rose ¥4,680mn from the end of the previous fiscal year to ¥27,666mn. To fund the construction of the new factories, interest-bearing debt increased ¥1,398mn, while notes and accounts payable-trade rose ¥2,807mn. Also, net assets increased ¥1,325mn from the end of the previous fiscal year to ¥29,781mn. This was mainly due to increases of ¥1,111mn in retained earnings on the recording of net profit attributable to parent shareholders and of ¥193mn for the valuation difference on other available-for-sale securities.

Looking at management indicators, total assets grew mainly from the acquisition of fixed assets alongside the concept for the Group's production bases, while interest-bearing debt increased to fund these acquisitions. Therefore, the equity ratio fell 3.5 percentage points from the end of the previous fiscal year to 51.8%, while the interest-bearing debt ratio rose 3.5 percentage points to 30.4%, so the financial structure worsened slightly.

In the concept for the Group's production bases, the Company plans to invest a total of more than ¥15bn by FY3/19. In the current Q2, it spent ¥4,133mn to acquire tangible fixed assets, and it seems that the majority of this spending was related to the concept for the Group's production bases and around ¥12bn is required to fund the remaining capital expenditure for this concept. The Company is planning to cover this amount from cash in hand and borrowings, so interest-bearing debt may increase from now until FY3/19. However, the financial burden from borrowing is low as ultra-low interest rates continue, and judging from its current profitability, we think that the Company will maintain its financial soundness even if interest-bearing debt increases.

Consolidated balance sheet

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18 1H	Change
Current assets	18,704	21,836	29,196	32,164	2,967
(Cash and deposits)	4,778	7,412	13,779	14,440	661
(Inventories)	2,309	2,601	2,817	2,798	-19
Fixed assets	20,744	20,469	22,245	25,284	3,038
Total assets	39,448	42,306	51,442	57,448	6,006
Total liabilities	21,481	22,994	22,985	27,666	4,680
(Interest-bearing debt)*	8,584	7,617	7,651	9,050	1,398
Total net assets	17,967	19,311	28,456	29,781	1,325
(Stability)					
Current ratio	129.7%	133.9%	177.1%	164.5%	-12.6pt
Shareholders' equity ratio	45.5%	45.6%	55.3%	51.8%	-3.5pt
Interest-bearing debt ratio	47.8%	39.4%	26.9%	30.4%	+3.5pt

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

Future outlook

Due to meticulous proposal activities tailored to industries and business formats, the outlook is for record high results again in FY3/18

1. Outlook for FY3/18

Initial forecasts have been left unchanged for the FY3/18 consolidated results. The Company projects net sales to increase 5.9% to ¥75,000mn, operating profit to rise 2.3% to ¥4,080mn, recurring profit to climb 2.1% to ¥4,100mn, and profit attributable to parent shareholders to rise 0.1% to ¥2,870mn. If the forecasts are achieved, the Company will once again achieve record high results. The 1H results were slightly below the forecasts, but the market price of potatoes has fallen more than anticipated, so at FISCO we think that the Company will be able to achieve the forecasts on a profits basis. On the other hand, although net sales have returned to the Company-forecast pace since October, it is possible that it will not be able to recover the 1H shortfalls and that therefore, the full fiscal year result will be slightly below the forecast.

FY3/18 consolidated outlook

(¥mn)

	FY3/17		FY3/18				1H progress rate
	Full-year result	YoY	1H result	YoY	Full-year forecast	YoY	
Net sales	70,812	+5.8%	37,021	+2.8%	75,000	+5.9%	49.4%
Operating profit	3,987	+16.0%	2,152	-13.1%	4,080	+2.3%	52.7%
Recurring profit	4,017	+17.2%	2,184	-12.3%	4,100	+2.1%	53.3%
Net profit attributable to parent shareholders	2,867	+37.5%	1,489	-11.9%	2,870	+0.1%	51.9%
Earnings per share (¥)	194.88		90.43		174.20		

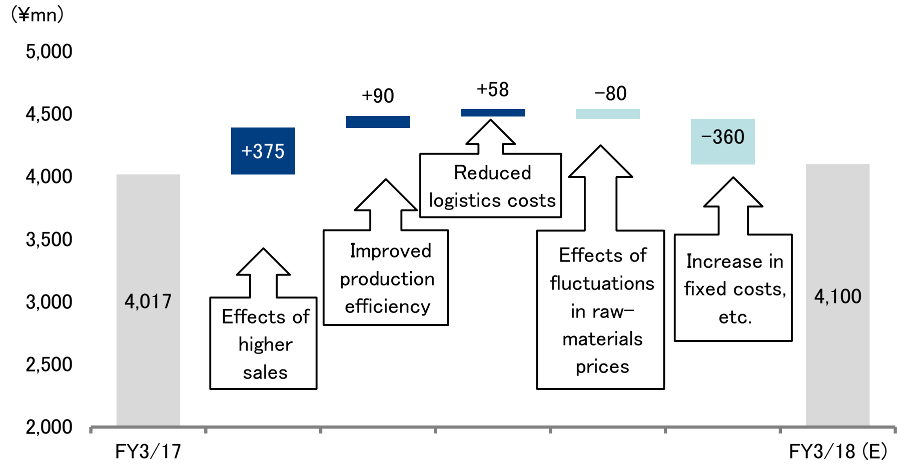
Source: Prepared by FISCO from the Company's financial results

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 not be a factor in rising coasts as the harvest yield has recovered. 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 tuna and other import materials. The impact from cooking oil will be kept down as the Company concludes forward contracts for more than half of its annual amount, so it is not considered that there will be a major fluctuation.

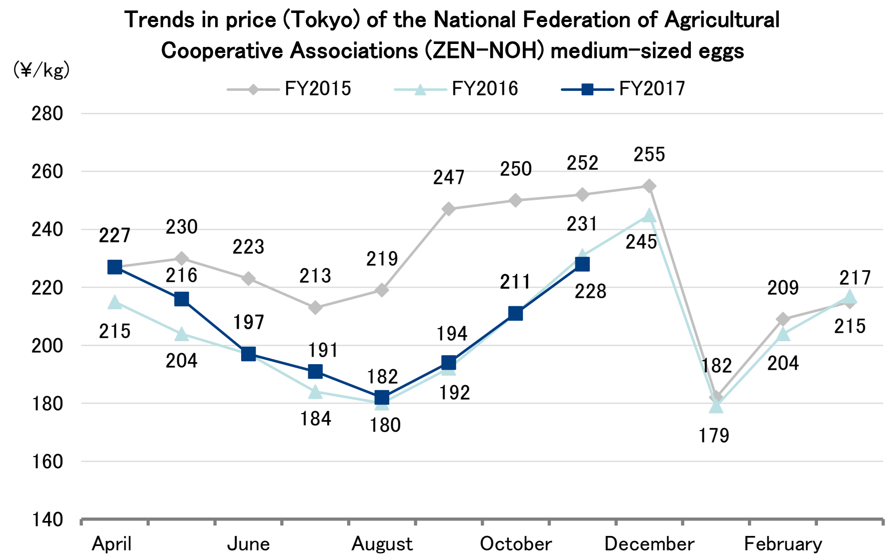
Therefore, the market conditions for eggs and potatoes may be the factors causing profits to change in the future, but eggs were trending basically unchanged YoY up to November, and it seems their market conditions are more or less as expected. Conversely, for potatoes, the 2017 harvest in Hokkaido, which is the main supplier region, has been upwardly revised from the initial forecast of an increase of 2.6% YoY to an increase of 9.6%, which exceeds the average harvest yield over the past five years. Therefore, the market prices are also clearly falling, for example in October, the wholesale price on the Tokyo Central Wholesale Market fell 37% compared to October 2016. Supposing that the wholesale price after November trends at around the same pace as in FY2015, the average annual price will fall by around 20% YoY. However, in the case of the Company, it purchases directly from the production areas in Hokkaido, and also, depending on the product, it uses potatoes harvested up until October in the previous year. Therefore, a slight time lag is expected between the decline in the market prices and the positive effect of this on profits. In addition, in order to reduce procurement risk, since FY3/18 the Company has been increasing its procurement from regions other than Hokkaido.

With regards to logistics costs, in recent years logistics companies have been raising prices, but the Company has been working to reduce these costs, including by reviewing its delivery routes (for example, direct from the factory to the customer, not via a warehouse), and by increasing delivery efficiency, such as by reducing the number of deliveries (bulk deliveries).

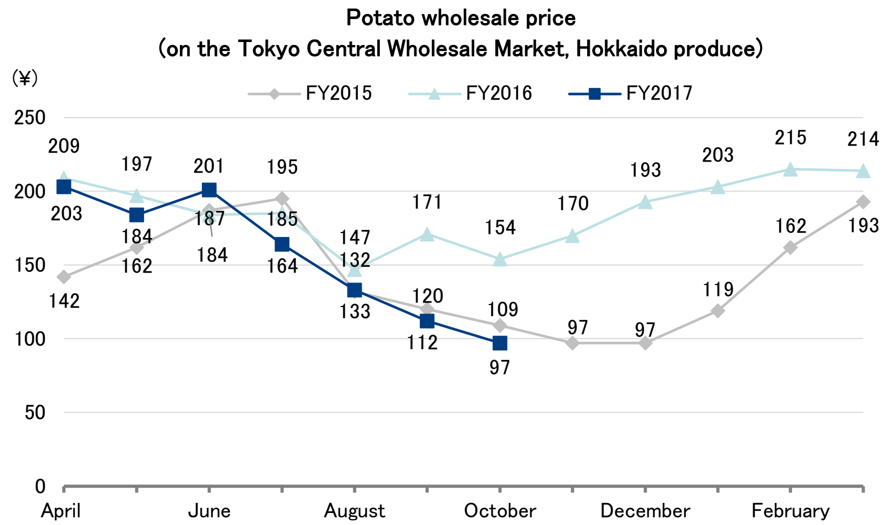
Recurring profit change forecast (FY3/18)



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



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



Source: prepared by FISCO from the Tokyo Central Wholesale Market materials

2. Sales outlook by segment

Looking at the sales outlook by segment also, the initial forecasts have been left unchanged and no particular revisions have been made. In the seasoning and processed food business, the forecast is for sales to increase 5.1% YoY to ¥61,477mn; in the delicatessen-related business, to rise 10.4% to ¥12,210mn; and in other businesses, to grow 6.1% to ¥1,313mn. Based on the progress rates up to 1H, it is highly possible that the result will be slightly below forecast in the delicatessen-related business.

Net sales by segment

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18 (E)	Growth rate
Seasoning and processed food	49,733	55,035	58,511	61,477	5.1%
Salads and delicatessen items	16,758	18,903	19,685	20,729	5.3%
Mayonnaise and 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, the Company is continuing to focus on measures tailored to industries and business formats and strengthening product lineups. Among the products, sales of salads and delicatessen items are forecast to increase 5.3% YoY. Sales of commercial-use, small packaged long-life salads are growing, while the Company is also strengthening its lineup of pre-processed potato products and Japanese-style delicatessen items, for which demand is increasing.

Sales of processed egg products are forecast to increase 6.1% YoY. The growth in sales to CVS has been slightly less than anticipated, but the Company is strengthening sales proposals for the Sozaitei® series for mass retailers, and also continuing the development and sales of new products that meet diverse needs.

Sales of mayonnaise and dressings are forecast to increase 4.1% YoY. The Company is focusing on strengthening the lineup of the Triple Balance® series that address increased health consciousness and developing functional foods, and it is aiming to increase sales not only for the restaurants market, but also for the food dispensing, CVS, and mass retailers markets.

The delicatessen-related business is collaborating with the head office to strengthen menu proposals in order to meet diversifying needs, while also enhancing sales activities toward the start of operations at the new and expanded factories. In the other businesses also, the Company is working to strengthen proposals for Japanese-style salads in Salad Cafe, and for the overseas business, it is aiming to achieve the profit-loss breakeven level for the full fiscal year.

Longer-term management strategy

The sales capacity is scheduled to increase by around ¥10bn with two new factories and expanded facilities at two existing factories becoming operational in FY3/19

1. Concept for the Group's production bases

For its domestic bases, the Company plans to invest more than ¥15bn in expanding facilities at two factories and building two new factories with a focus on 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 (with a single operating team working in a day). The plan is to increase the production lines at the Shizuoka Fujisan Factory and Nishi-Nihon Factory while watching demand, but since construction costs are rising, it is possible that the capital expenditure amount will be slightly higher than initially planned.

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	January 2018	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	September 2017	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 factory 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 further expand its share of the omelet market, in which it is currently ranked third.

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

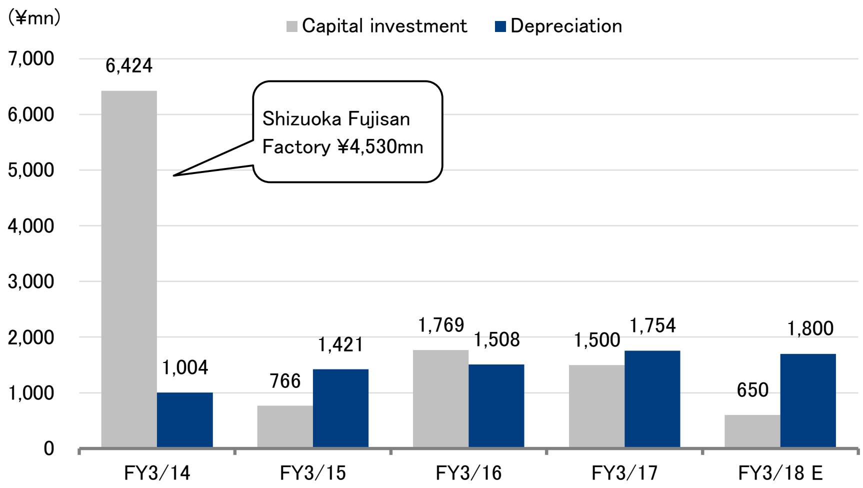
Since KANTOH DIETCOOK's existing factory in Tokorozawa had become too constricted, the Company newly purchased land in Odawara City, Kanagawa Prefecture, as the site to build a new factory to produce fresh delicatessen items. Its construction is scheduled for completion in June 2018 and it is expected to increase sales by approximately ¥6,000mn. Space at the Tokorozawa Factory became too constricted due to rising demand over the last few years, and because of this the picking process had to be moved to another location which resulted in an increase in costs. But after the current expansion in production capacity, there will be excess capacity from the operations at the Odawara Factory, so the picking process can be returned to within the factory, which will be a factor improving profitability.

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 pre-processed potato products, which demand is increasing, 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, in addition to the effects of higher sales, the effect of a reduction in the personnel costs rate can also be expected at the existing factories. So at FISCO, we think that the Company will be able to maintain the recurring profit margin at a level of above 5%. Previously, in order to respond to demand during the busy season, nighttime overtime work was increased so that the factory was fully operational, which caused the personnel costs rate to rise. But when the new and expanded factories become operational, there will be room in terms of production capacity, so personnel costs are expected to decline in line with reduction in nighttime overtime work.

The capital investment amount in FY3/18 will be ¥600mn-¥700mn and no particularly large investments are planned. Depreciation expenses are forecast to be ¥1,800mn, a slight increase YoY.

Change in capital expenditure and depreciation



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

Aiming for stable growth, while maintaining the recurring profit margin at a level above 5%

2. Progress made on the Mid-term Management Plan

FY3/18 is the final year of the mid-term management plan KENKO Five Code 2015-2017. Its numerical management targets are consolidated net sales of ¥75,000mn, a consolidated recurring profit margin of 5%, an equity ratio of 50%, and ROE of above 8%. Other than for net sales, it can be said that achieving these targets is in sight.

KENKO Five Code 2015-2017

(¥mn)

	FY3/15 result	FY3/16 result	FY3/17 result	FY3/18	
				Mid-term Plan targets	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

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 business formats in order to respond to issues in the restaurant industry, such as demand in product and menu that contribute to "simplification" of cooking due to its chronic shortage of labor, and development of menus that reflect the rising awareness of health among consumers. This has enabled 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 small packaged long-life salads as PB products and increased adoption of the processed egg products to CVS.

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. Although there are inquiries for openings of the "Salad Cafe" salad specialty stores, the Company's policy is to judges whether or not to open a store while watching conditions.

Also, in order to “Strengthen the management platform to proactively promote expansion into global markets,” the Company is developing products that meet the needs in various countries, and it is also strengthening measures to expand exports, including actively participating in exhibitions (a total of 6 times between April and September 2017, including in the United States and Hong Kong). As of the end of September 2017, the Company was exporting to 36 countries and regions and steadily introducing its products into local Japanese companies (including CVS and restaurant companies). The forecast for export sales in FY3/18 is around ¥600mn, and while this does not achieve the medium-term management target, the Company intends to grow the scale of sales by increasing the number of export products and expanding the sales areas going forward. The Indonesian equity-method affiliate has started sales of Halal-certified mayonnaise to local Japanese-food supermarkets and it is steadily expanding its business scale through launching exports to neighboring countries, and the aim is for it to become profitable in FY3/19.

Going forward, the Company plans to formulate the next mid-term management plan, which will start from FY3/19, but there is no doubt that the driving force behind growth will be the start of operations at the two new factories and the two factories with expanded facilities. Going forward, it is expected to maintaining a recurring profit margin of above 5% as the top priority and continue to aim for stable profit growth.

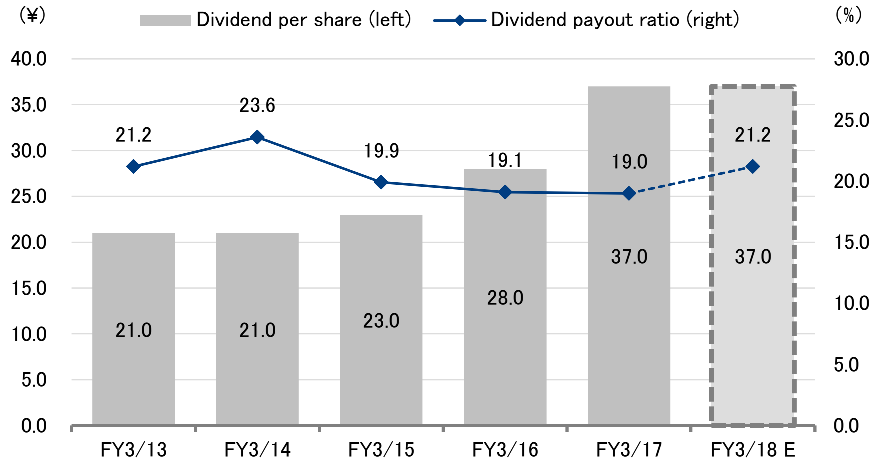
Shareholder return policy

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

Information security measures

As its information security measures, the Company transferred the management information that is being managed on a mission-critical system to an external data center that implements disaster countermeasures. In addition, in order to prevent the loss of or tampering with information and other such problems, it has established a thorough information management system and is implementing various security measures, including maintenance and preservation measures for systems failures. To defend against cyber-attacks, it has introduced a proxy server to restrict external access and is implementing a range of other measures, such as strengthening the certification system. Also, as the measures to prevent the leakage of information from inside to outside of the Company, it has formulated information management rules and conducts employee education. Data can only be taken from inside to outside of the Company on a USB memory device with an encryption key.

Disclaimer