COMPANY RESEARCH AND ANALYSIS REPORT

SFP Holdings Co., Ltd.

3198

Tokyo Stock Exchange First Section

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FISCO Ltd. Analyst

Ikuo Shibata

FISCO Ltd.

http://www.fisco.co.jp

Index

Summary

Results have stagnated due to the curtailment of new location openings However, the Company is pursuing an acceleration of growth through the original Alliance Conception, and its listing was moved to the TSE First Section on February 28, 2019

1. Company profile

SFP Holdings Co., Ltd. <3198> (hereinafter, also "the Company") primarily operates restaurants such as ISOMARU SUISAN, a popular 24-hour seafood restaurant located adjacent to train stations and in urban commercial districts on the street level. It has achieved robust profitability and growth thanks to a unique income model that takes maximum advantage of customer draw from prime locations. The Company had 229 restaurants (besides 10 franchise restaurants) as of the end of February 2019. By format, ISOMARU SUISAN is the largest with 121 locations, and by area, 207 restaurants are concentrated with in the Tokyo metropolitan area (including 131 restaurants in Tokyo). Recently, Toriyoshi Shoten (chicken specialty izakaya), a second major format that utilizes the same income model as ISOMARU SUISAN, gained momentum and Ichigoro (gyoza izakaya), a new format, ramped up smoothly. Results have stagnated (unchanged YoY), mainly because the Company is curtailing openings of new locations, but it is aiming to accelerate growth through its newly launched and original Alliance Conception. On February 28, 2019, its listing was upgraded to the Tokyo Stock Exchange (TSE) First Section.

2. FY2/19 results

In the FY2/19 consolidated results, net sales increased 2.5% year on year (YoY) to ¥37,751mn and operating income decreased 17.6% to ¥2,907mn. So, although profits decreased, sales increased and achieved a new record high. However, both sales and profits were below the initial forecasts. The main reasons for the higher sales were the full fiscal year contributions of the locations opened in the previous fiscal year and the openings of 15 new locations. The Company is strategically curtailing new openings, and therefore the moderate increase in sales for the second consecutive fiscal year was as anticipated. However, in addition to the deliberate curtailment of openings from the planned 20 new locations due to the increased burden and impact at current locations in line with changing business formats, the format changes implemented at 26 locations as the main element in the strategy were falling short of expectation overall in regards to improving business results. In terms of profits, operating income declined and was below the initial forecast because of the impact of the decline in sales per location and that sales from some locations that had undergone format conversions were less than expected, and as personnel costs increased. On the other hand, toward realizing the SFP Food Alliance Conception (hereafter, the Alliance Conception), which is its new growth strategy, the Company has made a good start, including completing the first (M&A) project.

3. FY2/20 outlook

For FY2/20, the Company forecasts a 3.3% increase in net sales YoY to ¥39,000mn and a 17.4% decrease in operating income to ¥2,400mn. So the outlook is profit decrease despite sales increase mainly due to exits from unprofitable locations. The consolidation of Joh Smile Restaurant System Inc. (hereafter, JS), which is the first Alliance Conception project, is expected to contribute to the increase in sales. Nevertheless, the reason for the continuation of a moderate increase in sales is due to the Company working on more robust improvements to the management structure through support to existing locations while also restricting the number of new openings to 7 and actively withdrawing from unprofitable locations. The outlook is for a decrease in profits because of costs relating to the support for existing locations and to exits from unprofitable locations, and also due to upfront costs toward accelerating growth in the future.

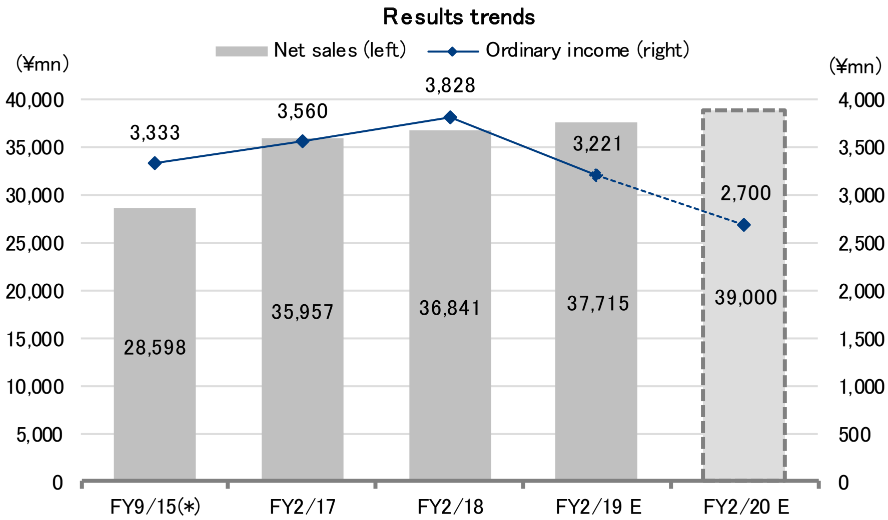
4. Growth strategy

The Company has established the Alliance Conception to respond to a situation in which environmental changes (such as recruitment difficulties, including for restaurant staff) are acting as a drag on growth, and also as a strategy to effectively enter regional cities. Specifically, it is putting in place a mechanism to support growth through conducting capital tie-ups with companies that manage izakaya and that have an abundance of management expertise in regional cities, and then providing them with the Company's main brands (including ISOMARU SUISAN). This mechanism can provide various benefits to both parties; for example, it enables the Company to quickly lock in place a business foundation in regional cities (such as acquiring sites for openings and human resources), while for its partners, it enables them to add popular brands, such as ISOMARU SUISAN and Toriyoshi Shoten, to serve as a second growth engine (source of earnings), while they continue with their own brands. In other words, it is not merely the addition to the Company's results from an M&A, and its features include that it is ultimately one part of a growth strategy centered on the main brands and that it utilizes the partner's independence and desire for growth.

Alongside the launch of the Alliance Conception, the Company has announced a new three-year medium-term management plan. The targets for the plan's final fiscal year (FY2/22) are net sales of ¥59,000mn, ordinary income of ¥4,200mn, and net income of ¥2,500mn. For organic growth by the Company itself, it is working on various measures, including continuing to open restaurants at first-class locations, mainly in the Tokyo metropolitan area, at the same time as developing new brands and advancing the "multiple content in prime locations" strategy. Thus the Company is depicting a two-layered image of growth: sustained organic growth and accelerated growth through the Alliance Conception.

Key Points

- Profits decreased in FY2/19 although sales increased moderately
- Sales growth rate was moderate for the second consecutive fiscal period because openings of new locations were strategically kept down and the results improvement effects from the format conversions were less than expected. Profits decreased mainly due to the costs of format conversions
- Aiming to accelerate growth through launching the original Alliance Conception and utilizing M&A to open new locations in regional cities
- Outlook for FY2/20 is a decrease in profits as the Company will actively withdraw from unprofitable locations. Toward realizing the growth strategy, it first intends to work on improvements towards a more robust management structure.



Note: FY2/16 not shown because it was an irregular period of just five months
* Non-consolidated results in FY9/15 only
Source: Prepared by FISCO from the Company's financial results

Company profile

Develops popular brands, including ISOMARU SUISAN and Toriyoshi Shoten
On February 28, 2019, listing was upgraded to the TSE First Section

1. Business overview

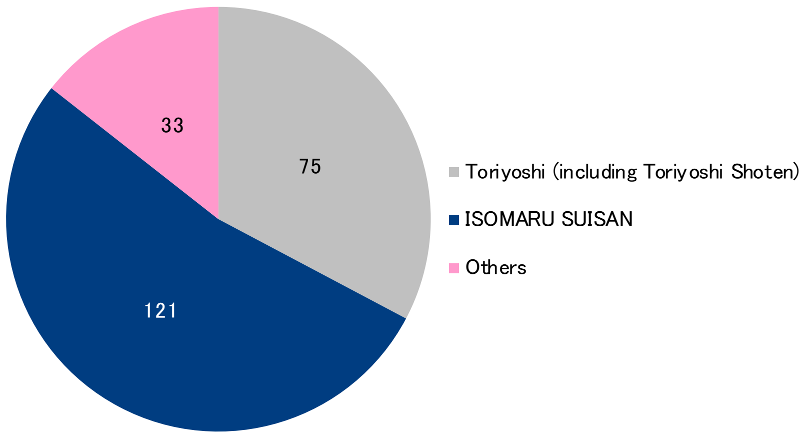
The Company primarily operates seafood izakaya ISOMARU SUISAN, a popular restaurant open 24 hours a day* at locations adjacent to train stations and in commercial districts (street level). The Company had 229 restaurants (besides 10 franchise restaurants) as of the end of February 2019. ISOMARU SUISAN is the largest format with 121 locations, and 207 restaurants are concentrated in the Tokyo metropolitan area (including 131 in Tokyo). The Company has established brand presence and expanded the number of restaurants with focused openings in the Tokyo metropolitan area (particularly in central Tokyo and entertainment districts). It concluded a capital alliance with create restaurants holdings inc. <3387> in April 2013 to become a consolidated subsidiary and listed shares on the TSE Second Section in December 2014, and on February 28, 2019, its listing was upgraded to the First Section.

* Depending on the market characteristics, there are also some locations that are not open 24 hours a day.

Recently, Toriyoshi Shoten (chicken specialty izakaya), has gained momentum using the same income model as ISOMARU SUISAN as a second brand, while Ichigoro (gyoza izakaya), a new format, has made a smooth start. The Company is also actively developing more new formats and aiming for sustainable growth through a strategy of "multiple contents in prime locations" that fully utilizes the strengths of prime locations. Further, it has established the new Alliance Conception and intends to launch fully-fledged measures to increase the number of locations in regional cities through utilizing M&A (the provision of the Company's own brands in a franchise format).

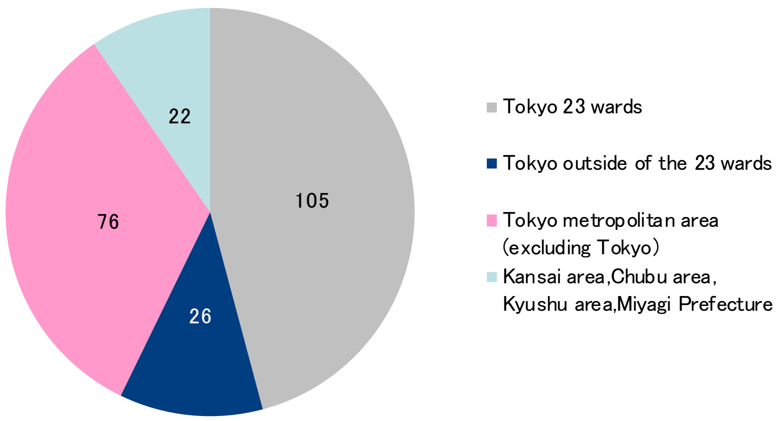
While the Company only has the food and beverages segment, it operates in three areas – the founding Toriyoshi business (including Toriyoshi Shoten), the mainstay ISOMARU SUISAN business, and other business including new formats. The ISOMARU SUISAN business generates approximately 60% of net sales (FY2/19 result), but recently, the reliance on it has been trending downward due to the growth of the Toriyoshi business and other businesses.

No. of restaurants by format (Excludes franchise restaurants)



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

No. of restaurants by area (Excludes franchise restaurants)



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

Features by brand

Brand	Features
ISOMARU SUISAN	Seafood izakaya centered on grilled cuisine
Toriyoshi	Chicken specialty restaurant that serves fried chicken wings with a special sauce
Toriyoshi Shoten	Tasty, quick provision of chicken izakaya fare
Omotenashi Toriyoshi	New Toriyoshi with refined hospitality
Ichigoro (Toragoro)/Ichigoro Shokudo	Izakaya where you can enjoy a wide variety of gyoza. Ichigoro Shokudo has an extensive menu of meals.
Kizuna Sushi	Delicious and inexpensive fresh food. You can also enjoy “all-you-can-eat sushi.”
CASA DEL GUAPO	Authentic recreation of a Spanish bar
Teppan 200°c	Casual teppanyaki at a large counter
Misonikomi Udon Tamacho Honten	Nagoya’s famous misonikomi udon (udon in a thick miso soup)
Bistro ISOMARU	Casual Western-style izakaya
Kisoba Tamagawa	Reasonable and freshly-prepared boiled soba noodles
Home Base	Japanese-style pub with a retro atmosphere reminiscent of the Showa era (1925-1989); the Company’s first standing bar (tachinomi) format
Go-no-Go	Japanese-style pub that invigorates office workers for the next day
Hamayaki Dragon	A “hamayaki” barbecue style restaurant/izakaya where you can cook fresh live shellfish, such as Japanese scallops and turban shell (sazae), yourself
Hitsuji Hachiban	A Mongolian-style barbecue restaurant that focuses on freshness, providing fresh mutton that has been procured in a chilled (non-frozen) state and is cut after it is ordered.

Source: Prepared by FISCO from the Company’s materials

Income model of 24-hour operation at locations adjacent to train stations and in commercial districts (street level) is a key strength

2. Corporate characteristics

The Company’s advantage lies in its unique income model, in addition to the conventional izakaya income model. Mainstay ISOMARU SUISAN’s income model selects locations adjacent to train stations and in commercial districts with high rents for its street-level locations. It sustains high turnover by maximizing customer draw at these prime sites with unique and highly visible facades, welcoming and open atmospheres, and 24-hour operations that cover a wide range of demand. It realizes leverage by securing large sales that sufficiently cover expensive rents that would erode profitability at typical izakaya restaurants. This format cannot be easily copied because it relies on a location analysis scheme, street-level restaurant development skills, know-how in 24-hour operations and rotating optimal menus for specific hours. We think expensive opening costs and the difficulties of 24-hour operations present major hurdles to other companies. The Company’s accumulation of know-how ahead of others and build-up of robust brand presence through focused openings in the metropolitan Tokyo area have driven a beneficial cycle of lowering opening risk. The Company still has considerable room to open restaurants at prime locations in the Tokyo metropolitan area, and plans to start full-fledged efforts to enter regional cities utilizing M&A through the Alliance Conception in FY2/20. We think it enjoys unique positioning to achieve high profitability and growth.

The Company can also apply the income model established for ISOMARU SUISAN (hereinafter, "the ISOMARU SUISAN model") to other formats and has substantial room for further evolution. Toriyoshi Shoten, which has become a second major brand, applied the ISOMARU SUISAN model to the Company's founding Toriyoshi business and has been steadily gaining momentum. Key points are openings along with ISOMARU SUISAN (at the same time or in the same area as existing ISOMARU SUISAN) and selective openings that meet market features (location and format). The Company opened Toriyoshi Shoten adjacent to ISOMARU SUISAN, and their coexistence proves that demand will not be cannibalized for these brands. Additionally, the Company is successfully improving results in some cases in conversions of ISOMARU SUISAN suburban locations that have exhausted vibrancy from their openings. Therefore, we expect income contributions. The Company is currently ramping up the new Ichigoro format as its third main brand. We think it possesses potential via expansion of the network by developing a variety of new formats using the ISOMARU SUISAN model and should also improve the probability of sustaining and lifting income after openings.

Founded with the Toriyoshi restaurant that specializes in Nagoya-style fried chicken wings

3. History

The Company started with the opening of Toriyoshi, a fried chicken wing specialty restaurant, in Tokyo's Musashino City (now Toriyoshi Shoten's Kichijoji South Exit restaurant) in April 1984 by founder Ryosaku Samukawa (former Representative Director and Chairman, retired in December 2015). Toriyoshi served Nagoya-style fried chicken wings arranged with a special recipe as its main menu and steadily increased the number of locations. It presented a vision of "becoming a comprehensive food service business that creates a rich menu of foods" in 2001 and expanded operations to 50 locations, including format diversification, in 2008.

Following the economic downturn triggered by the Lehman Brothers bankruptcy and changes in the industry environment, the Company revised its vision to "become a specialty restaurant group that enriches Japan." With the switch in course to pursuit of "specialty restaurants," it opened ISOMARU SUISAN based on a unique income model in 2009 and built the foundation for growth.

Having smoothly ramped up ISOMARU SUISAN and confirmed a growth path, the Company decided to pursue listing its stock as the quickest path to "building a lasting corporate organization." It accepted capital participation by Polaris No.2 Investment Limited Partnership (Polaris Capital Group Co., Ltd.), a private-equity fund, in December 2010 as well as enhanced management and the accuracy of organizational operation by adopting objective standards and rational methods. San Francisco Holdings Co., Ltd., which was established as an SPC (special purpose company), became the nominal surviving company and absorbed the prior main operating entity Samukawa Food Planning Co., Ltd. in May 2011 (the Company was renamed SFP Dining Co., Ltd. in October 2011). The Company transitioned to a holding company framework in September 2016 and renamed itself as SFP Holdings Co., Ltd. in June 2017.

The Company concluded a capital alliance with create restaurants holdings, which mainly operates restaurants and food courts in suburban shopping centers, and became a consolidated subsidiary in April 2013 and listed on the TSE Second Section in December 2014. On February 28, 2019, listing was upgraded to the TSE First Section.

The Company accelerated the pace of openings for ISOMARU SUISAN, which had solidified a brand presence as a popular format, after listing on the market and reached 100 locations for ISOMARU SUISAN in May 2015. It also started franchising ISOMARU SUISAN in Nagoya City, Aichi Prefecture*1. It began opening Toriyoshi Shoten restaurants, which are the second major growth driver, and ramped up this business*2.

*1 Started ISOMARU SUISAN franchise operations in Kyushu (Fukuoka Prefecture) in June 2017.
*2 Operates 75 restaurants in the Toriyoshi business as of the end of February 2019.

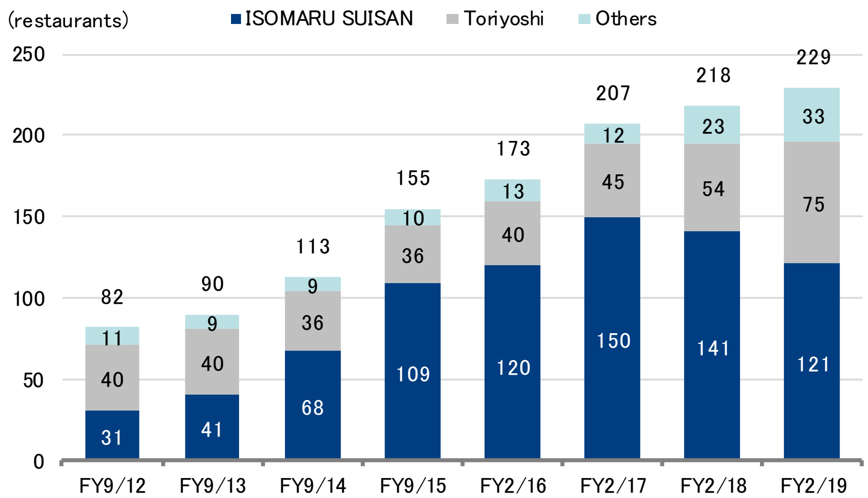
Performance trends

Realized high growth and profitability while also actively increasing the number of locations
However, results have stagnated as openings of new locations are being strategically kept down

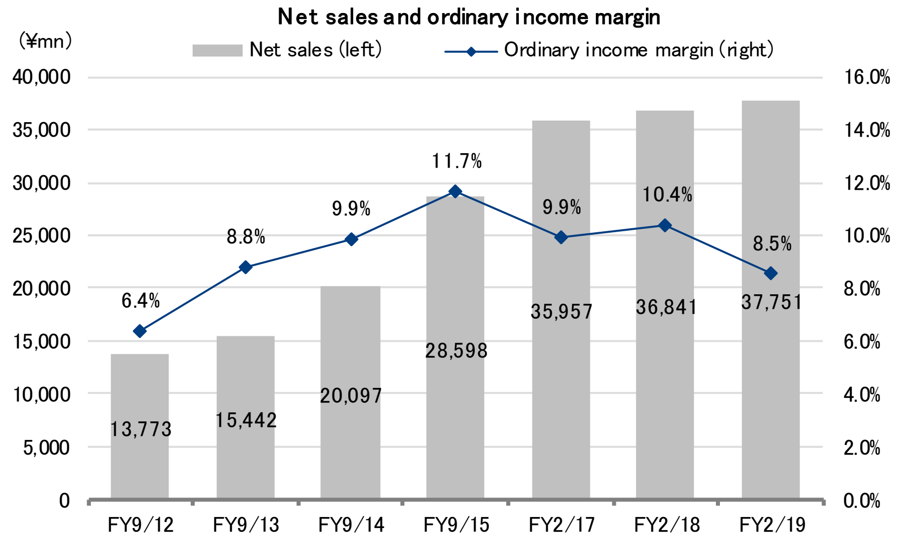
1. Past performance

Increases in the number of restaurants have driven the Company's growth in past years. Income growth accelerated from FY9/10 when the Company ramped up openings of ISOMARU SUISAN based on a unique income model, and ordinary profit margin improved significantly with the rise in sales. The margin exceeded the 8% goal in FY9/13 and subsequently rose to 11.7% in FY9/15. It has remained at a strong level since then. However, from FY2/18, results grew only moderately for two consecutive fiscal years. This was because the Company reviewed its restaurant opening policy and decided to strategically keep down openings of new locations to respond to environmental changes and with an eye to realizing sustainable growth in the future (including the reducing the number of restaurants in suburbs susceptible to economic fluctuations). At the same time, it allocated the excess investment capacity resulting from this to strengthening existing locations and to developing new business formats (such as the Ichigoro gyoza izakaya).

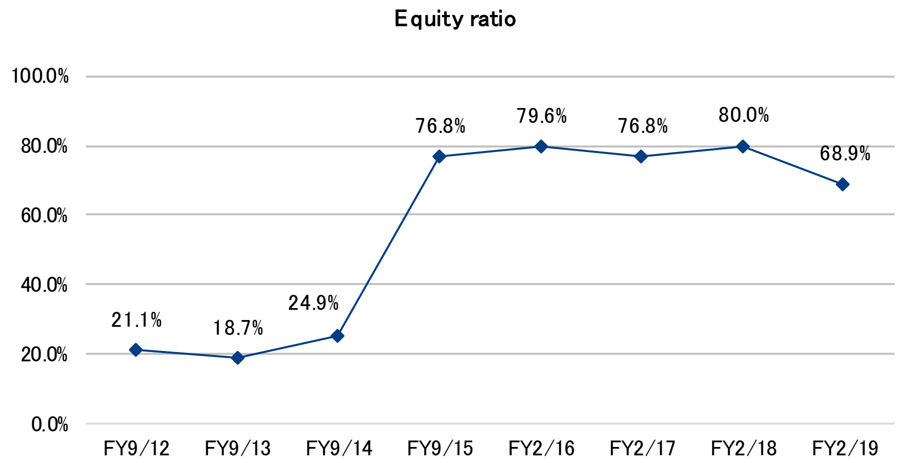
Restaurant number trends (Excludes franchise restaurants)



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



Note: FY2/16 not shown because it was an irregular period of just five months
Source: Prepared by FISCO from the Company's financial results



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

In financial standing, the equity ratio had been about 20% for many years, but strengthened to 76.8% at the end of FY9/15 owing to the public offering capital increase for the TSE Second Section listing in December 2014 (about ¥12,758mn), and it has trended at a high level thereafter. Also, there have been no significant changes since the acquisition (and cancellation) of treasury stock, which was resolved upon in January 2018.

ROE, which indicates capital efficiency, climbed along with improvement in ordinary income margin, and has also been sustaining a high level since FY9/15 after the reinforcement of capital. Although ROE has been declining in the last few years due to spending on strategic costs (including to strengthen existing locations and for format conversions), it is still being maintained at a double-digit level, and we think the Company possesses excellent financial standing.

In FY2/19, sales increased but profits decreased
Improvement to results through the openings of new locations and format conversions was less than expected

2. FY2/19 consolidated results

In FY2/19, profits were lower despite sales growth, with a 2.5% increase in net sales to ¥37,751mn while operating income decreased 17.6% to ¥2,907mn. Ordinary income decreased 15.8% to ¥3,221mn, and profit attributable to owners of parent decreased 33.4% to ¥1,955mn. Sales reached new record high, but both sales and profits missed forecast.

The main reasons for the higher sales were the full fiscal year contributions of the 18 locations opened in the previous fiscal year and the openings of 15 new locations. The Company is strategically curtailing new openings, and therefore the moderate increase in sales for the second consecutive fiscal year was as anticipated. However, in addition to the deliberate curtailment of openings from planned 20 new locations due to the increased burden and impact at current locations in line with changing business formats, the format changes implemented at 26 locations as the main element in the strategy were falling short of expectation overall in regards to improving business results.

In terms of profits, although costs relating to the openings of new locations declined, impacts such as a decline in sales at each location and sales at number of stores performed lower than expectations, as well an increase in personnel costs led operating income to decline below forecast. The operating income margin fell to 7.7% from 9.6% in the previous fiscal year. An absence of the gain on a consumption tax exemption (¥972mn) that was recorded in the previous fiscal year also contributed the significant decrease in final profits.

From a financial perspective, total assets declined by 13.7% on the end of the previous fiscal year to ¥22,585mn because of the decrease in short-term loans receivable from subsidiaries and associates. Net assets also decreased significantly, down 25.6% to ¥15,566mn, due to the acquisition and cancellation of treasury stock, etc. This caused the equity ratio to decline, but it remains at a high level and this decline is not a cause for concern in terms of the Company's financial stability.

Overview of FY2/19 results

(¥mn)

	FY2/18 results		FY2/19 results		Change		FY2/19 initial forecast		Achievement rate
		% of total		% of total		Change (%)		% of total	
Net sales	36,841		37,751		909	2.5%	39,600		95.3%
Toriyoshi	8,443	22.9%	10,725	28.4%	2,281	27.0%	-	-	-
ISOMARU SUISAN	25,464	69.1%	22,542	59.7%	-2,921	-11.5%	-	-	-
Others	2,933	8.0%	4,483	11.9%	1,550	52.8%	-	-	-
Cost of sales	10,501	28.5%	10,749	28.5%	247	2.4%	-	-	-
Gross profit	26,339	71.5%	27,001	71.5%	661	2.5%	-	-	-
SG&A expenses	22,810	61.9%	24,094	63.8%	1,284	5.6%	-	-	-
Operating income	3,529	9.6%	2,907	7.7%	-622	-17.6%	3,550	9.0%	81.9%
Ordinary income	3,828	10.4%	3,221	8.5%	-606	-15.8%	3,850	9.7%	83.7%
Profit attributable to owners of parent	2,934	8.0%	1,955	5.2%	-979	-33.4%	2,350	5.9%	83.2%
Total assets	26,156		22,585		-3,570	-13.7%			
Net assets	20,928		15,566		-5,362	-25.6%			
Equity ratio	80.0%		68.9%		-11.1pt				

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

Results are reviewed by main business field below.

Net sales in the Toriyoshi business increased significantly, rising 27.0% to ¥10,725mn. Sales grew significantly mainly due to the full fiscal year contributions of strong performance in Toriyoshi Shoten locations opened in the previous fiscal year (9 locations), and locations that underwent format conversions (21 locations), including ISOMARU SUISAN. Existing location net sales trended solidly overall, at 96.1% of the result in the previous fiscal year, but they fell below the forecast because some openings from format conversions did not achieve the expected results. The number of restaurants in the business as a whole rose greatly to 75 locations (up 21 locations on the end of the previous fiscal year).

Net sales in the ISOMARU business decreased 11.5% to ¥22,542mn. This was mainly due to the strategic format conversions to other formats (24 locations) and was as anticipated. Existing location net sales trended stably, at 97.6% of the result in the previous fiscal year, because of the format conversions of unprofitable locations. The number of restaurants in the business as a whole declined to 121 locations (down 20 locations on the end of the previous fiscal year), which was due to the openings of 6 new locations and the closure of 26 locations (of which, format conversions of 24 locations). The number of franchise restaurants increased to 10 locations (up 3 locations on the end of the previous fiscal year).

Net sales in other businesses increased greatly, up 52.8% YoY to ¥4,483mn, although the scale of sales is still small. The main reasons for the higher sales were the full fiscal year contributions of the 9 locations opened in the previous fiscal year*1, the openings of new 9 locations*2, and the format conversions of 5 locations from ISOMARU SUISAN and other formats to Ichigoro (gyoza izakaya). Existing location net sales trended solidly, at 95.5% of the result in the previous fiscal year. The number of restaurants in the business as a whole increased to 33 locations (up 10 locations on the end of the previous fiscal year) from the openings of 9 new locations and the exits from 4 locations (of which, format conversions of 2 locations).

*1 In the previous fiscal period, the opening of 9 locations of the new business format Ichigoro (Toragoro) (gyoza izakaya).
*2 Openings of 2 Ichigoro (gyoza izakaya) locations, 3 Go no Go (bar format) locations, and 1 Kizuna Sushi location, and in addition, the trial openings of locations for the new business formats, Hamayaki Dragon and Akasaka Hitsuji Hachiban

Openings and closures in FY2/19

	Business			Total	Region			
	Toriyoshi	ISOMARU SUISAN	Others		Tokyo 23 wards	Tokyo outside the 23 wards	Tokyo metropolitan area (excluding Tokyo)	Kansai area, Chubu area, Kyushu area, Miyagi Prefecture
End of February 2018	54	141 (7)	23	218 (7)	101	28	72	17 (7)
Openings	0	+6 (+3)	+9	+15 (+3)	+6	0	+4	+5 (+3)
Format conversions	+21	0	+5	+26	+9	+4	+12	+1
Closures (including format conversions)	0	-26 [-24]	-4 [-2]	-30 [-26]	-11 [-9]	-6 [-4]	-12 [-12]	-1 [-1]
End of February 2019	75	121 (10)	33	229 (10)	105	26	76	22 (10)
Full-year opening plan	+6	+6	+8	+20	-	-	-	-

The [ ] figure shows the number of closures through conversions included in the total number.
The ( ) figure is the number of franchise restaurants excluded from the total number.
Source: Prepared by FISCO from the Company's results briefing materials

Initiatives

Despite the format conversions producing less improvements to business results than expected, a certain level of results was achieved, such as the Alliance Conception (M&A)

To summarize the activities in the previous fiscal year, the Company strategically kept down openings of new locations for the second consecutive period while it worked to use the excess investment capacity as a result of this to strengthen existing locations and to reduce the number of unprofitable locations through actively investing in format conversions. It has also achieved a certain level of results in terms of developing the strategy of "multiple contents in prime locations,"* and it completed the first M&A (the details are given below) toward realizing the new Alliance Conception. The results of the main activities are as described below.

* To fully leverage the strength of its unique income model of "street-level restaurants in prime locations adjacent to train stations," the Company's strategy is to respond to the needs of a broad range of customers and realize sustainable growth by implementing a variety of contents in the ISOMARU SUISAN model (changing products and provision methods).

1. Format conversion initiatives

The Company conducted format conversions of 26 locations in order to reduce the number of unprofitable locations (such as those in the suburbs), of which a certain number have occurred due to the large number of openings in the past. Within this number, 20 locations were converted from ISOMARU SUISAN to Toriyoshi Shoten. As a result, it seems that while some locations achieved results as expected, overall, the results were less than expected. It is thought that the locations that did not produce results are the candidates for exits in this fiscal period. However, it is considered that the empirical rules obtained through these efforts, including for the parts for which there had been misConceptionions, will constitute important expertise toward improving the accuracy of the "multiple contents in prime locations" strategy. So, on this point, the results can be evaluated as being more significant than merely closing locations.

2. M&A results

In January 2019, the Company decided to acquire the shares of JS*, which mainly manages the Maekawa Suigun izakaya in Kumamoto Prefecture, and to make it a subsidiary (consolidated from March 1, 2019). It has been positioned as the first project in the Alliance Conception, which is the new growth strategy. So it can be said that the Company has made a good start toward increasing the number of locations in regional cities through M&A.

* The results of JS in the most recent fiscal year (FY3/18) were net sales of ¥1,478mn and operating income of ¥141mn from the management of 19 locations.

Future growth strategy

Aiming to accelerate growth from continuous organic growth and the Company's own Alliance Conception

1. SFP Food Alliance Conception

The Company has established the Alliance Conception to respond to a situation in which external factors (such as recruitment difficulties, including of restaurant staff) and internal factors (like the limit on the control range alongside the growth in scale, and the shortage of human resources for middle management) are acting as a drag on growth, and also as a strategy to effectively enter into regional cities. Specifically, in regional cities, it is putting in place a mechanism to support growth through conducting capital tie-ups with companies that manage izakaya and that have an abundance of management expertise and then providing them with the Company's main brands (including ISOMARU SUISAN). For the Company, this mechanism enables it to quickly lock in place a business foundation in regional cities (such as acquiring sites for openings, human resources, and a regional network, and also excellent management-level employees who are competent and ambitious). For its partners, it enables them to add popular brands, such as ISOMARU SUISAN and Toriyoshi Shoten, to serve as a second growth engine (source of earnings), while they continue with their own brands, while also providing them with various scale merits and opportunities to expand scale (such as the nationwide expansion of the partners' brands). Moreover, it also makes possible the sharing of business formats and knowledge between the partners. In other words, it is not merely the addition to the Company's result from an M&A, and its features include that it is ultimately one part of a growth strategy centered on the main brands and that it utilizes the partner's independence and desire for growth. This strategy benefits from 1) popular brands that can be lined up even in the regions, 2) a track record of breaking away from owner companies, 3) and the fact that Company itself had been an acquired in an M&A deal. Therefore, as it is being conducted by the Company, it can be said that it is a model that is sufficiently persuasive.

Entering into regional cities through M&A and franchises is one of the growth axes that the Company has investigated. But the reasons for changing direction at this juncture are thought to be external factors that are proving beneficial for conducting M&A, in addition to responding to the aforementioned environmental changes. It is targeting, for example, managers who have been successful in establishing appealing brands locally but who are having problems in finding successors, and young managers who are struggling to overcome barriers to growth, and it is planning partnerships with around 10 companies in the next 3 years.

2. Medium-term management plan

Alongside the start of the Alliance Conception, the Company has announced a new three-year medium-term management plan. The targets for the plan's final fiscal year (FY2/22) are net sales of ¥59,000mn, ordinary income of ¥4,200mn, and net income of ¥2,500mn. It has positioned the current fiscal period (FY2/20) as a year to build the foundations on which to advance the Alliance Conception, and it plans to fully get on a growth track from the next fiscal period onwards. Also, for organic growth by the Company itself, it is working on various measures, including continuing to open restaurants at prime locations, mainly in the Tokyo metropolitan area, and at the same time, to develop new brands and advance the "multiple contents in prime locations" strategy. So it is depicting a two-layered image of growth, of accelerating growth through the continuous organic growth and the Alliance Conception.

At FISCO, we do not think that the targets are that high of a hurdle because, for example, if the Company partners with companies with sales on a scale of ¥1bn to ¥1.5bn, the same as JS, the first company, then its sales would double from the opening of 3 to 5 ISOMARU SUISAN locations. Based on this premise, we provisionally calculate an expected increase of sales of ¥20bn through partnerships with 10 companies with sales of ¥1bn. Therefore, it seems that the key to success will be how it will gather supporters for the Alliance Conception in the core cities in each region across the country. The more supporters it gathers, the greater we can expect its value as a platform to increase. In addition, for the organic growth of the Company itself, there remains ample room to open locations in the Tokyo metropolitan area, including openings of multiple formats in the same location, and we can expect results to be supported by the "multiple contents in prime locations" strategy, for which a certain level of response is being obtained. Therefore, there has been no change to our view that sustainable growth is possible.

Medium-term management plan

(¥mn)

	FY2/19 results	FY2/20 target	FY2/21 target	FY2/22 target
Net sales	37,751	39,000	48,000	59,000
(Growth rate)	2.5%	3.3%	23.1%	22.9%
Ordinary income	3,221	2,700	3,300	4,200
(Margin)	8.5%	6.9%	6.9%	7.1%
Net income	1,955	1,600	1,950	2,500
(Margin)	5.2%	4.1%	4.1%	4.2%

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

Outlook

Outlook for FY2/20 is for a temporary decrease in profits, although sales will increase
Working to building the foundation on which to advance the Alliance Conception

The Company expects higher sales but lower profits in FY2/20 mainly due to closure of unprofitable locations with a 3.3% increase in net sales YoY to ¥39,000mn, a 17.4% decrease in operating income to ¥2,400mn, a 16.2% decrease in ordinary income to ¥2,700mn, and an 18.2% decrease in profit attributable to owners of parent to ¥1,600mn.

The consolidation of JS, which is the first Alliance Conception project, is expected to contribute to the increase in sales. However, the reason why the sales increase rate will be only moderate is that the Company will work on improvements toward realizing a more robust management structure by curtailing new openings to 7 locations and working to support existing locations, at the same time as actively withdrawing from unprofitable locations. In particular, its policy is to assign new recruits and employees who had worked at locations it has exited from to existing locations, and to conduct measures to improve productivity.

The outlook is for a temporary decrease in profits because of costs relating to the support for existing locations (costs for renovations and repairs) and to exit from unprofitable locations, and also for upfront costs toward accelerating growth in the future (including personnel costs due to the strengthening of recruitment, and upfront costs toward realizing M&A).

Therefore, results will remain stagnated. But it is necessary to be aware that, as previously stated, the Company has positioned the current fiscal period as a year in which to build the foundation on which to advance the growth strategy in the future through both defensive measures (curtailing openings of new locations and strengthening existing locations alongside the exits from unprofitable ones) and an offensive measure (advancing the Alliance Conception).

At FISCO, we understand the level of the Company's forecasts to be its minimum commitment. Also, to advance the Alliance Conception, we evaluate that it decision to first strengthen its own existing locations and maintain a solid earnings foundation to be a rational one, and in this process, we accept as unavoidable that results will remain stagnated. The biggest focal point for the Company will be to create a path that guides success for the Alliance Conception project; this obviously includes the results of the PMI at JS in creating synergies in the integration process, but also ways to disclose more specific results such as acquisition of partner to follow on from JS, which serves as the first Alliance Conception project. We think that this will affect the accuracy and speed toward increasing the number of partners in the future. In particular, the Company is planning to increase the number of locations through alliances in the next 3 years from the current 229 locations to around 470 locations, and it is necessary to be aware that this may become an upside factor for results depending on the speed of this increase and the conditions for the PMI.

FY2/20 forecast

(¥mn)

	FY2/19		FY2/20		Change	
	Results	% of total	Forecast	% of total		Change (%)
Net sales	37,751		39,000		1,248	3.3%
Cost of sales	10,749	28.5%	11,167	28.6%	417	3.9%
Gross profit	27,001	71.5%	27,833	71.4%	831	3.1%
SG&A expenses	24,094	63.8%	25,433	65.2%	1,338	5.6%
Operating income	2,907	7.7%	2,400	6.2%	-507	-17.4%
Ordinary income	3,221	8.5%	2,700	6.9%	-521	-16.2%
Profit attributable to owners of parent	1,955	5.2%	1,600	4.1%	-355	-18.2%

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

Shareholder returns

Focuses on paying stable and continuous dividends
Outlook for FY2/20 is to maintain the annual dividend of ¥26

The Company aims for a stable dividend. It plans to pay a ¥26 annual dividend (¥13 interim, ¥13 year-end) for FY2/19, in line with initial forecast (putting payout ratio at 34.4%). It is targeting ¥26 (¥13 interim, ¥13 year-end) again in FY2/20 (payout ratio at 42.0%).

The Company has also adopted a shareholder gift program. It allocates food coupons that can be used as the Company's restaurants twice a year (covering shareholders with 100 or more shares listed in the shareholder registry at the end of February and the end of August). The gift amount varies depending on the number of shares owned.

Shareholder gift program

Number of shares owned	Shareholder gift coupon (each distribution)
100-499 shares	¥4,000
500-999 shares	¥10,000
1,000 or more shares	¥20,000

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

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