COMPANY RESEARCH AND ANALYSIS REPORT

SFP Holdings Co., Ltd.

3198

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Summary

Earnings down sharply in FY2/21 due to COVID-19 impact Focus on strengthening the income structure and expects to achieve ordinary profitability in FY2/22

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, and Toriyoshi Shoten (chicken specialty restaurants). It has achieved robust profitability and growth thanks to a unique income model that takes maximum advantage of customer draw from prime locations. Also, since FY2/20, it has been developing its own SFP Food Alliance Conception (hereafter, the Alliance Conception). The Company positions this conception as a future growth driver. However, current results have weakened significantly due to the COVID-19 pandemic, and management plans to restrict new restaurant openings and other large investments and strengthen the income structure with cost cutbacks in the near term. As of the end of February 2021, the Company had 227 restaurants (with 14 franchise restaurants), including two subsidiaries* (a total of 35 restaurants) within consolidated scope through the Alliance Conception.

* The Company calls these subsidiaries Food Alliance members (hereafter, Alliance members).

2. FY2/21 results

Consolidated results in FY2/21 were ¥17,428mn in net sales (down 56.7% YoY) and a ¥5,339mn operating loss (vs. ¥2,549mn in operating income in FY2/20). Sales were down sharply and losses occurred at the various income levels due to COVID-19 impact. All restaurant formats posted significantly lower sales because of intermittent suspensions of all restaurants (or some restaurants) and shortened business hours as part of pandemic restrictions. Despite signs of recovery in 3Q with the resumption of normal business, results slowed in 4Q because of a renewed outbreak (third wave). In income too, while the Company worked on lowering SG&A expenses with employee reassignments, adjustments to restaurant costs, and other measures, it still had a large operating loss because of heavy fixed-cost burden (restaurant rent, personnel expenses, etc.) accompanying substantial sales decline. Positive factors that should help in the future, meanwhile, were reinforcement of the income structure through closures of restaurants with large decrease in sales and others and some progress in efforts to capture new demand, such as takeout and delivery services.

3. FY2/22 forecast

In FY2/22 guidance, the Company targets ¥25,000mn in net sales (up 43.4% YoY) and ¥0 operating income and hence anticipates breakeven operating income (and ordinary profitability) on recovery in net sales. While continued shorter operating hours related to issuance of a third state of emergency declaration is likely to weaken 1Q results, the Company depicts a scenario of incremental sales recovery based on resuming normal operations in 2Q. In income, it expects to cover losses with cooperation funds and subsidies for preventing infection spread in 1Q facing difficult conditions and then steadily improve earnings on sales recovery and sustained curtailment of SG&A expenses from 2Q. Additionally, the Company is holding back on new restaurant openings and other large investments for the time being and keeping itself to smaller investments, mainly for format conversion and renovation at existing restaurants.

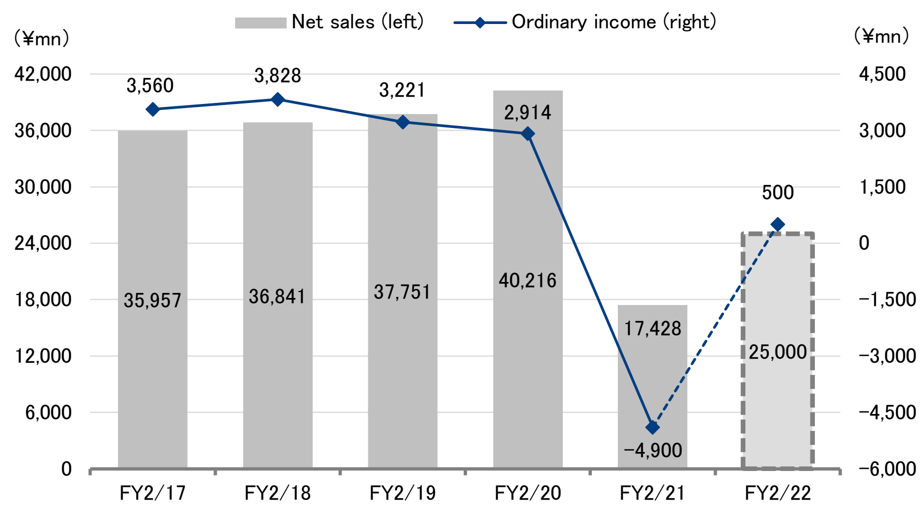
4. Direction

The Company previously disclosed three-year medium-term management plans annually, but this year it has delayed disclosure thus far because of uncertain prospects with the impact of the COVID-19 pandemic. However, it has frozen investments in new restaurants, M&A (including promotion of the Alliance Conception), and other areas and is not making major changes in the direction of pursuing prompt recovery in earnings by strengthening existing restaurants (format conversions and renovations) and improving the income structure. While flexibly and timely making minor adjustments and engaging in trial-and-error initiatives that address changes in the business environment related to the pandemic (new normal), it intends to assess the content and timing of investments aimed at renewed growth. Despite impact on all business formats without exception from pandemic-related activity constraints, FISCO believes that the ISOMARU SUISAN format has not lost its advantages and pursuit of shoring up management structure through closures of unprofitable restaurants and other reforms and adjustment to environment changes are necessary process in returning to a growth trajectory.

Key Points

- Earnings down sharply in FY2/21 due to COVID-19 impact
- Achieved some success by strengthening the income structure through closures of unprofitable restaurants and other initiatives and capturing new demand such as takeout and delivery
- FY2/22 guidance expects restoration of ordinary profitability on recovery in sales and sustained cost curtailment
- Pursuing enhanced income structure in the near term and targeting return to a growth trajectory from FY2/22

Results trends



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

Company profile

Develops popular brands, including ISOMARU SUISAN and Toriyoshi Shoten

1. Business overview

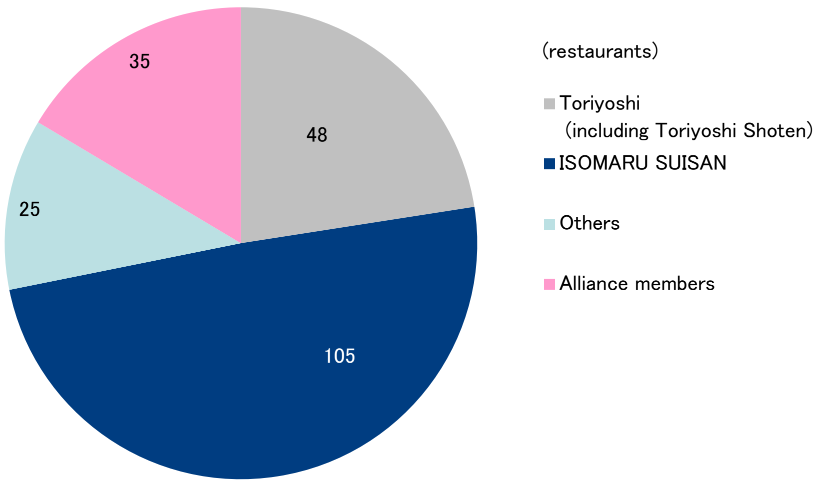
The Company primarily operates seafood izakaya ISOMARU SUISAN, a popular restaurant open 24 hours a day* at locations adjacent to train stations and in commercial districts (street level). In recent years, Toriyoshi Shoten (chicken specialty izakaya), has gained momentum using the same income model as ISOMARU SUISAN as a second brand. In addition, since FY2/20, the Company has been developing its own Alliance Conception. The aim is to expand the network of restaurants in regional cities (provision of brands via the in-company franchise format) through utilizing M&A. Impact from the COVID-19 pandemic is currently affecting the entire industry, and the Company is focused on strengthening the income structure for the time being and aims to respond effectively to prompt recovery and changes in the environment.

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

As of the end of February 2021, the Company had 227 restaurants (including 14 franchise restaurants) including the 2 Alliance members (a total of 35 restaurants). ISOMARU SUISAN is the largest format with 119 locations (including 13 franchise restaurants), and 195 restaurants are concentrated in the Tokyo metropolitan area (including 124 in Tokyo). The Company has established brand presence and expanded the number of restaurants with focused openings in the Tokyo metropolitan area. But recently, it has looked toward opening restaurants in regional cities, including through the Alliance Conception. 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.

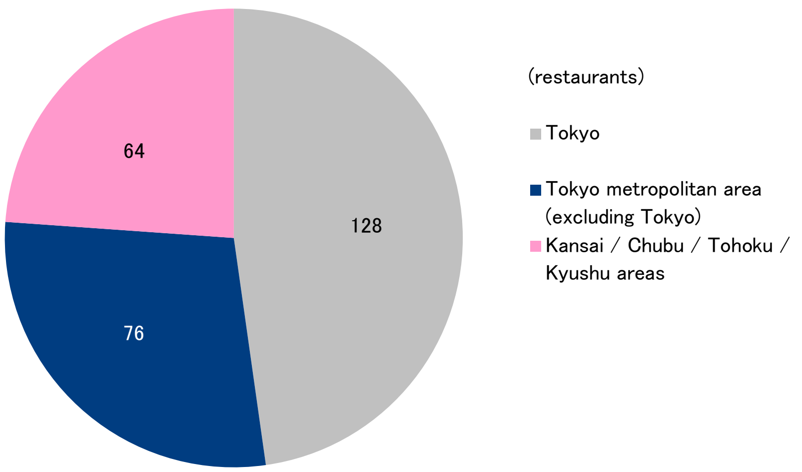
While the Company only has one business segment, the food and beverages segment, it operates in 4 areas according to format: the Toriyoshi business (including Toriyoshi Shoten), the mainstay ISOMARU SUISAN business, other business including new formats, and also from the previous fiscal period, the contributions of the Alliance members have been added as the fourth area. The ISOMARU SUISAN business provides 59.2% of net sales (FY2/21 result).

No. of restaurants by format



Note: excluding franchise restaurants
Source: Prepared by FISCO from the Company's results briefing material

No. of restaurants by area



Note: excluding 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	Further refining the “Omotenashi” hospitality to create new value
Ichigoro	Izakaya where you can enjoy a wide variety of gyoza
Kiduna Sushi	Delicious and inexpensive fresh food.
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 bistros that use carefully selected seafood
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 pubs you will want to visit every day to feel full of vitality the following 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
Torihei Chan	Japanese-style pubs proud of their piping-hot omelets and grilled chicken
Machizushi Torotaku	Restaurant and bar with an extensive line-up of sushi, tempura, and sashimi
ISOMARU SUISAN Shokudo	Restaurant with a wide range of food items, including fresh sashimi meals, seafood rice bowls, grilled fish meals, and “Unagi-no-Okajima” thick eels

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. Company 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 Tokyo metropolitan area have driven a beneficial cycle of lowering opening risk. While shorter business hours and stay-home requests accompanying the COVID-19 pandemic erased some important aspects of the ISOMARU SUISAN business (prime location near the train station, 24-hour operations, etc.), FISCO thinks advantages of the income model itself have not changed significantly.

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). Also, after assessing the environmental changes once the COVID-19 pandemic has settled down (such as changes to consumer behaviors), it is considered that it will be necessary to respond flexibly through fine tuning (model changes), and it can be said that the Company’s true value will be seen in its attitude of pursuing this sort of hypothesis verification-type evolution.

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 it 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*. It began opening Toriyoshi Shoten restaurants, which are the second major growth driver.

* Started ISOMARU SUISAN franchise operations in Kyushu (Fukuoka Prefecture) in June 2017.

The Company started its own Alliance Conception from FY2/20, and it is working to open restaurants in regional cities (provision of brands via the in-company franchise format) through utilizing M&A.

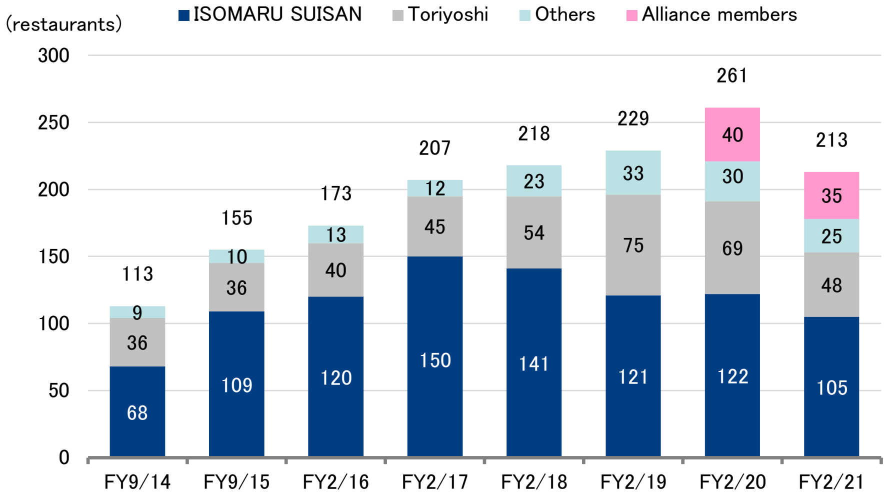
Performance trends

Realized high growth and profitability while also actively increasing the number of locations

1. Past performance

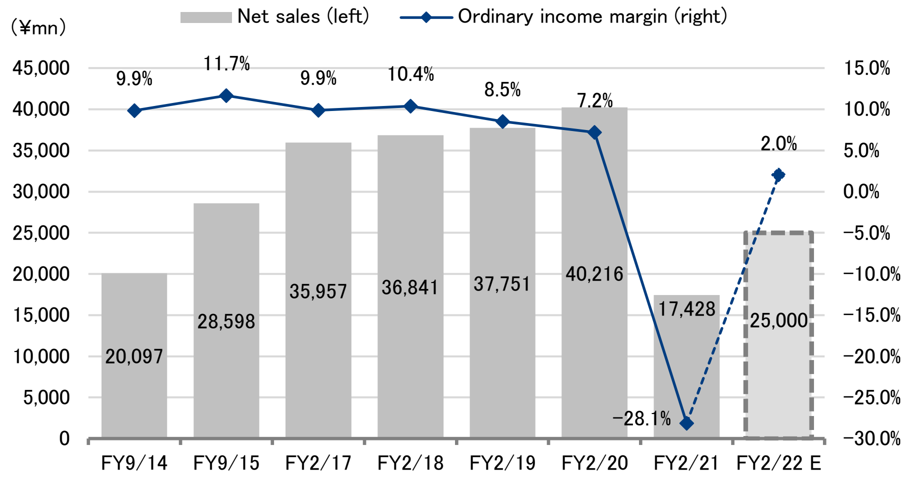
Prior to the COVID-19 pandemic (through FY2/20), increases in the number of restaurants led the Company's growth. Income growth accelerated from FY9/10 when the Company ramped up openings of ISOMARU SUISAN based on a unique income model, and ordinary profit margin improved significantly with the rise 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 reduction of the number of restaurants in suburbs susceptible to economic fluctuations). At the same time, it allocated the excess investment capacity and business resources resulting from this to strengthening existing locations and to developing new business formats. The Company expanded the number of stores and earnings with the launch of the unique SFP Food Alliance Conception in FY2/20. However, it faced major setback in earnings due to COVID-19 impact and conducted large-scale restaurant closures mainly of unprofitable restaurants in FY2/21.

Restaurant number trends (excluding franchise restaurants)



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

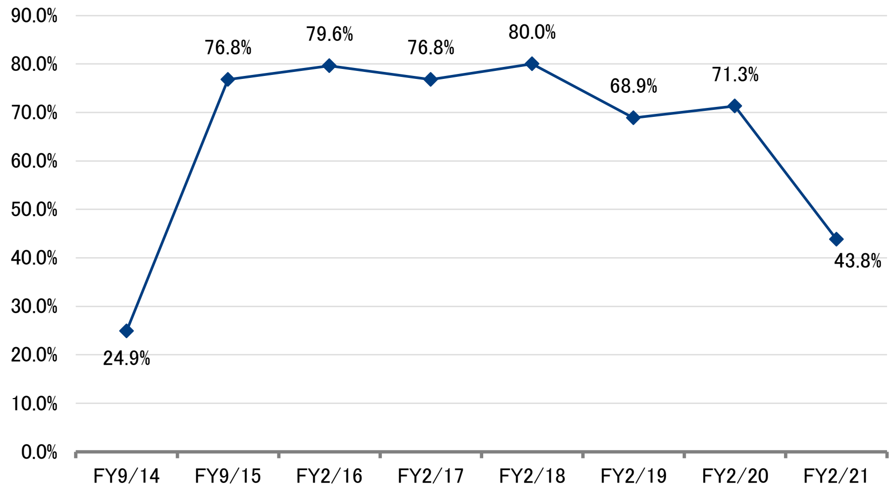
Net sales and ordinary income margin



Note 1: FY2/16 not shown because it was an irregular 5-months period
Note 2: Consolidated results from FY2/17 onwards. Non-consolidated results in and before FY9/15.
Source: Prepared by FISCO from the Company's financial results

In finances, the Company's equity ratio climbed to 76.8% at end of FY9/15 after the public-offering capital increase (about ¥12,758mn) accompanying the TSE-2 market IPO in December 2014 and subsequently stayed above 70%. While the equity ratio dropped in FY2/21 due to booking a net loss due to the impact of COVID-19 and borrowing about ¥9bn in working capital, it is still at about 50% and the Company is sustaining soundness in the financial base.

Equity ratio



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

2. FY2/21 consolidated results

The Company reported FY2/21 consolidated results with ¥17,428mn in net sales (down 56.7% YoY), a ¥5,339mn operating loss (vs. ¥2,549mn in operating income in FY2/20), a ¥4,900mn ordinary loss (vs. ¥2,914mn in ordinary income), and a ¥5,650mn net loss attributable to owners of the parent (vs. ¥1,461mn in net income attributable to owners of the parent). Sales were down sharply and losses occurred at the various income levels due to COVID-19 impact.

All restaurant formats posted significantly lower sales because of intermittent suspensions of all restaurants (or some restaurants) and shortened business hours as part of pandemic restrictions. In particular, sales were down significantly in 1Q on suspension of all restaurants in April and shortened business hours (May) in the first state of emergency declaration and stalled in 2Q on shortened business hours (August) related to the COVID-19 pandemic (second wave). Despite signs of recovery in 3Q with the resumption of normal business, including support from the government's "GoTo Eat campaign," results slowed again in 4Q because of a renewed outbreak (third wave) that caused some suspensions and shorter business hours (Jan-Feb).

Suspension requests and shorter business hours heavily affected mainstay ISOMARU SUISAN because of its income model that relies on 24-hour operations at locations adjacent to train stations and in commercial districts (street level) as strengths. For example, the breakdown of daily business hours is morning (5am-11am), lunch (11am-2pm), idle (2pm-5pm), dinner (5pm-midnight), and night (midnight-5am). Under shorter business hours, these stores suspend morning and night operations and shorten dinner hours to 8pm and thereby only operate at 38% of the typical level in terms of hours. Shortening hours the dinner category, which generated about half of daily sales, had a major impact on sales. Conversely, it could be argued that other time categories offset the impact of business hour restrictions to some extent (since traditional izakaya pubs obtain almost all of their sales at dinnertime).

Looking at the monthly trend in sales from existing restaurants (including restaurants suspending operations; same below), levels were down sharply at just 5.2% of the previous year in April when all restaurants suspended business and 16.1% in May when restaurants operated on shorter business hours (and suspended operations in some cases) and while activity recovered moderately in June and July, sales slowed again in August when the second wave of COIVD-19 expanded due to shorter business hours (and some suspended operations). Sales temporarily improved from September with resumption of normal business and returned to 70% of the previous-year level in October. However, sales slumped again to 26.0% in January and 27.7% in February because of shorter business hours (and some suspended operations) accompanying expansion of the third wave of COVID-19.

The status of restaurant openings and closures is as follows: the total number of restaurants was 227 restaurants (including 14 franchise restaurants) at the end of February 2021 based on new openings of five restaurants that already had contracted in 1Q and closures of 53 unprofitable restaurants during the year, mainly among city-center stores with high fixed costs and restaurants located on the second floors of buildings or higher with large sales declines (Toriyoshi format, etc.). The Company closed 31 restaurants just in 4Q with the aim of improving future earnings.

In income, the Company booked a massive operating loss, despite efforts to reduce SG&A expenses by reassigning personnel, postponing new hires, revising restaurant spending, and taking other steps, due to the heavy burden of fixed costs (restaurant rent, personnel expenses, etc.) amid sharply lower sales. Looking at the quarterly income situation, while earnings reached the breakeven point on a real basis in 3Q when sales temporarily recovered (at 62% of the year-ago level), difficulty covering fixed costs and expansion of restaurant closure costs and other expenses in 4Q weighed on earnings. The Company booked pandemic-related employment adjustment subsidies from the government (about ¥2.4bn) in extraordinary income, and losses caused by the pandemic* (about ¥1.3bn) and fixed asset impairment losses (about ¥1.6bn) in extraordinary losses.

* These losses cover food disposal and rent and personnel expenses for closed stores related to April's closure requests.

In the financial condition, total assets rose 6.8% versus end-FY2/20 to ¥24,535mn, even with decline in fixed assets due to restaurant closures and other factors, the Company secured "cash and deposits" funds with bank loans in response to risk of a prolonged pandemic. Shareholders' equity, meanwhile, dropped 34.4% to ¥10,743mn due to booking a loss attributable to owners of parent and the equity ratio slipped to 43.8% (vs. 71.3% at end-FY20). Nevertheless, the large increase in cash and deposits with interest-bearing debt strongly affected decline in the equity ratio, and this aspect could be understood as a temporary factor until contraction of "cash and deposits" and interest-bearing debt and restoration of normal conditions. While the level of short-term interest-bearing debt rose substantially to ¥9,580mn (vs. ¥137mn at end-FY2/20), since cash and deposits value is even larger at ¥11,628mn and the net D/E ratio* remains negative, financial condition is not a concern. The Company intends to curtail new restaurant openings and other large investments and sustain financial operations with emphasis on liquidity for the time being.

* Calculated as (interest-bearing debt – cash and deposits) ÷ shareholders' equity; cash and deposits value exceeds interest-bearing debt in the Company's case

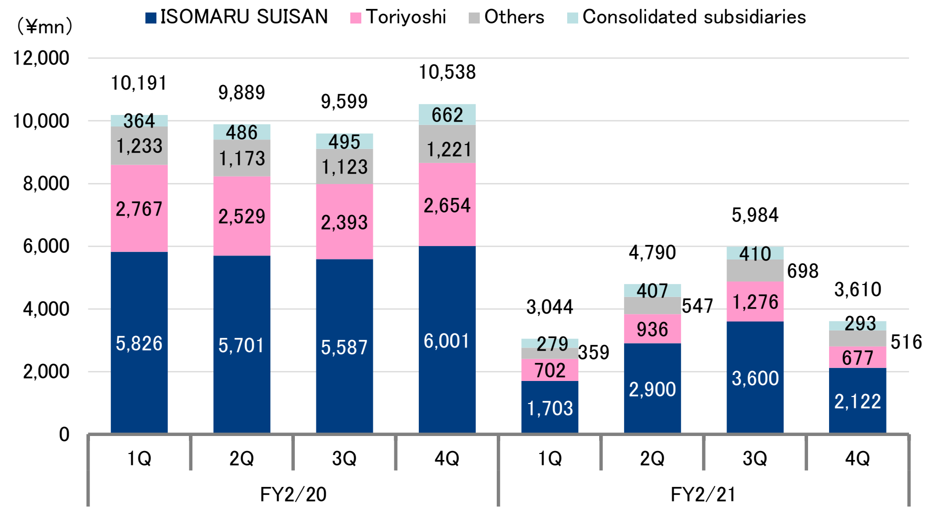
Overview of FY2/21 results

(¥mn)

	FY2/20		FY2/21		Change	
	Results	% of total	Results	% of total	Amount	%
Net sales	40,216		17,428		-22,787	-56.7%
Toriyoshi	10,343	25.7%	3,591	20.6%	-6,752	-65.3%
ISOMARU SUISAN	23,115	57.5%	10,326	59.2%	-12,789	-55.3%
Others	4,750	11.8%	2,120	12.2%	-2,631	-55.4%
Subsidiaries	2,007	5.0%	1,389	8.0%	-618	-30.8%
Cost of sales	11,691	29.1%	4,941	28.4%	-6,750	-57.7%
Gross profit	28,525	70.9%	12,487	71.6%	-16,037	-56.2%
SG&A expenses	25,975	64.6%	17,826	102.3%	-8,148	-31.4%
Operating income (loss)	2,549	6.3%	-5,339	-30.6%	-7,888	-
Ordinary income (loss)	2,914	7.2%	-4,900	-28.1%	-7,814	-
Profit (Loss) attributable to owners of parent	1,461	3.6%	-5,650	-32.4%	-7,111	-

	End of February 2020 Results	End of February 2021 Results	Change	
			Amount	%
Total assets	22,975	24,535	1,559	6.8%
Shareholders' equity	16,371	10,743	-5,627	-34.4%
Equity ratio	71.3%	43.8%	-27.5pt	-

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



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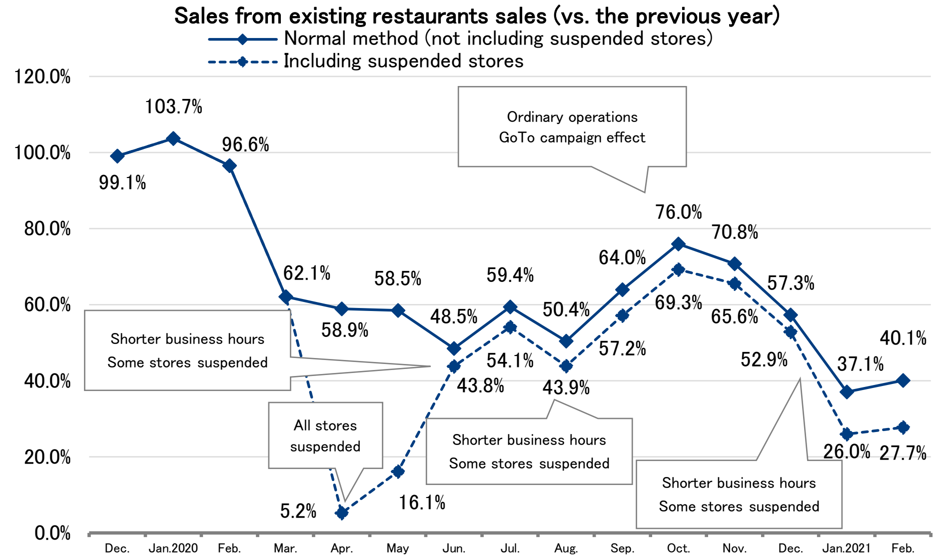

Source: Prepared by FISCO from the Company's results briefing material

Results are reviewed by main business field below.

(1) The Toriyoshi business

Net sales declined 65.3% YoY to ¥3,591mn. This business had 48 restaurants at the end of February 2021 with one restaurant opening for Omotenashi Toriyoshi as a conversion of a Toriyoshi restaurant and closures of 11 Toriyoshi restaurants and 10 Toriyoshi Shoten restaurants.

(2) The ISOMARU business

Net sales declined 55.3% YoY to ¥10,326mn. This business had 119 restaurants at the end of February 2021 (including 13 franchise restaurants) with one ISOMARU SUISAN opening and one opening of a franchise restaurant in Aichi Prefecture and closures of 17 ISOMARU SUISAN restaurants.

(3) Other businesses

Net sales declined 55.4% YoY to ¥2,120mn. This business had 24 restaurants at the end of February 2021 with one restaurant opening each of Kisoba Tamagawa and Machizushi Torotaku, three closures of Ichigoro restaurants, and one restaurant closure each of Go-no-Go, Teppan 200℃, Kiduna Sushi, CASA DEL GUAPO and Hitsuji Hachiban.

(4) Food Alliance members (consolidated subsidiaries)

Net sales were down 30.8% YoY to ¥1,389mn. Joh Smile Restaurant System Inc. opened one ISOMARU SUISAN restaurant and one restaurant each as format conversions of Mura Ichiban, Maekawa Coffee Restaurant, Heiyochin, and Hyakusho Dyaya and six restaurants closures. CLOOC DINING CO., LTD. opened one restaurant each as format conversions of Buta no Sanpo and Bistro ISOMARU KAIKAN and closed one Karaage Center (franchise restaurant). The number of restaurants at the end of February 2021 were 15 Joh Smile restaurants and 21 CLOOC DINING restaurants (including one franchise restaurant).

3. Overview of FY2/21

Our review of FY2/21 in light of the above points is that the Company had a tough year with major setbacks in income results after steady growth previously and massive losses due to COVID-19 impact for the entire year. Pandemic-related curtailment of people movement and shorter business hours significantly affected the Company's business that relied on 24-hour operations at stores located adjacent to train stations and in commercial districts mainly in city centers. Nevertheless, considering the quicker return of customer traffic than at rival restaurants in the same vicinity in 3Q during temporary resumption of normal operations, FISCO thinks the business model itself has not lost its advantages. Despite booking losses for the full year, attention should be given to securing profitability on a real basis, excluding one-time costs for restaurant closures, in 3Q because of scaling back fixed costs and realization of a steep reduction in the breakeven point for the next fiscal year as important factors in assessing future profit recovery potential. Furthermore, we see positive implications from obtaining sufficient cash as preparation for a prolonged pandemic and achieving some success in efforts to capture of new demand with expansion of takeout and delivery services and other initiatives (see below for details).

Efforts to address the COVID-19 pandemic

Achieved some success in efforts to capture new demand by expanding takeout and delivery services and opening food-oriented restaurant formats

1. Offering safe and reliable restaurants

The Company formulated “10 initiatives for our valuable customers” as measures to prevent COVID-19 infections and is rigorously managing restaurant hygiene by having employees wear masks, sanitizing the inside of restaurants with alcohol-based sanitizers, and installing acrylic panels to prevent droplet infection.

2. Loss reduction through menu revisions

The Company realized efficient restaurant operations through reduction of food loss and improved operations with revisions to ISOMARU SUISAN’s grand menu.

3. Expanded takeout and start of delivery service (from May 2020)

The Company substantially expanded the original takeout menu that had been focused on rice-bowl dishes with broiled seafood, hors d’oeuvres, meal boxes, and other items. It also introduced LINE Pokeo takeout service and Uber Eats and Demaecan delivery services at ISOMARU SUISAN and Toriyoshi Shoten. It captured new demand with COVID-19 as the catalyst and appears to have raised these sales to 5-10% of total restaurant sales.

4. Development of delivery-only restaurants (from July 2020)

The Company started development of delivery-only restaurants that utilize kitchens at direct-operation existing restaurants. It launched Unagi-no-Okajima that provides eel at reasonable pricing on July 21 and Karaage Senmonten Kyosho-no-Shokutaku that serves large juicy fried chicken on September 1. These sites accept orders from Uber Eats and Demaecan. The Company smoothly ramped up the sites because they do not involve much extra burden on operations and add sales.

Delivery-only Unagi-no-Okajima and Karaage Senmonten Kyosho-no-Shokutaku are also conducting renewal openings in collaboration (joint site) with existing restaurants. This format gives customers eat-in or take-out choices for menu items previously only available through delivery. Joint-site volume is currently at four restaurants for Karaage Senmonten Kyosho-no-Shokutaku and one Unagi-no-Okajima restaurants.

5. Opening food-oriented restaurant formats (from March 2021)

In FY2/21, the Company updated existing ISOMARU SUISAN restaurants as ISOMARU SUISAN Shokudo restaurants that serve a wide range of menu items, including fresh sashimi meals, seafood rice bowls, and grilled fish meals and opening Machizushi Torotaku restaurants, a Japanese-style sushi pub for the general public with sushi, tempura, and sashimi dishes. Trends in these businesses should be closely monitored as an initiative for formats with stronger emphasis on food.

Outlook

Expecting ordinary profitability in FY2/22 on sales recovery and continued curtailment of costs

1. FY2/22 forecast

The Company expects a 43.4% increase in net sales YoY to ¥25,000mn, ¥0mn in operating income, ¥500mn in ordinary income, and ¥0mn in profit attributable to owners of parent. The Company expects breakeven operating income (and ordinary profitability) driven by recovery in sales.

Despite the prospect of weakness in 1Q due to continuation of shorter business hours related to the third state of emergency declaration, the Company has outlined a scenario for incremental recovery in sales assuming the resumption of normal operations in 2Q. It expects return to about 62% of sales prior to the pandemic (FY2/20; ¥40,216mn).

In income, it expects to cover losses with cooperation funds and subsidies for preventing infection spread in 1Q facing difficult conditions and then steadily improve earnings on sales recovery and sustained curtailment of SG&A expenses from 2Q. These trends should support breakeven operating income (and ordinary profitability). Additionally, the Company is holding back on new restaurant openings and other large investments for the time being and keeping itself to smaller investments, mainly for format conversion and renovation at existing restaurants.

FY2/22 forecast

(¥mn)

	FY2/21		FY2/22		Change	
	Results	% of total	Revised forecast	% of total	Amount	%
Net sales	17,428		25,000		7,571	43.4%
Operating income (loss)	-5,339	-30.6%	0	0.0%	5,339	-
Ordinary income (loss)	-4,900	-28.1%	500	2.0%	5,400	-
Profit (Loss) attributable to owners of parent	-5,650	-32.4%	0	0.0%	5,650	-

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

2. Our outlook

FISCO thinks it is still necessary to follow the impact of COVID-19, but the sales outlook is attainable if the state of COVID-19 settles down and normal business resumes in 2Q as projected by the Company. It also believes that breakeven income at ¥25bn in annual sales should not be difficult considering the 3Q FY2/21 situation when normal business resumed (reaching effectively breakeven at about ¥6bn in net sales) and subsequent exits from unprofitable restaurants (improving the income structure). It is obviously necessary to be aware of high uncertainty in sales because it is still unclear how COVID-19 will proceed going forward. However, even if sales undershoot because of ongoing shortened business hours, earnings shortfall should be limited by additional support funds.

Direction

Strengthening existing restaurants and improving income structure for the time being and assessing the content and timing of investments aimed at renewed growth

1. Direction

The Company previously disclosed three-year medium-term management plans annually, but this year it has delayed disclosure thus far because of uncertain prospects with the impact of the COVID-19 pandemic. However, it has frozen investments in new restaurants, M&A (including promotion of the Alliance Conception*), and other areas and is not making major changes in the direction of pursuing prompt recovery in earnings by strengthening existing restaurants (format conversions and renovations) and improving the income structure. While flexibly and timely making minor adjustments and engaging in trial-and-error initiatives that address changes in the business environment related to the pandemic (new normal), such as expansion of takeout and delivery services, opening restaurants with more emphasis on food (rice dishes, sushi, etc.), and attracting family customers, it intends to assess the content and timing of investments aimed at renewed growth.

* 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.

2. Our focus points

FISCO favorably assesses the direction of shifting to an income structure that generates profits, even if sales do not rebound fully, by pursuing improved income structure and lowering the breakeven point. Despite impact on all business formats without exception from pandemic-related activity constraints, FISCO believes that the ISOMARU SUISAN format has not lost its advantages and pursuit of shoring up management structure through closures of unprofitable restaurants and other reforms and adjustment to environment changes are a necessary process in returning to a growth trajectory. If this is realized, changes in the business environment involving industry reorganization should broaden opportunities, including resumption of the Alliance Conception. The Company might also cultivate next-generation growth drivers from new initiatives addressing changes. Overcoming this phase might even provide the biggest advantage in restoring a growth trend.

Shareholder returns

Postponed dividends in FY2/21 due to profit setback from the COVID-19 pandemic
FY2/22 interim and period-end dividends undecided at this point

The Company postponed the interim and period-end dividends in FY2/21 due to profit setback from the pandemic. In FY2/22, it has not decided interim and period-end dividends at this point because of the lack of clarity. Nevertheless, it intends to implement the shareholder gift program as usual.

FISCO

Disclaimer

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