18-D-0193
June 7, 2018

Highlights of Food Service Companies' Financial Results for Fiscal Year 2017

The following are Japan Credit Rating Agency, Ltd. (JCR)'s perception of the current status and highlights for rating concerning the financial results for the fiscal year 2017 (FY2017) and earnings forecasts for FY2018 of Japan's 5 food service companies: ZENSHO HOLDINGS CO., LTD. ("ZENSHO HD"), SKYLARK CO., LTD, COLOWIDE CO., LTD., ROYAL HOLDINGS Co., Ltd. ("ROYAL HD"), and KISOJI CO., LTD.

1. Industry Trend

According to Japan Food Service Association's "Food Service Industry Market Trends," net sales of food service companies have been increasing year-on-year for 20 months in a row since September 2016 till April 2018 against the background of turnaround of consumption environment thanks to the improved consumer spending and increased number of foreign visitors (Chart 1). Growth of net sales has been above that of the number of stores, which indicates that the existing stores have been faring well. JCR guesses that their store strategies are increasingly more focused on enhancement of existing stores in the face of constrained new store opening due to rise of costs for new store opening and labor shortage and that remodeling of existing stores and infrastructure investments have generated good results. By business format, fast food and family restaurants have been firmly growing, pubs/ *izakaya* Japanese pubs have been declining year-on-year. It is considered that this difference reflects the heightened health consciousness and competition among business formats. The performance has been solid in general, but there is clear difference in the performance, whether it is strong or weak, depending on business formats.

The foodstuff and personnel expenses are on the rise. While foodstuff expenses are affected by a weaker yen and high market price, as an example, prices of US beef and domestically produced rice are staying high, personnel expenses are affected by serious labor shortage. The food service companies are making efforts to secure sufficient manpower through raising hourly wages for temporary employees and spending much money on welfare expenses, but they in general have to raise product prices. Although consumption environment has improved, consumers remain sensitive to price. In cases where consumers judge that the prices do not correctly reflect the quality and services, there is a risk that those consumers will walk away from the stores. Many food service companies have been successful in making the decline in the number of customers smaller, but more careful management of menu/ pricing policies are required of them.

2. Financial Results

While total net sales of 3 major food service companies (ZENSHO HD, SKYLARK, and COLOWIDE) increased year-on-year to 1,184.5 billion yen, total operating income of the 3 companies decreased 7.6% year-on-year to 50 billion yen for FY2017 (Chart 2). Sales in general fared well thanks to new store opening and growth of existing stores, but the increased costs including raw materials and personnel expenses put downward pressure on their operating income. Both ZENSHO HD and SKYLARK increased the revenue, but decreased the operating income due to the increased costs that exceeded the favorable contributions from growth of *gyudon* store format as a result of the overseas store opening and price revisions for ZENSHO HD and from the maintenance of same-store sales even with the reduced business hours for SKYLARK. COLOWIDE increased both its revenue and operating income, supported by full-scale contributions from the subsidiary acquired in the previous fiscal year, although its *izakaya* Japanese pubs stagnated. ROYAL HD managed to increase both revenue and operating income in FY2017 thanks to growth of the Hotel and In-flight Catering businesses, although the Restaurant business roughly remained unchanged from FY2016. KISOJI increased both revenue and operating income thanks to the measures to improve efficiency including shift work and revisions to sales promotion method as well as recovery of existing stores.

The aggregate equity ratio and D/E ratio of the 3 major food service companies in FY2017 resulted in a slight improvement from 25.7% and 2.0x a year earlier to 26.9% and 1.8x, respectively. Although there are companies which recorded impairment losses, such losses remained at a level that can be absorbed by periodic income, and their total equity capital increased to 227.5 billion yen from 216.4 billion yen a year earlier thanks to the increased retained earnings. As their business investments were covered by operating cash flow, their total interest-bearing debt decreased to 412.9 billion yen in FY2017 from 423.3 billion yen a year earlier. It can be said that solid maintenance of solid business results and cash flow generation capacity in general resulted in these good financial ratios and figures, although their total operating income decreased. ZENSHO HD roughly kept in FY2017 the same financial level as in FY2016, despite its acquisition of its own shares. SKYLARK and COLOWIDE both slightly improved their financial structure with accumulation of shareholders' equity and reduction of interest-bearing debt. Both ROYAL HD and KISOJI keep good financial structure.

3. Highlights for Rating

The total net sales of the 3 major companies are expected to increase 6.0% year-on-year to 1,256 billion yen and their total operating income is expected to increase 11.6% year-on-year to 57.9 billion yen for FY2018. ROYAL HD and KISOJI also expect both revenue and operating income to increase for FY2018. All companies assume an increase of costs, but they plan to cover the increasing cost by new store opening and growth of revenue and operating income at the existing stores as well as their strict cost control. JCR therefore will pay attention to the following points.

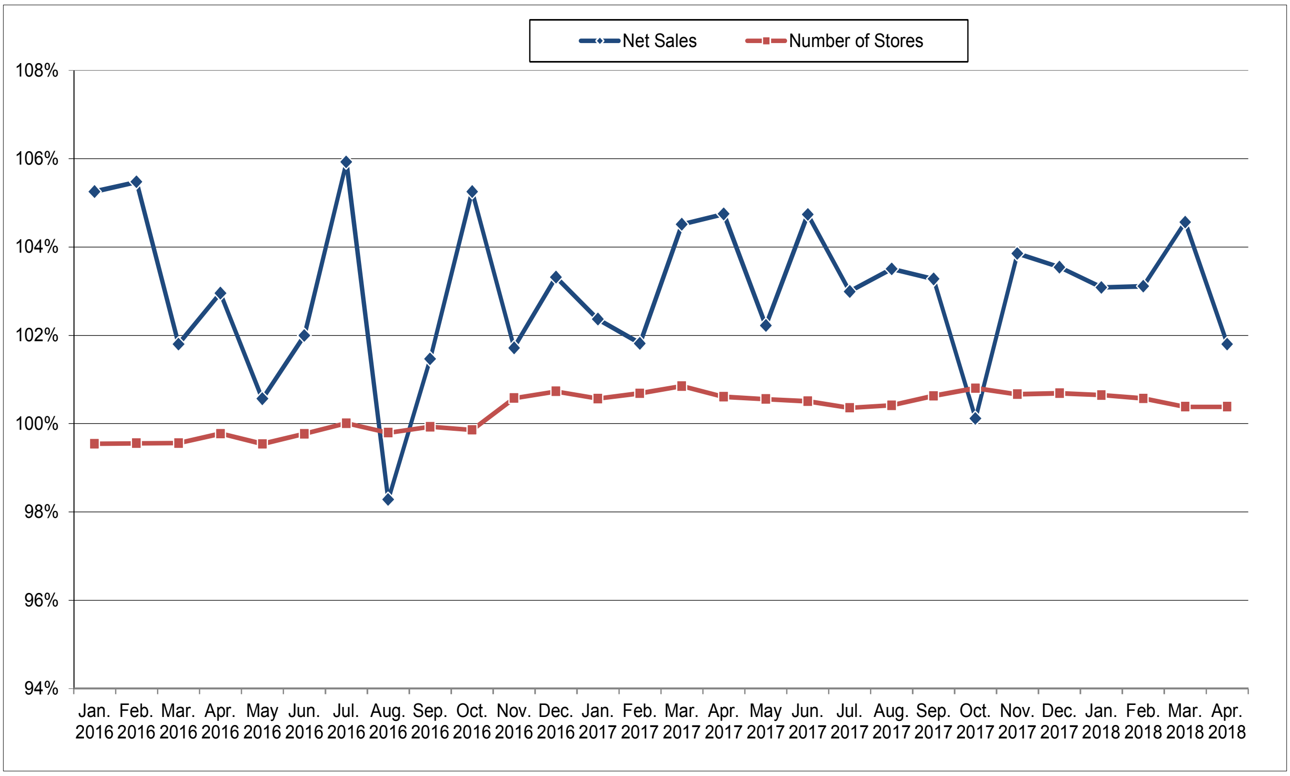
First, JCR will pay attention to the same-store sales. Although consumption environment improved, many food service and home replacement meal companies compete against one another. It is important to brush up quality and services by strengthening menu or methods for offering services and settlement methods in order to meet the diversifying consumer needs. As described above, more careful management of pricing policies is also important, because various kinds of costs are still rising as before. For companies which revised prices in FY2017, JCR is paying attention to whether they can keep both the number of customers and the rise of per-customer spending. JCR will also confirm continued efforts for cost reduction by improvement of cost rate through reduction of loss of ingredients and mixing of menus, control of personnel expenses through investments for labor saving, and improvement of logistics efficiency through revisions to distribution systems. Given that there are companies in which costs for existing stores rise above a level of growth of the same-store sales, JCR considers that it is essential for those companies to expand the business size through new store opening. JCR sees that future differences in the profit growth will depend on whether they can steadily promote store opening through strengthening their store development capability including development of franchise system and diversifying store formats in the situation where the pace of new store opening is constrained.

From a medium-term perspective, overseas business development will be a challenge in order to overcome the domestic aging and falling population issues. There are many cases where companies in general incur losses till they establish a certain store network due to burdens for the infrastructure development and management cost in the overseas business development. Under circumstances where amount of profit can be easily made smaller, a financial strength that can tolerate risks will be required.

JCR sees that the financial structure in FY2018 will be in general at the same level in the FY2017, as their financial structure can easily improve in light of the facts that impairment risk has been reduced thanks to the good performance of existing stores and that their capital expenditures cannot easily increase due to the slowdown of the new store opening. As shown in the case of recent major fast food chain, however, there is a risk that the impairment risk comes to the surface due to rapid worsening of performance at the existing stores and this will lead to impairment of shareholders' equity if a compliance problem occurs. M&A is also expected for growth-oriented companies, and there is a risk that it will cause a financial burden.

Shigenobu Tonomura, Masaki Abe

(Chart 1) Year-on-Year Changes in Net Sales and Number of Stores



Source: Japan Food Service Association “Food Service Industry Market Trends”

(Chart 2) Business Performance of Food Service Companies

(JPY100 mn, %, times)

		FY2015	FY2016	FY2017	FY2018 F
ZENSHO HD (7550)	Net Sales	5,257	5,440	5,791	6,237
	Operating Income	121	188	176	204
	Shareholders' Equity	617	679	675	
	Interest-bearing Debt	1,494	1,481	1,503	
	Equity Ratio	22.2	23.5	22.7	
	Interest-bearing Debt/EBITDA	4.7	3.8	3.9	
	D/E Ratio	2.4	2.2	2.2	
SKYLARK (3197)	Net Sales	3,511	3,545	3,594	3,738
	Operating Income	278	312	281	287
	Shareholders' Equity	1,032	1,142	1,254	
	Interest-bearing Debt	1,545	1,417	1,376	
	Equity Ratio	32.8	35.9	39.3	
	Interest-bearing Debt/EBITDA	3.5	3.0	3.2	
	D/E Ratio	1.5	1.2	1.1	
COLOWIDE (7616)	Net Sales	2,339	2,344	2,459	2,585
	Operating Income	69	41	42	88
	Shareholders' Equity	352	342	346	
	Interest-bearing Debt	1,146	1,334	1,249	
	Equity Ratio	15.7	14.7	15.1	
	Interest-bearing Debt/EBITDA	5.8	7.4	6.5	
	D/E Ratio	3.3	3.9	3.6	
Total	Net Sales	11,108	11,330	11,845	12,560
	Operating Income	468	541	500	579
	Shareholders' Equity	2,001	2,163	2,275	
	Interest-bearing Debt	4,186	4,233	4,129	
	Equity Ratio	24.5	25.7	26.9	
	Interest-bearing Debt/EBITDA	4.4	4.1	4.1	
	D/E Ratio	2.1	2.0	1.8	

		FY2015	FY2016	FY2017	FY2018 F
ROYAL HD (8179)	Net Sales	1,303	1,330	1,356	1,375
	Operating Income	49	52	60	62
	Shareholders' Equity	458	474	510	
	Interest-bearing Debt	251	262	253	
	Equity Ratio	50.4	50.3	52.5	
	Interest-bearing Debt/EBITDA	2.5	2.4	2.2	
	D/E Ratio	0.5	0.6	0.5	
KISOJI (8160)	Net Sales	442	443	444	455
	Operating Income	5	11	22	25
	Shareholders' Equity	287	289	289	
	Interest-bearing Debt	13	13	13	
	Equity Ratio	76.2	76.5	75.2	
	Interest-bearing Debt/EBITDA	0.8	0.6	0.4	
	D/E Ratio	0.0	0.0	0.0	

Source: financial materials of above companies

Notes: Japanese GAAP: ZENSHO HD, ROYAL HD and KISOJI (unconsolidated)
EBITDA (Japanese GAAP) = operating Income + interest and dividend income + depreciation expenses + goodwill amortization
Interest-bearing Debt (Japanese GAAP) = short-term borrowing + long-term borrowing + corporate bonds + lease obligations
IFRS: SKYLARK and COLOWIDE
EBITDA (IFRS) = (gross profit – SG & A expenses) + interest and dividend income + depreciation expenses
Interest-bearing debt (IFRS) = short-term borrowing + long-term borrowing + corporate bonds + other financial liabilities

<Reference>

Issuer: ZENSHO HOLDINGS CO., LTD.

Long-term Issuer Rating: BBB Outlook: Stable

Issuer: ROYAL HOLDINGS Co., Ltd.

Long-term Issuer Rating: BBB Outlook: Positive

Issuer: KISOJI CO., LTD.

Long-term Issuer Rating: BBB- Outlook: Stable

Japan Credit Rating Agency, Ltd.
Jiji Press Building, 5-15-8 Ginza, Chuo-ku, Tokyo 104-0061, Japan
Tel. +81 3 3544 7013, Fax. +81 3 3544 7026