## **News Release**



#### Japan Credit Rating Agency, Ltd.

21-D-0206 June 1, 2021

# Highlights of Food Service Companies' Financial Results for Fiscal Year 2020

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 2020 (FY2020) and earnings forecasts for FY2021 of Japan's 5 food service companies: FOOD & LIFE COMPANIES LTD. (former Sushiro Global Holdings Ltd., "FOOD & LIFE COMPANIES") with fiscal year ending September, SKYLARK HOLDINGS CO., LTD. ("SKYLARK HD"), ROYAL HOLDINGS Co., Ltd. ("ROYAL HD") with fiscal year ending December, ZENSHO HOLDINGS CO., LTD. ("ZENSHO HD"), and KISOJI CO., LTD. ("KISOJI") with fiscal year ending March. (IFRS are applied to FOOD & LIFE COMPANIES and SKYLARK HD)

#### 1. Industry Trend

There are still no signs of the COVID-19 pandemic being contained, and business environment surrounding food service companies is severe. According to Japan Food Service Association's "Food Service Industry Market Trends," net sales, which had been generally steady for the past several years, have remained well below the previous year's level since March 2020 (Chart 1). Customer for food service industries are greatly affected by restrictions on behaviors such as declaration of a state of emergency and requests to refrain from going out. To curb the flow of people, stores have been repeatedly asked to shorten their opening hours, ban the serving of alcoholic beverages, and take other measures to downsize their operations. Although there were temporary signs of recovery due to the calming down of the pandemic situation and the effects of the Go To Eat campaign, sales have been fluctuating due to the repeated re-expansion of the COVID-19 pandemic. The widespread use of vaccines is expected to be a key factor for a turnaround, but it is expected to take some time before the situation is under control. It is important for the companies to continue to implement sales measures such as take-out and delivery services that are in line with the current situation to raise the level of sales, while continuing to improve management efficiency through fixed cost reduction and other measures to further improve their earnings structure.

#### 2. Financial Results

Total net sales of the 5 food service companies in FY2020 were 1,203.8 billion yen (down 13.4% from the previous year), and they posted an operating loss of 22.4 billion yen (compared to an income of 62.1 billion yen for FY2019) (Chart 2). The main reason for the significant decline in both the revenue and profit was that the COVID-19 pandemic impact moved into full swing in FY2020. Looking at individual companies, only two companies, ZENSHO HD and FOOD & LIFE COMPANIES, remained in the black. In addition to their strength in providing daily meals and their high adaptability to ready-made meal, their store format of setting up stores in suburban areas led to solid earnings power. FOOD & LIFE COMPANIES also achieved record net sales, boosted by the opening of new stores even under the COVID-19 pandemic impact. On the other hand, SKYLARK HD, ROYAL HD and KISOJI posted lower revenue and profit, resulting in operating loss, due to negative impact of the characteristics of their store styles, which focus on in-store dining for multiple people. It can be said that the strength of resistance to the COVID-19 pandemic came to the surface depending on the store categories.

On the financial front, the combined equity ratio of the 5 food service companies as of the end of FY2020 was 26.8% (34.4% a year earlier), and DER was 2.0x (1.3x a year earlier). Shareholders' equity decreased to 329.4 billion yen (376.8 billion a year earlier), while interest-bearing debt increased to 673.4 billion yen (505.7 billion yen a year earlier). Looking at the individual companies, 3 companies, SKYLARK HD, ROYAL HD and KISOJI, impaired their shareholders' equity due partly to impairment losses. In addition, their recovery in cash flow generating ability has been slow, and they are increasing their interest-bearing debt in order to secure fund in hand, resulting in a noticeable deterioration in their financial structure. KISOJI was partially affected by the acquisition of DAISYOGUN CO., LTD as a wholly owned subsidiary at the end of March 2021. The deterioration in the financial structure of ZENSHO HD and FOOD & LIFE COMPANIES is mainly due to the increase in assets and liabilities resulting from the adoption of IFRS 16, and there is no particular concern about



the economic realities (ZENSHO HD has adopted IFRS for some of its overseas consolidated subsidiaries).

#### 3. Highlights for Rating

While ROYAL HD and KISOJI said that their earnings forecasts for FY2021 are undecided, ZENSHO HD and FOOD & LIFE COMPANIES have announced their forecasts for an increase in both revenue and profit, and SKYLARK HD has announced its forecast for a decrease in revenue and an increase in profit, returning to profitability. However, as the business environment is expected to remain uncertain, it is necessary to closely monitor the trend of same-store sales.

There is a disparity in the recovery of same-store sales by store category. Fast food has been relatively strong thanks to its ability to respond well to take-out and delivery services, as well as its ability to lower the psychological hurdle of eating and drinking inside restaurants with the small number and short-time usage form. Family restaurants, on the other hand, are easily influenced by the COVID-19 pandemic situation, and the recovery trend has been seesawing. Izakaya (Japanese-style pubs), which mainly cater to demand for banquets, are unlikely to see a full-fledged recovery as people are reluctant to eat and drink in large groups. In order to raise the level of sales, each company is focusing on introducing sales measures that fit the new behavioral patterns of consumers. Typical examples include development of specialized take-out stores to capture the growing demand for ready-made meal, and introduction of in-house delivery services to expand the delivery coverage area. In addition, opportunities for consumers to visit stores are shifting from a stopover to a targeted visit. Increasing the attractiveness of stores by converting to specialty stores and strengthening menu strategies is one of the ways to recover customer numbers. In addition, food service companies are accelerating their investment in labor-saving measures such as digital menu books and self-checkout systems. These initiatives not only improve productivity, but also serve as a reassurance to customers when using the stores as a hygiene measure. From the perspective of ability to attract customers to stores under the COVID-19 pandemic impact, importance of non-contact initiatives is high.

With sales remaining at a low level, cost control remains essential to lower the break-even point. Since the outbreak of COVID-19 pandemic, companies have been reducing fixed costs as an emergency measure by negotiating for lower rents, reducing bonuses, and closing unprofitable stores. In addition, they have also begun to implement drastic structural reforms in a full scale, such as reorganizing their organizations and businesses, and improving management efficiency through solicitation for early voluntary retirement. JCR will pay attention to whether they can transform their earnings structure and generate profits, even though sales will not reach the previous level.

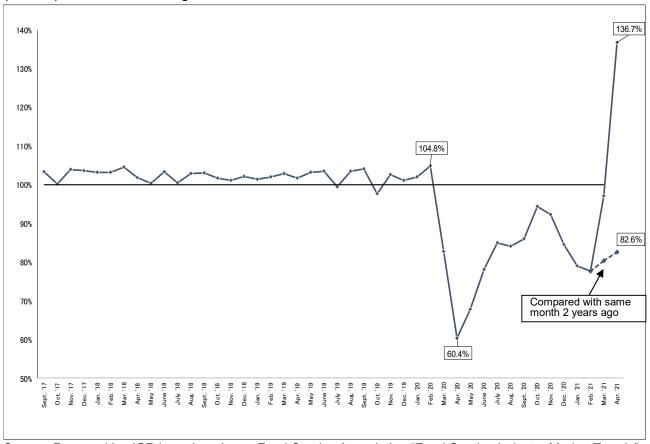
JCR is also closely watching the status of store development. Trade areas are changing drastically due to the penetration of telework and self-restraint in travel. While there are differences among store categories, type of location, such as suburban or urban, also has a significant impact on their ability to attract customers. While companies that prioritize securing their financial strength continue to cut back on new store openings, some companies that have reserve power maintain an aggressive pace of store openings and continue to open stores in central part of Tokyo in anticipation of recovery after end of the COVID-19 pandemic. JCR will confirm the effectiveness of location strategy and earnings capacity of the stores.

From a financial perspective, JCR is focusing on the level of liquidity on hand and status of shareholders' equity. They are taking necessary steps to secure financing needs for the time being by additional financing and extending terms of loans. However, if the COVID-19 pandemic continues a longer period of time, there are concerns that food service companies will delay in getting out of the red and that their interest-bearing debt will swell further. In addition, there is a risk of rapid loss of shareholders' equity due to impairment losses and reversal of deferred tax assets. JCR will closely monitor their business relationships with financial institutions, cash flow situation, and measures to restore their financial base.

Shigenobu Tonomura, Misa Ishizaki



### (Chart 1) Year-on-Year Changes in Net Sales



Source: Prepared by JCR based on Japan Food Service Association "Food Service Industry Market Trends"



## (Chart 2) Business Performance of Food Service Companies

(JPY100 mn, %, times)

		FY2018	FY2019	FY2020	FY2021
ZENSHO HD	Net Sales	6,077	6,304	5,950	6,881
(7550)	Operating Income	188	209	121	225
	Shareholders' Equity	1,022	1,166	1,203	
	Interest-bearing Debt	1,826	1,715	1,933	
	Shareholders' Equity Ratio	27.0	31.9	30.4	
	Interest-bearing Debt/EBITDA	4.5	3.8	5.0	
	D/E Ratio	1.8	1.5	1.6	
SKYLARK HD	Net Sales	3,664	3,754	2,884	2,850
(3197)	Operating Income	229	206	-230	50
	Shareholders' Equity	1,305	1,328	1,138	
	Interest-bearing Debt	1,419	2,585	2,658	
	Shareholders' Equity Ratio	39.5	29.3	25.8	
	Interest-bearing Debt/EBITDA	3.7	3.4	7.4	
	D/E Ratio	1.1	1.9	2.3	
FOOD & LIFE	Net Sales	1,749	1,991	2,050	2,506
COMPANIES	Operating Income	117	145	121	173
(3563)	Shareholders' Equity	408	474	509	
	Interest-bearing Debt	472	421	1,363	
	Shareholders' Equity Ratio	30.9	34.7	21.5	
	Interest-bearing Debt/EBITDA	2.8	2.1	4.8	
	D/E Ratio	1.2	0.9	2.7	
ROYAL HD	Net Sales	1,377	1,406	843	N/A
(8179)	Operating Income	57	46	-193	N/A
	Shareholders' Equity	499	508	209	
	Interest-bearing Debt	290	315	622	
	Shareholders' Equity Ratio	50.1	49.6	19.7	
	Interest-bearing Debt/EBITDA	2.5	2.8	-4.8	
	D/E Ratio	0.6	0.6	3.0	
KISOJI	Net Sales	451	439	311	N/A
(8160)	Operating Income	26	14	-42	N/A
	Shareholders' Equity	298	292	235	
	Interest-bearing Debt	18	19	154	
	Shareholders' Equity Ratio	75.6	76.5	50.9	
	Interest-bearing Debt/EBITDA	0.5	0.7	-5.0	
	D/E Ratio	0.1	0.1	0.7	
Total	Net Sales	13,317	13,894	12,038	N/A
	Operating Income	621	621	-224	N/A
	Shareholders' Equity	3,768	3,768	3,294	
	Interest-bearing Debt	5,057	5,057	6,734	
	Shareholders' Equity Ratio	34.4	34.4	26.8	
	Interest-bearing Debt/EBITDA	3.3	3.3	7.7	
	D/E Ratio	1.3	1.3	2.0	

Source: Prepared by JCR based on financial materials of above companies



#### Notes:

Japanese GAAP: ZENSHO HD, ROYAL HD and KISOJI (applied consolidated accounting from FY2020.)

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: FOOD & LIFE COMPANIES and SKYLARK HD

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

ZENSHO HD's financial indicators are after consideration of equity content of subordinated loan

<Reference>

Issuer: FOOD & LIFE COMPANIES LTD.

Long-term Issuer Rating: A- Outlook: Stable

Issuer: ROYAL HOLDINGS Co., Ltd.

Long-term Issuer Rating: BBB Outlook: Negative

Issuer: ZENSHO HOLDINGS CO., LTD.

Long-term Issuer Rating: BBB Outlook: Positive

Issuer: KISOJI CO., LTD.

Long-term Issuer Rating: BBB Outlook: Negative

#### Japan Credit Rating Agency, Ltd.

Jiji Press Building, 5-15-8 Ginza, Chuo-ku, Tokyo 104-0661, Japan Tel. +81 3 3544 7013, Fax. +81 3 3544 7026

Information herein has been obtained by JCR from the issuers and other sources believed to be accurate and reliable. However, because of the possibility of human or mechanical error as well as other factors, JCR makes no representation or warranty, express or implied, as to accuracy, results, adequacy, timeliness, completeness or merchantability, or fitness for any particular purpose, with respect to any such information, and is not responsible for any errors or omissions, or for results obtained from the use of such information. Under no circumstances will JCR be liable for any special, indirect, incidental or consequential damages of any kind caused by the use of any such information, including but not limited to, lost opportunity or lost money, whether in contract, tort, strict liability or otherwise, and whether such damages are foreseeable or unforesceable. JCR's ratings and credit assessments are statements of JCR's current and comprehensive opinion regarding redemption possibility, etc. of financial obligations assumed by the issuers of financial products, and not statements of opinion regarding any risk other in a redit risk, such as market liquidity risk or price fluctuation risk. JCR's ratings and credit assessments are statements of poinion, and not statements of fact as to credit risk decisions or recommendations regarding decisions to purchase, sell or hold any securities such as individual bonds or commercial paper. The ratings and credit assessments may be changed, suspended or withdrawn as a result of changes in or unavailability of information as well as other factors. JCR receives a rating fee paid by issuers for conducting rating services in principle. JCR retains all rights pertaining to this document, including JCR's rating data. Any reproduction, adaptation, alteration, etc. of this document, including such rating data, sprohibited, whether or not wholly or partly, without prior consent of JCR.

JCR is registered as a "Nationally Recognized Statistical Rating Organization" with the U.S. Securities and Exchange Commission with respect to the following four classes. (1) Financial institutions, brokers and dealers, (2) Insurance Companies, (3) Corporate Issuers, (4) Issuers of government securities, municipal securities and foreign government securities.

JCR publishes its press releases regarding the rating actions both in Japanese and in English on the same day. In case that it takes time to translate rating rationale, JCR may publicize the summary version, which will be replaced by the full translated version within three business days. (Regarding Structured Finance products, JCR only publicize the summary version in English.)

Copyright  ${\Bbb C}$  Japan Credit Rating Agency, Ltd. All rights reserved.