JAPAN FOODS HOLDING LTD.

JAPAN FOODS HOLDING LTD.
(UEN 200722314M)
Incorporated in the Republic of Singapore

Responses to SIAS' questions on Japan Foods' Annual Report FY2018

Japan Foods Holding Ltd. ("**Japan Foods**") has received questions from the Securities Investors Association (Singapore) ("**SIAS**") relating to the Annual Report for FY2018 as part of their initiative to improve the quality of Annual General Meetings ("**AGM**"). Our responses to the questions are as follows:

Question 1

As seen in the Corporate Profile (page 1 of the annual report), the group has 6 self-developed brands and 9 franchised brands. Under the Group's four-pronged strategy (page 2), the development of new concepts (including the launch of self-developed brands) is one of the group's growth pillars.

The Group's own brands include Dutch Baby Café (1 restaurant), Fruit Paradise (2 restaurants), Ginza Kushi-Katsu (1 restaurant), Japanese Gourmet Town (1 restaurant), Aji Tei (no outlet) and the newly launched Curry is Drink (1 restaurant).

According to the revenue breakdown (page 14), Fruit Paradise and Japanese Gourmet Town each contribute to 3.6% of revenue while the largest contributors by brands are Ajisen Ramen (39.5%), Menya Musashi (23.3%) and Osaka Ohsho (11.6%)

(i) Can management help shareholders better understand the positioning of its two largest brands, Ajisen Ramen and Menya Musashi? Do they serve different sub-segments in the ramen market? Is there any risk of cannibalisation if the number of Menya Musashi restaurants increases, especially if the restaurants are located in the same mall/neighbourhood?

(ii) Are there significant differences to the profitability/margins of the group's different brands?

(iii) From the group's self-developed brands, only Fruit Paradise and Japanese Gourmet Town contribute meaningful revenue of 3.6% each to the group. Has the board evaluated if the group's innovative efforts in the development of proprietary brands have been positive over the long term?

(iv) In addition, can management update shareholders on the performance of its first non-Japanese concept restaurant (i.e. New ManLee Bak Kut Teh)? What has management learnt about this new consumer segment after operating a non-Japanese restaurant brand for the past 2-3 years? Are there opportunities for the group to scale up its non-Japanese restaurant segment to a meaningful scale?

Reply:

(i) Japan has a strong ramen culture and its different regions and provinces have their own way of cooking it. The texture of the noodles, the type of soup base and the accompaniments and toppings all depend on the origins of the ramen. Both brands hail from different parts of Japan. Ajisen is from Kumamoto while Menya Musashi is from Tokyo. Both offer different tastes and connoisseurs of ramen appreciate these differences. Rather than cannibalise each other, we believe both brands have contributed to broadening Singapore's ramen offerings.

(ii) Generally there are no significant differences to the margins of the Group's different brands. The key benefit of having so many brands in our portfolio is that we are able to practice restaurant portfolio management in order to maximise overall profitability and margins for the Group.

(iii) The self-developed brands are part of the Group's long term strategy to establish a diversified multi-brand restaurant chain. The self-developed brands complement our franchised brands and have generated positive long term impact for the group. For example, Japanese Gourmet Town is actually a multi-brand restaurant concept where diners can enjoy several of our brands under one roof.

(iv) New ManLee Bak Kut Teh is our first non-Japanese cuisine brand. We launched it because it shares many synergies with our existing brands in the fact that its pork bone soup is similar to the tonkatsu ramen broth. We believe that it remains a viable brand for our Group. Moving forward, we will monitor its performance and continue to explore options for non-Japanese brands.

Question 2

While revenue grew by 3.5% to $67.8 million in FY2018, total employee compensation increased by 8.3% from $17.5 million to $18.9 million in FY2018 (Note 8 - Employee compensation, as shown below).

8 EMPLOYEE COMPENSATION

	THE GROUP	
	2018 $'000	2017 $'000
Wages and salaries	15,658	14,387
Directors' fees	115	119
Employer's contribution to Central Provident Fund	1,100	1,111
Employee performance shares	242	182
Other short-term benefits	1,796	1,665
	18,911	17,464

(Source: Company annual report)

In particular, wages and salaries increased disproportionally faster, by 8.8%, to $15.7 million.

(i) What are the plans by the group to better manage its manpower costs?

In the value add statement, it can be seen that the distribution of value add to employees has stayed high since 2015.

	FY2014 S$'000	FY2015 S$'000	FY2016 S$'000	FY2017 S$'000	FY2018 S$'000
Distribution of total value added:					
To employees					
- Salaries and other staff costs	15,492	17,536	17,336	17,464	18,911
Total value added	28,508	27,610	27,307	28,338	30,273
As a percentage	**54.3%**	**63.5%**	**63.5%**	**61.6%**	**62.5%**

(ii) How much more cost cutting is feasible without affecting the service standards in its restaurants?

(iii) Has management evaluated other innovative ways to reduce the reliance on manpower in both the front line service and the backend operations?

Reply:

Singapore has been facing manpower challenges in the F&B sector. The tight labour supply has resulted in an increase in labour rate. A spike in the foreign worker levy and other measures by MOM to control the foreign worker ratio has also increased overall manpower costs. As such, the Group is constantly working/looking into ways to increase productivity via technology, automation and training. Having a central kitchen helps.

In view of competitive environment, we are not able to elaborate in detail.

Question 3

In Note 31(d) (page 127 – Financial risk management: Capital risk), the group has stated that the primary objective of its capital management "is to safeguard the Group's ability to continue as going concern and to maintain an optimal capital structure as to maximise shareholder value."

In addition, management monitors the group's capital based on its gearing ratio. As seen from the Financial Highlights, the group is in a net cash position for the past five years (and longer) and its net cash position has increased steadily over time.

S$' MILLION	FY2014	FY2015	FY2016	FY2017	FY2018
Financial Ratios Analysis					
Gross profit margin (%)	81.6	83.4	84.2	84.9	85.0
Earnings per share (Singapore cents)	4.21	2.73	2.17	2.68	3.3
Net asset value per share (Singapore cents)	16.93	17.57	17.74	18.29	19.63
Return on assets (%)	19.0	12.4	9.8	11.5	13.3
Return on equity (%)	24.9	15.5	12.2	14.8	17.0
Net debt to equity ratio	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Asset Turnover (Times)	1.7	1.6	1.6	1.6	1.6

(Source: Company annual report)

(i) Can the board elaborate further on the deliberations it has had on the group's capital management approach?

(ii) Given the growth trajectory and the capital needs of the group, does the board consider it opportune to review the capital structure of the group?

(iii) For the benefit of both new and old shareholders, can the board (re)state and clarify its optimal capital structure?

As seen in Note 11 (page 105 – Cash and bank balances), the group's cash and cash equivalent as per the consolidated statement of cash flow have increased to $19.8 million, or nearly 60% of the group's total equity of $34.0 million.

(iv) What is the board's guidance to management on the group's return on equity (ROE)?

(v) Has the board evaluated declaring a special dividend to rightsize the balance sheet and to optimise the capital structure so as to maximise shareholder value?

Reply:

(i) to (iii) The Group is very careful with its cash management and capital deployment. It is important that we have cash on hand as a buffer for emergencies such as epidemic outbreak (SARS) and preserve the cash for investment opportunities either in the areas of M&As, JV or expansion of productive facilities.

Over the years, we have drawn lessons from companies that have become insolvent due to bad credit management and environment.

Rising funding costs would be another reason why we do not wish to take on highly leveraged investments.

(iv) The Board does not dictate/prescribe a target ROE because ROE is just one of the reference points in the performance measurement. We analyse a group of operating ratios to monitor and control the performance of the Group.

(v) We have always believed in rewarding our shareholders and have been doing so since IPO. In May 2017, we raised our target dividend payout ratio to at least 50% of our net profits attributable to shareholders annually. While there will be a need for cash for future growth, there are no plans to declare a special dividend at the moment.

BY ORDER OF THE BOARD

TAKAHASHI KENICHI
Executive Chairman and CEO
20 July 2018

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*This Announcement has been reviewed by the Company's sponsor, CIMB Bank Berhad, Singapore Branch ("**Sponsor**") for compliance with the Singapore Exchange Securities Trading Limited ("**SGX-ST**") Listing Manual Section B: Rules of Catalist ("**Catalist Rules**"). The Sponsor has not independently verified the contents of this Announcement. This Announcement has not been examined or approved by the SGX-ST. The Sponsor and the SGX-ST assume no responsibility for the contents of this Announcement, including the correctness of any of the statements or opinions made or reports contained in this Announcement. The contact person for the Sponsor is Ms Tan Cher Ting, Director, Investment Banking, CIMB Bank Berhad, Singapore Branch, at 50 Raffles Place, #09-01 Singapore Land Tower, Singapore 048623, Telephone: +65 6337 5115.*