



Securities Investors Association (Singapore)

7 Maxwell Road #05-03 MND Building Annexe B Singapore 069111

Tel: (65) 6227 2683 Fax: (65) 6220 6614

Email: admin@sias.org.sg www.sias.org.sg

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Issuer: Japan Foods Holding Ltd.

Security: Japan Foods Holding Ltd.

Meeting details:

Date: 23 July 2018

Time: 10.00 a.m.

Venue: Imagination Room, Level 5, National Library Building, Singapore 188064

Company Description

Japan Foods Holding Ltd., together with its subsidiaries, operates a chain of restaurants in Singapore, Malaysia, and Vietnam. The company operates its restaurants under the Ajisen Ramen, Botejyu, Hanamidori, Kazokutei, Keika Ramen, Menzo Butao, Menya Musashi, New ManLee Bak Kut Teh, Osaka Ohsho, Yonehachi, Dutch Baby Café, Fruit Paradise, Ginza Kushi-Katsu, and Japanese Gourmet Town brand names. It also sub-franchises the Ajisen Ramen restaurants to operators in Malaysia and Vietnam. In addition, the company supplies food ingredients to its sub-franchisees and franchisee. As of March 31, 2017, it operated 50 self-operated restaurants and food court outlets; 13 restaurants through associated companies; and 5 restaurants operated by sub-franchisees. The company was founded in 1997 and is headquartered in Singapore.

(Source: http://www.sgx.com/wps/portal/sgxweb/home/company_disclosure/stockfacts?code=50I)

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?**

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 disproportionately 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?

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?**

A copy of the questions for the Annual Report for the financial year ended 31 March 2017 could be found here:

https://sias.org.sg/index.php?option=com_qaannualreports&view=qareports&filter_company=218

The company's response could be found here:

https://sias.org.sg/media/qareport/company_responce/1507688095_2017.08.01_JFH_Responses-to-SIAS-Questions.pdf