Consolidated Financial Results for the Nine-Month Period Ended September 30, 2019 [Japanese GAAP]

November 14, 2019

Company name: PEPPER FOOD SERVICE Co., Ltd.
Stock Exchange Listing: Tokyo Stock Exchange
Stock code: 3053
URL: http://www.pepper-fs.co.jp
Representative: Kunio Ichinose, Representative Director, President and Chief Executive Officer
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Date of filing of the quarterly Securities Report: November 14, 2019
Scheduled date of commencement of dividend payments: -
Supplementary materials for quarterly financial results: None
Briefing on the quarterly financial results: None

(Millions, rounded down to the nearest million yen)

1. Consolidated Financial Results for the Nine-Month Period Ended September 30, 2019 (from January 1, 2019 to September 30, 2019)

(1) Consolidated Operating Results

(Percentages represent changes from the same period in the previous year)

	Net Sales		Operating Income		Ordinary Income		Net Income Attributable to Shareholders of the Parent Company	
	Millions of yen	%	Millions of yen	%	Millions of yen	%	Millions of yen	%
Nine-month period ended September 30, 2019	51,857	15.2	44	-98.2	19	-99.2	-1,922	—
Nine-month period ended September 30, 2018	45,023	79.7	2,394	42.0	2,430	42.9	1,156	21.8

(Note) Comprehensive Income
Nine-month period ended September 30, 2019 -¥1,862 million (-%)
Nine-month period ended September 30, 2018 ¥1,130 million (18.6%)

	Quarterly Earnings Per Share	Diluted Earnings Per Share
	Yen	Yen
Nine-month period ended September 30, 2019	-91.78	—
Nine-month period ended September 30, 2018	55.75	53.66

(2) Consolidated Financial Position

	Total Assets	Net Assets	Equity Ratio
	Millions of yen	Millions of yen	%
As of September 30, 2019	26,031	1,393	4.8
As of December 31, 2018	25,993	3,745	13.6

(Reference) Shareholders equity
As of September 30, 2019 ¥1,250 million
As of December 31, 2018 ¥3,542 million

2. Dividends

	Annual Dividend				
	End Of First Quarter	End Of Second Quarter	End Of Third Quarter	Year-End	Annual
	Yen	Yen	Yen	Yen	Yen
Fiscal year ended December 31, 2018	—	15.00	—	15.00	30.00
Fiscal year ending December 31, 2019	—	15.00			
Fiscal year ending December 31, 2019 (Forecast)			—	0.00	15.00

(Note) Revision of dividend forecast from the latest announcement: Yes

3. Consolidated Financial Forecasts for the Fiscal Year Ending December 31, 2019 (from January 1, 2019 to December 31, 2019)

(Percentages indicate the net change in comparison with the previous year for full year figures)

	Net Sales		Operating Income		Ordinary Income		Profit Attributable to Shareholders of the Parent Company		Net Earnings Per Share
	Millions of yen	%	Millions of yen	%	Millions of yen	%	Millions of yen	%	Yen
Full Year	66,536	4.8	-731	—	-731	—	-2,503		-119.46

(Note) Changes from the latest consolidated forecasts: Yes

* Notes

(1) Changes in important subsidiaries during this consolidated cumulative quarter (changes in the scope of consolidation): None

(2) Application of specific accounting treatments for preparation of the quarterly consolidated financial statements: None

(3) Changes in accounting policies, changes in accounting estimates, and restatements

1) Changes in accounting policies associated with the revision of accounting standards : None
2) Changes in accounting policies other than those in 1) above : Yes
3) Changes in accounting estimates : Yes
4) Restatements : None

(4) Number of shares issued and outstanding (common stock)

1) Number of shares issued and outstanding (including treasury stocks) at end of period	Third quarter ended September 30, 2019	21,070,800 shares	Fiscal year ended December 31, 2018	20,802,800 shares
2) Number of treasury stocks at end of period	Third quarter ended September 30, 2019	220 shares	Fiscal year ended December 31, 2018	220 shares
3) Average number of shares issued and outstanding during the period	Nine months ended September 30, 2019	20,951,221 shares	Nine months ended September 30, 2018	20,737,206 shares

* These consolidated financial results for the quarter fall outside the scope of quarterly review by certified public accountants and auditing firms.

* Description of appropriate use of business forecasts; other special matters

1. The forecasts for results of operations in this report are based on information currently available to PEPPER FOOD SERVICE Co., Ltd. and assumptions determined to be reasonable, and actual results may differ significantly from the forecasts due to various factors.
2. Previously, the monetary values of all items recorded in the quarterly consolidated financial statements of PEPPER FOOD SERVICE Co., Ltd. were stated in thousands of yen, but we modified them by stating those in millions-of-yen units from the first quarter of the current consolidated accounting period and the first quarter of the current consolidated cumulative period. Moreover, to facilitate comparison, the previous consolidated accounting period and the third quarter of the previous consolidated accounting period are also stated in units of one million yen.

○ Index of Supporting Data

1. Qualitative Information on Consolidated Final Results

(1) Explanation of Business Performance

During the first nine months of the current fiscal year, the Japanese economy showed a moderate recovery due to improvements in corporate earnings and employment. However, factors such as prolonged trade friction between China and the United States and the deterioration of relations between Japan and South Korea due to strengthening of export controls have brought about the risk of a decline in consumer sentiment, and the future of the economy remains unclear.

In the restaurant industry, in addition to a strong rise in consumers' preference to save, the increase of personnel expenses and logistics expenses due to the labor shortage, the rise in raw material expenses and also poor weather such as a long rainy season and large typhoons have affected customer movements, and the situation remains severe.

Under such circumstances, according to the basic precept of our group, "to enjoy rapid growth and become a local, public institution that acts in all good faith, with a sense of humility," we worked to expand our business with the goal of opening 25 new Pepper Lunch restaurants and 210 new Ikinari! Steak restaurants, but as stores opened, sales of existing stores decreased compared to our plan due to the impact of factors such as competition between Ikinari! Steak restaurants in some regions. In response to this, the plan for new Ikinari! Steak stores was changed to 115 stores, and focus was placed on measures to increase sales of existing stores, but the impact of competition between the Company's own brands could not be dispelled, and sales of existing stores decreased significantly. As a result of consideration aimed at eliminating competition between the Company's own brands, the Company decided to close 44 Ikinari! Steak stores, and recorded extraordinary losses.

Furthermore, there were also stores that were forced to suspend business or reduce business hours due to the impact of large typhoons.

As a result, net sales for the first nine months of the current fiscal year were ¥51,857 million (an increase of 15.2% over the same period of the previous year), operating income was ¥44 million (a decrease of 98.2% from the same period of the previous year), ordinary income was ¥19 million (a decrease of 99.2% from the same period of the previous year), and net loss attributable to shareholders of the parent company was ¥1,922 million (net income attributable to shareholders of the parent company was ¥1,156 million in the same period of the previous year).

Performance by segment is as follows:

(i) Pepper Lunch Business

In the Pepper lunch business, the "25th Anniversary Win A Trip to Taiwan" (July 12 – September 5) campaign was conducted to commemorate the 25th anniversary of Pepper Lunch in July, and the first Pepper Lunch store was opened in Houston, Texas in August. Furthermore, we expanded the number of stores supported by the Uber Eats home delivery service to 19.

The Pepper Lunch Business overseas had sales of ¥309 million (an increase of 10.3% over the same period of the previous year) due to the sale of equipment, etc. associated with the launch of new stores and royalty revenue.

As a result, net sales for the first nine months of the current fiscal year were ¥6,473 million (an increase of 15.0% over the same period of the previous year), and segment income was ¥937 million (a decrease of 6.5% from the same period of the previous year). In addition, the opening of 64 new stores (40 of which are located overseas) brought the total number of Pepper Lunch restaurants to 505.

(ii) Restaurant Business

In the Restaurant Business, we have been working to improve sales and profits in existing stores through initiatives such as brushing up main products and introducing seasonal products on the menu in individual stores to promote various business lines such as *Sumiyaki Steak Kuni* in the steak line, *Kodawari Tonkatu Katsukitei* in the pork cutlet line, and *Gyutan Sendai Natori* in the tender beef line. In addition, the Akasaka store of Sumiyaki Steak Kuni was closed and the Akasaka store of OYSTER+STEAK was opened in August.

However, net sales for the first nine months of the current fiscal year were ¥1,006 million (a decrease of 12.1% over the same period of the previous year), and segment income was ¥37 million (a decrease of 55.1% from the same period of the previous year). In addition, the total number of restaurants in the Restaurant Business is now 14.

(iii) Ikinari! Steak Business

The Ikinari! Steak Business opened a store at the *TV Asahi Roppongi Hills Summer Festival SUMMER STATION* summer festival event held in Roppongi Hills in July (July 13 – August 25), and also implemented a campaign in a movie tie-up with *Fast & Furious Presents: Hobbs & Shaw* (July 12 – August 8). Furthermore, in addition to replacing the high tables and high chairs with low tables and low chairs in each store, the lunch menu limited to weekdays was provided on weekends and holidays as *Happy Holiday Lunch*. In addition, we held an *Angus Beef Fair* (August 8 – August 22) that provides more value the more you eat, 10X bonus money charge for meat on August 29 (Meat Day), and the *Ikinari! Steak Autumn App Scratch Festival* (September 25 – October 17) offering total prizes of ¥10 million in September.

As a result, net sales for the first nine months of the current fiscal year were ¥44,222 million (an increase of 16.0% over the same period of the previous year) due to the launch of new stores, but segment income was ¥1,758 million (a decrease of 51.9% from the same period of the previous year) due to the impact of competition between Ikinari! Steak stores in some regions. In addition, the opening of 99 new stores (1 of which is located overseas) brought the total number of Ikinari! Steak restaurants to 484.

(iv) Product Sales Business

In the Product Sales Business, sales were conducted via major Internet vendors for products such as *Tonkatsu Sauce*, *Frozen Pepper Rice*, *Frozen Hamburg Steaks*, and *Ikinari! Steak Sets* that can be enjoyed in the home. Furthermore, *Ikinari! Yakisoba* was launched in supermarkets and convenience stores nationwide (starting August 5) as a collaboration product with Toyo Suisan Kaisha, Ltd. in August.

As a result, net sales for the first nine months of the current fiscal year including royalty revenue from Ikinari! Steak collaboration products were ¥155 million (an increase of 13.7% over the same period of the previous year), and segment income was ¥20 million (an increase of 44.0% from the same period of the previous year).

(2) Explanation of Financial Position

At the end of the first nine months of the current fiscal year, total assets were ¥26,031 million, up ¥38 million from the end of the previous fiscal year. This was primarily due to a decrease of ¥1,178 million in cash and cash equivalents, a decrease of ¥814 million in trade accounts receivable, an increase of ¥1,066 million in buildings and structures, net, an increase of ¥245 million in lease deposits receivable, and an increase of ¥621 million in deferred tax assets (investments and other assets).

Total liabilities were ¥24,638 million, up ¥2,390 million from the end of the previous year. This was mainly due to a decrease of ¥831 million in accounts payable - other, a decrease of ¥1,249 million in accrued corporate tax payable, a decrease of ¥406 million in allowances for business structure improvements, and an increase of ¥4,082 million in loans payable.

Net assets were ¥1,393 million, down ¥2,352 million from the end of the previous fiscal year. This was largely due to an increase of ¥1,922 million in net loss attributable to shareholders of the parent company and ¥627 million in surplus distributed as dividends. Retained earnings decreased by ¥2,550 million, and share capital and legal capital surplus increased by ¥99 million respectively due to the exercise of stock acquisition rights. Additionally, the capital equity ratio decreased by 8.8 points from the end of the previous fiscal year to 4.8%.

(3) Explanation for Future Projections such as Consolidated Earnings Forecast

See the “Notice of Revision of Earnings Forecast and Revision of Dividend Forecast (No Dividend), and Recording of Extraordinary Losses” dated November 14, 2019.

2. Quarterly Consolidated Financial Statements and Important Notes

(1) Quarterly Consolidated Financial Position Statement

(Unit: millions of yen)

	Prior Fiscal Year (ended December 31, 2018)	First Nine Months (ended September 30, 2019)
Assets		
Current assets		
Cash and cash equivalents	6,732	5,554
Trade accounts receivable	2,838	2,023
Merchandise	456	377
Supplies	186	154
Other	2,288	1,661
Allowance for doubtful accounts	-0	-4
Total current assets	12,502	9,767
Non-current assets		
Tangible fixed assets		
Buildings and structures	10,107	11,910
Accumulated depreciation	-1,806	-2,544
Buildings and structures, net	8,300	9,366
Other	2,088	2,716
Accumulated depreciation	-984	-1,153
Other, net	1,103	1,562
Total tangible fixed assets	9,403	10,929
Intangible assets	72	106
Investments and other assets		
Lease deposits receivable	2,750	2,995
Other	1,274	2,243
Allowance for doubtful accounts	-11	-11
Total investments and other assets	4,013	5,228
Total non-current assets	13,490	16,263
Total assets	25,993	26,031

(Unit: millions of yen)

	Prior Fiscal Year (ended December 31, 2018)	First Nine Months (ended September 30, 2019)
Liabilities		
Current liabilities		
Accounts payable	7,097	6,633
Current portion of long-term loans payable	2,270	3,455
Accounts payable-other	2,043	1,212
Income taxes payable	1,513	264
Deposit liabilities	1,445	2,403
Provision for bonuses	—	149
Asset retirement obligations	0	134
Provision for business structure improvement	331	724
Other	1,401	995
Total current liabilities	16,104	15,973
Non-current liabilities		
Long-term loans payable	2,931	5,828
Deposit liabilities	1,363	1,544
Asset retirement obligations	644	848
Provision for business structure improvement	1,187	388
Other	15	55
Noncurrent liabilities	6,142	8,664
Total liabilities	22,247	24,638
Net assets		
Shareholders' equity		
Share capital	1,532	1,631
Capital surplus	813	912
Retained earnings	1,210	-1,340
Treasury shares	-0	-0
Total shareholders' equity	3,556	1,203
Accumulated other comprehensive income		
Valuation difference on available-for-sale securities	-1	-2
Deferred gains or losses on hedges	—	-27
Foreign currency translation adjustment	-11	76
Total accumulated other comprehensive income	-13	47
Stock options	203	142
Total net assets	3,745	1,393
TOTAL LIABILITIES AND NET ASSETS	25,993	26,031

(2) Quarterly Consolidated Profit-and-Loss Statement and Quarterly Consolidated Statement of Comprehensive Income

(Quarterly Consolidated Profit-and Loss-Statement)

(For the Nine-month Period Ended September 30)

(Millions of yen)

	For the nine-month period ended September 30, 2018 (January 1, 2018 to September 30, 2018)	For the nine-month period ended September 30, 2019 (January 1, 2019 to September 30, 2019)
Net sales	45,023	51,857
Cost of sales	25,797	30,555
GP from sales	19,225	21,302
Selling, general and administrative expenses	16,830	21,257
Operating income	2,394	44
Non-operating income		
Interest income	1	6
Dividend income	0	0
Sponsorship income	13	26
Prepaid card balances	27	48
Foreign exchange gains	30	—
Other	11	31
Total non-operating income	83	112
Non-operating expenses		
Interest expenses	18	26
Foreign exchange losses	—	90
Share issuance cost	7	—
Other	21	21
Total non-operating expenses	47	137
Ordinary income	2,430	19
Extraordinary income		
Gain on sales of non-current assets	22	8
Gain on reversal of share acquisition rights	0	52
Total extraordinary income	22	60
Extraordinary losses		
Loss on disposals of non-current assets	2	12
Impairment losses	76	1,791
Provision for business structure improvement	—	128
Other	—	1
Total extraordinary losses	79	1,934
Pre-tax quarterly net income (loss)	2,374	-1,854
Income taxes-current	1,423	691
Income taxes-deferred	-205	-622
Total income tax	1,218	68
Quarterly net income (loss)	1,156	-1,922
Net income (net loss) attributable to shareholders of the parent company	1,156	-1,922

(Quarterly Consolidated Statement of Comprehensive Income)

(For the Nine-month Period Ended September 30)

(Millions of yen)

	For the nine-month period ended September 30, 2018 (January 1, 2018 to September 30, 2018)	For the nine-month period ended September 30, 2019 (January 1, 2019 to September 30, 2019)
Quarterly net income (loss)	1,156	-1,922
Other comprehensive income		
Valuation difference on available-for-sale securities	-1	-1
Deferred gains or losses on hedges	—	-27
Foreign currency translation adjustment	-24	88

Total other comprehensive income	-25	60
Quarterly comprehensive income	1,130	-1,862
(Breakdown)		
Comprehensive income for the period attributable to shareholders of the parent	1,130	-1,862

(3) Important Notes on Quarterly Consolidated Financial Statements

(Notes on the Going Concern Assumption)

Not applicable.

(Notes When There Have Been Significant Changes in the Amount of Shareholders' Equity)

I. For the nine-month period ended September 30, 2018 (January 1, 2018 to September 30, 2018)

Dividends Paid

(Resolution)	Class of Stock	Total Amount Of Dividends (millions of yen)	Dividends Per Share (Yen)	Date of Record	Payment Date	Dividend Source
March 29, 2018 General Shareholders' Meeting	Common Stock	309	15.00	December 31, 2017	March 30, 2018	Retained earnings
July 30, 2018 Board of Directors meeting	Common stock	311	15.00	June 30, 2018	September 7, 2018	Retained earnings

II. For the nine-month period ended September 30, 2019 (January 1, 2019 to September 30, 2019)

Dividends Paid

(Resolution)	Class of Stock	Total Amount Of Dividends (millions of yen)	Dividends Per Share (Yen)	Date of Record	Payment Date	Dividend Source
March 28, 2019 General Shareholders' Meeting	Common stock	312	15.00	December 31, 2018	March 29, 2019	Retained earnings
August 9, 2019 Board of Directors meeting	Common stock	315	15.00	June 30, 2019	September 6, 2019	Retained earnings

(Changes in Accounting Estimates and Changes in Accounting Policies that are Difficult to Distinguish from Changes in Accounting Estimates)

(Changes in depreciation methods; changes in the number of years of useful life; changes in estimates of asset retirement obligations)

In the past, we used the declining balance method to depreciate key tangible fixed assets, but as of the consolidated cumulative first quarter we have changed to the straight-line method.

This change in accounting policy has been triggered by the creation of long-term stability in our business environment, as we have determined an increase in the demand for our business lines thanks to changing consumer preferences. This has allowed us to review our store strategy and open significantly more restaurants, while at the same time withdrawing from fewer. In light of these internal and external environmental changes, we examined the consumption pattern of economic benefits related to store facilities, which constitute our main assets. The result of these examinations led us to expect that our assets would be used in a stable manner over a long period of time, with equal consumption over the course of their useful lives; thus we decided to change to the straight-line method of depreciation, as we believe it better reflects our consumption patterns.

Furthermore, the useful life for conventional store facilities, etc. was primarily based on the number of years stipulated under the Corporate Tax Law, but with the change in depreciation method we are reviewing the number of years of an asset's useful life with effect from the consolidated cumulative first quarter. As a result, we have changed the useful life of buildings and structures such as store facilities—which was 18 years in the majority of cases—to 12 years in light of the estimated period of economic viability given the number of years that the store is expected to survive in operation.

In conjunction with that, we have also changed our estimates regarding the period of time before our store-related asset retirement obligations need to be fulfilled in order to take account of the number of years that a store is expected to survive in operation; note that these obligations are recorded as the obligation to restore a property to its original condition in line with store real estate lease contracts.

With the changes above, operating income, ordinary income, and pre-tax income for the first nine months of the current fiscal year have each increased by ¥276 million compared to calculations under the previous depreciation method.

(Changes in Estimates of Business Structure Improvement Allowances, etc.)

The Company recorded reasonable estimates in the previous consolidated fiscal year for anticipated losses to be incurred in business structure improvements for consolidated subsidiaries. These mainly contained any lease payments that could not be canceled and that we did not expect to be able to recover through sales or sub-leasing, etc., i.e., payments stipulated in building lease agreements connected with unprofitable stores and stores scheduled for closure. Subsequently, we revised our accounting estimates as we obtained new information thanks to progress made in business structure improvements, through negotiations with landlords who had signed building lease agreements, etc., which allowed us to calculate more accurate estimates. In conjunction with this, the difference between the earlier estimate and this estimate was included as a provision for business structure improvement, and quarterly net income before taxes increased by ¥533 million in the first nine months of the current fiscal year.

The Company has decided to close 44 stores to alleviate competition between Ikinari! Steak stores that is occurring in certain regions of Japan. In conjunction with this, we expect to incur losses such as penalties for the termination of building lease agreements for stores being closed. In the first nine months of the current fiscal year, the Company has included ¥661 million that can be rationally expected to arise in future losses in provision for business structure improvement, and pre-tax quarterly net income has been reduced by the same amount. As a result, the ¥128 million difference between the provision and reversal during the nine-month period ended September 30, 2019 has been recorded under extraordinary losses as a provision for business structure improvement.

(Additional Information)

(Application of “Partial Amendments to Accounting Standard for Tax Effect Accounting”)

(Application of “Partial Amendments to Accounting Standard for Tax Effect Accounting”)

“Partial Amendments to Accounting Standard for Tax Effect Accounting” (ASBJ Statement No. 28; February 16, 2018) have been applied since the start of the first quarter of the current fiscal year. Deferred tax assets are shown under “Investments and Other Assets,” while deferred tax liabilities are shown under “Non-current Liabilities.”

(Segment Information, etc.)

[Segment Information]

I. The previous consolidated cumulative third quarter (from January 1, 2018 to September 30, 2018)

1. Information on Sales and Profit/Loss for Each Reporting Segment

(Unit: millions of yen)

	Reporting Segments				Total	Adjustments (Note 1)	Amount recorded in Quarterly Consolidated Profit-and-Loss Statements (Note 2)
	Pepper Lunch	Restaurants	Ikinari! Steak	Products			
Sales Sales to External Customers	5,628	1,144	38,113	136	45,023	―	45,023
Total	5,628	1,144	38,113	136	45,023		―
Segment Profit	1,002	82	3,657	14	4,757	-2,362	2,394

(Note) 1. A segment profit adjustment of minus ¥2,362 million was recorded as corporate expenses not allocated to each segment. Such expenses are mostly general administrative expenses not attributable to reporting segments.

2. Adjustment is made to operating income reported in the consolidated quarterly statement of income.

2. Information on Impairment Losses from Non-Current Assets and Goodwill for Each Reporting Segment

(Unit: millions of yen)

	Pepper Lunch	Restaurants	Ikinari! Steak	Products	Total	Amount recorded in Quarterly Consolidated Financial Statements
Impairment loss	34	―	42	―	76	76

II. For the nine-month period ended September 30, 2019 (January 1, 2019 to September 30, 2019)

1. Information on Sales and Profit/Loss for Each Reporting Segment

(Unit: millions of yen)

	Reporting Segments				Total	adjustment amount (Note 1)	Amount recorded in Quarterly Consolidated Profit-and-Loss Statements (Note 2)
	Pepper Lunch	Restaurants	Ikinari! Steak	Products			
Sales Sales to External Customers	6,473	1,006	44,222	155	51,857	―	51,857
Total	6,473	1,006	44,222	155	51,857	―	51,857
segment profit	937	37	1,758	20	2,754	-2,710	44

(Note) 1. A segment profit adjustment of minus ¥2,710 million was recorded as corporate expenses not allocated to each segment. Such expenses are mostly general administrative expenses not attributable to reporting segments.

2. Adjustment is made to operating income reported in the consolidated quarterly statement of income.

2. Information on Impairment Losses from Non-Current Assets and Goodwill for Each Reporting Segment

(Unit: millions of yen)

	Pepper Lunch	Restaurants	Ikinari! Steak	Products	Total	Amount recorded in Quarterly Consolidated Financial Statements
Impairment loss	-	8	1,783	―	1,791	1,791

3. Other

Significant Subsequent Events Related to the Going Concern Assumption

Not applicable.