

Kotobuki Spirits Co., Ltd.

Q2 Financial Results Briefing for the Fiscal Year Ending March 2023

November 2, 2022

Event Summary

[Company Name]	Kotobuki Spirits Co., Ltd.	
[Company ID]	2222-QCODE	
[Event Language]	JPN	
[Event Type]	Earnings Announcement	
[Event Name]	Q2 Financial Results Briefing for the Fiscal Year Ending March 2023	
[Fiscal Period]	FY2022 Q2	
[Date]	November 2, 2022	
[Number of Pages]	37	
[Time]	11:00 – 11:57 (Total: 57 minutes, Presentation: 32 minutes, Q&A: 25 minutes)	
[Venue]	Kabutocho Heiwa Building 2F, 3-3 Kabutocho Nihonbashi, Chuo-ku, Tokyo 103-0026 (Hosted by The Securities Analysts Association of Japan)	
[Venue Size]	145 m ²	
[Participants]		
[Number of Speakers]	2	
	Seigo Kawagoe	President & CEO
	Shinji Matsumoto	Managing Director, Corporate Administration Manager
[Analyst Names]*	Kenji Araki Ryozo Minagawa Masao Yoshida	
	Tokai Tokyo Research Institute SMBC Nikko Securities Ichiyoshi Research Institute	

*Analysts that SCRIPTS Asia was able to identify from the audio who spoke during Q&A.

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Presentation

Moderator: Thank you very much for your patience. The meeting is now called to order, and Kotobuki Spirits Co., Ltd. will hold a financial results briefing.

First, I would like to introduce the two people from the Company who are with us today.

Mr. Seigo Kawagoe, President and CEO.

Kawagoe: My name is Kawagoe. Thank you for joining us today.

Moderator: Mr. Shinji Matsumoto, Managing Director, Corporate Administration Manager.

Matsumoto: I am Matsumoto. Thank you for joining us.

Moderator: Thank you very much.

Today, we will start with a presentation by Mr. Matsumoto, the Managing Director, followed by a few words from Mr. Kawagoe, the President. After their prepared remarks, we will have time for a Q&A session.

Let's begin.

Matsumoto: I would now like to present an overview of the financial results for Q2 of the fiscal year ending March 2023, as well as our approach to the full-year earnings forecast.

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FY2023(1Q-2Q) Highlight

Net sales 20,100million yen 168.1%(YoY)

Ordinary profit 3,055million yen FY2022(1Q-2Q)Δ481million yen

In the end of March, Intensive measures to prevent spread were completely lifted, economic activities progressed toward normalization. Sales and profits recovered due to aggressive measures such as product enhancement.

●Sales<except for overseas subsidiaries>

	Apr.	May.	Jun.	Jul.	Aug.	Sep.
Compared to FY2022(1Q-2Q)(%)	50.9	73.5	77.3	45.3	84.1	86.4
Compared to FY2020(1Q-2Q)(%)	Δ 14.4	Δ 10.7	Δ 1.9	Δ 9.3	Δ 15.3	Δ 4.8

	FY2020	FY2021	FY2022	FY2023	YoY	Compared to FY2020 (1Q-2Q)
(Unit:Millions of yen)	1Q-2Q	1Q-2Q	1Q-2Q	1Q-2Q		
Net sales	22,388	7,905	11,959	20,100	168.1%	89.8%
Operating profit(loss)	3,519	Δ 3,421	Δ 1,418	2,830	-	80.4%
Ordinary profit(loss)	3,548	Δ 1,956	Δ 481	3,055	-	86.1%
Net profit(loss)	2,268	Δ 1,290	Δ 283	1,994	-	87.9%

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In terms of the business environment during Q2, while the recovery in the demand for long-distance tourism and hometown visits was sluggish due to the impact of the seventh wave of the novel coronavirus infection, for the first time in three years, there were no restrictions on activities, and the Golden Week, a nationwide spring holiday week, and summer season were underway. Customer traffic has been generally on a recovery track.

The Company worked hard to thoroughly enhance the product, sales, and sales space capabilities. While keeping an eye on changes in the market environment, the Company promoted brand appeal and measures to stimulate consumption. As a result of these efforts, sales in Q2 increased significantly, up 68.1% from the same period of the previous year.

Looking at the same quarter of the fiscal year that ended in March 2020, which was not affected by the novel coronavirus infection, I would like to highlight that performance has recovered to about 90% of what it was, despite the fact that inbound demand has not yet rebounded.

Profits also returned to the black for the first time in three interim periods as sales recovered.

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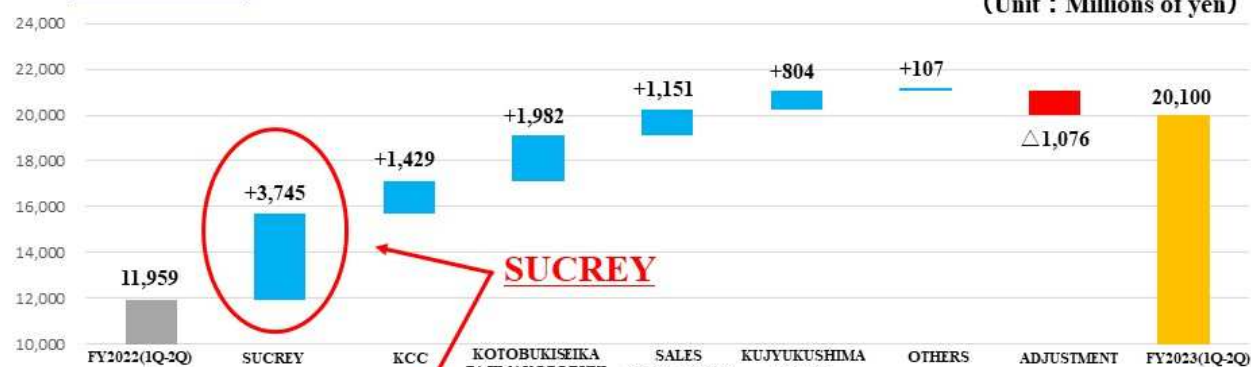
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FY2023(1Q-2Q) increase or decrease of amount

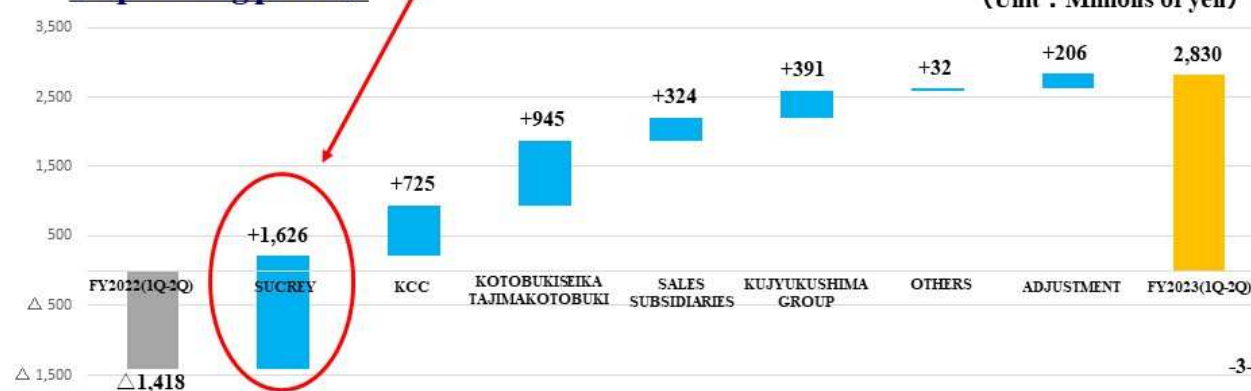
【Net sales】

(Unit : Millions of yen)



【Operating profit】

(Unit : Millions of yen)



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The next section shows a waterfall chart of the analysis of changes in sales and operating profit by segment.

In terms of business segments, Sucrey's sales and profits have recovered significantly thanks to the success of its business initiatives, such as a new brand and aggressive store openings in favorable locations, which has contributed significantly to consolidated performance.

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FY2023(1Q-2Q)Topics ① (Opening of large-scale shop)

- Sucrey opened 2 brand shops that DROOLY in Hanshin Department Store and The MASTER by Butter Butler in Abeno harukas Kintetsu Department Store.



DROOLY Hanshin Department Store(Umeda Main Store)
(Apr.2022)



The MASTER by Butter Butler
Abeno harukas Kintetsu Department Store(Sep.2022)

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We are pleased to highlight the Sucrey-led success.

First, as part of our aggressive expansion into department stores, we launched the new brand DROOLY in the Hanshin Umeda Department Store's flagship location in April this year. We also launched THE MASTER by Butter Butler in the Abeno Harukas Kintetsu Department Store's flagship location at the end of September. Both are at premium locations. Both stores made a remarkable start with impressive presence. I would like to highlight their success as one of the topics.

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FY2023(1Q-2Q)Topics ②

(Tokyo station sweets sales ranking at GRANSTA Tokyo and ecute Tokyo)

4 sweets ranked among the top 10 sales rankings!

COCORIS won the No.1!

※GRANSTA Tokyo and ecute Tokyo are commercial facilities inside of ticket gates at Tokyo Station.



”JR East Cross Station Development company press release”(Jun.2022)

<https://www.jr-cross.co.jp/info/items/46568b1dc052b1aea6ad85600a802e1e527b9a44.pdf>



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Next, let me mention that our group dominates the top sales ranking in the area surrounding Tokyo Station. Recently, the top 10 fan favorites of Tokyo Station Ekinaka Sweets shopping mall were announced. Four of them are produced by our group companies. The number one item is sold only at the COCORIS shop, managed by Sucrey.

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FY2023(1Q-2Q)Topics ②

(Tokyo station sweets sales ranking at TOKYO GIFT PALETTE)

3 sweets ranked among the top 10 sales rankings!

Anbataya won the No.1!

※TOKYO GIFT PALETTE is commercial facility outside of ticket gates at Tokyo Station.



No.1(Anbata financier)
Anbataya(KCC)

“Tokyo station development company press release”(Jul.2022)

<https://prtimes.jp/main/html/rd/p/000000039.000037893.html>



No.2(Pistage)
PISTA&TOKYO(KCC)



No.5(Butter Financier)
Butter Butler(SUCREY)

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Also announced was the top five cumulative sales ranking of the Tokyo Gift Palette mall located at the Yaesu North Exit of Tokyo Station. Three of our brands ranked in. Our Okada Kinsei Anbataya brand, managed by KCC, was in first place.

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FY2023(1Q-2Q)Topics ③

(The Maple Mania held 10th anniversary event at Tokyo Station)

The Maple Mania 10th anniversary pop up shop departed from Tokyo station to Tohoku region ! A press event was held with the participation of famous entertainers.



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One of the driving forces in the Tokyo Station area sales managed by Sucrey is called THE MAPLE MANIA. This year marks its 10th anniversary. In September, we held a press event at Tokyo Station, the place where the brand was born. We plan to promote pop-ups during H2, starting at Tokyo Station, to further raise awareness of the brand.

We had three stores in the Tokyo Station area before COVID-19, and it grew to a total of 12 stores managed by different subsidiaries that form our group. The Tokyo Station area continues to be the largest consumer market in Japan. It is also a strong base to send out messages. Our policy is to thoroughly strengthen our performance in this area.

Our mail-order sales volume got hit by a reaction to the consumption supported by the stay-home demand during the previous fiscal year, yet still it maintained the same performance level as the same period of the previous year due to the growth in Sucrey and other factors.

Overseas sales have been very strong in Taiwan and Singapore. In China, revenues are down due to the impact of the Shanghai lockdown. Overall sales themselves remained at approximately the same level as in the previous year.

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Results of FY2023 1Q-2Q (YoY)

Net sales + 68.1 point/Ordinary loss turned profitable

(Millions of Yen, %)	FY2022(1Q-2Q)		FY2023(1Q-2Q)		YoY(Change)		FY2022(1Q-4Q)	
	amount	To-sales rate	amount	To-sales rate			amount	To-sales rate
Net sales	11,959	—	20,100	—	8,141	68.1	32,192	—
Gross profit	5,841	48.8	11,771	58.6	5,931	101.5	17,623	54.7
SG&A expenses	7,259	60.7	8,941	44.5	1,682	23.2	16,220	50.4
Operating profit(Δloss)	Δ 1,418	—	2,830	14.1	4,249	—	1,403	4.4
Ordinary profit(Δloss)	Δ 481	—	3,055	15.2	3,536	—	2,921	9.1
Net profit(Δloss)	Δ 283	—	1,994	9.9	2,277	—	1,916	6.0
EPS (Yen)	Δ 9.08		64.09		73.17	—	61.56	

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I would now like to discuss our business performance for H1 of the fiscal year.

Net sales increased 68.1% YoY to JPY20.1 billion, and ordinary profit returned to the black at JPY3.055 billion from a loss of JPY481 million in the same period of the previous year. The ordinary profit margin has recovered to a level of 15.2%.

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Results of FY2023 1Q-2Q (Compared to FY2020 1Q-2Q)

Compared to FY2020(1Q-2Q), Net sales $\Delta 10.2\%$, ordinary profit $\Delta 13.9\%$

(Millions of Yen, %)	FY2020(1Q-2Q)		FY2023(1Q-2Q)		YoY(Change)	YoY(%)	FY2020(1Q-4Q)	
	amount	To-sales rate	amount	To-sales rate			amount	To-sales rate
Net sales	22,388	—	20,100	—	$\Delta 2,288$	$\Delta 10.2$	45,181	—
Gross profit	13,260	59.2	11,771	58.6	$\Delta 1,489$	$\Delta 11.2$	26,702	59.1
SG&A expenses	9,741	43.5	8,941	44.5	$\Delta 801$	$\Delta 8.2$	20,248	44.8
Operating profit	3,519	15.7	2,830	14.1	$\Delta 688$	$\Delta 19.6$	6,455	14.3
Ordinary profit	3,548	15.9	3,055	15.2	$\Delta 493$	$\Delta 13.9$	6,475	14.3
Net profit	2,268	10.1	1,994	9.9	$\Delta 274$	$\Delta 12.1$	4,100	9.1
EPS (Yen)	72.89		64.09		$\Delta 8.80$		131.76	

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Compared to the fiscal year that ended in March 2020, which was not affected by COVID-19, sales and ordinary profit have recovered to levels of 10.2% and 13.9%, respectively.

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Impact of the New Revenue Recognition Standard on Business Performance

Gross profit rate $\Delta 1.8$ point / SG&A expense rate $\Delta 1.4$ point

(Millions of yen, %)	FY2023 (1Q-2Q)				amount of impact
	Before	To-sales rate	After	To-sales rate	
Net sales	19,528	—	20,100	—	572
Cost of sales	7,741	39.6	8,329	41.4	588
Gross profit	11,787	60.4	11,771	58.6	$\Delta 16$
SG&A expenses	8,959	45.9	8,941	44.5	$\Delta 18$
Promotion	1,240	6.3	1,232	6.1	$\Delta 7$
Freight	897	4.6	670	3.3	$\Delta 227$
Rent	1,588	8.1	620	3.1	$\Delta 967$
Commission expenses	440	2.3	1,623	8.1	1,183
Others	4,795	24.6	4,794	23.9	$\Delta 1$
Operating profit	2,828	14.5	2,830	14.1	2

● The above impact amount is due to the application of “New Revenue Recognition Standard”. Due to changes in digestion type sales transaction, delivery service for mail order, points of our own EC site, etc. The impact on operating loss is minor.

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The material is provided for your reference regarding the impact of the application of the accounting standard for revenue recognition, which became effective last year.

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Compared to FY2020(1Q-2Q), pre-application of New Revenue Recognition Standard**Gross profit rate +1.2 points compared to FY2020(1Q-2Q)**

(Millions of yen, %)	FY2020(1Q-2Q)		FY2023(1Q-2Q)		Compared to FY2020	
	amount	To-sales rate	amount	To-sales rate	(Change)	(%)
Net sales	22,388	-	19,528	-	△ 2,860	△ 12.8
Cost of sales	9,127	40.8	7,741	39.6	△ 1,387	△ 15.2
Gross profit	13,260	59.2	11,787	60.4	△ 1,473	△ 11.1
SG&A expenses	9,741	43.5	8,959	45.9	△ 782	△ 8.0
Personnel expenses	3,881	17.3	3,530	18.1	△ 351	△ 9.1
Advertising	127	0.6	173	0.9	46	35.8
Freight	970	4.3	897	4.6	△ 74	△ 7.6
Traveling and transportation expenses	320	1.4	154	0.8	△ 165	△ 51.7
Promotion	1,549	6.9	1,240	6.3	△ 310	△ 20.0
Rent	1,518	6.8	1,588	8.1	70	4.6
Commission expenses	275	1.2	440	2.3	165	59.9
Depreciation	264	1.2	195	1.0	△ 69	△ 26.2
Others	837	3.7	743	3.8	△ 94	△ 11.2
Operating profit	3,519	15.7	2,828	14.5	△ 691	△ 19.6

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The next comparison is on a pre-application basis.

The gross profit margin increased by 1.2 percentage points to 60.4% when compared to the unique fiscal year that ended March 2020.

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Results of FY2023 (1Q-2Q) (SEGMENTS)

All segments on recovery trend (especially SUCREY)

(Millions of Yen, %)	Net sales				Operating profit(Δ loss)		
	FY2022 (1Q-2Q)	FY2023 (1Q-2Q)	YoY(Change)	YoY(%)	FY2022 (1Q-2Q)	FY2023 (1Q-2Q)	YoY(Change)
SUCREY	4,257	8,002	3,745	88.0	Δ 403	1,223	1,626
KCC	4,107	5,536	1,429	34.8	Δ 275	451	725
KOTOBUKISEIKA TAJIMAKOTOBUKI	2,408	4,390	1,982	82.3	Δ 317	628	945
SALES SUBSIDIARIES	1,138	2,289	1,151	101.1	Δ 192	132	324
KUJYUKUSHIMA GROUP	1,043	1,847	804	77.0	Δ 392	Δ 1	391
OTHERS	219	326	107	48.7	4	36	32
SEGMENTS TOTAL	13,173	22,390	9,217	70.0	Δ 1,574	2,469	4,043
ADJUSTMENT	Δ 1,215	Δ 2,290	Δ 1,076	88.6	156	362	206
TOTAL	11,959	20,100	8,141	68.1	Δ 1,418	2,830	4,249

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These are the results by segment.

As I mentioned at the beginning of this report, Sucrey has been a major driving force, and all segments are on a recovery trend across the board.

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Sales channel

(millions of yen, %)	FY2022(1Q-2Q)		FY2023(1Q-2Q)			
	amount	To-sales rate	amount	To-sales rate	YoY (Change)	YoY (%)
Net sales	11,959	—	20,100	—	8,141	68.1
Domestic(Wholesale)	3,429	28.7	6,985	34.8	3,556	103.7
Domestic(Retail)^{※1}	5,413	45.3	9,989	49.7	4,576	84.5
Mail Order	2,314	19.4	2,302	11.5	△ 12	△ 0.5
Other^{※2}	2	0.0	2	0.0	-	-
Domestic Total	11,159	93.3	19,279	95.9	8,120	72.8
Overseas(Wholesale)^{※3}	614	5.1	526	2.6	△ 88	△ 14.4
Overseas(Retail)	185	1.5	295	1.5	110	59.1
Overseas Total	800	6.7	821	4.1	21	2.7

※1 Retail are shops and Pop up stores.

※2 Other is insurance agency business.

※3 Overseas wholesale consists shipment sales to overseas and FC royalties

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Next is the data on sales by sales channel.

The recovery in customer traffic has been a tailwind for domestic retail sales and domestic wholesale sales, each of which has seen a significant increase in revenue.

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Cost of sales ▪ Gross profit

Gross profit margin improved significantly due to the normalization of factory operations following the recovery in sales

(Millions of Yen, %)	FY2022(1Q-2Q)		FY2023(1Q-2Q)		YoY(Change)		FY2022(1Q-4Q)	
	amount	To-sales rate	amount	To-sales rate			amount	To-sales rate
Net sales	11,959	—	20,100	—	8,141	68.1	32,192	—
Material cost	2,746	23.0	4,471	22.2	1,724	62.8	7,178	22.3
Labor cost	1,815	15.2	2,071	10.3	256	14.1	3,807	11.8
Expense	900	7.5	1,078	5.4	178	19.7	2,140	6.6
Manufacturing cost	5,461	45.7	7,619	37.9	2,158	39.5	13,126	40.8
Others	657	5.5	710	3.5	53	8.0	1,443	4.5
Cost of sales	6,118	51.2	8,329	41.4	2,211	36.1	14,569	45.3
Gross profit	5,841	48.8	11,771	58.6	5,931	101.5	17,623	54.7

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Next is the data on the cost of sales and gross profit.

With this recovery in sales, warehouse production volume is beginning to normalize. Although still in the process of recovery, the gross profit margin has improved significantly due in part to these factors.

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SG&A expenses /Operating profit

SG&A expenses rate decreased by 16.2 points due to sales recovery and cost control

(Millions of Yen, %)	FY2022(1Q-2Q)		FY2023(1Q-2Q)		YoY(Change)		FY2022(1Q-4Q)	
	amount	To-sales rate	amount	To-sales rate			amount	To-sales rate
Gross profit	5,841	48.8	11,771	58.6	5,931	101.5	17,623	54.7
Personnel expenses	3,332	27.9	3,530	17.6	198	5.9	6,793	21.1
Promotion	961	8.0	1,232	6.1	271	28.3	2,293	7.1
Freight	441	3.7	670	3.3	229	52.0	1,047	3.3
Advertising	139	1.2	173	0.9	33	23.9	349	1.1
Rent	494	4.1	620	3.1	126	25.5	1,110	3.4
Depreciation	211	1.8	195	1.0	△ 16	△ 7.6	433	1.3
Traveling and transportation expenses	99	0.8	154	0.8	55	55.5	245	0.8
Commission expenses	951	8.0	1,623	8.1	672	70.7	2,584	8.0
Others	630	5.3	743	3.7	113	17.9	1,368	4.2
SG&A expenses	7,259	60.7	8,941	44.5	1,682	23.2	16,220	50.4
Operating profit(Δloss)	△ 1,418	-	2,830	14.1	4,249	-	1,403	4.4

The increase in personnel expenses was mainly due to the reaction to the reduction in executive compensation and bonuses implemented in the previous fiscal year.

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Next is a breakdown of selling, general and administrative expenses.

As a result of the sales recovery and other factors, as well as the various cost and expense reviews promoted by the pandemic, the SG&A ratio has decreased by 16.2 points to the pre-COVID-19 level, or, in percentage terms, has recovered to the pre-COVID-19 level. The SG&A ratio has recovered to the pre-COVID-19 level.

Regarding the achievement rate, we announced the H1 revision on October 24.

The aggressive development of business measures featuring Sucrey was successful, and both sales and profits exceeded the initial forecast.

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Balance Sheet

The increase in current assets was due to an increase in cash and deposits and Inventory

(Millions of yen, %)	FY2021		FY2022		FY2023(2Q)		Compared to FY2022 (Change)	Compared to FY2022 (%)
	amount	rate	amount	rate	amount	rate		
Current assets	12,615	50.4	15,804	57.5	17,132	60.1	1,327	8.4
Non-current assets	12,437	49.6	11,666	42.5	11,380	39.9	△ 286	△ 2.5
Assets	25,052	100.0	27,470	100.0	28,512	100.0	1,041	3.8
Current liabilities	3,077	12.3	4,620	16.8	4,655	16.3	34	0.7
Non-current liabilities	2,634	10.5	2,493	9.1	2,419	8.5	△ 74	△ 3.0
Liabilities	5,711	22.8	7,114	25.9	7,074	24.8	△ 40	△ 0.6
Net assets	19,342	77.2	20,357	74.1	21,438	75.2	1,081	5.3
Liabilities and net assets	25,052	100.0	27,470	100.0	28,512	100.0	1,041	3.8
BPS(Yen)	621.53		654.15		688.90		34.75	5.3
CAPEX	540		403		228		△ 175	△ 43.4
Depreciation	1,420		1,220		551		△ 669	△ 54.8

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I will now skip a few pages and discuss the balance sheet.

The increase in current assets was mainly due to an increase in cash and deposits and an increase in inventories. Capital expenditures amounted to JPY228 million, and the actual amount of depreciation and amortization was JPY551 million.

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Statements of Cash Flows

Cash and deposits increased by 831 million yen from the beginning of the period

(Millions of yen, %)	FY2021	FY2022		FY2023	YoY(Change)	YoY(%)
	1Q-4Q	1Q-2Q	1Q-4Q	1Q-2Q		
Cash flows from operating activities	83	953	4,293	2,180	1,227	128.7
Cash flows from investing activities	△ 605	△ 251	△ 527	△ 302	△ 51	20.2
Free Cash flows	△ 522	702	3,767	1,878	1,176	167.5
Cash flows from financing activities	△ 463	△ 1,055	△ 1,176	△ 1,055	△ 0	0.0
Effect of exchange rate change on cash and cash equivalents	3	4	13	9	5	146.7
Cash increase / decrease	△ 982	△ 350	2,603	831	1,181	-
Cash and cash equivalents (Beginning of period)	8,291	7,309	7,309	9,913	2,603	35.6
Cash and cash equivalents (End of period)	7,309	6,960	9,913	10,744	3,784	54.4
Interest-bearing debt	966	846	726	606	△ 240	△ 28.4

-19-

Cash flow increased by JPY831 million from the end of the previous period to JPY10.744 billion at the end of September, mainly due to an increase in operating cash flow.

This was a bit of a rush, but this is a summary of the Q2 financial results.

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Next, I would like to discuss our full-year earnings forecast for the current fiscal year.

As for the business environment in H2, we are maintaining our basic forecast for H2 in light of the still uncertain outlook. In addition, we have not factored in the recovery of inbound sales or the government's measures to stimulate consumption in our initial forecast.

While there is a rising trend in raw material prices, we have not factored this into our initial forecast. However, since the price revisions implemented during the period were also not factored into our earnings forecast, we have determined that they will not hurt our forecast figures as a result.

The national travel discount support frameworks will begin in October. With this as a tailwind, we are determined to work toward the next stage of growth, ensuring a recovery to the pre-COVID-19 level of performance in the current fiscal year.

Kotobuki Spirits Co., Ltd.

Business Forecast for FY2023

Net sales +33.3%/Operating profit+337.7% (YoY)

(millions of yen, %)	FY2022		FY2023(Forecast)		YoY(Change)	YoY(%)
	amount	To-sales rate	amount	To-sales rate		
Net sales	32,192	-	42,920	-	10,728	33.3
Gross profit	17,623	54.7	25,271	58.9	7,648	43.4
SG&A expenses	16,220	50.4	19,131	44.6	2,911	17.9
Operating profit	1,403	4.4	6,140	14.3	4,737	337.7
Ordinary profit	2,921	9.1	6,384	14.9	3,463	118.5
Net profit	1,916	6.0	4,175	9.7	2,259	117.9
EPS(yen)	61.56		134.16		72.60	117.9
Dividend/stock (yen)	30.00		30.00		-	-
CAPEX	403		1,000		597	148.4
Depreciation	1,220		1,200		△ 20	△ 1.7

-20-

As for the full-year forecast figures, net sales are expected to increase 33.3% YoY to JPY42.9 billion, the gross profit margin is 58.9%, the operating profit is JPY6.140 billion, and the final net profit forecast is JPY4.175 billion. If the projected net profit figures are achieved, it will be a new record high.

There is no change from the beginning of the period concerning the dividend per share, capital expenditure plan, and depreciation forecast.

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Business Forecast for FY2023 (SEGMENTS)

Aiming for higher sales and profits in all segments

(Million of Yen, %)	Net sales				Operating profit		
	FY2022	FY2023 (Forecast)	YoY(Change)	YoY(%)	FY2022	FY2023 (Forecast)	YoY(Change)
SUCREY	11,958	16,832	4,874	40.8	868	2,650	1,782
KCC	10,959	12,676	1,717	15.7	583	1,235	652
KOTOBUKISEIKA TAJIMAKOTOBUKI	6,053	8,967	2,914	48.1	△ 100	869	969
SALES SUBSIDIARIES	3,007	4,824	1,817	60.4	△ 186	294	480
KUJYUKUSHIMA GROUP	2,872	3,982	1,110	38.6	△ 407	73	480
OTHERS	567	676	109	19.3	49	83	34
SEGMENTS TOTAL	35,415	47,957	12,542	35.4	807	5,204	4,397
ADJUSTMENT	△ 3,223	△ 5,037	△ 1,814	56.3	596	936	340
TOTAL	32,192	42,920	10,728	33.3	1,403	6,140	4,737

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We are aiming to increase sales and profits in all segments, with Sucrey as the driving force.

This concludes my explanation. I would now like to turn the presentation over to Mr. Kawagoe for future management policies and other matters.

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Philosophy Management of KOZUCHI

We have introduced a business management method of Amoeba Management since FY1996.

We made a Management philosophy notebook “KOZUCHI” in 2003.

Every person who works for Kotobuki Spirits Group put KOZUCHI philosophy into practice in everyday work.

《KOZUCHI national convention》

KOZUCHI national convention is held once a year for the purpose of sharing achievements with fellows.



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Corporate Philosophy

To create happiness, provide happiness

Policy

Today, I make an enthusiastic fan

Vision

General Producer of the Sweets



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Kawagoe: I think you can get a general idea of the current fiscal status for H1, Q3, and Q4 based on what has been going on recently, so I will skip that part.

Today, on pages 31 and 32, I would like to discuss one of our business areas, the premium sweets and savory gift business, as well as the philosophy-based participative management style, which is one of our characteristics.

Let me discuss these two because I think they are the most useful indicators to see what the future of Kotobuki Spirits will look like in the long run.

First, the premium sweets and savory gifts. This is our core business. We are specialized in gift-giving in the form of souvenirs, concessions, and crowd-pleasers on any occasion. I believe this is a very important point.

I would like to position our business to support self-gifting premium sweets, which means we don't handle cheap snacks.

Let me explain.

For sweets and desserts that people buy for themselves, if the population is 100 million, 100 million people are the target, well, in general.

In our case, for example, if 10,000 people are targeted, we go for 10,000 times 100 million. I don't know what the exact digits may be, but it is 10,000 times 100 million. I don't know how to say it.

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Our target is extremely broad. In other words, our target to sell our products, or rather, the level of food consumed is far out. So, we don't need to produce something ordinary; however, for our business, it is absolutely necessary to create something extraordinary.

From the standpoint of the gift recipients, whether the gift might have been for themselves or their family members, premium gifts are highly welcomed. We don't need to deal with cheap stuff because the higher the value of the gift, the better the recipients would feel. However, it is important to note that the perceived value needs to be higher than the actual cost. I say high three steps, which means a focus on customer satisfaction that surpass the high cost. This is a precious point.

What is more crucial is quality. As Mr. Matsumoto put it, there are various factors to think about—the products, sales floor, and customer service skills. It is important to attain the highest level possible.

Especially the flavor, I believe that there is nothing better than the highest level of attention to the details and attitude of creating delicious food products that are better today than yesterday and tomorrow than today.

Imagine that one customer experienced one of our products. The following day, the same person tried our products again and was impressed even more. A year later, again, the flavor was enhanced.

This is the cycle of value increase I have in mind. This is characterized by, one part, the comparison of last time and this time, and another, an intensity in loving particular items.

If a food product is skewed too heavily on a particular feature, it will not sell at convenience stores or supermarkets where 100 million people are looking for just normal stuff. This is where the headcount of people who eat and the money they spend are on an equal scale, which also means that to gain sales, you'd have to appeal to a mass, bigger audience.

That is not the case with us. We can focus on a smaller target. We can, for example, focus on those who are crazy about cheese. We can focus on people who are obsessed with dark chocolates. We have 100 million to multiply because of the level of the gift recipients. This is the best feature. That's why we specialize in premium sweets and savory gift businesses.

In the end, it is important to create high-brand value by refining the products, sales space, and customer service skills, as I mentioned earlier.

Since this is a business, I believe that the most important thing is to create ever-increasing growth, with sales increasing from today to tomorrow, from tomorrow to next year, and from next year to the year after that.

What I like about this business is that if you try it once and enjoy it, you are enticed to share it with others as a form of gift or present. If the recipients are happy with the product, they will give it to more people. Our sales can spread in this way. In short, if the value of the product is high, if the customer is satisfied, sales will increase. This is the characteristic. Do you see?

Since this is our business model, the best strategy is to aim for high quality honestly. I am not interested in short-sell products, products that sell only for a limited time or at a specific event. However, generating a group of repeating customers makes some sense.

It is not a business model that requires special advertising or anything like that. The most important feature is that those who have eaten the food are repeat customers by word of mouth, and those who receive the food themselves are repeat customers again, such that the base of customers' purchases is increasing steadily.

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If not, then the product is still not appreciated. It means that customer service is not appreciated, and that is what we can say.

In the case of our business classification, we were originally engaged in the wholesale and OEM business. Even now, Kotobuki Seika and others have such a business model where their sales include wholesaling to their own retail and wholesale divisions.

However, we have shifted considerably to this business model of localized retailing. This is a genre of manufacturing-direct, regional sweets, and the premium sweets and savory gift business. This has been and will continue to be the core business.

What is good is that, after all, the biggest sales increase in this premium sweets and savory gift business is the demand for souvenirs, that is, souvenirs when people visit hometowns to see their family members and for other reasons. These people also buy souvenirs on the way back. There is a pattern of both going and returning, if I may say so, but this demand is very great.

So that's where the insistence on locale specifics comes in. For example, if someone bought a Tokyo souvenir but found exactly the same item in Hokkaido, the customer will never ever buy the same thing again. So, locale specificity can be a key for sales, though this business model may not be so explosive.

That said, over time, it will be effective. As I said earlier, if we consider the idea of repeat behavior and its propagation, I still think the most important thing is how the next sale looks. This is important because it will lead to the assurance of the sales personnel structure, the store structure, and the factory manufacturing structure itself.

As Mr. Matsumoto mentioned, we are starting little by little to introduce limited items to department stores, and we have two patterns. One is to sell products at locale-specific department stores, and the other, sell products at specific department stores without the restrictions of their locations.

If we pick the latter, we will lose the best market—souvenirs. As I said earlier, this is a pattern where customers find the same things in Tokyo and Hokkaido. For this reason, I'm hesitant to go with this route, but in the long run, I expect that we will begin to see consumer demand that is not specific to the regional factors.

For that reason, I will keep this scenario like you saw we are doing with THE MASTER Butter Butler brand, with one store at the Takashimaya department store in Yokohama and another store at the Abeno Harukas.

However, locale-specific items sell the best at department stores. If we are to do this with department stores alone and without locale specifics, we must specially strengthen our own demand, the so-called self-gifting demand. In the far future, the souvenirs demand can disappear. Hence, one of the major challenges for us is to increase the demand for self-gifting.

We will focus on limited-quantity products that cannot be produced in large quantities, products that require a lot of time and effort, and raw products that cannot be produced in large quantities. The price will be high, but the so-called scarcity value, or the fact that it is not made in large quantities, is a pattern that customers appreciate.

Such is a very significant feature of the premium sweets and savory gift business. As we continue to work in this area, the number of brands can increase, but how can we pursue efficiency while carrying a small number of stores? It will become imperative to stay at the top or upper ranking on best-selling lists to be profitable. This means that we will be looking very hard at the conditions for opening new stores.

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Let me shift the discussion to our all-manager-management style. We do not assign a single person in charge of opening new stores. The regional managers, department heads, and the presidents all together take their time and evaluate or align the department stores' requests and ours.

The end result is not a pattern of opening many stores all at once. Our style is to develop brands that are anchored in meticulously selected areas.

I would like to go into the details of our all-member participation management.

The smallest unit of the profit division, the sales division, is the store. In our case, the manufacturing department is called team or line, and the team leader, line leader, and their subordinates all work around this person, which is called all-member participation management. The most important feature is that the management is centered around the person in charge of the smallest profitable department on the ground.

At most organizations, the headquarters do the planning, and their retail sites execute the plans. We take an ultra-field-oriented approach. When the headquarters is the head and the field is the body, it will be very difficult to go with the ever-changing situation at the site because data and so on are not enough to grasp what might be really going on at the sales floor.

At our company, the store manager and other front-line team members are given a great deal of authority. This is what makes the job itself worth living, and as a company, our response to customers is a harmony of top-down and bottom-up approaches, with major policies from the President and other management coming from the top down. Day-to-day retail execution is tasked to the store managers. The same goes for manufacturing operations.

This is the most significant feature. I believe this is what makes the unique management style of the Kotobuki Spirits Group.

So, the on-site is strong. We are not doing this on our own. I believe that the most important characteristic of our company is that we have a top-down major policy, but we also have creativity and ingenuity on the front lines, and when we think and work together, it is the front lines that take action and produce results. I would like to present this point today, and I believe that our future development depends on it.

A negative aspect of the Company's growth is the availability of talent. We don't have enough manpower in manufacturing and sales. We have a management philosophy called kozuchi, which means that our job is to practice our management philosophy based on 120 principles.

On the first page, there is the all-member participation management, where everyone participates in management. It is 400 words to say that everyone participates in management from the day they join the Company, and this is the most important thing we will work on. The most important issue for our management is how to recruit and train the best employees, who are the managers on the front lines, to become even more capable and competitive.

I do not know how Kotobuki Spirits Group will be judged in the long term, but I have discussed the most important points from our point of view and this business area.

That's all from me. Thank you very much.

Moderator: Thank you for the detailed explanation.

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Question & Answer

Moderator [M]: We will now begin the question-and-answer session. If you have any questions, please raise your hand, and a staff member will bring the microphone to you.

A full transcript of this financial results presentation, including the question-and-answer portion, will be made available to the public. Therefore, if you wish to remain anonymous, please do not give your name when asking a question.

Third from the front, please.

Araki [Q]: Thank you very much for your presentations. My name is Araki from Tokai Tokyo Research Center. I have two questions if that's ok.

The first question is about the operating margin. Your company set a target of 20% of ordinary profit margin. When you filter the performance to three months, Q1 was 12%. The margin for Q2 was 15%, which is a very large increase, but I believe that the margin for H2 is quite low, although H2 is also included in the margin. How much of a hassle did you undergo to achieve 15%? Or perhaps, are you surprised to see such a lift? Do you anticipate keeping the momentum in the last half? Please share your quantitative evaluation. That is my first question.

The second question is about a regional strategy. On page five of this presentation deck, you compare sales by region to the performance of the fiscal year ending March 2020. Of course, I have the impression that the metropolitan area is very strong, but earlier you indicated regional outlets such as department stores.

There is a view that the declining birthrate and aging population may make it difficult for local regions, but what are your thoughts on strategies, including the meaning of future capital investment in the region, and to go even further, is it better to be more aggressive in overseas markets? Please tell us about these two points, which would be very helpful.

Kawagoe [A]: Thank you very much.

First of all, in terms of operating margin, we had a very difficult summer in Q2, from the middle of July to the beginning of September. As the number of people infected with COVID-19 increased, a mood of self-restraint prevailed, and the number of people shopping and traveling decreased drastically. It caused us to reduce production volume. We got hit hardest during Obon, a week of the Festival of the Dead in Japan. The profit margin itself did not reach the level it had originally been at.

As you know, the business is still booming, so one thing is that without full factory production itself, the selling price issue itself is, as you know, a problem. And although the price of raw materials has risen considerably, mainly imports, the problem of their selling prices has itself been solved.

The other biggest issue is the labor cost ratio, the expense ratio, and whether or not it is possible to keep productivity high and operate at full capacity, which in turn leads to a shortage of labor. We are struggling to make them, and since we don't have enough people to sell our products, we are trying very hard to accommodate them.

In terms of regional strategy, we are expanding mainly in the Kanto region and will continue to do so in the future. The other issue is how to focus on Hokkaido, which is a major consumer and tourist destination.

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As for overseas markets, we are not expecting to see a huge market size for Japanese brands, so we must come up with customized strategies for overseas. We are currently working on some businesses in high-cost-of-living countries like Australia and the US. If we were to develop any business involving the food and beverage industry, we must create a new business model for overseas expansion. So far, I don't think there will be any notable development.

That's all from me.

Araki [Q]: I'm sorry, the first question, but if you look at the first three months, the margin in Q1 was about 12%, but in Q2, it went up to the 15% range. Why is this?

Matsumoto [A]: There are seasonal factors to begin with, so the top line and sales will increase in Q2. This will increase factory operations to a certain extent and absorb fixed costs, so we believe that profit margins will tend to increase here. The profit margin will be higher in Q2 than in Q1.

Araki [Q]: But in your earlier explanation, July to September.

Matsumoto [A]: It was bad.

Kawagoe [A]: Still better than Q1.

Matsumoto [A]: In its own way [inaudible] than Q1.

Araki [Q]: I see. What contributed to it?

Matsumoto [A]: Summer sales season. People only move around during Golden Week during Q1.

Araki [Q]: Or, for example, did you increase the weight of high-value-added products in your product strategy itself, or did you open more stores for Sucrey? A total of 12, I suppose. Did those factors ultimately raise the overall margin?

Kawagoe [A]: Q2 was better. Better than Q1. Yes, we had new store launches, and we did price revisions.

Araki [Q]: I understand. I'm sorry, but I was wondering if you felt that the 15% level was particularly stressful, or what you are planning to do from H2 onward if you consider this 15% level to be a merkmal, a German term meaning feature or characteristic, from Q3 onward. You have already presented the full year's results, but this is a qualitative idea. In short, please give us your take on whether exceeding 15% is a piece of cake or not.

Kawagoe [A]: I don't know how COVID-19 affects us. The performance in October is very good. Obviously good. We are balancing manufacturing and sales with great trepidation.

Araki [Q]: I understand. As for the overseas places, is it my understanding that your statement for overseas market development is for the short term? If you think about the long term, for example, if the metropolitan area of Japan itself is already saturated, do you think that Japan will be more proactive in promoting overseas areas, although, of course, it is still looking at overseas areas?

Kawagoe [A]: That is correct.

Araki [M]: Thank you very much.

Kawagoe [A]: I just don't think this current Japanese business model will work.

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Araki [M]: Thank you very much.

Moderator [M]: Next question.

Minagawa [Q]: Thank you. My name is Minagawa from SMBC Nikko Securities Inc. I would like to ask you two questions.

First of all, rather than filtering to the Company, if we separate the stores into new stores built after COVID-19 and existing stores built before COVID-19, how much do the new stores contribute to this year's performance? I think the new stores are probably in prime locations, but can you tell us if the profitability is different in this area compared to the previous store? That's the first question.

And secondly, I think that Sucrey's figures are stronger in terms of both sales and profit than those of other companies. Is this due to the large contribution from the new, or is it because the prime location benefited from high customer traffic? Or, perhaps, it is not about the location at all, but rather the success of Sucrey can be benefited from the organization structure that is different from KCC or any other affiliate of your group companies. Could you please share your thoughts on the reason why Sucrey is a hit?

Matsumoto [A]: Your first question regarding the impact of new store launches compared with the existing store performance, well, since Sucrey is the only segment that managed new store openings, I would like to talk about Sucrey.

Looking at the H1 year-to-date total, existing stores are roughly at 70% of the total. About 70% to 80% recovery. Therefore, we believe that the effect of new store openings has made a considerable contribution in H1 of this fiscal year, especially in the area surrounding Tokyo Station.

Also, as is the case with fixed stores, with the pop-up and other types of events, [inaudible] has also increased compared to the pandemic era, and the sales per store and per day of events have also increased.

On your second question about the factors behind Sucrey's strong performance. As you mentioned, there are both the effects of new stores and the location in the metropolitan area, the largest consumer market. I don't think there is any organizational difference, but I think the location and the fact that the measures we have taken so far are very effective.

Minagawa [M]: I understand. Thank you.

Moderator [M]: Thank you very much.

Yoshida [Q]: My name is Yoshida from Ichiyoshi Research Institute. Thank you. I have two questions.

The first question, I would like to ask is how you view the market. We're not quite over COVID-19. May I say we are adapting to the age of the novel coronavirus? How do you see the market changing? In other words, if the rural areas are going to be more active now, it's hard to say, since the novel coronavirus infection is starting to spread in some parts of the country.

I wonder if there are some new entrants to the market, in other words, some stores that attract lines of customers in tourist areas with their local products and souvenirs. I think some new things will emerge in those areas. I would like to ask whether you consider that positive or negative. There may be opportunities to supply OEMs, or it may simply be that the target market is different, so there may be no relationship.

Secondly, in the section on this fiscal year's results, you mentioned a cooling trend of consumer sentiment due to rising prices as a risk factor in addition to COVID-19. What will the impact actually be this time? For

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example, I think there are many different types of customers and buyers. The younger generation and the older generation. I know that there are many different types of people, the wealthy and not-so-wealthy, but what are your thoughts on consumption trends?

Matsumoto [A]: Regarding your first question, or rather, my view of the changes in the market, it may be my personal opinion that after COVID-19 fades, the market will return to the pre-COVID-19 environment to a certain extent.

I believe that domestic travel and tourism will become more and more active. We see this as a very positive development, as we believe that it will increase commercial opportunities for our group.

Kawagoe [A]: The market size is going to be still different. If one place is not getting as much attention as it used to, that is the course of the market trend and it is unavoidable. After all, major population conversions, or major tourist destinations, such as Hokkaido or Okinawa, will grow. I think it is difficult from a business standpoint to have a good place in such a place that no one knows about.

I wonder what company you know of? I'm curious when you mentioned that some region-specific sweets got people's attention.

Yoshida [Q]: For example, there may be some shops somewhere that are not widely known and Insta-worthy. It doesn't matter what. Let's say you can eat cream puffs at a specific location. I have seen a queue of people lining up to experience food items that they have not seen before at a very specific location. How is your company sizing up with such market trends? These are not happening in the major tourism locations, so I understand that it may be outside of what your company is aiming at.

Kawagoe [A]: I think that's true everywhere, but in the end, it's a question of size. There are many candy shops in Tokyo that sell out in the morning and are thriving all the time. After all, those are family-business-level sales. It's a little bit like not being able to grow up. In short, they are selling for scarcity value. As I mentioned earlier with department stores and the like, we are responding to those areas to the extent we can. We are doing this in a way that leverages that to improve our brand value while also increasing the demand for other products that you can buy yourself.

Matsumoto [A]: I think your second question was about the cooling of consumer sentiment, or rather, what is being done about these consumption trends. In other words, the selection of products that sell and those that don't will become more intense. In such a situation, we are taking measures to strengthen our measures so that we can be on the winning side.

Kawagoe [A]: Also, I think it is a big problem that people, in general, are becoming more and more distant. Gifts and sweets can play a very important role as a lubricant of communication once the interaction gets freer and more active. On the other hand, when society goes into a self-restraint mindset, the demand can fall sharply.

It makes it difficult for us to set up the forecast for the current and next fiscal year. People don't live alone so once the pandemic restriction is lifted, the custom of gift-giving can revive to play a crucial role once again as a lubricant of interpersonal relationships.

When that happens, as Matsumoto put it, people will clearly see quality products and others. I believe that the pursuit of quality will take us to the next business opportunity.

That's all from me.

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Yoshida [Q]: You mentioned that there was a period from July to September that was affected by the voluntary compliance to the restraint orders. But I believe that the number of new COVID-19 infected cases in Hokkaido is now at 90% of the peak. I was slightly optimistic that if there were no restrictions on activities, your sales won't be affected so much, but does the self-restraint behavior of consumers still have an impact? Since we can only see it in the last three months, it doesn't seem to have been affected that significantly over here.

Kawagoe [A]: If there is a government order for self-restraint or stay-home, people will follow. Even if the government doesn't ask, there will be many people who limit their outing behavior, even if the number of infected people and the severity of the disease is not significant. So, compared to the summer of 2019, there was still a 30% to 40% impact, both in terms of the transportation situation and in terms of the lodging situation.

If the government announces a restriction order, it will affect more than half. If the government asks to close retail stores, it means we will lose about 90% of our sales.

Right now, it's like everyone should travel and meet with people, evident over all kinds of policies. In a time like, this our business booms. This is not limited to travel-related businesses, but I believe that high-end, premium consumption is soaring.

I don't know about the future. As you can see if you look at what is going on overseas, people in Japan are so afraid of COVID-19, and I just can't predict how that affects our business.

That's all from me.

Yoshida [M]: Thank you very much.

Moderator [M]: Thank you very much. Does anyone have any questions?

Ariga [Q]: My name is Ariga from Advanced Research Japan. I just want to confirm a few details.

On page seven, when you talked about Sucrey, you said that before COVID-19, there were three stores. Now, you have 12? Could you share some details? I believe Sucrey originally started with three stores.

Matsumoto [A]: There were three stores in Tokyo Station.

Ariga [Q]: You mean you had three Sucrey stores inside the Tokyo Station building?

Matsumoto [A]: Yes. Sucrey has eight now.

Kawagoe [A]: Groups.

Matsumoto [A]: As a total of groups. Yes. We have three stores under KCC and one under the Group, which means that we are expanding to 12 stores now.

Ariga [Q]: So, Sucrey operates eight stores, but all of them have different brands, is that correct?

Matsumoto [A]: Yes, that's right.

Ariga [M]: I understand.

Moderator [M]: Thank you very much. Are there any other questions?

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Since there seem to be no further questions, I will now conclude.

Thank you very much, President Kawagoe and Executive Director Matsumoto, for your time today.

Thank you for taking the time to join us today. Thank you very much for your participation.

[END]

Document Notes

1. *Portions of the document where the audio is unclear are marked with [Inaudible].*
2. *Portions of the document where the audio is obscured by technical difficulty are marked with [TD].*
3. *Speaker speech is classified based on whether it [Q] asks a question to the Company, [A] provides an answer from the Company, or [M] neither asks nor answers a question.*
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