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Partial Revisions of Several Rating Methodologies

Japan Credit Rating Agency, Ltd. (JCR) hereby announces that it has revised several rating methodologies by sector.

The revised methodologies are "Real Estate," "Electric Power," and " Food Service."

The revisions do not alter the framework, point of view, treatment, or other contents of the methodologies. Descriptions in the methodologies have been revised to reflect recent trends and other factors in the explanation of industry characteristics that form the backgrounds of the methodologies, or to make the explanation of the point of view easier to understand. Therefore, there is no impact on individual ratings.

The revised rating methodologies will be posted on the page of “Rating Methodologies: Corporates” (https://www.jcr.co.jp/en/rrinfo/meth_corp/) of JCR’s website.

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Rating Methodology by Sector

Real Estate

1. Business base

In the real estate industry, while housing sale and agency business do not necessarily require a high market position to be competitive, rental business and large redevelopment projects offer advantages to large companies ranked high in the industry, and the current rankings are unlikely to change easily. When observing this industry, JCR focuses on financial capacity, proportion of stable rental business, and competitiveness of the assets of rental business in addition to such rankings.

(1) Characteristics of the industry

(i) Market overview

Because of its social importance and public nature, Japan's real estate industry is subject to various laws and regulations, including the City Planning Law, Building Standards Law, Building Lots and Buildings Transaction Business Law, and real estate taxation, to eliminate uncontrolled development and real estate speculation. Any company rating assessment needs to adequately take into account the trends in these laws and policies.

Forms of entry include the rental of real property, such as office buildings and commercial facilities; sale of real property, such as condominiums and houses; brokerage of real estate buying, selling, and rental; and property management of office buildings, condominiums, etc. With the increase in the number of public REITs, private REIT, and real estate funds, securitization market has expanded and financial commercialization of real property has progressed, resulting in an increase in the business sphere such as asset management.

Real estate business handles immovable assets and traditionally holds direct dealings between a seller and buyer. Unlike stock trading, the absence of an open market makes the business more like a local industry, with a complete domestic market. As noted above, however, the financial commercialization of real estate has been increasing, causing an increase in funds flowing in from overseas investors.

In general, the industry is affected by domestic business fluctuations, and the level of volatility varies among the subsectors. The market of short-term turnover business, such as sale of condominiums, is highly variable, and business is unstable. Meanwhile, real estate rental business capable of earning long-term, fixed rental income is considered stable and predictable.

Not only the domestic population, but also the working population is expected to decrease as the birthrate declines and the population ages. Medium- and long-term trends in the demand for such properties as condominiums and office buildings, therefore, must be monitored. High growth in the domestic real estate industry is thus unlikely, and entry to overseas markets is expected to become an important management strategy going forward.

(ii) Competitive situation

Entry barriers are thought to be relatively lower than in other industries. Even individuals are able to enter the market if financing is available and the appropriate real estate license for buying, selling, and trading land and buildings, acting as a proxy, or brokering rental properties has been obtained. In particular, real estate agency business, with its low funding requirements and community-based business, allows a large number of individual entries. The entrants range from the aforementioned individuals as well as housing dealers and renters to general real estate companies operating in multiple categories.

The real estate rental industry comprises numerous long-established general real estate companies, which have owned properties in good locations since the time of lower property values. In new development projects, they maintain a highly competitive edge with their development capacity, financial strength to withstand financial burden, and tenant appeal. Meanwhile in condominium sales business, while brand power and product planning capabilities are important, property locations and selling prices are more important in terms of competition. Any advantage based on company size and brand power, therefore, is not necessarily absolute, and competition develops for each individual property. High market volatility, however, results in an increase in new entrants when the market booms. When the market is sluggish, on the other hand, small and medium-sized companies whose finances are unstable tend to be ousted from the market, and continuing this business is considered difficult unless they are companies mainly dealing in stable income businesses such as real estate rental or companies backed by sponsors.

(iii) Cost structure

While the cost structure varies in each subsector, the industry generally carries a heavy burden of fixed cost. The proportion of depreciation cost is large in the business of real estate rental, and companies operating subleasing face increased real estate rent. Because most such costs are determined by the start of a project, ensuring adequate sales is more important in terms of profitability than controlling costs. The cost structure of housing sale business largely consists of direct costs, such as the cost of land and construction. Like rental business, most of the cost is fixed when a project starts, and thus, the success of the project depends on how much it cost to purchase the property and how quickly it can be sold so as to avoid the effect of changes in market conditions.

(2) Important factors in market position and competitiveness

(i) Market position

Each business in the real estate industry competes individually in each area or property, and particularly housing sale and agency business do not necessarily require a high market position to be competitive. In public tenders for large redevelopment projects, large companies having rich experience and expertise in development that are ranked high in the industry have a more competitive edge. The market positions of such large companies have been achieved through their long histories, and they are unlikely to be taken over by smaller companies in the near future.

(ii) Finance capacity

Other than those of real estate agency and some other businesses, projects require a large amount of funds, including the cost of land and construction, which is difficult to be paid with the company's own funds. Project periods exceed two years, even for housing developments with their relatively short time frames, while large projects, in some cases, continue for more than 10 years. In addition, the periods for investment recovery can be several decades for rental business, and, thus, the availability of long-term, stable external financing is key to maintaining the management base and competitiveness. When the market is stagnant, in particular, financial institutions tend to tighten their loan restrictions, and reduced fund availability has caused a series of bankruptcies in the past. The financial capacity of each company, including its relationships with financial institutions and financing structure from normal times, must be carefully monitored.

(iii) Business structure

In general, the market of short-term turnover business, such as sale of condominiums, is highly volatile, and stable cash flow is difficult to achieve. In contrast, real estate rental and management businesses capable of earning long-term, fixed rent and fee income maintain stable cash flow. Increasing the cash flow and component ratios of these businesses will, therefore, improve the company's resilience to the risk of market fluctuations and facilitate future cash flow stability. JCR therefore examines this as an important factor.

(iv) Rental asset portfolio

Whether the asset portfolio will reduce risk so as to improve the cash flow stability of real estate rental business is observed. Whether a portfolio not influenced by particular properties has been developed must be taken into consideration. While asset diversification is necessary to a certain extent, potential demand in regional cities is thought to be low and business risk is considered high. Having a large number of competitive properties in areas with high potential demand, such as the five wards of central Tokyo (Chiyoda, Chuo, Minato, Shinjuku, and Shibuya) and being able to supply new properties is viewed as one of the requirements for improving the competitiveness of the asset portfolio.

2. Financial base

(1) Cash flow

The ability to generate cash flow, the funds for debt redemption, is important. Not only the cash flow level, but its sources also need to be examined. Cash flow generated in real estate rental business is relatively stable, and, conversely, cash flow from asset or housing sales is highly susceptible to external environment factors and, thus, considered unstable. JCR also monitors trends in cash flow, taking into account the balance with financial aspects, such as interest-bearing debt.

Key financial indicators:

- EBITDA
- Cash flow from operating activities
- Ratio of interest-bearing debt to EBITDA

(2) Safety

The real estate industry often requires large capital expenditure. Real estate rental and housing sale businesses, in particular, need to pay a large amount of funds to acquire land for development. Such purchases are rarely made using the companies' own funds, but require external financing. The ability to maintain adequate income levels and financial safety to obtain smooth financing, therefore, is considered to cause disparities among companies. Especially, increasing the level of equity capital is thought to create a buffer against the risk of asset degradation.

Key financial indicators:

- Operating income
- Ordinary income
- Shareholders' equity
- Interest-bearing debt
- Equity ratio
- Debt equity ratio
- Unrealized profit on assets held

(3) Financing structure

As previously noted, in this industry in which a large amount of external funds is acquired for property development, the quality and flexibility of financing is likely to significantly affect future business development and is crucial when the business environment deteriorates. For instance, whether long-term financing has been made for assets with a long period of investment recovery must be confirmed. If the term of redemption for borrowings or corporate bonds has expired when the business environment is deteriorating, refinancing may become difficult. The ratio of secured debts and level of collateral margin are also likely to cause differences in future financing and, therefore, must be observed.

Key financial indicators:

- Collateral margin
- Secured debts
- Ratio of unsecured debts
- Ratio of long-term and short-term borrowings

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Rating Methodology by Sector

Electric Power

1. Business base

JCR in this report primarily describes outline of rating methodology for Japan's electricity utilities (power companies), which are engaged in power generation, transmission/distribution, and retail, and adds factors that should be noted for large power generation company (former wholesale electricity utilities, etc.)

As a supplier of energy that is fundamental to Japan's production and consumption activities with a high degree of public use, Japan's electricity business has been regulated by the government in many ways to protect the users. Stepwise deregulation has been made 4 times since 1995. The electricity system reform as a result of the Great East Japan Earthquake was a large-scale revision to the system for the first time in 60 years. This reform is intended for utmost control of electricity rates and expansion of users' options and business operators' opportunities based on assumption of stable supply of electricity. It was carried out for 5 years from April 2015 to April 2020 in 3 stages: the 1st stage for establishment of the Organization for Cross-regional Coordination of Transmission Operators in April 2015; the 2nd stage for the full liberalization of the retail market and abolishment of wholesale regulation in April 2016; and the 3rd stage for unbundling of the transmission/distribution sector from the generation/retail sector in April 2020.

From the 2nd stage beginning in April 2016, business types of "general electricity utility," "specified-scale electricity utilities" and "wholesale electricity utility" have been abolished and 3 types including "power generation company," "power transmission/distribution company" and "power retail company" have been established. JCR assesses individual power companies, placing a relatively large value on the stability of Japan's electricity business system as foundation, while also paying attention to individual companies' characteristics and considering comprehensive capabilities for power generation, transmission/distribution and retail, and will continue to reflect the impact of regulatory changes on their business bases as appropriate.

(1) Characteristics of the industry

(i) Market overview

While affected by short-term business fluctuations and weather changes, demand for electricity has been steadily growing along with Japan's economic growth. However, demand may gradually decline over the long term, due to the shrinking domestic population, changes in the industrial structure, progress in measures to reduce CO_2 emissions and prevent global warming, well-established consumer mind for saving electricity after suspension of operation of nuclear power stations stemming from the accident at Fukushima Daiichi of Tokyo Electric Power Company, and widespread use of energy-saving equipment.

(ii) Competitive situation

Economies of scale strongly work on electricity business, which is a social infrastructure. Electricity cannot be saved in high volume and its quality is always the same, despite differences in frequencies. In cases where principle of market mechanism is introduced into this kind of market or product, it will fall into price competition at last, and the existing customer base, capacity to procure fuel, financial strength, and so on determine the competitive strength. As a supplier of electricity, power companies, which are engaged in power generation, transmission and distribution for the users, account for majority of the market at the moment. These power companies, however, will face a risk that their business base will be impaired by new entrants' entry into the monopolistic market in effect. On the other hand, the principle of market mechanism will allow them to take strategic management approaches including increasing their opportunities to enter areas outside their own service areas and flexible setting of electricity rates. Checking the speed and degree of changes of competition advancement as a result of the electricity system reform, JCR will assess how changes in the power companies' competitiveness, as shown by acquisition or loss of demand, can have an impact on their earnings power and financial structure.

(iii) Cost structure

Excluding retail business, electricity is a typical large process industry that requires a large amount of fixed cost in an inflexible cost structure. The cost of fuel, a major variable cost of power generation business, can fluctuate relatively significantly, depending on fuel price trends. A matter to note concerning cost structures for power generation business is that an increase in greenhouse gas emissions is inevitable due to its nature. A possible scenario is that government environmental regulations will be strengthened, causing a burden to the electricity industry, depending on design of such regulations, and will result in an adverse effect on the industry's profit and financial structure. This may not only add downward pressure on the power companies' credit risk, but also slow down their growth by spending their management resources on technological development and capital expenditure for low-carbon emissions. For power generation and retail businesses, application of the full cost plus pricing method is to be discontinued in the future after a period of transitional measures. Accordingly, JCR will assess the certainty of investment recovery by checking the stability of their customer base.

Meanwhile, power transmission/distribution businesses remain under the group's umbrella as wholly-owned subsidiaries of power companies even after the business divestiture in April 2020. Revenue cap regulation was introduced in April 2023. This system is designed to promote management efficiency and ensure that business operators are able to make necessary investments. Under the system, the certainty of investment recovery is expected to be maintained, and even compared to the previous full cost plus pricing method, the stability of business operators' income and cash flow can be maintain.

(2) Key factors in market position and competitiveness

(i) Market position

JCR will examine how the relative positions of the electricity industry in the overall industries, or of power companies among themselves can change in accordance with changes to the framework of the electricity business system and impact of these changes on the individual power companies' cash flow levels, flexibility of distribution of their cash flows, improvement of financial conditions, etc.

There are following 3 major electricity generation companies, which provide power companies, etc. with electricity: Electric Power Development Co., Ltd., The Japan Atomic Power Company and JERA Co., Inc. As all the 3 companies with cost-competitive power sources hold important positions in Japan's power supply portfolio, JCR will analyze and assess them in line with the power companies' credit assessment, while focusing on individual business risk and changes in the contractual relationships with power recipients.

(ii) Business structure

Power companies engage themselves mostly in the electricity business, while involved in information and communications businesses by using the network infrastructure of their electricity business, as well as life services business based on their public use and closeness to local communities, among others. As domestic electricity business is expected to grow only moderately in the future, some power companies would develop derivative businesses, including enhancement of gas business, regional expansion such as investment in or management of overseas power generation business, investment in interests for stable procurement of fuel resources, or strengthening of sale of fuel to other companies. Achieving these matters, however, requires long-term strategies as a comprehensive energy business operator and a strong financial base to ensure the viability of the strategies. For this reason, JCR will check the direction of the strategies, as well as financing and investment policies, achievements in these policies, and establishment of a risk management structure.

(iii) Power source composition

Power companies attempt to achieve the "best mix of power sources" by using individual characteristics of hydropower, thermal power, nuclear power, and others, in a balanced manner. Under greenhouse gas emission controls and in line with targets for the best mix of power sources in the government's energy basic plan, companies are assumed to make more efforts to improve efficiency of thermal power generation, achieve high stabilization of capacity utilization in nuclear power generation or decommission of their facilities, and develop renewable energies.

Note should be taken on nuclear power generation, a base power source with high power generation efficiency. The higher the ratio of nuclear power in the power source composition, the larger the effect of capacity utilization fluctuations on profit and loss. Consequently, JCR needs to pay attention to effects of operation period, capacity utilization rates, applicable period of regular inspection cycle, and status of holding of alternative power sources in case of unexpected low-level operation (or shutdown, including reactor decommissioning) on income. If a nuclear accident happens, risks from it including liability for damages should be huge. Power companies can receive financial support from Nuclear Damage Compensation and Decommissioning Facilitation Corporation. However, JCR needs to watch carefully the method of sharing of the liability burden. Furthermore, it is necessary to watch trends in improvement of environment for private business operators for its stable assumption of nuclear power business including decommissioning in the fully liberalized market. As described above, risks in relation to nuclear power generation business are diverse and many of them put downward pressure on credit ratings for a long period of time and structurally, and impact on the credit ratings is large.

(iv) Investment in power sources and transmission/distribution network

Development of power sources in anticipation of non-application of the full cost plus pricing method in the future is assessed based on factors such as scale of development, investment amount, price competitiveness, and future demand-supply balance. In practice, the operation is based on assessment of trends in demand and competition and changes in the effects of these factors on the profit. Concerning demand and supply, the adjustment capacity is large due to postponement of a power source development plan and suspension and cancellation of long-term plans for obsolete power sources. Meanwhile, JCR considers that there is still some room for additional implementation of rationalization that was promoted in the entire industry as a result of liberalization. In addition to quantitative analysis, therefore, qualitative analysis and comparison to see how each company makes a decision in response to changes in external environment is also important.

Legal unbundling of the transmission/distribution sector was implemented in April 2020 to ensure neutrality of this sector. Despite rules governing behavior of the transmission/distribution sector in order to ensure neutrality, supply of capital in the group is not separated. Therefore, rating credit assessment for power companies based on group's unity is possible even after the legal unbundling. If the policy-planning authorities strengthen its rules of conduct on the transmission/distribution sector, restricting liquidity of funds seriously, JCR may review the rating methodology.

2. Financial base

(1) Profitability

For the power generation business, trends in fuel prices, particularly import prices of thermal power fuels (petroleum, LNG, and coal), have effects on profit in the short run. Fuel cost adjustment functions that reflect short-term fluctuations in the fuel price are often incorporated into electricity rates, enabling companies to reduce impact on profits in the medium run. JCR considers, however, price competition in the retail market, changes to the government's environmental regulations and so on will have a significant negative impact on electricity utilities. JCR will therefore monitor medium- and long-term profit margin. Construction of a large-scale power station requires a large amount of initial investment. As it is a business model that requires a long time to recover the investment, while the payback period differs depending on the power source composition, JCR will examine investment efficiency, watching carefully capacity utilization of power source facilities, demand size and stability of demand inside and outside the service areas.

Key financial indicators:

- Ratio of ordinary income to sales
- Capacity utilization of power source facilities

(2) Cash flow generation capacity

Power companies are at a phase of facing a heavy burden of investments due to constant maintenance/renewal, response to aging power transmission/distribution facilities, installation/replacement of power generation facilities for higher efficiency, response to safety measures for nuclear power plants, among others. Power companies that are suspending nuclear power operation for a long period of time continue bearing a burden of cost for thermal power as a substitute for nuclear power. In the midst of a full-scale price competition in the retail market, a raise in electricity rates is difficult. JCR therefore will pay attention to whether companies are taking measures to improve their cash flow generation capacity by cost reduction through management efficiency enhancement and expansion of new business categories including overseas business.

Key financial indicators:

- EBITDA
- Free cash flow
- Ratio of interest-bearing debt to EBITDA

(3) Safety

As power generation and transmission/distribution businesses require a large amount of capital investment, many companies carry a large amount of interest-bearing debt. Their financial structure is relatively unstable, with a higher ratio of fixed assets to total assets and a weaker balance between debt and capital as compared with other industries. Capital needs different in quality from conventional ones, such as those for investment in overseas power generation business and measures against global warming, may increase. Moreover, in the case that the financial base is significantly damaged because of profit worsen by long-term suspension of operation of nuclear power plants, the financial base should be recovered. Efforts for improving the financial structure is highly important in order to respond to changes in business risks arising from competition progressed through liberalization, entry to businesses other than domestic electricity business, among others.

Key financial indicators:

- Equity ratio
- Debt equity ratio

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Rating Methodology by Sector

Food Service

1. Business base

The industry has a large market size, but the industry itself is mature. The industry characteristic is that the booms and busts of companies can be drastic, and the risks of earnings fluctuations are also high. For these reasons, the rating assessment focuses on the sustainability of differentiation that is the basis for competitiveness, including the appeal of the core menu and restaurant management capability. It also focuses on the ability to maintain a certain level of earnings in the medium-to-long term by taking advantage of cost structures and other factors.

(1) Characteristics of the industry

(i) Market overview

Although some companies in Japan's food service industry are operating overseas, most companies' main market is the domestic market. Therefore, the food service industry as a whole is in a mature phase, due to the nation’s population decline and the impact of the falling birthrate and aging population as well as changes in customer preference. However, although the market size of the food service industry has been shrinking since its peak of approximately 29 trillion yen in 1997, it is still a huge market, and the market size of relatively industrialized businesses such as fast food and family restaurants is not necessarily shrinking. As the shakeout of small, medium, and micro businesses continues, there is room for new store openings.

With the transient preferences of consumers, the industry is characterized by large fluctuations in earnings, with the market expanding rapidly during a temporary boom and then declining sharply in a subsequent reactionary decline. In addition, as consumer behavior patterns change, opportunities to eat out outside of restaurants, such as take-out and delivery, are expanding. JCR will check whether a company can smoothly respond to such changes in demand and the external environment and build a business portfolio that is in line with current trends.

Meanwhile, due to the handling of food, the industry is required to take thorough measures in terms of hygiene management. Moreover, with the tightening of regulations on traceability and other aspects of "food security and safety" and rising consumer interest, it is also essential to address these risks.

(ii) Competitive situation

As entering the restaurant business is relatively easy with the low barriers to entry, the market is very competitive. In the past, hamburger chains and beef bowl operators have waged a war of attrition, in the wake of a series of price-cutting competitions. Meanwhile, the narrowly defined restaurant industry is competing with the ready-made meals industry, which offers packed lunches in convenience stores and other take-away meals.

Small, privately managed restaurants account for most of the industry, and the share of more industrialized chain restaurants is relatively small. However, with the rise of the companies that operate chain restaurants and the shakeout of small, medium, and micro restaurants, the share of the major chain restaurants has been gradually growing. In particular, in the fast food and family restaurant categories, oligopoly by the major chains has been progressing.

(iii) Cost structure

The cost structure of the industry comprises the so-called FLR costs, the three major costs of foodstuffs, labor, and rent. Of these three, procuring foodstuffs often accounts for the largest part of total costs, and it involves the risk of price fluctuations due to adverse weather conditions, outbreaks of disease, and other temporary factors. In addition, foreign exchange effects should be kept in mind. There is also concern that prices of meat, marine products, soybeans, and other products may rise over the long term due to changes in the global demand structure. For these reasons, JCR confirms whether the company has a procurement base that enables it to procure foodstuffs stably and at low prices. JCR also pays attention to the company's efforts for reduction of food waste through the use of central kitchens and AI demand forecasting, as well as flexible menu strategies to maintain appropriate cost levels, in addition to the securing stable suppliers and diversifying procurement routes, for the purpose of lowering foodstuff procurement costs.

Labor costs are the second-largest cost category, after foodstuffs. The industry is a labor-intensive industry, and the weight of labor costs is relatively high. To deal with this, the industry needs to try to reduce fixed labor costs by making use of part-time and temporary workers. It also needs to manage restaurant operations through effective worker deployment. On the other hand, the industry has more severe working conditions than other industries, making it difficult to secure and retain human resources. In addition, given social structural issues such as the declining birthrate and aging and shrinking population, it is important to standardize work for quickly bringing human resources into the capable workforce and to promote efficiency by reducing the store operations themselves. If store personnel can be allocated to tasks that create more added value by eliminating simple tasks, the value of the store experience and customer satisfaction will increase, and this may lead to differentiation from the competitors.

The third cost category after foodstuff costs and labor costs is rent. In the industry, the companies often manage a number of restaurants using rented properties. As a result, the weight of rents related to opening new restaurants accounts for a relatively high share of the companies' costs. In particular, rent is a cost that is easily fixed, and the cost burden becomes more severe when sales are declining. Therefore, JCR confirms whether the companies contain the ratio of rents to sales to a certain level. In addition, JCR also pays attention to whether the company has concluded lease contracts under relatively expensive terms in a hurry to open new restaurants.

(2) Market position and competitiveness

(i) Market position

It is relatively easy for new players to enter the industry. As a result, operators are rapidly rising and falling, and rankings of market share or sales today are not always good indicators of competitiveness tomorrow.

Meanwhile, restaurant operators can use economies of scale to exert purchasing power when procuring foodstuffs and other materials. In addition, the high-profile companies that operate nationwide restaurant chains have an advantage in property referrals and other aspects when developing new restaurants. Moreover, it is difficult to bear the cost of ensuring "food security and safety," such as the establishment of a traceability system, without a certain level of business scale.

(ii) Ability to attract customers

With a mature market and strong supply pressure, the industry is struggling with an overstored condition. Consequently, restaurant operators are prone to declines in same-store sales and profitability. As sales in the industry fluctuate markedly with boom and bust trends, it is vital for restaurant operators to maintain and increase same-store sales. The key in maintaining same-store sales is to attract repeat customers who visit the restaurants on a weekly, monthly, or other regular basis. To achieve this, restaurant operators can try initiatives such as including the introduction of menus or discount programs that are provided for a limited period as well as the distribution of coupons. Still, the most critical point in securing repeat customers is the extent of menu and price differentiation.

(iii) The appeal of core menus

The starting point for differentiation in the industry is the core menu. A strong core menu, rather than an extensive menu, tends to be a better indicator of success in this industry. Consequently, the focus needs to be on such factors as whether or not a company responds to customer needs by offering a core menu with competitive quality and prices that are hard to beat, whether it provides service that satisfies customers and offers value for money, and whether it takes steps to maintain its edge and prevent customers from wearying of its menu and services.

(iv) Capabilities to open new restaurants and develop business categories

In managing a large number of restaurants, it is important to select and secure desirable locations. JCR confirms whether a company has established an organizational structure that enables it to do this. However, if the attractiveness of the core menu deteriorates and existing business categories fall out of fashion, there are clearly many cases in which simple changes in menus or prices within existing business categories do not produce a noticeable improvement in operations. More positive results have been produced when a company has instead changed the structure of its existing categories by developing and adopting new business categories. This shows the importance of having a structure that enables companies in the industry to develop new categories to promptly respond to changes in the business environment. For the development of new categories, JCR focuses on the ability of a company to maintain a competitive edge through the early stages by taking advantage of its accumulated management expertise and economies of scale. JCR also emphasizes the ability to build a portfolio of business categories. For example, if a company operates multiple business categories, such as fast food, family restaurants, and dinner restaurants, with different customer segments and usage patterns, the company can diversify its revenue sources and absorb the negative effects of a deteriorating external environment.

(v) Management capabilities

JCR pays attention to whether or not the business philosophy and policies of top management are known to all employees in the company, including restaurant staff, and whether comprehensive action is taken to adhere to the principle of quality, service, and cleanliness (QSC). There is also a focus on whether services are consistent across a restaurant chain, and whether individual restaurants can take initiatives tailored to local characteristics. JCR also checks to see if a company is acting to secure and train staff in step with the expansion of its network of restaurants and to lower procurement, production, and logistics costs, while taking other appropriate measures, such as ensuring the "food security and safety," and developing price policies. In the past, there have been cases where governance systems were inadequate and labor management and quality control problems were found, adversely affecting business performance. In addition to misconduct by part-time and temporary workers, there is also a need for measures to address inappropriate behavior caused by customers. In particular, when misconduct or problems occur at stores or other workplaces, there is a strong possibility that the fundamental ability to attract customers and brand power will be damaged, and it is essential to develop and thoroughly implement internal systems and measures to prevent recurrence.

2. Financial base

(1) Earnings strength

In the industry, there are companies that achieve relatively strong profitability despite their limited sales volumes. Still, the characteristic of the industry is that profitability fluctuates quite significantly due to changes in the external environment and customer preferences. For these reasons, when ratings the industry, JCR takes into account the risks of profit fluctuations and makes slightly stricter assessments compared with the quantitative criteria.

By opening new restaurants, companies in the industry can easily bolster sales, but existing restaurants are the basis for earnings. As indicators to measure the profitability of existing restaurants, other than net sales, JCR values the year-on-year change of same-store sales.

Key financial indicators

- Year-on-year change of same-store sales
- Operating income margin
- Operating income

(2) Cash flow

One of the characteristics of the financing of the industry is that the burden on working capital is light because most service bills are paid in cash. Some companies, in fact, maintain liquidity on hand that exceeds their borrowings. In addition, because most restaurants are leased properties, companies in the industry basically have fewer financial burdens and relatively small interest-bearing liabilities, unless they adopt policies of investing in their own restaurants or undertake substantial mergers and acquisitions. It is, however, necessary to determine if the ability to repay debts has deteriorated, as a result of a decline in the ability to generate cash flow associated with a fall in same-store sales.

Key financial indicators

- EBITDA
- Interest-bearing liabilities/ EBITDA ratio

(3) Safety

In the restaurant industry, there is a risk of a plunge in sales due to restaurant closures or reduced operating hours in the event of an outbreak of an animal or plant disease that affects foodstuffs or a pandemic of an infectious disease among consumers. For this reason, it is important for companies in the industry to have sufficient financial strength to withstand losses that may arise from these unexpected events. In addition, it is necessary to pay attention to the risk of impairment losses for restaurant companies operating the chain restaurant business, because the decision to apply impairment accounting is basically made for each restaurant. In addition, for companies that have adopted IFRS, there are cases where a large amount of goodwill has been recorded due to corporate acquisitions in the past, so attention should also be paid to the risk of goodwill impairment losses due to a sudden deterioration in business performance. For these reasons, in rating the industry, emphasis is placed on whether the companies have sufficient capital to withstand the risk of such accounting losses.

Key financial indicators

- Shareholders' equity
- Equity capital ratio
- Debt equity ratio

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