

# Shareholders 'Letter

## Review of the 36th fiscal year

( 2001.3.1 ~ 2002.2.28 )  
(PDF Version)

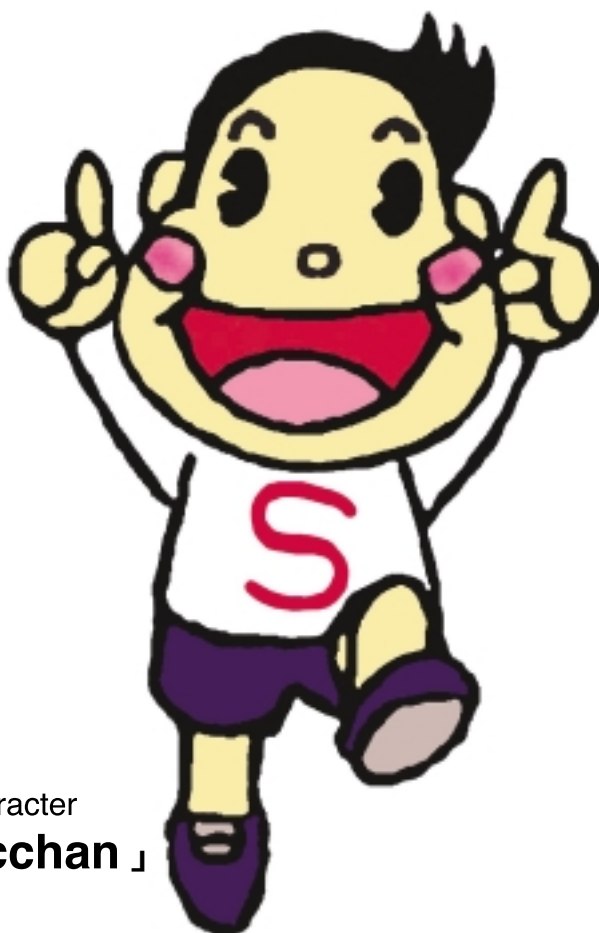


Image Character  
「 Kotecchan 」

This letter is modified for home page use.

# S Foods Inc.

# To Our Shareholders

During the term under review, the Japanese economy experienced a year of turbulence. The domestic recession lingered, as evidenced by the negative real growth in the GNP. In September, the first case of BSE (bovine spongiform encephalopathy) was discovered in Japan, the terrorist attacks shocked the United States, and a large retailer went bankrupt in Japan. Our industry also experienced numerous problems, including the outbreak of foot-and-mouth disease, initiation of safeguard for pork, and outbreak of BSE in Europe. In particular, the BSE problem and the problem with food labeling in Japan caused consumers to lose trust in meat. Combined with the recession, the problems have placed our company at unprecedented risk.



May 2002

Hayao Morishima President and CEO

We cannot expect to make a breakthrough, however, if we concern ourselves only with external factors and environmental changes. In order to build a bright future for our company, we will first reviewed the corporate creed and motto, and then launched a reengineering effort by scrap and build. As a part of this effort, we made major changes to our company, including the shut down of Funabashi No. 2 Plant. Despite this effort, during the consolidated accounting term, sales fell to ¥43,245 million (down 20.9% from previous year) and income before extraordinary items fell to ¥198 million (down 91.2%). As we have had to post large special losses for BSE and reengineering, we have recorded a net loss for the term of ¥2,235 million.

Sales have suffered in every business segment in our company due to BSE and other problems. Sales to business corporations recorded ¥40,646 million (down 21.5%). Sales to consumers posted ¥2,598 million (down 9.1%). By geographical segment, sales in Japan fell to ¥42,325 million (down 21.2%) and operating loss amounted to ¥309 million. In the United States, sales rose to ¥920 million (up 1.2%) and operating income fell to ¥116 million (down 0.2%).

Although the environment surrounding our company is harsh, we have succeeded in developing a sound balance sheet and strengthening our organization. We eliminated idle facilities by reengineering and streamlined our operations by eliminating negative assets and incurring revaluation loss of certain inventories. Combined with the project to renew our flagship product, "Kotecchan," we have recorded a profit on monthly basis from March. Monthly consolidated sales on year-on-year basis also increased from 48.2% in February to 60.2% in March. Sales in April are increasing at a faster pace than in March. As a result, for the fiscal year ending in February 2003, we expect sales of ¥42,000 million (down 2.9%), income before extraordinary items of ¥1,050 million (up 429.6%), and net income for the term of ¥550 million.

A handwritten signature in black ink, appearing to read 'Hayao Morishima', written over a horizontal line.

# Challenge 21-Reengineering plan

Last fiscal year we started a medium-year (three-year) business plan called "Challenge 21." Our vision of this plan is to "build a powerful company" in line with the company's creed of "providing tasty and appealing stamina-enhancing foods, thereby making a contribution to the world." We took on the challenge of tiding over these turbulent times and establishing a solid and unshakable position as a pioneer in the distribution of beef variety meats, which is major part of our business scope.

However, regrettably, we were hit and affected hard in terms of sales activities by Japan's first BSE (bovine spongiform encephalopathy) problem last September. To restore our business basis we changed "Challenge 21" to "Challenge 21 - Reengineering Plan". Reengineering in our company means "tear down and recreate." The first thing to do is to dismantle the present management system. The next thing is to extract the management resources necessary for the future operation of S Foods and allocate them to those divisions, products and projects that have promise and future potential on a priority basis and in optimal proportions. In this way, we will build a slim and tough managerial constitution and regain financial health by speeding up reforms and achieve the goal of the initial plan within the next two years, as originally scheduled.

## Management system reform

In rebuilding our management system and organization, we shall place an emphasis on "the improvement of corporate governance" and "speedy decision-making and execution of tasks," and further separate management from day-to-day business operations. To ensure that business operations run smoothly, we are introducing a system that places officers in charge of each of the Sales Business Group, the Manufacturing Operations Group, and the Management & Administration Group, as well as assigning corporate officers to major divisions.

## Introduction of a new corporate officer system

We are introducing a new corporate officer system to ensure that the tasks commissioned by the board of directors will be speedily executed under the direction of the representative director. Corporate officers will be given the authority to attain the targets under clearly defined roles and responsibilities. Corporate officers will be selected from among employees based on merit, regardless of age and sex, and will be paid according to the results achieved. By adopting this system, we will motivate employees and create a workplace where they feel rewarded.

## Personnel strategy

Management resources such as personnel, assets, capital, information and know-how etc. will be allocated optimally from a new perspective. With respect to human resources, we will introduce an innovative compensation system that gives capable and motivated employees an incentive to demonstrate their ability. We will also ensure that our employees learn to identify and solve problems on their own.

## Development strategy

We will bolster our organization and product lineup, with an emphasis placed on the development of core products that will become our brands in the future.

## Sales strategy

The Sales Business Group will drastically change its organization to shift emphasis from quantity to quality and establish a profitable business model. The group will be reorganized into divisions according to the types of products and commodities handled. Three new divisions, in charge of national brand products, products processed outside the company, and commodities, respectively, will be established. Two sales divisions will be created for the centralized management of all places of business to bolster the company's domestic marketing power. We are also setting up a distribution center to build an efficient company-wide distribution system and reduce distribution costs. As part of our global sales strategy, we will shortly set up an operation base in China so that a tripolar system comprising Japan, the U.S. and China will operate business independently, but complement one another to maximize the group's profit. We have already organized a China business team in this group.

## Manufacturing strategy

The Manufacturing Operations Group reviewed all of the items of production upon the closure of the No. 2 Funabashi Factory. It is building an efficient production system in the remaining three factories. The group will also build a production structure strategically integrated with the Sales Business Group and Development Center, and will modernize the factories in such a way that they will be able to take orders directly from customers. The substantial assets of No. 2 Funabashi Factory were sold to Naruo Kosan K.K., a property holding and managing subsidiary established February 2002, so that the factory facilities will be put to good use.

## Q1. What caused the large drop in sales and profit in the 36th term?

A. The outbreak of the first case of BSE (bovine spongiform encephalopathy) in Japan, the prolongation of the problem due to lagging action by the government, and the problem with food labeling caused consumers to lose confidence. As a result, our performance suffered a severe damage.



## Q2. How did you deal with BSE?

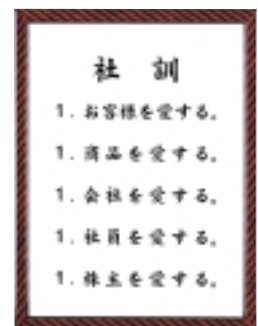
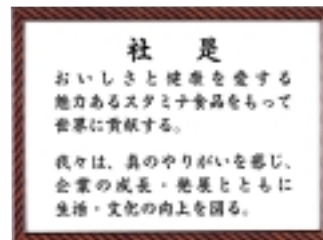
A. Since the first case of BSE was discovered on September 10 last year, we have aggressively made every effort to society on safety. For example, we have made "safety declaration" in newspapers, on the Home Page, with pamphlets, and at butcher shops, supermarkets, and barbecued meat restaurants. We have placed the raw material and country of origin on every product and package that we sell. Our manufacturing and sales departments advanced such powerful promotion activities to regain the trust of distributors and consumers in meat. At the same time, we have worked jointly with the United States Meat Export Federation (USMEF) and the Meat and Livestock Association of Australia (MLA) to explain the safety of beef from these countries and restore demand for the meat industry as a whole.

## Q3. What is your role in the meat industry?

A. Please take a look at our corporate creed. Our role is to provide customers with food products that are delicious, safe, nutritious, functional, healthy, attractive, and develop stamina at reasonable prices that satisfy customers. By performing this role, we can make people around the world happy, including producers in the United States and Australia, people who work at local meat packers, our customers, and consumers. We can do this only if we have a solid relationship of trust and the foundation for mutual cooperation. To this end, we have set new company motto based on the "Five Loves" and designated them as our future activity guidelines.

Five Loves are as follows;

- to love our customers    •to love our products    •to love our company
- to love our employees    •to love our stockholders



## Q4. Do you have a specific plan to restore business performance?

A. We will perform reengineering by scrap and build to develop a slim and strong business entity. We have already streamlined the balance sheet by cutting down inventory and some facilities and downsized our organization. We are now capable of making a profit even if our sales are 80% of that of the 35th term. We will also restore our business performance by putting into action our annual business policies for the 37th term:

- <1> Reinforce marketing
- <2> Reinforce development of products
- <3> Develop human resources who can solve problems
- <4> Renovate internal business process
- <5> Create a better corporate culture

## Q5. What is the outlook for the 37th term?

A. Major changes have taken place since last March. We have seen clear signs that consumers are eating beef again. As you know, the demand for barbecued beef is returning steadily. As a result of the reengineering and our positive measures such as the renovation of our flagship product, "Kotecchan," we have turned a profit on monthly basis from March. Monthly consolidated sales on year-on-year basis also increased from 48.2% in February to 60.2% in March and to 66.9% in April. Sales in May are also increasing at a fast pace. As a result, for the consolidated fiscal year ending in February 2003, we expect sales of ¥42,000 million (down 2.9% from previous year), income before extraordinary items of ¥1,050 million (up 429.6% from previous year), and net profit for the term of ¥550 million.

## Q6. Please elaborate on the company motto, "to love stockholders"

A. Our company owes its success to stockholders. We must always be thankful and make an effort to meet stockholders' expectations. We operate our business with the highest priority on the stockholders' profit. We make an effort to aggressively disclose business strategies and performance trends, and fully explain the business situation. We feel that our responsibility to stockholders is to return as much profit as possible (dividends) and raise our stock price. We have incorporated these concepts into our company motto, and will set ¥12 per share in normal annual dividend as the basic target for consistent and continuous profit return beginning in the term ending February 2003. We will raise the goal of dividend ratio from 30% to 40% and further reward stockholders of improvement in business performance. In addition, by reducing the number of shares in one unit of trading from 1,000 to 500 shares, we would like as many investors as possible to become our stockholders.



## Q7. What is in the future for the barbecue meat market?

A. Since the company started, we have developed in overseas countries numerous variety meats products for barbecued meat industry in Japan, and have built our solid basis with a business model for importing these products. One principal example is "Joomino-MC Tripe," which was first developed and imported by S Foods. We also developed the foundation for the mass import of "Harami-Outside Skirt" and "Shimacho (Tecchan)-Large Intestine," which today are popular barbecue products, into Japan. "P-toro" (referred to as "Buta-toro Jowlmeat" at some restaurants, it is a valuable product (only about 200g can be retrieved from each pig) has gained popularity in recent years. We were one of the first to commercialize the product after seeing a boom in Hokkaido, one of islands located northern part of Japan and the first to find suppliers in the United States and import the product to trigger a nationwide boom. As these examples illustrate, we have fought the preconceived notion that "barbecue meat is delicious but expensive," and provided inexpensive and safe barbecue products in an effort to develop the barbecue meat culture. There is still room for growth in the barbecue meat market, and many ingredients that have yet been explored. As a niche pioneer, we will continue our product development efforts with our technology, and provide inexpensive, safe, healthy, and delicious barbecue meat to further enlarge the market.

## Q8. What is the future and direction of S Foods?

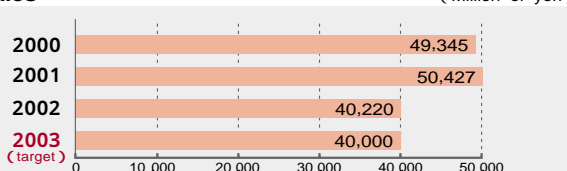
A. My motto is to love what I do, help society, and share in the joy. Since the company started, we have nurtured our dream and hope of helping others. As a pioneer, we decided to develop barbecue products overseas. As I mentioned a while ago, by developing and importing variety meats that had not been used, we have managed to help producers, local meat packers, domestic customers, and consumers. We will continue to build on our dream and hope to become the largest barbecue meat company in Japan and the largest variety meat company in the world.



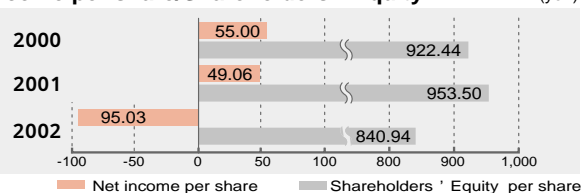


## Financial Summary (unconsolidated)

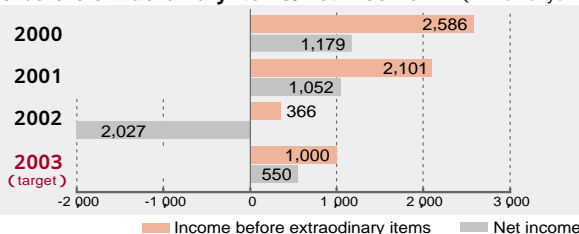
### Net sales (Million of yen)



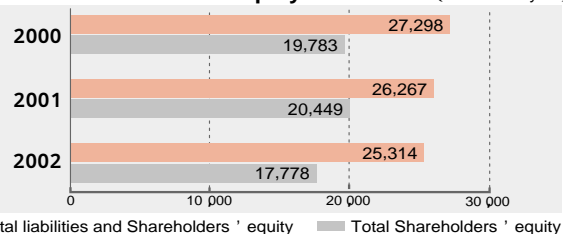
### Net income per share/Shareholders' Equity (yen)



### Income before extraordinary items/Net income (Million of yen)



### Total Assets/Shareholders' Equity (Millions of yen)



## Balance Sheet & Income Statement

### Unconsolidated Balance Sheet (Summary) (Million of yen)

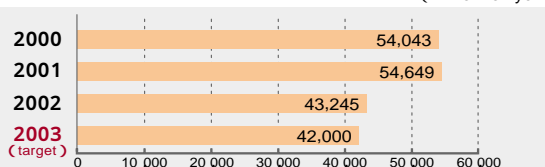
	2003 (target)	2002	2003
<b>Assets</b>			
Current assets		10,480	11,563
Fixed assets		14,834	14,704
<b>Total assets</b>	<b>24,300</b>	<b>25,314</b>	<b>26,267</b>
<b>Liabilities</b>			
Current liabilities		7,145	5,337
Fixed liabilities		390	479
<b>Total liabilities</b>	<b>6,200</b>	<b>7,536</b>	<b>5,817</b>
<b>Shareholders' Equity</b>			
Common stock		4,226	4,226
Additional paid-in capital		4,171	4,171
Earned surplus		590	540
Retained earnings		8,995	11,511
<b>Total shareholders' equity</b>	<b>18,100</b>	<b>17,778</b>	<b>20,449</b>
<b>Total liabilities &amp; shareholders' equity</b>	<b>24,300</b>	<b>25,314</b>	<b>26,267</b>

### Unconsolidated Statements of Income (Summary) (Million of yen)

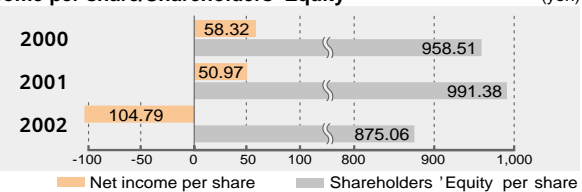
	2003 (target)	2002	2003
Net sales	40,000	40,220	50,427
Cost and expenses	<b>39,050</b>	<b>40,355</b>	<b>48,314</b>
<b>Operating income</b>	950	135	2,112
<b>Non-operating income</b>		<b>553</b>	<b>295</b>
Non-operating expenses		<b>51</b>	<b>306</b>
Income before extraordinary items	1,000	366	2,101
Extraordinary gains		166	—
Extraordinary losses		4,026	241
<b>Income before income taxes</b>		<b>3,493</b>	<b>1,860</b>
<b>Income taxes-current</b>		60	909
<b>- deferred</b>		1,526	101
<b>Net income</b>	<b>550</b>	<b>2,027</b>	<b>1,052</b>
Retained earnings carried forward	806	960	904
Unappropriated retained earnings	<b>1,356</b>	<b>1,066</b>	<b>1,956</b>

## Consolidated Financial Summary

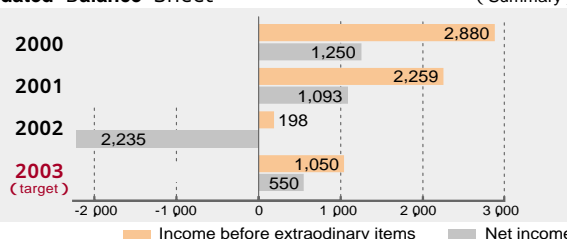
### Net sales (Million of yen)



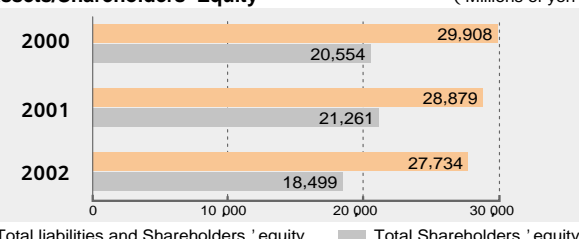
### Net income per share/Shareholders' Equity (yen)



### Consolidated Balance Sheet (Summary) (Million of yen)



### Total Assets/Shareholders' Equity (Millions of yen)



## Consolidated Balance Sheet & Income Statement

### Consolidated Balance Sheet (Summary) (Million of yen)

	2002	2001
<b>Assets</b>		
Current assets	12,129	13,268
Fixed assets	15,604	15,591
Foreign currency translation adjustments	—	19
<b>Total assets</b>	<b>27,734</b>	<b>28,879</b>
<b>Liabilities</b>		
Current liabilities	8,067	5,949
Fixed liabilities	434	1,032
<b>Total liabilities</b>	<b>8,502</b>	<b>6,981</b>
<b>Minority interests</b>	<b>732</b>	<b>637</b>
<b>Shareholders' Equity</b>		
Common stock	4,226	4,226
Additional paid-in capital	4,171	4,171
Consolidated retained earnings	10,200	12,863
Treasury stocks	194	0
<b>Total shareholders' equity</b>	<b>18,499</b>	<b>21,261</b>
<b>Total liabilities, minority interest &amp; shareholders' equity</b>	<b>27,734</b>	<b>28,879</b>

### Consolidated Statements of Income (Summary) (Million of yen)

	2002	2001
Net sales	43,245	54,649
Cost and expenses	<b>43,465</b>	<b>52,378</b>
<b>Operating income</b>	220	2,270
<b>Non-operating income</b>	<b>499</b>	<b>322</b>
Non-operating expenses	<b>80</b>	<b>333</b>
Income before extraordinary items	198	2,259
Extraordinary gains	114	25
Extraordinary losses	3,958	252
<b>Income before income taxes</b>	<b>3,646</b>	<b>2,032</b>
<b>Income taxes-current</b>	114	976
<b>- deferred</b>	1,558	85
<b>Net income</b>	<b>2,235</b>	<b>1,093</b>

## Net Sales by Product Division(unconsolidated)

Sub total of Finished Product  
/16,670millions(41.4%)

Sub total of Commerical Product  
/23,549millions(58.6%)



## Summary of Cash Flows Statement(unconsolidated) (Millions of Yen)

Subject	2002	2001
Net Cash provided by Operating Activities	1,261	1,362
Net Cash used in Investing Activities	196	95
Net Cash used in Financing Activities	2,267	1,805
Cash and Cash Equivalents at End of Year	2,301	1,406

Annual Dividend

¥126.843 thousands ( ¥6 Per Share )

## Company Profile

### Line of business

Manufacturing, processing, wholesale and retail of meat products, sauce and seasoning

### Offices

Head office :

1-22-13 Naruohama, Nishinomiya City, Hyogo  
Phone No. +81-798-43-1065 Fax No. +81-798-43-1067

Tokyo Head office :

38-24 Takasecho, Funabashi City, Chiba  
Phone No. +81-47-435-0811 Fax No. +81-47-433-3301

### Year of foundation

May 22, 1967

### Paid in capital

¥4,226.64million (as of end February, 2002)

### Directors & Auditors (effective May 28,2002)

Representative Director	Hayao Morishima
Director	Susumu Tomisawa
Director	Naoki Tomonaga
Director	Motohiro Tanaka
Director	Kunitaka Dan
Director	Masatsugu Tanaka
Auditor	Yujiro Ohiro
Auditor	Hideo Konishi
Auditor	Masanobu Nakano

### Number of employee

378

(as of end February, 2002)

### Annual sales

¥40.2 billion

### Affiliates

Mr. Stamina KK  
KK Kenshoku  
KK Ajicho  
FOEM Shokuhin KK  
Fremont Beef Company  
Goai Yakiniku Concept KK  
Sukoyaka Shokuhin KK  
Goai Foods Services KK  
Naruo Kosan KK