

Interview with the CEO

Switching to Fast Casual

Fulfilling corporate social responsibility

Q1: Same-store sales are recovering, showing a year-on-year increase in the second half of fiscal 2003, ended March 31, 2004. Please give us an overview of non-consolidated performance in fiscal 2003?

According to the Japan Food Service Association, industry-wide same-store sales in 2003 declined 5.8% compared with the previous year, highlighting the tough conditions faced in the food service industry. Under these conditions, MOS concentrated efforts on product development to invigorate same-store sales. We developed the *Nippon's Burger Takumi*, reflecting our passion and originality in creating delicious food, and continued to add new food creations to our menu. We also bolstered our time marketing strategy and aggressively worked to preserve the environment. As a result of repositioning and renovating stores, the total number of stores decreased, but the number of prime stores increased, substantially contributing to the recovery in same-store sales. Through these measures, sales of the MOS Burger chain rose 0.2%, the first increase in six fiscal years, although same-store sales declined 0.5% year on year.

As a result, net sales increased 1.6% to ¥55,957 million, operating income climbed 23.2% to ¥2,178 million, and ordinary income grew 19.7% to ¥2,501 million. Net income declined 10.8% to ¥1,011 million, owing to the absence of an extraordinary gain of ¥1,016 million on the sales of subsidiary stock recorded in the previous fiscal year.

We consider the return of profits to shareholders to be a fundamental management issue. Accordingly, we have decided to distribute annual dividends of ¥22 per share, an increase of ¥2 per share compared with the previous fiscal year and ¥2 per share higher than our original plans.

Q2: In fiscal 2003, MOS released the distinctly unique Takumi burger. Where is MOS focusing its product strategy?

In August 2003, to enhance the MOS Burger brand value, we took our accumulated know-how in making hamburgers and focused it on creating a

truly unique and delicious product, the *Nippon's Burger Takumi* (¥610). The *Nippon's Burger Takumi* is a high-grade hamburger that combines carefully chosen ground beef, buns, vegetables and soy sauce with our special cooking techniques. The name Takumi also represents a chef carrying on a tradition of devotion to taste. The ingredients, cooking methods, distinctive taste and naming of *Nippon's Burger Takumi* signify our dedication to Japanese tradition and our confidence in creating the best-tasting Japanese-style hamburgers. In January 2004, we released the second product of the Takumi series—the *Nippon's Burger Takumi Lettuce* (¥610), a hamburger for health-conscious customers that uses lettuce instead of buns to sandwich the hamburger. Praised by customers as part of our highly distinct fast food menus, these products have contributed substantially to improving the MOS Burger brand value, as they have been mentioned on numerous occasions in the mass media. According to Brand Japan 2004, published in the April 13, 2004 issue of the *Nikkei Marketing Journal*, the MOS Burger brand ranked 25th out of 1,000 companies in a survey of approximately 25,000 consumers, a marked improvement from 28th place in the previous year. In the food service category, the MOS Burger brand ranked second, compared with fourth in the previous year, demonstrating the strong recognition of our brand name.



<p>Nippon's Burger Takumi 610Yen</p>
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MOS has also further refined its original food menu along with food flavor and product concepts. In August, we revealed the *Jambalaya Chicken Burger* (¥320 not including tax), and in December, we released the *BBQ Focaccia* (¥350 not including tax). These became hit products because of their refreshingly original and delicious taste.

Under our time marketing strategy, we aimed to broaden our dessert

menu and stimulate demand for coffee by introducing Specialty Coffee in all stores in October. At appropriately located stores, we implemented new menus for breakfast and dinner, effectively increasing customer traffic to these stores during each time period of the day.



Specialty Coffee

Q3. Please describe progress on initiatives during fiscal 2003, namely store relocation, cost reductions and new business development.

In fiscal 2003, we opened 64 stores and closed 97, for a total of 1,476 stores as of March 31, 2004, a reduction of 33 outlets from the end of the previous fiscal year. The decline in stores was the result of ongoing efforts to streamline stores. We rebuilt 17 stores, and sales at these stores improved substantially compared with the previous year. In addition, we continued efforts to reduce costs in mainly ingredients while maintaining quality and safety. As a result, we achieved supply cost reductions of ¥350 million, lowering the cost of sales by ¥404 million and the cost of sales ratio by 1.7 percentage points from the previous fiscal year.

MOS is promoting the creation of a franchise package business format by constantly conducting feasibility studies on new business models and new business development. In fiscal 2003, we opened on a trial basis the Stefan GRILL as a steak and hamburger restaurant targeting new customer groups comprising male salaried employees and students. The number of Mother Leaf specialty teashops increased to 15 as of March 31, 2004, with the opening of Mother Leaf Aoyama Oval Building in Aoyama, Tokyo. Mother Leaf is entering the final testing stages prior to franchise development, and we are focusing energies on store design and menus that target dinnertime customers in addition to meeting coffee/teashop demand. In addition to new business development, we are starting to develop concepts for future MOS businesses. In line with our organizational change in March 2004, we established the future business group within the new business division.

Also in fiscal 2003, we took major steps forward in overseas business development. We opened new stores in Singapore, and expanded the number of stores in Taiwan from 42 to 75 over the past year. As our brand recognition takes hold locally, we plan to expand the number of stores to 100 in fiscal 2004. I lived in Taiwan for five years launching new businesses there, and I am proud to say that MOS is becoming widely known there. While redoubling efforts to make MOS indispensable to the restaurant scene in Taiwan, I believe that my mission is to lead MOS from Japan into Asia and then on to the world.

Q4: How were results on a consolidated basis?

Revenues and profits declined during fiscal 2003 at TOMOS, Inc., which manages the *Chirimentei* chain of Chinese noodle restaurants, as a result of measures to close unprofitable stores and refurbish restaurants. Shikina, Inc., which operates *AEN* organic food restaurants, has attracted the support of customers with its concept of creating Japanese food using carefully grown vegetables. In fiscal 2003, Shikina, Inc. opened the Marui Mizokuchi Store and the Yokohama CIAL Store for a total of four *AEN* restaurants. In other operations, two companies provide financial, insurance and sanitation support for MOS Burger and Chirimentei businesses. These two companies performed in line with original expectations.

Q5: Society is increasingly concerned about the safety of the food supply and corporate ethics as a result of bovine spongiform encephalopathy (BSE) occurring in the United States in December 2003 and the bird influenza incident in Japan. How has MOS responded to this phenomenon?

Over the past few years, corporate social responsibility (CSR) has come to the forefront in terms of the economy, environment and society. As a foods-related company, we take CSR seriously. Since its foundation, MOS's corporate philosophy has been to contribute to people and society first and foremost by creating delicious, safe and healthy food. This philosophy is reflected in our corporate activities and is the wellspring of MOS as we strive to contribute to the happiness of our customers. In March 2004, MOS acquired ISO 14001 certification for its environmental management systems at all MOS Burger stores, all new business stores and the franchise headquarters. With this accomplishment, we are redoubling our efforts to

preserve the environment, and established the CSR Promotion Division to proactively implement measures to fulfill our corporate responsibilities to society. (Please refer to CSR News for further details.)

Owing to BSE and bird influenza outbreaks, consumers are uneasy and wary about their food. Against this social backdrop, we believe our ongoing efforts to ensure peace of mind, safety and health in our food will be appreciated. We believe that the firm sales recorded in the second half of the fiscal year under review are a sign of consumer confidence in MOS. However, this is not the end-all goal for our CSR efforts. The continuation of sincere CSR efforts will lead to an improvement in the corporate value of MOS.

Q6: What position is MOS aiming to maneuver into?

In an era of low-cost strategies, overall consumer spending trends, including spending in restaurants, have struck a balance between quality and prices. We sense that consumers are willing to pay a slightly higher price for higher quality as long as they are balanced. In August 2003, we introduced the *Nippon's Burger Takumi* for ¥610. We are extremely confident in our product creation capabilities, as the products we develop are based on the idea of creating the most delicious hamburgers that only we can make. However, the price of ¥610 was, to be frank, a major challenge. We were curious as to how customers would react to the price. The *Nippon's Burger Takumi* was well supported by customers on its release, and it was covered extensively by the mass media. In 1997, we were the first in the industry to pursue the ultimate in ingredients through MOS Vegetables and MOS Beef under the first salvo of our new price value campaign. While our emphasis on high quality went against the low-cost strategies of other companies, we believe that customers have appreciated our constant pursuit of perfection.

The times are changing. MOS is striving to stay one step ahead of these changes by withdrawing from the fast food business model and switching to a fast and casual model that we call Green MOS. In the first salvo of our new price value campaign, we aimed to increase the basic value of our products. Seven years later, we are now positioning our transition to a fast and casual business model and the Green MOS as the second salvo of our new price value campaign. MOS plans to significantly increase the basic value of its stores and employees in addition to enhancing the value of its products. Green MOS is from the color of our new fast and casual store signs to represent peace of mind, safety and the environment. "Japanese Fine Burger

& Coffee” is written below our logo on the sign, clearly conveying our Japanese origins and commitment to Japanese taste and food culture while strongly attracting coffee shop related demand. Customers want true value, and we believe the Green MOS model of fast and casual service meets these customer demands.

Q7: In conclusion, please tell us about your measures and outlook for the future.

In April 2003, we introduced an executive officer system, changing our director system and organization. In March 2004, in the second stage of reforms, we further separated the responsibilities of directors to formulate overall management strategies and observe management, from those of executive officers to execute business activities. We also reinforced corporate governance. In order to further improve the value of the MOS brand name and achieve stronger earnings growth, MOS has bolstered its Office of Brand Strategies & Planning and upgraded its structure for promoting CSR activities. We aim to forge a link between the recovering performance of existing stores and the steady growth of MOS in the future.

Encouraged by the success of the *Nippon's Burger Takumi*, our greatest challenge in the fiscal year under review, MOS is more aware of the strong customer needs for high-value-added products and services. In the fiscal year ending March 31, 2005, MOS will push forward with its transformation into a fast and casual business model and strive to fulfill these customer needs. We ask for the understanding and support of our shareholders as we pursue these endeavors.

Atsushi Sakurada
President and Chief Executive Officer

Topics

There is Something New at MOS

A New Hamburger With a Katsuo Patty

Nippon's Burger Katsuo with Marinated Bamboo Shoots

MOS is offering a unique product that features seasonal Japanese katsuo (bonito) and bamboo shoots for a limited time only, from May 21 to early July 2004. We combined Japanese spirit with Western learning to create the original taste of the Nippon's Burger Katsuo with Marinated Bamboo Shoots based on a katsuo patty and seasonal vegetables for Japanese people that celebrate the changing of seasons. Our katsuo patty is made from minced katsuo in a flake shape and finely chopped onion, decorated with teriyaki sauce and served with marinated bamboo shoots and a full-bodied tomato sauce. Amid heightened concerns for food safety in society, we believe the Nippon's Burger Katsuo with Marinated Bamboo Shoots will broaden the range of our menu and please our customers, especially women and the elderly who are concerned about their health.



**Nippon's Burger Katsuo with
Marinated Bamboo Shoots 380Yen**

The All-New MOS Natsumi

A New Style of the Standard Hamburger Wrapped in Lettuce

On April 1, 2004, as a part of our vegetable hamburger series, we released the MOS Natsumi Roast Cutlet (¥320), MOS Natsumi Shrimp Cutlet (¥340) and the MOS Natsumi Fish (¥280). As with the Nippon's Burger Takumi Lettuce, the MOS Natsumi series uses lettuce instead of bread to wrap the fillings for a healthier alternative with fewer calories. The MOS Natsumi is one of our leading products that delivers the deliciousness of MOS Vegetables cultivated with an absolute minimum of herbicides and chemical fertilizers, which we

ensure with the cooperation of approximately 2,000 farming households throughout Japan. From May 21, 2004, we added the MOS Natsumi Fresh (¥300) to the standard MOS Natsumi menu lineup.



Natsumi Fresh 300Yen

Start of Local Burgers

MOS Rice Burger Miso Cutlet Released in the Tokai Area

On April 1, 2004, we began selling the MOS Rice Burger Miso Cutlet (¥350) as our first limited region standard product in the Tokai region, which includes Aichi Prefecture. We took a generous slice of roasted pork cutlet, added our original sauce made from *Haccho miso*, a locally produced soybean product, and wrapped it all in a rice bun with fresh cabbage. In this way, MOS is advancing the development of unique products using local flavors. Another popular product was our Yuzu Drink, which is made of *yuzu* (Chinese lemons) from Wakayama Prefecture and offered for a limited time only in the Kinki region in June 2002. Yuzu Drink went on to become a hit item on our menu as a limited time only, seasonal drink every year. We are making concerted efforts to create new products with strong local roots.

Time Marketing

Offering a Bountiful Menu of Food All Day Long

In order to create opportunities for as many customers as possible to visit our restaurants, MOS is making an all-out effort to enhance its desert menu and introduce menus for the morning and dinner time periods of the day. The MOS Dinner Set, which was revealed in November 2002, is sold at about 570 restaurants throughout Japan and has contributed to higher customer visits during dinnertime, when demand had fallen. As a part of our efforts to meet customer demand for coffee shops, we began selling Specialty Coffee after installing advanced coffee machines in all of our restaurants in October 2003.

MOS expanded its range of cold drinks offerings by adding iced coffee machines to all restaurants in June 2004. These new menus have contributed to sales, and our seasonal limited time only deserts have also enticed customers.

**Second Salvo of Our New Price Value Campaign
Speeding Up Our Transformation to the Green MOS Burger Based on
Fast and Casual Service**

On February 16, 2004, MOS reopened the refurbished MOS Burger Shinbashi 2-Chome Store as the first Green MOS Burger restaurant under the fast and casual business model. MOS is aiming for a fast and casual style of service that provides food on a quality rivaling that of restaurants in a relaxed, comfortable setting with polite and prompt service. This kind of fast and casual restaurant model features the same convenience of fast food while offering a complete takeout menu, and is growing fast in the United States and attracting attention in Japan. We have been proactively shifting from MOS Burger to Green MOS Burger from fiscal 2004. Our standards for Green MOS Burger restaurants are non-smoking or clearly designated smoking environments, natural and wood-themed interiors, sales of products such as Takumi, Takumi Lettuce and future items, the acquisition of master licenses (a new headquarters licensed store manager system) and the placement of hospitality managers (floor service managers).



**Green MOS
Outside**

MOS FOOD SERVICES, INC.

From 350 restaurants in fiscal 2004, the starting year for Green MOS Burger, we aim to switch more than 1,000 restaurants to the Green MOS Burger model within the next three years and switch all of our restaurants within five years. Under the first salvo of the new price value campaign in 1997, we strived to improve the fundamental value of our products by using low-herbicide and low-fertilizer vegetables through cooperation with farming households, and using beef from free-range cattle raised in the southern islands of New Zealand as well as Tasmania and other regions in southern Australia. Under the second salvo of the new price value campaign, MOS is accelerating its transformation from a fast food business model to a fast and casual model by drastically improving the fundamental value of its restaurants and employee services, in addition to increasing product value.



**Green MOS
Inside**

CSR News

1. Strengthening CSR Activities

As concerns heighten for food quality management and environmental preservation, as a foods-related company, MOS is taking more aggressive steps to fulfill its corporate social responsibility (CSR). In March 2004, we upgraded the CSR Promotion Office to the CSR Promotion Division in a position alongside the Quality Management Group, Auditing Group and Customer Consultation Group. MOS has established the Compliance Committee with the president as chairman in order to further strengthen compliance and CSR. Our ongoing efforts are aimed at ensuring the observance of laws and regulations, fairness and ethics in the operation of our franchise. MOS positions the development of a CSR structure as a critical measure for generating new value, and is committed to further strengthening CSR activities.

2. Acquisition of ISO 14001 Certification

All of our MOS Burger restaurants, new businesses, new business models and headquarters have acquired ISO 14001 certification for their environmental management systems as of March 2004. In June 2004, MOS created its first Environmental Report and worked to expand its range of activities to help preserve the environment. Further information on our environmental efforts is available on our Web site. Moreover, MOS aims to instill these measures through the MOS Burger Ethics Charter distributed to all stores, and has incorporated compliance programs into its environmental management systems. We are also strengthening oversight functions and pursuing results through the Plan-Do-Check-Action management cycle.

3. Promoting Information Disclosure of Food Ingredients

MOS updated the content of its Web site (<http://www.mos.co.jp/>) in November 2003, bolstering information disclosure on food ingredient production and distribution processes. For MOS Burger products, we are able to trace the process ingredients travel from production and distribution to final preparation. For vegetables, at each restaurant we display information on the origins of MOS Vegetables used in our products. Through our ongoing cooperative relationships with producers, we are building an industry-leading system able to confirm whether fertilizer and agrochemicals were used to grow vegetables.

4. Launch of Food Cultivation Promotion Committee

As a foods-related company, MOS pays the strictest attention to its social responsibility to provide worry-free, safe and healthy foods prepared with delicious MOS recipes. We believe that this attention is key to strengthening the position of MOS in the foods industry. To further these efforts, we established the MOS Burger Food Cultivation Promotion Committee in April 2004. MOS is preparing to step up efforts to cultivate high-quality foods in the future.

MOS's Endeavors in Fiscal 2003

1. Reduced the number of take-home plastic bags by approximately 1.1 million (5%) as of March 31, 2004
2. Started feasibility tests on a wastewater recycling system at the MOS Burger Kawagoe Yamada Store
3. Continued experiments in Sendai on an integrated food delivery and recovery system
4. Continued experiments on recycling systems with the installation of drying-type garbage processors
5. Gave away MOS Soap (recycled soap) to customers on *Midori no Hi*, a Japanese holiday for enjoying the environment



MOS Soap