

J. Front Retailing
Summary of Q&A session at
results presentation for the first six months of the fiscal year ending February 28, 2023
Date and time: 16:30 – 17:40 on Tuesday, October 11, 2022

Q. The sales of the Department Store Business have fallen short of forecast in H1 and their forecast for H2 has been slightly revised down. I think Mr. Yoshimoto explained that they were greatly affected by the external environment. I would like to confirm with you whether my understanding is correct.

This is partly because of how the plan is placed but also because the sales of some other department store operators have exceeded their plans. In this context, what areas are deviating from your original forecast? Or are there any internal factors that are causing problems or not? I would like you to explain more about these points.

A. (Sawada)

As for the downward revision of sales, the external factors such as the 6th and 7th waves of COVID-19 have an extremely large negative impact of ¥8.4 to 8.5 billion. As to whether there were any other problems, I will summarize the areas where things did not go as planned. The Department Store's website, or e-commerce, which had been operated under a truly weak structure, was launched on a new platform in March but its sales did not grow as expected. The same is true for our cosmetics website DEPACO did not increase either. We found that it is not so easy to increase the sales of newly launched sites. However, since we saw an improvement trend around August and September, I do not think the decline for the full year will be so large. For H1 alone, sales in these areas decreased slightly. On the other hand, I would like to add that the sales areas that are undergoing investment in renovation are achieving positive results as targeted.

Q. I assume that you are taking a somewhat more cautious view of the situation in H2 than you did at first. But are you taking a cautious view simply because the situation is unpredictable? Or do you actually sense a slight change as the top management?

A. (Sawada)

Considering how long the 7th wave will last, I think we can look at sales a little more strongly, but we said the same for H1 and slightly fell short of our plan. Therefore, to be honest, we are taking a slightly firmer view of the situation.

A. (Yoshimoto)

Just to follow up a little bit, as the sales forecast of each store for H2 is shown on page 18 of the document, in the Department Store, the Umeda and Tokyo stores undoubtedly pose a challenge to us. The Q4 forecast shows that these two stores have yet to fully recover, so we have taken a cautious approach in this area.

Q. You told that you will spin off the Developer Business from Parco to strengthen initiatives in key cities. What strengths should we expect from your Developer Business by bringing together Parco's know-how and the know-how originally possessed by Daimaru Matsuzakaya?

And when investing in the CVC fund, I think the incubation capabilities of the J. Front Retailing Group as a whole are very important, so how do you think these areas can be utilized?

A. (Yoshimoto)

If you look at page 28 of the document, you will see three phrases: “Ensure proper business management,” “Ensure proper decision making,” and “Ensure proper organization and personnel.” They are major goals of the establishment of the Developer Business. Six months ago, we created three new divisions in the holding company, including the CRE Planning Division, the Business Portfolio Transformation Promotion Division, and the Group Digital Unit. Each division has operated with an Executive Officer assigned from Parco for these six months.

As for the Developer, Mr. Hirai, Executive Officer, joined the CRE Division from Parco. Up to now, all the real estate business has been transferred to Parco and mainly people from Parco and many members transferred from the Department Store, with the entire Group working together as one, have made solid progress including building a pipeline for the future. However, in order to accelerate further here, we felt that we had to enter the next stage to achieve these three goals.

In terms of “ensuring proper business management,” the amount of investment will inevitably increase as we seek to grow the Developer Business. As Mr. Wakabayashi will explain later, we must be prepared for this risk as a group. In addition, rather than having two divisions with very different business characteristics within Parco to manage, we thought that having one business under a firm management structure would be beneficial in the future and would also speed up the process.

Regarding “ensuring proper decision making,” one of the goals is to speed up decision making as a business that is placed near the holding company. The other is that, although the Developer Business is now located within Parco and is responsible for the entire Group. If the Developer Business is to have a presence in these seven areas in the future, it will evolve by incorporating not only hardware but also concept and technologies for Web 3, as stated at the bottom of page 28. The Developer Committee is currently working on this with the participation of people from the Group System Unit and the Group Digital Unit. We thought it would be best to work on the seven business areas in a neutral position when making decisions that include such aspect of software.

Regarding the last point, “ensuring proper organization and personnel,” in line with the Developer Business, we would like to create a competitive personnel and salary system within this business so that we can be more prompt in acquiring human resources from outside. In addition, we will also strive to further retain and develop internal human resources.

Based on this approach, we have decided to reorganize the Developer Business in March next year. In that sense, the creation of the CRE Planning Division in the holding company has brought us to this point in six months.

Q. When investing in the CVC fund, I think the incubation capabilities of the J. Front Retailing Group as a whole are very important, so how do you think these areas can be utilized?

A. (Yoshimoto)

The Business Portfolio Transformation Promotion Division is taking the lead in promoting CVC, but I believe that it is also very important to think really more proactively about new businesses, to work on them, or to put it another way, to raise the level of enthusiasm in terms of culture and human

resource development of the entire Group. We are planning to take various actions in three directions, namely, “raising the heat level of the community,” “raising the heat level of the content,” and “raising the heat level with employees’ passion and enthusiasm.” As for CVC, it is stated on page 37 of the document that 4,800 employees are expected to participate, and in a scheme in which a two-person cooperative will conduct the project with outside support, although it will naturally aim for return, I would like to set two main objectives including human resource development and the evolution of creation culture as strategic return.

In that sense, the 4,800 employees are not a rough figure, specifically, about a half of the total number of employees. We have deliberately discussed with people at various CVCs and startups for the past six months and we would like to create various opportunities that will contribute to these objectives.

First, we would like to hold meet-up events for about 50 people and create opportunities for dialogue between CVC, partners, startup managers, and the Group employees about five times a year. If we conduct them for about eight years, about 2,000 people will participate.

There are currently four members involved in this CVC, and we are considering using a chat room to exchange business ideas with these four members. This will create opportunities for direct communication with approximately 300 people per year. As a result, we would like to select members who are likely to have a big future and collaborate with them in training programs and awards, and eventually send five to six people a year to startups and venture capital firms. I know this is quite a tour de force, but we have also included in the process so far members who are young and hopeful about the future in the Group. We would like to continue to organize caravans with each of the Group companies, mainly these members, and discuss the process together. Our main goal is to develop human resources and reform corporate culture.

Q. Naturally, there is no limit to the amount of investment that can be made in the Developer Business and CVC. There is no particular upper limit, or rather, I think we can look as high as we want, but I would like to ask you again what kind of financial caps you will be looking at in your position as the Senior Executive General Manager of Financial Strategy Unit.

A. (Wakabayashi)

We believe that the Group’s challenge in achieving regrowth from fiscal 2024 onward, and even more so in achieving dramatic growth toward fiscal 2030, is to achieve growth that is accompanied by profitability.

In the past, in the so-called retail business, centered on the Department Store or Shopping Center Business, the first thing to think about was how to increase sales, and if it was unfortunately difficult to raise the top line, the story or scenario was to ensure profitability by controlling costs.

If we consider transforming our portfolio from this point, specifically placing the Developer Business at the center of the portfolio, we will need to make a large upfront investment due to the nature of the business. Experts within the Group often tell us that it takes about seen to eight years from the planning stage of the Developer’s project to its concrete contribution to profits. In order to promote this process, we believe it is necessary to create multiple scenarios and plans that will ensure return on investment. In terms of key performance indicators, this means developing ROIC, ROIC by business segment.

Although there are some differences between the Developer and CVC, I believe that they are the

same in terms of the large upfront investment that will be made. In other words, it is not just a matter of making more and more investments, but it is also important to see that the returns are steadily increasing, even if it will be several years down the road. While there will be some major challenges, we would like to establish a system that can reliably support operating companies from a financial perspective.

Q. Regarding Parco. I have the impression that the revision is quite large relative to the scale of the business, although total sales forecast was not achieved in H1, and the revision for the full year and H2 is slightly smaller. At the Takashimaya presentation I just attended, it was said that Toshin Development, which operates commercial facilities, is head of its budget, although the customer base is different. In your explanation, you mentioned various factors such as the delay in renovation, but I would like to confirm whether it is really only due to the delay in renovation. The reduction is a little smaller in H2, but we would like to see you do a little better. I would like President Makiyama to explain more about Parco's difficult situation and future restructuring measures.

A. (Makiyama)

First of all, as for the fact that store sales did not increase compared to the budget during H1, the stores were more drastically renovated than originally planned in H1. In other words, we started H1 by including business suspension for renovation, so I think the difference largely in our expectations was in its impact in July, August, and September, which caused a slight stagnation, in addition to the impact of COVID-19.

The effects of this spring's renovation have been steadily increasing, and we are thinking of making this the minimum for H2. In any case, in order to achieve over ¥10.0 billion in operating profit in stores in fiscal 2023, or in other words, to achieve the medium-term plan as a matter of course, we will bring forward the renovation, which was planned for fiscal 2023, during H2, and even if we include this in the plan, we are determined to create a story that will ensure we achieve the target in fiscal 2023.

Q. In that sense, are you saying that, regardless of the original budget, you are doing what you can do during the current period toward fiscal 2023?

A. (Makiyama)

Yes, that's right. We have seen fewer corporate bankruptcies than we had expected, and we are seeing a steady return of the relaxed conditions to the original ones, so we are confident that we will be able to secure rental income, including that. Given that, we are planning to establish a system that will allow us to generate income in excess of the standard sales amount.

Q. I believe there was around ¥2.5 billion of relaxing of conditions in the previous fiscal year. Is it correct to say that this figure will be halved this year and eliminated in fiscal 2023?

A. (Makiyama)

That is the case. There is some question as to the extent of relaxing of conditions, but in fiscal 2021, a total of about ¥2.9 billion of relaxing of conditions occurred. The point of this is that we lowered the standard sales amount due to relaxing of conditions. There is a partial shortening of business hours, but there is no business suspension. As the return of the conditions actually returned ¥0.9

billion of the ¥2.9 billion in H1, which means that more than half of the total amount will be returned.

Therefore, in fiscal 2022, we expect that a total of around ¥0.5 billion will remain for relaxing of conditions. This does not mean that in fiscal 2023 there will be zero, but rather the conditions will have to be relaxed by about ¥0.2 billion, or perhaps the conditions themselves will have to be set at that level. On the other hand, the plan is naturally based on the assumption that the profit of the replaced stores will exceed the ¥0.2 billion and become a positive figure.

Q. Isn't it possible that the so-called heat level in the field lower than that of the President? I took the 4,800 employees and various other things in this explanation as a message for internal use to some extent, but I wonder if the various layers of employees, from the President to the front-line employees, will really be able to work toward the same vector.

A. (Yoshimoto)

We have included the number of people on two pages of the document as our targets: for the development of digital human resources on page 35; and on page 37, as I mentioned earlier, for the promotion of human capital management through CVC. I am sure that my intention is strongly behind this, but as I mentioned earlier, this spring we create the Group Digital Unit and the Business Portfolio Transformation Promotion Division as new organizations.

This will probably have to be more integrated in the future, but if we look at this as a culmination of the past six months, I am not speaking only from my own thoughts, but for example, the development of 100 digital human resources by fiscal 2024, which is stated on page 35, is an activity that has already begun. The development of two types of digital human resources including data analysts and digital designers has already started in a program that is fairly self-managed, with the arrival of Mr. Hayashi from Parco as Executive Officer, and with the inclusion of people hired from outside.

The curriculum for data analysts and digital designers is almost finalized, and the first call for participants for the digitally oriented curriculum was made last week, and we quickly received about 100 applications. Of course, the remote nature of the program makes it easier for people to participate, but I believe that there is already more enthusiasm among companies to learn such things on their own than I had expected.

Based on this, the 1,000 people in 2030 are digital core human resources that can be used only for basic part but in a fairly strategic manner. The 1,000 people will account for more than 10% of the total headcount. I do not believe that the current common sense will hold true, but I have no doubt that we will be able to become a digital company.

Of course, operating companies are doing many things, but the Business Portfolio Transformation Promotion Division, which I mentioned earlier, is conducting CVC, and four members are now working hard toward this and trying to make this take root. The Group's employees are truly passionate about this kind of thing. I believe that it is my role to bring about this kind of formulation.

As I said in my message at the end of our presentation, I believe that the COVID-19 pandemic has given us a great sense of crisis and a great opportunity for change, and we are determined to carry this out.

Q. In that sense, especially in CVC, I think it is impossible to "hit a hundred times out of a

hundred,” but it is more important to challenge than to avoid failure, and it is important to voluntarily do something. Is it correct to say that employees understand this kind of evaluation? Are you sure that the message has been sufficiently understood?

A. (Yoshimoto)

I would like to believe that it has been understood. Since we formulated the JFR Way, which includes the phrase “Try without fear of failure,” under the Vision of “Create and Bring to Life ‘New Happiness’” in 2017, we have been trying to achieve it, but we have not been able to reach that point. Now, in a sense, the entire Group has a heightened sense of crisis because of the current COVID-19. As we are creating a movement to raise the level of enthusiasm for the future, we are determined to carry it out.

Q. The slide of the SC Business on page 8 of the handout shows that in Q2, business profit decreased by ¥0.4 billion Q on Q although revenue increased Q on Q. And I would like to confirm what kind of movement there was in costs. Looking at Parco’s cost and SGA in your data book, utilities expenses in cost remarkably increased Q on Q and I could say this is the cause. However, I wonder if these utilities expenses can be offset as common area expenses by revenue. I would like to know if this is the case or not.

Also based on that, I understand that the business profit plan for H2 is unchanged, but if we look at the situation in H1, there are some areas that are moving differently from each other. First of all, this SC Business did not achieve the plan in H1, but if this is due to utilities and other expenses, please confirm whether there is a risk that a slight downward trend compared to that plan will continue.

A. (Makiyama)

As you mentioned, in H1, utilities expenses, or rather electricity costs, exceeded the budget by about ¥0.3 billion. This ¥0.3 billion is for the so-called common area though electricity costs are paid by the tenants.

Although we have made considerable efforts to improve cost efficiency, for example, by switching power suppliers, some of these suppliers are now going out of business. So we had to switch again to a power supplier that places stricter conditions giving priority to securing electricity, and in this sense, electricity prices are rising as told.

There may be further price increase in H2, and we still expect that a half of the electricity charge for the common area alone will increase by about ¥0.2 billion in H2 as well. In order to cover that ¥0.2 billion in the overall business and ensure a solid business profit in H2, we will of course start by increasing sales in stores, but we are also thinking of devising outsourcing expenses so as to cover additional electricity charge in order to improve efficiency.

Q. Just to follow up a little bit, in terms of Q1 and Q2, can I think the increase in electricity costs was largely in Q2? Or did it start in Q2?

A. (Makiyama)

It started in Q1, not in Q2.

A. (Yoshimoto)

If I follow up a little bit on what he just said, I think there is really no telling how far utilities expenses will rise for H2, as well as for H1. The Department Store, mainly Daimaru and Matsuzakaya, has

been working with major power suppliers on a total, comprehensive basis, so they have not been affected as much, but I think it is clear that Parco has been significantly affected.

Regarding how we see H2, I think it contains a lot of very difficult aspects. Right now, looking at the startup of September and the first half of October, I believe that both the Department Store and Parco have started off relatively well. Today, immigration restrictions, etc. have been greatly eased and there have been reports of expectations for inbound travel in quite a few ways. I mentioned earlier that only the figures for the Tokyo and Umeda stores are sluggish, but I have no doubt that the Tokyo store's sales will rise as domestic travel increases. I see the Tokyo store's numbers improving considerably from the latter half of September to October. The numbers for business travelers may not change that much, but the numbers for travelers are quite large for this store, so in that sense, as I mentioned earlier, I am certain that we are taking a cautious look at this time, so I think it is quite possible that there will be an upward swing.

However, as mentioned earlier, we expect to face some difficult situations in H2 in terms of cost control, such as utilities expenses and high prices. The outlook for the Department Store and Parco is based on the fact that there are still some very risky situations.

On the other hand, I believe that there are some factors that could lead to an upward swing, and I would like to make sure that the top line is on the upswing. As I have already mentioned, I would like to make sure that the results of our efforts to date can be delivered here.

Q. On the other hand, the Developer and the Finance have seen an upturn in H1, but I would like to know if this upturn is not temporary but there is a possibility that it will continue in H2.

A. (Yoshimoto)

With regard to the Developer and the Payment and Finance, the Developer Business has special factors in H2, so I do not think there will be a large upward swing in the figures for this situation. In the Payment and Finance Business, there is a slight discrepancy between H1 and H2, but we are taking some aggressive measures in this area, including a slight increase in SGA in H2 for the future. We will need to increase the number of customers, but we believe that there are some areas where we can make a slight upward swing, while monitoring the situation from time to time.

Overall, we have stated operating profit of ¥40.3 billion for the next fiscal year, so we would like to keep the current year's operating profit of ¥23.5 billion and business profit of ¥24.0 billion as a bar, and work out how far we can increase inbound sales to the next ¥40.3 billion. Furthermore, we would like to work out how we can expand toward the next ¥40.3 billion, while pushing aside domestic *gaisho* sales, rent concessions at Parco, and all other factors.

Q. Looking at the medium-term plan from outside, I have the impression that it is difficult to reach ¥40.3 billion, and that it is necessary to jump up to a little over ¥40 billion. Of course, there is the question of how the current fiscal year will turn out, but from the perspective of management, do you have the impression that the probability of achieving the medium-term plan, for example, has increased through H1? Or do you have the impression that there is still a lot of work to do compared to the beginning of the period?

A. (Yoshimoto)

I myself feel that it is the Department Store Business and the Shopping Center Business that will be

problematic. That is why I have been in firm communication with the two Presidents who are participating today. I am sure that this will be based on certain assumptions and with certain conditions, but we will not lower the flag of ¥40.3 billion, and I would like to firmly reiterate what we are all working on as a group.

I am sure that there is a view that looking at the current figures only in total, it may not be easy, but we would like to take a close look at each store.

As for the Department Store, as stated as store sales forecast in the handout, perhaps if the paths of the Tokyo and Umeda stores can be firmly mapped out, it will be able to reach the numbers originally envisioned.

While there is certainly still some uncertainty about the recovery of inbound sales and the recovery of both of these stores, I think the situation is such that there are many stores that are recovering strongly.

As for Parco, I think it is as discussed earlier. Although some of the large stores have difficulty meeting their original targets, we believe that stores such as Shibuya PARCO, Shinsaibashi PARCO, and Urawa PARCO will be able to achieve positive results compared to their original plans, and we would like to work within the context of achieving these targets somehow.

Of course, we are also working on cost reduction through restructuring, but we would like to continue to focus on the top line as our first priority, so please continue to look at us in this way.

End