J. Front Retailing
Summary of Q&A session at
results presentation for the fiscal year ended February 28, 2023
Date and time: 16:30 – 17:50 on Tuesday, April 11, 2023

<Q&A session>

Q. Compared to six months ago, you seemed to have a much better response, and I am glad to hear that your tone was very upbeat. I think the way you see things has changed considerably, especially in the six months since you last talked to us. I think the consumption trend has changed, but in which areas are you seeing a particular response?

(Sawada)

A. I believe that around October was the turning point. The almost complete elimination of restrictions on domestic travel and the easing of border control measures have led to a sharp increase in the number of inbound travelers via Haneda and Narita in eastern Japan, particularly in Tokyo. Therefore, in Q4, there has been a sharp recovery. In particular, in terms of stores, the Tokyo store, which had been lagging behind in FY2020 and FY2021, began to recover at a rapid pace in around the latter half of Q3, with an increase in the number of passengers at Tokyo Station.

In addition, concerning the Kobe store, in which we have strategically invested, as a large Louis Vuitton boutique opened in the spring, and the store could attract several strong luxury brands, sales are increasing as targeted. We are seeing the same strategic investment effects at the Sapporo and Kyoto stores, and we are getting a positive response.

(Kawase)

A. I assumed a position as President in March of this year. The part of the business that has been referred to as the SC Business is called the Parco Business in our company from this fiscal year. What I mean is that we do not want to define ourselves as a store or a shopping center, but we have been involved in the culture, entertainment, animation, and game businesses in the past. In the future we will further integrate such “content” and “commercial spaces.” I would like to develop it into such a business that provides Parco’s unique value, not in comparison to others.

I have a career in entertainment, digital, business development, and M&A, rather than in stores and shopping centers, so I would like to fit my career into the Parco Business and open up the future of the Parco Business.

President Sawada mentioned responses he feels at the Department Store Business, and the situation at Parco has changed considerably since October as well. It is getting better at an accelerated rate. Clothing has been performing much better since January. From March to the beginning of April, foot traffic has almost recovered, and the number of visitors has increased by about 20%, compared to the previous year. Sales and transaction volume have also increased by about 20% from the previous year, so we are feeling a positive response from them.

Also, in terms of inbound, Shibuya PARCO and Shinsaibashi PARCO had opened during the COVID-19 pandemic period, so there were very few customers from overseas. Since October last year, however, we have seen customers coming from overseas to visit Shibuya PARCO. We are currently in the process of renovating it into a hands-on facility that mixes such culture and content, with plans to spread it to Ikebukuro, Sapporo, and other locations.

I would like to use this response as an innovative force to revitalize J. Front Retailing as a whole.

Q. The current fiscal year is the final year of the mid-term plan, and the new mid-term plan will start next year. You mentioned that you are feeling good about existing and new businesses, but that there are also risks. I would like you to tell again what additional areas you need to focus on in the next mid-term plan.

Since existing businesses are recovering quite well, does this mean that you can make a certain level of profit at existing businesses, or are you going to accelerate new businesses from the very beginning? I would appreciate it if you could explain a little more, including the image of such a time frame.

(Yoshimoto)

A. What is most encouraging to me is that, as President Sawada and President Kawase mentioned earlier, our two core businesses have, in a sense, regained considerable momentum or confidence.

We are working on it, in the context of backcasting especially with 2030 in mind, so we have been talking about what we should be doing in 2030, within our management team. But we, including young members, are now thinking hard about what we can add to our strengths such as goodwill, brand, customers, and favorable locations, as we are certain that we can no longer compete with others only with these strengths.

Currently, we think we need to have something more to generate excitement. Alternatively, we will have to better position ourselves in the community. Now, we have been working on environmental initiatives within our ESG activities, but we will have to evolve these things into business. I believe that these issues must be considered by the holding company.

Mr. Kawase, Parco's new president, has worked for the holding company for a year, and now the holding company has quite a lot of so-called career recruits and people from Parco, and probably more than 40% of people there are not from Daimaru Matsuzakaya Department Stores, and we are seeing a lot of diversity. In this context, I believe that a new system is moving more forcefully to step into the next era.

It has been difficult for the holding company to lift up and incorporate the ideas that come from many sites. It was not easy to do so even within the operating companies, but by firmly combining such diverse human resources, we have been able to make tremendous progress, and I can now feel strongly that we are moving forward voluntarily. I believe that the role of the holding company is to look at the next new era and invest well toward it.

Q. President Yoshimoto, in your earlier explanation, you mentioned that you are looking at things that will return to normal, things that will grow, and things that will not return. In light of the current environment, what do you consider to be the things that will return to normal and grow, and what are not?

(Yoshimoto)

A. As for what will return and what will not return, I still believe that things are becoming very clear amid this COVID-19 pandemic. Especially in 2020, the first 18 months or two years of COVID-19 situation have been quite challenging in terms of where we will really find future growth.

In this context, the market for high-end products or wealthy people has grown consistently. In other words, COVID-19 was a support for it. Luxury items were coming around Japan as they did not go overseas due to travel restrictions. In such a situation, our network with customers such as gaisho customers and cardholders functioned in a very positive way and supported us. We need to look carefully at whether this situation will really continue.

In terms of categories, for example, sales of women's clothing dropped to almost half at one point, but it is now recovering at a much faster pace. Looking at apparel companies' financial results, they were already struggling in FY2019 and before, but I think they had a much tougher time in 2020 and 2021, but they made a tremendous effort, and first of all, profits returned, and now I think they are in a phase where sales are also recovering. I would say that the way they do business is changing dramatically. I think they are now building a business model that allows them to control their inventories while also responding to customers who come to department stores. I believe that sales have now returned to nearly 70% of pre-COVID levels, but I personally believe that even if sales do not return to 100%, they are still able to conduct transactions and business that are quite substantial.

These are probably the typical things that will “return” and will “not return.” In terms of stores, it was very difficult for stores in front of the stations, but the Tokyo store is rapidly recovering sales. As for the Umeda store, we are not looking at it without doing anything. We have made a solid investment in things that can grow and move forward in the current times, for example, introducing the second Nintendo store in Japan and expanding Rolex and other luxury watch boutiques, and these efforts are taking steady effect. I think it will be very important to create things that are substantial and can contribute to the store.

Q. As for the performance mainly of the Department Store Business, I have the impression that while the top line improved, profits did not improve in the previous fiscal year. In terms of how to create a business plan for this fiscal year, do you have a relatively firm view of sales, but also factor in expenses, and what nuances do you see in the projected performance of the Department Store Business?

(Sawada)

A. One is that while sales of high-end products, especially luxury goods, have increased significantly during the COVID-19 pandemic, profit margin was down about 0.3 points in FY2022, due to the changing composition of the product, such as declining sales of cosmetics due to decreased inbound sales and declining sales of mass-produced clothing. In addition, restructuring has reduced total personnel expenses considerably, but in some areas, the increase in energy costs could not be fully absorbed, so I think profits did not grow in proportion to the growth in sales.

The Department Store Business has lowered its break-even point, and the structure is such that business profit will jump in proportion to sales growth from now on. In FY2023, the amount is expected to well exceed ¥700.0 billion, and business profit can rise along with sales growth.

There is no doubt that cosmetics sales will increase compared to the previous year or to FY2020 or FY2021. We do not think that apparel sales will return to 100% of 2019 levels due to a market change, but we expect it to return to the 85-90% range as people's movements, including travel, will become more active. Since there is also a change in the composition of sales in this area, we expect profit margins to increase.

As for costs, while we were looking at the current situation firmly, we were not sure if the increase in energy costs would be as high as it was in March, but we were taking a somewhat firm view of the situation.

As you can see in the document, this fiscal year's target is a top line increase of 9.4% from the previous year, but in March, we saw a 16.7% increase. So it is increasing more than expected. We set a figure of 13.7% increase for H1, which is higher than H2. And as the actual growth exceeded it, we are making a good start.

Q. The document says that you plan to record a gain on sale in the Developer Business this fiscal year, and I would appreciate it if you could tell me the amount.

(Yoshimoto)

A. In terms of the plan that has been incorporated from the beginning, the gain on sale will be a little more than ¥3.0 billion.

Q. The slide No. 23 says that the SC Business expects to eliminate the easing of tenant conditions, but looking at the plans for H1 and H2, I think you assume that the rent concessions will end in H2. Since you mentioned earlier that the situation of tenants is getting better and that you are getting a good response, can you tell me whether, apart from this company plan, you have already started to eliminate the easing of conditions, or whether you still expect to eliminate them in H2 for negotiations with tenants and other reasons?

(Kawase)

A. We have not announced the circumstances under which we will proceed with the elimination of the easing of conditions in H1 or H2, but we are mainly using the timing of contract renewal for each section as the starting point for this change. The tenants' situation is getting much better recently. We will eliminate the easing of conditions by the end of the current fiscal year, in sequence, taking advantage of this tailwind.

In terms of remodeling, there is usually a tendency to remodel more sections in H2, but this fiscal year, we are taking more area for remodeling in H1 in order to maximize the impact of the remodeling on FY2023. The impact of this has been reflected in larger figures in H2.

Q. In fact, in the past, there have been cases where we were told that the concessions would be eliminated and they were not, but can I understand that this time the situation is different from the past?

(Kawase)

A. Yes, we will eliminate them. In short, we believe that the first priority is to create an environment in which tenants can do business so that the inside of the shop is busy with customers. In this environment, we have set the rent at an appropriate level, and we are planning to return the rent to an appropriate level for existing tenants. And for the sections that are to be renovated, we will not discount the rent, but will charge an appropriate level of rent to renovate them. We believe that this plan will be further advanced this fiscal year.

Q. Concerning the Developer Business on page 24, you explained that there is a gain of about ¥3.0 billion on sale in the profit plan. Do you expect this gain to appear every year or every few years? How often will it appear? Is this ¥3.0 billion the standard size of the gain on sale that will appear in the future, or is the amount for this fiscal year exceptionally large?

As for your approach to future consolidated capital investment for growth of the Developer Business, looking at the plan for the previous fiscal year and the new fiscal year, the consolidated capital investment is about ¥20.0 billion, so in total, I think the Developer Business will continue to move forward without much increase. However, if you are going to be more aggressive, I would like to know, to the extent possible at this point, whether capital investment will also increase.

(Yoshimoto)

A. I was put in charge of the CRE Strategy Unit, which leads the entire CRE planning process in the holding company. It is because we have gained a sense of value from the idea of using all the management resources within the Group, such as Daimaru Matsuzakaya Department Stores, Parco, JFR Card, and newly created J. Front City Development, to first of all, speed up the process of making the best of what we have, instead of putting the Developer Business as a whole within Parco as we have done in the past.

The plan of the Developer Business for this fiscal year includes a gain of a little over ¥3.0 billion, but it is not a simple sale as in the past. They are so-called residential properties. In the future, as the real estate business becomes a mainstay, developing residences, adding value to them, and selling them at higher prices than expected will naturally occur, and we will continue to do so.

However, ¥3.0 billion at this point in the current fiscal year may be a bit much. From the beginning, we planned to sell some of these residence properties at this time, and we had factored it into our mid-term plan, but we are also approaching a situation where we can sell them with more added value than we had originally thought.

We are certain that we will increase this type of business in the future, so I think we will see more sales projects in conjunction with so-called building maintenance, property management, and other businesses, not just the rental business. I would like to explain pipelines, the amount of investment, and others, including such things, in the Developer Business in the upcoming mid-term plan.

Q. As for the Finance Business on slide No. 25, in the plan for the current fiscal year, while an 11% increase is expected in revenue, business profit is expected to increase by 2%, which is quite modest or a bit weak. I would like to know what is the background for the assumed increase in SGA and whether this is a one-time event.

(Yoshimoto)

A. For the Payment and Finance Business, there was quite a large growth from 2021 to 2022. This figure was raised by the renewal of the card itself and the success of that initiative. For this fiscal year, I believe it is time to make a firm commitment to the next stage of growth. From here on, as I mentioned earlier today, the two main points, the efforts within the issuing platform and expansion into the finance business, are important.

Of course, we need to make efforts to serve our customers in our department stores and Parco, but we believe that it is time to invest in developing different human resources and acquiring different know-how for the next stage of growth. In this sense, the profit growth for the current fiscal year is expected to be slightly lower.

Q. Is it safe to assume that the profit margin will be weak only this fiscal year and normally be a bit higher from the next fiscal year?

(Yoshimoto)

A. If we don't do that, I don't see the point of these efforts. As I mentioned earlier, our operating profit target is ¥5.0 billion, and we have to make a start toward it in the next fiscal year and beyond.

Q. Is the gain on sale in the Developer Business from a so-called CRE project, which is very profitable, or another project that was normally developed by your company from scratch? I think you mentioned that in the Developer Business, you would thoroughly manage risks for each because ROIC would be different between CRE and the projects developed from scratch, and hurdle rates would also be viewed differently.

(Yoshimoto)

A. They are the products of what we started out developing by transferring the Group's assets to Parco, so they are the properties that we had from the beginning. In that sense, they were included in the plan from the beginning, and they will be completed as planned and sold at this time.

Q. If they are CRE, I can watch from the outside with considerable peace of mind, but if you are developing from scratch, I am a little concerned about competition with other developers and in terms of profit margins, but are you sure that you will do everything you can in that respect?

(Yoshimoto)

A. The three main projects that are coming up are for the properties that we have, that is, CRE.

Q. At the “head office and corporations” of Daimaru Matsuzakaya Department Stores, I think its sales increased significantly in the previous fiscal year but a double-digit decrease is planned for the new fiscal year. What is a background for this?

(Sawada)

A. It includes corporate sales and G6 as well, so I think they resulted in that figure. The Corporate Sales Division received quite a few orders to deliver meal kits to people receiving treatment at home for COVID-19, mainly in Tokyo, so I think there will be a reactionary decline. The sales were about ¥3.0 billion, so if we look at a 20% profit on sales, the impact would be about ¥500 or ¥600 million.

Q. Compared to the pre-COVID-19 period, profit margin in FY2022 was nearly one percentage

point lower, or in terms of gross profit, I think it has dropped by more than ¥10.0 billion. If sales of cosmetics and clothing return to a certain level, and if sales return by implementing other various restructuring initiatives, including sales method reforms and cost control, will the profitability of the Department Store Business return, or will you not be able to fully offset the decline in the profit margin? Please tell me about that.

(Sawada)

A. I think there will be a decline in profit margin, but I just think that it will not be the same decline as in FY2020, FY2021, or FY2022, but will be on the rise in FY2023. However, since the sales composition will change, we do not expect the profit margin to exceed the 2018 level.

Rather than covering it by reducing costs, we expect the top line to rise, since the change in the sales composition means that the products that currently fit the market are selling well.

On the other hand, we have been able to reduce fixed costs by almost ¥8.0 billion compared to FY2019. So, we are going to deal with the situation by doing that.

Q. In that sense, fixed costs have been cut significantly by restructuring, so it is easy to generate profits from the sales above the break-even point. Is it correct logic that if total sales increase, the gross margin decrease will be covered by fixed cost reduction and top line?

(Sawada)

A. Yes, your logic is correct.

Q. I think sales to affluent or gaisho customers are very solid right now, but with the risk that they will go overseas, if sales of your company were to slow down in particular, where would it come from? Or is there a more positive way to look at it, like it is actually very, very long-lived?

Also, in the sales forecast for each store for this fiscal year, I have the impression that the assumptions for sales at the Shinsaibashi and Sapporo stores are quite high for budgeting purposes, although you may be thinking of this based on sales in the last month or two. Please tell me what I can expect about these two points individually.

(Yoshimoto)

A. I think it was gaisho sales of high-end products that really supported us over the past three years. I think customers moved better than we expected. What is certain, I think, is that those people did not go abroad for shopping, and that the products that could be sold were on the market mainly in Japan and in the Far East region, which was relatively stable amid the circumstances of COVID-19.

As I mentioned about GINZA SIX earlier, what we did not anticipate was that many young people entered the market and started to buy these kinds of products. Even if all of them are not luxury items, but certain items are expensive. I really feel that we are starting to see this kind of consumer activity. I mentioned earlier that more than 50% of GINZA SIX customers are in their 20s and 30s, but I had not anticipated this at all, and we are also seeing more younger people signing up for a gaisho account. In this sense, I believe there are still many potential markets.

However, what we must take care of is that most of the luxury brands and famous watch brands mentioned above are imported. These products are manufactured overseas and then delivered to us. It can get affected by exchange rates, and in terms of the supply system in the home country, it is difficult for us to make final decisions on which areas to distribute them.

As I have been saying, since we have invested in our core stores, there is no doubt that customers are moving to these core stores including GINZA SIX, tenants around the Kobe store, and tenants around the Shinsaibashi store, and we have invested in them. So, a new market is being taken there, but still, unambiguously speaking, there is a possibility that something may move that we really cannot control. I think we must always keep an eye on such risks as exchange rate issues and product supply systems. I think the market itself is expanding tremendously.

(Sawada)

A. As for the reason why the growth rate for the Sapporo and Shinsaibashi stores is so high, we see an increase in inbound sales in these two stores because both of them have very strong inbound sales. In particular, we see an increase in inbound sales of over ¥10.0 billion in the Shinsaibashi store, and an increase in inbound sales of nearly ¥5.0 billion in the Sapporo store. In addition, we are planning to introduce two large-scale brands in the Sapporo store during this fiscal year, so we expect to see an increase in revenue from these brands as well.

Q. Regarding the imported products that were mentioned earlier, are you seeing a trend whereby products are supplied only to larger stores, or, as it has been said for department stores that only the number one or number two stores can sell these products, are you seeing quite a bit of that kind of movement?

(Yoshimoto)

A. Especially among the top brands, I think the number of stores is rather declining in Japan, and some of them are becoming more concentrated in large stores. More to the point, I think that Japan's pricing policy and the fact that Japan is a stable and very secure country, as well as these factors, have made the pricing relatively stable and competitive in terms of brand-side pricing policy.

I believe that this positioning will continue in the future, and if we continue to build strong relationships with brands, create such stores, and firmly enforce the policies of working within such stable relationships of trust, we will of course be able to do so stably even under the current circumstances.

If we are to further increase the growth of the market in response to the large growth over the past few years, I believe it will be necessary to develop new markets.

End