J. Front Retailing

Earnings call for the third quarter (Q3) of the fiscal year ending February 28, 2021

Date and time: 15:30 - 16:15 on Monday, December 28, 2020

Q. Concerning the impact of the current spread of COVID-19 on sales trend, I would like to know about more detailed situation of each store including the number of customers and strong and weak items. There seems to be a positive report that traditional New Year's foods (*osechi* in Japanese) sell well. How do they perform actually? And during the year end and new year holidays when many customers visit your stores and you should capture sales from them, how will you achieve both safety and security and sales?

A. I will provide an overview including the current situation. On a store-by-store basis, terminal stores such as the Tokyo and Umeda stores are struggling affected by the 3rd wave of COVID-19. The Sapporo store is also affected by the 3rd wave. It has a high rate of inbound sales but showed a recovery trend in September and October. However, the spread of COVID-19 starting in early November adversely affected customer traffic and sales. On the other hand, the stores with a high rate of loyal customers are on a gradual recovery trend but they are at a standstill currently.

On a customer group basis, *gaisho* sales are strong because stock prices are relatively strong. They purchase big-ticket items and products with high asset value, which may be affected by a voluntary ban on travel. For volume class customers, apparel sales are sluggish but sales of seasonal items such as *osechi*, Christmas cakes and gifts continue strong.

During the year end and new year holidays, as we have released, we will act based on safety and security. In the past, it was internally reported how many customers had lined up before opening at the beginning of the year. This season, however, we will take measures to avoid three Cs, including earlier and dispersed bargain sales and sales of lucky bags online and by lottery in advance in some stores.

Q. With regard to cost reduction, you have worked on cost management until now. What additional items are you thinking of reducing? I think the new Medium-term Plan, which will be announced in April next year, is under discussion. And are you discussing additional cost reduction, which is needed partly due to the current 3rd wave of COVID-19? I would like to know what you think about costs including the next Medium-term Business Plan.

A. As you said, we have worked on cost reduction and incorporated some measures in the budget for H2. Therefore, we will not be able to reduce ¥0.5 billion or ¥1 billion with one or two measures excluding costs proportional to sales. In December, the management of the holding company and operating companies told us to review all cost items and thoroughly manage costs. The original plan in October contained sales promotions, etc. for H2 based on a recovery trend unlike until Q2. However, as the situation has changed suddenly, we will take cost reduction measures again. This fiscal year is the launching pad for the new Medium-term Business Plan, which will start in the next fiscal year. So firstly, I think it is important to ensure the current performance. At the same time, we are discussing the Medium-term Business Plan and Outside Directors say we need “speed and thorough implementation.” I recognize we have also received similar advice from investors. I recognize it is crucial to accelerate structural reform in terms of costs as well as the current cost reduction.

Q. When you announced Q2 results in October, you said factors contributing to a temporary increase in SGA in H2 include ¥0.4 billion of cost of the transfer of the Real Estate Business to Parco, ¥1.4 billion of cost of Shinsaibashi PARCO and ¥0.6 billion of the effect of a change in accounting method for annual membership fee of the Credit and Finance Business. How were they actually in Q3?

A. Looking at each segment, sales of Department Store differed from our guidance released in October and fell below our plan. Parco is difficult to purely compare to the previous fiscal year due to the transfer of Real Estate and opening of Shinsaibashi PARCO. In Q3, however, there was an effect of reduction of cost of sales. Particularly, cost of measures to maintain sales floors, which was factored in because some of their suppliers are smaller compared to Department Store, fell below expectations. Q3 results of the Credit and Finance Business, including the effect of a change in accounting method for annual membership fee and cost reduction during the same period, were almost the same as our guidance.

The point of Q4 forecast is the extent to which Department Store sales will recover in January and February. By complementing with cost reduction of Department Store as well as the Parco Business and associated businesses including Daimaru Kogyo whose electronic device department performs well thanks to nesting demand, we will aim to meet our consolidated earnings forecast for H2.

Q. I don’t know the extent to which the effect of COVID-19 was reflected in Department Store sales but sales decrease was 23.2% against your Q3 forecast of 18.6% decrease. Is this decrease below your target within the margin of error in terms of consolidated business profit? You expect sales to decrease by 11.3% in Q4. Though the bar for 4Q last year is lower, will you be able to make up for the gap with the measures you explained before? I am afraid it will become just a goal to strive for.

A. It is difficult to forecast Department Store sales precisely. As we cannot expect a significant sales recovery, we will complement with cost reduction of Department Store and other businesses and Parco and associated businesses. In Q3, business profit was above our internal plan. We will aim to achieve business profit (¥0.95 billion) for entire H2 including Q3.

Q. Was business profit in Q3 above your internal target?

A. Exactly.

Q. SGA of the Department Store Business of Daimaru Matsuzakaya Department Stores increased to ¥25.3 billion in 3Q from ¥24 billion in 2Q. Were there any factors in such increase from Q2 to Q3? I think you control SGA as tightly as before, but at the same time, do aggressive factors also increase? I would like to know that.

A. The basis is different between Q2 and Q3. Unlike Q2, we took measures to capture sales. We were in no situation to take such measures in Q2, but for example, we invested cost to hold *gaisho* events in Tokyo and Osaka, and in addition, we strengthened sales promotions through a tie-up with Rakuten Card. We continue to manage costs thoroughly, and at the same time, we spend money where needed in order of priority. In Q4, while tightly controlling the inflow and outflow of money, we will strive to ensure profit.

Q. You said Parco's Q3 performance was above your plan. Concerning whether this upward trend will continue, how shall I see the next Q4?

A. As for Parco's results in Q3, tenant sales in stores are disclosed on a monthly basis. Revenue of the entertainment business has recovered to almost the same level as the previous year partly because restrictions on the number of seats, etc. were gradually eased starting in September. And as I said before, cost was reduced and cost of measures to maintain sales floors also fell below expectations. Unless we are asked to voluntarily refrain from operating stores, we expect our performance to gradually recover in Q4. However, as the impact of the 3rd wave of COVID-19 is unforeseeable, the situation does not allow optimism.

Concerning what growth we will aim for, including the transfer of the Real Estate Business, in the next fiscal year and beyond, we are discussing currently and would like to show it later.

End