J. Front Retailing
Q & A summary
Results presentation for the fiscal year ending February 28, 2021
Date and time: 16:30 – 18: 00 on Tuesday, April 13, 2021

Q. I would like to know what you think about business profit and operating profit plan for the current period. Do you think it is the minimum level you want to achieve in the first year of the medium-term plan? With the external environment remaining unpredictable, I would like to know what you thought, including about cost control, when formulating the plan.

A. For FY2021, our business is expected to gradually recover, starting this March, though the current condition remains uncertain. We have made a forecast on the assumption that domestic sales, in particular, will recover in all stores. Sales of Daimaru Matsuzakaya Department Stores increased 33% from the previous year, just as expected.

Real outcome will be decided by how we will recover from here. We assume that domestic sales will recover around 10% toward February next year. Currently, with the arrival of April, I strongly feel our store and *gaisho* customers' desire to buy in spite of the tough situation. And I believe we will be able to certainly improve domestic sales if we make great efforts to implement these three strategies.

In the meantime, inbound sales were as expected in March but I feel their recovery is more unpredictable than domestic sales. Concerning the three-year plan, I recognize that increasing domestic sales to the level close to gross sales in FY2019 by implementing the three growth strategies will be a great hurdle even if inbound sales are not fully recovered in FY2023.

Q. Slide No. 37 shows your plan to add profits, ¥5.7 billion by "enhancement of appeal of stores/content" and ¥3.7 billion by "digital shift" under the Real × Digital Strategy. And I would like you to explain how you will make profits under the Real × Digital Strategy.

A. Concerning the enhancement of appeal of stores/content, it shows that both Department Store and Parco will invest in the areas which they expect to produce effects in the three-year plan and decide to strengthen. In that sense, ¥5.7 billion by "enhancement of appeal of stores/content" and ¥3.7 billion by "digital shift" are shown among the items whose effects produced by sales floor renovation and new content can be quantified on the stair chart. We will closely monitor these KPIs at each measure level. Specific initiatives, including "AnotherADdress", OMO for cosmetics and Parco's initiatives, are listed on the final page. I would really like you to see it. We would like to increase revenue steadily by implementing these initiatives.

Q. With respect to gross sales for FY2023, you said you would increase domestic sales to the level close to sales in FY2019. Is the effect of the Real × Digital Strategy included in it?

A. Of course, yes. The effects of these strategies are factored in.

Q. If new initiatives contribute to profit, how much do you think will be realized under the Real × Digital Strategy, that is, by the initiatives presented today?
A. The initiatives presented today are only a small part. We will implement these measures both physically and digitally. Both Department Store and Parco are considering OMO through "people" in stores and for *gaisho* sales. For example, on the information website for *gaisho* customers (connaissligne), we are working to improve content. Concerning *gaisho* activities, which were centered on visit to customers, we will be able to expand various possibilities by changing our course to communicating with customers using digital technologies.

A. On department store sales basis, we expect a positive sales effect of ¥20 billion compared to 2020 through "digital shift." Specifically, current e-commerce sales are slightly over ¥10 billion and expected to increase ¥15 billion in three years. The effect of OMO for cosmetics is expected to be ¥5 billion.

As for connaissligne mentioned before, we added live shopping function and conducted a pilot trial, which was found to be much more effective than at-home sales. It was demonstrated that we can sell online by improving content. So we expect to have sales of around ¥10 billion yen including remote sales in the three-year period.

A. With regard to Parco's digital shift, Parco, which operates tenant business while Department Store sells specialized products and serves customers digitally, will get in between tenants to serve customers in stores and digitally and create OMO sales channels that enable sending, serving and selling customers through "people" both physically and online. We are reforming our online store by segmenting using AI. In the future, we will cooperate with tenants to create a system in which we can find where and what products each tenant has in stock.

I think we will earn more revenue digitally in the future. Recently, online store sales are significantly increasing, exceeding ¥0.1 billion in one month last December. Furthermore, we will activate products by adding game factors and amusement using the latest digital technologies so that digital customer service will function well. I would like to implement the Real × Digital Strategy in such a way.

Q. I had the impression that business profit for FY2021, the first year, is lower than expected and that you will need to increase substantially during the following two-year period. Though fixed costs are expected to decrease due to structural reform, I think you will need to substantially increase business profit to achieve its target of ¥4.4 billion in FY2023. I would like you to give a supplementary explanation on how you will produce profits in the next period and the period after next.
A. Slide No. 38 shows a path to full recovery of PL up to FY2023. We expect a step-by-step increase of operating profit to ¥11 billion in FY2021, ¥26 billion in FY2022, and ¥40.3 billion in

FY2023. In order to “achieve full recovery” in this plan, we need to not only expect sales recovery but also newly acquire sales. As a matter of course, this plan requires investment. Therefore, we cannot make a bullish forecast for the first year. Last October, we wished to achieve ¥40.3 billion a little earlier in the three-year period. However, seeing the current condition, we can hardly expect it to recover. it is also difficult to forecast inbound sales, which were ¥60 billion in FY2019, for the three-year period.

In this unpredictable situation, concerning this plan, we are in a position to achieve the target by implementing the measures of the three growth strategies. We plan to concentrate investment in those that can be expected to produce effects steadily within the scope of depreciation in the three-year period.

Concerning structural reform, those we expect to produce great effects this fiscal year include overhaul of advertising and offices, which can be carried out soon. Organization and HR structure reform will work mainly in FY2022 and beyond. With these efforts, we will achieve numerical targets.

Q. In FY2021, the portion of SGA and cost of sales reclassified to “other expenses” in the previous period will come back. While sales will not recover enough, costs will return. When the impact of COVID-19 is mitigated and sales recover, you will be able to achieve “full recovery.” Is this understanding correct?

A. Gross sales are expected to be ¥105 billion in FY2021. Though it is difficult to forecast when COVID-19 will come to an end, we will steadily promote the growth strategy and structural reform.

Q. With respect to cash flow on slide No. 55, I think that operating CF numbers include right-of-use assets depreciation and that FCF numbers include the repayment of lease liabilities. I would like to know the level of real FCF excluding these effects.

A. It is expected to be positive at around ¥30 billion on an IFRS basis in FY2021. As you said, however, due to the annual repayment of lease liabilities of around ¥28 to 29 billion, real FCF is expected to be slightly over ¥1 billion in FY2021, around ¥30 billion in total for three years.

Q. As FCF also provides funds for improving corporate value, I would very much like to ask you to keep it positive.

A. Certainly. We will remain committed to keeping FCF positive as we did in the past.

Q. With regard to the Real × Digital Strategy, what customer segment are you targeting? Your measures for affluent people are clear. However, are you targeting a wide range of customers or narrowing down target customers, for example, by age and fashion sensitivity? It is like preaching to the choir, but in a digital world, you will incur a lot of advertising expenses without proper segmentation, which will result in no effect. Real stores cost nothing because customers visit them. However, a digital world costs much. What do you think about that?

A. We need to seriously consider to what customers, what products, and how we will provide in a department store business model. But it is true that the situation varies by store. The top performing store of ours is the Kobe store. In the environment in which it is better to drive to the neighboring Kobe area, not the Osaka area, due to COVID-19, the store has a full assortment of currently popular brands of luxury items, watches, cosmetics, etc. Such a store is easy to narrow down a target. On the other hand, the Tokyo and Umeda stores, which have various customers, have difficulty.

We do not think of implementing the Real × Digital Strategy in all merchandise categories at the same time. We will concentrate investment in the categories that can be expected to produce effects, including cosmetics, art and watches, in both stores and a digital world.

Gaisho staff and sales staff in stores are our valuable assets. Particularly, we have operated *gaisho* business mainly by visiting customers. To advance communication with customers digitally as well as physically will be our big challenge. We already have in place a platform for target *gaisho* customers that staff can approach with hypotheses. And we would like to improve it.

Q. I would like to ask Mr. Sawada and Mr. Makiyama. While you have been engaged in management for one year amid the COVID-19 pandemic, did you renew awareness of the strengths of Department Store and Parco, respectively? And how are they reflected in the Medium-term Business Plan?

A. It was very clearly recognized amid the COVID-19 pandemic that people can live every day without department stores. In other words, it has become clear that a department store is not a place that sells essentials. How much value other than use value is provided is important for customers. Department stores can compete enough concerning the products and brands that have contexts that create value behind them and I think they will become our major battlefields. They include underground food floors called *depachika*, beauty and luxury in a broad sense. On the other hand, staple product categories are shrinking in stages.

The beauty adviser appearing in the video of cosmetics OMO presented in the link list attached to the presentation material is our employee. Development of more and more human resources who have expertise and knowledge to deliver value and use of digital technologies by these human resources enable establishment of relations with many customers beyond time and place.

This plan presents "media commerce focused on people." And I recognize that we need to transform ourselves into a human media company. We can expand categories and content as our strengths through "people" online as well as physically. We will create online and real stores featuring people.

A. Please see the examples listed on slide No. 59. We have set Parco's purpose of "cutting through the world with sensibility." Over the past year, we have accelerated use of digital technologies in addition to real stores based on sustainability using our strengths of having various external networks in Parco-like way. We developed new sales floors not by shifting from products to experiences but adding Parco's production capability between them. Parco creates new value by being involved as a producer instead of supporting and managing tenants. We established “one and only” Shibuya PARCO, and advanced it with Shinsaibashi PARCO. Our confidence that we have received support from many customers including Department Store’s customers has led to such action.

Q. SGA of Daimaru Matsuzakaya Department Stores is planned to increase ¥20 billion this fiscal year. What are structural reform costs of ¥6 billion and where are they included in this numerical plan? When will fixed costs reduction of ¥10 billion take effect in the three-year period?

A. Structural reform costs of ¥6 billion are included in “other expenses,” not SGA. We will reduce fixed costs through business model reform, preceded by “other expenses.” Their effects will be shown as reduction of both cost of sales and SGA. On the other hand, an increase in SGA for this fiscal year is mainly attributable to a reaction to the portion of fixed costs associated with store closure, etc., which were reclassified in the previous year, and cost increase in proportion to sales increase due to our sales recovery efforts.

Concerning the accuracy of structural reform, we estimated on a yearly and monthly basis to achieve the reduction target of ¥10 billion. Our yearly reduction targets are ¥3 billion in FY2021, ¥4 billion in FY2022, and ¥3 billion in FY2023.

Q. Why did you separate the SC Business and the Developer Business? They look the same for us. What company will grow as the core of the Developer Business?

A. Looking ahead to regrowth as a group, we position the Developer Business as a growth business. The Real Estate Business, which had been included in Daimaru Matsuzakaya, was integrated into Parco in September last year. At the same time, employees who worked for the Real Estate Business of Department Store are working there.

Both Department Store and Parco focused on commercial business in the past. But I think we can use our real estate more effectively beyond the framework of commercial business to maximize our real estate value. Our properties concentrate in Shinsaibashi and Nagoya. However, in an integrated manner as a group, I think not only conventional commercial development but new area development will be possible.

Q. You told about the development of the site of Kumamoto PARCO. Won’t you be able to conduct it more flexibly unless the SC and the Developer are separated?

A. The SC Business will mainly operate under the trade name of Parco. The SC Business will be dedicated to increasing value as commercial facilities. The Developer Business will promote not only commercial but mixed use development.

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