J. Front Retailing

Q & A summary

Earnings call for the first quarter (Q1) of the fiscal year ending February 28, 2021

Date and time: 15:15 – 16:00 on Monday, June 29, 2020

Q. I think Daimaru Matsuzakaya Department Stores and Parco felt their way amid the COVID-19 crisis in Q1. Could you tell me "what was as expected" and what was unexpected in each segment? You announced the situation through mid-June but I would like you to explain what you feel in light of the situation in June after the reopening of your stores.

A. Exactly as you said, we felt our way in Q1. In terms of business performance, a state of emergency was declared immediately before we announced earnings forecast on April 10 and most of our stores closed until after the consecutive holidays broke in May. The situation was greatly different from the earnings forecast announced in April. It was unexpected. Not just store sales plunged but also the Parco Business and the Real Estate Business were forced to reduce real estate rental income. Therefore, the earnings forecast was revised down significantly from the original forecast. Decline in earnings in Q1 was largely due to closure. It was not "as expected" and we put first the survival of the Company and the safety and security of customers and employees and acted accordingly. We received various voices from customers concerning closure and reopening and I think we, including employees at each store, responded to them in a responsible manner.

With regard to the current situation in June, almost all department stores and Parco stores reopened with reduced business hours in phases from late May. Sales decreased by 30% from the previous year immediately after reopening but now they have recovered to around 20% decrease. However, things such as promotions to entice shoppers into stores and sales activities of *gaisho* have not come back to normal yet. Inbound sales are not expected to recover. So we will aim to recover domestic sales in the immediate future. We would like to strive to ensure earnings in Q2, H2 and beyond with first priority on safety and security.

Q. You said you had recorded store closure-related costs under "other operating expenses." Specifically, which costs were transferred from business profit? It is a technical matter but I would like you to supplement the information.

A. The components of costs transferred to "other operating expenses" are provided by item as cost/expenses on page 6 of reference data. According to the guidelines of the Japanese Institute of Certified Public Accountants, fixed costs incurred during closure (personnel expenses, depreciation, utilities expenses, etc.) are included in extraordinary losses under JGAAP. But the Company adopts IFRS and recognized them as "other operating expenses."

Q. Newspapers, etc., say it would be appropriate to exempt companies from recognizing impairment losses because the current slump due to a decline in earnings caused by the COVID-19 crisis is temporary. If such measures are adopted at the year end, will impairment losses recognized as a result of a quarterly stress test be reversed at the year

end? If the Government issues such guidelines, will you rely on them?

A. I know there were such reports, but under IFRS, which requires companies to run a stress test on a quarterly basis, we recognized impairment losses in Q1 according to principles after repeated discussions with accountants. As you said, however, I recognize it will be possible to reverse them depending on the degree of business recovery in the future.

Q. You seem to have made a severe sales forecast for H2. While safety and security are considered, inbound sales cannot be expected. So is it "unforeseeable"? Or this time did you eliminate optimism and forecast sales factoring in risks? I would like to know how you see figures. Department stores have a small number of customers but I think the number of paying customers and average spend per customer who buys with purpose can be expected to increase.

A. Given the current COVID-19 crisis, I recognize it is difficult to set an aggressive performance goal though our stores reopened. Currently, we cannot conduct normal activities such as sales promotions that attract customers, external *gaisho* events, and visits to customers. With regard to forecast for H2, we will develop specific measures in the future, but at present, inbound sales cannot be expected to recover in H2 and we have made this forecast with an outlook of recovering domestic consumption under the sales system that puts first safety and security.

Q. You said you had reduced investments because of harsh performance. Specifically, what investments did you reduce? Though you reduced in the current period, will you have to increase investments by the same amount in the next and subsequent periods?

A. With respect of investments, in April, we announced our policy that we would reduce investments by half excluding investment on the north wing of the Shinsaibashi store, which is planned to open in H2. At present, based on this policy, we reduced investments by half on a consolidated basis excluding investment on the north wing of the Shinsaibashi store. We cannot stop or postpone safety and security-related investments but we will significantly reduce investments on normal store renovations, etc. and conduct zero-based review. As a result, Daimaru Matsuzakaya Department Stores expects a decrease of ¥2 billion in expenses on the P/L. We will not add these postponed investments in the next and subsequent periods. I recognize we will newly develop an investment plan for the next and subsequent periods in the first year of the next Medium-term Business Plan.

Q. Do you mean by "reduced investments" that you did not reduce further from "reduction by half" explained in your announcement in April but "reduced by half" as planned?

A. That's right. Our policy of reduction by half, which was explained in our April announcement, is progressing as planned.

Q. You seem to strive to reduce costs and I would like to know the details of cost reduction. Do you reduce temporarily or will you reduce again in the next period?

A. Consolidated SGA forecast is provided in reference data. A decrease in depreciation in and after Q2 is mainly attributable to investment reduction. With respect to personnel expenses, we extended retirement age and reviewed the retirement benefit plan, and as a result, an expanded voluntary early retirement program was applied to over 200 employees in the previous fiscal year. We also strive to reduce overtime and temporary labor. Concerning room for cost reduction, we have no plan for significant cost reduction at present but we will continue to reduce mainly controllable costs. With respect to forecast for H2, I recognize we need to make it again in view of the status of business recovery in the future. Concerning "room for further cost reduction," we have factored in what can be factored in at present in this earnings forecast.

Q. I would like to ask about the real estate business of Daimaru Matsuzakaya Department Stores and the Parco Business. How did you respond concerning rent in the real estate business of Daimaru Matsuzakaya Department Stores and the Parco Business in Q1? What do you expect for Q2 and subsequent quarters and under what conditions are you planning? Particularly, concerning the real estate business of Parco, what is your future outlook and how do you think it can move into the black or get back on the track? Judging by the expression of easing of rental conditions and H2 loss guidance, it seems "unlikely to be improved."

A. Ginza Six, which is the main real estate business of Daimaru Matsuzakaya Department Stores, was forced to close and reduced rent depending on the length of closure. The effect on the real estate business of Daimaru Matsuzakaya Department Stores including Ginza Six was approximately ¥1 billion. As we cannot expect sales percentage rent in and after Q2, the total effect is expected to be around ¥1.3 billion in H1. We also expect earnings in H2 to fall short of the original plan due to a decrease in sales percentage rent, etc.

Parco also reduced rent during closure. I cannot tell about the future forecast because we will individually negotiate that with each tenant but we expect around 10 to 20% easing of conditions. As you said, I recognize we need to discuss again our outlook for losses in H2.

Q. Parco is expected to remain unprofitable in H2. In that regard, is there a background that you see assumptions about transaction volume severer than the Department Store Business, or is it affected by rent terms? I would like you to explain a little more.

A. The Parco Business operates the entertainment business as well as the store business that mainly receives rent from tenants. During the current period, the entertainment business is recovering gradually from the closure of its locations like the store business. However, in light of the COVID-19 crisis as assumptions about this earnings forecast, we expect the number of available seats to decrease by 50% in H2 as well. The outlook for the business of Neuve A remains challenging partly affected by COVID-19. Thirdly, we plan to transfer the real estate business of Daimaru Matsuzakaya Department Stores to Parco, which will involve an increase in one-time cost. For the reasons above, at present, though the store business is expected to be profitable, the entire Parco business is expected to post losses in H2.

Q. I would like to ask you about whether great changes can happen to the Department Store Business in the future. In Japan, bankruptcies seem to be fewer than in the US. Can more tenants in department stores and the rental business move out? And is it possible that you cannot make a contract on the same terms and conditions as before?

A. Some bankruptcies of apparel companies, etc. are reported. However, at present, there is no risk that may cause a significant change in assumptions about this revision of earnings forecast. However, I recognize we need to keep abreast of what specific risks are present in each business and respond to them to forecast the future business and earnings because the business conditions vary by tenant. The management team already gave directions. Negotiations for exit, etc. will be conducted individually but we will continue to pay close attention.

Q. I would like to know about rent reduction for the Daimaru Tokyo store and the Daimaru Umeda store as tenants.

A. This matter is under negotiation and so we have not factored it in this earnings forecast. We will factor it in based on negotiations with their landlords as needed.

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