J. Front Retailing
Q & A summary
Results presentation for the fiscal year ended February 28, 2022
Date and time: 16:30 – 17:50 on Tuesday, April 12, 2022

Q. You are finally going on the offensive and will be investing quite a bit in the current fiscal year. I have been looking at the data file to see what the capital investment will be, but as you mentioned earlier, I have a feeling that renovation will be the main focus. Could you reiterate how you are going to allocate those investments and what kind of effects do you expect from those investments?

A. (Yoshimoto)

We invested ¥12.6 billion in the last fiscal year and plan to invest ¥34.4 billion in the current fiscal year. In this situation, one thing that is still true is that Developer has had a lot of investment in the current fiscal year from the beginning. Since we have been holding back considerably in the last fiscal year, we had only done what we could really see until last fiscal year, so we still need to do a great deal in the current fiscal year in order to recover the fully restored figure of the operating profit of ¥40.3 billion in FY2023.

Specifically, we expect to invest ¥21.8 billion of the ¥34.4 billion investment in store development and sales floor renovation. Half of these are for Developer, and looking at Department Store, we increased the investment from ¥3.1 billion in the last fiscal year to ¥7.5 billion, and Parco has increased its sales floor investment from ¥1.9 billion to ¥3.4 billion. We will make the necessary investments in the current fiscal year in order to be “aggressive,” which we have seen for our future expansion.

At the same time, another axis is system investment. In the last fiscal year, the actual amount was ¥4.3 billion, but in the current fiscal year, it will be ¥7.8 billion, and this will be done in a concentrated manner in the current fiscal year. We plan to downsize again to more than ¥5.0 billion in the next fiscal year.

In that sense, we intend to invest considerably in the current fiscal year in both hardware and software, and in doing so, we hope to create a system that will directly lead to earnings in FY2023.

For the two years since the COVID-19 pandemic began, we have had our share of troubles, and we have been thinking about what form our future growth should take. However, I am confident that there is no mistake in the direction of our three growth strategies: Developer, Real × Digital, and Prime Life. The idea is to make a solid investment in the real and digital worlds that we see in this process.

Q. I would like to know about the concept of the Director candidates that you released today. I believe that Mr. Sawada and Mr. Makiyama will step down from the Board of Directors to concentrate on the execution of business of the operating companies and that the ratio of Outside Directors will be more than half. The release states that the purpose of this is to separate the functions of the Board of Directors from those of business execution. I would like to know the thoughts of Mr. Yoshimoto such as the background behind these decisions and these candidates for the Board of Directors.

A. (Yoshimoto)

The J. Front Retailing (the “Company”) places a high priority on governance and has taken various measures in the past. And I believe that we will be able to reach a certain goal in this form in the context of my own concept of separating supervision and execution.

In the current fiscal year’s plan, what we are considering in the execution of the J. Front Retailing Group (the “Group”) is to make the role of the holding company extremely clear.

The role of the holding company is to consider what is optimal for the entire Group and consider growth strategies accordingly. We must also properly allocate management resources, such as people, goods, and money, to each of our business segments. I think this will be the main one.

In terms of our relationship with the operating companies, we will have to communicate more closely with their presidents than before. We will fulfill various things with commitments while facing each other firmly beyond each idea. I believe this is the kind of relationship we should have.

In that sense, we will work more closely than ever with Mr. Makiyama, Mr. Sawada, and the presidents of the operating companies, but we will also consider growth strategies that are optimized for the whole. In addition, we will firmly consider a good allocation of people, goods, and money. I would like to make the holding company more specific in this way.

Q. You said quite a spirited “gear change.” The top line of Department Store always has a higher assumption than other companies in the same industry every year, and costs also seem to be higher. You were doing well in the results for the first half even though profits were down. I'm wondering if the top line view is stronger than Takashimaya, which released an earnings report recently, by 10% or more in the current fiscal year.

On the other hand, you plan to spend quite a bit on expenses and I understand that you must do it now rather than making small profits this year in order to achieve an operating profit of over ¥40.0 billion for the next fiscal year, a full recovery, and growth beyond that. Please tell us how you think about the balance between the gas pedal and the brake in this context.

A. (Yoshimoto)

Since I mentioned a “change of gears,” I personally would like to put a lot of effort into this area.

I know that the top line view of Department Store is very strong. Especially compared to FY2019, we still have an unstable element for the inbound ones and we share with the management of Department Store the fact that we will have a hard time reaching these numbers unless we get the numbers excluding inbound back to at least the 2019 base in FY2023, that is, the next fiscal year. I think it is also true that if the performance of Department Store does not return, it will be very difficult for the Group’s performance to return in a significant way.

In this context, I mentioned earlier that in the real and digital areas, we have seen things that we can expect to see in the future quite strongly, so we will invest in these areas in the current fiscal year. We would like to try to increase the top line by combining the real and the digital.

The investment for the Group as a whole (excluding right-of-use assets), which was ¥12.6 billion in the last fiscal year, is planned to be ¥34.4 billion in the current fiscal year, so it is clear that we are placing considerable weight on the current fiscal year. However, we will thoroughly pursue how we can downsize this investment.

As for costs, it is true that there have been quite a few increasing factors from the beginning in the current fiscal year. The investment-related increase I mentioned earlier alone would amount to ¥5.0 billion to ¥6.0 billion in terms of expenses for the current fiscal year. As a matter of course, we will work to downsize this, and there is also a reactionary increase from last fiscal year's transfer from fixed costs, which arose during the period of business suspension, to other operating expenses. Alternatively, as sales increase, variable costs will absolutely increase. In this way, the increasing factors would amount to ¥10.0 billion or more.

On the other hand, we will steadily reduce so-called fixed costs through the restructuring that we are undertaking. What we call fixed costs is the expenses that will continue to decrease while operating business and will not be restored. We are doing this in the actual personnel expenses related in the personnel restructuring and in the other cost related, and we will ensure that this is done.

However, partly due to geopolitical factors, I believe that the current fiscal year's costs will include price increases for materials, components, and energy. We would like to well control investment and costs while keeping a close watch on the movements in our stores.

Looking at the figures for April of last year or January and February of this year, it is clear that the Kansai region was greatly affected by the spread of COVID-19, so I think the damage to the previous year's figures is a bit larger (compared to our competitors) for the Group that has a strong store base in the Kansai region.

We would like to try to achieve this figure. On the other hand, after our earnings forecast was announced in October last year, we began to tighten expenses considerably when we saw that the situation was severe. We will continue to do so without losing that stance.

Q. Concerning Shopping Center Parco, while Shibuya PARCO has been growing considerably, the five stores named today are still slowing down in terms of current trends. In renovating, I think the tenants are quite damaged by the COVID-19 pandemic, and I'm not sure if the tenants will be able to come in under good terms. Is it alright to say that any major renovations have been taking place since negotiations with tenants in that area are highly prospective? Since you are planning to increase the business profit of Shopping Center, I would like to know how the tenants will change through the renovation and how the profit will be increased. Or the tenants are quite damaged, and I would also like to know whether there is a possibility or a risk that the easing of conditions could be prolonged or not.

A. (Makiyama)

As for the five stores that we plan to grow, in terms of how they fared in FY2019, only Shibuya PARCO had special factors, but other than that, the original potential they have is clear. In Ikebukuro PARCO and Nagoya PARCO, we are currently renovating mainly the ground floor, and we expect to certainly return the floor to its original potential of ¥4.0 billion in operating profit in Nagoya PARCO and ¥2.5 billion in Ikebukuro PARCO by FY2023, after returning it to 80% of these figures in FY2022.

The strengthening of these two stores alone will lead to quite a profit. The relaxation of conditions is only for the business categories that have not been able to operate on a business basis due to the reduction in hours, mainly in the food and beverage industry. We also supported a tour counter and a movie theater in entertainment temporarily.

The amount of this relaxation of conditions totals about ¥2.5 billion this year, which is much less than last year. We believe that we will be able to bring that back up to 90% by FY2023, so in that sense, we are certainly in a position to do this.

Also, Shibuya PARCO is growing right now. There is a sense of various changes and every day it is changing in various ways. So customers absolutely want to experience them and they see that many things are happening there. And the number of customers who have such expectation is increasing. Building on that base, we expect it will reach the potential that had originally been there. The operating profit base for FY2022 is ¥1.1 billion, but we believe that the potential is ¥2.0 billion. Especially, Shibuya PARCO is our image hub. By enhancing the image of Shibuya PARCO by renting out the location, so-called plazas and spaces, and holding events using 5G in various facilities, etc., as well as earning revenue from the lease, various ancillary businesses have been added. The lease will actually bring it back up to ¥2.0 billion, but I believe there will be more positive factors than that.

In addition, we are currently working on the renovation of Nagoya PARCO and hoping to make sure that we can show a positive figure since the elements of Shibuya PARCO are now expected in Nagoya PARCO and such a store will be opened this spring.

Almost all of the PARCO stores nationwide, especially the flagship stores, intentionally have pop-up shops so that they can be operated in a variety of ways. It doesn't mean that there are not many tenant candidates, but on the contrary, there is a long queue for tenant candidates in the Shibuya area, including luxury shops, who are eager to be tenants.

Q. I have a question about cost restructuring and management restructuring on page 33 of your presentation materials. To a certain extent, these are also projected in the current fiscal year's plan. For example, is it correct to say that there is still more that can be done in a single fiscal year to further reduce fixed costs?

A. (Yoshimoto)

I think so. Our plan is to reduce fixed costs by ¥10.0 billion over three years, and initially, we were thinking of reducing by ¥3.0 billion in the last fiscal year, ¥4.0 billion in the current fiscal year, and ¥3.0 billion in the final fiscal year.

Although we believe we were able to help reduce fixed costs by about ¥4.3 billion in the last fiscal year, we are seeing a lot of what we need to do to meet our ¥4.0 billion target for the current fiscal year.

The current fiscal year's target of ¥4.0 billion is a bit of a large bar, so we will have to work a little harder, but we are now working on this part of the project, in terms of both personnel expenses and other expenses.

To be more specific, personnel restructuring will be a major factor, but if we want to lower personnel expenses, we absolutely must proceed with both tasks at the same time. What it means is to create a small group structure. At the same time as reducing the number of employees to a small number, the sales floor or workplace that can be operated with that number of employees must be firmly assembled. I think we have to do both of these things.

In the last fiscal year, the department store group also conducted personnel restructuring, and some sales areas are now temporarily short of personnel. When it comes to such places, we have to temporarily reinforce our staff there. This is done within the variable costs and I think our approach to personnel restructuring is to match the personnel and organizational structure as much as possible and to do so speedily, without waste and without loss.

Even without personnel restructuring, about 200 to 300 of our employees who work around department stores leave their jobs each year. We will work to reduce the costs of these efforts at the same time, which is the approach we have been taking all along.

As I mentioned earlier, we would like to rethink of human resources as the target of our investment. And especially, we would like to work hard to reskill the younger and more experienced employees.

In terms of costs, we will not just reduce fixed costs by ¥4.0 billion in the current fiscal year and ¥3.0 billion in the next fiscal year but also thoroughly address any variable factors in sales or investment for reduction.

Q. Concerning the Real×Digital Strategy, I think you mentioned that you are starting to see a lot in this area and would like to step on the gas pedal as well. As for what you are actually starting to see, for example, an increase in *gaisho* sales on page 28 and the expansion of the OMO on page 27, is it correct to say that sales to luxury customers are not increasing temporarily, but rather that you have a good response that will allow you to increase sales on a regular basis?

A. (Yoshimoto)

We think so. Of course, this is true in terms of categories, but I also mentioned GINZA SIX and the Daimaru Kobe store in my explanation. GINZA SIX has many customers who do not see it as a department store, so it may not be so easy to expand horizontally, but in the case of the Kobe store, I believe it is the best example for us to follow.

In that sense, the Kobe store is on the flip side of, say, the Tokyo store or the Umeda store, and these terminal stores, looking at the figure for FY2023, are only about 85% of domestic sales excluding inbound sales. In other words, we expect a decrease of about 15% to remain.

Looking at the categories, I think we have to assume that the situation will remain quite severe for fashion products, interior goods, and other mid-priced items. In this way, we have a clear picture of the areas where we will thoroughly expand sales through *gaisho* sales, luxury brands, and various sales promotions using digital technology, and I think it is important to make the first move toward these areas in FY2023.

Mr. Nishisaka, who is closer to the department stores, would like to talk a little about this.

A. (Nishisaka)

First of all, let me explain how the Real×Digital Strategy is moving, especially when viewed from the product category axis. The results for FY2021 show that the category known as luxury has already exceeded the FY2019 level by more than double digits. Meanwhile, art is also on par with FY2019 and up 50% against FY2020. Watches are also above the FY2019 level.

As we reported earlier on the case of GINZA SIX, where the number of young affluent customers is increasing, Daimaru Matsuzakaya as a whole is seeing an increase in the number of young customers, a growth in purchase volume, and an increase in sales share. And the number of new *gaisho* customers is also increasing. These categories are growing against the backdrop of such a strengthened customer base.

On the other hand, we are also working to match our strategy with that of our suppliers, who are also formulating strategies to open new stores within narrowly defined areas, and we are aiming to open one store per area in the Kobe and Sapporo areas by firmly adjusting our strengths to their strategies.

I believe that recently the reason for this support from customers is not simply in luxury products, but rather in the context of sustainability, craftsmanship itself, or the solidity of its intrinsic value. I think that is likewise true of watches, and art has been very popular partly due to their asset value. The art market in Japan is said to be ¥250.0 billion, but it is still a small market compared to the world as a whole. So I think that there is still room for growth.

In particular, the younger and wealthier people respond very well to contemporary art, especially that represented by Banksy. The investment plan mentioned earlier is based on the strategy of aggressively investing in our strong categories including those mentioned above in the current Medium-term Plan to secure further overwhelming superiority.

In digital services, we launched new services in the current fiscal year, including the second half of last fiscal year, to be exact.

One is ARToVILLA, which started on January 7. This is not just digital media, but more and more people such as those who are familiar with various art forms, architects, designers, or those who make a business out of art itself are being cast on the board to send out all kinds of information. Such new way of enjoying art is becoming more and more popular.

Since its release in January, we have already received more than ¥100 million sales online, and the response has been extremely high. In addition, young people who are not our existing customers are using the service. In this way, it leads to customer development.

In addition, we released a cosmetics website called DEPACO in March. By not simply selling cosmetics through e-commerce but extending the power of people using digital technology, we are starting to see our unique OMO, or use of digital technology, which is not comprehensive or algorithmic. We are considering launching a third or fourth service in the future.

Q. Regarding fixed costs, I remember that about 20 years ago, when the baby boomers entered their 50s, department stores were divided into two groups: those that cut costs by hundreds of millions of yen through restructuring in personnel expenses and those that did nothing and got in big trouble. The bubble generation and baby boomers are now entering their 50s, and there is a strong push for personnel expenses due to the age structure of the workforce. Under these circumstances, your company is in an environment where it is easy to implement restructuring, including attrition, but since you are already implementing restructuring ahead of others, do you feel that they are not having much effect on your company? Or rather are you implementing this restructuring using such things as a tailwind? Assuming such a view is correct, please briefly explain for how many more years the effect, or rather the reduction in fixed costs, is possible and whether it can be continued.

A. (Yoshimoto)

We have been working on sales reform since around 1998 at the end of the 20th century to reduce fixed costs, not only personnel expenses, and have continued to do so for a long time. In that sense, we are a highly streamlined organization, so it is difficult to advance all at once, but as I mentioned earlier, we have accumulated a certain amount of know-how. We also have a systematic approach in our organization, and we will continue to work on these issues in the field. I believe that the disposition to work without being told to do so is ingrained in us.

I believe what we need to do now is to support and assist the entire Company and Group as a whole in promoting such awareness at all workplaces.

As I mentioned earlier, we implemented restructuring in the last fiscal year. There are now a little more than the usual number of retirees in the department store organization. This is something that each of us has been working on while also thinking about our own future and providing various kinds of support. At the same time, we have continued to build an organization to operate department stores, shopping centers, etc. as a more productive organization for the future. However, it is quite difficult to accelerate the process all at once, so if half of the ¥10.0 billion in fixed cost reductions I mentioned earlier is to be done in personnel expenses-related areas, I think it will be necessary to come up with about half of that amount in the plan and get it done.

Naturally, bonuses and other payments will rise as business recovers, so we will take this into account. As I mentioned earlier, our organization’s greatest strength is that such disposition permeates in each of workplaces and that we are able to move well when instructed. Even without instructions, we can move well. I think this is the kind of constitution we need to have.

However, if you are looking for a big result all at once, you have to do it in a very systematic way.

Q. From a longer view of profit growth, your company has historically redeveloped its own properties and then added products and content to increase the profit level significantly. From that perspective, I think that once the revitalization of Nagoya Matsuzakaya is complete, the next large-scale location will be needed to significantly improve the profit level. What are your views at this point on such seeding for the future?

A. (Yoshimoto)

In the Developer Business, we are now sorting out the higher-level concepts of what direction we should take with regard to what we currently own, lease, or will acquire in the future in our CRE. I would like to have a chance to talk about this somewhere in the near future.

From the standpoint of our potential, Shinsaibashi has achieved a certain level of success, but I believe it still has a potential to grow in the future. As you say about Nagoya, there are many possibilities.

In the form of Tokyo, Nagoya, and Osaka, we would like to consider this in the Tokyo area as well. Fukuoka is also an area where both Daimaru Matsuzakaya Department Stores and Parco are strong. I mentioned earlier that Kobe is the strongest zone and we will consider our near future in these areas.

We are looking for a direction where we can contribute to the development of each area with our uniqueness. We want to create the stores that can make money. We want to create the areas that can make money. We would like to move forward with this in mind. We would like to have an opportunity to share our Developer Strategy and vision as soon as possible.

End