"We Aim to Reform Management at the ‘Level of Changing Business Formats’ Rather Than Just Modifying or Improving Existing Operations."

Q: Would you outline operating results for fiscal 2009?

A: When reporting the consolidated third quarter results of J. Front Retailing (JFR) Group in January 2010, sales and other figures were closely reviewed amid severe consumption environment and uncertainty about the future. After that, however, department store sales exceeded forecast significantly, and at the same time, we controlled costs thoroughly. As a result, operating income, ordinary income and net income exceeded forecast by ¥3.88 billion (26.4%), ¥4.46 billion (28.8%) and ¥1.66 billion (25.6%) respectively. Though that resulted in a revenue decline of 10.4% over the previous year, the ranges of decrease in operating income (33.8%) and ordinary income (29.4%) reduced compared to the previous fiscal year and net income increased for the first time in two fiscal years (13.9%).

The decrease in operating income is mainly attributable to stagnant department store business. In order to put JFR Group on the path of real profit growth, it is essential to “renew” its core department store business into a new format that has strong competitive edge and high profitability. This is why we accelerate management reforms at the “level of changing business formats,” instead of just modifying or improving existing department store operations, toward the creation of innovative framework that ensures sustainable growth of sales and profits and the achievement of results.

Q: What is behind your thought that you should “reform management at the level of changing business formats”?

A: Over the past 10 years, we have tackled department store management reforms including store-based sales reform. They are mainly changes of internal structure and have achieved remarkable results in streamlining of business operations and cost reduction. However, they have not increased the appeal of floors and stores to the level that customers can recognize clearly and I have to say that they do not sufficiently meet market changes.

With severe changes in consumer spending and keen competition across industrial sectors continuing, department stores have become alike and narrowed the range of target customers and markets by selecting brands and merchandise mainly from among their existing suppliers with too much weight on the heightening of prices, women’s clothing, the middle-aged, high-income persons, authentic and dress-up.
Above all, we lag behind the recent major consumer trends toward more casual attire and greater price consciousness and have failed to catch up with the speed of market changes.

Since consumption and competition environments facing department stores are expected to grow increasingly severe, it will be difficult to survive, let alone grow, by using a traditional department store model with weak market response capabilities, high-cost structure and low-efficiency operation.

Is it based on such background that you merged Daimaru and Matsuzakaya a year earlier than originally scheduled and formed Daimaru Matsuzakaya Department Stores Co. Ltd. in March 2010?

We will restructure the organizations and functions of three companies including JFR, Daimaru and Matsuzakaya to build a simple framework of business operation. The business planning and merchandising divisions of department stores, which had been centralized and integrated in JFR since the management integration in September 2007, were transferred to Daimaru Matsuzakaya Department Stores. Daimaru Matsuzakaya Department Stores will become a self-contained organization that has all the functions of department store operation. It will expedite decision-making and speed up business planning. In addition, we will centralize and streamline organization, personnel and facilities to enhance productivity and management efficiency. Thus we will accelerate business structure reforms centered on the new department store model by clarifying the respective roles and functions of JFR and Daimaru Matsuzakaya Department Stores and operating in close cooperation between the two companies.

<table>
<thead>
<tr>
<th>Process from management integration to integration of department store business into one company</th>
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<tbody>
<tr>
<td><strong>Sep 2007</strong></td>
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<tr>
<td>Merged Daimaru and Matsuzakaya Holdings. Formed J. Front Retailing Co., Ltd.</td>
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<tr>
<td><strong>Mar 2008</strong></td>
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<tr>
<td>Standardized house card systems. Integrated planning divisions including marketing and PB product planning.</td>
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<tr>
<td><strong>Sep</strong></td>
</tr>
<tr>
<td>Integrated information systems. Standardized gasho (out-of-store sales) card systems. Standardized personnel systems.</td>
</tr>
<tr>
<td><strong>Mar 2009</strong></td>
</tr>
<tr>
<td>Integrated merchandising strategy functions of women’s accessories and children’s wear department.</td>
</tr>
<tr>
<td><strong>Sep</strong></td>
</tr>
<tr>
<td>Integrated merchandising strategy functions of women’s wear, men’s wear and accessories and foodstuff departments.</td>
</tr>
<tr>
<td><strong>Mar 2010</strong></td>
</tr>
<tr>
<td>Formed Daimaru Matsuzakaya Department Stores Co. Ltd. (Completed reorganization into one company per sector.) J. Front Retailing became a pure holding company.</td>
</tr>
</tbody>
</table>

What is different about the new department store model JFR aims to build than a traditional one?

What makes our new department store model different greatly from a traditional one is to shift focus from a traditional “merchandising-focused retailer type” to a “marketing-centered commercial facility producer type.”

As you know, the retail space of department stores in Japan consists of a “shoka shire” (purchase of goods as they are sold) type that does not have goods and sales risk, which makes up 80% to 90% of the total, and a “kaitori/jishuhanbai” (purchase of all goods/independent selling) type that takes such risk, which represents 20% to 10%.

In shoka shire type sections, in order to meet changing customer and market needs, it is required to manage sales and space, change space composition, newly introduce, and implement scrap-and-build measures in units of brands or shops. In kaitori/jishuhanbai type sections, department stores need to plan and manage the selection, buying, selling and inventory in units of items and SKUs at their own risk.

These two types vary widely in role and responsibility sharing with suppliers in a business process, personnel arrangement, profit structure and method of staff training.

Especially, for the purpose of responding to customer and market changes in a timely and efficient manner, large-scale department stores with total floor area of more than 50,000 square meters should create and operate stores that attract customers and are highly efficient in terms of management by operating kaitori/jishuhanbai and shoka shire type sections as “merchandising-focused retailer” and “marketing-centered commercial facility producer” respectively and combining them effectively in line with store or floor concept.
Q Would you explain in short the “new department store model”? 
A Our new department store model is a "department store renewal program to create attractive and profitable stores that entice customers to visit.” 

One of the important tasks of the new department store model is "to improve market response capabilities" and "adaptation to market changes" and “expansion of target market” will constitute its pillars.

Based on these, each store will widely review too partial customer base, merchandise mix, pricing structure, and the tastes and minds of goods on its shelves according to the characteristics and actual competition of the area in which it is located to find the best balance and strengthen its competitive edge.

Historically, department stores, specifically in Japan, have developed and prospered always through “mass selling with high-class image” based on “mass” customers. Since most of their floors use low-margin “shoka shiire” type of purchase and they operate in huge premises whose real estate costs are high, it is essential to make “great sales” supported by a wide customer base, that is, “the masses” in terms of management unlike U.S. department stores.

Our basic merchandising policy is a “wide range of product composition and lineup premised on high quality and good taste.”

Our main urban large-scale stores with more than 50,000 square meters of floor space can offer a wide variety of merchandise, prices, directions and tastes, which is greatly instrumental in differentiating themselves from other downtown retail channels and sharpening their competitive edge.

To take pricing as an example, we should change the weight applied to each price range in a balanced manner to meet changing customer needs based on the wide breadth from the low price range “of department stores” to the high price range.

One of the current strong customer needs is to increase the assortment of valuable items in the low to middle price range “of department stores” and it is urgent to meet such needs. When circumstances change and the needs for high quality/high-priced goods grow, however, we will offer more brands and items in the high price range quickly to respond to these changes. Such ability to accommodate changes is a strength of “shoka shiire taking no inventory risk.”

Daimaru Matsuzakaya Department Stores and almost completed preparations for the organization and business operation systems to establish the new department store model.

This reform seems to take a lot of trial and error and time because it has no precedent and will be implemented on a large scale that will drastically change department store operation systems. However, we will carry it out by putting speed first.

Q What are the key elements to create stores that “entice customers to visit”? 
A In order to create attractive stores that entice customers to visit, we need to differentiate ourselves from the peer group and other retail channels and build "specialty" floors and zones that customers feel at first glance "are their shopping places.”

By selecting and offering brands, shops and products based on concept and theme tailored to the values and lifestyles of each target customer segment, we will accelerate our efforts to aggressively develop "specialty zones" that create "special added value” and brand them.

Among various types of specialty zones, JFR will develop mainly two types for the time being.

One is a “tightly targeted type” that seeks specialty in
lifestyles. “Ufufu Girls” and “Golf World” in the north wing of Shinsaibashi store are included in this type. The other is a “power category type” that narrows down items and its appeal is an overwhelming ability to assert items. A good example is Nordstrom’s women’s shoes floors.

The competitiveness and favorable image of stores are generated by placing many zones that have such specialty and strategically branding them.

**Q** How do you develop these “specialty zones” in your department stores?

**A** In November 2009, we opened the north wing of Shinsaibashi store. Particularly we feel that the success of “Ufufu Girls” on its young fashion floors, which is positioned as the specialty zone of our new department store model and targeted at the anticipated young and around 30-year-old women, has a great effect.

Its success seems attributable to clarified target, stylish café and a variety of events as well as fashionable clothing and accessories that are popular among young women, and new tools for communication with customers including a blog site operated by dedicated bloggers, email and free information paper, which department stores did not use in the past.

“Ufufu Girls” has risen in both awareness and popularity among young women and its branding is getting successful in such a short period.

The opening of the north wing generates synergy effects such as increase in the number of customers visiting the existing main building and more young women shopping in cosmetics, sweets and prepared food departments as well.

With reference to the purchases by identifiable customers in the whole Shinsaibashi store for the period from November 2009, when the north wing opened, to the last day of February 2010, the actual figures by young persons (aged 18 to 24) doubled to 118% from a year earlier and the ones by around 30-year-old persons (aged 25 to 34) increased by 27%. The same figures by persons aged around 40, around 50 and around 60 also grew by 16%, 19% and 10% respectively.

In Kyoto store, which completed its first phase of refurbishment on April 22, 2010, specialty zones including Kyoto store version of “Ufufu Girls” taking account of its geographical characteristics, women’s shoes and accessories and food sections were opened and have gained popularity among customers.

We will accelerate our efforts to open retail space and zones well suited to our new department store model in Umeda store, which will increase its floor space next spring, and other stores including Kobe and Nagoya stores.

"Ufufu Girls" on the 1st and 2nd floors of Daimaru Kyoto store

"Ufufu Girls” in the north wing of Daimaru Shinsaibashi store
It is important how you will retain new customers who shop in specialty zones and feel that “they are their shopping places.”

A customer loyalty strategy for identifiable customers holding our company-branded cards provides a very effective tool to retain customers who visit specialty zones, which are the important strategic retail space of our new department store model, and make them repeaters as well as ensure steady sales.

For fiscal 2009, Daimaru and Matsuzakaya posted year-on-year sales declines of 6.6% and 10.1% respectively on an unconsolidated basis. Concerning sales to identifiable customers including mostly cardholders and bridal circle members, however, they did well with Daimaru showing a drop of 4.3% and Matsuzakaya reporting a growth of 1.1%.

The percentages of sales to identifiable customers to total sales to individual customers of Daimaru and Matsuzakaya were 71%, up 1.6 percentage points from the previous year, and 59.3%, as many as six percentage points higher than the previous year, respectively.

Particularly the percentage of Matsuzakaya’s M Card sales to total sales to individual customers was only 3.5% partly because it has been issued just recently, though the sales amount expanded by six times from the previous year to ¥7.4 billion. Thus it leaves much room for growth compared to Daimaru’s D Card sales of ¥86 billion and its percentage to total sales to individual customers of 21.2%.

Since specialty zones have a higher number and percentage of customers who feel that they are “their favorite shopping places” compared to other floors due to their clear concept and large scale, they have conditions to easily acquire and retain new cardholders.

As “Ufufu Girls” floors of Shinsaibashi store have more and more new customers who cannot be identified, at the end of February 2010, we began to issue “Ufufu Girls Card” and encourage shoppers to register their email addresses. As a result, we accepted 6,800 applications for the card and 5,400 for email registration by the end of May.

We will be fully committed to finding and increasing our cardholders and email members in keeping with the development of specialty zones to be opened in our stores in an effort to identify and retain new customers.

What is the progress on your operational reform, which is considered as another important task of department stores together with the improvement of market response capabilities?

Another important task of our new department store model is a switch to “low cost operation structure.” With the new model, retail floor operation is divided into two types including “shop operation” and “independent operation” and we are working on establishing an operation system, planning staff distribution and training personnel to suit their respective characteristics.

Especially, the new model enables the operation of department stores with a small number of employees. This March, it became possible to operate the 40,000-square-meter north wing of Shinsaibashi store with 75 employees and about 50 outsourced workers including cashiers and telephone operators owing to the overwhelmingly large number of shop operation type sections and support in back-office functions from the existing staff of the main building and the south wing.

With the sophistication and establishment of our new department store model as well as the merger of department store chains into one company, the number of personnel required to operate department stores will drastically decrease.

As of March 2010, JFR and Daimaru Matsuzakaya Department Stores have about 7,500 employees in total including regular and contract ones. At the end of February 2011, the number of these personnel will be reduced to 6,000 persons through attrition, including retirement, and transfer to JFR Group and other companies.

We will focus on developing and using human resources required by the new model on the basic premise that we will protect jobs.

<table>
<thead>
<tr>
<th>Dividing retail floor operation into “shop operation” and “independent operation”</th>
<th>Shop operation</th>
<th>Independent operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales share</td>
<td>80%</td>
<td>20%</td>
</tr>
<tr>
<td>JFR’s major roles in retail floor operation</td>
<td>Management of sales and retail floors, changes of floor composition, introduction and scrapping and building in units of brands and shops</td>
<td>Plan and management of merchandising at item/SKU level</td>
</tr>
</tbody>
</table>
Macro indicators show a sign of improvement and what is the financial outlook for fiscal 2010?

For fiscal 2010, JFR aims to achieve consolidated operating income of ¥19 billion, which is the first increase in three fiscal years. As for segment operating income, we expect ¥13 billion for department store business, ¥1.4 billion for supermarket business, ¥2.5 billion for wholesale business and ¥3.3 billion for other businesses, all of which are projected to increase above the previous year’s level.

While big-ticket items including jewelry, timepieces and art works begin to move in department stores, shoppers are still severely price-conscious. Polarization in consumption may continue for a while. With these in mind, we need to develop merchandising and sales policies carefully.

We will invest ¥26.5 billion mainly in the realization of our new department store model including Kyoto store’s first phase of remodeling and Umeda store that will increase its floor space by 1.6 times in 2011.

What do you think about profit distribution to shareholders?

Our basic policy is to divide up profits appropriately with a dividend payout ratio of 30% in consideration of its profit level, future capital investment and cash flow trends while maintaining and improving sound financial position. We also consider stock buyback from time to time to improve capital efficiency and implement capital policies in a flexible manner.

For fiscal 2009, in light of the increase in net income achieved for the first time in two fiscal years and other income items that exceeded the announced figures, we have revised our dividend upward from ¥6 in the original forecast to ¥7. This represents a consolidated dividend payout ratio of 45.3%.

For fiscal 2010, in view of our future performance and capital investment, we will pay an annual dividend of ¥7 per share comprising an interim dividend of ¥3.50 at the end of the second quarter and a term-end dividend of ¥3.50. The dividend payout ratio is expected to be 40.2%.