〈Top Interview〉

Our Mission Is to Contribute to the Early Recovery of the Japanese Economy as One Company. For This Purpose, We Need to Further Speed Up Management Reforms.

OKUDA Tsutomu, Chairman and CEO

Q First, would you outline operating results for fiscal 2010?

A While consolidated sales for fiscal 2010 fell slightly, 0.8%, below the forecast announced at the second quarter results presentation in October 2010, operating income and ordinary income exceeded the forecast by 7.0% or ¥1.32 billion and 8.7% or ¥1.69 billion respectively due to thorough cost control. As a result, the percentage decrease in sales significantly improved from 10.4% in the previous year to 3.3%. Operating income, ordinary income and net income increased by 9.4%, 5.6% and 8.5% to ¥20.3 billion, ¥21 billion and ¥8.8 billion respectively. Operating income and ordinary income both increased for the first time in three years since fiscal 2007 and net income rose for the second consecutive year following the previous fiscal year. We have decided to pay a year-end dividend of ¥3.5 per share as planned. Together with the interim dividend restored for the first time in two years, the annual dividend will total ¥7 per share, the same amount as the previous fiscal year.

Daimaru Matsuzakaya Department Stores, which was formed through merger in March 2010, implemented various measures including reviewing the selection of products and brands, actively introducing brands and shops new to department stores to widen its target customer base and promoting the development and introduction of sales space offering items selected according to clear target and concept. Meanwhile, the whole company united efforts to further streamline costs.

As a result of these efforts, sales of five stores including Daimaru Shinsaibashi and Sapporo stores were above the previous year's level. However, total sales declined by 2.9% and gross profit fell by ¥7.7 billion (4.7%) from a year earlier partly because the floor space of Daimaru Umeda store significantly decreased by an annual average of about 45% due to expansion work. In terms of costs, SG&A expenses decreased by ¥9.1 billion (5.9%) over the previous year owing to the efforts to reduce labor costs by reviewing retail floor operation and cut all other costs including advertising expenses. As a result, operating income increased by 15.8% from the previous year to ¥10 billion.

We think the results of our efforts to build a new department store model as a pillar of our management reforms are beginning to show up in figures, though only gradually.

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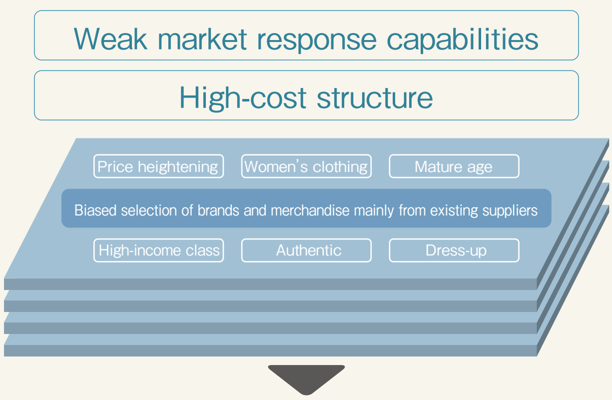
Q: Why has not the department store industry seen a real recovery even two years after Lehman's collapse?

A: We think sluggish department store business is essentially attributed to the structural problems of existing department store business model including "weak market response capabilities" and "high-cost structure" as well as an economy-wide slowdown.

Especially, department stores could not meet major market changes such as "the trend toward a more casual lifestyle" and "belt-tightening and higher price sensitivity" and have selected brands and merchandise mainly from among their existing suppliers with too much weight on high prices, women's clothing, mature age, high-income persons, authentic taste and dress-up. As a result, department stores have narrowed their target market and customer base and have become increasingly homogenized though they have large-scale stores in prime locations in big cities.

"The trend toward a more casual lifestyle" and "belt-tightening and higher price sensitivity" are worldwide tendencies, but not temporary phenomena. Therefore, as long as department stores continue the current business model, we think their performance will remain weak and continue to deteriorate, and we are working on establishing a new department store business model to replace the traditional one. This view of ours basically has not changed after the recent great earthquake, and rather, we think we need to further speed up our efforts.

Structural problems of department stores



Shrinking of target market/homogenization with competitors

Q: What is "the new department store model" you are working on at the level of changing business formats to break out of such sluggish performance?

A: The new department store model we are working on is "a department store renewal program to create attractive and profitable stores that entice customers to visit."

Unlike department stores in Europe and especially in the U.S., Japanese department stores have developed and prospered, mainly supported by a wide customer base, that is, "the masses." They have been admired and strongly supported by the overwhelming majority of customers by offering a wide variety of merchandise without omission ranging from fashion items to household goods and food products, which are widely priced from department store worthy low to super high, to meet the demands of their wide customer base.

However, "the masses" have changed both qualitatively and quantitatively with the times and we are aware that department stores failed to meet these changes and have moved away from the current "masses."

With the new department store model, we would like to go back to the starting points of "department stores walking with the masses" and simply rethink "what we should do to bring many customers back again" to transform ourselves into new department stores that adapt to the times.

What are the starting points of department stores?

Change into new department stores adapting to the times

Where do the concrete results appear?

The new department store model has two important tasks. One is "to improve market response capabilities" and the other is "a switch to low-cost operation structure."

In order to "improve market response capabilities," we thoroughly analyze the regional market of each store and develop a store strategy with the aim of strengthening competitiveness in each area, and based on this store strategy, we are specifically reviewing the lineup of merchandise and brands to adapt to major market changes including "the trend toward a more casual lifestyle" and "belt-tightening and higher price sensitivity" and expand target market. The results of these efforts are visible in the form of the increased number of customers visiting our stores. Though visitors to department stores have been on the decrease after Lehman's collapse, more customers visit Daimaru and Matsuzakaya department stores since we started working on building a new department store model. During fiscal 2010, the number of visitors to 10 major stores increased by 5.8% from a year earlier, and especially in the second half, most stores except Umeda store, which was affected by expansion work, had more customers. We understand that is because the customers who had moved to other retail channels including shopping centers and station buildings visit Daimaru and Matsuzakaya stores as a result of the efforts to expand our target customer base.

Change in no. of customers visiting 10 major stores (YoY %)

	Fiscal 2010	
	1H	2H
Shinsaibashi	78.9	15.1
Umeda	△8.9	△8.5
Tokyo	△1.2	△2.0
Kyoto	2.9	2.8
Kobe	4.0	0.2
Sapporo	4.4	2.6
Nagoya	△1.1	3.8
Ueno	4.5	4.8
Shizuoka	△2.3	1.9
Ginza	38.4	25.6

That means that the efforts to "expand customer base" as a challenge are steadily advanced.

Especially as a result of speedily opening "Ufufu Girls" zones, which made a debut when the north wing of Daimaru Shinsaibashi store opened in November 2009, in many stores including Daimaru Kyoto store in April 2010, Matsuzakaya Ginza store in October 2010 and Daimaru Kobe store in February 2011, more young and around 30-year-old women who had seldom shopped at department stores seem to visit our stores.

Sales to identifiable young and around 30-year-old customers are increasing significantly across the board. Sales to young and around 30-year-old customers at our stores except Umeda store whose floor space reduced due to refurbishment work affected sales and closed stores increased by 11.8% over the previous year, and among them, sales to young customers greatly increased by 59.3%.

We know these new customers shop at not only "Ufufu Girls" but also other departments including cosmetics, food products such as confectionery and luxury brands. Thus, amid declining purchase amount per person due to customers' continuing "belt-tightening and higher price sensitivity," we believe we will be able to boost sales by increasing the number of visitors to our stores as well as increasing the quantity purchased per person with the use of the department stores' strengths of merchandise mix and a wide selection of products, which no other retail channels have.

The number of customers who visited Kyoto store, which completed refurbishment in April 2010, increased by almost 3% in both the first and second halves. Among four specialty zones introduced after refurbishment, "Ufufu Girls" is enjoying strong sales with the support of women working nearby who were newly set as a strategic target. Sales of "International Boutique," which carries luxury brands, were also favorable, up 13.8% from a year earlier. Though sales of Kyoto store fell slightly below the previous year's level in the first half partly due to refurbishment work and competitor's closing-out sale, sales for the second half increased by 0.7% year on year and its share in the area was also up 0.6 points from the previous year, driven by women's wear that enjoyed good sales in specialty zones.

What is the progress on the switch to low-cost operation structure?

With regard to "a switch to low-cost operation structure," we mainly worked on radical reforms of personnel structure. Based on the premise that we should maintain employment for our employees, we promoted "the streamlining of organization and personnel" and "the wide use and reassignment of personnel from the perspective of the Group" through three approaches including ① the streamlining of headquarters back-office functions, ② the establishment of operation fitting with the respective characteristics of "shop operation type sales sections" and "independent operation type sales sections" and personnel assignment based on such operation and ③ the reassignment of streamlined personnel. As a result, the total number of the workers including regular and contract ones employed by J. Front Retailing alone and Daimaru Matsuzakaya Department Stores decreased by about 1,500 persons from 7,500 persons in March 2010 to 6,000 persons in March 2011. In March, the back-office operations of Daimaru Shinsaibashi and Umeda stores in the Osaka area were integrated, which was followed by the integration of the back-office functions in the Tokyo metropolitan area in June. Thus we will continue to promote personnel structure reforms and aim to achieve a reduction to 5,500 employees by the end of this fiscal year.

Additionally, since the earnings environment for this fiscal year is expected to become harsher in the aftermath of the great earthquake, we will radically overhaul all costs with no sacred cows to further control costs.

Q In 2011, Osaka department store war finally broke out. With what store planning will Umeda store fight?

A Daimaru Umeda store, of which all floors grand reopened on April 19, 2011, has changed from a specialty department store specializing in women's fashion items to a fashionable and contemporary urban lifestyle store making comprehensive lifestyle proposals with broader mix and assortment of food, household products, luxury brands and other goods. There are three points in the store planning of Daimaru Umeda.

The first is to use its locational advantage to thoroughly bring in visitors to the area and greatly widen its customer base. By identifying families with small children who seldom shop at department stores and the younger set visiting the area around Umeda as its new strategic targets while retaining existing regular customers and by introducing merchandise that department stores lack, Umeda store will meet more customers' demands and attract more customers.

The next is to further enhance fashionability based on the contemporary taste that has been cultivated since it opened. Western luxury brands, which Umeda store had hardly carried, were introduced on the third floor, which became a new entrance after the remodeling of Osaka station, and many "specialty zones" including the company's largest 5,100-square-meter "Ufufu Girls" and the Kansai area's biggest women's lingerie department were newly developed and introduced.

The third is to combine "high sensitivity" and "dailiness." The new Umeda store aims to be a "daily" store offering "highly sensitive and reasonable-priced" merchandise by realizing a wide selection of products that can satisfy the immediate and daily needs of people working around Umeda and uniting the excitement of shopping and the convenience of daily use. Food department was expanded by 1.5 times and its lineup was significantly increased to range from specialties unique to *depachika* (department store's basement food floor) to daily food products. Women's accessories department aims to create the floor that customers can enjoy even if they visit every day by offering trends as quickly as possible with the area's greatest assortment.

In terms of operation, six departments divided by merchandise category were consolidated into three departments by floor and back-office functions were integrated with those of Shinsaibashi store to greatly streamline the organization.

Daimaru Umeda store

Ufufu Girls, Daimaru Umeda store

Q Other than department store business, on what are you strengthening your efforts?

A While promoting the management reforms of department store business, we are working on changing business structure from the traditional management with an excessive focus on department store business to raise profits and grow in a balanced manner throughout the Group by reinforcing existing affiliated businesses and increasing expansion into new growth areas. To this end, instead of concentrating management resources on department store business as in the past, we will make a well-balanced investment in affiliated businesses as well to increase the operating income of affiliated businesses for fiscal 2011.

Daimaru Web Shopping website

Matsuzakaya Internet Shopping website

With regard to direct marketing, which is expected to grow in the future, the internet retail business of Daimaru Matsuzakaya Department Stores was consolidated into The Daimaru Home Shopping, Inc., a direct retailer mainly via catalogs, and made a fresh start as JFR Online Co. Ltd. in March 2011. For the time being, the company will expand and reinforce internet retail business with funds from earnings generated by the underlying catalog retail business.

As for Peacock Stores, its business declined in the second half of fiscal 2010 partly due to the effect of closed stores and prices set too low to meet competition from its rivals. For fiscal 2011, however, we would like to recover performance early through the enhancement of merchandise accuracy and the improvement of the capabilities to negotiate with and make proposals to suppliers resulted from the integration and rebuilding of information system planned for late this fiscal year as well as the emerging effect of supplier consolidation and the standardization and streamlining of operation process.

Q You acquired a stake in StylingLife Holdings Inc. and will you continue to work on such M&A and alliance?

A The Group looks to survive as a general retailer with department store chain as its core and seeks additional value to contribute to customers' rich lives.

In this situation, on March 30, 2011, we acquired a 48.5% (49.0% as of April 28, 2011) stake in StylingLife Holdings Inc. (SLH), a company operating variety stores "PLAZA," cosmetics business, direct marketing business and restaurant and confectionery business, and made it an equity method affiliate. We think deeper partnership with SLH, which has some advantages not shared by us, will lead to an increase in the number of customers in their 20s to 30s and the enhancement of our own selection of merchandise and sales floor development by using chain operation ideas and the know-how of editing sales floors that we lack. In terms of human resource development, we expect to learn and adopt SLH's excellent corporate culture through personnel exchanges.

We would like to continue to work on alliance and M&A toward the growth of the Group.

PLAZA Shinsaibashi store

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Q It became difficult to forecast for the new fiscal year due to the aftermath of the Great East Japan Earthquake and do you see a change in consumer behavior?

A Our department stores were heavily affected immediately after the earthquake, posting a decline of more than 50% in sales of five stores in the Tokyo metropolitan area and a decrease of more than 10% in sales of other stores due to a nationwide mood of self-restraint. In April, rolling blackouts and transportation adjustment in the Tokyo metropolitan area, which had been the causes for concern, were suspended and the opening hours of department stores returned to normal. Stores in the Tokyo metropolitan area greatly increased sales as the days passed and sales of other stores recovered to above the previous year's level in late March.

For the future, the impacts on businesses are expected to be severer, including the disruption of supply chains, sluggish production activities caused by electricity shortages and harmful rumors hitting Japanese products in Japan and abroad stemming from nuclear power plant accident as well as power saving that is likely to affect stores in the Tokyo metropolitan area in summer and winter. And there is a fear that consumer confidence could cool down due to the effect of weak corporate performance on employment and income, a mood of self-restraint and an expected tax increase to generate reconstruction funds.

Thus the earthquake is expected to make the business environment severe and likely to even more change customers' values and lifestyles, which have been changing since the end of high economic growth period. Especially, we think major market trends including "the trend toward a more casual lifestyle" and "belt-tightening and higher price sensitivity" will further accelerate.

Q What roles and responsibilities do you think JFR should fulfill to meet this unprecedented crisis?

A The recent earthquake was the worst postwar disaster combined with tsunami and nuclear power plant accident. Immediately after the earthquake, the Group began support activities including a monetary donation and delivery of blankets, masks, food and daily necessities to suit the needs of the affected areas. We started to raise money on the day after the earthquake and received a goodwill donation of more than ¥30 million from customers, employees and suppliers by the end of April. We will present the money together with J. Front Retailing's donation of ¥30 million to the Japanese Red Cross Society and other institutions to benefit disaster victims. We sincerely appreciate their kind cooperation.

The whole country needs to unite efforts to recover from this historic crisis. As we feel through fund raising and other activities, Japanese people are united like never before. On the other hand, it is undeniable that such sense of unity unnecessarily enhances a mood of self-restraint. If economic activity is dampened, the recovery of the disaster areas will not progress.

We believe the greatest mission the Group should carry out is to contribute to the early recovery of the Japanese economy as one company. Companies have a fundamental mission to cause the growth and affluence of society through their activities, and in that sense, they are "the public institutions of society." Taking this crisis positively as an opportunity to expedite further changes, the whole Group will more speedily work together on management reforms including the establishment of a new department store model and be fully committed to contributing to the reconstruction of society facing unprecedented difficulties.