“We Need to Achieve Operating Profit of ¥50 Billion Early to Attain the Status of Leading Retail Company in Japan.”

First, would you look back at financial results for fiscal 2011?

The Great East Japan Earthquake occurred in March 2011 and our consolidated performance for fiscal 2011 saw a rocky start. However, a decline in March was offset in April and beyond, resulting in a marginal drop in sales of 0.9%, 6.3% growth in operating profit to ¥21.5 billion and 8.8% increase in ordinary profit to ¥22.9 billion. For fiscal 2011, we have started to adopt the Accounting Standard for Asset Retirement Obligations and their past portion of ¥2.2 billion was recorded as extraordinary loss, while deferred income taxes decreased due to a change in income tax rate. As a result, net profit jumped by 112% to ¥18.8 billion. Both operating and ordinary profits grew for two consecutive years and net profit rose for three consecutive years.

Daimaru Matsuzakaya Department Stores celebrated the grand opening of Daimaru Umeda store with more floor space in April 19, 2011. Other stores also implemented various measures including the introduction of brands and shops new to department stores, the development and introduction of Ufufu Girls and other specialty zones, the efforts to meet Cool Biz demand and the enhancement of gaisho, or out-of-store, sales.

As a result of these efforts, six stores including Daimaru Umeda and Sapporo stores and Matsuzakaya Nagoya store posted higher sales than a year ago. In spite of the effects of the earthquake and the closing of Matsuzakaya Nagoya Station store in 2010, sales of Daimaru Matsuzakaya Department Stores increased by 0.8%. In terms of costs, in spite of additional cost of ¥4.4 billion including facility and other expenses incurred from the floor expansion of Daimaru Umeda store, SG&A expenses decreased by ¥2.3 billion (1.6%) from the previous year thanks to all possible cost-cutting measures including the integration of back-office sections in the Osaka and Tokyo areas and other personnel restructuring to reduce labor costs and power-saving initiatives including the introduction of LED lighting system in stores and offices. This resulted in operating profit of ¥11.3 billion, up 13.9% from a year earlier.

We have decided to increase the year-end dividend by ¥1 from the originally planned amount of ¥3.5 per share to ¥4.5 per share. Combined with the interim dividend, the dividend will total ¥8 per share for the full year, up ¥1 from the previous year.
Some people say that there are various factors triggering a decline in income including less population over the medium to long term. Will the downward trend of department store sales continue?

External factors such as economic environment contribute to prolonged slump in department store business. However, I think more fundamental cause lies in the structural problems of existing department store business model including weak market response capabilities and high-cost structure. The past sales statistics of department stores may show a downward trend. However, the statistical sales trend of department stores do not apply to individual companies, but rather, they seem totally different. These statistics may have applied to any company at the time when retail business was sharply demarcated. Now it has no boundaries and the actual situation is different from the trend of the entire industry and varies by company, store or area.

Our ongoing new department store model is premised on thorough store strategy, namely, thorough area marketing to create attractive stores wanted by customers in each area. Umeda store, which had its grand opening with increased floor space in April 2011, has produced good results because it attracts the markets we could not draw in the past, that is, many customers who had shopped with retailers other than department stores by expanding its target customer base and widening the range of products and prices in particular, rather than competing with its existing peers for customers. Thus if we can develop a clear strategy for each store and each area and create stores adapted to respective market changes, there are still many growth opportunities left for us. Now our ability to respond to changes is being questioned.

At this time, how do you assess Daimaru Umeda store, which expanded its floor space and had its grand opening as the culmination of new department store model?

Specifically, our current initiatives to establish new department store business model include: (1) expanding target customer base; (2) widening the range of products and prices in particular; (3) developing specialty zones; and (4) increasing management efficiency, as well as maintaining and strengthening the middle to high-end product offerings in which department stores have traditionally been strong, while clarifying and thoroughly implementing store strategy in each store, in a bid to adapt to major market changes including the consumer shift to more casual lifestyles and more frugal and price-sensitive behavior.

Accordingly, Daimaru Umeda store, which celebrated its grand opening with increased floor space in April 2011, was created as the culmination of new department store model, instead of just expanding in size, and that resulted in year-on-year sales growth of 65.7% for fiscal 2011.

Initially, Umeda store was expected to have an average of 90,000 visitors a day. Since its grand opening, however, there has been far more footfall than expected, and even now, one year after its opening, around 120,000 shoppers on weekdays and more than 150,000 shoppers on weekends and holidays visit the store.

As a result, our customer base is significantly widening. Comparison of sales to identifiable customers for fiscal 2011 with fiscal 2009 when the store was not affected by the expansion work shows that the number of young and around 30-year-old paying customers soared by 47% and that their spend grew by 26%. Over the past year, Umeda store added 190,000 new cardholders and it is successfully gaining the loyalty of customers.

For fiscal 2012, the opening of Hankyu Umeda flagship store with more floor space planned for late November is expected to increase the already fierce competition in the Umeda area, Osaka. Daimaru Umeda store hopes to achieve sales above the level of fiscal 2011 by changing floor layouts, scrapping and building brands, increasing the loyalty of customers and improving the approach to loyal customers in order to increase the rate of purchase and spend per purchase, which are the store’s challenges.

Focus of department store business

<Establishing new department store model>

- Enhancing marketing capabilities
- Planning and promoting store strategy
- Innovating operation system
- Expanding target customer base
- Widening the range of products and prices in particular
- Developing specialty zones
- Increasing management efficiency

Daimaru Umeda store
Fiscal 2011 saw a sharp increase in commercial accumulation in the Umeda area, Osaka. How did this affect your stores in its surrounding areas? And what will you do about the more competitive situation in fiscal 2012?

For fiscal 2011, our department stores in the Kansai region, which were expected to be affected by competition from the Umeda area, strived to retain and better serve loyal customers such as gaisho customers and cardholders in an attempt to mitigate the effect of competition. At the same time, Shinsaibashi store introduced big tenant shops selling livingware like Muji, Franfran and Yuzawaya on the middle and upper floors of its north wing to draw more customers to the building, while Kobe store introduced Utufu Girls.

At Shinsaibashi store, especially gaisho sales were favorable, up 1.5%, and the decrease in total sales stays below our initial forecast. Though, in May, Kyoto and Kobe stores were affected by the Umeda area where customers were concentrated, the size of this effect was below our forecast and sales from June to fiscal year-end have recovered to nearly the previous year’s level, down 0.5% at Kyoto store and down 1.7% at Kobe store. Accordingly, for fiscal 2011, we think these stores were less affected by competition from the Umeda area than expected.

For fiscal 2012, we will renovate and improve the sales floors of our stores in the Kansai region, while continuing our efforts to retain and better serve loyal customers.

At Kobe store, food floor was renovated and celebrated its grand opening on April 27. It was the first major renovation in 15 years since the store was restored from the earthquake damage and reopened in 1997. We introduced many Kansai’s first excellent shops and greatly enhanced the assortment of Kobe’s symbolic Western confectionery and delicatessen. That includes the introduction of the first Dean & DeLuca shop in the Kansai region and the development and introduction of new specialty zone named Table Plus, which mainly offers bakery goods. Thus we successfully created a food floor that provides many topics and proposals. Since its grand opening, the food floor has enjoyed very good sales particularly in delicatessen and Japanese and Western sweets sections.

Kyoto store marks the 100th anniversary of its opening in Shijo Karasuma in 2012 and we will hold various centennial events over the year, while trying a mixed approach combining store sales with catalog sales in collaboration with the Group’s direct marketing company JFR Online. At Shinsaibashi store, we will maintain and further increase its already strong gaisho sales and renovate women’s accessories sections and luxury brand shops on the first floor to revitalize its sales floors.

We will use these efforts at our stores in the Kansai region to minimize the effect of competition from the Umeda area.

I heard that your Matsuzakaya Nagoya flagship store would also undergo major renovation from 2012 to 2013. What is the key point of this renovation?

At Nagoya store, we will make full use of its floor space as large as approximately 87,000 square meters in total of the main building, south wing and north wing. With the aim of creating a full-scale department store catering to wide market needs, we have set around 30-year-old visitors to the Sakae area and trend-savvy around 50 year olds as its new targets based on the retention and expansion of its existing main customers. We will introduce many hot fashion items and cosmetics to widen its fashion offering, as well as building a specialty zone with clear concept so that customers can feel it is their ideal shopping place.

In spring 2012, as the first phase of renovation, the store renewed its first and second floors, which are the face of department store, to become much more competitive with its rivals including department stores. The key point of this renovation is to differentiate each building: the south wing targeting young and around 30-year-old customers; the main building as a traditional department store; and the north wing focusing on livingware.

Specifically, in the south wing, Utufu Girls was introduced on the second floor and selected women’s fashion items were brought together and the first H&M shop in the Chubu region, which is one of the biggest in Japan, was introduced on the first floor. In the main building, cosmetics and women’s accessories sections were refurbished and many Nagoya’s first brands were introduced on the first floor, while, on the second floor, which carries the store’s strong special selections, was reorganized by introducing six new luxury brands including Nagoya’s first one to further increase Nagoya’s number-one lineup of products and thoroughly differentiate the floor. And in the north wing, skin care, body care and hair care products were brought together on the first floor to create one of the biggest natural cosmetics zones in the Nagoya area.

For the second phase of renovation, we are planning to completely rebuild its food floor in spring 2013.
Tokyo store will expand its floor space and open at last in fall 2012. Will you tell me the details of the store you are planning to create?

Tokyo store will increase its floor space by approximately 1.4 times from the current 34,000 square meters to 46,000 square meters and open in fall 2012. This time its floors will be extended to the south of the existing store that was relocated and opened with increased sales floor in November 2007. The number of visitors is expected to greatly increase because we will add new entrances direct from the Yaesu Central exit of Tokyo station on the extended parts of the first basement and the first aboveground floors. Furthermore, additional escalators on the extended parts will facilitate customer’s movement upstairs and downstairs and improve customer’s circulation on each floor.

The new Tokyo store has developed its store concept of “Department Store with Compact Assortment of the ‘Current’ Tokyo” and will utilize its excellent location to become strong in gift items, souvenirs and travelling gear. Among its strong food products, we will further strengthen lunch boxes and sweets both in quality and quantity. And we will expand and reorganize women’s and men’s accessories and mature women’s fashion items, all of which are the strengths of department stores. Meanwhile, in the newly added space, we will introduce many shops that can draw more customers, including Western luxury brands, large specialty shops and select shops, all of which are new to the store, to enhance the store’s appeal.

In terms of operation, we will use the achievements and know-how of Umeda store to streamline the organization and consolidate and integrate back-office sections. Even after increasing its sales floor space by 1.4 times, we will be able to operate the store without additional staff. Through this floor expansion, we aim at sales growth of ¥14 billion on an annual basis.

Do you see some results of the efforts of Original Merchandising Division, which was created in September 2011?

Concerning women’s and men’s accessories, which are the strengths of department stores, Original Merchandising Division was created in September 2011 as business operating organization that plans and manages the whole process from buying to selling. For the first six months, their sales were ¥26.7 billion, up 7.3% from the previous year, which increased its share of the total sales by 0.3 points and improved the company’s overall profit margins by 0.03 points.

Unlike shop operation sales sections, Original Merchandising Division can expand or shrink sales space and change product selection freely and timely at its discretion. Utilizing these advantages, the division has developed many new out-of-the-box sales ideas, for example, sales space featuring trendy joshikai, or a girls-only party, and sales space offering only special bags and small leather articles made by Japanese craftsmen. They gained popularity among customers. In January and February when temperatures were lower than average year, we could boost sales by flexibly responding to the increasing demand for cold weather gear.

For fiscal 2012, we will create sales zones from a new perspective, respond flexibly to market changes and increase sales of completely bought items and high margin merchandise to achieve our sales target of ¥57 billion and improve profit margin by about one point.

How are your efforts to achieve highly efficient management progressing?

Our focus remains on personnel structure reform including more efficient organization and staffing and the wide use and restructure of human resources from the Group’s perspective to achieve highly efficient management. While placing our people so as to more efficiently operate each of shop operation and our own operation sales areas, we integrated the back-office sections of two stores in Osaka in March 2011 and three stores in the Tokyo area in June. As a result, the total number of the employees of Daimaru Matsuzakaya Department Stores including regular employees and contract ones decreased by about 700 persons from about 6,000 persons.
in March 2011 to about 5,300 persons at the end of February 2012.

In addition, we further integrated the back-office functions of the Osaka area, which had been integrated in 2011, with the ones of Kyoto and Kobe stores in March 2012 and transferred part of sales operations to the Group’s staffing service company Dimples to promote our personnel structure reform. We aim to decrease the number of the company’s employees to 4,100 persons by the end of fiscal 2012. The total number of the employees of the Group will decline from 13,400 persons at the end of 2012 to 13,100 at the end of 2013.

For fiscal 2012, facility expenses are expected to increase due to the floor expansion of Tokyo store and the renovation of other stores and variable costs will also rise in proportion of sales growth. Therefore, we will radically overhaul all of our costs with no sacred cows to improve the efficiency of SG&A expenses.

The management reforms of your department stores seem to make steady progress. How about the enhancement of other businesses of the Group?

We aim to attain group-wide growth by reforming the management of our core department store business as well as enhancing other existing businesses and expansion into new growth areas.

With regard to our management resources over-invested in department store business in the past, we make a balanced investment in department store business and other businesses. Concerning human resources in particular, we are strategically transferring young and mid-career employees from department stores to other companies of the Group so that we can widely use human resources from the Group’s perspective.

Peacock Stores standardized and renewed the company-wide information system in March 2012. Using the new system, we will quickly adapt our offerings to demand changes, improve our buying power, reduce product losses and review our store operations to enhance our abilities to respond to the market, procure merchandise and operate stores.

Concerning StylingLife Holdings Inc., which became our equity method affiliate in March 2011, we put forth efforts to generate synergy. Specifically, at Daimaru Matsuzakaya Department Stores, we opened their general merchandise shop Plaza and offered their Vecua Honey cosmetics at its stores as promotional events and used their characters for its company-wide sales promotion. In the meantime, they used our know-how of efficient management to reduce their costs. As a result, I hear that StylingLife Holdings achieved increases both in sales and profit for fiscal 2011.

J. Front Retailing has formed alliances and M&A since last year, including the acquisition of shares of Parco Co., Ltd. in March 2012, to enhance retailing business.

In March 2012, we acquired a 33.2% stake in Parco Co., Ltd. from Mori Trust Co., Ltd. and made it an equity method affiliate of the Group.

Seeing its tenants as its partners, Parco, as a shopping mall operator, has in place a system to grow and develop together with them. With its vision of “Urban Lifestyle Producer,” Parco has excellent know-how to create attractive stores combining goods, experience and services and the company is highly recognized by many customers.

Deeper alliance with Parco will allow us to accelerate our efforts to change our department store business model through new department store model and strengthen our competitive edge. And at the same time, as a retail group operating various businesses and channels, we will be able to increase the growth potential of the whole Group.

Especially, our shop operation sales areas, which constitute the majority of our department store sales, will greatly benefit from Parco’s know-how in their efforts to enhance their counseling capabilities related to sales and services and their producing capabilities needed to select shops and brands and create attractive sales space.

Parco and J. Front Retailing both intend to operate high quality and high value added retail business in big cities and their customers are also similar in grade and taste. Therefore, we believe we will be able to increase each other’s corporate value by effectively sharing each other’s store and customer bases and maximizing synergy.

We already set up an operation study committee with Parco and have meetings on a regular basis. And we will speed up our efforts to achieve synergy and results.

As a result of this acquisition of shares of Parco, we are expecting to record equity in earnings of affiliates totaling ¥1.7 billion as non-operating profit for fiscal 2012.
J. Front Retailing has launched proactive overseas initiatives from the multidimensional perspective of the Group.

In May 2012, J. Front Retailing has reached a basic agreement with Shanghai New World Co., Ltd. and Shanghai Xin Nan Dong Project Management Co., Ltd., marking our launch of department store business in the burgeoning Chinese market. The trade name of Daimaru will be used for the new store, which is planned to open in late 2014 or early 2015 as one of the top high-end department stores in China. We will also provide technical support related to marketing, merchandise mix and the management and operation of the store. We expect this initiative will allow us to accumulate know-how to expand business and develop human resources there. And at the same time, with the increasing presence of our department store in Asia, we hope Chinese tourists to Japan will shop at our department stores more often and that it will result in sales growth.

J. Front Retailing and StylingLife Holdings will jointly establish a new company around summer 2012 to operate Plaza shops in Asia. First, we open several shops in department stores and shopping malls only in the Taipei area, Taiwan, and the first shop is planned to open around spring 2013. Once putting the business in Taipei on track, we will expand into other cities in Taiwan such as Taichung and Kaohsiung, and then, other Asian countries.

Besides the above, J. Front Design & Construction opened a representative office in Shanghai in December 2011 to receive orders for designing commercial facilities in China, and Daimaru Kogyo established a company in Thailand in January 2012 to expand business in the ASEAN region. J. Front Retailing, as a group, will continue to aggressively develop the growing Asian and other overseas markets.

J. Front Retailing has set numerical targets of consolidated operating profit of ¥30 billion for fiscal 2013, and for the near future after that, ¥50 billion.

We need to achieve our highest operating profit of ¥50 billion, which exceeds our consolidated operating profit of ¥42.6 billion for fiscal 2007 when we merged, as early as possible to establish the status of leading retail company in Japan both in quality and quantity, which is our corporate vision.

As the first step to reach that goal, last year we developed a three-year plan starting in fiscal 2011. We refrained from announcing the plan due to the earthquake, but, within the Group, we are committed to achieving operating profit of ¥30 billion for fiscal 2013, which is the final year of the plan. We will be able to draw a path to this goal by continuing to achieve steady results through the above-mentioned management innovation of department store business, the enhancement of the Group businesses including alliances and overseas businesses.

After that, it is no doubt that, if we stand still, we will not be able to achieve our operating profit target of ¥50 billion. Instead, we will enter the stage entirely different from the past. It is necessary to add something extra, that is, various more drastic actions including alliances and M&A, as well as to change our mindset again to further change the business formats of department stores. To this end, we should achieve operating profit of ¥30 billion first, and then, by solving the problems found in this process, the contours of our target of ¥50 billion will become clear.

Consolidated operating profit targets

- ¥20.3 bn in fiscal 2010
- ¥21.5 bn in fiscal 2011
- ¥26 bn in fiscal 2012
- ¥30 bn in fiscal 2013
- ¥50 bn in fiscal 20XX

*Figures for fiscal 2010 and 2011 are actual amounts, and figures for fiscal 2012 and beyond are targets.*