“Governance Reform Is Exactly Management Reform. Its Tangible Results Will Enhance Corporate Value.”

Would you explain about an overview of business results for fiscal year 2015?

Consolidated net sales of J. Front Retailing (the “Company”) were ¥1,163.5 billion, up 1.2% year on year. Consolidated operating income, consolidated ordinary income and consolidated net income were ¥48 billion, up 13.9% year on year, ¥47.9 billion, up 18.4% year on year, and ¥26.3 billion, up 31.8% year on year, respectively. As a result, operating income increased for the sixth consecutive year, achieving a record high since the Company was established and a 6.9% ROE, which we define as an important management index.

With regard to the year-end dividend, we have decided to pay ¥14 per share, ¥1 higher than planned. The annual dividend together with the interim dividend of ¥13 is ¥27 per share, up ¥2 from the previous year on a post-share consolidation basis, marking the fifth consecutive year of increase.

By segment, in the Department Store Business, net sales increased by 0.4% from the previous year due to favorable sales of mainly luxury brands and big-ticket items driven by the active consumption of affluent customers and foreign tourists to Japan mainly in urban stores and operating income rose by 24.1% thanks to stricter cost control.

In the Parco Business, net sales and operating income grew by 2.5% and 2.7%, respectively, compared to the previous year, supported by the continued strong performance of Fukuoka Parco, which increased floor space last year, the full operation of Nagoya Zero Gate and the new opening of Nagoya Midi. For your information, Parco Co., Ltd. reported another record high in operating income.

The Wholesale Business decreased net sales by 2.6%, but its operating income increased by 23.2%. The Credit Business increased net sales by 0.7% but decreased operating income by 21.1% due to increased costs of card replacement and write-off of doubtful accounts. The Other Businesses increased net sales by 7.6% and operating income by 16.1%, driven by the construction and interior design business.

YAMAMOTO Ryoichi
President and Representative Director
The Department Store Business achieved 20%-plus income growth and serves as a driver. What are the main causes of such strong performance?

Daimaru Matsuzakaya Department Stores focused on renovating the sales floors of flagship stores including the Nagoya and Sapporo stores to build a new department store model, better meeting inbound tourists’ demand and acquiring new customers from the new rich class.

As a result of these efforts, net sales steadily increased by 1.9% year on year mainly in urban stores in the first to third quarters, but in the fourth quarter alone, net sales decreased by 1.8% due to approximately 40% reduced sales floor area of the Shinsaibashi store for the reconstruction work of its main building since January as well as a record warm winter and a rapid deterioration in business sentiment and full year net sales edged up by 0.9% from the previous year.

By store, sales of four flagship stores including the Shinsaibashi, Umeda, Tokyo and Sapporo stores exceeded the previous year’s level. The Nagoya store slightly reduced sales by 0.6%, partly affected by the expansion of lease area since the end of October.

Duty-free sales of Daimaru Matsuzakaya Department Stores, which serve as an indicator of inbound tourist demand, increased 2.2-fold from the previous year to ¥33.8 billion and its share of total sales increased to 5.0%. In the second half, when the effect of the expansion of duty-free coverage came to an end, average sales per customer decreased by 13.2% from the same period last year, but the number of customers jumped by 62.8%, which drove sales.

Gross margin was down 0.18 points in the first half, but in the second half, it rose by 0.09 points, pushed up by various improvement measures mainly for promotion methods and increased rental revenue.

In terms of costs, SGA decreased by ¥4.9 billion from the previous year due to reduction of advertising expenses through a review and streamlining of loyal point program and reduction of labor costs through decreased retirement benefit expenses and human resource restructuring.

As a result, Daimaru Matsuzakaya Department Stores surged operating income by 30.0% to ¥26.1 billion.

After the start of the year, share markets plunged and the economic environment has greatly changed. What is your outlook for fiscal year 2016?

Our awareness of the business environment is that uncertainty about the global economy has been heightened since the second half of last year and that fears of slowdown of the domestic economy are also increasing. The growth of real wages remains sluggish. Increasingly budget-minded consumer spending combined with a plunge in share prices at the start of the year have sharply deteriorated consumer confidence.

Thus the consumption environment allows no optimism. It is expected that the “polarization of income” and the “polarization of consumption” which have become clearer after the consumption tax hike two years ago, will continue to increase and that the gap between urban and rural/suburban areas will become increasingly remarkable. In the meantime, it goes without saying that personal financial assets worth approximately ¥1,700 trillion in Japan can be a great opportunity if we take proper action.

According to the Family Income and Expenditures Survey of the Ministry of Internal Affairs and Communications, the ratio of “clothing” to the “annual average of monthly consumer spending per household” decreased from 7.3% in 1991 to 4.1% in 2014. Behind this trend, we assume that there are great changes in ways of self-expression and values particularly among young people as well as increasing globalization and casualization of fashion. In department stores, however, sales areas for clothing, particularly women’s clothing, have been enlarged since around the bubble economy. And the current sales floor configuration does not respond to changes in customers sufficiently.

Under these circumstances, we believe that minor differences will become greater and gaps among companies will widen if we can capture growing markets properly and respond to struggling markets appropriately and carefully.
What are the main measures that department stores take to establish a new business model?

We are “overhauling sales floor configuration” in respective areas where our stores are located to “establish a new department store model.” We will thoroughly scrutinize the sales floor productivity of each store and dare to reduce low productive sales areas and shops. In new spaces created through such reduction, we will expand strong sales areas and introduce new categories and brands to better respond to markets with growth potential.

Specifically, the Nagoya store renovated 30% of total sales floor area from last spring to this spring. By category, we reduced the sales floor area mainly for women’s clothing and homeware by about 15% and introduced Yodobashi Camera as a new category on the 4th to 6th floors of the south wing. In the north wing, which was renewed and reopened on April 21, “men’s clothing and accessories” are offered in increased sales areas on lower floors from the 1st to 3rd floors and “golf and sports goods” were brought together on the 4th floor right above them to offer a total assortment of men’s items on a larger scale. Also in the Kyoto and Sapporo stores, women’s volume zone clothing areas were reduced, and instead luxury zones were expanded to better cater to the new rich class.

We think it will become more important to enhance the appeal of stores by taking these actions and the measures against struggling women’s volume zone clothing.

What specific initiatives will you take to develop sales areas toward the creation of new markets?

Currently we are developing new curated sales areas in two directions.

The first is to expand the introduction of “accessible luxury.” At the present time when consumption is increasingly polarized, we see accessible luxury offered at relatively affordable prices as a new growth area for the future. The curated luxury area, which opened in the Kyoto store ahead of other stores and performs well, was exactly a trial to such a growth market. This initiative also started in the Shinsaibashi store in March and will be expanded into other stores.

The second is to develop “curated mixed-category areas.” We are currently developing a specific plan. In the second half of this year, a new curated area with cosmetics as its main items, which are one of the drivers to expand the inbound tourist market, combined with accessories will open in the Kyoto store. We hope the beauty shop with a clear concept will bring in a wide range of new customers.

In addition, we will accelerate our efforts to revitalize sales areas to create new markets including the curated area to which non-apparel categories are added on the mature women’s fashion floor.

What do you do to attract affluent people and foreign tourists?

In order to strengthen the well-performing affluent market, we will continue efforts to acquire more new customers with the target of developing 14,600 accounts during the year. Especially in this fiscal year, we will implement promotion measures in the “Keihanshin area” on an unprecedented scale to minimize the effect of a decrease in the floor area of the Shinsaibashi store. Thereby we aim to increase the active account ratio of new and existing customers for earnings growth. At the same time, we will also strongly promote customer acquisition with an eye to the future in the “Tokyo metropolitan area” to expand our customer base.

As for inbound foreign tourists who drove sales last year, we will
strengthen initiatives to “retain the loyalty of steadily increasing repeat customers.” According to the data of a credit card company, the ratio of repeat customers among the foreign tourists who shopped with us has reached as many as about 10%. In order to certainly bring in these customers and encourage them to come back again and again, we issued the Exclusive Card with various services and benefits to the customers whose total purchase amount exceeds ¥1 million to retain them as loyal customers. We will also expand the adoption of the “WeChat payment”, which is spreading rapidly in China, in response to diversifying payment methods.

Is the alliance with Senshukai, which was converted into an equity method associate last May, progressing?

With respect to the alliance with Senshukai, we are working to strengthen “product development” and “department store’s online sales.”

Firstly, as for the strengthening of product development, we recreated Senshukai’s original brand Kcarat as a new “original fashion brand” jointly planned and developed by Daimaru Matsuzakaya Department Stores and Senshukai and launched the products in five Daimaru stores in March 2016. In May, they became available on our website as well. Through this initiative, the customer information of our stores and website is centralized, and for example, sales staff can suggest the products that best meet individual customer preferences including items not available on store shelves by operating a tablet in the store. Even if the items are not available in the store, we can deliver them speedily using Senshukai’s excellent fulfillment.

Secondly, as for the strengthening of department store’s online sales, this fall we will implement the first phase of renewal of department store website and replace systems using Senshukai’s e-commerce expertise. Furthermore, next spring the department store website will significantly expand its product range partly through integration with Click & Collect and make its grand opening.

The Urban Dominant Strategy is taking shape in one area after another and finally the Ginza store will open next April.

The Company is actively working to increase the appeal of the entire area with a store as its core and promoting the Urban Dominant Strategy, a business model for growing with local communities. Through this initiative, we will strive to “increase asset values” and “make real estates profitable” in the medium term. Currently four big projects are underway.

The first is the Ginza 6-chome District Redevelopment Project. We will develop a large-scale complex combining commercial facilities and offices with the functions necessary for the district including cultural facilities and a tourist hub in an effort to further enhance the appeal of the Ginza area, one of the most prestigious areas in Japan. With regard to the Ginza area’s largest retail space as the core of this redevelopment, we have already determined approximately 240 tenants which will occupy it and preparation for opening is steadily progressing. We will invest approximately ¥7 billion in interior work and others. The completion of construction is scheduled for next January and it will open next April.

The second is the Rebuilding Project for the South Wing of the Matsuzakaya Ueno Store. The south wing of the Ueno store will be rebuilt into a high-rise complex comprising Parco, a cinema complex and sophisticated office facilities. We are also developing mainly our own properties around the Ueno store. We will establish a business model to contribute to revitalizing the Ueno Okachimachi area and grow with local communities. The total investment amount for this project including the rebuilding of the south wing and the accompanying renovation of the main building will be approximately ¥21.3 billion and its opening is scheduled for next fall.
In addition, you have decided to rebuild the “main building of the Daimaru Shinsaibashi store” and “Shibuya Parco” last fiscal year.

The third is the Rebuilding Project for the Main Building of the Daimaru Shinsaibashi Store, which we newly announced last fall. The new main building is expected to be approximately 60 meters high with three basement floors and 11 floors above ground. We will create sales floors totaling 40,000 square meters, about 30% larger than before. The main building is planned to open in fall 2019. Furthermore, the main building will be connected and unified with the north wing over the road after completing the reconstruction to dramatically improve each other’s accessibility. The connection work is planned to be completed in spring 2021. By thus creating the new Shinsaibashi store, we will increase the competitiveness of the area and draw new crowds while contributing to the development of the area by enhancing the safety of the building and inheriting the value of Vorries’ architectural work. The total investment amount associated with this project is expected to be approximately ¥38 billion.

The fourth is the Shibuya Parco Rebuilding Project. Parco, as a scheduled executor of the Udagawa-cho 15 Development Project, submitted a future development proposal to the Tokyo Metropolitan Government for “urban planning as a special urban renaissance district” including existing Shibuya Parco in accordance with the Act on Special Measures Concerning Urban Renaissance last June and the project was approved in December. We will consider the details of the new building and expect it to be approximately 110 meters high with the total floor area of approximately 65,000 square meters comprising 20 floors above ground and three basement floors. The construction period is scheduled to start in March 2017 and end in September 2019.

You said you would strengthen the financial strategy and what specific initiatives are you taking?

The Company aims to achieve ROE of 8% early, and as its milestone, we are pursuing initiatives to achieve operating income of ¥50 billion and ROE of 7.1% in the fiscal year ending February 28, 2017, which is the final year of the current Medium-term Plan. In order to realize them, it is the most important to increase free cash flow, accompanied by steady profit growth, and continuously improve ROE. We believe this will result in sustainable growth and the mid-and-long term enhancement of corporate value.

In the meantime, we currently recognize some issues. Our internal sales management relies too much on P/L items. The processes to be followed by business divisions to achieve ROE of 8% and the breakdown into the field level are unclear.

Toward the resolution of these issues, we will introduce the concept of “by-store B/S” in the department store’s management perspective this fiscal year and decomposed ROE and ROA as management indicators into a tree structure to promote the efficient use of our assets and improve total assets turnover.

We will also determine a return on investment from a financial perspective by setting quantitative criteria for development, store renovation and M&A and forming the Investment Project Review Committee while recognizing our capital cost to strengthen the support system for management decision making.
You increase dividends for five consecutive years and what do you think about shareholder return?

We would like to actively return profits to shareholders with an eye on the balance among investment for growth, free cash flow trends and others as well as enhance profit level. The Company’s basic policy on shareholder return is to maintain stable dividend payments and appropriately return profits targeting a dividend payout ratio of at least 30%. At the same time, we will consider share buyback as appropriate for the purpose of improving capital efficiency and flexibly implementing our capital policy.

During the fiscal year ended February 29, 2016, we repurchased our own shares of ¥5 billion from April to May 2015. In the fiscal year ending February 28, 2017, we are planning to increase the annual dividend for six years in a row. We will continue efforts aimed at improving capital efficiency including such active shareholder return.

![Dividend and DOE graph]

The first is to strengthen the operation of the Board of Directors based on third-party assessment. In order to concentrate on critical strategic agenda at the Board of Directors, we reviewed the criteria for submitting agenda items to its meetings from both qualitative and quantitative aspects. And the Board system was changed to involve outside members in discussions on important matters including the Group Vision, financial strategies and the Medium-term Business Plan in early stage so that decisions can be made with an outside perspective.

The second is to strengthen the function of the Human Resources and Remuneration Committee and ensure its transparency. The Human Resources and Remuneration Committee was chaired by President, but now it is chaired by Outside Director to enhance transparency and objectivity through discussions based on internal performance data and objective third-party data.

The third is to use the knowledge of Outside Directors and Outside Audit & Supervisory Board Members by holding the meetings of the Governance Committee. The meetings provide opportunities for regular substantive discussions related to the essence of corporate governance including the development of initiatives to reform the Board of Directors, the establishment of the Corporate Governance Guidelines and an appropriate institutional design for the Company.

However, the initiatives to reform our corporate governance have only just begun. In order to meet the expectations of our stakeholders, we would like to change gears toward the “output stage” of generating tangible results.

The year 2015 was said to be the “first year of governance reform” and what is J. Front Retailing’s progress?

Last December the Company disclosed the Corporate Governance Report as well as the Corporate Governance Guidelines. Particularly, we focused on the following three points to strengthen our corporate governance.