Steadily Capturing the Two Sides of Risks and Accelerating the Transformation of Business Portfolio

Q. Would you explain about your business results for fiscal year 2017?

The Company has applied the International Financial Reporting Standards (IFRS) since fiscal year 2017. Therefore, results for fiscal year 2016 have been converted into IFRS-based figures and year-on-year comparison for fiscal year 2017 has been made with thus converted figures.

The Company’s consolidated sales revenue was ¥469.9 billion, up 3.8% year on year, in fiscal year 2017. Consolidated operating profit and profit attributable to owners of parent were ¥49.5 billion, up 18.7% year on year, and ¥28.4 billion, up 5.3% year on year, respectively. Consolidated operating profit exceeded forecast in October by ¥0.5 billion.

Considering comparability with our past performance and other companies, we also release “gross sales” close to net sales under Japanese generally accepted accounting principle (“JGAAP”), which we had applied until fiscal year 2016, and “business profit,” which has been calculated by excluding the impact of other operating income and other operating expense from operating profit under IFRS, as our own reference indicators.

“Gross sales” were ¥1,138.9 billion, up 0.4% year on year, and “business profit” was ¥46.8 billion, up 4.3% year on year. “Gross sales” were ¥3 billion below forecast in October but “business profit” was ¥0.3 billion above the same forecast. Consolidated ROE on which we place the most importance was 7.5%.

We paid a year-end ordinary dividend of ¥18 per share, ¥3 more than originally planned, and an additional dividend of ¥1 per share commemorating the 10th anniversary of the establishment of J. Front Retailing, totaling ¥19. The annual dividend including the interim dividend of ¥16 was ¥35 per share, up ¥5 year on year, marking the seventh consecutive year of increase.

Q. How did you perform by business segment?

By segment, the Department Store Business saw further accelerated spending by inbound tourists to Japan in the second half. Spending by affluent people in Japan was also strong throughout the fiscal year. In the meantime, the severe sales slump in the suburban and rural stores continued.

We sold the real estate owned by Daimaru
Matsuzakaya Department Stores from the perspective of improving asset efficiency. As a result, sales revenue increased by 2.3% from the previous year and operating profit significantly increased by 20.0%.

"Business profit” also grew by 9.1%

With respect to the Parco Business, "Parco_ya,” a store in new Parco format, which opened as the anchor tenant of "Ueno Frontier Tower” on November 4, 2017, performed well attracting many "a little older” people than Parco’s existing target customers as expected. Meanwhile, partly due to the impact of Shibuya Parco, which closed temporarily in August 2016 for rebuilding, continuing until the first half, the impact of the closing of Chiba Parco and the sluggish performance of Neuve A, sales revenue and operating profit in total decreased by 2.3% and 9.7% year on year, respectively.

The "Real Estate Business” significantly increased sales revenue by 168.3% and operating profit by ¥3.7 billion compared to the previous year due to the great effect of "Ginza Six,” which opened in April 2017, and "Ueno Frontier Tower,” which opened in November 2017.

In addition, the effect of withdrawal from unprofitable businesses including JFR Online and JFR Plaza contributed to improving consolidated performance.

The Company transferred all shares of Forest, a consolidated subsidiary operating a direct marketing business, which was included in Other, as of August 31, 2017 to replace the business.

In conjunction with that, the Company has decided to accede to Senshukai Co., Ltd., an associate accounted for using equity method, purchasing its own shares in February 2018.

0. The top line (sales) of the Department Store Business is growing.

In Daimaru Matsuzakaya Department Stores, spending by inbound tourists dramatically increased due to the success of the measures taken by its flagship stores with strong sales to inbound tourists to cater to increasing foreign tourists to Japan including the expansion of timepiece area, the expansion of sales areas that accept mobile payments at the point of sale and the strengthening of promotion using SNS at stores.

Tax-free sales of Daimaru Matsuzakaya Department Stores grew by 62.8% year on year to ¥47.9 billion or 1.4 times from those amid shopping spree called “bakugai” in fiscal year 2015 and have reached a level where they can be expected to exceed ¥50 billion a year. In particular, the number of customers jumped by 50.6% year on year. By merchandise category, sales of "consumables” mainly including cosmetics doubled from the previous fiscal year to almost the same level as "general products.”

Credit sales of their flagship stores, which represent the company’s gaisho sales, increased by 1.5% from the previous year because the strengthening of events including a rare “selection of products” and highly attractive “experience” value in response to brisker spending by affluent people in Japan against the backdrop of stable share price level and the expansion of customer base by acquiring new gaisho customers worked well. Thanks to the efforts to develop new gaisho cardholders, we could acquire 13,250 new accounts.

By store, sales of the Shinsaibashi store, which has
an overwhelming ability to attract inbound tourists, significantly increased for 14 consecutive months, up 14.0% year on year. The Tokyo store, which accurately brought in affluent people and increasing neighborhood office workers through strategic customer acquisition initiatives, increased sales for 18 consecutive months and the Sapporo store also increased sales for 15 consecutive months. Sales of six flagship stores were above the previous year’s level and total sales of existing stores increased for 12 consecutive months.

In the meantime, in terms of costs, though advertising expenses (up ¥0.6 billion) and operational costs (up ¥0.4 billion) associated with the opening of “Ginza Six” and “Ueno Frontier Tower,” repair expenses for replacement of facilities (up ¥0.1 billion) and supplies expense (up ¥0.05 billion) including utility costs increased, the whole company strived to further reduce costs by decreasing actual personnel expenses (down ¥0.1 billion) including outsourcing expenses and rent (down ¥0.1 billion). The company also sold its real estate from the perspective of improving asset efficiency.

As a result, operating profit of Daimaru Matsuzakaya Department Stores soared by 41.0% year on year to ¥28.2 billion and business profit as a reference indicator significantly increased by 22.7% from the previous year to ¥27.1 billion. Operating profit and business profit exceeded forecast in October by ¥2.6 billion and ¥0.9 billion, respectively.

Free cash flow was positive at ¥3.8 billion, better than forecast in October.

Q. In the meantime, why do you expect both business profit and operating profit of the Department Store Business to decrease in the current fiscal year 2018?

The Department Store Business is expected to increase sales revenue by 3.3% year on year because mainly the flagship stores of Daimaru Matsuzakaya Department Stores are projected to increase sales while the severe sales slump in rural and suburban stores is forecast to continue. However, factoring in system-related one-time costs including the replacement of POS systems with the ones that enable payment processing in the presence of customers in the second half and cost increase resulting from the improvement of facilities to make our stores safe and secure, we expect “business profit” to decrease by 2.2%. Since extraordinary income and extraordinary losses under JGAAP are included in operating profit under IFRS and there will be an additional decline in reaction to gain on sales of real estate recorded at approximately ¥1.4 billion in the previous year, operating profit is expected to decrease by 6.6%.

Factoring in the full operation of “Parco_ya,” a store in a new format, which opened in “Ueno Frontier Tower” in November 2017, the opening of Harajuku Zero Gate and Sannomiya Zero Gate and the performance of Neuve A business, which was sluggish last year but is expected to improve in the second half and beyond due to the rebuilding of strategy, the Parco Business expects to increase sales revenue and “business profit” by 4.8% and 4.5% year on year, respectively. However, operating profit is expected to remain at the same level as the previous year partly due to the absence of reversal of impairment loss recorded in the previous year.

The Real Estate Business expects sales revenue and “business profit” to significantly increase by 27.4% and 26.1% year on year, respectively, to which the full operation of Ginza Six, which opened in April 2017, and “Ueno Frontier Tower,” which opened in November 2017, will contribute. As is the case in the Department Store Business, however, operating profit is expected to decrease by 20.1% in reaction to gain on sales of real estate recorded in the previous year (¥1.6 billion).

The Credit and Finance Business expects sales revenue to increase by 7.1% year on year. While “business profit” is expected to decrease by 1.5%
because system costs associated with security enhancements will increase, operating profit is expected to increase by 0.3%. Other expects the growth rate of sales revenue to be almost at the same level as the previous year at 0.1% partly due to the negative impact of the transfer of shares of Forest. However, “business profit” and operating profit are expected to increase by 29.8% and 22.2%, respectively, factoring in the improvement of the performance of J. Front Design & Construction, which struggled in the previous fiscal year.

Q. Collaboration with Parco seems to be progressing further in the wake of the opening of Ueno Frontier Tower.

Customer traffic to the main building of the Matsuzakaya Ueno store significantly increased after opening Ueno Frontier Tower on November 4, 2017. I think positive factors will certainly emerge by adding various events while implementing the Urban Dominant Strategy with new elements such as Parco, a cinema complex and offices under the new concept of “Shitamachi, Front.” The Matsuzakaya Ueno store intends to change the main building after researching new visitors after the opening of Ueno Frontier Tower instead of making a large investment before its opening. With respect to Shitamachi, Front, I think Daimaru Matsuzakaya Department Stores and Parco are successfully working with local shopping malls and the government.

We have decided to open Parco in the north wing of the Daimaru Shinsaibashi store as its anchor tenant after completing the main building. We are working on this project with Parco closely exchanging information with each other. The main building will open first in fall 2019. We will share information on it to build the Parco and Real Estate Businesses in the north wing. It is important to develop an idea of what constitutes an ideal form as a large hybrid commercial complex with a floor area of more than 80,000 square meters. What we would like to borrow from Parco is information on what to do after departure from department store’s traditional merchandise mix by category or where the new markets which department stores fail to tap into are created. You can expect the advanced form of collaboration with Parco beyond the results achieved in Ueno Frontier Tower.

Q. What are the achievements and challenges after fiscal year 2017 as the first year of the Medium-term Business Plan?

I think the last fiscal year 2017 as the first year of the Medium-term Business Plan, when big projects including “Ginza Six” and “Ueno Frontier Tower” contributed to growing the new Real Estate Business segment more than originally expected, got off to a good start as the first step of the “transformation of business portfolio” toward discontinuous growth which we are aiming at.

In the meantime, with respect to ICT initiatives as the measures to reinforce sales capabilities and a response to the Credit and Finance Business, which is highly positioned as a growth business, we are repeating trial and error. Unfortunately, however, it is undeniable that its progress lacks in speed and we have not achieved visible or tangible results yet. I think we need to shift gears to solve these urgent business issues.

The business environment is changing at an unprecedented speed. Various changes in the business environment mean “uncertainty” for businesses. Such uncertainty or risk includes an “opportunity” as a positive side and “threat” as a negative side. We need to capture these two sides of risk.

To this end, the Company redefined changes in the business environment as the risk associated with the Company, and at first, identified 138 risk items. The Risk Management Committee met and the Board members lodged together to discuss in-depth the business risks we consider particularly important among them, and finally, 15 items were identified.

Q. Could you talk about these risks a little more?

138 risks are classified into strategic risks, finance risks, operation risks and hazard risks. We set priorities according to importance in the end. As a matter of course, however, the risks identified are different between the holding company and operating companies including department store operators and...
The Company has strengthened the orientation toward so-called B/S-based management that is conscious of asset efficiency since last year, for example, by making a balance sheet for each department store. It was the perspective of Executive Officer in charge of finance strategy who had been invited from manufacturing industry, not from retail industry, that triggered this. He said he felt something was wrong with the situation where we discussed only P/S at the internal performance report of department stores though they conduct business activities using significant assets. Therefore, we introduced store B/S and started the business management that incorporates ROA as a store manager’s performance indicator.

Also in the ICT field that currently requires a response with speed, we appointed a talent who possesses insight with respect to overall digital including AI from outside the Group as Executive Officer. Furthermore, in the credit and finance field that is expected to grow in the future, we appointed a highly professional person from outside the Group as the President of JFR Card, a consolidated subsidiary in the Group.

Recently, I often talk about the “combination of different elements” inside and outside the Company. I think it is possible that the new values demanded by the present times will be born in a place where different values and cultures bump into each other. It can be said that exactly the combination of different elements through discussions and collaboration among four companies that share high goals beyond company level enabled us to create and open an unprecedented luxury mall “Ginza Six” in April 2017.

I think “discontinuous growth” which the Company is aiming at is the aggregate results of new out-of-the-box initiatives born by breaking internal conventional rules and combining different elements.

Q. You have actively proceeded with governance reforms. How will you address the reforms from an ESG perspective?

As you know, GPIF, the world’s largest pension fund, signed the United Nations Principles for Responsible Investment (PRI) in 2015 and announced the selection of three ESG indices. This showed that financial information only is not enough to understand the reality of corporations and assess their...
sustainability and growth potential and that non-financial information including ESG information plays a more important role. I recognize it as a great change in capital market trends and as a strong message addressed to corporations which are regarded as the “public entities of society.”

The Company has actively taken the initiative in the reform of the “G” of ESG or governance. In light of these trends in the capital markets, we created “ESG Promotion Division” as a dedicated unit in March. And going forward, we will also strengthen initiatives and information disclosure concerning the “E” and “S” both in terms of quality and quantity.

To this end, we identified materiality or “important tasks” we should address. Firstly, we conducted a questionnaire of stakeholders concerning 25 candidate materiality items and collected responses from 4,250 stakeholders. In the next step, we had internal discussions based on major guidelines including the GRI Standards and ISO 26000 and the assessment items of research institutes. And we have formally decided the degrees of materiality through discussions at the Board of Directors meetings. Thus by identifying and disclosing our materiality, we will make clearer the relevance between social issues and business activities and proceed with initiatives based on the concept of “CSV” or “Creating Shared Value.”

Going forward, we will set the medium- to long-term quantitative materiality goals which we should achieve, and in fall, we will hold “ESG briefings” for institutional investors.

Q. Would you explain your view of shareholder return?

During the five-year period of the Medium-term Business Plan, we will generate operating cash flows of ¥260 billion or more and allocate ¥200 billion to capital investment and growth investment for the innovation of existing businesses and the transformation of business portfolio.

Investment in the five-year period of the Medium-term Business is expected to peak in fiscal year 2019 when the “main building of the Daimaru Shinsaibashi store” and “new Shibuya Parco,” which are being rebuilt, and subsequently, in fiscal year 2020 and 2021, free cash flows of more than ¥20 billion each are projected to be generated.

Five-year cumulative free cash flows of ¥60 billion or more will be allocated to shareholder return and the expansion of equity. Our shareholder return policy is to consider purchasing our own shares as appropriate on the basis of dividend payout ratio of at least 30% and in view of our financial condition.

The Company increased dividends for seven consecutive years until the previous fiscal year ended on February 28, 2018. Also in the fiscal year ending on February 28, 2019, we are planning to increase an annual ordinary dividend by ¥2, marking the 8th consecutive dividend increase.

As mentioned above, by promoting capital policy in consideration of the balance of strategic investment, the improvement of shareholder return and the expansion of equity, we will strive to realize the management structure that can achieve ROE of 8% continuously.

The Company’s current cost of shareholders’ equity has been calculated to be about 6%, and over the medium term, it is expected to remain within the range of 6 to 7%. Therefore, I recognize that the target ROE of 8% set under the current Medium-term Business Plan is the minimum level to be achieved in order to meet shareholders’ expectations. The transformation of business portfolio is expected to lead to reduction of equity cost as well as helping building up a business structure foundation. We would like to steadily accumulate tangible results to develop as a “Multi Service Retailer” beyond the framework of retail.