# Building a Financial Base to Achieve an ROE of 8%

## Promoting management in recognition of capital cost

The Group aims to achieve a consolidated ROE of 8% or more in fiscal year 2021, which is the final year of the Medium-term Business Plan. We began with recognizing shareholders'/ investors' expected return, that is, our cost of shareholders' equity to set an ROE target of 8%.

The cost of shareholders' equity has been calculated at a little less than 6% at the end of February 2018 but we see it moving in the range of 6% to 7% over the medium to long term. Therefore, we think we are expected to stably achieve an ROE of 8% or more exceeding the cost of shareholders' equity mentioned above.

| FY2021 consolidated ROE target | | Cost of shareholders' equity recognized by the Company |
|---|---|---|
| **8.0** % or more | > | **6–7** % |

The WACC (weighted average cost of capital) has been calculated at a little less than 5% at the end of February 2018. But we recognize the WACC of the whole Group has been at the level of around 5% over the medium to long term and each of our main businesses including the Department Store Business, Parco Business, Real Estate Business and Credit and Finance Business also recognizes its WACC.

In the process of changing our business portfolio, we will be conscious of decreasing capital cost by reducing shareholders'/investors' recognition of business risks and pursuing an optimal capital structure.

## Generation of cash flows and the balance between growth and return

The Group will generate operating cash flows of ¥260 billion or more in total during the five-year period of the current Medium-term Plan (FY 2017 to 2021), and from them, ¥200 billion will be allocated mainly to capital investment in existing businesses and growth strategy investment to expand into new businesses toward restructuring its business portfolio.

A little more than 60% of such investment will be allocated to the Department Store Business and Parco Business, which are the Group's core businesses, a little less than 20% to the Real Estate Business, which was newly created as an independent segment, and a little less than 10% to Other. We are planning to invest ¥27 billion in M&A for growth.

We expect to generate free cash flows of ¥60 billion or more in five years. They will be used to expand equity targeting an equity ratio of 40% and to return profits to shareholders targeting a consolidated dividend payout ratio of at least 30%. We will also consider purchasing our own shares as appropriate.

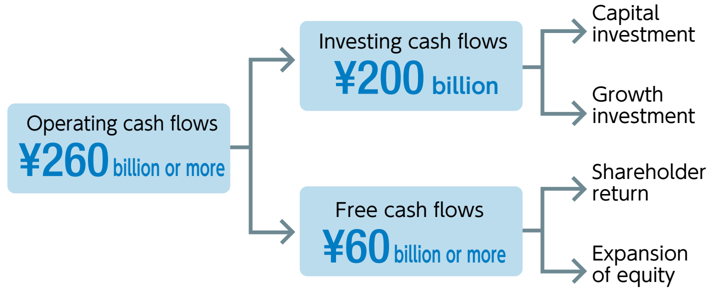
## Adopting store-by-store balance sheet

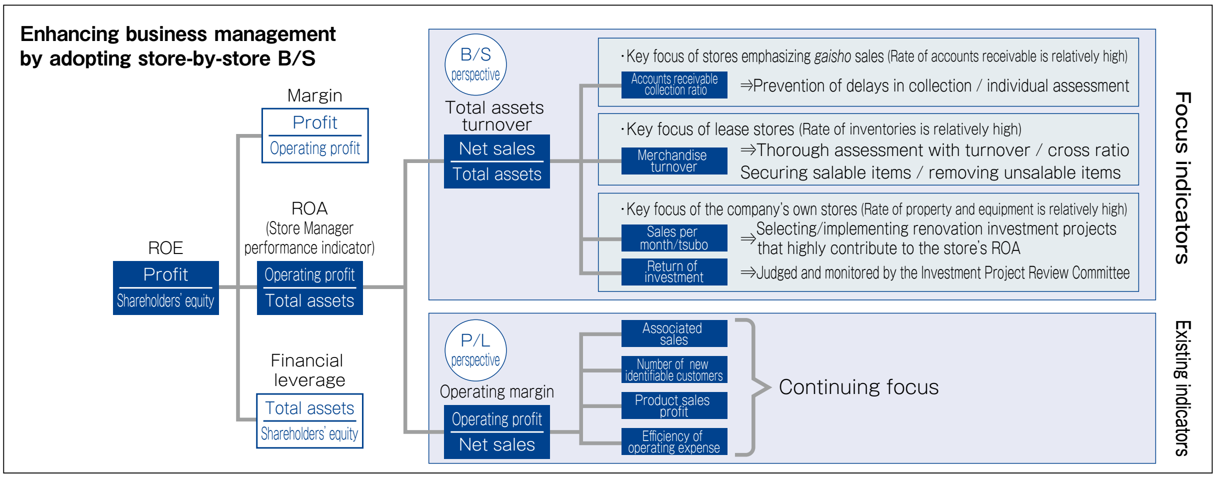
The Department Store Business operates using large assets. In fact, however, a strong focus had been put on profit and loss statement (P/L) at a store level. In other words, stores had been less conscious of balance sheet (B/S). Therefore, we have decided to "change employee mindset" to increase ROE across the Department Store Business including all its companies and stores by adding a B/S perspective (assets/liabilities/shareholders' equity) to business management and clarifying the management targets of the whole Business and each department store.

Specifically, beginning in March 2017, each department store develops a B/S budget, which enables us to compare it with results and understand asset profitability. We prioritize investments considering each store's ability to achieve a return on investment and expect effects from this that will lead to a curb on investment plans intended only to maintain or increase sales and drastic measures for poorly performing divisions. Each store will actively implement measures to enhance asset efficiency according to business size, regional characteristics and asset composition in an effort to improve ROA, asset turnover and performance.

In the first year of adoption, we visualized each store's B/S like an independent company by transferring land and buildings, operating receivables and payables and others, which had been recorded by the head office, to each store and budgeted ROA of each store and added it to the performance indicators of Store Managers and others. As a result, partly thanks to an increase in operating margin

**Cash flow allocation** *Total for FY 2017 to 2021





**Enhancing business management by adopting store-by-store B/S**

due to profit growth, "inventories" and "property and equipment" in B/S, which can be managed by each store, were generally controlled against the budget set at the beginning of the period and ROA was improved.

Going forward, we will promote strategic initiatives to enhance asset efficiency including: (i) defining KPIs from a perspective of asset efficiency (B/S) and breaking them down at a store level; (ii) verifying the investment action plan of each store and implementing the PDCA cycle; and (iii) developing a growth investment model to improve ROA by replacing and adding assets.

## Investment Project Review Committee and Revitalization Plan Review Committee

The Company has created the "Investment Project Review Committee" and the "Revitalization Plan Review Committee" to support management decision-making on investment, business revitalization and withdrawal from a financial perspective.

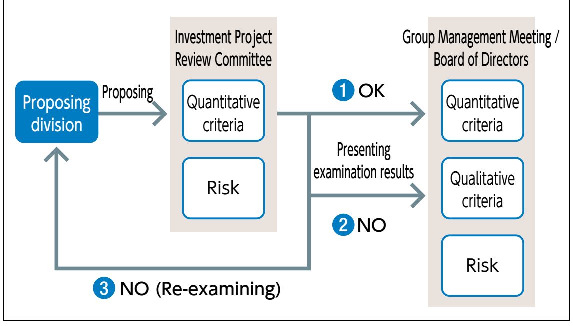
The "Investment Project Review Committee" consists of the Senior Executive General Manager of Financial Strategy Unit as its Chairperson, the Senior General Manager of Management Planning Division as its Vice Chairperson and other members from Financial Strategy Unit, Management Planning Division and Legal Division. The Committee has in place a system that enables the participation of external institutions in order to present more objective and stricter opinions. We make an investment decision using the payback method for investment in store renovations, the NPV method for development investment (present value discounted using WACC ≧ 0), and the DCF method for M&A. In addition, the Committee checks many areas including legal risks and financial risks (calculation of shareholder value).

Specifically, in fiscal year 2017, they examined Parco's new store opening projects in Kinshi-cho and the north wing of the Daimaru Shinsaibashi store and the establishment of new operating company (JFR Kodomo Mirai Co., Ltd.).

The "Revitalization Plan Review Committee" is composed of the Senior General Manager of Management Planning Division of Management Strategy Unit as its Chairperson, the Senior General Manager of Budget and Management Support Division of Financial Strategy Unit as its Vice Chairperson, the Senior Executive General Manager of Management Strategy Unit and other members from Budget and Management Support Division.

Specifically, the Committee classifies the businesses of the Group into three phases including "I. Normal," "II. Caution needed" and "III. Revitalization or withdrawal to be considered" and reviews them on a regular basis. One of the criteria for the "phase III" in which revitalization or withdrawal is to be considered is "two consecutive periods of operating loss." Concerning the companies, businesses, stores and others that meet the criterion, mainly a relevant company prepares the measures for "revitalization or withdrawal." The Committee validates these businesses and determines the validity of the measures as well as providing information to facilitate swift management decision-making at the Group Management Meetings and the Board of Directors meetings.

**Flow of the "Investment Project Review Committee"**




**Classification into phases by the "Revitalization Plan Review Committee"**