Promotion of management in recognition of the cost of capital

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 have calculated our cost of shareholders’ equity (shareholders’ and investors’ expected return), which is a hurdle rate for ROE, at 6% at the end of February 2019 but we expect it to move in the range of 6 to 7% over the medium to long term. Therefore, we recognize that the 8% ROE is the minimum level we should achieve to meet the expectations of shareholders.

The WACC (weighted average cost of capital) is a little higher than 4% at the end of February 2019 and we expect it to be at the level of around 5% over the medium to long term. We also calculate WACC by business segment such as the Department Store Business, Parco Business, Real Estate Business and Credit and Finance Business and set hurdle rates to be used when considering investments.

By recognizing the cost of capital, we will promote management activities to expand spread, which funds the sustainable and medium- to long-term enhancement of corporate value.

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 (fiscal years 2017 to 2021), of which ¥200 billion will be allocated mainly to capital investment in existing businesses and growth strategy investment to restructure its business portfolio. It is not included in our quantitative management objectives but return on this investment (ROIC) is expected to exceed our hurdle rate (WACC) of 5%.

A little more than 60% of such investment will be allocated to the Group’s core Department Store Business and Parco Business and slightly less than 20% to the Real Estate Business, and a little less than 10% to Other. And ¥27 billion will be allocated to M&A for growth. Capital investment during the period of the current Medium-term Plan will peak in fiscal year 2019 when the new main building of the Daimaru Shinsaibashi store and Shibuya Parco will open.

We expect to generate free cash flows of ¥60 billion or more during the five-year period. We will strive to increase shareholder return and equity and promote balanced capital policy.

Cash flow allocation

<table>
<thead>
<tr>
<th>Cash flow allocation</th>
<th>Capital investment</th>
<th>Growth investment</th>
<th>Shareholder return</th>
<th>Expansion of equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating cash flows</td>
<td>¥260 billion or more</td>
<td>Investing cash flows</td>
<td>¥200 billion</td>
<td>Free cash flows</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>¥60 billion or more</td>
</tr>
</tbody>
</table>

Promotion of department store management based on separate B/S for each store

The greatest focus of each operating company is on increasing ROA to realize a consolidated ROE of 8%. Though the core Department Store Business operates using large assets, we had little perspective of asset efficiency. Therefore, we adopted management based on separate B/S for each store. We have "raised awareness" to incorporate not only a P/L perspective, which places disproportionate weight on sales and profit, but also a B/S perspective, which seeks appropriate return from assets, to management at a store level.

Specifically, beginning in March 2017, each store develops a B/S budget, which enables us to compare it with results and understand asset profitability. Investments are prioritized considering each store’s ability to recover investment. It contributes to a curb on investment plans intended only to maintain or increase sales and drastic measures for poorly performing divisions. We will improve and increase ROA through each store’s active implementation of measures.

Going forward, we will apply asset efficiency (B/S) KPIs to stores, create medium-term targets, and promote the building of investment PDCA cycle by introducing the "Investment Project Review Committee" to the Department Store Business to improve asset efficiency. In addition, in order to advance B/S-based management, we started to consider determining the "amount of capital by store" that visualizes cumulative profits, which have been centralized in the head office of the Department Store Business.
Investment Project Review Committee and Revitalization Plan Review Committee

The Company has the "Investment Project Committee" and "Revitalization Plan Review Committee" to support management decision-making on investment, business revitalization and withdrawal from a financial perspective. Both Committees do multifaceted checks including quantitative review and financial and legal confirmation of risks.

The "Investment Project Committee" makes an investment decision using the payback method for investment in store renovations, the NPV method (present value discount using a hurdle rate \( \geq 0 \)) for development investment, and the DCF method for M&A. They check many areas (calculate risks and business risks. The difference between the amount of operating deficit. Concerning the companies, businesses, stores and others that meet the criterion, the measures for "revitalization or withdrawal" are developed. The Committee validates these businesses and determines the validity of the measures as well as provides information to facilitate swift management decision-making at the Group Management Meetings and the Board of Directors meetings.

Optimization of the amount of equity of each company in the Group

We worked to optimize the amount of equity of each company in the Group and reduce its total assets so that each company can promote B/S-conscious management and improve asset efficiency in consideration of financial safety.

Specifically, we determined the appropriate equity ratio of each company by examining necessary funds including operating funds and the amount that can avoid impairment risks and business risks. The difference between the amount of equity and the amount of appropriate equity on the record date (the last day of February 2018) was absorbed as a special dividend to the holding company J. Front Retailing to increase the amount of its equity. As a result, the double leverage* ratio, which is one of important indicators for rating a holding company, improved from 100% to 94%.

*Double leverage: This occurs when a holding company uses debt to acquire shares in subsidiaries and associates and the subsidiaries and associates procure debt financing.

Optimization of the amount of equity of each company in the Group

<table>
<thead>
<tr>
<th>Calculation formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>Double leverage ratio (100% or less is desirable)</td>
</tr>
<tr>
<td>= Shares of subsidiaries and associates / Equity of JFR</td>
</tr>
</tbody>
</table>

Investment Project Committee

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