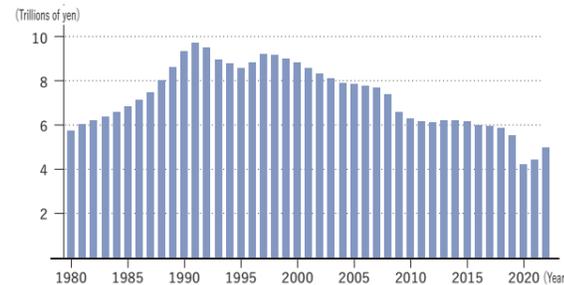


Value Creation

A Major Turning Point in the Department Store Business Model

Will Department Stores Recover or Transform?

National department store sales trends



Post-COVID-19 recovery in full swing

Department stores, which had lagged the most in the retail industry, have finally entered a full-fledged recovery phase amid the prolonged COVID-19 pandemic. The reason for this was the start of nationwide travel support in October 2020 and the drastic relaxation of border measures. As a result, people started to move remarkably, and boosted by inbound tourists and the rapid depreciation of the yen, the economy began to regain its vitality, mainly in the consumption of high-priced goods.

National department store sales have been on a downward trend since peaking at 9.7 trillion yen in 1991. And it is said that the COVID-19 pandemic triggered a decade's worth of changes all at once, with sales disappearing by 1.2 trillion yen a year in 2020. The shrinkage of the department store market is due in part to macroeconomic factors such as a declining population and the collapse of the middle class due to increasing bipolarization, as well as intensifying competition across industries, including the rapid expansion of e-commerce, but the essential issue is the obsolescence of business models that cannot respond to changes in customers and rapid changes in the environment.

Behavioral changes caused by COVID-19 have had a tremendous impact on department stores. In addition to the decline in human flow due to the voluntary restraint of going out, all aspects of consumption and business are rapidly moving online. This has exposed the deadlock in business models that are overly dependent on human flow or real stores. It is no exaggeration to say that the very existence value of department stores was questioned.

The COVID-19 pandemic has brought about major changes not only in the quantity of consumption, but rather in the quality of consumption. Department stores are now being tested on their ability to respond. We believe that the crisis brought about by COVID-19 must be used as an "opportunity for change," and that we must accelerate the transformation of our business model.

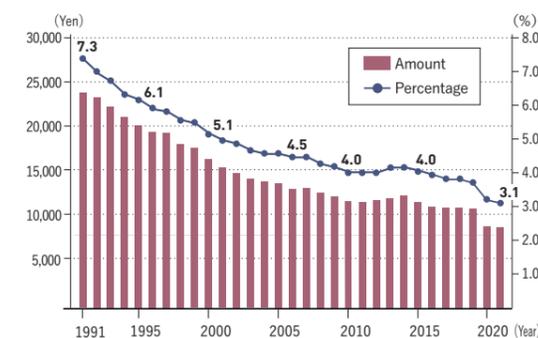
100 years since the Department Store Declaration

The department store business model was born about 100 years ago. Large stores were opened and they expanded their product categories as they developed and prospered, from

men's and women's clothing to kimono, children's clothing and toys, furniture, home appliances, and foodstuffs. In terms of business structure, department stores mainly purchased products on a no return basis and took inventory risk, which is called *kaitori* in Japanese. But in the 1980s, a new form of transaction without inventory called *shoka shiire* expanded to around 80%. In *shoka shiire*, purchase is recorded when the product is sold to a customer and the product is not recorded as department store inventory. And the focus of the business shifted from merchandising to marketing or brand assortment. At the same time, department stores overly depended on clothing, particularly women's clothing, against the backdrop of the DC brand boom, instead of carrying a full line of products, which is the origin of the Japanese word *hyakkaten* for a department store (literally, a store selling hundreds of products). It was then that department store sales peaked.

On the other hand, according to the Family Income and Expenditure Survey by the Ministry of Internal Affairs and Communication, the percentage of expenditure on clothing and footwear decreased to 3.1% in 2021, less than half of 7.3% in 1991. However, department stores could hardly get out of past successes that they grew with apparel and continued to allot too much space to women's clothing. It widened the gap with customers' tastes and buying behavior. This was further accelerated due to COVID-19 and the content of department stores and the way of providing it, that is to say, the business model itself became outdated and they are in urgent need of drastic structural changes.

Trends in "clothing and footwear" as a percentage of household consumption expenditures

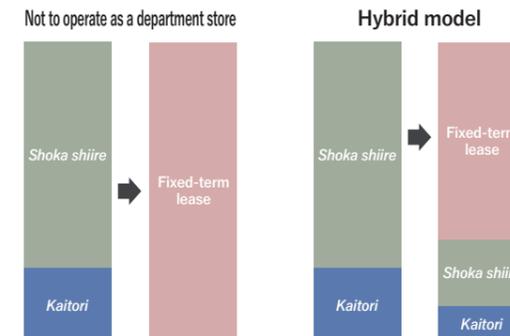


Content will evolve with business model conversion

First, we took two directions to build a new department store business model.

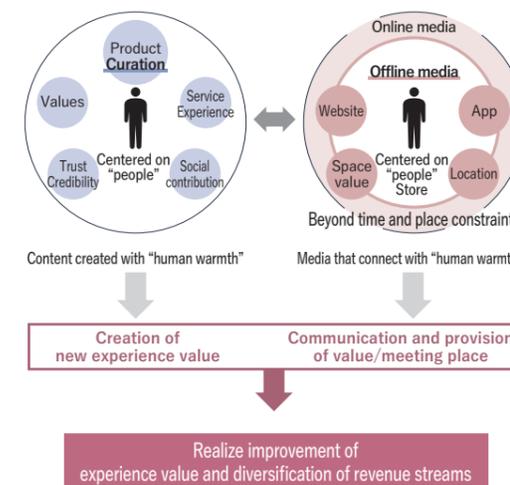
One is a choice "not to operate as a department store." That is to say, we converted some stores to a 100% real estate business without adopting department store's traditional transaction formats of *kaitori* and *shoka shiire*. Its typical example is GINZA SIX, a luxury mall which was created in 2017 by developing the two blocks including the former site of the Matsuzakaya Ginza store as one.

The other is to build a "hybrid model" that combines real estate rental with *kaitori* and *shoka shiire* under the "department store brand." Its typical example of a large-scale flagship store is the new main building of the Daimaru Shinsaibashi store, which opened in 2019. Some undersized stores also attract new crowd through business model conversion. For example, the Daimaru Suma store introduced a library in 2020 and the Matsuzakaya Shizuoka store installed an aquarium in 2022.



The advantage of *shoka shiire* is that we can seek greater return through sales growth. On the other hand, the advantages of fixed-term lease are not only to realize stable revenue and the reduction of operation costs but also to increase the variety of tenants to strengthen the response to service consumption and experience-based consumption, which makes the store look fresher. Furthermore, the Daimaru Tokyo store developed new content named "asumise" based on commission income with the concept of "a store that does not sell."

Innovation of customer experience through the digitalization of touch points



What has become most apparent during the recent COVID-19 pandemic is the delay in responding to digitalization. As for the direction of our digitalization, we focus on digitalizing touch points through "app" rather than expanding e-commerce. The app allows us to connect with our customers 24 hours a day. This deepens communication with our customers and

dramatically improves the accuracy of purchase forecasts, which can lead to more sophisticated CRM.

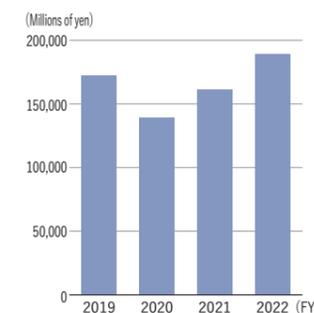
It is a challenge to overcome the constraints of time and place by building a unique people-centered media. We then aim to evolve into a media commerce that provides content that creates new experience value through that media, thereby diversifying revenue streams.

Deep cultivation of the luxury market

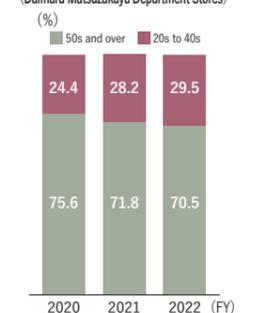
Luxury content has steadily increased sales even during the COVID-19 pandemic, and has already significantly exceeded pre-COVID-19 levels. Though overall store sales for Daimaru Matsuzakaya Department Stores in fiscal 2022 are lower than in fiscal 2019, sales of luxury items are already showing a high growth of 52.8% compared to fiscal 2019. While capital investment is limited due to the COVID-19 pandemic, we have strategically focused our investment on expanding the luxury items of our core stores, and we have achieved great results.

In addition, our gaisho sales, which have organized wealthy customers, have already exceeded pre-COVID-19 levels by double digits. The core of the gaisho business is "people" to "people," and the COVID-19 pandemic has triggered the digitalization of the gaisho business as well. Specifically, in addition to the rapid spread of the app, the use of the closed website "connaissigne" has changed the way business is conducted, and the promotion of online sign-up has helped develop younger affluent customers.

Department Stores Business gaisho sales trends



Trends in gaisho customer sales share by age group (Daimaru Matsuzakaya Department Stores)



Value of the real world becomes more important

Another reality revealed by the COVID-19 pandemic is how precious and irreplaceable the real experience value obtained from the five senses is. Our main task is to increase the value we deliver through people-to-people communication, which is our strength. We will expand human power using digital technologies. Its starting point is in physical stores. From now on, the locality of each store will become more important. By creating a sense of the world based on content and unique curation capabilities, we will further refine our physical stores and integrate digital technologies into them. We believe that these are the basis of the department store business model that lives in the present age.