**J. Front Retailing**
**Q & A summary**
**Results presentation for the first six months of the fiscal year ending February 28, 2022**
**Date and time: 16:30 – 18:00 on Tuesday, October 12, 2021**

**Q. With regard to the SC Business (Parco), according to your presentation materials (page 7), while gross sales increased from Q1 to Q2, revenue decreased, and as a result, business profit also decreased. I would like to know its background. I am afraid that business profit will not increase in H2 even though foot traffic will follow a recovery trend and gross sales will improve.**

A. (Mr. Makiyama)

As last year our stores closed mainly in April and May (Q1), percentage changes for this fiscal year significantly react to it. Store closures bring about significant negative impact including a decrease in rent and common service charge. However, our stores operated in the current period and our support for the tenants that suspended operations this fiscal year is smaller than last year. For Q2, revenue rose much above standard sales because sales increased in June last year due to revenge consumption. This year, however, sales moved at an average pace from June to the middle of August and revenue in Q2 does not seem to have jumped year on year compared to Q1. Actually, sales have recovered smoothly and business profit has also increased. Thus we expect to ensure enough business profit in H2.

**Q. When comparing Q2 with Q1 this fiscal year, revenue and business profit did not increase. Is it due to seasonal reasons?**

A. (Mr. Makiyama)

We transferred Neuve A on June 30 and it had a significant impact. Concerning changes from Q1 to Q2 excluding Neuve A, I would like to explain after confirming.

<Supplemental data>

*Supplement (1) SC Business (excluding Neuve A)

| | Q1 | Q2 |
|---|---|---|
| Gross sales | ¥48.9 billion | ¥52.0 billion |
| Revenue | ¥11.4 billion | ¥12.2 billion |

Supplement (2) Excluding the effect of transfer of fixed costs in the SC Business
(Q1: approx. ¥0.5 billion, Q2: almost zero)

| | Q1 | Q2 |
|---|---|---|
| Business profit | ¥1.2 billion | ¥1.3 billion |

**Q. I understand H2 plan for consolidated SGA remains unchanged from June forecast. However, Q2 results were below June forecast. Is it not because you reduced costs in H1 and carried them over to H2 but because you just reduced costs? Concerning forecast for H2, is additional cost reduction that is not contained in your plan possible? Concerning forecast for the reduction of fixed costs in FY2021, you told results in H1 were above the plan. Actually, how much cost did you reduce?**

A. (Mr. Yoshimoto)

Sales were relatively strong in June but sluggish from late July to August. And we reviewed SGA flexibly. Some of them will be carried over to H2. The basic scenario for forecast for H2 aims for sales recovery. Therefore, particularly in November and December, basically, we will spend necessary cost. On the other hand, in the prolonged uncertain situation, we have multiple scenarios to respond to risks.

Concerning the current situation, as we made a good start in October both in terms of customer traffic and sales, I think SGA will be as expected if sales continue on a recovery trend.

Concerning the structure reform ("reduce fixed costs ¥10.0 billion in three years" as described on page 40 of our presentation materials), it is based on the assumption that fixed costs are defined as the costs of which reduction effect will not be temporary just in a single year but will continue in later years. Therefore, for example, the temporary reduction of outsourcing expenses is not included. We define fixed costs as the costs of which reduction effect will continue in the relevant fiscal year and subsequent fiscal years. Such reduction will be made by changing our business model. It includes the shift from paper to digital to reduce advertising expenses and the minimization of organization to reduce personnel expenses.

Of our three-year reduction target of ¥10.0 billion (compared to fiscal 2019), we plan to reduce (i) ¥6.0 billion through human resource structure reform and (ii) ¥4.0 billion through cost structure reform. Considering the current severe situation, we should aim to reduce more than ¥10.0 billion. However, they are big targets and we would like to strive to achieve it.

Expected reduction of ¥3.7 billion for fiscal 2021 (compared to fiscal 2019) includes:

(i) Human resource structure reform

There is attrition of 250 to 300 employees due to retirement every year. However, while reviewing and reducing positions, we reduce new graduate and mid-career recruitment. As a result, we expect to eliminate 500 positions in these three years. We will continue to strive to minimize costs through organizational and human resource structure reforms.

(ii) Cost structure reform

We already work to reduce advertising expenses. We shifted to digital to reduce costs continuously. We plan to reduce costs ¥1.0 billion by decreasing offices and transfer without family, and in addition, further promoting the joint purchase of the Group.

Reduction of ¥3.7 billion in fiscal 2021 includes SGA reduction of ¥3.0 billion and cost reduction of ¥0.7 billion. SGA reduction of ¥3.0 billion includes the reduction of ¥1.4 billion made in H1 and the reduction of ¥1.6 billion expected for H2.

**Q. You told you have multiple scenarios for forecast for H2. If sales increase above forecast, do you think you will invest costs looking ahead to the future? I would like to know what you qualitatively think about the balance between periodic profit or loss and measures with an eye to the future.**

A. (Mr. Yoshimoto)

Forecast for H2 is based on the idea that consumption will recover gradually. It is not based on the negative impact of so-called 6th and 7th wave of COVID-19. Concerning inbound tourists, we assume that restriction on their entry to Japan, etc. will not be eased immediately.

On the other hand, we learned from our experience during the last year and a half that we can respond to some situations by reducing SGA. And we are always conscious of the situation that causes impairment losses like in H1 last year. We will respond flexibly assuming various scenarios.

For the target in the medium-term plan (operating profit in fiscal 2023: ¥40.3 billion), I recognize we have started late this fiscal year, which is the first year of the plan, due to COVID-19. We need to make up for the delay somewhere. And I think we should accelerate the Real × Digital Strategy, the Prime Life Strategy and others. The Department Store, Parco and JFR Card will implement them steadily.

**Q. Concerning your idea of fixed-term lease, you told about the Nagoya store. And is it correct to understand that it will change company-wide? Or is it limited to the Nagoya store? I would like to know what you think about that.**

A. (Mr. Yoshimoto)

In our business strategy presentation in 2019, I told that we would remodel the Nagoya store following the Shinsaibashi store. Though the plan has been temporarily suspended due to COVID-19, looking at the Developer Strategy in the Nagoya Sakae area and with its three building structure in mind, we are considering building a new hybrid model for the Matsuzakaya Nagoya store. The ratio of fixed-term lease of 40% of the Nagoya store can be realized without rebuilding its buildings unlike the Shinsaibashi store. Fixed-term lease is only methodology, but it will be difficult to introduce the tenants that are attractive for customers only in the format of *uriage shiire* (purchase recorded at the time of sale). And as a result, I think the ratio of fixed-term lease will increase.

On top of it, strong *gaisho* sales are cited as the feature of the Nagoya store and we will build a model in light of them. The Department Store needs to establish and customize an optimal model according to the characteristics of each store. First, we would like to launch the renovation of the Nagoya store by fiscal 2023 to show tangible results as early as possible.

**Q. Concerning forecast for margin ratio, if composition by merchandise category changes and margin ratio decreases around 1% compared to before COVID-19, business profit will decrease ¥6.0 billion to ¥7.0 billion. If sales return to normal to some extent, is there no need to worry about that? On the other hand, if you assume that there are adverse factors, what measures will you take?**

A. (Mr. Yoshimoto)

Concerning profit margin in product sales, in the past, it was the accepted view that profit margin will decrease if share of women's clothing decreases and share of luxury items increases. Share of women's clothing has considerably decreased in these one or two years. Profit margin of luxury items has been almost average or above average though it depends on items. There remains a concern that profit margin will decline when sales recover in the future. However, I recognize that profit margin will not necessarily continue to decrease due to increasing share of luxury items.

**Q. I think profit margin will not decrease so much in the future. But it has already decreased more than 1% compared to 2018 – 2019 and gross margin is expected to decrease ¥6.0 billion to ¥7.0 billion compared to before. Do you intend to cover them by reducing fixed costs and making the transition to fixed-term lease?**

A. (Mr. Yoshimoto)

I think it may be good to offset the impact of decreased profit margin while investing in the transition to fixed-term lease. However, in terms of the measures to be taken until fiscal 2023, we will mainly reduce SGA.

**Q. I would like to ask Mr. Sawada. On page 29 of your presentation materials, you tell about "what will recover" and "what will not recover" concerning market changes in the future. I think your view about it is on page 34. And I would like you to supplement it a little more specifically about what is likely to return and what can become killer content. Last week showrooming space opened in the Daimaru Tokyo store. I would also like to know whether something like that will become a core.**

A. (Mr. Sawada)

The one and a half year period since the COVID-19 outbreak yields various results and changes. Based on them, we are discussing the future market in the company. From such discussion, we consider art will grow in the future. Compared to advanced countries, its market in Japan is smaller and it has room to grow.

We have implemented various initiatives since H2 last year, and particularly, modern art events have produced good results. Even in rural stores, they have made a big achievement. We have a strong pipe with art galleries, which was created through our past efforts and we would like to steadily grow this field.

We also consider cosmetics as a market expected to grow. Various products including skin care, hair care, and face care products and those from natural sources, which are not developed by only large manufacturers. We recognize this market will grow. We also see luxury watches as a growth field.

On the other hand, the apparel market is obviously segmentalized. Conventional department store's idea of categories such as Mrs., New Mrs., and Career has obviously become outdated. For example, we curated and offered very strong brands targeting young women in a tranquil environment in the Kyoto store. Then middle-aged women briskly buy the clothing that their daughters bought. The business that produces many products semiannually and sells unsold products at discount prices has reached the limit. There have emerged some companies that manufacture good products and leave them as if archiving them. Some brands attract customers who empathize with their stances and support them. I think it will be important for us to find such brands carefully. If we can do this, the market will expand enough.

I will tell about the "asumise" in the Daimaru Tokyo store. Department stores use energy for finding currently selling products. Similarly, we need to find the products that will sell in the future. Connoisseurship is required and I think we also need an “equipment” to realize that. We would like to make the “asumise” function as an equipment to find the products that will sell in the future.

**Q. You told art would grow. Is it like the event held on the higher floors of the Daimaru Tokyo store?**

A. (Mr. Sawada)

Such events were held in the Tokyo store, the Kyoto store, etc. as store-wide promotion and we will use art galleries in our stores including GINZA SIX. We have also found that art is easy to sell online. Experts present art works with clear explanation online, and in some cases, we sell such works by lottery online. We will proceed with initiatives that combine the real and virtual worlds.

**Q. I think Parco always captures changes and I would like to know what customers will return and what content will become strong in the process that customer traffic will return.**

A. (Mr. Makiyama)

Like the Department Store, I think art is a growth field. For example, Parco published four books on Banksy and the combination of “artist,” “gallery” and “Parco” have delivered strong results.

A fashion lover watches a documentary film on a designer and shops in a shop or an art lover watches a documentary film on an artist and buys related products. Parco makes such unique proposals that combine “goods” and “entertainment.”

Concerning what products are selling, even young people buy so-called street luxury items. In the past, it was pointed out that the price range conflicted with the range of customers, but recently, they are selling well. I think this field is expected to grow further.

Last fall, we opened a new zone Outdoor Park in Shibuya PARCO. Lifestyles are changing partly due to the COVID-19 pandemic. But by creating a zone which urban people long for in the center of the city, fashion lovers are attracted. It caused a buzz on SNS and made a good start.

Fashion is diversified and fashion lovers seek genuine goods that have stories. We would like to develop good plans and gain recognition that Parco always communicates new fashion themes so that Parco’s branding will evolve.

**Q. I would like to ask Mr. Yoshimoto. You mentioned a “sense of speed” several times as a key phrase in dialogues during the past half year or one year. In the increasingly changing external environment, has the sense of speed of the management team and frontline employees improved when you actually engage in management?**

A. (Mr. Yoshimoto)

Our initiative to “digitalize touch points using app” is presented on page 30 of our presentation materials. I think app is the starting point of our digital strategy and recognize that we have made progress partly due to the COVID-19 pandemic. *Gaisho*’s connaissligne has 80,000 members and strives to improve its products and customer service function. I think they are making progress with a sense of speed. However, there is a problem with the shortage of experts who promote digitalization.

In the meantime, for physical stores, while shifting their focus to experience and lifestyle and expanding prime content, I recognize that we need to face the current situation and accelerate our efforts to decrease originally curated space by half and reduce women’s volume zone clothing.

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