J. Front Retailing
Summary of Q&A session at
results presentation for the fiscal year ended February 29, 2024
Date and time: 16:30 – 17:40 on Monday, April 15, 2024

<Q&A session>

Q. This is my first time meeting President Ono and President Munemori, so I would like to start by asking them about their aspirations. I am particularly interested in how they feel about their companies' strengths and how they are trying to exploit their potentials, as was included in the new medium-term plans.

Also, we have been communicating with President Kawase for about a year, but I would like to ask him again how he plans to work under the new structure.

A. (Ono)

I believe that there will be more situations in the future where we will have to fight based on the collective strength of the Group. In terms of the Group's strengths, I believe that above all it has a nationwide network of Daimaru Matsuzakaya Department Stores and PARCO stores, which are located in seven key cities, from Sapporo to Fukuoka.

In terms of making firm connections with customers in each area, the Daimaru Sapporo store is now maintaining a very strong position in the north, and this will continue in the future. As I mentioned briefly today, I expect to see significant growth in the future when a new complex is built in Fukuoka and Sakae is to compete as an area in Nagoya. As for the Kansai region, there are some places where there is quite a lot of competition, but we can compete in the "area" of Keihanshin. In the Tokyo area, there are not only department stores, but also unique commercial facilities such as GINZA SIX and Shibuya PARCO. We would like to demonstrate a variety of presence and increase our presence in each area throughout Japan.

Furthermore, I believe that the strengths we have developed nationwide will not only come into play on the demand side, but also on the supply side. We will discover what is attractive in each area, disseminate it, and ultimately disseminate it to the world. We will work together as a group throughout Japan to literally disseminate Japan to the world as J. Front Retailing. This is how we intend to promote the future management of the Group.

A. (Munemori)

I think we have to make sure that we first solve the problems of the Department Store and develop their strengths. Currently, we are enjoying continued good performance thanks to the help of spending by inbound tourists and wealthy people, but I think there are many issues to be addressed.

In terms of customers, first of all, we would like to continue to boost our already growing gaisho sales and inbound sales. On the other hand, as the middle class is seeing a decline in purchasing due to the aging of the population, we would like to attract new customers. In other words, we need to have a strategy to make sure that we attract the MZ generation of customers.

In terms of products, we would like to continue to grow luxury items, watches, and art, which are already growing, this fiscal year. However, they can naturally become homogenized with other department stores.

The company has 15 physical stores, from Sapporo in the north to Hakata, Kyushu in the south. Through the valuable human resources of the employees who work there, we will discover the appeal of local content and firmly bring out the strengths unique to the local areas. For example, there is now a movement to combine local content with luxury items. At the Kyoto store, we actually team up with an Italian luxury brand and a local historical indigo dyer to create original products and new value. That is what we want to do. I think that is also what it means to expand local content.

And the perspective of new content. I mentioned earlier that the challenge is to develop the MZ generation, and I think we need to focus on developing new content to achieve this. Last fall, the company set up a new content development division, and over the past year we have already decided to introduce new content, such as the development of more than 70 brands, and things are starting to move forward strongly, including pop-ups.

In the face of these challenges and crisis of homogenization of department stores, we will create a unique position as a department store. The company intends to focus on creating the value that Daimaru Matsuzakaya is known for, and to further improve its performance.

A. (Kawase)

I was appointed to the current position one year ago, and after a year, I have reaffirmed that the sense of crisis I had a year ago is, conversely, one of Parco's strengths. The sense of crisis I felt a year ago was that we had not been able to create anything interesting or topical for the past three years. Our employees were concerned about not being able to attract people to our stores.

This has exploded considerably over the past year. Young employees have the ability to honestly tell those around them that what they find interesting is interesting, and to involve them, including influencers and creators. Parco's strength lies in its ability to create new cultural value from these connections, such as the one that can be seen at Shibuya PARCO. In terms of management efficiency, there may be more rational ways to use Shibuya PARCO, but I think it has been able to create unique value that cannot be found anywhere else.

Until 2019, there were almost no inbound tourists who visit Shibuya PARCO. However, Shibuya PARCO is now able to capture demand from overseas customers, with over 32% of its transaction volume coming from inbound tourists. The creativity and cultural values of the young generation that we are able to create are finally reaching a level that is comparable to the rest of the world. As Mr. Ono explained earlier, I feel that Parco's greatest potential now is to disseminate this as world-class content or events in the future.

Q. The investment in Tenjin Big Bang will probably continue until around 2030, but when it comes time to "grow rapidly," what segment will accumulate further profits?

Based on today's explanation, I imagine that content is probably important, but I would like to know what you are most looking forward to.

A. (Ono)

In terms of segments, the Developer Business will blossom in 2030 as we make upfront investments, and that will be a milestone.

However, as I mentioned earlier, the key is to generate the Group synergies, and it is a question of how to do this in each area. I am now talking about examples in Nagoya and Fukuoka, but one of the key points is, in terms of software, in what areas we can multiply as a group, including outside the Group, while, in terms of hardware, carrying on store development and reinvestment in other areas.

In doing so, we would like to pick up local content in each area and link it firmly to revenue across the area, overseas, or in the digital domain. We would like to create these two cycles: improving our presence in each area and doing business in new growth areas.

Q. The combined inbound sales of Parco, GINZA SIX and Daimaru Matsuzakaya Department Stores probably amount to over 100.0 billion yen, but when considering overseas expansion, rather than investing in overseas markets, there is the possibility of attracting overseas customers through alliances and earning through know-how and content. What are your thoughts on overseas markets?

A. (Ono)

In overseas markets, I think there are two sides: inbound and outbound. In outbound, the key point is to have content, which I have already mentioned. I think it is a big risk for Daimaru Matsuzakaya Department Stores and Parco to open stores overseas using the current format. For example, by having confectionery content within the Group, we envision doing business in commercial facilities outside the Group, and eventually expanding it overseas. We will create a cycle in which we will sell Japanese sweets locally, thereby raising the profile of the Group locally, and creating a secondary effect when local customers return as inbound tourists. This is the kind of image I have in mind for both MD content and IP content.

On the other hand, it is inbound sales that need to come to fruition in a slightly faster timeframe, but I believe that inbound tourism is an uncontrollable market, so it is essential to make it controllable first.

For this reason, one thing we will do is to work with our overseas partners to mutually refer customers. We do not have any overseas outlets that we invest capital in, and that is why I think we can expand such initiatives in various countries and areas. I think one of the things that we can do is to use such paradoxical strengths.

The other thing is to expand the conversion of visitors to our stores into our customers to include inbound tourists. We would like to strengthen organizational interactions with our overseas partners, as well as respond to and manage individual customers.

Q. Rather than a larger investment in property, plant and equipment for the future, there is an image that investment in so-called intangible assets will increase, including various types of assets such as content, IP, and CVC fund. In this context, when it comes to not increasing fixed costs too much, an equity ratio of more than 30% is sufficient in terms of financial leverage, and in order to aim for ROE of 10% in the future, while also managing equity capital, you should not increase the denominator too much. Within such an overall strategy, I would like to see whether there has been a major change in the way of thinking when looking at financial leverage, or dividing it into investment in property, plant and equipment and investment in intangible assets.

A. (Wakabayashi)

There are some areas where it is not possible to clearly distinguish between investment in property, plant and equipment and investment in intangible assets, but in particular, the 50 billion yen of growth investment quota in cash allocation, which is shown on page 54 of the slide, is centered on strengthening content, as explained by the President. It is an investment that includes the ownership of the content itself, and I think it also falls under the so-called intangible asset investment.

On the other hand, in order to advance the evolution of business, a certain amount of investment will be required in the Department Store Business or the SC Business, and even in the Developer Business. In this diagram, we are currently assuming an investment amount of 125.0 billion yen, with resources based on operating cash flow.

However, this is only an estimate at the moment, and we would like to firmly control our investments from a financial perspective with a view to profitable growth as we move forward with our business, but if we come up with a project that meets our needs, we would like to consider further increasing investment without focusing on cash allocation.

Q. In that sense, is it correct to recognize that the way of investing has changed considerably from the past? Is it correct to say that, rather than investing in stores because you are a department store operator, you decide what is best for the Group as a whole and allocate resources accordingly, with the result that shareholder returns have been considerably increased this time around?

A. (Wakabayashi)

I think that is correct. Rather than simply dividing the amount of investment by segment, for example, in the Developer Business, large investments will be made over the next three years, but these are not just in the area of developer, but we would like to proceed based on the understanding that these investments will have a synergistic effect on the Department Store Business and SC Business.

Q. A share buyback of up to 10.0 billion yen was announced today. At the end of the previous fiscal year, you had 71.3 billion yen in cash and deposits, and looking at the trends in your company's cash and deposits, I think you increased your cash on hand during the COVID-19 pandemic, but in normal times, I think you were able to operate with around 40.0 billion yen.

How much cash on hand do you actually need at present? I think you could have bought back more of your own shares, but on the other hand, an upfront cash out may be made for investments in the current medium-term plan. I would like to know your thoughts on this matter.

A. (Wakabayashi)

I believe that the appropriate level of cash and deposits on hand remains unchanged at around 30.0 billion yen. In that sense, it can be said that the cash and deposits balance at the end of the previous fiscal year was more than 70.0 billion yen, which means that there is a surplus of just over 40.0 billion yen.

A portion of this money will be used for dividends and share buybacks in order to strengthen shareholder returns, but in addition to that, we would also like to use these cash and deposits for capital investment, as mentioned earlier. From the perspective of being more directly linked to revenue, we would like to carefully determine how to use it.

Q. I would like to confirm the amount of investment. On page 55 of the slide, the amount of capital investment for the new fiscal year 2024 is 65.0 billion yen, while on page 7 of the supplementary information to financial results, the amount of consolidated capital expenditures is 44.5 billion yen, or 44.9 billion yen including right-of-use assets. What is the difference? I would also like to know the amount of depreciation for each fiscal year of the three years of the medium-term plan.

A. (Wakabayashi)

Page 7 of the supplementary information to financial results shows the amount of capital expenditures on a capitalized basis, while page 55 of the slide shows the combined amount of capital investment and growth investment on a cash flow basis.

Depreciation is roughly in the range of 25.0 to 30.0 billion yen, excluding the depreciation portion of the right-of-use assets. There will be a considerable amount of new investment, but including the depreciation of that portion, we expect it to be at such a level. Including the depreciation of right-of-use assets, it will be about 50.0 billion yen. (*Partially abridged with additions)

Q. I would like to ask you to give us a picture of the segments in terms of the way the business profit will be generated for the three years. There is a disclosure of segment profits for the final year, but in terms of the way total business profit looks, the bar chart appears to show that the current year's profit will be almost flat and that profit will increase by about the same amount as in 2025 and 2026. On the other hand, there are many events in each segment, such as many renovations in 2025 at PARCO in the SC Business and the opening of the Nishiki 3-chome District 25 Project in 2026 in the Developer Business.

I think there are quite a few ups and downs depending on the business, but if I am correct in that understanding, I would like to know what factors cause the increases and decreases each year.

In particular, if PARCO will undergo many renovations in 2025, and if profits are expected to increase in 2026 due to the Nishiki 3-chome District 25 Project, I think there will be some slowdown in 2026, so I would like to know about that.

A. (Ono)

With regard to FY2025, which you just pointed out, there is a reasonable amount of initiatives and preparations that will blossom in FY2026, so we expect that there will be a tendency for profits to come out significantly in FY2026 rather than a linear increase from FY2024 to FY2025 and FY2026.

One of the reasons for this is the movements in the Nagoya area, and one of them is that the Nishiki 3-chome District 25 Project will be completed during FY2026. The Matsuzakaya Nagoya store will also be renovated in stages. Taking this into account, we assume that there will be a large increase in FY2026. I hope you will understand this.

A. (Kawase)

Shibuya PARCO will undergo major renovations in FY2025. Based on the current strong performance, Shinsaibashi PARCO, which had a tough start due to the COVID-19 pandemic, will also proceed with contract renewals that will lead to major renewals during the same period. There are currently many projects underway at PARCO that will produce results in FY2026 and FY2027, rather than in FY2025

Q. You mentioned synergies earlier, but I have the impression that synergies have not been visible until now. I would like to know if there are any changes that will be made over the next three or 30 years that have not been possible so far.

A. (Ono)

As for the emergence of synergies, each operating company is responsible for its own figures, so even if we talk about cooperation within an area, for example, in attracting tenants, there can be competition for the most popular tenants.

I think it is quite significant that the structure has been renewed at the start of the current medium-term plan. I, Mr. Munemori, the President of Daimaru Matsuzakaya Department Stores, and Mr.

Kawase, the President of Parco, are working very closely together, and we at the holding company and the core operating companies are trying to find a direction of the design of how each area should be dealt with first in the top management discussions.

I believe that this will be clearly effective in each area, close to the site. In some cases, I think that the holding company could take a little more initiative within each area to strengthen management in terms of collaboration within the area.

Going back to the past, there was a time when the Urban Dominant Strategy was launched as a group. I still think the idea was right. Perhaps the strategy was right, but the execution was not accompanied by it. There may have been barriers that made it difficult for synergies to emerge. This time, we are trying to break down those barriers.

Q. When considering the so-called bottom profit of ROE, I think that other expenses such as impairment losses are also relevant, but when I look at the plan for this fiscal year, it seems that this portion is larger.

Going forward, I think there will inevitably be some impairment losses in the medium-term plan, but how do you view costs in this regard?

A. (Wakabayashi)

It is still true that there is a slight difference in the current performance situation between urban and rural stores, whether we look at the Department Store Business or the SC Business. Therefore, certain restructuring expenses will continue to be factored in. If possible, we would like to establish a system and cycle whereby the denominator is not reduced using them, but whereby the appropriate amount of equity capital is set and a profit commensurate with this is recorded. If possible, we would like to establish a system and cycle whereby the denominator is not reduced through the use of such a system, but whereby the appropriate amount of equity capital is set and a profit commensurate with this is recorded.

Although we have not yet envisaged any specific projects for the current financial year, we would like you to understand that the figures have been recorded as a sign that we assess how we will generate revenue, and that we will not take no action at all, but will do what needs to be done with a sense of speed.

End