J. Front Retailing
Summary of Q&A Session at
Results Presentation for the First Six Months of the Fiscal Year Ending February 28, 2025
Date and Time: 16:30-17:40 on Tuesday, October 8, 2024

<Q&A Session>

Q. I would like to confirm the assumptions regarding inbound sales. The figures on page 17 of the presentation material are for the Department Store Business, and I believe they include Hakata Daimaru, but what are the figures excluding Hakata Daimaru, that is, for Daimaru Matsuzakaya Department Stores alone, which is also disclosed in the supplementary information? Also, based on that standard, how do you expect monthly inbound sales in H2?

A. (Munemori)

Duty-free sales for H2 excluding Hakata Daimaru are expected to be 64.5 billion yen. Regarding inbound sales, the growth rate differed significantly between H1 and H2 of last year, so we do not see this as a year-on-year increase. If we roughly calculate the share of Q3 and Q4 in 2019, Q4 is about 33% higher than Q3, because of Christmas, year end and new year holidays, and Chinese New Year. In other words, in terms of the ratio between Q3 and Q4, the weight is placed on Q4.

Furthermore, we expect the number of international flights to increase from the second half of October in particular in Q4, so we expect inbound sales to increase by around 40% from Q3 to Q4.

Inbound sales in the Department Store Business were originally estimated at 7.1 billion yen in September, and ended up at 7.1 billion yen, which is in line with our projections. The first week of October, which falls on the Chinese National Day holidays, ended yesterday with a very good level of average spend per customer. In August, the yen fell sharply, causing the average spend per customer to temporarily drop to around 70,000 yen. However, we believe that once the yen returns to the upper 140 yen range against the dollar, the average spend per customer will recover to around 100,000 yen, and we have made our calculations based on this standard.

Q. On September 24, you revised your earnings forecast for this fiscal year upward, but I would like to hear more details about the increased upfront investment costs and restructuring expenses. At the beginning of the fiscal year, restructuring expenses of 4.5 billion yen were factored in, and did you add about 2.0 billion yen to this amount?

A. (Ono)

We see increased risks, and as you said, we increased restructuring expenses by just over 2.0 billion yen. Inbound sales have been more buoyant than expected for the past six months or more, and sales of our department stores in urban areas have already increased by about 10% compared to pre-COVID-19 levels. Meanwhile, sales of rural and suburban stores are only 80% of pre-COVID-19 levels in FY2019, and we take seriously the fact that a significant gap is emerging between urban and rural areas. Therefore, from the perspective of risk management, I would like you to understand that we added just over 2.0 billion yen as restructuring expenses.

The upfront investment will hit business profit, and we plan to drive efforts worth about 1.0 billion to 1.5 billion yen toward the latter half of this fiscal year. As an example, we would like to make a small step forward by incurring costs with JFR Card, in order to get a head start with the issuance of the new PARCO Card.

Q. Is it correct to imagine that upfront investment based on business profit is basically ahead of schedule?

A. (Ono)

It includes not only bringing forward the portion that was initially scheduled for 2025, but also increasing investment costs to increase the effects. It is not that everything has been brought forward, but please understand that the proportion of upfront investment is large.

Q. You are currently making a focused upfront investment in the Nagoya area, but when will you see results?

A. (Ono)

The effects of the renovations of the Matsuzakaya Nagoya store and Nagoya PARCO will be seen mainly from FY2025. As stated on page 16 of the presentation material, the Matsuzakaya Nagoya store is forecasting a 2.6% decrease in sales in Q3 and a 12.2% increase in Q4. As the renovated floors will be opened one after another from mid-November, the effect on sales will start to increase in the latter half of this fiscal year.

However, as for the completion in the area as a whole, since the commercial facilities at The Landmark Nagoya Sakae are scheduled to open in FY2026, most of the benefits will be realized during FY2026, but the effects will be maximized in FY2027, when the area will be in full operation. We believe that it is important to have such hardware aspects be combined with software aspects in order to produce a coordinated effect.

Q. On page 31 of the presentation material, is the profit increase of approximately 3.0 billion yen a comparison between FY2026, when it will be in full operation, and FY2023?

A. (Munemori)

The renovation of Matsuzakaya Nagoya store itself will involve some closures during FY2025, so considering the full opening of the main building of the Nagoya store, I think figures for FY2026 will be the most straightforward.

Q. Regarding sales to Japanese customers at your department stores, they have been steadily increasing after the COVID-19 pandemic. Will this upward trend continue in the future? I would like to know your current outlook on this matter.

A. (Munemori)

Regarding the status of “cash” and “credit” sales excluding inbound sales at our department stores, cash sales increased by 1.0% year on year, which is a little slower than the 3.6% growth we forecasted in April. Excluding some technical factors in sales posting, the actual growth is about 1% slower than we had expected.

Credit sales increased by 6.8% year on year in H1, showing stable growth. Looking at the details, among wealthy customers, sales to the highest rank of customers who spend more than 10 million yen a year, known as SS rank customers, have been growing, and sales recorded on the day of a VIP event held in H1 to serve our top-ranking customers increased by 1.8 billion yen compared to the previous year. We believe that our proactive approach to the wealthy is having an effect. Therefore, we expect gaisho sales to continue to grow by about 6.8% in H2. In order to further accelerate this growth, we have already begun to renovate the lounge at the Nagoya store, and in 2H we plan to do the same at the Kyoto store and Hakata Daimaru to considerably strengthen services for the wealthy.

On the other hand, in terms of strengthening measures to grow the middle class, the renovation of the Matsuzakaya Nagoya store will mark the start of our efforts. We will replace and refurbish 61% of existing women’s clothing brands, which are products purchased by the so-called large number middle class people and have not yet returned to sales levels of FY2019 before the COVID-19 pandemic. Once this effect is realized, I believe that we will be able to establish an approach to reach the middle class, which we should adopt in the future. I hope you will look forward to the effects of the renovation of the Nagoya store, which will open form November onward.

Q. On page 43 of the presentation material, you say that you will prioritize investments for growth, but I understand that you originally established a growth investment quota in the medium-term plan announced in April, and that the plan was made with a certain amount of investment destinations in sight, including real estate. Going into this issue in more detail, can you tell me a bit more about what areas you plan to target for growth investment, or what areas you plan to consider in the future?

A. (Ono)

In terms of the contents of the medium-term plan announced this April, one of the aims is to expand the retail business as a “united area” by leveraging the Developer Business while steadily evolving the existing retail business. The other, as I have already mentioned, is that we will own content and create a new vision for retail business. We would like to focus our growth strategy investments, including M&A, toward this goal. We believe that our investments will be used to evolve our existing retail business, including the Developer Business, and to prepare for the content business.

Q. In that sense, do you mean that you have not changed your thinking qualitatively, but have made it clear that you will spend more money in such areas?

A. (Ono)

That is qualitatively true, and quantitatively we have started with a policy of setting and managing a growth investment quota of 50.0 billion yen. However, with regard to the allocation of cash generated in excess of the initial plan as a result of improved performance, we would like to prioritize investments with an eye to the future and step on the gas for medium- to long-term growth, while also considering a balance with returns based on our policy of a dividend payout ratio of 40% or more.

Q. Parco does not expect gross sales to increase much in H2. However, even at the beginning of the fiscal year, you said that sales would not increase much, but I think that the company made a big contribution to the upswing in performance at the two upward revisions. I would like you to explain why gross sales are not expected increase much but costs will be spent in H2.

A. (Kawase)

We expect sales, or transaction volume, to increase in H2, but it will be five years since Shibuya PARCO opened in November 2019. We expect the renovation of Shibuya PARCO to have a large impact, including the impact of closures during the renovation, and we still plan to increase sales, so we are by no means bearish.

Q. Conversely, if there is a change in tenants, would it be fair to say that rent levels will rise?

A. (Kawase)

Naturally, for us it's a matter of supply and demand, so we would like to set the rent appropriately depending on the situation.

Q. With the 40% reduction in the floor space of the Daimaru Umeda store, I am tempted to say what the previous expansion was, but will the reduced portion be returned or subleased? It is in competition with Hankyu Umeda and appears to be in the toughest situation among your large urban stores, but to what level do you intend to increase profits?

A. (Munemori)

The Umeda store, Hankyu Umeda, and Hanshin Department Store are located next to each other, and Isetan also entered into the same area, which was referred to as a department store war at the time. The Umeda store’s floor space was approximately 40,000 square meters, but it was expanded to 64,000 square meters, and introduced unprecedented merchandise and tenants, some of which were under fixed-term leases, in an effort to gain a foothold in the Osaka trade area. After that, as the number of commercial facilities in the area has increased enormously, and partly due to the COVID-19 pandemic, the content of sales at the Umeda store has changed significantly over the past few years.

In light of these changes, we are still examining what will be inside the renovated store so I cannot comment, but we would like to create a store that stands out among the department stores in the Umeda area. In order to develop a department store model that is different from previous models, including merchandising and presentation, we decided together with the JR Group and other partners that it would be ideal for us to operate the 2nd basement floor to the 9th floor.

Q. In that sense, when JR Isetan Mitsukoshi located in Osaka Station was closed down, shops on its sales floors were gradually replaced by JR’s specialty shops, and is it similar to this?

A. (Munemori)

The changes won't be that great. We will continue to operate the 2nd basement floor to the 9th floor. With large-scale developments underway in the surrounding area, the key point is how to work together with JR to revitalize the South Gate Building. We are currently in the process of having thorough discussions with each other to decide on the size of the floor area that should be used and the content that should be included.

Q. Since you expect business profit to decrease in H2 and strategic investments are included in this figure, I would like you to explain the details of what you added this time, particularly with respect to renovations and other items.

A. (Ono)

We plan to make upfront investments of, or invest upfront costs of approximately 1.0 billion to 1.5 billion yen based on the business profit impact. Regarding renovations, we have to consider our suppliers, so we cannot do anything too dynamic in a short period of time. We will invest expenses in promotion that will not end with a temporary effect, such as the investment to acquire new PARCO Card members, as mentioned earlier. We are also considering using the funds to make up for the areas where we have not been able to do so far, such as facilities for employees and safety and security measures, although they are not very large amounts. Please be aware that what we had thought would have to be implemented at some point after FY2025 will now be carried out ahead of schedule in FY2024.

Q. Earlier, you explained domestic sales divided into cash sales and credit sales, but roughly speaking, what percentage do you expect to be for duty-free sales and sales to domestic customers in H2? You expect inbound sales to triple, while sales to domestic customers are expected to only slightly increase, which looks like a cautious estimate, and I think you actually have a buffer there.

A. (Munemori)

I don’t have the figures at hand right now, so I will let you know later. I think it was probably a little over 3%.

*Gross sales (excluding duty-free sales) of the Department Store Business: +3.1%

Q. Regarding the Umeda store, are you planning to basically operate it as a department store on your own? Or are you considering strengthening the operation model such as a fixed-term lease? Before its reopening, I got the impression that your strategy was to strengthen fixed-term leases and seek stability in order to limit the downside. After its reopening, I feel that the strategy has changed to one of trying to capture the upside by operating as a department store. It may have been a change in strategy under the former management, but I would like to know, if possible, which of the two could be the basis of your thinking for the Umeda store.

A. (Ono)

We, as a group, have been pursuing a hybrid of department stores’ conventional so-called *uriage-shiire* (purchase-as-sold transaction) business and fixed-term lease business, but this does not necessarily mean a shift to fixed lease, as you understand. However, we intend to maximize the profit of the Umeda store by trying to make the best of the situation. We may adopt an *uriage-shiire*-type approach for products with high profit margins and sales, and a fixed-term lease-type approach for areas with low profitability but high customer attraction. While following this basic approach, we intend to make use of the hybrid know-how we have developed at the Daimaru Shinsaibashi and other stores. I cannot give you a specific answer at this time, but please look forward to it in the future.

Q. I would like to confirm your thoughts on the revision of the medium-term plan that will be released next spring. I believe that the medium-term plan announced in April showed that profits would increase by about the same amount in FY2025 and FY2026. The slides this time show that you will actively renew your cards and introduce a common system for the entire Group, while also revealing that you are about to start reaping the benefits of the renovation of the Nagoya store, and that construction work will also begin at the Umeda store. Do you still expect profits to increase in stages, or are you prioritizing steady growth in

FY2027 and beyond, and placing emphasis on investment in FY2025 as you do this fiscal year, so that we can expect the overall benefits to come in FY2026 or beyond?

A. (Ono)

I think we need to take a close look at the external conditions in the next six months, including the points you just mentioned. My intention is to accumulate profits in stages. In our initial announcement, a business profit target for FY2024 was 44.5 billion yen, with no increase from FY2023, and we planned to build up profits in FY2025 and FY2026 to reach 52.0 billion yen.

In today's announcement, we have indicated that we expect to achieve the medium-term plan in the first year, but we would like to first determine how much of the success is due to our management efforts so far and how much is due to a tailwind from the external environment, which I often refer to as a "windstorm." Then, over the next six months, we plan to forecast the impact of the House of Representatives election, the presidential election, trends in the Chinese economy, and the situation in the Middle East, and determine what numerical targets we can aim for toward FY2026.

To conclude, I would like to say that growth projects are moving forward, such as in Umeda, Fukuoka, and the south building of the Shinsaibashi store, but they will not finally come to fruition until around FY2030. In that sense, I think the basic approach will be to increase overall current profits while carefully managing upfront investments for the future.

End