

Overview of Q&A Session at Analysts Briefing for Q1 FY June 2023

This document provides an overview of the Q&A session at the analysts briefing for the second quarter results. Questions and answers have been edited for clarity.

Q1. Was the improvement in gross profit largely due to PB/OEM results? How about the progress of other measures? Also, what were the results or effects that made it possible to say that it is possible to accelerate the cycle of PB/OEM?

A: We have also been working on previous measures beyond PM/OEM, such as optimizing inventory. When we say it is possible to accelerate the cycle of the PB/OEM, we mean that it has become possible to gain the cooperation of stores in the aspect of store creation and design. There is also improved understanding about product development for PB/OEM. We have managed to focus on the shelf allocation and placement for PB, OEM, and NB respectively, even down to the sub-categories, and the preparations are complete.

We are continuing with efforts to control inventory, but partly due to seasonality, we are placing the emphasis on the period from the second quarter to the fourth quarter. In the aspect of inventory control, we have successfully reduced inventory of more than 10 billion yen in domestic retail stores, and a little less than 24 billion yen in existing domestic stores. Overseas, inventory is at an optimal level although its value is increasing as the result of new stores and the impact of exchange rates.

Q2. For the Asia business in which products are shipped from Japan, I get the impression that sales can increase more due to the yen depreciation. Even taking into account factors such as the impact of cannibalization and the backlash from the previous year, is it still too early to consider drawing a discontinuous growth curve?

A: While it may be possible to aim for discontinuous growth against the backdrop of yen depreciation, the cost burden of logistics expenses and selling, general, and administrative expenses are rising significantly. Time and money will be expended on controlling the consolidation of indirect departments overseas and strengthening systems. Consequently, we will aim for discontinuous growth in the future.

Q3. What kind of developments are you considering for the export of Japanese agricultural products, including PPIC initiatives?

A: In the long-term, we think that the export of Japanese agricultural products will increase.

However, partly due to bottlenecks on the producer side, we will move forward while engaging in consultations with producers and the government. Apart from Singapore and Hong Kong, which are free ports, we will face difficulties with exporting these products. However, we aim to overcome these problems in the medium-term.

Q4. Which are the areas that were especially successful in the first quarter? Are there any areas of concern?

A: After the easing of movement restrictions, sales increased in the non-food categories for PB/OEM and boosted sales composition ratio as compared to the previous year. Growth was centered around food products and consumables in the previous third and fourth quarters, but it is focused on non-food products in the current period.

We are making positive progress toward the Guidance. Breaking it down, the domestic Discount Store Business is driving growth so we can say that it has been especially successful, but other areas are also performing well.

Rather than concerns, one of the future issues that we are working on is the development of products that can be shifted significantly to PB/OEM on a category basis. We are reaping great rewards in the development of PB/OEM on a single-product basis. Following from that, we believe there is room for increasing PB/OEM composition ratio by shifting categories such as miscellaneous household goods and apparel to PB/OEM.

Q5. Concerning human resources goals, what do you anticipate from the new management system, and what messages are you sending out to the executive officers?

A: Under the new system, those in their mid-40s are involved in the top management. This is not just about the importance of rejuvenation; we will take time so that the next generation can actively take on higher positions and be involved in decision-making. When it comes to overcoming weaknesses in the retail business, it is rational for those who have more than 20 years of experience in our company to take on central roles in sales and to manage the business.

As the company has expanded rapidly, there is no sure-fire method for winning. Hence, we will delegate authority starting from this stage while focusing on the next generation. There is a need to create, within the sales departments, a mechanism that allows the organization to expand without becoming too complex.

Q6. North America registered a decrease in profits for the first quarter. According to the Guidance, it is necessary to increase profits by as much as 2.5 billion from the second quarter onwards. What is the outlook for Q2 and beyond?

A: Profits are expected to increase in the North America business, with the increase split evenly between Gelson's and others. We originally expected an increase in gross profit as a driving force. In addition to improvements in gross profit, we will focus on efforts to control costs.

Q7. In North America, was cost control an initiative that was added during the fiscal period?

A: It is an initiative incorporated in addition to the initiatives we had originally envisioned, in order to cope with changes in the external environment. We will explain the details in the second quarter.

Q8. What is the percentage of duty-free sales in the Discount Store Business in October? What are the differences with duty-free sales compared to the past, and how is the reaction to recovery?

A: Sales composition ratio has recovered to approximately 1%. Compared to 2019, prior to the COVID-19 pandemic, it has recovered by close to 20%, and is growing further in November. Duty-free sales are directly impacted by the number of arrival and departure flights at local airports, so recovery has been observed in Tokyo, Osaka, and Fukuoka.

Q9. With the resumption of inbound tourism, what do you think is the potential for inbound demand?

A: While it is advisable not to expect too much during the current period, we consider this very important in the medium-term, and will continue to implement measures in line with this stance as we did before. In the interim, we will revive the inbound team and move forward steadily with preparations with many new leaders and new employees.

Q10. Concerning the improvement in gross profit, what are the contributions of the respective factors such as PB/OEM, seasonal factors, product composition, and reduction of slow-moving inventory?

A: Looking at the Discount Store Business, gross profit improved by about 1.5 points overall, and PB/OEM accounted for half of that. The remaining half was the effect of other factors including

seasonal factors and pricing. With regard to PB/OEM, the effect of increasing composition ratio, along with the effect of gross profit improvement for PB/OEM itself, each accounted for half of the improvement.

Q11. Will the contribution of PB to gross profit improvement remain the same in the future, and will we continue with the disposal of slow-moving inventory?

A: The increase in the disposal costs for slow-moving inventory started from the third quarter of the previous fiscal year. In the current period, we made progress with disposal, and it has the effect of driving down gross profit. Throughout the current period, we will move forward with inventory disposal at a higher rate than in the previous period, so this will also be carried out in the second quarter.

The gross profit effect from PB/OEM is progressing slightly higher than budgeted for in the first quarter. Going forward, if we can return to progress in line with the budget, the effects may cool off.

Q12. Concerning the MD issues in the GMS Business, are there issues with the accuracy of pricing at this point? Also, what kind of initiatives will you implement for the integration of MD in the Discount Store and GMS Businesses?

A: The MD for the GMS Business is not in a satisfactory state and requires changes. In fact, gross profit is increasing and pricing is effective in producing results, but we do not think it is acceptable to remain in this state. Individual store management is difficult for those who have no experience in procurement if they do not go straight through to MD, so there is a need to create a system for the headquarters to follow-up. It is important to transform MD in order to identify the ideal vision in response to the question, "What is GMS?" The merging of accounts is a decisive process for MD, and we will make the judgement on the approaches to the mix and PB with a view to carrying out the process in a cross-cutting manner.

Q13. Do you envision the MD integration for the GMS Business to proceed in line with the plans for the GMS Business, or will the measures be able to aim above that?

A: First, we aim to achieve the Guidance for the current period. To achieve the Medium-Term Management Plan, we must gain the customers' understanding of GMS and further strengthen our business.