MARUI GROUP Co., Ltd.
Financial Results Teleconference for the 3 Months Ended June 30, 2019
<Questions and Answers＞

Q. It is believed that the profit decline in the Retailing Segment was caused by the tough overall consumption environment. I believe it is necessary to keep an eye on future profit downside risk factors, such as poor performance in consignment sales floors. What is Marui's view?

A. The consignment sales floors is no longer a significant portion of our overall sales floors, but one of the main factors behind the fall in profits was poor performance at self-operated specialty stores. We have been reviewing the return profile of these self-operated specialty stores and are proceeding to convert more of their space into SC type fixed-term rental contract space, thus we believe the negative impact here should become somewhat smaller in future. In addition to terminating some of our product categories, we are also considering to operate new categories, such as animation business.

Q. Regarding poor performance at self-operated stores, were there any particular product categories where performance was below your expectations?

A. Virtually all categories performed poorly.

Q. The company's annual EC Division target called for ¥0.5 billion increase in profits, but profits fell YoY, how was the business situation different to your assumptions?

A. Sales trends in EC were tough, particularly the fall-off in sales with existing clients. This is because we over-focused on promotional efforts aimed at new clients, such as issuance of discount coupons. Going forward we also need to pay attention to our existing customer base, with the aim of enhancing our stock-type business with them. If we fail to get our existing customer base to keep using our EC site repeatedly, we believe it will be difficult to change the challenging situation.

Q. Until last year the company was saying the Platform Business was recovering on a pick-up in orders, but just looking at the First Quarter results the situation does not look as good, what happened?

A. Historically fashion retail related store refurbishment was the main area of business, and demand from this area is now weakening, resulting in a negative impact on the First Quarter performance. However, we are assuming performance will gradually recover, as we are expecting some Olympics related demand to start appearing in the second half and we expect some projects linked to capital alliance formed with Sumitomo Forestry in July will also start appearing in the second half.

Q. It seems that in certain aspects of the Retailing Segment, including the EC business, is not performing as well as Marui expected, but does the company remain confident about meeting the Full-Year Targets for ¥1.6 billion profit increase YoY in the overall Retailing Segment by reviewing cost control efforts?

A. We are now considering various measures in order to meet our full-year targets.

Q. Looking at quarterly rent income trends, they fell to ¥10.6 billion quarter-on-quarter. Given your "value-up" strategy (gradually replacing existing tenants with better tenants) why should rental income fall?

A. Even for SC type fixed-term rental contracts there is a limited proportion of rental income linked to the sales performance of the tenant. The quarter-on-quarter fall in overall rent income is coming from the decline in tenant sales performance related rent collection portion.

Q. Given the latest Retailing Segment performance it has become apparent that despite success in shifting most of sales floorspace to SC type fixed-term rental contracts and reduction of exposure to apparel tenants, a tough overall consumption environment still can cause profits to fall in this segment. What does Marui think about this situation?

A. Within the Retailing Segment we see weakness in self-operated stores and EC business as the main problems, thus require counter-measures. As you have pointed-out we are deeply concerned that Retailing Segment earnings fell due to negative impact from the external environment.

Q. I believe the level of interest repayments have not changed much compared to last year, but compared to the previous fiscal year-end, how were claims and actual repayment amount trends?

A. In the First Quarter, interest repayments were ¥1.0 billion. Claims trends have not changed. There has been no additional provisioning in the First Quarter as trends are proceeding largely in-line with what we assumed when we made additional interest repayment provisions back at the time of the fiscal year ended March 31, 2019. However, we will monitor the level of claims, which is a forward indicator, and decide whether any future action is required.

Q. The negative impact from "Eliminations / Corporate" has expanded and was actually a factor behind the YoY decline in overall profits. Last year the negative impact here was due to new business investments and adjustments to intra-group interest rates, what were reasons for the negative figures in the First Quarter?

A. Like last year there was an increase in personnel costs linked to new business projects and some consulting fees. Furthermore, we have newly established an IT R&D Division so related research and development costs appeared.

Q. Is it correct to assume that the increase in SG&A expenses are being controlled within management plans? There are no cost transfers between segment as seen last year are there?

A. Correct, no cost transfers between segments have been booked.

Q. Looking at operating profits by the Retailing Segment and FinTech Segment separately, how did they respectively perform versus management's internal plans for each in the First Quarter?

A. We only make segment-based operating profit plan for the full year, but based on progression rate versus our Full-Year Targets, the FinTech Segment is seeing a similar progression rate trend to last year, whereas the Retailing Segment is lagging. We believe the issue we need to address is tough conditions in the Retailing Segment we experienced in the First Quarter.

Q. As much of the transition to SC type fixed-term rental contacts has been completed, I believe it becomes necessary to think about overall sales trends at each Marui and Modi store. I believe overall store sales have previously been rising, but what is the trend now?

A. Overall store sales are growing YoY but not as much as seen last year, while some individual shops are seeing flat YoY sales, so we consider store traffic footfall and store transaction trends to be healthy.

Q. It was mentioned that Marui is concerned about the Retailing Segment performance, can you tell us what specific counter-measures are being planned?

A. We will continue convert poor performance self-operated stores space into SC type fixed-term rental space for tenants. Replacing poor return self-operated stores space with fixed-term rental tenant shops will have a positive impact on profits. Also, we are considering the transfer of employees belonging to self-operated stores into new business divisions. We will invite more digital native brands to open brick-and-mortar shops within Marui stores and as these digital native brands often have no off-line retail experience, so Marui retail staff can support their off-line shop operations. Services such as the off-line store operation outsourcing business we started with Wacom should increase in future. We would like to seek new business opportunities utilizing our existing know-how pool. Meanwhile in our own EC operations, the area of weakness was addressing existing customer needs, so the improvement focus will be there. Until now almost all purchases were through browsers rather than apps, but our app should become operational in September. By increasing app members, we believe various measures to encourage repeat purchases by existing customers becomes possible.

Q. I believe EC transactions were growing 5~6% YoY last year, what was the growth rate in the First Quarter?

A. The data is provided on Page 12 of our latest FACTBOOK. EC transactions were 92.4%, which indicates sales fell 7.6% YoY.

Q. The fall-off in EC sales was very sudden compared to growth trends seen in the past. Was it only due to excess focus on new clients, or were there any other extraordinary factors involved?

A. There were no major extraordinary factors. Previously we developed new brands and that resulted in new client increases. In the First Quarter, only a few new brands were introduced, thus sales fell as a result.

Q. It was mentioned that there was a negative impact of ¥0.3 billion on Operating income stemming from the amortization of accounts receivable. But is it correct you are assuming a positive impact of ¥2.0 billion for the entire year?

A. The total impact of accounts receivable liquidation, including profit on sale and expected amortization should be a positive impact of ¥2.0 billion.

Q. It will depend on the timing of accounts receivable liquidation but over the course of the remaining three quarters there should be a cumulative positive impact of ¥2.0 billon?

A. That is correct.

Q. As indicated on Page 11 of the FACTBOOK the combined total transaction of Store and Web in the First Quarter increased by 0.9% YoY. Meanwhile revenue for the Retailing Segment fell by 10% YoY in the First Quarter, so the gap is large. Is the sudden sharp YoY fall-off in EC sales only due to less traction with existing clients or the overall product appeal ability deteriorating? Perhaps customer traffic remains strong but average spending levels have fallen? Please provide more details.

A. The main reason for the poor EC performance was the fall-off from existing clients, but one of the factors behind this was poor PB (Private Brand) trends. We consider the deterioration of product appeal was also involved.

Q. Due to the transition to SC type fixed-term rental contacts customer traffic at Marui and Modi shops have increased, despite this Retailing Segment profits fell YoY. Perhaps the reason is management de-prioritized PB product sales, but these products sold through self-operated stores floors actually still have a big impact on the bottom line?

A. Yes, we believe what you mentioned is one factor for the profit decline.

Q. Total transaction value of the Retailing Segment (Store and Web) rose 0.9% YoY but revenue fell about 10% YoY. Can this discrepancy be explained by the sharp fall in EC and self-operated stores sales alone?

A. The big reason is the fall off in EC and self-operated stores sales. Furthermore, transaction values vary by category, thus the overall correlation between total transaction value and revenue trends is beginning to weaken.

Q. Regarding interest repayments, levels fell significantly in the First Quarter of last year as it coincided with the closure of a large law firm (involved in reclaiming excess interest payments for their clients). After that regional banks and other banks started to tighten their lending policies so I suspect more of your consumer loan clients are defaulting. Depending on how the situation unfolds I fear that further provisioning for loss on interest repayment will be required. What is your view? How are actual trends in July?

A. As you mentioned, due to the issue of the big lawyer office closure the year before last, the level of claims were falling until the First Quarter. Thus we need to see if there is a backlash impact and closely monitor whether claim levels remain flat YoY or begin to fall and take appropriate action.

Q. In the Retailing Segment, you explained that self-operated stores was being converted to fixed-term rental space for tenants and to house animation and other new business operations, but given that space renewal is seasonally concentrated in February and August will there be significant progress during this financial year? Or is any positive impact going to be concentrated in the next financial year?

A. The shift to fixed-term rental space for tenants should have an impact from this financial year. We mention animation business earlier, but please understand what we meant to say was new business categories like animation could potentially utilize the converted space. Contribution from new business categories is likely to occur next financial year and beyond.

Q. The FinTech Segment, particularly the Service Business seems to be undershooting growth projections made for the full year. Transactions were up 25% YoY in the First Quarter so somewhat lower than 29% growth assumed for the full year. Service revenues were up 14% YoY in the First Quarter so short of 24% growth assumed for the year. I believe the main source of business here is rent guarantees, please provide an update on the Service Business and explain if business here is running behind plan.

A. We consider overall the FinTech Segment is proceeding in-line with target in the First Quarter, as it should be noted that our Full-Year Targets includes net add-on of ¥2.0 billion from the sales of liquidated operating receivables. The Service Business mostly comes from rent guarantees. In the rent guarantee business, joint efforts with our partner ABLE Inc started in earnest only from May and the business is seasonally concentrated in the Third and Fourth Quarter, thus has a bigger impact towards the end of the financial year. Given these factors we think Service Business will perform virtually in-line with Full-Year Targets.

Q. Please explain the growth rate discrepancy between rent guarantee transaction value and rent guarantee revenue.

A. Rent guarantee transaction value is equivalent to rent payment, while rent guarantee revenue is fee income received. Fees are a percentage of rent payment, but the rate varies by business agent, so the average fee rate for the business is affected by the agent mix.

Q. In regard to active membership of EPOS cards, the active ratio (usage within past one year) on a YoY basis has fallen compared to the previous fiscal year-end for last year. Is this just a natural result of a pick-up in new cardholder acquisitions, or does it represent signs of some negative underlying trends?

A. The short answer is we don’t see a problem. The factor affecting active ratio is the fact that the level of card cancellations has fallen rather than a pick-up in new cardholder acquisition. Churn has fallen to 80% of previous levels due to extension of expiry date of card membership by one year. Taking this into account, the active cardholder ratio relative to total cardholders looks to be stable.