MARUI GROUP Co., Ltd.

Financial Results Briefing for the Nine Months Ended December 31, 2022

<Questions and Answers>

Q. First-half gross profit for the Retailing segment was ¥400 million, but the third-quarter result was a ¥200 million loss. Why was that?

A. Firstly, affiliate company performance. Segment gross profit was down ¥100 million year-on-year in the first half and decreased a further ¥300 million in the third quarter. This was mainly due to the struggles of the store interior design business of AIM CREATE Co., Ltd. Store/Web gross profit was also down slightly in the third quarter. As we're currently in the process of closing down our directly managed sales floors and replacing them with event spaces and fixed-term rental contract tenants, non-operational floor space is increasing. This, in addition to the impact of store closures, led to decreased Store/Web gross profit in the third quarter.

Q. I imagine store closures also lead to cost reductions. Would it be right to say that profit is up because you've been able to offset reduced revenue through the ¥2.8 billion reduction in expenses?

A. Yes. The reduced revenue due to store closures is being offset by the reduction in expenses.

Q. E-commerce seems to have stabilized at last. What kinds of items are selling well?

A. Cosmetics and anime-related items are seeing year-on-year sales growth. The impact is not very significant, however, since the weighting of those items is low. Sales have basically grown across all categories.

Q. What's your outlook for e-commerce? Do you think the upward trend will still continue, or do you think growth will settle down for a while at around the 16% level seen in the third quarter? We would like to know what your feeling is.

A. E-commerce traffic is growing due to our SEO measures, and I believe that in addition to that, the proportion of visits leading to sales is increasing due to UI/UX improvements. Since we'd hardly implemented any SEO measures at all previously, the impact is very significant and I think the current trend will continue for the time being.

Q. Would it be right to say that, even though the weighting of anime-related sales is still low, SEO measures are turning the category into a hook attracting more traffic, and that MARUI is finally becoming able to leverage its unique strengths in the e-commerce sector?

A. Yes. While I think the anime category has further growth potential, it's certainly already helping to attract more traffic.

Q. Listening to the FinTech results briefing, I felt that a lot of good results have been achieved. For example, while issuance costs for "cards tailored to each individual's interests" aren't very high, a range of KPIs, including the balance of receivables, are showing steady improvements. In light of this performance, the profit increase in real terms of ¥200 million seems quite small. How should we view this?

A. We're certainly seeing growth in credit cards with low per-unit issuance costs, such as "cards tailored to each individual's interests". Since the overall number of cards issued is increasing, however, issuance costs are up significantly year-on-year. Installment and revolving payment transaction volume hadn't grown much since the start of the pandemic, but it started to grow from around the start of the current fiscal year. There's a lag between transaction volume growth and revenue growth, so that delay also creates discrepancies. Profit growth has been modest in the current fiscal year due to substantial upfront costs, but I think that from the next fiscal year we'll enter a cycle of steadily increasing revenue growth.

Q. You said that performance through the third quarter was generally in line with forecasts. When subtracting cumulative third-quarter results from full-year targets, it can somewhat be assumed that the Retailing segment's fourth-quarter operating income could meet the target. For FinTech though, it looks like significant fourth-quarter profit growth would be required. In addition, if Eliminations/Corporate remains at the same level seen through the first three quarters, I think you'll have to strive even harder in the fourth quarter to reach your target for consolidated operating income.

A. Yes, as you say, without additional efforts we believe it will be difficult to reach our targets. We won't be implementing some of the cash reward measures we implemented in the fourth quarter of last fiscal year, and we expect this will reduce costs. Each fourth quarter, rent guarantee revenue also expands. When you also take into account a number of further cost reductions and other initiatives, we believe our targets are sufficiently achievable, and that's why we've left our forecast unchanged.

Q. Are there any elements of Eliminations/Corporate that can be improved in the fourth quarter?

A. Not in particular, so we expect it to keep trending at the current level.

Q. I understand third-quarter FinTech operating income was up ¥200 million in real terms when excluding the ¥700 million in extraordinary factors outlined on page 16 of the presentation materials—namely liquidated accounts receivable and size-based business tax. Meanwhile, it's also stated in the presentation materials that cumulative third-quarter FinTech operating income was ¥600 million when excluding extraordinary factors, but the second-quarter materials stated that first-half cumulative operating income was ¥700 million. Does that mean FinTech recorded a loss in the third quarter? If so, I'd like to know the reasons for the difficulty. Can we simply conclude that third-quarter results were below target, or should we see it more positively as a transitional phase the segment just happened to be passing through?

A. The extraordinary factors on page 16 relate to third-quarter results only, not cumulative results. So, you simply need to subtract them to see that there was a third-quarter profit increase in real terms. Regarding liquidated accounts receivable, for example, the ¥300 million decrease is the year-on-year decrease compared with the third quarter of the previous fiscal year. That is, results for the three-month period rather than cumulative results. Having said that, it's only a ¥200 million profit increase in real terms after excluding those extraordinary factors, so, as you suggested, the increase was small. Factors behind this included an increased weighting of card issuance costs within variable expenses, and a delay in the build-up of installment and revolving payment receivables, the transaction volume of which is growing. Although revenue and profits will expand from the next financial year onward, we believe upfront costs are quite large this financial year.

Q. I think it was mentioned that, although the cost of issuing "cards tailored to each individual's interests" is lower than for ordinary cards, the number of cards issued to new cardholders was higher than expected, and the associated upfront costs were higher than anticipated. Would it be correct to say that, even after the end of the third quarter, the number of cards issued to new cardholders and the associated costs are also higher than expected?

A. Although we factored issuance costs into our forecasts to a certain extent, the costs expanded beyond our expectations. “Variable expenses ②” on page 15 of the presentation materials is card issuance costs, and this was up ¥1.9 billion year-on-year, which we view as a significant factor.

Q. Retailing segment results show that cost-cutting alone had a positive ¥2.8 billion impact. Actual profit from the segment’s core business is down year-on-year in real terms. I believe the reason for this is, as has been explained, that the amount of non-operational floor space has increased as you’re still in the process of transitioning to new tenants. Would it be safe to assume that the amount of non-operational floor space will rapidly decrease from the next fiscal year onward, or will the current situation continue through the first half?

A. A large proportion of the cost reductions is reduced personnel costs resulting from our withdrawal from directly managed sales floors. That also led to decreased revenue, and the decreases in revenue and costs were roughly equivalent. Therefore it would be more accurate to say that the cost reductions were large because of our withdrawal from directly managed sales floors, rather than to say that the situation would’ve been difficult for the segment without cost reductions.

Q. I think sales floor area decreased because the core business struggled. How long will this situation continue?

A. The closure of directly managed sales floors is scheduled to be completed by the end of the current fiscal year. I think the amount of non-operational floor space will start to decrease from that point.

Q. Although transaction volume grew 17.6%, revenue from fixed-term rental tenants declined ¥70 million. The full-year target was a ¥690 million increase to ¥39.0 billion, so a mere 7% slide results in a decrease in revenue of about ¥4.0 billion. Could you please explain the relationship between transaction volume and revenue?

A. We’re making progress with our transition to fixed-term rental contracts, and the number of fixed rental income tenants—which has no relation to transaction volume fluctuations—is increasing markedly. That impacts the amount of floor space under fixed-term rental contracts as well as perstore revenue. We are generating transaction volume, but I think it needs to be looked at separately from revenue. It's not the case that revenue necessarily increases because transaction volume increases or decreases because transaction volume decreases.

Q. It was mentioned that meeting operating income targets involves not only fixed-term rental revenue, but also cost reductions. How do you view that? Also, do you think that fixed-term rental revenue for the full year will only reach about the same level as the previous fiscal year, and what do you think will happen in the following fiscal year?

A. Although the amount of non-operational floor space is up year-on-year, it will decrease to the year-earlier level between now and the end of the fiscal year, so we think we'll be able to hedge fixed-term rental revenue and gross profit at the beginning of the next fiscal year. However, in the current fiscal year it's resulted in reduced revenue, so we can't expect an increase in fixed-term rental revenue even for the full year. Therefore, we'll work on achieving operating income targets through cost reductions and other measures.

Q. Would it be right to say that revenue figures were weak even when excluding the impact of non-operational floor space?

A. I think the figures were somewhat weak from the first half through the third quarter.

Q. Is it not the case that the figures are weak because the number of "stores that don't sell" has increased?

A. I believe it's more due to the fact that tenant leasing didn't quite keep up with the normal expiration of fixed-term rental tenant leases in addition to the closure of directly managed sales floors.

Q. When MARUI abandoned the consignment sales system and transitioned to fixed-term rental contracts, a gap existed between your ideal situation and reality for about a year and a half, but ultimately it turned out well. Now you've made a similarly significant decision, this time to scrap all directly managed sales floors. Do you think there's a gap between your vision and reality again?

A. We ought to have leased out the space vacated as we scrapped directly managed sales floors, but we didn't have sufficient resources to do so, resulting in an increase in non-operational floor space, and I think that's the issue.

Q. Do you think you'll be able to recover from that from the next fiscal year onward?

A. The personnel responsible have told me that we're finally catching up so I'm not concerned at the moment.

Q. Weren't FinTech results weak compared to third-quarter targets? Growth of card shopping transaction volume at affiliates was sluggish in November and December, as monthly performance report figures clearly showed. I personally feel that this might be the reason for the weak results, although it contradicts the explanation from MARUI. I think one reason why results for November and December were weak was the impact of mild temperatures in November. In the retail sector, many companies were impacted by the mild weather, so the card shopping transaction volume figures make sense. On the other hand, the performance of many companies recovered in December. Could you explain the background to the sluggish growth in your monthly FinTech figures?

A. Please look at page 17 of the presentation materials. In the third quarter of the previous fiscal year, COVID-related restrictions on activities were eased, consumption rapidly increased, and "card credit" transaction volume was up 14% year-on-year. Because of that, the year-on-year increase is lower this fiscal year than that 14% increase or the 20% second-quarter increase, but compared to pre-pandemic 2019, the results were up 44%, even higher than the second quarter results, which were up 39%. It only looks like performance is trending downward because of that strong year-earlier performance, and I don't believe growth was sluggish.

Q. From here on the hurdles to beating the strong year-earlier results will rise substantially. Would it be fair to say we can't really expect a return to 20% increases?

A. Last year's figure was also high at 16%, so with current trends I don't think the increase will be very high, but we're moving ahead with measures relating to rent and other areas, and we intend to achieve an increase as close as possible to 20% as we can.

Q. I have a question about FinTech cash reward costs. The number of new cardholders in the third quarter didn't change much on a quarter-on-quarter or year-on-year basis, but cash reward costs increased quite a lot on both a quarter-on-quarter and year-on-year basis. Was that due to new sales promotions or enhancements in areas other than new cardholder acquisition?

A. Our Gold and Platinum Cardholders are eligible for bonus points, and the number of such cardholders is increasing, so I believe that's the reason for the increase in cash reward costs.

Q. Would it right to assume this won't only be a third-quarter increase and the cash reward cost increase will remain above the previous level?

A. It's linked to the number of Gold and Platinum cardholders, so if the number of such cardholders increases, cash reward costs will also increase.

Q. Overall SG&A expenses appear to be trending slightly above forecast. Is that due to higher-than-expected sales promotion expenses like new cardholder sign-up points and Gold cardholder points? Also, if you subtract the "other" figure under SG&A expenses in the Factbook for the three months of the third quarter, it's up about 60% year-on-year. Could you please explain that also?

A. The increase in cash reward costs is a major reason why overall SG&A expenses are up. Also, the weighting of utility costs has increased slightly this year, and I believe that increase has had an impact. The "other" costs include "taxes and dues" and "financial expenses" among other things, and the increase was due to the negative ¥400 million impact from the size-based business tax, which I explained on page 16.

Q. I think this was raised in the second-quarter Q&A session, but service revenue seems to be trending substantially below the Medium-Term Management Plan target. I've heard there are few new properties and growth in relocation figures is sluggish, among other factors. Could you explain the divergence from the target? Do you think growth of around 10% would be acceptable if the current trend continues in the next fiscal year and beyond? I'd like to hear your outlook for the next fiscal year onward.

A. The reason for that is sluggish growth in new acquisitions in the "rent guarantee" component of service revenue. We're currently assigning a lot of personnel to work on advancing new acquisitions, and I think the situation will have improved somewhat by the end of the fiscal year. In addition, from the next fiscal year onward we'll be pursuing partnerships in this area, so we're implementing measures to facilitate a return to the previous growth rate.

Q. Would it be right to say you've got your sights on a growth rate higher than 10%? In the range of about 20% maybe?

A. During the period covered by the current management plan we're aiming for around 20%.

Q. I understand that initiatives such as "BNPL by Epos" and "Epos Smartphone Cards", which were mentioned in the second-quarter result briefing, were launched from the second half. How has the response been so far?

A. We haven't promoted the Epos Smartphone Card very much yet, but we're already seeing a significant number of signups. We also started small with "BNPL by Epos", but as expected there's already a large number of customers using the service. Only about 10% of those customers are Epos cardholders. We're proactively implementing measures aimed at increasing the number of Epos cardholders through the service.

Q. Would it be correct to assume that younger non-cardholders are using the service, meaning there's future potential for boosting cardholder numbers?

A. Yes. And with regard to Epos Smartphone Cards, we're also expecting 230,000 people to register this fiscal year. This is more than expected given that we haven't particularly promoted the service. Roughly 10% of "Lifestyle" app users have already registered, so we're also looking to implement measures to boost this percentage as well.