

“We Need to Structurally Change the Framework of Department Store Business at This ‘Historic Turning Point.’”



Tsutomu Okuda, President and CEO

Overview of operating results for fiscal 2008

Q Would you outline consolidated operating results for fiscal 2008?

A Consolidated sales of J. Front Retailing Group slightly increased compared with the forecast announced at the third quarter results presentation in January 2009 (an increase of ¥690 million and 0.1%). Thanks to the efforts to further reduce costs, operating income, ordinary income and net income increased by ¥3,090 million (12.4%), ¥2,990 million (11.8%) and ¥1,170 million (19.5%) respectively. However, that resulted in a fall of 6.9% in income and only reduced the range of decrease in operating income, ordinary income and net income.

The main cause of poor results is sluggish sales of department stores that account more than 70% of the total sales of the Group. Sales and operating income of department store business decreased by 7.0% and 36.6% respectively for the full year and dropped by 11.0% and 49.7% respectively for the second half of the year because a decline in consumer confidence was further accelerated and sales of clothing, branded accessories and big-ticket items, which have been the strong items of department stores, were poorer than expected. Particularly, a great slump in sales of the main stores in Shinsaibashi, Kobe and Nagoya affected the performance.

These are partly due to rapid changes in the macro environment, but the greater cause is the structural factors of department stores. We acknowledge that department stores are at the very “historic turning point.”

Department stores at a “historic turning point”

Q What is behind the fact that a department store business model is facing a “historic turning point” ?

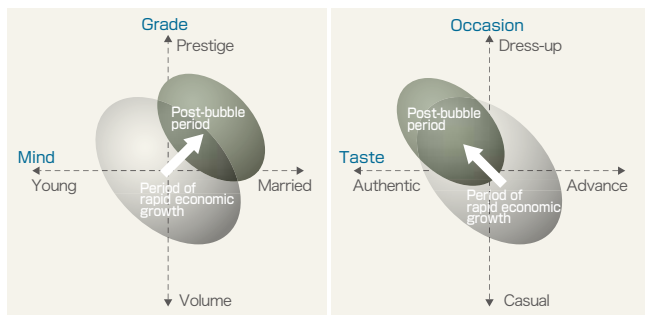
A The structural issues of department stores — “weak market response capabilities and high-cost structure” — have two main causes. One is “weak marketing mind as business quality and fundamental marketing strategy error.”

“The goods on their shelves moved well without making an effort” in the period of rapid economic growth, which created the “supplier-dependent quality of companies” with weak “change response capabilities,” “outer-directedness” and “thinking power.” Department stores in Japan are different from in Europe and the U.S., and particularly, they differ radically in a business model from the U.S. department stores. Due to their basic business structure, the sales activities of Japanese department stores have been based on popular appeal and targeted a wide

range of customers in terms of age, income and lifestyle.

With a view to catering to customers' various demands, their prices ranged from low to the highest and their product lineup included fashion, living and food products for occasions ranging from casual to dress-up to formal and with tastes varying from authentic to advance. At the same time, they have survived by responding to the changing times and customers and the characteristics of the local market and taking advantage of small inventory risk while balancing well and changing flexibly the weight of each of these factors.

However, after the bubble economy heyday in the late 1980s, they lost balance and they were excessively shifted to "high prices" and "clothing, the middle-aged, high-income persons, authentic and dress-up." That made them rigid and weakened their response capabilities to changes in consumers' values and lifestyles.



Changes in merchandise mix from the period of rapid economic growth to the post-bubble period

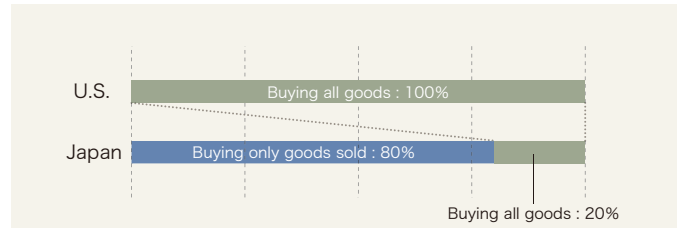
Q Do you mean that department stores themselves moved away from the "public" ?

A As a result, department stores lacked variation and individuality for consumers and "went beyond their reach" with high-priced offerings and little dailiness.

The second cause is "Japan's unique forms and ways of operating sales floors."

Unlike in other countries, department store sales structure in Japan is very unique. It consists of "shop operation type sections" with a sales share of 80% where the purchase of most goods is recorded only when they are sold and "independent operation type sections" with a sales share of 20% that are operated in American retail way of "purchasing and independent selling."

These two operation forms seem almost the same for



Difference in sales operation forms between Japan and U.S.

customers. Seen from the viewpoint of corporate management, however, they are "close but not the same." They are greatly different in "business operation process, the division of responsibilities and authorities between suppliers and department stores, merchandise information system, personnel planning and distribution, knowledge and skills required for staff and profit structure centered on margins and costs."

They also significantly differ in the concrete ways to respond to changes in the market. "Shop operation" type sections respond at the brand level while "independent operation" ones at the item or SKU level. Partly due to the historic background of Japanese department stores, however, the distinction between these two operation types remain unclear and they have been mixed up as if they were the same. This is one of the major factors that caused "weak market response capabilities" and "high cost structure" with low human productivity.

In addition, since fresh and attractive products that customers want and the items and brands that "sell well" in department stores generally have low margins, it is difficult to introduce them in the high cost structure. It caused a vicious cycle between the "poor assortment of items and brands that customers want in department stores" and the "high cost structure," which led to "loss of customers."

The performance of department stores will never recover until these structural issues are resolved, even if the economic environment improves in the future. We believe that we will see a completely different landscape when we go through a tunnel of the current global recession.

Development of new department store business model

Q What new department store business model will you develop to resolve these issues?

A In the second half of last year, J. Front Retailing initiated a full effort to develop a new department store model with a focus on the “improvement of marketing capabilities” and the “innovation of business operation structure” to revive department stores.

Our target image of a department store is an “urban lifestyle store” that adopts a new operation model.



For this purpose, we will basically shift our focus from the past “merchandising-driven retailer type” to the “creation of the appeal of stores as commercial facilities centered on marketing.” We will “widely define customers, merchandise mix, price structure, tastes and occasions” based on “popular appeal” and “lifestyle proposing industry” as the fundamentals of department stores to determine their weights according to changes in customer needs and regional characteristics.

We will develop clear strategies for individual stores that place top priority on competition strategies in the local markets and effectively combine the factors including “merchandise, brands, software and hardware services, sales promotion and sales floor environment” based on these strategies to “create attractive stores that customers choose to visit.”

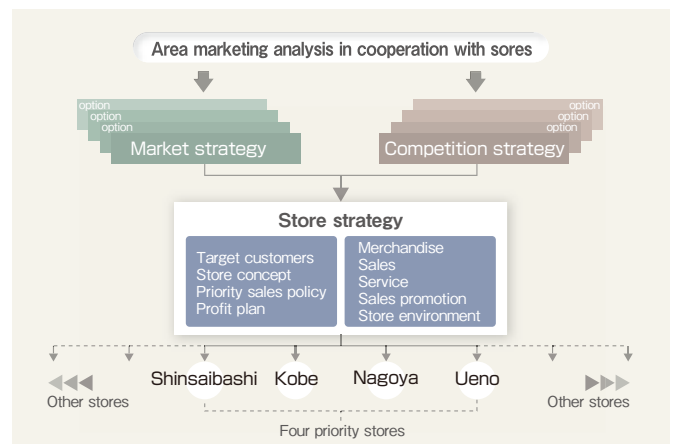
In the meantime, we will focus on “quick response to the changes of the times” by always providing fresh information and suggestions, “appropriate fashionability,” “good taste,” “acceptable prices,” “high quality services” and “exciting sales promotion” as well as further leveraging the strengths of department stores including “security, safety, high quality and trust.” At the same time, we will establish a “business operation structure that can realize them with high efficiency and at low cost.”

“Improvement of marketing capabilities and establishment of store strategies”

Q Would you specify the improvement of marketing capabilities?

A **Development of new store strategies**
In order to meticulously respond to changes of customers on a daily basis, we need to clarify store strategies to define “to whom, what and how we should offer,” that is, what products and services we should offer in what store environment and with what sales promotion to respond to what customer demands through regional analysis and increase competitiveness.

In developing store strategies, we will specify the target customers, store concept and image, priority sales policy and profit plan of each store. By integrating sales activities including products, sales, services, sales promotion and store environment in line with store concept, we will create step-by-step unique and competitive stores that fit the regional characteristics.



Particularly, we attach importance to “quantitative” analysis with a combination of the three axes such as “age, income and lifestyle” as well as traditional qualitative analysis to analyze and define target customers. We will “widely” determine the target customers of each store by weighting according to regional characteristics. And each sales department will offer finely-tuned products and services to meet the demands of each target customer cluster.

New customer classification = Age × Income × Lifestyle

	Young	Around 30	Around 40	Around 50	Around 60	Senior	
High consumer							×
Upper consumer							
Medium consumer							
Standard consumer							
Lower consumer							
							Advanced class
							Active class
							Conservative class

We are developing new store strategies for priority stores including Daimaru Kobe and Shinsaibashi stores and Matsuzakaya Nagoya and Ueno stores, and then other stores.

The market research of our stores revealed many problems in responding to the market. For example, though more than 60% of people who visit Shinsaibashi area in Osaka are 35 years old or younger, Daimaru Shinsaibashi store fails to attract many of them with the shares of sales on Daimaru-branded cards to its customers in their 30s and 20s of 16.5% and 7.8% respectively. Though Daimaru Kobe store has many identifiable customers aged around 30, the number of which accounts for 23% of the total, their sales share is 16%, seven percentage points lower. The purchase rates of cosmetics and confectionary are high, but that of women's clothing is as low as about 30%. While analyzing these actual conditions and reflecting them in store strategies, we will set a timeline to remodel and improve merchandise mix, assortment and pricing policy.

Q

Customers' purchasing channels are not only real stores but their choices are diversified. Among them, Internet sales seem important.

A

Click-and-mortar business

The strengthening of Internet business is essential to attract customers who do not shop in our stores and to increase sales of the products that are not offered in our stores.

One of our unique approaches is an Internet cosmetics shopping site "Marucollet." Traditionally, department stores have dealt in top brand cosmetics. But the survey of customers' buying behavior revealed that they skillfully use cosmetics from department stores and others. Therefore, we launched a new business "Marucollet" in which we find excellent cosmetics, which complement the ones sold in department stores, and offer them to the customers of department stores.



<http://www.marucollet.jp>

Its sales are still small in total amount but have been growing on a doubling pace since it started in fiscal 2007. Using the infrastructure of this business model, we are expanding into

women's accessories and other merchandise categories.

The number of customers registering their email addresses with Daimaru, with whom we can communicate through the Internet or cell phone text messages, is rapidly increasing and already exceeded 300 thousand persons. Thus the sales base interconnecting the website and stores is expanding.

Q

The fiercer competition becomes, the more important "customer retention" seems to become. How will you address that?

A

Strengthening of regular customer strategies

Currently, Daimaru and Matsuzakaya have more than four million "identifiable" customers in total who hold their company-branded cards. The expansion of customer base and the strengthening of effective CRM (Customer Relationship Management) are one of our important tasks.

Sales from customers who hold Daimaru-branded cards account for about 70% of total sales from individual customers and Daimaru will improve CRM based on the cardholder information infrastructure, which is excellent in terms of both quality and quantity as the company's main strength, and the know-how to get regular customers. At the same time, Daimaru will improve and thoroughly implement its efforts to create, develop and retain regular customers.

Matsuzakaya will introduce Daimaru's systems and know-how and use the information system dramatically improved through integration to strengthen regular customer strategies that the company had hardly addressed in the past.

We will strengthen the interaction with store marketing strategies to increase the number of the high priority target customers and other regular customers of each store, while upgrading and bolstering our efforts to implement regular customer strategies including the improvement of the card usage rate and the sales rise to the top level.



Establishment of store operation structure that enables both stronger market response capabilities and low-cost management

Q Specifically, how will a business operation structure change in the future?

A **New store operation**
Daimaru is leading JFR's effort to "establish a new business operation structure" mainly for stores. Under this new structure, sales floor operation is divided into two types including "shop operation" and "independent operation" to be based on their respective different features.

	Shop operation	Independent operation
Sales share	About 80%	About 20%
Operation type	Buying only goods sold (No merchandise risk)	Buying all goods and sell independently (Some merchandise risk)
SCM plan and management	Supplier	JFR
JFR's major roles in operation	<ul style="list-style-type: none"> ● Extracting and solving issues by brand in each SCM process with shop managers to increase sales ● Local operation by stores ● Scrapping and building brands and shops 	<ul style="list-style-type: none"> ● Merchandising = Headquarters ● Sales services = Stores ● Central operation ● Detailed and quick response to changes by item or SKU
Profit margin	Medium to low	High
Cost	Low	Medium

In "shop operation" type sections, suppliers plan and manage the whole process of SCM (Supply Chain Management), and basically, the purchase of goods are recorded only when they are sold and the company assumes no responsibility for inventory. Though their profit margin is low compared with independent operation type sections, they are low cost and highly profitable. Their sales account for about 80% of the total. Stores operate them locally. Managers in charge of these sections work with "shop managers" from suppliers to effectively extract and solve issues on a brand-by-brand basis in each SCM process with the main goal of "increasing sales."

In "independent operation" type sections, the company plans and manages SCM. All the goods are "purchased and independently sold" to achieve high profit at high margin and high cost. Their sales mainly from private brands and independently selected items offered in non-partitioned open space account for about 20% of the total. While stores provide sales and services, the operation of merchandising is centralized in the headquarters. Since they can reflect the company's intention in the whole SCM, they aim at agile operation to differentiate themselves from competing stores, develop people, complement the products that are not offered in shops, and flexibly and quickly respond to changes.

Q How will sales floor arrangement change?

A We will arrange sales floors by highlighting the strengths of and effectively combining these two operation types centered on shop operation type and based on the floor classification tailored to new customer needs. Utilizing the strengths of department stores such as "good location, large floor space, huge customer base and advanced information system connecting the customer base, strong customer drawing power and high reliability," we will introduce new shops and brands that actively respond to customer needs without being constrained by the existing suppliers.

Mainly in the sale of goods and other areas including restaurant business and services, we will improve the response to new market by accelerating the renewal and replacement of brands and shops through the introduction of the best ones that will attract attention and popularity from customers, and the mix and scrapping and building of brands and shops. Thus we will always maintain and enhance the appeal of our stores as commercial facilities.

As part of these efforts to "establish a new store operation structure," our stores already began to introduce new shops to their shop operation type sections without being limited to the existing suppliers to bolster "low- to mid-priced offerings," which are in particularly strong demand from customers. Independent operation type sections also try to increase the reasonable priced products of men's wear brands Trojan and Velocé and career women's wear brand Sofuol by using the advantages of being able to respond quickly to customer needs.



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Human resources development, business operation manual and improvement of support systems

Q If operation changes, will the required human resources also change?

A Under the new store operation, we have to mix shops and brands most effectively always in the interests of customer needs and profitability to keep our stores attractive and lively. That requires “highly skilled professionals,” “the compilation of operating procedures in a manual for efficient operation” and “the improvement of information systems supporting the streamlining of operations.”

Required expertise differs greatly between shop operation type and independent operation type. While independent operation type sections focus on “sophisticated merchandising capabilities and the capabilities to sell out products,” shop operation type sections emphasize “producing capabilities and counseling capabilities.”

“Producing capabilities” are to optimally combine and integrate various goods of popular brands and shops, services, sales promotion and store environment under the leadership of store managers to make the stores more attractive. “Counseling capabilities” are that our managers work with shop managers from suppliers based on the counseling program to help “increase sales” by analyzing the actual situation of the performance, assortment and sales structure of each shop.

Q More expertise and efficiency of business operation will be required to implement these and how will you support stores?

A The counseling program as an operating procedures manual serves as important data that can be used to decide to replace shops and brands as well as helping develop and revitalize shops.

To this end, we introduced to Daimaru’s six directly managed stores a sales productivity analysis system to be used for the operational management and counseling of shops in April 2009. The same system will be introduced to Matsuzakaya stores successively in and after September 2009.

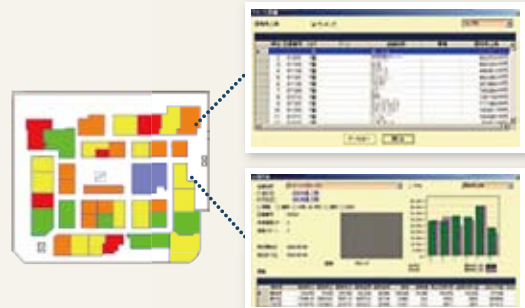
With one click, this system visualizes the data necessary for evaluating shops and counseling, including each shop’s daily sales, number of customers, per-customer sales as well as monthly sales per square meter, “deemed profit” calculated by deducting costs from earnings, and customer service satisfaction in service surveys. It enables us to see the situation at a glance.

Managers will use this system to improve counseling capabilities and management efficiency and shops will be supported and replaced to revitalize sales floors, which we expect will lead to sales growth.



Development and introduction of sales productivity analysis system

- Enhance the capabilities of counseling shops
- Improve management efficiency
- Introduced the system to Daimaru’s six directly managed stores in April 2009 and will introduce it to Matsuzakaya in September 2009



Promotion of low-cost and high-efficiency management to increase human productivity

Q The management of sales floors will also change.

A The shift to a new department store business model will significantly change our sales floor operation management.

As a profit and loss model by sales floor operation type, we will operate shop operation type sections flexibly to respond to customer needs and achieve a good balance between earnings and costs instead of focusing on profit margins as excessively as in the past, while in independent operation type sections, which was high margin and high cost, we will structurally reduce costs keeping profit margins high so that both sections will be able to achieve high profits.

Coupled with the above-mentioned overhaul of sales floor operations through a new approach, we are planning a drastic overhaul of business operations, organizations and personnel planning at a company-wide level including out-of-store sales, general affairs, human affairs, accounting and other administrative support sections when Daimaru and Matsuzakaya are integrated into one company in the next fiscal year. And thereby we will aim for highly productive department store operation by a few select people, which involves changes in our way of thinking and working.

Integration of Daimaru and Matsuzakaya into one company and integration of their merchandise

Q What effect is expected by integrating Daimaru and Matsuzakaya into one company?

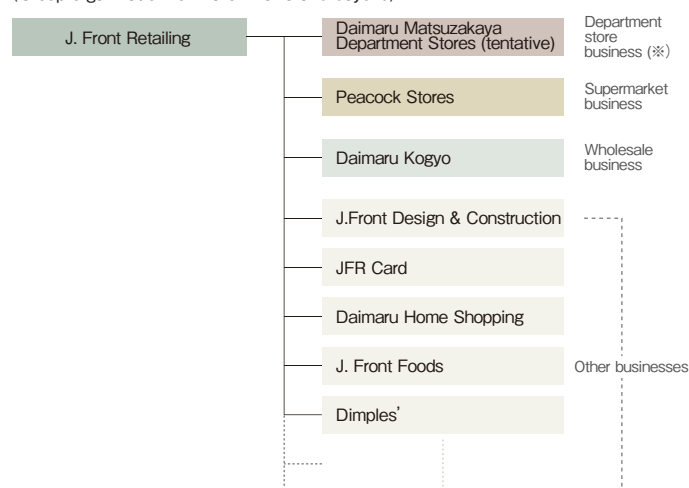
A The “integration of Daimaru and Matsuzakaya into one company” as one of the main pillars of our business structure reforms will be carried out in March 2010, a year ahead of the original schedule. This will unify the management implementation structure and speed up decision-making, as well as significantly reducing duplication of organizational functions, with the aim of achieving high-efficiency and low-cost management.

We are also in the process of integrating the merchandise of the two companies. Following the integration of women’s accessories and children’s wear departments in March 2009, women’s wear departments, men’s wear and accessories departments and foodstuff departments will be integrated in September 2009 and the integration of the remaining home furnishings departments and art work, kimono and jewelry

departments will be completed in March 2010.

The complete integration of merchandise under one company is expected to produce great results in terms of sales activities, including supplier policy and product development through scale expansion, and in terms of costs and productivity, including the streamlining and downsizing of purchasing organization.

< Group organization for March 2010 and beyond >



※In addition, Hakata Daimaru, Shimonoseki Daimaru, Kochi Daimaru and other companies will operate business as subsidiaries of the new department store company.



Outlook for fiscal 2009

Q Fiscal 2009 remains unpredictable and what is the financial outlook for the year?

A Consolidated performance for fiscal 2009 depends on department store sales. Honestly, it is very difficult to forecast our business for the year under these economic circumstances. Department store sales for fiscal 2009 are expected to be ¥745.7 billion (a decline of 10.8% from the previous year) because a sharp sales drop for the second half of fiscal 2008 will recover in the second half of fiscal 2009 but the consumption environment will remain severe.

Since we will reduce selling, general and administrative expenses by ¥10.3 billion from the previous year by strictly

controlling expenses without sanctuary, operating income is projected to be ¥6.5 billion.

Sales of supermarket business, wholesale business and other businesses are forecasted to be ¥127.5 billion, ¥75.5 billion and ¥87 billion respectively, whereas we expect operating income to be ¥0.9 billion for supermarket business, ¥2.9 billion for wholesale business and ¥2.1 billion for other businesses.

As a result, consolidated sales and operating income are expected to be ¥990 billion and ¥12 billion respectively. On a consolidated basis, we will invest ¥64 billion mainly in big projects for the future including the new annex to Daimaru Shinsaibashi store, which will open in November 2009, and Daimaru Umeda store whose floor space will increase by 1.6 times in spring 2011.



Shareholder return

Q What do you think about profit distribution to shareholders?

A Our basic policy is to divide up profits appropriately with a dividend payout ratio of 30% in consideration of its profit level, future capital investment and cash flow trends while maintaining and improving sound financial position. We also consider stock buyback from time to time to improve capital efficiency and implement capital policies in a flexible manner.

For fiscal 2008, comprehensively evaluating the performance for the year and the business environment, we have decided to decrease a term-end dividend by ¥1 from ¥4.50 for the previous year to ¥3.50 and pay an annual dividend of ¥8 combined with an interim dividend of ¥4.50. That results in a dividend payout ratio of 59.0% for the year. However, excluding the effect of loss on valuation of investment securities caused by the unexpected rapidly deteriorating stock markets, it is 32.5%.

For fiscal 2009, comprehensively evaluating the interim and term-end earning forecasts in the largely unpredictable business environment, we will omit an interim dividend and pay a term-end dividend of ¥6.