Q&A session on results for three months to November 2006

You can view text of the main questions asked on January 11, 2007 about our business results for the three months to November 2006. Part of the content has been edited for the sake of brevity and clarity.

Q1: You said that you failed to achieve your initial targets for first quarter operating income at the domestic UNIQLO operation due to ‘unusual weather patterns’. But were there any other unforeseen factors on the product or operational side for instance?
A1: I think that unusual weather was the main reason for the below forecast result. For instance, in October, there were days when the temperature exceeded 20 degrees, hence sales of autumn, and winter goods too, were extremely slow. Last year we experienced a shortage in some of our winter garments in December. So, this year, we had set up our autumn/winter sales structure to ensure that we had a good month’s worth of winter stock on hand. However, after the goods failed to sell very well in October, we decided to instigate early aggressive bargain sales and also to offload inventory at the same time. As a result, while we ended up suffering on the profit front in the first quarter, our aggressive discounts in November successfully attracted customers, boosting our existing store sales by an extremely high 8% year on year, and pushing overall net sales in the first quarter above our initial estimates.

Q2: You have revised your first half forecast for operating income at the domestic UNIQLO operation, but can you tell us the actual revision breakdown for the first and second quarters?
A2: Operating income in the three months to November 2006 fell short of target by roughly ¥1.0bln. For the three months to February 2007, we have already seen a slight fall off in existing store sales in December, and our gross profit margin has also fallen below initial forecasts. Therefore we have revised expectations for the second quarter as well. Our overall revision for operating income in the first six months to February 2007 is down ¥3.9bln compared to the initial forecast.

Q3: Can you tell us the level of inventory at the domestic UNIQLO operation at end November 2006?
A3: Inventory at the domestic UNIQLO operation at end November 2006 stood at ¥37.2bln, an increase of ¥4.2bln or roughly 12% on the previous year’s level. We do not feel that this level of inventory creates any problems.

Q4: Can you tell us the gross margin forecast for the three months to February 2007?
A4: If you take the actual result for the first quarter away from the revised first half estimate, then you will come to the same figure, but we are predicting a gross margin for the three months to February 2007 of 45.0%, down 0.7 points year on year.

Q5: This is a question about the relationship between stock levels and gross margin. We know that net sales at existing stores for the month of December were down 3.3% year on year. And there is a strong possibility that inventory levels in December were fairly bloated compared to end November. Just how far have you factored in the impact of discounting to offload that inventory (namely a deterioration in gross margin)?

A5: Gross margin in the first quarter fell 1.6 points year on year following our aggressive sales promotion in November and expanded discounting to offload inventory. We have incorporated the sales and inventory position in December into our revisions for gross profit margin in the second quarter. We don't expect the gross margin in the second quarter to deteriorate as far as it did in the first quarter year on year. To talk in a bit more detail, since existing store net sales fell in December, gross margin also fell somewhat below forecast. However, we will continue to run down inventory as planned in January and February. And assuming we can achieve sales in line with forecast, then we now expect gross margin to be only slightly lower than initially forecast.

Q6: You have not changed your initial forecast for gross margin of 47.6% (up 1.2 points year on year) for the second half of the business year, the six months to August 2007. How do you plan to generate this improvement in second half gross margin?

A6: We feel that there are 3 main reasons to expect an improvement in gross margin in the second half of the business year. Firstly, we are not thinking of the second half gross margin in terms of improving on the first half level. Rather, we view it as returning gross margin to original forecast levels. We have fully analyzed the reasons for the fall in gross margin during the autumn/winter seasons (first half), and we plan to use this analysis in the spring/summer seasons (second half). Secondly, since the sales structures, and products, are so different for the autumn/winter and spring/summer seasons, we do not believe that a fall in gross margin in the autumn/winter period will necessarily directly affect spring/summer performance. So we are looking to maintain a high gross margin by reviewing and carefully reconfiguring our whole sales business. Thirdly, by offering greater value-added products, we believe that we can cap the amount of discounting required. For those reasons, we feel that we can achieve our initial forecast of 47.6% for gross margin in the second half through August 2007.

Q7: You say that you are going to introduce higher value-added products in the second half, but does that mean that you have to do even more on the planning front in the second half?

A7: In the first half we received high acclaim from our customers with our popular SKINNY jeans and down jackets, etc. One by one, we want to introduce even more products that can draw strong support from our customers.

Q8: I'd like to ask about revisions to your g.u. operation. You haven't changed your full year forecast for 50 new stores but you have revised down your expectations for net sales from ¥9.6bln to ¥5.3bln. Can you tell us the reasons behind this revision?

A8: As you can see in the table on slide number 23 of your handouts that explains our store opening plans, we are planning to open 25 stores in the first half and 25 stores in the second half, and we expect to achieve our initial full year forecast for 50 g.u. stores. The reasons why sales fell below target were that we failed to attract as many customers to our stores as planned, and, in actual fact, more women made up the customer base than initially expected. That led to a gap in the product line up. We have already put measures in place to improve these factors. And we are looking to rectify the sales situation in the second half by changing the product make up and manufacturing more attractive garments for this market. We are also looking to tighten management of SG&A costs even further to generate incremental improvements in profitability at g.u..

Q9: Are you making any changes to the development of g.u. from next business year onwards?
A9: In view of the current circumstances, we are considering making gradual adjustments to our store opening plans from next business year.