

Analysts' Meeting Q&A

Business Results for Fiscal 2018 first quarter (September to November 2017)

Below are questions from our analyst's meeting concerning business results for the first quarter of FY2018. The answers have been edited for clarity.

Q1: In the first quarter results, you mentioned how the weakening of internal exchange rates was putting upward pressure on cost of sales. However, in the latest securities report, you state your one-year dollar-yen exchange rate is hedged at 104.90. Do you expect the weakening in internal exchange rates will have run its course within 12 months? Also, are costs rising at Chinese sewing factories?

A1: Takeshi Okazaki, Group Executive Vice President & CFO – There has been little change in the cost of sales trend for UNIQLO in Japan since I discussed this previously. At that time, I said that we would experience a continued high cost percentage for just over one year. Some time has passed since then, so we are now likely to experience a high cost percentage for just under a year. The high cost percentage is affected by the exchange rate, but strip that out and you can see that the cost of sales is not rising that rapidly. Once the weakening trend in the yen runs its course, I expect the cost percentage will improve.

Q2: You said first-quarter profit at UNIQLO Japan “far exceeded your expectations” while you described UNIQLO International’s profit performance simply as “exceeding expectations.” The year-on-year rise in profit at UNIQLO International was considerable, so had you already factored in a large first-quarter profit gain for that segment?

A2: CFO Okazaki – Yes, it does. We expected UNIQLO International to generate high profit growth as the main pillar of future Group growth. In contrast, we were not firmly optimistic about the outlook for UNIQLO Japan at the start of the business year, and that is why the first-quarter result was able to outstrip expectations to such a large extent.

Q3: Business cost ratios at UNIQLO International have been improving year on year for some time. Has that positive benefit now run its course, or do you expect further improvement?

A3: CFO Okazaki – We have been following a clear ongoing strategy for transforming our business cost structure, and the medium-term benefits of those changes are gradually starting to show through. However, there is still much left to do and plenty of room for further improvements in business cost ratios. For instance, we can improve cost ratios by pursuing greater efficiencies in the inventory to net sales ratios, and we can reduce costs further by simply changing our purchasing methods. I believe we still have plenty of room to cut business costs further going forward.

Q4: You reported considerable improvement in cost ratios at UNIQLO International in the first quarter, but was this improvement uniform across regional operations? For instance,

how did progress compare in Southeast Asia and the United States?

A4: CFO Okazaki – I believe we were able to improve business cost ratios evenly across all regions in the first quarter. It is fair to say that we started from a fairly low launch pad in the United States, so we have certainly witnessed some solid improvement there. However, even in regions such as Greater China, South Korea and Southeast Asia that have already reduced costs, we were able to achieve the forecasted additional improvement in first-quarter business cost ratios. Reforms to our business cost structure have enabled us to reduce business costs. Additionally, strong sales and more sophisticated crucial commercial skills such as better inventory management and more accurate sales planning, have also helped improve business cost ratios.

Q5: Can you update us on your progress with the Ariake Project? Are you improving distribution costs and overall efficiency, and can you now cite some concrete benefits of the Ariake Project to date?

A5: CFO Okazaki – The Ariake Project is essentially a companywide transformation conducted over a medium-term horizon, so it covers broad, cumulative reforms ranging from soft changes in the way we work and cooperate across the Group to hard changes in terms of radically new systems and new warehousing. Over the past 18 months, we have made great progress on embracing radically different working styles. For instance, coordinated communication between departments has greatly improved. We have improved business accuracy by getting our merchandising, marketing and R&D departments to work out of the same office, as a single, unified team. By adding the production and distribution teams, we have been able to effectively coordinate sales and distribution planning, and link production planning and actual production. We are also starting to experience better coordination between UNIQLO's global operations. Previously, the Tokyo global headquarters conducted central management, and was tasked with introducing proven successful business methods from Japan across international operations. Today, we have a firm cycle in place in which central senior management teams hold weekly business reviews with management from individual UNIQLO international operations and make improvements. That system is now starting to produce positive results. Our individual business operations are more accurate and efficient.

As we complete the hard reforms of our systems and warehouse holdings, the Ariake Project will really come into its own, achieving systematic, large-scale operations. The project is less than half way through in practical terms, and less than a third of the way through compared to what we actually want to do. That said, we are already experiencing the positive benefits and are enthusiastic about the project.

Q6: You said UNIQLO Japan not only enjoyed extremely strong demand in the first quarter, but that solid levels of Winter inventory also contributed to firm sales. Could that be seen as a sign of the nascent success of the Ariake Project?

A6: CFO Okazaki – Naturally, you need to hold sufficient inventory of strong-selling products, but

our business has been faring well thanks to improvements in the accuracy of volume planning, and our ability to carve a solid position while controlling risks. I believe the Ariake Project is starting to bear fruit, and, given we are pursuing the project globally, we are also starting to see the benefits emerge in operations such as UNIQLO Greater China and UNIQLO South Korea.

Q7: Could you clarify progress regarding your digital strategy and any problems you are experiencing, especially relating to GU's pilot fashion digital store? Do you intend to introduce this concept across GU stores, and maybe also at UNIQLO?

A7: CFO Okazaki – The GU digital store is doing well, but successful digitalization is not just about expanding the store's digital equipment to other stores. The aim of our digital strategy is to create stores that are easy to shop in, and to encourage customers to shop online via smartphone. The GU store is a pilot scheme designed to progress those aims. We are currently ascertaining what methods we want to introduce across our store network.

Q8: Your distribution of online purchases suffered various setbacks last year, but what issues are you currently facing? Your systems crashed during the bumper UNIQLO Anniversary Sale in November. What exactly was the problem?

A8: CFO Okazaki – During the UNIQLO Anniversary Sale, we experienced significant problems with both distribution and IT, which caused inconvenience to our customers. In terms of IT issues, the sheer speed and concentrated volume of access requests to our website took us by surprise. System performance was greatly compromised, making it difficult to proceed with purchases, so we took to the decision to close the online store altogether for a period. Basically, we had not expected such a large level of demand, and we have subsequently reviewed our forecasts and taken measures to expand IT capacity. Distribution suffered similar failings. While we have made great improvements compared to last year's distribution inefficiencies, we experienced extremely high levels of orders during peak seasons such as the UNIQLO Anniversary Sale and the year-end sales, which resulted in extended delivery lead times. We were slightly reluctant in our response at the time, but we know we must expand distribution capacity in order to fully serve expanding online demand.

Q9: You have been actively expanding IT investment, so was the problem more one of far higher-than-expected online access and online orders?

A9: CFO Okazaki – Yes, that would be an accurate assessment. Naturally, we had been gradually strengthening our IT capability, but the level of demand far outstripped our expectations. We have been investing heavily in IT, but we believe we need to accelerate that process.

Q10: Have you made any changes to your pricing strategy for the 2018 Spring Summer season at UNIQLO Japan?

A10: CFO Okazaki – We are not planning any changes to pricing at this stage, and intend to

continue with our instantly recognizable pricing strategy to make it easier for customers to make purchases.

Q11: Now you have strengthened your profit structure, Fast Retailing is likely to continue generating high cash flow levels. How do you intend to use this cash flow, and can you comment on your current cash-flow position?

A11: CFO Okazaki – I believe it is important to maintain cash-flow at the current level from two broad perspectives. First, we want to press ahead with rapid digitalization across the Group's global operations and this will require greater investment in systems and logistics. We also need some leeway to enable us to proactively implement our scrap and build policy in response to large changes in technological environments. Second, it is important to have sufficient funds available to respond effectively in a global operating environment that displays rapidly increasing and varied risks. Global environments can change suddenly and sharply, and so it is not unusual to experience an unexpected decline in sales or a contraction in the gross profit margin. We feel obliged to maintain ample cash holdings to ensure consistent smooth business operations, regardless of any changes we may experience.