July 11 2019
Fast Retailing Co., Ltd.

Analysts' Meeting Q&A

Business Results for Fiscal 2019 Third Quarter (September 2019 to May 2019)

Below are some questions from our analysts' meeting concerning Fast Retailing business results for the third quarter of FY2019. The answers have been edited for clarity.

Q1: This is a question concerning inventories. Inventory levels did fall a little at the end of the second half, but they fell sharply compared to the previous year in the third quarter. Having said that, the third-quarter gross profit margin doesn't seem to have been as adversely impacted as you might expect from such as large drop in inventory levels. Can you explain your current inventory situation in a little more detail?

A1: Takeshi Okazaki, Group Executive Vice President & CFO – We always work to keep inventory at appropriate levels, so when inventory rose in the first quarter, we proceeded to run down that inventory in the second quarter. The drive to control inventory in the third quarter was just an extension of that process. Starting with this Spring Summer season ranges however, we did decide to adopt a stronger, more proactive approach to cutting prices, even early in the season, to offload inventory of poor-selling items. We have applied this stronger approach not only to Japan, but across our global operations. It did result in broader discounting in the third quarter than we had originally anticipated, but it also enabled us to pursue healthy inventory management. Also, despite squeezing inventory, we were still able to extend sales. I think that indicates just how much slack there was in the system to date. I think there is still plenty of room to further improve our inventory management, and that is something we will definitely be doing going forward.

Q2: This is a question about your UNIQLO operation in China. Why exactly is sales momentum so strong there?

A2: CFO Okazaki – Our performance in China continues on a fundamentally strong trend. Same-store sales continue to exhibit near double-digit growth, new store opening conditions are favorable, and we enjoy very stable management in that market. In the quarter just past, our new UT graphic T-shirt collaborative products sold well, and we were able to successfully attract customers by conveying an impressive flow of fresh news.

Q3: Regarding your store opening plans, can you tell us why you now expect to open fewer new stores in Greater China and Southeast Asia in FY2019 than you did at the end of the first half in February? Also, what about new store plans for FY2020?

A3: CFO Okazaki – We have not changed our fundamental target of opening approximately 100 new stores in Greater China and 50 new stores in Southeast Asia and Oceania every year. The number of new stores set to open in F2019 has declined simply because it takes time to negotiate the conditions for each individual store, and progress has been slightly slowly than we initially expected. This does not mean that there has been any change to our new opening strategy at all, or that new store opening conditions are starting to get tougher.

Q4: The gross profit margin suffered somewhat in the third quarter from your determined effort to achieve ideal inventory levels not only at UNIQLO Japan, but at UNIQLO International as well. Now that has been achieved, would you expect the fourth-quarter gross profit margin to improve at UNIQLO International as well as UNIQLO Japan? Your fourth-quarter gross profit margin has tended to worsen as prices are slashed towards the end of the season, but is that pattern set to change?

A4: CFO Okazaki – We are entering the fourth quarter with good inventory conditions, so if we achieve regular levels of sales, I think the fourth-quarter gross profit margin will improve. I think we will see fewer instances of drastic price-cutting in the latter half of the season. From now on, we will be looking to manage inventory in a way that seeks to achieve ideal levels at an early stage and keeps inventory running at appropriate levels, so we do not find ourselves having to cut prices in the latter half of the season.

Q5: Do you expect GU performance to keep improving?

A5: CFO Okazaki – To be entirely honest, part of the strong recovery in performance we are seeing in the current business year is a reflection of how poorly GU performed in the previous year. But it is also due to astute inventory management, the development of products that are firmly focused on mass trend fashion, and the determined marketing of those mass-trend focused products. So, yes, I think we can expect a strong performance from GU next year and in subsequent years to come.

Q6: The distribution cost-to-net-sales ratio increased 0.5 point year on year at UNIQLO Japan in the nine months to May 2019. Do you expect this rising trend in the distribution ratio to have run its course by the beginning of the next business year?

A6: CFO Okazaki – The distribution cost ratio increased this year because we had excess inventory in the first quarter. We offloaded most of that in the second quarter, but we kept a portion of Winter inventory and I think that has pushed up distribution costs (warehousing costs) more than we thought. At the same time, distribution unit prices are rising in general. We haven’t escaped that, but we have been able to absorb the higher unit price by constantly working to improve distribution productivity. If we can achieve an appropriate range of inventory stock and appropriate inventory levels, I don’t think distribution costs will continue to rise at the same pace as they have been doing, and, next year, we will actually be able to start curtailing distribution costs.

Q7: You said that third-quarter inventory shrank partly because of your decision to rundown inventory of slow-selling Spring and Summer ranges. Did this involve looking at each item and deciding how much to discount it, or, did you adopt a flexible approach to price cuts, such as dynamic pricing?

A7: CFO Okazaki – We are not pursuing a dynamic pricing approach. Each product sells differently, even different color patterns, so we carefully scrutinize how each individual item is selling, and revise prices to the appropriate level as early as possible. We have no intention to constantly changing prices in a fluid way. We operate our business on the fundamental everyday-low-price premise that enables customers to purchase products at the same reasonable price any day of the week.

Q8: Did the improvement in cost of sales generated by the appreciation in yen settlement rates relate mainly to the Japanese operation? If so, given the fairly large impact of the third-quarter inventory rundown in Japan, might you experience another similar inventory rundown loss in the first quarter of FY2020 when the Fall Winter season starts?

A8: CFO Okazaki – First, yes, the cost of sales has improved primarily at UNIQLO Japan. Regarding inventory, we will adopt the same approach for the coming Fall Winter season as we have here. We haven't started selling Fall Winter products yet, so it is hard to say, but, basically, we are determined not to leave inventory rundown management until the latter part of the season.

Q9: Are you not likely to experience a similar inventory rundown loss in the first quarter of FY2020 on the Fall Winter stock you have carried over at UNIQLO Japan?

A9: CFO Okazaki – The inventory we are carrying over is nearly all year-round products, so we are not carrying large amounts of excess stock. Having said that, we will be scrutinizing the launch of the Fall Winter season ranges and changing prices if judged necessary.

Q10: Your China operation is strong, but could you comment on the local environment, in terms of consumer trends, economic conditions, conditions for new store openings, and any other pertinent factors?

A10: CFO Okazaki – As you read in global reports, I do think the Chinese economy and broad consumption environment is slowing down slightly, but our business is still not experiencing any such impact right now. New store opening conditions remain broadly the same. The cut in the Chinese value added tax, similar to the Japanese sales tax, has been positive for our business performance. Some products have seen prices fall and others not, so we haven't enjoyed that benefit across the board, but it has been a positive.