April 9, 2020

Fast Retailing Co., Ltd.

Business Results for Fiscal 2020 First Half (September 2019 to February 2020)

Below are some questions from our analysts' meeting concerning business results for the first half of FY2020, or the six months to February 29, 2020. The answers have been edited for clarity.

Q: You say you are starting to see signs of a recovery in same-store sales in China, but when do you think you will see a full recovery?

Takeshi Okazaki, Board Member, Group Executive Vice President & CFO: We are watching the situation closely and are in daily contact with our management team in China. While sales declined 80% year on year in February, sales then began recovering more each week in March as the impact of the new coronavirus (COVID-19) calmed down. In the latter part of March, there were some days when sales recovered to similar levels seen in the previous year due to pent up demand, but those spikes have tempered somewhat now, and sales are down roughly 30% year on year.

To analyze the current level of recovery in sales, first, people are still concerned about the risk of infection and so we are not seeing a return to the vigorous buying we saw in the recent past. Second, given the economic damage caused by the virus, people are not feeling optimistic about their future income and so they are keeping a tight rein on their purse strings. Third, I think customers are waiting to see if retailers will launch bargain sales given the fact that the industry as a whole is carrying large levels of inventory. Fast Retailing would not consider entering any discounting war. We want to capture real demand and build a solid recovery in sales. We expect sales will gradually return to normal over the second half of 2020.

Q: While circumstances make it difficult to estimate future business with any accuracy, what sales projections are you basing your initial ordering plans for 2020 Fall Winter season ranges on? Also, given the temporary closure of some of your stores, can you give us a sense of the extent of excess Spring Summer inventory you expect to have?

CFO Okazaki: We are already experiencing excess Spring Summer inventory, but how large that stockpile becomes will depend on how well sales recover going forward, so I cannot give you a definitive answer at this stage. However, we will not be looking to discount and sell off all excess stock during the current season. Instead, we intend to scrutinize our excess stock and separate it into core items that customers will consider to have longer-lasting worth and value and items that are more heavily affected by latest fashion trends, and then we will be looking to gradually sell off the excess stock to normalize inventory over the next 18 months. We are not concerned about our medium to long-term sales growth potential, but since we cannot predict when COVID-19 will be brought under control or what final impact it will have on the global economy, we felt we had no choice but to use conservative estimates in our FY2021 sales projections.

Q：In Mr. Yanai's presentation, you said that you want to "courageously scrap old frameworks, go back to the starting point and transform the company." Does that mean that you want to pursue ongoing IT, digital, and distribution reforms even more aggressively as well as your LifeWear=Sustainability strategy?

Tadashi Yanai, Chairman, President and CEO: LifeWear already is the optimum global clothing concept, but it will become even more so going forward. I think we will see a huge rise in the number of people who, rather than buying clothes to dress up, want to buy the clothes that are best for them and make them feel really attractive in themselves. I think lifestyles will change and clothing tastes will gradually change to favor traditional, basic clothes with just a hint of fashion. I want to sell clothes based on value rather than price by selling the highest-quality products at the lowest possible price. I want to ensure customers can find the products they like best at UNIQLO, GU, or Theory. My aim is to develop clearly defined, unique characteristics for each of these brands, and sell products that offer true value through each brand.

Q： You explained your revised full-year business estimates in some detail in terms of sales, but can you tell us more about your expectations for gross profit margin and business costs?

CFO Okazaki: I would first like to add a few words regarding our sales forecasts. It took between three and four months from the initial spread of COVID-19 before we started to see signs of a gradual recovery in sales in China. Currently, nearly all our stores have been temporarily closed, with the exception of East Asia, so we have based our sales forecasts on what we know about the expected length of lockdown periods in each market and the assumption that we will see a similar post-lockdown recovery in sales in other markets to the one we have witnessed in China. Our estimates did not account for any extension in lockdown periods or the announcement of a state of emergency in Japan, so please understand that our business estimates are likely to change considerably in the wake of such additional factors.

In terms of the gross profit margin, we intend to classify our products into those that we should take our time selling and those that we should sell off more quickly, and then discount the items for quick sale over the latter part of the second half from March to August 2020. Having said that, we don't intend to cut deeply into our gross profit margin, but to gradually normalize inventory while maintaining the gross profit margin. In terms of SG&A expenses, this will depend on the level of store rent we have to pay during the temporary store-closure period. The business estimates we have disclosed to you today are based on our utmost efforts in the areas which we can control, but many factors remain uncertain at this point in time, so I'm afraid I cannot give you any further comment.

Q: You have revised your FY2020 annual dividend forecast to the same level as FY2019. Does this suggest that you are more focused on avoiding a reduction in the actual dividend paid than on the dividend payout ratio right now?

CFO Okazaki: Since we cannot tell right now when COVID-19 will be brought under control, I am not overly optimistic about the outlook for the next 12 months, but I know we can recover over the medium term. We did suffer a fall in profit in the first half of FY2020 and so it was difficult to justify increasing the shareholder dividend as we had scheduled at the beginning of the business year. However, we do not have a cashflow problem, so we judged it appropriate to provide a steady shareholder return that avoided a reduction in the actual dividend received.

Q: Mr. Yanai, in your presentation, you talked about pressing ahead with investment in distribution and systems, but do you see any potential improvements or problems in this area based on recent experiences in China?

CEO Yanai: In regular times and in irregular times such as these, our management and product policies are in sync with large global trends in the true sense of the word. We turn information into commercial products, deliver the clothes that will sell worldwide as quickly as possible, consider how we should incorporate changing lifestyles into our products, and consider everything from the customer's point of view. I believe our approach is the right one, and the more globalized our operations become, the more integrated that approach will become worldwide. In fact, recent events will likely serve as a tailwind for companies like ours seeking to become true global brands. Going forward, people will expect even more from our product strategy, LifeWear concept, and approach to globalization. We will need to resolve problems not just for a single nation, but on a global scale, and, to do that, we ourselves must become a truly global company.

Q: First-half inventory declined at UNIQLO Japan, but rose at UNIQLO International due to COVID-19. Do you expect the excess inventory problem will become even more severe from March onwards in Japan and your global operations outside of China?

CFO Okazaki: Broadly speaking, yes. However, at the beginning of the business year, we didn't incorporate such as large decline in Spring Summer sales in China into our business projections, so we are likely to experience a slight sense of excess Spring inventory in China. As for our other markets, many of our stores are temporarily closed. We can't generate sales during this period of temporary shutdown, so that stock will be shifted to inventory, which we intend to offload gradually through FY2021.

Q: UNIQLO Japan same-store sales data for March were lower than other listed apparel companies. Why was that?

CFO Okazaki: One reason is because UNIQLO caters to a wide range of customers and so we are likely to be more heavily impacted than brands that focus on one particular segment of the population. For instance, our fun, low-priced GU brand attracts more young customers than our UNIQLO brand, and, as a result, GU March same-store sales fared better than UNIQLO March same-store sales.

In addition, we could probably have expanded e-commerce sales further than we did during the temporary closure of physical stores in March. Looking back, we didn't do absolutely everything that we could have done, and we needed to be more aggressive. We have learned from that experience and intend to improve going forward.