July 13, 2023

Fast Retailing Co., Ltd.

Business Results for the First Nine Months of Fiscal 2023 (September 2022 to May 2023)

Below are some questions from our analysts' meeting concerning business results for the third quarter of FY2023, or the nine months to May 31, 2023. The answers have been edited for clarity.

Q: What underpinned the higher-than-expected performance from UNIQLO in the Mainland China market?

Takeshi Okazaki, Group Senior Executive Officer & CFO: The Mainland China market suffered considerably due to COVID-19 through to the end of 2022, but now that the pandemic has run its course, consumption seems to be recovering strongly, at least from what we can see. In addition, demand for the day-to-day clothing that we offer in our price bracket is very high. I think the reason why we have been able to firmly capture demand as the market recovers is because we continued to invest in marketing, branding, wage increases, and recruitment even during the pandemic. The Mainland China market results were higher than expected, but the way that the market has bounced back is just as we had expected. We want to maintain this momentum in FY2024.

Q: North America, Europe, and Southeast Asia continued to generate strong results. However, revenue for the third quarter from March to May 2023 only rose by roughly 30% year on year, which seems to be slightly less powerful than in the past. Has anything changed of late?

CFO Okazaki: The Southeast Asia, North America, and Europe regions all continued to generate strong performances. While changing temperatures did cause some volatility in performance, LifeWear's presence in all three markets has become much more solid, fundamental demand is strong, and the operations are consolidating their experience and becoming increasingly successful in their individual regions. I believe we will be able to continue to enjoy strong performances if we build a full range of stock keeping units (SKU) into our store operations of the inventory that customers most want.

Q: Inventory levels seem to have returned to normal levels on a global scale in the third quarter, but is the level of inventory in the Mainland China market at an acceptable level?

CFO Okazaki: Yes. Inventory in the Mainland China market returned to normal levels after sales outstripped our expectations in the third quarter. Overall inventory is also at an acceptable level on a global scale. Distribution is now much smoother and we have firm control over orders. However, the most important thing for maximizing sales and the gross profit margin is to ensure the precise volume and a full range of colors, patterns, and sizes of the products that customers desire to avoid any surplus or shortages. I think there is room to improve our performance on this point. Now that overall inventory has returned to normal levels, we believe the key issue going forward will be to improve inventory accuracy at the SKU level.

Q: Sales from the Southeast Asian region proved strong. However, some markets continued to see profits rise and some countries saw profits contract. What caused these differences on the profit front? Also, how are you progressing with your plans to accelerate new store openings in the Southeast Asia region?

CFO Okazaki: While sales proved strong in Malaysia, the Philippines, Indonesia, and Vietnam, operating profit contracted in the third quarter. In Indonesia, the gross profit margin declined due to the impact of safeguards on imports. We have been increasing the ratio of local production in Indonesia, so that impact is reducing and I think this situation will improve even further going forward. As for Malaysia, the Philippines, and Vietnam, last year, we were not able to conduct strategic discounting after disruptions to our distribution systems resulted in delayed transportation and shortages of some products, and the gross profit margin remained fairly high as a result. While we are promoting a business model worldwide that doesn't rely on discounting, conducting certain discount sales as part of our sales promotions can actually prove very effective, so, this year, we did conduct some strategic discounting and the gross profit margin declined as a result. Having said that, the original gross profit margin was already sitting at a high level, so we are not particularly concerned about this. In addition, on the cost front, we are actively increasing marketing spend for the purpose of medium- to long-term branding and we are strengthening our investment in human capital. These cost investments are fueled by strategic motives, so they are not a cause for concern. I think that the gross profit margin and the SG&A ratio will improve going forward, and profits will increase.

In terms of new store openings, we are currently opening new stores at a pace of approximately 70 new stores a year, and we are creating a pipeline for the opening of a targeted 70 to 80 stores. However, we don't want to clock up store numbers by opening new stores without much thought. Instead, we are focusing on quality in our store-opening activities by, for instance, selecting superior locations that satisfy customer demand and insisting on the most competitive locations even inside shopping malls. New store numbers might fluctuate slightly, but I would like you to understand that these are just minor adjustments within a broader aggressive store-opening policy.

Q: UNIQLO Japan reported a decline in profits in the nine months through May 2023. The yen is likely to continue to weaken in FY2024, which will subsequently boost cost of sales, so how are you planning to generate higher revenue and profit and improve profitability going forward?

CFO Okazaki: The gross profit margin declined slightly compared to plan in the March-to-May quarter after the spot yen exchange rates that we use for additional production orders weakened further than we had estimated. From FY2024, we will continue to take out forward exchange contracts, and the gap between the contract rates and spot rates will gradually shrink, making it easier to control cost of sales. One other important factor to consider regarding prices when seeking to improve the gross profit margin is to generate business based on merchandising that can be successfully sustained at the most immediate exchange rates, while constantly reviewing the balance between demand and price in terms of product features, materials, design, and any other pertinent elements.

On the cost front, we still believe that we will be able to absorb the increase in wages that we recently implemented by improving medium-term productivity. Productivity is already improving, but there are some elements that have not yet been fully absorbed, so we will continue with our efforts to improve productivity even further. More specifically, we will strive to eliminate any wastage of resources in our store operations and channel any free time into customer service activities, while also seeking to increase sales per employee. Furthermore, automated warehouses have certain fixed costs, so we can improve the SG&A ratio by steadily increasing sales. I want to fuel a renewed rise in the profit margin by working on these kinds of initiatives.

Q: Looking back over the Spring Summer season, how do you think consumers have responded to price revisions?

CFO Okazaki: I think our customers are extremely sensitive to price. I feel they are very strict about price and carefully assess every purchase to ascertain whether they are getting a bargain or great value for money. Some of the products that meet customer needs and offer a good balance in terms of price, materials, functionality, and design have generated significantly higher sales, even though the price of those products has increased from the previous fiscal year. At the same time, we have witnessed a slowdown in sales of some products whose price has remained the same because they failed to capture the latest trend or suffered a tapering off in demand. This experience reconfirms the importance of carefully determining the best balance between price and intrinsic product value.