January 11, 2024

Fast Retailing Co., Ltd.

Q&A Session on Business Results for Fiscal 2024 First Quarter (September to November 2023)

Below are questions from our analysts' meeting concerning business results for the first quarter of FY2024, or the three months through November 30, 2023. The answers have been edited for clarity.

Q: How do your consolidated results compare with your plan, including the month of December? Also, people are talking about the weak macroeconomic environment in the Mainland China market, but does this concern you in terms of future sales trends?

Takeshi Okazaki, Group Senior Executive Officer & CFO: As we mentioned, UNIQLO Japan sales contracted sharply in December. In East Asia, sales fell short of our estimates in December due to the warm winter weather. However, we still expect to be able to achieve our first-half business estimates on a consolidated basis despite this development.

In the Mainland China market, harsher COVID-19 restrictions on movement were introduced from mid-December onward in 2022. By contrast, same-store sales increased by approximately 30% year on year in December 2023. Yes, the recovery in consumption in the Mainland China market has been fairly soft, but any impact on our performance there has been due more to the weather factor than economic conditions. Business has been somewhat stifled by the warm winter weather, but our most active spring sales period starts in February, so we expect things to start picking up from now on. We do not have any significant concerns from a long-term perspective.

Q: Your inventory levels have fallen considerably. Does that mean you have been able to create a solid system whereby 70% of your products are ordered before the season starts and 30% are ordered through subsequent additional production? Are you able to operate this system globally as well as in Japan?

CFO Okazaki: Pursuing operations that involve ordering roughly 70% of our products before the season starts and a further 30% or so depending on subsequent sales trends is something that we are now able to do not only in Japan but on a global scale as well. Overall inventory levels are improving year on year but inventory is not always uniform at the stock keeping unit (SKU) level. In other words, we have some products that we should have stopped ordering that we didn't curtail completely and some products that required additional orders that we didn't manage to order in sufficient volumes. This is one area where we are looking to make considerable improvements going forward.

Q: How did the first-quarter discounting rate across UNIQLO operations compare to the previous year?

CFO Okazaki: The discounting rate rose slightly year on year. This was due to the fact that disruptions in the supply chain last year delayed the delivery of products in some regions so we weren't able to conduct sales promotions in the same way as we usually would. We think that the discounting rate has returned to appropriate levels this year.

Q: Can you explain the factors underlying the year-on-year improvement and improving compared to the plan in the UNIQLO Japan first-quarter gross profit margin?

CFO Okazaki: We experienced a sharp depreciation in the Japanese yen in the first quarter of FY2023 and orders exceeded the levels covered by our forward foreign exchange contracts, which resulted in a large increase in cost of sales and a decline in the gross profit margin. By contrast, the forex impact eased in the first quarter of FY2024, resulting in a significant year-on-year improvement in the gross profit margin. We did sanction a slight increase in discounting due to the adverse impact of the warm winter weather, especially in September and October.

Compared to our initial estimates, the gross profit margin came in slightly higher than expected as we successfully controlled orders, the foreign exchange impact eased more than expected, and comparative discount sales proved better than originally planned.

Q: What fueled the higher-than-expected first-quarter performance from UNIQLO operations in North America and Europe?

CFO Okazaki: Our operations in North America and Europe are growing rapidly, but we have also been actively investing in branding and marketing. We opened our first Luxembourg store in October 2023. Visibility is growing as the opening of new global flagship stores and the refurbishment of existing global flagship stores assists with branding. Our products are also winning wider customer support as we strengthen the development of items that best suit American and European customer needs. I think it is the formation of this kind of virtuous cycle that has helped achieve such a strong business performance.

Q: Can you explain in more detail the comment on slide four about taking STOP&GO decisions on costs and orders to reflect latest sales trends?

CFO Okazaki: STOP&GO decisions on costs refers to our ability to suppress controllable expenses in the face of a significant drop in sales. We experienced large fluctuations in sales on multiple occasions during the COVID-19 pandemic, so we improved our ability to control expenses as an organization. STOP&GO decisions on orders refers to the curtailment of orders or the flexible ordering of additional production based on most recent sales trends. We have always wrestled with this issue, but we have gradually gotten better at controlling orders. I think our ability to control both costs and orders across our organization has improved as we have focused our efforts in this area and built up more in-house experience. We responded particularly well in this first quarter to the sharp fluctuations in sales caused by the warm weather in September and October and the sudden drop in temperatures in November. However, there is plenty of room for improvement on an individual-store or SKU basis, so we are not fully satisfied with the current level of achievement.

Q: Performance from the Southeast Asia, India & Australia region came in slightly below target in the first quarter but the region still reported considerable increases in both revenue and profit. Does this mean there are no specific issues with the operation's continued expansion or growing local affinity toward LifeWear?

CFO Okazaki: Broadly speaking, that is correct. We offered a similar Fall Winter product mix in Southeast Asia this year as in other regions. To date, given the still small-scale nature of our business, most of our activity has been concentrated in urban areas with buoyant demand for Fall Winter items to satisfy outbound travel needs. We experienced particularly strong demand for Fall Winter items in FY2023 due to the lifting of COVID-19 restrictions and reopening of markets, which helped boost growth. However, that demand had run its course by FY2024 and, regrettably, we were not able to offer enough products that suited the everyday needs of local customers and, more specifically, enough fresh and newsworthy items for Southeast Asia's eternal summer weather. There is plenty of room for us to improve and grow in the future. I think this is the key reason why we were not able to expand performance beyond our initial expectations in the Southeast Asian region, which is also experiencing less favorable economic conditions.

Q: How do you intend to improve product lineups and marketing in Southeast Asia from the second half of FY2024 onward?

CFO Okazaki: I think the issues with our product lineup are the most significant, so our basic focus should be on reviewing exactly what type of staple products we should be offering in regions with everlasting summer weather. Specifically, we have to consider when, how, and what kind of products we should release as a follow up to Fall ranges, and we are already starting to implement marketing and other initiatives that will better showcase the fresh elements of our staple Summer items in the second half of FY2024. We will also make some significant changes in the product lineup for Fall Winter 2024.

Q: North America continues to generate a strong performance overall, but are there any differences in performance in different regions?

CFO Okazaki: Our North America operation currently focuses on the New York area on the East Coast and the Los Angeles area on the West Coast. Our efforts to strengthen marketing in these areas are helping to boost brand visibility and generate significant increases in same-store sales. The next challenge will be deciding how to expand the number of areas that can mimic this performance. North America has diverse needs, so we will seek to expand our business one area at a time. However, we are enjoying a strong reception in the areas we have focused on to date.

Q: You have listed the formation of product lineups that suit everyday needs in each local region, managing inventory by individual SKU, and promoting local store management as some current issues. Is your approach to these issues the same at both UNIQLO Japan and UNIQLO International?

CFO Okazaki: There is always room to improve inventories on a SKU level and at each individual store, but the issues we need to address vary from market to market. We are not generally talking about external factors, such as the different characteristics of each market, but rather internal factors such as skilled management talent, so we need to raise our ability to nurture human resources and implement other relevant measures. It is especially important for us to raise the basic level of local store management by training store managers and increasing the number of potential leaders across all our operations, which harbor great potential for growth. For example, we are now comparatively adept at implementing STOP&GO decisions on orders and costs in North America, where business performance has improved significantly. However, we still have many issues to address, so we want to focus on raising the base line at all our operations.

Q: We saw a reduced forex impact and a 2.7 point improvement in the gross profit margin at UNIQLO Japan in the first quarter. Will this trend continue through the second quarter and beyond? Is the gross profit margin at UNIQLO International also getting a boost from foreign exchange moves?

CFO Okazaki: UNIQLO Japan was significantly impacted by spot exchange rates throughout the first half of FY2023 so we expect the comparative gross profit margin to continue to improve in the first half of FY2024. However, I think curbing discounting will be a more significant factor than the impact of spot exchange rates in the second half. The impact of spot exchange rates is different for each country, but it is safe to say that Japan has been the most affected, while markets outside Japan have not been largely impacted.

Q: What are the reasons underlying the actual improvement in the SG&A ratio?

CFO Okazaki: We always strive to accurately forecast sales, but we also worked hard to strengthen our control over costs to flexibly reflect those latest sales trends. We focused specifically on advertising costs, temporary instore personnel costs, and distribution costs, such as revisions in delivery frequency. Basically, we are looking to control any expenses that don't need to be injected at that particular time, especially when business performance is tight. While these cost controls cannot offset all downturns in sales, I think we are much better at flexibly controlling costs than we were in the past.

Q: Have you reached the stage where productivity improvements are able to offset higher personnel costs due to wage increases?

CFO Okazaki: Yes, we are currently entering that stage. Total personnel costs are rising, but sales growth is exceeding the increase in labor costs.