UNITED ARROWS LTD.
Earnings Announcement Q&A
for Fiscal 2018, the Fiscal Year Ended March 31, 2018

UNITED ARROWS LTD. (or "the Company") held earnings announcement presentations on May 7 and 8, 2018, at which analysts and institutional investors were in attendance. The principal questions received, and answers given during each session have been presented by category below. Certain details have been added or amended to further understanding of the UNITED ARROWS Group's performance and activities.

Fiscal 2018 Business Results

Q. Can you provide us with details of additional costs incurred during the 4Q of FY2018?

A. Selling, general and administrative (SGA) expenses for the three-month January to March 4Q exceeded forecasts announced at the beginning of the period by just under ¥900 million. UNITED ARROWS LTD. accounted for around ¥700 million of this excess expenditure. In specific terms, roughly ¥600 million was paid as bonuses for achieving established plans, around ¥100 million was spent on repairs and maintenance (the maintenance and repair of stores, installation of LED lighting, and headquarters office investments), and approximately ¥200 million as advertising expenses. In contrast, personnel expenses fell roughly ¥250 million below forecast budgets owing mainly to difficulties in hiring activities. COEN CO., LTD. (COEN) exceeded costs by around ¥200 million. This was made up of a special bonus of slightly under ¥100 million as well as ¥50 million each for advertising expenses and consumables.

Q. Can you provide us with details of growth rates and sales composition by e-commerce site?

A. UNITED ARROWS LTD.'s online sales came in at ¥23.2 billion, an increase of 16.4% compared with the previous year. Looking at each major online site, UNITED ARROWS LTD. ONLINE STORE (UA ONLINE STORE) sales climbed 35% compared with the previous year and comprised 23.2% of total online sales, up 3.1 percentage points year on year.

ZOZOTOWN sales grew 12% while making up 57%, down 2.4 percentage points. Rakuten BRAND AVENUE sales increased 64% while accounting for 6.5%, up 1.8 percentage points, and Amazon sales expanded 28%, comprising 2.8% of total online sales, up 0.2 of a percentage point.

Q. Looking at the results of subsidiary companies, COEN CO., LTD. (COEN) and CHROME HEARTS JP, GK (CHJP) sales appear to have stalled during the three-month 4Q. What you provide us with background details? Also, what measures do you have in mind to rebuild FIGO CO., LTD. (FIGO), which continues to struggle?

A. Looking at COEN, which closed its accounts in January 2018, the rate of sales growth in November-January 4Q was slightly sluggish compared with the period through to the 3Q. This largely reflects corrections to the substantial volume of inventory held in the 4Q of the fiscal year ended January 31, 2017 and the success of reduction efforts through clearance sales. Thanks mainly to the positive flow-on effect of measures aimed at controlling inventories in the fiscal year ended January 31, 2018, the gross margin improved compared with the corresponding period of the previous fiscal year. As far as CHJP is concerned, sales between January and March 2018 were weak owing primarily to delays in the release of new products. Trends have since improved due to a variety of factors including the launch of new products in April. Turning to FIGO, we will position the company on a path to recovery by identifying underperforming activities, bolstering education, and strengthening online sales.

Fiscal 2019 Business Results Forecasts

Q. Existing store retail and online sales growth forecasts at UNITED ARROWS LTD. appear weak. What are your thoughts?

A. While existing retail store sales have shown signs of improvement from the 2H of FY2018, we are adopting a cautious approach toward forecasts after taking into consideration the increasingly skillful manner in which customers are strategically utilizing physical and online stores. As far as online sales are concerned, figures reflect current trends and conditions at the time forecasts were made. This includes low rates of growth during January and February this year on the back of such factors as thin sales inventories. Since March, we have witnessed double-digit percentage sales growth with the potential for slightly stronger results going forward.

Q. The Company has forecast a gross margin of 52% for the fiscal year ending March 31, 2019. This would appear a little strong. What are your reasons for making this forecast?

A. We are seeing some progress with efforts to narrow markdown losses. This includes the segmentation of season merchandising and steps to control the injection of inventories. Thanks also to such factors as improved inventory efficiency, we believe we will be able to increase the gross margin in the fiscal year ending March 31, 2019. As an area where there is a tendency for large markdown losses, we see online sales in particular as providing room for improvement.

Q. Can you provide us with a breakdown of the increase in SGA expenses in the fiscal year ending March 31, 2019?

A. In the 1H of FY2019, SGA expenses are projected to increase around ¥1.4 billion compared with the corresponding period of the fiscal year under review on a consolidated basis. UNITED ARROWS LTD. is expected to account for just under ¥1.0 billion of this increase, and COEN for slightly less than ¥0.5 billion. Looking at the specifics of the increase in SGA expenses at UNITED ARROWS LTD., which is forecast to total just under ¥1.0 billion, temporary costs associated with the reorganization of distribution centers, personnel expenses in connection with efforts to fill vacancies, increases in advertising expenses, and expenditures relating to office function improvements including the establishment of a photo studio for online sales use are expected to make up roughly ¥0.5 billion, ¥0.2 billion, ¥0.1 billion, and ¥0.1 billion, respectively. At COEN, we are projecting increases of approximately ¥250 million in advertising expenses and over ¥0.2 billion in variable costs associated with the growth in sales as well as other expenses. As mentioned, this will bring the forecast increase in SGA expenses at the company to slightly less than ¥0.5 billion. Turning to the 2H of FY2019, SGA expenses are estimated to come in at around the same level as the corresponding period of the fiscal year under review. The ratio of SGA expenses to total sales is anticipated to decline year on year.

Q. What is your outlook for capital expenditures and depreciation for the fiscal year ending March 31, 2019?

A. Capital expenditures are projected to reach roughly ¥4.5 billion on a consolidated basis. Of this total, around ¥1.3 billion will be directed toward new distribution centers. Depreciation is forecast to total approximately ¥1.8 billion.

Q. Can you tell us about the Group's plans to strengthen online sales from the fiscal year ending March 31, 2019?

A. A photo studio has been established within the Company at UNITED ARROWS green label relaxing (GLR). In addition to accelerating the pace of such related operations as the taking of photos and measurements as well as the writing of drafts, this initiative is producing various other benefits including increased image quality. Looking ahead, we will upgrade and expand the functions of this in-house studio and extend its positive flow-on effects to other businesses. Moreover, we will further enhance collaboration between physical and online stores while also reinforcing the ability to pick up products at brick and mortar stores. We are already seeing an increase in the number of customers who are using this pickup service and will continue to address customers' strong needs to physically confirm the size of a product after finding an item online.

Q. Plans are in place to expand the use of radio frequency identification (RFID) from the fiscal year ending March 31, 2019. What kind of effects are you anticipating going forward?

A. As we explained during our 3Q earnings announcement, the introduction of RFID is expected to shorten customer waiting times at register counters when paying for an item and to reduce the burden of inventory stock-taking operations. As far as the use of RFID in the product planning process is concerned, we are still at the assessment phase.

Q. Can you tell us about the Group's store opening and closing plans in the fiscal year ending March 31, 2019. What are your thoughts on the opening of GLR and COEN stores, which are seen as the engines of future growth?

A. We ae looking to open 22 new stores in FY2019. Of this total, eight are GLR stores and six are COEN stores. The GLR stores that we plan to open will include WORK TRIP OUTFITS stores that specialize in business attire and Lurow stores that handle women's wear. As far as COEN stores are concerned, we not only intend to open new stores, but plan to concurrently close underperforming stores.

Q. Looking at forecasts for the fiscal year ending March 31, 2019, it appears that the plan is to control the ratio of SGA expenses to sales while at the same time undertaking investments with a view to the medium and long term. In contrast, the previous tendency was more toward managing medium- and long-term investments, while preventing any increase in the SGA expenses to sales ratio. How have circumstances changed?

A. In the fiscal year ended March 31, 2018, we undertook a review of underperforming businesses and activities. As a result, steps were taken to reassign personnel engaging in activities that had been terminated to existing businesses. For this reason, we are anticipating a slight improvement in the vacancy ratio and a drop in the number new hires. In addition, we are considering measures that will help minimize ancillary store operations with a view to increasing efficiency. With this in mind, the decision was made to undertake medium- and long-term investment while controlling the SGA expenses to sales ratio. Looking also at past levels, we are aware that at 45%, the forecast SGA expenses to sales ratio in FY2019 is projected to remain at a high level. Moving forward, we will strive to reduce this ratio.

Q. You have identified organizational culture and human resources reform as key priorities among the Group's pending issues. What do you see as specific issues?

A. While the UNITED ARROWS LTD. has to date achieved sales growth under a structure comprised of the four United Arrows, Beauty & Youth, Green Label Relaxing, and Small Business Unit division system, this structure has led to excessive vertical segmentation and a weakening of the connections between divisions as well as internal communication. By reorganizing and consolidating these four divisions into the two larger Business Unit I and Business Unit II, we will strengthen horizontal ties. At the same time, we are considering the use of job rotation while reviewing evaluation systems. Through these means, we believe we can reinvigorate the organization.

Distribution Center Reorganization

Q. What volume of sales do you think you can handle at the new and Kashiwanoha centers?

A. The purpose of reorganizing distribution centers in this instance is to rationalize operations that have become increasingly complex over time. Rather than look to expand our warehousing capacity, our goals are to reduce distribution costs and to stabilize logistics operations. By building a mechanism that allows us to segment season merchandising and manage the injection of stock thereby procuring products and completing deliveries to frontline stores in a timely manner, we are better positioned to ensure efficient warehousing operations while accommodating future sales growth.

Q. What criteria did you use when deciding whether or not to invest in the purchase of material handling machinery?

A. The machinery that we purchased in this instance has been customized to suit our specific needs. Based on a cost-benefit analysis, we decided to purchase the machinery rather than lease.

Q. What is your current annual distribution cost?

A. Just under 3% of consolidated net sales and roughly ¥4.2 billion for the fiscal year ended March 31, 2018.

Q. In your simulation in the earnings announcement presentation materials, the quantitative effect of distribution center reorganization is based on annual sales growth of 3%. What would be the effect if annual net sales growth came in at 6%?

A. Assuming sales growth of around 6%, we can anticipate a cost reduction of between ¥0.2 and ¥0.3 billion each fiscal year for the next two to three years and between ¥0.5 and ¥0.7 billion after four to six years compared with results if reorganization was not undertaken.

Q. Do you have any concerns about your ability to ensure stable operations by undertaking the planning of the new distribution center in your own right? How will you deal with this?

A. In undertaking the reorganization of distribution centers, we will adopt a gradual approach toward the shift to a new distribution center in this instance. We will offset any risks by working to stabilize operations at the new distribution center while at the same time operating existing centers.

Other

Q. What are your thoughts on conditions across the industry as a whole and changes in fashion trends?

A. Looking at the fashion industry as a whole, women's items remain robust. This largely reflects the increase in working women. In addition to an upswing in items that can simultaneously address the needs for business and casual attire by both men and women, products that utilize functional materials continue to attract high demand. As far as the Company is concerned, trends differ depending on the market. For example, we are seeing an increase in the need for higher quality in the trend-conscious market. In this context, the frequency of repeat customers is climbing in line with efforts to strengthen our lineup of products in the high price range. In the basic trend-conscious market, customers are continuing to adopt a severe approach toward product prices. Here, items that can concurrently fulfill both the business and casual needs of customers and products that utilize functional materials remain extremely popular.

Q. New spending trends including smart shopping as well as used and rental items are gaining in prominence. How will you respond to these changes?

A. With the underlying assumption of product sale, the number of people purchasing items with clearly recognizable value is increasing. We will consider the possibility of reuse and repair over the long term. Having said this, we have launched the RE: Store & Flea UNITED ARROWS LTD. project on a trial basis. Through this project, we have commenced the sale of display items and store fixtures that we were unable to market due to minor damage after their remodeling and repair.