UNITED ARROWS LTD.
First Half Fiscal 2016 Earnings Announcement Q&A

UNITED ARROWS LTD. held earnings announcement presentations on November 6, 2015 and November 9, 2015, at which the media, analysts, and institutional investors were in attendance. Details on the principal questions received and answers given by category during each session are presented as follows, with certain details expanded or modified in an attempt to provide readers with a deeper understanding of the UNITED ARROWS Group's performance and activities.

About Business Results in the First Half (April 1, 2015 to September 30, 2015) of Fiscal 2016 (April 1, 2015 to March 31, 2016)

Q. Can you provide us with a breakdown of non-consolidated inventory?

A. Both the amount and composition of non-consolidated inventory for the 1H of FY16 came in at about the same levels as those of the corresponding period of the previous fiscal year. As of September 30, 2015, fall and winter items for the current year, past inventories, and products that were not linked to any particular season accounted for 47%, 34%, and slightly higher than 18%, respectively, of total non-consolidated inventory. The balance of past inventories as of the end of FY15 was roughly ¥1.7 billion higher than the balance as of the end of FY14. As previously identified, the balances of past inventories as of the end of the 1Q and the 2Q of FY16 were approximately ¥1.2 billion and ¥0.2 billion higher year on year. Taking these figures into consideration, we are seeing a steady decline in the balance of past inventories. Moving forward, we intend to continue promoting various initiatives, including sales events in the 2H, to further reduce past inventories.

Q. What are the Company's forecasts for inventory as of the end of FY16?

A. We anticipate the balance of inventory will come in at slightly lower than that at the end of the previous fiscal year.

Q. What are your thoughts for the 2H with respect to opportunities that were lost to boost sales due to efforts to control the introduction of inventories in the 1H?

A. Our primary concern in the 1H was to limit the amount of inventory. We therefore took steps to control the introduction of additional items even at the expense of a limited incidence of opportunity loss. As a result, there was indeed a slowdown toward the latter half of clearance sales periods. Our approach toward controlling inventories remains unchanged for the 2H. We will, however, take into consideration trends throughout the 1H and will continue to monitor the status of inventory reduction. In this regard, a procurement budget outside existing plans has been authorized. By drawing on this budget, we will work to introduce additional inventories of any products that exhibit higher-than-anticipated sales in each business. In this manner, we will endeavor to minimize any incidence of opportunity loss.

Q. What are your thoughts on the non-consolidated gross margin?

A. In the 1H, the total business unit gross margin declined 1.6 points compared with the corresponding period of the previous fiscal year. While mark down losses improved by 0.3 of a percentage point, changes in the sales composition of private label brands and purchased products are estimated to have lowered the gross margin by 0.3 of a percentage point. At the same time, the effects of movements in foreign currency exchange rates and the upswing in the cost of goods purchased ratio attributable to prices that were set with the aim of attracting customers are estimated to have reduced the gross margin by 1.6 percentage points. Despite expectations that these trends will continue into the 2H, we believe that sales will remain steady and anticipate little downside risk with respect to the amount of profit.

Q. Should we assume that the effects of movements in foreign currency exchange rates on procurement costs will continue this fall and winter as well as in FY16?

A. Movements in foreign currency exchange rates will continue to have a slight impact on this year's fall and winter seasons. After taking into consideration results during the spring and summer seasons of 2015, we will look to raise the prices of those items based on efforts to bolster product development capabilities for the spring and summer seasons of 2016.

Q. Is the decrease in SGA expenses compared with plans attributable to efforts aimed at controlling operating overhead expenses or the result of expenses carried over into the 2H?

A. We are indeed working to control SGA expenses for certain businesses that have failed to achieve their plans; however, that does not mean we are looking to control expenses on a Group-wide basis. The potential exists in the 2H to bring forward investments that will help boost performance in FY16 based on an assessment of sales and profits trends.

Q. Can you tell us about the composition of private label brands and purchased brands at UNITED ARROWS (UA) and BEAUTY&YOUTH (BY)? What are the Company's plans with respect to composition rates in the future?

A. Sales of private label brands made up 43% of total sales in the 1H of FY16 on a Company-wide basis. By comparison, 1H sales of private label brands at UA and BY accounted for 35% and 50%, respectively, of total sales. On a full fiscal year basis and after including the fall and winter seasons, these composition rates are projected to show slight increases. There are no plans for any major change in composition rates going forward. Reflecting on the excessive volume of private label brands at stores up to the previous year, we are taking steps to return to composition rates that are more in line with select shop-type businesses, which are in greater demand by customers.

Q. How do you account for the robust trends at CHROME HEARTS (CH)?

A. In addition to growth in inbound demand, robust trends at CH can be attributed to an upswing in the number of domestic customers from the youth and women's markets.

Q. The number of purchasing customers has continued to recover since September 2015. Why do you think this is so?

A. There are signs of a recovery in the number of purchasing customers mainly at UNITED ARROWS green label relaxing (GLR). While disclosure of the number of purchasing customers is limited to the Company's retail stores, customer numbers—including online store sales—are projected to improve by about three percentage points. A major factor in this improvement in the number of purchasing customers can be attributed to the review of prices. After raising the level of lower price range products last year, signs of a negative reaction began to emerge among customers. In 2005, we returned the level of lower price range products to their original level. Furthermore, changes in women's trends have become increasingly marked since spring and summer, and efforts to put forward fresh product proposals are also contributing to the upswing in customer numbers.

Q. Despite profits in the 1H exceeding plans, why is the Company not revising its forecasts for the full fiscal year?

A. Assuming that current sales and profit trends continue, the potential exists to bring forward operating overhead expenses aimed at boosting sales in FY17. Taking this into consideration as well as the possible incidence of such expenses as period-end bonuses, the profit upside of the 1H may not continue across the full fiscal year. We will endeavor to bring in profits at close to the forecast level.

Q. You have stated that 8-season merchandising will be extended to businesses other than GLR. What specific measures will you take?

A. The introduction of 8-season merchandising is based on SPA-type businesses where we are able to control all aspects of operating activities, including product purchasing schedules. We will initially set up a model for the women's market, which is sensitive to changes in the weather and trends, and where we believe 8-season merchandising will prove effective. The success achieved at GLR has been shared with all other businesses. UA and BY have, for example, adopted the 8-season merchandising approach for their women's private label brands. We expect to see progress from this fall and winter and through to next spring and summer. Taking into consideration the central role that women's SPA-type businesses play in the activities of SBUs, major changes will also be made in this area from spring and summer of 2016.

Q. Please tell us about the Company's product proposals and efforts to address trends. In the past, the Company has shown us the ability to address changing trends. Of late, however, has it failed to make the necessary adjustments due to such factors as the timing of product planning?
A. As an initial step, we take into consideration a variety of factors, including social tastes, when collating information on trends. An overall assessment and direction are then disseminated across the Company. Each business is responsible for incorporating this assessment into its plans and determining the composition of its lineup. While we have always been astute at assessing trends, we fell short in our ability to confirm that information had been properly incorporated into each business. As a result, the Fashion Marketing Department is now taking steps to ensure that there are no errors or gaps in the product purchasing activities of each business and those product proposals properly address trends after the start of each season.

Q. We are seeing a number of large-scale urban commercial facility developments take shape, including those in Tokyo's Shinjuku area. What are your thoughts on opening new stores next spring and the possibility of over-supply?
A. We plan to open several stores in new commercial facilities in Shinjuku. We will adopt a selective approach toward large-scale commercial facilities in other areas in a bid to avoid over-supply.

Q. The Company had previously suspended opening stores in the new ASTRAET (AST) business format. Why has it now decided to open new AST stores from spring?
A. AST results are yet to reach expected levels. Nevertheless, customers are becoming increasingly aware of this business format. Signs that AST products are attracting favorable comments from customers are also beginning to emerge. The AST store that will open this spring in the new NEWoMan commercial facility will take up the challenge of capturing customers in the female adult market.

Q. What are your thoughts on EN ROUTE (ENR) amid the growing trend toward casual sports and sporting wear trends?
A. Test marketing is currently under way with consideration given to the relevant findings. Our efforts are essentially at the trial-and-error stage. As people's interest in sports continues to grow, we are reevaluating the direction that we believe the ENR business should take. Turning to your comments regarding the opening of new stores, we are finding it difficult to properly convey the ENR brand concept together with such related features as running stations. We therefore recognize the need to consider store opening methods. Meanwhile, the response from overseas customers is high, with our ENR store included in tours of Tokyo's Ginza district for customers with a strong interest in fashion.

About Online Store Sales

Q. Online store sales are robust. Can you elaborate on trends by site?

A. ZOZOTOWN sales have increased 13% compared with the previous fiscal year and account for 56% of the Company's total online store sales. UNITED ARROWS LTD. ONLINE STORE sales have grown 12% year on year and make up a further 23%. Online sales through MAGASEEK and i LUMINE have increased 48% and 34%, respectively, with each comprising roughly 4% of total online store sales. In overall terms, growth was most notable through sites where the scale of sales is relatively small. A system is in place where items are sent after each fashion e-commerce site receives an order. The ordered items sent to each site are then delivered to customers. There are clear indications that this system is having a positive effect.

Q. While the industry as a whole is experiencing an upswing in online store sales, the Company appears to be posting especially high sales growth. Which measures do you see as having the most effect?

A. By bringing in-house the photographic shooting of products, we have significantly improved visual quality and presentation. Other measures include the sharing of distribution warehouse inventory information. These initiatives in particular are contributing to growth in online store sales. In order to maintain the fresh appeal of stores we have shortened the period of clearance sales at actual stores. The decision to concentrate clearance sales products at online stores is another factor that is underpinning sales growth.

About Improvements at SBUs

Q. In addition to reviewing its approach to brands as well as target markets, is there a chance that the Company will go even further by either improving or eliminating brands when looking to strengthen SBUs? In the event the Company chooses to either improve or eliminate a brand, what criteria will it apply?

A. Turning to SBUs, we are reviewing the manner in which value is provided and the position of each brand. At the same time, we are rethinking target markets. In overall terms, we believe that each new business should recoup all accumulated losses by its fifth year of operation. We apply this rough rule of thumb when determining whether or not to continue operations as a going concern. When a business fails to achieve this milestone, we take into consideration future potential and recovery prospects. Currently, there are no SBUs that fall within these parameters. The standard shop floor space of SBUs is 100 ㎡ compared with 330 ㎡ for mainstay businesses. Operations are therefore conducted by a small number of sales personnel. While a high level of customer service and coordination proposals that compare favorably with our mainstay businesses will continue to provide the key to success among competitors crowded within fashion buildings, we anticipate difficulties will arise in securing sales personnel in the future. Accordingly, we are revising our business model.

About Tax-Free Sales

Q. Please tell us about tax-free sales.

A. Up 2.5 times compared with the previous fiscal year, tax-free sales came to approximately ¥2.2 billion and accounted for 3.8% of total sales on a non-consolidated basis. The amount of tax-free sales continues to increase, making up 3.9% of total sales in October. Furthermore, the scale of tax-free sales has expanded considerably following changes to tax-free systems in October 2014. Despite the hurdles of the previous fiscal year, tax-free sales have trended at close to double earlier levels.

About Subsidiary Companies

Q. Please tell us about sales trends at existing COEN CO., LTD. stores.

A. In the 1H of FY16, existing retail and online store sales increased about 6%.

About the Cancellation of Treasury Stock

Q. In the past, the Company has explained that it will consider the use of treasury stock in the event of a favorable capital alliance or M&A. What factors contributed to the decision to cancel all treasury stock in this instance?

A. We are not looking to undertake M&A purely for the sake of expansion. When an M&A opportunity arise, we take into consideration synergy benefits and affinity with the Company. While proposals have indeed been received, certain issues relating to compatibility with our philosophy and the priority placed on stores led us to the decision to cancel all treasury stock at this time.

Q. What are your thoughts on future finance, capital, and investment strategies as well as the allocation of free cash flows as a result of the cancellation of treasury stock?

A. While withdrawing our medium-term business plan, we have continued to identify long-term targets. Our policy, for example, is to maintain an ROE of 20% or more on a consolidated basis. As we work toward realizing this goal, it is essential that we utilize internal controls to secure free cash flows. We will also prioritize the return of profits to shareholders through the continuous acquisition of treasury stock, review of our dividend payout ratio, and other initiatives.