UNITED ARROWS LTD. Third Quarter Fiscal 2012 Earnings Announcement Q&A

UNITED ARROWS LTD. held an earnings announcement presentation attended by the mass media, analysts, and institutional investors on February 7, 2012 (Tuesday) and February 8, 2012 (Wednesday). Details of principal questions received and answers given by category during each session are presented as follows. Certain details have been expanded or modified to provide readers with a deeper understanding of the UNITED ARROWS Group's performance and activities.

The UNITED ARROWS Group's operating results and activities for fiscal 2012, the fiscal year ending March 31, 2012, as well as forecasts for fiscal 2013, the fiscal year ending March 31, 2013

Q. We would again like to confirm with you the robust nature of the Group's current operating results.

A. The UNITED ARROWS Group's current robust operating results are underpinned by a variety of factors. In addition to a well-established product platform[*1] that enables customers to purchase products when they want and in the quantities they want, successful efforts to build to a Product and Sales Division cooperative model that synchronizes store feedback with fashion trends, to secure optimal balance between procured merchandise and private label brands, and to promote easy-to-understand sales and promotional initiatives in collaboration with the Promotion Division have led to a strong business performance.

Q. What factors contributed to the improvement in the Company's non-consolidated third quarter gross profit margin?

A. Outlet stores contributed significantly to the improvement in the gross profit margin during the third quarter of the fiscal year under review. Due primarily to a substantial year-on-year drop in the disposal of inventory attributable to sales promotions at department stores and related events, we have seen a positive reaction. At the same time, such factors as improvements in mark-down losses, a lower cost of goods purchased ratio and continued progress in eliminating inventory discrepancies have helped to lift the gross profit margin. Turning specifically to the cost of goods purchased ratio, the decline was largely attributable to strategic steps to raise the share of merchandise manufactured overseas.

Q. What factors, if any, do you anticipate will lead to a substantial improvement in the gross profit margin in the fourth quarter?

A. Recognizing that the gross profit margin up to the third quarter of the fiscal year under review has exceeded initial forecasts, we revised upward our estimate for the fourth quarter. The gross profit margin in the fourth quarter has on the other hand contracted due to markdown items following withdrawal from the Cath Kidston, SOUNDS GOOD and TOKISHIRAZU businesses during the previous fiscal year. Taking into consideration the low level recorded in the previous period, it appears as if margins have expanded substantially year on year.

Q. The gross profit margin in the third quarter of fiscal 2012 reflected the accumulation of various positive factors. Are there any factors that would suggest further improvement in fiscal 2013? Or, on the assumption that the gross profit margin will remain unchanged or decline, will an increase in revenue ensure that the amount of profit is maintained?

A. We are yet to determine forecasts and a concrete plan for the fiscal year ending March 31, 2013. At this stage, we can therefore only provide an outline of the general trend and direction. In putting in place a plan, we made the distinction between business expansion while maintaining profitability and business expansion while improving profitability. Our policy with respect to businesses with the primary goal of enhancing profitability is to improve both the gross profit margin and the selling, general and administration (SGA) ratio. Recognizing that there remains room to improve the profitability mainly of SBUs, we believe that we can lift the gross profit margin in overall terms. Another area that requires improvement is the content of inventory. Progress has already been made in reducing previous fiscal years' inventory. There is a strong possibility that this will lead to a decline in the ratio of outlet store sales as well as an upswing in the gross profit margin in fiscal 2013.

Q. The Company has upwardly revised its operating income forecast by around ¥1,050 million. How much of this was factored into business results as of December 31, 2011? How much have earnings for the third quarter of the fiscal year under review surpassed internal estimates?

A. Operating income through to the third quarter has surpassed internal estimates by well over ¥2,000 million. Turning to the fourth quarter of the fiscal year under review, plans are in place to bring forward increases in operating overhead expenses. This includes higher advertising expenses, the payment of additional period-end bonuses and expenditure relating to the maintenance and repair of stores as well as furniture and fixtures.

Q. Your estimates for sales in March 2012 have risen substantially on a year-on-year basis. What are your underlying assumptions?

A. We are looking at year-on-year growth in existing retail and online store sales of between 27 and 28% in March 2012. Taking into consideration the year-on-year drop in existing retail and online store sales of 17% in March 2011 due mainly to the Great East Japan Earthquake, we do not believe that this estimate is overly optimistic. We also expect positive contributions from large-scale promotional events scheduled in March.

Q. Please provide us with specific details regarding meetings held to attract advance orders in the BEAUTY&YOUTH UNITED ARROWS (BY) business. What effects has this initiative produced?
A. Advance order meetings allow customers to place online orders for designated products around two months prior to their release. By examining these orders, we are better able to assess sales trends encompassing the color, shape and size of products. In gauging the level and content of advance orders, we are also able to arrange for additional production as required. At the time products are actually released and sold at stores, this information allows us to accurately manage inventory. Of equal importance is our ability to offset any shortages in the supply of popular items. Taking into consideration its affordable price range and largely casual lineup, BY brand products are relatively easy to purchase. If we are in the position to roughly estimate high sales volumes, this mechanism serves as a positive tool to predict demand.

Q. What results have cross-media promotions produced in the green label relaxing (GLR) business?
A. Cross-media promotions conducted between September and November 2011 in the GLR business contributed to a 9.8% year on year increase in existing retail store sales and 5.3% upswing compared with the corresponding period of the previous fiscal year in the number of purchasing customers at retail stores. These results surpassed the Company average for the quarter.

Q. Please provide us with details of large-scale promotions in the UNITED ARROWS (UA) business scheduled for March 2012.
A. We are not currently in a position to provide details. We are, however, considering the use of television media. Given the specific characteristics of the UA business, the methods we use will differ from those of the GLR business.

Q. The opening of certain UA stores has been delayed until the next fiscal year. Please provide us with details. What are your plans for opening new stores during the fiscal year ending March 31, 2013?
A. The opening of independent UA women’s stores has been delayed until the next fiscal year. While we are currently in the throes of putting in place a plan and therefore unable to provide specific details, we anticipate the number of newly opened stores on a non-consolidated basis in fiscal 2013 will remain roughly in line with fiscal 2012. We do, however, plan to increase the number of newly opened COEN CO., LTD. stores compare with the current fiscal year.

Q. Historically, the Company has not undertaken large levels of advertising expenditure. For the first three quarters of the fiscal year under review, however, the ratio of advertising expenses has risen to 2.2%. This figure is expected to climb slightly higher after taking into account expenditure during February and March 2012. Please tell us about advertising expenditure levels in the future.

A. Since the Company was first established we have effectively held advertising expenses to around a maximum of 2.0%. Over the past several years, however, we have become increasingly aware that our concept has not been adequately conveyed to customers. Our efforts, therefore, to correct this situation has resulted in the recent upswing in advertising expenses. Moving forward, we intend to channel our energies toward securing an optimal balance. Accordingly, we are looking at maintaining the ratio of advertising expenses to between 2.0 and 2.5%.

Traffic Sales Channel

Q. In which fields is the traffic channel being employed effectively, and where has it failed to take affect? Are there any plans to change the traffic sales channel business merchandising[*2] mix?

A. Both THE STATION STORE UNITED ARROWS LTD. and THE HIGHWAY STORE UNITED ARROWS LTD. have a attracted a greater than anticipated number of customers. Each business is further distinguished by a product lineup that is easily identified and determined. In our STATION STORE operations, fluctuations in temperatures and weather conditions have had a greater than expected impact on demand. In the HIGHWAY STORE business, gifts and souvenirs are in high demand. Logo products are also proving popular. Currently, we are working to modify our merchandising in an effort to address this issue and ensure that the development of products is more finely attuned to the particular characteristics of demand.

Q. Has the traffic channel format been fully determined and defined? Is there room for further potential?

A. We believe there is still room to increase earning capacity in THE STATION STORE and THE HIGHWAY STORE businesses. We continue to review activities in THE AIRPORT STORE UNITED ARROWS LTD. business. We have not yet fully grasped the characteristics of this channel and are unable at this stage to provide a definitive reply.

Market Trends and the Consumption Environment

Q. Sales at existing and newly opened stores continue to grow. Do you have any concerns about fiscal 2013 and beyond?

A. We are now entering our third year of year-on-year increases in monthly sales at existing stores. We are well aware, however, that a significant amount of hard work and effort will be required to continue this trend. There is a concern that in this third year of growth the motivation of our employees may taper off. While we are not at this stage overly concerned about external factors, it is important to maintain a sense of urgency and caution toward the potential negative impact of internal factors.

Q. In addition to the declining trend in raw material costs, factors such as the strong yen are contributing to a drop in prices. Have you changed your pricing policies?
A. Outside such factors as fluctuations in foreign currency exchange rates, we are not aware of any factors that are likely to trigger a sharp decline in costs. We do not believe current circumstances warrant any change in pricing policies.
(Note: The price of raw cotton has remained stable compared with a year ago. The cost of wool and leather-related materials, on the other hand, continues to climb. Labor charges for such processing activities as spinning, weaving, and dyeing are also showing an upward trend. On this basis, we do not believe that the cost of raw materials will decline for the foreseeable future.)

Q. Please tell us about prospects for spring items as well as spending trends.
A. To be perfectly honest, we are in the dark with respect to prospects for spring items. Given the weather conditions and temperatures during January and the beginning of February 2012, we anticipate the release of spring items will be delayed compared with the previous year. It is difficult to imagine consumer sentiment shifting over to spring products in the short term. In recent days, we have had to adopt a wait and see attitude toward any impact on February spending trends. Having said this, however, it is quite clear that we will not experience the downturn in fashion spending that occurred immediately after the earthquake disaster. Consumers are looking to enjoy the pleasures of fashion and are likely to delve deeper into their pockets to purchase that extra special item. While it is difficult to comment without looking at the startup of spring item sales, we anticipate this positive outlook will continue into the future.

Q. It is now one year since renovations were completed at UNITED ARROWS HARAJUKU FOR WOMEN. What have been the results?
A. While sales at UNITED ARROWS HARAJUKU FOR WOMEN have surpassed levels recorded for the previous year they are yet to reach initial plans. We intend to further bolster events and other promotions. The large-scale promotion that we have planned for March will focus on showcasing the image of our brands. UNITED ARROWS HARAJUKU FOR WOMEN, which is recognized as a driver of growth in the UA women’s brand, is therefore projected to boost results.

Q. What view is the retail sector taking toward increases in the consumption tax rate?

A. Any increase in the consumption tax rate will have far-reaching consequences that extend well beyond the fashion business. From a retail sales perspective, it is vital that the sector pay close attention to developing products that fully satisfy customer needs. It is equally important that we hone our product development skills by business unit and to clearly identify those areas in which we maintain competitive advantage over our rivals. In fiscal 2013, we will therefore place considerable emphasis on strengthening our product development capabilities.

Medium-Term Prospects

Q. Business results for the fiscal year ending March 31, 2012 are projected to surpass ¥100 billion for the first time. Under your medium-term business plan, you are targeting net sales of between ¥110 and ¥120 billion. At the current pace, what prospects do you hold for bringing forward your medium-term plans?
A. While we have disclosed a target range for net sales over the medium term, it is more than likely that we will pursue a higher result.

Q. How do you view the potential of online sales? Have you set a definitive ratio for online sales? Does the Company have an established target for own online site sales as a ratio of total online sales?
A. On a non-consolidated basis, we identified a target of between ¥12 and ¥14 billion for online sales under our medium-term business plan. This target would then account for between 12 and 13% of forecast total net sales. On a long-term basis, we are looking to lift this ratio to 15%. We are not currently in the position to comment on any targets for own online site sales as a ratio of total online sales. We do, however, have several strategies aimed at expanding own online site sales.

Other

Q. How will you translate efforts aimed at enhancing product capabilities into visible action at frontline stores?
A. Our view of frontline stores as based entirely on the concept of providing great service, great products and great stores. Within this concept, we will pay particular attention to enhancing our product development capabilities throughout the fiscal year ending March 31, 2013. Our primary concern will focus on accurately aligning raw and secondary materials as well as designs to fashion trends and to express customers’ tastes through appropriate product development. As a part of these ongoing efforts, we will establish an archive and atelier to house the Company’s resources.

Q. Can you tell us more about the repayment of debt? How will you appropriate the Group's retained earnings and balance the needs for investments, dividends, and debt repayment?
A. We will explain our basic stance when outlining our policies for the next fiscal year.

Q. Several years ago, major apparel manufacturers entered the market during the select shop boom period. How do current conditions differ from that era?
A. Select shops were originally defined as stores where imported goods comprised more than 50% of the total product lineup. Rather than create an equivalent Japanese term, the English denotation "select shop" was generally accepted and has continued through to the present day. Thanks largely to the emergence of select shops, customers in Japan were able to purchase products that were previously only available in Europe and the U.S. Unfortunately, imported products are often accompanied by unstable delivery. We have therefore sought to fill the gap and consistently provide products that are in high demand by customers by offering private label brands that reflect customer needs. As a result, customer support shifted from specialty stores offering mainly domestic items to select shops that included imported goods. We believe that select shop expansion is attributable to this unique consumption structure in Japan. The nature of select shop business is fundamentally different from the apparel business. From this perspective, major apparel manufacturers are confronted by significant hurdles when attempting to enter the market.

Q. What is the percentage of House Card members who purchase only from retail stores? What is the percentage of House Card members who purchase from both retail and online stores?
A. House Cards cannot be used for purchases at ZOZOTOWN and other online site stores that are not directly operated by the Company. Accordingly, we are not in a position to provide an accurate breakdown of House Card members who undertake purchases at both retail and online stores. In addition, data for House Card and own online site members is managed separately. As such, it is difficult to extract accurate numbers for concurrent members. As a reference, approximately 30% of own online site sales are currently made up of house card member purchases. We believe that this is roughly the percentage of members who purchase from retail and online stores.

*1 UNITED ARROWS LTD.'s product plat form is comprised of its merchandising and production platforms. It entails wide-ranging activities including product procurement, production, product launch, and inventory reduction. The platform itself was designed to break free from a business process and practice that overly relies on the skills and experience of individual artisans. Emphasis is therefore placed on a common and consistent set of forms and benchmarks that all appropriate parties can quickly master and perform with a high degree of accuracy. Information that underpins the selection of factories and raw materials procured is collated and shared throughout the Company.

By applying the product platform, the Company is better positioned to promote stable merchandising processes and to improve gross profit and cash flows.

*2 Merchandising (MD): Often abbreviated as “MD,” merchandising comprises both the product and merchandise planning process. While the “merchandise” image remains dominant, merchandising also includes the notions of price determination and sales format selection. Accordingly, the overall concept entails identifying what product is to be provided, at what price and how to an established target market. Individuals responsible for merchandising are often referred to as merchandisers, which can also be abbreviated as “MD.”
(Source: Glossary of fashion terms provided by SENKEN SHIMBUN Co., Ltd. URL: http://www.senken.co.jp/yougo/ (in Japanese only))