Second Quarter of Fiscal 2023 Financial Results Explanatory Material

SANYO SHOKAI LTD.

October 6, 2022

Note: This document is a translation of the original Japanese document and is only for reference purposes. In the any discrepancy between this translated document and the original Japanese document, the later shall prevail.

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Note: Figures for the period before the previous fiscal year are reference values that have been replaced in simplified form according to the New Revenue Recognition Standard, unless otherwise noted.

Consolidated PL: Cumulative Second Quarter

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Net sales were ¥25.46bn, operating loss was ¥310m, and net loss was ¥240m.

(Unit: ¥100m)	FY2019 Results[1]	Previous Year	Forecast	Current Year	vs. FY2019	vs. PY	vs. Forecast
Net sales	351.3	209.1	246.5	254.6	-96.7	+45.5	+8.1
Gross profit	210.4	121.9	148.8	156.3	-54.1	+34.4	+7.5
SG&A expenses	231.4	142.2	159.4	159.5	-71.9	+17.2	+0.1
Operating income	-21.0	-20.3	-10.6	-3.1	+17.9	+17.2	+7.5
Ordinary income	-20.6	-18.7	-10.9	-1.4	+19.2	+17.3	+9.5
Net income	-18.5	-19.1	-11.2	-2.4	+16.1	+16.7	+8.8

1. Because FY2019 results were calculated based on the irregular duration of 14 months, the results from March to August are referenced.

Consolidated PL: KPI

Gross profit margin improved by 1.0pt vs. forecast and 3.1pt YoY.
Operating margin improved by 3.1pt against forecast.

	FY2019 Results[1]	Previous Year	Forecast	Current Year	vs. FY2019	vs. PY	vs. Forecast
Gross profit margin	60.0%	58.3%	60.4%	61.4%	+1.4pt	+3.1pt	+1.0pt
SG&A expense ratio	65.9%	68.0%	64.7%	62.6%	-3.3pt	-5.4pt	-2.1pt
Operating margin	-6.0%	-9.7%	-4.3%	-1.2%	+4.8pt	+8.5pt	+3.1pt
Ordinary income margin	-5.9%	-9.0%	-4.4%	-0.6%	+5.3pt	+8.4pt	+3.8pt
Net income margin	-5.3%	-9.1%	-4.5%	-1.0%	+4.3pt	+8.1pt	+3.5pt

1. Reference values (Mar ~ Aug 2019)

Achievement of 1H Forecasts

Despite the lingering impact of the COVID-19 pandemic, net sales exceeded the projection. Furthermore, in addition to an improvement in the gross profit margin due to our strengthening full price sales and controlling the discount rate of discounted sales, SG&A expenses progressed almost as projected, resulting in both operating income and net income exceeding projections.

(Unit: ¥100m)	Forecast	Results	vs. FCST
Net sales	246.5	254.6	+8.1
Gross profit	148.8	156.3	+7.5
SG&A Expenses	159.4	159.5	+0.1
Operating income	-10.6	-3.1	+7.5
Ordinary income	-10.9	-1.4	+9.5
Net income	-11.2	-2.4	+8.8

Overview

Despite being affected by the sixth and seventh waves of COVID-19, net sales and profits both exceeded projections.

- The top line remained strong partly because of the lack of regulatory restrictions, such as a state of emergency declaration or priority measures implemented to prevent virus transmission, which would have led to restrictions on social activity.
- Gross profit was boosted by strengthening full price sales and controlling the discount rate of discounted sales, as planned.
- SG&A expenses progressed almost as projected, excluding sales-linked factors.

Operating income was ¥750m and net income was ¥880m, both exceeding projections.

Consolidated BS:
2Q Consolidated Accounting Period

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Total assets were ¥50.6bn, an increase of ¥2.8bn YoY.
Net assets also increased by ¥2.4bn yen, resulting in an equity ratio of 67.4%.

(Unit: ¥1m)	8/31/2021	8/31/2022	Change (value)
Cash and deposits	14,808	17,499	2,691
Accounts receivable	2,217	2,468	251
Merchandise and finished goods	8,795	7,739	(1,056)
Tangible fixed assets	9,210	8,619	(591)
Intangible fixed assets	3,728	3,794	66
Other assets	9,052	10,547	1,495
Total assets	**47,810**	**50,666**	**2,856**
Accounts payable	3,227	4,350	1,123
Loans	5,800	6,800	1,000
Other liabilities	4,592	5,350	758
Total liabilities	13,619	16,500	2,881
Capital	15,002	15,002	-
Total shareholders’ equity	27,863	30,216	2,353
Other net assets	3,826	3,949	123
Total net assets	31,689	34,165	2,476
Total liabilities and net assets	**47,810**	**50,666**	**2,856**

Cash and deposits

- Increase in cash reserves due to sale of investment securities at the end of the previous fiscal year, continued control on purchasing, and reduction in SG&A expenses.

Merchandise and finished goods

- Inventory reduction through new purchase controls.

Tangible fixed assets

- Decreased due to store impairment losses in the previous fiscal year.

Loans

- Borrowing increased due to new loans from Shoko Chukin Bank in the previous fiscal year.

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Summary: Progress of Priority Measures

Priority measures were implemented as planned, or even more than as planned.

Priority Measures	Progress	
Favorable net sales	○	**Higher results than PY in all channels. Physical store sales in particular saw an increase.** • Market conditions recovered when new COVID-19 infections decreased between March and June, and sales were strong. • Market conditions deteriorated from mid-July onwards due to the effects of the seventh wave of COVID-19 and unseasonable weather. However, results were higher YoY, partly because there was no state of emergency declaration and no priority measures implemented to prevent virus transmission, which would have led to restrictions on social activity.
Gross profit margin improved	○	**1H was 61.4%, exceeding the forecast by 1.0pt.** • Achieved a 3.1pt YoY improvement in 1H, against the target of a 2.5pt YoY improvement in the full year gross profit margin. • Full price sales ratio improved to 66% through strengthened full price sales (+8.4pt change YoY), progressing as planned by reducing carryover inventory and controlling the discount rate of discount sales.

Summary:
Progress of Priority Measures (consolidated)

Priority Measures | **Progress**

Priority Measures		Progress	
Business restructuring	Controls on SG&A expenses	○	**Controlled as projected.** • The increase of ¥1.72bn remained almost unchanged YoY, when the ¥1.33bn in sales commissions linked to sales, ¥210m in extraordinary losses recorded in the previous fiscal year, and other variable costs and non-recurring expenses are excluded.
	Inventory reduction	○	**Progressed as planned.** • Total inventory decreased ¥1.0bn YoY to ¥7.7bn – Carry-over inventory decreased by ¥1.6bn YoY, and is significantly improving. – In order to strengthen full price sales during the July and August mark down period, we launched new Autumn items in advance, resulting in an increase of about ¥700m for the next season’s items.
	Financial reform	○	**Equity ratio: 67.4%; Debt-to-equity ratio (DER): 0.20** • Net assets: ¥34.1bn, from ¥31.6bn compared to same month PY. • Net assets: ¥50.6bn, from ¥47.8bn compared to same month PY. • Interest-bearing liabilities: ¥6.8bn, from ¥5.8bn compared to same month PY. • Cash position: ¥17.4bn, from ¥14.8bn compared to same month PY. • Equity ratio improved to 67.4%, from 66.3% compared to same month PY.

Reference: Sales by Channel

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Sales in 1H were up 122% YoY, increasing in all sales channels. Physical store sales[1] grew 129% YoY, while EC grew 104% YoY. The full price sales margin and gross profit margin improved

Revenue (Unit: ¥1m)

	Mar	Apr	May	Mar ~ May	Sales composition ratio	Jun	Jul	Aug	Jun ~ Aug	Sales composition ratio	Mar ~ Aug	Sales composition ratio
Department stores	3,416	3,049	3,098	9,562	67%	2,720	3,017	1,574	7,311	66%	16,874	66%
Directly managed stores	246	207	192	645	4%	206	208	127	540	5%	1,185	5%
EC & mail/online orders	684	592	611	1,887	13%	514	705	560	1,780	16%	3,667	14%
Outlets	440	487	566	1,493	10%	374	435	468	1,277	11%	2,770	11%
Other	196	457	115	767	5%	64	32	104	200	2%	968	4%
Total	4,981	4,792	4,582	14,355	100%	3,878	4,397	2,834	11,109	100%	25,464	100%

YoY

	Mar	Apr	May	Mar ~ May	Jun	Jul	Aug	Jun ~ Aug	Mar ~ Aug
Department stores	107%	136%	202%	137%	106%	117%	130%	115%	127%
Directly managed stores	113%	121%	148%	124%	105%	107%	107%	106%	115%
EC & mail/online orders	97%	104%	112%	104%	92%	117%	104%	104%	104%
Outlets	139%	167%	171%	159%	135%	143%	168%	149%	154%
Other	59%	131%	59%	88%	26%	32%	219%	51%	76%
Total	105%	132%	168%	129%	101%	117%	129%	113%	122%

vs. 2019

	Mar	Apr	May	Mar ~ May	Jun	Jul	Aug	Jun ~ Aug	Mar ~ Aug
Department stores	66%	70%	75%	70%	63%	70%	57%	64%	67%
Directly managed stores	50%	47%	50%	49%	54%	58%	51%	55%	52%
EC & mail/online orders	106%	99%	119%	107%	103%	115%	124%	114%	110%
Outlets	133%	150%	175%	153%	165%	178%	167%	170%	160%
Other	29%	49%	28%	38%	42%	15%	29%	28%	35%
Total	68%	72%	80%	73%	69%	77%	69%	72%	72%

1. Total of department stores, directly managed stores, and outlets

Reference: SG&A Expenses

1H SG&A expenses increased by ¥1.72 bn from the previous year, but remained almost unchanged when extraordinary losses of ¥210m due to store closures in the previous fiscal year, sales commissions of ¥1.33bn linked to sales, and other variable and non-recurring expenses are excluded.

(Unit: ¥1m)	2021	2022	vs. PY
Sales expenses	9,242	10,806	1,563
Sales promotion expenses	489	696	207
Equipment expenses	303	329	26
Personnel expenses	1,900	2,133	234
Administrative expenses	1,307	1,222	-86
Logistics expenses	806	780	-26
Other	180	-15	-195
Total SG&A expenses	14,227	15,950	1,723

Sales expenses + ¥1.56bn Increase of ¥1.35bn in real terms, after excluding ¥210m recorded as an extraordinary loss in the previous fiscal year.

- Sales commissions increased by ¥1.33bn, linked to sales.
- Increased sales commissions linked to sales.
- Real estate rents decreased.
- Maintained PY's level by optimizing sales staff allocations.

Promotional expenses increased by ¥200m.

- Publication of comprehensive catalog.
- Strengthened promotion of a diffusion line approach.

Equipment expenses increased by ¥20m.

- Maintained the PY level.

Personnel expenses increased by ¥230m.

- Increased provision for bonuses.

Administrative expenses decreased by ¥80m.

- Promotion of paperless operations and remote work; reduction of outsourcing costs.

Other expenses decreased by ¥190m

- Decreased due to absorption-type merger of subsidiaries.

Sales expenses: FA expenses, rent expenses for real estate, sales commissions, outsourcing fees (sales-related), etc. Figures for 2021 include sales commissions equivalent to department store credit rate; Equipment expenses: Shops setup expenses, depreciation expenses (shops-related), lease fees, repair costs, etc.; Personnel expenses: Personnel compensation, statutory welfare benefits, etc.; Administrative expenses: Depreciation expenses (management-related), outsourcing expenses (management-related), utility expenses, travel & transportation expenses, communication expenses, and miscellaneous expenses

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Basic Policy for FY2023

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Basic Policy

Establish a stable profit structure guided by results from Revitalization Plan execution.

Start promoting growth strategies for business expansion.

Full-Year Forecast: Consolidated PL

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In light of 1H results, the full-year plan was revised to net sales of ¥56.6bn, gross profit of ¥35.12bn, SG&A expenses of ¥33.52bn, operating income of ¥1.6bn, and net income of ¥1.44bn.

		FY2022	FY2023				Reference: FY2019
		Results	Initial FCST	Revised Plan	vs. FY2022	vs. Initial FCST	Results[1]
Financial Figures (Unit: ¥100m)	Net sales	496.3	560.0	566.0	114%	101%	757.5
	Gross profit	295.3	347.2	351.2	119%	101%	448.6
	SG&A expenses	305.9	335.2	335.2	110%	100%	478.2
	Operating income	-10.5	12.0	16.0	-	133%	-29.6
	Ordinary income	-7.3	11.4	17.5	-	154%	-29.8
	Net income	6.6	9.0	14.4	218%	160%	-27.7
Major Financial Indicators	GP margin	59.5%	62.0%	62.0%	+2.5pt	0pt	59.2%
	SG&A %	61.6%	59.9%	59.2%	-2.4pt	-0.7pt	63.1%
	Operating margin	-2.1%	2.1%	2.8%	+4.9pt	+0.7pt	-3.9%
	Ordinary income margin	-1.5%	2.0%	3.1%	+4.6pt	+1.1pt	-3.9%
	Net income margin	1.3%	1.6%	2.5%	+1.2pt	+0.9pt	-3.7%

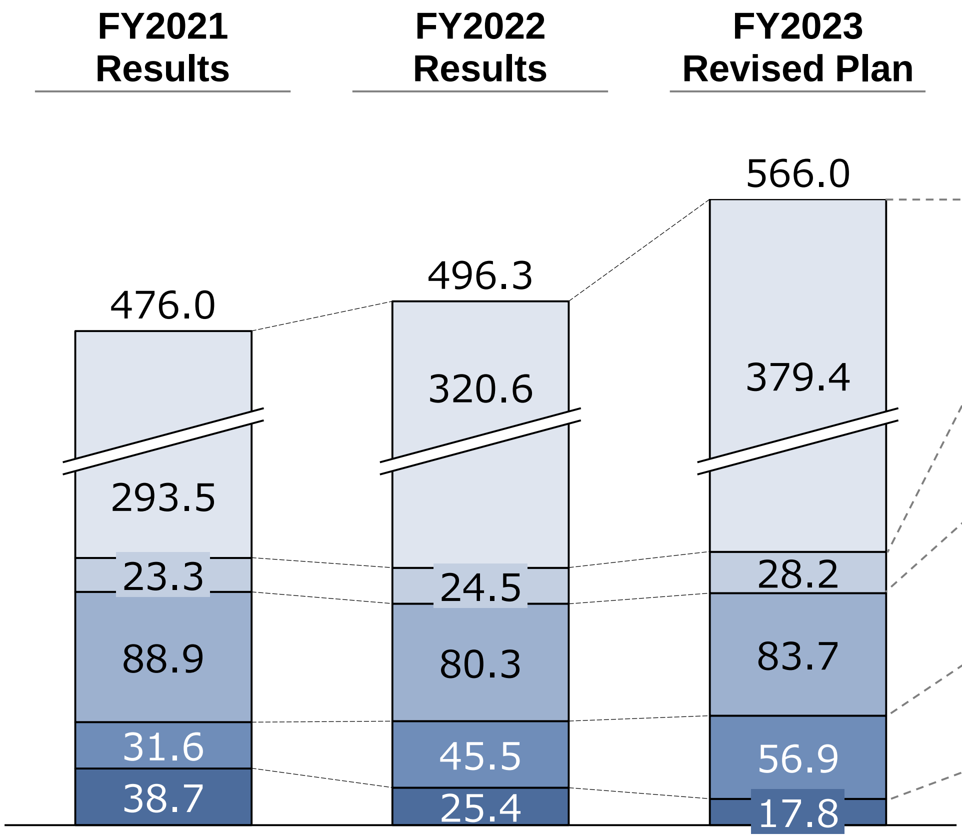
1. Because FY2019 results were calculated based on the irregular duration of 14 months, the results from March 2019 to February 2020 are referenced.

Favorable Net Sales

114% YoY is projected. For directly managed stores, we aim for 115% growth YoY through opening of stores promoting core brands and diffusion lines. For outlets, we aim to grow existing stores through prompt product transfer and outlet special products.

Net sales plan

(Unit: ¥100m)



	YoY	Measures
TTL net sales	114%	
Department stores	118%	Recover from the impact of store closures in PY. Improve sales per square foot. Promote OMO by utilizing comprehensive catalogs etc.
Directly managed stores	115%	Open more stores promoting core brands, and open new stores in urban FB/SC through a diffusion line approach.
EC	104%	Continue to expand EC-only products and enhance full price sales. Enhance reciprocal customer transfers with physical stores.
Outlets	125%	Proactively open stores in leading facilities. 2 new stores opened in 1H.
Other[1]	70%	

1. Subsidiaries, employee sales, wholesale, etc.

Measures to Improve Gross Profit Margin

Continual promotion of measures to reduce procurement cost margins, improve full price sales margins, control inventory, etc. We aim to increase gross profit margin by 2.5pt against FY2021.

Quantitative Target: Increase gross profit margin by 2.5pt (vs. FY2021)

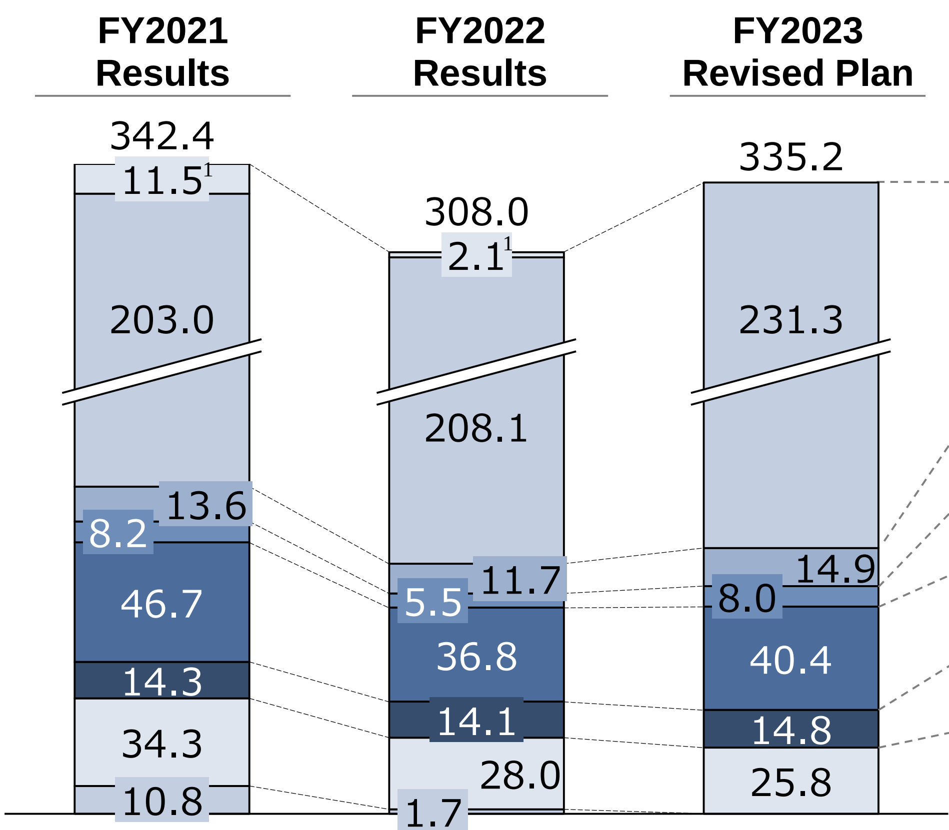
Qualitative policies	Specific measures
Reduction in procurement cost margin	• Optimize SCM by strengthening initiatives with major suppliers. • Plan for procurement cost margin of 22.8% for the full year (YoY difference of ±0pt, difference of -1.6pt compared to 2020). – Achieved projections with 22.8% in 1H (YoY difference of ±0pt, difference of -2.0pt compared to 2020)
Fundamental improvements in full price sales margins and total sell-through rate	• Full price sales margin: Plan to improve from 61% for the full FY2022 to over 70% Target for 2H is 74%. – Reduce SKUs/aggregate merchandising, and add bestselling products during the period. – Strengthen the appeal of full price sales at stores and EC, control discount rates, and shorten bargain sales periods. – Develop high value-added products through efforts of the Product Development Committee. • Aim for total sell-through rate of over 80%, from the 73% of FY2022.
Inventory control	• Keep back 20% of purchases in order to control over-purchasing. ¥17.0bn projected for end of FY 2023. • Product inventory at end of FY2023 is projected as ¥6.9bn. – Product inventory at end of FY2022 was ¥7.7bn (decreased by ¥100m from beginning of period). – Improve inventory turnover rates by shortening merchandising cycles and developing a Quick Response system.

Controls on SG&A Expenses

Proactively invest in stores, branding, etc. while continuing to control fixed costs that have been reduced under the Revitalization Plan

Past results vs. FY2023 revised plan

(Unit: ¥100m)



	vs. PY	Measures
SG&A (total)	**+27.2**	An increase of ¥500m.
Sales expenses	**+23.2**	Sales commissions linked to sales increased by ¥2.22bn YoY. Optimization of sales staff by closing unprofitable stores, and reduction in store operating costs.
Promotional expenses	**+3.2**	Enhanced promotion of new businesses.
Equipment expenses	**+2.5**	Investment in stores with opening of new stores.
Personnel expenses	**+3.6**	Increased provision for bonuses.
Logistics expenses	**+0.7**	Increase in conjunction with sales and purchases.
Administrative expenses	**-2.2**	Control fixed costs.
Other	**-1.7**	

1. Recorded extraordinary losses
Sales expenses: FA expenses, sales commissions, rent for real estate, etc.; Equipment expenses: Shops setup costs, depreciation expenses, lease fees, repair costs, etc.; Personnel expenses: Compensation, statutory welfare benefits, etc.
Logistics expenses: Packing & transportation costs, logistics outsourcing fees ; Administrative expenses: Business outsourcing fees, physical distribution costs, utility expenses, travel and transportation expenses, communication expenses, miscellaneous expenses

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Enhancement of Shareholder Returns

Due to an upward revision of the full-year plan, we project the payment of a DOE 2% dividend ahead of schedule beginning this fiscal year, increasing the dividend to ¥50. In accordance with the basic policy of the medium-term business plan, we intend to further enhance shareholder returns.

Policy for shareholder returns

("Medium-term Business Plan" published on April 14, 2022)

Establish a solid financial base

Aim for shareholders' equity of over ¥40bn.

- Accumulate capital by expanding the ability to create profitability: ¥4-5bn in 3 years.
- Securitization of assets: ¥4-5bn.

Aim for ROE of 8.5%.

Invest proactively for future growth

Proactively pursue investments for future growth with the establishment of a solid financial base.

Improve shareholder returns

Resume payout of dividends in FY2023, with a projected dividend of ¥40.

Aim for DOE of 2% for dividend payments beginning FY2024.

Updated

Enhancement of shareholder returns

We have decided to pay a DOE 2% dividend ahead of schedule beginning FY2023, and have revised the dividend forecast for this fiscal year to ¥50.

- The dividend forecast has been increased by ¥10 from the previous ¥40, due to an upward revision of the full-year plan.

We are considering further enhancement of shareholder returns, including the flexible implementation of share buybacks, in accordance with a basic policy of implementing a DOE dividend of 2%.

- Our aim is to improve earnings per share.

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