Adastria Co., Ltd.

FY2018/02 1H Financial Results & Business Strategy

September, 2017

ADASTRIA

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I. FY2018/02 1H Results and FY2018/02 Forecast

Representative Director, Chief Operating Officer
Masa Matsushita

Summary of FY2018/02 1H

- **Net sales increased; operating income and ordinary income decreased; net income increased year on year**

  Record high first-half sales due to the consolidation of new subsidiaries.
  Operating and ordinary income decreased due to a difficult environment for existing businesses, the establishment of a new business, and head office relocation expenses.
  However, net income increased because of the gain on sales of investment securities.

- **Missed the sales and operating income target**

  Sales fell behind the target even more in the 2nd quarter due to the weak performance of some core brands during the summer discount sale period.
  The higher price discount rate for reducing inventories resulted in a lower gross profit margin.
  Although SG&A expenses were controlled, operating income fell below the forecast.

- **Expansion and infrastructure improvement for new business**

  New brands were established and there was a good start for the post-merger integration of two acquired companies: ALICIA Co.,Ltd. and Velvet, LLC. Update of infrastructure IT system also progressed steadily.

Consolidated Income Statement

(Millions of yen)

Consolidated	FY2017/02 1H Results	FY2017/02 1H Ratio	FY2018/02 1H Initial forecast	FY2018/02 1H Results	FY2018/02 1H Ratio	FY2018/02 1H YoY
Net sales	97,726	100.0%	110,300	107,793	100.0%	110.3%
Adastria(Non-consolidated)	93,415	95.6%	-	97,324	90.3%	104.2%
Overseas *1 *2	5,257	5.4%	-	6,230	5.8%	118.5%
ALICIA *3	-	-	-	5,057	4.7%	-
Gross profit	56,545	57.9%	-	60,099	55.8%	106.3%
SG&A expenses	48,491	49.6%	-	56,066	52.0%	115.6%
Advertising & promotion	2,971	3.0%	-	3,460	3.2%	116.5%
Personnel	16,780	17.2%	-	18,645	17.3%	111.1%
Rent & depreciation	19,323	19.8%	-	22,322	20.7%	115.5%
Amortization of goodwill	1,092	1.1%	-	1,301	1.2%	119.2%
Others	8,323	8.5%	-	10,336	9.6%	124.2%
Operating income	8,054	8.2%	5,500	4,033	3.7%	50.1%
Adastria (Non-consolidated) (Amortization of goodwill excluded)	8,920	-	-	5,446	-	61.1%
Overseas *2 (Amortization of goodwill excluded)	▲ 334	-	-	▲ 865	-	-
ALICIA (Amortization of goodwill excluded)	-	-	-	184	-	-
Adastria Logistics	361	-	-	400	-	111.0%
Ordinary income	8,050	8.2%	5,500	4,143	3.8%	51.5%
Net income	4,848	5.0%	5,900	5,037	4.7%	103.9%
EBITDA	11,903	12.2%	9,600	8,601	8.0%	72.3%
Depreciation and amortization	2,757	2.8%	2,900	3,267	3.0%	118.5%
Amortization of goodwill	1,092	1.1%	1,200	1,301	1.2%	119.2%
Capital expenditure	3,140			7,009		

*1：Oversea business is the sum of 6 overseas subsidiaries: Hong Kong, Taiwan, China, Singapore, Korea, USA.

*2：The sales and profit of Adastria USA, Inc. is recorded from FY2018/2Q.

*3：The sales and profit of ALICIA Co.,Ltd. is recorded from FY2018/1Q.

Consolidated Income Statement Highlights

- **Net sales: 107.7 billion yen (+10.3% YoY)**
  - Non-consolidated: Net sales of existing stores in Japan declined 0.1% year on year, solid performances of some brands such as niko and ..., studio CLIP and BAYFLOW.
  - Overseas: Net sales increased due to the consolidation of USA business from the 2nd quarter, while the Asian business was sluggish overall.
  - Inclusion of sales and earnings of ALICIA Co.,Ltd. started in FY2018/1Q.

- **Gross profit margin: 55.8% (-2.1p YoY)**
  - The price discount rate increased to reduce inventories.

- **SG&A expense ratio: 52.0% (+2.4p YoY)**
  - Advertising & promotion: 3.2% (+0.2p YoY) Strengthened promotions for core brands.
  - Rent & depreciation: 20.7% (+0.9p YoY) 1.0 billion yen head office relocation expense
  - Others: 9.6% (+1.1p YoY) Relocation expenses, IT system update, etc.

- **Operating income: 4.0 billion yen (-49.9% YoY)**
  - Operating margin: 3.7% (-4.5p YoY), EBITDA margin: 8.0% (-4.2p YoY)

- **Net income: 5.0 billion yen (+3.9% YoY)**
  - 4.3 billion yen gain on sales of investment securities was recorded as extraordinary income.

Non-consolidated Income Statement

(Millions of yen)

(non-consolidated)	FY2017/02 1H Results	FY2018/02 2H Results	YoY
Net sales	93,415	97,324	104.2%
(Existing stores YoY)	102.3%	99.9%	
Global Work	18,364	18,828	102.5%
niko and...	11,629	13,608	117.0%
studio CLIP	11,010	12,404	112.7%
LOWRYS FARM	11,981	11,150	93.1%
LEPSIM	7,741	7,444	96.2%
Gross profit	53,278	53,760	100.9%
Gross margin	57.0%	55.2%	▲ 1.8p
SG&A expenses (before amortization of goodwill)	44,357	48,314	108.9%
SG&A ratio	47.5%	49.6%	+2.2p
Operating income (before amortization of goodwill)	8,920	5,446	61.1%
Operating margin	9.5%	5.6%	▲ 4.0p

Number of stores	FY2016/02 1H	FY2017/02 1H
Opened	38	71
Closed	21	16
Renovated	41	30
As of the end of fiscal year	1,237	1,298

Overseas Business

（Millions of yen）

		FY2017/02 1H	FY2018/02 1H		
		Results	Results	YoY (JPY)	YoY (Local currency)
Net sales		5,257	6,230	118.5%	117.7%
	Hong Kong	3,249	2,982	91.8%	91.4%
	China	890	895	100.6%	105.8%
	Korea	363	431	118.8%	114.1%
	Taiwan	753	806	107.0%	99.0%
	Singapore	0	-	-	-
	USA	-	1,114	-	-
Operating income (before amortization of goodwill)		▲ 334	▲ 865	-	-
	Hong Kong	▲ 152	▲ 342	-	-
	China	▲ 140	▲ 206	-	-
	Korea	▲ 143	▲ 93	-	-
	Taiwan	97	69	71.7%	66.3%
	Singapore	4	-	-	-
	USA (before amortization of goodwill)	-	▲ 291	-	-

Consolidated Balance Sheet

(Millions of yen)

Consolidated	End of 2016/8		End of 2017/2		End of 2017/8			
		Ratio		Ratio		Ratio	Compared with the end of 2016/8	Compared with the end of 2017/2
Current assets	44,227	50.8%	48,178	53.3%	49,858	51.7%	+5,630	+1,679
Cash and deposits	16,211	18.6%	20,734	22.9%	18,774	19.5%	+2,563	▲1,959
Inventories	16,707	19.2%	16,351	18.1%	18,066	18.7%	+1,359	+1,714
Fixed assets	42,775	49.2%	42,210	46.7%	46,640	48.3%	+3,864	+4,429
Property, plant and equipment	10,913	12.5%	10,444	11.6%	12,052	12.5%	+1,138	+1,607
Goodwill	4,401	5.1%	3,309	3.7%	6,449	6.7%	+2,047	+3,139
Investments and other assets	25,819	29.7%	26,213	29.0%	25,011	25.9%	▲ 808	▲1,202
Total assets	87,003	100.0%	90,389	100.0%	96,498	100.0%	+9,495	+6,109
Liabilities	32,460	37.3%	34,353	38.0%	39,792	41.2%	+7,331	+5,438
Interest-bearing debt	1,591	1.8%	2,027	2.2%	2,538	2.6%	+947	+510
Net assets	54,543	62.7%	56,035	62.0%	56,706	58.8%	+2,163	+671
Treasury stocks	▲2,077	▲2.4%	▲4,645	▲5.1%	▲4,649	▲4.8%	▲ 2,571	▲3

FY2018/02 Forecast (Consolidated)

(Millions of yen)

Consolidated	FY2017/02	FY2018/02 1H			FY2018/02			
	Results	Initial forecast	Results		Initial forecast	Revised forecast		
				YoY			Ratio	YoY
Net sales	203,686	110,300	107,793	110.3%	233,000	230,500	100.0%	113.2%
Operating income	14,916	5,500	4,033	50.1%	15,000	13,500	5.9%	90.5%
Ordinary income	15,126	5,500	4,143	51.5%	14,900	13,500	5.9%	89.2%
Net income	11,575	5,900	5,037	103.9%	11,900	11,000	4.8%	95.0%
ROE	21.2%	-	-	-	19.8%	19.1%	-	▲ 2.1p
EBITDA	23,028	9,600	8,601	72.3%	23,600	22,800	9.9%	99.0%
Depreciation &Amortization	5,928	2,900	3,267	118.5%	6,200	6,600	2.9%	111.3%
Amortization of goodwill	2,184	1,200	1,301	119.2%	2,400	2,700	1.2%	123.6%
Capital expenditure	7,992				16,800	16,800		

■ Revised forecast for FY2018/02 :

- Revised by using 1st half actual results adding 2nd half initial forecast
- 2nd half net sales increased because the sales is forecasted to increased on non-consolidate-basis, as well as adding the sales from velvet and ALICIA, the newly acquired subsidiaries. 2H operating income is also forecasted to increase year on year from the improvement of last year's excessive inventory issue.

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FY2018/02 Forecast (Non-consolidated)

（Millions of yen）

（non-consolidated）	FY2017/02 Results	FY2018/02 Initial forecast	FY2018/02 Revised Forecast	YoY
Net sales	194,611	207,000	206,200	106.0%
（Existing stores YoY）	102.5%	103.3%	101.8%	
Gross profit	108,043	117,400	115,200	106.6%
Gross margin	55.5%	56.7%	55.9%	+0.4p
SG&A expenses (before amortization of goodwill)	91,506	100,700	99,600	108.8%
SG&A ratio	47.0%	48.6%	48.3%	+1.3p
Operating income (before amortization of goodwill)	16,536	16,700	15,600	94.3%
Operating margin	8.5%	8.1%	7.6%	▲ 0.9p

Number of stores	FY2017/02 Results	FY2018/02 Initial forecast	FY2018/02 Revised Forecast
Opened	79	97	102
Closed	56	37	57
Renovated	70	70	70
As of the end of fiscal year	1,243	1,303	1,288

Return to Shareholders

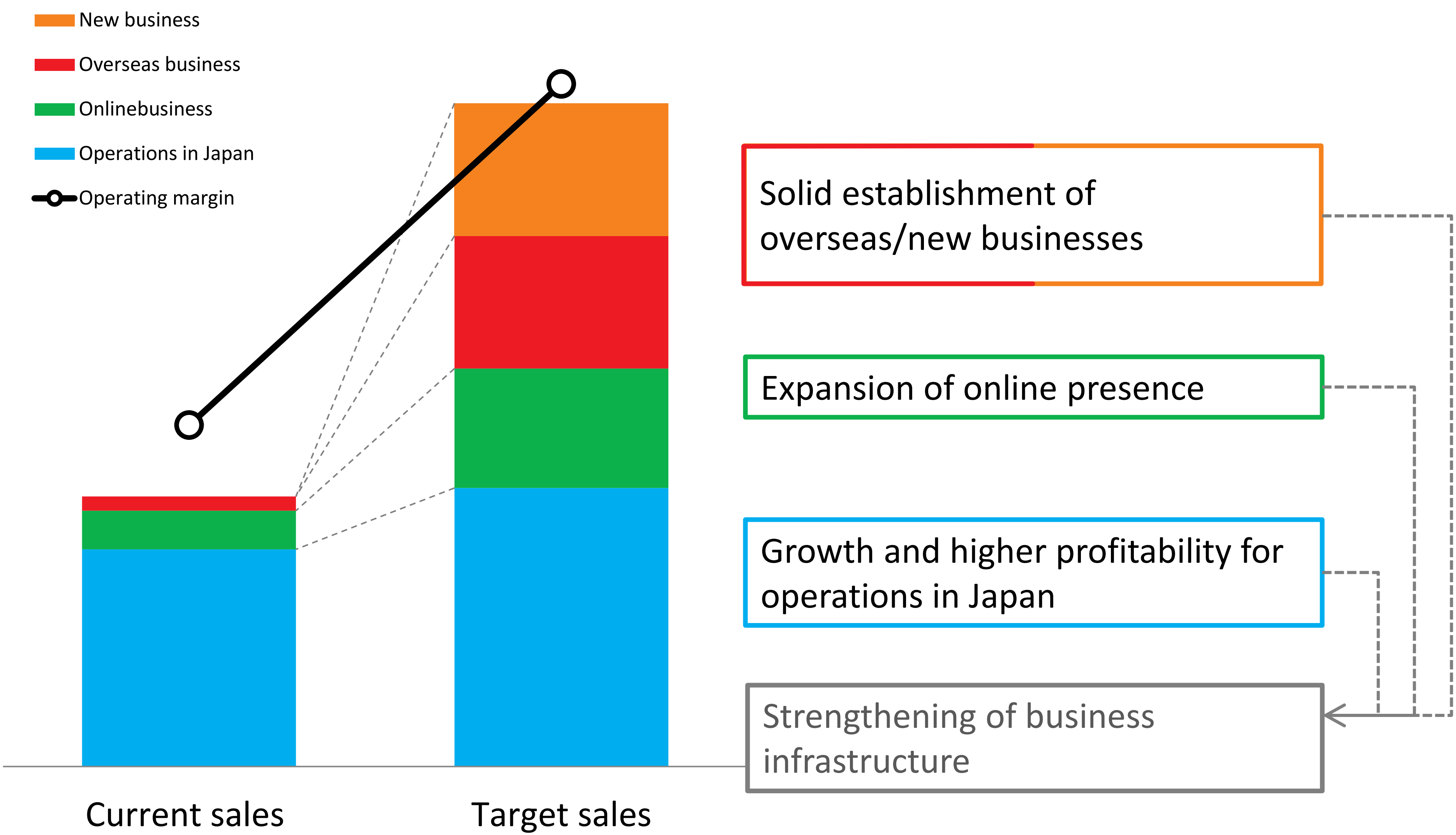
	FY2013/02	FY2014/02	FY2015/02	FY2016/02	FY2017/02	FY2018/02 (Forecast)
Dividend per share (Yen)	60	37.5	37.5	65	75	75
	(25)	(25)	(15)	(20)	(35)	(35)
Total dividend (MM yen)	2,679	1,697	1,821	3,138	3,608	3,569
Net profit (consolidated)	5,508	▲4,731	503	9,122	11,575	11,000
Amortization of goodwill	64	8,326	2,937	2,213	2,184	2,700
Dividend payout ratio	49.7%	-	361.5%	34.5%	30.9%	32.1%
(Amortization of goodwill excluded)		(47.8%)	(52.9%)	(27.8%)	(26.0%)	(25.8%)
Share repurchase (MM yen)	5,947	4,000	0	1,395	2,564	-

*1 The number is adjusted based on the 2:1 stock split executed on March 1st, 2016

Ⅱ. Initiatives for the Next Stage of Sales Growth

Representative Director, Chief Operating Officer
Masa Matsushita

The Next Stage of Sales Growth from 200 Billion Yen



Operations in Japan

Level up for production management

Formulation of hybrid SPA model
(Quick response + planned manufacturing)

- Consolidate and reinforce relationships with competitive factories
- Prepare materials beforehand
- Manage excess materials
- Receive on time production capacity information

Cost reduction

- Explore and utilize ASEAN factories
- Aggregate auxiliary material factories
- Implement Adastria's standard quality control procedure in top level factories
- Increase use of the same materials in many products

Operations in Japan

Finished the establishment of all 17 branches nationwide in September 2017

Reduce the labor shortage

Started recruiting and managing part-time personnel by using shopping mall units instead of individual brands

➡ **Increasing the flexibility of recruiting and managing part-time personnel**

Enhance training programs

Conduct and focus shop personnel training and shop skill training programs for all brands

➡ **Increasing the number of participants and reducing the time between training and official start for part-time personnel**

Local marketing

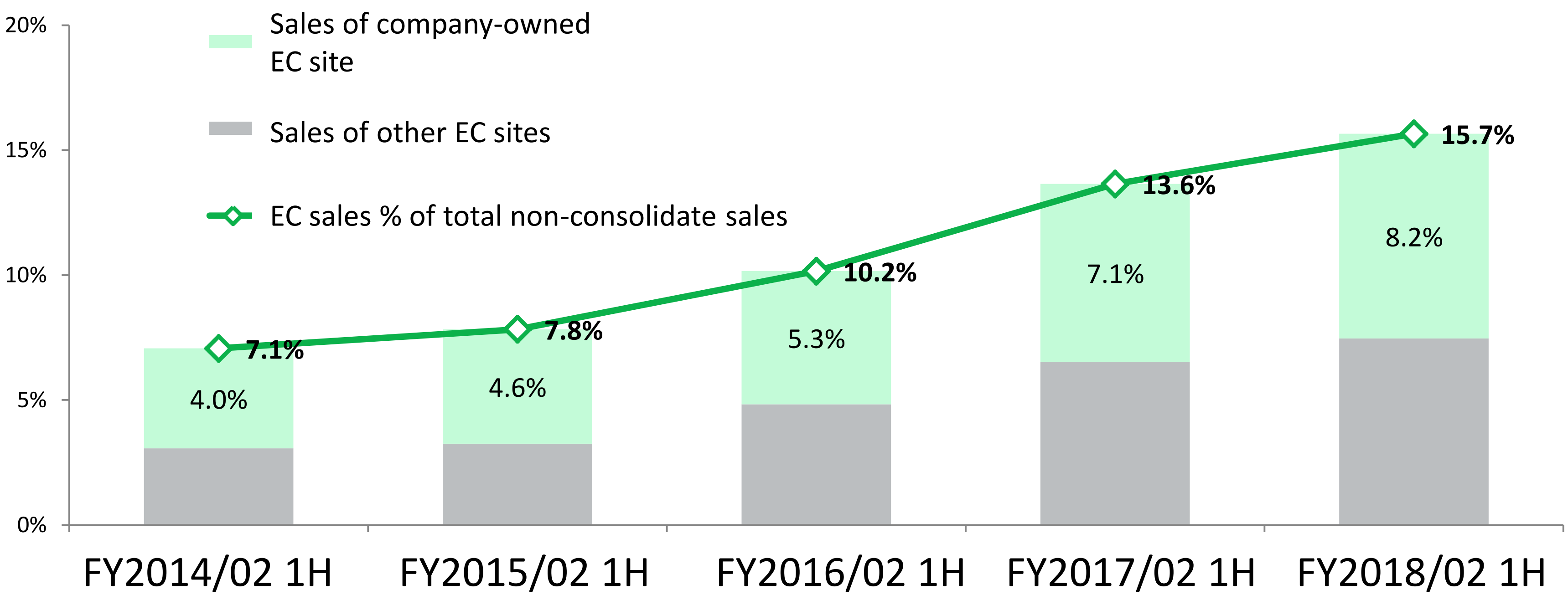
Hold collaboration events with local enterprises and organizations

➡ **Rejuvenating communities and increasing public awareness of ADASTRIA**

Online Business

Net sales: 15.2 billion yen (+19.5% yoy)

Online sales ratio of total non-consolidated sales: 15.7%（company-owned EC site 8.2%）
Members of company's e-commerce website [.st]: approx. 6.2 million
(+0.6m from 6 months ago)



- FY2014/02 figures include TRINITY ARTS INC.
- *Sales and ratio figures has been revised from the past due to the booking rule change for sales of company owned E-commerce site

Online Business

Expand the company's e-commerce website [.st]

- Drive traffic between physical stores and e-commerce site
- Reinforce customer relationship management
- Added three brands from ALICIA on [.st]
- Enhance the incentives for [.st] members
- Consider adding more payment methods

→

- Reactivate existing members
- Obtain new members

[Online business department talent enhancement]

Group brands by "customer profiling x purchase pattern" and solve issues at each brand group

Overseas Business

Launch niko and ... in Taiwan market

Launch niko and ... shops in Taiwan by using strategies that were successful in Korea

- Use brand headquarters in Japan to lead activities for maintaining a consistent global brand image
- Open flagship store first for the effective establishment of a brand concept

After the niko and ... Gangnam flagship store, niko and ... Taipei will open in October with a wide variety of merchandise, including apparel, household goods and niko and ... COFFEE.

niko and ... Gangnam

niko and ... Taipei will open in October

Overseas Business

velvet
BY GRAHAM & SPENCER

- Velvet is included in the income statement starting in the 2nd quarter of FY2018/02 and the balance sheet starting in the 1st quarter.
- Goal is to increase sales by maintaining the performance of the existing wholesale business and using the retailing know-how of ADASTRIA.

	FY2017/12	FY2018/12
Open more directly managed stores	• Standardization of operations, product lineup and policy for opening new stores • Identify issues involving products and quality	• Complete the standard retail model
Enhance talent and organization	• Temporarily transfer talent from Japan • Add more local talent for merchandising, operations and PR	• Hire people for the expansion phase • Add talent for increasing the number of stores
Branding	• Design brand statement • Revise online marketing strategy	• Execute promotions for increasing awareness

New Business

ALICIA

- Sales and earnings included starting with the 1st quarter of FY2018/02.
- Completed structural reforms 6 months earlier than planned and aim to continue improving profitability.

Structural reforms completed

	FY2018/01 1H	FY2018/01 2H
Concentrate on the retailing business	• Exited the wholesale business • Exited franchising business	
Strengthen online business	• Expanded sales on ZOZOTOWN (+100% YoY)	• Start sales on ADASTRIA's EC site [.st]
Utilize infrastructure of Adastria group	• Integrated the logistics, system, performance review policy into Adastria group	
Reform production and procurement process	• Consolidated suppliers • Implemented "Open to buy" method	• Implement SPA framework

Progress of Three Year Medium-term Strategy

Three year medium-term strategy (FY2018/02～2020/02)		Target number	Status at 1H of FY2018/02	Going forward
Consolidated		Net sales 260 billion yen	• Moved head office to Shibuya	
Existing business	Japan	• Average 5% sales growth YoY • Operating margin 10%	• Opened large GLOBAL WORK and niko and ... stores • Started the Hybrid SPA model • Established 17 branches	• Add new product categories (accessories, intimates)
	Online		• Growth of online business • 6.2 million [.st] membership	• Add three brands from ARICIA on [.st] • Execute plan to reactivate and increase membership of [.st]
Overseas business		Net sales 40 billion yen	• Completed acquisition of Velvet, LLC • Sales increased of niko and ... Korea	• Continue post merger integration of Velvet • Launch in niko and ... In Taiwan
New business			• Completed structural reforms of ARICIA • Launched new brand LAKOLE	• Launch new brands for accessories and intimates

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