WATTS (TSE Prime, 2735) FY8/23 Q4 Operating Results

While the external environment remains challenging, the Company is focused on improving profitability through reforms in both shops and products.

<Brief summary>

Overview of FY8/23 results

- Sales were 59,309 million yen (+1.6% YoY) and operating profit was 621 million yen (-37.7%), showing an increase in sales and a decline in profits. The same-store sales in the 100-Yen shop business decreased YoY, but overall sales increased slightly due to a large number of new shop openings. On the profit side, costs have remained high due to soaring raw material prices and the sharp depreciation of the yen. Although the Company made a downward revision to its business forecasts at the time of Q3 announcement, the performance recovered in Q4 as it was able to successfully introduce higher-priced products, resulting in an upward revision.
- The number of shops opened reached a record high of 228. Among these, more than 90% were highly profitable consignment-type models. The Company already renovated 70% of its shops to WATTS brand, beginning to show signs of completion. In parallel with the shop openings, it has been proactively closing unprofitable shops, bringing the total number of shops closed to 100.
- Gross margin was 37.9% for the full year, down 0.3ppt. from the previous fiscal year. The decline was mainly attributable to the sharp rise in raw material costs following the sharp depreciation of the yen, rising utility costs, and the full accounting of expenses related to the acquired Ontsu F･RETAIL (OFR). As a countermeasure, the Company aggressively introduced higher-priced products priced above 100 yen. Since the share of sales from higher-priced products at present exceeds 16% of total sales, the gross margin has been improving. As of the end of Q4, it has improved to 38.4%.
- Other businesses tend to be more cost flexible than the 100-Yen shop business as price adjustments are more likely to be accepted. However, due to the concentration of resources on the 100-Yen shop business, there have been no major changes in the performance of other businesses. As for overseas business, the Company launched a new business model in Thailand.

In the current fiscal year (FY8/24), implementing reforms in both shops and products to combat higher costs.

- The Company forecasts sales of 59,100 million yen (-0.4% from FY8/23) and operating profit of 500 million yen (-19.6%), showing declines in sales and profits. In anticipation of the ongoing challenging external environment, the Company will focus on enhancing profitability in the current fiscal year. The Company intends to improve its operating profit margin through measures such as increasing the proportion of higher-priced products, proactively closing unprofitable shops and opening new shops, especially consignment-type models.

Stock price data (October 26, 2023 closing price)

Stock price	562 yen
Shares issued	13,898,800 shares
Market cap	7,811 million yen
PER (est.)	28.03 times
PBR (actual)	0.63 times
Dividend yield forecast %	2.67%

Performance (Figures for FY8/24 are the Company's estimates)

(Million yen)	Net sales	YoY (%)	Operating profit	YoY (%)	Recurring profit	YoY (%)	Net income	YoY (%)	EPS (¥)	Dividend (Yen)	ROE (%)
FY8/21	50,702	-4.0	1,669	-5.6	1,586	-8.3	965	24.7	72.09	22.0	8.9
FY8/22	58,347	15.1	998	-40.2	1,148	-27.6	781	-19.1	57.83	15.0	6.7
FY8/23	59,309	1.6	621	-37.7	648	-43.5	250	-67.9	18.46	15.0	2.1
FY8/24(E)	59,100	-0.4	500	-19.6	400	-38.3	270	7.8	20.05	15.0	2.3

Overview of FY8/23 results

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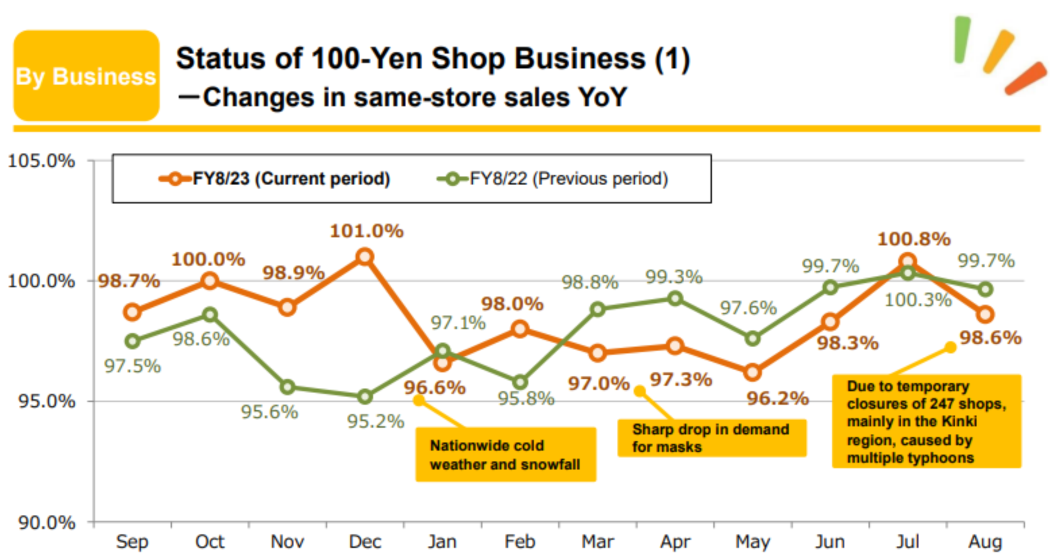
＜Overview of 100-Yen Shop Business 1 -Introducing higher-priced products to counter the challenging external environment>

- Sales from directly managed 100-Yen shops totaled 52,996 million yen (+2.3% YoY; 89.4% of total sales). The company opened 228 new shops compared to a plan of 236, and closed 100 shops compared to a plan of 90. The number of shops was almost in line with the plan, with a net increase of 128 shops and a total of 1,769 shops (+7.8% YoY). Considering the rising costs, more than 90% of the shop openings are of the highly profitable consignment-type model.
- The full-year same-store sales declined to 98.5% of the previous fiscal year. Until around December last year, it remained stable at over 100% YoY, partly due to the easing of the COVID-19 impact, but the situation changed with the depreciation of the yen. The number of discontinued items, typically fewer than 1,000 per month, has surged due to rising costs. Currently, discontinuing more than 1,000 items per month has become the norm.
- Furthermore, as of last December, there was an abnormal situation where 3,000 items were discontinued each month. The focus on measures against the discontinuations and the allocation of resources to mass shop openings have impacted the results, leading to a weak performance in same-store sales.
- On the other hand, The introduction of higher-priced products is steadily progressing. Sales of these products accounted for 15.5% of total sales (+5.7ppt. YoY) at the end of Q4 FY8/23, totaling 3,275 items. With costs remaining at a high level, the introduction of higher-priced products is an important measure to enhance profitability, and there is an ongoing aggressive development aiming to achieve the mid-to long-term goal of reaching 20% of total sales. The Company explains that these products have higher gross margins than 100-yen products, which contributes significantly to the increase in sales per customer. (In FY8/23, average spend per customer increased by 1.1 ppt. YoY).



Full year	Sales	No. of customers	Spending per customer
Previous period	97.9%	96.5%	100.3%
Current period	**98.5%**	**97.6%**	**101.4%**

✓ The same-store sales slightly fell below the YoY figure at 98.5%, as many of our resources were allocated to mass shop openings and product replacement due to product discontinuation caused by soaring costs.

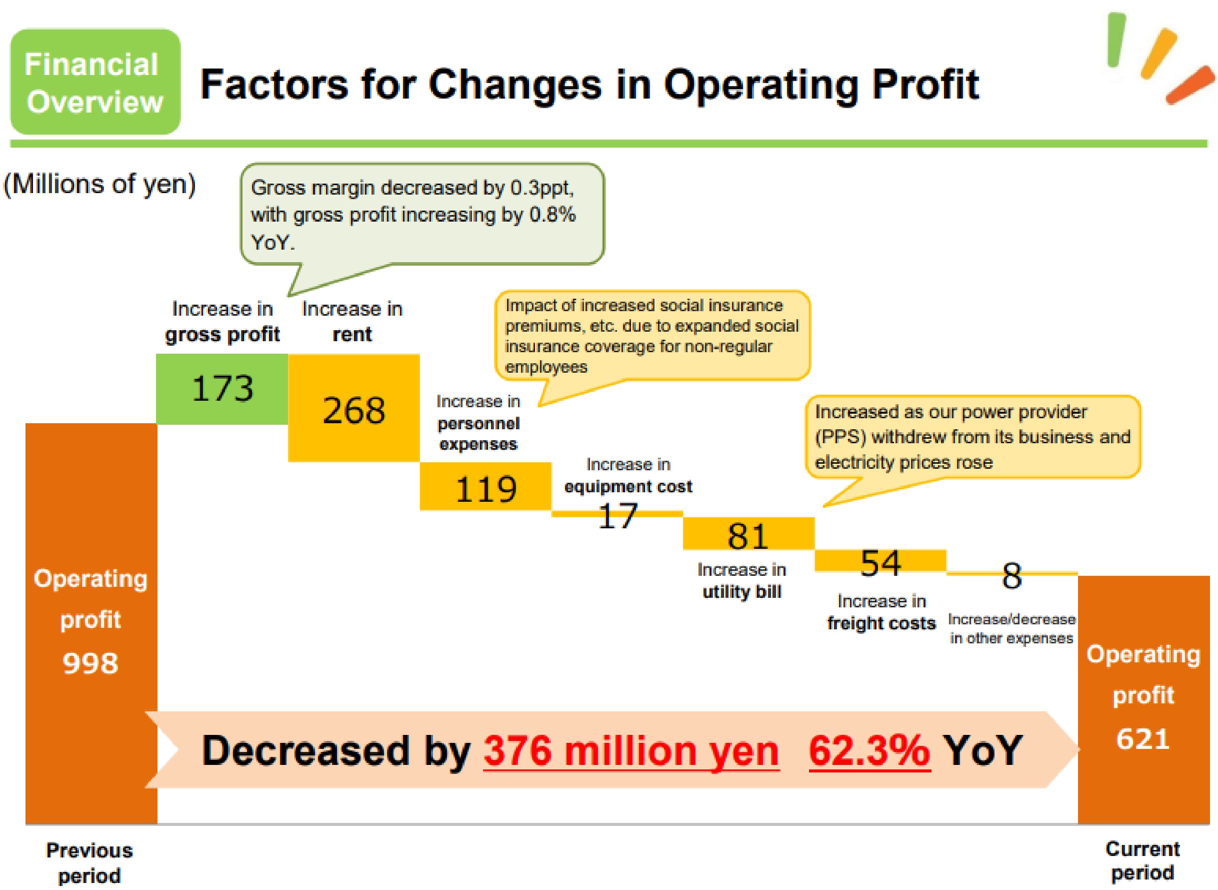
✓ On the other hand, sales of WATTS branded shops were 99.9% of the previous fiscal year.

<Overview of 100 Yen Shop Business 2 - Costs remain high>

- The gross margin was 37.9% for the full year, down 0.3ppt. YoY. The major factors were the rapid depreciation of the yen and soaring purchase costs due to rising raw material prices. Although the gross margin fell to 37.4% in Q3, it is showing signs of improvement, reaching 38.4% in the current Q4, primarily due to the introduction of higher-priced products. Alongside the increase in the proportion of higher-priced products, the cost ratio is also indicating signs of improvement, with further enhancements anticipated in the future. The Company mentioned that the best-selling products are in the price range of around 300-500 yen. Despite high competition in this price range, these products are considered affordable for consumers. Additionally, in the OFR shops acquired in FY8/22, there was an issue with a high proportion of low-margin food products. The Company is addressing this by enhancing profitability, introducing collaborative sections with other brands, and expanding the lineup of lifestyle goods.

- SG&A expenses, including labor costs and utilities, remained high. Starting from this fiscal year, the costs of the acquired OFR are fully reflected. Among the increased figures stated in the picture below, approximately 30% of the rents and around 80% of personnel expenses are attributed to the costs of OFR. To address the increasing logistics costs, the Company is working to enhance delivery efficiency; one initiative involves setting fixed days of the week for warehouse deliveries. As a result of these cost increases, the SG&A to sales ratio was 36.8%, up 0.3ppt. YoY.

- In the balance sheet, merchandise and finished goods increased significantly YoY, but this was due to an increase in inventories for the aggressive rollout of higher-priced products. Since this is also an emergency measure to prepare for the rapid depreciation of the yen, the Company expects to optimize the inventory in the future.



•Source: The Company's materials on financial results

＜Other Businesses: Despite headwinds, new business models were launched overseas>

- Overseas business remained stagnant with sales of 1,214 million yen, down 15.0% YoY, due in part to the sharp fluctuation in exchange rates. While the impact of COVID-19 has subsided, the environment remains difficult due to the political unrest in Peru and other factors. In Thailand, the Company's mainstay market, 12 shops were closed as a result of shop liquidation, bringing the total number of shops to 25. Also in Thailand, Watts.up+, a new business model mainly offering higher-priced products, was launched in September. With this new business format, the Company is aiming for a shop development model similar to that of Japan's Muji. The goal is to attract a younger customers that differs from the older customer base traditionally targeted.

- Buona Vita, which operates the lifestyle product shops, reported robust same-store sales of 112.2% YoY. This was attributed to strong sales of clothing and bags as the pandemic subsided and demand for outings increased. As of August 31, it operates 15 shops, and the number of customers has returned to pre-COVID levels. During the fiscal year under review, the Company did not open any new Buona Vita shops. Although the number of shops decreased by 8 from 23 at the end of the previous fiscal year, only 2 of them were actually closed, and the remaining 6 were due to the integration of the management companies. These shops, operated as a consignment-type model within the Company's 100-Yen shops, were not included in the figure. Regarding the tenant-type model, tenant owners tend to prefer fancy general merchandise shops like Buona Vita, so Buona Vita will pursue a strategy of collaboration by combining shops with 100-Yen shops. It plans to open 1 new shop this fiscal year.

- As for the household items brand "Tokino:ne," which divide its sales zones into morning, noon, evening, and night products, there has been no change in the number of shops, with 2 shops. Tokino:ne is also expanding its product section in 100-Yen shops, with more than 200 of these shops now featuring the brand's products.

- The discount shop "Real", like its 100-Yen shops, is receiving requests from its suppliers to raise prices. However, it is performing well. as they are able to control selling prices (price pass-through), unlike 100-Yen shops. As of August 31, there has been no change in the number of shops, with 5 shops. The collaboration with 100-Yens shops is also going well, and 1 new store is scheduled to open in November.

- The online shop is experiencing the effects of cost burdens, leading to a slight deficit. To address this, the Company implemented several countermeasures, including reforming the sales platform. Additionally, as a measure to tackle escalating logistics costs, the Company increased the number of shops offering in-store pickup services. In September 2023, the site underwent a redesign, and in-store pickup coverage was expanded to 180 shops. By not only offering 100-Yen shop items but also incorporating lifestyle products from other brands, the Company aims to enhance its appeal and value.

•Source: The Company's materials on financial results

Watts.up+ Central Rama 2 (Thailand)

<Full-year Forecasts -Priority is placed on improving profitability>

FY8/24 full-year forecasts

- The Company forecasts sales of 59,100 million yen (-0.4% YoY), operating profit of 500 million yen (-19.6% YoY), recurring profit of 400 million yen (-38.3% YoY), and net income attributable to owners of parent of 270 million yen (+7.8% YoY), expecting a decrease in sales and profits. The theme for this fiscal year is to improve profitability. The Company has been actively closing unprofitable shops while at the same time curbing shop openings to a certain degree to both improve existing store operations, which has been an issue, and improve profitability. The Company plans to open 160 new shops, down about 30% from the previous fiscal year, and close 120 shops, up 20% from the previous fiscal year. By opening more than 90% of its shops on a consignment basis, the Company will increase the ratio of low-cost, highly profitable shop model. On the other hand, sales growth for the consignment-type model is limited due to the small monthly sales per shop. While the introduction of higher-priced products is expected to improve profitability, investments such as renovations and the introduction of full-function self-checkout registers are concurrently taking place this fiscal year, leading to an anticipated decline in profits. Net income is expected to increase from the previous fiscal year, as impairment losses are expected to trend downward due to the closure of unprofitable shops.
- As of October 26, 2023, the Company's P/B ratio (actual) was 0.63x, indicating a situation commonly referred to as a "P/B ratio of less than one." Despite the Company's estimated cost of equity being in the range of 4-5%, the ROE based on this year's forecast is 2.3%, with the ROE currently lower than the cost of equity. The Company perceives this situation as a challenge and is actively working to enhance the P/B ratio. Measures include the previously mentioned initiatives to improve profitability, ongoing treasury stock acquisition, and proactive efforts in investor relations.
- According to the Company, "Although we wanted to limit new shop openings from the previous fiscal year in order to improve profitability, it is not possible to stop openings that have already been decided. Therefore, we will actively start restraining openings and strategic closures from this fiscal year." Although there is still no way out of the steep rise in foreign exchange rate and raw material prices, it is expected that closing unprofitable shops and increasing the number of consignment-type shops, which has traditionally been the Company's strength, will not only improve profitability but also help them to demonstrate its originality in the industry.

<Shareholder Returns - Consolidated into dividends starting this fiscal year>

Dividend policy/Acquisition of treasury stock

- In light of the principle of shareholder equality, the Company abolished its shareholder benefit program in the previous fiscal year. Going forward, the Company intends to return profits to shareholders through dividends and flexible treasury stock acquisition. The Company's basic policy is to pay a stable dividend. The Company says "We consider 20-30% of the payout ratio." The dividend forecast for the current fiscal year is 15 yen per share. Despite the forecasted decrease in profits, the Company plans to pay the same amount as in the previous fiscal year. The dividend payout ratio is expected to be 74.8%.
- The Company also announced a treasury stock acquisition of up to 300 million yen on July 10. The acquisitions will continue until March 29 of next year, and as of October 2, approximately 120 million yen worth of acquisitions have been completed. If purchases are expected to be made up to the upper limit, there is still plenty of room for more.

•Source: The Company's materials on financial results

(Millions of yen)

Business forecasts	FY8/22			FY8/23			FY8/24 (Forecast)		
		Ratio to sales	YoY		Ratio to sales	YoY		Ratio to sales	YoY
Sales	58,347	-	115.1%	59,309	-	101.6%	**59,100**	-	**99.6%**
Gross profit	22,281	38.2%	113.5%	22,454	37.9%	100.8%	-	-	-
SG&A	21,282	36.5%	118.4%	21,832	36.8%	102.6%	-	-	-
Operating profit	998	1.7%	59.8%	621	1.0%	62.3%	**500**	**0.8%**	**80.4%**
Recurring profit	1,148	2.0%	72.4%	648	1.1%	56.5%	**400**	**0.7%**	**61.7%**
Net income attributable to owners of parent	781	1.3%	80.9%	250	0.4%	32.1%	**270**	**0.5%**	**107.8%**
Net income per share (yen)	57.83		-	18.46		-	**20.05**		-
ROE	6.7%		-	2.1%		-	**2.3%**		-

<Latest Press Releases>

The Company's major press releases disclosed since the Q3 of FY8/23 are as follows. (Click on the image below to check press releases on the IRSTREET.)

11/07/2023	Notice Regarding October 2023 Monthly YoY Change in Sales and Number of Shops
11/02/2023	Notice of Convocation Annual General Meeting 2023
10/13/2023	Operating Results for the Fiscal Year Ended August 2023 and Business Forecasts for the Fiscal Year Ending August 2024
10/10/2023	Consolidated Financial Results for the Fiscal Year Ended August 31, 2023 (Under Japanese GAAP)
10/06/2023	Notice Regarding September 2023 Monthly YoY Change in Sales and Number of Shops
10/04/2023	[Delayed] Notice Concerning Revisions to Business Forecasts
09/07/2023	Notice Regarding August 2023 Monthly YoY Change in Sales and Number of Shops
08/07/2023	Notice Regarding July 2023 Monthly YoY Change in Sales and Number of Shops
08/01/2023	[IR STREET REPORT]: Announced a revision to the full-year forecasts. Despite the continued challenging environment, the pace of opening shops has been robust.

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