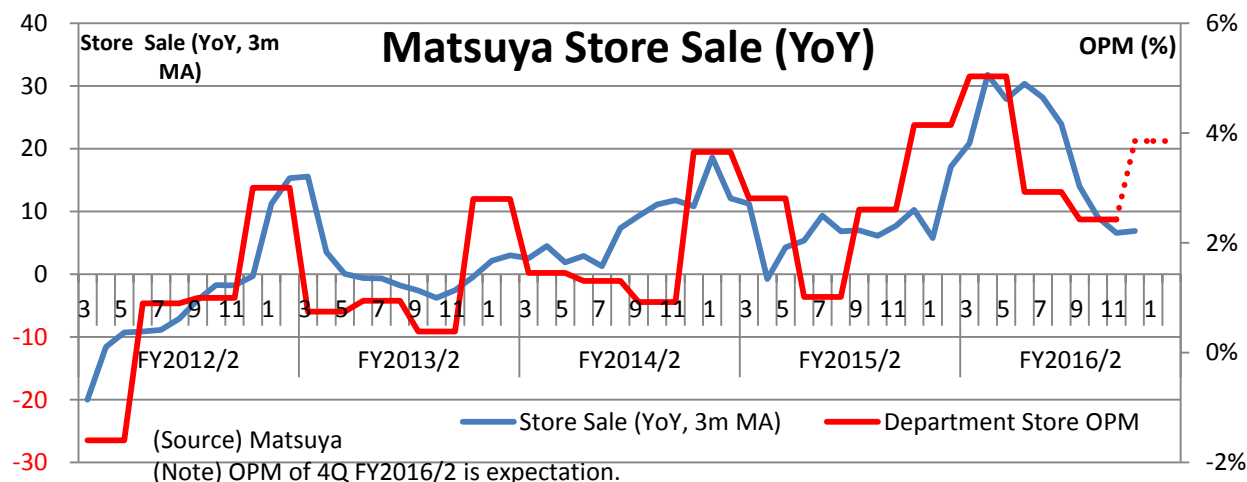


Changing 'Inbound' Consumption

1. Likely to have hit the peak in 1H 2015

For the period March-August in the previous year, overall retail sales remained flat, super market sale fell by 0.1% and department store sale fell by 0.4%, while convenience stores rose 5.6% from the same period of the previous year. For department store sale for the same period, only Tokyo gained 3.7% YoY, while regional stores lost 1.1% YoY struggling consumer spending slump hit by tax hike in April 2014. Among positive +3.7 % YoY sale growth Tokyo department stores, Ginza soared outstandingly 21.1% YoY, compared with other areas such as Shibuya +4.2%, Shinjuku +3.5%, Nihonbashi +1.9%, Ikebukuro -0.3% and Joto -5.3%. Tourists are gathering to the shopping town, Ginza where a number of top world luxury brands open direct run stores. Spurred by acceleration of 'inbound' sale, Ginza based department stores like Matsuya (8237) gained to +23.7% YoY from +1.8% in FY2013/2, +6.5% in FY2014/2 and +8.3% in FY2015/2. Unit price also jumped to +20.9% YoY in 1H FY2016/2 from +4.1% in FY2013/2, +5.5% in FY2014/2, +7.9% in FY2015/2. For reference, February 2016 Tokyo department store sales rose +2.7% YoY and nationwide department sales inched up 0.2% YoY. Matsuya's earnings have been recovering from conservative spending hit by East Japan earthquake in 2011, as OP margin improved in line with department store sale growth due to sale acceleration to foreign tourists (see table below).



2. Change in 'inbound' goods sale at department stores

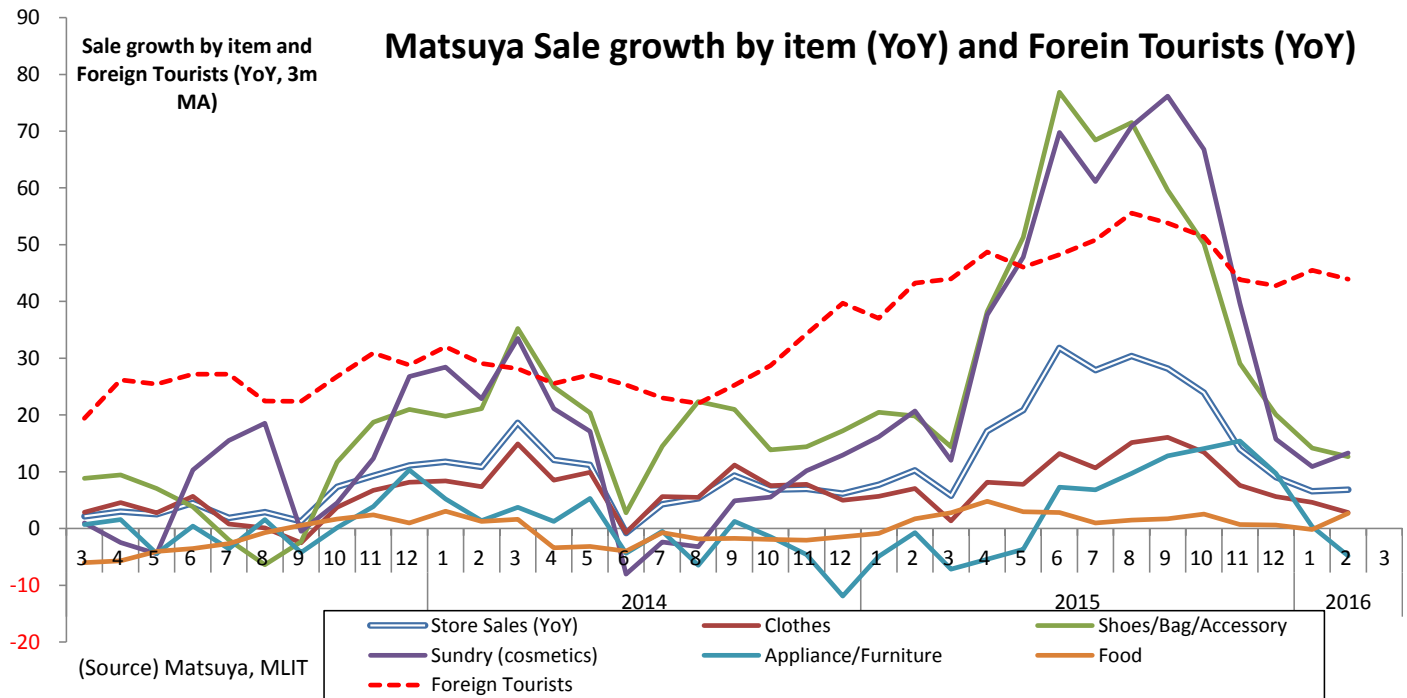
Visitors coming from other countries are buying mostly Personal belongs such as bags, shoes and accessory, and Sundry goods including cosmetics. For 1H, Personal belongs jumped 56.1% YoY in Matsuya Ginza vs. 9.1% YoY in Tokyo department stores, and Sundry grew 54.4% in Ginza vs. 13.2% in Tokyo. This trend is likely to continue going forward but would be changing in visitors' travel/consumption style and currency movements as well as China's policy such as cross border e-Commerce promotion. The table below is correlation of store sale by item vs. Foreign Tourists and USD/JPY. According to the correlation table, Matsuya store sales, Shoes/Bag/Accessory and Sundry (cosmetics) are more correlate with Foreign Tourists and USD/JPY. Foreign tourists seem to buy those more 2 items than others and are sensitive to currency rates, too. Particularly, cosmetics are very popular item for visitors as shown its correlation with foreign tourists of 0.68.

	Matsuya Store Sales	Clothes	Shoes/Bag/Accessory	Sundry (cosmetics)	Appliance/Furniture	Food	USD/JPY
Foreign Tourists	0.56	0.27	0.59	0.68	0.26	0.46	0.82
USD/JPY	0.53	0.30	0.56	0.53	0.20	0.46	-

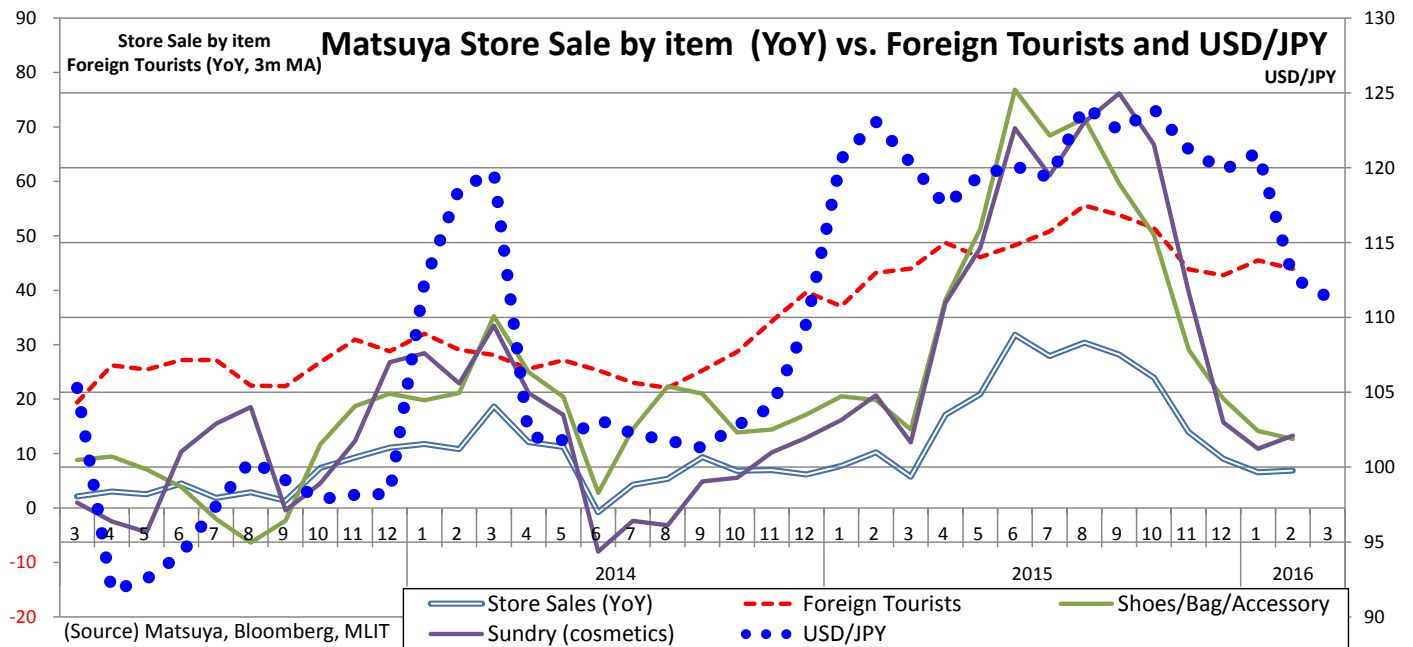
(Source) Matsuya, Bloomberg

(Note) Monthly data is from March 2013.

The chart below shows sale growth by items and YoY growth in number of foreign tourists. The 3-month MA sale growth of Shows/Bag/Accessory and Sundry surged to +70% YoY in the period from May to September in 2015 and plunged to mid-+10% YoY, whereas number of foreign tourists maintains leveling off at high +30% YoY after the peak in August. The divergence of growth rates between sales and number of foreign tourists would be influenced by other factors. One of the factors would be a currency rate.

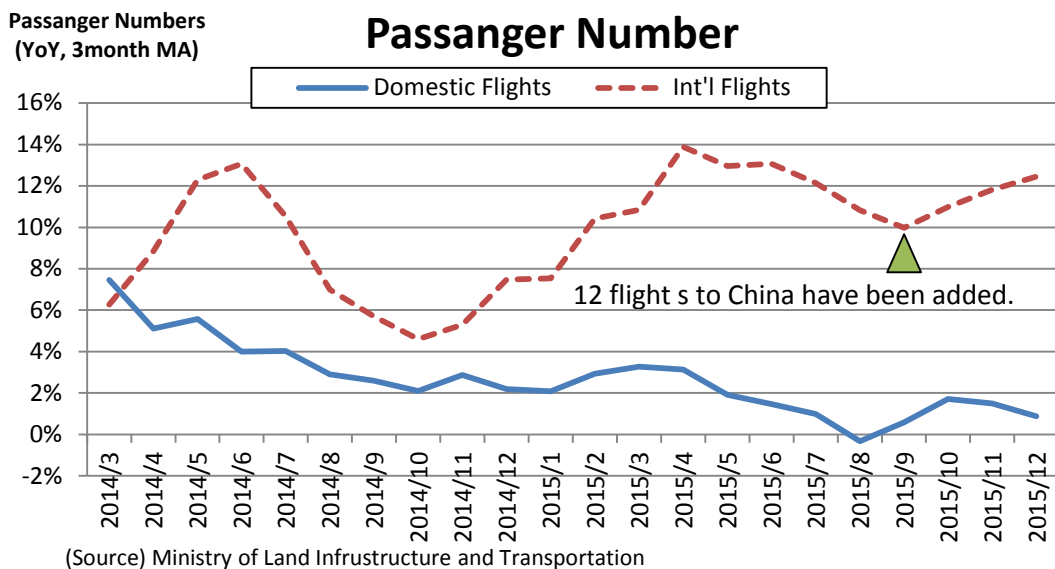


Another chart below adds USD/JPY to sale growth of Matsuya store sale, popular items and number of foreign tourists. The sale growth rates have been decelerating in line with weakness in USD/JPY rate since October, while the growth in number of foreign tourists has not declined so much. Recent sliding in USD/JPY would put downward pressure on store sales going forward. The 'inbound' goods sale is very likely to hit the peak at this moment in May to September. According to data by JDSA (Japan Department Stores Association), sale by item in Tokyo for February, Personal belongings such as shoes/bags/accessory fell 0.2% YoY and sundry gained 12.2% YoY, and of Sundry, Cosmetics expanded 27.9% YoY. Only cosmetics are selling very well for the month and this can be seen at the sales floor in Ginza department stores, too.



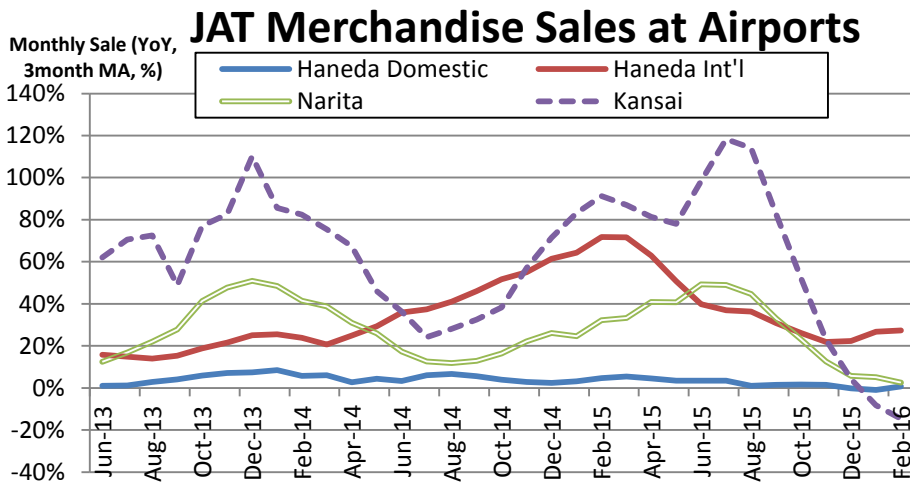
3. Another example at Duty Free Shopping at airports

Due to solid growth of air passengers spurred by the expansion of population and urbanization in Asian region, demand of air traffic of Japan from Asian countries is increasing. Japan's government has set the target of inbound tourist of rising to 40 million a year in 2020 from 19.7 million in 2015. In long-term, the number of foreign visitors is expected to grow; Japan Aircraft Development Corporation (JADC) expects the passengers within Asian region to grow at 5.6% annually. This secular trend would be intact, but examining the content of activity, it is really changing. The following chart shows the YoY growth of air passengers. Passengers of domestic flights are slow to grow, whereas those of international flights grew at slower pace after the peak in May 2015 but have recovered since October Haneda airport added 12 flights a day to China route.



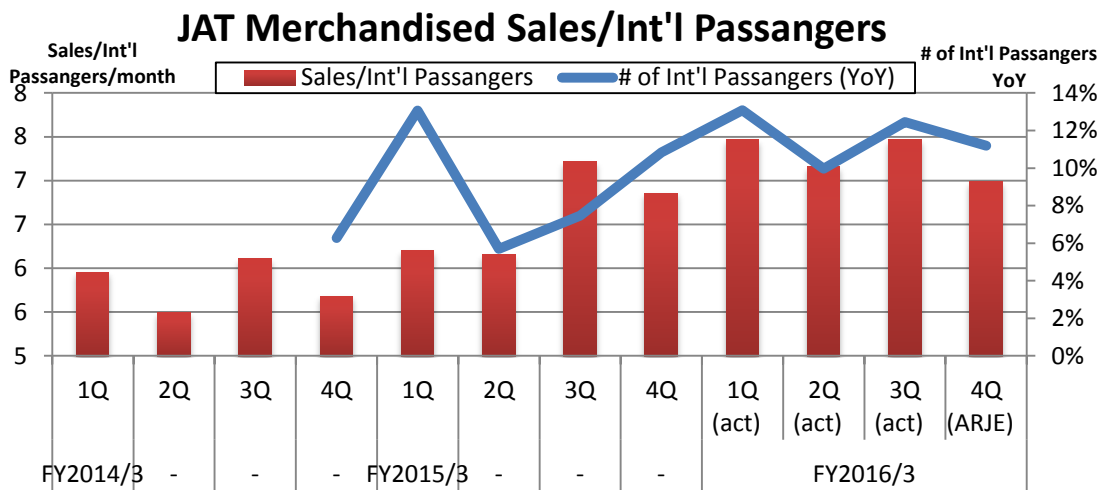
The next chart, Merchandise Sales at Airport shows only Haneda Int'l is recovering helped by additional flights on 25th October after the peak in March 2015. Narita and Kansai plunged from August, while sales of Haneda Domestic remain leveling off. Although the number of international passengers bounced back in October, the merchandised sales of JAT

have recovered at slower rate.



(source) Japan Airport Terminal (JAT)

The following chart shows a change in shopping activity of international passengers. Examining Merchandise sale/number of int'l passengers/Month, as the sale is more influenced by spending of inbound tourists; the value bounced back in 3Q FY2016/3 but is expected to slide again in 4Q FY2016/3. Merchandise sale/number of int'l passengers/Month or dollar value spent by an international passenger reached high of 7.47 in 1Q and 3Q FY2016/3 but is very likely to slip to 6.98 in 4Q on its latest monthly sale and passenger trend. This would be verified by the telephone interview with Japan Airport Terminal (9706); the IR manager said, "Sale of expensive goods is getting soft from the peak." Really, JAT opened 'Japan Duty Free GINZA' on January 27th at Mitsukoshi Department Store in Ginza, selling world luxury brands, but is not performing well at this moment. I guess 'made in Japan' goods are selling well even at slightly higher price, but it is not time for all visitors to buy expensive world brand goods.



(Source) MLIT, JAT

4. Conclusion

2 evidences such as department store sale in Ginza and duty free shopping at airports were examined. In a long term, the number of foreign visitors is very likely to continue growing. However, their consumer spending is changing from 2H in the previous year. The sale of highly popular items by tourists such as shoes/bag/accessory and cosmetics is apparently decelerating at department stores and the price per an international passenger is also sagging. Weakening USD/JPY would

be another headwind on such 'inbound' goods sale, as they are more sensitive to currency rates.

(Aki Matsumoto, CFA)