TSI HOLDINGS CO., LTD.

Q3 Financial Results Briefing for the Fiscal Year Ending February 2020

January 14, 2020

Event Summary

[Company Name]	TSI HOLDINGS CO., LTD.
[Event Type]	Earnings Announcement
[Event Name]	Q3 Financial Results Briefing for the Fiscal Year Ending February 2020
[Fiscal Period]	FY2019 Q3
[Date]	January 14, 2020
[Number of Pages]	15
[Time]	09:59 – 10:42 (Total: 43 minutes, Presentation: 31 minutes, Q&A: 12 minutes)
[Venue]	Aoyama Building 6F 1-2-3 Kita-Aoyama, Minato-ku, Tokyo 107-0061
[Venue Size]	
[Participants]	
[Number of Speakers]	1 Shinichi Uetadani — Chief Executive Officer Masaaki Oishi — Director

Presentation

Moderator: Good morning. We will now begin a briefing session for the financial results of TSI HOLDINGS CO., LTD., which were announced later last week.

First, as usual, Mr. Uetadani, Chief Executive Officer of the Company, will explain the outcomes in accordance with the materials on hand. Following that, we will hold a question and answer session.

Uetadani: I would like to explain the details of the financial results in the third quarter.

I think it would be better to talk about the overall picture rather than talk about each brand. We will spend a little more time on answering questions.

Consolidated Financial Highlights -Profit and Loss-

Unit:Million Yen

	Cumulative Q3RD 2019 Ending Feb.		Cumulative Q3RD 2020 Ending Feb.			
	Results	Composition Rate (%)	Results	Composition Rate (%)	Y/Y Change	Y/Y (%)
Net Sales	117,373	100.0	125,823	100.0	8,449	107.2
Gross Profit	64,486	54.9	68,524	54.5	4,037	106.3
SG&A Expenses	61,179	52.1	66,583	52.9	5,403	108.8
SG&A Expenses(excl. Goodwill Amortization, Depreciation and Amortization)	57,735	49.2	62,547	49.7	4,812	108.3
Goodwill Amortization	601	0.5	774	0.6	173	128.8
Depreciation and Amortization	2,842	2.4	3,261	2.6	418	114.7
Operating Income	3,306	2.8	1,940	1.5	-1,366	58.7
Ordinary Income	4,588	3.9	3,312	2.6	-1,275	72.2
Extraordinary Income	274	0.2	3,109	2.5	2,834	1130.7
Extraordinary Loss	453	0.4	145	0.1	-308	32.0
Profit Before Taxes	4,409	3.8	6,276	5.0	1,866	142.3
Profit Attributable to Owners of Parent	2,569	2.2	4,821	3.8	2,252	187.7
EBITDA ※	6,751	5.8	5,976	4.7	-775	88.5

*EBITDA＝Operating Income ＋ Goodwill Amortization ＋ Depreciation and Amortization

TSI HOLDINGS 2

First of all, I will explain the general results according to the materials.

Please see the overview of profits and losses on page two. In the figures below the top right part in dark blue, sales were up 7.2% YoY.

The biggest contributor was Ueno-Shokai, which we acquired last year and was consolidated on a full-year basis in the current year. Last year, there were still some brands that were being abolished, and excluding the effects of them and Ueno-Shokai, sales were down 1%, a slight decrease or almost flat. Therefore, it does not mean that sales in the existing brands increased.

However, we have decided to focus on profits rather than sales in the current fiscal year. Considering various environmental factors, we understand that the results were reasonable. The slight problem is in gross profit below, which was up 6.3% YoY. The growth rate was smaller than that of sales.

After struggling in the first half of the fiscal year, our businesses did not recover in the second half. Excluding Ueno-Shokai and the businesses that were closed last year, gross profit fell 4%.

In this regard, I was convinced that this was not a temporary phenomenon because we also had a mild winter last year. We were trying to curb inventories, as our stance was not to seek a forcible increase in sales. Even so, we were unable to keep up with the year-before figures.

As a result, although sales and gross profit rose YoY, they decreased slightly, excluding the impact of Ueno-Shokai.

SG&A expenses grew even faster than sales. Similarly, SG&A expenses in the continuing operations were up around 3% YoY.

We did not waste our resources. In fact, SG&A expenses rose simply while sales and gross profit ended in the sluggish growth. In particular, as we slashed the holding company's expenses considerably, we were far from wasting our money. Despite soaring distribution costs and personnel costs, there was no major factor that caused SG&A expenses to swell. I believe that we could not manage the costs satisfactorily amid the overall trend.

As a result, operating income was down over 40% and ordinary income was down nearly 30%. Net income increased, but this is because of the capital gains by selling our stake in Callaway Apparel to Callaway Golf, which was our joint venture partner, in the first half.

That was the overall picture. Excluding the acquired business and others, sales declined slightly and gross profit fell a little more, resulting in operating income that fell short of the target.

Brands Overview

Unit:Million Yen

	Cumulative Q3RD 2019 Ending Feb.			Cumulative Q3RD 2020 Ending Feb.			Y/Y	
	Sales	Composition Rate (%)	Gross Profit Ratio (%)	Sales	Composition Rate (%)	Gross Profit Ratio (%)	Sales (%)	Gross Profit Ratio (pt)
1. nano・universe	19,140	16.3	50.5	19,157	15.2	47.0	100.1	-3.5
2. NATURAL BEAUTY BASIC	12,048	10.3	59.2	11,668	9.3	59.1	96.8	-0.1
3. MARGARET HOWELL	10,563	9.0	59.8	10,459	8.3	59.5	99.0	-0.3
4. PEARLY GATES	9,164	7.8	52.8	9,555	7.6	52.2	104.3	-0.6
5. AVIREX ※1	-	-	-	6,064	4.8	61.7	-	-
6. ROSE BUD	5,239	4.5	48.1	4,537	3.6	51.0	86.6	+2.9
7. STUSSY	4,130	3.5	69.6	3,863	3.1	70.0	93.5	+0.4
8. HUMAN WOMAN	3,747	3.2	56.4	3,555	2.8	56.5	94.9	+0.1
9. HUF	3,977	3.4	49.3	3,421	2.7	48.3	86.0	-1.0
10. UNDEFEATED	2,782	2.4	43.2	3,400	2.7	45.0	122.2	+1.8
TOP10	70,793	60.3	54.5	75,683	60.2	54.3	106.9	-0.2
Other Brands	41,369	35.2	57.0	49,964	39.7	54.9	120.8	-2.1
Continuing Brands	112,163	95.6	55.4	125,647	99.9	54.5	112.0	-0.9
Closed Brands	5,210	4.4	44.3	175	0.1	8.9	3.4	-35.3
TOTAL	117,373	100.0	54.9	125,823	100.0	54.5	107.2	-0.4

*1 As we acquired the stock of UENO-SHOKAI Co., LTD. on October 26, 2018, we regarded the deemed acquisition date on November 30, 2018.
Therefore we only count UENO-SHOUKAI CO., LTD on this fiscal year.

TSI HOLDINGS 3

The summary of the brands is described on page three. We will not explain them individually, but if you have any questions, we will answer them later. As you can see, roughly the top 10 sales were not necessarily good, though the results were not uniform.

Gross profit does not necessarily increase simply because sales decline. There was not a major blow as a whole because each brand has controlled inventories and implemented a sales strategy without bargains. nano・universe showed the biggest sales. This brand was a major failure. Sales were almost the same as a year earlier, but gross profit margin ratio, fell 3.5 percentage points. This was largely due to a considerable impact in the first half of the current year. Sales grew more in the first half, but the brand tended to do business with relatively large inventories. In the second half, though inventories were tightened considerably, nano・universe was dealt the biggest blow.

As I will explain later, there were small effects in the brands that have established their positions at relatively high price levels, and the brands targeting the high-volume zone performed most poorly. That was the situation in the third quarter.

As nano・universe was on an uptrend, we planned to increase sales further, but it failed to grow out. Gross profit decreased, as we could not grow sales at usual prices even though inventories were narrowed down. It was of no use to keep our inventories after the season, so we had to decide on bargains at some point. However, we believe that the sharp fall in GPM was a larger problem than the decline in sales.

The other brands appear to have stayed relatively steady as they controlled inventories and took the sales strategy without discounts while sales were slightly shy of the targets.

Gross profit of PEARLY GATES, the fourth biggest brand, seems to have declined remarkably, but sales performed well, including those from loyal customers, in the 30th year of the brand and new products were sold well during this season. While the other brands were seriously affected by the irregular weather, the tax hike, and other factors, PEARLY GATES held momentum to overcome adverse factors on a full-year basis. However, GPM declined slightly partly due to an increase in wholesale sales. Even so, PEARLY GATES was far from poor sales results during this season and left a high level of inventories. The decline in GPM came within a manageable extent.

Among the other brands, sales of NATURAL BEAUTY BASIC and MARGARET HOWELL failed to reach their year-before levels. However, both brands managed to show slight rises in gross profit.

ROSE BUD has been operating with its inventories further tightened than in the previous year since the first half of the current year. Although sales declined, GPM rose and the business was even more robust.

STUSSY, which had been struggling, has shifted to a healthier state. Sales in HUMAN WOMAN declined slightly in reaction to last year's large-scale promotions during the brand's 20th year, but GPM was steady.

In UNDEFEATED, a sneaker brand, sales and profits have been increasing steadily, along with opening new stores at a smoothly growing pace.

There was a problem with HUF, an American streetwear brand we acquired. Its Japanese business has been extremely strong. However, in the US, gross profit declined slightly in a switch from wholesale targeting large-scale retailers to directly managed stores.

As for directly managed stores in the US, sales declined due to a delay in the opening of stores behind the initial plan. As inventories rose slightly, they were reduced by sales at off-price stores, so gross profit also declined.

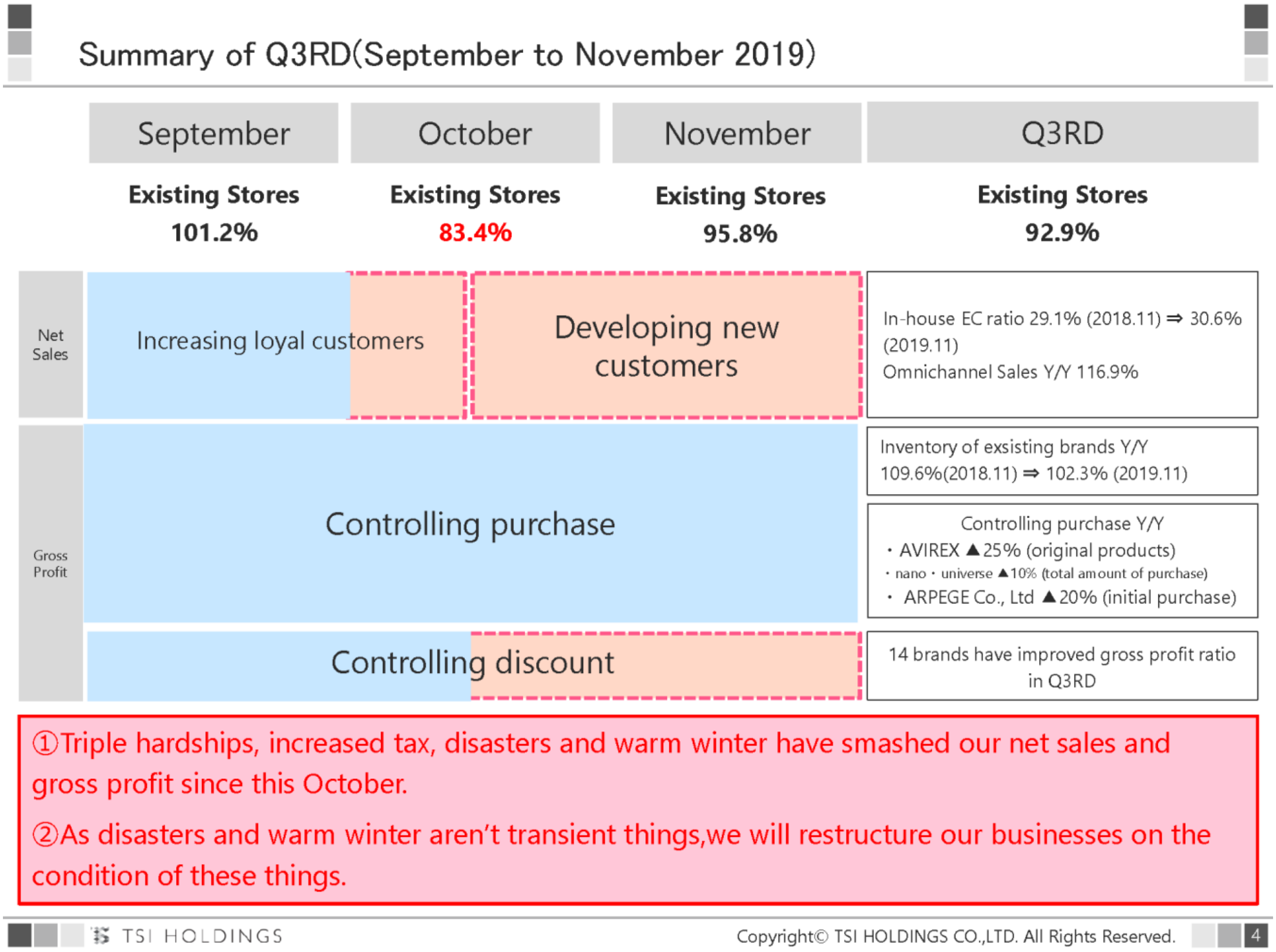
Since it has taken time for the rebranding of HUF in the US, the US and Japanese teams are currently working together to upgrade the HUF products for directly managed stores. This approach follows the pattern implemented at a group company called JACK, which operated STUSSY, improved the quality and brand power in Japan, and then circulated those changes around the world.

The quality of new-year merchandise has greatly increased, and the HUF brand has developed a good reputation with customers, including wholesalers. However, as I previously mentioned, the rebranding in the US is taking a considerable amount of time.

We had planned to expand HUF into a global brand after we acquired it. In addition to the Japanese market, we also had planned to develop the brand in China. However, the trade friction between the US and China has been a point of concern. Though we are proceeding with the plan somewhat cautiously, if we finally agree with a partner company in China, we will be able to get it off to a good start in the next fiscal year. We will announce the start of the business as soon as a contract with the partner is finalized. We plan to start the HUF business in China with the suitable partner in the coming fiscal year.

You can see the third line from the bottom in terms of the total number of continuing brands. Sales rose remarkably as Ueno-Shokai was consolidated but I think that the problem is a decline in GPM.

That is the overview of the whole situation.



In this situation, I will take measures when each brand has a problem, and of course we will increase the purchase rate among visitors. I will explain our thoughts about the situation on page four.

So far, I have been talking about the cumulative results up to the end of November. Looking at the third quarter–September through November–alone, sales at existing stores (excluding new stores) declined 1.2% YoY in September, 16.6% in October, and 4.2% in November. Cumulative sales in September through November were down around 7%.

Of course, the biggest reason would be in our products and sales efforts, but I believe this is a major trend that will continue in the future.

People often cite the tax increase, disasters, and a warm winter. Though there will be no tax increase next year, consumer sentiment will remain depressed. Consumers will continue to refrain from buying wasteful items and will only buy what they need. We cannot expect that they will go shopping without a clear purpose, partly due to eco-friendly consciousness.

As far as natural disasters and global warming are concerned, I do not believe that the frequency of typhoons and heavy rains will be decrease for the time being as global warming advances, so the impact of natural disasters will not be limited to the current fiscal year. I think it is better to assume that heavy rains and typhoons may occur again. In addition, the warm winter will also continue for the time being.

Our businesses were strongly affected by these circumstances in the current year. Regarding the consumption tax increase in October, in fact, our brands were not luxury brands with high asset values, and we did not expect a last-ditch rush of consumption ahead of the tax hike and a reactive fall in demand afterward.

Psychologically, we assumed that there would be no buying spree beforehand, but thought there may be a reaction after the tax increase. As such, we planned to sell whatever we could among the autumn and winter goods in August and September, hold off in October, and then try to rebuild sales in November and thereafter. The trend was just as we had expected, but the decline in October was so large that it was difficult to recover in November.

Sales to highly loyal customers begin in September to October, or as early as in August. The key point is that they did not buy our goods at the beginning of the season as it became cold, but we steadily attracted customers who are loyal to our brands and bought our products, including coats and outerwear, during the hot season.

Brands with particularly loyal customers, such as ADORE, MARGARET HOWELL, PEARLY GATES and Ueno-Shokai's brands, marked sales above the year-before levels in August and September. However, there were declines thereafter. The brands failed to recover sales in October and November, as they were unable to attract general customers to go shopping after it became cold.

However, this strategy should not be looked upon as a failure. We will continue focusing our services to loyal customers and generate sales. The problem is that it is a matter of course that general customers do not buy autumn or winter goods unless it gets cold. Therefore, we have to formulate an overall plan on the assumption that this trend will continue.

As written in the section of sales on page four, we plan to raise in-house EC ratioand our omni-channel customers. Sales from customers who have registered as members and buy our goods through ecommerce and at stores have steadily been increasing, so we will maintain this route. What we have to do is to work out an entire plan on the assumption that sales will fall in October and November and that there may not be cold weather next year.

Regarding gross profit, we cannot afford to lower the cost of sales ratio and provide customers with low-quality products at this time, so I do not want to adopt a strategy of lowering the cost of sales ratio at all. We would like to reduce wasteful costs, but will continue to compete by increasing the ratio of proper sales without discounts while keeping inventories at low levels.

As we cited examples here, we have narrowed down inventories for AVIREX, nano・universe and ARPEGE, and will continue to implement this strategy as well. We simply cannot maintain a plan of producing a large quantity of goods at the beginning of a year and reduce the inventories by selling them during the year.

We also worked to restrain discounts on a number of occasions this time. We used AI to carefully decide how far we can discount, whether we offer a 30% discount from the beginning or wait with a 20% discount, or whether or not to discount depending on item numbers. We have made considerable efforts to restrain discounts, but the efforts have not catch up with the trend, though we will continue to restrain them.

Roughly speaking, we will operate at a small number of directly managed stores with a small quantity of inventories. I think it would be impossible to maintain an approach of opening a large number of stores, providing a large amount of inventory, and reducing inventories by selling them at all stores. Using our own ecommerce inventories, we will concentrate on a way to send out products in desirable colors and sizes to customers who visit our stores and order them in our ecommerce inventories.

At our Company, the brands that have a lot of highly loyal customers and relatively high unit prices are moving ahead, and we continue this approach thoroughly. We intend to combine the way of increasing the ratio of our own ecommerce services to turn customers into omni-channel members with the way of doing business with fewer inventories.

Overall, what I have discussed with you today is no different from what I said last year. Though I intended to prepare for the trend, my preparations were not satisfactory and I apologize for being unable to catch up with the trend.

There is no major change in our model or strategy. In addition to maintaining the proper sales strategy, we will not follow the conventional marketing tactics, as they no longer fit the current climate conditions.

Though we provide some of our products for bargains according to stores, brands like ARPEGE and STUSSY will continue to refrain from offering any discounts. MARGARET HOWELL and ADORE do not offer discounts for coats and outerwear.

I would like to talk about a determined plan at a briefing session for the year, but in these circumstances, we intend to accelerate the structural reform that was announced in the medium-term plan. We transferred authority to each brand in a fairly complete manner and made it possible to build a distinctive character as a brand. However, we will not be able to make it in time for digital investment, logistics, procurement, or overseas expansion unless we compete by exerting collective power. We plan to change the overall business structure toward March. The new plan will be announced as soon as possible.

Regarding the problem of what will be the key, as I mentioned earlier, overseas and digital operations have become major pillars for us, and we need to establish a group-wide organization. Including this, we are currently preparing for a major change in the next fiscal year.

This is the summary of the third quarter results.

Net Sales Per Channel

	Cumulative Q3RD 2019 Ending Feb.		Cumulative Q3RD 2020 Ending Feb.			
	Results (Million yen)	Composition Rate (%)	Results (Million yen)	Y/Y (%)	Composition Rate (%)	Composition Rate Y/Y Change
Department Stores	19,263	16.4	16,478	85.5	13.1	-3.3pt
Commercial Facilities(*1)	56,566	48.2	64,193	113.5	51.0	+2.8pt
E-Commerce	22,570	19.2	25,370	112.4	20.2	+1.0pt
Overseas	7,483	6.4	6,299	84.2	5.0	-1.4pt
Others(*2)	11,490	9.8	13,481	117.3	10.7	+0.9pt
TOTAL	117,373	100.0	125,823	107.2	100.0	-

*1 Fashion buildings, shopping centers, railroad station buildings, individual stores, outlet shops etc. except for department stores.
*2 Apparel businesses such as wholesale, in-company sales and non-apparel businesses of the group companies.

TSI HOLDINGS 7

As usual, the supplementary material refers to sales figures by sales channel and the number of stores. In terms of sales channels, ecommerce sales continued to grow, and specifically in-house ecommerce sales increased sharply with double-digit growth. We will continue to increase mainly the weight of in-house ecommerce.

Although sales at department stores appear to have declined, sales at urban department stores grew. Especially when we try to sell items with relatively established brand characters at high unit prices, leading department stores will continue to be an important channel.

Consequently, our business with urban department stores has been expanding nationwide, and the new brands launched this fiscal year have opened stores at a top-class department store in each region. Though sales at department stores appear to have fallen, there are additional factors, such as a rise in the weight of Ueno-Shokai, which has no department store channel. Our strategy is to increase transactions with department stores in urban areas considerably, even if those with regional department stores decrease.

The decline in overseas sales is due to the impact of the sale of our stake in Beijing Tsubomi Fashion late last year.

In concluding the overall explanation, I suspect you will ask why we don't make a downward revision in this sales and profit situation. My policy is to disclose unpleasant issues as soon as they are perceived.

At present, however, we have sales data in December, but do not have profit figures in the month. If necessary, we will announce a downward revision without waiting for our full-year results.

Currently, since we have narrowed down our inventories, we do not expect a worse situation by incurring a huge appraisal loss in the fourth quarter. We planned a profit-making plan for the fourth quarter and expect a better situation than currently, but we are not optimistic about whether we will reach the disclosed target levels. I expect quite a severe situation. Please allow us time to report how severe the situation will be after we have obtained necessary figures.

Document Notes

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