

Convenience Store Business

Message from the President

CVS

Convenience Store
Business

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FamilyMart

One FamilyMart: A New Mission to Achieve Real Integration

Moving from Brand to Organizational Integration

I became president in September 2016, a little over a year and a half ago. During this time, the whole Company has made a concerted effort to integrate Circle K and Sunkus stores under the FamilyMart brand. Converted stores are seeing significant increases in daily sales and customers. Moreover, we have integrated manufacturing and logistics at the same time. As a result, our expansion of the convenience store network is creating economies of scale that are growing the earnings of the whole chain, and we plan to complete integration by November 2018. We have been able to proceed successfully with this 5,000-store brand conversion thanks to the tireless efforts of franchised stores, suppliers, and personnel as well as the know-how and business partner networks developed

through previous initiatives, and the general mobilization of the capabilities of our organization and personnel. As well as being proud of our employees, I am genuinely thankful to everyone involved.

Our next task is to rebuild the head office's support system for franchised stores. I feel that making brand integration our first priority has given rise to a range of issues with respect to optimization of the head office organization and personnel assignment. In fiscal 2018, under our new *One FamilyMart* slogan, we will achieve "real" integration that coalesces personnel as well as brands and infrastructure, and we will establish an environment that allows us to maximize our support for franchised stores as important partners.

Stepping Up Efforts through a Results-Oriented Organization

As we advance brand integration, enhancing the quality of our store network in Japan, which has reached 17,000 stores, has become a pressing management task for the near term. We aim to change course significantly by transitioning from scale expansion to the stepped-up pursuit of quality and the cultivation of solidarity as a company. To these ends, we will take a range of measures that clarify roles and responsibilities in the organization and enable it to achieve results.

As part of these efforts, we renewed FamilyMart's organization at the beginning of fiscal 2018. Aiming to establish a group of autonomous organizations with their own goals and responsibilities, we changed from a chain of command directly under the control of the president to a system in which each division has overall control of important functions. The new system also clarifies key performance indicators. Under this system, we will accelerate efforts to heighten the quality of our stores.

Aiming to Be Rooted in Local Communities

Being rooted in local communities is the guiding principle of FamilyMart's medium-to-long-term growth scenario. As Japan's population declines, competition in the retail industry is becoming challenging. In addition, e-commerce businesses are increasing the pace of their forays into the retail industry. Our existing approach of rolling out homogeneous products and services cannot win against such fierce competition. By being deeply rooted in each local community and responding flexibly to its distinctive consumer behavior and events, stores will become indispensable and achieve significant differentiation. With this in mind, we will create systems that support the innovation and decision-making of individual stores. Furthermore, we will consider "localizing" supervisors who work in frontline operations supporting franchised stores so that supervisors can participate in store development with a stronger sense of ownership. Through marketing that reflects demand in retail zones and store management that accords with local communities, we aim to create convenience stores

that earn the overwhelming trust and endorsement of customers and grow while contributing to local communities.

Recent years have seen remarkable advances in a range of technologies. Seeing great potential in such technologies, we are working with multiple specialist organizations to utilize leading-edge technologies for conserving energy in store operations and the development of next-generation convenience stores. Meanwhile, the greatest strength of our business is the points of contact with customers that brick-and-mortar stores give us. I am convinced that the age of digitization will, in fact, create strong demand for a return to basics and services provided by people.

As the name FamilyMart suggests, franchised stores, suppliers, and the many other members of our "family" business will unite to continue building a chain that customers support because it is the "family" that belongs to local communities and to Japan.

Raising the Value of the Entire Chain by Strengthening Support for Franchised Stores

Overview of Business Conditions

In Japan, there are nearly 60,000 convenience stores, with three major chains accounting for nearly 90% of them. Due to fiercer competition with companies in an expanding e-commerce market and with other business formats, convenience store operators must increase the competitiveness of chains by leveraging store networks as infrastructure and expanding and improving their capabilities. Also, in response to the decline in Japan's population, chains urgently need to increase work efficiency and reduce workloads if they are to sustain long business hours and high-quality store operations.



STRATEGY 1

Heightening Store Quality

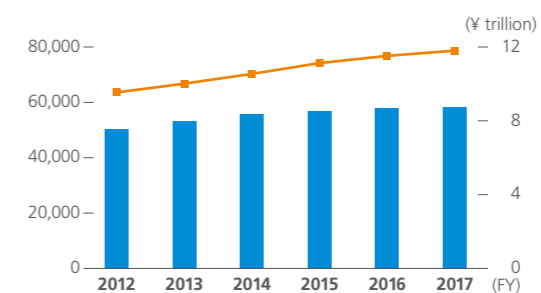
Opening Quality Stores

Through management integration, we established a network with the second largest number of stores in Japan. As Japan's population trends downward, the number of convenience stores is approaching a saturation point in the country's retail zones. Mindful of these business conditions, we will give first priority to establishing a quality store network. For new store openings, our basic policy will be to continue stringent selection of high-quality stores that promise stable earnings.

Concentrating on directly managed stores, we

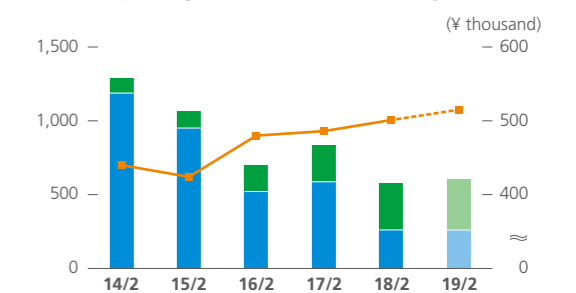
will close underperforming stores. As a result, the number of stores in our domestic network will temporarily dip toward the end of the current fiscal year. Meanwhile, the benefits of our uncompromising approach to new store selection are emerging, with the average daily sales of newly opened stores surpassing ¥500,000 in fiscal 2017. Moreover, from the current fiscal year onward we expect lower impairment loss risk because we brought forward measures to mitigate this issue. In fiscal 2019 and beyond, we will continue developing highly profitable stores.

Store Numbers and Market Size in Japan



Sources: *Current Survey of Commerce*, Ministry of Economy, Trade and Industry; and *Convenience Store Sokuho*, Ryutsu Sangyo Shinbunsha
Note: For each year, figures for the number of stores are as of the end of February, while figures for market size are as of the end of March.

Store Openings and New Store Daily Sales

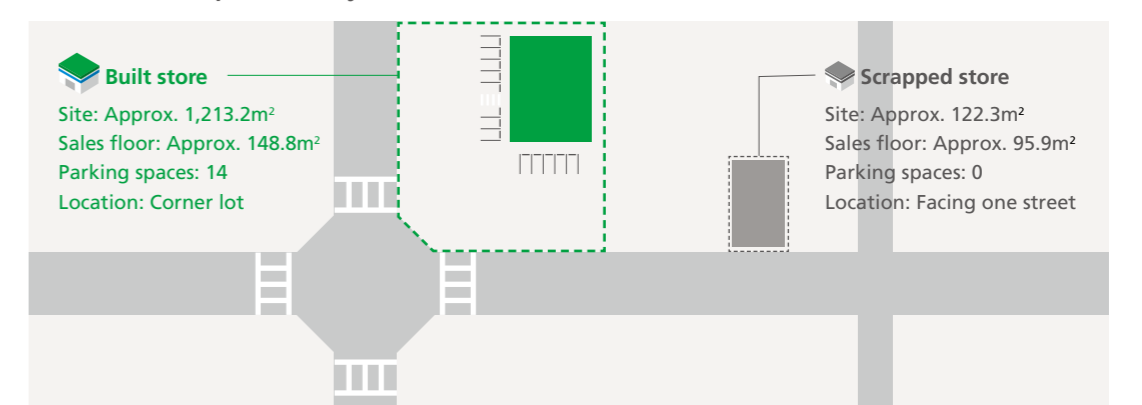


Building Competitiveness through Strategic Store Openings

As a measure to heighten the competitiveness of individual stores, we are moving forward with a build-and-scrap (B&S) strategy. This entails relocating existing stores to stores with locations and sales floor areas that suit retail zones. The B&S strategy relocated 110 stores in fiscal 2014. In fiscal 2017, this number had risen steeply to 315, or more than half of all store openings. The benefits of

improvements, such as the establishment of store parking spaces and eat-in spaces, are emerging steadily. At stores for which we have implemented the B&S strategy, daily sales are at least 15% up from their level before relocation. As of February 28, 2018, roughly 7,000 stores had introduced eat-in spaces—which boost daily sales. Plans call for establishing these spaces in even more stores.

A Build-and-Scrap Case Study



Convenience Store Business

STRATEGY
2

Strengthening Measures to Support Franchised Stores

1 Accelerating Reform of Store Operations

FamilyMart has begun reforming store operations in earnest to increase their efficiency. In fiscal 2017, in addition to the short-term measures of simplifying work manuals and reducing sales promotion items, we introduced next-generation point-of-sale (POS) cash registers and invested in IT. As a result, we reduced store work by six hours. In fiscal 2018, we will eliminate the need for inspections of products when they are delivered and introduce larger, labor-saving store fixtures and food preparation equipment. Also,

we plan to introduce about 1,000 self-checkout cash registers. Through these additional measures to increase work efficiency, we expect to reduce store work hours by a further 3.5 hours. FamilyMart will actively invest to improve store operations and to establish environments that enable store staff to focus on strengthening the differentiating features of brick-and-mortar stores, such as customer service and high-quality store management.



A next-generation POS cash register



New drawer-type shelves



A new fryer

1 Accelerating Reform of Store Operations

- Simplifying manuals
- Eliminating need for product inspections
- Introducing next-generation POS cash registers
- Introducing self-checkout cash registers
- Reducing workloads by introducing new fixtures

2 Enabling Head Office to Support Stores

- Helping to hire and train store staff
- Assisting with store staff retention
- Having head office employees support store operation

3 Support Systems for Franchised Stores

- New franchise contract
- Support for management of multiple stores
- Senior Citizen Franchisee System



2 Enabling Head Office to Support Stores

Due to the concern over the ongoing decline in Japan's working-age population, securing and training store staff along with rising personnel expenses are becoming management issues. Therefore, we are creating systems that enable the head office to help hire and train store staff. To alleviate the work burden involved for franchised stores when recruiting store staff, we have established a store staff recruitment section, FamiJOB, on the FamilyMart website. In addition, we have extended the reach of our recruitment. By establishing flexible working hours, we are encouraging applications from those without convenience store work experience, such as housewives and senior citizens. Also, we have prepared work manuals in multiple languages so that we can more actively hire non-Japanese people who would like to work in our stores.

To ensure that store staff can contribute to store operations as soon as possible, we began the FamilyMart School system in April 2017. Under this system, head office training managers visit training facilities and franchised stores nationwide and provide training in accordance with the proficiency levels of store staff. In fiscal 2017, roughly 30,000 store staff participated in 6,500 training sessions. Also, we are developing

an environment that encourages motivated store staff to work at our stores long term. For example, we have introduced a qualification system that reflects work proficiency as well as an award system that recognizes talented store staff.

Aiming to allow supervisors to exercise their abilities to the utmost, we have revised training and evaluation methods so that they can be adapted to a range of different individual abilities, and we have optimized the scope of responsibilities by reducing the number of stores supervisors manage from eight to seven. By increasing the efficiency of supervisors, we want to establish an optimal support system for franchised stores as rapidly as possible.



During sales promotions and other busy periods, head office employees help with store operations. To date, 2,200 employees have taken part in this system.

3 Support Systems for Franchised Stores

FamilyMart has established a range of systems that allow franchisees to manage their convenience stores with peace of mind. Since September 2016, we have been switching over to a new franchise contract. Under this new contract, the head office reduces the financial burden of store operations by subsidizing a certain percentage of utility costs and losses on unsold ready-to-eat items and giving each franchised store ¥1.2 million per year as assistance for store management.

In 2001, FamilyMart became the first convenience store operator to introduce a system that encourages the management of multiple stores under the FamilyMart brand. As of the end of February 2018, approximately 70% of all

Main Points of Change in New Franchise Contract

	Old contract	New contract
Product disposal costs	Franchisee responsibility	Head office offsets portion of product loss
Support for utility bills	Franchisee responsibility	Head office pays 90% of portion, less than ¥3.6 million annually
Store management support	N/A	¥1.2 million per year

stores were operated through the multiple-store management system. Other initiatives include our establishment of the Senior Citizen Franchisee System, which encourages senior citizens to become franchisees by shortening contract periods from 10 to five years and offering flexible contract details.





STRATEGY

3

Strengthening Product Appeal

Developing and Increasing the Efficiency of Supply Chains

By advancing structural reform in ready-to-eat items, we are continuing to market ready-to-eat items that have even greater value and appeal. This structural reform has two aims: rationalizing supply chains through the development and optimization of production and distribution bases and enhancing the quality of ready-to-eat items.

In fiscal 2018, we are progressing with an integration of production and distribution bases that includes Circle K and Sunkus while transitioning to a phase of enhancing product appeal even further. In efforts to raise the

quality of ready-to-eat items, we aim to renew mainstay products and develop distinctive, attractive products. To these ends, since fiscal 2015 at plants that produce ready-to-eat items we have been collaborating with producers of ready-to-eat items to invest in renovation measures that are compliant with HACCP* principles, as well as invest in food preparation equipment that enables the manufacture of differentiated products.

* Hazard Analysis Critical Control Point is a method of food hygiene management.

Heightening the Quality of Ready-to-Eat Items

As it continues renewing rice balls, noodles, sandwiches, and other mainstay products, FamilyMart will emphasize ingredients, preparation methods, and appearance. To realize tastiness that surpasses that of specialty store offerings, we will carefully select ingredients and introduce the latest food preparation equipment as needed. Further, through such measures as increasing our selection of health-focused products, we will provide an extensive product lineup that caters to diverse customer needs.

The use of self-service coffee machines has become firmly established among convenience store customers in Japan. By the end of fiscal 2019, nearly all of our stores will have new coffee

machines equipped with the latest functions, thereby enabling us to offer higher-value products. For example, customers will be able to order a richer flavored coffee by adding beans or a smooth caffe latte finely blended with milk. In addition, the machines' drip brewing process ensures that all of the beverages have a rich, refreshing flavor. We expect that these machines will boost coffee beverage sales by at least 10%.



A new coffee machine

STRATEGY

4

Advancing Measures for Next-Generation Stores

Discovering New Potential for Stores

Amid increasing interest in health, we decided to enter the fitness business to cater to customers who want a convenient place to work out. We have begun establishing Fit & GO gyms, which are open 24 hours a day year round. Other initiatives to add to store functions that meet everyday needs will include the launch of laundromat services through Famima Laundry. Also, we are considering the introduction of an in-store key delivery service that caters to the growing demand for vacation rentals. Through such initiatives, we will continue discovering new possibilities for

combining existing stores with highly compatible businesses to create store formats that have added functions and as such go beyond merchandising.



An integrated convenience store and laundromat

Introducing the Don Quijote Way to Convenience Stores

In June 2018, we began the joint trial development of convenience stores that incorporate Don Quijote's product lineup, sales floors, and management methods. We introduced special product shelves that are much higher than normal shelves, and the stores carry approximately 5,000

items, of which 2,800 are Don Quijote items, such as daily necessities, confectioneries, and processed foods. Through this joint trial, we will provide the kind of shopping fun that only brick-and-mortar stores can offer.



The FamilyMart Tachikawa Minamidori Store, which was remodeled and reopened in June 2018



A Don Quijote-style sales floor and product lineup

Creating Next-Generation Stores

In June 2017, FamilyMart announced a business alliance with ITOCHU Corporation and LINE Corporation. The alliance is premised on using LINE's various services to cooperatively develop new products, technologies, and services. We are considering incorporating the company's services in a wide range of store operations, such as the establishment of communication with customers that reflects their needs and purchase history, the improvement of payment equipment and other store equipment, the enhancement of customer convenience, and the mitigation of the workloads of store staff.

The merits of utilizing leading-edge technology in the CVS business are not limited to increases in the efficiency of store openings and operations. As well as using the technology of Google LLC to incorporate AI in store development, we are exploring ways of enhancing marketing efficiency through digital advertising. By capitalizing on the distinctive advantages that brick-and-mortar stores and points of contact with customers give it, FamilyMart will embrace state-of-the-art technology to create a new generation of stores.