President and CEO Kenji Kawahara on Strategy

Our goal is to be the number one retail financial services company in Asia. We are therefore collaborating with local partners within our service areas, and building an "AFS Ecosystem" that integrates our physical and digital networks.

Kenji Kawahara
President and CEO

Strategies for Constructing the "AFS Ecosystem"

Constructing the most customer-oriented ecosystem in Asia by 2025 is one milestone toward our goal of being the number one retail financial services company in Asia. As the financial services arm of the AEON Group, we provide financing that connects people to the required lifestyle goods, creating value in the process and thus playing an essential role in our customers' lives. The result is a value creation cycle that continues and further expands. This business model is what we call the "AFS Ecosystem" – our framework for providing services that other financial institutions cannot and for delivering the solutions that customers require. To generate sustainable growth within our ecosystem, we must identify and address customer needs and social issues in the countries and regions we serve.

Guided by this philosophy, we are executing the following strategies for building the "AFS Ecosystem" that will make us number one in Asia.

Constructing the Most Customer-Oriented Ecosystem in Asia by 2025

Expanding Our Customer Base

The "AFS Ecosystem" concept comes from a change in perceptions. In the past, our services focused on the middle-income demographic, but our new approach broadens our target to include the unbanked.* Our key objective in expanding our target demographic is to increase transaction volume by significantly increasing the number of member IDs from the current number of approximately 41 million to 300 million over the near term, which we nevertheless view as a modest target. With Fintech now driving the financial services market, 300 million should be seen as a minimum target in order to avoid being sidelined from the market. Expanding our customer base requires us to develop a platform that boosts the functionality of the network and mechanisms we have built in Asia and to link them to other economic spheres outside the current scope of our activities.

* People without accounts or access to credit at banks or financial institutions for reasons including low income or migrant status.

Linkage with Other Economic Spheres

By organically integrating the ecosystem we are constructing with other economic spheres, we believe we will be able to achieve greater customer satisfaction. We therefore need bold, flexible ideas that are not confined to specific markets or businesses. A good example is our auto loan business in the Philippines, where we are partnering with local taxi associations to offer our services. By linking the "AFS Ecosystem" with the economic sphere in which taxi drivers operate, we were able to expand our customer base by more than a thousand within a short time frame. Our goal is to use this precedent and similar approaches to achieve large-scale expansion of our customer base and acquire a total of 300 million IDs across economic spheres worldwide.

Fusing Physical and Digital Networks

The key to offering services that are closely linked to lifestyles is fusing physical and digital networks for the accurate and on-time identification of customer needs. To increase access to financial products and services, we are expanding our customer base through digitalization and IT systems, including enhanced functionality for smartphone apps. We now offer smartphone apps that address the various needs related to credit card functions and asset management.

Next, it is important to analyze and make use of the accumulated information in our customer database. Moreover, we will utilize digital technologies and collected data at brick-and-mortar stores to reduce redundancy and improve efficiency so as to maximize contact time with customers and accurately identify their needs. By exhibiting more of our existing strength in face-to-face interaction, we will raise the standard of consultations, including our ability to resolve concerns and make proposals that satisfy customers, thus further strengthening our relationships with them.

These initiatives will enable us to provide low-cost, low-risk financial products and services, and will spur further evolution of needs-driven services.

Our Core Policies Moving Forward

We predict that by 2020, payments via smartphone will become mainstream and it will be possible to complete all types of financial service-related transactions with just a smartphone. As such, we must further transform our current business model by anticipating market changes and technological evolution. We are therefore focusing on three key policies: a complete digital shift, meeting customer needs through a wider range of products and services, and speeding up the growth of our Global Business.

A Complete Digital Shift

We plan to invest a total of ¥100 billion in IT systems and digitalization in the three years from fiscal 2017 through fiscal 2019. Key themes we aim to address by accelerating digitalization are improving convenience for and responding more quickly to customers, and structurally reforming our operations. Improving convenience entails further addressing credit card and asset management needs through the expansion of smartphone app functions, and we are already seeing results. For example, we have made our services more timely with the AEON Wallet app, which uses beacon technology to distribute coupons when customers approach a store they frequent. The app also displays electronic receipts that enable immediate confirmation of purchase history. In addition, our household spending app Kakeibu delivers optimized asset management services by using AI to analyze customer asset and AEON Group settlement information, and provides easy-to-understand visualizations of household cash flow and assets. One aspect of our digital shift is the introduction of robotic process automation (RPA)* at our head office as part of initiatives toward increasing productivity.

* RPA automates business operations by deploying cognitive technologies such as rule engines, AI and machine learning in software robots.

Digital Shift and Evolution of Our Business Model to Address Customer Needs

Meeting Customer Needs through a Wider Range of Products and Services

Our top priority is fully addressing our customers' needs. This is closely related to the digital shift just mentioned, which if achieved, could perhaps resolve roughly 60% of all our customers' needs. The first key is to enhance our systems to make use of various data. We hold personal data such as customer attribute information as well as a wide array of data on customer needs that has been accumulated via our platform, which encompasses multiple channels including stores, smartphone apps and call centers. We will use this information platform to strengthen customer-oriented marketing and develop and provide financial products and services suited to each customer.

Our digitalization efforts will also empower operators at call centers to quantitatively increase and qualitatively improve proposals to customers. We will enhance the level of convenience for customers, raise the speed of response to inquiries, thereby increasing access to financial products and services. The use of AI is one example of how we can respond to frequently asked questions without human assistance. This shortens response time, and lets us devote greater time to customers in need of in-depth consultation. This in turn can make call centers into a new sales platform that complements conventional bank branches and digital channels.

Speeding Up the Growth of Our Global Business

We must further accelerate the growth of our Global Business to become number one in Asia. We have been strengthening existing businesses since fiscal 2016 by shifting from loans to consumer financing, and thereby enhancing our return on assets. Successes are already evident and our Global Business has entered a period of renewed growth. The countries and regions we serve in Asia face various social issues, and we consider solutions to these problems to be business opportunities that will further increase our earnings. For example, in fiscal 2017, through the use of an IoT device, we were able to begin offering auto loans to taxi drivers in the Philippines for three-wheeled taxis known as tricycles. Our core themes in this auto loan business are job creation and wage growth. In Cambodia, as an attempt to address social issues relating to sovereign currency circulation, we launched e-money denominated in riel. Through such initiatives, we are linking our expertise with social issues to create new businesses. Moreover, we are leveraging our close involvement in the daily lives of our customers to rapidly expand our Global Business. For example, by issuing prepaid cards in Malaysia in collaboration with local AEON Group companies, we enhance the services we provide to the unbanked population.

Further development of our Global Business will also involve enhancing productivity and return on assets through methods including introduction of RPA and the use of mobile devices.

Our Investment Strategy and Approach to Deploying Resources

In fiscal 2018, we intend to execute ¥35 billion of our planned ¥100 billion investment in IT systems and digitalization. In Japan, we will develop and launch smartphone apps to improve financial products and services, and we will continue to make investments in new product development to expand our fee business, which includes foreign currency deposits, as well as in improvements to information security. Moreover, we will combat increasing complexity in reward point programs across the Group to improve convenience and enhance customer benefits, as well as introduce the use of AI at our call centers, which act as key points of contact with customers. Other key investments include the enhancement of credit screening systems and the introduction of a new credit management system, through which we will reduce labor costs and bad debt expenses. Through the consolidation of business functions, we are also preparing to reduce headcount at the head office by 30% by March 2019.

We will then allocate the human resources freed up by these initiatives to our overseas operations and affiliated merchant development, which are part of our strategic investment objectives.

The Capabilities of Our People Are Our Strength

Our people empower our strategies and the construction of the "AFS Ecosystem." They share two attributes. One, they are entrepreneurs with a frontier spirit, and capable innovators. They think outside the box, and transcend the typical frameworks that banks and the finance industry cling to. Two, they are consummate business leaders. They are attuned to each region we serve, are eager, and have a discerning approach of quickly identifying and systematically building business models driven by customer needs. We will leverage and refine these two attributes to achieve our objectives.

Corporate Management Going Forward

Becoming the Number One in Asia by Creating True Value through the "AFS Ecosystem"

I would like to sum up our strategies by discussing our goals and aspirations. By building and harnessing unique strengths to provide financial services to individuals, we want to have a strong presence among Asian consumers, for whom the AEON Group will be the provider of choice for financial products and services and the first port of call for all types of financial consultations. Furthermore, our affiliated merchants are valued partners, and we therefore intend to help them grow their businesses through means such as establishing information service business models and analyzing big data.

Of course, we still have plenty to do to achieve our aspirations, so we will think innovatively and work diligently in order to deliver services that are easy for customers to use and thereby complete what we consider a true ecosystem.

As the financial services company that customers feel closest to, we will continue to build an organization that provides one-stop solutions, and will resolve various social issues to support and truly enrich the daily lives of our customers so as to become the number one retail financial services company in Asia.

I will oversee the financial side of achieving our aspirations and medium-term strategy.

Hideki Wakabayashi

Senior Managing Director in charge of Corporate Management, Head of Corporate Management Division

Our Financial Strategies for Supporting Sustainable Growth

Major changes are impacting the financial industry, including the entry of companies from different industries and the advance of technological innovation. We are therefore implementing the following initiatives under the theme of optimizing resource deployment to achieve sustainable growth, and building a framework that will embed them as a standard part of our operations.

1. Effectively Deploy Human Resources

We will improve productivity by reforming our business structure and consolidating head office functions and seek to accelerate growth by redeploying the labor resources freed up into business fields where we expect future growth.

2. Invest in IT Systems and Digitalization

We will invest ¥100 billion in IT and digitalization in the three years from fiscal 2017 through fiscal 2019 to adapt to the rapid advancement of digital technology and improve productivity. Based on target ROI levels, we have carefully chosen investment areas and are focusing on key performance indicators (KPIs) such as earnings growth ratio, bad debt expense ratio, and labor cost efficiency to measure the effectiveness of our investments.

3. Raise Capital Efficiency

To ensure the sound equity ratio that is expected of a bank holding company, we are carrying out enhancement measures using an asset and liability management business model that incorporates securitizing finance receivables, optimizing capital efficiency and controlling risk assets.

Review of Fiscal 2017 and Outlook for Fiscal 2018

● Growth Investment KPIs

Our Global Business segment continues to expand and drive consolidated results as it enters a period of renewed growth, where growth in ordinary income in fiscal 2017 is expected to continue in fiscal 2018.

Our initiatives to reduce the ratio of bad debt expenses to ordinary income in the Global Business have been successful. This ratio declined from 26% in fiscal 2016 to 24% in fiscal 2017.

Initiatives to reduce the ratio of personnel expenses to ordinary income proceeded according to plan in the Domestic Business, where we integrated banking-related operations of two subsidiaries and consolidated head office functions. On the other hand, this ratio stayed level year on year in the Global Business as a result of initiatives to strengthen marketing, including a co-branding program with a major retail group in Thailand.

In fiscal 2018, we expect to see results from investments made in fiscal 2017 mainly in call centers, credit screening and receivables management.

Key Performance Indicators

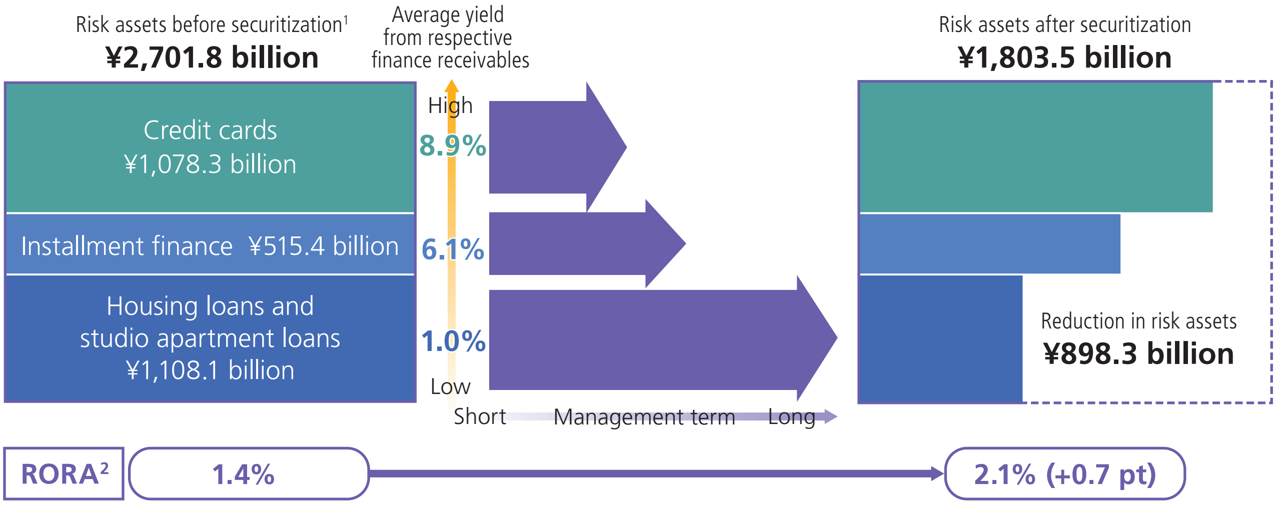
	Fiscal 2015	Fiscal 2016	Fiscal 2017	Fiscal 2018 (Plan)
Ordinary income YoY	+9%	+4%	+9%	+8%
Reference: Ordinary income	¥359.6 billion	¥375.1 billion	¥407.9 billion	¥440.0 billion
Ratio of Bad Debt Expenses to Ordinary Income (Global)	25%	26%	24%	20%
Ratio of Personnel Expenses to Ordinary Income (Domestic)	18%	17%	16%	16%
Ratio of Personnel Expenses to Ordinary Income (Global)	15%	15%	15%	11%

Initiatives to Improve Return on Assets

Consolidated finance receivables before securitization at the end of fiscal 2017 increased by approximately ¥800 billion from the previous fiscal year-end to ¥5.2 trillion. As we expand finance receivables to increase earnings, we must regulate the level of risk assets in order to maintain an appropriate equity ratio. In addition, the expansion of long-term, low-yield finance receivables such as housing loans not only exposes us to interest rate risk with regard to funding, but also bloats our balance sheet and puts pressure on our return on assets.

We will address these challenges and continue enhancing our return on assets in fiscal 2018 by compressing risk assets and by securitizing finance receivables with the objective of improving the spread between funding cost and yield on finance receivables.

Improving Return on Assets



1. Pro forma figures obtained by adding securitized portion of risk assets to risk assets after securitization as of March 31, 2018.
2. Return on risk-weighted assets = Profit attributable to owners of parent for the year ended March 31, 2018 ÷ Risk assets before/after securitization

Capital Efficiency and Shareholder Returns

The management integration of AEON Credit Service Co., Ltd. and AEON Bank, Ltd. in April 2013 established AEON Financial Service Co., Ltd. as a bank holding company. By bringing together the financial services companies of the AEON Group and establishing a business model that harnesses the funding capabilities available to a bank, we are expanding our businesses, improving performance and increasing capital efficiency.

Our basic policy for shareholder returns is to appropriately distribute profits to shareholders while increasing AEON Financial Service's competitiveness by deploying internal reserves to expand our businesses and increase productivity. In the five years since the management integration we have been growing steadily and, as per our basic policy, we continue to focus on distributing profits to our shareholders.

Dividends per share for fiscal 2017 were unchanged from the previous fiscal year at ¥68, and the dividend payout ratio was 37.9%. We forecast that dividends for fiscal 2018 will remain at ¥68 per share because of our ongoing investment in growth, with a payout ratio of 34.9%.

Going forward, we will strive to sustainably improve corporate value by building the foundation for growth and investing in business expansion while generating shareholder returns.

Capital Efficiency before and after Management Integration

	Fiscal 2012 (before management integration)	Fiscal 2017	Change
Equity	¥231.3 billion	¥370.0 billion	1.6 times
Return on equity	7.0%	10.8%	1.5 times
Earnings per share	¥88.12	¥179.29	2.0 times
Book value per share	¥1,235.28	¥1,714.92	1.4 times

Changes in Equity Capital after Management Integration

	Cumulative total for fiscal 2013–2017
Profit attributable to owners of parent	+¥165.1 billion
Dividends paid (average payout ratio)	–¥62.9 billion (38.1%)
Conversion of convertible bonds (issued fiscal 2011)	+¥30.0 billion
Acquisition of treasury stock (fiscal 2014)	–¥25.0 billion
Issuance of new shares (fiscal 2016)	+¥30.4 billion
Other	+¥1.0 billion
Cumulative change in equity capital	+¥138.7 billion