CFO Message

We will give financial support to businesses as they transform amid the "new normal."

Hideki Wakabayashi

Director and Senior Managing Executive Officer in charge of Corporate Management, Head of Corporate Management Division

Building a Financial Structure in Keeping with Our Changing Business Model

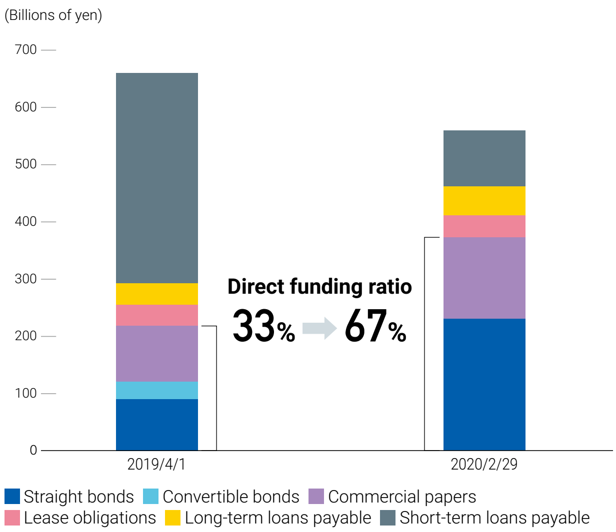
Amid highly uncertain conditions brought about by the spread of COVID-19, business model reform is an urgent matter for business continuity. In light of the lifestyle changes expected to set in as the pandemic extends into the long term—the "new normal"—we will reform our financial structure, placing the highest priority on both putting forth safe and secure products and services and hiring a steady stream of employees, while also constructing IT systems and digital platforms capable of responding to the changing environment.

Funding and Financial Health

From a financial perspective, the Company is focused on ensuring on-hand liquidity and financial stability by centralizing the funding of subsidiaries through loans from the parent company (AEON Group), extending funding periods, and diversifying funding methods. Domestic companies will shift to direct funding by increasing their direct long-term funding from the parent company by ¥140.0 billion, making use of the Company's creditworthiness. Free space for indirect funding will be allocated to overseas subsidiaries in preparation for future expansion.

The greatest challenge we face in fiscal 2020 is responding to the shift toward the "new normal." A digital shift in operations to support work, products, and services is important in this regard. Our business is in need of a major transformation, and for that to occur, we must visualize the current situation in order to get a handle of any problem points and make the appropriate investments toward solving them. Our aim is to maintain a sustainable financial structure that will support those investments while always keeping the well-being of our business in mind.

Interest-Bearing Debt (Domestic)



Since fiscal 2019, we have been working to streamline Groupwide funding and to diversify funding methods by consolidating funding of domestic Group companies into the Company. As a result, the ratio of direct funding has increased and we have been able to realize a shift to low-interest, long-term funding. In particular, in fiscal 2019 we issued ¥180.0 billion in corporate bonds. Regarding the use of funds, we allocate capital with consideration for the balance

Major Financial Indicators

(Billions of yen)

	Fiscal 2015	Fiscal 2016	Fiscal 2017	Fiscal 2018	Fiscal 2019
Operating revenue*1	359.7	375.2	408.0	439.0	457.3
Year-on-year increase/decrease	109.3%	104.3%	108.7%	107.6%	104.3%
Operating profit*2	59.4	61.6	65.7	70.2	65.1
Year-on-year increase/decrease	111.9%	103.7%	106.7%	106.8%	92.7%

*1 Ordinary revenue from fiscal 2015–fiscal 2018.
*2 Ordinary profit from fiscal 2015–fiscal 2018.

between appropriate capital and risk assets for domestic and overseas subsidiaries through purchasing of subordinate beneficiary rights issued by domestic subordinates, and acquiring subordinate loans from overseas subsidiaries in addition to intercompany loans and increased capital funding from the parent company to our subsidiaries. Specifically, intercompany loans for fiscal 2019 amounted to ¥199.7 billion and capital increases to overseas subsidiaries amounted to ¥7.0 billion. We funded our subsidiaries through a variety of methods. In addition to purchasing AEON Bank's mortgage loan subordinate beneficiary rights to a total of ¥40.0 billion, AEON Specialized Bank (Cambodia) Plc. received a subordinate loan of $4.0 million USD (approximately ¥0.44 billion), while AEON Credit Service (M) Berhad issued subordinate bonds (Islamic bonds, wakala sukuk) amounting to RM100.0 million (approx. ¥2.6 billion).

IT Systems and Digitalization Investments and Capital Efficiency

One of the items highlighted in our previous medium-term strategy (2017–2019) was an investment plan totaling ¥100.0 billion devoted to IT systems and digitalization. This investment plan is separated into three policies.

1) Investment toward innovation in products and services to promote strategies common across the AEON Group, the Asia shift, urban shift, senior shift, and digital shift
2) Investment toward streamlining credit screening and collection
3) Investment toward improving labor productivity

We have set the ratio of bad debt allowance to operating income and ratio of personnel expenses (labor share ratio) to operating income as KPIs for verifying the effectiveness of an investment. We have reached our initial targets in the Domestic Business by going paperless and promoting system infrastructure development. In the Global Business we carried out our plan by focusing on systemizing credit screening and collection in Asian countries utilizing online and mobile solutions and by improving our labor share ratio. However, the uncertainty of the economic outlook coupled with a change in the recording method for allowance of doubtful accounts resulted in the ratio of bad debt allowance to operating income exceeding planned levels.

As a result, the total amount invested in IT systems and digitalization was ¥103.0 billion over three years. While we were able to steadily promote IT and digitalization, there were issues that arose as we made these efforts that we are still working to resolve.

IT Systems and Digitalization Investment Results

(Billions of yen)

		Fiscal 2017	Fiscal 2018	Fiscal 2019	Total	Planned
Investment results		35.3	34.4	33.3	103.0	100.0
	Domestic	26.0	28.0	28.1	82.1	70.0
	Global	9.3	6.5	5.1	20.9	30.0

Investment KPIs

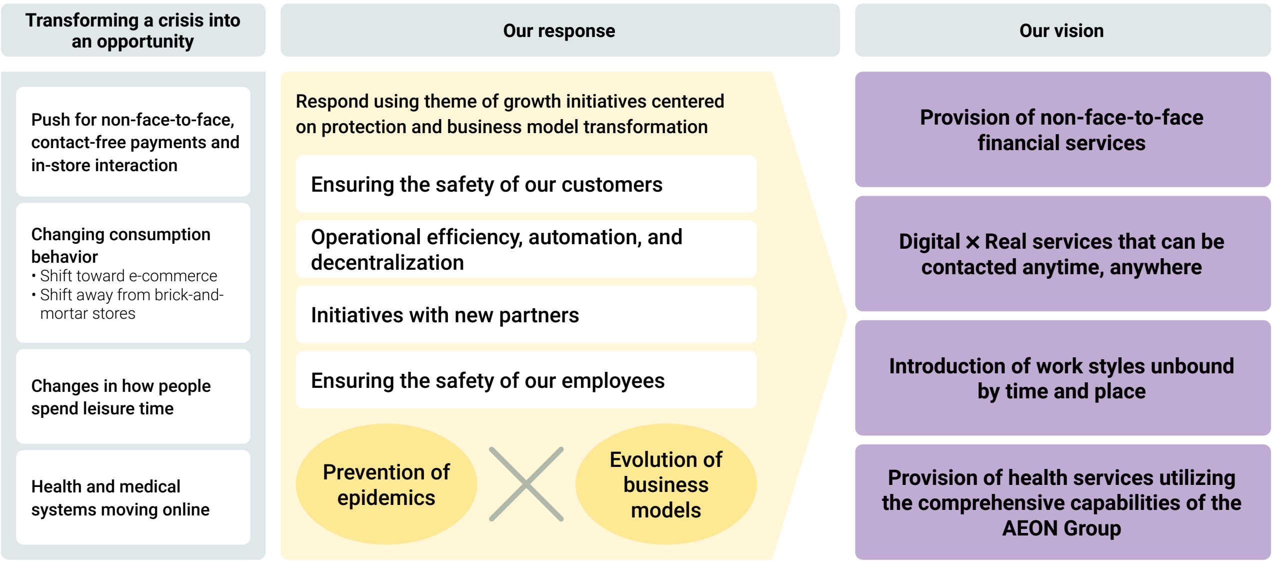
		Fiscal 2017	Fiscal 2018	Fiscal 2019	Planned
Ratio of bad debt allowance to operating revenue	Domestic	7.1%	7.5%	6.9%	7.0%
	Global	24.1%	22.9%	28.5%	22.0%
Ratio of personnel expenses to operating revenue	Domestic	16.4%	15.6%	14.9%	15.0%
	Global	14.8%	14.7%	14.3%	14.0%

Adjusting to the Effects of COVID-19

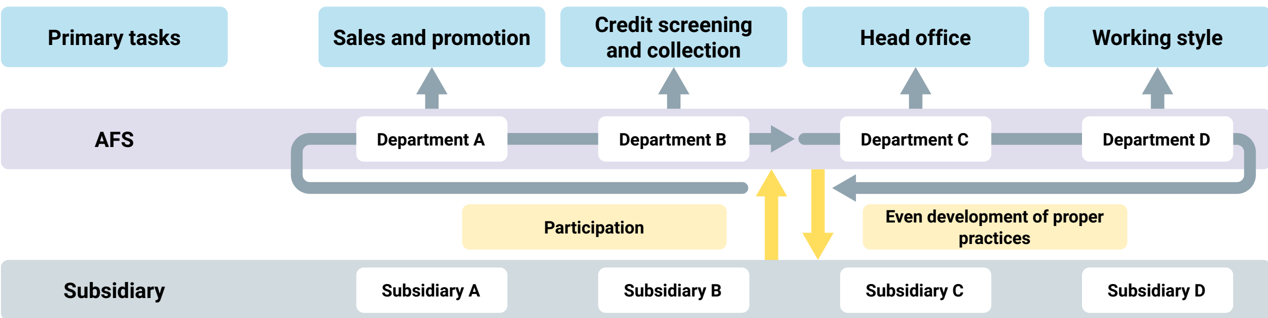
Furthermore, we must respond to major changes in the lifestyles and behavior patterns of customers that have emerged due to the spread of COVID-19 and accelerate our digitalization and systemization efforts, but in terms of pursuing business growth and mitigating the effects of the pandemic. We must also make major changes to the products and services we offer customers. We need to make a fundamental reassessment of the special benefits we offer with credit cards, our insurance products, what comprises the ideal bank branch, and other aspects of our business, and then re-verify whether they are truly in line with what customers need. Moreover, to meet individual customer needs in a prompt manner, not only for sales but for credit screening as well, we will move past the conventional face-to-face approach and utilize automated confirmation and AI to increase efficiency while using digital technology to facilitate person-to-person interaction. In terms of both work efficiency and mitigating the impact of the pandemic, we need to make a significant shift in our existing concept of work styles and introduce work-from-home and remote working options. In that same vein, we need to consolidate call centers and other center-based operations as well as head office functions. To us, these circumstances have presented a challenging opportunity to bring about great change and we intend to carry out the necessary investments in vital fields to do so. To achieve early stage results, we are working as a task force to determine how the Group should respond as a whole, and have made these efforts an urgent priority.

In addition, we will complement this business model, especially in the Global Business, by promoting M&A investment to achieve further growth and by accelerating our response to external conditions. We also aim for long-term profit growth, with an ROE of 15% as the target value for our desired capital efficiency.

Responding to Changes in Operating Environment Caused by COVID-19



Take on Challenges and Realize Change by Creating a Cross-Functional Task Force



Policy for Shareholder Returns

We consider shareholder returns to be an important part of management policy and distribute profits to shareholders appropriately. In the past, our policy has been to maintain a payout ratio of 30%–40%, but based on the particularly harsh outlook of fiscal 2020 results, we have set our annual dividend at ¥23.0 per share. This includes an interim dividend of ¥11.0 per share.

The Group is working as a whole to tackle issues in a swift manner, while staying aware our conventional payout standards, and we will continue to utilize our internal reserves to carry out investing and asset improvements in order to raise corporate competitiveness.