Financial Strategy:
Message From the Director in Charge of Finance and Accounting

Managing Director in Charge of Finance and Accounting
Hiroshi Yokoyama

Amid a rapidly and dramatically changing business environment, we strive to achieve truly integrated ESG management that creates economic, social, and environmental value for our stakeholders. AEON MALL began operating under our latest medium-term management plan (FY2023-FY2025) in fiscal 2023. Under this plan, we are building solid financial foundations and resilient organizations from the perspective of sustainability for sustainable growth.

Hiroshi Yokoyama, director in charge of finance and accounting, explains the financial management issues revealed by an analysis of our current situation, measures to address these issues, and our future vision for enhancing corporate value.

Analysis, Management Indicators, and Share Price

To maximize cash flows in the future and improve corporate value, the Company has established the following target financial indicators: EPS growth rate of 7% (annual growth rate beginning FY2019); net interest-bearing debt/EBITDA ratio of 4.5 times or less, and return on invested capital (ROIC) of at least 5%. Our historical results are shown in the figure below. We did not achieve targets in these indicators, due in large part to sluggish performance since 2020 and the COVID-19 pandemic.

Looking at share price indicators (▶ P.89/11-Year Financial Highlights), we see that price-to-book ratios have traditionally remained above 1.0 times. Since 2020, the start of the COVID-19 pandemic, our price-to-book ratios have trended below 1.0 times. If we break price-to-book down into price-earnings ratio (PER) and return on equity (ROE), we see that the decline in ROE due to weak earnings has been a significant factor.

Target Performance Indicators

Indicators	Type	Target	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019
ROIC	Efficiency	6% or higher	4.9%	4.5%	4.4%	4.6%	4.4%	4.3%
Equity	Safety	30% or higher	36.4%	34.2%	34.6%	33.2%	31.9%	28.5%
Net D/E ratio (times)	Safety	1.0 times	0.5	0.8	0.8	0.9	1.1	1.5

We modified performance indicators due to the adoption of IFRS 16 in fiscal 2019, as well as to maximize future cash flows and increase corporate value.

Indicators	Type	Target	FY2020	FY2021	FY2022
ROIC	Efficiency	5% or higher	2.2%	2.4%	2.5%
EPS Growth Rate (annual growth vs. FY2019)	Growth	7%	–*	▲25.0%	▲27.6%
Interest-bearing debt EBITDA (times)	Safety	4.5 times or less	6.2	6.6	6.0

* We did not calculate EPS growth rate for fiscal 2020 as we recorded a net loss per share.

Value Creation Strategy
22 Three-Year Medium-Term Management Plan Overview and Progress
23 2023-2025 Three-Year Medium-Term Management Plan Policies and Strategies
33 Financial Strategy: Message From the Director in Charge of Finance and Accounting
40 Special Feature Dialogue Between Outside Director and Securities Analyst
44 Digital Transformation (DX) Strategy
46 Sustainability Strategy
47 Human Resources Strategy
60 Environmental Strategy
68 Attention to Human Rights

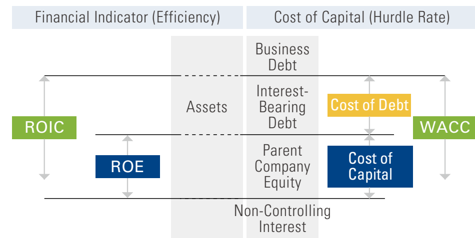
Financial Strategy:
Message From the Director in Charge of Finance and Accounting

Understanding the Cost of Capital

ROE must exceed the cost of capital (positive equity spread) if a company is to increase corporate value. AEON MALL uses cost of capital and WACC as corresponding measures related to ROE and ROIC, respectively, which are indicators of efficiency.

We calculate the cost of capital on a capital asset pricing model (CAPM) basis. Given historical trends, we set the AEON MALL cost of capital generally in the 6% to 7% range. To calculate WACC, we use the weighted average of the cost of capital and cost of debt, setting WACC at approximately 3%.

The relationship between efficiency indicators and cost of capital is shown below; the cost of equity for ROE and WACC correspond to ROIC.



We calculate cost of capital on a CAPM basis.

Cost of Capital: 6% to 7%

= Risk-Free Rate (0.0% to 0.5%) + β (0.8~1.1) × Market Risk Premium (7% (Roughly))

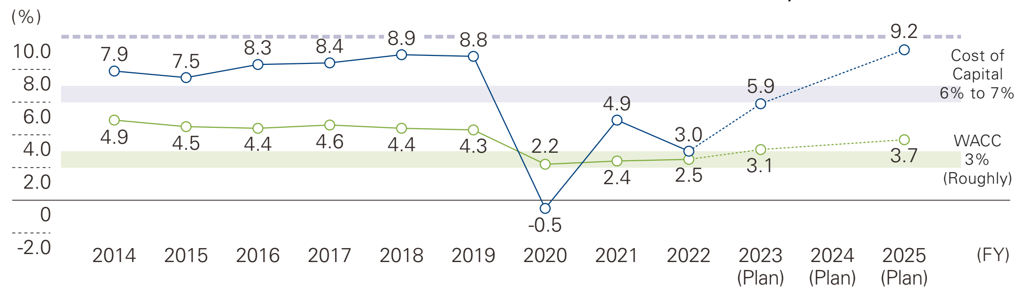
We calculate WACC as the weighted average of cost of capital and cost of debt.

WACC: 3% (Roughly)

= Cost of Capital × Market Capitalization / (Market Capitalization + Interest-Bearing Debt) + Cost of Debt × Interest-Bearing Debt / (Market Capitalization + Interest-Bearing Debt)

As shown in the chart below, in FY2020, cost of capital (currently between 6% and 7%) fell below ROE. In other words, we have continued to experience a negative equity spread. Although we expect ROE to recover to 5.9% on the basis of this year's profit plan, we feel the urgency in returning our equity spread to positive territory as soon as possible.

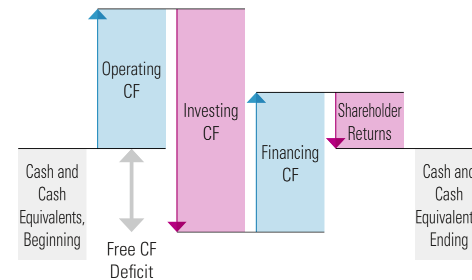
ROE, ROIC Performance



Cash Allocation

The figure below shows our current cash allocation. Investment cash flow exceeds operating cash flow, with free cash flow continuing as a deficit. The shortfall is covered by financial cash flows from interest-bearing debt financing, including bond issuances and borrowings from financial institutions. As leverage increases, the net interest-bearing debt-to-EBITDA ratio declines. While eliminating the free cash flow deficit is a major issue for us, we are in a phase requiring continued investment in growth. We must manage our finances to maximize operating cash flow while balancing investment cash flow.

Current Status



For the time being, capital investment will outpace operating cash flows due to active overseas mall openings in areas of expected high growth.

Given these circumstances, we recognize the need to address ROE at less than the cost of capital and the continuation of free cash flow deficits as priority financial issues.

To enhance corporate value, we established goals to achieve ROE of 9% by fiscal 2025 and free cash flow surpluses by fiscal 2028. We expect that achieving these goals will lead to improvements in our target performance indicators as a matter of course.

Issues	Targets
• ROE less than the cost of capital • Continuation of free cash flow deficits	• FY2025 ROE of 9%+ • FY2028 free cash flow surplus

22 Three-Year Medium-Term Management Plan Overview and Progress
23 2023-2025 Three-Year Medium-Term Management Plan Policies and Strategies
33 Financial Strategy: Message From the Director in Charge of Finance and Accounting
40 Special Feature Dialogue Between Outside Director and Securities Analyst
44 Digital Transformation (DX) Strategy
46 Sustainability Strategy
47 Human Resources Strategy
60 Environmental Strategy
68 Attention to Human Rights

Financial Strategy:
Message From the Director in Charge of Finance and Accounting

Achieving ROE of 9% and Challenges to ROE Improvement

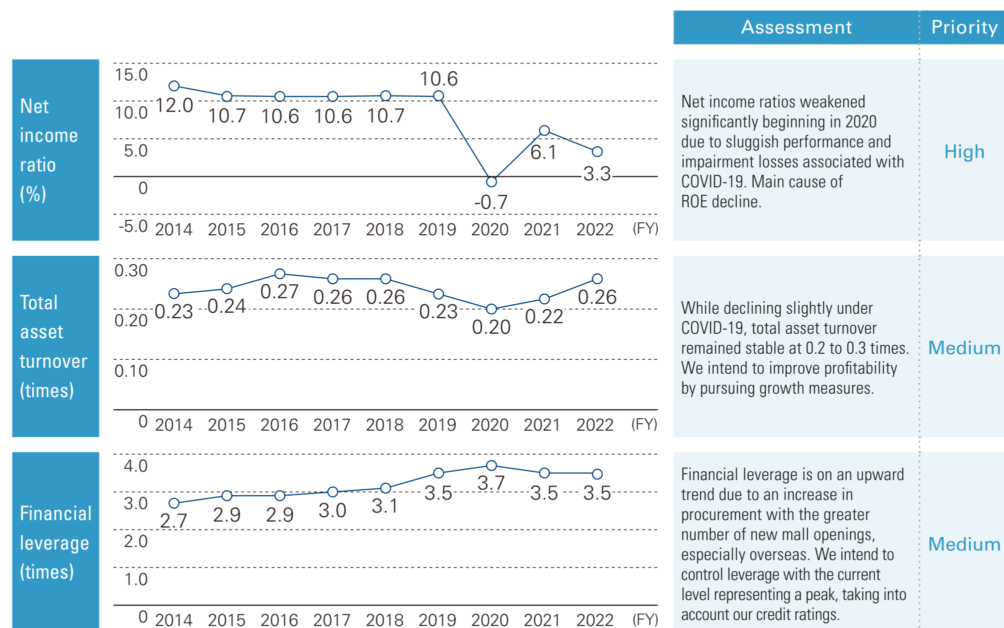
Breaking ROE into the three components of net income ratio, total asset turnover, and financial leverage provides a clear picture of the current issues.

The net income ratio has been trending downward due to the COVID-19 pandemic beginning in fiscal 2020. Extraordinary losses related to impairment and scrap-and-build have also contributed to the current decline.

Total asset turnover has stabilized; however, we must improve profitability through steady growth initiatives as described in our medium-term management plan.

Financial leverage is trending upward as we accumulate interest-bearing debt to meet our funding needs for the expansion of overseas mall openings. Increasing leverage would be undesirable when considering the reaction of rating agencies, and we intend to control leverage by maintaining current levels while implementing a liquidation scheme.

Considering these factors, the first order of business in improving ROE is to maximize net income.



	Assessment	Priority
Net income ratio	Net income ratios weakened significantly beginning in 2020 due to sluggish performance and impairment losses associated with COVID-19. Main cause of ROE decline.	High
Total asset turnover	While declining slightly under COVID-19, total asset turnover remained stable at 0.2 to 0.3 times. We intend to improve profitability by pursuing growth measures.	Medium
Financial leverage	Financial leverage is on an upward trend due to an increase in procurement with the greater number of new mall openings, especially overseas. We intend to control leverage with the current level representing a peak, taking into account our credit ratings.	Medium

ROE Improvement Measures

The chart below summarizes our plans in terms of business, finance, and sustainability to achieve our ROE goal of 9% or more by fiscal 2025.

In terms of business, we plan to improve our business portfolio through necessary investments in Japan and overseas in consideration of growth and efficiency. In the area of finance, we plan to improve efficiency through balance sheet control and positive free cash flow. In terms of sustainability, we will continue to address social issues in earnest, including decarbonization, resource recycling, and human capital. In these ways, we intend to earn the trust of our stakeholders and continue to be the Company of choice.

These efforts are in line with the growth measures outlined in our three-year medium-term management plan (FY2023-FY2025). We expect ROE to exceed 9% based on our profit plan through fiscal 2025, which will be the final year of our current plan. We believe it is important that we achieve the profit targets defined in our three-year medium-term management plan.

Targets	Area	Measures	FY2023-FY2025 Three-Year Medium-Term Management Plan
FY2025 ROE of 9%+	Business	**Improve business portfolio by making investments that emphasize future growth and capital efficiency** • Open new malls aggressively through focused investment in growth markets overseas • Achieve stable growth through business model innovation in Japan • Be selective in new mall investments in Japan • Withdraw from and downsize unprofitable businesses • Create new sources of revenue through new businesses	**Initiatives** Pursue a Regional Shift in Japan and Overseas Create a Platform for Health and Wellness
	Financial	**Improve Efficiency Through B/S Control and Achieve Positive Free Cash Flow** • Execute investments based on return on investment criteria (ROIC > WACC) • Maintain and improve financial leverage by liquidating properties • Improve free cash flow • Increase dividends in a stable manner and based on profit growth	**Growth Initiatives** Discover and Commercialize Business Opportunities in Overseas Growth Markets Pursue Business Model Innovation in Japan Create New Business Models That Break From Existing Business Frameworks
	Sustainability	**Pursue Sustainability Initiatives for Truly Integrated ESG Management** • Operate malls using locally produced, locally consumed renewable energy for decarbonization • Position circular malls as a key component of circular economic zones • Exercise human capital management to develop and produce human resources who will be the driving force of innovation	**Foundation Building** Build Strong Financial Foundations and Resilient Organizations From the Perspective of Sustainability

* Each indicator is calculated as follows.
• ROE = Net income attributable to owners of parent ÷ equity
• Net income ratio = Net income attributable to owners of parent ÷ operating revenue
• Total asset turnover = Operating revenue ÷ total assets
• Financial leverage = Total assets ÷ equity

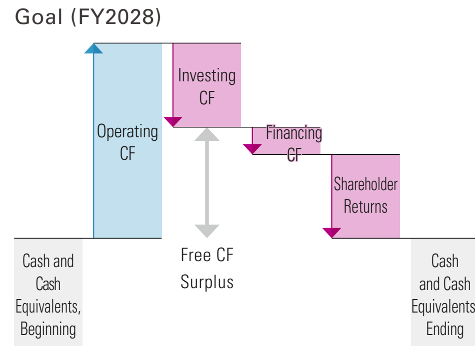
22 Three-Year Medium-Term Management Plan Overview and Progress
23 2023-2025 Three-Year Medium-Term Management Plan Policies and Strategies
33 Financial Strategy: Message From the Director in Charge of Finance and Accounting
40 Special Feature Dialogue Between Outside Director and Securities Analyst
44 Digital Transformation (DX) Strategy
46 Sustainability Strategy
47 Human Resources Strategy
60 Environmental Strategy
68 Attention to Human Rights

Introduction
Top Message
2030 Vision
Value Creation
Value Creation Strategy
Corporate Governance
Corporate Data

Financial Strategy:
Message From the Director in Charge of Finance and Accounting

Free Cash Flow Surplus

The figure on the right illustrates our cash allocation goals. Our aim is to increase operating cash flow, make capital investments within the scope of said cash flow, and reduce interest-bearing debt. The following describes cash flows for the period under review.



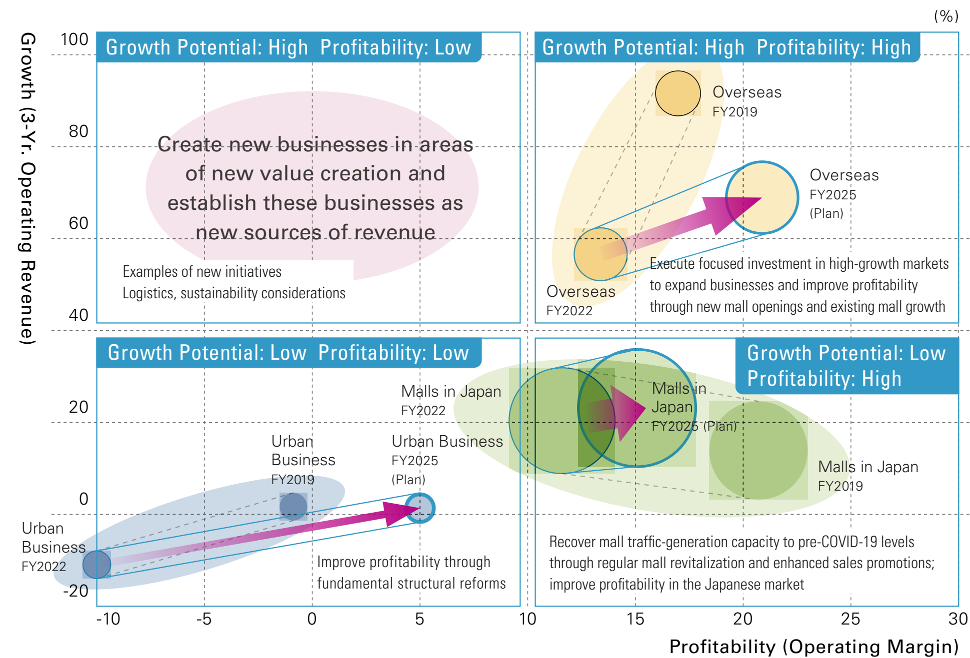
Operating Cash Flow

The figure on the right describes our business portfolio, with profitability (operating margin) on the horizontal axis and growth (three-year operating revenue growth rate) on the vertical axis. The chart maps the position of each business for fiscal 2019, fiscal 2022, and fiscal 2025. The size of each circle indicates the relative size of operating revenue.

The upper right quadrant shows our overseas business. While this business, which is a growth driver, weakened in fiscal 2022 in terms of profitability and growth due to the impact of COVID-19, we will grow the scale of our businesses and profitability through new mall openings and high growth at existing malls.

The lower-right quadrant of the figure shows our mall business in Japan. Our malls in Japan also experienced declining profits, but the most apparent issue arising from the COVID-19 pandemic is our ability to attract customers. We will recover our ability to attract customers through activities to revitalize local markets, large-scale events, and sales promotions, working to achieve stable growth.

The lower-left quadrant shows our urban business. While performance has been sluggish to date, stemming from a slow response to changing consumer trends, we will focus on delivering profits by fiscal 2025 through fundamental structural reforms.



* Growth rate compared to operating revenues over the three previous fiscal years.
* The size of each circle indicates the relative size of the business (by operating revenue).

The upper-left quadrant shows how we will pursue new business creation for value in this era of uncertainty (VUCA) and rapid change. So far, we have not established any revenue-supporting pillars, we aim to make these businesses profitable based on our philosophy of community co-creation.

Every business has its own position in our portfolio, and specific measures will differ for each. However, the common thread is that we must execute investments oriented to growth and efficiency in Japan and overseas to improve our portfolio and maximize operating cash flow.

22 Three-Year Medium-Term Management Plan Overview and Progress
23 2023-2025 Three-Year Medium-Term Management Plan Policies and Strategies
33 Financial Strategy: Message From the Director in Charge of Finance and Accounting
40 Special Feature Dialogue Between Outside Director and Securities Analyst
44 Digital Transformation (DX) Strategy
46 Sustainability Strategy
47 Human Resources Strategy
60 Environmental Strategy
68 Attention to Human Rights

Financial Strategy:
Message From the Director in Charge of Finance and Accounting

The chart below shows the actual performance of our overseas business, domestic business, consolidated results, ROIC by business, and targets for fiscal 2025. We view ROIC as an indicator of investment efficiency by business segment. We forecast the domestic business to achieve 5.3%, surpassing the ROIC target by fiscal 2025. At the same time, we forecast the overseas business to be 2.4%, which will drag ROIC lower on a consolidated basis.

As we have invested in Vietnam and other regions of high future growth potential, ROIC improvement appears slow and low when cutting off projections at fiscal 2025.

			FY2019 Actual	FY2022 Actual	FY2025 Plan
Overseas Business		Operating revenue	¥49.1 billion	¥77.3 billion	¥130.0 billion
		Operating income	¥8.3 billion	¥9.8 billion	¥27.0 billion
		Operating margin	16.9%	12.7%	20.8%
		ROIC (by business)	2.0%	1.5%	2.4%
Japan Business	Malls in Japan	Operating revenue	¥250.3 billion	¥299.8 billion	¥368.0 billion
		Operating income	¥52.6 billion	¥36.3 billion	57.0
		Operating margin	21.0%	12.1%	15.5%
	Urban Business	Operating revenue	¥24.6 billion	¥21.8 billion	¥22.0 billion
		Operating income	-¥0.2 billion	-¥2.2 billion	¥1.0 billion
		Operating margin	-0.8%	-10.4%	4.5%
		ROIC (by business) (Total of Japanese Malls and Urban Business)	4.6%	2.7%	5.3%
Consolidated		Operating revenue	¥324.1 billion	¥398.2 billion	¥520.0 billion
		Operating income	¥60.7 billion	¥43.9 billion	¥85.0 billion
		Operating margin	18.8%	11.0%	16.3%
		ROIC (overall)	4.3%	2.5%	3.7%

* ROIC (by business) is simply calculated as the ratio of after-tax operating income to the residual carrying value of each business.

While we expect to achieve an ROIC of 5% or greater in Japan as of FY2025, we project ROIC of 3.7% on a consolidated basis due to the failure to achieve the target in our overseas businesses.

The upper section of the figure below shows the profit/loss model and ROIC per project for overseas malls. The lower section shows the number of overseas malls opened and ROIC (per business) for the overseas business. On a project basis, ROIC for overseas malls generally exceeds the 5% target after eight years.

Since the opening of our overseas business in earnest in fiscal 2015, the percentage of malls in their eighth year or later will increase in the future. The ratio of malls in their eighth year of operation or longer will increase in fiscal 2025 and later, and we project to achieve our ROIC target of 5% for the overseas business by fiscal 2030.

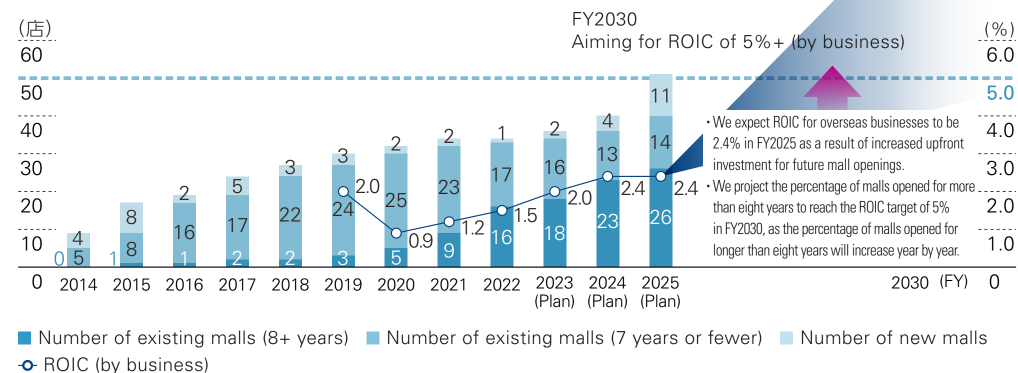
Overseas Mall Profit Model and ROIC (Per-Project Basis)

	Year 1	Year 4	Year 8	Year 12
Operating revenue	¥1.45Bn	¥2.18Bn	¥3.70Bn	¥4.93Bn
Operating income	- ¥0.27Bn	¥ 0.72Bn	¥ 1.39Bn	¥ 2.43Bn
Operating income margin	-18.5%	33.0%	37.5%	49.3%
ROIC (per-project basis)	—	2.6%	5.0%	8.8%

- We expect operating revenue and operating income to increase in overseas malls due to high economic growth in the areas where malls are located and growing populations within the market area.
- We expect ROIC (per-project basis) to improve year by year in line with profit growth. In year eight, ROIC exceeds the target level of 5% and continues to improve thereafter.

* Model case reflecting existing mall performance

Overseas Business Number of Malls Opened and ROIC (by Business)



* One mall in China will close in FY2023

22 Three-Year Medium-Term Management Plan Overview and Progress
23 2023-2025 Three-Year Medium-Term Management Plan Policies and Strategies
33 Financial Strategy: Message From the Director in Charge of Finance and Accounting
Special Feature
40 Dialogue Between Outside Director and Securities Analyst
44 Digital Transformation (DX) Strategy
46 Sustainability Strategy
47 Human Resources Strategy
60 Environmental Strategy
68 Attention to Human Rights

Financial Strategy: Message From the Director in Charge of Finance and Accounting

Investing Cash Flow

The chart below shows the composition of capital investments (cash basis) by region for the three years of our current medium-term plan. We plan to invest a higher proportion in ASEAN, including Vietnam, which we see as a growth market and one of our key strategic areas.

Total capital investment under the current plan will total ¥500 billion over three years. We increased capital investment in response to the impact of COVID-19, which pushed back the opening of certain overseas properties. We expect future capital investment to reach a cruising pace of ¥150 billion per year, as we use development-type leases and other mall opening schemes to reduce the initial investment.

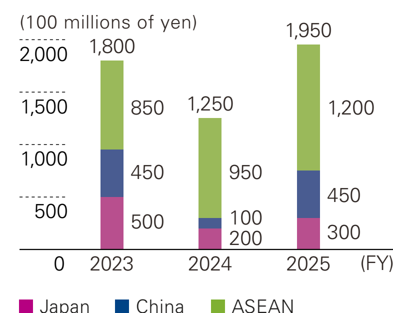
Upfront investments for new mall openings will continue for some time to ensure future growth in inland China and ASEAN countries, particularly in Vietnam. However, we aim to achieve positive free cash flow by fiscal 2028 by growing operating cash flow through profit growth at existing overseas malls, which have become a larger proportion of our total sales.

Capital Investment Plan

(100 millions of yen)

	2023	2024	2025	3-Yr. Total
Japan	500	200	300	1,000
New	375	120	230	725
Revitalization	110	50	50	210
Urban SC	15	30	20	65
Overseas	1,300	1,050	1,650	4,000
China	450	100	450	1,000
ASEAN	850	950	1,200	3,000
Total	1,800	1,250	1,950	5,000

Capital Investment Allocation Plan



* Capital investment plan represents net figures reflecting development type leases and the use of REITs.

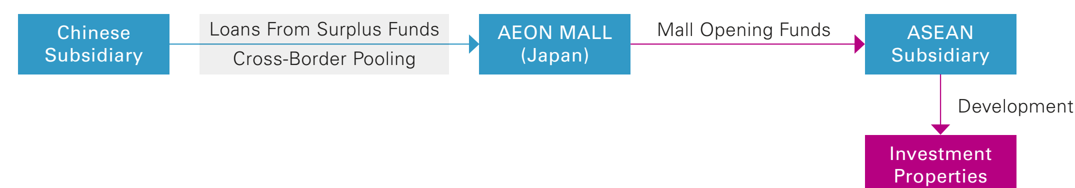
Financing Cash Flow

As we continue to engage in capital Investment in growth markets while running deficits in free cash flow, we must continue to raise funds through interest-bearing debt, including bond issuances and loans from financial institutions. At the same time, our financial leverage is on an upward trend. Considering our credit rating, it may be difficult to apply excessive leverage further. Therefore, we will need to control leverage at this current peak level.

A balanced approach to financial management will be required to achieve free cash flow surpluses, and it will be imperative to secure a variety of funding sources for this purpose. Therefore, AEON MALL conducts indirect financing, direct financing, and real estate liquidation schemes in Japan and overseas. In other words, we pursue a global financing mix.

Specific initiatives include the use of cross-border pooling to enhance cash management. As the AEON MALL overseas business continues to expand in scale and transition to the profit generation stage, cash balances have increased significantly in certain regions. We optimize cash management by transferring funds flexibly from regions with cash surpluses to regions with a strong demand for cash.

One example is the cross-border pooling established in fiscal 2020 between our Chinese subsidiary and AEON MALL (Japan). Here, surplus funds from the Chinese subsidiary were loaned to AEON MALL (Japan) beginning in fiscal 2021 to reduce interest-bearing debt, fund store openings at ASEAN subsidiaries, and other purposes.

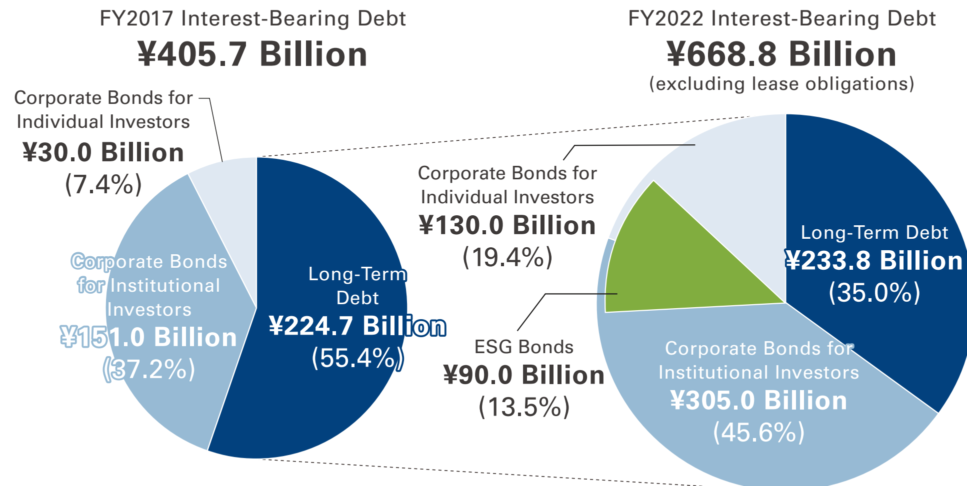


22 Three-Year Medium-Term Management Plan Overview and Progress
23 2023-2025 Three-Year Medium-Term Management Plan Policies and Strategies
33 Financial Strategy: Message From the Director in Charge of Finance and Accounting
Special Feature
40 Dialogue Between Outside Director and Securities Analyst
44 Digital Transformation (DX) Strategy
46 Sustainability Strategy
47 Human Resources Strategy
60 Environmental Strategy
68 Attention to Human Rights

Financial Strategy:
Message From the Director in Charge of Finance and Accounting

Another example is how we strengthen our procurement base by expanding ESG finance initiatives. Investors have become increasingly interested in ESG issues in recent years, and AEON MALL engages in ESG finance initiatives.

In terms of corporate bond procurement, we issued ¥30 billion in sustainability bonds in September 2020 to fund measures against COVID-19, to construct environmentally friendly malls, and for other purposes. In November of the following year, we issued ¥20 billion in sustainability-linked bonds with the goal of making the electricity used at all AEON MALL facilities in Japan CO_2-free by the year 2025. Utilizing the same linked bond framework, we issued Japan's first-ever sustainability linked bonds for private investors in April 2023 in the amount of ¥40 billion. By conducting ESG financing in this way, we demonstrate sustainability while securing a stable base of financing by developing new investors and sourcing funds from the Funds-Supplying Operations to Support Financing for Climate Change Responses of the Bank of Japan. We hope to create a virtuous cycle by utilizing the funds raised for ESG initiatives and investments, enhancing external evaluations and stabilizing our procurement environment.

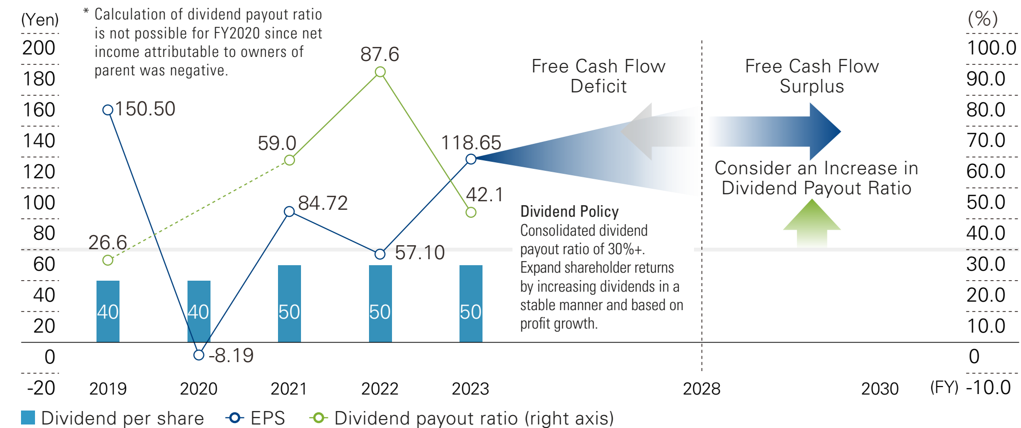


Expanded Shareholder Returns

Last, I want to address shareholder returns. Our dividend policy emphasizes stable dividends and a consolidated payout ratio of 30% or greater. As shown in the chart below, EPS declined during the COVID-19 pandemic, but we did not reduce dividends, holding to our policy of paying stable returns. We believe we have provided a minimum standard, albeit insufficient, return to shareholders.

Free cash flow has been at a deficit due to increased investments for growth, and we find ourselves in a difficult position related to share buybacks or raising the dividend payout ratio as methods to raise shareholder returns. Based on our profit plan for fiscal 2025, we expect EPS to be approximately ¥200 per share. We intend to increase shareholder returns by raising dividend levels supported by profit growth.

When free cash flow becomes a surplus again in fiscal 2028, we will consider raising the dividend payout ratio target, which is 30% or greater presently.



• Based on our three-year profit plan, we expect EPS in the final year of the plan (FY2025) to grow to roughly ¥200.
• At the stage we achieve positive free cash flow (FY2028 target), we will consider another increase in the dividend payout ratio.

AEON MALL pursues steady growth measures to achieve our numerical targets, and we will conduct well-balanced financial management by interweaving various procurement methods to improve ROE, ROIC, and other management indicators as we achieve free cash flow surpluses.

22 Three-Year Medium-Term Management Plan Overview and Progress
23 2023-2025 Three-Year Medium-Term Management Plan Policies and Strategies
33 Financial Strategy: Message From the Director in Charge of Finance and Accounting
40 Special Feature Dialogue Between Outside Director and Securities Analyst
44 Digital Transformation (DX) Strategy
46 Sustainability Strategy
47 Human Resources Strategy
60 Environmental Strategy
68 Attention to Human Rights