

MANAGEMENT DISCUSSION AND ANALYSIS

Financial Performance

Hong Kong economy still remained sluggish despite six successive interest rate cuts in the first half of the year. With the rate of unemployment remaining at a high level, the reductions in interest rate have not been able to trigger a rebound in the confidence of public spending. On the other hand, a more keen competition is noted with the entering of more new entrants into the consumer finance business.

Operating Results

The Company has managed to maintain its share in the credit card market while at the same time grow its personal loan business. In the first six months, the Company recorded an increase in sales transaction by 18% to HK\$2 billion and 15.8 million, which is a remarkable growth when compared with the 4% increase last year. Net profit increased by 10.1% to HK\$112.2 million with earnings per share at 26.78 HK cents, an increase of 10.1% over last year.

Sales transaction for card credit purchase and cash advance increased by 16.2% and 18.9% respectively when compared with last year. With the overwhelming response to AeON-CASH, which was first launched on February 12, sales transaction for personal loan has recorded a new high of HK\$273.5 million.

Interest income in the first half of the year increased by 6.6% to HK\$406.8 million, which resulted mainly from the growth in personal loan business. The drop in HIBOR has reduced the average funding cost from 8.9% in the fourth quarter of 2000/01 to 8.1% in the first quarter and further down to 7.8% in the second quarter of this year, with average funding cost for the first half being 7.9%. Average funding cost in August even reached 7.7%. Funding cost in the first half was HK\$88.1 million, a drop of 8.8% when compared with last year. The Company's net interest income recorded an increase of 11.9% to HK\$318.7 million from HK\$284.8 million in 2000.

The Company's other operating income fell by 21.4% to HK\$30.3 million from HK\$38.5 million in 2000, mainly due to the waiver of handling charge for cash advance.

During the first half of the year, the management continued to take active measures to control operating expenses, with its cost to income ratio improved from 42.3% to 40.5%. Operating expenses increased marginally from HK\$136.7 million in 2000 to HK\$141.4 million in the first half of the year.

There was an increase in bankruptcy cases in the past six months, resulted in the charge for bad and doubtful debts increased by 16.3% to HK\$79.4 million in the first half of the year from HK\$68.3 million in the same period last year. The total provision for bad and doubtful debts amounted to HK\$97.8 million and it represented 3.4% of the total debtor balance as at 20th August 2001.

Financial Position

With the increase in credit card receivables and personal loan debtor balance by HK\$42.7 million and HK\$126.1 million respectively, the total debtor balance as at 20th August 2001 amounted to HK\$2 billion and 899 million, an increase of HK\$158.2 million when compared with the balance of 20th February 2001.

On funding and capital, the Company relied principally on its internally generated capital and bank borrowings to fund its business. The principal source of internally generated capital is from accumulated profits. As at 20th August 2001, the Company had bank borrowings amounted to HK\$1,605.7 million, of which HK\$425.7 million is repayable within one year, and HK\$540 million issued debt securities backed by credit card receivables. The shareholders' funds of the Company were strengthened by 7.6% to HK\$981.6 million as at 20th August 2001 due to an increase in accumulated profits. Debt-to-equity ratio improved from 2.5 as at 20th February 2001 to 2.3 as at 20th August 2001.

Review of Operation

During the period under review, the Company launched the AEON Jusco American Express Card and our call center in Hong Kong started to provide 30 minutes approval for AEON Hello Kitty MasterCard, International AEON MasterCard, AEON American Express Card and AEON Batman™ MasterCard. The total number of cardholders increased by 47,000 in the first half to 770,000.

Keeping the Company in the forefront of providing speedy and convenient services to our customers, the Company launched AEON-DIRECT which applications are processed through our call center with 30 minutes turnaround time and only approved customers need to come to our branches for documentation. Up to now, eight products had already been launched in the market under AEON-DIRECT.

On the ATM network, the Company joined the MasterCard Cirrus network in August, and together with our CD network and American Express Global network, the combined network consists of 2,300 machines. From August 17 to August 20, there were 86 cash advance transactions by AEON cardholders on non-AEON ATM network, 17 cash advance transactions by non-AEON cardholders on AEON ATM network and 52 balance enquiry transactions on AEON ATM network.

Prospect

On credit card operation, the Company will focus its marketing efforts on recruiting Jusco cardholders using the branch network of Jusco stores as Jusco cardholders tend to use the card for credit purchase which is considered low credit risk. We will launch AEON Jusco Visa card in the second half year, and together with the existing AEON Jusco MasterCard and AEON Jusco American Express Card, a steady increase in the number of cardholders is expected, especially through the recruitment program during Jusco Anniversary Sales and Jusco Private Sales. Besides Jusco card, the Company will also launch AEON Visa card in October. We anticipate a positive growth in the number of cardholders, with the number expected to reach 820,000 by the end of fiscal year 2001/02.

To achieve a higher active ratio, the Company, in making use of the customer relationship management (CRM) capabilities, will perform analysis on customer information and transform the data into marketing campaigns with merchants. By using CRM and database marketing, we expect to increase the active ratio while at the same time reduce marketing cost.

The Company has recently further upgraded its CRM infrastructure and has used the upgraded CRM tool to restructure the existing customer records from account number based into HKID based. The database is expected to continue to enlarge through the marketing and collection activities, the call center and Internet. This database will be used mainly for two purposes. One is for database marketing to boost up sales while the other is for credit analysis to improve collection.

In view of the slow-down in the recovery of the Hong Kong's economy and the rising level of bankruptcies, the Company will make use of its CRM capabilities to market high revenue products to low risk customer database. At the same time, the Company will perform analysis on its own customer database, in particular customer profile, spending and payment pattern, to identify common attributes with default tendency and compile a list of these features to be built into the auto-judgment system for credit control as well as to alert the collection department to take prompt collection action. These alert features will also be incorporated into the customer segmentation for database marketing.

To further enhance its capability in direct selling and cross selling, the Company is in the process of developing operational knowledge management system. With the implementation of this system, call center and branch staff will have access to customer and prospect information online which will enable them to carry out direct selling and cross selling.

Despite the fact that the consumer finance business will remain highly competitive and challenging in the second half year, the Company will continue to capitalize on its competitive advantages, namely the ongoing product and service innovation and operational cost effectiveness, and actively participate in the market competition.