

Managing Director's Operational Review



Masanori KOSAKA
Managing Director

INTRODUCTION

On behalf of the Board of Directors, I am pleased to present to you the Annual Report of the Company for the year ended 20th February 2003. During the year under review, Hong Kong's economy was faced with structural problems with high unemployment and declining property prices, causing the number of personal bankruptcy cases to soar to a new high of 27,000, being two times the figure of last year. In view of this adverse situation, the Company had implemented various measures to tackle the increase in personal bankruptcy cases, including the implementation and use of the auto-judgment system with improved judgment accuracy to underwrite new applications and the start on the development of a fraud detection system. The Company had also carried out branch restructuring exercise to tighten up its control on costs, especially on branch-related expenses including rental.

REVIEW OF FINANCIAL RESULTS

At the operating level, the Company recorded an increase in operating profit before allowances by 12.1% from HK\$483.1 million in 2001/02 to HK\$541.6 million in 2002/03. However, the high level of personal bankruptcies had resulted in the significant increase in the bad debt expenses as well as the allowance for bad and doubtful debts, with charge for bad and doubtful debts increased sharply by 71.4% or HK\$168.0 million to HK\$403.4 million from HK\$235.4 million in the previous year. Even with the implementation of various cost-cutting measures, the Company did not manage to achieve a profit growth for the first time, with net profit dropped by 44.4% from HK\$211.0 million to HK\$117.3 million and earnings per share dropped from 50.39 HK cents to 28.01 HK cents. We have recommended a final dividend of 8.0 HK cents per share and, together with the interim dividend of 5.0 HK cents, the total dividend for the year was 13.0 HK cents. The dividend payout ratio for this year was 46.4%, as compared with 25.8% in 2001/02.

Operating income before interest expenses for the year was HK\$959.6 million, an increase of 1.0% when compared with HK\$950.3 million in 2001/02. Interest income decreased by 18.0% to HK\$659.0 million, and with the drop in interest expense by 15.8% to HK\$143.9 million, the Company's net interest income recorded a drop of 18.7% to HK\$515.2 million.

The Company recorded securitisation income of HK\$192.2 million in 2002/03, representing the gains on sale of credit card receivables, investment income from the seller and subordinated interests and unrealised gains on interest-only strips. Other operating income increased by 40.1% to HK\$109.9 million from HK\$78.5 million in 2001/02, mainly resulted from the servicer fee on credit card securitisation and the gain on disposal of investment securities and other investments. During the year, the Company exercised stringent cost control and implemented cost reduction programs such as closing down street level branches, cutting back in staff number and advertising expenses, which resulted in a further drop of cost-to-income ratio to 33.6%.

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With the transfer of credit card receivables to a special purpose entity under the new securitisation program, total debtor balance as at 20th February 2003 was HK\$1,876.7 million, when compared with HK\$2,924.2 million as at 20th February 2002. As at 20th February 2003, the Company had bank borrowings amounted to HK\$1,401.2 million and HK\$326.7 million issued debt securities backed by credit card receivables. Shareholders' funds were strengthened by 6.0% to HK\$1,118.7 million as at 20th February 2003 mainly due to the increase in retained earnings. Total debt-to-equity ratio improved from 2.1 in 2001/02 to 1.6 in 2002/03.

REVIEW OF OPERATION

Marketing, Credit Control and Collection

To maintain the quality of new members, instead of recruiting members through street level branches, members were recruited through affinity member-stores. Moreover, the implementation of the auto-judgment system had improved the judgment accuracy due to the standardisation of the approval process. To further control the credit risk, the Company analysed the utilisation history of its delinquent customers and applied the findings to its credit judgment process on new and existing customers. With the outdoor visit collection activities carried out by its outdoor visit team, the Company was able to take prompt collection actions on risk-identified customers at the earliest opportunity. In addition, the Company had set up a special account control team to recover amounts due under long outstanding delinquent and written-off accounts.



*Member recruitment
inside affinity member-stores*

Cost Control



*Shenzhen call centre –
provides collection and customer service*

During the year, the Company carried out branch restructuring exercise along with the change in its members recruitment strategy, resulting in the closure of 14 street level branches and merger of some of the branches. The operation in the head office was also streamlined to increase efficiency and productivity which included the shifting of collection activities and customer service to the Shenzhen call centre. As a result, the number of staff had reduced by 54. The cost reduction exercise would be expected to continue in the coming year.

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Credit Card Business

On credit card business, the Company continued to partner with different affinity member-stores to issue new credit cards. The newly launched AEON Jusco Visa Card, AEON Watami Visa Card and AEON Mega Warehouse MasterCard were aimed at our inactive customers to stimulate usage so as to increase the overall active ratio. We plan to issue at least three affinity cards in the coming year.



Launching of new affinity cards



*Hire purchase counter
inside Jusco store in Shenzhen*

Shenzhen Call Centre

The Shenzhen call centre has been providing support to our collection, tele-marketing and customer service operation since 2000. Last year, it started to provide consultancy services to third parties on hire purchase financing and accounts management. The know-how and experience gained from the Shenzhen call centre will be useful for our entry into the consumer finance business in the future.

PROSPECTS

Year 2003 is expected to remain a tough operating year for consumer finance business. Notwithstanding all the challenges and uncertainties ahead, the Company will continue to reinforce its foundation and prepare for further business growth. In Year 2003, the Company aims to accomplish three main tasks, namely to improve the quality of its core business, to implement a low cost operation and to explore a new source of revenue.

Credit card business will continue to be the core business of the Company, with the primary target on strengthening its customer database and increasing its receivables. The Company will make use of its customer database, customer relationship management tools and existing infrastructure, including its call centre, branch and cash dispensing machine network to grow its core business and to extend to a new line of business, so as to retain existing cardholders and increase the card active ratio. The Company plans to increase the number of cash dispensing machines from 270 to 290. New machines will be installed along the West Rail Line and also inside convenience stores.

Marketing Activities

The Company will strengthen its co-operation with Jusco stores to boost its credit card sales. With the existing customer database, the Company will launch marketing programs like summer sale, AEON Card Festival and discount coupon to increase its credit purchase transactions. In launching these programs, the Company will be able to differentiate cash advance customers from credit

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purchase transactors. With these available data, the Company will launch loyalty programs to retain quality customers while at the same time to boost up credit purchase sales. In addition, the Company will partner with other service providers to promote recurrent transactions like mobile bill payment and insurance premium payment through AEON credit cards which provides convenience to the customers while increasing the card active ratio. Following the joint



Joint promotions with convenience stores

promotion programs on the usage of cash dispensing machines inside convenience stores, other programs to boost cash advance transactions will be launched to target sleeping and inactive customers and also to convert non AEON-cardholders to become our members.



Purpose loan products

Different discount programs will be launched within the Company's merchant network to boost up both credit purchase and hire purchase sales. As female customers comprise the bulk of our customer database and are generally considered to have lower credit risks, the Company will line up with merchants in the fields of beauty and fitness, fashion and cosmetics to capture this customer segment progressively.

On personal loan business, the Company will continue to focus on cross selling and up selling member's loan, web loan to our selected low risk, inactive and sleeping customers. Moreover, different purpose loan products, such as study loan, decoration loan, insurance loan and health product instalment loans, will be developed to satisfy the different demand in the market and at the same time to attract quality customer database.

Positive Credit Data Sharing

On customer quality, following the launch of positive credit data sharing in the second half, the Company will be able to obtain more information on new applications which will be incorporated into the auto-judgment system to enable the Company to arrive at a more accurate credit judgment. By offering minimal credit limit, the management believes that there is room to grow the receivables even though keen competition will intensify after the launch of positive credit data sharing.

New Business

The Company will ride on its existing customer database to move into insurance agency business, selling tailor-made insurance products through its call centre and branch network and thereby generating a new source of revenue to the Company.



Tailor-made insurance products

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China Business

With China being admitted to the World Trade Organisation, the Company is actively exploring different scenarios to enter the consumer finance business in China. The Shenzhen call centre offers a solid foundation for our operation in China and with the plan to set up another branch in Guangzhou, the Company intends to establish its base in the Guangdong Province for future expansion.

Future

The solid business foundation that we have built over these years, the active steps that we have taken to constantly improve our services and products and the investment that we have made on the infrastructure for our future growth and expansion will steer us through the current economic difficulties and open up new horizons.

SYSTEMS DEVELOPMENT

The Company will continue to enhance its systems to meet customers' changing needs and expectations and to improve on risk detection and efficiencies within the Company. Moreover, the Company will re-vamp the enterprise-wide contingency plan to cater for any unforeseen circumstances. The measures in the Business Continuity Plan will be tested on a recurrent basis to ensure their effectiveness during the time of need.

During the year under review, the Company had completed the development of the data warehouse and the operating systems for the auto-judgment system as well as the launching of the AEON Jusco Visa Card and AEON Watami Visa Card.

In the coming year, the Company will put its efforts in developing the hire purchase instant approval system, the business intelligence system and the fraud detection system. In addition, modification work will be carried out on the existing auto-judgment system to cope with the launching of the positive credit data sharing in the second half of the year.

HUMAN RESOURCES COMMITMENT

The total number of staff as at 20th February 2003 and 20th February 2002 was 286 and 340 respectively. A series of programs is in place to retain quality staff and to realise employees' career potential. The Company will continue to put emphasis on staff training and development, with training being provided on both new product knowledge and servicing skills. The Company is well positioned to face the challenges ahead with a resilient and dedicated workforce.

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CONTRIBUTION TO THE SOCIETY



Launching ceremony for organic plant growing competition

Over the years, the Company has been working hard to be a responsible corporate citizen placing special attention on local community and environment needs. We emphasize on three key words, “peace”, “people” and “community” in our Company’s philosophy. Besides the donation through its seven charity cards to support vital charity causes in the community, the Company has also participated in the activities of environmental conservation, education and cultural exchange through the AEON Jusco Fund.

The AEON Jusco Fund had recently organized an event known as “Green Flea Market” to arouse the attention of general public to reuse second hand items and to reduce waste. The proceeds received from this activity were donated to a beneficiary engaged in carrying out environmental project. In Hong Kong, the AEON Jusco Fund has made donations to support the charitable activities including the green community pilot scheme and the organic plant growing competition for primary and secondary schools. In China, the AEON Jusco Fund has continued to support to the agro-forestry project in Panyang of Ningxia, the set up of Tsinghua-AEON Jusco Research and Education Funds and quality teaching for remote minority regions in China.



Agro-forestry trip to Panyang, Ningxia

ACKNOWLEDGEMENT

I am most grateful to our customers, business partners, and shareholders whose generous support has helped the Company to prevail over the existing adverse economic conditions. On behalf of the Board, I would like to take this opportunity to express our sincere thanks to our customers, our business partners and our shareholders for their continuous support, dedication and loyalty in the past one year. Our appreciation also goes to our dedicated management and staff who have continued their commitment and perseverance in delivering the highest customer satisfaction to the public even under the current tough operating environment.



Masanori KOSAKA
Managing Director

Hong Kong, 25th April 2003