

Management Discussion and Analysis

The Company continues to be engaged in the provision of consumer credit finance services which include the issuance of credit cards, the provision of vehicle financing, the provision of hire purchase financing and the provision of personal loan financing.

The operating environment in Hong Kong remained tough last year, with a continuous high unemployment rate, a decline in property prices, deflation in asset value and a record personal bankruptcy cases. As a result, there was a significant increase in the charge-off for credit cards. At the same time, credit demand in the consumer finance field continued to fall and industry competition became fierce.

KEY FINANCIAL HIGHLIGHTS

The Company recorded a profit of HK\$117.3 million for the year ended 20th February 2003, representing a drop of HK\$93.7 million or 44.4% when compared with the previous year. Accordingly, the Company's earnings per share dropped to 28.01 HK cents per share from 50.39 HK cents per share.

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. Net interest income recorded a drop of 18.7% to HK\$515.2 million from HK\$633.3 million in 2001/02.

Operating expenses decreased from HK\$296.4 million in 2001/02 to HK\$274.1 million, with cost-to-income ratio being 33.6% for this fiscal year.

The Company's 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.

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.

The Board recommended the payment of a final dividend of 8.0 HK cents per share. Together with the interim dividend of 5.0 HK cents per share already paid, the total dividend for the year was 13.0 HK cents per share, with dividend payout ratio increased to 46.4% from 25.8% in 2001/02.

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INCOME STATEMENT ANALYSIS

Operating Income

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. Under the new securitisation program backed by credit card receivables entered in September 2002, the Company is required to sell from time to time certain designated credit card receivables to a special purpose entity. Interest income and fees and commissions of these credit card receivables will be distributed back to the Company in the form of investment income from the seller and subordinated interests in the securitisation trust. Interest income decreased by 18.0% to HK\$659.0 million from HK\$804.1 million in 2001/02.

With HIBOR continued to remain low, the average funding cost for the year was 6.1%, with average funding cost in the fourth quarter even moved down to 5.6%. Interest expense amounted to HK\$143.9 million, representing a decrease of 15.8% or HK\$26.9 million from HK\$170.8 million in 2001/02. The Company's net interest income recorded a drop of 18.7% to HK\$515.2 million from HK\$633.3 million in 2001/02.

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. Besides securitisation income, the Company also recorded other operating income of HK\$109.9 million, representing an increase of 40.1% or HK\$31.4 million from HK\$78.5 million in 2001/02. The increase was mainly resulted from the servicer fee on credit card securitisation and the gain on disposal of investment securities and other investments.

Operating Expenses

In view of the tough operating environment, 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. Operating expenses for the year amounted to HK\$274.1 million, a drop of 7.5% or HK\$22.3 million when compared with HK\$296.4 million in 2001/02, with cost-to-income ratio at 33.6%. Staff cost represented 82.6% when compared with last year, resulting from the retrenchment of branch network, the restructuring in the head office and the cut down of promoter cost. Advertising fee represented 76.5% when compared with last year and a further cut down would be expected in the coming year.

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Charge for Bad and Doubtful Debts

Considering the murky economic prospects and the high level of personal bankruptcies, the Company increased the amount of allowance for bad and doubtful debts. During the year, the Company's 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, with HK\$360.7 million for specific allowance and HK\$42.7 million for general allowance.

BALANCE SHEET ANALYSIS

The Company's shareholders' funds as at 20th February 2003 was HK\$1,118.7 million, representing a growth of 6.0%, or HK\$62.9 million, when compared with the balance as at 20th February 2002. Net asset value (before final dividend) per share as at 20th February 2003 was HK\$2.67 per share, compared with HK\$2.52 per share as at 20th February 2002.

Debtor Balance

With the transfer of credit card receivables to a special purpose entity under the new securitisation program, credit card receivables as at 20th February 2003 was HK\$1,275.9 million, as compared to HK\$2,337.6 million as at 20th February 2002. With the launching of new purpose loan products, instalment loans receivable reached HK\$375.8 million as at 20th February 2003, an increase of 24.3% when compared with HK\$302.4 million as at 20th February 2002. 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.

Allowance for bad and doubtful debts amounted to HK\$235.9 million as at 20th February 2003, an increase of HK\$87.2 million when compared with previous year and representing 12.6% of total outstanding receivables.

Set out below is an analysis of debtor balance of hire purchase debtors, instalment loans receivable and credit card receivables which is overdue for more than 1 month:

	20th February 2003		20th February 2002	
	HK\$'000	%*	HK\$'000	%*
Overdue 1 month but less than 2 months	176,250	9.4	116,692	4.0
Overdue 2 months but less than 3 months	34,420	1.8	32,177	1.1
Overdue 3 months or above	129,332	6.9	127,444	4.3
	<u>340,002</u>	<u>18.1</u>	<u>276,313</u>	<u>9.4</u>

* Percentage of total debtor balance

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RETAINED INTERESTS IN SECURITISATION TRUST

During the year, the Company raised HK\$600 million through the realisation of credit card receivables originated and selected by the Company to a special purpose entity, which issued trust certificates backed by such receivables.

Under this transaction, the entitlements to interest spread and cash reserve accounts are stated at fair values whereas seller interest and subordinated interest are stated at their allocated amounts and subject to amortisation. The interest-only strips, which are retained by the Company, represent the net present value of the projected cash flows expected to be produced from the securitised credit card receivables during their estimated lives.

As at 20th February 2003, the Company had retained interests in the securitisation trust in the forms of seller interest, subordinated interest, interest-only strips and cash reserve account amounting to HK\$732.6 million.

Bank Borrowings and Capital Financing

The Company relied principally on its internally generated capital, bank borrowings and structured finance to fund its business. The principal source of internally generated capital is from retained earnings.

During the year, the Company had a major fund raising exercise. With the commencement of the amortization period of the HK\$540 million on balance sheet credit card securitisation, the Company had entered into an off balance sheet asset securitisation in September 2002. As a result, the Company managed to reduce its interest-bearing liabilities by HK\$600 million.

As at 20th February 2003, the Company had borrowings amounted to HK\$1,727.9 million, which included on balance sheet issued debt securities of HK\$326.7 million. Out of these borrowings, 56.6% will mature within one year whilst 28.1% between one to two years and 15.3% over two years. The Company had further strengthened its financial position as compared with 2001/02. As at 20th February 2003, total debt-to-equity ratio was 1.6, as compared with 2.1 in 2001/02. All the Company's borrowings were denominated in Hong Kong dollars.

The net asset value of the Company as at 20th February 2003 was HK\$1,118.7 million, or HK\$2.67 per share. Assets were pledged to secure structured finance facilities, short term general banking facilities and the sharing of ATM network. There was no major change in assets pledged when compared to that disclosed in the Company's 2001/02 Annual Report.

The Company's principal operations were transacted and recorded in Hong Kong dollars and thereby did not subject to any exposure on exchange rate fluctuation. During the year, the Company engaged in derivative financial instruments mainly to hedge its exposure on interest rate fluctuations.

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Capital expenditure for the year amounted to HK\$31.8 million as compared to HK\$53.1 million in the previous year. This was mainly related to the system development on different operating systems, including the auto-judgment system. As at 20th February 2003, capital commitments entered were mainly related to the purchase of property, plant and equipment.

Taking into account the financial resources available to the Company including internally generated funds and available banking facilities, the Company has sufficient working capital to meet its present requirements.

In determining the dividend payment, the objective is to reward shareholders with dividend income while retaining funds for future business development and expansion. Due to the unstable economic situation, a moderate growth in debtor balance was anticipated in the coming year. Moreover, shareholders have generally expected a higher dividend amount to compensate for the thin trading in the stock market. In view of this, the Board decided to maintain the absolute dividend payment amount despite a drop in net profit. For the year ended 20th February 2003, the Board recommended the payment of a final dividend of 8.0 HK cents per share, which together with an interim dividend of 5.0 HK cents per share, making a total dividend of 13.0 HK cents per share and a payout ratio of 46.4%.

SEGMENT INFORMATION

The Company's business comprised mainly three operating divisions, namely credit card, hire purchase and instalment loan. In 2002/03 and 2001/02, 85% of the Company's turnover was contributed from credit card operation. In 2002/03, 94.1% of the Company's operating income after deducting charge for bad and doubtful debts was contributed from credit card operation, as compared to 77.2% in 2001/02.

The operating income for credit card operation increased by 13.3% from HK\$623.2 million in 2001/02 to HK\$706.2 million in 2002/03. However, with the significant increase in charge for bad and doubtful debts by 56.7% to HK\$318.4 million, the operating income after deducting charge for bad and doubtful debts for credit card operation was dropped by 7.7% from HK\$420.0 million in 2001/02 to HK\$387.8 million in 2002/03.

There was a drop in net interest income and other operating income for hire purchase operation due to the keen competition in the market. With the increase in the charge for bad and doubtful debts, the operating income after deducting charge for bad and doubtful debts for hire purchase operation was decreased from HK\$22.7 million in 2001/02 to HK\$4.6 million in 2002/03.

The operating income for instalment loan operation recorded a slight increase of 1.4% from HK\$65.6 million in 2001/02 to HK\$66.5 million in 2002/03. However, this operation recorded an operating loss of HK\$6.1 million after deducting charge for bad and doubtful debts, due to the significant increase in charge for bad and doubtful debts.

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COMPETITIVE ADVANTAGES

Synergy

The launching of various well-accepted credit cards and personal loan products in the market had resulted in a continuous though a moderate growth in the number of cardholders and personal loan customers.

Know-how and Expertise

AEON Credit Japan has extensive know-how and expertise in the consumer finance industry and has assisted the Company in tackling the changing market environment by imparting innovative ideas on marketing and recruitment programs.

Targeted Customer Base

The targeted customer base of the Company is widely diversified. The new cardholders recruited in this financial year were mainly through the newly launched affinity cards, including the AEON Jusco Visa Card and the AEON Watami Visa Card. Around 80% of the customer database is in the age range of 21 to 40 years old and 50% of them are female cardholders.

Convenient Service

In providing consumer credit services to customers, the Company emphasizes on convenience. With the Company's extensive cash dispensing machine network supported by its branch network and call centres in Hong Kong and Shenzhen, customers can enjoy cash advance and personal loan services at a speedy and convenient way. As for credit purchase, the combined merchant network of MasterCard, Visa and American Express continues to provide convenience and wide-ranging choice to our cardholders.

GROWTH PHILOSOPHY

The four key elements of the Company's growth philosophy are (1) ongoing product and service innovation; (2) total consumer credit services; (3) operational cost effectiveness; and (4) a strong network of affiliated merchants. Consumers in Hong Kong have widely accepted and appreciated the innovative consumer credit finance services provided at low costs by the Company.