

# Managing Director's Operational Review

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**Masanori KOSAKA**  
*Managing Director*

## INTRODUCTION

On behalf of the Board of Directors (“the Board”), I am pleased to present to you the Annual Report of the Company for the year ended 20th February 2004.

In the first half of 2003, the economy of Hong Kong was adversely affected by the outbreak of SARS. As a result, social activities ceased and tourists avoided Hong Kong. Hotels and restaurants were badly affected and the July’s unemployment rate jumped to 8.7%, a record high in many years. Despite the adversity, the economy bounced back and the labour market improved in the second half.

As the Company’s card portfolio consists mainly of AEON Stores affinity cards, SARS had little impact on credit purchase transactions. Following the implementation of positive credit data sharing in the second half of the financial year, the Company launched a series of affinity cards and utilised its expanded merchant network to recruit new members. Together with the launch of various spending campaigns and the use of tele-marketing to cross-sell loan products to our customers, the Company recorded an increase in the overall sales volume when compared with last year. On the other hand, with the unemployment rate still at a high level, the overall charge-off rate remained at double digit. In view of the slow recovery in the economic situation, the Company continued to exercise tight control on the operating expenses, especially on advertising and branch-related expenses.

## PERFORMANCE REVIEW

Despite the difficult operating conditions in the first half of the year, the Company was able to achieve a slight profit growth, with net profit increased by 1.8% to HK\$119.4 million from HK\$117.3 million in 2002/03. Earnings per share increased from 28.01 HK cents to 28.50 HK cents. The Board has recommended the payment of a final dividend of 9.0 HK cents per share and, together with the interim dividend of 5.0 HK cents, total dividend for the year was 14.0 HK cents per share. The dividend payout ratio was 49.1%, as compared with 46.4% in 2002/03.

At the operating level, the Company recorded a decrease in operating profit before charge for bad and doubtful debts by 9.6% from HK\$541.6 million in 2002/03 to HK\$489.6 million in 2003/04. Operating income before interest expense for the year was HK\$840.3 million, a decrease of 12.4% when compared with HK\$959.6 million in 2002/03. Interest income decreased by 27.2% to HK\$479.8 million, while interest expense dropped by 18.7% to HK\$117.0 million.

The Company recorded securitisation income of HK\$252.2 million in 2003/04, as compared with HK\$192.2 million in 2002/03. Other operating income was decreased by 0.9% to HK\$108.9 million from HK\$109.9 million in 2002/03.

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During the year, the Company continued to exercise stringent control on operating expenses, especially on staff costs and advertising expenses, which resulted in a further drop in cost-to-income ratio to 32.3%. With the slight recovery in the economic situation, the Company's charge for bad and doubtful debts decreased by 14.7% or HK\$59.5 million to HK\$343.9 million from HK\$403.4 million in the previous year. This was further attributed to the tightened credit control, prompt collection efforts and improved credit quality as a result of the positive credit data sharing.

With the pick up in sales volume in the second half, and despite the transfer of additional amount of receivables to a special purpose vehicle under the enlarged credit card securitisation programme, total debtor balance still recorded an increase of HK\$58.8 million to HK\$1,935.5 million as at 20th February 2004 from HK\$1,876.7 million as 20th February 2003. As at 20th February 2004, the Company had bank borrowings amounted to HK\$1,644.9 million. Shareholders' funds were strengthened by 5.8% to HK\$1,183.6 million as at 20th February 2004 mainly due to the increase in retained earnings.

## REVIEW OF OPERATION

### Marketing

The implementation of positive credit data sharing in Hong Kong turns out to be an effective marketing tool for the Company to expand its customer base. With a better understanding on the total credit exposure of new applicants, it helps the credit control staff to better assess the credit risk and results in a better approval rate. To minimise the advertising expenses, the Company has used the merchant network as the recruitment base and launched new affinity cards to capture new customer database. A series of affinity cards was launched in the second half of the year, which included the IDD 007 AEON Visa Card, the Japan Home Visa Card, the MJ Life Privilege MasterCard and the Katiga MasterCard. The newly acquired member base will become a new backbone for the Company to cross-sell personal loan products, which in turn would increase both personal loan and card sales.



*Launch of new affinity cards to capture new customer database*



*New Tsim Sha Tsui branch*

### Branch Operation

Following the continuous expansion of payment network, our 15 branches have been successfully transformed into marketing centres, which now actively participate in card and merchant recruitment and tele-marketing activities. Besides pre-set sales target, branch staff has to ensure the delivery of quality service to our customers. This has strengthened the Company's

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marketing force in expanding the merchant network for card and personal loan products and recruiting new members. To meet the demand of customers, a new branch was opened in Tsim Sha Tsui in October 2003 with a display corner for merchants' products. Together with the launch of insurance and purpose loan products, the branch network has become a focal point for cross-selling exercise.

## Customer Service

On the customer service side, besides the convenience store payment network, the Company has signed up with a bank to offer payment service to customers through phone banking, internet banking and ATM network. Being an agent of Octopus Card, our cardholders can now enjoy the automatic add-value service to their Octopus cards. Furthermore, the discount merchant network has been expanded to provide additional card benefits to cardholders, with the number of discount merchant outlets reaching around 1,200 in Hong Kong and 4,500 in the PRC.



*Launch of Octopus add-value service*



*Provision of collection service to third parties through Shenzhen call centre*

## Outsourcing Business

For outsourcing business, the Company is now providing both hire purchase consultation service and collection service to external third parties through Shenzhen call centre and special accounts control team. In addition, the Company is managing a bonus point programme for a sizeable customer base for one of its business partners.

## PROSPECTS

Although Hong Kong still encounters problems like huge deficit, continued deflation and high unemployment, the economic situation is expected to continue to recover in the coming years. On the other hand, the operating environment for consumer finance business will become more competitive and challenging, as the competition amongst financial institutions to increase their market share in consumer loans will intensify. In order for the players to achieve better results, they must be innovative and adaptive to the needs of the customers. As one of the leading participants in this field, the Company will make use of its niche in the market and progress to tackle the challenges coming ahead. The mission for Year 2004 is to launch products that meet the needs of the public, to provide quality service to our customers, and to develop credit-related business.

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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. With additional new card benefits and convenient services provided to customers, the Company aims to increase the card active ratio and to retain the loyalty of existing cardholders. Moreover, we will cross-sell personal loan and insurance products to this enlarged member base to generate additional revenue. With the well-established infrastructure, the Company will extend its outsourcing business on hire purchase consultation, collection and credit-related services.

## Credit Card Business – Back on Track to Expand the Base

The average card spending per person is expected to increase with the recovery of economic situation. To capture this rising trend, the Company will strengthen its co-operation with member-stores. Tailor-made marketing programmes will be launched to fit into the promotion schedule of individual merchants, including 1-day discount passport and AEON membership festival. This not only would increase the average card spending, but also would help to recruit new members effectively. Since merchant network is a cost-effective channel to recruit new members, the Company will issue more affinity cards, with a target of at least four in the coming year. By launching new affinity cards and making use of the merchant network, the Company aims to issue additional 120,000 cards in the market.

The Company has successfully lined up with Octopus Card, internet service providers, mobile phone and insurance companies for recurrent transactions through credit cards and our next target will be the utility companies. By settling their monthly payments through our credit cards, it not only offers convenience to customers, but also increases the card active ratio.



On card benefits, the Company will continue to utilise its branches to source new discount merchants in Hong Kong and build a network of 2,000 outlets by the end of this year. The Company will source for attractive products to be offered to cardholders as new bonus point redemption gifts. Moreover, the Company will launch card instalment plan to facilitate cardholders to settle their credit purchase by instalments.



*Tailor-made marketing programmes*

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Cash advance transactions are expected to increase at a fast pace in the second half, following the return of confidence level in job security. In view of this, the Company will extend its cash dispensing machine network inside convenience stores and in other high traffic and convenient locations to capture a new customer sector. The previous joint promotion programmes have successfully boosted up the usage of our cash dispensing machines inside Circle K and more programmes will be launched, including the offering of cash coupons to sleeping and inactive customers. We also aim to convert non-AEON cardholders to become our members.



*Joint promotion with convenience stores*

## Personal Loan Business – A New Growth Area

On personal loan business, the Company will make use of the merchant network to develop different purpose loan products to satisfy the demand in the market, such as beauty loan, decoration loan, study loan and car loan. With the use of positive credit data, more sizable loans would be granted to quality customers. The sales volume of personal loan is expected to grow by at least 10% in the coming year.



*Purpose loan products*

## Customer Quality – Expect to Improve Further

On the customer quality side, following the launch of positive credit data sharing, the Company is now able to obtain more information on new applicants and as a result the auto-judgement system can be fully utilised, which improves judgement accuracy. With the improvement in economic situation, the quality of existing customer portfolio is expected to improve as well.

## Credit-Related Business – Area to Develop

On the development of credit-related business, in addition to offering insurance products to our cardholders to generate additional revenue, our special accounts control team has started to provide collection services to corporate clients in Hong Kong. We aim to undertake three additional corporate accounts in this year.

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## **China Business – Build up Solid Experience**

We will continue to encourage card usage by our cardholders in the PRC by extending the merchant network and linking up with other ATM network in the Guangdong Province to facilitate cash advance transactions. This not only generates additional revenue but also allows us to understand the spending behaviour of our cardholders in the PRC. Moreover, we will continue to provide hire purchase consultation service to merchants to gather new customer database for future operation.

## **Future**

The solid business model that we have built over these years, the continuous improvement in customer service quality and product development, and the investment that we have made on the infrastructure for future growth and expansion into the PRC market will give us a head start in this competitive operating environment.

## **SYSTEMS DEVELOPMENT**

The Company will continue to enhance its systems to meet customers' needs and expectations and to improve on risk detection and efficiencies within the Company. Moreover, the Company will revamp 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 efficiencies in time of need.

During the year under review, the Company had completed the operating systems for new payment channels through convenience stores and other ATMs as well as the launching of new affinity cards. On the judgement side, modification has been made on the auto-judgement system to cater for the launch of positive credit data sharing. On fraud detection, 'ACE' – the alarm system for credit card fraud effectuation – was implemented in the fourth quarter to effect prompt detection on irregular transactions.

In the coming year, the Company will put efforts to upgrade the functions of its cash dispensing machines, including add-value services. Moreover, the card instalment plan will be launched in the market in the coming year. With the aim to offer convenient services to our customers, our web service will be upgraded and new card services will be launched in the market.

## **HUMAN RESOURCES**

The total number of staff as at 20th February 2004 and 20th February 2003 was 260 and 286 respectively. Employees are remunerated according to the job nature and market trends, with a built-in merit component incorporated in the annual increment to reward and motivate individual performance. Apart from medical insurance and provident fund, discretionary bonuses are awarded to employees based on individual performance and the financial performance of the Company. The Company also provides in-house training programmes and external training sponsorships to strengthen its human resources.

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## CONTRIBUTION TO THE SOCIETY

Over the years, we emphasize on three key words, “peace”, “people” and “community” in our Company’s philosophy. Besides striving hard to provide a reasonable return to our shareholders, the Company also aspires to be a responsible corporate citizen placing special attention on local community and environment needs. During the year, the Company made donations through its charity cards to support vital charity causes in the community and also participated in the activities of environmental conservation, education and cultural exchange through the AEON Fund.



*Green Parent Award Presentation Ceremony*

The AEON Fund continues to promote environmental protection through its newly established Green Horizon website, the organisation of Home Environmental Ambassadors Selection and tailor-made promotion programmes on Environmental Home Exhibition for schools. In addition, the Company also sponsored the Youth Leadership Seminar, the publication of the green magazines, the green study trip to Bangkok, Thailand and Xinjiang, the PRC and the election of the “Most Beautiful River & Stream in Hong Kong”.



*Tsinghua University Scholarship Award Presentation Ceremony*

In the PRC, the AEON Fund has continued its support to the green campus, the scholarship and the research programmes in Tsinghua University, and the tree planting and student exchange in Inner Mongolia.

## ACKNOWLEDGEMENT

I am most grateful to our customers, business partners, and shareholders whose generous support has guided the Company through the adverse operating environment. 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 year. Last but not least, I wish to express my gratitude to the members of the Board for their diligent guidance and support, and to thank the management team and staff for their unstinting efforts and dedication.



**Masanori KOSAKA**  
*Managing Director*

Hong Kong, 14th April 2004