

**MANAGEMENT DISCUSSION & ANALYSIS**



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**Kazumasa ISHII,**  
*Managing Director*

**RESULTS**

AEON Stores (Hong Kong) Co., Limited (the "Company") and its subsidiaries (the "Group" or "AEON Stores") recorded a turnover of HK\$4,609 million for the year ended 29 February 2004, representing a rise of 16% over the previous year's figure of HK\$3,961 million. Profit attributable to shareholders and earnings per share rose 40% to HK\$86 million and 33.02 HK cents (2003: 23.59 HK cents) respectively.

**DIVIDENDS**

The Board of Directors has recommended a final dividend of 13.0 HK cents per share (2003: 9.0 HK cents) to be paid on or before 28 July 2004, subject to shareholders' approval at the forthcoming annual general meeting on 17 June 2004. Together with the interim dividend of 1.0 HK cent per share distributed in December 2003, this represented, a total dividend of 14.0 HK cents (2003: 9.0 HK cents) per share for the fiscal year.

**FINANCIAL REVIEW**

Turnover of the Group increased 16% to HK\$4,609 million mainly attributable to our newly opened stores in the PRC and the increase in sales from our existing stores.

Group's performance improved primarily due to the increase in sales partially offset by the cost of closing down our Tsz Wan Shan Store. The Group successfully reversed the previously declining trend of profit, with our net profit recording a growth of 40% to HK\$86 million.

Gross margin decreased 1.1% to 26.1% compared to the previous year. It was partially due to the effect of the Severe Acute Respiratory Syndrome ("SARS") epidemic and the change in sales mix, which our food sector accounted for 33% of sales compared to 30% in the preceding year.

The staff costs to turnover ratio decreased from 9.6% to 8.9% while rental costs to turnover decreased from 9.2% to 8.0%.

As at year end, the Group maintained a solid financial position with no bank borrowings and cash on hand of over HK\$830 million as compared to HK\$400 million a year ago.

Capital expenditure during the year amounted to HK\$67 million mainly incurred in the opening of the Zhongshan Store in the PRC and the three JUSCO \$10 Plaza in Hong Kong, and partly incurred in the renovation of some of our existing stores.

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The Group will continue to finance its capital expenditure by internal resources and short-term bank borrowings.

Exchange rate fluctuations had no material impact on the Group as less than 5% of the total purchases are settled in foreign currencies.

### BUSINESS REVIEW

During the year under review, the global consumer market in the first half of the year was hard hit by the war in Iraq and the outbreak of the SARS epidemic, suppressing general consumer sentiment. These unfortunate events created a challenging business environment and the retail industry was the first to suffer.

#### *Hong Kong Operations*

Sales in Hong Kong recorded a growth of 8% to HK\$3,493 million, and profit from operations grew 26% to HK\$100 million. Although the business environment was especially challenging during the SARS period, yet by providing high level of hygiene in our stores, we gained the confidence of customers in the safety of the shopping environment. To our customers, our General Merchandise Stores ("GMS") are perceived as clean and hygienic, providing daily necessities at reasonable prices. Our outlets had become one of our customers' very few acceptable shopping areas during the critical SARS period. Our commitment to providing customers with merchandise and a shopping environment that guaranteed "safety", "confidence" and "trust" became our advantage during this difficult period.

After repeated and unsuccessful negotiations with the landlord of our Tsz Wan Shan Store and serious consideration, the management decided not to renew the lease upon expiration. The store was closed in January 2004 and recorded HK\$8 million closure costs. We believe the closure will not generate any material impact on our daily operations and our existing GMS in Hong Kong as we can better allocate the resources to other GMS.

As for our product branding, JUSCO's merchandise has long been recognised as "value-for-money" and our dedication to providing customers with a rich merchandise mix at reasonable prices remain unchanged. TOPVALU has been our competitive tool of differentiation from our competitors. The brand provides a full range of daily needs with over 600 food, clothing and household products in Hong Kong. This brand has developed a reputation for stringent product selection, safety, environmental friendliness and product development guided by the views of customers.

In the past two years, we have successfully developed our JUSCO \$10 Plaza as our new line of business. The potential of this niche market has led us to open three additional JUSCO \$10 Plaza during the year, strategically located in Kowloon City, Yuen Long and Sheung Wan. All these shops are located outside our GMS in high-density residential and commercial areas, providing quality goods at bargain prices.

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In conjunction with our 16th Anniversary, we have launched a series of promotional campaigns either on our own, or jointly with other companies. These campaigns contributed successfully to higher customer flows and business activities. Leveraging our established relationships with agricultural bureaux of numerous countries, our food fairs remain one of our major promotional activities. On the other hand, J Card continued to act as a reliable communication channel for our customers. Private sales and promotional benefits are granted to our members, maintaining our loyal customer base and encouraging frequent shopping in our stores. The number of members significantly increased approximately 42% to 227,000 during the year, demonstrating good reception to our promotion efforts.

Building on our "customer first" philosophy, we consistently provide quality services and merchandise to our customers. Our well-recognised commitment was key to our consecutive winning of "The 14th Top Service Award" organised by Next Magazine in June 2003. We were elected as the best service provider in the "Department Store Category".

We also received "The First Hong Kong Merchants of Integrity Award (2003-2004)" from Guangzhou Daily and further testifying to our brand recognition by South China customers.

#### *PRC Operations*

The PRC remains our priority during the year. Despite the keen competition in the country, our sales reached HK\$1,115 million with a 51% growth, while profit from operations increased 208% to HK\$11 million. The full year operation of those GMS opened in the last fiscal year together with our new Zhongshan Store opened in July 2003 were mainly attributable to the improvement in sales of the GMS in the PRC, demonstrating the increasing brand recognition of "JUSCO" there. Due to the strategic locations of our GMS, customers had become more familiar with the "JUSCO" brand and perceived that "JUSCO" was the excellent choice in providing daily necessities at reasonable prices. The comfortable shopping environment and diversified quality products make the GMS an ideal place for family shopping, especially during holiday periods. The growing GDP and the general rise in living standards in the PRC were also essential factors that contributed to the satisfactory results during the year.

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To better serve the needs of customers, our marketing team conducts surveys in various localities to gauge the needs of the local customers. The Teem Plaza Store underwent renovation and a part of the store was closed for three months. The supermarket was re-designed for satisfying the local demand. It is understood that the growth of the GMS in the PRC shares the same growth driver as in Hong Kong - the supermarket. Therefore, like in Hong Kong, we strengthened our food sector by providing quality and competitively priced food merchandise. We believe this strategic move will draw our customers to visit other sectors of our GMS, boosting the overall sales of the store.

### *Community Contribution*

To celebrate our 16th Anniversary, the Group launched a one-year "AEON Love and Care Campaign" in October 2003, providing support and promotional opportunities to 60 social services projects through the donation of a certain percentage of our sales and encouraging participation of our customers. This stemmed from our Group's commitment to rewarding our community and fulfilling the obligation of corporate citizenship. Our "Old Book Recycling Campaign", as well as other charitable activities, continued to be held during the year. Recognised as a social caring company, the Group was awarded "Caring Company" by the Hong Kong Council of Social Service for consecutive years, which acknowledged companies with active participation in social services and made great contribution to the Hong Kong community.

### *Human Resources*

As at 29 February 2004, the Group employed about 3,000 full-time and 1,800 part-time staff in Hong Kong and the PRC. The Group remunerates employees based on their performance, experience and prevailing practices in the industry.

One of the key factors for our success as a high-quality company is our commitment to staff training. Apart from offering staff benefits such as professional tuition and training subsidies, our JUSCO University, which has been established for many years, was upgraded to South China AEON University. Staff training was extended to cover the whole South China region. The University will further expand the coverage of its courses and provide more training seminars to continuously enhance the knowledge and skills of our staff and equip them to better serve our customers.

## PROSPECTS

### *Hong Kong Operations*

Thanks to the relaxation of the travel restriction to mainland travellers under the Individual Traveller Scheme, the overall economy in the second half of the year saw a rebound. Meanwhile, the announcement of the Closer Economic Partnership



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Arrangement improved the overall market sentiment and the retail industry in Hong Kong was revitalised. We believe the retail market will continue be positive in this fiscal year.

In the coming year, the Group will continue to look for sites for opening new GMS that can serve the communities in high-density residential areas to take full advantage of busy customer traffic. This will be one of our criteria in our expansion strategy.

By the end of May 2004, we will resume full operation of our Tseung Kwan O ("TKO") Store after 3-month renovation, providing a better shopping environment for our customers. TKO is a satellite town with many young families and an abundance of opportunities exist in serving this community. We have expanded and strengthened our TKO supermarket to include a hot and cold delicatessen to cater for the needs of the young working couples with more convenience for home cooking. The supermarket in TKO Store will become the largest one among all of our GMS in Hong Kong. In addition, we intend to provide more modern brands to suit the tastes of younger customers in the TKO service district.

The Group will maintain the momentum of expanding the market share of the JUSCO \$10 Plaza in this niche market. Targeted locations will be highly populated commercial or residential areas along major mass transportation networks.

Our own brand, TOPVALU has long been one of our competitive strengths that distinguishes us from our competitors. We provide more than 600 items in Hong Kong, covering areas of clothing, food and household products, receiving strong support of our customers. This year is the 10th Anniversary of TOPVALU, and a series of campaigns will be implemented to celebrate this event. More distinctive quality items will be introduced to the customers in both Hong Kong and the PRC.

During the year, we rolled out the "AEON Code of Conduct". All our staff members are committed to providing excellent services and making immediate response to our customers needs. We take pride in our constant ability to deliver services that exceed the expectation of our customers. However, we are never complacent. Our target is to keep providing the best of our best to our customers, in fulfillment of our motto "Everything we do, we do for our customers".

#### *PRC Operations*

Although competition in the PRC retail sector is expected to remain intense, the management believes there is abundant room for the expansion of the PRC operations.

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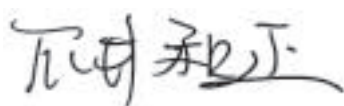
We position ourselves as a unique GMS which is different from that of our established competitors, the department store. AEON Stores is the pioneer of GMS operation in the PRC, providing one-stop shopping convenience for customers. We will continue to promote the concept of GMS and expand our operation in the China market.

To differentiate our products from our competitors, our sourcing team is dedicated to developing our quality private brands in different categories of products. Besides, we will also improve the layout of stores and enhance display methods to attract more customers. We will also provide diversified product categories and a comfortable shopping environment that guarantee "safety", "confidence" and "trust" for our customers.

Two GMS, in Foshan and Shenzhen, are to be opened in 2004, aiming to bring one-stop shopping convenience to customers in the regions. In the long run, we aim at establishing our "JUSCO" brand name in the PRC through developing chain-store operation. This will in turn lead to the achievement of economies of scale in logistics and merchandise sourcing. We will continue to conduct market research and maintain regular store monitoring to adapt the store layout, merchandise mix and product display to cater to the needs and demands of local customers, thereby maximising customer satisfaction.

**CONCLUSION**

Last but not least, on behalf of AEON Stores, I would like to express my sincere gratitude for the support of our customers and our shareholders in the past year. I would also like to thank our dedicated staff members who have made a solid and sustained effort to improve the Group's performance, especially in such a challenging year. In the years to come, we will continue to commit ourselves to providing quality service to our valued customers, maximising returns for our shareholders and making contribution to the well-being of the community.



**Kazumasa ISHII**  
*Managing Director*

Hong Kong, 14 May 2004

