

p.6 Management Discussion and Analysis



Kazumasa ISHII
Managing Director

I am pleased to present this annual report of AEON Stores (Hong Kong) Co., Limited (the "Company") and its subsidiaries (the "Group" or "AEON Stores") to our shareholders, which was made up to the end of 2004. As we have changed our financial year end date to 31 December from end of February, this annual report covered only 10 months from 1 March 2004 to 31 December 2004.

RESULTS

For the 10 months period ended 31 December 2004, the Group recorded a turnover of HK\$3,981 million, compared with HK4,609 million for the year ended 29 February 2004. Net profit reached HK\$79 million (year ended 29 February 2004: HK\$86 million) and earnings per share was 30.56 HK cents (year ended 29 February 2004: 33.02 HK cents).

DIVIDENDS

The Board of Directors has recommended a final dividend of 8.5 HK cents per share (year ended 29 February 2004: 13 HK cents). Together with the interim dividend of 4 HK cents (year ended 29 February 2004: 1 HK cent) distributed in November 2004, this represents a total dividend of 12.5 HK cents (year ended 29 February 2004: 14 HK cents) per share for the period.

FINANCIAL REVIEW

As a result of the change of year end date, turnover of the Group decreased 14% to HK\$3,981 million. Yet, with the same 10 months reporting basis, the Group managed to have 8% increase in turnover, thanks to the pleasing sales of existing stores together with the newly opened stores in the PRC.

With the improvement of the operating results of our stores and we could maintain the gross margin at 26.1%, the Group's net profit decreased only 7% to HK\$79 million.

The staff costs to turnover ratio dropped 0.1% to 8.8% while rental costs to turnover ratio also dropped 0.1% to 7.9%.

At end of December 2004, the Group maintained a solid financial position with no bank borrowings, and cash on hand was over HK\$776 million as compared with HK\$832 million as at 29 February 2004.

Capital expenditure during the period amounted to HK\$82 million. It mainly incurred for the renovation of existing stores, opening of the Foshan Store and Shenzhen East Lake Store in the PRC and 3 independent JUSCO \$10 Plaza in Hong Kong.

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

Retail market witnessed positive market sentiment in both Hong Kong and the PRC during 2004. Riding on the waves of optimism toward the future and enthusiasm in spending, the global economy has been recovering, with previous uncertainties giving way to significant improvement in economic conditions. Furthermore, the booming property market and the relaxation of the PRC travellers had also enhanced the economy, resulting in a good market sentiment in Hong Kong throughout the period. Meanwhile, the retail market in the PRC remains strong, with the continuous rise in living standard and the PRC customers pursuing reputable brands with quality merchandise.

Hong Kong Operations

Driven by the continued positive market sentiment and shopping-spree atmosphere around the city, together with the increasing tourist volume - particularly travellers from the PRC since 2004, Hong Kong people seemed to be fast catching up with the spending desires. Our sales in Hong Kong recorded HK\$2,878 million for the 10 months ended 31 December 2004, decreased 18% as compared with last year. When compared under the same period basis, turnover in 2004 has a positive growth of 2%. The slight sales increment was due to the closure of the Tsz Wan Shan Store in January 2004. Given a sound performance during the period, profit from operations decreased only 7% to HK\$93 million.

The satisfactory results were attributed partly to our successful introduction of a "new concept" JUSCO in Tseung Kwan O. During the period, we closed our Tseung Kwan O Store partially from March to May 2004 for renovation. The supermarket has been expanded into the largest of all JUSCO stores in Hong Kong providing different kinds of hot and cold food items, as well as ready-to-eat delicatessen to meet the needs of young working couples and nucleus families nearby. Meanwhile, other General Merchandise Store ("GMS") also continued to perform well by committing to provide customers with merchandise and a shopping environment that guaranteed "safety", "confidence" and "trust", which became our edge in the competitive retail industry in Hong Kong.

Moreover, our dedication to providing customers with a rich product-mix at reasonable prices has also been one of the attributable factors to the satisfactory results. Our product branding, TOPVALU, has long been recognised as "value-for-money" and our competitive tool of differentiation from our competitors. The brand caters to a full range of daily necessities established a brand reputation for stringent selection, safety, environmental friendliness and customer-guided product development.

In 2004, we further expanded our JUSCO \$10 Plaza network, with new locations at Tseung Kwan O, North Point and Jordan. We have now established a total of 7 JUSCO \$10 Plaza strategically located around Hong Kong. With quality source of supply, unit price and prime locations, our stores were well received by customers.



PRC Operations

The PRC business remained strong and has been our driving force during the period. Sales reached HK\$1,103 million, decreased 1% compared with last year, but if with the same period basis reflected a surge of 27% in sales. Profit from operations significantly increased 23% to HK\$13 million for the 10 months period ended 31 December 2004. The full-period operation of the Zhongshan Store, together with the newly opened Foshan Store and Shenzhen East Lake Store attributed to the sales improvement of the GMS operation in the PRC. Despite the keen competition, leveraging its highly recognised "JUSCO" brand, AEON Stores has further established a concrete footprint in the PRC. The prime locations, together with an excellent selection of daily necessities at reasonable prices, attract customers to shop frequently. 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 period.

During the period, the Group established a wholly owned subsidiary, AEON (China) Co., Limited ("AEON China"). AEON China was granted a license to open new GMS in the PRC. The new company, which focuses on merchandise sourcing and providing logistics support for the Group and store development in the Pearl River Delta region, will significantly boost the Group's operational efficiency. The Group believes that the new move will also enable it to further explore the tremendous business opportunities in the PRC. In order to serve as a procurement centre for AEON Stores, AEON China is working with the Group's sister company AIC Inc. and its subsidiaries. We believe that this business move will optimise resources allocation for the Group and create synergies among our members.



Achievements

Building on our motto “Everything we do, we do for our customers”, we consistently provide services and merchandises of high quality to our customers. Our well recognised commitment was key to our consecutive winning of “The Top Service Award” organised by Next Magazine for the third consecutive years. Determined by readers’ votes and adjudication of a panel of judges from different industries, the award was presented to AEON Stores for its outstanding service to customers in retail industry.

During the period, we were also recognised as the “Caring Company 2004/05” by the Hong Kong Council of Social Service. This is the third consecutive years for us to be awarded the Logo, which entitled us as “Caring Company 2002-05”. In addition, our JUSCO stores and JUSCO \$10 Plaza are approved by Hong Kong Tourism Board as “Merchant of Quality Tourism Services”.

The most outstanding achievement during the period of the Group was it being named one of the “Regional Best-Managed Company” (small-cap) in Asiamoney’s 13th Annual Best-Managed Companies Poll. The polls are recognised as the most prestigious and accurate measure of excellence for companies in the Asia-Pacific region (including Australia and Japan). The Group received high praise for its corporate strategy, financial management, operational efficiency, investor relations, focus on shareholder value, annual reports and web sites.

Human Resources

As at 31 December 2004, the Group employed about 3,300 full-time and 3,400 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. Adhering to this commitment, the Group will continue to invest resources into staff training to boost service quality and staff knowledge. By empowering our staff through constantly providing them with a series of training seminars, we hope to continuously enhance their knowledge and skills in better serving our customers. This will in turn further enhance the overall operation of the Group.

During the period, all our staff members are committed to providing excellent services and making immediate response to our customers needs through strictly carrying out the “AEON Code of Conduct”. 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.

PROSPECTS

Hong Kong Operations

We remain optimistic about Hong Kong’s retail market in view of the benefits brought by relaxation of travel restrictions for mainland travellers under the Individual Traveller Scheme. Meanwhile, with the overall market sentiment being improved by the booming property market and the revitalisation of Hong Kong’s retail industry, we believe the retail market will continue to be positive in the coming year.

In the coming year, the Group will continue to look for appropriate sites for opening new GMS and JUSCO \$10 Plaza that can serve the communities in high-density residential areas along major mass transportation networks by taking full advantage of busy customer traffic. In the meantime, the Tai Po Store will have renovation in mid 2005. We aim at providing a store that fits the customer needs of the district. Partial section will be closed and the renovation is expected to be completed in July this year.



In January 2005, the Group has announced the opening of an independent Supermarket at apm, the retail flagship mall of Sun Hung Kai Properties, in Kwun Tong. The investment is approximately HK\$20 million which is financed by internal resources. This new store will open in May 2005, covering a total floor area of about 33,000 square feet. JUSCO Supermarket will carry cutting-edge products. Adopting the operative model used in Japan, our new store will be the first supermarket detached from GMS of AEON Stores in Hong Kong. Building on the solid foundation of GMS, the Group will venture into supermarkets tailored for customers looking for modern life style. JUSCO Supermarket will be operated with a unique approach entailing the offering of a great variety of merchandises, especially on our private brand "TOPVALU". Building on our expertise in operating supermarket and in sourcing a wide range of quality merchandise, the Group is confident in adopting this new business mode and views it as an important part of our diversifying source of revenue. The Group is now looking into other possible locations to open more independent supermarkets, aiming to serve the districts that our GMS do not reach.

PRC Operations

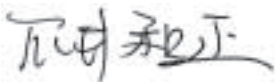
The South China Region's retail market is expected to remain strong growth. Yet the Group provides diversified product categories and a shopping environment that guarantees "safety" (安全), "confidence" (安心) and "trust" (信賴) for the customers, as proven by the frequent shopping habits of the communities nearby.

Understanding that there are still rooms for expanding our market share in the Shenzhen Special Economic Zone, we are set to open our third GMS in Shenzhen in early July. In addition, a new store at Shunde will also open by the end of 2006.

JUSCO's brand name will be further promoted in the PRC through development in chain store operation. Apart from that, the Group is now considering the establishment of other business modes to further enhance our reputation and market share in the PRC. Thorough market research and survey will be conducted in order to provide the best services and address the needs 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 to our customers and shareholders for their support in the past period. I would also like to thank our dedicated staff members who have devoted solid and sustained effort to improve the Group's performance. 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 contributing to the well-being of the community.



Kazumasa ISHII

Managing Director

Hong Kong, 24 March 2005