

Management Discussion and Analysis

The economy of Hong Kong grew relatively stronger in the past one year. With the improvement in unemployment rate, coupled with the low interest rate environment and pick up in the investment sector, there is an increase in card spending and a stronger demand for consumer loans. In view of this improved economic situation, the Company launched several different affinity cards and loan products to meet the needs of customers of different age groups. As a result, the Company recorded an increase in the overall sales volume by 18.0% when compared with last year. With the drop in the unemployment rate, the charge-off rate also reduced. Although the Company had to spend more on advertising and promoters to expand its customer base, the Company continued to exercise tight control on the operating expenses and managed to maintain the cost-to-income ratio at 34.7%.

KEY FINANCIAL HIGHLIGHTS

The Company achieved a profit growth of 22.6%, with net profit increased from HK\$119.4 million in the previous year to HK\$146.3 million. Earnings per share increased by 22.6% from 28.50 HK cents to 34.95 HK cents in 2004/05.

Operating income was HK\$755.0 million, an increase of HK\$31.6 million when compared with HK\$723.4 million in 2003/04. Operating expenses increased by 12.2% from HK\$233.8 million to HK\$262.3 million, with cost-to-income ratio increased to 34.7% from 32.3% in the previous year.

The Company's charge for bad and doubtful debts decreased by 8.4% or HK\$29.0 million to HK\$314.9 million from HK\$343.9 million in the previous year.

With the higher volume of consumer loan transactions during the year, total debtor balance recorded an increase of 17.6% or HK\$341.6 million, from HK\$1,935.5 million as at 20th February 2004 to HK\$2,277.1 million as at 20th February 2005.

Net asset value per share as at 20th February 2005 was HK\$3.0, as compared to HK\$2.8 as at 20th February 2004.

The Board recommended the payment of a final dividend of 10.5 HK cents per share. Together with the interim dividend of 5.5 HK cents per share already paid, the total dividend for the year increased to 16.0 HK cents per share from 14.0 HK cents per share in 2003/04, with the dividend payout ratio being 45.8%.

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INCOME STATEMENT ANALYSIS

Operating Income

The Company's net interest income recorded an increase of 27.9% from HK\$362.9 million in 2003/04 to HK\$464.2 million in 2004/05. With the growth in interest earning assets, interest income increased by 14.6% from HK\$479.8 million in 2003/04 to HK\$549.7 million in 2004/05.

With HIBOR continued to remain at a low level and with the renewal of long-term borrowings at lower interest rates, the average funding cost moved down from an average of 4.8% in 2003/04 to 3.7% in 2004/05. Average funding cost was 3.8% in the first half and 3.5% in the second half of the year. Interest expense amounted to HK\$85.4 million, representing a decrease of 27.0% when compared with HK\$116.9 million in the previous year.

The record of gains on sales of credit card receivables in the previous year and the revaluation loss on the interest-only strips had resulted in the drop of credit card securitisation income by 26.1% to HK\$186.5 million. The lower volume of cash advance transactions, coupled with the extension of convenient payment network and recovery in economic situation had resulted in the drop in handling, late and storage charges. Although there was an increase in fees and commissions, other operating income decreased by 3.1% from HK\$108.9 million in 2003/04 to HK\$105.6 million in 2004/05.

Other loss of HK\$1.3 million was mainly resulted from the loss on disposal of computer equipment and leasehold improvements, and the impairment loss recognised on investment securities.

Operating Expenses

In view of a stronger demand for consumer finance, the Company spent more on advertising and hired additional part-time staff to recruit new members within the merchant network, with advertising expenses and staff costs increased by 32.5% from HK\$71.7 million in 2003/04 to HK\$95.0 million in 2004/05. At the same time, the Company exercised tight control on other operating expenses. Total operating expenses increased by 12.2% from HK\$233.8 million in 2003/04 to HK\$262.3 million in 2004/05. Consequently, the Company's cost to income ratio increased to 34.7% in 2004/05 from 32.3% in 2003/04.

Charge for Bad and Doubtful Debts

For the year ended 20th February 2005, the Company's specific allowances made decreased by 10.4% or HK\$36.3 million from HK\$348.3 million in 2003/04 to HK\$312.0 million in 2004/05. This was attributed to the tightened credit control, prompt collection efforts and improved credit quality as a result of lower personal bankruptcies. With an increase in general allowances by HK\$3.0 million, the charge for bad and doubtful debts decreased by 8.4% or HK\$29.0 million to HK\$314.9 million from HK\$343.9 million in the previous year.

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BALANCE SHEET ANALYSIS

The Company's shareholders' funds as at 20th February 2005 were HK\$1,269.2 million, representing a growth of 7.2%, or HK\$85.6 million, when compared with the balance as at 20th February 2004.

Debtor Balance

With the transfer of additional credit card receivables to the special purpose entity under the securitisation program, credit card receivables as at 20th February 2005 was HK\$1,039.0 million, as compared to HK\$1,080.3 million as at 20th February 2004. With the launching of new purpose loan products and the increase in customer base, instalment loans receivable reached HK\$1,005.1 million, an increase of 48.7% when compared with HK\$676.1 million as at 20th February 2004. Total debtor balance recorded an increase of 17.6% or HK\$341.6 million, from HK\$1,935.5 million as at 20th February 2004 to HK\$2,277.1 million as at 20th February 2005.

Considering the drop in overdue debtor balance for 3 months or above, the Company reduced the amount of allowance for bad and doubtful debts. Allowance for bad and doubtful debts amounted to HK\$174.1 million as at 20th February 2005, a decrease of HK\$16.2 million when compared with previous year and representing 7.6% of total debtor balance.

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

	20th February 2005		20th February 2004	
	HK\$'000	%*	HK\$'000	%*
Over 1 month but less than 2 months	94,046	4.1	135,315	7.0
Over 2 months but less than 3 months	18,094	0.8	23,609	1.2
Over 3 months	84,570	3.7	95,470	4.9
	<u>196,710</u>	<u>8.6</u>	<u>254,394</u>	<u>13.1</u>

* Percentage of total debtor balance

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Retained Interests in Securitisation Trust

The Company raised a total of HK\$850 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 the securitisation program, the entitlements to interest-only strips and cash reserve account are stated at fair values whereas seller and subordinated interests are stated at their allocated amounts and subject to amortisation. The interest-only strips, which are retained by the Company, represent the present value of expected cash flows generated from the securitised credit card receivables during their estimated lives.

As at 20th February 2005, 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\$937.5 million, as compared with HK\$913.5 million as at 20th February 2004.

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.

As at 20th February 2005, the Company had bank borrowings amounted to HK\$1,875.6 million, with 77.9% being fixed in interest rates. Out of these borrowings, 33.0% will mature within one year, 14.7% between one and two years, 14.7% between two and three years, 22.1% between three and four years and 15.5% over four years. The Company continued to maintain a strong financial position. As at 20th February 2005, total debt-to-equity ratio was 1.63. All the Company's borrowings were denominated in Hong Kong dollars.

The net asset value of the Company as at 20th February 2005 was HK\$1,269.2 million, or HK\$3.0 per share, as compared with HK\$2.8 per share as at 20th February 2004. No assets were pledged as at 20th February 2005.

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\$43.9 million as compared to HK\$15.2 million in the previous year. This was mainly related to the purchase of new ATMs, the purchase of computer equipment upon exercise of purchase option under lease agreement, and the system development on new products. As at 20th February 2005, 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. As the economic situation is expected to continue to recover in the coming year, demand for consumer loans will increase. Moreover, shareholders generally expect a reasonable return on their investments and would expect a higher dividend amount when the share price goes up. In order to meet shareholders' expectation, the Board decided to increase the absolute dividend amount by 2.0 HK cents. For the year ended 20th February 2005, the Board recommended the payment of a final dividend of 10.5 HK cents per share, which together with an interim dividend of 5.5 HK cents per share, making a total dividend of 16.0 HK cents per share and a payout ratio of 45.8%.

SEGMENT INFORMATION

The Company's business comprised mainly three operating divisions, namely credit card, hire purchase and instalment loan. In 2004/05, credit card operation accounted for 70.8% of the Company's turnover, as compared to 79.5% in 2003/04. For operating income after deducting charge for bad and doubtful debts, credit card operation accounted for 64.7% in 2004/05, as compared to 85.8% in 2003/04.

With the change in borrowing behaviour from cash advance to personal loans, net interest income from credit card operation recorded a drop of HK\$4.3 million, from HK\$270.7 million in 2003/04 to HK\$266.4 million in 2004/05. The record of gains on sales of credit card receivables in the previous year and the revaluation loss on the interest-only strips had resulted in the drop of credit card securitisation income from HK\$252.2 million in 2003/04 to HK\$186.5 million in 2004/05. The lower volume of cash advance transactions and recovery in economic situation had resulted in the drop in other operating income from credit card operation by 7.2% to HK\$81.4 million. Operating profit before charge for bad and doubtful debts decreased by HK\$76.4 million to HK\$534.3 million in 2004/05. Although there was a drop in charge for bad and doubtful debts by 12.5% from HK\$285.1 million in 2003/04 to HK\$249.6 million in 2004/05, operating income after deducting charge for bad and doubtful debts from credit card operation still recorded a drop of 12.5% from HK\$325.6 million in 2003/04 to HK\$284.8 million in 2004/05.

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With the drop in funding cost, there was an increase in net interest income and other operating income by HK\$1.2 million from hire purchase operation. With an increase in charge for bad and doubtful debts by HK\$2.4 million, operating income after deducting charge for bad and doubtful debts from hire purchase operation decreased from HK\$4.0 million in 2003/04 to HK\$2.8 million in 2004/05.

In view of the strong demand for consumer loans, the Company launched new loan programs. Together with the use of call centers and branches to cross-sell different loan products, the Company had successfully boosted up the instalment loan business, with net interest income recorded an increase of 91.2% from HK\$109.0 million in 2003/04 to HK\$208.4 million in 2004/05. Other operating income also recorded an increase of 47.3% to HK\$9.1 million. With a slight increase in charge for bad and doubtful debts by 7.6% from HK\$56.7 million in 2003/04 to HK\$61.0 million in 2004/05, operating income after deducting charge for bad and doubtful debts from instalment loan operation was increased by HK\$98.1 million from HK\$58.5 million in 2003/04 to HK\$156.6 million in 2004/05.

COMPETITIVE ADVANTAGES

Synergy

The Company continued to benefit from the launching of new card and loan products in the market resulting in the continuous growth in the number of cardholders and personal loan customers.

Know-how and Expertise

AEON Credit Service Co., Ltd. has extensive know-how and expertise in the consumer finance industry and has assisted the Company in tackling the changing market environment and in bringing in innovative ideas on the marketing and recruitment programs.

Customer Base

The customer base of the Company is widely diversified. Using merchant network as the recruitment base, the Company had launched several new affinity cards to capture new customer sectors. The new cardholders recruited in this financial year were mainly through the affinity cards related to retail and catering sectors. Around 70% of the customers is in the age range of 26 to 45, out of which 40% is young generation. With the launch of more affinity cards, the percentage of female cardholders has reached 67%.

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Convenient Service

In providing consumer credit services to customers, the Company emphasises on convenience. On payment, customers can settle their payments through branch counters, convenience store payment network, phone banking, internet banking and ATM network. With the extensive ATM network in Hong Kong and the Guangdong Province in China, coupled with the Company's branch network and the call centers 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 extensive discount merchant network continues to provide convenience and wide-ranging choices to 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 companies. Consumers in Hong Kong have widely accepted and appreciated the innovative consumer credit finance services provided at low costs by the Company.