Management Discussion and Analysis

The private consumption in Hong Kong was on a steady upward trend throughout the year, on the back of improving employment incomes, along with a buoyant stock market and a stable property market. Consumer sentiment remained optimistic, especially with the pause in interest rate hikes. During the year under review, the Group continued to record a growth in credit card and personal loan business, despite market players moved aggressively into these sectors, resulting in an increase in the overall sales volume by 16.0% when compared with last year.

CONSOLIDATED FINANCIAL STATEMENTS

As a consequence of the Companies (Amendment) Ordinance 2005 which amended the statutory definition of a "subsidiary" to make it more closely aligned with HKAS 27 (Revised), the Company is required to consolidate the special purpose entities under asset backed financing transactions and prepare consolidated financial statements for the current year. Comparative figures have been restated to conform to current year's presentation.

KEY FINANCIAL HIGHLIGHTS

For the financial year ended 20th February 2007, on an audited basis, profit before taxation was HK$319.8 million, an increase of 4.5% when compared with last year. After deducting income tax expense of HK$53.1 million, the Group achieved a profit growth of 5.8%, with net profit increased from HK$252.0 million in the previous year to HK$266.7 million. Earnings per share increased by 5.8% from 60.17 HK cents to 63.69 HK cents in 2006/07.

Operating revenue before interest expense for the year was HK$1,122.1 million, as compared with HK$1,047.2 million in 2005/06.

Operating income was HK$977.3 million, an increase of HK$61.1 million when compared with HK$916.2 million in 2005/06. Operating expenses increased by 20.0% from HK$294.7 million to HK$353.7 million, with cost-to-income ratio increased to 36.2% from 32.2% in the previous year.

The Group's impairment losses and impairment allowances decreased by 4.1% or HK$12.9 million to HK$303.1 million from HK$316.0 million in the previous year.

With the higher volume of consumer loan transactions, total debtor balance increased by 14.5% or HK$552.0 million, from HK$3,803.1 million at 20th February 2006 to HK$4,355.1 million at 20th February 2007.

Net asset value per share (after final dividend) at 20th February 2007 was HK$3.4, as compared to HK$3.0 at 20th February 2006.

The Board proposed the payment of a final dividend of 17.5 HK cents per share, out of which 5.0 HK cents per share is a special dividend to mark the Company's 20th anniversary. Together with the interim dividend of 8.5 HK cents per share already paid, the total dividend for the year increased to 26.0 HK cents per share from 18.0 HK cents per share in 2005/06, representing a dividend payout ratio of 40.8%.

CONSOLIDATED INCOME STATEMENT ANALYSIS

Operating Income

With the pick up in sales transactions, interest income increased by 6.1% from HK$930.3 million in 2005/06 to HK$987.4 million in 2006/07. With a slight drop in long term interest rate in the second half, the average funding cost moved down from 4.9% in the first half to 4.7% in the second half. The full year average funding cost was 4.8%, as compared to 4.7% in the previous year. With increase in funding requirement, interest expense was HK$144.7 million, an increase of 10.5% or HK$13.7 million, when compared with last year. The Group's net interest income increased by 5.4% from HK$799.3 million in 2005/06 to HK$842.6 million in 2006/07.

Although there was a drop in handling and late charges, the increase in commission income had resulted in the increase in other operating income by 3.3% from HK$112.2 million in 2005/06 to HK$115.9 million for the year.

Other income of HK$18.8 million mainly represents net gain on disposal of investments. During the year, the Group disposed of its investments in shares listed overseas, resulting in a gain of HK$19.2 million for available-for-sale investments and loss of HK$0.3 million for investments held for trading. The proceeds are for general working capital requirements.

Operating Expenses

The Group incurred more on advertising expenses to capture the growth of demand in consumer finance market. In addition, following the recruitment of more members and the launch of new promotion programs, the Group had spent more on card and loan processing expenses. Together with the employment of more staff and entering into new leases as a result of the expansion of branch network, operating expenses increased by 20.0% to HK$353.7 million.

Impairment Losses and Impairment Allowances

The Group lent conservatively and strived to continually improve its asset quality. Even though there was an increase in the sales transactions and debtor balance, charge to the consolidated income statement maintained at around HK$334.0 million in both years. With the great effort contributed by the Group's recovery team, recoveries from bad debts increased by 72.8% from HK$17.9 million in 2005/06 to HK$30.9 million in 2006/07. Total impairment losses and impairment allowances reduced by 4.1% from HK$316.0 million in 2005/06 to HK$303.1 million in 2006/07.

CONSOLIDATED BALANCE SHEET ANALYSIS

The Group's shareholders' equity at 20th February 2007 were HK$1,477.0 million, representing a growth of 11.9%, or HK$156.5 million, when compared with the balance at 20th February 2006.

Debtor Balance

With the issue of more cards and launch of new marketing programs, credit card receivables increased by HK$318.7 million from HK$2,553.6 million at 20th February 2006 to HK$2,872.3 million at 20th February 2007. The opening of new branches had expanded the Group's distribution network to cross-sell loan products. Together with the introduction of new purpose loan products, instalment loans receivable reached HK$1,357.9 million, an increase of HK$247.2 million when compared with last year. Although there was a slight drop in hire purchase debtors to HK$124.9 million, total debtor balance increased by 14.5% or HK$552.0 million, from HK$3,803.1 million at 20th February 2006 to HK$4,355.1 million at 20th February 2007.

Considering the drop in overdue debtor balance for 3 months or above, the Group reduced the amount of impairment allowances. Impairment allowances amounted to HK$134.2 million at 20th February 2007, a decrease of HK$24.5 million when compared with previous year and representing 3.1% of total debtor balance.

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

	20th February 2007		20th February 2006	
	HK$'000	**%***	HK$'000	%*
Overdue 1 month but less than 2 months	**96,448**	**2.2**	86,871	2.3
Overdue 2 months but less than 3 months	**27,859**	**0.6**	34,468	0.9
Overdue 3 months or above	**57,051**	**1.3**	81,902	2.1
	181,358	**4.1**	203,241	5.3

* *Percentage of total debtor balance*

Investments in Associates and Available-for-Sale Investments

During the year, the Group injected HK$38,946,000 into AEON Credit Guarantee (China) Co., Ltd. ("ACG China"), a guarantee company set up in Beijing mainly engaged in the provision of credit guarantee services. ACG China is owned as to 50% by the Group and is accounted for as an associate of the Group using equity method. This investment will facilitate the Group's plan to launch hire purchase service in major cities in China. With an emergence of the middle class in major cities in China who endeavour to improve their living quality and with increasing consumption power, this investment is expected to bring good returns to the Group in the long run.

The Group also increased its investment in AEON Credit Card (Taiwan) Co., Ltd. ("ACC Taiwan") by subscribing 4.2 million new shares at HK$10,120,000. ACC Taiwan is owned as to 12.2% by the Group and is accounted for as available-for-sale investments measured at fair value at each balance sheet date subsequent to initial recognition. With the anticipated recovery in the economy in Taiwan in the near future, ACC Taiwan will grow faster in the coming years and the investment is expected to bring good returns to the Group in the long run.

Collateralised Debt Obligation

During the year under review, the Company entered into a HK$850,000,000 collateralised debt obligation transaction (the "Transaction") to refinance the securitisation programme which had been fully paid off in October 2006. Pursuant to this Transaction, the Company transferred credit card receivables to a trust established solely for this financing purpose. The Company is the sole beneficiary of the trust and holds the entire undivided interest in the credit card receivables transferred to the trust. The Transaction is for a period of five years and will commence amortisation in 2012. According to HKAS 39, both assets transferred and debt issued under this Transaction have not been derecognised and remained in the Group's consolidated financial statements.

The collateralised debt obligation amounted to HK$846.8 million at 20th February 2007 and carried a fixed interest coupon. This was secured by credit card receivables of HK$1,284.8 million and restricted cash of HK$120.0 million.

Bank Borrowings and Capital Financing

The Group relied principally on its internally generated capital, bank borrowings and structured finance to fund its business. At 20th February 2007, 31.1% of its funding is derived from shareholders' equity, 17.9% from structured finance and 51.0% from direct borrowings with financial institutions.

The principal source of internally generated capital is from accumulated profits. Besides the collateralised debt obligation transaction mentioned above, at 20th February 2007, the Group had bank borrowings, bank overdrafts and cross-currency syndicated term loan amounted to HK$2,421.9 million, with 86.7% being fixed in interest rates.

Including the collateralised debt obligation, 21.6% of those indebtedness will mature within one year, 12.7% between one and two years, 11.0% between two and three years, 11.2% between three and four years, 16.6% between four and five years and 26.9% over five years. The average duration of indebtedness is around three years. The Group's bank borrowings were denominated in Hong Kong dollars, except for a syndicated term loan of Yen 7.5 billion which was hedged by a cross-currency interest rate swap.

The Group continued to maintain a strong financial position. At 20th February 2007, total debt-to-equity ratio was 2.35. The net asset value of the Group at 20th February 2007 was HK$1,477.0 million, as compared with HK$1,320.5 million at 20th February 2006.

The Group'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 Group engaged in derivative financial instruments mainly to hedge its exposure on interest rate and exchange rate fluctuations.

Capital expenditure for the year amounted to HK$44.1 million as compared to HK$54.1 million in the previous year. This was mainly related to the software development on the enhancement of the operating and security systems. At 20th February 2007, capital commitments entered were related to the purchase of property, plant and equipment and the purchase of available-for-sale investments.

Taking into account the financial resources available to the Group, including internally generated funds and available banking facilities, the Group 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 current growing economic situation is expected to continue in the coming year, demand for consumer finance will increase. On the other hand, under the present surging stock market, shareholders generally expect a reasonable return on their investments and a higher dividend amount when the share price goes up. In order to meet shareholders' expectation and to mark the Company's 20th anniversary, the Board decided to increase the dividend amount by 8.0 HK cents, out of which 5.0 HK cents represents a special dividend. For the year ended 20th February 2007, the Board recommended the payment of a final dividend of 17.5 HK cents per share, which together with the interim dividend of 8.5 HK cents per share, making a total dividend of 26.0 HK cents per share and a payout ratio of 40.8%.

SEGMENT INFORMATION

The Group's business comprised mainly three operating divisions, namely credit card, instalment loans and hire purchase. In 2006/07, credit card operation accounted for 64.5% of the Group's turnover, as compared to 68.1% in 2005/06. For operating income after deducting impairment losses and impairment allowances, credit card operation accounted for 68.6% in 2006/07, as compared to 63.5% in 2005/06.

Notwithstanding a reduction in cash advance interest rate during the year, net interest income from credit card operation increased by HK$3.9 million, from HK$534.8 million in 2005/06 to HK$538.7 million in 2006/07. Although there was a drop in handling and late charges, the increase in commission income had resulted in the increase in other operating income from credit card operation by HK$4.2 million from HK$93.5 million in 2005/06 to HK$97.7 million. With a drop in the impairment losses and impairment allowances by HK$73.1 million from HK$246.9 million in 2005/06 to HK$173.8 million in 2006/07, operating results from credit card operation recorded an increase of 21.3% or HK$81.2 million from HK$381.4 million in 2005/06 to HK$462.6 million in 2006/07.

With the gradual recovery of the economic situation and the availability of positive data from credit bureau, the Group is active in exploring new instalment loan products and widening its distribution channels for personal loan business. Instalment loan sales continued to record a stable growth in the reporting year. Net interest income from instalment loans operation recorded an increase of HK$39.6 million, from HK$260.1 million in 2005/06 to HK$299.7 million in 2006/07. However, with the waiver of certain related charges to maintain competitiveness in the market, other operating income dropped by HK$1.3 million from HK$18.2 million in 2005/06 to HK$16.9 million in 2006/07. There was an increase in impairment losses and impairment allowances by HK$55.6 million from HK$70.5 million in 2005/06 to HK$126.1 million in 2006/07. As a result, the operating results from instalment loans operation decreased by 8.3% or HK$17.2 million from HK$207.8 million in 2005/06 to HK$190.6 million in 2006/07.

With the higher usage of card instalment plan, there was a continuous decrease in hire purchase sales, resulting in the drop in interest income and other operating income from hire purchase transactions by HK$0.2 million from HK$4.7 million in 2005/06 to HK$4.5 million in 2006/07. Impairment losses and impairment allowances amounted to HK$3.2 million in 2006/07 as compared with a release of impairment allowances of HK$1.4 million in 2005/06. As a result, the operating results from hire purchase operation decreased from HK$6.1 million in 2005/06 to HK$1.2 million in 2006/07.

COMPETITIVE ADVANTAGES

Synergy

The Group continued to benefit from the strong connections with affiliated merchants by launching various co-branded cards and using the merchants' networks as card acquisition base and cross-selling channels, resulting in the continuous growth in the number of cardholders and instalment loan customers.

Know-how and Expertise

ACS Japan has extensive know-how and expertise in the consumer finance industry and brings in innovative ideas on marketing and card acquisition programmes.

Customer Base

The customer base of the Group is widely diversified. Using merchant networks as the card and loan acquisition base, the Group had launched several new co-branded cards and loan products to capture new customer sectors. The new cardholders recruited in this financial year were mainly through the co-branded cards related to merchants in the retail, catering and travel industries. Around 60% of the customers are in the age range of 26 to 45, out of which 40% are young generation. With the launch of more co-branded cards, the percentage of female cardholders has reached 70%.

Convenient Service

In providing consumer credit services to customers, the Group emphasises on convenience. For ease of payment, customers can settle their payments through branch counters, convenience stores networks, phone banking, internet banking and ATM networks. Customers can also have easy access to speedy and convenient cash advance and personal loan services through the extensive ATM networks in Hong Kong and Guangdong Province in China as well as the Group's branch network and call centres in Hong Kong and Shenzhen. For card spending, the extensive discount merchant network continues to provide convenience and wide-ranging choices to cardholders.

GROWTH PHILOSOPHY

The four key elements of the Group'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 Group.