

Hong Kong

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Aeon Credit (Asia)

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Buy

Initiating Coverage

Credit where credit is due

Aeon Credit (Asia) has been all but abandoned by investors due to (justifiable) fears about consumer credit losses in Hong Kong. However, stable margins and scale in a consolidating market make Aeon worth another look.

More losses to come ... Aeon is a pure consumer finance company, and as such, has been hit hard by rising customer delinquencies. Charge-offs have risen from 240bp of average loans two years ago to 351bp in the most recent period, decimating core earnings.

... but momentum will resume. The company has taken steps to improve its business by focusing on affiliate relationships and hire purchase, while formulating an intriguing China strategy that offers upside with very low risk. Core income will recover in FY04–05.

Valuation is attractive. The bad news about Aeon's business is well known, but credit costs are peaking and returns should improve. Aeon's valuation, at 0.9x book value and 5.9x FY04F EPS, is too low given an ROE that consistently beats its cost of capital.

Forecasts and ratings

Yr to Feb	02	03F	04F	05F
Core income (HK\$m)	149.1	117.9	167.7	208.3
Net profit (HK\$m)	211.0	141.8	167.7	208.3
EPS (HK\$)	0.50	0.34	0.40	0.50
EPS growth (%)	0.5	-32.8	18.3	24.2
PER (x)	4.71	7.02	5.93	4.77
Core PER (x)	6.67	8.44	5.93	4.77
P/BV (x)	0.94	0.88	0.81	0.73
DPS (HK\$)	0.13	0.13	0.15	0.19
Yield (%)	5.5	5.5	6.3	7.9

Source: Company data, ING estimates

HK\$2.38

2/10/02

Target price: 12 months

HK\$2.94 (+23.5%)

Financial data

	FY02	FY03F
ROE (%)	21.58	12.54
Core ROE (%)	15.25	10.43
ROA (%)	6.54	4.34
Core ROA (%)	4.62	3.61
BVPS (HK\$)	2.52	2.70
Adj. BVPS (HK\$)	2.52	2.70

Share data

Market cap (US\$m)	127.5
No of shares (m)	418.7
Daily turnover (US\$m)	0.7
Free float (%)	34.8
52-week hi/lo (HK\$)	2.30-3.45

Price performance (%)

	Absolute	Relative to HSI
1m	-7.7	0.6
3m	-22.6	-8.8
12m	-4.0	5.8

Price chart



Source: Bloomberg

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Executive summary

Pure consumer finance player.

Aeon is the #3 card issuer in Hong Kong, behind Standard Chartered and HSBC/Hang Seng. All of the company's other business is consumer-related as well, consisting primarily of hire purchase and instalment lending. Although consumer finance in Hong Kong has been hit hard by economic weakness and changes in the Bankruptcy Act, it is important to bear in mind that the business is sustainable in the long term for players with sufficient scale.

Asset quality is a major risk ...

Charge-offs on credit card portfolios in Hong Kong are at historic levels – at a 13% annualised rate for the industry in 2Q02 – and we expect them to have risen through the third quarter. By comparison, Korean card companies' credit costs are less than half of this level, but already high enough to spook investors. Are we, then, *barking mad* to buy a pure play in this market?

... but one that is fully priced in.

As to madness, clearly, we think not: losses on Aeon's portfolio are being taken on the P&L as incurred, reserves are adequate and increasing, and the portfolio of over-levered borrowers is burning itself out. Meanwhile, a poor market has removed pricing pressure and will force marginal competitors to exit.

Margins are stable.

Interest margins are high and show little sign of deterioration – particularly since most bank competitors are becoming more risk-averse and minimising their exposure to the sector. Falling interest rates (and Aeon's currently excessive funding costs) will cushion the remaining competitive pressure to maintain strong net interest income.

Shift to middle-class lending lowers risk profile.

Aeon's client base is increasingly middle class and acquired through hire purchase accounts or affinity cards. This client base is more price sensitive, but is also considerably more credit-worthy – and thus more profitable overall.

China strategy could be a winner.

The company is following its affiliate Jusco Stores into the mainland market, and will earn fees by handling instalment loan servicing without taking credit risk, pending Aeon's approval for a licence. This is a low-risk entry into a potentially large market.

Valuation is low.

Aeon will more than earn its 12% cost of capital even at the bottom of the credit cycle (and in a poor economy), yet the company trades at less than 1x book value. On PERs of 7x for FY03F and 6x for FY04F, we see substantial upside to our target price of HK\$2.94, which is based on 1.08x book value.

Consumer finance

Aeon’s primary business is consumer finance, which the company offers through three major product groupings: credit cards; hire purchase; and instalment finance.

Credit cards

Aeon punches above its weight in credit cards, coming in behind Hang Seng but ahead of Dah Sing in market share

Aeon is the fourth-largest credit card issuer in Hong Kong (third-largest if HSBC and Hang Seng are combined), with approximately 800,000 cards in issue. Card receivables account for 79% of total loans, although the company has been reducing its emphasis on some types of card extension as a consequence of the parlous credit environment.

Fig 1 Hong Kong credit card market share: 2Q02

Institution	Credit card market share (%)
StanChart	23
HSBC (HongkongBank only)	18
Hang Seng	9
Aeon Credit	8
DSF	7
BEA	6

Source: Reuters, Company data, ING estimates

The company issues cards under three main programmes: house cards; affiliate cards; and charity cards.

- **House cards.** House cards are Aeon’s own branded MasterCard, Visa, and American Express offerings, as well as the more fashion-oriented Batman and Hello Kitty Mastercards. Customers use house cards mainly for cash advance purposes, one reason why Aeon has de-emphasised marketing of these products.
- **Affiliate cards.** Affiliate cards are issued in conjunction with retailers such as Jusco (a corporate cousin of Aeon HK and the source of approximately half of the card portfolio), and offer customers lower interest rates (see Figure 2) and special discounts at the affiliated merchant. Merchants are happy to promote the cards, as their customers can buy more with Aeon’s financing; however, they do not have any direct stake in the card revenues nor do they have any role in credit approval.
- Affiliate card customers have significantly better credit characteristics than house card customers – one reason why this area is Aeon’s main focus.
- **Charity cards.** Charity cards are a special type of affiliate programme under which the designated charity receives 25% of the annual fee (which is, however, four times the rate of Aeon’s house cards) and 0.1% of overall charge volume.

Fig 2 Aeon credit card products

AEON card product	Annual fee (HK\$)	Int rate (%)	Cash adv rate (%)	Special benefits		
AEON International MasterCard AEON Visa		20	24.92	42.62	Spending reward scheme	
AEON American Express		20	24.92	42.62	60-day grace period Travel Assistance and insurance Other AmEx Services	
AEON Privilege MasterCard <i>Targeted at Japanese residents in Hong Kong</i>		250	24.92	26.87	Travel assistance, medical hotline (all Japanese-speaking), plus club membership privileges	
Hello Kitty Card		20	24.92	42.62	5% off Sanrio Merchandise	
Batman MasterCard		20	24.92	42.62	Free credit insurance (unemployment and disability)	
Jusco MasterCard/Visa		20	18.13	42.62	Up to 2% cash back on Jusco purchases 5% discounts at twice-monthly sales. Free delivery 6-/12-/18-month 0% financing on appliances and furniture.	
Jusco American Express		20	18.13	42.62	Same benefits as Jusco MC/Visa, plus all AmEx services.	
AEON HKNeT MasterCard		20	18.13	42.62	Double bonus points for HKNet Internet or IDD service fees paid by card.	
Watami Visa Card		20	18.13	42.62	HK\$200 in coupons for Watami restaurants, plus continuing 5% discount and special offers. 0.25% of all charges donated to the Children's Cancer Fund 1% of pre-tax profits donated to the AEON JUSCO Education and Environment Fund	
AEON Mega Warehouse		20	18.13	42.62	5% discount on appliances or 6-month 0% financing	
BEST DENKI MasterCard		80 (Free first year)	18.13	42.62	3% discount on purchases and repairs at Best Denki outlets. 9-/12-/18-month 0% financing on appliances	
Toys"R"Us MasterCard		20	18.13	42.62	Special monthly 5% discount sales Toys "R" Us rewards points and discounts	
Hon Po MasterCard		20	18.13	42.62	HK\$300 per year in discount coupons for HK\$10,000+ in spending.	
AEON Rainbow Card		20	18.13	42.62	5% discount on Rainbow cosmetics Special offers	
AEON Baleno MasterCard		20	18.13	42.62	10% discount on purchases at Baleno stores. HK\$20 in coupons for every HK\$1,000 spent at Baleno stores.	
Charity Cards						
						
AEON SPCA MasterCard	AEON ECC MasterCard	Spring Blossom Foundation MasterCard	Save the Children MasterCard	Miss Hong Kong MasterCard	HK Federation of Women MasterCard	AEON Yan Chai International MasterCard
Charity-affiliated cards	80	24.92	42.62	25% of annual fees and 0.1% of charge volume donated to respective charities.		

Source: Company data

Card revenue sources

Interest and fees on credit cards account for 84% of Aeon's gross revenues. Revenues from customers are earned through annual card fees (ranging from HK\$20-250) and interest on revolving balances (18.13-42.62% APRs).

In addition, the company receives fees levied on merchants that accept the cards, amounting to approximately 1% of gross charge volume. Although MasterCard, Visa, and American Express all have different posted merchant fee schedules (approximately 2.5% for the interbank associations versus 4% for AmEx), Aeon management reports that discounting and special offers for specific classes of merchants are so common that the company receives approximately the same revenue from each type of card, and so has no incentive to prefer one over the others.

Hire purchase is an increasingly important part of Aeon's plans

Hire purchase

Aeon's hire purchase business is comprised of a legacy auto finance business and a continuing appliance and computer HP effort that is one of the company's main customer acquisition tools.

Fig 3 Hire purchase portfolio breakdown (HK\$m)

	1H03	
	Aug-02	% total
Vehicle HP	55	20.9
Other HP	208	79.1
Total HP lending	263	100.0

Source: Company reports, ING estimates

Vehicles

Exiting auto HP because of high defaults and low growth

Aeon has historically done vehicle financing for purchasers of low-end automobiles such as Daihatsu, but is in the process of exiting this business as charge-offs are expected to move into double-digits in the future from a base level of 4-5% currently. In addition, competition from auto-makers' captive finance arms makes it difficult to move up to higher-value marques in order to keep pace with the growing affluence of Aeon's customers. Auto lending at Aeon has always been for personal use, and is not taxi finance as with JCG Holdings, keeping the average loan size down to HK\$100,000-150,000.

In addition to auto lending, the company has, and will continue to operate, a motorcycle finance business, where the credit costs and competition are both lower.

Fig 4 Hire purchase rates and delinquencies

	Rate (APR) (%)	Who pays?	Charge-offs (%)
Auto finance	24.7-28.1	Customer	10+
Motorcycle finance	24.7-28.1	Customer	4-5
Other HP	15-20	Retailer	<2

Source: Company reports, ING estimates

Appliances

Retailers market Aeon's hire purchase plans to their customers – and pay the interest bill

The majority of Aeon's HP business (and the clear focus area going forward) is appliance financing, which the company does in conjunction with its retail partners. The retailers want the added sales that financing makes possible, but do not want to operate the collection and servicing business – or take on the credit risk; hence, their outsourcing of this to Aeon. From Aeon's perspective, store chain tie-ups are an efficient marketing tool, as the retailer promotes the product.

Aeon's retail partners (including PCCW, Jusco, and Best Denki take loan applications from their customers at the point of purchase. These applications are then faxed to Aeon's service centre, which responds in as little as 30 minutes (while-you-wait service for PCCW computer buyers) or as much as two to three days (for major appliances that require delivery). Credit approval is not yet automated, although this will begin to change over the next year.

After approval is granted, the seller releases the product and typically pays Aeon a capitalised sum representing all interest due under the contract upfront, with an effective interest rate of 15-20%. The purchaser does not explicitly pay interest to Aeon (although, naturally, the retailers' prices are adjusted to take this into account), but only the price of goods in equal instalments.

Any credit losses are Aeon's responsibility; there are no retailer charge-backs. However, the company reports that, due to the short term and zero interest rate of these contracts, charge-offs are below 2% on this portfolio. Additionally, the customer data gleaned from these contracts is fertile ground for cross-selling additional products, and thus bolsters Aeon's database.

We see this portfolio as a key growth area for Aeon, as rising delinquencies should force retailers that have been operating their own instalment finance plans to consider outsourcing.

*Narrowly targeted
lending products let
Aeon pursue market
segmentation*

General instalment lending

In addition to credit cards and hire purchase, Aeon offers a variety of special purpose and general purpose lending plans, typically at quite high rates and with high charge-offs (12% average for personal lending). This strategy of attracting customers with narrowly targeted offers allows Aeon to segment the market effectively. A sampling of plans:

- **Education lending:** The company offers education loans for both local and overseas study on a secondary and university level. These loans range in amount from HK\$5,000 to HK\$100,000, with tenors of up to 36 months and effective interest rates of 12.3% (for short-term overseas study) to 28% (for long-term local study). There are no payment deferrals during the term of study, as with a typical US loan, and this combined with the short repayment period means that they are aimed mainly at parents of students rather than at the students themselves.
- **General instalment and privilege lending:** Aeon lends up to 6x the monthly salary to consumers for general purposes. These loans are mainly for 18 months or less for new customers, but can go up to 24 months for existing customers with good repayment histories. As with JCG, these repeat customers earn lower interest rates.
- **Mortgage lending:** Aeon is not competitive with bank lending in the mortgage arena, with rates of Prime -0.5%, versus as low as Prime -2.6% for banks. Even so, at a 4.7% yield (albeit one with virtually no credit losses given a maximum 70% LTV), this is not an exceedingly attractive product for Aeon given an average 7% cost of funds. Aeon's selling point has been that the company will finance properties of any age, something that banks were once loath to do, but this distinction has been erased as banks have become more desperate for growth.

Corporate strategy

Jusco – The China card

China growth: Yes

China NPLs: No

Aeon's most important relationship is the one it enjoys with its affiliate Jusco Stores (Hong Kong), which is 71.6% owned by Aeon HK's parent company, Aeon Co Ltd. We estimate that this relationship accounts for 43% of Aeon's revenues, split between hire-purchase commissions on Jusco merchandise and the revenues from 400,000 Jusco co-branded credit cards.

Fig 5 Aeon revenues from Jusco-related business (HK\$000)

	Feb-02
Jusco HP commissions paid	20,388
Jusco card revenue*	289,157
Total Jusco revenue	309,545
Annual revenue per store	30,954

* Estimated net interest income and fees on Jusco-branded cards.

Source: Company reports, ING estimates

Jusco currently operates eight warehouse-type stores in Hong Kong, along with four mainland stores: two in Guangzhou, one in Dongguan, and one in Shenzhen. China expansion is clearly a focus for Jusco, which opened two of its four mainland stores in 2002 and plans to add at least six more over the next three years.

Fig 6 Jusco Hong Kong and China stores

Store	Opened	Size (sq ft)
Hong Kong:		
Kornhill	Nov-87	261,000
Tsuen Wan	Apr-91	116,000
Lok Fu	Jun-91	148,000
Tai Po	Oct-95	85,000
Tseung Kwan O	Oct-97	164,000
Tsz Wan Shan	Mar-98	98,000
Whampoa	Nov-98	187,000
Tuen Mun	Dec-98	152,000
China:		
Guangzhou - Teem Plaza	Jun-96	123,000
Guangzhou - China Plaza	Jun-00	156,000
Dongguan	Jun-02	155,000
Shenzhen	Sep-02	214,000

Source: Company reports

Fig 7 Jusco sales by category

	Feb-02 (%)
Fashion	22
Food	28
Household	43
Catering	7

Source: Company reports

Aeon is preparing for the ability to lend directly in China

Currently, Aeon may not handle HP financing for Jusco in China, nor may it issue credit cards to mainland customers. Even users of Aeon's Hong Kong-issued cards may not use them to make purchases at Jusco mainland stores. However, Aeon has come to an agreement with Jusco whereby the finance company will operate a hire purchase arm for Jusco's mainland operations on a fee basis, with Jusco booking the loans and taking all of the credit risk.

Aeon will handle credit approval and servicing – and will thus be able to start building its database of credit behaviour even before launching its own China financing operations. Fees for this service have not yet been set, but Aeon expects to make a profit even without interest income as it has excess capacity and an existing Shenzhen call centre.

Management's intention is to convert this business into a full-fledged financing one as quickly as possible, which will require a hire-purchase licence. We expect that Aeon will receive a licence by the end of 2003 (possibly through a JV with a local bank), which will permit HP in Guangzhou only – additional licences will likely need to be granted on a province-by-province basis. Credit card operations are considerably further off; for this, Aeon would almost definitely require a local partner.

Despite the limited nature of China operations, we see this as a coup for Aeon, in that the company will gain credit and marketing experience with mainland customers without taking any risk, and will be able to expand after licensing via its partner's existing network.

Based on current experience, each new Jusco store could add over HK\$2m in annual HP revenue once Aeon has a licence. The addition of card privileges would indicate a potential revenue stream of HK\$30m annually per store. Due to its contingent nature, this revenue is not included in our current forecasts for Aeon, but represents potential upside.

An outsourcing beneficiary

Consolidation and slowdown make outsourcing more attractive to smaller banks

Aeon has already had discussions with foreign banks in Hong Kong about becoming an outsourcing provider for their credit card back office operations. As the market has become mature in terms of growth, and charge-offs have risen, it is no longer a given that any bank can be profitable in credit cards in Hong Kong, even though the business retains very high gross interest spreads.

We believe that any bank that is not already at 500,000 cards or above (~5% market share), and that can not reach 1m cards within the next three years, will be hard pressed to continue making the IT and marketing investments necessary to compete. Aeon is well positioned to partner with these banks as it is not a competitor in other areas, as HSBC, StanChart, and Dah Sing – the other natural service providers – are for smaller banks.

Bank M&A not on the cards barring regulatory change

Potential M&A

If Aeon were to obtain a banking licence, funding costs could be dramatically lowered due to improved interbank access and deposit-taking capabilities. In addition, the acquisition of a bank with China branches and/or renminbi capabilities would facilitate an early start to the Jusco mainland business.

Although we believe that Aeon's parent would support such a move financially if it were accretive, management has advised us that the HKMA will not countenance such a move as the top tier parent is a non-bank and not a bank. As the HKMA does favour consolidation, and as acquisitions of banks by non-bank financial companies are permitted in many other jurisdictions, we see scope for this issue to be revisited in the future.

History and structure

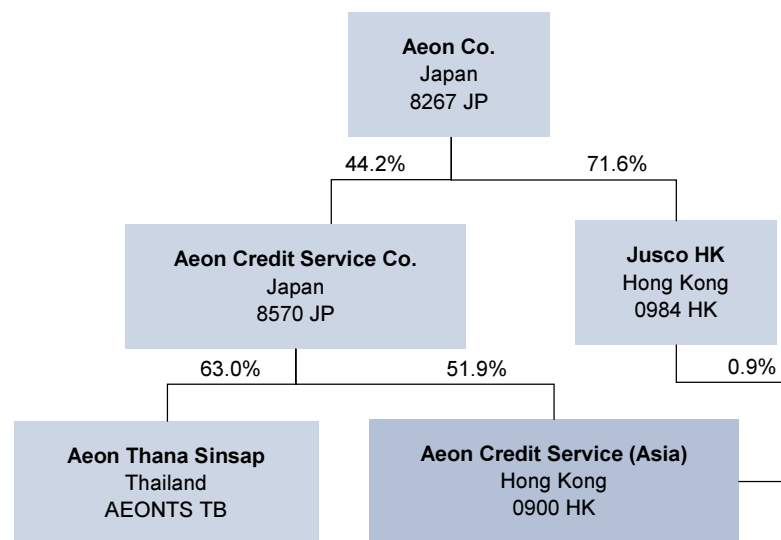
History

Aeon HK (then known as Nihon Credit Service (Asia) Co) was launched in 1988 as a branch of its Japanese parent, providing hire purchase and supporting the operations of Jusco. Aeon added vehicle finance in 1990 and proprietary credit cards in 1993, switching to interbank cards (MasterCard and Visa) a year later. Aeon was listed in Hong Kong in September 1995.

Ownership

Aeon HK is controlled by its top tier parent, Aeon Co, through Aeon Credit Service Co Ltd. Together, Aeon Co and its affiliates own 66.2% of Aeon HK, with the remainder being free float.

Fig 8 Aeon ownership structure



Source: Company reports, ING estimates

Network

Aeon’s network consists of 19 branches, 269 cash dispensing machines, and 14 cash repayment machines. Aeon is also a member of the PLUS and Cirrus networks, which allows its customers to take cash advances at ATMs worldwide.

Branches are located throughout Hong Kong island (5), Kowloon (8), and the New Territories (6), while cash machines are located in Circle K convenience stores (123) and KCRC Railway stations (8).

Rate competition is ebbing as delinquencies rise

Rates and margins

Aeon's is a very high-spread business, as one would expect from a predominantly credit card company. Despite rising competition in the past few years, consumer interest rates have remained high with no significant discounting below the 18% level (18.6% APR), and most issuers at 24% or above. As Aeon's market tends to be at the low- to middle-income bracket, bank competition has not had much of an impact on rates, and JCG Finance is more of a direct competitor for the company.

Fig 9 Aeon lending rates (%)

Product	Rate type	Rate (APR)
Mortgage	Prime -0.5%	4.7
Credit card	Fixed	18.1-42.6
Auto loan	Fixed	24.7-28.1
Cash advance	Fixed	48.4-50.5
Study loan	Fixed	12.3-28.0
Privilege loan	Fixed	12.3-18.4
Member's loan	Fixed	24.7-39.2

Source: Company reports, ING estimates

Aeon's loans are mainly made at rates of 18-43%, encompassing credit card loans, non-card cash advances, and hire purchase. Although the company's funding rate, at 7.07% in the most recent period, is considerably higher than that of a bank, high asset yields mean that Aeon has kept a net interest margin of just over 20%.

Fig 10 Key interest margin components: 1H01-1H03 (%)

	1H01 Aug-00	2H01 Feb-01	1H02 Aug-01	2H02 Feb-02	1H03 Aug-02
Yield on earning assets	25.88	25.91	26.68	26.05	24.87
Cost of interest-bearing liabilities	9.16	8.92	8.28	7.75	7.07
Interest spread	16.72	17.00	18.40	18.29	17.79
Net interest margin	19.58	19.73	21.08	20.63	20.03

Source: Company reports, ING estimates

Fig 11 Key interest margin components: FY00-04F (%)

Yr to Feb	00	01	02	03F	04F
Yield on earning assets	26.00	25.68	26.36	24.87	23.82
Cost of interest-bearing liabilities	8.63	8.98	8.00	6.91	6.22
Interest spread	17.38	16.70	18.35	17.96	17.60
Net interest margin	20.79	19.70	20.94	19.96	19.97

Source: Company reports, ING estimates

A high NIM is critical for a business such as Aeon's, as interest income must be rich enough to sustain the high cost of operating a high-transaction-volume, low-dollar-amount business as well as large credit charge-offs. However, this margin has been falling for the last 18 months as asset yields have come off. We attribute this decline to three factors:

Fig 12 Change in key interest margin components: 1H01-1H03 (bp)

	1H01 Aug-00	2H01 Feb-01	1H02 Aug-01	2H02 Feb-02	1H03 Aug-02
Yield on earning assets	-105	+4	+77	-64	-118
Cost of interest-bearing liabilities	-31	-24	-63	-53	-68
Interest spread	-73	+28	+140	-11	-50
Net interest margin	-181	+15	+135	-45	-60

Source: Company reports, ING estimates

1. **Increased competition from banks.** Banks that disdained the mass consumer market during the period of easy expansion have come around as mortgage lending, their main product area, has become un- or marginally profitable. New entrants have driven down effective prices (if not quoted interest rates) through balance transfer programmes with low ‘teaser’ rates, and have contributed to rising costs by marketing extensively.

Although we believe that the market will remain more crowded than it once was, immediate pressure is declining as most banks pull back from their once indiscriminate issuance. Smaller banks (ex-Dah Sing) do not have enough critical mass to be able to make money at current default rates, which will limit their desire and ability to compete on price over the next several years.

2. **A shift in customer focus towards a more middle-class clientele.** Aeon is changing its focus from low-income customers who primarily use its cards for cash advance purchases towards middle-class consumers who use its cards for purchases; hence, the concentration of effort on marketing affinity cards and hire purchase plans. These customers pay lower rates, but also have significantly better credit loss experience and are thus more profitable.

Although this strategy will tend to lower interest margins over time, profitability should improve.

3. **Long-term liability strategy during a falling rate environment.** Our recent meeting with Aeon management confirmed that its funding strategy continues to be based around maintaining a large portion (target 80%) of long-term liabilities; this directive originates with management of Aeon’s Japanese parent. This, along with Aeon’s lack of a core deposit base, has resulted in high funding costs – 7.07% in the most recent period, compared with an average of 1.52% for its prime Hong Kong bank competitors.

Fig 13 Aeon credit funding mix (HK\$m)

	End-2002		1H03	
	Feb-02	% Total	Aug-02	% Total
Short-term bank borrowing	530	19	465	17
Long-term bank borrowing	560	20	560	20
Debt securities	524	19	527	19
Other liabilities	106	4	103	4
Equity	1,056	38	1,107	40

Source: Company reports, ING estimates

Aeon management has disclosed that the company would like to open a Deposit Taking Company (DTC) in Hong Kong to lower its cost of funds; pending execution of such a strategy, its potential effect on margins is not included in our forecasts.

Fig 14 Comparative cost of funds: Aeon vs major banks

1H02	Cost of funds (%)
HSB	1.15
DSF	1.68
BEA	1.74
Aeon*	7.07

* Aeon Credit as of 1H03 (period ended 7/02).

Source: Company reports, ING estimates

Asset quality

Asset quality is poor, but charges are taken to income quickly and fully

Asset quality at Aeon is poor and has been deteriorating – not a surprise given the poor environment for retail lending in Hong Kong. As a substantial mitigating factor, Aeon has been provisioning well against delinquent accounts, and exceeds our required level of reserving given its NPLs.

Gross NPLs have risen 55% from a year ago, increasing from HK\$235m to HK\$365m even as total loans have stagnated. On a percentage basis, impaired loans rose from 8.1% of total loans to 12.5% despite charge-offs during the period of over 7% of the loan book. Although this experience is in line with the general delinquency and charge-off experience in Hong Kong (and thus not a failing specific to Aeon), it is nonetheless horrific in its impact on profitability.

Fig 15 Asset quality summary: 1H99-1H03 (HK\$m)

	1H99 Aug-98	2H99 Feb-99	1H00 Aug-99	2H00 Feb-00	1H01 Aug-00	2H01 Feb-01	1H02 Aug-01	2H02 Feb-02	1H03 Aug-02
Gross NPLs	160.3	147.2	179.0	160.7	162.2	192.3	235.6	276.3	365.8
% of total loans	7.01	5.94	6.96	6.10	6.09	7.01	8.13	9.45	12.49
Gross reserves	72.8	83.1	92.1	85.1	89.7	90.5	97.8	148.7	172.8
% of total loans	3.18	3.35	3.58	3.23	3.37	3.30	3.37	5.08	5.90
% of gross NPLs	45.41	56.44	51.46	52.99	55.30	47.06	41.49	53.81	47.25

Source: Company reports, ING estimates

Net charge-offs ran at 351bp of average loans in the most recent period, down slightly from 2H02 but well above the loss experience of the 1H01-1H02 period. Most important to us is that Aeon has fully provisioned against actual losses (unlike some other Hong Kong lenders), with P&L charges for bad debts outpacing realised losses in each of the past five halves. This has boosted the reserve from 327bp at end-2000 to 591bp currently – or, more importantly, from 174 days of charge-offs to 307 days, despite the much higher rate of loss the company is now sustaining.

Fig 16 Net charge-offs and provisioning

	2H00 Feb-00	1H01 Aug-00	2H01 Feb-01	1H02 Aug-01	2H02 Feb-02	1H03 Aug-02
Provisions	315.94	257.66	247.00	281.52	535.88	433.73
Net charge-offs	342.63	240.43	244.12	255.73	360.97	351.21
Provisions less charge-offs	(26.69)	17.23	2.88	25.79	174.91	82.52
Accumulated reserves	327.09	338.55	334.84	346.67	510.65	590.67

Source: Company reports, ING estimates

Reserve adequacy

Reserves are adequate

Reserve adequacy is less important for a pure consumer finance company as its NPLs are all written off within 180 days. Additionally, the majority of losses now incurred through bankruptcy occur without first becoming past due – the accounts are current up until the arrival of a bankruptcy petition, and are then written off completely. Nevertheless, we have run our standard regional reserve adequacy model for Aeon, assigning loans 30-90 days past due to the Special Mention category and those 90-180 days past due to the Substandard category. There are no Doubtful or Loss assets under this method, as any loans that meet the 180+ days delinquent criteria are already fully written down and do not appear on the balance sheet.

Fig 17 Reserve adequacy: 1H03 standard methodology (HK\$000)

	Gross amount	Reserve percentage (%)	Required reserve
Pass	2,561,790	1	25,618
Special mention	216,715	5	10,836
Substandard	149,063	20	29,813
Doubtful	-	50	-
Loss	-	100	-
ORE	-	20	-
Excess AIR	-	20	-
Total	2,927,568		66,266
Actual reserves			172,822
Shortfall			(106,556)
Actual/required (%)			261
Shortfall/capital (%)			-10

Source: Company reports, ING estimates

Using the standard model shows that Aeon's actual reserves exceed our required figure by an additional 161%, clearly a good showing. However, this model output is heavily driven by changes in the general provision we assess on performing (pass) loans, which is 1% in our base-case methodology.

Given that Aeon is involved in pure consumer finance – a riskier business than most other bank lending – we have also calculated required reserves using a 4% general provision (equal to more than six months of actual losses on the entire portfolio at current rates), with S/M and S/S provisioning bumped up to 10% and 25%, respectively. Under this conservative scenario, Aeon still exceeds our required reserve by 7%, giving us comfort that the company is fully provisioned against the current asset base.

Fig 18 Reserve adequacy: 1H03 severe methodology (HK\$000)

	Gross amount	Reserve percentage (%)	Required reserve
Pass	2,561,790	4	102,472
Special mention	216,715	10	21,672
Substandard	149,063	25	37,266
Doubtful	-	50	-
Loss	-	100	-
ORE	-	20	-
Excess AIR	-	20	-
Total	2,927,568		161,409
Actual reserves			172,822
Shortfall			(11,413)
Actual/required (%)			107
Shortfall/capital (%)			-1

Source: Company reports, ING estimates

A Hong Kong credit bureau will benefit smaller players including Aeon

Information sharing will benefit Aeon

A long-awaited plan that would permit Hong Kong banks and finance companies to share credit information about their consumer borrowers will likely be put into place, despite fears that the institution of a credit database would spark another round of personal loan defaults and give rise to privacy issues for consumers.

We continue to believe that a true shared credit information system is imperative to avoid future large-scale defaults, and that purposeful ignorance will benefit neither banks nor consumers. Smaller companies like Aeon will be primary beneficiaries of such a move; while large banks like HSBC will still see lower credit costs, they will be comparatively disadvantaged compared with their current strong positions.

The power of positive information

Hong Kong lenders currently have no organised means of sharing information about consumer borrowers and potential borrowers, other than strictly specified negative factors. In other words, lenders can only disclose information to each other about delinquent customers – information that frequently comes too late as borrowers who default tend to do so on all obligations around the same time.

On this basis, while your banker will ask you about your income and calculate your ability to handle credit and properly repay before issuing you a credit card, she would never know that you already have eight other cards with large balances issued by other banks – as long as you are not in default on any of those loans.

An HKMA working paper informs us that the average defaulting individual in Hong Kong has taken out borrowings from 12 financial institutions and owes an average of 55x his or her monthly salary.

Continuous re-rating is key

Of particular concern to consumer groups is a measure that will allow banks to access data on customers when reviewing their existing loan portfolio, rather than only when considering new credit lines.

We view the periodic updating of credit information and re-rating of borrowers as a normal and prudent credit practice, and would find the credit bureau proposal materially degraded without it.

Because consumer borrowers frequently give no warning before filing a bankruptcy petition, and are thereafter allowed to discharge their unsecured debts, a large part of managing risk well is to spot problem borrowers in time to cut off their credit before they use it all – it is a banking truism that no borrower goes bankrupt without first using 100% of his/her available credit.

Expect another round of defaults when re-rating is introduced

Aeon management is enthusiastic about the credit bureau system, but cautions that investors should expect an additional inflow of bad debts once re-rating is permitted, as lenders will cut off the remaining credit of marginal borrowers and force them into default.

For further information on the credit bureau proposal, please refer to our note of 15 August 2002 entitled “*Hong Kong banks: Will HK credit bureau lead to a credit crunch?*”

Earnings and forecasts

Earnings will not return to the peak ... but positive momentum is in sight

Aeon has a long way to go to recapture the glory days of FY97-99, where ROE on a core basis and annual loan growth both routinely topped 20%. We do not see this combination returning in the near term, and are forecasting another poor result in 2H03 on continued high provisions. However, Aeon will have quite strong earnings momentum beginning in FY04, with our forecast for net income increasing by 42% in FY04 and 24% in FY05 from the FY03 trough.

Fig 19 Key earnings components: FY97-05F (HK\$m)

Yr to Feb	97	98	99	00	01	02	03F	04F	05F
Net interest income	276.1	405.9	529.1	563.7	578.1	633.3	603.4	607.8	642.6
Non-interest income	28.5	42.1	63.5	78.7	72.2	112.1	87.1	55.4	58.8
Non-interest expenses	174.3	244.3	304.9	276.1	272.8	296.3	276.0	263.6	263.4
Loan loss provisions	37.6	69.2	113.7	159.2	135.0	235.4	246.9	200.0	190.0
Core income	76.9	112.1	146.5	180.1	207.4	149.1	117.9	167.7	208.3
Net income	76.9	112.1	146.4	180.0	210.0	211.0	141.8	167.7	208.3

Source: Company reports, ING estimates

Fig 20 Key earnings ratios: FY97-05F (%)

Yr to Feb	97	98	99	00	01	02	03F	04F	05F
ROA	6.03	6.22	6.17	6.38	6.84	6.54	4.34	5.09	6.04
Core ROA	6.03	6.22	6.18	6.38	6.75	4.62	3.61	5.09	6.04
ROE	23.12	24.66	26.81	26.97	25.67	21.58	12.54	13.57	15.26
Core ROE	23.12	24.66	26.83	26.97	25.36	15.25	10.43	13.57	15.26
NIM	22.14	23.35	23.29	20.79	19.70	20.94	19.96	19.97	20.16
Cost/income	57.21	54.53	51.45	42.98	41.95	39.76	39.97	39.74	37.55
Overheads	13.97	14.06	13.42	10.18	9.30	9.80	9.13	8.66	8.26
Effective tax rate	17.05	16.62	15.75	13.04	13.27	17.16	15.38	16.00	16.00

Source: Company reports, ING estimates

The fall in corporate core income in FY02 and FY03F is attributable almost entirely to asset quality, as expenses have been kept well in line and margins are actually above the FY01 level. In addition, fee income has been falling due to competition on both the customer and merchant sides – a trend that will not, in our opinion, be reversed even over the long term.

Fig 21 Key earnings components: 1H99-1H03 (HK\$m)

	1H99 Aug-98	2H99 Feb-99	1H00 Aug-99	2H00 Feb-00	1H01 Aug-00	2H01 Feb-01	1H02 Aug-01	2H02 Feb-02	1H03 Aug-02
Net interest income	254.7	274.4	277.6	286.1	284.8	293.3	318.7	314.6	305.8
Non-interest Income	25.1	38.4	40.7	38.0	38.5	33.7	30.3	81.8	60.7
Non-interest expenses	152.9	152.1	145.9	130.2	136.4	136.4	141.4	154.9	140.4
Loan loss provisions	47.7	66.0	77.0	82.2	68.3	66.7	79.4	156.0	126.9
Core income	66.1	80.2	81.2	98.9	99.3	108.2	112.2	39.2	60.3
Net income	66.1	80.2	81.2	98.9	101.8	108.2	112.2	98.8	84.3

Source: Company reports, ING estimates

Fig 22 Key earnings ratios: 1H99-1H03 (%)

	1H99 Aug-98	2H99 Feb-99	1H00 Aug-99	2H00 Feb-00	1H01 Aug-00	2H01 Feb-01	1H02 Aug-01	2H02 Feb-02	1H03 Aug-02
ROA	5.98	6.59	6.33	7.23	6.72	6.95	7.01	6.05	5.11
Core ROA	5.98	6.59	6.33	7.23	6.55	6.95	7.01	2.40	3.66
ROE	25.52	26.82	25.45	26.84	25.14	24.06	22.85	18.72	15.24
Core ROE	25.52	26.82	25.47	26.84	24.51	24.06	22.85	7.43	10.90
NIM	23.01	23.03	22.07	21.39	19.58	19.73	21.08	20.63	20.03
Cost/income	54.65	48.64	45.83	40.19	42.19	41.71	40.52	39.08	38.32
Overheads	6.91	6.38	5.80	4.87	4.69	4.59	4.68	5.08	4.60
Effective tax rate	16.44	15.20	14.93	11.42	13.91	12.65	12.52	24.13	14.95

Source: Company reports, ING estimates

With margins basically stable on the back of lower funding costs, and fee income as a percentage of revenue declining, future earnings growth will have to come from any or all of the following three factors:

- Expense reduction.** Aeon has already taken steps to cut its operating expenses by 15-20% (approximately HK\$40-60m per annum), mainly by reducing staffing and by rolling down marketing expenses as the company's focus on affinity cards and hire-purchase offloads some of these costs onto the company's merchant partners. We believe that absolute costs will continue to fall through end-2004 (-7% in FY03 and -4% in FY04), before moving up 1% in FY05 and 2% in FY06.
- Loan growth:** Loan growth will remain slack for the projectable future. Hong Kong's poor economy and continued high unemployment make this a bad environment in which to aggressively source new consumer loans. We do expect the China tie-up with Jusco to be a potential long-term source of new loans, but we expect any impact to occur after FY04 as Aeon does not yet have a licence. Overall, we expect a 2% contraction in lending in FY03, and 3% and 6% growth in FY04 and FY05, respectively.
- Declining provisions:** Provisions, at an annualised rate of 8.7% of average loans in 1H03, are murderously high and will impede an earnings recovery until such time as they come down. Although we project total provisions will remain high at 8.5% for the whole of FY03, this will come down to 6.7% in FY04 and to 6.2% in FY05. This will add approximately HK\$55m to pre-tax income, 23% of our projected FY04 total.

Core versus non-core earnings

As a general rule, we avoid taking into account one-time factors when looking at a bank's historical and future earnings capacity. For this reason, we focus on measures of core income, which excludes tax-affected securities gains, asset disposals, non-cash charges such as goodwill amortisation, and other extraordinary items. We do consider loan loss provisions as part of core income (unlike our calculation of underlying profitability), as they are part of the ongoing business of being a credit intermediary. Note that we do not project items such as securities gains or asset sales going forward unless we have specific information about gains or losses that have already taken place.

Valuation

Valuation is too low even for a bear scenario

Aeon's valuation has been beaten down excessively by the market, even on our very bearish assumptions about continued poor macro growth, high unemployment, and thus high charge-offs. Our assessment of average ROE of 13% in FY03-04 and cost of capital of 12% yields a fair value of 1.09x end-2003 book value per share of HK\$2.70, or a target price of HK\$2.94. We are hence initiating coverage of Aeon shares with a BUY rating.

Valuation at current price

Aeon currently trades at 0.90x trailing and 0.88x forward book value, with a PER of 7.0x FY03F EPS. Note that our EPS estimates of HK\$0.34 in FY03 and HK\$0.40 in FY04 are extremely conservative compared with consensus¹ forecasts of HK\$0.43 and HK\$0.48 for those periods, respectively. This is somewhat worrisome, as we believe that Aeon will disappoint based on these expectations; however, the stock is poorly followed and so we tend to discount the impact of consensus earnings figures.

Fig 23 Share valuation at current price

Yr to Feb	01	02	03F	04F	05F
Share price (HK\$)	2.38				
PER (x)	4.74	4.71	7.02	5.93	4.77
PER (core) (x)	4.79	6.67	8.44	5.93	4.77
P/BV (x)	1.11	0.94	0.88	0.81	0.73
P/ABV (x)	1.11	0.94	0.88	0.81	0.73

Source: Company reports, ING estimates

High dividend yield

Dividend yield almost as high as Hang Seng's, but Aeon pays out less than 50% of core earnings, while HSB pays out 100% or more

Also note that Aeon has a quite attractive yield of 5.5% based on its current HK\$0.13 annual dividend level. As the company is very well capitalised (equity/assets of 33.5%) and the payout ratio will not exceed 50% of core earnings, we believe that this level of dividending is eminently sustainable.

Fig 24 EPS and dividend summary

Yr to Feb	00	01	02	03F	04F	05F
EPS (HK\$)	0.43	0.50	0.50	0.34	0.40	0.50
Core EPS (HK\$)	0.43	0.50	0.36	0.28	0.40	0.50
DPS (HK\$)	0.10	0.13	0.13	0.13	0.15	0.19
Dividend payout (%)	24	25	26	38	37	38
Dividend payout on core EPS (%)	24	25	37	46	37	38
Dividend yield (%)	4.4	5.3	5.5	5.5	6.3	7.9

Source: Company reports, ING estimates

¹ Per I/B/E/S.

Valuation at target price

At our target price of HK\$2.94, Aeon will be trading at 1.09x end-2003F BVPS, and on 10.4x FY03F and 7.3x FY04F core EPS.

Fig 25 Share valuation at target price

Yr to Feb	01	02	03F	04F	05F
Share price (HK\$)	2.94				
PER (x)	5.86	5.83	8.68	7.34	5.91
PER (core) (x)	5.94	8.26	10.44	7.34	5.91
P/BV (x)	1.37	1.17	1.09	1.00	0.90
P/ABV (x)	1.37	1.17	1.09	1.00	0.90

Source: Company reports, ING estimates

Sector comparison

Aeon trades below even weak Hong Kong banks like BEA and BOCHK^[b] on both a price-to-book and price-to-earnings basis, despite a superior ROE and better growth prospects for the 2003-05 period. Although low market cap demands a discount for Aeon, we still find it mispriced not only on an absolute, but on a relative view as well.

Fig 26 Sector valuation comparison

	Rating	P/BV (x)	ROE (%)		PER (x)	
		1H02A	2001A	2002F	2001A	2002F
AEON*	BUY	0.90	21.58	12.54	4.71	7.02
HSB	SELL	3.54	22.44	22.36	15.50	16.15
BOCHK ^[b]	NR	1.54	6.47	10.79	29.79	14.37
BEA	SELL	1.32	11.45	10.89	11.90	11.86
DSF	BUY	1.72	18.74	18.51	9.51	8.87

Note: Aeon's BV as of 1H03A; ROEs and PERs are for 2002A and 2003F, respectively.

Source: Company reports, ING estimates

Fig 27 Aeon Credit financial summary

Share price: HK\$2.38		Index: 9,109.35		Reuters code: 900.HK							
52-week price range: HK\$2.30-3.45		Current yield: 0.0%		Bloomberg code: 900 HK							
				Shares outstanding (m): 418.77							
Income statement	1996	1997	1998	1999	2000	Balance sheet	1996A	1997A	1998A	1999A	2000A
(HK\$000s) year ending Feb						(HK\$000s) as at Feb					
Interest income	229,460	330,278	497,636	684,361	746,455	Gross loans	957,629	1,342,846	1,931,099	2,479,557	2,635,425
Interest expense	48,734	54,176	91,778	155,275	182,750	Loan loss reserves	13,039	15,438	56,915	83,099	85,138
Net interest income	180,726	276,102	405,858	529,086	563,705	Net loans	944,590	1,327,408	1,874,184	2,396,458	2,550,287
<i>Ave. int. earning assets</i>	<i>933,623</i>	<i>1,247,327</i>	<i>1,737,897</i>	<i>2,272,050</i>	<i>2,711,610</i>	Total earning assets	1,010,187	1,484,467	1,991,326	2,552,773	2,870,446
NIM (%)	19.36	22.14	23.35	23.29	20.79	Other assets	20,313	33,778	96,276	101,709	118,367
Non-interest income	17,142	28,479	42,135	63,488	78,656	Total assets	1,030,500	1,518,245	2,087,602	2,654,482	2,988,813
Total operating inc	197,868	304,581	447,993	592,574	642,361	Deposits	-	-	-	-	-
Non-interest expense	107,548	174,251	244,279	304,901	276,102	Customer deposits	-	-	-	-	-
Pre-provision profit	90,320	130,330	203,714	287,673	366,259	Other deposits	-	-	-	-	-
Loan loss provisions	32,768	37,633	69,245	113,731	159,184	Other paying liabilities	715,153	998,534	1,464,248	1,882,454	2,118,680
Non-operating income	0	0	0	-155	-55	Other liabilities	66,034	104,012	129,681	173,503	133,465
Pre-tax profit	57,552	92,697	134,469	173,787	207,020	Total liabilities	781,187	1,102,546	1,593,929	2,055,957	2,252,145
Tax	10,038	15,806	22,350	27,397	27,000	Equity with revaluation	249,313	415,699	493,673	598,525	736,668
Net profit	47,514	76,891	112,119	146,390	180,020	Adjusted equity	249,313	415,699	493,673	598,525	736,668
Core earnings	47,514	76,891	112,119	146,545	180,075	Balance sheet ratios	1996A	1997A	1998A	1999A	2000A
Per share data (\$\$)	1996A	1997A	1998A	1999A	2000A	Loan-to-IBL	133.9%	134.5%	131.9%	131.7%	124.4%
EPS	0.14	0.20	0.29	0.38	0.43	Equity to assets	24.2%	27.4%	23.6%	22.5%	24.6%
DPS	8.47	8.48	0.00	0.10	0.10	Total loan loss prov	3.18%	2.48%	3.32%	4.28%	5.33%
<i>Effective payout ratio</i>	<i>35%</i>	<i>40%</i>	<i>34%</i>	<i>27%</i>	<i>24%</i>	Asset quality	1996A	1997A	1998A	1999A	2000A
BVPS	0.75	1.08	1.29	1.57	1.76	Nonperforming assets	N/A	N/A	160,937	147,246	160,660
ABVPS	0.75	1.08	1.29	1.57	1.76	Special mention	N/A	N/A	112,548	86,879	95,058
Valuation (x)	1996A	1997A	1998A	1999A	2000A	Substandard	N/A	N/A	48,389	60,367	65,602
Price to book value	3.2	2.2	1.8	1.5	1.4	Doubtful	N/A	N/A	-	-	-
Price to adj book value	3.2	2.2	1.8	1.5	1.4	Loss	N/A	N/A	-	-	-
Price to earnings	16.7	11.9	8.1	6.2	5.5	ORE	N/A	N/A	N/A	N/A	N/A
Profitability ratios (%)	1996A	1997A	1998A	1999A	2000A	NPAs/total loans	N/A	N/A	8.3%	5.9%	6.1%
Net interest margin	19.36	22.14	23.35	23.29	20.79	Res coverage of NPAs	N/A	N/A	35.4%	56.4%	53.0%
Yield on int earn assets	22.71	22.25	24.99	26.81	26.00	Required reserves	9,576	13,428	33,007	39,740	42,621
Cost on int bearing liab	6.81	5.43	6.27	8.25	8.63	Actual reserves	13,039	15,438	56,915	83,099	85,138
Net interest spread	15.90	16.82	18.72	18.56	17.38	Shortfall (surplus)	(3,462)	(2,009)	(23,908)	(43,359)	(42,517)
Non-int inc (% Op inc)	8.66	9.35	9.41	10.71	12.24	Actual to required res	136.2%	115.0%	172.4%	209.1%	199.8%
Cost to income	54.35	57.21	54.53	51.45	42.98	Shortfall to capital	-1.4%	-0.5%	-4.8%	-7.2%	-5.8%
Overhead ratio	11.52	13.97	14.06	13.42	10.18	Growth rates (%)	1996A	1997A	1998A	1999A	2000A
Cost coverage	183.98	174.79	183.39	194.35	232.65	Income statement					
ROA	4.99	6.03	6.22	6.17	6.38	Net interest income	N/A	52.8	47.0	30.4	6.5
ROE	19.06	23.12	24.66	26.81	26.97	Non-interest income	N/A	66.1	48.0	50.7	23.9
Oroa analysis (%)	1996A	1997A	1998A	1999A	2000A	Total operating income	N/A	53.9	47.1	32.3	8.4
Net interest margin	19.36	22.14	23.35	23.29	20.79	Non-interest expenses	N/A	62.0	40.2	24.8	-9.4
Non-int inc/gross inc	8.66	9.35	9.41	10.71	12.24	Pre-provision earnings	N/A	44.3	56.3	41.2	27.3
Efficiency ratio	54.35	57.21	54.53	51.45	42.98	Loan loss provisions	N/A	14.8	84.0	64.2	40.0
Provision/assets	3.18	2.48	3.32	4.28	5.33	Core earnings	N/A	61.8	45.8	30.7	22.9
Op return on assets	6.49	7.97	8.40	8.38	8.18	Net profit	N/A	61.8	45.8	30.6	23.0
Equity/assets	24.19	27.38	23.65	22.55	24.65	Balance sheet					
Op return on equity	26.84	29.11	35.54	37.15	33.19	Loan growth	N/A	40.2	43.8	28.4	6.3
						Interest earning assets	N/A	46.9	34.1	28.2	12.4
						Asset growth	N/A	47.3	37.5	27.2	12.6
						Deposit growth	N/A	39.6	46.6	28.6	12.5
						Shareholders' funds	N/A	66.7	18.8	21.2	23.1

Source: Company reports, ING estimates

Fig 27 Aeon Credit financial summary – cont.

Share price:	HK\$2.38					Index:	9,109.35					Reuters code:	900.HK										
52 week price range:	HK\$2.30-3.45					Current yield:	0.0%					Bloomberg code:	900 HK					Shares outstanding (m):	418.77				
Income statement	2001A	2002A	2003F	2004F	2005F	Balance sheet	2001A	2002A	2003F	2004F	2005F												
(HK\$000s) year ending Feb						(HK\$000s) as at Feb																	
Interest income	769,868	804,115	744,850	736,707	769,313	Gross loans	2,740,720	2,924,206	2,869,017	2,962,977	3,143,422												
Interest expense	191,777	170,798	141,497	128,872	126,706	Loan loss reserves	90,483	148,679	155,857	146,785	144,077												
Net interest income	578,091	633,317	603,353	607,835	642,607	Net loans	2,650,237	2,775,527	2,713,160	2,816,192	2,999,345												
<i>Ave. int. earning assets</i>	<i>2,934,153</i>	<i>3,024,324</i>	<i>3,022,764</i>	<i>3,043,779</i>	<i>3,186,994</i>	Total earning assets	2,997,860	3,050,788	2,994,740	3,092,818	3,281,170												
NIM (%)	19.70	20.94	19.96	19.97	20.16	Other assets	157,054	244,555	245,656	253,701	269,151												
Non-interest income	72,194	112,100	87,081	55,377	58,812	Total assets	3,154,914	3,295,343	3,240,395	3,346,518	3,550,321												
Total operating inc	650,285	745,417	690,434	663,211	701,419	Deposits	-	-	-	-	-												
Non-interest expense	272,785	296,344	275,996	263,584	263,385	Customer deposits	-	-	-	-	-												
Pre-provision profit	377,500	449,073	414,438	399,627	438,034	Other deposits	-	-	-	-	-												
Loan loss provisions	135,019	235,407	246,904	200,000	190,000	Other paying liabilities	2,134,517	2,133,800	2,048,395	2,070,383	2,155,577												
Non-operating income	-307	34,005	0	0	0	Other liabilities	121,122	105,706	61,397	40,661	29,441												
Pre-tax profit	242,174	247,671	167,534	199,627	248,034	Total liabilities	2,255,639	2,239,506	2,109,792	2,111,044	2,185,018												
Tax	32,170	36,669	25,764	31,940	39,685	Equity with revaluation	899,275	1,055,837	1,130,603	1,235,475	1,365,304												
Net profit	210,004	211,002	141,770	167,687	208,348	Adjusted equity	899,275	1,055,837	1,130,603	1,235,475	1,365,304												
Core earnings	207,434	149,057	117,903	167,687	208,348	Balance sheet ratios	2001A	2002A	2003F	2004F	2005F												
Per share data (\$)	2001A	2002A	2003F	2004F	2005F	Loan-to-IBL	128.4%	137.0%	140.1%	143.1%	145.8%												
EPS	0.50	0.50	0.34	0.40	0.50	Equity to assets	28.5%	32.0%	34.9%	36.9%	38.5%												
DPS	0.13	0.13	0.13	0.15	0.19	Total loan loss prov	4.28%	7.14%	7.62%	5.98%	5.35%												
<i>Effective payout ratio</i>	<i>25%</i>	<i>26%</i>	<i>38%</i>	<i>37%</i>	<i>38%</i>	Asset quality	2001A	2002A	2003F	2004F	2005F												
BVPS	2.15	2.52	2.70	2.95	3.26	Nonperforming assets	192,260	276,313	492,170	351,576	319,322												
ABVPS	2.15	2.52	2.70	2.95	3.26	Special mention	108,501	148,869	291,599	208,301	189,191												
Valuation (x)	2001A	2002A	2003F	2004F	2005F	Substandard	83,759	127,444	200,570	143,275	130,131												
Price to book value	1.1	0.9	0.9	0.8	0.7	Doubtful	-	-	-	-	-												
Price to adj book value	1.1	0.9	0.9	0.8	0.7	Loss	-	-	-	-	-												
Price to earnings	4.7	4.7	7.0	5.9	4.8	ORE	N/A	N/A	N/A	N/A	N/A												
Profitability ratios (%)	2001A	2002A	2003F	2004F	2005F	NPA's/total loans	7.0%	9.4%	17.2%	11.9%	10.2%												
Net interest margin	19.70	20.94	19.96	19.97	20.16	Res coverage of NPAs	47.1%	53.8%	31.7%	41.8%	45.1%												
Yield on int earn assets	25.68	26.36	24.87	23.82	23.45	Required reserves	47,898	59,533	78,463	65,184	63,727												
Cost on int bearing liab	8.98	8.00	6.91	6.22	5.88	Actual reserves	90,483	148,679	155,857	146,785	144,077												
Net interest spread	16.70	18.35	17.96	17.60	17.57	Shortfall (surplus)	(42,585)	(89,146)	(77,394)	(81,601)	(80,350)												
Non-int. inc (% Op inc)	11.10	15.04	12.61	8.35	8.38	Actual to req reserves	188.9%	249.7%	198.6%	225.2%	226.1%												
Cost to income	41.95	39.76	39.97	39.74	37.55	Shortfall to capital	-4.7%	-8.4%	-6.8%	-6.6%	-5.9%												
Overhead ratio	9.30	9.80	9.13	8.66	8.26	Growth rates (%)	2001A	2002A	2003F	2004F	2005F												
Cost coverage	238.39	251.54	250.16	251.61	266.31	Income statement																	
ROA	6.84	6.54	4.34	5.09	6.04	Net interest income	2.6	9.6	-4.7	0.7	5.7												
ROE	25.67	21.58	12.54	13.57	15.26	Non-interest income	-8.2	55.3	-22.3	-36.4	6.2												
Oroa analysis (%)	2001A	2002A	2003F	2004F	2005F	Total operating income	1.2	14.6	-7.4	-3.9	5.8												
Net interest margin	19.70	20.94	19.96	19.97	20.16	Non-interest expenses	-1.2	8.6	-6.9	-4.5	-0.1												
Non-int inc/gross inc	11.10	15.04	12.61	8.35	8.38	Pre-provision earnings	3.1	19.0	-7.7	-3.6	9.6												
Efficiency ratio	41.95	39.76	39.97	39.74	37.55	Loan loss provisions	-15.2	74.4	4.9	-19.0	-5.0												
Provision/assets	4.28	7.14	7.62	5.98	5.35	Core earnings	15.2	-28.1	-20.9	42.2	24.2												
Op return on assets	8.59	7.71	6.09	7.15	8.39	Net profit	16.7	0.5	-32.8	18.3	24.2												
Equity/assets	28.50	32.04	34.89	36.92	38.46	Balance sheet																	
Op return on equity	30.12	24.05	17.46	19.38	21.82	Loan growth	4.0	6.7	-1.9	3.3	6.1												
						Interest earning assets	4.4	1.8	-1.8	3.3	6.1												
						Asset growth	5.6	4.5	-1.7	3.3	6.1												
						Deposit growth	0.7	0.0	-4.0	1.1	4.1												
						Shareholders' funds	22.1	17.4	7.1	9.3	10.5												

Source: Company reports, ING estimates.

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