

# Management Discussion and Analysis

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## BUSINESS REVIEW

### Overview

Despite rising interest rates, oil price hikes and the cooling measures imposed on the PRC economy in the first half of 2005, the steady upturn of Hong Kong's economy continued to be sustained by positive economic outlook, Macao gambling-linked stocks, speculations of the Renminbi's re-valuation and Mainland IPO activities. All of which attracted hot money into Hong Kong financial markets and boosted activities in both the property and the equity markets. As a result, the Hang Seng Index surged to a high of 14,287 in June 2005 from a low of 11,933 in July 2004 and the average monthly trading volume on The Stock Exchange of Hong Kong Limited (the "SEHK") increased to HK\$331.8 billion for the year under review as compared to the corresponding period in 2004 of HK\$316.8 billion.

In this increasingly favourable economic and investment climate, we met both new and existing opportunities with a focus on diversifying our revenues and product mix, and continuing to strengthen our core businesses in futures and securities broking, margin financing, wealth management, insurance agency and corporate finance.

Japan's Tokyo Grain Exchange ("TGE") and Tokyo Commodity Exchange ("TOCOM") have been in operation since 1952 and 1984 respectively and are amongst the largest commodity futures markets in the world. As investors' interests in the Japanese futures market shifted to other investment alternatives, the volume of trade in Hong Kong's Japanese futures shrank by 26.0% in terms of the number of contracts even though that of overseas markets were still expanding.

In Hong Kong's TGE market, the Group is still the largest broker for Japanese commodity futures in terms of trading volume. Despite the decrease in activity of the

TGE futures market in Hong Kong, Tanrich still maintained its dominant with 59.0% market share of TGE futures in Hong Kong in terms of trading volume for the year ended 30 June 2005.

## OPERATION REVIEW

### Futures

Following the boost of Hong Kong's economy, the unemployment rate went down from a high of 7.3% in January 2004 to a low of 5.7% in June 2005. The rebound of labour market resulted from the sustained growth of every industry, especially in the financial and property sectors. Needless to say, Tanrich's high caliber and competent account executives who had strong client base were the targets of our competitors' recruitment efforts and even those of banks. In addition to the shrinkage of the Japanese futures market in Hong Kong, Tanrich also suffered from the departure of a number of account executives, of directly and significantly affecting the Group's commission income derived from the Japanese futures turnover, which dropped by 46.9% to HK\$53.0 million from HK\$99.7 million for the same period of last year. The Group's operating loss amounted to HK\$11.0 million for the financial year under review while it recorded an operating profit of HK\$15.6 million for the corresponding period of last year.

We have always recognised that frontline employees are the essential assets of the Group's businesses. After having been selected by a centralised recruitment program, new recruits have to go through a series of extensive training programs in various areas including but not limited to operation, regulation and product knowledge. These programs aim to strengthen our sales force to provide all-round and professional financial services to the clients. We are confident that our sales force, be it in terms of size or their customised professional service, will continue to improve.

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## Securities Broking and Margin Financing

Although the capital market was supported by buoyant fund raising activities in the primary and secondary stock markets, the category A and B stock exchange participants, which represent the top 65 amongst of all stock exchange participants in Hong Kong, dominated at least 80.0% of the market share throughout the year and even up to 88.8% in June 2005. This reflected the retail investors' preference for the sizeable fund. Due to our tightened credit control system, the Group's total turnover of securities broking and margin financing businesses for the financial year ended 30 June 2005 decreased by 25.2% to HK\$9.5 million (2004: HK\$12.7 million) and recorded an operating profit of about HK\$1.8 million, dropping by 21.7% compared with the corresponding period of last year. This result shows that we succeeded in providing more protection to our clients. We will continue to expand our client base by seizing the opportunities brought forth PRC investors' increasing interest in Hong Kong's stock market.

## Money Lending

The Group captured some profit generating opportunities by identifying credit worthy corporate clients with a view to provide money lending services. The Group always aims to maintain prudent and conservative money lending policies and strict credit control systems in which the borrower's credit worthiness and background, as well as the collateral's quality and value, is thoroughly assessed. The turnover of the Group's money lending business for the financial year ended 30 June 2005 increased markedly from HK\$1.8 million to HK\$3.5 million and we also achieved an operating profit of approximately HK\$3.5 million, an increase of 94.4% compared to the corresponding period of last year.

## Proprietary Trading

Due to the unexpected surge in oil prices and the price fluctuations in the equities, currency and commodities markets, Tanrich took a more prudent approach in its proprietary trading and thus its turnover dropped remarkably by 94.0% to HK\$0.9 million and recorded a small loss of HK\$0.1 million for the financial year ended 30 June 2005.

## Wealth Management and Insurance Agency

The fast-growing wealth management and insurance agency businesses continue to be an integral part of our plan to diversify our income streams. With a high savings-to-income ratio and a relatively low penetration of wealth management and insurance agency services, the potential of the wealth management and insurance agency industry is enormous. During the year under review, the turnover of the Group's wealth management and insurance agency businesses grew by 3.7 times to HK\$8.9 million and its operation loss fell by 55.4% to HK\$1.3 million in 2005 when compared to that of same period of last year. As a distributor of comprehensive financial products managed by over 30 international asset management companies, we will continue to expand our client base.

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## Corporate Finance

The Group's corporate finance business is expected to be one of its core businesses in the long-term even though it is still in its developing stage. Notwithstanding that its turnover increased by 157.1% to HK\$1.8 million for the year under review as compared with HK\$0.7 million for the corresponding period in 2004, the Group suffered an operating loss of HK\$4.0 million (2004: loss of HK\$2.5 million) because more human resources were invested for expansion in this business segment. During the year under review, we executed a number of corporate finance transactions and have been engaged as joint sponsor for two proposed listing companies. We are dedicated to focusing our main efforts towards exploring business opportunities to strengthen our corporate finance business.

## Internal Control & Risk Management

During the year, Tanrich enhanced and modified its credit control and risk management policies and procedures to reflect changes in the markets and business strategies. These enhanced policies and procedures can more comprehensively identify, monitor and control risk exposure by using of administration and information systems and thus ultimately to maximise returns to clients and shareholders. In today's volatile financial markets, risk management and internal control are indispensable key factors to sustaining long-term growth of the Group's businesses.

## Risk Control Committee

This Risk Control Committee, comprising members of the Board of Directors, the Financial Controller of the Group and the Associate Director of legal and compliance division of the Group has to develop and implement business risk minimisation policies and procedures so as to confine business risks, formulate credit and risk control policies and procedures of Tanrich Securities Company Limited ("TSC"), an indirect wholly-owned subsidiary of the Company.

## Credit Control Committee

Comprising members of the Board of Directors, the Financial Controller of the Group and the Associate Director of legal and compliance division of the Group, the main task of the Credit Control Committee is to administer the credit control policies and procedures formulated by this committee.

## FINANCIAL REVIEW

### Liquidity, Financial Resources, Gearing Ratio and Capital Structure

The Group's financial policy is to maintain a healthy and sound financial position. The subsidiaries licensed by the Securities and Futures Commission (the "SFC") fully complied with the financial resources rules promulgated by the SFC. As at 30 June 2005, the Group had total cash and bank balances of HK\$38.3 million (2004: HK\$53.6 million), while net current assets amounted to HK\$66.0 million (2004: HK\$104.6 million). The strong liquidity of the Group is proven by its current ratio, that being current assets divided by current liabilities, of 2.4 times which remained unchanged from last year.

As at 30 June 2005 and 30 June 2004, the Group had no bank borrowings which resulted in a zero gearing ratio. The gearing ratio represents the ratio of total borrowings to the total equity of the Group.

As at 30 June 2005 and 30 June 2004, the Group had aggregate banking facilities of HK\$106.0 million, composed of HK\$85.0 million, the draw down of which is subject to the pledged value of marketable securities, and HK\$21.0 million general banking facilities.

These banking facilities were secured by clients' pledged securities, certain non-trading investments of the Group, and corporate guarantees issued by the Company. All banking facilities were denominated in Hong Kong dollars and based on commercial floating interest rates. There were no seasonal factors in our borrowing requirements.

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During the year end review, the Company has not issued any additional shares or made share repurchases.

## Significant Investments Held and Material Acquisition and Disposal

As at 30 June 2005, the Group had 1,306,000 shares of listed securities of Hong Kong Exchanges and Clearing Limited with a fair value of HK\$26.3 million (2004: HK\$20.9 million). An unrealised gain of HK\$5.4 million (2004: HK\$7.2 million) was recorded in the Group's investment revaluation reserve for the financial year ended 30 June 2005.

During the year under review, there was no material acquisition or disposal of investments, subsidiaries and associated companies.

## Material Investments

As far as practical and up to the date of this analysis, the Group does not have any plans for major investments or acquisitions of capital assets.

## Charge on Group Assets

Marketable securities with an aggregate value of approximately HK\$26.2 million (2004: HK\$8.0 million) were pledged as collateral for banking facilities. These marketable securities were beneficially owned by a subsidiary of the Company.

The subsidiaries of the Company pledge bank deposits as collateral to authorised institutions from time to time for foreign exchange deferred trading and banking facilities. As at 30 June 2005, they have pledged bank deposits of HK\$1,000,000 (2004: HK\$1,560,000) and HK\$500,000 (2004: HK\$1,763,000) to authorised institutions for foreign exchange deferred trading and banking facilities respectively.

## Exposure to Fluctuations in Exchange Rates and Related Hedges

The Group is exposed to foreign exchange fluctuation as a result of placing margin deposits in Japanese Yen with three designated futures commission merchants in Japan on behalf of its clients in Hong Kong. According to the Group's hedging policy, the Group hedges at least 80.0% of its net foreign exchange exposure with USD/JPY foreign exchange deferred trading in order to minimise its foreign exchange risk.

As at 30 June 2005, the Group's total margin deposit placed with the three designated futures commission merchants was 145.0 million Japanese Yen and had a bank deposit of 10.4 million Japanese Yen, total Japanese Yen being equivalent to HK\$10.9 million. This amount was fully hedged with USD/JPY foreign exchange deferred trading.

## Contingent Liabilities

As at 30 June 2005, the Company has guaranteed banking facilities of HK\$105.5 million granted to two of its subsidiaries. The banking facilities were applied in the normal course of their business activities. The Company has also guaranteed the liabilities of one of its subsidiaries up to an aggregate amount of not less than HK\$10.0 million in order to comply with the requirement of unencumbered assets contained in the Rules Governing the Listing of Securities on the Growth Enterprise Market of the SEHK (the "GEM Listing Rules").

As at 30 June 2005, an independent third party and Tanrich Futures Limited ("TFL"), an indirect wholly-owned subsidiary of the Company, were engaged in arbitration proceedings concerning, inter alia, the alleged unauthorised trading of futures contracts by an ex-employee of TFL. TFL was in the course of defending the said arbitration proceedings. In the event that the defence of the arbitration proceedings is unsuccessful, TFL may be held liable for an amount in the region of HK\$1.5 million to HK\$2.5 million, inclusive of interest

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and legal costs. Exchange of correspondence is currently in process between two parties and no conclusion was reached as at 30 June 2005. It is not currently possible to estimate the eventual outcome of the claim and based on legal advice to date, the directors of the Company consider that no provision needs to be made in the accounts.

## STAFF

As at 30 June 2005, the Group had a total of 186 full time employees. The Group operates different remuneration schemes for account executives and other supporting and general staff, respectively. Account executives are remunerated on the basis of on-target-earning packages comprising base pay or fixed salary, commission and/or bonus. Other supporting and general staff are offered basic salary and year-end discretionary bonus subject to the business results of the Group. Employees' remuneration excluding directors' emoluments amounted to HK\$45.2 million for the year under review (2004: HK\$53.4 million). The Group ensures that the remuneration paid to its employees is competitive and employees are rewarded within the general framework of the Group's salary and bonus system. The Group also provides training programs for the staff to enhance their skills and knowledge of products and regulations.

## OUTLOOK

In view of such challenging market environment, Tanrich will deploy a considerable amount of resources in fortifying its leading position in the financial services industry while enhancing service quality and product variety. The Group will continue to pursue for excellent product quality, impeccable services and higher standard of operation efficiency by adopting stringent quality controls and internal risk management systems.

By leveraging on its core competencies, diversified product portfolio and healthy financial position, the Group will further strengthen its sales and marketing

team as well as recruit eligible staff. By providing centralised training to our dedicated staff and organising recruitment programs, the Group is strived to offer cross-product selling opportunity and comprehensive investment services to our valuable clients.

In addition, the establishment of market promotion team will further strengthen brand equity and research capabilities by exploring and promoting various communication channels, such as TV, newspapers and internets. Through such marketing initiatives, the Group is able to promote the corporate image for its new services and cross-product selling opportunity.

With improving operating efficiency, the Group targets to launch more powerful and advanced futures and securities trading systems in the coming years. In addition, the Group will upgrade its management standards and operational processes to refine its operational techniques, so as to strengthen the Group's core competence.

While consolidating its existing business foundation, Tanrich will proactively seek after new business opportunities, paving its way for strategic business expansion and propelling future growth. The Group will cooperate with different business partners and renowned financial institutions to explore potential products and services in the Greater China region.

Looking ahead, Tanrich will capitalise on the immense potential generated from the booming economic and investment market as well as the recent appreciation of Renminbi. By reinforcing its quality management and board members, the Group is optimistic towards the promising prospect and potential of financial market in the Greater China region in the long run. Tanrich is well-poised to achieving even greater success in the coming future, and ultimately, creating fruitful returns to its supportive shareholders.