Management discussion and analysis of operations

2005 has been a successful year for the Group. The number of agents grew to 1,696 as at year end, as compared to 1,268 a year before. Individual single and first year premium grew by 24.1%, renewal premium grew by 6.2% and total premium grew by 8.8%.

1. Operational Review

The Group reported a net profit from ordinary activities attributable to shareholders of HK$42.5 million for the year ended 31 December 2005, representing a decrease of 77.4% from HK$188.3 million in 2004. Basic earnings per share was HK$0.05 as compared to HK$0.23 in 2004. The decrease in earnings was mainly due to the reclassification of the investment portfolio from “trading” to “available-for-sale” following adoption of the new accounting standard HKAS 39. As a result of this reclassification, there was a balance of HK$187.5 million in the available-for-sale financial assets revaluation reserve as at the end of 2005, which was booked as equity in the balance sheet. If the portfolio had not been reclassified from “trading” to “available-for-sale”, this reserve would have been reported as unrealised gains in the income statement for 2005.

The adoption of HKFRS 4 results in the classification of life insurance contracts into insurance contracts and investment contracts. Receipts and payments from investment contracts were previously reported as premiums and surrenders in the profit and loss accounts with an offset in the increase in future insurance liabilities. Starting from 2005, these receipts and payments, net of charges, were booked directly into the balance sheet. This change has had no effect on the net profit of the Group.

On life insurance business, the Group achieved an annualised first year premium on new business of HK$323.7 million, representing 24.5% growth from the restated figure of HK$260.0 million for 2004, following adoption of HKFRS 4. Single and first year premium increased 24.4% to HK$296.0 million, renewal premium increased 5.5% to HK$1,500.1 million and total premium increased 8.2% to HK$1,796.1 million.

Investment income, net gains, and other income was HK$373.8 million only. However, it was mainly due to the reclassification of the investment portfolio from “trading” to “available-for-sale” as described above.

Policyholders’ benefits decreased by 0.6% to HK$581.4 million. Agency commission and allowances increased 33.2% to HK$389.2 million as compared to the previous year, which was attributable to the increase in number of agents and more new business transacted during the year.

Management expenses decreased by 0.2% to HK$303.6 million. Total operating expenses for the year were HK$1,259.6 million, or 1.2% below 2004, despite the Group’s continued expansion of its operations. Expense Ratio has increased from 106.3% to 108.4%.

The following is the Expense Ratio of the Group for the past five years:

Year	Expense ratio
2005	108.4%
2004	106.3%
2003	120.6%
2002	125.9%
2001	110.8%

Commissions, override and other variable expenses are assumed to be equal to 100% of the first year premiums and 10% of the renewal premiums. Administrative expenses are assumed to be equal to 25% of the first year premiums and 5% of renewal premiums. Dividing actual expenses by the summation of the four components above gives the “Expense Ratio”.

a) Agency Operations

The number of agents as at 31 December 2005 increased to 1,696 from 1,268 in 2004. Agent productivity measured by Individual AFYP per Agent Month was HK$19,000, representing a 4.4% increase as compared to 2004.

In order to improve the professionalism and quality of our agents, we have set up the PCI Academy of Professional Development and a new training centre in Langham Place. The PCI Academy of Professional Development designs and provides different training programs for our agents to improve their selling skills and product knowledge, and to attain professional qualifications in the insurance industry.

We have also expanded our Agency Development team to build a more efficient and effective communication channel and to provide better support to our agency force.

During the year, the Group has launched several new products to accommodate the different needs of our policyholders.

Looking ahead, we will continue to expand our agency force, both in quantity and quality, diversify our product range and improve productivity.

b) Life Operations

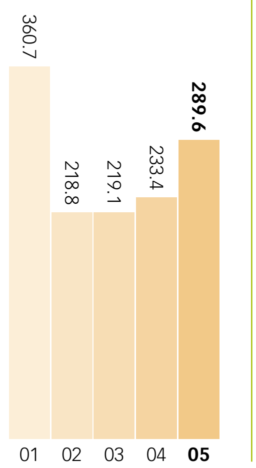
As at 31 December 2005, the total number of inforce policies was 294,457 compared to 277,489 in 2004, an increase of 6.1%. We also managed to increase the total premium by 8.2%.

13th month persistency rate has improved from 86.6% to 88.8%. Renewal ratio continued to improve to 100.3% as compared to 98.9% for 2004. Claim ratio has also improved from 99.2% in 2004 to 95.5% in 2005.

i) Individual single and first year premium

The following chart shows the Group's new sales based on individual single and first year premium over the last five years.

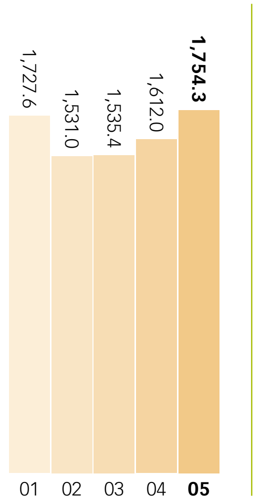
Individual single and first year premium
(HK$ million)



ii) Individual total premium

The following chart shows the Group's individual total premium over the last five years.

Individual total premium
(HK$ million)



iii) Renewal ratio

The renewal ratio has improved significantly in the last two years. This was mainly due to the stability of our agency force, our improved quality services to policyholders as well as our agents' professional ethics. The following is the Renewal Ratio of the Group for the past five years:

Year	Renewal ratio
2005	100.3%
2004	98.9%
2003	94.9%
2002	85.0%
2001	98.0%

Renewal Ratio is derived by assuming that 80% of first year premium will stay on the books the following year and 93% of the renewal premium will still be on the books the year after. Adding the two together produces the expected modeled renewal premium (EMRP). To arrive at the Renewal Ratio, the actual renewal premium in the following year is then divided by EMRP; a 100% Renewal Ratio means the Group's persistency is exactly as calculated whereas an above 100% Renewal Ratio means that the Group experienced a better persistency and vice versa.

iv) Claims experience

For the past five years, the Group's claim experiences have been better than the pricing assumptions. The following chart gives the Group's overall claims experience, on a claim ratio basis, over the last five years.

Year	Claims ratio
2005	95.5%
2004	99.2%
2003	91.0%
2002	95.0%
2001	97.4%

v) Products and Services

A total of 6 products were introduced in 2005 to cater for different needs of our existing and potential policyholders. One of these products is a unit-linked investment product with various payment periods. The other five products are insurance contracts aiming to supplement our existing portfolio to meet the need of our policyholders.

Starting in January of 2005, we worked on a project to implement a new policy administration system aiming to improve our operation efficiency and thus better serve our policyholders. The new system is targeted to be completed in 2007.

c) Group Insurance

For the period under review, the Group Insurance Department recorded HK$41.8 million in premiums with net loss of HK$1.4 million compared to HK$47.6 million and net profit of HK$0.7 million in 2004 respectively. The drop in premium and profit was due to fierce competition in the market place.

During 2005, systems were enhanced to provide internet enquiries of policy benefits, billing and claim information to agents, policyholders and their members for a faster and more efficient service.

d) Retirement Scheme Business and Mandatory Provident Fund

Since the conclusion of the Transfer Agreement with HSBC Life (International) Limited ("HSBC Life") in June 2002, the Group has successfully transferred 13,000 members and HK$180 million of assets to HSBC Life. Approximately HK$21 million and 1,800 members still remained with us as at 31 December 2005.

e) General Insurance

Total premiums for 2005 was HK$50.4 million of which HK$37.9 million came from our agency force and HK$12.4 million from PCI Services (H.K.) Ltd., a broking arm set up in 2003, representing an increase of 6.9% in total premiums as compared to 2004.

f) PCI Investment Management Limited ("PCIIM")

2005 was a year of consolidation for PCI Investment Management Limited. Total funds under management continued to grow, albeit modestly, to HK$11.6 billion as of the end of 2005. On 1 December 2005, PCIIM teamed up with Polaris, a Taiwanese financial services firm, to launch a Greater China hedge fund. The fund is sponsored by Gerken Capital Associates, an alternative asset manager based in San Francisco. The fund is structured for PCIIM to manage Hong Kong and China markets and for Polaris to focus on the Taiwan investments. Recent data suggested that global economic growth remains solid and more balanced going into 2006. While initial signs of a cooling-off in the US housing market has emerged, improved outlook in emerging Asia, Japan and Europe would help to counter-balance a moderate slowdown in US growth. However, we will continue to adopt a cautious approach in managing our portfolios as the current strained geopolitical situation in the Middle East, development of avian influenza and terrorist attack are all potential external shocks that can change the financial environment abruptly.

g) Human Resources

The Group had 303 employees as at 31 December 2005, an increase of 5.2% over 288 employees last year. Total remuneration (excluding Directors' fees) for the year was HK$125.1 million as compared to HK$155.6 million for 2004.

We place high value on our employees as they are our greatest assets to grow with the Group. We encourage our people to be the best in their roles by providing training in diversified fields that address both personal developments and work skills. We also provide workshops for staff at different levels to build team spirit and morale. Our staff were rewarded based on the Company performance as well as their personal performance and contribution.

2. China Expansion Plan

In June 2005, the Group subscribed for an Exchangeable Note for HK$508.3 million. The Note gave the Group the right to exchange into the entire issued share capital of two PRC companies which together hold a 22.09% interest in Sino Life Insurance Co. Ltd. ("Sino Life"). Since three representatives from the Group were not appointed to the board of Sino Life by 28 February 2006, the Note was cancelled and the Group received HK$521,866,004, being the principal amount of the Note and accrued interest. The Group will continue to look for suitable investment opportunities to gain access to the rapidly growing insurance market in China.

3. Capital Adequacy and Financing

As at 31 December 2005, the Group has cash and bank balances of HK$1,162.4 million and time deposits of HK$249.4 million. Invested assets increased by HK$859.0 million to HK$8,352.6 million, which was mainly due to premium income received.

As at 31 December 2005, the Group's total assets were HK$10,198.0 million and net assets were HK$2,616.6 million, an increase of 10.5% and 5.5% respectively as compared to 2004.

On a statutory reporting basis, the net assets of the Company's insurance subsidiary far exceeded the statutory net surplus required by the Hong Kong Insurance Regulations. The Group performs resilience tests regularly to examine its solvency position for movements in equity markets and interest rates and any potential risks will be drawn to the attention of the management.

As at 31 December 2005, the gearing ratio of the Group was 29.4%.

Gearing Ratio is the ratio of interest-bearing loans to capital and reserves.

4. Rating

Fitch Ratings, Moody's Investors Service, The A.M. Best Company and Standard & Poor's have all reaffirmed their financial strength ratings of "A-", "Baa2", "A- (Excellent)" and "BBB-" respectively on PCI in their 2005 annual review.

5. Embedded Value

Basis

Embedded value is the sum of the adjusted statutory net asset value plus the value of inforce business, adjusted for the cost of holding the required solvency margin.

The following are the key assumptions used :
Investment return:
7% per annum (2004: 7%)

Risk discount rate:
10% per annum (2004: 10%)

Embedded Value

The embedded value per share as at 31 December 2005 and the past four years are as follows:

Year	Embedded value per share (HK$)
2005	4.947
2004	4.327
2003	3.940
2002	3.557
2001	3.917

Value of one year's new business

The value of one year's new business is the sum of the discounted projected future after-tax statutory profits generated from the new business written during the year, adjusted for the cost of holding the required solvency margin. The assumptions used are the same as those used in the calculation of embedded value. For the year ended 31 December 2005, the value of new business is HK$60,648,000.

The methodology and actuarial assumptions used in the calculation of embedded value and value of new business as at 31 December 2005 have been reviewed and considered as reasonable by Watson Wyatt, an internationally renowned actuarial consulting firm.

Sensitivity

The following reflects our estimates of the embedded values associated with the changes in the assumptions.

	HK$
Base scenario	4.947
12% risk discount rate	4.589
90% lapse rate	5.125
90% operating expenses	5.008
90% mortality/morbidity rate	5.078
6.75% investment rate (no adjustment on dividends)	4.755

Other than the sensitivity at the 12% risk discount rate, all the other sensitivity results were performed by the Group and have not been reviewed by Watson Wyatt.

6. Investment

2005 was another volatile year for all financial markets as actions of the US Federal Reserve took centre stage. Most markets started the year with a lack of direction. In February, some higher than expected US inflation figures fueled concerns of more aggressive interest rate hikes and led to a sell-off in the fixed income markets. As a result of rising bond yields, equity markets worldwide moved sharply lower in March. However, the markets began to recover at the end of the second quarter because some softer than expected economic figures eased concerns of more aggressive monetary policy tightening. Although the markets performed well at the beginning of the third quarter, some harsh inflation comments by the Federal Reserve pushed prices significantly lower at the end of the third quarter. Weakness in both bond and equity markets continued for the month of

October. Once again, the markets recuperated quickly and ended the year very strongly amid ample liquidity and on hopes that the current interest rate cycle would soon peak. Despite the rise in energy prices and higher interest rates, the US economy showed remarkable strength in 2005. There has also been some pick up in recovery momentum in both Japan and the European economy. We continued to see funds flow into emerging markets on improving fundamentals.

Apart from the China expansion plan, there were no material acquisitions and disposal of subsidiaries and associated companies during the year.

		Fixed interest	Mortgage & loans	Cash	Equities	Others	Total
By currency	US$	32.6%	2.6%	10.7%	7.7%	11.6%	65.2%
	HK$	7.2%	1.4%	8.6%	4.1%	–	21.3%
	Others	–	–	(0.2%)	13.7%	–	13.5%
	Total	**39.8%**	**4.0%**	**19.1%**	**25.5%**	**11.6%**	**100.0%**
By geographic area	US	8.9%	–	–	1.0%	4.0%	13.9%
	Europe	4.6%	–	–	0.4%	–	5.0%
	Japan	0.3%	–	–	3.1%	1.0%	4.4%
	HK/China	10.5%	4.0%	19.1%	10.8%	3.2%	47.6%
	Other Asia	12.1%	–	–	9.3%	–	21.4%
	Others	3.4%	–	–	0.9%	3.4%	7.7%
	Total	**39.8%**	**4.0%**	**19.1%**	**25.5%**	**11.6%**	**100.0%**

7. Details of Charges on Group Assets

As at 31 December 2005, there were no charges on any of the Group's assets other than a US$2m (equivalent to HK$15.8m as a cash collateral) to the counterparty for the cross currency swap agreement entered by the Group during the year (2004: nil).

8. Purchase, Sale or Redemption of Listed Securities

A total of 5,862,000 ordinary shares of HK$1.00 each were repurchased by the Company during the year at prices ranging from HK$2.80 to HK$3.15 per share. The aggregate price paid by the Company for such repurchases, before share repurchase expenses, was HK$17,954,000.

The repurchased shares were cancelled and the issued share capital of the Company was reduced by the par value thereof. The premium paid on the repurchase of the shares and related expenses, in the amount of HK$12,172,000, was charged to the share premium account.

The repurchases of the Company's shares during the year were effected by the directors pursuant to the mandate from shareholders received at the previous annual general meeting, with a view to benefiting shareholders as a whole by enhancing the net asset value per share and earnings per share of the Group.

Except as disclosed above, neither the Company nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year.