Management Discussion and Analysis

Corporate Development in the Year 2006

(a) Rebranding of corporate identity

To align the corporate identity of the Group as a subsidiary of Public Bank Berhad ("Public Bank") of Malaysia and as a member of the Public Bank Group, the Group's principal operating subsidiary, JCG Finance Company, Limited changed its name to Public Finance Limited in January 2006 and the signage of its 40 branches was replaced with the new signage name reflecting the new name at the same time. Subsequently, at the Company's annual general meeting on 8 March 2006, the shareholders of the Company approved the change of the Company's name from JCG Holdings Limited to Public Financial Holdings Limited. The rebranding has had a positive impact to the image and financial standing of the Group as a member of Malaysia's Public Bank Group.

(b) Acquisition of Asia Commercial Bank

The Company successfully completed the acquisition of a 100% equity interest in Asia Commercial Bank Limited ("ACB"), a commercial bank incorporated in Hong Kong with a branch network of 12 branches in Hong Kong, one branch in Shenzhen, the PRC, and a representative office each in the cities of Shanghai and Shenyang in the PRC and in Taipei, Taiwan, on 30 May 2006.

The purchase consideration of ACB was partly financed by a rights issue of HK$2.6 billion, and a 3-year term loan of HK$2.0 billion. Upon completion of the acquisition of ACB, ACB changed its name to Public Bank (Hong Kong) Limited on 30 June 2006. The acquisition of Public Bank (Hong Kong) is expected to bring to the Group synergies of lower operating and funding costs, greater economies of scale and greater customer reach with a broader customer base and provide the Group with a platform to offer full banking services in Hong Kong as well as in the PRC through its Shenzhen branch.

(c) Business development of Public Bank (Hong Kong) after the acquisition by the Company

Total loans and advances (including trade bills) of Public Bank (Hong Kong) grew during the second half year of 2006 by 12.9% or HK$1.16 billion to HK$10.16 billion from HK$9.0 billion as at the end of June 2006. Customer deposits also grew 9.9% or HK$1.21 billion to HK$13.43 billion from HK$12.22 billion as at end of June 2006.

In December 2006, Public Bank (Hong Kong) opened 3 new branches in Hong Kong. A new sub-branch in Shenzhen is expected to open for business in February 2007, thereby bringing Public Bank (Hong Kong)'s branch network to a total of 17 branches.

For the year ended 31 December 2006, Public Bank (Hong Kong) recorded a significant improvement in profit after tax of 68.0% to HK$145.50 million from HK$86.59 million for the year ended 31 December 2005.

Financial Review

Group

For the year ended 31 December 2006, the Group recorded a profit after tax of HK$496.6 million, representing an increase of 11.3% or HK$50.3 million when compared to HK$446.3 million in the previous financial year. The increase in profit after tax was mainly attributed to the consolidation of the financial performance of Public Bank (Hong Kong) for the period from May 2006 to December 2006.

The Group's basic earnings per share for the year ended 31 December 2006 was HK$0.50 per share with the enlarged issued share capital after the rights issue of 1 rights share for every 2 shares held in April 2006. The directors have declared a first interim dividend of HK$0.05 per share in June 2006 and a second interim dividend of HK$0.20 per share in December 2006. The Directors do not recommend the payment of a final dividend, making a total dividend paid for the year of HK$0.25 per share.

Financial Review (Continued)

Group (Continued)

The Group's net interest income for the year ended 31 December 2006 increased by 18.8% or HK$144.4 million to HK$910.4 million when compared to the previous year. Interest income increased by 80.0% or HK$642.1 million to HK$1,444.8 million after consolidation of the interest income of Public Bank (Hong Kong). Correspondingly, interest expense increased by HK$497.8 million to HK$534.4 million, again mainly due to the consolidation of Public Bank (Hong Kong), and interest expense of approximately HK$65.30 million on the 3-year term loan to partly finance the acquisition of Public Bank (Hong Kong).

The Group's non-interest income increased by 54.3% or HK$72.8 million to HK$207.0 million after consolidation of Public Bank (Hong Kong).

During the year under review, the Group's operating expenses increased by 46.9% or HK$99.1 million to HK$310.7 million with the consolidation of Public Bank (Hong Kong). The Group's tight control over its operating costs together with operating synergies derived from the initial integration of some operations between Public Bank (Hong Kong) and Public Finance contributed to a low cost to operating income ratio of 27.8% for the year ended 31 December 2006.

However, the Group's impairment allowance for impaired assets rose by 32.8% or HK$52.1 million to HK$210.8 million mainly due to the increase in bad debts of personal loans of Public Finance arising from an increase in bankruptcy petitions and individual voluntary arrangement of its customers in 2006.

As at 31 December 2006, the Group's total loans and advance (including trade bills) was HK$13,775.0 million while total deposits from customers, financial institutions and issuance of certificates of deposits were HK$16,139.4 million.

Segmental information

The Group's business comprised mainly of two segments: retail and commercial banking and other businesses. Over 90% of the Group's operating income and profit before tax was contributed by retail and commercial banking. When compared to the previous year, the Group's operating income from retail and commercial banking increased by 22.5% or HK$198.8 million to HK$1,083.7 million after the consolidation of Public Bank (Hong Kong). Consequently, profit before tax from retail and commercial banking increased by 16.7% or HK$82.4 million to HK$574.2 million when compared to the previous year.

Contingent liabilities and commitments

The Group had no material contingent liabilities (other than those related to treasury, trade finance and loan commitments disclosed in the notes to the financial statements) at the end of the year under review. The Group also did not incur any material capital expenditure or entered into any material commitments in respect of capital expenditure during the year under review. The charge over a subsidiary's deposit placement with a bank as disclosed in the 2005 annual report was uplifted in the second half of 2006.

Operational Review

Funding and capital management

The main objective of the Group's funding activities and capital management is to ensure the availability of funds at reasonable cost to meet all contractual financial commitments, to fund loan growth and to generate reasonable returns from available funds. The Group also encourages its subsidiaries to be self-reliant in funding their business growth.

Operational Review (Continued)

Funding and capital management (Continued)

The Group relied principally on its internally generated capital, customer deposits, deposits from financial institutions, issuance of certificate of deposits and bank loans to fund its retail consumer financing business and commercial banking business. The Group's bank borrowing of HK$2.0 billion in the form of a 3-year term loan denominated in Hong Kong dollars at floating interest rates are to partly finance the acquisition cost of Public Bank (Hong Kong). This bank borrowing has increased the Group's gearing ratio from nil at the end of the previous year to 37.6% at the end of December 2006. The Group has entered into foreign exchange and interest rate contracts to reduce foreign exchange risk and interest rate risk exposures in its normal banking business.

Asset quality

Following the acquisition of Public Bank (Hong Kong), the Group's overdue and impaired loan ratio has improved significantly from 5.8% at the end of December 2005 to 2.4% at the end of June 2006, and further improved to 2.2% as at 31 December 2006. The asset quality of Public Bank (Hong Kong) had also improved with its overdue and impaired loan ratio reduced from 1.2% at the end of June 2006 to 0.8% as at the end of December 2006 as a result of more prudent credit risk management.

Human resources management and development

The objective of the Group's human resources management activities is to reward and recognise performing staff by providing a competitive remuneration package and implementing a sound performance appraisal system with appropriate incentives, and to promote career development and progression within the Group. Staff were enrolled for external training courses, seminars, professional and technical courses with appropriate sponsorship from the Group in order to upgrade their technical knowledge and skills, to increase their awareness of the market and technological changes, and to improve their business acumen. The Group also encourage staff to participate in social activities organised to promote team spirit and building a cohesive workforce as well as to serve the community at large as part of corporate responsibility.

To further retain, motivate and enhance staff morale, options to subscribe for 66,526,000 shares in the Company were granted to employees of the Group in May 2005 pursuant to the Group's share option scheme approved by shareholders on 28 February 2002. As at the end of December 2006, options to subscribe for 43,068,000 shares in the Company remained unexercised.

As at the end of December 2006, the Group's staff force increased to over 800 employees with the inclusion of the staff from Public Bank (Hong Kong). For the year ended 31 December 2006, the Group's staff cost amounted to HK$169.3 million.

Prospects

The economic outlook of Hong Kong is expected to remain positive in 2007. However, there remains uncertainties in the trend of interest rate movements which may have an impact on the economic growth. With the improved employment market and expected positive wage growth, the Hong Kong economy is expected to sustain its growth momentum and consumer spending is expected to increase leading to higher demand for consumer financing.

With the acquisition of Public Bank (Hong Kong), the Group will focus on expanding its retail and commercial banking business through Public Bank (Hong Kong) and its consumer financing business through Public Finance. The Group will continue to seek further synergies in lowering operating costs and greater economies of scale through integration of the support functions of Public Bank (Hong Kong) and Public Finance where appropriate and cross-selling through the combined branch network of Public Finance and Public Bank (Hong Kong) to a wider customer base. Public Bank (Hong Kong) will continue its branch expansion programme and the Group will continue to target selected market segments with aggressive marketing promotions and business strategies to grow its retail and commercial banking and consumer financing businesses.