

# REPORT FROM CHIEF EXECUTIVE OFFICER

Dear friends and fellow shareholders

2002 proved to be a challenging year for our Group. The year was characterized by war on terrorism, uncertain global economic environment, accounting scandal putting continuing pressure on profits, and a much weaker equity market, each posing significant challenges.

During the year under review, our net profit decreased 62% to \$77 million from record profit 2001 reflecting significantly reduced industry wide activity. The Group's shareholders' funds continued to grow from HK\$718 million to HK\$771 million (with minimal borrowings).

In this difficult environment, we continued to take a focused approach in developing and managing our franchise. We are committed to compete in markets where we believe we can add value and provide solutions. This approach is exemplified by the deepening of our Corporate Finance and Research divisions' resources; continuation of building our "core" China presence and the continued expansion of our Fund Management business.

Successful cost containment in our Brokerage division has also made an important contribution in maintaining a profit. Our Group's cost-to-income ratio in our Brokerage division has declined from 73% in the previous corresponding year to 69% this year. This was a substantial improvement and we expect to continue to successfully constrain our expense growth through ongoing focus on efficiency initiatives.

## INVESTMENT IN SECURITIES

The tragic events in the United States on Sept 11 2001, coupled with a wave of major corporate accounting scandals, mean that recovery in the major global economies continues to be uncertain, putting at risk the sustainability of the equities markets.

This uncertainty in the equity markets was one of the factors that affected investment returns in this Division.

In view of this uncertainty and the markets trading erratically and not sustaining any trends, the Division conducted a prudent assessment of the trading opportunities. After this careful risk management review, the Division decided to divert part of the resources to convertible bonds investment and loans, the aim being to provide a better sustainable return with lower volatility while maintaining an upside capability to invest in companies at a lower entry price in the future. However, this comes at a cost, in that the investments will not benefit from the full upside swing, if such upside eventuates.

All of these factors contributed to a reduced operating profit of HK\$51 million compared to HK\$189 million in the previous corresponding year.

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## INVESTMENT IN SECURITIES (Continued)

Consistent with past practice of building a strong portfolio to support its business, the Group made significant investment in Shenzhen Investments Ltd. However, the Division's short term performance is subject to market and economic conditions which appear to deteriorate in the fourth quarter of the year.

## BROKERAGE AND EQUITY CAPITAL MARKET ("ECM")

In the face of minimal or negative economic growth, as well as continued high unemployment rate in Hong Kong, average daily market turnover shrank by 20% from HK\$9.5 billion in the first half of 2001 to HK\$7.6 billion in the first half of 2002. Reflecting the depressed market conditions, our Brokerage and ECM divisions' revenue dropped. Gross brokerage commission dropped from HK\$43 million to HK\$16 million and gross ECM fee income decreased by 22% to HK\$25 million (2001 : HK\$32 million).

As part of a re-balancing of resources so as to better reflect revenue/cost base, we re-deployed certain resources in these two divisions to other divisions so as to be more customer-focused. This re-balancing measure caused the operating profit of our Brokerage and ECM divisions remained approximately the same level as previous corresponding profit of HK\$26 million.

As we predicted in the first half, we have seen deterioration in earnings from brokerage operations as a result of drastic fall in average daily turnover of securities transactions in Hong Kong. This has been evidenced particularly through some defaults of local brokerage houses and branch closures by other broker-dealers. To reflect this changing landscape arising from global economic uncertainty, as well as the events of September 11th, we decided to dispose our holdings in a newly acquired securities house back to previous management, and to close down all our branch network.

As to why branch closures were necessary - we could offer a number of reasons, but more importantly is to look at the changing landscape of securities trading in Hong Kong. The first quarter of 2002 average daily turnover of securities trading in Hong Kong averages approximately HK\$7.1 billion a day, Category A broker (1-14 participants) took approximately 48% of the markets; the next 15-65 participants, Category B brokers, took 31%, while the next tier - Category C brokers numbering approximately 440 participants only had approximately 21% of the market, which means shrinking profit or increasing loss for over 85% of exchange participants.

That is the explanation – but the important thing is the corrective measures adopted to ensure our clients will continue to have adequate trading securities access. When we found that the branch network was not viable, we put in place a more cost-effective and hence more sustainable trading facility in the head office.

## BROKERAGE AND EQUITY CAPITAL MARKET (“ECM”) (Continued)

Recognizing the changing environment where customer needs have heightening the demand for research information and advice, we have strengthened our Research Department by recruiting senior experienced research analysts and an economist to our Research Department. The appointments have dramatically raised the profile of the Group’s research by greatly increasing direct contact between research analysts and clients.

By broadening the relationship through integrating clients and research, we believe our research will be able to pursue a higher profile than in previous years, thus enabling the sales team to develop new trading strategies in response to changing requirements of our client base.

To underpin this commitment of serving our clients well, we have separated our research products from underwriting and corporate finance work. We believe this commitment is important to ensure quality and integrity of the firm’s research process.

Consistent with this context, we have rebranded our research products under the brand name of “LiberResearch”.

LiberResearch will focus on in-depth and fundamental analysis of small and medium sized companies in Hong Kong, the PRC and North Asia. The products include individual company reports, economics research, market overview, and the information updates, which are distributed to our institutional clients.

## CORPORATE FINANCE

The Division’s progress last year was characterized by building the fundamentals to improve its long-term profitability. In line with this strategy, the Division recruited additional experienced professionals. With these recruitments, we deepened our resource pool by around 60% in experienced professionals.

However, the business remains leveraged to market conditions. For the year 2002, the market remained weak and the general market fund raising activities contracted as compared to the previous year.

As at 30th June 2002, the Division’s net operating profit was HK\$7 million down slightly from HK\$8 million the previous year.

More importantly, activities remained high and at year end, the Division was appointed to 90 deals which included 24 initial public offerings (“IPOs”), 39 corporate advisory assignments, 25 capital raising exercises and 2 merger and acquisition transactions, an increase of 50% compared to last year activities. Unfortunately, deal size shrunk with corresponding decrease in margins.

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## CORPORATE FINANCE (Continued)

The Group believes the fundamentals are in place to take advantage of opportunities that arise. There is encouraging evidence that the build up of our resources has borne fruit as evidenced by increased mandates being granted at the latter part of the financial year.

The Group intends to become the natural choice, as a sponsor/underwriter for any primary transactions including IPOs for any major Chinese small and medium size enterprises capital raisings.

## ASSET AND FUND MANAGEMENT

The Division recorded strong financial performance for the year under review. Operating profit grew to HK\$10 million compare to a loss of HK\$2 million from the corresponding year. This result was achieved partly as a result of additional revenue earned from offering ad hoc investment and asset management advisory services, as well as close focus on financial controls, enhanced expense accountability and fund performance.

The results are especially gratifying given the weakness in capital markets, deteriorating investor confidence and depressed activity in general fund management business.

Consistent with last year's strategy, the Division continued to focus on its strategy of organic growth, innovative products, targeted acquisition and performance.

### Organic Growth

A program of active new client relationship management targeted at small and medium sized enterprises' mandatory provident funds (MPF) business helped us to maximize performance and efficiency.

Through the troubled markets of 2002, our customer base of MPF contributors increased 44% while yearly contribution amounts grew 213% compared to the pervious corresponding year. We believe this customer-centric service will enhance our competitive strength in the Hong Kong MPF market.

### Innovative Products

During the year, the Division promoted a new fund named 'Kingsway Capital Market Portfolio' which is primarily designed to invest in IPO issues. The fund was well supported and performed well in spite of the year's turbulent markets and investor uncertainty.

The Group also launched a private equity management fund jointly with Sinochem Hong Kong (Holdings) Co. Ltd. The joint venture fund will engage in direct pre-IPO investments predominately in the Greater China region. Up to the date of this report, the joint venture fund made a number of new investments and expects that these investments will contribute to the Group's financial performance in the coming year.

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## ASSET AND FUND MANAGEMENT (Continued)

### Innovative Products (Continued)

The launch of these two funds has added a new layer to our core mutual fund business, where we can provide different investment opportunities at all stages for a company's capital raising activities to meet investment needs of investors.

### Targeted Acquisition

During the year, the Group acquired Kingsway-HIA Investment Products Limited (formerly known as Haussmann International Asia Ltd), the Asian Pacific distribution arm of the Deutsche Bank Group in Asia. This acquisition gave us an exclusive right to distribute European and Global equity funds under the Haussmann label in Asia. We hope, through this acquisition, we can capture value through extending our distribution network and relationships, benefit from economy of scale and to broaden the depth and breadth in our products and service range.

### Performance

The Division continues to receive recognition for excellence in fund management. During the year, Kingsway Fund Management Ltd took first and second places for best performing equity funds in the inaugural year (2001) of Hong Kong's Mandatory Provident Fund Scheme. Another milestone achieved was Kingsway Korea Fund with an exceptional return of 25.4%. This was the highest return of all 300 MPF constituent funds across all investment categories.

The Hong Kong Investment Funds Associations also ranked Kingsway Pacific Fund as the top performing fund under the Pacific Equity category for the year 2001.

## IMPROVING CHINA GEOGRAPHICAL PRESENCE

Recognizing the importance of our China's operation, we have continued the process of building our infrastructure amidst a difficult economic environment. Our progress last year was characterized by strategic development of our delivery channels (through our wholly owned advisory and consultancy company in China) around infrastructure, services and geographies.

We are in the process of negotiating strategic partnerships with PRC based financial institutions that will bring new revenue streams and add to our future growth.

We are also in the process of opening new branches and representative offices in China for greater presence and efficiency.

## LIQUIDITY AND FINANCING RESOURCES MANAGEMENT

Total assets decreased by HK\$18 million (2%) to HK\$909 million which is represented substantially by current assets.

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## LIQUIDITY AND FINANCING RESOURCES MANAGEMENT (Continued)

Over 81% of our Group's net assets at 30th June 2002 was current in nature. The Group's net current assets increased by 2% to HK\$631 million compared to HK\$617 million at last financial year end. Current assets, including bank balances, investments and receivables, decreased from HK\$821 million to HK\$759 million, while current liabilities which were mainly composed of payables and provision for taxation declined with greater extent from HK\$204 million to HK\$128 million.

The Group generally finances its operations with internally generated cash flows. The total banking facilities available to the Group exceeded HK\$230 million of which only a negligible borrowing of HK\$1.5 million was drawn at year end.

The Group's interests in land and building in Hong Kong with a carrying value of HK\$12 million (2001: HK\$12 million) as well as fixed deposits of HK\$2 million (2001: HK\$30,000,000) were pledged as securities against bank overdraft facilities and bank loan granted to the Group respectively.

## EMPLOYMENT, TRAINING AND DEVELOPMENT POLICIES

The number of full time employees decreased from 143 to 132 which was mainly due to enhanced cost control measures.

Salaries are reviewed annually in conjunction with the employee performance appraisals and the results of the Group as a whole. The Group has provided in-house training courses to all staff in particular professional staff registered with The Securities and Futures Commission to meet the mandatory continuous profession training requirement.

The Group also runs an employee share option scheme. This scheme is available to all the full time employees. Details of the scheme are set out in the Report of the Directors under the paragraph "Share options". As at 30th June 2002, there are 77,031,000 outstanding options (2001 : 74,290,000), with an exercise price of HK\$0.7 to HK\$1.42 exercisable between 28th March 2001 to 28th December 2006.



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## CORPORATE GOVERNANCE

Our Group has always been committed to conduct our business ethically and in a way that is transparent, accountable to shareholders and the community, and having an independent and effective board.

We believe our corporate governance practices, as a regulated entity and also as a listed company, are appropriately rigorous and of high standard.

As we have done in the previous year, we have included a separate statement on our corporate governance practices in detail. Please refer to page 13 for further details.

## COMMUNITY

In line with our business philosophy of giving to the poor and the needy, despite our falling profit, we have contributed about HK\$800,000 to charitable organization.

## OUTLOOK

The past year was a year marked by the tragic events in the United States in September 2001, global financial shocks, troubled markets, economic uncertainties and disappearing investor confidence. This means, there is a considerable degree of uncertainty as to the direction that markets will take over the next financial year. This uncertainty will affect performance from investment in securities and may dampen revenues on Group activities that are predicated on market activity.

The year under review was also a year when we put our efforts to build a stronger and perhaps a leaner company. The objective of such a review is to enhance our franchise as a leading local investment bank, which will be, among other things, efficient and competitive, financially sound, integrated and balanced, and able to capitalize appropriately on the latest available technology.

Looking ahead, the Group's key focus remains in the development of our brand that embodies the core values and cultures that we have started to establish. Geographically, we remain focused on expanding our business in Hong Kong and China. We are confident that we would be able to meet the challenges and seize the opportunities that lie ahead.

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Within this environment, our staff have demonstrated remarkable capacity for achievement. On behalf of the Board, I thank them for their hard work and dedication.

On a personal level, I would also like to take this opportunity to express my deepest appreciation to the Board for their continuing strategic guidance.

More importantly, on behalf of the Group, I wish to thank our customers, stakeholders, business partners and collaborators and you, our shareholders, for your unwavering and invaluable support.

**William Ka Chung Lam**

*Chief Executive Officer*

7th October 2002