MANAGEMENT DISCUSSION AND ANALYSIS

Financial Highlights

Throughout 2002 and into 2003, the Hong Kong economic conditions remained anaemic which further weakened the equity market sentiments. During the period under review, loss attributable to shareholders amounted to HK$131 million compared with previous comparable period of a profit of HK$70 million. The large loss posted was because the Group has made a significant provision in respect of one particular investment. Had the investment been valued at its market price at the balance sheet date, an unrealised profit of approximately HK$134 million would have been recognised by the Group and the profit attributable to shareholders for the current period would be HK$2.7 million.

Under such challenging market conditions, we continued our strategy of closing our retail branches, while at the same time strengthening our core business of Corporate Finance, Equity Capital Market ("ECM"), Research and Fund Management teams. Since the audited balance sheet date of 30 June 2002, we continued to expand our China operation to compete in markets which offer better growth potential and in which, we believe, our competitive edge is.

Brokerage and Equity Capital Market ("ECM")

With a turbulent political environment, negative economic growth and unfavourable investment sentiments prevailing in the global markets, the average daily turnover in the Hong Kong equity market shrank by 19% from HK$8.2 billion in 2001 to HK$6.65 billion in 2002. The investment sentiment was especially weak in the second half of 2002. The average daily turnover in the Hong Kong equity market dropped further to HK$4.9 billion in December 2002, down 27% from the corresponding period in 2001. Reflecting this continued weakness in the equity market, gross brokerage commission of the Group dropped by 45% and gross ECM fee income decreased by 49% from the corresponding period in 2001.

In the face of such difficult market conditions, the Brokerage and ECM divisions took positive actions to improve our business and to maintain profitability. On one hand, as mentioned in our last annual report, we streamlined our retail broking business and closed down all our branch network in the period. On the other hand, we focused on the expansion of our institutional sales and ECM teams to strengthen our revenue base.

During the period, the Group completed 19 ECM deals and the Brokerage and ECM divisions contributed HK$5.8 million to the profit before taxation of the Group.

Corporate Finance

Our strategy in the previous year to strengthen and expand our Corporate Finance team found its reward in the current period. Despite the unfavourable market conditions, our Corporate Finance team increased its market share and raised its gross fee income substantially by 51% to over HK$14 million. During the period, the number of deals increased from 34 to 41 which included 10 IPOs, 5 placings, 2 rights issues, 1 mergers and acquisitions and 23 corporate advisory works.

However, due to a squeeze on margins caused by competition in a depressed market, operating profit of the Corporate Finance division decreased to HK$3.1 million. In the short term, the performance depends on the market conditions and sentiments. However, the Group will take the opportunity in the current environment to improve market share and to expand in our niche market, as an investment bank, for the small and medium size enterprises.

Asset and Fund Management

In the face of weak market sentiments, the gross fee incomes of the division decreased to HK$12 million and the division posted a loss of HK$1.4 million.

Despite the adverse market conditions during the period, our customer base of Mandatory Provident Fund ("MPF") contributors increased by 39% while total contribution amount grew at 122% compared with previous corresponding period. It proves that our continuous effort in deepening our client relationship, particularly with small and medium sized enterprises, is effective and has helped our MPF business to achieve phenomenon growth.

In addition to our dedicated customer services, good investment return is another dominant factor that helped us to attract new clients. As at the end of 2002, our Kingsway Korea Fund was ranked 1st while our Kingsway Asia Pacific (ex-Hong Kong) Fund was ranked 4th among all 78 MPF equity funds in Hong Kong since inception. Likewise, our Kingsway Hong Kong SAR Fund was ranked 2nd among 17 Hong Kong equity funds over the same period. (Source: Standard & Poor's Micropal)

We strongly believe that our customer-centric services and market performance will continue to enhance our competitive strength in Hong Kong MPF market.

While our asset and fund management division is still at an early stage of development, we believe in the long term, positioning Kingsway as a fund manager for Greater China is essential to the division's growth strategy. To this end, we are exploring opportunities in China to participate in joint ventures.

Investment in Securities

On a backdrop of a gloomy global investment market caused by the culminating political conflicts and sluggish economy in the period, the worsening structural fiscal deficit and rising unemployment in Hong Kong added gloom to the Hong Kong equity market. The Hang Seng Index closed at the end of 2002 at 9321.29, a decrease of 18% from the year end of 2001.

This crisis of confidence and the woeful economic conditions certainly rattled the investing public, and there is an obvious correlation between the economic conditions and the short term move in the markets which affected profitability of the division. During the period, the division posted a loss of HK$137 million. The loss can be more fully explained by reading the condensed consolidated profit and loss account of the Group. With all these uncertainties, the Group is cautious towards the short term market performance. However, we do believe the maintenance of a portfolio of potentially undervalued marketable securities will bring fruitful return once their true values are recognised and will fuel our long term growth and we do believe our Group possesses such a portfolio.

MANAGEMENT DISCUSSION AND ANALYSIS (Continued)

China Operation

With continuous strong economic growth and the development of the financial markets in China, development of our financial services business into Mainland China is our long term strategy. On one hand, we are in the process of opening new branches and representative offices in strategic locations in China for stronger presence and closer supervision. In addition to our existing Beijing office, our Shanghai office is opened. On the other hand, we will study the possibility of joint ventures with reputable China financial institutions in order to tap into the enormous business opportunities emerged from the development of the China economy. While contribution from the China operation is not expected to be material in the short term, the China operation is a driver for our long term growth.

Outlook

With sustained fiscal deficits, high unemployment and slow or negative economic growth, Hong Kong is experiencing one of its most difficult time in decades. The culminating conflicts in international politics and sluggish global economy bring further uncertainties to the economic outlook of Hong Kong in the near term.

Given the market uncertainties, the Group continuously reviews our business to look for means to streamline our operations. In particular, the Group re-directs resources to strengthen our Corporate Finance, ECM and Institutional Sales teams with a view to capture market share in the short and medium term when most competitors are contracting their operations. At the same time, we have also been implementing a wide range of key corporate governance and risk management initiatives to mitigate any regulatory risks.

Despite all the political and economic uncertainties, we will consistently focus on our business development and monitor our long term game plan. China operation is a key play in our long range plan. After such a lengthy recession, there may be a sustained recovery. What we are doing is to ensure that we are well-positioned to benefit from the recovery and we are confident that we will be there.

LIQUIDITY AND FINANCING RESOURCES

The Group continued to maintain a low gearing ratio, calculated as a percentage of bank borrowings over shareholders' funds, at 4.5% at the balance sheet date. In view of the low interest rate environment, we cautiously exploited business opportunities to employ our assets in a more efficient way to get higher returns. The Group generally finances its investments with internal cash flows. The total bank facilities well exceeded HK$250 million, of which only HK$28 million was utilised at the balance sheet date.