

# Chief Executive's Statement Financial and Operation Review

## The Markets

The market faced a lot of challenges during the 2005 Financial Year. The rising interest rates, the high price of crude oil and other natural resources and uncertainties associated with the macroeconomic austerity measures in China had all affected the market. However, the continuous recovery of the property markets, the reduction in unemployment rate and the buoyant retail market helped to keep the market at a relatively high level. The IPO market remained quiet for most part of the year but there were two short active periods at December 2004 and June 2005.

The Hang Seng Index increased from 12,286 at the end of June 2004 to 14,230 at the end of December 2004. The index was trading at a narrow range below the 14,200 level during the first six months of 2005. The index closed at 14,201 at end of June 2005. The market became more active close to the 2005 Financial Year end and the bullish sentiments extended to the period after the year end.

Monthly market turnover continued to improve during the 2005 Financial Year compared with last year. The monthly turnover increased from HK\$225 billion in July 2004 to peak at HK\$438 billion in November 2004. The monthly turnover stayed at a relatively high level throughout the first six months of 2005 and stood at HK\$378 billion in June 2005. Total funds raised from IPO listings on the Main Board increased from HK\$39.5 billion in the second half of 2004 to HK\$62.61 billion in the first half of 2005. However, the IPO market was dominated by a few listings of Chinese companies with very large capitalisation. The mid to low tier markets were very quiet. Funds raised from IPO listings on the GEM Board, which usually cater for those smaller companies, reduced from HK\$0.4 billion in second half of 2004 to HK\$82 million in the first half of 2005.

## Business Activities

### Financial Highlights

The Board is pleased to announce that the Group continued to perform well in the 2005 Financial Year. Profit attributable to shareholders is HK\$84.6 million, which is approximately 3.9% better than the results in the corresponding period. Trading gain on investments reduced by 26.2% as the effect of exponential recovery from SARS last year was not repeated. Commission and fee income increased by 23.3% to HK\$91.7 million in the 2005 Financial Year as a result of the better performance of the Brokerage and the Investment Banking divisions. Interest and dividend income of HK\$16.4 million was marginally higher than last year. The effect of the reduced average level of loan receivables was only partially offset by the rising interest rate throughout the 2005 Financial Year. The reduction in interest income was compensated by higher dividend payout from the investment portfolio held. The increase in general and administrative expenses by 12% to HK\$110.3 million was mainly due to increase in staff related costs to match the increased business activities, which was partly offset by the tight cost control measures imposed by management and recovery of doubtful debts provided for in prior periods.

The Group was the Sponsor and Global Coordinator and Bookrunner for the International Placing and Hong Kong Public Offer for Xinyi Glass Holdings Limited ("Xinyi Glass") in February 2005. Including the exercise of an over allotment option, Xinyi Glass raised a total of HK\$836 million. The deal generated substantial commission and fee income for the Group.

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The Group has made some minor adjustments to the realignment described in our 2004 annual report after further consideration. We are pleased to report that the results for the year are analysed according to new segmental classifications. There are now two business groups: the Clients Services Group and the Proprietary Investment Group. The Clients Services Group is further divided into four major divisions, including Brokerage, Investment Banking, Private Equity and Wealth Management. Similarly, the Proprietary Investment Group is sub-divided into Merchant Banking and Investment in Securities. Management firmly believes that this realignment will enhance our ability to provide clients with innovative and integrated products and services.

In February 2005, the Board declared an interim dividend of 0.33 HK cent per share, which was paid in March 2005. The Board has recommended paying a final dividend of 0.67 HK cent per share, subject to the approval of the shareholders at the coming annual general meeting.

*Brokerage*

Total revenues of the division increased by 20.5% to HK\$56.4 million in the 2005 Financial Year. The division contributed HK\$1 million to the profit before taxation of the Group.

The Group is focused on providing its clients with quality execution services. There is a balanced mix of income from institutional and retail clients. LiberResearch, our research product, is well received by our clients for in-depth local knowledge and bottom-up approach to stock picks. The awards from leading industry magazines demonstrate market recognition to the professional teams in Kingsway. The Group has commenced a project to upgrade its computer trading platform to further improve our capability to serve quality clients. A major milestone for this project is the link up with the E\*Trade Japan trading platform earlier this year.

*Investment Banking*

The division generated a revenue of HK\$47.4 million for the year, which increased by HK\$5.6 million over last year. However, due to a reduction in percentage shares of other sub-agents, the contribution improved and net divisional profit was HK\$12.8 million, which represented an increase of 7.5% over last year.

In line with our strategy to become the preferred financial solutions provider, we have been actively pursuing transactions in the mid-market segment. The successful listing of Xinyi Glass reinforced our belief that the Group is capable of handling larger assignments.

*Wealth Management*

During the year under review, the division recorded HK\$16.9 million in revenue, of which HK\$14.9 million was received from group companies for providing investment advisory and consultancy services. Net contribution to the Group results was HK\$5.8 million.

Our MPF funds' assets under management rose 57% on a year-on-year basis. The number of MPF scheme participants also increased by 24.8% over the same period. The continuous growth over the past few years was due to the industrious work of the MPF team.

Assets under management for our major authorised unit trusts rose by 48% on a year-on-year basis. Kingsway Middle Kingdom Fund achieved the highest growth in per unit net asset value of 25%. It is one of the Eligible Collective Investment Schemes under the Capital Investment Entrant Scheme approved by the Hong Kong Immigration Department.

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The division is looking beyond Hong Kong into Greater China for growth. The Group, through its joint venture in China, has submitted an application to China Securities Regulatory Commission to set up a joint venture fund management company ("JV Company") based in Shanghai. The Group is committed to inject an equivalent of RMB33 million for a 33% equity interest in the JV Company.

### *Private Equity*

The division contributed HK\$6.6 million in revenue and HK\$3.7 million in net profit. The two established funds achieved good growth in NAV during the 2005 Financial Year and the team is working on a number of other opportunities.

Sinochem Kingsway Capital Inc, a private equity fund co-sponsored with Sinochem Group, achieved a gross return of 21.6% in the 2005 Financial Year on its investment in a steel company in China. Kingsway SBF Investment, another private equity fund co-sponsored with Softbank Investment Corporation, invested in Xinyi Glass before its IPO and achieved a net return of 17.4% for the 2005 Financial Year.

### *Investment in Securities and Merchant Banking*

Overall, the two segments contributed a combined revenue of HK\$90.1 million and segment results of HK\$59.2 million to the Group.

Our 2004 financial year was the first period after the market recovered from SARS and we achieved very good returns from our investment holding. However, the 2004 segment results were affected by provision for diminution in value in some long term investments as these investee companies were unable to recover from the epidemic.

In 2005, the contribution from the Merchant Banking segment was reduced. The market already started at a higher level and there were less investment opportunities available. In addition, as a result of the Group's strategy to diversify its investments into real estate investments in China, less resources were allocated for the portfolio investments. Nevertheless, as the market was more active, the fall in Merchant Banking results was compensated by better trading results in our Investment in Securities segment, which focused on shorter holding period trading for management of our treasury and liquidity position.

## Important Appointments

With effect from 22 September 2004, Mr Stanley Kam Chuen Ko was appointed as an Independent Non-executive Director, the Chairman of the Compensation Committee and a Member of the Audit Committee of the Company. On the same date, Ms Rebecca Yuk Fung Lau and Mr Patrick Sun were appointed as Executive Directors of the Company. Subsequent to their appointment to the Board, Mr Ko and Ms Lau were appointed as members of the Corporate Governance Committee upon its formation during this financial year.

Mr Michael Wai Chung Wu, Executive Director of the Company, was re-designated as a Non-executive Director with effect from 1 January 2005. Mr Wu was also appointed as the Chairman of the Corporate Governance Committee upon its formation during this financial year.

## Liquidity and Financial Resources

Total assets as at end of June 2005 were HK\$1,256 million, of which approximately 94.4% was current in nature. Net current assets were HK\$604 million and accounted for approximately 95.8% of the net assets of the Group as at end of June 2005.

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The Group generally finances its operations from internal resources. The Group has drawn approximately HK\$65 million of bank credit facility and approximately HK\$80.7 million of other short term loans. The funding was mainly used for the financing business of the Group. All of the borrowings at the end of June 2005 were short term in nature, except two mortgage loans of approximately HK\$7 million secured by the Company's office premises at Beijing and Shenzhen. They were mainly denominated in Hong Kong dollar or United States dollar to match the funding requirements of our business operations. At the year end, the Group's gearing ratio, calculated as a percentage of bank borrowings over shareholders' fund, was approximately 10.3%.

The Group's properties with a carrying value of HK\$13.1 million were pledged as security against bank loans and credit facilities granted to the Group.

**Foreign Exchange Exposure**

The Group's assets are mainly in Hong Kong and most of the monetary assets and liabilities of the Group are denominated in Hong Kong dollars. The Group has purchased and committed to purchase properties in the PRC for its own use and investment purposes. In addition, the Group also committed to inject share capital in RMB to the JV Company in the PRC. These assets are financed by internal resources and loans denominated in either Hong Kong dollar or US dollar. In view of the recent revaluation of the RMB in July and the subsequent stability in the exchange rate against Hong Kong and US dollars, the Group considers that there is no need to hedge these assets denominated in RMB. Management will monitor the situation closely and will introduce suitable hedging measures if there are any adverse changes. The Group does not have other material exposure to fluctuation in exchange rates and no hedging instruments are used.

**Employment, Training and Development Policies**

There was a marginal increase in staff resources to match with the increased activities level. The number of full time employees increased from 139 last year to 145 at the end of the 2005 Financial Year.

Remunerations and bonus are based on performance and are reviewed annually in conjunction with the annual employee performance appraisal and with reference to the results of the division to which the employee belongs and the Group as a whole.

The Group provides a full induction program and in-house training courses to all staff and in particular, to professional staff registered with relevant regulatory bodies to meet their mandatory continuous professional training requirements.

The Group also operates an employee share option scheme. The scheme is available to all full time employees of the Group. Details of the scheme are set out in the section "Share Options" of the Report of the Directors.

**Corporate Governance**

The Group is committed to conducting our business ethically and in a way that is transparent, accountable to shareholders and the community, and under the governance of 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. The Group reviews its practices on a regular basis to ensure that any new developments in best practices are reviewed and considered by the Group.

As in previous years, we have included a separate and detailed statement on our corporate governance practices under the heading "Corporate Governance Report".

## Community

In line with our philosophy of being a responsible corporate citizen, the Group contributed approximately HK\$1 million to charitable organisations during the 2005 Financial Year. Please refer to our Social Responsibility Report for further details.

## Outlook

The market became very active in June 2005 and the bullish sentiments extended into the first two months of the new financial year. The market is looking forward to the listing of the major state owned banks in the remainder of the year. The Brokerage and the Investment Banking divisions will benefit from any improvement in market sentiments.

With increased recognition from the market for our Brokerage services as evidenced by the awards from industry publications for two consecutive years, the Group will continue to develop and enhance its capabilities to serve our clients better. Our project to upgrade the computer trading platform will extend into the new financial year.

In order to diversify the Group's investment portfolio, the Group acquired a major property interest in Beijing in April 2005. The Group is evaluating the options available, including the set up of real estate investment trusts. To explore and benefit from the opportunities available for this new asset class, the Group has set up a new Real Estate Services department under our Private Equity segment in the new financial year. The department will focus on the use of financial techniques to enhance the return from real estate holdings.

The successful formation of our five pillars platform could not have been accomplished without the hard work, faith and perseverance of our outstanding team. Now we must go forward to build upon what we have accomplished so far. On behalf of the Board, I would like to congratulate and thank our staff for the tremendous strides we have made. I look forward to the year ahead as we continue to grow and deliver results.

Of equal importance is the guidance and support I have received from my fellow Board members. I am honored to work with such experienced and esteemed Board members. Our thanks and appreciation go to Ms Mary Yuk Sin Lam who served as Executive Director and retired in November 2004; and to Dr Douglas Ching Shan Hui, who served as Non-executive Director and retired in November 2004. Ms Mary Yuk Sin Lam continues to serve as Group Managing Director of Kingsway Financial Services Group Limited.

On behalf of the Board, I would like to thank our customers, stakeholders, business partners and you, our shareholders for your commitment and support throughout the year.

**William Ka Chung Lam**  
*Chief Executive Officer*

16 September 2005