The Market

The rising interest rates, the high price of crude oil and other natural resources, uncertainties associated with the macroeconomic austerity measures in the People's Republic of China ("PRC") and geo-political tension in the Middle East and other parts of the world were all affecting the market. However, the continuous recovery of the property market and the hope that interest rate hikes would end soon provided some positive stimulus for the market. The IPO market was dominated by the listing of big PRC state owned companies. The Hong Kong market reached post tech bubble high in May 2006 but entered into a sharp correction thereafter following the global market trend.

The Hang Seng Index increased from 14,201 at the end of June 2005 to 14,876 at the end of December 2005 and was trading within a narrow range during that period. The market became more active in 2006 and closed at 16,268 at end of June 2006. The Hang Seng index reached a post tech bubble high of over 17,300 on 8 May 2006.

Monthly market turnover continued to improve during the Financial Year compared with last year. The monthly turnover was close to HK$400 billion during most of the months from July to December 2005. The market turnover further increased in 2006 and reached a peak of HK$709 billion in May 2006. Total funds raised from IPO listings on the Main Board increased from HK$62.6 billion in the first calendar half of 2005 to HK$99.9 billion in the second calendar half of 2005. The figure reached a new recent high of HK$105.3 billion in the first calendar half of 2006. The IPO market continued to be dominated by a few PRC listings with very large capitalisation (China Construction Bank in October 2005 and Bank of China in June 2006). The mid to low tier markets were quiet. Funds raised from IPO listings on the GEM Board, which usually caters for those smaller companies, stayed at a low level of around HK$0.6 billion for each of the six months periods ended December 2005 and June 2006.

Business Activities

FINANCIAL HIGHLIGHTS

The Group performed satisfactorily in an environment which was difficult for small and mid-cap players. The results were adversely affected by the significant fair value adjustment in relation to the Group's investment in Ocean Grand Holdings Limited of approximately HK$31.7 million and impairment loss of a margin loan secured by shares of Ocean Grand Holdings Limited of approximately HK$7.4 million. Profit attributable to shareholders of the Company is HK$19.3 million, which is approximately 77% less than the results in the last year. Net realised and unrealised gains from investment holding reduced by 53% to HK$38.0 million. The Group has diversified its investment portfolio to include real estate and led to lower gain from a smaller shares investment portfolio. A revaluation gain of HK$47.8 million was recognised in relation to the investment properties held. Commission and fee income decreased by 4% to HK$87.6 million in the Financial Year as a result of the smaller amount of total funds raised in the Investment Banking division, despite an increase in number of deals closed. Interest and dividend income of HK$24.8 million was higher than last year as a result of the rising interest rates. The increase in general and administrative expenses by 19% to HK$131.7 million was mainly due to operation expenses for the PRC investment properties, the impairment loss in the Brokerage division for a doubtful margin account and increase in staff related costs to match the increased business activities and rising compensation level for experienced professionals. In addition, there was a net income tax credit of HK$12.3 million booked in the last Financial Year.

The Group adopted a number of new accounting standards during the Financial Year. A detailed explanation of the impact is included in note 3 to the financial statements. The new accounting standard on the recognition and measurement of financial instruments has a major impact on the Group's financial statements. Under the new standard, the Group ceased to make provisions on investments based on shareholding concentration, market liquidity and lock up period. The cumulative provision was adjusted to the opening retained profits for the Financial Year. If the Group was able to continue with its valuation policy as adopted in prior years, the realised/unrealised gain on investments would have increased by HK$22.8 million, mainly as a result of the release of provisions upon completion of lock up periods.

In February 2006, the Board declared an interim dividend of 0.33 HK cent per share, which was paid in March 2006. 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. When recommending the amount of final dividend, the Board has taken into account the non-cash and special nature of the fair value adjustment and impairment loss related to Ocean Grand Holdings Limited.

BROKERAGE

Total revenue of the division increased by 14% to HK$64.5 million in the Financial Year. The division recorded a loss of HK$6.2 million before taxation. The result of the division was adversely affected by the impairment loss of a margin loan secured by shares in Ocean Grand Holdings Limited of approximately HK$7.4 million made against a doubtful margin account.

Kingsway is determined to deliver quality execution services to its clients. There were upgrades to the electronic trading platform and the futures brokerage business was also transferred from Kingsway SW Futures Limited to Kingsway Financial Services Group Limited to streamline the operations. In 2005/2006, Kingsway again received top rankings from FinanceAsia and Asiamoney Brokers Poll. However, the competition in the market remains keen and the major retail banks are stepping up their marketing efforts to gain market shares in the securities brokerage market.

INVESTMENT BANKING

The division generated a revenue of HK$41.5 million for the year, which was 12% less than last year. However, due to lower staff cost attributable to the division, the contribution continued to improve and net divisional profit was HK$13.2 million, which represented an increase of 3% over last year.

The successful listing of Ju Teng International Holdings Limited at the end of October 2005 was one of the major achievements for the division. Market sentiment was quite negative at the time and a number of IPOs were either postponed or cancelled. The transaction was completed successfully due to careful planning and execution by our experienced team.

We have again demonstrated our ability to work with our clients on a continuous basis. Successful secondary placements were arranged during the Financial Year for Xinyi Glass Holdings Limited, Jolimark Holdings Limited and China Wireless Technologies Limited, of which we were the sponsor and/or lead manager or co-lead manager when they had their IPOs in 2004/2005.

WEALTH MANAGEMENT

During the year under review, the division recorded HK$18.1 million in revenue, of which HK$16.0 million was received from group companies for providing investment advisory and consultancy services. Net contribution of the division was HK$4.5 million.

Our MPF funds' assets under management rose 62% on a year-on-year basis. The number of MPF scheme participants also increased by 10% over the same period. Assets under management for our major authorised unit trusts rose by 46% on a year-on-year basis. The MPF constituent funds and authorised unit trusts achieved extremely good investment performance in 2006 and a number of them received top rankings in their respective categories and on overall basis as shown by Standard & Poor and Lipper ratings.

Kingsway SRI Asia Fund has become a constituent fund of a SRI Asia fund in Japan since November 2005. Kingsway China Fund has been selected as one of the investments to be included in a Greater China fund segregated portfolio managed by another fund manager.

PRIVATE EQUITY

The division contributed HK$14.9 million in revenue and HK$1.8 million in net profit. The two established funds achieved good growth in NAV during the Financial Year and the team is working on a number of other opportunities.

Sinochem Kingsway Capital Inc, a private equity vehicle co-sponsored with Sinochem Group, achieved a return of 10.5% in the Financial Year. Kingsway SBF Investment, another private equity vehicle co-sponsored with Softbank AM Corporation achieved a return of 26.2% for the Financial Year.

The Real Estate Services department was formed to explore opportunities in this asset class. In addition to providing services to our own investment properties, the department also assists investors to search and secure high quality property investments in the PRC. It also advises our clients on the best structure and strategy in order to maximise returns on the investments. The team is also in discussion with a number of interested investors with a view to form a private equity fund focusing on properties in the PRC.

INVESTMENT IN SECURITIES AND MERCHANT BANKING

Overall, the two segments contributed a combined revenue of HK$43.0 million and segment results of HK$28.7 million to the Group. The results were adversely affected by the significant fair value adjustment of HK$31.7 million in relation to the Group's investment in Ocean Grand Holdings Limited.

In 2006, the contribution from the Investment in Securities and Merchant Banking segments was reduced due to less holding gains from our strategic investments. The major contributor was the property investment in Beijing, which has appreciated in value since acquisition. The Group diversified its investment portfolio to asset classes other than equity securities and the performance proved that the strategy was working well. As funding was allocated to the property investment, return from the equity portfolio was affected.

Changes in Board Composition

In April 2006, the Company sadly announced that the founder and former CEO of the Company, Mr William Ka Chung Lam, passed away. Following that, Ms Mary Yuk Sin Lam and Mr William Wai Leung Wu were appointed as Executive Directors of the Company. Both Ms Lam and Mr Wu have served the Company for a long period of time and contributed to the success of the Company. The Board later announced that Ms Lam was appointed as the Deputy Chairman, Mr Wu was appointed as the CEO and Ms Rebecca Yuk Fung Lau was appointed as the Deputy CEO of the Company.

In May 2006, the Company announced the resignation of Mr Patrick Sun as an Executive Director.

Liquidity and Financial Resources

Total assets as at end of June 2006 were HK$933.2 million, of which approximately 62% was current in nature. Net current assets were HK$447.9 million and accounted for approximately 65% of the net assets of the Group as at end of June 2006.

The Group generally finances its operations from internal resources. The Group has not drawn any short term credit facility at end of June. Total borrowings of approximately HK$118 million at the end of June 2006 were mortgage loans secured by the Company's office premises in Beijing and Shenzhen and investment properties in Beijing. They were mainly denominated in Hong Kong dollar or United States dollar to match the future cash flows 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 19%.

The Group's property, securities held for trading and bank deposits with a carrying value of HK$293.5 million, market value of HK$44.6 million and carrying value of HK$4.2 million respectively were pledged as security against bank overdrafts and credit facilities granted to the Group.

Foreign Exchange Exposure

The Group's assets are mainly in Hong Kong and the PRC and most of the monetary assets and liabilities of the Group are denominated in Hong Kong dollar. Financial assets, including equity and debt investments, denominated in foreign currencies are monitored on a daily basis together with the changes in market value of these investments as part of our investment monitoring process. The Group has purchased properties in the PRC for its own use and investment purposes. These assets are financed by internal resources and loans denominated in either Hong Kong dollar or US dollar. In view of the revaluation of the RMB last year and the subsequent gradual appreciation 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 145 last year to 153 at the end of this 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.

As a listed company mainly engaged in regulated businesses, we believe our corporate governance practices 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 has contributed HK$0.8 million to charitable organizations during the Financial Year. Please refer to our Social Responsibility Report for further details.

Outlook

There are a number of uncertainties in the market today. The trend in interest rate is a crossroad with the US Federal Reserve Board deciding to keep the discount rate unchanged for the first time in August since rate hikes began two years ago. Geo-political tensions are affecting market sentiments and so is the threat from terrorist attacks. There are signs that the PRC government is going to step up pressure on the economy as it is still growing too fast despite the various macro-economic austerity measures taken by the government so far. On the positive side, liquidity in the market remains strong and the market has continued to witness new highs in recent weeks. The IPO of China Merchants Bank and the planned IPO of the Industrial and Commercial Bank of China also add to the positive sentiments. With the vast experience gained during the past peaks and lows, our staff are well equipped to handle the situation and we are confident that the Group will continue to perform well.

The Group is determined to provide a full range of financial services to mid cap players. We can advise our clients on private equity arrangements, IPO services and secondary placements, following the stage of development of our clients. The Proprietary Investment division also compliments these services and provides support in capital. The PRC is undergoing rapid development and we are confident that demand for financial advices and services from mid cap companies will grow at a fast pace. The capital formation process in the PRC presents us with great opportunities.

As disclosed in the Company's announcement dated 7 September 2006, the partnership with Marubeni Corporation to manage our investment properties in Beijing will bring additional expertise to the project. We are both confident in the development of the property market in the PRC and Beijing in particular. We hope this project will bring more value to our shareholders in the coming years.