

Report of the Directors

The directors have the pleasure in submitting their report together with the audited financial statements for the year ended 30 June 2006.

Principal activities

The principal activity of the Company is investment holding. The principal activities and other particulars of significant subsidiaries are set out in note 35 on the financial statements.

The analysis of the principal activities and geographical locations of the operations of the Group are set out in note 12 on the consolidated financial statements.

Results and appropriations

The profit of the Group for the year ended 30 June 2006 and the state of the Company's and the Group's affairs as at that date are set out in the consolidated financial statements on pages 44 to 110.

An interim dividend for the year ended 30 June 2006 of 0.33 HK cents per ordinary share was paid on 17 March 2006. The directors propose, subject to the approval of the shareholders at the forthcoming Annual General Meeting, the payment of a final dividend of 0.67 HK cents per ordinary share for the year.

Five year financial summary

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 111 of the annual report.

Reserves

Movements in the reserves of the Group during the year are set out in note 31 on the financial statements.

Donations

Charitable and other donations made by the Group during the year amounted to HK\$828,275 (2005: HK\$1,036,000).

Other properties and equipment

Movements in other properties and equipment of the Group during the year are set out in note 14 on the financial statements.

Share capital

Details of the movements of the Company's share capital during the year are set out in note 29 on the financial statements.

Distributable reserves

The Company's reserves available for distribution to shareholders as at 30 June 2006 consisted of contributed surplus of HK\$199,299,696 (2005: HK\$199,299,696) and retained profits of HK\$106,196,440 (2005 (restated): HK\$32,212,207).

Share options

Details of the share options granted by the Company are disclosed below pursuant to the requirements under Chapter 17 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules"):

(a) INFORMATION OF THE SHARE OPTION SCHEME

Details of the share option scheme (the "Scheme") approved by the shareholders of the Company on 23 August 2000, which became unconditional upon listing of the Company's shares on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), are summarised as follows:

- | | | |
|--|---|---|
| (i) Purpose of the Scheme | : | As an incentive to executive management and employees. |
| (ii) Participants of the Scheme | : | Eligible full-time employees including executive directors of the Company and its subsidiaries. |
| (iii) Maximum number of shares available for subscription | : | Before 1 September 2001, the maximum number of shares in respect of which options could be granted under the Scheme and any other share option schemes of the Company could not exceed 10% of the issued share capital of the Company from time to time. On or after 1 September 2001, it cannot exceed 10% of the issued share capital as at the date of approval of the Scheme. |
| (iv) Total number of shares available for issue under the Scheme | : | As at the date of this report, 244,941,034 shares (representing 7.54% of total issued share capital) are available for issue under the Scheme, of which 38,000,000 shares represents shares that will be issued upon exercise of outstanding options. |

Share options (Continued)

(a) INFORMATION OF THE SHARE OPTION SCHEME (Continued)

- (v) Maximum entitlement of each participant under the Scheme : Before 1 September 2001, 25% of the aggregate number of shares issued and issuable under the Scheme. After 1 September 2001, in any 12-month period not more than 1% of the shares in issue.
- (vi) Minimum period for which an option must be held before it can be exercised and the exercise period of the option : Subject to the decision of the Board, the exercise period of the option cannot exceed a period of 42 months commencing on the later of (i) the expiry of 6 months after the date on which the option is accepted or (ii) the expiry of 12 months from the date of employment of such grantee with the Group, or such shorter period as the Board may from time to time determine, provided that only up to one-third of the option granted can be exercised in any 12-month period.
- (vii) Amount payable on acceptance of the option and the period within which payment must be made : Nominal amount of HK\$1 upon acceptance of the option.
- (viii) Basis of determining the exercise price : For options granted before 1 September 2001, the exercise price is determined by the Board and will not be less than 80% of the average closing prices of the Company's shares on the Stock Exchange for the five trading days immediately preceding the date of offer of the option or the nominal value of the Company's shares, whichever is the higher.
- For options granted on or after 1 September 2001, the exercise price is the highest of the nominal value of the shares; the closing price of the shares on the Stock Exchange on the date of grant; and the average closing price of the shares on the Stock Exchange for the five business days immediately preceding the date of grant.
- (ix) Remaining life of the Scheme : The Scheme will expire on 22 August 2010.

Note: For more details of options granted to individual directors, please refer to the section "Directors' and chief executives' interests and short positions in the shares, underlying shares and debentures of the Company or any associated corporation" on page 34.

Directors

The directors during the year and up to the date of this report were:

CHAIRMAN

Jonathan Koon Shum Choi

EXECUTIVE DIRECTORS

Mary Yuk Sin Lam (Deputy Chairman) (appointed on 25 April 2006)

William Wai Leung Wu (appointed on 25 April 2006)

Rebecca Yuk Fung Lau

Michael Koon Ming Choi

William Ka Chung Lam (deceased on 24 April 2006)

Patrick Sun (resigned on 31 May 2006)

NON-EXECUTIVE DIRECTOR

Michael Wai Chung Wu

INDEPENDENT NON-EXECUTIVE DIRECTORS

Robert Tsai To Sze

Raymond Wai Yung Wu

Stanley Kam Chuen Ko

In accordance with clauses 86(2) and 87(1) of the Company's Bye-Laws, Dr Jonathan Koon Shum Choi, Ms Mary Yuk Sin Lam, Mr William Wai Leung Wu and Mr Stanley Kam Chuen Ko will retire at the forthcoming Annual General Meeting and being eligible, offer themselves for re-election.

The Company has received annual confirmations of independence from Mr Robert Tsai To Sze, Dr Raymond Wai Yung Wu and Mr Stanley Kam Chuen Ko and as at the date of this report, still considers them to be independent.

Biographical details of directors and senior management

Biographical details of directors and senior management are set out on pages 26 to 29.

Directors' service contracts

No director proposed for re-election at the forthcoming Annual General Meeting has entered into any service agreements with any member of the Group which is not determinable within one year without payment of compensation, other than statutory compensation.

Report of the Directors

Directors' interests in contracts

No contract of significance to which the Company, any of its holding companies, subsidiaries or fellow subsidiaries, was a party and in which a director of the Company had a material interest, subsisted at the end of the year or at any time during the year.

Directors' and chief executive's interests and short positions in the shares, underlying shares and debentures of the Company or any associated corporation

As at 30 June 2006, the interests and/or short positions of each director and chief executive in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV the Hong Kong Securities and Futures Ordinance ("SFO"), as recorded in the register maintained under Section 352 of the SFO or as notified to the Company were as follows:

(I) INTEREST IN LONG POSITIONS OF ORDINARY SHARES OF THE COMPANY

Name of director	Type of interest	* Number of ordinary shares in the Company	* % of total issued shares
Dr Jonathan Koon Shum Choi**	Corporate	2,411,661,327	74.25%
Ms Mary Yuk Sin Lam**	Corporate	2,411,661,327	74.25%
Ms Mary Yuk Sin Lam	Personal	7,500,000	0.23%
Ms Rebecca Yuk Fung Lau	Personal	4,200,000	0.13%
Mr Michael Wai Chung Wu	Personal	2,514,000	0.08%
Mr Stanley Kam Chuen Ko	Corporate	1,200,000	0.04%

* Excludes interest in options to acquire ordinary shares of the Company which is disclosed in section (iv) below.

** Dr Jonathan Koon Shum Choi and Ms Mary Yuk Sin Lam are deemed to be interested in 2,411,661,327 ordinary shares by virtue of the SFO. Such interest in shares is also set out under the section "Substantial shareholders' interests and short positions in the shares and underlying shares of the Company" shown on page 38.

Directors' and chief executive's interests and short positions in the shares, underlying shares and debentures of the Company or any associated corporation (Continued)

(II) INTEREST IN LONG POSITIONS OF COMMON SHARES OF KINGSWAY INTERNATIONAL HOLDINGS LIMITED ("KINGSWAY INTERNATIONAL"), THE ULTIMATE HOLDING COMPANY OF THE COMPANY

Name of director	Personal interest	Family interest	Corporate interest	Other interest	* Total number of common shares	* % of total issued shares
Dr Jonathan Koon Shum Choi **	10,101,596	–	26,828,055 (Note 1)	–	36,929,651	46.1%
Ms Mary Yuk Sin Lam **	9,790,507	–	–	22,641,810 (Note 2 & 3)	32,432,317	40.5%
Mr Michael Koon Ming Choi	106,937	–	–	–	106,937	0.1%
Mr Stanley Kam Chuen Ko	20,400	–	–	–	20,400	<0.1%
Ms Rebecca Yuk Fung Lau	100	–	–	–	100	<0.1%

* Excludes interest in options to acquire common shares of Kingsway International which is disclosed in section (v) below.

** By virtue of their interest in Kingsway International, Dr Jonathan Koon Shum Choi and Ms Mary Yuk Sin Lam are deemed to be interested in the shares of the subsidiaries (including the Company as disclosed in section (i) above) of Kingsway International under the SFO.

Notes:

- (1) Of these, 12,750,000 shares are held by Sun Wah Capital Limited. Dr Jonathan Koon Shum Choi is deemed to be interested in these shares as he is entitled to exercise or control the exercise of one third or more of the voting power at general meetings of Sun Wah Capital Limited.

The remaining 14,078,055 shares are held by Scarlet Red Limited. Dr Jonathan Koon Shum Choi is deemed to be interested in these shares as he is entitled to exercise or control the exercise of one third or more of the voting power at general meetings of Scarlet Red Limited.

- (2) Of these, 9,726,750 shares are held by the estate of Mr William Ka Chung Lam who was the spouse of Ms Mary Yuk Sin Lam.

- (3) Of these, 10,515,060 shares are held by Dynasty International Holdings Limited which is a wholly owned subsidiary of Global Fame Limited. Global Fame Limited is wholly owned by The WKC Lam Family Trust which is a discretionary trust with Ms Mary Yuk Sin Lam's two children as the beneficiaries. Ms Lam is a trustee of The WKC Lam Family Trust.

Of these, 2,400,000 shares are held by Abundant World Limited. Abundant World Limited is wholly owned by The Mary Lam Family Trust which is a discretionary trust with Ms Mary Yuk Sin Lam and her two children as the beneficiaries.

Report of the Directors

Directors' and chief executive's interests and short positions in the shares, underlying shares and debentures of the Company or any associated corporation (Continued)

(III) INTEREST IN LONG POSITIONS OF ORDINARY SHARES OF HK WEAVER GROUP LIMITED, A FELLOW SUBSIDIARY OF THE COMPANY

Name of director	Type of interest	Number of ordinary shares	% of total issued shares
Ms Mary Yuk Sin Lam	Personal	28,518	2.2%
Ms Mary Yuk Sin Lam	Other	59,620	4.6%
Mr Michael Wai Chung Wu	Personal	39,474	3.0%
Ms Rebecca Yuk Fung Lau	Personal	5,000	0.4%

(IV) INTEREST IN OPTIONS TO ACQUIRE ORDINARY SHARES OF THE COMPANY

Details of the directors' interests in options under the Scheme are as follows:

Name of director	Exercise period	Exercise price per share	At 1 July 2005	Lapsed during the year	At 30 June 2006
Ms Mary Yuk Sin Lam	1 March 2002 to 31 August 2005	\$0.3233	18,000,000	(18,000,000)	–
Mr Michael Koon Ming Choi	1 March 2002 to 31 August 2005	\$0.3233	1,500,000	(1,500,000)	–
Ms Rebecca Yuk Fung Lau	1 March 2002 to 31 August 2005	\$0.3233	900,000	(900,000)	–
	5 October 2003 to 4 April 2007	\$ 0.363	24,000,000	–	24,000,000
Mr William Wai Leung Wu	2 October 2003 to 1 April 2007	\$0.3833	3,000,000	–	3,000,000
	24 September 2004 to 23 March 2008	\$ 0.43	7,000,000	–	7,000,000

Directors' and chief executive's interests and short positions in the shares, underlying shares and debentures of the Company or any associated corporation (Continued)

(V) INTEREST IN OPTIONS TO ACQUIRE COMMON SHARES OF KINGSWAY INTERNATIONAL

Pursuant to a share option plan operated by Kingsway International, certain directors had been granted options to subscribe for the shares of Kingsway International. There were no options outstanding as at 30 June 2006 and no options were granted to the directors during the year.

Save as disclosed above, none of the directors and chief executive of the Company or any of their spouses or children under 18 years of age has interests or short positions in the shares, underlying shares or debentures of the Company and associated corporations as recorded in the register required to be kept under Section 352 of the SFO or as otherwise notified to the Company pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

Save as disclosed above, as at 30 June 2006, none of the directors and chief executive had any interests or short positions in the shares of the Company and its associated corporations as defined in the SFO, and none of the directors and chief executive or their spouses or children under 18 years of age had been granted any rights to subscribe for the shares of the Company, or had exercised any such rights during the year.

Save as disclosed above, at no time during the year was the Company or any of its holding companies, subsidiaries and fellow subsidiaries a party to any arrangement to enable the directors or chief executive of the Company to hold any interests or short positions in the shares or underlying shares in, or debentures of, the Company or any other body corporate.

Report of the Directors

Substantial shareholders' interests and short positions in the shares and underlying shares of the Company

As at 30 June 2006, the register of substantial shareholders maintained under Section 336 of the SFO shows that the Company had been notified of the following substantial shareholders' interests, being 5% or more of the Company's issued share capital. These interests represent long positions in the shares of the Company.

	Name of shareholders	Country of incorporation	Number of ordinary shares in the Company		% of total	issued Note
			interest	Direct interest	Deemed shares	
(1)	World Developments Limited	British Virgin Islands	2,411,661,327	–	74.25%	(a)
(2)	Innovation Assets Limited	British Virgin Islands	–	2,411,661,327	74.25%	(a)
(3)	Kingsway International Holdings Limited	Bermuda	–	2,411,661,327	74.25%	(a)

Note:

- (a) These shares represent the same interest and are therefore duplicated amongst World Developments Limited, Innovation Assets Limited and Kingsway International. World Developments Limited is a wholly owned subsidiary of Innovation Assets Limited whose entire issued share capital is beneficially owned by Kingsway International. Dr Jonathan Koon Shum Choi beneficially owns or has control of approximately 46.1% of the issued share capital of Kingsway International and therefore is deemed (by virtue of the SFO) to be interested in these 2,411,661,327 shares. Ms Mary Yuk Sin Lam beneficially own or have control of approximately 40.5% of the issued share capital of Kingsway International and therefore are deemed (by virtue of the SFO) to be interested in these 2,411,661,327 shares.

Save as disclosed above, the register of substantial shareholders maintained under Section 336 of the SFO shows that the Company had not been notified of any substantial shareholders' interests and short positions, being 5% or more of the Company's issued share capital.

Management contracts

No contracts of significance concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

Purchase, sale or redemption of shares

The Company has not redeemed any of its shares during the year. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the year.

Pre-emptive rights

There are no provisions for pre-emptive rights under the Company's Bye-Laws, or the laws of Bermuda, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

Major customers and suppliers

During the year, the Group earned less than 30% of its turnover from its five largest customers.

The Group is a provider of financial services. In the opinion of the directors, it is therefore of no value to disclose details of the Group's suppliers.

Related party and connected party transactions

Significant related party and connected party transactions entered into by the Group during the year are disclosed in note 34 on the financial statements.

Details of those transactions which also constitute connected transactions and are required to be disclosed under Chapter 14A of the Listing Rules are disclosed as follows:

- (a) Security transactions between Kingsway Financial Services Group Limited ("Kingsway Financial"), Kingsway SW Futures Limited and each of the directors of the Group and their respective associates (the "Security Transactions")

Brokerage commission was received from the Group's directors and their respective associates in the ordinary course of the Group's business of dealing in securities and futures. Commission rates are set at the same level as those normally offered to third party clients or the applicable staff rate if the clients are directors or employees of the Group. The total brokerage commissions received by the Group from a corporation controlled by the father of a director amounted to HK\$1,239,120 for the year ended 30 June 2006.

Related party and connected party transactions (Continued)

- (b) Margin financing transactions between Kingsway Financial, and each of the directors of the Group and their respective associates (the “Margin Financing Transactions”)

Total loans for the purpose of subscribing to initial public offer of securities granted to any director and their respective associates are less than HK\$10 million. During the year, the respective associates of a director (sister and sister-in-law for the director) were granted loans for subscribing initial public offers and the loan amounts exceeded HK\$1 million. Maximum loan amount granted to any of the director and the respective associates is HK\$8,193,174. The interest received by the Group amounted to HK\$26,039. The interest rates are set at the same level as those normally offered to third party clients or the applicable staff rate if the clients are directors or employees of the Group.

- (c) Securities transactions between Kingsway Financial and SBI E*Trade Securities Company Limited (SBI E*Trade) (the “E*Trade Transactions”)

SBI E*Trade is a subsidiary of SBI Holdings, Inc., which in turn is a minority shareholder of a subsidiary of the Group. SBI E*Trade entered into a brokerage agreement with Kingsway Financial on 11 March 2005 and appointed Kingsway Financial as its executing broker and custodian, to execute and facilitate the clearing of all of SBI E*Trade’s securities transactions for securities traded on the Stock Exchange made through the electronic trading platform. The appointment will terminate on 14 March 2007. The brokerage commission rate is set at the same level as those normally offered to third party clients and is subject to a minimum monthly fee. The total brokerage commission received by the Group amounted to HK\$1,200,000 for the year ended 30 June 2006.

The Securities Transactions, Margin Financing Transactions and E*Trade Transactions are hereinafter referred to as the “Transactions”.

The independent non-executive directors have reviewed the Transactions as disclosed in notes (a), (b) and (c) above and confirmed that:

- (1) the Transactions are:
- (i) entered into in the ordinary course of business of each of the companies of the Group;
 - (ii) on normal commercial terms; and
 - (iii) fair and reasonable so far as the shareholders of the Company are concerned;
- (2) (i) the aggregate amount of the commission received by the Group in respect of the Securities Transactions for the year ended 30 June 2006 did not exceed HK\$10 million; and
- (ii) the aggregate amount of the loan granted and amount of interest charged by the Group in respect of the Margin Financing Transactions for the year ended 30 June 2006 did not exceed HK\$10 million.

Related party and connected party transactions (Continued)

The auditors of the Company have reviewed the continuing connected transactions during the year as disclosed in note (c) above and confirmed that these transactions:

- (i) were approved by the board of directors of the Company; and
- (ii) had been entered into in accordance with the relevant agreements governing the transactions.

Sufficiency of public float

According to the information that is publicly available to the Company and within the knowledge of the Board, the percentage of the Company's shares which are in the hands of the public exceeds 25% of the Company's total number of issued shares as at the date of this report, the latest practicable date to ascertain such information prior to the issue of this annual report.

Corporate Governance

The Company is committed to maintaining a high standard of corporate governance practices. Information on the corporate governance practices adopted by the Company is set out in the Corporate Governance Report on pages 15 to 25.

Directors' interest in competing business

Set out below is information disclosed pursuant to paragraph 8.10 of the Listing Rules:

- (1) Kingsway International and its subsidiaries, other than those in the Group ("Kingsway International Group"), are mainly engaged in direct and regional investments, the development, production and distribution of software products and the provision of technical services relating to the financial markets in Hong Kong and Asia Pacific countries, and the provision of other financial services in Australia and Canada. The Company has entered into a non-competition undertaking with Kingsway International on 25 August 2000 ("the Kingsway International Undertaking"). According to the Kingsway International Undertaking, Kingsway International shall not, and shall procure Kingsway International Group not to, among other things, engage in the provision of financial, advisory, stockbroking, financing, fund management and futures brokerage services relating to stocks and futures in Hong Kong. Kingsway International has also undertaken not to, and will procure Kingsway International Group not to, apply for or obtain licenses to conduct such services in Hong Kong. In addition, investment in securities for the Group and the Kingsway International Group are performed independently from each other.

Report of the Directors

Directors' interest in competing business (Continued)

- (2) The Company and Dr Jonathan Koon Shum Choi ("Dr Choi") entered into a non-competition undertaking ("the Choi's Undertaking") on 10 August 2000. According to the Choi's Undertaking, Dr Choi shall not, and shall procure the covenantors (as defined therein) not to, among other things, engage in the provision of financial, advisory, stockbroking, financing, fund management and futures broking services relating to stocks and futures in Hong Kong which may only be lawfully provided by a registered person (as defined therein) but excluding the provision of financial accommodation which does not fall within the definition of "Securities Margin Financing" for the purposes of the Hong Kong Securities Ordinance (which was repealed on 1 April 2003 and replaced by the SFO) in competition with the Group.

Auditors

KPMG were first appointed as auditors of the Company in 2004 upon the retirement of PricewaterhouseCoopers.

KPMG retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

By order of the board

Jonathan Koon Shum Choi

Chairman

Hong Kong, 13 September 2006