
RISK FACTORS

RISKS ASSOCIATED WITH THE GROUP

Risk of compliance failure

The securities market in Hong Kong is highly regulated. The businesses operated by the Group are classified as regulated activities under the SFO and the Group's operating subsidiaries, namely Emperor Securities and Emperor Futures, and their responsible officers and account executives are required under the SFO to be licensed by the SFC and be subject to any rules and regulations promulgated by the SFC. As securities and futures trading activities are executed through the Stock Exchange or Futures Exchange, Emperor Securities and Emperor Futures are required to be their respective registered participants and trading right holders and be subject to the regulation from time to time introduced by the two exchanges. Failure to comply with the SFO, the rules and regulations promulgated by the Stock Exchange or Futures Exchange or any applicable laws or rules or regulations may result in revocation or suspension of the licences of Emperor Securities or Emperor Futures or their responsible officers or account executives, thereby adversely affecting the business and financial performance of the Group.

As set out in detail under the section headed "Business – Disciplinary actions" of this prospectus, there were disciplinary actions taken by the SFC against two former licensed representatives, a former responsible officer and a licensed representative of the Group. In addition, Emperor Futures and/or Emperor Securities are currently subject to two investigation cases and the SFC has informed that it has completed one investigation case and has proposed disciplinary actions including public reprimand and a fine of HK\$200,000 against Emperor Securities. Emperor Securities has made a submission to the SFC seeking to mitigate the above proposed disciplinary actions. Except for the above investigation case, the SFC is yet to conclude the result of its investigation in the remaining pending investigation case on the internal control systems of Emperor Securities and Emperor Futures as regards cold calling activities. SFC may take actions including revocation or suspension of licences, public or private reprimand, issue of warning letter or imposition of pecuniary penalties against the Group's two major operating subsidiaries and/or their licensed representatives including responsible officers and/or account executives. Any of such disciplinary actions taken against the Group's two major operating subsidiaries and/or their licensed persons may have an adverse impact on the Group's business, financial position or performance, and the magnitude of impact cannot be ascertained at this stage.

Besides the above, the internal control systems of Emperor Securities and Emperor Futures had certain weaknesses or require further enhancements, as revealed in, among others, the past regulatory visits and the two reports issued by the Reviewing Firm on the review of certain internal control systems of the Company, Emperor Securities and Emperor Futures undertaken recently. Although Emperor Securities and Emperor Futures have significantly enhanced their systems in response to, among others, the weaknesses identified by the regulators or the Reviewing Firm in its two reports issued in November 2006 and January 2007 respectively, many of the enhanced control systems have a short period of implementation and some of them have not been sample tested by the Reviewing Firm. Internal controls, no matter how well designed and operated, can provide only reasonable assurance of achieving an entity's control objective. The likelihood of achievement is affected by limitations inherent to internal control. These include the realities that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human failures such as simple errors or mistakes.

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Additionally, internal controls, whether manual or automated, can be circumvented by the collusion of two or more people or inappropriate management override. If the internal control systems of Emperor Securities or Emperor Futures fail to be consistently and effectively implemented, there would be adverse impact on the Group's businesses and/or financial performance.

Credit risks

Cash clients of Emperor Securities have to settle their securities transaction within two trading days from the transaction day ("T+2"). If a client (either being a cash client or margin client) fails to settle the transaction within T+2, Emperor Securities is required to settle the same on the client's behalf with HKSCC with its own funds. As at 31 December 2006, the total amount due from all cash clients within two trading days from transaction day amounted to approximately HK\$31.2 million. There is a risk of default in payment by cash clients.

For year ended 31 March 2004, the Group made a provision for margin loans of approximately HK\$1.0 million. A further provision for margin loans and amounts due from cash clients of approximately HK\$34,000 was made for the nine months ended 31 December 2006.

For the year ended 31 March 2004, the Group made a provision for loans and advances of approximately HK\$7.0 million.

The Futures Exchange and the Stock Exchange prescribe the minimum margin deposit required for opening of each futures and option contract. Clients of the Group are required to maintain at all times the minimum margin deposit with the Group from time to time as determined by the Futures Exchange and the Stock Exchange. When a client is unable to meet a margin call, the Group may close out the futures and/or option contract. In the event that the client's margin deposit with the Group is unable to cover the loss arising from closing out of the futures and/or option contract, the Group would be exposed to the risk of not being able to recover such shortfall from the clients, particularly in times of a volatile market.

Risk of financing business

Interest income from financing activities accounted for approximately 42.95%, 39.62%, 45.73%, 44.10% and 38.08% of the Group's turnover for each of the three years ended 31 March 2006 and the nine months ended 31 December 2005 and 2006 respectively. As at 31 December 2006, the Group's outstanding margin loan amount as well as loans and advances were approximately HK\$97.5 million and HK\$56.9 million respectively.

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Margin loan provided to a client is required to be maintained within the margin value of his pledged securities, which means the aggregate market value of his pledged securities, after the haircut. Once the margin value falls below the outstanding amount of the loan as a result of market downturn or adverse movement in the prices of the pledged securities, the Group will make a margin call requesting the client to deposit additional funds, sell securities or pledge additional securities to top up their margin value. If the client is unable to meet a margin call, the Group will dispose of the pledged securities to recover the loan. Similarly, for loans and advances, if the client is unable to repay the Group, the Group will dispose of the pledged securities to recover the loan. However, the amount recovered from the sale of the pledged securities may fall short of the outstanding amount of the loan. In the event that the Group fails to recover the shortfall from the clients, it would suffer a loss.

Reliance on stockbroking commission and securities financing

During the three years ended 31 March 2006 and the nine months ended 31 December 2005 and 2006, provision of brokerage service for securities and financing service has been the principal source of income of the Group. For each of the three years ended 31 March 2006 and the nine months ended 31 December 2005 and 2006, commission income derived from stockbroking businesses accounted for approximately 45.23%, 46.05%, 34.00%, 34.45% and 32.76% respectively of the Group's total turnover, while interest income generated from the Group's financing business including margin and initial public offer financings and loans and advances accounted for approximately 42.95%, 39.62%, 45.73%, 44.10% and 38.08% respectively of the Group's turnover for the corresponding years and period.

Both of the Group's stockbroking business and financing business will be affected by external factors, including the performance of the Hong Kong, Japan and the US financial markets which is generally subject to economic conditions and investment sentiment and fluctuations in interest rates, which are beyond the Group's control. There is no assurance that the Group's income derived from its stockbroking business as well as financing business in the past would be sustained.

Reliance on major clients

For each of the three years ended 31 March 2006 and the nine months ended 31 December 2006, stockbroking commission or interest income derived from the Group's top five clients, most of whom are retail clients, accounted for approximately 35.46%, 34.75%, 26.27% and 20.52% of the Group's total turnover respectively. After making reasonable enquiry, the Directors confirm that these top five clients, except one is an associated company of EIHL, are independent of and not connected with the Directors, chief executive or substantial shareholders of the Company or any of its subsidiaries, or any of their respective associates. Investors should be aware that the Group's business and profitability may be adversely affected if any of these major clients does not continue to use, or if any of them significantly reduces his/her use of the financial services provided by the Group.

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Competition in the securities industry

The Group's business focus is on the retail market in Hong Kong which is characterised by a large number of market participants. The Group is subject to significant competition from securities brokerage firms, local and international banks operating in Hong Kong, which may include competitors that have greater financial and other resources. As at 31 December 2006, there are about 425 and 135 exchange participants on the Stock Exchange and the Futures Exchange respectively. Many of the international and local banks operating in Hong Kong compete for substantially the same customers with small to medium sized securities firms. If the Group fails to maintain its competitive edge, the Group's business and profitability may be adversely affected.

Risk of underwriting business

Underwriting (including sub-underwriting) and placing commission accounted for approximately 5.20%, 10.41%, 5.47%, 7.06% and 4.25% of the Group's total turnover for each of the three years ended 31 March 2006 and the nine months ended 31 December 2005 and 2006 respectively. Performance of underwriting business would be severely deteriorated during sluggish and volatile market conditions when the securities underwritten by the Group are undersubscribed and the Group as the underwriter/sub-underwriter is required to take up the unsubscribed securities. The financial position of the Group would be adversely affected if the underwritten securities taken up by the Group become illiquid and/or their market values drop.

Risk of error trading

The Group has to take immediate action to close out error trade positions made by its staff in the course of processing orders placed by clients once the error trades are reported. The error trade positions usually arise from mistakes made by staff when inputting data or recording clients' instructions. The Group will bear any losses arising from such error trades.

For each of the three years ended 31 March 2006 and the nine months ended 31 December 2005 and 2006, the Group incurred losses from error trades, which amounted to HK\$102,000, HK\$67,000, HK\$160,000, HK\$133,000 and HK\$105,000 respectively. Investors should be aware that the Group's profitability may be adversely affected if error trades are not effectively prevented or controlled by the Group.

Risk of operational system failure

The operation of the Group's business is highly dependent on the capability and reliability of the computer systems used. Since technology advances rapidly, the Group may not be competitive or that further costs for the development or maintenance of a more competitive system may be required.

The network infrastructure used by the Group for its business may be vulnerable to computer viruses, hackers or other disruptive actions by visitors or other internet users and therefore causing data corruption and interruptions, delay or cessation in the services provided through the Group's securities trading facilities which could have a material adverse effect on the Group's business. Inappropriate use of the internet by third parties may also jeopardise the security of confidential information (such as client data or trading records) stored in the computer systems of the Group and cause losses to the Group.

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Competition from internet securities trading

The Group faces increasing competition because of internet trading technology currently being developed or which may be developed in the future by both its existing competitors as well as new market entrants. The Group cannot accurately predict how emerging and future technological changes in internet trading will affect the Group's operation or the competitiveness of the Group's services. The current mode of the Group's business operation may be subject to intense competition from new technologies that emerge in the future.

The Hong Kong stock market

In September 2001, the stock market in Hong Kong experienced a significant drop as a result of the attack on the World Trade Center in the US by terrorists on 11 September 2001 ("9-11 incident"). The HSI at the end of September 2001 was 9,951 points, representing a decrease of approximately 10% from the previous month and approximately 36% from September 2000. The stock market experienced another trough in 2003 due to the outbreak of SARS in Hong Kong and the HSI closed at 8,634 points at the end of March 2003. On 24 January 2007, the HSI reached a historical high of 20,821 points. However, the HSI recorded an accumulative lost of almost 2,160 points down to 18,664 points on 5 March 2007, which represented a drop of approximately 10% as compared to the highest point recorded in January 2007.

As the Group's businesses may be adversely affected by external factors including the volatility of the Hong Kong stock market as illustrated above, which are beyond the control of the Group, investors should be aware that there is no assurance that the Group will be able to maintain its historical results in times of difficult economic conditions or unstable political environments. Investors should not rely heavily on the historical profit levels as an indication of its future financial performance.

The US and Japan futures markets

Apart from the Hong Kong stock market, the futures market in the US and Japan also affect the performance of the Group's business. Similar to stock market and other financial markets, the futures market also encounters three major risk factors, namely the market risk, credit risk and operational risk, though the futures market bears a lower credit risk due to the fact that the exchange clearing house is virtually the counterparty for all trades. Investors are reminded to observe market risk such as the 9-11 incident.

In the aftermath of the 9-11 incident, most stock and futures exchanges in New York suspended their stock and financial futures tradings for four trading days. S&P 500, one of the most commonly used benchmarks for the overall US stock market, fell 5.2% from 1,095.7 points to 1,039.0 points after resumption of trading on 17 September 2001. The shock of the 9-11 incident caused a global stock market crash. When the US markets suspended trading, the Nikkei 225 Index futures in Osaka Stock Exchange plummeted 9.7% from 10,320 points on 11 September 2001 to a closing of 9,320 points on 12 September 2001. Investors should be careful in assessing the future performances of the Group in light of the possible fluctuations of the Group's results which are subject to these market risks.

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Reliance on key management personnel

The Group's performance depends to a significant extent on the continued services and performance of Ms. Daisy Yeung, the managing Director, who is responsible for formulating the Group's strategy and day-to-day management. The Group has entered into a service contract with Ms. Daisy Yeung. The contract provides for a term of three years commencing from 1 March 2007. The service contract is terminable by either party upon giving three months' written notice to the other party. The loss of Ms. Daisy Yeung could have a material adverse effect on the Group's business, financial condition or results of operation.

Foreign exchange exposure

In order to facilitate its clients to trade commodities and financial futures in Japan and the US, the Group's customers are only required to place margin deposits in Hong Kong dollars. The Group will try to limit the foreign exchange exposure by placing margin deposits in Japanese yen and US dollars with its respective brokerage firms engaged to execute transactions on behalf of its clients in overseas markets. Fluctuations in exchange rates between the Hong Kong dollar and the Japanese yen as well as the US dollars lead to foreign exchange losses, thereby affecting the Group's profitability. If the Japanese yen and/or the US dollars depreciate, the Group will suffer an exchange loss.

In addition, the Group receives commission from its clients in Hong Kong dollars while it pays its commissions to its engaged brokerage firms for the transactions executed in Japanese yen and US dollars. If the Japanese yen and/or the US dollars appreciate, the Group's profit margin may be adversely affected.

Collection of deposit placed with brokerage firms in Japan and the US

In order to facilitate the Group's brokerage services for commodities and financial futures traded on exchanges in Japan and the US, the Group is required to place margin deposits with its engaged brokerage firms in Japan and the US to conduct transactions. Therefore, if any of its engaged brokerage firms defaults, the Group will suffer a loss for the outstanding balance maintained with such engaged brokerage firms. As at 31 March 2004, 2005 and 2006 and 31 December 2005 and 2006, the Group had an outstanding balance with its engaged brokerage firms of approximately nil, HK\$1.6 million, HK\$8.6 million, HK\$13.0 million and HK\$26.6 million respectively, representing approximately 0%, 1.65%, 5.21%, 11.71% and 15.11% respectively of the Group's total trade receivables as at the respective year/period end dates.

Dividend policy

The Group has declared dividend for the year ended 31 March 2004. No dividend was paid or declared by the Company and its subsidiaries during the years ended 31 March 2005 and 2006.

On 2 April 2007, Emperor Securities and Emperor Futures declared and paid special interim dividends of HK\$178.5 million and HK\$38.5 million respectively to their then shareholders, which are wholly owned by EIHL.

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The declaration of future dividends will be at the discretion of the Directors and will depend on, among others, the Group's earnings, financial condition, cash requirements and availability, and other factors as the Directors may deem relevant. Accordingly, potential investors should note that historical dividend payments should not be regarded as an indication of future dividend policy.

Licensing of trademarks

The Group is currently using the trademark “英皇” and “Emperor” as trade names (“Trademarks”) and the “crown” logo (“Logo”) for its business. The Trademarks and the Logo were registered by Emperor Management Services Limited (“Emperor Management”), a wholly owned subsidiary of EIHL. Historically, the Trademarks and the Logo were used by Emperor Management Services (Overseas) Limited (“EMO”). EMO is a company under the Yeung Family Discretionary Trust, a discretionary trust set up by Mr. Yeung Lik Shing, Michael, the brother of Mr. Yeung Sau Shing, Albert (“Mr. Albert Yeung”). The Company has entered into a trademarks agreement (“Trademarks Agreement”) dated 2 April 2007 with Emperor Management, EMO and EIHL. Emperor Management, EMO and EIHL are connected persons of the Company as defined under the Listing Rules. Pursuant to the Trademarks Agreement, Emperor Management and EMO agreed to grant a non-exclusive licence to the Group to use the Trademarks and the Logo. Details of the Trademarks Agreement are set out in the paragraph headed “Licensing of trademarks” under the section headed “Business – Exempt continuing connected transactions” of this prospectus.

Investors should be aware that although Emperor Management and EMO have undertaken in the Trademarks Agreement that they shall maintain validity of, and renew the registration of the Trademarks and the Logo, the Group might not be able to use the Trademarks and the Logo if Emperor Management or EMO fails to renew the registration of the Trademarks and the Logo and the Trademarks Agreement will therefore be terminated. The loss of use of the Trademarks and Logo by the Group may have an adverse impact on the Group's operation.

RISKS ASSOCIATED WITH THE INDUSTRY

High level of liquidity required

A licensed corporation shall at all times maintain liquid capital which is not less than the required liquid capital as stipulated under the FRR. For each of Emperor Securities and Emperor Futures, the required liquid capital is the higher of HK\$3 million and 5% of the aggregate of (a) its adjusted liabilities; (b) the aggregate of the initial margin requirements in respect of outstanding futures contracts and outstanding options contracts held by it on behalf of its clients; and (c) the aggregate of the amounts of margin required to be deposited in respect of outstanding futures contracts and outstanding options contracts held by it on behalf of its clients, to the extent that such contracts are not subject to payment of initial margin requirements.

In order to comply with the FRR, the Group must maintain a high level of liquidity at all times. Failure to meet the above requirement may cause the SFC to take appropriate actions against the Group, which may adversely affect the Group's operations and performance.

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Rules amendments and changes to the Code of Conduct to address risks arising from securities margin financing

The following rules amendments and changes to the Code of Conduct were gazetted on 19 May 2006 and came into effect on 1 October 2006:

- a) Securities and Futures (Financial Resources) (Amendment) Rules 2006;
- b) Securities and Futures (Client Securities) (Amendment) Rules 2006;
- c) Securities and Futures (Contract Notes, Statements of Account and Receipts) (Amendment) Rules 2006; and
- d) Amendments to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct).

These amendments aim to implement the proposed measures set out in the Consultation Conclusions on Proposed Measures to Address Risks Arising from Securities Margin Financing published on 7 April 2006 (the “Margin Financing Consultation Conclusions”) by the SFC. The measures seek to:

- a) introduce limits on repledging in two stages – initially (commencement date being 1 October 2006) the limit on the amount of margin clients’ securities collateral which may be repledged by securities firms that conduct securities margin financing will be 180% of the total margin loans of the securities firms and after a period of 12 months, that is repledging on 1 October 2007, such limit will be reduced to 140%; and
- b) make some moderate changes to selected FRR haircut percentages which include:
 - 1) the increase of the hair cut percentages assigned to non-index constituent stocks from the existing 30% to 60% for securities firms which repledge margin clients’ securities, collateral, while keeping all other existing haircut percentages on listed shares unchanged.
 - 2) the increase of the haircut percentage of warrants to 100%, which will be applied to margin clients’ securities collateral (whether the securities from repledged such clients’ collateral or otherwise, house positions and other securities transactions).

To comply with the above new rules, more funding may be required by the Group for extension of margin loans to clients with securities having been repledged by the Group. The Group’s margin financing operations and profitability may in turn be adversely affected.

Amendments to the rules and procedures of HKCC

HKCC has amended the HKCC rules and procedures whereby every HKCC Clearing Participant shall maintain liquid capital of no less than HK\$5 million or the required liquid capital under the FRR. The amendment came into operation on 1 November 2005 with a one-year grace period being given to existing HKCC Clearing Participants.

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Emperor Futures is a HKCC Clearing Participant and the increase of liquid capital from HK\$3 million to HK\$5 million as from 31 October 2006 requires the Group to maintain a higher level of liquidity. Failure to meet the above requirements may cause HKCC to take appropriate actions against the Group which may adversely affect the Group's operations and performance.

Grant of new trading rights

Holding of a trading right of each of the Stock Exchange and the Futures Exchange is a pre-requisite to a participant's access to the trading facilities of the Stock Exchange and the Futures Exchange respectively since the merger of both exchanges on 6 March 2000 (the "Effective Date"). The Stock Exchange and the Futures Exchange imposed a moratorium on the issue of new trading rights (except for such rights as may be issued in respect of alliances with other exchanges) for a period of two years from the Effective Date. Furthermore, no new Stock Exchange Trading Right or Futures Exchange Trading Right was issued for less than the specified consideration for a further period of two years. The moratorium on the issue of new trading rights and the lower limit on the price of new trading rights were removed on 6 March 2002 and 6 March 2004 respectively. An increase in the number of trading rights on the Stock Exchange and/or the Futures Exchange will inevitably further intensify competition in the brokerage industry for securities, futures and options. The increase in number of brokers who hold the trading rights of the Stock Exchange and Futures Exchange as a result of an increase in the supply of such trading rights may adversely affect the market share of the Group in its businesses and hence the Group's results of operation and prospects.

Moreover, the Group is currently holding four Stock Exchange Trading Rights and two Futures Exchange Trading Rights, which are transferable within ten years from the Effective Date. The value of these trading rights may also be adversely affected by such increase of supply of trading rights resulting from any possible new grant thereof from HKEC.

RISKS ASSOCIATED WITH HONG KONG

Macroeconomic considerations

Hong Kong and many Asian countries have experienced a significant economic down-turn and related difficulties in the last few years, which have been exacerbated by the global economic recession. As the economic crisis spread across the region, many Asian governments initially raised interest rates to defend their weakening currencies, which had a negative impact on domestic growth rates. In addition, liquidity was substantially reduced as foreign investors curtailed investments in the region. The currency, as well as interest rate fluctuations and other factors, materially and adversely affected the economy of Hong Kong.

Since all of the Group's earnings are derived from Hong Kong, its businesses and results of operations are directly related to the performance of the Hong Kong stock market which is influenced by factors affecting the general state of the Hong Kong economy. These factors include changes in the regulatory environment, changes in local and international economic and political conditions, general market sentiment, volatility of exchange rates and fluctuations in the interest rates, and its effect as described above may have an adverse impact on the Group's business.

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RISKS ASSOCIATED WITH THE SHARES

Marketability and possible price volatility of the Shares

Prior to the Share Offer, there has been no public trading market for the Shares, and there is no assurance that an active trading market for the Offer Shares will develop or be sustained upon completion of the Share Offer. It is possible that the Offer Shares will be subject to fluctuations in price that may not be directly related to the Group's financial condition or business performance.

Dilution of Shareholders' equity interests

The Group may need to raise additional funds in the future to finance, among other things, expansion of or new developments relating to its existing operations or new acquisitions. In case such additional funds are raised or such acquisitions are made through the issue of new equity or equity-linked securities of the Company other than on a pro-rata basis to the existing Shareholders, the percentage ownership of the existing Shareholders may be reduced and the existing Shareholders may experience dilution of their equity interests in the Company and/or such securities may have rights, preferences and privileges over those attaching to the Shares.

RISK ASSOCIATED WITH THIS PROSPECTUS

Forward-looking statements

This prospectus contains forward-looking statements in respect of the Group's future business plans and the Directors' expectation of the market trend. Such forward-looking statements involve assumptions regarding the environment in which the Group will operate in future. There are also uncertainties, risks and other unforeseen factors which may cause the actual performance or achievements of the Group to be materially different from the performance or achievements implied by the forward-looking statements.