

Chairman's Statement and Management Discussion and Analysis

I am pleased to report the activities of South China Brokerage Company Limited (the "Company") and its subsidiaries (collectively "the Group") for the year ended 31 December 2005.

BUSINESS REVIEW

Rising oil prices, successive interest rate hikes in the US and Hong Kong and macro-tightening in Mainland China seemed to have little impact on Hong Kong economy. The property market still held firm on the back of rising mortgage rates. However, the Hong Kong stock market was monotonous. The Hang Seng Index traded within a narrow range, with a yearly high of 15,508 and a low of 13,320. Amidst these uncertainties in the macro economic environment the Hang Seng Index closed at 14,876 for 2005, compared with 14,230 at the end of 2004 with a mere 4.5% appreciation, one of the worst-performing markets globally.

The Group recorded a decrease in turnover to HK\$117 million for the year ended 31 December 2005, as compared to HK\$132 million in last year. The decrease was in part a reflection of a directionless market environment throughout the first half of the year under review. The brokerage revenue in the second half of the year began to pick up though at a much slower pace when the expectation that the US Federal Reserve might soon end its cycle of rising interest rates greatly improved the sentiment of the securities markets in the region. The profit for the year of 2005 decreased to HK\$4.2 million.

During the year, we launched the trading of a range of global commodity futures contract both with a view to provide better service to our clients as well as to minimise the impact on business performance by market cycles.

We are pleased that the financial services industry continues to recognize our market niche as South China Research was rated at the top of the "RQ Analysing the Analyst" award list since 2nd Quarter 2005 to 4th Quarter 2005 by the internationally acclaimed AQ Research, which analyses the quality of analyst recommendations around the world including those from some of the most prominent international investment banks.

OPERATION REVIEW

Securities broking, trading and investment

During the year ended 31 December 2005, performance of the Group's brokerage business dropped due to a decrease in income from securities and futures broking by 11% to HK\$65.6 million for the year of 2005 as compared with 2004. The result from broking operation in 2005 was a loss of HK\$5.1 million as compared with a profit of HK\$6.2 million in 2004. The drop was largely attributed to low market turnover of China-related stocks during the first half of 2005, which was the investment focus of many of the Group's brokerage business clients.

Income from securities trading and investment was HK\$6.8 million for the year of 2005 as compared with HK\$18.6 million for the year of 2004. There was a fair value loss in financial assets at fair value through profit or loss of HK\$15.7 million which resulted in an overall loss of HK\$13.2 million in this segment. The Group had financial assets at fair value through profit or loss of HK\$58.2 million and available-for-sale financial asset of HK\$12.3 million in value by the end of the year.

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Margin financing and money lending

These activities registered a decline in business and profitability.

Corporate advisory and underwriting

Revenue from this segment in 2005 increased by 18% to HK\$9.8 million as compared with the year of 2004. With the additional cost of establishments in Mainland China, the result for the year of 2005 was a loss of HK\$1.3 million being an improvement as compared with a loss of HK\$1.6 million in 2004.

Property investment and others

We maintained a bullish view of the property market and there has been a valuation gain on the property of HK\$30 million.

LIQUIDITY AND FINANCIAL RESOURCES

The Group has obtained facilities which are renewable on a yearly basis from a number of banks. The facilities for the share margin finance operations are secured by the securities of margin clients and the Group. The facilities for the money lending operations are clean loans. All the facilities are guaranteed by the Company.

As at 31 December 2005, the Group's long term bank borrowings apart from those for share margin finance business and personal loan business amounted to HK\$51 million (2004: HK\$29 million), which, when related to the Group's equity of HK\$322.8 million (2004: HK\$308.4 million), represent a gearing ratio of approximately 15.8% (2004: 9.4%).

EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES AND RELATED HEDGES

As at 31 December 2005, the Group had no significant exposure to fluctuations in exchange rates and any related hedges.

CAPITAL STRUCTURE

The Group had no other debt securities or capital instruments as at 31 December 2005.

MATERIAL ACQUISITIONS AND DISPOSALS OF SUBSIDIARIES AND ASSOCIATES

The Group had no material acquisitions and disposals of subsidiaries and associates for the year ended 31 December 2005.

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CHARGES ON ASSETS

As at 31 December 2005, the Group's leasehold land and building was pledged to a bank for installment and revolving loan facilities.

CONTINGENT LIABILITIES

At the balance sheet date, the Group's contingent liabilities not provided for in the financial statements are as follows:

	GROUP		COMPANY	
	2005 HK\$'000	2004 HK\$'000	2005 HK\$'000	2004 HK\$'000
Guarantees given to certain financial institutions in connection with commodities and bullion trading facilities granted to subsidiaries	—	—	11,953	11,957
Guarantees given to banks in connection with banking facilities granted to subsidiaries	—	—	514,910	541,000

INVESTMENTS

For the year ended 31 December 2005, the Group's portfolio of Hong Kong listed securities decreased due to a drop of market prices.

Save as disclosed in note 41 to the financial statements, post balance sheet event, as at 31 December 2005, the Group did not have any significant investment plans or significant investment held.

EMPLOYEES

As at 31 December 2005, the total number of employees of the Group was approximately 192 (31 December 2004: approximately 198). Employees' cost (including directors' emoluments) amounted to approximately HK\$49 million for the year (2004: HK\$41 million).

The Group considers its employees as its most valuable asset. Apart from salary payment, other staff benefits include medical subsidies, life insurance, provident fund and subsidized external training. Continuous Professional Training will continue to be arranged for those staff registered with the Securities and Futures Commission. Performance of the employees is normally reviewed on an annual basis with adjustment compatible to the market. Individual employee may also receive a discretionary bonus at the end of each year based on performance. The Company adopted an employee share option scheme on 31 May 2002 which became effective on 28 June 2002.

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PROSPECTS

The local and global economies continue to grow and especially the Chinese economy. Hong Kong remains as the preferred listing location for Mainland enterprises and with the coming IPO's of major state owned companies in the PRC, we see robust prospects for the local stock market in 2006.

While we continue to grow our revenue from our traditional brokerage business, we concurrently look for new opportunities in business sectors with high growth potential. Through a wholly-owned subsidiary, the Group is acquiring a 51% equity interest in a mining holding company in China. This company has already been granted exploration rights in gold, copper and tungsten mining projects and the Group is currently performing due diligence work.

The demand for natural resources is huge and we believe that the acquisition will provide a good opportunity for us to expand into the mining industry. Upon completion, this new strategic acquisition will allow us to further enhance shareholders' value by participating in the mining industry in China.

The Group takes the view that the precious metals mining industry in the PRC is a new activity that could rapidly become a very promising major cornerstone amongst our existing businesses. We plan to grow this division by acquisition and the purchase of the equity interest in a PRC company with exploration rights in gold, copper and tungsten is the Group's very first step. Due to our recent active search for investment opportunities in this industry, the Group is currently negotiating with a number of joint venture partners with offers for further major expansion. The offers cover widespread geographical mining zones in the Mainland, including Gansu, Guizhou, Guangxi, Yunan, Xinjiang, Tibet, Mongolia, Shanxi. We have already formed a special task force for studying the potential projects. The management expects that there will be more significant commitments to mining ventures in the near future.

APPRECIATION

On behalf of the Board, I wish to express my gratitude to our shareholders and clients for their support and all our staff for their hard work and dedicated service.

Ng Hung Sang

Chairman

Hong Kong, 19 April 2006