

# Chairman's Statement and Management Discussion and Analysis

I am pleased to report the activities of South China Financial Holdings Limited (formerly known as South China Brokerage Company Limited) (the "Company") and its subsidiaries (collectively the "Group") for the year ended 31 December 2006.

## **BUSINESS REVIEW**

With the listing of the major PRC stated owned banks and a number of mega-cap PRC companies in Hong Kong during the year and the inclusion of H-shares in the Hang Seng Index stimulated the Hang Seng Index as well as the daily market turnover reached historical highs since 2000. Hang Seng Index closed at 19,965 for 2006, compared with 14,876 at the end of 2005 with a 34.2% appreciation, a record year for the Hong Kong stock market.

The Group recorded an increase in turnover to HK\$157 million for the year ended 31 December 2006, as compared to HK\$117 million in last year. The profit for the year of 2006 increased to HK\$25.3 million as compared to HK\$4.2 million in last year.

## **OPERATION REVIEW**

### **Securities broking, trading and investment**

During the year ended 31 December 2006, performance of the Group's brokerage business improved substantially as a result of an increase in income from securities and futures broking by 29% to HK\$84.4 million for the year of 2006 as compared with 2005. The result from broking operation in 2006 was a profit of HK\$9.7 million as compared with a loss of HK\$5.1 million in 2005.

Income from securities trading and investment was HK\$13.3 million for the year of 2006 as compared with HK\$6.8 million for the year of 2005. There was a fair value gain in financial assets at fair value through profit or loss of HK\$2.6 million which resulted in an overall profit of HK\$10.3 million in this segment. The Group had financial assets at fair value through profit or loss of HK\$81.2 million and available-for-sale financial asset of HK\$23.2 million in value by the end of the year.

### **Margin financing and money lending**

Income from margin financing and money lending business increased by 38% from HK\$38.1 million in the previous year to HK\$52.6 million this year. The profit of this segment for the year of 2006 increased by 204% to HK\$13.5 million as compared with 2005. Our loan and advances portfolio for margin financing and personal loan increased by 35% to HK\$214 million by the end of the year 2006.

### **Corporate advisory and underwriting**

Revenue from this segment in 2006 decreased by 8% to HK\$9 million as compared with the year of 2005. There was a loss of HK\$3.7 million in 2006.

### **Property investment and others**

Rental income from the investment property at Lippo Centre increased by 53% to HK\$4.4 million in 2006. There has been a valuation gain on the property of HK\$7 million.

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## 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 2006, the Group's long term bank borrowings apart from those for share margin finance business and personal loan business amounted to HK\$44.9 million (2005: HK\$51 million), which, when related to the Group's equity of HK\$368.1 million (2005: HK\$322.8 million), represent a gearing ratio of approximately 12.2% (2005: 15.8%).

## EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES AND RELATED HEDGES

As at 31 December 2006, 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 2006.

## 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 2006.

## CHARGES ON ASSETS

As at 31 December 2006, 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	
	2006 HK\$'000	2005 HK\$'000	2006 HK\$'000	2005 HK\$'000
Guarantees given to certain financial institution in connection with commodities and bullion trading facilities granted to subsidiaries	—	—	—	11,953
Guarantees given to banks in connection with banking facilities granted to subsidiaries	—	—	845,910	514,910

## INVESTMENTS

For the year ended 31 December 2006, the Group's portfolio of Hong Kong listed securities increased mainly due to net addition during the year and increase of market prices lead to increase in fair value on the balance of investment portfolio.

As at 31 December 2006, the Group did not have any significant investment plans or significant investment held.

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## EMPLOYEES

As at 31 December 2006, the total number of employees of the Group was approximately 181 (31 December 2005: approximately 192). Employees' cost (including directors' emoluments) amounted to approximately HK\$48 million for the year (2005: HK\$49 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.

## PROSPECTS

Year 2007, the Group changed its name to South China Financial Holdings Limited to reflect the commitment for expansion and diversification strategies. The stock market is going to be volatile but the economic growth of Hong Kong is expected to remain stable in 2007. The Group will continue to focus and grow its securities broking arm as a result of the ongoing supply of Mainland China-related IPOs. To fortify our position among our competitors, the Group will extend more valuable features on our online trading platform to improve our services to our clients.

In the second half, on the money lending business, the Group plans to open one more branch that will create new channel for target marketing. The Group will continue to expand its lending business through more aggressive promotions and marketing activities to a wider spectrum and penetration to SME customers in Hong Kong.

On China side, the Group has established a number of footholds through its joint ventures or representative offices in China, and simultaneously strengthens its investment banking and corporate finance activities. This marks a milestone for the Group's business expansion into China market.

## 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, 3 April 2007