

Quarterly Financial Review of the Securities Industry Intermediaries Supervision Department¹ October 2004

Summary

During the second quarter of 2004, there were various uncertain market factors such as movements of the interest rate and oil prices affecting the performance of the securities market. Under these influences, the market turnover and profitability of the securities industry reduced as compared to the first quarter of 2004.

Overview of the Securities Industry in the Second Quarter of 2004

1. The securities market in this quarter was influenced by various uncertain market factors such as interest rates and oil prices. Table 1 summarises the securities market's statistical information and financial highlights for the second quarter of 2004. The slight reduction in the balance sheet figures between the second and first quarters of 2004 as shown in Table 1 reflected a less active market in the quarter. It was noticed that the total value of transaction reported in the second quarter of 2004 decreased by 24% which led to a respective adjustment in net securities commission income by 28%, as compared to the first quarter of 2004. Under such market condition, the profitability of the industry was reduced by about 45% to HK\$3.2 bn in this quarter.
2. Despite the lower market turnover and reduced profitability, the shareholders' fund of the industry was still further strengthened by about 7% to HK\$74 bn during the quarter. In addition, it was noted that both the amount of margin loan and the average collateral coverage ratio did not have significant fluctuation. This suggested that the quality of margin loans remained steady in this quarter.

¹ This paper is for pure fact-finding and research purpose, and is not an attempt to comment on the developments of any markets/ companies or interpret the policies concerned. The views expressed in this paper do not represent those of the SFC.

Table 1 – Statistical Information and Financial Position of the Securities Industry		
As at	30/06/2004	31/03/2004
Total number of securities dealers & securities margin financiers	667	669
Total number of active cash clients ¹	666,621	706,136
Total number of active margin clients ¹	75,419	92,012
Balance Sheet (HK\$ mn)		
Cash in hand and at bank ²	99,811	97,938
Amounts receivable from margin clients ³	16,008	16,481
Amounts receivable from clients and other dealers arising from dealing in securities	77,496	89,208
Other assets	103,754	109,942
Total assets	297,069	313,569
Amounts payable to clients and other dealers arising from dealing in securities	124,815	139,040
Total borrowings from financial institutions	41,642	44,901
Other liabilities	56,505	60,191
Total shareholders' fund ⁴	74,107	69,437
Total liabilities and shareholders' fund	297,069	313,569
	3 months to	3 months to
	30/06/2004	31/03/2004
Profit and loss (HK\$ mn)		
Total value of transactions ⁵	3,674,470	4,861,593
Net securities commission income	4,153	5,803
Gross interest income	530	703
Other income ⁶	7,050	8,516
Total overheads and interest expense	(8,526)	(9,184)
Net profit for the period	3,207	5,838
Remarks:		
¹ Active clients are clients for whom the licensed corporation is required to prepare and deliver monthly statement of accounts in respect of the relevant reporting month in accordance with Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules.		
² Cash in hand and at bank includes trust monies held on behalf of clients amounting to HK\$43,019 mn (31/3/2004: HK\$44,620 mn).		
³ Average collateral coverage (the number of times the aggregate market value of securities collateral deposited by clients covers the amounts receivable from margin clients on a given date on an industry-wide basis) :		
	<u>As at 30/06/2004</u>	<u>As at 31/03/2004</u>
	4.3	4.2
⁴ The value of shareholder's fund includes value of redeemable shares.		
⁵ The value of transactions includes trading in equities and bonds both in Hong Kong and overseas.		
⁶ Other income mainly comprises corporate finance income, fund management income, net profit/loss on proprietary trading, intercompany charges and others.		
Sources: Monthly Financial Returns submitted in accordance with the Securities and Futures (Financial Resources) Rules by securities dealers and securities margin financiers.		

Business Performance of SEHK Participants

3. After the uptrend in market turnover for three consecutive quarters, the average daily turnover shrank by 29% from HK\$19 bn to HK\$14 bn and the Hang Seng Index fluctuated between 10,917 and 13,126 during the quarter. This slowdown in

market activity produced an across-the-board income effect on all SEHK participants. The result as summarised in Table 2 indicated that the profitability of SEHK participants declined to HK\$1.5 bn in the second quarter of 2004, down 58% as compared to the first quarter of 2004.

Table 2 – Financial Performance of SEHK Participants

	Quarter 2 2003	Quarter 3 2003	Quarter 4 2003	Quarter 1 2004	Quarter 2 2004
Total value of transactions (HK\$ bn)	1,125	1,766	2,172	2,777	1,986
Net securities commission income (HK\$ mn)	1,960	3,126	3,570	4,360	3,078
Net profit/(loss) from proprietary trading (HK\$ mn)	96	170	156	293	(8)
Net profit for the period (HK\$ mn)	597	1,993	1,384	3,517	1,480

Sources: Monthly Financial Returns submitted in accordance with the Securities and Futures (Financial Resources) Rules by securities dealers and securities margin financiers.

4. In addition, we further analysed the financial performance of each category of SEHK participants as shown in Table 3 and noticed that all three categories of SEHK participants experienced a drop in the quarterly total operating income which was primarily due to a decline in

market turnover. While the operating costs of Categories A and B SEHK participants remained stable, Category C SEHK participants continued to control its operating costs down by 13% to partially offset the adverse effect arising from the decline in turnover. ■■■

Table 3 – Financial Performance of SEHK Participants – Breakdown in Different Categories (HK\$ mn)

	Category A*		Category B*		Category C*		All SEHK Participants	
	Quarter 1 2004	Quarter 2 2004	Quarter 1 2004	Quarter 2 2004	Quarter 1 2004	Quarter 2 2004	Quarter 1 2004	Quarter 2 2004
Total value of transactions	1,278,673	946,680	966,755	692,833	531,701	345,999	2,777,129	1,985,512
Total operating income	4,087	2,923	1,715	1,169	1,341	924	7,143	5,016
Total overheads and interest expense	(1,888)	(1,916)	(957)	(938)	(781)	(682)	(3,626)	(3,536)
Net profit for the period	2,199	1,007	758	231	560	242	3,517	1,480

* Categories A, B and C SEHK participants are identified on a monthly basis, based on their turnover on the SEHK. Category A SEHK participants refer to the top 14 brokers by market turnover, whilst Category B SEHK participants refer to those ranked 15 - 65 and the remainders are grouped under Category C SEHK participants.

Sources: Monthly Financial Returns submitted in accordance with the Securities and Futures (Financial Resources) Rules by securities dealers and securities margin financiers.