

Quarterly Financial Review of the Securities Industry

Intermediaries Supervision Department¹

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Summary

The total value of transactions and securities commission income of the securities industry remained stable during this quarter. Overall profitability of the industry continued to grow considerably primarily due to considerable reduction in overheads as compared with the last quarter.

Overview of the Securities Industry in the First Quarter of 2005

1. During this quarter, Hong Kong stock market was surrounded by various market uncertainties such as interest rate hikes and oil prices. While the Hang Seng Index adjusted downward by 5%, the average daily turnover on Main Board mildly increased by 2% to HK\$18 bn during this quarter.
2. Table 1 summarised the securities industry's statistical information and financial highlights for the first quarter of 2005.
3. Total value of transactions and securities commission income of the securities industry kept at a similar level of the fourth quarter of 2004. However, non-commission income decreased substantially by 25% which was mainly attributable to the slowdown of IPO activities during this quarter. For example, the number of newly listed companies and amount of funds raised in this quarter significantly decreased by 61% (18 to 7) and 84% (HK\$38 bn to HK\$6 bn) respectively as compared with last quarter.
4. Overall profitability of the industry increased by 34% as the financial effect of static commission income source and drop in non-broking income was offset by significant reduction in overhead expenses by 20% during the first quarter of 2005.
5. On the other hand, amounts receivable from margin clients stood at around HK\$15 bn in this quarter but average collateral coverage slightly adjusted downward from 4.6 times to 4.2 times, largely in line with decline in the Hang Seng Index.

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	31/03/2005	31/12/2004
Total number of securities dealers & securities margin financiers	628	663
Total number of active cash clients ¹	601,594	609,281
Total number of active margin clients ¹	69,568	76,546
Balance Sheet (HK\$ mn)		
Cash in hand and at bank ²	102,208	110,176
Amounts receivable from margin clients ³	17,515	17,158
Amounts receivable from clients and other dealers arising from dealing in securities	98,850	65,357
Proprietary positions	77,615	77,777
Other assets	66,973	61,145
Total assets	363,161	331,613
Amounts payable to clients and other dealers arising from dealing in securities	158,181	124,739
Total borrowings from financial institutions	63,074	56,264
Short positions held for own account	21,588	26,552
Other liabilities	43,499	47,068
Total shareholders' fund ⁴	76,819	76,990
Total liabilities and shareholders' fund	363,161	331,613
	3 months to	3 months to
	31/03/2005	31/12/2004
Profit and loss (HK\$ mn)		
Total value of transactions ⁵	4,655,896	4,525,501
Net securities commission income	4,555	4,561
Gross interest income	838	792
Net profit on proprietary trading	270	74
Other income ⁶	6,763	9,037
Total overheads and interest expense ⁷	(10,174)	(12,781)
Net profit for the period	2,252	1,683
Remarks:		
¹ Active clients are clients for whom the licensed corporation is required to prepare and deliver monthly statements of account 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\$48,107 mn (31/12/2004: HK\$49,305 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 31/03/2005</u>	<u>As at 31/12/2004</u>
	4.2	4.6
⁴ The value of shareholder's fund includes value of redeemable shares.		
⁵ Total 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, intercompany charges and others.		
⁷ Total overheads include salary and staff benefits paid to non-commission based staff of licensed corporations. Commission paid to account executives and others has been netted off with commission income to arrive at the net securities commission income.		
	<u>3 months to 31/03/2005</u>	<u>3 months to 31/12/2004</u>
	(HK\$ mn)	(HK\$ mn)
	5,257	6,340
Salary and staff benefits		
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

6. After a strong quarter buoyed by active IPO activities, there was no significant change in the total value of transactions and net securities

commission of SEHK participants. However, the net profit grew by 18%, caused by a 20% reduction in overheads during this quarter.

Table 2 – Financial Performance of SEHK Participants

	Quarter 1 2004	Quarter 2 2004	Quarter 3 2004	Quarter 4 2004	Quarter 1 2005
Total value of transactions (HK\$ bn)	2,777	1,986	1,894	2,785	2,872
Net securities commission income (HK\$ mn)	4,359	3,078	2,897	3,678	3,564
Net profit/(loss) from proprietary trading (HK\$ mn)	293	(8)	12	116	9
Net profit for the period (HK\$ mn)	3,517	1,480	1,239	818	967

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

7. Table 3 summarised the financial performance of each category of SEHK participants.

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

	Category A*		Category B*		Category C*		All SEHK Participants	
	Quarter 4 2004	Quarter 1 2005	Quarter 4 2004	Quarter 1 2005	Quarter 4 2004	Quarter 1 2005	Quarter 4 2004	Quarter 1 2005
Total value of transactions	1,289,472	1,347,773	938,785	1,080,793	557,237	443,033	2,785,494	2,871,599
Total operating income	2,888	2,313	2,318	1,830	1,221	1,340	6,427	5,483
Overheads and interest expense	(2,641)	(1,964)	(1,692)	(1,418)	(1,276)	(1,134)	(5,609)	(4,516)
Net profit for the period	247	349	626	412	(55)	206	818	967

* 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

8. During this quarter, Categories A and B SEHK participants could keep their transaction volume largely stable. However, the total value of transactions of Category C SEHK participants declined by 20% as their average quarterly market share dropped from 17% to 15% as compared with last quarter.

9. Categories A and C SEHK participants reported increase in their quarterly earnings due to the decrease in overheads by 26% and 11% respectively. However, operating profit of Category B SEHK participants was adversely affected by the decline in total operating income by 21% during the quarter. ■