2006
Annual Report

NETEL TECHNOLOGY (HOLDINGS) LIMITED

(incorporated in the Cayman Islands with limited liability)

(Stock Code: 8256)

CHARACTERISTICS OF THE GROWTH ENTERPRISE MARKET ("GEM") OF THE STOCK EXCHANGE OF HONG KONG LIMITED (THE "STOCK EXCHANGE")

GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on GEM and the business sectors or countries in which the companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

Given the emerging nature of companies listed on GEM, there is a risk that securities traded on GEM may be more susceptible to high market volatility than securities traded on the Main Board and no assurance is given that there will be a liquid market in the securities traded on GEM.

The principal means of information dissemination on GEM is publication on the Internet website operated by the Stock Exchange. Listed companies are not generally required to issue paid announcements in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website in order to obtain up-to-date information on GEM-listed users.

This report, for which the directors of Netel Technology (Holdings) Limited ("Netel") collectively and individually accept full responsibility, includes particulars given in compliance with the GEM Listing Rules for the purpose of giving information with regard to Netel. The directors of Netel, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief: (i) the information contained in this report is accurate and complete in all material respects and not misleading; (ii) there are no other matters the omission of which would make any statement in this report misleading; and (iii) all opinions expressed in this report have been arrived at after due and careful consideration and are founded bases and assumption that are fair and reasonable.

Contents

Corporate information

DIRECTORS

James Ang
Yau Pui Chi, Maria
Yeung Kam Yuen, Roderick*
Li Chi Wing*
Chan Chun Chung William*

* *Independent Non-executive Directors*

COMPANY SECRETARY

Chan Fai Tai

COMPLIANCE OFFICER

James Ang

QUALIFIED ACCOUNTANT

Chan Fai Tai

AUTHORISED REPRESENTATIVES

James Ang
Chan Fai Tai

AUDIT COMMITTEE

Yeung Kam Yuen, Roderick
Li Chi Wing
Chan Chun Chung, William

BANKERS

DBS Bank Limited

AUDITORS

Lau & Au Yeung C.P.A. Limited

REGISTERED OFFICE

Century Yard Cricket Square
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George Town
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Cayman Islands
British West Indies

HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS IN HONG KONG

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REGISTRARS *(in Cayman Islands)*

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Butterfield House
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British West Indies

REGISTRARS *(in Hong Kong)*

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WEBSITE

http://www.neteltech.com.hk.

GEM STOCK CODE

8256

Chairman's statement

The last 2005-2006 fiscal year was a year of changes, evolution and achievement. The group underwent a lot of changes such as streamlining the retail outlets of calling cards, stay away from the low-margin wholesales minutes market, evolve into voice over IP products, and migration from local to overseas market, etc, and these changes resulted a big improvement in profit and loss of the group. Although the company still reported a loss for the year, there was a substantial improvement comparing to previous two years. The loss for the year was mainly attributable to keen market competition and depreciation of fixed assets. In short, the group has been turning around in this year.

The company successfully pulled out from the retail shops business and significantly reduced overhead cost. Fortunately, due to our long presence in the calling cards business, there are still significant number of customers who keep on consuming our products and services. However, our focus has gradually moved to overseas markets.

The group set up a business alliance with a reputable family in the Philippines and started selling Web phones and SIP phones to the Filipino market. On the other hand, the group also successfully penetrated into the market of Japan, Malaysia, Nepal and other overseas countries by promoting voice over IP equipments.

The group also utilised the WiFi technology to carry voice over IP through wireless application and successfully demonstrated in different countries of such application. Since the group already invested in the central hub of equipments of the Web phone, SIP phone and WiFi phones, it will continue this strategy and bring in overseas partners and distribution channels to promote related products and services.

As a result of growth of the group's business in a faster manner, the group is very close to conclude a deal of investing in a foreign operator who has license to operate in the related country and this will be the strategy to be employed in the foreseeable future to speed up our growth in the business.

Finally, I would like to extend my sincere thanks to the shareholders, fellow staff of the group who tried all the best to support the growth of the group in the last year.

James Ang
Chairman

Hong Kong, 25 August 2006

Management discussion and analysis

RESULTS FOR THE YEAR

The Group recorded a total turnover HK$11.7 million in the year ended 31st May 2006, a decrease of 55.3% from HK$26.2 million for the year ended 31st May 2005. The decrease was attributable to the decrease in calling card sales and carrier sales. Although the turnover dropped in this year, the gross profit margin increased from 15.9% for last year to 40.8% for this year. The increase in overall gross profit margin was mainly attributable to the significant decrease in carrier sales that only contributed very thin profit margin and the increase in sales of web phones. The loss for the year was also narrowed down from HK$13.3 million in the last year to HK$5.3 million in this year, reflecting a significant improvement. The reduction in the loss for the year was due to the improvement of gross profit margin as the company is shifting from the wholesales minutes to voice over IP and there were significant cost reduction on the retail outlets.

The administrative expenses decreased by HK$7.2 million from HK$17.0 million of last year to HK$9.8 million for this year. It was mainly attributable to the decrease of rental expenses of HK$2.4 million and the decrease of salary and allowance of HK$1.6 million.

BUSINESS REVIEW

During the year, the company has gone through a significant cost reduction on the calling cards retail outlets and expand the market to foreign countries such as Japan, Malaysia, Philippines and other countries. The product mix is also enhanced to incorporate the voice over IP hardware and services.

VOICE OVER IP HARDWARE

The Company has set up the IP platform including billing system and exchange facilities to enable the sales of web phones and SIP phones in overseas countries. These hardware can be used by connecting to computers or as a stand alone phone set by connecting to boardband network anywhere in the world. These hardware are also memory devices with built-in communication software. The Company has made significant sales of these equipments to overseas market.

OVERSEAS MARKETS

During the year, the Group explored business opportunities with foreign partners with an aim to secure voice over IP telecom licenses for conducting related business in overseas countries. Management sees better profit margin and bigger market size in these foreign countries in respect of voice over IP products so the Group will focus on these foreign markets in the coming future.

Management discussion and analysis

FINANCIAL REVIEW

Liquidity and Financing

For the year ended 31st May 2006, the Group incurred a loss of HK$5.3 million and the net cash outflow from operations was approximately HK$5.7 million. The outflow was mainly attributable to operating loss before changes in working capital of approximately HK$2.5 million, decrease in receivable of HK$1.6 million and decrease in payables of HK$4.8 million. With the increase of amount due to a director of approximately HK$7.2 million, the net cash and cash equivalents of the Group was increased by approximately HK$32,000.

As at 31st May 2006, the group had a cash and cash equivalent balance of HK$0.2 million. The total obligations under finance lease of approximately HK$0.3 million which was substantially short-term in nature and were secured by fixed assets of the Group. The gearing ratio, defined as total bank and finance lease borrowings divided by the shareholders' fund as at 31st May 2006 was not applicable as there was negative shareholders' fund (2005: not applicable). The Group had net current liabilities of HK$27.0 million as at 31st May 2006 as compared with HK$23.6 million as at 31st May 2005.

Most of the transactions of the Group are denominated in US Dollars and HK Dollars. As the exchange rate of US Dollar against HK dollars is fairly stable, the Board is of the view that the exposure to foreign currency exchange risk is limited. Hence, no other arrangements to reduce the currency risk have been implemented.

BUSINESS OUTLOOK

The Company has evolved from a local IDD calling cards supplier to an international operator as well as a voice over IP supplier. The business for the company will be more focused on the voice over IP products especially in the foreign markets.

As a matter of fact, the IDD rate in Hong Kong is becoming lower and lower and the competition is very keen. However, the voice over IP provides advanced technology especially the wireless applications such as WiFi and Wimax which can assist the Group to expand the products and services to voice, data and video applications.

The Group believes this market and related revenue stream will be more stable and longer term than the previous IDD calling cards.

EMPLOYEE INFORMATION

At 31st May 2006, the Group employed a total of 19 (2005: 25) employees including Directors. The Salaries and benefits of the Group's employees are kept at a competitive level. The Group also operates a share option scheme where options to subscribe for shares of the Company may be granted to the executive Directors and full time employees of the Group. As at 31st May 2006, no share options have been granted from the share option scheme.

Directors and senior management

EXECUTIVE DIRECTORS

Mr. James Ang ("Mr. Ang"), age 47, is the chairman of the Company and the founder of the Group. Mr. Ang is responsible for the business planning on overall development of the Group. He has around 20 years of experience in telecommunications industry. Prior to joining the Group in 1996, he served as a sales manager of Swire Telecom from 1984 to 1986 and was responsible for the establishment of offices in the PRC. After being employed with Swire Telecom, Mr. Ang served as a Director of the telecom division of AT&T from 1986 to 1995 and took charge of its business development in different countries. He obtained an honours diploma in Business and Management from the Hong Kong Baptist College (now the Hong Kong Baptist University) in 1983. He is also a graduate from the University of London with bachelor degree in laws. He was called to the bar in United Kingdom and Hong Kong in 1991 and 1992 respectively.

Ms. Yau Pui Chi Maria ("Ms. Yau"), aged 46, Mr. Ang's spouse, who has more than 18 years of commercial experience, is the vice president of the customer service department of the Group. Ms. Yau obtained an honours diploma in Business and Management from the Hong Kong Baptist College (now the Hong Kong Baptist University) in 1983. After graduation, she has been working in Airland Mattress Co. in charge of marketing and promotion activities in the People's Republic of China ("PRC") and Hong Kong. She also worked in Inni Company as an assistant manager from 1984 to 1990. Since 1989, she has been the Director of Charmfine Investments Limited and is responsible for the sales of accessory products. Ms. Yau is experienced in direct interface with dealers and end-users. Ms. Yau joined the Group in 1999.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. Yeung Kam Yuen Roderick ("Mr. Yeung"), aged 56, has studied Laws in the University of London and obtained his academic qualification of Bachelor of Laws in 1988. He obtained his post-graduate certificate in Laws in the University of Hong Kong in 1989. In 1995, he commenced his own business and had since been the partner of the firm, Yeung & Chan Solicitors. His major areas of practice are conveyancing, civil and criminal litigation. Mr. Yeung is also a member of the Institute of Housing of the United Kingdom since 1978 and was qualified as a member of the Law Society of England in 1992.

Mr. Li Chi Wing ("Mr. Li"), aged 47, obtained an honours diploma in Business and Management from the Hong Kong Baptist College (now the Hong Kong Baptist University) in 1983. After graduation, he worked as a sales executive in RCL Semiconductors Limited until 1986. He then joined Wellchem Pharmaceutical Limited and worked as a medical retailer for a year. From 1987 to 1990, he served as a senior marketing executive in KCL Electronics Co. and was responsible for promoting products and formulating marketing plans and proposals. From 1991 to 2004, Mr. Li was appointed as the assistant marketing manager in Ling Kee Publishing Company Limited. Since April 2004, Mr. Li became a consultant of a local trading company. Mr. Li was re-appointed as the assistant marketing manager of Ling Kee Publishing Company Limited in April 2005.

Directors and senior management

Mr. Chan Chun Chung William ("Mr. Chan"), aged 49, has been practising as a certified public accountant since 1996 and is now a partner of Chan, Lam & Company, CPA. Prior to this, he worked as company secretary and financial and corporate service advisor in a number of listed companies in Hong Kong. He is an associate member of the Hong Kong Institute of Certified Public Accountants and a fellow member of the Association of Chartered Certified Accountant. Mr. Chan is also an associate member of both the Institute of Chartered Secretaries and Administrators in United Kingdom and Hong Kong Institute of Company Secretaries.

SENIOR MANAGEMENT

Mr. Woo Moon Yuen ("Mr. Woo"), aged 30, is the vice president of the sales department of the Group and is responsible for the sales development of telecommunication services with the telecommunication carriers and the sales activities of the Group's prepaid telephone cards business. Prior to joining the Group in November 2000, Mr. Woo was responsible for the sales and marketing management of telephone cards business, in a local ETS operator, Asia Touch International Co., Ltd. since April 2000. He obtained a bachelor degree in business administration from Clayton University in 1999.

Corporate governance report

The Group acknowledges the importance of corporate governance as a key for the value of the Group. The Group is also committed to a high standard of corporate governance that can properly protect and promote the interest of the shareholders and enhance the value of the corporation.

CORPORATE GOVERNANCE PRACTICES

The corporate governance principles of the company emphasise a quality Board, sound internal controls, transparency and accountability to all shareholders. Throughout the financial year ended 31st May 2006, the Group has compiled with the code provisions in the Code on Corporate Governance Practices (the Code) as set out in Appendix 15 of the GEM Listing Rules, except for the code provision A 2.1 stipulated in the following paragraphs.

The code provision A 2.1 stipulates that the roles of Chairman and Chief Executive Officer ("CEO") should be separate and should not be performed by the same individual. The division of responsibilities between the Chairman and Chief Executive Officer should be clearly established and set out in writing.

Mr. James Ang is both the Chairman and CEO of the Company who is responsible for managing the Board and the Group's business. Mr. Ang has been the Chairman and CEO since the establishment of the Company. The Board considers that, with the present board structure and scope of business, there is no imminent need to separate the roles into two individuals. However, the Board will continue to review the effectiveness of the Group's corporate governance structure to assess whether the separation of the position of Chairman and CEO is necessary.

BOARD OF DIRECTORS

The Board comprises two executive Directors and three independent non-executive Directors. Each Director has relevant experiences, competence and skills appropriate to the requirement of the business of the Company. Two of the Directors have professional qualification, they provide valuable skills and ideas for the Corporation.

The Board members as at 31st May 2006 were:

Executive Directors
Mr. James Ang
Ms. Yau Pui Chi Maria

Independent Non-Executive Directors ("INEDs")
Mr. Yeung Kam Yuen Roderick
Mr. Li Chi Wing
Mr. Chan Chun Chung William

Corporate governance report

The Board is responsible for directing the Group to success and enhancing shareholders' value by formulating the Group's overall strategy, key objectives and policies. The Board monitors and oversees the operating and financial performance of the Group pursuant to these objectives.

The Board has established two Board Committees, namely the Audit Committee and the Remuneration Committee, to oversee particular aspects of the Company's affairs and to assist in the execution of certain aspects of the Board's responsibilities.

The Board has also delegated the day-to-day management and operation of the Group's business to the management team.

There are currently three non-executive Directors on the Board, all of whom are independent. They have been appointed for a specific term and subject to retirement by rotation in accordance with the Company's Articles of Association and thus submit themselves, on a rotation basis, for re-election by shareholders.

AUDIT COMMITTEE

The Company has established an Audit Committee ("AC") with specific terms of reference explaining its role and authorities delegated by the Board. The AC consists of three independent non-executive Directors, Mr. Li Chi Wing, Mr. Chan Chun Chung, William and Mr. Yeung Kam Yuen, Roderick who together have sufficient accounting and financial management expertise, legal and business experience to carry out their duties.

The AC's principal duties include reviewing the Group's financial control, internal control and risk management, review and monitor the integrity of financial statements and reviewing annual, interim and quarterly financial statements and report before submission to the Board. The AC meets with the external auditors and the management of the Group to ensure that the audit findings are addressed properly.

The AC has reviewed the annual, interim and quarterly results of the Company for the year ended 31st May 2006 and was content that the accounting policies of the Group are in accordance with the generally accepted accounting practices in Hong Kong.

Corporate governance report

REMUNERATION OF DIRECTORS AND SENIOR MANAGEMENT

The Company has established a Remuneration Committee (RC) with specific terms of reference which deals clearly with its authorities and duties. Mr. Li Chi Wing, an independent non executive Director, is the Chairman of the RC and other members are Mr. Chan Chun Chung, William and Ms. Yau Pui Chi, Maria. All RC members are independent non-executive Directors of the Company.

The role and function of RC is to oversee Board remuneration matters, including recommend the Board the Company's policies and structure for the remuneration of the Directors and senior management, determine the remuneration packages of all executive Directors and senior management, review compensation to Directors and senior management in connection with any loss or termination of their office or appointment and to ensure that no Director or any of his associates is involved in deciding his own remuneration.

APPOINTMENT, RE-ELECTION AND REMOVAL OF DIRECTORS

The Board as a whole is responsible for the appointment of its own members. The Board does not establish a Nomination Committee and is not considering to establish the same in view of the small size of the Board. The Chairman of the Board is responsible for identifying appropriate candidate and proposing qualified candidate to the Board for consideration. The Board will review profiles of the candidates recommended by the Chairman and make recommendation the appointment, re-election and retirement of the Directors. Candidates are appointed to the Board on the basis of their skill, competence and experience that they can contribute to the Company.

The Company believes that members of the Board, individually and collectively, have satisfactorily discharged duties and will review the need for Nomination Committee at a later time.

BOARD MEETINGS

The full Board met five times in last year to discuss relevant business and strategy of the Company. The discussion also covered the financial performance, new products and services to be deployed by the company and also suggestion to further improve the operation.

The members of the Board fully complied with the required standard with respect to the securities dealings of the Company and there was no event of non-compliances.

During regular meetings of the Board, the Directors discuss and formulate the overall strategies of the Group, monitor financial performances and discuss the annual and interim results, set annual budgets as well as discuss on the corporate directions.

The Chairman ensures that management will supply the Board and its committees with all relevant information in a timely manner. They may make further enquiries if in their opinion it is necessary or appropriate to request for further informations.

Corporate governance report

ATTENDANCE RECORD AT BOARD AND AUDIT COMMITTEE MEETINGS

The Directors' attendance at Board meetings and Audit Committee meetings during the year are set out below:

	Number of meeting attended/ Number of meeting held	
	Board	Audit Committee
Directors		
Executive Directors		
Mr. James Ang	5/5	N/A
Ms. Yau Pui Chi Maria	5/5	N/A
Independent Non-Executive Directors		
Mr. Yeung Kam Yuen Roderick	1/5	1/4
Mr. Li Chi Wing	5/5	4/4
Mr. Chan Chun Chung William	5/5	4/4
Number of meeting held during the year	5	4

INTERNAL CONTROL

The Board is responsible for maintaining sound and effective internal systems for the Company to safeguard its assets and shareholders' interests.

The Board reviews the internal control system of the Group annually and will take any necessary and appropriate action to maintain adequate internal control system to safeguard Company's equity. The effectiveness of the internal control system was discussed on annual basis with the Audit Committee.

SHAREHOLDERS' RELATIONS

The Company commits to provide its shareholders with high standards of disclosure and financial transparency through the publication of annual, interim and quarterly reports, announcements and circulars made through Stock Exchange's website.

The Board also maintains an on-going dialogue with shareholders and use general meeting to communicate with shareholders. The Company encourages all shareholders to attend general meeting which provides a useful forum for shareholders to exchange views with the Board. The Chairman of the Board and members of relevant committees and senior management of the Company are also available to answer the shareholders' questions.

Corporate governance report

ACCOUNTABILITY AND AUDIT

The Directors are responsible for the preparation of financial statements for each financial period which give a true and fair view of the state of the affairs of the Group and of the results and cash flow for that period. In preparing the financial statements for the year ended 31st May 2006, the Directors have selected suitable accounting policies and applied them consistently by adopting appropriate Hong Kong Financial Reporting Standards.

AUDITORS' REMUNERATION

For the year ended 31st May 2006, the external auditors provided the following services to the Group:

	2006 **HK$'000**
Audit and taxation advisory services	**410**

Report of the directors

The directors submit their annual report together with the audited accounts for the year ended 31st May 2006.

PRINCIPAL ACTIVITIES AND GEOGRAPHICAL ANALYSIS OF OPERATIONS

The principal activity of the Company is investment holding. The activities of the subsidiaries are set out in note 17 to the accounts.

An analysis of the Group's performance for the year by business and geographical segments is set out in note 6 to the accounts.

RESULTS AND APPROPRIATIONS

The results of the Group for the year are set out in the consolidated income statement on page 21.

The directors do not recommend the payment of a dividend in respect of the year ended 31st May 2006 (2005: NIL).

RESERVES

Movements in the reserves of the Group and of the Company during the year are set out in note 25 to the accounts.

FIXED ASSETS

Details of the movements in plant and equipment of the Group are set out in note 16 to the accounts.

SHARE CAPITAL

Details of the movements in share capital of the Company are set out in note 24 to the accounts.

DISTRIBUTABLE RESERVES

Distributable reserves of the Company at 31st May 2006 amounted to HK$380,000 (2005: HK$1,096,000), comprising share premium and retained earnings. Under section 34 of the Companies Law (Revised) of the Cayman Islands, the share premium is available for distribution to shareholders subject to the provisions of the Articles of Association of the Company, and no distribution may be paid to shareholders out of the Company's share premium unless the Company shall be able to pay its debt as they fall due in the ordinary course of business.

Report of the directors

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's Articles of Association and there was no restriction against such rights under the laws of the Cayman Islands.

FIVE YEAR FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 58.

PURCHASES, SALE OR REDEMPTION OF SECURITIES

The Company has not redeemed any of its shares during the year. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the year.

SHARE OPTIONS

Pursuant to written resolution of the sole shareholder of the Company dated 4th December 2002, the Company has conditionally adopted the Share Option Scheme whereby eligible participants of the scheme who the Board considers, in its sole discretion, have contributed to the Group, may be granted option to subscribe for shares.

As at 31st May 2006, no share option was granted under the Share Option Scheme.

DIRECTORS

The Directors during the year and up to the date of this report were:

Mr. James Ang
Ms. Yau Pui Chi, Maria
Mr. Yeung Kam Yuen, Roderick
Mr. Li Chi Wing
Mr. Chan Chun Chung, William

In accordance with Article 87 of the Company's Article of Association, Mr. Yeung Kam Yuen, Roderick retires by rotation and, being eligible offer himself for re-election.

Report of the directors

DIRECTORS' SERVICE CONTRACTS

Each of Mr. James Ang and Ms. Yau Pui Chi, Maria has entered into a service contract with the Company for an initial term of three years commencing from 25th November 2002, which expired on 24th November 2005. The services contracts shall continue thereafter until terminated by either party not less than three months' prior notice in writing.

Under the above service contracts, each of Mr. James Ang and Ms. Yau Pui Chi, Maria are entitled to a fixed salary of HK$600,000 and HK$480,000 per annum subject to an annual increment as approved by the Board. Each of the executive Directors will also be entitled to all reasonable out-of-pocket expenses.

During the year, total emoluments, including bonus, paid and payable to the executive Directors amounted to approximately HK$1,104,000 (2005: HK$1,104,000).

Mr. Yeung Kam Yuen, Roderick and Mr. Li Chi Wing, independent non-executive Directors, had entered into service contracts with the Company on 23rd November 2002 and 25th November 2002 respectively for an initial term of two years from 23rd November 2002 and 25th November 2002 respectively and which expired on 22nd November 2004 and 24th November 2004 respectively. The service contracts shall continue thereafter until terminated by either party giving to the other not less than three months' prior written notice.

Mr. Chan Chun Chung, William, an independent non-executive Director, has entered into a service contract with the Company on 22nd September 2004 for an initial term of one year from 22nd September 2004 and expiring on 21st September 2005. The service contract shall continue thereafter until terminated by either party giving to the other not less than three months' prior written notice.

Save as disclosed in this report, none of the Directors has entered into any service agreements with any members of the Group.

DIRECTORS' INTERESTS IN CONTRACTS

Apart from those disclosed in note 28 to the accounts, no contracts of significance in relation to the Group's business to which the Company, its subsidiaries or its holding company was a party and in which a Director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

DIRECTORS' INTERESTS AND CHIEF EXECUTIVES' INTERESTS IN AND SHORT POSITIONS IN THE SHARES, UNDERLYING SHARES AND DEBENTURES OF THE COMPANY OR ANY ASSOCIATED CORPORATION

At 31st May 2006, apart from the details as follows, the Directors and chief executive do not have any other interests and short positions in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of the Securities and Futures Ordinance ("SFO")), as recorded in the register maintained by the Company under Section 352 of the SFO or as notified to the Company:

Ordinary shares of HK$0.01 each in the Company

		Number of Share held		
Name of Directors		**Family interest**	**Corporate interest**	**Percentage**
Mr. James Ang ("Mr. Ang")	Long position	–	204,272,000 *(Note)*	52.89%
Ms. Yau Pui Chi, Maria (Spouse of Mr. Ang)	Long position	204,272,000 *(Note)*	–	52.89%

Note: These Shares are registered as to 192,200,000 Shares in the name of Nanette Profits Limited ("Nanette"), 5,692,000 Shares in the name of Benevolent Trading Limited ("Benevolent") and 6,380,000 Shares in the name of Cyber Wealth Company Group Limited ("Cyber Wealth"). Mr. Ang is the beneficial owner of the entire issued share capital of Nanette, Benevolent and Cyber Wealth and is deemed to be interested in the shares registered in the name of such companies.

SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN THE SHARES, UNDERLYING SHARES OF THE COMPANY

The register of substantial shareholders maintained by the Company under Section 336 of the SFO shows that as at 31st May 2006, the Company had been notified of the following substantial shareholders' interests, being 5% or more of the Company's issued share capital. These interests are in addition to those disclosed above in respect of the Directors and Chief Executives.

Name of Shareholders		**Corporate interest**	**Percentage**
LeeMah Holdings, Ltd	Long position	11,244,000	2.91%
Mr. Mah Bing Hong	Long position	11,244,000	2.91%
		22,488,000	5.82%

Note: LeeMah Holdings, Ltd is wholly owned by LeeMah Corporation which is owned as to 98.62% by Mah Family Partnership in which Mr. Mah Bing Hong is the beneficial owner. Mr. Mah Bing Hong is deemed to be interested in 11,244,000 shares held by LeeMah Holdings, Ltd.

Report of the directors

MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

MAJOR CUSTOMERS AND SUPPLIERS

The percentages of purchases and sales for the year attributable to the Group's major suppliers and customers are as follows:

Purchases	
– the largest supplier	29.2%
– five largest suppliers combined	64.2%

During the year, the Group sold less than 30% of its goods and services to its 5 largest customers.

None of the Directors, their associates or any shareholders (which to the knowledge of the Directors owns more than 5% of the Company's share capital) had an interest in the major suppliers noted above.

CONNECTED TRANSACTIONS

Significant related party transactions entered by the Group during the year ended 31st May 2006, which constitute exempted connected transactions under the Rules Governing the Listing of Securities on the GEM ("GEM Listing Rules"), are disclosed in note 28 to the accounts.

DIRECTORS' INTEREST IN COMPETING BUSINESS

None of the Directors has an interest in a business which compete or may compete with the business of the Group.

PENSION SCHEMES

The Group did not operate any retirement scheme up to 30th November 2000. With effect from 1st December 2000, a Mandatory Provident Fund scheme (the "MPF scheme") has been set up for employees, including executive Directors, in Hong Kong, in accordance with the Mandatory Provident Fund Scheme Ordinance (the "MPF Ordinance"). Under the MPF scheme, the Group's contributions are at 5% of employees' relevant income as defined in the MPF Ordinance up to a maximum of HK$1,000 per employee per month. The employees also contribute a corresponding amount to the MPF scheme from 31st December 2000 if their relevant income is more than HK$4,000 per month. The contributions are fully and immediately vested with the employees as accrued benefits once they are paid.

Report of the directors

AUDITORS

The accompanying accounts have been audited by Lau & Au Yeung C.P.A. Limited. A resolution for their reappointment will be proposed at the forthcoming annual general meeting.

On behalf of the Board

James Ang
Chairman

Hong Kong, 25th August 2006

Report of the auditors

劉歐陽會計師事務所有限公司
LAU & AU YEUNG C.P.A. LIMITED

Lau & Au Yeung C.P.A. Limited
Room 2701, 27th Floor, Wing On House
71 Des Voeux Road Central
Hong Kong

AUDITORS' REPORT TO THE SHAREHOLDERS OF
NETEL TECHNOLOGY (HOLDINGS) LIMITED
(incorporated in the Cayman Islands with limited liability)

We have audited the financial statements on pages 21 to 57 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Company's Directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view, it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

BASIS OF OPINION

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Report of the auditors

FUNDAMENTAL UNCERTAINTY

In forming our opinion, we have considered the adequacy of the disclosures made in the note 2(a) to the financial statements which indicates that the Group's total liabilities exceeded its total assets by approximately HK$20.3 million and its current liabilities exceeded its current assets by approximately HK$27.0 million. The financial statements have been prepared on a going concern basis, the validity of which depends upon the generation of sufficient working capital from the Group's future operations, the raising of shareholder's loans and other measures as explained in the note 2(a) to the financial statements. The Directors, after careful review of the future cash flow projection of the Group, have concluded that the preparation of the financial statements on a going concern basis is appropriate. The financial statements do not include any adjustments that would result from a failure to obtain the aforesaid fundings. We consider that the fundamental uncertainty has been adequately accounted for and disclosed in the financial statements and our opinion is not qualified in the respect.

OPINION

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31st May 2006 and of the Group's loss and cash flows for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Lau & Au Yeung C.P.A. Limited
Certified Public Accountants
Hong Kong, 25 August 2006

Franklin Lau Shiu Wai
Director
Practising Certificate Number P1886

Consolidated income statement

For the year ended 31st May 2006

	Notes	**2006** **HK$'000**	2005 HK$'000
Turnover	6&7	**11,693**	26,189
Cost of sales		**(6,920)**	(22,030)
Gross profit		**4,773**	4,159
Other revenues	7	**319**	500
Selling and marketing expenses		**(309)**	(675)
Administrative expenses		**(9,812)**	(17,037)
Operating loss	8	**(5,029)**	(13,053)
Finance costs	9	**(221)**	(229)
Loss for the year		**(5,250)**	(13,282)
Attributable to:			
Equity holders of the Company		**(5,245)**	(13,289)
Minority interests		**(5)**	7
Loss for the year		**(5,250)**	(13,282)
Loss per share			
– basic and diluted	13	**HK (1.4 cents)**	HK (3.5 cents)

The accompanying notes form an integral part of these financial statements.

Consolidated balance sheet

At as 31st May 2006

	Notes	2006 HK$'000	2005 HK$'000
ASSETS			
Non-current assets			
Plant and equipment	16	**6,850**	8,561
Current assets			
Inventories	18	**185**	193
Trade and other receivables	19	**2,261**	4,127
Bank balances and cash	20	**164**	132
		2,610	4,452
Total assets		**9,460**	13,013
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital	24	**3,862**	3,862
Reserves	25	**(24,183)**	(18,938)
		(20,321)	(15,076)
Minority interests		**2**	7
Total equity		**(20,319)**	(15,069)
LIABILITIES			
Non-current liabilities			
Long-term liabilities	23	**172**	60
Current liabilities			
Accounts and other payables	21	**20,640**	25,361
Due to a director	22	**8,877**	1,690
Current portion of long-term liabilities	23	**90**	971
		29,607	28,022
Total liabilities		**29,779**	28,082
Total equity and liabilities		**9,460**	13,013
Net current liabilities		**(26,997)**	(23,570)
Total assets less current liabilities		**(20,147)**	(15,009)

James Ang
Director

Yau Pui Chi, Maria
Director

The accompanying notes form an integral part of these financial statements.

Balance sheet

At as 31st May 2006

	Notes	2006 HK$'000	2005 HK$'000
ASSETS			
Non-current assets			
Investments in subsidiaries	17	**5,901**	6,566
Current assets			
Other receivables	19	**37**	69
Total assets		**5,938**	6,635
EQUITY			
Capital and reserves			
Share Capital	24	**3,862**	3,862
Reserves	25	**380**	1,096
		4,242	4,958
LIABILITIES			
Current liabilities			
Accruals and other payables	21	**1,696**	1,677
Total equity and liabilities		**5,938**	6,635
Net current liabilities		**(1,659)**	(1,608)
Total assets less current liabilities		**4,242**	4,958

James Ang
Director

Yau Pui Chi, Maria
Director

The accompanying notes form an integral part of these financial statements.

Consolidated statement of changes in equity

For the year ended 31st May 2006

	Share capital HK$'000	Share premium HK$'000	Merger reserve HK$'000	Accumulated losses HK$'000	Total HK$'000	Minority interests HK$'000	Total equity HK$'000
Balance at 1st June 2004	3,800	13,949	39,307	(64,811)	(7,755)	–	(7,755)
Issuance of shares	62	6,168	–	–	6,230	–	6,230
Share issue expenses	–	(262)	–	–	(262)	–	(262)
Loss for the year	–	–	–	(13,282)	(13,282)	(7)	(13,289)
Balance at 1st June 2005	3,862	19,855	39,307	(78,093)	(15,069)	(7)	(15,076)
Loss for the year	–	–	–	(5,250)	(5,250)	5	(5,245)
Balance at 31st May 2006	3,862	19,855	39,307	(83,343)	(20,319)	(2)	(20,321)

The accompanying notes form an integral part of these financial statements.

Consolidated cash flow statement

For the year ended 31st May 2006

	Notes	**2006** **HK$'000**	2005 HK$'000
Net cash outflow from operations	26(a)	**(5,690)**	(5,972)
Interest paid		**(181)**	(229)
Net cash used in operating activities		**(5,871)**	(6,201)
Investing activities			
Purchases of property, plant and equipment		**(516)**	(190)
Interest received		**1**	9
Decrease in pledged bank deposits		**–**	1,936
Net cash (used in)/generated from investing activities		**(515)**	1,755
Financing activities	26(b)		
Issuance of shares		**–**	5,968
Capital elements of finance lease payments		**(635)**	(970)
Repayments of bank loans		**(134)**	(517)
Increase in amount due to a director		**7,187**	1,362
Net cash generated from financing activities		**6,418**	5,843
Net increase in cash and cash equivalents		**32**	1,397
Cash and cash equivalents at 1st June		**132**	(1,265)
Cash and cash equivalents at 31st May		**164**	132
Analysis of balances of cash and cash equivalents			
– Bank balances and cash		**164**	132

The accompanying notes form an integral part of these financial statements.

Notes to the financial statements

1 CORPORATE INFORMATION

Netel Technology (Holdings) Limited (the "Company") was incorporated in the Cayman Islands with limited liability. The principal place of business of the Company is located in Hong Kong.

The Company is listed on the Growth Enterprise Market ("GEM") of the Stock Exchange of Hong Kong Limited (the "Exchange").

The principal activities of the Company and its subsidiaries (collectively referred to as the "Group") are trading of telecommunication equipment and provision of long distance call services in Hong Kong. There were no significant changes in the nature of the Group's principal activities during the year.

2 BASIS OF PREPARATION

(a) The financial statements have been prepared on a going concern basis, the Group had incurred a loss attributable to shareholders of HK$5.3 million for the year ended 31st May 2006. As at 31st May 2006, the Group had net current liabilities and net liabilities of HK$27.0 million and HK$20.3 million respectively. These conditions indicate the existence of a material uncertainty which may cast significant doubt about the Group's ability to continue as a going concern. In preparing the financial statements, the Directors have carefully reviewed the Group's cash position as at the balance sheet date and the cash flow forecast for the next twelve months. In reviewing the Group's cash flows, the Directors have considered the following factors:

- Shareholder's loans of not less than HK$5.0 million will be made available to the Company to meet the present and future cashflow requirement from operation and settlement of claims set forth in the annual report for the year ended 31st May 2006;

- Cash to be generated from new revenue source and new business development;

- Commitment on continuous development and improvement of the Group's products and services;

- The successful outcome to re-scheduling of the overdue liabilities and

- The cost control measures.

The Directors believe that the Group is able to meet its financial obligations in full as and when they fall due and consider that the preparation of accounts on going concern basis is appropriate.

2 BASIS OF PREPARATION *(Continued)*

(b) The consolidated financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") which include Hong Kong Accounting Standards ("HKASs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention.

The consolidated financial statements are presented in Hong Kong dollars ("HK$") and all values are rounded to the nearest thousand except when otherwise indicated.

2.1 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

The following new and revised HKFRSs affect the Group and are adopted for the first time for the current year's financial statements:

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 12	Income Taxes
HKAS 14	Segment Reporting
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 18	Revenue
HKAS 19	Employee Benefits
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 33	Earnings Per Share
HKAS 36	Impairment of Assets
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets

2 BASIS OF PREPARATION *(Continued)*

2.1 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS *(Continued)*

The adoption of HKASs 1, 2, 7, 8, 10, 12, 14, 16, 17, 18, 19, 21, 23, 24, 27, 33, 36, 37 had no material impact on the accounting policies of the Group and the Company and the methods of computation in the Group's and the Company's financial statements.

The following is a summary of changes in principal accounting policies or presentation of the financial statements as a result of the adoption of the new HKFRSs:

(a) Changes in presentation (HKAS 1, Presentation of financial statements and HKAS 27, Consolidated and separate financial statements)

(i) In prior years, minority interests at the balance sheet date were not a part of equity and were presented on the face of the consolidated balance sheet as a deduction from net assets. Minority interests were also separately presented on the income statement as a deduction before arriving at the profit attributable to shareholder. Movement of minority interests was not shown in the consolidated statement of changes in equity.

With adoption of HKAS 1 and HKAS 27, minority interests are not an item of income or expense and do not fall into the definition of a liability. Accordingly, minority interests are now shown as a part of equity in the consolidated balance sheet. Movement of minority interests is also now shown in the consolidated statement of changes in equity. Allocation of loss attributable to minority interests and equity shareholders of the Company are shown after profit/loss for the year in the consolidated income statement.

(ii) In prior years, comparative information is not required for the analysis of the movements in property, plant and equipment.

With adoption of HKAS 1, comparative information for the analysis of the movements in property, plant and equipment is now disclosed in the notes to the financial statements.

The change in accounting policy has no material effect on the group's net liabilities and results for prior and current years.

Other than the above, the accounting policies and methods of computation used in the preparation of these financial statements are consistent with those used in the annual financial statements of the Group for the year ended 31st May 2005.

Notes to the financial statements

3 PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below:

(a) Consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries made up to 31st May.

Subsidiaries are those entities in which the Company, directly or indirectly, controls more than one half of the voting power; has the power to govern the financial and operating policies; to appoint or remove the majority of the members of the board of directors; or to cast majority of votes at the meetings of the board of directors.

The results of subsidiaries acquired or disposed of during the year are consolidated from the effective date of acquisition, being the date on which the Group obtains control, or up to the effective date of disposal, as appropriate and continue to be consolidated until the date that such control ceases.

The acquisition of subsidiaries during the year has been accounted for using the purchase method of accounting. This method involves allocating the cost of the business combinations to the fair value of the assets acquired, and liabilities and contingent liabilities assumed at the date of acquisition. The cost of the acquisition is measured at the aggregate of the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition.

The gain or loss on the disposal of a subsidiary is calculated by reference to the net assets at the date of disposal including the attributable amount of goodwill but does not include any attributable goodwill previously eliminated against reserves.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Minority interests represent the interests of outside equity shareholders in the results and net assets of the Company's subsidiaries.

In the Company's balance sheet, the investments in subsidiaries are stated at cost less any impairment losses. The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable.

Notes to the financial statements

3 PRINCIPAL ACCOUNTING POLICIES *(Continued)*

(b) Plant and equipment

Plant and equipment are stated at cost less accumulated depreciation and any impairment losses. The cost of an item of plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

Expenditure incurred after items of plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of plant and equipment, and where the cost of the item can be measured reliably, the expenditure is capitalised as an additional cost of that asset or as a replacement.

Plant and equipment are depreciated at rates sufficient to write off their cost less accumulated impairment losses and residual value, if any, over their estimated useful lives on a straight-line basis. The principal annual rates are as follows:

Leasehold improvement	20%
Furniture, fixtures and equipment	20%
Computer and software	$33^1/_3$%
Telecommunication equipment	10%
Motor vehicles	20%

The useful lives and residual values of the assets are reviewed and adjusted, if necessary, at each balance sheet date.

Major costs incurred in restoring the plant and equipment to their normal working condition to allow continued use of the overall asset are charged to the income statement.

An item of plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on disposal or retirement recognised in the income statement in the year the asset is derecognised is the difference between the net sales proceeds and the carrying amount of the relevant asset.

3 PRINCIPAL ACCOUNTING POLICIES *(Continued)*

(c) Impairment of non-financial assets

Where an indication of impairment exists, or when annual impairment testing for an asset is required (other than inventories, deferred tax assets, financial assets, investment properties and goodwill), the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's or cash generating unit's value in use and its fair value less costs to sell, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is charged to the income statement in the period in which it arises, unless the asset is carried at a revalued amount, in which case the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss of an asset other than goodwill is reversed only if there has been a change in the estimates used to determine the recoverable amount of that asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years. A reversal of such impairment loss is credited to the income statement in the period in which it arises, unless the asset is carried at a revalued amount, in which case the reversal of the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

(d) Assets under leases

(i) Finance leases

Leases that substantially transfer to the Group all the risks and rewards of ownership of assets are accounted for as finance leases. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased assets or the present value of the minimum lease payments. Each lease payment is allocated between the capital and finance charges so as to achieve a constant rate on the capital balances outstanding. The corresponding rental obligations, net of finance charges, are included in long-term and short-term liabilities, as appropriate. The finance charges are charged to the income statement over the lease periods.

Assets held under finance leases are depreciated over the shorter of their estimated useful lives or the lease periods.

3 PRINCIPAL ACCOUNTING POLICIES *(Continued)*

(d) Assets under leases *(Continued)*

(ii) Operating leases

Leases where substantially all the risks and rewards of ownership of assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases net of any incentives received from the leasing company are charged to the income statement on a straight-line basis over the lease periods.

(e) Inventories

Inventories comprise mainly long distance calling cards and are stated at the lower of cost and net realisable value. Cost comprises purchase costs which are assigned to individual items on the first-in, first out basis. Net realisable value is determined on the basis of anticipated sales proceeds less estimated selling expenses.

(f) Trade and other receivables

Trade and other receivables are recognised initially at fair value and thereafter stated at amortised cost using the effective interest method unless the effect of discounting would be immaterial, in which case they are stated at cost less impairment losses for bad and doubtful debts. A provision of impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision, recognised in the income statement, is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate.

(g) Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purpose of the cash flow statement, cash and cash equivalents comprise cash on hand and deposits held at call with banks and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management.

For the purpose of the balance sheet, cash and bank balances comprise cash on hand and at banks, including term deposits, which are not restricted as to use.

Notes to the financial statements

3 PRINCIPAL ACCOUNTING POLICIES *(Continued)*

(h) Trade and other payables

Trade and other payables are initially recognised at fair value and thereafter stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(i) Borrowings

Borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in profit or loss over the period of the borrowings using the effective interest method.

(j) Income tax

Income tax comprises current and deferred tax. The charge for income tax is based on the results for the year as adjusted for items, which are non-assessable or disallowable. Income tax is recognised in the income statement, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

Deferred tax is provided in full, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax credits and unused tax losses can be utilised except:

(i) where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

Notes to the financial statements

3 PRINCIPAL ACCOUNTING POLICIES *(Continued)*

(j) Income tax *(Continued)*

(ii) in respect of deductible temporary differences associated with investments in subsidiaries, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Conversely, previously unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

(i) where the deferred tax liability arises from goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

(ii) in respect of taxable temporary differences associated with investments in subsidiaries, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

(k) Foreign currencies translation

These financial statements are presented in HK$, which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

Foreign currency transactions are initially recorded using the functional currency rates ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rates of exchange ruling at the balance sheet date. All differences are taken to the income statement.

3 PRINCIPAL ACCOUNTING POLICIES *(Continued)*

(k) Foreign currencies translation *(Continued)*

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(l) Provisions

A provision is recognised when the Group has a present legal or constructive obligation as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the income statement.

(m) Employee benefits

(i) Employee leave entitlements

The Group provides paid annual leave to its employees under their employment contracts on a calendar year basis. Under certain circumstances, such leave which remains untaken as at the balance sheet date is permitted to be carried forward and utilised by the respective employees in the following year. An accrual is made at the balance sheet date for the expected future cost of such paid leave earned during the year by the employees and carried forward.

(ii) Pension obligations

The Group operates a defined contribution retirement benefits scheme (the "MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for those employees who are eligible to participate in the MPF Scheme. Contributions are made based on a percentage of the employees' basic salaries and are charged to the income statement as they become payable in accordance with the rules of the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in an independently administered fund. The Group's employer contributions vest fully with the employees when contributed into the MPF Scheme.

Notes to the financial statements

3 PRINCIPAL ACCOUNTING POLICIES *(Continued)*

(n) Contingent liabilities

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that outflow is probable, they will then be recognised as a provision.

(o) Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

(i) Revenue in respect of long distance call services provided to customers is recognised upon delivery of the services.

(ii) Revenue from the sale of equipment is recognised on the transfer of risks and rewards of ownership, which generally coincides with the time when the equipment is delivered to customers and the title has passed.

(iii) Interest income is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rates applicable.

(p) Segmental reporting

In accordance with the Group's internal financial reporting, the Group has determined that business segments be presented as the primary reporting format and geographical as the secondary reporting format.

Unallocated costs represent corporate expenses. Segment assets consist primarily of intangible assets, property, plant and equipment, inventories, receivables and operating cash, and mainly exclude certain corporate assets, investment in associated company and other investment. Segment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate borrowings. Capital expenditure comprises additions to intangible assets and property, plant and equipment.

In respect of geographical segment reporting, sales are based on the country in which the customer is located. Total assets and capital expenditure are where the assets are located.

3 PRINCIPAL ACCOUNTING POLICIES *(Continued)*

(q) Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if:

(a) the party, directly or indirectly through one or more intermediaries, (i) controls, is controlled by, or is under common control with, the Group; (ii) has an interest in the Group that gives it significant influence over the Group; or (iii) has joint control over the Group;

(b) the party is a member of the key management personnel of the Group;

(c) the party is a close member of the family of any individual referred to in (a) or (b);

(d) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (b) or (c); or

(e) the party is a post-employment benefit plan for the benefit of the employees of the Group, or of any entity that is a related party of the Group.

4 FINANCIAL RISK MANAGEMENT

The Group is exposed to cash flow interest rate risk, foreign currency risk and liquidity risk. These risks are managed by the Group's financial management policies and practices as described below to minimize potential effects on the Group's financial performance.

(a) Cash flow interest rate risk

The Group has no significant interest-bearing assets, its income and operating cash flows are substantially independent of changes in market interest rates.

(b) Foreign currency risk

Operations of the Group are mainly conducted in Hong Kong Dollars ("HK$") and United States Dollars ("US$") and its revenue, expenses, assets, liabilities and borrowings are principally denominated in HK$ and US$, which do not pose significant foreign currency risk at present. Procedures are in place to monitor possible exposure to foreign currency risk in the operations on a continuous basis.

4 FINANCIAL RISK MANAGEMENT *(Continued)*

(c) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash. The Group currently relies on funding from its director and is exploring other business opportunities which can provide more stable streams of cash inflow.

5 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements used in preparing the financial statements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Group makes estimate and assumptions concerning the future. The resulting accounting estimates may not be equal to the related actual results. The estimates and assumptions that have a significant effect on the carrying amounts of assets and liabilities are discussed below:

(a) Useful lives of plant and equipment

The directors determine the estimated useful lives and residual values for its plant and equipment. The directors revise the depreciation charge when useful lives are different from previous estimates. Obsolete or non-strategic assets, that have been abandoned or sold, shall be written off or written down.

(b) Contingent liabilities in respect of litigations and claims

The Group has been engaged in a number of litigations and claims in respect of certain carrier purchases and unsettled rentals in the past. Contingent liabilities arising from these litigations and claims have been assessed by management with reference to legal advice. Provisions on the possible obligation, if appropriate, are made based on management's best estimates and judgements.

6 SEGMENT INFORMATION

(a) Business segments – primary reporting format

The following table presents revenue, results and certain assets, liabilities and expenditure information for the Group's business segments.

		2006		
		Long distance call services		
	Sale of equipment HK$'000	End-users direct sales HK$'000	Carrier sales HK$'000	Group HK$'000
Turnover	1,983	9,630	80	11,693
Segment results	(26)	(2,321)	(682)	(3,029)
Other revenues				319
Operating loss				(2,710)
Unallocated cost				(2,319)
Finance costs				(221)
Loss for the year				(5,250)
Segment assets	1,086	5,873	2,268	9,227
Unallocated assets				233
Total assets				9,460
Segment liabilities	1,845	11,848	14,302	27,995
Unallocated liabilities				1,784
				29,779
Capital expenditures	–	306	210	516
Unallocated capital expenditures				–
				516
Depreciation	47	1,241	372	1,660
Unallocated depreciation				–
				1,660

6 SEGMENT INFORMATION *(Continued)*

(a) Business segments – primary reporting format *(Continued)*

	2005			
		Long distance call services		
		End-users		
	Sale of	direct	Carrier	
	equipment	sales	sales	Group
	HK$'000	HK$'000	HK$'000	HK$'000
Turnover	484	17,133	8,572	26,189
Segment results	306	(9,667)	(1,428)	(10,789)
Other revenues				500
Operating loss				(10,289)
Unallocated cost				(2,764)
Finance costs				(229)
Loss for the year				(13,282)
Segment assets	167	8,365	4,119	12,651
Unallocated assets				362
Total assets				13,013
Segment liabilities	18	14,961	11,348	26,327
Unallocated liabilities				1,755
				28,082
Capital expenditures	–	107	83	190
Unallocated capital expenditures				–
				190
Depreciation	–	1,431	323	1,754
Unallocated depreciation				100
				1,854

6 SEGMENT INFORMATION *(Continued)*

(b) Geographical segments – secondary reporting format

	2006			
	Turnover	Segment Results	Total Assets	Capital Expenditures
	HK$'000	HK$'000	HK$'000	HK$'000
Hong Kong	**9,608**	**(3,679)**	**9,372**	**516**
Mainland China	**11**	**(21)**	**1**	**–**
Other countries	**2,074**	**(1,648)**	**87**	**–**
	11,693	**(5,348)**	**9,460**	**516**
Other revenues		**319**		
Operating loss		**(5,029)**		

	2005			
	Turnover	Segment Results	Total Assets	Capital Expenditures
	HK$'000	HK$'000	HK$'000	HK$'000
Hong Kong	20,330	(11,959)	12,688	190
Mainland China	197	(54)	30	–
Other countries	5,662	(1,540)	295	–
	26,189	(13,553)	13,013	190
Other revenues		500		
Operating loss		(13,053)		

7 TURNOVER AND REVENUES

The Group is principally engaged in the provision of long distance call services and trading of telecommunication equipment. Revenues recognised during the year are as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
Turnover		
Long distance call services	**9,710**	25,705
Sale of equipment	**1,983**	484
	11,693	26,189
Other revenues		
Bank interest income	**1**	9
Promotion income	**–**	242
Sundry income	**318**	249
	319	500
Total revenues	**12,012**	26,689

8 OPERATING LOSS

Operating loss is stated after charging the following:

	Group	
	2006	2005
	HK$'000	HK$'000
Charging		
Auditors' remuneration	**410**	408
Cost of inventories sold	**1,329**	1,138
Depreciation		
– owned property, plant and equipment	**1,539**	1,456
– leased property, plant and equipment	**121**	398
Loss on disposal of fixed assets	**567**	233
Net exchange loss	**7**	7
Operating leases in respect of land and buildings	**1,042**	3,464
Provision for impairment of receivables	**260**	1,757
Provision for slow moving inventories	**–**	248
Staff costs (including directors' emoluments) *(note 14)*	**3,645**	5,288

9 FINANCE COSTS

	Group	
	2006	2005
	HK$'000	HK$'000
Interests on bank loans and overdrafts	**25**	87
Interest element of finance leases	**156**	109
Other interests	**40**	33
	221	229

10 INCOME TAX

No provision for Hong Kong Profits tax has been made in the financial statements as the Group has no estimated assessable profit for the year (2005: Nil).

No deferred taxation has been provided as the group has no material unprovided deferred tax assets or liabilities which are expected to be crystallized in the foreseeable future (2005: Nil).

Income tax on the Group's loss before income tax differs from the theoretical amount that would arise using the taxation rate of Hong Kong as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
Loss before income tax	**(5,245)**	(13,289)
Calculated at a taxation rate of 17.5% (2005: 17.5%)	**(918)**	(2,325)
Income not subject to taxation	**–**	(2)
Expenses not deductible for taxation purposes	**71**	240
Tax losses not recognised	**738**	1,934
Accelerated depreciation not recognised	**109**	153
Income tax charges	**–**	–

11 NET LOSS ATTRIBUTABLE TO SHAREHOLDERS

Net loss attributable to shareholders for the year ended 31st May 2006 dealt with in the financial statements of the Company was HK$716,000 (2005: HK$6,638,000).

12 DIVIDENDS

The board of directors has resolved not to recommend any final dividend for the year ended 31st May 2006 (2005: Nil).

13 LOSS PER SHARE

The calculation of basic loss per share is based on the Group's loss attributable to shareholders of HK$5,245,000 (2005: loss of HK$13,289,000 and weighted average number of 386,230,000 ordinary shares in issue during the year (2005: 384,147,644 shares).

Diluted loss per share for the current and prior year is not presented as there is no dilutive instrument granted by the Company.

14 STAFF COSTS (INCLUDING DIRECTORS' REMUNERATION)

	Group	
	2006	2005
	HK$'000	HK$'000
Wages and salaries	**3,551**	5,126
Pension cost-defined contribution plans	**94**	162
	3,645	5,288

Notes to the financial statements

15 EMOLUMENTS FOR DIRECTORS AND HIGHEST PAID INDIVIDUALS

(a) Directors' emoluments

The aggregate amount of emoluments paid and payable to the directors of the Company are as follows:

	Group				
	2006				2005
	Fees	Salaries, allowances and benefits in kind	Retirement benefit scheme contributions	Total	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Executive Directors					
Mr. James Ang	–	600	12	612	612
Ms. Yau Pui Chi, Maria	–	480	12	492	492
	–	1,080	24	1,104	1,104
Non-executive Directors					
Mr. Yeung Kam Yuen, Roderick	48	–	–	48	50
Mr. Li Chi Wing	48	–	–	48	50
Mr. Chan Chun Chung, William	48	–	–	48	55
Total	144	–	–	144	155

None of the directors of the Company waived any emoluments paid by the Group during the year (2005: Nil).

15 EMOLUMENTS FOR DIRECTORS AND HIGHEST PAID INDIVIDUALS *(Continued)*

(b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include two (2005: two) directors whose emoluments have been reflected in the analysis presented above. The emoluments payable to the remaining three (2005: three) individuals during the year are as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
Salaries, allowances and benefits in kind	**770**	801
Retirement benefit scheme contributions	**30**	26
	800	827

The emoluments of these individuals fell within the following bands:

	Group	
	Number of individuals	
	2006	2005
Emolument bands		
Nil to HK$1,000,000	**3**	3
	3	3

During the current and prior years, no emoluments were paid by the Group to any of the above directors or the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office.

Notes to the financial statements

16 PLANT AND EQUIPMENT

Group

	Leasehold improvement HK$'000	Furniture and office equipment HK$'000	Computer and soft-ware HK$'000	Telecom-munication equipment HK$'000	Motor vehicles HK$'000	Total HK$'000
At cost						
At 1st June 2004	808	1,229	1,085	12,516	–	15,638
Accumulated depreciation	(304)	(576)	(622)	(3,678)	–	(5,180)
Net book value	504	653	463	8,838	–	10,458
Year ended 31st May 2005						
Opening net book amount	504	653	463	8,838	–	10,458
Additions	2	20	66	82	20	190
Depreciation	(140)	(230)	(241)	(1,240)	(3)	(1,854)
Disposals	(15)	(27)	–	(191)	–	(233)
Closing net book value	351	416	288	7,489	17	8,561
At 31st May 2005						
Cost	781	1,214	1,151	12,392	20	15,558
Accumulated depreciation	(430)	(798)	(863)	(4,903)	(3)	(6,997)
Net book value	351	416	288	7,489	17	8,561
Year ended 31st May 2006						
Opening net book value	**351**	**416**	**288**	**7,489**	**17**	**8,561**
Additions	**302**	**4**	**–**	**210**	**–**	**516**
Depreciation	**(138)**	**(181)**	**(172)**	**(1,165)**	**(4)**	**(1,660)**
Disposals	**(50)**	**(21)**	**(95)**	**(401)**	**–**	**(567)**
Closing net book value	**465**	**218**	**21**	**6,133**	**13**	**6,850**
At 31st May 2006						
Cost	**1,000**	**1,159**	**981**	**12,068**	**20**	**15,228**
Accumulated depreciation	**(535)**	**(941)**	**(960)**	**(5,935)**	**(7)**	**(8,378)**
Net book value	**465**	**218**	**21**	**6,133**	**13**	**6,850**

Note: The net book values of office equipment held under finance leases amounted to HK$121,000 (2005: HK$2,441,000).

17 INVESTMENTS IN SUBSIDIARIES

	Company 2006 HK$'000	2005 HK$'000
Unlisted investments at cost *(Note (a))*	**6,499**	6,499
Due from subsidiaries *(Note (b))*	**19,402**	20,067
	25,901	26,566
Less: Provision for investments in and amounts due from subsidiaries	**(20,000)**	(20,000)
	5,901	6,566

Notes:

(a) Details of the subsidiaries at 31st May 2006 are as follows:

Name	Place of incorporation/ establishment	Principal activities and place of operation	Particulars of issued/registered and fully paid share capital	Attributable equity interest held
DIRECTLY HELD:				
Netel Phone Limited	British Virgin Islands ("BVI")	Investment holding in Hong Kong	1,786,000 ordinary shares of US$1 each	100%
INDIRECTLY HELD:				
Netel Technology Limited	Hong Kong	Trading of telecommunication equipment and provision of long distance call services in Hong Kong	10,000 ordinary shares of HK$1 each	100%
Think Gold Assets Limited	BVI	Investment holding in Hong Kong	100 ordinary shares of US$1 each	100%
Pacific Long Distance Telephone Corporation Limited	Hong Kong	Provision of long distance call services and sale of long distance call cards in Hong Kong	10,000 ordinary shares of HK$1 each	100%
Silver Holdings Limited	Hong Kong	Sale of long distance call cards in Hong Kong	2 ordinary share of HK$1 each	100%
True Capital Holdings Limited	BVI	Sale of telecommunication equipment	100 ordinary shares of US$1 each	51%
Pacific Honour Limited	Hong Kong	Sale of telecommunication equipment	1 ordinary shares of HK$1 each	100%

(b) The amount due are unsecured, interest-free and not repayable within twelve months from the balance sheet date.

18 INVENTORIES

	Group	
	2006	2005
	HK$'000	HK$'000
Telecommunication equipment	**–**	28
Long distance call cards	**185**	413
	185	441
Less: provision for slow moving inventories	**–**	(248)
	185	193

As at 31st May 2006 and 31st May 2005, all inventories are stated at cost.

19 TRADE AND OTHER RECEIVABLES

	Group		Company	
	2006	2005	**2006**	2005
	HK$'000	HK$'000	**HK$'000**	HK$'000
Trade receivables *(Note (a))*	**835**	2,300	**–**	–
Other receivables, prepayments and deposits	**1,426**	1,827	**37**	69
	2,261	4,127	**37**	69

Note:

(a) Majority of the Group's turnover are entered into on credit terms ranging from 30 to 120 days. Ageing analysis of trade receivables at the respective balance sheet dates is as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
0 – 30 days	**321**	707
31 – 60 days	**56**	558
61 – 90 days	**45**	198
91 – 180 days	**129**	610
181 – 365 days	**275**	1,659
Over 365 days	**3,704**	2,003
	4,530	5,735
Less: provision for impairment of receivables	**(3,695)**	(3,435)
	835	2,300

Notes to the financial statements

20 BANK BALANCES AND CASH

Bank balances and cash were denominated in HKD and of approximately HK$164,000 (2005: HK$132,000).

21 TRADE AND OTHER PAYABLES

	Group		Company	
	2006	2005	**2006**	2005
	HK$'000	HK$'000	**HK$'000**	HK$'000
Trade payables *(Note (a))*	**10,268**	12,203	**–**	–
Other payables and accruals	**9,349**	11,000	**1,696**	1,677
Receipt in advance	**1,023**	2,158	**–**	–
	20,640	25,361	**1,696**	1,677

Note:

(a) Majority of the Group's purchase are entered into on credit terms ranging from 60 to 90 days. Ageing analysis of trade payables at respective balance sheet dates is as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
0 – 30 days	**661**	2,109
31 – 60 days	**360**	687
61 – 90 days	**199**	383
91 – 180 days	**385**	973
181 – 365 days	**1,427**	3,752
Over 365 days	**7,236**	4,299
	10,268	12,203

22 DUE TO A DIRECTOR

Amount due to a Director is interest-free, unsecured and has no fixed terms of repayment.

Notes to the financial statements

23 LONG-TERM LIABILITIES

	Group 2006 HK$'000	2005 HK$'000
Bank loans, secured *(note (a))*	**–**	134
Obligation under finance leases *(note (b))*	**262**	897
	262	1,031
Less: Current portion of long-term liabilities	**(90)**	(971)
	172	60
The analysis of the above is as follows:		
Wholly repayable within five years	**262**	1,031
Current portion of long-term liabilities	**(90)**	(971)
	172	60

Notes:

(a) The Group's bank loans are repayable as follow:

	Group 2006 HK$'000	2005 HK$'000
Within one year	**–**	134

(b) Obligations under finance lease are payable within the following periods:

	Group 2006 HK$'000	2005 HK$'000
Within one year	**90**	837
In the second year	**90**	60
In the third to fifth years	**82**	–
	262	897

24 SHARE CAPITAL

	Company	
	Number of shares ('000)	HK$'000
Authorised ordinary shares of HK$0.01 each		
At 31st May 2006 and 2005	**1,000,000**	**10,000**
Issued and fully paid ordinary shares of HK$0.01 each		
At 31st May 2006 and 2005	**386,230**	**3,862**

25 RESERVES

(a) Group

	Share premium	Merger reserve *(Note)*	Accumulated losses	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Balance at 1st June 2004	13,949	39,307	(64,811)	(11,555)
Issuance of shares	6,168	–	–	6,168
Share issue expenses	(262)	–	–	(262)
Loss for the year	–	–	(13,289)	(13,289)
Balance at 1st June 2005	19,855	39,307	(78,100)	(18,938)
Loss for the year	–	–	(5,245)	(5,245)
Balance at 31st May 2006	19,855	39,307	(83,345)	(24,183)

Note: Merger reserve represents the difference between the nominal value of the share capital of subsidiaries acquired and the nominal value of shares issued by the Company.

25 RESERVES *(Continued)*

(b) Company

	Share premium HK$'000	Accumulated losses HK$'000	Total HK$'000
Balance at 1st June 2004	20,430	(18,602)	1,828
Issuance of shares	6,168	–	6,168
Share issue expenses	(262)	–	(262)
Loss for the year	–	(6,638)	(6,638)
Balance at 1st June 2005	26,336	(25,240)	1,096
Loss for the year	–	(716)	(716)
Balance at 31st May 2006	26,336	(25,956)	380

26 CONSOLIDATED CASH FLOW STATEMENT

(a) Reconciliation of operating loss to net cash outflow from operations

	Group	
	2006	2005
	HK$'000	HK$'000
Operating loss	**(5,029)**	(13,053)
Interest received	**(1)**	(9)
Depreciation	**1,660**	1,854
Loss on disposal of fixed assets	**567**	233
Provision for obsolete stock	**–**	248
Provision for impairment of receivables	**260**	1,757
Operating loss before working capital changes	**(2,543)**	(8,970)
Decrease in inventories	**8**	22
Decrease/(increase) in trade and other receivables	**1,606**	(935)
(Decrease)/increase in accounts and other payables	**(4,761)**	3,911
Net cash outflow from operations	**(5,690)**	(5,972)

26 CONSOLIDATED CASH FLOW STATEMENT *(Continued)*

(b) Analysis of changes in financing during the year

	Group			
	Share capital including share premium and merger reserve	**Bank loans and obligations under finance leases**	**Amount due to a director**	**Minority interests**
	HK$'000	HK$'000	HK$'000	HK$'000
At 1st June 2004	57,056	2,518	328	–
Issuance of shares	5,968	–	–	–
Minority interests' share of profit	–	–	–	7
Cash outflows from financing	–	(1,487)	1,362	–
At 1st June 2005	63,024	1,031	1,690	7
Minority interests' share of loss	–	–	–	(5)
Cash inflow/(outflow) from financing	–	(769)	7,187	–
At 31st May 2006	63,024	262	8,877	2

27 COMMITMENTS

(a) Commitments under operating leases

As at 31st May 2006, the Group had future aggregate minimum lease payments under non-cancellable operating lease in respect of building as follows:

	Group	
	2006	2005
	HK$'000	HK$'000
Not later than one year	**642**	2,003
Later than one year but not later than five years	**267**	–
	909	2,003

(b) The Company did not have material capital commitment as at 31st May 2006 and 2005.

28 RELATED PARTY TRANSACTIONS

Save as disclosed in other notes to the financial statements, significant related party transactions, which were carried out in the normal course of the Group's business, are as follows:

		Group	
		2006	2005
	Note	**HK$'000**	HK$'000
Rental expenses paid to Charmfine Investment Limited ("Charmfine")	(a)	**120**	120
Commission paid to minority shareholder of a subsidiary		**202**	–

Note:

(a) Charmfine is beneficially owned by Mr. James Ang and Ms. Yau Pui Chi, Maria. Rental expenses were charged in accordance with the terms of the underlying agreements.

29 LITIGATIONS

As at the date of this report, the Group has been involved in the following litigations:

(a) On 16 December 2004, a writ was issued by a telecom service provider ("plaintiff") against two wholly-owned subsidiaries of the Group and a director of the Company for outstanding and disputed invoices amounting to approximately HK$4,357,000 and claimed that the subsidiaries and the director have no right to defense. On 20 July 2005, the High Court ruled that the subsidiaries and the director had right to defense and refused to grant order to the Plaintiff. The directors are of the opinion that the negotiation of the disputed balances and the reconciliation of call records will involve lengthy process. As such, settlement of the case is not expected in the near future. No further action was taken by the service provider since the date of order up to the date of this report. As at 31 May 2006, the net payable recorded in the consolidated balance sheet of the Group to the service provider was approximately HK$3,649,000 and is considered adequate by the directors.

(b) On 6 January 2005, a writ was issued by a software provider against a wholly-owned subsidiary of the Group for outstanding and disputed invoices amounting to approximately HK$281,000. The Group is in dispute with the software provider of the outstanding balance as the delivery of software products was not completed. On 29 July 2005, the wholly-owned subsidiary made a counter claim against the software provider of approximately HK$4,418,000 representing the damages made to the Group as a result of the breach of service contract by the software provider. Although full provision has been made in the accounts, the directors are of the opinion that the Group is not liable to the balance claimed by the software provider. Up to the date of this report, no further action was taken by the software provider and the Group.

Notes to the financial statements

29 LITIGATIONS *(Continued)*

(c) On 16 June 2005, a writ was issued by a bank against the Company, a wholly-owned subsidiary and two directors of the Company for outstanding finance lease principal and interests of approximately HK$680,000 and outstanding installment loan principal and interests of approximately HK$152,000. The above amounts were fully settled during the year.

(d) Other than the writs as mentioned above, up to the date of this report, the Group has a number litigation processings in respect of outstanding liabilities arising in the normal course of its business of approximately HK$1,495,000. The Directors of the Company are in the process to negotiate with the creditors for revision of repayment schedule of the outstanding balances.

The Directors are of the opinion that the ultimate liability under these proceedings, if any, would not have any significant impact on the financial position of the Group as adequate provisions have been made in the accounts for the year ended 31 May 2006.

Apart from the actions against the Group disclosed above, there were no other material outstanding writs and litigations against the Group and/or the Company.

30 COMPARATIVE FIGURES

Certain comparative figures have been adjusted or reclassified as a result of the changes in accounting policies as described in Notes 2 and 3.

31 APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 25 August 2006.

Five years financial summary

	2006 HK$'000	2005 HK$'000	2004 HK$'000	2003 HK$'000	2002 HK$'000
Turnover	**11,693**	26,189	52,829	46,096	69,016
(Loss)/profit attributable to shareholders	**(5,245)**	(13,289)	(18,481)	(9,358)	4,599
Assets and liabilities					
Total assets	**9,460**	13,013	18,391	27,273	31,377
Total liabilities	**(29,779)**	(28,082)	(26,146)	(16,547)	(31,013)
Minority interests	**(2)**	(7)	–	–	–
Shareholders' (deficits)/fund	**(20,321)**	(15,076)	(7,755)	10,726	364