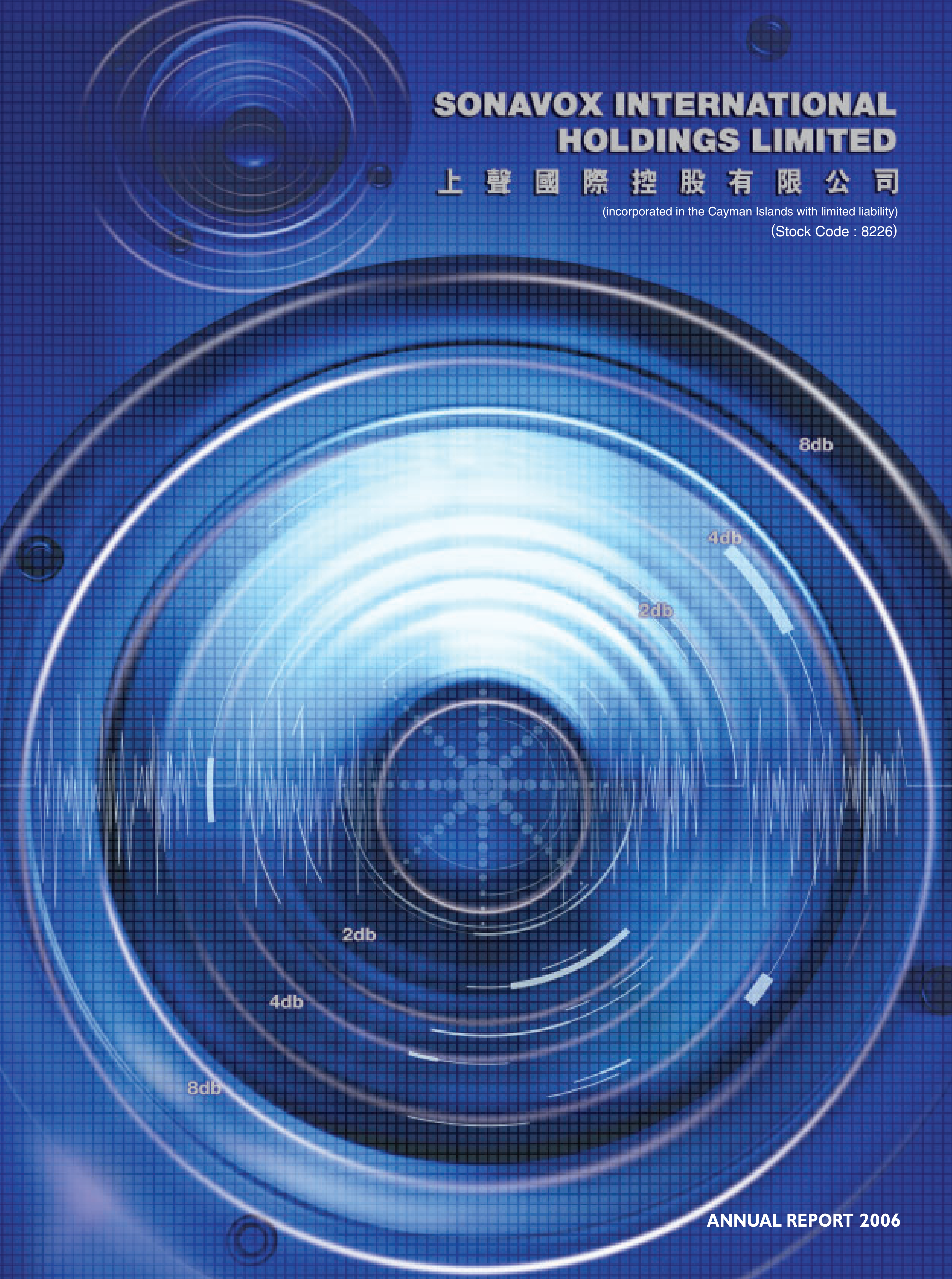
# SONAVOX INTERNATIONAL HOLDINGS LIMITED

# 上聲國際控股有限公司

(incorporated in the Cayman Islands with limited liability)

(Stock Code : 8226)




ANNUAL REPORT 2006

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*This document, for which the Directors of Sonavox International Holdings Limited (the "Company") collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the GEM of the Stock Exchange (the "GEM Listing Rules") for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief:- (1) the information contained in this document is accurate and complete in all material respects and not misleading; (2) there are no other matters the omission of which would make any statement in this document misleading; and (3) all opinions expressed in this document have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.*

# CONTENTS

# FINANCIAL HIGHLIGHTS

The Group's financial highlights are as follows:

| | **2006** | 2005 | (%) Change between 2005 and 2006 |
|---|---|---|---|
| In HK$'000 | | | |
| Sales | **369,302** | 234,288 | 58% |
| Gross profit | **63,199** | 44,602 | 42% |
| Profit from operations | **18,577** | 12,283 | 51% |
| Earning before Interest, Tax, Depreciation and Amortization ("EBITA") | **30,834** | 19,928 | 55% |
| Profit attributable to equity holders of the Company | **3,602** | 23 | 15,561% |
| Total assets | **362,940** | 228,602 | 59% |
| Total assets less current liabilities | **185,375** | 134,890 | 37% |
| Total equity | **148,214** | 132,998 | 11% |
| *Business performance ratios:* | | | |
| Return on total assets (%) | **5%** | 5% | –% |
| Return on Shareholders' funds | **4%** | 0% | 13,953% |
| Gross profit margin (%) | **17%** | 19% | –10% |
| Current ratio | **1.01** | 1.27 | –20% |
| Quick ratio | **0.79** | 1.05 | –25% |
| Gearing ratio | **0.59** | 0.24 | 146% |

Definitions for business performance ratios:

| | | |
|---|---|---|
| Return on total assets | $\dfrac{\text{Profit from operations}}{\text{Total assets}}$ | x 100% |
| Return on Shareholders' funds | $\dfrac{\text{Profit attributable to shareholders}}{\text{Shareholders' funds}}$ | x 100% |
| Gross profit margin | $\dfrac{\text{Gross profit}}{\text{Turnover}}$ | x 100% |
| Current ratio | $\dfrac{\text{Current assets}}{\text{Current liabilities}}$ | |
| Quick ratio | $\dfrac{\text{Current assets excluding inventories}}{\text{Current liabilities}}$ | |
| Gearing ratio | $\dfrac{\text{Corporate borrowings}}{\text{Total equity}}$ | |

# FIVE YEARS FINANCIAL SUMMARY



The following is a summary of the published consolidated income statements and balance sheets of the Group:

## 1 CONSOLIDATED INCOME STATEMENTS

| | 2002<br>HK$'000 | 2003<br>HK$'000 | 2004<br>HK$'000 | 2005<br>HK$'000 | **2006**<br>**HK$'000** |
|---|---|---|---|---|---|
| Turnover | 76,656 | 115,348 | 205,552 | 234,288 | **369,302** |
| Cost of sales | (50,782) | (81,409) | (152,512) | (189,686) | **(306,103)** |
| Gross profit | 25,874 | 33,939 | 53,040 | 44,602 | **63,199** |
| Other gains – net | 244 | 231 | 266 | 567 | **4,805** |
| Selling and marketing costs | (4,123) | (4,922) | (9,440) | (12,591) | **(15,403)** |
| Administrative expenses | (6,867) | (11,361) | (10,602) | (20,295) | **(34,024)** |
| Operating profit | 15,128 | 17,887 | 33,264 | 12,283 | **18,577** |
| Finance costs | (536) | (684) | (1,291) | (1,548) | **(6,711)** |
| Profit before income tax | 14,592 | 17,203 | 31,973 | 10,735 | **11,866** |
| Income tax expense | (1,402) | (1,688) | (9,360) | (5,920) | **(3,156)** |
| Profit after taxation | 13,190 | 15,515 | 22,613 | 4,815 | **8,710** |
| Minority interests | (7,326) | (9,152) | (12,527) | (4,792) | **(5,108)** |
| Profit attributable to equity holders of the Company | 5,864 | 6,363 | 10,086 | 23 | **3,602** |

## 2 CONSOLIDATED BALANCE SHEETS

| | 2002<br>HK$'000 | 2003<br>HK$'000 | 2004<br>HK$'000<br>(Restated) | 2005<br>HK$'000 | **2006**<br>**HK$'000** |
|---|---|---|---|---|---|
| Total assets | 132,602 | 154,834 | 209,900 | 228,602 | **362,940** |
| Total liabilities | (33,359) | (50,293) | (85,374) | (95,604) | **(214,726)** |
| Total assets less liabilities | 99,243 | 104,541 | 124,526 | 132,998 | **148,214** |
| Minority interests | (35,841) | (37,369) | (53,432) | (58,250) | **(63,358)** |
| Net assets | 63,402 | 67,172 | 71,094 | 74,748 | **84,856** |

# CHAIRMAN'S STATEMENT

## TO OUR SHAREHOLDERS

I am pleased to present the annual results of Sonavox International Holdings Limited (the "Company") and its subsidiaries (together the "Group" or "Sonavox") for the year ended 31st December 2006.

Sonavox has made significant achievements in the past year in acquiring the entire issued share capital of Sonavox Canada Inc. (formerly known as Indigo Manufacturing Inc.) ("SCI") in April 2006, an audio manufacturer with patented technology that already has a strong base of customers using its patented amplifier technology – BASH for audio applications. The synergistic effect of combining Sonavox's expertise on production capabilities and SCI's strong R&D had added value to the Group's audio products and innovative audio solution services for our existing and potential customers in the year 2006.

With increasing order placements from overseas customers, we are very pleased that our development strategy for overseas markets and as a result of the acquisition of SCI, sales dramatically increased by 58% from approximately HK$234 million to HK$369 million, and EBITA increased by 55% from approximately HK$20 million to HK$31 million. We are confident that contribution from sales in overseas markets will continue to grow and contribute a significant portion to our total turnover.

Sonavox continued to cooperate with overseas automakers when they entered into the Mainland China market. We maintained good relationship with them and hence sustained our position as qualified export supplier. After all the assessment by General Motors Worldwide ("GMW") who sells vehicles and parts to dealers and affiliates outside the United States, we had been recognised as one of the qualified vendors of GMW in the year 2006. The whole assessment processes of obtaining this qualification proved to be a huge benefit for Sonavox, helping us to identify the areas where we could improve and further obtain a better understanding of General Motors's quality and management requirements.

During the year 2006, the Group increased in investment on rolling out several major projects with new customers in overseas and further investment on expanding the Group's sales and manufacture of components for automobiles and home theatres in Mainland China. To ensure continuous robust growth, Sonavox remains committed to raising R&D investment to reinforce its successful businesses in loudspeaker systems for automobiles and home theatre. The Group pursues to heighten efficiency by improving its production capabilities and design of production lines. We are confident that these efforts, mirroring our determination to grow, will improve our profit margins and bring promising returns. We are anticipating fruitful returns in the coming years after we ramp up our production scale.

For audio product development, the Group launched several loudspeaker systems for iPod and MP3 products encompassed new patent technology in the year 2006. The persistently rising demand for iPod, MP3 and MP4 products worldwide and the trend of installing quality audiovisual entertainment systems are driving the demands for high quality subwoofers, loudspeaker systems and docking systems. We are confident that the Group's entry into the consumer electronic market and its ability to capture new business opportunities will achieve a stable return in the next year.

## PROSPECTS

Looking into 2007, the business growth is robust and we are excited about the growth opportunities we see ahead. Our consistent quality and R&D improvement have boosted our confidence in expanding overseas in the future. Additionally, our success in cultivating business relations with those automobile giants in overseas market, also demonstrated our total competence in providing top quality and high performance loudspeaker systems to internationally renowned brand names.

As the selling price of automobiles in Mainland China to become stable, the growth in demand for automobiles is expected to gradually accelerate in the year 2007. We are very confident of further expanding the market share of our top quality and high performance loudspeaker systems for automobiles in the Mainland China and also maintaining our leading position in the industry.

Business performance of the home theatre sector will contribute significant revenue for the Group's strategic developments, reinforcing its capacities for business growth. With the Group's know-how in innovative audio solution, unique and better performance sub-woofer systems will be launched next year.

With our strong foundation, excellent business opportunity will be created for Sonavox in year 2007. I am highly encouraged that with our persistence pursuit of quality and attention to detail, we are well positioned for achieving even better results and creating value for our shareholders and customers.

## APPRECIATION

Last but not least, on behalf of Sonavox, the senior management and I would like to thank our customers, suppliers, bankers, investors and business partners for their continued trust and support. I would also like to extend my gratitude to all our staff for their hard work and contribution to the Group and shareholders in the past year. Sonavox is poised as "one-stop" audio solution provider in the audio market and bring stable returns for our shareholders.

**Yang Tsu Ying**
*Chairman*

Hong Kong, 27th March 2007

# MANAGEMENT DISCUSSION AND ANALYSIS

## FINANCIAL REVIEW

Triggered by the growth in the overseas market and resulted from the acquisition of a subsidiary in Canada, the Group achieved a turnover of approximately HK$369 million, representing a jump of 58% for the year ended 31st December 2006. However, the Group's gross profit margin slightly decreased from approximately 19% to 17% due to the increase in cost of manufacturing overhead, especially that of labour and related welfare costs which slightly pushed up the Group's cost of production. During the year under review, revenue from overseas markets surged from approximately HK$158 million to approximately HK$262 million, representing surge of 66%.

The Group's selling and distribution expenses increased approximately 22% from approximately HK$12,591,000 to approximately HK$15,403,000. The increase was mainly attributable to the expanding markets in overseas, leading to additional business trip expense and traveling cost to these countries. Besides, additional shipping costs to deliver loudspeakers systems on time to fill unexpected new orders from new customers also increase the distribution costs during the year under review.

Administrative expenses increased by approximately 67% from approximately HK$20,295,000 to approximately HK$34,024,000 during the year 2006. Since one of the Mainland China subsidiaries has commenced its operation since May 2006, operating costs was unavoidably increased following its operation commenced in May 2006, therefore, additional undergraduate degree holders as administrative supporting staffs with higher salary level have been hired for this new subsidiary. Furthermore, the persistent rising demand for quality audiovisual entertainment systems for home use, the Group incurred research and development expense of approximately HK$6.8 million, 1,051% up compared with the year 2005. The additional subsidiary in Canada incurred administrative expenses of approximately HK$8 million since the acquisition in April 2006.

Finance costs surged from approximately HK$1,548,000 to approximately HK$6,711,000. The increase in finance costs was mainly due to the issuance of convertible bonds in April 2006 and general increase in market interest rate. Details of the finance costs are set out in Note 7 to the consolidated financial statements.

The 55% increase of EBITA from approximately HK$19,928,000 in year 2005 to approximately HK$30,834,000 was mainly attributable to the acquisition of wholly-owned subsidiary in Canada.

### Liquidity, financial resources and treasury policies

During 2006, the Group's major business operations took place in Mainland China and Canada, financed mainly by the cash revenue generated from operating activities and by corporate borrowings. As at 31st December 2006, the Group had cash and bank deposits of approximately HK$34,599,000 (2005: HK$47,460,000). During the year under review, the Group's cashflow generated from operations decreased by 43% from approximately HK$33,517,000 to HK$19,387,000. Current ratio dropped from 1.27 to 1.01 mainly due to the Company issued convertible bonds during the year, resulted in recognition of embedded derivative financial instrument of approximately HK$6,604,000 and amounts due to certain building contractors in Mainland China of approximately HK$10 million was recognised in accruals and other payables. A convertible bonds of US$5,000,000 was issued by the Company in April 2006, triggered the increase in gearing ratio from 0.24 as at 31st December 2005 to 0.59 as at 31st December 2006. Detailed convertible bonds and embedded derivative financial instrument are shown in Note 26 to the consolidated financial statements. The Group had bank overdrafts of approximately HK$9,499,000 bearing interest rates at commercial prime lending rate plus 0.75% per annum and short-term bank loans of approximately HK$35,917,000 bearing interest rates ranging from 4.20% to 5.58% per annum with repayment within a year.

The Group adopts conservative treasury policies in managing its cash and financial matters, with all the Group's treasury activities carried out in Canada, Mainland China and Hong Kong. Currently, cash and bank deposits are placed in interest-bearing bank accounts denominated in Hong Kong dollars ("HKD"), Renminbi ("RMB"), U.S. dollars ("USD"), European dollars ("Euros") and Canadian dollars ("CAD"). The Group's liquidity and financial arrangements are reviewed regularly by the Board and senior management.

## CAPITAL COMMITMENT AND CONTINGENT LIABILITIES

As at 31st December 2006, the Group has capital commitment of approximately HK$19,480,000 in respect of the acquisition of property, plant and equipment and non-cancellable operating lease commitment of approximately HK$1,765,000.

Suzhou Shangsheng Technology Co., Ltd. and Suzhou Hesheng Industries Co., Ltd. were established with registered capital of US$13,000,000 and US$5,000,000 respectively. As at 31st December 2006, the Company had outstanding commitments of approximately US$3,931,000 and US$2,050,000 respectively for capital contribution to these two subsidiaries.

As at 31st December 2006, the Group did not have any significant contingent liabilities.

## MATERIAL ACQUISITION/DISPOSALS AND SIGNIFICANT INVESTMENT

During the year, the Group completed the acquisition of Sonavox Canada Inc. (formerly known as Indigo Manufacturing Inc.), a company incorporated in Canada engaging in the sales and manufacture of audio products in April 2006. The total purchase consideration for this acquisition amounted to approximately HK$29,711,000.

Other than aforementioned, there was no other material acquisition which would have been required to be disclosed under the GEM Listing Rules.

At present, the Group has no future plan for material disposal of significant investments.

## EXPOSURE ON EXCHANGE RATE FLUCTUATION

Most of the Group's bank borrowings were denominated in RMB, CAD and USD, whilst receipts and expenditures of the Group were denominated in RMB, HKD, USD, Euros and CAD during the year. The Group is subject to foreign exchange exposure in RMB / CAD against USD and Euros. However, the Group was able to partially mitigate the foreign exchange impact by entering sale transaction with overseas customers denominated in RMB and entering purchase contract with overseas suppliers in USD. The Directors and senior management will continue to monitor closely the exchange risks and hedging by forward contracts and applicable derivatives when necessary.

## BANKING FACILITIES AND PLEDGE OF ASSETS

The Group had aggregate banking facilities of approximately HK$66,055,000 for overdrafts and loan financing as at 31st December 2006. Unused bank facilities as at the same date amounted to approximately HK$20,639,000. These facilities were secured by land use rights, buildings and certain trade receivables of the Group with a carrying value of approximately HK$120,136,000.

## DIVIDEND

The Directors do not recommend the payment of a final dividend for the year ended 31st December 2006.

# MANAGEMENT DISCUSSION AND ANALYSIS

## BUSINESS REVIEW

Recognised as the engine for economic growth, the Mainland China automobile market continued to experience strong growth during the year. According to the China Association of Automobile Manufacturers ("CAAM"), Mainland China produced 7.2797 million vehicles and sold 7.216 million in year 2006, up 27.32 and 25.13 percent respectively compared with the year 2005. Production and sales of passenger vehicles recorded 5.2331 million and 5.176 million respectively in year 2006, up 32.76 and 30.02 percent respectively compared with the year 2005, and production and sales of commercial vehicles was at 2.0466 million and 2.04 million respectively in year 2006, up 15.25 and 14.23 percent respectively. Mainland China became the second largest new car market in the world behind the US. During the year, the Group continued to provide quality and high performance loudspeaker systems for leading automobile players in Mainland China markets and overseas markets. Sales of loudspeaker systems for automobiles remained as the Group's major revenue stream, accounted for approximately 55% of its total turnover.

With regard to the Group's loudspeaker systems for home theatre, another impressive year of growth as a result of the synergistic effect of the acquisition of a wholly-owned subsidiary in Canada. Loudspeaker systems for home theatre sales increased from approximately HK$43 million to approximately HK$165 million, representing a growth of approximately 284%. Strengthening relationships with key audio players in the overseas markets, in a strategy to become their business partner and supplier, further enhanced the Group's sales. Demand from audio-visual products, such as DVD, iPod and MP3, has further driven the demand for home theatres loudspeaker systems and newly developed docking systems for iPod and MP3. The Group maintained competitive gross margin compared with competitors and focused on delivering top quality and high performance loudspeaker systems to the Group's customers.

To further achieve the benefit from vertical integration and meet the future sale orders from customers, the Group further expanded its production capabilities during the year under review. As part of the vertical integration plan, the Group acquired 6 improved automated assembly lines in order to increase efficiency by more than 35% and increase total output to more than 30,000,000 units per year. Machinery and equipment for ABS injection components, voice coils, cones, electroplating were acquired and upgraded. In-house laboratory capability and in-house environmental test capability for manufacture of cones and electroplating was further upgraded and fully tested during the year under review. Capital expenditure of approximately HK$52,942,000 was incurred for the year ended 31st December 2006.

## NUMBER OF EMPLOYEES

A breakdown of the number of employees of the Group by function as at 31st December 2005 and 2006 is set out below:

| | **2006** | 2005 |
|---|---|---|
| Management and administration | **68** | 27 |
| Sales and marketing | **40** | 23 |
| Manufacturing and operations | **1,370** | 1,035 |
| Research and development | **70** | 52 |
| Quality assurance and quality control | **126** | 157 |
| Finance and accounting | **14** | 12 |
| Total | **1,688** | 1,306 |

## REMUNERATION OF EMPLOYEES AND POLICIES

The Group recognises that its staff is one of the Group's most important assets. Aiming at providing competitive salary packages, the Group adjusts employees' salary level in close association with the performance, qualifications and experience of individual staff as well as labour market conditions. In addition to the regular remuneration, discretionary bonus and share options may be awarded to eligible employees with reference to individual performance and the Group's business performance.

The Group enjoys good relations with staff and has not experienced any disruption of operations due to major labour disputes. In addition to the remuneration as mentioned above, the Group also provides fringe benefits which comply with the relevant laws and regulations of the Mainland China and Hong Kong in relation thereto including contributions to society security scheme of the Mainland China, contribution to the Mandatory Provident Fund Scheme of Hong Kong and provision of training programmes to eligible employees.

Total employee benefit expense incurred for the year ended 31st December 2006 increased to approximately HK$46,739,000 (2005: HK$30,100,000) due to the consolidation of the new subsidiary in Canada and increase in pension costs for workers, wages and salaries for managerial staff and quality control staff in Mainland China during the year under review. The Company's directors had received remuneration of approximately HK$718,000 (2005: HK$1,513,000) during the year ended 31st December 2006. Detailed director's and management's emoluments was described in Note 13 to the consolidated financial statements.

## TRAINING SCHEMES

The Group provides on-going training programmes for its employees to keep them abreast of the latest market trends and new technologies of loudspeaker systems, and also to enhance their knowledge on latest international quality standards. During the year, the Group provided more than 60 different training programmes to its management staff to sharpen their management skills and techniques.

## BUSINESS PROSPECTS

According to CAAM, forecast of automobiles sales will exceed eight million units in 2007. The Directors are highly confident of the Group's future developments. Given the Group's success in cultivating business relations with the world's leading automakers in Mainland China, North America, Europe and Japan, the Directors are very optimistic about future business co-operations with other international automobile manufacturers. Loudspeaker systems for automobile sale orders from overseas markets are expected to be significantly increased as a result of the Group successfully became one of the qualified vendors of General Motors Worldwide in year 2006. Additionally, the Group has successfully delivered and sold loudspeaker systems for one of the leading automobile manufacturers in Germany in the second half of 2006, the Directors believe that sales related to automobile loudspeaker systems will gradually increase in 2007.

To cope with the changing role of Mainland China to become one of the major automobiles supply in the world following the Group's association with those renowned automakers, the Group continued to expand its production capabilities in Mainland China. These new facilities will further enhance the efficiency and flexibilities of the Group's operation and production.

# MANAGEMENT DISCUSSION AND ANALYSIS

Apart from the loudspeaker systems for automobile market, our management believes that the global consumer electronics market is huge and has plenty of room for continuous growth over the next few years. According to Consumer Electronics Association, MP3 players, such as iPod, will account for 90 percent of the US$6 billion in revenues for the portable entertainment market. Thirty-four million units of MP3 players shipped in 2006 and an additional 41 million units are expected to ship in 2007. In 2006, the Group entered into the mainstream consumer electronics, with its first iPod docking stations. With the continued market development, the Group will launch four new systems in 2007, capturing the largest market segment growth for 2007 and possibly years to come.

Senior management further believed that CRT-based television sets are giving way to flat panel displays. The successful ongoing transition to digital television is driving demand in television market space. Associated with the consumer electronic market, senior management believes that there is potential revenue being generated from provision of innovative audio solution services for new customers. To further capture the lion's share of these digitalisation market trend, the Group will focus its efforts in developing more digital platforms to integrate its rich power electronic background. Continuous efforts in R&D, senior management has confident to develop better powerful amplifier systems for home audio systems market. The above launches are significant to the Group because they represent new markets and open the door for the Group to further grow.

The Directors expect 2007 to be another rewarding year, promising good returns from our continuous efforts to expand audio markets. The Directors also believe that the Group's persistent strive for quality and advanced technical expertise will allow the Group to capture the immense business opportunities ahead.

# BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

## EXECUTIVE DIRECTORS

**Mr. Yang Tsu Ying**, aged 73, is the chairman of the Company and one of the founders of the Group. He has over 30 years of experience in manufacturing and trading of loudspeaker systems in overseas markets and over 10 years of experience in manufacturing and trading of loudspeaker systems in the Mainland China. He is responsible for the development of the overall corporate policy and strategies as well as overseeing the Group's operation management.

Mr. Yang Ching Yau, aged 37, is the chief executive officer and one of the founders of the Group. He has over 16 years of experience in the sales, engineering, marketing and manufacturing of loudspeaker systems. He is responsible for the sales and marketing, operations and corporate finance of the Group. He is the son of Mr. Yang Tsu Ying.

## INDEPENDENT NON-EXECUTIVE DIRECTORS

**Mr. Yiu Chi Wah**, aged 43. Mr. Yiu has over 15 years of experience in finance and investment advisory affairs. He holds a bachelor's degree in arts with National Taiwan University in Taiwan and had worked for Polaris Securities (Hong Kong) Limited as a Responsible Officer and an investment adviser registered under the Securities Ordinance. Mr. Yiu was also a director of Polaris Finance Company Limited.

**Mr. Wong Kai Tung, Simon**, aged 39. Mr. Wong had worked for DBS Bank Limited, VC CEF Capital Limited and Deutsche Bank in the investment banking service for the Greater China area. Mr. Wong has over 17 years of corporate and investment banking experience. Mr. Wong holds a bachelor's degree in arts (Honour) from the University of Hong Kong, a post-graduate certificate in Hong Kong Laws from the City University of Hong Kong and the executive certificate from Paris' INSEAD on Young Manager Program.

**Mr. Fan Chi Fai, Paul**, aged 45, is a qualified accountant. Mr. Fan is a member of Institute of Chartered Accountants in England and Wales and works as Finance Director of Networks Business for Motorola (China) Electronics Ltd. Mr. Fan has obtained an honour degree in Bachelor of Accountancy, Finance and Economics from the University of Essex, U.K.

# BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

## SENIOR MANAGEMENT

**Mr. Zhou Jian Ming**, aged 49, is the general manager of subsidiaries in Mainland China. He is responsible for the general administration of all subsidiaries in Mainland China. He obtained a master's degree in business administration from Nanjing University in Mainland China. He has extensive experience in enterprise management and has over 15 years of experience in the production management of loudspeaker systems. Mr. Zhou had worked for Wuxian Radio Components First Factory (吳縣無綫電元件一廠) and was responsible for corporate administration works. Currently, he is also involved in the sales and marketing activities in Mainland China and overseas.

**Mr. Pan Hui Hua**, aged 51, is the production manager and assistant general manager of subsidiaries in Mainland China. Mr. Pan joined the Group in 1994 and is responsible for the production of loudspeaker systems. He has over 20 years of experience in the development and production of loudspeaker systems. Mr. Pan had worked for Likou Town Government Industrial Co. ("LTGIC") (蠡口鎮政府工業總公司) as manager and was responsible for monitoring the operations of factories under the control of LTGIC.

**Mr. Joe Riggi**, aged 42, is the president of Sonavox Canada Inc. (formerly known as Indigo Manufacturing Inc.) ("SCI"). Mr. Riggi joined Indigo Manufacturing Inc. in 1986 and has been in a senior management role for more than 10 years. He holds an Engineering Technologist Degree with DeVry University in Canada and is one of the active members of the Young President's Organisation ("YPO") group. Mr. Riggi is currently responsible for the operation of SCI and implementation of product development and sales and marketing of the Group.

**Mr. Poon Lai Yin, Michael**, aged 35, is the chief financial officer and the company secretary of the Group. Mr. Poon is responsible for the overall financial management and accounting function of the Group. He is an associate member of Hong Kong Institute of Certified Public Accountants and a member of the CPA Australia. He holds a bachelor's degree in administrative studies with York University in Canada and a master's degree in practicing accounting with Monash University in Australia. Mr. Poon has over 11 years of experience in auditing, taxation and accounting. Prior to joining the Group in March 2002, Mr. Poon worked for an international accounting firm and was responsible for providing business advisory and assurance services to some listed clients.

# CORPORATE GOVERNANCE REPORT



The board of Directors of Sonavox International Holdings Limited (the "Company") is committed to good standards of corporate governance in order to protect and enhance the interests of our shareholders. The Directors believe that high standards of corporate governance provide a framework and solid foundation for achieving, attracting and retaining the high standard and quality of the Group's management, promoting high standards of accountability and transparency and meeting the expectations of all of the Group's various stakeholders.

The principles of corporate governance adopted by the Group emphasize a quality board, sound internal control, and transparency and accountability to all stakeholders.

The Company has complied with the Appendix 15 of the Rules Governing the Listing of Securities on The Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (the "GEM Listing Rules") throughout the year ended 31st December 2006 except that independent non-executive Directors had no set term of office but retire on a rotation basis. The Company is in compliance with all code provisions of the new Code on Corporate Governance Practices of the GEM Listing Rules.

Below are the corporate governance practices adopted by the Group.

The corporate governance practices adopted by the Group are as follows:

- Code of ethics and securities transactions;
- Corporate governance practice manual;
- Term of reference for audit committee;
- Term of reference for board committee;
- Term of reference for remuneration committee; and
- Term of reference for nomination committee.

## DIRECTORS' SECURITIES TRANSACTIONS

The Code of Ethics and Securities Transactions is adopted by the Company to regulate securities dealings by directors, senior management and certain employees of the Group, and to provide guidelines and procedures on conflict of interests of Directors.

The first part of this Code of Ethics and Securities Transactions is based on the GEM listing rules 5.48 to 5.67 (the "required standard") against which Directors must measure their conduct regarding transactions in securities of their listed issuers, and the Securities Future Ordinance ("SFO").

The second part of this Code of Ethics and Securities Transactions establishes guidelines and procedures regarding conflict of interests of Directors in order to protect the best interests of the Company.

During the year ended 31st December 2006, all Directors have compiled with the Code of Ethics and Securities Transaction.

# CORPORATE GOVERNANCE REPORT

## BOARD OF DIRECTORS

The Board is responsible for the oversight of the management of the Company's business and affairs of the organization with the objective of enhancing shareholder value.

The Board, led by the Chairman, Mr. Yang Tsu Ying, is responsible for the approval and monitoring of Group wide strategies and policies, approval of business plans and oversight of senior management. The senior management is responsible for the day-to-day operations of the Group under the leadership of the Chief Executive Officer ("CEO"), Mr. Yang Ching Yau.

As at 31st December 2006, the Board comprised two executive Directors, including Chairman and CEO, and three independent non-executive Directors. Biographical details of the Directors referred to pages 11 to 12 of this annual report.

For a Director to be considered independent, the Board must determine that the Director does not have any direct or indirect material relationship with the Group. In determining the independence of Directors, the Board follows the requirements set out in the GEM Listing Rules.

The roles of the Chairman and the CEO are segregated and are not exercised by the same individual. Such division of responsibilities helps to reinforce their independence and accountability.

The Chairman is responsible for providing leadership to, and overseeing, the functioning of the Board to ensure that the Board acts in the best interests of the Group so that Board meetings are planned and conducted effectively. The Chairman is primarily responsible for approving the agenda for each Board meeting, taking into account, where appropriate, matters proposed by other Directors for inclusion in the agenda. With the support of CEO and the company secretary, the Chairman seeks to ensure that all Directors are properly briefed on issues arising at Board meetings and receive adequate and reliable information in a timely manner. The Chairman also encourages Directors to be fully engaged in the Board's affairs and make contribution to the Board's functions. The Board have adopted good corporate governance practices and procedures and taken appropriate steps to provide effective communication with shareholders.

The CEO is responsible for managing the businesses of the Group, attending to the formulation and successful implementation of the Group's policies and assuming full accountability to the Board for all business operations. The CEO develops strategic plans and is directly responsible for maintaining the operational performance of the Group. Working with the Chief Financial Officer ("CFO") and the senior management of the Group, the CEO ensures that the Board is fully informed of the requirements of the businesses of the Group and presents business and financial information to the Board for consideration and approval.

The CEO, with the assistance of the CFO, ensures that the funding requirements of the businesses are met and closely monitors the operating and financial results against plans and budgets, taking remedial actions when necessary and advising the Board of significant developments and issues. He maintains an ongoing dialogue with the Chairman and all Directors to keep them fully informed of all major business development and issues. He is also responsible for building and maintaining an effective executive team to support him in his role.

Directors' Board meeting is held at least 4 times a year and as when required by the CEO. In addition, Directors have full access to information on the Group and independent professional advice whenever deemed necessary by the Directors.

The Board held six board meetings in 2006. Attendance of the full board meetings are as follows:

| | Name of Directors | Attended/Eligible to attend |
|---|---|---|
| Chairman | Yang Tsu Ying | 100% |
| CEO | Yang Ching Yau | 100% |
| Independent non-executive Directors | Yiu Chi Wah | 100% |
| | Wong Kai Tung, Simon | 100% |
| | Fan Chi Fai, Paul | 100% |

Save for the Chairman of the Company, all Directors are subject to re-election by shareholders at the annual general meeting following their appointment. At each annual general meeting one-third of the Directors for the time being, or, if their number is not three or a multiple of three, then the number nearest to but not less than one-third, shall retire from office by rotation provided that every Director, including those appointed for a specific term, shall be subject to retirement by rotation at least once every three years. A retiring Director shall be eligible for re-election. The Company at the general meeting at which a Director retires may fill the vacated office. The Directors to retire by rotation shall include (so far as necessary to obtain the number required) any Director who wishes to retire and not to offer himself for re-election. Any further Directors so to retire shall be those who have been longest in office since their last re-election or appointment and so that as between persons who became or were last re-elected Directors on the same day those to retire shall (unless they otherwise agree among themselves) be determined by lot.

## REMUNERATION OF DIRECTORS

The remuneration committee was established on 28th June 2005. The remuneration committee is chaired by an independent non-executive Director with the responsibility of approving the remuneration policy for all Directors and senior executives. The remuneration committee members include a majority of independent non-executive Directors as follows:

Mr. Yiu Chi Wah* – *Committee Chairman*
Mr. Wong Kai Tung, Simon*
Mr. Fan Chi Fai, Paul*
Mr. Yang Ching Yau

* *Independent non-executive Director*

All remuneration committee members met at the end of the year for the determination of the remuneration packages of Directors and senior management of the Group. In addition, the remuneration committee members also meets as and when required to consider remuneration related matters.

The works carried out by the remuneration committee are set out below:

(a) to make recommendations to the Board on the Company's policy and structure of remuneration of Directors and the senior management and on the establishment of a formal and transparent procedure for developing policy on such remuneration;

(b) to determine the specific remuneration packages of all executive Directors and the senior management, including benefits in kind, provident/retirement benefits and compensation payments, including any compensation payable for loss or termination of their office or appointment, and make recommendations to the Board of the remuneration of independent non-executive Directors;

(c) to review and approve performance-based remuneration by reference to corporate goals and objectives resolved by the Board from time to time;

(d) to review and approve the compensation payable to executive Directors, senior management in connection with any loss or termination of their office or appointment to ensure that such compensation is determined in accordance with relevant contractual terms and that such compensation is otherwise fair and not excessive for the Company; and

(e) to review and approve compensation arrangements relating to dismissal or removal of Directors for misconduct to ensure that such arrangements are determined in accordance with relevant contractual terms and that any compensation payment is otherwise reasonable and appropriate.

The remuneration of every Director for the year ended 31st December 2006 is set out below:

| Name of Director | Fees | Salary | Discretionary bonuses | Inducement fees | Other benefits(a) | Employer's contribution to pension scheme | Compensation for loss of office as director | Total |
|---|---|---|---|---|---|---|---|---|
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| Mr. Yang Tsu Ying | – | 170 | – | – | – | – | – | 170 |
| Mr. Yang Ching Yau | – | 260 | – | – | – | – | – | 260 |
| Mr. Fan Chi Fai, Paul | 96 | – | – | – | – | – | – | 96 |
| Mr. Yiu Chi Wah | 96 | – | – | – | – | – | – | 96 |
| Mr. Wong Kai Tung, Simon | 96 | – | – | – | – | – | – | 96 |

## NOMINATION OF DIRECTORS

The nomination committee was established on 28th June 2005. The nomination committee chaired by the CEO to make recommendations to the Board on the appointment of Directors and the senior management personnel with reference to certain guidelines as agreed by the nomination committee members. The nomination committee members include a majority of independent non-executive Directors as follows:

Mr. Yang Ching Yau – *Committee Chairman*
Mr. Yiu Chi Wah*
Mr. Wong Kai Tung, Simon*

** Independent non-executive Director*

All nomination committee members met at the end of the year.

The works carried out by the nomination committee members are set out below:

(a) to review the structure, size and composition (including the skills, knowledge and experience) and to make recommendations to the Board after such review;

(b) to assess the suitability and qualification of candidates put forward by the CEO and to become new board members and to report to the Board on their assessment;

(c) to assess the independence of independent non-executive Directors, having regard to the requirements under the GEM Listing Rules; and

(d) to make recommendations to the Board on relevant matters relating to the appointment of Directors and succession planning for Directors, in particular, the Chairman and the CEO.

## AUDIT COMMITTEE

The audit committee comprises three independent non-executive Directors and one independent non-executive Director who possess the appropriate business and financial experience and skills to understand financial statements. The audit committee is chaired by Mr. Fan Chi Fai, Paul, and the other audit committee members are Mr. Yiu Chi Wah and Mr. Wong Kai Tung, Simon.

Under its terms of reference for audit committee passed under a directors' resolution dated 28th June 2005, is required, amongst other things, to oversee the relationship with the external auditors, to review the Group's preliminary results, interim results and annual financial statements and to monitor compliance with statutory and listing requirements, to engage independent legal or other advisers as it determines is necessary and to perform any investigations.

The audit committee members held six meetings in 2006. Attendance of the audit committee meetings is as follows:

| Name of member | Attended |
|---|---|
| Yiu Chi Wah | 100% |
| Wong Kai Tung, Simon | 100% |
| Fan Chi Fai, Paul | 100% |

## FINANCIAL STATEMENTS

The audit committee met and held discussions with the CEO and CFO of the Group on the interim report, quarterly financial reports and Annual Report. The audit committee reviews and discusses the management's reports and representations with a view to ensuring that the Group's consolidated financial statements are prepared in accordance with Hong Kong Accounting Standards and Hong Kong Financial Reporting Standards and compliance with the GEM Listing Rules and other legal requirements.

It also considers reports from the Group's principal external auditors on the scope and outcome of annual audit of the consolidated financial statements.

## INTERNAL CONTROL

The Board has overall responsibilities for maintaining a sound and effective internal control systems ("ICS") of the Group. The Group adopted a Risk-Based approach and methodology according to COSO (Committee of Sponsoring Organizations of Treadway Commission) and Internal Control and Risk Management – A Basic Framework released by Hong Kong Institute of Certified Public Accountants to assess the effectiveness of ICS of the Group. The ICS is designed to provide reasonable assurance against material misstatement or substantial loss, and to mitigate risk to a level that is acceptable to the audit committee members. The audit committee members play a major role in monitoring the ICS of the Group. It has unrestricted access to review all aspects of the Group's activities and ICS .

# CORPORATE GOVERNANCE REPORT

## EXTERNAL AUDITORS AND REMUNERATION

The audit committee also makes recommendations to the Board on the appointment ShineWing (HK) CPA Limited ("ShineWing") as external auditors on 14th December 2006. The Group engaged ShineWing for business advisory and assurance service that includes audit services provided in connection with the audit of the consolidated financial statements for the year ended 31st December 2006 with auditors' remuneration fee of approximately HK$330,000. No other non-audit related services were performed by ShineWing.

By Order of the Board

**Yang Ching Yau**
*Chief Executive Officer*

Hong Kong, 27th March 2007

The Directors have the pleasure of presenting the annual report together with the audited accounts of Sonavox International Holdings Limited (hereinafter referred to as the "Company") and its subsidiaries (together with the Company hereinafter as the "Group") for the year ended 31st December 2006.

## PRINCIPAL ACTIVITIES

The Company is an investment holding company. Its subsidiaries are principally engaged in the manufacture and sales of loudspeaker systems to customers in the People's Republic of China ("Mainland China") and overseas markets.

An analysis of the Group's performance by business and geographical segments is set out in Note 6 to the consolidated financial statements.

## CUSTOMERS AND SUPPLIERS

For the year ended 31st December 2006, the five largest customers accounted for approximately 47% of the Group's total turnover and the five largest suppliers of the Group accounted for approximately 18% of the Group's total purchases. The largest customer of the Group accounted for approximately 24% of the Group's total turnover while the largest supplier accounted for approximately 9.5% of the Group's total purchases.

None of the Directors, their associates, or any shareholders (which, to the knowledge of the Directors, owned more than 5% of the Company's share capital) had a beneficial interest in the Group's five largest customers and suppliers.

## RESULTS AND APPROPRIATIONS

Details of the Group's results for the year ended 31st December 2006 are set out in the consolidated income statement on page 29.

The Directors do not recommend the payment of a final dividend.

## SHARE CAPITAL

Details of the movements in share capital of the Company are set out in Note 22 to the consolidated financial statements.

## RESERVES

Movements in reserves of the Group during the year are set out in the consolidated statement of changes in equity on page 32.

## DISTRIBUTABLE RESERVES

Distributable reserves of the Company as at 31st December 2006 amounted to approximately HK$53,346,000 (2005: HK$57,465,000).

## PURCHASE, SALE OR REDEMPTION OF SHARES

Neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of the Company's listed shares during the year.

## 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 Companies Law (Revised) of the Cayman Islands.

# REPORT OF THE DIRECTORS

## SUBSIDIARIES

Particulars of the Company's subsidiaries are set out in Note 38 to the consolidated financial statements.

## PROPERTY, PLANT AND EQUIPMENT

Details of movements in property, plant and equipment during the year are set out in Note 14 to the consolidated financial statements.

## COMMITMENTS

Particulars of commitments as at 31st December 2006 are set out in Note 31 to the consolidated financial statements.

## RETIREMENT PLANS

Details of the retirement plans are set out in Note 34 to the consolidated financial statements.

## CONNECTED TRANSACTIONS

The following connected tanrsactions took place subsequent to 31st December 2006 and up to the date of this annual report.

a. On 9th January 2007, Sonavox Acoustics, a non wholly-owned subsidiary of the Company, entered into with SCI a sale and purchase contract, pursuant to which Sonavox Acoustics agreed to buy and SCI agreed to sell machineries at a cash consideration of CAD879,461 (equivalent to approximately HK$6,048,000) including the purchase price of 30 sets of machineries and costs directly attributable to bringing the machineries to the Mainland China. The terms of the sale and purchase contract were determined on an arm's length basis and were on normal commercial terms. As Shangsheng Electric, Shangsheng Technology and Suzhou Hesheng owned as to 49% by the same minority shareholder and two directors were nominated by the minority shareholder to the board of directors of Shangsheng Electric. Shangsheng Technology, Suzhou Hesheng and Sonavox Acoustics in the Mainland China. Sonavox Acoustics is an associate of the minority shareholder and therefore is a connected person within the meaning of Chapter 20 of the GEM Listing Rules.

b. On 28th February 2007, Sonavox Acoustics entered into sale and purchase agreements (the "Agreements) with Asian Elite International Company Limited ("Asian Elite"), a company incorporated in Mainland China and indirectly wholly-owned by Mr. Yang Ching Yau, and Sonavox Electronics (Suzhou Industrial Park) Company Limited ("Sonavox Electronics"), a company incorporated in Mainland China and indirectly owned as to 65% by Mr. Yang Ching Yau and his family members, respectively. Pursuant to the Agreements, Sonavox Acoustics has agreed to purchase amplifier systems from Asian Elite, subwoofer and tweeter systems from Sonavox Electronics. Pursuant to the GEM Listing Rules, these continuing connected transactions are subject to the approval by the independent shareholders at the extraordinary general meeting ("EGM") of the Company to be held at 11:30 a.m. on Monday, 16th April 2007 in which Mr. Yang Ching Yau and his associates, with material interest in the continuing connected transactions, will be required to abstain from voting in relation to the resolutions to approve the continuing connected transactions at the EGM.

Apart from the connected transaction and continuing connection transactions mentioned above, the Group had other connected transactions exempted under the GEM Listing Rules, details of which are disclosed in Note 32 to the consolidated financial statements.

## DIRECTORS AND DIRECTORS' SERVICE CONTRACTS

The directors who held office during the year and up to the date of this report are:

### EXECUTIVE DIRECTORS

Mr. Yang Tsu Ying
Mr. Yang Ching Yau

### INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. Yiu Chi Wah
Mr. Wong Kai Tung, Simon
Mr. Fan Chi Fai, Paul

In accordance with the Articles of Association of the Company, Mr. Yang Ching Yau, Mr. Wong Kai Tung, Simon and Mr. Fan Chi Fai, Paul will retire from office and, will be eligible to offer themselves for re-election at the forthcoming annual general meeting of the Company.

The independent non-executive Directors of the Company are not appointed for specific contracted terms but are subject to retirement by rotation in accordance with the Company's Articles of Association.

None of the Directors being proposed for re-election at the forthcoming annual general meeting has a service contract with the Company or any of its subsidiaries which is not terminable by the Group within one year without payment of compensation other than statutory compensation.

## DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS OR SHORT POSITIONS IN THE SHARES OR DEBENTURES

As at 31st December 2006, the interests and short positions of the Directors and Chief Executives in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")) which are required (a) to be notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have taken under such provisions of the SFO); or (b) pursuant to section 352 of the SFO, to be entered in the register referred to therein; or (c) pursuant to Rule 5.46 to 5.68 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange, were as follows:

### (A) LONG POSITIONS IN THE SHARES

| Name of Director | Type of interests | Capacity | Number of shares | Percentage of interest |
|---|---|---|---|---|
| Mr. Yang Tsu Ying *(Note)* | Corporate | Interest of a controlled corporation | 240,000,000 | 73.83% |
| Mr. Yang Ching Yau *(Note)* | Corporate | Interest of a controlled corporation | 240,000,000 | 73.83% |

*Note:* These shares are registered in the name of Newood Consultancy Limited, a company wholly owned by Silver Way Limited. The entire issued share capital of Silver Way Limited is in turn owned by HSBC International Trustee Limited as the trustee of The SEI Trust, and the discretionary objects of which are Mr. Yang Tsu Ying and Mr. Yang Ching Yau.

### (B) LONG POSITIONS IN THE SHARES OF EQUITY DERIVATIVES OF THE COMPANY

| Name of Director | Capacity | Description of equity derivatives | Number of share options | Percentage of interest |
|---|---|---|---|---|
| Mr. Yang Tsu Ying | Beneficial owner | Share option | 2,000,000 | 0.615% |
| Mr. Yang Ching Yau | Beneficial owner | Share option | 2,000,000 | 0.615% |

Save as disclosed in this paragraph, as at 31st December 2006, none of the Directors and Chief Executives had interests or short positions in any shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which are required (a) to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have taken under such provisions of the SFO); or (b) pursuant to section 352 of the SFO, to be entered in the register referred to therein; or (c) pursuant to Rule 5.46 to 5.68 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange.

## SUBSTANTIAL SHAREHOLDERS

So far as was known to any Director of the Company, as at 31st December 2006, the persons or companies (not being a Director of the Company) who had interests or short positions in the shares or underlying shares which would fall to be disclosed to the Company and the Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO and/or required to be entered in the register maintained by the Company pursuant to section 336 of the SFO were as follows:

### (A) LONG POSITIONS IN THE SHARES OF THE COMPANY

| Name | Capacity | Number of ordinary shares held | Percentage of interest |
|---|---|---|---|
| Newood Consultancy Limited *(Note 1)* | Beneficial owner | 240,000,000 | 73.83% |
| Silver Way Limited *(Note 1)* | Interest of a controlled corporation | 240,000,000 | 73.83% |
| HSBC International Trustee Limited *(Note 1)* | Trustee | 240,000,000 | 73.83% |
| Mr. Yang Tsu Ying *(Note 1)* | Beneficiary of a trust | 240,000,000 | 73.83% |
| Mr. Yang Ching Yau *(Note 1)* | Beneficiary of a trust | 240,000,000 | 73.83% |
| Madam Yang Chuang Ching-Hsiu *(Note 2)* | Interest of spouse | 240,000,000 | 73.83% |
| Ms. Helen Lee *(Note 3)* | Interest of spouse | 240,000,000 | 73.83% |

### (B) LONG POSITIONS IN THE SHARES OF EQUITY DERIVATIVES OF THE COMPANY

| Name | Capacity | Description of equity derivatives | Number of share options | Percentage of interest |
|---|---|---|---|---|
| Yang Tsu Ying | Beneficial owner | Share option | 2,000,000 | 0.615% |
| Yang Ching Yau | Beneficial owner | Share option | 2,000,000 | 0.615% |
| Yang Chuang Ching-Hsiu *(Note 2)* | Interest of spouse | Share option | 2,000,000 | 0.615% |
| Helen Lee *(Note 3)* | Interest of spouse | Share option | 2,000,000 | 0.615% |

*Notes:*

1. Newood Consultancy Limited is a company wholly owned by Silver Way Limited. The entire issued share capital of Silver Way Limited is in turn owned by HSBC International Trustee Limited as the trustee of The SEI Trust, and the discretionary objects of which are Mr. Yang Tsu Ying and Mr. Yang Ching Yau.

2. Madam Yang Chuang Ching-Hsiu is the spouse of Mr. Yang Tsu Ying and, under section 316 of the SFO, is therefore deemed to be interested in all 240,000,000 shares and 2,000,000 share options in which Mr. Yang Tsu Ying is interested.

3. Ms. Helen Lee is the spouse of Mr. Yang Ching Yau and, under section 316 of the SFO, is therefore deemed to be interested in all 240,000,000 shares and 2,000,000 share options in which Mr. Yang Ching Yau is interested.

Save as disclosed above, as at 31st December 2006, the Directors were not aware of any other person or company who had an interest or short position in the shares or underlying shares which would fall to be disclosed to the Company and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO and/or required to be entered in the register maintained by the Company pursuant to section 336 of the SFO.

## OTHER INTERESTS DISCLOSEABLE UNDER THE SFO

Save as disclosed in the preceding paragraphs headed “Directors’ and Chief Executives’ interests or short positions in the shares or debentures” and “Substantial Shareholders”, so far as is known to the Directors, there is no other person or company who has an interest or short position in the shares, underlying shares or debentures of the Company that is discloseable under the SFO.

## DIRECTORS' INTEREST IN COMPETING BUSINESS

The Group's ultimate controlling shareholders and executive Directors, Mr. Yang Tsu Ying and Mr. Yang Ching Yau, are also engaged in the business of manufacturing and trading of various types of loudspeakers through Sonavox Electronics (Suzhou Industrial Park) Company Limited, Sonavox Electronics Inc., Sonavox Electronics Limited, Fortune Win Limited, Asian Elite International Company Limited and their respective subsidiaries and associated companies (collectively known as the "Private Group"). As the business of the Group is overlapping with that of the Private Group to the extent that the Private Group is engaged in the manufacture and sale of loudspeakers for automotive aftermarket, Mr. Yang Tsu Ying, Mr. Yang Ching Yau and the Private Group have entered into the deed of undertaking on 15th July 2002 with the Company pursuant to which Mr. Yang Tsu Ying, Mr. Yang Ching Yau and the Private Group have given to the Group certain non-compete and referral of business opportunities undertakings.

Save as disclosed above, none of the Directors or the management shareholders of the Company (as defined in the GEM Listing Rules) had an interest in a business, which competes or may compete with the business of the Group.

## RIGHTS OF DIRECTORS AND EMPLOYEES TO ACQUIRE SHARES OR DEBENTURES

The Company operates a share option scheme (the "Scheme") for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Eligible participants of the Scheme include any directors, employees, consultants or professional advisors, and suppliers or customers of the Group. The Scheme became effective on 8th September 2002 and, unless otherwise cancelled or amended, will remain in force for a period of 10 years commencing on the effective date. The share options granted to and held by the Company's directors during the year were as follows:

| Name | Outstanding as at 31st December 2005 and 31st December 2006 | Granted during the year | Exercised during the year | Cancelled/ lapsed during the year | Exercise period | Subscription price HK$ |
|---|---|---|---|---|---|---|
| Mr. Yang Tsu Ying | 2,000,000 | – | – | – | 28th June 2005 to 27th June 2015 | 0.345 |
| Mr. Yang Ching Yau | 2,000,000 | – | – | – | 28th June 2005 to 27th June 2015 | 0.345 |

## DIRECTORS' INTERESTS IN CONTRACTS

Save as disclosed in Note 32 to the consolidated financial statements, 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 any of the Company's directors or members of its management had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

## 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.

## AUDIT COMMITTEE

The Company established an audit committee on 8th July 2002 with written terms of reference in compliance with Rules 5.28 to 5.33 and Appendix 15 of the GEM Listing Rules. The primary duties of the audit committee are to review and supervise the financial reporting process and internal control systems of the Group. The audit committee members include:

Mr. Fan Chi Fai, Paul* – *Committee Chairman*
Mr. Yiu Chi Wah*
Mr. Wong Kai Tung, Simon*

** Independent non-executive Director*

In the audit committee meeting held on 26th March 2007, the financial results and the financial position, major accounting and internal auditing issues of the Group for the year ended 31st December 2006 were reviewed and reported to the Board of Directors.

## NOMINATION COMMITTEE

The nomination committee was established on 28th June 2005 with written terms of reference in compliance with Appendix 15 of the GEM Listing Rules and chaired by the independent non-executive Director to make recommendations to the Board on the appointment of directors and the senior management personnel with reference to certain guidelines as endorsed by the Nomination Committee members. The nomination committee members include a majority of independent non-executive Directors as follows:

Mr. Yang Ching Yau – *Committee Chairman*
Mr. Yiu Chi Wah*
Mr. Wong Kai Tung, Simon*

** Independent non-executive Director*

## REMUNERATION COMMITTEE

The remuneration committee was established on 28th June 2005 with written terms of reference in compliance with Appendix 15 of the GEM Listing Rules and is chaired by an independent non-executive Director with the responsibility of approving the remuneration policy for all directors and senior executives. The remuneration committee members include a majority of independent non-executive Directors as follows:

Mr. Yiu Chi Wah* – *Committee Chairman*
Mr. Wong Kai Tung, Simon*
Mr. Fan Chi Fai, Paul*
Mr. Yang Ching Yau

** Independent non-executive Director*

# REPORT OF THE DIRECTORS

## COMPLIANCE WITH RULES 5.48 TO 5.67 OF THE GEM LISTING RULES

The Company has adopted a code of conduct regarding Directors' securities transactions on terms no less exacting than the required standard of dealings as set out in Rules 5.48 to 5.67 of the GEM Listing Rules. Having made specific enquiry of all Directors, the Company's directors have complied with such code of conduct and the required standard of dealings and its code of conduct regarding securities transactions by the Directors throughout the year ended 31st December 2006.

## CORPORATE GOVERNANCE PRACTICES AND PROCEDURES

The Group believes that enhancing good corporate governance demands long-term commitment from management and that the distinctive roles and functions of different committees are important in strengthening internal control.

During the year, the Company has compiled with the new Code on Corporate Governance Practices as set out in the Appendix 15 of the GEM Listing Rules.

## AUDITORS

Messrs. PricewaterhouseCoopers, who acted as auditors of the Group for the year ended 31st December 2005, resigned on 14th December 2006 and Messrs. ShineWing (HK) CPA Limited were appointed on 14th December 2006 to fill the casual vacancy following the resignation of PricewaterhouseCoopers.

A resolution will be submitted to the forthcoming annual general meeting to re-appoint Messrs. ShineWing (HK) CPA Limited as auditors of the Group.

On behalf of the Board,

**Yang Tsu Ying**
*Chairman*

Hong Kong, 27th March 2007

**SHINEWING** (HK) CPA Limited
Suities 09-18, 20/F.
Shui On Centre
6-8 Harbour Road
Wanchai, Hong Kong

**TO THE SHAREHOLDERS OF**
**SONAVOX INTERNATIONAL HOLDINGS LIMITED**
*(incorporated in the Cayman Islands with limited liability)*

We have audited the consolidated financial statements of Sonavox International Holdings Limited (the "Company") and its subsidiaries (collectively referred as the "Group") set out on pages 29 to 67, which comprise the consolidated balance sheet as at 31st December 2006, the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

## DIRECTORS' RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation and the true and fair presentation of these consolidated financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

## AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit 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. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the consolidated financial statements are free from material misstatement.

# REPORT OF THE AUDITORS

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## OPINION

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

**SHINEWING (HK) CPA Limited**
*Certified Public Accountants*
**Chan Wing Kit**
Practising Certificate Number: P03224

Hong Kong
27th March 2007

# CONSOLIDATED INCOME STATEMENT



For the year ended 31st December 2006

| | Notes | **2006 HK$'000** | 2005 HK$'000 |
|---|---|---|---|
| Sales | 6 | **369,302** | 234,288 |
| Cost of goods sold | | **(306,103)** | (189,686) |
| Gross profit | | **63,199** | 44,602 |
| Other gains – net | 6 | **4,805** | 567 |
| Selling and marketing costs | | **(15,403)** | (12,591) |
| Administrative expenses | | **(34,024)** | (20,295) |
| Finance costs | 7 | **(6,711)** | (1,548) |
| Profit before income tax | 8 | **11,866** | 10,735 |
| Income tax expense | 9 | **(3,156)** | (5,920) |
| Profit for the year | | **8,710** | 4,815 |
| Attributable to: | | | |
| Equity holders of the Company | | **3,602** | 23 |
| Minority interests | | **5,108** | 4,792 |
| | | **8,710** | 4,815 |
| Earnings per share | 10 | | |
| – Basic | | **HK cent 1.11** | HK cent 0.01 |
| – Diluted | | **HK cent 1.11** | HK cent 0.01 |
| Dividends | 11 | **–** | – |

# CONSOLIDATED BALANCE SHEET

As at 31st December 2006

| | Notes | 2006 HK$'000 | 2005 HK$'000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Property, plant and equipment | 14 | **140,758** | 93,366 |
| Land use rights | 15 | **11,651** | 11,322 |
| Deferred tax assets | 24 | **5,849** | 3,681 |
| Intangible assets | 16 | **19,600** | – |
| Goodwill | 17 | **5,299** | – |
| Total non-current assets | | **183,157** | 108,369 |
| **Current assets** | | | |
| Inventories | 18 | **38,617** | 20,295 |
| Land use rights | 15 | **276** | 464 |
| Trade and note receivables | 19 | **92,599** | 45,216 |
| Prepayments, deposits and other current assets | | **11,098** | 4,669 |
| Due from a minority shareholder of Mainland China subsidiaries | 20 | **878** | 1,613 |
| Due from a related company | 32 | **–** | 516 |
| Bank balances and cash | 21 | **34,599** | 47,460 |
| Deferred tax assets | 24 | **1,716** | – |
| Total current assets | | **179,783** | 120,233 |
| **Current liabilities** | | | |
| Trade and note payables | 27 | **91,851** | 46,767 |
| Accruals and other payables | | **29,451** | 9,842 |
| Obligations under finance lease – due within one year | 23 | **201** | – |
| Bank borrowings – due within one year | 25 | **45,489** | 32,037 |
| Embedded derivative financial instrument | 26 | **6,604** | – |
| Tax payable | | **3,969** | 5,066 |
| Total current liabilities | | **177,565** | 93,712 |
| **Net current assets** | | **2,218** | 26,521 |
| **Total assets less current liabilities** | | **185,375** | 134,890 |
| **Non-current liabilities** | | | |
| Obligations under finance lease – due after one year | 23 | **295** | – |
| Deferred tax liabilities | 24 | **1,892** | 1,892 |
| Bank borrowings – due after one year | 25 | **2,472** | – |
| Convertible bonds | 26 | **32,502** | – |
| Total non-current liabilities | | **37,161** | 1,892 |
| | | **148,214** | 132,998 |

# CONSOLIDATED BALANCE SHEET



As at 31st December 2006

| | Notes | 2006 HK$'000 | 2005 HK$'000 |
|---|---|---|---|
| **Capital and reserves** | | | |
| Share capital | 22 | **3,251** | 3,200 |
| Reserves | | **81,605** | 71,548 |
| Equity attributable to equity holders of the Company | | **84,856** | 74,748 |
| Minority interests | | **63,358** | 58,250 |
| | | **148,214** | 132,998 |

The consolidated financial statements on pages 29 to 67 were approved and authorised for issue by the Board of Directors on 27th March 2007 and are signed on its behalf by :

| | |
|---|---|
| **YANG TSU YING** | **YANG CHING YAU** |
| *Chairman* | *Director* |

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31st December 2006

| | Attributable to equity holders of the Company | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Property revaluation reserve | Statutory reserves (Note a) | Share-based payment reserve | Merger reserve (Note b) | Cumulative translation adjustment reserve | Accumulated profits | Total | Minority interests | Total |
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| At 1st January 2005 | 3,200 | 25,753 | 2,569 | 5,610 | – | 2,441 | 75 | 31,446 | 71,094 | 53,432 | 124,526 |
| Profit for the year | – | – | – | – | – | – | – | 23 | 23 | 4,792 | 4,815 |
| Transfer to statutory reserves | – | – | – | 856 | – | – | – | (856) | – | – | – |
| Dividend paid by a Mainland China subsidiary to a minority shareholder | – | – | – | – | – | – | – | – | – | (12,749) | (12,749) |
| Surplus on revaluation of buildings | – | – | 39 | – | – | – | – | – | 39 | 36 | 75 |
| Recognition of deferred tax liabilities | – | – | (10) | – | – | – | – | – | (10) | (10) | (20) |
| Share-based payment | – | – | – | – | 1,948 | – | – | – | 1,948 | – | 1,948 |
| Capital injection by Mainland China minority shareholder | – | – | – | – | – | – | – | – | – | 12,749 | 12,749 |
| Translation adjustments | – | – | – | – | – | – | 1,654 | – | 1,654 | – | 1,654 |
| At 31st December 2005 and 1st January 2006 | 3,200 | 25,753 | 2,598 | 6,466 | 1,948 | 2,441 | 1,729 | 30,613 | 74,748 | 58,250 | 132,998 |
| Profit for the year | – | – | – | – | – | – | – | 3,602 | 3,602 | 5,108 | 8,710 |
| Transfer to statutory reserves | – | – | – | 347 | – | – | – | (347) | – | – | – |
| Shares issued on acquisition of a wholly-owned subsidiary | 51 | 1,929 | – | – | – | – | – | – | 1,980 | – | 1,980 |
| Translation adjustments | – | – | – | – | – | – | 4,526 | – | 4,526 | – | 4,526 |
| At 31st December 2006 | 3,251 | 27,682 | 2,598 | 6,813 | 1,948 | 2,441 | 6,255 | 33,868 | 84,856 | 63,358 | 148,214 |

Notes:

**(a) Statutory reserves**

Pursuant to the articles of association of the Group's subsidiaries in Mainland China, appropriations are made from the accumulated profits to certain statutory reserves, based on a percentage of profit in accordance with the rules and regulations in Mainland China. Such appropriations to reserves would be made only with approval from the board of directors of the Group's subsidiaries.

**(b) Merger reserve**

Merger reserve of the Group represents the difference between the nominal value of the share capital issued by the Company and the share capital and share premium of a subsidiary acquired through an exchange of shares.

# CONSOLIDATED CASH FLOW STATEMENT



For the year ended 31st December 2006

| | Notes | 2006 HK$'000 | 2005 HK$'000 |
|---|---|---|---|
| **Operating activities** | | | |
| Net cash inflow generated from operations | 28 | **26,028** | 43,270 |
| Adjustments for: | | | |
| Interest paid | | **(3,127)** | (1,548) |
| Canada corporation income tax paid | | **(1,357)** | – |
| Mainland China enterprise income tax paid | | **(2,157)** | (8,205) |
| Net cash inflow from operating activities | | **19,387** | 33,517 |
| **Investing activities** | | | |
| Acquisition of property, plant and equipment | | **(52,317)** | (38,029) |
| Proceeds from disposal of property, plant and equipment | | **243** | 53 |
| Acquisition of a wholly-owned subsidiary (net of cash and cash equivalents acquired) | 30 | **(27,174)** | – |
| Interest received | | **306** | 114 |
| Net cash used in investing activities | | **(78,942)** | (37,862) |
| Net cash outflow before financing | | **(59,555)** | (4,345) |
| **Financing activities** | | | |
| New bank loans raised | | **38,778** | 65,396 |
| Repayment of short-term bank loans | | **(32,037)** | (62,159) |
| Repayment of mortgage loan | | **(52)** | – |
| Issue of convertible bonds | | **38,791** | – |
| Transaction costs in relation to issue of convertible bonds | | **(337)** | – |
| Repayment of capital element of finance lease | | **(129)** | – |
| Capital injection from a minority shareholder of Mainland China subsidiaries | | **–** | 12,749 |
| Decrease/(increase) in amounts due from a minority shareholder of Mainland China subsidiaries | | **735** | (435) |
| Dividends paid to a minority shareholder of Mainland China subsidiaries | | **–** | (12,749) |
| Net cash inflow from financing activities | | **45,749** | 2,802 |
| Net decrease in cash and cash equivalents | | **(13,806)** | (1,543) |
| Cash and cash equivalents at 1st January | | **47,460** | 48,493 |
| Effect of foreign exchange rate changes | | **945** | 510 |
| Cash and cash equivalents at 31st December | | **34,599** | 47,460 |

## 1. GENERAL INFORMATION

Sonavox International Holdings Limited (the "Company") and its subsidiaries (collectively referred as the "Group") are principally engaged in the investment holding, manufacture and sales of loudspeaker systems to customers in the People's Republic of China ("Mainland China") and overseas markets.

The Company is a limited liability company incorporated in the Cayman Islands. The address of its registered office is 14th Floor, Kam Sang Building, No. 255-257 Des Voeux Road Central, Hong Kong.

The shares of the Company have been listed on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited since 19th July 2002.

The consolidated financial statements are presented in Hong Kong dollars, which is the same as the functional currency of the Company.

## 2. APPLICATION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

In the current year, the Group has applied, for the first time, a number of new and revised Hong Kong Financial Reporting Standards ("HKFRSs"), Hong Kong Accounting Standards ("HKASs") and Interpretations (hereinafter collectively referred to as "new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") which are effective for accounting periods beginning on or after 1st December 2005 or 1st January 2006. The application of the new and revised HKFRSs has had no material effect on how the results and financial position for the current and prior accounting years are prepared and presented. Accordingly, no prior year adjustment has been required.

The Group has not early applied the following new standards, interpretations and amendments that have been issued but are not yet effective as at 31st December 2006. The directors of the Company anticipate that the application of these standards, interpretations and amendments will have no material impact on the results and the financial position of the Group.

| | |
|---|---|
| HKAS 1 (Amendment) | Capital Disclosures[1] |
| HKFRS 7 | Financial Instruments: Disclosures[1] |
| HKFRS 8 | Operating Segments[2] |
| HK (IFRIC) – Interpretation ("INT") 7 | Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies[3] |
| HK (IFRIC) – INT 8 | Scope of HKFRS 2[4] |
| HK (IFRIC) – INT 9 | Reassessment of Embedded Derivatives[5] |
| HK (IFRIC) – INT 10 | Interim Financial Reporting and Impairment[6] |
| HK (IFRIC) – INT 11 | HKFRS 2 - Group and Treasury Share Transactions[7] |
| HK (IFRIC) – INT 12 | Service Concession Arrangements[8] |

[1] Effective for annual periods beginning on or after 1st January 2007.
[2] Effective for annual periods beginning on or after 1st January 2009.
[3] Effective for annual periods beginning on or after 1st March 2006.
[4] Effective for annual periods beginning on or after 1st May 2006.
[5] Effective for annual periods beginning on or after 1st June 2006.
[6] Effective for annual periods beginning on or after 1st November 2006.
[7] Effective for annual periods beginning on or after 1st March 2007.
[8] Effective for annual periods beginning on or after 1st January 2008.

## 3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis, except for certain buildings and financial instruments, which are measured at revalued amounts and fair values, respectively, as explained in the accounting policies set out below.

The consolidated financial statements have been prepared in accordance with HKFRSs issued by the HKICPA. In addition, the consolidated financial statements included applicable disclosures required by the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited and the Hong Kong Companies Ordinance.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Basis of consolidation**

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, incomes and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are presented separately from the Group's equity therein. Minority interests in the net assets consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

**Business combinations**

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under HKFRS 3 "Business Combinations" are recognised at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with HKFRS 5 "Non-Current Assets Held for Sale and Discontinued Operations", which are recognised and measured at fair value less costs to sell.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in profit or loss.

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

**Goodwill**

Goodwill arising on an acquisition of a subsidiary represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of the relevant subsidiary at the date of acquisition. Such goodwill is carried at cost less any accumulated impairment losses.

Capitalised goodwill arising on an acquisition of a subsidiary is presented separately in the consolidated balance sheet.

For the purposes of impairment testing, goodwill arising from an acquisition is allocated to each of the relevant cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the acquisition. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, and whenever there is an indication that the unit may be impaired. For goodwill arising on an acquisition in a financial year, the cash-generating unit to which goodwill has been allocated is tested for impairment before the end of that financial year. When the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated to reduce the carrying amount of any goodwill allocated to the unit first, and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in the consolidated income statement. Impairment loss for goodwill is not reversed in subsequent periods.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Goodwill (continued)**

On subsequent disposal of the subsidiary, the attributable amount of goodwill capitalised is included in the determination of the amount of profit or loss on disposal.

**Segment reporting**

A business segment is a group of assets and operations engaged in providing products or a service that are subject to risk and returns that are different from those of other business segments. A geographic segment is engaged in providing products or a service within a particular economic environment that are subject to risk and returns that are different from those of segments operating in other economic environments.

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

Unallocated costs represent corporate expenses. Segment assets consist primarily of intangible assets, property, plant and equipment, inventories, receivables and operating cash. Segment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate borrowings. Capital expenditure comprises additions to property, plant and equipment, including additions resulting from acquisitions through purchases of subsidiaries.

Sales are based on the country in which the customer is located and total assets and capital expenditure are where the assets are located.

**Foreign currencies**

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in its functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognised in profit or loss in the year in which they arise, except for exchange differences arising on a monetary item that forms part of the Group's net investment in a foreign operation, in which case, such exchange differences are recognised in equity in the consolidated financial statements. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the year except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity, in which cases, the exchange differences are also recognised directly in equity.

For the purposes of presenting the consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into the presentation currency of the Company (i.e. Hong Kong dollars) at the rate of exchange prevailing at the balance sheet date, and their income and expenses are translated at the average exchange rates for the year, unless exchange rates fluctuate significantly during the period, in which case, the exchange rates prevailing at the dates of transactions are used. Exchange differences arising, if any, are recognised as a separate component of equity (the cumulative translation adjustment reserve). Such exchange differences are recognised in profit or loss in the year in which the foreign operation is disposed of.

Goodwill and fair value adjustments on identifiable assets acquired arising on an acquisition of a foreign operation are treated as assets and liabilities of that foreign operation and translated at the rate of exchange prevailing at the balance sheet date. Exchange differences arising are recognised in the cumulative translation adjustment reserve.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Property, plant and equipment**

Buildings comprise mainly factory premises. Buildings are shown at fair value, based on periodic, but at least triennial, valuations by external independent valuers, less subsequent accumulated depreciation and any subsequent accumulated impairment losses. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. All other property, plant and equipment are stated at historical cost less subsequent accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Cost may also include transfers from equity of any gains/losses on qualifying cash flow hedges of foreign currency purchases of property, plant and equipment.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the consolidated income statement during the financial period in which they are incurred.

Increases in the carrying amount arising on revaluation of buildings are credited to property revaluation reserve in shareholders' equity. Decreases that offset previous increases of the same asset are charged against property revaluation reserve directly in equity; all other decreases are expensed in the consolidated income statement. Each year the difference between depreciation based on the revalued carrying amount of the asset expensed in the consolidated income statement and depreciation based on the asset's original cost is transferred from property revaluation reserve to accumulated profits.

Construction in progress is stated at cost less any recognised impairment losses. Cost includes all attributable costs of bringing the asset to working condition for its intended use. This includes direct costs of construction as well as interest expense capitalised during the period of construction and installation. Capitalisation of these costs will cease and the construction in progress is transferred to property, plant and equipment when the construction activities necessary to prepare the assets for their intended use are completed. No deprecation is provided in respect of construction in progress.

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate cost or revalued amounts to their residual values over their estimated useful lives, as follows:

| | **Expected useful life** | **Estimated residual value** |
|---|---|---|
| Buildings | Over terms of leasehold land, or 30 years whichever is shorter | 0% |
| Leasehold improvements | 5 years | 10% |
| Machinery, furniture and equipment | 5-10 years | 10% |
| Motor vehicles | 5 years | 10% |

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the assets. Gain and losses on disposal are determined by comparing proceeds with carrying amount. These are included in the consolidated income statement. When revalued assets are sold or retired, the amounts included in property revaluation reserve are transferred to accumulated profits.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, the term of the relevant lease.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Intangible assets**

Intangible assets acquired in a business combination are identified and recognised separately from goodwill where they satisfy the definition of an intangible asset and their fair values can be measured reliably. The cost of such intangible assets is their fair value at the acquisition date.

Subsequent to initial recognition, intangible assets with finite useful lives are carried at costs less accumulated amortisation and any accumulated impairment losses. Amortisation for intangible assets with finite useful lives is provided on a straight-line basis over their estimated useful lives.

Intangible assets with finite useful lives are tested for impairment when there is an indication that an asset may be impaired (see the accounting policies in respect of impairment of non-financial assets below).

**Impairment of non-financial assets**

Assets that have an indefinite useful life are not subject to amortisation, which are at least tested annually for impairment and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairment loss is recognised as an expense immediately for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

When impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years.

**Impairment (other than goodwill and intangible assets - see the accounting policies in respect of goodwill above)**

At each balance sheet date, the Group reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment loss is recognised as expense immediately, unless the relevant asset is carried at a revalued amount under another standard, in which case the impairment loss is treated as a revaluation decrease under that standard.

Where impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount under another standard, in which case the reversal of the impairment loss is treated as a revaluation increase under that standard.

**Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises design costs, raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Financial instruments**

Financial assets and financial liabilities are recognised on the balance sheet when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

Financial assets

The Group's financial assets are mainly loans and receivables. All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace. The accounting policy adopted is set out below.

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables (including trade and note receivables, deposits and other current assets, due from a minority shareholder of Mainland China subsidiaries and due from a related company) are carried at amortised cost using the effective interest method, less any identified impairment losses. An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Financial liabilities and equity

Financial liabilities and equity instruments issued by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities. The Group's financial liabilities are generally classified into financial liabilities at fair value through profit or loss and other financial liabilities. The accounting policies adopted in respect of financial liabilities and equity instruments are set out below.

*Financial liabilities at fair value through profit or loss*

Financial liabilities at fair value through profit or loss has two subcategories, including financial liabilities held for trading and those designated at fair value through profit or loss on initial recognition. A financial liability other than a financial liability held for trading may be designated as at fair value through profit or loss upon initial recognition if:

– such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or

– the financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or

– it forms part of a contract containing one or more embedded derivatives, and HKAS 39 permits the entire combined contract (asset or liability) to be designated as at fair value through profit or loss.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Financial instruments (continued)**

At each balance sheet date subsequent to initial recognition, financial liabilities at fair value through profit or loss are measured at fair value, with changes in fair value recognised directly in profit or loss in the period in which they arise.

*Other financial liabilities*

Other financial liabilities including bank borrowings, trade and note payables, other payables, obligations under finance lease and tax payable are subsequently measured at amortised cost, using the effective interest method.

Convertible bonds

Convertible bonds issued by the Company that contain both liability and conversion option components are classified separately into respective items on initial recognition. Conversion option will be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company's own equity instruments is a conversion option derivative. At the date of issue, both the liability and conversion option components are recognised at fair value.

In subsequent periods, the liability component of the convertible bonds is carried at amortised cost using the effective interest method. The conversion option derivative is measured at fair value with changes in fair value recognised in profit or loss.

Transaction costs that relate to the issue of the convertible bonds are allocated to the liability and conversion option components in proportion to the allocation of the proceeds. Transaction costs relating to the conversion option derivative is charged to profit or loss immediately. Transaction costs relating to the liability component are included in the carrying amount of the liability portion and amortised over the period of the convertible bonds using the effective interest method.

Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

Embedded derivatives

Derivatives embedded in non-derivative contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at fair value with changes in fair value recognised in profit and loss.

Financial guarantee contracts

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. A financial guarantee contract issued by the Group and not designed as at fair value through profit or loss is recognised initially at its fair value less transaction costs that are directly attributable to the issue of financial guarantee contract. Subsequent to initial recognition, the Group measures the financial guarantee contact at the higher of: (i) the amount determined in accordance with HKAS 37 "Provisions, Contingent Liabilities and Contingent Assets"; and (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 "Revenue".

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the assets expire or, the financial assets are transferred and the Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and the cumulative gain or loss that had been recognised directly in equity is recognised in profit or loss.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Financial instruments (continued)**

Financial liabilities are derecognised when the obligation specified in the relevant contract is discharged, cancelled or expired. The difference between the carrying amount of the financial liability derecognised and the consideration received or receivable is recognised in profit or loss.

**Taxation**

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill (or negative goodwill) or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising from investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

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 profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the year when the liability is settled or the asset is realised. Deferred tax is charged or credited to the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

**Employee benefits**

Employee leave entitlements:
Employee entitlements to annual leave and long service leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave and long service leave as a result of services rendered by employees up to the balance sheet date. Employee entitlements to non-accounting compensated absences are not recognised until the time of leave.

Profit sharing and bonus plans:
The Group recognises a liability and an expense for bonuses and profit-sharing, based on a formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The Group recognises a provision where contractually obliged or where there is a past practice that has created a constructive obligation.

Pension obligations:
A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity. The Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

Payments to defined contribution plan are charged as an expense when employees have rendered services entitling them to the contributions.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Employee benefits (continued)**

Share-based compensation:
The Group operates an equity-settled, share-based compensation plan. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the entity revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the consolidated income statement, with a corresponding adjustment to equity.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

At the time when the share options are exercised, the amount previously recognised in share based payment reserve will be transferred to share premium. When the share options are forfeited after the vesting date or are still not exercised at the expiry date, the amount previously recognised in share based payment reserve will be transferred to accumulated profits.

**Revenue recognition**

Revenue comprises the fair value of the consideration received or receivable for the sales of goods in the ordinary course of the Group's activities. Revenue is shown as net of value-added tax, rebates and discounts and after eliminating sales within the Group. Revenue is recognised as follows:

**Sales of goods**

Sales of goods are recognised when goods are delivered and title has passed.

**Interest income**

Interest income is recognised on a time-proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised using the original effective interest rate.

**Government grant**

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Grants are recognised as income over the periods necessary to match them with the related costs.

Government grants relating to the purchase of property, plant and equipment are included in non-current liabilities as deferred government grants and are recognised in the consolidated income statement on a straight-line basis over the expected lives of the related assets.

**Borrowing costs**

All borrowing costs are recognised as and included in finance costs in the consolidated income statement in the year in which they are incurred.

**Leasing**

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

**The Group as lessee**

Assets held under finance leases are recognised as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to profit or loss.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**The Group as lessee (continued)**

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight-line basis.

**Research and development cost**

Research expenditure is expensed as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be successful considering its commercial and technological feasibility, and costs can be measured reliably. Other development expenditures are expensed as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Development costs with a finite useful life that have been capitalised are amortised from the commencement of the commercial production of the product on a straight-line basis over the period of its expected benefit, not exceeding five years.

**Provisions**

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

## 4. FINANCIAL RISK MANAGEMENT

**Financial risk factors**

The Group's activities expose it to a variety of financial risks: market risk (including currency risk and price risk), credit risk, liquidity risk and cash flow interest rate risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance.

Risk management is carried out by the Group's Finance Department under policies approved by the Board of Directors. The Group's Finance Department identifies and evaluates financial risks in close co-operation with the Group's operating units. The Board provides principles for overall risk management, as well as policies covering specific areas, such as foreign exchange risk, interest-rate risk, credit risk and investment of excess liquidity.

**(a) Market risk**

*(1) Foreign exchange risk*

The Group principally operates in Mainland China and Canada and is exposed to foreign exchange risk arising mainly from future commercial transactions primarily with respect to Renminbi and the Canadian Dollar.

The Group has certain investments in foreign operations, whose net assets are exposed to foreign currency translation risk. Currency exposure arising from the net assets of the Group's foreign operations in Mainland China and Canada is managed primarily through borrowings denominated in the relevant foreign currencies.

*(2) Price risk*

The Group is not exposed to equity securities price risk or commodity price risk as it does not held investments classified as available-for-sale financial assets or as financial assets at fair value through profit or loss.

**(b) Credit risk**

The Group has no significant concentration of credit risk. It has policies in place to ensure the sales of products are made to customers with an appropriate credit history. In addition, a predetermined credit limit and term have been set for each customer.

**(c) Liquidity risk**

Prudent liquidity risk management implies maintaining sufficient cash and the availability of funding through an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, the Group's Finance Department aims to maintain flexibility in funding by keeping committed credit lines available.

## 4. FINANCIAL RISK MANAGEMENT (CONTINUED)

### (d) Cash flow interest rate risk

As the Group has no significant interest-bearing assets, the Group's income and operating cash flows are independent of changes in market interest rates.

The Group's interest rate risk exposure arises from borrowings. Borrowings issued at variable rates expose the Group to cash flow interest rate risk.

**Fair value estimation**

The nominal value less impairment provision of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

Estimates and judgments 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.

## 5. CRITICAL ACCOUNTING ESTIMATES, ASSUMPTIONS AND JUDGMENTS

**Critical accounting estimates and assumptions**

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Useful life of property, plant and equipment

The Group's management determines the estimated useful lives for its property, plant and equipment. The estimate is based on the expected lifespans of those property, plant and equipment. It could change significantly as a result of technical innovation in response to industry cycles. Management will increase/decrease the depreciation expense where useful lives are less/more than previously estimated lives, or it will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold.

Amortisation of intangible assets

Intangible assets are amortised on a straight-line basis over their estimated useful lives. The estimated useful life of intangible assets requires management to make estimates and assumptions that may differ from the original estimate, such a difference may impact the amortisation in the year and the estimate will be changed in the future period.

Estimated impairment of goodwill and intangible assets

Determining whether goodwill and intangible assets are impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the cash-generating units and a suitable discount rate in order to calculate the present value. Where the actual future cash flows are less than expected, a material impairment loss may arise.

**Critical judgment in applying the entity's accounting policies**

Trade receivables

Trade receivables are measured at initial recognition at fair value and are subsequently measured at amortised cost using the effective interest method. A provision for impairment for estimated irrecoverable amounts is established in the consolidated income statement when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables.

In determining whether a provision for impairment of trade receivables is required, the Group takes into consideration the ageing status and the likelihood of collection. Following the identification of doubtful debts, the responsible sales personnel discuss with the relevant customers and report on the recoverability. Provision for impairment is only made for trade receivables that are unlikely to be collected.

## 6. TURNOVER, REVENUE AND SEGMENT INFORMATION

The Group is principally engaged in the manufacture and sales of loudspeaker systems. Revenues recognised during the year are as follows:

| | **2006 HK$'000** | 2005 HK$'000 |
|---|---|---|
| Turnover | | |
| Manufacture and sales of loudspeaker systems (a) | **369,302** | 234,288 |
| Other gains – net | | |
| Interest income | **306** | 114 |
| Subsidy income (b) | **282** | 413 |
| Sales of scrap materials | **3,379** | – |
| Gain on issue of convertible bonds | **468** | – |
| Fair value changes in embedded derivative financial instrument *(Note 26)* | **171** | – |
| Others | **199** | 40 |
| | **4,805** | 567 |
| Total revenues | **374,107** | 234,855 |

*Notes:*

(a) Approximately 47% of the Group's turnover for the year ended 31st December 2006 (2005: 73%) arose from the Group's top five customers.

(b) Subsidy income represented local government subsidies paid to the Group based on the pre-determined level of expenditures spent on certain advanced technology projects by the Group during the year ended 31st December 2006.

The Group is organised on a world wide basis with one business segment in the Mainland China, Japan, North America, European Union countries and other Asian countries. Accordingly, the directors consider there is one business segment and six geographical segments.

| | **2006** | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Hong Kong HK$'000** | **Mainland China HK$'000** | **Japan HK$'000** | **North America HK$'000** | **European Union countries HK$'000** | **Other Asian countries HK$'000** | **Group HK$'000** |
| Turnover | | | | | | | |
| External sales | **7,777** | **99,132** | **20,564** | **200,095** | **13,031** | **28,703** | **369,302** |
| Segment results | **(2,705)** | **3,706** | **734** | **9,430** | **731** | **1,876** | **13,772** |
| Other gains – net | | | | | | | **4,805** |
| Finance costs | | | | | | | **(6,711)** |
| Profit before income tax | | | | | | | **11,866** |
| Income tax expense | | | | | | | **(3,156)** |
| Profit for the year | | | | | | | **8,710** |
| Minority interests | | | | | | | **(5,108)** |
| Profit attributable to equity holders of the Company | | | | | | | **3,602** |

## 6. TURNOVER, REVENUE AND SEGMENT INFORMATION (CONTINUED)

| | 2006 | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Hong Kong HK$'000** | **Mainland China HK$'000** | **Japan HK$'000** | **North America HK$'000** | **European Union countries HK$'000** | **Other Asian countries HK$'000** | **Group HK$'000** |
| Segment assets | **7,990** | **290,852** | **–** | **56,533** | **–** | **–** | **355,375** |
| Unallocated assets | | | | | | | **7,565** |
| Total assets | **7,990** | **290,852** | **–** | **56,533** | **–** | **–** | **362,940** |
| Segment liabilities | **5,437** | **120,974** | **–** | **43,348** | **–** | **–** | **169,759** |
| Unallocated liabilities | | | | | | | **44,967** |
| Total liabilities | **5,437** | **120,974** | **–** | **43,348** | **–** | **–** | **214,726** |
| Capital expenditure | **4,614** | **47,101** | **–** | **1,227** | **–** | **–** | **52,942** |
| Depreciation and amortisation | **164** | **11,506** | **–** | **587** | **–** | **–** | **12,257** |
| Loss/(gain) on disposal of property, plant and equipment | **–** | **736** | **–** | **(63)** | **–** | **–** | **673** |
| (Reversal of provision)/ provision for impairment loss of trade receivables | **–** | **(803)** | **–** | **571** | **–** | **–** | **(232)** |

Segment assets consist primarily of land use rights, property, plant and equipment, inventories, receivables and operating cash. They exclude deferred taxation.

Segment liabilities comprise operating liabilities. They exclude items such as taxation, deferred taxation and corporate borrowings.

Capital expenditure comprises additions to property, plant and equipment (Note 14).

| | 2005 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Hong Kong HK$'000 | Mainland China HK$'000 | Japan HK$'000 | North America HK$'000 | European Union countries HK$'000 | Other Asian countries HK$'000 | Group HK$'000 |
| Turnover | | | | | | | |
| External sales | – | 75,394 | 18,237 | 136,485 | 4,172 | – | 234,288 |
| Segment results | (4,956) | 5,365 | 1,298 | 9,712 | 297 | – | 11,716 |
| Other gains – net | | | | | | | 567 |
| Finance costs | | | | | | | (1,548) |
| Profit before income tax | | | | | | | 10,735 |
| Income tax expense | | | | | | | (5,920) |
| Profit for the year | | | | | | | 4,815 |
| Minority interests | | | | | | | (4,792) |
| Profit attributable to equity holders of the Company | | | | | | | 23 |

## 6. TURNOVER, REVENUE AND SEGMENT INFORMATION (CONTINUED)

| | 2005 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Hong Kong HK$'000 | Mainland China HK$'000 | Japan HK$'000 | North America HK$'000 | European Union countries HK$'000 | Other Asian countries HK$'000 | Group HK$'000 |
| Segment assets | 5,901 | 195,145 | 875 | 21,044 | 1,956 | – | 224,921 |
| Unallocated assets | | | | | | | 3,681 |
| Total assets | 5,901 | 195,145 | 875 | 21,044 | 1,956 | – | 228,602 |
| Segment liabilities | 470 | 88,176 | – | – | – | – | 88,646 |
| Unallocated liabilities | | | | | | | 6,958 |
| Total liabilities | 470 | 88,176 | – | – | – | – | 95,604 |
| Capital expenditure | – | 38,029 | – | – | – | – | 38,029 |
| Depreciation and amortisation | – | 7,645 | – | – | – | – | 7,645 |
| Gain on disposal of property, plant and equipment | – | (3) | – | – | – | – | (3) |
| Provision on inventories to net realisable value | – | 608 | – | – | – | – | 608 |
| Provision for impairment loss of trade receivables | – | 1,348 | – | 86 | 1,316 | – | 2,750 |

Segment assets consist primarily of land use rights, property, plant and equipment, inventories, receivables and operating cash. They exclude deferred taxation.

Segment liabilities comprise operating liabilities. They exclude items such as taxation and deferred taxation.

Capital expenditure comprises additions to property, plant and equipment (Note 14).

## 7. FINANCE COSTS

| | **2006 HK$'000** | 2005 HK$'000 |
|---|---|---|
| Interest on: | | |
| Bank loans and overdrafts wholly repayable within five years | **3,007** | 1,548 |
| Mortgage loan | **92** | – |
| Finance lease | **28** | – |
| Interest on convertible bonds | | |
| – 8% interest payable *(Note 26)* | **2,293** | – |
| – Imputed interest *(Note 26)* | **1,291** | – |
| | **6,711** | 1,548 |

## 8. PROFIT BEFORE INCOME TAX

Profit before income tax has been arrived at after charging/(crediting):

| | 2006 HK$'000 | 2005 HK$'000 |
|---|---|---|
| Depreciation on property, plant and equipment | **10,536** | 7,181 |
| Amortisation on intangible assets | **1,400** | – |
| Amortisation of prepaid lease payments on land use rights | **321** | 464 |
| Employee benefit expense (Note 12) | **46,739** | 30,100 |
| Changes in inventories of finished goods and work in progress | **5,017** | 6,236 |
| Raw materials and consumables used | **298,637** | 150,607 |
| Auditors' remuneration | **435** | 492 |
| Operating lease charges | **1,372** | 84 |
| Research and development costs | **6,765** | 588 |
| Provision on inventories to net realisable value | **–** | 608 |
| (Reversal of provision)/provision for impairment loss of trade receivables | **(232)** | 2,750 |
| Loss/(gain) on disposal of property, plant and equipment | **673** | (3) |
| Foreign exchange loss | **537** | 1,775 |

## 9. INCOME TAX EXPENSE

The Company is incorporated in the Cayman Islands and is exempted from taxation in the Cayman Islands until 2021. The Company's subsidiary established in the British Virgin Islands is incorporated under the International Business Companies Acts of the British Virgin Islands and, accordingly, is exempted from payment of the British Virgin Islands income taxes.

The Company's subsidiary established in Canada, Sonavox Canada Inc. ("SCI") is subject to National and Ontario corporation income taxes at an aggregate rate of 38%.

Suzhou Shangsheng Electrics Co. Ltd. ("Shangsheng Electrics"), Suzhou Sonavox Acoustics Co. Ltd. ("Sonavox Acoustics"), Suzhou Shangsheng Technology Co. Ltd. ("Shangsheng Technology") and Suzhou Hesheng Industrial Co., Ltd. ("Suzhou Hesheng"), being foreign investment enterprises established in the Coastal Open Economic Region of Suzhou, Mainland China, are subject to preferential enterprise income tax ("EIT") rate of 27%, representing 24% state EIT rate and 3% local EIT rate, and are entitled to full exemption from EIT for two years starting from its first profit-making year to be followed by a 50% reduction for the next consecutive three years in accordance with the relevant tax rules and regulations applicable to foreign investment enterprises in Mainland China.

Shangsheng Electrics was exempted from Mainland China enterprise income tax up to 31st December 1997 and it is subject to EIT at a rate of 15% from 1st January 1998 to 31st December 2000. Pursuant to an approval from the local tax authority of Mainland China, Shangsheng Electrics continued to be entitled to 50% reduction in tax rate from 1st January 2001 to 31st December 2003, being qualified as a "new and high technology enterprise". The tax exemption and reduction period of Shangsheng Electrics expired in 2005. As Shangsheng Electrics is recognised as a "Technology-incentive and Labour-incentive Enterprise", it is currently subject to EIT of 15%. Sonavox Acoustics, Shangsheng Technology and Suzhou Hesheng have been reporting tax loss since its establishment.

No provision for Hong Kong profits tax has been made as there is no assessable profit (2005: nil) for the subsidiaries operating in Hong Kong during the year ended 31st December 2006.

## 9. INCOME TAX EXPENSE (CONTINUED)

The amount of taxation charged to the consolidated income statement represents:

| | 2006 HK$'000 | 2005 HK$'000 |
|---|---|---|
| Current taxation | | |
| – Canada corporation income tax | **2,538** | – |
| – Mainland China enterprise income tax | **1,396** | 5,517 |
| Over-provision of Mainland China enterprise income tax in prior year | **(1,517)** | – |
| Deferred taxation (Note 24) | **739** | 403 |
| | **3,156** | 5,920 |

The income tax expense can be reconciled to the profit before income tax as per the consolidated income statement as follows:

| | 2006 HK$'000 | 2005 HK$'000 |
|---|---|---|
| Profit before income tax | **11,866** | 10,735 |
| Tax calculated at domestic tax rates applicable to profits in the respective countries | **5,075** | 3,369 |
| Over-provision of income tax in prior year | **(1,517)** | – |
| Expenses not deductible for taxation purposes | **1,848** | 117 |
| Incomes not subject to tax | **(497)** | – |
| Utilisation of previously unrecognised tax losses | **(1,181)** | (188) |
| Unrecognised tax losses | **721** | 1,123 |
| Effect of concessionary tax rate | **(1,735)** | – |
| Net effect of deductible temporary differences not recognised | **442** | 1,499 |
| Income tax expense | **3,156** | 5,920 |

## 10. EARNINGS PER SHARE

### (a) Basic

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year.

| | 2006 | 2005 |
|---|---|---|
| Profit attributable to equity holders of the Company (HK$'000) | **3,602** | 23 |
| Weighted average number of ordinary shares in issue ('000) | **323,682** | 320,000 |
| Basic earnings per share (HK cent per share) | **1.11** | 0.01 |

### (b) Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Company has share options as the dilutive potential ordinary shares (Note 33). The calculation is due to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

## 10. EARNINGS PER SHARE (CONTINUED)

### (b) Diluted (continued)

As the exercise prices for the Company's outstanding share options were higher than the average market price of the shares of the Company for 2006, the conversion of the share options would not have any dilutive effect on the earnings per share.

In addition, the computation of diluted earnings per share does not assume the conversion of the Company's outstanding convertible bonds since their exercise would result in an increase in profit per share from continuing operations.

| | **2006** | 2005 |
|---|---|---|
| Profit used to determine diluted earnings per share (HK$'000) | **3,602** | 23 |
| Weighted average number of ordinary shares in issue ('000) | **323,682** | 320,000 |
| Effect of dilutive potential ordinary shares ('000) | **–** | 500 |
| Weighted average number of ordinary shares for diluted earnings per share ('000) | **323,682** | 320,500 |
| Diluted earnings per share (HK cent per share) | **1.11** | 0.01 |

## 11. DIVIDENDS

The directors of the Company do not recommend the payment of a final dividend for the year ended 31st December 2006 (2005: nil).

## 12. EMPLOYEE BENEFIT EXPENSE

| | **2006 HK$'000** | 2005 HK$'000 |
|---|---|---|
| Wages and salaries | **42,773** | 24,659 |
| Share-based payment | **–** | 1,948 |
| Pension costs | **3,966** | 3,493 |
| | **46,739** | 30,100 |

## 13. DIRECTOR'S AND MANAGEMENT'S EMOLUMENTS

### (a) Directors' emoluments

The remuneration of every director for the year ended 31st December 2006 is set out below:

| Name of director | Fees HK$'000 | Salary HK$'000 | Discretionary bonuses HK$'000 | Inducement fees HK$'000 | Other benefits (a*) HK$'000 | Employer's contribution to pension scheme HK$'000 | Compensation for loss of office as director HK$'000 | Total HK$'000 |
|---|---|---|---|---|---|---|---|---|
| Executive: | | | | | | | | |
| – Mr. Yang Tsu Ying | – | 170 | – | – | – | – | – | 170 |
| – Mr. Yang Ching Yau | – | 260 | – | – | – | – | – | 260 |
| Independent non-executive: | | | | | | | | |
| – Mr. Fan Chi Fai, Paul | 96 | – | – | – | – | – | – | 96 |
| – Mr. Yiu Chi Wah | 96 | – | – | – | – | – | – | 96 |
| – Mr. Wong Kai Tung, Simon | 96 | – | – | – | – | – | – | 96 |

## 13. DIRECTOR'S AND MANAGEMENT'S EMOLUMENTS (CONTINUED)

### (a) Directors' emoluments (continued)

The remuneration of every director for the year ended 31st December 2005 is set out below:

| Name of director | Fees | Salary | Discretionary bonuses | Inducement fees | Other benefits (a*) | Employer's contribution to pension scheme | Compensation for loss of office as director | Total |
|---|---|---|---|---|---|---|---|---|
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| Executive: | | | | | | | | |
| – Mr. Yang Tsu Ying | – | 260 | – | – | 325 | – | – | 585 |
| – Mr. Yang Ching Yau | – | 260 | – | – | 325 | – | – | 585 |
| Independent non– executive: | | | | | | | | |
| – Mr. Fan Chi Fai, Paul | 109 | – | – | – | – | – | – | 109 |
| – Mr. Yiu Chi Wah | 117 | – | – | – | – | – | – | 117 |
| – Mr. Wong Kai Tung, Simon | 117 | – | – | – | – | – | – | 117 |

*Note:*

* Other benefits include share-based payment, housing and other allowances.

No director waived any emoluments during both years. No incentive payment for joining the Group or compensation for loss of office was paid or payable to any director for both years.

Analysis of directors' emoluments by number of directors and emolument range is as follows:

| | **2006** | 2005 |
|---|---|---|
| Executive directors | | |
| – nil to HK$1,000,000 | **2** | 2 |
| Independent non-executive directors | | |
| – nil to HK$1,000,000 | **3** | 3 |
| | **5** | 5 |

### (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 are reflected in the analysis presented above. The emoluments payable to the remaining three (2005: three) individuals during the year are as follows:

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Basic salaries and allowances | **1,082** | 1,449 |
| Pension costs | **30** | 30 |
| Share-based payment | **–** | 974 |
| | **1,112** | 2,453 |

During the year, no emoluments were paid to the five highest paid individuals as inducement to join or upon joining the Group or as compensation for loss of office.

The emoluments of all of the five highest paid individuals fell within the range of nil to HK$1,000,000.

## 14. PROPERTY, PLANT AND EQUIPMENT

| | Buildings HK$'000 | Leasehold improvements HK$'000 | Machinery, furniture and equipment HK$'000 | Motor vehicles HK$'000 | Construction in progress HK$'000 | Total HK$'000 |
|---|---|---|---|---|---|---|
| **Cost or valuation** | | | | | | |
| At 1st January 2005 | 27,064 | 2,802 | 48,886 | 2,874 | 8,715 | 90,341 |
| Additions | – | – | 2,243 | 670 | 35,116 | 38,029 |
| Transfers | – | – | 888 | – | (888) | – |
| Disposals | – | – | – | (365) | – | (365) |
| Translation adjustments | 488 | 51 | 914 | 55 | 692 | 2,200 |
| Revaluation | (1,085) | – | – | – | – | (1,085) |
| At 31st December 2005 and 1st January 2006 | 26,467 | 2,853 | 52,931 | 3,234 | 43,635 | 129,120 |
| Additions | 19,743 | 37 | 15,022 | 773 | 17,367 | 52,942 |
| Acquired on acquisition of a subsidiary | – | 135 | 2,658 | – | – | 2,793 |
| Transfers | 27,655 | – | – | – | (27,655) | – |
| Disposals | – | – | (3,446) | (147) | – | (3,593) |
| Translation adjustments | 1,039 | 112 | 2,079 | 127 | 1,713 | 5,070 |
| **At 31st December 2006** | **74,904** | **3,137** | **69,244** | **3,987** | **35,060** | **186,332** |
| **Accumulated depreciation** | | | | | | |
| At 1st January 2005 | – | 2,266 | 24,523 | 2,343 | – | 29,132 |
| Charge for the year | 1,147 | 541 | 5,231 | 262 | – | 7,181 |
| Disposals | – | – | – | (315) | – | (315) |
| Translation adjustments | 13 | 46 | 497 | 360 | – | 916 |
| Revaluation | (1,160) | – | – | – | – | (1,160) |
| At 31st December 2005 and 1st January 2006 | – | 2,853 | 30,251 | 2,650 | – | 35,754 |
| Charge for the year | 2,581 | 78 | 7,531 | 346 | – | 10,536 |
| Disposals | – | – | (2,677) | – | – | (2,677) |
| Translation adjustments | – | 112 | 1,745 | 104 | – | 1,961 |
| **At 31st December 2006** | **2,581** | **3,043** | **36,850** | **3,100** | **–** | **45,574** |
| **Net book values** | | | | | | |
| **At 31st December 2006** | **72,323** | **94** | **32,394** | **887** | **35,060** | **140,758** |
| At 31st December 2005 | 26,467 | – | 22,680 | 584 | 43,635 | 93,366 |

## 14. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

Depreciation expense of approximately HK$4,548,000 (2005: HK$7,181,000) has been included in cost of goods sold.

If buildings were stated on the historical cost basis, the amounts would be as follows:

| | **2006** **HK$'000** | 2005 HK$'000 |
|---|---|---|
| Cost | **74,410** | 25,973 |
| Accumulated depreciation | **(8,368)** | (5,803) |
| Net book amount | **66,042** | 20,170 |

Bank borrowings are secured by buildings for the carrying amount of approximately HK$72,323,000 (2005: HK$26,467,000) (Note 25).

The net book value of machinery, furniture and equipment includes an amount of approximately HK$531,000 (2005: nil) in respect of assets held under finance leases.

The analysis of the cost or valuation at 31st December 2006 of the above asset is as follows:

| | **Buildings** HK$'000 | **Leasehold improvements** HK$'000 | **Machinery, Furniture and equipment** HK$'000 | **Motor vehicles** HK$'000 | **Construction in progress** HK$'000 | **Total** HK$'000 |
|---|---|---|---|---|---|---|
| At cost | **48,437** | **3,137** | **69,244** | **3,987** | **35,060** | **159,865** |
| At valuation | **26,467** | **–** | **–** | **–** | **–** | **26,467** |
| | **74,904** | **3,137** | **69,244** | **3,987** | **35,060** | **186,332** |

The analysis of the cost or valuation at 31st December 2005 of the above asset is as follows:

| | **Buildings** HK$'000 | **Leasehold improvements** HK$'000 | **Machinery, Furniture and equipment** HK$'000 | **Motor vehicles** HK$'000 | **Construction in progress** HK$'000 | **Total** HK$'000 |
|---|---|---|---|---|---|---|
| At cost | – | 2,853 | 52,931 | 3,234 | 43,635 | 102,653 |
| At valuation | 26,467 | – | – | – | – | 26,467 |
| | 26,467 | 2,853 | 52,931 | 3,234 | 43,635 | 129,120 |

At 31st December 2005, the Group's buildings were valued on the basis of open market value by Malcom & Associates Appraisal Limited, an independent qualified valuer. The fair value of the buildings is, in the opinion of the company's directors, not less than their carrying value as at 31st December 2006.

## 15. LAND USE RIGHTS

The Group's land use rights represent prepaid operating lease payments and their net book value are analysed as follows:

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Outside Hong Kong, held on leases of 50 years | **11,927** | 11,786 |

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Beginning of year | **11,786** | 12,034 |
| Amortisation of prepaid lease payments | **(321)** | (464) |
| Translation adjustments | **462** | 216 |
| | **11,927** | 11,786 |

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Analysed for reporting purposes as: | | |
| Current asset | **276** | 464 |
| Non-current asset | **11,651** | 11,322 |
| | **11,927** | 11,786 |

Bank borrowings are secured by land use rights for the carrying amount of approximately HK$11,927,000 (2005: HK$11,786,000) (Note 25).

## 16. INTANGIBLE ASSETS

| | **Trademark and patents** |
|---|---|
| | HK$'000 |
| Cost | |
| Acquisition of a subsidiary (Note 30) and at 31st December 2006 | 21,000 |
| Amortisation | |
| Provided during the year and at 31st December 2006 *(Note)* | 1,400 |
| Carrying amount | |
| At 31st December 2006 | 19,600 |

*Note:*

Amortisation of approximately HK$1,400,000 is included in administrative expenses in the consolidated income statement.

The above intangible assets have finite useful lives. Such intangible assets are amortised on a straight-line basis over 15 years.

## 17. GOODWILL

| | HK$'000 |
|---|---|
| Cost | |
| Arising on acquisition of a subsidiary (Note 30) and at 31st December 2006 | **5,299** |
| Impairment | |
| Impairment loss recognised during the year and at 31st December 2006 | – |
| Carrying amount | |
| At 31st December 2006 | **5,299** |

Goodwill of approximately HK$5,299,000 was arising on acquisition of SCI and will be tested for impairment at least annually.

The recoverable amount of SCI has been determined based on a value in use calculation. During the year ended 31st December 2006, the senior management of the Group prepared profit forecast and cash flow forecast (the "Forecast") in respect of SCI. The Forecast was based on financial budgets approved by senior management covering one year. The Forecast is based on the budgeted gross margins during the budgetary period. Budgeted gross margins have been determined based on the management's past performance and expectation for the consumer electronic market development. The expected growth rate does not exceed the annual growth rate for the consumer electronic business in which SCI operates. The directors are of the opinion, based on the Forecast, that the recoverable amount of the goodwill arising from acquisition of SCI does not exceed its carrying amount in the consolidated balance sheet and any reasonably possible change in any of these assumptions would not cause the aggregate carrying amount of SCI to exceed its aggregate recoverable amount. No impairment loss is necessary.

## 18. INVENTORIES

| | **2006 HK$'000** | 2005 HK$'000 |
|---|---|---|
| Raw materials | **18,099** | 10,628 |
| Work-in-progress | **6,712** | 3,996 |
| Finished goods | **13,806** | 5,671 |
| | **38,617** | 20,295 |

At 31st December 2006, inventories of approximately HK$13,806,000 (2005: HK$16,299,000) were stated at net realisable value.

The cost of inventories recognised as expense and included in cost of goods sold amounted to HK$303,654,000 (2005: HK$156,843,000).

## 19. TRADE AND NOTE RECEIVABLES

| | **2006 HK$'000** | 2005 HK$'000 |
|---|---|---|
| Trade and note receivables | | |
| – third parties | **95,653** | 48,507 |
| – related parties *(Note 32)* | **160** | 155 |
| | **95,813** | 48,662 |
| Less: Provision for impairment loss of receivables | **(3,214)** | (3,446) |
| | **92,599** | 45,216 |

The fair value of trade and note receivables approximated the carrying value.

## 19. TRADE AND NOTE RECEIVABLES (CONTINUED)

The majority of the Group's sales is on open account in accordance with terms specified in the contacts governing relevant transactions. At 31st December 2006, the ageing analysis of the Group's trade and note receivables was as follows:

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| 0 – 30 days | **43,548** | 28,592 |
| 31 – 60 days | **29,072** | 9,559 |
| 61 – 90 days | **12,278** | 3,353 |
| 91 – 180 days | **6,796** | 3,206 |
| 181 – 360 days | **2,434** | 2,287 |
| Over 360 days | **1,685** | 1,665 |
| | **95,813** | 48,662 |
| Less: Provision for impairment loss of receivables | **(3,214)** | (3,446) |
| | **92,599** | 45,216 |

As at 31st December 2006, the top five customers accounted for 43% (2005: 52%) of the Group's trade and note receivables.

The Group has reversed a provision of approximately HK$232,000 (2005: Recognised a loss of approximately HK$2,750,000) for impairment loss of trade and note receivables during the year ended 31st December 2006. The reversed provision has been net off against the selling and marketing costs in the consolidated income statement.

## 20. DUE FROM A MINORITY SHAREHOLDER OF MAINLAND CHINA SUBSIDIARIES

Amount due from a minority shareholder of Mainland China subsidiaries is unsecured, interest-free and repayable on demand.

The directors consider that the carrying amounts of them approximate their fair values.

## 21. BANK BALANCES AND CASH

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Cash and bank deposits denominated in: | | |
| Renminbi | **23,222** | 34,376 |
| United States dollar | **8,043** | 8,176 |
| Hong Kong dollar | **3,320** | 4,906 |
| Others | **14** | 2 |
| | **34,599** | 47,460 |

The Group's cash and bank deposits of approximately HK$23,222,000 (2005: HK$34,376,000) are denominated in Renminbi and are placed with banks in Mainland China. The remittance of these funds out of Mainland China is subjected to the exchange control restriction imposed by the government of Mainland China.

The effective interest rates on short-term bank deposits ranged from 0.72% to 1.4% (2005: from 1.4% to 3.0%).

## 22. SHARE CAPITAL

| | Number of ordinary shares of HK$0.01 each | Nominal value HK$'000 |
|---|---|---|
| Authorised: | | |
| At 1st January 2005, 31st December 2005 and 31st December 2006 | 20,000,000,000 | 200,000 |
| Issued and fully paid: | | |
| At 1st January 2005, 31st December 2005 and 1st January 2006 | 320,000,000 | 3,200 |
| Issued on acquisition of a wholly-owned subsidiary | 5,089,974 | 51 |
| At 31st December 2006 | 325,089,974 | 3,251 |

The Company issued 5,089,974 ordinary shares (the "Consideration Shares") on 12th April 2006 (1.57% of the enlarged issued share capital of the Company) to the shareholders of SCI as part of the purchase consideration for the entire issued shares of SCI. The Consideration Shares rank pari passu with the existing shares in all respects except that the Consideration Shares are restricted to be transferred or disposed of within 12 months from 12th April 2006. The fair value of the Consideration Shares, determined using the discounted price at the date of the acquisition, amounted to approximately HK$1,980,000 (HK$0.389 per share) (Note 30).

## 23. OBLIGATIONS UNDER FINANCE LEASE

It is the Group's policy to lease one of its machinery, furniture and equipment under finance lease. The lease term is fixed at three years. Interest rate underlying the obligations under finance lease is fixed at 8.5%. No arrangements have been entered into for contingent rental payments.

| | Minimum lease payments | | Present value of minimum lease payments | |
|---|---|---|---|---|
| | **2006 HK$'000** | 2005 HK$'000 | **2006 HK$'000** | 2005 HK$'000 |
| Amounts payable under finance lease: | | | | |
| Within one year | **235** | – | **201** | – |
| In more than one year but not more than two years | **235** | – | **218** | – |
| In more than two years but not more than three years | **78** | – | **77** | – |
| | **548** | – | **496** | – |
| Less: Future finance charges | **(52)** | – | **N/A** | N/A |
| Present value of lease obligations | **496** | – | **496** | – |
| Less: Amount due for settlement within one year (shown under current liabilities) | | | **(201)** | – |
| Amount due for settlement after one year | | | **295** | – |

The Group's obligations under finance lease as at 31st December 2006 is denominated in Canadian Dollars. It is secured by the lessor's charge over the leased assets.

## 24. DEFERRED TAXATION

The movement in deferred tax assets and liabilities (prior to offsetting of balances within the same taxation jurisdiction) during the year is as follows:

| | Accelerated tax depreciation | | Provision for assets | | Tax losses | | Total | |
|---|---|---|---|---|---|---|---|---|
| | **2006 HK$'000** | 2005 HK$'000 | **2006 HK$'000** | 2005 HK$'000 | **2006 HK$'000** | 2005 HK$'000 | **2006 HK$'000** | 2005 HK$'000 |
| **Deferred tax assets** | | | | | | | | |
| At 1st January | **2,540** | 2,391 | **1,141** | 188 | **–** | 1,496 | **3,681** | 4,075 |
| Acquisition of a wholly-owned subsidiary | **–** | – | **–** | – | **4,613** | – | **4,613** | – |
| Translation adjustments | **7** | 6 | **3** | – | **–** | 3 | **10** | 9 |
| Credited/(charged) to consolidated income statement | **133** | 143 | **309** | 953 | **(1,181)** | (1,499) | **(739)** | (403) |
| At 31st December | **2,680** | 2,540 | **1,453** | 1,141 | **3,432** | – | **7,565** | 3,681 |

| | Revaluation of buildings | |
|---|---|---|
| | **2006 HK$'000** | 2005 HK$'000 |
| At 1st January | **(1,892)** | (1,872) |
| Charged to equity | **–** | (20) |
| At 31st December | **(1,892)** | (1,892) |

Deferred tax assets and liabilities are further analysed as follows:

| | **2006 HK$'000** | 2005 HK$'000 |
|---|---|---|
| Deferred tax assets: | | |
| – Deferred tax assets to be recovered after 12 months | **5,849** | 3,681 |
| – Deferred tax assets to be recovered within 12 months | **1,716** | – |
| | **7,565** | 3,681 |
| Deferred tax liabilities to be settled after 12 months | **(1,892)** | (1,892) |

Deferred tax assets are recognised for tax losses carry forwards to the extent that the realisation of related tax benefits through the future taxable profits is probable. The Group did not recognise deferred tax assets of approximately HK$1,633,000 (2005: HK$3,395,000) that can be carried forward against future taxable income. Losses amounting to approximately HK$13,494,000 (2005: HK$4,870,000) will expire during 2009 to 2026.

## 25. BANK BORROWINGS

| | 2006 HK$'000 | 2005 HK$'000 |
|---|---|---|
| Bank overdrafts | **9,499** | – |
| Short term bank loans | **35,917** | 32,037 |
| Mortgage loan | **2,545** | – |
| | **47,961** | 32,037 |
| Secured | **47,961** | 17,637 |
| Unsecured | **–** | 14,400 |
| | **47,961** | 32,037 |
| Carrying amount repayable: | | |
| On demand or within one year | **45,489** | 32,037 |
| More than one year, but not exceeding two years | **77** | – |
| More than two years, but not exceeding five years | **261** | – |
| More than five years | **2,134** | – |
| | **47,961** | 32,037 |
| Less: Amounts due within one year shown under current liabilities | **(45,489)** | (32,037) |
| | **2,472** | – |

As at 31st December 2006, the Group's variable-rate bank borrowings bore interest at effective interest rates ranging from 4.42% to 6.75% (2005: from 4.96% to 5.58%) per annum.

The exposure of the Group's variable-rate borrowings to interest rate changes and the contractual repricing dates at the balance sheet date are as follows:

| | 2006 HK$'000 | 2005 HK$'000 |
|---|---|---|
| 6 months or less | **15,002** | 28,197 |
| 6 to 12 months | **30,487** | 3,840 |
| More than one year but not more than two years | **77** | – |
| More than two years but not more than three years | **82** | – |
| More than three years but not more than four years | **87** | – |
| More than four years but not more than five years | **92** | – |
| More than five years | **2,134** | – |
| | **47,961** | 32,037 |

The carrying amounts of the borrowings are denominated in the following currencies:

| | 2006 HK$'000 | 2005 HK$'000 |
|---|---|---|
| Renminbi | **35,917** | 28,800 |
| United States dollar | **–** | 2,847 |
| Hong Kong dollar | **2,545** | 390 |
| Canadian dollar | **9,499** | – |
| | **47,961** | 32,037 |

During the year, the Group obtained new loans in the amount of approximately HK$38,778,000. The loans bear interest at market rates and will be repayable within one year except a mortgage loan of approximately HK$2,598,000 which will be repayable in a period of 20 years.

The directors consider that the carrying amounts of bank borrowings approximate their fair values.

## 26. CONVERTIBLE BONDS AND EMBEDDED DERIVATIVE FINANCIAL INSTRUMENT

On 6th April 2006, the Company issued 8% convertible redeemable bonds ("Convertible Bonds") due 2011 at a principal amount of US$5,000,000 (equivalent to approximately HK$38,791,000). The Convertible Bonds can be converted up to an aggregate 96,977,500 ordinary shares of the Company at HK$0.40 each. The Company shall have the option to redeem the Convertible Bonds in whole or in part (i) at any time after the second anniversary of the date of issue of the Convertible Bonds until 30 days prior to the maturity date, provided that the average closing price of the shares stated in the daily quotation sheet of the Stock Exchange for 20 consecutive trading date exceed 130% of the prevailing conversion price; or (ii) at any time the outstanding Convertible Bonds is less than 20% of the total issued amount. The amount payable for any redemption shall be 100% of the relevant amount of the principal amount of the Convertible Bonds so redeemed together with interest accrued thereon up to the date of repayment. On the second, third and fourth anniversary of the date of issue of the Convertible Bonds and only on such date, each holder of the Convertible Bonds shall have the right at such holder's option to require the Company to redeem the Convertible Bonds held by such holder at 100% of the principal amount with respect to such Convertible Bonds together with interest accrued thereon up to the date of repayment.

The Convertible Bonds contain two components, a liability component and an embedded derivative financial instrument. The fair value of the liability component, included in non-current liabilities, amounted to approximately HK$31,211,000, net of transaction costs, at the issuance date. The fair value of the embedded derivative financial instrument was estimated at the issuance date by reference to the Binomial Model. The effective interest rate of the liability component is 11.5%. The embedded derivative is subsequently measured at fair value with changes in fair value recognised in profit or loss.

The movement of the liability component and embedded derivative financial instrument for the year is set out as below:

| | **Liability component** HK$'000 | **Embedded derivative financial instrument** HK$'000 |
|---|---|---|
| Issue of Convertible Bonds | 31,211 | 6,775 |
| 8% interest payable *(Note 7)* | 2,293 | – |
| Imputed interest charged *(Note 7)* | 1,291 | – |
| Gain arising on change in fair value *(Note 6)* | – | (171) |
| At 31st December 2006 | 34,795 | 6,604 |
| Less: Accrued interest included in accruals and other payables | (2,293) | – |
| | 32,502 | 6,604 |

The fair value of the liability component of the Convertible Bonds at 31st December 2006, determined based on the present value of the estimated future cash outflows discounted at the prevailing market rate for an equivalent non-convertible loan at the balance sheet date, was approximately HK$36,321,000.

The fair value of the embedded derivative financial instrument is determined by reference to Binomial model. The significant assumptions used in the calculation of the value of the embedded derivative financial instrument were as follows:

(a) The valuation is ground on the hypothesis that the condition precedent stated in the subscription agreement will be fulfilled, and there is no default, no delay of payments to bondholders, no earlier redemption, no potential violation of governing law as prescribed in the subscription agreement.

## 26. CONVERTIBLE BONDS AND EMBEDDED DERIVATIVE FINANCIAL INSTRUMENT (CONTINUED)

(b) The volatility has made reference to the Company's historical volatility. The estimated volatility is 30% and is assumed to be constant in future. The historical volatility suggests an average 15% volatilities. Less weighting has been taken on the historical volatility as future volatility is expected to be on the high side in contract to the market average.

(c) The risk free rate has made reference to the Hong Kong Exchange Fund Notes ("EFN") with similar duration of the Convertible Bonds. The five-year EFN had a yield of 4.55% at the issue date of the Convertible Bonds.

(d) It is assumed that no dividend is expected to payout during the Convertible Bond's life.

## 27. TRADE AND NOTE PAYABLES

At 31st December 2006, the ageing analysis of the Group's trade and note payables was as follows:

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| 0 – 30 days | **40,187** | 14,914 |
| 31 – 60 days | **27,490** | 11,951 |
| 61 – 90 days | **18,931** | 10,534 |
| 91 – 180 days | **4,155** | 9,102 |
| 181 – 360 days | **648** | 197 |
| Over 360 days | **440** | 69 |
| | **91,851** | 46,767 |

The fair value of trade and note payables approximated the carrying value.

## 28. NOTES TO CONSOLIDATED CASH FLOW STATEMENT

Reconciliation of profit before income tax to net cash inflow generated from operations:

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Profit before income tax | **11,866** | 10,735 |
| Share-based payment | **–** | 1,948 |
| Interest income | **(306)** | (114) |
| Interest expenses | **6,711** | 1,548 |
| Gain on issue of convertible bonds | **(468)** | – |
| Fair value change in embedded derivative financial instrument | **(171)** | – |
| Depreciation and amortisation | **12,257** | 7,645 |
| Loss/(gain) on disposal of property, plant and equipment | **673** | (3) |
| Operating profit before working capital changes | **30,562** | 21,759 |
| (Increase)/decrease in inventories | **(12,487)** | 2,427 |
| (Increase)/decrease in trade and note receivables | **(28,254)** | 11,281 |
| Increase in prepayments, deposits and other current assets | **(1,329)** | (1,493) |
| Decrease in due from a related company | **516** | – |
| Increase in trade and notes payables | **29,471** | 6,321 |
| Increase in accruals and other payables | **7,549** | 2,975 |
| Net cash inflow generated from operations | **26,028** | 43,270 |

## 29. BANKING FACILITIES

As at 31st December 2006, the Group had aggregate banking facilities of approximately HK$66,055,000 (2005: HK$52,800,000). Unused bank facilities as at 31st December 2006 amounted to approximately HK$20,639,000 (2005: HK$20,673,000). These facilities were secured by land use rights, buildings and certain trade receivables of the Group with a carrying value of approximately HK$120,136,000 (2005: HK$38,253,000).

## 30. ACQUISITION OF A WHOLLY-OWNED SUBSIDIARY

On 12th April 2006, the Group acquired the entire issued share capital of SCI, a company incorporated in Ontario, Canada, engaged in the design, development and marketing of home and automotive audio products. The acquired business contributed net profit of approximately HK$5,254,000 to the Group for the period from 12th April 2006 to 31st December 2006. Details of net assets acquired and goodwill are as follows:

Details of net assets acquired and goodwill are as follows:

| | HK$'000 |
|---|---|
| Cash paid | 26,177 |
| Direct cost relating to the acquisition | 1,554 |
| Fair value of shares issued *(Note 22)* | 1,980 |
| Total purchase consideration | 29,711 |
| Fair value of net assets acquired - shown as below | (24,412) |
| Goodwill *(Note 17)* | 5,299 |

The goodwill is attributable to the high profitability of the acquired business and the significant synergies expected to arise after the Group's acquisition of SCI.

The assets and liabilities arising from the acquisition are as follows:

| | **Acquiree's carrying amount and fair value** HK$'000 |
|---|---|
| Cash and short-term deposit | 557 |
| Trademark and patents *(Note 16)* | 21,000 |
| Trade receivables | 19,129 |
| Prepayments, deposits and other current assets | 5,100 |
| Inventories | 5,835 |
| Deferred tax assets | 4,613 |
| Property, plant and equipment | 2,793 |
| Bank borrowings | (9,235) |
| Trade payables | (15,613) |
| Accruals and other payables | (9,767) |
| Net assets acquired | 24,412 |
| Satisfied by : | |
| Total purchase consideration | 29,711 |
| Less : Fair value of shares issued *(Note 22)* | (1,980) |
| Cash and short-term deposit acquired | (557) |
| Net outflow of cash and cash equivalents in respect of acquisition of a subsidiary | 27,174 |

## 30. ACQUISITION OF A WHOLLY-OWNED SUBSIDIARY (CONTINUED)

If the acquisition had been completed on 1st January 2006, total group sales for the year would have been approximately HK$386,553,000, and profit for the period would have been approximately HK$9,417,000. The pro-forma information is for illustrative purpose only and is not necessarily an indication of revenue and results of operations of the Group that actually would have been achieved had the acquisition been completed on 1st January 2006, nor is it intended to be a projection of future results.

## 31. COMMITMENTS

### (a) Capital commitments

Capital commitments at the balance sheet date but not yet incurred are as follows:

| | **2006** **HK$'000** | 2005 HK$'000 |
|---|---|---|
| Property, plant and equipment | | |
| Contracted but not provided for | **19,480** | 20,964 |

### (b) Commitments under operating leases

At 31st December 2006, the Group had aggregate minimum lease payments under non-cancellable operating lease as follows:

| | **2006** **HK$'000** | 2005 HK$'000 |
|---|---|---|
| Within one year | **1,553** | 28 |
| In the second to fifth year inclusive | **200** | – |
| Over five years | **12** | – |
| | **1,765** | 28 |

Operating lease payments represent rentals payable by the Group for certain of its office premises and property, plant and equipment. Leases and rentals are negotiated and fixed for an average of 3 years.

## 32. RELATED PARTY TRANSACTIONS

The following transactions were carried out with related parties:

### (a) Sales of goods

| | **2006** **HK$'000** | 2005 HK$'000 |
|---|---|---|
| Sales of goods | | |
| – Sonavox Electronics (Suzhou Industrial Park) Company Limited | – | 551 |

Goods were sold on the basis of the price lists in force with non-related parties.

### (b) Key management compensation

| | **2006** **HK$'000** | 2005 HK$'000 |
|---|---|---|
| Salaries and other short-term employee benefits | **1,112** | 1,999 |
| Share-based payments | – | 1,624 |
| | **1,112** | 3,623 |

## 32. RELATED PARTY TRANSACTIONS (CONTINUED)

### (c) Amounts due from related parties

| | **2006** **HK$'000** | 2005 HK$'000 |
|---|---|---|
| Trade receivables due from Asian Elite International Company Limited (i and ii) *(Note 19)* | **160** | 155 |
| Due from Sonavox Electronics Limited (i) | **–** | 516 |
| Due from Suzhou City Xiangchen District Yuanhe Town Collective Assets Operation Company, minority shareholder of Mainland China subsidiaries *(Note 20)* | **878** | 1,613 |

*Notes:*

(i) These are companies in which Mr. Yang Tsu Ying and Mr. Yang Ching Yau, directors of the Company, have beneficial interests.

(ii) In the opinion of the directors, the above transactions with related companies are carried out in the ordinary course of business on terms as agreed with the related parties.

**(d)** Subsequent to the balance sheet date on 28th February 2007, Sonavox Acoustics entered into sale and purchase agreements (the "Agreements") with Asian Elite International Company Limited ("Asian Elite"), a company incorporated in Mainland China and indirectly wholly-owned by Mr. Yang Ching Yau, and Sonavox Electronics (Suzhou Industrial Park) Company Limited ("Sonavox Electronics"), a company incorporated in Mainland China and indirectly owned as to 65% by Mr. Yang Ching Yau and his family members, respectively. Pursuant to the Agreements, Sonavox Acoustics has agreed to purchase amplifier systems from Asian Elite, subwoofers and tweeter systems from Sonavox Electronics.

## 33. SHARE BASED COMPENSATION

The Group adopted a share option scheme which became effective at 8th June 2002. Under which, share options are granted any employees, consultants or professional advisors, and suppliers or customers of the Group.

The exercise price of the granted options is the highest of (i) the closing price of the Company's shares on the date of the offer of grant, which must be a business day; (ii) the average closing price of the Company's shares for the five trading days immediately preceding the date of the offer of grant; (iii) the nominal value of the share. The options are exercisable at the grant date and have a contractual option term of ten years. The Group has no legal or constructive obligation to repurchase or settle the options in cash.

The maximum number of shares of the Company which may be issued upon exercise of all options granted under its share option scheme or any other share option scheme adopted by the Company must not in aggregate exceed 30% of its issued share capital of the Company from time to time. The total number of shares which may be issued upon exercise of all options to be granted under the share option scheme and any other share option scheme of the Group must not in aggregate exceed 10 per cent of the shares in issue as at the date of passing the relevant resolution adopting the scheme unless it is approved by shareholders in a general meeting of the Company.

At 31st December 2006, the number of shares of the Company in respect of which options had remained outstanding under the share option scheme of the Company was 12,000,000, representing 3.7% of the shares of the Company in issue at that date.

## 33. SHARE BASED COMPENSATION (CONTINUED)

The offer of a grant of share options may be accepted within 21 business days from the date of the offer of grant of the option. The consideration for a grant of options of the Company is HK$1.00. The exercise period of the share options granted is determined by the Board of Directors.

Movements in the number of share options outstanding and their related weighted average exercise prices are as follows:

| | Date of grant | Outstanding at 1/1/2005 '000 | Granted during the year '000 | Exercised/ lapsed during the year '000 | Outstanding at 31/12/2005 and 31/12/2006 '000 | Exercise share price HK$ |
|---|---|---|---|---|---|---|
| Directors | 28/6/2005 | – | 4,000 | – | 4,000 | 0.345 |
| Employees | 28/6/2005 | – | 8,000 | – | 8,000 | 0.345 |
| | | – | 12,000 | – | 12,000 | |
| Exercisable at the end of the year | | | | | 12,000 | |

Share options outstanding (in thousands) at the end of the year have the following expiry date and exercise prices:

| | Exercise price HK$ per share | Share options |
|---|---|---|
| Expire on 27th June 2015 | 0.345 | 12,000 |

No share options have been granted to the directors and employees during the year ended 31st December 2006.

During the year ended 31st December 2005, options were granted on 28th June 2005. The fair value of the options granted determined using the Black-Scholes valuation model was approximately HK$1,948,000. The significant inputs into the model were share price of HK$0.345 (at the grant date), exercise price of HK$0.345, standard deviation of expected share price returns of 49.83%, expected life of options of 5 years, zero expected dividend paid out rate and annual risk-free interest rate of 3.33%. The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of daily share prices over the last three years. The Group recognised the total expenses of approximately HK$1,948,000 for the year ended 31st December 2005 in relation to share options granted by the Company.

## 34. RETIREMENT PLANS

The employees of the Group in Hong Kong participate in the Mandatory Provident Fund Scheme (the "MPF Scheme"), a defined contribution scheme managed by an independent trustee. The Group and its employees each make monthly contributions to the scheme at 5% of the employees' earnings with the maximum contribution by each of the Group and the employees limited to HK$1,000 per month and thereafter contributions are voluntary. During the year, the aggregate contributions made by the Group to the MPF Scheme amounted to HK$12,000 (2005: HK$12,000).

As stipulated by the rules and regulations in Mainland China, the Group contributes to a state-sponsored retirement plan for its employees in Mainland China at a rate of 20% of the basic salaries of its employees, and has no further obligations for the actual payment of pensions or post-retirement benefits. The state-sponsored retirement plans are responsible for the entire pension obligations payable to retired employees. For the year ended 31st December 2006, the aggregate amount of the Group's employer contributions was approximately HK$3,334,000 (2005: HK$1,389,000).

## 35. MAJOR NON-CASH TRANSACTIONS

During the year ended 31st December 2006, the Group entered into the following non-cash transactions:

(a) The Company issued 5,089,974 ordinary shares of HK$0.01 each at the cash price of HK$0.389 per share to settle part of the consideration for the acquisition of equity interest SCI.

(b) The Group entered into a finance lease arrangement in respect of a machine with a total capital value at the inception of the lease of approximately HK$625,000.

## 36. ULTIMATE HOLDING COMPANY

The directors regard Newood Consultancy Limited, a company incorporated in the British Virgin Islands, as the ultimate holding company.

## 37. BALANCE SHEET OF THE COMPANY

| | 2006<br>HK$'000 | 2005<br>HK$'000 |
|---|---|---|
| **Non-current asset** | | |
| Investments in subsidiaries | **16,204** | 57,330 |
| **Current assets** | | |
| Prepayments, deposits and other current assets | **183** | 451 |
| Due from subsidiaries | **80,835** | – |
| Due from a related company | **–** | 516 |
| Bank balances and cash | **3,320** | 4,786 |
| **Total current assets** | **84,338** | 5,753 |
| **Current liabilities** | | |
| Accruals and other payables | **2,891** | 470 |
| Embedded derivative financial instrument | **6,604** | – |
| **Total current liabilities** | **9,495** | 470 |
| **Net current assets** | **74,843** | 5,283 |
| **Total assets less current liabilities** | **91,047** | 62,613 |
| **Non-current liability** | | |
| Convertible bonds | **32,502** | – |
| | **58,545** | 62,613 |
| **Capital and reserves** | | |
| Share capital | **3,251** | 3,200 |
| Share premium | **27,682** | 25,753 |
| Share-based payment reserve | **1,948** | 1,948 |
| Merger reserve | **19,550** | 19,550 |
| Accumulated profits | **6,114** | 12,162 |
| | **58,545** | 62,613 |

## 38. PRINCIPAL SUBSIDIARIES

The following is a list of the subsidiaries as at 31st December 2006:

| Name | Place and date of incorporation and kind of legal entity | Principal activities | Issued/paid up capital | Interest held |
|---|---|---|---|---|
| Taraki Inc. (a) | British Virgin Islands, 6th September 1991, Limited liability company | Investment holding | US$2 | 100% |
| Suzhou Shangsheng Electrics Co. Ltd. (b) | Mainland China, 27th June 1992, Sino-foreign equity joint venture | Manufacture and sales of loudspeaker systems for automobiles | US$2,380,000 | 51% |
| Suzhou Sonavox Acoustics Co. Ltd. (b) | Mainland China, 20th June 2000, Sino-foreign equity joint venture | Manufacture and sales of loudspeaker systems for home theatres | US$2,500,000 | 51% |
| Suzhou Shangsheng Technology Co. Ltd. (b & c) | Mainland China, 23rd March 2006, Sino-foreign equity joint venture | Manufacture and sales of loudspeaker systems | US$5,124,000 | 51% |
| Suzhou Hesheng Industrial Co., Ltd. (b & c) | Mainland China, 26th April 2006, Sino-foreign equity joint venture | Manufacture and sales of parts for loudspeaker systems | US$500,000 | 51% |
| Taraki Services Company Limited | Hong Kong, 6th February 2002, Limited liability company | Provision of management services to group companies | HK$2 | 100% |
| Detroit Sonavox Inc. | U.S.A., 2nd January 2005 limited liability company | Provision of after-sales services | US$1 | 51% |
| Sonavox Electronics Company Limited | Samoa, 19th August 2002, limited liability company | Inactive | US$1 | 100% |
| Indigo Enterprise Inc. | Samoa, 19th December 2005, limited liability company | Investment holding | US$1 | 100% |
| Sonavox Canada Inc. (Formerly known as Indigo Manufacturing Inc.) | Canada, 1st April 1999, limited liability company | Design , development and marketing of home and automotive audio products | CAD504,103 | 100% |

*Notes:*

(a) The shares of Taraki Inc. are held directly by the Company. The shares of other subsidiaries are held indirectly.

(b) Shangsheng Electrics, Sonavox Acoustics, Shangsheng Technology and Suzhou Hesheng are sino-foreign equity joint ventures established in Mainland China with an operating life of 50 years up to 2042, 2050, 2054 and 2054 respectively.

(c) Shangsheng Technology and Suzhou Hesheng were established in 2005 with registered capital of US$13,000,000 and US$5,000,000 respectively. As at 31st December 2006, the Group had outstanding commitments of approximately US$3,921,000 and US$2,050,000 respectively for capital contribution to these two subsidiaries.

None of the subsidiaries had issued any debt securities subsisting at the end of the year or at any time during the year.

# CORPORATE INFORMATION

## DIRECTORS

### EXECUTIVE DIRECTORS

Yang Tsu Ying – *Board Chairman*
Yang Ching Yau – *Chief Executive Officer*

### INDEPENDENT NON-EXECUTIVE DIRECTORS

Yiu Chi Wah
Wong Kai Tung, Simon
Fan Chi Fai, Paul

## COMPANY SECRETARY

Poon Lai Yin, Michael, CPA (HKICPA), CPA (Aust.)

## QUALIFIED ACCOUNTANT

Poon Lai Yin, Michael, CPA (HKICPA), CPA (Aust.)

## AUDIT COMMITTEE

Fan Chi Fai, Paul – *Committee Chairman*
Yiu Chi Wah
Wong Kai Tung, Simon

## NOMINATION COMMITTEE

Yang Ching Yau – *Committee Chairman*
Yiu Chi Wah
Wong Kai Tung, Simon

## REMUNERATION COMMITTEE

Yiu Chi Wah – *Committee Chairman*
Wong Kai Tung, Simon
Fan Chi Fai, Paul
Yang Ching Yau

## AUTHORISED REPRESENTATIVES

Yang Ching Yau
Poon Lai Yin, Michael

## REGISTERED OFFICE

Century Yard
Cricket Square
Hutchins Drive
P.O. Box 2681 GT
George Town
Grand Cayman
British West Indies

## HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS

14th Floor
Kam Sang Building
No. 255-257 Des Voeux Road Central
Hong Kong

## COMPLIANCE OFFICER

Yang Ching Yau

## PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Bank of Butterfield International (Cayman) Limited
Butterfield House
68 Fort Street
P.O. Box 705
George Town
Grand Cayman
Cayman Islands

## HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Union Registrars Limited
Room 1803
Fook Lee Commercial Centre
Town Place, 33 Lockhart Road
Wanchai
Hong Kong

## AUDITORS

ShineWing (HK) CPA Limited

## PRINCIPAL BANKER

The Hong Kong and Shanghai Banking Corporation Limited
Bank SinoPac

## STOCK CODE

8226