

Report of the Directors

The directors herein present their report and the audited financial statements of the Company and the Group for the year ended 31 December 2003.

Principal Activities

The principal activity of the Company is investment holding. The principal activities of the subsidiaries comprise the manufacture and sale of mobile phones. There were no significant changes in the nature of the Group's principal activities during the year.

Results and Dividends

The Group's loss for the year ended 31 December 2003 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 29 to 69.

The directors do not recommend the payment of any dividends in respect of the year.

Summary Financial Information

A summary of the published results and of the assets, liabilities and minority interests of the Group for the last five financial years/period, as extracted from the audited financial statements and reclassified as appropriate, is set out on page 70. This summary does not form part of the audited financial statements.

Fixed Assets

Details of movements in the fixed assets of the Group during the year are set out in note 16 to the financial statements.

Share Capital, Share Options and Warrants

There were no movement in the Company's authorised share capital during the year. Details of movements in the Company's share capital, share options and warrants during the year, together with the reasons therefor, are set out in notes 28 and 29 to the financial statements.

Pre-Emptive Rights

There are no provisions for pre-emptive rights under the Company's bye-laws or the laws of Bermuda which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

Purchase, Sale or Redemption of Listed Securities of the Company

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

Reserves

Details of movements in the reserves of the Company and the Group during the year are set out in note 30 to the financial statements and in the consolidated statement of changes in equity, respectively. Under the Companies Act 1981 of Bermuda (as amended), the contributed surplus is distributable to shareholders in certain circumstances.

Distributable Reserves

At 31 December 2003, the Company's reserves available for distribution, calculated in accordance with the provisions of the Companies Act 1981 of Bermuda (as amended), amounted to HK\$165,118,000 (2002: HK\$1,034,603,000). In addition, the Company's share premium account, in the amount of HK\$70,174,000 (2002: HK\$70,040,000), may be distributed in the form of fully paid bonus shares.

Major Customers and Suppliers

The information in respect of the Group's sales and purchases attributable to the major customers and suppliers, respectively, during the financial year is as follows:

	Percentage of the Group's total			
	Sales		Purchases	
	2003 %	2002 %	2003 %	2002 %
The largest customer	72	51	—	—
Five largest customers in aggregate	99	90	—	—
The largest supplier	—	—	12	23
Five largest suppliers in aggregate	—	—	33	63

During the year, Haier Group Corporation ("Haier"), who is taken to be interested in the shares of the Company, had beneficial interest in one of the five largest customers of the Group.

In 2002, CCT Telecom Holdings Limited ("CCT Telecom"), a substantial shareholder of the Company, and Haier each had beneficial interests in two of the five largest customers of the Group.

Save as disclosed above, at no time during the year did the directors, their associates or any shareholder of the Company (which, to the best knowledge of the directors, owns more than 5% of the Company's share capital) have any interest in these major customers and suppliers.

Directors

The directors of the Company during the year and up to the date of this report were as follows:

Executive directors:

Mak Shiu Tong, Clement
 Wu Ke Song
 Chai Yong Sen
 Cui Shao Hua
 Liang Hai Shan
 Tam Ngai Hung, Terry
 Man Wei Dong

Independent non-executive directors:

Lam Kin Kau, Mark
 Fung Hoi Wing, Henry

In accordance with the bye-laws of the Company, Messrs. Chai Yong Sen, Lam Kin Kau, Mark and Fung Hoi Wing, Henry will retire and, being eligible, will 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 any specific terms and are subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the bye-laws of the Company.

Directors' and Senior Management's Biographies

Biographical details of the directors of the Company and the senior management of the Group are set out on page 8 to 9 of this annual report.

Report of the Directors

Directors' Service Contracts

During the year, no director had a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

Directors' Interests in Contracts

No director had a material interest, either directly or indirectly, in any contract of significance to the business of the Group to which the Company or any of its subsidiaries or fellow subsidiaries was a party during the year.

Share Option Scheme

The share option scheme adopted by the Company on 24 November 1997 and subsequently amended on 4 December 1997 (the "Old Share Option Scheme") was terminated and a new share option scheme (the "New Share Option Scheme") was adopted by the Company on 28 February 2002 to comply with the new amendments to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") in respect of the share option schemes of a listed company. As a result, the Company may no longer grant further share options under the Old Share Option Scheme. However, all share options granted prior to the termination of the Old Share Option Scheme will remain in full force and effect. Unless otherwise cancelled or amended, the New Share Option Scheme will remain in force for 10 years from the date of adoption. As at 31 December 2003, there were 3,000,000 and 880,500,000 share options outstanding under the Old Share Option Scheme and the New Share Option Scheme respectively. Based on these outstanding share options, the total number of shares available for issue is 883,500,000, which represents approximately 8.87% of the existing issued share capital of the Company as at the date of this report.

The purpose of the New Share Option Scheme is to provide incentives and rewards to the eligible participants who contribute to the success of the operations of the Group. Eligible participants of the New Share Option Scheme include any employee, executive or officer of the Group (including executive and non-executive directors of the Group) and any supplier, consultant, agent, adviser, shareholder, customer, partner or business associate who, at the sole discretion of the board of directors of the Company (the "Board"), has contributed to the Group.

Pursuant to the New Share Option Scheme, the maximum number of shares in respect of which share options may be granted under the New Share Option Scheme is such number of shares, when aggregated with shares subject to any other share option scheme(s) of the Company (which, for this purpose, excludes the Old Share Option Scheme), must not exceed 10% of the issued share capital of the Company as at the date of adoption of the New Share Option Scheme. The maximum number of shares issuable upon exercise of the share options granted under the New Share Option Scheme and any other share option scheme(s) of the Company (including exercised, cancelled and outstanding share options) to each eligible participant in any 12-month period is limited to 1% of the shares of the Company in issue as at the date of grant. Any further grant of share options in excess of this 1% limit shall be subject to the issue of a circular by the Company (and if required, the holding company) and the shareholders' approval of the Company (and if required, the approval of the shareholders of the holding company) at a general meeting.

Share options granted to a director, chief executive or substantial shareholder of the Company, or to any of their respective associates, are subject to the approval in advance by the independent non-executive directors of the Company (and if required, the independent non-executive directors of the holding company), excluding the independent non-executive director(s) of the Company and the holding company who is/are the grantee(s) of the share options. In addition, any share option granted to a substantial shareholder or an independent non-executive director of the Company, or to any of their respective associates, in excess of 0.1% of the shares of the Company in issue as at the date of grant or with an aggregate value (based on the closing price of the shares of the Company as at the date of grant) in excess of HK\$5 million, within any 12-month period, are subject to the issue of a circular by the Company (and if required, the holding company) and the shareholders' approval of the Company (and if required, the approval of the shareholders of the holding company) in advance at a general meeting.

Share Option Scheme (cont'd)

The offer of a grant of share options may be accepted within 28 days from the date of the offer, upon payment of a nominal consideration of HK\$1 in total by the grantee. The exercise period of the share options granted is determinable by the Board, and commences on a specified date and ends on a date which is not later than 10 years from the date of grant of the share options or the expiry date of the New Share Option Scheme, whichever is earlier.

The exercise price of the share options is determinable by the Board, but may not be less than the highest of (i) the closing price of the shares of the Company as stated in the daily quotation sheet of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on the date of grant, which must be a trading day; (ii) the average closing price of the shares of the Company as stated in the Stock Exchange's daily quotation sheets for the five trading days immediately preceding the date of grant; and (iii) the nominal value of the shares of the Company.

Details of the movements of share options under the Old Share Option Scheme during the year were as follows:

Name or category of participant	Outstanding as at 1 January 2003	Number of share options			Outstanding as at 31 December 2003	Date of grant of share options (Note 1)	Exercise period of share options	Exercise price per share (Note 2) HK\$	Price of
		Granted during the year	Exercised during the year	Lapsed/ cancelled during the year					at exercise date of share options (Note 3) HK\$
EMPLOYEES									
In aggregate	2,075,000	—	(1,075,000)	(1,000,000)	—	27/6/2001	29/12/2001 - 28/6/2003	0.170	0.289
	3,650,000	—	(650,000)	—	3,000,000	13/7/2001	13/1/2002 - 12/7/2004*	0.190	0.282
	5,725,000	—	(1,725,000)	(1,000,000)	3,000,000				

Notes:

- The vesting period of the share options is from the date of grant until the commencement of the exercise period.
 - The exercise price of the share options is subject to adjustment(s) in the case of rights or bonus share issues, or other similar changes in the share capital of the Company.
 - The price of the shares of the Company as at the date of exercise of the share options is the weighted average of the closing prices of the shares of the Company as listed on the Stock Exchange on the trading day immediately before the dates on which the share options were exercised.
- * The date of expiry has been extended one year from the original date of expiry of 12 July 2003 to 12 July 2004 pursuant to the Board resolution of the Company passed on 2 July 2003.

Report of the Directors

Share Option Scheme (cont'd)

Details of the movements of share options under the New Share Option Scheme during the year were as follows:

Name or category of participant	Outstanding as at 1 January 2003	Number of share options			Outstanding as at 31 December 2003	Date of grant of share options (Note 1)	Exercise period of share options	Exercise price per share (Note 2) HK\$
		Granted during the year	Exercised during the year	Lapsed/ cancelled during the year				
EXECUTIVE DIRECTORS								
Mak Shiu Tong, Clement	89,000,000	—	—	—	89,000,000	16/8/2002	16/8/2003 - 15/8/2007	0.156
Tam Ngai Hung, Terry	89,000,000	—	—	—	89,000,000	16/8/2002	16/8/2003 - 15/8/2007	0.156
Wu Ke Song	89,000,000	—	—	—	89,000,000	19/11/2002	19/11/2003 - 18/11/2007	0.150
Chai Yong Sen	89,000,000	—	—	—	89,000,000	19/11/2002	19/11/2003 - 18/11/2007	0.150
Cui Shao Hua	89,000,000	—	—	—	89,000,000	19/11/2002	19/11/2003 - 18/11/2007	0.150
Liang Hai Shan	89,000,000	—	—	—	89,000,000	19/11/2002	19/11/2003 - 18/11/2007	0.150
Man Wei Dong	89,000,000	—	—	—	89,000,000	19/11/2002	19/11/2003 - 18/11/2007	0.150
	623,000,000	—	—	—	623,000,000			
INDEPENDENT NON-EXECUTIVE DIRECTORS								
Lam Kin Kau, Mark	5,000,000	—	—	—	5,000,000	16/8/2002	16/8/2003 - 15/8/2007	0.156
Fung Hoi Wing, Henry	5,000,000	—	—	—	5,000,000	16/8/2002	16/8/2003 - 15/8/2007	0.156
	10,000,000	—	—	—	10,000,000			
OTHER EMPLOYEES								
In aggregate	258,500,000*	—	—	(11,000,000)	247,500,000*	16/8/2002	16/8/2003 - 15/8/2007	0.156
	258,500,000*	—	—	(11,000,000)	247,500,000*			
	891,500,000	—	—	(11,000,000)	880,500,000			

Notes:

- The vesting period of the share options is from the date of grant until the commencement of the exercise period.
- The exercise price of the share options is subject to adjustment(s) in the case of rights or bonus share issues, or other similar changes in the share capital of the Company.

* The balances include 94,000,000 share options held by two former directors of the Company.

The financial impact of the share options granted is not recorded in the balance sheet of the Company or the Group until such time as the share options are exercised, and no charge is recorded in the profit and loss account or balance sheet for their cost. Upon exercise of the share options, the resulting shares issued are recorded by the Company as additional share capital at the nominal value of the shares, and the excess of the exercise price per share over the nominal value of the shares is recorded by the Company in the share premium account. Share options which are lapsed or are cancelled prior to their exercise date are deleted from the register of outstanding share options.

Share Option Scheme (cont'd)

The directors of the Company do not consider it appropriate to disclose a theoretical value of the share options granted to the directors and employees of the Company, because a number of factors crucial for the valuation cannot be determined. Accordingly, any valuation of the share options based on various speculative assumptions would not be meaningful, but would be misleading to the shareholders of the Company.

Directors' Interests in Shares and Warrants in the Company

As at 31 December 2003, the directors and the chief executive of the Company and/or any of their respective associates had the following interests and short positions in the shares, underlying shares and debentures of the Company or any of its associated corporation (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) (the "SFO")) as recorded in the register required to be kept by the Company under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to Part XV of the SFO or the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") under the Listing Rules:

- (i) Long positions in the shares of the Company:

Name of director	Number of shares beneficially held and nature of interest			Total	Approximate percentage of total shareholding (%)
	Personal	Family	Corporate		
Mak Shiu Tong, Clement (Note)	20,574,412	1,150,391	85,494,864	107,219,667	1.08
Tam Ngai Hung, Terry	10,000,000	—	—	10,000,000	0.10

Note: The family interest of Mr. Mak Shiu Tong, Clement in 1,150,391 shares in the Company was held by his wife, Ms. Yiu Yu Ying, and the corporate interest of Mr. Mak Shiu Tong, Clement in 85,494,864 shares in the Company was held by Capital Interest Limited, the issued share capital of which his wife, Ms. Yiu Yu Ying, and his two sons had beneficial interests, under the provisions of Part XV of the SFO.

Report of the Directors

Directors' Interests in Shares and Warrants in the Company (cont'd)

(ii) Long positions in the underlying shares of equity derivatives of the Company:

(a) Share options:

The Company has granted to certain directors of the Company the rights to subscribe for shares in the share capital of the Company. Details of the interests in the share options under the New Share Option Scheme granted to the directors of the Company are disclosed under the section headed "Share Option Scheme" above.

(b) The 2004 warrants*:

Name of director	Amount of 2004 warrants* beneficially held and nature of interest			Number of total underlying shares	Approximate percentage of total shareholding (%)
	Personal HK\$	Family HK\$	Corporate HK\$		
Mak Shiu Tong, Clement (Note)	1,069,869.32	59,820.28	4,444,651.64	10,719,887	0.11
Tam Ngai Hung, Terry	520,000.00	—	—	1,000,000	0.01

* The 2004 warrants in the Company entitle the holders thereof to subscribe for its shares at a subscription price of HK\$0.52 per share, subject to adjustment(s), until 26 February 2004 (the "2004 Warrants"). The 2004 Warrants were expired on 26 February 2004 and the subscription rights attaching to the 2004 Warrants which have not been exercised by 26 February 2004 were expired and lapsed.

Note: The family interest of Mr. Mak Shiu Tong, Clement in the 2004 Warrants in an aggregate amount of HK\$59,820.28 in the Company was held by his wife, Ms. Yiu Yu Ying, and the corporate interest of Mr. Mak Shiu Tong, Clement in the 2004 Warrants in an aggregate amount of HK\$4,444,651.64 in the Company was held by Capital Interest Limited, the issued share capital of which his wife, Ms. Yiu Yu Ying, and his two sons had beneficial interests, under the provisions of Part XV of the SFO.

Save as disclosed above, as at 31 December 2003, none of the directors and the chief executive of the Company and/or any of their respective associates had any interests and short positions in the shares, underlying shares and debentures of the Company or any of its associated corporation (within the meaning of Part XV of the SFO) as recorded in the register required to be kept by the Company under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to Part XV of the SFO or the Model Code.

Directors' Rights to Acquire Shares in the Company

Save as disclosed under the section headed "Share Option Scheme" above in respect of the share options under the New Share Option Scheme granted to the directors of the Company, at no time during the year were rights to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any of its associated corporation (within the meaning of Part XV of the SFO) granted to any director of the Company or their respective spouse or children under 18 years of age, or were any such rights exercised by them, or was the Company, or any of its associated corporation (within the meaning of Part XV of the SFO) a party to any arrangement to enable the directors of the Company to acquire such rights in any other body corporate.

Substantial Shareholders' Interests

As at 31 December 2003, the following persons (other than the directors or the chief executive of the Company) had an interest or a short position in the shares or underlying shares of the Company as recorded in the register required to be kept by the Company under section 336 of the SFO:

- (i) Long positions in the shares of the Company:

Name of shareholder	Notes	Number of shares held	Approximate percentage of total shareholding (%)
CCT Telecom Holdings Limited	(1)	4,346,772,486	43.62
Soaring Profit Holdings Limited	(2)	4,346,772,486	43.62
Info-net International Corp.		899,000,000	9.02
Greatway International Corp.		880,172,486	8.83
Clear Access Agents Limited		810,000,000	8.13
Super Control Investments Limited		733,600,000	7.36
Invest Paradise Group Limited		700,000,000	7.03
Haier Group Corporation	(3)	2,983,000,000	29.94
Qingdao Haier Collective Asset Management Association	(4)	2,983,000,000	29.94
Qingdao Haier Investment & Development Co., Ltd.	(5)	2,983,000,000	29.94
Qingdao Haier International Trading Co., Ltd.	(6)	1,960,000,000	19.67
Haier (Hong Kong) Company Limited	(7)	1,960,000,000	19.67
Orient Rich (H.K.) Limited		1,960,000,000	19.67

Notes:

- (1) The interest disclosed comprises 4,346,772,486 shares indirectly owned by Soaring Profit Holdings Limited through the subsidiaries as disclosed in note (2) below. Soaring Profit Holdings Limited is a wholly-owned subsidiary of CCT Telecom Holdings Limited.
- (2) The interest disclosed comprises 899,000,000 shares held by Info-net International Corp., 880,172,486 shares held by Greatway International Corp., 810,000,000 shares held by Clear Access Agents Limited, 733,600,000 shares held by Super Control Investments Limited, 700,000,000 shares held by Invest Paradise Group Limited and 324,000,000 shares held by Full Elite Assets Limited. Info-net International Corp., Greatway International Corp., Clear Access Agents Limited, Super Control Investments Limited, Invest Paradise Group Limited and Full Elite Assets Limited are wholly-owned subsidiaries of Soaring Profit Holdings Limited.
- (3) Haier Group Corporation is acting in concert with Qingdao Haier Investment & Development Co., Ltd.. As Qingdao Haier Investment & Development Co., Ltd. is holding 1,023,000,000 shares and is interested in 1,960,000,000 shares held by Orient Rich (H.K.) Limited as stated in notes (5), (6) and (7) below, Haier Group Corporation is also taken to be interested in 1,023,000,000 shares held by Qingdao Haier Investment & Development Co., Ltd. and 1,960,000,000 shares held by Orient Rich (H.K.) Limited.
- (4) Qingdao Haier Collective Asset Management Association is interested in 1,023,000,000 shares held by its non wholly-owned subsidiary, namely Qingdao Haier Investment & Development Co., Ltd., and 1,960,000,000 shares held by Orient Rich (H.K.) Limited as stated in notes (5), (6) and (7) below.
- (5) Qingdao Haier Investment & Development Co., Ltd. is holding 1,023,000,000 shares and is interested in 1,960,000,000 shares held by Orient Rich (H.K.) Limited through its non wholly-owned subsidiary, namely Qingdao Haier International Trading Co., Ltd., as stated in notes (6) and (7) below.
- (6) Qingdao Haier International Trading Co., Ltd. is interested in 1,960,000,000 shares held by Orient Rich (H.K.) Limited through its non wholly-owned subsidiary, namely Haier (Hong Kong) Company Limited, as stated in note (7) below.
- (7) Haier (Hong Kong) Company Limited is interested in 1,960,000,000 shares held by Orient Rich (H.K.) Limited. Orient Rich (H.K.) Limited is a non wholly-owned subsidiary of Haier (Hong Kong) Company Limited.

Substantial Shareholders' Interests (cont'd)

(ii) Long positions in the underlying shares of equity derivatives of the Company:

Name of holder of equity derivatives	Notes	Amount of the 2004 Warrants held HK\$	Number of total underlying shares	Approximate percentage of total shareholding (%)
CCT Telecom Holdings Limited	(1)	238,512,168.96	458,677,248	4.60
Soaring Profit Holdings Limited	(2)	238,512,168.96	458,677,248	4.60
Info-net International Corp.		46,748,000.00	89,900,000	0.90
Greatway International Corp.		45,768,968.96	88,017,248	0.88
Clear Access Agents Limited		42,120,000.00	81,000,000	0.81
Super Control Investments Limited		38,147,200.00	73,360,000	0.74
Invest Paradise Group Limited		36,400,000.00	70,000,000	0.70
Haier Group Corporation	(3)	101,920,000.00	196,000,000	1.97
Qingdao Haier Collective Asset Management Association	(4)	101,920,000.00	196,000,000	1.97
Qingdao Haier Investment & Development Co., Ltd.	(5)	101,920,000.00	196,000,000	1.97
Qingdao Haier International Trading Co., Ltd.	(6)	101,920,000.00	196,000,000	1.97
Haier (Hong Kong) Company Limited	(7)	101,920,000.00	196,000,000	1.97
Orient Rich (H.K.) Limited		101,920,000.00	196,000,000	1.97

Notes:

- (1) The interest disclosed comprises 458,677,248 underlying shares indirectly owned by Soaring Profit Holdings Limited through the subsidiaries as disclosed in note (2) below. Soaring Profit Holdings Limited is a wholly-owned subsidiary of CCT Telecom Holdings Limited.
- (2) The interest disclosed comprises 89,900,000 underlying shares held by Info-net International Corp., 88,017,248 underlying shares held by Greatway International Corp., 81,000,000 underlying shares held by Clear Access Agents Limited, 73,360,000 underlying shares held by Super Control Investments Limited, 70,000,000 underlying shares held by Invest Paradise Group Limited and 56,400,000 underlying shares held by Full Elite Assets Limited. Info-net International Corp., Greatway International Corp., Clear Access Agents Limited, Super Control Investments Limited, Invest Paradise Group Limited and Full Elite Assets Limited are wholly-owned subsidiaries of Soaring Profit Holdings Limited.
- (3) Haier Group Corporation is acting in concert with Qingdao Haier Investment & Development Co., Ltd.. As Qingdao Haier Investment & Development Co., Ltd. is interested in 196,000,000 underlying shares held by Orient Rich (H.K.) Limited as stated in notes (5), (6) and (7) below, Haier Group Corporation is also taken be interested in 196,000,000 underlying shares held by Orient Rich (H.K.) Limited.
- (4) Qingdao Haier Collective Asset Management Association is interested in 196,000,000 underlying shares held by Orient Rich (H.K.) Limited as stated in notes (5), (6) and (7) below.
- (5) Qingdao Haier Investment & Development Co., Ltd. is interested in 196,000,000 underlying shares held by Orient Rich (H.K.) Limited through its non wholly-owned subsidiary, namely Qingdao Haier International Trading Co., Ltd., as stated in notes (6) and (7) below.
- (6) Qingdao Haier International Trading Co., Ltd. is interested in 196,000,000 underlying shares held by Orient Rich (H.K.) Limited through its non wholly-owned subsidiary, namely Haier (Hong Kong) Company Limited, as stated in note (7) below.
- (7) Haier (Hong Kong) Company Limited is interested in 196,000,000 underlying shares held by Orient Rich (H.K.) Limited. Orient Rich (H.K.) Limited is a non wholly-owned subsidiary of Haier (Hong Kong) Company Limited.

Save as disclosed above, as at 31 December 2003, no other person (other than the directors or the chief executive of the Company) had any interests or short positions in the shares or underlying shares as recorded in the register required to be kept by the Company under section 336 of the SFO.

Connected Transactions

During the year, the Company had transactions with connected persons as defined in the Listing Rules, which constituted connected transactions under Section 14 of the Listing Rules. Details of the transactions are as follows:

- (a) During the year, the Group had the following connected transactions with Haier, subsidiaries of Haier, and subsidiaries of Qingdao Haier Investment & Development Co., Ltd. (“Haier Investment”). Haier and Haier Investment are substantial shareholders of the Company:

	Notes	2003 HK\$'000	2002 HK\$'000
Sales of mobile phones	(i)	1,197,120	338,955
Purchases of materials	(ii)	81,388	18,985
Utility service fee expenses	(iii)	3,724	859
General security service fee expenses	(iii)	439	127
Human resources service fee expenses	(iii)	159	28
Legal consultancy service fee expenses	(iii)	64	236
Interest expense	(iv)	3,346	834
Interest income	(iv)	73	16

Notes:

- (i) The sales of mobile phones were made in accordance with the terms and conditions set out in the products distribution agreement entered into between Pegasus Telecom (Qingdao) Co., Ltd. (“Pegasus Qingdao”) and Qingdao Haier Telecommunications Co., Ltd. on 10 January 2003.

The sales were determined based on the costs of materials plus a processing fee ranging from 5% to 40% of the purchase price of the materials.

- (ii) The purchases of materials were made in accordance with the terms and conditions set out in the materials procurement agreement entered into between Pegasus Qingdao, Qingdao Haier International Trading Co., Ltd. and Qingdao Haier Parts Procurement Co., Ltd. on 10 January 2003.

The purchases were determined based on the lower of the average market price or the consolidated and the integrated tender and bidding price plus 2.6% commission.

- (iii) The utility service fee expenses, legal consultancy service fee expenses, human resources service fee expenses and general security service fee expenses were charged by Qingdao Haier Energy Power Co., Ltd. (“Haier Energy”), Qingdao Haier Intellectual Property Rights and Legal Services Centre (“Haier Legal”), Qingdao Haier Human Resources Development Co., Ltd. (“Haier Human Resources”) and Qingdao Haier Security Services Co., Ltd. (“Haier Security”), respectively, in accordance with the terms and conditions set out in the service agreement (the “Service Agreement”) entered into between Pegasus Qingdao, Haier Energy, Haier Legal, Haier Human Resources, Haier Security and Haier Group Finance Co., Ltd. (“Haier Finance”) on 10 January 2003.

The utility service fees, legal consultancy service fees, human resources service fees and general security service fees were charged on an actual cost basis.

- (iv) The interest expense was charged by and the interest income was received from Haier Finance in accordance with the terms and conditions set out in the Service Agreement. The average daily balance of loan plus interest and deposits plus interest for each of the twelve months ended 31 December 2003 did not exceed RMB150 million (equivalent to approximately HK\$140 million) and RMB30 million (equivalent to approximately HK\$28 million), respectively, as specified in the Service Agreement.

The interests were determined with reference to the standard rates published by the People’s Bank of China.

On 10 January 2003, the Company provided a letter of indemnity to Haier pursuant to which the Company agreed to guarantee and counter indemnify Haier for a maximum amount of US\$45,150,000 (equivalent to approximately HK\$352 million), representing 64.5% of the guarantee amount of US\$70,000,000 (equivalent to approximately HK\$546 million) granted by Haier to the China Construction Bank, Qingdao High Technology Park Branch, as a security to banking facilities granted to Pegasus Qingdao. The indemnity was automatically released when the relevant guarantee granted by Haier to Pegasus Qingdao expired on 23 April 2003.

Connected Transactions (cont'd)

(a) (cont'd):

The above transactions were defined as “Ongoing Connected Transactions” in the circular to the shareholders of the Company dated 17 March 2003 and were approved by the shareholders at a special general meeting of the Company on 2 April 2003.

The Stock Exchange has granted conditional waivers to the Company from strict compliance with the connected transactions requirements as set out in the Listing Rules for the two financial years ending 31 December 2004.

The independent non-executive directors of the Company have reviewed and confirmed the Ongoing Connected Transactions were:

- (i) less than the cap amounts which were set out in the relevant agreements;
 - (ii) entered into in the usual and ordinary course of business of Pegasus Qingdao;
 - (iii) conducted either on normal commercial terms; or if there is not sufficient comparable transactions to judge whether they are on normal commercial terms, on terms that are fair and reasonable so far as the shareholders are concerned; and
 - (iv) entered into either in accordance with the terms of the agreements governing such transactions; or if there are no such agreements, on terms that are no less favourable than terms available to or from independent third parties.
- (b) On 15 November 2002, the Company, Haier Investment and Pegasus Qingdao entered into a shareholders' loan agreement pursuant to which each of the Company and Haier Investment agreed to grant to Pegasus Qingdao an interest-free loan of RMB250,000,000 (equivalent to HK\$236,000,000) (the “Loan”) in proportion to the respective shareholdings of the Company and Haier Investment in Pegasus Qingdao. The repayment term of the Loan was three years from the date of grant. As at 31 December 2002, the Company had advanced its respective portion of the Loan in the amount of HK\$152,220,000 (equivalent to RMB162,875,000) (the “Haier-CCT Loan”) to Pegasus Qingdao.
- The Loan was initially intended to be utilised by Pegasus Qingdao for its mobile phone manufacturing business. Subsequently, on 15 May 2003, the Company, Pegasus Qingdao and Haier Investment entered into an agreement pursuant to which, inter alia, the aforementioned shareholders' loan agreement was to be terminated. The Haier-CCT Loan was then fully repaid by Pegasus Qingdao to the Company by cash on 11 August and 12 August 2003.
- (c) On 20 June 2003, Haier provided two corporate guarantees of RMB40,000,000 (equivalent to HK\$37,383,000) each to the China Merchants Bank, Qingdao Branch, as securities for banking facilities granted to Pegasus Qingdao for the period from 20 June 2003 to 20 June 2004 and 2 July 2003 to 2 July 2004, respectively. As at 31 December 2003, the above banking facilities were fully utilised.
- (d) On 27 June 2003, Haier provided a corporate guarantee of RMB70,000,000 (equivalent to HK\$65,421,000) to Haier Finance as a security for banking facilities granted to Pegasus Qingdao for the period from 27 June 2003 to 27 June 2004. As at 31 December 2003, the above banking facilities were fully utilised.
- (e) On 10 November 2003, Haier provided a corporate guarantee of RMB50,000,000 (equivalent to HK\$46,729,000) to the Bank of Communications, Qingdao Branch, as a security for banking facilities granted to Pegasus Qingdao for the period from 10 November 2003 to 10 May 2004. As at 31 December 2003, the above banking facilities were fully utilised.
- (f) On 23 December 2003, Haier provided a corporate guarantee of US\$15,000,000 (equivalent to HK\$117,000,000) to the China Construction Bank, Qingdao Haier Technology Park Branch, as a security for banking facilities granted to Pegasus Qingdao for the period from 23 December 2003 to 22 June 2004. As at 31 December 2003, the above banking facilities were fully utilised.

Post Balance Sheet Events

Details of the significant post balance sheet events of the Group are set out in note 35 to the financial statements.

Compliance with the Code of Best Practice

In the opinion of the Board, the Company has complied with the Code of Best Practice (the "Code") as set out in Appendix 14 to the Listing Rules throughout the financial year covered by this report, except that the independent non-executive directors of the Company are not appointed for any specific terms as required by paragraph 7 of the Code, but are subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the bye-laws of the Company.

Audit Committee

Pursuant to the requirements of the Listing Rules, the Company has established an audit committee comprising two independent non-executive directors of the Company. A set of written terms of reference which describes the authorities and duties of the audit committee, was adopted by the Board.

The audit committee is answerable to the Board and the principal duties of the audit committee include the review and supervision of the financial reporting process and internal control of the Company. The audit committee had reviewed the audited consolidated financial statements of the Group for the year ended 31 December 2003.

Auditors

Ernst & Young retire and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting of the Company.

ON BEHALF OF THE BOARD

Mak Shiu Tong, Clement

Chairman

Hong Kong
23 April 2004