# Notes to Financial Statements

31 December 2003

## 1. CORPORATE INFORMATION

The registered office of Haier-CCT Holdings Limited is located at Canon's Court, 22 Victoria Street, Hamilton HM12, Bermuda.

During the year, the principal activities of the Group comprised the manufacture and sale of mobile phones.

## 2. IMPACT OF A REVISED STATEMENT OF STANDARD ACCOUNTING PRACTICE ("SSAP")

SSAP 12 (Revised) "Income taxes" is effective for the first time for the current year's financial statements and has had a significant impact thereon.

SSAP 12 prescribes the accounting for income taxes payable or recoverable, arising from the taxable profit or loss for the current period (current tax); and income taxes payable or recoverable in future periods, principally arising from taxable and deductible temporary differences and the carryforward of unused tax losses (deferred tax).

The principal impact of the revision of this SSAP on these financial statements is described below:

Measurement and recognition:

- deferred tax assets and liabilities relating to the differences between capital allowances for tax purposes and depreciation for financial reporting purposes and other taxable and deductible temporary differences are generally fully provided for, whereas previously the deferred tax was recognised for timing differences only to the extent that it was probable that the deferred tax asset or liability would crystallise in the foreseeable future; and

- a deferred tax asset has been recognised for tax losses arising in the current/prior periods to the extent that it is probable that there will be sufficient future taxable profits against which such losses can be utilised.

Disclosures:

- the related note disclosures are now more extensive than previously required. These disclosures are presented in notes 11 and 27 to the financial statements and include a reconciliation between the accounting loss and the tax income for the year.

Further details of these changes and the prior year adjustments arising from them are included in the accounting policy for deferred tax in note 3 and in note 27 to the financial statements.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Statements of Standard Accounting Practice, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention.

### Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2003. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

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

### Subsidiaries

A subsidiary is a company whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's profit and loss account to the extent of dividends received and receivable. The Company's interests in subsidiaries are stated at cost less any impairment losses.

### Goodwill

Goodwill arising on the acquisition of subsidiaries represents the excess of the cost of the acquisition over the Group's share of the fair values of the identifiable assets and liabilities acquired as at the date of acquisition.

Goodwill arising on acquisition is recognised in the consolidated balance sheet as an asset and amortised on the straight-line basis over its estimated useful life not exceeding 20 years.

On disposal of subsidiaries, the gain or loss on disposal is calculated by reference to the net assets at the date of disposal, including the attributable amount of goodwill which remains unamortised and any relevant reserves, as appropriate.

The carrying amount of goodwill is reviewed annually and written down for impairment when it is considered necessary. A previously recognised impairment loss for goodwill is not reversed unless the impairment loss was caused by a specific external event of an exceptional nature that was not expected to recur, and subsequent external events have occurred which have reversed the effect of that event.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

### Impairment of assets

An assessment is made at each balance sheet date of whether there is any indication of impairment of any asset, or whether there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use or its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years.

A reversal of an impairment loss is credited to the profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the reversal of the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

### Fixed assets and depreciation

Fixed assets, other than construction in progress, are stated at cost less accumulated depreciation and any impairment losses. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of that asset.

Depreciation is calculated on the straight-line basis to write off the cost of each asset over its estimated useful life. The principal annual rates used for this purpose are as follows:

| | |
|---|---|
| Buildings | 4.5% |
| Leasehold improvements | 50% |
| Plant and machinery | 9% |
| Tools, moulds and equipment | 18% |
| Furniture, fixtures and office equipment | 18% - 20% |
| Motor vehicles | 20% |

The gain or loss on disposal or retirement of a fixed asset recognised in the profit and loss account is the difference between the net sales proceeds and the carrying amount of the relevant asset.

### Construction in progress

Construction in progress represents a building under construction and equipment pending installation. It is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction. Construction in progress is reclassified to the appropriate category of the fixed assets when completed and ready for use.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

### Intangible assets

Patents and licences
Purchased patents and licences are stated at cost less any impairment losses and are amortised on the straight-line basis over their estimated useful lives of 10 years.

Research and development costs
All research costs are charged to the profit and loss account as incurred.

Expenditure incurred on projects to develop new products is capitalised and deferred only when the projects are clearly defined; the expenditure is separately identifiable and can be measured reliably; there is reasonable certainty that the projects are technically feasible; and the products have commercial value. Product development expenditure which does not meet these criteria is expensed when incurred.

### Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessor, assets leased by the Group under operating leases are included in non-current assets and rentals receivable under the operating leases are credited to the profit and loss account on the straight-line basis over the lease terms. Where the Group is the lessee, rentals payable under the operating leases are charged to the profit and loss account on the straight-line basis over the lease terms.

### Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour and an appropriate proportion of overheads. Net realisable value is based on the estimated selling prices less any estimated costs to be incurred to completion and disposal.

### Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the profit and loss account or in equity if it relates to items that are recognised in the same or a different period, directly in equity.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences:

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

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

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

### Income tax (cont'd)

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

- except where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

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

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

### Employee benefits

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

Employment Ordinance long service payments
Certain of the Group's employees have completed the required number of years of service to the Group in order to be eligible for long service payments under the Hong Kong Employment Ordinance in the event of the termination of their employment. The Group is liable to make such payments in the event that such a termination of employment meets the circumstances specified in the Employment Ordinance.

Share option schemes
The Company operates two share option schemes for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. The financial impact of share options granted under the share option schemes is not recorded in the Company's or the Group's balance sheet until such time as the options are exercised, and no charge is recorded in the profit and loss account or balance sheet for their cost. Upon the 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. Options which are cancelled prior to their exercise date, or which lapse, are deleted from the register of outstanding options.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

### Employee benefits (cont'd)

Pension schemes

The Group operates a defined contribution retirement benefits scheme for those employees who were eligible to participate in this scheme. This scheme operates in a similar way to the Mandatory Provident Fund retirement benefits scheme, except that when an employee leaves this scheme before his/her interest in the Group's employer contributions vest fully, the ongoing contributions payable by the Group are reduced by the relevant amount of the forfeited employer contributions.

The employees of the Group's subsidiaries in the PRC are required to participate in central pension scheme operated by the local municipal government. This subsidiaries are required to contribute a certain percentage of its payroll costs to the central pension scheme. The contributions are charged to the profit and loss account as they become payable in accordance with the rules of the central pension scheme.

### Foreign currencies

Foreign currency transactions are recorded at the applicable exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable exchange rates ruling at that date. Exchange differences are dealt with in the profit and loss account.

On consolidation, the financial statements of overseas subsidiaries are translated into Hong Kong dollars using the net investment method. The profit and loss accounts of overseas subsidiaries are translated into Hong Kong dollars at the weighted average exchange rates for the year, and their balance sheets are translated into Hong Kong dollars at the exchange rates ruling at the balance sheet date. The resulting translation differences are included in the exchange fluctuation reserve.

For the purpose of the consolidated cash flow statement, the cash flows of overseas subsidiaries are translated to Hong Kong dollars at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of overseas subsidiaries which arise throughout the year are translated to Hong Kong dollars at the weighted average exchange rates for the year.

### Cash and cash equivalents

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

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

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

### Revenue recognition

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

(a) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;

(b) income from the provision of technical and management services, and software and hardware designs, when the services are rendered;

(c) rental income, on a time proportion basis over the lease terms; and

(d) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable.

### Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained profits within the capital and reserves section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim dividends are simultaneously proposed and declared, because the Company's bye-laws grant the directors the authority to declare interim dividends. Consequently, interim dividends are recognised immediately as a liability when they are proposed and declared.

### Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

## 4. SEGMENT INFORMATION

Segment information is presented by way of two segment formats: (i) on a primary segment reporting basis, by business segment; and (ii) on a secondary segment reporting basis, by geographical segment.

The Group's operating businesses are structured and managed separately, according to the nature of their operations and the products and services they provide. Each of the Group's business segment represents a strategic business unit that offers products and services which are subject to risks and returns that are different from those of the other business segments. Summary details of the business segments are as follows:

(a) the telecom products segment manufactures and sells mobile phones; and

(b) the corporate and others segment includes general corporate income and expense items.

In determining the Group's geographical segments, revenues are attributed to the segments based on the location of the customers, and assets are attributed to the segments based on the location of the assets.

## 4. SEGMENT INFORMATION (cont'd)

### (a) Business segments

The following tables present revenue and profit/(loss) and certain asset, liability and expenditure information for the Group's business segments.

| Group | Telecom products | | Baby care products (discontinued on 4 March 2002) | | Corporate and others | | Inter-segment eliminations | | Consolidated | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2003 HK$'000 | 2002 HK$'000 | 2003 HK$'000 | 2002 HK$'000 | 2003 HK$'000 | 2002 HK$'000 | 2003 HK$'000 | 2002 HK$'000 | 2003 HK$'000 | 2002 HK$'000 (Restated) |
| Segment revenue: | | | | | | | | | | |
| Sales to external customers | 1,664,638 | 472,615 | — | 27,262 | — | — | — | — | 1,664,638 | 499,877 |
| Other revenue | 3,148 | 2,415 | — | 1,234 | — | 2,336 | — | (1,000) | 3,148 | 4,985 |
| Total revenue | 1,667,786 | 475,030 | — | 28,496 | — | 2,336 | — | (1,000) | 1,667,786 | 504,862 |
| Segment results | (25,666) | 4,725 | — | 1,245 | (8,309) | (5,398) | | | (33,975) | 572 |
| Interest income | | | | | | | | | 2,157 | 5,787 |
| Amortisation and impairment of goodwill | (815,087) | (74,803) | — | — | — | — | | | (815,087) | (74,803) |
| Finance costs | | | | | | | | | (18,845) | (4,682) |
| Loss before tax | | | | | | | | | (865,750) | (73,126) |
| Tax | | | | | | | | | 1,653 | 832 |
| Loss before minority interests | | | | | | | | | (864,097) | (72,294) |
| Minority interests | | | | | | | | | 7,733 | 6,032 |
| Net loss from ordinary activities attributable to shareholders | | | | | | | | | (856,364) | (66,262) |

## 4. SEGMENT INFORMATION (cont'd)

### (a) Business segments (cont'd)

Group

| | Telecom products | | Baby care products (discontinued on 4 March 2002) | | Corporate and others | | Consolidated | |
|---|---|---|---|---|---|---|---|---|
| | 2003 HK$'000 | 2002 HK$'000 (Restated) | 2003 HK$'000 | 2002 HK$'000 | 2003 HK$'000 | 2002 HK$'000 | 2003 HK$'000 | 2002 HK$'000 (Restated) |
| Segment assets | 2,181,342 | 2,416,474 | — | — | 150,520 | 202,892 | 2,331,862 | 2,619,366 |
| Unallocated assets | | | | | | | 8,624 | 4,077 |
| Total assets | | | | | | | 2,340,486 | 2,623,443 |
| Segment liabilities | 468,815 | 296,867 | — | — | 1,400 | 1,365 | 470,215 | 298,232 |
| Unallocated liabilities | | | | | | | 549,037 | 140,187 |
| Total liabilities | | | | | | | 1,019,252 | 438,419 |
| Other segment information: | | | | | | | | |
| Capital expenditure | 194,176 | 26,494 | — | 715 | — | 351 | 194,176 | 27,560 |
| Depreciation | 23,648 | 7,128 | — | 332 | 75 | 75 | 23,723 | 7,535 |
| Amortisation | 84,017 | 75,092 | — | — | — | — | 84,017 | 75,092 |
| Impairment of goodwill | 732,226 | — | — | — | — | — | 732,226 | — |
| Loss on disposal of fixed assets, net | — | — | — | 67 | — | 1,484 | — | 1,551 |
| Write off of fixed assets | 5,197 | — | — | — | — | — | 5,197 | — |
| Write off of intangible assets | 1,128 | — | — | — | — | — | 1,128 | — |
| Provision for bad and doubtful debts | — | 21,275 | — | — | — | 17 | — | 21,292 |
| Provision for obsolete and slow-moving inventories | 55,544 | 10,375 | — | — | — | — | 55,544 | 10,375 |

### (b) Geographical segments

The following table presents revenue information for the Group's geographical segments.

Group

| | United States of America | | Hong Kong | | Elsewhere in the PRC | | European Union | | Unallocated | | Consolidated | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2003 HK$'000 | 2002 HK$'000 | 2003 HK$'000 | 2002 HK$'000 | 2003 HK$'000 | 2002 HK$'000 | 2003 HK$'000 | 2002 HK$'000 | 2003 HK$'000 | 2002 HK$'000 | 2003 HK$'000 | 2002 HK$'000 |
| Segment revenue: | | | | | | | | | | | | |
| Sales to external customers | — | 27,708 | 1,005 | 54,092 | 1,361,655 | 382,117 | 299,695 | 35,066 | 2,283 | 894 | 1,664,638 | 499,877 |
| Other revenue | — | — | 242 | 4,534 | 2,906 | 451 | — | — | — | — | 3,148 | 4,985 |
| Total revenue | — | 27,708 | 1,247 | 58,626 | 1,364,561 | 382,568 | 299,695 | 35,066 | 2,283 | 894 | 1,667,786 | 504,862 |

No further geographic segment information is presented as over 90% of the Group's assets are located in the PRC.

## 5. TURNOVER

Turnover represents the net invoiced value of goods sold, net of value-added tax and after allowances for returns and trade discounts, and the value of services rendered.

Revenue from the following activities has been included in turnover:

Group

| | 2003 HK$'000 | 2002 HK$'000 |
|---|---|---|
| Continuing operations: | | |
| Manufacture and sale of mobile phones | 1,664,471 | 376,519 |
| Sourcing of raw materials | 167 | 51,763 |
| Provision of technical and management services | — | 44,333 |
| | 1,664,638 | 472,615 |
| Discontinued operations (note 6): | | |
| Manufacture and sale of baby care products | — | 27,262 |
| Turnover | 1,664,638 | 499,877 |

## 6. DISCONTINUED OPERATIONS

On 14 January 2002, the Company and CCT Telecom Holdings Limited ("CCT Telecom"), a substantial shareholder of the Company, entered into a sale and purchase agreement pursuant to which CCT Telecom agreed to acquire from the Company the entire interest of Current Profits Limited ("Current Profits"), a then wholly-owned subsidiary of the Company, at a total purchase price of HK$60,000,000. Current Profits and its subsidiaries were engaged in the manufacture and sale of baby care products.

The purchase price was payable by CCT Telecom by way of a set-off against the entire amount of the HK$60,000,000 loan note issued by the Company to an indirect wholly-owned subsidiary of CCT Telecom on 17 December 2001.

The transaction was completed on 4 March 2002 and the gain on the disposal was approximately HK$2,240,000. The discontinued baby care products operation contributed HK$27,262,000 to the Group's turnover and HK$1,252,000 to the Group's results from operating activities for the year ended 31 December 2002.

Net cash flows attributable to the discontinued operations are as follows:

| | 1 January to 4 March 2002 HK$'000 |
|---|---|
| Operating | 5,516 |
| Investing | (559) |
| Financing | 9,635 |
| Net cash inflow | 14,592 |

## 7. LOSS FROM OPERATING ACTIVITIES

The Group's loss from operating activities is arrived at after charging/(crediting):

| | Notes | 2003 HK$'000 | 2002 HK$'000 |
|---|---|---|---|
| Depreciation | 16 | 23,723 | 7,535 |
| Amortisation of intangible assets* | 17 | 1,156 | 289 |
| Research and development costs* | | 11,302 | 1,184 |
| Goodwill: | | | |
| Amortisation for the year** | 18 | 82,861 | 74,803 |
| Impairment arising during the year** | 18 | 732,226 | — |
| | | 815,087 | 74,803 |
| Auditors' remuneration | | 1,400 | 1,300 |
| Staff costs (including directors' remuneration - note 9): | | | |
| Wages and salaries | | 11,909 | 16,929 |
| Net pension scheme contributions*** | | 2,774 | 643 |
| Total staff costs | | 14,683 | 17,572 |
| Minimum lease payments under operating leases: | | | |
| Land and buildings | | 1,373 | 1,365 |
| Plant and machinery | | 2,301 | 147 |
| | | 3,674 | 1,512 |
| Loss on disposal of fixed assets, net | | — | 1,551 |
| Provision for bad and doubtful debts | | | |
| - Trade receivables | | — | 4,652 |
| - Other receivables | | — | 16,640 |
| Provision for obsolete and slow-moving inventories | | 55,544 | 10,375 |
| Write off of fixed assets**** | 16 | 5,197 | — |
| Write off of intangible assets**** | 17 | 1,128 | — |
| Foreign exchange losses/(gains), net | | 2,428 | (271) |
| Write back of provision for bad and doubtful debts | | — | (3,000) |
| Gross rental income | | (474) | — |
| Less: Outgoings | | — | — |
| Net rental income | | (474) | — |
| Interest income | | (2,157) | (5,787) |

* The amortisation of intangible assets and research and development costs for the year are included in "Cost of sales" on the face of the consolidated profit and loss account.

** The amortisation and impairment of goodwill for the year are disclosed on the face of the consolidated profit and loss account.

*** At 31 December 2003, the Group had no forfeited contributions available to reduce its contributions to the pension scheme in future years (2002: Nil).

**** The write off of fixed assets and write off of intangible assets for the year are included in "Other operating expenses" on the face of the consolidated profit and loss account.

## 8. FINANCE COSTS

Group

| | 2003 HK$'000 | 2002 HK$'000 |
|---|---|---|
| Interest on bank and other loans wholly repayable within five years | 18,845 | 4,629 |
| Interest on finance leases | — | 53 |
| | 18,845 | 4,682 |

## 9. DIRECTORS' REMUNERATION

Directors' remuneration for the year, disclosed pursuant to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and Section 161 of the Companies Ordinance, is as follows:

| | 2003 HK$'000 | 2002 HK$'000 |
|---|---|---|
| Executive directors: | | |
| Fees | — | — |
| Other emoluments: | | |
| Salaries, allowances and benefits in kind | — | — |
| Performance related bonuses | — | — |
| Pension scheme contributions | — | — |
| | — | — |
| Independent non-executive directors: | | |
| Fees | 300 | 240 |

The number of directors whose remuneration fell within the following band is as follows:

| | Number of directors 2003 | 2002 |
|---|---|---|
| Nil - HK$1,000,000 | 9 | 12 |
| | 9 | 12 |

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

## 10. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year did not include any director (2002: Nil), details of whose remuneration are set out in note 9 above. Details of the remuneration of the five (2002: five) non-director, highest paid employees for the year are as follows:

| | 2003<br>HK$'000 | 2002<br>HK$'000 |
|---|---|---|
| Salaries, allowances and benefits in kind | 2,498 | 3,205 |
| Performance related bonuses | — | 64 |
| Pension scheme contributions | 75 | 87 |
| | 2,573 | 3,356 |

The number of non-director, highest paid employees whose remuneration fell within the following bands is as follows:

| | Number of employees | |
|---|---|---|
| | 2003 | 2002 |
| Nil - HK$1,000,000 | 5 | 4 |
| HK$1,000,001 - HK$1,500,000 | — | 1 |
| | 5 | 5 |

## 11. TAX

No provision for Hong Kong profits tax has been made as the Group did not generate any assessable profits arising in Hong Kong during the year. In 2002, Hong Kong profits tax has been provided at the rate of 16% on the estimated assessable profits arising in Hong Kong during that year. Taxes on profits assessable elsewhere have been calculated at the rates of tax prevailing in the countries in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

Certain subsidiaries of the Group established in the PRC, which are either categorised as a Sino-foreign equity joint venture enterprise or a wholly-foreign owned enterprise, are entitled to preferential tax treatments including full exemption from PRC corporate income tax for two years starting from its first profit-making year following by a 50% reduction for the next consecutive three years.

| | 2003<br>HK$'000 | 2002<br>HK$'000<br>(Restated) |
|---|---|---|
| Group: | | |
| Current - Hong Kong: | | |
| Charge for the year | — | 670 |
| Underprovision/(overprovision) in prior years | 1,130 | (532) |
| Current - Elsewhere | 1,935 | — |
| Deferred (note 27) | (4,718) | (970) |
| Tax income for the year | (1,653) | (832) |

## 11. TAX (cont'd)

A reconciliation of the tax income applicable to loss before tax using the statutory or applicable rate for the locations in which the Company and its subsidiaries are domiciled to the tax charge/(income) at the effective tax rates, and a reconciliation of the statutory or applicable rate to the effective tax rates, are as follows:

Group - 2003

| | Hong Kong | | PRC | | Total | |
|---|---|---|---|---|---|---|
| | HK$'000 | % | HK$'000 | % | HK$'000 | % |
| Loss before tax | (839,218) | | (26,532) | | (865,750) | |
| Tax at the statutory or applicable tax rate | (146,863) | 17.5 | (6,368) | 24.0 | (153,231) | 17.7 |
| Income not subject to tax | (266) | — | (160) | 0.6 | (426) | 0.1 |
| Expenses not deductible for tax | 143,047 | (17.0) | 5,680 | (21.4) | 148,727 | (17.2) |
| Adjustments in respect of current tax of previous periods | 1,130 | (0.1) | — | — | 1,130 | (0.1) |
| Tax losses not recognised | 4,082 | (0.5) | — | — | 4,082 | (0.5) |
| Tax exemption | — | — | (1,935) | 7.3 | (1,935) | 0.2 |
| Tax charge/(income) at the Group's effective rate | 1,130 | (0.1) | (2,783) | 10.5 | (1,653) | 0.2 |

Group - 2002

| | Hong Kong | | PRC | | Total | |
|---|---|---|---|---|---|---|
| | HK$'000 | % | HK$'000 | % | HK$'000 | % |
| Loss before tax | (55,167) | | (17,959) | | (73,126) | |
| Tax at the statutory or applicable tax rate | (8,827) | 16.0 | (4,310) | 24.0 | (13,137) | 18.0 |
| Income not subject to tax | (1,305) | 2.4 | — | — | (1,305) | 1.8 |
| Expenses not deductible for tax | 9,093 | (16.5) | 2,197 | (12.2) | 11,290 | (15.4) |
| Tax expenses from discontinued operations | 670 | (1.2) | — | — | 670 | (0.9) |
| Adjustments in respect of current tax of previous periods | (532) | 1.0 | — | — | (532) | 0.7 |
| Tax losses not recognised | 1,039 | (1.9) | — | — | 1,039 | (1.5) |
| Tax exemption | — | — | 1,143 | (6.4) | 1,143 | (1.5) |
| Tax charge/(income) at the Group's effective rate | 138 | (0.2) | (970) | 5.4 | (832) | 1.2 |

## 12. NET LOSS FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS

The net loss from ordinary activities attributable to shareholders for the year ended 31 December 2003 dealt with in the financial statements of the Company, was HK$869,485,000 (2002: HK$553,000) (note 30(b)).

## 13. DIVIDENDS

No dividend has been paid or declared by the Company during the year (2002: Nil).

## 14. LOSS PER SHARE

The calculation of basic loss per share is based on the net loss attributable to shareholders for the year of HK$856,364,000 (2002 (restated): HK$66,262,000), and the weighted average of 9,963,179,734 (2002: 9,179,016,822) ordinary shares in issue during the year.

Diluted loss per share amounts for each of the years ended 31 December 2003 and 2002 have not been disclosed, as the share options and warrants outstanding during these years had an anti-dilutive effect on the basic loss per share for these years.

## 15. RELATED PARTY TRANSACTIONS

In addition to transactions and balances detailed elsewhere in these financial statements, the Group had the following material transactions with Haier Group Corporation ("Haier"), Qingdao Haier Investment & Development Co., Ltd. ("Haier Investment"), and their subsidiaries. Haier and Haier Investments are substantial shareholders of the Company. Haier and Haier Investment, and their subsidiaries (hereinafter referred to as the "affiliates of Haier") are companies that have certain key management personnel in common with the Company.

(a) During the year, the Group had the following material transactions with Haier and the affiliates of Haier:

| | 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 expense | (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 |
| Rental income | (v) | 474 | — |

## 15. RELATED PARTY TRANSACTIONS (cont'd)

(a) (cont'd)

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 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 the 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 expenses were charged by and the interest income were received from Haier Finance in accordance with the terms and conditions set out in the Service Agreement.

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

(v) The monthly rental was calculated by reference to rentals of properties in the proximate locations as quoted by the Company's directors.

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.

The above transactions, except the rental income described in (v) above, 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 of Hong Kong Limited (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.

## 15. RELATED PARTY TRANSACTIONS (cont'd)

(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 another 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.

## 15. RELATED PARTY TRANSACTIONS (cont'd)

(g) In 2002, the Group had the following material transactions with Pegasus Qingdao and Coreland Limited ("Coreland") up to the date Pegasus Qingdao and Coreland became subsidiaries of the Group:

| | Notes | 2003 HK$'000 | 2002 HK$'000 |
|---|---|---|---|
| Purchases of mobile phones | (i) | — | 34,531 |
| Sales of raw materials | (ii) | — | 78,393 |
| Technical and management service fee income | (iii) | — | 44,333 |
| Software and hardware design fee income | (iv) | — | 2,307 |

Notes:

(i) The purchases of mobile phones from Pegasus Qingdao were made in accordance with the terms and conditions set out in a letter of intent and a supplemental agreement (collectively the "Export Agreements") entered into between Pegasus Telecom (H.K.) Co., Ltd ("Pegasus HK") and Pegasus Qingdao on 3 July 2001 and 15 August 2001, respectively.

(ii) The sales of raw materials to Pegasus Qingdao were made in accordance with the terms and conditions set out in an agreement and a supplemental agreement (collectively the "Sourcing Agreements") entered into between Pegasus HK and Pegasus Qingdao on 3 July 2001 and 15 August 2001, respectively.

(iii) The technical and management service fee income from Coreland was charged in accordance with the terms and conditions set out in a technical service and management agreement and a supplemental agreement (collectively the "Management Agreements") entered into between Foreland Agents Limited and Coreland on 21 September 2000 and 27 August 2001, respectively.

(iv) The software and hardware design fee income from Pegasus Qingdao was charged in accordance with the terms and conditions set out in the Sourcing Agreements.

## 16. FIXED ASSETS

Group

| | Buildings HK$'000 | Leasehold improvements HK$'000 | Plant and machinery HK$'000 | Tools, moulds and equipment HK$'000 | Furniture fixture and office equipment HK$'000 | Motor vehicles HK$'000 | Construction in progress HK$'000 | Total HK$'000 |
|---|---|---|---|---|---|---|---|---|
| Cost: | | | | | | | | |
| At 1 January 2003 | 44,580 | 312 | 164,177 | 27,186 | 1,967 | 1,384 | 16,860 | 256,466 |
| Additions | 67,101 | — | 112,960 | 12,586 | — | — | 1,529 | 194,176 |
| Write off | — | — | (91) | (11,541) | — | — | (219) | (11,851) |
| Transfers | 16,834 | — | 55 | 808 | — | — | (17,697) | — |
| At 31 December 2003 | 128,515 | 312 | 277,101 | 29,039 | 1,967 | 1,384 | 473 | 438,791 |
| Accumulated depreciation: | | | | | | | | |
| At 1 January 2003 | 3,531 | 160 | 20,462 | 8,333 | 617 | 483 | — | 33,586 |
| Provided during the year | 3,795 | 152 | 13,287 | 5,825 | 387 | 277 | — | 23,723 |
| Write off | — | — | — | (6,654) | — | — | — | (6,654) |
| At 31 December 2003 | 7,326 | 312 | 33,749 | 7,504 | 1,004 | 760 | — | 50,655 |
| Net book value: | | | | | | | | |
| At 31 December 2003 | 121,189 | — | 243,352 | 21,535 | 963 | 624 | 473 | 388,136 |
| At 31 December 2002 | 41,049 | 152 | 143,715 | 18,853 | 1,350 | 901 | 16,860 | 222,880 |

## 16. FIXED ASSETS (cont'd)

As at 31 December 2003, the land use rights of the two parcels of land occupied by the Group in the PRC were not acquired by and registered under the name of the respective subsidiaries of the Company. The land use right of one of the land occupied by the Group was owned by Haier and used by the Group for nil consideration during the year. As at 31 December 2003, the Group is in the process of negotiating with Haier for the acquisition of this land use right.

As at 31 December 2003, all of the Group's buildings do not have building ownership certificates registered under the name of the respective subsidiaries of the Company.

Moreover, on 3 February 2004, Haier issued an undertaking to the Company pursuant to which Haier agreed to provide other suitable properties to the Group to ensure the continuing operations of the respective subsidiaries of the Group and indemnify the Company or the respective subsidiaries for any moving cost/loss incurred, if, for any reason, the respective subsidiaries were not able to continue using the buildings before the related acquisition and application procedures are completed.

In the opinion of the directors, the Group is entitled to lawfully and validly occupy and use the buildings for its daily operations, notwithstanding the fact that the related land use rights have not been acquired by and registered under the name of the respective subsidiaries of the Company and the application procedures for the building ownership certificates have not yet been completed.

## 17. INTANGIBLE ASSETS

Group

| | Patents and licences HK$'000 |
|---|---|
| Cost: | |
| At 1 January 2003 | 8,424 |
| Write off | (2,614) |
| At 31 December 2003 | 5,810 |
| Accumulated amortisation: | |
| At 1 January 2003 | 1,637 |
| Amortisation provided during the year | 1,156 |
| Write off | (1,486) |
| At 31 December 2003 | 1,307 |
| Net book value: | |
| At 31 December 2003 | 4,503 |
| At 31 December 2002 | 6,787 |

## 18. GOODWILL

The amounts of the goodwill capitalised as an asset in the consolidated balance sheet, arising from the acquisitions of subsidiaries, are as follows:

| Group | HK$'000 |
|---|---|
| Cost: | |
| At 1 January 2003 | |
| As previously reported | 1,637,170 |
| Prior year adjustment: | |
| SSAP 12 - restatement of deferred tax | (1,894) |
| As restated and at 31 December 2003 | 1,635,276 |
| Accumulated amortisation and impairment: | |
| At 1 January 2003 | 77,822 |
| Amortisation provided during the year | 82,861 |
| Impairment provided during the year (Note) | 732,226 |
| At 31 December 2003 | 892,909 |
| Net book value: | |
| At 31 December 2003 | 742,367 |
| At 31 December 2002 (restated) | 1,557,454 |

Note: Due to intensifying competition and price reduction of mobile phones in the mobile phone market, the Group has performed an assessment of the fair value of its interest in the mobile phone operations acquired in prior years, including the related goodwill that had been capitalised as an asset in the consolidated balance sheet, as at 31 December 2003. As a result, based on the estimated value in use of the mobile phone operations determined using a discount rate of 21%, the Group recognised an impairment loss of approximately HK$732 million in the consolidated profit and loss account for the year ended 31 December 2003.

## 19. INTERESTS IN SUBSIDIARIES

Company

| | 2003 HK$'000 | 2002 HK$'000 |
|---|---|---|
| Unlisted shares, at cost | 1,946,185 | 1,518,084 |
| Due from subsidiaries | 848 | 1,583,273 |
| | 1,947,033 | 3,101,357 |
| Provision for impairment | (864,228) | (1,201,691) |
| | 1,082,805 | 1,899,666 |

The amounts due from subsidiaries are unsecured, interest-free and are repayable on demand.

## 19. INTERESTS IN SUBSIDIARIES (cont'd)

Particulars of the principal subsidiaries are as follows:

| Name | Place of establishment/ operations | Nominal value of registered capital | Percentage of equity directly attributable to the Company | Principal activities |
|---|---|---|---|---|
| Pegasus Telecom (Qingdao) Co., Ltd * | The PRC | US$12,000,000 | 64.5% | Manufacture and sale of mobile phones |
| Pegasus Electronic (Qingdao) Co., Ltd. ** | The PRC | US$29,980,000 | 100% | Manufacture and sale of mobile phones |

* Registered as a Sino-foreign equity joint venture enterprise under the PRC law.

** Registered as a wholly-foreign owned enterprise under the PRC law.

The above table lists the subsidiaries of the Company which, in the opinion of the directors, principally affected the results for the year or formed a substantial portion of the net assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

## 20. INVENTORIES

Group

| | 2003 HK$'000 | 2002 HK$'000 |
|---|---|---|
| Raw materials | 257,916 | 147,595 |
| Work in progress | 36,670 | 53,524 |
| Finished goods | 46,542 | 105,732 |
| | 341,128 | 306,851 |

The carrying amount of inventories carried at net realisable value included in the above balance was approximately HK$19,450,000 (2002: HK$61,804,000) as at the balance sheet date.

## 21. TRADE AND BILLS RECEIVABLES

The Group normally allows an average credit period of 30 to 90 days to its trade customers. An aged analysis of the trade and bills receivables as at the balance sheet date is as follows:

Group

| | 2003 | | 2002 | |
|---|---|---|---|---|
| | HK$'000 | Percentage | HK$'000 | Percentage |
| Within 1 month | 482,056 | 92 | 79,211 | 61 |
| 1 to 2 months | 35,744 | 7 | 32,380 | 25 |
| 2 to 3 months | 2,888 | — | 11,404 | 9 |
| Over 3 months | 3,241 | 1 | 6,619 | 5 |
| | 523,929 | 100 | 129,614 | 100 |

Included in the Group's trade and bills receivables are amounts due from the affiliates of Haier of HK$246,352,000 (2002: HK$47,025,000), which are repayable on similar credit terms to those offered to the major customers of the Group. Further details in respect of the sales to these related parties are set out in note 15 to the financial statements.

## 22. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

| | Group | | Company | |
|---|---|---|---|---|
| | 2003 HK$'000 | 2002 HK$'000 | 2003 HK$'000 | 2002 HK$'000 |
| Prepayments | 5,862 | 5,550 | 5,485 | — |
| Deposits and other receivables | 57,964 | 15,342 | — | — |
| | 63,826 | 20,892 | 5,485 | — |

Included in other receivables are rental income receivable from the affiliates of Haier amounting to HK$474,000 (2002: Nil). The balances of these rental income receivables are unsecured, interest-free and are repayable on demand.

## 23. CASH AND CASH EQUIVALENTS AND PLEDGED DEPOSITS

| | Group | | Company | |
|---|---|---|---|---|
| | 2003 HK$'000 | 2002 HK$'000 | 2003 HK$'000 | 2002 HK$'000 |
| Cash and bank balances | 126,653 | 178,704 | 3,484 | 6,386 |
| Time deposits | 141,320 | 196,184 | 141,320 | 196,184 |
| Less: Pledged deposits | (1,079) | — | — | — |
| Cash and cash equivalents | 266,894 | 374,888 | 144,804 | 202,570 |

## 23. CASH AND CASH EQUIVALENTS AND PLEDGED DEPOSITS (cont'd)

At the balance sheet date, the cash and bank balances of the Group denominated in Renminbi ("RMB") amounted to HK$123,075,000 (2002: HK$169,290,000). The RMB is not freely convertible into other currencies, however, under the PRC Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for other currencies through banks authorised to conduct foreign exchange business.

Included in the Group's cash and cash equivalents are deposits of approximately HK$19,995,000 (2002: HK$459,000) placed with Haier Finance, a financial institution approved by the People's Bank of China. The interest rate on these deposits was 0.72% per annum.

Further details of the interest income attributable to the deposits placed with Haier Finance are set out in note 15 to the financial statements.

## 24. TRADE PAYABLES

An aged analysis of the trade payables as at the balance sheet date is as follows:

Group

| | 2003 | | 2002 | |
|---|---|---|---|---|
| | HK$'000 | Percentage | HK$'000 | Percentage |
| Within 1 month | 363,792 | 82 | 240,286 | 98 |
| 1 to 2 months | 47,343 | 10 | — | — |
| 2 to 3 months | 8,688 | 2 | — | — |
| Over 3 months | 25,832 | 6 | 3,835 | 2 |
| | 445,655 | 100 | 244,121 | 100 |

Included in the Group's trade payables are trade payables of HK$4,174,000 (2002: HK$40,755,000) due to affiliates of Haier, which are repayable on similar credit terms to those offered by the affiliates of Haier to their major customers. Further details of the purchases from these related parties are set out in note 15 to the financial statements.

## 25. OTHER PAYABLES AND ACCRUALS

| | Group | | Company | |
|---|---|---|---|---|
| | 2003 | 2002 | 2003 | 2002 |
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| Other payables | 22,324 | 49,949 | — | — |
| Accruals | 2,236 | 4,162 | 1,400 | 1,364 |
| | 24,560 | 54,111 | 1,400 | 1,364 |

Included in other payables and accruals are sales deposits in respect of sales of mobile phones to the affiliates of Haier amounting to HK$19,543,000 (2003: Nil) as at 31 December 2002. The balances of these sales deposits were unsecured, interest-free and were repayable on demand.

## 26. INTEREST-BEARING BANK AND OTHER LOANS, UNSECURED

Group

| | 2003<br>HK$'000 | 2002<br>HK$'000 |
|---|---|---|
| Bank loans repayable within one year or on demand | 377,757 | 74,766 |
| Other loan repayable within one year or on demand - Note | 65,421 | 65,421 |
| Trust receipt loans repayable within one year | 105,750 | — |
| | 548,928 | 140,187 |
| Portion classified as current liabilities | (548,928) | (140,187) |
| Non-current portion | — | — |

Note:

The other loan was borrowed from Haier Finance, which is guaranteed by Haier, bear interest at a rate of approximately 5% per annum and is repayable on 26 June 2004 (2002: 27 June 2003). Further details of the interest expense attributable to the loan borrowed from Haier Finance are set out in note 15 to the financial statements.

## 27. DEFERRED TAX

The movement in deferred tax asset (representing the provision for obsolete and slow-moving inventories) during the year is as follows:

Group

| | 2003<br>HK$'000 |
|---|---|
| At 1 January 2003 | |
| As previously reported | — |
| Prior year adjustment: | |
| SSAP 12 - restatement of deferred tax | 3,906 |
| As restated | 3,906 |
| Deferred tax credited to the profit and loss account during the year (note 11) | 4,718 |
| At 31 December 2003 | 8,624 |

Group

| | 2002<br>HK$'000 |
|---|---|
| At 1 January 2002 | 240 |
| Disposal of subsidiaries (note 31(b)) | (240) |
| Prior year adjustment: | |
| Deferred tax credited to the profit and loss account during the year: | |
| As previously reported | — |
| SSAP 12 - restatement of deferred tax (note 11) | 970 |
| As restated | 970 |
| Acquisition of subsidiaries (note 31(a)) | |
| As previously reported | — |
| SSAP 12 - restatement of deferred tax | 2,936 |
| As restated | 2,936 |
| At 31 December 2002 (restated) | 3,906 |

The Group has tax losses arising in Hong Kong of HK$36,075,000 (2002: HK$17,649,814) that are available indefinitely for offsetting against future taxable profits of the companies in which the losses arose. Deferred tax assets have not been recognised in respect of these losses as they have arisen in the Company and subsidiaries that have been loss-making for some time.

At 31 December 2003, there is no significant unrecognised deferred tax liability (2002: Nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries as the Group has no liability to additional tax should such amounts be remitted.

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

## 27. DEFERRED TAX (cont'd)

SSAP 12 (Revised) was adopted during the year, as further explained in note 2 to the financial statements. The change in accounting policy has resulted in an increase in the Group's deferred tax asset by HK$4,718,000 and HK$3,906,000, an increase in the Group's minority interests by HK$1,675,000 and HK$1,386,000, and a decrease in the Group's goodwill by nil and HK$1,894,000 as at 31 December 2003 and 31 December 2002, respectively. As a consequence, the Group's consolidated net losses attributable to shareholders for the year ended 31 December 2003 and 2002 have been decreased by HK$3,043,000 and HK$626,000, respectively, and the consolidated retained profits at 1 January 2003 have been increased by HK$626,000, as detailed in the consolidated statement of changes in equity.

## 28. SHARE CAPITAL

### Shares

| Company | 2003<br>HK$'000 | 2002<br>HK$'000 |
|---|---|---|
| Authorised: | | |
| 20,000,000,000 (2002: 20,000,000,000) shares of HK$0.10 each | 2,000,000 | 2,000,000 |
| Issued and fully paid: | | |
| 9,964,016,574 (2002: 9,962,291,000) shares of HK$0.10 each | 996,402 | 996,229 |

A summary of the transactions involving the Company's share capital during the year is as follows:

| | Number of shares in issue | Issued capital HK$'000 | Share premium HK$'000 | Total HK$'000 |
|---|---|---|---|---|
| At 1 January 2002 | 8,569,966,000 | 856,996 | 253,813 | 1,110,809 |
| Issue upon private placements | 368,000,000 | 36,800 | 73,600 | 110,400 |
| Issue of consideration shares | 1,023,000,000 | 102,300 | — | 102,300 |
| Exercise of share options | 1,325,000 | 133 | 95 | 228 |
| Share issue expense | — | — | (3,655) | (3,655) |
| Transfer of share premium to set off against accumulated losses | — | — | (253,813) | (253,813) |
| At 31 December 2002 and beginning of year | 9,962,291,000 | 996,229 | 70,040 | 1,066,269 |
| Exercise of share warrants | 574 | — | — | — |
| Exercise of share options (Note) | 1,725,000 | 173 | 134 | 307 |
| At 31 December 2003 | 9,964,016,574 | 996,402 | 70,174 | 1,066,576 |

Note:

Details of the Company's share option schemes and the share options issued under the schemes are included in note 29 to the financial statements.

## 28. SHARE CAPITAL (cont'd)

### Warrants

On 22 February 2002, the Company made a bonus issue of warrants to the shareholders whose names appeared on the register of members of the Company on 22 February 2002, on the basis of one unit of warrant for every ten shares of HK$0.10 each in the share capital of the Company held on that date. As a result, 893,876,600 units of warrants (the "2004 warrants") in the amount of HK$464,815,832 were issued pursuant to the bonus issue. Each unit of warrant entitles the holder thereof to subscribe for new ordinary shares of the Company at an initial subscription price of HK$0.52 per share, payable in cash and subject to adjustment, at any time between 26 February 2002 and 26 February 2004 (both dates inclusive).

During the year, 574 warrants were exercised for 574 shares of HK$0.52 per share. At the balance sheet date, the Company had 893,876,026 warrants outstanding. The exercise in full of such warrants would, under the present capital structure of the Company, result in the issue of 893,876,026 additional shares of HK$0.52 each.

The 2004 warrants was 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.

## 29. SHARE OPTION SCHEMES

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 Listing Rules in respect of the share option schemes of a listed company. As a result, the Company may no longer grant further options under the Old Share Option Scheme. However, all 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.

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 Company) and any supplier, consultant, agent, adviser, shareholder, customer, partner, business associate who, in 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 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 options granted under the New Share Option Scheme and any other share option scheme(s) of the Company (including exercised, cancelled and outstanding 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.

## 29. SHARE OPTION SCHEMES (cont'd)

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 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.

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 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:

| | Number of share options | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Name or category of participant | Outstanding as at 1 January 2003 | Granted during the year | Exercised during the year | Lapsed/ cancelled during the year | Outstanding as at 31 December 2003 | Date of grant of share options (Note 1) | Exercise period of share options | Exercise price per share option (Note 2) HK$ | Price of the shares of the Company 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:

1. The vesting period of the share options is from the date of grant until the commencement of the exercise period.

2. 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.

3. 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.

## 29. SHARE OPTION SCHEMES (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 | Number of share options: Outstanding as at 1 January 2003 | Granted during the year | Exercised during the year | Lapsed/ cancelled during the year | 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$ |
|---|---|---|---|---|---|---|---|---|
| **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:

1. The vesting period of the share options is from the date of grant until the commencement of the exercise period.

2. 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.

## 29. SHARE OPTION SCHEMES (cont'd)

The 1,725,000 share options exercised during the year resulted in the issue of 1,725,000 ordinary shares of the Company and new share capital of HK$173,000 and share premium of HK$134,000 (before issue expenses), as detailed in note 28 to the financial statements.

At the balance sheet date, the Company had 3,000,000 and 880,500,000 share options outstanding under the Old Share Option Scheme and the New Share Option Scheme, respectively, which represented a total of approximately 8.87% of the Company's shares in issue as at that date. The exercise in full of these remaining share options would, under the present capital structure of the Company, result in the issue of 883,500,000 additional ordinary shares of the Company and additional share capital of HK$88,350,000 and share premium of HK$46,908,000 (before issue expenses).

## 30. RESERVES

### (a) Group

The movements of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity on page 31 of the financial statements.

The contributed surplus of the Group represents the difference between the nominal value of the shares of the subsidiaries acquired over the nominal value of the Company's shares issued in exchange therefor.

### (b) Company

| | Share premium account HK$'000 | Contributed surplus HK$'000 | Accumulated losses HK$'000 | Total HK$'000 |
|---|---|---|---|---|
| At 1 January 2002 | 253,813 | 1,843,087 | (1,164,044) | 932,856 |
| Issue of consideration shares | — | 102,300 | — | 102,300 |
| Placement of shares | 73,600 | — | — | 73,600 |
| Exercise of share options | 95 | — | — | 95 |
| Share issue expenses | (3,655) | — | — | (3,655) |
| Transfer of share premium and contributed surplus to set off against accumulated losses - Note | (253,813) | (910,231) | 1,164,044 | — |
| Net loss for the year | — | — | (553) | (553) |
| At 31 December 2002 and beginning of the year | 70,040 | 1,035,156 | (553) | 1,104,643 |
| Exercise of share warrants | — | — | — | — |
| Exercise of share options | 134 | — | — | 134 |
| Net loss for the year | — | — | (869,485) | (869,485) |
| At 31 December 2003 | 70,174 | 1,035,156 | (870,038) | 235,292 |

## 30. RESERVES (cont'd)

### (b) Company (cont'd)

The contributed surplus of the Company represents the excess of the fair values of the shares of the subsidiaries acquired, over the nominal value of the Company's shares issued in exchange therefor. Under the Companies Act 1981 of Bermuda (as amended), the contributed surplus is distributable to shareholders in certain circumstances.

Note: A special resolution was passed at the annual general meeting of the Company held on 24 May 2002 to approve the amount of HK$253,813,000 and HK$910,231,000 standing to the credit of the share premium account and contributed surplus account, respectively, to be reduced and applied to set off against an equivalent amount of the accumulated losses of the Company as at 31 December 2001.

## 31. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

### (a) Acquisition of subsidiaries

| | 2003<br>HK$'000 | 2002<br>HK$'000<br>(Restated) |
|---|---|---|
| Net assets acquired: | | |
| Fixed assets | — | 200,788 |
| Intangible assets | — | 7,076 |
| Deferred tax asset | — | 2,936 |
| Inventories | — | 244,204 |
| Trade and bills receivables | — | 213,918 |
| Prepayments, deposits and other receivables | — | 6,540 |
| Cash and cash equivalents | — | 15,073 |
| Trade payables | — | (182,618) |
| Other payables and accruals | — | (158,601) |
| Interest-bearing bank and other loans, unsecured | — | (185,607) |
| | — | 163,709 |
| Minority interests | — | (89,345) |
| | — | 74,364 |
| Goodwill on acquisition | — | 186,239 |
| | — | 260,603 |
| Satisfied by: | | |
| Cash paid for incidental acquisition costs | — | 1,062 |
| Cash paid for settlement of shareholder's loan | — | 54,941 |
| Issue of consideration shares | — | 204,600 |
| | — | 260,603 |

## 31. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (cont'd)

### (a) Acquisition of subsidiaries (cont'd)

An analysis of the net outflow of cash and cash equivalents in respect of the acquisition of subsidiaries is as follows:

| | 2003 HK$'000 | 2002 HK$'000 |
|---|---|---|
| Cash paid | — | (56,003) |
| Cash and cash equivalents acquired | — | 15,073 |
| Net outflow of cash and cash equivalents in respect of the acquisition of subsidiaries | — | (40,930) |

The subsidiaries acquired in the prior year contributed HK$303,764,000 to turnover and post-acquisition loss of approximately HK$17,959,000 to the Group's loss after tax for the year ended 31 December 2002.

### (b) Disposal of subsidiaries

| | 2003 HK$'000 | 2002 HK$'000 |
|---|---|---|
| Net assets disposed of: | | |
| Fixed assets | — | 6,740 |
| Club memberships | — | 13,739 |
| Inventories | — | 2,491 |
| Trade and bills receivables | — | 37,650 |
| Prepayments, deposits and other receivables | — | 3,178 |
| Pledged deposits | — | 2,635 |
| Cash and cash equivalents | — | 20,860 |
| Trade and bills payables | — | (13,691) |
| Tax payable | — | (1,622) |
| Other payables and accruals | — | (12,963) |
| Finance lease payables | — | (1,017) |
| Deferred tax | — | (240) |
| | — | 57,760 |
| Gain on disposal of subsidiaries | — | 2,240 |
| | — | 60,000 |
| Satisfied by: | | |
| Cash | — | — |
| Set-off against the loan note issued by the Company | — | 60,000 |
| | — | 60,000 |

## 31. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (cont'd)

### (b) Disposal of subsidiaries (cont'd)

An analysis of the net outflow of cash and cash equivalents in respect of the disposal of subsidiaries is as follows:

| | 2003<br>HK$'000 | 2002<br>HK$'000 |
|---|---|---|
| Cash consideration | — | — |
| Cash and cash equivalents disposed of | — | (20,860) |
| Net outflow of cash and cash equivalents in respect of the disposal of subsidiaries | — | (20,860) |

The subsidiaries disposed of in the prior year contributed HK$27,262,000 to turnover and HK$582,000 to the consolidated loss after tax for the year ended 31 December 2002.

## 32. CONTINGENT LIABILITIES

At the balance sheet date, neither the Group nor the Company had any significant contingent liabilities.

## 33. OPERATING LEASE ARRANGEMENT

The Group leases part of its buildings (note 16 to the financial statements) under an operating lease arrangement, with the lease negotiated for a term of eight months.

At the balance sheet date, the Group has total future minimum lease receivables under the non-cancellable operating lease with its tenants falling due as follows:

| | Group | |
|---|---|---|
| | 2003<br>HK$'000 | 2002<br>HK$'000 |
| Within one year | 284 | — |

## 34. COMMITMENTS

In addition to the operating lease arrangement detailed in note 33 above, the Group and the Company had the following commitments at the balance sheet date:

| | Group | | Company | |
|---|---|---|---|---|
| | 2003 HK$'000 | 2002 HK$'000 | 2003 HK$'000 | 2002 HK$'000 |
| Contracted, but not provided for: | | | | |
| Acquisition of fixed assets | 17,441 | 47,575 | — | — |
| Authorised, but not contracted for: | | | | |
| Acquisition of fixed assets | 140 | 185,209 | — | — |
| Contracted, but not provided for, capital contribution payable to a wholly-owned subsidiary in the PRC | — | — | 31,606 | — |
| | 17,581 | 232,784 | 31,606 | — |

## 35. POST BALANCE SHEET EVENTS

(i) On 5 March 2004, the Company, Haier and Haier Investment entered into a conditional agreement (the "Asset Injection Agreement") pursuant to which the Company agreed to acquire from Haier and Haier Investment the entire share capital of Haier Holdings (BVI) Limited ("Haier BVI"), a wholly-owned subsidiary of Haier, and Qingdao Haier Investment and Development Holdings (BVI) Limited ("QD Haier BVI"), a wholly-owned subsidiary of Haier Investment, respectively, for an aggregate consideration of approximately RMB1,100 million (equivalent to approximately HK$1,035 million), subject to adjustments (the "Asset Injection").

The total consideration will be satisfied by the followings:

(a) as to HK$724,807,200 by the issue of 4,026,706,667 new shares of the Company at a price of HK$0.18 each;

(b) as to HK$260,000,000 by the issue of convertible notes of the Company. The convertible notes are convertible into the shares of the Company at the convertible price of HK$0.18 per share (subject to adjustment) at any time during the convertible period; and

(c) as to the balance of HK$50,000,000 in cash.

Haier BVI and QD Haier BVI and their subsidiaries are principally engaged in the manufacture and sale of washing machines. The Asset Injection is expected to be completed in June 2004.

## 35. POST BALANCE SHEET EVENTS (cont'd)

(ii) According to the Asset Injection Agreement, the Company also indicated its intention to exercise a call option, namely the PRC JV Option, to acquire the remaining 35.5% interest in Pegasus Qingdao owned by Haier Investment for a consideration of HK$468.6 million in accordance with the Acceleration Agreement dated 8 August 2002 (the "Call Option Exercise").

The Company intends to exercise the PRC JV Option in such a way that its completion takes place at the same time as the completion of the Asset Injection. If the independent shareholders of the Company do not approve the Asset Injection, or should completion of the Asset Injection not take place, the Company will not then exercise the PRC JV Option at that time. The PRC JV Option will remain exercisable on or before 31 July 2004 and the Company may or may not exercise the PRC JV Option.

As the above transactions are to be completed after the date on which these financial statements were approved by the directors of the Company, the financial impact of these transactions cannot be reliably estimated at the date of approval of these financial statements.

## 36. COMPARATIVE AMOUNTS

As further explained in note 2 to the financial statements, due to the adoption of the revised SSAP 12 during the current year, the accounting treatment and presentation of certain items and balances in the financial statements have been revised to comply with the new requirements. Accordingly, certain prior year adjustments have been made and certain comparative amounts have been restated to conform with the current year's presentation.

## 37. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 23 April 2004.