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The Art of Retailing

❸ Synergistic chain store network leads to new growth opportunities

Based on our "Boundless Commerce, Harmonic Mutuality" business philosophy, we will expand beyond our home markets and branch into new regions. The expansion will allow better efficiency in utilizing our network resources, and ultimately benefit consumers to a greater extend

❹ Collective efforts to strive for perfection

The key to GOME's success lies in our keen attention to detail. We carefully source only the highest quality products and offer them at attractive prices without compromising our service quality. Our continuous pursuit of excellence in serving our customers allows us to offer more variety of products at competitive prices.

Management
Discussion and Analysis

Group Review

Year 2004 was an exciting year for the Group. During the nine-month period ended 31 December 2004, the Group went through a corporate transformation following the acquisition of all the issued shares of Ocean Town for a total consideration of HK$8.3 billion. Ocean Town was incorporated in the British Virgin Islands on 28 December 2001 with limited liability and has not carried out any business since the date of incorporation other than holding a 65% equity interest in Gome Appliance, a company registered in the PRC. Gome Appliance is engaged in the retailing of electrical appliances and consumer electronics in the PRC under the trading name of "GOME". Accordingly, the name of the Company was changed to GOME Electrical Appliances Holding Limited in August 2004 to reflect the transformation and the new focus of the Group.

As a result of the acquisition, the Group has successfully transformed itself into the largest retail chain operator of electrical appliances and consumer electronics in the PRC with a total of 144 outlets at the end of 2004. Traditionally, an outlet typically ranges from 3,000 to 6,000 square meters in size and is located in retail districts with good public transportation access. These stores offer a wide variety of products, ranging from traditional white goods to small electrical appliances and accessories. In mid-2004, the Group started to explore a smaller outlet format, which at the time was labeled 'digital store'. These digital stores aim to sell high end consumer electronics in locations with very busy traffic. However, the Group encountered two major challenges with this experiment. First, the Group found that consumers typically prefer larger retail shops with products across different categories. Second, the available variety of high end consumer electronics in the PRC was not rich enough at that time. Therefore, the Group has scaled down this digital store plan. Instead, the Group will be more flexible and adept in size consideration when it looks to open a store in a specific location.

At the end of 2004, these 144 stores spanned across 25 cities in the PRC. Additionally, there were 74 outlets at the end of 2004 which were not under the Group's umbrella but were operating in locations not in competition with the Group.

The management of the Group believes that there is enormous growth potential in the retail market of electrical appliances in the PRC. According to the State Information Center of the PRC, this industry has grown at a compound average growth rate or CAGR of 11.4% between 1992 and 2002. Furthermore, it has forecasted that the industry would continue to grow at a CAGR of 12.5%, reaching a market size of RMB778 billion in 2008. Similarly, the management believes in the rapid growth trend of the market but we are even more optimistic as to the size of the market.

The securities and futures brokerage operation in the Group is immaterial in terms of both revenue and net profit contribution. Additionally, the Group also holds a piece of raw land in Beijing. These assets are considered non-core and the management will not commit any further capital to them. Therefore, the management is actively looking for suitable opportunities to dispose of these assets.

To enhance operating coordination and financial reporting within the Group, the financial year end date was changed from 31 March to 31 December, with effect in 2004. Accordingly, the results of this financial year only cover a period of nine months from 1 April to 31 December 2004 ("Period A") and are not directly comparable with the results of the previous period from 1 April 2003 to 31 March 2004 ("Period B"). Given that these two periods are not directly comparable and such a format provides little information to our shareholders about the year to year change in the Group's financial performance, the management of the Group believes that it would serve the financial market and our shareholders better by adjusting and disclosing comparable financial information for the full years of 2003 and 2004 in a separate section entitled "Supplementary Information to Shareholders" on pages 87-90.

The supplementary information has been reviewed by our auditor, Ernst & Young, who provided a review of such information in accordance with Statement of Auditing Standards 700 issued by the Hong Kong Institute of Certified Public Accountants. Such a review consists principally of making enquiries of management and applying analytical procedures to financial information under review and based thereon, assessing whether the accounting policies and presentation have been consistently applied.

In Period A, turnover of the Group was HK$9.2 billion, compared to HK$9.7 billion in Period B. The turnover mainly consisted of sales generated from retail business with less than 1% from securities and futures brokerage. During Period A, the Group continued to expand its retail network and was therefore able to further grow its sales. It is the Group's firm intention to focus its management and financial resources on the retail sector. The Group's strategic objective is to consolidate its market leadership position and further develop its retail network throughout the country into an undisputed market leader by capitalizing on the following competitive strengths:

- Eighteen years of history, which are longer than any of our domestic competitors and the resultant wealth of retail experience in the PRC market
- Superior shopping experience offered to customers in terms of competitive prices, convenient locations and good customer services
- Expanding national network of outlets, which offer true economies of scale
- Long-established relationship with major suppliers, domestic and foreign
- The GOME brand, which is nationally recognized

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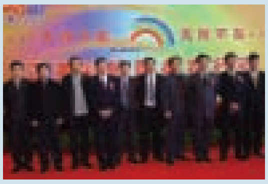

Gross Profit in Period A amounted to HK$899 million. In Period B, it amounted to HK$781 million. Operating Profit and Net Profit amounted to HK$569 million and HK$353 million respectively in Period A while those for Period B are HK$440 million and HK$244 million respectively. Earnings per Share or EPS are 22 HK cents and 16 HK cents in Period A and Period B respectively.

The Board of Directors of the Group has decided to declare a dividend of 2.5 HK cents per share.

Business Review

Business Environment

With the continuous development of the PRC economy, the retail sector of electrical appliances and consumer electronics has witnessed rapid advances. Accordingly to statistics from the State Information Centre of the PRC, the market size of the electrical appliances retail industry grew by a CAGR of 11.4% between 1992 and 2002 and is expected to further grow at 12.5% from 2004 to 2008. In the management's opinion, growth is driven by multiple factors including the following:

- Income growth in both urban and rural areas which leads to enhanced purchasing power. Even though coming off from a low base, income growth in the rural areas will be a formidable force driving sales of household appliances, especially in the white goods arena. According to research, both rural and urban income growth were clocked at 11.4% in the first three quarters of 2004

- Urbanization which leads to increasing penetration of household appliances. According to research, the urbanization rate in the PRC was 41% in 2003. Both the PRC government and the Asian Development Bank forecast the rate to hit 50% in 2010. The forecast increase in urbanization would create 40 million new urban household

- Rapid residential property development which leads to larger living space. According to research, an average household occupied 75 square meters in 2003 or about 25 square meters per capita. Further residential property development should boost this statistic

- Replacement and upgrading demand, especially in the household appliance category, which is coming into play and creating a sustainable demand cycle in the industry

- Increasing demand for high-end, sophisticated, and trendy gadgets among the growing ranks of middle class consumers which leads to bigger purchases

As the retail market of electrical appliances and consumer electronics grows rapidly in the PRC, traditional retail outlets such as small shops, department store counters are losing market share to special retail chains. According to statistics released in February 2005 by the Ministry of Commerce of the People's Republic of China, retail chain enterprises have firmly established themselves as cornerstone players in the PRC retail sector. The top 30 retailers now account for 7.1% of the retail market share in China. Management of the Group believes that the percentage accounted for by specialist chains in the retail market of household appliances and electronics is significantly higher. These specialist chains are rapidly gaining popularity among consumers as they increasingly look for better prices, better variety, better shopping experience, and better after-sale services.

As the largest retail chain operator of electrical appliances and consumer electronic products in the PRC, the Group is well positioned to capitalize on the economic growth in the PRC market and the positive transformational changes seen in its industry.

Retail Network Coverage

During Period A, the Group went through a rapid expansion plan which had contributed significantly to the satisfactory results the Group was able to achieve.

At the end of 2004, the Group operated a total of 144 outlets spanning across 25 cities in the PRC. During Period A the Group opened 58 new outlets and expanded into 5 new cities. The following illustrates the locations of our outlets at the end of 2004:

Location	Number of Outlets
Beijing	24
Tianjin	15
Chongqing	14
Chengdu	13
Guangzhou	10
Shenzhen	9
Shenyang	9
Wuhan	7
Xi'an	7
Fuzhou	6
Qingdao	5
Jinan	5
Others	20
Total:	144

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In addition, there were another 74 outlets operated under the GOME name at the end of December 2004, owned and operated by companies ultimately owned by the substantial shareholder of the Group, Mr. Wong Kwong Yu. Furthermore, there were another 9 franchise stores at the end of 2004 operating under the GOME name, which are also owned by Mr. Wong Kwong Yu. These stores did not belong to the Group and were operating in locations separated from the Group's outlets and not in competition with the Group. Pursuant to the agreement entered into between the Group and Mr. Wong, each party has the exclusive right to operate in their existing locations respectively and the Group has the right of first refusal in entering into a new market where neither party has existing operation.

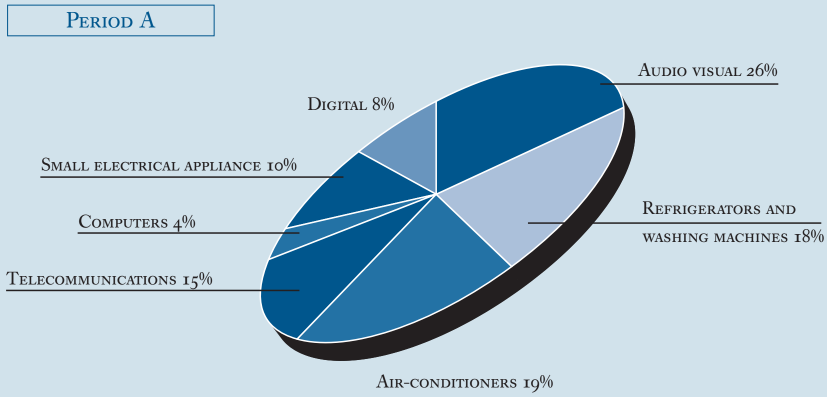
The rapid expansion of the retail network has offered the Group stronger negotiation power. The Group was able to leverage its increasing purchasing platform and scale in securing favorable terms in volume rebate, as well as other concessions from suppliers.

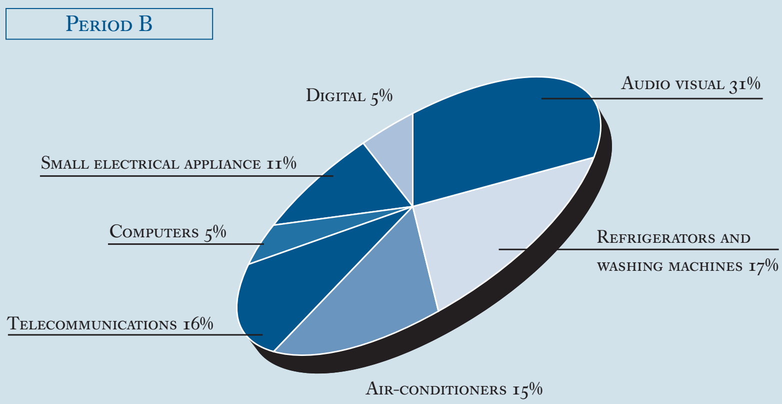
Even though the Group's network expansion pace was rapid in Period A, the Group was able to adhere to its high level of service standards. When the Group enters a new market, it strictly follows a pre-determined set of procedures, rules and standards with certain specific localized attributes in designing outlet layout and setting operating processes. As a result, the Group was able to achieve an increasingly diversified revenue base and to further develop its network into a true national one. For example, revenues generated from the Group's Beijing operation only contributed to about 20% of the total.

Total usable area was approximately 410,000 square meters at the end of 2004, representing an increase of about 107,000 square meters in Period A.

Product Sales

Traditional white goods (including refrigerators, washing machines and air-conditioners) accounted for 37% of total sales in Period A, representing an increase of 5% from Period B. Still very much a developing country, the PRC should continue to see sustainable demand for white goods in the future. Audio and visual products accounted for 26%, representing a decline of 5% from Period B. Digital products accounted for a larger proportion of the revenue in Period A at 8%, compared to only 5% in Period B as these products became more affordable to the rising ranks of eager customers. In summary, sales by product category were more balanced in Period A, compared to Period B.





The Group enjoys a competitive advantage over its competitors by selling a large number of exclusive models in its outlets. Exclusive arrangements include new models made available to GOME stores first, models made to specifications designated by GOME, and a number of other situations. Sales accounted by such exclusive arrangements contributed to about 20% of total revenue in Period A and they typically command a higher gross margin than that on a comparable but non-exclusive model. The availability of exclusive models at the Group's outlets spans across different product categories and it contributes to the level of gross margin the Group has been able to achieve.

In Period A, foreign brands and local brands each accounted for about half of the total revenue in dollar terms while local brands dominated slightly foreign ones in terms of units sold. Such balance reflects a healthy mix of products and brands, in the management's opinion. It also reflects balanced preference by consumers and the ability of the Group to work effectively with both foreign and domestic brands and to distribute their products through its retail channels.

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Internet sales accounted for less than 1% of revenue in Period A. Such sales mainly involve traditional white goods and small appliances with highly standardized features and low value. Despite the fact that Internet transactions currently account for a very small percentage of the Group's total sales, the Group's management is scrutinizing the development of e-commerce in the PRC closely and is keen to capitalize on its upward trend in the future.

Procurement

As mentioned throughout the section, the Group's retail network expanded significantly during the period. The management believes that an expanding national network and presence is critical in extracting economies of scale in the operating model and in negotiating with suppliers. Currently, both the Group and the stores not owned by the Group but operated under the GOME name undertake procurement on a joint basis in order to reap better volume rebate and favorable terms from suppliers. Under the current procurement platform, 80% of the Group's purchase is transacted directly with suppliers.

Given this centralized procurement arrangement and the fact that the Group's management also looks after GOME stores outside the Group's structure, the Group derives a percentage of those stores' sales as management fee and purchasing service fee. Please see a later section for further details.

The Group actively seeks to further foster long-term strategic relationship with major suppliers. Management of the Group believes that only by working with our strategic suppliers on a mutually satisfactory and long term basis can the Group continue to prosper in the future.

Competition

In some cities or regions, the Group faces competition from local or regional players and is even trailing behind competition in market share. In these cities, the Group typically does not yet have a well-established network or is weak in a number of areas, such as relationship with suppliers, product varieties, promotional initiative, selection of store locations, etc. These disadvantages have therefore led to difficulty in growing the business scale and improving traffic flow at stores. The Group fully recognizes such problems and is actively addressing these issues. Action steps being implemented include the following:

- Implement Proactive management training, especially in the ranks of middle and store managers

- Establish a Strategic Alliance Unit within the Sales and Purchasing Department to better co-ordinate with key strategic suppliers

- Simplify procurement procedure with regard to telecommunication and digital products to enhance working relationship with suppliers
- Enhance the availability of accessories, small appliances, and IT products across different brands, product categories and models
- Improve marketing strategy at a number of outlets to improve traffic and sales
- Increase the proportion of sales from exclusive models
- Increase effective utilization of store display space
- Improve customer services, especially in air-conditioner sales
- Host key conferences to further promote the GOME brand and recognition
- Internal Compliance Department to put in place stringent measures to weed out irregularities

Financial Review

Profit Margins

In Period A, turnover of the Group was HK$9.2 billion. In Period B, turnover was HK$9.7 billion. The Group was able to achieve Gross Profit Margin of 9.8% in Period A, compared to 8.1% in Period B. The rise in Gross Profit Margin would be attributed to a rising proportion of sales accounted for by exclusive models, more direct purchases from suppliers, and better terms from suppliers as the Group's purchasing scale grew.

Operating Profit Margin increased to 6.2% from 4.6% due to a number of factors. First, Gross Profit Margin increased to 9.8% from 8.1%. Second, Operating Profit Margin was further boosted by higher other operating incomes, even though operating expenses as a percentage of revenue increased to 7.6% in Period A from 7.0% in Period B. Net Profit Margin during Period A increased to 3.9% from 2.5% in Period B.

The following table shows the margin comparison:

	Period A	**Period B**
Gross Profit Margin	9.8%	8.1%
Operating Profit Margin	6.2%	4.6%
Net Profit (before MI) Margin	6.0%	3.8%
Net Profit (after MI) Margin	3.9%	2.5%

Other Operating Income

In addition to volume rebate and margin guarantee, the Group has been able to secure other operating income from suppliers, including store opening concessions, shelf fees, sharing of joint promotional expenses, etc.

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The following table illustrates a summary of other operating income:

	Period A	Period B
	HK$m	*HK$m*
From suppliers		
Promotion income	137	169
Management fee income	38	44
Display space leasing fees	38	27
Product listing fees	21	21
Subtotal	234	261
Management fees for air-conditioner installation	28	30
Royalty income from franchise stores	1	5
Management fee from the Parent Group	57	16
Others	44	21
Total operating income	**364**	**333**

Operating Expenses

As a retail business, the Group's profitability is driven by volume and margins. Therefore, it is critical for the Group to constantly look for ways to enhance its profit margins and implement effective cost controls. In Period A, the total operating expenses as a percentage of revenue was 7.6%, compared to 7.0% in Period B.

The breakdown of operating expenses during these two periods is as follows:

	Period A	Period B
	HK$m	*HK$m*
Selling and distribution expenses	514	508
Administrative expenses	123	124
Others	58	42
Total operating expenses	**695**	**674**

In Period A, the Group experienced pressure on rental expenses as a result of increased demand for good retail locations. Therefore, rental expenses as a percentage of sales in the period increased to 1.7% from 1.5% in Period B. At the same time, the Group devoted more resources to staff training, development and retention. As a result, staff expenses as a percentage of sales increased from 1.8% in Period B to 1.9% in Period A. The Group is of the view that recruiting and retaining a high quality workforce is becoming increasing critical as it continues to grow its retail outlets.

The impact of the increase in operating expenses was partially offset by improvement in the other operating incomes. As a result, Operating Profit Margin improved to 6.2% in Period A from 4.6% in Period B. The Group's Net Profit Margin also increased to 3.9% in Period A from 2.5% in Period B.

Outlook and prospect

2005 Expansion Plan

Since the acquisition of Ocean Town, the Group has expressed a firm intention to focus its management and financial resources on the development of the electrical appliances and consumer electronics retail business. With the retail market demonstrating enormous growth potential as the PRC economy continues to grow, the management is optimistic about the industry prospects and its own growth potential.

Management of the Group believes that 2005 is a pivotal year as it is the first of a very aggressive four-year expansion initiative that the Group is embarking on. The strategic objective of the expansion plan is to increase its market share and further consolidate the Group's market leadership position. Therefore, the Group plans to further extend its existing retail network by opening approximately 130 new outlets across the country, thus seeking to double its number of outlets by the end of 2005. Under this expansion plan, there may be pressure on the Group's profit margins overall. However, the Group is confident that negative impact on profit margins will be mitigated to a certain extent by implementing cost control, maintaining same store sales growth, and enhancing strategic relationship with key suppliers.

The Group plans to open these new outlets in major cities such as Beijing, Tianjin, Shenzhen, etc. under an initiative to further consolidate the strength of its network in these existing cities and to take way market share from competition. At the same time, the Group will also enter cities with population concentration and supportive GDP per capita to further extend the Group's national network, bringing the services of GOME to a broader population in the country. Typically, the Group would target cities with population of 500,000 and above. The Group believes that there are genuine economies of scale in the business and therefore consider growth of market share as a key strategic initiative in the next four years.

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The Group believes that with 18 years of experience in the industry, a scalable business model and a widely recognized GOME brand name, the 2005 expansion plan will further develop the Group into an even stronger competitor and consolidate its market leadership position. To ensure the satisfactory implementation of the plan, the Group believes that management resources and employee training and empowerment are critical. Therefore, the Group is undertaking the following initiatives:

- Implementing a 3-tiered management structure – to cope with the rapid expansion of the Group, a new management structure was put in place, dividing the retail operation into 7 regional offices which oversee local branches. The head office in Beijing is responsible for formulating strategic objectives and plans, making major investment decisions, negotiating procurement contracts with suppliers, and implementing internal control and compliance. Regional offices focus on deploying group strategies on regional level and finally branch office management on executing in each locality. The Group's management believes that such a structure would lead to better utilization of resources, enhanced local customization, and quicker response time.

- Empowering sales staff – sales resources at the front line drive our business success. The Group seeks to work with suppliers in ensuring that sales representatives from suppliers are properly managed and trained in both sales skills and technical product knowledge.

- Training store managers – under the four year expansion plan, demand for good store managers will be significant. To address this issue, GOME Management Institute was founded in Beijing in early 2005 as a training ground. At GOME Management Institute, management theories and skills, joint courses with colleges and universities, and executive programs constitute major elements of the curriculum.

- Mentorship – Experienced managers are paired up with junior staff in a mentorship program with the clear objective of training future senior leadership.

- Recruiting middle and senior management – the Group has launched a university campus recruitment and a comprehensive management trainee program. Regular spring and autumn recruitments are in place. Additionally, the Group also actively seeks to recruit talents from the industry.

- Aligning incentives with performance – by clearly crystallizing performance targets and monitoring progress, the Group seeks to align our employees' interest with the Group's strategic initiatives by awarding them for the achievement of pre-set performance benchmarks.

Another key factor in determining whether the Group will be able to make satisfactory progress in achieving objectives set out under the expansion plan is securing suitable store locations. To ensure an efficient and satisfactory selection process, the Group has put together a standard comprehensive store selection manual and all new store locations must meet a set of guidelines. Additionally, once a location is selected, standardized store opening procedures are in place.

These action steps are in addition to those being employed to address the competition in a previous section entitled ‘Competition’ under Business Review.

ERP System Improvement

The Group plans to undertake a number of improvement initiatives to its ERP system. The Group currently estimates that the project is likely to cost about RMB15 million in both hardware and software investments. The initiatives being implemented include:

- Inventory monitoring mechanism to better identify slow moving inventory and to necessitate corrective actions
- Linkage to suppliers’ IT infrastructure so that suppliers can monitor movement of their own brands at the Group’s stores
- Improvement to the existing online infrastructure so as to create a better online shopping experience

Market Share Penetration

The key premise of the Group’s expansion plan is to increase market share penetration in the immediate future. Management of the Group believes that the Group’s market share in existing cities ranges from 20% to 60%. Nationally, management believes that the Group’s market share is still very small, given that the industry is still very fragmented and a majority of the cities across the PRC are still not served by specialist retail chains like Group’s. In order to derive maximum value offered by economies of scales and to leverage the strength of a large presence at both local level and national level, management of the Group is of the view that it is critical to enhance its market share in both cities or regions in which it already operates and on a national level. Therefore the 2005 expansion strategy is a two-pronged approach.

Product Differentiation

The Group will also seek to increase the proportion of sales by exclusive models. Through this exclusive model arrangement with suppliers, the Group is able to improve its profitability due to exclusive models’ higher gross margins. Additionally, the availability of exclusive models with highly desirable features across product categories is also a key differentiating factor offered by the Group and it serves to improve customers’ shopping experience. It also serves to enhance customer loyalty to the GOME brand name.

In addition to having a higher proportion of sales by exclusive models, it is equally important to offer the right mix of products to consumers. At the same time, it is essential that the Group promotes products with higher margins such as small electrical appliances and accessories. Therefore, the Group seeks to actively address this issue to the satisfaction of our customers.

Future Acquisition Plan

Following the lifting of foreign ownership restriction of retail assets in the PRC as part of the country’s WTO commitments on 11 December 2004, the market is likely to see further competition, especially when foreign competitors enter this market. Therefore it is essential the Group further builds up its market share and financial strength. Therefore, the Group would consider buying the remaining 35% stake in GOME Appliance if the stake became available. The Group has been granted the right of first refusal with regard to the purchase of this 35% stake.

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Liquidity and Financial Resources

At the end of 2004, the Group had cash and cash equivalents of HK$1.6 billion, which was HK$1.2 billion more than as of 31 March 2004. Additionally, the Group had HK$850 million in pledged deposits at the end of 2004 (HK$762 million as of 31 March 2004). Except for trade payables and bills payable, which amounted to HK$3,012 million at the end of 2004, the Group did not have any bank borrowings. Trade payables and bills payable amounted to HK$2,385 million as of 31 March 2004. Inventories also increased from HK$784 million as of 31 March 2004 to HK$1,046 million at the end of 2004.

Cash flow from operating activities amounted to HK$648 million in Period A. During Period B, such cash flow amounted to HK$1,384 million. Capital expenditure amounted to HK$51 million and HK$79 million respectively in the two periods under review. Such capital expenditure was mainly used for new outlet openings and IT systems development and improvement.

Very Substantial Acquisition and Connected Transactions

In July 2004, the Group acquired the entire equity interest of Ocean Town, a company incorporated in the British Virgin Islands which holds 65% of the shareholding of GOME Appliance, a Sino-foreign equity joint venture established under the laws of the PRC, which in turn held the entire interest of 96 electrical appliances retail outlets in 22 cities in the PRC at that time. The consideration for the acquisition was RMB8.8 billion or approximately HK$8.3 billion. The consideration was satisfied as follows:

1. as to HK$243.5 million by the allotment and issue of approximately 44.1 million new shares after the capital reorganization consolidating 40 shares into 1 new share;

2. as to approximately HK$7,031.4 million by the issue of First Convertible Notes; and

3. as to approximately HK$1,026.9 million by the issue of the Second Convertible Notes.

The electrical appliances retail network under the brand name "GOME" operated a total of 135 outlets in 37 cities in the PRC as at the acquisition date. However, only 96 outlets in 22 cities (the "Target Group") were identified by the management of the Group for acquisition while the remaining 39 outlets in 15 cities (the "Parent Group") remained as they were for the following reasons:

1. the Target Group has a more established track record and hence a stable base for future development; and

2. as compared with the Target Group, the business in the remaining cities is less developed and hence entails higher business risks.

The Target Group and the Parent Group operated in different locations and thus no direct competition will be imposed. To maximize the competitive advantages in the network operations, the Target Group and the Parent Group are under the same senior management team and have entered into agreements for the following connected transactions:

1. **Transitional Purchasing Service Agreement**

Prior to the acquisition, the Parent Group had entered into purchasing contracts with various suppliers and purchased electrical appliances for both retail outlets under the Parent Group and the Target Group. As a transitional arrangement, the Parent Group and the Target Group had previously entered into an agreement pursuant to which the Parent Group would continue to purchase from those suppliers for the Target Group. Such transitional arrangement expired on 30 September 2004. During the nine-month period ended 31 December 2004 following the acquisition to 30 September 2004, total purchase by the Target Group from the Parent Group amounted to HK$983 million.

2. **Purchasing Service Agreement**

The Target Group and the Parent Group have entered into an agreement pursuant to which the Target Group will provide purchasing services to the Parent Group for a service fee at a rate of 0.9% of the revenue generated from the sales of electrical appliances and consumer electronic products of the Parent Group for a term of 36 months commencing upon completion of the acquisition. During the nine-month period ended 31 December 2004, service fee income from the Parent Group amounted to HK$30 million.

3. **Management Agreement**

The Target Group and the Parent Group have entered into an agreement pursuant to which the Target Group will provide management services for the Parent Group for an annual management fee at a rate of 0.75% of the total revenue generated from sales of electrical appliances and consumer electronic products of the Parent Group if such revenue is equal or less than RMB5 billion (approximately HK$4.7 billion) or at a rate of 0.6% if such revenue exceeds RMB5 billion. During the nine-month period ended to 31 December 2004, management income from the Parent Group amounted to HK$27 million.

As at the acquisition date, an amount of RMB1,088.5 million (approximately HK$1,026.9 million) was owed by the Parent Group to the Target Group. The amount was subsequently repaid in full in October 2004.

Charges on Capital Assets

As at 31 December 2004, the Group had pledged deposits amounting to HK$850 million to secure the general banking facilities granted to the Group.

Contingent Liabilities and Capital Commitment

There were no material contingent liabilities and capital commitments as at 31 December 2004.

Foreign currencies and treasury policy

The Group has little exposure to foreign fluctuations as most of the Group's business transactions, assets and liabilities are principally denominated in either RMB, or Hong Kong dollar. It's the Group's treasury policy to manage its foreign currency exposure, if any, only when its potential financial impact is material to the Group. The Group will continue to monitor its foreign exchange position and, if necessary, will hedge its foreign currency exposure by forward foreign exchange contracts.

Human Resources

As at 31 December 2004, the total numbers of employees of the Group were 9,245, including 9,219 in the PRC and 26 in Hong Kong. The Group values its human resources and recognizes the important of attracting and retaining qualified staff for its continuing success. Remuneration packages are generally structured by reference to market terms and individual qualifications.