

Financial Review

BUSINESS REVIEW

Washing Machine Business

The Group continues to be the leader in the washing machine market in the PRC. Sales of washing machines amounted to HK\$3,312 million in fiscal 2005, up by approximately 20% from the year 2004. In view of the growth in sales, a new factory with an annual production capacity of approximately 1 million units of washing machines has been established in Jiaonan, Shandong Province, the PRC in the fourth quarter of 2005 with a focus on manufacturing products for exports. The new factory has boosted our total annual production capacity to more than 6 million units. To cater for further increase in demand, the Group is planning to set up another production base in Chongqing, the PRC which will add a further annual production capacity of 1 million units of washing machines in the second half of 2006.

Operating profit of the washing machine business amounted to HK\$95 million in fiscal 2005, representing a decrease of 25% as compared to HK\$128 million in 2004. The decline was mainly due to substantial expenditure incurred in developing new products in the first half of 2005. The new products were launched in the second half of the year, and have since been providing substantial contribution to operating profit. Operating profit in the second half of 2005 amounted to HK\$73 million, up substantially from HK\$22 million in the first half of the year, and up by about 1.3% from the corresponding period in 2004 notwithstanding the rise in the cost of certain raw materials such as plastic and steel plates.

The Board is optimistic on the performance of the washing machine business in 2006. Our new models are expected to continue to provide substantial contribution in 2006. The Group is also focusing on higher end products with higher profit margins, such as dual drive washing machines, which already resulted in a substantial increase in operating profit in the second half of the year. We are also seeing signs that the cost of certain raw materials, such as steel plates, are stabilizing or dropping.

We see ourselves as a pioneer in the industry with a strong research and development capability. Our new models of environmentally friendly dual drive washing machines, which do not require the use of washing powder and use far less water and electricity than industry standards, have obtained more than 70 patents and was awarded the National Technology Advance Second-class Award by State Council of the PRC. The products are also well-received in overseas markets and won a gold medal in the 95th Concours Lépine International France and have been recommended by international organizations as a reference for new international standards. As our consumers are becoming increasingly environmentally conscious, we are committed to developing innovative and environmentally friendly products to satisfy their needs. We are confident in our ability to remain as a leader in the industry and a pioneer in technology innovation.



Mobile Handset Business

For the year ended 31 December 2005, turnover of the mobile handset business amounted to HK\$1,629 million, representing a decrease of 48% from the year 2004. Competition remained intensive due to over capacity in the industry, price cutting strategy adopted by foreign branded manufacturers and the flood of illegal handsets into the PRC market which forced a majority of the domestic branded manufacturers to clear their inventories by cutting prices. These had adversely impacted the Group, and lead to a drop in volume and increase in provisions for doubtful debts and inventories. These resulted in an operating loss of HK\$139 million in 2005, as compared to an operating profit of HK\$47 million in the year 2004.

In view of the intense competition in the mobile handset market in the PRC, during the year, the Board had conducted a review and decided to write off the entire amount of goodwill attributable to the Group's acquired interest in the mobile handset business, which resulted in an impairment loss of HK\$322 million in 2005. The impairment loss had already been included in the Group's interim results for the six months ended 30 June 2005 announced on 23 September 2005.

LIQUIDITY AND FINANCIAL RESOURCES

The Group has maintained a healthy financial and liquidity position with a current ratio of 116% at 31 December 2005 (2004: 119%). As at 31 December 2005, the Group had a cash balance of HK\$560 million (2004: HK\$243 million), total bank and other loans of approximately HK\$125 million (2004: HK\$147 million) and zero-coupon 3-year convertible notes ("Convertible Notes") with a face value of HK\$233 million and a liability element of HK\$212 million (2004: Nil). The Convertible Notes were issued to the Haier Group as part consideration for the Asset Injection, and are convertible into ordinary shares of the Company at HK\$0.18 per share. During the year, 150,000,000 new shares were issued upon part conversion of the Convertible Notes. All the other borrowings of the Group were arranged on a short-term basis for working capital purposes, and were denominated in Renminbi, repayable within one year and bore interest at floating rates.

Due to our focus on cash flow management, the Group has been able to generate a net cash inflow from operating activities of HK\$350 million in 2005 despite a substantial loss being reported. The Group also has a very healthy cash position with a net cash balance (cash balance less borrowings) of HK\$224 million as at 31 December 2005.

There is no material effect of seasonality on the Group's borrowing requirements.

The Group had contracted capital commitments amounting to HK\$3 million as at 31 December 2005, which were mainly related to purchase of machinery for the expansion in production capacity of the Group's washing machines business.



Financial Review (cont'd)

CAPITAL STRUCTURE AND GEARING RATIO

As at 31 December 2005, the Group maintained a comfortable gearing ratio (total borrowings over shareholders' equity) of 53% (2004: 29%), or 20% if the Convertible Notes are excluded.

TREASURY POLICIES

The Group employs a conservative approach to cash management and risk controls. Most of the Group's receipts and payments are in Renminbi and Hong Kong dollars. Cash is generally placed in short term deposits denominated either in Renminbi or Hong Kong dollars. As at 31 December 2005, apart from the Convertible Notes which are denominated in Hong Kong dollars, most of the Group's outstanding borrowings were denominated in Renminbi and were principally made on a floating rate basis. Foreign currency risk is not significant as liabilities in Renminbi will be matched by the Group's earnings, most of which are also denominated in Renminbi. The Group does not have any significant interest rate risk, as the current interest rate in the PRC stays at low level and is relatively stable. The Group does not have any financial instruments for hedging purposes.

EMPLOYEES AND REMUNERATION POLICY

The total number of employees of the Group as at 31 December 2005 was approximately 5,600, representing an increase of approximately 25% as compared to 31 December 2004.

The Group ensures that the remuneration packages for its employees are competitive and employees are generally remunerated with a fixed monthly income, which is normally reviewed on an annual basis, plus discretionary performance related bonuses. Employees are also provided with benefits including provident fund and medical insurance. The Group maintains a share option scheme as an incentive to attract and retain talented employees. As at 31 December 2005, there were outstanding share options entitling the grantees to subscribe for approximately 607.5 million new shares of the Company.

MATERIAL ACQUISITION AND DISPOSAL OF SUBSIDIARIES AND ASSOCIATES

Please refer to note 2.1 to the consolidated financial statements below for details of material acquisition of subsidiaries during the year.



CHARGE OF ASSETS

As 31 December 2005, bank deposits of approximately HK\$70,000 were pledged to secure general banking facilities granted to a subsidiary of the Group.

