Notes to Financial Statements

(year ended 31 December 2005)

1. CORPORATE INFORMATION

Haier Electronics Group Co., Ltd. is a limited liability company incorporated in Bermuda. The registered office of the Company 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 and washing machines.

2.1 GROUP REORGANISATION

On 28 January 2005, the Company acquired from Haier Group Corporation ("Haier Corp") and Qingdao Haier Investment and Development Co., Ltd. ("Haier Investment") (collectively "Haier Group") their entire 100% interest in Haier Holdings (BVI) Limited and Qingdao Haier Investment and Development Holdings (BVI) Limited (collectively "Haier BVI"), for an aggregate consideration of RMB1,100 million (equivalent to approximately HK$1,035 million) (the "Asset Injection"). The total consideration was satisfied as to HK$725 million by the issuance of 4,027 million ordinary shares of the Company at HK$0.18 each, HK$260 million by the issuance of convertible notes of the Company and HK$50 million in cash.

On the same date, the Company exercised its call option to acquire from Haier Investment its entire 35.5% interest in Pegasus Telecom (Qingdao) Co., Ltd. ("Pegasus Qingdao") for a consideration of HK$468.6 million (the "Call Option Exercise"). The consideration was satisfied by the issuance of 2,343 million ordinary shares of the Company at HK$0.20 each.

Upon completion of the Asset Injection and Call Option Exercise, Haier Group's interest in the Company collectively increased to 50.2% (2004: 29.9%) and Haier Group became the controlling shareholder of the Company.

2.2 REVERSE ACQUISITION

Under Hong Kong Financial Reporting Standard ("HKFRS") 3 "Business Combinations", the Asset Injection and Call Option Exercise have been accounted for as a reverse acquisition since the issuance of the consideration shares resulted in Haier Group becoming the controlling shareholder of the Company. For accounting purpose, Haier Group's interest in Haier BVI and Pegasus Qingdao (collectively "Haier Businesses") is treated as the acquirer while the Company and its relevant interest in the then subsidiaries (collectively the "Former Group") is deemed to have been acquired by Haier Businesses on 28 January 2005. These consolidated financial statements have been prepared as a continuation of the Haier Businesses and accordingly,

(i) the assets and liabilities of Haier Businesses are recognised and measured at the date of acquisition at their historical carrying values prior to the Asset Injection and Call Option Exercise;

(ii) the retained profits and other equity balances recognised in the consolidated financial statements are the retained profits and other equity balances of Haier Businesses;

(iii) the amount recognised as issued equity in the consolidated financial statements, comprising share capital, contributed surplus and share premium, has been determined by adding to the issued equity of Haier Businesses immediately before the Asset Injection and Call Option Exercise the cost of acquisition of the Former Group. However, the equity structure in the consolidated financial statements (i.e. the number and type of shares issued) reflects the equity structure of the Company, including the shares issued by the Company to effect the Asset Injection and Call Option Exercise; and

(iv) comparative information presented in the consolidated financial statements is that of Haier Businesses for the year ended 31 December 2004 and as at 31 December 2004.

In preparing these consolidated financial statements, Haier Businesses has applied the purchase method to account for the acquisition of the Former Group. In applying the purchase method, the identifiable assets and liabilities of the Former Group were recorded in the consolidated balance sheet at their fair values at the date of completion of the acquisition on 28 January 2005.

3.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") (which also include Hong Kong Accounting Standards ("HKASs") and Interpretations) issued by Hong Kong Institute of Certified Public Accountants, 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. These financial statements are presented in Hong Kong dollars (HK$) and all values are rounded to the nearest thousand except when otherwise indicated.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2005. The results of subsidiaries acquired are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. 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.

3.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

The following new and revised HKFRSs affect the Group and are adopted for the first time for the current year's financial statements:

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 11	Construction Contracts
HKAS 12	Income Taxes
HKAS 14	Segment Reporting
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 18	Revenue
HKAS 19	Employee Benefits
HKAS 20	Accounting for Government Grants and Disclosure of Government Assistance
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 28	Investments in Associates
HKAS 31	Interests in Joint Ventures
HKAS 32	Financial Instruments: Disclosure and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS 39 Amendment	Transition and Initial Recognition of Financial Assets and Financial Liabilities
HKAS 40	Investment Property
HKFRS 2	Share-based Payment
HKFRS 3	Business Combinations
HKFRS 5	Non-current Assets Held for Sale and Discontinued Operations
HK(SIC)-Int 21	Income Taxes – Recovery of Revalued Non-depreciable Assets
HK-Int 4	Lease – Determination of the Length of Lease Term in respect of Hong Kong Land Leases

3.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS (cont'd)

The adoption of HKASs 2, 7, 8, 10, 11, 12, 14, 16, 18, 19, 20, 21, 23, 27, 28, 31, 32, 33, 37, 38, 39 and 40 and HKFRS 2 and 5, HK(SIC)-Int 21 and HK-Int 4 has had no material impact on the accounting policies of the Group and the Company and the methods of computation in the Group's and the Company's financial statements.

HKAS 1 has affected the presentation of minority interests on the face of the consolidated balance sheet, consolidated income statement, consolidated statement of changes in equity and other disclosures.

HKAS 21 had no material impact on the Group. In respect of acquisitions subsequent to 1 January 2005, any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of the assets and liabilities are treated as assets and liabilities of the foreign operation and are translated at the closing rate in accordance with HKAS 21.

HKAS 24 has expanded the definition of related parties and affected the Group's related party disclosures.

The impact of adopting the other HKFRSs is summarised as follows:

(a) HKAS 17 – Leases

In prior years, leasehold land and buildings held for own use were stated at cost less accumulated depreciation and any impairment losses.

Upon the adoption of HKAS 17, the Group's leasehold interest in land and buildings is separated into leasehold land and buildings. The Group's leasehold land is classified as an operating lease, because the title of the land is not expected to pass to the Group by the end of the lease term, and is reclassified from property, plant and equipment to prepaid land premiums, while buildings continue to be classified as part of property, plant and equipment. Prepaid land premiums for land lease payments under operating leases are initially stated at cost and subsequently amortised on the straight-line basis over the lease term. When the lease payments cannot be allocated reliably between the land and buildings elements, the entire lease payments are included in the cost of the land and buildings as a finance lease in property, plant and equipment.

This change in accounting policy has had no effect on the consolidated income statement and retained profits. The comparative amounts in the consolidated balance sheet for the year ended 31 December 2004 have been restated to reflect the reclassification of the leasehold land.

(b) HKFRS 2 – Share-based Payment

In prior years, no recognition and measurement of share-based payment transactions in which employees (including directors) were granted share options over shares in the Company were required until such options were exercised by employees, at which time the share capital and share premium were credited with the proceeds received.

Upon the adoption of HKFRS 2, when employees (including directors) render services as consideration for equity instruments ("equity-settled transactions"), the cost of the equity-settled transactions with employees is measured by reference to the fair value at the date at which the instruments are granted.

The main impact of HKFRS 2 on the Group is the recognition of the cost of these transactions and a corresponding entry to equity for employee share options. The revised accounting policy for share-based payment transactions is described in more detail in note 3.5 "Summary of significant accounting policies" below.

The Group has adopted the transitional provisions of HKFRS 2 under which the new measurement policies have not been applied to (i) options granted to employees on or before 7 November 2002; and (ii) options granted to employees after 7 November 2002 but which had vested before 1 January 2005.

As the Group did not have any employee share options which were granted during the period from 7 November 2002 to 31 December 2004 but had not yet vested as at 1 January 2005, the adoption of HKFRS 2 has had no impact on the retained profits as at 31 December 2003 and at 31 December 2004.

3.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS (cont'd)

(c) HKFRS 3 – Business Combinations and HKAS 36 – Impairment of Assets

In prior years, goodwill arising on acquisitions on or after 1 January 2001 was capitalised and amortised on the straight-line basis over its estimated useful life and was subject to impairment testing when there was any indication of impairment.

The adoption of HKFRS 3 and HKAS 36 has resulted in the Group ceasing annual goodwill amortisation and commencing testing for impairment at the cash-generating unit level annually (or more frequently if events or changes in circumstances indicate that the carrying value may be impaired).

Any excess of the Group's interest in the net fair value of the acquirees' identifiable assets and liabilities over the cost of acquisition of subsidiaries (previously referred to as negative goodwill), after reassessment, is recognised immediately in the income statement.

During the year, the Company has adopted HKFRS 3 and the Asset Injection and the Call Option Exercise have been accounted for using reverse acquisition accounting, details of which are set out in note 2.2 to the financial statements.

3.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE HONG KONG FINANCIAL REPORTING STANDARDS

The Group has not applied the following new and revised HKFRSs, that have been issued but are not yet effective, in these financial statements. Unless otherwise stated, these HKFRSs are effective for annual periods beginning on or after 1 January 2006:

HKAS 1 Amendment	Capital Disclosures
HKAS 19 Amendment	Actuarial Gains and Losses, Group Plans and Disclosures
HKAS 39 Amendment	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 Amendment	The Fair Value Option
HKAS 39 & HKFRS 4 Amendments	Financial Guarantee Contracts
HKFRSs 1 & 6 Amendments	First-time Adoption of Hong Kong Financial Reporting Standards and Exploration for and Evaluation of Mineral Resources
HKFRS 6	Exploration for and Evaluation of Mineral Resources
HKFRS 7	Financial Instruments: Disclosures
HKFRS-Int 4	Determining whether an Arrangement contains a Lease
HKFRS-Int 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
HK(IFRIC)-Int 6	Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment

The HKAS 1 Amendment shall be applied for annual periods beginning on or after 1 January 2007. The revised standard will affect the disclosures about qualitative information about the Group's objective, policies and processes for managing capital; quantitative data about what the Company regards as capital; and compliance with any capital requirements and the consequences of any non-compliance.

HKFRS 7 corporates the disclosure requirements of HKAS 32 relating to financial instruments. This HKFRS shall be applied for annual periods beginning on or after 1 January 2007.

In accordance with the amendments to HKAS 39 regarding financial guarantee contracts, financial guarantee contracts are initially recognised at fair value and are subsequently measured at the higher of (i) the amount determined in accordance with HKAS 37 and (ii) the amount initially recognised, less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18.

The HKAS 19 Amendment, HKAS 39 Amendment regarding cash flow hedge accounting of forecast intragroup transactions, HKFRSs 1 and 6 Amendments, HKFRS 6, HKFRS-Int 5 and HK(IFRIC)-Int 6 do not apply to the activities of the Group. HK(IFRIC)-Int 6 shall be applied for annual periods beginning on or after 1 December 2005.

Except as stated above, the Group expects that the adoption of the other pronouncements listed above will not have any significant impact on the Group's financial statements in the period of initial application.

Notes to Financial Statements (cont'd) *(31 December 2005)*

3.4 SUMMARY OF THE IMPACT OF CHANGES IN ACCOUNTING POLICIES

Effect on the consolidated balance sheet

Increase/(decrease)	Effect of adopting HKAS 17 # Prepaid land premiums 31 December 2005 HK$'000	1 January 2005 HK$'000
Property, plant and equipment	**(26,015)**	**(12,150)**
Prepaid land premiums	**25,462**	**11,885**
Prepayments, deposits and other receivables	**553**	**265**
	–	**–**

\# *Adjustments/presentation taken effect retrospectively*

3.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Subsidiaries

A subsidiary is an entity 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 income statement 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 business combination over the Group's interest in the net fair value of the acquirees' identifiable assets acquired and liabilities assumed as at the date of acquisition.

Goodwill on acquisition for which the agreement date is on or after 1 January 2005

Goodwill arising on acquisition is initially recognised in the consolidated balance sheet as an asset initially measured at cost and subsequently at cost less any accumulated impairment losses.

The carrying amount of goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

3.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Goodwill on acquisition for which the agreement date is on or after 1 January 2005 (cont'd)

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated:

- represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and

- is not larger than a segment based on either the Group's primary or the Group's secondary reporting format determined in accordance with HKAS 14 "Segment Reporting".

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units) to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised.

Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

An impairment loss recognised for goodwill is not reversed in a subsequent period.

Excess over the cost of business combinations (applicable to business combinations for which the agreement date is on or after 1 January 2005)

Any excess of the Group's interest in the net fair value of the acquirees' identifiable assets and liabilities over the cost of the acquisition of subsidiaries (previously referred to as negative goodwill), after reassessment, is recognised immediately in the income statement.

Impairment of assets

Where an indication of impairment exists, or when annual impairment testing for an asset is required (other than inventories, deferred tax assets, financial assets and goodwill), the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's or cash-generating unit's value in use and its fair value less costs to sell, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is charged to the income statement in the period in which it arises.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment loss may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss of an asset other than goodwill is reversed only if there has been a change in the estimates used to determine the recoverable amount of that 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 income statement in the period in which it arises.

3.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Related parties

A party is considered to be related to the Group if:

(a) directly or indirectly through one or more intermediaries, the party (i) controls, is controlled by, or is under common control with, the Group; (ii) has an interest in the Group that gives it significant influence over the Group; or (iii) has joint control over the Group;

(b) the party is an associate;

(c) the party is a jointly-controlled entity;

(d) the party is a member of the key management personnel of the Group or its parent;

(e) the party is a close member of the family of any individual referred to in (a) or (d); or

(f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e).

Property, plant and equipment and depreciation

Property, plant and equipment, other than construction in progress, are stated at cost less accumulated depreciation and any impairment losses. When an item of property, plant and machinery is classified as held for sale or when it is part of a disposal group classified as held for sale, it is not depreciated. The cost of an item of property, plant and equipment 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 items of property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement 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 an item of property, plant and equipment and the cost of the item can be measured reliably, the expenditure is capitalised as an additional cost of that asset or as a replacement.

Depreciation is calculated on the straight-line basis to write off the cost of each item of property, plant and equipment to its residual value over its estimated useful life. The principal annual rates used for this purpose are as follows:

Buildings	2% to 10%
Plant and machinery	5% to 19%
Tools, furniture and fixtures	10% to 33%
Motor vehicles	9% to 20%

Where parts of an item of property, plant and equipment have different useful lives, the cost of that item is allocated on a reasonable basis among the parts and each part is depreciated separately.

Residual values, useful lives and depreciation method are reviewed, and adjusted if appropriate, at each balance sheet date.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on disposal or retirement recognised in the income statement in the year the asset is derecognised is the difference between the net sales proceeds and the carrying amount of the relevant asset.

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 during the period of construction. Construction in progress is reclassified to the appropriate category of the property, plant and equipment when completed and ready for use.

3.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Intangible assets (other than goodwill)

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each balance sheet date.

Patents and licence

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 income statement as incurred.

Expenditure incurred on projects to develop new products is capitalised and deferred only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the project and the ability to measure reliably the expenditure during the development. Product development expenditure which does not meet these criteria is expensed when incurred.

Deferred development costs are stated at cost less any impairment losses and are amortised using the straight-line basis over the commercial lives of the underlying products, commencing from the date when the products are put into commercial production.

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 income statement 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 income statement on the straight-line basis over the lease terms.

Prepaid land premiums under operating leases are initially stated at cost and subsequently recognised on the straight-line basis over the lease terms.

Investments and other financial assets (applicable to the year ended 31 December 2005)

Financial assets in the scope of HKAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, and available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Group determines the classification of its financial assets, after initial recognition and, where allowed and appropriate, re-evaluates this designation at the balance sheet date.

All regular way purchases and sales of financial assets are recognised on the trade date, i.e., the date that the Group commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

3.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Impairment of financial assets (applicable to the year ended 31 December 2005)

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired.

Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effect interest rate computed at initial recognition). The carrying amount of the asset is reduced either directly or through the use of an allowance account. The amount of the impairment loss is recognised in profit or loss.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

Derecognition of financial assets (applicable to the year ended 31 December 2005)

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;

- the Group retains the rights to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; or

- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risk and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group's continuing involvement is the amount of the transferred asset that the Group may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Group's continuing involvement is limited to the fair value of the transferred asset and the option exercise price.

3.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method.

Gains and losses are recognised in net profit or loss when the liabilities are derecognised as well as through the amortisation process.

Convertible notes

The component of convertible notes that exhibits characteristics of a liability is recognised as a liability in the balance sheet, net of transaction costs. On issuance of convertible notes, the fair value of the liability component is determined using a market rate for an equivalent non-convertible note; and this amount is carried as a long term liability on the amortised cost basis until extinguished on conversion or redemption. The remainder of the proceeds is allocated to the conversion option that is recognised and included in shareholders' equity, net of transaction costs. The carrying amount of the conversion option is not remeasured in subsequent years.

Transaction costs are apportioned between the liability and equity components of the convertible notes based on the allocation of proceeds to the liability and equity components when the instruments are first recognised.

Derecognition of financial liabilities (applicable to the year ended 31 December 2005)

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference between the respective carrying amounts is recognised in profit or loss.

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.

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.

Provision

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the income statement.

Provisions for installation services and product warranties granted by the Group on certain products are recognised based on sales volume and past experience of the level of installation service rendered, repairs or returns, discounted to their present values as appropriate.

3.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Income tax

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

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the tax authorities.

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 interests in subsidiaries, 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.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax credits 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 credits 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 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 deductible temporary differences associated with interests 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 reassessed at each balance sheet date and 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.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Government grants

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the income statement over the expected useful life of the relevant asset by equal annual instalments.

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

(c) interest income, on an accrual basis using the effective interest method by applying the rate that discounts the estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset.

Employee benefits

Share-based payment transactions

The Company operates a share option scheme for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Employees (including directors) of the Group receive remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments ("equity-settled transactions").

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company ("market conditions"), if applicable.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (the "vesting date"). The cumulative expense recognised for equity-settled transactions at each balance sheet date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the income statement for a period represents the movement in the cumulative expense recognised as at the beginning and the end of that period.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any modification, which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings/(loss) per share.

The Group has adopted the transitional provisions of HKFRS 2 in respect of equity-settled awards and has applied HKFRS 2 only to equity-settled awards granted after 7 November 2002 that had not vested on 1 January 2005 and to those granted on or after 1 January 2005.

3.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Employee benefits (cont'd)

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.

Pension schemes

The Group operates a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for those employees who are eligible to participate in the MPF Scheme. Contributions are made based on a percentage of the employees' basic salaries and are charged to the income statement as they become payable in accordance with the rules of the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in an independently administrated fund. The Group's employer voluntary contributions, which are refunded to the Group when the employee leaves employment prior to the contributions vesting fully, in accordance with the rules of the MPF Scheme.

In addition to the MPF Scheme, the Group operates a separate 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 MPF 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 Mainland China are required to participate in central pension scheme operated by the local municipal government. These subsidiaries are required to contribute a certain percentage of its payroll costs to the central pension scheme. The contributions are charged to the income statement as they become payable in accordance with the rules of the central pension scheme.

Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained profits within the equity 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.

Foreign currencies

These financial statements are presented in Hong Kong dollars, which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Foreign currency transactions are initially recorded using the functional currency rates ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rates of exchange ruling at the balance sheet date. All differences are taken to profit or loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

3.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Foreign currencies (cont'd)

The functional currencies of certain overseas subsidiaries are currencies other than the Hong Kong dollar. As at the balance sheet date, the assets and liabilities of these entities are translated into the presentation currency of the Company at exchange rates ruling at the balance sheet date and, their income statements are translated into Hong Kong dollars at the weighted average exchange rates for the year. The resulting exchange differences are included in a separate component of equity as the exchange fluctuation reserve. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement.

For the purpose of the consolidated cash flow statement, the cash flows of overseas subsidiaries are translated into 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 into Hong Kong dollars at the weighted average exchange rates for the year.

4. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

Judgements

In the process of applying the Group's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect on the amounts recognised in the financial statements:

Operating lease commitments – Group as lessor

The Group has entered into commercial property leases on its property portfolio. The Group has determined that it retains all the significant risks and rewards of ownership of these properties which are leased out on operating leases.

Classification between investment properties and owner-occupied properties

The Group determines whether a property qualifies as an investment property and has developed criteria in making that judgement. Investment property is a property held to earn rentals or for capital appreciation or both. Therefore, the Group considers whether a property generates cash flows largely independently of the other assets held by the Group.

Some properties comprise a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes. If these portions could be sold separately (or leased out separately under a finance lease), the Group accounts for the portions separately. If the portions could not be sold separately, the property is an investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.

Judgement is made on an individual property basis to determine whether ancillary services are so significant that a property does not qualify as investment property.

Estimation uncertainty

The key assumption concerning the future and other key sources of estimation uncertainty at the balance sheet date, that has a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year is discussed below.

Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The goodwill arising from the Asset Injection and Call Option Exercise amounting to HK$321,947,000 was impaired during the year. Further details are set out in note 19 to the financial statements.

Notes to Financial Statements (cont'd) *(31 December 2005)*

5. 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 segments 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 mobile handset business segment manufactures and sells mobile phones;

(b) the washing machine business segment manufactures and sells washing machine; and

(c) 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.

(a) Business segments

The following tables present revenue, profit/(loss) and certain asset, liability and expenditure information for the Group's business segments for the year ended 31 December 2005 and 2004.

	Mobile handset business		Washing machine business		Corporate and others		Consolidated	
	2005 HK$'000	2004 HK$'000 (Restated)	**2005 HK$'000**	2004 HK$'000 (Restated)	**2005 HK$'000**	2004 HK$'000 (Restated)	**2005 HK$'000**	2004 HK$'000 (Restated)
Segment revenue:								
Sales to external customers	**1,628,830**	3,143,385	**3,311,644**	2,750,454	**-**	-	**4,940,474**	5,893,839
Other revenue	**8,346**	8,842	**4,680**	5,787	**-**	-	**13,026**	14,629
Total	**1,637,176**	3,152,227	**3,316,324**	2,756,241	**-**	-	**4,953,500**	5,908,468
Segment results	**(139,002)**	47,006	**95,206**	127,723	**(18,336)**	-	**(62,132)**	174,729
Interest income							**3,329**	3,069
Finance costs							**(20,232)**	(12,152)
Impairment of goodwill							**(321,947)**	-
Profit/(loss) before tax							**(400,982)**	165,646
Tax							**(16,855)**	(17,018)
Profit/(loss) for the year							**(417,837)**	148,628

5. SEGMENT INFORMATION (cont'd)

(a) Business segments (cont'd)

	Mobile handset business		Washing machine business		Corporate and others		Eliminations		Consolidated	
	2005 HK$'000	2004 HK$'000 Restated)	**2005 HK$'000**	2004 HK$'000 (Restated)	**2005 HK$'000**	2004 HK$'000 (Restated)	**2005 HK$'000**	2004 HK$'000 (Restated)	**2005 HK$'000**	2004 HK$'000 (Restated)
Assets and liabilities:										
Segment assets	**1,099,562**	1,121,903	**821,219**	802,455	**8,931**	-	**(7,429)**	-	**1,922,283**	1,924,358
Deferred tax assets									**12,736**	21,527
Tax recoverable									**3,342**	4,940
Pledged deposits									**70**	2,501
Cash and cash equivalents									**560,337**	242,741
Total assets									**2,498,768**	2,196,067
Segment liabilities	**700,440**	764,900	**754,055**	593,137	**6,226**	-	**(7,429)**	-	**1,453,292**	1,358,037
Tax payable									**5,030**	825
Interest-bearing bank and other borrowings									**124,807**	147,044
Convertible notes									**211,528**	-
Deferred tax liabilities									**-**	606
Total liabilities									**1,794,657**	1,506,512
Other segment information:										
Depreciation and amortisation	**50,076**	22,153	**20,418**	20,198	**216**	-	**-**	-	**70,710**	42,351
Capital expenditure	**4,717**	30,923	**113,551**	19,455	**185**	-	**-**	-	**118,453**	50,378
Provision for obsolete and slow-moving inventories	**53,148**	18,430	**683**	-	**-**	-	**-**	-	**53,831**	18,430
Provision for bad and doubtful debts	**34,303**	-	**1,360**	-	**-**	-	**-**	-	**36,663**	-
Product warranty and installation provision	**-**	-	**108,272**	83,513	**-**	-	**-**	-	**108,272**	83,513

Notes to Financial Statements (cont'd) *(31 December 2005)*

5. SEGMENT INFORMATION (cont'd)

(b) Geographical segments

The following table presents revenue information for the Group's geographical segments for the year ended 31 December 2005 and 2004.

	Hong Kong		Elsewhere in the People's Republic of China (the "PRC")		European Union		Others		Consolidated	
	2005 HK$'000	2004 HK$'000 (Restated)	**2005 HK$'000**	2004 HK$'000 (Restated)	**2005 HK$'000**	2004 HK$'000 (Restated)	**2005 HK$'000**	2004 HK$'000 (Restated)	**2005 HK$'000**	2004 HK$'000 (Restated)
Segment revenue:										
Sales to external customers	**47,095**	154,457	**4,893,379**	5,626,353	**-**	75,137	**-**	37,892	**4,940,474**	5,893,839
Other revenue	**-**	-	**13,026**	14,629	**-**	-	**-**	-	**13,026**	14,629
Total revenue	**47,095**	154,457	**4,906,405**	5,640,982	**-**	75,137	**-**	37,892	**4,953,500**	5,908,468

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

6. REVENUE, OTHER INCOME AND GAINS

Revenue, which is also the Group's turnover, represents the net invoiced value of goods sold, net of value-added tax and after allowances for returns and trade discounts.

An analysis of revenue, other income and gains is as follow:

Group	**2005 HK$'000**	2004 HK$'000 (Restated)
Revenue		
Sale of washing machines	**3,311,644**	2,750,454
Sale of mobile phones	**1,628,830**	3,143,385
	4,940,474	5,893,839
Other income and gains, net		
Compensation received from suppliers	**4,575**	–
Interest income	**3,329**	3,069
Sale of scrap materials	**2,739**	3,000
Government subsidies *(note)*	**2,121**	4,963
Gross rental income in respect of:		
Land and buildings	**1,548**	1,892
Plant and machinery	**–**	4,401
	1,548	6,293
Others	**2,043**	373
	16,355	17,698

Note: During the year, two of the Group's subsidiaries in Mainland China received subsidies from the relevant authorities of Qingdao Municipality and Shunde Municipality as an encouragement for advanced research and development.

7. PROFIT/(LOSS) BEFORE TAX

The Group's profit/(loss) before tax is arrived at after charging/(crediting):

	Notes	2005 HK$'000	2004 HK$'000 (Restated)
Cost of inventories sold		**4,205,871**	5,182,772
Depreciation	*16*	**69,602**	41,508
Amortisation for prepaid land premiums	*17*	**510**	262
Amortisation of intangible assets*	*18*	**598**	581
Research and development costs*		**94,611**	75,557
Auditors' remuneration		**6,000**	2,100
Staff costs (including directors' remuneration – *note 9*):			
Wages and salaries		**133,922**	65,191
Net pension scheme contributions		**22,964**	17,936
Total staff costs		**156,886**	83,127
Minimum lease payments under operating leases in respect of land and buildings		**8,676**	3,522
Provision for obsolete and slow-moving inventories*		**53,831**	18,430
Provision for bad and doubtful debts**:			
Trade receivables		**34,303**	–
Other receivables		**1,360**	–
		35,663	–
Product warranty and installation provision		**108,272**	83,513
Impairment of goodwill***		**321,947**	–
Loss on disposal of items of property, plant and equipment**		**4,587**	–
Foreign exchange differences, net		**(3,686)**	1,072

* The amortisation of intangible assets, research and development costs and provision for obsolete and slow-moving inventories for the year are included in "Cost of sales" on the face of the consolidated income statement.

** The loss on disposal of items of property, plant and equipment and provision for bad and doubtful debts are included in "Other expenses" on the face of the consolidated income statement.

*** The impairment of goodwill is disclosed on the face of the consolidated income statement.

Notes to Financial Statements (cont'd) *(31 December 2005)*

8. FINANCE COSTS

Group	2005 HK$'000	2004 HK$'000 (Restated)
Interest on bank and other loans wholly repayable within five years	**10,497**	12,152
Interest on convertible notes *(note 28)*	**9,735**	–
	20,232	12,152

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 Hong Kong Companies Ordinance, is as follows:

Group	2005 HK$'000
Fees	**943**
Other emoluments:	
Salaries, allowances and benefits in kind	**–**
Performance related bonuses	**–**
Employee share option benefits	**–**
Pension scheme contributions	**–**
	943

There was no remuneration paid by the Group to the Company's directors in the prior year as the Company was not yet consolidated into the Group in the prior year.

(a) Independent non-executive directors:

The fees paid to independent non-executive directors during the year were as follows:

	2005 HK$'000
Lam Kin Kau, Mark	**240**
Fung Hoi Wing, Henry	**240**
Lau Ho Wai, Lucas	**240**
Wu Yinong	**223**
	943

There was no other emolument payable to the independent non-executive directors during the year.

9. DIRECTORS' REMUNERATION

(b) Executive directors:

	Fees HK$'000	**Salaries, allowances and benefits in kind** HK$'000	**Performance related bonuses** HK$'000	**Employee share option benefits** HK$'000	**Pension scheme contributions** HK$'000	**Total** HK$'000
2005						
Yang Mian Mian	–	–	–	–	–	–
Wu Ke Song	–	–	–	–	–	–
Chai Yong Sen	–	–	–	–	–	–
Liang Hai Shan	–	–	–	–	–	–
Cao Chun Hua	–	–	–	–	–	–
Cui Shao Hua	–	–	–	–	–	–
Song Chun Guang	–	–	–	–	–	–
Mak Shiu Tong, Clement*	–	–	–	–	–	–
Tam Ngai Hung, Terry*	–	–	–	–	–	–
Man Wei Dong*	–	–	–	–	–	–
	–	–	–	–	–	–

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

* Mak Shiu Tong, Clement, Tam Ngai Hung, Terry and Man Wei Dong resigned as directors of the Company on 28 January 2005.

10. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year did not include any director (2004: Nil), details of whose remuneration are set out in note 9 above. Details of the remuneration of the five (2004: five) non-director, highest paid employees for the year are as follows:

Group	**2005** **HK$'000**	2004 HK$'000 (Restated)
Salaries, allowances and benefits in kind	**4,124**	4,153
Performance related bonuses	**–**	–
Employee share option benefits	**–**	–
Pension scheme contributions	**34**	14
	4,158	4,167

10. FIVE HIGHEST PAID EMPLOYEES (cont'd)

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

	Number of employees	
	2005	2004
Nil to HK$1,000,000	**3**	4
HK$1,500,001 to HK$2,000,000	**2**	–
HK$2,000,001 to HK$2,500,000	**–**	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 (2004: Nil).

The Group has seven subsidiaries established in the PRC, four of which are Sino-foreign equity joint ventures, two of which are wholly-foreign owned enterprises and the remaining one is a limited liability company. Except for the limited liability company and one Sino-foreign equity joint venture, all subsidiaries are entitled to preferential tax treatments including reduction of PRC corporate income tax ("CIT") and full exemption from CIT tax for two years starting from its first profit-making year following by a 50% reduction for the next consecutive three years.

	2005	2004
	HK$'000	HK$'000
		(Restated)
Group:		
Current – Mainland China:		
Charge for the year	**8,068**	18,617
Overprovision in prior years	**–**	(1,860)
Deferred *(note 30)*	**8,787**	261
Tax charge for the year	**16,855**	17,018

11. TAX (cont'd)

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

Group – 2005

	Hong Kong		**PRC**		**Total**	
	HK$'000	**%**	**HK$'000**	**%**	**HK$'000**	**%**
Loss before tax	(339,816)		(61,166)		(400,982)	
Tax at the statutory or applicable tax rates	(59,468)	17.5	(20,185)	33.0	(79,653)	19.9
Income not subject to tax	(1,742)	0.5	–	–	(1,742)	0.4
Expenses not deductible for tax	56,350	(16.5)	–	–	56,350	(14.1)
Tax losses not recognised	4,860	(1.5)	45,350	(74.1)	50,210	(12.5)
Temporary differences not recognised	–	–	21,182	(34.7)	21,182	(5.3)
Tax exemption	–	–	(29,492)	48.2	(29,492)	7.4
Tax charge at the Group's effective rate	–	–	16,855	(27.6)	16,855	(4.2)

Group – 2004

	Hong Kong		PRC		Total	
	HK$'000	%	HK$'000	%	HK$'000	%
Profit before tax	–	–	165,646	–	165,646	–
Tax at the statutory or applicable tax rates	–	–	54,663	33.0	54,663	33.0
Expenses not deductible for tax	–	–	2,601	1.6	2,601	1.6
Overprovision in prior years	–	–	(1,860)	(1.1)	(1,860)	(1.1)
Tax exemption	–	–	(38,386)	(23.2)	(38,386)	(23.2)
Tax charge at the Group's effective rate	–	–	17,018	10.3	17,018	10.3

12. NET PROFIT/(LOSS) FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT

The net loss from ordinary activities attributable to equity holders of the parent for the year ended 31 December 2005 dealt with in the financial statements of the Company, was HK$1,250,311,000 (note 33(b)).

13. DIVIDEND

No dividend has been paid or declared by the Company during the year (2004: Nil).

The dividend disclosed for the year ended 31 December 2004 represented dividend declared by a subsidiary of Haier Holdings (BVI) Limited to its previous owner, Haier Corp, out of its retained profits after setting aside a required percentage of its net earnings to the relevant statutory reserves in accordance with the rules and regulations applicable in the PRC and its article of association.

14. EARNINGS/(LOSS) PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT

Under reverse acquisition accounting method (note 2.2), the 6,369,706,667 ordinary shares issued by the Company for the purposes of the Asset Injection and the Call Option Exercise (note 2.1) are deemed to be issued on 1 January 2004 for the purposes of calculating earnings/(loss) per share.

The calculation of basic earnings/(loss) per share amounts is based on the net profit/(loss) for the year attributable to ordinary equity holders of the parent, and the weighted average number of ordinary shares in issue during the year.

A diluted loss per share amount for the year ended 31 December 2005 has not been disclosed as share options and convertible notes outstanding during the year had anti-dilutive effects on the basic loss per share amount for the year.

A diluted earnings per share amount for the year ended 31 December 2004 has not been disclosed as no diluting events existed during that year.

The calculations of basic earnings/(loss) per share is based on:

	2005	2004
	HK$'000	HK$'000
		(Restated)
Earnings		
Net profit/(loss) attributable to ordinary equity holders of the parent, used in the basic earnings/(loss) per share calculation	**(432,964)**	119,479

	Number of shares	
	2005	2004
		(Restated)
Shares		
Weighted average number of ordinary shares in issue during the year used in the basic earnings/(loss) per share calculation	**15,620,283,153**	6,369,706,667

15. RELATED PARTY TRANSACTIONS

(a) In addition to the related party transactions detailed in notes 16, 22, 23, 24, 25, 26, 27, and 28 to the financial statements, the Group had the following material transactions with related parties during the year.

(i) The Company's subsidiary, Pegasus Qingdao, had the following material transactions with Haier Corp, Haier Investment, their subsidiaries and associates. Haier Corp, Haier Investment, their subsidiaries and associates are companies that have certain key management personnel in common with the Company.

		Group	
		2005	2004
	Notes	**HK$'000**	HK$'000
Sales of mobile handset products	*(i)*	**1,523,428**	2,747,869
Purchases of materials	*(ii)*	**606,607**	1,786,847
Utility service fee expenses	*(iii)*	**5,745**	4,657
Interest expenses	*(iv)*	**3,594**	3,442
Interest income	*(iv)*	**165**	143
Other service fee expenses	*(v)*	**1,286**	174

Notes:

(i) For the year ended 31 December 2005, the sales of mobile handset products were made at selling prices based on the costs of raw materials plus a processing fee which is not less than the industry standard.

For the year ended 31 December 2004, the sales of mobile phones were made at selling prices based on the cost of materials plus processing fees ranging from 5% to 40% of the purchase price of the materials.

(ii) The purchases were charged no more than the average market price or the consolidated and integrated tender and bidding price plus a 2.6% commission.

(iii) Utility service fee expenses were charged with reference to the state-prescribed prices.

(iv) Interest expenses/income was determined with reference to the standard rates published by the People's Bank of China.

(v) Other service fee expenses included legal consulting service fee, general security service fee, human resources service fee which were determined with reference to actual costs incurred.

Notes to Financial Statements (cont'd) *(31 December 2005)*

15. RELATED PARTY TRANSACTIONS (cont'd)

(ii) The Company's subsidiaries, Qingdao Haier Washing Machine Co., Ltd., Foshan Shunde Haier Electric Co., Ltd., Hefei Haier Washing Machine Co., Ltd., Qingdao Jiaonan Haier Washing Machine Co., Ltd. (collectively the "Washing Machine Companies") and Qingdao Haier Electronics Sales Co., Ltd. had the following material transactions with Haier Corp, Haier Investment, their subsidiaries and associates.

		Group	
		2005	2004
	Notes	**HK$'000**	HK$'000
Sales of washing machines			
– before 28 January 2005	*(vi)*	**287,492**	2,750,454
– on or after 28 January 2005	*(vii)*	**310,782**	–
Purchases of materials	*(viii)*	**2,680,706**	2,089,496
Printing and packaging fee expenses	*(ix)*	**1,985**	315
Mould charges	*(x)*	**60,880**	48,598
Utility service fee expenses	*(xi)*	**11,783**	9,471
Logistics charges	*(xii)*	**128,684**	112,424
Promotion fee expenses	*(xiii)*	**19,231**	–
Other service fee expenses	*(xiv)*	**14,572**	12,235
Interest income	*(xv)*	**572**	879
Trademark licence fee expenses	*(xvi)*	**26,226**	6,720

Notes:

(vi) The sales of washing machines before 28 January 2005 comprised domestic sales made to subsidiaries and fellow subsidiaries of Haier Investment and export sales made to Haier Electrical Appliances Co., Ltd. ("Haier Electrical"), a subsidiary of Haier Investment.

The domestic sales of washing machines were made at selling prices quoted by the subsidiaries and fellow subsidiaries of Haier Investment to third party distributors less discounts ranging from 10.5% to 17.5%. The export sales of washing machines were made at selling prices representing differences between the selling prices of washing machines mutually agreed and the selling expenses of Haier Electrical not exceeding 2.5% of the selling prices of washing machines.

(vii) The sales of washing machines on or after 28 January 2005 were made to Haier Electrical at selling prices representing differences between the selling prices of washing machines mutually agreed and the selling expenses of Haier Electrical not exceeding 2.5% of the selling prices of washing machines.

Subsequent to 28 January 2005, all domestic sales of washing machines are directly made to third party customers and are no longer transacted through the related companies.

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

(ix) Printing and packaging fee expenses were determined with reference to actual costs incurred.

(x) Moulds were charged with reference to the average market tender and bidding price.

(xi) Utility service fee expenses were charged with reference to the state-prescribed prices.

(xii) Logistics charges were determined with reference to actual costs incurred.

(xiii) Promotion fee expenses were determined at the lower of 1.2% of the domestic sales of washing machines and RMB20 million (equivalent to HK$19,231,000) for the year ended 2005.

(xiv) Other service fee expenses included legal consulting service fee, catering and travel agency service fee, human resources service fee, general security service fee, product certification service fee and equipment repair and maintenance service fee which were determined with reference to actual costs incurred.

(xv) Interest income was determined with reference to the standard rates published by the People's Bank of China.

(xvi) Trademark licence fee expenses were charged at a rate of 0.8% (2004: 0.5%) of certain sales made by the Washing Machine Companies.

15. RELATED PARTY TRANSACTIONS (cont'd)

(b) On 25 June 2005, Haier Corp provided a corporate guarantee of RMB70,000,000 (equivalent to HK$67,308,000) to Haier Group Finance Co., Ltd. ("Haier Finance"), a subsidiary of Haier Corp and a financial institution approved by the People's Bank of China, as a security for banking facilities granted to Pegasus Qingdao for the period from 25 June 2005 to 24 June 2006. As at 31 December 2005, Pegasus Qingdao utilised all of the above banking facilities.

(c) On 30 December 2005, Haier Corp provided a corporate guarantee of RMB30,000,000 (equivalent to HK$28,846,000) to Haier Finance as a security for banking facilities granted to Qingdao Jiaonan Haier Washing Machine Co., Ltd. ("Jiaonan Washing Machine") for the period from 30 December 2005 to 29 December 2006. As at 31 December 2005, Jiaonan Washing Machine utilised RMB15,000,000 of the above banking facilities.

(d) During the year, the remuneration paid or payable to the Company's directors by the Group amounted to HK$943,000, details of which are set out in note 9 to the financial statements.

The related party transactions in respect of items (a), (b) and (c) above also constitute continuing connected transactions or connected transactions as defined in Chapter 14A of the Listing Rules.

16. PROPERTY, PLANT AND EQUIPMENT

Group	**Buildings** HK$'000	**Plant and machinery** HK$'000	**Tools, furniture and fixtures** HK$'000	**Motor vehicles** HK$'000	**Construction in progress** HK$'000	**Total** HK$'000
31 December 2005						
At 31 December 2004 and 1 January 2005 (as restated):						
Cost	181,441	353,221	56,568	5,089	475	596,794
Accumulated depreciation and impairment	(45,997)	(163,955)	(14,894)	(4,243)	–	(229,089)
Net carrying amount	135,444	189,266	41,674	846	475	367,705
At 1 January 2005, net of accumulated depreciation and impairment	135,444	189,266	41,674	846	475	367,705
Additions	53,618	38,689	6,011	528	5,582	104,428
Acquisition of subsidiaries *(note 34)*	80,439	120,339	27,038	207	–	228,023
Disposals	–	(11,445)	–	–	–	(11,445)
Depreciation provided during the year	(11,266)	(41,637)	(16,296)	(403)	–	(69,602)
Transfers	682	4,273	920	–	(5,875)	–
Exchange realignment	6,228	8,930	1,982	25	14	17,179
At 31 December 2005, net of accumulated depreciation and impairment	265,145	308,415	61,329	1,203	196	636,288
At 31 December 2005:						
Cost	323,737	475,120	92,947	5,967	196	897,967
Accumulated depreciation and impairment	(58,592)	(166,705)	(31,618)	(4,764)	–	(261,679)
Net carrying amount	265,145	308,415	61,329	1,203	196	636,288

Notes to Financial Statements (cont'd) *(31 December 2005)*

16. PROPERTY, PLANT AND EQUIPMENT (cont'd)

Group

	Buildings HK$'000	**Plant and machinery** HK$'000	**Tools, furniture and fixtures** HK$'000	**Motor vehicles** HK$'000	**Construction in progress** HK$'000	**Total** HK$'000
31 December 2004 (as restated)						
At 1 January 2004:						
Cost	181,340	339,591	31,136	4,828	2,951	559,846
Accumulated depreciation and impairment	(39,728)	(139,462)	(9,770)	(4,103)	–	(193,063)
Net carrying amount	141,612	200,129	21,366	725	2,951	366,783
At 1 January 2004, net of accumulated depreciation and impairment	141,612	200,129	21,366	725	2,951	366,783
Additions	101	16,587	24,956	353	1,522	43,519
Disposals	–	(1,055)	–	(34)	–	(1,089)
Depreciation provided during the year	(6,269)	(29,501)	(5,540)	(198)	–	(41,508)
Transfers	–	3,106	892	–	(3,998)	–
At 31 December 2004, net of accumulated depreciation and impairment	135,444	189,266	41,674	846	475	367,705
At 31 December 2004:						
Cost	181,441	353,221	56,568	5,089	475	596,794
Accumulated depreciation and impairment	(45,997)	(163,955)	(14,894)	(4,243)	–	(229,089)
Net carrying amount	135,444	189,266	41,674	846	475	367,705

16. PROPERTY, PLANT AND EQUIPMENT (cont'd)

As at 31 December 2005, four of the Group's buildings situated in Qingdao or Shunde, the PRC, did not have building ownership certificates registered under the name of the respective subsidiaries of the Company. The carrying amounts of those buildings situated at Qingdao and Shunde at 31 December 2005 were HK$164,745,000 and HK$53,885,000 respectively. In addition, two of the aforementioned buildings in Qingdao did not have land use right certificates registered under the name of the respective subsidiaries of the Company at 31 December 2005.

On 24 February 2005, Haier Corp issued an undertaking to the Company pursuant to which Haier Corp agreed to provide other suitable properties to the Group to ensure the continuing operations of the respective subsidiaries of the Company operating in Qingdao. That undertaking also indemnifies the Group to bear any losses arising from the above defective land use right and property title issues in Qingdao and 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 registration 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 right certificates have not yet obtained and the application procedures for the building ownership certificates have not yet been completed.

17. PREPAID LAND PREMIUMS

Group	**2005** **HK$'000**	2004 HK$'000 (Restated)
Carrying amount at 1 January		
As previously reported	**–**	–
Effect of adopting HKAS 17 *(note 3.4)*	**12,150**	5,553
As restated	**12,150**	5,553
Additions	**14,025**	6,859
Exchange realignment	**350**	–
Recognised during the year	**(510)**	(262)
Carrying amount at 31 December	**26,015**	12,150
Current portion included in prepayments, deposits and other receivables	**(553)**	(265)
Non-current portion	**25,462**	11,885

The Group's leasehold land is held under a medium term lease and is situated in Mainland China.

As at 31 December 2005, the land use rights of two parcels of land occupied by the Group in Qingdao, the PRC, were not acquired by and registered under the name of the respective subsidiaries of the Company, details of which are set out in note 16 to the financial statements.

During the year, one of the Group's subsidiaries in Jiaonan, the PRC, acquired a parcel of land for a cash consideration of HK$3,538,000. The respective land use right certificate was obtained by that subsidiary on 6 January 2006.

Notes to Financial Statements (cont'd) *(31 December 2005)*

18. INTANGIBLE ASSETS

Group	**Patents and licenses** HK$'000
31 December 2005	
At 1 January 2005:	
Cost	5,810
Accumulated amortisation	(1,888)
Net carrying amount	3,922
Cost at 1 January 2005, net of accumulated amortisation	3,922
Amortisation provided during the year	(598)
Exchange realignment	113
At 31 December 2005	3,437
At 31 December 2005:	
Cost	5,978
Accumulated amortisation	(2,541)
Net carrying amount	3,437
31 December 2004	
At 1 January 2004:	
Cost	5,810
Accumulated amortisation	(1,307)
Net carrying amount	4,503
Cost at 1 January 2004, net of accumulated amortisation	4,503
Amortisation provided during the year	(581)
At 31 December 2004	3,922
At 31 December 2004:	
Cost	5,810
Accumulated amortisation	(1,888)
Net carrying amount	3,922

19. GOODWILL

Group	HK$'000
31 December 2005	
Cost at 1 January 2005 (as restated)	–
Acquisition of subsidiaries *(note 34)*	321,947
Impairment during the year	(321,947)
Cost and net carrying amount at 31 December 2005	–
31 December 2004	
Cost and net carrying amount at 1 January and 31 December 2004 (as restated)	–

Impairment testing of goodwill

Goodwill acquired through business combination has been allocated to the mobile handset business cash-generating unit, which is a reportable segment, for impairment testing.

Mobile handset business cash-generating unit

The recoverable amount of the mobile handset business cash-generating unit has been determined based on a value in use calculation using cash flow projections based on financial budgets approved by senior management covering a five-year period. The discount rate applied to cash flow projections is 17.2% and cash flows beyond the five-year period are extrapolated using a growth rate of 3% which is determined with reference to the prevailing inflation rate in Mainland China. Senior management estimated the budgeted gross margin based on past performance and their expectations for market development. The discount rate used is before tax and reflects specific risks relating to the mobile handset business cash-generating units.

During the year, due to intensifying competition and price reduction of mobile phones in the mobile phone market in Mainland China, the Group recognised a goodwill impairment loss of HK$321,947,000 for its mobile handset business. The goodwill impairment loss is determined with reference to the recoverable amount of the Group's mobile handset business.

20. INTERESTS IN SUBSIDIARIES

Company	**2005** **HK$'000**	2004 HK$'000
Unlisted investments, at cost	**3,517,747**	1,963,638
Due from subsidiaries	**2,360**	608
Due to a subsidiary	**(8,894)**	(8,747)
	3,511,213	1,955,499
Impairment	**(2,127,707)**	(904,028)
	1,383,506	1,051,471

20. INTERESTS IN SUBSIDIARIES (cont'd)

During the year, due to intensifying competition and price reduction of mobile phones in the Mainland China market, the Company recognised an impairment loss of investment costs of HK$1,223,679,000 for its subsidiaries engaging in the mobile phone business. The impairment loss is determined with reference to the recoverable amount of the subsidiaries.

The amounts due from/to subsidiaries are unsecured, interest-free and have no fixed terms of repayment.

Particulars of the principal subsidiaries are as follows:

Name	Place of registration and operations	Nominal value of registered capital	Percentage of equity attributable to the Company		Principal activities
			Direct	Indirect	
Pegasus Telecom (Qingdao) Co., Ltd*	PRC	US$12,000,000	100	–	Manufacture and sale of mobile phones
Pegasus Electronic (Qingdao) Co., Ltd.*	PRC	US$29,980,000	100	–	Manufacture and sale of mobile phones
Qingdao Haier Washing Machine Co., Ltd.**	PRC	RMB150,000,000	–	93.44	Manufacture and sale of washing machines
Foshan Shunde Haier Electric Co., Ltd.**	PRC	RMB48,000,000	–	60	Manufacture and sale of washing machines
Hefei Haier Washing Machine Co., Ltd.**	PRC	RMB12,000,000	–	98.69	Manufacture and sale of washing machines
Qingdao Jiaonan Haier Washing Machine Co., Ltd.***	PRC	RMB10,000,000	–	94.49	Manufacture and sale of washing machines
Qingdao Haier Electronics Sales Co., Ltd.**	PRC	RMB5,000,000	50	30#	Sale of washing machines

* Registered as a wholly-foreign-owned enterprise under the PRC law.
** Registered as a Sino-foreign equity joint venture enterprise under PRC Law.
*** Registered as a limited liability company under the PRC law.
# Interest held through Foshan Shunde Haier Electric Co., Ltd., a 60% indirectly owned subsidiary of the Company.

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.

21. INVENTORIES

Group	2005 HK$'000	2004 HK$'000 (Restated)
Raw materials	**113,927**	224,735
Work in progress	**68,993**	123,212
Finished goods	**250,725**	88,992
	433,645	436,939

22. TRADE AND BILLS RECEIVABLES

The Group normally allows an average credit period of 30 to 90 days to its trade customers. Trade receivables are non-interest-bearing.

An aged analysis of the trade and bills receivables as at the balance sheet date, based on the invoice date and net of provisions, is as follows:

Group	2005 HK$'000	2004 HK$'000 (Restated)
Trade receivables		
Within 1 month	**310,244**	605,370
1 to 2 months	**114,645**	233,715
2 to 3 months	**77,899**	10,037
Over 3 months	**33,803**	47,002
	536,591	896,124
Bills receivable	**140,919**	76,047
	677,510	972,171

Included in the Group's trade and bills receivables are amounts due from subsidiaries and associates of Haier Corp and Haier Investment of HK$485,608,000 (2004: HK$847,738,000 (as restated)), 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.

Notes to Financial Statements (cont'd) *(31 December 2005)*

23. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	Group		Company	
	2005 HK$'000	2004 HK$'000 (Restated)	**2005 HK$'000**	2004 HK$'000
Prepayments	**55,052**	54,394	**2**	23,134
Deposits and other receivables	**90,889**	77,342	**–**	–
	145,941	131,736	**2**	23,134

Included in prepayments are amounts advanced to subsidiaries and associates of Haier Corp and Haier Investment of HK$49,228,000 (2004: HK$48,411,000) (as restated)) for the purchases of moulds and materials. The amount are unsecured, interest free and are repayable on demand.

24. CASH AND CASH EQUIVALENTS AND PLEDGED DEPOSITS

	Group		Company	
	2005 HK$'000	2004 HK$'000 (Restated)	**2005 HK$'000**	2004 HK$'000
Cash and bank balances	**533,045**	245,242	**23,906**	1,168
Time deposits	**27,362**	–	**27,362**	113,662
	560,407	245,242	**51,268**	114,830
Less: Pledged deposits	**(70)**	(2,501)	**–**	–
Cash and cash equivalents	**560,337**	242,741	**51,268**	114,830

At the balance sheet date, the cash and bank balances and time deposits of the Group denominated in Renminbi ("RMB") amounted to HK$432,514,000 (2004: HK$242,741,000 (as restated)). 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.

Cash at banks earns interest at floating rates based on daily bank deposit rates. Short term time deposits are made for varying periods of between one day and one month depending on the immediate cash requirement of the Group, and earn interest at the respective short term time deposit rates. The carrying amounts of the cash and cash equivalents and the pledged deposits approximate to their fair values.

Included in the Group's cash and cash equivalents are deposits of approximately HK$260,133,000 (2004: HK$59,524,000 (as restated)) 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.

25. TRADE AND BILLS PAYABLES

An aged analysis of the trade payables as at the balance sheet date, based on the invoice date, is as follows:

Group	2005 HK$'000	2004 HK$'000 (Restated)
Trade payables		
Within 1 month	**445,144**	618,215
1 to 2 months	**129,504**	104,033
2 to 3 months	**119,850**	91,458
Over 3 months	**181,473**	323,234
	875,971	1,136,940
Bills payable	**96,145**	–
	972,116	1,136,940

Included in the Group's trade payables are amounts due to subsidiaries of Haier Corp and Haier Investment of HK$756,040,000 (2004: HK$793,724,000 (as restated)) which are repayable on similar credit terms to those offered by the major suppliers of the Group. Further details of the purchases from these related parties are set out in note 15 to the financial statements.

The trade payables are non-interest-bearing and are normally settled on credit terms ranging from 30 to 60 days.

26. OTHER PAYABLES AND ACCRUALS

	Group		Company	
	2005 HK$'000	2004 HK$'000 (Restated)	2005 HK$'000	2004 HK$'000
Other payables	**301,086**	124,955	**–**	–
Accruals	**151,100**	75,655	**6,071**	2,162
	452,186	200,610	**6,071**	2,162

Included in the Group's other payables are amounts due to subsidiaries of Haier Corp and Haier investment of HK$57,638,000 (2004: HK$73,446,000 (as restated)) which are unsecured, interest-free and are repayable on demand.

Notes to Financial Statements (cont'd) *(31 December 2005)*

27. INTEREST-BEARING BANK AND OTHER BORROWINGS

	Effective interest rate (%)	Maturity	Group 2005 HK$'000	Group 2004 HK$'000 (Restated)	Company 2005 HK$'000	Company 2004 HK$'000
Current						
Other loans, unsecured *(note)*	4 - 6	2006 or on demand	**81,731**	65,421	**–**	–
Trust receipts, unsecured	3 - 5	2006 or on demand	**43,076**	81,623	**–**	–
			124,807	147,044	**–**	–
Non-current						
Convertible notes *(note 28)*	4.75	2008	**211,528**	–	**211,528**	–
			336,335	147,044	**211,528**	–

	Group 2005 HK$'000	Group 2004 HK$'000 (Restated)	Company 2005 HK$'000	Company 2004 HK$'000
Analysed into:				
Bank loans repayable:				
Within one year or on demand	**43,076**	81,623	**–**	–
Other borrowings repayable:				
Within one year or on demand	**81,731**	65,421	**–**	–
In the second year	**–**	–	**–**	–
In the third to fifth year, inclusive	**211,528**	–	**211,528**	–
	293,259	65,421	**211,528**	–
	336,335	147,044	**211,528**	–

Note: Other loans comprised two loans borrowed from Haier Finance, which are guaranteed by Haier Corp, bear interest at a rate of approximately 5% per annum and are repayable within one year. Further details of the interest expense attributable to the loans borrowed from Haier Finance are set out in note 15 to the financial statements.

The Group's other loans are denominated in RMB and the convertible notes are denominated in Hong Kong Dollars. The Group's trust receipts are denominated in either United States Dollars or Japanese Yen.

Except for the convertible notes, all other borrowings of the Group bear interest at floating interest rates.

The directors consider that the carrying amounts of the Group's current borrowings approximate to their fair values. The fair value of the liability portion of the convertible notes is estimated at approximately HK$200 million, which is calculated by discounting the expected future cash flows at the prevailing interest rates.

28. CONVERTIBLE NOTES

On 28 January 2005, the Company issued convertible notes with an aggregate principal amount of HK$260 million to a subsidiary of Haier Group, Qingdao Haier Group Holdings (BVI) Ltd., as part of the purchase consideration for the Asset Injection. Further details are set out in note 2.1 to the financial statements.

The convertible notes have a three-year term and are non-interest-bearing. Each note is convertible at any time prior to the fifth business days before 27 January 2008, at the note holder's option, into the Company's ordinary shares at a conversion price of HK$0.18 per share. When the notes were issued, the prevailing market interest rate for similar notes without the conversion option was higher than the interest rate at which the notes were issued.

The fair value of the liability component of the convertible notes was determined at the issuance date, using the prevailing market interest rate for similar debt without a conversion option of 4.75% and is carried as a long term liability. The remaining portion was allocated to the conversion option that was recognised and included in shareholders' equity.

The net proceeds received from the issue of the convertible notes have been split between the liability and the equity components, as follows:

Group and Company	**2005** **HK$'000**	2004 HK$'000
Nominal value of convertible notes issued during the year	**260,000**	–
Equity component	**(33,790)**	–
Liability component at the issuance date	**226,210**	–
Interest expense *(note 8)*	**9,735**	–
Conversion of convertible notes *(note)*	**(24,417)**	–
Liability component at 31 December *(note 27)*	**211,528**	–

Note: During the year, convertible notes with face value of HK$ 27,000,000 were converted into 150,000,000 ordinary shares of the Company. Accordingly, the equity component and liability component of the convertible notes were reduced by HK$3,509,000 and HK$24,417,000, respectively.

Subsequent to the balance sheet date, on 3 January 2006 and 8 February 2006, 350,000,000 ordinary shares of the Company were issued upon conversion of the convertible notes with face value of HK$63,000,000 at a conversion price of HK$0.18 per share.

Notes to Financial Statements (cont'd) *(31 December 2005)*

29. PROVISIONS

Group	**Product warranties and installation**	
	2005	2004
	HK$'000	HK$'000
		(Restated)
At beginning of year (as restated)	**20,487**	21,735
Additional provision	**108,272**	83,513
Amounts utilised during the year	**(100,360)**	(84,761)
Exchange realignment	**591**	–
At 31 December	**28,990**	20,487
Portion classified as current liabilities	**(20,184)**	(16,499)
Non-current portion	**8,806**	3,988

The Group provides installation services and three-year warranties to its customers on washing machines, under which faulty products are repaired or replaced. The amount of provisions is estimated based on sales volume and past experience of the level of installation service rendered, repairs or returns. The estimation basis is reviewed on an ongoing basis and revised where appropriate.

30. DEFERRED TAX

The movements in deferred tax assets and liabilities (representing the provision for obsolete and slow-moving inventories, accruals and provisions) during the year are as follows:

Deferred tax assets	**2005**	2004
	HK$'000	HK$'000
		(Restated)
Group		
At 1 January (as restated)	**21,527**	23,260
Deferred tax charged to the income statement during the year *(note 11)*	**(9,410)**	(1,733)
Exchange realignment	**619**	–
At 31 December	**12,736**	21,527

Deferred tax liabilities	**2005**	2004
	HK$'000	HK$'000
		(Restated)
Group		
At 1 January (as restated)	**606**	2,078
Deferred tax credited to the income statement during the year *(note 11)*	**(623)**	(1,472)
Exchange realignment	**17**	–
At 31 December	**–**	606

30. DEFERRED TAX (cont'd)

The Group has tax losses arising in Hong Kong of HK$35,702,000 (2004: HK$40,419,000 (as restated)) 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 2005, there is no significant unrecognised deferred tax liability (2004: 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.

31. ISSUED EQUITY

Group	**Issued equity** HK$'000
At 1 January 2004 and 2005	352,324
Acquisition of subsidiaries *(note (i))*	445,307
Conversion of convertible notes *(note 28)*	27,926
Exercise of share options *(note (ii))*	28,602
At 31 December 2005	854,159

Due to the use of reverse acquisition accounting (note 2.2), the amount of issued equity, comprising share capital, contributed surplus and share premium in the consolidated balance sheet, represents the amount of issued equity of legal subsidiaries, the Haier Businesses. The equity structure (i.e. the number and type of shares) reflects the equity structure of the legal parent, Haier Electronics Group Co., Ltd.

Company	**2005** **HK$'000**	2004 HK$'000
Authorised:		
30,000,000,000 (2004: 30,000,000,000) shares of HK$0.10 each	**3,000,000**	3,000,000
Issued and fully paid:		
16,670,734,612 (2004: 9,964,027,945) shares of HK$0.10 each	**1,667,073**	996,403

31. ISSUED EQUITY (cont'd)

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$'000	Share premium account HK$'000	Total HK$'000
At 1 January 2004	9,964,016,574	996,402	70,174	1,066,576
Warrants exercised	11,371	1	5	6
At 31 December 2004 and beginning of year	9,964,027,945	996,403	70,179	1,066,582
Transfer of share premium account and contributed surplus to set off against accumulated losses *(note (iii))*	–	–	(70,179)	(70,179)
Issue of shares on the Asset Injection *(note 2.1)*	4,026,706,667	402,670	322,136	724,806
Issue of shares on the Call Option Exercise *(note 2.1)*	2,343,000,000	234,300	234,300	468,600
Conversion of convertible notes *(note 28)*	150,000,000	15,000	12,926	27,926
Exercise of share options *(note (ii))*	187,000,000	18,700	9,902	28,602
At 31 December 2005	16,670,734,612	1,667,073	579,264	2,246,337

Notes:

(i) The deemed consideration in respect of the acquisition of subsidiaries amounted to HK$755,307,000 (note 34). The convertible notes of HK$260,000,000 and cash consideration of HK$50,000,000 satisfied by the Company in respect of the acquisition of subsidiaries (note 2.1) are regarded as deemed distributions to Haier Group.

(ii) Details of the Company's share option schemes and the share options issued under the schemes are included in note 32 to the financial statements.

(iii) Pursuant to a special resolution passed at the annual general meeting of the Company held on 25 May 2005, the Company carried out the following capital reorganisations:

(a) the credit balance of share premium account amounted to HK$70,179,000 was reduced and applied to offset an equivalent amount of the accumulated losses of the Company as at 31 December 2004; and

(b) the credit balance of contribution surplus amounted to HK$844,286,000 was reduced and applied to offset an equivalent amount of the accumulated losses of the Company as at 31 December 2004.

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.

11,371 warrants were exercised for 11,371 shares at HK$0.52 per share in 2004. On 26 February 2004, all outstanding 2004 warrants were expired and the subscription rights attaching to the 2004 warrants which have not been exercised by 26 February 2004 were expired and lapsed.

32. 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. The share options granted under the Old Share Option Scheme were fully exercised during the year. As at 31 December 2005, there were 607,500,000 share options outstanding under the New Share Option Scheme.

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 and 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.

Share options granted to a director 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 no 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.

Notes to Financial Statements (cont'd) *(31 December 2005)*

32. SHARE OPTION SCHEMES (cont'd)

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

Category of participant	Number of share options: Outstanding as at 1 January 2005	Exercised during the year	Lapsed/ cancelled during the year	Outstanding as at 31 December 2005	Date of grant of share options *(Note 1)*	Exercise period of share options	Exercise price per share *(Note 2)* HK$
EMPLOYEES							
In aggregate	3,000,000	(3,000,000)	–	–	13/7/2001	13/1/2002– 12/7/2006*	0.190

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 date of expiry has been extended one year from the original date of expiry of 12 July 2005 to 12 July 2006 pursuant to the Board resolution of the Company passed on 30 June 2005.

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 2005	Exercised during the year	Lapsed/ cancelled during the year	Transfer from/(to) other category during the year	Outstanding as at 31 December 2005	Date of grant of share options *(Note 1)*	Exercise period of share options	Exercise price per share *(Note 2)* HK$	Price of Company's shares: Immediately before the exercise date HK$	At exercise date of option HK$
Executive directors										
Wu Ke Song	89,000,000	(27,000,000)	-	-	62,000,000	19/11/2002	19/11/2003 - 18/11/2007	0.150	0.217	0.214
Chai Yong Sen	89,000,000	(27,000,000)	-	-	62,000,000	19/11/2002	19/11/2003 - 18/11/2007	0.150	0.219	0.216
Liang Hai Shan	89,000,000	(29,000,000)	-	-	60,000,000	19/11/2002	19/11/2003 - 18/11/2007	0.150	0.217	0.215
Cui Shao Hua	89,000,000	(29,000,000)	-	-	60,000,000	19/11/2002	19/11/2003 - 18/11/2007	0.150	0.218	0.216
Mak Shiu Tong, Clement *(Note 3)*	89,000,000	-	-	(89,000,000)	-	16/8/2002	16/08/2003 - 15/08/2007	0.156	-	-
Tam Ngai Hung, Terry *(Note 3)*	89,000,000	-	-	(89,000,000)	-	16/8/2002	16/08/2003 - 15/08/2007	0.156	-	-
Man Wei Dong *(Note 3)*	89,000,000	-	(89,000,000)	-	-	19/11/2002	19/11/2003 - 18/11/2007	0.150	-	-
	623,000,000	(112,000,000)	(89,000,000)	(178,000,000)	244,000,000					

32. SHARE OPTION SCHEMES (cont'd)

Details of the movements of share options under the New Share Option Scheme during the year were as follows: (cont'd)

	Number of share options								Price of Company's shares	
Name or category of participant	Outstanding as at 1 January 2005	Exercised during the year	Lapsed/ cancelled during the year	Transfer from/(to) other category during the year	Outstanding as at 31 December 2005	Date of grant of share options (Note 1)	Exercise period of share options	Exercise price per share (Note 2) HK$	Immediately before the exercise date HK$	At exercise date of option HK$
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	(3,000,000)	-	-	2,000,000	16/8/2002	16/8/2003 - 15/8/2007	0.156	0.207	0.205
	10,000,000	(3,000,000)	-	-	7,000,000					
Other employees										
In aggregate	247,500,000	-	-	(247,500,000)	-	16/8/2002	16/8/2003 - 15/8/2007	0.156	-	-
Other participants										
In aggregate	-	(69,000,000)	-	425,500,000	356,500,000	16/8/2002	16/8/2003 - 15/8/2007	0.156	0.222	0.217
	880,500,000	(184,000,000)	(89,000,000)	-	607,500,000					

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.

3. Mak Shiu Tong, Clement, Tam Ngai Hung, Terry, and Man Wei Dong resigned as directors of the Company on 28 January 2005.

At the balance sheet date, the Company had 607,500,000 share options outstanding under the New Share Option Scheme, which represented a total of approximately 3.64% 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 607,500,000 additional ordinary shares of the Company and additional share capital of HK$60,750,000 and share premium of HK$32,556,000 (before issue expenses).

Subsequent to the balance sheet date, certain directors exercised in aggregate 206,500,000 share options (52,000,000 share options each for Wu Ke Song and Chai Yong Sen, 50,000,000 share options each for Liang Hai Shan and Cui Shao Hua and 2,500,000 share options for Lam Kin Kau, Mark) and certain other participants exercised 51,000,000 share options. In addition, an employee was granted 5,000,000 share options subsequent to the balance sheet date.

33. RESERVES

(a) Group

The amounts 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 32 the financial statements.

In accordance with the relevant PRC laws and regulations applicable to sino-foreign venture enterprises and wholly-owned enterprises, certain subsidiaries of the Company in the PRC are required to transfer a certain percentage of their net profit for the year to reserve funds. These funds are non-distributable. For the purpose of determining the appropriations to these funds, the net profit is determined in accordance with the applicable financial rules and regulations in the PRC.

(b) Company

	Share premium account HK$'000	**Contributed surplus** HK$'000	**Accumulated losses** HK$'000	**Total** HK$'000
At 1 January 2004	70,174	1,035,156	(870,038)	235,292
Exercise of warrants	5	–	–	5
Net loss for the year	–	–	(44,427)	(44,427)
At 31 December 2004 and beginning of the year	70,179	1,035,156	(914,465)	190,870
Transfer of share premium account and contributed surplus to set off against accumulated loss *(note 31(iii))*	(70,179)	(844,286)	914,465	–
Issue of shares on the Asset Injection *(note 2.1)*	322,136	–	–	322,136
Issue of shares on the Call Option Exercise *(note 2.1)*	234,300	–	–	234,300
Conversion of convertible notes *(note 28)*	12,926	–	–	12,926
Exercise of share options *(note 31(ii))*	9,902	–	–	9,902
Net loss for the year	–	–	(1,250,311)	(1,250,311)
At 31 December 2005	579,264	190,870	(1,250,311)	(480,177)

Note: The contributed surplus of the Company represents the excess of the fair value 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.

34. BUSINESS COMBINATION

On 28 January 2005, the Company acquired Haier Businesses, which are treated as the acquirer for accounting purpose in the business combination under HKFRS 3, details of which are set out in note 2.2 to the financial statements.

The fair values of the identifiable assets and liabilities of the Former Group as at the date of acquisition, which have no significant differences from their carrying amounts immediately before the acquisition were as follows:

	Notes	2005 HK$'000	2004 HK$'000
Property, plant and equipment		**228,023**	–
Cash and bank balances		**130,189**	–
Prepayments and other receivables		**30,805**	–
Trade payables		**(134)**	–
Accruals and other payables		**(75,136)**	–
Minority interests		**119,613**	–
		433,360	–
Goodwill	*19*	**321,947**	–
		755,307	–
Consideration satisfied by:			
Issued equity	*31*	**445,307**	–
Convertible notes*		**260,000**	–
Cash*		**50,000**	–
		755,307	–

* *regarded as deemed distributions to Haier Group (note 31)*

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

	2005 HK$'000	2004 HK$'000
Cash and bank balances acquired	**130,189**	–
Cash consideration	**(50,000)**	–
Net inflow of cash and cash equivalents in respect of the acquisition	**80,189**	–

The Former Group had no post-acquisition contribution to the Group's turnover and contributed HK$114,687,000 to the Group's consolidated loss for the year ended 31 December 2005.

There would have been no significant differences to the Group's consolidated loss for the year had the combination taken place at the beginning of the year.

Notes to Financial Statements (cont'd) *(31 December 2005)*

35. CONTINGENT LIABILITIES

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

36. OPERATING LEASE ARRANGEMENTS

(a) As lessor

The Group leases part of its buildings under an operating lease arrangement, with the lease negotiated for a term of twelve months.

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

	Group	
	2005	2004
	HK$'000	HK$'000
Within one year	**1,356**	1,646
In the second to fifth year, inclusive	**–**	721
	1,356	2,367

(b) As leasee

The Group leases certain of its buildings under operating lease arrangement. Leases for the buildings are negotiated for terms ranging from one to ten years.

At the balance sheet date, the Group had total future minimum lease payments under non-cancellable operating lease falling due as follows:

	Group	
	2005	2004
	HK$'000	HK$'000
Within one year	**1,908**	2,341
In the second to fifth year, inclusive	**5,213**	5,604
After five years	**–**	1,136
	7,121	9,081

37. COMMITMENTS

In addition to the operating lease commitments detailed in note 36(b) above, the Group and the Company had the following commitments at the balance sheet date:

	Group		Company	
	2005	2004	**2005**	2004
	HK$'000	HK$'000	**HK$'000**	HK$'000
Contracted, but not provided for:				
Acquisition of fixed assets	**2,982**	13,764	**–**	–
Contracted, but not provided for:				
Capital contribution payable to				
a wholly-owned subsidiary in the PRC	**–**	–	**–**	14,153
	2,982	13,764	**–**	14,153

38. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments, comprise convertible notes, other interest-bearing loans and cash and short term deposits. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations.

It is, and has been, throughout the year under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are cash flow interest rate risk, foreign currency risk, credit risk and liquidity risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below.

Cash flow interest rate risk

The Group's exposure to the risk of changes in market interest rates related primarily to the Group's short term debt obligations with a floating interest rate. The Group's policy is to manage its interest cost using an appropriate mix of fixed and variable rate borrowings.

Foreign currency risk

The Group has transactional currency exposures. Such exposures arise from sales or purchases by operating units in currencies other than the units' functional currency. Foreign currency risk is not considered significant because most of the Group's sales and purchases are denominated in RMB.

Credit risk

The Group trades only with recognised and creditworthy customers. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis and the Group's exposure to bad debts is not significant.

With respect to credit risk arising from the other financial assets of the Group, which comprise cash and cash equivalents, the Group's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these financial assets.

Since the Group trade only with recognised and creditworthy customers, there is no requirement for collateral.

38. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (cont'd)

Liquidity risk

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank loans and other borrowings. As the Group's major operations are in Mainland China, all of the Group's borrowings (except for the convertible notes) are borrowed from Haier finance or major local banks in Mainland China, on a short term basis for working capital purpose.

39. COMPARATIVE AMOUNTS

As further explained in notes 2.1, 2.2, 3.2 and 3.4 to the financial statements, due to the application of reverse acquisition accounting and adoption of new and revised HKFRSs during the current year, the comparative amounts and presentation of certain items and balances in the financial statements have been reclassified and restated to comply with the current year's presentation and accounting treatment.

40. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 19 April 2006.