Management Discussion and Analysis

FINANCIAL REVIEW

The revenue of the Group amounted to approximately HK$45.8 million for the year ended 31 December 2005, representing an increase of approximately 218 per cent as compared with that for the year 2004. The Group reported a net loss of approximately HK$320.6 million for the year ended 31 December 2005, as compared to a net profit of approximately HK$67.7 million for the year 2004.

Revenue from property investment and management continued to decrease as the Group has disposed of certain investments in property in the second half of 2004, in order to carry out its plan of diversifying business. The Group started cultural recreation content provision business, through acquiring and establishing subsidiaries, and generated revenue. At the same time, the Group started finance leasing business during the year. As the revenue generated by the new businesses has outweighed the decrease in revenue of property investment and management, the Group's revenue increased.

Due to that one of the Group's subsidiaries, Global Digital Creations Holdings Limited ("GDC"), was under restructuring after it is acquired by the Group and started a new business as a contractor for computer graphic ("CG") production and creation, the new business has not generated gross profit after deducting certain starting up costs. Although the Group has generated gross profit in other businesses, including property investment and finance leasing, the Group has incurred gross losses in aggregate during the year ended 31 December 2005.

During the year ended 31 December 2005, other income amounted to approximately HK$19.9 million which was mainly consist of increase in fair value of investment properties, dividend income from an associate held for sale, interest income and gain on disposal of investments held for trading. Other income for the year 2004 was mainly interest income.

Through acquisition of GDC, the Group has entered into the business of digital content distribution and exhibitions, which include sales of digital cinema equipment. This business incurred distribution costs amounted to approximately HK$2.5 million during the year ended 31 December 2005.

During the year ended 31 December 2005, administrative expenses amounted to approximately HK$102.4 million, representing an increase of approximately 175% as compared with that of the year 2004 amounted to approximately HK$37.2 million. The increase in administrative expenses was mainly due to that the Group has acquired and established a number of subsidiaries to carry out its plan of diversifying business and more expenses was incurred to restructure and to implement control on the subsidiaries. At the same time, in order to improve the incentive scheme to the management and staff of the Group, most of the former share option scheme has been cancelled during the year ended 31 December 2005. Expenses related to share option increased as economic value of the share option cancelled which would originally be charged to the Group's income statement throughout the vesting period has been totally charged as expense for the year ended 31 December 2005.

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During the year ended 31 December 2005, finance costs amounted to approximately HK$7.0 million, representing an increase of approximately 233% as compared with that of the year 2004 amounted to approximately HK$2.1 million. It is mainly the result of that balance of borrowings from shareholder, bank and other corporations and individuals increased as the Group increased in aggregate its borrowings from these parties to finance its diversifying business and working capital requirements during the process of diversification.

During the year ended 31 December 2005, there was an expense of impairment of goodwill amounted to approximately HK$191.5 million. During the year 2004, there were two non-recurring transactions, namely exceptional gain on deemed disposal of the Group's holding in shares of Shougang Concord Technology Holdings Limited amounted to approximately HK$189.2 million and expenses of impairment and amortisation of goodwill and net assets of a jointly controlled entity amounted to approximately HK$90.0 million.

BUSINESS REVIEW AND OUTLOOK

The Group has been actualising its business plan of diversifying its core business into businesses other than property investment and management, namely financial service provision and cultural recreation content provision.

PROPERTY INVESTMENT AND MANAGEMENT

Hong Kong Investment Properties

Both rental income and resalable value of the Group's investment properties has been improving comparing with 2004. However, as the Group had disposed of certain investments in industrial property, the aggregate amount of rental income decreased.

Beijing Dongzhimen International Apartment Co., Limited ("Beijing Dongzhimen")

The Group continually holds 44% interests in Beijing Dongzhimen. Despite competition in Beijing service department market is severe, the performance of Beijing Dongzhimen was significantly improved. At the same time, the Directors consider that there were no further impairment in book value of Beijing Dongzhimen's net asset and a provision for such impairment which was amounted to approximately HK$67.5 million for the corresponding period in 2004 is not necessary. Further, as there is no balance of goodwill of investment in Beijing Dongzhimen, there was no amortisation and/or write-off of goodwill, which was amounted to approximately HK$22.5 million for the year 2004, charged to the income statement during the year ended 31 December 2005.

Management Discussion and Analysis

FINANCIAL SERVICE PROVISION

Finance Leasing

The Group has acquired 60 per cent interest in South China International Leasing Company Limited ("South China Leasing") during the year ended 31 December 2005. In addition, the Group has agreed with a third party to acquire its entire equity interest in Valuework Investment Holdings Limited ("Valuework"), a company incorporated in the British Virgin Islands with limited liability and held 20% equity interest of South China Leasing, for a consideration of approximately RMB1,520,000, or equivalent to approximately HK$1,460,000. As at 31 December 2005, although the transfer has been documented by an instrument of transfer, the Group has not yet paid the consideration. Accordingly, the Group has not yet recognised its control on the 100% equity interest in Valuework and its indirect 20% equity interest in South China leasing in its accounting records. During the year ended 31 December 2005, business of South China Leasing was restructured and streamlined and resumed generating finance lease income from July 2005.

Financial Investment

To explore financial service provision business, the Group through its wholly owned subsidiary, 首方投資管理(深圳)有限公司 ("Capital Steel"), utilising its own fund, actively made financial service business such as asset custodian and project financial investment, as well as providing clients consultancy service such as design and evaluation of merger and acquisition and bank financing scheme. By the end of the year 2005, Capital Steel has signed an memorandum of cooperation on asset management with 國投資產管理公司 and been successfully making a direct financial investment amounted to RMB30 million in a project and generating income within the same year.

Possible Subscription of Shares in China Life Insurance (Overseas) Company Limited ("China Life (Overseas)")

Negotiation on a proposed subscription of shares in China Life (Overseas) has been terminated by mutual agreement between the shareholder of China Life (Overseas) and the Group as the two parties have been failed to agree on certain material terms of a proposed shareholder agreement between the shareholders of China Life (Overseas) after the proposed subscription. The conclusion of the proposed shareholder agreement is a condition to completion of the proposed subscription. Neither the shareholder of China Life (Overseas) and the Group is entitled to claim the other for any losses, damages and expenses as a result of the termination.

The Group is continuing to actively explore other opportunities to be engaged in finance service business.

CULTURAL RECREATION CONTENT PROVISION

By a voluntary conditional share exchange offer, the Group acquired approximately 82.22% interest in GDC, a group of companies listed on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited and mainly engaged in creation and production of CGs, distribution and exhibition of digital content, and training of CG artists. To comply with the requirements of GEM Listing Rules in respect of maintaining minimum public floating of 25%, the Group placed out shares of GDC held by the Group equivalent to approximately 7.24 per cent of GDC's share capital in September 2005. After the voluntary conditional share exchange offer being completed, the Group reorganised GDC's business and expected it will generate positive return in the foreseeable future.

Management Discussion and Analysis

During the year ended 31 December 2005, through subsidiaries other than GDC, the Group started providing cultural recreation content, including movies and television drama series and generating revenue.

OUTLOOK

The Directors will monitor closely the property market and will dispose of its investments in property, especially in industrial property, in case of such disposal will offer satisfactory return. The Directors expect that there will be continuous stable growth in return from Beijing Dongzhimen for the foreseeable future.

The finance leasing business of the Group is expected to start to be profitable from the year 2006. The Group has been negotiating and concluding finance leasing contracts of material amount. Such contracts are expected to contribute significant revenue to the Group. In the coming year, Capital Steel will firmly carry out financial investment in industries including infrastructure, culture and real estate, etc. Its business is expected to have further breakthrough and become a new growing point of income of the Group.

The Group has focused its strategy in cultural recreation content provision business at subcontracting for production and creation of CG. The subcontracting business is expected to contribute cash inflow from operation to the Group in the year 2006. The Group is also engaged in digital content distribution and exhibition business. In case digitalisation of cinema is rolled out during the year 2006, as anticipated by participants in the industry, the Group business of sale of digital cinema equipment will be a point of dramatic growth. To capture the benefit of the enormous growth in digital cinema equipment business, the Group is restructuring its subsidiary engaged in the business by inviting the subsidiary's management and staff to become shareholders of the subsidiary and inviting strategic partner to invest in the subsidiary.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

The shareholders' fund of the Company amounted to approximately HK$210.5 million as at 31 December 2005 (2004: HK$342.3 million). The decrease was mainly arisen from the net loss for the year that was partially offset by the increment of share premium as a result of shares issued for acquisition of a subsidiary.

The Group had bank balances and cash and pledged bank deposits of approximately HK$36.3 million as at 31 December 2005 (2004: HK$185.2 million) which were mainly denominated in Hong Kong dollars and Renminbi. The decrease was mainly because of that cash were used in operating activities of the Group.

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The Group's bank borrowings and other banking facilities utilised amounted to approximately HK$91.2 million as at 31 December 2005 which comprised approximately HK$61.6 million and HK$29.6 million repayable within one year and repayable more than one year as at 31 December 2005 respectively. Bank loans include approximately HK$25.0 million fixed-rate borrowing which carry interest at 6% per annum. The remaining bank loans and banking facilities utilised are variable-rate borrowings which carry interest at Hong Kong Interbank Offered Rate ("HIBOR") plus 1.35% per annum.

Gearing ratio (calculated as bank borrowings less bank balances and cash and pledged bank deposits divided by shareholders' fund) as at 31 December 2005 was approximately 26.1% (no gearing ratio as at 31 December 2004 has been presented as the Group had a net cash position at the balance sheet date). The Group's leverage increased was mainly due to that the Group needed additional working capital to finance its new businesses.

Approximately HK$66.3 million and HK$25.0 million of the bank borrowings and other banking facilities utilised outstanding at 31 December 2005 were secured and unsecured respectively. The Group's bank borrowings were secured by pledged bank deposits, investment properties, land and buildings with carrying value of approximately HK$16.5 million, HK$83.0 million, HK$1.7 million and HK$0.8 million as at 31 December 2005 respectively.

The routine business operation and investment of the Group are in Hong Kong and the PRC, with revenue and expenditure denominated mainly in Hong Kong dollars, Renminbi and United States dollars. The Renminbi income from the PRC and United States dollar incomes from areas outside the PRC and Hong Kong are mainly remitted to Hong Kong at the prevailing official exchange rate. Given the stable official exchange rate among Hong Kong dollars, Renminbi and United States dollars, the Directors believe that it will not be subject to any significant exposure associated with fluctuation in exchange rates under foreseeable circumstances.

CONTINGENT LIABILITIES

Saving for the litigations in process as disclosed in note 50 to the financial statements, as at 31 December 2005, the Group did not have any material contingent liability.

EMPLOYEES AND REMUNERATION POLICIES

As at 31 December 2005, there were about 410 employees (2004: 16) (excluding those under the payroll of the associates and the jointly-controlled entity of the Group) for the Group. Remuneration packages are reviewed either annually or by special increment. In addition to basic salary, other staff benefits include medical and hospitalization subsidies, and mandatory provident fund scheme.

During the year ended 31 December 2005, the Company and its subsidiaries did not pay or commit to pay any amount as an inducement to join or upon joining the Company and/or its subsidiaries to any individual.