

# Haier 海尔

Haier Electronics Group Co., Ltd.  
海爾電器集團有限公司\*

(Incorporated in Bermuda with limited liability)  
(於百慕達註冊成立之有限公司)

Stock Code 股份代號 : 1169



Interim Report

# 2006

中期報告

\* for identification purpose only  
僅供識別

# MISSION

**To become the listed flagship of Haier Group's white goods businesses and ultimately to be a global top 3 white goods manufacturer.**

## CONTENTS

2	CORPORATE INFORMATION
	CONDENSED CONSOLIDATED:
3	INCOME STATEMENT
5	BALANCE SHEET
7	STATEMENT OF CHANGES IN EQUITY
8	CASH FLOW STATEMENT
9	NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
30	MANAGEMENT DISCUSSION AND ANALYSIS
37	DISCLOSURE OF INTERESTS
41	SHARE OPTION SCHEME

**CORPORATE INFORMATION****Company Name**

Haier Electronics Group Co., Ltd.

**Board of Directors****Executive Directors**

Ms. YANG Mian Mian (*Chairman*)  
 Mr. WU Ke Song (*Deputy Chairman*)  
 Mr. CHAI Yong Sen  
 Mr. LIANG Hai Shan  
 Mr. CAO Chun Hua  
 Mr. CUI Shao Hua  
 Mr. SONG Chun Guang

**Independent Non-executive Directors**

Mr. LAM Kin Kau, Mark  
 Mr. FUNG Hoi Wing, Henry  
 Mr. WU Yinong

**Board Committees****Audit Committee**

Mr. LAM Kin Kau, Mark (*Chairman*)  
 Mr. FUNG Hoi Wing, Henry  
 Mr. WU Yinong

**Remuneration Committee**

Mr. FUNG Hoi Wing, Henry (*Chairman*)  
 Mr. LAM Kin Kau, Mark  
 Mr. WU Yinong  
 Mr. WU Ke Song  
 Mr. CUI Shao Hua

**Qualified Accountant & Company Secretary**

Mr. YIP Wai Ming

**Legal Adviser**

Mallesons Stephen Jaques

**Principal Banker in Hong Kong**

Nanyang Commercial Bank, Ltd.

**Principal Banker in the PRC**

China Construction Bank Corporation

**Auditors**

Ernst & Young

**Financial Calendar**

Six-month interim period end : 30 June  
 Financial year end : 31 December

**Registered Office**

Clarendon House  
 2 Church Street  
 Hamilton HM 11  
 Bermuda

**Head Office and Principal Place of Business in Hong Kong**

Unit 3513  
 35/F., The Center  
 99 Queen's Road Central  
 Hong Kong

**Principal Place of Business in the PRC**

No. 1, Haier Road  
 Hi-tech Zone  
 Qingdao, the PRC

**Branch Share Registrar and Transfer Office in Hong Kong**

Tengis Limited  
 26/F., Tesbury Centre  
 28 Queen's Road East  
 Hong Kong

**Telephone Number**

+852 2169 0000

**Fax Number**

+852 2169 0880

**Stock Code**

1169

**Website**

www.haier-elec.com.hk

**INTERIM RESULTS**

The Board of Directors of Haier Electronics Group Co., Ltd. (“the Company”, together with its subsidiaries, the “Group”) hereby announces the unaudited consolidated interim results of the Group for the six months ended 30 June 2006 together with comparative figures for the corresponding period in 2005. These condensed consolidated interim financial statements have not been audited, but have been reviewed by the Company’s audit committee.

**CONDENSED CONSOLIDATED INCOME STATEMENT**

For the six months ended 30 June 2006

		<b>For the six months ended 30 June</b>	
		<b>2006</b>	2005
		<b>(Unaudited)</b>	(Restated)
	Notes	<b>HK\$'000</b>	<b>HK\$'000</b>
<b>CONTINUING OPERATIONS</b>			
REVENUE	2	<b>1,785,958</b>	1,304,081
Cost of sales		<b>(1,311,806)</b>	(1,012,227)
Gross profit		<b>474,152</b>	291,854
Other income and gains	3	<b>3,598</b>	5,288
Selling and distribution costs		<b>(313,348)</b>	(209,027)
Administrative expenses		<b>(111,192)</b>	(72,599)
Finance costs	4	<b>(4,079)</b>	(4,417)
PROFIT BEFORE TAX		<b>49,131</b>	11,099
Tax	6	<b>(20,662)</b>	(2,888)
PROFIT FOR THE PERIOD FROM CONTINUING OPERATIONS		<b>28,469</b>	8,211
<b>DISCONTINUED OPERATION</b>			
Profit/(loss) for the period from a discontinued operation	9	<b>103,420</b>	(399,733)
PROFIT/(LOSS) FOR THE PERIOD	5	<b>131,889</b>	(391,522)
Attributable to:			
Equity holders of the parent		<b>126,575</b>	(397,006)
Minority interests		<b>5,314</b>	5,484
		<b>131,889</b>	(391,522)
DIVIDEND	7	<b>Nil</b>	Nil

**CONDENSED CONSOLIDATED INCOME STATEMENT** (Continued)

For the six months ended 30 June 2006

	Note	For the six months ended 30 June	
		2006 (Unaudited) HK\$'000	2005 (Restated) HK\$'000
<b>EARNINGS/(LOSS) PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT</b>	8		
Basic			
— For profit/(loss) for the period		<u>0.74 cents</u>	<u>(2.68) cents</u>
— For profit from continuing operations		<u>0.13 cents</u>	<u>0.02 cents</u>
Diluted			
— For profit/(loss) for the period		<u>0.71 cents</u>	<u>N/A</u>
— For profit from continuing operations		<u>0.13 cents</u>	<u>0.02 cents</u>

**CONDENSED CONSOLIDATED BALANCE SHEET**

30 June 2006

	Notes	30 June 2006 (Unaudited) HK\$'000	31 December 2005 (Audited) HK\$'000
<b>NON-CURRENT ASSETS</b>			
Property, plant and equipment	10	244,061	636,288
Prepaid land premiums		24,894	25,462
Intangible assets		—	3,437
Deferred tax assets		13,437	12,736
Total non-current assets		282,392	677,923
<b>CURRENT ASSETS</b>			
Inventories		165,576	433,645
Trade and bills receivables	11	132,638	677,510
Prepayments, deposits and other receivables		69,672	145,941
Amount due from a fellow subsidiary	15(e)	419,954	—
Tax recoverable		218	3,342
Pledged deposits		—	70
Cash and cash equivalents		629,283	560,337
Total current assets		1,417,341	1,820,845
<b>CURRENT LIABILITIES</b>			
Trade and bills payables	12	223,388	972,116
Tax payable		18,486	5,030
Other payables and accruals		321,760	452,186
Provisions		36,142	20,184
Interest-bearing bank and other borrowings		—	124,807
Total current liabilities		599,776	1,574,323
NET CURRENT ASSETS		817,565	246,522
TOTAL ASSETS LESS CURRENT LIABILITIES		1,099,957	924,445

**CONDENSED CONSOLIDATED BALANCE SHEET** *(Continued)*

30 June 2006

	<i>Notes</i>	<b>30 June 2006 (Unaudited) HK\$'000</b>	31 December 2005 (Audited) HK\$'000
<b>NON-CURRENT LIABILITIES</b>			
Convertible notes	13	<b>157,957</b>	211,528
Provisions		<b>16,606</b>	8,806
Total non-current liabilities		<b>174,563</b>	220,334
Net assets		<b>925,394</b>	704,111
<b>EQUITY</b>			
Equity attributable to equity holders of the parent			
Issued equity	14	<b>965,082</b>	854,159
Equity component of convertible notes	14	<b>22,094</b>	30,281
Reserves	14	<b>(138,437)</b>	(251,670)
Minority interests	14	<b>848,739</b>	632,770
Total equity		<b>76,655</b>	71,341
		<b>925,394</b>	704,111

**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY***For the six months ended 30 June 2006*

	Notes	For the six months ended 30 June	
		2006	2005
		(Unaudited) HK\$'000	(Unaudited) HK\$'000
Total equity at 1 January		704,111	689,555
Changes in equity during the period:			
Profit/(loss) for the period	14	131,889	(391,522)
Dividend to minority interests	14	—	(6,126)
Equity-settled share option arrangements	14	409	—
Exercise of share options	14	45,005	6,708
Issue of convertible notes	14	—	33,791
Conversion of convertible notes	14	57,322	—
Acquisition of subsidiaries	14	—	325,694
Disposal of subsidiaries	14	(13,342)	—
Total equity at 30 June		<u>925,394</u>	<u>658,100</u>
Total income and expense for the period attributable to:			
Equity holders of the parent		126,575	(397,006)
Minority interests		5,314	5,484
		<u>131,889</u>	<u>(391,522)</u>



**CONDENSED CONSOLIDATED CASH FLOW STATEMENT***For the six months ended 30 June 2006*

	<b>For the six months ended 30 June</b>	
	<b>2006</b>	2005
	<b>(Unaudited)</b> <i>HK\$'000</i>	(Unaudited) <i>HK\$'000</i>
NET CASH INFLOW FROM OPERATING ACTIVITIES	<b>135,144</b>	70,429
NET CASH INFLOW/(OUTFLOW) FROM INVESTING ACTIVITIES	<b>(53,978)</b>	56,545
NET CASH INFLOW/(OUTFLOW) FROM FINANCING ACTIVITIES	<b>(12,220)</b>	19,879
NET INCREASE IN CASH AND CASH EQUIVALENTS	<b>68,946</b>	146,853
Cash and cash equivalents at beginning of period	<b>560,337</b>	242,741
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<b>629,283</b>	389,594
ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS		
Cash and bank balances	<b>594,899</b>	353,797
Time deposits with original maturity of less than three months when acquired	<b>34,384</b>	35,797
	<b>629,283</b>	389,594

**NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS***30 June 2006***1. Accounting Policies**

The condensed consolidated interim financial statements are prepared in accordance with Hong Kong Accounting Standard (“HKAS”) 34 “Interim Financial Reporting”. The accounting policies and basis of preparation adopted in the preparation of the interim financial statements are the same as those used in the annual financial statements for the year ended 31 December 2005, except in relation to the following new and revised Hong Kong Financial Reporting Standards (“HKFRSs”, which also include HKASs and Interpretations) that affect the Group and are adopted the first time for the current period’s financial statements:

HKAS 39 Amendment	The Fair Value Option
HKAS 39 & HKFRS 4 Amendments	Financial Guarantee Contracts
HK(IFRIC)-Int 4	Determining whether an Arrangement contains a Lease

The adoption of the above new and revised HKFRSs does not have any significant impact on the Group’s condensed consolidated financial statements.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 2. Segment Information

The Group's operating businesses are structured and managed separately according to the nature of their operations and the products they provide. Each of the Group's business segments represents a strategic business unit that offers products which are subject to risks and returns that are different from those of the other business segments. The following tables present revenue and result for the Group's primary segments.

For the six months ended 30 June 2006

	Continuing operations			Discontinued operation	
	Washing machine business (Unaudited) HK\$'000	Corporate and others (Unaudited) HK\$'000	Total (Unaudited) HK\$'000	Mobile handset business (Unaudited) HK\$'000	Total (Unaudited) HK\$'000
Revenue:					
External sales	1,785,958	—	1,785,958	1,014,163	2,800,121
Other income and gains	859	—	859	882	1,741
	<u>1,786,817</u>	<u>—</u>	<u>1,786,817</u>	<u>1,015,045</u>	<u>2,801,862</u>
Segment results	<u>62,891</u>	<u>(12,420)</u>	50,471	(49,795)	676
Gain on disposal of the discontinued operation			—	156,449	156,449
Unallocated income			2,739	283	3,022
Finance costs			(4,079)	(3,517)	(7,596)
Tax			(20,662)	—	(20,662)
Profit for the period			<u>28,469</u>	<u>103,420</u>	<u>131,889</u>

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 2. Segment Information (Continued)

For the six months ended 30 June 2005

	Continuing operations			Discontinued operation	
	Washing machine business (Unaudited) HK\$'000	Corporate and others (Unaudited) HK\$'000	Total (Unaudited) HK\$'000	Mobile handset business (Unaudited) HK\$'000	Total (Unaudited) HK\$'000
Revenue:					
External sales	1,304,081	—	1,304,081	813,955	2,118,036
Other income and gains	4,048	—	4,048	2,791	6,839
	<u>1,308,129</u>	<u>—</u>	<u>1,308,129</u>	<u>816,746</u>	<u>2,124,875</u>
Segment results	<u>22,382</u>	<u>(8,106)</u>	14,276	(65,710)	(51,434)
Unallocated income			1,240	175	1,415
Finance costs			(4,417)	(4,433)	(8,850)
Impairment of goodwill			—	(321,947)	(321,947)
Tax			(2,888)	(7,818)	(10,706)
Profit/(loss) for the period			<u>8,211</u>	<u>(399,733)</u>	<u>(391,522)</u>

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 3. Other Income and Gains

	For the six months ended 30 June	
	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Continuing operations:		
Interest income	2,739	1,240
Rental income	163	2,673
Government subsidies (Note)	—	1,221
Others	696	154
	<u>3,598</u>	<u>5,288</u>
Discontinued operation:		
Interest income	283	175
Rental income	385	573
Sale of spare parts	—	2,154
Others	497	64
	<u>1,165</u>	<u>2,966</u>
Total other income and gains	<u>4,763</u>	<u>8,254</u>

Note: In 2005, a subsidiary of the Group operating in the People's Republic of China (the "PRC") received subsidies from an authority of Shunde Municipality for advanced research and development. No subsidy was received by the Group in 2006.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 4. Finance Costs

	For the six months ended 30 June	
	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Continuing operations:		
Interest on bank and other loans wholly repayable within five years	328	—
Interest on convertible notes	3,751	4,417
	<u>4,079</u>	<u>4,417</u>
Discontinued operation:		
Interest on bank and other loans wholly repayable within five years	3,517	4,433
	<u>3,517</u>	<u>4,433</u>
Total finance costs	<u>7,596</u>	<u>8,850</u>

## 5. Profit/(Loss) for the Period

Profit/(loss) for the period is arrived after charging:

	For the six months ended 30 June	
	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Continuing operations:		
Depreciation	11,967	9,999
Amortisation of prepaid land premiums	568	132
Discontinued operation:		
Depreciation	23,514	23,894
Amortisation of intangible assets	299	291
Impairment of goodwill	—	321,947
Provision for obsolete and slow-moving inventories	23,008	36,693
Provision for bad and doubtful debts	—	20,187
	<u>—</u>	<u>20,187</u>

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 6. Tax

	For the six months ended 30 June	
	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Current — PRC corporate income tax		
Charge for the period	18,616	1,045
Underprovision in prior years	2,747	—
Deferred	(701)	1,843
Total tax charge for the period	20,662	2,888

No provision for Hong Kong profits tax has been made as the Group did not generate any assessable profits arising in Hong Kong for the six months ended 30 June 2006 and 2005.

The Group has seven subsidiaries established in the PRC, six of which are Sino-foreign equity joint ventures 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 exemption from corporate income tax ("CIT") for first two profitable years and 50% reduction of the CIT rate for the third to fifth years.

The Group has tax losses arising in Hong Kong 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.

## 7. Dividend

The directors do not recommend payment of any interim dividend for the six months ended 30 June 2006 (2005: Nil).

## 8. Earnings/(Loss) Per Share

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

**NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS** (Continued)**8. Earnings/(Loss) Per Share** (Continued)

The calculation of diluted earnings per share amounts is based on the net profit for the period attributable to ordinary equity holders of the parent, adjusted to reflect the interest on the convertible notes, where applicable (see below). The weighted average number of ordinary shares used in the calculation is the ordinary shares in issue during the period, as used in the basic earnings per share calculation, and the weighted average number of ordinary shares assumed to have been issued at no consideration on the deemed exercise or conversion of all dilutive potential ordinary shares into ordinary shares.

Dilutive loss per share amount has not been disclosed as share options and convertible notes outstanding have anti-dilutive effects on the basic loss per share amount.

The calculations of basic and diluted earnings/(loss) per share are based on:

	<b>For the six months ended 30 June</b>	
	<b>2006</b>	2005
	<b>(Unaudited)</b>	(Unaudited)
	<b>HK\$'000</b>	HK\$'000
<b>Earnings/(loss)</b>		
Net profit/(loss) attributable to ordinary equity holders of the parent, as used in the basic earnings/(loss) per share calculation:		
From continuing operations	<b>23,155</b>	2,727
From a discontinued operation	<b>103,420</b>	(399,733)
	<b>126,575</b>	(397,006)
Interest on convertible notes (note 4) #	<b>3,751</b>	4,417
Net profit/(loss) attributable to ordinary equity holders of the parent before interest on convertible notes	<b>130,326</b>	(392,589)
Attributable to:		
Continuing operations #	<b>26,906</b>	7,144
Discontinued operation	<b>103,420</b>	(399,733)
	<b>130,326</b>	(392,589)



## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 8. Earnings/(Loss) Per Share (Continued)

	For the six months ended 30 June	
	2006 (Unaudited)	2005 (Unaudited)
<b>Shares</b>		
Weighted average number of ordinary shares in issue during the period, as used in the basic earnings/(loss) per share calculation	<b>17,194,251,187</b>	14,819,658,465
Effect of dilution — weighted average number of ordinary shares:		
Share options	<b>152,146,296</b>	221,660,673
Convertible notes #	<b>987,934,534</b>	1,444,444,444
	<b>1,140,080,830</b>	1,666,105,117
Total #	<b>18,334,332,017</b>	16,485,763,582

# Because the diluted earnings per share amounts for net profit from continuing operations for the six months ended 30 June 2006 and 2005 are increased when taking convertible notes into account, the convertible notes had an anti-dilutive effect on the basic earnings per share amounts for profit from continuing operations and were ignored in the calculation of diluted earnings per share amounts for profit from continuing operations. Therefore, diluted earnings per share amounts for profit from continuing operations are based on the net profit attributable to ordinary equity holders of the parent attributable to continuing operations of HK\$23,155,000 (2005: HK\$2,727,000) and the weighted average of 17,346,397,483 (2005: 15,041,319,138) ordinary shares in issue during the year.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 9. Discontinued Operation

During the period, the Group disposed of its entire interest in Pegasus Telecom (Qingdao) Co., Ltd. ("Pegasus Qingdao") and Pegasus Electronic (Qingdao) Co., Ltd. ("Pegasus Electronic") to Qingdao Haier Group Holdings (BVI) Limited ("Haier BVI") at a consideration aggregating HK\$411 million. Haier BVI is a substantial shareholder of the Company. Pegasus Qingdao and Pegasus Electronic are principally engaged in the manufacture and sale of mobile handsets. The above transaction was approved by the independent shareholders of the Company at a special general meeting held on 15 June 2006 and was completed on 27 June 2006.

The results of Pegasus Qingdao and Pegasus Electronic for the period are presented below:

	For the six months ended 30 June	
	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Revenue	1,014,163	813,955
Expenses	(1,063,675)	(879,490)
Finance costs	(3,517)	(4,433)
Impairment of goodwill	—	(321,947)
Loss before tax from the discontinued operation	(53,029)	(391,915)
Tax	—	(7,818)
Loss for the period from discontinued operation	(53,029)	(399,733)
Gain on disposal of the discontinued operation	156,449	—
Profit/(loss) for the period from the discontinued operation	103,420	(399,733)
Earnings/(loss) per share:		
Basic, from the discontinued operation	0.60 cents	(2.70) cents
Diluted, from the discontinued operation	0.56 cents	N/A

Dilutive loss per share amount has not been disclosed as share options and convertible notes outstanding have anti-dilutive effects on the basic loss per share amount.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 9. Discontinued Operation (Continued)

The calculations of basic and diluted earnings/(loss) per share for the discontinued operation are based on:

	For the six months ended 30 June	
	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Earnings/(loss)		
Net profit/(loss) attributable to ordinary equity holders of the parent from the discontinued operation	<u>103,420</u>	<u>(399,733)</u>
	For the six months ended 30 June	
	2006 (Unaudited)	2005 (Unaudited)
Shares		
Weighted average number of ordinary shares in issue during the period, as used in the basic earnings/(loss) per share calculation	<u>17,194,251,187</u>	<u>14,819,658,465</u>
Weighted average number of ordinary shares, as used in the diluted earnings/(loss) per share calculation	<u>18,334,332,017</u>	<u>N/A</u>

The net cash flows incurred by Pegasus Qingdao and Pegasus Electronic are as follows:

	For the six months ended 30 June	
	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Operating activities	<u>54,774</u>	(13,416)
Investing activities	<u>(135)</u>	(2,841)
Financing activities	<u>(45,991)</u>	27,210
Net cash inflow	<u>8,648</u>	<u>10,953</u>

**NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS** (Continued)**10. Property, Plant and Equipment**

During the six months ended 30 June 2006, the Group incurred construction costs for production plants and purchased fixed assets of HK\$5,444,000 and HK\$7,852,000, respectively (2005: HK\$13,336,000 and HK\$14,699,000, respectively). There was no disposal of fixed assets during the six months ended 30 June 2006 (2005: HK\$1,551,000).

**11. 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 the invoice date and net of provisions, is as follows:

	<b>30 June 2006 (Unaudited) HK\$'000</b>	31 December 2005 (Audited) HK\$'000
Trade receivables		
Within 1 month	65,925	310,244
1 to 2 months	10,806	114,645
2 to 3 months	—	77,899
Over 3 months	—	33,803
	<hr/>	<hr/>
	76,731	536,591
Bills receivable	55,907	140,919
	<hr/>	<hr/>
Total	<b>132,638</b>	<b>677,510</b>

Included in the Group's trade receivables are amounts due from subsidiaries and associates of Haier Group Corporation ("Haier Corp") and Qingdao Haier Investment and Development Co., Ltd. ("Haier Investment") of HK\$53,820,000 (31 December 2005: 485,608,000), which are repayable on similar credit terms to those offered to the major customers of the Group. Haier Corp, Haier Investment, their subsidiaries and associates (collectively the "Haier Group") are companies that have certain key management personnel in common with the Company. Further details in respect of the sales to these parties are set out in note 15.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 12. 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:

	<b>30 June 2006 (Unaudited) HK\$'000</b>	31 December 2005 (Audited) HK\$'000
Trade payables		
Within 1 month	216,560	445,144
1 to 2 months	406	129,504
2 to 3 months	820	119,850
Over 3 months	5,602	181,473
	<u>223,388</u>	875,971
Bills payable	—	96,145
	<u>223,388</u>	<u>972,116</u>

Included in the Group's trade payables are amounts due to subsidiaries and associates of Haier Corp and Haier Investment of HK\$213,213,000 (31 December 2005: HK\$756,040,000), which are repayable on similar credit terms to those offered by major suppliers of the Group. Further details of the purchases from these related parties are set out in note 15.

## 13. Convertible Notes

On 28 January 2005, the Company issued convertible notes with an aggregate principal amount of HK\$260 million to Haier BVI.

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.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 13. Convertible Notes (Continued)

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 is recognised and included in shareholders' equity.

During the period, convertible notes with face value of HK\$63,000,000 (2005: Nil) were converted into 350,000,000 (2005: Nil) ordinary shares of the Company. At 30 June 2006, the outstanding aggregate principal amount of the convertible notes was HK\$170 million (31 December 2005: HK\$233 million).

## 14. Equity

	Attributable to equity holders of the parent								
	Equity component of convertibleShare option				Retained profits/ Exchange fluctuation		Total	Minority interests	Total equity
	Issued equity	notes	reserve	Reserve fund	(accumulated losses)	reserve			
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	
At 1 January 2005	352,324	—	—	29,412	127,443	—	509,179	180,376	689,555
Loss for the period	—	—	—	—	(397,006)	—	(397,006)	5,484	(391,522)
Dividend	—	—	—	—	—	—	—	(6,126)	(6,126)
Exercise of share options	6,708	—	—	—	—	—	6,708	—	6,708
Issue of convertible notes	—	33,791	—	—	—	—	33,791	—	33,791
Acquisition of subsidiaries	445,307	—	—	—	—	—	445,307	(119,613)	325,694
At 30 June 2005	<u>804,339</u>	<u>33,791</u>	<u>—</u>	<u>29,412</u>	<u>(269,563)</u>	<u>—</u>	<u>597,979</u>	<u>60,121</u>	<u>658,100</u>
At 1 January 2006	854,159	30,281	—	59,260	(335,369)	24,439	632,770	71,341	704,111
Profit for the period	—	—	—	—	126,575	—	126,575	5,314	131,889
Equity-settled share option arrangements	—	—	409	—	—	—	409	—	409
Exercise of share options	45,414	—	(409)	—	—	—	45,005	—	45,005
Conversion of convertible notes	65,509	(8,187)	—	—	—	—	57,322	—	57,322
Disposal of subsidiaries	—	—	—	(3,010)	3,010	(13,342)	(13,342)	—	(13,342)
At 30 June 2006	<u>965,082</u>	<u>22,094</u>	<u>—</u>	<u>56,250*</u>	<u>(205,784)*</u>	<u>11,097*</u>	<u>848,739</u>	<u>76,655</u>	<u>925,394</u>

\* These reserves accounts comprise the consolidated reserves in the condensed consolidated balance sheet.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 15. Related Party Transactions

- (a) In addition to the related party transactions detailed in notes 9, 11, 12 and 13 to the financial statements, the Group had the following material transactions with related parties during the period.
- (i) Pegasus Qingdao and Pegasus Electronic, which were disposed of during the period (note 9), had the following material transactions with Haier Corp and Haier Investment, their subsidiaries and associate.

	Notes	For the six months ended 30 June	
		2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Sales of mobile handset products	(i)	817,038	783,357
Purchases of materials	(ii)	816,103	243,466
Utility service fee expenses	(iii)	2,546	3,371
Interest expenses	(iv)	3,517	3,467
Interest income	(iv)	248	—
Other service fee expenses	(v)	1,230	624

## Notes:

- (i) 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.
- (ii) The purchases were charged no more than the average market price or the consolidated and integrated tender and bidding price plus 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 CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 15. Related Party Transactions (Continued)

- (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., Foshan Shunde Haier Intelligent Electronic 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.

		For the six months ended 30 June	
		2006	2005
		(Unaudited)	(Unaudited)
	Notes	HK\$'000	HK\$'000
Sales of washing machines			
— before 28 January 2005	(vi)	—	287,492
— on or after 28 January 2005	(vii)	182,064	121,569
Purchases of materials	(viii)	1,217,031	1,076,983
Printing and packaging fee expenses	(ix)	2,638	5,104
Mould charges	(x)	22,074	27,751
Utility service fee expenses	(xi)	5,443	4,577
Logistics charges	(xii)	55,050	53,473
Promotion fee expenses	(xiii)	19,259	—
Other service fee expenses	(xiv)	9,031	5,912
Interest income	(xv)	1,015	273
Trademark licence fee expenses	(xvi)	12,473	10,416

## 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.



**NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS** *(Continued)***15. Related Party Transactions** *(Continued)*

- (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 a rate of 1.2% of the domestic sales of washing machines.
- (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% of certain sales made by the Washing Machine Companies.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 15. Related Party Transactions (Continued)

- (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. Pegasus Qingdao was disposed of to Haier BVI during the period (note 9).
- (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. Jiaonan Washing Machine borrowed RMB15,000,000 (equivalent to HK\$14,423,000) from Haier Finance in December 2005 and the borrowings were fully repaid during the period.
- (d) Compensation of key management personnel of the Group:

	<b>For the six months ended 30 June</b>	
	<b>2006</b>	2005
	<b>(Unaudited)</b>	(Unaudited)
	<b>HK\$'000</b>	HK\$'000
Short term employee benefits	<b>1,530</b>	1,382
Post-employment benefits	<b>6</b>	10
Share-based payments	<b>409</b>	—
Total compensation paid to key management personnel	<b>1,945</b>	1,392

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 15. Related Party Transactions (Continued)

- (e) Outstanding balances with related parties

In addition to the trade receivables, trade payables and convertible notes with the subsidiaries and associate of Haier Corp and Haier Investment as disclosed in notes 11, 12, and 13 to the financial statements, respectively, the Group has the following outstanding balances with the related parties:

		<b>30 June 2006 (Unaudited) HK\$'000</b>	31 December 2005 (Audited) HK\$'000
	<i>Notes</i>		
Subsidiaries and associate of Haier Corp and Haier Investment			
Cash and cash equivalents	<i>(i)</i>	<b>368,445</b>	260,133
Prepayments, deposits and other receivables	<i>(ii)</i>	<b>41,338</b>	49,228
Amount due from a fellow subsidiary	<i>(iii)</i>	<b>419,954</b>	—
Other payables and accruals	<i>(iv)</i>	<b>45,944</b>	57,638
Interest-bearing borrowings	<i>(v)</i>	<b>—</b>	81,731
		<b>875,681</b>	<b>448,730</b>

Notes:

- (i) The balance represented deposits placed with Haier Finance. The interest rate on these deposits was 0.72% per annum.
- (ii) Prepayments, deposits and other receivables from subsidiaries and associates of Haier Corp and Haier Investment are unsecured, interest free and are repayable on demand.
- (iii) The balance represented the consideration receivable from Haier BVI relating to the disposal of Pegasus Qingdao and Pegasus Electronic (*note 9*) aggregating approximately HK\$411 million and related to the assignment of debts to Haier BVI aggregating approximately HK\$9 million which were originally owed by Pegasus Qingdao and Pegasus Electronic to the Company and one of its subsidiaries. The balance is unsecured, bears interest at a rate of 5.2% per annum and is repayable on demand within one year.
- (iv) Other payables and accruals from subsidiaries of Haier Corp and Haier Investment are unsecured, interest-free and are repayable on demand.
- (v) Interest-bearing borrowings were borrowed from Haier Finance, which were interest bearing at rates ranging between 5% and 6% per annum.

**NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS** (Continued)**15. Related Party Transactions** (Continued)

- (f) During the period, certain of the Group's properties situated in the PRC did not have building ownership certificates registered under the name of the respective subsidiaries of the Company. 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 certain subsidiaries of the Company and indemnify the Group to bear any losses arising from the defective 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 registration procedures are completed.

**16. Contingent Liabilities**

At the balance sheet date, the Group did not have any significant contingent liabilities.

**17. Operating Lease Arrangements****(i) As lessor**

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

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:

	<b>30 June</b> <b>2006</b> <b>(Unaudited)</b> <b>HK\$'000</b>	31 December 2005 (Audited) HK\$'000
Within one year	<u>42</u>	<u>1,356</u>

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

## 17. Operating Lease Arrangements (Continued)

## (ii) As lessee

The Group leases certain of its buildings under operating lease arrangements. Leases for these 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 leases falling due as follows:

	30 June 2006 (Unaudited) HK\$'000	31 December 2005 (Audited) HK\$'000
Within one year	1,778	1,908
In the second to fifth years, inclusive	4,397	5,213
	<u>6,175</u>	<u>7,121</u>

## 18. Commitments

In addition to the operating lease arrangements detailed in note 17 above, the Group had the following commitments at the balance sheet date.

	30 June 2006 (Unaudited) HK\$'000	31 December 2005 (Audited) HK\$'000
Contracted, but not provided for:		
— Acquisition of property, plant and equipment	<u>32,904</u>	<u>2,982</u>

**NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS** *(Continued)***19. Post Balance Sheet Event**

On 18 August 2006, the Company entered into an asset injection agreement with Haier BVI pursuant to which Haier BVI agreed to procure Haier Group to sell and the Company agreed to acquire subsidiaries of Haier Group engaging in the manufacture and sale of front-loading washing machines and water heaters for a total consideration of HK\$900 million.

This asset injection transaction has not yet completed as at the date on which these financial statements were approved.

**20. Approval of The Interim Financial Statements**

These condensed consolidated interim financial statements were approved and authorised for issue by the board of directors on 22 September 2006.

## MANAGEMENT DISCUSSION AND ANALYSIS

### OVERVIEW

The first half of the 2006 financial year was a transitional period in the Group's corporate history. As part of the Group's long-term strategy to focus on developing its white goods businesses, in June 2006, the Group completed the disposal of the mobile handset business to its parent company and controlling shareholder, the Haier Group, for a total consideration of approximately HK\$420 million (comprising approximately HK\$411 million for the equity interests and approximately HK\$9 million for assignment of debt). This strategic move demonstrated the Group's commitment to achieving its ultimate goal of becoming a global white goods giant.

### GROUP RESULTS

Turnover from continuing operations of the Group, i.e. the top loading washing machine business, for the six months ended 30 June 2006 amounted to HK\$1,786 million, representing an increase of approximately 37% from HK\$1,304 million in the same period last year. Net profit attributable to shareholders amounted to HK\$127 million for the six months ended 30 June 2006, against a loss attributable to shareholders of HK\$397 million in the first half of 2005. Such turnaround was mainly attributed from the strong growth in the Group's top loading washing machine business, with operating profit from this business increased substantially by 181% from HK\$22 million in the first half of 2005 to HK\$63 million in the first half of 2006. In addition, the mobile handset business, which was disposed of during the period, recorded a net profit of approximately HK\$103 million (which mainly arose from the gain on disposal of this business) against a net loss of HK\$400 million in the same period last year.

### BUSINESS REVIEW

#### *Top loading washing machine business*

The top loading washing machine business reported substantially improved results with sales of HK\$1,786 million, representing an increase of 37% as compared to the first half of 2005. Gross profit margin improved from 22.4% in the first half of 2005 to 26.5% in the first half of 2006. As a result, operating profit grew substantially by 181% from HK\$22 million in the first half of 2005 to HK\$63 million in the first half of 2006. The strong performance was the results of our successful product positioning and marketing strategies whilst focusing effort on technology innovation, leading to higher growth in sales of high end products which generated better margins.

**MANAGEMENT DISCUSSION AND ANALYSIS** *(Continued)***BUSINESS REVIEW** *(Continued)****Top loading washing machine business*** *(Continued)*

Our environmentally friendly dual-drive washing machines, which are developed by our own R&D team and do not require the use of washing powder, in particular, recorded a robust growth in sales and established a sound reputation both domestically and internationally for its environmentally friendly, safety and energy efficient features. In recognition of its excellence in both technology and quality, our dual-drive washing machines have been awarded quality and technology certificates from international organizations in more than 10 countries. Moreover, our environmentally friendly dual-drive washing machines were awarded a golden prize in 2006 China International Patent Fair, adding another trophy to the already long list of awards we have on our washing machine products.

To cope with our rapid growth in sales, a new factory with annual production capacity of approximately 1 million units was recently established in Jiaonan, Shandong Province, the PRC. Production has commenced in the fourth quarter of 2005, boasting our annual production capacity to more than 6 million units. To cater for further growth of our washing machine business, another factory with annual production capacity of approximately 1 million units is being constructed in Chongqing, the PRC and is scheduled to commence production in the fourth quarter of 2006. This will further increase our annual production capacity to more than 7 million units by the end of 2006.

We will continue to leverage on our committed team of R&D professionals to focus on developing products with high level of quality, reliability and technology innovation. The Directors are confident that the top loading washing machine business of the Group will continue to perform well in the second half of 2006.

***Mobile handset business***

With competition in the PRC's mobile handset industry remained intensive and given the Haier Group's determination to transform the Group into the listed flagship of its white goods businesses, with the mobile handset business falling outside the scope of its white goods businesses, the Company entered into an agreement in April 2006 to dispose of the mobile handset business to the Haier Group for a consideration of approximately HK\$420 million. The disposal was completed in June 2006, enabling the Group to focus on improving its core competencies in the white goods businesses. Moreover, resources could now be better directed to our white goods businesses with promising prospects, resulting in improved profitability in the future.



**MANAGEMENT DISCUSSION AND ANALYSIS** *(Continued)***BUSINESS REVIEW** *(Continued)****Injection of front loading washing machine business and water heater business from the Haier Group into the Group***

Subsequent to the period end, a further significant step has been taken by the Group in achieving its mission, which is to become the listed flagship of the Haier Group's white goods businesses. On 18 August 2006, the Company entered into an agreement to acquire from the Haier Group the front loading washing machines and water heaters businesses, which are the leading players in their respective markets in the PRC, for a total consideration of HK\$900 million (the "Asset Injection").

Upon completion of the Asset Injection, in addition to the top loading washing machine business currently undertaken by the Group, the Group will also be engaged in the business of research, development, production and sale of front loading washing machines and water heaters. The Directors believe that such consolidation of businesses will create a comprehensive product portfolio and significantly strengthen the overall competitiveness of the Group's washing machine business while eliminating potential competition and conflict of interests between the Group and the Haier Group on the management of the washing machines businesses. Moreover, as both washing machines and water heaters are consumer white goods with similar sale and marketing strategies, the Asset Injection will create synergies and increase the value of the Group as a whole. The Asset Injection is also expected to significantly improve the financial performance of the Group.

Further information on the Asset Injection will be contained in our circular to be dispatched to our shareholders in due course. The Asset Injection is subject to several conditions including approval by the independent shareholders of the Company at the forthcoming special general meeting of the Company. Subject to the fulfilment of all such conditions, it is expected that the Asset Injection will be completed by the fourth quarter of 2006.

**OUTLOOK**

Looking forward, the Group will continue to build on its platform of extensive resources in the PRC and the prestigious Haier brand to reinforce the leading position of its white goods businesses in the PRC market. In addition, to accomplish the global branding strategy launched by the Haier Group in 2006, the Group is committed to bringing its products worldwide in order to globalize its white goods business and to sustain our long-term business growth.

**MANAGEMENT DISCUSSION AND ANALYSIS** *(Continued)***OUTLOOK** *(Continued)*

Meanwhile, the Group continues to move towards its goal of becoming the listed flagship of the Haier Group's white goods businesses and ultimately become a global top 3 white goods manufacturer. In addition to the divestment of the mobile handset business in the first half 2006 and the expected completion of injection of front loading washing machine business and water heater business by the end of the current 2006 financial year, the Group is also actively looking for further asset injection opportunities from the Haier Group, in particular, the Haier Group's equity interests in Qingdao Haier Co., Ltd. (a joint stock company listed on the Shanghai Stock Exchange) which is principally engaged in the research, development, production and sale of air-conditioners, refrigerators and other small home appliances. No definite time schedule has been set and no binding agreement has yet been entered into with the Haier Group in respect of further asset injections. The Group will make announcement to provide further update on the development of such possible asset injections in accordance with the requirements of the Listing Rules, as and when appropriate.

**LIQUIDITY AND FINANCIAL RESOURCES**

The Group has maintained a healthy financial and liquidity position with a current ratio of 236% as at 30 June 2006 (as at 31 December 2005: 116%). As at 30 June 2006, the Group had a cash balance of HK\$629 million (as at 31 December 2005: HK\$560 million), no bank and other loans (as at 31 December 2005: HK\$125 million) and zero-coupon 3-year convertible notes (the "Convertible Notes") with a face value of HK\$170 million and a liability element of HK\$158 million (as at 31 December 2005: HK\$212 million).

The Group has a net cash balance (cash balance less borrowings and Convertible Notes) of HK\$471 million as at 30 June 2006, up substantially from HK\$224 million as at 31 December 2005. The Group has been able to maintain a very strong cash position due to its focus on cashflow management and has been able to record a net cash inflow from operating activities of HK\$135 million in the first half of 2006.

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

The Group had contracted capital commitments amounting to HK\$33 million as at 30 June 2006, which were mainly related to contracted construction cost and purchase of machinery for the expansion in production capacity of the Group's washing machines business.

**MANAGEMENT DISCUSSION AND ANALYSIS** *(Continued)***CAPITAL STRUCTURE AND GEARING RATIO**

As at 30 June 2006, the Group maintained a comfortable gearing ratio (total borrowings plus Convertible Notes over shareholders' equity) of 19% (as at 31 December 2005: 53%).

**TREASURY POLICIES**

The Group employs a conservative approach to cash management and risk controls. Most of the Group's receipts and payments are in Renminbi and Hong Kong dollars. Cash is generally placed in short term deposits denominated either in Renminbi or Hong Kong dollars. As at 30 June 2006, the Convertible Notes were denominated in Hong Kong dollars and the Group has no other outstanding borrowings. Foreign currency risk is not significant as liabilities in Renminbi will be matched by the Group's earnings, most of which are also denominated in Renminbi. The Group does not have any significant interest rate risk, as the current interest rate in the PRC stays at low level and is relatively stable. The Group does not have any financial instruments for hedging purposes.

**EMPLOYEES AND REMUNERATION POLICIES**

The total number of employees of the Group as at 30 June 2006 was approximately 4,300, representing a decrease of approximately 23% as compared to 31 December 2005.

The Group ensures that the remuneration packages for its employees are competitive and employees are generally remunerated with a fixed monthly income, which are normally reviewed on an annual basis, plus discretionary performance related bonuses. Employees are also provided with benefits including provident fund and medical insurance. The Group maintains a share option scheme as an incentive to attract and retain talented employees. As at 30 June 2006, there were outstanding share options entitling the grantees to subscribe for 318 million new shares of the Company.

**MATERIAL ACQUISITION AND DISPOSAL OF SUBSIDIARIES AND ASSOCIATES**

Please refer to note 9 to the condensed consolidated interim financial statements above for details of material disposal of subsidiaries during the period.

**MANAGEMENT DISCUSSION AND ANALYSIS** *(Continued)***PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES OF THE COMPANY**

Neither the Company, nor any of its subsidiaries had purchased, sold or redeemed any of the listed securities of the Company during the period.

**CORPORATE GOVERNANCE PRACTICES**

The corporate governance practices adopted by the Company throughout the period of six months ended 30 June 2006 were consistent with those disclosed in the Company's 2005 Annual Report.

***Compliance with Code on Corporate Governance Practices of the Listing Rules***

As at 30 June 2006, the Company has complied with the majority of the applicable code provisions (the "Code Provision(s)") and principles under the Code on Corporate Governance Practices (the "CG Code") as set out in Appendix 14 to the Listing Rules, except for the following deviations:

***Code Provision A.2.1***

Under the Code Provision A.2.1, the roles of chairman and chief executive officer ("CEO") should be separate and should not be performed by the same individual. The Company does not currently have any person holding the title of CEO. Ms. Yang Mian Mian is the chairman of the Board and is also performing the functions of a CEO. The Board meets regularly to consider major matters affecting the business and operation of the Group. The Board considers that this structure will not impair the balance of power and authority between the Board and management and believes that this structure enables the Group to make and implement decisions promptly and efficiently.

***Code Provision A.4.1***

Under the Code Provision A.4.1, non-executive directors should be appointed for specific terms, subject to re-election. Currently, the independent non-executive directors of the Company are not appointed for a specific term but are subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the Company's Bye-laws. As such, the Board considers that sufficient measures have been taken to ensure that the Company's corporate governance practices are no less exacting than those set out in the CG Code.

**MANAGEMENT DISCUSSION AND ANALYSIS** *(Continued)***MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS**

The Company has adopted a Model Code for Securities Transactions by Directors (the “Haier Electronics Model Code”) on no less exacting terms than the Model Code for Securities Transactions by Directors of Listed Issuers set out in Appendix 10 to the Listing Rules. Upon enquiry by the Company, all directors of the Company have confirmed that they have complied with the required standard as set out in the Haier Electronics Model Code throughout the period of six months ended 30 June 2006.

**AUDIT COMMITTEE**

The Company has established an audit committee comprising three independent non-executive directors of the Company. The audit committee had reviewed with the management the accounting principles and practices adopted by the Group and discussed internal controls and financial reporting matters including the review of the unaudited condensed consolidated interim financial statements of the Group for the six months ended 30 June 2006.

**APPRECIATION**

I would like to take this opportunity to thank all my fellow directors and staff for their dedicated services, contributions and support during the period.

By Order of the Board

**Yang Mian Mian**

*Chairman*

Hong Kong, 22 September 2006

## DISCLOSURE OF INTERESTS

## Interests of Directors

As at 30 June 2006, the interests and short positions of the directors and the chief executive of the Company in the shares (the "Share(s)"), underlying Shares and debentures of the Company or shares, underlying shares and debentures of any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) (the "SFO") as recorded in the register required to be kept by the Company under section 352 of the SFO or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to Part XV of the SFO or the Model Code (the "Model Code") for Securities Transactions by Directors adopted by the Company on 29 December 2004, which is on no less exacting terms than The Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 to the Listing Rules, were as follows:

*Long positions in the underlying Shares — Share options outstanding under the share option scheme adopted by the Company on 28 February 2002:*

Name of Director	Date of grant	Exercisable period	Exercise price per Share HK\$	Number of share options			Approximate percentage of total shareholding
				Outstanding as at 1 January 2006	Exercised during the period	Outstanding as at 30 June 2006	
Mr. Wu Ke Song	19/11/2002	19/11/2003-18/11/2007	0.150	62,000,000	(52,000,000)	10,000,000	0.06
Mr. Chai Yong Sen	19/11/2002	19/11/2003-18/11/2007	0.150	62,000,000	(52,000,000)	10,000,000	0.06
Mr. Liang Hai Shan	19/11/2002	19/11/2003-18/11/2007	0.150	60,000,000	(50,000,000)	10,000,000	0.06
Mr. Cui Shao Hua	19/11/2002	19/11/2003-18/11/2007	0.150	60,000,000	(50,000,000)	10,000,000	0.06
Mr. Lam Kin Kau, Mark	16/08/2002	16/08/2003-15/08/2007	0.156	5,000,000	(2,500,000)	2,500,000	0.01
Mr. Fung Hoi Wing, Henry	16/08/2002	16/08/2003-15/08/2007	0.156	2,000,000	—	2,000,000	0.01
				<u>251,000,000</u>	<u>(206,500,000)</u>	<u>44,500,000</u>	<u>0.26</u>

**DISCLOSURE OF INTERESTS** *(Continued)***Interests of Directors** *(Continued)*

Save as disclosed above, as at 30 June 2006, none of the directors and the chief executive of the Company and their respective associates had any interests and short positions in the Shares, underlying Shares and debentures of the Company or shares, underlying shares and debentures of any of its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be kept by the Company under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to Part XV of the SFO or the Model Code.

**Interests of Substantial Shareholders**

As at 30 June 2006, the following shareholders (other than the directors or the chief executive of the Company) had interests or short positions in the Shares or underlyings Shares as recorded in the register required to be kept by the Company under section 336 of the SFO:

*Long positions in the Shares:*

<b>Name of shareholder</b>	<i>Notes</i>	<b>Number of Shares interested</b>	<b>Approximate percentage of total shareholding</b>
Qingdao Haier Collective Asset Management Association ("Haier Collective Asset Management")	(1)	13,633,945,930	78.74
Haier Group Corporation ("Haier Corp")	(2)	13,633,945,930	78.74
Qingdao Haier Investment and Development Co., Ltd. ("Haier Investment")	(3)	13,633,945,930	78.74
Qingdao Haier Group Holdings (BVI) Limited ("Haier BVI")	(4)	8,497,001,486	49.07
Deutsche Bank Aktiengesellschaft ("Deutsche Bank")	(5)	12,145,981,486	70.15

**DISCLOSURE OF INTERESTS** *(Continued)***Interests of Substantial Shareholders** *(Continued)*

*Short positions in the underlying Shares:*

<b>Name of Shareholder</b>	<i>Note</i>	<b>Number of underlying Shares interested</b>	<b>Approximate percentage of total shareholding</b>
Deutsche Bank	(5)	3,926,774,819	22.68

*Long positions in the underlying Shares:*

<b>Name of shareholder</b>	<i>Note</i>	<b>Number of underlying Shares interested</b>	<b>Approximate percentage of total shareholding</b>
Haier BVI	(4)	944,444,444	5.45

*Notes:*

- (1) By virtue of the SFO, Haier Collective Asset Management was deemed to be interested in (i) 3,366,000,000 Shares held by its non-wholly owned subsidiary, namely Haier Investment; (ii) 826,500,000 Shares held by Haier Investment's indirect non-wholly owned subsidiary. In addition, as Haier Investment was acting in concert with Haier Corp and Haier BVI is a non-wholly owned subsidiary of Haier Corp, Haier Collective Asset Management was also deemed to be interested in an aggregate of 9,441,445,930 Shares held by Haier BVI as stated in note (4) below pursuant to the SFO.

Ms. Yang Mian Mian, Mr. Wu Ke Song, Mr. Chai Yong Sen and Mr. Liang Hai Shan, the executive directors of the Company, are also members of the board of management of Haier Collective Asset Management.

- (2) As Haier BVI is a non-wholly owned subsidiary of Haier Corp, Haier Corp was deemed to be interested in an aggregate of 9,441,445,930 Shares held by Haier BVI as stated in note (4) below pursuant to the SFO.



**DISCLOSURE OF INTERESTS** *(Continued)***Interests of Substantial Shareholders** *(Continued)*

Furthermore, as Haier Corp was acting in concert with Haier Investment, Haier Corp was deemed to be interested in 3,366,000,000 Shares held by Haier Investment and 826,500,000 Shares held by a non-wholly owned subsidiary of Haier Investment.

Ms. Yang Mian Mian, Mr. Wu Ke Song, Mr. Chai Yong Sen and Mr. Liang Hai Shan, the executive directors of the Company, are also members of the management committee of Haier Corp.

- (3) Haier Investment was holding 3,366,000,000 Shares and was deemed to be interested in 826,500,000 Shares held by its indirect non-wholly owned subsidiary and an aggregate of 9,441,445,930 Shares held by Haier BVI as stated in note (4) below pursuant to the SFO by reason of its acting in concert with Haier Corp.

Ms. Yang Mian Mian and Mr. Cui Shao Hua, the executive directors of the Company, are also directors of Haier Investment.

- (4) Haier BVI was holding 4,526,706,667 Shares. In addition, Haier BVI was acting in concert with Deutsche Bank pursuant to an undertaking letter dated 5 January 2006 executed by Haier BVI and Deutsche Bank, pursuant to which Deutsche Bank agreed that, unless otherwise agreed and subject to the exceptions set out therein, Deutsche Bank will not sell or dispose of any of the 3,926,774,819 DB Shares (as defined in note (5) below). Accordingly, Haier BVI was deemed to be interested in the DB Shares pursuant to the SFO.

Haier BVI was also interested in 944,444,444 underlying Shares under the convertible notes as part of the consideration pursuant to an agreement dated 5 March 2004 entered into between Haier Corp, Haier Investment and the Company respectively.

Ms. Yang Mian Mian and Mr. Wu Ke Song, the executive directors of the Company, are also directors of Haier BVI.

- (5) Deutsche Bank has a long position in 12,145,981,486 Shares. In addition, it has a short position in 3,926,774,819 underlying Shares (the "DB Shares") acquired pursuant to an agreement dated 16 November 2005 entered into between Deutsche Bank and CCT Telecom Holdings Limited. In addition, pursuant to a subscription agreement dated 16 November 2005 entered into between Deutsche Bank and Haier BVI, Haier BVI agreed to issue and Deutsche Bank agreed to subscribe for warrants in respect of the 3,926,774,819 DB Shares which, upon exercise, will entitle the holder to put such Shares to Haier BVI.

Save as disclosed above, as at 30 June 2006, no other persons or corporations (other than the directors or the chief executive of the Company) had any interests or short positions in the Shares or the underlying Shares as recorded in the register required to be kept by the Company under section 336 of the SFO.

## SHARE OPTION SCHEME

The share option scheme adopted by the Company on 24 November 1997 and subsequently amended on 4 December 1997 (the "Old Share Option Scheme") has been terminated on 28 February 2002 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 no longer grants any further share options under the Old Share Option Scheme. As at 30 June 2006, there were no outstanding options granted under the Old Share Option Scheme and there were 318,000,000 share options remained outstanding under the New Share Option Scheme. Based on these outstanding share options, the total number of Shares that may be issued as at 30 June 2006 was 318,000,000, representing approximately 1.84% of the issued share capital of the Company.

Details of the movements of share options under the New Share Option Scheme during the period between 1 January 2006 and 30 June 2006 were as follows:

Name/category of participants	Date of grant (Note 1)	Exercisable period	Exercise price per Share HK\$ (Note 2)	Number of share options			Outstanding as at 30 June 2006
				Outstanding as at 1 January 2006	Granted during the period	Exercised during the period	
<b>Executive directors</b>							
Mr. Wu Ke Song	19/11/2002	19/11/2003-18/11/2007	0.150	62,000,000	—	(52,000,000)	10,000,000
Mr. Chai Yong Sen	19/11/2002	19/11/2003-18/11/2007	0.150	62,000,000	—	(52,000,000)	10,000,000
Mr. Liang Hai Shan	19/11/2002	19/11/2003-18/11/2007	0.150	60,000,000	—	(50,000,000)	10,000,000
Mr. Cui Shao Hua	19/11/2002	19/11/2003-18/11/2007	0.150	60,000,000	—	(50,000,000)	10,000,000
				<u>244,000,000</u>	<u>—</u>	<u>(204,000,000)</u>	<u>40,000,000</u>
<b>Independent non-executive directors</b>							
Mr. Lam Kin Kau, Mark	16/08/2002	16/08/2003-15/08/2007	0.156	5,000,000	—	(2,500,000)	2,500,000
Mr. Fung Hoi Wing, Henry	16/08/2002	16/08/2003-15/08/2007	0.156	2,000,000	—	—	2,000,000
				<u>7,000,000</u>	<u>—</u>	<u>(2,500,000)</u>	<u>4,500,000</u>
<b>Other employees</b>							
In aggregate	23/01/2006	23/01/2006-22/01/2011	0.2134	—	5,000,000	(5,000,000)	—
<b>Other participants</b>							
In aggregate	16/08/2002	16/08/2003-15/08/2007	0.156	356,500,000	—	(83,000,000)	273,500,000
				<u>607,500,000</u>	<u>5,000,000</u>	<u>(294,500,000)</u>	<u>318,000,000</u>

**SHARE OPTION SCHEME** *(Continued)**Notes:*

1. The vesting period of the share options is from the date of grant until the commencement of the exercisable 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. No share options were lapsed or cancelled under the New Share Option Scheme during the period.
4. During the period, the weighted average closing price per Share as quoted on the Stock Exchange immediately before the dates on which the share options were exercised was HK\$0.259 whilst the closing price per Share as quoted on the Stock Exchange immediately before the date on which the share options were granted was HK\$0.213.

|| | || | **Haier** 海尔 || | ||