## 1. GROUP REORGANISATION

Fortune Sun (China) Holdings Limited (the "Company") was incorporated in the Cayman Islands on 28 January 2003 as an exempted company with limited liability under the Companies Law, Cap.22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. Following the Group's reorganisation (the "Reorganisation") implemented on 10 June 2006 to rationalise the structure of the Group in preparation for the listing (the "Listing") of the Company's shares on the main board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), the Company became the holding company of Millstone Developments Limited ("Millstone"), Shanghai Fu Yang Property Consultant Co., Ltd. ("Shanghai Fortune Sun") and SinoCity Asset Management Consultancy (Shanghai) Limited ("SinoCity") upon completion of the Reorganisation as fully explained in Appendix V to the Company's prospectus dated 23 June 2006 (the "Prospectus").

The Group resulting from the Reorganisation is regarded as a continuing entity. Accordingly, the consolidated income statement, consolidated balance sheet, consolidated statement of changes in equity and consolidated cash flow statement of the Group as set out on pages 33 to 39, have been prepared as if the group structure for Listing had been in existing throughout the periods or since their date of incorporation where this is a shorter period.

The shares of the Company were listed on the main board of the Stock Exchange on 5 July 2006 (the "Listing Date").

The principal activities of the Company are investment holding. During the year, the Group was principally engaged in providing property consultancy and agency services for the primary property market in the People's Republic of China (the "PRC"). The principal activities of its subsidiaries are set out in note 19. The addresses of the registered office and principal place of business of the Company are disclosed in the "Corporate Information" of the annual report.

The financial statements are presented in Renminbi ("RMB"), rounded to the nearest thousand, which is the functional currency of the Company.

## 2. BASIS OF PREPARATION AND ADOPTION OF NEW STANDARDS, AMENDMENTS AND INTERPRETATIONS

The consolidated financial statements have been prepared in accordance with the Hong Kong Financial Reporting Standards ("HKFRS") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA"), accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on the Stock Exchange. The financial statements have been prepared under the historical cost convention except for certain assets and financial instruments which are stated at fair values, as explained in the significant accounting policies, set out in note 3.

The accounting policies and methods of computation used in the preparation of these financial statements are consistent with those used in the consolidated financial statements of the Group for the year ended 31 December 2005, except that the Group has changed certain of its accounting policies following its adoption of new/revised HKFRS and Hong Kong Accounting Standards ("HKAS") (collectively referred to as the "New HKFRSs"), which have become effective for accounting periods beginning on or after 1 January 2006, and had not been early adopted by the Group for the preparation of the consolidated financial statements of the Group for the year ended 31 December 2005. The applicable New HKFRSs adopted in these financial statements are set out below.

| | |
|---|---|
| HKAS 19 (Amendment) | Employee benefits — Actuarial gains and losses, group plans and disclosures |
| HKAS 21 (Amendment) | The effect of changes in foreign exchange rates — Net investment in a foreign operation |
| HKAS 39 (Amendment) | Cash flow hedge accounting of forecast intragroup transactions |
| HKAS 39 (Amendment) | The fair value option |
| HKAS 39 and HKFRS 4 (Amendments) | Financial instruments: Recognition and measurement and insurance contracts — Financial guarantee contracts |
| HKFRS 6 | Exploration for and evaluation of mineral resources |
| HKFRS - Int 4 | Determining whether an arrangement contains a lease |
| HKFRS - Int 5 | Rights to interests arising from decommissioning, restoration and environment rehabilitation funds |
| HK(IFRIC) - Int 6 | Liabilities arising from participating in a specific market — waste electrical and electronic equipment |
| HKAS 1, HKAS 27 and HKFRS 3 (Amendments) | As a consequence of the Hong Kong Companies (Amendment) Ordinance 2005 |

The adoption of these New HKFRSs did not result in substantial changes to the accounting policies of the Group and the methods of computation used in the consolidated financial statements. As there is no material effect on the results for the current or prior accounting periods, no prior period adjustment is required.

## 2. BASIS OF PREPARATION AND ADOPTION OF NEW STANDARDS, AMENDMENTS AND INTERPRETATIONS *(Continued)*

As at the date of the approval of these financial statements, the following standards and interpretations were in issue but not yet effective:

| | | |
|---|---|---|
| HKAS 1 (Amendment) | Note a | Capital disclosures |
| HKFRS 7 | Note a | Financial instruments: Disclosures |
| HKFRS 8 | Note b | Operating segments |
| HK(IFRIC) - Int 7 | Note c | Applying the restatement approach under HKAS 29 — Financial reporting in hyperinflationary economies |
| HK(IFRIC) - Int 8 | Note d | Scope of HKFRS 2 |
| HK(IFRIC) - Int 9 | Note e | Reassessment of embedded derivatives |
| HK(IFRIC) - Int 10 | Note f | Interim financial reporting and impairment |
| HK(IFRIC) - Int 11 | Note g | HKFRS 2 — Group and treasury share transactions |
| HK(IFRIC) - Int 12 | Note h | Service concession arrangements |

Note a: effective for annual periods beginning on or after 1 January 2007
Note b: effective for annual periods beginning on or after 1 January 2009
Note c: effective for annual periods beginning on or after 1 March 2006
Note d: effective for annual periods beginning on or after 1 May 2006
Note e: effective for annual periods beginning on or after 1 June 2006
Note f: effective for annual periods beginning on or after 1 November 2006
Note g: effective for annual periods beginning on or after 1 March 2007
Note h: effective for annual periods beginning on or after 1 January 2008

The Group has begun to consider the potential impact of the above standards and amendments, but is not yet in a position to determine whether these HKFRSs would have a significant impact on how its results of operations and financial position are prepared and presented. These standards and amendments may result in changes in the future as to how the results and financial position are prepared and presented.

## 3. SIGNIFICANT ACCOUNTING POLICIES

### (a) Basis of consolidation

The consolidated financial statements has been prepared using the merger basis of accounting as a result of the Reorganisation. Under this basis, the Company has been treated as the holding company of its subsidiaries for the financial periods presented rather than from the date of their acquisition. The consolidated/combined results of the Group for the years ended 31 December 2006 and 2005 include the results of the Company and its subsidiaries with effect from 1 January 2005 or since their respective dates of incorporation, where this is a shorter period. The comparative combined balance sheet as at 31 December 2005 has been prepared on the basis that the existing Group had been in place at that date.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### (b) Subsidiary companies

A subsidiary is an entity controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities; to appoint or remove the majority of the members of the board of directors; or to cast majority of votes at the meetings of the board of directors.

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. The Company's investments in subsidiaries are stated at cost less any impairment losses.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus cost directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill (Note 3(d)). If the cost of acquisition is less than the fair value of the net assets of the subsidiaries acquired, the difference is recognised directly in the income statement.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by the other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are presented separately from the Group's equity therein. Minority interests in the net assets consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### (c) Associated companies

An associated company is an entity in which the equity interest is held for long term and significant influence is exercised in its management.

An investment in an associated company is accounted for in the consolidated financial statements under the equity method of accounting and is initially recorded at cost and the carrying amount is increased or decreased to recognise the Group's share of the net assets of the investee after the date of acquisition.

The income statement reflects the Group's share of the post-acquisition results of the associated companies for the year, including any impairment loss. When the Group's share of losses exceeds its interests in the associated company, the Group's interest in the associated company is reduced to nil and recognition of further losses is discontinued unless the Group has incurred obligations or guaranteed obligations in respect of the associated company.

Unrealised gains arising from transactions between the Group and its associated companies are eliminated to the extent of the Group's interest in the associated company. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

### (d) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associated company at the date of acquisition.

Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. An impairment loss recognised for goodwill is not reversed in a subsequent period.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### (e) Translation of foreign currencies

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Renminbi ("RMB"), which is the Group's functional and presentation currency.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

The results and financial position of all the group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate ruling at the balance sheet date;

(ii) income and expenses for each income statement are translated at the average exchange rates. Where this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, the relevant income and expenses are translated at the transactions dates; and

(iii) all resulting exchange differences are recognised as a separate component of equity.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### (f) Fixed assets

Fixed assets are stated at cost less accumulated depreciation and accumulated impairment losses. The initial cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

Fixed assets are depreciated at rates calculated to write down their cost, less accumulated impairment losses, to the estimated residual value over their estimated useful lives on the straight-line basis. Estimated useful lives of fixed assets used for this purpose are as follows:

| **Description** | **Useful life** |
|---|---|
| Furniture and fixtures | 3 to 5 years |
| Computers | 3 to 5 years |
| Motor vehicles | 5 years |
| Leasehold improvements | Over the unexpired period of the lease |

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is eliminated. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that fixed assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such impairment losses are recognised in the income statement.

The gain or loss arising from the retirement or disposal of fixed assets is determined as the difference between the net disposal proceeds and the carrying amount of the relevant asset and is recognised in the income statement on the date of retirement or disposal.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### (g) Investment properties

Investment properties, which are properties held to earn rentals and/or for capital appreciation, rather than for use in the production or supply of goods or services or for administrative purposes; or for sale in the ordinary course of business.

Investment properties comprises land held under operating leases and buildings held under finance leases. Land held under operating leases is accounted for as investment property when the rest of definition of investment properties in met. The operating lease is accounted for as it were a finance lease. The prepaid premium for land leases is amortised on the straight-line basis over the remaining term of lease.

Investment properties are stated at cost, less accumulated depreciation and any provisions for impairment losses required to reflect recoverable amounts.

Depreciation is calculated to write off the cost of investment properties over their estimated useful lives, on the straight-line basis, for 40 years after taking into account a residual value of 10%.

Gains or losses arising from the retirement or disposal of the property are determined as difference between the sales proceeds and the carrying amount of the property and is recognised in the income statement.

### (h) Golf club membership

Golf club membership is stated at cost less accumulated impairment losses, if any. No depreciation is charged as the membership is permanent in nature.

### (i) Trade receivables and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less provision for bad and doubtful debts and impairment losses (see note 3(r)), except where the receivables are interest free loans made to related parties without any fixed repayment terms, or where the effect of discounting would not be material. In such cases, the receivables are stated at cost less provision for bad and doubtful debts and impairment losses (see note 3(r)).

### (j) Trade deposits

Trade deposits are required to be placed with property developers as security for the continuing performance of the Group under the relevant contracts. These deposits will be refunded when the Group is compliant with the prescribed terms in the underlying agency contracts.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### (j) Trade deposits *(Continued)*

As the deposit can be forfeited if the Group fails to achieve the prescribed terms in the underlying agency contract, a provision of 18% (2005: 30%) of the trade deposit under each individual agency contract is made when the deposit is paid. This provision is determined based on the present value of the estimated future cash flow and will be released when the Group is compliant with the prescribed terms in the agency contract and the deposit becomes refundable unconditionally.

At each balance sheet date, an assessment of the performance of each property service assignment will be made. A specific provision against the trade deposit will be made, on an individual basis, when the prescribed terms in the agency contracts are unlikely to be attained, within the timeframe specified in the underlying contracts, taking into consideration of current market conditions.

### (k) Cash and cash equivalents

Cash and cash equivalents are carried at the balance sheet at cost. For the purpose of the cash flow statement, cash and cash equivalents comprise cash on hand, deposits held at call with banks, and cash investments with a maturity of three months or less from date of investment.

### (l) Convertible bond

The convertible bond is interest free and can be converted to share capital at the option of the holder into a number of shares based on the outstanding principal of the bond at the date of the mandatory conversion notice. The bond in principal does not vary with the changes in their fair value and is accounted for as a compound financial instrument with both liability and equity components.

The liability component of the convertible bond is calculated as the present value of the future principal payments, discounted at a market rate of interest applicable to similar liabilities that do not have a conversion option. The liability component is stated net of unamortised discounts on convertible bond.

The equity component is calculated at the excess of the issue proceeds over the liability component.

Transactions costs incurred on issuance of the convertible bond are charged to the income statement when incurred.

The discounts on the convertible bond, being the amount classified as equity as referred to above, are set off against the liability component and are amortised as an interest expense on an effective interest rate method until conversion or maturity.

On conversion, the liability component with the relevant portion of the equity component constitutes the consideration for the ordinary shares being issued.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### (m) Revenue recognition

Provided it is probable that economic benefits associated with a transaction will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised on the following bases:

(i) Service income

Service income is recognised when all services stipulated in the contracts are rendered to customers. For those comprehensive property consultancy and sales agency service projects, service income is generally recognised when

(1) the property developer and property purchasers enter into the relevant sale and purchase agreement; and

(2) if required, all ancillary services as stipulated in the agency contracts have been rendered; and

(3) the billing summary for the service fee have been acknowledged by the property developer.

For property consultancy service projects, service income is recognised when the services rendered by the Group reach the relevant stages as specified in the contracts upon and the property developers have an obligation to pay for the services. The relevant stages as stipulated in the contracts include the following:

(1) Completion of a property development consultancy report on a project which includes a land search report, analysis of the investment of return, feasibility study and/or advice on the project planning and design;

(2) Completion of a marketing planning report on a project which includes advice on the market positioning of the relevant properties and/or representing the customer to undertake the project negotiation; and

(3) Completion of a promotion planning report on a project which includes sales strategies, suggesting selling prices and plans for sales promotion for the relevant properties.

(ii) Interest income

Interest income is recognised on a time apportionment basis taking into account the principal amounts and interest rates applicable using the effective interest method.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### (n) Income tax

(i) Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are generally recognised in the income statement except to the extent that they relate to items recognised directly in equity, in which case they are recognised in equity.

(ii) Current tax is the expected tax payable on the taxable income for the year, using the tax rates enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

(iii) Deferred taxation is provided in full, using liability method, on temporary differences between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements.

(iv) Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax assets also arise from unused tax losses and unused tax credits.

(v) Deferred taxation is provided on temporary differences arising on investments in subsidiaries, except 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.

### (o) Operating leases

Where the Group has the use of assets under operating leases, payments made under the leases are charged to the income statement in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in the income statement as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the income statement in the accounting period in which they are incurred.

### (p) Employee benefits

(i) Defined benefit retirement plan obligations

The Group participates in employee social security plans of the PRC, including defined contribution pension, medical, housing and other welfare benefits, organised by the government authorities in accordance with relevant regulations.

According to the relevant regulations, premium and welfare benefit contributions are remitted to the social welfare authorities on a monthly basis and are calculated based on percentages of the total salary of employees, subject to a certain ceiling. Contributions to the plans are charged to the income statement as incurred.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### (p) Employee benefits *(Continued)*

(ii) Share-based payments

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.

The fair value of share options granted to employees is recognised as an employee cost with a corresponding increase in a capital reserve within equity. The fair value is measured at grant date using the Binomial Option Pricing Model, taking into account the terms and conditions upon which the options were granted. Where the employees have to meet vesting conditions before becoming unconditionally entitled to the options, the total estimated fair value of the options is spread over the vesting period, taking into account the probability that the options will vest.

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.

During the vesting period, the number of share options that are expected to vest is reviewed. Any adjustment to the cumulative fair value recognised in prior years is charged/credited to income statement for the year of review, unless the original employee expenses qualify for recognition as an asset, with a corresponding adjustment to the capital reserve. On the vesting date, the amount recognised as an expense is adjusted to reflect the actual number of options that vest, with a corresponding adjustment to the capital reserve, except where forfeiture is only due to not achieving vesting conditions that relate to the market price of the Company's shares. The equity amount is recognised in the capital reserve until either the option is exercised, when it is transferred to the share premium account, or the option expires, when it is released directly to retained earnings.

### (q) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Company has a legal or constructive obligation arising as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditures expected to settle the obligation.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### (q) Provisions and contingent liabilities *(Continued)*

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow economic benefits is remote.

### (r) Impairment of assets

(i) Impairment of trade and other receivables

For trade and other current receivables and other financial assets carried at amortised cost, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate, the effective interest rate computed at initial recognition of these assets, where the effect of discounting is material.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement. A reversal of an impairment loss shall not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.

(ii) Impairment of other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

– fixed assets;
– investment properties;
– investments in subsidiaries and associated companies;
– intangible assets;
– goodwill.

If any such indications exist, the asset's recoverable amount is estimated. In addition, for goodwill and intangible assets that have indefinite useful lives, the recoverable amount is estimated annually whether or not there is any indication of impairment.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### (r) Impairment of assets *(Continued)*

(ii) Impairment of other assets *(Continued)*

– Calculation of recoverable amount

The recoverable amount of an asset is the greater of its net selling price and value in use. 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. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generate cash inflows independently, denominated as a cash-generating unit.

– Recognition of impairment losses

An impairment loss is recognised in the income statement whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit, or group of units, and then, to reduce the carrying amount of the other assets in the unit, or group of units, on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

– Reversals of impairment losses

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of impairment losses is limited to the asset's carrying amounts that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the income statement in the year in which the reversals are recognised.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### (s) Related parties

For the purposes of these financial statements, parties are considered to be related to the Company if the Company has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operation decision, or vice versa, or where the Company and the party are subject to common control or common significant influence. Related parties may be members of key management personnel, significant shareholders and/or their close family members, or other parties and include entities which are under the significant influence of related parties of the Company where those parties are individuals, and post-employment benefit plans exist which are for the benefit of employees of the Company or of any entity that is a related party of the Company.

## 4. FINANCIAL RISK MANAGEMENT

The Group's activities expose it to a number of financial risks: currency risk, price risk, credit risk, liquidity risk and cash flow interest-rate risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance on a timely and effective manner.

### (a) Currency risk

As the Group's sales and purchases are mainly denominated in Renminbi, the currency risk is considered not significant. The Group currently does not have a foreign currency hedging policy. However, the management monitors foreign exchange exposure and will consider hedging significant foreign currency exposure should the need arise.

### (b) Credit risk

The Group's credit risk is primary attributable to its trade receivables and trade deposits and the amount of contingencies as disclosed is in note 32. The credit period granted to customers for trade receivables generally ranges from one to three months. The refund of trade deposits is in accordance with the terms of the underlying agency agreements. In order to minimise the credit risk, management of the Group has designated a team to be responsible for the determination of credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts on a regular basis. In addition, the Group reviews the recoverable amount of each individual trade receivable and trade deposit at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors of the Company consider that the Group's credit risk is significantly reduced.

The credit risk on bank deposits and balances is limited because the counterparties are banks with high credit ratings assigned by international credit rating agencies.

## 4. FINANCIAL RISK MANAGEMENT *(Continued)*

### (c) Liquidity risk

Prudent liquidity risk management requires maintaining sufficient cash and ensuring the availability of funding through an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, the Group treasury unit aims to maintain flexibility in funding by keeping committed credit lines available.

### (d) Cash flow and fair value interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates as the Group has no significant interest bearing assets except for certain cash and cash equivalents. The Group's exposure to changes in interest rates is mainly attributable to its cash and cash equivalents which are charged at variable rates and expose the Group to cash flow interest rate risk.

## 5. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Group makes estimates and assumptions concerning the future course of business. The resulting accounting estimates will, by definition, seldom equate to the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

### (a) Depreciation

Fixed assets are depreciated on a straight-line basis over the estimated useful lives of the assets. The Group reviews the estimated useful lives of the assets annually in order to determine the amount of depreciation expense to be recorded during any reporting period. The useful lives are based on the Group's historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are material changes from previous estimates.

### (b) Impairments

Impairment losses on trade and other receivables are assessed and provided based on the directors' regular review of ageing analysis and evaluation of collectibility. A considerable level of judgement is exercised by the directors when assessing the creditworthiness and past collection history of each individual customer. Any increase or decrease in impairment losses would affect income statement in future years.

## 5. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS *(Continued)*

### (b) Impairments *(Continued)*

Internal and external sources of information are reviewed by the Group at each balance sheet date to assess whether there is any indication that fixed assets, investment properties, intangible assets and goodwill may be impaired. If any such indication exists, the recoverable amount of the asset is estimated to determine impairment losses on the assets. Changes in facts and circumstances may affect the conclusion of whether an indication of impairment exists and result in revised estimates of recoverable amounts, which would affect income statement in future years.

## 6. TURNOVER

The Group is principally engaged in providing property agency services for the primary property market in the PRC. Turnover during the year represents income from the following services:

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Comprehensive property consultancy and sales agency service projects | **74,774** | 111,556 |
| Pure property consultancy service projects | **50** | 4,306 |
| | **74,824** | 115,862 |

The Group has carried on business in a single geographical segment, which is the provision of agency services for the sale of properties and property consultancy services in the PRC, and therefore no segmental information has been presented.

## 7. PROFIT BEFORE INCOME TAX

Profit before income tax is arrived at after crediting and charging the following:

| | 2006 | 2005 |
|---|---|---|
| | RMB'000 | RMB'000 |
| **Crediting:** | | |
| Interest income | **745** | 128 |
| **Charging:** | | |
| Auditors' remuneration | **789** | 145 |
| Amortisation of discounts on the convertible bond (Note 26) | **755** | 536 |
| Amortisation of prepaid premium for land leases | **83** | — |
| Depreciation of fixed assets | **748** | 702 |
| Depreciation of investment properties | **95** | — |
| Loss on disposals of fixed assets | **29** | 75 |
| Net foreign exchange loss | **149** | — |
| Operating lease rentals in respect of buildings | **4,064** | 6,487 |
| Staff costs (excluding directors' remuneration (Note 13)): | | |
| - Wages and salaries | **6,155** | 4,930 |
| - Pension costs (defined contribution plan) and other social benefits | **1,353** | 1,335 |
| - Employee share option benefits | **757** | — |
| (Write-back)/Provision for doubtful debts | | |
| - Trade receivables | **1,195** | 536 |
| - Other receivables | **227** | 192 |
| - Trade deposits | **(943)** | 393 |

## 8. TAXATION

### (a) Income tax in the consolidated income statement

Income tax expense represents:

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Current income tax – PRC enterprise income tax | **2,881** | 4,642 |
| Deferred tax assets (Note 18(a)) | **549** | 220 |
| Deferred tax liabilities (Note 18(b)) | **934** | 2,755 |
| Total income tax expense | **4,364** | 7,617 |

The Company, Millstone and High Color Investments Limited ("High Color"), the Company's wholly owned subsidiaries, are not subject to any income tax.

The Company's operating subsidiaries, namely Shanghai Fortune Sun and SinoCity, are foreign investment enterprises registered in Pudong New District of Shanghai, the PRC. According to confirmations from the state and local tax authorities, both Shanghai Fortune Sun and SinoCity are currently subject to the preferential tax rate of 15%. PRC enterprise income tax is calculated at the applicable rate of 15% on the estimated assessable profit of Shanghai Fortune Sun and SinoCity for the year ended 31 December 2006. As the local preferential tax policy has not been approved by the State Council or the State Administration of Tax, there is no assurance that Shanghai Fortune Sun and SinoCity will continue to enjoy the 15% preferential tax rate in the future.

The Company has set up a 75% indirectly held operating subsidiary, namely Full Sincerity Advertising Company Limited ("Full Sincerity") on 27 November 2006 in Taiwan, to provide property consultancy and agency services for the primary property market in Taiwan. Full Sincerity does not have any assessable income during the year.

No Hong Kong profits tax has been provided as the Group did not derive any assessable profit from Hong Kong during the year.

## 8. TAXATION *(Continued)*

### (a) Income tax in the consolidated income statement *(Continued)*

A reconciliation between income tax and accounting profit, at applicable tax rates is set out below:

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Profit before income tax | **23,421** | 48,604 |
| Notional tax on profit before income tax, calculated at tax rates applicable to profits in the countries concerned | **3,513** | 7,291 |
| Tax effect of expenses not deductible for tax purposes | **213** | 326 |
| Tax effect of unrecognised tax losses | **595** | — |
| Tax effect of income not taxable | **(186)** | — |
| Others | **229** | — |
| Income tax | **4,364** | 7,617 |

### (b) Business tax in the consolidated income statement

Shanghai Fortune Sun and SinoCity are subject to PRC business tax at a rate of 5% on turnover from the provision of property agency and consultancy services and the provision of property consultancy services respectively.

## 9. PROFIT ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY

The consolidated profit attributable to equity shareholders of the Company includes a loss of RMB2,463,000 (2005: RMB86,000) which has been dealt with in the financial statements of the Company.

## 10. DIVIDENDS

The Company was incorporated on 28 January 2003. No dividend has been paid or declared by the Company since its incorporation. In May 2006, prior to the Reorganisation, the directors of Millstone declared dividends amounting to RMB10,000,000 to its then shareholders in respect of the year ended 31 December 2005, which were subsequently paid in June 2006.

On 24 April 2007, the directors resolved to recommend to the shareholders of the Company a declaration of a final dividend of HKD2.4 cents per share, totalling HKD4,800,000 (equivalent to approximately RMB4,747,000) for the year ended 31 December 2006. The final dividend is subject to approval by the shareholders of the Company at the forthcoming annual general meeting.

## 11. EARNINGS PER SHARE

### (a) Basic earnings per share

The calculation of basic earnings per share was based on the consolidated profit attributable to equity shareholders of the Company for the year of approximately RMB19,199,000 (2005: RMB40,987,000) and the weighted average number of ordinary shares of approximately 174,520,548 (2005: 150,000,000 shares deemed to be issued). The deemed shares in issue of 150,000,000 in the prior year comprised 2,361,888 shares in issue and 147,638,112 shares from a capitalisation issue on 10 June 2006.

### (b) Diluted earnings per share

The diluted earnings per share was the same as the basic earning per share as calculated based on the consolidated profit attributable to equity shareholders of the Company for the year of approximately RMB19,199,000 and the weighted average number of ordinary shares of approximately 174,520,548 as there was no dilutive effects in respect of ordinary shares to be issued pursuant to the exercise of the options granted under the Pre-IPO Share Option Scheme (Note (28)) until 6 July 2007. There were no dilutive potential ordinary shares in existence during the year 2005.

## 12. RETIREMENT BENEFIT SCHEME

The Group participates in a government defined contribution pension plan in the PRC. Contributions are made based on 22% (2005: 22.5%) of the employees' total minimum basic salaries and are charged to the income statement as incurred.

The Group has also operated a MPF Scheme for the eligible employees in Hong Kong in 2006. The Group contributes 5% (2005: Nil) of the employees' relevant income each month as defined in the MPF Schemes Ordinance, subject to a maximum of HK$1,000 per person or up to the amount of the voluntary contribution from the respective employee.

## 13. DIRECTORS' REMUNERATION

### (a) Directors' emoluments

The emoluments paid and payable to the directors to each of the directors of the Company for the year ended 31 December 2006 as disclosed pursuant to the Listing Rules and Section 161 of the Hong Kong Companies Ordinance, are as follows:

| | Fees | Basic salaries and other allowances | Pension costs – defined contribution plan | Employee share option benefits | Total |
|---|---|---|---|---|---|
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| Executive directors: | | | | | |
| Mr. Chiang Chen Feng | — | 808 | — | 161 | 969 |
| Ms. Chang Hsiu Hua | — | 569 | — | 118 | 687 |
| Mr. Han Lin | — | 297 | 17 | 161 | 475 |
| Non-executive director: | | | | | |
| Ms. Lin Chien Ju | 67 | 53 | — | — | 120 |
| Independent non-executive directors: | | | | | |
| Mr. Ng Wai Hung | 72 | — | — | — | 72 |
| Mr. Cui Shi Wei | 77 | — | — | — | 77 |
| Dr. Cheng Chi Pang | 77 | — | — | — | 77 |
| | 293 | 1,727 | 17 | 440 | 2,477 |

## 13. DIRECTORS' REMUNERATION *(Continued)*

### (a) Directors' emoluments *(Continued)*

Details of the emoluments paid and payable to the directors within the Group in respect of their services in managing the subsidiaries for the year ended 31 December 2005 are as follows:

| | Fees | Basic salaries and other allowances | Pension costs – defined contribution plan | Total |
|---|---|---|---|---|
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| Executive directors: | | | | |
| Mr. Chiang Chen Feng | — | 867 | — | 867 |
| Ms. Chang Hsiu Hua | — | 274 | — | 274 |
| Mr. Han Lin | — | 214 | 11 | 225 |
| Non-executive director: | | | | |
| Ms. Lin Chien Ju | — | 120 | — | 120 |
| | — | 1,475 | 11 | 1,486 |

### (b) Five highest paid individuals

Two (2005: Two) of the five highest paid individuals are directors whose emoluments have been included above. Details of the emoluments paid to the remaining three (2005: three) highest paid individuals are as follows:

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Basic salaries and other allowances | **1,633** | 1,019 |
| Pension costs – defined contribution plan | **9** | 11 |
| Employee share option benefits | **180** | — |
| | **1,822** | 1,030 |

All emoluments of the five highest paid individuals for the year fell within the range of nil to HKD1,000,000 (equivalent to RMB1,005,000).

During the year, no emoluments were paid by the Group to the directors, or any of the five highest paid individuals, as an inducement to join or upon joining the Group or as compensation for loss of office. No directors waived any emoluments during the year.

## 14. FIXED ASSETS

### The Group

| | Furniture and fixtures RMB'000 | Computers RMB'000 | Leasehold improvements RMB'000 | Motor vehicles RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|
| Cost | | | | | |
| At 1 January 2005 | 527 | 1,216 | 1,128 | 1,333 | 4,204 |
| Additions | 53 | 197 | — | — | 250 |
| Disposals | (120) | (78) | — | (419) | (617) |
| At 31 December 2005 and 1 January 2006 | 460 | 1,335 | 1,128 | 914 | 3,837 |
| Additions | 126 | 572 | 504 | 380 | 1,582 |
| Acquisition of a subsidiary company | — | 163 | — | — | 163 |
| Disposals | (30) | (195) | — | — | (225) |
| At 31 December 2006 | 556 | 1,875 | 1,632 | 1,294 | 5,357 |
| Accumulated depreciation | | | | | |
| At 1 January 2005 | 386 | 445 | 644 | 704 | 2,179 |
| Charge for the year | 33 | 249 | 193 | 227 | 702 |
| Disposals | (107) | (58) | — | (377) | (542) |
| At 31 December 2005 and 1 January 2006 | 312 | 636 | 837 | 554 | 2,339 |
| Acquisition of a subsidiary | — | 15 | — | — | 15 |
| Charge for the year | 56 | 279 | 259 | 154 | 748 |
| Disposals | (15) | (33) | — | — | (48) |
| At 31 December 2006 | 353 | 897 | 1,096 | 708 | 3,054 |
| Net book value | | | | | |
| At 31 December 2006 | 203 | 978 | 536 | 586 | 2,303 |
| At 31 December 2005 | 148 | 699 | 291 | 360 | 1,498 |

## 14. FIXED ASSETS *(Continued)*

**The Company**

| | Furniture and fixtures RMB'000 | Computers RMB'000 | Leasehold improvements RMB'000 | Total RMB'000 |
|---|---|---|---|---|
| Cost | | | | |
| Additions and at 31 December 2006 | 110 | 67 | 293 | 470 |
| Accumulated depreciation | | | | |
| Charge for the year and at 31 December 2006 | 15 | 7 | 55 | 77 |
| Net book value | | | | |
| At 31 December 2006 | 95 | 60 | 238 | 393 |

## 15. GOODWILL

Goodwill represents the excess of the cost of an acquisition made in May 2006 over the fair value of SinoCity, formerly the Group's associated company in which the Group had indirect equity interests of 45% as at 31 December 2005. After acquisition of the remaining equity interest in SinoCity by Shanghai Fortune Sun in May 2006, SinoCity became an indirect wholly-owned subsidiary of the Company. Details of the net assets acquired and goodwill arising from the acquisition are as follows:

| | RMB'000 |
|---|---|
| Total purchase consideration | 1,009 |
| Fair value of net assets acquired | (819) |
| Goodwill | 190 |

Goodwill is accounted for as an intangible asset and is stated at cost less accumulated impairment losses. Goodwill is allocated to cash-generating units for the purpose of impairment testing which is carried out annually at the balance sheet date.

## 16. INVESTMENT PROPERTIES AND DEPOSITS FOR INVESTMENT PROPERTIES

| | Investment properties RMB'000 | Deposits for investment properties RMB'000 | Total RMB'000 |
|---|---|---|---|
| Cost | | | |
| At 1 January 2005 | — | 899 | 899 |
| Additions | — | 8,324 | 8,324 |
| Transferred from deposit | 899 | (899) | — |
| At 31 December 2005 and 1 January 2006 | 899 | 8,324 | 9,223 |
| Additions | — | 132 | 132 |
| Transferred from deposit | 8,456 | (8,456) | — |
| Transferred to prepaid premium for land leases (Note 17) | (4,398) | — | (4,398) |
| At 31 December 2006 | 4,957 | — | 4,957 |
| Accumulated depreciation | | | |
| At 31 December 2005 and 1 January 2006 | — | — | — |
| Charge for the year | 95 | — | 95 |
| At 31 December 2006 | 95 | — | 95 |
| Net book value | | | |
| At 31 December 2006 | 4,862 | — | 4,862 |
| At 31 December 2005 | 899 | 8,324 | 9,223 |

The Group paid on deposits for the acquisition of properties in Chongqing and Beijing, the PRC in 2005. Upon the local authorities acknowledging that the registration of the related purchase contracts had been completed, these deposits were accounted for as investment properties.

Had investment properties been carried at their fair value, the amount would be approximately RMB11,880,000.

## 17. PREPAID PREMIUM FOR LAND LEASES

| | Leases less than 50 years | Leases over 50 years | Total |
|---|---|---|---|
| | RMB'000 | RMB'000 | RMB'000 |
| Cost | | | |
| At 31 December 2005 and 1 January 2006 | — | — | — |
| Transferred from investment properties (Note 16) | 376 | 4,022 | 4,398 |
| At 31 December 2006 | 376 | 4,022 | 4,398 |
| Accumulated amortisation | | | |
| At 31 December 2005 and 1 January 2006 | — | — | — |
| Charge for the year | 8 | 75 | 83 |
| At 31 December 2006 | 8 | 75 | 83 |
| Net book value | | | |
| At 31 December 2006 | 368 | 3,947 | 4,315 |
| At 31 December 2005 | — | — | — |

## 18. DEFERRED TAX ASSETS AND LIABILITIES

Deferred taxation is calculated in full on temporary differences under the liability method using a tax rate of 15%.

The movements in deferred tax assets and liabilities of the Group during the year are as follows:

### (a) Deferred tax assets

| | Accrued expenses and others | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Beginning of the year | **549** | 769 |
| Charged to income statement during the year | **(549)** | (220) |
| End of the year | **—** | 549 |

### (b) Deferred tax liabilities

| | Uninvoiced revenue | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Beginning of the year | **4,519** | 1,764 |
| Charged to income statement during the year | **934** | 2,755 |
| End of the year | **5,453** | 4,519 |

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current assets against current liabilities and when the deferred income taxes relate to the same fiscal authority.

## 19. INVESTMENT IN AND AMOUNTS DUE FROM/(TO) SUBSIDIARIES

| | The Company | |
|---|---|---|
| | **2006** | 2005 |
| | **RMB'000** | RMB'000 |
| Investments in unlisted shares, at cost | **497** | — |
| Amounts due from subsidiaries | **50,631** | — |
| Amounts due to subsidiaries | **(6,630)** | (109) |

Amounts due from/(to) subsidiaries are unsecured, interest free and have no fixed terms of repayment.

Particulars of the principal subsidiaries of the Group at 31 December 2006 is as follows:

| **Name** | **Place of incorporation and operation and date of incorporation** | **Issued/ registered and fully paid capital** | **Attributable equity interests** | **Principal activities** |
|---|---|---|---|---|
| **Directly held:** | | | | |
| Millstone Developments Limited | British Virgin Islands, 29 October 2002 | 100,000 ordinary shares of USD1.00 each | 100% | Investment holding |
| High Color Investments Limited | British Virgin Islands, 5 July 2006 | 50,000 ordinary shares of USD1.00 each | 100% | Investment holding |
| **Indirectly held:** | | | | |
| Shanghai Fu Yang Property Consultant Co., Limited | The PRC, 11 April 1997 | USD3,450,000 registered capital | 100% | Property consultancy and agency services providing for the primary property market in the PRC |
| SinoCity Asset Management Consultancy (Shanghai) Limited | The PRC, 26 September 2005 | USD200, 000 registered capital | 100% | Provision of property consultancy and agency services in the PRC |
| Full Sincerity Advertising Company Limited | Republic of China, 27 November 2006 | 2,000,000 ordinary shares of NTD10.00 each | 75% | Property consultancy and agency services providing for the primary property market in Taiwan |

## 20. INVESTMENTS IN ASSOCIATED COMPANY

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| Share of net assets | | |
| Beginning of the year | **272** | — |
| Share of net profit/net assets during the year | **398** | 272 |
| | **670** | 272 |
| Transfer to investment in subsidiaries | **(670)** | N/A |
| End of the year | **—** | 272 |
| Amount due from associated company | **—** | 602 |

SinoCity was incorporated as a wholly foreign owned enterprise on 26 September 2005 in the PRC. As at 31 December 2005, its registered and fully paid capital amounted to USD200,000 and was owned as to 45% by Millstone, a wholly owned subsidiary of the Company. In May 2006, Shanghai Fortune Sun acquired the remaining 55% equity interest in SinoCity at a cash consideration of RMB819,000 and since then, SinoCity became an indirect wholly owned subsidiary of the Company.

## 21. GOLF CLUB MEMBERSHIP

Based on the information obtained from the golf club which issues the membership, the membership admission fee as at 31 December 2006 was USD170,000 (2005: USD169,000).

## 22. TRADE RECEIVABLES

The credit period granted to customers generally ranges from 1 month to 3 months. The ageing analysis of trade receivables is as follows:

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Within 90 days | **37,713** | 17,885 |
| Between 91 and 180 days | **5,560** | 6,025 |
| Between 181 and 365 days | **7,338** | 2,127 |
| Between 1 and 2 years | **975** | 4,341 |
| | **51,586** | 30,378 |
| Provision for doubtful debts | **(1,735)** | (540) |
| | **49,851** | 29,838 |

## 23. TRADE DEPOSITS

Trade deposits represent the amounts paid for comprehensive property consultancy and sales agency service contracts, which are usually refunded to the Group in stages according to the contract terms when the sales volumes specified in the contracts are met.

The ageing analysis of trade deposits is as follows:

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Within 90 days | **2,300** | 163 |
| Between 91 and 180 days | **11,080** | 2,200 |
| Between 181 and 365 days | **9,257** | 6,300 |
| Between 1 and 2 years | **663** | 13,847 |
| Between 2 and 3 years | **11,548** | 400 |
| Over 3 years | **—** | 200 |
| | **34,848** | 23,110 |
| Provision for doubtful debts | **(5,990)** | (6,933) |
| | **28,858** | 16,177 |

## 24. DEFERRED EXPENSES

These represent professional fees paid in connection with the initial listing of the shares of the Company on the Main Board of the Hong Kong Stock Exchange and have been fully charged to the share premium account during the year.

## 25. CASH AND CASH EQUIVALENTS

| | The Group | | The Company | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | **RMB'000** | RMB'000 | **RMB'000** | RMB'000 |
| Cash and cash equivalents in the balance sheet and consolidated cash flow statement | **67,209** | 34,402 | **—** | — |
| Cash and cash equivalents are denominated in | | | | |
| RMB (in the PRC) | **39,137** | 24,003 | **—** | — |
| USD (in the PRC) | **15** | 50 | **—** | — |
| HKD (in the PRC) | **15,081** | — | **15,079** | — |
| USD (outside the PRC) | **11** | 6,331 | **—** | — |
| HKD (outside of the PRC) | **8,843** | 4,018 | **7,451** | — |
| NTD (outside of the PRC) | **4,122** | — | **—** | — |
| | **67,209** | 34,402 | **22,530** | — |

RMB is not a freely convertible currency and the remittance of funds out of the PRC is subject to exchange control restrictions imposed by the PRC government.

## 26. CONVERTIBLE BOND

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Beginning of the year | **25,945** | — |
| Proceeds from issue of the convertible bond (the "Bond") (Note (a)) | **—** | 26,026 |
| Amounts classified as equity component (Note (b)) | **—** | (617) |
| Discount on the Bond | **755** | 536 |
| Conversion during the year (Note (c)) | **(26,700)** | — |
| End of the year | **—** | 25,945 |

Notes:

(a) In October 2005, Millstone issued a convertible Bond with a nominal value of HK$25,000,000 (equivalent to RMB26,026,000) to an independent party (the "Holder"). The Bond was guaranteed by Ms. Lin Chien Ju and Mr. Chiang Chen Feng, both are directors of the Company, and is non-interest bearing except in respect of any default in payment by Millstone of any sum due and payable under the Bond, In that case, Millstone would have to pay interest on such sum to the Holder from the due date to the date of actual payment, calculated at the rate of 18% per annum.

(b) The value of the liability and equity components of the Bond was determined by an independent firm of surveyors, Sallmanns (Far East) Limited, who have among their staff Fellows of the Hong Kong Institute of Surveyors, based on the discounted cash flow method at date of issuance of the Bond.

(c) The maturity date of the Bond is on 30 April 2007 or the Listing Date, whichever the earlier. During the year, the Bond was converted into 361,888 ordinary shares of the Company (note 27 (d)) in accordance with its terms and conditions.

## 27. SHARE CAPITAL

| | Notes | Number of ordinary shares (in thousand) | Nominal value HK$'000 | Nominal value RMB'000 |
|---|---|---|---|---|
| Authorised | | | | |
| Ordinary share of HK$0.1 each as at 31 December 2005 | (a) | 1,000 | 100 | 103 |
| Increase in authorised share capital during the year | (b) | 1,999,000 | 199,900 | 205,897 |
| | | 2,000,000 | 200,000 | 206,000 |
| Issued and fully paid | | | | |
| Balance as at 31 December 2005 | | — | — | — |
| Credited as fully paid as part of Reorganisation during the year | (a) | 1,000 | 100 | 103 |
| Ordinary shares of HK$0.1 each issued as consideration for acquisition of the entire issued share capital of Millstone | (c) | 1,000 | 100 | 103 |
| Conversion of the Bond | (d) | 362 | 36 | 37 |
| Capitalisation Issue | (e) | 147,638 | 14,764 | 15,207 |
| Issue of ordinary shares of HK$0.1 each upon listing | (f) | 50,000 | 5,000 | 5,150 |
| | | 200,000 | 20,000 | 20,600 |

Notes:

(a) On 28 January 2003, the Company was incorporated in the Cayman Islands with an initial authorised share capital of HK$100,000 (equivalent to RMB103,000) divided into 1,000,000 ordinary shares of HK$0.1 each. On 28 February 2003, 1,000,000 ordinary shares of HK$0.1 each were allotted and issued as nil paid. All such nil paid shares were subsequently credited as fully paid at par during the year.

(b) Pursuant to a resolution passed on 10 June 2006, the Company's authorised share capital was increased from HK$100,000 to HK$200 million by the creation of an additional 1,999,000,000 ordinary shares of HK$0.1 each in aggregate.

(c) On 10 June 2006, as part of the Reorganisation (Note 1), the Company issued an additional 1,000,000 ordinary shares of HK$0.1 each in the capital of the Company, credited as fully paid to the then shareholders of Millstone in consideration for the acquisition of the entire issued share capital of Millstone.

## 27. SHARE CAPITAL *(Continued)*

Notes: *(Continued)*

(d) On 10 June 2006, the Bond in the principal amount of HK$25 million was converted into 361,888 ordinary shares in the share capital of the Company.

(e) On 4 July 2006, 147,638,112 ordinary shares of HK$0.1 each were allotted and issued as fully paid to the holders of the shares whose names appeared on the register of members of the Company as at the close of business on 10 June 2006, in proportion to their shareholdings, by way of capitalisation of the sum of HK$14,763,811.2 standing to the credit of share premium account of the Company ("Capitalisation Issue").

(f) On 4 July 2006, 50,000,000 ordinary shares of HK$0.1 each were issued to the public at HK$1.06 each for a total cash consideration, before deducting the share issuance expenses, of RMB53,000,000.

The share capital of RMB828,000 presented as at 31 December 2005 represented the share capital of Millstone, which was the then holding company of the Group.

## 28. SHARE OPTION SCHEMES

The Group recognises the fair value of the share options or shares granted as an expense over the vesting period and the corresponding amount is recognised in the employee share-based compensation reserve under equity. When the eligible participants choose to exercise share options, the respective amount in employee share-based compensation reserve is transferred to share capital and share premium, together with exercise price. At each balance sheet date, the Group revises its estimates of the number of share options or shares that are expected to become vested. The impact of the revision of original estimates, if any, is recognised in the income statement with a corresponding adjustment to the employee share-based compensation reserve over the remaining vesting period.

A share option scheme (the "Pre-IPO Share Option Scheme") was adopted pursuant to a written resolution passed by all shareholders of the Company on 10 June 2006. The purpose of the Pre-IPO Share Option Scheme is to recognise and reward the contribution of certain directors, senior management, employees, consultants and advisers of the Group to the growth and development of the Group and the Listing. For the year ended 31 December 2006, options to subscribe for an aggregate of 6,000,000 shares of the Company have been granted by the Company to the eligible participants under the Pre-IPO Share Option Scheme, 450,000 options lapsed during the year and no option was exercised as at 31 December 2006.

A further share option scheme (the "Share Option Scheme") was also adopted pursuant to a written resolution passed by all shareholders of the Company on 10 June 2006. The purpose of the Share Option Scheme is to enable the Group to grant options to selected participants as incentive or reward for their contribution to the Group. The Share Option Scheme will remain in force for a period of 10 years commencing from 10 June 2006.

## 28. SHARE OPTION SCHEMES *(Continued)*

The maximum number of unexercised options currently permitted to be granted under the Share Option Scheme is an amount equivalent, upon their exercise, to 30% of the shares of the Company in issue at any time. The maximum number of shares issuable under the options to each eligible participant in the Share Option Scheme within any 12-month period is limited to 1% of the shares of the Company in issue at any time. Any further grant of options in excess of this limit is subject to shareholders' approval in a general meeting

The exercise price of the options is determinable by the directors, but shall not be less than the highest of (i) the closing price of the Company's shares as quoted on the Stock Exchange's daily quotation sheets on the date of the offer for grant of the options; and (ii) the average closing price of the Company's shares as quoted on the Stock Exchange's daily quotation sheets for the five trading days immediately preceding the date of offer for grant of the options; and (iii) the nominal value of the Company's shares.

As at 31 December 2006, no option had been granted under the Share Option Scheme.

The fair value of share options granted under the Pre-IPO Share Option Scheme are determined at the dates of grant using the Binominal Option Pricing Model by an independent valuer and the following assumptions were used to calculate the fair value of share options:

| | |
|---|---|
| Option value | HK$0.41 |
| Exercise price | HK$0.795 |
| Risk-free interest rate | 4.84% |
| Expected volatility | 45% |
| Dividend yield | 3.5% |
| Life of options | 9 years |

## 28. SHARE OPTION SCHEMES *(Continued)*

The expected volatility is based on historical volatility (calculated based on the weighted average remaining life). Expected dividends are based on historical dividends. Changes in the subjective input assumptions could materially affect the fair value estimate.

Details of the movements of the outstanding share options granted under the Pre-IPO Share Option Scheme of the Company were as follows:

| | Number of shares in respect of share options | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Name or Category of Participant | Granted during the year | Exercised during the year | Lapsed during the year | Outstanding as at 31 December 2006 | Date of grant | Exercisable period | Exercise price per share | Weighted average exercise price |
| | | | | | | | HK$ | HK$ |
| **Directors:** | | | | | | | | |
| Chiang Chen Feng | 750,000 | — | — | 750,000 | 10/06/2006 | 05/07/2007 - 04/07/2016 | 0.795 | 0.795 |
| Han Lin | 750,000 | — | — | 750,000 | 10/06/2006 | 05/07/2007 - 04/07/2016 | 0.795 | 0.795 |
| Chang Hsiu Hua | 550,000 | — | — | 550,000 | 10/06/2006 | 05/07/2007 - 04/07/2016 | 0795 | 0.795 |
| **Employees:** | | | | | | | | |
| In aggregate | 3,950,000 | — | 450,000 | 3,500,000 | 10/06/2006 | 05/07/2007 - 04/07/2016 | 0.795 | 0.795 |
| Total | 6,000,000 | — | 450,000 | 5,550,000 | | | | 0.795 |

## 29. RESERVES

### (a) The Group

The amounts of the Group's reserves and the movements therein for the current and previous years are presented in the consolidated statement of changes in equity on page 39 of the financial statements.

The merger reserve of the Group represents the difference between the nominal value of the share capital issued by the Company and the aggregate of share capital and the share premium of Millstone acquired pursuant to the Reorganisation.

According to the articles and association of Shanghai Fortune Sun, at least 10% of its net profit as stated in its statutory accounts prepared under the applicable PRC accounting regulations and relevant regulations in the PRC shall be transferred to the reserve fund before dividend distribution, until the balance of such fund has reached 50% of its registered capital. The reserve fund can only be used, upon approval by the relevant authority, to offset accumulated losses or increase capital.

### (b) The Company

| | Share premium RMB'000 | Employee share-based compensation reserve RMB'000 | Exchange reserve RMB'000 | Accumulated losses RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|
| Balance as at 1 January 2005 | — | — | — | — | — |
| Loss for the year | — | — | — | (86) | (86) |
| Balance as at 31 December 2005 and 1 January 2006 | — | — | — | (86) | (86) |
| Share capital fully paid (Note 27(a)) | (103) | — | — | — | (103) |
| Conversion of the Bond (Note 27(d)) | 27,280 | — | — | — | 27,280 |
| Capitalisation Issue (Note 27(e)) | (15,207) | — | — | — | (15,207) |
| Initial public offering (Note 27(f)) | 49,440 | — | — | — | 49,440 |
| Share issuance expense | (12,029) | — | — | — | (12,029) |
| Employee share option benefits | — | 1,197 | — | — | 1,197 |
| Currency translation differences | — | — | (1,985) | — | (1,985) |
| Loss for the year | — | — | — | (2,463) | (2,463) |
| Balance as at 31 December 2006 | 49,381 | 1,197 | (1,985) | (2,549) | 46,044 |

## 30. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

The assets and liabilities arising from the acquisition of subsidiaries are as follows:

| | RMB'000 |
|---|---|
| Net assets acquired: | |
| Fixed assets | 148 |
| Deferred assets | 180 |
| Trade and other receivables | 158 |
| Cash and cash equivalents | 7,204 |
| Accrued expenses and other payables | (1,389) |
| Minority interests | (1,203) |
| Net assets | 5,098 |
| Goodwill | 190 |
| Total consideration | 5,288 |
| Satisfied by: | |
| Cash consideration | 4,428 |
| Other consideration | 190 |
| Transfer from investment in an associated company | 670 |
| | 5,288 |
| Net cash inflow in respect of acquisition of subsidiaries | |
| Purchase consideration settled in cash as at 31 December 2006 | (4,428) |
| Cash and cash equivalents in subsidiaries acquired | 7,204 |
| Cash inflow on acquisition | 2,776 |

## 31. MAJOR NON-CASH TRANSACTIONS

During the year, on 10 June 2006, all the convertible bond issued by Millstone amounting to HK$25,000,000 was converted into 361,888 ordinary shares of the Company. On the same day, 147,638,112 ordinary shares of HK$0.1 each were issued by way of capitalisation of the sum of HK$14,763,811 standing to the credit of share premium account of the Company.

## 32. CONTINGENCIES

As at 31 December 2006, the Group had the following contingencies:

| | Notes | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|---|
| Combined property consultancy and agency contracts for the property projects in | | | |
| - Ningbo | (a) | **—** | 1,500 |
| - Shanghai | (b) | **5,000** | — |
| | | **5,000** | 1,500 |

Notes:

(a) Pursuant to the comprehensive property consultancy and agency contract for one property project in Ningbo entered into in 2002, if the Group is not able to fulfil the committed sales target at the end of the contract, the Group is obliged to apply the Group's trade deposit amounting to RMB1,500,000 (2005: RMB1,500,000) deposited to the relevant property developer to purchase the unsold properties at a contracted price stipulated in the relevant contracts. The Group has subsequently entered into a termination agreement, whereby the forfeiture of trade deposits has been released and the Group has no commitment to purchase the unsold properties.

(b) Pursuant to a comprehensive property consultancy and agency contract for one property project in Shanghai entered into by the Group in 2006, if the Group is not able to fulfil the committed sales target pursuant to the relevant terms as stipulated in the contract, the Group is obliged to arrange a third party to purchase the unsold properties at a price stipulated in the contract. As at 31 December 2006, the aggregate price of the related unsold properties according to the contract amounted to approximately RMB5,000,000.

## 33. OPERATING LEASE COMMITMENTS

As at 31 December 2006, the Group had future aggregate minimum lease payments under non-cancellable operating leases for office buildings as follows:

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Within one year | **2,711** | 2,829 |
| Later than one year but not later than five years | **584** | 1,447 |
| | **3,295** | 4,276 |

## 34. SUBSEQUENT EVENTS

On 3 February 2007, Shanghai Fortune Sun entered into a loan agreement with a bank in respect of RMB15,000,000 loan facility. The loan facility is secured by the deposit of RMB15,000,000 of the Company. As at the date of the approval of these financial statements, the loan facility has not been utilised.

## 35. COMPARATIVE FIGURES

Certain comparative figures have been re-classified to conform with the current year's presentation of the financial statements.