2018 Annual Report

KUANGCHI SCIENCE LIMITED

Incorporated in Bermuda with limited liability | Stock Code: 439

KUANGCHI 光啟科學

CONTENTS

CORPORATE INFORMATION

BOARD OF DIRECTORS

Executive Directors

Dr. Liu Ruopeng *(Chairman)*
Dr. Zhang Yangyang *(Co-Chief Executive Officer)*
Dr. Luan Lin *(Co-Chief Executive Officer & Chief Technology Officer)*
Mr. Dorian Barak

Non-executive Directors

Mr. Ko Chun Shun, Johnson *(Resigned on 16 November 2018)*
Mr. Song Dawei *(Resigned on 1 August 2018)*

Independent Non-executive Directors

Dr. Liu Jun
Dr. Wong Kai Kit
Ms. Cao Xinyi

AUDIT COMMITTEE

Ms. Cao Xinyi *(Chairman)*
Dr. Liu Jun
Dr. Wong Kai Kit

REMUNERATION COMMITTEE

Dr. Wong Kai Kit *(Chairman)*
Dr. Liu Jun
Dr. Zhang Yangyang

NOMINATION COMMITTEE

Dr. Liu Ruopeng *(Chairman)*
Dr. Liu Jun
Dr. Wong Kai Kit

COMPANY SECRETARY

Mr. Cheng Chi Chung Kevin

AUDITOR

Crowe (HK) CPA Limited
Certified Public Accountants

REGISTERED OFFICE

Clarendon House
2 Church Street, Hamilton HM11
Bermuda

HEAD OFFICE IN HONG KONG

Unit 1220, 12/F, Leighton Centre,
77 Leighton Road,
Causeway Bay,
Hong Kong

HEAD OFFICE IN SHENZHEN

2/F., Software Building,
No. 9 Gaoxin Zhong 1st Road,
Nanshan District, Shenzhen,
Guangdong Province, PRC
Postal code: 518057

Email: info@kuang-chi.com
Website: www.kuangchiscience.com

Tel: (86) 0755 8664 9703
Fax: (86) 0755 8664 9700

REGISTRARS

Hong Kong

Tricor Secretaries Limited
Level 22, Hopewell Centre
183 Queen's Road East, Hong Kong

Bermuda

Conyers Corporate Services (Bermuda) Limited
2 Church Street
Hamilton HM 11
Bermuda

PRINCIPAL BANKERS

Bank of China (Hong Kong) Limited
China Construction Bank
PingAn Bank Co., Ltd.

STOCK CODE

439

MANAGEMENT DISCUSSION AND ANALYSIS

PERFORMANCE REVIEW AND PROSPECTS

The Company and its subsidiaries are principally engaged in the research and development as well as manufacture of innovative products for future technology businesses, and the provision of other innovative technology service solutions (the "Future Technology Business"). For the twelve months ended 31 December 2018 (the "Period"), total income of the Company and its subsidiaries amounted to HK$158,406,000. Net loss was HK$497,616,000, an increase of 6.5 times over the previous year. The increase in net loss was primarily attributable to (i) the absence of the after-tax gains arising from fair value changes of derivative financial assets for the year ended 31 December 2018 as compared to an amount of HK$524 million for the year ended 31 December 2017; (ii) a significant decrease in the gross profit of the Company and its subsidiaries from approximately HK$129 million for year ended 31 December 2017 to approximately HK$19 million for year ended 31 December 2018. Such decrease was mainly caused by a decrease in the revenue generated from the Company and its subsidiaries' "future space" technology products; and (iii) increase in impairment loss on trade receivables from approximately HK$24 million for year ended 31 December 2017 to approximately HK$108 million for year ended 31 December 2018 (note 27 to the consolidated financial statements).

The Future Technology Business – in-depth development of vertical business sectors

The Company and its subsidiaries put their focus on the Future Technology Business. They are striving to build future smart cities by developing and integrating different future technologies, including "AI overlay" technology and "future space" technology. These technologies will allow them to provide a comprehensive range of innovative products, services and solutions, thereby enhancing service efficiency, satisfying residents' needs, upgrading living quality and, in particular, solving various problems that are faced by human beings.

In terms of the "AI overlay" technology business, the Company and its subsidiaries followed the national policy trend by independently developing the "Matrix Intelligent Engine" (access to the IntelliSense node to build a "Super Intelligent Tracking System", which was an AI technology product to be applied to the field of urban public security. In particular, the "Super Intelligent Tracking System" was an "AI Overlay Network" built with the application of "AI Overlay Technology", which was primarily used for the urban public security field), which helped upgrade comprehensive social governance and public security intelligence. During the Period, the Company and its subsidiaries solely focused on the principal intelligent business by promoting the practical application of the "Super Intelligent Tracking System" in public security throughout the country. In the eastern part of Shanghai, the Company entered into the first order with the relevant departments in Shanghai for the "Super Intelligent Tracking System", making a breakthrough in the sales. The system was already operating online and functioning during the Period. In the northern part, the Company and its subsidiaries began to fully collaborate with the relevant enterprises and public security authorities in Xiong'an New District during the Period on a plan to promote aggressively the "Super Intelligent Tracking System" project to the local public security business. During the same period, the Company and its subsidiaries entered into a memorandum of cooperation with China Mobile Xiong'an Information Communication Technology Co., Ltd., and reached a strategic cooperation agreement with China United Network Communications Ltd. and its subsidiaries on intelligent security prevention and control in the core areas of the city. In the western part, following full collaboration and business discussions of the Company and its subsidiaries with the various local branch offices of Chongqing Municipal Public Security Bureau during the Period, the "Super Intelligent Tracking System" project and AI technology were approved by relevant authorities, and preparations were made for various tasks according to relevant requirements during the Period. In the southern part, the Company and its subsidiaries began to collaborate with some regional governments and public security authorities in Guangdong during the Period. In August 2018, the "Super Intelligent Tracking System" project was agreed as a pilot scheme for a pedestrian street in urban area in Shenzhen. In December 2018, the "Super Intelligent Tracking System" project was initially agreed by the Shunde District Government and Shunde Public Security Bureau.

MANAGEMENT DISCUSSION AND ANALYSIS

As to the “future space” technology business, the Company and its subsidiaries collected multi-source information such as visible light and infrared by using self-developed aerospace products such as drones (“KC” series and “H” series) and “Cloud”. By means of advanced AI algorithms, various target objects were detected accurately and tracked continuously on an automatic and real-time basis, providing a data base for intelligent security. During the Period, the performance of “Cloud” was further optimized. During the same period, the Company further proceeded with drones for remote inspection of energy facility pipelines and a distance solution to drone automation.

In line with national policy trends, “Matrix Intelligent Engine” contributed to comprehensive social governance and public security intelligence upgrade

Since the new management method from “social management” to “social governance” was proposed at the 18th National Congress of the Communist Party of China, General Secretary Xi further emphasized, in the report of the 19th National Congress of the Communist Party of China, the need for “enhancing security and improving people’s living standards, strengthening and innovating social governance, creating a new era for building a commonly governed and shared social governance structure together, and relying on more and better scientific and technological innovation to assure national security”. Xi called for “enhancing the socialization of social governance, the rule of law, intelligence and professionalism” to “build effective social governance and a good social order to make the people’s sense of gain, sense of happiness and sense of security more substantial, more secure and more sustainable”.

AI technology has been distributed in the field of pattern recognition, such as face, speech and semantic recognition. It is similar to a single-point technology. For the first time, the “AI Overlay” technology has changed the pattern of intelligent capabilities from a single-point pattern to a mesh overlay, similar to the evolution of the communications industry from fixed networks to mobile communication networks and to mobile Internet. The emergence of mobile communication overlay networks meets the core target of human communication, allowing anyone to communicate freely any time, anywhere. The “AI Overlay” technology also renders intelligent sensing, calculation, analysis and processing capabilities available any time, anywhere, becoming a new type of infrastructure that truly portrays and predicts the world in a highly digital way to build a more intelligent city and a more efficient society.

The Company and its subsidiaries reacted to the call for building a system for the prevention and control of public security under China’s “13th Five-Year Plan” by independently developing the “Matrix Intelligent Engine”, an AI product used in the fields of comprehensive governance and public security intelligence. Access to the IntelliSense node builds a “Super Intelligent Tracking System”, which is an “AI Overlay Private Network” for the urban public security field created by the application of AI overlay technology. As the core of the whole system, “Matrix Intelligent Engine” has applied cutting-edge technologies such as “photoelectric sensor overlay technology”, “radar tracking technology” and “high performance modeling and high concurrent computing technology” which have solved the three major industry problems, i.e. “wide-range global intelligent overlay”, “real-time concurrency of massive dynamic targets” and “substantial reduction in unit area overlay and concurrent costs”. In particular, the processing, enhancement, recognition and multi-dimensional comprehensive judgment of information such as videos and images are all handled by the “Matrix Intelligent Engine”. The front-end intelligent sensing nodes comprise photoelectric radar sensing nodes, Wi-Fi probes, police intelligent helmets, etc. In traditional applications, it is not possible to connect a monitoring system with an intelligence system. However, the “Super Intelligent Tracking System” is able to identify a target with the front-end sensors, then starts to track and identify and make judgment, and conducts comprehensive analysis with the back-end intelligence system to form the entire combat system. Front-end video surveillance combined with the “Super Intelligent Tracking System” and the new intelligence system to form a new policing operation that integrates AI, smart sensing and big data applications across the entire combat system. At the China International Social Security Products Expo at the end of October 2018, the Company unveiled the “Super Intelligent Tracking System” which, for the first time in the industry, made possible the real-time tracking of massive moving targets such as people, vehicles and mobile phones, building a multi-dimensional, multi-domain intelligent tracking network.

The management believes the “AI Overlay Network” as a new generation of infrastructure is not only used for public security, but can be used to benefit in many areas such as traffic management, urban governance, education, finance, medical care, commerce and resident services. It is able to comprehensively and effectively raise the efficiency of social governance and industry operations, with enormous application needs and market prospects in the smart city field.

MANAGEMENT DISCUSSION AND ANALYSIS

Sole focus on the principal intelligent business by promoting the practical application of "AI Overlay Network" in nationwide public security

"AI Overlay Network" is a new generation of highly intelligent core digital infrastructure. It is a super digital system composed of photoelectric senor overlay and Matrix Intelligent Engine that can holographically map real-time moving targets in cities. AI overlay technology is breakthrough achievement of the Company in military-civilian integrated innovation. Its core technologies comprise radar tracking technology, photoelectric sensor overlay technology, high-performance modeling and high concurrent computing technology. Its core build-up indicator is concurrency per second between overlay area and concurrent capacity. AI overlay has successfully solved the three key technologies and core problems, i.e. wide-range global overlay, real-time concurrency of massive moving targets, and substantial reduction in unit area overlay and concurrent costs by evolving the application of the existing AI technology from "pattern recognition" to overlay technology for "global non-sensing certification", "massive target tracking" and "high-quality big data management", a general trend of creating a high-quality digital world in the intelligent era. The "Super Intelligent Tracking System" is a specialized system using AI overlay technology in the field of public security. The core technology for AI overlay has been included in the "National Key R&D Programme under the 13th Five-Year Plan", and has been employed to undertake key project for "Technical Equipment for Public Security Risk Prevention and Control and Emergency" jointly supported by the Ministry of Public Security and the Ministry of Science and Technology.

In Shanghai, leap-forward development was achieved for the "Super Intelligent Tracking System" project during the Period as a breakthrough was made in market sales. During the Period, the Company entered into a contract for the "Super Intelligent Tracking System" with a security service provider in Shanghai, under which the "Super Intelligent Tracking System" was officially launched online and functioning at the Bund Police Station, making the area become a fully intelligent security defense demonstration area as well as a major platform and window for promoting the "Super Intelligent Tracking System". The system is currently used for identifying and tracking massive targets, and has provided the public security authorities with accurate information and evidence on various cases/matters, delivering intelligent solutions to social governance and urban refined management in the new era. Moreover, the system also gives warning about large-scale flows of moving people for large-scale security activities as it has provided information on detailed regional flows of moving people for security during new year's eve at Shanghai Bund for the second year in a row. Meanwhile, the Company entered into a cooperation framework agreement for the "Super Intelligent Tracking System" project with the Criminal Investigation Corps of the Shanghai Public Security Bureau, pursuant to which the system expanded the advantages of both sides and jointly promoted the development and progress in the field of public security science and technology based on the actual combat requirements for public security.

During the same period, the "Super Intelligent Tracking System" project established interactive communication with relevant work units such as the Shanghai Public Security Bureau. The increasingly mature and growing number of customer channels have established an essential base for the promotion of the "Super Intelligent Tracking System" project in the eastern region, thus increasing the influence of the Company and its products in Shanghai.

In Xiong'an, the Company's "Super Intelligent Tracking System" and artificial intelligence overlay technology were approved after the Company and its subsidiaries fully collaborated with Xiong'an Group Co., Ltd. and its subsidiaries in Xiong'an New District and Xiong'an New District's public security authorities during the Period. By incorporating the establishment of a video network in Xiong'an New District into the build-up of a smart city in Xiong'an New District, the Company played an active role in the overall planning and top-level design for the establishment of the video network in Xiong'an New District; promoted the release of the video standard specifications for the new district; played a dominant role in a pilot scheme for the AI overlay network in Xiong'an New District; and offered products and solutions in relation to the establishment of an urban-level dynamic big data sensor network. With all of these, a world-leading, static-dynamic AI overlay network will be built, which will become a digital infrastructure for smart cities for the future, and which can be extended and promoted nationwide and even globally, offering broad market prospects.

MANAGEMENT DISCUSSION AND ANALYSIS

During the same period, the Company entered into a non-legally binding memorandum of cooperation ("MOC") with China Mobile Xiong'an Information Communication Technology Co., Ltd. ("China Mobile Xiong'an Industry Research Institute"), a wholly-owned subsidiary of China Mobile Communications Co., Ltd., pursuant to which China Mobile Xiong'an Industry Research Institute will, based on the information held by the Company, work together intensively with China Mobile Research Institute in Beijing on the establishment of an innovative system that deeply integrates industry, academia and research, and of an open and shared R&D ecosystem directed at the fields of smart city, AI and next-generation network technology, so as to help build a smart city in Xiong'an New District. The management believes by relying on the favourable geographical location of Xiong'an New District and major strategic development opportunities, the Company's partnership with Xiong'an Industry Research Institute can enhance both business innovation core competence and market competitiveness.

Moreover, the Company and its subsidiaries began to fully collaborate with China Unicom Group and China Unicom System Integration Ltd. in the second quarter of 2018. China Unicom has entered into "Smart City" contracts with the local governments at more than 150 cities (urban areas), pursuant to which the Company and its subsidiaries, as a member of "China Unicom's Industry Alliance for New Smart Cities" and an investor introduced under China Unicom's mixed reform programme, can collaborate with China Unicom Group's government and enterprise department and China Unicom System Integration Ltd. on the promotion of the Company's "Super Intelligent Tracking System" project and related intelligent technologies in China Unicom's key areas across the country. In the fourth quarter of 2018, the Company and its subsidiaries published a joint plan for smart security prevention and control in the core areas of the city, under which they reached a strategic cooperation agreement with China Unicom, pursuant to which China Unicom would give priority to the Company in the procurement of relevant products from the Company for the security scenarios in the core areas of the city.

In the western part, the Company and its subsidiaries reaped initial results following intensive collaboration and business discussions with various local branch offices of the Chongqing Municipal Public Security Bureau during the Period. The Company's "Super Intelligent Tracking System" project and AI technology were approved by the relevant branch offices, and preparations for various tasks were made aggressively in accordance with relevant requirements during the Period. Using the Company's related systems and products as the core for the build-up, the Company participated in the "Project for Technologies for the Prevention of Area Anti-terrorism and Anti-riot at Chongqing North Railway Station" by providing key personnel deployment control, intelligent tracking and other functions. Moreover, the Company's "Prevention of Crowd Crushing and Trampling Alarm System" ("Prevention of Crowd Crushing and Trampling Alarm System" is a customized professional system based on the "Super Intelligent Tracking System" combined with specific scenarios) assures "three-night security" for the Chongqing Liberation Monument. Together with an overall security plan, the system accurately tracks and gives statistics on the number of people in all controlled areas on a real-time basis, controls the flow direction and density of people on a real-time basis, and makes predictions and judgments and gives instructions and interactions on a real-time basis, providing "three-night security" and Spring Festival consolidated security services for the Chongqing Liberation Monument. During the same period, the Company and its subsidiaries collaborated with Chongqing Public Security Science and Technology Research Institute, BOCOM Intelligent Information Technology Co., Ltd. and Guoxin Youe Data Co., Ltd. on reporting to the National Development and Reform Commission a "pilot project for the application of information system integration and sharing in the field of social governance – establishment of a system for the prevention and control of social security information in the new era". The project has been approved by the National Development and Reform Commission, and the joint unit is making a design proposal on the project. Moreover, the Company and its subsidiaries continued to keep full communications with the Criminal Investigation Corps of the Chongqing Public Security Bureau during the Period. The Company's laboratory overall visualization and intelligent build-up proposal on the application of AI technology was approved. The overall proposal is currently put online at an experimental office, where network environment build-up has been completed, servers deployed and communication links tuned. The criminal investigation and on-site intelligent project can be directly used in nationwide criminal investigation and added with intelligent modules based on hardware and software architecture according to different types of policing, so that it can be used in other policing services.

MANAGEMENT DISCUSSION AND ANALYSIS

In the southern part, the Company and its subsidiaries began to collaborate with public authorities such as some regional governments of Guangdong Province and the Guangdong Provincial Public Security Department during the Period. In August 2018, the "Super Intelligent Tracking System" project was used as a pilot scheme for a pedestrian street in urban area in Shenzhen. In December 2018, the "Super Intelligent Tracking System" project was initially approved by the Shunde District Government and the Shunde Public Security Bureau. Based on AI overlay technology, the project proposal will digitalize real-time massive moving targets in a city, and upgrade the existing "point-like bayonet-type AI pattern recognition" into an intelligent overlay network that features "global non-sensing certification", "massive target tracking" and "high-quality big data management", thus increasing AI overlay efficiency by 18 times at the same cost, increasing the intelligent concurrent processing capability by 35 times and accounting for only 1/24 of the build-up costs in existing industry solutions. In the southern part, the Company and its subsidiaries will build a new-generation AI overlay technology innovation centre and demonstration base in Shenzhen and Foshan's Shunde for building an AI overlay demonstration network in the Guangdong-Hong Kong-Macau Greater Bay Area.

Self-developed drones, "Clouds" and other aviation products continued to provide accurate detection, offering a data base for intelligent security

With the development of spatial information technology, there is a higher requirement for the security field. The setup of a digital, application-oriented and highly generalized product system will provide technical assurance for intelligent security. The Company and its subsidiaries collect multi-source information such as visible light and infrared with aerospace products such as self-developed drones ("KC" series and "H" series) and "Clouds". By means of cutting-edge image processing technology together with AI algorithm, accurate detection and continuous tracking of multiple types of ground targets can be carried out automatically, on a real-time basis, on an all-weather basis, at different regions and under complex environments.

During the Period, the "Clouds" were improved substantially in terms of wireless communication distance, system capacity, equipment integration capability and system stability, offering a big data base for urban surveillance, ecological monitoring and emergency communication for urban intelligent management.

Under the "SkyX" project, a strategic investment, super-vision, low-cost intelligent patrol solution was successfully developed, ready to enter the commercialization stage

The Company made a strategic investment in SkyX Ltd. ("SkyX"), a Canada-based long-haul industrial drone service provider. SkyX uses a body design with integrated patented fixed-wings and rotary-wings, capable of making vertical taking off and landing as well as long-distance, high-speed patrol flights at a speed of up to 150 kilometers per hour, and of carrying out automatic patrol using AI technology. Its newly developed BVR AI industrial drone system can offer solutions to low-cost air patrol over large-scale infrastructure facilities such as oil and gas pipelines, power transmission networks and railway tracks with a length of several thousand kilometers on an all-weather, all-terrain and unmanned basis.

FINANCIAL REVIEW

Revenue and operating performance

The revenue of the Company and its subsidiaries decreased by approximately HK$148 million or 48.4% to approximately HK$158 million for the year ended 31 December 2018 from approximately HK$306 million for the year ended 31 December 2017. Such decrease is mainly caused by a decrease in the revenue generated from the Company and its subsidiaries' "future space" technology products.

MANAGEMENT DISCUSSION AND ANALYSIS

The net loss of the Company and its subsidiaries increased by approximately HK$431 million or 647% to approximately HK$497.6 million for the year ended 31 December 2018 from approximately HK$66.6 million for the year ended 31 December 2017. Such increase is primarily attributable to: (i) a significant decrease in the gross profit of the Company and its subsidiaries from approximately HK$130 million for the year ended 31 December 2017 to approximately HK$18.8 million for the year ended 31 December 2018; (ii) the absence of the after-tax gains arising from fair value changes of derivative financial assets for the year ended 31 December 2018 as compared to an amount of HK$524 million for the year ended 31 December 2017 as disclosed in the announcement of the Company dated 14 August 2018; (iii) an impairment loss on account receivable of approximately HK$107.5 million for the year ended 31 December 2018; and (iv) an impairment loss on deposits for acquisition of plant and equipments of approximately HK$35.6 million. Details of (iii) and (iv) refer to Supplemental Information on Pages 163 to 166.

Manpower development

With regard to staff development, the Company strengthened the talent nurturing system and designed new employee development system and mechanism to enhance staff quality. The Company and its subsidiaries will adopt the core strategy to continue to attract and nurture high-calibre employees, while introducing talents on space technology and AI at a global level.

During the year, the Company and its subsidiaries had 420 employees being experts on high and new technology from around the world and approximately 21% of them were with master's degree or above. This has provided a strong talent foundation that in turn strengthened their core competitiveness.

Other results

The Company granted replacement and new share options to directors and employees of the Company and its subsidiaries in 2015, and the relevant share-based payment expenses for the year was approximately HK$8,066,000 (2017: HK$33,188,000).

Net exchange loss of approximately HK$423,000 was recognised during the year (2017: net exchange gain of HK$8,672,000) and it was mainly due to the depreciation of RMB to HKD in 2018.

CAPITAL STRUCTURE

On 30 September 2015, the Board of Company announced that the Company will cancel a total of 67,537,000 share options granted to certain Directors and employees of the Company and its subsidiaries on 26 August 2014 and the Company will conditionally grant 67,537,000 new share options as replacement options to the relevant grantees. On the same day, the Board of the Company further announced that the Company will conditionally grant 70,000,000 new share options to certain Directors and employees of the Company and its subsidiaries under the share option scheme adopted by the Company on 31 July 2012.

No share option scheme was launched for the year ended 31 December 2018. As at 31 December 2018, the balance of issued ordinary shares was 6,156,928,860.

USE OF PROCEEDS

The total proceeds from the fund raising activities, including the subscriptions completed on 22 August 2014 and 29 September 2014 respectively, during the nine months period ended 31 December 2014 were approximately HK$1,888,401,000. During the years ended 31 December 2017, 2016 and 2015, approximately HK$168,628,000, HK$217,728,000 and HK$625,117,000 were utilised according to the intended use as specified in the annual report of year 2014. As at 31 December 2017, approximately HK$614,115,000 was unutilised.

MANAGEMENT DISCUSSION AND ANALYSIS

Below is an analysis for the use of proceeds from the previous fund raising activities during the year ended 31 December 2018:

Intended use of proceeds	Unutilised proceeds as at 1 January 2018 HK$"000	Reclassification (Note) HK$"000	Utilised during the year HK$"000	Unutilised proceeds as at 31 December 2018 HK$"000
Acquisition of land site and construction of manufacturing facilities and expansion of production capacity for the Future Technology Business ("acquisition and expansion for Future Technology Business")	614,115	(84,035)	(110,061)	420,019
Research and development for products and expenses for the Future Technology Business	–	84,035	(84,035)	–
General working capital	–	–	–	–
Global merger and acquisition of In-depth space services industry and products	–	–	–	–
	614,115	–	(194,096)	420,019

Note:

The Company and its subsidiaries strive to build future smart cities by developing and integrating different future technologies, including "AI overlay" technology and "future space" technology. These will require funding and resources to support the activities. Therefore, the management considers it appropriate to deploy its financial resources more effectively and to reclassify approximately HK$84,035,000 from the original intended use for acquisition and expansion for Future Technology Business to research and development for products and expenses for the Future Technology Business. Management believes that such reclassification of approximately HK$84,035,000 is not a material change of the use of proceeds from the previous fund raising activities considering the amount and the purpose.

The unutilised proceeds up to 31 December 2018 were approximately HK$420,019,000.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2018, the total shareholders' funds of the Company and its subsidiaries amounted to approximately HK$1,431,915,000 (31 December 2017: HK$2,534,049,000), the total assets of approximately HK$2,148,823,000 (31 December 2017: HK$3,333,301,000) and the total liabilities of approximately HK$716,908,000 (31 December 2017: HK$799,252,000).

As at 31 December 2018, the Company and its subsidiaries had bank balances and cash of approximately HK$429,611,000 (31 December 2017: HK$787,477,000), time deposits of HK$ Nil (31 December 2017: HK$180,120,000) and pledged bank deposits of HK$310,000 (31 December 2017: Nil). The gearing ratio as of 31 December 2018, defined as the percentage of the total interest bearing debt, including bank and other borrowings of approximately HK$466,449,000 (31 December 2017: HK$396,193,000), to net asset value, was approximately 32.58% (31 December 2017: 15.63%).

Most of the assets, liabilities and transactions of the Company and its subsidiaries are primarily denominated in HK$, RMB and US$ and CAD. The Company and its subsidiaries have not entered into any instruments on the foreign exchange exposure. The Company and its subsidiaries will closely monitor exchange rate movement and will take appropriate activities to reduce the exchange risk.

MANAGEMENT DISCUSSION AND ANALYSIS

SIGNIFICANT INVESTMENTS, MATERIAL ACQUISITIONS OR DISPOSALS

Investment in SkyX

On 9 August 2018, the Company and a new investor (together, the "Investors") entered into a preferred share purchase agreement. Pursuant to the agreement, the Company and its subsidiaries' equity interest in SkyX has been diluted from 64.92% to 53.2%, and the Company and its subsidiaries were unable to control the board of SkyX and resulting in a loss in control over SkyX. Accordingly, the assets and liabilities of SkyX were deconsolidated from the Company and its subsidiaries' consolidated statement of financial position and the interest in SkyX has been accounted for as an associate using equity method. Details were disclosed in note 40(a) to the consolidated financial statements.

KC Subscription in Kuang-Chi Technologies Co., Ltd. ("KCT")

On 25 March 2015, the Company and its subsidiaries entered into a subscription agreement with KCT, which listed on the Shenzhen Stock exchange, pursuant to which KCT conditionally agreed to issue, and the Company and its subsidiaries conditionally agreed to subscribe for 42,075,736 new shares of KCT at the consideration of RMB300 million (equivalent to approximately HK$345,000,000). On 11 November 2016, the Company and its subsidiaries obtained the approval from the China Securities Regulatory Commission for the subscription and certain conditions of the subscription agreement have been satisfied. The subscription right is a derivative that measured at fair value through profit or loss. During the year ended 31 December 2016, the Company and its subsidiaries recognised a gain of HK$1,021,151,000 on the initial recognition of the subscription right of such shares and a loss from changes in fair value of HK$229,913,000. The subscription has been completed and the new shares was listed on the Shenzhen Stock Exchange on 13 February 2017 and was recognised as available-for sale financial assets on the same day. As at 13 February 2017, the fair value of the derivatives right of shares of KCT amounted to approximately HK$1,419,691,000 and hence the Company and its subsidiaries recognised a fair value gain of HK$616,404,000 upon the conversion of derivative in the consolidated statement of profit or loss. Subsequent to the completion of subscription on 13 February 2017, the Company and its subsidiaries hold approximately 3.2% of the ordinary shares of KCT issued. The directors of the Company consider the Company has no significant influence over KCT and no right to appoint any director, and hence classified the investment in KCT as AFS investment at HK$1,419,691,000 which is the fair value of KCT as at 13 February 2017. For the year ended 31 December 2018, the fair value loss of HK$540,933,000 (2017: HK$427,108,000) was recognised in other comprehensive loss.

Save as disclosed above, the Company and its subsidiaries did not have any other significant investment and there are no other material acquisition or disposal of subsidiaries and associated company during the year.

EVENT AFTER THE REPORTING PERIOD

There were no material events occurred after the year ended 31 December 2018.

MANAGEMENT DISCUSSION AND ANALYSIS

CHARGES ON THE COMPANY AND ITS SUBSIDIARIES' ASSETS

As at 31 December 2018, certain assets of the Company and its subsidiaries were pledged to secure banking facilities and other borrowings granted to the Company and its subsidiaries as follows:

	31 December 2018 HK$'000	31 December 2017 HK$'000
Financial assets at FVOCI	**806,282**	–
Available-for-sale financial assets – Shares in KCT	**–**	1,420,811
Prepaid land lease payments	**82,995**	89,900
Construction in progress	**287,221**	191,433
Pledged bank deposits	**310**	–
	1,176,808	1,702,144

Contingent Liabilities

As at 31 December 2018, the Company and its subsidiaries did not have any material contingent liabilities (31 December 2017: Nil).

CAPITAL COMMITMENT

	31 December 2018 HK$'000	31 December 2017 HK$'000
Significant capital expenditure contracted for at the end of the reporting period but not recognised as liabilities: Property, plant and equipment	**204,788**	209,483
Financial commitments on an investment (Note 43 to the consolidated financial statements)	**–**	140,400

EMPLOYEES AND REMUNERATION POLICY

As at 31 December 2018, the Company and its subsidiaries had approximately 420 employees. The Company and its subsidiaries provide competitive remuneration packages to employees with the share option scheme and the restricted shares award scheme. The Company and its subsidiaries also provide attractive discretionary bonus payable to those with outstanding performance and contribution to the Company and its subsidiaries.

SHARE OPTION SCHEMES AND RESTRICTED SHARE AWARD

Please refer to pages 38 to 40 for details.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

ABOUT THIS REPORT

KuangChi Science Limited (the "Company"), together with its subsidiaries (the "Group"), is pleased to present this Environmental, Social and Governance Report (the "Report") to provide an overview of the Group's management on significant issues affecting the operation, and the performance of the Group in terms of environmental and social aspects. This Report is prepared by the Group with the professional assistance of APAC Compliance Consultancy and Internal Control Services Limited.

Preparation Basis and Scope

This Report is prepared in accordance with Appendix 27 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") (the "Listing Rules") – "Environmental, Social and Governance Reporting Guide" (the "ESG Reporting Guide") and has complied with the "comply or explain" provisions in the Listing Rules.

This Report summarises the performance of the Group in respect of corporate social responsibility, covering its operating activities which are considered as material by the Group – research, development and manufacture of innovative products for future technology business in the People's Republic of China ("PRC") and the Hong Kong Special Administrative Region of the PRC ("Hong Kong"). This Report shall be published both in Chinese and English on the website of the Stock Exchange. Should there be any discrepancy between the Chinese and the English versions, the English version shall prevail.

Reporting Period

This Report demonstrates our sustainability initiatives during the reporting period from 1 January 2018 to 31 December 2018.

Contact Information

The Group welcomes your feedback on this Report for our sustainability initiatives. Please contact us at (852) 2292 3900.

INTRODUCTION

The Group is a global high-tech innovation company focusing on expanding human's living space. The nickname "Alien Tech" implies that the Group will bring a better life to human beings with future technologies.

The Group's sustainability management approach is based on the compliance with current legal requirements, the principle of sustainability and stakeholders engagement. Therefore, we focus on these fields of activity: environment, employment and labour practices, operating practice and community involvement. The Group have established a system to oversee compliance issues that related to environmental, health and safety and quality management. The Group has formulated policies to promote sustainability and manage risks related to these four areas. Details of the management approach in different areas have been explained in respective section of this Report. The Group has recognised the importance of social responsibility. Our commitment includes:

1. Saving lives by providing relief to disaster-stricken and impoverished areas

2. Improving society by making cities smarter

3. Innovating lifestyles for a better tomorrow

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

STAKEHOLDERS ENGAGEMENT AND MATERIALITY ASSESSMENT

The Group understands the success of the Group's business depends on the support from its key stakeholders, who (a) have invested or will invest in the Group; (b) have the ability to influence the outcomes within the Group; and (iii) are interested in or affected by or have the potential to be affected by the impact of the Group' s activities, products, services and relationships. The Group will continue to ensure effective communication and maintain good relationship with each of its key stakeholders.

Stakeholders are prioritised from time to time in view of the Group's roles and duties, strategic plan and business initiatives. The Group engages with its stakeholders to develop mutually beneficial relationships and to seek their views on its business proposals and initiatives as well as to promote sustainability in the marketplace, workplace, community and environment.

The Group acknowledges the importance of intelligence gained from the stakeholders' insights, inquiries and continuous interest in the Group's business activities. The Group has identified key stakeholders that are important to our business and established various channels for communication. The following table provides an overview of the Group' s key stakeholders, and various platforms and methods of communication are used to reach, listen and respond.

Stakeholders	Expectations of Concern	Engagement channels	Measures
Government and regulatory authorities	– Comply with the laws and regulations – Proper tax payment – Promote regional economic development and employment	– On-site inspections and checks – Annual reports and announcements – Group websites	– Operated managed and paid taxes according to laws and regulations, strengthened safety management accepted the government's supervision, inspection and evaluation (e.g. accepted 1-2 on-site inspections throughout the year), and actively undertook social responsibilities
Shareholders and Investors	– Low risk – Return on the investments – Information disclosure and transparency – Protection of interests and fair treatment of shareholders – Comply with the laws and regulations	– Annual general meetings and other shareholder meetings – Annual reports and announcements – Group websites	– Issued notice of general meeting and proposed resolutions according to regulations, disclosed company's information by publishing announcements/ circulars and three periodic reports in total in the year. Carried out different forms of investor activities with an aim to improve investors' recognition. Held results briefing once. Disclosed company contact details on website and in reports and ensured all communication channels are available and effective

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Stakeholders	Expectations of Concern	Engagement channels	Measures
Employees	– Safeguard the rights and interests of employees – Good working environment – Career development opportunities – Occupational health and safety – Self-actualisation	– Meetings and conferences – Training, seminars, briefing sessions – Cultural and sport activities – Intranet and emails	– Provided a healthy and safe working environment developed a fair mechanism for promotion; established labor unions at all levels to provide communication platforms for employees; cared for employees by helping those in need and organizing employee activities
Customers	– Legal and high-quality products/services – Stable relationship – Information transparency – Business ethics and integrity	– Group websites, brochures, annual reports and announcements – Email and customer service hotline – Regular meetings	– Established laboratory, strengthened quality management to ensure stable production and smooth transportation, and entered into long-term strategic cooperation agreements
Business partners	– Long-term partnership – Fair and open – Information resources sharing – Risk reduction – Business ethics and integrity	– Business meetings, supplier conferences, phone calls and interviews – On-site audit or checks	– Perform contracts according to agreements; enhance daily communication and establish cooperation with quality suppliers and contractors
Peers/Industry associations	– Experience sharing – Co-orperations – Fair competition	– Industry conferences and meetings – Company visits	– Stick to fair play; cooperate with peers to achieve win-win; share experiences and attend seminars of the industry so as to promote sustainable development of the industry.
Finance Institutions	– Repayments on schedule – Business status – Operational risk – Business integrity	– Business conferences – Site visits	– Comply with regulatory requirements in a strict manner; disclose latest Company information in a timely and accurate manner according to rules and regulations.
Public and communities	– Career opportunities – Community involvement – Environmental responsibilities – Social responsibilities	– Volunteering – Charity and social investment – Annual reports and announcements	

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With these on-going dialogues, the Group understands the expectations and concerns from stakeholders. The feedbacks obtained allow the Group to make more informed decisions, and to better assess and manage the resulting impact.

The principle of materiality strengthens the Group's Environmental, Social and Governance (the "ESG") reporting which means understanding the ESG issues that are important to the Group' s business, informing the issue and key performance indicators (KPIs) to cover in the Report. The Group's approach to materiality in this Report is based on the best-practice recommendations of the ESG Reporting Guide and the Global Reporting Initiative Guidelines.

In 2018, the Group evaluated the importance of global sustainability challenges to the Group. As part of this exercise, internal and external stakeholders, including employees, consumers, distributors, investors, suppliers and the community, contributed their perspectives regarding ESG reporting and the broader ESG issuers relevant to the Group. The assessment also considered ESG issues relevant to the Group' s industry and operation locations and included the following steps:

Step 1: Identification – Industry Benchmarking

- Relevant ESG issues were identified based on feedback from investors, sustainability indices and the ESG reports of the Group's local and international industry peers.

- The materiality of each ESG issue was determined based on the frequency of its disclosure by selected peer companies.

Step 2: Prioritization – Stakeholder Engagement

- The Group engaged key stakeholders on ESG issues affecting the Group.

- Stakeholders were asked to rank each of the shortlisted ESG issues according to their view of its importance to the operation of the Group.

Step 3: Validation – Determining Material Issues

- The Group's management validated the range of ESG issues being reported to ensure the results of the materiality assessment were in line with and reflective of issues important to business development.

As a result of this process carried out in 2018, those important issues to the Group were discussed in this Report.

ENVIRONMENTAL ASPECT

There has been a rising concern on environmental issues nowadays. The Group's commitment to environmental protection encompasses all our business activities, from minimising emissions to conserving energy and resources and much more. The Group's Environment and Wastes Policy demonstrates our determination in developing, implementing and constantly improving its procedures and processes to reduce the negative impact of the Company's operational activities on the environment.

ASPECT A1: EMISSIONS

The Group has developed procedures to monitor the emission of air pollutants, wastes, wastewater and noise. We are strictly in compliance with relevant laws and regulations, which including Air Pollution Control Ordinance (Cap. 311) in HK and Environmental Protection Law in PRC. Emission control is essential to mitigate the impact to the environment and to protect the health of employees. Our air pollutants emission is mainly generated from the mobile source. During the reporting period, no concluded cases regarding emissions brought against the Group or their employees were noted.

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Air Pollutants Emission

Air pollutants emission control is vital to both environmental protection and health of employees. Emission from the Group's operation complies with the Emission Limits of Air Pollutants (DB44/27–2001) in the PRC. For example, exhaust gas treatment facilities require regular maintenance to secure that they meet the emission standard. Containers for chemicals storage are sealed properly to prevent leakage. Air pollutants emission of the Group mainly comes from vehicles and stationary source. The significant decrease in air pollutants emission in 2018 was mainly attributable to the decrease in the revenue generated from the Group's "future space" technology products during the year, as well as the decrease in fuel consumption and travelling distance of vehicles as a result of the temporary cessation of the development and commercialization of jetpack products in New Zealand since the beginning of 2018.

The air pollutants emission during the reporting period is as follows:

Air Pollutants	Unit	2018 PRC	2018 HK	2018 Total	2017 Total
Nitrogen oxides (NO_x)	kg	**6.28**	**2.66**	**8.94**	41.30
Sulfur dioxide (SO_2)	kg	**1.75**	**0.07**	**1.82**	2.01
Particular matter (PM)	kg	**1.18**	**0.20**	**1.38**	3.23

Greenhouse Gas (GHG) Emission

Climate change is gradually concerned by the public as it does affect our daily life. GHG is considered as one of the major contributors to the climate change. The Group manages the carbon footprint by minimising the energy and water consumptions in its operation as these activities cause significant emission of GHG. The Group has adopted energy saving policy (as mentioned in the section Use of Resources) in order to reduce the carbon footprint. During the reporting period, our GHG emission scopes 1 and 2 mainly came from mobile combustion and purchased electricity. The significant decrease in GHG emission in 2018 was attributable to the sharp decrease in the revenue generated from the Group's "future space" technology products during the year.

During the reporting period, the emission of greenhouse gas is as follows:

Greenhouse Gas Emission[1]	Unit	2018 PRC	2018 HK	2018 Total	2017 Total
Scope 1[2]	tonnes of CO_2-e	**51.25**	**13.21**	**64.46**	69.67
Scope 2[3]	tonnes of CO_2-e	**261.58**	**4.48**	**266.06**	2,423.42
Total	tonnes of CO_2-e	**312.83**	**17.69**	**330.52**	2,493.09
Intensity	tonnes of CO_2-e/m^2	**0.05**	**0.16**		

1 The calculation of the greenhouse gas emission is based on the "Corporate Accounting and Reporting Standard" from greenhouse gas protocol.
2 Scope 1: Direct emission from sources that are owned or controlled by the Group.
3 Scope 2: Indirect emissions from the generation of purchased electricity consumed by the Group.
4 NZ refers to the future technology business segment which focused on the design of technology products, operated in New Zealand in 2017.

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Hazardous and Non-hazardous Wastes

The Group's Wastes Management Policy provides guideline on handling wastes. According to the characteristics of wastes, they are classified as general waste, industrial waste and hazardous waste. General waste and industrial waste are collected, stored, labelled and weighted before being delivered to qualified recycling companies. There are some measures implemented in the office to reduce the waste generated, for example, paper is printed on both sides to reduce paper waste. The Group introduces paperless solutions in the operation to reduce the paper usage. Recycling bins are placed in the office to recycle paper and other materials. The slight decrease in non-hazardous wastes produced was mainly attributable to the Group's effort in reducing non-hazardous wastes produced with aforementioned strategies being implemented.

The wastes generated by the Group during the reporting period are as follows:

Wastes disposal	Unit	2018 PRC	2018 HK	2018 Total	2017 Total
Hazardous wastes	tonnes	–	–	–	5.55[5]
Hazardous wastes produced intensity	tonnes/m²	–	–	–	0.0048
Non-hazardous wastes produced	tonnes	0.82	N/A[6]	0.82	0.96
Non-hazardous wastes produced intensity	tonnes/m²	0.0025	N/A[5]		0.0049

Noise

Production plants in the PRC are required to comply with the regulation of Emission Standard for Industrial Enterprises Noise at Boundary (GB12348-2008). For premises that are equipped with generators and compressors, noise reduction devices are installed to reduce the noise generated from operation of machineries.

ASPECT A2: USE OF RESOURCES

The resources consumed by the Group are mainly water, electricity, fuel, paper, etc. In order to save resources and mitigate the adverse effect on environment, the Group' Energy Resources Control Management Regulation is established to set out the framework and guideline for employee to implement resource-saving practices. Regular audits and review for resources usage allow us to identify any potential risk related to resource consumption.

Energy Consumption

Generally, trainings or activities are offered to employees to raise their awareness on energy saving. Energy efficiency is one of the key considerations for procurement department when purchasing machineries. The Group also established and implemented policy of Office Environment Management Regulation to provide guidelines for employee to save energy in office. The key measures to reduce the energy consumption in office include:

- Lights and electronic appliances need to be turned off when employees leave office and factories.
- The operation mode of air-conditioning system is adjusted according to the weather.

5 Hazardous wastes were generated by the factory in the PRC subsidiary of "深圳光啓空間技術有限公司" only in 2017 and the factory ceased operation in early 2018.

6 N/A refers to "not available". As the non-hazardous wastes were collected by the contractor and the weight of it were not provided by the collector.

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Energy usage is recorded by responsible department and analysis is carried out to compare the usage with the same month of the previous year. If there is any substantial increase in the energy consumption, The Group will analyse the causes to rectify the problems promptly. During the reporting period, the significant decrease in energy consumption was due to the decrease in the revenue generated from the Group's "future space" technology products. The significant decrease in purchased electricity in 2018 was mainly attributable to the cessation of business of a PRC subsidiary's branch "深圳光啓空間技術有限公司(三溪基地)" at the beginning of 2018.

During the reporting period, the energy consumption is as follows:

Energy	Unit	2018 PRC	2018 HK	2018 Total	2017 Total
Purchased electricity	kWh in '000s	**387.46**	**6.97**	**394.43**	3,665.44
Petrol	kWh in '000s	**208.86**	**43.38**	**252.24**	235.98
Diesel	kWh in '000s	**–**	**–**	**–**	27.70
Total	kWh in '000s	**596.32**	**50.35**	**646.67**	3,929.12
Intensity	kWh in '000s/m^2	**0.102**	**0.466**		0.271

Water Consumption

Water is another important resource. The water consumption data in Hong Kong was not presented in 2018 due to the Hong Kong office is operated in commercial building where the water supply is solely controlled by the property management company. Hence, it is not feasible for the Group to provide water consumption data for these subsidiaries in 2018 as there is no sub-metering to record water usage. In spite of this, the Group strives to conserve water and reduce its usage, the Group remind employees to turn off the water tap when it is not in use and do not leave it running. Regular maintenance is also carried out for pipes to prevent leakage so as to save water resource. The decrease in water consumption in 2018 was attributable to the Group's effort in conserving water with aforementioned water-saving strategies being implemented during the year.

The water consumption during the reporting period is as follow:

Water	Unit	2018 PRC	2018 HK[7]	2018 Total	2017 Total
Total water consumption	m^3	**3,911.31**	**N/A**	**3,911.31**	4,363.00
Intensity	m^3/m^2	**1.68**	**N/A**		0.26

Wastewater

The Group always complies with the national regulation of Discharge Limits of Water Pollutants (DB44/26–2001) of the PRC on wastewater management. Wastewater is strictly forbidden to be mixed with rainwater. To reduce wastewater generation, the volume of wastewater production is one of our key concerns when designing new products and carrying out research on technology. All the chemical wastes are stored in specific location. It is not allowed to discharge wastewater into unauthorised locations, such as washroom and greenery area, etc.

7 The amount of water consumption data was not presented in 2018 due to the HK office is located at the commercial building, which provides water supply service.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

ASPECT A3: THE ENVIRONMENT AND NATURAL RESOURCES

The Group's Environmental Policy has outlined its environmental plan, which allows us to identify risks that are related to environment. By monitoring these risks, we can develop methods and emergency procedures if any adverse effect on environment is noticed. Moreover, the Group will continue to implement environment-friendly practices in the Group's operation in order to enhance environmental sustainability.

SOCIAL ASPECT
EMPLOYMENT AND LABOUR PRACTICES

The Group prides themselves on a creative, dedicated and enthusiastic workforce that strives to achieve our common goal. By taking ownership of responsibilities, trusting and supporting each other, our employees are able to keep their promises and bring the Group's vision to life with a sense of pride in what they do and the Group's achievements. Our labour force is international and this diverse culture helps us to be a global company. Although such diversity does create some challenges, it provides unique opportunities as each culture brings a different way of thinking. For a disruptive technology company, this ensures that we are constantly testing our thinking from different angles.

Employment

The Group expects that all employees and contractors treat one another with respect and dignity. In the Group's policy, it has covered issues relating to compensation and dismissal, recruitment and promotion, working hours, rest period, equal opportunity, diversity anti-discrimination and other benefits and welfare. The Group strictly abide by relevant laws and regulations, such as the Labour Law of the PRC, the Labour Contract Law of the PRC and the Employment Ordinance of Hong Kong (chapter 5 of the laws of Hong Kong). In 2018, the Group was not subject to any punishment by the government and was not involved in any lawsuit relating to employment.

Equal Opportunity

The Group specifically prohibits discrimination on the basis of age, colour, disability, ethnicity, marital or family status, national origin, race, religion, sex, sexual orientation, or any other characteristics protected by the law. These thoughts are extended to all employment decisions, including but not limited to recruiting, training, promotion, etc.

Harassment-Free Workplace

All employees are committed to maintaining a professional and harassment-free working environment – places where employees act with respect for one another and for those with whom we do business. Behaviours such as unwelcome conduct and sexual harassment are strictly prohibited.

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ASPECT B2: HEALTH AND SAFETY

The Group is committed to providing a healthy and safe workplace for all its employees as stipulated in the Group's Code of Conduct and Safety Policy. We have a set of safety management system which outlines detailed guidelines in different circumstances. The Group is in strict compliance with related laws and regulations, such as Law of the PRC on the Prevention and Control of Occupational Diseases, Occupational Safety and Health Ordinance by the Labour Department in Hong Kong. The Group also seeks to exceed the minimum legal standards. It is our intent to avoid all injuries and to be recognised as an industry leader in safety. We support a "no blame" culture that encourages individuals to report failures in systems and to share these with the entire company in order to raise awareness and facilitate learning. Key occupation health and safety measures are adopted as follow:

1. Employees must receive safety training before performing duties

2. Safety equipment is checked regularly to secure it is in good condition

3. Personnel who uses organic solvent must follow the regulations adopted by the Group

4. The Group provides health and occupational diseases checkup to our employees

To further enhance the health of safety in workplace, The Group has commissioned a consultancy company to review its safety working procedures. During the year, this can help the Group to improve the safety standard. The Group is also concerned about both mental and physical well-being of employees. The Group's Workplace Stress and Fatigue Management Policy aims to provide a system for us to identify and manage any workplace stress and fatigue.

In 2018, the Group was not subject to any punishment by the government and were not involved in any lawsuit related to health and safety.

ASPECT B3: DEVELOPMENT AND TRAINING

The Group provides diversified on-the-job trainings based on the needs of respective positions and talents and interests of employees. According to the Employee Training Policy, the Group provides both internal and external trainings for employees, including orientation training for new employees, specialised trainings for different departments, management trainings, etc. The trainings are particularly focused on safety trainings with the aim to improve the quality of employees' safety and to establish a corporate safety culture. With these trainings, the safety knowledge of the employees can be strengthened and the safety awareness can be enhanced. This can decrease the occurrence of work-related accidents. Moreover, the Group's Performance Management Policy and Guidelines is established to assess the performance of employee so as to identify and implement development programs for employees.

ASPECT B4: LABOUR STANDARDS

The Group respects the right of employee and maintain a high labour standard. The Group is strictly in compliance with the Labour Contract Law of the PRC and the Employment Ordinance of Hong Kong. The Group does not tolerate any form of forced child labour and forced labour. In the Group's recruitment guideline, candidate who aged under 18 is not allowed to work in the company. In 2018, the Group was not subject to any punishment by the government and was not involved in any lawsuit relating to child and forced labour.

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OPERATING PRACTICES
ASPECT B5: SUPPLY CHAIN MANAGEMENT

A long-term cooperation between the Group and its suppliers is important to the operation of the business. The Group's Procurement Management Regulation provides guideline on supply chain management. The choice of suppliers is based on the performance on different areas, including but not limited to compliance, environmental, health and safety management and quality management as stipulated in our internal Supplier Evaluation and Approval Standard. Continuous supplier assessments and on-site audits are carried out to evaluate the performance of our existing suppliers. We always seek opportunities to improve the product quality by conducting conference meetings to discuss product improvement and environmental sustainability improvement. The Group has ISO9001 quality management system demonstrating our commitment to quality and our capability to satisfy customer's requirements.

ASPECT B6: PRODUCT RESPONSIBILITY

The Group is a world leader in future technology, as well as the owner of the relevant core intellectual properties. The Group has a world-class research and development team that integrates various advanced technologies in electronic information, mathematics and statistics, and other disciplines and has over 736 patent applications. Product responsibility is a key consideration across all aspects of the development of the Group's products including design, manufacturing, training and operations. The Group complies with laws and regulations related to product responsibility in the regions where it operates, for instance, Product Quality Law of the PRC and Trademark Law of the PRC. In 2018, the Group was not subject to any punishment by the government and was not involved in any lawsuit relating to product responsibility.

Safety and Quality Management

Safety is a vital aspect of any products, especially for aircrafts, that have been deeply implanted in the operation of the Group. To ensure the safety and quality of our products, the Group has established a comprehensive quality management system to monitor the entire production process. Incoming Quality Control is implemented to evaluate the quality of material from suppliers. The standard procedures for packaging, transportation and storage of products are stipulated in the internal regulations. Finished products are inspected to identify any defects. If nonconforming product is noticed, it will be decided whether to rework, accept or be considered as scrap.

Complaint Handling

Once a compliant is received by telephone, email or letter, it must be reported to the management. Investigation is carried out to identify the reason of the compliant. Responsible department is required to formulate long term strategy and the result will be reviewed by quality assurance department.

Intellectual Property Protection

Protection of intellectual property has been taken very seriously by the Group. Significant technology and intellectual property developed through research and development of the Group has been protected under registered patents. The Group's policy of Intellectual Property Management System describes clearly the practices on protection of intellectual property rights. Every employee is required to sign an agreement, which states clearly the ownership of the intellectual property. Before disclosure of patent application is made, every employee has the responsibility to keep all related information in secret.

Customer Data Protection and Privacy

Data is our valuable asset. The Group has developed a policy of Information Management System to provide guidance to staff on control and usage of company data and to restrict access or use where necessary to protect the interests of the Group. Data is classified into different levels according to the confidentiality as public, internal, and restricted/confidential.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

ASPECT B7: ANTI-CORRUPTION

The Group maintains a high standard of business integrity throughout its operations and tolerates no corruption or bribery in any form according to the Group's Code of Conduct. The Group strictly complies with relevant laws and regulations relating to anti-corruption, bribery, extortion, fraudulent behaviour and money-laundering, including but not limited to the Criminal Law of the PRC, the Prevention of Bribery Ordinance of (chapter 201 of the laws of Hong Kong).

The Group is committed to adhering to the highest ethical standards. All employees are distributed with a code of conduct that they are required to adhere. Such code explicitly prohibits employees from soliciting, accepting or offering bribes or any form of advantage. The Code of Conduct also outlines the Group's expectations on staff with regard to conflicts of interest.

To minimise the possibility of corruption, the Group's Gift Policy defines the meaning of gift and clarifies the rules in relation to giving and receiving gifts. The Group's Whistle Blower Policy encourages Board members, staff and others to report suspected or actual occurrences of illegal, unethical or inappropriate events (behaviours or practices) without retribution.

In 2018, the Group was not subject to any punishment by the government and were not involved in any lawsuit related bribery, extortion, fraud and money laundering.

COMMUNITY
ASPECT B8: COMMUNITY INVESTMENT

The Group has established a Community Involvement Policy to promote community involvement and social contribution. It provides an opportunity for employees to volunteer and serve the community. The Group has contributed in different areas so as to build a better society.

Community Involvement

As a global high-tech innovation company, the Group endeavours to support technical innovation and learning and hosts students and enthusiasts at its facilities and offers talks and demonstrations. Moreover, the Group held an open day in May 2018 for sharing our professional knowledge with public citizen. In addition, many of our employees spend time to give talks to universities, schools and clubs to encourage education and interest in science, technology and engineering.

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BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

EXECUTIVE DIRECTORS

Dr. Liu Ruopeng, aged 35, is currently the chairman and executive Director of the Company and also the chairman of nomination committee of the Company. Dr. Liu joined the Company in August 2014. Dr. Liu has been the president of Kuang-Chi Institute of Advanced Technology, a private not-for-profit research organisation which focuses on science research since 2010. Dr. Liu has been the director of the State Key Laboratory of Metamaterial Electromagnetic Modulation Technology since 2012, and vice chairman of the National Technical Committee of Standardization for Electromagnetic Metamaterial Technology and Products since 2013. Dr. Liu is executive vice chairman of the Youth Committee of the All-China Federation of Returned Overseas Chinese, deputy of the National People's Congress, vice chairman of Shenzhen Federation of Industry and Commerce, a commissioner for recommending young talents to Shenzhen, a member of the Standing Committee of Shenzhen Youth Federation, a member of the Shenzhen-Hong Kong Youth Consulting Committee for Authority. Dr. Liu obtained a collective award of "Guangdong Youth May 4th Medal" in 2011. Dr. Liu was awarded "China Youth May 4th Medal", the top honour for young Chinese people, in 2014.

Dr. Liu obtained a master's degree and a doctorate degree from Duke University, the United States in 2009 and a bachelor's degree from Zhejiang University, China in 2006. Dr. Liu was a non-executive director of Martin Aircraft Company Limited ("MACL") until 26 September 2018, which removed from the official list of Australian Securities Exchange with effect from 4 June 2018. Afterward, MACL had arranged to transition its shares to the Unlisted Securities Exchange ("USX") (a New Zealand unlisted share trading platform) with effect from 7 June 2018. Dr. Liu is a chairman of Kuang-Chi Technologies Co., Ltd., a company listed on the Shenzhen Stock Exchange (security code: 002625.SZ). Dr. Liu has extensive experience in research and development of advanced technologies and business network in relation to metamaterial, near space and other innovative technology industries. Dr. Liu has made outstanding contributions to business management, the system innovation of new-type research institutions and the construction of the Global Community of Innovation.

Dr. Zhang Yangyang, aged 39, is currently the co-chief executive officer and executive Director of the Company and also a member of remuneration committee of the Company. Dr. Zhang joined the Company in August 2014. Dr. Zhang has been the executive vice president of Kuang-Chi Institute of Advanced Technology since 2010. Dr. Zhang has been vice president of Shenzhen Young Science and Technology Talents Association since 2012. Dr. Zhang obtained a collective award of "Guangdong Youth May 4th Medal" in 2011.

Dr. Zhang obtained a doctorate degree from the University of Oxford, the United Kingdom in 2008, and a master's degree and a bachelor's degree from the Northeastern University, China in 2004 and 2002 respectively. Dr. Zhang was a non-executive director of MACL until 16 August 2016, which removed from the official list of Australian Securities Exchange with effect from 4 June 2018. Afterward, MACL had arranged to transition its shares to the Unlisted Securities Exchange ("USX") (a New Zealand unlisted share trading platform) with effect from 7 June 2018. Dr. Zhang has extensive experience in research and development of advanced technologies and business network in relation to metamaterial, near space and other innovative technology industries. Dr. Zhang has extensive experience in business management and team management.

Dr. Luan Lin, aged 39, is currently the co-chief executive officer and chief technology officer and executive Director of the Company. Dr. Luan joined the Company in August 2014. Dr. Luan has been the vice president of Kuang-Chi Institute of Advanced Technology since 2010. Dr. Luan obtained a collective award of "Guangdong Youth May 4th Medal" in 2011.

Dr. Luan obtained a doctorate degree from Duke University, the United States in 2010 and a master's degree from Peking University, China in 2004. Dr. Luan is a non-executive director of Martin Aircraft Company Limited, which removed from the official list of Australian Securities Exchange with effect from 4 June 2018. Afterward, MACL had arranged to transition its shares to the Unlisted Securities Exchange ("USX") (a New Zealand unlisted share trading platform) with effect from 7 June 2018. Dr. Luan has extensive experience in research and development of advanced technologies and business network in relation to electronic information, near space and other innovative technology industries. Dr. Luan has extensive experience in business management and team management.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Mr. Dorian Barak, aged 45, is currently an executive Director of the Company. Mr. Barak joined the Company in February 2017. Mr. Barak is a veteran private equity investor and fund manager specializing in emerging markets. He serves on the boards of companies active in the technology, aviation and natural resources sectors in Israel, China and Africa. He was a non-executive director of Yunfeng Financial Group Limited (stock code: 376) from 16 January 2014 to 9 November 2015. Mr. Barak is CEO of Indigo Global, which advises leading companies and funds on strategy and investment transactions. Over the past two decades, Mr. Barak has filled key investment and strategy positions in the US, Israel and Europe. He was the Head of Global Strategy and M&A at Hapoalim, Israel's leading financial group; an M&A Attorney with the Skadden Arps law firm in New York; and a Consultant with the Boston Consulting Group (BCG) in Chicago. He was awarded a Juris Doctor by Yale University, a master degree from Oxford University, and a BA from UCLA.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Dr. Liu Jun, aged 54, is currently an independent non-executive Director of the Company and also a member of the audit committee, nomination committee and remuneration committee of the Company. Dr. Liu joined the Company in August 2014. Dr. Liu was appointed a professor of statistics at Harvard University in 2000 and has written research papers and publications about Markov chain Monte Carlo algorithms. Dr. Liu received a number of awards including The Committee of Presidents of Statistical Societies 2002 Presidents' Award in 2002 and the Morningside Gold Medal in Mathematics in 2010. Dr. Liu was elected as a fellow of the Institute of Mathematical Statistics in 2004 and the American Statistical Association in 2005. Dr. Liu obtained a doctorate degree from The University of Chicago, the United States of America in 1991.

Dr. Wong Kai Kit, aged 45, is currently an independent non-executive Director of the Company and also the chairman of remuneration committee and a member of audit committee and nomination committee. Dr. Wong joined the Company in August 2014. Dr. Wong was appointed a professor at the Department of Electronic and Electrical Engineering, University College London, United Kingdom in October 2015. Dr. Wong had other teaching and research roles in universities and education institutes in Hong Kong, the United States of America and the United Kingdom. Dr. Wong is an academician of The Institution of Engineering and Technology Inc. ("IET") and a fellow of The Institute of Electrical and Electronics Engineers Inc.. Dr. Wong obtained a doctorate degree, a master's degree and a bachelor's degree from the Hong Kong University of Science and Technology, Hong Kong, in 2001, 1998 and 1996 respectively.

Ms. Cao Xinyi, aged 36, is currently an independent non-executive Director of the Company and also the chairman of audit committee. Ms. Cao joined the Company in October 2016. Ms. Cao is the chairman, executive Director and company secretary of E-Commodities Holdings Limited ("E-Commodities"), a company incorporated in the British Virgin Islands with limited liability and the shares of which are listed on the Stock Exchange of Hong Kong (stock code: 1733). Ms. Cao has long term experience in the business and operations of E-Commodities, and has been closely involved with the financial affairs of E-Commodities and has extensive experience in investors' relationship. From 2005 to 2009, Ms. Cao has served at PricewaterhouseCoopers. She graduated from the City University of Hong Kong with a bachelor's degree in Business Administration in 2005. Ms. Cao is a member of the Hong Kong Institute of Certified Public Accountants.

Note:

The interests of Directors in shares of the Company, if any, within the meaning of Part XV of the Securities and Futures Ordinance ("SFO") as at 31 December 2018 are disclosed in the section headed "Directors' and Chief Executives' Interests in Shares" of the Directors' Report of this annual report.

DIRECTORS' REPORT

The Directors are pleased to present their report and the audited consolidated financial statements of the Company and its subsidiaries for the year ended 31 December 2018.

PRINCIPAL ACTIVITIES

The Company is an investment holding company. The principal activities of its subsidiaries are engaged in the research and development as well as manufacture of innovative products for future technology business, and the provision of other innovative technology service solutions (the "Future Technology Business"). Details of the principal activities of the principal subsidiaries of the Company are set out in note 1 to the consolidated financial statements of this annual report. There were no significant changes in the nature of the Company and its subsidiaries' principal activities during the year ended 31 December 2018.

MAJOR CUSTOMERS AND MAJOR SUPPLIERS

During the year, the Company and its subsidiaries' five largest suppliers and the largest supplier accounted for approximately 86.1% and 38.7% respectively of the Company and its subsidiaries' total purchases.

During the year, the Company and its subsidiaries' five largest customers accounted for approximately 96.7% of the Company and its subsidiaries' total sales. The largest customer accounted for approximately 49.3% of the Company and its subsidiaries' total sales.

None of the Directors, their close associates or any shareholders of the Company, which to the knowledge of the Directors, own more than 5% of the Company's issued share capital has a beneficial interest in any of the Company and its subsidiaries' five largest suppliers and customers during the year.

RESULTS AND APPROPRIATIONS

The results of the Company and its subsidiaries for the year ended 31 December 2018 are set out in the consolidated financial statements on pages 58 to 64.

The Directors do not recommend the payment of any dividend in respect of the year ended 31 December 2018.

BUSINESS REVIEW

Overview

A business review, particulars of important events that have occurred since the end of the year and future development of the Company and its subsidiaries are set out in the section headed "Management Discussion and Analysis" on pages 3 to 11 of this annual report, which forms part of this directors' report.

Key financial and business performance indicators

The key financial and business performance indicators comprise gross profit margin; EBITDA, share based payment and impairment loss recognised in respect of goodwill; and debt to equity ratio. Details of key performance indicators are discussed below.

The Company and its subsidiaries' gross profit margin, based on gross profit for the year to revenue, was 12% (2017: 42%) for the year ended 31 December 2018. The gross profit margin for 2018 decreased as compared to that for 2017, mainly due to sale of other products of lower margin for 2018.

DIRECTORS' REPORT

EBITDA and share based payment represented earnings from continuing operations before interest, taxes, depreciation and amortisation. The Company and its subsidiaries' EBITDA and share based payment decrease by HK$769,075,000 (2017: HK$484,206,000) reflecting the decrease in revenue and increase in other operating expenses during the year ended 31 December 2018.

The level of debt (including obligations under finance lease and bank and other borrowings) to equity of the Company and its subsidiaries was at a healthy level of 0.33 times as at 31 December 2018 (2017: 0.16). The Company and its subsidiaries will continue to safeguard its capital adequacy position, manage key risks cautiously and set prudent yet flexible business development strategies to strike a balance between business growth and prudent risk management.

Environmental policies

The Company and its subsidiaries are committed to the long-term sustainability of the environment and communities in which we operate and are committed to building an environmentally-friendly corporation that pays close attention to conserving natural resources. We strive to minimize our environmental impact by saving electricity and encouraging recycle of office supplies and other materials. For details, please refer to the section headed "Environmental, Social and Governance Report".

Health and safety

The Company and its subsidiaries provide health and safety information to raise employees' awareness of occupational health and safety issues. Risk assessments of workstations are performed regularly. Improvement and maintenance of tools, office equipment are performed to cope with the needs and demands of employees. Cleaning of workstations and office equipment are carried out at regular intervals in order to provide a safe, hygienic and healthy working environment to all staff.

Employees are also expected to take all practical measures to ensure a safe and healthy working environment, in complying with their defined responsibilities and applicable laws. For details, please refer to the section headed "Environmental, Social and Governance Report".

Environment protection

Conservation of the environment remains a key focus for the Company and its subsidiaries, the conscious minimising in consumption of resources and adoption of environmental best practices across the Company and its subsidiaries' businesses underlie our commitment to conserving and improving the environment. The Company and its subsidiaries comply with environmental legislation, encourage environmental protection and promote our awareness to all employees of the organization.

The Company and its subsidiaries commit to the principle and practice of recycling and reducing. To help conserve the environment, we implement green office practices such as re-deployment of office furniture as far as possible, encourage use of recycled paper for printing and copying, double-sided printing and copying, reduce energy consumption by switching off idle lightings, air conditioning and electrical appliances.

The Company and its subsidiaries will review their environmental practices from time to time and consider implementing further eco-friendly measures, sustainability targets and practices in the operation of the Company and its subsidiaries' businesses to embrace the principles of reduce, recycle and reuse, and further minimise our already low impact on the natural environment. For details, please refer to the section headed "Environmental, Social and Governance Report".

Community involvement

The Company and its subsidiaries support and encourage staff to actively participate in a wide range of charitable events outside working hours, to raise awareness and concern for the community, and to inspire more people to take part in serving the community. For details, please refer to the section headed "Environmental, Social and Governance Report".

DIRECTORS' REPORT

Compliance with laws and regulations

The Company and its subsidiaries continue to update our compliance and risk management policies and procedures, and the senior management are delegated with the continuing responsibility to monitor compliance with all significant legal and regulatory requirements. These policies and procedures are reviewed regularly. For the year ended 31 December 2018 and up to the date of this report, as far as the Board of Directors and management are aware, we have complied in material respects with the relevant laws and regulations that have a significant impact on the business and operation of the Company and its subsidiaries. For the year ended 31 December 2018, the Company was not engaged in any litigation or arbitration of material importance and no litigation or claim of material importance is known to the Directors to be pending or threatened against the Company.

Principal risks and uncertainties

A number of factors may affect the results and business operations of the Company and its subsidiaries, some of which are inherent risks and some are from external sources. Major risks are summarized below.

(1) Industry risk

Our business operates in an industry that is subject to changes in market conditions, technological advancements, developing industry standards and changing customers' needs and preferences for our new products and/or services. If we are unable to respond to these changes promptly or unable to continually enhance our existing products and market new products in a timely manner, our performance may be adversely affected. We continued to invest significant resources in research and development of the future technology business to ensure we retain the leadership in the business.

(2) Macroeconomic environment

The business environment in near future is challenging due to a number of factors such as uncertainty over the global economy, the PRC economy entering a "new normal". Slower consumer spending may result in reduced demand for our products, reduced sales price, order cancellations, lower revenue and margins. It is therefore important that the Company and its subsidiaries are aware of any such changes of economic environment and adjust our business plan under different market conditions.

(3) Foreign Exchange Rate Risk

The majority of the Company and its subsidiaries' assets and sales business are located in the PRC. Most of our sales transactions are denominated in Renminbi while our financial statements are presented in Hong Kong Dollar. The depreciation of Renminbi will result in lower sales and asset value of the Company and its subsidiaries. The Company and its subsidiaries currently have minimal exposure to foreign currency risk, but continue to monitor the relative foreign exchange positions of the mix of its assets and liabilities. When appropriate, hedging instruments including forward contracts, swaps and currency loans would be used to manage the foreign exchange exposure. The foreign currency risk is managed and monitored on an on-going basis by senior management of the Company and its subsidiaries.

Relationships with key stakeholders

The Company and its subsidiaries' success also depend on the support from key stakeholders which comprise employees, customers and suppliers.

Employees

Employees are regarded as the most important and valuable assets of the Company and its subsidiaries. The objective of the Company and its subsidiaries' human resource management is to reward and recognise performing staff by providing a competitive remuneration package and implementing a sound performance appraisal system with appropriate incentives, and to promote career development and advancement through appropriate training and opportunities provided within the Company and its subsidiaries.

DIRECTORS' REPORT

Customers

The Company and its subsidiaries maintain a good relationship with the customers. It is the Company and its subsidiaries' mission to provide excellent customer service in future technology business and other businesses whilst maintaining long term profitability, business and asset growth. Various means have been established to strengthen the communications between the customers and the Company and its subsidiaries in the provision of excellent customer service. A customer complaint handling mechanism is in place to receive, analyse and study complaints and make recommendations on remedies with the aim of improving service quality.

Suppliers

Sound relationships with key suppliers of the Company and its subsidiaries are important in supply chain, meeting business challenges and regulatory requirements, which can derive cost effectiveness and foster long term business benefits. We have developed long-standing relationships with a number of our suppliers and take great care to ensure that they share our commitment to quality and ethics. We carefully select our suppliers and require them to satisfy certain assessment criteria including track record, experience, financial strength, reputation, ability to produce high-quality products and quality control effectiveness.

RESERVES

Details of movements in the reserves of the Company and its subsidiaries during the year are set out in the consolidated statement of changes in equity on page 63 and other details of the reserves of the Company are set out in note 35 and 45 to the consolidated financial statements.

DISTRIBUTABLE RESERVES

At 31 December 2018, the Company had no reserves available for distribution. However, the Company's share premium account, in the amount of approximately HK$2,339,550,000 may be distributed in the form of fully paid bonus shares.

FIXED ASSETS

Details of movements in the Company and its subsidiaries' property, plant and equipment and prepaid land lease payments during the year are set out in notes 17 and 24 to the consolidated financial statements respectively.

SHARE CAPITAL

Details of movements in the Company's share capital during the year are set out in note 34 to the consolidated financial statements and "Capital Structure" in the section headed "Management Discussion and Analysis" on page 8 of this annual report.

FINANCIAL SUMMARY

A summary of the published results and assets and liabilities of the Company and its subsidiaries for the last five financial years is set out on page 162.

DIRECTORS' REPORT

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's Bye-laws, which would oblige the Company to offer new shares on a pro rata basis to existing shareholders, although there are no restrictions against such rights under the laws in Bermuda.

EQUITY-LINKED AGREEMENT

Other than the Share Option Scheme (as defined below) and the RSA Scheme (as defined below) disclosed below, no equity-linked agreements that will or may result in the Company issuing shares or that require the Company to enter into any agreements that will or may result in the Company issuing shares were entered into by the Company during the year or subsisted at the end of the year.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

During the year, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

SHARES ISSUED

The Company did not issue any shares during the year ended 31 December 2018.

DIRECTORS AND SERVICE CONTRACTS

The Directors during the year and up to the date of this report were:

Board of Directors
Executive Directors
Dr. Liu Ruopeng *(Chairman)*
Dr. Zhang Yangyang *(Co-Chief Executive Officer)*
Dr. Luan Lin *(Co-Chief Executive Officer & Chief Technology Officer)*
Mr. Dorian Barak

Non-executive Directors
Mr. Ko Chun Shun, Johnson*
Mr. Song Dawei#

Independent Non-executive Directors
Ms. Cao Xinyi
Dr. Liu Jun
Dr. Wong Kai Kit

* Resigned on 16 November 2018
\# Resigned on 1 August 2018

In accordance with Bye-laws 87(1) of the Company, Dr. Zhang Yangyang, and Dr. Luan Lin will retire by rotation at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

DIRECTORS' REPORT

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Biographical details of the Directors and senior management of the Company are set out on pages 26 to 27.

INDEPENDENT NON-EXECUTIVE DIRECTORS' CONFIRMATION

The Company has received from each of the independent non-executive Directors an annual confirmation of his/her independence to Rule 3.13 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rule") and as at the date of this report still considers that all of the independent non-executive Directors to be independent.

DIRECTORS' SERVICE CONTRACTS

None of the retiring Directors proposed for re-election at the forthcoming annual general meeting has a service contract with the Company or its subsidiaries which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

DIRECTORS' INTERESTS IN CONTRACTS, TRANSACTIONS AND ARRANGEMENTS OF SIGNIFICANCE

Other than as disclosed under the section of "Continuing Connected Transactions, Connected Transactions and Other Related Party Transactions", no contracts, transactions and arrangements of significance in relation to the Company and its subsidiaries' business to which the Company, its holding company, or any of its subsidiaries was a party and in which Director had a material interest, either directly or indirectly, subsisted at any time during or at the end of the year.

PERMITTED INDEMNITY PROVISION

Pursuant to the Company's Bye-laws, every Director, other officer and auditor shall be entitled to be indemnified out of assets and profits of the Company against all losses or liabilities incurred or sustained by him/her as a Director, auditor or other officer of the Company about the execution of the duties of his/her office or otherwise in relation thereto. The Company has arranged appropriate directors' and officers' liability insurance coverage for the Directors and officers of the Company and its subsidiaries.

EMOLUMENT POLICY

The emolument policy of the employees of the Company and its subsidiaries is set up by Remuneration Committee on the basis of their merit, qualifications and competence.

The emolument of the Directors are decided by Remuneration Committee, having regard to the Company's operating results, individual performance and comparable market statistics.

The Company has adopted a share option scheme and restricted share award scheme as an incentive to Directors and eligible employees, details of which are set out in note 10 and 37 to the consolidated financial statements.

DIRECTORS' REPORT

EMOLUMENTS OF DIRECTORS AND FIVE HIGHEST PAID INDIVIDUALS

Details of the emoluments of the Directors and the five highest paid individuals of the Company and its subsidiaries during the year ended 31 December 2018 are set out in note 10 and 12 to the consolidated financial statements respectively. The remunerations of the Directors are determined based on the market price and contribution made by such Directors to the Company. There has been no arrangement under which any Director has waived or agreed to waive any emoluments.

CONTINUING CONNECTED TRANSACTIONS, CONNECTED TRANSACTIONS AND OTHER RELATED PARTY TRANSACTIONS

Save as disclosed below, the Company and its subsidiaries had not entered into any connected transactions or continuing connected transactions which are required to be disclosed in this annual report in compliance with the requirements of Chapter 14A of the Listing Rules during the year ended 31 December 2018. The Directors confirm that they have complied with the disclosure requirements in accordance with Chapter 14A of the Listing Rules.

Continuing connected transactions

During the year, the Company and its subsidiaries did not have any continuing connected transactions which are required to be disclosed in this annual report.

Connected transactions

During the year, the Company and its subsidiaries did not have any connected transactions which are required to be disclosed in this annual report.

Other related party transactions

The other related party transactions during the year as disclosed in note 38 to the consolidated financial statements are de minimis transactions that are partially exempted from announcement and/or independent shareholders' approval under Chapter 14A of the Listing Rules.

The Company has complied with the disclosure requirements prescribed in Chapter 14A of the Listing Rules with respect to the connected transactions entered into by the Company and its subsidiaries during the year ended 31 December 2018.

DIRECTORS' REPORT

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN SHARES

As at 31 December 2018, the following Directors or chief executives of the Company or his associates had interests or short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations, as notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the Securities and Futures Ordinance (the "SFO"), or as recorded in the register to be kept under Section 352 of the SFO or as notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code").

	Number of Shares held		Number of underlying Shares held		Approximate percentage
Name of Director/Chief executive	Personal interest	Corporate interests	Personal interest	Total	of total issued Shares
Dr. Liu Ruopeng ("Dr. Liu")	–	3,078,500,000 (L) (Note 2)	–	3,078,500,000 (L)	50.00%
		1,067,862,045 (S) (Note 3)		1,067,862,045 (S)	17.34%
Dr. Zhang Yangyang ("Dr. Zhang")	–	–	8,000,000 (L) (Note 4)	8,000,000 (L)	0.13%
Dr. Luan Lin ("Dr. Luan")	–	–	7,900,000 (L) (Note 5)	7,900,000 (L)	0.13%
Dr. Liu Jun	80,000 (L)	–	–	80,000 (L)	0.001%
Mr. Dorian Barak ("Mr. Barak")	–	–	1,000,000 (L) (Note 6)	1,000,000 (L)	0.016%

Notes:

1. "L" represents long position in Shares/underlying Shares and "S" represents short position in Shares.
2. This represents the interests in 3,078,500,000 shares of the Company directly held by two companies: – (1.) 3,078,000,000 shares held by New Horizon Wireless Technology Limited ("New Horizon"), being a wholly-owned subsidiary of Wireless Connection Innovative Technology Limited which is owned as to 51% by Kuang-Chi Innovative Technology Limited and as to 49% by Shenzhen Kuang-Chi Hezhong Technology Limited. Kuang-Chi Innovative Technology Limited is a subsidiary of Shenzhen Dapeng Kuang-Chi Technology Limited, which is in turn a subsidiary of Shenzhen Dapeng Kuang-Chi Lianzhong Technology Partnership (Limited Liability Partnership) of which Dr. Liu is the controlling shareholder, and Dr. Liu is the controlling shareholder of Shenzhen Kuang-Chi Hezhong Technology Limited; and (2.) 500,000 shares held by Sky Aisa Holdings Limited ("Sky Asia"), being a wholly-owned subsidiary of Shenzhen KuangChi Youlu Technology Co., Ltd, which is wholly owned by Shenzhen Kuang-Chi Hezhong Technology Limited, and as mentioned above, Dr. Liu is the controlling shareholder. Accordingly, Dr. Liu is deemed to be interested in the same number of shares of the Company held by New Horizon and Sky Asia respectively.
3. This represents the share charge given by New Horizon in favour of Everbright Fortune over 1,067,862,045 Shares owned by New Horizon.
4. This represents interests in the share options of the Company held by Dr. Zhang.
5. This represents interests in the share options of the Company held by Dr. Luan.
6. This represents interests in the share options of the Company held by Mr. Barak. Mr. Barak was interested in an aggregate of 120,126 warrants of SkyX Limited, a subsidiary (became an associate of the Company as at 9 August 2018 as set out in note 40(a) to the consolidated financial statements) of the Company, which entitling the holder to subscribe for 120,126 shares (equivalent to approximately 2.89% of the fully diluted shareholding).
7. As of 31 December 2018, the issued shares of the company were 6,156,928,860.

DIRECTORS' REPORT

Save as disclosed above, as at 31 December 2018, no interests or short positions were held or deemed or taken to be held under Part XV of the SFO by any director or chief executive of the Company or their respective associates in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Part XV of the SFO or pursuant to the Model Code or which were required to be entered in the register maintained by the Company pursuant to section 352 of the SFO.

SUBSTANTIAL SHAREHOLDERS' INTERESTS IN SHARES

As at 31 December 2018, the following shareholders had interests, directly or indirectly, or short positions in the shares and underlying shares of the Company would fall to be disclosed to the Company and the Stock Exchange under provisions of Division 2 and 3 of Part XV of the SFO or as recorded in the register required to be kept by the Company under Section 336 of the SFO:

Name of Substantial Shareholder	Capacity	Number of Shares held	Number of underlying Shares held	Total	Approximate percentage of total issued Shares
Ms. Huang Weizi	Interest of spouse	3,078,500,000 (L) (note 2) 1,067,862,045 (S)	–	3,078,500,000 (L) 1,067,862,045 (S)	50.00% 17.34%
New Horizon	Beneficial owner	3,078,000,000 (L) 1,067,862,045 (S) (note 3)	–	3,078,000,000 (L) 1,067,862,045 (S)	49.99% 17.34%
Wireless Connection Innovative Technology Limited	Interest of controlled corporation	3,078,000,000 (L) 1,067,862,045 (S)	–	3,078,000,000 (L) 1,067,862,045 (S)	49.99% 17.34%
深圳大鵬光啟科技有限公司 (*Shenzhen Dapeng Kuang-Chi Technology Limited)	Interest of controlled corporation	3,078,000,000 (L) 1,067,862,045 (S)	–	3,078,000,000 (L) 1,067,862,045 (S)	49.99% 17.34%
深圳大鵬光啟聯眾科技合伙企業(有限合伙) (*Shenzhen Dapeng Kuang-Chi Lianzhong Technology Partnership (Limited Liability Partnership))	Interest of controlled corporation	3,078,000,000 (L) 1,067,862,045 (S)	–	3,078,000,000 (L) 1,067,862,045 (S)	49.99% 17.34%
深圳光啟合眾科技有限公司 (*Shenzhen Kuang-Chi Hezhong Technology Limited)	Interest of controlled corporation	3,078,500,000 (L) 1,067,862,045 (S)	–	3,078,500,000 (L) 1,067,862,045 (S)	50.00% 17.34%

* *For identification purpose only*

DIRECTORS' REPORT

Name of Substantial Shareholder	Capacity	Number of Shares held	Number of underlying Shares held	Total	Approximate percentage of total issued Shares
深圳光啟創新技術有限公司 (*Shenzhen Kuang-Chi Innovative Technology Limited)	Interest of controlled corporation	3,078,000,000 (L) 1,067,862,045 (S)	–	3,078,000,000 (L) 1,067,862,045 (S)	49.99% 17.34%
上海光大富尊璟琿投資中心（有限合伙）(*Shanghai Everbright Fortune Jinghui Investment Center) (Limited Liability Partnership)) (Note 4)	Person having a security interest in Shares	1,067,862,045 (L)	–	1,067,862,045 (L)	17.34%
光大富尊泰鋒投資管理（上海）有限公司 (*Everbright Fortune Evertop Investment Management (Shanghai) Co., Ltd) (Note 5)	Interest of controlled corporation	1,067,862,045 (L)	–	1,067,862,045 (L)	17.34%
光大富尊投資有限公司 (*Everbright Fortune Investment Co., Ltd) (Note 6)	Interest of controlled corporation	1,067,862,045 (L)	–	1,067,862,045 (L)	17.34%
光大証券股份有限公司 (*Everbright Securities Company Limited)	Interest of controlled corporation	1,067,862,045 (L)	–	1,067,862,045 (L)	17.34%
Central Faith International Ltd.	Beneficial owner and Interest of controlled corporation	972,981,013 (L)	–	972,981,013 (L)	15.80%
World Treasure Global Limited (Note 7)	Beneficial owner	618,981,013 (L)	–	618,981,013 (L)	10.05%
Ye Cheng (Note 8)	Interest of controlled corporation	347,471,988 (L)	–	347,471,988 (L)	5.64%

* *For identification purpose only*

Notes:

1. "L" represents long position in Shares/underlying Shares and "S" represents short position in Shares.

2. This represents the interest in the shares of the Company held by New Horizon and Sky Asia. Ms. Huang Weizi ("Ms. Huang"), being the spouse of Dr. Liu, is deemed to be interested in the same number of Shares held by New Horizon and Sky Asia.

3. This represents the share charge given by New Horizon in favour of Everbright Fortune over 1,067,862,045 Shares owned by New Horizon.

4. 50% of equity interest of Shanghai Everbright Fortune Jinghui Investment Center (Limited Liability Partnership) is held by Everbright Fortune Evertop Investment Management (Shanghai) Co., Ltd.

DIRECTORS' REPORT

5. 85% of equity interest of Everbright Fortune Evertop Investment Management (Shanghai) Co., Ltd is held by Everbright Fortune Investment Co., Ltd.

6. 100% of equity interest of Everbright Fortune Investment Co., Ltd. is held by Everbright Securities Company Limited.

7. World Treasure Global Limited is a wholly owned subsidiary of Central Faith International Ltd.

8. Mr. Ye Cheng is the sole owner of Cutting Edge Global Limited which have direct interest on 206,818,877 shares and LUCKY TIME GLOBAL LIMITED which have direct interest on 140,653,111 shares.

9. As at 31 December 2018, the issued shares of the company were 6,156,928,860.

Save as disclosed above, as at 31 December 2018, the Company was not aware of any other person (other than the director or chief executives of the Company) who had an interest, directly or indirectly, or short position in the shares and underlying shares of the Company which would fall to be disclosed to the Company and the Stock Exchange under provisions of Divisions 2 and 3 of Part XV of the SFO or as recorded in the register required to be kept by the Company under Section 336 of the SFO.

SHARE OPTION SCHEME AND RESTRICTED SHARE AWARD SCHEME

Share Option Scheme

Pursuant to an ordinary resolution passed at the special general meeting of the Company held on 31 July 2012, a share option scheme (the "Share Option Scheme") was adopted by the Company.

The purpose of the Share Option Scheme is to enable the Company to provide incentive to participants in recognition of their contribution to the Company and its subsidiaries. The directors of the Company may offer to grant any employee or director of the Company or any adviser, consultant, agent, contractor, customers and supplier of any member of the Company and its subsidiaries or whom the Board in its sole discretion considers eligible for the scheme on the basis of his or her contribution to the Company and its subsidiaries.

The total number of shares in respect of which options may be granted under the Share Option Scheme must not in aggregate exceed 10% of the shares in issue unless approval from the Company's shareholders has been obtained. The total number of shares issued and to be issued upon exercise of the options granted and to be granted to each individual in any twelve-month period up to and including the date of grant shall not exceed 1% of the shares in issue at the date of grant unless approval from Company's shareholders has been obtained.

The Directors have discretion to set a minimum period for which an option has to be held and the option period shall not exceed 10 years from the date of acceptance of option. HK$1 is payable on acceptance of an option within 21 days from the date of grant.

The exercise price shall be determined by the directors of the Company, and shall not be less than the highest of: (i) the closing price of the shares as stated in the Stock Exchange's daily quotations sheet on the date of grant; (ii) the average closing price of the shares as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant; and (iii) the nominal value of the Company's shares.

The Share Option Scheme will remain valid for a period of 10 years commencing on 31 July 2012.

As at the date of this report, the total number of share options available for issue under the scheme is 270,606,779 shares. Other than the share options granted on 26 August 2014 and 30 September 2015 as mentioned below, no other option was granted under the Share Option Scheme up to the year end 31 December 2018.

DIRECTORS' REPORT

Save as disclosed below, none of the Directors or their spouses and children under the age of 18 had any right to subscribe for the securities of the Company, or had exercised any such share options during the Period.

Movement of options granted under the Share Option Scheme is as follows:

Category of participant	Date of Grant	Exercise price HK$	Exercisable period (1)	Outstanding as at 1 January 2018	Granted during the year	Exercised during the year	Outstanding as at 31 December 2018
Directors							
Dr. Zhang Yangyang	30.9.2015	1.604	30.9.2015-29.9.2019(2)	8,000,000	–	–	8,000,000
Dr. Luan Lin	30.9.2015	1.604	30.9.2015-29.9.2019(2)	7,900,000	–	–	7,900,000
Mr. Barak Dorian	30.9.2016	1.604	30.9.2016-29.9.2019(2)	1,000,000	–	–	1,000,000
Sub-total				16,900,000	–	–	16,900,000
Employees							
Other employees	30.9.2015	1.604	30.9.2015-29.9.2019(2)	53,100,000	–	–	53,100,000
Total				70,000,000	–	–	70,000,000

(1) Vesting of the share options is conditional upon the achievement of certain performance targets as set out in respective offer letters.

(2) Commencing from the first, second and third anniversaries of the date of grant of the options, the relevant grantee may exercise up to 33%, 33% and 34% respectively of the options granted.

(3) No option was cancelled and lapsed during the year.

Restricted Share Award Scheme

Under the restricted share award scheme ("RSA Scheme") approved and adopted by the shareholders in the general meeting of the Company on 10 December 2014, the Company may grant restricted shares to participants including directors and full-time or part-time employees of the Company or any of its subsidiaries as determined by the Share Award Committee ("SA Committee").

The purpose of the RSA Scheme is to recognise and motivate the contribution of the participants and to provide them with a direct economic interest in attaining the long-term business objectives of the Company. Pursuant to the rules of the RSA Scheme, the SA Committee may, from time to time, at its absolute discretion select any participant after taking into account, among other things, the performance of the relevant participants and/or their contributions to the Company and its subsidiaries as it deems appropriate for participation in the RSA Scheme as a selected participant. The SA Committee shall determine the number of existing Ordinary Shares to be purchased or new Ordinary Shares to be issued as restricted shares granting to the selected participants. Pursuant to the rules of the RSA Scheme, existing Ordinary Shares shall be purchased by an appointed trustee, and/or new Ordinary Shares may be allotted and issued to the trustee, to hold on trust for the participants until such restricted shares are vested.

During the year ended 31 December 2018, no restricted shares were granted by the Company. During the year ended 31 December 2018, no equity shares were purchased nor issued by the Company for the purposes of the RSA Scheme.

DIRECTORS' REPORT

ARRANGEMENTS TO PURCHASE SHARES OR DEBENTURES

Other than the Share Option Scheme and the RSA Scheme as mentioned above, at no time during the year ended 31 December 2018 was the Company or its subsidiaries, or fellow subsidiaries a party to any arrangements to enable the Directors or their respective associates to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company or its subsidiaries were entered into or existed during the year ended 31 December 2018.

SUFFICIENCY OF PUBLIC FLOAT

Based on information that is publicly available to the Company and within the knowledge of the Directors as at the date of this annual report, the Company has maintained sufficient public float as required under the Listing Rules.

COMPETING INTERESTS

During the year ended 31 December 2018, in so far as the Directors were aware, none of the Directors or their respective associates had any interest in a business that competed or was likely to compete with the business of the Company and its subsidiaries.

CHANGE IN INFORMATION OF DIRECTORS PURSUANT TO RULE 13.51B(1) OF THE LISTING RULES

Please refer to section "Biographical Details of Directors and Senior Management" in this Annual Report.

PROFESSIONAL TAX ADVICE RECOMMENDED

If the shareholders are unsure about the taxation implications of purchasing, holdings, disposing of, dealing in, or the exercise of any rights in relation to, the Shares, they are advised to consult an expert.

DIRECTORS' REPORT

EVENT AFTER REPORTING PERIOD

There were no material events occurred after the year ended 31 December 2018.

REVIEW BY THE AUDIT COMMITTEE

Audit Committee

The Audit Committee comprises three independent non-executive directors of the Company. The Audit Committee has adopted terms of reference which are in line with the CG Code (as defined in Corporate Governance Report). The Audit Committee has reviewed the audited results for the year ended 31 December 2018 and agreed with the accounting treatment adopted. The Audit Committee is satisfied with the Company and its subsidiaries' internal control procedure and financial reporting disclosures.

AUDITOR

The financial statements for the year ended 31 December 2018 have been audited by Crowe (HK) CPA Limited. PricewaterhouseCoopers* resigned as auditors of the Company with effect from 28 December 2018. Crowe (HK) CPA Limited was appointed as auditor of the Company with effect from 28 December 2018 to fill the casual vacancy and to hold office until the conclusion of the next annual general meeting of the Company.

* PricewaterhouseCoopers was appointed as auditor of the Company in 2017 upon the retirement of Deloitte Touche Tohmatsu.

On behalf of the Board

Dr. Liu Ruopeng
Chairman and Executive Director

Hong Kong, 26 March 2019

CORPORATE GOVERNANCE REPORT

The Board is pleased to present this Corporate Governance Report of the Company and its subsidiaries for the year ended 31 December 2018.

CORPORATE GOVERNANCE PRACTICES

The Board acknowledges the importance of the highest standards of corporate governance as the Board believes that effective corporate governance practices are fundamental to enhancing the shareholders' value and safeguarding the interests of the shareholders. Accordingly, the Company has adopted sound corporate governance principles that emphasis effective internal controls and accountability to all shareholders.

The Board is responsible for performing the corporate governance functions with the applicable code provisions of the Corporate Governance Code as set out in Appendix 14 to the Listing Rules (the "CG Code"). During the year under review, the Board reviewed the Company's corporate governance policies and practices, training and continuous professional development of directors and senior management, the Company's policies and practices on compliance with legal and regulatory requirements, the compliance of the Company's code of conduct, and the Company's compliance with the Code Provision and disclosure in this Corporate Governance Report.

Save as the deviations from the code provisions A.6.7 and E.1.2 of the CG Code, the Company has complied with the CG Code during the year under review.

Code provisions A.6.7 and E.1.2 of the CG Code stipulate that independent non-executive directors, non-executive directors and the chairman of the board of directors should attend annual general meetings. The Chairman of the Board of Directors, Dr. Liu Ruopeng, non-executive Director, Mr. Song Dawei, and two independent non-executive Directors Ms. Cao Xinyi and Dr. Liu Jun, did not attend the annual general meeting held on 30 May 2018, due to other business commitments.

THE BOARD

Responsibilities

The Board is responsible for the leadership and control of the Company and oversees the Company and its subsidiaries' business, strategic decisions and performances. The senior management was delegated the authority and responsibilities by the Board of the day-to-day management and operations of the Company and its subsidiaries. Approval has to be obtained from the Board prior to any significant transactions entered into by the senior management.

All Directors have full and timely access to all relevant information in relation to the Company as well as the advice and services of the company secretary, if and when required, with a view ensuring that the Board procedures and all applicable rules and regulations are followed. To oversee particular aspects of the Company's affairs, the Board has established three Board Committees including the Audit Committee, the Remuneration Committee and the Nomination Committee (together the "Board Committees"). The Board has delegated to the Board Committees responsibilities as set out in their respective terms of reference.

There are established procedures for directors to seek independent professional advice for them to discharge their duties and responsibilities, where appropriate, at the Company's expenses.

CORPORATE GOVERNANCE REPORT

Board diversity

The Company has recognised the importance of board diversity to corporate governance and the board effectiveness in terms of examination and evaluation of corporate issues from different perspectives. As such, the Company updated its board diversity policy (the "Diversity Policy") and adopted the Nomination Policy which set out the objectives and principles regarding board diversity and nomination in December 2018.

Pursuant to the Diversity Policy, the effective implementation of the Diversity Policy requires that shareholders are able to judge for themselves whether the Board as constituted is a reflection of diversity, or a gradual move to increased diversity, on a scale and at a speed which they support.

The Board will also take into account the below aspects:

- Articulate the benefits of diversity, including gender diversity, and the importance of being able to attract, retain and motivate employees from the widest possible pool of available talent;

- To diversify at all levels, including gender, age, cultural and educational background, or professional experience;

- Assess annually on the diversity profile including gender balance of the directors and senior management and its progress in achieving its diversity objectives;

- Ensure that recruitment and selection practices at all levels (from the board downwards) are appropriately structured so that a diverse range of candidates are considered; and

- Has identified and implemented programs that will assist in the development of a broader and more diverse pool of skilled and experienced employees and that, in time, their skills will prepare them for senior management and board positions.

Having reviewed the Diversity Policy and the Board's composition, the Nomination Committee considered that the requirements set out in the Diversity Policy had been met.

CORPORATE GOVERNANCE REPORT

Nomination Policy

The Group adopted a nomination policy (the "Nomination Policy") in December 2018. A summary of this policy is disclosed as below.

Objective

The nomination committee of the Company ("Nomination Committee") shall nominate suitable candidates to the Board for it to consider and make recommendations to shareholders for election as directors of the Company at general meetings or appoint as Directors to fill casual vacancies or as an addition to the existing Board.

Selection Criteria

The factors listed below would be used as reference by the Nomination Committee in assessing the suitability of a proposed candidate.

- Reputation for integrity
- Accomplishment and experience
- Compliance with legal and regulatory requirements
- Commitment in respect of available time and relevant interest
- Diversity in all its aspects, including but not limited to gender, age (18 years or above), cultural and educational background, ethnicity, professional experience, skills, knowledge and length of service

Nomination Procedures

The Secretary of the Nomination Committee shall call a meeting of the Nomination Committee, and invite nominations of candidates from Board members if any, for consideration by the Nomination Committee prior to its meeting. The Nomination Committee may also put forward candidates who are not nominated by Board members.

For filling a casual vacancy, the Nomination Committee shall make recommendations for the Board's consideration and approval. For proposing candidates to stand for election at a general meeting, the Nomination Committee shall make nominations to the Board for its consideration and recommendation.

Dividend Policy

The Company has adopted a dividend policy ("Dividend Policy"), pursuant to which the Company may declare and distribute dividends to the shareholders of the Company (the "Shareholders") to allow Shareholders to share the Company's profits and for the Company to retain adequate reserves for future growth.

General power to declare dividends

Subject to the Bermuda Bye-Laws, the Company may from time to time in general meeting declare dividends in any currency to be paid to the members of the Company but no dividend shall be declared in excess of the amount recommended by the Board.

CORPORATE GOVERNANCE REPORT

Board's power to pay interim dividends

The Board may also, without convening a general meeting, from time to time declare interim dividends as appear to the Board to be justified by the profits of the Company, and, in particular (but without prejudice to the generality of the foregoing), if at any time the share capital of the Company is divided into different classes, the Board may pay such interim dividends in respect of those shares in the capital of the Company which confer on the holders thereof deferred or non-preferential rights as well as in respect of those shares which confer on the holders thereof preferential rights with regard to dividend.

The Board may also pay half-yearly or at other intervals to be selected by it any dividend which may be payable at a fixed rate if the Board is of the opinion that the profits available for distribution justify the payment.

Board's power to declare and pay special dividends

The Board may in addition from time to time declare and pay special dividends on shares of any class of such amounts and on such dates as they think fit.

Dividends to be paid out of profits or reserves

No dividend shall be declared or payable except out of the profits and reserves of the Company lawfully available for distribution, including share premium. No dividend shall carry interest against the Company.

The Board may, before recommending any dividend, set aside out of the profits of the Company such sums as it thinks fit as a reserve or reserves which shall, at the discretion of the Board, be applicable for meeting claims on or liabilities of the Company or contingencies or for paying off any loan capital or for equalising dividends or for any other purpose to which the profits of the Company may be properly applied, and pending such application may, at the like discretion, either be employed in the business of the Company or be invested in such investments as the Board may from time to time think fit, and so that it shall not be necessary to keep any reserves separate or distinct from any other investments of the Company.

The Board may also without placing the same to reserve carry forward any profits which it may think prudent not to distribute by way of dividend.

Scrip dividends

Whenever the Board or the Company in general meeting has resolved that a dividend be paid or declared on the share capital of the Company, the Board may further resolve that such dividend be satisfied wholly or in part in the form of an allotment of shares credited as fully paid up, provided that the shareholders entitled thereto will be entitled to elect to receive such dividend (or part thereof) in cash in lieu of such allotment. In case of the Board elects to pay the dividend in shares, the Company shall abide by the provisions of the Bye-Laws of the Company on scrip dividends.

The Board will continually review the Dividend Policy and reserves the right in its sole and absolute discretion to update, amend and/or modify the Dividend Policy at any time, and the Dividend Policy shall in no way constitute a legally binding commitment by the Company that dividends will be paid in any particular amount and/or in no way obligate the Company to declare a dividend at any time or from time to time.

CORPORATE GOVERNANCE REPORT

Composition

The Board currently comprises four executive Directors and three independent non-executive Directors from different business and professional fields. The Directors, including independent non-executive Directors, have brought a wide spectrum of valuable business and professional expertise, experiences and independent judgement to the Board for its efficient and effective delivery of the Board function.

At the date of this report, the Board comprises the following Directors:

Executive Directors	Dr. Liu Ruopeng Dr. Zhang Yangyang Dr. Luan Lin Mr. Dorian Barak
Independent Non-executive Directors	Dr. Liu Jun Dr. Wong Kai Kit Ms. Cao Xinyi

The profiles of each director are set out in the "Biographical Details of Directors and Senior Management" section on pages 26 to 27. Saved as disclosed in this annual report (if any), to the knowledge of the Directors, the Board members have no financial, business, family or other material relationship with each other.

Chairman and Chief Executive Officers

Dr. Liu Ruopeng is the chairman of the Company, Dr. Zhang Yangyang and Dr. Luan Lin are the Co-chief executive officers ("CEOs") of the Company. The roles of the chairman and CEOs are served by different individuals to achieve a balance of authority and power. The main responsibility of the chairman is to lead the Board and manage its work to ensure that it effectively operates and fully discharges its responsibilities. Supported by the members of committees of the Board, the CEOs are responsible for the day-to-day management of the Company and its subsidiaries' business, recommending strategies to the Board, and determining and implementing operational decisions.

Directors' and officers' insurance

The Company purchased the directors' and officers' liability insurance for members of the Board for the year to provide protection against claims arising from the lawful discharge of duties by the Directors.

Independent Non-Executive Directors

Throughout the period and up to the date of this report, the Company has complied with the requirements under Rules 3.10 of the Listing Rules. It requires at least three independent non-executive directors and that at least one of the independent non-executive directors must have appropriate professional qualifications or accounting or related financial management expertise. The Company has received written annual confirmation from each independent non-executive director of their independence pursuant to the requirements of rule 3.13 of the Listing Rules. The Company considers all independent non-executive directors to be independent in accordance with the independence guidelines set out in the Listing Rules.

CORPORATE GOVERNANCE REPORT

Delegation by the Board

The Board reserves for its decision all major matters of the Company, including approving and monitoring of all policy matters, overall strategies and budgets, internal control and risk management systems, material transactions (in particular those that may involve conflict of interests), financial information, appointment of Directors and other significant financial and operational matters. Directors could have recourse to seek independent professional advice in performing their duties at the Company's expense and are encouraged to access and to consult with the Company's senior management independently.

The daily management, administration and operation of the Company and its subsidiaries are delegated to the senior management. The delegated functions and responsibilities are periodically reviewed by the Board. Approval has to be obtained from the Board prior to any significant transactions entered into by the management.

Appointments, re-election and removal of directors

The bye-laws of the Company provide that any Director appointed by the Board, (i) to fill a casual vacancy in the Board, shall hold office only until the next following general meeting of the Company and shall be subject to re-election at such meeting, (ii) as an addition to the Board shall hold office until the next annual general meeting of the Company and shall then be eligible for re-election and (iii) one-third of the Directors for the time being shall retire from office by rotation, provided that every Director shall be subject to retirement by rotation at least once every three years.

Role and function of the Board and the management

An updated list of the directors of the Company identifying their role and function is maintained on the websites of the Hong Kong Stock Exchange ("Stock Exchange") and the Company.

Compliance with the Model Code for Directors' securities transactions

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 to the Listing Rules (the "Model Code") as its model code for securities transactions by Directors. All the Directors have confirmed, following specific enquiry procedures by the Company that they had complied with the requirements as set out in the Model Code throughout the year.

Directors' continuous training and development

Directors should participate in continuous professional development to develop and refresh their knowledge and skills. This is to ensure that their contribution into the Board remains informed and relevant. The Directors are committed to complying with the CG Code A.6.5 on directors' training. All Directors have participated in continuous professional development by attending seminars and/or studying materials relevant to director's duties and responsibility and provided a record of training they received for the financial year ended 31 December 2018 to the Company.

BOARD COMMITTEES

The Board has established three committees, namely the Remuneration Committee, Audit Committee and Nomination Committee, each of which has specific written terms of reference.

Remuneration Committee

The Remuneration Committee comprises one executive Director and two independent non-executive Directors. The Committee is chaired by Dr. Wong Kai Kit with Dr. Zhang Yangyang and Dr. Liu Jun as members.

CORPORATE GOVERNANCE REPORT

The principal responsibilities of the Remuneration Committee include making recommendations to the Board on the remuneration policy and structure and remuneration packages of the executive Directors, non-executive Directors and senior management. The Remuneration Committee is also responsible for recommending to the Board of transparent procedures for developing such remuneration policy and structure and ensuring no director or any of his associates will participate in deciding his own remuneration, and that the remuneration will be determined by reference to the performance of the individual and the Company as well as market practice and conditions. The written terms of reference of Remuneration Committee are available on the websites of the Stock Exchange and the Company.

During the year under review, the Remuneration Committee has reviewed and made recommendation to the Board on the remuneration policy and structure of the Company, and determined the remuneration packages of the Directors and senior management. Details of the Directors' remuneration and five individuals with highest emoluments are set out in Notes 10 and 12 to the consolidated financial statements.

In addition, pursuant to the code provision B.1.5, the annual remuneration of the member of the current senior management (other than Directors) by band for the year ended 31 December 2018 are disclosed in Note 10 to the consolidated financial statements.

For the year ended 31 December 2018, there was one meeting held by the Remuneration Committee to review and make recommendation to the Board on the remuneration policy and structure of the Company, and the remuneration package of the executive Directors and senior management and other related matter.

Audit Committee

The Audit Committee comprises three independent non-executive Directors. The Committee is chaired by Ms. Cao Xinyi with Dr. Liu Jun and Dr. Wong Kai Kit as members. None of the members of the Audit Committee is a former partner of the Company's existing external auditors.

The main duties of the Audit Committee include the following:

(a) to review the financial statements and reports and consider any significant or unusual items raised by the qualified accountant, compliance officer (if any), internal auditor (if any) or external auditor before submission to the Board;

(b) to review the relationship with the external auditor by reference to the work performed, their fees and terms of engagement, and make recommendation to the Board on the appointment, reappointment and removal of external auditor; and

(c) to review the adequacy and effectiveness of the Company's financial reporting system, risk management and internal control systems and associated procedures.

The written terms of reference of Audit Committee are available on the websites of the Stock Exchange and the Company.

The Audit Committee held three meetings during the year ended 31 December 2018 to review the financial results and to recommend the appointment of new external auditors. Pursuant to the code provision C.3.3 of the CG Code, the Audit Committee should meet with the Company's auditors at least twice a year. The Company has complied with the CG Code C.3.3 during the year under review.

CORPORATE GOVERNANCE REPORT

Nomination Committee

The Nomination Committee comprises one executive Director and two independent non-executive Directors. The Committee is chaired by Dr. Liu Ruopeng with Dr. Wong Kai Kit and Dr. Liu Jun as members.

The principal responsibilities of the Nomination Committee are regular review of the Board composition, identifying and nominating suitable candidates as Board members, assessment of the independence of the independent non-executive Directors and Board evaluation. The Nomination Committee also reviews the structure, size and composition (including the skills, knowledge, experience and gender) of the Board at least annually and makes recommendations on any proposed changes to the Board to complement the Company's corporate strategy. The written terms of reference of Nomination Committee are available on the websites of the Stock Exchange and the Company.

The Board adopted a board diversity policy (the "Board Diversity Policy") setting out the approach to diversify members of the Board since 2016 and updated in December 2018. The Company believes that a diversified perspective can be achieved through implementation of the Board Diversity Policy. The diversity of the Board members should be assessed on a diversity of perspectives including but not limited to gender, age, cultural and educational background, ethnicity, professional experience, skills, knowledge and length of service. The ultimate decision will be based on objective criteria, merit and contribution that the selected candidates will bring to the Board having due regard for the benefits of diversity on the Board.

For the year ended 31 December 2018, one Nomination Committee meeting was held to (1.) review of the structure, size and diversity of the Board; (2.) assessment and confirmation of the independence of the INEDs; (3.) consider the re-appointment of retiring directors at the annual general meeting of the Company, and (4.) review and endorse the board diversity policy of the Company for Board's approval.

Meetings

Regular Board meetings are held at least four times a year at approximately quarterly intervals for reviewing and approving the financial and operating performance, and considering and approving the overall strategies and policies of the Company. The Board met eight times during the year ended 31 December 2018.

Agenda and Board papers together with all appropriate, complete and reliable information are normally sent to all Directors before each Board meeting to keep the Directors apprised to the latest developments and financial position of the Company and to enable them to make informed decisions. All Directors are given the opportunity to include matters in the agenda for regular Board meetings. The Board and each Director also have separate and independent access to senior management whenever necessary.

CORPORATE GOVERNANCE REPORT

Minutes of all Board meetings, other Board Committee meetings and general meetings contain sufficient details of matters considered and decisions reached are kept by the secretary of the meetings and are open for inspection by the Directors. The attendance of individual members of the Board meetings, other Board Committee meetings and general meetings during the year ended 31 December 2018 is set out in the table below:

	Meetings attended/Eligible to attend				
	Board of Directors	**Audit Committee**	**Remuneration Committee**	**Nomination Committee**	**Annual General Meeting**
Executive Directors					
Dr. Liu Ruopeng	3/8	N/A	N/A	1/1	0/1
Dr. Zhang Yangyang	6/8	N/A	1/1	N/A	0/1
Dr. Luan Lin	8/8	N/A	N/A	N/A	1/1
Mr. Dorian Barak	8/8	N/A	N/A	N/A	1/1
Non-executive Directors					
Mr. Ko Chun Shun, Johnson*	5/5	N/A	N/A	N/A	1/1
Mr. Song Dawei#	0/4	N/A	N/A	N/A	0/1
Independent Non-executive Directors					
Dr. Liu Jun	3/8	1/3	1/1	1/1	0/1
Dr. Wong Kai Kit	5/8	3/3	1/1	1/1	1/1
Ms. Cao Xinyi	8/8	3/3	N/A	N/A	0/1

* Resigned on 16 November 2018
\# Resigned on 1 August 2018

Apart from regular Board meetings, the Chairman, Dr. Liu Ruopeng, also held a meeting with the independent non-executive Directors without the presence of executive Directors during the year under review.

CORPORATE GOVERNANCE REPORT

Conflict of interest

If a Director has a conflict of interest in relation to a transaction or proposal to be considered by the Board, the individual is required to declare such interest and to abstain from voting. The matter is considered at a Board meeting attended by Directors who have no material interest in the transaction. The Company and its subsidiaries also adopted certain internal control policies to manage potential conflicts of interest.

Corporate Governance function

The Board is responsible for developing and reviewing the Company's policies and practices on corporate governance and performing corporate governance duties as set out in code provision D.3.1 of the CG Code. The following is a non-comprehensive summary of the duties performed by the Board for the year:

- Reviewed and monitored the training and continuous professional development of Directors;
- Reviewed and monitored the Company's policies and practices on compliance with legal and regulatory requirements;
- Reviewed and monitored the code of conduct applicable to employees and Directors; and
- Reviewed the Company's compliance with the CG Code and disclosure in the Corporate Governance Report.

COMPANY SECRETARY

The Company's secretarial functions are outsourced to external service provider. Pursuant to Appendix 14 paragraph N(a) of the Listing Rules, the primary contact person at the Company is Mr. He Yu, the Chief Financial Officer of the Company. All Directors may access to the advice and services of the Company Secretary. The Company Secretary regularly updates the Board on governance and regulatory matters.

The Board is fully involved in selection, appointment and dismissal of the Company Secretary. The Company Secretary is also responsible for ensuring the procedures of the Board meetings are observed and providing the Board opinions on matters in relation to the compliance with the procedures of the Board meetings.

For the year ended 31 December 2018, the Company Secretary has undertaken no less than 15 hours of relevant professional training in compliance with Rule 3.29 of the Listing Rules.

FINANCIAL REPORTING, RISK MANAGEMENT AND INTERNAL CONTROL

Directors' responsibilities for the Financial Statements

The Directors acknowledge their responsibility for preparing the financial statements of the Company and its subsidiaries and have adopted the accounting principles generally accepted in Hong Kong and compiled with the requirements of Hong Kong Financial Reporting Standards which also include Hong Kong Accounting Standards and Interpretations issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. As at 31 December 2018, Directors are not aware of any material uncertainties relating to events or conditions which may cast significant doubt upon the Company's ability to continue as a going concern. Accordingly, the Directors have prepared the financial statements of the Company on a going concern basis. The accounting systems, risk management and internal control systems of the Company are designed to prevent any misappropriation of the Company's assets, any unauthorised transactions as well as to ensure the accuracy of the accounting records and the true and fairness of the financial statements. Pursuant to the code provision C.1.1 of the CG Code, the management has provided to the Board such explanation and information as are necessary to enable the Board to carry out an informed assessment of the Company's financial statements, which are put to the Board for approval. The Company provides all members of the Board with monthly updates on Company's performance, positions and prospects.

CORPORATE GOVERNANCE REPORT

The Board also acknowledges its responsibility to present a balanced, clear and understandable assessment in the Company's financial reports, inside information announcements and other financial disclosures required under Listing Rules, and reports to the regulators as well as information required to be disclosed pursuant to statutory requirements. The reporting responsibilities of the Company's independent auditor are set out in the Independent Auditor's Report on pages 54 to 57.

Risk management and internal control

The Board, recognising its overall responsibility in ensuring the systems of risk management and internal controls of the Company and for reviewing their effectiveness, is committed to implement an effective and sound risk management and internal control systems to safeguard the interests of shareholders and the assets of the Company and its subsidiaries against unauthorised use or disposition. The Board designated this responsibility to Audit Committee. During the year under review, the Audit Committee has conducted a review of the effectiveness and adequacy of the risk management and internal control systems of the Company and its subsidiaries covering all material controls, including financial, operational and compliance controls and risk management functions, and has reached the conclusion that the Company and its subsidiaries' risk management and internal control systems were in place and effective. As at the date of this report, the Company has an internal audit function.

External auditor and auditor's remuneration

Following the resignation of PricewaterhouseCoopers as the Company's external auditor on 28 December 2018, Crowe (HK) CPA Limited ("Crowe") was appointed as the new external auditor of the Company on even date to fill the casual vacancy and to hold office until the conclusion of the 2019 annual general meeting of the Company. The responsibilities of the auditor with respect to the financial reporting are set out in the Independent Auditor's Report on pages 54 to 57 of this Annual Report. The independence of the external auditor is monitored by the Audit Committee which is primarily responsible for making recommendations to the Board on the appointment of the external auditor as well as approving their terms of engagement and remuneration.

For the year ended 31 December 2018, the total remuneration in respect of the audit services and other services provided by the external auditors of the Company were as follows:

Services rendered for the Company

	HK$'000
Audit services for the year	1,803
Underprovision for the previous years	999
Other services	1,300
Total	4,102

SHAREHOLDER RIGHTS, INVESTOR RELATIONS AND COMMUNICATIONS WITH SHAREHOLDERS

Shareholders' rights

To safeguard shareholder interest and rights, a separate resolution is proposed for each substantially separate issue at shareholder meetings, including the election of individual directors.

Enquiries of shareholders can be sent to the Company by post to the Company's Hong Kong head office at Unit 1220, 12/F, Leighton Centre, 77 Leighton Road, Causeway Bay, Hong Kong. Shareholders' enquiries and concerns, where appropriate, will be forwarded to and answered by the Board. In addition, shareholders can contact the share registrar of the Company if they have any enquiries about their shareholdings. All resolutions put forward at shareholder meetings will be voted on by poll pursuant to the Listing Rules and poll results will be posted on the websites of the Stock Exchange and the Company after each shareholder meeting.

CORPORATE GOVERNANCE REPORT

Pursuant to the Bye-Laws of the Company, the Board may whenever it thinks fit call special general meetings, and the shareholders holding at the date of deposit of the requisition not less than one-tenth of the paid up capital of the Company carrying the right of voting at general meetings of the Company shall at all times have the right, by written requisition to the Board or the Secretary of the Company, to require a special general meeting to be called by the Board for the transaction of any business specified in such requisition; and such meeting shall be held within two months after the deposit of such requisition.

Investor relations and communications with shareholders

The Board recognises the importance of good communication with shareholders. The Company has established a shareholders communication policy to set out the Company's procedures in providing shareholders and the investment community with ready, equal and timely access to balanced and understandable information about the Company, in order to enable shareholders to exercise their rights in an informed manner, and to allow shareholders and the investment community to engage actively with the Company.

Information in relation to the Company and its subsidiaries is disseminated to shareholders in a timely manner through a number of formal channels, which include interim and annual reports, announcements and circulars. Such published documents together with the latest corporate information are also made available on the Company's website.

The Company regards the annual general meeting of the Company as an important event and all directors, senior management and external auditors make an effort to attend the annual general meeting of the Company to address shareholders' queries. Shareholders are encouraged to attend all general meetings of the Company, such as the annual general meeting for which at least 21 clear days or 20 clear business days notice is given (whichever is longer).

The Company has complied with the requirements concerning voting by poll under the Listing Rules. Details of the poll voting procedures and the rights of shareholders to demand a poll are included in circulars to shareholders of the Company dispatched by the Company where applicable.

Constitutional documents

During the year ended 31 December 2018, there are no changes in the Company's constitutional documents.

INDEPENDENT AUDITOR'S REPORT

Crowe

國富浩華（香港）會計師事務所有限公司
Crowe (HK) CPA Limited
香港 銅鑼灣 禮頓道77號 禮頓中心9樓
9/F Leighton Centre,
77 Leighton Road,
Causeway Bay, Hong Kong

To the shareholders of KuangChi Science Limited
(incorporated in Bermuda with limited liability)

Opinion

We have audited the consolidated financial statements of KuangChi Science Limited (the "Company") and its subsidiaries (collectively referred to as the "Group") set out on pages 58 to 161, which comprise the consolidated statement of financial position as at 31 December 2018, the consolidated statement of profit or loss, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and the notes to the consolidated financial statements, which include a summary of significant accounting policies.

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2018, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the disclosure requirements of the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the HKICPA. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group in accordance with the HKICPA's Code of Ethics for Professional Accountants (the "Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

INDEPENDENT AUDITOR'S REPORT

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matter	How our audit addressed the Key Audit Matter
Recoverability of trade receivables and contract assets	
Refer to notes 4.1(b), 5, 26 and 27 to the consolidated financial statements The carrying amounts of the Group's trade receivables and contract assets as at 31 December 2018 were HK$344,856,000 and HK$14,598,000, after net of allowance for expected credit loss ("ECL") of HK$25,788,000 and HK$626,000 respectively, represented approximately 16.7% of the total assets of the Group. The adoption of HKFRS 9 has fundamentally changed the Group's accounting for impairment loss on financial assets by replacing HKAS 39's incurred loss approach with a forward-looking ECL approach. The measurement of ECL requires the application of significant judgement and increased complexity which include the identification of exposures with a significant deterioration in credit quality, and assumptions used in the ECL models (for exposures assessed individually or collectively), such as the expected future cash flows and forward-looking macroeconomic factors. Management made a loss allowance of HK$107,513,000 and HK$7,884,000 on trade receivables and contract assets respectively based on their assessment. We identified the recoverability of trade receivables and contract assets as a key audit matter due to the significance of the balances to the consolidated financial statements, combined with the significant degree of estimations, in evaluating the ECL of trade receivables and contract assets which may affect the carrying amounts at the end of the reporting period.	Our audit procedures in relation to the management's assessment for impairment of trade receivables and contract assets included: • Obtaining an understanding on how the management assess the ECL of trade receivables and contract assets by applying the ECL model; • Testing the integrity of information used by management to develop the provision matrix, including trade receivables ageing analysis as at 31 December 2018, on a sample basis, by comparing individual items in the analysis with the relevant sales agreements, sales invoices and other supporting documents; • Challenging management's basis and judgement in determining credit loss allowance on trade receivables and contract assets as at 31 December 2018, including their identification of credit impaired trade receivables and contract assets, and the basis of estimated loss rates applied in each category in the provision matrix (with reference to historical default rates and forward-looking information); and • Testing subsequent settlements of trade receivables and contract assets, on a sample basis, by inspecting supporting documents in relation to cash receipts from trade debtors subsequent to the end of the reporting period.

INDEPENDENT AUDITOR'S REPORT

Other Information

The directors of the Company are responsible for the other information. The other information comprises the information included in the annual report, but does not include the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Directors and Those Charged with Governance for the Consolidated Financial Statements

The directors of the Company are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with HKFRSs issued by the HKICPA and the disclosure requirements of the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. We report our opinion solely to you, as a body, in accordance with Section 90 of the Companies Act 1981 of Bermuda and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with HKSAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

INDEPENDENT AUDITOR'S REPORT

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements (Continued)

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Crowe (HK) CPA Limited
Certified Public Accountants

Hong Kong, 26 March 2019

Chan Wai Dune, Charles
Practising Certificate Number P00712

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

For the year ended 31 December 2018

	Note	**2018 HK$'000**	2017 HK$'000 (Restated)
Continuing operations			
Revenue	6	**158,406**	306,192
Cost of sales		**(139,563)**	(176,551)
Gross profit		**18,843**	129,641
Other income	7	**6,016**	69,854
Other gains, net	8	**31,594**	576,118
Impairment loss on trade receivables		**(107,513)**	(23,993)
Impairment loss on contract assets		**(7,884)**	–
Impairment loss on deposits for acquisition of plant and equipment	9	**(35,565)**	–
Selling and distribution expenses		**(44,189)**	(53,304)
Research and development expenses		**(150,579)**	(237,198)
Administrative expenses		**(114,121)**	(134,988)
Operating (loss)/profit	9	**(403,398)**	326,130
Finance income		**4,435**	13,099
Finance costs		**(23,692)**	(21,370)
Finance costs, net	11	**(19,257)**	(8,271)
Share of results of associates	20	**(7,340)**	(25,455)
Impairment loss recognised in respect of an investment in an associate	20(c)	**–**	(8,933)
(Loss)/profit before tax		**(429,995)**	283,471
Income tax expense	13	**(3,452)**	(99,225)
(Loss)/profit from continuing operations		**(433,447)**	184,246
Loss from discontinued operation	14	**(64,169)**	(250,858)
Loss for the year		**(497,616)**	(66,612)

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

For the year ended 31 December 2018

	Note	2018 HK$'000	2017 HK$'000 (Restated)
(Loss)/profit for the year attributable to:			
Owners of the Company		**(457,609)**	66,051
Non-controlling interests		**(40,007)**	(132,663)
		(497,616)	(66,612)
(Loss)/profit for the year from continuing operations attributable to:			
Owners of the Company		**(425,218)**	196,522
Non-controlling interests		**(8,229)**	(12,276)
		(433,447)	184,246
Loss for the year from discontinued operation attributable to:			
Owners of the Company		**(32,391)**	(130,471)
Non-controlling interests		**(31,778)**	(120,387)
		(64,169)	(250,858)
(Loss)/earnings per share			
From continuing and discontinued operations			
Basic (HK cents per share)	15	**(7.43)**	1.08
Diluted (HK cents per share)	15	**(7.43)**	1.08
From continuing operations			
Basic (HK cents per share)	15	**(6.91)**	3.22
Diluted (HK cents per share)	15	**(6.91)**	3.20

The above consolidated statement of profit or loss should be read in conjunction with the accompanying notes.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2018

	2018 HK$'000	2017 HK$'000 (Restated)
Loss for the year	**(497,616)**	(66,612)
Other comprehensive loss		
Items that may be reclassified to profit or loss:		
Changes in fair value of available-for-sale financial assets	**–**	(427,108)
Income tax relating to fair value change of available-for-sale financial assets	**–**	64,067
Release of reserve upon deemed disposal of a subsidiary	**205**	–
Exchange differences on translation of foreign operations	**(76,204)**	130,923
	(75,999)	(232,118)
Items that will not be subsequent reclassified to profit or loss:		
Changes in fair value of financial assets at fair value through other comprehensive income	**(620,783)**	–
Income tax relating to fair value change of financial assets through other comprehensive income	**81,140**	–
	(539,643)	–
Other comprehensive loss, net of tax	**(615,642)**	(232,118)
Total comprehensive loss for the year	**(1,113,258)**	(298,730)
Total comprehensive loss for the year attributable to:		
Owners of the Company	**(1,075,183)**	(167,956)
Non-controlling interests	**(38,075)**	(130,774)
	(1,113,258)	(298,730)
Total comprehensive loss attributable to owners of the Company arising from:		
Continuing operations	**(1,044,288)**	(38,950)
Discontinued operation	**(30,895)**	(129,006)
	(1,075,183)	(167,956)
Total comprehensive loss attributable to the non-controlling interests arising from:		
Continuing operations	**(7,678)**	(11,702)
Discontinued operation	**(30,397)**	(119,072)
	(38,075)	(130,774)

The above consolidated statement of comprehensive income should be read in conjunction with the accompanying notes.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2018

	Note	2018 HK$'000	2017 HK$'000
ASSETS			
NON-CURRENT ASSETS			
Property, plant and equipment	17	**304,972**	228,409
Intangible assets and goodwill	18	**10,184**	15,438
Investments in associates	20	**61,346**	27,582
Financial assets at fair value through other comprehensive income	21	**837,246**	–
Available-for-sale financial assets	22	**–**	1,518,572
Prepaid land lease payments	24	**80,747**	89,900
Deposits for acquisition of plant and equipment		**–**	23,493
Long-term deposits and prepayments	27	**21,436**	12,859
Total non-current assets		**1,315,931**	1,916,253
CURRENT ASSETS			
Prepaid land lease payments	24	**2,248**	–
Inventories	25	**4,000**	20,472
Contract assets	26	**14,598**	–
Trade and other receivables	27	**372,394**	401,141
Loans receivables	28	**9,731**	24,224
Income tax recoverable		**–**	3,614
Time deposits	29	**–**	180,120
Pledged bank deposits		**310**	–
Cash and cash equivalents	29	**429,611**	787,477
Total current assets		**832,892**	1,417,048
Total assets		**2,148,823**	3,333,301
EQUITY			
Share capital	34	**61,569**	61,569
Other reserves	35	**1,549,961**	2,159,252
Retained earnings/(accumulated losses)		**(221,479)**	237,644
Equity attributable to owners of the Company		**1,390,051**	2,458,465
Non-controlling interests		**41,864**	75,584
Total equity		**1,431,915**	2,534,049

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2018

	Note	2018 HK$'000	2017 HK$'000
LIABILITIES			
NON-CURRENT LIABILITIES			
Bank and other borrowings	32	**443,677**	360,955
Deferred income tax liabilities	33	**69,705**	159,086
Total non-current liabilities		**513,382**	520,041
CURRENT LIABILITIES			
Trade and other payables	30	**141,139**	223,935
Contract liabilities	26	**4,043**	–
Deferred government grants	31	**22,430**	11,528
Income tax payable		**13,142**	8,510
Bank and other borrowings	32	**22,772**	35,238
Total current liabilities		**203,526**	279,211
Total liabilities		**716,908**	799,252
Total equity and liabilities		**2,148,823**	3,333,301

The above consolidated statement of financial position should be read in conjunction with the accompanying notes.

The consolidated financial statements on pages 58 to 161 were approved and authorised for issue by the Board of Directors on 26 March 2019 and were signed on its behalf:

Dr. Liu Ruopeng
DIRECTOR

Dr. Luan Lin
DIRECTOR

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2018

	Attributable to the Owners of the Company					
	Share capital HK$'000 (note 34)	**Other reserves** HK$'000 (note 35)	**Retained earnings/ (accumulated losses)** HK$'000	**Subtotal** HK$'000	**Non-controlling interests** HK$'000	**Total** HK$'000
At 1 January 2017	60,894	2,228,448	171,593	2,460,935	268,776	2,729,711
Profit/(loss) for the year	–	–	66,051	66,051	(132,663)	(66,612)
Other comprehensive loss for the year:						
– Currency translation difference	–	129,034	–	129,034	1,889	130,923
– Changes in fair value of available-for-sale financial assets, net of deferred tax	–	(363,041)	–	(363,041)	–	(363,041)
Total comprehensive (loss)/income for the year	–	(234,007)	66,051	(167,956)	(130,774)	(298,730)
Exercise of share option	675	107,639	–	108,314	–	108,314
Change in shareholding in existing subsidiaries without changing control upon exercise of underlying options	–	(217)	–	(217)	217	–
Share-based compensation	–	33,188	–	33,188	2,314	35,502
Deemed disposal of a subsidiary (note 40)	–	24,201	–	24,201	(64,949)	(40,748)
At 31 December 2017	61,569	2,159,252	237,644	2,458,465	75,584	2,534,049
At 1 January 2018	**61,569**	**2,159,252**	**237,644**	**2,458,465**	**75,584**	**2,534,049**
Loss for the year	**–**	**–**	**(457,609)**	**(457,609)**	**(40,007)**	**(497,616)**
Other comprehensive loss for the year:						
– Currency translations difference	**–**	**(78,136)**	**–**	**(78,136)**	**1,932**	**(76,204)**
– Deemed disposal of a subsidiary	**–**	**205**	**–**	**205**	**–**	**205**
– Change in fair value of financial assets at fair value through other comprehensive income	**–**	**(539,643)**	**–**	**(539,643)**	**–**	**(539,643)**
Total comprehensive loss for the year	**–**	**(617,574)**	**(457,609)**	**(1,075,183)**	**(38,075)**	**(1,113,258)**
Change in shareholding in an existing subsidiary without change of control (note 44)	**–**	**217**	**(1,514)**	**(1,297)**	**(9,916)**	**(11,213)**
Share-based compensation	**–**	**8,066**	**–**	**8,066**	**–**	**8,066**
Deemed disposal of a subsidiary (note 40)	**–**	**–**	**–**	**–**	**14,271**	**14,271**
At 31 December 2018	**61,569**	**1,549,961**	**(221,479)**	**1,390,051**	**41,864**	**1,431,915**

The above consolidated statement of changes in equity should be read in conjunction with the accompanying notes.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2018

	Note	2018 HK$'000	2017 HK$'000
Cash flow from operating activities			
Cash used in operations	41(a)	**(463,345)**	(57,294)
Income tax refund/(paid)		**3,352**	(25,311)
Interest paid		**(22,775)**	(20,635)
Net cash used in operating activities		**(482,768)**	(103,240)
Cash flow from investing activities			
Purchase of property, plant and equipment		**(123,110)**	(100,542)
Purchase of intangible assets		**(15,612)**	(25,379)
Proceeds from disposal of property, plant and equipment		**52**	1,035
Dividend income		**549**	–
Interest received		**5,129**	11,491
Advance of loan receivables		**–**	(24,721)
Proceeds from repayment of loan receivables		**14,493**	273,988
Release of time deposits		**170,790**	256,474
Repayment from an associate		**5,888**	–
Placement of time deposits		**–**	(177,914)
Placement of pledged deposits		**(310)**	–
Release of structured bank deposits		**–**	476,396
Placement of structured bank deposits		**–**	(462,520)
Net cash inflow from disposal of a subsidiary	41(b)	**–**	9,096
Investment in available-for-sale financial assets		**–**	(436,757)
Net cash outflow from deemed disposal of a subsidiary	41(c)	**(5,302)**	(42,948)
Net cash generated from/(used in) investing activities		**52,567**	(242,301)
Cash flow from financing activities			
Proceeds from bank and other borrowings		**94,480**	719,009
Repayment of bank and other borrowings		**–**	(602,397)
Acquisition of non-controlling interests		**(5,144)**	–
Issuance of shares upon exercise of share option		**–**	108,314
Net cash generated from financing activities		**89,336**	224,926
Net decrease in cash and cash equivalents		**(340,865)**	(120,615)
Cash and cash equivalents at the beginning of the year		**787,477**	870,558
Effect of exchange rate changes on cash and cash equivalents		**(17,001)**	37,534
Cash and cash equivalents at the end of the year	29	**429,611**	787,477

The above consolidated statement of cash flows should be read in conjunction with the accompanying notes.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

1 GENERAL INFORMATION

KuangChi Science Limited (the "Company") is a limited company incorporated in Bermuda and its shares are listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). The address of its registered office of the Company is Clarendon House, 2 Church Street, Hamilton HM11, Bermuda. The principal place of its business is located at Unit 1220, 12/F, Leighton Centre, 77 Leighton Road, Causeway Bay, Hong Kong.

The Company is an investment holding company. The principal activities of the Company and its subsidiaries (together the "Group") are in the research, and development and manufacturing of innovative products for future technology business, and provision of other innovative technology service solution.

These consolidated financial statements are presented in Hong Kong dollars ("HK$"), unless otherwise stated.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs"), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs") and Interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. The consolidated financial statements for the year ended 31 December 2018 comprise the Company and its subsidiaries and the Group's interests in associates. These financial statements also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong.

The consolidated financial statements have been prepared on a historical cost basis, except for the financial assets at fair value through other comprehensive income ("FVOCI"), available-for-sale financial assets ("AFS") and derivative financial assets, which are measured at fair value.

The preparation of financial statements in conformity with HKFRSs requires the use of certain critical accounting estimates. It also requires management exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas when assumptions and estimates are significant to the consolidated financial statements are disclosed in note 5.

(i) New and amended standards adopted by the Group

The Group has applied the following standards and amendments to HKFRSs for the first time for their annual reporting period commencing 1 January 2018:

HKFRS 9	Financial instruments
HKFRS 15	Revenue from contracts with customers
Amendments to HKFRS 2	Classification and measurement of share-based payment transactions
Amendments to HKFRS 4	Applying HKFRS 9 Financial Instruments with HKFRS 4 Insurance Contracts
Amendments to HKFRS 15	Clarifications to HKFRS 15 Revenue from Contracts with customers
Amendments to HKAS 28	As part of the Annual Improvements to HKFRSs 2014-2016 Cycle
Amendments to HKAS 40	Transfer of investment property
HK (IFRIC)-Int 22	Foreign currency transactions and advance consideration

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.1 Basis of preparation (Continued)

(i) New and amended standards adopted by the Group (Continued)

The Group has changed its accounting policies and made retrospective adjustments as a result of adopting HKFRS 9 and HKFRS 15, the impacts of which are set out in note 3. The adoption of other amendments to HKFRS does not have significant effect on the financial performance and position of the Group for the current and prior years and/or disclosures set out in these consolidated financial statements.

(ii) New standards and amendments to HKFRS in issue but not yet effective

The Group has not early applied the following new and amendments to HKFRSs that have been issued but are not yet effective:

HKFRS 16	*Leases*[1]
HKFRS 17	*Insurance Contracts*[3]
HK(IFRIC)-Int 23	*Uncertainty over Income Tax Treatments*[1]
Amendments to HKFRS 3	*Definition of a Business*[4]
Amendments to HKFRS 9	*Prepayment Features with Negative Compensation*[1]
Amendments to HKFRS 10 and HKAS 28	*Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*[2]
Amendments to HKAS 1 and HKAS 8	*Definition of Material*[4]
Amendments to HKAS 19	*Plan Amendment, Curtailment or Settlement*[1]
Amendments to HKAS 28	*Long-term Interests in Associates and Joint Ventures*[1]
Amendments to HKFRSs	*Annual Improvements to HKFRSs 2015-2017 Cycle*[1]

1 Effective for annual periods beginning on or after 1 January 2019
2 Effective for annual periods beginning on or after a date to be determined
3 Effective for annual periods beginning on or after 1 January 2021
4 Effective for annual periods beginning on or after 1 January 2020

Except for the new and amendments to HKFRSs mentioned below, the directors of the Company anticipate that the application of all other new and amendments to HKFRSs will have no material impact on the consolidated financial statements in the foreseeable future.

HKFRS 16 Leases

HKFRS 16 introduces a comprehensive model for the identification of lease arrangements and accounting treatments for both lessors and lessees. HKFRS 16 supersedes HKAS 17 Leases and the related interpretations when it becomes effective.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.1 Basis of preparation (Continued)

(ii) New standards and amendments to HKFRS in issue but not yet effective (Continued)

HKFRS 16 Leases (Continued)

HKFRS 16 distinguishes lease and service contracts on the basis of whether an identified asset is controlled by a customer. In addition, HKFRS 16 requires sales and leaseback transactions to be determined based on the requirements of HKFRS 15 as to whether the transfer of the relevant asset should be accounted as a sale. HKFRS 16 also includes requirements relating to subleases and lease modifications.

Distinctions of operating leases and finance leases are removed for lessee accounting, and is replaced by a model where a right-of-use asset and a corresponding liability have to be recognised for all leases by lessees, except for short-term leases and leases of low value assets.

The right-of-use asset is initially measured at cost and subsequently measured at cost (subject to certain exceptions) less accumulated depreciation and impairment losses, adjusted for any remeasurement of the lease liability. The lease liability is initially measured at the present value of the lease payments that are not paid at that date. Subsequently, the lease liability is adjusted for interest and lease payments, as well as the impact of lease modifications, amongst others. For the classification of cash flows, the Group currently presents upfront prepaid lease payments as investing cash flows in relation to leasehold lands for own use while other operating lease payments are presented as operating cash flows. Upon application of HKFRS 16, lease payments in relation to lease liability will be allocated into a principal and an interest portion which will be presented as financing cash flows by the Group.

Under HKAS 17, the Group has already recognised an asset and a related finance lease liability for finance lease arrangement and prepaid lease payments for leasehold lands where the Group is a lessee. The application of HKFRS 16 will not result in changes in classification of these assets since the Group will present right-of-use assets separately at which the corresponding underlying assets would be presented if they were owned.

Other than certain requirements which are also applicable to lessor, HKFRS 16 substantially carries forward the lessor accounting requirements in HKAS 17, and continues to require a lessor to classify a lease either as an operating lease or a finance lease.

Furthermore, extensive disclosures are required by HKFRS 16.

As at 31 December 2018, the Group has non-cancellable operating lease commitments of HK$6,332,000 as disclosed in note 42. A preliminary assessment indicates that these arrangements will meet the definition of a lease. Upon application of HKFRS 16, the Group will recognise a right-of-use asset and a corresponding liability in respect of all these leases unless they qualify for low value or short-term leases.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.1 Basis of preparation (Continued)

(ii) New standards and amendments to HKFRS in issue but not yet effective (Continued)

HKFRS 16 Leases (Continued)

In addition, the Group currently considers refundable rental deposits paid as rights under leases to which HKAS 17 applies. Based on the definition of lease payments under HKFRS 16, such deposits are not payments relating to the right to use the underlying assets, accordingly, the carrying amounts of such deposits may be adjusted to amortised cost. Adjustments to refundable rental deposits paid would be considered as additional lease payments and included in the carrying amount of right- of-use assets. Adjustments to refundable rental deposits received would be considered as advance lease payments.

The application of new requirements may result in changes in measurement, presentation and disclosure as indicated above. The Group intends to elect the practical expedient to apply HKFRS 16 to contracts that were previously identified as leases applying HKAS 17 and HK(IFRIC)-Int 4 *Determining whether an Arrangement contains a Lease* and not apply this standard to contracts that were not previously identified as containing a lease applying HKAS 17 and HK(IFRIC)-Int 4. Therefore, the Group will not reassess whether the contracts are, or contain a lease which already existed prior to the date of initial application. Furthermore, the Group intends to elect the modified retrospective approach for the application of HKFRS 16 as lessee and will recognise the cumulative effect of initial application to opening accumulated losses without restating comparative information.

2.2 Principles of consolidation and equity accounting

(i) Subsidiaries

Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

The acquisition method of accounting is used to account for business combinations by the Group (refer to note 2.3). Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the transferred asset. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Non-controlling interests in the results and equity of subsidiaries are shown separately in the consolidated statement of profit or loss, statement of comprehensive income, statement of changes in equity and statement of financial position respectively.

(ii) Associates

Associates are all entities over which the Group has significant influence but not control or joint control. This is generally the case where the Group holds between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting (see (iii) below), after initially being recognised at cost.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.2 Principles of consolidation and equity accounting (Continued)

(iii) Equity accounting

Under the equity method of accounting, the investments are initially recognised at cost and adjusted thereafter to recognise the Group's share of the post-acquisition profits or losses of the investee in profit or loss, and the Group's share of movements in other comprehensive income of the investee in other comprehensive income. Dividends received or receivable from associates and joint ventures are recognised as a reduction in the carrying amount of the investment.

When the Group's share of losses in an equity-accounted investment equals or exceeds its interest in the entity, including any other unsecured long-term receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the other entity.

Unrealised gains on transactions between the Group and its associates and joint ventures are eliminated to the extent of the Group's interest in these entities. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of equity accounted investees have been changed where necessary to ensure consistency with the policies adopted by the Group.

The carrying amount of equity-accounted investments is tested for impairment in accordance with the policy described in note 2.9.

(iv) Changes in ownership interests

The Group treats transactions with non-controlling interests that do not result in a loss of control as transactions with equity owners of the Group. A change in ownership interest results in an adjustment between the carrying amounts of the controlling and non-controlling interests to reflect their relative interests in the subsidiary. Any difference between the amount of the adjustment to non-controlling interests and any consideration paid or received is recognised in equity attributable to owners of the Company.

When the Group ceases to consolidate or equity account for an investment because of a loss of control, joint control or significant influence, any retained interest in the entity is remeasured to its fair value with the change in carrying amount recognised in profit or loss. This fair value becomes the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss or transferred to another category of equity as specified/permitted by applicable HKFRSs.

If the ownership interest in a joint venture or an associate is reduced but joint control or significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income are reclassified to profit or loss where appropriate.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.3 Business combinations

The acquisition method of accounting is used to account for all business combinations, regardless of whether equity instruments or other assets are acquired. The consideration transferred for the acquisition of a subsidiary comprises the:

- fair values of the assets transferred
- liabilities incurred to the former owners of the acquired business
- equity interests issued by the Group
- fair value of any asset or liability resulting from a contingent consideration arrangement, and
- fair value of any pre-existing equity interest in the subsidiary.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are, with limited exceptions, measured initially at their fair values at the acquisition date. The Group recognises any non-controlling interest in the acquired entity on an acquisition-by-acquisition basis either at fair value or at the non-controlling interest's proportionate share of the acquired entity's net identifiable assets.

Acquisition-related costs are expensed as incurred.

The excess of the

- consideration transferred,
- amount of any non-controlling interest in the acquired entity, and
- acquisition-date fair value of any previous equity interest in the acquired entity

over the fair value of the net identifiable assets acquired is recorded as goodwill. If those amounts are less than the fair value of the net identifiable assets of the business acquired, the difference is recognised directly in profit or loss as a bargain purchase.

Where settlement of any part of cash consideration is deferred, the amounts payable in the future are discounted to their present value as at the date of exchange. The discount rate used is the entity's incremental borrowing rate, being the rate at which a similar borrowing could be obtained from an independent financier under comparable terms and conditions. Contingent consideration is classified either as equity or a financial liability. Amounts classified as a financial liability are subsequently remeasured to fair value with changes in fair value recognised in profit or loss.

If the business combination is achieved in stages, the acquisition date carrying value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date. Any gains or losses arising from such remeasurement are recognised in profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.4 Separate financial statements

Investments in subsidiaries are accounted for at cost less impairment. Cost includes direct attributable costs of investment. The results of subsidiaries are accounted for by the Company on the basis of dividend received and receivable.

Impairment testing of the investments in subsidiaries is required upon receiving a dividend from these investments if the dividend exceeds the total comprehensive income of the subsidiary in the period the dividend is declared or if the carrying amount of the investment in the separate financial statements exceeds the carrying amount in the consolidated financial statements of the investee's net assets including goodwill.

2.5 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker.

The Company has appointed the executive directors as the chief operating decision maker to review the operating results of the Group on a consolidated basis, and make strategic decisions.

2.6 Foreign currency translation

(a) Functional and presentation currency

Items included in the consolidated financial statements of the Company and its subsidiaries 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 HK$, which is the Company's functional and the Company and its subsidiaries' presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies at year end exchange rates are recognised in the consolidated statement of profit or loss, except when deferred in equity if they relate to qualifying cash flow hedges and qualifying net investment hedges or are attributable to part of the net investment in a foreign operation.

Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the consolidated statement of profit or loss within 'finance (costs)/income, net'. All other foreign exchange gains and losses are presented in consolidated statement of profit or loss on a net basis within 'other gains, net'.

Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Translation differences on assets and liabilities carried at fair value are reported as part of the fair value gain or loss. For example, translation differences on non-monetary assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss and translation differences on non-monetary assets such as equities classified as fair value through other comprehensive income are recognised in other comprehensive income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.6 Foreign currency translation (Continued)

(c) Group companies

The results and financial position of the foreign operations (none of which has the currency of a hyper-inflationary economy) 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 at the date of that consolidated statement of financial position;

(ii) income and expenses for each statement of profit or loss are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions); and

(iii) all resulting currency translation differences are recognised in other comprehensive income.

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the closing rate. Currency translation differences arising are recognised in other comprehensive income.

(d) Disposal of foreign operation and partial disposal

On the disposal of a foreign operation (that is, a disposal of the Group's entire interest in a foreign operation, or a disposal involving loss of control over a subsidiary that includes a foreign operation, a disposal involving loss of joint control over a joint venture that includes a foreign operation, or a disposal involving loss of significant influence over an associate that includes a foreign operation), all of the currency translation differences accumulated in equity in respect of that operation attributable to owners of the Company are reclassified to the profit or loss.

2.7 Property, plant and equipment

Property, plant and equipment, comprising plant and machinery, furniture and fixtures, office equipment, leasehold improvements and motor vehicles, are stated at cost less accumulated depreciation and accumulated impairment losses, if any. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

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 derecognised. All other repairs and maintenance are charged to the consolidated statement of comprehensive income during the financial period in which they are incurred.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.7 Property, plant and equipment (Continued)

Depreciation of property, plant and equipment is calculated using the straight line method to allocate their costs net of their residual values, over their estimated useful lives, at the following rates per annum:

Leasehold improvements	Over the shorter of lease terms or 5 years
Plant and machinery	6.6% – 50%
Furniture and fixtures	8% – 33%
Office equipment	10% – 50%
Motor vehicles	10% – 33%

The assets residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains or losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within other gains, net in the consolidated statement of profit or loss.

Construction in progress represents property, plant and equipment under construction or pending installation and is stated at cost less impairment losses, if any. No provision for depreciation is made on assets under construction in progress until such time as the relevant assets are completed and available for their intended use. Upon completion, the relevant assets are transferred to property, plant and equipment at cost less accumulated impairment losses.

2.8 Intangible assets

(i) Goodwill

Goodwill is measured as described in note 2.9. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill is not amortised but it is tested for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired, and is carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

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. The units or groups of units are identified at the lowest level at which goodwill is monitored for internal management purposes.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.8 Intangible assets (Continued)

(ii) Intangible assets acquired in a business combination

Intangible assets acquired in a business combination and recognised separately from goodwill are initially recognised at their fair value at the acquisition date (which is regarded as their cost).

Subsequent to initial recognition, intangible assets acquired in a business combination are reported at cost less accumulated amortisation and accumulated impairment losses Alternatively, intangible assets acquired in a business combination with indefinite useful lives are carried at cost less any subsequent accumulated impairment losses (see the accounting policy in respect of impairment losses on tangible and intangible assets below).

(iii) Internally-generated intangible assets – research and development expenses

An internally-generated intangible asset arising from development activities (or from the development phase of an internal project) is recognised if, and only if, all of the following have been demonstrated:

- the technical feasibility of completing the intangible asset so that it will be available for use;
- the intention to complete the intangible asset and use or sell it;
- the ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- the ability to measure reliably the expenditure attributable to the intangible asset during its development.

Research expenditure and development expenditure that do not meet the criteria above are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

The amount initially recognised for internally-generated intangible asset is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria listed above. Where no internally generated intangible asset can be recognised, development expenditure is charged to profit or loss in the period in which it is incurred. Subsequent to initial recognition, internally-generated intangible asset is measured at cost less accumulated amortisation and accumulated impairment losses (if any), on the same basis as intangible assets acquired in a business combination disclosed above.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.8 Intangible assets (Continued)

(iv) Amortisation

The Group amortises intangible assets with a limited useful life using the straight- line method over the following periods:

• Software	3-5 years
• Technical knowhow and patents	3-10 years

2.9 Impairment of non-financial assets

Goodwill and intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the assets carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows which are largely independent of the cash flows from other assets or group of assets (cash-generating- units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting period.

2.10 Non-current assets (or disposal groups) held for sale and discontinued operations

Non-current assets (or disposal groups) are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use and a sale is considered highly probable. They are measured at the lower of their carrying amount and fair value less costs to sell, except for assets such as deferred tax assets, assets arising from employee benefits, financial assets and investment property that are carried at fair value and contractual rights under insurance contracts, which are specifically exempt from this requirement.

An impairment loss is recognised for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell. A gain is recognised for any subsequent increases in fair value less costs to sell of an asset (or disposal group), but not in excess of any cumulative impairment loss previously recognised. A gain or loss not previously recognised by the date of the sale of the non-current asset (or disposal group) is recognised at the date of derecognition.

Non-current assets (including those that are part of a disposal group) are not depreciated or amortised while they are classified as held for sale. Interest and other expenses attributable to the liabilities of a disposal group classified as held for sale continue to be recognised.

Non-current assets classified as held for sale and the assets of a disposal group classified as held for sale are presented separately from the other assets in the consolidated statement of financial position. The liabilities of a disposal group classified as held for sale are presented separately from other liabilities in the consolidated statement of financial position.

A discontinued operation is a component of the entity that has been disposed of or is classified as held for sale and that represents a separate major line of business or geographical area of operations, is part of a single co-ordinated plan to dispose of such a line of business or area of operations, or is a subsidiary acquired exclusively with a view to resale. The results of discontinued operations are presented separately in the consolidated statement of profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.11 Investments and other financial assets

(i) Classification

From 1 January 2018, the Group classifies their financial assets in the following measurement categories:

- those to be measured subsequently at fair value (either through profit or loss, or through other comprehensive income), and
- those to be measured at amortised cost.

The classification depends on the entity's business model for managing the financial assets and the contractual terms of the cash flows.

For assets measured at fair value, gains and losses will either be recorded in profit or loss or other comprehensive income. For investments in equity instruments that are not held for trading, this will depend on whether the Group has made an irrevocable election at the time of initial recognition to account for the equity investment at fair value through other comprehensive income (FVOCI).

The Group reclassifies debt investments when and only when its business model for managing those assets changes.

(ii) Recognition and derecognition

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Group has transferred substantially all the risks and rewards of ownership.

(iii) Measurement

At initial recognition, the Group measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss (FVPL), transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVPL are expensed in profit or loss.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

Debt instruments

Subsequent measurement of debt instruments depends on the Group's business model for managing the asset and the cash flow characteristics of the asset. There are three measurement categories into which the Group classified its debt instruments:

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. Interest income from these financial assets is included in finance income using the effective interest rate method. Any gain or loss arising on derecognition is recognised directly in profit or loss and presented in other gains/(losses) together with foreign exchange gains and losses. Impairment losses are presented as separate line item in the statement of profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.11 Investments and other financial assets (Continued)

(iii) Measurement (Continued)

Debt instruments (Continued)

- FVOCI: Assets that are held for collection of contractual cash flows and for selling the financial assets, where the assets' cash flows represent solely payments of principal and interest, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest income and foreign exchange gains and losses which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in other gains/(losses). Interest income from these financial assets is included in finance income using the effective interest rate method. Foreign exchange gains and losses are presented in other gains/(losses) and impairment expenses are presented as separate line item in the statement of profit or loss.

- FVPL: Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVPL. A gain or loss on a debt investment that is subsequently measured at FVPL is recognised in profit or loss and presented net within other gains/(losses) in the period in which it arises.

Equity instruments

The Group subsequently measures all equity investments at fair value. Where the Group's management has elected to present fair value gains and losses on equity investments in other comprehensive income, there is no subsequent reclassification of fair value gains and losses to profit or loss following the derecognition of the investment. Dividends from such investments continue to be recognised in profit or loss as other income when the Group's right to receive payments is established.

Changes in the fair value of financial assets at FVPL are recognised in other (losses)/gains, net in the consolidated statement of profit or loss as applicable. Impairment losses (and reversal of impairment losses) on equity investments measured at FVOCI are not reported separately from other changes in fair value.

(iv) Impairment

The Group recognises an allowance for expected credit loss ("ECL") for all debt instruments not held at fair value through profit or loss. ECL is based on the difference between the contractual cash flows due in accordance with the contract and all the cash flows that the Group expects to receive, discounted at an approximation of the original effective interest rate. The expected cash flows will include cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms.

General approach

ECL is recognised in two stages. For credit exposures for which there has not been a significant increase in credit risk since initial recognition, ECL is provided for credit losses that result from default events that are possible within the next 12-months (a 12-month ECL). For those credit exposures for which there has been a significant increase in credit risk since initial recognition, a loss allowance is required for credit losses expected over the remaining life of the exposure, irrespective of the timing of the default (a lifetime ECL).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.11 Investments and other financial assets (Continued)

(iv) Impairment (Continued)

General approach (Continued)

At each reporting date, the Group assesses whether the credit risk on a financial instrument has increased significantly since initial recognition. When making the assessment, the Group compares the risk of a default occurring on the financial instrument as at the reporting date with the risk of a default occurring on the financial instrument as at the date of initial recognition and considers reasonable and supportable information that is available without undue cost or effort, including historical and forward-looking information.

The Group may consider a financial asset to be in default when internal or external information indicates that the Group is unlikely to receive the outstanding contractual amounts in full before taking into account any credit enhancements held by the Group. A financial asset is written off when there is no reasonable expectation of recovering the contractual cash flows.

Financial assets at amortised cost are subject to impairment under the general approach and they are classified within the following stages for measurement of ECL except for trade receivables and contracts assets which apply the simplified approach as detailed below.

Simplified approach

For trade receivables and contract assets that do not contain a significant financing component or when the Group applies the practical expedient of not adjusting the effect of a significant financing component, the Group applies the simplified approach in calculating ECL. Under the simplified approach, the Group does not track changes in credit risk, but instead recognises a loss allowance based on lifetime ECL at each reporting date. The Group has established a provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment.

(v) Accounting policies applied until 31 December 2017

The Group has applied HKFRS 9 retrospectively, but has elected not to restate comparative information. As a result, the comparative information provided continues to be accounted for in accordance with the Group's previous accounting policy.

(i) Classification

Until 31 December 2017, the Group classifies its financial assets in the following categories:

- financial assets at fair value through profit or loss,
- loans and receivables, and
- available-for-sale financial assets.

The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition. See note 22 for details about each type of financial asset.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.11 Investments and other financial assets (Continued)

(v) Accounting policies applied until 31 December 2017 (Continued)

(i) Classification (Continued)

(a) Financial assets at fair value through profit or loss

The Group classifies financial assets at fair value through profit or loss if they are acquired principally for the purpose of selling in the short term, ie are held for trading. They are presented as current assets if they are expected to be sold within 12 months after the end of the reporting period; otherwise they are presented as non-current assets.

Derivatives are initially recognised at fair value at the date when derivative contracts are entered into and are subsequently remeasured to their fair value at the end of the reporting period. The resulting gain or loss is recognised in profit or loss immediately.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. If collection of the amounts is expected in one year or less they are classified as current assets. If not, they are presented as non-current assets. The Group's loans and receivables comprise of trade and other receivables, loan receivables, time deposits, structured bank deposits and cash and cash equivalents in the consolidated statement of financial position.

(c) Available-for-sale financial assets

Investments are designated as available-for-sale financial assets if they do not have fixed maturities and fixed or determinable payments, and management intends to hold them for the medium to long-term. Financial assets that are not classified into any of the other categories (at fair value through profit or loss on loans and receivables) are also included in the available-for- sale category.

The financial assets are presented as non-current assets unless they mature, or management intends to dispose of them within 12 months of the end of the reporting period.

(ii) Reclassification

The Group may choose to reclassify a non-derivative trading financial asset out of the held for trading category if the financial asset is no longer held for the purpose of selling it in the near term. Financial assets other than loans and receivables are permitted to be reclassified out of the held for trading category only in rare circumstances arising from a single event that is unusual and highly unlikely to recur in the near term. In addition, the Group may choose to reclassify financial assets that would meet the definition of loans and receivables out of the held for trading or available-for-sale categories if the Group has the intention and ability to hold these financial assets for the foreseeable future or until maturity at the date of reclassification.

Reclassifications are made at fair value as of the reclassification date. Fair value becomes the new cost or amortised cost as applicable, and no reversals of fair value gains or losses recorded before reclassification date are subsequently made. Effective interest rates for financial assets reclassified to loans and receivables and held-to-maturity categories are determined at the reclassification date. Further increases in estimates of cash flows adjust effective interest rates prospectively.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.11 Investments and other financial assets (Continued)

(v) Accounting policies applied until 31 December 2017

(iii) Recognition and derecognition

Regular way purchases and sales of financial assets are recognised on trade-date, the date on which the Group commits to purchase or sell the asset. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Group has transferred substantially all the risks and rewards of ownership.

When securities classified as available-for-sale are sold, the accumulated fair value adjustments recognised in other comprehensive income are reclassified to profit or loss as gains and losses from investment securities.

(iv) Measurement

At initial recognition, the Group measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at fair value through profit or loss are expensed in profit or loss.

Loans and receivables and held-to-maturity investments are subsequently carried at amortised cost using the effective interest method.

Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Gains or losses arising from changes in the fair value are recognised as follows:

- for 'financial assets at fair value through profit or loss' – in the consolidated statement of profit or loss within other gains, net.

- for available-for-sale financial assets that are monetary securities denominated in a foreign currency – translation differences related to changes in the amortised cost of the security are recognised in profit or loss and other changes in the carrying amount are recognised in other comprehensive income.

- for other monetary and non-monetary securities classified as available-for-sale – in other comprehensive income.

Dividends on financial assets at fair value through profit or loss and available-for-sale equity instruments are recognised in profit or loss as part of revenue from continuing operations when the Group's right to receive payments is established.

Interest income from financial assets at fair value through profit or loss is included in the finance income in the consolidated statement of profit or loss. Interest on available-for-sale securities and loans and receivables calculated using the effective interest method is recognised in the consolidated statement of profit or loss as part of revenue from continuing operations.

Details on how the fair value of financial instruments is determined are disclosed in note 4.3.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.11 Investments and other financial assets (Continued)

(v) Accounting policies applied until 31 December 2017

(v) Impairment of financial assets

The Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered an indicator that the assets are impaired.

Assets carried at amortised cost

For loans and receivables, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in profit or loss. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the reversal of the previously recognised impairment loss is recognised in profit or loss.

Assets classified as available-for-sale

If there is objective evidence of impairment for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in profit or loss.

Impairment losses on equity instruments that were recognised in profit or loss are not reversed through profit or loss in a subsequent period.

If the fair value of a debt instrument classified as available-for-sale increases in a subsequent period and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.12 Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously. The legally enforce right must not be contingent on future event and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy of the Company or the counterparty.

2.13 Trade receivables

Trade receivables are amounts due from customers for goods sold or services performed in the ordinary course of business. Trade receivables are recognised initially at the amount of consideration that is unconditional unless they contain significant financing components, when they are recognised at fair value. The Group holds the trade receivables with the objective to collect the contractual cash flows and therefore measures them subsequently at amortised cost using the effective interest method. See note 27 for further information about the Group's accounting for trade receivables and note 4.1 for a description of the Group's impairment policies.

2.14 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

2.15 Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method. Net realisable value represents the estimated selling price for inventories less all estimated cost of completion and cost necessary to make the sale.

2.16 Share capital

Ordinary shares are classified as equity (note 34).

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Where the Company's shares are acquired from the market under the employee share scheme, the total consideration of shares acquired from the market (including any directly attributable incremental costs) is presented as shares held for employee share scheme and deducted from total equity. Upon vesting, the related costs of the vested shares for employee share scheme purchased from the market are credited to shares held for employee share scheme, with a corresponding decrease in employee share-based compensation reserve for employee share scheme.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.17 Trade and other payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

2.18 Borrowings

Borrowings are initially recognised at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in profit or loss over the period of the borrowings using the effective interest method. Fees paid on the establishment of loan facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, the fee is deferred until the draw down occurs. To the extent there is no evidence that it is probable that some or all of the facility will be drawn down, the fee is capitalised as a prepayment for liquidity services and amortised over the period of the facility to which it relates.

The fair value of the liability portion of a convertible bond is determined using a market interest rate for an equivalent non-convertible bond. This amount is recorded as a liability on an amortised cost basis until extinguished on conversion or maturity of the bonds. The remainder of the proceeds is allocated to the conversion option. This is recognised and included in shareholders' equity, net of income tax effects.

Borrowings are removed from the consolidated statement of financial position when the obligation specified in the contract is discharged, cancelled or expired. The difference between the carrying amount of a financial liability that has been extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognised in consolidated statement of profit or loss as finance income or finance costs.

Where the terms of a financial liability are renegotiated and the entity issues equity instruments to a creditor to extinguish all or part of the liability (debt for equity swap), a gain or loss is recognised in profit or loss, which is measured as the difference between the carrying amount of the financial liability and the fair value of the equity instruments issued.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the reporting period.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.19 Borrowing costs

General and specific borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of that asset, until such time as the assets are substantially ready for their intended use or sale. All other borrowing costs are charged to the consolidated statement of profit or loss in the period in which they are incurred.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

2.20 Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessor

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term.

The Group as lessee

Assets held under finance leases are recognised as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the consolidated statement of financial position as a finance lease obligation.

Lease payments are apportioned between finance expenses and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance expenses are recognised immediately in profit or loss, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the Group's general policy on borrowing costs. Contingent rentals are recognised as expenses in the periods in which they are incurred.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.20 Leasing (Continued)

The Group as lessee (Continued)

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognised as an expense in the period in which they are incurred.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expenses on a straight-line basis.

Leasehold land and building

When a lease includes both land and building elements, the Group assesses the classification of each element as a finance or an operating lease separately based on the assessment as to whether substantially all the risks and rewards incidental to ownership of each element have been transferred to the Group, unless it is clear that both elements are operating leases in which case the entire lease is classified as an operating lease. Specifically, the entire consideration (including any lump- sum upfront payments) are allocated between the land and the building elements in proportion to the relative fair values of the leasehold interests in the land element and building element of the lease at the inception of the lease.

To the extent the allocation of the lease payments can be made reliably, interest in leasehold land that is accounted for as an operating lease is presented as "prepaid land lease payments" in the consolidated statement of financial position and is amortised over the lease term on a straight-line basis except for those that are classified and accounted for as investment properties under the fair value model. When the lease payments cannot be allocated reliably between the land and building elements, the entire lease is generally classified as a finance lease and accounted for as property, plant and equipment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.21 Revenue recognition

Applicable from 1 January 2018

Revenue from contracts with customers

Revenue from contracts with customers is recognised when control of goods or services is transferred to the customers at an amount that reflects the consideration to which the Group expects to be entitled in exchange for those goods or services.

When another party is involved in providing goods or services to a customer, the Group determines whether the nature of its promise is a performance obligation to provide the specified goods or services itself (i.e. the Group is a principal) or to arrange for those goods or services to be provided by the other party (i.e. the Group is an agent).

The Group is a principal if it controls the specified good or service before that good or service is transferred to a customer. The Group is an agent if its performance obligation is to arrange for the provision of the specified good or service by another party. In this case, the Group does not control the specified good or service provided by another party before that good or service is transferred to the customer. When the Group acts as an agent, it recognises revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the specified goods or services to be provided by the other party.

(a) Revenue from sales of "Cloud"

The "Cloud" is a flying apparatus platform providing integrated services including communication, internet access, big data collection and analysis. Some contracts include multiple deliverables, such as the provision of hardware and software and related maintenance services. The related maintenance services are accounted for as a separate performance obligations in (b) below, where the contracts include multiple performance obligations, the transactions price will be allocated to each performance obligation based on the stand-alone selling prices. Revenue is recognised at a point in time when hardware and/or software products are delivered and installed at the customers' specific location with their signed acceptance and the Group has present right to payment and the collection of the consideration is probable.

(b) Revenue from provision of maintenance services of "Cloud"

Services of "Cloud" represent maintenance services in relation to future technology business. Revenue from the maintenance services is recognised over time as maintenance services are transferred over time, and customers simultaneously receive and consume the benefits from maintenance service provided by the Group.

(c) Revenue from sales of super intelligent tracking system

Super intelligent tracking system allows full-intelligent security applications in the security field. Revenue is recognised over time as the Group's performance does not create an asset with an alternative use to the Group and the Group has an enforceable right to payment for performance completed to date. The progress towards complete satisfaction of the performance obligation is measured based on the Group's efforts or inputs to the satisfaction of the performance obligation, by reference to the contract costs incurred up to the end of reporting period as a total estimated costs for each contract.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.21 Revenue recognition (Continued)

Applicable from 1 January 2018 (Continued)

(d) Revenue from provision of wifi network equipment and installation services

Revenue from provision of wifi network installation services is recognised at a point in time when hardware and/or software products are delivered and installed at the customers' specific location with their signed acceptance and the Group has present right to payment and the collection of the consideration is probable.

(e) Revenue from sales of chips

Revenue from sales of chips and electronic components is recognised at a point in time when control of the products has transferred being when the products are delivered to customers' specific location, the customer has accepted the products and the Group has present right to payment and the collection of the consideration is probable.

(f) Revenue from provision of procurement services

Procurement service fee revenue is primarily earned from transactions in which the Group earns commissions by procurement of goods on behalf of customers. Procurement service revenue from those transactions is reported on a net basis as the purchase price collected from the customer less the portion of the purchase price that is payable to merchants. The Group recognize revenue from those transactions at a point in time when the commission has been earned, which occurs when the goods are made available and control of the goods passed to the customers directly from the merchants.

Applicable before 1 January 2018

Revenue is measured at the fair value of the consideration received or receivable. Amounts disclosed as revenue are net of returns, trade allowances, rebates and amounts collected on behalf of third parties.

The Group recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Group's activities as described below. The Group bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

The Group evaluates whether it is appropriate to record the gross amount of sales of goods and the related costs or the net amount earned as commission. When the Group has the primary responsibility for providing the goods to the customer or for fulfilling the order, is subject to inventory risk, has latitude in establishing prices and bears the customer's credit risk, or has several but not all of these indicators, revenues is recognised on a gross basis. When the Group does not have exposure to the significant risks and rewards associated with the sale of goods, revenues are recorded on a net basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.21 Revenue recognition (Continued)

Applicable before 1 January 2018 (Continued)

Revenue from the sale of goods is recognised when the purchasers accept delivery, and installation and inspection are complete. Deposits and instalments received from purchasers prior to meeting the above criteria for revenue recognition are included in the consolidated statement of financial position under current liabilities.

(a) *Revenue from sale of "Cloud"*

The "Cloud" is a flying apparatus platform providing integrated services including communication, internet access, big data collection and analysis.

(b) *Services of "Cloud"*

Maintenance fees in relation to future technology business are recognised in the accounting period in which the services are rendered.

(c) *Revenue from provision of wifi network equipment and installation services*

Revenue from provision of wifi network installation services is recognised in the accounting period in which the services are rendered, by reference to stage of completion of the specific transaction and assessed on the price specified in the sales contracts basis of actual services provided as a proportion of the total service to be provided.

Revenue from wifi network equipment products are recognised when a group entity has delivered products to the customer; the customer has accepted the products and collectability of the related receivables is reasonably assured.

(d) *Revenue from sale of chips*

Revenue from sale of chips are recognised on a gross basis when the Group acts as a principal and recognised when the customer has accepted the goods and the related risks and rewards of ownership.

2.22 Interest income

Interest income is calculated by applying the effective interest rate to the gross carrying amount of a financial asset except for financial assets that subsequently become credit-impaired. For credit-impaired financial assets the effective interest rate is applied to the net carring amount of the financial asset (after deduction of the loss allowance).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.23 Dividend income

Dividend income is recognised when the right to receive payment is established.

2.24 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the consolidated financial statements in the period in which the dividends are approved by the Company's shareholders or directors, where appropriate.

2.25 Government grants

Grants from the government are recognised at their fair values when there is a reasonable assurance that the grants will be received and the Group will comply with all attached conditions.

Government grants relating to costs are deferred and recognised within "other income" in the consolidated statement of profit or loss over the period necessary to match them with the costs that they are intended to compensate.

2.26 Employee benefits

(i) Short-term obligations

Liabilities for wages and salaries, including non-monetary benefits and accumulating sick leave that are expected to be settled wholly within 12 months after the end of the period in which the employees render the related service are recognised in respect of employees' services up to the end of the reporting period and are measured at the amounts expected to be paid when the liabilities are settled. The liabilities are presented as other payables in the consolidated statement of financial position.

(ii) Other long-term employee benefit obligations

The liabilities for long service leave and annual leave are not expected to be settled wholly within 12 months after the end of the period in which the employees render the related service. They are therefore measured as the present value of expected future payments to be made in respect of services provided by employees up to the end of the reporting period using the projected unit credit method. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using market yields at the end of the reporting period of high-quality corporate bonds with terms and currencies that match, as closely as possible, the estimated future cash outflows. Remeasurements as a result of experience adjustments and changes in actuarial assumptions are recognised in profit or loss.

The obligations are presented as current liabilities in the consolidated statement of financial position if the entity does not have an unconditional right to defer settlement for at least twelve months after the reporting period, regardless of when the actual settlement is expected to occur.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.26 Employee benefits (Continued)

(iii) Post-employment obligations

The Group operates defined contribution pension plans.

The Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

(iv) Termination benefits

Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or when an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits at the earlier of the following dates: (a) when the Group can no longer withdraw the offer of those benefits; and (b) when the entity recognises costs for a restructuring that is within the scope of HKAS 37 and involves the payment of terminations benefits. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the end of the reporting period are discounted to present value.

2.27 Taxation

The tax expense for the year comprises current and deferred tax. Tax is recognised in the consolidated statement of profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or equity directly, respectively.

(i) Current income tax

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the Company and its subsidiaries and associates operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.27 Taxation (Continued)

(ii) Deferred income tax

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred tax liabilities and assets are not recognised for temporary differences between the carrying amount and tax bases of investments in foreign operations where the company is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

(iii) Offsetting

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.28 Share-based payment arrangements

The Group operates a number of equity-settled, share-based compensation plans, under which the entity receives services from employees as consideration for equity instruments (options) of the Company and its subsidiaries. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed is determined by reference to the fair value of the options granted:

- including any market performance conditions (for example, an entity's share price);
- excluding the impact of any service and non-market performance vesting conditions (for example, profitability, sales growth targets and remaining an employee of the entity over a specified time period); and
- including the impact of any non-vesting conditions (for example, the requirement for employees to save or holding shares for a specified period of time).

At the end of each reporting period, the Group revises its estimates of the number of options that are expected to vest based on the non-marketing performance and service conditions. It recognises the impact of the revision to original estimates, if any, in the consolidated statement of profit or loss, with a corresponding adjustment to equity.

In addition, in some circumstances employees may provide services in advance of the grant date and therefore the grant date fair value is estimated for the purposes of recognising the expense during the period between service commencement period and grant date.

When the options are exercised, the Group issues new shares. The proceeds received net of any directly attributable transaction costs are credited to share capital.

When the Group modifies the terms and conditions on which the equity instruments were granted, the Group recognises, as a minimum, the services received measured at the grant date fair value of the equity instruments granted, unless those equity instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date. This applies irrespective of any modifications to the terms and conditions on which the equity instruments were granted. In addition, the Group recognises the effects of modifications that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employees.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

2.28 Share-based payment arrangements (Continued)

If the modification increases the fair value of the equity instruments granted, measured immediately before and after the modification, the Group includes the incremental fair value granted in the measurement of the amount recognised for services received as consideration for the equity instruments granted. The incremental fair value granted is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period. If the modification occurs after vesting date, the incremental fair value granted is recognised immediately, or over the vesting period if the employee is required to complete an additional period of service before becoming unconditionally entitled to those modified equity instruments.

At the acquisition date, when the outstanding equity-settled share-based payment transactions held by the employees of an acquiree are not exchanged by the Company and its subsidiaries for its share-based payment transactions, the acquiree share-based payment transactions are measured at their market-based measure at the acquisition date. If the share-based payment transactions have vested by the acquisition date, they are included as part of the non-controlling interest in the acquiree. However, if the share-based payment transactions have not vested by the acquisition date, the market-based measure of the unvested share-based payment transactions is allocated to the non-controlling interest in the acquiree based on the ratio of the portion of the vesting period completed to the greater of the total vesting period or the original vesting period of those share options. The balance is recognised as remuneration cost for post-combination service.

2.29 Contract assets and contract liabilities

A contract asset is recognised when the Group recognises revenue before being unconditionally entitled to the consideration under the payment terms set out in the contract. Contract assets are assessed for expected credit losses (ECL) in accordance with the note 4.1 and are reclassified to receivables when the right to the consideration has become unconditional.

A contract liability is recognised when the customer pays consideration before the Group recognises the related revenue. A contract liability would also be recognised if the Group has an unconditional right to receive consideration before the Group recognises the related revenue. In such cases, a corresponding receivable would also be recognised.

For a single contract with the customer, either a net contract asset or a net contract liability is presented. For multiple contracts, contract assets and contract liabilities of unrelated contracts are not presented on a net basis.

When the contract includes a significant financing component, the contract balance includes interest accrued under the effective interest method.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

3 CHANGES IN ACCOUNTING POLICIES

The impact of the adoption of HKFRS 9 "Financial Instruments" and HKFRS 15 "Revenue from Contracts with Customers" on the consolidated financial statements of the Group that have been applied from 1 January 2018 was summarised below. This directors considered that other new or amended HKFRSs that are effective from 1 January 2018 did not have any material impact on the Group's accounting policies.

(a) Impact on the consolidated financial statements

Changes in an entity's accounting policies may result in prior year consolidated financial statements to be restated. As explained in note (b) and (c) below, HKFRS 9 and HKFRS 15 were generally adopted without restating comparative information. The reclassifications and the adjustments arising from the adoption of these standards are therefore not reflected in the consolidated statement of financial position as at 31 December 2017, but are recognised in the opening consolidated statement of financial position on 1 January 2018.

The following tables show the adjustments recognised for each individual line item. Line items that were not affected by the changes have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided. The adjustments are explained in more detail by below.

	31 December 2017 As originally presented HK$'000	**Impact on application of HKFRS 9** HK$'000	**Impact on application of HKFRS 15** HK$'000	**1 January 2018 As restated** HK$'000
Consolidated statement of financial position (extract)				
Non-current assets				
Financial assets at fair value through other comprehensive income	–	1,518,572	–	1,518,572
Available-for-sale financial assets	1,518,572	(1,518,572)	–	–
Current assets				
Trade and other receivables	401,141	–	(13,329)	387,812
Contract assets	–	–	13,329	13,329
Total assets	3,333,301	–	–	3,333,301
Current liabilities				
Trade and other payables	223,935	–	(9,397)	214,538
Contract liabilities	–	–	9,397	9,397
Total liabilities	799,252	–	–	799,252

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

3 CHANGES IN ACCOUNTING POLICIES (Continued)

(b) HKFRS 9 "Financial Instruments" – Impact of adoption

HKFRS 9 replaces the provisions of HKAS 39 that relate to the recognition, classification and measurement of financial assets and financial liabilities, derecognition of financial instruments, impairment of financial assets and hedge accounting.

The adoption of HKFRS 9 "Financial Instruments" from 1 January 2018 resulted in changes in accounting policies and adjustments to the amounts recognised in the consolidated financial statements.

(i) Classification and measurement

On 1 January 2018 (the date of initial application of HKFRS 9), management of the Group has assessed which business models apply to the financial assets held by the Group and has classified its financial instruments into the appropriate HKFRS 9 categories. The effects resulting from this reclassification are as follows:

	Available-for-sale financial assets	Financial assets at fair value through other comprehensive income	Available-for-sale financial assets reserve	Financial assets at fair value through other comprehensive income reserve
	HK$'000	HK$'000	HK$'000	HK$'000
Closing balance as at 31 December 2017, as originally presented	1,518,572	–	363,041	–
Reclassify non-trading equities from available-for-sale financial assets to financial assets at fair value through other comprehensive income	(1,518,572)	1,518,572	(363,041)	363,041
Opening balance as at 1 January 2018 as restated	–	1,518,572	–	363,041

The Group elected to present changes in the fair value of all its equity investments previously classified as available-for-sale financial assets to financial assets at fair value through other comprehensive income as these investments are held as long-term strategic investments that are not expected to be sold in the short to medium term. As a result, the available-for-sale financial assets with fair value of HK$1,518,572,000 as at 1 January 2018 were reclassified to financial assets at fair value through other comprehensive income and the related accumulated fair value changes of HK$363,041,000 were reclassified from the available-for-sale financial assets reserve to financial assets at fair value through other comprehensive income reserve on 1 January 2018.

There is no impact on the Group's accounting for financial liabilities, as the new requirements only affect the accounting for financial liabilities that are designated at fair value through profit or loss and the Group does not have any such liabilities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

3 CHANGES IN ACCOUNTING POLICIES (Continued)

(b) HKFRS 9 "Financial Instruments" – Impact of adoption (Continued)

(ii) Impairment of financial assets

The Group has three types of financial assets that are subject to HKFRS 9's new expected credit loss ("ECL") model:

- Trade receivables
- Contract assets, and
- Other financial assets at amortised cost

The Group was required to revise its impairment methodology under HKFRS 9 for each of these classes of assets.

While cash and cash equivalents and time deposits are also subject to the impairment requirements of HKFRS 9, the identified impairment loss was immaterial.

Trade receivables and contract assets

The Group applies the simplified approach to provide for ECL prescribed by HKFRS 9, which permits the use of the lifetime expected losses for all trade receivables and contract assets.

To measure the expected credit losses, trade receivables and contract assets have been grouped based on shared credit risk characteristics and the days past due. The contract assets relate to unbilled work in progress and have substantially the same risk characteristics as the trade receivables for the same types of contracts. The Group have therefore concluded that the expected loss rates for trade receivables are a reasonable approximation of the loss rates for the contract assets.

The expected loss rates are based on the payment profiles of revenue from the corresponding customer at each report date and their historical credit losses experienced up to 2 years and are adjusted to reflect current and forward-looking information on macroeconomic factors affecting the ability of customers to settle the receivables.

Management has closely monitored the credit qualities and the collectability of the trade receivables and contract assets. The adoption of the simplified ECL approach under HKFRS 9 has not resulted in any additional impairment loss for trade receivables and contract assets as at 1 January 2018. Since the customers are primarily local government related entities, the directors of the Company considered the credit risk is not high. As at 31 December 2017, the expected credit loss does not have a material impact to the consolidated financial statements of the Group.

Trade receivables and contract assets are written off when there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, amongst others, the failure of a customer to establish a repayment plan with the Group and to make contractual payments accordingly.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

3 CHANGES IN ACCOUNTING POLICIES (Continued)

(b) HKFRS 9 "Financial Instruments" – Impact of adoption (Continued)

(ii) Impairment of financial assets (Continued)

Other financial assets at amortised cost

For other financial assets carried at amortised cost, including other receivables and loan receivables in the consolidated statement of financial position, the ECL is based on the 12-month ECL. It is the portion of lifetime ECL that results from default events on a financial instrument that are possible within 12 months after the reporting date. However, when there has been a significant increase in credit risk since origination, the allowance will be based on the lifetime ECL. Management has closely monitored the credit qualities and the collectability of the other financial assets at amortised cost and considers that the ECL is immaterial. As at 31 December 2017, the ECL is immaterial to the consolidated financial statements of the Group.

(c) HKFRS 15 "Revenue from Contracts with Customers" – Impact of adoption

The Group has adopted HKFRS 15 from 1 January 2018 which resulted in changes in accounting policies and adjustments to the amounts recognised in the consolidated financial statements. The Group have elected to use the cumulative effect transition method and have recognised the cumulative effect of initial application as an adjustment to the opening balance of equity at 1 January 2018. Therefore, comparative information has not been restated and continues to be reported under HKAS 18. As allowed by HKFRS 15, the Group has applied the new requirements only to contracts that were not completed before 1 January 2018.

In summary, the following adjustments were made to the amounts recognised in the consolidated statement of financial position as at date of initial application (1 January 2018):

	HKAS 18 carrying amount as at 31 December 2017, as originally presented HK$'000	Reclassification HK$'000	**HKFRS 15 carrying amount as at 1 January 2018, as restated HK$'000**
Trade and other receivables	401,141	(13,329)	**387,812**
Contract assets	–	13,329	**13,329**
Trade and other payables	223,935	(9,397)	**214,538**
Contract liabilities	–	9,397	**9,397**

There was no impact on the Group's retained profits as at 1 January 2018.

Presentation of assets and liabilities related to contracts with customers

The Group has also changed the presentation of certain amounts in the consolidated statement of financial position to reflect the terminology of HKFRS 15:

- Contract assets recognised in relation to revenue contracts of maintenance service income of Cloud, which were previously presented as part of trade and other receivables (HK$13,329,000 as at 1 January 2018).

- Contract liabilities in relation to receipts in advance from customers for a revenue contract of maintenance service income of Cloud, which were previously included in trade and other payables (HK$9,397,000 as at 1 January 2018).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

4 FINANCIAL RISK MANAGEMENT

4.1 Financial risk factors

The Group's major financial instruments include bank balances and cash, time deposit, trade and other receivables, contract assets, loan receivables, financial assets at fair value through other comprehensive income, available-for-sale financial assets, trade and other payables, contract liabilities and bank and other borrowings. Details of these financial instruments are disclosed in respective notes. The risks associated with these financial instruments include market risk (foreign exchange risk, price risk and interest rate risk), credit risk and liquidity risk. The policies on how to mitigate these risks are set out below. Management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

(a) Market risk

(i) Foreign exchange risk

The Group operates internationally and are exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the United States dollars ("USD") and Chinese Renminbi ("RMB") and Canadian dollars ("CAD"). Foreign exchange risk arises from future commercial transactions and recognised assets and liabilities which are denominated in currency that is not the entity's functional currency.

The Group's financial assets including trade and other receivables, contract assets, loans receivables, time deposits and cash and cash equivalents, are substantially denominated in HK$, USD, RMB and CAD. The Group's financial liabilities including trade and other payables, deferred government grants and bank and other borrowings were substantially denominated in USD and RMB.

Financial assets and financial liabilities denominated in currency other than the entities' functional currency are summarised as follows:

	2018 **HK$'000**	2017 HK$'000
Denominated in USD		
Trade and other receivables	**146,209**	24,112
Loans receivables	**9,731**	24,224
Cash and cash equivalents	**112,581**	421,382
Trade and other payables	**–**	(19,090)
	268,521	450,628

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

4 FINANCIAL RISK MANAGEMENT (Continued)

4.1 Financial risk factors (Continued)

(a) Market risk (Continued)

(i) Foreign exchange risk (Continued)

	2018 HK$'000	2017 HK$'000
Denominated in CAD		
Cash and cash equivalents	**31,322**	34,869

	2018 HK$'000	2017 HK$'000
Denominated in RMB		
Cash and cash equivalents	**686**	721
Trade and other payables	**(709)**	–
	(23)	721

Since HK$ are pegged to the USD, management considers the foreign exchange risk of USD financial assets and liabilities to the Group is not significant.

As at 31 December 2018, if CAD had strengthened/weakened by 5% against HK$ with all other variables held constant, the post-tax loss (2017: post-tax profit) for the year would be lower/higher (2017: higher/lower) by approximately HK$1,308,000 (2017: HK$1,456,000), mainly as a result of foreign exchange gains/losses on translation of CAD-denominated net assets.

As at 31 December 2018, if RMB had strengthened/weakened by 5% against HK$ with all other variables held constant, the post-tax loss (2017: post-tax profit) for the year would be higher/lower by approximately HK$1,000 (2017: HK$30,000) mainly as a result of foreign exchange gains/losses on translation of RMB-denominated net assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

4 FINANCIAL RISK MANAGEMENT (Continued)

4.1 Financial risk factors (Continued)

(a) Market risk (Continued)

(ii) Interest rate risk

The Group's interest-rate risk arises from borrowings with variable rates. It is the Group's policy to keep certain of its borrowings at floating interest rates so as to reduce the fair value interest rate risk.

For the year ended 31 December 2018, a 100 basis points increase/decrease is used which represents management's assessment of the reasonably possible change in interest rates. If interest rate had been 100 basis points higher/lower with all other variables held constant, the Group's post-tax loss for the year would increase/decrease approximately HK$937,000 (2017: HK$264,000).

The Group's borrowings at the end of the reporting period are as follows:

	2018 HK$	% of total loans	2017 HK$	% of total loans
Variable rate borrowings:				
12 months or less	**22,772**	**5%**	35,238	9%
Over 1 – 5 years	**102,097**	**22%**	–	–
Fixed rate borrowings:				
Over 1 – 5 years	**341,580**	**73%**	360,955	91%
	466,449	**100%**	396,193	100%

An analysis by maturities is provided in note 4.1(c). The percentage of total loans shows the proportion of loans that are currently at variable rates in relation to the total amount of borrowings.

(iii) Price risk

The Group's exposure to equity securities price risk arises from investments held by the Group's and classified in the consolidated statement of financial position as financial assets at fair value through other comprehensive income as at 31 December 2018 and available-for-sale financial assets as at 31 December 2017.

Other components of equity (net with tax effect) would increase/decrease by approximately HK$68,534,000 (2017: HK$120,769,000) as a result of 10% gains/losses on listed equity instruments measure at fair value through other comprehensive income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

4 FINANCIAL RISK MANAGEMENT (Continued)

4.1 Financial risk factors (Continued)

(b) Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in a financial loss to the Group. The Group is exposed to credit risk in relation to its trade and other receivables, contract assets, loan receivables and cash deposits at banks. The carrying amounts of trade and other receivables, contract assets, loan receivables, cash and cash equivalents and restricted cash represent the Group's maximum exposure to credit risk in relation to financial assets.

The Group expects that there is no significant credit risk associated with cash deposits at banks since they are substantially deposited at state-owned banks and other medium or large-sized listed banks. Management does not expect that there will be any significant losses from non-performance by these counterparties.

For trade receivables and contract assets, the Group has monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews the recoverability of these receivables at the end of each reporting period to ensure that adequate impairment losses are made for irrecoverable amounts.

The Group considers the probability of default upon initial recognition of asset and whether there has been a significant increase in credit risk on an ongoing basis throughout each reporting period. To assess whether there is a significant increase in credit risk, the Group compares the risk of a default occurring on the asset as at the reporting date with the risk of default as at the date of initial recognition. It considers available reasonable and supportive forwarding-looking information. Especially the following indicators are incorporated:

- credit rating;
- actual or expected significant adverse changes in business, financial or economic conditions that are expected to cause a significant change to the customer's ability to meet its obligations;
- actual or expected significant changes in the operating results of the debtor/customer;
- significant changes in the expected performance and behaviour of the customer, including changes in the payment status of customer in the Group and changes in the operating results of the customer.

(i) Loan receivables

The credit risk of loan receivables are managed through internal process of the Group. The Group actively monitors the outstanding amounts owned by each debtor and identifies any credit risk in a timely manner in order to reduce the risk of a credit related loss. In addition, the Group, accounts for its credit risk by appropriately providing for expected credit losses. In calculating the expected credit loss rates, the Group considers historical loss rates for each category of receivables and adjusts for forward looking macroeconomic data. In this regard, the directors of the Company considered that the Group's credit risk is significantly reduced.

As at 31 December 2018, the internal credit rating of loan receivables were performing. The Group has assessed that the expected credit loss rate for these receivables is immaterial under 12 months expected losses method. Thus no loss allowance for loan receivables was recognised.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

4 FINANCIAL RISK MANAGEMENT (Continued)

4.1 Financial risk factors (Continued)

(b) Credit risk (Continued)

(ii) Trade receivables and contract assets

The Group applies the simplified approach to provide for expected credit losses prescribed by HKFRS 9, which permits the use of the lifetime expected loss provision for all trade receivables and contract assets. As at 31 December 2018, the Group has assessed that the expected loss rate for other receivables was immaterial. Thus no loss allowance for other receivables was recognised.

To measure the expected credit losses, trade receivables and contract assets have been grouped based on aging.

The expected loss rates are based on the payment profiles of sales and the corresponding historical credit losses experienced. The historical loss rates are adjusted to reflect current and forward-looking information on macroeconomic factors affecting the ability of the customers to settle the receivables.

On that basis, the loss allowance as at 31 December 2018 was determined as follows for trade receivables and contract assets:

	Contract asset	Trade receivables					
	Days past due	Days past due					
	Current HK$'000	Current HK$'000	1-90 days HK$'000	91-180 days HK$'000	181-365 days HK$'000	1-2 years HK$'000	Total HK$'000
31 December 2018							
Expected loss rate	4.2%	4.2%	6.8%	7.0%	7.2%	8.7%	–
Gross carrying amount	15,224	127,224	14,935	7,321	16,428	204,736	370,644
Loss allowance	626	5,336	1,019	510	1,183	17,740	25,788

Trade receivables are written off when there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, amongst others, the failure of a debtor to engage in a repayment plan with the Group, and a failure to make contractual payments for a period of greater than 2 years past due.

Impairment losses on trade receivables and contract assets are presented as impairment losses within operating profit. Subsequent recoveries of amounts previously written off are credited against the same line item.

As at 31 December 2018, the Group has concentration at credit risk at 68% of the total trade debtors were due from the Group's five largest customers for the year ended 31 December 2018.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

4 FINANCIAL RISK MANAGEMENT (Continued)

4.1 Financial risk factors (Continued)

(b) Credit risk (Continued)

(ii) Trade receivables and contract assets (Continued)

Prior to 1 January 2018, an impairment loss was recognised only when there was objective evidence of impairment. In order to minimise the credit risk, management of the Group has monitored the determination of credit limits, credit approvals and other monitoring procedures to ensure that follow- up action is taken to recover overdue debts. In addition, the Group reviews the recoverable amount of each individual trade receivable at the end of the reporting period to ensure that adequate provisions for impairment are made for irrecoverable amounts. In this regard, the directors of the Company consider that the credit risk is maintained at a satisfactory level.

As at 31 December 2017, trade receivables of approximately HK$228,110,000 were past due but not impaired. These trade receivables are due from local government related bodies. The aging analysis of trade receivables which are past due but not impaired is presented as follows:

	2017 HK$'000
Overdue by	
1-90 days	23,192
91-180 days	–
181-365 days	129,686
Over 365 days	75,232
	228,110

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. The default risk of the industry and country in which the customers operate also has an influence on credit risk but to a lesser extent. At 31 December 2017, the Group has a concentration of credit risk at approximately 91% of the total trade debtors were due from the Group's five largest customers. Trade debtors with overdue balances as at 31 December 2017 have governmental background and despite the lack of track record, management consider that these customers have satisfactory credit quality. For other trade debtors, management consider the balances are recoverable in view of the business relationship and continuous repayment record.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

4 FINANCIAL RISK MANAGEMENT (Continued)

4.1 Financial risk factors (Continued)

(c) Liquidity risk

To manage liquidity risk, the Group monitors and maintain a level of cash and cash equivalents deemed adequate by the management to finance the Group's daily operations and mitigate the effects of fluctuations in cash flows. Management also monitors the utilisation of bank borrowings and ensures compliance with loan covenants.

Liquidity risk tables

The following tables detail the Group's remaining contractual maturity for its non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest dates on which the Group can be required to pay. The maturity dates for other non-derivative financial liabilities are based on the agreed repayment dates.

Specifically, for bank and other borrowing which contain a repayable on demand clause which can be executed at the bank and the borrower's sole discretion, the analysis shows the cash outflow based on the earliest date in which the Group can be required to pay, that is if the lenders were to invoke their unconditional rights to call the loans with immediate effect.

The table below analyses the Group's financial liabilities into relevant maturity groupings based on the remaining period at the end of the financial period to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

4 FINANCIAL RISK MANAGEMENT (Continued)

4.1 Financial risk factors (Continued)

(c) Liquidity risk (Continued)

At 31 December 2018

	Within 1 year HK$'000	2-5 years HK$'000	More than 5 years HK$'000	Total undiscounted cash flow HK$'000	Carrying amount HK$'000
Trade and other payables	126,121	–	–	126,121	126,121
Other borrowings	22,203	347,480	–	369,683	341,580
Bank borrowings	31,048	117,173	–	148,221	124,869
	179,372	464,653	–	644,025	592,570

At 31 December 2017

	On demand HK$'000	Within 1 year HK$'000	2 to 5 Years HK$'000	More than 5 years HK$'000	Total undiscounted cash flow HK$'000	Carrying amount HK$'000
Trade and other payables	–	120,480	–	–	120,480	120,480
Other borrowings	–	23,416	389,965	–	413,381	360,955
Bank borrowings	35,238	–	–	–	35,238	35,238
	35,238	143,896	389,965	–	569,099	516,673

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

4 FINANCIAL RISK MANAGEMENT (Continued)

4.2 Capital risk management

The Group manages its capital to ensure that the group companies will be able to continue as a going concern while maximising the return to shareholders through the optimisation of debt and equity balance. The Group's overall strategy remains unchanged from prior year.

The Group monitors capital on the basis of the gearing ratio. The gearing ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings (including bank and other borrowings as shown in the consolidated statement of financial position) less bank balances and cash. Total capital is calculated as "Total Equity", as shown in the consolidated statements of financial position, plus net debt.

The gearing ratios as at 31 December 2018 and 2017 were as follows:

	2018 **HK$'000**	2017 HK$'000
Bank and other borrowings	**466,449**	396,193
Less: Cash and cash equivalents	**(429,611)**	(787,477)
Pledged bank deposits	**(310)**	–
Time deposits	**–**	(180,120)
Net debt/(cash)	**36,528**	(571,404)
Total equity	**1,431,915**	2,534,049
Total capital	**1,468,443**	1,962,645
Gearing ratio	**2.5%**	Not meaningful

The directors review the capital structure on an annual basis. As part of this review, the directors consider the cost of capital and the risks associate with each class of capital. Based on recommendations of the directors, the Group will balance their overall capital structure through new share issues as well as raising of new borrowings and repayment of existing borrowings.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

4 FINANCIAL RISK MANAGEMENT (Continued)

4.3 Fair value estimation

Financial assets and liabilities

(a) Fair value hierarchy

This section explains the judgements and estimates made in determining the fair values of the financial instruments that are recognised and measured at fair value in the consolidated financial statements. To provide an indication about the reliability of the inputs used in determining fair value, the Group has classified its financial instruments into the three levels prescribed under the accounting standards. An explanation of each level follows underneath the table.

Recurring fair value measurements

	Notes	**Level 1** HK$'000	**Level 2** HK$'000	**Level 3** HK$'000	**Total** HK$'000
At 31 December 2018					
Financial assets					
Financial assets at fair value through other comprehensive income	21				
– listed equity securities		**806,282**	**–**	**–**	**806,282**
– unlisted equity securities		**–**	**–**	**30,964**	**30,964**
		806,282	**–**	**30,964**	**837,246**
At 31 December 2017					
Financial assets					
Available-for-sale financial asset	22				
– listed equity securities		–	1,420,811	–	1,420,811
– unlisted equity securities		–	–	97,761	97,761
		–	1,420,811	97,761	1,518,572

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

4 FINANCIAL RISK MANAGEMENT (Continued)

4.3 Fair value estimation (Continued)

Financial assets and liabilities (Continued)

(a) Fair value hierarchy (Continued)

During the year ended 31 December 2018, there has been transfers of investments from Level 2 to Level 1 due to resumption of trading. The Group's policy is to recognise transfers between levels of fair value hierarchy as at the end of the reporting period in which they occur. There were no transfers between levels 1, 2 and 3 for recurring fair value measurements during the year ended 31 December 2017.

Level 1: The fair value of financial instruments traded in active markets (such as publicly traded derivatives and equity securities) is based on quoted market prices at the end of the reporting period. The quoted market price used for financial assets held by the Group is the current bid price. These instruments are included in level 1.

Level 2: The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined using valuation techniques which maximise the use of observable market data and rely as little as possible on entity-specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

Level 3: If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3. This is the case for unlisted equity securities.

(b) Fair value measurements using significant unobservable inputs (level 3)

The following table presents the changes in level 3 items for the years ended 31 December 2018 and 2017:

	Financial assets at fair value through other comprehensive income		Available-for-sale financial assets		Share Swap		Total	
	2018 HK$'000	2017 HK$'000	**2018 HK$'000**	2017 HK$'000	**2018 HK$'000**	2017 HK$'000	**2018 HK$'000**	2017 HK$'000
At 1 January	**–**	–	**97,761**	29,040	**–**	7,674	**97,761**	36,714
Reclassification upon adoptions of HKFRS 9	**97,761**	–	**(97,761)**	–	**–**	–	**–**	–
At 1 January (restated)	**97,761**	–	**–**	29,040	**–**	7,674	**97,761**	36,714
Addition	**13,364**	–	**–**	91,757	**–**	–	**13,364**	91,757
Fair value change recognised in the other comprehensive income	**(79,850)**	–	**–**	–	**–**	–	**(79,850)**	–
Impairment	**–**	–	**–**	(23,270)	**–**	–	**–**	(23,270)
Currency transfer difference	**(311)**	–	**–**	234	**–**	–	**(311)**	234
Derecognised upon exercise or expiry of underlying options	**–**	–	**–**	–	**–**	(7,674)	**–**	(7,674)
At 31 December	**30,964**	–	**–**	97,761	**–**	–	**30,964**	97,761

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

4 FINANCIAL RISK MANAGEMENT (Continued)

4.3 Fair value estimation (Continued)

Financial assets and liabilities (Continued)

(c) Valuation inputs and relationships to fair value

Financial instruments	Fair value as at 31 December 2018 HK$'000	Fair value as at 31 December 2017 HK$'000	Fair value hierarchy	Valuation techniques and key inputs	Significant unobservable input(s) 31 December 2018	Significant unobservable input(s) 31 December 2017
1) Listed securities			2018: Level 1 (2017: Level 2)	Fair value is estimated on basis of the quoted market price (2017: quoted market price and adjusted for trading suspension as at 31 December 2017)	N/A	N/A
– Financial assets at FVOCI	806,282	–				
– Available-for-sale financial assets	–	1,420,811				
2) Unlisted securities			Level 3	Discounted cash flow model is adopted and the key inputs are revenue growth rate, terminal growth rate and discount rate	Revenue growth rate from 6% to 7 times[#] Terminal growth rate of 3% Discount rate of 17% to 26%	Revenue growth rate ranging from 28% to 33% Terminal growth rate of 5% Discount rate of 8%
– Financial assets at FVOCI	30,964	–				
– Available-for-sale financial assets	–	91,757				

[#] The revenue base of an investee company was very small in the initial year of operation, so there was a significant growth rate of 7 times in the second year of the financial projection. The growth rate was declining during the period of financial projection.

Certain of the financial instruments are measured at fair value for financial reporting purposes. The board of directors of the Company has set up a valuation team headed by the Chief Financial Officer of the Company, to determine the appropriate valuation techniques and inputs for fair value measurements.

In estimating the fair value, the Group uses market-observable data to the extent it is available. Where Level 1 inputs are not available, the Group engaged independent third party qualified valuers to perform the valuation. The valuation team works closely with the qualified external valuers to establish the appropriate valuation techniques and inputs to the model. The Chief Financial Officer reports the valuation team's findings to the board of directors of the Company every quarter to explain the cause of fluctuations in fair values.

For the financial instruments above, slight increases in the perpetual growth rates or volatility used in isolation or share price would result in significant increases in the fair value measurement of the derivatives and vice versa.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

4 FINANCIAL RISK MANAGEMENT (Continued)

4.4 Financial Instruments By Category

	2018 HK$'000	2017 HK$'000
Financial assets		
Financial assets at fair value through other comprehensive income	**837,246**	–
Available-for-sale financial assets	**–**	1,518,572
At amortised cost		
– Trade and other receivables	**351,833**	350,591
– Loan receivables	**9,731**	24,224
– Time deposits	**–**	180,120
– Pledged bank deposits	**310**	–
– Cash and cash equivalents	**429,611**	787,477
	1,628,731	2,860,984
Financial liabilities		
At amortised cost		
– Bank and other borrowings	**466,449**	396,193
– Trade and other payables	**126,121**	120,480
	592,570	516,673

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

5 CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

The preparation of financial statements requires the use of accounting estimates which, by definition, will seldom equal the actual results. Management also needs to exercise judgement in applying the Group's accounting policies.

Estimates and judgements are continually evaluated. They are based on historical experience and other factors, including expectations of future events that may have a financial impact on the entity and that are believed to be reasonable under the circumstances.

(a) Recoverability and estimated impairment of trade receivables and contract assets

After 1 January 2018, the Group uses provision matrix to calculate ECL for the trade receivables and contract assets. The provision rates are based on past-due status of debtors as groupings of various debtors on this basis demonstrate similar loss patterns with shared credit risk characteristics. The provision matrix is based on the Group's historical default rates taking into consideration forward-looking information that is reasonable and supportable available without undue costs or effort. At each reporting date, the historical observed default rates are reassessed and changes in the forward-looking information are considered. In addition, trade receivables and contract assets with significant balances and credit impaired are assessed for ECL individually.

The provision of ECL is sensitive to changes in estimates. Where the actual future cash flows are less than expected, a material impairment loss may arise. As at 31 December 2018, the aggregate carrying amount of trade receivables and contract assets was HK$359,454,000, after a net of allowance for doubtful debts of HK$26,414,000.

Prior to 31 December 2017, when there is objective evidence of impairment loss, the Group takes into consideration the estimation of future cash flows. The amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). Where the actual future cash flows are less than expected, a material impairment loss may arise. As at 31 December 2017, the carrying amount of trade receivable was HK$333,940,000, after a net of allowance for doubtful debt of HK$24,916,000. Despite the lack of repayment track record, management considered there are no further impairment on these receivables as these customers are local government related bodies and have a solid financial background.

(b) Estimation of impairment of goodwill and intangible assets

The Group tests whether goodwill has suffered any impairment on an annual basis. The recoverable amount of a cash generating unit ("CGU") is determined based on value-in-use calculations which require the use of assumptions. The calculations use cash flow projections based on financial budgets approved by management covering a five-year period.

Details of impairment charge, key assumptions and impact of possible changes in key assumptions are disclosed in note 19.

(c) Estimation of the fair values of certain financial assets

The fair value of financial instruments that are not traded in an active market is determined using valuation techniques. The Group uses its judgement to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period. For details of the key assumptions used and the impact of changes to these assumptions see note 4.3(c).

(d) Revenue recognition

As explained in policy note 2.21, revenue from sales of super intelligent tracking system is recognised over time. Such revenue and profit recognition on uncompleted projects is dependent on estimating the total outcome of the contract, as well as the work done to date. Based on the Group's recent experience and the nature of the activities undertaken by the Group, the Group has made estimates of the point at which it considered the work was sufficiently advanced such that the outcome of the contract can be reasonably measured. Actual outcomes in terms of total cost or revenue may be higher or lower than estimated at the end of the reporting period, which would affect the revenue and profit recognised in future years as an adjustment to the amounts recorded to date.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

6 REVENUE AND SEGMENT REPORTING

(a) An analysis of the Group's revenue for the year is as follows:

	2018 HK$'000	2017 HK$'000
From continuing operations		
Revenue from contracts with customers within the scope of HKFRS 15		
Disaggregated by major products or service lines		
Revenue recognised at a point in time		
– Sales of "Cloud"	**14,929**	252,596
– Sales of chips	**105,044**	40,412
– Provision of wifi network equipment and installation services	**–**	8,213
– Provision of procurement services	**7,209**	–
Revenue recognised over time		
– Sales of super intelligent tracking system	**26,854**	–
– Provision of "Cloud" maintenance services	**4,370**	4,941
	158,406	306,162
Revenue from other sources		
Gross rental income from investment property	**–**	30
	158,406	306,192

(b) **Segment Information**

HKFRS 8 "Operating Segments" requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reviewed by the executive directors, the chief operating decision maker (the "CODM"), in order to allocate resources to the segments and to assess their performance.

The financial information provided to the CODM does not contain profit or loss information of each product line or each market segment and the CODM review the operating results of the Group on a consolidated basis. Therefore, the operation of the Group constitutes one single reportable segment and no further analysis of segments is presented.

Segment revenue and results

The financial information presented to the CODM is consistent with the consolidated statement of profit or loss. The CODM consider the Group's loss for the year as the measurement of the segment results.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

6 REVENUE AND SEGMENT REPORTING (Continued)

(b) Segment Information (Continued)

Geographical information

The Group operates so in four principal geographical areas – the People's Republic of China (excluding Hong Kong) (the "PRC"), Hong Kong, New Zealand and Canada.

Information about the Group's revenue from external customers is presented based on the location at which the goods delivered or the services were provided. Information about the Group's non-current assets is presented based on the geographical locations of the assets.

	Revenue from external customers		Non-current assets*	
	2018 HK$'000	2017 HK$'000	**2018 HK$'000**	2017 HK$'000
PRC	**46,153**	265,750	**417,181**	328,944
Hong Kong	**112,253**	40,442	**158**	1,210
New Zealand	**–**	–	**–**	12,060
Canada	**–**	–	**–**	15,956
	158,406	306,192	**417,339**	358,170

* Non-current assets exclude financial instruments, financial assets at fair value through other comprehensive income, available-for-sale financial assets and investments in associates. In 2017, partial long-term deposits and prepayments were also excluded.

Information about major customers

Revenues from customers contributing 10% or more of the total revenue of the Group for the years ended 31 December 2018 and 2017:

	2018 HK$'000	2017 HK$'000
Customer 1	**78,140**	–
Customer 2	**26,904**	–
Customer 3	**26,052**	–
Customer 4	**N/A#**	135,568
Customer 5	**N/A#**	116,197

\# The corresponding revenue did not contribute 10% or more of the total revenue of the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

7 OTHER INCOME

	2018 **HK$'000**	2017 HK$'000 (Restated)
From continuing operations		
Government grants	**2,057**	69,378
Dividend income from equity instruments at FVOCI	**549**	–
Sundry income	**3,410**	476
	6,016	69,854

8 OTHER GAINS, NET

	Notes	**2018** **HK$'000**	2017 HK$'000 (Restated)
From continuing operations			
Fair value changes of derivative financial assets	23	**–**	616,404
Exchange (loss)/gain, net		**(423)**	8,672
Gain on disposal of a subsidiary	39	**–**	84
Loss on disposal of plant and equipment		**(2,342)**	–
Loss on derecognition of swap right	23	**–**	(7,674)
Gain/(loss) on deemed disposal of subsidiaries	40	**34,359**	(18,091)
Impairment on available-for-sale financial assets	22	**–**	(23,270)
Others		**–**	(7)
		31,594	576,118

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

9 OPERATING (LOSS)/PROFIT

Operating (loss)/profit has been arrived at after charging:

	Notes	2018 HK$'000	2017 HK$'000 (Restated)
From continuing operations			
Employee benefit expenses	10	**153,471**	189,454
Cost of inventories sold		**137,810**	176,551
Cost of services		**1,753**	–
Amortisation of intangible assets		**6,147**	1,296
Amortisation of prepaid land lease payments	24	**2,341**	2,283
Auditor's remuneration			
– Audit services for the year		**1,803**	2,700
– Underprovision for the previous years		**999**	–
– Other services		**1,300**	–
Depreciation of property, plant and equipment		**7,538**	45,256
Operating lease rental on land and buildings		**27,588**	14,123
Impairment loss on loan receivables	28	**–**	24,746
Impairment loss on trade receivables	27	**107,513**	23,993
Impairment loss on contract assets	27	**7,884**	–
Impairment loss on prepayment and other receivables		**3,420**	5,140
Impairment loss on deposits for acquisition of plant and equipments	(a)	**35,565**	–

Note

(a) In prior years, the Group paid deposits of RMB18,000,000 (approximately HK$21,339,000) to a vendor for the Traveller project and the Group recorded the payments as deposits for acquisition of plant and equipment. However, the Group ceased the Traveller project in 2018 and the directors considered that all the capital expenditures relating to the Traveller project should be written off accordingly. In addition, the payable for the unpaid contract sum of RMB12,000,000 (approximately HK$14,226,000) under the contract was also recognised in 2018 according to the contract terms. Therefore, a total impairment loss of RMB30,000,000 (approximately HK$35,565,000) was provided in 2018.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

10 EMPLOYEE BENEFIT EXPENSES

	2018 HK$'000	2017 HK$'000 (Restated)
From continuing operations		
Salaries, wages and other benefits	**144,496**	152,154
Retirement benefits scheme contributions	**10,684**	10,227
Share options granted to directors and employees	**8,066**	33,188
	163,246	195,569
Less: capitalised portion	**(9,775)**	(6,115)
	153,471	189,454

	2018 HK$'000	2017 HK$'000 (Restated)
Represented in		
– Selling and distribution expenses	**23,868**	29,340
– Research and development expenses	**64,733**	109,964
– Administrative expenses	**64,870**	50,150
	153,471	189,454

Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year included three (2017: three) directors are reflected in the analysis shown in note 12. The emoluments payable to the remaining two (2017: two) individuals, who are neither a director nor chief executive of the Company, during the year were as follows:

	2018 HK$'000	2017 HK$'000
Salaries and other allowances	**2,227**	2,696
Discretionary bonuses	**869**	–
Retirement benefits scheme contributions	**47**	–
Share based payments	**158**	–
	3,301	2,696

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

10 EMPLOYEE BENEFIT EXPENSE (Continued)

Five highest paid individuals (Continued)

The number of the highest paid employees who are not the directors of the Company whose remuneration fell within the following bands is as follows:

	Number of Individuals	
	2018	2017
Nil - HK$1,000,000	**–**	–
HK$1,000,001 to HK$1,500,000	**1**	2
HK$1,500,001 to HK$2,000,000	**–**	–
HK$2,000,001 to HK$2,500,000	**1**	–
	2	2

11 FINANCE COSTS, NET

	2018 HK$'000	2017 HK$'000 (Restated)
From continuing operations		
Finance income		
Interest income:		
– Short term and time deposits	**2,946**	9,681
– Loans to third parties	**–**	1,677
– Loan to the related parties (note 38)	**1,489**	1,741
	4,435	13,099
Finance costs		
Interest expenses:		
– Bank and other borrowings	**(29,764)**	(27,484)
– Convertible debenture	**–**	(37)
	(29,764)	(27,521)
Amounts capitalised	**6,072**	6,151
Finance costs	**(23,692)**	(21,370)
Finance costs, net	**(19,257)**	(8,271)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

12 BENEFITS AND INTERESTS OF DIRECTORS

Directors' and chief executive's emoluments

The remuneration of each director and chief executive is set out below:

For the year ended 31 December 2018

	Fees HK$'000	Salary and other allowance HK$'000	Discretionary bonus HK$'000	Retirement benefits scheme contributions HK$'000	Share-based payments HK$'000	Total HK$'000
Executive Directors						
Dr. Liu Ruopeng ("Dr. Liu R"), Chairman	949	–	733	–	–	1,682
Dr. Zhang Yangyang, Co-Chief Executive Officer	889	–	546	–	466	1,901
Dr. Luan Lin, Co-Chief Executive Officer	830	–	546	–	460	1,836
Mr. Dorian Barak	1,175	–	–	–	132	1,307
Non-executive Directors						
Mr. Ko Chun Shun, Johnson (resigned on 16 November 2018)	219	–	–	–	–	219
Mr. Song, Dawei (resigned on 1 August 2018)	146	–	–	–	–	146
Independent Non-executive Directors						
Dr. Liu Jun	250	–	–	–	–	250
Dr. Wong Kai Kit	250	–	–	–	–	250
Ms. Cao Xinyi	250	–	–	–	–	250
	4,958	–	1,825	–	1,058	7,841

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

12 BENEFITS AND INTERESTS OF DIRECTORS (Continued)

Directors' and chief executive's emoluments (Continued)

For the year ended 31 December 2017

	Fees HK$'000	Salary and other allowance HK$'000	Discretionary bonus HK$'000	Retirement benefits scheme contributions HK$'000	Share-based payments HK$'000	Total HK$'000
Executive Directors						
Dr. Liu R., Chairman	923	–	694	–	–	1,617
Dr. Zhang Yangyang, Co-Chief Executive Officer	865	–	347	–	3,622	4,834
Dr. Luan Lin, Co-Chief Executive Officer	808	–	463	–	2,813	4,084
Mr. Dorian Barak	1,068	–	–	–	476	1,544
Non-executive Directors						
Mr. Ko Chun Shun, Johnson*	–	–	–	–	–	–
Mr. Song, Dawei (appointed on 1 February 2017)	229	–	–	–	–	229
Independent Non-executive Directors						
Dr. Liu Jun	250	–	–	–	–	250
Dr. Wong Kai Kit	250	–	–	–	–	250
Ms. Cao Xinyi	250	–	–	–	–	250
	4,643	–	1,504	–	6,911	13,058

* re-designated from an executive director to a non-executive director with effect from 16 May 2017

Neither the chief executives nor any of the directors waived or agreed to waive any emoluments during the years ended 31 December 2018 and 2017.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

12 BENEFITS AND INTERESTS OF DIRECTORS (Continued)

No emoluments have been paid by the Group to any of the directors of the Company and the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office during the year (2017: Nil).

Save as disclosed in note 38, no other transactions, arrangements and contracts of significance in relation to the Group's business to which the Company's subsidiary was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the years or at any time during the years.

13 INCOME TAX EXPENSE

	2018	2017
	HK$'000	HK$'000
From continuing operations		
Current income tax		
PRC Corporate Income Tax		
– Current year	**–**	6,511
– Under-provision in prior years	**3,452**	253
	3,452	6,764
Deferred income tax (note 33)	**–**	92,461
Income tax expenses	**3,452**	99,225

Hong Kong profits tax is calculated at 16.5% of the estimated assessable profits for the year (2017: 16.5%).

PRC subsidiaries are subject to PRC Corporate Income Tax ("CIT") at 25% except for a PRC subsidiary established in Qianhai and another PRC subsidiary under High and New Technology Enterprise that are subject to a reduced preferential CIT rate of 15% for 3 years from 2016 to 2019 according to the applicable CIT Law.

Prima facie tax in New Zealand is calculated at a rate of 28% of the estimated assessable profits for the year ended 31 December 2018 (2017: 28%). Statutory tax in Canada is calculated at a rate of 26.5% of the estimated assessable profits for the year ended 31 December 2018 (2017: 26.5%). No current tax was provided in these jurisdictions for the year ended 31 December 2018 as there were no assessable profits (2017: Nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

13 INCOME TAX EXPENSE (Continued)

The tax charge for the year can be reconciled to the (loss)/profit before tax per the consolidated statement of profit or loss as follows:

	2018 HK$'000	2017 HK$'000 (Restated)
From continuing operations		
(Loss)/profit before tax	**(429,995)**	283,471
Tax at Hong Kong tax rate of 16.5%	**(70,949)**	46,773
Tax effect of different tax rates of subsidiaries operations in other jurisdictions and region	**(6,454)**	(9,033)
Expenses not deductible for tax purposes	**41,378**	42,121
Income not taxable for tax purposes	**(10,823)**	(19,016)
Tax losses not recognised	**46,972**	38,127
Tax effect of temporary differences not recognised	**131**	–
Utilisation of tax losses previously not recognised	**(255)**	–
Under-provision in prior years	**3,452**	253
Income tax expense	**3,452**	99,225

14 DISCONTINUED OPERATION

At a special meeting of shareholders of Martin Aircraft Company Limited ("MACL") held on 1 May 2018, the shareholders approved the removal of MACL from the official list of the Australian Securities Exchange (the "ASX") and the delisting of its ordinary shares. As part of the delisting process, MACL has arranged to transition its shares to the USX (a New Zealand unlisted share trading platform) to allow shareholders to continue to trade their shares. MACL was delisted from ASX on 4 June 2018 and the trading of MACL's shares on USX commenced on 7 June 2018.

During the year, MACL faced difficulties in developing its products into commercial use and all business operations were stopped in late 2018. Therefore, MACL was classified as a discontinued operation.

The comparative figures in the consolidated statement of profit or loss and the consolidated statement of comprehensive income have been restated to re-present the Jetpack business operation as a discontinued operation.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

14 DISCONTINUED OPERATION (Continued)

The operating results of the discontinued operation were as follows:

	2018 HK$'000	2017 HK$'000
Revenue	**–**	–
Other income	**171**	13
Other (losses)/gains, net	**–**	190
Loss on disposal of property, plant and equipment	**(858)**	–
Impairment loss on intangible assets	**–**	(162,791)
Impairment loss on property, plant and equipment	**(10,020)**	–
Impairment loss on prepayment and other receivables	**(2,739)**	–
Write-down of inventories	**(1,628)**	–
Research and development expenses	**(23,640)**	(18,073)
Selling and distribution expenses	**(434)**	(1,634)
Administrative expenses	**(25,255)**	(36,918)
Impairment loss on goodwill	**–**	(32,364)
Operating loss	**(64,403)**	(251,577)
Finance income	**234**	765
Finance costs	**–**	(46)
Finance income, net	**234**	719
Loss before tax	**(64,169)**	(250,858)
Income tax expense	**–**	–
Loss for the year from discontinued operation	**(64,169)**	(250,858)
Net operating cash outflow	**(14,632)**	(57,828)
Net investing cash outflow	**(1,047)**	(3,835)
Net financing cash inflow	**–**	–
Net cash outflow	**(15,679)**	(61,663)

No tax charge or credit arose on the discontinued operation.

Basic and diluted loss per share from the discontinued operation is HK$0.52 cents (2017: basic and diluted loss per share of HK$2.14 cents), based on the loss for the year attributable to owners of the Company from the discontinued operation of approximately HK$32,391,000 (2017: loss of approximately HK$130,471,000) and the weighted average number of 6,156,929,000 shares (2017:6,110,545,000 shares).

The computations of diluted loss per share does not assume the exercise of the outstanding shares options issued since the assumed exercise would result in a decrease in loss per share.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

15 (LOSS)/EARNINGS PER SHARE

From continuing operations

The calculation of the basic and diluted (loss)/earnings per share attributable to the shareholders of the Company is based on the following data:

(Loss)/earnings figures are calculated as follows:

	2018 HK$'000	2017 HK$'000
(Loss)/profit for the year attributable to owners of the Company	**(457,609)**	66,051
Add: Loss for the year from discontinued operation	**32,391**	130,471
(Loss)/profit for the purpose of basic and diluted (loss)/earnings per share from continuing operations	**(425,218)**	196,522

	2018 '000	2017 '000
Number of shares		
Weighted average number of ordinary shares for the purpose of basic (loss)/earnings per share	**6,156,929**	6,110,545
Effect of dilutive potential ordinary shares:		
Share options of the Company	**–**	27,677
Weighted average number of ordinary shares for the purpose of diluted (loss)/earnings per share	**6,156,929**	6,138,222

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

15 (LOSS)/EARNINGS PER SHARE (Continued)

From continuing operations and discontinued operations

The calculation of the basic and diluted (loss)/earnings per share from continuing and discontinued operations attributable to owners of the Company is based on the following data:

	2018 HK$'000	2017 HK$'000
(Loss)/earnings		
(Loss)/profit for the year attributable to owners of the Company	**(457,609)**	66,051

For the year ended 31 December 2018

The computation of diluted loss per share does not assume the exercise of the outstanding shares options issued since the assumed exercise would result in a decrease in loss per share.

For the year ended 31 December 2017

The share options granted by the Company have potential dilutive effect on the earnings per share. Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding by the assumption of the conversion of all potential dilutive ordinary shares arising from share options, granted by the Company (collectively forming the denominator for computing the diluted EPS). No adjustment is made to earnings (numerator).

In addition, the preferred shares granted by the Company's non-wholly owned subsidiaries and associates, and the convertible bonds of the subsidiaries could have potential dilutive effect on the earnings per share. During the year ended 31 December 2017, these share options, preferred shares and convertible bonds had anti-dilutive effect to the Company and its subsidiaries and associates.

16 DIVIDEND

No dividend was paid or proposed during the year ended 31 December 2018, nor has any dividend been proposed since the end of the reporting period (2017: Nil).

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For the year ended 31 December 2018

17 PROPERTY, PLANT AND EQUIPMENT

	Plant and machinery HK$'000	Furniture and fixture HK$'000	Office equipment HK$'000	Leasehold improvements HK$'000	Motor vehicles HK$'000	Construction in progress HK$'000	Total HK$'000
COST							
At 31 December 2016 and 1 January 2017	47,715	561	10,133	7,079	5,846	90,739	162,073
Additions	4,546	17	8,823	5,439	634	125,189	144,648
Transferred to plant and machinery	33,679	–	–	–	–	(33,679)	–
Disposals	(118)	–	(356)	(405)	(606)	–	(1,485)
Disposal through deemed disposal of a subsidiary	(24,067)	–	(1,662)	(440)	–	–	(26,169)
Currency translation differences	3,771	39	675	453	354	9,184	14,476
At 31 December 2017	65,526	617	17,613	12,126	6,228	191,433	293,543
At 1 January 2018	**65,526**	**617**	**17,613**	**12,126**	**6,228**	**191,433**	**293,543**
Additions	**229**	**–**	**5,823**	**205**	**228**	**110,061**	**116,546**
Disposals	**(41,212)**	**(387)**	**(1,587)**	**(3,539)**	**(63)**	**–**	**(46,788)**
Disposal through deemed disposal of a subsidiary	**–**	**–**	**(1,068)**	**(222)**	**–**	**–**	**(1,290)**
Currency translation differences	**(1,754)**	**(14)**	**(783)**	**(445)**	**(265)**	**(14,273)**	**(17,534)**
At 31 December 2018	**22,789**	**216**	**19,998**	**8,125**	**6,128**	**287,221**	**344,477**
ACCUMULATED DEPRECIATION AND IMPAIRMENT							
At 31 December 2016 and 1 January 2017	4,757	242	3,864	1,850	1,925	–	12,638
Depreciation	40,452	178	6,195	3,137	1,130	–	51,092
Disposals	(72)	–	–	–	(28)	–	(100)
Disposal through deemed disposal of a subsidiary	(1,146)	–	(310)	(440)	–	–	(1,896)
Provision for impairment	1,230	–	–	–	–	–	1,230
Currency translation differences	1,687	21	238	81	143	–	2,170
At 31 December 2017	46,908	441	9,987	4,628	3,170	–	65,134
At 1 January 2018	**46,908**	**441**	**9,987**	**4,628**	**3,170**	**–**	**65,134**
Depreciation	**2,708**	**92**	**3,886**	**2,527**	**817**	**–**	**10,030**
Disposals	**(39,639)**	**(330)**	**(798)**	**(2,764)**	**(5)**	**–**	**(43,536)**
Disposal through deemed disposal of a subsidiary	**–**	**–**	**(314)**	**(146)**	**–**	**–**	**(460)**
Provision for impairment	**7,951**	**–**	**1,427**	**231**	**411**	**–**	**10,020**
Currency translation differences	**(999)**	**(11)**	**(297)**	**(203)**	**(173)**	**–**	**(1,683)**
At 31 December 2018	**16,929**	**192**	**13,891**	**4,273**	**4,220**	**–**	**39,505**
CARRYING AMOUNTS							
At 31 December 2018	**5,860**	**24**	**6,107**	**3,852**	**1,908**	**287,221**	**304,972**
At 31 December 2017	18,618	176	7,626	7,498	3,058	191,433	228,409

The construction in progress mainly represents building under construction for research and development purpose and for use as an office. As at 31 December 2018, the construction in progress with a carrying amount of HK$287,221,000 (2017: HK$191,433,000) was pledged for the banking facilities (note 32).

During the year ended 31 December 2017, the depreciation included one-off accelerated depreciation of HK$38,272,000 charged on a machinery. The economic benefit of the machinery was substantially consumed upon an experimental test.

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18 INTANGIBLE ASSETS AND GOODWILL

	Goodwill HK$'000	Capitalised development cost HK$'000	Software HK$'000	Technical knowhow and patents HK$'000	Total HK$'000
COST					
At 1 January 2017	80,945	107,848	5,711	125,218	319,722
Additions	–	25,091	47	241	25,379
Deemed disposal of a subsidiary	(39,382)	(28,554)	–	(47,436)	(115,372)
Currency translation differences	65	1,199	(1)	858	2,121
At 31 December 2017	41,628	105,584	5,757	78,881	231,850
At 1 January 2018	**41,628**	**105,584**	**5,757**	**78,881**	**231,850**
Additions	**–**	**–**	**–**	**15,612**	**15,612**
Deemed disposal of a subsidiary	**(9,264)**	**–**	**–**	**(7,018)**	**(16,282)**
Currency translation differences	**(1,641)**	**(1,226)**	**(67)**	**(2,293)**	**(5,227)**
At 31 December 2018	**30,723**	**104,358**	**5,690**	**85,182**	**225,953**
ACCUMULATED AMORTISATION AND IMPAIRMENT					
At 1 January 2017	39,382	–	3,817	20,433	63,632
Amortisation	–	–	540	4,774	5,314
Deemed disposal of a subsidiary	(39,382)	–	–	(7,710)	(47,092)
Provision for impairment	32,364	106,006	1,407	55,378	195,155
Currency translation differences	–	(422)	(7)	(168)	(597)
At 31 December 2017	32,364	105,584	5,757	72,707	216,412
At 1 January 2018	**32,364**	**105,584**	**5,757**	**72,707**	**216,412**
Amortisation	**–**	**–**	**–**	**6,147**	**6,147**
Deemed disposal of a subsidiary	**–**	**–**	**–**	**(1,986)**	**(1,986)**
Currency translation differences	**(1,641)**	**(1,226)**	**(67)**	**(1,870)**	**(4,804)**
At 31 December 2018	**30,723**	**104,358**	**5,690**	**74,998**	**215,769**
CARRYING AMOUNTS					
At 31 December 2018	**–**	**–**	**–**	**10,184**	**10,184**
At 31 December 2017	9,264	–	–	6,174	15,438

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For the year ended 31 December 2018

18 INTANGIBLE ASSETS AND GOODWILL (Continued)

Particulars regarding impairment testing on goodwill are disclosed in note 19.

Amortisation of HK$6,147,000 (2017: HK$5,314,000) is included in the consolidated statement of profit or loss within the 'Research and development expenses'.

19 IMPAIRMENT TEST FOR GOODWILL AND INTANGIBLE ASSETS

For the purposes of impairment testing, goodwill, technical know how and patents have been allocated to two individual CGU, being two groups of subsidiaries operating in development and commercialisation of jetpack products business ("Jetpack CGU") and SkyX unmanned aircraft business ("SkyX CGU").

The carrying amounts of goodwill (net of accumulated impairment losses) and certain technical knowhow and patents as at 31 December 2018 and 2017 allocated to these two CGUs are as follows:

	Goodwill		**Technical knowhow and patents**	
	2018 HK$'000	2017 HK$'000	**2018 HK$'000**	2017 HK$'000
Jetpack CGU	**–**	–	**–**	–
SkyX CGU	**–**	9,264	**–**	5,870
	–	9,264	**–**	5,870

The recoverable amount of the CGUs are determined based on value-in-use ("ViU") calculations. These calculations use pre-tax cash flow projections based on financial budgets approved by management covering a five year period. Cash flows beyond the five-year period are extrapolated using the perpetual growth rates. Management estimates the pre-tax discount rate that reflects market assessment of the time value of money and specific risk relating to the industry.

Jetpack CGU

Year ended 31 December 2018

During the year ended 31 December 2018, the business operations of Jetpack CGU were discontinued. The details of which are set out in note 14.

Year ended 31 December 2017

In 2017, management of the Company recognised provision for impairment of approximately HK$32,364,000 and approximately HK$162,791,000 to the goodwill and intangible assets of the Jetpack CGU respectively.

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19 IMPAIRMENT TEST FOR GOODWILL AND INTANGIBLE ASSETS (Continued)

In April 2017, MACL commenced product flight testing in respect of its jetpack products as the market is demanding for jetpack products that are certified. The current engine in MACL's jetpack products has proved sufficient for testing and demonstration purposes. However, after the flight test, the MACL management was of the view that the jetpack may not be able to obtain the relevant certification without further investment in improving the existing engine or adopting an alternative proven engine. This has resulted in greater uncertainty for funding of the commercial pathway given the existing financing means of MACL and the expected costs to complete the jetpack products. As such, provision for impairment was made to the relevant goodwill and intangible assets.

During the year ended 31 December 2017, the MACL management used ViU valuation methodology to determine its recoverable amount. Details and key assumptions of the impairment assessment, including but not limited to the growth rate and discount rate used in the valuation, MACL's publication on the Australian Securities Exchange was assessable via https://www.asx.com.au/index.htm for the full report. The ViU valuation methodology is developed through the application of the income approach technique known as the discounted cash flow ("DCF') method. Given the nature of the jetpack products in development phrase and the sector in which the Company and its subsidiaries operate, significant judgement is therefore required in determining inputs to the DCF valuation methodology.

The Company has engaged an independent valuer that is not connected with the Company and its subsidiaries to review the valuation model and assumptions adopted by the MACL management. Based on the assessment performed, the Board of the Company recognised a provision for impairment of goodwill and intangible assets related to the Jetpack CGU.

SkyX CGU

Year ended 31 December 2018

As disclosed in note 40, SkyX was derecognised as a subsidiary and become an associate of the Group on 9 August 2018, hence the corresponding goodwill and intangible assets had been derecognised since then.

Year ended 31 December 2017

The recoverable amount of the CGU is determined based on a ViU valuation methodology which uses cash flow projection based on financial budgets approved by the directors of the Company covering a five-year period, and a pre-tax discount rate of 28.71% per annum.

Assumed growth rate is used to extrapolate the cash flows in the following years. The financial budgets are prepared based on a five-year business plan which is appropriate after considering the sustainability of business growth, stability of core business developments and achievement of business targets. The financial model assumes an average growth rate of 2% per annum beyond the five-year period taking into account of long term gross domestic product growth, inflation rate and other relevant economic factors.

The directors assessed that no provision for impairment was recognised for the year ended 31 December 2017 as the recoverable amounts exceeded the carrying amounts, and the directors of the Company believe that any reasonably possible change in the key assumptions on which the recoverable amount is based would not cause the carrying amount of the CGUs to exceed the their recoverable amounts.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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20 INVESTMENTS IN ASSOCIATES

The following list contains the particulars of associates, all of which are unlisted corporate entities whose quoted market price is not available.

Name of entity	Country of incorporation/ registration and Principal place of business	Notes	Percentage of ownership interest 2018	2017	Principal activity	Carrying amount 2018 HK$'000	2017 HK$'000
SkyX Limited ("SkyX")	BVI/Canada	(a)	**53.2**	N/A	Development and commercialisation of SkyX aircrafts	**31,702**	N/A
Agent Video Intelligence Ltd. ("Agent VI")	Israel	(b)	**25.37**	25.37	Development of video analytics solutions	**29,644**	27,582
Solar Ship Inc. ("Solar Ship")	Canada	(c)	**37.77**	37.77	Development and commercialisation of solar power aircrafts	**–**	–
						61,346	27,582

(a) SkyX

	2018 HK$'000	2017 HK$'000
At 1 January	**–**	–
Fair value of retained interest	**40,825**	–
Share of loss and total comprehensive loss	**(9,123)**	–
At 31 December	**31,702**	–

On 9 August 2018, SkyX entered a preferred share purchase agreement with a new investor (the "Investors") pursuant to which SkyX agreed to issue new shares to the Investors and the Investors also acquired additional interests from existing shareholders. After the investment by the Investors, the Group's equity interest in SkyX was decreased from 64.92% to 53.2% After the appointment of the new director by the Investors, the Group was unable to control the board of SkyX and resulting in a loss in control over SkyX. Accordingly, the investment in SkyX was reclassified as interest in associate as at 31 December 2018. Details are set out in note 40(a).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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20 INVESTMENTS IN ASSOCIATES (Continued)

(b) Agent VI

	2018 **HK$'000**	2017 HK$'000
At 1 January	**27,582**	33,166
Share of profit/(loss) and total comprehensive income/(loss)	**1,783**	(5,687)
Currency translation differences	**279**	103
At 31 December	**29,644**	27,582

(c) Solar Ship

	2018 **HK$'000**	2017 HK$'000
At 1 January	**–**	–
Derecognition from a subsidiary to an associate	**–**	28,701
Share of loss and total comprehensive loss	**–**	(19,768)
Provision for impairment	**–**	(8,933)
At 31 December	**–**	–

Full provision for impairment on investment in Solar Ship of HK$8,933,000 was made during the year ended 31 December 2017 as the Board was of the view that the aforesaid investment was difficult to meet its development and business plan. The loans provided by the Group to Solar Ship of approximately HK$22,378,000 (note 28) were also impaired in the year ended 31 December 2017. After the preliminary assessment by the Board with reference to the latest available information, no reversal of the impairment was necessary as at 31 December 2018.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

21 FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	Notes	2018 HK$'000	2017 HK$'000
At 1 January		–	–
Reclassified from available-for-sale financial assets upon adoption of HKFRS 9	22	1,518,572	–
At 1 January (as restated)		1,518,572	–
Currency translation differences		(73,907)	–
Additions		13,364	–
Fair value loss		(620,783)	–
At 31 December		837,246	–
Representing:			
Listed equity securities	(a)	806,282	–
Unlisted equity securities	(b)	30,964	–
		837,246	–

Notes:

(a) Listed equity securities

As at 31 December 2018, the Group hold 71,528,751 (2017: 42,075,736) ordinary shares of Kuang-Chi Technologies Co., Ltd. ("KCT"), representing 3.32% (2017: 3.32%) of the issued ordinary shares of KCT. Shenzhen Kuang-Chi Hezhong Technology Limited, which is partially owned by the directors of the Company, Dr. Liu R and Dr. Luan Lin with shareholding of 35.09% and 15.79% respectively, holds more than 5% shareholding of KCT. KCT is a company listed on the Shenzhen Stock Exchange. The increase in the number of shares of KCT was resulted from a capital restructuring pursuant to which additional 7 ordinary shares were allotted for every 10 ordinary shares held during the year ended 31 December 2018. These investments are not held for trading, instead, they are held for long-term strategic purposes. The directors of the Company have elected to designate these investments in financial assets at FVOCI as they believe that recognising short-term fluctuations in these investments in profit or loss would not be consistent with the Group's strategy of holding these investments for long-term purposes and realising their performance potential in the long run.

(b) Unlisted equity securities

The unlisted equity investment represent the Group's equity interest in the private entities. Included in unlisted equity securities above is the Group's investment in Gilo Industries Group Limited ("Gilo"), a company incorporated in United Kingdom, with a carrying amount of approximately HK$17,600,000. The investment represents 19.14% equity interest in Gilo. Gilo is principally engaged in the research and development and manufacturing of aviation engines. The remaining balance of HK$13,364,000 was a financial instrument issued by SkyX that would be settled in a fixed number of shares of SkyX. The Group has elected to designate these investments as financial assets at FVOCI because the investments are held for long-term strategic purpose.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

22 AVAILABLE-FOR-SALE FINANCIAL ASSETS

	Notes	**2018 HK$'000**	2017 HK$'000
Listed security:			
– Equity security	(a)	–	1,420,811
Unlisted securities:			
– Equity securities		–	121,031
Less: provision for impairment	(b)	–	(23,270)
		–	97,761
		–	1,518,572

Notes:

(a) Upon the completion of subscription on 13 February 2017, the Group held 3.32% of the ordinary shares of KCT, while Shenzhen Kuang-Chi Hezhong Technology Limited, which is partially owned by the directors of the Company, Dr. Liu R. and Dr. Luan with shareholding of 35.09% and 15.79% respectively, held more than 5% of the shareholding of KCT.

(b) An equity security is considered to be impaired if there has been a significant or prolonged decline in the fair value below its cost. During the year ended 31 December 2017, provisions for impairment were made to the investment in Beyond Verbal of HK$23,270,000 and a loan to Beyond Verbal of HK$2,368,000.

The available-for-sale financial assets have been reclassified to financial assets at fair value through other comprehensive income upon the adoption of HKFRS 9 "Financial Instrument".

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

23 DERIVATIVE FINANCIAL ASSETS

	Share swap HK$'000	Right to subscribe for shares HK$'000 (note)	Total HK$'000
At 1 January 2017	7,674	791,238	798,912
Fair value changes recognised in the consolidated statement of profit or loss	–	616,404	616,404
Loss on derecognised upon expiry of underlying options	(7,674)	–	(7,674)
Derecognised upon exercise of subscription right	–	(1,419,691)	(1,419,691)
Currency translation differences	–	12,049	12,049
At 31 December 2017 and 2018	–	–	–

Note:

On 25 March 2015, the Group entered into a subscription agreement with Kuang-Chi Technologies Co., Ltd. ("KCT", formerly known as "Zhejiang Longsheng Auto Parts Co., Ltd. (浙江龍生汽車部件股份有限公司)), which is a company listed on the Shenzhen Stock Exchange. Pursuant to the subscription agreement, KCT conditionally agreed to issue, and the Group conditionally agreed to subscribe for 42,075,736 new shares of KCT at a consideration of approximately HK$345,000,000. On 11 November 2016, the Group obtained the approval from the China Securities Regulatory Commission for the subscription and the subscription right was then recognised as a derivative financial asset measured at fair value through profit or loss. As it was not a publicly traded financial instrument, a marketability discount rate applied when determining its fair value.

After satisfying all the conditions of the subscription agreement, the Group completed the subscription on 13 February 2017. As at 13 February 2017, the fair value of the derivative financial asset was approximately HK$1,419,691,000 and a fair value gain of approximately HK$616,404,000 was recognised in the consolidated statement of profit or loss upon subscription.

Subsequent to the completion of subscription on 13 February 2017, the Group hold approximately 3.32% of the equity interest of KCT. The directors of the Company consider there is no significant influence over KCT and no right to appoint any director in KCT, so the investment in KCT was classified as available-for-sale financial assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

24 PREPAID LAND LEASE PAYMENTS

	2018 HK$'000	2017 HK$'000
At 1 January	**89,900**	85,785
Amortisation	**(2,341)**	(2,283)
Currency translation differences	**(4,564)**	6,398
At 31 December	**82,995**	89,900
Current portion	**(2,248)**	–
Non-current portion	**80,747**	89,900

The prepaid land lease payments represented cost of land use rights in respect of land located in the PRC. The purpose of the leased land is to build a technology research centre to support the future technology business.

As at 31 December 2018, the prepaid land lease payments of HK$82,995,000 (2017: 89,900,000) was pledged against the bank borrowings of the Group (note 32).

25 INVENTORIES

	2018 HK$'000	2017 HK$'000
Raw materials	**2,588**	20,472
Finished goods	**1,412**	–
	4,000	20,472

The analysis of the amount of inventories recognised as an expense and included in profit or loss is as follows:

	2018 HK$'000	2017 HK$'000
Carrying amount of inventories sold	**126,544**	176,551
Write-down of inventories	**12,894**	–
	139,438	176,551

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26 CONTRACT ASSETS AND CONTRACT LIABILITIES

(a) Contract assets

	Note	31 December 2018 HK$'000	1 January 2018 HK$'000	31 December 2017 HK$'000
Arising from performance under service income of cloud	(i)	5,693	13,329	–
Arising from performance under made-to-order arrangements		9,531	–	–
		15,224	13,329	–
Less: allowance for expected credit loss		(626)	–	–
		14,598	13,329	–

Note:

(i) Upon the adoption of HKFRS 15, certain amounts previously included as "trade receivables" under "trade and other receivables" (note 27) were reclassified to contract assets as at 1 January 2018.

As at 31 December 2018, the amount of contract assets that is expected to be recovered after more than one year is HK$9,140,000 (2017 HK$6,004,000).

The movements in loss allowance account for contract assets is disclosed in note 27.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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26 CONTRACT ASSETS AND CONTRACT LIABILITIES (Continued)

(b) Contract liabilities

	Note	**31 December 2018 HK$'000**	1 January 2018 HK$'000	31 December 2017 HK$'000
"Cloud" maintenance services				
– Receipts in advance of performance	(i)	**4,043**	9,397	–

Note:

(i) Upon the adoption of HKFRS 15, amounts previously included as "receipts in advance" under "trade and other payables" (note 30) were reclassified to contract liabilities.

(ii) Movements in contract liabilities:

	2018 HK$'000
Balance at 1 January	**9,397**
Currency translation differences	**(286)**
Decrease in contract liabilities as a result of recognising revenue during the year that was included in the contract liabilities at the beginning of the year	**(5,068)**
Balance at 31 December	**4,043**

The amount of billings in advance of performance and forward sales deposits and instalments received expected to be recognised as income after more than one year is HK$Nil (2017: HK$4,263,000, which were included under "trade and other payables").

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27 TRADE AND OTHER RECEIVABLES

	Note	**31 December 2018 HK$'000**	1 January 2018 HK$'000	31 December 2017 HK$'000
Trade receivables	(a)	**370,644**	345,527	358,856
Less: allowance for expected credit loss	(d)	**(25,788)**	(24,916)	(24,916)
Trade receivables, net		**344,856**	320,611	333,940
Deposits and other receivables		**3,341**	17,893	17,893
Interest receivables	(b)	**3,636**	4,096	4,096
Prepayment for advertising		**–**	5,664	5,664
Prepayments to suppliers		**16,051**	38,282	38,282
Rental prepayments		**32,105**	19,463	19,463
		399,989	406,009	419,338
Less: impairment of prepayment and doubtful receivables		**(6,159)**	(5,338)	(5,338)
		393,830	400,671	414,000
Less: non-current portion		**(21,436)**	(12,859)	(12,859)
		372,394	387,812	401,141

Upon the adoption of HKFRS 15, some of trade receivables in relation to revenue contracts of maintenance service income of cloud were reclassified to contract assets as disclosed in note 26(a). The Group did not hold any collateral over these balances (2017: Nil).

Note:

(a) Included in the trade receivables of approximately HK$8,457,000 (2017: HK$9,678,000) represented the receivables arising from provision of wifi network equipment and installation services to a related company controlled by Dr. Liu Ruopeng.

(b) The interest receivable of HK$3,636,000 as at 31 December 2018 was due from a related company controlled by Dr. Lin Ruopeng as disclosed in note 28.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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27 TRADE AND OTHER RECEIVABLES (Continued)

(c) The following is an aging analysis of trade receivables presented based on date of revenue recognition and net of allowance as at 31 December 2018 and 2017:

	2018 HK$'000	2017 HK$'000
0-90 days	**120,593**	94,958
91-180 days	**11,650**	31,063
181-365 days	**25,617**	–
1 to 2 years	**84,791**	118,879
2 to 3 years	**102,205**	89,040
	344,856	333,940

(d) Movements in loss allowance account for the trade receivables and contract assets during the years ended 31 December 2018 and 2017 are as follows:

		2018			2017
	Notes	**Trade receivables HK$'000**	**Contract assets HK$'000**	**Total HK$'000**	Trade receivables HK$'000
At 1 January		**24,916**	**–**	**24,916**	–
Provision for impairment loss	(i)	**107,513**	**7,884**	**115,397**	23,993
Currency translation differences		**(5,262)**	**(312)**	**(5,574)**	923
Uncollectible amounts written off	(ii)	**(101,379)**	**(6,946)**	**(108,325)**	–
At 31 December		**25,788**	**626**	**26,414**	24,916

Notes:

(i) During the year ended 31 December 2018, the provision for impairment loss including the following:

- Additional ECL provision of HK$80,945,000 on trade receivables and HK$7,232,000 on contract assets which are mainly relating to two customers of the Group. Since the end of 2017, the Group had been continuously making regular contacts with these two customers for collection of the outstanding amount and received positive feedback from them. However, the market conditions in the PRC changed significantly in the last quarter of 2018. The Group faced difficulties in chasing these two customers for repayment and encountered difficulties in contacting them. The Group made telephone calls and demand letters but did not receive any positive responses from these two customers. Furthermore, the Group learned that the cloud products sold to these two customers were no longer operated. Given the non-payment of the outstanding payments notwithstanding the repeated demands for payments and the cloud products having become inoperable to these two customers as aforesaid, the Group was of the view that there was no reasonable expectation of recovering any outstanding payments from these two customers and therefore made a full impairment provision for the outstanding trade receivables and contract assets (i.e. approximately HK$80,673,000 and HK$7,232,000 respectively, and HK$87,905,000 in aggregate) in relation to these two customers in 2018.

- ECL provision for the year of HK$27,220,000 for trade receivables and contract assets based on historical loss data of the trade receivables adjusted with forward-looking information.

(ii) As the directors of the Company considered that the amounts of HK$108,325,000 of trade receivables and contract assets (mainly relating to the two customers as mentioned in note (a)) were uncollectible, the loss allowance of HK$108,325,000 (including the loss allowance of HK$24,916,000 brought forward from 2017) was written off in 2018.

(iii) Details of the Group's credit policy please refer to note 4.1.

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28 LOANS RECEIVABLES

	Notes	2018 HK$'000	2017 HK$'000
Loan to a related party	(a)	**9,731**	24,224
Loans to third parties	(b)	**2,368**	2,368
Loan to an associate	(c)	**22,378**	22,378
		34,477	48,970
Less: provision for impairment of loan receivables	(b), (c)	**(24,746)**	(24,746)
		9,731	24,224

Notes:

(a) The amount represented an advance to a potential investee, Zwipe AS. It is pledged with the patents of the borrower, interest bearing at 8% per annum and repayable within 24 months from the inception date. According to the terms of the loan agreement, the Company and its subsidiaries have the right to convert the loan into the borrower's shares at agreed conversion price if the borrower fails to reach certain milestones stated in the loan agreement. As the loan contains an embedded conversion option, the embedded conversion option is accounted for as a separate derivative as it meets the definition of a derivative, the risks and characteristics are not closely related to those of the loan and the loan is not measured at fair value through profit or loss. The directors of the Company consider that the fair value of this derivative is immaterial as the milestones are expected to be fulfilled. During the year ended 31 December 2017, the repayment date of the loan was revised to 12 November 2018 and the conversion right was cancelled.

Both Dr. Liu R (the controlling shareholder and executive director of the Company and its subsidiaries) and Huang Weizi (spouse of Dr. Liu R) are directors of Zwipe AS. In additions, Photon Future Limited, a company controlled by Dr. Liu R, holds approximately 20% shares of Zwipe AS, and agrees to provide financial support to the investee to settle this loan. On 1 September 2018, the Group entered into a revised loan agreement with Zwipe AS pursuant to which the repayment date was extended to 31 January 2019. The outstanding loan receivable of HK$9,731,000 was fully settled after the end of the reporting period.

The maximum outstanding balance for the loan receivable is HK$25,517,000 during the year ended 31 December 2018 (2017: HK$24,224,000).

(b) As at 31 December 2018 and 2017, the balance represented a loan to Beyond Verbal of HK$2,368,000, which is unsecured, interest bearing at 6% per annum and mature on 31 March 2018. The loan was fully impaired in 2017 as management considered the recoverability of the loans is remote. No repayment was made by Beyond Verbal during the year ended 31 December 2018.

(c) As at 31 December 2018 and 2017, the balance represented a loan to Solar Ship of HK$22,378,000, which is secured by all of the present and future undertaking and personal property of the associate. CAD2,500,000 (approximately HK$15,759,000) of the loan is interest-free and CAD1,050,000 (approximately HK$6,619,000) is interest-bearing at 10% per annum, both of which are repayable on demand.

During the year ended 31 December 2017, management recognised full provision for impairment to the loans to Solar Ship. No repayment was made by Solar Ship during the year ended 31 December 2018.

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29 CASH AND CASH EQUIVALENTS AND TIME DEPOSITS

	Note	**2018 HK$'000**	2017 HK$'000
Cash and cash equivalents	(a)	**429,611**	787,477
Time deposit	(b)	**–**	180,120
		429,611	967,597

Note:

(a) As at 31 December 2018, interest rates over bank deposits ranged from 0.01% to 0.35% (2017: 0.01% to 0.35%) per annum.

(b) As at 31 December 2017, interest rates over the time deposit ranged from 1.58% to 2.15% per annum and has an original maturity of more than three months but within one year.

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30 TRADE AND OTHER PAYABLES

	Notes	31 December 2018 HK$'000	1 January 2018 HK$'000	2017 HK$'000
Trade payables	(a)	**25,927**	48,661	48,661
Receipts in advance	(b)	**–**	–	9,397
Accrued employee benefits		**16,420**	22,192	22,192
Other tax payables	(c)	**15,018**	94,058	94,058
Other payables and accruals		**44,091**	9,449	9,449
Consideration payable for acquisition of non-controlling interest		**6,069**	–	–
Accrued construction costs		**33,614**	40,178	40,178
		141,139	214,538	223,935

Notes:

(a) The following is an aged analysis of trade payables presented based on the invoice date at the end of the reporting period.

	2018 HK$'000	2017 HK$'000
0-90 days	**4,057**	36,223
Over 90 days	**21,870**	12,438
	25,927	48,661

The average credit period on purchase of goods is 90 days. The Group has financial risk management policies in place to ensure that all payables are settled within the credit timeframe.

(b) As a result of the adoption of HKFRS 15, receipts in advance is included in contract liabilities as disclosed in note 26(b).

(c) At 31 December 2017, other tax payables mainly include value-added tax payable of HK$82,655,000 arising from sales of Clouds.

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31 DEFERRED GOVERNMENT GRANTS

At 31 December 2018, the balance represented deferred government grant of HK$22,430,000 (2017: HK$11,528,000) received from certain local governments. Local governments performed regular assessments on whether the attached conditions are properly fulfilled. Grants that have fulfilled the required conditions are recognised as "other income" in the consolidated statement of profit or loss.

32 BANK AND OTHER BORROWINGS

As 31 December 2018, the bank and other borrowings were as follows:

		2018			2017		
	Notes	**Current HK$'000**	**Non-Current HK$'000**	**Total HK$'000**	Current HK$'000	Non-Current HK$'000	Total HK$'000
Bank borrowings	(a)	**22,772**	**102,097**	**124,869**	35,238	–	35,238
Other borrowings	(b)	**–**	**341,580**	**341,580**	–	360,955	360,955
Total		**22,772**	**443,677**	**466,449**	35,238	360,955	396,193

As 31 December 2018, the Group's borrowings were repayable as follows:

	Bank borrowings		Other borrowings	
	2018 HK$'000	2017 HK$'000	**2018 HK$'000**	2017 HK$'000
Within 1 year	**22,772**	35,238	**–**	–
Between 1 and 2 years	**22,772**	–	**341,580**	–
Between 2 and 5 years	**79,325**	–	**–**	360,955
	124,869	35,238	**341,580**	360,955

Notes:

(a) Bank borrowings

As at 31 December 2018, the bank borrowings carried interest at a floating rate from 6.7% to 7.4% per annum (2017: 6.7% per annum) which was secured by the prepaid land lease payments and the construction-in-progress, amounting to HK$82,995,000 (2017: HK$89,900,000) and HK$287,221,000 (2017: HK$191,433,000) and was guaranteed by the Company and a company which is controlled by Dr. Liu R.

As at 31 December 2018, the total available banking facilities granted to the Group were HK$398,510,000 (2017: HK$420,280,000), of which HK$273,641,000 (2017: HK$385,042,000) were unutilised.

(b) Other borrowings

Other borrowings carried interest at a fixed rate of 6.5% per annum (2017: 6.5%). The other borrowings are secured by the Group's investment in KCT classified as financial assets at FVOCI with a carrying amount of HK$806,282,000 (2017: available-for-sale investment of HK$1,420,811,000) and guaranteed by the Company's shareholders and a company which is controlled by Dr. Liu R.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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33 DEFERRED TAXATION

The following is the major deferred tax liability recognised and movements thereon during the current and prior periods:

	Accelerated tax depreciation HK$'000	Fair value change of right of shares of KCT and investment in KCT's shares HK$'000	Fair value change of financial assets at FVOCI HK$'000	Total HK$'000
At 1 January 2017	(33)	(118,686)	–	(118,719)
Derecognised upon disposal of a subsidiary	33	–	–	33
Charge to the consolidated statement of profit or loss (note 13)	–	(92,461)	–	(92,461)
Credited to the other comprehensive income	–	64,067	–	64,067
Currency translation differences	–	(12,006)	–	(12,006)
At 31 December 2017	–	(159,086)	–	(159,086)
At 1 January 2018	**–**	**(159,086)**	**–**	**(159,086)**
Adoptions of HKFRS 9	**–**	**159,086**	**(159,086)**	**–**
At 1 January 2018 (restated)	**–**	**–**	**(159,086)**	**(159,086)**
Credited to the other comprehensive income	**–**	**–**	**81,140**	**81,140**
Currency translation differences	**–**	**–**	**8,241**	**8,241**
At 31 December 2018	**–**	**–**	**(69,705)**	**(69,705)**

As at 31 December 2018, the Group had unrecognised tax losses of approximately of HK$704,532,000 (2017: HK$428,521,000) available for offset against future profits. No deferred tax asset has been recognised for such losses due to the unpredictability of future profit streams. The tax losses in PRC may be carried forward for 5 years. The tax losses in Hong Kong and New Zealand have no expiry date. Unrecognised tax losses of HK$279,631,000 (2017: HK$210,300,000) have no expiry date, the remaining losses will expire at variable dates up to 2023.

Deferred income tax liabilities have not been recognised for the withholding tax that would be payable on the unremitted earnings of certain PRC subsidiaries of HK$Nil (2017: HK$72,144,000). Such amounts are expected to be permanently reinvested and not intended to be distributed to the shareholders outside the PRC in the foreseeable future.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

34 SHARE CAPITAL

	Number of shares	Equivalent to HK$'000
Ordinary shares		
Authorised:		
Ordinary shares of HK$0.01 each at 1 January 2017 and 31 December 2017 and 2018	7,316,666,668	73,167
Issued and fully paid:		
At 1 January 2017	6,089,401,125	60,894
Issue of ordinary shares upon exercises of share options (note)	67,527,735	675
At 31 December 2017 and 2018	6,156,928,860	61,569

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. All ordinary shares rank equally with regard to the Company's residual assets.

Note:

During the year ended 31 December 2017, 67,527,735 shares were issued upon the exercise of share options. The exercise price was HK$1.604 per share and resulted in approximately HK$675,000 increase in share capital and HK$243,404,000 increase in share premium.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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35 OTHER RESERVES

	Share premium HK$'000	Available-for-sale financial assets reserve HK$'000	Financial assets at fair value through other comprehensive income reserve HK$'000	Capital reserve HK$'000 (note a)	Contributed surplus HK$'000 (note b)	Share-based payment reserve HK$'000 (note c)	Exchange translation reserve HK$'000	Total HK$'000
At 1 January 2017	2,096,146	–	–	(6,301)	103,941	141,056	(106,394)	2,228,448
Currency translation differences	–	–	–	–	–	–	129,034	129,034
Fair value changes of available-for-sale financial assets, net of deferred tax	–	(363,041)	–	–	–	–	–	(363,041)
Other comprehensive (loss)/income for the year	–	(363,041)	–	–	–	–	129,034	(234,007)
Total comprehensive (loss)/income for the year	–	(363,041)	–	–	–	–	129,034	(234,007)
Exercise of share option (note 34)	243,404	–	–	–	–	(135,765)	–	107,639
Change in shareholding in existing subsidiary without losing control upon exercise of underlying options	–	–	–	(217)	–	–	–	(217)
Share-based payment compensation	–	–	–	–	–	33,188	–	33,188
Deemed disposal of a subsidiary	–	–	–	24,201	–	–	–	24,201
At 31 December 2017	2,339,550	(363,041)	–	17,683	103,941	38,479	22,640	2,159,252
At 31 December 2017 as originally presented	2,339,550	(363,041)	–	17,683	103,941	38,479	22,640	2,159,252
Adoption of HKFRS 9	–	363,041	(363,041)	–	–	–	–	–
At 1 January 2018 as restated	2,339,550	–	(363,041)	17,683	103,941	38,479	22,640	2,159,252
Currency translation differences	–	–	–	–	–	–	(78,136)	(78,136)
Deemed disposal of a subsidiary	–	–	–	–	–	–	205	205
Fair value changes of financial assets at fair value through other comprehensive income, net of deferred tax	–	–	(539,643)	–	–	–	–	(539,643)
Other comprehensive loss for the year	–	–	(539,643)	–	–	–	(77,931)	(617,574)
Share-based payment compensation	–	–	–	–	–	8,066	–	8,066
Change in shareholding in an existing subsidiary without change of control	–	–	–	217	–	–	–	217
At 31 December 2018	2,339,550	–	(902,684)	17,900	103,941	46,545	(55,291)	1,549,961

Note:

(a) The balance of capital reserve represents the capital reserve arising from the Group's restructuring which took place in 1992.

(b) The balance of contributed surplus arose as result of the Company's capital reduction exercises which took place in the financial years of 2003 and 2006.

(c) The balance of share-based payment reserve represents share options granted on 26 August 2014 and 30 September 2015.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

36 RETIREMENT BENEFIT SCHEME CONTRIBUTIONS

The Group operates a Mandatory Provident Fund Scheme ("MPF" Scheme) for all qualifying employees in Hong Kong. The assets of the MPF Scheme are held separately from those of the Group in funds under the control of trustees. The Group contributes 5% of relevant payroll costs to the MPF Scheme, which is matched by employees. The total costs charged to the consolidated statement of profit or loss of approximately HK$75,000 for the year ended 31 December 2018 (2017: HK$88,000) represent retirement benefit contributions payable to the MPF Scheme by the Group.

The employees of the subsidiaries in the PRC and overseas are members of a state-managed retirement benefit scheme operated by the government of the PRC. The only obligation of the Group with respect to the retirement benefit scheme is to make the specified contributions. The total costs charged to the consolidated statement of profit or loss of approximately HK$10,609,000 for the year ended 31 December 2018 (2017: HK$10,139,000) represent retirement benefit contributions payable to this scheme by the Group.

37 SHARE-BASED PAYMENT TRANSACTIONS

Pursuant to an ordinary resolution passed at the special general meeting of the Company held on 31 July 2012, a share option scheme (the "Scheme") was adopted by the Company. The purpose of the Scheme is to enable the Company to provide incentive to participants in recognition of their contribution to the Group. The directors of the Company may offer to grant any employee or director of the Company or any adviser, consultant, agent, contractor, customers and supplier of any member of the Group or whom the Board in its sole discretion considers eligible for the scheme on the basis of his or her contribution to the Group.

On 26 August 2014, a total of 67,747,000 share options under the Scheme were granted (the "2014 Share Options"). On 30 September 2015, the Company modified the 2014 Share Options, and the exercise price was repriced from HK$5.386 to the then current market price of HK$1.604, together with an extended vesting period (the "2014 Repriced Options"). On 30 September 2015, a total of 70,000,000 new share options under the Scheme were granted (the "2016 Share Options"). The details of these share options are summarised as follows:

	% of the total share	2014 Share Options		2014 Repriced Options		2015 Share Options	
		Vesting period	Exercisable period	Vesting period	Exercisable period	Vesting period	Exercisable period
Tranche 1	33%	26 August 2014 to 26 August 2015	26 August 2015 to 25 August 2019	Immediately vested on 30 September 2015	30 September 2015 to 31 December 2017	30 September 2015 to 30 September 2016	30 September 2016 to 29 September 2019
Tranche 2	33%	26 August 2014 to 26 August 2016	26 August 2016 to 25 August 2019	30 September 2015 to 30 September 2016	30 September 2016 to 31 December 2017	30 September 2015 to 30 September 2017	30 September 2017 to 29 September 2019
Tranche 3	34%	26 August 2014 to 26 August 2017	26 August 2017 to 25 August 2019	30 September 2015 to 30 September 2017	30 September 2017 to 31 December 2017	30 September 2015 to 30 September 2018	30 September 2018 to 29 September 2019

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For the year ended 31 December 2018

37 SHARE-BASED PAYMENT TRANSACTIONS (Continued)

	2014 share option	2014 Repriced Options	2015 Share Options
Recognised as expenses for the year ended 31 December 2018 (HK$)	N/A	N/A	8,066,000
Recognised as expenses for the year ended 31 December 2017 (HK$)	N/A	23,838,125	9,349,345
Number of share options granted to executive directors of the Company	24,900,000	24,900,000	15,900,000
Number of share options granted to employees of the Company	42,847,000	42,637,000	54,100,000
Total number of share options granted	67,747,000	67,537,000	70,000,000
Exercise price (HK$)	5.386	1.604	1.604
Grant date/modification date	26 August 2014	30 September 2015	30 September 2015
Fair value on grant date (HK$)	115,074,000	N/A	46,545,000
Fair value on modification date (HK$)	14,182,000	36,271,000	N/A

The following table lists the inputs to the fair value as at 30 September 2015 of the 2014 Share Repriced Options and 2016 Share Options:

	2015 Share Options	2014 Repriced Options
Share price at the date of grant/modification (HK$)	1.59	1.59
Exercise price (HK$)	1.604	1.604
Expected volatility	56.28%	56.59%
Risk-free interest rate (%)	0.78%	0.77%
Exercise multiple	2.2-2.8	2.2-2.8
Expected dividend yield	Nil	Nil

The incremental fair value upon modification of HK$22,089,000 was calculated as the difference between the fair value of the 2014 Repriced Options and that of the 2014 Share Options, estimated as at 30 September 2015, being the date of the modification.

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37 SHARE-BASED PAYMENT TRANSACTIONS (Continued)

The following table discloses movements of the Company's share options held by employees and directors during the year:

Option type	Outstanding at 1 January 2018	Exercised during year	Forfeited during year	Outstanding at 31 December 2018
2015 Share Options	70,000,000	–	–	70,000,000
Total	70,000,000	–	–	70,000,000

Option type	Outstanding at 1 January 2017	Exercised during year	Forfeited during year	Outstanding at 31 December 2017
2014 Share Options/2014 repriced options	67,537,000	(67,527,735)	(9,265)	–
2015 Share Options	70,000,000	–	–	70,000,000
Total	137,537,000	(67,527,735)	(9,265)	70,000,000

The Group recognised an expense of approximately HK$8,066,000 for the year ended 31 December 2018 (2017: HK$33,188,000) in relation to share options granted by the Company, and an expense of approximately HK$Nil in relation to share options granted by its subsidiaries (2017: HK$236,000). The directors consider that the financial impact of the share-based payments granted by the subsidiaries is not material to the Group.

As at 31 December 2018, 70,000,000 (2017: 46,200,000) share options were exercisable and had remaining contractual life of 0.75 year (2017: 1.75 years).

38 RELATED PARTY TRANSACTIONS

(a) Immediate and ultimate holding company

In the opinion of the directors of the Company, its immediate holding company is New Horizon Wireless Technology Limited which is incorporated in the British Virgin Islands. Its ultimate holding company is Shenzhen Dapeng Kuang-Chi Lianzhong Technology Partnership which was established in the People's Republic of China. Its ultimate controlling party is Dr. Liu R., who is also an executive director of the Company.

(b) Related party balances

Details of the Group's balances with related parties are set out below:

	Note	2018 HK$'000	2017 HK$'000
Trade receivables			
– Photon Technology Limited ("Photon Technology")	38(c)(i)	**8,457**	9,678
Loan and interest receivables			
– Zwipe AS		**13,367**	24,224
– Solar Ship		**22,378**	22,378
Less: Impairment		**(22,378)**	(22,378)
		–	–

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38 RELATED PARTY TRANSACTIONS (Continued)

(c) Related party transactions

Name of parties	Nature of transactions	Note	2018 HK$'000	2017 HK$'000
Photon Technology	Provision of wifi network equipment and installation services	(i)	–	8,213
Zwipe AS	Interest income	(ii)	1,283	1,741
SkyX	Interest income		206	–

Notes:

(i) The director and controlling shareholder of the Company, Dr. Liu R., is a controlling shareholder of Photon Technology. The above transaction was conducted in the normal course of business of the Company and charged at terms mutually agreed by the parties concerned or in accordance with the terms of the underlying agreements, where appropriate.

(ii) The interest income was arisen from the loan advanced to Zwipe as disclosed in note 28. Both Dr. Liu R (the controlling shareholder and executive director of the Company) and Huang Weizi (spouse of Dr. Liu R) are directors of Zwipe AS. In addition, Photon Future Limited holds approximately 20% shares of Zwipe AS.

(d) Compensation of key management personnel

The remuneration of directors and other members of key management during the year were as follows:

	2018 HK$'000	2017 HK$'000
Salaries and other short-term benefits	7,185	7,873
Discretionary business	2,694	1,504
Retirement benefit scheme contributions	47	–
Share-based payments	1,216	6,911
	11,142	16,288

39 DISPOSAL OF A SUBSIDIARY

In February 2017, the Company has completed the disposal of the entire issued share capital of Fanda Pacific Limited ("Fanda Pacific"), a wholly owned subsidiary of the Company, to an independent third party, at a total consideration of HK$9,900,000. Fanda Pacific is principally engaged in property holding in Hong Kong. A gain on disposal of a subsidiary of HK$84,000 was recognised in the consolidated statement of profit or loss for the year ended 31 December 2017.

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40 DEEMED DISPOSAL OF SUBSIDIARIES

(a) SkyX

On 9 August 2018, the Company and a new investor (together, the "Investors") entered into a preferred share purchase agreement pursuant to which SkyX agreed to issue new shares to the Investors and the Investors also acquired additional interest from existing shareholders. After the investment by the Investors, the Group's equity interest in SkyX was decreased from 64.92% to 53.2% and only 2 out of 5 directors could be nominated by the Group. The Group was therefore unable to control the board of SkyX and resulting in a loss in control over SkyX.

The assets and liabilities of SkyX were deconsolidated from the Group's consolidated statement of financial position and the interest in SkyX has been accounted for as an associate using equity method. The fair value of the 53.2% retained interest in SkyX at the date on which the control was lost is regarded as the cost on initial recognition of the investment in SkyX as an associate.

(i) Details of the disposal were as follows:

	HK$'000
Fair value of retained interest held by the Group (note 20(a))	40,825
Goodwill	(9,264)
Net deficit disposed of	17,274
Non-controlling interest	(14,271)
Cumulative exchange difference in respect of the net assets of SkyX reclassified from equity to profit or loss	(205)
Gain on deemed disposal	34,359

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

40 DEEMED DISPOSAL OF SUBSIDIARIES (Continued)

(a) SkyX (Continued)

(ii) The carrying amounts of assets and liabilities as at the date of which control was lost were as follows:

	HK$'000
Intangible assets	5,032
Property, plant and equipment	830
Trade and other receivables and prepayments	269
Income tax recoverable	616
Cash and cash equivalents	5,302
Total assets	12,049
Trade payables	(2,558)
Other payables and accruals	(26,765)
Total liabilities	(29,323)
Net liabilities	(17,274)

(iii) An analysis of the net cash outflow of cash and cash equivalents in respect of deemed disposal of a subsidiary is as follows:

	HK$'000
Proceeds received in cash	–
Cash in subsidiary disposed of	(5,302)
Net cash outflow on deemed disposal	(5,302)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

40 DEEMED DISPOSAL OF SUBSIDIARIES (Continued)

(b) Solar Ship

On 3 April 2015, the Company and Solar Ship entered into an investment agreement, pursuant to which upon Solar Ship fulfilling certain conditions ("Solar Ship Conditions"), the Company will subscribe for 79,070 new common shares in Solar Ship, representing approximately 37.77% of the outstanding common shares in Solar Ship for consideration of CAD17,000,000. Also on the same day, the Company and Solar Ship entered into an option agreement, pursuant to which the Company was granted the option ("Option") exercisable by the Company during the period from the completion of Solar Ship Conditions to 15 October 2016 to subscribe for 116,279 additional common shares in Solar Ship for consideration of CAD25,000,000 (equivalent to approximately HK$156,158,000), which will result in the Company holding approximately 54.42% of the outstanding common shares in Solar Ship. The dilution effect of the convertible debenture and outstanding share options issued by Solar Ship is insignificant to the Company's shareholding in Solar Ship.

On 29 May 2015, the Solar Ship Conditions were fulfilled. As a result, the Company subscribed for 79,070 new common shares in Solar Ship at the subscription money of CAD17,000,000 (equivalent to approximately HK$106,085,000), representing 37.77% of the outstanding common shares of Solar Ship. During the year ended 31 December 2016, it is agreed between the Company and Solar Ship that the latest date for exercising the Option shall be extended from 15 October 2016 to 15 January 2017. As at 31 December 2016, the Company still had the right to exercise the Option. Accordingly, Solar Ship was still a subsidiary of the Company.

On 15 January 2017, the Company did not exercise the Option and hence the Option lapsed. The investment in Solar Ship was then derecognised from a subsidiary to an associate of the Company upon the expiry of the Option. A loss on deemed disposal of a subsidiary of approximately HK$18,091,000 was recognised in the consolidated statement of profit or loss for the year ended 31 December 2017.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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41 NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS

(a) Reconciliation of profit for the year to cash used in operations:

	Note	2018 HK$'000	2017 HK$'000
OPERATING ACTIVITIES			
(Loss)/profit before tax from continuing operations		**(429,995)**	283,471
Loss before tax from discontinued operation	14	**(64,169)**	(250,858)
(Loss)/profit before tax		**(494,164)**	32,613
Adjustments for:			
Depreciation of property, plant and equipment		**10,030**	51,092
Amortisation of intangible assets		**6,147**	5,314
Amortisation of prepaid land lease payments		**2,341**	2,283
Write-down of inventories		**12,894**	–
Dividend income		**(549)**	–
Finance income		**(4,669)**	(13,864)
Gain on disposal of a subsidiary		**–**	(84)
Loss on disposal of property, plant and equipment		**3,200**	350
Impairment loss recognised in respect of goodwill		**–**	32,364
Impairment loss recognised in respect of intangible assets		**–**	162,791
Impairment loss recognised in respect of property, plant and equipment		**10,020**	1,230
Loss upon derecognition of swap right		**–**	7,674
Impairment loss recognised in respect of available-for-sale financial assets		**–**	23,270
Provision for impairment of loan receivables		**–**	24,746
Impairment loss recognised in respect of investment in an associate		**–**	8,933
Impairment loss on trade receivables		**107,513**	23,993
Impairment loss on contract assets		**7,884**	–
Impairment loss on deposits for acquisition of plant and equipment		**35,565**	–
Impairment loss on prepayment and other receivables		**6,159**	5,140
Fair value changes of derivative financial assets		**–**	(616,404)
Finance costs		**23,692**	21,416
Share of results of associates		**7,340**	25,455
(Gain)/loss on deemed disposal of a subsidiary		**(34,359)**	18,091
Share-based payment expenses		**8,066**	35,502
Foreign exchange net		**22,460**	–
Operating cash flows before movements in working capital		**(270,430)**	(148,095)
Changes in inventories		**2,519**	121,436
Changes in trade and other receivables		**(104,099)**	88,294
Changes in contract assets		**(22,482)**	–
Changes in trade and other payables		**(75,152)**	(45,866)
Changes in contract liabilities		**4,043**	–
Changes in long-term deposits, prepayments and other receivables		**(9,243)**	(7,848)
Changes in deferred government grants		**11,499**	(65,215)
Cash used in operations		**(463,345)**	(57,294)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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41 NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS (Continued)

(b) Net cash inflow from disposal of a subsidiary comprises:

	2018 HK$'000	2017 HK$'000
Cash consideration received	–	9,900
Less: bank balances and cash disposed of	–	(804)
Net cash inflow from investing activities	–	9,096

(c) Net cash outflow from deemed disposal of a subsidiary comprises:

	2018 HK$'000	2017 HK$'000
Cash consideration received	–	–
Less: Cash and cash equivalent disposed of	(5,302)	(42,948)
Net cash outflow from investing activities	(5,302)	(42,948)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

41 NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS (Continued)

(d) Reconciliation of liabilities arising from financing activities

	Bank borrowings HK$'000	Other borrowings HK$'000	Consideration payable HK$'000	Total HK$'000
At 1 January 2017	264,147	–	–	264,147
Cash flows	(230,278)	346,890	–	116,612
Currency translation differences	1,304	13,349	–	14,653
Accrued interest	65	716	–	781
At 31 December 2017	35,238	360,955	–	396,193
At 1 January 2018	**35,238**	**360,955**	**–**	**396,193**
Cash flows	**94,480**	**–**	**(5,144)**	**89,336**
Currency translation differences	**(5,088)**	**(20,053)**	**–**	**(25,141)**
Accrued interest	**239**	**678**	**–**	**917**
Acquisition of non-controlling interests	**–**	**–**	**11,213**	**11,213**
At 31 December 2018	**124,869**	**341,580**	**6,069**	**472,518**

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42 OPERATING LEASES

At the end of the period, the Group had commitments for future minimum lease payments under non-cancellable operating leases which fall due as follows:

	2018 HK$'000	2017 HK$'000
Not later than 1 year	**3,692**	5,549
Later than 1 year and no later than 5 years	**2,640**	1,741
	6,332	7,290

As at 31 December 2018, operating leases related to factory and offices with lease terms of 1 to 3 years (2017: 1 to 2 years). The Group does not have an option to purchase the leased assets at the expiry of the lease period.

43 COMMITMENTS

	2018 HK$'000	2017 HK$'000
Significant capital expenditure contracted for at the end of the reporting period but not recognised as liabilities is as follows		
Property, plant and equipment	**204,788**	209,483
Financial commitments on an investment (note)	**–**	140,400

Note:

On 16 January 2017, the Group entered into an investment agreement with an investee. Pursuant to the agreement, the investment will be completed in three stages. The Group has completed the first stage during the year ended 31 December 2017 and such investment has been recognised as an unlisted available-for-sale financial asset as at 31 December 2017. In case the investee completes certain milestones before the agreed date set out in the investment agreement, the Group shall further subscribe for new and existing shares issued by the investee. As the investee was unable to complete the milestones before the agreed timetable, the Group was not obligated to subscribe the investee's shares and therefore there was no financial commitments as at 31 December 2018.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

44 PARTICULARS OF PRINCIPAL SUBSIDIARIES OF THE COMPANY

(a) Details of the Company's principal subsidiaries as at 31 December 2017 and 2018 are disclosed as follows:

The principal subsidiaries of the Group at 31 December 2018 and 2017 are set out below. They have share capital consisting solely of ordinary shares and potential ordinary shares that are held directly by the Group, and the proportion of ownership interests held equals the voting rights held by the Group.

Name of subsidiary	Place of incorporation	Principal place of business	Issued and fully paid share/ registered capital	Percentage of nominal value of issued share/registered capital directly held by the Company		Principal activities
				31 Dec 2018	31 Dec 2017	
Direct subsidiaries						
MACL	New Zealand	New Zealand	NZD39,304,595	**52.01%**	52.01%	Development and commercialisation of the Martin Jetpacks
SkyX@	BVI	Canada	USD6,000,000	**N/A**	64.92%	Development and commercialisation of SkyX aircrafts
Kuang Chi Science Holdings Limited	HK	HK	HK$1	**100%**	100%	Provision of administrative services
Indirect subsidiaries						
* Shenzhen Kuang Chi Space Technology Limited *深圳光啟空間技術有限公司	PRC	PRC	USD50,000,000	**100%**	100%	Provision of in-depth space services and other innovative technology business
* Dongguan Space Technology City Company Limited *東莞空間科技城實業有限公司	PRC	PRC	USD35,000,000	**100%**	100%	Provision of innovative technology business
* Dongguan Advanced Technology Institute *東莞前沿技術研究院	PRC	PRC	RMB10,000,000	**100%**	100%	Provision of innovative technology business
* Shenzhen Kuang-Chi Dream Technology Company Limited *深圳光啟夢想科技有限公司	PRC	PRC	USD70,000,000	**100%**	100%	Provision of in-depth space services and other innovative technology business
# Shenzhen Kuang-Chi Manned Space Technology Company Limited #深圳光啟載人空間技術有限公司	PRC	PRC	RMB40,000,000	**100%**	80%	Provision of in-depth space services and other innovative technology business
*Xian KuangChi Intelligent Technology Limited. *西安光啟智能技術有限公司	PRC	PRC	RMB10,000,000	**100%**	N/A	Provision of innovative technology business
*Chengdu KuangChi Space Technology Limited *成都光啟空間科技有限公司	PRC	PRC	RMB1,000,000	**100%**	N/A	Provision of innovative technology business
##Zhongjing KuangChi Science Technology (HK) Co., Limited 中京光啟科學技術(香港)有限公司	HK	HK	HK$5,000,000	**50%**	N/A	Trading of chips

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

44 PARTICULARS OF PRINCIPAL SUBSIDIARIES OF THE COMPANY (Continued)

(a) Details of the Company's principal subsidiaries as at 31 December 2017 and 2018 are disclosed as follows: (Continued)

Note:

None of the subsidiaries had any debt securities outstanding as at the end of the reporting period or at any time during the reporting period.

* A wholly-foreign-owned enterprise established under the PRC law. The English name is for identification purpose only.

\# Sino-foreign joint venture company under PRC law.

@ As at 9 August 2018, the Group lost its control over SkyX. The investment in SkyX was derecognised as a subsidiary and became an associate of the Group (note 40).

\## As the Group could nominate 3 out of 5 directors in the board. the directors of the Company are of the view that the Group has control over this subsidiary.

(b) During the year, the Group entered into agreements to acquire additional 20% equity interest in a subsidiary namely, 深圳光啟載人空間技術有限公司（"光啟載人"） from a non-controlling shareholder at a total consideration of RMB9,330,000 (equivalent to HK$11,213,000). The Group's interest in 光啟載人 is increased from 80% to 100% upon completion of the transaction. The increase in equity interest in 光啟載人 does not result in any changes of the Group's control over 光啟載人 and is accounted for as equity transaction. The surplus of HK$1,297,000 representing the difference between the consideration of HK$11,213,000 and the amount of non-controlling interest HK$9,916,000 was recorded in reserves.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

44 PARTICULARS OF PRINCIPAL SUBSIDIARIES OF THE COMPANY (Continued)

(c) Non-controlling Interests

Set out below is summarised financial information for each subsidiary that has non-controlling interests that are material to the Group for the year ended 31 December 2017. The amounts disclosed for each subsidiary are before inter-company eliminations No such information was disclosed for the year ended 31 December 2018 as there were no individual material non-controlling interests.

Summarised statement of financial position	**MACL**	**SkyX**
	2017	2017
	HK$'000	HK$'000
Current assets	38,867	7,826
Current liabilities	(21,528)	(15,346)
Current net assets/(liabilities)	17,339	(7,520)
Non-current assets	12,631	6,692
Non-current liabilities	–	–
Non-current net assets	12,631	6,692
Net assets/(liabilities)	29,970	(828)
Accumulated NCI	73,252	(7,584)

Summarised statement of comprehensive income	**MACL**	**SkyX**
	2017	2017
	HK$'000	HK$'000
Revenue	–	718
Loss for the year	(250,858)	(30,140)
Other comprehensive income	2,780	430
Total comprehensive loss	(248,078)	(29,710)
Loss allocated to NCI	(120,387)	(11,106)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

45 INFORMATION ABOUT THE STATEMENT OF FINANCIAL POSITION AND RESERVES OF THE COMPANY

Information about the statement of financial position of the Company at the end of the reporting period includes:

	Note	2018 HK$'000	2017 HK$'000
ASSETS AND LIABILITIES			
NON-CURRENT ASSETS			
Investment in subsidiaries		**407,346**	1,043,413
Amounts due from subsidiaries		**810,413**	874,022
Investment in associates		**73,991**	25,998
Financial assets at fair value through other comprehensive income		**13,364**	–
		1,305,114	1,943,433
CURRENT ASSETS			
Prepayment and other receivables		**4,299**	965
Loan receivables		**9,731**	24,230
Bank balances and cash		**61,349**	356,135
		75,379	381,330
CURRENT LIABILITIES			
Other payables and accruals		**2,938**	1,200
Amount due to a subsidiary		**178**	524
		3,116	1,724
NET CURRENT ASSETS		**72,263**	379,606
TOTAL ASSET LESS CURRENT LIABILITIES		**1,377,377**	2,323,039
CAPITAL AND RESERVES			
Share capital	34	**61,569**	61,569
Reserves		**1,315,808**	2,261,470
TOTAL EQUITY		**1,377,377**	2,323,039

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

45 INFORMATION ABOUT THE STATEMENT OF FINANCIAL POSITION AND RESERVES OF THE COMPANY (Continued)

Movement in reserves

	Share Premium HK$'000	Contributed surplus HK$'000	Accumulated losses HK$'000	Shares-based payment reserve HK$'000	Total HK$'000
At 1 January 2017	2,096,146	103,941	(160,601)	141,056	2,180,542
Loss and total comprehensive loss for the year	–	–	(59,899)	–	(59,899)
Exercise of share options	243,404	–	–	(135,765)	107,639
Share based compensation	–	–	–	33,188	33,188
At 31 December 2017	2,339,550	103,941	(220,500)	38,479	2,261,470
At 1 January 2018	**2,339,550**	**103,941**	**(220,500)**	**38,479**	**2,261,470**
Loss and total comprehensive loss for the year	**–**	**–**	**(953,728)**	**–**	**(953,728)**
Share based compensation	**–**	**–**	**–**	**8,066**	**8,066**
At 31 December 2018	**2,339,550**	**103,941**	**(1,174,228)**	**46,545**	**1,315,808**

46 COMPARATIVE FIGURES

The Group initially applied HKFRS 15 and HKFRS 9 at 1 January 2018. Under the transition methods chosen, comparative information is not restated. Further details of the changes in accounting policies are disclosed in note 3. Certain comparative figures for the consolidated statement of profit or loss and consolidated statement of comprehensive income have been restated due to the discontinued operation.

FIVE-YEAR FINANCIAL SUMMARY

CONSOLIDATED RESULTS

	Period ended 31 December	Year ended 31 December			
	2014	2015	2016	2017	**2018**
	HK$'000	HK$'000	HK$'000	HK$'000 (Restated)	**HK$'000**
Revenue	79,464	279,162	290,492	306,192	**158,406**
Profit (loss) before tax	(152,674)	42,982	737,464	283,471	**(429,995)**
Income tax expense	(861)	(14,761)	(140,430)	(99,225)	**(3,452)**
Profit (loss) for the year from continuing operations	(153,535)	28,221	597,034	184,246	**(433,447)**
Loss for the year from discontinued operation	–	(33,205)	(490)	(250,858)	**(64,169)**
Profit (loss) for the year	(153,535)	(4,984)	596,544	(66,612)	**(497,616)**
Attributable to:					
Owners of the Company	(153,535)	30,012	664,315	66,051	**(457,609)**
Non-controlling interest	–	(34,996)	(67,771)	(132,663)	**(40,007)**
	(153,535)	(4,984)	596,544	(66,612)	**(497,616)**

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	As at 31 December				
	2014	2015	2016	2017	**2018**
	HK$'000	HK$'000	HK$'000	HK$'000	**HK$'000**
Total assets	1,936,751	2,457,909	3,504,108	3,333,301	**2,148,823**
Total liabilities	(218,510)	(282,911)	(774,397)	(799,252)	**(716,908)**
	1,718,241	2,174,998	2,729,711	2,534,049	**1,431,915**
Share capital	34,061	57,137	60,894	61,569	**61,569**
Preferred share	10,733	3,757	–	–	**–**
Reserves	1,668,445	1,861,237	2,400,041	2,396,896	**1,328,482**
Equity attributable to owners of the Company	1,713,239	1,922,131	2,460,935	2,458,465	**1,390,051**
Non-controlling interest	5,002	252,867	268,776	75,584	**41,864**
Total equity	1,718,241	2,174,998	2,729,711	2,534,049	**1,431,915**

SUPPLEMENTAL INFORMATION

IMPAIRMENT LOSS ON TRADE RECEIVABLES AND CONTRACT ASSETS

The impairment loss on trade receivables of approximately HK$107.5 million and contract assets of approximately HK$7.9 million made during the year ended 31 December 2018 were in accordance with the Company and its subsidiaries' accounting policy on impairment as stipulated in note 2.11 (iv) and note 5 and further details in note 26 and note 27 to the consolidated financial statements and comprised: –

1) provision of trade receivables and contract assets from a customer in Dongguan, PRC ("Dongguan Customer") of approximately HK$21.6 million and approximately HK$3 million respectively;

2) provision of trade receivables and contract assets from a customer in Guizhou, PRC ("Guizhou Customer") of approximately HK$59 million and approximately HK$4.3 million respectively;

3) provision of trade receivables from other debtors of approximately HK$0.3 million; and

4) the expected credit loss of trade receivables and contract assets for the financial year ended 31 December 2018 of approximately HK$26.6 million and approximately HK$0.6 million.

The Dongguan Customer

The Company and its subsidiaries entered into a contract with the Dongguan Customer on 29 December 2015 in relation to the construction of an intelligent community system ("Dongguan Cloud Product"). The Dongguan Cloud Product has been delivered to the Dongguan Customer and a total of RMB145 million had been recognised as revenue in previous years. The Dongguan Cloud Product had been operating on a piece of land designated by the Dongguan Customer ("Dongguan Land"). The carrying amounts of trade receivable from the Dongguan Customer under the contract as at 31 December 2017 was approximately RMB20.8 million.

Since the end of 2017, the Company and its subsidiaries had been continuously making regular contacts with the Dongguan Customer for collection of the outstanding amount and received positive feedback from the Dongguan Customer. However, the market conditions in the PRC changed significantly in the last quarter of 2018. The Company and its subsidiaries faced difficulties in chasing the Dongguan Customer for repayment and encountered difficulties in contacting the Dongguan Customer. The Company and its subsidiaries made telephone calls and demand letters but did not receive any positive responses from the Dongguan Customer.

Furthermore, the Company and its subsidiaries learned that the Dongguan Land had violated certain PRC regulations and it must be reinstated to its original state within a prescribed time period. As a result, the Dongguan Cloud Product can no longer be operated on the Dongguan Land and, hence, is rendered inoperable to the Dongguan Customer.

Given the Dongguan Cloud Product having become inoperable to the Dongguan Customer and in view of the non-payment of the outstanding payments notwithstanding the repeated demands for payments as mentioned aforesaid, the Company and its subsidiaries were of the view that there is no reasonable expectation of recovering any outstanding payments from the Dongguan Customer and therefore made a full impairment provision during the year ended 31 December 2018 for the outstanding trade receivables and contract assets of approximately HK$24.6 million in aggregate, being the HK$ equivalent of RMB20.8 million in relation to the Dongguan Customer.

SUPPLEMENTAL INFORMATION

The Guizhou Customer

The Company and its subsidiaries entered into a contract with the Guizhou Customer on 29 December 2015 in relation to the construction of an intelligent city system ("Guizhou Cloud Product"). The Guizhou Cloud Product has been delivered to the Guizhou Customer and a total of RMB100.8 million had been recognised as revenue in previous years. The carrying amounts of trade receivable from the Guizhou Customer under the contract as at 31 December 2017 was approximately RMB53.4 million.

Since early 2017, the Company and its subsidiaries had been continuously making regular contacts with the Guizhou Customer for collection of the outstanding payments and received positive feedback from the Guizhou Customer. However, the market conditions in the PRC changed significantly in the last quarter of 2018. The Company and its subsidiaries faced difficulties in chasing the Guizhou Customer for repayment and encountered difficulties in contacting the Guizhou Customer. The Company and its subsidiaries made telephone calls and demand letters but did not receive any positive responses from the Guizhou Customer.

Furthermore, the Company and its subsidiaries were informed by the Airways Control Department of the PRC government in January 2019 that renewal for the permit to fly the Guizhou Cloud Product in the relevant airspace would not be granted as high-altitude flying operations would no longer be allowed in the relevant airspace. As a result, the Guizhou Cloud Product has become inoperable to the Guizhou Customer.

Given the Guizhou Cloud Product would become inoperable to the Guizhou Customer and based on the information available to the Company and its subsidiaries at the time when the financial information for the year ended 31 December 2018 was finalised and in view of the non-payment of the outstanding payments notwithstanding the repeated demands for payments as mentioned aforesaid, the Company and its subsidiaries were of the view that there is no reasonable expectation of recovering any outstanding payments from the Guizhou Customer and therefore made a full impairment provision during the year ended 31 December 2018 for the outstanding trade receivables and contract assets of approximately HK$63.3 million in aggregate, being the HK$ equivalent of RMB53.4 million in relation to the Guizhou Customer.

The transactions with the Dongguan Customer and the Guizhou Customer (collectively, the "Customers") in relation to the Dongguan Cloud Product and the Guizhou Cloud Product respectively were entered into in line with the Company's credit policy adopted in 2015 (the "Credit Policy").

Taking into account the distinctiveness of the Companies and its subsidiaries' products at the time, the Company and its subsidiaries have classified the customers into two major categories based on the customers' characteristics. The Customers are state-owned enterprises and meet the standards of "Grade A" customers whether in terms of reputation, repayment ability, and financial status. The Company has reviewed credit report and relevant shareholding background of the Customers.

The Credit Policy was formulated and adopted in 2015 when the Company and its subsidiaries' customer profile was more concentrated and relatively few in numbers. Since the adoption of the Credit Policy in 2015, the Company mainly engages in measures including verbal negotiations, telephone reminders and issuing demand letters in chasing for outstanding receivables and has not incurred significant financial loss in the past years. As such, the Company is of the view that the Credit Policy has been effective in controlling the Company's exposure to credit risks on trade receivables and the Company will review and amend the Credit Policy when necessary.

SUPPLEMENTAL INFORMATION

Regarding the possible actions which could be taken by the Company and its subsidiaries, including issuing demand letters, issuing formal lawyers' letters and instituting legal procedures, etc. the Company has sought professional advice from its PRC legal advisers in November 2018. However, the Company understood from its PRC legal advisers that, given the Customers are PRC government-related entities, there would be practical difficulties in litigating or enforcing against PRC government-related entities, such as the process would be long, the opportunity cost might be high and the final outcome might be uncertain and unpredictable, and further, considering the Company and its subsidiaries' major businesses being conducted in the PRC and PRC government-related entities being potential customers of the Company and its subsidiaries' products, the board of directors of the Company (the "Board") is therefore of the view that the issuing of formal lawyers' letters and the institution of legal procedures against PRC government-related entities may be overly aggressive and may harm or stale other business cooperation or opportunities now or in the future between the Company and its subsidiaries and the PRC local government in the circumstances.

In view of the above, the Company, having considered the advice of its PRC legal advisers, decided to issue demand letters only to the Customers and to maintain discussions with the Customers with a view to recovering the outstanding payments through amicable negotiations. Despite the Board has made full impairments of all the trade receivables and contract assets in relation to the Customers for the year ended 31 December 2018, the management of the Company has kept following up the outstanding payments with the Customers.

In relation to the Dongguan Customer, two executive directors of the Company visited the Dongguan Customer in mid-April 2019 to discuss the next steps in the repayment proposal and plan.

In relation to the Guizhou Customer, the Company understood that there has been a change of leadership in February 2019. As such, the Company is currently in communication with the municipal and local government to confirm the appropriate contact person(s) for the Guizhou Customer.

The Company continues to discuss and negotiate with the Customers with the aim of resolving the outstanding payment issues. Notwithstanding the Dongguan Cloud Product and the Guizhou Cloud Product having become inoperable, the Company believes that maintaining a good relationship with the Customers and the possibility of having future business opportunities would increase the chance of recovering the outstanding payments.

The preliminary plan is set out as follows:

- Invite the Dongguan Customer and the Guizhou Customer to Shanghai to survey and observe the New AI Product by June 2019 and July 2019 respectively

- Visit the Customers for preliminary discussions about the new cooperation project by August 2019

- Visit the Customers for in-depth discussions about the new cooperation project and the proposal of incorporating the payment of outstanding amounts in respect of the Dongguan Cloud Product and the Guizhou Cloud Product (as the case may be) into the new cooperation project by October 2019

- Visit the Customers to negotiate the specific terms of the new cooperation project and payment of the outstanding amounts in respect of the Dongguan Cloud Product and the Guizhou Cloud Product (as the case may be) by the end of 2019

SUPPLEMENTAL INFORMATION

Provision of trade receivables from other debtors

The Company and its subsidiaries have made impairment provision of trade receivables from other debtors of approximately HK$0.3 million for the year ended 31 December 2018 in accordance with the Company's credit policy and bad debt policy.

Expected credit loss

In accordance with HKFRS 9, the Company and its subsidiaries apply the simplified approach to provide for expected credit loss provisions on outstanding trade receivables and contract assets not otherwise written off at year end.

The expected credit loss of approximately HK$26.6 million in trade receivables was computed based on the outstanding trade receivables not otherwise written off of approximately HK$370.6 million as at 31 December 2018 multiplied by the expected credit loss rates which are calculated based on historical credit losses and adjusted for forward-looking information.

The expected credit loss of approximately HK$0.6 million in contract assets was computed based on the outstanding contract assets not otherwise written off of approximately HK$15 million as at 31 December 2018. The expected credit loss rates for trade receivables were used for calculating expected credit loss on contract assets, as the contract assets have substantially the same risk characteristics as the trade receivables.

IMPAIRMENT LOSS ON DEPOSIT FOR ACQUISITION OF PLANT AND EQUIPMENT

The impairment on deposit for acquisition of plant and equipment of approximately HK$35.6 million related to the Traveller project. The Traveller project is an experimental research and development ("R&D") initiative to develop near-space flying apparatus to tap into the space tourism market.

While the Company and its subsidiaries were developing the aerostat component for the Traveller project in-house, the Company and its subsidiaries have outsourced and entered into a contract with an independent third-party vendor in May 2015 to develop the near-space manned capsule component ("Manned Capsule") for a total contract sum of RMB30 million.

During 2015 to 2018, the Company and its subsidiaries had successfully applied for the relevant airspace permit and completed the R&D of flight capability test of the aerostat with near-space transportation of non-human life creature. The next stage of R&D would involve flight test of the Manned Capsule carrying human being(s).

The Manned Capsule was substantially completed by the vendor and has been stored in warehouse of the vendor since July 2018. The Company and its subsidiaries have already paid RMB18 million to the vendor in prior years, recorded as deposit paid for acquisition of plant and equipment, and accruals for the remaining contract sum of RMB12 million was made during the year ended 31 December 2018.

The flight test with the Manned Capsule would require a substantively much larger airspace than the flight test with non-human life creature. However, the Company was informed by the relevant PRC government authority that the relevant airspace permits necessary to accommodate the flight test for the Manned Capsule would not be granted. In the circumstances, the Traveller project cannot proceed further to the next stage of R&D.

Given the Manned Capsule was substantially completed and that the contract was not capable of further performance by the vendor due to the inability of obtaining airspace permit by the Company and its subsidiaries which are of no fault on the part of the vendor, the management of the Company is of the view that (i) the unpaid balance of RMB12 million should be recorded as payables for the year ended 31 December 2018; and (ii) the whole amount of RMB30 million relating to the Manned Capsule should be written off. Therefore, a total amount of HK$35.6 million (being the HK$ equivalent of RMB30million) was impaired and written off during the year ended 31 December 2018.