MANAGEMENT DISCUSSION AND ANALYSIS

FOUR SAFEGUARDS
Our commitment to providing customer services which exceed the national standard

BUSINESS OVERVIEW

China Paradise is one of the top three household appliances retail chain operators in China. With strong roots in Shanghai, the Group enjoys a leading position in Shanghai with a dominant 50% market share by sales value. Since its establishment in 1996, the Group has developed an extensive network through continuous organic expansion as well as selective acquisitions and has accumulated bountiful experience and established a strong foothold. The Group also achieved a leading position in the Yangtze River Delta region, the nation's most affluent and urbanised region. Currently, the Group's retail network covers markets such as the Pearl River Delta region, the Capital Economic Zone and Mid-Western China.

Our leading position has allowed us to achieve the following objectives:

- obtain competitive product pricing and after-sales service support from suppliers by leveraging on strong purchasing power;
- further strengthen brand awareness and customer loyalty and differentiate from competitors;
- offer value-added customer services through large customer base and insight into customer preference;
- achieve cost efficiencies in marketing, logistics and resources management;
- launch new products and marketing campaigns in an efficient and effective manner;
- open new stores in prime locations in order to reach a wide spectrum of customers; and
- attract and retain talented personnel.

MARKET POSITION

At present, the Group is a leading player in the household appliances retail market in major provinces and cities in China. In terms of sales, we are the largest household appliances chain retailer in Shanghai and Henan. We captured the largest market share in the Yangtze River Delta region and have a dominant position in Zhejiang and Fujian.

MARKET REVIEW

The growing affluence of local consumers brought about by China's rapid economic growth has fueled the demand for household appliances and consumer electronics products. According to the PRC State Information Centre, the retail sales of these products grew at a CAGR of 15%, from RMB296.9 billion in 2000 to RMB542.0 billion in 2005.

Despite the rapid increase in the sales of household appliances and consumer electronics products, the penetration rate of such products in China lags behind developed countries such as Japan, offering ample room for sustainable development. According to a forecast by the PRC State Information Centre, the market for household appliances and consumer electronics products is expected to grow steadily, with annual sales in 2010 reaching RMB951.5 billion.

This rapid growth in the household appliances and consumer electronics products market in China gives rise to the emergence of specialty retail stores for such products. As these specialty stores provide customers a wide selection of products complemented by superior customer services, they have accelerated the market shift from conventional sales outlets such as department stores and small independent retailers to specialty stores. According to the PRC State Information Centre, between 2000 and 2005, sales of household appliances and consumer electronics products via specialty retail stores grew at a remarkable CAGR of 45%. In 2005, 45% of all the household appliances and consumer electronics products was sold through specialty retail stores.

According to the statistics shown above, specialty retail stores will further replace conventional sales channels and this coupled with the continuous increase in purchasing power of domestic consumers mean there is considerable room for future development. The market has immense potential and the Group, leveraging on its leading position and invaluable experience gained in Shanghai and around the Yangtze River Delta region, is well-positioned to benefit from this positive trend.

REVIEW OF OPERATIONS

The directors and management team of the Group are committed to enhance operational efficiency. Maximizing the interests of shareholders has always been one of the most important considerations of the Group in its decision-making process. The evaluation of the Group's past performance was principally based on the following criteria, which also serve as indicators for our future business development:

- Expansion of retail outlet – to succeed in a competitive industry, the Group believes that extensive retail network and excellent brand name are indispensable. These two elements are complementary, as an excellent brand name facilitates penetration into new markets, and an extensive business network helps brand building. As a rapidly growing enterprise, the Group considers network expansion as our top priority and focuses on the development of potential markets especially those urbanised and affluent regions which the Group has already entered and other potential markets the Group intends to enter.

- Total return from suppliers – the Group's gross profit come directly from sales (i.e. the difference between the purchase price and retail price of goods) and the rebate and price subsidy from suppliers (net of inventory provision). The Group also receives sponsorship fees from suppliers. We adopt the "total return from suppliers" (percentage of the total sum of gross profit margin before provision for inventory and sponsorship fees to revenue) as an important measure of our supplier management capability and to clearly reflect the return from suppliers.

- Market share and net profit margin – the Group has experienced rapid expansion and established market leadership after years of development. Our market share reflects our position in such markets. At the same time, the Group also adopts a steady development strategy. Apart from turnover growth, cost control and ultimate profitability are also our objectives and net profit margin reflects our competitiveness.

The Group will report in the following sections under the Management Discussion and Analysis the performance of its business operations and analyze the management results based on the above indicators.

FINANCIAL HIGHLIGHTS

Pursuant to our proactive business expansion plan, our operation and financial performance have seen significant improvements. In the year under review, our consolidated turnover rose by 48.1% to RMB12,246,168,000; while our gross profit margin was maintained at 7.5%, a level slightly higher than the previous year. Our operating profit (before tax subsidy income). during the period increased by 6.6% to RMB243,863,000; profit attributable to shareholders increased by 55.9% to RMB289,474,000, exceeding the forecast in the Prospectus. Our earnings per share was RMB17.3 cents (approximately HK 16.3 cents).

FINAL DIVIDEND AND DIVIDEND POLICY

In view of the strong operational performance and sound financial position, the Board of Directors recommends that 20% and 10% of the profit attributable to equity holders for the year ended 31 December 2005 be distributed to shareholders as final dividends and special dividends respectively, and recommends the payment of a final dividend of HK2.6 cents per share and a special dividend of HK1.3 cents per share.

	Summarised income statement for the year ended 31 December		
	2005 (RMB million)	2004 (RMB million)	Change (%)
Revenue	**12,246**	8,267	48.1
Gross profit	**914**	583	56.9
Sponsorship fees	**625**	266	134.7
Total return from suppliers	**1,476**	893	65.3
Selling and distribution costs	**(1,097)**	(508)	115.8
Administrative expenses	**(260)**	(128)	103.5
Operating profit (excluding tax subsidy income)	**244**	229	6.6
Profit attributable to shareholders	**289**	186	55.9
Earnings per share (RMB cents)			
Basic	**17.3**	12.0	44.2
Diluted	**15.9**	11.8	34.7

	For the year ended 31 December	
	2005 (%)	2004 (%)
Gross profit margin	**7.5**	7.1
Total return from suppliers	**12.1**	10.8
Operating profit margin (excluding tax subsidy income)	**2.0**	2.8
Net profit margin	**2.4**	2.2

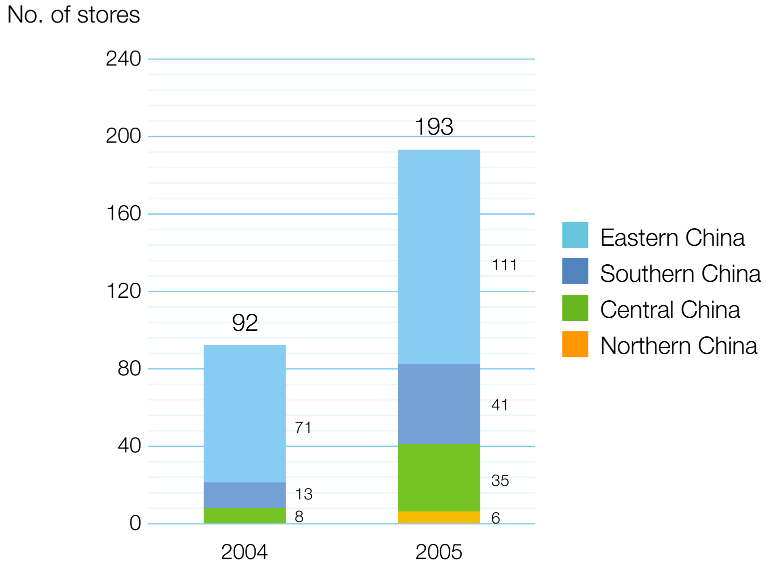
RETAIL NETWORK

The Group's strategy is to expand into major cities and regions with growth potential. In recent years, the Group grew rapidly through organic growth of existing business and selective acquisitions. In 2005, the increase in number of stores was in line with the management's expectation, from 92 in 2004 to 193 by the end of 2005, extending our network coverage from 34 cities in 2004 to 72 cities in 2005.

The Group has a total of 53 stores in Shanghai and continues to maintain a leading position in Shanghai, capturing a 50% share by sales value. We are also the leader in the Yangtze River Delta region with 108 stores, capturing a market share of 31%. In addition, the Group is the largest household appliances chain retailer in the Henan region and maintained a leading position in the Zhejiang and Fujian regions.

STORE DISTRIBUTION

The following diagram shows the geographical distribution of our stores in 2004 and 2005.



		For the year ended 31 December 2005		For the year ended 31 December 2004	
Region	Province/centrally-administered municipalities	**No. of cities covered**	**Total no. of stores**	No. of cities covered	Total no. of stores
Eastern China	Shanghai	1	53	1	37
	Jiangsu	24	33	15	17
	Zhejiang	16	22	13	17
	Anhui	2	3	–	–
	Subtotal	**43**	**111**	**29**	**71**
Southern China	Fujian	8	22	2	5
	Guangdong	6	19	2	8
	Subtotal	**14**	**41**	**4**	**13**
Central China	Sichuan	3	13	1	8
	Henan	9	20	–	–
	Shanxi	1	2	–	–
	Subtotal	**13**	**35**	**1**	**8**
Northern China	Beijing	1	3	–	–
	Tianjin	1	3	–	–
	Subtotal	**2**	**6**	–	–
Total		**72**	**193**	**34**	**92**

	For the year ended 31 December 2005	
City classifications	No. of cities	Total no. of stores
First tier	12	116
Second tier	34	49
Third tier	26	28
Total	**72**	**193**

NEW STORES OPENED IN 2005

Development by organic growth		
Region	Province/centrally-administered municipalities	Number of new stores
Eastern China	Shanghai	10
	Jiangsu	15
	Zhejiang	5
	Anhui	—
	Subtotal	**30**
Southern China	Fujian	3
	Guangdong	12
	Subtotal	**15**
Central China	Sichuan	1
	Henan	2
	Shanxi	2
	Subtotal	**5**
Northern China	Beijing	3
	Tianjin	3
	Subtotal	**6**
Total		**56**

Development by acquisitions and strategic alliance			
Type	Project	Region	Number of new stores
Acquisition of assets	Tsann Kuen	Shanghai/Jiangsu/Fujian	8
	Tongli	Henan	18
	Hongtai	Anhui	3
	Siwen	Fujian	7
Strategic alliance	Fujian Commercial Group	Minbei region of Fujian	5
Acquisition of strategic partner	Chengdu Tower	Sichuan	4
Total			**45**

The Group can expand its network rapidly and capture stores with prime location through careful selection of acquisition targets. The Group and its strategic partners are able to achieve a win-win situation in business development through formation of strategic alliances with other industry players.

Furthermore, Yongle (China) acquired the remaining 50% equity interest in Sichuan Yongle Electronics Retail Co., Ltd. ("**Sichuan Yongle**") from Chengdu Department Tower Household Appliances Chain Retailer Co. Ltd. ("**Chengdu Tower**"). Sichuan Yongle is a joint venture enterprise owned as to 50% by each of Yongle (China) and Chengdu Tower and had a total of 12 stores at the time of acquisition by Yongle (China).

STORE FORMAT

The Group has established a comprehensive retail network which covers the Eastern China region and is extending into other potential markets. Our stores can be divided into the following three categories:

- **Standardised stores:** normally with a floor area of approximately 2,000 sq. m. to 5,000 sq. m., which provide a wide array of household appliances and consumer electronics products for basic household needs of customers.
- **Mega stores:** large retail outlets that typically have a total floor area of 5,000 sq. m. to 12,000 sq. m.. They are designed to provide a more comprehensive shopping experience to customers and to enhance brand image.
- **Specialty stores:** small outlets with floor area of approximately 300 sq. m. to 500 sq. m. They are located in urban districts with heavy pedestrian flow. Specialty stores are mainly engaged in the sales of mobile phones and accessories, computers and digital products in order to satisfy the increasing demand of customers who wish to upgrade the technology and functionality of their existing products.

As at 31 December 2005, the number of standardised stores, mega stores and specialty stores was 183, 6 and 4 respectively, representing an increase of 93, 4 and 4 stores respectively over the previous year.

Store location is of paramount importance to the success of retailers. During the year under review, the Group re-assessed the performance of each of its stores. Those with unsatisfactory performance were relocated to areas where pedestrian flow is heavier. Such an adjustment contributed to more efficient deployment of staff and resources, and it helped to enhance our overall competitiveness.

	For the year ended 31 December 2005		
Region	Standardised stores	Mega stores	Specialty stores
Eastern China	103	4	4
Southern China	40	1	–
Central China	34	1	–
Northern China	6	–	–
Total number of stores	183	6	4
Single shop area (sq. m.)	2,000-5,000	5,000-12,000	300-500
Approximate total floor area (sq. m.)	657,333	73,567	2,015

TURNOVER ANALYSIS

Revenue

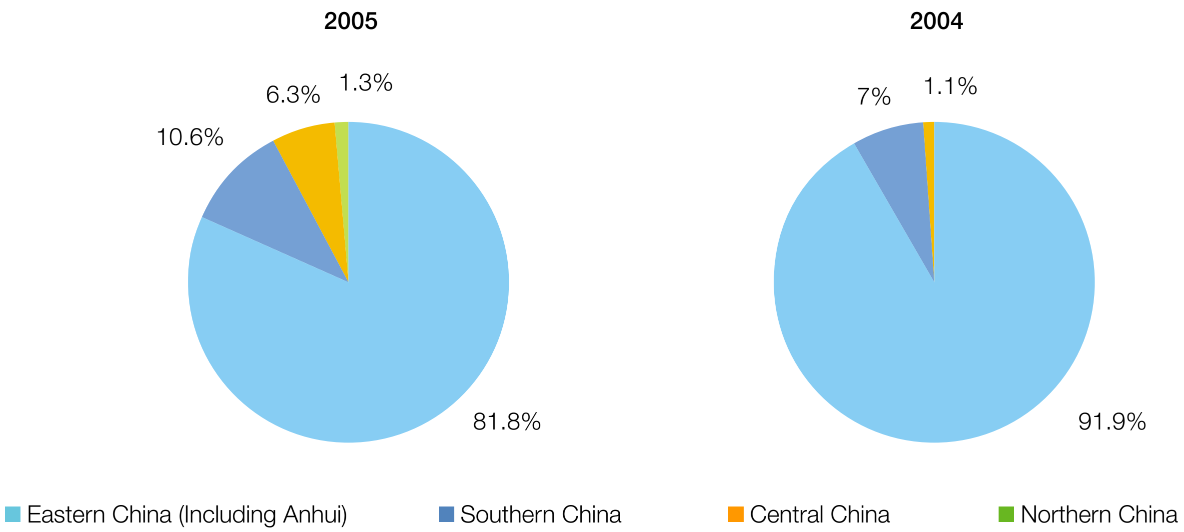
The Group's revenue mainly comes from the sale of household appliances and consumer electronics products. The Group also derives revenue from telephone service charges based on shared promotion scheme of mobile communication businesses. Revenue from sale of household appliances and consumer electronics products or provision of services represents the net invoiced value of goods sold or the value of services rendered, after allowances for goods returned and trade discounts, net of sales taxes and surcharges. Sales revenue for the year ended 31 December 2005 was RMB12,246,168,000, representing an increase of 48.1% from RMB8,266,956,000 for the year ended 31 December 2004. This was mainly attributable to the expanded retail network via organic growth and selective acquisitions. The number of retail stores of the Group increased from 92 for the year ended 31 December 2004 to 193 for the year ended 31 December 2005.

Geographical analysis

Geographically, the Group derived most of its revenue from Shanghai, Jiangsu and Zhejiang, its founding base, and the revenue from these markets in aggregate accounted for 81.8% of our turnover in 2005 with Shanghai continuing to be our major market. However, in view of our continuous growth in Jiangsu, Zhejiang, Guangdong and Sichuan, the percentage of revenue attributable to Shanghai decreased accordingly.

GEOGRAPHICAL BREAKDOWN OF REVENUE

The following diagrams illustrate the revenue of the Group in 2004 and 2005 attributable to different regions of China.



	For the year ended 31 December			
	2005		2004	
Revenue	**(RMB million)**	**Percentage of revenue (%)**	(RMB million)	Percentage of revenue (%)
Eastern China (Including Anhui)	**10,012**	**81.8**	7,598	91.9
Southern China	**1,302**	**10.6**	575	7.0
Central China	**775**	**6.3**	94	1.1
Northern China	**157**	**1.3**	–	–
Total	**12,246**	**100**	8,267	100

Product analysis

The Group values customers as our first priority and offers wide varieties of over 20,000 types of products.

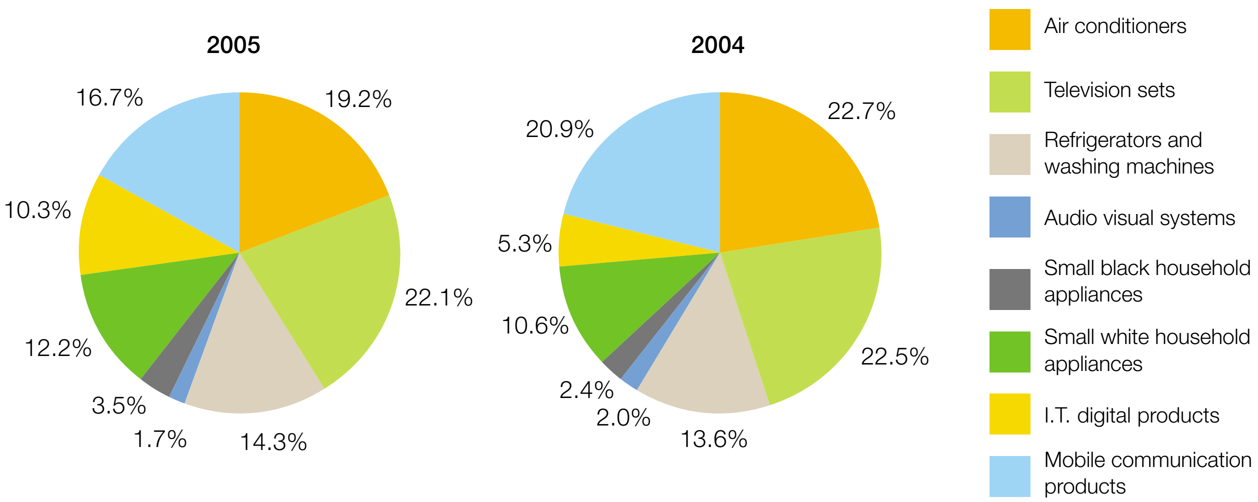
As for our product categories, most of them recorded significant growth.

Principal types of products of the Group

Categories	Type of products
Air conditioners	Air conditioners and air purifiers
Television sets	Televisions
Refrigerators and washing machines	Refrigerators and washing machines
Audio visual systems	Home entertainment systems and audio systems
Small black household appliances	DVD and VCD players, video tape recorders and hair dryers
Small white household appliances	Rice cookers, kettles, irons, microwaves, food processors, toasters, hoovers, dish-washers, corded and cordless phones and accessories, beauty appliances, ovens and water heaters
I.T. digital products	Desktop computers, laptop computers, monitors, printers, scanners, facsimile machines, MP3 players, handheld devices (PDAs), digital video recorders, digital cameras and accessories
Mobile communication products	Mobile handsets and accessories, mobile SIM cards, mobile communication services and phone cards

REVENUE BY PRINCIPAL PRODUCT LINES

The following diagrams illustrate the revenue of the Group for 2004 and 2005 attributable to different product categories.



	For the year ended 31 December			
	2005		2004	
Revenue	**(RMB million)**	**Percentage of revenue (%)**	(RMB million)	Percentage of revenue (%)
Air conditioners	**2,352**	**19.2**	1,877	22.7
Television sets	**2,711**	**22.1**	1,857	22.5
Refrigerators and washing machines	**1,756**	**14.3**	1,125	13.6
Audio visual systems	**203**	**1.7**	161	2.0
Small black household appliances	**432**	**3.5**	202	2.4
Small white household appliances	**1,493**	**12.2**	879	10.6
I.T. digital products	**1,258**	**10.3**	441	5.3
Mobile communication products	**2,041**	**16.7**	1,725	20.9
Total	**12,246**	**100**	8,267	100

A Fast Growing Industry Undergoing Consolidation

We have confidence in the future development of specialty household appliances chain retail industry. Being a dominant player, we shall benefit from market consolidation and generate further growth.

The Group constantly evaluates and reviews the sales performance of different products, and analyzes the shopping habits and preference of customers based on the data from our I.T. management system which enables us to keep abreast of market trends, to react to trends promptly and to determine a suitable product mix accordingly.

In respect of product categories, sales of conventional household appliances such as air conditioners, television sets, refrigerators and washing machines remained the Group's principal sources of revenue, accounted for 55.6% of our turnover in 2005.

However, the focus of sales has shifted from conventional household appliances to innovative household appliances, such as I.T. digital and mobile communication products. As such, the percentage of sales of I.T. digital products to the total revenue rose to 10.3% in 2005 from 5.3% in 2004. Furthermore, as the collaboration with China Unicom ended in 2005, percentage of mobile communication revenue to total revenue decreased to 16.7%.

The penetration rate and popularity of mobile communication products and I.T. digital products are relatively lower than those of conventional household appliances. However, with the accelerating replacement rate of such mobile communication and I.T. digital products, the Group anticipates that their potential is immense and will become a profit driver in the future.

TURNOVER BREAKDOWN BY OVERSEAS AND DOMESTIC BRAND NAME PRODUCTS

	For the year ended 31 December	
Brand	**2005**	2004
Overseas	**40%**	49%
Domestic	**60%**	51%
Total	**100%**	100%

As the Group extends its network from mature markets in the Eastern China region where the average per capita income is relatively higher to new developing markets with high potentials, and domestic brands have better brand recognition in local markets, therefore percentage of sales of domestic brand products is relatively higher.

OPERATING DATA

	For the year ended 31 December		
	2005 (RMB million)	2004 (RMB million)	Change (%)
Revenue	**12,246**	8,267	48.1
Number of stores	**193**	92	109.8
Number of cities covered	**72**	34	111.8
Approximate sales area (sq. m)	**732,915**	332,037	120.7
Approximate weighted average sales area per annum (sq. m.)	**480,567**	204,262	135.3
Approximate weighted average revenue per sq.m. per annum (RMB)	**25,482**	40,472	(37.0)
Same-store sales	**7,421**	7,636	(2.8)

WEIGHTED AVERAGE REVENUE PER SQ. M. PER ANNUM

The Group endeavours to achieve the highest revenue per square metre of its stores. The flexible layout of our stores enables us to change the store front at regular intervals during the year. In allocating store areas, the Group will take into account the expected customer flow, consumers' shopping habits, growth potential of different products, seasonality as well as the specific requirements of suppliers. Nevertheless, as the Group expanded its network coverage to 5 new markets during the year, and from developed regions with higher disposable income per capita to developing markets, and taking into consideration the relatively lower income base during the initial store opening stage, the weighted average revenue per square metre per annum declined from RMB40,472 in 2004 to RMB25,482 in 2005. Despite this, the Group believes that the store expansion plan will broaden its geographical presence and customer base, achieving a higher economies of scale and enabling it to optimize its overall cost structure. These initiatives will be favourable to our long-term development.

COMPARISON OF SAME-STORE SALES

In the year under review, the same-store sales amounted to RMB7,421,000,000, which represents a decrease over 2004, mainly due to:

- the dilution in the sales revenue of existing stores as a result of the increase in market share brought about by the development of sales network
- opening of new stores by competitors in the proximity our existing stores which intensifies competition

COST OF SALES AND GROSS PROFIT MARGIN

The cost of sales of the Group for the year ended 31 December 2005 increased by 47.5% as compared to 2004 and amounted to RMB11,331,763,000. The increase in cost of sales was basically in line with the revenue growth.

The gross profit was derived from direct sales (the difference between the purchase price and the retail price of our merchandise), as well as rebate and price subsidies obtained from suppliers after deducting provision for inventory. During the period under review, the gross profit increased by 46.1% to RMB851,663,000 after deducting the write-back of inventory provision, but the gross profit margin decreased by 0.6 percentage point to 6.9%. The decrease was attributable to the intensified market competition and an increase in the percentage of sales discount to the sales amount as a result of increased promotional sales.

	For the year ended 31 December			
	2005		2004	
Gross Profit	**Gross margin (%)**	**Percentage of Gross margin (%)**	Gross margin (%)	Percentage of Gross margin (%)
Air conditioners	**6.7**	**17.3**	6.3	20.4
Television sets	**4.9**	**14.7**	5.4	17.2
Refrigerators and washing machines	**6.8**	**13.0**	6.7	12.9
Audio visual systems	**22.9**	**5.1**	26.2	7.3
Small black household appliances	**8.2**	**3.9**	8.2	2.8
Small white household appliances	**12.3**	**20.0**	11.3	17.0
I.T. digital products	**1.9**	**2.5**	3.0	2.3
Mobile communication products	**10.5**	**23.5**	6.8	20.1
Total	**7.5**	**100.0**	7.1	100.0

PURCHASING AND LOGISTICS MANAGEMENT

The Group's purchasing strategy is to establish direct contacts with major manufacturers of household appliances and consumer electronics products through bulk purchases. The Group provides an effective sales platform for its suppliers which enables them to launch and promote their new products without delay. Our suppliers also benefit from the expansion of our network. Direct purchase from these manufacturers enables us to reduce cost and offer our customers wide selection at reasonable prices. Over the years, one of the keys to our success was to maintain excellent and close working relationships with suppliers. For the year ended 31 December 2005, 70% of the Group's purchase was direct purchase from manufacturers (2004: 73%), and the remaining 30% was mainly procured from mobile handsets and digital product distributors (2004: 27%). Direct procurement from suppliers decreased as a 3% of the total sum mainly because of the increasing weight of digital products in the total sales mix. The Group has entered into standardised long-term agreement with a majority of suppliers in order to effectively improve our bargining power.

The Group has an effective and efficient inventory logistics management system. Most of our inventory is delivered directly by our suppliers to warehouses operated by our local dispatch centres in order to minimize time and resources in handling. At present, the Group has 35 dispatch centres across China with a total area of 192,805 sq. m., which provide services for stores located in the proximity. Moreover, the computer systems of these dispatch centres are linked to the I.T. management system of our headquarters, which handles product purchasing, store delivery and inventory management.

SPONSORSHIP FEES FROM SUPPLIERS

Revenue from sponsorship fees includes (i) promotion fees, i.e., the expenses paid by suppliers to participate in our promotional activities and (ii) display fees, i.e., the fees paid by suppliers to display their goods on the shelves and special counters. For the year ended 31 December 2005, the sponsorship fees from suppliers amounted to RMB625,126,000, an increase of 134.7% from RMB266,343,000 over the same period of last year. The increase was mainly attributable to:

- Expansion of our scale of operation;
- Reinforcement and implementation of the contracts entered into with suppliers;
- Increase in fees paid by our suppliers as result of the increased promotional activities provided by us.

Total return from suppliers

"Total return from suppliers" is the most important measure of our supplier management capability, which is calculated as gross profit before inventory provisions plus sponsorship fees as a percentage of revenue. For the year ended 31 December 2005, the total return from suppliers amounted to RMB1,476,000,000, or 12.1% of our turnover, representing an 65.3% or 1.3 percentage points from RMB893,000,000 or 10.8% of the turnover for 2004.

Increase in the total return from the suppliers was mainly attributable to the following:

- Rolling out specially designed marketing plans for suppliers, to achieve a win-win situation
- Excellent brand name and customer service give confidence to customers, which obviates the need to adopt huge price-cutting promotions.

	For the year ended 31 December	
	2005 (RMB million)	2004 (RMB million)
Gross profit	**914**	583
Provision/(write-back) of inventory	**(63)**	44
Sponsorship fees from suppliers	**625**	266
Total return in revenue from suppliers	**1,476**	893
Rate of total return from suppliers	**12.1%**	10.8%

WAREHOUSING MANAGEMENT AND INVENTORY PROVISION POLICY

Most of our goods are returnable to suppliers. In spite of this, the Group has adopted a relatively conservative policy in the past to make a provision of 3% for inventories of 180 days, 50% and 100% for inventories over 180 days but less than one year and inventories over one year which such provisions were made at the time of listing of the Group mainly due to relatively high turnover days of inventories in hand. Such provisions are reflected in the cost of sales. The Group also made provisions for inventories which were not returnable to suppliers.

During the year under review, as most of the aged inventory was sold, and the age of certain inventory was shortened as a result of the return of the inventory to suppliers, a total of RMB62,742,000 was written back. This was mainly a result of the development of inventory management system and the formulation of a comprehensive inventory management policy coupled with the use of suppliers who participate in discount promotions and accept return of merchandise.

Having consulted our Audit Committee, we shall be adjusting our treatment for inventory provisions in 2006 to what is being generally adopted in the industry. General provision for inventory according to inventory turnover days will not be made. Instead, we shall make provisions according to the specific conditions of each product and whether or not they are returnable to the suppliers. In doing so, the Group can eliminate the needs for making provisions followed by subsequent write-back, and at the same time more accurately reflect our cost of sales and profitability. Accordingly, we anticipate that no significant general provisions for our inventory will be required in 2006.

OTHER INCOME AND REVENUE (Excluding sponsorship fees from suppliers)

Other income and revenue for the year ended 31 December 2005 rose by 295.9% to RMB135,080,000. Increase in other income and revenue was mainly attributable to:

- Increased income from a new subsidiary acquired in April 2004 that engages in the provision of air conditioning services. The subsidiary recorded RMB30,576,000 in revenue. The Group will extend its service scope to cover a wider range of after-sales services. Not only will this broaden our service scope, but also increase our recurring revenue base.
- Receipt of a tax subsidy of approximately RMB61,454,000 from the Shanghai municipal government. The Shanghai municipal government refunds part of the tax paid to enterprises as a sign of encouraging enterprises to invest in Shanghai. The Group anticipates to be entitled to such refund in future.

OPERATING COST

Operating costs include selling and distribution costs, administrative expenses and other expenses.

	As a percentage of revenue (%)	
	2005	2004
Store rental	**2.7**	1.5
Advertising and promotion expenses	**1.8**	1.6
Store staff costs	**1.5**	1.2
Delivery expenses	**0.8**	0.7
Water and Electricity	**0.7**	0.5
Others	**1.5**	0.6
Total	**9.0**	6.1

SELLING AND DISTRIBUTION COSTS

The selling and distribution costs of the Group for the year ended 31 December 2005 amounted to RMB1,096,602,000, denoting an increase of 115.8% over RMB508,071,000 in 2004. Percentage of selling and distribution costs to turnover also increased from 6.1% in 2004 to 9.0% in 2005.

The increase in selling and distribution costs was mainly attributable to the increase in sales as well as the following factors:

- As most of our stores are leased properties, the number of properties we leased increased due to business expansion. Rental costs rose by 161.6% to RMB328,176,000 and accounted for 2.7% of our turnover;
- With the expansion of our scale of operation and increased efforts in tapping new markets, advertising and promotion expenses increased by 65.5% to RMB224,377,000; and
- Expansion of business led to an increase in the number of employees, in addition, we recruited more experienced and talented personnel in order to strengthen our management, together with the rising salary level and related employee benefits, cost of employees for the sales team increased by 81.2% to RMB179,223,000.

COST CONTROL MEASURES

As the economy of China experiences rapid growth, we anticipate that rental costs will rise further. As such, we have adopted the following measures to control rental expenses effectively:

- entering into long-term leases of 10 years with landlords to lock in costs. As at 31 December 2005, other than eight self-owned stores, the remaining 185 stores were leased by the Group with an average term of 7.5 years. Of the new leases we entered into in 2005, the term ranged from 5 years to 10 years.
- reorganizing the internal layout of our stores to make more room for subletting to retailers who are not in competition with us and are able to attract customer flow thereby reduces our rental expenses and increases our sales per square metre.

We continuously invest in upgrading our customer service and build up our brand name to differentiate ourselves from our competitors.

EXCELLENT CUSTOMER SERVICES

Excellent customer services is one of our endless pursuits. In achieving this, Yongle (China) has obtained the internationally acclaimed ISO 9001:2000 accreditation. This is attributable to the following superior services:

- Customers are entitled to the “Four Safeguards” of refunds and exchanges, product quality assurance, lowest price guarantee and reimbursement of expenses, which exceed national standards.
- We have established a toll-free customer services hotline which networks with all stores across China. At present, 600 operators work in shifts at all call centres.
- We have a strong customer information management system in place which records information of customers such as purchase, deliveries, installation, repair and maintenance and complaints. This will help strengthen our relationship with customers and enhance customer loyalty.

Superior Customer Services

We commissioned an independent consumer behaviour market research in Shanghai in 2005 and found that our “Yolo Home Appliance” brand was ranked as the best-known household appliances and consumer electronics products retailer in Shanghai.

- To address customers' complaints promptly and to avoid any unnecessary waiting and loss due to different service standards of manufacturers, a "reimbursement fund" was established.
- We endeavour to upgrade our after-sales service standard with the establishment of the special dispatch system, which includes express delivery and installation services upon purchase, after-sales visit after delivery, one-year free reinstallation services for air conditioners.

STRONG BRAND NAME

A strong brand name is the key to success in the retail business. We commissioned an independent consumer behaviour market research in Shanghai in 2005 and found that our brand name "Yolo Home Appliance" was ranked as the best-known household appliances and consumer electronics products retailer in Shanghai. We were also recognized as one of China's most famous brands for 2004 by the China General Chamber of Commerce in 2005. The fact that the Group has established an excellent brand name is attributable to the following key factors:

- Quality customer services
- Optimization of our store layout to create a comfortable shopping environment
- Speedy change in product mix in response to the preference of different markets

ADMINISTRATIVE EXPENSES

In the year under review, administrative expenses rose by 103.5% to RMB259,559,000, which accounted for 2.1% of the Group's turnover. It was mainly due to our business expansion and the recruitment of more senior management personnel engaged in the retail business. These expenses on the other hand brought about management styles that are in line with international practice. In addition, there was also an increase in other administrative expenses such as office expenses, government levies and entertainment expenses.

OTHER EXPENSES

The Group's other expenses in 2005 amounted to RMB13,133,000, slightly less than that in 2004. Such expenses were mainly loss on disposal of property, plant and equipment, goodwill impairment and other operating costs.

INTEREST INCOME

The interest income of the Group for 2005 amounted to RMB52,925,000, denoting an increase of 69.5% from 2004, mainly due to increase in bank deposits.

INCOME TAX AND THE EFFECTIVE TAX RATE

Our taxation expenses for the year ended 31 December 2005 amounted to RMB28,596,000, a decrease of 36.3% over 2004. The effective tax rate decreased from 17.5% to 8.2%.

The Group has established a centralized purchasing arm in Shanghai to handle purchasing for stores in different locations. Not only has this streamlined our purchasing staff, but it has also maximized the preferential tax benefits.

In addition, we have been acting proactively to obtain preferential tax concessions from local governments in localities outside Shanghai, so as to reduce the effective tax rate and to increase our profitability.

Summarised Consolidated balance sheet as at 31 December

	2005 (RMB million)	2004 (RMB million)	Change (%)
Non-current assets	**1,005**	510	97.1
Current assets	**6,712**	3,300	103.4
Of which:			
– inventory	**1,649**	799	106.4
– pledged deposits	**1,780**	1,124	58.4
– cash and cash equivalents	**1,541**	495	211.3
Current liabilities	**5,370**	3,316	61.9
Of which:			
– trade payables and bills payables	**4,795**	3,022	58.7
Non-current liabilities	**46**	69	(33.4)
Shareholders' equity	**2,197**	379	479.7
Net cash[1]	**1,201**	299	301.7
Current ratio[2]	**1.2**	1.0	20.0
Turnover of inventory[3] (days)	**39**	28	39.3
Turnover of trade receivables and bills receivables (days)	**1**	4	(25.0)
Turnover of trade payables and bills payables (days)	**126**	112	12.5

Notes:
1. cash and cash equivalents – bank loans
2. current assets/current liabilities
3. average inventory during the period/selling cost X 365
   average inventory = (inventory at beginning of period + inventory at end of period)/2

PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

Owing to the aforesaid reasons, the profit attributable to equity holders for the year ended 31 December 2005 rose by 55.9% year on year, to RMB289,474,000, which was in line with the profit forecast described in the Prospectus. The net profit margin for the year (i.e. profit attributable to our equity holders divided by revenue) was 2.4%, an increase by 0.2 percentage point over the same period of last year, which was mainly due to increased margin from rapid expansion. Basic and diluted earnings per share increased substantially by 44.2% and 34.7% respectively in 2005 to RMB17.3 cents and RMB15.9 cents.

Pursuant to the Prospectus, the Group shall apply part of the listing proceeds to acquire from Messrs. Chen Xiao, Shu Wei, Liu Hui and Yuan Yashi in aggregate 3% equity interest in Yongle (China). The profit attributable to equity holders of the Company will increase as a result of the acquisition.

RETURN ON EQUITY

Return on equity decreased from 66.7% in 2004 to 22.5% in 2005, due to the increased shareholders' equity from the listing of the Group.

MANAGEMENT OF WORKING CAPITAL

Current ratio

Our current ratio for the year ended 31 December 2005 was 1.2, which increased significantly compared with 1.0 as at the same day in 2004. The increase was attributable to the net proceeds from listing received in October 2005 of approximately RMB1.2 billion, resulting in a substantial increase in our cash balance at the end of 2005.

Following the application of the listing proceeds in our development, we shall bring the current ratio to a reasonable level which will maintain our financial soundness on one hand, and at the same time will ensure the funds are applied effectively.

TURNOVER OF WORKING CAPITAL

Other than the remarkable sum of money from our listing, the mode of operation of China's retail business also generates a large amount of cash, which is reflected in the negative turnover day of working capital. This is because most customers pay in cash and suppliers are repaid in months after the credit was given, and in addition, inventories are usually sold in about a month. The following is an analysis of these turnover days:

TURNOVER OF INVENTORY

The inventory turnover for 2005 increased by 11 days from 2004. It is because the Chinese New Year in 2006 was one month earlier than that in 2005, and in order to cope with the usual surging sales around the Chinese New Year period, the store inventories at the end of 2005 increased significantly when compared with that in 2004. At the same time, with the Group's expanding retail sales network, stores were more diversified and more inventories were needed. Inventory turnover days therefore increased.

TURNOVER OF TRADE RECEIVABLES AND BILLS RECEIVABLES

The receivables turnover for 2005 was 1 day, which was similar to 2004, indicating that most sales continued to be conducted in cash.

TURNOVER OF TRADE PAYABLES AND BILLS PAYABLES

The payables turnover for 2005 was 126 days, 14 days more than that for 2004 due to the increase in the proportion of bills payables we used, and the repayables period for bills payables is longer than trade payables.

Since a large amount of capital was obtained upon our listing, we will shorten the period we pay our suppliers, and by means of which we shall be able to demand higher returns.

Most suppliers have accepted payment by bills payable in six months for payment of purchases. Bills payables were secured by fixed deposits and certain leasehold land, buildings and inventories. As at the end of the year, the credit facilities provided by banks and the unused amount were RMB2,402,000,000 and RMB548,000,000 respectively.

Consolidated Cash Flow Statement as at 31 December			
	2005 (RMB million)	2004 (RMB million)	Change (%)
Net cash inflow from operating activities	**232**	445	(47.9)
Net cash outflow from investing activities	**(1,034)**	(246)	320.3
Net cash inflow from financing activities	**1,848**	81	2,181.5
Cash and cash equivalents at end of the year	**1,541**	495	211.3

Decrease in net cash inflows from operating activities was mainly attributable to the expansion of stores and the increase in inventory to cope with the surging demand during the Chinese New Year.

Increase in net cash outflow from investment activities was attributable to the acquisitions the Group made in 2005 and the increase of pledged deposits, so that banks would be able to issue more bills payables to suppliers.

Increase in net cash inflow was mainly attributable to the proceeds raised from the listing in the sum of RMB1,200,000,000 and the fund of approximately RMB413,840,000 privately raised by Morgan Stanley.

The Group has abundant cash at hand which amounted to RMB1,541,000,000 as at 31 December 2005, and, the Group has an outstanding interest-bearing loan of RMB340,000,000 at an interest rate of 5.38% which is repayable within one year. Further, the amount of cash held by the Group right now is sufficient to meet the capital expenditure of the Group in the coming year.

CAPITAL EXPENDITURE

There is little change in the use of the proceeds from listing and capital expenditure in 2006 does not differ much from the disclosure in the Prospectus.

The capital expenditure of the Group in 2005 was RMB381,000,000.

	Anticipated capital expenditure in 2006
	(RMB Million)
Opening of stores (excluding acquisitions)	180
Construction of distribution logistic centre	140
Upgrading of information system and network	50
Total	370

Use of proceeds from listing

We successfully listed on the Stock Exchange in October 2005. As the approval of the Chinese government is required for the fund raised to be remitted back to China, therefore, the fund of approximately RMB1.2 billion has not yet been applied as at the end of 2005. Given the rising interest rate of US dollars, the fund was deposited in one-month US dollar fixed deposit in order to maximize interest income.

Market risks

The Group is exposed to various market risks in the ordinary course of business, including the following:

Interest rate risk

Our exposure to the risk of changes in interest rate is mainly the impact on our interest bearing loans, our future needs of loans and interest bearing assets such as deposits. Our outstanding interest-bearing loans as at 31 December 2005 amounted to RMB340,000,000. These were all short-term loans. We have not used any derivatives to hedge our interest rate risk.

Credit risk

Most of our sales are conducted in cash and debit cards. Therefore, the credit risk we are exposed to is relatively low. We are exposed to the underlying credit risk of our bank deposit. Our cash and cash equivalents are mainly deposited with reputable banks. Our policies restrict our exposure to any single financial institution. We are also exposed to the underlying credit risk of prepayment to suppliers. We have a diversified base of suppliers and make prepayments only to those suppliers which are established and having long-term business relationships with us.

Risk of foreign exchange

All of our operations are in China and sales are denominated in Renminbi. Other than the listing proceeds which was denominated in Hong Kong dollars, all of our financial assets and liabilities are denominated in Renminbi. However, the prices at which we purchase from suppliers may be affected as a result of fluctuations in the prices of imported raw materials or parts or in the foreign exchange rate. Amid in views of the appreciation of Renminbi, the Group has applied to the Chinese government to remit the funds which are currently placed in US dollar deposit with higher interest rate back to China.

Future prospects

Our competitive strength:

The Board of Directors believes that our achievements to date and our future growth potential are dependent on the integration of a number of strengths, including:

- leveraging on our dominant position in Shanghai, we shall capture the strategic position of the rapidly growing retail business in China;
- strong brand name and excellent customer services;
- strong supplier management capability;
- our track record in organic growth of existing business and selective acquisitions has been remarkable;
- our continuous improvement in corporate governance; and
- our experienced and dedicated management team.

Market outlook

The retail market for household appliances is enormous and is expanding rapidly. Despite the good prospects, competition is also getting more intense. As a market leader, we will benefit from the growth potential but at the same time face the pressures from competition which include:

- continuing pricing pressure due to keen competition and lack of differentiated products from suppliers;
- suppliers have limited margin, which leaves retailers with less room for margin expansion;
- foreign players will join the Chinese market;
- significant store openings by the 5 largest consumer electronics retailers led to decrease in sales per square metre and same-store sales;
- rapid economic development pushes up rental costs;
- the continuous increase in the number of retail stores entails the increased employment of store sales staff, and the staff cost keeps escalating;
- intensifying market competition prolongs the Group's return on investment in stores located in new markets.

Development strategies

In response to these market changes, the Group adopts a steady and prudent development strategy. On one hand we shall continue to expand our operations, and on the other we shall exercise stringent cost control to achieve a win-win situation.

We intend to maintain and consolidate our present position in the market, and to capture a leading position in new markets we enter.

The Group has been focusing on store performance, and has been working towards improving the operating effectiveness of stores. During the period, the Group has made a full evaluation of our stores, and has 3 metrics as key indicators of our business development, these include: (1) pace of development of our retail network; (2) the total return from suppliers; (3) market share and net profit margin. While we aim at expanding, we also maintain good profitability and develop on a sound basis, which has been approved by our investors. We are committed to adopt the following business strategies to enhance our value for shareholders:

1. ***Further explore existing markets and enlarge market share***

   The regions we have covered are urbanised and affluent regions with higher per capita income. Therefore, we intend to strengthen our existing market position and enhance our market share and expand our retail business network in existing market through organic growth. With such penetrating strategies and economies of scale, stores can share resources, such as our logistic facilities and marketing. We anticipate that about 90 more stores will be opened in the markets we have entered.

   In the year to come, we will focus on premium and second tier cities in the regions we have covered, and we shall open mega stores which help brand building. We anticipate that 10 or more mega stores will be opened across the country in the year to come. As for the Yangtze River Delta region, as our operations in these markets are relatively mature with higher penetration rates, we will open smaller stores to enhance operation effectiveness.

   Moreover, we shall make attempts to open joint venture stores in third tier cities with our expertise in operation and goods supply, thereby increasing the penetration rate in these regions.

2. ***Enter new markets by selective alliances or acquisitions***

   In the year under review, Shanghai and the Yangtze River Delta region were our principal sources of revenue. We have completed our acquisitions of businesses in Henan, Fujian and Sichuan respectively, and have commenced operation. As operations in the Yangtze River Delta region have advanced after more than two years of development, it is expected that there will be continuous and steady growth in these regions in the year to come.

   Our management believes that the retail market in China will undergo further consolidation and the weaker industry players will be eliminated. This will provide us with rare acquisition opportunities. Therefore, we are considering employing different means to seek new opportunities of development in entering these markets, such as strategic alliances or acquisitions. In 2006, we established strategic alliance with Beijing Dazhong, the largest household appliances retailer in Beijing. In 2005, both parties agreed to set up a joint venture to explore the markets in Xi'an and Qingdao with 50% held by each party. This is the precedent in China for benevolent competition among industry players. Both parties operate on the joint brand name to avoid a waste of resources as a result of competition. Instead, such cooperation may shorten the development cycle and the risk can be shared.

   With our experience accumulated over the years, we have an effective mode of operation on hand. In the past, ZhongYongTongTai, which was established under our lead, has also provided a fine platform for the management to understand and grasp different market development information more quickly and effectively.

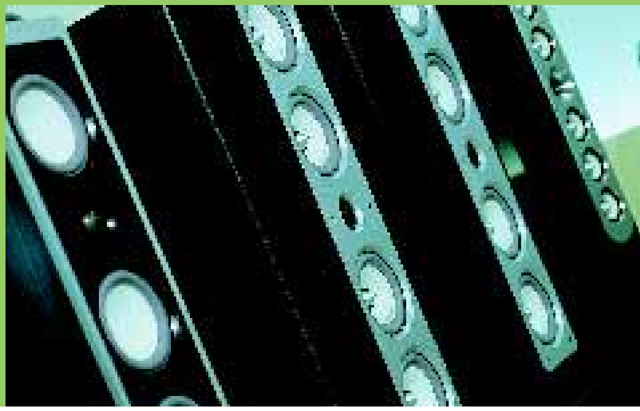
   Shanghai is the city where competition in the household appliances retail business is most intense. However, we have captured the largest market share in Shanghai since 2001, and we are about to replicate our success in other regions with this strategy.

3. ***Increase the proportion in the sale of electronics and digital and mobile communication products***
   Given the short life cycle and continuous roll out of new products, the growth potential of digital and mobile communication products is great among the many household appliances and consumer electronics products. We intend to increase the proportion in the sale of digital products to capture the business opportunity. This will also bring about more customer flow, which in turn will push the sales of other products.

4. ***Wide array of product categories and development of products with high gross profit***
   Other than selling household appliances of international and domestic brand names, we have also established "Eden" and "Yuehao", our private label audio visual equipment. As the gross profit for private label merchandise is higher, we shall be launching more private label merchandise from this year onwards. Also, we successfully secured the role of one of the three major distribution agents for iPod in China, making it profitable for us in both wholesale and retail. In the long term, this will help to enhance our profitability.

5. ***Strengthen our partnership with suppliers and backup supports***
   In order to further consolidate our partnership with suppliers, we have already entered into strategic collaboration with certain suppliers in order that the Group can provide comprehensive after-sales services. On one hand our customers will have more pleasurable shopping experience, and on the other hand we can work even more closely with suppliers, and we can open up new sources of revenue as well.

   In terms of backup supports, we are constructing the largest and most automated logistics centre in Shanghai, with a floor area of approximately 92,000 sq.m.. It is expected to commence operation in early 2007, which will then provide strong logistics support for the Yangtze River Delta region and help us to grasp the inventory level and the flow of goods more easily. In the long term, it will help to reduce cost as well. Also, it will provide logistics service for more suppliers. Not only can this bring in more revenue for us, but the advanced logistics facilities can also help suppliers better understand the turnover of goods, thus minimizing the risk of inventory accumulation. As such, it will enhance our relationship with suppliers.



6. *Optimize customer service and improve customer loyalty*

   The Group has been committed to improve customer services quality, and by providing more convenient shopping channels for shopping convenience, we are looking forward to achieving customer satisfaction and loyalty.

   The Group issued the first affinity credit card in China jointly with Bank of Shanghai and MasterCard in January 2006, and card holders are entitled to special discounts and services. The purchase by installments offered to card holders forms an ideal platform for building a loyal base of customers.

   Moreover, the Group has formed a strategic collaboration in March 2006 with eBay, a leading online transaction service provider, opening up a new retail channel. The Group has established an online commercial city as an extension of the traditional sales and marketing channel. This strategy of the Group aims at opening up more sales channels to provide a quicker way of shopping with more choices. This will ultimately strengthen our competitiveness.

   In the future, the Group will consider more suitable strategies for our customers to enjoy better customer service in addition to the existing four safeguards.

The Chinese government has just introduced the 11th Five-Year Plan aiming at making people affluent and stimulating internal demand. With this in mind, there is great potential in the household appliances retail business in China. With our clearly defined direction of development and streamlined corporate structure and a team of management dedicated to the business of household appliances retail business, we are confident that we shall be achieving sustainable profit in the future and to share the result of our efforts with our shareholders.