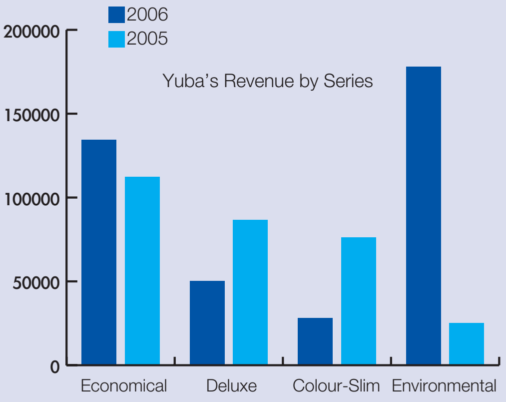
# MANAGEMENT DISCUSSION AND ANALYSIS

## BUSINESS AND FINANCIAL REVIEW




### Revenue

For the year ended 31 December 2006, the revenue of the Group amounted to approximately RMB448,209,000, representing an increase of approximately 33.2% as compared with the revenue which amounted to approximately RMB336,513,000 for the year ended 31 December 2005. The increase in revenue was mainly attributable to the increase in revenue of the Environmental Series and Economical Series of *AUPU* Bathroom Master 3-in-1 and the launch of *AUPU* Bathroom Roof 1+N. The revenue of *AUPU* Bathroom Master 3-in-1 increased from approximately RMB300,587,000 for the year ended 31 December 2005 to RMB391,110,000 for the year ended 31 December 2006, representing an increase of approximately RMB90,523,000 or approximately 30.1%. The revenue of *AUPU* Bathroom Master 3-in-1 accounted for approximately 89.3% and 87.3% of the Group's total revenue for the year ended 31 December 2005 and 2006 respectively. In particular, the revenue of Economical Series increased from approximately RMB112,450,000 for the year ended 31 December 2005 to approximately RMB134,377,000 for the year ended 31 December 2006, representing an increase of approximately RMB21,927,000 or approximately 19.5%. For the year ended 31 December 2006, the revenue of Environmental Series which was launched in August 2005 amounted to approximately RMB178,210,000. Due to changes in product mix, the revenue of Deluxe Series decreased from approximately RMB86,605,000 for the year ended 31 December 2005 to approximately RMB50,449,000 for the year ended 31 December 2006 while the revenue of Colour-Slim Series decreased from approximately RMB76,398,000 to RMB28,073,000 for the same period. The revenue of *AUPU* Bathroom Roof 1+N which was launched in April 2006 amounted to approximately RMB26,382,000 for the year ended 31 December 2006.

### Costs of sales

For the year ended 31 December 2006, the costs of sales of the Group amounted to approximately RMB216,519,000. The costs of parts and components, direct labour and overhead represented approximately 96.4%, 1.2% and 2.4% of the total costs of sales respectively. For the year ended 31 December 2005, the total costs of sales amounted to approximately RMB165,961,000. The costs of parts and components, direct labour and overhead represented approximately 96.4%, 1.3% and 2.3% of the total costs of sales respectively.

### Gross profit and gross profit margin

Gross profit increased from approximately RMB170,552,000 for the year ended 31 December 2005 to approximately RMB231,690,000 for the year ended 31 December 2006, representing an increase of approximately 35.8%. Overall gross profit margin increased from approximately 50.7% for the year ended 31 December 2005 to approximately 51.7% for the year ended 31 December 2006. The increase in revenue from Environmental Series which provides higher gross profit margin and the engagement of an OEM manufacturer to produce a certain specification of *AUPU* Bathroom Master 3-in-1 contributed to the increase in overall gross profit margin.

### Other income

Other income increased from approximately RMB6,700,000 for the year ended 31 December 2005 to approximately RMB8,241,000 for the year ended 31 December 2006 due to the significant increase in interest income of bank deposits and subsidy income.

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### Selling and distribution expenses

The selling and distribution expenses amounted to approximately RMB99,789,000 for the year ended 31 December 2006. It mainly comprised of advertising expenses of approximately RMB28,679,000, sales promotion expenses of approximately RMB13,629,000, salary expenses of sales and marketing staff of approximately RMB23,991,000, after-sales services expenses of approximately RMB5,191,000 and transportation expenses of approximately RMB10,663,000. The selling and distribution expenses amounted to approximately RMB72,369,000 for the year ended 31 December 2005. It mainly comprised of advertising expenses of approximately RMB25,200,000, sales promotion expenses of approximately RMB8,000,000, salary expenses of sales and marketing staff of approximately RMB18,000,000, after-sales services expenses of approximately RMB2,500,000 and transportation expenses of approximately RMB8,700,000. The increase in selling and distribution expenses for the year ended 31 December 2006 compared with the year ended 31 December 2005 was mainly due to increase in salary expenses of sales and marketing staff and increase in sales promotion expenses.

### Administrative expenses

The administrative expenses amounted to approximately RMB39,065,000 for the year ended 31 December 2006. It mainly comprised of salary expenses of general and administrative staff of approximately RMB12,359,000, depreciation of approximately RMB2,514,000, professional fees and related disbursements of approximately RMB14,532,000, office expenses of approximately RMB4,110,000. The administrative expenses amounted to approximately RMB25,477,000 for the year ended 31 December 2005. It mainly comprised of salary expenses of general and administrative staff of approximately RMB9,500,000, depreciation of approximately RMB2,800,000, professional fees and related disbursements of approximately RMB6,200,000 and office expenses of approximately RMB2,300,000. The increase in administrative expenses for the year ended 31 December 2006 compared with the year ended 31 December 2005 was mainly due to significant increase in professional fees arising from the booking of listing expenses and increase in salary expenses of general and administrative staff.

### Other expenses

Other expenses increased from approximately RMB2,463,000 for the year ended 31 December 2005 to approximately RMB3,473,000 for the year ended 31 December 2006 due to increase in cost of spare parts and non-operating expenses.

### Profit before tax

Based on the above factors, the Group's profit before tax increased from approximately RMB76,978,000 for the year ended 31 December 2005 to approximately RMB97,604,000 for the year ended 31 December 2006, representing an increase of approximately 26.8%.

### Income tax expenses

Leveraging on the well-known brand name, technology know-how and the well-established distribution network of *AUPU*, Hangzhou AUPU Bathroom & Kitchen Technology Co., Ltd. ("AUPU Technology") was able to generate a remarkable profit immediately following the commencement of its commercial production in 2006.

AUPU Technology is a foreign investment enterprise of a manufacturing nature established in national economic and technology development zone in the PRC. In accordance with the tax legislations, AUPU Technology is entitled to a preferential enterprise income tax rate of 16.5 per cent, inclusive of 1.5 per cent for local enterprise income tax. AUPU Technology is entitled to obtain approval from the relevant tax authority for an exemption from PRC enterprise income tax for two years starting from its first profit making year of operations, followed by a 50 per cent tax relief for the following

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three years. As 2006 was the first taxable profit making year for AUPU Technology and therefore no provision of taxation has been made in respect of the estimated assessable profit of AUPU Technology for the year ended 31 December 2006, the income tax expenses of the Group decreased from approximately RMB21,691,000 for the year ended 31 December 2005 to approximately RMB13,954,000 for the year ended 31 December 2006 and the effective tax rate decreased from approximately 28.2% for the year ended 31 December 2005 to approximately 14.3% for the year ended 31 December 2006.

### Profit attributable to equity holders of the Company

The profit attributable to equity holders of the Company increased from approximately RMB55,287,000 for the year ended 31 December 2005 to approximately RMB83,650,000 for the year ended 31 December 2006. Due to the PRC enterprise income tax exemption to be enjoyed by AUPU Technology in 2006 as mentioned above, the net profit margin (stated in its percentage of revenue) increased from approximately 16.4% for the year ended 31 December 2005 to approximately 18.7% for the year ended 31 December 2006.

## ANALYSIS OF FINANCIAL POSITION

### Inventory turnover

The following table sets out the summary of the Group's inventory turnover days for the two years ended 31 December 2005 and 2006:

| | **2006** | 2005 |
|---|---|---|
| Inventory turnover days (Note) | **59** | 59 |

Note:

The inventory turnover days is arrived at by dividing average inventories by cost of sales and then multiplying by 365 for the two years ended 31 December 2006. Average inventories is arrived at by dividing the sum of the inventories at the beginning of year and that at the end of the year by 2. Inventory primarily comprised parts and components and finished goods. For the year ended 31 December 2006, inventory turnover days remained stable at 59.

According to the historical information, raw materials and finished goods with aging over one year but below two years has around 50% chance to be eventually consumed and sold respectively while raw materials and finished goods with aging over two years has low chance to be eventually consumed and sold respectively. In order to account for the risk of slow moving and obsolete inventories in the accounts, the Group provides general provision for inventories at the year end of each financial year end as follows:

– No provision is made for inventories (excluding those specific provision having been made for slow moving and obsolete inventories) with aging below one year

– Provision calculated at 50% of outstanding balance is made for inventories (excluding those specific provision having been made for slow moving and obsolete inventories) with aging over one year but below two years

– Full provision is made for inventories (excluding those specific provision having been made for slow moving and obsolete inventories) with aging over two years

Any over and under provision using the above formula is adjusted in the income statement.

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## Turnover days of trade receivables

The following table set out the summary of the Group's turnover days of trade receivables for the two years ended 31 December 2005 and 2006:

| | **2006** | 2005 |
|---|---|---|
| Turnover days of trade receivables (Note) | **32** | 31 |

Note:

The turnover days of trade receivables is arrived at by dividing average trade receivables by revenue and then multiplying by 365 for the two years ended 31 December 2006. Average trade receivables is arrived at by dividing the sum of the trade receivables at the beginning of year and that at the end of the year by 2.

The turnover days of trade receivables increased from 31 days for the year ended 31 December 2005 to 32 days for the year ended 31 December 2006.

According to the historical information, trade debtor with aging over one year but below two years has around 50% chance to become bad debt while trade debtor with aging over two years has low chance to recover. In order to account for the risk of bad debt in the accounts, the Group provides general provision for trade debtors at the year end of each financial year end as follows:

– No provision is made for trade debtors (excluding those specific bad debt provision having been made) with aging below one year

– Provision calculated at 50% of outstanding balance is made for trade debtors (excluding those specific bad debt provision having been made) with aging over one year but below two years

– Full provision is made for trade debtors (excluding those specific bad debt provision having been made) with aging over two years

Any over and under provision using the above formula is adjusted in the income statement.

# MANAGEMENT DISCUSSION AND ANALYSIS

### Aging analysis of trade receivables

The aging analysis of trade receivables of the Group as at 31 December 2005 and 2006 is as follows:

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Trade receivables analysed by age: | | |
| Within 90 days | **49,053** | 27,114 |
| 91 – 180 days | **2,903** | 467 |
| 181 – 365 days | **572** | 67 |
| Over 365 days | **73** | 22 |
| Total trade receivables | **52,601** | 27,670 |

Most of the authorised agents of the Group are required to place deposits or pay upon delivery of the Group's products. The balances of trade receivables are mainly related to retail chain stores which are usually granted credit terms ranging from 0 to 90 days, depending on several factors such as the length of relationship, financial strength and settlement history of each customer.

### Other receivables

The following table sets out the breakdown of other receivables of the Group as at 31 December 2005 and 2006:

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Staff advances | **745** | 516 |
| Utilities and rental deposits | **825** | 750 |
| Prepayments | **132** | 354 |
| Others | **1,310** | 870 |
| Amounts due from ICEA in respect of over payment of listing expenses | **3,955** | – |
| Total other receivables | **6,967** | 2,490 |

The increase in the balance of other receivables as at 31 December 2006 comparing with 31 December 2005 was mainly attributable to approximately RMB3,955,000 in relation to over payment of the listing expenses which will be recovered in 2007.

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## Turnover days of trade payables

The following table sets out the summary of the Group's turnover days of trade payables for the two years ended 31 December 2005 and 2006:

| | **2006** | 2005 |
|---|---|---|
| Turnover days of trade payables (Note) | **41** | 49 |

Note:

The turnover days of trade payables is arrived at by dividing average trade payables by cost of sales and then multiplying by 365 for the two years ended 31 December 2006. Average trade payables is arrived at by dividing the sum of the trade payables at the beginning of year and that at the end of the year by 2. The turnover days of trade payables decreased from 49 days in 2005 to 41 days in 2006 as the Group has changed the payment terms for certain suppliers in relation to materials for new products.

## Aging analysis of trade payables

The aging analysis of trade payables of the Group as at 31 December 2005 and 2006 is as follows:

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Trade receivables analysed by age: | | |
| Within 90 days | **25,012** | 20,297 |
| 91 – 180 days | **890** | 38 |
| 181 – 365 days | **995** | 350 |
| Over 365 days | **276** | 203 |
| Total trade payables | **27,173** | 20,888 |

Trades payables are mainly related to purchases from suppliers. Invoices would generally be received from suppliers upon delivery of goods and the credit period taken for trade purchases is 0 to 90 days. Trade payables are generally settled by cheques, bank drafts and bank transfers. The Group continuously supervises the level of trade payable balances.

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### Other financial liabilities

*Retention sum due to suppliers*

To ensure the products quality of suppliers, the Group retains a deposit representing 7% to 12% of the annual purchases by the Group from the respective suppliers. The retention sum due to suppliers will be released to respective suppliers 30 days after receipt of the goods and completion of satisfactory quality check by the Group.

*Advance from customers*

The advances from customers mainly represents sales made to authorised agents and distributors who are required to pay in advance before the delivery of goods. As the Group has some new customers in 2006 which are required by the Group to pay in advance before the delivery of goods, the balance of advances from customers as at 31 December 2006 increased comparing with 31 December 2005.

*Others*

The following table sets out the breakdown of other payables of the Group as at 31 December 2005 and 2006:

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Deposits received | **679** | 545 |
| Unpaid land premium cost | **1,832** | 1,832 |
| Payroll payablesPrepayments | **536** | 815 |
| Union and education fees | **995** | 807 |
| Accrued charges | **2,469** | 2,726 |
| Total | **6,511** | 6,725 |

### Current ratio, quick ratio and gearing ratio

The current ratio, quick ratio and gearing ratio of the Group as at 31 December 2005 and 2006 was as follows:

| | **2006** | 2005 |
|---|---|---|
| Current ratio | **4.88** | 1.96 |
| Quick ratio | **4.39** | 1.52 |
| Gearing ratio | **Nil** | Nil |

Note:

Current ratio is arrived at by dividing the current assets by current liabilities at the end of the corresponding year. Quick ratio is calculated as total current assets excluding inventories divided by total current liabilities at end of the year. Gearing ratio is arrived at by dividing the total external financing debt by total assets at the end of the corresponding year. The numbers in the above table are expressed in the form of ratio and not as a percentage.

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The current ratio increased from approximately 1.96 times as at 31 December 2005 to 4.88 times as at 31 December 2006 as the Company received cash in the amount of approximately RMB239,000,000 from new issue of shares.

The quick ratio increased from approximately 1.52 times as at 31 December 2005 to 4.39 times as at 31 December 2006 due to same reason stated above.

The Group had a zero gearing ratio as at 31 December 2005 and 31 Decrease 2006 as the Group did not have external bank loans as at 31 December 2005 and 31 December 2006.

## LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

The Group's principal sources of liquidity and capital resources have been, and are expected to continue to be internally generated cash flow. The Group's principal uses of cash have been, and are expected to continue to be, operational costs and the expansion of production and the Group's sales network.

### Cash flow

The table below summarises the Group's cash flow for the two years ended 31 December 2005 and 31 December 2006:

| | **2006** | 2005 |
|---|---|---|
| | **RMB million** | RMB million |
| Net cash from operating activities | **60.6** | 62.2 |
| Net cash used in investing activities | **(13.7)** | (7.7) |
| Net cash from (used in) financing activities | **184.6** | (16.5) |

The Group's working capital mainly comes from net cash from operating activities and financing activities. The Directors expect that the Group will rely on net cash from operating activities and the net proceeds from the Share Offer to meet its working capital and other capital expenditure requirements in the near future. In the long run, the Group will be funded by net cash from operating activities and if necessary, by additional equity financing or bank borrowings.

### Operating activities

Cash inflow from operations is mainly derived from cash receipt from sales of the Group's products. Cash outflow from operations is principally generated for the purchase of parts and components, staff costs, selling and distribution expenses and administrative expenses. Net cash from operating activities was approximately RMB 62.2 million and RMB60.6 million for the year ended 31 December 2005 and 31 December 2006 respectively.

# MANAGEMENT DISCUSSION AND ANALYSIS

### Investing activities

Cash inflow from investing activities was mainly derived from interest received and repayment of advances from related parties. Cash outflow from investing activities was mainly applied to the purchase of property, plant and equipment and advances to related parties. Net cash used in investing activities was approximately RMB13.7 million for the year ended 31 December 2006 which was primarily attributable to purchases of property, plant and equipment. Net cash used in investing activities were approximately RMB7.7 million for the year ended 31 December 2005 which was primarily attributable to purchases of property, plant and equipment.

### Financing activities

Cash inflow from financing activities was mainly derived from net proceeds from share offer and capital contribution by shareholders. Cash outflow from financing activities was mainly attributable to the payment of dividends to shareholders. Net cash from financing activities was approximately RMB184.6 million for the year ended 31 December 2006, being the net amount of net proceeds from share offer of approximately RMB248.6 million minus approximately RMB54 million for dividends paid and listing expenses approximately RMB10 million during the year ended 31 December 2006. Net cash used in financing activities was approximately RMB16.5 million in 2005. Such decrease was attributable to dividends paid.

### Capital expenditures

Capital expenditure was used for construction in progress, purchases of land use rights, property, plant and equipment. For the year ended 31 December 2006, the Group's capital expenditure were approximately RMB16,057,000. The significant capital expenditures during the year ended 31 December 2006 were mainly for buildings, properties under construction and motor vehicles.

## INDEBTEDNESS

### Borrowings

As at the close of business on 31 December 2006, the Group did not have any outstanding borrowings.

### Bank facilities

As at the close of business on 31 December 2006, the Group did not have any banking facilities.

### Debt securities

As at the close of business on 31 December 2006, the Group did not have any debt securities.

### Contingent liabilities

As at the close of business on 31 December 2006, the Group did not have any material contingent liabilities or guarantees.

## PLEDGE OF ASSETS

As at the close of business on 31 December 2006, the Group did not have any pledge of assets.

# MANAGEMENT DISCUSSION AND ANALYSIS

### Capital commitments and other commitments

As at 31 December 2006, the future aggregate minimum lease payments under non-cancellable operating lease in respect of rental properties amounted to approximately RMB3,089,000 and the Group had no capital commitment.

## HUMAN RESOURCES

The Group employed approximately 1,016 people on 31 December 2006 (about 634 people on 31 December 2005). The total personnel cost of the Group was approximately RMB42,798,000 for the year ended 31 December 2006 (2005: RMB30,701,000). Employees' remuneration packages are based on individual experience and work profile. The packages are reviewed annually by the management who takes into account the overall performance of the working staff and market conditions. The Group also participates in the Mandatory Provident Fund Scheme in Hong Kong and state-managed retirement benefit scheme in the PRC.

On 16 November 2006, a share option scheme was approved by a resolution of the sole shareholder and the Board of Directors of the Company. The purpose of the share option scheme is to encourage the existing eligible employees for making further contributions to the future performance of the Group. However, no option have been granted or agreed to be granted to any person under the share option scheme by the end of 2006.

## FUTURE PROSPECTS

The Directors consider that the demand for bathroom masters in the PRC will continue to grow in the future. The targeted consumer base for bathroom masters is expected to expand as the product becomes increasingly affordable by the middle class consumers in the PRC and gradually gains acceptance in towns and in villages. The increase in disposable income of consumers in the PRC has also contributed towards the demand for a more comfortable lifestyle and higher-end products. This would mean that consumers in the PRC would readily accept bathroom master as a necessary amenity in the household (which can be used for various purposes throughout the entire year), as opposed to the traditional view that it was a luxury item which could only be used for heating purposes at cold weather.

Apart from bathroom masters, the Directors are of the view that consumers are also looking for other quality household products including exhaust fans and other home appliances. Accordingly, the Group intends to leverage on the strength of its brand, AUPU, to design, manufacture and distribute other quality home electrical appliances that will capture the emerging needs of consumers in the PRC. In addition, the Directors consider that with its leading position and well-recognised brand name in the PRC, the Group will be able to continue to developing overseas markets for its products.

### Maintenance of brand name management

The Directors consider that brand name management is crucial to the success of the Group. Since the establishment of Hangzhou AUPU Electrical Appliances Co., Ltd. ("AUPU Electrical") the Group has successfully built a reputation for its AUPU Bathroom Master 3-in-1 as high quality, safe and reliable products. The Group attaches very great importance to marketing and promotion of the AUPU brand and corporate image of the Group, which provides the Group with an important competitive advantage and has helped the Group in building a leading market position in the bathroom master industry in the PRC.

# MANAGEMENT DISCUSSION AND ANALYSIS

In September 2005, AUPU was recognised as a "China Well-known Trademark" by Wuhan Intermediate People's Court, after taking into consideration, among other things, the reputation of the Group and the market share of the Group's products. This award demonstrates strong consumer recognition and awareness of the Group's brand name. The Group has successfully positioned itself as a brand name manager, as evidenced by its well-established brand name, AUPU, which is known for its high quality and efficient services, its market leadership and its safe and reliable products. The Group intends to develop its brand recognition across the PRC to (i) expand its position in markets in other regions of the PRC where the Directors foresee growth potential, including secondary cities and rural areas in the PRC, and (ii) promote the sale of AUPU Bathroom Roof 1+N which was launched in 2006. The Group will continue to leverage on its strength in providing high quality products and efficient customer services, and will continue to promote the AUPU brand, its corporate image and products through television advertisements and participation in trade fairs.

### Establishment of a new production plant

The Directors are optimistic about the business prospects of the Group as the living standard of the people in the PRC is improving. The Group endeavours to increase its production capacity to meet the anticipated increase in demand for its products in the PRC market. The Group will also set up a new production plant in Hangzhou Economic and Technological Development Area with a gross floor area of approximately 80,000 sq.m. for the production of AUPU Bathroom Roof 1+N, AUPU Bathroom Master 3-in-1 and other new products of the Group. The new production plant will include production workshop, showroom, research centre for development of other home electrical appliances, logistic centre and office building. The Group has signed documents with the local government authorities in the PRC in December 2006, regarding the acquisition of a piece of land with a total site area of approximately 38,686 sq.m in Hangzhou Economic and Technological Development Area.

The unit purchase costs of the land is approximately of RMB250 per sq.m. and the acquisition costs have been paid from the net proceeds received by the Company from the new issue of shares in December 2006. The construction work is expected to be commenced around June 2007. The new production plant will eventually become the head office of the Group and the Directors believe that such expansion plan would enhance the GroupOs competitiveness in the PRC home electrical appliance industry.

### Enhancement and expansion of the Group's sales and distribution network in the PRC

As at 31 December 2006, the Group had nine branch offices and 39 sales and distribution centres in the PRC which cover major cities in approximately 22 provinces or autonomous regions and four centrally-administered cities. To further explore the PRC home electrical appliance market and to further increase the market share of the Group, the Group intends to enhance and further develop its sales and distribution network by (1) setting up its own stores; (2) establishing retail chain stores by franchise; and (3) increasing the number of points-of-sales, especially in secondary cities in the PRC.

The Directors consider that the living standard in the PRC is improving and, accordingly, the demand for bathroom accessories will also increase. As such, the Group is optimistic about the business prospects of chain stores of bathroom accessories in the PRC.

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Pursuant to Measures for the Administration of Foreign Investment in the PRC Commercial Sector and Administrative Measures on Commercial Franchising Operations, which were promulgated by the Ministry of Commerce of the PRC in April 2005 and December 2005 respectively, the Group obtained a new business licence recently, which allows AUPU Electrical to engage in the retail business, and the Group further intends to make an application for a licence to carry on franchise business in order to enable it to establish retail chain stores by franchise.

As at 31 December 2006, the Group owned and operated one store in Hangzhou. The Group intends to set up a total of approximately 20 stores in the next five years to cover major cities in the PRC as part of its vertical expansion plan. Also, to reduce the Group's business risks and to speed up the establishment of the Group's chain stores, the Group will also establish retail chain stores by franchise. The Group intends to establish approximately 100 retail chain stores by franchise in the next five years to further cover other major cities in the PRC. As at 31 December 2006, the Group had not granted any franchise in relation to the sales of its products. The Directors' plan is that the chain stores owned or operated by franchise in the future will mainly focus on selling the Group's new products, such as AUPU Bathroom Roof 1+N (which provides customised services such as design and installation), whereas the distributors of the Group will be mainly responsible for the distribution of AUPU Bathroom Master 3-in-1. The Directors also intend to establish approximately 500 new points-of-sales through its authorised agents and distributors in the next five years and to convert some of the existing points-of-sales into franchised stores of the Group.

### Enhancement of product development capability

The Directors believe that strong product development capability is one of the key factors for success in the home electrical appliance industry and is important for maintaining the Group's position as the market leader in the PRC bathroom master industry and increasing its market share for other products distributed under its brand, AUPU. In order to develop innovative home electrical appliances, the Group intends to strengthen its product development capability by setting up its own research and development centre and a rapid prototyping centre with computer-assisted technology and equipment to facilitate the designing and developing of new models of bathroom masters and exhaust fans. The Group also intends to recruit approximately 60 additional research and development professionals with relevant skills and expertise in years 2007 and 2008. The Group will also collaborate with or engage universities and professional organisations to develop new products or new technology which will be applied by the Group in product development. With its increased product development capability, the Group intends to further expand its products portfolio and enhance product quality and functionality.

### Improvement and upgrade of information and management systems

In order to improve internal control of the Group, the Group has set up a new centralized information and management system, including production information, logistic information and information security.

## FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's major financial instruments include bank balances, trade and other receivables and payables. Details of these financial instruments are disclosed in the Consolidated Financial Statements.

It is, and has been throughout the year, the Group's policy not to enter into trading of financial instruments.

The main risks arising from the Group's financial instruments are foreign currency risk, credit risk, interest rate risk and liquidity risk. The directors review and monitor policies implemented for managing each of these risks are summarised below.

### Foreign currency risk

The Group's exposure to foreign currency risk is arising mainly from:

(1) the exchange rate movements of Hong Kong Dollars as the Group has significant bank deposits denominated in this currency; and

(2) subsidiaries of the Company also have foreign currency sales and trade receivables denominated in currencies other than the functional currency of the relevant subsidiaries, which expose the Group to foreign currency risk.

The Group currently does not have a foreign currency hedging policy. In order to mitigate the foreign currency risk, the management closely monitors such risks and will consider hedging significant foreign currency exposure should the need arises.

### Credit risk

The Group's financial assets are bank balances and trade and other receivables, which represent the Group's maximum exposure to credit risk in relation to financial assets.

In order to minimise the credit risk in relation to trade receivables, the management has delegated a team responsible for 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 debt at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors consider that the Group's credit risk is significantly reduced. The amounts presented in the balance sheet are net of allowances for doubtful receivables, if any, estimated by the management based on prior experience, their assessment of the current economic environment and future discounted cash flow to receive.

The Group has no significant concentration of credit risk for its trade receivables which are spread over a large number of counterparties and customers.

The credit risk on liquid funds is limited because majority of the counterparties are banks with high credit-ratings assigned by international credit-rating agencies.

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### Cash flow interest rate risk

The Group's cash flow interest rate risk relates primarily to variable-rate for bank deposits which are all short-term in nature. Therefore, any future variations in interest rates will not have a significant impact on the results of the Group.

### Liquidity risk

The Group manages liquidity risk by maintaining adequate level of cash and cash equivalents by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

## PROPERTY VALUATION

Sallmanns (Far East) Limited, an independent valuer, has valued the Group's property interests as at 30 August 2006 and is of the opinion that the Group's property interests is valued at an aggregate amount of approximately RMB35.9 million as at 31 August 2006. Such valuation is approximately equal to the book value of the Group's property interests as at August 2006. Should the Group's property interests be stated at such valuation, there will not be any material additional depreciation charges for both the years of 2005 and 2006.