Management Discussion and Analysis

The board of directors (the "Directors") of Zhong Hua International Holdings Limited (the "Company") would like to present the Annual Report of the Company and its subsidiaries (collectively the "Group") for the year ended 31 December 2006.

Review of Results

The Group recorded a turnover of HK$12,739,000 (31 December 2005: HK$17,213,000) for the year ended 31 December 2006, representing a decrease of 26% compared with 2005. Net loss for the year attributable to ordinary equity holders of the Company was HK$145,761,000 (31 December 2005: HK$13,771,000).

Final Dividend

The Directors do not recommend the payment of a final dividend for the year ended 31 December 2006.

Closure of Register of Members

The Register of Members of the Company will be temporarily closed from Thursday, 19 July 2007 to Friday, 20 July 2007, both dates inclusive, during which period no transfer of shares will be effected. In order to qualify for the attendance at the Company's annual general meeting to be held on Friday, 20 July 2007 all completed transfer forms accompanied by the relevant share certificates must be lodged with the Company's branch share registrar in Hong Kong, Tengis Limited at 26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong for registration not later than 4:00 p.m. on Wednesday, 18 July 2007.

Business Review

The Group's turnover in the year mainly comprised of the rental income generated from the commercial podium in Chongqing, the leasing of Point-of-sale ("POS") equipment in Guangzhou and the provision of telecommunication and other related services in Mainland China.

Property investment

The rental income generated from leasing of the commercial units in Gang Yu Square in Chongqing was increased in the year compared with 2005. The occupancy rate of the square in the year remained satisfactory. It is expected that the business will continue to generate a steady stream of income to the Group.

Leasing of equipment

Since 2003, the Group had engaged in leasing of corded and cordless POS equipment in Guangzhou for a term of five years with an option to extend till 17 July 2011. The demand for POS equipment remained steady during the year. The Group will explore business opportunities for other value added services adhered to the leasing of the POS equipment.

Provision of telecommunication and other related services

Since 2004, the Group had engaged in the business of providing integrated telecommunication network services to online game developers and other broadband media providers via its operating subsidiary. Due to cut-throat competition in the dynamic online business market in Guangzhou, it was difficult for integrated telecommunication network service providers to secure a steady profit margin unless new and attractive online games and/or related broadband media products kept emerging from the market to drum up demand for such services. The Directors therefore considered it appropriate to liquidate the investment in the Telesuccess Group (as defined below) for immediate cash and focused its resources on other more promising investment opportunities in future.

On 6 November 2006, pursuant to a sales and purchase agreement entered into between the Group and an independent third party, the Group agreed to dispose of its entire equity interest in Telesuccess International Limited and its wholly-owned subsidiary, Sky City Network Communication Limited (collectively known as the "Telesuccess Group"), and net inter-company balances payable to the Group for a consideration of HK$50,000,000, which recognised a loss on disposal of HK$106,187,000.

The transaction was completed on 29 December 2006. Following the disposal of the entire interest in Telesuccess Group, the Group ceased the operation of provision of telecommunication and other related services.

Financial Review

Liquidity and financial resources

The Group generally financed its businesses with internally generated cash flows, banking facilities, net proceeds from placing of new shares and exercise of share options during the year.

Cash and bank balances of the Group as at 31 December 2006 amounted to HK$178,602,000 (2005: HK$133,151,000) and pledged deposits of HK$404,000 (2005: HK$354,000).

As at 31 December 2006, the Group had outstanding borrowings of approximately HK$25,543,000 (2005: HK$84,437,000) comprising interest-bearing bank loans amounted to HK$22,933,000 (2005: HK$54,140,000), convertible bonds payable amounted to HK$nil (2005: HK$29,782,000) and finance lease payable amounted to HK$2,610,000 (2005: HK$515,000). Of the Group's interest-bearing bank loans, 22%, 24% and 54% respectively are repayable within one year or on demand, in the second year, in the third to fifth years, inclusive. No bank loan as at 31 December 2006 was charged at fixed interest rates. An amount of HK$26,564,000 bank loans as at 31 December 2005 was charged at fixed interest rates.

The Group's gearing ratio as at 31 December 2006 was 0.2 (2005: 0.28), calculated based on the Group's total liabilities, excluding deferred income, of HK$118,848,000 (2005: HK$210,531,000) over total assets of HK$589,795,000 (2005: HK$754,633,000).

Currency structure

The Group had limited exposure to foreign exchange rate fluctuations as most of its transactions, including borrowings, were mainly conducted in Hong Kong dollars or Renminbi and the exchange rates of these currencies were relatively stable throughout the year.

Pledge of assets

The Group had utilised bank loan facilities amounting to approximately HK$22,933,000 (2005: HK$54,140,000) as at 31 December 2006. The bank loans were supported by certain of the Group's investment properties and corporate guarantees executed by the Company.

Contingent liabilities

As at 31 December 2006, guarantees given for mortgage loans granted by banks to certain purchasers of the Group's properties amounted to HK$4,039,000 (2005: HK$3,395,000).

Postponement of payment of the balance of a consideration

In November 2002, it was announced that the Group was contracted to dispose of certain assets to an independent third party at a consideration of HK$350,000,000 payable by installments. Pursuant to a second supplemental agreement dated 26 January 2005, the timing for payment of the balancing consideration of HK$90,000,000 in relation to the subject disposal was extended without interest to not later than 26 July 2005. However, given the total gross floor area of a proposed site of the underlying properties was not yet determined by the relevant governmental authorities, the purchaser to the transaction therefore requested that the payment of an amount of HK$40,000,000 be further deferred to not later than 30 January 2006 without interest. On 23 January 2006, the Group entered into an agreement with the purchaser to reschedule the repayment date of the remaining consideration of HK$40,000,000 on or before 31 January 2007.

Subsequent to the balance sheet date, on 25 January 2007, the Group entered into an agreement with the purchaser to further reschedule the repayment date of the remaining consideration of HK$40,000,000 on or before 31 January 2008. In this connection, the Group has received a sum of HK$310,000,000 out of HK$350,000,000 from the purchaser to the transaction.

Conversion of Convertible Bond

On 24 February 2006, Asia Pacific Broadband Entertainment Corporation Limited (formerly known as CNC Broadband Entertainment Corporation Limited), the holder of the Convertible Bond, exercised the conversion rights attached to the Convertible Bond. 20,000,000 shares with a par value of HK$0.20 each in the capital of the Company were converted at the conversion price of HK$1.50 per share.

The above number of shares and conversion price have been adjusted to reflect the capital reorganisation becoming effective on 27 April 2006 as further detailed in the section "Capital reorganisation" below.

Placement of new shares

On 28 March 2006, the Company entered into a subscription agreement with an independent third party which had conditionally agreed to subscribe for 17,000,000 shares to be issued and allotted by the Company at a subscription price of HK$0.30 per share. On 25 April 2006, the Company issued and allotted 17,000,000 shares at HK$0.30 per share resulting in raising a gross proceed of HK$5.1 million, which was used for general working capital of the Group.

The above number of shares and subscription price have been adjusted to reflect the capital reorganisation becoming effective on 27 April 2006 as further detailed in the section "Capital reorganisation" below.

Subscription of new shares and grant of option

On 31 August and 23 September 2005, a subscription agreement and a supplemental agreement were respectively entered into between the Company, a subscriber and a guarantor who are both independent third parties, pursuant to which the subscriber had conditionally agreed to subscribe for 20,000,000 new shares (the "Subscription Shares") at a subscription price of HK$0.36 per share, and the Company had conditionally agreed to grant an option (the "Option") to the subscriber at a price of HK$2,280,000. Pursuant to the terms of the deed of the Option, the subscriber was entitled to subscribe a maximum of 57,000,000 new shares (the "Option Shares") at an exercise price of HK$0.38 per share anytime from the date of the completion of the supplemental agreement and up to 31 December 2006. The Subscription Shares were allotted and issued to the subscriber in October 2005.

On 18 April 2006, the subscriber served the notice for subscription of 10,000,000 Option Shares at an exercise price of HK$0.38. The 10,000,000 Option Shares were allotted and issued on 25 April 2006 and a gross proceed of HK$3,800,000 was raised by the Company.

On 11 August 2006 and 22 August 2006, the subscriber served notices for subscription of 25,000,000 and 22,000,000 Option Shares at an exercise price of HK$0.38. The 25,000,000 and 22,000,000 Option Shares were allotted and issued on 14 August 2006 and 23 August 2006 respectively, and gross proceeds of HK$17,860,000 were raised by the Company. The Option had been fully exercised.

The above number of shares, subscription price and exercise price have been adjusted to reflect the capital reorganisation becoming effective on 27 April 2006 as further detailed in the section "Capital reorganisation" below.

Capital reorganisation

On 10 April 2006, the Company proposed a capital reorganisation (the "Reorganisation") to consolidate every ten ordinary shares of HK$0.02 each in the issued and unissued share capital of the Company into one ordinary share of HK$0.20 each (the "Consolidated Shares"). Pursuant to the Reorganisation, the authorised share capital of the Company was increased from HK$120 million to HK$200 million by the creation of 400 million additional Consolidated Shares of HK$0.20 each in the capital of the Company. The Reorganisation was approved by shareholders at the Company's special general meeting on 27 April 2006.

Litigation

(a) A writ of summons was issued in Hong Kong in August 2005 by a former director of a subsidiary of the Company (the "Former Director") against, inter alia, the Company, and a director and certain accounting staff of the Company. According to the summons, the Former Director claimed certain damages in relation to the acquisition of a subsidiary by the Group from a private company controlled by the Former Director in December 2000. In the Indorsement of Claims, the Former Director claimed that a receipt for a consideration of HK$33,500,000 signed by the private company controlled by her be set aside and demanded for payment of outstanding consideration in the amount of HK$33,500,000. The Company has filed an acknowledgement of service to defend the proceedings in February 2006. No further development took place since then.

Given that the aggregate amount under all the claims is not material to the Group as a whole and the litigation is expected to continue for a period of time before a judgment is made, the Group is of the view that the proceedings will not have any immediate material adverse impact on the financial position, cashflow and business operation of the Group. No provision for the proceedings has been made for the year.

(b) Two writs of summons were issued in Chongqing in November 2006 by a third party (the "Plaintiff") against a wholly-owned subsidiary of the Group (the "Defendant"). According to the two summons, the Plaintiff claimed certain damages in relation to the unilateral termination of an estate management contract by the Defendant. In the Endorsement of Claims, the Plaintiff demanded for payment of compensation and amounts due to the Plaintiff in an aggregate amount of RMB29.0 million (HK$28.8 million). The Defendant then filed another writ of summons in the capacity of plaintiff against the Plaintiff in Chongqing in November 2006 for counter-claim of an aggregate amount of RMB68.5 million (HK$68.2 million) plus interest. The Chongqing Municipal High People's Court (重慶市高級人民法院) has given direction to consolidate the proceedings of the three writs of summons.

Having consulted with the Defendant's legal counsel in Mainland China, the Group is of the view that the legal ground of the Plaintiff is thin and therefore no provision for the proceedings has been made at this stage.

Employee and remuneration policy

The Group employed 19 full time staff in Hong Kong, Chongqing and Guangzhou as at 31 December 2006. Employees are remunerated according to the nature of their job and market trend, with built-in merit components incorporated in the annual increment to reward and motivate individual performance. In Chongqing and Guangzhou, the Group provides staff welfare and bonuses to its employees in accordance with the prevailing labour law. In Hong Kong, other staff benefits include medical schemes, Mandatory Provident Fund Scheme and employee share option scheme.

Prospects

The Group is principally engaged in property investment and leasing of point-of-sale equipment in the Mainland China upon disposal of Telesuccess Group in December 2006. Given that the Group had extensive experience in property development and investment in the Mainland China since 1992, the Directors consider that they should capitalise their expertise and connections in this area for the Group's future business development. Hence, it is expected that the Group will consolidate its business sectors and formulate a new business direction in the coming year. In this respect, the Directors are optimistic that the continuing economic growth in the Mainland China will serve to facilitate the business growth of the Group.