# Xinyu Hengdeli Holdings Limited
# 新宇亨得利控股有限公司

*(Incorporated in the Cayman Islands with limited liability)*

*(Stock Code : 3389)*


ANNUAL REPORT **2006**

# The comprehensive retail network of Xinyu Hengdeli in the PRC

# Xinyu Hengdeli Group Retail 96 Shops

as at 31 December 2006

## BEIJING

1 Prime Time Beijing Hengdeli Wangfujing Department Store
*255 Wangfujing Street, Beijing, China.*

2 Prime Time Beijing Hengdeli Swiss Watch Shop
*271-273 Wangfujing Street, Beijing, China.*

3 Beijing Hengdeli HuaYu Fashion Shopping Center
*1/F, Shuma Tower B, 2 Zhongguancun South Street, Beijing, China.*

4 Prime Time Beijing Hengdeli Shuang An Shop
*1/F, Shuangan Department Store, 38 Sanhuan West Road, Haidian District, Beijing, China.*

5 Prime Time Beijing Hengdeli Urban-Rural Trade Center
*1/F, Chengxiang Center, 23 Fuxin Road, Beijing, China.*

6 Prime Time Beijing Hengdeli Cui Wei Tower Shop
*1/F, Cuiwei Tower, 33 Fuxin Road, Haidian District, Beijing, China.*

7 Beijing Hengdeli Cui Wei Mudan Yuan Shop
*19-1/F, Mudan Yuan Department Store, 2 Huayuan Road, Haidian District, Beijing, China.*

8 Beijing Zhongguancun Jin Le Hui Shop
*B1, Jin Le Hui Shop, Zhongguancun Shopping Center, 5 Haidian Street, Beijing, China.*

9 Prime Time Beijing Hengdeli New World Shop
*A1, 3 Chongwenmen Wai Street, Beijing, China.*

10 Beijing Hengdeli Yansha Friendship Department Store
*52 Liangmaqiao Road, Chaoyang District, Beijing, China.*

11 Beijing Chen Xi Shop
*B1 Level, Guomao Shop, 1 Jianwai Street, Chaoyang District, Beijing, China.*

12 Prime Time Beijing Grand Hyatt Tag Heuer Boutique
*UG Level, Tag Heuer Shop, Grand Hyatt Beijing, 1 East Changan Avenue, Dong Cheng District, Beijing, China.*

13 Prime Time Beijing Grand Hyatt Zenith Boutique
*GG02-UG Level, Grand Hyatt Beijing, 1 East Changan Avenue, Dong Cheng District, Beijing, China.*

14 Prime Time Beijing Grand Hyatt HMS Luxuries Shop
*GG09-UG Level, Grand Hyatt Beijing, 1 East Changan Avenue, Dong Cheng District, Beijing, China.*

15 Prime Time Beijing Grand Hyatt Jager-LeCoulter Boutique
*GG12-UG Level, Grand Hyatt Beijing, 1 East Changan Avenue, Dong Cheng District, Beijing, China.*

16 Prime Time Beijing Orient Plaza Rolex & Tudor Boutique
*SS01A 1/F, Orient Plaza Beijing, 1 East Changan Avenue, Dong Cheng District, Beijing, China.*

17 Beijing Dong Fang Xin Tian Di the Shop
*BB46B Underground F, Orient Plaza Beijing, 1 East Changan Avenue, Dong Cheng District, Beijing, China.*

## TIANJIN

18 Tianjin Binjiang Shopping Center
*29 Kaifeng Road, Hepin District, Tianjin, China.*

19 Tianjin International Plaza – A & B Shop
*211 Nanjin Street, Heping District, Tianjin, China.*

20 Tianjin Friendship Famouscity Department Store
*19 Huanghai Road, Jingji Jishu Develop District, Tianjin, China.*

21 Tianjin Friendship Newcity Department Store
*200 Shizilin Street, Hebei District, Tianjin, China.*

## HEBEI

22 Shijiazhuang San Li International Shop
*1/F, San Li International Department Store, 6 Jianshenan Street, Shijiazhang, China.*

23 Handan Guo Mao Shop
*1/F, Meite Guo Mao Department Store, 208 Renmingdong Street, Handan, China.*

## SHANXI

24 Taiyuan Paris Spring Shop
*53 Kaihuasi Street, Taiyuan, China.*

25 Taiyuan Feng Le Swiss Watch Centre
*62 Kaihuasi Street, Taiyuan, China.*

26 Taiyuan Hua Yu Shopping Centre Famous Watch Shop
*181 Kaihuasi Street, Taiyuan, China.*

27 Taiyuan Hua Yu Guoji Jingpin Commercial Building Famous Watch Shop
*169 Fuxi Street, Taiyuan, China.*

28 Taiyuan Hua Yu Guoji Jingpin Commercial Building Cartier Shop
*169 Fuxi Street, Taiyuan, China.*

## SHANGHAI

29 Shanghai Watch Shop
*478-492 Huaihai Middle Road, Shanghai, China.*

30 Shanghai Jinying Interntaional Shopping Center Xinyu Famous Watch Shop
*278 Shanxibei Road, Shanghai, China.*

31 Shanghai Orient Shopping Yangpu Shop
*2500 Siping Road, Yangpu District, Shanghai, China.*

32 Shanghai Hengdali Internatioanl Commercial Shop
*2/F, 819 Nanjingdong Road, Shanghai, China.*

## SHANDONG

33 Qingdao Xinyu Hengdeli No.1 Parkson Shop
*44-60 Zhongshan Road, Qingdao, China.*

34 Qingdao Hengdeli No.1 Watch Shop
*144 Zhongshan Road, Qingdao, China.*

35 Qingdao Sunshine Shopping Center Watch Shop
*38 Hongkong Road Middle, Qingdao, China.*

36 Qingdao Carrefour Watch Shop
*21 Hongkong Road Middle, Qingdao, China.*

37 Qingdao Yantai Parkson Watch Shop
*166 Nan Street, Yantai, China.*

## JIANGSU

38 Nanjing GoldenEagle Interntaional Shopping Center Xinyu Famous Watch Shop
*1/F, GoldenEagle International Shopping Center, 89 Hanzhong Street, Nanjing, China.*

39 Nanjing Shanxi Lu Baihuo Shop
*1/F, Shanxi Lu Baihuo Department Store, 107-114 Zhongshanbei Road, Nanjing, China.*

40 Nanjing DeJi Plaza Shop
*L107-1F, 18 Zhongshan Road, Nanjing, China.*

41 Xuzhou GoldenEagle Interntaional Shopping Center Xinyu Famous Watch Shop
*1/F, GoldenEagle International Shopping Center, 2 Zhongshanbei Road, Xuzhou, China.*

42 Xuzhou Wang Fu Jing Shop
*51 Huaihai East Road, Xuzhou, China.*

43 Changzhou Dongfang Commercial Building Shop
*1/F, Dongfang Commercial Building Department Store, 135 Yanlingxi Road, Changzhou, China.*

44 Yangzhou GoldenEagle Interntaional Shopping Center Xinyu Famous Watch Shop
*120 Wenhe South Road, Yangzhou, China.*

45 Wuxi Parkson Shop
*1/F, 127 Renmin Middle Road, Wuxi, China.*

46 Wuxi Orient Shopping Centre
*1/F, 188 Zhongshan Road, Wuxi, China.*

47 Wuxi Orient Shopping Centre
*1/F, 188 Zhongshan Road, Wuxi, China.*

48 Wuxi New World Shopping Mall Shop
*341 Zhongshan Road, New World Shopping Mall Shop, Wuxi, China.*

## ANHUI

49 Hefei Vista International Plaza Watch Shop
*1/F, Vista International Plaza, 108 Shouchun Road, Hefei, China.*

50 Hefei Baida Gulou Building Watch Shop
*1/F, 96 Suzhou Road, Hefei, China.*

51 Hefei Baida CBD Shopping Centre Watch Shop
*1/F, Baida CBD Shopping Centre, 369 Changjingzhong Road, Hefei, China.*

52 Hefei Vista Luxury Centre Watch Shop
*1/F, Vista Luxury Center, 1104 Changjiangdong Road, Hefei, China.*

53 Hefei Xinyu Hengdeli World Watches Centre
*Wenchangge, Huaihai Road, Hefei, China.*

## ZHEJIANG

54 Hangzhou Building Xinyu Famous Watch Shop
*Hangzhou Building, 21 Wulin Plaza, Hangzhou, China.*

55 Hangzhou Building Omega Shop
*Hangzhou Building, 21 Wulin Plaza, Hangzhou, China.*

56 Hangzhou Hengdeli Shop
*216-218 Jiefang Road, Hangzhou, China.*

57 Hangzhou JieBai New Century Commercial Building Xinyu Famous Watch Shop
*251 Jiefang Road, Hangzhou, China.*

58 Hangzhou Yuan Hua Shang Cheng Xinyu Famous Watch Shop
*179 Yan An Road, Hangzhou, China.*

59 Hangzhou Yin Tai Famous Watch Shop
*2/F, 530 Yan An Road, Hangzhou, China.*

60 Hangzhou Lancareford Shop
*906 Xinliang Hotel, 279 Tiyuchang Road, Hangzhou, China.*

61 Wenzhou Wuma Famous Watch Shop
*4 Wuma Street, Wenzhou, China.*

62 Wenzhou Kaitai Famous Watch Shop – A & B Shop
*1 Renming East Road, Wenzhou, China.*

63 Wenzhou Shi Dai Plaza Shopping Centre Watch Shop
*1-3 Shi Dai Plaza Shopping Centre, Wenzhou, China.*

64 Wenzhou Lian He Famous Watch Shop
*1/F, Lian He Plaza, Da Nan Men, Wenzhou, China.*

65 Wenzhou Commercial Watch Shop
*1/F, Commercial Tower Shop, Wenzhou, China.*

66 Ningbo Yintai Famous Watch Shop
*188 Zhongshan East Road, Ningbo, China.*

67 Wenzhou Rui An KaiTai Department Store Shop
*1/F, KaiTai Department Store, Hongqiao Road, Rui An, China.*

68 Jinhua Yintai Famous Watch Shop
*88 Wujiang West Road, Wujiang, Jinhua, China.*

69 Taizhou Jinjing Department Store Famous Watch Shop
*251 Jiefang Road, Jiaojiang District, Taizhou, China.*

## FUJIAN

70 Prime Time Fuzhou Dong Bai Shop
*84 North Road, 817 Fuzhou, China.*

## LIAONING

71 Prime Time Shenyang Commercial City Shop
*212 Zhong Street, Shenhe District, Shenyang, China.*

72 Prime Time Shenyang Tag Heuer Shop
*68 Zhonghua Street, Heping district, Shenyang, China.*

73 Xinyu Elegant Shenyang Qiu Lin Shop
*90 Zhongshan Street, Heping District, Shenyang, China.*

74 Prime Time Shenyang Xinmate Shop
*1 Xiaodong Road, Dadong District, Shenyang, China.*

75 Prime Time Shenyang Zhongxing Commercial Building Shop
*86 Taiyuan North Street, Shenyang, China.*

76 Prime Time Shenyang Zhongxing Commercial Building Shop
*86 Taiyuan North Street, Shenyang, China.*

77 Xinyu Fushun Department Store
*4 Dongyi Road, Xinfu District, Fushun, China.*

## HEILONGJIANG

78 Prime Time Haerbin Swiss Watch Centre
*3 Hongxia Street, 142 Zhongyang Street, Daoli District, Haerbin, China.*

79 Prime Time Haerbin New World Shop
*403 Huayuan Street, Nangang District, Haerbin, China.*

80 Prime Time Haerbin Lanecarfort Shop
*167 Zhongyang Street, Daoli District, Haerbin, China.*

81 Daqing Department Store
*7 Xibin Road, Ranghulu District, Daqin, Chian.*

## HENAN

82 Zhengzhou Jin Bo Da Shopping Center Watch Shop
*200 Er Qi Road, Zhengzhou, China.*

83 Zhengzhou Zhenghong Shopping Centre Xinyu Famous Watch Shop
*1/F, 224 Er Qi Road, Zhengzhou, China.*

84 Zhengzhou Dannisi Shopping Center Watch Shop
*2 Renmin Road, Zhengzhou, China.*

85 Zhengzhou Zhengdao Garden Shop
*8 Huayuan Road, Zhengzhou, China.*

86 Zhengzhou Hualian Shopping Center Watch Shop
*3 Minzhu Road, Zhengzhou, China.*

87 Luoyang Dannisi Shopping Center Watch Shop
*80 Nanchang Road, Luoyang, China.*

88 Luoyang Dannisi Shopping Center Cartier Shop
*80 Nanchang Road, Luoyang, China.*

## GUIZHOU

89 Guiyang Guomao Temp de lux Watch Shop
*1/F, Guomao Temp de lux Department Store, 1 Zhonghuabei Road, Guiyang, China.*

## GUANGDONG

90 Prime Time Shenzhen Shenhua Watch Center
*1/F, 1026 Jiabin Road, Luohu District, Shenzhan, China.*

91 Shenzhen Huaqiang Bei Mao Ye Sunshine Watch Shop
*1/F, Huaqiang North Road, Futian District, Shenzhan, China.*

92 Shenzhen Huaqiang Bei Mao Ye Sunshine Tag Heuer Shop
*1/F, Huaqiang North Road, Futian District, Shenzhan, China.*

## HONG KONG

93 Elegant – Ocean Terminal
*Shop OT, 286, Level 2, Ocean Terminal, Harbour City, Tsimshatsui, Hong Kong.*

94 Elegant – Ocean Centre
*Shop 331, Level 3, Ocean Centre, Harbour City, Tsimshatsui, Hong Kong.*

95 Elegant – Times Square
*Shop 406, Times Square, Causeway Bay, Hong Kong.*

96 Elegant – Central
*Shop 3, G/F, Luk Hoi Tong Building, 31 Queen's Road, Central, Hong Kong.*

# Contents


## Capture Business Opportunities

## Elaborate Our Competitive Edge

## Consolidate Our Strength

## Accomplish New Achievements

In 2006, by leveraging on our abundant resources, substantial experience and ambitious efforts, we captured enormous market opportunities through joint ventures, acquisitions and establishment of new outlets. Our continuous expansion of retail outlets and further enlargement of sales network both contributed to our rapid growth of business. We accomplished desirable results by unifying our team spirit and vision in order to deliver the best value for our shareholders and the community at large.

# Corporate Profile


Xinyu Hengdeli Holdings Limited ("Xinyu Hengdeli" or "the Company"; Stock Code: 3389.HK) and its subsidiaries, collectively as "the Group" is the largest watch retailer and wholesaler of internationally renowned brands in the PRC. Its strategic shareholders include The Swatch Group Limited, the world's largest watch manufacturer and distributor; the LVMH Group, the world's largest luxury goods conglomerate; and Temasek, the investment arm controlled by the Singapore Government.

As at the end of the period, the Group's extensive sales network comprises of 96 retail shops, distributing approximately 50 renowned international watch brands. For wholesale business, the Group has approximately 300 wholesale customers in over 40 cities in the PRC. For retail business, the group operates 92 shops in 30 cities in the Mainland China. In addition, in August 2006, the Group successfully acquired Elegant International Holdings Limited which owned 4 retail watch outlets selling internationally high-end watches in Hong Kong.

The Group maintains good business relationship with various world-famous watch brands suppliers such as the Swatch Group, the LVMH Group, the Richemont Group, the Rolex Group and the Desco Group, distributing 19 world-renowned watch brands, of which 17 are on an exclusive basis. The Group also owns watch brands namely Nivada, Olma and Numa Jeannin.


The Group provides comprehensive customer service, on top of the sizable repair and maintenance centers in Beijing and Shanghai. Immediate repair at each retail shop, nationwide joint repair and maintenance services are also available. The Group holds a production plant in Guangzhou which engages in accessories production and product packaging. The plant specializes in design and manufacturing of packing boxes for luxury watches, display counters for high-end stores, marketing props and other decorative products for high-end retail shops.

Xinyu Hengdeli was listed on the main board of The Stock Exchange of Hong Kong Limited since 26 September 2005.

# Corporate Profile

## Brands distributed by Xinyu Hengdeli Group in the PRC

**LVMH Group**
TAG Heuer
Zenith
Christian Dior
Fendi

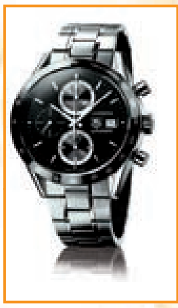
**Swatch Group**
Tissot
Calvin Klein
Certina
Hamilton

**Richemont Group**
Jaeger-LeCoultre
Baume & Mercier
Alfred Dunhill

**Independent Brands**
Audemars Piguet
Carl F. Bucherer
Maurice Lacroix
EDOX
Enicar
Carven
Cyma
Claude Bernard

## Brands sold at Xinyu Hengdeli Group's PRC outlets as authorised dealer

**Swatch Group**
Tissot
Calvin Klein
Certina
Hamilton
Breguet
Longines
Omega
Rado
Blancpain



**LVMH Group**
TAG Heuer
Zenith
Christian Dior
Fendi

**Richemont Group**
Jaeger-LeCoultre
Baume & Mercier
Alfred Dunhill
Cartier
Vacheron Constantin

**Rolex Group**
Rolex
Tudor


**Independent Brands**
Audemars Piguet
Carl F. Bucherer
Maurice Lacroix
EDOX
Enicar
Carven
Cyma
Claude Bernard
Ball
Gucci
Oris
Raymond Weil
Titoni

# Corporate Profile

## Brands sold at Xinyu Hengdeli Group's Hong Kong outlets as authorised dealer

Baume & Mercier
Bedat & Co.
Bell & Ross
Blancpain
Breguet
Breitling
British Master


Hermes
Hublot
IWC
Jaeger LeCoultre

Jaquet Droz
JeanRichard
Locman
Montblanc
Oris


Bvlgari
Chopard
Chronoswiss
Corum
CVSTOS
Cartier
Ebel

Panerai
Parmigiani
TAG Heuer
Ulysse Nardin
Vacheron Constantin
Zenith

Franck Muller
Girard Perregaux
Glashutte
Grand Seiko
Gucci

# Corporate Information

## STOCK SHORT NAME

Xinyu Hengdeli

## BOARD OF DIRECTORS

### Executive Directors

Mr. Zhang Yuping *(the Group's Chairman)*
Mr. Song Jianwen
Mr. Huang Yonghua

### Non-executive Directors

Mr. Chen Sheng
Mr. Shen Zhiyuan
Mr. Shi Zhongyang *(Appointed on 15 February 2006)*
Mr. Chuang Jian, George *(Appointed on 23 October 2006)*

### Independent Non-executive Directors

Mr. Liu Huangsong
Mr. Cai Jianmin
Mr. Wong Kam Fai, William

## AUDIT COMMITTEE

Mr. Cai Jianmin *(Committee Chairman)*
Mr. Liu Huangsong
Mr. Wong Kam Fai, William
Mr. Chuang Jian, George

## REMUNERATION COMMITTEE

Mr. Zhang Yuping *(Committee Chairman)*
Mr. Liu Huangsong
Mr. Cai Jianmin

## NOMINATION COMMITTEE

Mr. Song Jianwen *(Committee Chairman)*
Mr. Liu Huangsong
Mr. Cai Jianmin

## COMPANY SECRETARY AND QUALIFIED ACCOUNTANT

Mr. Ng Man Wai, Peter *(HKICPA, ACCA)*

## AUTHORIZED REPRESENTATIVES

Mr. Song Jianwen
Mr. Ng Man Wai, Peter *(HKICPA, ACCA)*

## REGISTERED OFFICE

Cricket Square
Hutchins Drive
P.O. Box 2681
Grand Cayman KY1-1111
Cayman Islands

## HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Room 301, 3/F, Lippo Sun Plaza
28 Canton Road, Tsim Sha Tsui
Kowloon, Hong Kong

## AUDITORS

KPMG
*Certified Public Accountant*
8/F, Prince's Building
10 Chater Road
Central, Hong Kong

## COMPANY'S LEGAL ADVISER

As to Hong Kong Law
Gallant Y. T. Ho & Co.
5/F, Jardine House
1 Connaught Place
Central, Hong Kong

## HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Computershare Hong Kong Investor Services Limited
Shops 1712-1716
17th Floor, Hopewell Centre
183 Queen's Road East
Wanchai, Hong Kong

## CAYMAN ISLANDS PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Butterfield Fund Services (Cayman) Limited
Butterfield House
68 Fort Street
P.O. Box 705
George Town
Grand Cayman
Cayman Islands

## MEDIA AND INVESTORS ENQUIRY

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Xinyu Hengdeli Holdings Limited
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Kowloon, Hong Kong
Tel: (852) 2375 7863
Fax: (852) 2375 8010
Email: sallus.wong@hengdeli.com.hk

## FINANCIAL PUBLIC RELATIONS CONSULTANT

Porda International (Finance) P.R. Co., Ltd.
7/F, CMA Building
64 Connaught Road Central
Central, Hong Kong
Tel: (852) 2544 6388
Fax: (852) 2544 6126
Email: info@pordafinance.com.hk

# Corporate Highlights in 2006

## January

The Group together with Richemont Group opened a Cartier Watch Boutique in Huayu International Exiquisite Commodities Building in Taiyuan City, Shanxi Province, PRC.

## April to May

The Group acquired 70% equity interest of Henan Fuhao Watch Ltd. (河南富豪表行有限責任公司).

The Group established Anhui Sanxin Watch & Clock Ltd. (安徽三新鐘錶有限公司) together with a renowned retailer in Anhui.

## June

The Swatch Group increased its shareholdings in Xinyu Hengdeli to 7.24% through an assignment of 12,500,000 sale shares. The transaction has further deepened the relationship between the Group and the Swatch Group.

## July

The Group renewed the sole agency agreement with Audemars Piguet (Hong Kong) Ltd., a subsidiary of Audemars Piguet Holding SA. Pursuant to the agreement, the two parties would continue their long-term cooperation for an extended term of 3 years.


## August

The Group issued 148,500,000 new shares in aggregate to three strategic investors, namely Dunearn, a wholly-owned subsidiary of Temasek, the investment arm of the Singapore Government, Swatch Group and United Capital Investment (UCI). Upon completion of the transaction, Temasek became the second largest shareholder of the Group, holding 9.94% of its enlarged share capital.

The Group acquired 100% equity interest of Elegant International Holdings Limited (三寶鐘錶珠寶集團), which engages in retailing of international branded watches in Hong Kong with 4 high-end watch shops in Tsimshatsui, Causeway Bay and Central, Hong Kong.

## September

The Group renewed the Maurice Lacroix sole agency agreement with Desco (China) Limited (達世高(上海)貿易有限公司), a subsidiary of Desco Group – a world famous watches group. Pursuant to the agreement, the two parties would continue their long-term cooperation for an extended term of 5 years. It marked a new era of cooperation between Xinyu Hengdeli and Maurice Lacroix.

## October

The Group succeeded in acquiring 100% equity interest of Artdeco Decorating & Packaging Co., Ltd. in Guangzhou province (廣州市雅迪裝飾包裝有限公司) and establishing CAPS Projects Limited (新宇創念管理有限公司) in Hong Kong, thereby strengthening the ancillary business to the Group's core business. This further expanded the business scope of and brought new sources of revenue to the Group.

LVMH announced that it had accumulated acquisition of 7.24% shares of Xinyu Hengdeli through purchases in the open market to further enhance the cooperative relationship with Xinyu Hengdeli.

## November

The Group entered into a new cooperative agreement with Wenzhou Huayu Watch & Clock Co., Ltd. (溫州華宇鐘錶有限公司), establishing Wenzhou Xinyu Watch & Clock Co., Ltd. (溫州新宇鐘錶有限公司), which increased the number of retail stores of the Group in the Mainland China to 92.

# CHAIRMAN'S STATEMENT

Zhang Yuping
Chairman

## An Extraordinary Vigour Ever Fresh

# Chairman's Statement

**Dear Shareholders,**

On behalf of the board of directors (the "Board of Directors"), I am pleased to present the annual report for the year ended 31 December 2006 (hereinafter as the "Year") of Xinyu Hengdeli Holdings Limited (hereinafter as the "Company") and its subsidiaries (hereinafter as the "Group") for your review.

Following the satisfactory development trend of the previous year, the Group was able to maintain a rapid business development in 2006 and achieve outstanding results. The Group's revenue reached 2.4 billion (RMB, as all amounts hereinafter shall refer to), increased 72.2% as compared to last year. Profit for the year was 214 million, increased 62.1% from that of last year.


In this year, the Group continued to expand the domestic as well as overseas retail networks by various means. In China market, the Group extended the retail network to regions like Hefei, Zhengzhou and Wenzhou through joint ventures and acquisitions, gaining more than 85% or 90% in market share of middle-to-high-end import watches. The notable results achieved represents our successful implementation of the Group's strategy of swift and steady expansion in retail business. At the same time, our retail network in Harbin, Shenyang and Taiyuan also achieved new breakthrough. During the year under review, retail outlets of the Group in the PRC reached 92, surpassing the target we had previously set.


In particular, the Group successfully acquired the entire equity interests of Elegant International Holdings Limited which had 4 high-end watch outlets in Hong Kong in August 2006. The move marked a milestone of the Group's effort in implementing its overseas retail business strategy. During the four months from August to December 2006, the Elegant group achieved excellent results with more than 30% growth in both turnover and gross profit margin when compared to the previous corresponding period. This successful acquisition have enriched the experience and laid down a solid foundation for further overseas expansion of the Group.

# Chairman's Statement


On this basis, the Group has established a comprehensive retail business model, covering different classes of watches from the supreme luxury, middle-to-high-end, and the trendy watches.

During the year under review, Temasek has become a strategic investor of the Company. Moreover, each of the Swatch Group Limited (the world's largest watch manufacturer and distributor) and the LVMH Group (the world' s leading luxury goods conglomerate) has acquired and held more than 7% shareholding interest in the Company through share placement and purchase on the market respectively. The strategic investor profile of the Group testifies its leading position in the high-end import watch market. On the other hand, the opening of boutiques under various brands include Cartier of Richemont Group, Omega of the Swatch Group, TAG Heuer of LVMH Group, and Rolex of the Rolex Group; and renewal of long-term agency agreements with the Audemars Piguet and Maurice Lacroix, illustrate the Group is working even more closely with brand owners, thus its business development has entered into a new historical stage.



During the year under review, in view of providing highest level of confidence for customers, the Group committed to establish a group-scale customer service system with bases in Beijing, Shanghai and Hong Kong. During the year, the Group also acquired the entire interests of a decorating and packaging company, bringing synergy to its effort in enhancing outlet image as well as vertical development of the Group's luxury consumer products business.

# Chairman's Statement


Together with active business pursuit, the Group has always committed to maintaining and improving its corporate governance, so as to ensure decisions made by the Company will be in the interest of its shareholders as a whole, and bring greatest benefit to shareholders and the community.

Moving forward, under a favorable macro-economic environment, the Group will continue to leverage on its strengths to further expand the domestic and overseas retail networks in compliance with international standard. Effort will also be spent in building and maintaining long-term and deep cooperating relationship with the Group's brand owners, expanding and optimizing its high-end consumer products portfolio, further enhancing the customer service system in Greater China, and tirelessly striving for better quality in service and corporate governance, thereby maximize returns to its shareholders and the community.

On behalf of the Board of Directors, I would like to express our sincere gratitude to our shareholders, suppliers, customers and our other business partners for their heartfelt trust and support, as well as to our dedicating staff for their continued commitment and contribution during the past year.

By Order of the Board
**Zhang Yuping**
*Chairman*

Hong Kong, 10 April 2007

# MANAGEMENT DISCUSSION AND ANALYSIS

Pursuit of trueness
through perfect rendition

# Management Discussion and Analysis

## I MARKET OVERVIEW

The PRC economy maintained its impressive growth trend in 2006 with the gross domestic product (GDP) growing by 10.6% and total retail consumption in the community reached RMB8 trillion, representing an increase of 13.5% year-on-year. On top of that, the Central Government had also introduced a series of policies favorable for an continuous increase in people's income, such as the upward adjustment in the personal income tax exemption threshold, the agricultural tax exemption, and the rise in salaries of civil servants etc., leading to the increase in household's actual disposable income and substantially enhance consumers' purchasing power. This creates enormous demand for luxury goods such as watches of high-end brand names. As the market leader in the retail and distribution of internationally prestigious brand watches in the PRC, the Group had seen its business leap under such favorable market conditions.

## II FINANCIAL REVIEW

### Sales

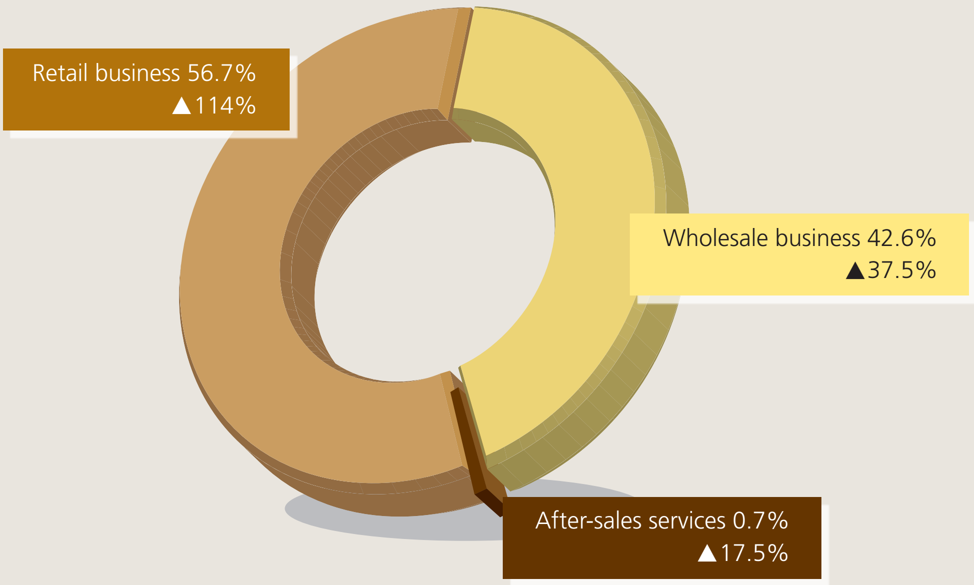
For the year ended 31 December 2006, the Group recorded sales of RMB2,404,699,000, of which sales from wholesale business amounted to RMB1,024,507,000 and accounted for 42.6% of the sales; sales from retail business amounted to RMB1,362,863,000 and accounted for 56.7% of the sales. The increase in sales was mainly attributable to the Group's ability to leverage the enormous demand in the PRC's luxury watches market, enhancement of the operating performance together with the brand name effects through a strong sales network, the Group's business performance therefore moving forward.

# Management Discussion and Analysis

Sales breakdown of the Group (for the year ended 31 December 2006):

| | **2006** | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|
| | **RMB'000** | **%** | RMB'000 | % | RMB'000 | % |
| Retail business | **1,362,863** | **56.7** | 636,725 | 45.6 | 530,264 | 34.9 |
| Wholesale business | **1,024,507** | **42.6** | 745,059 | 53.4 | 974,771 | 64.2 |
| After-sales services | **17,329** | **0.7** | 14,747 | 1.0 | 13,547 | 0.9 |
| Total | **2,404,699** | **100.0** | 1,396,531 | 100.0 | 1,518,582 | 100.0 |

**2006**



# Management Discussion and Analysis

## Gross profit and gross profit margin

For the year ended 31 December 2006, the Group's gross profit increased by 54.6% from last year to approximately RMB562,904,000, whereas our gross profit margin was down 2.7 percentage points over last year to approximately 23.4%. The increase was mainly due to the consolidation of sales and gross profits of the Elegant Group into the Group for the current year, while the gross profit margin in the Hong Kong market was lower than the market in Mainland China.


## Profit for the year and profit margin

Profit for the year increased by 62.1% to approximately RMB213,598,000 over last year.

## Distribution costs

During the year under review, the Group devoted to expand its retail network with 31 new outlets being opened. As a result, the Group's distribution costs was approximately RMB175,889,000, representing 7.3% of the Group's sales. The increase in distribution costs of the Group is in line with the growth of its business.

## Final dividend

The Company recommends the payment of a final dividend of RMB0.028 per share for the year ended 31 December 2006 in return for shareholders' support, subject to approval by shareholders at the Annual General Meeting to be held on 1 June 2007. The proposed final cash dividend will be paid on or before 26 June 2007 to shareholders whose names appear on the register of members of the Company on 31 May 2007.

## Current assets and current liabilities

As at 31 December 2006, the current assets of the Group amounted to approximately RMB1,968,560,000, including inventory of approximately RMB1,262,382,000, trade and other receivables of approximately RMB330,995,000, and cash and cash equivalents of approximately RMB298,275,000.

As at 31 December 2006, the current liabilities of the Group amounted to approximately RMB832,996,000, including bank loans and other interest bearing liabilities of approximately RMB387,814,000, trade and other payables of approximately RMB370,698,000, and current tax payable of approximately RMB74,484,000.

# Management Discussion and Analysis

## III Business Review

### Expansion of retail outlets


The Group's enormous retail network in the PRC provides an expressway for internationally renowned watch brands to enter the China domestic market. As at 31 December 2006, the Group has established 92 retail outlets across 30 cities throughout the PRC, representing an increase of 27 retail outlets to the same period in the previous year, that outnumbered our expected number of 20 stores.

In terms of our operating model, the Group owns 82 integrated retail outlets under Xinyu's brand portfolio and 14 individual brand boutique shops. Not only do different operating models help promptly establishing retail network for the Group, but also accelerate market penetration at the same time. Furthermore, they help the Group focus on various customer segments, cognize market positions with different retail brands and cope with customers' needs by providing suitable products and appropriate services.

All of the Group's retail outlets are located in prosperous zones which are strategically opened at prime locations in major cities including Beijing, Shanghai, Tianjing, Shenyang, Harbin, Hangzhou, Nanjing and Shenzhen.

While the Group has been driving hard for expanding the retail network in the PRC, speeding up the expansion of retail business in Hong Kong and other overseas markets is also one of the major tasks of the Group during the period. During the period under review, the Group succeeded in acquiring Elegant International (三寶集團) which have been engaged in retailing business of international branded watches in Hong Kong for 36 years with 4 luxury watch retail shops in which 2 at Tsimshatsui, 1 at Causeway Bay and 1 at Central. The acquisition would not only enhance profitability, but also leave a glorious chapter in the Group's quest to implement its overseas retail strategy, bolster our foundation for a steady development in the future. Since joining our Group, Elegant International had achieved rapid business growth, with both turnover and gross profit margin increased more than 30% from the corresponding period prior to the acquisition.

# Management Discussion and Analysis

During the period under review, the Group set up Anhui Sanxin Watch & Clock Ltd. jointly with a well-reputed retailer in Hefei, Auhui and acquired 70% shareholding of Henan Fuhao Watch Ltd. With these two projects, the total number of retail shops of the Group increased by 10, with a market share of 85% and 90% in the high and middle end watch retail market in Hefei and Zhengzhou respectively. In addition, the Company and a famed retailer in Wenzhou entered into an agreement in relation to the establishment of Wenzhou Xinyu Watch & Clock Co., Ltd., boosting the marketing share of middle and high end watches market in Wenzhou up to 90% and the number of retail outlets of the Group in the Mainland China to 92.

Retail network in both domestic and overseas markets have been growing in a fast pace, generating a strong driving force to the Group's development. During the reporting period, retail revenue grew 114% from last year, in which turnover from newly opened outlets accounted for four-fifth of turnover growth in the retail business. Sales from existing outlets had also been satisfactory, which registered a one-fifth of turnover growth in the retail business from last year.

At present, in order to standardize image & categorize operation, the Group's retail shops is basically divided into 3 categories: luxury shops, high to middle end integrated shops and fashion stores. As to the high to middle end integrated shops, they will gradually be promoted under a unified brand name of "PRIME TIME" (盛時表行).

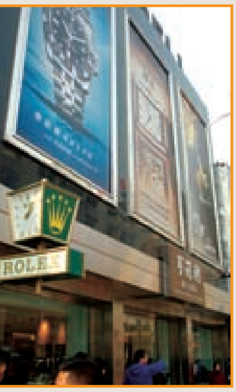
## Watch distribution business

The Group believes that the development of retail and distribution businesses is of equal importance and both are complementary to each other. Hence, while developing the retail business, the Group also stresses on expanding the distribution business and strives to set up an extensive distribution network. For the year ended 31 December 2006, the Group developed a distribution network spreading over 40 cities throughout the nation with a customer base of over 300 wholesale customers, most of whom are branded watch retailers of the PRC.

# Management Discussion and Analysis

## Reinforce co-operations with brand suppliers

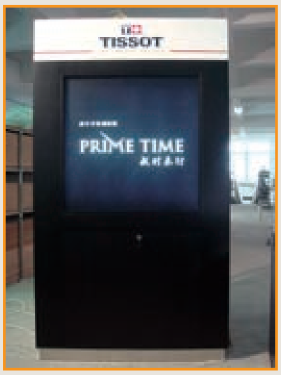
During the period under review, the Group has co-operated with various internationally renowned brand suppliers and jointly opened 6 new brand franchised shops, which include the cooperation with Richemont Group in the opening of two exclusive brand boutique shop under the brand name of Cartier in Huayu International Exquisite Commodities Building in Taiyuan, Shanxi province and Dannisi Shopping Center in Luoyang, Henan Province. 4 other brand boutique shops include the Beijing Grant Hyatt Zenith Boutique, Shenzhen Huaqiang Sunshine TAG Heuer Flagship Shop, Grand Hyatt Beijing TAG Heuer Flagship Shop and Shenyang TAG Heuer Flagship Shop. These 6 shops are all located in the prosperous and sumptuous business districts in Beijing, Shanxi, Shenzhen and Henan.




The Group has maintained good relationships with numerous brand suppliers of internationally-famous watches, namely the Swatch Group, the Richemont Group (曆峰集團), the LVMH Group, the Desco Group (達昌集團) and the Rolex Group (勞力士集團). As at 31 December 2006, the Group was the wholesalers of 19 internationally renowned watch brands, of which 17 brands were distributed under an exclusive basis, including Audemars Piguet (愛彼), Jaeger-LeCoultre (積家), Carl F. Bucherer (寶齊萊), TAG Heuer (豪雅), Zenith (真力時), Baume & Mercier (名士), Maurice Lacroix (艾美), CK, Christian Dior (克麗絲汀 • 迪奧). During the period under review, the Group also entered into a three-year and five-year renewable long-term exclusive agency agreements with Audemars Piguet and Maurice Lacroix respectively, These cooperation lay a strong foundation for both parties' business development in the PRC market in the long run.

## Strengthen ancillary production development

During the year, the Group completed the acquisition of Artdeco Decorating & Packaging Co., Ltd., a professional company engaged in the design and manufacture of package boxes for watches, jewellery, cosmetics, premium gifts etc., as well as manufacture of brand presentation boards, specialized props and outlet fixtures for marketing, furnishing etc. for retail outlets of high-end consumer products. At present, it mainly produces watch boxes, presentation boards and marketing props for renowned international watch brands. Upon the completion of acquisition of Artdeco Decorating & Packaging Co., Ltd., the Group could further expand its capacity in accessories production which complement to its principal business. It could also facilitate the enhancement in upgrading store image within the network and provide a strong foundation for product packaging design. The Group can also explore new business opportunities in manufacture of decorative packaging products at the same time.



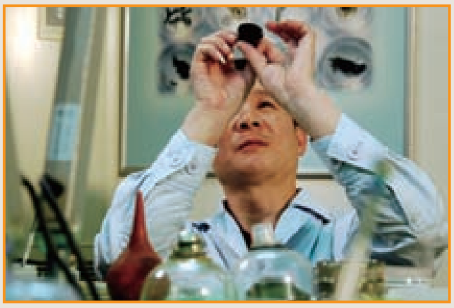
# Management Discussion and Analysis

## Marketing

In 2006, the Group actively participated in and implemented a number of marketing activities in order to promote the Group's image.

In order to achieve synergy effect in brand promotion, the Group collaborated with various brands to launch extensive marketing campaigns, one of which is to sponsor the promotion campaign of Ferrari. Besides, the Group also joins hands with China Merchants Bank Co., Ltd. to allow customers purchase products by credit card under installment so as to bring quick sale effects. Meanwhile, the Group has held road shows in selected clubhouse of four cities, during which guests were invited to take part and purchase luxurious watches exhibited thereof.

## Customer services



The Group has always focused on the provision of premium and quality customer services. Apart from establishing two sizeable repair and maintenance centers in Beijing and Shanghai, immediate repair and maintenance services are also provided with comprehensive after-sales service systems at each retail shop in order to all-rounded satisfy the needs of our customers. With the inauguration of our nationwide joint repair and maintenance services, the Greater China interactive customer services network covering Hong Kong and the PRC has also been duly launched, thereby serving our customers with best assurance in product quality.

## Future prospects

Given the increasing spending power of consumers and the rise of high income groups in the PRC, the purchasing power of the PRC will surge significantly, bringing about constant growth of demand for high end watches. It is expected that in 2007, the high-end watch market will undergo rapid and continuous development. In line with the enormous consumption market in the domestic and overseas markets, the Group will adhere itself to different approaches to expand sales network, so as to set forth a firm foundation for our development. In the coming years, the Group are expected to open 20 retail outlets to face the huge market opportunities ahead.

In addition to maintaining and fostering our close collaborative relationships with the brand suppliers of internationally renowned luxury watches, the Group will also actively develop ancillary products related to watch sales to boost profitability growth. Moreover, the Group will reinforce marketing efforts to raise the brand awareness for our new retail outlets. The Group will also foster higher operating efficiencies and improve resources allocation through optimized enterprise resources planning and management systems. The Group will continue to uphold its advantages to achieve larger market share, further improve service quality and assure the undertaking of providing premium quality service to our customers.


Noble and Elegant out from within

# Corporate Governance Report

Since its establishment, Xinyu Hengdeli has been committed to maintaining a high standard of corporate governance practice to ensure transparency, such that the interests of our shareholders, customers, employees so that the long term development of the Group can be safeguarded. The Group has established the board of directors, audit committee, remuneration committee and nomination committee that are up to the requirements as being diligent, accountable and professional. KPMG has been appointed as the Group's external auditors, and Guotai Junan Capital Limited has been appointed as the compliance adviser.

The Company has adopted the Code on Corporate Governance Practices (the "Code") of The Stock Exchange of Hong Kong Limited ("Stock Exchange"). In the opinion of the Board of Directors, the Company had complied with the Code on Corporate Governance Practices set out in Appendix 14 to the Listing Rules of the Stock Exchange throughout the year ended 31 December 2006 except for a derivation from the Code provision A.2.1. Given the Group's existing corporate structure, the roles of chairman and chief executive officer have not been separated. Although the functions and duties of chairman and chief executive officer have been performed by the same individual, all major decisions would only be made after consultation with the Board of Directors and (where applicable) the committees of the Board of Directors. There are three independent non-executive Directors in the Board of Directors. Therefore the Board of Directors considers the Company has achieved balance of power and sufficient protection for its interests.

To maintain a high level of independence and objectivity in decision making, and to exercise its power of supervising the management of the Group in a comprehensive and equitable manner, the Board of Directors comprises three executive Directors (Messrs. Zhang Yuping, Song Jianwen and Huang Yonghua), four non-executive Directors (Messrs. Chen Sheng, Shi Zhongyang, Shen Zhiyuan and Chuang Jian George) and three independent non-executive Directors (Messrs. Cai Jianmin, Liu Huangsong and Wong Kam Fai William).

To ensure the Board operates in an independent and accountable manner, the three executive Directors have been assigned with different responsibilities within our operations. Mr. Zhang Yuping, the Chairman, is in charge of the Group's overall management and strategic development, while Mr. Song Jianwen is in charge of the Group's finance and investments, and Mr. Huang Yonghua is in charge of the Group's brand management.

Each of the three independent non-executive Directors has professional expertise and extensive experience in the areas of accounting, economics, computing control and management, and business administration respectively. We believe the independent non-executive Directors can adequately act for the benefits of our shareholders.

In 2006, a total of seven regular meetings were held by the Board of Directors. All members of the Board attended these meetings and the rate of attendance was 100%. The Board will hold at least four regular meetings each year.

Members of the Board will be provided with appropriate and sufficient information in a timely manner so that they may be updated with the latest developments of the Group and supported in discharge of their duties.

# Corporate Governance Report

The Board has received confirmation from all independent non-executive Directors regarding their independence made in accordance with Rule 3.13 of the Rules Governing the Listing of Securities on the Stock Exchange ("Listing Rules"). The Board considers that all current independent non-executive Directors have met the requirements of the guidelines set out in Rule 3.13 of the Listing Rules, and remain independent.

## SECURITIES TRANSACTIONS BY DIRECTORS

The Board of the Company had adopted the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 to the Listing Rules as the Company's own code for securities transactions by its Directors. Following specific enquiry made with all Directors, the Company has confirmed that all Directors had complied with the required rules and regulations mentioned above.

## ACCOUNTABILITY AND AUDIT

The Directors acknowledge their responsibility for preparing the financial statements of the Group.

The statement of the auditors of the Company on their reporting responsibilities on the financial statements of the Group is set out in the Auditors' Report from pages 35 to 36.

## AUDITORS' REMUNERATION

The audit fee, to be received by the auditors of the Company, for the year ended 31 December 2006 will be approximately RMB2.7 million.

## AUDIT COMMITTEE

The Company has established an audit committee in compliance with the Listing Rules. The audit committee comprises three independent non-executive Directors, namely, Messrs. Cai Jianmin, Liu Huangsong and Wong Kam Fai William and one non-executive Director Chuang Jian, George, who joined the Board in October 2006, with the primary duties of reviewing the accounting principles and practices adopted by the Company as well as substantial exceptional items, internal controls and financial reporting matters, which included a review on the interim report of 2006 and the audited annual results for the year ended 31 December 2006.

The audit committee held one meeting each in April 2006 and August 2006 to review the full year and half year reports respectively. All members of the committee attended the meetings.

## REMUNERATION COMMITTEE

The Company has established a remuneration committee in compliance with the Listing Rules. The remuneration committee comprises three Directors including Messrs. Zhang Yuping (chairman), Cai Jianmin and Liu Huangsong. The primary duties of the remuneration committee are to review and determine the terms of remuneration packages, bonuses and other compensation payable to Directors and senior management.

The remuneration committee held one meeting during the year to review Directors' remuneration matters. All members of the committee attended the meeting.

# Corporate Governance Report

## NOMINATION COMMITTEE

The Company has established a nomination committee in compliance with the Listing Rules. The nomination committee comprises three Directors including Messrs. Song Jianwen, Cai Jianmin and Liu Huangsong. The nomination committee is mainly responsible for making recommendations to the Board on appointment of Directors and management of Board succession.

Two meetings had been held during the year to review the proposed appointment of Mr. Shi Zhongyang and Mr. Chuang Jian, George as Directors of the Company. All members of the committee attended the meetings.

## INVESTOR RELATIONS

The Company firmly believes the importance of communicating with the investment community at large and the shareholders in attaining a high level of transparency. Since the days of its preparation of listing, the Company has maintained various communication channels with the mass media, analysts and fund managers such as one-on-one meetings, roadshows, seminars, press conferences and press releases. The Company endeavours to provide timely and accurate information to the public, so as to enhance the understanding of our investors about the status of the PRC's luxury watch industry, as well as the business development strategy and direction of the Company.

# Report of the Directors

The Directors of the Company hereby present this annual report together with the audited accounts of the Company for the year ended 31 December 2006.

## THE COMPANY

The Group is engaged in the retail and distribution of internationally branded watches.

The principal activities of the subsidiaries of the Company which principally affected the results, assets and liabilities of the Group are set out in Note 16 to the financial statements.

## DISTRIBUTABLE RESERVE

As at 31 December 2006, the Company did not have any distributable reserve available for distribution to the Company's shareholders.

## PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's Articles of Association or the laws of the Cayman Islands, which would oblige the Company to offer new shares on a pro-rata basis to the existing shareholders.

## FINANCIAL SUMMARY

The summary of the results and assets and liabilities of the Group for the last five financial years ended 31 December is set out on page 96 of this annual report.

## PURCHASE, SALE OR REDEMPTION OF SECURITIES

Neither the Company nor its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the year under review.

## SHARE OPTION

A share option scheme ("Share Option Scheme") was adopted on 27 August 2005 by the way of passing written resolutions by all of the then shareholders of the Company. The Share Option Scheme enables the Group to grant share options to eligible participants as incentives and rewards for their contributions to the Group. Participants eligible to enroll the Share Option Scheme include all our Directors or employees, business partners, agents, consultants, persons seconded to participate in the work of the Group or an Associated Company with at least a devotion of 40% of their time to the business of the Group or an Associated Company, trusts representing the interests of the eligible persons or their direct relatives, and the companies controlled by the eligible participants or their direct families.

As at 31 December 2006, no option had been granted or agreed to be granted by the Company pursuant to the Share Option Scheme.

# Report of the Directors

## DIRECTORS' SERVICE CONTRACTS

The Company has entered into service contracts with each of the executive Directors for a term of three years.

## DIRECTORS' INTERESTS IN CONTRACTS

Save as disclosed in this annual report, no contracts of significance in relation to the Group's business in which the Company or its subsidiaries, its controlling shareholder or any of its subsidiaries and any Director of the Company had a material interest, whether directly or indirectly, subsisted during the year under review.

## REMUNERATION OF THE FIVE HIGHEST PAID DIRECTORS/EMPLOYEES

Details of remuneration of the Directors made in accordance with specific basis during the year under review are set out in Note 7 to the financial statements.

Details of remuneration of the five highest paid individuals during the year under review are set out in Note 8 to the financial statements.

## RETIREMENT BENEFIT SCHEME

Details of the Group's Retirement Benefit Scheme are set out in Note 27 to the financial statements.

## DIRECTORS AND SENIOR MANAGEMENT'S BIOGRAPHIES

Details of the Directors and senior management's biographies are set out on pages 32 to 34 of this annual report.

# Report of the Directors

## DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES OF THE COMPANY OR ANY OF ITS ASSOCIATED CORPORATION

As at 31 December, 2006, the interests or short positions of each of the Directors and chief executive in the shares, underlying shares and debentures of the Company or its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) ("SFO")) which were required pursuant to Section 352 of the SFO to be entered in the register required to be kept by the Company; or were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provision of the SFO); and were required pursuant to the Model Code for Securities Transactions by Directors of Listed Companies to be notified to the Company and the Stock Exchange were as follows:

| Name of Director | Nature of Interest | Number of Shares | Percentage of issued share capital of the Company |
|---|---|---|---|
| Mr. Zhang Yuping (alia, Cheung Yu Ping) ("Mr. Zhang") | Controlled Corporation *(Note 1)* | 713,800,000(L) | 57.46% |
| Mr. Song Jianwen | Controlled Corporation *(Note 2)* | 11,850,000(L) | 0.95% |

The letter "L" denotes the person's long position in the Shares.

*Note 1:* Mr. Zhang Yuping owned 77.7% of the issued share capital of Best Growth International Limited ("Best Growth"), which in turn owned 57.46% of the issued share capital of the Company.

*Note 2:* Mr. Song Jianwen owned the entire share capital of Artnew Developments Limited, which in turn owned 0.95% of the issued share capital of the Company.

# Report of the Directors

## SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES AND DEBENTURES OF THE COMPANY

As at 31 December 2006, the interests or short positions of the persons, other than a Director or chief executive of the Company, in the shares or underlying shares or debentures of the Company which were recorded in the register required to be kept by the Company pursuant to Section 336 of the SFO were as follows:

| Name of Shareholder | Number of Shares held | Approximate percentage of issued share capital of the Company |
|---|---|---|
| Best Growth *(Note 1)* | 713,800,000 (L) | 57.46% |
| Mr. Zhang Yuping *(Note 1)* | 713,800,000 (L) | 57.46% |
| Dunearn Investments (Mauritius) Pte Ltd *(Note 2)* | 123,500,000 (L) | 9.94% |
| Seletar Investments Pte Ltd *(Note 2)* | 123,500,000 (L) | 9.94% |
| Temasek Capital (Private) Limited *(Note 2)* | 123,500,000 (L) | 9.94% |
| Temasek Holdings (Private) Limited *(Note 2)* | 123,500,000 (L) | 9.94% |
| The Swatch Group Hong Kong Limited *(Note 3)* | 90,000,000 (L) | 7.24% |
| Hayek Nicolas Georges *(Note 3)* | 90,000,000 (L) | 7.24% |
| LVMH Watches & Jewelry Hong Kong Limited *(Note 4)* | 6,168,000 (L) | 0.50% |
| TAG Heuer SA *(Note 4)* | 6,168,000 (L) | 0.50% |
| TAG Heuer International SA *(Note 4)* | 6,168,000 (L) | 0.50% |
| LVMH Asia Pacific Limited *(Note 4)* | 83,832,000 (L) | 6.74% |
| Sofidiv SAS *(Note 4)* | 90,000,000 (L) | 7.24% |
| LVMH SA *(Note 4)* | 90,000,000 (L) | 7.24% |

The letters "L" denotes the person's long positions in the Shares.

# Report of the Directors

*Note 1:* Best Growth is owned by the Zhang's family in the following manner:

| | |
|---|---|
| Mr. Zhang Yuping | 77.7% |
| Ms. Zhang Yuhong, younger sister of Mr. Zhang | 14.7% |
| Mr. Zhang Yuwen, younger brother of Mr. Zhang | 2.4% |
| Ms. Zhang Huiling, younger sister of Mr. Zhang | 5.2% |

*Note 2:* These 123,500,000 Shares are held in the name of and registered in the capacity of Dunearn Investments (Mauritius) Pte Ltd as a beneficial owner. Dunearn Investments (Mauritius) Pte Ltd is 100% owned by Seletar Investments Pte Ltd, which is in turn beneficially wholly owned by Temasek Capital (Private) Limited. Temasek Capital (Private) Limited is wholly owned by Temasek Holdings (Private) Limited.

*Note 3:* These 90,000,000 Shares are held in the name of and registered in the capacity of The Swatch Group Hong Kong Limited as a beneficial owner. The entire issued share capital of The Swatch Group Hong Kong Limited is beneficially owned by The Swatch Group Limited, a 38.02% interest of which is in turn beneficially owned by Mr. Hayek Nicolas Georges. Pursuant to the SFO, both of The Swatch Group Limited and Mr. Hayek Nicolas Georges were deemed to be interested in all the shares held by The Swatch Group Hong Kong Limited.

*Note 4:* Out of these 90,000,000 Shares, 6,168,000 Shares are held in the name and registered in the capacity of LVMH Watches & Jewelry Hong Kong Limited, while 83,832,000 Shares are held in the name and registered in the capacity of LVMH Asia Pacific Limited. LVMH Watches & Jewelry Hong Kong Limited is 100% owned by TAG Heuer SA, which is in turn beneficially wholly owned by TAG Heuer International SA. TAG Heuer International SA and LVMH Asia Pacific Limited are 100% owned by Sofidiv SAS, which is in turn wholly owned by LVMH SA.

## ARRANGEMENT TO PURCHASE SHARES OR DEBENTURES

Save as disclosed under the section headed "Share Options" above, at no time during the 12 months ended 31 December 2006 was the Company, its holding company or its subsidiaries a party to any arrangements which enabled the Directors (including their spouses or children under 18 years of age), to acquire benefits by means of acquisition of Shares in or debenture of the Company or any other body corporate.

## MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or subsisted during the year under review.

# Report of the Directors

## MAJOR CUSTOMERS AND SUPPLIERS

The percentages of purchases and sales for the year under review attributable to the Group's major suppliers and customers are as follows:

| | | |
|---|---|---|
| **Purchases** | | |
| – | the largest supplier | 38.4% |
| – | five largest suppliers combined | 71.3% |
| **Sales** | | |
| – | the largest customer | 9.0% |
| – | five largest customers combined | 19.9% |

Swatch Group Limited and LVMH Group, through their respective subsidiaries, constituted two of the five largest suppliers. Save as disclosed above, none of the Directors, their associates or any shareholder (which to the knowledge of the directors owns more than 5% of the Company's share capital) had an interest in the major suppliers or customers noted above.

## CONNECTED TRANSACTIONS

During the year under review, the following continuing connected transactions (the "Transactions") have been entered into by the Group to which the Stock Exchange has granted waivers (subject to certain conditions ("Conditions")) to the Company from strict compliance with the announcement and/or independent shareholders' approval requirements under Chapter 14A of the Listing Rules:

### (a) THE LEASE AGREEMENT ENTERED INTO BETWEEN BEIJING HENGDELI SWISS TIMEPIECES LIMITED LIABILITY COMPANY ("BEIJING HENGDELI") AND BEIJING TIMEPIECES AND GLASSES COMPANY ("BEIJING TIMEPIECES")

Pursuant to a lease agreement dated 18 September 2002 as amended and supplemented by a supplemental agreement dated 25 August 2005 (the "Lease"), Beijing Hengdeli, a subsidiary of the Company, has been leasing a retail shop with a gross floor area of approximately 519 sq.m. situated at Nos. 271-273, Wangfujing Street, Dongcheng District, Beijing City from Beijing Timepieces for a term commencing from 1 January 2002 to 31 December 2007 at a monthly rent of RMB150,000 (approximately HK$144,200), representing an annual rent of RMB1,800,000 (approximately HK$1,730,800).

Beijing Timepieces is a state-owned enterprise under the supervision and management of Beijing Yi Shang Group which holds 45% interests in Beijing Hengdeli and is thus regarded as a connected person of the Company.

The monthly rent payable by Beijing Hengdeli is based on an arm's length negotiation between the parties thereto. The leased shop is located at a famous commercial street - Beijing Wangfujing Street, a prime commercial location in Beijing, and is the flagship shop of the Group in Beijing. The shop has a gross floor area of approximately 519 sq.m. and is the largest shop of the Group in terms of gross floor area. The Directors believe that securing such a prime commercial location for the Group's flagship shop in Beijing is crucial to the Group's retail business.

# Report of the Directors

The Stock Exchange has granted to the Company a waiver pursuant to Rule 14A.42(3) of the Listing Rules from strict compliance with the announcement requirements under the Listing Rules upon the listing of the Shares on the Stock Exchange in respect of the Lease between Beijing Hengdeli and Beijing Timepieces, subject to the maximum annual rent payable thereunder and the terms thereof, for the three financial years ending 31 December 2007.

The independent non-executive Directors has reviewed the Transactions and confirmed that the Transactions have been entered into:

(i) in the ordinary and usual course of business of the Group;

(ii) either on normal commercial terms, or, if there are not sufficient comparable transactions to judge whether they are on normal commercial terms, or terms no less favourable to the Group than terms available to or from (as appropriate) independent third parties; and

(iii) in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

The Directors confirm that the disclosure requirement in accordance with Chapter 14A of the Listing Rules has been complied with by the Company.

The related party transactions disclosed in the Note 32 to the financial statements.

## (b) THE LEASE AGREEMENT ENTERED INTO BETWEEN HENGDELI INTERNATIONAL COMPANY LIMITED ("HENGDELI INTERNATIONAL") AND WAI LUNG INTERNATIONAL COMPANY LIMITED ("WAI LUNG")

On 29 April 2005 and 22 June 2006, Hengdeli International entered into two tenancy agreements (the "Tenancy Agreements") with Wai Lung whereby Wai Lung agreed to lease to Hengdeli International an office premise at Units 301 and 314, 3rd Floor, Lippo Sun Plaza, 28 Canton Road, Tsim Sha Tsui, Kowloon, Hong Kong at a monthly rental of HK$58,000 and HK$75,000 respectively (exclusive of management fee, rates and utilities) for a term of three years commencing from 1 April 2005 and 1 June 2006 respectively, with an option to renew for a further term of three years. Wai Lung also agreed to the use of the said premises by the Company as its principal place of business in Hong Kong and Sunshine Peninsula Limited as its registered office.

Mr. Zhang Yuping holds a 50% interest in the issued share capital of Wai Lung, through Eastwealth International Limited, a company wholly owned by Mr. Zhang Yuping. Accordingly, Wai Lung is a connected person of the Company. Tenancy Agreements will constitute a continuing connected transaction under Chapter 14A of the Listing Rules. However, since each of the applicable percentage ratios as defined in Rule 14A.10 of the Listing Rules and calculated with reference to the annual rent payable under the Tenancy Agreements is less than 0.1%, the transaction is exempted from the reporting, announcement and independent shareholders' approval requirements pursuant to Rule 14A.33(3)(a) of the Listing Rules.

# Report of the Directors

(c) THE LEASE AGREEMENT ENTERED INTO BETWEEN HENGDELI INTERNATIONAL COMPANY LIMITED ("HENGDELI INTERNATIONAL") AND MAY CREATION LIMITED ("MAY CREATION")

On 22 June 2006, Hengdeli International entered into a tenancy agreement (the "Tenancy Agreement") with May Creation whereby May Creation agreed to lease to Hengdeli International a resident premise at Room F, 38/F, The Waterfront Tower III, 1 Austin Road West, Kowloon, Hong Kong at a monthly rental of HK$32,000 (exclusive of management fee, rates and utilities) for a term of three years commencing from 1 June 2006 with an option to renew for a further term of three years.

Mr. Zhang Yuping holds a 100% interest in the issued share capital of May Creation, through Eastwealth International Limited, a company wholly owned by Mr. Zhang Yuping. Accordingly, May Creation is a connected person of the Company. The Tenancy Agreement will constitute a continuing connected transaction under Chapter 14A of the Listing Rules. However, since each of the applicable percentage ratios as defined in Rule 14A.10 of the Listing Rules and calculated with reference to the annual rent payable under the Tenancy Agreement is less than 0.1%, the transaction is exempted from the reporting, announcement and independent shareholders' approval requirements pursuant to Rule 14A.33(3)(a) of the Listing Rules.

## PUBLIC FLOAT

Based on the information that is publicly available to the Company and to the best of the Directors' knowledge at the date of this annual report, there was a sufficient prescribed public float of the issued shares of the Company under the Listing Rules.

## AUDITORS

The financial statements of the Company for the year under review have been audited by KPMG which will retire and, being eligible, offer themselves for re-appointment at the forthcoming annual general meeting.

Since 9 July 2004, being the date of incorporation of the Company, there had been no change in our auditors.

On behalf of the Board
**Zhang Yuping**
*Chairman*

Hong Kong, 10 April 2007

# Directors and Senior Management's Biographies

## DIRECTORS

### Executive Directors

Mr. Zhang Yuping (alia, Cheung Yu Ping) (張瑜平), aged 46, is the chairman and chief executive officer of the Company and the founder of the Group. He founded the Group in September 2001. He is in charge of the Group's overall management and strategic development. He has more than 20 years of experience in the watch distribution industry for the PRC market.

Mr. Song Jianwen (宋建文), aged 54, is an executive Director. He is in charge of finance and investments of the Group. Mr. Song graduated from Zhongnan Finance Economics University (中南財經政法大學) with a master's degree in economics. Mr. Song has over 10 years of experience in finance and accounting.

Mr. Huang Yonghua (黃永華), aged 36, is an executive Director. He is in charge of the Group's brand management. He has more than 10 years of experience in the watch distribution industry and management for the PRC market.

### Non-executive Directors

Mr. Chen Sheng (陳聖), aged 42, is a non-executive Director. Mr. Chen graduated from Fudan University with a master degree in business administration. Mr. Chen is currently the chairman and the general manager of Shanghai Yi Min Department Stores Company Limited (上海益民百貨股份有限公司), a listed company in the PRC.

Mr. Shen Zhiyuan (沈致遠), aged 64, is a non-executive Director. He graduated from Beijing Commerce College (北京商學院). He was the general manager of Beijing Yi Shang Group. He is currently the vice-chairman of 中國商業企業協會 (Association of PRC Enterprises) and a standing committee member of Chinese People's Political Consultative Conference Beijing Committee (中國人民政治協商會議北京市第十屆委員會).

Mr. Shi Zhongyang (史仲陽), aged 32, is a non-executive Director. Mr. Shi graduated from Nanjing University in the PRC and University of Goetting in Germany with master degree in law. Mr. Shi joined The Swatch Group Limited in 2000. He is currently a legal counsel of the legal department of The Swatch Group Limited.

Mr. Chuang Jian, George (莊建), aged 36, is a non-executive Director. He has been the managing director of Temasek Holdings (HK) Limited (淡馬錫控股(香港)有限公司) since May 2005. Prior to the aforesaid, Mr. Chuang served as an executive director of Goldman Sachs (Asia) LLC from March 1999 to April 2005. Mr. Chuang was a solicitor of Sullivan & Cromwell (New York and Hong Kong) from 1995 to 1999. Mr. Chuang graduated from Harvard University in 1995 with a Master Degree in Law.

# Directors and Senior Management's Biographies

### Independent Non-executive Directors

Mr. Liu Huangsong (劉熀松), aged 39, is an independent non-executive Director. He graduated from Fudan University with a doctorate degree in economics. He is a supervisor of Centre of Economic Environment Research and Forecast, Shanghai Social Science Academy（上海社會科學院經濟景氣研究預測中心）.

Mr. Cai Jianmin (蔡建民), aged 63, is an independent non-executive Director. He graduated from Shanghai Finance College（上海財經學院）in industrial accounting faculty（工業會計系）. Mr. Cai holds a certificate for professional accountants（會計從業資格證書） in the PRC. He had held senior financial posts for several companies including Shanghai Hualian (Group)（上海華聯（集團））.

Mr. Wong Kam Fai, William (黃錦輝), aged 47, is an independent non-executive Director. He graduated from University of Edinburgh, Scotland with a bachelor's degree and a doctorate degree in electrical engineering. Mr. Wong is a professor in the Department of Systems Engineering and Engineering Management in the Chinese University of Hong Kong. He obtained the qualification as a Chartered Engineer (CEng) since 1991, and is now a member of the Institute of Electrical Engineers, a professional member of the Association of Computing Machinery.

## SENIOR MANAGEMENT

(Shanghai Xinyu as mentioned below represents our major holding subsidiary in the PRC – Shanghai Xinyu Watch & Clock Group, Ltd.)

Mr. Zhuang Liming (莊立明), aged 53, is the director and vice chairman of Shanghai Xinyu. Mr. Zhuang graduated in Beijing Foreign Trade College（北京外貿學院）. Before joining Shanghai Xinyu, Mr. Zhuang had worked for PRC Light Industry Commodities Import and Export Company（中國輕工業品進出口總公司）.

Ms. Wang Lingfei (王玲飛), aged 57, is the director and chief operating officer of Shanghai Xinyu. Before joining the Group, Ms. Wang was the deputy general manager of Beijing Yishang Group（北京一商集團）.

Mr. Zhang Xingen (張新根), aged 62, is the director and retail cooperation controller of Shanghai Xinyu and is responsible for retail cooperation business. Before joining the Group in 1999, Mr. Zhang was the general manager of Shanghai Watch Shop and a director of Yi Min Department Store.

Mr. Chen Hua (陳華), aged 51, is the director of Shanghai Xinyu. Before joining the Group, Mr. Chen worked in a number of companies which are engaged in watch operations including Guangzhou Haizhu District Watches Processing Factory（廣州市海珠區手錶裝配廠）.

Mr. Ng Man Wai, Peter (吳文偉), aged 36, is the company secretary to the Company, qualified accountant and financial controller of the Group. Mr. Ng graduated from the University of Toronto with a bachelor's degree in commerce. Mr. Ng is a member of the Association of Chartered Certified Accountants and a certified public accountant of the Hong Kong Institute of Certified Public Accountants.

# Directors and Senior Management's Biographies

Mr. Lee Wing On, Samuel (李永安), aged 42, is the Chief Executive Officer of Elegant International Holdings Limited. Mr. Lee joined the Group in 2006 and he has 20 years of experience in the Hong Kong watch retail industry and management for the Hong Kong market.

Ms. Tan Li (談麗), aged 42, is the assistant to the Chairman of the Company and the secretary to the board of Shanghai Xinyu. Ms. Tan graduated from Nanjing Normal University (南京師範大學) with a master's degree in Chinese literature.

Ms. Wong Shan Shan, Sallus (王珊珊), aged 34, is the Corporate Communications Director of the Company. After graduated in the City University of Hong Kong, Ms. Wong graduated in the Monash University, Australia with a bachelor of business degree. Pursuing graduated studies over years, she is the holder of a master of science degree in International Marketing from University of Strathclyde, Scotland; a master of art degree in Communication and New Media from the City University of Hong Kong; and a master of art degree in Chinese Politics from the Chinese University of Hong Kong. She possesses ten years of experience in corporate communications and marketing. Before joining the Group, she worked for A.S. Watson Group and was in charge of corporate communications of Chow Sang Sang Holdings International Limited.

Ms. Wang Xihao (王希浩), aged 51, is the financial controller of Shanghai Xinyu. Ms. Wang holds a certificate for professional accountants (會計從業資格證書) in the PRC.

Mr. Yang Xiaodong (楊小冬), aged 42, is the Brand Director of Shanghai Xinyu. After graduated from the Peking University, Mr Yang pursued his graduated studies in the Copenhagen School of Economics and Business Administration with a master of science degree in Economics. Mr. Yang possesses many years of experience in brand management. Before joining the company, he was the General Manager of Alfred Dunhill China.

Mr. Erich Steiner, aged 69, is the adviser to the chairman of the Group and is responsible for planning and improving the retail business. Mr. Steiner receives from Stadtisches Gymnasiums in Bern a diploma which entitles him to join commercial companies and the government of administration. Mr Steiner worked in International Watch Co. and Schlup & Co. Ltd. Rado Watches.

## COMPANY SECRETARY AND QUALIFIED ACCOUNTANT

Mr. Ng Man Wai, Peter (吳文偉), aged 36, is the company secretary, qualified accountant and financial controller of the Group. Mr. Ng graduated from the University of Toronto with a bachelor's degree in commerce. Mr. Ng is a member of the Association of Chartered Certified Accountants and a certified public accountant of the Hong Kong Institute of Certified Public Accountants.

# Auditor's report

KPMG

**Independent auditor's report to the shareholders of**
**Xinyu Hengdeli Holdings Limited**
*(Incorporated in the Cayman Islands with limited liability)*

We have audited the consolidated financial statements of Xinyu Hengdeli Holdings Limited (the "Company") set out on pages 37 to 95, which comprise the consolidated and company balance sheets as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

## DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

## AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of the report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

# Auditor's report

## OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2006 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

**KPMG**
*Certified Public Accountants*
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

10 April 2007

# Consolidated Income Statement

For the year ended 31 December 2006

| | Note | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|---|
| **Turnover** | *2* | **2,404,699** | 1,396,531 |
| Cost of sales | | **(1,841,795)** | (1,032,369) |
| **Gross profit** | | **562,904** | 364,162 |
| Other revenue and net income | *3* | **38,242** | 18,428 |
| Distribution costs | | **(175,889)** | (96,645) |
| Administrative expenses | | **(98,287)** | (62,994) |
| Other operating expenses | *4* | **(6,013)** | (2,748) |
| **Profit from operations** | | **320,957** | 220,203 |
| Finance costs | *5(i)* | **(27,048)** | (23,353) |
| Share of losses of a jointly controlled entity | | **(80)** | (187) |
| **Profit before taxation** | | **293,829** | 196,663 |
| Income tax | *6(i)* | **(80,231)** | (64,886) |
| **Profit for the year** | | **213,598** | 131,777 |
| **Attributable to:** | | | |
| Equity shareholders of the Company | | **199,101** | 121,011 |
| Minority interests | | **14,497** | 10,766 |
| **Profit for the year** | | **213,598** | 131,777 |
| Dividend attributable to the previous financial year, approved during the year | *10(b)* | **49,800** | 92,150 |
| Dividend declared after the balance sheet date | *10(a)* | **69,566** | 49,800 |
| **Basic earnings per share** | *11* | **RMB0.090** | RMB0.073 |

The notes on pages 44 to 95 form part of these financial statements.

# Consolidated Balance Sheet

At 31 December 2006

| | Note | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Property, plant and equipment | *13* | **251,101** | 96,208 |
| Intangible assets | *14* | **32,989** | 33,109 |
| Goodwill | *15* | **181,045** | – |
| Interest in a jointly controlled entity | *17* | **4,733** | 4,813 |
| Other investments | *18* | **250** | 250 |
| Deferred tax assets | *28(ii)* | **24,948** | 17,553 |
| | | **495,066** | 151,933 |
| **Current assets** | | | |
| Trading securities | *19* | **–** | 42,792 |
| Inventories | *20* | **1,262,382** | 662,142 |
| Trade receivables, prepayments and other receivables | *21* | **330,995** | 214,110 |
| Pledged bank deposits | *22* | **76,908** | 130,025 |
| Cash and cash equivalents | *23* | **298,275** | 142,502 |
| | | **1,968,560** | 1,191,571 |
| **Current liabilities** | | | |
| Trade and other payables | *24* | **370,698** | 185,376 |
| Bank loans and overdrafts | *25* | **387,814** | 314,000 |
| Current taxation | *28(i)* | **74,484** | 49,412 |
| | | **832,996** | 548,788 |
| **Net current assets** | | **1,135,564** | 642,783 |
| **Total assets less current liabilities** | | **1,630,630** | 794,716 |
| **Non-current liabilities** | | | |
| Other payables | *26* | **–** | 565 |
| Bank loan | *25* | **22,070** | – |
| | | **22,070** | 565 |
| **NET ASSETS** | | **1,608,560** | 794,151 |

The notes on pages 44 to 95 form part of these financial statements.

# Consolidated Balance Sheet *(Continued)*

At 31 December 2006

| | *Note* | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|---|
| **CAPITAL AND RESERVES** | *29* | | |
| Share capital | | **12,927** | 10,828 |
| Reserves | | **1,459,159** | 683,812 |
| **Total equity attributable to equity shareholders of the Company** | | **1,472,086** | 694,640 |
| **Minority interests** | | **136,474** | 99,511 |
| **TOTAL EQUITY** | | **1,608,560** | 794,151 |

Approved and authorised for issue by the board of directors on 10 April 2007.

**Zhang Yuping**
*Executive Director*

**Song Jianwen**
*Executive Director*

The notes on pages 44 to 95 form part of these financial statements.

# Balance Sheet

At 31 December 2006

| | Note | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Investments in subsidiaries | *16* | **568,352** | 199,352 |
| **Current assets** | | | |
| Trade and other receivables | *21* | **505,018** | 240,261 |
| Pledged bank deposits | *22* | **53,388** | 125,829 |
| Cash and cash equivalents | *23* | **66,495** | 4,980 |
| | | **624,901** | 371,070 |
| **Current liabilities** | | | |
| Trade and other payables | *24* | **7,831** | 7,714 |
| | | **7,831** | 7,714 |
| **Net current assets** | | **617,070** | 363,356 |
| **NET ASSETS** | | **1,185,422** | 562,708 |
| **CAPITAL AND RESERVES** | *29* | | |
| Share capital | | **12,927** | 10,828 |
| Reserves | | **1,172,495** | 551,880 |
| **TOTAL EQUITY** | | **1,185,422** | 562,708 |

Approved and authorised for issue by the board of directors on 10 April 2007.

**Zhang Yuping**
*Executive Director*

**Song Jianwen**
*Executive Director*

The notes on pages 44 to 95 form part of these financial statements.

# Consolidated Statement of Changes in Equity

For the year ended 31 December 2006

| | Note | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|---|
| *Equity attributable to equity shareholders of the Company:* | | | |
| **Balance at 1 January** | | **694,640** | 285,508 |
| Issuance of new shares | *29(c)(i)* | **656,359** | 199,352 |
| Shares issued under the Offering and Placement | | – | 344,090 |
| Shares issued under the over-allotment option related to the Placement | | – | 51,614 |
| Share issuance expenses | | **(17,253)** | (31,451) |
| Capital elimination on combination | | – | (183,334) |
| Profit for the year | | **199,101** | 121,011 |
| Dividend declared | *10(b)* | **(49,800)** | (92,150) |
| Exchange differences on translation into presentation currency | | **(10,961)** | – |
| **Balance at 31 December** | | **1,472,086** | 694,640 |
| *Minority interests:* | | | |
| **Balance at 1 January** | | **99,511** | 78,573 |
| Capital contribution from minority shareholders | | **27,435** | 14,850 |
| Acquisition of subsidiaries | *31* | **1,416** | 172 |
| Share of profit for the year | | **14,497** | 10,766 |
| Dividend declared | | **(6,385)** | (4,850) |
| **Balance at 31 December** | | **136,474** | 99,511 |
| *Total equity:* | *29* | **1,608,560** | 794,151 |

The notes on pages 44 to 95 form part of these financial statements.

# Consolidated Cash Flow Statement

For the year ended 31 December 2006

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| **Operating activities** | | |
| Profit before taxation | **293,829** | 196,663 |
| Adjustments for: | | |
| Depreciation | **15,970** | 12,024 |
| Amortisation of intangible assets | **120** | 120 |
| Interest income | **(6,171)** | (3,351) |
| Finance costs | **27,048** | 23,353 |
| Share of losses of a jointly controlled entity | **80** | 187 |
| Loss on disposal of property, plant and equipment | **41** | 39 |
| Changes in fair value on trading securities | **–** | (887) |
| Income from sales of trading securities | **(6,449)** | – |
| **Operating profit before changes in working capital** | **324,468** | 228,148 |
| Increase in inventories | **(251,800)** | (214,025) |
| Increase in trade receivables, prepayments and other receivables | **(86,719)** | (970) |
| Increase in trade and other payables and non-current payables | **71,657** | 134,413 |
| **Cash generated from operations** | **57,606** | 147,566 |
| Income tax paid | **(68,184)** | (49,365) |
| **Net cash (used in)/generated from operating activities** | **(10,578)** | 98,201 |

The notes on pages 44 to 95 form part of these financial statements.

# Consolidated Cash Flow Statement *(Continued)*

For the year ended 31 December 2006

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| **Investing activities** | | |
| Payment for purchase of property, plant and equipment | **(140,451)** | (12,688) |
| Payment for purchase of intangible assets | **–** | (23,083) |
| Proceeds from disposal of property, plant and equipment | **111** | 74 |
| (Net cash out flow)/cash acquired from acquisition of subsidiaries, net of cash paid | **(172,037)** | 965 |
| Interest income received | **6,171** | 3,351 |
| Payment for addition in a jointly controlled entity | **–** | (5,000) |
| Decrease/(increase) in pledged bank deposits | **53,117** | (130,025) |
| Payment for purchase of trading securities | **–** | (41,905) |
| Proceeds from disposal of trading securities | **49,241** | – |
| **Net cash used in investing activities** | **(203,848)** | (208,311) |
| **Financing activities** | | |
| Net proceeds from shares issued under the Offering and Placement and the over-allotment option related to the Placement | **–** | 364,253 |
| Net proceeds from issue of new shares | **454,606** | – |
| Capital contribution from minority shareholders | **27,435** | 14,850 |
| Proceeds from bank loans | **592,282** | 612,000 |
| Repayment of bank loans | **(623,818)** | (696,198) |
| Finance costs paid | **(27,048)** | (23,473) |
| Dividend paid to shareholders | **(49,800)** | (92,150) |
| Dividend paid to minority shareholders | **(3,028)** | (4,850) |
| **Net cash generated from financing activities** | **370,629** | 174,432 |
| **Net increase in cash and cash equivalents** | **156,203** | 64,322 |
| **Cash and cash equivalents at 1 January** | **142,502** | 78,180 |
| **Effect of foreign exchange rate changes** | **(4,032)** | – |
| **Cash and cash equivalents at 31 December** | **294,673** | 142,502 |

The notes on pages 44 to 95 form part of these financial statements.

# Notes to the Financial Statements

## 1. SIGNIFICANT ACCOUNTING POLICIES

Xinyu Hengdeli Holdings Limited ("the Company") is a company incorporated in the Cayman Islands as an exempted company with limited liability on 9 July 2004 under the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. The consolidated financial statements of the Company for the year ended 31 December 2006 comprise the Company and its subsidiaries (together referred to as the "Group"). The shares of the Company have been listed on the Main Board of the Stock Exchange of Hong Kong Limited (the "Stock Exchange") since 26 September 2005.

### (a) Statement of compliance

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (HKFRSs), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (HKASs) and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (HKICPA), accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. These financial statements also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on the Stock Exchange. A summary of the significant accounting policies adopted by the Group is set out below.

### (b) Basis of preparation of the financial statements

The consolidated financial statements for the year ended 31 December 2006 comprise the Company and its subsidiaries and the Group's interest in a jointly controlled entity.

The measurement basis used in the preparation of the financial statements is the historical cost basis, except for trading securities, which are stated at fair value as explained in the accounting policies 1(f).

The preparation of financial statements in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

# Notes to the Financial Statements

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

### (b) Basis of preparation of the financial statements *(Continued)*

Judgements made by management in the application of HKFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 36.

### (c) Subsidiaries and minority interests

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

An investment in a subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases. Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Minority interests represent the portion of the net assets of subsidiaries attributable to interests that are not owned by the Company, whether directly or indirectly through subsidiaries, and in respect of which the Group has not agreed any additional terms with the holders of those interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meets the definition of a financial liability. Minority interests are presented in the consolidated balance sheet within equity, separately from equity attributable to the equity shareholders of the Company. Minority interests in the results of the Group are presented on the face of the consolidated income statement as an allocation of the total profit or loss for the year between minority interests and the equity shareholders of the Company.

Where losses applicable to the minority exceed the minority's interest in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Group's interest is allocated all such profits until the minority's share of losses previously absorbed by the Group has been recovered.

In the Company's balance sheet, an investment in a subsidiary is stated at cost less impairment losses (see note 1(j)).

# Notes to the Financial Statements

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

### (d) Jointly controlled entities

A jointly controlled entity is an entity which operates under a contractual arrangement between the Group or Company and other parties, where the contractual arrangement establishes that the Group or Company and one or more of the other parties share joint control over the economic activity of the entity.

An investment in a jointly controlled entity is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the jointly controlled entity's net assets. The consolidated income statement includes the Group's share of the post-acquisition, post-tax results of jointly controlled entity for the year, including any impairment loss on goodwill relating to the investment in jointly controlled entity recognised for the year (see notes 1(e) and 1(j)).

When the Group's share of losses exceeds its interest in the jointly controlled entity, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the jointly controlled entity. For this purpose, the Group's interest in the jointly controlled entity is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the jointly controlled entity.

Unrealised profits and losses resulting from transactions between the Group and its jointly controlled entity are eliminated to the extent of the Group's interest in the jointly controlled entity, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognized immediately in profit or loss.

### (e) Goodwill

Goodwill represents the excess of the cost of a business combination or an investment in a jointly controlled entity over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (see note 1(j)). In respect of jointly controlled entities, the carrying amount of goodwill is included in the carrying amount of the interest in the jointly controlled entity.

Any excess of the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination or an investment a jointly controlled entity is recognised immediately in profit or loss.

# Notes to the Financial Statements

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

### (e) Goodwill *(Continued)*

On disposal of a cash generating unit, a jointly controlled entity during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

### (f) Other investments in debt and equity securities

The Group's and the Company's policies for investments in the debt and equity securities, other than investments in subsidiaries and jointly controlled entities, are as follows:

Investments in debt and equity securities held for trading are classified as current assets and are initially stated at fair value. At each balance sheet date the fair value is remeasured, with any resultant gain or loss being recognised in profit or loss.

Investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are recognised in the balance sheet at cost less impairment losses (see note 1(j)).

Other investments in securities are classified as available-for-sale securities. At each balance sheet date the fair value is remeasured, with any resultant gain or loss being recognised directly in equity, except for impairment losses (see note 1(j)) and, in the case of monetary items such as debt securities, foreign exchange gains and losses which are recognised directly in profit or loss. Where these investments are interest-bearing, interest calculated using the effective interest method is recognised in profit or loss. When these investments are derecognised, the cumulative gain or loss previously recognised directly in equity is recognised in profit or loss.

Investments are recognised/derecognised on the date the Group and/or the Company commits to purchase/sell the investments or they expire.

### (g) Property, plant and equipment

Property, plant and equipment are stated in the balance sheet at cost less accumulated depreciation and impairment losses (see note 1(j)).

The cost of self-constructed items of property, plant and equipment includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and an appropriate proportion of production overheads and borrowing costs(see note 1(u)).

Gains or losses arising from the retirement or disposal of a property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in profit or loss on the date of retirement or disposal.

# Notes to the Financial Statements

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

### (g) Property, plant and equipment *(Continued)*

Depreciation is calculated to write off the cost of items of property, plant and equipment on a straight-line basis over their estimated useful lives, to residual value, as follows:

| | |
|---|---|
| Buildings | 20-25 years |
| Leasehold improvements | 1-3 years |
| Motor vehicles | 8 years |
| Office equipment and other fixed assts | 4-5 years |

Where parts of an item of property, plant and equipment have different useful lives, the cost of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reviewed annually.

The fair value of property, plant and equipment recognised as a result of a business combination is based on market values. The market value of property is the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of items of plant, equipment, fixtures and fittings is based on the quoted market prices for similar items.

### (h) Intangible assets (other than goodwill)

The intangible assets that are acquired by the Group are stated in the balance sheet at cost less accumulated amortisation (where the estimated useful life is other than indefinite) and impairment losses (see note 1(j)). Expenditure on internally generated goodwill and brands is recognised as an expense in the period in which it is incurred.

Amortisation of intangible assets is charged to profit or loss on a straight-line basis over the assets' estimated useful lives unless such lives are indefinite. The following intangible asset with finite useful life is amortised from the date it is available for use and its estimated useful life is as follows:

| | |
|---|---|
| – EDOX agency rights | 10 years |

Both the period and method of amortisation are reviewed annually.

Intangible assets are not amortised while their useful lives are assessed to be indefinite. Any conclusion that the useful life of an intangible asset is indefinite is reviewed annually to determine whether events and circumstances continue to support the indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite is accounted for prospectively from the date of change and in accordance with the policy for amortisation of intangible assets with finite lives as set out above.

# Notes to the Financial Statements

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

### (i) Operating lease charges

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to profit or loss in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Contingent rentals are charged to profit or loss in the accounting period in which they are incurred.

### (j) Impairment of assets

*(i) Impairment of investments in debt and equity securities and other receivables*

Investments in debt and equity securities and other current receivables that are stated at cost or amortised cost or are classified as available-for-sale securities are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, any impairment loss is determined and recognised as follows:

– For unquoted equity securities carried at cost, the impairment loss is measured as the difference between the carrying amount of the financial asset and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material. Impairment losses for equity securities are not reversed.

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

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

# Notes to the Financial Statements

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

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

*(i) Impairment of investments in debt and equity securities and other receivables (Continued)*

– For available-for-sale securities, the cumulative loss that has been recognized directly in equity is removed from equity and is recognised in profit or loss. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in profit or loss.

Impairment losses recognised in profit or loss in respect of available-for-sale equity securities are not reversed through profit or loss. Any subsequent increase in the fair value of such assets is recognised directly in equity.

Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in profit or loss.

*(ii) Impairment of other asset*

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

– property, plant and equipment;
– intangible assets;
– investments in subsidiaries and joint ventures; and
– goodwill.

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

– Calculation of recoverable amount

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

# Notes to the Financial Statements

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

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

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

– Recognition of impairment losses

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

– Reversals of impairment losses

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

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

### (k) Inventories

Inventories are carried at the lower of cost and net realisable value.

Cost is calculated using the first-in first-out method and comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

When inventories are sold, the carrying amount of those inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

# Notes to the Financial Statements

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

### (k) Inventories *(Continued)*

The fair value of inventories acquired in a business combination is determined based on its estimated selling price in the ordinary course of business less the estimated costs of sales, and the reasonable profit margin based on the effort required to complete and sell the inventory.

### (l) Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less impairment losses for bad and doubtful debts (see note 1(j)).

### (m) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between the amount initially recognised and redemption value being recognised in profit or loss over the period of the borrowings, together with any interest and fees payable, using the effective interest method.

### (n) Trade and other payables

Trade and other payables are initially recognised at fair value and thereafter stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

### (o) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and other financial institutions, cash on hand and demand deposits with banks. Bank overdrafts that are repayable on demand and form an integral part of the Group’s cash management are also included as a component of cash and cash equivalent for the purpose of the cash flow statements.

### (p) Employee benefits

Salaries, annual bonuses, paid annual leave, contributions to defined contribution plans, including contributions to Mandatory Provident Funds as required under the Hong Kong Mandatory Provident Fund Scheme Ordinance, and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

### (q) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in profit or loss except to the extent that they relate to items recognised directly in equity, in which case they are recognised in equity.

# Notes to the Financial Statements

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

### (q) Income tax *(Continued)*

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

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination), and temporary differences relating to investments in subsidiaries to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

# Notes to the Financial Statements

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

### (q) Income tax *(Continued)*

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities, if the company or the group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Company or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or

- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:

  - the same taxable entity; or

  - different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

### (r) Provisions and contingent liabilities

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

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

# Notes to the Financial Statements

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

### (s) Revenue recognition

Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in profit or loss as follows:

*i) Sale of goods*

Revenue is recognised when significant risks and rewards of ownership have been transferred to the buyer. Revenue excludes value added tax and is after deduction of any trade discounts.

*ii) Dividends*

Dividend income from unlisted investments is recognised when the shareholder's right to receive payment is established.

*iii) Interest income*

Interest income is recognised as it accrues using the effective interest method.

*iv) Government grants*

An unconditional government grant is recognised in the consolidated income statement as other revenue and net income when the grant becomes receivable.

### (t) Translation of foreign currencies

Foreign currency transactions during the year are translated at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rates ruling at the balance sheet date. Exchange gains and losses are recognised in profit or loss.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was determined.

The results of group companies which have a functional currency other than Renminbi ("RMB") are translated into RMB at the exchange rates approximating the foreign exchange rates ruling at the dates of the transactions. Balance sheet items are translated into RMB at the foreign exchange rates ruling at the balance sheet date. The resulting exchange differences are recognised directly in a separate component of equity.

# Notes to the Financial Statements

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

### (u) Borrowing costs

Borrowing costs are expensed in profit or loss in the period in which they are incurred, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

The capitalisation of borrowing costs as part of the cost of a qualifying asset commences when expenditure for the asset is being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalisation of borrowing costs is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are interrupted or complete.

### (v) Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if:

(i) the party has the ability, directly or indirectly through one or more intermediaries, to control the Group or exercise significant influence over the Group in making financial and operating policy decisions, or has joint control over the Group;

(ii) the Group and the party are subject to common control;

(iii) the party is an associate of the Group or a joint venture in which the Group is a venturer;

(iv) the party is a member of key management personnel of the Group or the Group's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;

(v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or

(vi) the party is a post-employment benefit plan which is for the benefit of employees of the Group or of any entity that is a related party of the Group.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

# Notes to the Financial Statements

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

### (w) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

In accordance with the Group's internal financial reporting system, the Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format for the purposes of these financial statements.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. For example, segment assets may include inventories, trade receivables and property, plant and equipment. Segment revenue, expenses, assets, and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between group entities within a single segment. Inter-segment pricing is based on similar terms as those available to other external parties.

Segment capital expenditure is the total cost incurred during the period to acquire segment assets (both tangible and intangible) that are expected to be used for more than one period.

Unallocated items mainly comprise financial and corporate assets, interest-bearing loans, borrowings, tax balances, corporate and financing expenses and minority interests.

The Group's business is mainly managed in two principal geographical areas, the PRC (other than Hong Kong) and Hong Kong.

In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of customers. Segment assets are based on the geographical location of the assets.

## 2. TURNOVER

The principal activities of the Group are retail and wholesales of watches and jewellery.

# Notes to the Financial Statements

## 3. OTHER REVENUE AND NET INCOME

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Interest income | **6,171** | 3,351 |
| Government grants | **9,860** | 8,750 |
| Investment income | **10,024** | 4,400 |
| Changes in fair value on trading securities | **–** | 887 |
| Income from sales of trading securities | **6,449** | – |
| Others | **5,738** | 1,040 |
| | **38,242** | 18,428 |

One of the Group's subsidiaries, Shanghai Xinyu Watch & Clock Group, Ltd. ("Shanghai Xinyu"), received unconditional grants totalling RMB8,750 thousands and RMB9,860 thousands for the years ended 31 December 2005 and 2006, respectively, from the local government in Shanghai, in support of Shanghai Xinyu's development.

## 4. OTHER OPERATING EXPENSES

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Write-down of inventories | **5,565** | 1,811 |
| Impairment losses for doubtful accounts | **407** | 898 |
| Loss on disposal of property, plant and equipment | **41** | 39 |
| | **6,013** | 2,748 |

# Notes to the Financial Statements

## 5. PROFIT BEFORE TAXATION

Profit before taxation is arrived at after charging:

i) *Finance costs*

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Interest expense on bank loans and overdrafts | **23,193** | 21,004 |
| Bank charges | **3,855** | 2,349 |
| | **27,048** | 23,353 |

ii) *Staff costs*

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Wages, salaries and other benefits | **76,165** | 41,471 |
| Contributions to defined contribution plans | **6,161** | 3,591 |
| | **82,326** | 45,062 |

iii) *Other items*

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Cost of inventories# | **1,847,240** | 1,034,060 |
| Auditors' remuneration – audit services | **2,700** | 1,500 |
| Depreciation – property, plant and equipment | **15,970** | 12,024 |
| Amortisation of intangible assets | **120** | 120 |
| Operating leases charges in respect of properties | | |
| – minimum lease payments | **16,610** | 13,256 |
| – contingent rents | **59,693** | 35,726 |

\# *Cost of inventories includes RMB5,565 thousands (2005: RMB1,811 thousands), relating to write-down of inventories for the year ended 31 December 2006, which amount is also disclosed separately in note 4.*

# Notes to the Financial Statements

## 6. INCOME TAX IN THE CONSOLIDATED INCOME STATEMENT

(i) Taxation in the consolidated income statement represents:

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| **Current tax** | | |
| Provision for Hong Kong profits tax for the year | **5,577** | 84 |
| Provision for PRC income tax for the year | **84,935** | 71,351 |
| (Over)/under-provision in respect of prior years | **(2,886)** | 384 |
| **Deferred tax** | | |
| Origination of temporary differences | **(7,395)** | (6,933) |
| | **80,231** | 64,886 |

Pursuant to the rules and regulations of the Cayman Islands, the Company is exempt from income tax in the Cayman Islands. In addition, certain subsidiaries located in foreign jurisdictions are not subject to any income tax in these jurisdictions.

The provision for PRC income tax is based on a statutory rate of 33% of the assessable profits of subsidiaries in the PRC as determined in accordance with the relevant income tax rules and regulations of the PRC during the year, except for a subsidiary which is entitled to a preferential income tax rate of 15%.

Provision for Hong Kong profits tax during the year ended 31 December 2006 is calculated at 17.5% of the estimated assessable profits of subsidiaries in Hong Kong.

# Notes to the Financial Statements

## 6. INCOME TAX IN THE CONSOLIDATED INCOME STATEMENT *(Continued)*

(ii) Reconciliation between tax expense and accounting profit at applicable tax rate:

| | **2006**<br>**RMB'000** | 2005<br>RMB'000 |
|---|---|---|
| Profit before tax | **293,829** | 196,663 |
| Computed tax using the applicable tax rate to respective companies comprising the Group | **88,339** | 64,829 |
| Non-taxable income | **(6,562)** | (1,452) |
| Non-deductible expenses | **1,340** | 1,125 |
| (Over)/under-provision in respect of prior years | **(2,886)** | 384 |
| | **80,231** | 64,886 |

# Notes to the Financial Statements

## 7. DIRECTORS' REMUNERATION

Directors' remuneration disclosed pursuant to section 161 of the Hong Kong Companies Ordinance is as follows:

| | Fee RMB'000 | Basic salaries, allowances and other benefits RMB'000 | Contributions to retirement benefit plans RMB'000 *(note 27)* | Bonus RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|
| **Year ended 31 December 2005** | | | | | |
| **Executive Directors** | | | | | |
| Mr. Zhang Yuping | – | 1,296 | – | – | 1,296 |
| Mr. Song Jianwen | – | 276 | 32 | – | 308 |
| Mr. Huang Yonghua | – | 502 | – | – | 502 |
| **Non-executive Directors** | | | | | |
| Mr. Li Jialin | 26 | – | – | – | 26 |
| Mr. Chen Sheng | 13 | – | – | – | 13 |
| Mr. Shen Zhiyuan | 13 | – | – | – | 13 |
| **Independent Non-executive Directors** | | | | | |
| Mr. Liu Huangsong | 13 | – | – | – | 13 |
| Mr. Cai Jianmin | 13 | – | – | – | 13 |
| Mr. Wong Kam Fai, William | 26 | – | – | – | 26 |
| Total | 104 | 2,074 | 32 | – | 2,210 |

# Notes to the Financial Statements

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

| | Fee RMB'000 | Basic salaries, allowances and other benefits RMB'000 | Contributions to retirement benefit plans RMB'000 *(note 27)* | Bonus RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|
| **Year ended 31 December 2006** | | | | | |
| **Executive Directors** | | | | | |
| Mr. Zhang Yuping | – | 1,560 | – | – | 1,560 |
| Mr. Song Jianwen | – | 600 | 32 | – | 632 |
| Mr. Huang Yonghua | – | 660 | – | – | 660 |
| **Non-executive Directors** | | | | | |
| Mr. Li Jialin (resigned on 15 February 2006) | 13 | – | – | – | 13 |
| Mr. Chen Sheng | 50 | – | – | – | 50 |
| Mr. Shen Zhiyuan | 50 | – | – | – | 50 |
| Mr. Shi Zhongyang (appointed on 15 February 2006) | 88 | – | – | – | 88 |
| Mr. Chuang Jian, George (appointed on 23 October 2006) | – | – | – | – | – |
| **Independent Non-executive Directors** | | | | | |
| Mr. Liu Huangsong | 50 | – | – | – | 50 |
| Mr. Cai Jianmin | 50 | – | – | – | 50 |
| Mr. Wong Kam Fai, William | 100 | – | – | – | 100 |
| Total | 401 | 2,820 | 32 | – | 3,253 |

Save as disclosed above, no directors' remuneration has been paid or is payable by the Group during the two years ended 31 December 2005 and 2006. There was no arrangement under which a director waived or agreed to waive any remuneration during the two years ended 31 December 2005 and 2006.

# Notes to the Financial Statements

## 8. INDIVIDUALS WITH HIGHEST EMOLUMENTS

The five highest paid individuals of the Group during the year ended 31 December 2006 include 3 (2005: 2) directors of the Company, whose remuneration are reflected in note 7. Details of remuneration paid to the remaining highest paid individuals of the Group are as follow:

| | **2006**<br>**RMB'000** | 2005<br>RMB'000 |
|---|---|---|
| Basic salaries, allowances and other benefits | **1,299** | 1,569 |
| Contributions to retirement benefit plans | **12** | 25 |
| Bonus | **299** | – |
| | **1,610** | 1,594 |

The emoluments of the two (2005: three) individuals with the highest emoluments are within the following bands:

| RMB | **2006**<br>**Number of individuals** | 2005<br>Number of individuals |
|---|---|---|
| Nil-1,000,000 | **1** | 3 |
| 1,000,000-1,500,000 | **1** | – |

During the two years ended 31 December 2005 and 2006, no emoluments were paid by the Group to the directors or any of the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office.

# Notes to the Financial Statements

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

The consolidated profit attributable to equity shareholders of the Company includes a profit of RMB1,080 thousands (2005: loss of RMB897 thousands) which has been dealt with in the financial statements of the Company.

Reconciliation of the above amount to the Company's profit for the year:

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Amount of consolidated profit attributable to equity shareholders dealt with in the Company's financial statements | **1,080** | (897) |
| Dividends from subsidiaries attributable to the profits of the previous financial year, approved and paid during the year | **49,279** | – |
| Company's profit/(loss) for the year *(note 29(b))* | **50,359** | (897) |

## 10. DIVIDENDS

### (a) Dividends payable to equity shareholders of the Company attributable to the year

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Final dividend proposed after the balance sheet date of RMB0.028 per share (2005: RMB0.048 per share) | **69,566** | 49,800 |

The final dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date.

# Notes to the Financial Statements

## 10. DIVIDENDS *(Continued)*

(b) Dividends payable to equity shareholders of the Company attributable to the previous financial year, approved and paid during the year

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Final dividend in respect of the previous financial year, approved and paid during the year of RMB0.048 per share | **49,800** | 92,150 |

Pursuant to the resolution passed at the board of directors' meeting of Shanghai Xinyu held on 23 February 2005, dividend (excluding share of dividends to minority shareholders) of RMB92,150 thousands was declared by Shanghai Xinyu to its then major shareholders. The final dividend per share and the number of shares ranking for dividend are not presented above as such information is not meaningful having regard to the consolidated financial statements.

## 11. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit attributable to equity shareholders of the Company of RMB199,101 thousands (2005: RMB121,011 thousands) and the weighted average of 2,219,727,398 ordinary shares (2005: 1,652,191,780 ordinary shares) in issue during the year. The weighted average number of ordinary shares in issue for 2005 and 2006 has been retrospectively adjusted for the effect of the share split on 6 February 2007 (Note 34).

There were no dilutive potential ordinary shares for the years ended 31 December 2005 and 2006 and, therefore, diluted earnings per share are not presented.

# Notes to the Financial Statements

## 12. SEGMENT INFORMATION

Segment information is presented in respect of the Group's business and geographical segments. Business segment information is chosen as the primary reporting format because this is more relevant to the Group's internal financial reporting.

### Business segments

The Group comprises two principal business segments which are retail and wholesale respectively.

| | **2006 RMB'000** | 2005 RMB'000 |
|---|---|---|
| Turnover | | |
| Retail | **1,362,863** | 636,725 |
| Wholesale | **1,024,507** | 745,059 |
| Unallocated | **17,329** | 14,747 |
| Total | **2,404,699** | 1,396,531 |
| Segment result | | |
| Retail | **215,522** | 138,089 |
| Wholesale | **130,757** | 106,041 |
| Total | **346,279** | 244,130 |
| Unallocated operating income and expenses | **(25,322)** | (23,927) |
| Profit from operations | **320,957** | 220,203 |
| Finance costs | **(27,048)** | (23,353) |
| Share of losses of a jointly controlled entity | **(80)** | (187) |
| Income tax | **(80,231)** | (64,886) |
| Profit for the year | **213,598** | 131,777 |

# Notes to the Financial Statements

## 12. SEGMENT INFORMATION *(Continued)*

### Business segments *(Continued)*

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Segment assets | | |
| Retail | **1,189,775** | 492,999 |
| Wholesale | **642,559** | 411,137 |
| Total | **1,832,334** | 904,136 |
| Unallocated assets | **631,292** | 439,368 |
| Total assets | **2,463,626** | 1,343,504 |
| Segment liabilities | | |
| Retail | **267,013** | 72,321 |
| Wholesale | **83,648** | 54,322 |
| Total | **350,661** | 126,643 |
| Unallocated liabilities | **504,405** | 422,710 |
| Total liabilities | **855,066** | 549,353 |
| Capital expenditure | | |
| Retail | **46,029** | 7,251 |
| Unallocated | **94,422** | 19,970 |
| Total | **140,451** | 27,221 |
| Depreciation and amortisation | | |
| Retail | **7,158** | 3,192 |
| Unallocated | **8,932** | 8,952 |
| Total | **16,090** | 12,144 |
| Impairment losses for doubtful accounts | | |
| Wholesale | **407** | 898 |
| Write-down of inventories | | |
| Unallocated | **5,565** | 1,811 |

# Notes to the Financial Statements

## 12. SEGMENT INFORMATION *(Continued)*

### Geographical segments

The Group's business is mainly managed in two principal economic environment, the PRC (other than Hong Kong) and Hong Kong.

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Turnover | | |
| The PRC (other than Hong Kong) | **1,982,710** | 1,396,531 |
| Hong Kong | **421,989** | – |
| Total | **2,404,699** | 1,396,531 |
| Segment assets | | |
| The PRC (other than Hong Kong) | **1,847,415** | 1,149,157 |
| Hong Kong | **616,211** | 194,347 |
| Total | **2,463,626** | 1,343,504 |
| Capital expenditure | | |
| The PRC (other than Hong Kong) | **137,641** | 10,956 |
| Hong Kong | **2,810** | 16,265 |
| Total | **140,451** | 27,221 |

# Notes to the Financial Statements

## 13. PROPERTY, PLANT AND EQUIPMENT

**The Group**

| | Buildings RMB'000 | Leasehold improvements RMB'000 | Motor vehicles RMB'000 | Office equipment and other fixed assets RMB'000 | Construction in progress RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|---|
| **Cost:** | | | | | | |
| Balance at 1 January 2005 | 94,740 | 15,556 | 5,553 | 12,454 | 285 | 128,588 |
| Addition | 6,443 | 1,014 | 382 | 2,952 | 201 | 10,992 |
| Addition from acquisition of subsidiaries | – | – | – | 248 | – | 248 |
| Transfer from construction in progress | – | 323 | – | – | (323) | – |
| Disposals | – | (1,522) | – | (1,062) | – | (2,584) |
| Balance at 31 December 2005 | 101,183 | 15,371 | 5,935 | 14,592 | 163 | 137,244 |
| Addition | 125,488 | 5,668 | 2,456 | 5,856 | 983 | 140,451 |
| Addition from acquisition of subsidiaries | 25,276 | 5,140 | 963 | 3,679 | – | 35,058 |
| Transfer from construction in progress | – | 430 | – | – | (430) | – |
| Disposals | – | (211) | (633) | (473) | – | (1,317) |
| **Balance at 31 December 2006** | **251,947** | **26,398** | **8,721** | **23,654** | **716** | **311,436** |
| **Depreciation:** | | | | | | |
| Balance at 1 January 2005 | (12,385) | (11,167) | (2,209) | (5,508) | – | (31,269) |
| Charge for the year | (5,521) | (3,006) | (713) | (2,784) | – | (12,024) |
| Addition from acquisition of subsidiaries | – | – | – | (214) | – | (214) |
| Written-back on disposals | – | 1,522 | – | 949 | – | 2,471 |
| Balance at 31 December 2005 | (17,906) | (12,651) | (2,922) | (7,557) | – | (41,036) |
| Charge for the year | (5,616) | (5,806) | (948) | (3,600) | – | (15,970) |
| Addition from acquisition of subsidiaries | – | (2,087) | (555) | (1,852) | – | (4,494) |
| Written-back on disposals | – | 207 | 625 | 333 | – | 1,165 |
| **Balance at 31 December 2006** | **(23,522)** | **(20,337)** | **(3,800)** | **(12,676)** | **–** | **(60,335)** |
| **Net book value:** | | | | | | |
| **At 31 December 2006** | **228,425** | **6,061** | **4,921** | **10,978** | **716** | **251,101** |
| At 31 December 2005 | 83,277 | 2,720 | 3,013 | 7,035 | 163 | 96,208 |

i) All of the buildings owned by the Group are located in the PRC.

ii) As at 31 December 2006, the buildings in Shanghai and Shenzhen with the carrying amount of RMB66,673 thousands (2005: RMB30,195 thousands) were pledged to banks against certain loans (see note 25).

iii) As at 31 December 2006, the Group was in the process of obtaining the property ownership certificates of its buildings in Beijing, Guangzhou, Shenzhen, Taiyuan and Zhengzhou with the carrying amount of approximately RMB148,772 thousands (2005: RMB9,191 thousands).

# Notes to the Financial Statements

## 14. INTANGIBLE ASSETS

**The Group**

| | Trade marks | Edox agency rights | Total |
|---|---|---|---|
| | RMB'000 | RMB'000 | RMB'000 |
| **Cost:** | | | |
| At 1 January 2006 and 31 December 2006 | 32,149 | 1,200 | 33,349 |
| **Amortisation:** | | | |
| At 1 January 2006 | – | (240) | (240) |
| Charge for the year | – | (120) | (120) |
| At 31 December 2006 | – | (360) | (360) |
| **Net book value:** | | | |
| At 31 December 2006 | 32,149 | 840 | 32,989 |
| At 31 December 2005 | 32,149 | 960 | 33,109 |

The amortisation charge for the year is included in "Cost of sales" in the consolidated income statement.

The basis of impairment tests for cash-generating units containing trade marks with indefinite useful lives is as follows:

The recoverable amounts of the cash-generating units are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rate and growth rate. The Group prepared cash flow forecasts derived from the two-year financial budgets and extrapolates cash flows for the following eight years based on an estimated growth rate of 5% and a discount rate of 6%. The growth rate used does not exceed the average long-term growth rate for the relevant markets.

# Notes to the Financial Statements

## 15. GOODWILL

| | The Group RMB'000 |
|---|---|
| Cost: | |
| At 1 January 2006 | – |
| Addition | 181,045 |
| At 31 December 2006 | 181,045 |
| Accumulated impairment losses: | |
| At 1 January 2006 and 31 December 2006 | – |
| Carrying amount: | |
| At 31 December 2006 | 181,045 |
| At 31 December 2005 | – |

Goodwill is allocated to the Group's cash-generating units identified according to country of operation and business segment as follows:

| | **2006 RMB'000** | 2005 RMB'000 |
|---|---|---|
| Retail – PRC (other than Hong Kong) | **8,197** | – |
| Retail – Hong Kong | **171,163** | – |
| Wholesale – PRC (other than Hong Kong) | **1,685** | – |
| | **181,045** | – |

The recoverable amounts of the cash-generating units are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rate and growth rate. The Group prepared cash flow forecasts derived from the two-year financial budgets and extrapolates cash flows for the following eight years based on an estimated growth rate of 5% and a discount rate of 6%. The growth rate used does not exceed the average long-term growth rate for the relevant markets.

The goodwill is attributable to the significant synergies expected to arise after the Group's acquisition of subsidiaries disclosed in note 31.

# Notes to the Financial Statements

## 16. INVESTMENT IN SUBSIDIARIES

**The Company**

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| Unlisted shares, at cost | **568,352** | 199,352 |

The following list contains only the particulars of subsidiaries which principally affected the results, assets or liabilities of the Group. The class of shares held is ordinary unless otherwise stated.

All of these are controlled subsidiaries as defined under note 1(c) and have been consolidated into the consolidated financial statements.

| Name of company | Place of incorporation and operation | Percentage of equity held by the Company % | Percentage of equity held by subsidiaries % | Issued and fully paid-up/ registered capital | Principal activities |
|---|---|---|---|---|---|
| Shanghai Xinyu | the PRC | – | 95% | RMB360,000,000/ RMB360,000,000 | Retail and wholesale of watches |
| 北京市亨得利瑞士鐘錶有限責任公司 ("Beijing Hengdeli") | the PRC | – | 55% | RMB156,800,000/ RMB156,800,000 | Retail and wholesale of watches |
| 哈爾濱北亨捷夫鐘錶有限公司 ("Harbin Jiefu") | the PRC | – | 100% | RMB50,000,000/ RMB50,000,000 | Retail of watches |
| 遼寧寶瑞行鐘錶有限公司 ("Liaoning Bao Rui Hang") | the PRC | – | 100% | RMB40,000,000/ RMB40,000,000 | Retail of watches |
| 深圳市亨得利陽光鐘錶有限責任公司 ("Shenzhen Yangguang") | the PRC | – | 100% | RMB15,000,000/ RMB15,000,000 | Retail of watches |
| 河南富豪表行有限公司 ("Henan Fuhao") | the PRC | – | 70% | RMB30,000,000/ RMB30,000,000 | Retail of watches |

# Notes to the Financial Statements

## 16. INVESTMENT IN SUBSIDIARIES *(Continued)*

| Name of company | Place of incorporation and operation | Percentage of equity held by the Company % | Percentage of equity held by subsidiaries % | Issued and fully paid-up/ registered capital | Principal activities |
|---|---|---|---|---|---|
| 安徽三新鐘錶有限公司 ("Anhui Sanxin") | the PRC | – | 70% | RMB20,000,000/ RMB20,000,000 | Retail of watches |
| 北京新宇亨瑞鐘錶有限責任公司 ("Beijing Hengrui") | the PRC | – | 100% | RMB40,000,000/ RMB40,000,000 | Retail of watches |
| 廣州市雅迪裝飾包裝有限公司 ("Guangzhou Yadi") | the PRC | – | 100% | HK$45,000,000/ HK$45,000,000 | Decoration and packaging |
| 新宇亨得利鐘錶(深圳)有限公司 ("Shenzhen Xinyu") | the PRC | – | 100% | HK$50,000,000/ HK$50,000,000 | Wholesale of watches |
| Elegant Jewellery Holding Limited | Hong Kong | – | 100% | HK$5,000,000/ HK$5,000,000 | Retail of watches and jewellery |

*Note:* All the subsidiaries incorporated in the PRC are domestic enterprises, except for Shanghai Xinyu, Guangzhou Yadi and Shenzhen Xinyu, which are foreign investment enterprises.

# Notes to the Financial Statements

## 17. INTEREST IN A JOINTLY CONTROLLED ENTITY

**The Group**

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| Share of net assets | **4,733** | 4,813 |

Details of the Group's interest in the jointly controlled entity are as follows:

| Name of joint venture | Form of business structure | Place of incorporation and operation | Particulars of issued and paid up capital | Percentage of equity: Held by the Company | Percentage of equity: Held by a subsidiary | Principal activity |
|---|---|---|---|---|---|---|
| 北京亨聯達鐘錶有限責任公司 ("Beijing Henglianda") | Incorporated | People's Republic of China | Registered capital RMB 10,000,000 | – | 50% | Retail of watches |

Summary financial information on jointly controlled entity – Group's effective interest:

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| Non-current assets | **108** | 134 |
| Current assets | **11,670** | 5,251 |
| Non-current liabilities | **(5,000)** | – |
| Current liabilities | **(2,045)** | (572) |
| Net assets | **4,733** | 4,813 |
| Income | **9,253** | 933 |
| Expenses | **(9,333)** | (1,120) |
| Loss for the period | **(80)** | (187) |

# Notes to the Financial Statements

## 18. OTHER INVESTMENTS

**The Group**

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Unlisted investments | **250** | 250 |

## 19. TRADING SECURITIES

**The Group**

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Trading securities, at market value | | |
| Equity securities | – | 25,429 |
| Government bonds | – | 17,363 |
| | – | 42,792 |

## 20. INVENTORIES

As at 31 December 2005 and 2006, all the Group's inventories were finished goods.

# Notes to the Financial Statements

## 21. TRADE RECEIVABLES, PREPAYMENTS AND OTHER RECEIVABLES

**The Group**

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Trade receivables | **220,152** | 159,241 |
| Prepayments and other receivables | **100,856** | 53,881 |
| Receivables due from related parties *(note 32)* | **9,987** | 988 |
| | **330,995** | 214,110 |

**The Company**

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Other receivables | **235** | 228 |
| Receivables due from subsidiaries *(note 32)* | **504,783** | 240,033 |
| | **505,018** | 240,261 |

All of the trade and other receivables are expected to be recovered within one year.

Customers are normally granted credit terms of not more than 70 days depending on the credit worthiness of individual customers.

An ageing analysis of trade receivables (net of impairment losses for bad and doubtful debts) is as follows:

**The Group**

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Within 1 month | **154,458** | 121,719 |
| Over 1 month but less than 3 months | **57,581** | 30,589 |
| Over 3 months but less than 12 months | **8,113** | 6,933 |
| | **220,152** | 159,241 |

# Notes to the Financial Statements

## 22. PLEDGED BANK DEPOSITS

**The Group and the Company**

The amount mainly represents deposits pledged at banks to secure banking facilities granted to the Group. The pledged bank deposits will be released upon the termination of relevant banking facilities.

## 23. CASH AND CASH EQUIVALENTS

**The Group**

As at 31 December 2005 and 2006, all the Group's cash and cash equivalents in the consolidated balance sheet and the consolidated cash flow statement represented cash at bank and other financial institutions and cash in hand.

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Cash and cash equivalents in the balance sheet | **298,275** | 142,502 |
| Bank overdrafts *(note 25)* | **(3,602)** | – |
| Cash and cash equivalents in the consolidated cash flow statement | **294,673** | 142,502 |

**The Company**

As at 31 December 2005 and 2006, all the Company's cash and cash equivalents in the balance sheet represented cash at bank and in hand.

Included in cash and cash equivalent in the balance sheet are the following amounts denominated in a currency other than RMB:

| | **The Group** | | **The Company** | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | **'000** | '000 | **'000** | '000 |
| Hong Kong Dollars | **114,726** | 22,242 | **66,184** | 4,787 |

# Notes to the Financial Statements

## 24. TRADE AND OTHER PAYABLES

**The Group**

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Trade payables | **262,954** | 121,418 |
| Other payables and accrued expenses | **87,581** | 38,782 |
| Payables due to related parties *(note 32)* | **20,163** | 25,176 |
| | **370,698** | 185,376 |

**The Company**

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Other payables and accrued expenses | **439** | 271 |
| Payables due to subsidiaries *(note 32)* | **7,392** | 7,443 |
| | **7,831** | 7,714 |

An ageing analysis of trade payables is as follows:

**The Group**

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Within 1 month | **195,622** | 78,907 |
| Over 1 month but less than 3 months | **66,742** | 42,113 |
| Over 3 months but less than 12 months | **525** | 289 |
| Over 1 year | **65** | 109 |
| | **262,954** | 121,418 |

# Notes to the Financial Statements

## 25. BANK LOANS AND OVERDRAFTS

**The Group**

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Current | | |
| – secured bank loans | **75,212** | 20,000 |
| – unsecured bank loans | **309,000** | 294,000 |
| – secured bank overdrafts | **3,602** | – |
| | **387,814** | 314,000 |

The current secured bank loans as at 31 December 2005 and 2006 were secured by the Group's buildings with a carrying amount of RMB30,195 thousands and RMB28,148 thousands respectively. Certain secured bank loans as at 31 December 2006 were also secured by pledged deposits at banks. The current secured bank loans as at 31 December 2006 carried interest rates ranging from 4.9% to 6.12% (2005: 5.58%) per annum, and were all repayable within one year.

The current unsecured bank loans as at 31 December 2006 carried interest rates ranging from 5.30% to 6.30% (2005: 3.24% to 5.86%) per annum, and were all repayable within one year.

The secured bank overdrafts were secured by deposits pledged at bank.

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Non-current secured bank loan | **22,070** | – |

The non-current secured loan as at 31 December 2006 carried interest rate at 6.48% per annum. The loan was secured by the Group's building with a carrying amount of RMB38,525 thousands as at 31 December 2006.

Included in bank loans and overdrafts are the following amounts denominated in a currency other than RMB:

| | **2006** **'000** | 2005 '000 |
|---|---|---|
| Hong Kong Dollars | **48,586** | – |

# Notes to the Financial Statements

## 26. NON-CURRENT OTHER PAYABLES

The Group's non-current other payables were repayable as follows:

**The Group**

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Within 1 year | **565** | 1,696 |
| Over 1 year but less than 2 years | **–** | 565 |
| Over 2 years but less than 5 years | **–** | – |
| | **–** | 565 |
| | **565** | 2,261 |

The non-current other payables represent installment payables in respect of an office building acquired by the Group in March 2002.

## 27. EMPLOYEE RETIREMENT BENEFITS

As stipulated by the labour regulations of the PRC, the Group participates in various defined contribution retirement plans organised by municipal and provincial governments for its employees. The Group is required to make contributions to the retirement plans at rates ranging from 9% to 25% for the year ended 31 December 2005 and 2006 of the eligible employees' salaries.

The Group also operates a Mandatory Provident Fund Scheme ("the MPF scheme") under the Hong Kong Mandatory Provident Fund Schemes Ordinance for employees employed under the jurisdiction of the Hong Kong Employment Ordinance and not previously covered by the defined contribution plan as mentioned above. The MPF scheme is a defined contribution retirement scheme administered by independent trustees. Under the MPF scheme, the employer and its employees are each required to make contributions to the scheme at 5% of the employees' relevant income, subject to a cap of monthly relevant income of HK$20,000. Contributions to the scheme vest immediately.

The Group has no other obligation for the payment of its employees' retirement and other post-retirement benefits other than the contributions described above.

# Notes to the Financial Statements

## 28. INCOME TAX IN THE CONSOLIDATED BALANCE SHEET

i) Current taxation in the consolidated balance sheet represents:

**The Group**

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Provision for income tax for the year | **90,512** | 71,435 |
| Addition from acquisition | **5,630** | – |
| Income tax paid | **(22,062)** | (26,647) |
| | **74,080** | 44,788 |
| Balance of income tax provision related to prior years | **404** | 4,624 |
| | **74,484** | 49,412 |

ii) Deferred tax assets recognised:

The components of deferred tax assets recognised in the consolidated balance sheet and the movements during the two years ended 31 December 2006 are as follows:

**The Group**

| | **Impairment for trade receivables** RMB'000 | **Write down for inventories** RMB'000 | **Tax losses not utilised** RMB'000 | **Unrealised profit** RMB'000 | **Total** RMB'000 |
|---|---|---|---|---|---|
| At 1 January 2005 | 2,042 | 1,251 | 831 | 6,496 | 10,620 |
| Credited to consolidated income statement | 160 | 597 | 55 | 6,121 | 6,933 |
| At 31 December 2005 | 2,202 | 1,848 | 886 | 12,617 | 17,553 |
| Credited to consolidated income statement | 24 | 650 | 170 | 6,551 | 7,395 |
| At 31 December 2006 | 2,226 | 2,498 | 1,056 | 19,168 | 24,948 |

# Notes to the Financial Statements

## 29. CAPITAL AND RESERVES

### (a) The Group

| | Note | Attributable to equity shareholders of the Company Share capital RMB'000 | Share premium RMB'000 | Capital reserve RMB'000 | Exchange reserve RMB'000 | PRC statutory reserve RMB'000 | Retained profits RMB'000 | Total RMB'000 | Minority interests RMB'000 | Total equity RMB'000 |
|---|---|---|---|---|---|---|---|---|---|---|
| At 1 January 2006 | | 10,828 | 552,777 | (26,074) | – | 51,948 | 105,161 | 694,640 | 99,511 | 794,151 |
| Dividends approved in respect of the previous year | 10 | – | – | – | – | – | (49,800) | (49,800) | (6,385) | (56,185) |
| Transfer between reserves | | – | – | – | – | 21,659 | (21,659) | – | – | – |
| Issuance of new shares | 29(c)(i) | 2,099 | 654,260 | – | – | – | – | 656,359 | – | 656,359 |
| Shares issuance expenses | | – | (17,253) | – | – | – | – | (17,253) | – | (17,253) |
| Exchange difference on translation into presentation currency | | – | – | – | (10,961) | – | – | (10,961) | – | (10,961) |
| Acquisition of subsidiaries | 31 | – | – | – | – | – | – | – | 1,416 | 1,416 |
| Capital contribution from minority shareholders | | – | – | – | – | – | – | – | 27,435 | 27,435 |
| Profit for the year | | – | – | – | – | – | 199,101 | 199,101 | 14,497 | 213,598 |
| **At 31 December 2006** | | **12,927** | **1,189,784** | **(26,074)** | **(10,961)** | **73,607** | **232,803** | **1,472,086** | **136,474** | **1,608,560** |

### (b) The Company

| | Note | Share capital RMB'000 | Share premium RMB'000 | Exchange reserve RMB'000 | Retained losses RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|---|
| At 1 January 2006 | | 10,828 | 552,777 | – | (897) | 562,708 |
| Issuance of new shares | 29(c)(i) | 2,099 | 654,260 | – | – | 656,359 |
| Share issuance expenses | | – | (17,253) | – | – | (17,253) |
| Dividends approved in respect of the previous year | 10 | – | – | – | (49,800) | (49,800) |
| Profit for the year | | – | – | – | 50,359 | 50,359 |
| Exchange difference on translation into presentation currency | | – | – | (16,951) | – | (16,951) |
| **At 31 December 2006** | | **12,927** | **1,189,784** | **(16,951)** | **(338)** | **1,185,422** |

# Notes to the Financial Statements

## 29. CAPITAL AND RESERVES *(Continued)*

### (c) Share capital

| | Note | 2006 Number of shares | 2006 Amount HK$ | 2005 Number of shares | 2005 Amount HK$ |
|---|---|---|---|---|---|
| **Authorised:** | | | | | |
| Ordinary shares of HK$0.01 each | | **2,000,000,000** | **20,000,000** | 2,000,000,000 | 20,000,000 |

**Issued and fully paid:**

| | Note | 2006 Number of shares | 2006 Amount HK$ | 2005 Number of shares | 2005 Amount HK$ |
|---|---|---|---|---|---|
| At 1 January | | **1,037,500,000** | **10,375,000.00** | 1 | 0.01 |
| Issuance of new shares | *(i)* | **204,750,000** | **2,047,500.00** | 59,999,999 | 599,999.99 |
| Capitalisation issue | | – | – | 690,000,000 | 6,900,000.00 |
| Shares issued under the Offering and Placement | | – | – | 250,000,000 | 2,500,000.00 |
| Shares issued under the over-allotment option related to the Placement | | – | – | 37,500,000 | 375,000.00 |
| At 31 December | | **1,242,250,000** | **12,422,500.00** | 1,037,500,000 | 10,375,000.00 |
| | | | **equivalent RMB'000** | | equivalent RMB'000 |
| | | | **12,927** | | 10,828 |

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. All ordinary shares rank equally with regard to the Company's residual assets.

# Notes to the Financial Statements

## 29. CAPITAL AND RESERVES *(Continued)*

### (c) Share capital *(Continued)*

*(i) Issuance of new shares*

During 2006, the Company entered into an acquisition agreement with the equity shareholders of Elegant International Holdings Limited ("Elegant International") to acquire the entire interests of Elegant International ("the Acquisition"). The consideration payable by the Company included HK$180,000 thousands (equivalent to RMB184,500 thousands approximately) in cash and the issue of 56,250,000 new ordinary shares of HK$0.01 each at HK$3.2 (equivalent to RMB3.28 approximately) each by the Company. The Acquisition was completed on 24 August 2006.

On 24 August 2006, 148,500,000 new ordinary shares of HK$0.01 each in aggregate were issued to Dunearn Investments (Mauritius) Pte. Ltd., the Swatch Group Hong Kong Limited and United Capital Investment Group Limited at HK$3.1 (equivalent to RMB3.1775 approximately) for cash.

*(ii) Share option scheme*

The Company adopted a share option scheme pursuant to the resolutions of the shareholders of the Company passed on 27 August 2005. No option had been granted to the directors of the Company and employees of the Group during 2006.

### (d) Nature and purpose of reserves

*(i) Share premium*

The application of the share premium account is governed by the Companies Law of the Cayman Islands.

*(ii) PRC statutory reserve*

Transfers from retained earnings to PRC statutory reserves were made in accordance with the relevant PRC rules and regulations and the articles of association of the Company's subsidiaries incorporated in the PRC and were approved by the respective boards of directors.

PRC statutory reserves include general reserve, enterprise expansion fund, statutory surplus reserve and statutory public welfare fund.

In accordance with Accounting Regulations for Business Enterprises, foreign investment enterprises in the PRC are required to transfer at least 10% of their profit after taxation, as determined under accounting principles generally accepted in the PRC ("PRC GAAP") to the general reserve until the balance of the general reserve is equal to 50% of their registered capital. Moreover, they are required to transfer a certain percentage of their profit after taxation, as determined under PRC GAAP, to the enterprise expansion fund.

# Notes to the Financial Statements

## 29. CAPITAL AND RESERVES *(Continued)*

### (d) Nature and purpose of reserves *(Continued)*

*(ii) PRC statutory reserve (Continued)*

The general reserve fund can only be used to make good of previous years' losses upon approval by the relevant authority. The enterprise expansion fund can only be used to increase their capital or to expand their operations upon approval by the relevant authority.

Statutory surplus reserve can be used to reduce previous years' losses, if any, and may be converted into paid-up capital, provided that the balance after such conversion is not less than 25% of the registered capital of the subsidiaries. Statutory public welfare fund can only be utilised on capital items for the collective benefits of the employees such as the construction of staff quarters and other staff welfare facilities. This reserve is non-distributable other than in liquidation.

## 30. COMMITMENTS

### i) Operating lease commitments

Non-cancelable operating lease rentals are payable as follows:

| | **2006**<br>**RMB'000** | 2005<br>RMB'000 |
|---|---|---|
| Less than one year | **33,329** | 14,278 |
| Between one and five years | **74,518** | 19,449 |
| More than five years | **46,889** | 2,342 |
| | **154,736** | 36,069 |

The leases run for an initial period of one to ten years, with an option to renew the lease when all terms are renegotiated. In addition to the minimum rental payments disclosed above, the Group has a commitment to pay rent of a proportion of turnover for certain leased properties. Contingent rentals are not included in the above commitments as it is not possible to estimate the amounts which may be payable.

# Notes to the Financial Statements

## 30. COMMITMENTS *(Continued)*

### ii) Commitments of guaranteed profit

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Less than one year | **8,800** | 3,500 |
| Between one and five years | **33,200** | 8,000 |
| | **42,000** | 11,500 |

Pursuant to a management agreement dated 30 December 2006 entered into between Shanghai Xinyu and Shanghai Yi Min Department Stores Company Limited ("Yi Min"), whereby Yi Min agreed to entrust to Shanghai Xinyu the operation and management of a shop located in Shanghai, and in return, Yi Min is entitled to receive an annual guaranteed profit of RMB6,800 thousands from the Group for the period from 1 January 2007 to 31 December 2011.

Pursuant to a management agreement dated 31 December 2005 entered into between Shanghai Xinyu and 青島亨得利有限公司 ("Qingdao Company"), whereby Qingdao Company agreed to entrust to Shanghai Xinyu the operation and management of its four retail shops for the period from 31 December 2005 to 31 December 2010, and in return, Qingdao Company is entitled to receive an annual guaranteed profits of RMB2,000 thousands from the Group.

## 31. ACQUISITION OF SUBSIDIARIES

During 2006, the Group acquired 70% equity interest in Henan Fuhao for a consideration of RMB11,500 thousands, satisfied in cash. For the year ended 31 December 2006, Henan Fuhao contributed a net profit of RMB3,185 thousands to the consolidated profit attributable to equity holders of the Company in 2006.

During 2006, the Group acquired 100% equity interests in Guangzhou Yadi for a consideration of RMB7,392 thousands, satisfied in cash. For the year ended 31 December 2006, Guangzhou Yadi contributed a net loss of RMB103 thousands to the consolidated profit attributable to equity holders of the Company in 2006.

During 2006, the Group acquired 100% equity interests in Elegant International for a consideration of HK$360,000 thousands. The consideration was satisfied in cash of HK$180,000,000, and in the issue and allotment of 56,250,000 new ordinary shares of the Company at HK$3.2 (equivalent to RMB3.28 approximately). For the year ended 31 December 2006, Elegant International contributed a net profit of RMB25,826 thousands to the consolidated profit attributable to equity holders of the Company in 2006.

# Notes to the Financial Statements

## 31. ACQUISITION OF SUBSIDIARIES *(Continued)*

### Effect of acquisition

| | Pre-acquisition carrying amounts | | | | | |
|---|---|---|---|---|---|---|
| | Acquisition of 70% equity interests of Henan Fuhao in 2006 | Acquisition of 100% equity interests of Guangzhou Yadi in 2006 | Acquisition of 100% equity interests of Elegant International in 2006 | Subtotal | Fair value adjustment | Recognised values on acquisition |
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| Property, plant and equipment | 898 | 21,462 | 3,420 | 25,780 | 4,784 | 30,564 |
| Inventories | 31,020 | 1,088 | 312,206 | 344,314 | 4,126 | 348,440 |
| Trade receivables, prepayments and other receivables | 6,380 | 2,316 | 28,399 | 37,095 | – | 37,095 |
| Cash and cash equivalents | 76 | 1,945 | 29,334 | 31,355 | – | 31,355 |
| Bank loans and overdrafts | (250) | (17,893) | (105,675) | (123,818) | – | (123,818) |
| Trade and other payables | (33,392) | (7,739) | (68,612) | (109,743) | – | (109,743) |
| Current taxation | (13) | (256) | (5,361) | (5,630) | – | (5,630) |
| Minority interests | (1,416) | – | – | (1,416) | – | (1,416) |
| Net identifiable assets and liabilities | 3,303 | 923 | 193,711 | 197,937 | 8,910 | 206,847 |
| Goodwill | | | | | | 181,045 |
| | | | | | | 387,892 |
| Representing: | | | | | | |
| Consideration paid, satisfied in cash | | | | | | 203,392 |
| Consideration paid, satisfied in issue of new shares | | | | | | 184,500 |
| | | | | | | 387,892 |
| Consideration paid, satisfied in cash | | | | | | 203,392 |
| Cash acquired | | | | | | (31,355) |
| Net cash outflow | | | | | | 172,037 |

Pre-acquisition carrying amounts were determined based on applicable HKFRSs immediately before the acquisition. The values of assets, liabilities, and contingent liabilities recognised on acquisition are their estimated fair values (see note 1(g) and 1(k) for methods used in determining fair values).

# Notes to the Financial Statements

## 32. RELATED PARTY TRANSACTIONS

The Group has transactions with the companies controlled by the ultimate shareholders ("Ultimate shareholders' companies"), minority shareholders of subsidiaries ("Minority shareholders") and a jointly controlled entity. The following is a summary of principal related party transactions carried out by the Group with the above related parties for the two years ended 31 December 2006.

### (a) Recurring

| | **2006**<br>**RMB'000** | 2005<br>RMB'000 |
|---|---|---|
| **Lease expenses to:** | | |
| Minority shareholders | **4,800** | 4,800 |
| Ultimate shareholders' companies | **1,478** | 543 |
| **Guaranteed profit to:** | | |
| Minority shareholders | **3,500** | 1,500 |
| **Sales of goods to:** | | |
| Jointly controlled entity | **14,514** | 2,633 |
| **Advance to:** | | |
| Jointly controlled entity | **5,000** | – |

The directors of the Company are of the opinion that the above transactions with related parties were conducted in the ordinary course of business, on normal commercial terms and in accordance with the agreements governing such transactions.

# Notes to the Financial Statements

## 32. RELATED PARTY TRANSACTIONS *(Continued)*

### (b) Non-recurring

| | **2006 RMB'000** | 2005 RMB'000 |
|---|---|---|
| **Sales of goods to:** | | |
| Minority shareholders | – | 6,222 |
| **Purchase of goods from:** | | |
| Minority shareholders | – | 34,889 |
| **Acquisition of equity interests in subsidiaries from:** | | |
| Minority shareholders | – | 1,545 |
| **Unsecured bank loans guaranteed by:** | | |
| Ultimate shareholders' companies | – | 30,000 |

### (c) Trade and other receivables due from:

**The Group**

| | **2006 RMB'000** | 2005 RMB'000 |
|---|---|---|
| Jointly controlled entity | **9,987** | 988 |

**The Company**

| | **2006 RMB'000** | 2005 RMB'000 |
|---|---|---|
| Subsidiaries | **504,783** | 240,033 |

# Notes to the Financial Statements

## 32. RELATED PARTY TRANSACTIONS *(Continued)*

(d) Trade and other payables due to:

**The Group**

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Minority shareholders | **20,163** | 25,176 |

**The Company**

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Subsidiaries | **7,392** | 7,443 |

(e) Key management personnel compensation and post-employment benefit plans

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Short-term employee benefits | **6,720** | 4,785 |
| Post-employment benefits | **165** | 161 |
| | **6,885** | 4,946 |

# Notes to the Financial Statements

## 33. FINANCIAL INSTRUMENTS

Major financial assets for the Group include cash and cash equivalents, pledged bank deposits, trade receivables, prepayments and other receivables and trading securities. Major financial liabilities of the Group include trade and other payables and bank loans and overdrafts. Details of these financial instruments are disclosed in respective notes. Exposure to credit, liquidity, interest rate and currency risks arises in the normal course of the Group's business. These risks are limited by the Group's financial management policies and practices described below.

### (a) Credit risk

The Group's credit risk is primarily attributable to trade and other receivables and trading securities. Management has a credit policy in place and the exposures to these credit risks are monitored on an ongoing basis.

In respect of trade and other receivables, credit evaluations are performed on all customers requiring credit over a certain amount. Normally, the Group does not obtain collateral from customers.

At the balance sheet dates the Group had no significant concentration of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheets.

### (b) Interest rate risk

Cash and cash equivalents, trading government bonds and bank loans are the major types of the Group's financial instruments subject to interest rate risk.

Cash and cash equivalents comprise mainly bank deposits with fixed interest rates ranging from 0.72% to 3% per annum and the maturity dates of these bank deposits are within 1 year. The interest rates and terms of repayment of bank loans of the Group are disclosed in note 25 above.

### (c) Currency risk

The Group is exposed to foreign currency risk primarily through sales and purchases that are denominated in a currency other than the functional currency of the operations to which they related. The currency giving rise to this risk is primarily Hong Kong dollars. Depreciation or appreciation of Renminbi against foreign currencies will affect the Group's financial position and results of operations.

The amounts of financial assets and liabilities of the Group are substantially denominated in the functional currency of respective entity of the Group.

# Notes to the Financial Statements

## 33. FINANCIAL INSTRUMENTS *(Continued)*

### (d) Fair values

All financial instruments are carried at amounts not materially different from their fair values as at 31 December 2006 and 2005.

### (e) Estimation of fair values

The following summaries the major methods and assumptions used in estimating the fair values of each class of financial instruments.

*(i) Cash and cash equivalents, pledged bank deposits, trade receivables, prepayments and other receivables, trade and other payables*

The carrying values approximate fair value because of the short maturities of these instruments.

*(ii) Trading securities*

Fair value is based on quoted market prices at the balance sheet date without any deduction for transaction costs.

*(iii) Bank loans*

The fair value is estimated as the present value of future cash flows, discounted at current market interest rates for similar financial instruments.

## 34. NON-ADJUSTING POST BALANCE SHEET EVENTS

Pursuant to the PRC enterprise income tax law passed by the Tenth National People's Congress on 16 March 2007, the new enterprise income tax rates for domestic and foreign enterprises are unified at 25% and will be effective from 1 January 2008. The impact of such change of enterprise income tax rate on the Group's consolidated financial statements will depend on detailed pronouncements that are subsequently issued. Since implementation and transitional guidance applicable to the Group has not yet been announced, the Group cannot reasonably estimate the financial impact of the new law to the Group at this stage.

Pursuant to an ordinary resolution passed at the Extraordinary General Meeting held on 6 February 2007, the Company subdivided every issued and unissued ordinary shares of HK$0.01 each in the share capital of the Company into two ordinary shares of HK$0.005 each.

After the balance sheet date, the directors proposed a final dividend on 10 April 2007. Further details are disclosed in note 10.

## 35. ULTIMATE HOLDING COMPANY

The directors consider the ultimate holding company of the Company at 31 December 2006 to be Best Growth International Limited, which is incorporated in British Virgin Islands.

# Notes to the Financial Statements

## 36. ACCOUNTING ESTIMATES AND JUDGEMENTS

Notes 14,15 and 33 contain information about the assumptions and their risk factors relating to intangible assets impairment, goodwill impairment and financial instruments, other judgements made by management in the application of HKFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment are discussed below.

### (a) Impairment of receivables

The management maintains an allowance for doubtful accounts for estimated losses resulting from the inability of the customers to make the required payments. The management bases the estimates on the ageing of the individual receivable balance, customer credit-worthiness and historical write-off experience. If the financial condition of the customers were to deteriorate, actual write-offs would be higher than estimated.

### (b) Depreciation

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account the estimated residual values. The management reviews the estimated useful lives and the residual values of the assets regularly in order to determine the amount of depreciation expense to be recorded during any reporting period. The determination of the useful lives and the residual values are based on the historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

### (c) Net realisable value of inventories

Net realisable value of inventories is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling expense. These estimates are based on the current market condition and the historical experience of distributing and selling products of similar nature. Management will reassess the estimations by the balance sheet date.

# Notes to the Financial Statements

## 37. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED 31 DECEMBER 2006

Up to the date of issue of these financial statements, the HKICPA has issued a number of amendments, new standards and interpretations which are not yet effective for the year ended 31 December 2006 and which have not been adopted in these financial statements.

The Company is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the company's results of operations and financial position.

The following developments may result in new or amended disclosures in the financial statements:

| | **Effective for accounting periods beginning on or after** |
|---|---|
| HKFRS 7, *Financial instruments: disclosures* | 1 January 2007 |
| Amendment to HKAS 1, *Presentation of financial statements: capital disclosures* | 1 January 2007 |

# Financial Summary

| RESULTS | Year ended 31 December 2002 RMB'000 | 2003 RMB'000 | 2004 RMB'000 | 2005 RMB'000 | **2006 RMB'000** |
|---|---|---|---|---|---|
| Sales | 1,375,420 | 1,496,401 | 1,518,582 | 1,396,531 | **2,404,699** |
| Profit from operations | 43,999 | 113,355 | 176,378 | 220,203 | **320,957** |
| Finance costs | (9,569) | (13,661) | (17,614) | (23,353) | **(27,048)** |
| Share of losses of a jointly controlled entity | – | – | – | (187) | **(80)** |
| Profit before tax | 34,430 | 99,694 | 158,764 | 196,663 | **293,829** |
| Income tax | (11,071) | (32,498) | (52,881) | (64,886) | **(80,231)** |
| Profit for the year | 23,359 | 67,196 | 105,883 | 131,777 | **213,598** |
| Attributable to: | | | | | |
| Equity shareholders of the Company | 20,592 | 55,441 | 97,545 | 121,011 | **199,101** |
| Minority interests | 2,767 | 11,755 | 8,338 | 10,766 | **14,497** |
| Profit for the year | 23,359 | 67,196 | 105,883 | 131,777 | **213,598** |
| Basic earnings per share | RMB0.014 | RMB0.037 | RMB0.065 | RMB0.073 | **RMB0.090** |

| ASSETS AND LIABILITIES | At 31 December 2002 RMB'000 | 2003 RMB'000 | 2004 RMB'000 | 2005 RMB'000 | **2006 RMB'000** |
|---|---|---|---|---|---|
| Total assets | 577,644 | 690,088 | 864,329 | 1,343,504 | **2,463,626** |
| Total liabilities | 415,065 | 370,305 | 500,248 | 549,353 | **855,066** |
| Net assets | 162,579 | 319,783 | 364,081 | 794,151 | **1,608,560** |
| Equity attributable to equity shareholders of the Company | 103,692 | 220,561 | 285,508 | 694,640 | **1,472,086** |
| Minority interests | 58,887 | 99,222 | 78,573 | 99,511 | **136,474** |
| Total shareholders' equity | 162,579 | 319,783 | 364,081 | 794,151 | **1,608,560** |