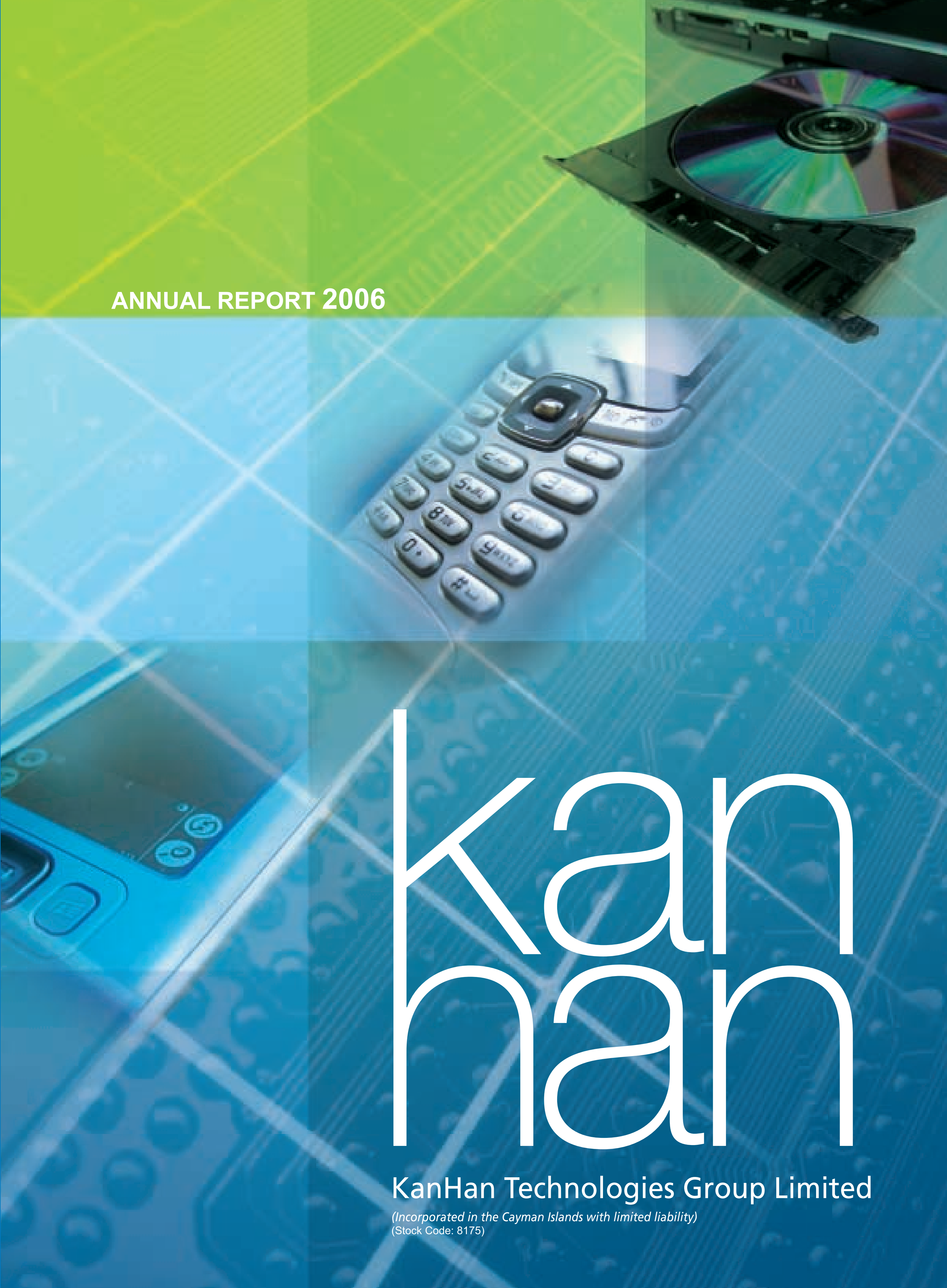

ANNUAL REPORT **2006**

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KanHan Technologies Group Limited

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 8175)

CHARACTERISTIC OF THE GROWTH ENTERPRISE MARKET ("GEM") OF THE STOCK EXCHANGE OF HONG KONG LIMITED (THE "STOCK EXCHANGE")

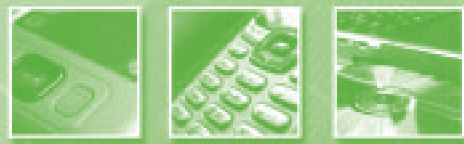
The Growth Enterprise Market ("GEM") of the Stock Exchange of Hong Kong Limited ("the Stock Exchange") has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on GEM and the business sectors or countries in which the companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

Given the emerging nature of companies listed on GEM, there is a risk that securities traded on GEM may be more susceptible to high market volatility than securities traded on Main Board and no assurance is given that there will be a liquid market in the securities traded on GEM.

The principal means of information dissemination on GEM is publication on the internet website operated by the Stock Exchange. Listed companies are not generally required to issue paid announcements in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website in order to obtain up-to-date information on GEM-listed issuers.

The Stock Exchange takes no responsibility for the contents of this report, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this report.

This report, for which the directors of KanHan Technologies Group Limited collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the GEM of the Stock Exchange for the purpose of giving information with regard to KanHan Technologies Group Limited. The directors, having made all reasonable enquiries, confirmed that, to the best of their knowledge and belief:– (1) the information contained in this report is accurate and complete in all material respects and not misleading; (2) there are no other matters the omission of which would make any statement in this report misleading; and (3) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.



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CORPORATE INFORMATION

BOARD OF DIRECTORS

Chairman & Executive Director

Ma She Shing, Albert

Executive Director

Mo Wai Ming, Lawrence

Independent Non-executive Directors

Hsu Shiu Foo, William
Kwok Chi Sun, Vincent
Lee Kun Hung

AUDIT COMMITTEE

Hsu Shiu Foo, William
Kwok Chi Sun, Vincent
Lee Kun Hung

REMUNERATION COMMITTEE

Kwok Chi Sun, Vincent
Mo Wai Ming, Lawrence
Lee Kun Hung

COMPANY SECRETARY

Au Shui Ming, Anna

QUALIFIED ACCOUNTANT

Au Shui Ming, Anna

COMPLIANCE OFFICER

Mo Wai Ming, Lawrence

AUTHORISED REPRESENTATIVES

Mo Wai Ming, Lawrence
Au Shui Ming, Anna

AUDITORS

Moores Rowland Mazars

REGISTERED OFFICE

Caledonian Bank & Trust Limited
Caledonian House
P.O. Box 1043
George Town
Grand Cayman
Cayman Islands

HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS

15/F., Sun House
181 Des Voeux Road Central
Hong Kong

SHARE REGISTRAR

Standard Registrars Limited
26/F., Tesbury Centre
28 Queen's Road East
Wanchai, Hong Kong

PRINCIPAL BANKERS

Standard Chartered Bank (Hong Kong) Limited

WEBSITE ADDRESS

www.kanhan.com

STOCK CODE

8175

CORPORATE PROFILE

Established in 1999, **KanHan Technologies Group Limited** is a global leader in Asian language infrastructure development for Internet enabled devices such as PCs and 3G mobile phones and PCs.

"With our HanVOICE server and patented HanFont Technology, our Group endeavors to become the market leader in web-based Chinese, Japanese and Korean (CJK) text to text and text to speech communications business."

Awards

- Hong Kong ICT Awards 2006: Digital Inclusion, Gold Award
- 2005 China Nomination to United Nation's "World Summit Award"
- The Hong Kong Computer Society, Certificate of Merit in the Communications Applications Category of the Asia Pacific Information and Communications Technology Awards, 2004
- The Hong Kong Computer Society, 6th IT Excellence Award; Certificate of Merit in the Product Category, 2004
- 2003 Asia-Pacific Technology Fast 500 Programme of Deloitte Touche Tohmatsu – 7th position
- The Hong Kong Awards for Industry, the Hong Kong Science & Technology Park Certificate of Merit in Technological Achievement, 2002
- The Hong Kong Awards for Industry, Federation of Hong Kong Industries Consumer Product Design Award, 2002
- The Hong Kong Awards for Industry, the Hong Kong Science & Technology Park Technological Achievement Award, 2001
- The Hong Kong Computer Society, IT Excellence Product Silver Award, 2001

FINANCIAL HIGHLIGHTS

	For the year ended 31 December				
	2002	2003	2004	2005	**2006**
	HK$'000	HK$'000	HK$'000	HK$'000	**HK$'000**
RESULTS					
Turnover	8,801	2,984	4,320	4,472	**6,622**
(Loss) profit from ordinary activities attributable to shareholders	3,721	(16,708)	(8,950)	(4,913)	**(6,273)**

ASSETS AND LIABILITIES

	As at 31 December				
	2002	2003	2004	2005	**2006**
	HK$'000	HK$'000	HK$'000	HK$'000	**HK$'000**
Total assets	11,713	7,858	6,179	4,394	**27,565**
Total liabilities	(8,551)	(4,819)	(3,630)	(3,643)	**(5,284)**
Balance of shareholders' funds	3,162	3,039	2,549	751	**22,281**

Notes:

1. The Company was incorporated in the Cayman Islands on 10 October 2002 and became the holding company of the Group on 15 January 2003 as a result of the Group Reorganisation.

2. The results for the year ended 31 December 2002 and the assets and liabilities as at 31 December 2002 have been prepared using the merger method of accounting as if the group structure immediately after the Group reorganisation had been in existence throughout the years concerned.

CHAIRMAN'S STATEMENT

KanHan Technologies Group Limited (the "Company" or "KanHan") and its subsidiaries (together known as the "Group") are proud to win major IT awards for technologies developed in Hong Kong 6 years in a row. Our Chinese JAWS (CJAWS) product, a screen reading technology KanHan co-develops with an U.S. partner to assist visually impaired persons in using computer, was awarded Gold Award in the Digital Inclusion category of 2006 ICT Award. CJAWS is the third line of products, in addition to HanWEB, HanVoice/HanPhone that KanHan develops to overcome barriers for Chinese speaking community in accessing latest IT technologies and the Internet. We treasure CJAWS accolade even more as it demonstrates KanHan as a caring corporate citizen and our commitment in bettering the life of the visually impaired persons in the global Chinese community.

I am also happy to report that Interactive Voice Response (IVR) and the e-Putonghua (PTH) business are progressing well. As of this reporting date, we have installed more than 600 telephone ports on HanPhone IVR technology platform for major government departments and commercial organizations in the past year notably the Hospital Authority's outpatient service booking service, Housing Authority's rent enquiry hotline, KBC Financial Products' warrant hotline and a major utility's engineering service booking service. These IVR projects are typical of improving customer service enabling phone users' access to IT applications via telephony interface provided by HanPhone IVR. As to the PTH subscription based business, number of participating schools has grown to more than 70 including primary, secondary and tertiary schools.

Results of the Year

As the new business on IVR and PTH are still in a market development stage despite of a year of fast expansion, the Group continues to operate at a loss which has shrunken further from last year. For the year ended 31 December 2006, the Group recorded a turnover of approximately HK$6,622,000 and the net loss attributable to shareholders was HK$6,273,000.

Dividend

The board of directors does not recommend the payment of a final dividend for the year ended 31 December 2006.

Outlook

Year 2006 was a year of solid growth from our early strategic investment into the IVR and PTH business. We forecast the two businesses will grow more substantially in 2007 with the momentum propelled by the major customer references established in the past two years. The EFAX subscription business has begun to take shape evolving into a small but sustainable business. More importantly, the Internet based retail service business becomes an important marketing channel generating sales leads to HanPhone IVR business. Companies can acquire HanPhone and turn it into an IVR/EFAX/SMS customer service and marketing channel of their own.

We are particularly optimistic in the growth of the PTH business with the introduction of printable extension to primary and secondary schools. Instead of collecting a school based annual subscription fee, the printable version will be provided with a PTH teaching curriculum targeting the replacement of hard copy text books that students pay on individual basis. The new business model will at least triple the revenue than the school based subscription model once the e-book concept is accepted by a school. Our sales goal is to grow the number of school users to 150 in 2007 and 350 by 2008. We will also put in more sales efforts in promoting the HanPhone based School-IVR rental service introduced in 2006 with one school using it successfully in improving school/ parent communication in the past 6 months. Schools will pay rental charge for the number of IVR lines hosted by KanHan for parents' access to the latest school/student information and voice mail to email service. The School-IVR platform will also serve as the interfacing vehicle for school subscription to our SMS and fax broadcast service.

HanWEB will continue to bring in a steady service income to KanHan in Hong Kong. Because of the 2008 Olympic in Beijing, we are hopeful more China government agent and department websites will require traditional Chinese interface to attract overseas Chinese visitors. HanWEB is well positioned for the increasing market demand as one of the two dominant software providing websites instant translations from simplified Chinese to traditional Chinese and therefore will be more aggressively recruiting resellers to promote the HanWEB business in China.

We will release a new version of Chinese JAWS supporting the latest Microsoft Windows and Software towards end of the year that will no doubt trigger more sales not just in Hong Kong but to Taiwan market. Through a local reseller, the Chinese JAWS has gradually been accepted by the Taiwan visually impaired users replacing the domestic brands of screener reader software. There are more than 1000 Braille display installations in Taiwan up for potential replacement in the coming 3 years.

The Group has always been active in seeking investment opportunities whether or not within the principal line of the company business so as to increase the value of the Group. At the date of this report, the Group has announced a major transaction in acquiring a fertilizer production company in China. We are of the opinions that the organic fertilizer production industry is a fast growing industry in view of the ongoing development of the agricultural industry in China and the increasing emphasis of environmental protection by the China government. The Directors consider that the proposal acquisition represents a good opportunity for the Group diversifying the existing business into a new line of business with significant growth potential while at the same time providing a solution to the plaguing environmental problem of treating organic wastes in China.

Appreciation

On behalf of the board, I wish to thank for our shareholders and business partners for their continued support and our staff members for their dedication, devotion and hard work in the past year.

Ma She Shing, Albert
Chairman
27 March 2007

BUSINESS REVIEW

SOFTWARE SALES BUSINESS

Majority of sales and marketing efforts were spent in calling on potential HanPhone IVR users in the past year. We were delighted at the winning of a few pivotal IVR projects for the HanPhone web-to-speech technology. In addition to direct sales, we began to invest into Internet key word search marketing which has so far resulted in two IVR projects. Chinese JAWS (CJAWS) continued to bring steady income from the Hong Kong blind users whom succeeded in obtaining funding from the HK$7m Jockey Club funding scheme for the blind. Shipment of CJAWS to Taiwan reseller started in later part of 2006. The sales of HanWEB still lagged behind of our expectation with new sales coming primarily from the government sector. Despite of its lack-luster sales volume, HanWEB has built up a sizable installed base generating a stable stream of maintenance income to the company.

SERVICE BUSINESS

The secondary school PTH platform (www.teens.putonghuaonline.com) was officially released just before the summer of 2006. The teens' platform has brought about our full coverage of the Hong Kong market in terms of Putonghua e-learning serving kids in primary schools, teens in secondary schools, young adults in tertiary institutions and working adults. Since its launch, the teens' platform has attracted more than 10 secondary schools paying an annual subscription fee of HK$8,000 each. The user base of kids' platform increased to 50 more schools. We also succeeded in selling our School-IVR rental service to one secondary school that uses it to improve school/parent communication using telephone.

The adult PTH won more reputable customers including HKSAR Government's Civil Service Bureau, Housing Society, Esquel Group, Tung Wah Group of Hospitals, Moores Rowland Mazars accounting firm and Chinese University. The Institute of Professional Education and Knowledge of Vocational Training Council continued to be a key partner in reselling the adult PTH to corporations.

We have begun to offer rental base IVR service to commercial sector and succeeded in conducting a 2-month service for a major fast food store in extending its web-based e-bidding promotional campaign to telephone users. The Office of Honorable Mandy Tam Heung-man, the legislative councilor subscribed to the IVR outbound service to help her collect public opinions through automatic telephone surveys.

The retail subscription of our EFAX has been growing steadily despite the number is still relatively small in Hong Kong while the China subscribers began to surface seeing the benefit of IDD saving to overseas countries. In order to make it more versatile, the SMS function was added to EFAX platform such that subscriber can use the platform to handle both fax and SMS communications. During recent holiday seasons, the SMS service jumped up in volume as companies used it to broadcast greeting and sales promotion messages. Packaging the EFAX and the outbound call IVR services, we promoted to corporations database e-marketing service using fax, SMS, outbound call and email. The gradual build-up of the value added messaging and marketing service business not only brought in steady income but also prospects for KanHan's other products and services.

MANAGEMENT DISCUSSION AND ANALYSIS

RESULTS OF OPERATION

For the year ended 31 December 2006, the Group recorded a turnover amounted to HK$6,622,000 compared with approximately HK$4,472,000 last year, representing a substantial increase of approximately 48.1%. The increase was mainly derived from the surge of revenue generated from the sales of licensed software, which customarily the Group's principal source of revenue, achieved 89.7% growth to approximately HK$4,979,000 (2005: HK$2,624,000).

The gross profit margin was approximately 47.3% in 2006 as compared to 57.8% in 2005. The reduction in profit margin was primarily due to the increase in direct costs for sales of JAWS.

During the year, other income mainly consisted of interest income from bank deposits of approximately HK$585,000 (2005: HK$27,000)

Selling and distribution expenses for the year ended 31 December 2006 increased by 12% to approximately HK$1,189,000 as compared to approximately HK$1,062,000 for the corresponding period last year. The increase was mainly attributable to the increase in commission expenses associated with the sales of licensed software.

Administrative expenses for the year ended 31 December 2006 amounted to HK$7,707,000 (2005: HK$5,389,000), representing an increase of 43%. The increase was mainly due to the recognition of equity-settled share base payment of approximately HK$2,314,000 (2005: HK$567,000) in respect of the share options granted during the year. Adjusted for this non-cash flow expense, the administrative expenses increased by 11.8% as a result of increase in professional expenses incurred for the business operations.

Consequently, the Group recorded a net loss attributable to shareholders of approximately HK$6,273,000 representing a 27.7% increase in loss as compared to HK$4,913,000 in last year. Such increase was due to the decrease in profit margin and increase in expenses as mentioned above.

TAXATION

No provision for taxation has been made in the financial statements for the year ended 31 December 2006 as the Group incurred a tax loss for that year.

Details of the deferred taxation asset not recognised are set out in note 22.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2006, the Group had current assets of approximately HK$27,407,000 (2005: HK$4,060,000). The current assets comprised of cash and bank balances of HK$22,707,000 (2005: HK$2,253,000) together with trade and other receivables of HK$4,638,000 (2005: HK$1,807,000). The Group's current liabilities comprised mainly of trade and other payables of approximately HK$3,989,000 (2005: HK$2,305,000). The Group had no bank borrowings at 31 December 2006 (2005: Nil) but an outstanding loan granted by government of approximately HK$1,295,000 at 31 December 2006 (2005: HK$1,338,000). As at 31 December 2006, the Group had a current ratio of approximately 6.49:1 as compared to that of 1.64:1 at 31 December 2005.

During the year ended 31 December 2006, the Group's operation was mainly financed by its internal financial resources and the net proceeds from the rights issue.

As at 31 December 2006, the Group had no charges on its assets.

SIGNIFICANT INVESTMENTS AND ACQUISITIONS

(a) On 15 May 2006, the Company entered into a non-legally binding memorandum of understanding ("MOU") with Excel State Group Limited ("Excel State") and Mr. Yang Shuxin in relation to the proposed acquisition of the whole or part of equity interests held by Mr. Yang Shuxin in Excel State, which holds 51% indirect interests in Shantou Jinshui Technology Limited ("Jinshui").

Jinshui is a company established in the People's Republic of China ("PRC") and is principally engaged in the design, provision and distribution of software and hardware for tax control purpose and the provision of other related services in the PRC.

A refundable amount of HK$2,500,000 was paid by the Company to Mr. Yang Shuxin as earnest money. As additional time is required for the negotiation process on the terms of the proposed acquisition, the long-stop date of the MOU has been extended from 31 August 2006 to 31 March 2007. If no legally-binding formal agreement has been entered into on or before 31 March 2007, the sum will be refunded to the Company in full.

Details of the proposed acquisition and its extension of long-stop date were set out in the announcements of the Company dated 15 May 2006 and 1 December 2006 respectively.

(b) On 2 February 2007, Rise Assets Limited ("Rise Assets", a wholly-owned subsidiary of the Company) entered into a conditional legally binding memorandum of understanding ("MOU") with Mr. Yang Pei Gen ("Mr. Yang"), in which Rise Assets has agreed to acquire and Mr. Yang has agreed to sell: (i) the Sale Share, representing the entire issued share capital of Silky Sky Investments Limited ("Silky Sky"); and (ii) the Sale Loan, representing all obligation, indebtedness and liabilities due by Silky Sky to Mr. Yang, for a total consideration of HK$61,000,000. On 21 March 2007, a formal agreement ("Formal Agreement") was entered into between Rise Assets and Mr. Yang. Details of the MOU and the Formal Agreement were disclosed in the announcements of the Company dated 9 February 2007 and 21 March 2007 respectively.

Sky Rich Investments Limited, a wholly-owned subsidiary of Silky Sky, will be owned as to 51% of interests in Beijing Shiji Jiangshan Resource Recycling Technology Limited ("Shiji Jiangshan"). Shiji Jiangshan, an equity joint venture company established in the PRC, is principally engaged in the production and distribution of organic fertilizer through a technology which converts organic wastes into organic fertilizer.

Deposits HK$20,000,000 were paid by the Company to Mr. Yang as of the date of these financial statements.

DISTRIBUTABLE RESERVES

As at 31 December 2006, the accumulated losses of the Company exceeded the aggregate of share premium and contributed surplus, thus the Company did not have any reserves available for distribution (2005: Nil).

FOREIGN EXCHANGE RISK

As at 31 December 2006, the Group had no significant exposure to fluctuation in foreign exchange rate.

CAPITAL STRUCTURE

As at 31 December 2005, the total issued share capital of the Company was HK$7,004,584 divided into 700,458,400 ordinary shares of HK$0.01 each. On 2 February 2006, 37,000,000 share options were exercised and 37,000,000 shares were issued and allotted.

On 28 February 2006, every five shares of HK$0.01 each in the issued and un-issued share capital of the Company were consolidated into one consolidated share of HK$0.05 each. The total issued share capital was consolidated into 147,491,680 shares.

On 30 March 2006, the Company completed to issue 442,475,040 new ordinary shares by way of rights issue on the basis of three rights shares for every one consolidated share of HK$0.05 each at a subscription price of HK$0.057.

As at 31 December 2006, the total issued share capital of the Company was HK$29,498,336 divided into 589,966,720 ordinary shares of HK$0.05 each.

WARRANT PLACING

On 28 August 2006, a conditional warrant placing agreement was entered into among the Company, Glory Force Limited (the "Subscriber") and Mr. Yip Yung Kan (the "Guarantor") in relation to a private placing of 117,800,000 warrants to the Subscriber, at an issue price of HK$0.015 per warrant. The warrant placing was completed on 14 September 2006 and 117,800,000 warrants had been issued to the Subscriber. The net proceeds from the warrant placing of approximately HK$1,469,000 will be applied as general working capital of the Group. The warrants entitle the Subscriber to subscribe for new shares at an initial subscription price of HK$0.155 per new share for a period of 18 months commencing from the date of issue of the warrants.

Upon the full exercise of the subscription rights attaching to the warrants, the Company will receive gross proceeds of approximately HK$18,259,000. It is of the view that the proceeds from the warrant placing will strengthen the capital position and enhance the flexibility of the Group to identify and participate in investments which are beneficial to the Group and the Shareholders as a whole.

Details of the warrant placing were set out in the announcements of the Company dated 30 August 2006 and 14 September 2006.

CONTINGENT LIABILITIES

As at 31 December 2006, the Group had no material contingent liabilities.

EMPLOYEE INFORMATION

As at 31 December 2006, the Group had 27 (2005: 24) full-time employees. Employee costs for the year 2006, excluding Directors' emoluments, amounted to HK$4,818,000 (2005: HK$3,687,000). All of the Group companies are equal opportunity employers, with the selection and promotion of individuals being based on suitability for the position offered. The salary and benefit levels of the Group's employees are kept at a competitive level and employees are rewarded on a performance related basis with the general framework of the Group's salary and bonus system which is reviewed annually. Selected benefit programs including medical coverage and provident funds were also provided. In addition, training and development courses were offered throughout the Group to upgrade employee skills and knowledge.

The Group also adopted employee share option scheme to provide eligible employees a performance incentive for continuous and improved service with the Group and to enhance their contributions to increase profits by encouraging capital accumulation and share ownership.

CORPORATE GOVERNANCE REPORT

CORPORATE GOVERNANCE PRACTICES

The Company has complied with the code provisions on Corporate Governance Practices as set out in the GEM Listing Rules by establishing formal and transparent procedures to protect and maximize the interests of shareholders during the period under review.

DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted a code of conduct regarding directors' securities transactions on terms no less exacting than the required standard of dealings as set out in Rules 5.48 to 5.67 of the GEM Listing Rules. Having made specific enquiry of all directors, the directors have complied with such code of conduct and the required standard of dealings regarding securities transactions throughout the year ended 31 December 2006.

BOARD OF DIRECTORS AND BOARD MEETING

The Board members for the year ended 31 December 2006 were:

Executive directors:

Mr. Ma She Shing, Albert *(Chairman)*
Mr. Mo Wai Ming, Lawrence

Independent non-executive directors:

Mr. Hsu Shiu Foo, William
Mr. Lee Kun Hung
Mr. Kwok Chi Sun, Vincent

The board of directors (the "Board") is responsible for the Group's corporate policy formulation, business strategies planning, business development, risk management, major acquisitions, disposals and capital transactions, and other significant operational and financial matters. Major corporate matters that are specifically delegated by the board of directors to the management include the preparation of annual and interim accounts for board approval before public reporting, execution of business strategies and initiatives formulated by the board of directors, implementation of adequate systems of internal controls and risk management procedures, and compliance with relevant statutory requirements and rules and regulations.

The directors' biographical information are set out on page 17 of this Annual Report. All executive directors have given sufficient time and attention to the affairs of the Group. Each executive director has sufficient experience to hold the position so as to carry out his duties effectively and efficiently. There is no relationship among the members of the board of directors.

The Company appointed three independent non-executive directors who have appropriate and sufficient experience and qualification to carry out their duties so as to protect the interests of shareholders. All of them have been appointed for a term of one year commencing from the date of appointment and will continue thereafter until terminated by either party giving each other not less than one month's notice. Every director should be subject to retirement by rotation at least once every three years.

Pursuant to the requirements of the GEM Listing Rules, the Company has received written confirmation from each independent non-executive director of his independence to the Company. Based on such confirmations of independence, the Company considers all of the independent non-executive directors to be independent.

The roles of the chairman and chief executive officer are segregated and are not exercised by the same individual, the chairman is responsible for leading the Board in formulating overall strategies of the Company, while the chief executive officer is to manage the operation of the Group's business.

The Board held a full board meeting for each quarter.

Details of the attendance of the meetings of the Board are as follows:

Directors	**Attendance**
Mr. Ma She Shing, Albert	4/4
Mr. Mo Wai Ming, Lawrence	4/4
Mr. Hsu Shiu Foo, William	3/4
Mr. Kwok Chi Sun, Vincent	4/4
Mr. Lee Kun Hung	4/4

Apart from the above regular board meetings of the year, the Board will meet on other occasions when a board-level decision on a particular matter is required.

REMUNERATION OF DIRECTORS

The remuneration committee was established in June 2005 with written terms of reference in compliance with the code provision. The remuneration committee consists of three members, of which two are independent non-executive directors, namely Mr. Kwok Chi Sun, Vincent and Mr. Lee Kun Hung, and one is executive director being Mr. Mo Wai Ming, Lawrence. The chairman of the committee is Mr. Kwok Chi Sun, Vincent.

The role and function of the remuneration committee include the determination of the specific remuneration packages of all executive directors, including benefits in kind, pension rights and compensation payments, including any compensation payable for loss or termination of their office or appointment, and make recommendations to the Board of the remuneration of non-executive directors.

During the period under review, a meeting of the remuneration committee was held in November 2006. Details of the attendance of the meeting of the remuneration committee are as follows:

Members	Attendance
Mr. Kwok Chi Sun, Vincent	1/1
Mr. Mo Wai Ming, Lawrence	1/1
Mr. Lee Kun Hung	1/1

NOMINATION OF DIRECTORS

The Board does not establish a nomination committee in consideration of the size of the Group. The Board is empowered under the Company's articles of association to appoint any person as a director either to fill a casual vacancy on or as an additional member of the Board. Suitable candidates will be proposed to the Board for consideration, and the Board will review the qualifications of the relevant candidate for determining the suitability to the Group on the basis of his qualifications, experience and background.

AUDITORS' REMUNERATION

The Company has appointed Moores Rowland Mazars as the auditors of the Group (the "Auditors"). The Board is authorized in the annual general meeting to determine the remuneration of the auditors. During the year, the Auditors performed the work of statutory audit for the year 2006 and involved non-audit assignment of the Group. The Auditors received approximately HK$260,000 and HK$82,000 for audit service and non-audit service respectively.

AUDIT COMMITTEE

The Company established an audit committee with written terms of reference in compliance with Rules 5.28 and 5.29 of the GEM Listing Rules. The primary duties of the audit committee are to review and supervise the financial reporting process and internal controls system of the Group and provide advice and comments on the Company's draft annual reports and accounts, interim reports and quarterly reports to directors. The audit committee comprises three members, Mr. Kwok Chi Sun, Vincent, Mr. Hsu Shiu Foo, William and Mr. Lee Kun Hung, all of them are independent non-executive directors. The chairman of the audit committee is Mr. Kwok Chi Sun Vincent.

The audit committee held four meetings during the year under review. Details of the attendance of the audit committee meetings are as follows:

Members	Attendance
Mr. Kwok Chi Sun, Vincent	4/4
Mr. Hsu Shiu Foo, William	3/4
Mr. Lee Kun Hung	4/4

The Group's unaudited quarterly and interim results and annual audited results for the year ended 31 December 2006 have been reviewed by the audit committee during the year, which was of the opinion that the preparation of such results complied with the applicable accounting standards and requirements and that adequate disclosures have been made.

INTERNAL CONTROL

The Board is responsible for maintaining the Group's internal control and for reviewing the effectiveness of these controls. Internal control systems are designed to meet the particular needs of the Group and the risk to which it is exposed.

In consideration of the size of the Group, the Board does not consider to establish an internal audit team at present. However, the key control procedure established by the Group is a day-to-day supervision of the business by the executive director, supported by the managers responsible for the operation and the key division support functions of finance, information system and human resources. Key elements of internal control described below have been in place throughout the year under review:

– procedures for the approval of capital expenditure and payments;

– regular financial information provided to management for reviewing the Group's performance;

– clearly defined management structure and lines of responsibility.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors are responsible for the preparation of the financial statements, which give a true and fair view. The auditors are responsible to form an independent opinion, based on the audit, on the financial statements prepared by the directors and report the opinion solely to the shareholders of the Company.

DIRECTORS' PROFILE

EXECUTIVE DIRECTORS

Mr. Mo Wai Ming, Lawrence, aged 47, is an executive director of the Company. Prior to founding of KanHan Technologies Inc. in 1999, Mr. Mo has over 10 years experience in the development and sales of solutions on local language computing for Asian languages and for electronic and Internet publishing. Being an expert in Chinese computing, he was appointed as a member of the HKSAR Government's Chinese Language Interface Advisory Committee in May 1999. Mr. Mo holds a degree in science from University of Toronto, Canada. As the chief executive, Mr. Mo has overall responsibility for the operations and performances of the Group. Mr. Mo also serves as a member of the remuneration committee of the Company.

Mr. Ma She Shing, Albert, aged 46, is an executive director of the Company. Mr. Ma has over 19 years of corporate banking and private banking experience in major US and European institutions. He was previously a vice president in a renowned US investment bank in Hong Kong. Mr. Ma holds a Bachelor of Arts degree in Economics from Pomona College, California, US.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. Hsu Shiu Foo, William, aged 56, is an independent non-executive director and audit committee member of the Company. Mr. Hsu has over 10 years of global business experience in tourism and service-oriented related fields in various international corporations. Mr. Hsu holds a Bachelor's degree in Arts from Brigham Young University, Hawaii and a Master's degree in Hotel Administration from Cornell University, New York.

Mr. Kwok Chi Sun, Vincent, aged 44, is an independent non-executive director and member of the audit committee and remuneration committee of the Company. Mr. Kwok is a sole proprietor of Vincent Kwok & Co. and is a Certified Public Accountant.

Mr. Lee Kun Hung, aged 41, is an independent non-executive director and member of the audit committee and remuneration committee of the Company. Mr. Lee has over 15 years of manufacturing experience in the watch industry. Mr. Lee holds a Bachelor of Arts degree from Boston College, Massachusetts, US.

DIRECTORS' REPORT

The directors present the annual report and the audited financial statements of the Group for the year ended 31 December 2006.

DATE OF INCORPORATION

The Company was incorporated and registered as an exempted company with limited liability in the Cayman Islands on 10 October 2002 under the Companies Law (Revised) of the Cayman Islands.

The shares of the Company were listed on the GEM of the Hong Kong Stock Exchange on 25 February 2003.

PRINCIPAL ACTIVITIES

The Company acts as an investment holding company.

Details of the principal activities of its subsidiaries are set out in note 13 to the financial statements.

RESULTS AND DIVIDENDS

The results of the Group for the year ended 31 December 2006 are set out in the consolidated income statement on page 26.

The directors do not recommend the payment of a dividend.

RESERVES

Details of movements in the reserves of the Group during the year ended 31 December 2006 are out in the consolidated statement of changes in equity on page 29.

PROPERTY, PLANT AND EQUIPMENT

Details of significant changes in the property, plant and equipment of the Group during the year are set out in note 12 to the financial statements.

SHARE CAPITAL

Details of movements in the share capital of the Company during the year are set out in note 17 to the financial statements.

DIRECTORS AND DIRECTORS' SERVICE CONTRACTS

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

Executive directors:

Mr. Mo Wai Ming, Lawrence
Mr. Ma She Shing, Albert

Independent non-executive directors:

Mr. Hsu Shiu Foo, William
Mr. Lee Kun Hung
Mr. Kwok Chi Sun, Vincent

In accordance with Articles 108 (a) and (b) of the Company's Articles of Association, Mr. Mo Wai Ming, Lawrence and Mr. Kwok Chi Sun, Vincent shall retire and, being eligible, offer himself for re-election at the forthcoming annual general meeting.

Each of the executive directors and independent non-executive directors of the Company has entered into a letter of appointment with the Company for a term of one year commencing from the date of appointment, which will continue thereafter until terminated by either party by giving to the other not less than one month's notice in writing.

The Board has obtained written confirmations from all independent non-executive directors of the Company concerning their independence in accordance with Rule 5.9 of the GEM Listing Rules. The Board of Directors believed that the existing independent non-executive directors are independent based on the guidelines set out in Rule 5.9 of the GEM Listing Rules.

Save as disclosed above, none of the directors being proposed for re-election at the forthcoming annual general meeting has a service contract with the Company or any of its subsidiaries which is not determinable by the Group within one year without payment of compensation, other than statutory compensation.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2006, the interests and short position of the directors and chief executive of the Company and their associates in the shares, underlying shares and debentures of the Company or any of its associated corporation (within the meaning of Part XV of the Securities and Future Ordinance ("SFO")) as recorded in the register maintained by the Company pursuant to Section 352 of the SFO, or otherwise notified to the Company and the Stock Exchange pursuant to the required standard of dealings by directors of the Company as referred to in Rules 5.46 of the GEM Listing Rules, were as follows:

(a) Directors' long positions in shares of the Company

Name	Capacity	Number of issued shares held	Percentage of the issued share capital
Mr. Mo Wai Ming, Lawrence *(Note 1)*	Beneficial owner	148,424,172	25.16%
Mr. Ma She Shing, Albert *(Note 2)*	Beneficial owner	10,000,000	1.70%

(b) Directors' short positions in shares of the Company

Name	Capacity	Number of issued shares held	Percentage of the issued share capital
Mr. Mo Wai Ming, Lawrence *(Note 3)*	Beneficial owner	129,766,892	22.00%

Notes:

1. Mr. Mo is interested in 144,024,172 shares and was granted options on 5 June 2006 to subscribe for 4,400,000 shares at a subscription price of HK$0.21 per share.

2. Mr. Ma is interested in 5,600,000 shares and was granted options on 5 June 2006 to subscribe for 4,400,000 shares at a subscription price of HK$0.21 per share.

3. Pursuant to a share charge agreement dated 13 April 2005, 129,766,892 of the 144,024,172 shares held by Mr. Mo Wai Ming, Lawrence, have been charged in favour of Manciple Enterprises Limited ("Manciple"), a company incorporated in the British Virgin Islands which is wholly and beneficially owned by Mr. Lau Kim Hung, Jack ("Mr. Lau") who is a third party independent of, and not connected with the Company and its connected persons. Under the SFO, each of Manciple and Mr. Lau is deemed to be interested in these 129,766,892 shares.

Save as disclosed above, as at 31 December 2006, none of the directors nor the chief executive of the Company had any interests or short positions in any shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be kept by the Company under Sections 352 of the SFO, or otherwise notified to the Company and the Stock Exchange pursuant to Rule 5.46 of the GEM Listing Rules.

SHARE OPTION SCHEME

The Company adopted a share option scheme (the "Scheme") on 24 January 2003 pursuant to a written resolution of the Company. Details of the movements in the number of share options during the year under the Scheme are as follows:

Categories of grantees	As at 1 January 2006	Options granted during the year	Options exercised during the year	Outstanding at 31 December 2006	Exercise price HK$	Grant date	Exercisable period
Directors							
Mo Wai Ming, Lawrence	7,000,000	–	(7,000,000)	–	0.029	8 July 2005	8 July 2005 – 7 July 2015
	–	4,400,000	–	4,400,000	0.210	5 June 2006	5 June 2006 – 4 June 2016
Ma She Shing, Albert	7,000,000	–	(7,000,000)	–	0.029	8 July 2005	8 July 2005 – 7 July 2015
	–	4,400,000	–	4,400,000	0.210	5 June 2006	5 June 2006 – 4 June 2016
Employees	23,000,000	–	(23,000,000)	–	0.029	8 July 2005	8 July 2005 – 7 July 2015
	–	10,600,000	–	10,600,000	0.210	5 June 2006	5 June 2006 – 4 June 2016
	37,000,000	19,400,000	(37,000,000)	19,400,000			

Particulars of the Company's share option scheme are set out in note 20 to the financial statements.

DIRECTORS' INTERESTS IN CONTRACTS

No director of the Company had a significant beneficial interest, either directly or indirectly, in any contract of significance to the business of the Group to which the Company, its holding company or any of its subsidiaries was a party during the year.

SUBSTANTIAL SHAREHOLDERS

As at 31 December 2006, other than the interests of a director or chief executive of the Company as disclosed under the heading "Directors' and chief executive's interests in shares, underlying shares and debentures" above, the interests and short positions of persons in the shares and underlying shares of the Company as recorded in the register required to be kept by the Company under Section 336 of the SFO were as follows:

Name	Capacity	Number of issued shares held	Percentage of the issued share capital
Mr. Lau Kim Hung, Jack	Interest of a controlled corporation *(Note 1)*	129,766,892	22.00%
Manciple Enterprises Limited	Person having a security interest in shares *(Note 1)*	129,766,892	22.00%
Mr. Yip Yung Kan ("Mr. Yip")	Beneficial owner *(Note 2)*	2,760,000	0.47%
	Interest of a controlled corporation *(Note 3)*	117,800,000	16.64%

Notes:

1. Pursuant to a share charge agreement dated 13 April 2005, 129,766,892 of the 144,024,172 shares held by Mr. Mo Wai Ming, Lawrence, have been charged in favour of Manciple Enterprises Limited ("Manciple"), a company incorporated in the British Virgin Islands which is wholly and beneficially owned by Mr. Lau Kim Hung, Jack ("Mr. Lau") who is a third party independent of, and not connected with the Company and its connected persons. Under the SFO, each of Manciple and Mr. Lau is deemed to be interested in these 129,766,892 shares.

2. Mr. Yip held 2,660,000 shares and his spouse, Ms. Lei I Si held 100,000 shares.

3. Mr. Yip beneficially owns 100% issued share capital of Glory Force Limited which was granted 117,800,000 warrants on 14 September 2006 to subscribe for 117,800,000 new shares at a subscription price of HK$0.155 per share. Upon full exercise of the subscriptions rights attaching to the warrants, a total of 117,800,000 new shares, representing 16.64% of the issued share capital of the Company as enlarged by the issue of new shares.

COMPETING INTERESTS

The directors believe that none of the directors or the management shareholders (as defined in the GEM Listing Rules) of the Company had an interest in a business which competes or may compete with the business of the Group.

DIRECTORS' RIGHTS TO ACQUIRE SHARES

Save as disclosed under the heading "Share Option Scheme" above, at no time during the year was the Company or any of its subsidiaries a party to any arrangements to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate, and neither the directors nor the chief executive, nor any of their spouses or children under the age of 18, had any right to subscribe for the securities of the Company, or had exercised any such right.

MAJOR CUSTOMERS AND SUPPLIERS

With reference to the Group's financial statements, in respect of the year ended 31 December 2006:

(i) The Group's largest supplier and the five largest suppliers accounted for 32.5% and 74.0% respectively, of the Group's total cost of sales.

(ii) The Group's largest customer and the five largest customers accounted for 21.3% and 55.2% respectively, of the Group's total turnover.

In the opinion of the directors, none of the directors, their associates or any shareholders who owned more than 5% of the Company's share capital had any interest in the Group's five largest suppliers or customers.

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

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

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 existing shareholders.

AUDITORS

A resolution will be submitted to the annual general meeting to re-appoint Messrs. Moores Rowland Mazars, Chartered Accountants, Certified Public Accountants, as auditors of the Company.

On behalf of the Board

Ma She Shing, Albert
CHAIRMAN

27 March 2007

INDEPENDENT AUDITORS' REPORT

Moores Rowland Mazars
摩斯倫・馬賽會計師事務所

Chartered Accountants
Certified Public Accountants
34th Floor, The Lee Gardens,
33 Hysan Avenue,
Causeway Bay, Hong Kong

To the members of
KanHan Technologies Group Limited
看漢科技集團有限公司
(incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of KanHan Technologies Group Limited (the "Company") set out on pages 26 to 56, which comprise the consolidated and Company balance sheet 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 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.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit and to report our opinion 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 this 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.

INDEPENDENT AUDITORS' REPORT

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our 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, we consider internal control relevant to the Group'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 Group's internal control. An audit also includes evaluating the appropriateness of accounting polices 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.

Opinion

In our opinion the consolidated financial statements give a true and fair view of the state of the affairs of the Company and the Group as at 31 December 2006 and of the Group's loss 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 Hong Kong Companies Ordinance.

Moores Rowland Mazars
Chartered Accountants
Certified Public Accountants
Hong Kong, 27 March 2007

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2006

	NOTE	2006 HK$'000	2005 HK$'000
Turnover	3	**6,622**	4,472
Cost of sales		**(3,489)**	(1,888)
Gross profit		**3,133**	2,584
Other income	5	**656**	204
Research and development expenses		**(1,166)**	(1,250)
Selling and distribution expenses		**(1,189)**	(1,062)
Administrative expenses		**(7,707)**	(5,389)
Loss before taxation	6	**(6,273)**	(4,913)
Taxation	8	**–**	–
Loss for the year		**(6,273)**	(4,913)
Attributable to:			
Equity holders of the Company	10	**(6,273)**	(4,913)
			(Restated)
Loss per share – Basic	11	**(1.11 cents)**	(1.13 cents)

CONSOLIDATED BALANCE SHEET

At 31 December 2006

	NOTE	2006 HK$'000	2005 HK$'000
NON-CURRENT ASSETS			
Property, plant and equipment	12	**158**	334
CURRENT ASSETS			
Inventories, at cost		**62**	–
Trade and other receivables	14	**4,638**	1,807
Bank balances and cash		**22,707**	2,253
		27,407	4,060
CURRENT LIABILITIES			
Trade and other payables	15	**3,989**	2,305
Financial assistance from government	16	**236**	166
		4,225	2,471
NET CURRENT ASSETS		**23,182**	1,589
TOTAL ASSETS LESS CURRENT LIABILITIES		**23,340**	1,923
NON-CURRENT LIABILITIES			
Financial assistance from government	16	**1,059**	1,172
NET ASSETS		**22,281**	751
CAPITAL AND RESERVES			
Share capital	17	**29,498**	7,004
Reserves	18	**(7,217)**	(6,253)
TOTAL EQUITY		**22,281**	751

The financial statements on pages 26 to 56 were approved and authorised for issue by the Board of Directors on 27 March 2007 and are signed on its behalf by:

Mo Wai Ming, Lawrence
DIRECTOR

Ma She Shing, Albert
DIRECTOR

BALANCE SHEET

At 31 December 2006

	NOTE	2006 HK$'000	2005 HK$'000
NON-CURRENT ASSETS			
Interests in subsidiaries	13	**132**	2,041
CURRENT ASSETS			
Other receivables		**2,804**	181
Bank balances		**22,150**	30
		24,954	211
CURRENT LIABILITIES			
Other payables		**532**	369
NET CURRENT ASSETS (LIABILITIES)		**24,422**	(158)
NET ASSETS		**24,554**	1,883
CAPITAL AND RESERVES			
Share capital	17	**29,498**	7,004
Reserves	18	**(4,944)**	(5,121)
TOTAL EQUITY		**24,554**	1,883

The financial statements on pages 26 to 56 were approved and authorised for issue by the Board of Directors on 27 March 2007 and are signed on its behalf by:

Mo Wai Ming, Lawrence
DIRECTOR

Ma She Shing, Albert
DIRECTOR

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2006

	Share capital HK$'000	Share premium HK$'000	Special reserve HK$'000 *(note a)*	Warrant subscription reserve HK$'000	Exchange reserve HK$'000	Employee share-based compensation reserve HK$'000	Accumulated losses HK$'000	Total HK$'000
At 1 January 2005	5,837	19,323	10,084	–	–	–	(32,695)	2,549
Issue of shares under the placing	1,167	1,518	–	–	–	–	–	2,685
Share issue expenses	–	(137)	–	–	–	–	–	(137)
Employee share-based compensation	–	–	–	–	–	567	–	567
Loss for the year	–	–	–	–	–	–	(4,913)	(4,913)
At 31 December 2005	7,004	20,704	10,084	–	–	567	(37,608)	751
Issue of rights shares	22,124	3,097	–	–	–	–	–	25,221
Issue of warrants under the placing	–	–	–	1,767	–	–	–	1,767
Share/warrants issue expenses	–	(2,250)	–	(298)	–	–	–	(2,548)
Shares issued upon exercise of share options	370	1,270	–	–	–	(567)	–	1,073
Employee share-based compensation	–	–	–	–	–	2,314	–	2,314
Exchange differences arising from consolidation	–	–	–	–	(24)	–	–	(24)
Loss for the year	–	–	–	–	–	–	(6,273)	(6,273)
At 31 December 2006	29,498	22,821	10,084	1,469	(24)	2,314	(43,881)	22,281

Note:

(a) The special reserve represents the difference between the nominal amount of shares and share premium of KanHan Technologies Inc. ("KanHan (BVI)") at the date on which it was acquired by the Company and the nominal amount of the Company's shares issued as consideration pursuant to the Group reorganisation taken place in 2003.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2006

	NOTE	2006 HK$'000	2005 HK$'000
NET CASH USED IN OPERATING ACTIVITIES	19	**(5,553)**	(4,384)
INVESTING ACTIVITIES			
Purchase of property, plant and equipment		**(49)**	(73)
Interest received		**585**	27
NET CASH USED IN INVESTING ACTIVITIES		**536**	(46)
FINANCING ACTIVITIES			
Proceeds from issue of shares		**–**	2,685
Proceeds from issue of rights shares		**25,221**	–
Proceeds from exercise of share options		**1,073**	–
Proceeds from issue of warrants		**1,767**	–
Share/warrants issue expenses		**(2,548)**	(137)
Repayment of financial assistance from government		**(43)**	(81)
NET CASH FROM FINANCING ACTIVITIES		**25,470**	2,467
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**20,453**	(1,963)
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR		**2,253**	4,216
CHANGES IN FOREIGN EXCHANGE RATE		**1**	–
CASH AND CASH EQUIVALENTS AT END OF THE YEAR, REPRESENTED BY BANK BALANCES AND CASH		**22,707**	2,253

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2006

1. CORPORATE INFORMATION

The Company was incorporated in the Cayman Islands on 10 October 2002 as an exempted company with limited liability under the Companies Law (Revised) of the Cayman Islands.

The shares of the Company were listed on the Growth Enterprise Market ("GEM") of The Stock Exchange of Hong Kong Limited on 25 February 2003.

The principal activity of the Company is investment holding. Details of the principal activities of its subsidiaries are set out in note 13.

2. PRINCIPAL ACCOUNTING POLICIES

A summary of the principal accounting policies adopted by the Group is set out below.

(a) Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS"), which collective term includes all applicable individual HKFRS, Hong Kong Accounting Standards ("HKAS") 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 have been prepared on a basis consistent with the accounting policies adopted in the 2005 financial statements. A summary of the principal accounting policies adopted by the Group is set out below.

The measurement basis used in the preparation of these financial statements is historical cost.

(b) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31 December each year.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

All inter-company transactions and balances within the Group have been eliminated on consolidation.

2. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

(c) Subsidiaries

A subsidiary is an entity, in which the Company, directly or indirectly, has the power to govern the financial and operating policies so as to obtain benefits from its activities.

In the Company's balance sheet, investments in subsidiaries are stated at cost less accumulated impairment losses. The carrying amount of the investment is reduced to its recoverable amount on an individual basis. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable.

(d) Property, plant and equipment

Property, plant and equipment are recorded at cost less accumulated depreciation and accumulated impairment losses.

The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Repairs and maintenance are charged to the income statement during the year in which they are incurred.

Depreciation is provided to write off the cost less accumulated impairment losses of property, plant and equipment over their estimated useful lives as set out below from the date on which they are available for use and after taking into account of their estimated residual values, using the straight-line method, at the following rates per annum:

Leasehold improvements	$33^1/_3$%
Furniture, fixtures and office equipment	20%
Computer equipment	$33^1/_3$%

(e) Trade receivables and payables

Trade receivables and payables are recognised at cost which approximates to their fair values, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all the amounts due according to the original terms of receivables. The amount of the provision is the difference between the assets' carrying amount and the present value of estimated future cash flow, discounted at the effective interest rate. The amount of provision is recognised in the income statement.

2. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

(f) Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue and costs, if applicable, can be measured reliably and on the following bases.

Sales of licensed software is recognised on the transfer of risks and rewards of ownership, which generally coincides with the time when the goods are delivered to customers and titles have been passed.

Software maintenance service income, which is received or receivable from customers when the maintenance service contracts are entered into, is amortised and credited to the income statement on a straight-line basis over the respective term of the maintenance service contract.

Software rental and subscription income from software application, website development and Putonghua learning platform are derived from providing software application to customers. The income is recognised when services are provided.

(g) Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency"). The consolidated financial statements are presented in Hong Kong dollars, which is the Group's functional and presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

2. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

(g) Foreign currency translation *(Continued)*

(iii) Overseas subsidiaries

On consolidation, the results and financial position of all overseas subsidiaries that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(a) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(b) income and expenses for each income statement are translated at average exchange rates; and

(c) all resulting exchange differences are recognised as a separate component of equity.

(h) Inventories

Inventories, which represent the licensed softwares for sale, are stated at lower of cost and net realisable value. Cost, which comprises all costs of purchase and, where applicable, other costs that have been incurred in bringing the inventories to their present location and condition, is calculated using the first in, first out method. Net realisable value represents the estimated selling price in the ordinary course of business less the estimated costs necessary to make the sale.

(i) Impairment of non-financial assets

At each balance sheet date, the Group reviews internal and external sources of information to determine whether its property, plant and equipment have suffered an impairment loss or impairment loss previously recognised no longer exists or may be reduced. If any such indication exists, the recoverable amount of the asset is estimated, based on the higher of its fair value less costs to sell and value in use. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the smallest group of assets that generates cash flows independently (i.e. cash-generating unit).

If the recoverable amount of an asset or a cash-generating unit is estimated to be less than its carrying amount, the carrying amount of the asset or cash-generating unit is reduced to its recoverable amount. Impairment losses are recognised as an expense immediately.

A reversal of impairment loss is limited to the carrying amount of the asset or cash-generating unit that would have been determined had no impairment loss been recognised in prior years. Reversal of impairment loss is recognised as income immediately.

2. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

(j) Leases

Leases which do not transfer substantially all the risks and rewards of ownership to the Group are classified as operating leases. Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease.

(k) Employee benefits

(i) Defined contribution plan

The obligations for contributions to defined contribution retirement scheme are recognised as an expense in the income statement as incurred. The assets of the scheme are held separately from those of the Group in an independently administered fund.

(ii) Share-based compensation transactions

The Group operates an employee share option plan for the purpose of providing incentives and/or rewards, to eligible employees of the Group.

Employees of the Group (including Directors) receives remuneration in the form of share-based payment transactions, whereby the employees render services in exchange for shares or rights over shares. The cost of such transactions with employees is measured by reference to the fair value at the transaction date. The fair value of share options granted to employees is recognised as an employee cost with a corresponding increase in a reserve within equity. The fair value is determined using Black-Scholes option pricing model, taking into account the terms and conditions of the transactions, other than conditions linked to the price of the shares of the Company ("market conditions").

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the year in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("vesting date"). During the vesting period, the number of share options that is expected to vest ultimately is reviewed. Any adjustment to the cumulative fair value recognised in prior years is charged/credited to the income statement for the year of the review, with a corresponding adjustment to the reserve within equity. When the option is exercised, the amount will be transferred to the share premium account.

2. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

(l) Taxation

The charge for current income tax is based on the results for the year as adjusted for items that are non-assessable or disallowed. It is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, if the deferred tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither the accounting profit nor taxable profit or loss, it is not accounted for.

The deferred tax liabilities and assets are measured at the tax rates that are expected to apply to the period when the asset is recovered or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the balance sheet date. Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the deductible temporary differences, tax losses and credits can be utilised.

(m) Related parties

A party is related to the Group if (a) directly, or indirectly through one or more intermediaries, the party controls, is controlled by or is under common control with the Group; or has an interest in the Group that gives it significant influence over the Group; or has joint control over the Group; (b) the party is an associate of the Group; (c) the party is a joint venture in which the Group is a venturer; (d) the party is a member of the key management personnel of the Group or its parent; (e) the party is a close member of the family of any individual referred to in (a) or (d); (f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or (g) the party is a post-employment benefit plan for the benefit of employees of the Group, or of any entity that is a related party of the Group.

2. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

(n) Critical accounting estimates and judgements

Estimates and judgements are currently evaluated and are based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances.

Allowance for bad and doubtful debts

The provisioning policy for bad and doubtful debts of the Group is based on the evaluation of collectability and ageing analysis of the trade receivables and on management judgements. A considerable amount of judgement is required in assessing the ultimate realisation of these receivables, including assessing the current creditworthiness and the past collection history of each customer. If the financial conditions of these customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowance will be required.

(o) Future changes in HKFRS

At the date of authorisation of these financial statements, the Group has not early adopted the new/revised standards and interpretations issued by HKICPA that are not effective for the current year. The directors anticipate that the adoption of these new HKFRS in the future periods will have no material impact on the results of the Group.

3. TURNOVER AND REVENUE

The Group is principally engaged in provision of server-based language technology. Turnover and revenue recognised during the year are as follows:

	2006	2005
	HK$'000	HK$'000
		(Restated)
Sales of licensed software	**4,979**	2,624
Software maintenance service	**741**	780
Software rental and subscription income	**306**	294
Website development	**308**	384
Putonghua learning platform	**288**	390
	6,622	4,472

4. SEGMENT INFORMATION

For the years ended 31 December 2005 and 2006, more than 90% of the Group's turnover and operating assets were attributable to the development of server-based language technologies in the Special Administrative Region of Hong Kong. Accordingly, no analysis by either business or geographical segment is included in these financial statements.

5. OTHER INCOME

	2006	2005
	HK$'000	HK$'000
Bank interest income	**585**	27
Commission income	**41**	177
Gain on exchange	**30**	–
	656	204

6. LOSS BEFORE TAXATION

	2006	2005
	HK$'000	HK$'000
This is stated after charging:		
Employee salaries and other benefits	**3,402**	3,194
Employee retirement benefit scheme contributions	**152**	140
Employee share-based payment	**1,264**	353
Total staff costs (excluding directors' emoluments)	**4,818**	3,687
Auditors' remuneration		
– Underprovision in prior year	**20**	–
– Current year	**260**	220
Cost of services and inventories	**3,489**	1,888
Depreciation	**173**	206
Operating lease payments		
– director's quarter	**–**	240
– office premises	**395**	355

7. EMOLUMENTS OF THE DIRECTORS AND THE HIGHEST PAID INDIVIDUALS

(a) DIRECTORS' EMOLUMENTS

	Directors' fees HK$'000	Salaries and other allowances HK$'000	Retirement benefit HK$'000	Employee share-based compensation HK$'000	2006 Total HK$'000
Executive directors					
Mo Wai Ming, Lawrence	**120**	**1,200**	**12**	**525**	**1,857**
Ma She Shing, Albert	**120**	**–**	**6**	**525**	**651**
Independent non-executive directors					
Hsu Shiu Foo, William	**60**	**–**	**–**	**–**	**60**
Lee Kun Hung	**60**	**–**	**–**	**–**	**60**
Kwok Chi Sun, Vincent	**60**	**–**	**–**	**–**	**60**
	420	**1,200**	**18**	**1,050**	**2,688**

	Directors' fees HK$'000	Salaries and other allowances HK$'000	Retirement benefit HK$'000	Employee share-based compensation HK$'000	2005 Total HK$'000
Executive directors					
Mo Wai Ming, Lawrence	60	1,300	12	107	1,479
Ma She Shing, Albert (appointed on 1 June 2005)	70	–	4	107	181
Wai Lai Yung (resigned on 1 June 2005)	21	–	–	–	21
Lee Chi Ming (resigned on 1 January 2005)	–	–	–	–	–
Non-executive directors					
Yuen Ka Lok, Ernest (resigned on 1 May 2005)	17	–	–	–	17
Independent non-executive directors					
Hsu Shiu Foo, William (appointed on 10 June 2005)	34	–	–	–	34
Lee Kun Hung (appointed on 1 June 2005)	34	–	–	–	34
Kwok Chi Sun, Vincent	55	–	–	–	55
Li Mo Ching, Joyce (resigned on 10 June 2005)	22	–	–	–	22
Tam Cheuk Ling, Jacqueline (resigned on 1 June 2005)	21	–	–	–	21
	334	1,300	16	214	1,864

7. EMOLUMENTS OF THE DIRECTORS AND THE HIGHEST PAID INDIVIDUALS *(Continued)*

(b) FIVE HIGHEST PAID INDIVIDUALS' EMOLUMENTS

The five highest paid individuals included one (2005: one) director of the Company, details of whose emoluments are set out above. The emoluments of the remaining four (2005: four) individuals, which fall within the band of nil to HK$1,000,000 for each of the two years ended 31 December 2006 and 2005, are as follows:

	2006	2005
	HK$'000	HK$'000
Salaries and other benefits	**1,268**	1,320
Retirement benefit scheme contributions	**47**	41
	1,315	1,361

During the year, no emoluments were paid by the Group to any of the directors or the five highest paid individuals (including directors and employees) as an inducement to join or upon joining the Group or as compensation for loss of office. In addition, none of the directors has waived any emoluments during each of the years ended 31 December 2006 and 2005.

8. TAXATION

No provision for Hong Kong Profits Tax has been made in the financial statements as the Company and its subsidiaries incurred tax loss during both years.

The tax charge for the year can be reconciled to the loss before taxation as follows:

	2006		2005	
	HK$'000	**%**	HK$'000	%
Loss before taxation	**(6,273)**		(4,913)	
Income tax at applicable tax rate of 17.5% (2005: 17.5%)	**(1,098)**	**(17.5)**	(860)	(17.5)
Non-deductible expenses	**705**	**11.3**	362	7.3
Tax exempt revenue	**(23)**	**(0.4)**	(32)	(0.7)
Unrecognised temporary difference	**21**	**0.3**	–	–
Unrecognised tax losses	**395**	**6.3**	530	10.9
Taxation for the year	**–**	**–**	–	–

9. DIVIDEND

No dividend has been paid or declared by the Company during the years ended 31 December 2006 and 2005.

10. LOSS ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The net loss attributable to equity holders of the Company included a loss of HK$5,156,000 (2005: HK$9,063,000) which has been dealt with in the financial statements of the Company.

11. LOSS PER SHARE

The computation of the basic loss per share is based on the net loss attributable to shareholders for the year of HK$6,273,000 (2005: HK$4,913,000) and the weighted average number of 565,096,432 (2005: Restated 432,915,369) shares in issue during the year.

The weighted average number of shares for the purpose of calculating the basic loss per share for the year 2006 and 2005 have been adjusted for the effect of the share consolidation and the rights issue as described in note 17 to these financial statements.

No diluted loss per share was presented as the share options and the conversion of the outstanding warrants of the Company are anti-dilutive.

12. PROPERTY, PLANT AND EQUIPMENT

	Leasehold improvements HK$'000	Furniture, fixtures and office equipment HK$'000	Computer equipment HK$'000	Total HK$'000
THE GROUP				
COST				
At 1 January 2006	165	354	846	1,365
Additions	11	13	25	49
Disposal	–	(53)	–	(53)
Exchange difference	–	1	–	1
At 31 December 2006	176	315	871	1,362
ACCUMULATED DEPRECIATION				
At 1 January 2006	67	241	723	1,031
Charge for the year	57	23	93	173
At 31 December 2006	124	264	816	1,204
NET BOOK VALUES				
At 31 December 2006	52	51	55	158
THE GROUP				
COST				
At 1 January 2005	157	339	796	1,292
Additions	8	15	50	73
At 31 December 2005	165	354	846	1,365
ACCUMULATED DEPRECIATION				
At 1 January 2005	13	201	611	825
Charge for the year	54	40	112	206
At 31 December 2005	67	241	723	1,031
NET BOOK VALUES				
At 31 December 2005	98	113	123	334

13. INTERESTS IN SUBSIDIARIES

	THE COMPANY	
	2006	2005
	HK$'000	HK$'000
Unlisted shares, at cost	**3,162**	3,162
Impairment loss	**(3,162)**	(3,162)
	–	–
Due from subsidiaries	**22,012**	22,236
Provision for doubtful debts	**(21,880)**	(20,195)
	132	2,041
	132	2,041

Details of the subsidiaries at 31 December 2006 are as follows:

Name of subsidiary	Place of incorporation	Issued and fully paid up ordinary share capital	Proportion of ownership interest and voting power held Directly %	Proportion of ownership interest and voting power held Indirectly %	Principal activity	Place of operation
KanHan Technologies Inc.	British Virgin Islands	US$116,225	100	–	Investment holding	Hong Kong
KanHan Technologies Limited	Hong Kong	HK$200,000	–	100	Provision of communication software platforms	Hong Kong
China Rise Investment Limited	Hong Kong	HK$1	–	100	Investment holding	Hong Kong
KanHan Technologies (China) Limited	The People's Republic of China	HK$1,000,000	–	100	Provision of communication software platforms	The People's Republic of China
Rise Assets Limited	British Virgin Islands	US$1	100	–	Investment holding	Hong Kong
Pharmanet Asia Limited	Hong Kong	HK$1	–	100	Sourcing agent	Hong Kong

13. INTERESTS IN SUBSIDIARIES *(Continued)*

The amounts due from subsidiaries are unsecured, interest-free and have no fixed term of repayment. In the opinion of the directors, the amounts are not expected to be realised in the next twelve months from the balance sheet date.

None of the subsidiaries had any debt capital outstanding at the end of the year or at any time during the year.

14. TRADE AND OTHER RECEIVABLES

	THE GROUP	
	2006	2005
	HK$'000	HK$'000
Trade receivables	**775**	1,019
Deposits, prepayments and other receivables	**1,363**	788
Deposits paid under a non-legally binding memorandum of understanding *(note (a))*	**2,500**	–
	4,638	1,807

The Group has a policy of allowing a credit period from 30 to 120 days to its trade customers. The following is an ageing analysis of the trade receivables at the balance sheet date:

	THE GROUP	
	2006	2005
	HK$'000	HK$'000
0 – 30 days	**175**	177
31 – 60 days	**559**	494
61 – 90 days	**10**	–
Over 90 days	**31**	348
	775	1,019

14. TRADE AND OTHER RECEIVABLES *(Continued)*

Note:

(a) On 15 May 2006, the Company entered into a non-legally binding memorandum of understanding ("MOU") with Excel State Group Limited ("Excel State") and Mr. Yang Shuxin in relation to the proposed acquisition of the whole or part of equity interests held by Mr. Yang Shuxin in Excel State, which holds 51% indirect interests in Shantou Jinshui Technology Limited ("Jinshui").

Jinshui is a company established in the People's Republic of China ("PRC") and is principally engaged in the design, provision and distribution of software and hardware for tax control purpose and the provision of other related services in the PRC.

A refundable amount of HK$2,500,000 was paid by the Company to Mr. Yang Shuxin as earnest money. As additional time is required for the negotiation process on the terms of the proposed acquisition, the long-stop date of the MOU has been extended from 31 August 2006 to 31 March 2007. If no legally-binding formal agreement has been entered into on or before 31 March 2007, the sum will be refunded to the Company in full.

15. TRADE AND OTHER PAYABLES

	THE GROUP	
	2006	2005
	HK$'000	HK$'000
Trade payables	**269**	499
Accrued charges and other creditors	**3,720**	1,806
	3,989	2,305

The following is an ageing analysis of the trade payables at the balance sheet date:

	THE GROUP	
	2006	2005
	HK$'000	HK$'000
0 – 30 days	**126**	499
31 – 60 days	**31**	–
61 – 90 days	**112**	–
	269	499

16. FINANCIAL ASSISTANCE FROM GOVERNMENT

The Innovation and Technology Fund ("ITF") of the Hong Kong Special Administrative Region government has provided financial assistance to the Group to assist in a specific product development. The funding is unsecured, non-interest bearing and repayable to ITF when revenue is generated from the specific product. The amount repaid, if any, will be in stages and calculated with reference to the revenue generated and received.

In the opinion of the directors, HK$236,000 (2005: HK$166,000) will be repayable to the ITF within the next twelve months from 31 December 2006 by reference to the forecast revenue generated to be from the specific product. Accordingly, HK$236,000 (2005: HK$166,000) has been classified as current liabilities and the remaining balance of HK$1,059,000 (2005: HK$1,172,000) is classified as non-current liabilities.

17. SHARE CAPITAL

	Number of shares	Amount
		HK$'000
Authorised:		
At 1 January 2005 and 31 December 2005, at HK$0.01 each	2,000,000,000	20,000
Share consolidation on 28 February 2006 *(note (a))*	(1,600,000,000)	–
Increase in authorised share capital *(note (a))*:		
1,600,000,000 ordinary shares of HK$0.05 each	1,600,000,000	80,000
At 31 December 2006, at HK$0.05 each	2,000,000,000	100,000
Issued and fully paid:		
At 1 January 2005, at HK$0.01 each	583,718,400	5,837
Issue of shares under the placement on 27 June 2005		
116,740,000 ordinary shares of HK$0.01 each	116,740,000	1,167
At 31 December 2005, at HK$0.01 each	700,458,400	7,004
Shares issued upon exercise of share options on 2 February 2006 *(note 20)*:		
37,000,000 ordinary shares of HK$0.01 each	37,000,000	370
	737,458,400	7,374
Share consolidation on 28 February 2006 *(note (a))*	(589,966,720)	–
At 28 February 2006, at HK$0.05 each	147,491,680	7,374
Issue of shares under the rights issue on 30 March 2006 *(note b)*:		
442,475,040 ordinary shares of HK$0.05 each	442,475,040	22,124
At 31 December 2006, at HK$0.05 each	589,966,720	29,498

17. SHARE CAPITAL *(Continued)*

Notes:

(a) Pursuant to an ordinary resolution passed by the shareholders in the extraordinary general meeting ("EGM") held on 28 February 2006, every five shares of HK$0.01 each in the issued and unissued ordinary share capital of the Company are consolidated into one consolidated share HK$0.05 each (the "Share Consolidation"). Subsequently, the authorised share capital of the Company has been increased from HK$20,000,000 divided into 400,000,000 shares of HK$0.05 each to HK$100,000,000 divided into 2,000,000,000 shares of HK$0.05 each by the creation of an additional 1,600,000,000 unissued shares of HK$0.05 each.

(b) Pursuant to an ordinary resolution passed by the shareholders in the EGM held on 28 February 2006, 442,475,040 ordinary shares are issued by way of rights issue on the basis of three rights shares for every one consolidated share of HK$0.05 each at a subscription price of HK$0.057 each. The shares were allotted by the Company on 30 March 2006.

All shares issued during the year rank pari passu with the existing shares in all respects.

18. RESERVES

THE GROUP

	Share premium HK$'000	Special reserve HK$'000	Warrant subscription reserve HK$'000 *(note d)*	Exchange reserve HK$'000	Employee share-based compensation reserve HK$'000 *(note c)*	Accumulated losses HK$'000	Total HK$'000
At 1 January 2005	19,323	10,084	–	–	–	(32,695)	(3,288)
Issue of share under the placing	1,518	–	–	–	–	–	1,518
Share issue expenses	(137)	–	–	–	–	–	(137)
Employee share-based compensation	–	–	–	–	567	–	567
Loss for the year	–	–	–	–	–	(4,913)	(4,913)
At 31 December 2005	20,704	10,084	–	–	567	(37,608)	(6,253)
Issue of rights shares	3,097	–	–	–	–	–	3,097
Issue of warrants under the placing	–	–	1,767	–	–	–	1,767
Share/warrants issue expenses	(2,250)	–	(298)	–	–	–	(2,548)
Shares issued upon exercise of share options	1,270	–	–	–	(567)	–	703
Employee share-based compensation	–	–	–	–	2,314	–	2,314
Exchange differences arising from consolidation	–	–	–	(24)	–	–	(24)
Loss for the year	–	–	–	–	–	(6,273)	(6,273)
At 31 December 2006	22,821	10,084	1,469	(24)	2,314	(43,881)	(7,217)

18. RESERVES *(Continued)*

THE COMPANY

	Share premium HK$'000	Contributed surplus HK$'000 *(note a)*	Warrant subscription reserve HK$'000 *(note d)*	Employee share-based compensation reserve HK$'000 *(note c)*	Accumulated losses HK$'000	Total HK$'000
At 1 January 2005	19,323	3,047	–	–	(20,376)	1,994
Issue of shares under the placing	1,518	–	–	–	–	1,518
Share issue expenses	(137)	–	–	–	–	(137)
Employee share-based compensation	–	–	–	567	–	567
Loss for the year	–	–	–	–	(9,063)	(9,063)
At 31 December 2005	20,704	3,047	–	567	(29,439)	(5,121)
Issue of rights shares	3,097	–	–	–	–	3,097
Issue of warrants under the placing	–	–	1,767	–	–	1,767
Share/warrants issue expenses	(2,250)	–	(298)	–	–	(2,548)
Share issued upon exercise of share options	1,270	–	–	(567)	–	703
Employee share-based compensation	–	–	–	2,314	–	2,314
Loss for the year	–	–	–	–	(5,156)	(5,156)
At 31 December 2006	22,821	3,047	1,469	2,314	(34,595)	(4,944)

18. RESERVES *(Continued)*

(a) The contributed surplus of the Company arose from the Group Reorganisation took place on 15 January 2003. The balance represents the difference between the nominal amount of the Company's shares issued and the consolidated shareholders' fund of KanHan (BVI).

(b) The Company did not have reserves available for distribution to shareholders as at 31 December 2006 (2005: Nil).

(c) Employee share-based compensation reserve represents the fair value of the actual or estimated number of unexercised share options granted to employees recognised in accordance with the accounting policy adopted for share-based compensation as described in note 2(k)(ii) to the financial statements.

(d) On 28 August 2006, the Company entered into a conditional placing agreement in relation to a private placing of 117,800,000 warrants granted to a subscriber at an issued price of HK$0.015 per warrant. The warrants entitle the subscriber to subscribe for new 117,800,000 ordinary shares of par value HK$0.05 at an initial price of HK$0.155 per new share for a period of 18 months commencing from the issue date of the warrants. Each warrant carries the right to subscribe for one new share.

19. NET CASH USED IN OPERATING ACTIVITIES

	2006	2005
	HK$'000	HK$'000
OPERATING ACTIVITIES		
Loss before taxation	**(6,273)**	(4,913)
Adjustments for:		
Depreciation	**173**	206
Exchange difference	**(25)**	–
Loss on disposal of property, plant and equipment	**53**	–
Employee share-based compensation	**2,314**	567
Interest income	**(585)**	(27)
Changes in working capital:		
Increase in trade and other receivables	**(2,829)**	(511)
(Increase)Decrease in inventories	**(62)**	200
Increase in trade and other payables	**1,681**	94
NET CASH USED IN OPERATING ACTIVITIES	**(5,553)**	(4,384)

20. EMPLOYEE SHARE OPTION SCHEME

On 24 January 2003, a share option scheme was adopted by the Company pursuant to a written resolution of the Company (the “Scheme”).

The purpose of the Scheme is to provide eligible employees with performance incentives for continuous and improved service with the Group and to enhance their contributions to increase profits by encouraging capital accumulation and share ownership. The Board of Directors may, at its discretion, invite any full-time employee of the Company, including any executive and non-executive directors of the Company, or any subsidiaries of the Company to take up options to subscribe for shares of the Company. The total number of shares in respect of which options may be granted under the Scheme shall not exceed 10% of the issued share capital of the Company from time to time. The total number of shares of the Company issued and to be issued upon exercise of the options granted to a participant under the Scheme and any other share option scheme adopted by the Company (including both exercised and outstanding options) in any 12-month period must not exceed 1% of the shares of the Company in issue from time to time.

An option may be exercised at any time during a period to be determined and notified by the Board of Directors to each participant. Options might be granted at a consideration of HK$1. Options granted to substantial shareholders or independent non-executive directors in excess of 0.1% of the Company’s share capital or with a value in excess of HK$5 million must be approved in advance by the Company’s shareholders.

The subscription price for the shares of the Company will be a price determined by the Board of Directors and will be the highest of (i) the closing price of the shares on the GEM as stated in the Stock Exchange’s daily quotation on the date of the offer grant; (ii) the average closing price of the shares on the GEM as stated in the Stock Exchange’s daily quotations for the five trading days immediately preceding the date of the offer grant; and (iii) the nominal value of the shares.

On 2 February 2006, all 37,000,000 share options granted on 8 July 2005 were exercised by the option holders at an exercise price of HK$0.029 each.

On 5 June 2006, the Company granted share options to certain of its directors and employees at a nominal consideration of HK$1 for each lot of share option to subscribe for an aggregate of 19,400,000 shares under the Scheme at an exercise price of HK$0.21 per share.

20. EMPLOYEE SHARE OPTION SCHEME *(Continued)*

(a) Movement in the number of share options outstanding during the year is as follows:

	Number of options	
	2006	2005
At 1 January	**37,000,000**	–
Exercised on 2 February 2006	**(37,000,000)**	–
Granted on 5 June 2006 (8 July 2005)	**19,400,000**	37,000,000
At 31 December	**19,400,000**	37,000,000

(b) Details of share options granted

Categories of grantees	Date of grant	Exercise period	Exercise price per share HK$	2006 Number of options	2005 Number of options
Directors	8/7/2005	8/7/2005-7/7/2015	0.029	–	14,000,000
	5/6/2006	5/6/2006-4/6/2016	0.210	8,800,000	–
Employees	8/7/2005	8/7/2005-7/7/2015	0.029	–	23,000,000
	5/6/2006	5/6/2006-4/6/2016	0.210	10,600,000	–
				19,400,000	37,000,000

20. EMPLOYEE SHARE OPTION SCHEME *(Continued)*

(c) The fair value of services received in return for share options granted are measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on the Black-Scholes option pricing model. The expected life of the option is used as an input into this model.

Fair value of share options and assumptions	**2006**	2005
Fair value at measurement date	**HK$0.1193**	HK$0.0153
Share price at grant date	**HK$0.210**	HK$0.027
Exercise price	**HK$0.210**	HK$0.029
Expected option life	**3 years**	5 years
Expected volatility	**84.66%**	41.76%
Expected dividends	**–**	–
Risk-free interest rate (based on Exchange Fund Notes)	**4.6%**	3.78%

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility due to publicly available information. Expected dividends are based on historical dividends. Changes in the subjective input assumptions could materially affect the fair value estimate.

21. RETIREMENT BENEFITS SCHEME

The Group operates a Mandatory Provident Fund Scheme ("Scheme") for all its qualifying employees. The assets of the Scheme are held separately from those of the Group in funds under the control of trustees. Both the Group and each eligible employee contribute the lower of 5% or HK$1,000 of the relevant payroll costs to the Scheme.

22. DEFERRED TAX

Recognised deferred tax (assets) liabilities

	Depreciation allowances HK$'000	Tax losses HK$'000	Total HK$'000
At 1 January 2005	33	(33)	–
(Credit) Charge to income	(21)	21	–
At 31 December 2005	12	(12)	–
Charge (Credit) to income	(12)	12	–
At 31 December 2006	–	–	–

Unrecognised deferred tax assets arising from

	2006 HK$'000	2005 HK$'000
Deductible temporary differences	**47**	–
Tax losses	**32,267**	29,887
At the balance sheet date	**32,314**	29,887

Both the tax losses and the deductible temporary differences do not expire under current tax legislation. Deferred tax assets have not been recognised in respect of these items because it is not probable that future taxable profit will be available against which the Group can utilise the benefits therefrom.

23. OPERATING LEASE COMMITMENTS

The Group as lessee

At the balance sheet date, the Group had total future minimum lease payments in respect of office premises under non-cancellable operating lease which are payable as follows:

	THE GROUP	
	2006	2005
	HK$'000	HK$'000
Within one year	**543**	281
In the second to fifth years inclusive	**430**	–
	973	281

24. FINANCIAL RISK MANAGEMENT OBJECTIVE AND POLICIES

The Group's principal financial instruments comprise bank balances and cash, trade receivables and trade payables, which arise directly from its business activities.

The Group does not have any written risk management policies and guidelines. However, the board of directors generally adopts conservative strategies on its risk management and limit the Group's exposure to these risks to a minimum.

The main risks arising from the Group's financial instruments are credit risks. The credit risks are managed via the following policies so as to minimise their exposure:

(a) The Group trades only with creditworthy third parties; and

(b) Receivables balances are monitored closely for objective evidence of any potential/existence of loss event.

25. POST BALANCE SHEET EVENTS

(a) On 13 February 2007, the Company granted further share options to certain of its directors and employees to subscribe for an aggregate 4,000,000 shares at a nominal consideration of HK$1 for each lot of share option under the Scheme at the exercise price of HK$0.19 per share.

(b) On 2 February 2007, Rise Assets Limited ("Rise Assets", a wholly-owned subsidiary of the Company) entered into a conditional legally binding memorandum of understanding ("MOU") with Mr. Yang Pei Gen ("Mr. Yang"), in which Rise Assets has agreed to acquire and Mr. Yang has agreed to sell: (i) the Sale Share, representing the entire issued share capital of Silky Sky Investments Limited ("Silky Sky"); and (ii) the Sale Loan, representing all obligation, indebtedness and liabilities due by Silky Sky to Mr. Yang, for a total consideration of HK$61,000,000. On 21 March 2007, a formal agreement ("Formal Agreement") was entered into between Rise Assets and Mr. Yang. Details of the MOU and the Formal Agreement were disclosed in the announcements of the Company dated 9 February 2007 and 21 March 2007 respectively.

Sky Rich Investments Limited, a wholly-owned subsidiary of Silky Sky, will be owned as to 51% of interests in Beijing Shiji Jiangshan Resource Recycling Technology Limited ("Shiji Jiangshan"). Shiji Jiangshan, an equity joint venture company established in the PRC, is principally engaged in the production and distribution of organic fertilizer through a technology which converts organic wastes into organic fertilizer.

Deposits HK$20,000,000 were paid by the Company to Mr. Yang as of the date of these financial statements.

26. COMPARATIVE FIGURES

Classification of certain revenue has been changed in order to better reflect their significance and nature in the financial statements as follows:

- Revenue from website development of HK$384,000 that was included in revenue from sales of licensed software in the 2005 financial statements has been separately disclosed to conform with the current year's presentation.

- Subscription income of HK$45,000 that was included in revenue from sales of licensed software in the 2005 financial statements has been reclassified to software rental and subscription income to conform with the current year's presentation.