ANNUAL REPORT 2005

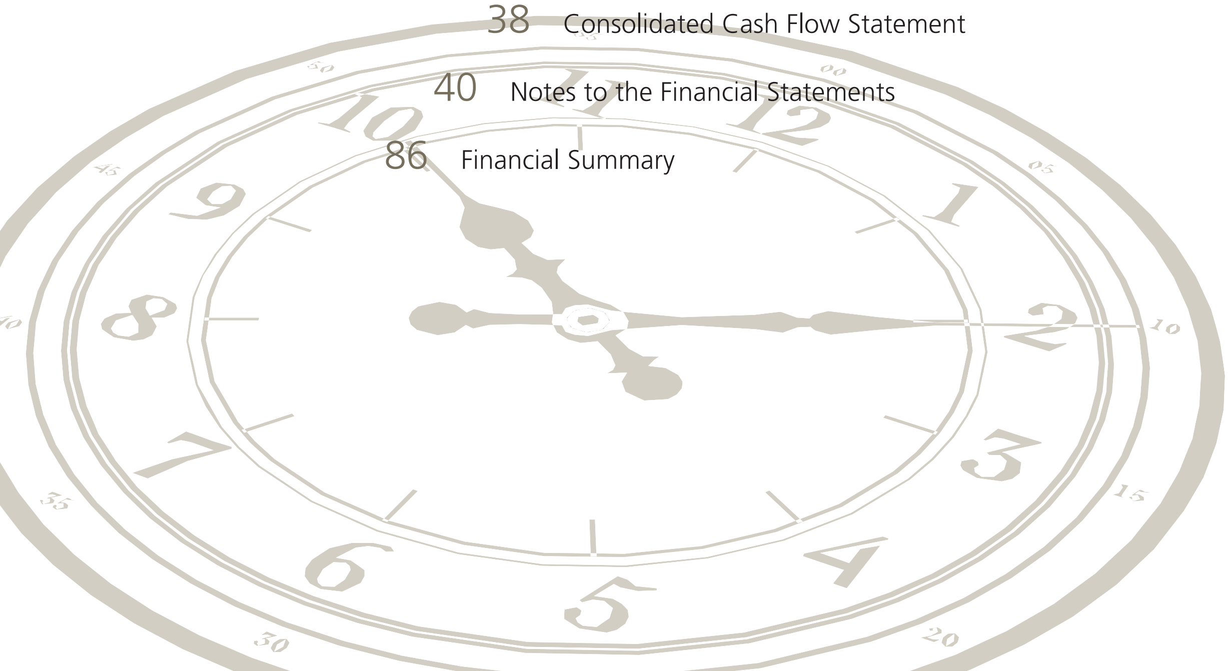
Xinyu Hengdeli Holdings Limited

新 宇 亨 得 利 控 股 有 限 公 司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code : 3389)

CONTENTS



CORPORATE PROFILE

Xinyu Hengdeli Holdings Limited ("Xinyu Hengdeli" or "the Company") and its subsidiaries, collectively as "the Group" (Stock Code: 3389), was listed on The Stock Exchange of Hong Kong Limited since 26 September 2005. The Group also introduced The Swatch Group (Hong Kong) Limited ("Swatch Hong Kong"), a subsidiary of the world's largest watch manufacturer and distributor, The Swatch Group Limited ("Swatch Group"), as the strategic shareholder of the Group.

Xinyu Hengdeli is a major retailer and distributor of imported medium and high-grade watch in the PRC, distributing 19 renowned watch brands of 4 major watch brand suppliers (LVMH Group, Swatch Group, Richemont Group and Desco Group), of which 15 are on exclusive basis. Xinyu Hengdeli also maintained good relationship with the Rolex Group. Meanwhile, the Group also owns the renowned Swiss watch brands of "NIVADA"（尼維達）, "OLMA"（奧爾瑪） and "NUMA JEANNIN"（龍馬珍）, enabling the Group to enjoy a predominant leading role in the industry. As at 31 December 2005, the Group had 65 retail outlets in various major cities of the PRC and had over 300 wholesale customers. Moreover, the Group provides professional after-sales services for the customers by setting up on-spot repair and maintenance services at all the outlets and there are also two large customer services centers in Beijing and Shanghai.

In addition, the Group has allied with 3 major famous watch retailers in the PRC, namely Shanghai San Lian Group（上海三聯（集團）有限公司）, Shanghai Oriental Commercial Building Ltd.（上海東方商廈有限公司）and Shenzhen Hengjili World Brand Watches Centre Ltd.（深圳市亨吉利世界名錶中心有限公司）. Such alliance can effectively counter competition and enhance operational efficiency. In 2003, the Company has set up a joint venture called "SMH SWISS WATCH"（瑞韻達）with Swatch Hong Kong, distributing the two international renowned watch brands: Omega（歐米茄）and Rado（雷達）under the Swatch Group.

CORPORATE INFORMATION

REGISTERED OFFICE
Century Yard
Cricket Square
Hutchins Drive
P.O.Box 2681 GT
George Cayman
British West Indies

HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS IN HONG KONG
Room 301, 3/F.
Lippo Sun Plaza
28 Canton Road
Tsim Sha Tsui
Kowloon
Hong Kong

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

Non-executive Directors
Mr. Chen Sheng
Mr. Shen Zhiyuan
Mr. Shi Zhongyang *(Appointed on 15 February 2006)*
Mr. Li Jialin *(Resigned on 15 February 2006)*

Independent Non-executive Directors
Mr. Liu Huangsong
Mr. Cai Jianmin
Mr. Wong Kam Fai, William

AUDIT COMMITTEE MEMBERS
Mr. Cai Jianmin *(Chairman)*
Mr. Liu Huangsong
Mr. Wong Kam Fai, William

REMUNERATION COMMITTEE MEMBERS
Mr. Zhang Yuping *(Chairman)*
Mr. Liu Huangsong
Mr. Cai Jianmin

NOMINATION COMMITTEE MEMBERS
Mr. Song Jianwen *(Chairman)*
Mr. Liu Huangsong
Mr. Cai Jianmin

COMPANY SECRETARY AND QUALIFIED ACCOUNTANT
Mr. Ng Man Wai, Peter *(HKICPA, ACCA)*

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

AUDITORS
KPMG
Certified Public Accountants
8/F
Prince's Building
10 Chater Road
Central
Hong Kong

LEGAL ADVISER
Hong Kong Law
Gallant Y. T. Ho & Co.
5/F
Jardine House
1 Connaught Place
Central
Hong Kong

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE
Computershare Hong Kong Investor Services Limited
Shops 1712-1716
17th Floor, Hopewell Centre
183 Queen's Road East
Wanchai
Hong Kong

CAYMAN ISLANDS PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE
Butterfield Fund Services (Cayman) Limited
Butterfield House
68 Fort Street
P.O. Box 705
George Town
Grand Cayman
Cayman Islands

FINANCIAL RELATIONS CONSULTANT AND MEDIA ENQUIRY
Ms. Barbara Yuen
Porda International (Finance) PR Co., Ltd.
7/F
CMA Building
64 Connaught Road Central
Central
Hong Kong
Tel : (852) 2544 6388
Fax : (852) 2544 6126
Email : barbara@pordafinance.com.hk

INVESTOR RELATIONS ENQUIRY
Mr. Ng Man Wai, Peter
Xinyu Hengdeli Holdings Limited
Hong Kong Office
Room 301, 3/F.
Lippo Sun Plaza
28 Canton Road
Tsim Sha Tsui
Kowloon
Hong Kong
Tel : (852) 2375 0788
Fax : (852) 2375 8010
Email : peter@hengdeli.com.hk

CHAIRMAN
Zhang Yuping

An extraordinary vigour ever fresh

CHAIRMAN'S STATEMENT

Dear Shareholders,

On behalf of the Board of Directors (the "Board of Directors"), I am pleased to present the annual report for the year ended 31 December 2005 (hereinafter as the "Year") of the Group, and hereby express our sincere gratitude to our shareholders and all staff for their continual support to the Company.

Our successful listing on the Main Board of the Stock Exchange of Hong Kong Limited (the "Stock Exchange") in 2005 marked a great step of the Company towards a brand new era. A sound capital operation platform following our listing paved a solid base for a regulated group management, which will in turn add contributive driving forces for achievement of our future development plans and continuously enhance the core competitiveness of the Group. Given our prime positioning as a leading industry player, our future corporate development will establish a solid and consolidated foundation.

During this listing, The Swatch Group Hong Kong Limited (being a company under Swatch Group which was an internationally reputed watch manufacturer and distributor and a business partner of the Company) subscribed 5% of the enlarged share capital of the Company, and became a strategic shareholder of the Company by gradually increasing its shareholding to over 6%.

In 2005, China's watch retail industry sustained vigorous development by leveraging on a strong demand for internationally famous imported watches from the domestic market. The Group fully captured each and every market opportunity by taking advantage of our intrinsic strengths, thereby flourishing fruitful results for the year. For the year ended 31 December 2005, the Company reported a sales of RMB1,396,531,000. Profit for the year grew by 24.5% to RMB131,777,000, whereas basic earnings per share grew by 15.4% to RMB0.15.

During 2005, by upholding our strategic move of devoting a concerted focus on expanding and consolidating our sales network coverage, the Group expanded into more widespread domestic and external distribution networks through various means, including by means of timely adjustments and reinforcement of our existing networks and enhancement of our retail shop quality, thereby forging towards a more solidified base for our future advancement.

By capitalizing on our close cooperative relationships with a pool of internationally famous brand watch suppliers, including Swatch Group, Richemont Group, LVMH Group, Rolex Group and Desco Group, the Group's business registered a sustainable stable growth despite of a rapid changing market environment.

CHAIRMAN'S STATEMENT

As part of our long-term development plans, the Group took a great leap in developing our proprietary brand NIVADA（尼維達）, and acquired the worldwide ownership rights of the Swiss famous brands namely OLMA（奧爾瑪）and NUMA JEANNIN（龍馬珍）.

Xinyu Hengdeli was listed on the Main Board of Stock Exchange on 26 September 2005

We place strong emphasis on effective cost controls and economies of scale on top of business expansion. At the same time, the Group has dedicated itself to further enhancing and maintaining a sound corporate governance mechanism by putting into place a whole-set regulated corporate governance system on the spectrums of finance, audit and human resources. Accordingly, the Company assured itself of making any and all decisions in the overall interest of our shareholders while delivering maximized shareholders' values.

The domestic high end consumer market stepped into times of a fierce rapid growth, since the accession of the PRC to the World Trade Organization (WTO), adding tremendous growing momentums for the medium and high end watch retail industry in China. To capture such an unprecedented valuable opportunity, the Group will continuously uphold a strategic direction of strengthening and solidifying our retail networks through a constant collaboration and enhancement of the Company's good relationships with our brand suppliers and other retailers. We committed endeavoured efforts in developing our proprietary brands. With the support of our shareholders, suppliers and business partners, unique core competitive strengths and wholehearted devotions of all staff, to the best belief of the Company, we will attain increasingly promising results in the rapidly growing domestic consumer market by creating the greatest shareholders' and social values.

Last but not the least, I, on behalf of the Board of Directors, would like to express our sincere gratitude to our shareholders, suppliers, customers and business partners for their heartfelt support, and to all our staff for their commitment and contribution.

By Order of the Board
Zhang Yuping
Chairman

Hong Kong, 12 April 2006

Pursuit of trueness through perfect rendition

MANAGEMENT DISCUSSION AND ANALYSIS

I MARKET OVERVIEW

In 2005, global economic environment was on a growing track. China not only reported an impressive achievement in terms of economic growth and enhanced efficiency in 2005, but also gained precious experience in the macroeconomic austerity measures and maintained good development trend. Accordingly, the overall economy remained growing healthily at a speedy pace. In 2005, China's preliminary audited Gross Domestic Product (GDP) amounted to RMB 18.2 trillion, increased by 9.9% over 2004. The domestic consumer prices were up by 1.8% over 2004, while the disposable income per capital in urban area increased by 9.6% compared with 2004. With a total commodity retail volume increased by over 12%, China became the country with the fastest growth in terms of the total commodity retail volume. A steady economic growth and an increasing income amongst the domestic citizens represented direct drivers for stimulated consumer spending. It should be noted that a continuous expanding middle to high income classes who are in pursuit of higher quality lifestyle and life tastes added a driving stimulus for an increasing demand for branded products from the high income class. On the side of the watch segment, high-end luxury imported watches enjoyed increasing popularity with an expanding market share and influence in the domestic market. Of which, the prestigious Swiss watches were highly appraised amongst consumers for their high qualities. According to the CCID report, a research report on the Watch and Clock industry in China published by CCID (CCID Consulting Company Limited), sales volume from the imported Swiss watches accounted for 64% of the total sales volume for watches in China.

The Group, as one of the key retailers and distributors of internationally prestigious watches in China, has been enjoying a period of robust development under the prevailing favourable operating environment.

II FINANCIAL REVIEW

Sales

For the year ended 31 December 2005, the Group recorded sales of RMB1,396,531,000, of which sales from wholesale business amounted to RMB745,059,000 and accounted for 53% of the sales. While sales from retail business amounted to of RMB636,725,000 and accounted for 46% of the sales. The Group's sales decreased slightly by 8% over 2004 mainly due to a transfer of the wholesale business of Omega and Rado by the Group to SMH Swiss Watch, a joint venture set up by the Group and Swiss Swatch Group.

MANAGEMENT DISCUSSION AND ANALYSIS

The breakdown of the sales of the Group is as follows:

	For the year ended 31 December			
	2005		2004	
	RMB'000	**%**	RMB'000	%
Retail business	**636,725**	**46**	530,264	35
Wholesale business	**745,059**	**53**	974,771	64
After-sales services	**14,747**	**1**	13,547	1
Total	**1,396,531**	**100**	1,518,582	100

Gross profit and gross profit margin

For the year ended 31 December 2005, the Group's gross profit increased by 18.2% for the last corresponding year to approximately RMB364,162,000. Whereas, our gross profit margin for 2005 was up by 28.6% over the last corresponding year to 26.1%. The increase was mainly attributable to our active expansion into retail business of higher gross profit margin, and diversification into a widened and broadened variety of our wholesale product mix of higher gross profit margin.

Distribution costs

During the year ended 31 December 2005, our distribution costs increased by 6.5% over the corresponding year to approximately RMB96,645,000, representing 6.9% of sales, given that the Group made committed efforts in expanding its retail outlets.

Finance costs

During the year under review, the Group's finance cost amounted to approximately RMB23,353,000, which mainly consisted of interest expense.

MANAGEMENT DISCUSSION AND ANALYSIS

Profit for the year and profit margin for the year

Overall speaking, despite the Group was still undergoing a consolidation period during which we built an operating structure mainly on a retail network oriented basis, we recorded an encouraging year-by-year profit growth in 2005. Profit for the year increased by 24.5% to approximately RMB131,777,000 over last year, while our profit margin for the year was up by 34.3% to approximately 9.4% over last year. The increase was partly attributable to the increased spending from the population group with high consumption power due to a rapid economic growth particularly arisen from a persistently expanding middle class in the PRC. Another reason was a booming spending on high-end consumer products due to a remarkably growing middle class population in the PRC. In particular, the three important reasons were: (1) our rapidly expanding retail network with an increased retail store number and a higher retail profit margin over wholesale profit margin; (2) a higher gross profit margin for our new agent products; and (3) our improved management quality.

Final dividend

The Board recommends the payment of a final dividend of RMB0.048 per Share for the year ended 31 December 2005 in return for shareholders' support, subject to approval by shareholders at the Annual General Meeting to be held on 8 June 2006. The proposed final cash dividend will be payable on or before 28 June 2006 to shareholders whose names appear on the register of members of the Company on 7 June 2006.

Current assets and current liabilities

As at 31 December 2005, the current assets of the Group amounted to approximately RMB1,191,571,000, including inventory of approximately RMB662,142,000, trade and other receivables of approximately RMB214,110,000, and cash and cash equivalents of approximately RMB142,502,000.

As at 31 December 2005, the current liabilities of the Group amounted to approximately RMB548,788,000, including bank loans of approximately RMB314,000,000, trade and other payables of approximately RMB185,376,000, and current tax payable of approximately RMB49,412,000.

MANAGEMENT DISCUSSION AND ANALYSIS

III BUSINESS REVIEW

Retail business

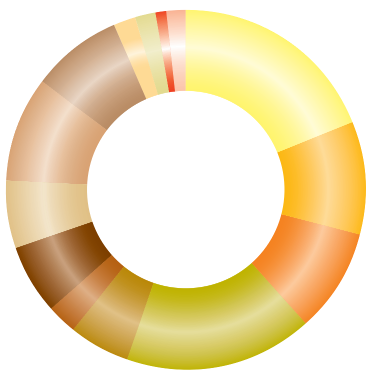
In 2005, the Group adhered itself to a strategic direction of concerted expansion and consolidation of our retail network. In line with our focused principle of economic effectiveness and strategically oriented synergic development of our wholesale and retail sectors, our domestic retail distribution networks were explored through various means, including acquisitions or co-operations with a large number of retailers through varying means; establishment of brand retail stores in cooperation with brand suppliers; direct investments in the opening of retail stores. At the same time, the Group will continuously upgrade the standard of its retail stores by adjusting the existing network strategy of our retail stores in line with market trends. As at 31 December 2005, the number of the Group's retail stores reached 65, outnumbering our expected stores. All the Group's retail stores were located in prosperous zones, and were strategically located within prime locations in major cities including Beijing, Shanghai, Tianjin, Shenyang, Harbin, Hangzhou, Nanjing and Shenzhen.

In addition, to cultivate an outstanding corporate image for a reflection of our increasingly upgraded quality of retail stores, the Group was under the process of renovating our retail stores under Xinyu brand namely "PRIME TIME – Xinyu Hengdeli Holdings" (盛時表行－新宇亨得利控股), through which Xinyu Hengdeli will eventually emerge as a unique retail brandname in the operation of international luxury watches.

Over a year of effort, the Group realized a retail sales of RMB636,725,000, representing an increase of 20.1% over last year, and recorded a retail gross profit of RMB221,241,000, which was a 29.9% growth over last year. In 2004, sales from retail and wholesale sectors was in the ratio of approximately 35:64, contrasting a ratio of approximately 46:53 in

MANAGEMENT DISCUSSION AND ANALYSIS

Breakdown by retail area distribution over different provinces and cities:



2005. In 2004, gross profit from retail and wholesale sectors was in the ratio of 55:42, contrasting a ratio of 61:37 in 2005. Based on the above comparative figures, it was apparently noted that the Group reported an increasingly booming profit with an expanding weighting of retail sector. In the overall, the Group's operating mode and the actual performance were completely in line with our strategic direction.

Apart from the above, the Group formed a retailing strategic alliance with other three major watch retailers, namely Shanghai San Lian Group Limited (上海三聯(集團)有限公司), Shanghai Oriental Commercial Building Ltd. (上海東方商廈有限公司) and Shenzhen Hengjili World Brand Watches Centre Ltd. (深圳市亨吉利世界名表中心有限公司). With over a hundred of retail outlets within the allied retail network, a market share of approximately 48% was secured in the international luxury watch markets in the PRC. The establishment of the alliance and its gathering of strength progressively represented a crucial factor for a regulated domestic luxury watch market and enhanced corporate profitability.

Wholesale business

With an extensive coverage of a well-established distribution network in the PRC, the Group secured a wholesale customer base of over 300 customers across 40 cities throughout the country during the year ended 31 December 2005.

The Group has maintained a good relationship with world-class watch manufacturers and suppliers, including Swatch Group, Richemont Group, LVMH Group and Desco Group. For the year ended 31 December 2005, out of our 19 brands under the international reputable watch groups, inclusive of the above four big groups, 15 brands were sold under an exclusive agent basis, including Audemars Piguet (愛彼), Jaeger-LeCoultre (積家), Carl F. Bucherer (寶齊萊), TAG Heuer (豪雅), Zenith (真利時), Baume & Mercier (名士), Maurice Lacroix (艾美), Christian Dior (克麗絲汀 • 迪奧), Fendi (芬迪), Dunhill (登喜路), Hamilton (漢密爾頓) and Certina (雪鐵那). Among which, Dunhill (登喜路), Hamilton (漢密爾頓) and Certina (雪鐵那) were new agent brands acquired in 2005. In addition, the Group established a particularly good relationship with Rolex Group, an international luxury watch manufacturer and supplier.

MANAGEMENT DISCUSSION AND ANALYSIS

The comprehensive wholesale network of Xinyu Hengdeli in the PRC

In 2003, the Group and Swatch Group, the world's largest watches manufacturer and distributor, established SMH Swiss Watch Trading (Shanghai) Co. Ltd. ("SMH Swiss Watch") on a joint venture basis. SMH Swiss Watch, as the first and the only joint venture of the Swatch Group on a worldwide basis, is set to access to exclusive distribution rights of the prestigiously branded watches of Omega (歐米茄) and Rado (雷達) in the PRC.

MANAGEMENT DISCUSSION AND ANALYSIS

Proprietary brands

During the year ended 31 December 2005, the Group's proprietary brand of NIVADA was well-received by the market, as noted from an approximately 45% and 90% growth in sales and gross profit from our proprietary branded NIVADA over the last corresponding figures to RMB30,000,000 and approximately RMB17,735,000 respectively.

To lure a further expansion of our proprietary branded business, during 2005, the Group newly acquired two Swiss famous brands, namely, OLMA (奧爾瑪) and NUMA JEANNIN (龍馬珍). To the Group's belief, our proprietary branded products will represent stronger profit generators for the Group and contributive factors for our prolonged development.

Marketing

In 2005, in order to further enhance our reputation, the Group took an active part in initiating a number of marketing activities, one of them being the "Famous Watches Fair in Three Regions" of Xinyu. With roadshow activities carried out by the Group in three cities including Shanghai, Nanjing and Hangzhou in December 2005, we gained overwhelming market responses by advocating a widespread participation of a large number of reputable brands including Audemars Piguet (愛彼), Baume & Mercier (名士), Cartier (卡地亞), Carl F. Bucherer (寶齊萊), Dunhill (登喜路), Jaeger-LeCoultre (積家), TAG Heuer (豪雅), Vacheron Constantin (江詩丹頓) and Zenith (真利時).

MANAGEMENT DISCUSSION AND ANALYSIS

Customer services

The Group valued quality customer services by offering free-of-charge after-sales services with a warranty period ranging from one to three years to our retail customers. For the year ended 31 December 2005, all retail outlets under the Group are capable of providing instant after-sales services to our customers. The two service centres operated in Beijing and Shanghai by the Group were equipped with a team of experienced technicians and engineers in order to handle technically sophisticated repairs. All of our repair technicians were accredited with professional qualifications, while some of them were in possession of a "Specific Brand Repair Technician", a "Model National Labour" and a "Leading Technically Advanced Technician in the Industry".

IV FUTURE PROSPECTS

Under a rapid surging domestic economy, coupled with an increasing spending power amongst the middle and high income group, all walks of life in our society are increasingly in pursuits of high quality lifestyles and tastes. Given an ever increasing demand for watches, the mid-range and high end watch sectors were embedded with enormous market potentials. In comparison with other developed countries, the PRC's watch market is relatively lagged behind in terms of consumption volume as noted from an average annual purchase of five watches for every 100 people in the PRC which is far below the average annual purchases of 27 and 18 watches in developed countries and developing countries. In this regard, the PRC's watch markets are set to uncover massive development spaces. With a vividly growing economy, the PRC is well positioned to become a huge consuming country of immense market potentials, thereby picturing an extremely bright future for the domestic luxury watch market. As an internationally renowned luxury watch retailer and distributor, the Company will meet the forthcoming market challenges with a stronger competency by steadfastly improving our existing businesses and establishing its leading position in the domestic luxury watch markets. We firmly believe that we will head towards a remarkable result performance by timely keeping abreast of market changes and opportunities.

MANAGEMENT DISCUSSION AND ANALYSIS

To grasp the ever growing business opportunities for flourishing our business growth, the Company will uphold the following business development strategies:

Expansion of Retail Sector at an Accelerated Speed via Different Channels

In 2006, the Company will adhere itself to a strategic direction of providing a quality and extensive distribution platform to a large pool of prestigious international branded watches vendors. In line with our focused principle of economic effectiveness and strategically oriented synergic development of our wholesale and retail sectors, our domestic and external retail distribution networks were further explored through various means. We will strive to increase our retail outlets to 90 by the end of 2006.

Speeding up the Development of Proprietary Brands and Agent Brands

The Group will speed up the establishment of proprietary brands and long term agent brands through its substantial efforts in developing its own brands and equipping with stronger core competitive strengths in order to create higher profit. In the long run, an in-house research and development department will be set up for designing, researching and developing our NIVADA and OLMA branded watches, and for enhancing our long term competitive capacities. We will be more committed to strengthen our long term agent brands, to continuously adjust its operational structure, to reinforce training and guidance to employees, in order to expand its business in the PRC.

MANAGEMENT DISCUSSION AND ANALYSIS

Putting into Place an Ancillary Production System for Principal Business

The ancillary facilities and accessories including renovation and setting of retail shops, elegant watch boxes, brand presentation boards, display boxes and various kinds of tools for watch displays, represent integral parts of luxury watch sales business. We identify considerable profits for such ancillary products. To meet the demand for such products from the proprietary brands, agent brands and outlets of the Group, the Group intends to establish its own production facility for such products and is confident that this will be beneficial to optimizing the ancillary services to luxury watch sales which will in turn effectively increase our profits.

Maintaining and Strengthening the Strategic Alliances of the Group

Xinyu Hengdeli has a vision of setting up an extensive and quality distribution platform for the internationally famous watch brands and of seeking joined forces in business development with other domestic retailers. The Group will work with other suppliers and retailers on a win-win situation basis by entering into and further strengthening close cooperation with our suppliers and strategic alliances with other domestic retailers.

Further Improving Corporate Governance

To boost a sustainable corporate growth and an increasing profit, Xinyu Hengdeli will take a greater leap in strengthening its corporate governance by constantly optimizing our finance and audit systems for a healthy corporate development. To encourage energetic and proactive values amongst our staff, our remuneration and incentive policies will persistently undergo improvements. We endeavour to minimize any potential risks associated with our development with continually optimized rules in respect of business discussions at board meetings.

Looking forward, in light of robustly prosperous growing prestigious watch retail markets in the PRC, as a key retailer and wholesaler in the domestic medium to high end watch market, the Group will leverage on the rapidly growing domestic consumer markets by timely capturing market opportunities in order to deliver the best value for our shareholders and the community at large.

Noble and elegant out from within

CORPORATE GOVERNANCE REPORT

Since its establishment, Xinyu Hengdeli has been committed to maintain a high standard of corporate governance practice, such that the interests of our shareholders, customers, employees as well as the long term development of the Group can be safeguarded. To this end, the Group has established the board of directors, audit committee, remuneration committee and nomination committee ensuring they are up to the requirements as being diligent, accountable and professional. KPMG has been engaged as the Group's external auditors, and Guotai Junan Capital Limited and Partners Capital International Limited have been engaged as the compliance advisers.

The Company has adopted the Code on Corporate Governance Practices (the "Code") of The Stock Exchange of Hong Kong Limited ("Stock Exchange"). In the opinion of the Board of Directors, the Company had complied with the Code on Corporate Governance Practices set out in Appendix 14 to the Listing Rules of the Stock Exchange throughout the year ended 31 December 2005 except for Code provision A.2.1. Given its existing corporate structure, the roles of chairman and chief executive officer have not been separated. Although the functions and duties of chairman and chief executive officer have been performed by the same individual, all major decisions would only be made after consultation with the Board of Directors and (where applicable) the committees of the Board of Directors. There are three independent non-executive Directors in the Board of Directors, all of them possess adequate independence and therefore the Board considers the Company has achieved balance of and provided sufficient protection to its interests.

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

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

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

CORPORATE GOVERNANCE REPORT

Subsequent to the listing of the Company in late September 2005, a total of two regular meetings were held by the Board of Directors. All members of the Board attended the two meetings and the rate of attendance was 100%. From 2006, the Board of the Company will hold at least four regular meetings each year.

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

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

SECURITIES TRANSACTIONS BY DIRECTORS

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

ACCOUNTABILITY AND AUDIT

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

The statement of the auditors of the Company on their reporting responsibilities on the financial statements of the Group is set out in the Auditors' Report on page 32.

AUDITORS' REMUNERATION

The audit fee, to be received by the auditors of the Company, for the year ended 31 December 2005 shall be approximately RMB1.50 million.

The Company also incurred approximately RMB3.44 million for the services provided by the reporting accountants in respect of the IPO and listing of the Company's shares on the Hong Kong Stock Exchange and the amount has been charged to the share premium account. It was not practicable to separate the amount payable for those services between the year 2004 and 2005.

AUDIT COMMITTEE

The Company has established an audit committee in compliance with the Rules Governing the Listing of Securities on the Stock Exchange ("Listing Rules"). The audit committee comprises three independent non-executive Directors, namely, Messrs. Cai Jianmin, Liu Huangsong and Wong Kam Fai William, with the primary duties of reviewing the accounting principles and practices adopted by the Company as well as substantial exceptional items, internal controls and financial reporting matters, which included a review on the audited annual results for the year ended 31 December 2005 and the interim report of 2005.

CORPORATE GOVERNANCE REPORT

The audit committee held one meeting each in September 2005 and April 2006 to review the half-year and full year reports. All members of the committee attended the meetings.

REMUNERATION COMMITTEE

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

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

NOMINATION COMMITTEE

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

The nomination committee did not hold any meeting during the year as there was no change of director. One meeting has been held in February 2006 to review the proposed appointment of Mr. Shi Zhongyang as a Director of the Company. All members of the committee attended the meeting.

INVESTOR RELATIONSHIP

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

REPORT OF THE DIRECTORS

The directors of the Company hereby present the annual report together with the audited accounts of the Company for the year ended 31 December 2005.

THE COMPANY

The Group is a watch wholesaler and retailer in the PRC with a focused operation of the retail and distribution of internationally branded watches.

The principal activities of the subsidiaries of the Company are set out in Note 17 to the financial statements.

USE OF PROCEEDS

The Company issued a total of 287,500,000 new Shares which included the over-allotment option that had been exercised ("New Offer") by way of a public offer and an international placing at a price of HK$1.32 per Share. Net proceeds of approximately HK$350 million were raised from the New Offer in September 2005. For the year ended 31 December 2005, all proceeds were applied in the manner as mentioned in the prospectus and were not used for any other purposes.

DISTRIBUTABLE RESERVE

As at 31 December 2005, the Company did not have any distributable reserve available for distribution to the Company's shareholders.

PRE-EMPTIVE RIGHTS

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

FINANCIAL SUMMARY

The summary of the results and assets and liabilities of the Group for the last four financial years ended 31 December is set out on page 86 of this annual report.

PURCHASE, SALE OR REDEMPTION OF SECURITIES

Neither the Company nor its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the period from the listing date of 26 September 2005 to 31 December 2005.

REPORT OF THE DIRECTORS

SHARE OPTION

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

As at 31 December 2005, no option had been granted or agreed to be granted by the Company pursuant to the Share Option Scheme.

DIRECTORS' SERVICE CONTRACTS

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

DIRECTORS' INTERESTS IN CONTRACTS

Save as disclosed in this annual report and in connection with the group reorganisation effected in preparation for the listing of the shares on the Stock Exchange, no contracts of significance in relation to the Group's business in which the Company or its subsidiaries, its controlling shareholder or any of its subsidiaries and any Director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

REMUNERATION OF THE FIVE HIGHEST PAID DIRECTORS/EMPLOYEES

Details of remuneration of the Directors made in accordance with specific basis during the year under review are set out in Note 9 to the financial statements.

Details of remuneration of the five highest paid individuals during the year under review are set out in Note 10 to the financial statements.

RETIREMENT BENEFIT SCHEME

Details of the Group's Retirement Benefit Scheme are set out in Note 29 to the financial statements.

REPORT OF THE DIRECTORS

DIRECTORS AND SENIOR MANAGEMENT'S BIOGRAPHIES

Details of the Directors and Senior Management's biographies are set out on pages 29 to 31 of this annual report.

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

As at 31 December, 2005, the interests or short positions of each of the Directors and chief executives in the shares, underlying shares and debentures of the Company or its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) ("SFO")) which were required pursuant to Section 352 of the SFO to be entered in the register required to be kept by the Company; or were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provision of the SFO); and were required pursuant to the Model Code for Securities Transactions by Directors of Listed Companies to be notified to the Company and the Stock Exchange were as follows:

Name of Director	Nature of Interest	Number of Shares	Percentage of issued share capital of the Company
Mr. Zhang Yuping (alia, Cheung Yu Ping) ("Mr. Zhang")	Controlled Corporation *(Note 1)*	726,300,000(L)	70%
Mr. Song Jianwen	Controlled Corporation *(Note 2)*	11,850,000(L)	1.142%

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

Note 1: Mr. Zhang Yuiping owned 51.5% of the issued share capital of Best Growth International Limited ("Best Growth"), which in turn owned 70% of the issued capital of the Company.

Note 2: Mr. Song Jianwen owned the entire share capital of Artnew Developments Limited, which in turn owned 1.142% of the issued share capital of the Company.

REPORT OF THE DIRECTORS

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

As at 31 December 2005, the interests or short positions of the persons, other than a Director or chief executive of the Company, in the shares or underlying shares or debentures of the Company which were recorded in the register required to be kept by the Company pursuant to Section 336 of the SFO were as follows:

Name	Number of Shares	Percentage of issued share capital of the Company
Best Growth *(Note 1)*	726,300,000(L)	70%
Mr. Zhang Yuping *(Note 1)*	726,300,000(L)	70%
The Swatch Group Hong Kong Limited *(Note 2)*	65,000,000(L)	6.27%
Hayek Nicolas Georges *(Note 2)*	65,000,000(L)	6.27%

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

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

Mr. Zhang Yuping	51.5%
Ms. Zhang Yuhong, younger sister of Mr. Zhang	14.7%
Mr. Jiang Xuebin, younger brother-in-law of Mr. Zhang	13.6%
Mr. Zhang Yuwen, younger brother of Mr. Zhang	2.4%
Ms. Zhang Qiuling, cousin of Mr. Zhang	1.4%
Ms. Zhang Huiling, younger sister of Mr. Zhang	5.2%
Ms. Xiao Meirong, mother of Mr. Zhang	9.6%
Ms. Xiao Xiaohong, cousin of Mr. Zhang	1.0%
Ms. Jiang Xueping, younger sister of Mr. Jiang Xuebin	

Note 2: The Swatch Group Hong Kong Limited increased its shareholding on 13 January 2006. These 65,000,000 Shares are held in the name of and registered in the capacity of a beneficial owner, The Swatch Group Hong Kong Limited (the entire issued share capital of The Swatch Group Hong Kong Limited is beneficially owned by The Swatch Group Limited, a 36.29% interest of which is in turn beneficially owned by Mr. Hayek Nicolas Georges). Pursuant to the Securities and Futures Ordinance, both of The Swatch Group Limited and Mr. Hayek Nicolas Georges were deemed to be interested in all the shares held by The Swatch Group Hong Kong Limited.

ARRANGEMENT TO PURCHASE SHARES OR DEBENTURES

Save as disclosed under the section headed "Share Options" above, at no time during the 12 months ended 31 December 2005 was the Company, its holding company or its subsidiaries a party to any arrangements which enabled the Directors (including their spouses or children under 18 years of age), to acquire benefits by means of acquisition of Shares in or debenture of the Company or any other body corporate.

REPORT OF THE DIRECTORS

MANAGEMENT CONTRACTS

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

MAJOR CUSTOMERS AND SUPPLIERS

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

Purchases	
– the largest supplier	31%
– five largest suppliers combined	75%
Sales	
– the largest customer	10%
– five largest customers combined	23%

None of the Directors, their associates or any shareholder (which to the knowledge of the directors owns more than 5% of the Company's share capital) had an interest in the major suppliers or customers noted above.

CONNECTED TRANSACTIONS

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

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

Pursuant to a lease agreement dated 18 September 2002 as amended and supplemented by a supplemental agreement dated 25 August 2005 (the "Lease"), Beijing Hengdeli, a subsidiary of the Company, has been leasing a retail shop with a gross floor area of approximately 519 sq.m. situated at No. 271-273, Wangfujing Street, Dongcheng District, Beijing City from 北京市鐘錶眼鏡公司 (Beijing Timepieces and Glasses Company) ("Beijing Timepieces") for a term commencing from 1 January 2002 to 31 December 2007 at a monthly rent of RMB150,000 (approximately HK$144,200), representing an annual rent of RMB1,800,000 (approximately HK$1,730,800).

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

REPORT OF THE DIRECTORS

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

It is expected that the applicable percentage ratios as defined in Rule 14A.10 of the Listing Rules and calculated with reference to the annual rent payable by Beijing Hengdeli to Beijing Timepieces under the Lease each year will exceed 0.1% but less than 2.5%. As such, the Lease will constitute a continuing connected transaction subject to the annual review requirements, the reporting requirements and the announcement requirements under Rules 14A.37 to 14A.41, Rules 14A.45 to 14A.46 and Rule 14A.47 of the Listing Rules but exempt from the independent shareholders' approval requirement.

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

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

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

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

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

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

The related party transactions disclosed in the Note 33 to the financial statements.

REPORT OF THE DIRECTORS

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

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

Mr. Zhang Yuping holds a 53% interest in the issued share capital of Wai Lung, through Eastwealth International Limited, a company wholly owned by Mr. Zhang Yuping. Accordingly, Wai Lung is a connected person of the Company. The transaction contemplated under the Tenancy Agreement will constitute a continuing connected transaction under Chapter 14A of the Listing Rules upon the listing of the Shares on the Stock Exchange. However, since each of the applicable percentage ratios as defined in Rule 14A.10 of the Listing Rules and calculated with reference to the annual rent payable under the Tenancy Agreement is less than 0.1%, the transaction is exempted from the reporting, announcement and independent shareholders' approval requirements pursuant to Rule 14A.33(3)(a) of the Listing Rules.

PUBLIC FLOAT

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

AUDITORS

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

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

On behalf of the Board
Zhang Yuping
Chairman

Hong Kong, 12 April 2006

DIRECTORS AND SENIOR MANAGEMENT'S BIOGRAPHIES

DIRECTORS

Executive Directors

Mr. Zhang Yuping (alia, Cheung Yu Ping) (張瑜平), aged 45, is the chairman and chief executive officer of the Company and the founder of the Group. He founded the Group in September 2001. He is in charge of the Group's overall management and strategic development. He has more than 20 years of experience in the watch distribution industry for the PRC market.

Mr. Song Jianwen (宋建文), aged 53, is an executive Director. He is in charge of finance and investments of the Group. Mr. Song graduated from Zhongnan Finance Economics University（中南財經政法大學）with a master's degree in economics. Mr. Song has over 10 years of experience in finance and accounting.

Mr. Huang Yonghua (黃永華), aged 35, is an executive Director. He is in charge of the Group's brand management. He has more than 10 years of experience in the watch distribution industry and management for the PRC market.

Non-executive Directors

Mr. Chen Sheng (陳聖), aged 41, is a non-executive Director. Mr. Chen graduated from Fudan University with a master degree in business administration. Mr. Chen is currently the chairman and the general manager of Shanghai Yi Min Department Stores Company Limited（上海益民百貨股份有限公司）, a listed company in the PRC.

Mr. Shen Zhiyuan (沈致遠), aged 63, is a non-executive Director. He graduated from Beijing Commerce College（北京商學院）. He was the general manager of Beijing Yi Shang Group. He is currently the vice-chairman of 中國商業企業協會 (Association of PRC Enterprises) and a standing committee member of Chinese People 's Political Consultative Conference Beijing Committee（中國人民政治協商會議北京市第十屆委員會）.

Mr. Shi Zhongyang (史仲陽), aged 31, is a non-executive Director. Mr. Shi graduated from Nanjing University in China and University of Goetting in Germany with master degree in law. Mr. Shi joined the Swatch Group Limited in 2000. He is currently a legal counsel of the legal department of The Swatch Group Limited.

DIRECTORS AND SENIOR MANAGEMENT'S BIOGRAPHIES

Independent Non-executive Directors

Mr. Liu Huangsong (劉熀松), aged 38, is an independent non-executive Director. He graduated from Fudan University with a doctorate degree in economics. He is a supervisor of Centre of Economic Environment Research and Forecast, Shanghai Social Science Academy(上海社會科學院經濟景氣研究預測中心).

Mr. Cai Jianmin (蔡建民), aged 62, is an independent non-executive Director. He graduated from Shanghai Finance College(上海財經學院)in (industrial accounting faculty) 工業會計系. Mr. Cai holds a certificate for professional accountants(會計從業資格證書) in the PRC. He holds senior financial posts for several companies including Shanghai Hualian (Group)(上海華聯(集團)).

Mr. Wong Kam Fai, William (黃錦輝), aged 46, is an independent non-executive Director. He graduated from University of Edinburgh, Scotland with a bachelor's degree and a doctorate degree in electrical engineering. Mr. Wong is a professor in the Department of Systems Engineering and Engineering Management in the Chinese University of Hong Kong. He obtained the qualification as a Chartered Engineer (CEng) since 1991, and is now a member of the Institute of Electrical Engineers, a professional member of the Association of Computing Machinery.

SENIOR MANAGEMENT

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

Ms. Li Ting (李婷), aged 38, is the vice-president of Shanghai Xinyu and is responsible for human resources administration, logistics and information system. Ms. Li finished her studies in Auckland University of Technology.

Ms. Tan Li (談麗), aged 41, is the assistant to the Chairman of the Company and the secretary to the board of Shanghai Xinyu. Ms. Tan graduated from Nanjing Normal University (南京師範大學) with a master's degree in Chinese literature.

Ms. Wang Xihao (王希浩), aged 50, is the financial controller of Shanghai Xinyu. Ms. Wang holds a certificate for professional accountants (會計從業資格證書)in the PRC.

Mr. Chen Hua (陳華), aged 50, is the director of Shanghai Xinyu. Before joining the Group, Mr. Chen worked in a number of companies which are engaged in watch operations including Guangzhou Haizhu District Watches Processing Factory(廣州市海珠區手錶裝配廠).

Ms. Wang Lingfei (王玲飛), aged 56, is the director of Shanghai Xinyu. Before joining the Group, Ms. Wang was the deputy general manager of Beijing Yishang Group(北京一商集團).

DIRECTORS AND SENIOR MANAGEMENT'S BIOGRAPHIES

Mr. Zhang Xingen (張新根), aged 61, is the director and the vice president, retail operation of Shanghai Xinyu, as well as the retail controller. Before joining the Group in 1999, Mr. Zhang was the general manager of Shanghai Watch Shop and a director of Yi Min Department Store.

Mr. Zhuang Liming (庄立明), aged 52, is the director of Shanghai Xinyu. Mr. Zhuang graduated in Beijing Foreign Trade College(北京外貿學院). Before joining Shanghai Xinyu, Mr. Zhuang had worked for PRC Light Industry Commodities Import and Export Company(中國輕工業品進出口總公司).

Mr. Guan Qijun (管齊軍), aged 35, is the vice retail controller of Shanghai Xinyu. Mr. Guan graduated from (Harbin Industry University) (哈爾濱工業大學) with a bachelor's degree in electro-mechanics(電子精密機械).

Mr. Mao Jiangang (毛劍剛), aged 34, is the vice brand controller of Shanghai Xinyu. Mr. Mao graduated from Shanghai University (上海大學) with a specialisation in applied computing(計算機應用).

Mr. Ng Man Wai, Peter (吳文偉), aged 35, is the company secretary to the Company, qualified accountant and financial controller of the Group. Mr. Ng graduated from the University of Toronto with a bachelor's degree in commerce. Mr. Ng is a member of the Association of Chartered Certified Accountants and a certified public accountant of the Hong Kong Institute of Certified Public Accountants.

Mr. Erich Steiner, aged 68, is the adviser to the chairman of the Group and is responsible for planning and improving the retail business. Mr. Steiner receives from Stadtisches Gymnasiums in Bern a diploma which entitles him to join commercial companies and the government of administration. Mr Steiner worked in International Watch Co. and Schlup & Co. Ltd. Rado Watches.

Mr. Tan Yongde (談永德), aged 63, is the adviser to the chairman of the Group. Mr. Tan completed the undergraduate course in economic management profession(經濟管理專業).

Mr. Xie Li (謝力), aged 38, is the vice financial controller of Shanghai Xinyu. Mr. Xie graduated from Wuhan University (武漢大學) with a bachelor's degree in economics.

COMPANY SECRETARY AND QUALIFIED ACCOUNTANT

Mr. Ng Man Wai, Peter (吳文偉), aged 35, is the company secretary, qualified accountant and financial controller of the Group. Mr. Ng graduated from the University of Toronto with a bachelor's degree in commerce. Mr. Ng is a member of the Association of Chartered Certified Accountants and a certified public accountant of the Hong Kong Institute of Certified Public Accountants.

AUDITORS' REPORT

KPMG

To the shareholders of
XINYU HENGDELI HOLDINGS LIMITED
(incorporated in Cayman Islands with limited liability)

We have audited the financial statements on pages 33 to 85 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Hong Kong Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements 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.

Basis of opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2005 and of the Group's profit and cash flows for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

KPMG
Certified Public Accountants
Hong Kong, 12 April 2006

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000
Sales	4	**1,396,531**	1,518,582
Cost of sales		**(1,032,369)**	(1,210,448)
Gross profit		**364,162**	308,134
Other revenue and net income	5	**18,428**	10,114
Distribution costs		**(96,645)**	(90,757)
Administrative expenses		**(62,994)**	(48,476)
Other operating expenses	6	**(2,748)**	(2,637)
Profit from operations		**220,203**	176,378
Finance costs	7(i)	**(23,353)**	(17,614)
Share of losses of a jointly controlled entity		**(187)**	–
Profit before taxation		**196,663**	158,764
Income tax	8(i)	**(64,886)**	(52,881)
Profit for the year		**131,777**	105,883
Attributable to:			
Equity shareholders of the Company		**121,011**	97,545
Minority interests		**10,766**	8,338
Profit for the year		**131,777**	105,883
Dividend attributable to the previous financial year, approved during the year	12(b)	**92,150**	32,598
Dividend declared after the balance sheet date	12(a)	**49,800**	92,150
Basic earnings per share	13	**RMB0.15**	RMB0.13

The notes on pages 40 to 85 form part of these financial statements.

CONSOLIDATED BALANCE SHEET

At 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000
Non-current assets			
Property, plant and equipment	*15*	**96,208**	97,319
Intangible assets	*16*	**33,109**	17,000
Interest in an associate	*18*	**–**	960
Interest in a jointly controlled entity	*19*	**4,813**	–
Other investments	*20*	**250**	250
Deferred tax assets	*30(ii)*	**17,553**	10,620
		151,933	126,149
Current assets			
Trading securities	*21*	**42,792**	–
Inventories	*22*	**662,142**	447,016
Trade and other receivables	*23*	**214,110**	212,984
Pledged bank deposits	*24*	**130,025**	–
Cash and cash equivalents	*25*	**142,502**	78,180
		1,191,571	738,180
Current liabilities			
Trade and other payables	*26*	**185,376**	72,928
Bank loans	*27*	**314,000**	398,198
Current taxation	*30(i)*	**49,412**	26,861
		548,788	497,987
Net current assets		**642,783**	240,193
Total assets less current liabilities		**794,716**	366,342
Non-current liabilities			
Other payables	*28*	**565**	2,261
NET ASSETS		**794,151**	364,081

The notes on pages 40 to 85 form part of these financial statements.

CONSOLIDATED BALANCE SHEET *(continued)*

At 31 December 2005

	Notes	**2005** **RMB'000**	2004 RMB'000
CAPITAL AND RESERVES	*31*		
Share capital		**10,828**	–
Reserves		**683,812**	285,508
Total equity attributable to equity shareholders of the Company		**694,640**	285,508
Minority interests		**99,511**	78,573
TOTAL EQUITY		**794,151**	364,081

Approved and authorised for issue by the board of directors on 12 April 2006.

Zhang Yuping
Executive Director

Song Jianwen
Executive Director

The notes on pages 40 to 85 form part of these financial statements.

BALANCE SHEET

At 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000
Non-current assets			
Investments in subsidiaries	17	**199,352**	–
Current assets			
Trade and other receivables	23	**240,261**	–
Pledged bank deposits	24	**125,829**	–
Cash and cash equivalents	25	**4,980**	–
		371,070	–
Current liabilities			
Trade and other payables	26	**7,714**	–
		7,714	–
Net current assets		**363,356**	–
NET ASSETS		**562,708**	–
CAPITAL AND RESERVES	31		
Share capital		**10,828**	–
Reserves		**551,880**	–
TOTAL EQUITY		**562,708**	–

Approved and authorised for issue by the board of directors on 12 April 2006.

Zhang Yuping
Executive Director

Song Jianwen
Executive Director

The notes on pages 40 to 85 form part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000
Equity attributable to equity shareholders of the Company:			
Balance at 1 January		**285,508**	220,561
Issuance of new shares	*31(c)(ii)*	**199,352**	–
Shares issued under the Offering and Placement	*31(c)(iv)*	**344,090**	–
Shares issued under the over-allotment option related to the Placement	*31(c)(v)*	**51,614**	–
Share issuance expenses		**(31,451)**	–
Capital elimination on combination	*31(d)(ii)*	**(183,334)**	–
Profit for the year		**121,011**	97,545
Dividend declared	*12(b)*	**(92,150)**	(32,598)
Balance at 31 December		**694,640**	285,508
Minority interests:			
Balance at 1 January		**78,573**	99,222
Capital contribution from minority shareholders		**14,850**	–
Acquisition of subsidiaries		**172**	–
Acquisition of additional interests in subsidiaries from minority shareholders		**–**	(22,018)
Share of profit for the year		**10,766**	8,338
Dividend declared		**(4,850)**	(6,969)
Balance at 31 December		**99,511**	78,573
Total equity:	*31*	**794,151**	364,081

The notes on pages 40 to 85 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2005

	2005 RMB'000	2004 RMB'000
Operating activities		
Profit before taxation	**196,663**	158,764
Adjustments for:		
Depreciation	**12,024**	12,356
Amortisation of intangible assets	**120**	21,448
Interest income	**(3,351)**	(655)
Finance costs	**23,353**	17,614
Share of losses of jointly controlled entity	**187**	–
Loss on disposal of property, plant and equipment	**39**	53
Changes in fair value on trading securities	**(887)**	–
Operating profit before changes in working capital	**228,148**	209,580
Increase in inventories	**(214,025)**	(122,503)
Increase in trade and other receivables	**(970)**	(29,286)
Increase/(decrease) in trade and other payables and non-current payables	**134,413**	(33,619)
Cash generated from operations	**147,566**	24,172
PRC income tax paid	**(49,365)**	(47,495)
Net cash generated from/(used in) operating activities	**98,201**	(23,323)

The notes on pages 40 to 85 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT *(continued)*

For the year ended 31 December 2005

	2005 RMB'000	2004 RMB'000
Investing activities		
Payment for purchase of property, plant and equipment	**(12,688)**	(45,084)
Payment for purchase of intangible assets	**(23,083)**	(34,162)
Proceeds from disposal of property, plant and equipment	**74**	639
Cash acquired for acquisition of subsidiaries, net of cash paid	**965**	–
Acquisition of additional interests in subsidiaries from minority shareholders	**–**	(6,000)
Interest income received	**3,351**	655
Payment for addition in interests in associates	**–**	(960)
Payment for addition in a jointly controlled entity	**(5,000)**	–
Increase in pledged bank deposits	**(130,025)**	–
Payment for purchase of trading securities	**(41,905)**	–
Net cash used in investing activities	**(208,311)**	(84,912)
Financing activities		
Net proceeds from shares issued under the Offering and Placement and the over-allotment option related to the Placement	**364,253**	–
Capital contribution from minority shareholders	**14,850**	–
Proceeds from bank loans	**612,000**	681,198
Repayment of bank loans	**(696,198)**	(483,500)
Repayment of other loans	**–**	(38,000)
Finance costs paid	**(23,473)**	(17,576)
Dividend paid to shareholders	**(92,150)**	(32,598)
Dividend paid to minority shareholders	**(4,850)**	(6,969)
Net cash generated from financing activities	**174,432**	102,555
Net increase/(decrease) in cash and cash equivalents	**64,322**	(5,680)
Cash and cash equivalents at 1 January	**78,180**	83,860
Cash and cash equivalents at 31 December	**142,502**	78,180

The notes on pages 40 to 85 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. REORGANISATION

Xinyu Hengdeli Holdings Limited ("the Company") was incorporated in the Cayman Islands as an exempted company with limited liability on 9 July 2004 under the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. Pursuant to a reorganisation (the "Reorganisation") of the Company and its subsidiaries (collectively referred to as the "Group") to rationalise the group structure in preparation for the public listing of the Company's shares on the Main Board of the Stock Exchange of Hong Kong Limited (the "Stock Exchange"), the Company became the holding company of the subsidiaries now comprising the Group. The shares of the Company have been listed on the Stock Exchange since 26 September 2005.

Details of the Reorganisation are set out in the prospectus dated 14 September 2005 issued by the Company and details of the subsidiaries acquired pursuant to the Reorganisation are set out in note 17 to the financial statements.

2. BASIS OF PREPARATION

The Group is regarded as a continuing entity resulting from the Reorganisation and has been accounted for on the basis of merger accounting. The consolidated financial statements have been prepared on the basis that the Company was the holding company of the Group for both years presented, rather than from the date when the Company became the holding company of the Group pursuant to the Reorganisation. Accordingly, the consolidated results of the Group for the years ended 31 December 2004 and 2005 include the results of the Company and its subsidiaries with effect from 1 January 2004 or since their respective dates of incorporation, whichever is a shorter period as if the current group structure had been in existence throughout the two years presented. The consolidated balance sheet at 31 December 2004 has been prepared on the basis that the current group structure was in place with effective from 1 January 2004. All material intra-group transactions and balances have been eliminated on combination.

In the opinion of the directors, the consolidated financial statements prepared on this basis present fairly the results of operations and the state of affairs of the Group as a whole.

3. SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

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

NOTES TO THE FINANCIAL STATEMENTS

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(a) Statement of compliance *(Continued)*

The HKICPA has issued a number of new and revised HKFRSs that are effective or available for early adoption for accounting periods beginning on or after 1 January 2005. The following new and revised HKFRSs, which are applicable to the Group, have been early adopted as at 1 January 2002, which is the earliest date for the preparation of the financial information in relation to the listing of the Company's shares:

- HKFRS 1 First-time adoption of Hong Kong Financial Reporting Standards
- HKFRS 3 Business combinations
- HKFRS 5 Non-current assets held for sale and discontinued operations
- HKAS 1 Presentation of financial statements
- HKAS 2 Inventories
- HKAS 7 Cash flow statements
- HKAS 8 Accounting policies, changes in accounting estimates and errors
- HKAS 10 Events after the balance sheet date
- HKAS 12 Income taxes
- HKAS 14 Segment reporting
- HKAS 16 Property, plant and equipment
- HKAS 17 Leases
- HKAS 18 Revenue
- HKAS 19 Employee benefits
- HKAS 20 Accounting for government grants and disclosure of government assistance
- HKAS 21 The effects of changes in foreign exchange rates
- HKAS 23 Borrowing costs
- HKAS 24 Related party disclosures
- HKAS 26 Accounting and reporting by retirement benefit plans
- HKAS 27 Consolidated and separate financial statements
- HKAS 28 Investments in associates
- HKAS 32 Financial instruments: Disclosure and presentation
- HKAS 33 Earnings per share
- HKAS 36 Impairment of assets
- HKAS 37 Provisions, contingent liabilities and contingent assets
- HKAS 38 Intangible assets
- HKAS 39 Financial instruments: Recognition and measurement

NOTES TO THE FINANCIAL STATEMENTS

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(b) Basis of preparation of the financial statements

The consolidated financial statements for the year ended 31 December 2005 comprise the Company and its subsidiaries and the Group's interest in associates and jointly controlled entities.

The measurement basis used in the preparation of the financial statements is the historical cost basis, except for trading securities, which are stated at fair value as explained in the accounting policies 3(e).

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

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

(c) Subsidiaries and controlled entities

A subsidiary is a company in which the Group, directly or indirectly, holds more than half of the issued share capital or controls more than half the voting power or controls the composition of the board of directors. Subsidiaries are considered to be controlled if the Company has the power, directly or indirectly, to govern the financial and operating policies, so as to obtain benefits from their activities.

An investment in a controlled subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases.

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

Minority interests at the balance sheet date, being the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the Company, whether directly or indirectly through subsidiaries, are presented in the consolidated balance sheet and statement of changes in equity within equity, separately from equity attributable to the equity shareholders of the Company. Minority interests in the results of the Group are presented on the face of the consolidated income statement as an allocation of the total profit or loss for the year between minority interests and the equity shareholders of the Company.

NOTES TO THE FINANCIAL STATEMENTS

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(c) Subsidiaries and controlled entities *(Continued)*

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

In the Company's balance sheet, an investment in a subsidiary is stated at cost less impairment losses (see note 3(i)).

(d) Associates and jointly controlled entities

An associate is an entity in which the Group or Company has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

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

An investment in an associate or a jointly controlled entity is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the associate's or the jointly controlled entity's net assets. The consolidated income statement includes the Group's share of the post-acquisition, post-tax results of the associates and jointly controlled entities for the year.

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

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

NOTES TO THE FINANCIAL STATEMENTS

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(e) Other investments in debt and equity securities

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

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

Investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are recognised in the balance sheet at cost less impairment losses (see note 3(i)).

Other investments in securities are classified as available-for-sale securities and are initially recognised at fair value plus transaction costs. At each balance sheet date the fair value is remeasured, with any resultant gain or loss being recognised directly in equity, except for impairment losses (see note 3(i)) and, in the case of monetary items such as debt securities, foreign exchange gains and losses which are recognised directly in profit or loss. Where these investments are interest-bearing, interest calculated using the effective interest method is recognised in profit or loss. When these investments are derecognised, the cumulative gain or loss previously recognised directly in equity is recognised in profit or loss.

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

(f) Property, plant and equipment

Property, plant and equipment are stated in the balance sheet at cost less accumulated depreciation and impairment losses (see note 3(i)).

The cost of self-constructed items of property, plant and equipment includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and an appropriate proportion of production overheads and borrowing costs (see note 3(t)).

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

NOTES TO THE FINANCIAL STATEMENTS

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(f) Property, plant and equipment *(Continued)*

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

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

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

(g) Intangible assets (other than goodwill)

The intangible assets that are acquired by the Group are stated in the balance sheet at cost less accumulated amortisation (where the estimated useful life is other than indefinite) and impairment losses (see note 3(i)). Expenditure on internally generated goodwill and brands is recognised as an expense in the period in which it is incurred.

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

– Preferential purchase arrangement	2 years
– EDOX agency rights	10 years

Both the period and method of amortisation and any conclusion that the useful life of an intangible asset is indefinite are reviewed annually.

(h) Operating lease charges

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

NOTES TO THE FINANCIAL STATEMENTS

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(i) Impairment of assets

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

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

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

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(i) Impairment of assets *(Continued)*

ii) Impairment of other assets

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

– property, plant and equipment;

– intangible assets; and

– investments in subsidiaries, associates and joint venture;

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

– Calculation of recoverable amount

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

– Recognition of impairment losses

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

NOTES TO THE FINANCIAL STATEMENTS

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(i) Impairment of assets *(Continued)*

ii) Impairment of other assets (Continued)

– Reversals of impairment losses

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

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

(j) Inventories

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

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

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

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

(k) Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less impairment losses for bad and doubtful debts (see note 3(i)).

(l) Interest-bearing borrowings

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

(m) Trade and other payables

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

NOTES TO THE FINANCIAL STATEMENTS

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(n) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and other financial institutions, cash on hand and demand deposits with banks.

(o) Employee benefits

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

(p) Income tax

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(p) Income tax *(Continued)*

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(p) Income tax *(Continued)*

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

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

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

  - the same taxable entity; or

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

(q) Provisions and contingent liabilities

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

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

NOTES TO THE FINANCIAL STATEMENTS

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(r) Revenue recognition

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

i) Sale of goods

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

ii) Dividends

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

iii) Interest income

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

iv) Government grants

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

(s) Translation of foreign currencies

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

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

The results of foreign operations are translated into Renminbi ("RMB") at the exchange rates approximating the foreign exchange rates ruling at the dates of the transactions. Balance sheet items are translated into RMB at the foreign exchange rates ruling at the balance sheet date. The resulting exchange differences are recognised directly in a separate component of equity.

On disposal of a foreign operation, the cumulative amount of the exchange differences recognised in equity which relate to that foreign operation is included in the calculation of the profit or loss on disposal.

NOTES TO THE FINANCIAL STATEMENTS

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(t) Borrowing costs

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

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

(u) Related parties

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

(v) Segment reporting

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

In accordance with the Group's internal financial reporting system, the Group has chosen business segment information as the reporting format for the purposes of these financial statements. No geographical segment information is separately presented as the Group's business segments are mainly managed and operated in the PRC. The major market of the Group's business segment is the PRC.

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

NOTES TO THE FINANCIAL STATEMENTS

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(v) Segment reporting *(Continued)*

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

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

4. SALES

The principal activities of the Group are retail and wholesale of watches. Sales mainly represent income arising from the sales of watches net of value added tax.

5. OTHER REVENUE AND NET INCOME

	2005 RMB'000	2004 RMB'000
Interest income	**3,351**	655
Government grants	**8,750**	9,459
Investment income	**4,400**	–
Changes in fair value on trading securities	**887**	–
Others	**1,040**	–
	18,428	10,114

Shanghai Xinyu Watch & Clock Group, Ltd. ("Shanghai Xinyu") received unconditional grants totalling RMB8,159 thousands and RMB8,750 thousands for the years ended 31 December 2004 and 2005, respectively, from the local government in Shanghai, in supporting of Shanghai Xinyu's development.

北京市亨得利瑞士鐘錶有限責任公司 ("Beijing Hengdeli") received an unconditional grant of RMB1,300 thousands in 2004 from the local government in Beijing to subsidise Beijing Hengdeli's interest expense.

6. OTHER OPERATING EXPENSES

	2005 RMB'000	2004 RMB'000
Write-down of inventories	**1,811**	1,805
Impairment losses for doubtful accounts	**898**	779
Loss on disposal of property, plant and equipment	**39**	53
	2,748	2,637

NOTES TO THE FINANCIAL STATEMENTS

7. PROFIT BEFORE TAXATION

Profit before taxation is arrived at after charging/(crediting):

i) Finance costs

	2005 RMB'000	2004 RMB'000
Interest expense on bank loans and other borrowings	**21,004**	15,793
Bank charges	**2,349**	1,821
	23,353	17,614

ii) Staff costs

	2005 RMB'000	2004 RMB'000
Wages, salaries and other benefits	**41,471**	28,584
Contributions to defined contribution plan	**3,591**	3,102
	45,062	31,686

iii) Other items

	2005 RMB'000	2004 RMB'000
Cost of inventories#	**1,034,060**	1,190,805
Auditors' remuneration – audit services	**1,500**	200
Depreciation	**12,024**	12,356
Net foreign exchange (gain)/loss	**(744)**	17
Amortisation of intangible assets	**120**	21,448
Operating leases charges in respect of properties		
– minimum lease payments	**13,256**	15,954
– contingent rents	**35,726**	30,348

\# *Cost of inventories includes RMB 1,811 thousands (2004: RMB1,805 thousands), relating to write-down of inventories for the year ended 31 December 2005, which amount is also disclosed separately in note 6.*

NOTES TO THE FINANCIAL STATEMENTS

8. INCOME TAX IN THE CONSOLIDATED INCOME STATEMENT

(i) Taxation in the consolidated income statement represents:

	2005 **RMB'000**	2004 RMB'000
Current tax		
Provision for Hong Kong profits tax for the year	**84**	–
Provision for PRC income tax for the year	**71,351**	61,079
Under-provision in respect of prior years	**384**	–
Deferred tax		
Origination and reversal of temporary differences	**(6,933)**	(8,198)
	64,886	52,881

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

The provision for PRC income tax is based on a statutory rate of 33% of the assessable profits of subsidiaries in the PRC as determined in accordance with the relevant income tax rules and regulations of the PRC during the year.

No provision for Hong Kong profits tax has been made during the year ended 31 December 2004 as those subsidiaries did not earn any assessable income for Hong Kong profits tax purposes. Provision for Hong Kong profits tax during the year ended 31 December 2005 is calculated at 17.5% of the estimated assessable profits of subsidiaries in Hong Kong.

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

	2005 **RMB'000**	2004 RMB'000
Profit before tax	**196,663**	158,764
Computed tax using the Group's PRC applicable tax rate	**64,899**	52,392
Non-taxable income	**(1,452)**	–
Non-deductible expenses	**1,125**	489
Rate differential on subsidiaries	**(70)**	–
Under-provision in respect of prior years	**384**	–
	64,886	52,881

NOTES TO THE FINANCIAL STATEMENTS

9. DIRECTORS' REMUNERATION

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

	Fee RMB'000	Basic salaries, allowances and other benefits RMB'000	Contributions to retirement benefit plans RMB'000	Bonus RMB'000	Total RMB'000
Year ended 31 December 2004					
Executive Directors					
Mr. Zhang Yuping	–	240	–	–	240
Mr. Song Jianwen	–	120	29	–	149
Mr. Huang Yonghua	–	96	–	–	96
Non-executive Directors					
Mr. Li Jialin	–	–	–	–	–
Mr. Chen Sheng	–	–	–	–	–
Mr. Shen Zhiyuan	–	–	–	–	–
Independent non-executive Directors					
Mr. Liu Huangsong	–	–	–	–	–
Mr. Cai Jianmin	–	–	–	–	–
Mr. Wong Kam Fai	–	–	–	–	–
Total	–	456	29	–	485

NOTES TO THE FINANCIAL STATEMENTS

9. DIRECTORS' REMUNERATION *(Continued)*

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

Save as disclosed above, no directors' remuneration has been paid or is payable by the Group during the two years ended 31 December 2004 and 2005. There was no arrangement under which a director waived or agreed to waive any remuneration during the two years ended 31 December 2004 and 2005.

10. INDIVIDUALS WITH HIGHEST EMOLUMENTS

The five highest paid individuals of the Group during the year ended 31 December 2005 include 2 (2004: 3) directors of the Company, whose remuneration are reflected in note 9. Details of remuneration paid to the remaining highest paid individuals of the Group are as follow:

	2005 RMB'000	2004 RMB'000
Basic salaries, allowances and other benefits	**1,569**	204
Contributions to retirement benefit plans	**25**	29
Bonus	**–**	–
	1,594	233

The above individuals' emoluments are within the band of Nil to RMB1,000,000.

During the two years ended 31 December 2004 and 2005, no emoluments were paid by the Group to the directors or any of the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office.

NOTES TO THE FINANCIAL STATEMENTS

11. PROFIT ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY

The consolidated profit attributable to equity shareholders of the Company includes a loss of RMB897 thousands (2004: nil) which has been dealt with in the financial statements of the Company.

12. DIVIDENDS

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

	2005 **RMB'000**	2004 RMB'000
Final dividend proposed after the balance sheet date (2005: RMB0.048 per share)	**49,800**	92,150

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

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

	2005 **RMB'000**	2004 RMB'000
Final dividend in respect of the previous financial year, approved and paid during the year	**92,150**	32,598

Pursuant to the resolutions passed at the board of directors' meeting of the Company's subsidiary, Shanghai Xinyu, held on 23 February 2004 and 29 March 2005, dividends (excluding share of dividends to minority shareholders) of RMB32,598 thousands and RMB92,150 thousands respectively, were declared by Shanghai Xinyu to its then major shareholders. The final dividend per share in respect of the previous financial year, approved and paid in 2004 and 2005 and the number of shares ranking for dividend are not presented above as such information is not meaningful having regard to the consolidated financial statements.

13. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit attributable to equity shareholders of RMB 121,011 thousands (2004: RMB97,545 thousands) and the weighted average of 826,095,890 ordinary shares (2004: 750,000,000 ordinary shares after adjusting for the capitalisation issue in 2005) in issue during the year. The weighted average number of shares used to calculate the basic earnings per share for 2004 included 60,000,000 ordinary shares in issue as at the date of the prospectus of the Company and 690,000,000 ordinary shares pursuant to the capitalisation issue as detailed in the paragraph headed "Resolution in writing of the Shareholders of the Company passed on 27 August 2005" set out in Appendix V to the prospectus of the Company, as if the shares were outstanding on 1 January 2004.

There were no dilutive potential ordinary shares for the years ended 31 December 2004 and 2005 and, therefore, diluted earnings per share are not presented.

NOTES TO THE FINANCIAL STATEMENTS

14. SEGMENT INFORMATION

Segment information is presented in respect of the Group's business segments based on the Group's management and internal reporting structure.

Business segments

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

	2005 RMB'000	2004 RMB'000
Sales		
Retail	**636,725**	530,264
Wholesale	**745,059**	974,771
Unallocated	**14,747**	13,547
Total	**1,396,531**	1,518,582
Segment result		
Retail	**138,089**	95,704
Wholesale	**106,041**	110,198
Total	**244,130**	205,902
Unallocated operating income and expenses	**(23,927)**	(29,524)
Profit from operations	**220,203**	176,378
Finance costs	**(23,353)**	(17,614)
Share of losses of a jointly controlled entity	**(187)**	–
Income tax	**(64,886)**	(52,881)
Profit for the year	**131,777**	105,883

NOTES TO THE FINANCIAL STATEMENTS

14. SEGMENT INFORMATION *(Continued)*

	2005 RMB'000	2004 RMB'000
Segment assets		
Retail	**492,999**	358,472
Wholesale	**411,137**	272,324
Total	**904,136**	630,796
Unallocated assets	**439,368**	233,533
Total assets	**1,343,504**	864,329
Segment liabilities		
Retail	**72,321**	12,254
Wholesale	**54,322**	4,877
Total	**126,643**	17,131
Unallocated liabilities	**422,710**	483,117
Total liabilities	**549,353**	500,248
Capital expenditure		
Retail	**7,251**	2,579
Unallocated	**19,970**	57,929
Total	**27,221**	60,508
Depreciation and amortisation		
Retail	**3,192**	3,879
Unallocated	**8,952**	29,925
Total	**12,144**	33,804
Impairment losses for doubtful accounts		
Wholesale	**898**	779

NOTES TO THE FINANCIAL STATEMENTS

15. PROPERTY, PLANT AND EQUIPMENT

The Group

	Buildings	Leasehold improvements	Motor vehicles	Office equipment and other fixed assets	Construction in progress	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Cost:						
Balance at 1 January 2004	57,040	13,498	5,553	9,901	246	86,238
Additions	38,300	2,058	–	2,590	440	43,388
Transfer from construction in progress	–	–	–	401	(401)	–
Disposals	(600)	–	–	(438)	–	(1,038)
Balance at 31 December 2004	94,740	15,556	5,553	12,454	285	128,588
Additions	6,443	1,014	382	2,952	201	10,992
Additions from acquisition	–	–	–	248	–	248
Transfer from construction in progress	–	323	–	–	(323)	–
Disposals	–	(1,522)	–	(1,062)	–	(2,584)
Balance at 31 December 2005	**101,183**	**15,371**	**5,935**	**14,592**	**163**	**137,244**
Depreciation:						
Balance at 1 January 2004	(6,094)	(7,976)	(1,577)	(3,612)	–	(19,259)
Charge for the year	(6,303)	(3,191)	(632)	(2,230)	–	(12,356)
Written-back on disposals	12	–	–	334	–	346
Balance at 31 December 2004	(12,385)	(11,167)	(2,209)	(5,508)	–	(31,269)
Charge for the year	(5,521)	(3,006)	(713)	(2,784)	–	(12,024)
Addition from acquisition	–	–	–	(214)	–	(214)
Written-back on disposals	–	1,522	–	949	–	2,471
Balance at 31 December 2005	**(17,906)**	**(12,651)**	**(2,922)**	**(7,557)**	**–**	**(41,036)**
Net book value:						
At 31 December 2005	**83,277**	**2,720**	**3,013**	**7,035**	**163**	**96,208**
At 31 December 2004	82,355	4,389	3,344	6,946	285	97,319

NOTES TO THE FINANCIAL STATEMENTS

15. PROPERTY, PLANT AND EQUIPMENT *(Continued)*

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

ii) As at 31 December 2005, the Group was in the process of obtaining the property ownership certificates of an office building in Beijing, with the carrying amount of approximately RMB9,191 thousands.

iii) As at 31 December 2004 and 2005, an office building in Shanghai with the carrying amount of RMB 33,500 thousands and RMB30,195 thousands respectively was pledged to banks against certain loans (see *note 27*).

16. INTANGIBLE ASSETS

The Group

	Preferential purchase arrangement	**Trade marks**	**Edox agency rights**	**Total**
	RMB'000	RMB'000	RMB'000	RMB'000
Cost:				
At 1 January 2004	44,594	–	–	44,594
Additions	–	15,920	1,200	17,120
At 31 December 2004	44,594	15,920	1,200	61,714
Additions	–	16,229	–	16,229
At 31 December 2005	**44,594**	**32,149**	**1,200**	**77,943**
Amortisation:				
At 1 January 2004	(23,266)	–	–	(23,266)
Charge for the year	(21,328)	–	(120)	(21,448)
At 31 December 2004	(44,594)	–	(120)	(44,714)
Charge for the year	–	–	(120)	(120)
At 31 December 2005	**(44,594)**	**–**	**(240)**	**(44,834)**
Net book value:				
At 31 December 2005	**–**	**32,149**	**960**	**33,109**
At 31 December 2004	–	15,920	1,080	17,000

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

17. INVESTMENT IN SUBSIDIARIES

The Company

	2005	2004
	RMB'000	RMB'000
Unlisted shares, at cost	**199,352**	–

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

All of these are controlled subsidiaries as defined under note 3(c) and have been consolidated into the consolidated financial statements.

Name of company	**Place of incorporation and operation**	**Percentage of equity attributable to the Company**		**Issued and fully paid-up/ registered capital**	**Principal activities**
		Direct	**Indirect**		
		%	%		
Xinyu Hengdeli China Limited	British Virgin Islands	100%	–	US$2/US$50,000	Investment holding
Xinyu Hengdeli Investments Limited	British Virgin Islands	100%	–	US$1/US$50,000	Investment holding
Shanghai Xinyu	the PRC	–	95%	RMB180,000,000/ RMB180,000,000	Retail and wholesale of watches
Beijing Hengdeli	the PRC	–	52.25%	RMB156,800,000/ RMB156,800,000	Retail and wholesale of watches
哈爾濱北亨捷夫鐘表有限公司 ("Harbin Jiefu")	the PRC	–	84.31%	RMB12,000,000/ RMB12,000,000	Retail of watches
遼寧寶瑞行鐘表有限公司 ("Liaoning Bao Rui Hang")	the PRC	–	90.73%	RMB40,000,000/ RMB40,000,000	Retail of watches
深圳市亨得利陽光鐘表有限責任公司 ("Shenzhen Yangguang")	the PRC	–	56.53%	RMB15,000,000/ RMB15,000,000	Retail of watches
天津市惠昌鐘表眼鏡有限公司 ("Tianjin Huichang")	the PRC	–	31.35%	RMB5,000,000/ RMB5,000,000	Retail of watches

NOTES TO THE FINANCIAL STATEMENTS

17. INVESTMENT IN SUBSIDIARIES *(Continued)*

Name of company	Place of incorporation and operation	Percentage of equity attributable to the Company Direct %	Percentage of equity attributable to the Company Indirect %	Issued and fully paid-up/ registered capital	Principal activities
合肥新宇亨得利世界名表中心有限公司 ("Hefei Xinyu")	the PRC	–	85.50%	RMB860,000/ RMB860,000	Retail of watches
杭州亨得利鐘表有限公司 ("Hangzhou Hengdeli")	the PRC	–	84.67%	RMB800,000/ RMB800,000	Retail of watches
青島新宇亨得利鐘表眼鏡有限公司 ("Qingdao Xinyu")	the PRC	–	52.25%	RMB600,000/ RMB600,000	Retail of watches
Sunshine Peninsula Limited	Hong Kong	–	95%	HK$100/ HK$10,000	Wholesale of watches
Hengdeli International Company Limited	Hong Kong	–	100%	HK$1/ HK$10,000	Wholesale of watches
Nivada PRC Limited	Cook Islands	–	100%	US$100/ US$1,000	Trademark holding
Numa Jeannin SA	Switzerland	–	100%	CHF50,000/ CHF50,000	Trademark holding

Note:

All the subsidiaries incorporated in the PRC are domestic enterprises, except for Shanghai Xinyu, which is a sino-foreign equity joint venture.

NOTES TO THE FINANCIAL STATEMENTS

18. INTEREST IN AN ASSOCIATE

The Group

	2005 **RMB'000**	2004 RMB'000
Share of net assets	**–**	439
Goodwill (Cost over the share of net assets)	**–**	521
	–	960

As at 31 December 2004, interest in an associate represented a 40% equity interest in Hangzhou Hengdeli. On 31 December 2005, the Group acquired an additional 49.125% equity interest in Hangzhou Hengdeli. As a result, Hangzhou Hengdeli became a subsidiary of the Group. The particulars of Hangzhou Hengdeli are presented in note 17.

19. INTEREST IN A JOINTLY CONTROLLED ENTITY

The Group

	2005 **RMB'000**	2004 RMB'000
Share of net assets	**4,813**	–

The Group and an independent third party jointly set up 北京亨聯達鐘表有限責任公司 ("Beijing Henglianda") on 25 May 2005 which is incorporated in the PRC. The Group and the third party each hold 50% interest in Beijing Henglianda. The issued and paid up capital of Beijing Henglianda amount to RMB10,000,000 and its principal activity is retail of watches. The operating period of Beijing Henglianda expires on 24 May 2010.

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

	2005 **RMB'000**	2004 RMB'000
Non-current assets	**134**	–
Current assets	**5,251**	–
Current liabilities	**(572)**	–
Net assets	**4,813**	–
Income	**933**	–
Expenses	**(1,120)**	–
Loss for the period	**(187)**	–

NOTES TO THE FINANCIAL STATEMENTS

20. OTHER INVESTMENTS

The Group

	2005 RMB'000	2004 RMB'000
Unlisted investments	**250**	250

21. TRADING SECURITIES

The Group

	2005 RMB'000	2004 RMB'000
Trading securities, at market value		
Equity securities	**25,429**	–
Government bonds	**17,363**	–
	42,792	–

22. INVENTORIES

As at 31 December 2004 and 2005, all the Group's inventories were finished goods.

23. TRADE AND OTHER RECEIVABLES

The Group

	2005 RMB'000	2004 RMB'000
Trade receivables	**159,241**	147,462
Other receivables	**53,881**	25,174
Receivables due from related parties	**988**	40,348
	214,110	212,984

NOTES TO THE FINANCIAL STATEMENTS

23. TRADE AND OTHER RECEIVABLES *(Continued)*

The Company

	2005 **RMB'000**	2004 RMB'000
Other receivables	**228**	–
Receivables due from subsidiaries	**240,033**	–
	240,261	–

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

Customers are normally granted credit terms of 0 to 70 days depending on the credit worthiness of individual customers.

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

The Group

	2005 **RMB'000**	2004 RMB'000
Within 1 month	**121,719**	89,833
Over 1 month but less than 3 months	**30,589**	44,102
Over 3 months but less than 12 months	**6,933**	13,527
	159,241	147,462

24. PLEDGED BANK DEPOSITS

The Group and the Company

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

NOTES TO THE FINANCIAL STATEMENTS

25. CASH AND CASH EQUIVALENTS

The Group

As at 31 December 2004 and 2005, all the Group's cash and cash equivalents in the consolidated balance sheet and the consolidated cash flow statement represented cash at bank and other financial institutions and cash in hand.

The Company

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

26. TRADE AND OTHER PAYABLES

The Group

	2005 **RMB'000**	2004 RMB'000
Trade payables	**121,418**	16,126
Other payables and accrued expenses	**38,782**	10,284
Payables due to related parties	**25,176**	46,518
	185,376	72,928

The Company

	2005 **RMB'000**	2004 RMB'000
Other payables and accrued expenses	**271**	–
Payables due to subsidiaries	**7,443**	–
	7,714	–

NOTES TO THE FINANCIAL STATEMENTS

26. TRADE AND OTHER PAYABLES *(Continued)*

An ageing analysis of trade payables is as follows:

The Group

	2005	2004
	RMB'000	RMB'000
Within 1 month	**78,907**	14,558
Over 1 month but less than 3 months	**42,113**	850
Over 3 months but less than 12 months	**289**	16
Over 1 year	**109**	702
	121,418	16,126

27. BANK LOANS

The Group

	2005	2004
	RMB'000	RMB'000
Current bank loans		
– secured	**20,000**	35,000
– unsecured	**294,000**	363,198
	314,000	398,198

The current secured bank loans as at 31 December 2004 and 2005 were secured by the Group's buildings with the carrying amount of RMB33,500 thousands and RMB30,195 thousands respectively. The current secured bank loans as at 31 December 2005 carried interest rate at 5.58% (2004: 5.31%) per annum, and were all repayable within one year.

The current unsecured bank loans as at 31 December 2005 carried interest rates ranging from 3.24% to 5.86% (2004: 4.54% to 5.86%) per annum, and were all repayable within one year.

NOTES TO THE FINANCIAL STATEMENTS

28. NON-CURRENT OTHER PAYABLES

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

The Group

	2005 RMB'000	2004 RMB'000
Within 1 year	**1,696**	1,696
Over 1 year but less than 2 years	**565**	1,696
Over 2 years but less than 5 years	**–**	565
	565	2,261
	2,261	3,957

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

29. EMPLOYEE RETIREMENT BENEFITS

As stipulated by the labour regulations of the PRC, the Group participates in various defined contribution retirement plans organised by municipal and provincial governments for its employees. The Group is required to make contributions to the retirement plans at rates ranging from 9% to 25% for the year ended 31 December 2004 and 2005 of the eligible employees' salaries.

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

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

NOTES TO THE FINANCIAL STATEMENTS

30. INCOME TAX IN THE CONSOLIDATED BALANCE SHEET

i) Current taxation in the consolidated balance sheet represents:

The Group

	2005 RMB'000	2004 RMB'000
Provision for income tax for the year	**71,435**	61,079
Income tax paid	**(26,647)**	(38,689)
	44,788	22,390
Balance of income tax provision related to prior years	**4,624**	4,471
	49,412	26,861

ii) Deferred tax assets recognised:

The components of deferred tax assets recognised in the consolidated balance sheet and the movements during the two years ended 31 December 2005 are as follows:

The Group

	Impairment for trade receivables RMB'000	Write down for inventories RMB'000	Tax losses not utilised RMB'000	Unrealised profit RMB'000	Others RMB'000	Total RMB'000
At 1 January 2004	1,785	654	218	6,754	49	9,460
Credited/(charged) to consolidated income statement	257	597	613	(258)	(49)	1,160
At 31 December 2004	2,042	1,251	831	6,496	–	10,620
Credited to consolidated income statement	160	597	55	6,121	–	6,933
At 31 December 2005	2,202	1,848	886	12,617	–	17,553

NOTES TO THE FINANCIAL STATEMENTS

30. INCOME TAX IN THE CONSOLIDATED BALANCE SHEET *(Continued)*

iii) Deferred tax liabilities recognised:

The components of deferred tax liabilities recognised in the consolidated balance sheet and the movements during the two years ended 31 December 2005 are as follows:

The Group

	Preferential purchase arrangement RMB'000
At 1 January 2004	7,038
Credited to consolidated income statement	(7,038)
At 31 December 2004 and 2005	–

NOTES TO THE FINANCIAL STATEMENTS

31. CAPITAL AND RESERVES

(a) The Group

		Attributable to equity shareholder of the Company							
	Note	Share capital RMB'000	Share premium RMB'000	Capital reserve RMB'000	PRC statutory reserve RMB'000	Retained profits RMB'000	Total RMB'000	Minority interests RMB'000	Total equity RMB'000
At 1 January 2004		–	–	157,260	17,905	45,396	220,561	99,222	319,783
Dividends approved in respect of the previous year	*12*	–	–	–	–	(32,598)	(32,598)	(6,969)	(39,567)
Transfer between reserves		–	–	–	18,801	(18,801)	–	–	–
Acquisition of additional interests in subsidiaries from minority shareholder		–	–	–	–	–	–	(22,018)	(22,018)
Profit for the year		–	–	–	–	97,545	97,545	8,338	105,883
At 1 January 2005		–	–	157,260	36,706	91,542	285,508	78,573	364,081
Dividends approved in respect of the previous year	*12*	–	–	–	–	(92,150)	(92,150)	(4,850)	(97,000)
Transfer between reserves		–	–	–	15,242	(15,242)	–	–	–
Issuance of new shares	*31(c)(ii)*	636	198,716	–	–	–	199,352	–	199,352
Capitalisation issue	*31(c)(iii)*	7,195	(7,195)	–	–	–	–	–	–
Capital elimination on combination		–	–	(183,334)	–	–	(183,334)	–	(183,334)
Shares issued under the Offering and Placement	*31(c)(iv)*	2,606	341,484	–	–	–	344,090	–	344,090
Shares issued under the over-allotment option related to the Placement	*31(c)(v)*	391	51,223	–	–	–	51,614	–	51,614
Shares issuance expenses		–	(31,451)	–	–	–	(31,451)	–	(31,451)
Acquisition of subsidiaries		–	–	–	–	–	–	172	172
Capital contribution from minority shareholders		–	–	–	–	–	–	14,850	14,850
Profit for the year		–	–	–	–	121,011	121,011	10,766	131,777
At 31 December 2005		**10,828**	**552,777**	**(26,074)**	**51,948**	**105,161**	**694,640**	**99,511**	**794,151**

NOTES TO THE FINANCIAL STATEMENTS

31. CAPITAL AND RESERVES *(Continued)*

(b) The Company

	Note	**Share capital** RMB'000	**Share premium** RMB'000	**Retained losses** RMB'000	**Total** RMB'000
At 1 January 2005		–	–	–	–
Issuance of new shares	*31(c)(ii)*	636	198,716	–	199,352
Capitalisation issue	*31(c)(iii)*	7,195	(7,195)	–	–
Shares issued under the Offering and Placement	*31(c)(iv)*	2,606	341,484	–	344,090
Shares issued under the over-allotment option related to the Placement	*31(c)(v)*	391	51,223	–	51,614
Share issuance expenses		–	(31,451)	–	(31,451)
Loss for the year		–	–	(897)	(897)
At 31 December 2005		**10,828**	**552,777**	**(897)**	**562,708**

NOTES TO THE FINANCIAL STATEMENTS

31. CAPITAL AND RESERVES *(Continued)*

(c) Share capital

		2005		2004	
	Note	**Number of shares**	**Amount HK$**	Number of shares	Amount HK$
Authorised:					
Ordinary shares of HK$0.01 each	*(i)*	**2,000,000,000**	**20,000,000**	38,000,000	380,000

Issued and fully paid:

		2005		2004	
	Note	**Number of shares**	**Amount HK$**	Number of shares	Amount HK$
At 1 January		**1**	**0.01**	–	–
Issuance of new shares	*(ii)*	**59,999,999**	**599,999.99**	1	0.01
Capitalisation issue	*(iii)*	**690,000,000**	**6,900,000.00**	–	–
Shares issued under the Offering and Placement	*(iv)*	**250,000,000**	**2,500,000.00**	–	–
Shares issued under the over-allotment option related to the Placement	*(v)*	**37,500,000**	**375,000.00**	–	–
At 31 December		**1,037,500,000**	**10,375,000.00**	1	0.01
			RMB equivalent		*RMB equivalent*
			10,828,393		0.01

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

NOTES TO THE FINANCIAL STATEMENTS

31. CAPITAL AND RESERVES *(Continued)*

(c) Share capital *(Continued)*

(i) Authorised share capital

The Company was incorporated in the Cayman Islands as an exempted company with limited liability on 9 July 2004 under the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands with its authorised share capital of HK$380,000 divided into 38,000,000 ordinary shares of HK$0.01 each.

Pursuant to the resolutions in writing of the sole shareholder of the Company passed on 12 January 2005, the authorised share capital of the Company was increased from HK$380,000 divided into 38,000,000 ordinary shares of HK$0.01 each to HK$10,000,000 divided into 1,000,000,000 ordinary shares of HK$0.01 each by the creation of an additional 962,000,000 ordinary shares.

Pursuant to the resolutions in writing passed by the shareholders of the Company on 27 August 2005, the authorised share capital of the Company was increased from HK$10,000,000 divided into 1,000,000,000 ordinary shares of HK$0.01 each to HK$20,000,000 divided into 2,000,000,000 ordinary shares of HK$0.01 each by the creation of an additional 1,000,000,000 ordinary shares.

(ii) Issuance of new shares

Pursuant to the resolutions in writing of the sole shareholder of the Company passed on 28 July 2004, one ordinary share of HK$0.01, credited as fully paid, was allotted and issued to the initial shareholder and such share was subsequently transferred at HK$0.01 to Best Growth International Limited ("Best Growth") on 12 January 2005.

Pursuant to the Reorganisation described in note 1 to the financial statements, an aggregate of 59,999,999 ordinary shares of HK$0.01 each were issued. Among them, 58,103,999 ordinary shares, 948,000 ordinary shares, 630,000 ordinary shares and 318,000 ordinary shares of HK$0.01 each were allotted and issued to Best Growth, Artnew Developments Limited ("Artnew Developments"), Business Up Trading Limited ("Business Up") and Spring Day Trading Limited ("Spring Day"), for cash consideration of HK$182,225,379 (equivalent to RMB193,052,386), HK$2,973,111 (equivalent to RMB3,149,760), HK$1,975,802 (equivalent to RMB2,093,195) and HK$997,309 (equivalent to RMB1,056,565) respectively.

The Company subsequently acquired the entire issued share capital of Xinyu Hengdeli China Limited and Xinyu Hengdeli Investments Limited, the intermediate holding companies of other subsidiaries, by a cash consideration of HK$188,171,502 (equivalent to RMB199,351,816), as part of the Reorganisation. As a result, the Company became the holding company of the Group.

NOTES TO THE FINANCIAL STATEMENTS

31. CAPITAL AND RESERVES *(Continued)*

(c) Share capital *(Continued)*

(iii) Capitalisation issue

On 23 September 2005, immediately upon completion of the offering and the placement (prior to any exercise of the over-allotment option below), capitalisation of the sum then standing to the credit of the share premium account of the Company as a result of completion of the share offer by way of applying such sum in paying up in full for the allotment and issue of a total of 690,000,000 shares of HK$0.01 each to Best Growth, Artnew Developments, Business Up and Spring Day in the proportion of their respective shareholdings in the Company was approved.

(iv) Shares issued under the Offering and Placement

On 23 September 2005, 250,000,000 ordinary shares of HK$0.01 each were issued under the Hong Kong Public Offering ("the Offering") and the International Placing ("the Placement") of the Company's shares at HK$1.32 per share. The total consideration amounted to HK$330,000,000 (equivalent to RMB344,090,000) before the related issue expenses.

(v) Shares issued under the over-allotment option related to the Placement

On 19 October 2005, the underwriters of the Placement exercised the over-allotment option for the issuance of 37,500,000 ordinary shares of HK$0.01 each at HK$1.32 per share. The total consideration amounted to HK$49,500,000 (equivalent to RMB51,613,650) before the related issue expenses.

(vi) Share option scheme

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

(d) Nature and purpose of reserves

(i) Share premium

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

(ii) Capital reserve

Capital reserve represents the excess of the consideration, amounting to RMB183,334 thousands, paid by the Company over the aggregate of the nominal value of the share capital of the subsidiaries, amounting to RMB157,260 thousands, acquired under the Reorganisation.

NOTES TO THE FINANCIAL STATEMENTS

31. CAPITAL AND RESERVES *(Continued)*

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

(iii) PRC statutory reserve

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

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

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

The general reserve can be used to reduce previous years' losses and to increase the capital of the subsidiaries while the enterprises expansion funds can be used to increase the capital of the subsidiaries, to acquire property, plant and equipment and to increase current assets.

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

32. COMMITMENTS

i) Operating lease commitments

Non-cancelable operating lease rentals are payable as follows:

	2005 **RMB'000**	2004 RMB'000
Less than one year	**14,278**	9,617
Between one and five years	**19,449**	14,450
More than five years	**2,342**	1,987
	36,069	26,054

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

NOTES TO THE FINANCIAL STATEMENTS

32. COMMITMENTS *(Continued)*

ii) Commitments of guaranteed profit

	2005 **RMB'000**	2004 RMB'000
Less than one year	**3,500**	1,500
Between one and five years	**8,000**	1,500
	11,500	3,000

Pursuant to a management agreement dated 5 July 2002 entered into between Shanghai Xinyu and Shanghai Yi Min Department Stores Company Limited ("Yi Min"), whereby Yi Min agreed to entrust to Shanghai Xinyu the operation and management of a shop located in Shanghai, and in return, Yi Min is entitled to receive an annual guaranteed profit of RMB 1,500 thousands from the Group for the period from 1 June 2002 to 31 December 2006.

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

33. RELATED PARTY TRANSACTIONS

The Group has transactions with the ultimate shareholders, the companies controlled by the ultimate shareholders ("Ultimate shareholders' companies"), minority shareholders of subsidiaries ("Minority shareholders"), an associate, a jointly controlled entity and the key management personnel.

The following is a summary of principal related party transactions carried out by the Group with the above related parties for the two years ended 31 December 2005.

(a) Recurring

	2005 **RMB'000**	2004 RMB'000
Lease expenses to:		
Minority shareholders	**4,800**	4,800
Ultimate shareholders' companies	**543**	–
Guaranteed profit to:		
Minority shareholders	**1,500**	1,500
Sales of goods to:		
Jointly controlled entity	**2,633**	–

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

NOTES TO THE FINANCIAL STATEMENTS

33. RELATED PARTY TRANSACTIONS *(Continued)*

(b) Non-recurring

	2005 **RMB'000**	2004 RMB'000
Sales of goods to:		
Minority shareholders	**6,222**	–
Purchase of goods from:		
Ultimate shareholders' companies	**–**	2,282
Minority shareholders	**34,889**	130,237
Interest expense to:		
Minority shareholders	**–**	797
Loans lent to:		
Associate	**–**	7,500
Lease expenses to:		
Ultimate shareholders' companies	**–**	1,041
Minority shareholders	**–**	3,050
Service fees to:		
Ultimate shareholders' companies	**–**	375
Disposal of assets classified as held for sale to:		
Ultimate shareholders' companies	**–**	17,125
Acquisition of equity interests in subsidiaries from:		
Ultimate shareholders' companies	**–**	8,597
Key management personnel	**–**	4,139
Minority shareholders	**1,545**	22,018
Unsecured bank loans guaranteed by:		
Ultimate shareholders' companies	**30,000**	30,000
Ultimate shareholders	**–**	27,198

NOTES TO THE FINANCIAL STATEMENTS

33. RELATED PARTY TRANSACTIONS *(Continued)*

(c) Trade and other receivables due from:

The Group

	2005 **RMB'000**	2004 RMB'000
Ultimate shareholders' companies	**–**	37,125
Minority shareholders	**–**	3,223
Jointly controlled entity	**988**	–
	988	40,348

The Company

	2005 **RMB'000**	2004 RMB'000
Subsidiaries	**240,033**	–

(d) Trade and other payables due to:

The Group

	2005 **RMB'000**	2004 RMB'000
Ultimate shareholders' companies	**–**	6,854
Minority shareholders	**25,176**	39,664
	25,176	46,518

The Company

	2005 **RMB'000**	2004 RMB'000
Subsidiaries	**7,443**	–

NOTES TO THE FINANCIAL STATEMENTS

33. RELATED PARTY TRANSACTIONS *(Continued)*

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

	2005 RMB'000	2004 RMB'000
Short-term employee benefits	**4,785**	1,123
Post-employment benefits	**161**	107
	4,946	1,230

34. FINANCIAL INSTRUMENTS

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

(a) Credit risk

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

In respect of trade and other receivables, credit evaluations are performed on all customers requiring credit over a certain amount. Normally, the Group does not obtain collateral from customers. Investments are normally only in liquid securities and with counterparties that have a credit rating equal to or better than the Group.

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

(b) Interest rate risk

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

Cash and cash equivalents comprise mainly bank deposits with fixed interest rates ranging from 0.72% to 3% per annum and the maturity dates of these bank deposits are within 1 year. Trading government bonds carried interest rates at 4.26% per annum. The interest rates and terms of repayment of bank loans of the Group are disclosed in note 27 above.

NOTES TO THE FINANCIAL STATEMENTS

34. FINANCIAL INSTRUMENTS *(Continued)*

(c) Currency risk

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

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

(d) Fair values

All financial instruments are carried at amounts not materially different from their fair values as at 31 December 2005 and 2004.

(e) Estimation of fair values

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

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

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

(ii) Trading securities

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

(iii) Bank loans

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

35. NON-ADJUSTING POST BALANCE SHEET EVENTS

After the balance sheet date, the directors proposed a final dividend on 12 April 2006. Further details are disclosed in note 12.

36. ULTIMATE HOLDING COMPANY

The directors consider the ultimate holding company of the Company at 31 December 2005 to be Best Growth International Limited, which is incorporated in British Virgin Islands.

37. ACCOUNTING ESTIMATES AND JUDGEMENTS

Notes 16 and 34 contain information about the assumptions and their risk factors relating to intangible assets impairment and financial instruments.

NOTES TO THE FINANCIAL STATEMENTS

38. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED 31 DECEMBER 2005

Up to the date of issue of these financial statements, the HKICPA has issued the following amendments, new standards and interpretations which are not yet effective for the accounting period ended 31 December 2005 and which have not been adopted in these financial statements:

	Effective for accounting periods beginning on or after
HKFRS 6, Exploration for and evaluation of mineral resources	1 January 2006
HK (IFRIC) 4, Determining whether an arrangement contains a lease	1 January 2006
HK (IFRIC) 5, Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds	1 January 2006
HK (IFRIC) 6, Liabilities arising from participating in a specific market-Waste electrical and electronic equipment	1 December 2005
HK (IFRIC) 7, Applying the restatement approach under IAS 29 Financial Reporting in hyperinflationary economies	1 March 2006
Amendments to HKAS 19, Employee benefits-Actuarial Gains and Losses, Group Plans and Disclosures	1 January 2006
Amendments to HKAS 21, Net investment in a foreign operation	1 January 2006
Amendments to HKAS 39, Financial instruments: Recognition and measurement:	
– Cash flow hedge accounting of forecast intragroup transactions	1 January 2006
– The fair value option	1 January 2006
– Financial guarantee contracts	1 January 2006
Amendments, as a consequence of the Hong Kong Companies (Amendment) Ordinance 2005, to:	
– HKAS 1, Presentation of financial statements	1 January 2006
– HKAS 27, Consolidated and separate financial statements	1 January 2006
– HKFRS 3, Business combinations	1 January 2006
HKFRS 7, Financial instruments: disclosures	1 January 2007
Amendment to HKAS 1, Presentation of financial statements: capital disclosures	1 January 2007

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that the adoption of HKFRS 6 and HK(IFRIC) 5 and the amendments to HKAS 1, HKAS 27 and HKFRS 3 made as a result of the Hong Kong Companies (Amendment) Ordinance 2005 are not applicable to any of the Group's operations and that the adoption of the rest of them is unlikely to have a significant impact on the Group's results of operations and financial position.

FINANCIAL SUMMARY

	Year ended 31 December			
RESULTS	2002	2003	2004	**2005**
	RMB'000	*RMB'000*	*RMB'000*	***RMB'000***
Sales	1,375,420	1,496,401	1,518,582	**1,396,531**
Profit from operations	43,999	113,355	176,378	**220,203**
Finance costs	(9,569)	(13,661)	(17,614)	**(23,353)**
Share of losses of a jointly controlled entity	–	–	–	**(187)**
Profit before tax	34,430	99,694	158,764	**196,663**
Income tax	(11,071)	(32,498)	(52,881)	**(64,886)**
Profit for the year	23,359	67,196	105,883	**131,777**
Attributable to:				
Equity shareholders of the Company	20,592	55,441	97,545	**121,011**
Minority interests	2,767	11,755	8,338	**10,766**
Profit for the year	23,359	67,196	105,883	**131,777**
Basic earnings per share	RMB0.03	RMB0.07	RMB0.13	**RMB0.15**

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