**THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION**

**If you are in any doubt** about any aspect of this Circular or as to the action to be taken, you should consult your licensed securities dealer, bank manager, solicitor, professional accountant or other professional advisors.

**If you have sold or transferred** all your Shares in CHINA OCEAN SHIPBUILDING INDUSTRY GROUP LIMITED (the "Company"), you should at once hand this Circular, together with the accompanying form of proxy, to the purchaser or transferee or to the bank, stockbroker or other agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

This Circular is addressed to the shareholders of the Company in connection with the special general meeting of the Company to be held on 16 August 2010. This Circular is not and does not constitute an offer of, nor is it intended to invite offers for, shares or other securities of the Company.



# CHINA OCEAN SHIPBUILDING INDUSTRY GROUP LIMITED

# 中 海 船 舶 重 工 集 團 有 限 公 司

*(Incorporated in Bermuda with limited liability)*

**(Stock code: 00651)**

# (1) PROPOSED OPEN OFFER ON THE BASIS OF ONE OFFER SHARE FOR EVERY TWO SHARES HELD ON THE RECORD DATE WITH BONUS ISSUE ON THE BASIS OF TWO BONUS SHARES FOR EVERY ONE OFFER SHARE TAKEN UP; (2) AMENDMENT TO THE BYE-LAWS; (3) SHARE PREMIUM REDUCTION AND (4) NOTICE OF SPECIAL GENERAL MEETING

**Financial Advisor to China Ocean Shipbuilding Industry Group Limited**

**KINGSTON CORPORATE FINANCE LIMITED**

**Underwriter to the Open Offer**

**KINGSTON SECURITIES LIMITED**

**Independent Financial Advisor to the Independent Board Committee and the Independent Shareholders**

**廣發融資(香港)有限公司**
**GF Capital (Hong Kong) Limited**

Terms used in this cover page have the same meanings as defined in this Circular.

The letter from the Independent Financial Advisor is set out on pages 30 to 45 of this Circular. The letter from the Independent Board Committee is set out on pages 28 to 29 of this Circular.

To qualify for the Open Offer, a Shareholder must be registered as a member of the Company on the Record Date, which is currently expected to be Monday, 16 August 2010. In order to be registered as a member of the Company on the Record Date, Shareholders must lodge any transfers of Shares (with the relevant Share certificate(s)) with the Registrar by 4:30 p.m. on Tuesday, 10 August 2010. The last day of dealings in Shares on a cum-entitlement basis is therefore expected to be Friday, 6 August 2010. The Shares will be dealt with on an ex-entitlement basis from Monday, 9 August 2010.

A notice convening the SGM to be held at Unit 1702-03, 17/F., China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road Central, Hong Kong at 10:00 a.m. on Monday, 16 August 2010 is set out on pages 139 to 141 of this Circular. If you are unable to attend the meeting in person, you are requested to complete and return the enclosed form of proxy in accordance with the instructions printed thereon and deposit it with the Company's Hong Kong branch share registrar, Tricor Abacus Limited at 26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong as soon as possible and in any event not less than 48 hours before the time appointed for holding the SGM. Completion and return of the form of proxy will not preclude you from attending and voting in person at the SGM if you so wish.

The Underwriting Agreement contains provisions granting Kingston Securities, by notice in writing, the right to terminate Kingston Securities' obligations thereunder on the occurrence of certain events. Kingston Securities may terminate the Underwriting Agreement on or before the Latest Time for Termination if prior to the Latest Time for Termination: (1) in the absolute opinion of the Underwriter, the success of the Open Offer would be materially and adversely affected by: (a) the introduction of any new law or regulation or any change in existing law or regulation (or the judicial interpretation thereof) or other occurrence of any nature whatsoever which may in the absolute opinion of the Underwriter materially and adversely affect the business or the financial or trading position or prospects of the Group as a whole or is materially adverse in the context of the Open Offer; or (b) the occurrence of any local, national or international event or change (whether or not forming part of a series of events or changes occurring or continuing before, and/or after the date hereof) of a political, military, financial, economic or other nature (whether or not ejusdem generis with any of the foregoing), or in the nature of any local, national or international outbreak or escalation of hostilities or armed conflict, or affecting local securities markets which may, in the absolute opinion of the Underwriter materially and adversely affect the business or the financial or trading position or prospects of the Group as a whole or materially and adversely prejudice the success of the Open Offer or otherwise makes it inexpedient or inadvisable to proceed with the Open Offer; or (c) the imposition of any moratorium, suspension or material restriction on trading of the Shares on the Stock Exchange due to exceptional financial circumstances or otherwise; or (2) any material adverse change in market conditions (including without limitation, any change in fiscal or monetary policy, or foreign exchange or currency markets, suspension or material restriction or trading in securities) occurs which in the absolute opinion of the Underwriter is likely to materially or adversely affect the success of the Open Offer or otherwise makes it inexpedient or inadvisable to proceed with the Open Offer; or (3) there is any change in the circumstances of the Company or any member of the Group which in the absolute opinion of the Underwriter will adversely affect the prospects of the Company, including without limiting the generality of the foregoing the presentation of a petition or the passing of a resolution for the liquidation or winding up or similar event occurring in respect of any of member of the Group or the destruction of any material asset of the Group; or (4) any event of force majeure including, without limiting the generality thereof, any act of God, war, riot, public disorder, civil commotion, fire, flood, explosion, epidemic, terrorism, strike or lock-out; or (5) any material adverse change in the business or the financial or trading position or prospects of the Group as a whole whether or not ejusdem generis with any of the foregoing; or (6) the Circular or the Prospectus Documents in connection with the Open Offer (with Bonus Issue) when published contain information (either as to business prospects or the condition of the Group or as to its compliance with any laws or the Listing Rules or any applicable regulations) which has not prior to the date of the Underwriting Agreement been publicly announced or published by the Company and which may in the absolute opinion of the Underwriter is material to the Group as a whole and is likely to affect materially and adversely the success of the Open Offer or might cause a prudent investor not to apply for its assured entitlements of Offer Shares under the Open Offer (with Bonus Issue); or (7) any suspension in the trading of securities generally or the Company's securities on the Stock Exchange for a period of more than ten consecutive business days, excluding any suspension in connection with the clearance of the Announcement, the Circular or the Prospectus Documents or other announcements or circulars in connection with the Open Offer (with Bonus Issue), Kingston Securities shall be entitled by notice in writing to the Company, served prior to the Latest Time for Termination, to terminate the Underwriting Agreement.

Kingston Securities shall be entitled by notice in writing to rescind the Underwriting Agreement if prior to the Latest Time for Termination: (1) any material breach of any of the representations, warranties or undertakings contained in the Underwriting Agreement comes to the knowledge of Kingston Securities; or (2) any specified event stated in the Underwriting Agreement comes to the knowledge of Kingston Securities.

Any such notice shall be served by Kingston Securities prior to the Latest Time for Termination and thereupon the obligations of all parties under the Underwriting Agreement, save for provisions specified in the Underwriting Agreement, shall terminate forthwith and no party shall have any claim against any other party for costs, damages, compensation or otherwise save for any antecedent breaches.

If the Underwriting Agreement is terminated by Kingston Securities on or before the aforesaid deadline or does not become unconditional, the Open Offer will not proceed.

The Shares will be dealt in on an ex-entitlement basis from Monday, 9 August 2010, and the Open Offer is conditional. If the conditions of the Open Offer are not satisfied by the relevant date(s) or, if no such date is specified, the Latest Time for Termination or such later date or dates as Kingston Securities may agree with the Company in writing, or the Underwriting Agreement is terminated by Kingston Securities, the Open Offer will not proceed and will lapse. Any persons contemplating buying or selling Shares from the date of the Announcement up to the date on which all the conditions of the Open Offer bear the risk that the Open Offer may not become unconditional or may not proceed. Any Shareholders or other persons contemplating dealing in the Shares are recommended to consult their own professional advisors.

23 July 2010

# CONTENTS

*The expected timetable for the Open Offer (with Bonus Issue) as set out below is indicative only and has been prepared on the assumption that the Open Offer (with Bonus Issue) will be approved by the Independent Shareholders at the SGM. The expected timetable is subject to change, and any such change will be announced in a separate announcement by the Company as and when appropriate:*

| | 2010 |
|---|---|
| Last day of dealings in the Shares on a cum-entitlement basis | 6 August, Friday |
| First day of dealings in the Shares on an ex-entitlement basis | 9 August, Monday |
| Latest time for lodging transfer of the Shares in order to qualify for the Open Offer (with the Bonus Issue) | 4:30 p.m. 10 August, Tuesday |
| Register of members of the Company closes for determining the entitlements under the Open Offer (both dates inclusive) | From 11 August, Wednesday to 16 August, Monday |
| Latest time for lodging forms of proxy for the SGM | 14 August, Saturday |
| Record Date | 16 August, Monday |
| SGM | 16 August, Monday |
| Announcement of results of SGM to be published on the Stock Exchange website | 16 August, Monday |
| Register of members of the Company re-opens | 17 August, Tuesday |
| Despatch of the Prospectus Documents | 17 August, Tuesday |
| Latest time for acceptance of, and payment for, the Offer Shares | 4:00 p.m. on 1 September, Wednesday |
| Latest time for the Open Offer (with Bonus Issue) to become unconditional | 4:00 p.m. on 3 September, Friday |
| Announcement of results of acceptance of the Open Offer (with Bonus Issue) to be published on the Stock Exchange website | before 9:00 a.m. on 7 September, Tuesday |

2010

Despatch of refund cheques in relation to wholly or partially unsuccessful applications for excess Offer Shares on or before . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 7 September, Tuesday

Despatch of share certificates for the Offer Shares and Bonus Shares on or before . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 7 September, Tuesday

Commencement of dealings in the Offer Shares and the Bonus Shares . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 9 September, Thursday

All times stated above refer to Hong Kong times. Dates or deadlines specified in this Circular are indicative only and may be extended or varied by agreement between the Company and the Underwriter. Any changes to the expected timetable for the Open Offer will be published or notified to the Shareholders as and when appropriate.

**EFFECT OF BAD WEATHER ON THE LATEST TIME FOR ACCEPTANCE OF AND PAYMENT FOR THE OFFER SHARES**

The latest time for acceptance of and payment for the Offer Shares will not take place if there is:

(a) a tropical cyclone warning signal number 8 or above, or

(b) a "black" rainstorm warning

(i) in force in Hong Kong at any local time before 12:00 noon and no longer in force after 12:00 noon on the Latest Time for Acceptance. Instead the latest time of acceptance of and payment for the Offer Shares will be extended to 5:00 p.m. on the same Business Day;

(ii) in force in Hong Kong at any local time between 12:00 noon and 4:00 p.m. on the Latest Time for Acceptance. Instead the latest time of acceptance of and payment for the Offer Shares will be rescheduled to 4:00 p.m. on the following Business Day which does not have either of those warnings in force at any time between 9:00 a.m. and 4:00 p.m.

If the latest time for acceptance of and payment for the Offer Shares does not take place on the Latest Acceptance Date, the dates mentioned in the section headed "Expected timetable" may be affected. An announcement will be made by the Company in such event as soon as practicable.

*In this Circular, unless the context otherwise requires, the following expressions have the following meanings:*

| | |
|---|---|
| "Announcement" | the announcement of the Company dated 15 June 2010 in relation to, among other things, the Open Offer (with the Bonus Issue), Amendment to Bye-laws and Share Premium Reduction |
| "Amendment to Bye-laws" | the proposed amendment to the Bye-laws to be considered and, if thought fit, approved by the Shareholders at the SGM by way of a special resolution |
| "Application Form(s)" | the form of application for use by the Qualifying Shareholders to apply for the Offer Shares (with Bonus Shares) which shall be in the agreed form |
| "associate(s)" | has the meaning ascribed thereto under the Listing Rules |
| "Board" | the board of directors of the Company |
| "Bonus Issue" | the issue of the Bonus Shares pursuant to the terms and conditions of the Underwriting Agreement and Prospectus Documents |
| "Bonus Shares" | the bonus Shares to be issued (for no additional payment) to the First Registered Holders in respect of the Open Offer on the basis of two (2) bonus Shares for every one (1) Offer Share taken up under the Open Offer subject to the terms and upon conditions as set out in the Underwriting Agreement and Prospectus Documents |
| "Business Day" | a day (other than a Saturday, Sunday, public holiday) on which licensed banks are generally open for business throughout their normal business hours in Hong Kong |
| "Bye-laws" | the bye-laws of the Company |
| "CCASS" | the Central Clearing and Settlement System established and operated by HKSCC |
| "Circular" | this circular dated 23 July 2010 |
| "Company" | China Ocean Shipbuilding Industry Group Limited (stock code: 00651), a company incorporated in Bermuda with limited liability and the issued securities of which are listed on the Main Board of the Stock Exchange |
| "Companies Act" | the Companies Act 1981 of Bermuda |

| | |
|---|---|
| "Companies Ordinance" | Companies Ordinance, Chapter 32 of the Laws of Hong Kong (as amended form time to time) |
| "connected person(s)" | has the meaning ascribed thereto under the Listing Rules |
| "Contributed Surplus Account" | the contributed surplus account of the Company |
| "Controlling Shareholder" | has the meaning ascribed thereto under the Listing Rules |
| "Convertible Notes" | the outstanding convertible note(s) in an aggregate principal amount of approximately HK$507.55 million which is convertible into 69,910,351 Shares at a conversion price of HK$7.26 per Share |
| "Director(s)" | director(s) of the Company |
| "EAF" | excess application form for the Excess Offer Shares |
| "Effective Date" | the date on which the Share Premium Reduction shall become effective, being the date on which the Open Offer becomes unconditional |
| "Excess Offer Shares" | the Offer Shares entitled by the Qualifying Shareholders but not validly applied for by them, any Offer Shares arising from the aggregation of fractional entitlements, if any, and any Offer Shares not offered to the Excluded Shareholders, if any |
| "Excluded Shareholder(s)" | the Overseas Shareholder(s) to whom the Company considers it necessary or expedient not to offer the Offer Shares |
| "First Registered Holders" | Qualifying Shareholders who have applied for and received the Offer Shares allotted to them by the Company after lodging valid Application Forms and EAFs (if applicable) |
| "GF Capital" | GF Capital (Hong Kong) Limited, a licensed corporation to carry on business in type 6 (advising on corporate finance) regulated activities under the SFO |
| "Group" | the Company and its subsidiaries |
| "HK$" | Hong Kong dollars, the lawful currency of the Hong Kong Special Administrative Region of the PRC |
| "HKSCC" | Hong Kong Securities Clearing Company Limited |
| "Hong Kong" | the Hong Kong Special Administrative Region of the PRC |

| | |
|---|---|
| "Independent Board Committee" | an independent board committee of the Board comprised of all the independent non-executive Directors, namely Mr. Zhang Xi Ping, Ms. Xiang Siying, Mr. Hu Bai He and Ms. Xiang Ying, formed for advising the Independent Shareholders in relation to the Open Offer (with the Bonus Issue) |
| "Independent Shareholders" | Shareholders other than the Directors (excluding the independent non-executive Directors), the chief executive of the Company and their respective associates |
| "Kingston Securities" or "Underwriter" | Kingston Securities Limited, a licensed corporation to carry out business in type 1 (dealing in securities) regulated activity under the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) |
| "Last Trading Day" | 15 June 2010, being the last trading day for the Shares on the Stock Exchange before the release of the Announcement |
| "Latest Practicable Date" | 21 July 2010, being the latest practicable date prior to the printing of this Circular of ascertaining certain information in this Circular |
| "Latest Time for Acceptance" | being 4:00 p.m. on 1 September 2010 or such other date and/or time as may be agreed between the Underwriter and the Company, being the latest time for acceptance of, and payment for, the Offer Shares (with Bonus Shares) as described in the Prospectus |
| "Latest Time for Termination" | 4:00 p.m. on the second Business Day after the Latest Time for Acceptance or such later time or date as may be agreed between the Underwriter and the Company, being the latest time to terminate the Underwriting Agreement |
| "Listing Committee" | has the meaning as defined in the Listing Rules |
| "Listing Rules" | The Rules Governing the Listing of Securities on the Stock Exchange |
| "Mr. Li" | Mr. Li Ming, being an executive Director |
| "Mr. Li's Undertaking" | the irrevocable undertaking given by Mr. Li in favour of the Company and the Underwriter in respect of the Open Offer, further details of which are set out in the paragraph headed "Undertaking given by Mr. Li" in the Circular |
| "Open Offer" | the proposed issue of the Offer Shares (with Bonus Shares) by way of open offer to the Qualifying Shareholders |

| | |
|---|---|
| "Offer Shares" | not less than 451,049,825 Shares and not more than 503,195,001 Shares proposed to be offered to the Qualifying Shareholders for subscription on the basis of one Offer Share for two Shares held on the Record Date pursuant to the Open Offer and the Underwriting Agreement |
| "Overseas Shareholder(s)" | the Shareholders whose address on the register of members of the Company on the Record Date are outside Hong Kong |
| "PRC" | the People's Republic of China |
| "Posting Date" | 17 August 2010 or such later date as may be agreed between the Company and the Underwriter for the despatch of the Prospectus Documents |
| "Prospectus" | the prospectus to be issued by the Company in relation to the Open Offer (with Bonus Issue) on the Posting Date |
| "Prospectus Documents" | the Prospectus, Application Form and EAF |
| "Qualifying Shareholders" | the Shareholders whose names appear on the register of members of the Company as at the close of business on the Record Date, other than the Excluded Shareholders |
| "Record Date" | 16 August 2010 or such other date as may be agreed between the Company and the Underwriter for the determination of the entitlements under the Open Offer |
| "SFO" | the Securities and Futures Ordinance of Hong Kong (Chapter 571) |
| "SGM" | the special general meeting of the Company to be convened and held on 16 August 2010 for the Shareholders or the Independent Shareholders (as the case may be) to consider and approve, among other things, the Amendment to Bye-laws, the Share Premium Reduction, the Open Offer (with Bonus Issue) and the transactions contemplated hereunder |
| "Share(s)" | the ordinary share(s) of HK$0.05 each in the share capital of the Company |
| "Share Options" | the option(s) to subscribe for Shares granted by the Company under the Share Option Scheme |
| "Share Option Scheme" | the share option scheme adopted by the Company on 27 May 2002 |

| | |
|---|---|
| "Shareholder(s)" | the holder(s) of the Shares |
| "Share Premium Account" | the share premium account of the Company |
| "Share Premium Reduction" | the cancellation of the entire amount standing to the credit of the Share Premium Account |
| "Stock Exchange" | The Stock Exchange of Hong Kong Limited |
| "Subscription Price" | the subscription price of HK$0.5 per Offer Share |
| "Underwriting Agreement" | the underwriting agreement dated 15 June 2010 in relation to the Open Offer and the Bonus Issue entered into between the Company and the Underwriter |
| "Underwritten Shares" | not less than 412,347,325 Offer Shares (with Bonus Shares) and not more than 464,492,501 Offer Shares (with Bonus Shares) underwritten by the Underwriter pursuant to the Underwriting Agreement |
| "Untaken Shares" | those (if any) of the Offer Shares for which duly completed Application Forms and EAF (accompanied by cheques or banker's cashier order for the full amount payable on application which are honoured on first or, at the option of the Company, subsequent presentation) have not been lodged for acceptance, or received, as the case may be, on or before the Latest Time for Acceptance which shall not more than 464,492,501 Offer Shares (with Bonus Shares) pursuant to the Underwriting Agreement |
| "%" | per cent. |

# CHINA OCEAN SHIPBUILDING INDUSTRY GROUP LIMITED
# 中海船舶重工集團有限公司

*(Incorporated in Bermuda with limited liability)*
**(Stock code: 00651)**

*Executive Directors:*
Mr. Chau On Ta Yuen *(Chairman)*
Mr. Li Ming *(Deputy Chairman & Chief Executive Officer)*
Mr. Zhang Shi Hong
Mr. Wang San Long

*Independent non-executive Directors:*
Mr. Zhang Xi Ping
Ms. Xiang Siying
Mr. Hu Bai He
Ms. Xiang Ying

*Registered office:*
Clarendon House
2 Church Street
Hamilton HM 11
Bermuda

*Principal place of business in Hong Kong:*
Unit 1103, 11/F.
China Merchants Tower
Shun Tak Centre
168-200 Connaught Road Central
Hong Kong

23 July 2010

*To the Shareholders,*

Dear Sirs or Madams,

## (1) PROPOSED OPEN OFFER ON THE BASIS OF ONE OFFER SHARE FOR EVERY TWO SHARES HELD ON THE RECORD DATE WITH BONUS ISSUE ON THE BASIS OF TWO BONUS SHARES FOR EVERY ONE OFFER SHARE TAKEN UP; (2) AMENDMENT TO BYE-LAWS; (3) SHARE PREMIUM REDUCTION AND (4) NOTICE OF SPECIAL GENERAL MEETING

### INTRODUCTION

Reference is made to the Announcement in relation to, among others, the proposed Open Offer (with the Bonus Issue). The Company proposes the following:

(a) to raise not less than approximately HK$225.5 million and not more than approximately HK$251.6 million, before expenses, by way of an open offer of not less than 451,049,825 Offer Shares and not more than 503,195,001 Offer Shares at the Subscription Price of HK$0.5 per Offer Share on the basis of one (1) Offer Share for every two (2) Shares held by the Qualifying Shareholders on the Record Date and payable in full on acceptance. The Open Offer is only available to the Qualifying Shareholders and will not be available to the Excluded Shareholders. The Qualifying Shareholders are entitled to apply for Excess Offer Shares in excess of their respective entitlements under the Open Offer;

(b) to amend Bye-law 148 to allow capitalization issue to the Shareholders which are not in proportion to the shareholding of the Shareholders; and

(c) to cancel the entire amount standing to the credit of the Share Premium Account as at the date of the SGM which shall take effect on the date the Open Offer becomes unconditional and to transfer the credit arising from the Share Premium Reduction to the Contributed Surplus Account.

Item (a) is conditional upon, among other things, the approval of the Independent Shareholders under the Listing Rules. The Independent Board Committee has been established to advise the Independent Shareholders in relation to the Open Offer. GF Capital has been appointed as the independent financial advisor to advise the Independent Board Committee and the Independent Shareholders in this respect.

Items (b) and (c) require the approval of the Shareholders at the SGM by way of special resolutions.

The purpose of the Circular is to provide you with further information regarding, among other things, (i) details of the Open Offer (with the Bonus Issue), Amendment to Bye-laws and Share Premium Reduction; (ii) a letter of recommendation from the Independent Board Committee to the Independent Shareholders in respect of the Open Offer; (iii) a letter of advice from the independent financial advisor to the Independent Board Committee and the Independent Shareholders on the Open Offer; and (iv) the notice of the SGM to be convened for the purpose of, among other things, considering and, if thought fit, approving the resolutions in relation to the above items.

**PROPOSED OPEN OFFER WITH BONUS ISSUE**

The Company and the Underwriter entered into the Underwriting Agreement on 15 June 2010 in respect of the Open Offer (with the Bonus Issue). Details of the Open Offer (with the Bonus Issue) are set out below:

***ISSUE STATISTICS***

| | | |
|---|---|---|
| Basis of the Open Offer | : | One (1) Offer Share for every two (2) Shares held on the Record Date and payable in full on acceptance, together with two (2) Bonus Shares for every one (1) Offer Share taken up |
| Subscription Price | : | HK$0.5 per Offer Share |
| Number of Shares in issue as at the Latest Practicable Date | : | 902,099,651 Shares |

| | | |
|---|---|---|
| Number of Shares in issue as at the Record Date | : | Not less than 902,099,651 Shares (assuming no outstanding Share Options and convertible securities of the Company are exercised or converted on or before the Record Date) and not more than 1,006,390,002 Shares (assuming all outstanding Share Options and convertible securities of the Company are exercised or converted on or before the Record Date) |
| Number of Offer Shares | : | Not less than 451,049,825 Offer Shares and not more than 503,195,001 Offer Shares |
| Number of Bonus Shares | : | Not less than 902,099,650 Bonus Shares and not more than 1,006,390,002 Bonus Shares to be issued to the First Registered Holders on the basis of two (2) Bonus Shares for every one (1) Offer Share taken up under the Open Offer |
| Total number of Shares in issue upon completion of the Open Offer and the Bonus Issue | : | Not less than 2,255,249,126 Shares and not more than 2,515,975,005 Shares |
| Number of Offer Shares underwritten by the Underwriter | : | Not less than 412,347,325 Offer Shares and not more than 464,492,501 Offer Shares |

As at the Latest Practicable Date, the Company has the following outstanding options and convertible securities:

1. Share Options for subscription of 34,380,000 Shares; and

2. Convertible Notes in the principal amount of approximately HK$507.55 million carrying rights to convert into 69,910,351 Shares at the conversion price of HK$7.26 per Share (subject to adjustment).

Save for the Share Options and Convertible Notes aforementioned, there were no outstanding options, warrants, derivatives or convertible securities which may confer any right to the holders thereof to subscribe for, convert or exchange into new Shares as at the Latest Practicable Date.

**Bonus Issue**

Subject to the satisfaction of the conditions of the Open Offer, the Bonus Shares will be issued to the First Registered Holders of the Offer Shares on the basis of two (2) Bonus Shares for every one (1) Offer Share taken up under the Open Offer. Shareholders who subsequently received or were transferred the Offer Shares from other Qualifying Shareholders or other investors will not be treated as the First Registered Holders.

On the basis of not less than 451,049,825 Offer Shares and not more than 503,195,001 Offer Shares to be issued under the Open Offer, not less than 902,099,650 Bonus Shares and not more than 1,006,390,002 Bonus Shares will be issued. The Bonus Shares will be funded out of the Contributed Surplus Account.

Assuming none of the outstanding Share Options and Convertible Notes will be exercised or converted on or before the Record Date, the minimum total number of Offer Shares and Bonus Shares of 1,353,149,475 Shares represents:

(i) approximately 150% of the Company's existing issued share capital as at the date of the Announcement; and

(ii) approximately 150% of the Company's existing issued share capital as at the Latest Practicable Date; and

(iii) approximately 60% of the Company's issued share capital as enlarged by the issue of the Offer Shares and the Bonus Shares.

Assuming exercise in full of all outstanding Share Options and convertible securities of the Company on or before the Record Date, the maximum total number of Offer Shares and Bonus Shares of 1,509,585,003 Shares represents:

(i) approximately 167% of the Company's existing issued share capital as at the date of the Announcement; and

(ii) approximately 167% of the Company's existing issued share capital as at the Latest Practicable Date; and

(iii) 60% of the Company's issued share capital as enlarged by the issue of the Offer Shares and the Bonus Shares.

**Subscription Price**

The Subscription Price of HK$0.5 per Offer Share is payable in full on application. The net price for each Offer Share is approximately HK$0.49. The Subscription Price represents:

(i) a discount of approximately 12.28% to the closing price of HK$0.570 per Share as quoted on the Stock Exchange on the Last Trading Day;

(ii) a discount of approximately 4.03% to the average closing price of HK$0.521 per Share for the last five consecutive trading days as quoted on the Stock Exchange up to and including the Last Trading Day;

(iii) a premium of approximately 1.63% to the average closing price of HK$0.492 per Share for the last ten consecutive trading days as quoted on the Stock Exchange up to and including the Last Trading Day;

(iv) a premium of approximately 52.44% to the theoretical ex-entitlement price of approximately HK$0.328 per Share calculated based on the closing price per Share as quoted on the Stock Exchange on the Last Trading Day; and

(v) a discount of approximately 11.03% to the audited consolidated net assets value per Share of approximately HK$0.562 as at 31 December 2009 (based on 902,099,651 Shares in issue as at the Last Trading Day); and

(vi) a premium of approximately 11.11% to the closing price of HK$0.45 per Share as quoted on the Stock Exchange on the Latest Practicable Date.

Since two Bonus Shares will be issued upon subscription of one Offer Share, for illustration purpose, the average price for each Share to be allotted and issued under the Open Offer (with the Bonus Issue) is HK0.167 which represents:

(i) a discount of approximately 70.70% to the closing price of HK$0.570 per Share as quoted on the Stock Exchange on the Last Trading Day;

(ii) a discount of approximately 67.95% to the average closing price of HK$0.521 per Share for the last five consecutive trading days as quoted on the Stock Exchange up to and including the Last Trading Day;

(iii) a discount of approximately 66.06% to the average closing price of HK$0.492 per Share for the last ten consecutive trading days as quoted on the Stock Exchange up to and including the Last Trading Day;

(iv) a discount of approximately 70.28% to the audited consolidated net asset value per Share of approximately HK$0.562 as at 31 December 2009 (based on 902,099,651 Shares in issue as at the Last Trading Day); and

(v) a discount of approximately 62.89% to the closing price of HK$0.45 per Share as quoted on the Stock Exchange on the Latest Practicable Date.

The Subscription Price was arrived at after arm's length negotiation between the Company and the Underwriter with reference to, among other things, the prevailing market price of the Shares and the recent market conditions and the financial requirements of the Group.

The Directors consider that the Subscription Price would encourage the Shareholders to participate in the Open Offer and accordingly maintain their shareholdings in the Company and participate in the future growth of the Group. In view of the current financial position of the Group, the prevailing market conditions of the capital market in Hong Kong and the benefits of the Open Offer (with the Bonus Issue), the Directors consider that the terms of the Open Offer (with the Bonus Issue) are fair and reasonable and in the interests of the Group and the Shareholders as a whole.

**Conditions of the Open Offer (with Bonus Issue)**

The Open Offer (with Bonus Issue) is conditional upon each of the following conditions being fulfilled:

(i) the passing of resolution(s) to extend the maturity date of the Convertible Notes as described in the Company's announcement dated 27 April 2010 at the special general meeting of the Company held on 25 June 2010 and the obtaining of all consents and approvals by the Stock Exchange required to be obtained for the extension of the maturity date of the Convertible Notes;

(ii) the passing of a special resolution by the Shareholders at the SGM to approve the Amendment to Bye-laws;

(iii) the passing of the necessary resolution(s) by the Shareholders at the SGM to approve the Share Premium Reduction and transfer of the credit arising therefrom to the Contributed Surplus Account;

(iv) the passing of the necessary resolution(s) by the Independent Shareholders at the SGM to approve the Open Offer (with Bonus Issue) and the transactions contemplated hereunder;

(v) the delivery to the Stock Exchange for authorisation and the registration with the Registrar of Companies in Hong Kong respectively of one copy of each of the Prospectus Documents duly signed by two Directors (or by their agents duly authorized in writing) as having been approved by resolution of the Directors (and all other documents required to be attached thereto) and otherwise in compliance with the Listing Rules and the Companies Ordinance not later than the Posting Date and the filing of the Prospectus Documents with the Registrar of Companies in Bermuda in compliance with the Companies Act;

(vi) the posting of the Prospectus Documents to the Qualifying Shareholders by the Posting Date and the posting of the Prospectus and a letter in the agreed form to the Excluded Shareholders, if any, for information purpose only explaining the circumstances in which they are not permitted to participate in the Open Offer (with Bonus Issue) on or before the Posting Date;

(vii) the Listing Committee of the Stock Exchange granting or agreeing to grant (subject to allotment) and not having withdrawn or revoked listing of and permission to deal in the Offer Shares and the Bonus Shares (in their fully-paid forms) by no later than then the first day of their dealings;

(viii) the Underwriting Agreement not being terminated or rescinded by the Underwriter pursuant to the terms thereof on or before the Latest Time for Termination;

(ix) compliance with and performance of all the undertakings and obligations of the Company under the terms of the Underwriting Agreement; and

(x) compliance with and performance of all undertakings and obligations of Mr. Li under Mr. Li's Undertaking.

Neither of the Company nor the Underwriter may waive the conditions (i) to (viii) and (x) above. The Underwriter may waive the condition (ix) in whole or in part by written notice to the Company. As at the Latest Practicable Date, condition (i) above has been satisfied. Details of which are set out in the announcement of the Company dated 25 June 2010.

If the above conditions are not satisfied and/or waived in whole or in part by the Underwriter by the Latest Time for Termination or such later date or dates as the Underwriter may agree with the Company in writing, the Underwriting Agreement shall terminate and no party will have any claim against any other party for costs, damages, compensation or otherwise (save in respect of any reasonable legal fees or other reasonably out-of-pocket expenses, if any, of the Underwriter, or the indemnity given to the Underwriter and any rights or obligations which may accrue under the Underwriting Agreement prior to such termination).

**Status of the Offer Shares and the Bonus Shares**

The Offer Shares and the Bonus Shares (when allotted and issued fully paid or credited as fully paid) will rank pari passu in all respects with the Shares in issue on the date of allotment and issue of the Offer Shares and the Bonus Shares. Holders of the Offer Shares and the Bonus Shares will be entitled to receive all future dividends and distributions which are declared, made or paid on or after the date of allotment and issue of the Offer Shares and the Bonus Shares.

**Qualifying Shareholders**

The Open Offer is only available to the Qualifying Shareholder.

To qualify for the Open Offer, a Shareholder must be registered as a member of the Company as at the close of business on the Record Date, and not being an Excluded Shareholder. In order to be registered as members of the Company on the Record Date, Shareholders must lodge any transfers of Shares (together with the relevant share certificate(s)) with the Company's branch share registrar, Tricor Abacus Limited at 26/F., Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong by 4:30 p.m. (Hong Kong time) on Tuesday, 10 August 2010.

**Closure of register of members**

The register of members of the Company in Hong Kong will be closed from Wednesday, 11 August 2010, to Monday, 16 August 2010, both dates inclusive, to determine the eligibility of the Shareholders to the Open Offer. No transfer of Shares will be registered during this period.

Shareholders with their Shares held by a nominee company should note that the Board will regard the nominee as a single shareholder according to the register of members of the Company. Shareholders with their Shares held by a nominee company are advised to consider whether they would like to arrange for the registration of the relevant Shares in the name of the beneficial owner(s) prior to the Record Date. For Shareholders whose Shares are held by their nominee(s) and would like to have their names registered on the register of members of the Company, they must lodge all necessary documents with the Company's branch share registrar, Tricor Abacus Limited, for completion of the relevant registration by 4:30 p.m. on Tuesday, 10 August 2010.

**Rights of Excluded Shareholders**

The Prospectus Documents will not be registered under the applicable securities legislation of any jurisdiction other than Hong Kong and Bermuda. Based on the register of members of the Company as at the Latest Practicable Date, there were three Shareholders with registered address in the United States of America, the PRC and the Macau Special Administrative Region of the PRC respectively. Pursuant to the Listing Rules, the Board has made enquiries as to whether there is any legal restriction under the applicable securities legislation of the relevant jurisdiction or requirement of any relevant regulatory body or stock exchange with respect to the offer of Offer Shares and the Bonus Shares to such Overseas Shareholders.

The Directors, after making enquiries pursuant to the Listing Rules, are of the view that (i) the Open Offer will be extended to the Overseas Shareholders with registered address in the PRC and the Macau Special Administrative Region of the PRC respectively as no local legal or regulatory compliance is required to be made in these jurisdictions and (ii) it would be necessary or expedient to exclude the Overseas Shareholder with registered address in the United States of America from the Open Offer due to the time and costs involved in complying with the relevant local legal or regulatory requirements. As such, the Overseas Shareholder with registered address in the United States of America is the Excluded Shareholder. The Company has therefore arranged for the Prospectus, and not the Application Form, to be sent to the Excluded Shareholder for information only. However, so long as the Excluded Shareholder is an Independent Shareholder, he/she is entitled to attend and vote at the SGM.

The Company will continue to ascertain whether there is any other Overseas Shareholders on the Record Date and will, in determining whether any such Overseas Shareholder(s) will be regarded as Excluded Shareholders, make enquiry pursuant the Listing Rules as to whether there is any legal restriction under the applicable securities legislation of the relevant jurisdiction or requirement of any relevant regulatory body or stock exchange with respect to the offer of Offer Shares and the Bonus Shares to such Overseas Shareholders. If, based on the relevant advice obtained by the Company, the Directors consider that it is necessary or expedient not to offer the Offer Shares and the Bonus Shares to the other Overseas Shareholders, the Open Offer (with the Bonus Issue) will not be available to such other Overseas Shareholders.

The Offer Shares which would otherwise have been provisionally allotted to the Excluded Shareholders will be made available for subscription by the Qualifying Shareholders under excess applications.

**Certificates of the Offer Shares and the Bonus Shares and refund cheques**

Subject to fulfillment of the conditions of the Open Offer as set out in the section headed "Conditions of the Open Offer (with Bonus Issue)" above, share certificates for all fully paid Offer Shares and the Bonus Shares are expected to be posted on or before Tuesday, 7 September 2010 to those Qualifying Shareholders who have accepted and paid for the Offer Shares by ordinary post at their own risk.

Refund cheques in respect of wholly or partially unsuccessful applications for excess Offer Shares are also expected to be posted on or before Tuesday, 7 September 2010 by ordinary post at the risk of the Qualifying Shareholders concerned.

Each Qualifying Shareholder who has applied and paid for the Offer Shares will receive one share certificate for all the entitlements to the Offer Shares and one share certificate for the relevant Bonus Shares in fully paid form issued in his favour.

**No transfer of nil-paid entitlements**

The invitation to subscribe for the Offer Shares to be made to the Qualifying Shareholders will not be transferable. There will not be any trading in nil-paid entitlements on the Stock Exchange.

**Fractional entitlements**

Entitlement to the Offer Shares will be rounded down to the nearest whole number. No fractional entitlements to the Offer Shares will be issued to the Qualifying Shareholders and no entitlements of the Excluded Shareholders to the Offer Shares will be issued to the Excluded Shareholders. The Offer Shares representing such fractional entitlements and entitlements of the Excluded Shareholders will be aggregated and made available for excess applications by the Qualifying Shareholders who wish to apply for the Offer Shares over and above their assured allotments.

**Application for listing**

The Company will apply to the Listing Committee of the Stock Exchange for the listing of, and permission to deal in, the Offer Shares and the Bonus Shares. No part of the securities of the Company is listed or dealt in or on which listing or permission to deal is being or is proposed to be sought on any other stock exchange.

Subject to the granting of listing of, and permission to deal in, the Offer Shares and Bonus Shares on the Stock Exchange as well as compliance with the stock admission requirements of the HKSCC, the Offer Shares and Bonus Shares will be accepted as eligible securities by the HKSCC for deposit, clearance and settlement in the CCASS with effect from the commencement date of dealings in the Offer Shares and Bonus Shares on the Stock Exchange or such other date as determined by the HKSCC. Settlement of transactions between participants of the Stock Exchange on any trading day is required to take place in the CCASS on the second trading day thereafter. All activities under the CCASS are subject to the general rules of CCASS and CCASS operational procedures in effect from time to time.

***PROCEDURE FOR APPLICATION***

**Application for the Offer Shares**

The Application Forms will be enclosed with the Prospectus which entitles the Qualifying Shareholders to whom they are addressed to apply for the number of Offer Shares as shown therein subject to payment in full by the Latest Time for Acceptance. The Qualifying Shareholders should note that they may apply for any number of Offer Shares only up to the number set out in the Application Form.

If the Qualifying Shareholders wish to apply for all the Offer Shares offered to them as specified in the Application Forms or wish to apply for any number less than their entitlements under the Open Offer, they must complete, sign and lodge the Application Forms in accordance with the instructions printed thereon, together with remittance for the full amount payable in respect of such number of Offer Shares they have applied for with Tricor Abacus Limited at 26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong by 4:00 p.m. on Wednesday, 1 September 2010. All remittance(s) must be made in Hong Kong dollars and cheques must be drawn on an account with, or bankers' cashier's orders must be issued by, a licensed bank in Hong Kong and made payable to "China Ocean Shipbuilding Industry Group Limited — Open Offer Account" and crossed "Account Payee Only" or any other bank account of the Company to be specified in the Prospectus.

It should be noted that unless the duly completed and signed Application Form, together with the appropriate remittance, have been lodged with, Company's branch share registrar, Tricor Abacus Limited at 26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong by 4:00 p.m. on Wednesday, 1 September 2010, the entitlements of the respective Qualifying Shareholders under the Open Offer and all rights in relation thereto shall be deemed to have been declined and will be cancelled.

**Application for Excess Offer Shares**

The Qualifying Shareholders shall be entitled to apply for the Excess Offer Shares by completing the EAF and lodging the same with a separate remittance for the Excess Offer Shares being applied with the Company's branch share registrar, Tricor Abacus Limited at 26/F., Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong by no later than the Latest Acceptance Time. All remittances must be made in Hong Kong dollars and cheques must be drawn on an account with, or banker's cashier orders must be issued by, licensed banks in Hong Kong and made payable to "China Ocean Shipbuilding Industry Group Limited — Excess Application Account" and crossed "Account Payee Only" or any other bank account of the Company to be specified in the Prospectus.

The Directors will allocate the Excess Offer Shares at their discretion, but on a fair and equitable basis, on a pro-rata basis to the Excess Offer Shares applied for by the Qualifying Shareholders. However, no preference will be given to topping-up odd lots to whole board lots. Shareholders or potential investors should note that the number of Excess Offer Shares which may be allocated to them may be different where they make applications for Excess Offer Shares by different names, such as making applications on their own names rather than through nominees who also hold Shares for other Shareholders or investors. Shareholders and investors should consult their professional advisers if they are in any doubt as to whether they should register their shareholding in their own names or apply for Excess Offer Shares themselves.

The Qualifying Shareholders may apply (using forms of EAF) for the Excess Offer Shares from Tuesday, 17 August 2010, to Wednesday, 1 September 2010. Any Offer Shares that are not taken up by Qualifying Shareholders will be underwritten by the Underwriter pursuant to the Underwriting Agreement.

The share registrar of the Company and transfer office will notify the Qualifying Shareholders of any allotment of the Excess Offer Shares made to them. It should be noted that unless the duly completed and signed EAF, together with appropriate payment, have been lodged with the Company's branch share registrar, Tricor Abacus Limited at 26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong by 4:00 p.m. on Wednesday, 1 September 2010, the EAF is liable to be rejected.

All cheques or banker's cashier orders will be presented for payment immediately following receipt and all interest earned on such application monies will be retained for the benefit of the Company. Any Application Form or EAF in respect of which the cheque or banker's cashier order is dishonoured on first or, at the option of the Company, subsequent presentation is liable to be rejected, and in that event the relevant entitlements of the Qualifying Shareholders under the Open Offer (with the Bonus Issue) will be deemed to have been declined and will be cancelled.

Both Application Form and EAF are for the use by the person(s) named therein only and are not transferable.

No receipt will be issued in respect of any application monies received.

**Undertaking given by Mr. Li**

As at the Latest Practicable Date, Mr. Li was beneficially owner of 92,705,000 Shares, of which 79,995,000 Shares were directly held by him and 12,710,000 Shares were indirectly held by his wholly-owned company, Lead Dragon Limited, representing approximately 10.28% of the existing issued share capital of the Company. Under the Open Offer, Mr. Li will be directly or indirectly entitled to subscribe for a maximum of 46,352,500 Offer Shares. With respect to 77,405,000 Shares held directly or indirectly by Mr. Li, Mr. Li has irrevocably undertaken to the Company and Kingston Securities that: (1) he will subscribe for or procure subscriptions by his associates or nominees for 38,702,500 Offer Shares (with Bonus Shares) to which he, his associates and nominees will be entitled to pursuant to the terms of the Open Offer but without taking up any Excess Offer Shares over and above the assured allotments to him, his nominee(s) and associate(s); (2) the Shares comprising his and his associates and nominees' current shareholdings will remain registered in the names of him, his associates or nominees at the close of business at the Record Date as they are on the date of Mr. Li's Undertaking; and (3) he will procure that the applications in respect of the 38,702,500 Offer Shares (with Bonus Shares) comprising his and his associates and nominees' entitlements under the Open Offer will be lodged with the Company's branch share registrar, Tricor Abacus Limited, with payment in full therefor in cash, by no later than the Latest Time for Acceptance and otherwise in accordance with the instructions printed on the Application Form(s).

With respect to the other 15,300,000 Shares that are directly held by Mr. Li but are not required to be undertaken in Mr. Li's Undertaking, Mr. Li has agreed to subscribe for those Offer Shares (with Bonus Shares) but not any Excess Offer Shares derived therefrom which he will be entitled pursuant to the terms of the Open Offer.

***UNDERWRITING AGREEMENT***

| | |
|---|---|
| Date: | 15 June 2010 (after trading hours) |
| Underwriter: | Kingston Securities |
| Basis of the Open Offer: | one (1) Offer Share for every two (2) Shares held by the Qualifying Shareholders on the Record Date and payable in full on acceptance, together with two (2) Bonus Shares for every one (1) Offer Share taken up |
| Subscription Price: | HK$0.5 per Offer Share |
| Total number of Offer Shares being underwritten by the Underwriter: | The Underwriter has agreed to fully underwrite not less than 412,347,325 Underwritten Shares and not more than 464,492,501 Underwritten Shares (having taken into account Mr. Li's undertaking to subscribe for or procure subscription of 38,702,500 Offer Shares) |
| Commission: | 1.5% of the aggregate Subscription Price in respect of the maximum number of the Underwritten Shares |

To the best of the Directors' knowledge, information and belief having made all reasonable enquiries, the Underwriter and its ultimate beneficial owners are third parties independent of and not connected with the Company and its connected persons.

Pursuant to the Underwriting Agreement, the Underwriter has conditionally agreed to subscribe or procure subscription for the Underwritten Shares which have not been taken up. Accordingly, the Open Offer is fully underwritten. The Directors are of the opinion that the terms of the Underwriting Agreement and the amount of commission given to the Underwriter are fair as compared to the market practice and commercially reasonable as agreed between the Company and the Underwriter.

**Termination of the Underwriting Agreement**

If, prior to the Latest Time for Termination (provided that for the purposes of the Underwriting Agreement if the date of the Latest Time for Termination shall be a Business Day on which a tropical cyclone warning signal no. 8 or above or a black rainstorm warning signal is or remains hoisted in Hong Kong between 9:00 a.m. and 4:00 p.m. on that day, the date of the Latest Time for Termination shall be the next Business Day on which no tropical cyclone warning signal no. 8 or above or no black rainstorm warning signal is or remains hosted in Hong Kong between 9:00 a.m. and 4:00 p.m. on that day):

1. in the absolute opinion of the Underwriter, the success of the Open Offer would be materially and adversely affected by:

   a) the introduction of any new law or regulation or any change in existing law or regulation (or the judicial interpretation thereof) or other occurrence of any nature whatsoever which may in the absolute opinion of the Underwriter materially and adversely affect the business or the financial or trading position or prospects of the Group as a whole or is materially adverse in the context of the Open Offer; or

   b) the occurrence of any local, national or international event or change (whether or not forming part of a series of events or changes occurring or continuing before, and/or after the date hereof) of a political, military, financial, economic or other nature (whether or not ejusdem generis with any of the foregoing), or in the nature of any local, national or international outbreak or escalation of hostilities or armed conflict, or affecting local securities markets which may, in the absolute opinion of the Underwriter materially and adversely affect the business or the financial or trading position or prospects of the Group as a whole or materially and adversely prejudice the success of the Open Offer or otherwise makes it inexpedient or inadvisable to proceed with the Open Offer; or

   c) the imposition of any moratorium, suspension or material restriction on trading of the Shares on the Stock Exchange due to exceptional financial circumstances or otherwise; or

2. any material adverse change in market conditions (including without limitation, any change in fiscal or monetary policy, or foreign exchange or currency markets, suspension or restriction or trading in securities) occurs which in the absolute opinion of the Underwriter is likely to materially or adversely affect the success of the Open Offer or otherwise makes it inexpedient or inadvisable to proceed with the Open Offer; or

3. there is any change in the circumstances of the Company or any member of the Group which in the absolute opinion of the Underwriter will adversely affect the prospects of the Company, including without limiting the generality of the foregoing the presentation of a petition or the passing of a resolution for the liquidation or winding up or similar event occurring in respect of any of member of the Group or the destruction of any material asset of the Group; or

4. any event of force majeure including, without limiting the generality thereof, any act of God, war, riot, public disorder, civil commotion, fire, flood, explosion, epidemic, terrorism, strike or lock-out; or

5. any material adverse change in the business or in the financial or trading position or prospects of the Group as a whole whether or not ejusdem generis with any of the foregoing; or

6. the Circular or the Prospectus Documents in connection with the Open Offer (with Bonus Issue) when published contain information (either as to business prospects or the condition of the Group or as to its compliance with any laws or the Listing Rules or any applicable regulations) which has not prior to the date of the Underwriting Agreement been publicly announced or published by the Company and which may in the absolute opinion of the Underwriter is material to the Group as a whole and is likely to affect materially and adversely the success of the Open Offer or might cause a prudent investor not to apply for its assured entitlements of Offer Shares under the Open Offer (with Bonus Issue); or

7. any suspension in the trading of securities generally or the Company's securities on the Stock Exchange for a period of more than ten consecutive Business Days, excluding any suspension in connection with the clearance of the Announcement, the Circular or the Prospectus Documents or other announcements or circulars in connection with the Open Offer (with Bonus Issue),

the Underwriter shall be entitled by notice in writing to the Company, served prior to the Latest Time for Termination, to terminate the Underwriting Agreement.

***WARNING OF THE RISK OF DEALING IN SHARES***

**The Shareholders and potential investors of the Company should note that the Open Offer (with Bonus Issue) is conditional upon, inter alia, the fulfillment of the conditions set out above under the section headed "Conditions of the Open Offer (with Bonus Issue)". In addition, the Underwriter is entitled under the Underwriting Agreement to terminate the Underwriting Agreement on the occurrence of certain events. The Open Offer (with Bonus Issue) is also subject to the Underwriter not terminating the Underwriting Agreement. Accordingly, the Open Offer (with Bonus Issue) may or may not proceed.**

**The Shareholders and potential investors of the Company should therefore exercise extreme caution when dealings in the Shares, and if they are in any doubt about their positions, they should consult their professional advisors.**

The Shareholders should note that the Shares will be dealt in on an ex-entitlement basis commencing from Monday, 9 August 2010 and that dealings in Shares will take place while the conditions to which the Underwriting Agreement is subject to remain unfulfilled. Any Shareholder or other person dealings in the Shares up to the date on which all conditions to which the Open Offer is subject to are fulfilled, will accordingly bear the risk that the Open Offer (with the Bonus Issue) may not become unconditional and may not proceed.

***CHANGES IN SHAREHOLDING STRUCTURE OF THE COMPANY ARISING FROM THE OPEN OFFER (WITH THE BONUS ISSUE)***

The existing and enlarged shareholding structures of the Company immediately before and after the completion of the Open Offer (with the Bonus Issue) are set out below for illustration purpose only:

(i) assuming no exercise of the outstanding Share Options and Convertible Notes on or before the Record Date:

| | | | **Immediately upon completion of the Open Offer and the Bonus Issue** | | | |
|---|---|---|---|---|---|---|
| | **As at the Latest Practicable Date** | | **Assuming all Qualifying Shareholders take up the Offer Shares (with Bonus Shares) in full** | | **Assuming no Qualifying Shareholder (other than Mr. Li) takes up the Offer Shares (with Bonus Shares)** *(Note 2)* | |
| | *No. of Shares* | *Approx. %* | *No. of Shares* | *Approx. %* | *No. of Shares* | *Approx. %* |
| Mr. Li *(Note 1)* | 92,705,000 | 10.28 | 231,762,500 | 10.28 | 231,762,500 | 10.28 |
| **Public Shareholders** | | | | | | |
| Underwriter | — | — | — | — | 1,214,091,975 | 53.83 |
| Other public Shareholders | 809,394,651 | 89.72 | 2,023,486,626 | 89.72 | 809,394,651 | 35.89 |
| **Total:** | 902,099,651 | 100.00 | 2,255,249,126 | 100.00 | 2,255,249,126 | 100.00 |

(ii) assuming exercise of the outstanding Share Options and convertible rights attached to the Convertible Notes in full on or before the Record Date:

| | As at the Latest Practicable Date | | Immediately upon completion of the Open Offer and the Bonus Issue | | | |
|---|---|---|---|---|---|---|
| | | | Assuming all Qualifying Shareholders take up the Offer Shares (with Bonus Shares) in full | | Assuming no Qualifying Shareholder (other than Mr. Li) takes up the Offer Shares (with Bonus Shares) *(Note 2)* | |
| | *No. of Shares* | *Approx. %* | *No. of Shares* | *Approx. %* | *No. of Shares* | *Approx. %* |
| Mr. Li *(Note 1)* | 92,705,000 | 10.28 | 231,762,500 | 9.21 | 231,762,500 | 9.21 |
| Chau On Ta Yuen *(Note 3)* | — | — | 7,500,000 | 0.30 | 3,000,000 | 0.12 |
| Zhang Shi Hong *(Note 3)* | — | — | 2,500,000 | 0.10 | 1,000,000 | 0.04 |
| Wang San Long *(Note 3)* | — | — | 6,500,000 | 0.26 | 2,600,000 | 0.10 |
| **Public Shareholders** | | | | | | |
| Underwriter | — | — | — | — | 1,370,527,503 | 54.47 |
| Other public Shareholders | 809,394,651 | 89.72 | 2,267,712,505 | 90.13 | 907,085,002 | 36.06 |
| **Total:** | 902,099,651 | 100.00 | 2,515,975,005 | 100.00 | 2,515,975,005 | 100.00 |

*Notes:*

1. Mr. Li, an executive Director, was beneficial owner of 92,705,000 Shares, of which 79,995,000 Shares were directly held by him and 12,710,000 Shares were indirectly held by Lead Dragon Limited, a company incorporated in the British Virgin Islands and wholly owned by Mr. Li.

2. This scenario is for illustrative purpose only and will never occur. Pursuant to the Underwriting Agreement, in the event of the Underwriter being called upon to subscribe for or procure subscribers to subscribe for any of the Untaken Shares:

   (a) The Underwriter shall not subscribe, for its own account, for such number of Untaken Shares which will result in the shareholding of it and parties acting in concert (within the meaning of the Takeovers Code) with it in the Company to exceed 19.9% of the voting rights of the Company upon the completion of the Open Offer; and

   (b) The Underwriter shall use all reasonable endeavours to ensure that each of the subscribers of the Untaken Shares procured by it (i) shall be third party independent of, not acting in concert (within the meaning of the Takeovers Code) with and not connected with the Directors or chief executive of the Company or substantial shareholders of the Company or their respective associates (as defined in the Listing Rules); and (ii) save for the Underwriter itself and its associates, shall not, together with any party acting in concert (within the meaning of the Takeovers Code) with it, hold 10.0% or more of the voting rights of the Company upon completion of the Open Offer.

3. Mr. Chau On Ta Yuen, Mr. Zhang Shi Hong and Mr. Wang San Long are executive Directors who have 3,000,000 Share Options, 1,000,000 Share Options and 2,600,000 Share Options respectively as at the Latest Practicable Date.

## *PREVIOUS FUND RAISING EXERCISE IN THE PRIOR 12-MONTH PERIOD*

Save as disclosed below, the Company has not conducted any fund raising activities in the past twelve months before the date of the Announcement and up to the Latest Practicable Date:

| Nature of transaction | Date of initial announcement | Net proceeds | Intended use of net proceeds as announced | Actual use of net proceeds |
|---|---|---|---|---|
| Open offer *(Note)* | 16 November 2009 | Not less than approximately HK$353.9 million and not more than approximately HK$395.6 million | As to HK$250 million for repayment of debts and the remaining balance for general working capital purposes | Not applicable |
| Placing of new Shares | 20 August 2009 | Approximately HK$63.43 million | Repayment of debts and general working capital of the Group | HK$39.8 million was utilized as intended and the remaining balance was retained as general working of the Group |
| Placing of new Shares | 21 May 2009 | Approximately HK$43.0 million | Repayment of debts and general working capital of the Group | Fully utilized as intended |

*Note:*

The resolution approving the open offer was not passed at the special general meeting of the Company dated 30 December 2009. Therefore, the open offer did not proceed.

### *USE OF PROCEEDS*

The estimated net proceeds of the Open Offer will be not less than approximately HK$220.0 million and not more than approximately HK$246.2 million. The net proceeds will be used for repayment of debts and general working capital purposes. The estimated net expenses of approximately HK$5.5 million in relation to the Open Offer, including, among others, financial, legal and other professional advisory fee, underwriting commission, printing and translation expenses will be borne by the Company.

### *REASONS FOR AND BENEFIT OF THE OPEN OFFER*

Having considered other possibilities or alternatives for fund raising options for the Group, such as bank borrowings, placing of convertible notes and placing of new Shares, and taking into account the benefits and cost of the viable options, the Board considers that the Open Offer and the Bonus issue are conducted in the best interest of the Company in view of the prevailing market conditions and in particular the financial situation and fund requirement of the Group.

The Open Offer allows the Group to significantly strengthen its financial position. This is specially the case when the Group incurred a significant loss for the year ended 31 December 2009 and, as of that date, the Group's current liabilities exceed its current assets. The Board considers that the Open Offer (together with the Bonus Issue) are in the interests of the Company and the Shareholders as a whole as they offer all the Qualifying Shareholders an equal opportunity to participate in the enlargement of the capital base of the Company and enable the Qualifying Shareholders to maintain their proportionate interests in the Company and continue to participate in the future development of the Company should they wish to do so. The Bonus Issue will give the Shareholders an incentive to take part in the Open Offer.

### *ADJUSTMENTS IN RELATION TO THE SHARE OPTIONS AND CONVERTIBLE NOTES*

As at the date of the Latest Practicable Date, the Company has the following outstanding options and convertible securities:

1. Share Options for subscription of 34,380,000 Shares;

2. Convertible Notes carrying rights to convert into 69,910,351 Shares at the conversion price of HK$7.26 per Share (subject to adjustment).

Adjustments to: (i) the exercise price and number of the outstanding Share Options, and (ii) the conversion price and the number of conversion Shares may be required under the relevant terms of the instrument constituting the Share Option Scheme and the Convertible Notes. Further announcement will be made by the Company in due course.

## AMENDMENT TO BYE-LAWS

The existing Bye-law 148 of the Bye-laws provides that the capitalisation of the Company's reserves or funds by way of distribution of bonus shares to the Shareholders should be in the same proportion to their shareholdings. Since the Qualifying Shareholders who do not take up the Offer Shares will not be entitled to the Bonus Shares, the Bonus Issue will not be in the same proportion to the shareholding of the Shareholders. To facilitate the Open Offer with the Bonus Issue, the Directors propose to amend the Bye-laws accordingly so that any declaration, making or payment of a distribution or dividend to the Shareholders otherwise than pro-rata to their shareholdings upon the capitalisation of any part of the Company's reserves or funds is allowed. Upon the Amendment to Bye-laws becoming effective and the necessary ordinary resolution approving the Open Offer (with Bonus Issue) being passed, the Bonus Shares and related issues can be allotted and issued in the proportions that the Board has proposed.

Accordingly, the existing Bye-law 148 will be deleted in its entirety and substituted with the following new Bye-law 148:

"The Company may, upon the recommendation of the Board, at any time and from time to time pass an ordinary resolution to the effect that it is desirable to capitalise all or any part of any amount for the time being standing to the credit of any reserve or fund (including the profit and loss account) whether or not the same is available for distribution and accordingly that such amount be set free for distribution among the Members or any class of Members who would be entitled thereto if it were distributed by way of dividend and in the same proportions or in such other proportion as the Company may by ordinary resolution determine, on the footing that the same is not paid in cash but is applied either in or towards paying up the amounts for the time being unpaid on any shares in the Company held by such Members or such other persons respectively or in paying up in full unissued shares, debentures or other obligations of the Company, to be allotted and distributed credited as fully paid up among such Members, or partly in one way and partly in the other, and the Board shall give effect to such resolution provided that, for the purposes of this Bye-law a share premium account and any reserve or fund representing unrealised profits, may be applied only in paying up in full unissued shares of the Company to be allotted to such Members credited as fully paid. In carrying sums to reserve and in applying the same the Board shall comply with the provisions of the Act."

The Directors consider the Amendment to Bye-Laws would facilitate the issue of the Bonus Shares and provide the Company with flexibility in raising capital from its Shareholders.

## SHARE PREMIUM REDUCTION

The Directors propose to put forward a special resolution to the Shareholders for approval at the SGM to cancel the entire amount standing to the credit of the Share Premium Account and transfer the same amount to the Contributed Surplus Account. Based on the audited account of the Company for the financial year ended 31 December 2009, the amount standing to the credit of the Share Premium Account was approximately HK$2,840.08 million. It is proposed that the amount payable on the Bonus Shares will be paid out of the Contributed Surplus Account upon the Share Premium Reduction becoming effective.

**Conditions**

The Share Premium Reduction is conditional upon:

(i) the passing by the Shareholders of a special resolution at the SGM to approve the Share Premium Reduction;

(ii) the due compliance with section 46(2) of the Companies Act, including the publication of a notice in an appointed newspaper in Bermuda in respect of the Share Premium Reduction; and

(iii) on the Effective Date, there is no reasonable grounds for believing the Company is, or after the Share Premium Reduction would be, unable to pay its liabilities as they become due.

Subject to the fulfillment of the above conditions, it is expected that the Share Premium Reduction will become effective on the date when the Open Offer becomes unconditional.

As none of the Shareholders has an interest in the Share Premium Reduction which is different from other Shareholders, no Shareholder is required to abstain from voting at the SGM in respect of Share Premium Reduction.

**LISTING RULES IMPLICATION ON THE OPEN OFFER**

As the Open Offer (with Bonus Issue) will increase the issued share capital of the Company by more than 50%, pursuant to Rule 7.24(5) of the Listing Rules, the Open Offer (with Bonus Issue) must be made conditional on approval by Independent Shareholders at the SGM and any Controlling Shareholders and their associates or where there is no Controlling Shareholder, the Directors (excluding independent non-executive Directors) and chief executive of the Company and their respective associates shall abstain from voting in favour of the relevant resolution relating to the Open Offer. As at the Latest Practicable Date, the Company had no Controlling Shareholder and therefore, the Directors (excluding the independent non-executive Directors) shall abstain from voting on the relevant resolution to approve the Open Offer at the SGM.

The shareholding of the aforesaid Shareholders who are required to abstain from voting is shown in the paragraph headed "CHANGES IN SHAREHOLDING STRUCTURE OF THE COMPANY ARISING FROM THE OPEN OFFER (WITH THE BONUS ISSUE)".

None of those Shareholders who are required to abstain from voting have intention to vote against the Open Offer.

There had been no voting trust or other agreement or arrangement or understanding entered into by or binding upon any such Shareholders, and no obligation or entitlement of any such Shareholders whereby any one of them has or may temporarily or permanently passed control over the exercise of the voting right in respect of their respective interest in the Company to a third parties either especially or on a case-by-case basis.

The Underwriter and the Company are aware of the requirement of Rule 13.32 of the Listing Rules which provides that at least 25% of an issuer's total share capital must at all times be held by the public. As set out in the paragraphs under the heading "Changes in shareholding structure of the Company arising from the Open Offer (with the Bonus Issue)" above, in the event of the Underwriter being called upon to subscribe for or procure subscribers for the Underwritten Shares not taken up, (a) the Underwriter shall not subscribe, for its own account, for such number of Underwritten Shares which will result in the shareholding of it and parties acting in concert (within the meaning of the Takeovers Code) with it in the Company to exceed 19.9% of the voting rights of the Company upon the completion of the Open Offer; and (b) the Underwriter shall use all reasonable endeavours to ensure that each of the subscribers of the Untaken Shares procured by it (i) shall be third party independent of, not acting in concert (within the meaning of the Takeovers Code) with and not connected with the Directors or chief executive of the Company or substantial shareholders of the Company or their respective associates (as defined in the Listing Rules); and (ii) save for the Underwriter itself and its associates, shall not, together with any party acting in concert (within the meaning of the Takeovers Code) with it, hold 10.0% or more of the voting rights of the Company upon completion of the Open Offer.

All the resolutions to be put forward for the Shareholders' approval at the SGM will be by way of poll.

**INFORMATION OF THE GROUP**

The Group is principally engaged in shipbuilding-related business and investments in securities.

**SGM**

The Company will convene the SGM at 10:00 a.m. on Monday, 16 August 2010 at Unit 1702-03, 17/F., China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road Central, Hong Kong at which resolutions will be proposed for the purpose of considering and if thought fit, approving the Open Offer (with the Bonus Issue), the Amendment to Bye-laws and the Share Premium Reduction. The notice of the SGM is set out on pages 139 to 141 of the Circular.

A form of proxy for use at the SGM or any adjourned meeting is enclosed. Whether or not you are able to attend the SGM in person, please complete the form of proxy in accordance with the instructions printed thereon and return the same to the Company Hong Kong branch share registrar Tricor Abacus Limited at 26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong as soon as possible and in any event not later than 48 hours before the time appointed for holding such meeting or any adjournment thereof. Completion and return of the form of proxy shall not preclude you from attending and voting at the SGM or any adjourned meeting should you so desire and in such event, the instruction appointing a proxy shall be deemed to be revoked.

**RECOMMENDATION**

Your attention is drawn to the letter from the Independent Board Committee set out on pages 28 to 29 in the Circular which contains its recommendation to the Independent Shareholders as to voting at the SGM in relation to the Open Offer (with the Bonus Issue) which is conditional upon the Shareholders' approval of the Open Offer (with the Bonus Issue), the Amendment to Bye-laws and the Share Premium Reduction.

Your attention is also drawn to the letter from the independent financial advisor set out on pages 30 to 45 in the Circular which contains its advice to the Independent Board Committee and the Independent Shareholders as regards the Open Offer (with the Bonus Issue) and the principal factors and reasons considered by it in arriving thereat.

The Independent Board Committee has considered the terms of the Open Offer (with the Bonus Issue) and the advice given by the independent financial advisor, and recommends the Independent Shareholders to vote in favour of the resolution in relation to the Open Offer (with the Bonus Issue) at the SGM (which necessarily to vote in favour of the Open Offer (with the Bonus Issue) the Amendment to Bye-laws and the Share Premium Reduction as well).

The Directors consider the terms of the Open Offer (with the Bonus Issue) are fair and reasonable and in the best interests of the Company and the Shareholders as a whole. They recommend the Shareholders to vote in favour of all resolutions proposed at the SGM.

**FURTHER INFORMATION**

Your attention is drawn to the information set out in the appendices to this Circular.

By order of the Board
**China Ocean Shipbuilding Industry Group Limited**
**CHAU On Ta Yuen**
*Chairman*

# CHINA OCEAN SHIPBUILDING INDUSTRY GROUP LIMITED
# 中海船舶重工集團有限公司

*(Incorporated in Bermuda with limited liability)*

**(Stock code: 00651)**

*To: the Independent Shareholders*

Dear Sir or Madam,

## (1) PROPOSED OPEN OFFER ON THE BASIS OF ONE OFFER SHARE FOR EVERY TWO SHARES HELD ON THE RECORD DATE WITH BONUS ISSUE ON THE BASIS OF TWO BONUS SHARES FOR EVERY ONE OFFER SHARE TAKEN UP; (2) AMENDMENT TO BYE-LAWS; (3) SHARE PREMIUM REDUCTION AND (4) NOTICE OF SPECIAL GENERAL MEETING

We refer to the circular dated 23 July 2010 of the Company (the "Circular"), of which this letter forms part. Terms defined in the Circular bear the same meanings in this letter unless the context otherwise requires.

We have been appointed as the Independent Board Committee to consider the Open Offer (with the Bonus Issue) and to advise the Independent Shareholders as to the fairness and reasonableness of the Open Offer (with Bonus Issue) and to recommend whether or not the Independent Shareholders should vote for the resolution to be proposed at the SGM to approve the Open Offer (with the Bonus Issue). GF Capital, the independent financial advisor, has been appointed to advise the Independent Board Committee in relation to the terms of the Open Offer (with the Bonus Issue).

We wish to draw your attention to the letter from the independent financial advisor to the Independent Board Committee and the Independent Shareholders which contains its advice to us in relation to the Open Offer (with the Bonus Issue) as set out in the Circular. We also draw your attention to the Letter from the Board in the Circular.

Having taken into account principal factors and reasons considered by and the opinion of the independent financial advisor as stated in its letter of advice, we consider the terms of the Open Offer (with the Bonus Issue) are fair and reasonable so far as the interests of the Independent Shareholders are concerned and are in the interests of the Company and the Shareholders as a whole.

We therefore recommend the Independent Shareholders to vote in favour of the resolution approving the Open Offer (with the Bonus Issue) (which necessarily to vote in favour of the Amendment to Bye-laws and the Share Premium Reduction as well) to be proposed at the SGM.

Yours faithfully,
For and on behalf of
**the Independent Board Committee**
**Mr. Zhang Xi Ping** **Ms. Xiang Siying**
**Mr. Hu Bai He** **Ms. Xiang Ying**
*Independent Non-executive Directors*

*The following is the text of a letter of advice from GF Capital, which has been prepared for the purpose of incorporation into this circular, setting out its opinion to the Independent Board Committee and the Independent Shareholders in connection with the Open Offer (with the Bonus Issue).*

廣發融資（香港）有限公司
GF Capital (Hong Kong) Limited

Rooms 2301-5 & 2313, COSCO Tower
183 Queen's Road Central, Hong Kong

23 July 2010

*To the Independent Board Committee and the Independent Shareholders of China Ocean Shipbuilding Industry Group Limited*

Dear Sirs,

## PROPOSED OPEN OFFER ON THE BASIS OF ONE OFFER SHARE FOR EVERY TWO SHARES HELD ON THE RECORD DATE WITH BONUS ISSUE ON THE BASIS OF TWO BONUS SHARES FOR EVERY ONE OFFER SHARE TAKEN UP

### INTRODUCTION

We refer to our appointment as the independent financial adviser to the Independent Board Committee and the Independent Shareholders in respect of the Open Offer (with the Bonus Issue), particulars of which are set out in the letter from the Board (the "**Letter from the Board**") contained in this circular (the "**Circular**") dated 23 July 2010 issued by the Company, of which this letter forms part. Capitalised terms used in this letter shall have the same meanings ascribed to them in the Circular unless the context otherwise requires.

On 15 June 2010, the Company announced its proposal to raise not less than approximately HK$225.5 million and not more than approximately HK$251.6 million, before expenses, by way of an open offer of not less than 451,049,825 Offer Shares and not more than 503,195,001 Offer Shares at the Subscription Price of HK$0.5 per Offer Share on the basis of one (1) Offer Share for every two (2) Shares held by the Qualifying Shareholders on the Record Date and payable in full on acceptance. Subject to the satisfaction of the conditions of the Open Offer, the Bonus Shares will be issued to the First Registered Holders of the Offer Shares on the basis of two (2) Bonus Shares for every one (1) Offer Share taken up the Open Offer. On the basis of not less than 451,049,825 Offer Shares and not more than 503,195,001 Offer Shares to be issued under the Open Offer, not less than 902,099,650 Bonus Shares and not more than 1,006,390,002 Bonus Shares will be issued. The Bonus Shares will be funded out of the Contributed Surplus Account. The Open Offer (with the Bonus Issue) is fully underwritten by the Underwriter.

Pursuant to the Open Offer, Mr. Li will be directly or indirectly entitled to subscribe for a maximum of 46,352,500 Offer Shares. With respect to 77,405,000 Shares held directly or indirectly by Mr. Li, Mr. Li has irrevocably undertaken to the Company and the Underwriter that: (i) he will subscribe for or procure subscriptions by his associates or nominees for 38,702,500 Offer Shares (with the Bonus Shares) to which, his associates and nominees will be entitled to pursuant to the terms of the Open Offer but without taking up any Excess Offer Shares over and above the assured allotments to him, his nominee(s) and associate(s); (ii) the Shares comprising his and his associates and nominees' current shareholdings will remain registered in the names of him, his associates or nominees at the close of business at the Record Date as they are on the date of Mr. Li's Undertaking; and (iii) he will procure that the applications in respect of 38,702,500 Offer Shares (with the Bonus Shares) comprising his and his associates and nominees' entitlements under the Open Offer will be lodged with the Company's branch share registrar, Tricor Abacus Limited, with payment in full therefore in cash, by no later than the Latest Time for Acceptance and otherwise in accordance with the instructions printed on the Application Form(s).

With respect to the other 15,300,000 Shares that are directly held by Mr. Li but are not required to be undertaken in Mr. Li's Undertaking, Mr. Li has agreed to subscribe for those Offer Shares (with the Bonus Shares) but not any Excess Offer Shares derived therefrom pursuant to the terms of the Open Offer.

As the Open Offer (with the Bonus Issue) will increase the issued share capital of the Company by more than 50%, pursuant to Rule 7.24(5) of the Listing Rules, the Open Offer (with the Bonus Issue) must be made conditional on approval by Independent Shareholders at the SGM and any Controlling Shareholders and their associates or, where there is no Controlling Shareholder, the Directors (excluding the independent non-executive Directors), the chief executive of the Company and their respective associates shall abstain from voting in favour of the relevant resolution relating to the Open Offer. As at the Latest Practicable Date, the Company had no Controlling Shareholder and therefore, the Directors (excluding the independent non-executive Directors) shall abstain from voting on the relevant resolution to approve the Open Offer and the Bonus Issue at the SGM.

**INDEPENDENT BOARD COMMITTEE**

The Independent Board Committee, comprising all the independent non-executive Directors, namely Mr. Zhang Xi Ping, Ms. Xiang Siying, Mr. Hu Bai He and Ms. Xiang Ying, has been established to advise the Independent Shareholders in respect of the Open Offer (with the Bonus Issue).

We have been appointed to advise the Independent Board Committee and the Independent Shareholders as to whether the terms of the Open Offer (with the Bonus Issue) are on normal commercial terms, whether they are fair and reasonable so far as the Independent Shareholders are concerned and whether the Open Offer (with the Bonus Issue) is in the interests of the Company and the Shareholders as a whole, and to make recommendation to the Independent Board Committee to advise the Independent Shareholders and to advise the Independent Shareholders on how to vote in relation to the resolution(s) in respect of the Open Offer.

## BASIS OF OUR OPINION

In formulating our opinion, we have relied solely on the statements, information, opinions and representations for matters relating to the Company contained in the Circular and the information and representations provided to us by the Company, its representatives and/or the Directors for which they are solely and wholly responsible. We have assumed that all such statements, information, opinions and representations for matters relating to the Company contained or referred to in the Circular or otherwise provided or made or given by the Company, its representatives and/or the Directors and for which they are solely responsible were true, accurate and complete at the time they were made and given and continue to be true, accurate and complete at the date of the Circular. We have assumed that all statements of belief, opinion and representations for matters relating to the Company made or provided by the Directors and/or the representatives of the Company contained in the Circular were reasonably made after due and careful enquiry. We have also sought and obtained confirmation from the Company that no material facts have been omitted from the information provided and referred to in the Circular. The Directors confirmed that they have provided us with all currently available information and documents which are available under present circumstances to enable us to reach an informed view and we have relied on the accuracy of such information and the information contained in the Circular to provide a reasonable basis of our opinion.

We consider that we have reviewed sufficient information which enables us to reach an informed view and to provide us with a reasonable basis for our opinion. We have no reason to suspect that any material facts or information which is known to the Company, its representatives and the Directors have been omitted or withheld from the information supplied or opinions expressed in the Circular nor to doubt the truth, accuracy and completeness of the information, facts, and representations provided, or the reasonableness of the opinions and representations expressed by the Company, its representatives and the Directors. We have not, however, carried out any independent verification on the information provided to us by the Company, its representatives and the Directors, nor have we conducted an independent in-depth investigation into the business and affairs of the Company and the prospects of the Company.

We have not considered the tax consequences on the Qualifying Shareholders arising from the subscription for, holding of or dealing in the Offer Shares or exercising any right attached thereto or otherwise since these are particular to their individual circumstances. Independent Shareholders who are in any doubt as to their tax position, or who are subject to overseas tax or Hong Kong taxation on securities dealing, should consult their own professional advisers without delay.

## PRINCIPAL FACTORS AND REASONS CONSIDERED

In assessing the Open Offer (with the Bonus Issue) and in giving our opinion and recommendation to the Independent Board Committee and the Independent Shareholders, we have considered the following principal factors and reasons:

### 1. Information on the Group

1.1 *Principal business of the Group*

The Group is principally engaged in shipbuilding-related business and investments in securities.

1.2 *Financial performance of the Group*

The financial results of the Group for each of the two years ended 31 December 2009, as extracted from the annual report of the Company (the "**2009 Annual Report**"), are summarized as below:

**Consolidated statement of comprehensive income**

| | For the year ended 31 December | |
|---|---|---|
| | **2009** | **2008** |
| | *HK$'000* | *HK$'000* |
| | *(Audited)* | *(Audited)* |
| Revenue | 1,239,532 | 1,191,596 |
| Gross profit / (loss) | (545,139) | 160,471 |
| Loss before tax | (2,191,742) | (474,990) |
| Loss after tax | (1,956,362) | (468,996) |

**Consolidated statement of financial position**

| | As at 31 December | |
|---|---|---|
| | **2009** | **2008** |
| | *HK$'000* | *HK$'000* |
| | *(Audited)* | *(Audited)* |
| Net current assets / (liabilities) | (480,059) | 206,125 |
| Net assets | 506,816 | 2,293,409 |
| Pledged bank deposits | 387,031 | 176,648 |
| Bank balances and cash | 269,588 | 158,155 |
| Bank borrowings (due within one year) | 511,364 | 113,637 |
| Bank borrowings (due after one year) | 113,636 | 227,273 |
| Total bank borrowings | 625,000 | 340,910 |
| Deferred consideration | 200,000 | 173,447 |

**Consolidated statement of cash flow**

| | For the year ended 31 December | |
|---|---|---|
| | **2009** | **2008** |
| | *HK$'000* | *HK$'000* |
| Net cash from operating activities | 175,273 | 322,366 |
| Net cash used in investing activities | (419,045) | (208,458) |
| Net cash from (used in) financing activities | 359,726 | (52,195) |

As shown in the above table, the Group recorded losses of approximately HK$1,956.36 million for the year ended 31 December 2009, represented an increase of approximately HK$1,487.37 million over the year ended 31 December 2008. According to the 2009 Annual Report, the significant increase in loss was mainly attributable to an impairment loss in goodwill and intangible assets of approximately HK$1,454.18 million as a result of the continuous effect of financial crisis occurred in September 2008.

As referred to in the 2009 Annual Report, the unsatisfactory performance of the Group for the year ended 31 December 2009 was mainly due to the decrease in new orders, the drop in the vessel price and the deferred delivery of vessel.

As at 31 December 2009, the Group had total bank borrowings of approximately HK$625.00 million, representing an increase of 83.3% as compared with that of approximately HK$340.91 million as at 31 December 2008. According to the management of the Company, the additional bank borrowings were mainly used for (i) financing the investment in property, plant and equipment of the Group; (ii) purchasing of raw materials; and (iii) pledging cash as collaterals to obtain banking facilities. As compared with the respective figures as at 31 December 2008, the amounts of (i) property, plant and equipment; (ii) prepayment of raw materials; and (iii) pledged bank deposits as at 31 December 2009 increased by approximately HK$154.44 million, HK$149.98 million and HK$210.38 million respectively.

According to the 2009 Annual Report, we noted that among the bank borrowings, approximately HK$511.36 million would be due within one year. As discussed with the management of the Company, the Company intends to roll-over the bank borrowings when they fall due. Having considered the Group's credit history and the amount of cash and other collaterals pledged with the banks, the Company believes that barring any unforeseen factors, the bank borrowings can be rolled over when they fall due. As a usual practice of the subsidiary of the Company, the subsidiary of the Company usually repays the bank borrowings when they fall due before such bank borrowings can be rolled over by the banks shortly afterwards.

Besides, we further noted that the Group breached covenants for two bank loans, amounted of approximately HK$23.00 million and HK$113.00 million arising from over leverage and insufficient pledged deposits respectively. As advised by the management of the Company, the Group has obtained a waiver letter for the breach of covenant for one of the loans relating to over leverage whilst for the breach of loan covenant arising from insufficient pledged deposits were partially settled by the subsidiary of the Company on 31 March 2010 and the bank agreed to extend the remaining loan balance by signing a supplement extension agreement. The Directors confirmed that the loans were not called by the banks as at the Latest Practicable Date.

We noted from the 2009 Annual Report that, without qualifying their opinion, the independent auditors of the Company had expressed a material uncertainty opinion (the "**Uncertainty Opinion**") concerning the Group's ability to continue as a going concern in view of its net loss of approximately HK$1,956.36 million incurred for the year ended 31 December 2009 and its net current liabilities of approximately HK$480.06 million as at 31 December 2009 respectively. We also noted that, as at the Latest Practicable Date, there were two ongoing arbitration proceedings (the "**Arbitrations**") between (i) Jiangxi Jiangzhou Union Shipbuilding Co., Ltd ("**Shipyard**"), a wholly owned subsidiary of the Company, and Intrepid Chem 1021 Corp ("**Intrepid**"); and (ii) between Shipyard and Sloman Neptun Schiffahrts-Aktiengesellschaft ("**Sloman"**) respectively, details of which are disclosed in the paragraph headed "Litigation" of Appendix III to this Circular. As advised by the management of the Company, the Company considers that the Arbitrations are of immaterial financial impact to the Group thus far. Furthermore, the Company is of the view that no provision for the claims is required at this early fact finding stage of the Arbitrations.

Notwithstanding the positive operating cashflow generated by the Group for the year ended 31 December 2009 and the payment to be made by the Company in relation to the acquisition of 100% interest in a wholly-owned subsidiary amounted to HK$200.00 million ("**Deferred Consideration**") was further deferred to 31 January 2012, we are of the opinion that the current financial position of the Company is unfavorable and it would be in the interests of the Company and the Shareholders as a whole to strengthen the equity capital base of the Company so as to enable it to repay its short-term bank borrowings as and when they fall due and before they can be rolled-over by banks; and to carry on the Group's business without a significant curtailment of operations. Therefore, we consider that it is commercially justifiable for the Company to proceed with the Open Offer (with the Bonus Issue).

**2. Reasons for the Open Offer (with the Bonus Issue) and the use of proceeds**

As stated in the Letter from the Board, the Directors consider that the Open Offer allows the Group to significantly strengthen its financial position. In view of (i) the significant loss incurred for the year ended 31 December 2009; and (ii) the Group's net current liabilities position as at 31 December 2009, the Directors consider that the Open Offer (with the Bonus Issue) is in the interests of the Company and the Shareholders as a whole. In addition, the Open Offer would provide an equal opportunity for all the Qualifying Shareholders to maintain their proportionate interests in the Company and continue to participate in the future development of the Company should they wish to do so. The Bonus Issue, on the other hand, would give the Shareholders an incentive to take part in the Open Offer.

As set out in the Letter from the Board, the estimated net proceeds from the Open Offer will not be less than approximately HK$220.0 million and not more than approximately HK$246.2 million. The net proceeds will be used for repayment of debts and the remaining for general working capital of the Company.

Taking into consideration the extension of the maturity date of the outstanding convertible notes amounted to approximately HK$507.55 million by the Company (details of such extension were set out in the announcement and circular of the Company dated 27 April 2010 and 9 June 2010 respectively, it is likely that the Group needs additional funding to meet its working capital requirement. As discussed under the paragraph headed "Financial performance of the Group" above, in light of the financial position of the Group, in particular, the Group has recorded (i) bank balances and cash of approximately HK$269.59 million; (ii) bank borrowings due within one year of approximately HK$511.36 million; and (iii) net current liabilities of approximately HK$480.06 million as at 31 December 2009, we are of the view that the Group may need external financing to provide additional cashflow to settle the outstanding debts including but not limited to the Deferred Consideration and for general working capital purposes. Based on the above, therefore, we concur with the Directors' view that the Open Offer is necessary.

We further noted that the Group conducted fund raising successfully for aggregate net proceeds of approximately HK$106.43 million during the past 12 months immediately preceding the Latest Practicable Date, of which approximately HK$82.8 million was utilized as intended and the remaining balance was retained as general working capital of the Company as at the Latest Practicable Date. Details of the use of proceeds has been set out under the section headed "Previous fund raising exercise in the prior 12-month period" in the Letter from the Board.

Having considered (i) the persistent loss-making track record of the Group; (ii) the unfavourable financial position of the Group and the Uncertainty Opinion; (iii) the Open Offer (with the Bonus Issue) would strengthen the capital base and hence the financial position of the Group; and (iv) the Open Offer (with the Bonus Issue) allows the Qualifying Shareholders maintain their respective proportional shareholdings in the Company and participate in the growth of the Company, we concur with the Directors' view that the Open Offer (with the Bonus Issue) is in the interests of the Company and the Shareholders as a whole.

**3. Financing alternatives available to the Group**

As stated in the Letter from the Board, the Directors have considered other possibilities or alternatives as fund raising options for the Group, such as bank borrowings, placing of convertible notes and placing of new Shares, and taking into account the benefits and cost of the viable options, the Directors considers that the Open Offer and the Bonus Issue are conducted in the best interest of the Company in view of the prevailing market conditions and in particular the financial situation and fund requirement of the Group.

Having discussed with the management of the Company, we understood that the alternative financing options considered by the Group include loan financing, the placing of convertible notes, rights issue and the placing of new Shares. In view of the net current liabilities position of the Group, it is likely that any possible loan financing offered to the Company and issuance of convertible notes may be subject to stringent terms, depending on the Group's financial position and capital structure and the prevailing market conditions. As such, the Directors are of the view that it is prudent to finance the Group's business and development by long term funding, preferably in the form of equity to bolster the financial position of the Group.

The management of the Company considered that financing by way of rights issue will incur additional costs in respect of the trading of nil-paid rights. In view of the dilution effect of the interests of the Shareholders in the case of placing of new Shares, and the fact that not all Shareholders can participate in such placement exercise on an equal basis, we concur with the view of the Directors that the Open Offer is a more desirable means for the Group to obtain the required funding as compared with other alternatives. Having considered the above we are of the view that fund raising by way of the open offer is fair and reasonable and it is in the interests of the Company and the Shareholders as a whole.

**4. Principal terms of the Open Offer (with the Bonus Issue)**

| | | |
|---|---|---|
| Basis of the Open Offer | : | One (1) Offer Share for every two (2) Shares held on the Record Date and payable in full on acceptance, together with two (2) Bonus Shares for every one (1) Offer Share taken up |
| Subscription Price | : | HK$0.5 per Offer Share |
| Number of Shares in issue as at the Latest Practicable Date | : | 902,099,651 Shares |
| Number of Shares in issue as at the Record Date | : | Not less than 902,099,651 Shares (assuming no outstanding Share Options and convertible securities of the Company are exercised or converted on or before the Record Date) and not more than 1,006,390,002 Shares (assuming all outstanding Share Options and convertible securities of the Company are exercised or converted on or before the Record Date) |
| Number of Offer Shares | : | Not less than 451,049,825 Offer Shares and not more than 503,195,001 Offer Shares |
| Number of Bonus Shares | : | Not more than 902,099,650 Bonus Shares and not more than 1,006,390,002 Bonus Shares to be issued to the First Registered Holders of the Offer Shares on the basis of two (2) Bonus Shares for every one (1) Offer Share taken up under the Open Offer |
| Total number of Shares in issue upon completion of the Open Offer and the Bonus Issue | : | Not less than 2,255,249,126 Shares and not more than 2,515,975,005 Shares |
| Number of Offer Shares underwritten by the Underwriter | : | Not less than 412,347,325 Offer Shares and not more than 464,492,501 Offer Shares |

The Subscription Price is HK$0.50 per Offer Share, payable in cash in full upon application, represents:

(i) a discount of approximately 12.28% to the closing price per Share of HK$0.570 per Share as quoted on the Stock Exchange on the Last Trading Day;

(ii) a discount of approximately 4.03% to the average of the closing prices per Share of HK$0.521 for the last five consecutive trading days as quoted on the Stock Exchange up to and including the Last Trading Day;

(iii) a premium of approximately 1.63% to the average of the closing prices per Share of approximately HK$0.492 for the last ten consecutive trading days as quoted on the Stock Exchange up to and including the Last Trading Day;

(iv) a premium of approximately 52.44% to the theoretical ex-entitlement price of approximately HK$0.328 per Share calculated based on the closing price per Share as quoted on the Stock Exchange on the Last Trading Day;

(v) a discount of approximately 11.03% to the audited consolidated net assets value per Share of approximately HK$0.562 as at 31 December 2009 (based on 902,099,651) Shares in issue as at the Last Trading Day; and

(vi) a premium of approximately 11.11% to the closing price per Share of HK$0.450 as quoted on the Stock Exchange as at the Latest Practicable Date.

Since two Bonus Shares will be issued upon subscription of one Offer Share, for illustration purpose, the average price for each Share to be allotted and issued under the Open Offer (with the Bonus Issue) (the "**Effective Subscription Price**") is HK$0.167, which represents:

(i) a discount of approximately 70.70% to the closing price per Share of HK$0.570 per Share as quoted on the Stock Exchange on the Last Trading Day;

(ii) a discount of approximately 67.95% to the average of the closing prices per Share of HK$0.521 for the last five consecutive trading days as quoted on the Stock Exchange up to and including the Last Trading Day;

(iii) a discount of approximately 66.06% to the average of the closing prices per Share of approximately HK$0.492 for the last ten consecutive trading days as quoted on the Stock Exchange up to and including the Last Trading Day;

(iv) a discount of approximately 70.28% to the audited consolidated net asset value per Share of approximately HK$0.562 as at 31 December 2009 (based on 902,099,651 Shares in issue as at the Last Trading Day); and

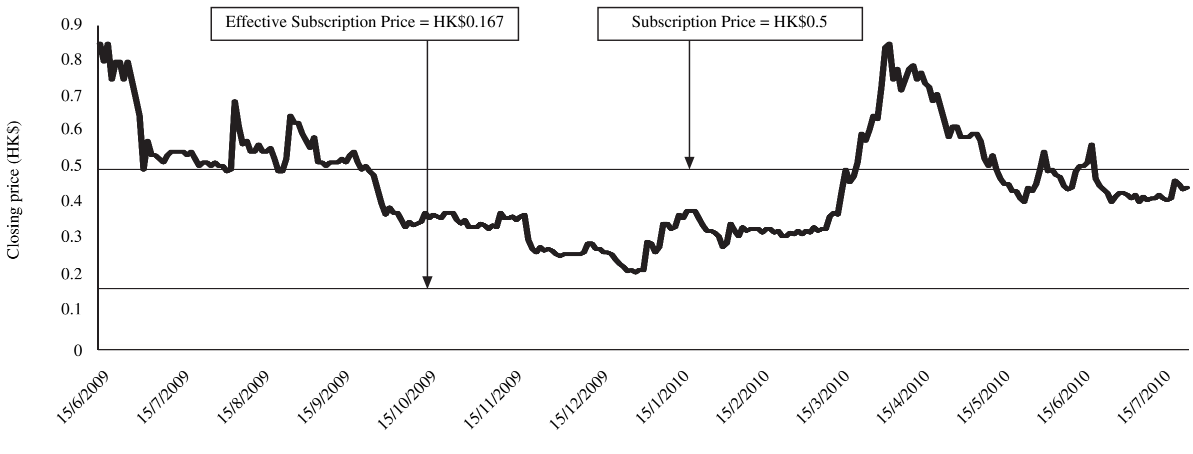
(v) a discount of approximately 62.89% to the closing prices per Share of HK$0.450 as quoted on the Stock Exchange as at the Latest Practicable Date.

As stated in the Letter from the Board, the Subscription Price was arrived at after arm's length negotiations between the Company and the Underwriter with reference to, among other things, the prevailing market price of the Shares, the recent market conditions and the financial requirements of the Group. The Directors consider that the Subscription Price would encourage Qualifying Shareholders to participate in the Open Offer and accordingly maintain their shareholdings in the Company and participate in the future growth of the Group. In view of the current financial position of the Group, the prevailing market conditions of the capital market in Hong Kong and the benefits of the Open Offer (with the Bonus Issue), the Directors consider that the terms of the Open Offer (with the Bonus Issue) are fair and reasonable and in the interests of the Company and the Shareholders as a whole.

To assess whether the Effective Subscription Price is fairly and reasonably determined, we have considered the following factors:

(a) *Historical closing prices*

We have reviewed the movements in trading price of the Shares during the period from 15 June 2009 (being the 12 calendar months period prior to the date of the Underwriting Agreement) to the Latest Practicable Date (the "**Review Period**"). The closing prices of the Shares during the Review Period are set out below:




*Source: website of the Stock Exchange (www.hkex.com.hk)*

*Note: Share consolidation on the basis of every fifty shares of HK$0.001 each into one consolidated share of HK$0.05 each was effective on 25 June 2009*

The closing prices of the Shares ranged from the lowest of HK$0.214 on 24 December 2009 to the highest of HK$0.85 on 30 March 2010 during the Review Period. As shown in the graph above, we noted that the Effective Subscription Price is lower than the closing prices of the Shares during the Review Period and up to and including the Latest Practicable Date.

We noted that it is a common market practice that, in order to enhance the attractiveness of an open offer exercise and to encourage the Shareholders to participate in an open offer, the subscription price of an open offer normally represents a discount to the prevailing market prices of the relevant shares. Hence, the fact that the Effective Subscription Price is lower than the prevailing market prices of the Shares is in line with general practice and is reasonable.

(b) *Underwriting Commission*

Pursuant to the Underwriting Agreement, the Underwriter has conditionally agreed to subscribe or procure subscription for the Underwritten Shares which have not been taken up. Accordingly, the Open Offer (with the Bonus Issue) is fully underwritten.

The Company will pay the Underwriter an underwriting commission of 1.5% (the "**Underwriting Commission**") of the aggregate Subscription Price in respect of the maximum number of the Underwritten Shares. To assess the fairness and reasonableness of the underwriting commission, we have researched into the open offers announced and conducted by other listed issuers in Hong Kong in the preceding six months prior to the Last Trading Day. We noted that the Underwriting Commission is in line with the market and is close to the lower end of the range of 1.00% to 4.00%. Therefore, we consider that the Underwriting Commission of 1.5% is on normal commercial terms and is fair and reasonable so far as the Independent Shareholders are concerned.

(c) *Application for Excess Offer Shares*

As set out in the Letter from the Board, Qualifying Shareholders shall be entitled to apply for Excess Offer Shares by completing the EAF and lodging the same with a separate remittance for the Excess Offer Shares being applied with the Company's branch share registrar, Tricor Abacus Limited by no later than the Latest Acceptance time.

The Directors will allocate the Excess Offer Shares at their discretion, but on a fair and equitable basis, on a pro-rata basis to the Excess Offer Shares applied for by the Qualifying Shareholders. However, no preference will be given to topping-up odd lots to whole board lots. Shareholders or potential investors should note that the number of Excess Offer Shares which may be allocated to them may be different where they make applications for Excess Offer Shares by different names, such as making applications on their own names rather than through nominees who also hold Shares for other Shareholders or investors.

The Directors consider that the allocation mechanism for the Excess Offer Shares on the above principles is fair and equitable as it is likely for a larger number of potential and qualifying applicants for Excess Offer Shares to have the opportunity to be successfully allocated with any Excess Offer Shares. We are not aware of the above allocation arrangement is unusual and consider the above allocation is in line with normal market practice.

(d) *The Bonus Issue*

Subject to the satisfaction of the conditions of the Open Offer as set out in the section headed "Conditions of the Open Offer (with the Bonus Issue)" in the Letter from the Board, the Bonus Shares will be issued to the First Registered Holders of the Offer Shares on the basis of two (2) Bonus Shares for every one (1) Offer Share taken up. Shareholders who subsequently received or were transferred the Offer Shares from other Qualifying Shareholders or other investors will not be treated as First Registered Holders of the Offer Shares.

On the basis of not less than 451,049,825 Offer Shares and not more than 503,195,001 Offer Shares to be issued under the Open Offer, not less than 902,099,650 Bonus Shares and not more than 1,006,390,002 Bonus Shares will be issued. The Bonus Shares will be funded out of the Contributed Surplus Account.

Assuming none of the outstanding Share Options and Convertible Notes is exercised or converted on or before the Record Date, the minimum total number of Offer Shares and Bonus Shares of 1,353,149,475 Shares represents:

(i) approximately 150% of the Company's existing issued share capital as at the date of the Announcement;

(ii) approximately 150% of the Company's existing issued share capital as at the Latest Practicable Date; and

(iii) approximately 60% of the Company's issued share capital as enlarged by the issue of the Offer Shares and the Bonus Shares.

Assuming exercise in full of all outstanding Share Options and convertible securities of the Company on or before the Record Date, the maximum total number of Offer Shares and Bonus Shares of 1,509,585,003 Shares represents:

(i) approximately 167% of the Company's existing issued share capital as at the date of the Announcement;

(ii) approximately 167% of the Company's existing issued share capital as at the Latest Practicable Date; and

(ii) approximately 60% of the Company's issued share capital as enlarged by the issue of the Offer Shares and the Bonus Shares.

Based on the above analysis and the facts that (i) the Shares were traded above the Effective Subscription Price throughout the Review Period; (ii) the underwriting arrangement and the Underwriting Commission are in line with the common market practice, we consider that the terms of the Open Offer (with the Bonus Issue) are on normal commercial terms, fair and reasonable so far as the Independent Shareholders are concerned.

(e) *Risk associated with the Open Offer (with the Bonus Issue) and the Underwriting Agreement*

Shareholders should note that, as stated in the Letter from the Board, the Open Offer is conditional upon, among other things, the Underwriting Agreement not being terminated or rescinded by the Underwriter pursuant to the terms thereof on or before the Latest Time for Termination (a summary of which is set out in the paragraph headed "Termination of the Underwriting Agreement" in the Letter from the Board). As such, the Open Offer (with the Bonus Issue) may or may not proceed. The Shareholders and potential investors should exercise caution when dealing in the Shares, and if they are in any doubt about their position, they should consult their professional advisers.

**5. Potential dilution effect of the Open Offer (with the Bonus Issue)**

The existing and enlarged shareholding structure of the Company immediately before and after the completion of the Open Offer (with the Bonus Issue) are extracted from the Letter from the Board and set out below for illustration purpose only:

(i) The shareholding structure of the Company, assuming no exercise of the outstanding Share Options and Convertible Notes on or before the Record Date:

| | As at the Latest Practicable Date | | Immediately upon completion of the Open Offer and the Bonus Issue | | | |
|---|---|---|---|---|---|---|
| | | | Assuming all Qualifying Shareholders take up the Offer Shares (with the Bonus Shares) in full | | Assuming no Qualifying Shareholder (other than Mr. Li) takes up the Offer Shares (with the Bonus Shares) *(Note 2)* | |
| **Shareholders** | *No. of Shares* | *Approx. %* | *No. of Shares* | *Approx. %* | *No. of Shares* | *Approx. %* |
| Mr. Li *(Note 1)* | 92,705,000 | 10.28 | 231,762,500 | 10.28 | 231,762,500 | 10.28 |
| **Public Shareholders** | | | | | | |
| Underwriter | — | — | — | — | 1,214,091,975 | 53.83 |
| Other public Shareholders | 809,394,651 | 89.72 | 2,023,486,626 | 89.72 | 809,394,651 | 35.89 |
| **Total** | 902,099,651 | 100.00 | 2,255,249,126 | 100.00 | 2,255,249,126 | 100.00 |

(ii) The shareholding structure of the Company assuming exercise of the outstanding Share Options and Convertible Notes on or before the Record Date:

| | | | Immediately upon completion of the Open Offer and the Bonus Issue | | | |
|---|---|---|---|---|---|---|
| | As at the Latest Practicable Date | | Assuming all Qualifying Shareholders take up the Offer Shares (with the Bonus Shares) in full | | Assuming no Qualifying Shareholder (other than Mr. Li) takes up the Offer Shares (with the Bonus Shares) *(Note 2)* | |
| **Shareholders** | *No. of Shares* | *Approx. %* | *No. of Shares* | *Approx. %* | *No. of Shares* | *Approx. %* |
| Mr. Li *(Note 1)* | 92,705,000 | 10.28 | 231,762,500 | 9.21 | 231,762,500 | 9.21 |
| Chau On Ta Yuen *(Note 3)* | — | — | 7,500,000 | 0.30 | 3,000,000 | 0.12 |
| Zhang Shi Hong *(Note 3)* | — | — | 2,500,000 | 0.10 | 1,000,000 | 0.04 |
| Wang San Long *(Note 3)* | — | — | 6,500,000 | 0.26 | 2,600,000 | 0.10 |
| **Public Shareholders** | | | | | | |
| Underwriter | — | — | — | — | 1,370,527,503 | 54.47 |
| Other public Shareholders | 809,394,651 | 89.72 | 2,267,712,505 | 90.13 | 907,085,002 | 36.06 |
| **Total** | 902,099,651 | 100.00 | 2,515,975,005 | 100.00 | 2,515,975,005 | 100.00 |

*Notes:*

1. Mr. Li, an executive Director, was beneficial owner of 92,705,000 Shares, of which 79,995,000 Shares Shares were directly held by him and 12,710,000 Shares were indirectly held by Lead Dragon Limited, a company incorporated in the British Virgin Islands and wholly owned by Mr. Li.

2. This scenario is for illustrative purpose only and will never occur. Pursuant to the Underwriting Agreement, in the event of the Underwriter being called upon to subscribe for or procure subscribers to subscribe for any of the Untaken Shares:

   (a) the Underwriter shall not subscribe, for its own account, for such number of Untaken Shares which will result in the shareholding of it and parties acting in concert (within the meaning of the Takeovers Code) with it in the Company to exceed 19.9% of the voting rights of the Company upon the completion of the Open Offer; and

   (b) the Underwriter shall use all reasonable endeavours to ensure that each of the subscribers of the Untaken Shares procured by it (i) shall be third party independent of, not acting in concert (within the meaning of the Takeovers Code) with and not connected with the Directors or chief executive of the Company or substantial shareholders of the Company or their respective associates (as defined in the Listing Rules); and (ii) save for the Underwriter itself and its associates, shall not, together with any party acting in concert (within the meaning of the Takeovers Code) with it, hold 10.0% or more of the voting rights of the Company upon completion of the Open Offer.

3. Mr. Chau On Ta Yuen, Mr. Zhang Shi Hong and Mr. Wang San Long are executive Directors who have 3,000,000 Share Options, 1,000,000 Share Options and 2,600,000 Share Options respectively as at the Latest Practicable Date.

The Open Offer (with the Bonus Issue) is offered to all Qualifying Shareholders on the same basis. All Qualifying Shareholders should note that each of them is entitled to subscribe for the Offer Shares so that they can maintain their proportionate interests in the Company if they take up their allotments under the Open Offer (with the Bonus Issue) in full.

Any Qualifying Shareholders who choose not to take up in full their assured entitlements under the Open Offer (with the Bonus Issue), depending on the extent to which they take up their respective entitlements, their shareholding interests in the Company will be diluted. For illustrative purposes, according to tables (i) and (ii), assuming that the Underwriter is being called upon to subscribe for all of the Offer Shares to be made to the Qualifying Shareholders, the Qualifying Shareholders' shareholding interests in the Company upon completion of the Open Offer (with the Bonus Issue) will have their shareholdings in the Company diluted by up to a maximum of approximately 53.7% for the shareholding interest upon completion of the Open Offer (with the Bonus Issue).

In all cases of open offers, the dilution on the shareholding of those Qualifying Shareholders who do not take up their full entitlements under the Open Offer is inevitable. In fact, the magnitude of dilution of any open offers depends primarily on the extent of the basis of entitlement under each particular open offer as the higher offering ratio of new shares to existing shares would result in the higher potential dilution effect on the shareholding of the existing shareholders who do not take up their entitlements in full.

Having taken into account the following factors:

(i) the inherent dilutive nature of open offer in general;

(ii) the Open Offer (with the Bonus Issue) is on the basis that all Qualifying Shareholders have been offered the same opportunity to maintain their proportionate interests in the Company and allows the Qualifying Shareholders to participate in the growth of the Company;

(iii) the needs of the Group for the additional funding to settle the outstanding debts and for its general working capital requirements; and

(iv) the Group's loss-making track record and relatively weak financial position which would place difficulties for the Company to raise capital from external sources.

We are of the view that such potential dilution of the Open Offer (with the Bonus Issue) on the shareholding of the Shareholders in the Company is acceptable.

**6. Possible financial effects on the Group upon completion of the Open Offer**

*Net tangible assets*

Based on the unaudited pro forma statement of consolidated net tangible assets of the Group (the "**Pro Forma Statement**") as set out in Appendix II to the Circular, the unaudited consolidated net tangible assets of the Group attributable to the Shareholders as at 31 December 2009 would be not more than HK$312.84 million upon completion of the Open Offer. Accordingly, the Group's net tangible asset per Share attributable to the Shareholders, will be not more than approximately HK$0.13 per Share upon completion of the Open Offer (with the Bonus Issue, assuming 503,195,001 Offer Shares and 1,006,390,002 Bonus Shares are to be issued), compared to a net tangible asset of approximately HK$0.07 per Share as at 31 December 2009.

*Cashflow*

According to the Letter from the Board, the estimated net proceeds of the Open Offer will be not less than approximately HK$220.0 million and not more than approximately HK$246.2 million. Therefore, the Group will have a net cash inflow in the range of approximately HK$220.0 million and HK$246.2 million upon completion of the Open Offer.

*Gearing ratio*

As the total capital base of the Group would be enlarged upon completion of the Open Offer (with the Bonus Issue) with borrowings of the Group unchanged, the gearing position of the Group is expected to improve as a result of the increase in equity capital from the net proceeds of the Open Offer.

Based on the above, although the Open Offer will dilute the per Share unaudited pro forma adjusted consolidated net tangible assets value, the Open Offer (with the Bonus Issue) will bring positive effects to the Group's net tangible assets, cashflow and gearing. Accordingly, we consider that the Open Offer (with the Bonus Issue) is in the interests of the Company and the Shareholders as a whole.

**CONCLUSIONS**

Having considered the abovementioned principal factors and reasons, we consider that the terms of the Open Offer (with the Bonus Issue) are on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned. In addition, we are of the opinion that the Open Offer (with the Bonus Issue) is in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the Independent Board Committee to advise the Independent Shareholders to vote in favour of the resolution(s) to approve the Open Offer (with the Bonus Issue) and the transaction contemplated thereunder at the SGM.

For and on behalf of
**GF Capital (Hong Kong) Limited**
**Danny Wan**
*Managing Director and Head of Corporate Finance*

## 1. SUMMARY OF FINANCIAL INFORMATION OF THE GROUP

The following is a summary of the audited consolidated financial results of the Group for each of the three years ended 31 December 2009 as extracted from the relevant annual reports of the Company.

### (i) Results

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* |
| Revenue | 1,239,532 | 1,191,596 | 5,203 |
| Cost of sales | (1,784,671) | (1,031,125) | (4,152) |
| | (545,139) | 160,471 | 1,051 |
| Other income | 14,190 | 14,679 | 5,574 |
| Other gains and losses | (340) | 9,276 | — |
| Loss on disposal of available-for-sale investments | — | (1,025) | — |
| Change in fair value of conversion option embedded in convertible note | — | — | 1,282 |
| Change in fair value of investments held for trading | (12,448) | (37,928) | (40,848) |
| Impairment loss on goodwill | (514,179) | (322,221) | — |
| Impairment loss on intangible assets | (940,000) | — | — |
| Distribution and selling expenses | (1,276) | (670) | — |
| Administrative expenses | (77,674) | (64,261) | (15,736) |
| Finance costs | (115,002) | (233,311) | (5,949) |
| Gain on disposal of subsidiaries | 126 | — | — |
| Loss before tax | (2,191,742) | (474,990) | (54,626) |
| Taxation | 235,380 | 5,994 | — |
| Loss for the year attributable to owners of the Company | (1,956,362) | (468,996) | (54,626) |
| Other comprehensive income (expense) | | | |
| Exchange difference arising on translation | — | 84,956 | — |
| Loss on change in fair value of available-for-sale investments | — | (1,286) | — |
| Release on disposal of available-for-sale investments | — | 1,025 | — |
| Other comprehensive income for the year | — | 84,695 | — |
| Total comprehensive loss for the year | (1,956,362) | (384,301) | — |
| Loss per share — basic and diluted/basic | (HK$2.54) | (HK$1.22) | (HK0.52) cents |

(ii) **Consolidated Statement of Financial Position**

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* |
| **Non-current assets** | | | |
| Property, plant and equipment | 1,071,307 | 916,871 | 1,133 |
| Deposit paid for acquisition of property, plant and equipment | 3,029 | 3,029 | — |
| Prepaid lease payments - non current portion | 337,899 | 345,004 | — |
| Goodwill | — | 514,179 | — |
| Intangible assets | 440,152 | 1,546,602 | — |
| Available-for-sale investments | — | — | 18,912 |
| Conversion option embedded in convertible note | — | — | 2,631 |
| | 1,852,387 | 3,325,685 | 22,676 |
| **Current assets** | | | |
| Inventories | 333,635 | 482,125 | 378 |
| Trade and other receivables | 615,640 | 562,518 | 4,979 |
| Prepayment for purchase of raw materials | 1,013,021 | 863,043 | — |
| Prepaid lease payment - current portion | 1,726 | 1,701 | — |
| Loan receivable | — | — | 48,364 |
| Amounts due from customers for contract work | 34,292 | — | — |
| Tax recoverable | 5,752 | — | — |
| Investments held for trading | 1,609 | 18,423 | 231,351 |
| Pledged bank deposits | 387,031 | 176,648 | — |
| Bank balances and cash | 269,588 | 158,155 | 84,796 |
| | 2,662,294 | 2,262,613 | 369,868 |
| **Current liabilities** | | | |
| Trade, bills and other payables | 986,094 | 1,371,331 | 4,952 |
| Amounts due to customers for contract work | 1,411,870 | 358,079 | — |
| Margin loan payable | — | 32,499 | 51,759 |
| Bank overdrafts | — | 4,521 | — |
| Bank borrowings - due within one year | 511,364 | 113,637 | — |
| Provision for warranty | 33,025 | 2,974 | — |
| Deferred consideration | 200,000 | 173,447 | — |
| | 3,142,353 | 2,056,488 | 56,711 |
| Net current (liabilities) assets | (480,059) | 206,125 | 313,157 |
| | 1,372,328 | 3,531,810 | 335,833 |
| **Capital and reserves** | | | |
| Share capital | 45,105 | 33,740 | 17,198 |
| Reserves | 461,711 | 2,259,669 | 272,410 |
| | 506,816 | 2,293,409 | 289,608 |
| **Non-current liabilities** | | | |
| Bank borrowings — due after one year | 113,636 | 227,273 | — |
| Convertible notes payable | 416,168 | 421,440 | 46,225 |
| Deferred tax liabilities | 335,708 | 589,688 | — |
| | 865,512 | 1,238,401 | 46,225 |
| | 1,372,328 | 3,531,810 | 335,833 |

## 2. AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Set out below are the audited consolidated financial statements of the Group for the two years ended 31 December 2009 which are extracted from the annual reports of the Group for the year ended 31 December 2009.

**Consolidated Statement of Comprehensive Income**
*For the year ended 31 December 2009*

| | *NOTES* | **2009** | **2008** |
|---|---|---|---|
| | | *HK$'000* | *HK$'000* |
| Revenue | 8 | 1,239,532 | 1,191,596 |
| Cost of sales | | (1,784,671) | (1,031,125) |
| | | (545,139) | 160,471 |
| Other income | 9a | 14,190 | 14,679 |
| Other gains and losses | 9b | (340) | 9,276 |
| Loss on disposal of available-for-sale investments | | — | (1,025) |
| Change in fair value of investments held for trading | | (12,448) | (37,928) |
| Impairment loss on goodwill | 36 | (514,179) | (322,221) |
| Impairment loss on intangible assets | 19 | (940,000) | — |
| Distribution and selling expenses | | (1,276) | (670) |
| Administrative expenses | | (77,674) | (64,261) |
| Finance costs | 10 | (115,002) | (233,311) |
| Gain on disposal of subsidiaries | 11 | 126 | — |
| Loss before tax | 12 | (2,191,742) | (474,990) |
| Taxation | 13 | 235,380 | 5,994 |
| Loss for the year attributable to owners of the Company | | (1,956,362) | (468,996) |
| Other comprehensive income (expense) | | | |
| Exchange difference arising on translation | | — | 84,956 |
| Loss on change in fair value of available-for-sale investments | | — | (1,286) |
| Release on disposal of available-for-sale investments | | — | 1,025 |
| Other comprehensive income for the year | | — | 84,695 |
| Total comprehensive loss for the year | | (1,956,362) | (384,301) |
| Loss per share | 16 | | |
| — basic and diluted | | (HK$2.54) | (HK$1.22) |

**Consolidated Statement of Financial Position**
*At 31 December 2009*

| | *NOTES* | **2009** *HK$'000* | **2008** *HK$'000* |
|---|---|---|---|
| **Non-current assets** | | | |
| Property, plant and equipment | 17 | 1,071,307 | 916,871 |
| Deposit paid for acquisition of property, plant and equipment | | 3,029 | 3,029 |
| Prepaid lease payments — non current portion | 18 | 337,899 | 345,004 |
| Goodwill | 36 | — | 514,179 |
| Intangible assets | 19 | 440,152 | 1,546,602 |
| | | 1,852,387 | 3,325,685 |
| **Current assets** | | | |
| Inventories | 22 | 333,635 | 482,125 |
| Trade and other receivables | 23 | 615,640 | 562,518 |
| Prepayment for purchase of raw materials | 23 | 1,013,021 | 863,043 |
| Prepaid lease payment — current portion | 18 | 1,726 | 1,701 |
| Amounts due from customers for contract work | 27 | 34,292 | — |
| Tax recoverable | | 5,752 | — |
| Investments held for trading | 24 | 1,609 | 18,423 |
| Pledged bank deposits | 25 | 387,031 | 176,648 |
| Bank balances and cash | 25 | 269,588 | 158,155 |
| | | 2,662,294 | 2,262,613 |
| **Current liabilities** | | | |
| Trade, bills and other payables | 26 | 986,094 | 1,371,331 |
| Amounts due to customers for contract work | 27 | 1,411,870 | 358,079 |
| Margin loan payable | 28 | — | 32,499 |
| Bank overdrafts | 25 | — | 4,521 |
| Bank borrowings — due within one year | 29 | 511,364 | 113,637 |
| Provision for warranty | 30 | 33,025 | 2,974 |
| Deferred consideration | 31 | 200,000 | 173,447 |
| | | 3,142,353 | 2,056,488 |
| Net current (liabilities) assets | | (480,059) | 206,125 |
| | | 1,372,328 | 3,531,810 |
| **Capital and reserves** | | | |
| Share capital | 32 | 45,105 | 33,740 |
| Reserves | | 461,711 | 2,259,669 |
| | | 506,816 | 2,293,409 |
| **Non-current liabilities** | | | |
| Bank borrowings — due after one year | 29 | 113,636 | 227,273 |
| Convertible notes payable | 33 | 416,168 | 421,440 |
| Deferred tax liabilities | 34 | 335,708 | 589,688 |
| | | 865,512 | 1,238,401 |
| | | 1,372,328 | 3,531,810 |

## Consolidated Statement of Changes in Equity

*For the year ended 31 December 2009*

| | Share capital | Share premium | Contributed surplus | Statutory reserve | Translation reserve | Capital reserve | Convertible notes reserve | Shared-based payment reserve | Investment revaluation reserve | Accumulated losses | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| At 1 January 2008 | 17,198 | 495,907 | 528,327 | — | — | 802 | 3,454 | — | 261 | (756,341) | 289,608 |
| Exchange differences on translation | — | — | — | — | 84,956 | — | — | — | — | — | 84,956 |
| Loss on change in fair value of available-for-sale investments | — | — | — | — | — | — | — | — | (1,286) | — | (1,286) |
| Release on disposal of available-for-sale investments | — | — | — | — | — | — | — | — | 1,025 | — | 1,025 |
| Loss for the year | — | — | — | — | — | — | — | — | — | (468,996) | (468,996) |
| Total comprehensive income (loss) for the year | — | — | — | — | 84,956 | — | — | — | (261) | (468,996) | (384,301) |
| Recognition of equity components of convertible notes payable | — | — | — | — | — | — | 889,887 | — | — | — | 889,887 |
| Deferred tax liability arising on recognition of equity component of convertible notes | — | — | — | — | — | — | (146,831) | — | — | — | (146,831) |
| Release of deferred tax liability upon conversion | — | — | — | — | — | — | 114,445 | — | — | — | 114,445 |
| Recognition of equity-settled shared-based payment | — | — | — | — | — | — | — | 42,012 | — | — | 42,012 |
| Conversion of convertible notes payable | 16,542 | 2,170,766 | — | — | — | — | (698,719) | — | — | — | 1,488,589 |
| At 31 December 2008 | 33,740 | 2,666,673 | 528,327 | — | 84,956 | 802 | 162,236 | 42,012 | — | (1,225,337) | 2,293,409 |
| Loss for the year and total comprehensive loss for the year | — | — | — | — | — | — | — | — | — | (1,956,362) | (1,956,362) |
| Transfer | — | — | — | 9,716 | — | — | — | — | — | (9,716) | — |
| Release of deferred tax liability upon conversion | — | — | — | — | — | — | 4,663 | — | — | — | 4,663 |
| Recognition of equity-settled shared-based payment | — | — | — | — | — | — | — | 5,682 | — | — | 5,682 |
| Shares issued | 10,900 | 97,896 | — | — | — | — | — | — | — | — | 108,796 |
| Transaction costs attributable to issue of shares | — | (2,270) | — | — | — | — | — | — | — | — | (2,270) |
| Conversion of convertible notes payable | 465 | 77,785 | — | — | — | — | (25,352) | — | — | — | 52,898 |
| At 31 December 2009 | 45,105 | 2,840,084 | 528,327 | 9,716 | 84,956 | 802 | 141,547 | 47,694 | — | (3,191,415) | 506,816 |

*Notes:*

(a) Contributed surplus of the Company mainly represents the difference between the value of the underlying net assets of certain subsidiaries acquired by the Company and the nominal amount of the share capital issued by the Company pursuant to a group reorganisation in 1998 and the amount arose from cancelling the paid up capital of the Company pursuant to a group reorganisation in 2001.

(b) According to the relevant laws in the People's Republic of China ("PRC"), wholly foreign-owned enterprises in the PRC are required to transfer 10% of their net profit after taxation, as determined under the relevant accounting principles and financial regulations applicable to companies established in the PRC, to statutory reserve until the statutory reserve balance reaches 50% of their registered capital. The transfer to this statutory reserve must be made before the distribution of dividend to equity owners. Statutory reserve can be used to offset previous years' losses, if any, and is non-distributable other than upon liquidation.

(c) Capital reseve represents the difference between the nominal value of share capital issued by the Company and the nominal value of the share capital and share premium of the companies now forming the Group pursuant to a group reorganisation prior to the listing of the Company's shares in 1998.

**Consolidated Statement of Cash Flow**
*For the year ended 31 December 2009*

| | *NOTES* | **2009** | **2008** |
|---|---|---|---|
| | | *HK$'000* | *HK$'000* |
| **OPERATING ACTIVITIES** | | | |
| Loss before tax | | (2,191,742) | (474,990) |
| Adjustments for: | | | |
| Depreciation of property, plant and equipment | | 52,222 | 33,959 |
| Change in fair value of investments held for trading | | 12,448 | 37,928 |
| Gain on disposal of a subsidiary | 11 | (126) | — |
| Loss on disposal of available-for-sale investment | | — | 1,025 |
| Loss on disposal of property, plant and equipment | | 642 | 624 |
| Interest income | | (6,235) | (7,617) |
| Finance costs | | 115,002 | 233,311 |
| Release of prepaid lease payment | | 7,080 | 4,812 |
| Amortisation of intangible asset | | 166,450 | 115,199 |
| Impairment loss on goodwill | | 514,179 | 322,221 |
| Impairment loss on intangible asset | | 940,000 | — |
| Share-based payment expense | | 5,682 | 42,012 |
| Operating cash flows before movements in working capital | | (384,398) | 308,484 |
| Decrease (increase) in inventories | | 148,490 | (135,742) |
| Increase in trade and other receivables, prepayment for purchase of raw materials | | (203,313) | (675,734) |
| Decrease in investments held for trading | | 4,367 | 175,000 |
| (Decrease) increase in trade, bills and other payables | | (392,705) | 1,120,181 |
| Increase (decrease) in provision of warranty | | 30,051 | (5,733) |
| Increase (decrease) in amounts due from(to) customers for contract work | | 1,019,499 | (452,447) |
| Decrease in margin loan payables | | (32,499) | (19,260) |
| Cash generated from operations | | 189,492 | 314,749 |
| Tax paid | | (20,454) | — |
| Interest received | | 6,235 | 7,617 |
| **NET CASH FROM OPERATING ACTIVITIES** | | 175,273 | 322,366 |

| | NOTES | 2009 HK$'000 | 2008 HK$'000 |
|---|---|---|---|
| **INVESTING ACTIVITIES** | | | |
| Increase in pledged bank deposit | | (210,383) | (161,100) |
| Purchase of property, plant and equipment | | (209,653) | (126,702) |
| Disposal of a subsidiary | 11 | (1,362) | — |
| Proceeds from disposal of property, plant and equipment | | 2,353 | 21 |
| Deposit paid for acquisition of property, plant and equipment | | — | (3,029) |
| Decrease in loan receivables | | — | 48,364 |
| Proceeds from disposal of available-for-sale investments | | — | 20,257 |
| Acquisition of a subsidiary | 35 | — | 13,731 |
| **NET CASH USED IN INVESTING ACTIVITIES** | | (419,045) | (208,458) |
| **FINANCING ACTIVITIES** | | | |
| New bank loan raised | | 454,545 | 16,314 |
| Proceeds from issue of shares | | 108,796 | — |
| Repayment of bank borrowings | | (170,455) | (41,807) |
| Interest paid | | (30,890) | (26,702) |
| Share issued expenses | | (2,270) | — |
| **NET CASH FROM (USED IN) FINANCING ACTIVITIES** | | 359,726 | (52,195) |
| **NET INCREASE IN CASH AND CASH EQUIVALENTS** | | 115,954 | 61,713 |
| **EFFECT OF FOREIGN EXCHANGE RATE CHANGES** | | — | 7,125 |
| **CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR** | | 153,634 | 84,796 |
| **CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR,** represented by | | 269,588 | 153,634 |
| Bank balances and cash | | 269,588 | 158,155 |
| Bank overdraft | | — | (4,521) |
| | | 269,588 | 153,634 |

**Notes to the Consolidated Financial Statements**
*For the year ended 31 December 2009*

## 1. GENERAL

The Company is incorporated in Bermuda as an exempted company with limited liability and its shares are listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). The addresses of the registered office and principal place of business of the Company are disclosed in the introduction to the annual report.

The Company is an investment holding company. The principal activities of its subsidiaries and associate are set out in notes 43 and 44, respectively.

The functional currency of the Company was originally Hong Kong dollars ("HKD"). On 16 April 2008, the Company acquired INPAX Group (as defined in note 35) which has Renminbi ("RMB") as its functional currency. The directors are of the opinion that after the acquisition of INPAX Group, the primary economic environment in which the Company operates is the PRC, taking into consideration that the Company's principal activity was holding of investments in subsidiaries. The directors have therefore determined that the functional currency of the Company was changed to RMB after the acquisition of the INPAX Group.

The consolidated financial statements are presented in HKD for the convenience of the shareholders as the Company is listed in Hong Kong.

## 2. BASIS OF PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS

In preparing the consolidated financial statements of the Group, the directors of the Company have given careful consideration to the future liquidity of the Group in light of the fact that the Group incurred a net loss of HK$1,956 million for the year ended 31 December 2009 and, as of that date, the Group's current liabilities exceeded its current assets by approximately HK$480 million. In addition, the following circumstances may affect the Group's financial position:

a) deferred consideration of HK$200 million which was due for payment on 31 January 2011 (note 31);

b) convertible notes payable with an aggregate carrying amount of approximately HK$416 million as at 31 December 2009 which will mature on 15 April 2011. The Group is required to redeem the convertible notes at their principal amount of approximately HK$508 million upon maturity (note 33); and

c) The Group breached several loan covenants for two of the bank loans with an aggregate amount of approximately HK$136 million. The amount was presented as current liabilities in the consolidated statement of financial position at 31 December 2009 (note 29).

In order to improve the Group's operating and financial position, the directors have been implementing various operating and financing measures as follows:

a) The Group has been actively pursuing new customers so as to enlarge its customer base. In addition, taking advantage of its expanded operation capacity which allows a better negotiating position, the Group places more stringent selection criteria for new sales orders with better margin from potential customers. At the same time, the Group has tightened cost control so as to reduce unnecessary expenditure. With all these measures, the Group is expecting to improve its performance in the coming years;

b) On 23 April 2010, the Group entered into an agreement to extend the payment of the deferred consideration of HK$200 million from 31 January 2011 to 31 January 2012 (note 31);

c) On 26 April 2010, the Group entered into a loan agreement with China MinSheng Banking Corp., Ltd and the bank agreed to grant a loan of RMB80 million for the operational requirements of the Group. The loan is interest bearing at 5.84% per annum and has a maturity date on 26 April 2011. The Group has not yet drawn the loan at the date of this report;

d) On 27 April 2010, the Group announced to have entered into an extension letter with each of the holders of the Group's convertible notes whereby the parties agreed to extend the maturity date of the outstanding convertible notes from 15 April 2011 to 15 April 2012. Except for the extension of the maturity date of the outstanding convertible notes, each and every term and condition under the existing convertible notes shall remain unchanged. The extension of the Group's convertible notes is conditional, among other things, on the approval by the shareholders of the Company at a special general meeting and the necessary consents and approvals by the Stock Exchange. Details of the extension of the maturity date of the convertible notes were set out in the Company's announcement dated 27 April 2010. The extension of the Group's convertible notes has not yet been completed at the date of this report (note 33);

e) The Group is in negotiation with potential convertible note holders to issue new convertible notes ("CBIII") to increase the Group's liquidity. The proceeds from CBIII will be used to finance the operations of the Group. As at the date of the report, the Group has not yet finalised CBIII in terms of, inter-alia, the principal amount and the conversion price; and

f) The Group has obtained a waiver letter from one of the banks in relation to the breach of covenants for one of its bank loans amounting to approximately HK$23 million. The Group has not obtained any waiver letter in respect of another loan of approximately HK$113 million (note 29).

The directors are of the opinion that, taking into account the measures as above, the Group will have sufficient working capital to meet its financial obligations as they fall due in the next twelve months from the date of this report. Accordingly, the consolidated financial statements have been prepared on a going concern basis.

## 3. APPLICATION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs")

In the current year, the Group has applied the following new and revised standards, amendments and interpretations ("new and revised HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") which are or have become effective.

| | |
|---|---|
| HKAS 1 (Revised 2007) | Presentation of Financial Statements |
| HKAS 23 (Revised 2007) | Borrowing Costs |
| HKAS 32 & 1 (Amendments) | Puttable Financial Instruments and Obligations Arising on Liquidation |
| HKFRS 1 & HKAS 27 (Amendments) | Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate |
| HKFRS 2 (Amendment) | Vesting Conditions and Cancellations |
| HKFRS 7 (Amendment) | Improving Disclosures about Financial Instruments |
| HKFRS 8 | Operating Segments |
| HK(IFRIC) - Int 9 & HKAS 39 (Amendments) | Embedded Derivatives |
| HK(IFRIC) - Int 13 | Customer Loyalty Programmes |
| HK(IFRIC) - Int 15 | Agreements for the Construction of Real Estate |
| HK(IFRIC) - Int 16 | Hedges of a Net Investment in a Foreign Operation |
| HK(IFRIC) - Int 18 | Transfers of Assets from Customers |
| HKFRSs (Amendments) | Improvements to HKFRSs issued in 2008, except for the amendment to HKFRS 5 that is effective for annual periods beginning or after 1 July 2009 |
| HKFRSs (Amendments) | Improvements to HKFRSs issued in 2009 in relation to the amendment to paragraph 80 of HKAS 39 |

Except as described below, the adoption of the new and revised HKFRSs had no material effect on the consolidated financial statements of the Group for the current or prior accounting periods.

*Hong Kong Accounting Standard ("HKAS") 1 (Revised 2007) Presentation of Financial Statements*

HKAS 1 (Revised 2007) has introduced terminology changes (including revised titles for the financial statements) and changes in the format and content of the financial statements.

*HKFRS 8 Operating Segments*

HKFRS 8 is a disclosure standard that has resulted in a redesignation of the Group's reportable segments (see note 8) and changes in the basis of measurement of segment profit or loss, segment assets and segment liabilities.

*Improving Disclosures about Financial Instruments*
*(Amendments to HKFRS 7 Financial Instruments: Disclosures)*

The amendments to HKFRS 7 expand the disclosures required in relation to fair value measurements in respect of financial instruments which are measured at fair value. The Group has not provided comparative information for the expanded disclosures in accordance with the transitional provision set out in the amendments.

The Group has not early applied the following new and revised Standards, Amendments or Interpretations that have been issued but are not yet effective.

| | |
|---|---|
| HKFRSs (Amendments) | Amendment to HKFRS 5 as part of Improvements to HKFRSs 2008[1] |
| HKFRSs (Amendments) | Improvements to HKFRSs 2009[2] |
| HKAS 24 (Revised) | Related Party Disclosures[5] |
| HKAS 27 (Revised) | Consolidated and Separate Financial Statements[1] |
| HKAS 32 (Amendment) | Classification of Rights Issues[4] |
| HKAS 39 (Amendment) | Eligible Hedged Items[1] |
| HKFRS 1 (Amendment) | Additional Exemptions for First-time Adopters[3] |
| HKFRS 1 (Amendment) | Limited Exemption from Comparative HKFRS 7 Disclosures for First-time Adopters[6] |
| HKFRS 2 (Amendment) | Group Cash-settled Share-based Payment Transactions[3] |
| HKFRS 3 (Revised) | Business Combinations[1] |
| HKFRS 9 | Financial Instruments[7] |
| HK(IFRIC) - Int14 (Amendment) | Prepayments of a Minimum Funding Requirement[5] |
| HK(IFRIC) - Int17 | Distributions of Non-cash Assets to Owners[1] |
| HK(IFRIC) - Int19 | Extinguishing Financial Liabilities with Equity Instruments[6] |

1 Effective for annual periods beginning on or after 1 July 2009.

2 Effective for annual periods beginning on or after 1 July 2009 and 1 January 2010, as appropriate.

3 Effective for annual periods beginning on or after 1 January 2010.

4 Effective for annual periods beginning on or after 1 February 2010.

5 Effective for annual periods beginning on or after 1 January 2011.

6 Effective for annual periods beginning on or after 1 July 2010.

7 Effective for annual periods beginning on or after 1 January 2013.

The application of HKFRS 3 (Revised) may affect the accounting for business combination for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2010. HKAS 27 (Revised) will affect the accounting treatment for changes in a parent's ownership interest in a subsidiary.

HKFRS 9 Financial Instruments introduces new requirements for the classification and measurement of financial assets and will be effective from 1 January 2013, with earlier application permitted. The Standard requires all recognised financial assets that are within the scope of HKAS 39 Financial Instruments: Recognition and Measurement to be measured at either amortised cost or fair value. Specifically, debt investments that (i) are held within a business model whose objective is to collect the contractual cash flows and (ii) have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost. All other debt investments and equity investments are measured at fair value. The application of HKFRS 9 might affect the classification and measurement of the Group's financial assets.

The directors of the Company anticipate that the application of the other new and revised standards, amendments or interpretations will have no material impact on the consolidated financial statements.

## 4. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared under the historical cost basis except for certain financial instruments which are measured at fair values, as explained in the accounting policies set out below.

The consolidated financial statements have been prepared in accordance with HKFRSs issued by the HKICPA. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules") and by the Hong Kong Companies Ordinance.

### Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

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

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expense are eliminated on consolidation.

**Business combinations**

The acquisition of businesses is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under HKFRS 3 *Business Combinations* are recognised at their fair values at the acquisition date.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised.

Business combination agreements with adjustments to the cost of combination based on contingent events are included in the cost of combination at the acquisition date if the adjustment is probable and can be measured reliably.

**Goodwill**

Goodwill arising on an acquisition of a business represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of the relevant business at the date of acquisition. Such goodwill is carried at cost less any accumulated impairment losses and is presented separately in the consolidated statement of financial position.

For the purposes of impairment testing, goodwill arising from an acquisition is allocated to each of the relevant cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the acquisition. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, and whenever there is an indication that the unit may be impaired. For goodwill arising on an acquisition in a financial year, the cash-generating unit to which goodwill has been allocated is tested for impairment before the end of that financial year. When the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated to reduce the carrying amount of any goodwill allocated to the unit first, and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in the consolidated statement of comprehensive income. An impairment loss for goodwill is not reversed in subsequent periods.

On subsequent disposal of the relevant cash-generating unit, the attributable amount of goodwill capitalised is included in the determination of the amount of profit or loss on disposal.

**Investment in an associate**

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in these consolidated financial statements using the equity method of accounting. Under the equity method, investments in associates are carried in the consolidated statement of financial position at cost as adjusted for post-acquisition changes in the Group's share of the profit or loss and of changes in equity of the associate, less any identified impairment loss. When the Group's share of losses of an associate equals or exceeds its interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognising its share of further losses. An additional share of losses is provided for and a liability is recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that associate.

Where a group entity transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant associate.

**Revenue recognition**

Revenue is measured at the fair value of the consideration received or receivable and represents amounts received and receivable for service rendered (for shipbuilding, see below "construction contracts" for details) in the normal course of business, net of discounts and sales related taxes.

Revenue from shipbuilding represents income arising on construction contracts for shipbuilding during the year.

Sales of goods are recognised when the goods are delivered are title has passed.

Interest income from a financial asset is accrued on a time basis, by reference to principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

**Property, plant and equipment**

Property, plant and equipment including buildings held for use in the production or supply of goods or services, or for administrative purposes (other than construction in progress) are stated at cost less subsequent accumulated depreciation and accumulated impairment losses.

Depreciation is provided to write off the cost of items of property, plant and equipment other than construction in progress over their estimated useful lives and after taking into account of their estimated residual value, using the straight-line method.

Construction in progress includes property, plant and equipment in the course of construction for production or for its own use purposes. Construction in progress is carried at cost less any recognised impairment loss. Construction in progress is classified to the appropriate category of property, plant and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the profit or loss in the period in which the item is derecognised.

**Prepaid lease payments**

Prepaid lease payments are up-front payments to acquire leasehold land interests. The prepaid lease payments are stated at cost and are charged to the condensed consolidated statement of comprehensive income over the period of the lease on a straight line basis.

**Provisions**

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect is material).

**Borrowing costs**

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets until such time as the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

**Construction contracts**

Where the outcome of a construction contract for shipbuilding can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the end of the reporting period, as determined by reference to the labour hours incurred up to the reporting date as a percentage of total estimated labour hours for each vessel. Variations in contract work, claims and incentive payments are included to the extent that the amount can be measured reliably and its receipt is considered probable.

Where the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that it is probable to be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Where contract costs incurred to date plus recognised profits less recognised losses exceed progress billings, the surplus is shown as amounts due from customers for contract work. For contracts where progress billings exceed contract costs incurred to date plus recognised profits less recognised losses, the surplus is shown as amounts due to customers for contract work. Amounts received before the related work is performed are included in the consolidated statement of financial position, as a liability, as advances received. Amounts billed for work performed but not yet paid by the customer are included in the consolidated statement of financial position under trade and other receivables.

**Financial instruments**

Financial assets and financial liabilities are recognised in the consolidated statement of financial position when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

**Financial assets**

The Group's financial assets are classified into financial assets held for trading, loans and receivables and available-for-sale financial assets. All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

*Effective interest method*

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Interest income is recognised on an effective interest basis for debt instruments.

*Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss of the Group includes financial assets held for trading.

A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling in the near future; or
- it is a part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

At the end of each reporting period subsequent to initial recognition, financial assets at fair value through profit or loss are measured at fair value, with changes in fair value arising from remeasurement recognised directly in profit or loss in the period in which they arise. The net gains or loss recognised in profit or loss excludes any dividend or interest earned on the financial assets.

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial recognition, loans and receivables (including trade and other receivables, pledged bank deposits and bank balances) are carried at amortised cost using the effective interest method, less any identified impairment losses (see accounting policy in impairment loss on loans and receivables below).

*Available-for-sale financial assets*

Available-for-sale financial assets are non-derivatives that are either designated or not classified as financial assets at financial assets at fair value through profit and loss, loans and receivables or held-to-maturity investments.

Available-for-sale financial assets are measured at fair value at the end of each reporting period. Changes in fair value are recognised in other comprehensive income and accumulated in investment revaluation reserve, until the financial asset is disposed of or is determined to be impaired, at which time, the cumulative gain or loss previously accumulated in the investment revaluation reserve is reclassified to profit or loss (see accounting policy on impairment loss on financial assets below).

For available-for-sale equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, they are measured at cost less any identified impairment losses at the end of each reporting period (see accounting policy on impairment loss on financial assets below).

**Impairment of financial assets**

Financial assets, other than those financial assets at fair value through profit or loss, are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the financial assets have been affected.

For all other financial assets, objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or

- default or delinquency in interest or principal payments; or

- it becoming probable that the borrower will enter bankruptcy or financial re-organisation.

For certain categories of financial assets, such as trade and other receivables, assets that are assessed not to be impaired individually are subsequently assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period, observable changes in national or local economic conditions that correlate with default on receivables.

For an available-for-sale equity investment, a significant or prolonged decline in the fair value of that investment below its cost is considered to be objective evidence of impairment.

An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade and other receivables, where the carrying amount is reduced through the use of an allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss. When trade and other receivables are considered uncollectible, they are written off against the allowance account. Subsequent recoveries of amounts previously written off are credited to profit or loss.

Impairment losses on available-for sale equity investments will not be reversed in profit or loss in subsequent periods. Any increase in fair value subsequent to impairment loss is recognised directly in other comprehensive income and accumulated in investment revaluation reserve. For available-for-sale debt investments, impairment losses are subsequently reversed if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

If, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment losses was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

**Financial liabilities and equity**

Financial liabilities and equity instruments issued by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument.

An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities.

***Effective interest method***

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees paid or received that from an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Interest expense is recognised on an effective interest basis.

**Convertible notes issued by the Group**

Convertible notes issued by the Group that contain both the liability and conversion option components are classified separately into respective items on initial recognition. Conversion option that will be settled by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company's own equity instruments is classified as an equity instrument.

On initial recognition, the fair value of the liability component is determined using the prevailing market interest of similar non-convertible debts. The difference between the proceeds of the issue of the convertible notes and the fair value assigned to the liability component, representing the conversion option for the holder to convert the notes into equity, is included in equity (convertible notes reserve).

In subsequent periods, the liability component of the convertible notes is carried at amortised cost using the effective interest method. The equity component, representing the option to convert the liability component into ordinary shares of the Company, will remain in convertible notes equity reserve until the embedded option is exercised (in which case the balance stated in convertible notes reserve will be transferred to share premium). Where the option remains unexercised at the expiry date, the balance stated in convertible notes reserve will be released to the retained profits. No gain or loss is recognised in profit or loss upon conversion or expiration of the option.

Transaction costs that relate to the issue of the convertible notes are allocated to the liability and equity components in proportion to the allocation of the proceeds. Transaction costs relating to the equity component are charged directly to equity. Transaction costs relating to the liability component are included in the carrying amount of the liability portion and amortised over the period of the convertible notes using the effective interest method.

*Other financial liabilities*

Other financial liabilities of the Group include trade and other payables, bills payable, margin loan payable, bank overdrafts, bank borrowings and deferred consideration which are subsequently measured at amortised cost, using the effective interest method.

*Equity instruments*

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

**Derecognition**

Financial assets are derecognised when the rights to receive cash flows from the assets expire or, the financial assets are transferred and the Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

Financial liabilities are derecognised when the obligation specified in the relevant contract is discharged, cancelled or expires. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

**Impairment losses on tangible and intangible assets other than goodwill**

At the end of each reporting period, the Group reviews the carrying amounts of its tangible and intangible assets other than goodwill to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

**Taxation**

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred taxation is recognised on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are generally recognised for all deductible temporary difference to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries and associates, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset is realised, based on tax rate (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to settle the carrying amount of its liabilities.

Deferred tax is recognised into profit or loss, except when it relates to items that are recognised in other comprehensive income or directly in equity, in which case the deferred tax is also recognised in other comprehensive income or directly in equity respectively.

**Foreign currencies**

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in its functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognised in profit or loss in the period in which they arise.

For the purposes of presenting the consolidated financial statements, the assets and liabilities of the group entities are translated into the presentation currency of the Group (i.e. Hong Kong dollars) at the rate of exchange prevailing at the end of the reporting period, and their income and expenses are translated at the average exchange rates for the year. Exchange differences arising, if any, are recognised as a separate component of equity (the translation reserve). Such exchange differences are recognised in profit or loss in the period in which the foreign operation is disposed of.

Goodwill and fair value adjustments on identifiable assets acquired arising on an acquisition of a foreign operation are treated as assets and liabilities of that foreign operation and retranslated at the rate of exchange prevailing at the end of the reporting period. Exchange differences arising are recognised in the translation reserve.

**Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method.

**Leasing**

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Operating lease payments are recognised as an expense on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight-line basis.

**Retirement benefits costs**

Payments to the Mandatory Provident Fund Scheme/State-managed retirement benefit scheme, which are defined contribution schemes, are charged as an expense when employees have rendered service entitling them to the contributions.

**Intangible assets**

Intangible assets acquired in a business combination are identified and recognised separately from goodwill where they satisfy the definition of an intangible asset and their fair values can be measured reliably. The cost of such intangible assets is their fair values at the acquisition date.

Subsequent to initial recognition, intangible assets with finite useful lives are carried at costs less accumulated amortisation and any accumulated impairment losses. Amortisation for intangible assets with finite useful lives is provided on a straight-line basis over their estimated useful lives.

**Share-based payment transactions**

***Share options granted to employees***

The fair value of services received determined by reference to the fair value of share options granted at the grant date is expensed on a straight-line basis over the vesting period with a corresponding increase in equity (share-based payment reserve).

At the end of the reporting period, the Group revises its estimates of the number of options that are expected to ultimately vest. The impact of the revision of the estimates, if any, is recognised in profit or loss, with a corresponding adjustment to share-based payment reserve.

At the time when the share options are exercised, the amount previously recognised in share-based payment reserve will be transferred to share premium. When the share options are forfeited after the vesting date or are still not exercised at the expiry date, the amount previously recognised in share-based payment reserve will be transferred to accumulated losses.

***Share options granted to consultants***

Share options issued in exchange for services are measured at the fair values of the services received, unless that fair value cannot be reliably measured, in which case the goods or services received are measured by reference to the fair value of the share options granted. The fair values of the goods or services received are recognised as expenses immediately, unless the goods or services qualify for recognition as assets.

## 5. KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Group's accounting policies, the directors of the Company are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. 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 of the revision affects both current and future periods.

**Key sources of estimation uncertainty**

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

**Construction contracts**

The Group recognises contract revenue and profit on each shipbuilding contract according to management's estimation of the eventual outcome of the contract as well as the percentage of completion of shipbuilding works. Notwithstanding that the management reviews and revises the estimates of both contract revenue and costs for the shipbuilding contracts as the contract progresses, the actual outcome of the contract in terms of its total revenue and costs may be higher or lower than the estimates and this will affect the revenue and profit recognised. The Group also revisits and revises the estimate of contract profit as the contract progresses based on the information available in the market. Foreseeable losses are provided when identified. During the year, due to unforeseen circumstances in completing certain shipbuilding contracts, the Group estimated foreseeable losses of approximately HK$393,966,000 (2008: Nil) in respect of certain shipbuilding contracts. Details of which are set out in note 27.

**Estimated impairment of goodwill and intangible assets**

Determining whether goodwill and intangible asset is impaired requires an estimation of the value in use of the cash-generating unit to which the goodwill and intangible assets have been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate the present value. Where the actual cash flows are less than expected, a material impairment loss may arise. As at 31 December 2009, the carrying amounts of goodwill and intangible assets are nil and approximately HK$440,152,000, respectively (2008: approximately HK$514,179,000 and HK$1,546,602,000, respectively) (net of accumulated impairment loss and amortisation of approximately HK$836,400,000 and HK$1,221,649,000, respectively (2008: HK$322,221,000 and HK$115,199,000, respectively)). Details of the recoverable amount calculation are disclosed in notes 19 and 36.

## 6. CAPITAL RISK MANAGEMENT

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance. The Group's overall strategy remains unchanged from prior year.

The capital structure of the Group consists of net debts, which include the cash and cash equivalents, net of margin loan payable, bank borrowings (note 29), deferred consideration (note 31), convertible notes payable (note 33) and equity attributable to owners of the Company, comprising issued share capital and reserves.

The directors of the Company review the capital structure regularly. As part of this review, the directors consider the cost of capital and the risks associates with each class of capital. Based on recommendations of the directors, the Group will balance its overall capital structure through the payment of dividends, new share issues and share buy-backs as well as the issue of new debt or the redemption of existing debt.

## 7. FINANCIAL INSTRUMENTS

### 7a. Categories of financial instruments

| | 2009<br>*HK$'000* | 2008<br>*HK$'000* |
|---|---|---|
| **Financial assets** | | |
| Fair value through profit or loss | | |
| — Held for trading | 1,609 | 18,423 |
| Loans and receivables (including cash and cash equivalents) | 1,064,253 | 777,577 |
| **Financial liabilities** | | |
| Liabilities measured at amortised cost | 1,726,863 | 1,294,596 |

### 7b. Financial risk management objectives and policies

The Group's major financial instruments include trade and other receivables, investments held for trading, bank balances, trade and other payables, margin loan payables, bills payable, bank borrowings, deferred consideration and convertible notes payable. Details of the financial instruments are disclosed in respective notes. The risks associated with these financial instruments include market risk (currency risk, interest rate risk and other price risk), credit risk and liquidity risk. The policies on how to mitigate these risks are set out below. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

***Market risk***

The Group's activities expose it primarily to the financial risks of changes in foreign currency, interest rates and equity prices. Market risk exposures are further measured by sensitivity analysis. There has been no significant change to the Group's exposure to market risks or the manner in which it manages and measures the risk. Details of each type of market risks are described as follows:

(i) *Currency risk*

The Company and its major operating subsidiary has RMB as its functional currency and is mainly exposed to United States dollars ("USD"), Euro ("EUR") and HKD, arising from foreign currency denominated bank balances, trade receivables, convertible notes payables and deferred consideration. The Group's other operating subsidiaries (all with HKD as their functional currency) do not have significant foreign currency exposure.

The Group currently does not have an foreign currency hedging policy. However, the management monitors foreign currency exposure and will consider hedging significant foreign currency exposure should the need arise.

The carrying amounts of the Group's foreign currency denominated monetary assets and monetary liabilities at the reporting date are as follows:

| | Liabilities | | Assets | |
|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** |
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| USD | 113,150 | — | 78,903 | 2,985 |
| EUR | — | — | 50,281 | 4,242 |
| HKD | 646,263 | 657,701 | 9,828 | 18,677 |

Sensitivity analysis

The following table details the Group's sensitivity to a 5% (2008: 5%) increase and decrease in RMB against USD, EUR and HKD, respectively. 5% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjust their translation at the year end for 5% change in foreign currency rates. The sensitivity analysis includes bank balances in USD, EUR and HKD, trade receivable in USD and EUR, bank borrowing in USD, deferred consideration and convertible notes payables in HKD where the denomination of the receivables or payables is in a currency other than the functional currency of the relevant group entities. A positive number indicates a decrease in loss for the year where RMB strengthens against USD, EUR and HKD. For weakening of RMB against USD, EUR and HKD would be an equal and opposite impact on the loss and the balance below would be negative.

| | **2009** | **2008** |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Loss for the year | | |
| — USD | 1,712 | (149) |
| — EUR | (2,514) | (212) |
| — HKD | 31,822 | 31,951 |

In management's opinion, the sensitivity analysis is unrepresentative of the inherent foreign exchange risk as the year end exposure does not reflect the exposure during the year.

(ii) *Interest rate risk*

The Group is exposed to cash flow interest rate risk in relation to variable-rate bank borrowings and bank deposits (2008: variable-rate bank overdraft and bank deposits), and exposed to fair value interest rate risk in relation to fixed-rate pledged bank deposits, bank borrowings, deferred consideration and the liability component of convertible notes payable (2008: fixed-rate pledged bank deposits, bank borrowings, liability component of convertible note payable, margin loan payables, deferred consideration and the liability component of convertible note payable).

The Group currently does not have an interest rate hedging policy. However, the management monitors interest rate exposure and will consider hedging significant interest rate exposure should the need arise.

The Group's exposures to interest rates on financial liabilities are detailed in the liquidity risk management section of this note. The Group's cash flow interest rate risk is mainly concentrated on the fluctuation of interest rate arising from the Group's variable rate bank borrowing in LIBOR and bank deposits.

Sensitivity analysis

The sensitivity analysis below has been determined based on the exposure to interest rates for variable-rate bank borrowing and bank deposits at the end of the reporting period. The analysis is prepared assuming the amount of the outstanding at that date was outstanding for the whole year. A 50 basis point increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

If interest rates had been 50 basis points (2008: 50 basis points) higher/lower for bank borrowings, 25 basis points (2008: 50 basis points) higher/lower for bank deposits, and all other variables were held constant, the Group's loss for the year would increase/decrease by HK$105,000 (2008: increase/decrease by HK$766,000). This is mainly attributable to the Group's exposure to interest rates on its variable-rate bank borrowings and bank deposits.

(iii) *Price risk on investments held for trading*

The Group is exposed to equity price risk through its investments held for trading. The Group's equity price risk is mainly concentrated on listed equity instruments quoted in respective stock exchanges. The management manages this exposure by closely monitoring the price risk and maintaining a portfolio of investments with different risks.

Sensitivity analysis

The sensitivity analysis below has been determined based on the exposure to equity price risks of investments held for trading at the reporting date.

If the prices of the respective equity instruments had been 5% (2008: 5%) higher/lower and all other variables were held constant, loss for year would decrease/increase by HK$80,000 (2008: HK$921,000) as a result of the changes in fair value of financial assets at fair value through profit or loss.

***Credit risk***

As at 31 December 2009, the Group's maximum exposure to credit risk which will cause a financial loss to the Group due to failure to discharge an obligation by the counterparties provided by the Group is arising from the carrying amount of the respective recognised financial assets as stated in the consolidated statement of financial position.

In order to minimise the credit risk, the management of the Group has credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews the recoverable amount of each individual receivable at the end of each reporting period to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors of the Company consider that the Group's credit risk on receivables is significantly reduced.

The Group has concentration of credit risks in respect of the shipbuilding contracts entered into with a few customers by the Group and significant concentration of credit risk with respect to customers' geographical location in Germany, which 81% (2008: 99%) of revenue is arisen from customers for Germany. In view of their good reputation and good business history in the past with the customers, the directors consider that the risks will be mitigated by strengthening strategic relationship with existing customers, improving customised services and exploring new markets for new customers.

In addition, the Group has concentration of credit risks on its outstanding trade and other receivables as 61.4% (2008: 75.7%) of its trade and other receivables were due from a customer and a stakeholder in sales contracts in aggregate.

In order to minimise the credit risk in respect of the receivables from the stakeholder, the Group signed fund transfer agreements with the stakeholder and banks with which the receivables are placed. The agreements specify the receivables placed in banks could only be withdrawn by the company for shipbuilding purpose. In the event of bankruptcy of the stakeholder's failure to function its note stipulated in the agreement B, the bank would retain the receivables for shipbuilding purpose under the arrangement. Regarding the receivable from a customer, in view of the long term relationship with the customer, the directors considered there is no significant credit risk.

The Group has concentration of credit risk on bank deposits as 70.5% (2008: 83.9%) of deposits are placed with three banks (2008: three banks). The credit risk on liquid funds is limited because the counterparties are banks with good reputation.

***Liquidity risk***

In management of the liquidity risk, the Group monitors and maintains a level of cash and cash equivalents considered adequate by the management to finance the Group's operations and mitigate the effects of fluctuations in cash flows. The management monitors the utilisation of borrowings and ensure compliance with loan covenants and financing activities plan (as detined in note 2).

The directors of the Company are taking active steps to improve the liquidity postion of the Group, details of which are set out in note 2.

The Group relied on bank borrowings and convertible notes as significant source of liguidity. Details of which are set out in note 29 and 33.

The following table details the Group's remaining contractual maturity for its financial liabilities based on the agreed repayment terms. The table for non-derivative financial liabilities has been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay. The table includes both interest and principal cash flows.

*Liquidity and interest risk tables*

| | **Weighted average effective interest rate** | **Less than 1 month** | **1 to 3 months** | **3 months to 1 year** | **1 to 2 years** | **2 to 5 years** | **Total undiscounted cash flow** | **Carrying amount at 31.12.2009** |
|---|---|---|---|---|---|---|---|---|
| | | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| **2009** | | | | | | | | |
| **Non-derivative financial liabilities** | | | | | | | | |
| Trade and other payables | — | 117,491 | 22,181 | — | — | — | 139,672 | 139,672 |
| Bills payables | — | 56,818 | 77,273 | 211,932 | — | — | 346,023 | 346,023 |
| Deferred consideration | 5% | — | 200,833 | — | — | — | 200,833 | 200,000 |
| Convertible notes payable | | | | | | | | |
| — liability component (note) | 16.25% | — | — | 5,400 | 510,249 | — | 515,649 | 416,168 |
| Bank borrowings | | | | | | | | |
| — variable rates | 4.96% | 113,636 | — | — | — | — | 113,636 | 113,636 |
| — fixed rates | 6.5% | 23,364 | 6,094 | 385,831 | 122,872 | — | 538,161 | 511,364 |
| | | 311,309 | 306,381 | 603,163 | 633,121 | — | 1,853,974 | 1,726,863 |

*Liquidity and interest risk tables*

| | Weighted average effective interest rate | Less than 1 month | 1 to 3 months | 3 months to 1 year | 1 to 2 years | 2 to 5 years | Total undiscounted cash flow | Carrying amount at 31.12.2008 |
|---|---|---|---|---|---|---|---|---|
| | | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| **2008** | | | | | | | | |
| **Non-derivative financial liabilities** | | | | | | | | |
| Trade and other payables | — | 80,121 | 3,031 | 34,082 | — | — | 117,234 | 117,234 |
| Bills payables | — | 45,454 | 159,091 | — | — | — | 204,545 | 204,545 |
| Margin loan payables | | | | | | | | |
| — fixed rates | 12% | 324 | 650 | 33,925 | — | — | 34,899 | 32,499 |
| Deferred consideration | 16.25% | — | — | 200,000 | — | — | 200,000 | 173,447 |
| Convertible notes payable | | | | | | | | |
| — liability component (note) | 16.25% | — | — | 5,400 | 5,400 | 579,999 | 590,799 | 421,440 |
| Bank borrowings | | | | | | | | |
| — variable rates | 7% | 4,521 | — | — | — | — | 4,521 | 4,521 |
| — fixed rates | 8.2% | 289 | 5,608 | 128,349 | 18,639 | 244,382 | 397,267 | 340,910 |
| | | 130,709 | 168,380 | 401,756 | 24,039 | 824,381 | 1,549,265 | 1,294,596 |

*Note:* This is categorised based on contractual term of redemption obligation at maturity, the holders of the convertible notes can convert the notes into the Company's shares anytime.

The amounts included above for variable interest rate instruments for non-derivative financial liabilities is subject to change if change in variable interest rates differ to those estimates of interest rate determined at the end of the reporting period.

7c. **Fair value**

The fair value of financial assets and financial liabilities are determined as follows:

- the fair value of financial assets with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices; and
- the fair value of other financial assets (including available-for-sale unlisted debt securities) and financial liabilities are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices or rates from observable current market transactions as input.

Excepted as detailed in the following table, the directors consider that the carrying amounts of financial liabilities recorded at amortised cost in the consolidated financial statements approximate their fair values:

| | 31/12/2009 | | 31/12/2008 | |
|---|---|---|---|---|
| | **Carrying amount** | **Fair value** | **Carrying amount** | **Fair value** |
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| **Financial liabilities** | | | | |
| Bank loans — long-term | | | | |
| — fixed rate | 130,682 | 131,703 | 227,273 | 223,297 |
| Convertible loan notes | | | | |
| — liability component | 416,168 | 405,193 | 421,440 | 394,051 |

**Fair value measurements recognised in the statement of financial position**

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable.

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active market for identical assets or liabilities.

- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

| | 31.12.2009 | | | |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| **Financial assets at fair value through profit and loss** | | | | |
| Non-derivative financial assets held for trading | 1,609 | — | — | 1,609 |

There were no transfers between Level 1 and 2 in the current year.

8. **SEGMENT INFORMATION**

The Group has adopted HKFRS 8 Operating Segments with effect from 1 January 2009. HKFRS 8 is a disclosure standard that requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reviewed by the chief operating decision maker (i.e. the executive directors of the Company) in order to allocate resources to segments and to assess their performance. In contrast, the predecessor standard (HKAS 14, Segment Reporting) required an entity to identify two sets of segments (business and geographical) using a risks and returns approach. In the past, the Group's primary reporting format was business segments. The application of HKFRS 8 has resulted in a redesignation of the Group's reportable segments as compared with the primary reportable segments determined in accordance with HKAS 14.

The Group determines its operating segments based on the reports reviewed by the chief operating decision maker, being the chief executive officer, for resources allocation and performance assessment. The segments are managed separately as each of the businesses, which operate in distinct geographical location, provide different types of services which requires different service information to formulate different marketing strategies. The Group's operating and reportable segments under HKFRS 8 are therefore as follows:

1) shipbuilding — newly acquired business operated in the PRC (a new operating segment in 2008)

2) metal trading — original business operated in Hong Kong

**2009**

| | **Shipbuilding** | **Metal trading** | **Total** |
|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* |
| Segment revenue | 1,239,532 | — | 1,239,532 |
| Segment result | (2,045,287) | (599) | (2,045,886) |
| Other income | | | 733 |
| Change in fair value of investment held for trading | | | (12,448) |
| Unallocated corporate expenses | | | (15,359) |
| Share-based payment expenses | | | (3,780) |
| Finance costs | | | (115,002) |
| Loss before tax | | | (2,191,742) |

**2008**

| | Shipbuilding | Metal trading | Total |
|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* |
| Revenue | 1,190,824 | 772 | 1,191,596 |
| Segment result | (151,405) | (34) | (151,439) |
| Other income | | | 12,891 |
| Change in fair value of investment held for trading | | | (37,928) |
| Loss on disposal of available-for-sale investments | | | (1,025) |
| Unallocated corporate expenses | | | (49,953) |
| Share-based payment expenses | | | (14,225) |
| Finance costs | | | (233,311) |
| Loss before tax | | | (474,990) |

The accounting policies of the reportable segments are the same as the Group's accounting policies described in note 3. Segment loss represents the loss from each segment without allocation of other income, central administrative costs, certain share-based payment expenses, finance costs and income tax expenses. This is the measure reported to the chief operating decision maker for the purpose of resource allocation and performance assessment.

**Segment and liabilities**

The following is an analysis of the Group's assets and liabilities by reportable segment:

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| **Assets** | | |
| Segment assets | | |
| — Shipbuilding | 3,824,507 | 5,232,411 |
| — Metal trading | 103 | 772 |
| Total segment assets | 3,824,610 | 5,233,183 |
| Bank and pledge bank deposit | 656,619 | 334,803 |
| Unallocated corporate assets | 33,452 | 20,312 |
| Consolidated assets | 4,514,681 | 5,588,298 |
| **Liabilities** | | |
| Segment liabilities for shipbuilding | 2,398,216 | 1,730,978 |
| Bank borrowings | 625,000 | 340,910 |
| Convertible notes payable | 416,168 | 421,440 |
| Deferred tax liabilities | 335,708 | 589,688 |
| Deferred consideration | 200,000 | 173,447 |
| Unallocated corporate liabilities | 32,773 | 38,426 |
| Consolidated liabilities | 4,007,865 | 3,294,889 |

For the purposes of monitoring segment performances and allocating resources between segments:

- all assets are allocated to reportable segments other than bank and pledged bank deposits, certain corporate property, plant and equipment and tax recoverable; and

- all liabilities are allocated to reportable segments other than bank borrowings, convertible notes payable, deferred consideration, deferred tax liabilities and interest payable to convertible note holders.

**Geographical information**

The Group's main operations, amounting to 99% of the Group's operation, are located in the PRC.

The Group's revenue from external customers, which is based on the location of customers, and information about its non-current assets by geographical locations of the assets are detailed below:

| **Name of the Country** | **Revenue from external customers for year ended 31 December** | | **Non-current assets at 31 December** | |
|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** |
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| Germany | 1,092,103 | 1,042,849 | — | — |
| United States of America | 147,404 | 145,030 | — | — |
| The PRC | 25 | 2,945 | 1,850,517 | 3,323,235 |
| Others | — | 772 | 1,870 | 2,450 |
| | 1,239,532 | 1,191,596 | 1,852,387 | 3,325,685 |

**Other segment information**

**2009**

Amounts included in the measure of segment loss or segment assets:

| | **Shipbuilding** | **Metal trading** | **Unallocated** | **Total** |
|---|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| Additions to property, plant and equipment | 209,640 | — | 13 | 209,653 |
| Depreciation, amortisation of intangible assets and prepaid lease payment | 225,157 | — | 595 | 225,752 |
| Loss on disposal of property, plant and equipment | 642 | — | — | 642 |
| Provision for warranty | 33,025 | — | — | 33,025 |
| Share based payment | 1,902 | — | 3,780 | 5,682 |
| Impairment loss on goodwill | 514,179 | — | — | 514,179 |
| Impairment loss on intangible assets | 940,000 | — | — | 940,000 |

Amounts regularly provided to the chief operating decision maker but not included in the measure of segment loss or segment assets:

| | **Shipbuilding** | **Metal trading** | **Total** |
|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* |
| Income tax expense | 14,702 | — | 14,702 |

**2008**

Amounts included in the measure of segment loss or segment assets:

| | Shipbuilding | Metal trading | Unallocated | Total |
|---|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| Additions to property, plant and equipment | 124,256 | — | 2,446 | 126,702 |
| Additions to deposit paid for acquisition of property, plant and equipment | 3,029 | — | — | 3,029 |
| Additions of prepaid lease payments | 343,640 | — | — | 343,640 |
| Additions to goodwill | 817,262 | — | — | 817,262 |
| Additions to intangible assets | 1,626,339 | — | — | 1,626,339 |
| Depreciation and amortisation | 153,455 | — | 515 | 153,970 |
| Loss on disposal of property, plant and equipment | 624 | — | — | 624 |
| Provision for warranty | 2,729 | — | — | 2,729 |
| Share based payment | 27,787 | — | 14,225 | 42,012 |
| Impairment loss on goodwill | 322,221 | — | — | 322,221 |

**Information about major customers**

Revenue from customers of the corresponding years contributing over 10% of the total sales of the Group is as follows:

| | Year ended 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Customer A[1] | 421,812 | 189,751 |
| Customer B[1] | 356,799 | 232,209 |
| Customer C[1] | 147,404 | 145,031 |

1 Revenue from shipbuilding

## 9a. OTHER INCOME

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Dividend income from investments held for trading | — | 2,385 |
| Interest on bank deposits | 6,235 | 6,762 |
| Interest on loan receivables | — | 855 |
| Sales of scrap materials | 6,931 | 4,626 |
| Others | 1,024 | 51 |
| | 14,190 | 14,679 |

## 9b. OTHER GAINS AND LOSSES

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Loss on disposal of property, plant and equipment | (642) | (624) |
| Foreign exchange gain | 302 | 9,900 |
| | (340) | 9,276 |

## 10. FINANCE COSTS

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Interest on borrowings wholly repayable within five years: | | |
| Convertible notes payable at effective interest rates (note 33) | 57,559 | 188,188 |
| Imputed interest expense on deferred consideration (note 31) | 26,553 | 18,809 |
| Bank borrowings | 28,443 | 19,353 |
| Other borrowings | 2,447 | 6,961 |
| | 115,002 | 233,311 |

11. **GAIN ON DISPOSAL OF SUBSIDIARIES**

In 2009, the Group disposed of Able King Investment Limited and its subsidiaries (collectively as "Able King Group") to an independent third party at a consideration of HK$1,000. The net liabilities of the Able King Group at the date of disposal were as follows:

| | *HK$'000* |
|---|---|
| Net liabilities disposed of: (Note) | |
| Other receivables | 213 |
| Bank balances | 1,363 |
| Other payables | (1,701) |
| | (125) |
| Gain on disposal | 126 |
| Cash consideration | 1 |
| Net cash outflow arising on disposal: | |
| Cash consideration | 1 |
| Bank balances disposed of | (1,363) |
| | (1,362) |

*Note:* Able King Group held an available-for-sale invesment (note 20) at cost of HK$13,489,000, which was fully impaired in 2006.

The Able King Group did not make any significant contribution to the results or cash flow of the Group for the year.

## 12. LOSS BEFORE TAX

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Loss before tax has been arrived at after charging: | | |
| Directors' emoluments | 8,638 | 19,591 |
| Other staff costs (including share-based payment of HK$984,000 (2008: HK$2,416,000)) | 52,686 | 39,314 |
| Contributions to retirement benefits scheme, excluding directors | 4,484 | 4,187 |
| Total staff costs | 65,808 | 63,092 |
| Share-based payment expense (included in cost of sales) | — | 22,842 |
| Auditors' remuneration | 1,268 | 1,150 |
| Amortisation of intangibles assets (included in cost of sales) | 166,450 | 115,199 |
| Depreciation of property, plant and equipment | 52,222 | 33,959 |
| Release of prepaid lease payments | 7,080 | 4,812 |
| Minimum lease payments under operating leases in respect of rented premises | 1,575 | 1,427 |
| Contract costs recognised as expenses | 1,784,671 | 1,030,747 |
| Claims and additional repair cost arising from a delivered vessel's defects (included in cost of sales) | 40,092 | — |
| Penalties and associated additional costs from delay in vessel delivery due to prolonged shipbuilding process (included in cost of sales) | 82,019 | — |
| Expected losses recognised in respect of foreseeable delay in vessel delivery and additional estimated costs (included in cost of sales) | 339,718 | — |

## 13. TAXATION

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Current tax: | | |
| PRC Enterprise Income Tax | 14,701 | — |
| Deferred tax | (250,081) | (5,994) |
| | (235,380) | (5,994) |

No provision for Hong Kong Profits Tax has been made since the Group has no assessable profits for both years.

In accordance with Article 8 of the Foreign Enterprise Income Tax ("FEIT") law of the PRC, foreign investment enterprises ("FIEs") of production nature are eligible to enjoy two years of exemption and three years of 50% deduction in FEIT starting from the first profit - making year (the "2+3 tax holidays"). The fully exempted financial years of Union Shipbuilding Co. (as defined in note 35) were the year ended 31 December 2007 and 2008, respectively.

Under the Law of the PRC on Enterprise Income Tax ("the EIT Law") and Implementation Regulation of the EIT Law, Union Shipbuilding Co. (as defined in note 35) continues to enjoy the preferential tax treatment (12.5% effective tax rate, i.e. 50% of the applicable tax rate of 25%) for each of the years from 2009 to 2011. Thereafter, the tax rate will ratchet up to 25% from 2012.

Income tax for the year can be reconciled to the loss before tax per the consolidated statement of comprehensive income as follows:

| | **2009** | **2008** |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Loss before tax | (2,191,742) | (474,990) |
| Tax at applicable domestic income tax rate of 25% (2008: 25%) | (547,936) | (118,748) |
| Tax effect of expenses not deductible for tax purpose | 318,367 | 148,764 |
| Tax effect of income not taxable for tax purpose | (166) | (3,382) |
| Tax effect of tax exemption granted to a PRC subsidiary | (14,702) | (54,333) |
| Deferred tax on undistributed earnings of a PRC subsidiary | 9,057 | 21,705 |
| Tax credit for the year | (235,380) | (5,994) |

At the end of the reporting period, the Group had unused tax losses of approximately HK$1,941,000 (2008: HK$25,906,000) available to offset against future profits. No deferred taxation asset has been recognised due to unpredictability of future profits streams. Tax losses may be carried forward indefinitely.

## 14. DIRECTORS' EMOLUMENTS

| | 2009 | | | | | 2008 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Fees | Salaries and other benefits | Retirement benefits scheme contributions | Share-based payments | Total | Fees | Salaries and other benefits | Retirement benefits scheme contributions | Share-based payments | Total |
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| Executive: | | | | | | | | | | |
| Mr. Chau On Ta Yuen | — | 1,300 | 12 | 2,750 | 4,062 | — | 1,300 | 12 | 10,460 | 11,772 |
| Mr. Li Ming | — | 1,093 | 10 | — | 1,103 | — | — | — | — | — |
| Mr. Zhang Shi Hong | — | 960 | 12 | 917 | 1,889 | — | 960 | 5 | 3,487 | 4,452 |
| Mr. Wang San Long | — | 278 | 4 | 1,031 | 1,313 | — | 137 | 4 | 2,807 | 2,948 |
| Mr. Tang Chi Ming | — | — | — | — | — | 132 | — | — | — | 132 |
| Independent non-executive: | | | | | | | | | | |
| Mr. Hu Bai He | 80 | — | — | — | 80 | 51 | — | — | — | 51 |
| Ms. Xiang Siying | 80 | — | — | — | 80 | 51 | — | — | — | 51 |
| Mr. Zhang Xiping | 80 | — | — | — | 80 | 31 | — | — | — | 31 |
| Ms. Xiang Ying | 31 | — | — | — | 31 | — | — | — | — | — |
| Mr. Sin Chi Fai* | — | — | — | — | — | 31 | — | — | — | 31 |
| Ms. Chan Ling, Eva* | — | — | — | — | — | 74 | — | — | — | 74 |
| Mr. Chan Sek Nin, Jackey* | — | — | — | — | — | 49 | — | — | — | 49 |
| | 271 | 3,631 | 38 | 4,698 | 8,638 | 419 | 2,397 | 21 | 16,754 | 19,591 |

* Directors resigned during the year ended 31 December 2008.

15. **EMPLOYEES' EMOLUMENTS**

Of the five individuals with the highest emoluments in the Group, four (2008: three) were directors of the Company whose emoluments are included in note 14 above. The emoluments of the remaining one (2008: two) highest paid individuals are as follows:

| | **2009** | **2008** |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Salaries and other benefits | 720 | 864 |
| Retirement benefits scheme contributions | 12 | 12 |
| Share-base payments | 113 | 1,699 |
| | 845 | 2,575 |

Their emoluments were within the following bands:

| | **2009** | **2008** |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Nil to HK$1,000,000 | 1 | — |
| HK$1,000,001 to HK$1,500,000 | — | 1 |
| HK$1,500,001 to HK$2,000,000 | — | 1 |

No emoluments were paid by the Group to the directors as an inducement to join or upon joining the Group or as compensation for loss of office and no director waived any emoluments in both years.

## 16. LOSS PER SHARE

The calculation of the basic and diluted loss per share attributable to owners of the Company is based on the following data:

| | 2009<br>*HK$'000* | 2008<br>*HK$'000* |
|---|---|---|
| **Loss** | | |
| Loss for the year attributable to owners of the Company for the purposes of basic and diluted losses per share | (1,956,362) | (468,996) |

| | 2009<br>*'000* | 2008<br>*'000*<br>*(restated)* |
|---|---|---|
| **Number of shares (Note)** | | |
| Weighted average number of ordinary shares for the purposes of basic loss per share | 769,465 | 383,202 |

The computation of diluted loss per share for the year ended 31 December 2009 and 2008 does not include the share options and covertible notes as the exercise of both share options and convertible notes has an anti-dilutive effect.

*Note:* The weighted average of ordinary shares for the purpose of calculating basic loss per share for the year ended 31 December 2008 have been retrospectively adjusted for the effect of share consolidation completed in 2009 (note 32(c)).

17. **PROPERTY, PLANT AND EQUIPMENT**

| | Buildings | Furniture and fixtures | Motor vehicles | Plant and machinery | Construction progress | Total |
|---|---|---|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| **COST** | | | | | | |
| At 1 January 2008 | 996 | 216 | — | — | — | 1,212 |
| Additions | 35 | 3,946 | 7,103 | 36,645 | 78,973 | 126,702 |
| Acquired on acquisition of a subsidiary | 651,976 | 638 | 14,746 | 41,492 | 87,795 | 796,647 |
| Disposals | (524) | (169) | (48) | — | — | (741) |
| Currency realignment | 15,302 | 298 | 830 | 4,263 | 9,150 | 29,843 |
| At 31 December 2008 | 667,785 | 4,929 | 22,631 | 82,400 | 175,918 | 953,663 |
| Additions | — | 846 | 3,885 | 18,049 | 186,873 | 209,653 |
| Transfer | 112,240 | — | — | — | (112,240) | — |
| Disposals | — | — | (153) | (3,367) | — | (3,520) |
| At 31 December 2009 | 780,025 | 5,775 | 26,363 | 97,082 | 250,551 | 1,159,796 |
| **DEPRECIATION** | | | | | | |
| At 1 January 2008 | 58 | 21 | — | — | — | 79 |
| Provided for the year | 26,164 | 351 | 2,053 | 5,391 | — | 33,959 |
| Eliminated on disposals | (59) | (21) | (16) | — | — | (96) |
| Currency realignment | 2,334 | 20 | 150 | 346 | — | 2,850 |
| At 31 December 2008 | 28,497 | 371 | 2,187 | 5,737 | — | 36,792 |
| Provided for the year | 36,348 | 650 | 3,523 | 11,701 | — | 52,222 |
| Eliminated on disposals | — | — | (41) | (484) | — | (525) |
| At 31 December 2009 | 64,845 | 1,021 | 5,669 | 16,954 | — | 88,489 |
| **CARRYING VALUES** | | | | | | |
| At 31 December 2009 | 715,180 | 4,754 | 20,694 | 80,128 | 250,551 | 1,071,307 |
| At 31 December 2008 | 639,288 | 4,558 | 20,444 | 76,663 | 175,918 | 916,871 |

The above items of property, plant and equipment are depreciated on a straight-line basis at the following rates per annum:

| | |
|---|---|
| Buildings | 5% |
| Furniture and fixtures | 25% |
| Motor vehicles | 12.5% |
| Plant and machinery | 6.67% - 25% |

For the year ended 31 December 2009, the Group's shipbuilding business suffered gross operating loss. The directors, after taking account the economic condition and industrial development prospect, have considered that the gross operating loss indicates impairment loss for the Group's buildings, plant and machinery and construction in progress and therefore conducted a review on the carrying amounts of the property, plant and equipment. Details of impairment test on property, plant and equipment are set out in note 36.

## 18. PREPAID LEASE PAYMENTS

The Group's prepaid lease payments comprise:

| | **2009** | **2008** |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Leasehold land held under medium-term lease in the PRC | 339,625 | 346,705 |
| Analysed for reporting purposes as: | | |
| Non-current asset | 337,899 | 345,004 |
| Current asset | 1,726 | 1,701 |
| | 339,625 | 346,705 |

## 19. INTANGIBLE ASSETS

| | Contracted and uncontracted customer relationships<br>*HK$'000* |
|---|---|
| **COST** | |
| At 1 January 2008 | — |
| Acquired on acquisition of INPAX Group (note 35) | 1,626,339 |
| Currency realignment | 35,462 |
| At 31 December 2008 and 2009 | 1,661,801 |
| **AMORTISATION AND IMPAIRMENT** | |
| At 1 January 2008 | — |
| Amortisation charge for the year | 115,199 |
| At 31 December 2008 | 115,199 |
| Amortisation charge for the year | 166,450 |
| Impairment loss recognised in the year | 940,000 |
| At 31 December 2009 | 1,221,649 |
| **CARRYING VALUES** | |
| At 31 December 2009 | 440,152 |
| At 31 December 2008 | 1,546,602 |

Intangible assets represent contracted and uncontracted customer relationships arising from the acquisition of INPAX Group in prior year.

The amount will be amortised over its estimated useful life of 10 years on a straight-line basis.

Details of the impairment test on intangible assets are set out in note 36.

20. **AVAILABLE-FOR-SALE INVESTMENTS**

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Unlisted securities: | | |
| Equity securities at cost | — | 13,489 |
| Less: impairment loss recognised | — | (13,489) |
| | — | — |

The unlisted investment for the year ended 31 December 2008 represents approximately a 5.94% interest in the issued share capital of Found Macau Investments International Limited ("Found Macau"), an investment holding company incorporated in the British Virgin Islands. Found Macau was formed to invest in gaming, entertainment and related business in Macau through its subsidiaries. Included in the investment cost is the fair value adjustment of HK$13,489,000 arising from an interest free loan advanced to Found Macau which was considered as deemed capital contribution.

In view of the recurring operating losses incurred by Found Macau, the directors of the Company reviewed the carrying amount of the unlisted investment based on its expected recoverable amount. Accordingly, an impairment loss of HK$13,489,000 was identified and charged to the consolidated statement of comprehensive income in 2006.

Such investment was disposed of through the disposal of Able King Group (note 11) during the year.

21. **INTEREST IN AN ASSOCIATE**

| | 2009 & 2008 |
|---|---|
| | *HK$'000* |
| Cost of unlisted investment in an associate | — |
| Loan to an associate | 54,050 |
| Less: Impairment loss recognised | (54,050) |
| | — |

In previous years, in view of the recurring operating loss incurred by the associate, full impairment had been recognised and the Group did not share loss of the associate as the unrecognised loss involved was negligent. Details of the Group's associate at 31 December 2009 are set out in note 44.

## 22. INVENTORIES

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Raw materials | 333,635 | 482,125 |

## 23. TRADE AND OTHER RECEIVABLES

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Trade receivables | 39,475 | 3,053 |
| Value-added tax recoverable | 195,423 | 109,385 |
| Deposits placed with a stakeholder (Note) | 338,382 | 426,004 |
| Others | 42,360 | 24,076 |
| Total trade and other receivables | 615,640 | 562,518 |
| Prepayment for purchase of raw materials | 1,013,021 | 863,043 |

*Note:* Certain vessel buyers have made progress payment for ship construction contracts to a stakeholder rather than directly to the Group. The Group has the entitlement to these progress payments in accordance with the contracts but they are placed under custody of the stakeholder to ensure these progress payments are used to pay for the costs incurred by the Group in relevant shipbuilding construction contracts. The progress payments in custody will be paid over to the Group based on the progress of the shipbuilding contract.

Trade receivables at the end of the reporting period represent the final instalment receivable from ship buyers which is due in August 2010. Credit period was based on mutual agreements reached between the entity and ship buyers which varies case by case.

Included in the Group's trade receivable balances at 31 December 2008 was a debtor with aggregate carrying amount of HK$3,053,000 which was past due but not provided for impairment loss. The amount was fully settled during year 2009.

The Group did not have trade receivables passed due but not impaired as at 31 December 2009.

Prepayment of raw materials represents amount paid for purchase of steel plates and vessel components for shipbuilding but not yet delivered to the Group at the end of the reporting period.

The directors consider that the carrying amounts of trade receivables and amount due from stakeholder approximate their fair values.

## 24. INVESTMENTS HELD FOR TRADING

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| At fair value: | | |
| Equity securities listed in Hong Kong | 1,609 | 18,423 |

The securities are measured at fair value which was determined based on quoted market prices from the Stock Exchange.

## 25. BANK BALANCES/PLEDGED BANK DEPOSITS/BANK OVERDRAFTS

**Bank balances/pledged bank deposits**

Bank balances carry interest at market rates ranging from 0.01% to 0.36% (2008: from 0.01% to 0.72%) per annum.

The pledged deposits carry a fixed interest rate of 1.89% (2008: 3.78%) per annum and are to pledge secure bills payables as required by the relevant banks.

**Bank overdrafts**

Bank overdrafts carry interest at market rate at prime rate + 2% per annum.

## 26. TRADE, BILLS AND OTHER PAYABLES

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Trade payable | 36,413 | 40,753 |
| Bills payable | 346,023 | 204,545 |
| Advances from customers for ship construction contracts | 476,084 | 1,024,767 |
| Interest payable | 30,095 | 20,160 |
| Dividend payable to former equity holders of a subsidiary | 21,757 | 21,757 |
| Consideration payable for acquisition of property, plant and equipment | 42,859 | 42,859 |
| Others payable and accruals | 32,863 | 16,490 |
| | 986,094 | 1,371,331 |

Advances from customers for ship construction contracts represent advances from customers for ship building but the construction work has not commenced at the end of the reporting period.

The following is an aged analysis of trade payables and bills payables at the end of the reporting periods:

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| 0 - 30 days | 79,409 | 79,538 |
| 30 - 60 days | 154,705 | 25,757 |
| 61 - 90 days | 9,781 | 1,916 |
| Over 90 days | 138,541 | 138,087 |
| | 382,436 | 245,298 |

The average credit period on purchase of goods is 90 days. The Group has financial risk management policies in place to ensure that all payable is settled within the credit timeframe.

Bills payable are secured by pledged bank deposits (note 25).

Non-trade payables are unsecured, non-interest bearing and repayable on demand.

## 27. AMOUNTS DUE FROM (TO) CUSTOMERS FOR CONTRACT WORK

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Contracts in progress at the end of the reporting period: | | |
| Contract costs incurred to date | 1,383,585 | 1,002,281 |
| Recognised profits less recognised losses | 37,432 | 314,905 |
| | 1,421,017 | 1,317,186 |
| Less: Progress payments and progress billings | (2,798,595) | (1,675,265) |
| Amounts due to customers for contract works | (1,377,578) | (358,079) |
| Analysed for reporting purposes as: | | |
| Amounts due from contract customers | 34,292 | — |
| Amounts due to contract customers | (1,411,870) | (358,079) |
| | (1,377,578) | (358,079) |

During the year, defects were identified for a new model of vessel subsequent to the completion of a shipbuilding contract. The defects led to claims by the customer as additional repair cost was incurred by the customer by hiring a shipbuilder in South Korea to mend the defects. The additional repair cost was fully reimbursed by the Group. The claims and repair cost amounting to approximately HK$40,092,000 (2008: Nil) in aggregate were determined in accordance with a rate stipulated in the shipbuilding contract and billing invoice from the shipbuilder in South Korea, which was included in cost of sales for the year ended 31 December 2009.

The commencement of the new vessel model together with the rectification work for the defects prolonged the Group's overall shipbuilding process and led to a general delay for ensuing vessel production and delivery. Penalties and associated additional costs amounting to HK$27,771,000 (2008: Nil) were agreed with a customer for such delay in respect of a shipbuilding contract completed before the end of the reporting period and was included in cost of goods sold. HK$54,248,000 (2008: Nil) was also provided and included in costs of goods sold in the consolidated financial statements for penalties and associated additional costs in respect of another shipbuilding contract completed subsequent to the end of the reporting period.

The delays encountered in the shipbuilding process in respect of the three shipbuilding contracts described above caused delays in the production schedules of outstanding shipbuilding contracts which were in progress as at 31 December 2009 such that their originally planned delivery schedule of 2010 and afterwards are no longer expected to be met. The Group recognises expected loss for these outstanding contracts as their total estimated contract costs to be incurred, as determined based on the original budgeted costs plus the claims, penalties and associated additional costs by reference to those incurred by the three precedent delayed vessels, will exceed the total contract revenue to be recognised in future periods. The Group recognised the expected losses of HK$339,718,000 in 2009 (2008: Nil).

## 28. MARGIN LOAN PAYABLE

The amount was unsecured, bore fixed interest rate at 12% (2008: 12%) per annum and the amount was fully repaid in 2009.

## 29. BORROWINGS

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Secured | 227,273 | 52,296 |
| Unsecured | 397,727 | 288,614 |
| | 625,000 | 340,910 |
| Carrying amount repayable: | | |
| Within one year | 511,364 | 113,637 |
| More than two years but not more than five years | 113,636 | 227,273 |
| | 625,000 | 340,910 |
| Less: Amounts due within one year shown under current liabilities | (511,364) | (113,637) |
| | 113,636 | 227,273 |

The exposure of the Group's fixed-rate borrowings and the contractual maturity dates are as follows:

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Fixed-rate borrowings: | | |
| Within one year | 397,728 | 113,637 |
| In more than two years but not more than five years | 113,636 | 227,273 |
| | 511,364 | 340,910 |

In addition, at 31 December 2009, the Group has a variable-rate borrowing of HK$113,636,000 repayable with one year (2008: Nil) which carries interest at London Interbank Offered Rate ("LIBOR") plus 3.2% per annum. Interest is repriced in accordance with the relevant bank's announcement.

The ranges of effective interest rates (which are also equal to contracted interest rates) on the Group's borrowings are as follows:

Effective interest rate:

| | **2009** | **2008** |
|---|---|---|
| Fixed-rate brownings | 4.86% to 8.42% | 6.66% to 10.2% |
| Variable-rate borrowing | 5.03% | N/A |

The Group's borrowings denominated in HKD, currency other than the functional currency of the relevant Group entity, are set out below:

| | *HK$'000* |
|---|---|
| As at 31 December 2009 | — |
| As at 31 December 2008 | 4,521 |

During the year, the Group breached covenants for two bank loans. One bank loan requires the Group not to leverage over a certain amount of bank borrowing while the other one requires the Group to pledge a certain amount of deposits in the bank to secure the borrowing from that bank. The Group has obtained a waiver letter for the breach of covenant for one of the loans relating to over leverage subsequent to 31 December 2009. Accordingly, the loan of HK$23,000,000 is presented as current liability in the consolidated statement of financial position. The Group has not obtained any waiver letter for the breach of loan covenant arising from insufficient pledged deposits to secure the relevant loan of HK$113,000,000. As the loan has a maturity of less than one year, it is also presented as current liabilities in the consolidated statement of financial position.

## 30. PROVISION FOR WARRANTY

| | *HK$'000* |
|---|---|
| At 1 January 2008 | — |
| Acquired on acquisition of INPAX Group (note 35) | 8,707 |
| Additional provision for the year | 2,729 |
| Reversal of provision | (8,177) |
| Currency realignment | (285) |
| At 31 December 2008 | 2,974 |
| Additional provision for the year | 33,025 |
| Reversal of provision | (2,974) |
| At 31 December 2009 | 33,025 |

The Group provides an one-year warranty on shipbuilding and undertakes to repair or replace items that fail to perform satisfactorily. The provision is estimated based on historical data of the level of repairs and replacement.

31. **DEFERRED CONSIDERATION**

| | **2009** | **2008** |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| At 1 January | 173,447 | — |
| Acquisition of INPAX Group (note 35) | — | 154,638 |
| Imputed interest expense | 26,553 | 18,809 |
| At 31 December | 200,000 | 173,447 |

The amount is interest free and repayable on 31 December 2009 and represents HK$200,000,000 deferred consideration payable for the acquisition of INPAX Group in 2008. The imputed interest rate is 16.25% per annum.

On 30 November 2009, the Company entered into an agreement with Million King (as defined in note 35) to defer its payment to 31 January 2010. On 7 January 2010, it was further deferred to 31 January 2011 upon the entering of another extention agreement and commences to carry interest at Hong Kong Prime rate.

On 23 April 2010, the Group further entered into an agreement with Million King to extend the payment from 31 January 2011 to 31 January 2012.

## 32. SHARE CAPITAL

| | Number of shares | | Share capital | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| | | | *HK$'000* | *HK$'000* |
| Ordinary shares of HK$0.05 (2008: HK$0.001) each (note c) | | | | |
| Authorised: | | | | |
| At the beginning of the year | 250,000,000,000 | 250,000,000,000 | 250,000 | 250,000 |
| Share constitution (note c) | (200,000,000,000) | — | — | — |
| At the end of the year | 500,000,000,000 | 250,000,000,000 | 250,000 | 250,000 |
| Issued and fully paid: | | | | |
| At the beginning of the year | 33,739,982,591 | 17,198,806,126 | 33,740 | 17,198 |
| Issue of new shares on 5 June 2009 (note a) | 3,400,000,000 | — | 3,400 | — |
| Conversion of convertible notes (note b) | 465,000,000 | 16,541,176,465 | 465 | 16,542 |
| | 37,604,982,591 | 33,739,982,591 | 37,605 | 33,740 |
| Share consolidation (note c) | (36,852,882,940) | — | — | — |
| Issue of new shares on 31 August 2009 (note d) | 150,000,000 | — | 7,500 | — |
| At the end of the year | 902,099,651 | 33,739,982,591 | 45,105 | 33,740 |

*Notes:*

(a) On 21 May 2009, the Company entered into a placing agreement with a placing agent for a placement of 3,400,000,000 ordinary shares of HK$0.001 each of the Company on a best-effort basis at a price of HK$0.013 per share, which represents a discount of approximately 13.33% to the closing price of HK$0.015 per share as quoted on the Stock Exchange, to independent third parties. The placing was completed on 5 June 2009 and an aggregate of 3.4 billion ordinary shares of the Company were issued.

(b) During the year ended 31 December 2009, part of the CBII (as defined in note 33) was converted into 465,000,000 ordinary shares of HK$0.001 each of the Company.

(c) Pursuant to an ordinary resolution at the annual general meeting held on 24 June 2009, every fifty issued and unissued shares of HK$0.001 each in the Company was consolidated into one share of HK$0.05 each in the Company and the share consolidation became effective on 25 June 2009.

(d) On 20 August 2009, the Company entered into another placing agreement with a placing agent for a placement of 150,000,000 ordinary shares of HK$0.05 each of the Company on a best-effort basis at the price of HK$0.43 per share, which represents a discount of approximately 18.87% to the closing price of HK$0.53 per share as quoted on the Stock Exchange, to independent third parties.

The placing was completed on 31 August 2009 and an aggregate of 150 million ordinary shares of the Company were issued.

All the shares issued during the year ranked pari passu with the then existing shares in all respect.

## 33. CONVERTIBLE NOTES PAYABLE

The Company issued convertible notes in 2007 and 2008. The details are as follows:

On 18 May 2007, the Company issued convertible loan notes ("CBI") with an aggregate principal amount of HK$150,000,000. The fair value of the liability component at the date of issue is HK$139,426,909. CBI carries a coupon of 4% per annum accrual on a day to day basis on the outstanding principal amount, payable annually in arrears, and would be mature on 17 May 2009. CBI is denominated in HKD. The initial conversion price is HK$0.17 per share and is adjusted to HK$0.017 following a share subdivision in 2007, which is subject to anti-dilutive adjustments. The effective interest rate of the liability component is 7.95% per annum.

The entire CBI was fully converted as at 31 December 2008.

The movement of the liability component of CBI is as follows:

| | **2009** | **2008** |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Liability component at the beginning of the year | — | 46,225 |
| Conversion | — | (45,990) |
| Interest charged | — | 2,264 |
| Interest paid | — | (2,499) |
| | — | — |

On 5 November 2007, the Company entered into a conditional agreement to issue convertible notes under an acquisition agreement for the acquisition of the entire interest in INPAX Group (see note 35). The convertible notes ("CBII") were issued on 16 April 2008 upon completion of the acquisition.

CBII comprises restricted convertible notes and unrestricted convertible notes.

The aggregate principal amount of the unrestricted convertible notes issued is HK$2,400 million.

The initial aggregate principal amount of the restricted convertible notes issued is HK$600 million, which is subject to a downward adjustment for the potential shortfall between the guaranteed profit of HK$600 million and the audited profit after taxation of INPAX Group for the year ended 31 December 2008. Based on the audited profit after taxation of INPAX Group of HK$217 million, the shortfall is determined to be approximately HK$383 million as compared to the guaranteed profit of HK$600 million.

The difference between the aggregate principal amount of the restricted and unrestricted CBII of HK$2,617 million, representing the aggregate amount of the principal amount of the unrestricted convertible notes of HK$2,400 million and the adjusted principal amount of the restricted convertible notes issued of HK$217 million, and the fair value of the liability component of the CBII of approximately HK$1.7 billion, represents the conversion option of approximately HK$0.9 billion, which is credited directly to equity as convertible loan notes reserve.

The holder(s) of the restricted convertible notes may convert the whole or any part of the principal amount of the restricted convertible notes outstanding into ordinary shares of the Company from 1 April 2009 to 15 April 2011, the date of maturity, at the initial conversion price of HK$0.15 per share, which was adjusted to HK$7.26 following the share placements (note 32(a) and 32(d)) and the share consolidation (note 32(c)) in 2009.

The holder(s) of the unrestricted convertible notes may convert the whole or any part of the principal amount of the unrestricted convertible notes outstanding into ordinary shares of the Company from 16 April 2008, the date of issue of the convertible notes, to 15 April 2011, the date of maturity, at an initial conversion price of HK$0.15 per conversion share, which was adjusted to HK$7.26 following the share placements and the share consolidation in 2009.

The conversion rights of CBII shall only be exercisable so long as the aggregate shareholdings in the Company held by Million King, its associates and parties acting in concert immediately upon such exercise will not reach or exceed 30% of the then issued share capital of the Company; and that Million King, its associates and parties acting in concert shall not become a controlling shareholder of the Company within the meaning of Listing Rules.

In respect of the restricted convertible note, no interest will be payable. For the unrestricted convertible note, coupon interest at the rate of 1.5% per annum will be accrued on a day to day basis on the outstanding principal amount, payable semi-annually in arrears. The interest due on October 2008, April 2009 and October 2009 amounting to approximately HK$27,984,000 in aggregate (2008: HK$22,584,000) was deferred to April 2010 in accordance with deferred agreements reached with the holders and was included in other payables in the consolidated statement of financial position.

The CBII is not redeemable at the option of the noteholder(s) prior to maturity. The Company shall have the right to redeem any portion of the CBII outstanding at an amount equals to the principal amount of the CBII together with any interest accrued at its sole and absolute discretion at any time prior to the maturity date of the CBII. In the opinion of the directors of the company, such redemption option has risks and characteristics that are closely related to CBII as the redemption option's exercise price is approximately equal on each exercise date to the amortised cost of the host instrument. Unless previously converted or redeemed, the Company shall redeem the CBII at par on the maturity date of the CBII.

The CBII is freely transferrable, provided that the noteholder(s) of the CBII must inform and obtain written consent from the Company of each transfer or assignment made by them. All noteholders of the CBII are still subject to the above-mentioned 30% limit.

The fair value of the equity component on intial recognition of the CBII was calculated using the Binominal option pricing model. The inputs used in the model in determining the fair value were as follows:

| | **Liability component of restricted convertible notes 16 April 2008** | **Liability component of unrestricted convertible notes 16 April 2008** |
|---|---|---|
| Share price | HK$0.149 | HK$0.149 |
| Exercise price | HK$0.15 | HK$0.15 |
| Contractual Life | 3 years | 3 years |
| Risk-free rate | 1.659% | 1.659% |
| Expected dividend yield | 0% | 0% |
| Volatility | 49.05% | 51.46% |

The movement of the liability component of CBII is as follows:

| | *HK$'000* |
|---|---|
| Liability component at 1 January 2008 | — |
| Issue of convertible note (16 April 2008) | 1,723,162 |
| Conversion | (1,469,597) |
| Interest charged | 185,924 |
| Interest paid | (18,049) |
| Liability component at 31 December 2008 | 421,440 |
| Conversion | (52,898) |
| Interest charged | 57,559 |
| Interest paid | (9,933) |
| Liability component at 31 December 2009 | 416,168 |

The effective interest rate of the liability portion of CBII was 16.25% per annum.

As at 31 December 2009, the principal amounts of restricted and unrestricted convertible notes which are outstanding are approximately HK$148 million (2008: HK$217 million) and approximately HK$360 million (2008: HK$360 million), respectively.

On 27 April 2010, the Group announced to have entered into an extension letter with each of the holders of the Group's convertible notes whereby the parties agreed to extend the maturity date of the outstanding convertible notes from 15 April 2011 to 15 April 2012. Except for the extension of the maturity date of the outstanding convertible notes, each and every term and condition under the existing convertible notes shall remain unchanged. The extension of the Group's convertible notes is conditional, among other things, on the approval by the shareholders of the Company at a special general meeting and the necessary consents and approvals by the Stock Exchange. Details of the extension of the maturity date of the convertible notes were set out in the Company's announcement dated 27 April 2010. The extension of the Group's convertible notes has not yet been completed at the date of this report.

34. **DEFERRED TAX LIABILITIES**

The following are the major deferred tax liabilities recognised and movements thereon during the current and prior years:

| | **Convertible loan notes** | **Withholding tax on undistributed earnings of the PRC subsidiaries** | **Fair value adjustments on properties and intangible asset** | **Total** |
|---|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| At 1 January 2007 | — | — | — | — |
| Acquisition of INPAX Group (note 35) | — | — | 532,006 | 532,006 |
| Currency realignment | — | — | 4,292 | 4,292 |
| (Credit) charge to profit or loss | (27,699) | 21,705 | — | (5,994) |
| Charge to equity for the year | 146,831 | — | — | 146,831 |
| Reversal on conversion of CBII during the (credit to equity) | (87,447) | — | — | (87,447) |
| At 31 December 2008 | 31,685 | 21,705 | 536,298 | 589,688 |
| (Credit) charge to profit or loss | (7,858) | 9,057 | (251,280) | (250,081) |
| Reversal on conversion of CBII during the year (credit to equity) | (3,899) | — | — | (3,899) |
| **At 31 December 2009** | 19,928 | 30,762 | 285,018 | 335,708 |

35. **ACQUISITION OF A SUBSIDIARY**

On 5 November 2007, the Company entered into a sale and purchase agreement with Million King Investments Limited ("Million King") to acquire 100% interest in INPAX Technology Limited and its subsidiary 江西江州聯合造船有限責任公司 ("Union Shipbuilding Co.") (collectively the "INPAX Group"). The completion date of the agreement was on 16 April 2008, which is also the acquisition date for accounting purposes.

The consideration for the acquisition comprises cash payment of HK$300,000,000, convertible loan notes (see note 33) and interest free deferred cash payment of HK$200,000,000 to be settled on 31 December 2009. The fair value of the total consideration was approximately HK$3,067,687,000.

INPAX Group is engaged in the shipbuilding business in Jiangxi region, the PRC.

The net assets acquired in the transaction, and the goodwill arising, are as follows:

| | **Acquiree's carrying amount before combination** | **Fair value adjustments** | **Fair value** |
|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* |
| Net assets acquired: | | | |
| Property, plant and equipment | 145,020 | 651,627 | 796,647 |
| Prepaid lease payment | 82,043 | 261,597 | 343,640 |
| Intangible assets | — | 1,626,339 | 1,626,339 |
| Inventories | 257,432 | 88,573 | 346,005 |
| Other receivables and prepayment | 746,948 | (2,100) | 744,848 |
| Pledged bank deposits | 15,548 | — | 15,548 |
| Bank balances and cash | 313,731 | — | 313,731 |
| Amounts due to customers for contract work | (810,526) | — | (810,526) |
| Trade and other payables | (196,486) | — | (196,486) |
| Bills payable | (22,206) | — | (22,206) |
| Provision for warranty | (8,707) | — | (8,707) |
| Bank borrowings | (366,402) | — | (366,402) |
| Deferred tax liabilities | (2,645) | (529,361) | (532,006) |
| Net assets acquired | 153,750 | 2,096,675 | 2,250,425 |
| Goodwill | | | 817,262 |
| Total consideration | | | 3,067,687 |

| | Acquiree's carrying amount before combination | Fair value adjustments | Fair value |
|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* |
| Total consideration satisfied by: | | | |
| Cash | | | 300,000 |
| Deferred consideration (note 31) | | | 154,638 |
| CBII (note 33) | | | 2,613,049 |
| | | | 3,067,687 |
| Net cash outflow of cash and cash equivalents in respect of acquisition of INPAX Group: | | | |
| Cash consideration paid | | | (300,000) |
| Bank balances and cash acquired | | | 313,731 |
| | | | 13,731 |

INPAX Group contributed a profit of approximately HK$190,850,000 to the Group's result for the period between the date of acquisition and 31 December 2008.

The accounting for the acquisition of INPAX Group involves identifying and determining the fair value to be assigned to the identifiable assets, liabilities and contingent liabilities and the cost of the business combination.

The fair value adjustments of the property, plant and equipment are determined based on the assessment carried by the directors using depreciated placement cost while the prepaid lease payment and inventories are determined using market approach by reference to market evidence of transaction prices for similar properties and inventories. For fair value adjustment of intangible assets, the directors adopted income capitalisation approach to determine the fair value.

The goodwill arising on the acquisition is attributable to the anticipated profitability of its business. In addition, the consideration paid for the combination effectively included amount in relation to the benefit of assembled work force amounting to approximately HK$115,000. This benefit is not recognised separately from goodwill as the amount is not significant.

If the acquisition had been completed on 1 January 2008, total group revenue for the year ended 31 December 2008 would have been approximately HK$1,387,182,000, and loss for the year would have been approximately HK$442,547,000. The pro forma information is for illustrative purposes only and is not necessarily an indication of revenue and results of operations of the Group that actually would have been achieved had the acquisition been completed on 1 January 2008, nor is it intended to be a projection of future results.

36. **GOODWILL**

The movement of the goodwill is as follows:

| | |
|---|---|
| COST | |
| At 1 January 2008 | — |
| Acquired on acquisition of INPAX Group (note 35) | 817,262 |
| Currency realignment | 19,138 |
| At 31 December 2008 and 2009 | 836,400 |
| IMPAIRMENT | |
| At 1 January 2008 | — |
| Impairment loss recognised for the year | 322,221 |
| At 31 December 2008 | 322,221 |
| Impairment loss recognised in the year | 514,179 |
| At 31 December 2009 | 836,400 |
| CARRYING VALUES | |
| At 31 December 2009 | — |
| At 31 December 2008 | 514,179 |

For the purposes of impairment testing, goodwill is allocated to one individual cash generating unit ("CGU"), being the shipbuilding segment.

The carrying amounts of goodwill, intangible assets and property, plant and equipment are attributable to the acquisition of INPAX Group which engaged in shipbuilding service.

The recoverable amount of this unit has been determined based on a value in use calculation. For impairment purpose, the calculation uses cash flow projections based on financial budgets approved by management covering a 5-year period, and discount rate of 20.5% (2008: 19.4%). The cash flows beyond the 5-year period are extrapolated with 3% (2008: 0%) growth rate. Other key assumptions for the value in use calculations relate to the estimation of cash inflows which include budgeted sales and gross margin. Such estimation is based on the unit's past performance and management's expectations for market development including deteriorated sentiment for sales of new vessels due to global economic recession commenced since the second half year of 2008, which cast doubt on the potential profitability in the shipbuilding industry in the PRC. The management of the Company therefore was of the opinion that their previous expectation on the potential profitability could not be met and as a result, goodwill was impaired accordingly.

During the year ended 31 December 2009, the Group recognised an impairment loss of approximately HK$514,179,000 (2008: HK$322,221,000) to fully write down the amount of goodwill and approximately HK$940,000,000 (2008: Nil) in respect of intangible assets which arose on acquisition of INPAX Group.

The impairment loss recognised for the shipbuilding CGU is first to reduce the carrying amount of goodwill and then to the intangible assets.

## 37. CAPITAL COMMITMENTS

| | **2009** | **2008** |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Capital expenditure in respect of acquisition of property, plant and equipment contracted for but not provided in the consolidated financial statements | 45,910 | 40,587 |
| Capital expenditure in respect of acquisition of properties, plant and equipment authorised but not contracted for | — | 79,418 |

## 38. PLEDGE OF ASSETS

| | **2009** | **2008** |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Bank deposits | 387,031 | 176,648 |
| Inventories | 53,290 | — |
| Properties, plant and equipment | 79,416 | — |
| Prepaid lease payments | — | 37,250 |
| | 519,737 | 213,898 |

Bank deposits, inventories, properties, plant and equipment and prepaid lease payments were pledged to banks for banking facilities granted by banks to the group.

Pledged bank deposits represents deposits pledged to banks to secure bills payable issued by the Group and is therefore classified as current assets. The pledge on the bank deposits will be released upon the settlement of relevant bills payables.

## 39. SHARE-BASED PAYMENT TRANSACTIONS

The Company's share option scheme (the "Scheme") was adopted pursuant to resolutions passed on 27 May 2002 for the primary purpose of providing incentives to directors and eligible employees, and will expire on 26 May 2012. Under the Scheme, the board of directors of the Company may grant options to eligible employees, including directors of the Company and its subsidiaries, to subscribe for shares in the Company. Additionally, the Company may, from time to time, grant share options to outside third parties for settlement in respect of goods or services provided to the Company.

At 31 December 2009, the number of shares with a par value of HK$0.05 in respect of which options had been granted and remained outstanding under the Scheme was 34,380,000 (2008: 34,380,000), representing 3.8% (2008: 5.1%) of the shares of the Company in issue at that date. The total number of shares in respect of which options may be granted under the Scheme is not permitted to exceed 10% of the shares of the Company in issue at any point in time, without prior approval from the Company's shareholders. The number of shares issued and to be issued in respect of which options granted and may be granted to any individual in any one year is not permitted to exceed 1% of the shares of the Company in issue at any point in time, without prior approval from the Company's shareholders.

Options granted must be taken up within 21 days of the date of grant, upon payment of HK$1 per person. Options may be exercised at any time during the exercise period. The subscription price of the option shall be determined by the board but in any case shall not be less than the higher of (i) the closing price of the shares as stated in the daily quotations sheet of the Stock Exchange on the date of grant which must be a trading day, (ii) the average closing price of the Shares as stated in the daily quotations sheet of the Stock Exchange for the five trading days immediately preceding the date of grant; or (iii) the nominal value of a share.

The following table discloses details of the options held by directors, employees and consultants and movements in such holding during the years ended 31 December 2008 and 2009:

| | | | | Number of share options | | | |
|---|---|---|---|---|---|---|---|
| Name | Date of grant | Exercisable period | Exercise price per share *(Note 1)* | Outstanding at 1.1.2008 *(Note 2)* | Granted during the year | Exercised during the year | Outstanding at 31.12.2008 and 31.12.2009 *(Note 2)* |
| Directors | 5 March 2008 | 5 March 2008 to 4 March 2018 | HK$9.0 | — | 1,600,000 | — | 1,600,000 |
| | | 5 March 2009 to 4 March 2018 | HK$9.0 | — | 1,200,000 | — | 1,200,000 |
| | | 5 March 2010 to 4 March 2018 | HK$9.0 | — | 1,200,000 | — | 1,200,000 |
| | | | | — | 4,000,000 | — | 4,000,000 |
| | 7 May 2008 | 7 May 2008 to 6 May 2018 | HK$7.15 | — | 1,040,000 | — | 1,040,000 |
| | | 7 May 2009 to 6 May 2018 | HK$7.15 | — | 780,000 | — | 780,000 |
| | | 7 May 2010 to 6 May 2018 | HK$7.15 | — | 780,000 | — | 780,000 |
| | | | | — | 2,600,000 | — | 2,600,000 |
| | | | | — | 6,600,000 | — | 6,600,000 |
| Employees | 7 May 2008 | 7 May 2008 to 6 May 2018 | HK$7.15 | — | 1,392,000 | — | 1,392,000 |
| | | 7 May 2009 to 6 May 2018 | HK$7.15 | — | 1,044,000 | — | 1,044,000 |
| | | 7 May 2010 to 6 May 2018 | HK$7.15 | — | 1,044,000 | — | 1,044,000 |
| | | | | — | 3,480,000 | — | 3,480,000 |
| Consultants | 7 May 2008 | 7 May 2008 to 6 May 2018 | HK$7.15 | — | 24,300,000 | — | 24,300,000 |
| | | | | — | 34,380,000 | — | 34,380,000 |

*Notes:*

1. The initial exercise prices of the shares options granted on 5 March 2008 and 7 May 2008 are HK$0.18 and HK$0.143 respectively. Upon the share consolidation became effective on 25 June 2009, the exercise prices of shares options were adjusted to HK$9.00 and HK$7.15 accordingly.

2. The number of outstanding share options has been adjusted retrospectively to take into account the effect of the share consolidation effective on 25 June 2009.

The consultants provided consultancy service with regard to the acquisition and operation of INPAX Group.

No share options were exercised during the year ended 31 December 2008 and 2009. The estimated fair values of the options granted on 5 March 2008 and 7 May 2008 are approximately HK$18,086,000 and HK$30,502,000 respectively.

These fair values were calculated using the Binominal option pricing model. The inputs into the model were as follows:

| | **5 March 2008** | **7 May 2008** |
|---|---|---|
| Grant date share price | HK$0.180 | HK$0.138 |
| Exercise price | HK$0.180 | HK$0.143 |
| Contractual life | 10 years | 10 years |
| Expected volatility | 43.73% | 44.73% |
| Dividend yield | 0% | 0% |
| Risk-free interest rate | 2.766% | 2.802% |

Expected volatility was determined by using the historical volatility of the Company's share price over the previous 5 years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non transferability, exercise restrictions and behavioural considerations.

The Group recognised the total expense of approximately HK$5,682,000 for the year ended 31 December 2009 (2008: HK$42,012,000) in relation to share options granted by the Company.

## 40. RETIREMENT BENEFITS SCHEME

The Group operates a Mandatory Provident Fund Scheme (the "MPF Scheme") for all its qualifying employees in Hong Kong. The assets of the MPF Scheme are held separately from those of the Group, in funds under the control of trustees. The Group contributes 5% or HK$1,000 in maximum of relevant payroll costs to the MPF Scheme, which contribution is matched by employees.

The Company's subsidiaries in the PRC are members of the state-managed retirement benefits scheme operated by the government of PRC. The retirement scheme contributions, which are based on a certain percentage of the basic salaries of the relevant subsidiaries' employees, are charged to the consolidated income statement in the period to which they relate and represent the amount of contributions payable by these subsidiaries to the scheme. The only obligation of the Group with respect to the retirement benefits schemes operated by the PRC is to make the required contributions under the schemes.

The retirement benefit cost charged to the consolidated statement of comprehensive income represents contributions payable to the scheme by the Group at rate specified in the rules of the scheme.

## 41. OPERATING LEASE COMMITMENTS

At the end of the reporting period, the Group had commitments for future minimum lease payments payable under non-cancellable operating leases which fall due as follows:

| | **2009** | **2008** |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| In respect of rented premises: | | |
| Within one year | — | 269 |
| In the second to fifth year inclusive | — | 95 |
| | — | 364 |

## 42. RELATED PARTY TRANSACTIONS

During the year, the Group had transactions with related parties as follows:

(1) The Group paid a guarantee fee of approximately HK$13,636,000 (2008: Nil) to 中國瑞聯實業集團有限公司（「瑞聯實業」）in respect of guarantee issued by 瑞聯實業 for the Group's entering of certain shipbuilding contracts. The Company's executive director, Mr. Li Ming, has beneficial interest in 瑞聯實業.

The amount due to 瑞聯實業 of approximately HK$10,227,000 (2008: Nil) at the end of the reporting period was included in other payables. The amount is unsecured, interest free and repayable on demand.

(2) The remuneration of directors and other members of key management during the year was as follows:

| | 2009 | 2008 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Short-term benefits | 3,902 | 2,816 |
| Post employment benefits (Retirement benefit contribution) | 38 | 21 |
| Share-based payment expenses | 4,698 | 16,754 |
| | 8,638 | 19,591 |

The remuneration of directors and the key executive is determined by the remuneration committee having regard to the performance of individual and market trends.

## 43. PARTICULARS OF SUBSIDIARIES

Particulars of the Company's principal subsidiaries as at 31 December 2009 and 2008 are as follows:

| Name of subsidiary | Place of incorporation/ operation | Issued share capital | Proportion of nominal value of issued share capital held by the Company | | | | Principal activities |
|---|---|---|---|---|---|---|---|
| | | | 2009 | | 2008 | | |
| | | | Directly | Indirectly | Directly | Indirectly | |
| | | | % | % | % | % | |
| Able King Investment Limited# | British Virgin Islands* | 1 ordinary share of US$1 each | — | — | 100 | — | Investment holding |
| Acewell Investments Limited# | British Virgin Islands* | 1 ordinary share of US$1 each | — | — | — | 100 | Investment holding |
| Ample Asset Investment Limited# | British Virgin Islands* | 1 ordinary share of US$1 each | — | — | — | 100 | Investment holding |
| China Ocean Shipbuilding Holdings Limited | British Virgin Islands* | I ordinary share of US$1 each | 100 | — | — | — | Investment holding |
| China Ocean Shipbuilding (Hong Kong) Limited | Hong Kong | 1 ordinary share of HK$1 each | — | 100 | — | — | Inactive |
| China Ocean Shipbuilding Services Limited | Hong Kong | 1 ordinary share of HK$1 each | — | 100 | — | — | Inactive |

| Name of subsidiary | Place of incorporation/ operation | Issued share capital | Proportion of nominal value of issued share capital held by the Company | | | | Principal activities |
|---|---|---|---|---|---|---|---|
| | | | 2009 | | 2008 | | |
| | | | Directly | Indirectly | Directly | Indirectly | |
| | | | % | % | % | % | |
| Global Empire Group Inc# | British Virgin Islands* | 1 ordinary share of US$1 each | — | — | — | 100 | Investment holding |
| Gold Castle Investments Limited# | British Virgin Islands* | 1 ordinary share of US$1 each | — | — | — | 100 | Investment holding |
| Giant Wave Limited# | Hong Kong | 1 ordinary share of HK$1 each | — | — | — | 100 | Securities investment |
| King Force International Limited# | British Virgin Islands* | 1 ordinary share of US$1 each | — | — | — | 100 | Investment holding |
| Merge Limited | Hong Kong | 1 ordinary share of HK$1 each | 100 | — | 100 | — | Inactive |
| Northlink Holdings Limited | British Virgin Islands* | 200 ordinary shares of US$1 each | 100 | — | 100 | — | Investment holding |
| Ocean Vision Investments Limited# | British Virgin Islands* | 1 ordinary share of US$1 each | — | — | — | 100 | Investment holding |
| Premier Win Investments Limited | British Virgin Islands* | 1 ordinary share of US$1 each | 100 | — | 100 | — | Inactive |
| Wealth Prospect Limited# | Hong Kong | 2 ordinary share of HK$1 each | — | — | — | 100 | Inactive |
| INPAX Technology Limited | British Virgin Islands* | 10,000 ordinary share of US$1 each | 100 | — | 100 | — | Investment holding |
| Jiangxi Union Ship building Company Limited** 江洲聯合船廠 | British Virgin Islands | RMB270,950,000 paid-up registered capital | — | 100 | — | 100 | Manufacturing metal vessel, vessel ancillary products and repiration of vessels |

* The companies are engaged in investment business and have no specific principal place of operation.

** The Company is registered in the form of a wholly foreign owned enterprise.

\# The companies were disposed of during 2009.

None of the subsidiaries had any debt securities at 31 December 2009 and 2008 or at any time during the years.

44. **PARTICULARS OF AN ASSOCIATE**

Particulars of the Group's associate as at 31 December 2009 and 2008 is as follows:

| Name of associate | Place of incorporation/ operation | Issued share capital | Nominal value of issued share capital held by the Group 2009 & 2008 | Principal activity |
|---|---|---|---|---|
| Chinachem Industries Limited | Hong Kong | 10,000 ordinary shares of HK$1 each | 49% | Inactive |

## 3. BUSINESS REVIEW AND PROSPECTS

The Group is engaged in the production and operation of shipbuilding and trading business. For the year ended 31 December 2009, the Group recorded a revenue of HK$1,239.53 million (2008: HK$1,191.60 million), an increase of approximately 4.02 % over the year 2008. The increase in revenues was due to the Group recorded full year revenues of shipbuilding business while it only recorded the revenues after the completion of acquisition of Inpax Group in 2008. The gross loss (before deducting the amortisation of intangible assets of HK$166.45 million (2008: HK$115.20 million) was HK$378.69 million (2008: gross profit of HK$275.67 million). The reasons of the gross loss of the Group are as follows:

(i) The shrank of new orders, the decrease in the price of new-build vessel, exchange difference arising from appreciation in the value of RMB, drastic fluctuations in the price of raw materials costs which reduce the overall gross profit of the Group for the year ended 31 December 2009.

(ii) During the year, the Group incurred modification costs to amend the defects for a new model of vessel. The modification works led to delay in delivery and claims by the customer. The claim and modification costs amounted to approximately HK$40.09 million (2008: nil) in aggregate.

(iii) The modification works, among other matters, prolonged the Group's overall shipbuilding process and led to a general delay for vessel production and delivery. Penalties and associated additional costs arising from delay in vessel delivery amounting to approximately HK$82.02 million. Furthermore, the Group also provided the estimated foreseeable losses of approximately HK$339.72 million in respect of the foreseeable delay, which were also included in costs of goods sold for the year ended 31 December 2009.

The impairment loss in goodwill and intangible assets recognised for the year ended 31 December 2009 was HK$1,454.18 million in aggregate (2008: HK$322.22 million). The significant increase in impairment loss has reflected the continuous effect of financial crisis occurred in September 2008. The new-orders shrank, the vessel price dropped and a strong recovery of shipbuilding industry seems remote, which cast doubt on the potential profitability of the shipbuilding segment.

The administrative expense was HK$77.67 million, up HK$13.41 million versus the corresponding period last year. The Group recorded finance costs of HK$115.00 million versus HK$233.31million for the corresponding period last year, reflecting a significant decrease in effective interest expenses. The decrease of effective interest was due to a majority of convertible notes which has been converted into shares.

To sum up, the loss for the year ended 31 December 2009 was amounting to approximately HK$1,956.36 million (2008: HK$469.00 million, it significantly increased by 317.13 % in comparing with year 2008.

**Shipbuilding business**

The China's Shipbuilding industry has swung sharply from rapid growth to uncertainty in the late 2008. After that, the industry faced a grim situation but shows signs of recovery in or about June 2009. However this recovery cannot be sustained, given the potentially excess in shipbuilding capacity. The ship-owners are very cautious on placing new orders, negotiating on lowering ship building price, deferring ship delivery or payment.

During the year ended 31 December 2009, the performance of shipbuilding sector of the Group was unsatisfactory. The shipbuilding business generated revenue of approximately HK$1,239.53 million to the Group, which representing an increase of approximately of 4.09% as compared to approximately HK$1,190.82 million in 2008. The increase in revenues was due to the Group recorded full year revenues during the year ended 31 December 2009 while it only recorded the revenues after the completion of acquisition of Inpax Group in 2008. The shipbuilding business recorded a loss before tax of HK$424.66 million (before deducting amortisation of intangible assets ,impairment cost on goodwill and impairment cost on intangible assets) (2008: profit of HK$286.01 million (before deducting amortisation of intangible assets and impairment cost on goodwill) .The poor performance of shipbuilding business were mainly due to the following factors: (i) deferred delivery of vessels (ii) exchange difference arising from appreciation in the value of RMB; (iii) drastic fluctuations of the price of raw materials and (iv) the modification costs. The details are disclosed above in the overall review section. As at 31 December 2009, the order in hand of the Group reached 35 vessels with shipbuilding work arranged to the mid of 2012.

**Trading business**

For year ended 31 December 2009, the trading businesses recorded a insignificant loss of approximately HK$599,000 (2008: HK$34,000).

**Prospects**

The unprecedented financial crisis has led to a sharp contraction in world economy in late 2008. While initially shipbuilding was to some degree insulated from these effects because of the strong order books, however new orders have fallen significantly, and the cancellations or deferral orders have increased in 2009. There is therefore a growing concern about overcapacity. Looking into the year 2010, the Directors expect that the conditions of the shipbuilding industry remain challenging. In the imbalanced supply and demand market, it would be very difficult to get new orders without offering competitive prices. The Group will continue adjusting its strategy to intensify its effort on the special vessels markets which was lightly hit by the industry downturn. The Group will continue to closely monitor the negotiations with the ship-owners and take a more flexible approach to prices and delivery of existing orders and actively assist the financing of ship-owners to ensure performance of secured orders.

The Directors will continue to reinforce the Group's financial position to leave the Group well placed when the recovery begins.

## 4. INDEBTEDNESS OF THE GROUP

As at the close of business on 31 May 2010, being the latest practicable date of this indebtedness statement, the Group had outstanding borrowings of approximately HK$1,806,147,000, comprising the following:

| | *HK$'000* |
|---|---|
| Secured bank borrowings *(note 1)* | 378,977 |
| Secured bills payable *(note 2)* | 434,091 |
| Unsecured but guaranteed bank borrowings *(note 3)* | 285,530 |
| Unsecured and unguaranteed deferred consideration *(note 4)* | 200,000 |
| Unsecured and unguaranteed convertible notes payable *(note 5)* | 507,549 |
| | 1,806,147 |

*Note:*

1. secured by certain of the Group's bank deposits, inventory, VAT recoverable, prepaid lease payments and plant and machinery with an aggregate carrying amount of approximately HK$97,280,000, HK$170,455,000, HK$203,203,000, HK$36,165,000 and HK$147,355,000 respectively as at 31 May 2010. Included is a bank borrowing of approximately HK$90,909,000 which is secured by the Group's VAT recoverable and guaranteed by an independent third party.

2. secured by certain of the Group's bank deposits with an aggregate carrying amount of approximately HK$336,206,000 as at 31 May 2010.

3. guaranteed by a related party, 中國瑞聯實業集團有限公司, in which a Director, Mr. Li Ming, has interest and two independent third parties.

4. amount represents the principal amount payable on 31 May 2010 to Million King Investments Limited ("Million King"), an entity from which the Company acquired INPAX Technology Limited and its subsidiary in April 2008. The amount was interest free and commenced to carry interest at Hong Kong Prime rate since 7 January 2010 upon the entering into of a repayment extension agreement with Million King.

5. amount represents principal amount of approximately HK$507,549,000 with a carrying amount of approximately HK$435,872,000 as at 31 May 2010. The Company's convertible notes comprise a restricted portion with a principal amount of approximately HK$147,549,000 carrying at zero coupon rate and an unrestricted portion with a principal amount of approximately HK$360,000,000 carrying at a coupon rate of 1.5% per annum and are measured at amortised costs with an imputed interest rate of 16.25%.

Save as aforesaid or as otherwise disclosed herein, and apart from intra-group liabilities and normal trade payables, the Group did not have outstanding at the close of business on 31 May 2010 any loan capital issued and outstanding or agreed to be issued, bank overdrafts, loans or other similar indebtedness, liabilities under acceptances or acceptable credits, debentures, mortgages, charges, hire purchases commitments, guarantees or other material contingent liabilities.

## 5. WORKING CAPITAL STATEMENT

(a) After taking into account the Group's

(i) internal financial resources;

(ii) present available banking facilities;

(iii) cash flows to be generated from the operating activities;

(iv) estimated net proceeds of the Open Offer to be received if the Open Offer becomes unconditional; and

(v) extension letters obtained from counterparties in respect of deferred consideration with a principal amount of HK$200 million and convertible notes with a principal amount of HK$507,549,000 to defer the maturity dates not falling in twelve months from the date of this Circular.

(b) After taking into account the following assumptions made by the Directors:

(i) no immediate repayment will be required for a bank loan of HK$46.9 million in respect of which the Group breached the loan covenants due to insufficient pledged deposits to secure the bank loan;

(ii) no settlement will be required in respect of the two ongoing arbitration proceedings between Jiangxi Jiangzhou Union Shipbuilding Co., Ltd, a wholly owned subsidiary of the Company, and two vessel owners regarding the validity of the rescission notices sent by these vessel owners requesting for return of their principal payments for two shipbuilding contracts and the related interest amounting to HK$378.4 million (the "Arbitration") because the ruling of the arbitration proceedings, after taking into legal advice sought by the directors of the Company, will not be concluded at least twelve months from the date of this Circular, details of which are set out under the paragraph headed "Litigation" on page 133 of this Circular; and

(iii) bank loans of HK$34 million, HK$79.5 million and HK$56.8 million borrowed from banks, with repayment due dates falling within twelve months from the date of the Circular, will be renewed and revolved, assuming similar precedent conditions allowing the Group's prior renewal and revolving of such loans, including but not limited to the requirement for guarantees from two guarantors and assets to be pledged, will be continuously applied by the banks and fulfilled by the Group.

The Directors are of the opinion that the Group will have sufficient working capital for at least twelve months from the date of this Circular to meet its present requirements.

However, in case any of the assumptions in point (b)(i) to (b)(iii) above do not eventuate as expected, resulting in

(i) immediate repayment for a bank loan of HK$46.9 million in respect of which the Group breached the loan covenants; and

(ii) settlement of HK$378.4 million in respect of the Arbitration to return the principal payments and related interest to the vessel owners; and/or

(iii) each of the bank loans of HK$34 million, HK$79.5 million and HK$56.8 million with repayment due dates falling within twelve months from the date of this Circular cannot be renewed and revolved,

the Group may not have sufficient working capital to meet its present requirements.

## 6. MATERIAL ADVERSE CHANGE

The Directors confirm that there was no material adverse change in the financial or trading position of the Group since 31 December 2009, being the date of which the latest audited financial statements of the Group were made up.

*The following unaudited pro forma financial information prepared in accordance with Paragraph 29 of Chapter 4 of the Listing Rules is for illustrative purposes only, and is set out here to provide Shareholders with further information about how the Open Offer might have affected the net tangible assets of the Group after completion of the Open Offer as if the Open Offer had taken place on 31 December 2009. Although reasonable care has been exercised in preparing the said information, Shareholders who read the information should bear in mind that these figures are inherently subject to adjustments and, because of their nature, they may not give a true picture of the Group's financial positions after completion of the Open Offer.*

## 1. UNAUDITED PRO FORMA STATEMENT OF ADJUSTED CONSOLIDATED NET TANGIBLE ASSETS OF THE GROUP

The following is an illustrative unaudited pro forma statement of adjusted consolidated net tangible assets attributable to owners of the Company (the "Unaudited Pro Forma Financial Information") which has been prepared on the basis of the notes set out below for the purpose of illustrating the effect of the Open Offer as if it had taken place on 31 December 2009. The Unaudited Pro Forma Financial Information of the Group is prepared based on the audited consolidated financial statements of the Group for the year ended 31 December 2009 and is adjusted for the effect of the Open Offer.

The Unaudited Pro Forma Financial Information of the Group has been prepared for illustrative purpose only and, because of its hypothetical nature, it may not give a true picture of the consolidated net tangible assets attributable to owners of the Company following the Open Offer.

| | Audited consolidated net assets of the Group attributable to owners of the Company as at 31 December 2009 | Audited intangible assets of the Group as at 31 December 2009 | Adjusted consolidated net tangible assets of the Group attributable to owners of the Company as at 31 December 2009 | Adjusted consolidated net tangible assets of the Group attributable to owners of the Company per share as at 31 December 2009 | Estimated net proceeds from the Open Offer | Unaudited pro forma adjusted consolidated net tangible assets of the Group after the completion of the Open Offer attributable to owners of the Company | Unaudited pro forma adjusted consolidated net tangible assets of the Group after the completion of the Open Offer attributable to owners of the Company per share |
|---|---|---|---|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* | | *HK$'000* | *HK$'000* | |
| | *(Note 1)* | *(Note 2)* | | *(Note 3)* | *(Note 4)* | | *(Notes 5 & 6 )* |
| Based on 451,049,825 Offer Shares issued ("Minimum Open Offer") | 506,816 | 440,152 | 66,664 | HK$0.07 | 220,103 | 286,767 | HK$0.13 |
| Based on 503,195,001 Offer Shares issued ("Maximum Open Offer") | 506,816 | 440,152 | 66,664 | HK$0.07 | 246,176 | 312,840 | HK$0.13 |

*Notes:*

1. The audited consolidated net assets of the Group attributable to owners of the Company as at 31 December 2009 is extracted from the published annual report of the Company for the year ended 31 December 2009.

2. Intangible assets of the Group as at 31 December 2009 representing contracted and uncontracted customer relationship of approximately HK$440,152,000 extracted from the published annual report of the Company for the year ended 31 December 2009.

3. The number of shares used for the calculation of adjusted consolidated net tangible assets of the Group attributable to owners of the Company per share as at 31 December 2009 and prior to the completion of the Open Offer is based on 902,099,651 shares in issue as at 31 December 2009.

4. The estimated net proceeds from the Open Offer of

   (i) approximately HK$220 million are calculated using the minimum number of 451,049,825 Offer Shares to be issued (based on 902,099,651 shares in issue on the Record Date) at a subscription price of HK$0.50 per Offer Share, after deduction of estimated related expenses directly attributable to the Open Offer of approximately HK$5.422 million.

(ii) approximately HK$246 million are calculated using the maximum number of 503,195,001 Offer Shares to be issued at a subscription price of HK$0.50 per Offer Share, after deduction of estimated related expenses directly attributable to the Open Offer of approximately HK$5.422 million. The maximum number of Offer Shares is determined based on 1,006,390,002 shares, comprising the following:

a. 902,099,651 shares in issue at the Record Date;

b. 69,910,351 shares assuming conversion of outstanding convertible notes with an aggregate principal amount of HK$507,549,000 at a conversion price of HK$7.26 per share; and

c. 34,380,000 shares assuming exercise of share options on or before the Record Date.

5. For Minimum Open Offer, the calculation of the unaudited pro forma adjusted consolidated net tangible assets attributable to owners of the Company per share is based on 2,255,249,126 shares which comprise 902,099,651 shares in issue as at 31 December 2009, 451,049,825 Offer Shares and 902,099,650 bonus shares to be issued.

6. For Maximum Open Offer, the calculation of the unaudited pro forma adjusted consolidated net tangible assets attributable to the owners of the Company per share is based on 2,411,684,654 shares which comprise 902,099,651 shares in issue as at 31 December 2009, 503,195,001 Offer Shares and 1,006,390,002 bonus shares to be issued.

## 2. ACCOUNTANTS' REPORT ON UNAUDITED PRO FORMA STATEMENT OF ADJUSTED CONSOLIDATED NET TANGIBLE ASSETS OF THE GROUP

**Deloitte.**
**德勤**

**TO THE DIRECTORS OF CHINA OCEAN SHIPBUILDING INDUSTRY GROUP LIMITED**

We report on the unaudited pro forma statement of adjusted consolidated net tangible assets ("Unaudited Pro Forma Financial Information") of China Ocean Shipbuilding Industry Group Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group") set out on pages 121 to 123 of Appendix II to the circular of the Company dated 23 July 2010 (the "Circular") in connection with (i) the issue of not less than 451,049,825 offer shares and not more than 503,195,001 offer shares of HK$0.05 each at a subscription price of HK$0.5 per offer share on the basis of one offer share for every two shares (the "Open Offer") held on the Record Date (as defined in the Circular) and (ii) bonus issue on the basis of two bonus shares for every one offer share taken up, which has been prepared by the directors of the Company for illustrative purposes only, to provide information about how the Open Offer might have affected the financial information presented, for inclusion in Appendix II of the Circular. The basis of preparation of the Unaudited Pro Forma Financial Information is set out in the accompanying introduction and notes to the Unaudited Pro Forma Financial Information included in Appendix II to the Circular.

**RESPECTIVE RESPONSIBILITIES OF DIRECTORS OF THE COMPANY AND REPORTING ACCOUNTANTS**

It is the responsibility solely of the directors of the Company to prepare the Unaudited Pro Forma Financial Information in accordance with paragraph 29 of Chapter 4 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and with reference to Accounting Guideline 7 "Preparation of Pro Forma Financial Information for Inclusion in Investment Circulars" issued by the Hong Kong Institute of Certified Public Accountants.

It is our responsibility to form an opinion, as required by paragraph 29(7) of Chapter 4 of the Listing Rules, on the Unaudited Pro Forma Financial Information and to report our opinion to you. We do not accept any responsibility for any reports previously given by us on any financial information used in the compilation of the Unaudited Pro Forma Financial Information beyond that owed to those to whom those reports were addressed by us at the dates of their issue.

## BASIS OF OPINION

We conducted our engagement in accordance with Hong Kong Standard on Investment Circular Reporting Engagements 300 “Accountants’ Reports on Pro Forma Financial Information in Investment Circulars” issued by the Hong Kong Institute of Certified Public Accountants. Our work consisted primarily of comparing the unadjusted financial information with source documents, considering the evidence supporting the adjustments and discussing the Unaudited Pro Forma Financial Information with the directors of the Company. This engagement did not involve independent examination of any of the underlying financial information.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Unaudited Pro Forma Financial Information has been properly compiled by the directors of the Company on the basis stated, that such basis is consistent with the accounting policies of the Group and that the adjustments are appropriate for the purpose of the Unaudited Pro Forma Financial Information as disclosed pursuant to paragraph 29(1) of Chapter 4 of the Listing Rules.

The Unaudited Pro Forma Financial Information is for illustrative purpose only, based on the judgments and assumptions of the directors of the Company, and, because of its hypothetical nature, does not provide any assurance or indication that any event will take place in future and may not be indicative of the financial position of the Group as at 31 December 2009 or any future date.

## OPINION

In our opinion:

a) the Unaudited Pro Forma Financial Information has been properly compiled by the directors of the Company on the basis stated;

b) such basis is consistent with the accounting policies of the Group; and

c) the adjustments are appropriate for the purposes of the Unaudited Pro Forma Financial Information as disclosed pursuant to paragraph 29(1) of Chapter 4 of the Listing Rules.

**Deloitte Touche Tohmatsu**
*Certified Public Accountants*
Hong Kong, 23 July 2010

## 1. RESPONSIBILITY OF THE DIRECTORS

The Circular, for which the Directors collectively and individually accept full responsibility, includes particular given in compliance with the Listing Rules for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief:

(a) the information contained in the Circular is accurate and complete in all material respects and is not misleading or deceptive;

(b) there are no other matters the omission of which would make any statement in the Circular misleading; and

(c) all opinions expressed in the Circular have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

## 2. SHARE CAPITAL

### (a) Share Capital

The authorized and issued share capital of the Company as at the Latest Practicable Date were, and following completion of the Open Offer will be, as follows:

| *Authorized* | | *HK$* |
|---|---|---|
| 5,000,000,000 | Shares as at the Latest Practicable Date | 250,000,000.00 |
| 5,000,000,000 | | 250,000,000.00 |

(I) Fully paid Shares in issue or to be issued (assuming no exercise of the outstanding Share Options and Convertible Notes):

| *Issued and to be issued as fully paid* | | *HK$* |
|---|---|---|
| 902,099,651 | Shares in issue as at the Latest Practicable Date | 45,104,982.55 |
| 451,049,825 | Offer Shares to be issued pursuant to the Open Offer | 22,552,491.25 |
| 902,099,650 | Bonus Shares to be issued pursuant to the Bonus Issue | 45,104,982.50 |
| 2,255,249,126 | | 112,762,456.30 |

(II) Fully paid Shares in issue or to be issued (assuming the exercise of the outstanding Share Options and convertible rights attached to the Convertible Notes in full):

| *Issued and to be issued as fully paid* | | *HK$* |
|---|---|---|
| 902,099,651 | Shares in issue as at the Latest Practicable Date | 45,104,982.55 |
| 34,380,000 | Shares to be issued pursuant to the outstanding Share Options | 1,719,000.00 |
| 69,910,351 | Shares to be issued pursuant to the outstanding Convertible Notes | 3,495,517.55 |
| 503,195,001 | Offer Shares to be issued pursuant to the Open Offer | 25,159,750.05 |
| 1,006,390,002 | Bonus Shares to be issued pursuant to the Bonus Issue | 50,319,500.10 |
| 2,515,975,005 | | 125,798,750.25 |

All the existing issued Shares rank pari passu in all respects including all rights as to dividends, voting and return of capital. All the Offer Shares and the Bonus Shares which will be issued upon completion of the Open Offer with Bonus Issue will rank pari passu in all respects with each other and with all the Shares in issue as at the date of allotment and issue of the Offer Shares and the Bonus Shares. All the Offer Shares and the Bonus Shares to be issued will be listed on the Stock Exchange.

(b) **Share Options**

The Share Option Scheme was adopted on 27 May 2002 for the primary purpose of providing incentives to directors and eligible employees, and will expire on 26 May 2012. Under the Share Option Scheme, the Board may grant Share Options to eligible employees, including directors of the Company and its subsidiaries, to subscribe for shares in the Company. Additionally, the Company may, from time to time, grant Share Options to outside third parties for settlement in respect of goods or services provided to the Company.

At the Latest Practicable Date, the number of Shares in respect of which Share Options had been granted and remained outstanding under the Share Option Scheme was 34,380,000, representing 3.81% of the Shares of the Company in issue at that date. The total number of Shares in respect of which Share Options may be granted under the Share Option Scheme is not permitted to exceed 10% of the Shares of the Company in issue at any point in time, without prior approval from the Company's Shareholders. The number of Shares issued and to be issued in respect of which Share Options granted and may be granted to any individual in any one year is not permitted to exceed 1% of the Shares of the Company in issue at any point in time, without prior approval from the Company's Shareholders.

As at the Latest Practicable Date, the following participants had interests in Share Options to subscribe for Shares in the Company and details of which are as follows:

| Name or Category of participant | No. of Share Options granted | No. of Share Options outstanding as at the Latest Practicable Date *(Note 1)* | Exercise price *(Note2)* | Date of grant | Exercise period |
|---|---|---|---|---|---|
| **Directors:** | | | | | |
| Chau On Ta Yuen | 60,000,000 | 1,200,000 | 9.00 | 05-03-08 | 05-03-08 to 04-03-18 |
| | 45,000,000 | 900,000 | 9.00 | 05-03-08 | 05-03-09 to 04-03-18 |
| | 45,000,000 | 900,000 | 9.00 | 05-03-08 | 05-03-10 to 04-03-18 |
| Zhang Shi Hong | 20,000,000 | 400,000 | 9.00 | 05-03-08 | 05-03-08 to 04-03-18 |
| | 15,000,000 | 300,000 | 9.00 | 05-03-08 | 05-03-09 to 04-03-18 |
| | 15,000,000 | 300,000 | 9.00 | 05-03-08 | 05-03-10 to 04-03-18 |
| Wang San Long | 52,000,000 | 1,040,000 | 7.15 | 07-05-08 | 07-05-08 to 06-05-18 |
| | 39,000,000 | 780,000 | 7.15 | 07-05-08 | 07-05-09 to 06-05-18 |
| | 39,000,000 | 780,000 | 7.15 | 07-05-08 | 07-05-10 to 06-05-18 |
| Sub-total | 330,000,000 | 6,600,000 | | | |
| **Employees:** | 69,600,000 | 1,392,000 | 7.15 | 07-05-08 | 07-05-08 to 06-05-18 |
| | 52,200,000 | 1,044,000 | 7.15 | 07-05-08 | 07-05-09 to 06-05-18 |
| | 52,200,000 | 1,044,000 | 7.15 | 07-05-08 | 07-05-10 to 06-05-18 |
| Sub-total | 174,000,000 | 3,480,000 | | | |
| **Other participants** | 1,215,000,000 | 24,300,000 | 7.15 | 07-05-08 | 07-05-08 to 06-05-18 |
| Total: | 1,719,000,000 | 34,380,000 | | | |

*Note 1:* The number of outstanding Share Options has been adjusted to take into account the effect of the share consolidation upon it took effect on 25 June 2009.

*Note 2:* The initial exercise prices of the Shares Options granted on 5 March 2008 and 7 May 2008 were HK$0.180 and HK$0.143 respectively, upon the share consolidation became effective on 25 June 2009, the exercise prices of Shares Options were adjusted to HK$9.00 and HK$7.15 respectively.

(c) **Convertible Notes**

The Company issued convertible notes in April 2008. The details are as follows:

On 5 November 2007, the Company entered into a conditional agreement to issue convertible notes under an acquisition agreement for the acquisition of the entire interest in INPAX Group. The convertible notes ("**CNI**") were issued on 16 April 2008 upon completion of the acquisition.

CNI comprises restricted convertible notes ("**Restricted Convertible Notes**") and unrestricted convertible notes ("**Unrestricted Convertible Notes**").

The aggregate principal amount of the Unrestricted Convertible Notes issued is HK$2,400 million.

The aggregate initial principal amount of the Restricted Convertible Notes issued is HK$600 million, which is subject to downward adjustment for the potential shortfall between the guaranteed profit of HK$600 million and the audited profit after taxation of INPAX Group for the year ended 31 December 2008. Based on the audited profit after taxation of INPAX Group of approximately HK$217 million, the shortfall was determined to be approximately HK$383 million as compared to the guaranteed profit of HK$600 million.

The holder(s) of the Restricted Convertible Notes may convert the whole or any part of the principal amount of the restricted convertible notes outstanding into the ordinary shares of the Company from 5 June 2009 to 15 April 2011 at the initial conversion price of HK$0.15 per share. The conversion price was adjusted to HK$7.50 upon the share consolidation with effect from 25 June 2009 and was further adjusted to HK$7.26 upon the completion of placing on 31 August 2009.

The holder(s) of the Unrestricted Convertible Notes may convert the whole or any part of the principal amount of the Unrestricted Convertible Notes outstanding into the ordinary shares of the Company from 16 April 2008, the date of issue of the convertible notes, to 15 April 2011, the date of maturity, at an initial conversion price of HK$0.15 per conversion share. The conversion price was adjusted to HK$7.50 upon the completion of share consolidation with effect from 25 June 2009 and was further adjusted to HK$7.26 upon the completion of placing on 31 August 2009.

In respect of the Restricted Convertible Note, no interest will be payable. For the Unrestricted Convertible Note, coupon interest at the rate of 1.5% per annum will be accrued on a day to day basis on the outstanding principal amount, payable semi-annually in arrears.

With the passing of a shareholders' resolution at the special general meeting of the Company held on 25 June 2010 and the obtaining of all consents and approvals by the Stock Exchange on 29 June 2010, the maturity date of the Convertible Notes has been extended from 15 April 2010 to 15 April 2011. Apart from the extension of the maturity date of the Convertible Notes, each and every term and condition under the Convertible Notes remain unchanged and valid.

As at the Latest Practicable Date, the Company has (i) outstanding Restricted Convertible Notes in the principal amount of HK$147,549,152 which are convertible into 20,323,574 Shares; and (ii) outstanding Unrestricted Convertible Notes in the principal amount of HK$360,000,000 which are convertible into 49,586,777 Shares.

Save as disclosed in this Circular, no share or loan capital of the Company or any member of the Group has been put under option or agreed conditionally or unconditionally to be put under option and no warrant or conversion right affecting the Shares has been issued or granted or agreed conditionally or unconditionally to be issued or granted.

There is no arrangement under which future dividends are waived or agreed to be waived.

## 3. DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS

Save as disclosed below, as at the Latest Practicable Date, none of the Directors or chief executives (if any) of the Company had, or was deemed to have, any interests or short positions in the Shares, underlying Shares and debentures of the Company or any of its associated corporations (within the meaning of part XV of the SFO) which were required (a) to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO); or (b) pursuant to section 352 of Part XV of the SFO to be entered in the register referred to therein; or (c) pursuant to the Model Code for Securities Transactions by Directors of Listed Companies to be notified to the Company and the Stock Exchange:

### (a) Long positions in the Shares

| Name of Director | Capacity in holding interest | Long/short position | No. of Shares | Approximate percentage of interest in the Company's issued share capital |
|---|---|---|---|---|
| Mr. Li | Beneficial owner | Long | 79,995,000 | 8.87 |
| Mr. Li | Interest of controlled corporation *(Note 1)* | Long | 12,710,000 | 1.41 |
| Mr. Li | Beneficial owner and interested of controlled corporation *(Note 2)* | Long | 139,057,500 | 15.41 |

*Note 1*: Mr. Li is the sole legal and beneficial owner of Lead Dragon Limited, which, as at the Latest Practicable Date, was interested in 12,710,000 Shares, by virtue of the provision of the Part XV of the SFO, Mr. Li is deemed to be interested in all the Shares in which Lead Dragon Limited is interested.

*Note 2:* These are the interests in 139,057,500 Offer Shares and Bonus Shares derived from Mr. Li's Undertaking and consent to apply for the entire number of Offer Shares in the assured allotments in which Mr. Li and Lead Dragon Limited are beneficially interested.

(b) **Long position in underlying Shares of equity derivatives of the Company**

**Share Option Scheme**

The interests in the underlying Shares arise from Share Options granted to the Directors under the Share Option Scheme, details of which were as follows:

| Name of Directors | Date of grant | Exercisable period | Exercise price per Share | Aggregate long position in underlying Shares | Approximate percentage of interest in the Company's issued share capital |
|---|---|---|---|---|---|
| Chau On Ta Yuen | 05/03/2008 | 05/03/2008 - 04/03/2018 | HK$9.00 | 3,000,000 | 0.33 |
| Zhang Shi Hong | 05/03/2008 | 05/03/2008 - 04/03/2018 | HK$9.00 | 1,000,000 | 0.11 |
| Wang San Long | 07/05/2008 | 07/05/2008 - 06/05/2018 | HK$7.15 | 2,600,000 | 0.29 |

*Note:*

The above interest constitutes a long position of the Director in a physically settled equity derivative for the purpose of the SFO.

## 4. SUBSTANTIAL SHAREHOLDERS' INTERESTS

Save as disclosed below, as at the Latest Practicable date, so far as is known to any Director or chief executive (if any) of the Company, no other person (not being a Director, chief executive (if any) of the Company) had an interest or short positions in the Shares and underlying Shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or who was, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any member of the Group.

## 5. MATERIAL CONTRACTS

The following contracts, not being contracts in the ordinary course of business of the Group, were entered into by the Company or its subsidiaries during the period commencing two years preceding the date of the Announcement and up to the Latest Practicable Date and are or may be material:

(A) the Underwriting Agreement;

(B) the termination agreement dated 31 December 2009 entered into among the Company, Kingston Securities and Li Ming in relation to cancellation of the underwriting agreement dated 16 November 2009;

(C) the underwriting agreement dated 16 November 2009 entered into among the Company, Kingston Securities and Li Ming in relation to a proposed open offer of not less than 1,804,199,302 new shares and not more than 2,012,780,004 new shares at the price of HK$0.20 per offer share;

(D) the placing agreement dated 20 August 2009 entered into between the Company and Kingston Securities in relation to the placing of 150,000,000 new shares of HK$0.05 each of the Company at the price of HK$0.43 per share; and

(E) the placing agreement dated 21 May 2009 entered into between the Company and Kingston Securities in relation to the placing of 3,400,000,000 shares of HK$0.001 each of the Company at the price of HK$0.013 per share.

## 6. DIRECTORS' INTERESTS IN ASSETS/CONTRACTS AND OTHER INTERESTS

Save as the guarantee contracts disclosed in the Company's announcements dated 4 November 2008 and 4 February 2009 and the Underwriting Agreement, none of the Directors was materially interested in any contract or arrangement entered into by any member of the Group subsisting at the Latest Practicable Date which was significant in relation to the business of the Group.

None of the Directors has any direct or indirect interests in any assets which have been acquired or disposed of by or leased to any member of the Group or are proposed to be acquired or disposed of by or leased to any member of the Group since 31 December 2009, being the date to which the latest published audited consolidated accounts of the Group were made up.

## 7. DIRECTORS' SERVICE CONTRACTS

As at the Latest Practicable Date, none of the Directors has entered into any service contracts with the Company or any of its subsidiaries or associated companies, excluding contracts expiring within one year without payment of compensation other than statutory compensation.

## 8. COMPETING INTERESTS

As at the Latest Practicable Date, none of the Directors or substantial Shareholders or their respective associates had any interests in any business which competes or may compete with the business of the Group.

## 9. LITIGATION

As at the Latest Practicable Date, neither the Company nor any of its subsidiaries was engaged in any litigation or arbitration of material importance and no litigation or claim of material importance was known to the Directors to be pending or threatened by or against the Company or any of its subsidiaries.

For the sake of transparency and to disclose claims of immaterial importance, as at the Latest Practicable Date, there were two ongoing arbitration proceedings between Jiangxi Jiangzhou Union Shipbuilding Co. Ltd ("**Shipyard**"), a wholly owned subsidiary of the Company, and Intrepid Chem 1021 Corp ("**Intrepid**") regarding the validity of the rescission notice sent by Intrepid and its request for return of the principal payment for shipbuilding and interest, amounting to US$24,229,634.62 and between Shipyard and Sloman Neptun Schiffahrts-Aktiengesellschaft ("**Sloman**") regarding the validity of the rescission notice sent by Sloman and its request for return of the principal payment for shipbuilding and interest, amounting to US$24,286,316.43. The principal payments for shipbuilding, in accordance with the shipbuilding contracts signed between by Shipyard and, respectively, Intrepid and Sloman, were for vessel building and payments to Shipyard for the construction services rendered. As at 31 December 2009, the costs incurred in vessel building and construction services relating to these two shipbuilding contracts amounted to approximately RMB138.7 million and RMB112.3 million, respectively.

If the result of the above arbitrations is unfavourable to Shipyard, the Group may be required to return the principal payments for shipbuilding and interests claimed by Intrepid and Sloman where (i) Shipyard might incur a loss resulting from the recoverable amount (through the disposal of the vessels to other parties) of the vessels falling short of the principal payments for shipbuilding and interests as claimed by Intrepid and Sloman, or (ii) Shipyard might record a gain resulting from the recoverable amount (through the disposal of the vessels to other parties) of the vessels exceeding the principal payments for shipbuilding and interests as claimed by Intrepid and Sloman. As the quality of the vessels of the Group is internationally recognised and in compliance with the international standards, the Company considers that the vessels can be resold to other parties without any material discount on the market price and material modification or alternation.

The Company is of the view that no provision for the claims is required at this early fact finding stage of the arbitrations.

## 10. EXPERTS AND CONSENTS

The following is the qualification of the experts who have given opinions or advice, which are contained or referred to in this Circular:

| Name | Qualification |
|---|---|
| GF Capital | A licensed corporation to carry on business in type 6 (advising on corporate finance) regulated activities under the SFO |
| Deloitte Touche Tohmatsu | Certified Public Accountants |

GF Capital and Deloitte Touche Tohmatsu have given and have not withdrawn their written consent to the issue of the Circular with the inclusion herein of their letters or opinions or reports or references to their names, in the form and context in which they appear. As at the Latest Practicable Date, neither GF Capital nor Deloitte Touche Tohmatsu had any shareholding in any member of the Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group.

GF Capital and Deloitte Touche Tohmatsu have not had any direct or indirect interests in any assets which have been, since 31 December 2009 (being the date to which the latest published audited accounts of the Company were made up), acquired or disposed of by or leased to any member of the Group, or which are proposed to be acquired or disposed of by or leased to any member of the Group.

**11. CORPORATE INFORMATION AND PARTIES INVOLVED IN THE OPEN OFFER**

| | |
|---|---|
| Registered Office: | Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda |
| Head office and, principal place of business in Hong Kong: | Unit 1103,11/F., China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road Central, Hong Kong |
| Principal share registrars and transfer office in Bermuda: | HSBC Bank Bermuda Limited<br>Bank of Bermuda Building, 6 Front Street, Hamilton HM11, Bermuda |
| Hong Kong branch share registrars and transfer office: | Tricor Abacus Limited<br>26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong |
| Authorized Representatives: | Mr. Chau On Ta Yuen<br>Unit 1103, 11/F., China Merchants Tower,<br>Shun Tak Centre, 168-200 Connuaught Road Central,<br>Hong Kong<br><br>Mr. Ngai Man Wo<br>Unit 1103, 11/F., China Merchants Tower,<br>Shun Tak Centre, 168-200 Connuaught Road Central,<br>Hong Kong |
| Principal Bankers: | Bank of Communications Co. Ltd.<br>20 Pedder Street, Central, Hong Kong<br><br>Chiyu Banking Corporation Ltd.<br>No.78, Des Vouex Road, Central, Hong Kong<br><br>China Merchants Bank Co. Ltd.<br>21/F., Bank of America Tower, 12 Harcourt Road,<br>Central, Hong Kong |

| | |
|---|---|
| Auditors: | Deloitte Touche Tohmatsu<br>35th Floor, One Pacific Place,<br>88 Queensway Hong Kong |
| Financial Adviser: | Kingston Corporate Finance Limited<br>Suite 2801,<br>28/F., One International Finance Centre,<br>1 Harbour View Street,<br>Central, Hong Kong |
| Independent Financial Adviser: | GF Capital (Hong Kong) Limited<br>Rooms 2301-2305, 2313 COSCO Tower,<br>183 Queen's Road, Central, Hong Kong |
| Underwriter: | Kingston Securities Limited<br>Suite 2801,<br>28/F., One International Finance Centre,<br>1 Harbour View Street,<br>Central, Hong Kong |
| Legal adviser: | *On Hong Kong law*<br>Cheung, Tong & Rosa<br>Room 501, 5/F.,<br>Sun Hung Kai Centre,<br>30 Harbour Road,<br>Wanchai, Hong Kong<br><br>*On Bermuda law*<br>Conyers Dill & Pearman<br>2901, One Exchange Square,<br>8 Connaught Place,<br>Central, Hong Kong |

## 12. MISCELLANEOUS

(a) The registered office of the Company is at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda and its principal place of business in Hong Kong is at Unit 1103, 11/F., China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road, Central, Hong Kong.

(b) The branch share registrar and transfer office of the Company in Hong Kong is Tricor Abacus Limited at 26/F., Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong.

(c) The secretary of the Company is Mr. Ngai Man Wo who is a member of the Hong Kong Institute of Certified Public Accountants and a fellow member of the Association of Chartered Certified Accountants.

(d) None of any part of the equity or debt securities of the Group is listed or dealt in or any other recognized stock exchange or on which listing or permission to deal is being or is proposed to be sought.

(e) As at the Latest Practicable Date, save as disclosed herein, the Directors were not aware of any significant event which had occurred to any business of the Company and within the Group since 31 December 2009, being the date to which the latest published accounts of the Group were made up of.

(f) In case of inconsistency, the English text of this prospectus shall prevail over the Chinese text.

## 13. DIRECTORS AND SENIOR MANAGEMENT

### Executive Directors

**Mr. Chau On Ta Yuen**, aged 62 was appointed a Director of the Company in September 2007 and is the Chairman of the Group, Mr. Chau graduated from Xiamen University majoring in Chinese Language and literature. He is currently the independent non-executive director of Wonderful World Holdings Limited, Buildmore International Limited and Come Sure Group (Holdings) Limited, the shares of which are listed on the Main Board of the Stock Exchange of Hong Kong Limited. From 5 June 2003 to 20 August 2009, Mr. Chau was an independent non-executive director of Everpride Biopharmaceutical Company Limited, the shares of which are listed on the Growth Enterprise Market of the Stock Exchange. From March 2000 to November 2006, he was appointed as the executive director and the vice chairman of Everbest Century Holdings Limited (now known as Dynamic Energy Holdings Limited) which is listed on the Main Board of the Stock Exchange. Mr. Chau is a member of the Chinese People Political Consultative Conference of the People Republic of China and the vice chairman of Hong Kong Federation of Fujian Associations. The business address of Mr. Chau is Unit 1103, 11/F, China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road Central, Hong Kong.

**Mr. Li Ming**, aged 47, was appointed a Director of the Company in February 2009 and is the Deputy Chairman and Chief Executive Officer of the Group. Mr. Li graduated from Jiangxi Finance Institute (now known as Jiangxi University of Finance & Economics) majoring in planning statistics. Prior to joining the Company, Mr. Li held senior positions in a number of well-known companies in the People's Republic of China and had extensive experience in management and business planning. During the period from 3 September 2002 to 5 October 2007, he was appointed as an non-executive director of Ningbo Yidong Electronic Company Limited, the shares of which are listed on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited. The business address of Mr. Li is Unit 1103, 11/F, China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road Central, Hong Kong.

**Mr. Zhang Shi Hong**, aged 41, was appointed a Director of the Company in December 2007. Mr. Zhang has over 15 years of experience in finance, credit management and investment management. He has worked for the head office of the Bank of China for around nine years and was mainly responsible for credit management. He also pursued investment management in various corporations in the PRC. Mr. Zhang holds a Master's degree in Economics. The business address of Mr. Zhang is Unit 1103, 11/F, China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road Central, Hong Kong.

**Mr. Wang San Long**, aged 59, was appointed a Director of the Compnay in May 2008. Mr. Wang has more than thirty years working experience in the field of ship-building. He is a senior engineer and was graduated from ship-building department of Huazhong Gong Xue Yuan (now known as Huazhong University of Science and Technology). Mr. Wang is a member of Changjiang Committee in China Classification Society. He is also a member of teaching guidance committee of ship engineering department in Jiujiang Vocational and Technical College. Mr. Wang is currently the director and general manager of one of the subsidiary of the Company, namely Jiangxi Jiangzhou Union Shipbuilding Co., Ltd. The business address of Mr. Wang is Unit 1103, 11/F, China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road Central, Hong Kong.

**Independent Non-Executive Directors**

**Mr. Hu Bai He**, aged 47, appointed an independent non-executive Director of the Company in May 2008. Mr. Hu was graduated from Jiangxi University of Finance & Economics. He is a Senior Accountant, Certified Public Accountant, Certified Public Valuer and Certified Tax Agent in the PRC. He has extensive experience in finance and accounting field. Mr. Hu is currently the General Manager of Peking Certified Public Accountants. Before he joined Peking Certified Public Accountants in 1993, he has had over seven years working experience with Ministry of Finance the PRC. The business address of Mr. Hu is Unit 1103, 11/F, China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road Central, Hong Kong.

**Ms. Xiang Si Ying**, aged 47, was appointed an independent non-executive Director of the Company in May 2008. Ms. Xiang holds an MBA degree from the London Business School. She has extensive experience in corporate finance, restructuring, initial public offering and merge and acquisitions deals. Ms. Xiang is currently an executive director of private equity department of China International Capital Corporation Limited ("CICC"). Prior to joining CICC in 2004, she has had over ten years working experience with International Finance Corporation, the private investment arm of the World Bank Group, in Washington DC, United States of America. The business address of Mr. Xiang is Unit 1103, 11/F, China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road Central, Hong Kong.

**Mr. Zhang Xi Ping**, aged 65, was appointed an independent non-executive Director of the Company in August 2008. Mr. Zhang graduated from the department of shipping design and building at Harbin Institute of Military Engineering in 1968 and completed a postgraduate course in fluid mechanics at Shanghai Jiao Tong University in 1977. He is a professorial engineer and a senior economist in the PRC. Mr. Zhang has extensive experience in shipping field and has held senior positions in several national companies. The business address of Mr. Zhang is Unit 1103, 11/F, China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road Central, Hong Kong.

**Ms. Xiang Ying**, aged 56, was appointed an independent non-executive Director of the Company in August 2009. Ms. Xiang was graduated and obtained her Bachelor's Degree in Economics from Zhongnan University of Economics and Law. Ms. Xiang is a qualified lawyer and a certified public accountant in the People's Republic of China. She also holds qualifications to act as a senior lecturer in Economic Law. Ms. Xiang has significant experience in the fields of mergers and acquisitions, financial services and risk management. Ms. Xiang is currently an independent supervisor of Guangdong Power Development Company Limited, the shares of which are listed on Shenzhen Stock Exchange. She is also an independent director of Guodian Nanjing Automation Company Limited and Guangdong Sky Dragon Ink Group Co. Ltd, the shares of which are listed on Shanghai Stock Exchange and Shenzhen Stock Exchange respectively. The business address of Ms. Xiang is Unit 1103, 11/F, China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road Central, Hong Kong.

## 14. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents are available for inspection during normal business hours at the principal place of business of the Company in Hong Kong at Unit 1103,11/F., China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road Central, Hong Kong on or before 31 July 2010 and in Unit 1702-03, 17/F., China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road Central, Hong Kong from 1 August 2010 onwards:

(a) the memorandum of association and bye-laws of the Company;

(b) the annual reports of the Company for the two years ended 31 December 2009;

(c) the material contracts referred to under the paragraph headed "MATERIAL CONTRACTS" in this Appendix;

(d) the letter from the Independent Board Committee, the text of which is set out on pages 28 to 29 of the Circular;

(e) the letter from GF Capital, the independent financial advisor, the text of which is set out on pages 30 to 45 of the Circular;

(f) the comfort letter issued by Deloitte Touche Tohmatsu on pro forma statement of unaudited adjusted consolidated net tangible assets of the Group;

(g) the written consents from the Independent Financial Advisor and Deloitte Touche Tohmatsu as referred to in paragraph headed "Experts and Consents" of this Appendix;

(h) the Circular; and

(i) The letter of Mr. Li's Undertaking.

# CHINA OCEAN SHIPBUILDING INDUSTRY GROUP LIMITED
# 中海船舶重工集團有限公司

*(Incorporated in Bermuda with limited liability)*
**(Stock code: 00651)**

**NOTICE IS HEREBY GIVEN** that a special general meeting (the "**Meeting**") of China Ocean Shipbuilding Industry Group Limited (the "**Company**") will be held at Unit 1702-03, 17/F., China Merchants Tower, Shun Tak Centre, 168-200 Connaught Road Central, Hong Kong on 16 August 2010 at 10:00 a.m. for the purpose of considering and, if thought fit, passing with or without amendments the following resolution:

**ORINDARY RESOLUTION**

1. "**THAT** conditional upon the passing of (i) the resolutions numbered 2 and 3 set out in the notice convening this SGM (the "**Notice**") and (in the case of paragraphs 1.2 and 1.3 below only) the fulfillment or waiver of the conditions to the Underwriting Agreement (as defined below):

   1.1. the underwriting agreement (the "**Underwriting Agreement**") dated 15 June 2010 entered into between the Company and the underwriter, Kingston Securities Limited, copy of which has been produced at the Meeting and marked "A" and initialed by the chairman of the Meeting for identification purpose be and is hereby approved, confirmed and ratified in all respects;

   1.2. the issue by way of open offer (the "**Open Offer**") of not less than 451,049,825 and not more than 503,195,001 new Shares of HK$0.05 each ("**Offer Shares**") for a subscription price of HK$0.5 per Offer Share to the shareholders of the Company (the "**Shareholders**") whose names appear on the register of members of the Company as at the close of business on 16 August 2010 (the "**Record Date**"), in the proportion of one Offer Share for every two existing Shares then held (with bonus Shares (the "**Bonus Shares**") in the proportion of two Bonus Shares for every one Offer Share taken up under the Open Offer (the "**Bonus Issue**")) and otherwise pursuant to and in accordance with the terms and conditions set out in the circular of the Company dated 23 July 2010 (the "**Circular**", a copy of which has been produced at the Meeting and marked "B" and initialed by the chairman of the Meeting for identification purpose) be and is hereby approved; and

   1.3. the Directors be and are hereby authorized (i) to allot and issue the Offer Shares and Bonus Shares pursuant to or in connection with the Open Offer with Bonus Issue notwithstanding the Bonus Shares may be offered, allotted or issued otherwise than pro rata to the existing Shareholders and, in particular, the Directors be and are hereby authorized to make such exclusions or other arrangements in relation to fractional entitlements or those Shareholders whose names appear on the register of members of the Company on the Record Date as having registered addresses outside the Hong Kong Special Administration of the People's Republic of China ("**Hong Kong**") or stipulated in place(s) where, in the Director's opinion, the Offer Shares and the Bonus Shares may not be offered without compliance with the registration and/or other legal or regulatory requirements of that jurisdiction as they deemed necessary or expedient having regard to any restrictions or obligations under the laws of, or the requirements of any recognized regulatory body or any stock exchange in, any territory outside Hong Kong applicable to the Company and (ii) generally to do such things or make such arrangements as they may think fit to effect the Open Offer, Bonus Issue, the Underwriting Agreement and the transactions contemplated thereunder."

## SPECIAL RESOLUTIONS

2. "**THAT** the existing Bye-law 148 will be deleted in its entirety and substituted with the following new Bye-law 148:

   The Company may, upon the recommendation of the Board, at any time and from time to time pass an ordinary resolution to the effect that it is desirable to capitalise all or any part of any amount for the time being standing to the credit of any reserve or fund (including the profit and loss account) whether or not the same is available for distribution and accordingly that such amount be set free for distribution among the Members or any class of Members who would be entitled thereto if it were distributed by way of dividend and in the same proportions or in such other proportion as the Company may by ordinary resolution determine, on the footing that the same is not paid in cash but is applied either in or towards paying up the amounts for the time being unpaid on any shares in the Company held by such Members or such other persons respectively or in paying up in full unissued shares, debentures or other obligations of the Company, to be allotted and distributed credited as fully paid up among such Members, or partly in one way and partly in the other, and the Board shall give effect to such resolution provided that, for the purposes of this Bye-law a share premium account and any reserve or fund representing unrealised profits, may be applied only in paying up in full unissued shares of the Company to be allotted to such Members credited as fully paid. In carrying sums to reserve and in applying the same the Board shall comply with the provisions of the Act."

3. "**THAT** conditional upon compliance with Section 46 (2) of the Companies Act 1981 of Bermuda and on the date when the Open Offer as referred to in ordinary resolution no. 1 above becomes unconditional (the "Effecitve Date"), the entire amount standing to the credit of the share premium account of the Company as at the date of the Meeting be cancelled (the "**Share Premium Reduction**") and the credit arising as a result of the Share Premium Reduction be transferred in full to the contributed surplus account of the Company."

By order of the Board
**China Ocean Shipbuilding Industry Group**
**CHAU On Ta Yuen**
*Chairman*

Hong Kong, 23 July 2010

*Registered Office:*
Clarendon House
2 Church Street
Hamilton HM 11
Bermuda

*Head office and principal place of business in Hong Kong:*
Unit 1103,11/F.
China Merchants Tower
Shun Tak Centre
168-200 Connaught Road Central
Hong Kong

*Notes:*

1. The register of members of the Company in Hong Kong will be closed from Wednesday, 11 August 2010, to Monday, 16 August 2010, both dates inclusive. No transfer of Shares will be registered during this period. In order to qualify for the Open Offer and attending and voting at the meeting, shareholders must lodge any transfers of Shares (with the relevant Share certificate(s)) with the Company's Hong Kong branch share registrar, Tricor Abacus Limited at 26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong by 4:30 p.m. on Tuesday, 10 August 2010.

2. A member of the Company entitled to attend and vote at the meeting convened by the above notice is entitled to appoint one or, if he is the holder of more than one share, more proxies to attend and, subject to the provisions of the Bye-laws, vote in his stead. A proxy need not be a member of the Company.

3. To be valid, the form of proxy together with a power of attorney or other authority, if any, under which it is signed or a certified copy of such power or authority must be lodged with the Company's branch share registrar in Hong Kong, Tricor Abacus Limited, at 26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong not less than 48 hours before the time appointed for holding the meeting or any adjournment thereof.

As at the date hereof, (i) the executive directors of the Company are Mr. Chau On Ta Yuen, Mr. Li Ming, Mr. Zhang Shi Hong and Mr. Wang San Long; and (ii) the independent non-executive directors of the Company are Mr. Zhang Xi Ping, Ms. Xiang Siying, Mr. Hu Bai He and Ms. Xiang Ying.