



Shanghai Merchants Holdings Limited

Stock Code: 1104

Annual Report **2005**

CONTENTS

1	Corporate Information
2-3	Chairman's Statement
4	Biographical Details of Directors and Senior Management
5-8	Directors' Report
9-14	Corporate Governance Report
15-16	Auditors' Report
17	Consolidated Income Statement
18	Consolidated Balance Sheet
19	Balance Sheet
20	Statement of Changes in Equity
21	Consolidated Cash Flow Statement
22-46	Notes to the Financial Statements
47	Financial Summary
48-50	Notice of Annual General Meeting

Board of Directors*Executive Directors:*Yue Jialin (*Chairman*)Lau Yau Cheung (*CEO*)*Independent Non-Executive Directors:*

Wong Wing Kuen, Albert

Tsui Robert Che Kwong

Wu Guo Jian

Legal Advisers

P.C. Woo & Co

Conyers Dill & Pearman

Auditors

Graham H.Y. Chan & Co

Company Secretary

Ng Kwok Ping

Stock Code

1104

Registered Office

Clarendon House

2 Church Street

Hamilton HM11

Bermuda

Head Office and Principal Place of Business

Rooms 2808-10

28/F Wing On House

71 Des Voeux Road Central

Hong Kong

Principal Share Registrar and Transfer Office

Butterfield Fund Services (Bermuda) Limited

Rosebank Centre

11 Bermudiana Road

Pembroke

Bermuda

Hong Kong Branch Share Registrar and Transfer Office

Secretaries Limited

26/F Tesbury Centre

28 Queen's Road East

Wanchai

Hong Kong

On behalf of the board of directors ("Board") of Shanghai Merchants Holdings Limited (the "Company"), I am pleased to present to the shareholders the results of the Company and its subsidiaries (the "Group") for the year ended 31 December 2005.

MANAGEMENT DISCUSSION AND ANALYSIS

Business Review

Turnover of the Group for the year ended 31 December 2005 was approximately HK\$68,393,000 (2004: HK\$22,305,000), which was up 207% from that of last year.

Profit of HK\$6,501,000 was recorded for the current year, as compared to a loss of HK\$36,299,000 in 2004.

Trading in base metals

Turnover for this sector for the year was approximately HK\$44,937,000 (2004: HK\$13,522,000). A growth of 232% was recorded as compared with last year. Following the resumption of the base metals trading business in last year, the Group has scaled up its operation in this sector in the year 2005. The base metals trading business segment contributed HK\$110,000 (2004: HK\$121,000) to the Group's operating profits which represented a drop of 9%.

Trading in fabric products and other merchandises

The Group's turnover for fabric products and other merchandises trading business segment reached HK\$23,456,000 during the year (2004: HK\$8,783,000), an increase of 167% over that of 2004. Segment profit attributable to the Group during the year amounted to HK\$966,000 (2004: HK\$393,000), an increase of 146% as compared with 2004. The Group's management has been taking active actions to expand the operations under the constraints of available working capital.

Business Outlook

With a view to expanding the Group's business operations and enhancing its financial performance, the Group and its controlling shareholder, Profit Harbour Investments Limited ("Profit Harbour"), entered into a deed of assignment on 12 April 2006. Pursuant to which Profit Harbour has conditionally agreed to acquire from the Group its receivable due from Great Center Limited of US\$4.5 million (approximately HK\$35.1 million) in full at its face value. The assignment of debt is conditional upon the approval by the independent shareholders at the forthcoming special general meeting.

The Company proposes to raise approximately HK\$82.6 million before expenses by way of a rights issue.

During the year ended 31 December 2005, the Company entered into a heads of terms with the shareholders of an acquisition target in the PRC, which is engaged in the trading of electronic component business, to acquire their interests in the entire issued share capital of the target at a consideration which will be settled by issuance of convertible bonds by the Company. The Board considers that the proposed acquisition will keep the Company abreast of the lucrative growth opportunities that the PRC market presents, thereby strengthening the Company's ability to meet the rising demand from its customers.

DIVIDEND

The Board does not recommend the payment of a dividend for the year ended 31 December 2005 (2004: Nil).

LITIGATION AND CONTINGENT LIABILITIES

Details of the material litigation and contingent liabilities are set out in note 24 to the financial statements.

PLEDGE OF ASSETS

Details of the pledge of assets are set out in note 25 to the financial statements.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2005, the Group had secured other loans of HK\$15 million (2004: HK\$15 million), and bank balances and cash were at approximately HK\$5,477,000 (2004: HK\$14,929,000).

FOREIGN EXCHANGE EXPOSURE

Since most business transactions conducted by the Group and payments made to suppliers are either in Hong Kong Dollars, or US Dollars, no use of financial instruments for hedging purposes is considered necessary.

EMPLOYEES AND REMUNERATION POLICY

As at 31 December 2005, the Group had 3 (2004: 5) managerial, administrative and trading staff in Hong Kong.

The Group remunerates its employees largely based on the prevailing industry practice.

APPRECIATION

The operating result of the Group is achieved due to the support of our shareholders and business partners, the commitment of the directors and the dedication of all our staff members. On behalf of the Board, I would like to take this opportunity to extend my sincere appreciation for their contributions and endeavor.

On behalf of the Board

Yue Jialin
Chairman

Hong Kong, 24 April 2006

Executive Directors

Mr. Yue Jialin, aged 38, appointed on 26 April 2004, is the Chairman and Executive Director of the Company. Mr. Yue is responsible for the strategic planning and corporate development of the Group. Mr. Yue has established in-depth knowledge of the PRC economic development and policies through his previous role as a judge in the Economic Court of People's Court in Luowu District, Shenzhen, the People's Republic of China (the "PRC") during 1989 to 1992. Mr. Yue also sits on the school of business administration of Changchun Industrial University as visiting professor. Recently, Mr. Yue is engaged in legal consultation in respect of the acquisition of state owned assets and foreign investments in the PRC.

Mr. Lau Yau Cheung, aged 45, appointed on 26 April 2004, is an Executive Director of the Company. Mr. Lau is the Company's Chief Executive Officer and responsible for the overall management and general administrative activities. Mr. Lau graduated in 1984 from the University of Toronto in Canada with a Bachelor of Commerce degree and has served in various senior management positions with both private and publicly listed companies in Hong Kong in the past years. Mr. Lau is also an independent non-executive director of Warderly International Holdings Limited (Stock Code : 607), a company listed on the Main Board of The Stock Exchange of Hong Kong Limited, since September 2005.

Independent Non-Executive Directors

Mr. Wong Wing Kuen, Albert, aged 55, appointed on 6 July 2004, is an Independent Non-executive Director of the Company. Mr. Wong is a fellow member of The Institute of Chartered Secretaries and Administrators, a fellow member of The Hong Kong Institute of Company Secretaries, a fellow member of the Taxation Institute of Hong Kong, a member of Hong Kong Securities Institute, a fellow member of Association of International Accountants, a fellow member of Society of Registered Financial Planners, a member of The Chartered Institute of Arbitrators, a member of The Chartered Institute of Bankers in Scotland and a full member of Macau Society of Certified Practising Accountants. Mr. Wong was also a director of Minghua Group International Holdings Limited, a listed public company in the USA, until 30 June 2004. Currently, Mr. Wong is the Managing Director of Charise Financial Consultants Limited, a private professional consulting firm in Hong Kong.

Mr. Tsui Che Kwong, Robert, aged 52, appointed on 6 July 2004, is an Independent Non-executive Director of the Company. Mr. Tsui is a graduate of University of Buckingham, England, with a bachelor degree in Law. He is the sole proprietor of Robert C.K. Tsui & Co., a firm of solicitors in Hong Kong. Mr. Tsui has been practising in the legal field for more than 20 years. He is also an independent non-executive director of Teem Foundation Group Limited. (Stock Code: 628), a company listed on the Main Board of The Stock Exchange of Hong Kong Limited since August 2004.

Mr. Wu Guo Jian, aged 60, appointed on 6 July 2004, is an Independent Non-executive Director of the Company. Mr. Wu is also a director of New Era International Holdings Limited and specializes in trading and property development for more than 15 years.

Senior Management

Mr. Ng Kwok Ping, aged 38, joined the Group in July 2004 and is the Financial Controller and Secretary of the Company. Mr. Ng has had over 10 years of experience in finance and accounting field. He has worked in an international audit firm and companies listed on the Stock Exchange. He has Master's Degree of Science in Finance and is a member of the Hong Kong Institute of Certified Public Accountants.

The directors present their annual report and the audited financial statements for the year ended 31 December 2005.

DE-CONSOLIDATION OF CHAOYANG HUA LOONG TEXTILES AND DYEING LIMITED (“CHAOYANG HUA LOONG”)

On 12 April 2003, the Company entered into a sale and purchase agreement to dispose of the entire issued share capital of Park Well International Group Limited (“Park Well”), including the 100% equity interest in Chaoyang Hua Loong, a company established in the PRC which is engaged in fabric processing and manufacturing, held by a wholly-owned subsidiary of Park Well, to Show Good Inc., a company incorporated in the British Virgin Islands, (the “Park Well Disposal Agreement”). Based on the Receivers’ (who were appointed on 17 June 2003 and were discharged on 2 July 2004) investigations, they are of the view that despite the Park Well Disposal Agreement, the purported disposal of Park Well was rescinded and not completed and therefore the Company remains to be the beneficial owner of Park Well. The Receivers had since then taken steps to secure control over various companies comprising the Park Well Group. However, Chaoyang Hua Loong remains not under the control of the Company. Having obtained legal advice, in the opinion of the directors, the Group is still unable to exercise control over the financial and operating decisions of Chaoyang Hua Loong. Accordingly, Chaoyang Hua Loong was not regarded as a subsidiary of the Company with effect from 1 January 2004, and fully provision was made for the investment cost in and amount due from Chaoyang Hua Loong.

PRINCIPAL ACTIVITIES

The Company is an investment holding company. The principal activities of its subsidiaries are set out in note 29 to the financial statements.

RESULTS

The results of the Group for the year ended 31 December 2005 are set out in the consolidated income statement on page 17.

PROPERTY, PLANT AND EQUIPMENT

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

RESERVES

Details of movements in reserves of the Group and of the Company during the year are set out in the statement of changes in equity on page 20.

DIRECTORS

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

Executive Directors:

Yue Jialin	(Chairman)
Lau Yau Cheung	(Chief Executive Officer)

Independent Non-Executive Directors:

Wong Wing Kuen, Albert
Tsui Robert Che Kwong
Wu Guo Jian

In accordance with Bye-law 87 of the Company's Bye-laws, Mr. Tsui Robert Che Kwong and Mr. Wu Guo Jian will retire at the forthcoming annual general meeting and, being eligible, offer themselves for re-election. All of the remaining directors shall continue in office.

No director being proposed for re-election at the forthcoming annual general meeting has a service contract with the Company or any of its subsidiaries which is not determinable by the Group within one year without payment of compensation, other than statutory compensation.

DIRECTORS' INTERESTS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2005, the interests and short positions held by the directors in the shares, underlying shares and debentures of the Company or its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")), as recorded in the register required to be kept by the Company under Section 352 of the SFO or otherwise notified to the Company and The Stock Exchange of Hong Kong Limited ("Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies ("Model Code") contained in the Rules Governing the Listing of Securities on the Stock Exchange ("Listing Rules"), were as follows:

(a) Long positions in shares of the Company

Name of director	No. of ordinary shares	Capacity and nature of interest	% of issued share capital
Yue Jialin	262,602,000	Interest of controlled corporation in 262,602,000 shares (<i>Note</i>)	63.58%

Note: These shares are registered in the name of, and beneficially owned by, Profit Harbour Investments Limited ("Profit Harbour"), a company incorporated in the British Virgin Islands, the entire issued share capital of which is beneficially owned by Mr. Yue Jialin.

(b) Long positions in underlying shares and debentures and short positions in shares, underlying shares and debentures

There were no long positions in the underlying shares and debentures or any short positions in the shares, underlying shares and debentures of the Company and its associated corporations, which were recorded in the register as required to be kept under Section 352 of Part XV of the SFO or otherwise notified to the Company and the Stock Exchange pursuant to the Model Code contained in the Listing Rules.

Save as disclosed above, neither the directors nor any of their associates had any interests or short positions in shares, underlying shares or debentures of the Company or any of its associated corporations as at 31 December 2005 as defined in Section 352 of the SFO.

SHARE OPTIONS

Particulars of the Company's share option scheme are set out in note 19 to the financial statements.

No options were granted to the directors during the year ended 31 December 2005 and no options were held by the directors as at 31 December 2005.

ARRANGEMENTS TO PURCHASE SHARES OR DEBENTURES

Save as disclosed under the section headed "SHARE OPTIONS" above, at no time during the year was the Company, its holding company or any of its subsidiaries a party to any arrangements to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

No contracts of significance, to which the Company, its holding company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

SUBSTANTIAL SHAREHOLDERS

As at 31 December 2005, the following shareholders were interested in more than 5% of the shares and underlying shares of the Company according to the register required to be kept under Section 336 of Part XV of the SFO:

Long positions in shares of the Company

Name of substantial shareholder	No. of ordinary shares	Capacity and nature of interest	% of issued share capital
Profit Harbour (<i>Note</i>)	262,602,000	Beneficial owner	63.58%
Yue Jialin	262,602,000	Interest of controlled corporation in 262,602,000 shares (<i>Note</i>)	63.58%

Note: The entire issued share capital of Profit Harbour is owned by Mr. Yue Jialin. Accordingly, Mr. Yue Jialin is deemed to be interested in all the shares in which Profit Harbour is interested pursuant to the SFO.

Save as disclosed above, no other person had interests or short positions in the shares and underlying shares of the Company, which are recorded in the register to be maintained by the Company pursuant to Section 336 of Part XV of the SFO.

DIRECTORS' INTERESTS IN COMPETING BUSINESSES

The directors are of the opinion that during the year ended 31 December 2005, the directors of the Company had no interests in any businesses which compete or are likely to compete, either directly or indirectly, with the businesses of the Group.

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

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

MAJOR CUSTOMERS AND SUPPLIERS

During the year, the Group's three customers in aggregate accounted for the entire turnover of the Group and the largest customer, the sole agent of the Group's base metal trade, accounted for approximately 65.7% of the total turnover of the Group.

The aggregate purchases attributable to the Group's five suppliers during the year accounted for 99.4% purchases of the Group and the largest supplier, the sole agent of the Group's base metal trade, accounted for approximately 67.8% of the total purchases of the Group.

At no time during the year did a director, an associate of a director or a shareholder of the Company, which to the knowledge of the directors owns more than 5% of the Company's issued share capital, have an interest in any of the five largest customers and suppliers of the Group.

CORPORATE GOVERNANCE

The Company is committed to maintaining a high standard of corporate governance practices. Information on the corporate governance practices adopted by the Company is set out in the Corporate Governance Report on pages 9 to 14.

PRE-EMPTIVE RIGHTS

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

POST BALANCE SHEET EVENTS

Details of the significant post balance sheet events are set out in note 28 to the financial statements.

PUBLIC FLOAT

As at the date of this report, the Company has maintained a sufficient public float under the Listing Rules, based on the information that is publicly available to the Company and within the knowledge of its directors.

AUDITORS

Messrs. Deloitte Touche Tohmatsu were auditors of the Company for the year ended 31 December 2004 and they resigned as auditors on 22 March 2006. Graham H.Y. Chan & Co was appointed to fill the vacancy on 12 April 2006.

A resolution will be submitted to the annual general meeting to re-appoint Graham H.Y. Chan & Co as auditors of the Company.

On behalf of the Board

Yue Jialin
Chairman

Hong Kong, 24 April 2006

The Company has always recognised the importance of the shareholders' transparency and accountability. It is the belief of the Board that shareholders can maximize their benefits from good corporate governance.

The Code of Corporate Governance Practices (the "CG Code") contained in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") became effective on 1 January 2005, the Board has reviewed the corporate governance practices of the Company with the adoption and improvement of the various procedures and documentation which are detailed in this report. The Company has applied the principles of and complied with the applicable code provisions of the CG Code during the year ended 31 December 2005 except for certain deviations in respect of the service term and rotation of directors.

THE BOARD

The Board is responsible for the leadership and control of the Company and overseeing the Group's businesses, strategic decisions and performances. The management was delegated the authority and responsibility by the Board for the management of the Group. In addition, the Board has established various committees, including an Audit Committee and a Remuneration Committee, each of which has its specific written terms of reference. Copies of minutes of all meetings and resolutions of the committees, which are kept by the Company Secretary, are circulated to the Board. Further details of these committees are set out in this report.

Board meetings are scheduled to be held at approximately quarterly interval and as required by business needs. During the year, six full Board meetings were held and the attendance of each director is set out as follows:

Name of Director	Number of Board meetings attended/held
Yue Jialin	6/6
Lau Yau Cheung	6/6
Wong Wing Kuen, Albert	5/6
Tsui Robert Che Kwong	5/6
Wu Guo Jian	2/6

At least 14 days' notice of a regular Board meeting is normally given to all directors who are given an opportunity to include matters for discussion in the agenda. The Company Secretary assists the Chairman in preparing the agenda for meetings and ensures that all applicable rules and regulations are complied with. The agenda and the accompanying Board papers are normally sent to all directors at least 3 days before the date of every Board meetings so that the directors have the time to review the documents. Draft minutes of each Board meeting are circulated to all directors for their comment before approval. All minutes are kept by the Company Secretary and are open for inspection at any reasonable notice by any director.

Every director is entitled to have access to Board papers and related materials and has access to the advice and services of the Company Secretary, and has the liberty to seek independent professional advice if so required. Directors will be continuously updated on the major development of the Listing Rules and other applicable regulatory requirements to ensure compliance and upkeep of good corporate governance practice.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

The Chairman and the Chief Executive Officer of the Company are Mr. Yue Jialin and Mr. Lau Yau Cheung respectively. The roles of the Chairman and the Chief Executive Officer are segregated and assumed by two separate individuals who have no relationship with each other to strike a balance of power and authority so that the job responsibilities are not concentrated on any one individual. The Chairman of the Board is responsible for the leadership and effective running of the Board, while the Chief Executive Officer is delegated with the authorities to manage the business of the Group in all respects effectively. The division of responsibilities between the Company and the Chief Executive Officer have been clearly established and set out in writing.

BOARD COMPOSITION

The Board comprises two executive directors, being Mr. Yue Jialin and Mr. Lau Yau Cheung and three independent non-executive directors, being Mr. Wong Wing Kuen, Albert, Mr. Tsui Robert Che Kwong and Mr. Wu Guo Jian. The Board members have no financial, business, family or other material/relevant relationships with each other. Such balanced board composition is formed to ensure strong independence exists across the Board and has met the practice under the CG Code that at least three independent non-executive directors were appointed. One of the independent non-executive directors has appropriate professional qualifications or accounting or related financial management expertise under Rule 3.10 of the Listing Rules. The brief biographical details of the directors are set out on page 4 of the annual report, which demonstrates a diversity of skills, expertise, experience and qualifications. The Board has received from the three independent non-executive directors annual confirmations of their independence, and considers that they are all independent under the guidelines set out in Rule 3.13 of the Listing Rules.

APPOINTMENTS AND RE-ELECTION OF DIRECTORS

The non-executive directors of the Company had no fixed term of office prior to 1 June 2005, but retired from office on a rotational basis in accordance with the relevant provisions of the Company's Bye-laws. According to the Bye-laws, one-third of the directors for the time being (or, if their number is not a multiple of three, the number nearest to but not greater than one-third) should retire from office by rotation, provided that the Chairman of the Board and/or the Managing Director of the Company should not be subject to retirement by rotation. Further, any director appointed to fill a casual vacancy or as an addition to the Board should hold office only until the next following annual general meeting and should then be eligible for re-election at that meeting.

To fully comply with code provision A.4.1 of the CG Code, all non-executive directors of the Company were appointed for a specific term on 1 June 2005 which shall continue until 31 December 2006, but subject to retirement by rotation and re-election by the shareholders of the Company. In addition, to ensure full compliance with the code provision A.4.2 of the CG Code, relevant amendments to the Bye-laws of the Company will be proposed for approval by the shareholders of the Company at the forthcoming annual general meeting of the Company so that (i) any director appointed to fill a casual vacancy shall be subject to re-election by shareholders at the Company's first general meeting after the appointment; and (ii) every director shall be subject to retirement by rotation at least every three years.

DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") as set out in Appendix 10 of the Listing Rules as its code of conduct regarding securities transactions by the directors. All directors have confirmed, following specific enquiry by the Company, that they have complied with the Model Code.

REMUNERATION COMMITTEE

The Remuneration Committee has been established in June 2005 in order to comply with the code provision B.1.1 of the CG Code. It currently comprises three independent non-executive directors. The Remuneration Committee is provided with sufficient resources to discharge its duties and has access to independent professional advice in accordance with the Company's policy if considered necessary.

The Remuneration Committee shall meet at least once a year. One Committee meeting was held in 2005 to review and discuss the existing policy and remuneration packages of both the executive and non-executive directors and the attendance of each member is set out as follows:

Committee Member	Number of Committee meetings attended/held
Wong Wing Kuen, Albert (<i>Chairman</i>)	1/1
Tsui Robert Che Kwong	1/1
Wu Guo Jian	1/1

The remuneration payable to directors will depend on their respective contractual terms under their employment or service contracts, and as recommended by the Remuneration Committee. Details of the directors' remuneration are set out in note 9 to the financial statements.

The major roles and functions of the Remuneration Committee are as follows:

1. to review and make recommendations to the Board on the Company's policy and structure for all remuneration of directors and senior management and on the establishment of a formal and transparent procedure for developing policy on such remuneration;
2. to have the delegated responsibility to determine the specific remuneration packages of all executive directors and senior management, including benefits in kind, pension rights and compensation payments, including any compensation payable for loss or termination of their office or appointment, and make recommendations to the Board of the remuneration of non-executive directors. The Remuneration Committee should consider factors such as salaries paid by comparable companies, time commitment and responsibilities of the directors, employment and conditions elsewhere in the Group and desirability of performance-based remuneration;
3. to review and approve performance-based remuneration by reference to corporate goals and objectives resolved by the Board from time to time;
4. to review and approve the compensation payable to executive directors and senior management in connection with any loss or termination of their office or appointment;
5. to review and approve compensation arrangements relating to dismissal or removal of directors for misconduct to ensure that such arrangements are determined in accordance with relevant contractual terms and that any compensation payment is otherwise reasonable and appropriate; and
6. to ensure that no director or any of his associates is involved in deciding his own remuneration.

AUDIT COMMITTEE

The Audit Committee has been established since July 2004 and currently comprises all three independent non-executive directors of the Company, Mr. Wong Wing Kuen, Albert, Tsui Robert Che Kwong and Wu Guo Jian.

The Audit Committee shall meet at least twice a year. Two Committee meetings were held during the year. The attendance of each member is set out as follows:

Committee Member	Number of Committee meetings attended/held
Wong Wing Kuen, Albert (<i>Chairman</i>)	2/2
Tsui Robert Che Kwong	2/2
Wu Guo Jian	1/2

Full minutes of Audit Committee meetings are kept by a duly appointed secretary of the meeting. Draft and final versions of minutes of the Audit Committee meetings are sent to all members of the Committee for their comment and records respectively, in both cases within a reasonable time after the meeting.

The major roles and functions of the Audit Committee are:

1. to consider and recommend to the Board on the appointment, re-appointment and removal of the external auditors, to approve the remuneration and terms of engagement of the external auditors, and any questions of resignation or dismissal of those auditors;
2. to consider and discuss with the external auditors the nature and scope of each year's audit;
3. to review and monitor the external auditors' independence and objectivity;
4. to review the interim and annual financial statements before submission to the Board;
5. to discuss any problems and reservation arising from the interim review and final audit, and any matters the external auditors may wish to discuss;
6. to review the external auditors' management letters and management's response;
7. to review the Group's financial controls, internal control and risk management systems; and
8. to consider any findings of major investigations of internal control matters as delegated by the Board and management's response.

During the meetings held in 2005, the Audit Committee had performed the work as summarized below:

1. reviewed the final results of the Group for the year ended 31 December 2004 and the interim results for the six months ended 30 June 2005 before submission to the Board;
2. reviewed the external auditors' independent review report in the relation to the 2005 interim results;
3. recommended to the Board, for the approval by shareholders, of the re-appointment of the auditors.

ACCOUNTABILITY AND AUDIT

The directors are responsible for overseeing the preparation of financial statements for each financial year which give true and fair view of the state of affairs of the Group and in presenting the interim and annual financial statements, and announcements to shareholders. The directors aim to present a balanced and understandable assessment of the Group's position and prospects. The Board is not aware of any material uncertainties relating to events or conditions that may cast significant doubt upon the Group's ability to continue as a going concern, the Board therefore continues to adopt the going concern approach in preparing the financial statements. The Board acknowledges its responsibility to present a balanced, clear and understandable assessment in the Company's annual and interim reports, other price-sensitive announcement and other financial disclosures required under the Listing Rules, and reports to the regulators.

INTERNAL CONTROLS

The Board is responsible for overseeing the Group's system of internal controls. However, such a system is designed to manage the Group's risks within an acceptable risk profile, rather than to eliminate the risk of failure, to achieve the business objectives of the Group. Accordingly, it can only provide reasonable assurance but not absolute assurance against material misstatement of management and financial information and records or against financial losses or fraud.

The Board has established an on-going process for identifying, evaluating and managing the significant risks faced by the Group and this process includes updating the system of internal controls when there are changes to business environment or regulatory guidelines.

The Board is of the view that the system of internal controls in place for the year under review and up to the date of issuance of the annual report and financial statements is sound and is sufficient to safeguard the interests of the shareholders, customers and the Group's assets.

AUDITORS' REMUNERATION

During the year under review, the remuneration paid to the Company's auditors, Messrs Graham H. Y. Chan & Co. is set out as follows:

Services rendered	Fee paid/payable <i>HK\$'000</i>
Audit services	250
Non-audit services	217
	<u>467</u>

COMMUNICATIONS WITH SHAREHOLDERS

The Board recognises the importance of good communication with shareholders. Information in relation to the Group is disseminated to shareholders in a timely manner through a number of formal channels, which include interim and annual reports, announcements and circulars.

The Company's annual general meeting (the "AGM") is a valuable forum for the Board to communicate directly with the shareholders. The Chairman actively participates in the AGM and personally chairs the meeting to answer any questions from the shareholders. A separate resolution is proposed by the Chairman in respect of each issue to be considered at the AGM. An AGM circular is distributed to all shareholders at least 21 days prior to the AGM, setting out details of each proposed resolution, voting procedures (including procedures for demanding and conducting a poll) and other relevant information. The Chairman explains the procedures for demanding and conducting a poll again at the beginning of the AGM, and (except where a poll is demanded) reveals how many proxies for and against have been received of each resolution.

**GRAHAM H.Y. CHAN & CO.**CERTIFIED PUBLIC ACCOUNTANTS
HONG KONG**To the Shareholders of
Shanghai Merchants Holdings Limited**

上海商貿控股有限公司

(incorporated in Bermuda with limited liability)

We have audited the financial statements on pages 17 to 46 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, in accordance with Section 90 of the Bermuda Companies Act, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Basis of opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants, except that the scope of our work was limited as explained below.

An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. However, the evidence available to us was limited as set out below.

Included in the consolidated balance sheet at 31 December 2005, there was available-for-sale investment. Such investment represents the Group's 100% equity interest in Chaoyang Hua Loong Textiles and Dyeing Limited ("Chaoyang Hua Loong"), a company established in the People's Republic of China, and is stated at nil value. In addition, full allowance against an amount of HK\$24,806,000 due from Chaoyang Hua Loong had been made by the Group in previous years. In the absence of reliable current financial information relating to the assets and liabilities of Chaoyang Hua Loong, we are unable to satisfy ourselves as to whether the interest in Chaoyang Hua Loong at 31 December 2005 is free from material misstatement and also whether the full allowance against the amount due from Chaoyang Hua Loong is appropriate. Any adjustment found to be necessary to the value of the available-for-sale investment and the amount due from Chaoyang Hua Loong would affect the profit of the Group for the year ended 31 December 2005 and its net assets as at that date.

In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Qualified opinion arising from limitations of audit scope

Except for any adjustments that might have been found to be necessary had we been able to obtain sufficient evidence concerning the matters referred to in the basis of opinion section of this report, in our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2005 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

In respect alone of the limitations on our work set out in the basis of opinion section of this report:

- we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and
- we were unable to determine whether proper books of account had been kept.

Graham H. Y. Chan & Co.

Certified Public Accountants (Practising)

Hong Kong

24 April 2006

Consolidated Income Statement

Shanghai Merchants Holdings Limited - Annual Report 2005

For the year ended 31 December 2005

	Notes	2005 HK\$'000	2004 HK\$'000
Turnover	5	68,393	22,305
Cost of sales		(66,113)	(21,369)
Gross profit		2,280	936
Other income	5	474	13
Credit arising from a scheme of arrangement with creditors	7	15,421	–
Distribution costs		(1,353)	(429)
Administrative expenses	8	(8,539)	(8,455)
Allowance for bad and doubtful debts		–	(14,816)
Profit/(loss) from operations		8,283	(22,751)
Finance costs – interest on other loans		(1,744)	(335)
Allowance for advance to an investee company	14	–	(24,806)
Gain on de-consolidation of a subsidiary	20	–	11,624
Profit/(loss) before taxation		6,539	(36,268)
Income tax expense	10	(38)	(31)
Profit/(loss) for the year		6,501	(36,299)
Earnings/(loss) per share – Basic	11	1.57 cents	(8.79) cents

Consolidated Balance Sheet

At 31 December 2005

Shanghai Merchants Holdings Limited - Annual Report 2005

	Notes	2005 HK\$'000	2004 HK\$'000
Non-current assets			
Property, plant and equipment	12	–	23
Investment in security	14	–	–
Available-for-sale investment	14	–	–
		–	23
Current assets			
Trade and other receivables	15	37,526	42,576
Pledged bank deposits	25	4,012	8,000
Bank balances and cash		1,465	6,929
		43,003	57,505
Current liabilities			
Trade and other payables	16	6,053	27,093
Secured other loans	17	15,000	15,000
Taxation payable		69	55
		21,122	42,148
Net current assets		21,881	15,357
Total assets less current liabilities		21,881	15,380
Capital and reserves			
Share capital	18	41,300	41,300
Reserves		(19,419)	(25,920)
Equity attributable to equity holders of the parent		21,881	15,380

The financial statements on pages 17 to 46 were approved and authorised for issue by the Board of Directors on 24 April 2006 and are signed on its behalf by:

Yue Jialin
Director

Lau Yau Cheung
Director

Balance Sheet

Shanghai Merchants Holdings Limited - Annual Report 2005

At 31 December 2005

	Notes	2005 HK\$'000	2004 HK\$'000
Non-current assets			
Interests in subsidiaries	13	6,296	32,121
Current assets			
Other receivables		145	218
Bank balances		7	5,566
		152	5,784
Current liabilities			
Other payables		3,840	7,525
Secured other loans	17	15,000	15,000
		18,840	22,525
Net current liabilities		(18,688)	(16,741)
		(12,392)	15,380
Capital and reserves			
Share capital	18	41,300	41,300
Reserves		(53,692)	(25,920)
		(12,392)	15,380

Yue Jialin
Director

Lau Yau Cheung
Director

Statement of Changes in Equity

For the year ended 31 December 2005

Shanghai Merchants Holdings Limited - Annual Report 2005

	Share capital <i>HK\$'000</i>	Share premium account <i>HK\$'000</i>	Contributed surplus <i>HK\$'000</i>	Special reserve <i>HK\$'000</i>	Accumulated losses <i>HK\$'000</i>	Total <i>HK\$'000</i>
The Group						
At 1 January 2004	41,300	106,957	–	(14,980)	(81,598)	51,679
Loss for the year	–	–	–	–	(36,299)	(36,299)
At 31 December 2004	41,300	106,957	–	(14,980)	(117,897)	15,380
Profit for the year	–	–	–	–	6,501	6,501
At 31 December 2005	41,300	106,957	–	(14,980)	(111,396)	21,881
The Company						
At 1 January 2004	41,300	106,957	60,274	–	(157,429)	51,102
Loss for the year	–	–	–	–	(35,722)	(35,722)
At 31 December 2004	41,300	106,957	60,274	–	(193,151)	15,380
Loss for the year	–	–	–	–	(27,772)	(27,772)
At 31 December 2005	41,300	106,957	60,274	–	(220,923)	(12,392)

The special reserve represents the difference between the nominal value of the aggregate share capital of the subsidiaries acquired and the nominal value of the share capital of the Company issued for the acquisition at the time of a group reorganisation in 1998.

The contributed surplus represents the difference between the consolidated net assets of the subsidiaries acquired and the nominal value of the share capital of the Company issued for the acquisition at the time of a group reorganisation in 1998.

In addition to accumulated profits, under the Companies Act 1981 of Bermuda (as amended), contributed surplus of the Company is also available for distribution to shareholders. However, the Company cannot declare or pay a dividend, or make a distribution out of contributed surplus, if:

- (a) it is, or would after the payment be, unable to pay its liabilities as they become due; or
- (b) the realisable value of its assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts.

In the opinion of the directors, the Company had no reserve available for distribution to shareholders at the balance sheet date.

Consolidated Cash Flow Statement

Shanghai Merchants Holdings Limited - Annual Report 2005

For the year ended 31 December 2005

	2005 HK\$'000	2004 HK\$'000
Operating Activities		
Profit/(loss) from operations	8,283	(22,751)
Adjustments for:		
Depreciation and amortisation	7	17
Loss on disposal of property, plant and equipment	16	112
Allowance for bad and doubtful debts	–	14,816
Credit arising from scheme of arrangement with creditors	(15,421)	–
Interest income	(160)	(4)
Operating cash flows before working capital changes	(7,275)	(7,810)
Decrease/(increase) in trade and other receivables	5,050	(7,212)
Decrease in trade and other payables	(5,619)	(1,549)
Cash used in operations	(7,844)	(16,571)
Interest paid	(1,744)	(335)
Hong Kong profits tax paid	(24)	–
Net Cash Used in Operating Activities	(9,612)	(16,906)
Investing Activities		
Decrease/(increase) in pledged bank deposits	3,988	(8,000)
Interest received	160	4
Net Cash from/(used in) Investing Activities	4,148	(7,996)
Financing Activities		
Secured other loans raised	15,000	15,000
Repayment of other loans	(15,000)	–
Net Cash from Financing Activities	–	15,000
Net Decrease in Cash and Cash Equivalents	(5,464)	(9,902)
Cash and Cash Equivalents at 1 January	6,929	16,831
Cash and Cash Equivalents at 31 December representing bank balances and cash	1,465	6,929

Notes to the Financial Statements

For the year ended 31 December 2005

Shanghai Merchants Holdings Limited - Annual Report 2005

1. General

The Company is incorporated as an exempted company with limited liability in Bermuda under the Companies Act 1981 of Bermuda (as amended) and its shares are listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). Its parent and ultimate holding company is Profit Harbour Investments Limited ("Profit Harbour"), a company incorporated in the British Virgin Islands. The address of its registered office and principal place of business of the Company are disclosed in the "Corporate Information" section of the annual report.

The Company is an investment holding company. The principal activities of its subsidiaries are set out in note 29.

The financial statements are presented in Hong Kong dollars ("HK\$") which is the Company's functional and presentation currency.

2. Impact of New Hong Kong Financial Reporting Standards ("HKFRSs") and Hong Kong Accounting Standards ("HKASs")

The Hong Kong Institute of Certified Public Accountants (the "HKICPA") has issued a number of new HKFRSs, HKASs and Interpretations that are effective for accounting periods beginning on or after 1 January 2005. The Group has adopted the following HKFRSs and HKASs which are pertinent to its operations and relevant to these financial statements.

-	HKAS 1	Presentation of Financial Statements
-	HKAS 7	Cash Flow Statements
-	HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
-	HKAS 10	Events after the Balance Sheet Date
-	HKAS 12	Income Taxes
-	HKAS 17	Leases
-	HKAS 18	Revenue
-	HKAS 19	Employee Benefits
-	HKAS 21	The Effects of Changes in Foreign Exchange Rates
-	HKAS 24	Related Party Disclosures
-	HKAS 27	Consolidated and Separate Financial Statements
-	HKAS 32	Financial Instruments: Disclosure and Presentation
-	HKAS 33	Earnings per Share
-	HKAS 36	Impairment of Assets
-	HKAS 37	Provisions, Contingent Liabilities and Contingent Assets
-	HKAS 39	Financial Instruments: Recognition and Measurement
-	HKAS 39 (Amendment)	Transition and Initial Recognition of Financial Assets and Financial Liabilities
-	HKFRS 2	Share-based Payment

2. Impact of New Hong Kong Financial Reporting Standards (“HKFRSs”) and Hong Kong Accounting Standards (“HKASs”) (Continued)

The adoption of HKASs 7, 8, 10, 12, 17, 18, 19, 21, 27, 33, 36 and 37 has had no material impact on the Group's accounting policies and the methods of computation, presentation and disclosure in the Group's financial statements. The major effects on adoption of the other HKFRSs and HKASs are summarised as follows:

- (a) The adoption of HKAS 1 requires the disclosure of judgments (apart from those involving estimations) and key assumptions concerning the future and other sources of estimation uncertainty. These disclosures are detailed in note 3 to the financial statements.
- (b) The adoption of HKAS 24 affects the identification of related parties and the disclosure of related party transactions.
- (c) The adoption of HKAS 32 and HKAS 39 has resulted in a change in accounting policy for recognition, measurement, derecognition and disclosure of financial instruments. HKAS 32 requires retrospective application. The application of HKAS 32 has had no material impact on how financial instruments of the Group are presented for current and prior accounting periods. HKAS 39 which is effective for annual periods beginning on or after 1 January 2005, generally does not permit the recognition, derecognition or measurement of financial assets and liabilities on a retrospective basis. The principal effects resulting from the implementation of HKAS 39 are summarised below.

The Group has applied the relevant transitional provisions of HKAS 39 with respect to classification and measurement of financial assets and financial liabilities that are within the scope of HKAS 39.

On or before 31 December 2004, the Group classified and measured its equity securities as investment securities, which are carried at cost less impairment losses (if any), in accordance with the benchmark treatment of Statement of Standard Accounting Practice 24 “Accounting for Investments in Securities” issued by the HKICPA. From 1 January 2005 onwards, the Group classifies and measures its equity securities as “available-for-sale financial assets”, which are carried at cost, as the equity securities do not have a quoted market price in an active market and whose fair value cannot be reliably measured, in accordance with HKAS 39. No adjustment on fair value of the equity securities has been required.

- (d) The adoption of HKFRS2 has resulted in a change in accounting policy for share options. Prior to this, no recognition and measurement of share-based transactions in which share options granted over shares in the Company was required until such options were exercised, at which time the share capital and share premium were credited with the proceeds received.

With effect from 1 January 2005, in order to comply with HKFRS 2, the Group has adopted a new policy for share options. Under the new policy, the Group recognises the fair value of such share options as an expense with a corresponding increase recognised in a capital reserve within equity. Further details of the new policy are set out in note 4.

There were no options granted by the Company after 7 November 2002 but had not vested before 1 January 2005. Accordingly, the adoption of HKFRS 2 in respect of share options granted has had no effect on these financial statements.

2. Impact of New Hong Kong Financial Reporting Standards (“HKFRSs”) and Hong Kong Accounting Standards (“HKASs”) (Continued)

The Group has not early applied the following new HKFRSs that have been issued by the HKICPA but not yet effective. The Group has considered these standards and interpretations but does not expect that they will have a material effect on how the results of operation and financial position of the Group are prepared and presented.

– HKAS 1 (Amendment)	Capital Disclosures ¹
– HKAS 19 (Amendment)	Actuarial Gains and Losses, Group Plans and Disclosures ²
– HKAS 21 (Amendment)	The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation ²
– HKAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions ²
– HKAS 39 (Amendment)	The Fair Value Option ²
– HKAS 39 and HKFRS 4 (Amendment)	Financial Instruments: Recognition and Measurement and Insurance Contracts – Financial Guarantee Contracts ²
– HKFRS 6	Exploration for and Evaluation of Mineral Resources ²
– HKFRS 7	Financial Instruments: Disclosures ¹
– HK(IFRIC) – INT 4	Determining Whether an Arrangement Contains a Lease ²
– HK(IFRIC) – INT 5	Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds ²
– HK(IFRIC) – INT 6	Liabilities Arising from Participating in a Specific Market – Waste, Electrical and Electronic Equipment ³
– HK(IFRIC) – INT 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies ⁴

¹ Effective for the annual period beginning on or after 1 January 2007

² Effective for the annual period beginning on or after 1 January 2006

³ Effective for the annual period beginning on or after 1 December 2005

⁴ Effective for the annual period beginning on or after 1 March 2006

3. Critical Accounting Judgments and Key Sources of Estimation Uncertainty

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

The Group makes estimates and assumption concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results.

There is no significant risk of key assumptions concerning the future and other key sources of estimation at the balance sheet date which will cause an adjustment to carrying amounts of assets and liabilities within the next year.

There are no significant effects on amounts recognised in the financial statements arising from the judgment or estimates used by management.

4. Significant Accounting Policies

The financial statements have been prepared in accordance with HKFRSs and HKASs issued by the HKICPA. They have been prepared under the historical cost convention. The principal accounting policies adopted are set out below:

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31 December each year. The results of subsidiaries are consolidated from the date of acquisition, being the date on which the Group obtains control, until the date such control ceases. All significant inter-company transactions and balances within the Group are eliminated on consolidation.

Subsidiaries

A subsidiary is a company in which the Company, directly or indirectly, controls more than 50% of its voting power or issued share capital or controls the composition of its board of directors or has power to govern its financial and operating policies.

Investments in subsidiaries are included in the Company's balance sheet at cost less any identified impairment loss. The results of subsidiaries are accounted for by the Company on the basis of dividend received and receivable.

Property, plant and equipment

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

Depreciation and amortisation are provided to write off the cost of items of property, plant and equipment over their estimated useful lives, using the straight-line method, at the following rates per annum:

Leasehold land	Over the shorter of the term of the lease, or 50 years
Buildings	Over the shorter of the term of the lease, or 50 years
Plant and machinery	12%
Furniture, fixtures and equipment	20-33 $\frac{1}{3}$ %

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 the derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year in which the item is derecognised.

Impairment

At each balance sheet date, the Group reviews the carrying amounts of its assets 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. Impairment loss is recognised as an expense immediately.

When an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so 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.

4. Significant Accounting Policies (Continued)

Revenue recognition

Sales of goods are recognised when goods are delivered and title has passed or when the relevant sales contracts become unconditional.

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

Foreign currencies

In preparing the financial statements, transactions in currencies other than the Group entity's functional currency (foreign currencies) are recorded at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

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. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity, in which case, the exchange differences are also recognised directly in equity.

On consolidation, the assets and liabilities of the Group's operations outside Hong Kong are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed of.

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 net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years, and it further excludes income statement 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 balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised only to the extent that it is probable that future 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 assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

4. Significant Accounting Policies (Continued)

Taxation (Continued)

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited to the profit or loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Financial instruments

Financial assets

The Group's financial asset is classified as available-for-sale investments.

Available-for-sale investments are those non-derivative financial assets in equity securities or are not classified in any of the other three categories under the scope of HKAS 39. After initial recognition, available-for-sale investments are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the income statement. For investments where there is no active market and whose fair value cannot be reliably measured, such investments are measured at cost less any impairment losses at each balance sheet date subsequent to initial recognition. An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired. The amount of the impairment loss is measured as the difference between the carrying amount of the asset and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses will not reverse in subsequent periods.

Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less impairment losses for bad and doubtful debts, except where the receivables are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less impairment losses for bad and doubtful debts.

Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with bank and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

Trade and other payables

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

Interest-bearing borrowings

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

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issuance of new shares are taken to equity as a deduction, net of tax, from the proceeds.

4. Significant Accounting Policies (Continued)

Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the leasing company are accounted for as operating leases. Rental payments applicable to such operating leases are charged to the income statement on the straight-line basis over the lease periods.

Borrowing costs

Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of that asset. All other borrowing costs are charged to the income statement in the year in which they are incurred.

Provision

Provision are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made.

Employee benefits costs

Salaries, annual bonuses, paid annual leave, leave passage and the cost to the Group of non-monetary benefits are accrued in the year in which the associated services are rendered by employees of the Group. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

Contributions to Mandatory Provident Fund as required under the Hong Kong Mandatory Provident Fund Schemes Ordinance, are recognised as an expense in the income statement as incurred.

Share-based payments

The Company operates share option schemes for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Employees (including directors) of the Group receive remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments ("equity-settled transactions").

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company, if applicable.

The cost of equity-settled transaction is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date of which the relevant employees became fully entitled to the award (the "vesting date"). The cumulative expense recognised for equity-settlement transactions at each balance sheet date until the vesting date reflects the extent to which (i) the vesting period has expired, and (ii) the Group's best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the income statement for a period represents the movements in cumulative expense recognised as at the beginning and end of the period.

4. Significant Accounting Policies (Continued)**Share-based payments** (Continued)

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any modification, which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings per share.

5. Revenue and Other Income

The principal business of the Group is trading of base metals and fabric products and other merchandises to outsider customers. Turnover and revenue recognised during the year are as follows:

	2005 HK\$'000	2004 HK\$'000
Turnover		
Sales revenue from trading of base metals	44,937	13,522
Sales revenue from trading of fabric products and other merchandises	23,456	8,783
	68,393	22,305
Other income		
Interest income	160	4
Exchange gain	–	7
Others	314	2
	474	13
Total income	68,867	22,318

6. Business and Geographical Segments

Business segments

For management purposes, the Group is currently organised into two operating divisions – trading in base metals and trading in fabric products and other merchandises. These divisions are the basis on which the Group reports its primary segment information.

Principal activities are as follows:

Continuing operations:

- | | | |
|---|---|---|
| Trading in base metals | – | trading in base metals |
| Trading in fabric products and other merchandises | – | trading in fabric products and other merchandises |

Discontinued operation:

- | | | |
|-------------------|---|--|
| Fabric processing | – | processing of raw fabric and the sale of finished fabric |
|-------------------|---|--|

In 2002, former directors of the Company determined to cease the Group's fabric processing operation which had been carried out under Chaoyang Hua Loong. Chaoyang Hua Loong was de-consolidated from the Group with effect from 1 January 2004, hence, except for the gain on de-consolidation of a subsidiary and allowance made on advance to an investee company, no results, assets and liabilities were attributable to the fabric processing operation during the year ended 31 December 2004. Details are set out in note 14.

6. Business and Geographical Segments (Continued)**Business segments** (Continued)

Segment information about these businesses is presented below.

2005

	<u>Continuing operations</u>		<u>Discontinued operation</u>	
	Trading in base metals HK\$'000	Trading in fabric products and other merchandises HK\$'000	Fabric processing HK\$'000	Consolidated HK\$'000
Turnover				
External sales	44,937	23,456	–	68,393
Results				
Segment profit	110	966	–	1,076
Unallocated corporate expenses				(8,214)
Credit arising from a scheme of arrangement with creditors				15,421
Finance costs – interest on other loans				(1,744)
Profit before taxation				6,539
Income tax expense				(38)
Profit for the year				6,501
Balance Sheet				
Assets				
Segment assets	432	1,719	–	2,151
Unallocated corporate assets				40,852
Consolidated total assets				43,003
Liabilities				
Segment liabilities	–	1,570	–	1,570
Unallocated corporate liabilities				19,552
Consolidated total liabilities				21,122

Notes to the Financial Statements

For the year ended 31 December 2005

Shanghai Merchants Holdings Limited - Annual Report 2005

6. Business and Geographical Segments (Continued)

Business segments (Continued)

2004

	Continuing operations		Discontinued operation	
	Trading in base metals <i>HK\$'000</i>	Trading in fabric products and other merchandises <i>HK\$'000</i>	Fabric processing <i>HK\$'000</i>	Consolidated <i>HK\$'000</i>
Turnover				
External sales	13,522	8,783	–	22,305
Results				
Segment profit	121	393	–	514
Allowance for advance to an investee company	–	–	(24,806)	(24,806)
Gain on de-consolidation of a subsidiary	–	–	11,624	11,624
Unallocated corporate expenses				(23,265)
Finance costs – interest on other loans				(335)
Loss before taxation				(36,268)
Income tax expense				(31)
Loss for the year				(36,299)
Balance Sheet				
Assets				
Segment assets	622	6,635	–	7,257
Unallocated corporate assets				50,271
Consolidated total assets				57,528
Liabilities				
Segment liabilities	1,287	3,467	–	4,754
Unallocated corporate liabilities				37,394
Consolidated total liabilities				42,148

6. Business and Geographical Segments (Continued)**Geographical segments**

The following tables provide an analysis of the Group's sales by geographical market, irrespective of the origin of the goods:

	Sales revenue by geographical market	
	2005 HK\$'000	2004 HK\$'000
Hong Kong	49,635	14,788
Africa	18,758	7,517
	68,393	22,305

All segment assets are located in Hong Kong. There was no addition of property, plant and equipment for each of the year ended 31 December 2004 and 2005 respectively.

7. Credit Arising from a Scheme of Arrangement with Creditors

On 28 February 2005, Merchants (Hong Kong) Limited ("Merchants HK"), a wholly-owned subsidiary of the Company, held a meeting with its creditors pursuant to the Order of The Honourable Deputy Justice Poon on 2 February 2005 authorising the convening of such meeting, at which a scheme of arrangement (the "Scheme") allowing Merchants HK to compromise its debts with its creditors was duly approved by the creditors present thereat. A petition hearing before the High Court took place on 19 April 2005 at which the Court also sanctioned the Scheme, the Order for which was duly filed with the Registrar of Companies in Hong Kong on the same date whereupon the Scheme has become fully effective with the effect of reducing the Group's liabilities by approximately HK\$15,421,000.

8. Administrative Expenses

	2005 HK\$'000	2004 HK\$'000
Administrative expenses include the following:		
Auditors' remuneration	250	430
Depreciation and amortisation	7	17
Legal and professional fees	4,760	5,093
Loss on disposal of property, plant and equipment	16	112
Retirement benefits scheme contributions, net of nil (2004: Nil) forfeited contributions	55	15
Staff costs, including directors' emoluments (Note 9) (NB)	1,513	496

NB: Staff costs to the amount of HK\$213,000 (2004: HK\$80,000) was also included in distribution costs in the consolidated income statement.

Notes to the Financial Statements

For the year ended 31 December 2005

Shanghai Merchants Holdings Limited - Annual Report 2005

9. Directors' and Employees' Emoluments

The remuneration of each director for the year ended 31 December 2005 and 2004 are set out below.

2005

	Fees	Salaries, allowances, and benefits	Retirement scheme contribution	Total
	HK\$'000	in kind HK\$'000	HK\$'000	HK\$'000
Executive directors				
Yue Jialin	–	–	–	–
Lau Yau Cheung	–	300	15	315
Independent non-executive directors				
Wong Wing Kuen, Albert	40	–	–	40
Tsui Robert Che Kwong	40	–	–	40
Wu Guo Jian	40	–	–	40
Total	120	300	15	435

2004

	Fees	Salaries, allowances, and benefits	Retirement scheme contribution	Total
	HK\$'000	in kind HK\$'000	HK\$'000	HK\$'000
Executive directors				
Yue Jialin	–	–	–	–
Lau Yau Cheung	–	–	–	–
Independent non-executive directors				
Wong Wing Kuen, Albert	20	–	–	20
Tsui Robert Che Kwong	20	–	–	20
Wu Guo Jian	20	–	–	20
Total	60	–	–	60

During the year ended 31 December 2005, Mr. Lau Yau Cheung waived part of the emoluments amounting to HK\$300,000, which were excluded in the above disclosure. Apart from the above, no director has waived or agreed to waive any emoluments during the years ended 31 December 2005 and 2004.

9. Directors' and Employees' Emoluments (Continued)

Of the five individuals with the highest emoluments in the Group, one (2004: one) individual was a director of the Company whose emoluments are included in the disclosure set out above. The aggregate emoluments of the five highest paid individuals were as follows:

	2005 HK\$'000	2004 <i>HK\$'000</i>
Salaries and allowances	1,393	456
Retirement benefits scheme contributions	55	15
	1,448	471

The remuneration of each of the five highest paid individuals for the years ended 31 December 2005 and 2004 fell within Nil to HK\$1,000,000 band.

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

10. Income Tax Expense

Hong Kong Profits Tax is calculated at 17.5% of the assessable profit for the year.

The charge for the year can be reconciled to the profit/(loss) before taxation per the income statement as follows:

	2005 HK\$'000	2004 <i>HK\$'000</i>
Profits /(loss) before taxation	6,539	(36,268)
Tax at Hong Kong Profits Tax rate of 17.5%	1,144	(6,347)
Tax effect of expenses not deductible for tax purpose	1,454	8,309
Tax effect of income not taxable for tax purpose	(2,755)	(2,051)
Tax effect of tax loss not recognised	193	120
Utilisation of tax loss previously not recognised	2	–
Tax charge for the year	38	31

At 31 December 2005, the Group had unused tax losses of approximately HK\$4,164,000 (2004: HK\$23,702,000) available for offset against future profits. No deferred tax asset has been recognised in respect of such losses due to the unpredictability of future profit streams. The tax losses may be carried forward indefinitely.

The Company had no significant unprovided deferred taxation at the balance sheet date.

Notes to the Financial Statements

For the year ended 31 December 2005

Shanghai Merchants Holdings Limited - Annual Report 2005

11. Earnings/(Loss) Per Share

The calculation of the basic earnings/(loss) per share is based on the profit for the year of HK\$6,501,000 (2004: loss of HK\$36,299,000) and on 413,000,000 (2004: 413,000,000) shares in issue during the year.

Diluted loss per share has not been presented for the years ended 31 December 2005 and 2004 as there were no potential dilutive shares outstanding during both years.

12. Property, Plant and Equipment

	Leasehold land and buildings <i>HK\$'000</i>	Plant and machinery <i>HK\$'000</i>	Furniture, fixtures and equipment <i>HK\$'000</i>	Total <i>HK\$'000</i>
The Group				
Cost				
At 1 January 2004	47,578	24,985	1,017	73,580
Disposals	–	–	(201)	(201)
De-consolidation of a subsidiary	(47,578)	(24,985)	–	(72,563)
At 31 December 2004	–	–	816	816
At 1 January 2005	–	–	816	816
Disposals	–	–	(816)	(816)
At 31 December 2005	–	–	–	–
Depreciation, Amortisation and Impairment Loss				
At 1 January 2004	33,030	15,790	865	49,685
Provided for the year	–	–	17	17
Eliminated on disposals	–	–	(89)	(89)
De-consolidation of a subsidiary	(33,030)	(15,790)	–	(48,820)
At 31 December 2004	–	–	793	793
At 1 January 2005	–	–	793	793
Provided for the year	–	–	7	7
Eliminated on disposals	–	–	(800)	(800)
At 31 December 2005	–	–	–	–
Net Book Value				
At 31 December 2005	–	–	–	–
At 31 December 2004	–	–	23	23

13. Interests in Subsidiaries

	The Company	
	2005 HK\$'000	2004 <i>HK\$'000</i>
Unlisted investments	75,274	75,274
Amounts due from subsidiaries, less allowances	6,296	32,121
	81,570	107,395
Less: Impairment loss	(75,274)	(75,274)
	6,296	32,121

The amounts due from subsidiaries are unsecured, non-interest bearing and have no fixed terms of repayment. In the opinion of the Directors, the amounts will not be repaid in the next twelve months from the balance sheet date and the amounts are therefore shown as non-current.

At the balance sheet date, the Directors had reviewed the carrying value of the investments in subsidiaries and identified that the recoverable amounts of certain subsidiaries were estimated to be lower than the carrying values of the investment in the respective subsidiary. The recoverable amount was determined by the Directors with reference to the existing operation plan and the recoverable value of the underlying assets and liabilities of the respective subsidiaries.

Particulars of the Company's subsidiaries at 31 December 2005 are set out in note 29.

14. Available-for-sale Investment/Investment in Security

	The Group	
	2005 HK\$'000	2004 <i>HK\$'000</i>
Overseas unlisted investment security (Note 20)	–	–
Advance to an investee company	24,806	24,806
Less: Allowance	(24,806)	(24,806)
	–	–

Notes to the Financial Statements

For the year ended 31 December 2005

Shanghai Merchants Holdings Limited - Annual Report 2005

14. Available-for-sale Investment/Investment in Security (Continued)

The investment represents a 100% equity interest in the registered capital of Chaoyang Hua Loong Textiles and Dyeing Limited ("Chaoyang Hua Loong"), a company established in the PRC which is engaged in fabric processing and manufacturing. On 12 April 2003, the Company entered into a sale and purchase agreement to dispose of the entire issued share capital of Park Well International Group Limited ("Park Well"), including the 100% equity interest in Chaoyang Hua Loong held by a wholly-owned subsidiary of Park Well, to Show Goods Inc., a company incorporated in the British Virgin Islands, (the "Park Well Disposal Agreement"). Based on the Receivers' (who were appointed on 17 June 2003 and were discharged on 2 July 2004) investigations, they are of the view that despite the Park Well Disposal Agreement, the purported disposal of Park Well was rescinded and not completed and therefore the Company remains to be the beneficial owner of Park Well. The Receivers had since then taken steps to secure control over various companies comprising the Park Well Group. However, Chaoyang Hua Loong remains not under the control of the Company. Having obtained legal advice, in the opinion of the directors, the Group is still unable to exercise control over the financial and operating decisions of Chaoyang Hua Loong. Accordingly, Chaoyang Hua Loong was not regarded as a subsidiary of the Company with effect from 1 January 2004 and was accounted for as an investment security and stated in the consolidated balance sheet at 31 December 2004 at nil value. The investment was reclassified as available-for-sale investment upon adoption of HKAS 39 in January 2005. Details of which are set out in note 20.

The advance to Chaoyang Hua Loong is unsecured, non-interest bearing and has no fixed terms of repayment. Despite the efforts placed by the directors to secure control over Chaoyang Hua Loong and its related assets and in light of the events described above, the directors have made full allowance against the advance to Chaoyang Hua Loong in the interests of prudence.

15. Trade and Other Receivables

The Group allows an average credit period of 60 days to its trade customers.

The following is an aged analysis of trade receivables at the balance sheet date:

	The Group	
	2005 HK\$'000	2004 HK\$'000
Trade receivables – 0 to 30 days	2,151	7,249
Other receivables	35,375	35,327
	37,526	42,576

The balance at the balance sheet date includes an amount of approximately HK\$35.1 million (2004: HK\$35.1 million) receivable from Great Center Limited (the "Debt"). Details of the Debt, and related litigations, are set out in notes 24(i) to (iii). Subsequent to the balance sheet date, on 12 April 2006, the Company and its controlling shareholder, Profit Harbour entered into a deed of assignment, pursuant of which Profit Harbour has conditionally agreed to acquire from the Company, the Debt at the consideration of US\$4.5 million (equivalent to approximately HK\$35.1 million) (the "Assignment of Debt"). The Assignment of Debt constitutes a connected transaction and a major transaction of the Company under the Rules Governing the Listing of Securities on of The Stock of Exchange of Hong Kong Limited and is therefore subject to independent shareholders' approval.

16. Trade and Other Payables

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

	The Group	
	2005 HK\$'000	2004 <i>HK\$'000</i>
Trade payables		
0 to 30 days	1,554	3,069
Over 365 days	–	1,287
	1,554	4,356
Other payables	4,499	22,737
	6,053	27,093

17. Secured Other Loans

As at 31 December 2005, the secured other loans bear interest at the Hong Kong Prime Rate plus 5% per annum and are due on 30 October 2006. Details of the assets pledged are set out in note 25.

18. Share Capital

	Number of ordinary shares of HK\$0.10 each	Amount <i>HK\$'000</i>
Authorised:		
At 1 January 2004, 31 December 2004 and 31 December 2005	1,000,000,000	100,000
Issued and fully paid:		
At 1 January 2004, 31 December 2004 and 31 December 2005	413,000,000	41,300

Notes to the Financial Statements

For the year ended 31 December 2005

Shanghai Merchants Holdings Limited - Annual Report 2005

19. Share Options Schemes

The existing share option scheme was adopted by the Company pursuant to an ordinary resolution passed on 22 September 2004 for the primary purpose of providing incentives to directors and eligible employees, and will expire on 21 September 2014 (the "Scheme"). Under the Scheme, the board of directors of the Company may grant options to eligible persons, including directors of the Company and its subsidiaries, to subscribe for shares in the Company.

Options granted must be taken up within 28 days of the date of grant, upon payment of HK\$1 per grant. Options may be exercised at any time from the date of grant of the share option to the 10th anniversary of the date of grant. The exercise price is determined by the directors of the Company, and will not be less than the highest of the closing price of the Company's shares on the date of grant, the nominal value of the Company's shares and the average closing price of the shares for the five business days immediately preceding the date of grant.

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 as at 22 September 2004, being the date of passing of the resolution regarding the Scheme, without prior approval from the Company's shareholders. The number of shares in respect of which options 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 to substantial shareholders or independent non-executive directors in excess of 0.1% of the Company's share capital or with a value in excess of HK\$5 million must be approved in advance by the Company's shareholders.

No option has been granted under the Scheme since its adoption.

20. De-consolidation of a Subsidiary

As set out in note 14, having obtained legal advice, in the opinion of the Directors the Group is not in a position to exercise control over the financial and operating decisions of Chaoyang Hua Loong. Accordingly, Chaoyang Hua Loong was not regarded as a subsidiary of the Company with effect from 1 January 2004 and was excluded from the consolidated financial statements of the Company on the same date.

	2005 HK\$'000	2004 HK\$'000
Net liabilities de-consolidated:		
Property, plant and equipment	-	23,743
Trade and other payables	-	(515)
Advance from Park Well	-	(24,806)
Taxation payable	-	(10,046)
	-	(11,624)
Gain on de-consolidation of a subsidiary	-	11,624
Reclassification of investment in a subsidiary to investment security (Note 14)	-	-

Chaoyang Hua Loong was de-consolidated during the year ended 31 December 2004 and it did not contribute to the turnover, operating results or cash flows of the Group.

21. Major Non-cash Transaction

As detailed on note 7 above, during the year, a wholly-owned subsidiary of the Company had effected a scheme of arrangement with creditors, with which the Group's liabilities were reduced by approximately HK\$15,421,000.

During the year ended 31 December 2004, other receivables amounting to HK\$14,134,000, which were offset against other payables of the same amount in prior year by the Receivers, were carried at their respective gross amounts.

22. Financial Risk Management

The Group's activities exposed it mainly to currency risk and credit risk. The Group's overall risk management programme seeks to minimize potential adverse effects on the Group's financial performance.

Currency risk

The Group operates internationally and certain trade receivables are denominated in foreign currencies, which is mainly in United States dollars that are pegged with Hong Kong dollars. Therefore, the Group does not have any significant exposure to currency risk.

Credit risk

The Group is exposed to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. It arises primarily from the Group's bank deposits and trade and other receivables. The Group only traded with recognised and creditworthy third parties. Receivable balances are monitored on an ongoing basis and the Group's exposure to bad debts is not significant. Bank balances are placed with high-credit-quality institutions and directors of the Company considered that the credit risk for such is minimal.

Interest rate risk

The Group's interest rate risk relates to impact of interest rate changes on interest bearing secured other loan. The interest rates and terms of repayment of the borrowings are disclosed in note 17.

The Group has not used any interest rate swaps to hedge its exposure to interest rate risk.

23. Commitments**Operating Lease – The Group as lessee**

	2005 HK\$'000	2004 HK\$'000
Minimum lease payments under operating leases in respect of rented premises during the year	465	748

Notes to the Financial Statements

For the year ended 31 December 2005

Shanghai Merchants Holdings Limited - Annual Report 2005

23. Commitments (Continued)

At the balance sheet date, the Group had commitments for future minimum lease payments under non-cancellable operating leases in respect of rented premises, which fall due as follows:

	The Group	
	2005 HK\$'000	2004 HK\$'000
Within one year	366	252
In the second to fifth year inclusive	153	—
	519	252

Operating lease payments represent rental payable by the Group for certain of its office premises. Leases are negotiated for an average term of two years.

Capital Commitment

On 19 April 2005, the Company has entered into a Heads of Terms with a third party in respect of a proposed acquisition of a company which is engaged in the trading of electronics parts at a consideration of HK\$4,500,000.

Apart from the above, the Company and/or the Group had no commitment at the balance sheet date.

24. Litigation and Contingent Liabilities

At 31 December 2005, the Group had the following litigation and contingent liabilities:

- (i) Having obtained legal advice, the Receivers commenced legal proceedings on 2 July 2003 against Great Center Limited ("Great Center"), a company incorporated in the British Virgin Islands, for the repayment of two sums totaling US\$4.5 million (or approximately HK\$35.1 million), remitted on or about 21 May 2003 with no apparent justification, from the bank accounts of Merchants (Hong Kong) Limited ("Merchants HK"), a wholly-owned subsidiary of the Company, to a bank account maintained in the name of Great Center, and interest thereon, damages and costs of the legal proceedings ("the Great Center Action"). In order to prevent the dissipation of Great Center's assets, an injunction order was applied for, and successfully obtained on 30 June 2003, from the High Court to restrict Great Center from, inter alia, disposing of or otherwise dealing with or diminishing assets of Great Center up to the value of US\$4.5 million (the "Injunction Order"). The relevant bank, the lawyers of Great Center and other relevant persons have been notified of the Injunction Order. The Injunction Order remained valid up to and including 11 July 2003 on which date the Injunction Order was continued until further order or final determination of the Great Center Action.
- (ii) The writ of summons issued on 2 July 2003 in relation to the claim against Great Center for the repayment of US\$4.5 million was amended on 10 July 2004 (the "Amended Writ") to include the claims for (i) the repayment of HK\$12.8 million remitted from a bank account of the Company to a bank account in the name of Great Center on or about 17 April 2003; and (ii) the repayment of HK\$22.0 million remitted from a bank account of the Company to a bank account in the name of Modern Shine Enterprises Limited ("Modern Shine"), a company incorporated in the British Virgin Islands, on or about 22 April 2003, interest thereon, damages and costs of legal proceedings. The sum of claims under the Amended Writ amounts to approximately HK\$69.9 million (the "Great Center Claim"). The Amended Writ also includes a bank in Hong Kong, Modern Shine, certain former executive directors, officers and employees of the Group, and all directors or authorised signatories of Great Center and Modern Shine as defendants (the "Defendants") for the purposes of seeking orders against them for the disclosure of documents and/or information. An application was made on 10 July 2003 to the High Court for an order (the "Disclosure Order") that the Defendants disclose to the Company and Merchants HK all relevant information and documents relating to the transfers of the amounts comprising the Great Center Claim. The Disclosure Order was granted by the High Court on 18 July 2003.

24. Litigation and Contingent Liabilities (Continued)

- (iii) Solicitors instructed by the directors have pursued the claim against Great Center and Modern Shine further and obtained the following directions from the court:
- (a) The Company do file and serve its list of documents by 21 March 2005;
 - (b) Great Center and Modern Shine do file and serve their lists of documents by 28 March 2005;
 - (c) There be inspection of documents by 11 April 2005;
 - (d) The parties do exchange signed witness statements of facts within 25 April 2005;
 - (e) The application for leave to set the case down for trial be adjourned to 25 April 2005 at 10:00 a.m. before the Listing Clerk for fixing an appointment before the Listing Master;
 - (f) The application to set down was adjourned by the court to a date to be fixed as Greater Centre was not ready to exchange its witness statements with the Company; and
 - (g) The date to exchange witness statements was postponed to 14 September 2005. The Company will apply to set down for trial after the exchange of witness statements.

The Company and Great Center have exchanged their lists of documents and solicitors for the Company have received copy documents from Great Center's solicitors for inspection. Modern Shine has failed to comply with the direction to file and serve its list of documents. Solicitors for the Company have taken out an application against Modern Shine for an order that it must serve and file its list of documents within 7 days of the order, failing which solicitors for the Company will further apply for an order that unless Modern Shine do comply with the direction of the court within 14 days, judgment be entered against it for the full amount claimed. After that it will be for the Company to trace the assets of Modern Shine in order to recover the judgment sum. As Modern Shine has failed to file its list of documents within the time limit imposed by the court, the court entered judgment against Modern Shine on 7 November 2005 for the sum of HK\$22,000,000 plus interest and damages for conversion and interest thereon.

Regarding the claim against Great Center, the Company is in negotiation with Great Center's liquidators for an amicable settlement.

24. Litigation and Contingent Liabilities (Continued)

- (iv) As a result of the information provided to the Company and Merchants HK under the Disclosure Order, the Receivers have discovered that, together with certain funds out of the Great Center Claim, an aggregate amount of approximately HK\$37 million was transferred, by a series of transfers, by Great Center and Modern Shine to Win Victory Holdings Limited ("Win Victory"), a company incorporated in Hong Kong and Mr. Chau Ching Ngai, former substantial shareholder of the Company and the spouse of Ms. Mo Yuk Ping, and Ms. Mo Yuk Ping, former chairman of the Company, are the registered shareholders of 49% and 51%, respectively, of the issued share capital of Win Victory, without apparent legitimate commercial reason. Having obtained legal advice, the Receivers commenced legal proceedings on 23 August 2003 against Win Victory (the "Win Victory Action") for the repayment of the HK\$37 million, interest thereon, damages and costs of legal proceedings (the "Win Victory Claim"). It should be noted that should any of the amount claimed against Win Victory be recovered from Great Center and/or Modern Shine in the Great Center Claim such amounts will be taken into account in the Win Victory Action. In order to prevent the dissipation of Win Victory's assets, the Company applied for, and obtained on 22 August 2003, from the High Court an injunction order against Win Victory (the "Win Victory Injunction Order") to restrict Win Victory from, among other things, disposing of or otherwise dealing with or diminishing the value of its assets up to the value of HK\$37 million. On 29 August 2003, the Win Victory Injunction Order was continued until further order or final determination of the Win Victory Action.
- (v) Having obtained legal advice, the Receivers, on behalf of the Company, petitioned for the winding-up of Win Victory on the grounds that Win Victory is unable to pay its debts and/or it is just and equitable for Win Victory to be wound up and obtained an order from the High Court on 24 September 2003, among other things, appointing Messrs. Desmond Chung Seng Chiong and Roderick John Sutton of Ferrier Hodgson Limited of 14th Floor, Hong Kong Club Building, 3A Chater Road, Hong Kong as the provisional liquidators of Win Victory. In the first instance, this order would remain valid up to and including 7 October 2003, on which date the matter would be heard again by the High Court.
- (vi) The appointment of Provisional Liquidators is continued by an order of the court made by Madam Justice Kwan on 7 October 2003 until the determination of the Winding Up Petition, which has been adjourned. Due to the lack of funds in Win Victory, the Provisional Liquidators have not undertaken an extensive investigation. The Provisional Liquidators have recently made an application to the court for the discharge of their appointment and their application is fixed to be heard on 20 April 2006. The continuation of the Petition was to enable a more thorough investigation of the flow of funds in and out of Win Victory. The Petition is being opposed by Mr. Chau Ching Ngai. Solicitors for the Company will continue with the Winding Up proceedings. In view of the application by the Provisional Liquidators, the official receiver made an application to restore the Petition, which has been adjourned to 24 April 2006 for hearing. The court had on the hearing of 24 April 2006 ordered that Win Victory be wound-up on the petition of the Company.
- (vii) Solicitors for the Company issued a writ of Summons on 17 December 2004 against Mr. Tsoi Hon Chung and his son Mr. Tsoi Chun Bun for the return of all statutory books, records and documents of Park Well Group on the basis that on 15 July 2003, those documents were sent by Secretaries Limited to Mr. Tsoi Chun Bun as the agent of Mr. Tsoi Hon Chun, who was at the material times the sole director of Park Well. The Company has a copy of the signed receipt by Mr. Tsoi Chun Bun for the above documents. Both Mr. Tsoi Hon Chun and Mr. Tsoi Chun Bun deny the receipt and/or receipt as agent of such statutory books and records in their Defence filed in February 2005. Solicitors for the Company have taken out a Summons for Directions for the exchange of lists of documents and witness statements in order to set the case down for trial. The court made an order for Directions on 27 April 2005 and the Company has exchanged list of documents with Mr. Tsoi Hon Chung and Mr. Tsoi Chun Bun. Mr. Tsoi Hon Chung has filed his witness statements denying knowledge of the whereabouts of the statutory books, records and document so the Park Well Group. Mr. Tsoi Chun Bun has exchanged his witness statement with the Company 20 August 2005.

25. Pledge of Assets

	The Group		The Company	
	2005 HK\$'000	2004 <i>HK\$'000</i>	2005 HK\$'000	2004 <i>HK\$'000</i>
(a) Banking facilities of HK\$4 million (2004: HK\$8 million) granted by a bank and secured by bank deposits of the Group	4,012	8,000	–	–
(b) Other loan facilities of HK\$15 million (2004: HK\$15 million) granted by a financial institution and secured by floating charges over:				
– Trade and other receivables	1,864	6,853	145	218
– Bank balances and cash	1,376	6,917	7	5,566
	3,240	13,770	152	5,784
	7,252	21,770	152	5,784

In addition, the Company's interests in its subsidiaries had been pledged under floating charges to secure the other loan facilities granted by a financial institution to the Group.

26. Retirement Benefits Scheme

The Group operates a Mandatory Provident Fund scheme for all qualifying employees of its Hong Kong subsidiaries. The assets of the scheme are held separately from those of the Group in funds under the control of trustees. The Group contributed 5% of the relevant payroll costs to the scheme, which contribution is matched by employees.

The total cost charged to the consolidated income statement of HK\$55,000 (2004: HK\$15,000) represents contributions payable to the scheme by the Group at rates specified in the rules of the scheme.

At the balance sheet date, there was no forfeited contribution, which arose upon employees leaving the retirement benefits scheme and which was available to reduce the contribution payables in the future years.

27. Related Party Transactions

Other than related party transactions in respect of key management personnel remuneration which was disclosed in note 9 above, the Group had no material related party transactions during the years ended 31 December 2005 and 2004.

Notes to the Financial Statements

For the year ended 31 December 2005

Shanghai Merchants Holdings Limited - Annual Report 2005

28. Post Balance Sheet Events

The following event took place subsequent to 31 December 2005.

On 12 April 2006, the Company and its controlling shareholder, Profit Harbour entered into a deed of assignment, pursuant of which Profit Harbour has conditionally agreed to acquire from the Company, the Debt at the consideration of US\$4.5 million (equivalent to approximately HK\$35.1 million) (the "Assignment of Debt"). The Assignment of Debt constitutes a connected transaction and a major transaction of the Company under the Rules Governing the Listing of Securities on of The Stock of Exchange of Hong Kong Limited and is therefore subject to independent shareholders' approval.

29. Particulars of Subsidiaries

Particulars of the subsidiaries of the Company as at 31 December 2005 are as follows:

Name of subsidiary	Place/country of incorporation/ establishment and operations	Paid up issued ordinary share capital	Proportion of nominal value of issued capital held by the Company		Principal activities
			Directly %	Indirectly %	
Asia Cheer Trading Limited	Hong Kong	HK\$1 ordinary share	100	–	Trading in fabric products and other merchandises
First Landmark Limited	British Virgin Islands	US\$1 ordinary share	100	–	Investment holding
Merchants HK	Hong Kong	HK\$2 ordinary shares	–	100	Inactive
Park Well International Group Limited	British Virgin Islands	US\$6 ordinary shares	100	–	Investment holding
Sino Chance Trading Limited	Hong Kong	HK\$1 ordinary share	100	–	Trading in base metals
Sky Joy Management Limited	Hong Kong	HK\$1 ordinary share	100	–	Provision of management services

The above list contains only the particular of subsidiaries which principally affected the results, assets or liabilities of the Group.

Results

	Year ended 31 December				2005 HK\$'000
	2001 HK\$'000	2002 HK\$'000	2003 HK\$'000	2004 HK\$'000	
Turnover	38,140	403,749	62,198	22,305	68,393
Profit/(loss) before Taxation	(47,049)	(50,069)	(54,935)	(36,268)	6,539
Income Tax Credit (Expense)	52	(24)	–	(31)	(38)
Profit/(loss) after Taxation	(46,997)	(50,093)	(54,935)	(36,299)	6,501
Minority Interests	1,439	99	–	–	–
Profit/(loss) for the Year	(45,558)	(49,994)	(54,935)	(36,299)	6,501

Assets and Liabilities

	At 31 December				2005 HK\$'000
	2001 HK\$'000	2002 HK\$'000	2003 HK\$'000	2004 HK\$'000	
Total Assets	126,120	95,462	76,772	57,528	43,003
Total Liabilities	(55,109)	(38,767)	(25,093)	(42,148)	(21,122)
Minority Interests	(5,496)	–	–	–	–
Shareholders' Funds	65,515	56,695	51,679	15,380	21,881

NOTICE IS HEREBY GIVEN that the Annual General Meeting of Shanghai Merchants Holdings Limited (the "Company") will be held at 20th Floor, Central Tower, 28 Queen's Road, Central, Hong Kong on 23 May 2006 (Tuesday) at 5:00 p.m. for the following purposes:

1. To receive and adopt the audited financial statements and the reports of the directors and auditors of the Company for the year ended 31 December 2005;
2.
 - (a) To re-elect Mr. Tsui Robert Che Kwong as director;
 - (b) To re-elect Mr. Wu Guo Jian as director;
 - (c) To authorise the board of directors to fix remuneration.
3. To re-appoint auditors and to authorize the board of directors of the Company to fix their remuneration;

As special business, to consider and, if thought fit, pass with or without amendments, each of the following resolutions 4, 5 and 6 as Ordinary Resolutions:

ORDINARY RESOLUTIONS

4. **"THAT**
 - (a) subject to paragraph (b) below, the exercise by the directors of the Company during the Relevant Period (defined as below) of all powers of the Company to repurchase shares of the Company on The Stock Exchange of Hong Kong Limited ("Stock Exchange") or on any other stock exchange recognised, for this purpose by the Securities and Futures Commission and the Stock Exchange, subject to and in accordance with all applicable laws and requirements, be and is hereby generally and unconditionally approved;
 - (b) the aggregate nominal amount of shares of the Company which the Company is authorised to repurchase pursuant to the approval in paragraph (a) above shall not exceed 10 per cent. of the aggregate nominal amount of the share capital of the Company in issue at the date of passing this Resolution and the said approval shall be limited accordingly; and
 - (c) for the purpose of this Resolution:

"Relevant Period" means the period from the time of passing of this Resolution until whichever is the earliest of:

 - (i) the conclusion of the next annual general meeting of the Company;
 - (ii) the expiration of the period within which the next annual general meeting of the Company is required by laws to be held; and
 - (iii) the revocation or variation of this Resolution by an ordinary resolution of the shareholders of the Company in general meeting."
5. **"THAT:**
 - (a) subject to paragraph (c) below, the exercise by the directors of the Company during the Relevant Period (as defined below) of all the powers of the Company to allot, issue and deal with additional

shares in the share capital of the Company and to make or grant offers, agreements and options which would or might require the exercise of such powers during or after the end of the Relevant Period, subject to and in accordance with all applicable laws, be and is hereby generally and unconditionally approved;

- (b) the approval in paragraph (a) above shall authorise the directors of the Company during the Relevant Period (as defined below) to make or grant offers, agreements and options which might require the exercise of such powers after the end of the Relevant Period;
- (c) the aggregate nominal amount of share capital allotted or agreed conditionally or unconditionally to be allotted (whether pursuant to an option or otherwise) and issued by the directors of the Company pursuant to the approval in paragraph (a) above, otherwise than pursuant to (i) a Rights Issue (as defined below); (ii) an issue of shares upon the exercise of subscription rights or conversion rights under any warrants of the Company or any securities of the Company which are convertible into shares of the Company; (iii) an issue of shares as scrip dividends (b) the approval in paragraph (a) above shall authorise the directors of the Company during the Relevant Period (as defined below) to make or grant offers, agreements and options which might require the exercise of such powers after the end of the Relevant Period; (c) the aggregate nominal amount of share capital allotted or agreed conditionally or unconditionally to be allotted (whether pursuant to an option or otherwise) and issued by the directors of the Company pursuant to the approval in paragraph (a) above, otherwise than pursuant to (i) a Rights Issue (as defined below); (ii) an issue of shares upon the exercise of subscription rights or conversion rights under any warrants of the Company or any securities of the Company which are convertible into shares of the Company; (iii) an issue of shares as scrip dividends pursuant to the Bye-laws of the Company from time to time; or (iv) an issue of shares under any option scheme or similar arrangement for the time being adopted for the grant or issue to employees or directors or such persons as may be specified under the share option scheme of the Company and/or any of its subsidiaries of shares in the capital of the Company or rights, to acquire shares in the capital of the Company shall not exceed aggregate of (i) 20 per cent. of the nominal amount of the share capital of the Company in issue as at the date of this Resolution; plus (ii) in addition, subject to the passing of Resolution No. 6 below, all those number of shares which may from time to time be purchased by the Company pursuant to the general mandate granted under Resolution No. 4 above, and the said approval shall be limited accordingly; and
- (d) for the purpose of this Resolution:

“Relevant Period” means the period from the time of passing of this Resolution until whichever is the earlier of:

- (i) the conclusion of the next annual general meeting of the Company;
- (ii) the expiration of the period within which the next annual general meeting of the Company is required by laws to be held; and
- (iii) the revocation or variation of this Resolution by an ordinary resolution of the shareholders of the Company in general meeting.

“Rights Issue” means the allotment, issue or grant of shares pursuant to an offer open for a period fixed by the directors of the Company to holders of shares or any class thereof on the register of members of the Company on a fixed record date pro rata to their then holdings of such shares or class thereof (whether or not there may be imposed any exclusions or other arrangements as the

directors of the Company may deem necessary or expedient in relation to fractional entitlements or having regard to any restrictions or obligations under the laws of, or the requirements of any recognised regulatory body of any stock exchange in, any territory outside Hong Kong).

6. **“THAT** conditional upon the passing of Resolution Nos. 4 and 5 above as set out in the notice of the meeting of which this resolution forms part, the aggregate nominal amount of the shares which are repurchased by the Company pursuant to and in accordance with Resolution No. 4 above shall be added to the aggregate nominal amount of the shares which may be allotted or agreed conditionally or unconditionally to be allotted by the directors of the Company pursuant to and in accordance with Resolution No. 5 above, provided that such additional amount shall not exceed 10 per cent. of the aggregate nominal amount of the share capital of the Company in issue as at the date of passing this Resolution.

As special business, to consider and, if thought fit, pass with or without amendments, the following resolution 7 as a Special Resolution:

SPECIAL RESOLUTION:

7. **“THAT** the bye-laws of the Company (the “Bye-laws”) be amended by:
- (a) substituting the existing Bye-law 86(2) with the following new Bye-law 86(2):

“86(2) The Directors shall have the power from time to time and at any time to appoint any person as a Director either to fill a casual vacancy on the Board or, subject to the authorization by the Members in general meeting, as an addition to the existing Board but so that the number of Directors so appointed shall not exceed any maximum number determined from time to time by the Members in general meeting. Any Director so appointed by the Board shall hold office only until the next following general meeting of the Company (in the case of filling a casual vacancy) or until the next following annual general meeting of the Company (in the case of an addition to the Board), and shall then be eligible for re-election at that meeting.”;
 - (b) by replacing the word “special” by “ordinary” immediately after the words “Subject to any provision to the contrary in these Bye-laws the Members any, at any general meeting convened and held in accordance with these Bye-laws, by” in the existing Bye-law 86(4); and
 - (c) substituting the existing Bye-law 87(1) with the following new Bye-law 87(1):

“87(1) Notwithstanding any other provisions in the Bye-laws, at each annual general meeting one-third of the Directors for the time being (or, if their number is not a multiple of three(3), the number nearest to but not less than one-third) shall retire from office by rotation and such that each Director (including those appointed for a specific term) shall be subject to retirement by rotation at least once every three years.”.

By Order of the Board

Shanghai Merchants Holdings Limited

Yue Jialin

Chairman

Hong Kong, 28 April, 2006