



## HARMONY ASSET LIMITED

亨亞有限公司\*

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

(Stock Code: 428)

(TSX Stock Symbol: HAR)

### MANAGEMENT DISCUSSION AND ANALYSIS PREPARED IN ACCORDANCE WITH CANADIAN SECURITIES LAW

**For the Year Ended:** December 31, 2012

**Date of Report:** March 28, 2013

#### **Nature of the Business**

Harmony Asset Limited (“**Harmony**” or the “**Company**”) was incorporated in the Cayman Islands on September 28, 1993. The Company’s ordinary shares are dual listed on the Hong Kong Stock Exchange (the “**HKEX**”) and the Toronto Stock Exchange (the “**TSX**”).

Harmony is an investment company that principally invests in securities listed on the HKEX with an emphasis on companies with undervalued and discounted shares. The Company also invests in private companies which have potential for earnings growth and capital appreciation. The Company takes an active role in building its investee companies and often retains a long-term strategic interest in the companies in which it invests. Harmony also takes on a consulting role and provides specialist advice to debt-stricken companies and medium-sized companies looking for financial and strategic partners for future growth.

This Management’s Discussion and Analysis (“**MD&A**”) includes the Financial Statements of Harmony and its wholly owned subsidiaries (together, the “**Group**”).

#### **Reporting Currency**

All monetary amounts contained in this MD&A are reported in Hong Kong dollars unless otherwise indicated.

#### **Caution Regarding Forward-Looking Statements**

This MD&A contains forward-looking statements which reflect the Company’s current beliefs with respect to future events and are based on information currently available to the Company. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. When reviewing the Company’s forward-looking statements, investors and others should not place undue reliance on these forward-looking statements and should carefully consider uncertainties and potential events. Unless otherwise required by applicable securities laws, the Company disclaims any intention or obligation to update the forward-looking statements. The Company has an ongoing obligation to disclose material information as it becomes available.

## OVERALL PERFORMANCE AND SIGNIFICANT EVENTS

### Overall Performance

Financial Highlights for the year ending December 31, 2012 with comparatives:

Operating Results (in HK\$)	For the year ended December 31, (audited)	
	2012	2011
Turnover, other revenue and other gains and (losses)	26,962,375	(28,322,935)
Profit (loss) before income tax	9,530,972	(45,704,441)
Profit (loss) attributable to owners of the Company	9,530,972	(48,045,466)
Basic earnings (loss) per ordinary share	0.24	(1.23)

- The Group maintained its debt-free status.
- The Group principally invests in securities listed on recognised stock exchanges and unlisted securities, including equity securities and convertible bonds issued by corporate entities.
- For the year ended December 31, 2012, the Group recorded a turnover of HK\$10,275,453 as compared to HK\$16,157,407 in the prior year, representing a decrease of 36%. Such decrease was due to less interest income and less dividend income received during the 2012 year.
- The Group recorded a turnover, other revenue and other gains and losses in an aggregate gain of HK\$26,962,375 for the year ended December 31, 2012, as compared to the total revenue in a loss of HK\$28,322,935 in the prior year. Such change has been discussed herein under the heading “Results of Operations”.
- For the year ended December 31, 2012, the profit before income tax was HK\$9,530,972 as compared to the loss of HK\$45,704,441 in the prior year. The profit attributable to owners of the Company was HK\$9,530,972 as compared to the loss of HK\$48,045,466 in the prior year. The profit for the year ended December 31, 2012 was mainly due to an increase in the unrealised gain of the Group's trading securities. Details of the unrealised gain of trading securities are discussed herein under the heading “Investments”.
- For much of the 2012 year, the global economy was still threatened by the European debt crisis. Until the fourth quarter of 2012, the crisis became more stable following the policy actions taken by European Central Bank and European authorities. The price index of the global stock markets turned upward in the fourth quarter of 2012. The share price of certain publicly traded securities held by the Company increased. The final result for the year ended December 31, 2012 increased to a net profit of HK\$9,530,972.
- The Group had available funds of HK\$34,096,412 which were mainly placed with banks as time deposits. The Group had no borrowing and did not have any capital expenditure commitments in the year ended December 31, 2012. Management believes that the Group's current cash position is sufficient to meet the ongoing needs of its business.

### Investments

For the year ended December 31, 2012, the Group recorded a turnover of HK\$10,275,453 as compared to HK\$16,157,407 in the prior year, representing a 36% decrease, which was primarily due to a decrease in dividend income and interest income as compared to the prior year. The Group recorded interest income of HK\$7,909,026 (2011: HK\$9,853,642). Dividends received from listed and unlisted investments were HK\$2,366,427 (2011: HK\$6,303,765). Details of dividend income for the year ended December 31, 2012 and 2011 are as follows:

All figures in HK\$		The year ended December 31, 2012	The year ended December 31, 2011
<i>Listed securities:</i>	<b>Stock code</b>		
Asia Standard	129	-	21,793
China Mobile	941	-	57,817
Hang Seng Bank	11	-	142,525
Hutchison	13	-	42,543
Neo-Neon	1868	-	28,840
New Heritage	95	22,968	-
PCCW	8	-	40,988
Prosperity Minerals	PMHL	621,757	428,623
Real Nutri	2010	79,584	18,400
Standard Chartered Bank	2888	-	122,732
Upbest Group	335	139,132	79,504
		<u>863,441</u>	<u>983,765</u>
<i>Unlisted securities:</i>			
Bright Genius		2,986	220,000
Mainco Limited		1,500,000	5,100,000
		<u>1,502,986</u>	<u>5,320,000</u>
<b>Total</b>		<u>2,366,427</u>	<u>6,303,765</u>

For the year ended December 31, 2012, gains on disposal of listed investments amounted to HK\$5,522,640 (2011: HK\$5,624,865), representing a 2% decrease from the prior year. With the stabilisation of the share price of global stock markets in the fourth quarter of 2012, the prices of certain securities held by the Group as at December 31, 2012 had increased. The Group recorded a net unrealized gain of HK\$8,317,936 (2011: net loss of HK\$58,531,282) on its publicly traded securities. Details of the unrealised gain and loss of the trading securities for the year ended December 31, 2012 and 2011 are as follows:

		The year ended December 31, 2012	The year ended December 31, 2011
<b><i>Listed securities:</i></b>	<b>Stock code</b>		
American Oriental Bioeng Inc.	AOB	(608,670)	(1,018,285)
Art Textile	565	-	(1,235,610)
Asia Standard	129	-	(749,240)
Celsion Corp	CLSN	5,910,971	(2,349,654)
Century Iron Mines Corp	FER.V	-	(2,635,353)
Centurion Minerals Ltd	CTN	(1,317,375)	(389,062)
CH Nonferrous	8306	(254,490)	(2,024,235)
COLT Resources	GTP	-	(857,063)
CQRC Bank	3618	-	(789,864)
Eloro Resources Ltd	ELO.V	-	(1,397,812)
EntreMed Inc.	ENMD	615,127	-
Kaisun Energy Group Ltd	8203	(9,071,598)	(7,186,066)
MBMI Resources Inc	MBR.V	(4,422,843)	(25,918,233)
Medifocus Inc	MFS.P	20,218,344	(2,374,614)
New Heritage	95	(524,258)	(38,429)
Neo-Neon	1868	-	(2,793,347)
OTIS Gold Corp	OOO.V	-	(1,718,194)
Prosperity Minerals	PMHL	(1,942,472)	(1,583,568)
Real Nutri	2010	-	(734,919)
Tai Shing	8103	(764,800)	(1,503,573)
Upbest Group	335	480,000	(600,000)
Other securities		-	(634,161)
		<u>8,317,936</u>	<u>(58,531,282)</u>

For the year ended December 31, 2012, the Group valued its certain derivative financial instruments by an external valuator. As at December 31, 2012, the Group recorded a fair value gain on derivative financial instruments was HK\$12,796,455. The details information were as follows:

	The year ended December 31, 2012	The year ended December 31, 2011
<b><i>Derivative financial securities:</i></b>		
Warrants of Medifocus Inc	17,316,248	-
Convertible bonds	(4,519,793)	-
	<u>12,796,455</u>	-

The Group recorded a net realized gain on disposal of an unlisted investment of HK\$1,018,508 (2011: HK\$3,420,171) for the year ended December 31, 2012. Recovery of impairment loss on loans and receivables was HK\$1,632,065 (2011: 2,080,000). The impairment loss on unlisted investments was HK\$12,624,729 (2011: HK\$115,000). The impairment loss on loans and receivables were HK\$1,708,524 (2011: HK\$90,353). Recovery of impairment loss on accounts receivable was HK\$1,487,971 (2011: nil). The Group recorded the turnover, other revenue and other gains and losses in an aggregate gain of HK\$26,962,375 for the year ended December 31, 2012 as compared to the total loss of HK\$28,322,935 in the prior year.

For the year ended December 31, 2012, the profit before income tax was HK\$9,530,972 as compared to loss of HK\$45,704,441 in the prior year. The profit attributable to owners of the Company was HK\$9,530,972 as compared to the loss of HK\$48,045,466 in the prior year.

As at December 31, 2012, the Group's unlisted investments (comprised of available-for-sale financial assets ("AFS") and loans and receivables) were HK\$135,556,159 as compared to HK\$113,706,120 as at December 31, 2011, representing a 19% increase. The investments comprised the following activities: (1) net increase in fair value of HK\$4,555,410; (2) new investments were made by (a) investing of HK\$7,797,000 in a private investment fund (b) investing HK\$2,728,963 in an private overseas company (c) subscription of three convertible bonds in an aggregate amount of HK\$14,000,000; (3) receipt of HK\$1,938,152 by disposal of partial equity interest in an overseas private investment; and (4) increase in loans and receivables by (a) financing an aggregate amount of HK\$5,915,000 in four investee companies (b) providing an impairment loss of HK\$1,708,524 on a loan to an investee company and (c) receipt of the repayment of HK\$2,708,030 by four investee companies.

As at December 31, 2012, accounts receivable and prepayments amounted to HK\$12,438,006 as compared to HK\$6,414,293 as at December 31, 2011, representing a 94% increase. The net increase was the result of (1) financing HK\$2,700,000 to two private companies engaging with the business of retail and life science development; (2) further financing of HK\$2,000,000 in a hotel development project in PRC; (3) repayment of cash held by brokerages of HK\$346,970; and (4) a net increase in interest receivable and prepayment of HK\$1,586,984.

As at December 31, 2012, the Group held trading securities in the amount of HK\$82,031,396 as compared to HK\$65,365,498 as at December 31, 2011, representing a 25% increase. The net increase was the result of: (1) purchases of securities during the year ended December 31, 2012 for an aggregate amount of HK\$58,988,730; (2) the sale of certain securities with carrying amount of HK\$50,640,768 and net realized gain of HK\$5,522,640; and (3) the net increase in market value during the year ended December 31, 2012 in the amount of HK\$8,317,936 of the Group's listed securities.

### **Outlook**

According to the World Bank's Global Economic Prospects Report which is published twice annually, world economy is estimated to grow from 2.3 percent in 2012 to 2.4 percent in 2013.

Emerging markets, facing the prospect of higher inflation, probably will lead the engine of growth, while developed countries are still struggling to recover. Some of the long term structural challenges experienced by global economy in the last several years will take time to resolve. In Asia, however, some central banks have started monetary easing to ensure growth will continue. Asia is likely to be more robust and so we believe there will be ample investment opportunities in the equity market as well as in higher yielding bond market.

Business indicates for the emerging markets will remain at relatively elevated levels above the growth threshold of 50 in most economies. In China, investment growth has accelerated and will remain a cornerstone of government policies.

The Group will maintain focus on China as the government speeds up capital flows between China and Hong Kong. This will undoubtedly fuel greater interest in equities which appear to be in favour for 2013.

The Group has already made several investments which we hope will come to fruition in the medium term. Barring any unforeseeable circumstances such as adverse development in Europe, the Directors are cautiously optimistic in maintaining profitability for the next financial year.

## SELECTED ANNUAL INFORMATION

All figures in HK\$	As at December 31,		
	2012 (audited)	2011 (audited)	2010 (audited)
Net investment gains (loss) (operating profit (loss))	9,530,972	(45,704,441)	33,449,229
Income (total revenue and other gains and (losses))	26,962,375	(28,322,935)	51,579,976
Net income (loss) for the year (profit (loss) attributable to owners of the Company)	9,530,972	(48,045,466)	35,274,924
Basic earnings (loss) per ordinary share	0.24	(1.23)	0.90
Diluted earnings (loss) per ordinary share	0.24	(1.23)	0.90
Total assets	291,048,311	275,521,837	323,048,710
Total long-term financial liabilities	-	-	-
Shareholders' equity	282,783,731	268,697,349	309,289,512
Cash dividends declared per ordinary share	nil	nil	0.1

- Variation in the annual results is mainly a result of an increase in the realized gain on disposals of certain listed securities and fair value gain in market values of the publicly traded investments and derivative financial instruments, which are recognized in profit or loss.

## RESULTS OF OPERATIONS

The Group's selected financial highlights for the three months and the year ended December 31, 2012 with comparatives are as follows:

Operating Results (all figures in HK\$)	Three months ended December 31, (unaudited)		Year ended December 31, (audited)	
	2012	2011	2012	2011
Turnover (total investment income)*	3,497,676	7,299,997	10,275,453	16,157,407
Interest income	3,358,544	4,066,022	7,909,026	9,853,642
Dividends received	139,132	3,233,975	2,366,427	6,303,765
Gain (loss) on disposals of listed investments	1,573,167	(250,599)	5,522,640	5,624,865
Net income (loss) before tax	22,731,039	(3,725,538)	9,530,972	(45,706,441)
Profit (Loss) attributable to owners of the Company	22,731,039	(6,064,563)	9,530,972	(48,045,466)

\* Turnover comprises interest income (bank deposits, loans receivable and convertible bonds) and dividends received (public and private companies).

Other income, other gains and (losses) (all figures in HK\$)	Three months ended December 31, (unaudited)		Year ended December 31, (audited)	
	2012	2011	2012	2011
<b>Other income:</b>				
Service fee income	125,026	173	136,592	27,575
<b>Total other income</b>	<b>125,026</b>	<b>173</b>	<b>136,592</b>	<b>27,575</b>
<b>Other gains and (losses):</b>				
Net exchange gain (loss) on financial instruments not a fair value through profit or loss	170,747	(14,089)	108,008	(64,154)
Fair value changes on financial assets at fair value through profit and loss	35,510,792	(5,209,652)	21,114,391	(55,707,803)
Net realized gain on disposals of financial assets at fair value through profit and loss	1,573,167	(250,599)	5,522,640	5,995,137
Net realized gain on disposals of available-for-sale financial assets	1,018,508	-	1,018,508	3,420,171
Loss on disposal of property, plant and equipment	-	(25,915)	-	(25,915)
Recovery of impairment losses on loans and receivables previous recognised	1,349,820	976,380	1,632,065	2,080,000
Recovery of impairment losses on accounts and receivable	-	-	-	-
Impairment losses on loans and receivables	(1,708,524)	(90,353)	(1,708,524)	(90,353)
Impairment losses on available-for-sale financial assets				
-equity investments	(12,624,729)	(115,000)	(12,624,729)	(115,000)
- deposits on investments written off	-	-	-	-
<b>Total other gains and (losses)</b>	<b>25,289,781</b>	<b>(4,729,228)</b>	<b>16,550,330</b>	<b>(44,507,917)</b>
<b>Total</b>	<b>25,414,807</b>	<b>(4,729,055)</b>	<b>16,686,922</b>	<b>(44,480,342)</b>

For the year ended December 31, 2012, the Group recorded a turnover of HK\$10,275,453 as compared to HK\$16,157,407 in the prior year, representing a 36% decrease, which was primarily due to the decrease in dividend income and interest income as compared to the prior year. The Group recorded interest income of HK\$7,909,026 (2011: HK\$9,853,642). Dividends received from listed and unlisted investments were HK\$2,366,427 (2011: HK\$6,303,765).

For the year ended December 31, 2012, gains on disposal of listed investments amounted to HK\$5,522,640 (2011 HK\$5,624,865), representing a 2% decrease from the prior year. With the increasing stabilisation of the share price of global stock markets in the fourth quarter of 2012, the prices of certain securities held by the Group as at December 31, 2012 had increased. The Group recorded a net unrealized gain of HK\$8,317,936 (2011: net loss of HK\$58,531,282) on its publicly traded securities. For the year ended December 31, 2012, the Group valued its certain derivative financial instruments by external valuator. As at December 31, 2012, the Group recorded a fair value gain on derivative financial instruments was HK\$12,796,455.

The Group recorded a net realized gain on disposal of an unlisted investment of HK\$1,018,508 (2011: HK\$3,420,171) for the year ended December 31, 2012. Recovery of impairment loss on loans and receivables was HK\$1,632,065 (2011: HK\$2,080,000). The impairment loss on unlisted investments was HK\$12,624,729 (2011: HK\$115,000). The impairment loss on loans and receivables were HK\$1,708,524 (2011: HK\$90,353). Recovery of impairment loss on accounts receivable was HK\$1,487,971 (2011: nil).

The Group recorded the turnover, other revenue and other gains and losses in an aggregate gain of HK\$26,962,375 for the year ended December 31, 2012 as compared to the total loss of HK\$28,322,935 in the prior year.

For the year ended December 31, 2012, the profit before income tax was HK\$9,530,972 as compared to loss of HK\$45,704,441 in the prior year. The profit attributable to owners of the Company was HK\$9,530,972 as compared to the loss of HK\$48,045,466 in the prior year.

For the year ended December 31, 2012, due to the increment of salary, employee benefits expenses were HK\$3,431,119 (2011: HK\$3,176,136). Other operating expenses were HK\$13,293,216 as compared to HK\$11,971,351 in the prior year, representing an 11% increase. The increase was mainly due to an accrual of incentive fees of HK\$1,058,997 (2011: nil) for the year ended December 31, 2012. The management fee had decreased to HK\$3,915,231 (2011: HK\$4,342,743) due to the decrease in the net asset value during the year ended December 31, 2012. The operating lease expense in respect of land and buildings was HK\$2,777,112 (2011: HK\$2,543,678). The difference was due to the rent free incurred in January of 2011.

## SUMMARY OF QUARTERLY RESULTS

The following table sets out a summary of the Group's quarterly results for the eight most recently completed quarters is as follows:

This information has been derived from the financial statements of the Company, which have been prepared in accordance with International Financial Reporting Standards.

	Reviewed and Unaudited Financial Information for the Quarter ended			
	December 31, 2012	September 30, 2012	June 30, 2012	March 31, 2012
Net investment gains (loss)	22,731,039	(381,523)	(17,572,372)	4,753,828
Net income (loss) for the period	22,731,039	(381,523)	(17,572,372)	4,753,828
Earnings (loss) per ordinary share – basic	0.58	(0.01)	(0.45)	0.12
Earnings (loss) per ordinary share – diluted	0.58	(0.01)	(0.45)	0.12
	December 31, 2011	September 30, 2011	June 30, 2011	March 31, 2011
Net investment gains (loss)	(3,725,538)	(22,696,111)	(26,382,575)	7,097,783
Net income (loss) for the period	(6,064,563)	(22,696,111)	(26,382,575)	7,097,783
Earnings (loss) per ordinary share – basic	(0.16)	(0.58)	(0.68)	0.18
Earnings (loss) per ordinary share – diluted	(0.16)	(0.58)	(0.68)	0.18

Significant variations arise in the quarterly results due to unrealized gains on investments recognized in the income statement which results from the Group revaluing its investments. The values at which publicly traded investments are carried is subject to fluctuations in the public markets from quarter to quarter. The private investments are revalued when management adjusts its estimates of the fair value of the investments, which is completed on a quarterly or monthly basis. Management is not aware of any significant seasonal and cyclical factors that would contribute to the quarter-to-quarter variations in the Group's performance.

## FOURTH QUARTER

For the three months ended December 31, 2012, the Group recorded a turnover of HK\$3,497,676 as compared to HK\$7,299,997 in the same period last year, representing a 52% decrease which was primarily



due to the decrease in dividend income and interest income as compared to the prior year. The interest income was HK\$3,358,544 as compared to HK\$4,066,022 in the same period in the prior year, representing a 17% decrease. Dividends received from investments were HK\$139,132 (2011: HK\$3,233,975). Gain on the disposal of listed investments amounted to HK\$1,573,167 (2011: loss of HK\$250,599). With the increased stabilisation of share prices in global stock markets in the fourth quarter of 2012, the prices of certain securities held by the Group as at December 31, 2012 had increased. The Group recorded a net unrealized gain of HK\$22,714,337 (2011: loss of HK\$8,033,131) on trading securities and fair value gain of HK\$12,796,455 (2011: HK\$2,823,479) on derivative financial instruments. The Group recorded the turnover, other revenue and other gains and losses in an aggregate gain of HK\$28,912,483 for the three months ended December 31, 2012 as compared to HK\$2,570,942 in the same period in the prior year, representing a 1,025% increase.

For the three months ended December 31, 2012, the profit before income tax was HK\$22,731,039 as compared to a loss of HK\$3,725,538 in the same period last year. The profit attributable to owners of the Company was HK\$22,731,039 as compared to the loss of HK\$6,064,563 in the same period last year.

For the three months ended December 31, 2012, there were no significant changes in the Group's operations as compared to the same period in the prior year. The major sources of income were interest on bank deposits and loans receivable, dividends from investments held and gain on disposals of publicly traded investments.

For the three months ended December 31, 2012, the other operating expenses were HK\$4,940,455 as compared to HK\$3,147,296 for the same period in the prior year, representing a 57% increase. This increase was mainly due to an accrual of incentive fees of HK\$1,058,997 in the fourth quarter of 2012 (2011: nil). The new operating lease expense in respect of land and buildings was HK\$694,278 (2011: HK\$694,278). Due to a decrease in net asset value of the Group for the three months ended December 31, 2012, the payment of investment management fees decreased to HK\$970,879 as compared to HK\$1,002,945 for the same period in the prior year, representing a 3% decrease.

## CASH FLOW

The Group's selected cash flow information for the three months and the years ended December 31, 2012 and 2011 are as follows:

(Unaudited: reviewed by management)	Three months ended		Year ended	
	December 31, 2012	December 31, 2011	December 31, 2012	December 31, 2011
Net cash (used in) from operating activities	5,741,482	7,946,059	(22,043,625)	(55,404,876)
Net cash (used in) from investing activities	(3,585,059)	8,172,419	(19,264,572)	(4,415,611)
Net cash from (used in) financing activities	-	-	-	(5,858,792)
Net increase in cash and cash equivalents	2,156,423	16,118,478	(41,308,197)	(65,679,279)
Cash and cash equivalents at October 1 or January 1	31,939,989	59,286,131	75,404,609	141,083,888
Cash and cash equivalents at December 31	34,096,412	75,404,609	34,096,412	75,404,609
Analysis of the balance of cash and cash equivalents:				
Bank balances and cash	34,096,412	75,404,609	34,096,412	75,404,609

***For the three months ended December 31, 2012 versus the three months ended December 31, 2011***

For the three months ended December 31, 2012, net cash from operations was HK\$5,741,482 as compared to HK\$7,946,059 in the same period in the prior year, which figure comprises net cash from disposal of traded securities of HK\$4,569,670 (2011: HK\$28,728,351 used in purchases of traded securities). Cash of HK\$912,560 was used in increase of derivative financial instruments (2011: nil). Net cash from a decrease in accounts receivable was HK\$4,217,029 (2011: HK\$22,409,226). Increase in accounts payable was HK\$1,073,903 as compared to HK\$442,942 in the same period in the prior year. Hong Kong income tax (2011: HK\$4,021,209) was not required.

Net cash used in investing activities was HK\$3,585,059 as compared to net cash of HK\$8,172,419 from investing activities in the same period in the prior year. No cash dividend was received (2011: HK\$3,000,000) from unlisted investments. Cash received from interest income was HK\$1,502,317 (2011: HK\$217,419). Cash repayment of HK\$1,393,030 was received from loans and receivables (2011: nil). Cash advanced to investee companies was HK\$165,000 (2011: HK\$8,949,398). No cash was used for investment in or loans to an associate (2011: 7,800,000). Purchase of AFS was HK\$2,953,558 (2011: HK\$3,805,602). Purchase of convertible bonds was HK\$8,000,000 (2011: nil). Net cash proceeds of HK\$1,938,152 was received from the disposal of AFS (2011: nil).

No cash was used in financing activities for the three months ended December 31, 2012 (2011: nil).

***For the year ended December 31, 2012 versus the year ended December 31, 2011***

In the normal course of business for the Group, significant fluctuations in cash flows can occur. Generally, this category includes such items as share transactions, accounts receivable, operating loans to investees and listing expenses. For the year ended December 31, 2012, net cash flow used in operations of HK\$22,043,625 included:

- HK\$9.67 million loss before working capital changes (a non-cash item);
- HK\$8.35 million in purchases of shares in publicly traded companies;
- HK\$0.91 million increase in derivative financial instruments;
- HK\$4.54 million increase in accounts receivable and prepayments;
- HK\$0.38 million increase in accounts payable and accruals; and
- HK\$1.06 million decrease in amount due to a related company.

In contrast, for the year ended December 31, 2011, net cash flow used in operations of HK\$55,404,876 included:

- HK\$8.21 million loss before working capital changes (a non-cash item);
- HK\$57.94 million in purchases of shares in publicly traded companies;
- HK\$18.68 million decrease in accounts receivable and prepayments;
- HK\$0.01 million increase in accounts payable and accruals;
- HK\$3.93 million decrease in amount due to a related company; and
- HK\$4.02 million in income tax paid.

For the year ended December 31, 2012, net cash used in investing activities was HK\$19,264,572 as compared to HK\$4,415,611 generated from the prior year. The Group received cash dividends from private investments in the aggregate amount of HK\$1,502,986 (2011: HK\$5,320,000). Cash advanced to investee

companies was HK\$5,915,000 as compared to HK\$5,253,082 in the prior year. Repayment from investee companies was HK\$2,708,030 (2011: HK\$2,621,764). Purchase of AFS was HK\$10,750,558 (2011: HK\$8,098,750). No cash paid was paid for investment or loans to associates of the Group (2011: HK\$7,800,000). Purchase of convertible bonds was HK\$16,000,000 (2011: nil). Proceeds received from redemption of convertible bonds was HK\$2,000,000 (2011: nil). The net proceeds from disposal of AFS was HK\$1,938,152 (2011: HK\$3,420,171). Interest received by the Group was HK\$5,288,795 as compared to HK\$6,608,592 in the prior year. The Group purchased fixed assets of HK\$36,977 (2011: HK\$1,234,306).

For the year ended December 31, 2012, no net cash was used in financing activities (2011: HK\$5,858,792).

## **LIQUIDITY**

### **Debt, contractual obligation and contingent liabilities**

As at the date of this MD&A, the Group had no debt outstanding and no contingent liabilities.

The Group had available funds of HK\$34,096,412 which were mainly placed with banks as time deposits. Cash and bank balances held by the Group are mainly denominated in Hong Kong dollars and Canadian dollars.

As at December 31, 2012, the Group had no borrowing (2011: nil). The gearing ratio for the Group was 0% (2011: 0%) which represents the ratio of the Group's borrowings to the net asset value of the Group.

Management believes that the Group's current cash position is sufficient to meet the ongoing needs of its business. However, the Group may choose to access capital markets and/or bank financing for funding of future expansion and other opportunities.

### **CAPITAL RESOURCES**

As at the date of this MD&A, the Group has unutilized banking facilities of HK\$10,000,000 and requires no significant funding for investment and capital expenditure commitments. The interest rate charged on the banking facilities is 3% per annum over the applicable Hong Kong Interbank Offered Rate.

As of the date of this MD&A, except the commitment of the operating leases, the Group does not have any capital expenditure commitments and management is not aware of any expected fluctuations in the Group's capital resources. As at December 31, 2012, the Group had future aggregate minimum lease payments under non-cancellable operating leases in respect of land and buildings as follows:

<i>Contractual Obligations</i>	<i>Payments Due by Period (HK\$)</i>				
	<i>Total</i>	<i>Less than 1 year</i>	<i>1 - 3 years</i>	<i>4 - 5 years</i>	<i>After 5 years</i>
<i>Debt</i>	–	–	–	–	–
<i>Finance Lease Obligations</i>	–	–	–	–	–
<i>Operating Leases</i>	2,777,112	2,777,112	–	–	–
<i>Purchase Obligations<sup>1</sup></i>	–	–	–	–	–
<i>Other Obligations<sup>2</sup></i>	–	–	–	–	–
<i>Total Contractual Obligations</i>	2,777,112	2,777,112	–	–	–

The Group has sufficient funds to meet the requirement of the commitment of the operating leases. As at December 31, 2012, the Group has no other contractual obligations for which funds are required to be reserved for such purpose.

## FINANCIAL INSTRUMENTS

The Group has limited exposure to fluctuations in foreign exchange rates. This exposure is managed by careful attention to trends in money markets rather than relying on any financial instruments to hedge such exposure.

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

The Group's financial assets are classified into one of the three categories, comprising financial assets at fair value through profit or loss, loans and receivables, and available-for-sale financial assets. All regular way purchases or sales of financial assets are recognized and derecognized on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

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

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

The Group's financial instruments as at December 31, 2012 and 2011 are categorised as follows:

	<b>Group</b>	
	<b>December 31 2012 HK\$</b>	<b>December 31 2011 HK\$</b>
Available-for-sale financial assets	85,610,660	81,497,676
Loans and receivables		
Loans and receivables	49,945,499	32,208,444
Accounts receivable	10,449,982	5,474,251
Bank balances and cash	34,096,412	75,404,609
	<u>94,491,893</u>	<u>113,087,304</u>
Financial assets at fair value through profit or loss		
Trading securities	87,031,396	65,365,498
Derivative financial instruments	18,228,808	3,581,809
	<u>105,260,204</u>	<u>68,947,307</u>
Total financial assets	<u>285,362,757</u>	<u>263,532,287</u>
Other financial liabilities		
Accounts payable and accruals	7,205,583	6,824,488
Amount due to a related company	1,058,997	-
Total financial liabilities	<u>8,260,580</u>	<u>6,824,488</u>

As at and for the year ended December 31, 2012 the significant changes in financial instruments as compared to the statement of financial position as at December 31, 2011 consisted primarily of:

- (1) The change in the Group's AFS and loans and receivables was primarily due to: (1) net increase in fair value of HK\$4,555,410; (2) new investments were made by (a) investing of HK\$7,797,000 in a private investment fund (b) investing HK\$2,728,963 in an private overseas company (c) subscription of three convertible bonds in an aggregate amount of HK\$14,000,000; (3) receipt of HK\$1,938,152 by disposal of partial equity interest in an overseas private investment; and (4) increase in loans and receivables by (a) financing an aggregate amount of HK\$5,915,000 in four investee companies (b) providing an impairment loss of HK\$1,708,524 on a loan to an investee company and (c) receipt of the repayment of HK\$2,708,030 by four investee companies.
- (2) The movement in the Group's accounts receivable was primarily due to: (1) financing HK\$2,700,000 to two private companies engaging with the business of retail and life science development; (2) further financing of HK\$2,000,000 in a hotel development project in PRC (3) repayment of cash held by brokerages of HK\$346,970; and (2) a net increase in interest receivable and prepayment of HK\$1,586,984.
- (3) During the period, the Group had the following major trading transactions: (1) purchases of securities during the year ended December 31, 2012 for an aggregate amount of HK\$58,988,730; (2) the sale of certain securities with carrying amount of HK\$50,640,768 and net realized gain of HK\$5,522,640; and

(3) the net increase in market value during the year ended December 31, 2012 in the amount of HK\$8,317,936 of the Group's listed securities.

Further detailed information with respect to the financial instruments and significant assumptions made by the Group in estimation of fair value with respect to its financial instruments have been disclosed in notes (4)(e) and 29(b) of the audited financial statements of the Group for the year ended December 31, 2012

#### OFF-BALANCE SHEET ARRANGEMENTS

As at December 31, 2012 there are no off-balance sheet arrangements.

#### TRANSACTIONS WITH RELATED PARTIES

The Company has entered into an investment management agreement with Harmony Asset Management Limited (“HAML”), a company which is wholly-owned by a director of the Company, Dr. Chow Pok Yu Augustine. Under the investment management agreement together with a supplemental agreement entered into between the Company and HAML on May 17, 2007 (the “Original Investment Management Agreement”). HAML agreed to assist the Board with the day-to-day management of the Group for three years until May 31, 2010.

On April 8, 2010, the Company entered into a new investment management agreement (the “New Investment Management Agreement”) with HAML as detailed in the information circular of the Company dated April 29, 2010, whereby HAML has agreed to provide its management services for an additional three years until May 31, 2013. In accordance with the New Investment Management Agreement, HAML is entitled to a monthly management fee calculated at 1.5% per annum on the net asset value of the Group for the preceding month and an incentive fee calculated at 10% of the audited net profit of the financial year (before accrual of the incentive fee) subject to an aggregate cap of HK\$18,391,986 for the year ended December 31, 2012.

Dr. Chow Pok Yu Augustine, being a beneficial shareholder of HAML, had an interest in the Original Investment Management Agreement and the New Investment Management Agreement during the years ended December 31, 2012 and 2011. The management fees and incentive fee paid and payable to HAML are as follows:

	2012 HK\$	2011 HK\$
Management fees	3,915,231	4,342,743
Incentive fee	1,058,997	-
Total	4,974,228	4,342,743

#### PROPOSED TRANSACTIONS

The Company is not a party to any proposed asset or business acquisition or disposition or any proposed transaction that may have an effect on the financial condition, results of operations, or cash flows of the Company.

## OUTSTANDING SHARE DATA

The authorized share capital of the Company is HK\$100,000,000 divided into 100,000,000 ordinary shares with a nominal value of HK\$1.00 per ordinary share.

As at March 28 2012, the number of ordinary shares of the Company outstanding and the number of ordinary shares issuable pursuant to the outstanding options of the Company are as follows:

<u>Ordinary Shares</u>	<u>Number</u>
Outstanding.....	39,058,614
Issuable pursuant to options.....	nil
<b>Total diluted ordinary shares.....</b>	<b>39,058,614</b>

## PRINCIPAL ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES:

### 1. Basis of preparation

This MD&A should be read in conjunction with the audited financial statements of the Company for the financial year ended December 31, 2012 and December 31, 2011 (collectively, the “Financial Statements”), which were prepared in accordance with the International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board, the disclosure requirements of the Hong Kong Companies Ordinance and the Rules Governing the Listing of Securities on the HKEX.

The Financial Statements have been prepared under the historical cost basis, except that, as disclosed in the accounting policies shown in the Financial Statements, available-for-sale financial assets and financial assets at fair value through profit or loss are stated at fair value.

This MD&A includes the Financial Statements of Harmony and its wholly owned subsidiaries. All significant inter-company balances and transactions have been eliminated on consolidation.

### 2. Significant accounting polices

A summary of significant accounting policies are set out in the note 4 to the Financial Statements of the Company.

### 3. Use of estimates

The preparation of the consolidated financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates.

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

The Group adopts two principal methodologies to determine the fair value of majority of its financial assets carried at fair value:

(a) *Market price:*

The Group adopts the market price of financial assets through profit and loss for the calculation of their fair value. The surplus or deficit of the fair value will be recognized as unrealized gain or loss respectively through profit and loss.

(b) *Net asset value or discounted cash flows:*

The calculation of fair value of unlisted available-for-sale financial assets is principally based on the net asset value or discounted cash flows of those assets. The net change in fair value of available-for-sale financial assets is recognized in the fair value reserve account.

## **CHANGES IN ACCOUNTING POLICY**

Adoption of new or revised IFRSs during the year ended December 31, 2012 is detailed in note 2 to the audited financial statements. The adoption of new or revised IFRSs has no significant impact on the Group's financial statements. The Group is in the process of making an assessment of the potential impact of new or revised IFRSs that have been issued but are not yet effective for the year ended December 31, 2012 and the directors so far concluded that the application of these new or revised IFRSs will have no material impact on the Group's financial statements except for IFRS9, which is explained in note 2 to the audited Financial Sstatements.

## **EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

The Canadian Securities Administrators have published National Instrument 52-109 - *Certification of Disclosure in Issuers' Annual and Interim Filings* which requires public companies in Canada to submit annual and interim certificates relating to the design and effectiveness of the disclosure controls and procedures that are in use at the company. Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported on a timely basis to senior management, including the Company's Chairman and Chief Executive Officer and Chief Financial Officer, to enable this information to be reviewed and discussed so that appropriate decisions can be made regarding the timely public disclosure of the information.

As of December 31, 2012 management has evaluated the effectiveness of the design and the operating effectiveness of the disclosure controls and procedures as defined by National Instrument 52-109. This evaluation was performed under the supervision of and with the participation of the Company's Chairman and Chief Executive Officer and Chief Financial Officer. Based on this evaluation, the Company's Chairman and Chief Executive Officer and Chief Financial Officer concluded that the design and operation of the disclosure controls and procedures in use at the Company were effective as of December 31, 2012.

## **INTERNAL CONTROL OVER FINANCIAL REPORTING**

National Instrument 52-109 also requires public companies in Canada to submit an annual certificate relating to the design and operating effectiveness of internal control over financial reporting ("ICFR"). ICFR is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. Management is responsible for establishing and maintaining ICFR and management, including the Company's Chairman and Chief Executive Officer and Chief Financial Officer, has evaluated



the design and tested the effectiveness of the ICFR as at December 31, 2012. Based on this evaluation, management, with the participation of the Company's Chairman and Chief Executive Officer and Chief Financial Officer, has concluded that the design and operating effectiveness of ICFR in place at the Company was effective as of December 31, 2012. The Company has continued to use the basic framework for international control and risk management internal control framework issued by the Hong Kong Institute of Certified Public Accountants to design its ICFR. Due to its inherent limitations, ICFR may not prevent or detect misstatements on a timely basis as such systems can only be designed to provide reasonable as opposed to absolute assurance. Also projections of any evaluation of the effectiveness of ICFR to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

## **CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

National Instrument 52-109 also requires public companies in Canada to disclose in their MD&A any change in ICFR during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting. There were no changes in ICFR during the quarter ended December 31, 2012 that materially affected or are reasonably likely to materially affect the Company's ICFR.

### **Risk Factors**

The following are certain risk factors inherent in the Company's businesses and an investment in the ordinary shares of the Company. The following information is a summary only of certain risk factors and is qualified in its entirety by reference to, and must be read in conjunction with, the detailed information appearing in the Company's Annual Information Form for the financial year ended December 31, 2012 (the "AIF"). These risks and uncertainties are not the only ones facing the Company. Additional risks and uncertainties not currently known to the Company, or that the Company currently considers immaterial, may also impair the business of the Company. If any such risks actually occur, the business, financial condition, liquidity and results of operations of the Company could be materially adversely affected.

#### *1. Risks of Doing Business in the People's Republic of China*

Some of the Group's investments have operations located in the People's Republic of China ("PRC"). The PRC's economy and legal system differ from those of most developed countries in many respects, including the level of development and transparency. The Group will be affected by any political or economic instability in the PRC. Changes in investment policies or shifts in political attitude in the PRC may adversely affect the Group's businesses. Operations will also be adversely affected in varying degrees by government regulations including but not limited to restrictions on production, price controls, income taxes, and expropriation of property. The introduction of new policies, legislation or amendments to existing policies or legislation by various levels of government in the PRC or the interpretation of those laws in the PRC or elsewhere could impact adversely on the assets, operations and financial performance of the Group.

#### *2. Risk of Limited Number of Investments*

The Company intends to participate in a limited number of investments and, as a consequence, the aggregate return of the Company may be substantially adversely affected by the unfavourable performance of even a single investment. In addition, as the Company's investments are concentrated in certain sectors, the Company's performance will be disproportionately subject to adverse developments in those sectors.

### 3. *Marketability of the Company's Investments*

The Company often makes direct investments in publicly-traded securities. The value of these investments may be affected by factors such as investor demand, resale restrictions, general market trends and regulatory restrictions. Fluctuation in the market value of such investments may occur for a number of reasons beyond the control of the board of directors of the Company, and there is no assurance that an adequate market will exist for investments made by the Company. Many of the investments made by the Company may be relatively illiquid and may decline in price if a significant number of such investments are offered for sale by the Company or other investors.

The Company also invests in securities of privately held companies. Investments in privately held companies cannot be resold without a prospectus, an available exemption or an appropriate ruling under relevant securities legislation and there may not be any market for such securities. These limitations may impair the Company's ability to react quickly to market conditions or negotiate the most favourable terms for exiting such investments. Investments in privately held companies may offer relatively high potential returns, but will also be subject to a relatively high degree of risk. There can be no assurance that a public market will develop for any of the Company's private company investments or that the Company will otherwise be able to realize a return on such investments.

The value attributed to securities of privately held companies will be the cost or net asset value thereof, subject to adjustment in limited circumstances, and therefore may not reflect the amount for which they can actually be sold. Because valuations, and in particular valuations of investments for which market quotations are not readily available, are inherently uncertain, may fluctuate within short periods of time and may be based on estimates, determinations of fair value may differ materially from the values that would have resulted if a ready market had existed for the investments.

### 4. *(a) Due Diligence*

The due diligence process that the Company undertakes in connection with investments may not reveal all facts that may be relevant in connection with an investment. Before making investments, the Company conducts due diligence that it deems reasonable and appropriate based on the facts and circumstances applicable to each investment. When conducting due diligence, the Company may be required to evaluate important and complex business, financial, tax, accounting, environmental and legal issues. Outside consultants, legal advisors, accountants and investment banks may be involved in the due diligence process in varying degrees depending on the type of investment. Nevertheless, when conducting due diligence and making an assessment regarding an investment, the Company relies on the resources available to us, including information provided by the target of the investment and, in some circumstances, third-party investigations. The due diligence investigation that is carried out with respect to any investment opportunity may not reveal or highlight all relevant facts that may be necessary or helpful in evaluating such investment opportunity. Moreover, such an investigation will not necessarily result in the investment being successful.

### *(b) Lack of formal purchase agreements and/or shareholder/subscriber agreements*

The Company does not have formal purchase agreements and/or shareholder/subscriber agreements in place for some of its investments in privately held companies. As at December, 2012, a total carrying value of all these investments is approximately HK\$35.48 million, which is 12.55% of the net asset value of the Group. It is not entirely abnormal for the Company to make investments

in privately held companies in the absence of formal purchase agreements and/or shareholder/subscriber agreements. As mentioned in the preceding paragraph, due diligence process was undertaken by the Company in connection with its investments through internal resources or by hiring external consultancy and/or professional advisors and most of the investments in privately held companies made by the Company took the form of share equities. Under the laws of the jurisdictions of these privately held companies, the certificates specifying the shares held by the Company are prima facie evidence of the title of the Company to those share equities and the Board considers the risk of the Company having title to its investments challenged due to lack of formal purchase agreements and/or shareholder/subscriber agreements is low.

5. *Reliance upon the Directors and Management*

Shareholders must rely upon the expertise and discretion of the board of directors and management of the Company in selecting and investing in securities, the composition of the portfolio of such securities owned or acquired by the Company and in determining whether to dispose of any securities held by the Company. The success of the Company will be dependent upon the board of directors and management of the Company successfully identifying and managing the Company's investments. Accordingly, the Company's continued success will depend upon the continued services of these individuals who are not obligated to remain employed with the Company. The loss of the services of any of these individuals could have a material adverse effect on the Company's revenues, net income and cash flows and could harm the Company's ability to maintain or grow its existing assets and raise additional funds in the future.

6. *Currency and Foreign Exchange Rate Risks*

A substantial proportion of the Company's investments are made in Hong Kong dollars and the Company may also invest in securities denominated or quoted in other foreign currencies. Therefore, changes in currency exchange rates as well as associated transaction costs could adversely affect the value of the ordinary shares during any period. In addition, the Company could also make investments in jurisdictions which may place restrictions on the repatriation of funds. The Company does not enter into hedging or derivative arrangements to manage its foreign exchange risk.

7. *Liquidity Risk*

Should the Company be unable to dispose of any portion of the Company's portfolio, the Company may experience delays in receiving the proceeds of disposition of any security within the portfolio until such time as the Company is able to dispose of such securities. Further, should the Company wish to acquire particular securities for the Company's portfolio, the Company may be unable to acquire the desired quantity of such securities at a price acceptable to the Company should the market for such security prove illiquid.

Further, investments in small capitalization companies or privately held companies tend to be less liquid than other types of investments. Due to the Company's investment in particular small or unlisted companies that can be affected by political and economic events, the securities within the Company's portfolio may be difficult to value or sell. As a result, these securities may trade at values significantly lower than their true value. This may result in the Company's difficulty in converting these securities into cash in a timely and cost effective manner.

8. *Interest Rate Risk*

Due to the Company's investment strategy and portfolio composition, the value of the securities within the Company's portfolio may fluctuate with changes in interest rates. These changes mean that the market price for the securities held in the Company's portfolio will be affected by prevailing interest rates.

9. *Speculative Nature of Ordinary Shares*

The investment in the ordinary shares of the Company is speculative in nature and suitable only for investors able to sustain a total loss of their investment. Shareholders should not rely upon realizing any significant returns from the ordinary shares and should be aware that the value of the ordinary shares and the income from them could, in common with other shares and bonds, fluctuate. There is no assurance that the investment objectives of the Company will actually be achieved.

10. *Trading Price of Shares relative to Net Asset Value*

The Company is neither a mutual fund nor an investment fund and due to the nature of the Company's business and investment strategy and the composition of its investment portfolio, the market price of the ordinary shares, at any time, may vary significantly from its net asset value per share. This risk is separate and distinct from the risk that the market price of the ordinary shares may decrease.

## **FINANCIAL RISK MANAGEMENT**

The Company has implemented policies to manage its exposure to certain financial risks. Refer to Note 29 of the Notes to Financial Statements for a discussion regarding the Company's financial risk management.

## **ADDITIONAL INFORMATION**

Additional information relating to Harmony may be found on SEDAR at [www.sedar.com](http://www.sedar.com), the HKEX website at [www.hkex.com.hk](http://www.hkex.com.hk) or the Company's website at [www.harmonyasset.com.hk](http://www.harmonyasset.com.hk). Additional financial information is provided in the Company's AIF and Annual Report for the financial year ended December 31, 2012. The Annual Report includes the audited consolidated financial statements as at December 31, 2012, the notes thereto and the report of the Company's auditors thereon. Copies of these documents, together with copies of this MD&A and copies of any documents or the pertinent pages of any documents incorporated by reference in this MD&A, are available upon request to the Company, provided that the Company may require payment of a reasonable charge if the request is made by a person who is not a security holder of the Company.