# 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 Quarter Ended:** September 30, 2010

**Date of Report:** November 12, 2010

### 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 it invests in. 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 period ending September 30, 2010 with comparatives:

| | Three months ended September 30 (unaudited) | | Nine months ended September 30 (unaudited) | |
|---|---|---|---|---|
| **Operating Results (in HK$)** | **2010** | **2009** | **2010** | **2009** |
| Turnover, other revenue and gains and losses | 17,555,313 | (10,742,852) | 46,073,785 | 107,309,912 |
| Net income (loss) before tax | 14,631,239 | (16,888,067) | 36,539,582 | 92,619,708 |
| Profit (loss) attributable to equity holders | 14,334,295 | (15,816,991) | 36,075,021 | 77,512,813 |
| Basic earning (loss) per ordinary share | 0.37 | (0.41) | 0.924 | 1.99 |

- The Group maintained its debt-free status.
- The Group's core business remained focused on investment holding and less than 10% of the turnover and other revenue, results and assets of the Group are attributable to markets outside Hong Kong.
- For the nine months ended September 30, 2010, the Group recorded a turnover of HK$36,973,204 as compared to HK$5,562,492 in the same period in the prior year, representing a 565% increase, which was due to a substantial increase in interest income and dividend income. Income from interest was amounted to HK$4,469,453 (2009: HK$926,492). Dividends received from listed and unlisted investments were HK$32,503,751 (2009: HK$4,636,000). For the nine months ended September 30, 2010, gains on disposal of listed investments amounted to HK$13,005,508 (2009: HK$105,418,596). The decrease in gains on disposal of listed investments was due to exceptional increases in the prices of particular shares held by the Group in 2009. The Group took advantage of the increases in share prices by selling such shares and realised a strong gain in 2009. With the impact of the general downturn of global stock markets in the second quarter of 2010, the prices of certain securities held by the Group as at September 30, 2010 were lower than the prices as at the year ended December 31, 2009. The Group recorded a net unrealized loss of HK$14,925,737 (2009: net unrealized gain of HK$19,782,881) on its publicly traded securities. In addition, the Group recorded an unrealized gain of HK$6,991,713 on derivative financial instruments during the interim period, which gain was a result of the fair value change on the exercise of warrants and conversion of bonds into trading securities. The Group disposed some of the private investments resulting in a net realized gain of HK$14,015,560 for the nine months ended September 30, 2010. The profit before income tax was HK$36,539,582 as compared to HK$92,619,708 in the same period in the prior year, representing a 61% decrease, which was mainly due to the substantial increase in realised gain on trading securities in the prior year. The profit attributable to owners of the Company was HK$36,075,021 as compared to HK$77,512,813 in the prior year, representing a 53% decrease.

- Looking past over nine months of 2010, the European financial crisis seemed to be gradually recovering. As a result, the Group plans to continue to prudently dispose of stocks that are profitable and invest in selective stock.

- The Group had available funds of HK$98,046,292, which were mainly placed with banks as time deposits. The Group had no borrowing and also did not have any capital expenditure commitments. Management believes that the Group's current cash position is sufficient to meet the ongoing needs of its business.

## Investments

For the nine months ended September 30, 2010, due to the Group's increased participation in secured financing projects, income from interest amounted to HK$4,469,453 as compared to HK$926,492 in the same period last year, representing an increase of 382%. The interest from financing projects was HK$4,164,840. Dividends received from investments were HK$32,503,751 for the nine months ended September 30, 2010 as compared to HK$4,636,000 in the same period of prior year, representing an increase of 601%. This increase was mainly due to receiving cash dividends in the amount of HK$30,455,817 from two investee companies after they realised their listed securities into cash. Turnover was HK$36,973,204 for the nine months ended September 30, 2010 as compared to HK$5,562,492 in the same period last year, representing a 565% increase. With the impact of the general downturn of global stock markets in the second quarter of 2010, the prices of certain securities held by the Group as at September 30, 2010 were lower than the prices as at the year ended December 31, 2009. The Group recorded a net unrealized loss of HK$14,925,737 (2009: net unrealized gain of HK$19,782,881) on its publicly traded securities. In addition, the Group recorded an unrealized gain of HK$6,991,713 on the derivative financial instruments during the interim period. The Group disposed some of the private investments resulting in a net realized gain of HK$14,015,560 for the nine months ended September 30, 2010. An impairment loss of HK$9,888,919 on unlisted investments was recorded by reference to the value of the investee companies. Total revenue for the nine months ended September 30, 2010 was HK$46,073,785 (2009: HK$107,309,912), which was mainly due to the substantial increase in realised gain on trading securities in prior year.

For the nine months ended September 30, 2010, the profit before income tax was HK$36,539,582 as compared to HK$92,619,708 in the same period of prior year, representing a 61% decrease. The profit attributable to owners was HK$36,075,021 as compared to HK$77,512,813 in the same period of the prior year, representing a 53% decrease, which was mainly due to the substantial increase in realised gain on trading securities in prior year.

For the nine months ended September 30, 2010, the Group's unlisted investments, which comprised available-for-sale financial assets ("**AFS**") and loans and receivables, were HK$72,859,247 as compared to HK$117,168,628 as at December 31, 2009, representing a 38% decrease. Such decrease was the net result of: (1) the decrease in the fair value of the Group's AFS by HK$16,614,604; (2) the investment of HK$11,000,000 in an investee company by way of equity in the amount of HK$5,000,000 and convertible bond in the amount of HK$6,000,000; (3) the disposal of four investments with costs of HK$14,991,080; (4) the conversion of convertible bonds, of which the debt element in AFS was HK$13,314,073, into listed securities; (5) the advance to investee companies of HK$788,000; (6) the repayment of loans of HK$1,139,706 received from investee companies; (7) an impairment loss of HK$9,888,919 which was made on some unlisted investments; and (8) a deposit of HK$244,458 on an unlisted investment being written off due to significant accumulated losses of an investee company by offsetting a repayment of loan of HK$149,000 from its associate.

For the nine months ended September 30, 2010, accounts receivable and prepayments were HK$75,896,685 as compared to HK$17,810,465 as at December 31, 2009, representing a 326% increase. Such increase was primarily due to: (1) the Group recording a receivable in the amount of HK$40,177,414 as a result of the disposal of certain listed and unlisted securities; (2) participation in the amount of HK$33,500,000 in three financing projects with accrued interest of HK$483,962; (3) the repayment of accounts receivable and interest receivable of the last year in the amount of HK$16,979,262; and (4) an increase in rental deposits and other prepayments of HK$904,106.

## Outlook

The core business of the Group for the nine months ended September 30, 2010 remains in investment with an emphasis on undervalued, high-quality private companies. The Company will continue to focus on its core investment pursuits in the fields of resources and real estate development in Asia and the greater China region as these two business sectors are expected to demonstrate continuous strong growth and capital appreciation.

## RESULTS OF OPERATIONS

The Group's selected financial highlights for the three months and the nine months ended September 30, 2010 with comparatives are as follows:

| Operating Results (all figures in HK$) | Three months ended September 30 (unaudited) | | Nine months ended September 30 (unaudited) | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Turnover (total investment income)* | 27,845,200 | 812,693 | 36,973,204 | 5,562,492 |
| Interest income | 2,308,726 | 676,693 | 4,469,453 | 926,492 |
| Dividends received | 25,536,474 | 136,000 | 32,503,751 | 4,636,000 |
| Gain on disposal of listed investments | (224,418) | 98,260,257 | 13,005,508 | 105,418,596 |
| **Net income (loss) before tax** | **14,631,239** | **(16,888,067)** | **36,539,582** | **92,619,708** |
| **Profit (loss) attributable to equity holders** | **14,334,295** | **(15,816,991)** | **36,075,021** | **77,512,813** |

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

| Other income, other gains and (losses) (all figures in HK$) | Three months ended September 30 (unaudited) | | Nine months ended September 30 (unaudited) | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| **Other income:** | | | | |
| Sundry Income | 30,000 | 2,999,333 | 90,005 | 3,132,452 |
| **Total other income** | **30,000** | **2,999,333** | **90,005** | **3,132,452** |
| | | | | |
| **Other gains and (losses):** | | | | |
| Exchange gain, net | – | 505,897 | (57,090) | 509,285 |
| Fair value changes on financial assets at fair value through profit and loss | | | | |
| - trading securities | (4,589,671) | (113,575,032) | (14,925,737) | 19,782,881 |
| - derivative financial instruments | | | 6,991,713 | – |
| Net realized gain on disposal of financial assets at fair value through profit and loss | (225,418) | 98,260,257 | 13,005,508 | 105,418,596 |
| Gain on disposal of an associate | – | 100,000 | – | 100,000 |
| Impairment loss on accounts receivable | – | 100,000 | – | (13,910,574) |

| | | | | |
|---|---|---|---|---|
| Recovery of impairment loss on accounts receivable | 113,999 | | 113,999 | – |
| Impairment loss on loans and receivables | – | – | – | (12,771,569) |
| Recovery of impairment loss on loans and receivables | – | 54,000 | – | 54,000 |
| Net realized gain on disposal of AFS | 2,514,580 | – | 14,015,560 | – |
| Impairment loss on AFS | | | | |
| - equity investments | (7,888,919) | | (9,888,919) | – |
| - deposits on investments written off | (244,458) | – | (244,458) | (567,651) |
| **Total other gains and (losses)** | **(10,319,887)** | **(14,554,878)** | **9,010,576** | **98,614,968** |
| **Total** | **(10,289,887)** | **(11,555,545)** | **9,100,581** | **101,747,420** |

### *For the three months ended September 30, 2010 versus the three months ended September 30, 2009*

For the three months ended September 30, 2010, the Group recorded a turnover of HK$27,845,200 as compared to HK$812,693 in the same period in the prior year, representing a 3326% increase. Such increase was due to receiving cash dividends in the amount of HK$25,379,736 from unlisted investments. Income from interest amounted to HK$2,308,726 (2009: HK$676,693). Dividends received from investments were HK$25,536,474 (2009: HK$136,000). This increase was mainly due to receiving cash dividends in the amount of HK$23,678,735 from an investee company after it realised its listed securities into cash. With the impact of the general downturn of global stock markets in the second quarter of 2010, the prices of certain securities held by the Group as at September 30, 2010 were lower than the prices as at the year ended December 31, 2009. During the three months ended September 30, 2010, the Group recorded a net unrealized loss of HK$4,589,671 on its publicly traded securities as well as the Group disposed of certain of its publicly traded securities to record a realised loss of HK$225,418 (2009: gain of HK$98,260,257).

An impairment loss of HK$7,888,919 on unlisted investments was recorded by reference to the value of an investee company. A deposit of HK$244,458 (2009: nil) on an unlisted investment was written off by offsetting a repayment of loan of HK$149,000 from its associate. The Group recorded these provisions after taking into consideration the financial condition of its investee companies, including, but not limited to, the significant accumulated losses of each particular investee company as well the ability of the investee company to repay its debts obligations considering the investee company's net asset position. For the three months ended September 30, 2010, the Group's management team evaluated the accounts receivable and considered the provision for impairment loss on accounts receivable was adequate.

For the three months ended September 30, 2010, the Group acquired 92,592 shares of EntreMed Inc., a company listed on the Nasdaq in the United States, for a subscription amount of USD$250,000. Repayment of a loan of in the amount of HK$150,000 was received from an investee company. Partial repayment of principal in the amount of HK$5,000,000 was returned from a financing project. Cash in the amount of HK$12,000,000 was received from an account receivable. Cash proceeds in the amount of HK$3,094,343 were received from the disposal of an unlisted investment.

The Group recorded total revenue of HK$17,555,313 (2009: losses of HK$10,742,852), which comprised of turnover, other revenue and other gains and other losses. The profit before income tax was HK$14,631,239 as compared to a loss of HK$16,888,067 in the same period in the prior year. The profit attributable to owners of the Company was HK$14,334,295 as compared to a loss of HK$15,816,991 in the same period in the prior year.

For the three months ended September 30, 2010, employee benefits expenses were HK$567,138 (2009: HK$557,502). Other operating expenses were HK$2,277,920 as compared to HK$5,580,697 in the same period in the prior year, representing a 59% decrease. The decrease was due to no accrual of incentive fee as compared to HK$3,014,474 in the same period last year. On the other hand, the payment of investment management fees was increased to HK$1,109,422 (2009: HK$997,491) due to an increase in the Company's net asset value. The operating lease expense in respect of land and buildings was HK$550,605 (2009: HK$527,340).

***For the nine months ended September 30, 2010 versus the nine months ended September 30, 2009***

For the nine months ended September 30, 2010, due to the Group's increased participation in secured financing projects, income from interest amounted to HK$4,469,453 as compared to HK$926,492 in the same period last year, representing an increase of 382%. Dividends received from investments were HK$32,503,751 for the nine months ended September 30, 2010 as compared to HK$4,636,000 in the same period of prior year, representing an increase of 601%. The increase in dividends was mainly due to receiving cash dividend in the total amount of HK$30,455,817 from two investee companies after the realisation of their assets. Turnover was HK$36,973,204 for the nine months ended September 30, 2010 as compared to HK$5,562,492 in the same period last year, representing a 565% increase, which was due to a substantial increase in interest income and dividend income. With the impact of the general downturn of global stock markets in the second quarter of 2010, the prices of certain securities held by the Group as at September 30, 2010 were lower than the prices as at the year ended December 31, 2009. The Group recorded a net unrealized loss of HK$14,925,737 (2009: net unrealized gain of HK$19,782,881) on its publicly traded securities. In addition, the Group recorded an unrealized gain of HK$6,991,713 on derivative financial instruments during the interim period. However, the Group managed to dispose of some private investments resulting in a net realized gain of HK$14,015,560 for the nine months ended September 30, 2010. An impairment loss of HK$9,888,919 on unlisted investments was recorded by reference to the value of the investee companies. Total revenue for the nine months ended September 30, 2010 was HK$46,073,785 (2009: HK$107,309,912), which was mainly due to a substantial increase in realised gain on trading securities in the prior year. A deposit of HK$244,458 (2009: 567,651) on an unlisted investment was written off by offsetting a repayment of loan of HK$149,000 from its associate.

For the nine months ended September 30, 2010, the profit before income tax was HK$36,539,582 as compared to HK$92,619,708 in the same period of prior year, representing a 61% decrease. The profit attributable to owners was HK$36,075,021 as compared to HK$77,512,813 in the same period of the prior year, representing a 53% decrease.

For the nine months ended September 30, 2010, employee benefits expenses were HK$1,839,062 (2009: HK$1,874,460). Other operating expenses were HK$7,457,692 as compared to HK$12,755,170 in the same period in the prior year, representing a 42% decrease. This decrease was mainly due to a further accrual of incentive fee of HK$3,014,474 for the period ended September 30, 2009. The operating lease expense in respect of land and buildings was HK$1,624,673 (2009: HK$1,582,020).

## SUMMARY OF QUARTERLY RESULTS

A summary of the Group's quarterly results for the eight most recently completed quarters is as follows:

| | September 30, 2010 | June 30, 2010 | March 31, 2010 | December 31, 2009 |
|---|---|---|---|---|
| Net investment gains (loss) | 14,631,239 | (2,709,419) | 24,617,762 | 6,888,156 |
| Net income (loss) for the period | 14,334,295 | (3,131,721) | 27,872,447 | 7,442,150 |
| Earnings (loss) per ordinary share – basic | 0.37 | (0.08) | 0.64 | 0.19 |
| Earnings per ordinary share – diluted | 0.37 | (0.08) | 0.64 | 0.19 |
| | **September 30, 2009** | **June 30, 2009** | **March 31, 2009** | **December 31, 2008** |
| Net investment gains (loss) | (16,888,067) | 102,939,751 | 6,568,024 | (73,308,517) |
| Net income (loss) for the period | (15,816,991) | 85,903,780 | 7,426,024 | (69,342,143) |
| Earnings (loss) per ordinary share – basic | (0.41) | 2.20 | 0.19 | (1.78) |
| Earnings per ordinary share – diluted | N/A | 2.20 | 0.19 | N/A |

Significant variations arise in the quarterly results due to unrealized gains on investments recognized in the income statement which resulted from the Group revaluing its investments. The value at which publicly traded investments are carried are subject to fluctuations in the public markets from quarter to quarter. The private investments are re-valued 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 of the Group's performance.

## CASH FLOW

The Group's selected cash flow information for the three months and the nine months ended September 30, 2010 and 2009 are as follows:

| (Unaudited: reviewed by management) | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Net cash (used in) from operating activities | 583,538 | 83,081,513 | (14,720,176) | 79,108,966 |
| Net cash from (used in) investing activities | 4,741,951 | (10,033,407) | 18,606,973 | (5,460,567) |
| Net cash used in financing activities | – | (3,665,621) | (3,905,861) | (3,665,621) |
| Net (decrease) increase in cash and cash equivalents | 20,419,832 | 69,382,485 | (19,064) | 69,982,778 |
| Cash and cash equivalents at July 1 and January 1 | 77,626,460 | 10,853,078 | 98,065,356 | 10,252,785 |
| Cash and cash equivalents at September 30 | 98,046,292 | 80,235,563 | 98,046,292 | 80,235,563 |
| Analysis of the balance of cash and cash equivalents: | | | | |
| Bank balances and cash | 98,046,292 | 80,235,563 | 98,046,292 | 80,235,563 |

## *For the three months ended September 30, 2010 versus the three months ended September 30, 2009*

In the normal course of business for Harmony, 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 three months ended September 30, 2010, net cash flow of HK$583,538 from operations included:

- (HK$2.77) million in loss before working capital changes (a non-cash item);
- (HK$1.3) million increase in financial assets at fair value through profit or loss;
- HK$4.9 million decrease in accounts receivable and prepayments; and
- (HK$0.25) million decrease in accounts payable and accruals.

In contrast, for the three months ended September 30, 2009, net cash flow of HK$83,081,513 from operations included:

- HK$95.88 million in profit before working capital changes (a non-cash item);
- HK$2.59 million decrease in financial assets at fair value through profit or loss;
- (HK$19.14) million increase in accounts receivable and prepayments; and
- HK$3.75 million increase in accounts payable and accruals.

For the three months ended September 30, 2010, net cash from investing activities was HK$4,741,951 as compared to net cash of HK$10,033,407 used in investing activities in the same period in the prior year. The Group received cash dividends from private investments in the aggregate amount of HK$1,605,543 (2009: HK$136,000). During the three months ended September 30, 2010, the Group received cash proceeds of HK$15,094,343 from disposal of certain unlisted investments when compared to payments of HK$11,000,000 in deposits for real estate development projects in China in same period in the prior year. No cash was advanced to investee companies for the three months ended September 30, 2010 (2009: Nil). The repayment from an investee company was HK$150,000 (2009: HK$153,900). Due to the increase in the Group's participation in the secured financing projects, interest received by the Group was in an aggregate amount of HK$2,986,408 in 2010 as compared to HK$676,693 in the same period in the prior year.

## *For the nine months ended September 30, 2010 versus the nine months ended September 30, 2009*

For the nine months ended September 30, 2010, net cash flow of HK$14,720,176 from operations included:

- HK$4.2 million in profit before working capital changes (a non-cash item);
- (HK$21.9) million increase in financial assets at fair value through profit or loss;
- HK$28.31 million decrease in derivative financial instruments;
- (HK$18.25) million increase in accounts receivable and prepayments;
- (HK$1.07) million decrease in accounts payable and accruals; and
- (HK$6) million decrease in an amount due to a related company.

In contrast, for the nine months ended September 30, 2009, net cash flow of HK$79,108,966 from operations included:

- HK$94.68 million in profit before working capital changes (a non-cash item);

- HK$6.03 million decrease in financial assets at fair value through profit or loss;
- (HK$27.91) million increase in accounts receivable and prepayments; and
- HK$6.31 million increase in accounts payable and accruals.

For the nine months ended September 30, 2010, net cash from investing activities was HK$18,606,973 as compared to net cash of HK$5,460,567 used in investing activities in the same period in the prior year. The Group received cash dividends from private investments in the aggregate amount of HK$8,382,625 for the nine months ended September 30, 2009 (2009: HK$4,636,000). It was mainly due to receiving a cash dividend of HK$4,608,272 from an investee company after the realisation of its assets. During the nine months ended September 30, 2010, the Group received cash proceeds of HK$16,094,343 (2009: nil) from disposal of certain unlisted investments. The Group also invested in a new private company in the amount of HK$11,000,000 as compared to payments of HK$11,000,000 in deposits for real estate development projects in China in the same period in the prior year. Cash in the amount of HK$788,000 was advanced to two investee companies (2009: nil). Repayment of loans in the amount of HK$1,139,706 was received from two investee companies (2009: HK$153,900). Due to the increase in the Group's participation in the secured financing projects, interest received by the Group was an aggregate amount of HK$4,778,299 for the nine months ended September 30, 2010 as compared to HK$749,533 in the same period in the prior year.

## 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$98,046,292, 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.

For the nine months ended September 30, 2010, the Group had no borrowing (2009: nil). The gearing ratio for the Group was 0% (2009: 0%). The gearing ratio 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 unutilised banking facilities of HK$20,000,000 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 HIBOR.

As at the date of this MD&A, the Group does not have any capital expenditure commitment and is not aware of any expected fluctuations in its capital resources.

## FINANCIAL INSTRUMENTS

The Group has minor 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 recognised 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 recognised 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 recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

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 September 30, 2010 and December 31, 2009 are categorised as follows:

| | Group | |
|---|---|---|
| | September 30 2010 HK$ | December 31 2009 HK$ |
| Available-for-sale financial assets | 48,858,468 | 110,854,493 |
| Loans and receivables | | |
| Loans and receivables | 24,000,779 | 6,314,135 |
| Accounts receivable | 75,896,685 | 17,046,476 |
| Bank balances and cash | 98,046,292 | 98,065,356 |
| | 197,943,756 | 121,425,967 |
| Financial assets at fair value through profit or loss | | |
| Trading securities | 66,762,120 | 44,930,302 |
| Derivative financial instruments | – | 21,322,735 |
| | 66,762,120 | 66,253,037 |
| Total financial assets | 313,564,344 | 298,533,497 |

| | Group | |
|---|---|---|
| Other financial liabilities | | |
| Accounts payable and accruals | 5,289,196 | 1,249,956 |
| Amount due to a related company | – | 6,028,948 |
| Total financial liabilities | 5,289,196 | 7,278,904 |

For the nine months ended September 30, 2010, the significant changes in financial instruments as compared to the statement of financial position for the financial year ended December 31, 2009 consisted primarily of:

(1) Decreases in unlisted investments, which were comprised of available-for-sale financial assets ("**AFS**") and loans and receivables due to: (a) a decrease in the fair value of the Group's AFS by HK$16,614,604; (b) the investment of HK$11,000,000 in an investee company by way of equity in the amount of HK$5,000,000 and convertible bond in the amount of HK$6,000,000; (c) the disposal of four investments with the costs of HK$14,991,080; (d) the conversion of convertible bonds, of which the debt element in AFS was HK$13,314,073, into listed securities; (e) advances to investee companies in the amount of HK$788,000; (f) the repayment of loans in the amount of HK$1,139,706 received from investee companies, (g) an impairment loss of HK$9,888,919 was made on some unlisted investments; and (h) a deposit of HK$244,458 on an unlisted investment being written off by offsetting a repayment of loan of HK$149,000 from its associate;

(2) Increases in accounts receivable and prepayments due to: (a) the Group recording a receivable in the amount of HK$40,177,414 as a result of the disposal of certain listed and unlisted securities; (b) participation in the amount of HK$33,500,000 in three financing projects with accrued interest of HK$483,962; (c) the repayment of accounts receivable and interest receivable of the last year in the amount of HK$16,979,262; and (d) an increase in rental deposits and other prepayments of HK$904,106; and

(3) Increases in the value of trading securities and decreases in derivative financial instruments, which were comprised of: (a) a net unrealized loss in the amount of HK$14,925,737 on the Group's publicly traded securities; (b) an unrealized gain of HK$6,991,713 on derivative financial instruments; (c) the purchase of securities in the amount of HK$78,501,428; (d) the disposal of securities with an aggregate cost to the Group of HK$49,584,737; and (e) the value of derivative financial instruments in the amount of HK$21,322,735 being transferred out by the exercise of warrants and convertible bonds into 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 has been disclosed in notes (4)(g) and 28 (b) of the audited financial statements for the year ended December 31, 2009 under summary of significant accounting policies.

## OFF-BALANCE SHEET ARRANGEMENTS

As at September 30, 2010, there are no off-balance sheet arrangements.

## TRANSACTIONS WITH RELATED PARTIES

On April 8, 2010, the Company entered into a new management agreement (the "**Agreement**") with Harmony Asset Management Limited (the "**Management Company**"), a company wholly owned by Dr. Chow Pok Yu, Augustine, the Chief Executive Officer and an executive director of the Company. Under the Agreement, the Management Company has agreed to assist the board of directors of the Company with the day-to-day management of the Company and to provide the Company with investment management services, including identifying and analyzing investment opportunities and structuring and monitoring investments. In accordance with the Agreement, the Management Company is entitled to a monthly fee calculated at 1.5% per annum on the net asset value of the Group of the preceding month and an incentive fee which is calculated at 10% of the audited net profit of the preceding financial year subject to an annual cap of HK$9,057,158 for the period from June 1, 2010 to December 31, 2010. The caps on the management fees and the incentive fee under the original management agreement with the Management Company, which expired on May 31, 2010, were HK$4,042,670 and HK$2,729,170 for the five months ended May 31, 2010, respectively.

## 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 November 12, 2010, 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:

| Ordinary Shares | Number |
|---|---|
| Outstanding | 39,058,614 |
| Issuable under options | 522,047 |
| **Total diluted ordinary shares** | **39,580,661** |

On April 30, 2010, 988,000 share options expired. Other than the foregoing, no share options were granted, exercised, expired or cancelled pursuant to the Share Option Scheme of the Company

## PRINCIPAL ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES:

### 1. Basis of preparation

This MD&A should be read in conjunction with the unaudited financials statements for the interim period ended September 30, 2010 and the audited financial statements of the Company for the financial year ended December 31, 2009 (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 convention, 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. An extract of the accounting policies that the Company believes to be critical to the Financial Statements is set out below. For a summary of all significant accounting policies, refer to note 4 to the financial statements for the year ended December 31, 2009.

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

## 2. Financial instruments

Financial assets and financial liabilities are recognized on the balance sheet when the Group becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (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 the income statement.

## 3. Fair value

The Group considers that all of the financial instruments are carried at amounts not materially different from their fair values.

*(a)* *Publicly traded investments:*

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is current bid price.

*(b)* *Privately held investments:*

Fair value of financial assets which are not traded in an active market is estimated based on the following:

- financial position and results of the investee;
- risk profile of the investee;
- nature of business of the investee;
- prospects of the investee;
- other factors and assumptions not supported by observable market prices or rates;
- reference to recent market valuations for similar entities quoted in an active market; and
- current fair value of another investment that has substantially the same or applicable price/earning ratios for similar listed companies adjusted to reflect the circumstances of the investee.

Based on the directors' conservative analysis of each of the privately held investments, the directors consider that it is appropriate to estimate the fair values of these investments based on either their net asset value or recent transaction prices. The carrying amounts of these privately held investments may be materially different from their fair values as estimated by more complex valuation techniques.

## 4. Financial assets

The Group's financial assets are classified into one of the following three categories:

- 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 either regulation or convention in the marketplace.

## 5. Revenue recognition

Interest income is recognized as it accrues using the effective interest method. Income from provision of other services is recognized when the related services are rendered.

Dividend income is recognized when the shareholder's right to receive payment is established.

Income taxes for the year comprise current tax and movements in deferred tax assets and liabilities. Income taxes are recognized in the income statement except to the extent that they relate to items recognized directly in equity, in which case they are recognized in equity.

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

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

## 6. 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 Group adopts two principal methodologies to determine the fair value of its financial assets:

*(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:*

The calculation of fair value of unlisted available-for-sale financial assets is principally based on the net asset value 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

The Group has not adopted any new accounting policies or is expecting to adopt any new accounting policies subsequent to the date of this MD&A.

## EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Canadian Securities Administrators have issued 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 September 30, 2010, 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 were effective as of September 30, 2010.

## INTERNAL CONTROL OVER FINANCIAL REPORTING

National Instrument 52-109 also requires public companies in Canada to submit an interim 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 September 30, 2010. 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 was effective as of September 30, 2010. The Company has continued to use the basic frame work 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, internal control over financial reporting 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 September 30, 2010 that materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

### 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, 2008 (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*

   The majority of the Group 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 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. 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.

*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 us. 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 28 of the Notes to the Company's 2009 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, the HKEX website at www.hkex.com.hk or the Company's website at www.harmonyasset.com.hk. Additional financial information is provided in the Company's AIF and Annual Report for the financial year ended December 31, 2009. The Annual Report includes the audited consolidated financial statements as at December 31, 2009, 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.