# HARMONY ASSET LIMITED

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

(HKEX Stock Code: 428)

(TSX Stock Symbol: HAR)

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

**For the Quarter Ended:** March 31, 2012

**Date of Report:** May 14, 2012

### 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 Stock Exchange of Hong Kong Limited (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.

The Management's Disscussion 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 Management's Discussion and Analysis ("**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 ended March 31, 2012 with comparatives:

| Operating Results (in HK$) | Three months ended March 31 (unaudited) 2012 | 2011 |
|---|---|---|
| Turnover, other revenue and other gains | **8,398,004** | 10,189,169 |
| Profit before income tax | **4,753,828** | 7,097,783 |
| Profit attributable to shareholders | **4,753,828** | 7,097,783 |
| Basic earnings per ordinary share | **0.12** | 0.18 |

- 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 three months ended March 31, 2012, the Group recorded a turnover of HK$617,879 as compared to HK$4,604,839 in the same period last year, representing a 87% decrease. The Group recorded turnover, other revenue and other gains and losses in a gain of HK$8,398,003 for the three months ended March 31, 2012 as compared to HK$10,189,169 in the same period last year, representing a 18% decrease.

- For the three months ended March 31, 2012, the profit before income tax was HK$4,753,828 as compared to HK$7,097,783 in the same period last year, representing a 33% decrease. The profit attributable to owners was HK$4,753,828 as compared to HK$7,097,783 in the same period last year, representing a 33% decrease. The decrease in profit is mainly due to a decrease in dividend income received for the three months ended March 31, 2012 as compared to the same period last year.

- Looking back over the 1st quarter of 2012, the global economy is still uncertain. The European financial crisis continues to have impact on the global investment environment. The fluctuation in market value of publicly traded securities materially influenced the Company’s performance. This factor draws the Board of Directors’ (the “Board”) attention on reviewing its listed investment portfolio. The Board will further focus on listed securities with prices having a high discount to net asset value in order to minimize the risks related to investment in publicly traded securities.

- The Group had available funds of HK$39,949,367 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.

## 1. Investments

- For the period ended March 31, 2012, the Group disposed of certain of its publicly traded securities and derivative financial instruments to obtain a realised gain of HK$2,342,674 (2011: HK$2,723,203). Gain on fair value changes on trading securities was HK$5,180,112 (2011: loss of HK$195,081). There were no realized gains on disposal of unlisted investments (2011: HK$1,670,172). Recovery of impairment losses on accounts receivable previously recognised was HK$316,611 (2011: nil). No recovery of impairment losses on loans and receivables previously recognised (2011: HK$1,103,619). Net exchange loss for the period ended March 31, 2012 was HK$66,241 (2011: gain of HK$255,290). Total revenue was HK$8,398,003 for the three months ended March 31, 2012 as compared to HK$10,189,169 in the same period last year, representing a 18% decrease. Detailed information with respect to the changes in turnover, other income and other gains and (losses) is disclosed below with comparative figures to the same period last year:

| **Turnover, other revenue, other gains and losses** | **Three months ended March 31,** | |
|---|---|---|
| **(All figures in HK$)** | **2012** | 2011 |
| **Turnover:** | | |
| Interest income from | | |
| - bank interest | **144,432** | 193,337 |
| - loans receivable | **470,461** | 1,962,994 |
| Dividend income from | | |
| - unlisted investments | **2,986** | 128,508 |
| - unlisted investments | **-** | 2,320,000 |
| | **617,879** | 4,604,839 |
| **Other income** | | |
| Sundry income | **6,968** | 27,127 |
| | **6,968** | 27,127 |
| **Other gains and (losses)** | | |
| Exchange (loss) gain | **(66,241)** | 255,290 |
| Fair value changes on financial assets at fair value through profit or loss | **5,180,112** | (195,081) |
| Net realised gain on financial assets at fair value through profit or loss | | |
| - unlisted investments | **2,342,674** | 2,353,165 |
| - derivative financial instruments | **-** | 370,038 |
| Net realized gain on disposals of available-for-sale financial assets | **-** | 1,670,172 |
| Recovery of impairment losses on accounts receivable previous recognised | **316,611** | - |
| Recovery of impairment losses on loans and receivables previously recognised | **-** | 1,103,619 |
| | **7,773,156** | 5,557,203 |
| | **8,398,003** | 10,189,169 |

- As at March 31, 2012, the Group's unlisted investments (comprised of available-for-sale financial assets ("**AFS**") and loans and receivables) were HK$130,239,664 as compared to HK$113,706,120 as at December 31, 2011, representing a 14.5% increase. Such increase was mainly due to: (1) net decreases in fair value of HK$1,017,144; (2) increase in value of AFS by reallocation of equity of HK$2,351,389, and loans and receivables of HK$4,330,498 from an associate ; (3) subscription of two convertible bonds in an aggregate amount of HK$5,118,800; and (4) increases in loans and receivables in an aggregate amount of HK$5,750,000 in three investee companies.

As at March 31, 2012, accounts receivable and prepayments was HK$19,642,145 as compared to HK$6,414,293 as at December 31, 2011, representing a 206% increase. Such increase was primarily the result of (1) financing an aggregate amount of HK$10,116,955 to two investee companies; and (2) a deposit of HK$3,000,000 into a security firm for purchase of listed securities; and (3) net increase in interest receivable and prepayment of HK$110,897.

As at March 31, 2012, the Group held trading securities in the amount of HK$81,202,953 as compared to HK$65,365,498 as at December 31, 2011, representing a 24% increase. The increase was primarily due to: (1) purchases of securities during the three months ended March 31, 2012 for an aggregate amount of HK$21,904,492; (2) the disposal of certain securities which had a cost of HK$11,247,149; and (3) net increase in market value in the amount of HK$5,180,112 of the listed securities.

## 2. Outlook

For three months ended March 31, 2012, the core business of the Group remained focused on investments in the energy resources, real estate developments and manufacturing industries in Asia and the Greater China region. By maintaining a prudent attitude towards the macro business outlook and employing a stringent selection criteria on investment opportunities, the Group is resolute in its efforts to bring profitability back to meet the benefits of its shareholders.

**Results of Operations**

The Group's selected financial highlights for the three months ended March 31, 2012 and year ended December 31, 2011 with comparatives are as follows:

| **Operating Results (all figures in HK$)** | **Three months ended March 31, (unaudited)** | | **Year ended December 31, (audited)** | |
|---|---|---|---|---|
| | **2012** | 2011 | **2011** | 2010 |
| Turnover (total investment income)* | **617,879** | 4,604,839 | **16,157,407** | 40,628,394 |
| Interest income | **614,893** | 2,156,331 | **9,853,642** | 7,176,790 |
| Dividends received | **2,986** | 2,448,508 | **6,303,765** | 33,451,604 |
| Gain (loss) on disposal of listed investments | **2,342,674** | 2,723,203 | **5,624,865** | 19,847,468 |
| **Net income (loss) before tax** | **4,753,828** | 7,097,783 | **(45,706,441)** | 33,449,229 |
| **Profit (loss) attributable to shareholders** | **4,753,828** | 7,097,783 | **(48,045,466)** | 35,274,924 |

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

| **Other revenue, other (losses) and gains (all figures in HK$)** | **Three months ended March 31, (unaudited)** | | **Year ended December 31, (audited)** | |
|---|---|---|---|---|
| | **2012** | 2011 | **2011** | 2010 |
| **Other revenue:** | | | | |
| Sundry Income | **6,968** | 27,127 | **27,575** | 120,014 |

| | | | | |
|---|---|---|---|---|
| **Total other revenue** | **6,968** | 27,127 | **27,575** | 120,014 |
| **Other gains and (losses):** | | | | |
| Exchange gain (loss), net | **(66,241)** | 255,290 | **(64,154)** | 1,467,554 |
| Fair value changes on financial assets at fair value through profit or loss | **5,180,112** | (195,081) | **(55,707,803)** | (17,413,882) |
| Net realized gain on disposal of financial assets at fair value through profit or loss | **2,342,674** | 2,723,203 | **5,995,137** | 26,846,197 |
| Net unrealized gain on disposal of available-for-sale financial assets | **-** | 1,670,172 | **3,420,171** | 13,555,482 |
| Loss on disposal of property, plant and equipment | **-** | - | (25,915) | **-** |
| Recovery of impairment loss on loans and receivables previous recognised | **-** | 1,103,619 | **2,080,000** | **-** |
| Recovery of impairment loss on accounts and receivable previous recognised | **316,611** | - | **-** | 113,999 |
| Impairment loss on loans and receivables | **-** | - | **(90,353)** | (1,922,160) |
| Impairment loss on available-for-sale financial assets | | | | |
| -equity investments written off | **-** | - | **(115,000)** | (11,571,164) |
| -deposits on investments written off | **-** | - | **-** | (244,458) |
| **Total other gains and (losses)** | **7,773,156** | 5,557,203 | **(44,507,917)** | 10,831,568 |
| **Total** | **7,780,124** | 5,584,330 | **(44,480,342)** | 10,951,582 |

For the three months ended March 31, 2012, the Group received interest income in the aggregate amount of HK$614,893 as compared to HK$2,156,331 in the same period last year, representing a 71% decrease. Dividend income generated from the securities was HK$2,986 for the three months ended March 31, 2012 as compared to HK$2,448,508 in the same period last year, representing a 100% decrease. Turnover was HK$617,879 for the three months ended March 31, 2012 as compared to HK$4,604,839 in the same period last year, representing an 87% decrease. For the period ended March 31, 2012, the Group disposed of certain of its publicly traded securities and derivative financial instruments to obtain a realised gain of HK$2,342,674 (2011: HK$2,723,203). Gain on fair value changes on trading securities was HK$5,180,112 (2011: loss of HK$195,081). There were no realized gains on disposal of unlisted investments (2011: HK$1,670,172). Recovery of impairment losses on accounts receivable previously recognised was HK$316,611 (2011: nil). No recovery of impairment losses on loans and receivables previously recognised (2011: HK$1,103,619). Net exchange loss for the period ended March 31, 2012 was HK$66,241 (2011: gain of HK$255,290). The Group recorded turnover, other revenue and other gains and losses in a gain of HK$8,398,003 for the three months ended March 31, 2012 as compared to HK$10,189,169 in the same period last year, representing a 18% decrease.

For the three months ended March 31, 2012, the profit before income tax was HK$4,753,828 as compared to HK$7,097,783 in the same period last year, representing a 33% decrease. The profit attributable to owners was HK$4,753,828 as compared to HK$7,097,783 in the same period last year, representing a 33% decrease. The decrease in profit is mainly due to a decrease in dividend income received for the three months ended March 31, 2012 as compared to the same period last year.

**Summary of Quarterly Results**

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

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

| **Other revenue, other (losses) and gains (all figures in HK$)** | **Unaudited Financial Information for the Quarter ended** | | | |
|---|---|---|---|---|
| | **March 31, 2012** | **December 31, 2011** | **September 30, 2011** | **June 30, 2011** |
| Net investment gains (loss) | 4,753,828 | (3,725,538) | (22,696,111) | (26,382,575) |
| Net income (loss) for the period | 4,753,828 | (6,064,563) | (22,696,111) | (26,382,575) |
| Earnings (loss) per ordinary share – basic | 0.12 | (0.16) | (0.58) | (0.68) |
| Earnings per ordinary share – diluted | 0.12 | (0.16) | (0.58) | (0.68) |
| | **March 31, 2011** | **December 31, 2010** | **September 30, 2010** | **June 30, 2010** |
| Net investment gains (loss) | 7,097,783 | (3,090,353) | 14,631,239 | (2,709,419) |
| Net income (loss) for the period | 7,097,783 | (3,800,097) | 14,334,295 | (3,131,721) |
| Earnings (loss) per ordinary share – basic | 0.18 | (0.01) | 0.37 | (0.08) |
| Earnings per ordinary share – diluted | 0.18 | (0.01) | 0.37 | (0.08) |

Significant variations arise in the quarterly results due to interest income, dividend income, realized and unrealized gains/losses on investments recognised in the income statement. The values 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.

**First Quarter Results**

For the three months ended March 31, 2012, the Group received interest income in the aggregate amount of HK$614,893 as compared to HK$2,156,331 in the same period last year, representing a 71% decrease. Dividend income generated from the securities was HK$2,986 for the three months ended March 31, 2012 as compared to HK$2,448,508 in the same period last year, representing a 100% decrease. Turnover was HK$617,879 for the three months ended March 31, 2012 as compared to HK$4,604,839 in the same period last year, representing an 87% decrease. For the period ended March 31, 2012, the Group disposed of certain of its publicly traded securities and derivative financial instruments to obtain a realised gain of HK$2,342,674 (2011: HK$2,723,203). Gain on fair value changes on trading securities was HK$5,180,112 (2011: loss of HK$195,081). There were no realized gains on disposal of unlisted investments (2011: HK$1,670,172). Recovery of impairment losses on accounts receivable previous ly recognised was HK$316,611 (2011: nil). No recovery of impairment losses on loans and receivables previously recognised (2011: HK$1,103,619). Net exchange loss for the period ended March 31, 2012 was HK$66,241 (2011: gain of HK$255,290). The Group recorded turnover, other revenue and other gains and losses in a gain of HK$8,398,003 for the three months ended March 31, 2012 as compared to HK$10,189,169 in the same period last year, representing a 18% decrease.

For the three months ended March 31, 2012, the profit before income tax was HK$4,753,823 as compared to HK$7,097,783 in the same period last year, representing a 33% decrease. The profit attributable to owners was HK$4,753,823 as compared to HK$7,097,783 in the same period last year, representing a 33% decrease. The decrease in profit is mainly due to a decrease in dividend income received for the three months ended March 31, 2012 as compared to the same period last year.

As at March 31, 2012, the Group's unlisted investments (comprised of available-for-sale financial assets ("**AFS**") and loans and receivables) were HK$130,239,664 as compared to HK$113,706,120 as at December 31, 2011, representing a 14.5% increase. Such increase was mainly due to: (1) net decreases in fair value of HK$1,017,144; (2) increase in value of AFS by reallocation of equity of HK$2,351,389, and loans and receivables of HK$4,330,498 from an associate; (3) subscription of two convertible bonds in an aggregate amount of HK$5,118,800; and (4) increases in loans and receivables in an aggregate amount of HK$5,750,000 in three investee companies.

As at March 31, 2012, accounts receivable and prepayments was HK$19,642,145 as compared to HK$6,414,293 as at December 31, 2011, representing a 206% increase. Such increase was primarily the result of (1) financing an aggregate amount of HK$10,116,955 to two investee companies; and (2) a deposit of HK$3,000,000 into a security firm for purchase of listed securities; and (3) net increase in interest receivable and prepayment of HK$110,897.

As at March 31, 2012, the Group held trading securities in the amount of HK$81,202,953 as compared to HK$65,365,498 as at December 31, 2011, representing a 24% increase. The increase was primarily due to: (1) purchases of securities during the three months ended March 31, 2012 for an aggregate amount of HK$21,904,492; (2) the disposal of certain securities which had a cost of HK$11,247,149; and (3) net increase in market value in the amount of HK$5,180,112 of the listed securities.

For the three months ended March 31, 2012, other operating expenses were HK$2,755,942 as compared to HK$2,457,252 in the same period last year, representing a 12% increase. Such increase was mainly due to increase in general expenses including donation, entertainment, office rent and travelling expense etc. The payment of investment management fees was HK$979,417 (2011: HK$1,105,954) because of the decrease in the Company's net asset value.

## CASH FLOW

The Group's selected cash flow information for the financial years ended December 31, 2011 and 2010 and for the three month periods ended March 31, 2012 and 2011 is as follows:

| | **Three months ended** | | **Year ended** | |
|---|---|---|---|---|
| | **March 31, 2012** | **March 31, 2011** | **December 31, 2011** | **December 31, 2010** |
| Net cash (used in) from operating activities | (25,356,855) | (15,198,550) | (55,404,87) | (10,078,902) |
| Net cash from (used in) investing activities | (10,098,387) | 9,043,422 | (4,415,611) | 56,962,607 |
| Net cash from (used in) financing activities | - | - | (5,858,792) | (3,865,173) |
| Net (decrease) increase in cash and cash equivalents | (35,455,242) | (6,155,128) | (65,679,279) | 43,018,532 |
| Cash and cash equivalents at January 1 | 75,404,609 | 141,083,888 | 141,083,888 | 98,065,356 |
| Cash and cash equivalents at March 31 and December 31 | 39,949,367 | 134,928,760 | 75,404,609 | 141,083,888 |
| Analysis of the balance of cash and cash equivalents: | | | | |
| Bank balances and cash | 39,949,367 | 134,928,760 | 75,404,609 | 141,083,888 |

**Cash flow for the three months ended March 31, 2012**

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 March 31, 2012, net cash flow used in operations of HK$25,356,855 included:

- HK$1.19 million used in profit before working capital changes (a non-cash item)
- HK$10.66 million increase in trading securities
- HK$13.06 million increase in accounts receivable and prepayments
- HK$0.44 million decrease in accounts payable and accruals

In contrast, for the three months ended March 31, 2011, net cash flow used in operations of HK$15,198,550 included:

- HK$1.24 million in profit before working capital changes (a non-cash item)
- HK$0.61 million decrease in trading securities
- HK$16.77 million increase in accounts receivable and prepayments
- HK$0.27 million decrease in accounts payable and accruals

For the three months ended March 31, 2012, net cash used in investing activities was HK$10,098,387 as compared to cash of HK$9,043,422 from investing activities in the same period last year. The Group received cash dividends from private investments in the amount of HK$2,986 (2011: HK$2,320,000). Total cash of HK$10,868,800 was advanced to five investee companies for the three months ended March 31, 2012 (2011: nil) of which HK$5,118,800 was used to subscribe for two convertible bonds. No cash repayment was received from the investee company as compared to HK$1,002,380 in the same period last year. No cash paid for equity investment (2011: HK$2,600). The Group did not purchase any fixed assets during the three months ended March 31, 2012 as compared to HK$1,104,103 in the same period last year. Interest received by the Group was HK$767,427 for the three months ended March 31, 2012 as compared to HK$2,891,809 in the same period last year.

## LIQUIDITY

**Debt, contractual obligations 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$39,949,367 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 March 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 March 31, 2012, the Group had future aggregate minimum lease payments under non-cancellable operating leases in respect of land and buildings as follows:

| | **Group** | |
|---|---|---|
| | **As at March 31, 2012** | As at December 31, 2011 |
| | **HK$** | HK$ |
| Within one year | 2,777,112 | 2,777,112 |
| In the second to fifth years inclusive | 2,082,834 | 2,777,112 |
| Total | 4,859,946 | 5,554,224 |

## 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 March 31, 2012 and December 31, 2011 are categorised as follows:

| | Group | |
|---|---|---|
| | March 31 2012 HK$ | December 31 2011 HK$ |
| Available-for-sale financial assets | 82,831,921 | 81,497,676 |
| Loans and receivables | | |
| Loans and receivables | 47,407,742 | 32,208,444 |
| Accounts receivable | 15,758,841 | 5,474,251 |
| Bank balances and cash | 39,949,367 | 75,404,609 |
| | 103,115,950 | 113,087,304 |
| Financial assets at fair value through profit or loss | | |
| Trading securities | 81,202,953 | 65,365,498 |
| Derivative financial instruments | 3,581,809 | 3,581,809 |
| | 84,784,762 | 68,947,307 |
| Total financial assets | 270,732,633 | 263,532,287 |
| Other financial liabilities | | |
| Accounts payable and accruals | 6,380,634 | 6,824,488 |
| Amount due to a related company | - | - |
| Total financial liabilities | 6,380,634 | 6,824,488 |

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

(a) The movement in the Group's AFS and loans and receivables were primarily due to: (1) net decreases in fair value of HK$1,017,144; (2) increase in value of AFS by reallocation of equity of HK$2,351,389, and loans and receivables of HK$4,330,498 from an associate; (3) subscription of two convertible bonds in an aggregate amount of HK$5,118,800; and (4) increases in loans and receivables in an aggregate amount of HK$5,750,000 in three investee companies.

(b) The increase in accounts receivable was mainly the result of (1) financing an aggregate amount of HK$10,116,955 to two investee companies and (2) increase in interest and other receivables of HK$167,635.

(c) During the period, the Group had the following major trading transactions on trading securities: (1) purchases of securities during the three months ended March 31, 2012 for an aggregate amount of HK$21,904,492; (2) the disposal of certain securities which had a cost of HK$11,247,149; and (3) net increase in market value in the amount of HK$5,180,112 of the 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(a) of the audited financial statements of the Group for the year ended December 31, 2011.

## OFF-BALANCE SHEET ARRANGEMENTS

As at March 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 period ended March 31, 2012 and 2011. The management fees paid to HAML are as follows:

| | **2012**<br>**HK$** | **2011**<br>**HK$** |
|---|---|---|
| Management fees | 979,417 | 1,105,954 |

## 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 May 13, 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:

| **Ordinary Shares** | **Number** |
|---|---|
| Outstanding........................................................................ | 39,058,614 |
| Issuable pursuant to options………………………….. | nil |
| **Total diluted ordinary shares .........................................** | **39,058,614** |

On August 18, 2011, 522,047 share options expired and lapsed. Other than the foregoing, no share options were granted, exercised, expired or cancelled pursuant to the Share Option Scheme of the Company. There are no other options outstanding.

**PRINCIPAL ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES:**

## 1. Basis of preparation

This MD&A should be read in conjunction with the unaudited financial statements for the interim period ended March 31, 2012 and the audited financial statements of the Company for the financial year ended December 31, 2011and 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 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

Summary of significant accounting policies are set out in the note 4 to the financial statements of the Company for the year ended December 31, 2011.

### 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 Group adopts two principal methodologies to determine the fair value 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.

## 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* ("**National Instrument 52-109**") 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 March 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 March 31, 2012.

## 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 March 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 March 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 March 31, 2012 hat 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, 2011 (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. 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 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 of the Company 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 of the Company 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 the audited financial statements of the Company for the year ended December 31, 2011 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, 2011. The Annual Report includes the audited consolidated financial statements as at December 31, 2011, 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.