

# Report of Directors

The directors have pleasure in submitting their first annual report together with the audited financial statements of Tack Fat Group International Limited (“the company”) for the period from 12 March 2001 (date of incorporation) to 31 March 2002. Attached to the audited financial statements is the proforma financial information of the company and its subsidiaries (collectively referred to as “the group”) for the year ended 31 March 2002 prepared on the basis set out on page 31. The group was legally formed on 11 April 2002.

## Group reorganisation and share listing

The company was incorporated in the Cayman Islands on 12 March 2001 as an exempted company with limited liability under the Companies Law (Revised) of the Cayman Islands.

Pursuant to a reorganisation to rationalise the group structure in preparation for the public listing of the company’s shares, the company became the holding company of the group on 11 April 2002. Further details of the group reorganisation, including details of the subsidiaries acquired pursuant thereto, are set out in note 14 on the proforma financial information and in the company’s prospectus dated 16 April 2002.

On 29 April 2002, dealing in shares of the company commenced on the Main Board of The Stock Exchange of Hong Kong Limited (“SEHK”).

To facilitate comparison of the financial results and position of the group with that presented in the accountants’ report in the prospectus, proforma financial information comprising proforma combined income statement, balance sheet and cash flow statement are also included in the annual report. The basis of presentation of the proforma financial information is set out on page 31 of the annual report and the accounting policies set out on pages 37 to 42 have been consistently applied for presenting the proforma financial information referring to the group in this report.

## Principal activities

The company did not carry on business during the period from 12 March 2001 (date of incorporation) to 31 March 2002. The principal activity of the company currently is investment holding.

The principal activities of the group are the manufacturing and sale of garments. The principal activities and other details of individual subsidiaries of the company are set out in note 14 on the proforma financial information.

The analysis of the principal activities and geographical locations of the operations of the group during the year ended 31 March 2002 are set out in note 12 on the proforma financial information.

## Major customers and suppliers

The information in respect of the group’s proforma sales and purchases attributable to the major customers and suppliers respectively during the financial year is as follows:

	Percentage of the group’s total	
	Sales	Purchases
The largest customer	9.6%	
Five largest customers in aggregate	40.6%	
The largest supplier		7.1%
Five largest suppliers in aggregate		30.3%

At no time during the year have the directors, their associates or any shareholder of the company (which to the knowledge of the directors owns more than 5% of the company’s share capital) had any interest in these major customers and suppliers.

## Financial statements

The state of the company’s affairs as at 31 March 2002 are set out in the financial statements on pages 26 to 30.

The proforma combined profit of the group for the year ended 31 March 2002 and the state of the group’s affairs as at that date, are set out in the proforma financial information on pages 32 to 63.

## Dividends

For the year ended 31 March 2002, interim dividend amounting to HK\$24,000,000 was paid by a subsidiary of the company to the then shareholders.

Pursuant to a resolution passed at a directors' meeting on 23 July 2002, a final dividend of HK0.625 cent per share totalling HK\$8,300,000 was recommended to be paid to shareholders, subject to shareholders' approval at the forthcoming annual general meeting.

## Fixed assets

Details of movements in fixed assets of the group are set out in note 13 on the proforma financial information.

## Bank loans

Particulars of bank loans of the group as at 31 March 2002 are set out in note 22 on the proforma financial information.

## Share capital

Details of the movements in share capital of the company since 12 March 2001 (date of incorporation), together with reasons thereafter are set out in note 7 on the financial statements.

Details of the company's share option scheme are set out in the section headed "Share Option Scheme" in this report.

## Reserves

Details of movements in the reserves of the group are set out in note 27 on the proforma financial information.

## Directors

The directors during the period from 12 March 2001 (date of the company's incorporation) to 31 March 2002 and up to the date of this report were:

### **Executive directors**

Kwok Wing ( <i>Chairman</i> )	(appointed on 20 June 2001)
Lee Yuk Man	(appointed on 20 June 2001)
Kwok Yee Lin	(appointed on 20 June 2001)
Ho Yik Kin, Norman	(appointed on 20 June 2001)

### **Independent non-executive directors**

Leung Yin Wing, Eric	(appointed on 28 March 2002)
Ching Kwok Ho, Samuel	(appointed on 28 March 2002)

In accordance with article 87 of the company's articles of association, Mr Ho Yik Kin, Norman retires from the board by rotation at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

### **Directors' service contracts**

The independent non-executive directors were appointed by the board of directors on 28 March 2002. Their appointments do not have a specific term but are subject to rotation in annual general meeting pursuant to the company's articles of association. Their remuneration is determined by the board of directors on the anniversary of the date of their appointment.

No director proposed for re-election at the forthcoming annual general meeting has an unexpired service contract which is not determinable by the company or any of its subsidiaries within one year without payment of compensation, other than normal statutory obligations.

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## Share Option Scheme

The company has conditionally adopted a share option scheme approved by way of written resolution of the company on 11 April 2002 under which the directors of the company may invite any full-time employee, directors (including executive directors, non-executive directors and independent non-executive directors) and part-time employees of the group with weekly working hours of 10 hours and above, any adviser (professional or otherwise) or consultant, distributors, suppliers, agents, customers, partners, joint venture partners, promoter, service provider to the group from time to time to take up options to subscribe for shares of the company. Up to the date of this report, no options has been granted.

## Directors' and chief executives' interests in shares

As at 29 April 2002 (being the date of the company's shares were listed on the SEHK), the directors and chief executive of the company who held office at 31 March 2002 had the following interests in the issued share capital of the company, its holding company, subsidiaries and other associated corporations (within the meaning of the Securities (Disclosure of Interests) Ordinance) at that date as recorded in the register of directors' share interests:

Beneficial interests	Name of the company	Class of shares	Personal interests	Family interests	Corporate interests	Other interests
Mr Kwok Wing	Tack Fat Group International Limited	Ordinary shares of HK\$0.1 each	—	—	652,800,000 <i>(note 1)</i>	—
Mr Kwok Wing	Tack Fat Group International Limited	Ordinary shares of HK\$0.1 each	—	—	153,600,000 <i>(note 2)</i>	—
Mr Kwok Wing	Tack Fat International Holdings Limited	Non-voting deferred shares of HK\$1 each	5,000	—	—	—
Mr Kwok Wing	Chiu Wing Enterprise Company Limited	Non-voting deferred shares of HK\$1,000 each	1,500	—	—	—
Mr Kwok Wing	Tack Fat Swimwear Manufacturing Limited	Non-voting deferred shares of HK\$10,000 each	500	—	—	—

### Notes:

- The shares are owned by Efulfilment Enterprises Limited, a company incorporated in the BVI and 50% of the issued share capital of which is held by Mr Kwok Wing.
- The shares are owned by Sharp Asset Holdings Limited, a company incorporated in the BVI and whose entire issued share capital is held by Mr Kwok Wing.

At no time during the period from 12 March 2001 (date of incorporation) to 31 March 2002 and up to the date of this report was the company, its holding company or any of its subsidiaries or fellow subsidiaries, a party to any arrangement to enable the directors of the company or any their spouses or children under eighteen years of age to acquire benefits by means of the acquisition of shares in or debentures of the company or any other body corporate.

## Substantial interest in the share capital of the company

As at 31 March 2002, the following substantial shareholders were recorded in the register of members as holding 10% or more of the share capital of the company:

	Ordinary shares held	Percentage of total issued shares
Efulfilment Enterprises Limited ( <i>note</i> )	680,000	68%
Wisehead Group Limited ( <i>note</i> )	160,000	16%
Sharp Asset Holdings Limited ( <i>note</i> )	160,000	16%

Save as disclosed above, as at 31 March 2002, the company is not aware of any other registered shareholder who holds 10% or more of the issued share capital of the company.

Subsequent to the company's share listing on 29 April 2002 and the exercise of over-allotment option on 15 May 2002, the company has been notified of the following interests in the company's issued shares amounting to 10% or more of the ordinary shares in issue as at the date of this report:

	Ordinary shares held	Percentage of total issued shares
Efulfilment Enterprises Limited ( <i>note</i> )	652,800,000	49.16%
Wisehead Group Limited ( <i>note</i> )	153,600,000	11.57%
Sharp Asset Holdings Limited ( <i>note</i> )	153,600,000	11.57%

*Note:* The issued share capital of Efulfilment Enterprises Limited is beneficially owned by Mr Kwok Chiu and Mr Kwok Wing in the proportion of 50:50. The entire issued share capital of Wisehead Group Limited and Sharp Asset Holdings Limited are beneficially owned by Mr Kwok Chiu and Mr Kwok Wing respectively.

## Directors' interests in contracts

Apart from the related party transactions as disclosed in note 31 on the proforma financial information, no contract of significance to which the company, any of its holding company, subsidiaries or fellow subsidiaries was a party, in which a director of the company had a material interest, whether directly or indirectly, subsisted at the end of the year or any time during the year.

## Purchase, sale or redemption of shares

Since the listing of the company's shares on 29 April 2002, neither the company nor any of its subsidiaries has purchased, sold or redeemed any of the company's shares.

## Pre-emptive rights

There is no provision for pre-emptive rights under the company's articles of association although there are no restrictions against such rights under the law in the Cayman Islands.

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## Retirement benefit schemes

The group's subsidiary in the People's Republic of China ("PRC") participates in a pension scheme and an employment insurance scheme operated by the relevant local government authorities in the PRC. Under the present regulations imposed by the relevant local government authorities, this subsidiary is required to make monthly contributions to the pension scheme at a rate of 18% of the basic salaries and wages payable to its staff in the PRC.

The group operates a mandatory provident fund scheme for its staff in Hong Kong with a mandatory provident fund provider in Hong Kong and is required to make monthly contributions to the mandatory provident fund scheme at a rate of 5% of the basic salaries and wages payable to its staff in Hong Kong.

## Application of proceeds from capital arising

The group raised approximately HK\$98.0 million, net of related expenses, from the issue of 304,000,000 new shares of the company at HK\$0.385 per share during April and May 2002. The company's shares were successfully listed on the SEHK with effect from 29 April 2002. Up to the date of this report, the group has applied part of the proceeds amounting approximately HK\$49.7 million for the following purposes:

- (i) Approximately HK\$6.7 million for the expansion of the Group's production capacity in the PRC and Cambodia by hiring more workers and purchasing additional machines in order to benefit further from economies of scale; and
- (ii) Approximately HK\$43.0 million as additional working capital of the group.

Consistent with the disclosure in the company's prospectus dated 16 April 2002, the group intends to apply the remaining proceeds of approximately HK\$48.3 million for the following purposes:

- (i) as to approximately HK\$23.3 million for the expansion of the group's production capacity in the PRC and Cambodia by hiring more workers and purchasing additional machines in order to benefit further from economies of scale;
- (ii) as to approximately HK\$10.0 million for the automation of existing production facilities in the PRC and Cambodia in order to shorten production time and improve the quality of its products;
- (iii) as to approximately HK\$10.0 million for the development of retail operation to sell Blue Cat apparels in the PRC by investing in Blue Cat Development Company Limited which was granted the rights to open Blue Cat distribution and exhibition outlets in major cities in the PRC such as Shanghai, Guangzhou, Chengdu, Wuhan, Shenyang, Xian, Tianjin and Changsha; and
- (iv) as to approximately HK\$5.0 million for the establishment of its own production facilities to print and dye fabric to extend its level of vertical integration should opportunities arise.

The remaining net proceeds from the new share issue are currently placed on short term deposits with banks in Hong Kong.

## Connected Transactions

### Exclusive manufacturing agreement

On 25 March 2002, Blue Cat Development Company Limited (“Blue Cat Development”) entered into an exclusive manufacturing agreement (the “Blue Cat Agreement”) with Blue Cat Enterprises Limited (“Blue Cat Enterprises”). Pursuant to the Blue Cat Agreement, Blue Cat Development has granted to Blue Cat Enterprises the exclusive right to manufacture clothing and apparel accessories in relation to the Blue Cat cartoon characters.

The charges for clothing and apparel accessories developed and manufactured by Blue Cat Enterprises will be subject to:

- (a) the manufacturing fee (the “Fee”) for each product shall be such price as may be agreed between the parties, it being acknowledged that Blue Cat Enterprises will give Blue Cat Development no less favourable terms than Blue Cat Enterprises would give independent customers. In any event, however, such price shall, failing agreement or in any event, be no less than Blue Cat Enterprises’ ex-factory price plus a mark up of 5%. For this purpose, ex-factory price is a price determined by Blue Cat Enterprises by reference to ex-factory prices it charges to independent customers for comparable products or in instances where the products are identical, the ex-factory price for each product to be manufactured by Blue Cat Enterprises will be no less favourable than the ex-factory prices it charges to other independent customers; and
- (b) the aggregate Fees payable by Blue Cat Development to Blue Cat Enterprises will be based on actual number of products ordered to be manufactured by Blue Cat Development, and which is subject to a maximum amount of payment (the “Annual Cap”) for each financial year from 1 April to 31 March in the following calendar years (except for the first year which begins from 25 March 2002) listed out as follows:

	Year ending 31 March 2003 (From 25 March 2002 to 31 March 2003)	Year ending 31 March 2004 (From 1 April 2003 to 31 March 2004)	Year ending 31 March 2005 (From 1 April 2004 to 31 March 2005)
The Annual Cap amount	<i>RMB25,000,000</i> (the “2002 Cap Amount”)	<i>RMB35,000,000</i> (the “2003 Cap Amount”)	<i>RMB45,000,000</i> (the “2004 Cap Amount”)

Blue Cat Development is a company incorporated in the BVI with limited liability in which Blue Cat Enterprises, Sure Profit Trading Ltd. and three independent third parties hold 5%, 51% and 44% equity interest respectively. Sure Profit Trading Ltd. is a company incorporated in the BVI with limited liability the ultimate beneficial controlling shareholder of which is Mr Kwok Wing. Accordingly, Blue Cat Development is a connected person of the company under the Listing Rules.

On this basis, the transactions pursuant to the Blue Cat Agreement (“Transactions”) have constituted connected transactions for the company under the Listing Rules upon the listing of the company’s shares on the SEHK. The directors expect that the relevant Annual Cap will exceed the higher of HK\$10 million or 3% of the net tangible assets of the group for each of the three years ending 31 March 2005. Accordingly, the Transactions are subject to disclosure and shareholders’ approval requirements under Rule 14.26 of the Listing Rules.

### Waiver from the SEHK

As the Transactions are expected to continue and occur on a regular basis upon the listing of the company’s shares on the SEHK, the directors of the company consider that it would not be practicable to make disclosure and obtain independent shareholders’ approval for the Transactions each time they occur. Consequently, the company has applied for and obtained from the SEHK for a waiver from strict compliance with Rule 14.26 of the listing rules in respect of the Transactions for the three years ending 31 March 2005 on the conditions that:

- i. the Transactions are:
  - (a) in the ordinary and usual course of business of the company;
  - (b) on normal commercial terms; and
  - (c) in accordance with the Blue Cat Agreement, on terms that are fair and reasonable so far as the shareholders of the company are concerned.

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- ii. the annual aggregated value of the Transactions for each of the three financial years ending 31st March, 2005 will not exceed, in the relevant financial year, the 2002 Cap Amount, the 2003 Cap Amount and the 2004 Cap Amount respectively;
- iii. details of the Blue Cat Agreement, as set out under Rule 14.25(1)(A) to (D) will be disclosed in the company's annual report and accounts for the relevant financial year of the group;
- iv. the independent non-executive directors will review the Blue Cat Agreement and confirm in the company's annual report and accounts for the year in question that the Transactions have been conducted in the manner as stated in paragraphs (i) and (ii) above;
- v. The auditors of the company will review the Transactions annually and provide a letter to the board of directors (a copy of which should be provided to the SEHK) confirming that:
  - (a) the Transactions have received the approval of the board of directors of the company;
  - (b) the Transactions have been carried out in accordance with the terms of the Blue Cat Agreement; and
  - (c) the Transactions have not exceeded the relevant Annual Cap;

The company will promptly notify the SEHK if it knows or has reason to believe that the independent non-executive directors and/or the auditors will not be able to confirm the matters set out above or in the event of any material changes to the terms of the Blue Cat Agreement.

The board of directors of the company (including the independent non-executive directors) is of the view that the Blue Cat Agreement is on normal commercial terms and in the ordinary course of business of the group and that the terms of the Blue Cat Agreement are fair and reasonable as far as the company and the shareholders of the company as a whole are concerned.

## Code of best practice

Since the listing of the company's shares on 29 April 2002, the company has complied with the Code of Best Practice as set out by the SEHK in Appendix 14 to the Listing Rules, except that the independent non-executive directors of the company were not appointed for a specific term but are subject to rotation in annual general meeting pursuant to the company's articles of association.

## Audit committee

In accordance with paragraph 14 of the Code of Best Practice as set out in Appendix 14 to the Listing Rules of the SEHK, the Board of Directors has established an audit committee on 29 April 2002 comprising two independent non-executive directors. The audit committee has been convened for the purpose of reviewing the company's financial reporting and internal control systems.

## Auditors

KPMG were first appointed as auditors of the company in January 2002.

KPMG retire and, being eligible, offer themselves for re-appointment. A resolution for the reappointment of KPMG as auditors of the company is to be proposed at the forthcoming annual general meeting.

By order of the board  
**Kwok Wing**  
*Chairman*

Hong Kong, 23 July 2002