

Notes to the Financial Statements

For the year ended 31st December, 2000

1. GROUP REORGANISATION AND BASIS OF PREPARATION OF FINANCIAL STATEMENTS

The Company was incorporated as an exempted company with limited liability in the Cayman Islands under the Companies Law of the Cayman Islands on 27th April, 1998. Its ultimate holding company is Joyce Services Limited (“Joyce”), a company which is incorporated in the British Virgin Islands.

Pursuant to a group reorganisation (the “Group Reorganisation”) to rationalise the group structure in preparation for the listing of the Company’s shares on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”), the Company became the holding company of the group formed after the completion of the Group Reorganisation on 5th January, 2000.

The Group Reorganisation principally involved the exchange of fully-paid shares of the Company for all of the issued shares of Hua Lien Group (Holding) Company, Limited.

The group comprising the Company and its subsidiaries (the “Group”) resulting from the Group Reorganisation is regarded as a continuing entity. Accordingly, the financial statements of the Group for the year ended 31st December, 1999 and 31st December, 2000 have been prepared on the merger basis as if the Company had always been the holding company of the Group.

Details of the Group Reorganisation are set out in the prospectus issued by the Company dated 18th January, 2000.

The shares of the Company have been listed on the Stock Exchange since 2nd February, 2000.

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention and in accordance with accounting principles generally accepted in Hong Kong. The principal accounting policies adopted are set out below:

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31st December each year.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Notes to the Financial Statements

For the year ended 31st December, 2000

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Goodwill

Goodwill represents the excess of the purchase consideration over the fair value ascribed to the Group's share of the separable net assets at the date of acquisition of a subsidiary and is eliminated against reserves immediately on acquisition. Negative goodwill, which represents the excess over the purchase consideration of the fair value ascribed to the Group's share of the separable net assets at the date of acquisition of a subsidiary, is credited to reserves.

On disposal of an investment in a subsidiary, the attributable amount of goodwill previously eliminated against or credited to reserves is included in the determination of the profit or loss on disposal.

Turnover

Turnover represents the net amounts received and receivable from third parties for goods sold during the year.

Revenue recognition

Sales of goods are recognised when goods are delivered and title has passed while service revenue is recognised when services are provided.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the interest rate applicable.

Dividend income from investments is recognised when the shareholders' right to receive payment has been established.

Investments in subsidiaries

A subsidiary is an enterprise in which the Company, directly or indirectly, holds more than half of the issued share capital, or controls more than half of the voting power, or where the Company controls the composition of its board of directors or equivalent government body.

Investments in subsidiaries are included in the Company's balance sheet at cost, as reduced by any decline in the value of the subsidiary that is other than temporary.

Notes to the Financial Statements

For the year ended 31st December, 2000

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Property, plant and equipment

Property, plant and equipment, other than construction in progress, is stated at cost less accumulated depreciation and amortisation. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after the asset has been put into operation, such as repairs and maintenance and overhaul costs, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the asset, the expenditure is capitalised as an additional cost of the asset.

The gain or loss arising from the disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in the income statement.

Where the recoverable amount of an asset has declined below its carrying amount, the carrying amount is reduced to reflect the decline in value. In determining the recoverable amount of assets, expected future cash flows are not discounted to their present values.

Construction in progress is stated at cost which includes all construction costs and other direct costs attributable to such projects. Construction in progress is not depreciated until completion of construction and the asset is being put into use. Costs of completed construction works are transferred to the appropriate categories of property, plant and equipment.

The cost of land use rights or leasehold land is amortised over the period of the rights or leases using the straight line method.

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

Buildings	2% - 5%
Furniture and equipment	20% - 25%
Motor vehicles	20%
Plant and machinery	10%

Notes to the Financial Statements

For the year ended 31st December, 2000

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Investments in securities

Investments in securities are recognised on a trade date basis and are initially measured at cost.

At subsequent reporting dates, debt securities that the Group has the expressed intention and ability to hold to maturity (held-to-maturity securities) are measured at amortised cost, less any impairment loss recognised to reflect irrecoverable amounts. Any discount or premium on the acquisition of a held-to-maturity security is aggregated with other investment income receivable over the term of the instrument so that the revenue recognised in each period represents a constant yield on the investment.

Investments other than held-to-maturity debt securities are classified as investment securities and other investments.

Investment securities, which are securities held for an identified long-term strategic purpose, are measured at subsequent reporting dates at cost, as reduced by any impairment loss that is other than temporary.

Other investments are measured at fair value, with unrealised gains and losses included in net profit or loss for the period.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost, which comprises all costs of purchase and, where applicable, costs of conversion and other costs that have been incurred in bringing the inventories to their present location and condition, is calculated using the weighted average method. Net realisable value represents the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.

Notes to the Financial Statements

For the year ended 31st December, 2000

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Research and development costs

Research costs are recognised as an expense in the period in which they are incurred.

Expenditure on development is charged to the income statement in the year in which it is incurred except where a clearly-defined project is undertaken and it is reasonably anticipated that development costs will be recovered through future commercial activity. Such development costs are capitalised as an intangible asset and amortised on a straight-line basis over the life of the project from the date of commencement of commercial operation.

Taxation

The charge for taxation is based on the results for the year as adjusted for items which are non-assessable or disallowed. Timing differences arise from the recognition for tax purposes of certain items of income and expense in a different accounting period from that in which they are recognised in the financial statements. The tax effect of timing differences, computed under the liability method, is recognised as deferred taxation to the extent that it is probable that a liability or an asset will crystallise in the foreseeable future.

Foreign currencies

Transactions in currencies other than Hong Kong dollars are initially recorded at the rates of exchange ruling on the dates of the transactions. Monetary assets and liabilities denominated in such currencies are retranslated at the rates ruling on the balance sheet date. Profits and losses arising on exchange are dealt with in the income statement for the period.

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

Operating leases

Rentals payable under operating leases are charged to the income statement on a straight line basis over the period of the respective leases.

Notes to the Financial Statements

For the year ended 31st December, 2000

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Retirement benefits scheme contributions

Contributions payable by the Group to its defined contribution retirement benefits scheme and the Hong Kong Mandatory Provident Fund scheme are charged to the income statement in the period in which they become payable.

Cash equivalents

Cash equivalents represent short term, highly liquid investments which are readily convertible into known amounts of cash and which were within three months of maturity when acquired, less advances from banks repayable within three months from the dates of the advances.

3. SEGMENTAL INFORMATION

An analysis by activity is not presented as the Group is solely engaged in the manufacture and sale of leather. A geographical analysis of the turnover and contribution to operating profit by location of market is as follows:

	Turnover		Contribution to operating profit	
	2000 HK\$'000 (Note 1)	1999 HK\$'000 (Note 1)	2000 HK\$'000 (Note 1)	1999 HK\$'000 (Note 1)
United States of America	632,758	468,667	57,469	68,627
The PRC	123,567	130,018	6,893	13,522
Thailand	25,581	38,010	1,115	7,555
Taiwan	11,300	79,979	162	16,057
Other countries	21,181	35,050	1,163	7,848
	814,387	751,724	66,802	113,609
Unallocated corporate income			12,380	5,641
Operating profit			79,182	119,250

Notes to the Financial Statements

For the year ended 31st December, 2000

4. OPERATING PROFIT

	2000 HK\$'000 (Note 1)	1999 HK\$'000 (Note 1)
Operating profit has been arrived at after charging:		
Directors' remunerations (Note 6)		
– fees	–	–
– other emoluments	2,353	195
Retirement benefits scheme contributions	155	61
Other staff costs	16,770	10,128
Total staff costs	19,278	10,384
Auditors' remuneration:		
Current year	617	635
Overprovision in prior years	(270)	–
Depreciation and amortisation	34,252	25,555
Loss on disposal of property, plant and equipment	1,585	–
Operating lease rentals in respect of land and buildings	1,319	1,303
and after crediting:		
Dividend income from other investments	–	380
Gain on disposal of subsidiaries	–	73
Gain on disposal of other investments	–	54
Gain on disposal of property, plant and equipment	–	10
Interest income	3,050	853

5. FINANCE CHARGES

	2000 HK\$'000 (Note 1)	1999 HK\$'000 (Note 1)
Interest on bank borrowings wholly repayable within five years	11,871	8,588

Notes to the Financial Statements

For the year ended 31st December, 2000

6. DIRECTORS' REMUNERATIONS

Details of remuneration paid by the Group to directors during the year are as follows:

	2000 HK\$'000 (Note 1)	1999 HK\$'000 (Note 1)
Directors' fees	–	–
Salaries and allowances of executive directors	2,353	195
Total directors' remunerations	2,353	195

The emoluments of each of the executive directors of the Company did not exceed HK\$1,000,000.

During the year, no emoluments were paid by the Group to the five highest paid individuals (including directors and employees) as an inducement to join or upon joining the Group or as compensation for loss of office. None of the directors has waived any emoluments during the year.

7. EMPLOYEES' EMOLUMENTS

The aggregate emoluments of the five highest paid individuals included three (1999: one) executive director(s) of the Company, whose emoluments are included in note 6 above. The emoluments of the remaining two (1999: four) highest paid individuals are as follows:

	2000 HK\$'000 (Note 1)	1999 HK\$'000 (Note 1)
Salaries and allowances	1,187	652

The emoluments of each of the two (1999: four) highest paid individuals did not exceed HK\$1,000,000.

Notes to the Financial Statements

For the year ended 31st December, 2000

8. TAXATION

	2000 HK\$'000 (Note 1)	1999 HK\$'000 (Note 1)
The charge comprises:		
Overprovision of Hong Kong Profits Tax in previous year	–	(21)
PRC enterprise income tax		
Current year	5,546	8,935
Overprovision in prior year	–	(361)
	5,546	8,574
	5,546	8,553

Pursuant to the relevant laws and regulations in the PRC, all the Group's PRC subsidiaries are entitled to exemption from PRC enterprise income tax for the first two years commencing from their first profit-making year of operation and thereafter, these PRC subsidiaries will be entitled to a 50% relief from PRC enterprise income tax for the following three years. During the year, one of the PRC subsidiaries had applied for and obtained the 50% relief from PRC enterprise income tax for another three years on expiry of the original tax relief period. The reduced tax rate for the relief period, including the extended period of that subsidiary, is 12%. The charge of PRC enterprise income tax for the year has been provided for after taking these tax incentives into account.

No provision for Hong Kong Profits Tax has been made in the financial statements as the companies operating in Hong Kong did not have any estimated assessable income.

A portion of the Group's profit is not subject to taxation in the jurisdiction in which it operates.

There was no significant unprovided deferred taxation for the year or at the balance sheet date.

Notes to the Financial Statements

For the year ended 31st December, 2000

9. PROFIT FOR THE YEAR

Of the Group's profit for the year, a profit of HK\$26,573,000 (1999: nil) has been dealt with in the financial statements of the Company.

10. DIVIDENDS

The directors of the Company recommended a final dividend of 1 Hong Kong cent per share for the year ended 31st December, 2000 (1999: nil). No interim dividend was paid during the year (1999: nil).

The final dividend proposed for the year was calculated with reference to 686,400,000 shares in issue as at the date of this report.

11. EARNINGS PER SHARE

The calculation of the earnings per share for the year is based on profit for the year of HK\$52,526,000 (1999: HK\$88,375,000) and on the weighted average number of 681,322,521 shares (1999: 617,760,000 shares) in issue during the year. For the year ended 31st December, 1999, the 617,760,000 shares in issue were calculated on the assumption that the Group Reorganisation described in note 1 and the capitalisation issue of 598,566,004 shares of the Company as set out in note 21 had been effective as at 1st January, 1999.

The Company has no dilutive potential ordinary shares in both years.

Notes to the Financial Statements

For the year ended 31st December, 2000

12. PROPERTY, PLANT AND EQUIPMENT

	THE GROUP					Total HK\$'000
	Land and buildings	Furniture and equipment	Motor vehicles	Plant and machinery	Con- struction in progress	
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	
COST						
At 1st January, 2000						
(Note 1)	114,748	27,470	7,909	243,801	69,558	463,486
Currency realignment	1,055	254	74	2,396	656	4,435
Additions	33,444	872	484	8,527	29,854	73,181
Transfer	13,432	452	–	36,746	(50,630)	–
Disposals	(2,910)	(411)	–	(241)	–	(3,562)
At 31st December, 2000	159,769	28,637	8,467	291,229	49,438	537,540
DEPRECIATION AND AMORTISATION						
At 1st January, 2000						
(Note 1)	18,729	22,719	6,710	61,229	–	109,387
Currency realignment	171	210	64	584	–	1,029
Provided for the year	4,764	4,680	568	24,240	–	34,252
Eliminated on disposals	(550)	(262)	–	–	–	(812)
At 31st December, 2000	23,114	27,347	7,342	86,053	–	143,856
NET BOOK VALUE						
At 31st December, 2000	136,655	1,290	1,125	205,176	49,438	393,684
At 31st December, 1999						
(Note 1)	96,019	4,751	1,199	182,572	69,558	354,099

Notes to the Financial Statements

For the year ended 31st December, 2000

12. PROPERTY, PLANT AND EQUIPMENT (Cont'd)

The net book value of the Group's property interests at 31st December, 2000 comprised:

	THE GROUP	
	2000	1999
	HK\$'000	HK\$'000
		(Note 1)
Properties held under medium-term land use rights in the PRC	172,210	107,956
Properties held under a medium-term lease in Hong Kong	–	2,377
	172,210	110,333

13. INTERESTS IN SUBSIDIARIES

	THE COMPANY	
	2000	1999
	HK\$'000	HK\$'000
Unlisted shares, at cost	476,175	–
Amounts due from subsidiaries	52,933	–
	529,108	–

The carrying value of the unlisted shares is based on the book values of the underlying net assets of the subsidiaries attributable to the Group as at the date on which the Company became the holding company of the Group under the Group Reorganisation as explained in note 1.

Details of the Company's subsidiaries at 31st December, 2000 are set out in note 32.

In the opinion of the directors, the amounts due from subsidiaries are unlikely to be repaid within one year from the balance sheet date and are therefore shown in the balance sheet as non-current.

Notes to the Financial Statements

For the year ended 31st December, 2000

14. INVESTMENT SECURITIES

	THE GROUP	
	2000 HK\$'000	1999 HK\$'000 (Note 1)
Capital contribution, at cost	926	926

The investment represents the Group's 5% equity interest in 山東高泰鞋業集團股份有限公司 which was established in the PRC as a limited liability company and is engaged in the manufacture and sale of shoes and other leather products.

The directors are of the opinion that the investment is worth at least its carrying value.

15. INVENTORIES

	THE GROUP	
	2000 HK\$'000	1999 HK\$'000 (Note 1)
Raw materials	81,614	88,011
Work in progress	150,759	126,974
Finished goods	9,616	57,767
	241,989	272,752

Notes to the Financial Statements

For the year ended 31st December, 2000

16. TRADE AND OTHER RECEIVABLES

The Group has a policy of allowing an average credit period of 60 days to its trade customers. Included in trade and other receivables are trade receivables of HK\$169,074,000 (1999: HK\$118,340,000), the aged analysis of which at the balance sheet date is as follows:

	THE GROUP	
	2000 HK\$'000	1999 HK\$'000 (Note 1)
Up to 30 days	88,718	76,005
31 - 60 days	31,029	39,890
61 - 90 days	28,714	2,445
More than 90 days	20,613	—
	169,074	118,340

17. AMOUNT DUE FROM ULTIMATE HOLDING COMPANY

The amount is unsecured, interest-free and repayable on demand. The maximum amount outstanding during the year was approximately HK\$14,000.

18. TRADE AND OTHER PAYABLES

Included in trade and other payables are trade payables of HK\$16,621,000 (1999: HK\$24,026,000), the aged analysis of which at the balance sheet date is as follows:

	THE GROUP	
	2000 HK\$'000	1999 HK\$'000 (Note 1)
Up to 30 days	12,331	18,137
31 - 60 days	2,078	5,729
61 - 90 days	757	—
More than 90 days	1,455	160
	16,621	24,026

Notes to the Financial Statements

For the year ended 31st December, 2000

19. LOAN FROM A DIRECTOR

The loan from Mr. Liaw Yuan Chian (“Mr. Liaw”) is unsecured and interest-free. As at 31st December, 1999, repayment of a portion of the loan amounting to HK\$4,800,000 was subordinated (the “Subordination”) to certain bank borrowings granted to the Group, and the remaining balance of the loan was repayable in January 2001, subject to the availability of adequate financial resources for that purpose by that time. During the year, the Subordination was released upon the listing of the Company’s shares on the Stock Exchange and accordingly the Group repaid part of the loan to the director.

20. BANK LOANS

	THE GROUP	
	2000	1999
	HK\$'000	HK\$'000
		(Note 1)
Secured bank loans	74,958	152,073
Unsecured bank loans	96,107	2,804
	171,065	154,877
The bank loans are repayable:		
Within one year	169,623	150,766
One to two years	1,442	2,685
Two to five years	–	1,426
	171,065	154,877
Less: Amount due within one year shown under current liabilities	(169,623)	(150,766)
Due after one year	1,442	4,111

Notes to the Financial Statements

For the year ended 31st December, 2000

21. SHARE CAPITAL

	Number of shares	Value HK\$'000
Authorised:		
Ordinary shares of HK\$0.10 each		
At 1st January, 1999 and 1st January, 2000	3,500,000	350
Increase during the year	1,496,500,000	149,650
At 31st December, 2000	<u>1,500,000,000</u>	<u>150,000</u>
Issued and fully paid:		
Ordinary shares of HK\$0.10 each		
At 1st January, 1999 and 1st January, 2000	2	–
Issue of shares as consideration for the acquisition of a subsidiary pursuant to the Group Reorganisation	19,193,994	1,919
Capitalisation issue of shares	598,566,004	59,857
Issue of new shares upon listing of the Company's shares on the Stock Exchange	68,640,000	6,864
At 31st December, 2000	<u>686,400,000</u>	<u>68,640</u>

Details of the changes in the Company's share capital for the two years ended 31st December, 2000 are as follows:

- (a) The Company was incorporated on 27th April, 1998 with an authorised share capital of HK\$350,000 divided into 3,500,000 shares of HK\$0.10 each. On 27th April, 1998, two shares of HK\$0.10 each were allotted and issued, for cash at par, to provide the initial capital to the Company. At 31st December, 1999, the Company's issued and fully paid capital was HK\$0.20. The amount of issued share capital as at 31st December, 1999 had not been disclosed in the Company's balance sheet as the amount was insignificant.

Notes to the Financial Statements

For the year ended 31st December, 2000

21. SHARE CAPITAL (Cont'd)

- (b) By written resolutions of the then sole shareholder of the Company dated 3rd January, 2000:
- (i) the authorised share capital of the Company was increased from HK\$350,000 to HK\$150,000,000 by the creation of an additional 1,496,500,000 shares with a nominal value of HK\$0.10 each;
 - (ii) the Company issued an aggregate of 19,193,994 new shares of HK\$0.10 each in the Company, credited as fully paid, as consideration for the acquisition of the entire issued voting share capital of Hua Lien Group (Holding) Company, Limited.
- (c) On 4th January, 2000, further resolutions were passed by the Company to effect the following:
- (i) approximately HK\$54,178,000 and HK\$5,679,000 was directed to be capitalised against the share premium account and contributed surplus of the Company respectively and applied in paying up in full 598,566,004 shares of HK\$0.10 each in total for allotment and issue to the members of the Company at the close of business on 17th January, 2000.
 - (ii) the Company issued 68,640,000 new ordinary shares of HK\$0.10 each for cash at HK\$1 per share on 27th January, 2000 (the "New Issue") in accordance with the terms as set out in the Company's prospectus dated 18th January, 2000 in connection with the listing of the Company's shares on the Stock Exchange. During the year, HK\$27,997,000 from the New Issue was applied to finance the Group's construction of a new workshop in the PRC, HK\$738,000 was applied to the purchase of new machinery and equipment and HK\$2,491,000 was applied to the improvement of the waste water treatment facilities.

For the purpose of the preparation of the financial statements, the balance of the share capital shown in the consolidated balance sheet at 31st December, 1999 represented the issued capital of Hua Lien Group (Holding) Company, Limited which was acquired by the Company on 3rd January, 2000 pursuant to the Group Reorganisation.

22. SHARE OPTIONS

A share option scheme was adopted by the Company on 4th January, 2000, under which the directors and employees of the Company and its subsidiaries may be granted options to subscribe for shares in the Company. No share option has been granted under the share option scheme since its adoption.

Notes to the Financial Statements

For the year ended 31st December, 2000

23. RESERVES

	Share premium	Translation reserve	Goodwill reserve	Special reserve	Con-tributed surplus	PRC statutory reserves	Other capital reserve	Retained profits	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
				(Note i)	(Note ii)	(Note iii)	(Note iv)		
THE GROUP									
At 1st January, 1999 (Note 1)	-	4,713	(24,509)	17,009	-	9,514	75,266	157,867	239,860
Profit for the year	-	-	-	-	-	-	-	88,375	88,375
Transfer	-	-	-	-	-	1,972	-	(1,972)	-
Minority share of reserve	-	-	-	-	-	(671)	-	-	(671)
At 31st December, 1999 and 1st January, 2000 (Note 1)	-	4,713	(24,509)	17,009	-	10,815	75,266	244,270	327,564
Premium arising on New Issue	61,776	-	-	-	-	-	-	-	61,776
Share issue expenses	(7,598)	-	-	-	-	-	-	-	(7,598)
Capitalisation issue	(54,178)	-	-	-	-	-	-	(5,679)	(59,857)
Exchange differences arising from translation of operations in the PRC	-	1,901	-	-	-	-	-	-	1,901
On Group Reorganisation	-	-	-	221,957	-	-	(75,266)	-	146,691
Transfer	-	-	-	-	-	1,334	-	(1,334)	-
Minority share of reserve	-	(134)	-	-	-	(320)	-	-	(454)
Profit for the year	-	-	-	-	-	-	-	52,526	52,526
Dividends (Note 10)	-	-	-	-	-	-	-	(6,864)	(6,864)
At 31st December, 2000	-	6,480	(24,509)	238,966	-	11,829	-	282,919	515,685
THE COMPANY									
At 1st January, 1999 and at 1st January, 2000	-	-	-	-	-	-	-	-	-
Premium arising on New Issue	61,776	-	-	-	-	-	-	-	61,776
Share issue expenses	(7,598)	-	-	-	-	-	-	-	(7,598)
Capitalisation issue	(54,178)	-	-	-	(5,679)	-	-	-	(59,857)
On Group Reorganisation	-	-	-	-	474,255	-	-	-	474,255
Profit for the year (Note 9)	-	-	-	-	-	-	-	26,573	26,573
Dividends (Note 10)	-	-	-	-	-	-	-	(6,864)	(6,864)
At 31st December, 2000	-	-	-	-	468,576	-	-	19,709	488,285

Notes to the Financial Statements

For the year ended 31st December, 2000

23. RESERVES (Cont'd)

At 31st December, 2000, the Company's reserves available for distribution to shareholders of approximately HK\$488,285,000 comprised the contributed surplus and the retained profits of approximately HK\$468,576,000 (1999: nil) and approximately HK\$19,709,000 (1999: nil), respectively.

Note:

- (i) The special reserve of the Group at 1st January, 1999 and 31st December, 1999 represented the difference between the nominal amount of the share capital issued by Hua Lien Group (Holding) Company, Limited and the nominal amount of the share capital of its then subsidiaries acquired pursuant to a group reorganisation in 1995.

The special reserve of the Group arising during the year represents the difference between the nominal amount of the ordinary share capital issued by the Company in exchange for the nominal amount of the share capital of Hua Lien Group (Holding) Company, Limited acquired pursuant to the Group Reorganisation as set out in note 1.

- (ii) The contributed surplus of the Company represents the difference between the book value of the underlying net assets of the subsidiaries acquired by the Company under the Group Reorganisation and the nominal value of the Company's shares issued for the acquisition.

- (iii) PRC statutory reserves refer to the statutory surplus reserve fund and enterprise expansion fund. As stipulated by the relevant laws and regulations for foreign investment enterprises in the PRC, the PRC subsidiaries of the Group are required to provide for three reserve funds, being a statutory surplus reserve fund, an enterprise expansion fund and a staff welfare and incentive bonus fund. Appropriations to such reserve funds are made out of net profit after taxation of the statutory financial statements of the PRC subsidiaries and the amount and allocation basis are decided by their respective board of directors annually. The statutory surplus reserve fund can be used to make up prior year losses of the PRC subsidiaries, if any, and can be applied in conversion into capital by means of capitalisation issue. The enterprise expansion fund is used for expanding the capital base of the PRC subsidiaries by means of capitalisation.

The amounts transferred to the staff welfare and incentive bonus fund in the statutory financial statements of the PRC subsidiaries have been adjusted in the consolidated financial statements as cost of sales as in the opinion of the directors, this fund will be used to pay incentive bonus and other benefits to the PRC subsidiaries' employees.

- (iv) Other capital reserve represents reserve arising on issue of shares by Hua Lien Group (Holding) Company, Limited prior to the Group Reorganisation.

Notes to the Financial Statements

For the year ended 31st December, 2000

24. RECONCILIATION OF PROFIT FROM ORDINARY ACTIVITIES BEFORE TAXATION TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	2000 HK\$'000 (Note 1)	1999 HK\$'000 (Note 1)
Profit from ordinary activities before taxation	67,311	110,662
Depreciation and amortisation of property, plant and equipment	34,252	25,555
Gain on disposal of subsidiaries	-	(73)
Gain on disposal of other investments	-	(54)
Loss (gain) on disposal of property, plant and equipment	1,585	(10)
Dividend income from other investments	-	(380)
Interest income	(3,050)	(853)
Interest expense	11,871	8,588
Decrease (increase) in inventories	29,215	(62,381)
Increase in trade and other receivables	(57,815)	(47,309)
Increase in amount due from ultimate holding company	(14)	-
(Decrease) increase in trade and other payables	(11,422)	21,149
Increase in bills payable	2,780	2,902
Decrease in amounts due to minority shareholders	(2,192)	-
Increase in amounts due to related parties	-	12,829
Net cash inflow from operating activities	72,521	70,625

Notes to the Financial Statements

For the year ended 31st December, 2000

25. DISPOSAL OF SUBSIDIARIES

	2000 HK\$'000 (Note 1)	1999 HK\$'000 (Note 1)
Net assets disposed of:		
Bank balances	-	4
Trade and other payables	-	(77)
Proceeds	-	-
Gain on disposal of subsidiaries	-	73
Analysis of net cash outflow on disposal of subsidiaries:		
Bank balances disposed	-	(4)
Proceeds received	-	-
	-	(4)

The subsidiaries disposed of had no significant impact on the Group's cash flows or operating results for the year ended 31st December, 1999.

Notes to the Financial Statements

For the year ended 31st December, 2000

26. ANALYSIS OF CHANGES IN FINANCING DURING THE YEAR

	Bank loans with original maturity of more than 3 months	Loan from a director	Minority interests	Share capital (including share premium)
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1st January, 1999 (Note 1)	112,334	26,291	60,669	148,610
Dividends paid to minority shareholders	–	–	(15,196)	–
Profit for the year attributable to minority shareholders	–	–	13,734	–
Reserves attributable to minority shareholders	–	–	671	–
Amount offsetting against amounts due from related parties	–	(5,570)	–	–
Borrowings raised	29,084	–	–	–
Repayment of loans	(280)	–	–	–
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At 31st December, 1999 and 1st January, 2000 (Note 1)	141,138	20,721	59,878	148,610
Currency realignment	–	(960)	–	–
On Group Reorganisation	–	–	–	(146,691)
Issue of shares on New Issue	–	–	–	68,640
Expenses incurred on New Issue	–	–	–	(7,598)
Capitalisation issue	–	–	–	5,679
Dividends paid to minority shareholders	–	–	(13,798)	–
Profit for the year attributable to minority shareholders	–	–	9,239	–
Reserves attributable to minority shareholders	–	–	454	–
Borrowings raised	23,585	867	–	–
Repayment of loans	(19,371)	(15,561)	–	–
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At 31st December, 2000	145,352	5,067	55,773	68,640

Notes to the Financial Statements

For the year ended 31st December, 2000

27. ANALYSIS OF THE BALANCES OF CASH AND CASH EQUIVALENTS

	2000 HK\$'000	1999 HK\$'000 (Note 1)
Bank balances and cash	46,782	13,395
Trust receipt and import loans	(25,713)	(13,739)
	21,069	(344)

28. COMMITMENTS

(a) Operating lease commitments:

THE GROUP

A subsidiary was committed to make rental payments to 西安市人民制革廠 (Xian People's Tannery Factory) ("Xian People's Tannery") amounting to HK\$1,155,000 (1999: HK\$1,144,000) within one year in respect of land and buildings under a non-cancellable operating lease which expires in December 2012.

At 31st December, 2000, another subsidiary was also committed to make rental payments to a third party amounting to HK\$150,000 (1999: HK\$164,000) within one year in respect of land and buildings under a non-cancellable operating lease which expires in December 2001.

THE COMPANY

The Company did not have any significant operating lease commitments at the balance sheet date.

Notes to the Financial Statements

For the year ended 31st December, 2000

28. COMMITMENTS (Cont'd)

(b) Capital commitments:

Capital expenditure contracted for but not provided in the financial statements in respect of the acquisition of property, plant and equipment

THE GROUP	
2000	1999
HK\$'000	HK\$'000
	(Note 1)
4,969	3,194

The Company did not have any significant capital commitments at the balance sheet date.

(c) Other:

Under the terms of the cooperative joint venture agreement in respect of Xin Hui Hua Lien Tannery Co., Ltd. ("Xin Hui Hua Lien"), a subsidiary of the Company, Galloon International (Holding) Company, Limited ("Galloon International") is entitled to all of the net profit or loss of Xin Hui Hua Lien throughout the entire cooperative joint venture period after the payment of a pre-determined distribution by Xin Hui Hua Lien each year to the PRC joint venture partner. In the event that Xin Hui Hua Lien does not have sufficient distributable profit to make the required payments to the PRC joint venture partner, Galloon International is responsible for making such payments to the PRC joint venture partner as compensation. At 31st December, 2000, the pre-determined distributions to be paid to the PRC joint venture partner over the entire cooperative joint venture period are as follows:

	THE GROUP	
	2000	1999
	HK\$'000	HK\$'000
		(Note 1)
Amount payable:		
Within one year	5,239	5,239
One to two years	5,239	5,239
Two to five years	15,716	15,716
Over five years	75,516	80,755
	101,710	106,949

The Company did not have any significant other commitments at the balance sheet date.

Notes to the Financial Statements

For the year ended 31st December, 2000

29. BANKING FACILITIES

At 31st December, 2000, the Group's banking facilities were secured by the following:

- (i) certain of the Group's leasehold land and buildings with a carrying value of approximately HK\$87 million;
- (ii) bank deposits of the Group of approximately HK\$11 million;
- (iii) cross-guarantees between subsidiaries;
- (iv) the Company's corporate guarantee (at the balance sheet date, the aggregate amounts utilised by these subsidiaries amounted to approximately HK\$8,273,000);
- (v) corporate guarantee given by Xian People's Tannery; and
- (vi) certain of the plant and machinery of Xian Hua Lien Tannery Co., Ltd ("Xian Hua Lien") with an aggregate carrying value of approximately HK\$38 million.

At 31st December, 1999, the Group's banking facilities were secured by the following:

- (i) certain of the Group's leasehold land and buildings with a carrying value of approximately HK\$59 million;
- (ii) bank deposits of the Group of approximately HK\$5.1 million;
- (iii) cross guarantees between subsidiaries;
- (iv) personal guarantees given by Mr. Liaw, Mr. Lin Ching Wen and Mr. Loh Wee Ming;
- (v) property interests owned by Xian People's Tannery; and
- (vi) all the assets of Xian Hua Lien with an aggregate carrying value of approximately HK\$247 million.

In addition, an amount due to Mr. Liaw to the extent of HK\$4.8 million was subordinated to certain bank borrowings granted to the Group at 31st December, 1999.

The Company did not have any banking facilities at the year end date.

Notes to the Financial Statements

For the year ended 31st December, 2000

30. RETIREMENT BENEFITS SCHEME

The Company and its subsidiaries operating in Hong Kong do not operate any retirement schemes covering their local permanent employees. In November 2000, the Company enrolled all eligible employees in Hong Kong into a Mandatory Provident Fund (“MPF”) scheme. The retirement benefit cost for the MPF scheme charged to the income statement represents contributions payable to the MPF scheme by the Group at rates specified in the rules of the MPF scheme.

The PRC subsidiaries are required to contribute a certain percentage, ranging from 18% to 20%, of the payroll of their employees to the retirement benefits schemes to fund the benefits. The only obligation of the Group with respect to the retirement benefits schemes is to make the required contributions under the respective schemes. At the balance sheet date, there were no significant forfeited contributions, which arose upon employees leaving the retirement benefits schemes, available to reduce the contribution payable in the future periods.

31. RELATED PARTY TRANSACTIONS AND BALANCES

During the year, the Group had certain transactions with related parties. Details of these transactions for the year and balances at 31st December, 2000 with these related parties are as follows:

(a) Transactions

A subsidiary entered into a lease agreement (the “Lease Agreement”) with Xian People’s Tannery, its minority shareholder, to lease from Xian People’s Tannery the land use rights related to the site on which the factory building of the subsidiary is located at a monthly rental of RMB102,000 (approximately HK\$95,000). During the year, the Group paid rental expense of approximately HK\$1,155,000 (1999: HK\$1,227,000) and the amount paid was in accordance with terms of the Lease Agreement.

(b) Balances

Details of balances with the related parties at the balance sheet date are set out in the consolidated balance sheet, notes 17 and 19 respectively.

(c) Other

- (1) The Group was committed to pay a pre-determined distribution to the PRC joint venture partner of Xin Hui Hua Lien, details of which are set out in note 28(c).
- (2) The Group’s banking facilities were secured by guarantee given by a related party, details of which are set out in note 29.

Notes to the Financial Statements

For the year ended 31st December, 2000

32. SUBSIDIARIES

Details of the Company's subsidiaries at 31st December, 2000 are as follows:

Name of company	Place of incorporation/ operations	Nominal value of issued and fully paid share capital/ registered capital	Effective proportion of issued/ registered capital held by the Group	Principal activities
Hua Lien Group (Holding) Company, Limited ("Hua Lien Group (Holding)")	British Virgin Islands/Hong Kong	Ordinary shares US\$19,193,996 Note (i)	100%	Investment holding
Galloon International (Holding) Company, Limited ("Galloon International")	British Virgin Islands/Taiwan	Ordinary shares US\$1	100%	Sale and marketing of leather, raw materials sourcing and investment holding
Hua Lien (Hong Kong) Company Limited ("Hua Lien Hong Kong")	Hong Kong	Ordinary shares HK\$10,000 Non-voting deferred shares HK\$15,000,000 Note (ii)	100%	Provision of management services
新會華聯製皮工業有限公司 Xin Hui Hua Lien Tannery Co., Ltd.	PRC	Registered capital US\$14,522,000	70.5% Note (iii)	Manufacture and sale of leather
新會嘉聯皮革工業有限公司 Xin Hui Galloon Tannery Co., Ltd. ("Xin Hui Galloon")	PRC	Registered capital US\$21,700,000 Note (iv)	100%	Manufacture and sale of leather
西安華聯製皮工業有限公司 Xian Hua Lien Tannery Co., Ltd.	PRC	Registered capital US\$7,530,000	51% Note (v)	Manufacture and sale of leather

Notes to the Financial Statements

For the year ended 31st December, 2000

32. SUBSIDIARIES (Cont'd)

Notes:

- (i) Hua Lien Group (Holding) is held by the Company directly. All other subsidiaries are held by the Company indirectly.
- (ii) The deferred shares of Hua Lien Hong Kong, which are not held by the Group, practically carry no rights to dividends or to receive notice of or to attend or vote at any of its general meetings or to participate in any distribution on its winding up.
- (iii) Xin Hui Hua Lien was initially established as a limited liability equity joint venture enterprise for a term of 20 years commencing 27th August, 1992. Pursuant to a management agreement (the "Management Agreement") entered into between Galloon International and Xin Hui Hua Lien, Galloon International guaranteed that Xin Hui Hua Lien's distributable profit would reach pre-determined levels (the "Guaranteed Profit") for each of the five years commencing 1st April, 1996. In the event that Xin Hui Hua Lien failed to make the Guaranteed Profit, Galloon International would be responsible to pay such Guaranteed Profit to Xin Hui Hua Lien to ensure that its distributable profit reached such levels. If the distributable profit of Xin Hui Hua Lien exceeded the Guaranteed Profit, Galloon International would be entitled to all such excess profits.

On 26th June, 1998, Xin Hui Hua Lien was converted into a limited liability cooperative joint venture enterprise and its term of operation was extended to 26th August, 2022. The Management Agreement was then terminated. Under the terms of the cooperative joint venture agreement, Galloon International holds 70.5% of the registered capital of Xin Hui Hua Lien, but it is entitled to all of the net profit or loss of Xin Hui Hua Lien throughout the entire cooperative joint venture period, after the payment of a pre-determined distribution by Xin Hui Hua Lien each year to the cooperative joint venture partner, details of which are set out in note 28(c).

At the end of the cooperative joint venture period, Galloon International is entitled to the distribution of all the remaining assets of Xin Hui Hua Lien according to its capital contribution ratio in Xin Hui Hua Lien.

- (iv) During the year, Xin Hui Galloon increased its registered capital from US\$14,000,000 to US\$21,700,000. As at the date of this report, the registered capital of Xin Hui Galloon was paid up to the extent of US\$14,000,000 (1999: US\$7,833,436).

Notes to the Financial Statements

For the year ended 31st December, 2000

32. SUBSIDIARIES (Cont'd)

- (v) The Group holds a 51% equity interest in Xian Hua Lien with the remaining 49% held by Xian People's Tannery. Xian Hua Lien was established on 18th December, 1992 as a limited liability sino-foreign equity joint venture enterprise ("EJV") for a term of operation of 20 years. Since the establishment of Xian Hua Lien, Xian People's Tannery received 40% of the profit distribution made by Xian Hua Lien in respect of the period from the date of its establishment to 31st December, 2000 (rather than in proportion to the 49% equity interest that it holds in Xian Hua Lien) and, pursuant to an agreement dated 31st December, 2000 made between Galloon International, Hua Lien Hong Kong, Xian Hua Lien and itself, Xian People's Tannery waived its remaining entitlement to such profit distribution in favour of the Group. The Group therefore effectively had a 60% attributable economic interest in Xian Hua Lien for the period from the date of establishment of Xian Hua Lien to 31st December, 2000.

At the end of the joint venture period, the Group is entitled to the distribution of all the remaining assets in Xian Hua Lien according to its capital contribution ratio in Xian Hua Lien.

In May 2000, Xian Hua Lien was converted into a limited liability sino-foreign cooperative joint venture enterprise ("CJV") with the same operating terms. According to the conversion document, the conversion would be effective on issuance of the renewed business licence, which had not been issued up to the date of this report. As a result, Xian Hua Lien continues to be treated as an EJV at the balance sheet date. Under the terms of the joint venture agreement of the CJV, Xian People's Tannery would entitle to receive 39% of the profit distribution each year from Xian Hua Lien, rather than in proportion to the 49% equity interest that it holds in Xian Hua Lien as an EJV.

None of the subsidiaries had any debt securities outstanding at the end of the year, or at any time during the year.