

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

1. GENERAL

The Company is incorporated in Bermuda as an exempted company with limited liability and its shares are listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). Its ultimate holding company is Stangee International Limited, a company incorporated in the British Virgin Islands.

The Company acts as an investment holding company. The principal activities of its subsidiaries are set out in note 16.

The Group's accounting books and records are maintained in Hong Kong dollars, the currency in which the majority of its transactions is denominated.

2. BASIS OF PREPARATION OF FINANCIAL STATEMENTS

In preparing the financial statements, the directors have given careful consideration to the future liquidity of the Group in the light of its loss for the year ended March 31, 2001 of HK\$137,958,000 and its net current liabilities of HK\$150,092,000 at that date.

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During the year and subsequent to the balance sheet date, the banking facilities utilised by the Group exceeded the limits offered by its principal bankers. As explained in note 41, the Group has reached an informal standstill understanding with its principal bankers, one of which has subsequently confirmed the informal standstill in writing. To date, no further action has been taken by any of the Group's bankers. However, as a consequence of the standstill arrangements, the Group's production facilities have operated below capacity subsequent to the balance sheet date because of working capital constraints.

At the same time, as explained in note 41, claims have been brought against the Group by certain creditors with an aggregate amount claimed at the reporting date amounting to HK\$30,252,000 and the Group is in the process of negotiating with certain other creditors to postpone the repayment of the amounts due to them.

Against this background, the Group is currently in discussion with its principal bankers to secure their ongoing support for the Group. At the same time, as further explained in note 41, subsequent to the balance sheet date, the Group has been in discussion with potential investors in order to obtain additional funds for its operations.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

2. BASIS OF PREPARATION OF FINANCIAL STATEMENTS *(continued)*

Provided that agreement can be reached with the Group's principal bankers to secure their continued support for the Group and that the Group can obtain sufficient additional funds from new investors, the directors are satisfied that the Group has sufficient working capital to restore its production facilities to normal capacity and that the Group will be able to meet in full its financial obligations as they fall due for the foreseeable future. The financial statements are prepared on a going concern basis.

3. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention, as modified for the revaluation of certain investments in securities.

The financial statements have been prepared in accordance with accounting principles generally accepted in Hong Kong. The principal accounting policies adopted are set out as follows:

Basis of consolidation

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

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

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

Investments in subsidiaries

A subsidiary is an enterprise in which the Company, directly and 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 governing body.

Investments in subsidiaries are included in the Company's balance sheet at cost as reduced by any impairment loss that is other than temporary. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

Revenue recognition

Sales of goods are recognised when goods are delivered and title has passed.

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

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

Property, plant and equipment

Property, plant and equipment are stated at cost less depreciation or amortisation. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its present working condition and location for its intended use. Expenditure incurred after the assets have 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 assets, 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 sales proceeds and the carrying amount of the asset and is recognised in the income statement.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

3. SIGNIFICANT ACCOUNTING POLICIES (continued)**Property, plant and equipment** (continued)

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.

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

Leasehold land	Over the term of the relevant lease
Buildings	4%
Leasehold improvements	20%
Equipment, furniture and fixtures	20%
Plant and machinery	20%
Motor vehicles	20%

Assets held under hire purchase contracts and finance leases, which contain provisions giving the lessees an option to acquire title to the asset upon the fulfilment of agreed conditions, are depreciated over their estimated useful lives on the same basis as assets owned by the Group.

Foreign currencies

Transactions in foreign currencies are translated at the rates ruling on the dates of the transactions or at the contracted settlement rate, if applicable. Monetary assets and liabilities denominated in foreign currencies are re-translated at the rates ruling on the balance sheet date. Gains and losses arising on translation are dealt with in the income statement.

On consolidation, the financial statements of subsidiaries which are denominated in currencies other than Hong Kong dollars are translated at the rates ruling on the balance sheet date. All exchange differences arising on consolidation are dealt with in the translation reserve.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Finance leases and hire purchase contracts

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership of the assets concerned to the Group. Assets held under finance leases are capitalised at their fair value at the dates of acquisition. The corresponding liability to the lessor, net of interest charges, is included in the balance sheet as a finance lease obligation. Finance costs, which represent the difference between the total leasing commitments and the original principal amounts at the inception of the leases, are charged to the income statement over the period of the relevant lease so as to produce a constant periodic rate of charge on the remaining balances of the obligations for each accounting period.

All other leases are classified as operating leases and the rentals are charged to the income statement on a straight line basis over the relevant lease terms.

Assets held under hire purchase contracts are accounted for on the same basis as finance leases.

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 using the liability method, is recognised as deferred taxation in the financial statements to the extent that it is probable that a liability or an asset will crystallise in the foreseeable future.

Intangible assets

Expenditure on research and development is charged to the income statement in the year in which it is incurred except where a major project is undertaken and it is reasonably anticipated that development costs will be recovered through future commercial activity. Such development costs are deferred and written off over the life of the project from the date of commencement of commercial operation subject to a maximum of five years or the anticipated product life of the merchandise being developed, whichever is the shorter.

Technical know-how is stated at cost less amortisation and accumulated impairment losses. The cost is amortised on a straight line basis over three years. The amortisation period and the amortisation method are reviewed at each financial year end. An impairment loss is recognised when the estimated recoverable amount of the asset has declined below its carrying amount.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

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 first-in, first-out 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.

Investments in securities

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

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.

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 date of the advances.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

4. TURNOVER AND SEGMENTAL INFORMATION

The Group's turnover and contribution to (loss) profit before taxation analysed by principal activity are as follows:

	Turnover		Contribution to (loss) profit before taxation	
	2001 HK\$'000	2000 HK\$'000	2001 HK\$'000	2000 HK\$'000
Assembly and sales of goods				
Electronic organisers and other electronic consumables	473,867	578,872	(54,205)	34,024
Liquid crystal display ("LCD") modules and LCD panels	259,795	311,341	(38,393)	31,620
Telecommunications products	253,664	17,844	(40,220)	(23,635)
	<u>987,326</u>	<u>908,057</u>	<u>(132,818)</u>	<u>42,009</u>
Other revenue			1,704	2,604
Unallocated administrative expenses			(1,166)	(678)
Unallocated finance costs			(9,964)	(1,758)
Goodwill of a subsidiary written off			(117)	—
(Loss) profit before taxation			<u>(142,361)</u>	<u>42,177</u>

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

4. TURNOVER AND SEGMENTAL INFORMATION (continued)

An analysis of the Group's turnover and contribution to (loss) profit before taxation analysed by geographical market is as follows:

	Turnover		Contribution to (loss) profit before taxation	
	2001 HK\$'000	2000 HK\$'000	2001 HK\$'000	2000 HK\$'000
Europe	435,776	304,817	(64,278)	1,655
Asia	325,605	350,289	(39,050)	20,874
United States of America	219,478	223,340	(28,601)	16,921
Mexico	—	19,156	—	1,945
Others	6,467	10,455	(889)	614
	987,326	908,057	(132,818)	42,009
Other revenue			1,704	2,604
Unallocated administrative expenses			(1,166)	(678)
Unallocated finance costs			(9,964)	(1,758)
Goodwill of a subsidiary written off			(117)	—
(Loss) profit before taxation			(142,361)	42,177

5. COST OF SALES

Included in cost of sales is an amount of HK\$40,033,000 (2000: HK\$23,116,000) in respect of write-down of obsolete inventories and specific provision for certain raw materials.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

6. OTHER REVENUE

	2001 HK\$'000	2000 HK\$'000
The amount comprises:		
Dividends from listed investments	66	46
Interest earned on bank deposits	447	1,451
Net foreign exchange gain	—	598
Profit on disposal of plant and equipment	388	—
Sundry income	803	289
Unrealised holding gain on listed investments	—	220
	1,704	2,604

7. (LOSS) PROFIT FROM OPERATIONS

	2001 HK\$'000	2000 HK\$'000
(Loss) profit from operations has been arrived at after charging:		
Amortisation of intangible assets	9,969	3,278
Auditors' remuneration	1,005	1,004
Depreciation and amortisation		
Owned assets	55,567	23,970
Assets held under a finance lease and a hire purchase contract	6,539	—
Loss on disposal of plant and equipment	—	107
Net foreign exchange loss	178	—
Operating lease rentals in respect of		
Rented premises	6,192	2,534
Plant and machinery	75	—
Provision for doubtful debts	5,000	2,074
Research and development costs incurred	23,438	17,449
Less: amount capitalised	(10,725)	(14,262)
	12,713	3,187
Development costs written off	4,372	3,035
Staff costs:		
Directors' emoluments (note 9)	5,592	7,165
Mandatory Provident Fund Scheme contributions	627	—
Provision for long service payments	882	545
Salaries and other benefits	97,493	57,168
	104,594	64,878
Unrealised loss on club debentures	616	—

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

8. FINANCE COSTS

	2001 HK\$'000	2000 <i>HK\$'000</i>
Interest on bank borrowings wholly repayable within five years	12,527	1,758
Interest on obligations under a finance lease and a hire purchase contract	1,773	—
	14,300	1,758

9. DIRECTORS' EMOLUMENTS

	2001 HK\$'000	2000 <i>HK\$'000</i>
Directors' fees		
Executive directors	—	—
Independent non-executive directors	240	240
	240	240
Other emoluments (executive directors):		
Salaries and other benefits	5,332	5,584
Mandatory Provident Fund Scheme contributions	20	—
Performance related incentive payments	—	1,341
Total emoluments	5,592	7,165

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

9. DIRECTORS' EMOLUMENTS (continued)

Emoluments of the directors were within the following bands:

	2001	2000
	Number of directors	Number of directors
Nil — HK\$1,000,000	7	4
HK\$1,000,001 — HK\$1,500,000	—	3
HK\$2,000,001 — HK\$2,500,000	1	1
	<u>1</u>	<u>1</u>

No emoluments were paid during the year as compensation for loss of office as directors of the Company and its subsidiaries.

No director waived any emoluments during the year.

10. EMPLOYEES' EMOLUMENTS

During the year, the five highest paid individuals included three directors (2000: five directors), details of whose emoluments are set out in note 9. The emoluments of the remaining two highest paid individuals for the current year were as follows:

	2001
	HK\$'000
Salaries and other benefits	1,820
Mandatory Provident Fund Scheme contributions	35
Performance related incentive payments	—
	<u>1,855</u>

Their emoluments were within the following bands:

	2001	2000
	Number of employees	Number of employees
NIL — HK\$1,000,000	1	—
HK\$1,000,001 — HK\$1,500,000	1	—
	<u>1</u>	<u>—</u>

NOTES TO THE FINANCIAL STATEMENTS

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11. TAXATION CREDIT (CHARGE)

	2001 HK\$'000	2000 <i>HK\$'000</i>
The taxation credit (charge) comprises:		
Hong Kong Profits Tax		
Current year	—	(3,400)
Over(under)provision in prior years	125	(3,000)
	125	(6,400)
Deferred taxation (<i>note 29</i>)		
Current year	4,161	(3,296)
	4,286	(9,696)

No provision for Hong Kong Profits Tax has been made in the financial statements for the current year as the Group companies incurred tax losses for the year. The taxation credit represents the overprovision of Hong Kong Profits Tax in prior years.

In the prior year, Hong Kong Profits Tax was calculated at 16% of the estimated assessable profit for that year.

12. NET (LOSS) PROFIT FOR THE YEAR

Of the Group's loss for the year of HK\$137,958,000 (2000: profit of HK\$32,507,000), a loss of HK\$76,195,000 (2000: profit of HK\$6,783,000) has been dealt with in the financial statements of the Company.

13. DIVIDEND

	2001 HK\$'000	2000 <i>HK\$'000</i>
Proposed final dividend — Nil (2000: 2.30 cents) per share	—	7,360

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

14. (LOSS) EARNINGS PER SHARE

The calculation of the basic (loss) earnings per share is based on the Group's loss for the year of HK\$137,958,000 (2000: profit of HK\$32,507,000) and on 320,000,000 (2000: 320,000,000) shares in issue during the year.

No dilutive potential shares were outstanding during either the current or prior years. Accordingly, no amount is presented for diluted earnings per share.

15. PROPERTY, PLANT AND EQUIPMENT

	Leasehold land and buildings <i>HK\$'000</i>	Leasehold improvements <i>HK\$'000</i>	Equipment, furniture and fixtures <i>HK\$'000</i>	Plant and machinery <i>HK\$'000</i>	Motor vehicles <i>HK\$'000</i>	Total <i>HK\$'000</i>
THE GROUP						
COST						
At April 1, 2000	77,236	25,773	45,408	187,046	6,914	342,377
Additions	452	8,775	14,434	64,358	1,558	89,577
Disposals	—	—	—	(3,358)	—	(3,358)
At March 31, 2001	<u>77,688</u>	<u>34,548</u>	<u>59,842</u>	<u>248,046</u>	<u>8,472</u>	<u>428,596</u>
DEPRECIATION AND AMORTISATION						
At April 1, 2000	5,388	13,967	6,396	63,015	4,427	93,193
Provided for the year	2,733	6,691	10,797	40,786	1,099	62,106
Eliminated on disposals	—	—	—	(3,358)	—	(3,358)
At March 31, 2001	<u>8,121</u>	<u>20,658</u>	<u>17,193</u>	<u>100,443</u>	<u>5,526</u>	<u>151,941</u>
NET BOOK VALUES						
At March 31, 2001	<u>69,567</u>	<u>13,890</u>	<u>42,649</u>	<u>147,603</u>	<u>2,946</u>	<u>276,655</u>
At March 31, 2000	<u>71,848</u>	<u>11,806</u>	<u>39,012</u>	<u>124,031</u>	<u>2,487</u>	<u>249,184</u>

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

15. PROPERTY, PLANT AND EQUIPMENT (continued)

The net book value of leasehold land and buildings shown above comprises:

	THE GROUP	
	2001	2000
	HK\$'000	HK\$'000
Land and buildings in Hong Kong under medium-term leases	20,553	21,346
Land and buildings in other locations in the People's Republic of China (the "PRC") under medium-term leases	49,014	50,502
	69,567	71,848

At March 31, 2001, the net book value of plant and machinery included an amount of HK\$30,557,000 (2000: nil) in respect of assets held under a finance lease and a hire purchase contract.

16. INVESTMENTS IN SUBSIDIARIES

	THE COMPANY	
	2001	2000
	HK\$'000	HK\$'000
Unlisted shares	129,026	129,026
Less: Provision	(75,000)	—
	54,026	129,026

The carrying value of the unlisted shares is based on the values of the underlying net assets of the subsidiaries attributable to the Group as at the date on which they became members of the Group under the group reorganisation in 1997, less provision for impairment loss made as considered necessary by the directors.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

16. INVESTMENTS IN SUBSIDIARIES (continued)

Particulars of the Company's subsidiaries at March 31, 2001 are as follows:

Name	Place of incorporation/ operation	Issued and fully paid share capital	Proportion of nominal value of issued capital held by the Company	Principal activities
Agenda Computing Asia Limited	Hong Kong	Ordinary HK\$1,000	100%	Not yet commenced business
Agenda Computing (BVI) Limited (Formerly known as Kessel Computing (BVI) Limited and Eagle Linux (BVI) Limited)	British Virgin Islands	Ordinary US\$1,000	100%	Investment holding
Agenda Computing (Deutschland) GmbH	Germany	EURO25,000	100%	Trading and marketing of electronic products
Agenda Computing (HK) Limited	Hong Kong	Ordinary HK\$2	100%	Not yet commenced business
Agenda Computing, Inc.	United States of America	Common US\$10,000	100%	Trading and marketing of electronic products
Agenda Computing Manufacturing Limited	British Virgin Islands	Ordinary US\$1	100%	Investment holding
Dongguan Kepo Electronics Limited	PRC	(see note a)	100%	Manufacturing of LCD and electronic products

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

16. INVESTMENTS IN SUBSIDIARIES (continued)

Name	Place of incorporation/ operation	Issued and fully paid share capital	Proportion of nominal value of issued capital held by the Company	Principal activities
Kego Technology Limited	Hong Kong	Ordinary HK\$1,000	100%	Providing computer software programming services to group companies
Kego Display Technology Limited	Hong Kong	Ordinary HK\$100	100%	Trading and marketing of LCD and electronic products
Kego Electronics Limited	British Virgin Islands/PRC	Ordinary US\$1,250	100%	Arranging processing work and provision of management and quality control over manufacturing of electronic products
Kego Time Limited	Hong Kong	Ordinary HK\$10,000 Deferred HK\$1,000,000 (see notes b & c)	100%	Inactive
Kesonic Limited	Hong Kong	Ordinary HK\$1,000	100%	Sale of electronic products and components
Kessel Inc. (Formerly known as Kesonic Inc.)	United States of America	Common US\$100,000	100%	Trading and marketing of electronic products

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For the year ended March 31, 2001

16. INVESTMENTS IN SUBSIDIARIES (continued)

Name	Place of incorporation/ operation	Issued and fully paid share capital	Proportion of nominal value of issued capital held by the Company	Principal activities
Kessel Electronics (BVI) Limited	British Virgin Islands	Ordinary US\$2,500	100%	Investment holding
Kessel Electronics GmbH (Formerly known as Kego Electronics GmbH)	Germany	EURO 25,000	100%	Trading and marketing of electronic products
Kessel Electronics (H.K.) Limited	Hong Kong	Ordinary HK\$10,000 Deferred HK\$1,000,000 (see note b)	100%	Research and development, marketing and sale of electronic products
Kessel International Investments Limited	British Virgin Islands	Ordinary US\$1	100%	Not yet commenced
Kessel Japan Company Limited	Japan	YEN10,000,000	95%	Trading and marketing of electronic products
Kessel Management Company Limited	Hong Kong	Ordinary HK\$2	100%	Not yet commenced business
Kessel Technology SAS	French	EURO 40,000	100%	Trading and marketing of electronic products
Kessel Technology (UK) Limited	United Kingdom	Ordinary GBP1	100%	Inactive

NOTES TO THE FINANCIAL STATEMENTS

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16. INVESTMENTS IN SUBSIDIARIES (continued)

Name	Place of incorporation/ operation	Issued and fully paid share capital	Proportion of nominal value of issued capital held by the Company	Principal activities
Kessel Telecom Limited	Hong Kong	Ordinary HK\$1,000	100%	Research and development, marketing and sales of telecommunications products
Ketech Limited	British Virgin Islands	Ordinary US\$1	100%	Not yet commenced business
Keview Technology (BVI) Limited	British Virgin Islands	Ordinary US\$1,000	100%	Investment holding
Kingo Industrial Limited	Hong Kong	Ordinary HK\$100,000	100%	Provision of management services to group companies
The Kessel Software Studio, Inc.	United States of America	Common US\$100,000	100%	Research and development

With the exception of Kessel Electronics (BVI) Limited and Kessel International Investments Limited which are directly held by the Company, all other subsidiaries are indirectly held by the Company.

None of the subsidiaries had any loan capital outstanding at the end of the year or at any time during the year.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

16. INVESTMENTS IN SUBSIDIARIES (continued)

Notes:

- (a) Dongguan Kepo Electronics Limited ("DKEL") was established with a registered capital of HK\$35 million. Under the provisions of the Articles of Association of DKEL, the aggregate investment in DKEL was HK\$70 million which had to be paid up within two years from the date of its establishment. The registered capital and the aggregate investment are subsequently increased to HK\$76 million and HK\$152 million respectively during the year ended March 31, 2001. At March 31, 2001, the Group has paid up the registered capital in full in the form of investment in property, plant and equipment, which was verified by certified public accountants in the PRC subsequent to the year end date.
- (b) The deferred shares carry no voting rights, limited rights to a return of the capital paid up on the shares and very limited rights to participate in a distribution of profits.
- (c) 49% of the issued deferred shares of Kepo Time Limited are held by Kessel Electronics (H.K.) Limited.

17. INVESTMENTS IN SECURITIES

	2001 HK\$'000	2000 HK\$'000
Investment securities shown as non-current assets:		
Club debentures, at cost	—	656
Other investments shown as current assets:		
Shares listed on the Stock Exchange, at market value	820	820
Club debenture, at fair value (note)	40	—
	860	820

Note: In prior years, the club debenture was held for an identified long term strategic purpose and was measured at cost, as reduced by any impairment loss that is other than temporary. During the year, the management of the Group changed its intention such that the club debenture should be held for short term purposes. Accordingly, the club debenture is classified as other investment and is stated at its fair value at the balance sheet date.

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18. INTEREST IN PROPERTIES

By a lease agreement dated August 8, 1997 between one of the Company's subsidiaries and an independent party in the PRC, which replaced a composite agreement dated June 19, 1996 between the same parties, the subsidiary was given the rights to construct at its own cost and expense three buildings on land to be designated by the independent party. These buildings are provided by the subsidiary for the processing of the Group's products and will be transferred to the independent party at no cost in January 2013. The construction costs of these buildings are capitalised and are written off to the income statement on a straight line basis up to January 2013. The amount to be written off within one year from the balance sheet date is included in trade and other receivables.

19. INTANGIBLE ASSETS

	Development costs	Technical know-how	Total
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
THE GROUP			
COST			
At April 1, 2000	16,831	7,745	24,576
Additions	10,725	—	10,725
Amounts written off	(8,118)	—	(8,118)
	<hr/>	<hr/>	<hr/>
At March 31, 2001	19,438	7,745	27,183
	<hr/>	<hr/>	<hr/>
AMORTISATION			
At April 1, 2000	4,144	215	4,359
Provided for the year	7,387	2,582	9,969
Eliminated on write off	(3,746)	—	(3,746)
	<hr/>	<hr/>	<hr/>
At March 31, 2001	7,785	2,797	10,582
	<hr/>	<hr/>	<hr/>
NET BOOK VALUES			
At March 31, 2001	<u>11,653</u>	<u>4,948</u>	<u>16,601</u>
At March 31, 2000	<u>12,687</u>	<u>7,530</u>	<u>20,217</u>

NOTES TO THE FINANCIAL STATEMENTS

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20. DEPOSITS PAID

The deposits paid in the prior year represented consideration paid for the acquisition of plant and machinery.

21. INVENTORIES

	THE GROUP	
	2001	2000
	HK\$'000	HK\$'000
Raw materials	146,840	138,727
Work in progress	23,287	17,508
Finished goods	18,895	15,490
	189,022	171,725

At March 31, 2001, raw materials of HK\$37,657,000 (2000: HK\$285,000) are carried at net realisable value. Furthermore, certain other raw materials, work in progress and finished goods are considered obsolete and have been fully provided for.

22. TRADE AND OTHER RECEIVABLES

The Group allows an average credit period of 30 days to its trade customers. An aged analysis of trade receivables is as follows:

	THE GROUP	
	2001	2000
	HK\$'000	HK\$'000
0 — 30 days	31,139	11,519
31 — 60 days	126	996
61 — 90 days	1,354	210
Over 90 days	5,602	4,564
	38,221	17,289

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

23. BILLS RECEIVABLE

An aged analysis of bills receivable is as follows:

	THE GROUP	
	2001	2000
	HK\$'000	HK\$'000
0 — 30 days	5,161	12,026
31 — 60 days	1,210	—
61 — 90 days	496	1,705
	6,867	13,731

24. TRADE AND OTHER PAYABLES

An aged analysis of trade payables is as follows:

	THE GROUP	
	2001	2000
	HK\$'000	HK\$'000
0 — 30 days	41,613	45,401
31 — 60 days	27,090	43,376
61 — 90 days	19,887	19,644
Over 90 days	75,089	18,402
	163,679	126,823

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

25. BILLS PAYABLE

An aged analysis of bills payable is as follows:

	THE GROUP	
	2001	2000
	HK\$'000	HK\$'000
0 — 30 days	20,929	17,791
31 — 60 days	27,085	9,581
61 — 90 days	25,793	9,241
Over 90 days	41,529	12,198
	115,336	48,811

26. OBLIGATIONS UNDER A FINANCE LEASE AND A HIRE PURCHASE CONTRACT

	THE GROUP	
	2001	2000
	HK\$'000	HK\$'000
The schedule for repayment of the obligations under a finance lease and a hire purchase contract is as follows:		
Within one year	14,488	—
More than one year but not exceeding two years	3,586	—
More than two years but not exceeding five years	951	—
	19,025	—
Less: Amount due within one year shown under current liabilities	(14,488)	—
Amount due after one year	4,537	—

Subsequent to the balance sheet date, the Group was in default of payment of certain obligations under the finance lease and the hire purchase contract, details of which are set out in note 41.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

27. BANK BORROWINGS

	THE GROUP	
	2001	2000
	HK\$'000	HK\$'000
Bank borrowings comprise the following:		
Instalment loans	32,838	—
Packing loans	5,670	—
Bank overdrafts	24,508	13,196
	63,016	13,196

The instalment loans are unsecured and bear interest at commercial rates.

The packing loans are secured by way of assignment of proceeds under documentary credits issued in favour of the Group as beneficiary. The loans bear interest at commercial rates.

During the year, the banking facilities utilised by the Group exceeded the limits offered by its principal bankers. This represents a breach of the loan agreements and consequently all the bank borrowings become repayable on demand and are classified as current liabilities.

28. OTHER LOAN

	THE GROUP	
	2001	2000
	HK\$'000	HK\$'000
Other loan	13,500	—
Less: Amount due within one year shown under current liabilities	(10,500)	—
Amount due after one year	3,000	—

The loan is unsecured and bears interest at commercial rate.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

29. DEFERRED TAXATION

	THE GROUP	
	2001	2000
	HK\$'000	HK\$'000
Movement during the year is as follows:		
Balance brought forward	6,223	2,927
Movement for the year (note 11)	(4,161)	3,296
Balance carried forward	<u>2,062</u>	<u>6,223</u>

At the balance sheet date, the major components of deferred taxation liability (asset), provided and unprovided, are as follows:

	Provided		Unprovided	
	2001	2000	2001	2000
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
THE GROUP				
Tax effect of timing differences because of:				
Excess of tax allowances over depreciation	9,421	6,223	2,001	1,856
Estimated unutilised taxation losses	(7,359)	—	(14,537)	(9,021)
	<u>2,062</u>	<u>6,223</u>	<u>(12,536)</u>	<u>(7,165)</u>

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

29. DEFERRED TAXATION *(continued)*

The components of the unprovided deferred taxation (credit) charge for the year are as follows:

	THE GROUP	
	2001	2000
	HK\$'000	HK\$'000
Tax effect of timing differences because of:		
Excess of tax allowances over depreciation	145	1,774
Tax losses arising	(5,516)	(8,280)
	<u>(5,371)</u>	<u>(6,506)</u>

THE COMPANY

At the balance sheet date, the Company has no significant unprovided deferred taxation.

30. SHARE CAPITAL

	2001 & 2000	
	Number of shares	Amount HK\$'000
Authorised:		
Shares of HK\$0.10 each	<u>1,000,000,000</u>	<u>100,000</u>
Issued and fully paid:		
Shares of HK\$0.10 each	<u>320,000,000</u>	<u>32,000</u>

There were no movements in the Company's share capital during the year.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

31. SHARE OPTION SCHEME

Under the terms of the share option scheme (the "Scheme") which became effective on September 2, 1997, the Board of Directors of the Company may, at its discretion, grant options to eligible employees, including executive directors, of the Company or any of its subsidiaries to subscribe for shares in the Company at a price not less than 80 per cent. of the average of the closing prices of the shares on the Stock Exchange on the five trading days immediately preceding the date of grant of the options or the nominal value of the shares, whichever is the higher.

The maximum number of shares in respect of which options may be granted under the Scheme shall not exceed 10 per cent. of the issued share capital of the Company from time to time and the maximum number of shares in respect of which options may be granted to any one employee shall not exceed 25 per cent. of the maximum number of shares for the time being issued and issuable under the Scheme.

No options under the Scheme were granted or exercised during the year and no options were outstanding as at March 31, 2001.

32. RESERVES

	Accumulated						
	Share premium	profits (losses)	Special reserve	Translation reserve	Contributed surplus	Goodwill reserve	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
THE GROUP							
At April 1, 1999	69,823	169,893	(22,470)	—	—	—	217,246
Net profit for the year	—	32,507	—	—	—	—	32,507
Dividend	—	(7,360)	—	—	—	—	(7,360)
Exchange differences arising on translation of overseas subsidiaries	—	—	—	(25)	—	—	(25)
At March 31, 2000	<u>69,823</u>	<u>195,040</u>	<u>(22,470)</u>	<u>(25)</u>	<u>—</u>	<u>—</u>	<u>242,368</u>

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

32. RESERVES (continued)

	Accumulated						
	Share premium	profits (losses)	Special reserve	Translation reserve	Contributed surplus	Goodwill reserve	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At April 1, 2000	69,823	195,040	(22,470)	(25)	—	—	242,368
Net loss for the year	—	(137,958)	—	—	—	—	(137,958)
Goodwill on acquisition of additional shares in a subsidiary	—	—	—	—	—	(117)	(117)
Goodwill written off	—	—	—	—	—	117	117
Exchange differences arising on translation of overseas subsidiaries	—	—	—	(92)	—	—	(92)
At March 31, 2001	<u>69,823</u>	<u>57,082</u>	<u>(22,470)</u>	<u>(117)</u>	<u>—</u>	<u>—</u>	<u>104,318</u>
THE COMPANY							
At April 1, 1999	69,823	5,222	—	—	105,026	—	180,071
Net profit for the year	—	6,783	—	—	—	—	6,783
Dividend	—	(7,360)	—	—	—	—	(7,360)
At March 31, 2000	69,823	4,645	—	—	105,026	—	179,494
Net loss for the year	—	(76,195)	—	—	—	—	(76,195)
At March 31, 2001	<u>69,823</u>	<u>(71,550)</u>	<u>—</u>	<u>—</u>	<u>105,026</u>	<u>—</u>	<u>103,299</u>

The special reserve of the Group represents the difference between the nominal amount of the share capital of the subsidiaries acquired and the nominal value of the Company's shares issued for the acquisition pursuant to the corporate reorganisation and capitalisation in paying up 1,000,000 nil paid shares prior to the listing of the Company's shares.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

32. RESERVES (continued)

The contributed surplus of the Company represents the difference between the consolidated shareholders' funds of subsidiaries at the date on which they were acquired by the Company and the nominal amount of the share capital of the Company issued under the corporate reorganisation and capitalisation in paying up 1,000,000 nil paid shares. Under The Companies Act 1981 of Bermuda (as amended), the contributed surplus of the Company is available for distribution to shareholders.

33. RECONCILIATION OF (LOSS) PROFIT BEFORE TAXATION TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	2001 <i>HK\$'000</i>	2000 <i>HK\$'000</i>
(Loss) profit before taxation	(142,361)	42,177
Interest income	(447)	(1,451)
Interest expense on bank borrowings	12,527	1,758
Interest on obligations under a finance lease and a hire purchase contract	1,773	—
Dividend income from investments in securities	(66)	(46)
Unrealised holding loss on unlisted investments	616	—
Unrealised holding gain on listed investments	—	(220)
Amortisation of intangible assets	9,969	3,278
Depreciation and amortisation	62,106	23,970
(Gain) loss on disposal of plant and equipment	(388)	107
Development costs written off	4,372	3,035
Goodwill of a subsidiary written off	117	—
Provision for doubtful debts	5,000	2,074
Decrease in interest in properties	256	256
Increase in inventories	(17,297)	(45,371)
(Increase) decrease in trade and other receivables	(15,339)	1,862
Decrease (increase) in bills receivable	6,864	(4,403)
Increase in trade and other payables	35,468	110,154
Increase in bills payable	66,525	20,901
Effect of foreign exchange rate changes	(99)	(25)
	<hr/>	<hr/>
Net cash inflow from operating activities	29,596	158,056

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

34. ANALYSIS OF CHANGES IN FINANCING DURING THE YEAR

	Bank loans	Other loan	Obligations under a finance lease and a hire purchase contract	Minority interests
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
At April 1, 1999	—	—	—	—
Contribution from a minority shareholders of a subsidiary	—	—	—	117
Share of loss by minority shareholders	—	—	—	(26)
	<hr/>	<hr/>	<hr/>	<hr/>
At March 31, 2000	—	—	—	91
New loans raised	46,000	13,500	—	—
Repayments during the year	(13,162)	—	—	—
Inception of a finance lease and a hire purchase contract	—	—	25,000	—
Repayment of obligations under a finance lease and a hire purchase contract	—	—	(5,975)	—
Contribution from a minority shareholder of a subsidiary	—	—	—	38
Share of loss by minority shareholders	—	—	—	(117)
Minority interests' share of translation reserve	—	—	—	(7)
	<hr/>	<hr/>	<hr/>	<hr/>
At March 31, 2001	<u>32,838</u>	<u>13,500</u>	<u>19,025</u>	<u>5</u>

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

35. ANALYSIS OF THE BALANCES OF CASH AND CASH EQUIVALENTS

	2001 HK\$'000	2000 HK\$'000
Bank balances and cash	16,624	23,320
Bank overdrafts	(24,508)	(13,196)
Bank loans repayable within three months from the date of the advances	(5,670)	—
	<u>(13,554)</u>	<u>10,124</u>

36. MAJOR NON-CASH TRANSACTIONS

During the year, the Group entered into a finance lease and a hire purchase contract with an aggregate principal value of approximately HK\$25,000,000 (2000: nil) to finance the purchase of plant and machinery at cost of approximately HK\$37,096,000 (2000: nil).

37. CONTINGENT LIABILITIES

	THE GROUP	
	2001 HK\$'000	2000 HK\$'000
Bills of exchange discounted with recourse	<u>21,346</u>	<u>12,776</u>

In addition, the Group is involved in the following litigation:

Legal action against a substantial customer in USA

On or about July 23, 1999, the Company was informed by a customer in USA that (a) legal action was commenced in USA by Palm Computing, Inc. ("Palm"), a manufacturer and distributor of personal digital assistant products in USA, to claim for damages for copyright infringement against that customer; and (b) a preliminary injunction was imposed by a court in USA restraining the substantial customer, inter alia, from importing and distributing certain personal digital assistant products purchased from the Group (the "Products") on alleging copyright infringement in respect of the operating system ("OS") software loaded in the Products. There have been no significant development in respect of this legal action during the year.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

37. CONTINGENT LIABILITIES *(continued)***Legal actions against Kessel and a software contractor in Hong Kong**

In mid-August, 1999, the Company's subsidiary, Kessel Electronics (H.K.) Limited ("Kessel Electronics"), was served with a Writ of Summons claiming damages by Palm for software copyright infringement in relation to the Products. Notice of contest of the claim was filed by the Group's legal counsel on behalf of the Group. Thereafter, an injunction was filed in Hong Kong by Palm's solicitors against Kessel Electronics restraining Kessel Electronics from dealing with certain files contained in the software of certain operating system used in the Products. The files which ran on Nexus OS source code were designed by a software company in Hong Kong (the "Software Designer"). Against this background, a similar injunction application against the Software Designer was also filed by Palm. The application was heard by the court in Hong Kong and the judge ordered that the case be adjourned for the parties to file evidence. The judge also ordered that the action against the Software Designer be heard with the action against Kessel Electronics. This means that these two actions are now being tried as one action.

Full Statement of Claim was filed by Palm's solicitors in September 1999. Defence of the Software Designer was filed in October 1999 denying any infringement of copyright of the files of the Products. Meanwhile, the solicitors of the Group considered that it was unable to file any meaningful defence without allowing the experts appointed by the Group to analyse the OS source code of the products manufactured by Palm and the OS source code written by the Software Designer. Against this background, Kessel Electronics requested Palm to release the full OS source code to the Group's experts for analysis, which request was refused by Palm. With no other alternative, an application was filed by Kessel Electronics in November 1999 against Palm and the Software Designer for full disclosure of their respective source codes. The application was heard in the court in Hong Kong. Prior to the application being heard, the Software Designer settled with the Group to the effect that if Palm was ordered to release their full Palm OS source code to Kessel Electronics, it would also provide its full Nexus OS source code for analysis.

The application against Palm was unsuccessful after the hearing in January 2000 but the judge ordered he would let the parties to agree on the terms and scope of release but if the parties could not agree, the judge was ready to hear the application again. As no agreement was reached among the parties, another hearing was fixed for September 2000 and Palm was ordered to release the Palm OS source code to Kessel Electronics for comparison with the Nexus OS source code. Agreements were reached between the Group's solicitor and solicitors of both Palm and the Software Designer separately regarding the terms of inspection of the OS source codes of both Palm and the Software Designer by Kessel Electronics' experts and lawyers.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

37. CONTINGENT LIABILITIES *(continued)*

Legal actions against Kessel and a software contractor in Hong Kong *(continued)*

In the course of the case, both Palm and the Software Designer amended their Statements of Claim in 1999 which do not change the position of Kessel Electronics' defence. In the meantime, in order to support its application for full disclosure from Palm, a holding defence was filed in September 2000 by Kessel Electronics denying any copyright infringement and reserving the right to file further defence after comparison of the OS source codes of Palm and the Software Designer.

The Group has engaged two experts in the United States to examine the OS source codes and to give their opinions. However, such examination has not yet commenced.

Assessment of liabilities and damages not possible at this stage

At present, without any experts' opinion, the directors are unable to determine the outcome of the action. Against this background, the directors consider that the assessment of the quantum of damages and liability of Kessel Electronics, if any, at this stage is not feasible. Accordingly, no provision for any liabilities or damages, which might arise in connection with this matter has been made in these financial statements.

THE COMPANY

The Company has issued corporate guarantees to banks to secure general banking facilities granted to certain subsidiaries. The extent of facilities utilised by the subsidiaries and guaranteed by the Company at March 31, 2001 amounted to HK\$177,322,000 (2000: HK\$51,088,000).

The Company has given an indemnity and undertaking to a financial institution to indemnify the financial institution against any loss resulting from or arising out of the hire purchase contract entered into between the financial institution and a subsidiary. The subsidiary's obligations under the hire purchase contract and indemnified by the Company at March 31, 2001 amounted to HK\$7,775,000 (2000: nil).

The Company has issued guarantee under a finance lease to guarantee the due and punctual payment of the obligations under a finance lease entered into between a financial institution and a subsidiary. The subsidiary's obligations under the finance lease and guaranteed by the Company at March 31, 2001 amounted to HK\$11,250,000 (2000: nil).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

37. CONTINGENT LIABILITIES (continued)**THE COMPANY** (continued)

The Company has also issued corporate guarantee to a trade creditor to secure the trade credit granted to a subsidiary. The extent of credit utilised by the subsidiary and guaranteed by the Company at March 31, 2001 amounted to HK\$2,444,000 (2000: nil).

In addition, the Company has given indemnity to a landlord against all losses, damages and expenses caused by any default by one of the Company's subsidiaries which rents the premises.

38. COMMITMENTS

	THE GROUP	
	2001 <i>HK\$'000</i>	2000 <i>HK\$'000</i>
Capital expenditure contracted for but not provided in the financial statements in respect of:		
— Acquisition of property, plant and equipment	3,342	13,330
— Product development costs	155	5,272
	3,497	18,602

At the balance sheet date, the Group and the Company had outstanding commitments under non-cancellable operating leases payable within the next year in respect of rented premises, as follows:

	THE GROUP		THE COMPANY	
	2001 <i>HK\$'000</i>	2000 <i>HK\$'000</i>	2001 <i>HK\$'000</i>	2000 <i>HK\$'000</i>
Operating leases which expire:				
Within one year	3,185	145	—	—
In the second to fifth years inclusive	22	1,614	—	—
Over five years	4,455	4,583	3,351	3,351
	7,662	6,342	3,351	3,351

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

38. COMMITMENTS (continued)

Pursuant to a contract entered into between one of the Company's subsidiaries and an independent party in the PRC where one of the Group's factories is located, the Group is committed to pay to the independent party an annual management fee of HK\$260,000 at an increment of 10% per five years interval.

Pursuant to the same contract, the Group was also committed to pay to that independent party an annual service fee of HK\$975,000 up to August 2003 and thereafter on a pre-determined basis with reference to the number of employees in the aforementioned factory and at an increment of 10% per five years interval.

THE COMPANY

Apart from the operating lease commitments set out above, the Company did not have any other significant commitments at the balance sheet date.

39. RETIREMENT BENEFITS SCHEME

In the prior year, the Group did not operate any retirement benefits scheme for employees. The provision for long service payments is stated at the amount which would have been payable, had all employees in Hong Kong retired at the balance sheet date. The difference in the provision amount at each balance sheet date is dealt with in the income statement.

With effect from December 1, 2000, the Group had joined the Mandatory Provident Fund Scheme (the "Scheme") under the rules and regulations of the Mandatory Provident Fund Authority in Hong Kong. The Group's employees in Hong Kong are required to join the Scheme. The contributions to the Scheme charged to the income statement amounted to HK\$647,000 for the year ended March 31, 2001.

40. PLEDGE OF ASSETS

At March 31, 2001, the Group's credit facilities offered by banks were secured by a pledge of the Group's leasehold land and buildings with an aggregate net book value of HK\$18,500,000 (2000: HK\$19,221,000).

A negative pledge was executed by DKEL to a bank to secure a bank loan of HK\$36,000,000 raised during the year.

NOTES TO THE FINANCIAL STATEMENTS

*For the year ended March 31, 2001***41. POST BALANCE SHEET EVENTS**

The following events took place subsequent to March 31, 2001:

- (a) The Group was in default of payment of certain bank borrowings.
- (b) The Group was also in default of payment of certain obligations under a finance lease and a hire purchase contract of an aggregate principal amount and interest of HK\$953,000 and HK\$157,000 respectively at the reporting date. Accordingly, aggregate obligations at the reporting date of HK\$17,251,000 became due for payment on demand by the lessors.
- (c) The Group has reached an informal standstill understanding with its principal bankers, one of which has subsequently confirmed the informal standstill in writing.
- (d) The Group has been discussing with potential investors in order to obtain additional funds for its operations.
- (e) Claims have been filed by certain creditors in the courts in Hong Kong and under statutory demand against the Group for the recovery of claimed outstanding debts in the aggregate amount up to date of this report of HK\$30,252,000. The Group has engaged its legal counsels to handle these cases.
- (f) A claim was launched by a contractor who had been engaged to construct a clean room in the PRC for a subsidiary of the Company in prior years. The contractor has claimed against that subsidiary for a sum of HK\$8,366,000 in respect of charges for alleged variations and additional works rendered together with the overdue interest thereon. The subsidiary refuted the claim and it was then referred to arbitration by the contractor. The contractor has written to the Hong Kong International Arbitration Centre to issue a formal claim against the subsidiary. Up to the reporting date, no formal claim has been served against the subsidiary and based on the current stage, the directors consider the subsidiary has a valid defence and it is premature to give any opinion and conclusion on the outcomes of the claim unless and until the formal claim against the subsidiary has been served and fully studied. Against this background, no provision for any liabilities which might arise in respect of the works performed by the contractor, has been made in these financial statements. However, it is not possible to quantify the effects, if any, of the resolution of the uncertainty arising from the arbitration.