

Executive Directors' Statement

BUSINESS REVIEW

Results

The year ended 31 December 2003 was a difficult and disappointing year for the Group whose businesses in the PRC, Hong Kong and Singapore were badly hit by the outbreak of Severe Acute Respiratory Syndrome ("SARS") in the first half of the year. The gradual recovery of the Group's businesses after the SARS outbreak were adversely affected by the negative publicity surrounding the summary judgment awarded on 4 July 2003 in favour of Mr. Alfred Siu ("Mr. Siu") an ex-chairman of the Company, against the Company amounting to HK\$25.8 million and the consequent capital reorganisation, creditors' scheme of arrangement, open offer and application for whitewash waiver announced on 1 September 2003. Both our suppliers and customers were reluctant to extend new businesses and credits to the Group thus hampering its recovery in the second half of the year.

The Group's turnover and net loss for the year ended 31 December 2003 were approximately HK\$14 million (2002: HK\$25 million) and HK\$262 million (2002: HK\$213 million) respectively. Loss per share was HK\$2.62 (2002: HK\$2.40 after adjusting for the 20 to 1 share consolidation effective on 2 December 2003).

The decrease in revenue for the year 2003 was due to a 36% drop in revenue of the construction division and the de-consolidation of the turnover of the network security services and hotel operations as the Board intended not to provide additional financial resources to support the network security services business and hotel management operation.

Dividend

No interim dividend was paid during the year (2002: Nil). The Board of Directors does not recommend the payment of a final dividend for the year (2002: Nil).

Change of Company Name

The shareholders of the Company resolved at the Annual General Meeting held on 27 May 2003 that the name of the Company be changed from Prosper eVision Limited to China Nan Feng Group Limited and to adopt "中國南峰集團有限公司" as its Chinese name for identification purpose.

Construction Contractor

Despite the recovery of the overall economy in Hong Kong in the second half of the year after the SARS outbreak and the strong rebound of the property sector, the construction industry in Hong Kong did not stage a meaningful recovery and continued to be one of the sectors which lagged behind the general economic recovery in Hong Kong. In view of the continuing difficult operating environment and the high costs of maintaining a full construction management team in Hong Kong, the Group decided to substantially scaled down its loss making Hong Kong construction division in the second half of the year and focused its efforts in the more promising construction market in Guangdong Province, the PRC. The turnover of the construction division as a whole recorded a decrease of 36% from approximately HK\$22 million for the year 2002 to approximately HK\$14 million for the year 2003. The turnover in the PRC amounted to approximately HK\$12 million, an increase of 28% over that in year 2002. We believe the turnover of the PRC construction business would increase markedly after the completion of the Group's restructuring in April 2004.

Executive Directors' Statement

Construction contract costs mainly represent direct materials and subcontracting costs for construction projects. It decreased by 33% from approximately HK\$24 million in year 2002 to approximately HK\$16 million this year, roughly in line with the drop in turnover.

In the coming year, we would increase our resources to grasp and develop the growing and more profitable construction and property related businesses in the PRC.

Provision of Network Security Services

During the year, 深圳安網達網絡技術有限公司 (“安網達”), which was principally engaged in the development and manufacture of internet-secured personal computers and network security devices, suffered from the SARS outbreak and the unfavourable environment in the computer and internet industry after the burst of the Internet bubble coupled with our Group's conservative approach towards the significant funding requirement, led to the continuing losses of its operations. The Directors would closely monitor our investment strategy in this industry and the investment in 安網達 was treated as an investment in the accounts. The Directors also decided to fully provide for impairment of the Group's investment in 安網達, amounting to HK\$116 million which consisted mainly of patents and trademarks. This HK\$116 million included HK\$98 million of amortisation of patents and trademarks for the year should the financial statements of 安網達 be included in the consolidation.

System Integration and IT Training

Intwell Technology (S) Private Limited (“Intwell”), of which the Group holds a 50% beneficial interest (2002: 50%) was principally engaged in the development, production and sale of computer hardware and software, integration of computer software and provision of training and after sales services in Singapore. The business of Intwell was hard hit by the SARS outbreak and the substantial cutback of the education budget by the Ministry of Education in Singapore. In view of this, the Directors decided to fully provide for the premium on consolidation amounting to approximately HK\$11.9 million.

Hotel Operation

The hotel management business suffered severely with the SARS outbreak. Despite the gradual recovery in tourist arrival, the results were not encouraging. The Directors decided not to provide additional financial resources to support the hotel management operation.

Operating Expenses

General and administrative expenses, which included staff costs, professional fees, consultancy fees and general administrative expenses increased by 33% from approximately HK\$24 million in 2002 to approximately HK\$32 million in 2003 due to increase in professional fees as a result of an increased number of litigations and Capital Reorganisation, which were one-off expenses. The directors would endeavour to control the overheads of the Company in line with the level of its business activities and their geographically locations.

Amortisation of Intangible Assets

Amortisation of intangible assets amounted to approximately HK\$15 million (2002: HK\$152 million). The intangible assets being amortised, were mainly hotel operating licence in this year and patents and trademarks in 2002.

Executive Directors' Statement

Provision for Litigation Losses and Claims

Included in the provision for litigation losses and claims were the followings:

Mr. Alfred Siu

On 15 August 2002, Mr. Alfred Siu ("Mr. Siu"), an ex-chairman of the Company, issued a writ against the Company for the alleged suffer of loss and damages relating to purported share options exercised in 1999 amounting to approximately HK\$18.8 million. On 4 July 2003, a summary judgment was awarded against the Company in the amount of HK\$18.8 million plus interest and costs. The Company appealed against the summary judgment, which was heard on 6 October 2003. The Court gave a judgment in favour of Mr. Siu. On 10 November 2003, the Company appealed against the judgment in the Court of Appeal to be heard on 25 March 2004 which was subsequently adjourned sine die with liberty to restore. Full provision has been made in the accounts of the Company and the sum was fully settled through the creditors' scheme sanctioned by the Hong Kong and Bermuda Courts on 16 March 2004 and 19 March 2004 respectively ("Creditors' Scheme").

Beijing Oriental Plaza

Beijing Oriental Plaza Co. Ltd. took legal actions against Prosperity Construction and Decoration Limited ("PCDL") and Prosperity Construction and Decoration (HK) Limited ("PCDHK") for approximately HK\$42.7 million in relation to a dispute on construction work performed in Beijing. On 10 December 2003, a judgment from the Peoples' Court in Beijing was entered in favour of PCDL in the amount of RMB4,994,978 and HK\$146,025 for unpaid contract sum plus interest on the judgment sum assessing at judgment rate for the period starting from 15 November 2000. In addition, judgment was entered against PCDL in the amount of RMB8,847,703 and HK\$28,255,579 in respect of breaches of nominated subcontract works. Therefore, there was a net judgment debt of RMB3,852,725 and HK\$28,109,554 against PCDL. Full provision has been made in the accounts of PCDL.

China Top Consultants

On 4 August 2003, China Top Consultants Ltd. ("China Top") obtained a judgment in the sum of HK\$3.86 million plus interest and costs of approximately HK\$2.54 million against PCDL. Full provision has been made in the accounts of PCDL.

Cosmic Insurance

On 30 April 2003, Cosmic Insurance Corporation Limited ("Cosmic Insurance") issued a writ against the Company, PCDL and PCDHK (collectively the "Defendants") in relation to the security for a counter-indemnity issued by the Company in favour of Cosmic Insurance in the amount of HK\$8.7 million. A summary judgment was awarded against the Defendants on 9 September 2003. The Defendants filed a Notice of Appeal on 11 October 2003 to appeal against the summary judgment. The appeal was fixed to be heard on 4 May 2004 but the parties agreed to dismiss the appeal on 8 January 2004. Full provision, including legal fees, has been made in the accounts of the Company and the sum was fully settled through the Creditors' Scheme.

Executive Directors' Statement

PRC Construction and Renovation Contracts

The Company provided guarantees to certain developers/main contractors in the PRC in respect of certain constructions and renovation contracts entered into by Keyway China Limited, a wholly owned subsidiary of the Company. In July and August 2003, claims were received from these developers/main contractors in respect of two construction and renovation projects in the PRC amounting to approximately HK\$17.3 million. Full provision has been made in the accounts of the Company and the sum was fully settled through the Creditors' Scheme.

Liquidity and Financial Resources

Support for Subsidiaries with Capital Deficiencies

As at 31 December 2003, many subsidiaries of the Company were in capital deficiency, the most notable one being PCDL, with a capital deficiency of over HK\$60 million.

The Directors decided only to provide financial support for the following subsidiaries, namely, Keyway China Limited, Lucky Dragon Assets Limited and United Bright Holdings Limited. Other subsidiaries with capital deficiency would not receive continuing financial support from the Company.

Debt Equity Swap

In May 2003, the Group has entered into settlement agreements ("Debt Equity Swap") with 16 creditors whereby these creditors agreed to accept 108,774,440 new shares of the Company at HK\$0.10 each as full and final settlements of the aggregate liabilities due to these creditors amounting to HK\$10,877,000.

Redeemable Debentures

During the year, a total of HK\$12.8 million redeemable debentures were settled (2002: HK\$68 million). The aggregate amount of the redeemable debentures outstanding as at 31 December 2003 was HK\$40 million which was fully settled through the Creditors' Scheme.

Loan Notes

On 29 October 2003, the loan noteholder entered into an agreement with the Company, to waive the conversion rights attaching to the convertible loan notes. During the year, HK\$7 million (2002: HK\$Nil) of the loan notes were settled. The aggregate amount of the loan notes outstanding as at 31 December 2003 was HK\$10 million which was fully settled through the Creditors' Scheme.

Gearing Ratio

As the shareholders' equity of the Group was a deficiency of approximately HK\$178 million (2002: positive HK\$74 million), calculation of gearing ratio as at 31 December 2003 was inappropriate (2002: 91%).

Finance Cost

Interests on the Group's borrowings were based on the normal commercial interest rates for redeemable debentures, loan notes and the shareholder's loan.

Executive Directors' Statement

Exchange Rate Risk Exposure

Most of the Group's transactions were in Hong Kong Dollars and Renminbi ("RMB"). As the exchange rate of Renminbi against Hong Kong Dollar was relatively stable during the year, we were not exposed to any significant exchange risk in 2003.

Contingent Liabilities

As at 31 December 2003, there were contingent liabilities in respect of certain legal proceedings against certain subsidiaries of the Company with their customers or sub-contractors in respect of alleged contractual entitlements. The aggregate amount of claim was approximately HK\$8,483,000 (2002: HK\$5,190,000). In the opinion of the directors, the liabilities were remote and no provision has been made in the financial statements.

Capital Reorganisation, Creditors' Scheme of Arrangement, Open Offer and Whitewash Waiver

In response to the summary judgment awarded against the Company and the statutory demand issued by Mr. Siu an ex-chairman of the Company, the Company announced on 1 September 2003 that the board of directors proposed that the Company:

- (i) to implement a capital reorganisation of the Company ("Capital Reorganisation") which will involve (a) a reduction in the nominal value of each issued share from HK\$0.10 to HK\$0.0005; (b) a subdivision of each authorized and unissued share into 200 adjusted shares of HK\$0.0005 each; (c) cancellation of the entire amount standing to the credit of the share premium account of the Company; and (d) consolidation of every 20 adjusted shares of HK\$0.0005 each into 1 consolidated share of HK\$0.01 each ("Consolidated Share");
- (ii) to implement a scheme of arrangement under section 99 of the Companies Act 1981 of Bermuda and under section 166 of the Companies Ordinance (Chapter 32 of the laws of Hong Kong) between the Company and the scheme creditors (the "Creditors' Scheme") which will result in the indebtedness and liabilities owing to scheme creditors ("Total Indebtedness") as at the date for determination of entitlements of the scheme creditors (the "Scheme Record Date") being discharged in full and final settlement by way of a combination of the cash payment and the issuance of Consolidated Shares ("Creditors Shares") to the scheme creditors. Pursuant to the Creditors' Scheme, for every HK\$1 of valid claim, the Scheme Creditors will receive (a) cash payment of not more than HK\$0.1; and (b) not more than 1.5 Creditors Shares (the exact amount of cash payment and number of Creditors Shares will depend on the amount of Total Indebtedness as at the Scheme Record Date) which will be issued credited as fully paid at HK0.1 per Creditors Shares; and
- (iii) raise a minimum of approximately HK\$23.1 million (before expenses) by way of the issue of not less than 512,308,705 new Consolidated Shares ("Offer Shares") on the basis of an assured allotment of five Offer Shares for the equivalent of every Consolidated Share held by shareholders other than overseas shareholders (the "Qualifying Shareholders") at the subscription price of HK\$0.045 per Offer Share (the "Open Offer"). Qualifying Shareholders will not be allotted any Offer Shares in excess of their assured allotments.

Executive Directors' Statement

The implementation of the Capital Reorganisation, the Creditors' Scheme and the Open Offer is inter-conditional to each other.

The Capital Reorganisation and the Creditors' Scheme became effective and the Open Offer became unconditional and that all conditions precedent to the Restructuring Proposal have been fulfilled and the Restructuring Proposal was completed on 27 April 2004. There were 39 valid acceptances in respect of assured allotments of Offer Shares for a total of 181,161,680 Offer Shares (including 53,750,000 Offer Shares taken up by Euro Concord Assets Limited ("Euro Concord")). The remaining 331,147,025 Offer Shares have been taken up by Main Faith Limited ("Main Faith") under the Underwriting Agreement. After the Capital Reorganisation and the Creditors' Scheme became effective and the Open Offer became unconditional, Mr. Tam Jin Rong, together with Euro Concord and Main Faith held 410,935,123 shares, representing 51.7% of the total number of issued shares of 794,770,446 of the Company.

Net Asset Value of the Company after the Capital Reorganisation and the Creditors' Scheme became effective and the Open Offer became unconditional

Based on the capital deficiency of the Company of approximately HK\$129 million as at 31 December 2003 and adjusted for the effect of Capital Reorganisation, the Creditors' Scheme and the Open Offer, which comprised of the receipt of net proceeds from the Open Offer of approximately HK\$20.9 million, issuance of Creditors' Shares of HK\$18 million and the elimination of Scheme Indebtedness pursuant to the Creditors' Scheme of approximately HK\$97.2 million, the proforma net tangible asset of the Company was approximately HK\$7.1 million.

Future Prospects

The bright spot for the Group's businesses was the construction and property related sectors in the PRC, in particular the Guangdong Province where the Directors have extensive business networks and local expertise. We would therefore focus our efforts in pursuing opportunities in the construction and property related areas in the PRC so as to fully utilize our construction expertise.

The Directors were not optimistic with the Group's network security services business in the PRC and the system integration and IT training business in Singapore and intend not to provide additional financial support to these businesses.

We would also look for other opportunities in both Hong Kong and the PRC for investments which would generate positive cashflows and profits to the Company.

Employee

As of 31 December 2003, the Group had approximately 20 employees (2002: 18 employees) in Hong Kong, the PRC and Singapore.