

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

1. GENERAL

The Company was 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").

The Company acts as an investment holding company. The Group is principally engaged in the design, manufacture, sale and distribution of baby products comprising mainly musical toys and components, plastic and electronic toys, ride-on cars and motorised toy vehicles.

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention.

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

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 inter-company transactions and balances between group enterprises are eliminated on consolidation.

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 governing body.

Investments in subsidiaries are included in the Company's balance sheet at cost less any impairment loss.

Interests in associates

An associate is an enterprise over which the Group is in a position to exercise significant influence, through participation in financial and operating policy decisions of the investee.

The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting. The carrying amount of such interests is reduced to recognise any decline, other than a temporary decline, in the value of individual investments.

When the group enterprise transacts with its associate of the Group, unrealised profits and losses are eliminated to the extent of the Group's interest in the relevant associate, except where unrealised losses provide evidence of an impairment of the asset transferred.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Turnover

Turnover represents the net amounts received and receivable for goods sold by the Group to outside customers during the year/period.

Revenue recognition

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

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. 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 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.

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 is 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:

| | |
|--|----------------------------|
| Land held on medium-term leases in the People's Republic of China ("PRC") | Over the term of the lease |
| Buildings in the PRC | Over the term of the lease |
| Furniture, fixtures and equipment | 20% |
| Moulds | 20% |
| Leasehold improvements | 20% |
| Motor vehicles | 33 $\frac{1}{3}$ % |
| Plant and machinery | 20% |

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment (continued)

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, the term of the relevant lease.

Assets held under hire purchase contracts are depreciated over their expected useful lives on the same basis as owned assets.

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 income 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, which is on average approximately 5 years.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the first-in, first-out method. Net realisable value represents the estimated selling price less all estimated costs to completion and costs to be incurred in marketing, selling and distribution.

Finance leases and hire purchase contracts

Leases are classified as finance leases whenever the terms of the leases transfer substantially all the risks and rewards of ownership of the assets to the Group. Assets held under finance leases and hire purchase contracts are capitalised at their fair value at the dates of acquisition. The principal portions of the corresponding commitments are shown as obligations of the Group. The finance costs, which represent the difference between the total commitments and the fair value of the assets acquired, are charged to the income statement over the period of the relevant lease or contract 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 lease terms.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Foreign currencies

Transactions in foreign currencies are translated at the rates ruling on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are re-translated at the rates ruling on the balance sheet date. Profits and losses arising on translation are dealt with in the income statement.

On consolidation, the financial statements of the subsidiary which are denominated in currencies other than Hong Kong dollar are translated using the temporal method. Exchange differences arising on translation are dealt with in the income statement.

Taxation

The charge for taxation is based on the results for the year/period 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 the resulting timing differences, computed using the liability method, is recognised as deferred taxation in the financial statements to the extent that it is probable a liability or an asset will crystallise in the foreseeable future.

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 advances.

3. SEGMENTAL INFORMATION

The Group has one business segment only. The Group turnover analysed by geographical market is as follows:

| | 1.1.2000 | 1.4.1999 |
|--|-------------------|------------|
| | to | to |
| | 31.12.2000 | 31.12.1999 |
| | HK\$'000 | HK\$'000 |
| North America (principally the United States of America) | 109,962 | 119,850 |
| Asia | 15,541 | 12,883 |
| Europe | 7,276 | 14,857 |
| South America | 958 | 617 |
| Others | 304 | 2,296 |
| | 134,041 | 150,503 |

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

3. SEGMENTAL INFORMATION (continued)

Contribution to net loss by geographical market has not been presented as the contribution to net loss from each market is substantially in line with the overall Group ratio of net loss to turnover.

4. COST OF SALES

Included in cost of sales is an amount of HK\$9,899,000 (1999: HK\$319,000) being provision for slow moving stocks.

5. (LOSS) PROFIT FROM OPERATIONS

| | 1.1.2000 | 1.4.1999 |
|---|----------------------|----------------------|
| | to | to |
| | 31.12.2000 | 31.12.1999 |
| | HK\$'000 | HK\$'000 |
| (Loss) profit from operations has been arrived at after charging: | | |
| Amortisation of development costs | 1,506 | 1,130 |
| Auditors' remuneration | 594 | 520 |
| Depreciation | | |
| Owned assets | 9,326 | 8,532 |
| Assets held under finance leases and hire purchase contracts | 1,322 | 1,180 |
| Operating lease payments in respect of rented premises | 1,428 | 754 |
| Provision for doubtful debts | 3,625 | 1,226 |
| Bad debts written-off | 615 | — |
| Staff costs, included directors' emoluments | 23,086 | 22,361 |
| | <u>23,086</u> | <u>22,361</u> |

6. DIRECTORS' EMOLUMENTS

| | 1.1.2000 | 1.4.1999 |
|--|---------------------|---------------------|
| | to | to |
| | 31.12.2000 | 31.12.1999 |
| | HK\$'000 | HK\$'000 |
| Directors' fees: | | |
| Executive | — | — |
| Independent non-executive | 120 | 90 |
| | 120 | 90 |
| Other emoluments (executive directors): | | |
| Salaries and other benefits | 3,233 | 3,663 |
| Contribution to retirement benefits scheme | 292 | — |
| Long service payment | 660 | — |
| | 4,305 | 3,753 |
| | <u>4,305</u> | <u>3,753</u> |

Include in other emoluments of executive directors is an amount of HK\$294,000 (1.4.1999 to 31.12.1999: HK\$264,000) in respect of operating lease payments of rented premises.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

6. DIRECTORS' EMOLUMENTS (continued)

The directors' emoluments were within the following bands:

| | 1.1.2000 | 1.4.1999 |
|-------------------------------|------------------------|------------------------|
| | to | to |
| | 31.12.2000 | 31.12.1999 |
| | HK\$'000 | HK\$'000 |
| | Number of | Number of |
| | Directors | Directors |
| Nil — HK\$1,000,000 | 4 | 6 |
| HK\$1,000,001 — HK\$1,500,000 | 1 | — |
| HK\$1,500,001 — HK\$2,000,000 | 1 | 1 |
| | <u> </u> | <u> </u> |

7. EMPLOYEES' EMOLUMENTS

The five highest paid individuals in the Group for the year ended 31st December, 2000 and for the period from 1st April, 1999 to 31st December, 1999 were all directors of the Company and details of their emoluments are set out in note 6 above.

8. FINANCE COSTS

| | 1.1.2000 | 1.4.1999 |
|--|------------------------|------------------------|
| | to | to |
| | 31.12.2000 | 31.12.1999 |
| | HK\$'000 | HK\$'000 |
| Interest on: | | |
| Bank borrowings wholly repayable within five years | 2,959 | 3,213 |
| Finance leases and hire purchase contracts | 280 | 327 |
| Loans from a director, net of interest waived | 2,451 | 4,047 |
| Other | 8 | 72 |
| | <u> </u> | <u> </u> |
| | 5,698 | 7,659 |
| | <u> </u> | <u> </u> |

9. INVESTMENT INCOME

| | 1.1.2000 | 1.4.1999 |
|----------------------------------|------------------------|------------------------|
| | to | to |
| | 31.12.2000 | 31.12.1999 |
| | HK\$'000 | HK\$'000 |
| Interest income on bank deposits | 891 | 577 |
| | <u> </u> | <u> </u> |

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

10. TAXATION

| | 1.1.2000 | 1.4.1999 |
|--|-------------------|------------|
| | to | to |
| | 31.12.2000 | 31.12.1999 |
| | HK\$'000 | HK\$'000 |
| The (charge) credit comprises: | | |
| Overprovision of Hong Kong Profits Tax in previous year | 5 | — |
| Overseas taxation | (4) | — |
| | 1 | — |

No provision for Hong Kong Profits Tax has been made as the Group had no assessable profit for the year/period. Overseas taxation is calculated at the rate applicable in the respective jurisdiction.

11. NET LOSS FOR THE YEAR/PERIOD

Of the Group's net loss for the year of HK\$44,875,000 (1.4.1999 to 31.12.1999: HK\$2,184,000), a net loss of HK\$56,318,000 (1.4.1999 to 31.12.1999: nil) has been dealt with in the financial statements of the Company.

12. LOSS PER SHARE

The calculation of the basic loss per share is based on the net loss for the year/period of HK\$44,875,000 (1.4.1999 to 31.12.1999: HK\$2,184,000) and on the weighted average number of 443,577,978 shares (1.4.1999 to 31.12.1999: 290,100,000) in issue during the year.

No diluted loss per share figures have been presented as the exercise of the potential shares is anti-dilutive for the year ended 31st December, 2000 and the exercise prices of the Company's outstanding share options were higher than the fair value per share of the Company during the period from 1st April, 1999 to 31st December, 1999.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

13. PROPERTY, PLANT AND EQUIPMENT

| | Leasehold land and buildings <i>HK\$'000</i> | Furniture, fixtures and equipment <i>HK\$'000</i> | Moulds <i>HK\$'000</i> | Leasehold improve- ments <i>HK\$'000</i> | Motor vehicles <i>HK\$'000</i> | Plant and machinery <i>HK\$'000</i> | Total <i>HK\$'000</i> |
|-------------------------------|---|---|---------------------------|---|--------------------------------------|--|--------------------------|
| THE GROUP | | | | | | | |
| COST | | | | | | | |
| At 1st January, 2000 | 92,154 | 11,085 | 24,792 | 8,219 | 1,939 | 40,267 | 178,456 |
| Additions | 16,452 | 811 | 2,345 | — | — | 456 | 20,064 |
| Provision for impairment loss | (8,000) | — | — | — | — | — | (8,000) |
| At 31st December, 2000 | <u>100,606</u> | <u>11,896</u> | <u>27,137</u> | <u>8,219</u> | <u>1,939</u> | <u>40,723</u> | <u>190,520</u> |
| DEPRECIATION | | | | | | | |
| At 1st January, 2000 | 6,320 | 6,364 | 20,030 | 7,497 | 1,761 | 31,815 | 73,787 |
| Provided for the year | <u>2,158</u> | <u>1,960</u> | <u>2,801</u> | <u>302</u> | <u>77</u> | <u>3,350</u> | <u>10,648</u> |
| At 31st December, 2000 | <u>8,478</u> | <u>8,324</u> | <u>22,831</u> | <u>7,799</u> | <u>1,838</u> | <u>35,165</u> | <u>84,435</u> |
| NET BOOK VALUES | | | | | | | |
| At 31st December, 2000 | <u>92,128</u> | <u>3,572</u> | <u>4,306</u> | <u>420</u> | <u>101</u> | <u>5,558</u> | <u>106,085</u> |
| At 31st December, 1999 | <u>85,834</u> | <u>4,721</u> | <u>4,762</u> | <u>722</u> | <u>178</u> | <u>8,452</u> | <u>104,669</u> |

The net book value of property, plant and equipment of the Group includes an amount of HK\$2,320,000 (1999: HK\$5,131,000) in respect of assets held under finance leases and hire purchase contracts.

At the balance sheet date, the leasehold land and buildings are held under medium-term leases in the PRC.

**Furniture,
fixtures and
equipment**
HK\$'000

THE COMPANY

COST

At 1st January, 2000 and at 31st December, 2000 38

DEPRECIATION

At 1st January, 2000 and at 31st December, 2000 38

NET BOOK VALUE

At 31st December, 2000 and at 31st December, 1999 —

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

14. DEVELOPMENT COSTS

| | THE GROUP |
|---|------------------|
| | <i>HK\$'000</i> |
| COST | |
| At 1st January, 2000 and at 31st December, 2000 | 9,464 |
| AMORTISATION | |
| At 1st January, 2000 | 4,298 |
| Provided for the year | 1,506 |
| At 31st December, 2000 | 5,804 |
| NET BOOK VALUES | |
| At 31st December, 2000 | <u>3,660</u> |
| At 31st December, 1999 | <u>5,166</u> |

15. INTEREST IN SUBSIDIARIES

| | THE COMPANY | |
|--|------------------------|-----------------|
| | 2000 | 1999 |
| | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Unlisted shares | 40,275 | 40,275 |
| Amounts due from subsidiaries | 164,517 | 78,697 |
| Provision on amounts due from subsidiaries | (56,318) | — |
| | <u>148,474</u> | <u>118,972</u> |

The amounts due from subsidiaries are unsecured, non-interest bearing and have no fixed terms of repayment.

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 in 1994, less dividends distributed from pre-reorganisation reserves of the subsidiaries.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

15. INTEREST IN SUBSIDIARIES (continued)

Details of the Company's subsidiaries at 31st December, 2000, all of which are held indirectly by the Company except Rockapetta Investment Limited, are as follows:

| Name of subsidiary | Place of incorporation or registration/ operations | Attributable equity interest of the Group | Nominal value of issued ordinary share capital/ registered capital* | Principal activities |
|---|--|---|---|--|
| Rockapetta Investment Limited | British Virgin Islands/ Hong Kong | 100% | US\$10,000 | Investment holding |
| Rockapetta International Limited | British Virgin Islands/ Hong Kong | 100% | US\$1 | Sale and distribution of plastic toys |
| Rockapetta Industrial Company Limited | Hong Kong | 100% | HK\$1,200,000 | Sale and distribution of plastic toys |
| Rockapetta Toys Limited | Hong Kong | 100% | HK\$2 | Inactive |
| Rockapetta Toys Manufacturing Company Limited | Hong Kong | 100% | HK\$1,000,000 | Sale and distribution of plastic toys |
| Grand Extend Investments Limited | Hong Kong | 100% | HK\$10 | Inactive |
| Mitsuyo Seiki (H.K.) Company Limited | Hong Kong | 100% | HK\$2 | Manufacture and sale of musical movements and components |
| Shenzhen Rockapetta Toys Co., Ltd. | PRC | 100% (Note) | US\$7,530,000* | Manufacture and sale of plastic toys |

Note:

Shenzhen Rockapetta Toys Co., Ltd. was established in the PRC under a joint venture agreement with a PRC party. Under a separate agreement, the Group is responsible for managing the operations and production facilities. The Group is responsible for its assets and liabilities and is entitled to share 100% of its results after the payment of a fixed amount of management fee to the PRC party each year during the term of the joint venture.

None of the subsidiaries had any loan capital outstanding at the end of the year/period.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

16. INTEREST IN ASSOCIATES

| | THE GROUP | |
|---------------------|---------------------|-----------------|
| | 2000 | 1999 |
| | HK\$'000 | <i>HK\$'000</i> |
| Share of net assets | <u>1,540</u> | <u>1,696</u> |

At 31st December, 2000, the Group has not paid up its share of the capital of an associate which is represented by the amount due to an associate amounting to HK\$2,168,000 (1999: HK\$2,168,000).

Particulars of the associates at 31st December, 2000 are as follows:

| Name of company | Form of business structure | Place of incorporation | Principal place of operation | Class of shares held | Proportion of nominal value of issued capital held by the Group | Principal activities |
|--------------------------------------|----------------------------------|---------------------------|------------------------------------|-------------------------|---|-------------------------|
| Sanyu (B.V.I.) Ltd. | Incorporated | British Virgin Islands | Hong Kong | Ordinary | 40% | Investment holding |
| Sanyu Engineering Company Limited | Incorporated | Hong Kong | Hong Kong | Ordinary | 40% | Inactive |

17. INVENTORIES

| | THE GROUP | |
|------------------|----------------------|-----------------|
| | 2000 | 1999 |
| | HK\$'000 | <i>HK\$'000</i> |
| Raw materials | 28,044 | 32,633 |
| Work in progress | 11,145 | 11,914 |
| Finished goods | <u>21,071</u> | <u>22,597</u> |
| | <u>60,260</u> | <u>67,144</u> |

Included above are raw materials of HK\$3,663,000 (1999: HK\$2,772,000), work in progress of HK\$2,067,000 (1999: HK\$34,000) and finished goods of HK\$3,197,000 (1999: HK\$567,000) which are carried at their net realisable values.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

18. DEBTORS, PREPAYMENTS AND DEPOSITS

Included in debtors, prepayments and deposits are trade debtors of HK\$14,122,000 (1999: HK\$19,653,000). The Group allows an average credit period of 60 days to trade customers. The aged analysis of trade debtors is as follows:

| | THE GROUP | |
|--------------------|------------------|------------------|
| | 2000 HK\$'000 | 1999 HK\$'000 |
| Aged: | | |
| 0 to 60 days | 3,658 | 14,235 |
| 61 to 90 days | 3,774 | 679 |
| 91 to 120 days | 4,530 | 555 |
| more than 120 days | 2,160 | 4,184 |
| | <u>14,122</u> | <u>19,653</u> |

19. CREDITORS AND ACCRUED CHARGES

Included in creditors and accrued charges are trade creditors of HK\$20,766,000 (1999: HK\$26,687,000). The aged analysis of trade creditors is as follows:

| | THE GROUP | |
|--------------------|------------------|------------------|
| | 2000 HK\$'000 | 1999 HK\$'000 |
| Aged: | | |
| 0 to 60 days | 7,415 | 21,645 |
| 61 to 90 days | 6,678 | 2,764 |
| 91 to 120 days | 4,352 | 580 |
| more than 120 days | 2,321 | 1,698 |
| | <u>20,766</u> | <u>26,687</u> |

20. LOANS FROM A DIRECTOR

The loans at 31st December, 2000 are unsecured, bear interest at prime rate and have no fixed terms of repayment. During the year, interest amounting to HK\$3,167,000 (1.4.1999 to 31.12.1999: HK\$1,200,000) was waived by the director.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

21. SECURED BANK BORROWINGS

| | THE GROUP | |
|---------------------|----------------------|-----------------|
| | 2000 | 1999 |
| | HK\$'000 | <i>HK\$'000</i> |
| Trust receipt loans | 4,496 | 12,106 |
| Bank loans | 23,853 | 28,552 |
| Bank overdrafts | 2,178 | 2,048 |
| | <u>30,527</u> | <u>42,706</u> |

The bank borrowings are repayable within one year or on demand.

22. OBLIGATIONS UNDER FINANCE LEASES AND HIRE PURCHASE CONTRACTS

| | THE GROUP | |
|---|---------------------|-------------------|
| | 2000 | 1999 |
| | HK\$'000 | <i>HK\$'000</i> |
| The maturity of obligations under finance leases and hire purchase contracts is as follows: | | |
| Within one year | 494 | 1,823 |
| More than one year but not exceeding two years | <u>—</u> | <u>588</u> |
| | 494 | 2,411 |
| Less: Amount due within one year shown under current liabilities | <u>(494)</u> | <u>(1,823)</u> |
| Amount due after one year | <u><u>—</u></u> | <u><u>588</u></u> |

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

23. SHARE CAPITAL

| | Number of shares | Value HK\$'000 |
|--|----------------------|--------------------|
| Ordinary shares of HK\$0.10 each: | | |
| Authorised: | | |
| At 1st April, 1999 and 1st January, 2000 | 500,000,000 | 50,000,000 |
| Increment in current year (<i>note a</i>) | <u>4,500,000,000</u> | <u>450,000,000</u> |
| At 31st December, 2000 | <u>5,000,000,000</u> | <u>500,000,000</u> |
| Issued and fully paid: | | |
| At 1st April, 1999 and 1st January, 2000 | 290,100,000 | 29,010 |
| Issue of shares upon subscription (<i>notes b and c</i>) | 238,000,000 | 23,800 |
| Exercise of options | 1,660,000 | 166 |
| Exercise of conversion right of convertible notes (<i>note d</i>) | <u>30,000,000</u> | <u>3,000</u> |
| At 31st December, 2000 | <u>559,760,000</u> | <u>55,976</u> |

Notes:

(a) Pursuant to a special resolution passed on 16th June, 2000, the authorised share capital of the Company was increased from HK\$50,000,000 to HK\$500,000,000 by the creation of an additional 4,500,000,000 ordinary shares of HK\$0.10 each ranking pari passu with the existing issued and unissued shares of the Company in all respects.

(b) On 23rd March, 2000, arrangements were made for a private placement to independent private investors of 58,000,000 shares of HK\$0.10 each in the Company held by Victory Wall Enterprises Limited, a substantial shareholder of the Company, at a total consideration of HK\$31,199,000 per share representing a discount of approximately 28% to the closing market price of the Company's shares on 22nd March, 2000.

Pursuant to a subscription agreement of the same date, Victory Wall Enterprises Limited subscribed for 58,000,000 new shares of HK\$0.10 each in the Company in a total consideration of HK\$31,199,000. The proceeds were used to reduce short-term borrowings and to provide additional working capital for the Group. These new shares were issued under the general mandate granted to the directors at the annual general meeting of the Company held on 30th September, 1999 and rank pari passu with other shares in issue in all respects.

(c) On 28th April, 2000, the Company issued and placed 180,000,000 new ordinary placing shares of HK\$0.10 each in the share capital of the Company at a price of HK\$0.20 per share representing a discount of approximately 23.1% to the closing market price of the Company's shares on 25th April, 2000. The proceeds were used as general working capital for the day to day operations of the Group. These shares rank pari passu with other shares in issue in all respects.

(d) In August, 2000, the Company allotted an aggregate of 30,000,000 new shares of HK\$0.1 each at HK\$0.22 per share as a result of the exercise of conversion rights of convertible notes as detailed in note 27. These shares rank pari passu with other shares in issue in all respects.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

24. SHARE OPTIONS

Under the Company's share option scheme, the directors may at their discretion grant options to employees of the Group, including directors in full time employment with the Company and its subsidiaries, to subscribe for shares in the Company. The subscription price of the option shares shall be a price to be determined by the directors being not less than 80% of the average of the closing prices of the Company's shares on the Stock Exchange for the five trading days immediately preceding the date of offer of the option or the nominal value of a share, whichever is higher. The maximum number of shares in respect of which options may be granted under the share option scheme shall not exceed 10% of the issued share capital of the Company from time to time. The movement in the number of share options during the period and the balance outstanding at 31st December, 2000 are as follows:

| Exercise price | Number of share options | | | | |
|--------------------|-------------------------|-------------------------------|---------------------------------|------------------------------|-------------------|
| | At 1.1.2000 | Granted during the year | Exercised during the year | Lapsed during the year | At 31.12.2000 |
| HK\$0.62 per share | 6,260,000 | — | — | 4,000,000 | 2,260,000 |
| HK\$0.61 per share | 600,000 | — | — | — | 600,000 |
| HK\$0.32 per share | 1,660,000 | — | 1,660,000 | — | — |
| HK\$0.17 per share | — | 11,600,000 | — | — | 11,600,000 |
| | <u>8,520,000</u> | <u>11,600,000</u> | <u>1,660,000</u> | <u>4,000,000</u> | <u>14,460,000</u> |

During the year ended 31st December, 2000, no consideration was received from the granting of share options.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

25. RESERVES

| | Share premium <i>HK\$'000</i> | Contributed surplus <i>HK\$'000</i> <i>Note (a)</i> | Capital reserve <i>HK\$'000</i> <i>Note (b)</i> | Deficit <i>HK\$'000</i> | Total <i>HK\$'000</i> |
|--|-------------------------------------|--|--|----------------------------|--------------------------|
| THE GROUP | | | | | |
| At 1st April, 1999 | 42,247 | — | 2,099 | (11,971) | 32,375 |
| Net loss for the period | — | — | — | (2,184) | (2,184) |
| At 31st December, 1999 | 42,247 | — | 2,099 | (14,155) | 30,191 |
| Premium arising from exercise of options | 365 | — | — | — | 365 |
| Shares issue expenses | (1,627) | — | — | — | (1,627) |
| Premium arising from issue of shares upon subscription | 43,399 | — | — | — | 43,399 |
| Premium arising from exercising conversion right of convertible notes | 3,600 | — | — | — | 3,600 |
| Net loss for the year | — | — | — | (44,875) | (44,875) |
| At 31st December, 2000 | <u>87,984</u> | <u>—</u> | <u>2,099</u> | <u>(59,030)</u> | <u>31,053</u> |
| THE COMPANY | | | | | |
| At 1st April, 1999 and 31st December, 1999 | 42,247 | 50,492 | — | (2,539) | 90,200 |
| Premium arising from exercise of options | 365 | — | — | — | 365 |
| Shares issue expenses | (1,627) | — | — | — | (1,627) |
| Premium arising from issue of shares upon subscription | 43,399 | — | — | — | 43,399 |
| Premium arising from exercising conversion right of convertible notes | 3,600 | — | — | — | 3,600 |
| Net loss for the year | — | — | — | (56,318) | (56,318) |
| At 31st December, 2000 | <u>87,984</u> | <u>50,492</u> | <u>—</u> | <u>(58,857)</u> | <u>79,619</u> |

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

25. RESERVES (continued)

Notes:

- (a) The contributed surplus of the Company represents the difference between the underlying net tangible assets of the subsidiaries which were acquired by the Company and the nominal value of the share capital issued by the Company to acquire the assets.

Under the Companies Act 1981 of Bermuda (as amended), the contributed surplus of the Company is available for distribution. However, the Company cannot declare or pay a dividend, or make a distribution out of contributed surplus if:

- (i) it is, or would after the payment be, unable to pay its liabilities as they become due; or
 - (ii) the realisable value of its assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts.
- (b) The capital reserve arising from the group reorganisation represents the difference between the nominal value of the share capital issued by the Company in exchange for the aggregate nominal values of the share capital of the subsidiaries.

The Company has no reserves available for distribution to shareholders.

26. OTHER PAYABLE

The amount is unsecured, interest free and repayable after one year.

27. CONVERTIBLE NOTES

Convertible notes of HK\$13,200,000 were issued on 22nd June, 2000. The convertible notes are unsecured, interest free and are repayable on the second anniversary of the issue date. The noteholders have the rights to convert all or part of the principal amount of the convertible notes outstanding into shares of the Company of HK\$0.10 each at an initial conversion price of HK\$0.22 per share, within two years of the issue of the convertible notes.

In August, 2000, convertible notes with a nominal value of HK\$6,600,000 were converted into shares of the Company at a conversion price of HK\$0.22 per share resulting in the issue of 30,000,000 shares of HK\$0.10 each of the Company.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

28. DEFERRED TAXATION

At the balance sheet date, the Group and the Company each have a deferred taxation asset which has not been recognised in the financial statements as it is not certain whether the asset will be realised in the foreseeable future. The components of the deferred taxation asset not recognised in the financial statements at the balance sheet date are as follows:

| | THE GROUP | | THE COMPANY | |
|---|---------------------|---------------------|-------------------|-------------------|
| | 2000 HK\$'000 | 1999 HK\$'000 | 2000 HK\$'000 | 1999 HK\$'000 |
| Tax effect of timing differences attributable to: | | | | |
| Shortfall of tax allowances over depreciation | 739 | 669 | 1 | 1 |
| Tax losses | <u>8,488</u> | <u>7,855</u> | <u>671</u> | <u>643</u> |
| Deferred taxation asset | <u>9,227</u> | <u>8,524</u> | <u>672</u> | <u>644</u> |

The components of unprovided net deferred taxation credit for the year/period is as follows:

| | THE GROUP | | THE COMPANY | |
|---|--|--|--|--|
| | 1.1.2000 to 31.12.2000 HK\$'000 | 1.4.1999 to 31.12.1999 HK\$'000 | 1.1.2000 to 31.12.2000 HK\$'000 | 1.4.1999 to 31.12.1999 HK\$'000 |
| Tax effect of timing differences attributable to: | | | | |
| Shortfall of tax allowances over depreciation | 70 | 736 | — | — |
| Tax losses arising | <u>633</u> | <u>270</u> | <u>28</u> | <u>34</u> |
| | <u>703</u> | <u>1,006</u> | <u>28</u> | <u>34</u> |

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

29. RECONCILIATION OF LOSS BEFORE TAXATION TO NET CASH (OUTFLOW) INFLOW FROM OPERATING ACTIVITIES

| | 1.1.2000 | 1.4.1999 |
|---|------------------------|----------------------|
| | to | to |
| | 31.12.2000 | 31.12.1999 |
| | HK\$'000 | HK\$'000 |
| Loss before taxation | (44,876) | (2,184) |
| Share of losses of associates | 156 | 10 |
| Interest income | (891) | (577) |
| Interest expense | 5,418 | 7,332 |
| Interest on obligations under finance leases and hire purchase contracts | 280 | 327 |
| Amortisation of development costs | 1,506 | 1,130 |
| Depreciation | 10,648 | 9,712 |
| Provision for impairment loss of property, plant and equipment | 8,000 | — |
| Provision for slow moving inventories | 9,899 | 319 |
| Provision for doubtful debts | 3,625 | 1,226 |
| Bad debts written off | 615 | — |
| Increase in inventories | (3,015) | (3,890) |
| Increase in debtors, prepayments and deposits | (1,859) | (7,732) |
| (Decrease) increase in creditors and accrued charges | (4,376) | 5,933 |
| | <hr/> | <hr/> |
| Net cash (outflow) inflow from operating activities | <u>(14,870)</u> | <u>11,606</u> |

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

30. ANALYSIS OF CHANGES IN FINANCING DURING THE YEAR/PERIOD

| | Share capital and share premium <i>HK\$'000</i> | Loans from a director <i>HK\$'000</i> | Amount due to a director <i>HK\$'000</i> | Trust receipt loans <i>HK\$'000</i> | Bank loans <i>HK\$'000</i> | Obligations under finance leases and hire purchase contracts <i>HK\$'000</i> | Convertible notes <i>HK\$'000</i> |
|---|---|--|---|--|----------------------------------|---|---|
| Balance at 1st April, 1999 | 71,257 | 83,000 | — | 3,260 | 28,552 | 4,978 | — |
| New borrowings | — | — | 2,320 | 38,048 | 10,000 | — | — |
| Repayments | — | — | — | (40,451) | (10,000) | (2,567) | — |
| Balance at | | | | | | | |
| 31st December, 1999 | 71,257 | 83,000 | 2,320 | 857 | 28,552 | 2,411 | — |
| Proceeds from issue of shares upon subscription and exercise of options | 67,730 | — | — | — | — | — | — |
| Shares issue expenses | (1,627) | — | — | — | — | — | — |
| New borrowings | — | — | 622 | 55,301 | — | — | 13,200 |
| Repayments | — | (38,500) | — | (53,657) | (4,699) | (1,917) | — |
| Proceeds from issue of shares upon exercise of conversion right of convertible notes | 6,600 | — | — | — | — | — | (6,600) |
| Balance at | | | | | | | |
| 31st December, 2000 | <u>143,960</u> | <u>44,500</u> | <u>2,942</u> | <u>2,501</u> | <u>23,853</u> | <u>494</u> | <u>6,600</u> |

31. ANALYSIS OF THE BALANCES OF CASH AND CASH EQUIVALENTS

| | 2000 <i>HK\$'000</i> | 1999 <i>HK\$'000</i> |
|------------------------|-------------------------|-------------------------|
| Bank balances and cash | 7,199 | 3,677 |
| Bank overdrafts | (2,178) | (2,048) |
| Trust receipt loans | (1,995) | (11,249) |
| | <u>3,026</u> | <u>(9,620)</u> |

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

32. NON CASH TRANSACTIONS

Additions to leasehold land and buildings during 2000 amounting to HK\$11,713,000 (1.4.1999 to 31.12.1999: Nil) were acquired on deferred payment term, and will be settled in cash in the future years.

33. PLEDGE OF ASSETS

At 31st December, 2000, certain of the Group's bank deposits of HK\$8,267,000 (1999: HK\$13,560,000) were pledged to banks to secure banking facilities granted to a subsidiary.

At 31st December, 2000, certain of the Group's leasehold land and buildings in PRC with an aggregate net book value of HK\$82,053,000 (1999: HK\$63,697,000) were pledged to banks to secure bank loans granted to a subsidiary.

34. OPERATING LEASE COMMITMENTS

At the balance sheet date, the Group had annual commitments payable in the following year under non-cancellable operating leases in respect of rented premises as follows:

| | 2000 | 1999 |
|--|---------------------|--------------|
| | HK\$'000 | HK\$'000 |
| Operating leases which expire: | | |
| Within one year | 237 | 169 |
| In the second to fifth years inclusive | 1,394 | 1,214 |
| | <u>1,631</u> | <u>1,383</u> |

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

35. CAPITAL COMMITMENTS

| | THE GROUP | |
|---|-------------------|------------|
| | 2000 | 1999 |
| | HK\$'000 | HK\$'000 |
| Capital expenditure contracted for but not provided in the financial statements in respect of acquisition of: | | |
| — furniture, fixtures and equipment | 97 | — |
| — land and buildings | 190 | 392 |
| | <u>287</u> | <u>392</u> |
| Capital expenditure authorized but not contracted for in the financial statement in respect of acquisition of land and building | <u>212</u> | <u>—</u> |

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2000

36. CONTINGENT LIABILITIES

| | THE GROUP | | THE COMPANY | |
|---|-----------|----------|--------------|----------|
| | 2000 | 1999 | 2000 | 1999 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Guarantees given to banks in respect of banking facilities utilised by subsidiaries | — | — | 6,674 | 14,153 |

37. RELATED PARTY TRANSACTIONS

During the year, the Group sold its products to two related parties for an aggregate amount of HK\$16,715,000 (1.4.1999 to 31.12.1999: HK\$71,130,000). The amount owed by these related parties at 31st December, 2000 included in debtors was HK\$10,685,000 (1999: HK\$8,081,000). The parties concerned are related to the Company since they are enterprises controlled by a shareholder of the Company. The transactions were carried out on cost plus mark up basis.

Total loans from Mr. Kwok Chin Wing as at 31st December, 2000 amounted to HK\$44,500,000 (1999: HK\$83,000,000). The loans bear interest at prime rate. Interest amounting to HK\$3,167,000 (1.4.1999 to 31.12.1999: HK\$1,200,000) was waived by the director, accordingly interest payable by the Group on the loans during the year amounted to HK\$2,451,000 (1.4.1999 to 31.12.1999: HK\$4,047,000).

The amount due from an associate and the amount due to a director are unsecured, non-interest bearing and have no fixed terms of repayment.

38. RETIREMENT BENEFITS SCHEME

The Group has operated a defined contribution retirement benefits scheme ("Benefits Scheme") for all qualifying employees since January, 2000. The assets of the Benefits Scheme are held separately under a provident fund managed by an independent trustee. The retirement benefits scheme contributions represent contributions payable to the fund by the Group at rates specified in the Benefits Scheme. In December, 2000, the Group had joined the Mandatory Provident Fund Scheme ("MPF Scheme") under the rules and regulations of the Mandatory Provident Fund Authority. All the previous retirement benefits scheme contributions were transferred to the MPF Scheme.

The staff costs as disclosed in note 5 to the financial statements include Benefits Scheme contributions of HK\$222,000.