



# Notes to Financial Statements

31 December 2000

## 1. CORPORATE INFORMATION AND UPDATE

During the year, the Group was involved in the processing and sale of semi-finished and finished leather, and the design, manufacture and sale of leather ware products.

The Group reported a net loss attributable to shareholders of approximately HK\$85 million for the year ended 31 December 2000 (1999: HK\$65 million) and its consolidated net current assets were approximately HK\$261 million (1999: HK\$200 million) and had amounts due to bank creditors of approximately HK\$226 million (1999: HK\$273 million) as at that date. In prior years, the Directors are of the view that a number of the Group's loan covenants, as required by certain loan agreements, have not been complied with. As at 31 December 1999, nearly all the amounts due to bank creditors had become repayable on demand and, accordingly, have been classified as current liabilities. In preparing these financial statements, the Directors have given careful consideration to the future liquidity of the Group in the light of its own resources and prospects, together with the current financial position of Guangdong Investment Limited ("GDI", and together with its subsidiaries referred to as the "GDI Group"), the Company's immediate holding company and previous ultimate holding company before the completion of the Acquisition, as described below.

As has been publicised in a number of the Company's official announcements starting in 1999 jointly with GDI, the GDI Group, including the Group, underwent a restructuring to reschedule the GDI Group's financial borrowings (including those of the Group, but excluding those of Guangdong Brewery Holdings Limited and subsidiaries and loans owing to any banks or financial institutions established in Mainland China by the GDI Group companies that were established in Mainland China) (the "Debt Restructuring"). A banks' steering group was formed and negotiated with the GDI Group, including the Group, the terms of formal agreements relating to the Debt Restructuring. The eventual outcome of these negotiations was dependent on the completion of GDI's acquisition of Dongshen Water Project as further explained below. During such negotiations, the interest payments at normal contractual non-default rates continued to be made by the Group, but the repayment of loan principal was temporarily postponed.

As part of the restructuring of Guangdong Enterprises (Holdings) Limited ("GDE", the then substantial shareholders of GDI) and its subsidiaries (the "GDE Group") (the "GDE Restructuring"), on 22 December 2000, GDI completed an acquisition of an 81% equity



## Notes to Financial Statements (Cont'd)

31 December 2000

### 1. CORPORATE INFORMATION AND UPDATE (Cont'd)

interest in GH Water Supply (Holdings) Limited ("GH Water") (the "Acquisition") from GDH Limited, which is a wholly-owned subsidiary of 廣東粵港投資控股有限公司 (Guangdong Yue Gang Investment Holdings Company Limited) ("Yue Gang Investment"), a company established by the Guangdong Provincial Government in Mainland China. GH Water holds a 99% interest in Guangdong Yue Gang Water Supply Company Limited which owns the Dongshen Water Supply Project that generates revenue mainly from the provision and supply of natural water to Hong Kong.

Upon GDI's completion of the Acquisition, GDI became a subsidiary of Yue Gang Investment and the GDI Group's Debt Restructuring, including the Group, was completed whereby, amongst other things, a Tannery Override Agreement dated 22 December 2000 (the "TOA") was entered into between the Company and its bank creditors and effected. Pursuant to the TOA, inter alia, the Group is required to repay approximately HK\$197 million, all of the Group's existing non-PRC bank debts as at 31 December 2000, by no later than 31 December 2003. The TOA will operate by way of a formal standstill, but override provisions will permit creditors to terminate the restructuring schemes and revert to the terms of the existing loan agreements upon the occurrence of events of default. Accordingly, the Group's bank borrowings as at 31 December 2000 have been reclassified according to the repayment schedule as contained in the TOA.

The Directors were informed that the GDE Restructuring was also completed on 22 December 2000. In the light of the completion of the GDE Restructuring, the Debt Restructuring (including the Group) and the Acquisition, the Directors believe that the Group has sufficient working capital to satisfy its future working capital and other financial requirements prescribed in the TOA. Accordingly, these financial statements have been prepared on a going concern basis.

In the opinion of the Directors, the ultimate holding company of the Company as at 31 December 2000 is Yue Gang Investment.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Statements of Standard Accounting Practice, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Companies Ordinance. They have been prepared under the historical cost convention, except for the remeasurement of investment properties and leasehold land and buildings, as further explained below.



## **Notes to Financial Statements** (Cont'd)

31 December 2000

### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

#### **Basis of consolidation**

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2000. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively. All significant intra-group transactions and balances within the Group are eliminated on consolidation.

#### **Subsidiaries**

Subsidiaries are companies in which the Company, directly or indirectly, controls more than half of their voting power or issued share/registered capital or controls the composition of their boards of directors. Interests in subsidiaries are stated at cost unless, in the opinion of the Directors, there have been permanent diminutions in values, when they are written down to values determined by the Directors.

#### **Associates**

An associate is a company, not being a subsidiary or a joint venture, in which the Group has a long term interest of not less than 20% of the equity voting rights and over which it is in a position to exercise significant influence.

The Group's share of the post-acquisition results and reserves of associates is included in the consolidated profit and loss account and consolidated reserves, respectively. The Group's interests in associates are stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting.

#### **Joint venture companies**

Joint venture companies comprise companies operating, directly or indirectly, in the mainland of the People's Republic of China ("Mainland China" or the "PRC") as independent business entities. The joint venture agreements between the venturers stipulate the capital contributions of the joint venture parties, the duration of the joint



## **Notes to Financial Statements** (Cont'd)

31 December 2000

### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

#### **Joint venture companies (Cont'd)**

venture and the basis on which assets are to be realised upon its dissolution. The profits and losses from operations and any distribution of surplus assets are shared by the venturers either in proportion to their respective capital contributions, or in accordance with the terms of the joint venture agreements.

A joint venture company is treated as a subsidiary if the Group has effective control over the joint venture company.

#### **Goodwill on consolidation**

Goodwill arising on consolidation of subsidiaries or on acquisition of associates represents the excess of the purchase consideration paid for subsidiaries and associates over the fair values ascribed to the net underlying assets acquired at the date of acquisition and is eliminated against reserves in the year of acquisition.

Upon disposal of subsidiaries or associates, the attributable amount of purchased goodwill on consolidation previously dealt with in reserves is realised and taken into account in arriving at the gain or loss on disposal of the investments.

Where there is an impairment in value of goodwill, it is written down to its recoverable amount as estimated by the Directors. The reduction in value is charged to the profit and loss account.

#### **Fixed assets and depreciation**

Fixed assets, other than construction in progress and investment properties, are stated at cost or valuation less accumulated 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 fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account 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 fixed asset, the expenditure is capitalised as an additional cost of the fixed asset.



## Notes to Financial Statements (Cont'd)

31 December 2000

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### Fixed assets and depreciation (Cont'd)

When assets are sold or retired, their cost and accumulated depreciation are eliminated from the financial statements. Any gain or loss resulting from their disposal is included in the profit and loss account.

Changes in the values of leasehold land and buildings are dealt with as movements in the property revaluation reserve. If the total of this reserve is insufficient to cover a deficit, on an individual asset basis, the excess of the deficit is charged to the profit and loss account. Any subsequent revaluation surplus is credited to the profit and loss account to the extent of the deficit previously charged. On disposal of a revalued asset, the relevant portion of the revaluation reserve realised in respect of previous valuations is transferred to retained earnings as a movement in reserves.

Depreciation is calculated on the straight-line basis to write off the cost or valuation of each asset over its estimated useful life. The principal annual rates used for this purpose are as follows:

Leasehold land held under long and medium term leases	Over the lease terms
Buildings	2% – 10%
Leasehold improvements	4% – 20%
Plant and machinery	10% – 12.5%
Electronic equipment	20%
Motor vehicles	15% – 20%
Furniture, fixtures and equipment	15% – 20%

#### Construction in progress

Construction in progress is stated at cost, which includes the costs of construction, interest charges and other direct costs attributable to the construction.

No provision for depreciation is made on construction in progress until such time as the relevant assets are completed and put into use.



## Notes to Financial Statements (Cont'd)

31 December 2000

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### Investment properties

Investment properties are interests in land and buildings in respect of which construction work and development have been completed and which are intended to be held on a long term basis for their investment potential. Such properties held on unexpired leases of over 20 years are not depreciated and are stated at their open market values, based on their existing use, on the basis of annual professional valuations. Leases of 20 years or less to expiry are amortised on a straight-line basis over the remaining terms of leases on the then carrying value. Changes in the values of investment properties are dealt with as movements in the property revaluation reserve. If the relevant total of this reserve is insufficient to cover a deficit, on a portfolio basis, the excess of the deficit is charged to the profit and loss account. Any subsequent revaluation surplus is credited to the profit and loss account to the extent of the deficit previously charged.

On disposal of an investment property, the relevant portion of the property revaluation reserve realised in respect of previous valuations is released to the profit and loss account.

#### Trademarks

Trademarks are stated at their acquisition costs less accumulated amortisation. Amortisation is calculated on a straight-line basis to write off their costs over a period of 20 years.

Expenditure incurred for the renewal of trademarks is charged to the profit and loss account in the period in which it is incurred.

Where, in the opinion of the Directors, the recoverable amounts of trademarks have declined below their carrying amounts, provisions are made to write down the carrying amounts of such assets to their recoverable amounts. Reductions of recoverable amounts are charged to the profit and loss account.



## **Notes to Financial Statements** (Cont'd)

31 December 2000

### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

#### **Operating leases**

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Rentals applicable to such operating leases are charged to the profit and loss account on the straight-line basis over the lease terms.

#### **Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour and an appropriate proportion of overheads. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

#### **Deferred taxation**

Deferred taxation is provided, using the liability method, on all significant timing differences to the extent it is probable that the liability will crystallise in the foreseeable future. A deferred tax asset is not recognised until its realisation is assured beyond reasonable doubt.

#### **Foreign currencies**

Foreign currency transactions are recorded at the applicable rates of exchange ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable rates of exchange ruling at that date. Exchange differences are dealt with in the profit and loss account.

On consolidation, the financial statements of subsidiaries and associates operating in Mainland China and overseas are translated into Hong Kong dollars at the applicable rates of exchange ruling at the balance sheet date. The resulting translation differences are included in the exchange translation reserve.



## Notes to Financial Statements (Cont'd)

31 December 2000

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### Pension costs

The Company and certain of its subsidiaries operate a defined contribution Mandatory Provident Fund retirement benefits scheme (the “Scheme”) under the Mandatory Provident Fund Schemes Ordinance, for those employees who are eligible to participate in the Scheme. The Scheme became effective from 1 December 2000. Contributions are made based on a percentage of the employees’ basic salaries and are charged to the profit and loss account as they become payable in accordance with the rules of the Scheme. The assets of the Scheme are held separately from those of the Group in an independently administered fund. The Group’s employer contributions vest fully with the employees when contributed into the Scheme except for the Group’s employer voluntary contributions, which are refunded to the Group when the employee leaves employment prior to the contributions vesting fully, in accordance with the rules of the Scheme.

Prior to the Scheme being effective, the Company and certain of its subsidiaries operated a defined contributions retirement benefits scheme for those employees who were eligible to participate in the scheme. This scheme operated in a similar way to the Mandatory Provident Fund retirement benefit scheme, except that when an employee left the scheme prior to his/her interest in the Group’s employee contributions vesting fully, the ongoing contributions payable to the Group were reduced by the relevant amount of forfeited contributions. With effect from 1 December 2000 this scheme was terminated.

For certain subsidiaries of the Company in Mainland China, contributions to government retirement benefit schemes are charged to the profit and loss account as incurred.

#### Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

- (a) on the sale of goods, properties, fixed assets and investments (collectively “goods and investments”), when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods and investments sold;





## **Notes to Financial Statements** (Cont'd)

31 December 2000

### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

#### **Revenue recognition (Cont'd)**

- (b) rental income, on an accruals basis;
- (c) interest, on a time proportion basis, taking into account the principal outstanding and the effective interest rate applicable; and
- (d) dividends and investment income when the right to receive payment/benefits is established.

#### **Related parties**

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party, or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

#### **Cash equivalents**

For the purpose of the consolidated cash flow statement, 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 advance. For the purpose of balance sheet classification, cash equivalents represent assets similar in nature to cash, which are not restricted as to use.

# Notes to Financial Statements (Cont'd)

31 December 2000

## 3. TURNOVER AND REVENUE

Turnover represents gross proceeds received and receivable on the processing and sale of leather and leather goods and the gross invoiced revenue arising from general merchandise trading, net of goods returned, trade discounts and value-added tax, during the year.

During the year, the Group had revenue arising from the following activities:

	2000 HK\$'000	1999 HK\$'000
Processing and sale of leather and leather goods	537,885	507,656
Sale of merchandise	160,683	64,819
Sale of packaging materials	22,573	22,519
Turnover	721,141	594,994
Rental income	1,014	1,288
Exchange gains, net	–	543
Interest income	8,248	7,598
Compensation for profit guaranteed	–	10,877
Others	756	2,096
Revenue	731,159	617,396

Pursuant to the requirements of the Rules Governing the Listing of Securities on the Hong Kong Stock Exchange (the “Listing Rules”), the Group’s turnover for the year is further analysed according to geographical location of operations as follows:

	2000 HK\$'000	1999 HK\$'000
Mainland China	665,059	510,494
Hong Kong	29,512	31,383
Elsewhere	26,570	53,117
	721,141	594,994

# Notes to Financial Statements *(Cont'd)*

31 December 2000

## 4. LOSS FROM OPERATING ACTIVITIES

Pursuant to the requirements of the Listing Rules, the Group's loss from operating activities for the year is analysed in the following activities:

	2000 HK\$'000	1999 HK\$'000
Processing and sale of leather and leather goods	(85,698)	(43,916)
Sale of merchandise	(6,564)	808
Sale of packaging materials	66	(645)
	<u>(92,196)</u>	<u>(43,753)</u>

Pursuant to the requirements of the Listing Rules, the Group's loss from operating activities for the year is further analysed according to geographical location of operations as follows:

	2000 HK\$'000	1999 HK\$'000
Mainland China	(64,021)	(42,611)
Hong Kong	(15,839)	(1,612)
Elsewhere	(12,336)	470
	<u>(92,196)</u>	<u>(43,753)</u>

# Notes to Financial Statements (Cont'd)

31 December 2000

## 4. LOSS FROM OPERATING ACTIVITIES (Cont'd)

The Group's loss from operating activities is arrived at after charging:

	2000 HK\$'000	1999 HK\$'000
Cost of inventories sold	641,926	571,876
Auditors' remuneration	1,060	930
Depreciation on fixed assets	21,024	21,697
Amortisation of trademarks	2,000	2,000
Deferred bank borrowing costs written off	–	2,016
Staff costs (excluding directors' remuneration):		
Wages and salaries	36,245	36,693
Pension scheme contributions	997	717
Less: forfeited contributions*	(37)	(31)
Net pension scheme expenses	960	686
	37,205	37,379
Loss on disposal of fixed assets, net	122	3,445
Annual fees paid to PRC joint venture partners	10,527	12,195
Operating lease expenses in respect of land and buildings	8,598	8,934

# Notes to Financial Statements (Cont'd)

31 December 2000

## 4. LOSS FROM OPERATING ACTIVITIES (Cont'd)

The Group's loss from operating activities is arrived at after charging: (Cont'd)

	2000 HK\$'000	1999 HK\$'000
<i>Expenses included in other operating expenses:</i>		
Provision for impairment of trademarks	26,000	–
Deficit arising on revaluation of investment properties	4,740	3,680
Deficit arising on revaluation of leasehold land and buildings	5,681	–
Provision against loans to an associate	18,767	–
Provisions against inventories**	4,669	8,394
Provisions for doubtful debts**	48,371	4,564
Less: recovery from possession of shares in Gastor (Note 30 (e))	(12,697)	–
	<u>35,674</u>	<u>4,564</u>
Release of goodwill in respect of impairment in value of an investment in a subsidiary	12,478	–
Exchange losses, net	<u>3,825</u>	<u>–</u>
and after crediting:		
Written back of deficit arising on previous revaluation of leasehold land and buildings, net	–	432
Compensation for profit guaranteed	–	10,877
Gross rental income from investment properties	1,014	1,288
Less: outgoings	(308)	(139)
Net rental income from investment properties	<u>706</u>	<u>1,149</u>
Interest income	8,248	7,598
Exchange gains, net	<u>–</u>	<u>543</u>

\* The amount of forfeited pension scheme contributions available at the current and prior year ends to reduce contributions in future years is not material.

\*\* Certain of these amounts in the previous year were classified as administrative expenses. To accord with the presentation adopted in the current year, which in the opinion of the Directors, better reflects the underlying nature of the transactions, they have been reclassified to other operating expenses.

# Notes to Financial Statements (Cont'd)

31 December 2000

## 5. FINANCE COSTS

	Group	
	2000	1999
	HK\$'000	HK\$'000
Interest on bank loans wholly repayable within five years	21,505	20,073
Interest on other loans	50	65
Finance charges for the Group's debt restructuring	–	1,970
	<u>21,555</u>	<u>22,108</u>

## 6. TAX

Hong Kong profits tax has been provided at the rate of 16% on the estimated assessable profits arising in Hong Kong for the year. No provision for Hong Kong profits tax had been made as the Group had no assessable profits arising in Hong Kong in 1999. Taxes on assessable profits of subsidiaries of the Company in Mainland China and overseas countries have been calculated at the rates of taxation applicable to those subsidiaries.

	2000	1999
	HK\$'000	HK\$'000
Group:		
Hong Kong	286	–
Elsewhere	–	3
Overprovision in previous years	(1,257)	(143)
	<u>(971)</u>	<u>(140)</u>
Hong Kong tax rebate	–	(117)
	<u>(971)</u>	<u>(257)</u>

There was no material unprovided deferred tax in respect of the year (1999: Nil).