

# Report of the Directors

The directors have pleasure in submitting their annual report together with the audited financial statements for the year ended 31 March 2003.

## GROUP REORGANISATION

Pursuant to a reorganisation to rationalise the group structure in preparation for the public listing of the Company's shares, the Company became the holding company of the Group on 11 April 2002. Further details of the group reorganisation, including details of the subsidiaries acquired pursuant thereto, are set out in notes 1 and 16 on the financial statements.

On 29 April 2002, dealing in shares of the Company on the Main Board of the SEHK.

## PRINCIPAL ACTIVITIES

The principal activities of the Company is investment holding. The principal activities of the Group are the manufacturing and sale of garments. The principal activities and other particulars of the subsidiaries are set out in note 16 on the financial statements.

The analysis of the principal activities and geographical locations of the operations of the Group during the financial year are set out in note 13 on the financial statements.

## MAJOR CUSTOMERS AND SUPPLIERS

The information in respect of the Group's sales and purchases attributable to the major customers and suppliers respectively during the financial year is as follows:

	Percentage of the Group's total	
	Sales	Purchases
The largest customer	11%	
Five largest customers in aggregate	34.2%	
The largest supplier		6.1%
Five largest suppliers in aggregate		23.7%

At no time during the year have the directors, their associates or any shareholder of the Company (which to the knowledge of the directors owns more than 5% of the Company's share capital) had any interest in these major customers and suppliers.

## FINANCIAL STATEMENTS

The profit of the Group for the year ended 31 March 2003 and the state of the company's and the group's affairs as at 31 March 2003 are set out in the financial statements on pages 24 to 63.

An interim dividend of HK0.8 cents per share (2002: interim dividend of HK\$24,000,000 was paid by a subsidiary of the Company to the then shareholders) was paid on 28 January 2003. The directors now recommend the payment of a final dividend of HK2.0 cents per share (2002: HK0.625 cents per share) in respect of the year ended 31 March 2003.

## RESERVES

Details of the movements in the reserves of the Company and the Group are set out in note 32 on the financial statements.

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## FIXED ASSETS

Details of the movements in fixed assets of the Group are set out in note 14 on the financial statements.

## BANK LOANS AND OVERDRAFTS

Particulars of bank loans and overdrafts of the Group as at 31 March 2003 are set out in note 24 on the financial statements.

## CONVERTIBLE BONDS

Particulars of convertible notes issued on 19 December 2002 are set out in note 25 on the financial statements.

## SHARE CAPITAL

Details of the movements in share capital of the Company during the year are set out in note 31 on the financial statements

## DIRECTORS

The directors during the financial year and up to the date of this report were:

### Executive directors

Kwok Wing, *Chairman*

Lee Yuk Man

Kwok Yee Lin

Ho Yik Kin, Norman

Kwok Kam Chuen

(appointed on 16 July 2003)

### Independent non-executive directors

Leung Yiu Wing, Eric

Ching Kwok Ho, Samuel

In accordance with article 87 of the Company's articles of association, Ms Kwok Yee Lin and Mr Kwok Kam Chuen retire from the board by rotation at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

## DIRECTORS' SERVICE CONTRACTS

The independent non-executive directors were appointed by the board of directors on 28 March 2002. Their appointments do not have a specific term but are subject to rotation in annual general meeting pursuant to the Company's articles of association. Their remuneration is determined by the board of directors on the anniversary of the date of their appointment.

No director proposed for re-election at the forthcoming annual general meeting has an unexpired service contract which is not determinable by the Company or any of its subsidiaries within one year without payment of compensation, other than normal statutory obligations.

## DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS IN SHARES

The directors and chief executive of the Company who held office at 31 March 2003 had the following interests in the issued share capital of the Company, its subsidiaries and other associated corporations (within the meaning of the Securities (Disclosure of Interests) Ordinance (the "SDI Ordinance")) at that date as recorded in the register of directors' share interests:

Beneficial interests	Name of the company	Class of shares	Personal interests	Family interests	Corporate interests	Other interests
Mr Kwok Wing	Tack Fat Group International Limited	Ordinary shares of HK\$0.1 each	-	-	652,800,000 (note 1)	-
Mr Kwok Wing	Tack Fat Group International Limited	Ordinary shares of HK\$0.1 each	-	-	153,600,000 (note 2)	-

Notes:

- (1) The shares are owned by Efulfilment Enterprises Limited, a company incorporated in the BVI and 50% of the issued share capital of which is held by Mr Kwok Wing.
- (2) The shares are owned by Sharp Asset Holdings Limited, a company incorporated in the BVI and whose entire issued share capital is held by Mr Kwok Wing.

In addition to the above, certain director has non-beneficial personal equity interest in certain subsidiaries held for the benefit of the Group solely for the purpose of complying with the minimum company membership requirements of the Hong Kong Companies Ordinance. Certain director also has beneficial interests in non-voting deferred shares practically carrying no rights to dividends or to receive notice of or to attend or vote at any general meeting or to participate in any distribution or winding up in a subsidiary.

Save as disclosed above, as at 31 March 2003, none of the directors or the chief executive of the Company or their respective associates had any interests in the equity or debt securities of the Company or any of its associated corporations as defined by the SDI Ordinance.

At no time during the year was the Company, any of its subsidiaries or fellow subsidiaries a party to any arrangement to enable the directors of the Company or any of their spouses or children under eighteen years of age to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

## SHARE OPTION SCHEME

The Company has conditionally adopted a share option scheme approved by way of written resolution of the Company on 11 April 2002 under which the directors of the Company may invite any full-time employee, directors (including executive directors, non-executive directors and independent non-executive directors) and part-time employees of the Group with weekly working hours of 10 hours and above, any advisers (professional or otherwise) or consultants, distributors, suppliers, agents, customers, partners, joint venture partners, promoters, service providers to the Group from time to time to take up options to subscribe for shares of the Company.

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## SHARE OPTION SCHEME (Continued)

The exercise price is determined by the board of directors at its absolute discretion and notified to each option holder but shall be no less than the highest of (i) the closing price of the shares as stated in the daily quotations sheets issued by the SEHK on the date of grant, (ii) the average closing price of the shares as stated in the daily quotations sheets issued by the SEHK for the five business days immediately preceding the date of grant, and (iii) the nominal value of a share on the date of grant. The options may be exercised in accordance with the terms of the share option scheme at any time during a period to be notified by the board of directors to each option holder but may not be exercised after the expiry of ten years of an option during the period an option may be exercised.

The maximum number of shares which may be issued upon the exercise of all outstanding options and yet to be exercised under the share option scheme shall not exceed 30% of the issued share capital of the Company from time to time. Subject always to the above overall limit, the board of directors may grant options under the share option scheme, generally and without further authority, in respect of such number of shares which may be issued upon exercise of all options to be granted under the share option scheme not exceeding 10% of the issued share capital of the Company as at 29 April 2002, being the date on which the Company's shares were listed on the SEHK. For the purpose of calculating the above, options lapsed in accordance with the share option scheme shall not be counted.

On 7 November 2002, the Company has granted 132,800,000 options at a nominal consideration under the share option scheme of the Company to certain employees of the Group to subscribe for shares of the company. Each option gives the holder the right to subscribe for one share of the Company at HK\$0.465 with exercisable period from 7 November 2002 to 6 November 2004.

Up to date of this report, none of the options is granted to the directors of the Company or options granted to the employees of the Group have been exercised.

The share options granted are not recognised in the financial statements until they are exercised. The weighted average value per option granted in 2003 estimated at the date of grant using the Black-Scholes pricing model was HK\$0.047. The calculation of the weighted average value per option granted during the year does not take into account options granted during the year. The weighted average assumptions used are as follows:

	<b>2003</b>
Risk-free interest rate	2.12 %
Expected life (in years)	2
Volatility	19.9 %
Expected dividend yield	2.1 %

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, such option pricing model requires input of highly subjective assumptions, including the expected stock price volatility. Because the Company's share options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, the Black-Scholes option pricing model does not necessarily provide a reliable measure of the fair value of the share options.

## SUBSTANTIAL INTEREST IN THE SHARE CAPITAL OF THE COMPANY

The Company has been notified of the following interests in the Company's issued shares at 31 March 2003 amounting to 10% or more of the ordinary shares in issue:

	Ordinary shares held	Percentage of total issued shares
Efulfilment Enterprises Limited ( <i>Note</i> )	652,800,000	48.88%
Wisehead Group Limited ( <i>Note</i> )	153,600,000	11.50%
Sharp Asset Holdings Limited ( <i>Note</i> )	153,600,000	11.50%

*Note:* The issued share capital of Efulfilment Enterprises Limited is beneficially owned by Mr Kowk Chiu and Mr Kwok Wing in the proportion of 50:50. The entire issued share capital of Wisehead Group Limited and Sharp Asset Holdings Limited are beneficially owned by Mr Kwok Chiu and Mr Kwok Wing respectively.

## DIRECTORS' INTERESTS IN CONTRACTS

Apart from the related party transactions as disclosed in note 35 on the financial statements, no contract of significance to which the Company, any of its subsidiaries or fellow subsidiaries was a party, in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or any time during the year.

## DISCLOSURE UNDER PRACTICE NOTE 19 TO THE LISTING RULES

On 1 August 2002, the Group obtained banking facilities of HK\$49,167,000 which are subjected to review by the relevant bank on or before 31 July 2003. According to the terms of the loan agreement, the controlling shareholders, Mr Kwok Chiu and Mr Kwok Wing, are required to maintain their shareholding not less than 51% in the Company at any time.

## PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's articles of association although there are no restrictions against such rights under the law in the Cayman Islands.

## PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

During the year ended 31 March 2003, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

## RETIREMENT BENEFIT SCHEMES

The Group's subsidiaries in the PRC have participated in a pension scheme and an employment insurance scheme operated by the relevant local government authorities in the PRC. Under the present regulations imposed by the relevant local government authorities, these subsidiaries are required to make monthly contributions to the pension scheme at a rate of 18% of the basic salaries and wages payable to its staff in the PRC.

The Group operates a mandatory provident fund scheme for its staff in Hong Kong with a mandatory provident fund provider in Hong Kong and is required to make monthly contributions to the mandatory provident fund scheme at a rate of 5% of the basic salaries and wages, subject to a cap of monthly basic salaries and wages of HK\$20,000, payable to its staff in Hong Kong.

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## APPLICATION OF PROCEEDS FROM CAPITAL ARISING

As disclosed in the 2001/02 annual report, the Group raised approximately HK\$98.0 million, net of expenses, from the issue of 304,000,000 new shares of the Company at HK\$0.385 per share during April and May 2002. Up to the date of this report, the Group has applied part of the proceeds amounting to approximately HK\$83.0 million for the following purposes:

- (i) approximately HK\$30.0 million for the expansion of the Group's production capacity in the PRC and Cambodia by hiring more workers and purchasing additional machines in order to benefit further from economies of scale;
- (ii) approximately HK\$10.0 million for the automation of existing production facilities in the PRC and Cambodia in order to shorten production time and improve the quality of its products; and
- (iii) approximately HK\$43.0 million as additional working capital of the Group.

Consistent with the disclosure made in the Company's prospectus dated 16 April 2002, the Group intends to apply the remaining proceeds of approximately HK\$15.0 million for the following purposes:

- (i) as to approximately HK\$10.0 million for the development of retail operation to sell "Blue Cat" apparels in the PRC by investing in Blue Cat Development which was granted the rights to open "Blue Cat" distribution and exhibition outlets in major cities in the PRC such as Beijing, Shanghai, Guangzhou, Chengdu, Wuhan, Shenyang, Xian, Tianjin and Changsha; and
- (ii) as to approximately HK\$5.0 million for the establishment of its own production facilities to print and dye fabric to extend its level of vertical integration should opportunities arise.

The remaining net proceeds from the new share issue are currently placed on short term deposits with banks in Hong Kong.

## CONNECTED TRANSACTIONS

### Exclusive manufacturing agreement

On 25 March 2002, Blue Cat Development Limited ("Blue Cat Development") entered into an exclusive manufacturing agreement (the "Blue Cat Agreement") with Blue Cat Enterprises Limited ("Blue Cat Enterprises"). Pursuant to the Blue Cat Agreement, Blue Cat Development has granted to Blue Cat Enterprises the exclusive right to manufacture clothing and apparel accessories in relation to the "Blue Cat" cartoon characters.

The charges for clothing and apparel accessories developed and manufactured by Blue Cat Enterprises are subject to:

- (a) the manufacturing fee (the "Fee") for each product shall be such price as may be agreed between the parties, it being acknowledged that Blue Cat Enterprises will give Blue Cat Development no less favourable terms than Blue Cat Enterprises would give independent customers. In any event, however, such price shall, failing agreement or in any event, be no less than Blue Cat Enterprises' ex-factory price plus a mark up of 5%. For this purpose, ex-factory price is a price determined by Blue Cat Enterprises by reference to ex-factory prices it charges to independent customers for comparable products or in instances where the products are identical, the ex-factory price for each product to be manufactured by Blue Cat Enterprises will be no less favourable than the ex-factory prices it charges to other independent customers; and

## CONNECTED TRANSACTIONS *(Continued)*

### Exclusive manufacturing agreement *(Continued)*

- (b) the aggregate Fees payable by Blue Cat Development to Blue Cat Enterprises will be based on actual number of products ordered to be manufactured by Blue Cat Development, and which is subject to a maximum amount of payment (the "Annual Cap") for each financial year from 1 April to 31 March in the following calendar years (except for the first year which begins from 25 March 2002) listed out as follows:

	<b>Year ending 31 March 2003 (From 25 March 2002 to 31 March 2003)</b>	<b>Year ending 31 March 2004 (From 1 April 2003 to 31 March 2004)</b>	<b>Year ending 31 March 2005 (From 1 April 2004 to 31 March 2005)</b>
The Annual Cap Amount	RMB25,000,000 (the "2002 Cap Amount")	RMB35,000,000 (the "2003 Cap Amount")	RMB45,000,000 (the "2004 Cap Amount")

Blue Cat Development is a company incorporated in the BVI with limited liability in which Blue Cat Enterprises, Sure Profit Trading Ltd. and three independent third parties hold 5%, 51% and 44% equity interest respectively. Sure Profit Trading Ltd. is a company incorporated in the BVI with limited liability the ultimate beneficial controlling shareholder of which is Mr Kwok Wing. Accordingly, Blue Cat Development is a connected person of the company under the Listing Rules.

The company has been granted conditional waiver by the SEHK from the requirements of shareholders' approval and disclosures by way of press announcement for the above connected transactions.

The independent non-executive directors of the Company have confirmed to the board of directors of the Company that they have reviewed the above transactions for the year ended 31 March 2003 and concluded that:

- i. the transactions for the year 31 March 2003 were entered (a) in the ordinary and usual course of business of the Company; (b) on normal commercial terms; and (c) in accordance with the Blue Cat Agreement, on terms that are fair and reasonable so far as the shareholders of the Company are concerned; and
- ii. the annual aggregate value in respect of the transactions for the year ended 31 March 2003 which amounted to approximately RMB 24,742,000 did not exceed the 2002 Cap Amount.

## COMPLIANCE WITH THE CODE OF BEST PRACTICE

Since the listing of the Company's shares on 29 April 2002, the Company has complied with the Code of Best Practice as set out by the SEHK in Appendix 14 to the Listing Rules, except that the independent non-executive directors of the Company were not appointed for a specific term but are subject to rotation in annual general meeting pursuant to the Company's articles of association.

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## AUDIT COMMITTEE

In accordance with paragraph 14 of the Code of Best Practice as set out in Appendix 14 to the Listing Rules of the SEHK, the board of directors has established an audit committee on 29 April 2002 comprising two independent non-executive directors. The audit committee has been convened for the purpose of reviewing the Company's financial reporting and internal control systems.

## AUDITORS

KPMG retire and, being eligible, offer themselves for reappointment. A resolution for the reappointment of KPMG as auditors of the Company is to be proposed at the forthcoming annual general meeting.

By order of the board

**Kwok Wing**

*Chairman*

Hong Kong, 16 July, 2003