
THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

If you are in any doubt as to any aspect of this circular or as to the action to be taken, you should consult your stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold all your shares in Hung Fung Group Holdings Limited, you should at once hand this circular and the accompanying form of proxy to the purchaser or to the bank, stockbroker or other agent through whom the sale or transfer was effected for transmission to the purchaser.

The Stock Exchange of Hong Kong Limited and Hong Kong Securities Clearing Company Limited take no responsibility for the contents of this circular, make no representation as to its accuracy or completeness and expressly disclaim any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this circular.

This circular is not an offer of, nor is it calculated to invite offers for, securities of Hung Fung Group Holdings Limited.

**HUNG FUNG GROUP HOLDINGS LIMITED**

(incorporated in Bermuda with limited liability)

**PROPOSED DEBT RESTRUCTURING INVOLVING
ISSUE OF NEW SHARES, CONVERTIBLE BONDS
AND CONVERTIBLE NOTE,
BANK COMPROMISE, CREDITOR SETTLEMENTS, OPEN OFFER OF
NOT LESS THAN 3,725,905,140 NEW SHARES,
GRANT OF WHITEWASH WAIVER,
INCREASE IN AUTHORISED SHARE CAPITAL AND
GENERAL MANDATE TO ISSUE SHARES**

Financial Adviser to Hung Fung Group Holdings Limited



SOMERLEY LIMITED

Independent Financial Adviser to the Independent Board Committee



EQUITAS CAPITAL LIMITED

A letter of advice from Equitas Capital Limited, the independent financial adviser to the independent board committee, containing its opinion regarding the proposed restructuring is set out on pages 40 to 61 of this circular.

A notice convening a special general meeting of Hung Fung Group Holdings Limited to be held at 9:00 a.m. on Monday, 13th May, 2002 at Conference Room, 30/F, Panda Hotel, 3 Tsuen Wah Street, Tsuen Wan, Hong Kong is set out on pages 140 to 143 of this circular. A form of proxy for use at the special general meeting is enclosed. Whether or not you intend to attend the meeting, you are requested to complete the accompanying form of proxy and return it in accordance with the instructions printed thereon as soon as possible to the Company's branch share registrars in Hong Kong, Tengis Limited at 4th Floor, Hutchison House, 10 Harcourt Road, Central, Hong Kong and in any event not less than 48 hours before the time appointed for the holding of the meeting. Completion and return of the form of proxy will not preclude you from attending and voting at the meeting or any adjourned meeting should you so wish.

26th April, 2002

CONTENTS

	<i>Page</i>
Expected timetable	1
Definitions	2
Letter from the Board	
Introduction	10
The Restructuring Proposal	12
The Bank Compromise	13
The Subscription	18
The Open Offer	19
The Investor	21
The Settlements	22
Effects of the Restructuring Proposal and the Settlements	27
Waiver of obligations under the Code	33
Reasons for the Restructuring Proposal	34
Use of proceeds	35
Future intention of the Investor regarding the Group	35
Listing	36
Management	36
Increase in authorised share capital	37
General mandate to issue Shares	37
Special General Meeting	37
Recommendations	37
General	38
Letter from the Independent Board Committee	39
Letter of advice from Equitas	40
Appendix I – Financial information	62
Appendix II – Property valuation	121
Appendix III – Letters on Working Capital Statement	127
Appendix IV – General information	132
Notice of Special General Meeting	140

EXPECTED TIMETABLE

2002

Shares become ex-entitlement to the Open Offer on the Stock Exchange	Wednesday, 8th May
Latest time for lodging transfers of Shares to qualify for entitlements to the Open Offer	4:00 p.m. on Thursday, 9th May
Book closure period (both dates inclusive)	Friday, 10th May to Monday, 13th May
Latest time for lodging forms of proxy for the Special General Meeting	9:00 a.m. on Saturday, 11th May
Record Date	Monday, 13th May
Special General Meeting	9:00 a.m. on Monday, 13th May
Prospectus Documents posted to Qualifying Shareholders	Monday, 13th May
Completion to take place	Thursday, 16th May
Latest time for application for Offer Shares and payment therefor	4:00 p.m. on Monday, 27th May
Underwriting Agreement becomes unconditional	Wednesday, 29th May
Announcement of the results of the Open Offer	Wednesday, 29th May
Certificates for Offer Shares posted on or before	Monday, 3rd June
Expected date of completion of the Settlements	Monday, 10th June

DEFINITIONS

In this circular, unless the context otherwise requires, the following expressions have the following meanings:–

“Announcement”	the announcement dated 22nd February, 2002 made jointly by the Company and the Investor regarding the Restructuring Proposal
“Application Form(s)”	the application form(s) for Offer Shares to be issued to the Qualifying Shareholders as mentioned herein, subject to the approval of the Open Offer at the Special General Meeting and registration in Hong Kong of the Prospectus Documents
“associates”	the meaning ascribed to it under the Listing Rules
“Bank Compromise”	the discharge of the Total Compromised Debt and the release of all security, receivables and rights given by the Group therefor or incidental thereto by the Bank Group in consideration for a cash settlement in an amount of approximately HK\$20.0 million and the issuance to the Bank Group of the Convertible Bonds pursuant to the Compromise Agreement
“Bank Group”	the banks and financial institutions that are creditors of the Group and are parties to the Compromise Agreement, including Dao Heng Bank Limited, DBS Kwong On Bank Limited, Citic Ka Wah Bank Limited, Equitable PCI Bank, Inc., HSBC, Jian Sing Bank Limited, Bank of China (HK) Limited and Chiyu Banking Corporation Limited
“Baxter”	Baxter Resources S.A. which is the current controlling shareholder of the Company and is beneficially owned by Mr. Chan Chun Hung and Ms. Wong Kin Ching
“Board”	the board of Directors
“CCASS”	the Central Clearing and Settlement System established and operated by Hongkong Clearing
“CN Settlement”	the proposed settlement pursuant to the CN Settlement Agreement of debts amounting in aggregate to RMB24,650,877 owed by HCTF to HZIC by payment in cash of RMB2,200,000 and issuance of the New Convertible Note

DEFINITIONS

“CN Settlement Agreement”	settlement agreement dated 27th March, 2002 entered into between HCTF and HZIC in relation to the CN Settlement
“Code”	the Hong Kong Code on Takeovers and Mergers
“Companies Act”	the Companies Act 1981 of Bermuda
“Company”	Hung Fung Group Holdings Limited, a company incorporated in Bermuda with limited liability and the shares of which are listed on the Stock Exchange
“Completion”	completion of the Compromise Agreement and the Subscription Agreement
“Compromise Agreement”	the agreement dated 1st February, 2002 entered into between the Group, the Investor, the Bank Group, the Coordinating Agent, Mr. Huang and Huang Worldwide in relation to, inter alia, the restructuring of the Total Compromised Debt
“Connected Person(s)”	a director, chief executive or substantial shareholder of the Company or any of its subsidiaries or an associate of any of them as defined under the Listing Rules
“Conversion Shares”	a total of 650,000,000 new Shares which may be issued upon full conversion of 100% of the original principal amount of the Convertible Bonds at an initial issue price of HK\$0.01 per Share (subject to adjustment)
“Conversion Shares (HZIC)”	the Shares which may fall to be issued upon conversion of the New Convertible Note
“Convertible Bonds”	the 3-year, 5% interest bearing convertible bonds in the principal amount of HK\$6.5 million to be issued to the Bank Group as part of the Bank Compromise
“Coordinating Agent” or “HSBC”	The Hongkong and Shanghai Banking Corporation Limited in its capacity as coordinating agent under the Compromise Agreement, or such other entity as may be appointed under the Compromise Agreement as coordinating agent

DEFINITIONS

“Creditors”	an aggregate of 30 creditors, being parties to the Share Settlement Agreements to whom the Group is indebted of a total of RMB12,063,092
“Creeper Authorisation”	the proposal to authorise the Investor and parties acting in concert with it to acquire Shares representing not more than 2% of the issued share capital of the Company as enlarged upon Completion and completion of the Open Offer (subject to the provision under Rule 26.1 of the Code) during the 12-month period immediately following Completion and completion of the Open Offer
“Deed”	the deed of settlement entered into between the Company and the Petitioner dated 22nd March, 2002 for the Company to settle the Deed Sum and for the Petitioner to withdraw the Petition
“Deed Sum”	the amount of HK\$2,135,529 to be paid by the Company pursuant to the Deed to settle the amount owing to the Petitioner by the Group
“Directors”	directors of the Company
“Equitas”	Equitas Capital Limited, an exempt dealer and an exempt investment adviser under the Securities Ordinance (Chapter 333 of the Laws of Hong Kong) and the independent financial adviser to the Independent Board Committee
“Executive”	the Executive Director of the Corporate Finance Division of the SFC and any delegate of the Executive Director
“Executive Directors”	Mr. Lo Ming Chi, Charles and Mr. Yu Wai Man
“Existing Convertible Note”	the existing HK\$3.0 million convertible note of the Company bearing interest at the rate of 5% per annum and carrying the right of conversion into Shares at a conversion price of HK\$0.015 per Share
“General Mandate”	the general mandate to issue shares of the Company to be sought at the Special General Meeting as described in this circular
“Group”	the Company and its subsidiaries

DEFINITIONS

“Guarantees”	guarantees given by members of the Group in favour of certain members of the Bank Group in respect of certain of the Total Compromised Debt
“HK\$”	Hong Kong dollars
“Hong Kong”	the Hong Kong Special Administrative Region of the PRC
“Hongkong Clearing”	Hong Kong Securities Clearing Company Limited
“Huang Group”	Huang Group (BVI) Limited, a company incorporated in the British Virgin Islands with limited liability and wholly owned by Mr. Kan Ka Chong, Frederick as trustee of a discretionary trust, the discretionary objects of which are Mr. Huang, his family members and unspecified charities
“Huang Worldwide”	Huang Worldwide Holding Limited, a company incorporated in the British Virgin Islands and wholly and beneficially owned by Huang Group
“HCTF”	Dongguan Shi Huangjiang Zhen Hung Cheong Toys Factory, a processing factory established in the PRC under a processing contract dated 23rd March, 1996 between Hung Cheong Industrial Company and HZIC. In March 1996, the business of Hung Cheong Industrial Company was acquired by a member of the Group
“HZIC”	Dongguan Shi Huangjiang Zhen Importing Company
“Independent Board Committee”	an independent board committee constituted by Mr. Wu Wing Kit and Mr. Wong Kwok Tai, the independent non-executive Directors, formed for the purpose of advising the Independent Shareholders in respect of the Restructuring Proposal
“Independent Shareholders”	Shareholders other than the controlling shareholder of the Company, which currently is Baxter, and their respective associates and concert parties and who are not involved in, or interested in the Subscription and the underwriting of the Open Offer

DEFINITIONS

“Investor”	Vision Century Group Limited, a company incorporated in the British Virgin Islands and wholly and beneficially owned by Huang Group
“Kingston”	Kingston Securities Limited, a dealer registered under the Securities Ordinance (Chapter 333 of the Laws of Hong Kong) and a sub-underwriter of the Open Offer
“Knight Frank”	Knight Frank, a firm of independent professional valuers
“Latest Practicable Date”	24th April, 2002, being the latest practicable date prior to the printing of this circular for the purpose of ascertaining certain information for inclusion in this circular
“Listing Rules”	the Rules Governing the Listing of Securities on the Stock Exchange
“Maturity Date”	maturity date of the New Convertible Note, which is the second anniversary of the date of issue of the New Convertible Note
“Mr. Huang” or “Guarantor”	Mr. Huang Cheow Leng
“New Convertible Note”	the HK\$16,000,000 convertible note of the Company proposed to be issued and carrying interest at the rate of 3% per annum, as partial settlement pursuant to the CN Settlement
“New Shares”	1,070,280,000 new Shares to be issued pursuant to the Share Settlement to certain creditors of the Group as partial settlement of debts of about HK\$11.3 million owed to them
“Offer Shares”	not less than 3,725,905,140 Shares to be offered to the Qualifying Shareholders pursuant to the Open Offer
“Open Offer”	the proposed issue of Offer Shares, with assured allotments of three Offer Shares for every two Shares held on the Record Date, to the Qualifying Shareholders
“Options”	existing share options in respect of 13,700,000 Shares granted under the Share Option Scheme, exercisable on or before 16th February, 2008 at an exercise price of HK\$0.046 per Share

DEFINITIONS

“Other Liabilities”	other liabilities of the Group, which sum as at 30th September, 2001 was approximately HK\$134.1 million. The Other Liabilities comprise (i) financial indebtedness mainly due to PRC banks and holders of the Existing Convertible Note of approximately HK\$70.4 million; and (ii) liabilities due mainly to trade creditors of approximately HK\$63.7 million, both as at 30th September, 2001.
“Other Settlement Debts”	approximately HK\$34.3 million to be settled under the CN Settlement and the Share Settlement
“Overseas Shareholders”	Shareholders whose addresses as shown in the branch register of members of the Company in Hong Kong on the Record Date are outside Hong Kong
“Petition”	the winding-up petition filed against the Company by the Petitioner
“Petitioner”	Midas Printing Limited
“PRC”	the People’s Republic of China
“Prospectus Documents”	the prospectus and Application Form to be despatched to Qualifying Shareholders in relation to the Open Offer
“Qualifying Shareholders”	Shareholders, other than Overseas Shareholders, whose names appear on the branch register of members of the Company in Hong Kong on the Record Date
“Record Date”	13th May, 2002, being the date by reference to which entitlements to assured allotments under the proposed Open Offer will be determined
“Registrar”	Tengis Limited at 4th Floor, Hutchison House, 10 Harcourt Road, Central, Hong Kong, the Hong Kong branch share registrar of the Company
“Restructuring Proposal”	the proposed restructuring of Hong Kong bank loans of the Group pursuant to the Compromise Agreement, the placing of new Shares pursuant to the Subscription and the Open Offer

DEFINITIONS

“RMB”	Renminbi, the official currency of the PRC
“Settlements”	the Share Settlement and the CN Settlement
“Share Settlement”	the settlement of an aggregate amount of RMB12,063,092 owed by HCTF to certain creditors of the Group pursuant to the Share Settlement Agreements by payment in cash of RMB19,011 and issuance of 1,070,280,000 New Shares
“Share Settlement Agreements”	an aggregate of 30 share settlement agreements all dated 27th March, 2002, entered into between HCTF and certain creditors of the Group in relation to the settlement of an aggregate amount of RMB12,063,092 owed by HCTF
“SDI Ordinance”	the Securities (Disclosure of Interests) Ordinance (Chapter 396 of the laws of Hong Kong)
“SFC”	the Securities and Futures Commission
“Share Option Scheme”	the share option scheme adopted by the Company on 17th February, 1998
“Share(s)”	ordinary share(s) of HK\$0.01 each in the capital of the Company
“Shareholders”	holders of the Shares
“Somerley”	Somerley Limited, an investment adviser and an exempt dealer registered under the Securities Ordinance (Chapter 333 of the Laws of Hong Kong), the financial adviser to the Company and a sub-underwriter of the Open Offer
“Special General Meeting”	a special general meeting of the Company to be held at Conference Room, 30/F, Panda Hotel, 3 Tsuen Wah Street, Tsuen Wan, Hong Kong on 13th May, 2002, notice of which is set out on pages 140 to 143 of this circular
“sq. m.”	square metres
“Stock Exchange”	The Stock Exchange of Hong Kong Limited

DEFINITIONS

“Subscription”	the proposed subscription of the Subscription Shares by the Investor pursuant to the Subscription Agreement
“Subscription Agreement”	the subscription agreement dated 1st February, 2002 entered into between the Investor and the Company with respect to the subscription of the Subscription Shares
“Subscription Shares”	3,000,000,000 new Shares to be subscribed by the Investor pursuant to the Subscription Agreement
“subsidiaries”	the meaning ascribed thereto in Section 2 of the Companies Ordinance (Chapter 32 of the Laws of Hong Kong)
“Total Compromised Debt”	all claims and other monies (including principal, interest and expenses) owed by the Group to the Bank Group and their related companies as at Completion.
“Underwriting Agreement”	the underwriting agreement dated 1st February, 2002 entered into between the Company and the Investor in relation to the Open Offer
“Whitewash Waiver”	a waiver from the Executive in respect of the obligations of the Investor and parties acting in concert with it to make a general offer for all the Shares not already owned by them as a result of the Subscription and the Open Offer pursuant to Note 1 of Dispensations from Rule 26 of the Code

Exchange rate of HK\$1.00 = RMB1.07 is used throughout this circular

LETTER FROM THE BOARD



HUNG FUNG GROUP HOLDINGS LIMITED

(incorporated in Bermuda with limited liability)

Directors:

Mr. Lo Ming Chi, Charles (*Chairman*)
Mr. Yu Wai Man
Mr. Wu Wing Kit*
Mr. Wong Kwok Tai*

Registered office:

Clarendon House
2 Church Street
Hamilton HM 11
Bermuda

Principal place of business:

Room 3A03-06, 3/F
New Mandarin Plaza
14 Science Museum Road
Tsimshatsui East
Hong Kong

* *independent non-executive Directors*

26th April, 2002

*To the Shareholders and, for information only,
holders of Options and the Existing Convertible Note*

Dear Sir or Madam,

**PROPOSED DEBT RESTRUCTURING INVOLVING
ISSUE OF NEW SHARES, CONVERTIBLE BONDS
AND CONVERTIBLE NOTE,
BANK COMPROMISE, CREDITOR SETTLEMENTS, OPEN OFFER OF
NOT LESS THAN 3,725,905,140 NEW SHARES,
GRANT OF WHITEWASH WAIVER,
INCREASE IN AUTHORISED SHARE CAPITAL AND
GENERAL MANDATE TO ISSUE SHARES**

INTRODUCTION

On 22nd February, 2002, the Company and the Investor jointly announced that on 1st February, 2002 the Compromise Agreement, the Subscription Agreement and the Underwriting Agreement had been entered into to give effect to the Restructuring Proposal. The Restructuring Proposal involves, among other things, (i) the Subscription; (ii) the Open Offer and (iii) the Bank Compromise.

LETTER FROM THE BOARD

Pursuant to the Restructuring Proposal, if approved,

- (i) approximately HK\$67.3 million of new capital in the form of cash will be injected into the Company by the Investor and Qualifying Shareholders and the Total Compromised Debt will be discharged together with any security, receivables and rights given in favour of the Bank Group arising from or incidental to the Total Compromised Debt;
- (ii) the liquidity of the Group will be improved and the net asset base of the Group will become positive;
- (iii) the core business of the Group will be maintained;
- (iv) the Investor will acquire control of the Company; and
- (v) the listing status of the Company will be maintained.

Pursuant to the Code, the issue of the Subscription Shares to the Investor under the Subscription and the issue of the Offer Shares to the Investor may give rise to an obligation on the part of the Investor to make a general offer to acquire all the issued shares of the Company unless the Whitewash Waiver is granted by the Executive. An application has been made to the Executive for the granting of the Whitewash Waiver and the Executive has indicated that, subject to the approval of the Independent Shareholders, the Whitewash Waiver will be granted. In addition, the Investor will, pursuant to the Compromise Agreement, seek to obtain the Independent Shareholders' approval of the Creeper Authorisation at the Special General Meeting.

Messrs. Lo Ming Chi, Charles and Yu Wai Man are both executive Directors and salaried employees of the Group. Accordingly, neither of them are considered to be independent under the Code insofar as the Whitewash Waiver, the Creeper Authorisation and the Restructuring Proposal are concerned and it is therefore considered inappropriate for either of them to give any advice or recommendation to the Independent Shareholders in this regard. Accordingly, the Independent Board Committee, comprising Messrs. Wu Wing Kit and Wong Kwok Tai, has been appointed to consider the terms of the Restructuring Proposal, the Whitewash Waiver and the Creeper Authorisation and to advise the Independent Shareholders thereon. Equitas has been appointed as the independent financial adviser to advise the Independent Board Committee on the Restructuring Proposal, the Whitewash Waiver and the Creeper Authorisation.

Huang Group has interests in New Century Group Hong Kong Limited, the shares of which are listed on the Stock Exchange. Messrs. Lo Ming Chi, Charles and Yu Wai Man is an executive director and a salaried employee, respectively, of New Century Group Hong Kong Limited. Mr. Wong Kwok Tai is an independent non-executive director of New Century Group Hong Kong Limited but is otherwise unconnected with the Investor or any of its associates. The Executive Directors consider him suitable to give advice to Independent Shareholders on the Restructuring Proposal, the Whitewash Waiver and the Creeper Authorisation.

LETTER FROM THE BOARD

Somerley has been appointed as the financial adviser to the Company in connection with the Restructuring Proposal.

Further to the proposed restructuring of the bank debts owed by the Group to the Bank Group, the Company announced on 2nd April, 2002 that pursuant to the CN Settlement and the Share Settlement, the Company has agreed to settle with certain creditors of the Group debts in the total amount of about HK\$34.3 million (part of the Other Liabilities) owed to them by way of (i) payment of approximately HK\$2.1 million in cash; (ii) issue of approximately 1,070.3 million new Shares at prices ranging from HK\$0.01 to HK\$0.015 per Share; and (iii) the issue of the New Convertible Note in the principal amount of HK\$16,000,000.

On 22nd March, 2002, the Company entered into the Deed with the Petitioner to settle the Deed Sum over eight instalments, with the last instalment to be made in October 2002.

The Directors also intend to propose resolutions at the Special General Meeting to renew the Directors' general mandate to issue Shares so that the number of Shares which are permitted to be issued under the General Mandate will be calculated by reference to the Company's issued share capital following Completion, completion of the Open Offer and completion of the Settlements.

The purpose of this circular is to provide you with further information on the Restructuring Proposal and the Settlements, to set out the advice of Equitas to the Independent Board Committee and the recommendation of the Independent Board Committee to the Independent Shareholders in respect of the Restructuring Proposal, the Whitewash Waiver and the Creeper Authorisation and to give you notice of the Special General Meeting where resolutions will be proposed to seek your approval of the Restructuring Proposal and the transactions contemplated thereunder, the Whitewash Waiver, the Creeper Authorisation, the Settlements, the increase in authorised share capital and the General Mandate.

THE RESTRUCTURING PROPOSAL

The Group, the Investor, the Bank Group, the Coordinating Agent, Huang Worldwide and the Guarantor have executed the Compromise Agreement and the Company and the Investor have executed the Subscription Agreement and the Underwriting Agreement on 1st February, 2002 to effect the Restructuring Proposal. The Restructuring Proposal involves:-

- (i) the subscription of 3,000,000,000 Subscription Shares at HK\$0.01 per Subscription Share by the Investor, at an aggregate subscription price of HK\$30.0 million;
- (ii) the Open Offer to Qualifying Shareholders of a minimum of 3,725,905,140 Offer Shares at HK\$0.01 per Offer Share on the basis of three Offer Shares for two Shares held by the Qualifying Shareholders on the Record Date. The Open Offer will raise a total of approximately HK\$37.3 million (before expenses based on the existing issued Shares) and is underwritten by the Investor; and

LETTER FROM THE BOARD

- (iii) release and discharge by the Bank Group of the Total Compromised Debt outstanding from the Group as at Completion and the release by the relevant members of the Bank Group of any further liabilities of the Group under the Guarantees in consideration for the payment of approximately HK\$20.0 million in cash and the issue of the Convertible Bonds by the Company to the Bank Group.

THE BANK COMPROMISE

I. Parties

The parties to the Compromise Agreement are:-

- (i) the Group;
- (ii) the Investor;
- (iii) the Bank Group;
- (iv) the Coordinating Agent;
- (v) Mr. Huang, the Investor's guarantor, who has guaranteed the due performance of all the Investor's obligations under the Compromise Agreement, the Subscription Agreement and the Underwriting Agreement; and
- (vi) Huang Worldwide.

II. Bank Compromise

As at 17th December, 2001, the Total Compromised Debt amounted to approximately HK\$99.7 million which sum was accounted for as current liabilities. Of the HK\$99.7 million, approximately HK\$88.1 million was accounted for as interest-bearing bank loans and other borrowings while the remaining approximately HK\$11.6 million was accounted for as other payables and accruals. Pursuant to the Compromise Agreement, the Bank Group will release and discharge all of the Group's obligation and liabilities to repay the Total Compromised Debt outstanding as at Completion and release the Guarantees given by the Group in favour of the Bank Group in respect of the Total Compromised Debt. In consideration for this, the Bank Group will (1) receive the payment in cash of approximately HK\$20.0 million by the Company; and (2) be issued Convertible Bonds in the aggregate principal amount of HK\$6.5 million. Members of the Bank Group are not acting in concert with Baxter or the Investor or their respective concert parties.

LETTER FROM THE BOARD

1. *Cash payment*

The Bank Group will, upon Completion, receive approximately HK\$20.0 million in cash, equivalent to approximately 20.1% of the Total Compromised Debt outstanding as at 17th December, 2001. An amount of HK\$2.0 million has been deposited by Huang Worldwide as escrow money with the legal adviser to the Bank Group, which sum (together with interests thereon) will be credited in or towards settlement of the amount of approximately HK\$20.0 million receivable by the Bank Group upon Completion. The Company will also bear legal costs incurred in the Restructuring Proposal.

2. *Convertible Bonds*

The Company will issue to the Bank Group 3-year 5% interest bearing Convertible Bonds in the aggregate principal amount of HK\$6.5 million. The principal amount of the Convertible Bonds is equivalent to approximately 6.5% of the Total Compromised Debt outstanding as at 17th December, 2001.

The principal terms of the Convertible Bonds are as follows:-

- (i) Interest: 5% per annum on the principal amount outstanding from time to time, payable semi-annually in arrears.
- (ii) Conversion and redemption : Unless previously redeemed on the basis referred to below, the outstanding amount of Convertible Bonds from time to time is convertible at any time over the three-year term of the Convertible Bonds at a conversion price of HK\$0.01 per Conversion Share (subject to adjustment). If not previously converted, the Company shall redeem in cash the Convertible Bonds in accordance with the following schedule :

Redemption Date	Redemption Amount
(a) First anniversary date from issue of the Convertible Bonds	HK\$2,166,667 or the whole outstanding amount, whichever is less (together with accrued interest thereon)

LETTER FROM THE BOARD

- | | | |
|-----|---|---|
| (b) | Second anniversary date from issue of the Convertible Bonds | A further HK\$2,166,667 or the whole outstanding amount, whichever is less (together with accrued interest thereon) |
| (c) | Third anniversary date from issue of the Convertible Bonds | The remaining balance of the outstanding amount (together with accrued interests thereon) |

- (iii) Early Redemption: Early redemption of all or some of the Convertible Bonds by the Company is permitted at any time after their date of issue, at a value equal to 105% of the outstanding principal amount (together with accrued interests thereon).
- (iv) Listing: No application will be made for a listing of the Convertible Bonds on any stock exchange. Application has been made for the listing of and permission to deal in the Conversion Shares on the Stock Exchange.
- (v) Conversion Shares: On the basis of the initial conversion price of HK\$0.01 per Conversion Share, a total of 650,000,000 Conversion Shares will be issued upon full conversion of the Convertible Bonds. The Conversion Shares will upon issue rank pari passu in all respects with the then issued Shares. The Convertible Bonds will be issued after the Record Date for the Open Offer. Accordingly, the Conversion Shares (if any) to be issued upon conversion of the Convertible Bonds will not carry rights to participate in the Open Offer.

LETTER FROM THE BOARD

- (vi) Transferability: The Convertible Bonds are not assignable or transferable except to another holder of the Convertible Bonds or with the prior written consent of the Company. The Company has undertaken to notify the Stock Exchange promptly if it becomes aware of any dealings in the Convertible Bonds by Connected Persons.

III. Conditions to the Compromise Agreement

Completion of the Compromise Agreement is subject to the following conditions being fulfilled:–

- (a) passing at a duly convened and held general meeting of Shareholders of each of the following:–
 - (i) an ordinary resolution approving an increase in the authorised share capital of the Company and authorising the Directors to effect the Subscription, the Open Offer and the issue of the Convertible Bonds;
 - (ii) an ordinary resolution (on which only Independent Shareholders vote) approving the Compromise Agreement and the transactions contemplated thereunder (to the extent that such approval is required by law, regulation or the Company's constitutional documents), including:–
 - (I) the Open Offer;
 - (II) the Convertible Bonds and their issue (including issue of Conversion Shares pursuant to conversion of the Convertible Bonds);
 - (III) the Subscription; and
 - (iii) an ordinary resolution of Independent Shareholders approving the Whitewash Waiver and the Creeper Authorisation;
- (b) the Bermuda Monetary Authority giving its approval of any matters requiring its approval including, without limitation, the issue of the Offer Shares, the Subscription Shares, the Conversion Shares and the Convertible Bonds;
- (c) the Executive granting the Whitewash Waiver to the Investor;
- (d) the Stock Exchange granting listing of and permission to deal in the Subscription Shares, the Offer Shares and the Conversion Shares;

LETTER FROM THE BOARD

- (e) the Shares remaining listed on the Stock Exchange and the Stock Exchange not having notified the Company that its listing will or may be withdrawn; and
- (f) trading in the Shares of the Company on the Stock Exchange being resumed.

The Investor and the Company's controlling shareholder, which is currently Baxter, and their respective associates and concert parties are required to abstain from voting on the ordinary resolutions as referred to in items (a)(ii) and (a)(iii) above. The ordinary resolution as referred to in item (a)(iii) above will be taken by poll in accordance with the Code.

Conditions (a) (iii) and (c) above can be waived by the Investor. The Investor has confirmed that it will not waive the conditions requiring the waiver to be obtained and approved, and the Creeper Authorisation to be approved. Consequent upon the recent change of the Code, it is now no longer necessary for the Investor to seek prior consent from Independent Shareholders for further acquisition of a 2% Shares following completion of the Restructuring Proposal. Nevertheless, according to legal advice, the Investor cannot waive the Creeper Authorisation without waiving the Whitewash Waiver which is part and parcel of the clause in the Compromise Agreement referring to the Creeper Authorisation. Accordingly, an ordinary resolution will be proposed to seek the Whitewash Waiver and the Creeper Authorisation from the Independent Shareholders.

IV. Resumption of trading of Shares

As mentioned above, completion of the Compromise Agreement is conditional on, among others, resumption of trading of Shares on the Stock Exchange. Trading of Shares on the Stock Exchange has been suspended since 22nd January, 2001. The Stock Exchange informed the Company on 15th January, 2002 that it had entered into the second stage of delisting procedures under Practice Note 17 of the Listing Rules. The Company submitted a proposal for the resumption of trading of the Shares (the "Resumption Proposal") on 4th April, 2002. The Restructuring Proposal will significantly reduce the Group's indebtedness level and strengthen its capital base.

Completion of the Restructuring Proposal is conditional upon, among other things, resumption of trading of Shares on the Stock Exchange. The issue of this circular does not indicate that the Restructuring Proposal and the Resumption Proposal will be successfully implemented and completed.

LETTER FROM THE BOARD

V. Completion

Completion of the Compromise Agreement shall take place on the second business day after all the conditions to the Compromise Agreement as set out in paragraph (III) above have been satisfied or waived. If the conditions are not fulfilled or waived by 1st June, 2002, being four months after the date of the Compromise Agreement, or such later date as may be agreed among the Investor, the Company and the Coordinating Agent, the Compromise Agreement will lapse and none of the parties shall have any claim against each other for costs, damages, compensation or otherwise (save in respect of any prior breach of the Compromise Agreement).

THE SUBSCRIPTION

I. Parties

The parties to the Subscription Agreement are:-

- (i) the Company; and
- (ii) the Investor

II. The Subscription

The Investor has agreed to subscribe in cash for 3,000,000,000 Subscription Shares at the price of HK\$0.01 per Subscription Share. The Subscription Shares represent 120.8% of the existing share capital and 54.7% of the Company's issued share capital as enlarged by the Subscription. The Subscription Shares shall upon issue rank pari passu in all respects with the then issued Shares. Completion of the Subscription Agreement will take place after the Record Date for the Open Offer. Accordingly, the Subscription Shares will not carry rights to participate in the Open Offer.

III. Conditions Precedent to the Subscription Agreement

The Subscription Agreement is conditional upon satisfaction of the conditions to the Compromise Agreement as more fully set out in paragraph (III) of the section headed "The Bank Compromise" above and completion of the Compromise Agreement.

If the Compromise Agreement is terminated, the Subscription Agreement will terminate and neither of the parties shall have any claim against each other for costs, damages, compensation or otherwise (save in respect of any prior breach of the Subscription Agreement).

LETTER FROM THE BOARD

THE OPEN OFFER

I.	Basis of Open Offer	:	Assured allotment of three Offer Shares for every two Shares held by the Qualifying Shareholders on the Record Date	
	Existing number of issued Shares	:	2,483,936,760 Shares	
	Number of Shares issuable assuming full exercise of outstanding Options	:	13,700,000 Shares	
	Number of Shares issuable assuming full conversion of all Existing Convertible Note	:	200,000,000 Shares	
	Enlarged issued Shares upon exercise of Options and the Existing Convertible Note	:	2,697,636,760 Shares	
			Minimum	Maximum
	Subscription price	:	HK\$0.01 per Offer Share	
	Number of Offer Shares	:	3,725,905,140 Offer Shares	4,046,455,140 Offer Shares
	Gross proceeds	:	HK\$37,259,051	HK\$40,464,551

II. Status of the Offer Shares

The Offer Shares when issued will rank pari passu in all respects with the then issued Shares. Holders of the Offer Shares will be entitled to receive all future dividends and distributions which are declared, made or paid after the date of allotment of the Offer Shares.

III. Rights of Overseas Shareholders

Documents to be issued in connection with the Open Offer will not be registered under the applicable securities legislation of any jurisdiction other than Hong Kong and Bermuda. As the Directors, having reviewed the register of members, are of the view that, in respect of the Overseas Shareholders, the Open Offer would, or might, in the absence of compliance with registration or other special formalities in other jurisdictions, be unlawful or impracticable, no offer of Offer Shares will be made to Overseas Shareholders. The Company will send copies of the Open Offer prospectus to the Overseas Shareholders for their information only, but will not send Application Forms to the Overseas Shareholders.

LETTER FROM THE BOARD

The Underwriting Agreement

I. Parties

The parties to the Underwriting Agreement are:-

- (i) Issuer : the Company; and
- (ii) Underwriter : the Investor

II. The Underwriting Arrangement

Pursuant to the Underwriting Agreement, the Investor will underwrite the entire Open Offer of a maximum of 4,046,455,140 Offer Shares. The businesses of the Investor do not include the underwriting of security issues. The Underwriting Agreement is not subject to any right of termination, including force majeure.

III. Sub-underwriting Arrangements

The Investor has entered into two sub-underwriting agreements with Somerley and Kingston whereby they have agreed to sub-underwrite 1 billion Offer Shares in the case of Somerley and 400 million Offer Shares in the case of Kingston. The sub-underwriting arrangements are subject to rights of termination. In the event that rights of termination are exercised by the sub-underwriters, the Investor will under the Underwriting Agreement take up all Offer Shares not taken up pursuant to the Open Offer.

IV. Conditions of the Underwriting Agreement:-

- (1) Completion of the Underwriting Agreement is conditional on, inter alia, the following conditions :
 - (a) completion of the Compromise Agreement;
 - (b) the passing at a special general meeting of the Company of an ordinary resolution to approve the Open Offer on which only Independent Shareholders vote;
 - (c) the Listing Committee of the Stock Exchange agreeing to grant listing of, and permission to deal in, the Offer Shares either unconditionally or subject to such conditions which the Company accepts and the satisfaction of such conditions (if any) by no later than the date on which the prospectus regarding the Open Offer are posted and not having withdrawn or revoked such listings and permission on or before 4:00 p.m. on the second business day following the final application day of the Offer Shares; and

LETTER FROM THE BOARD

- (d) the Company obtaining all relevant consents and approvals to the Open Offer, including approval by Shareholders and approval by the Bermuda Monetary Authority (if required).

The Investor, and the Company's controlling shareholder which is currently Baxter, and their respective associates and concert parties are required to abstain from voting on the ordinary resolution as referred above.

Listing and Dealings

The Subscription Shares, the Conversion Shares and the Offer Shares will, when issued, rank pari passu with the then issued Shares.

Application has been made to the Stock Exchange for the listing of and permission to deal in the Subscription Shares, the Conversion Shares and the Offer Shares.

Subject to the granting of listing of, and permission to deal in, the Subscription Shares, the Conversion Shares and the Offer Shares on the Stock Exchange, the Subscription Shares, the Conversion Shares and the Offer Shares will be accepted as eligible securities by Hongkong Clearing for deposit, clearance and settlement in CCASS with effect from the commencement dates of dealings in the Subscription Shares, the Conversion Shares and the Offer Shares on the Stock Exchange or such other dates as may be determined by Hongkong Clearing. Settlement of transactions between participants of the Stock Exchange on any trading day is required to take place in CCASS on the second trading day thereafter. All activities under CCASS are subject to the General Rules of CCASS and CCASS Operational Procedures in effect from time to time.

THE INVESTOR

The Investor is an investment holding company incorporated in the British Virgin Islands, having its registered office at P.O. Box 957, Offshore Incorporations Centre, Road Town, Tortola, British Virgin Islands, and is wholly and beneficially owned by Huang Group. Huang Group is in turn wholly owned by Mr. Kan Ka Chong, Frederick as trustee of a discretionary trust, the discretionary objects of which are Mr. Huang, his family members and the unspecified charities. Mr. Huang is engaged in tour business, cruise liner management and hotel and property investment in Southeast Asia. Huang Group has interests in New Century Group Hong Kong Limited, a company listed on the Stock Exchange.

Other than through the Subscription Agreement, neither of the Investor nor its concert parties (including Mr. Huang) is at present interested directly or indirectly in any Shares or convertible securities of the Company. The Investor and its beneficial owner and their respective associates are not connected persons of the Company. The Investor has confirmed that neither it nor any of its concert parties (including Mr. Huang) has dealt in the Shares or any convertible securities of the Company during the period beginning six-months preceding the date of the

LETTER FROM THE BOARD

Announcement up to the Latest Practicable Date. Nor will the Investor and its concert parties deal in securities of the Company up to the Special General Meeting.

THE SETTLEMENTS

Further to the proposed restructuring of the bank debts owed by the Group to the Bank Group, the Company announced on 2nd April, 2002 that the Company has agreed to settle with certain creditors of the Group debts in the total amount of about HK\$34.3 million (part of the Other Liabilities) owed to them by way of (i) payment of approximately HK\$2.1 million in cash; (ii) issue of approximately 1,070.3 million new Shares at prices ranging from HK\$0.01 to HK\$0.015 per Share; and (iii) the issue of the New Convertible Note in the principal amount of HK\$16,000,000.

Upon completion of the Settlements, the Group will be discharged and released from debts of about HK\$34.3 million in full.

The Directors are continuing negotiations with a number of other creditors of the Group with a view to securing further settlement arrangements with such creditors in respect of liabilities remaining after the settlement of the HK\$34.3 million debts.

CN Settlement Agreement

(i) Parties to the CN Settlement Agreement

The debtor is HCTF, which is a factory established for the Group's production in PRC. The assets and liabilities of the factory have been taken into account in the consolidated accounts of the Group. The creditor is HZIC, a company wholly-owned by the PRC local government. The debt owed to HZIC relates to “結匯分成” (“foreign exchange conversion charges”) pursuant to “工繳費結匯分成協議書” (“foreign exchange conversion charges contract”).

HZIC is an independent third party not connected with the directors (including ex-directors within the past 12 months), chief executives or substantial shareholders of the Company, its subsidiaries or any of their respective associates. HZIC is not acting in concert with Baxter or the Investor or their respective concert parties.

LETTER FROM THE BOARD

(ii) Terms of the CN Settlement

As at 28th February, 2002, the outstanding amount due to HZIC was RMB24,650,877 (or HK\$23,038,203). Pursuant to the CN Settlement Agreement, HZIC will release and discharge all of the Group's obligations and liabilities to repay such amount. In consideration for this, HZIC will receive before 31st July, 2002 (i) payment in cash of RMB2,200,000 (or HK\$2,056,075) by the Group; and (ii) the issue by the Company of the New Convertible Note in the principal amount of HK\$16,000,000.

The cash payment under the CN Settlement will be funded from proceeds generated from the Restructuring Proposal.

(iii) Terms of the New Convertible Note

Principal Amount of the New Convertible Note:	HK\$16,000,000, convertible into 1,600,000,000 new Shares. As at the Latest Practicable Date, the Group had approximately 2,483.9 million Shares in issue. Based on the above, the 1,600,000,000 Conversion Shares (HZIC) represent approximately 64.4% of the issued share capital of the Company, approximately 39.2% of the issued share capital of the Company enlarged by the Conversion Shares (HZIC) and approximately 31.0% of the issued share capital of the Company enlarged by the Conversion Shares (HZIC) and the New Shares. Upon completion of the Restructuring Proposal, the Conversion Shares (HZIC) will represent about 13.5% of the issued share capital of the Company enlarged by the Conversion Shares (HZIC) and the New Shares.
Maturity:	Unless previously converted into Shares, the principal amount outstanding under the New Convertible Note together with all interest accrued thereon is repayable on the second anniversary of the date of issue of the New Convertible Note.
Interest:	3% per annum on the principal amount outstanding from time to time, payable semi-annually in arrears.
Conversion:	The noteholder will have the right to convert the New Convertible Note into Conversion Shares (HZIC) at any time from the date of issue of the New Convertible Note until the Maturity Date at the conversion price of HK\$0.01 per Share, subject to adjustment. It is intended that the New Convertible Note could be converted in whole or in part.

LETTER FROM THE BOARD

The Conversion Shares (HZIC) will, when issued, rank pari passu in all respects with all other Shares in issue on the date of conversion including the right to any dividends or distributions.

Completion:	Subject to the satisfaction of the conditions, completion of the CN Settlement will take place on or before 31st July, 2002.
Application for Listing:	Application has been made to the Stock Exchange for the listing of, and permission to deal in, the Conversion Shares (HZIC).
Voting:	The noteholder will not be entitled to vote at any of the general meetings of the Company by reason only of being the holder of the New Convertible Note.
Redemption	The Company has the right to redeem all or part of outstanding principal amount of the New Convertible Note at the face value of the New Convertible Note being redeemed (together with accrued interest thereon) prior to the Maturity Date.

The CN Settlement Agreement is silent on the transferability of the New Convertible Note. It is intended by both parties that the noteholder shall not be entitled to assign its rights, title or interest in or to the New Convertible Note without the prior written consent of the Company. The Company has undertaken to notify the Stock Exchange promptly if it becomes aware of any dealings in the New Convertible Note by Connected Persons.

(iv) Conditions of the CN Settlement

The CN Settlement Agreement is conditional upon:

- (a) passing at a general meeting of the Shareholders of ordinary resolutions approving, among other things, an increase in authorised share capital of the Company, the CN Settlement Agreement, the New Convertible Note and its issue (including issue of Convertible Shares (HZIC) pursuant to conversion of the New Convertible Note);
- (b) the Bermuda Monetary Authority giving its approval of any matters requiring its approval including, without limitation, the issue of the New Convertible Note;
- (c) approval of the listing of, and permission to deal in, the Conversion Shares (HZIC) being granted by the Stock Exchange;
- (d) the Shares remaining listed on the Stock Exchange and the Stock Exchange not having notified the Company that its listing will or may be withdrawn; and

LETTER FROM THE BOARD

- (e) trading in the Shares on the Stock Exchange being resumed.

The CN Settlement Agreement and the Restructuring Proposal are not inter-conditional.

Share Settlement Agreements

(i) Parties to the Share Settlement Agreements

The debtor is HCTF. The Creditors comprise a total of 30 creditors who are mainly suppliers and trade creditors of the Group. The Creditors do not include HZIC or its associates.

The Creditors are independent third parties not connected with the directors (including ex-directors within the past 12 months), chief executives or substantial shareholders of the Company, its subsidiaries or any of their respective associates. The Creditors are not acting in concert with Baxter or the Investor or their respective concert parties.

(ii) Terms of the Share Settlement

As at 28th February, 2002, the outstanding amount due to the Creditors in respect of the Share Settlement was RMB12,063,092 (or approximately HK\$11,273,918). Pursuant to the Share Settlement Agreements, the Creditors will release and discharge all of the Group's obligations and liabilities to repay such amount. In consideration for this, the Creditors will receive before 31st July, 2002 (i) payment in cash of RMB19,011 (or approximately HK\$17,767) by the Group; and (ii) the issue by the Company of 1,070,280,000 New Shares.

(iii) New Shares

A total of 1,070,280,000 New Shares at prices ranging from HK\$0.01 to HK\$0.015 per Share will be issued under the Share Settlement. The issue prices of New Shares were agreed based on arms' length negotiations with each of the Creditors.

As at the Latest Practicable Date, the Group had approximately 2,483.9 million issued Shares. Based on the above, the New Shares will represent approximately 43.1% of the issued share capital of the Company and approximately 30.1% of the issued share capital of the Company as enlarged by the New Shares. The New Shares will also represent approximately 8.5% of the issued share capital as enlarged by the Subscription Shares, Offer Shares, Conversion Shares, New Shares and Conversion Shares (HZIC).

The Share Settlement will not of itself result in any creditor holding 10% or more of the Shares.

LETTER FROM THE BOARD

(iv) Rights of the New Shares

The New Shares will rank *pari passu* in all respects with the Shares in issue on the date of issue of the New Shares.

(v) Conditions of the Share Settlement

The Share Settlement Agreements are conditional upon:

- (a) passing at a general meeting of the Shareholders of ordinary resolutions approving, among other things, an increase in authorised share capital of the Company, the Share Settlement Agreements, the issue and subscription of the New Shares;
- (b) Bermuda Monetary Authority giving its approval of any matters requiring its approval including, without limitation, the issue and subscription of the New Shares;
- (c) approval of the listing of, and permission to deal in, the New Shares being granted by the Stock Exchange;
- (d) the Shares remaining listed on the Stock Exchange and the Stock Exchange not having notified the Company that its listing will or may be withdrawn; and
- (e) trading in the Shares on the Stock Exchange being resumed.

The Share Settlement Agreements and the Restructuring Proposal are not inter-conditional.

(vi) Application for listing

Application has been made to the Stock Exchange for the granting of the listing of, and permission to deal in, the New Shares.

(vii) Completion

Subject to the satisfaction of the conditions, payment under the Share Settlement and completion of the Share Settlement Agreements will take place on or before 31st July, 2002. The cash payment under the Share Settlement will be funded from proceeds generated from the Restructuring Proposal.

Upon completion of the Share Settlement Agreements, the Group will be discharged and released from debts of approximately HK\$11.3 million in full. The Other Liabilities as at 30th September, 2001 were approximately HK\$134.1 million. The Directors are continuing their negotiations with a number of other creditors of the Group with a view to securing

LETTER FROM THE BOARD

further settlement arrangements with such creditors in respect of outstanding liabilities which remain after the settlement of debts of approximately HK\$34.3 million under the Settlements. Announcement will be made if and when further agreements are reached.

As at the Latest Practicable Date, the Group has obtained written consent from the Group's bankers in the PRC to reschedule and extend the repayment period, subject to a repayment of HK\$2.3 million, of its bank borrowings at 28th February, 2002 of approximately HK\$30.2 million ("PRC Bank Borrowings") for another one year upon their original maturity in the second half of 2002.

Financial Impact and Reasons for the Settlements

The Company is undergoing a restructuring of its bank indebtedness. The Company has endeavored to further restructure its debts with a view to restoring the Group back into a stronger financial position. The Settlements will enable the Group to substantially reduce debts while limiting the cash outflow in the reduction of such debt. The Directors are of the view that the cash element of the Settlements will not have a material adverse impact on the trading and financial position of the Group.

EFFECTS OF THE RESTRUCTURING PROPOSAL AND THE SETTLEMENTS

I. Shareholding structure

The following table sets out the shareholding structure of the Company prior to and immediately following completion of the Restructuring Proposal and the Settlements. The tables depict the shareholding structures under four scenarios as follows:–

- Scenario 1 : Assuming applications by Qualifying Shareholders for all the Offer Shares pro rata to their existing shareholding and before conversion of any Convertible Bonds/New Convertible Note by the Bank Group or HZIC
- Scenario 2 : Assuming no applications by Qualifying Shareholders for any of the Offer Shares and before conversion of any Convertible Bonds/New Convertible Note by the Bank Group or HZIC
- Scenario 3 : Assuming applications by Qualifying Shareholders for all the Offer Shares pro rata to their existing shareholding and after full conversion of the Convertible Bonds and New Convertible Note (in case (b) below) by the Bank Group and HZIC, respectively
- Scenario 4 : Assuming no applications by Qualifying Shareholders for any of the Offer Shares and after full conversion of the Convertible Bonds and the New Convertible Note (in case (b) below) by the Bank Group and HZIC, respectively

LETTER FROM THE BOARD

In scenarios 2 and 4, it is assumed that all Offer Shares would be taken up by the Investor and the sub-underwriters in accordance with their underwriting or sub-underwriting obligations on their own accounts but without taking account of any further sub-underwriting or placing arrangements by any of them.

(a) Taking into account of the Restructuring Proposal

	After completion of the Subscription				Upon completion of the Open Offer <i>(Note 1)</i>							
	At present		Agreement		Scenario 1		Scenario 2		Scenario 3		Scenario 4	
	Million shares	%	Million shares	%	Million shares	%	Million shares	%	Million shares	%	Million shares	%
Baxter <i>(Note 2)</i>	1,595.1	64.2	1,595.1	29.1	3,987.8	43.3	1,595.1	17.3	3,987.8	40.5	1,595.1	16.2
The Investor	–	–	3,000.0	54.7	3,000.0	32.6	5,325.9	57.8	3,000.0	30.4	5,325.9	54.0
Bank Group	–	–	–	–	–	–	–	–	650.0	6.6	650.0	6.6
Somerley <i>(Note 3)</i>	–	–	–	–	–	–	1,000.0	10.9	–	–	1,000.0	10.1
Kingston	–	–	–	–	–	–	400.0	4.3	–	–	400.0	4.1
Other Shareholders	888.8	35.8	888.8	16.2	2,222.0	24.1	888.8	9.7	2,222.0	22.5	888.8	9.0
	<u>2,483.9</u>	<u>100.0</u>	<u>5,483.9</u>	<u>100.0</u>	<u>9,209.8</u>	<u>100.0</u>	<u>9,209.8</u>	<u>100.0</u>	<u>9,859.8</u>	<u>100.0</u>	<u>9,859.8</u>	<u>100.0</u>
Public												
Shareholders <i>(Note 3)</i>	<u>888.8</u>	<u>35.8</u>	<u>888.8</u>	<u>16.2</u>	<u>2,222.0</u>	<u>24.1</u>	<u>1,288.8</u>	<u>14.0</u>	<u>2,872.0</u>	<u>29.1</u>	<u>1,938.8</u>	<u>19.7</u>

LETTER FROM THE BOARD

(b) Taking into account of the Restructuring Proposal and the Settlements

	After completion of the Subscription Agreement				Upon completion of the Open Offer, CN Settlement and Share Settlement (Note 1)							
	At present				Scenario 1		Scenario 2		Scenario 3		Scenario 4	
	Million shares	%	Million shares	%	Million shares	%	Million shares	%	Million shares	%	Million shares	%
Baxter (Note 2)	1,595.1	64.2	1,595.1	29.1	3,987.8	38.8	1,595.1	15.5	3,987.8	31.8	1,595.1	12.7
The Investor	–	–	3,000.0	54.7	3,000.0	29.2	5,325.9	51.8	3,000.0	23.9	5,325.9	42.5
Bank Group	–	–	–	–	–	–	–	–	650.0	5.2	650.0	5.2
Somerley	–	–	–	–	–	–	1,000.0	9.7	–	–	1,000.0	8.0
Kingston	–	–	–	–	–	–	400.0	3.9	–	–	400.0	3.2
HZIC	–	–	–	–	–	–	–	–	1,600	12.8	1,600	12.8
Creditors	–	–	–	–	1,070.3	10.4	1,070.3	10.4	1,070.3	8.6	1,070.3	8.6
Other Shareholders	888.8	35.8	888.8	16.2	2,222.0	21.6	888.8	8.7	2,222.0	17.7	888.8	7.0
	<u>2,483.9</u>	<u>100.0</u>	<u>5,483.9</u>	<u>100.0</u>	<u>10,280.1</u>	<u>100.0</u>	<u>10,280.1</u>	<u>100.0</u>	<u>12,530.1</u>	<u>100.0</u>	<u>12,530.1</u>	<u>100.0</u>
Public Shareholders (Note 3)	<u>888.8</u>	<u>35.8</u>	<u>888.8</u>	<u>16.2</u>	<u>3,292.3</u>	<u>32.0</u>	<u>3,359.1</u>	<u>32.7</u>	<u>3,942.3</u>	<u>31.5</u>	<u>4,009.1</u>	<u>32.0</u>

Notes:

- The shareholding structure is prepared on the basis of the existing issued Shares as enlarged by the Subscription Shares, Conversion Shares and/or Conversion Shares (HZIC) and does not take into account any additional Offer Shares that may be issued upon conversion of the outstanding Options and the Existing Convertible Note.
- On 24th November, 2000, Baxter pledged 1,565,140,000 ordinary shares of HK\$0.01 each of the Company to E-Bigger Investments Limited (“E-Bigger”), an independent third party, to secure loan facilities granted by E-Bigger to Baxter. Baxter is beneficially owned as to 75% by Mr. Chan Chun Hung and as to the remaining 25% by Ms. Wong Kin Ching, both of them were former directors of the Company. As far as the Directors are aware, E-Bigger is not a Connected Person of the Company and is not connected, nor acting in concert, with the Investor and its associates.
- In case (a) above, public Shareholders include, “Kingston”, “Bank Group” and “Other Shareholders”. Depending on the level of applications for the Open Offer by the Qualifying Shareholders and subject to any further sub-underwriting or placing arrangement by Somerley, the shareholding in the Company held by Somerley upon completion of the Restructuring Proposal may fall below 10% and hence be counted as part of the public float. In case (b) above, public Shareholders include, “Somerley”, “Kingston”, “Bank Group” and “Other Shareholders”.

LETTER FROM THE BOARD

II. Financial position

The principal financial effects of the Restructuring Proposal will be to reduce the indebtedness of the Group and strengthen its capital base with the issue of new Shares pursuant to the Subscription and the Open Offer. The expected reduction in interest cost arising from the decrease in indebtedness will have positive effects on the Group's earnings and cash flow.

Upon completion of the Restructuring Proposal, the total liabilities of the Group will be reduced by approximately HK\$93.2 million (being the amount of the Total Compromised Debt as at 17th December, 2001 after netting off the principal amount of the Convertible Bonds of HK\$6.5 million). In addition to the Total Compromised Debt, the Group had Other Liabilities amounted to approximately HK\$134.1 million as at 30th September, 2001. The Other Liabilities comprised (i) financial indebtedness mainly due to PRC banks and convertible bondholders of approximately HK\$70.4 million; and (ii) liabilities due mainly to trade creditors of approximately HK\$63.7 million. Upon completion of the Settlements, the total liabilities of the Group will be further reduced by approximately HK\$34.3 million.

The Company on 19th January, 2002 received a winding-up petition filed by the Petitioner which has provided printing services to the Group. It was alleged in the Petition that a sum of HK\$2,135,529 together with interest thereon was due and owing to Petitioner. On 22nd March, 2002, the Company entered into the Deed with the Petitioner to settle the Deed Sum over eight instalments, with the last instalment to be made in October 2002. As at the Latest Practicable Date, the Group had paid two instalments totalling HK\$1.5 million to the Petitioner pursuant to the Deed. The remaining six instalments in an aggregate amount of HK\$635,529 will be paid on a monthly basis on or before 1st October, 2002 from the internal resources of the Group. Pursuant to the Deed, all enforcement proceedings, including the Petition, were to be withdrawn and dismissed by or with the consent of the Petitioner. The Petition was withdrawn on 16th April, 2002. Save as disclosed, there was no other outstanding winding-up petition filed against the Company or its subsidiaries as at the Latest Practicable Date.

Save as disclosed above and under the section headed "5. LITIGATION" in Appendix IV of this circular, there is currently no material legal action pending against the Group in respect of the Other Liabilities. Details of all material litigation of the Group are set out in Appendix IV of this circular.

LETTER FROM THE BOARD

a) Net asset position

The Group will be restored to a positive net asset position with pro forma net tangible assets of approximately HK\$45.6 million calculated as follows :

	<i>HK\$' million</i>
Audited consolidated deficiency in assets of the Group as at 31st March, 2001	(69.6)
Unaudited consolidated loss of the Group for the six months ended 30th September, 2001	(25.1)
Unaudited consolidated deficiency in assets of the Group as at 30th September, 2001	(94.7)
Revaluation deficit (<i>Note 2</i>)	(6.6)
Adjusted consolidated deficiency in assets before the Restructuring Proposal and the Settlements	(101.3)
Add: Indebtedness waived pursuant to the Restructuring Proposal (<i>Note 3</i>)	70.4
Proceeds from the Open Offer (<i>Note 5</i>)	37.3
Proceeds from the Subscription	30.0
Reduction of indebtedness pursuant to the Settlements (<i>Note 4</i>)	16.2
Less: Estimated professional fees and expenses in connection with the Restructuring Proposal	(7.0)
Pro forma unaudited adjusted consolidated net tangible assets of the Group after completion of the Restructuring Proposal and Settlements	45.6
	<i>HK\$</i>
Pro forma unaudited adjusted consolidated deficiency in assets per Share prior to completion of the Restructuring Proposal and Settlements (<i>Note 5</i>)	(0.041)
Pro forma unaudited adjusted consolidated net tangible assets per Share upon completion of the Restructuring Proposal and Settlements (<i>Note 6</i>)	0.0044

LETTER FROM THE BOARD

Notes:

1. The pro forma unaudited adjusted consolidated net tangible assets prepared above does not take into account the effect upon conversion of the outstanding Options, Existing Convertible Note, the Convertible Bonds and the New Convertible Note to be issued.
2. The carrying value of the leasehold land and buildings and the construction in progress of the Group as at 28th February, 2002 amounted to HK\$85.6 million and nil, respectively, and were revalued by Knight Frank, an independent firm of professional valuers, at 28th February, 2002 at approximately HK\$124.0 million in aggregate.

The revalued amounts of the leasehold land and buildings of the Group amounted to HK\$95.0 million as at 28th February, 2002 as set out in Appendix II of this circular. In the opinion of the Directors, certain of these leasehold land and buildings were impaired as they had been left vacant and currently not been used by the Group and provisions for impairment of HK\$16.0 million were made as at 31st March, 2001. The revaluation deficit of HK\$6.6 million as set out in the pro forma statement of unaudited adjusted consolidated net tangible assets, represents the shortfall of the revalued amounts of HK\$95.0 million after deducting the aforesaid provisions for impairment of HK\$16.0 million, under the then carrying values of leasehold land and buildings of HK\$85.6 million as at 28th February, 2002.

The construction in progress with no carrying value as at 28th February, 2002 had been revalued at HK\$29.0 million by Knight Frank as set out in Appendix II of this circular. In the opinion of the Directors, the aforesaid construction in progress were impaired as development of which had been put on hold by the Group. As a result, the corresponding revaluation surplus of approximately HK\$29.0 million has not been incorporated in the pro forma statement of unaudited adjusted consolidated net tangible assets.

3. Being the Total Compromised Debt of HK\$99.7 million after netting off the principal amount of the Convertible Bonds of HK\$6.5 million to be issued, HK\$20.0 million to be repaid to the Bank Group by cash and the interest accrued by the Group in respect of the Total Compromised Debt of HK\$2.8 million for the period from 1st October, 2001 to 17th December, 2001.
4. Being the settlement of debts of HK\$34.3 million due to certain creditors of the Group after netting off the payment of HK\$2.1 million cash and the issue of the New Convertible Note in the amount of HK\$16.0 million.
5. Based on the existing issued share capital of 2,483,936,760 Shares.
6. Based on the enlarged issued share capital of 10,280,121,900 Shares after the Restructuring Proposal and Settlements.

As a result of the implementation of the Restructuring Proposal and the Settlements, the unaudited consolidated net deficiency in assets of the Group of approximately HK\$94.7 million as at 30th September, 2001 will become a pro forma unaudited adjusted consolidated net tangible assets of approximately HK\$45.6 million upon completion of the Restructuring Proposal and completion of the Settlements.

LETTER FROM THE BOARD

b) *Working Capital*

The effect of the Restructuring Proposal and Settlements on the cash position of the Group is illustrated as follows:

	<i>HK\$' million</i>
<i>Inflow</i>	
Subscription	30.0
Open Offer	37.3
	67.3
<i>Outflow</i>	
Payment of professional fees in connection with restructuring	(7.0)
Repayment of bank indebtedness	(20.0)
Payment pursuant to the Settlements	(2.1)
	(29.1)
Net Cash Inflow	<u>38.2</u>

The Directors are of the opinion that on the basis of the information contained on pages 116 to 120 of this circular, in the absence of unforeseen circumstances, the Group will have sufficient working capital for its operations for the fourteen months ending 30th April, 2003 following completion of the Restructuring Proposal and the Settlements.

III. Dilution of Independent Shareholders' interests

Immediately upon completion of the Restructuring Proposal and the Settlements, assuming that the Independent Shareholders do not take up their entitlements under the Open Offer, the interests of the existing Independent Shareholders will be diluted from approximately 35.8% to a minimum of approximately 7.0% or a maximum of approximately 21.6% depending on different scenarios as set out in the section headed "Shareholding structure" above.

WAIVER OF OBLIGATIONS UNDER THE CODE

Immediately upon completion of the Restructuring Proposal (including the Open Offer but before the sub-underwriting of the Open Offer and the Settlements), the Investor will be interested in between approximately 30.4% and 73.0% of the enlarged issued share capital of the Company (depending on the level of applications for the Open Offer by the Shareholders). Accordingly, the Investor will, in the absence of the Whitewash Waiver, be required under Rule 26 of the Code to make a general offer for the Shares, Options and the Existing Convertible Note other than those held by the Investor and parties acting in concert with it.

LETTER FROM THE BOARD

The granting of the Whitewash Waiver by the Executive is a condition of the Compromise Agreement, which condition is waivable by the Investor. However the Investor has undertaken that it will not waive such condition. In the event that the Whitewash Waiver is not granted on or before 1st June, 2002, i.e. four months from the date of the Compromise Agreement (or such later date as may be agreed by the parties), the Compromise Agreement will lapse.

An application has been made to the Executive for the granting of the Whitewash Waiver and the Executive has indicated that, subject to the approval of the Independent Shareholders, the Whitewash Waiver will be granted.

Upon completion of the Restructuring Proposal and depending on the level of application for the Offer Shares by the Shareholders, the Investor and its concert parties may hold more than 50% of the Shares then in issue. In such event, the Investor may purchase additional Shares without triggering any further obligation for a general offer under the Code. On the other hand, if the aggregate interests of the Investor and its concert parties immediately upon completion of the Restructuring Proposal are between 30% and 50%, they will be allowed to acquire a further 2% Shares in the 12 months immediately following completion of the Restructuring Proposal.

Completion of the Compromise Agreement is conditional, among others, on the grant of the Whitewash Waiver.

REASONS FOR THE RESTRUCTURING PROPOSAL

The principal activities of the Group are the design, manufacture and sale of a wide range of toys. As a result of an investigation by the Independent Commission Against Corruption against the former Chairman of the Group, which incident was the subject of wide publicity in the press, the Group's reputation was severely impaired. All its bankers and suppliers either suspended or terminated their credit facilities granted to the Group and some of them demanded repayment of outstanding balances. Such actions created a shortage in the working capital of the Group. At the same time, the Group experienced a decline in profit margins attributable to keen competition in the toys industry and provisions made for trade receivables and inventories resulting from over-expansion of trading in the first half of 2000. According to the annual report of the Group for the year ended 31st March, 2001, the Group had audited consolidated net current liabilities of approximately HK\$182.8 million as at 31st March, 2001. The Group also incurred an audited consolidated net loss from ordinary activities attributable to shareholders of approximately HK\$279.3 million and reported a significant audited net cash outflow from operating activities of approximately HK\$80.1 million for the year ended 31st March, 2001. According to the interim report of the Group for the six months ended 30th September, 2001, the Group had unaudited net current liabilities of approximately HK\$207.2 million. The Group also incurred an unaudited consolidated net loss from ordinary activities attributable to shareholders of approximately HK\$25.1 million and reported an unaudited net cash outflow from operating activities of approximately HK\$7.0 million for the six months ended 30th September, 2001. The Group continues to experience financial difficulties and

LETTER FROM THE BOARD

currently has no unutilised banking facilities available to support its normal operating requirements. The Group has defaulted in repayments of bank borrowings, which sum amounted to approximately HK\$99.7 million as at 17th December, 2001. Certain suppliers and bankers of the Group had filed writs of summons seeking repayment of the outstanding amounts due by the Group as well as winding-up petitions against the Company and one of its subsidiaries.

The Group has held negotiations with various potential new equity investors including the Investor and has also explored the possibility of a self-rescue scheme. However, difficulties were encountered in such negotiations, including the need for investors to perform due diligence investigations particularly as regards the financial position of the Group's PRC subsidiaries. The Investor was prepared to proceed without making its Restructuring Proposal subject to formal "due diligence" investigations. Consequently, the Directors consider it is in the best interests of the Company to proceed with the Restructuring Proposal in order to restore the Group to positive net assets and to open up possibilities for future diversification.

USE OF PROCEEDS

It is estimated that the net proceeds raised for the Company from the Restructuring Proposal will be between approximately HK\$60.3 million and HK\$63.5 million. The Company intends to apply the net proceeds as to approximately HK\$20.0 million to repay the Bank Group pursuant to the Compromise Agreement, and as to the remainder as working capital and/or to repay outstanding liabilities of the Group (including HK\$2.1 million that is payable under the Settlements).

FUTURE INTENTION OF THE INVESTOR REGARDING THE GROUP

The Investor intends that the Group will continue its existing toy manufacturing and distribution businesses. The Company will endeavour to develop and strengthen the core business of the Group if suitable opportunities arise. However, no specific targets have been identified and the Investor at present does not have any plan to inject any assets into the Company. The Investor does not intend to implement major changes (including the redeployment of fixed assets) of the Group. After completion of the Restructuring Proposal, the Group will continue to seek to restructure its liabilities. The management of the Group will manage the operations of the Group along the following principles:

- strict control over capital expenditure and bank borrowings will be implemented with the primary objective to generate positive cashflow for the Group as soon as possible;
- the existing management of the Group will be retained to manage the core business of the Group; and
- the Company will seek to identify suitable investment targets which can enrich the Group's revenue stream.

LETTER FROM THE BOARD

With the accession of the PRC into the World Trade Organisation, the Investor is confident of the future prospects of both the export and domestic markets for toys. The investment in the Group will enable the Investor to benefit from a recovery of the Group with significantly improved financial position and future growth of the Group with promising industry prospects in the long term.

LISTING

The Stock Exchange has stated that if, at completion of the Restructuring Proposal, less than 25% of the shares of the Company are held by the public or if the Stock Exchange believes that a false market exists or may exist in the shares of the Company; or there are too few shares of the Company in public hands to maintain an orderly market, then it will consider exercising its discretion to suspend trading in the shares of the Company.

The Company and the Investor are aware that the public float of the Company may fall below the Listing Rules requirement of 25% immediately upon completion of the Restructuring Proposal. The Investor and the Company have undertaken to the Stock Exchange to take appropriate steps (which may include further issue of new Shares or arranging for sale of Shares by Shareholders) to ensure that as soon as possible following completion of the Restructuring Proposal, not less than 25% of the Company's issued securities will be held by the public.

The Stock Exchange has stated that, if the Company remains a listed company, any future injections into or disposals by the Company will be subject to the provisions of the Listing Rules. Pursuant to the Listing Rules, the Stock Exchange has the discretion to require the Company to issue a circular to the Shareholders irrespective of the size of the proposed transaction, particularly when such proposed transaction represents a departure from the principal activities of the Group following completion of the Restructuring Proposal. The Stock Exchange also has the power, pursuant to the Listing Rules, to aggregate a series of acquisitions, or disposals by the Company and any such acquisitions or disposals may, in any event, result in the Company being treated as a new applicant for listing and subject to the requirement for new applicants as set out in the Listing Rules.

MANAGEMENT

The current executive Directors are Mr. Lo Ming Chi, Charles and Mr. Yu Wai Man. The non-executive Directors are Mr. Wu Wing Kit and Mr. Wong Kwok Tai. It is the intention of the Investor that all the Directors will be invited to remain on the Board and the Investor has no intention to appoint further Directors to the Board. The Investor intends that all existing senior management and all employees will remain with the Group in order to ensure a smooth continuation of the Group's business following completion of the Restructuring Proposal. The Investor has no intention to retrench any employees by reason only of the completion of the Restructuring Proposal.

LETTER FROM THE BOARD

INCREASE IN AUTHORISED SHARE CAPITAL

The authorised share capital of the Company consists of 10,000,000,000 Shares, of which 2,483,936,760 Shares were in issue as at the Latest Practicable Date. In order to facilitate the issue of new shares of the Company pursuant to the Restructuring Proposal and the other proposals described in the circular and in the future, the Directors propose to increase the authorised share capital of the Company from HK\$100 million to HK\$300 million by the creation of an additional 20 billion Shares. The proposed increase in authorised share capital of the Company is subject to approval by Shareholders at the Special General Meeting.

GENERAL MANDATE TO ISSUE SHARES

At the Special General Meeting, an ordinary resolution will be proposed which, if approved, will grant to the Directors a general mandate to allot, issue and deal with additional new Shares not exceeding 20% of the aggregate of the nominal amount of the issued share capital of the Company at the date of the resolution as enlarged upon the allotment and issue of the Subscription Shares, the Conversion Shares, the Offer Shares, the Conversion Shares (HZIC) and the New Shares.

SPECIAL GENERAL MEETING

Set out in this circular is a notice convening the Special General Meeting which will be held at 9:00 a.m. on Monday, 13th May, 2002 at Conference Room, 30/F, Panda Hotel, 3 Tsuen Wah Street, Tsuen Wan, Hong Kong at which resolutions will be proposed to approve, among other things, the Restructuring Proposal and the transactions contemplated thereunder, the Whitewash Waiver, the Creeper Authorisation, the Settlements and the General Mandate.

A form of proxy for use at the Special General Meeting is enclosed with this circular. Whether or not you intend to attend the meeting, you are requested to complete the accompanying form of proxy and return it in accordance with the instructions printed thereon as soon as possible to the Company's Registrar, Tengis Limited at 4th Floor, Hutchison House, 10 Harcourt Road, Central, Hong Kong, and in any event not less than 48 hours before the time appointed for the holding of the Special General Meeting. Delivery of a form of proxy will not preclude you from attending and voting in person at the Special General Meeting or any adjourned meeting should you so wish.

RECOMMENDATIONS

Your attention is drawn to the letter from the Independent Board Committee set out on page 39 of this circular. Independent Shareholders are urged to read carefully the opinion of Equitas and the advice of the Independent Board Committee before deciding how to vote at the Special General Meeting.

LETTER FROM THE BOARD

The Directors believe that the proposal for the Settlements, the increase in authorized share capital and the grant of General Mandate are in the interests of the Company and the Shareholders. Accordingly, the Directors recommend the Shareholders to vote in favour of the ordinary resolutions to approve the Settlements, the increase in authorised share capital and the General Mandate.

GENERAL

Completion of the Restructuring Proposal is conditional upon, among other things, resumption of trading of Shares on the Stock Exchange. The issue of this circular does not indicate that the Restructuring Proposal and the Resumption Proposal will be successfully implemented and completed.

Your attention is drawn to the letters from Equitas and the Independent Board Committee and the additional information set out in the appendices to this circular.

Yours faithfully,
For and on behalf of the Board
Lo Ming Chi, Charles
Chairman

LETTER FROM THE INDEPENDENT BOARD COMMITTEE



HUNG FUNG GROUP HOLDINGS LIMITED

(incorporated in Bermuda with limited liability)

26th April, 2002

To the Independent Shareholders

Dear Sir or Madam,

As the Independent Board Committee, we have been appointed to advise you in connection with (i) the Subscription Agreement; (ii) the Compromise Agreement; (iii) the Open Offer; (iv) the Whitewash Waiver; and (v) the Creeper Authorisation, details of which are set out in the letter from the Board contained in the circular to the Shareholders dated 26th April, 2002 (the “Circular”), of which this letter forms part. Terms defined in the Circular shall have the same meanings when used herein unless the context otherwise requires.

Having considered the terms of (i) the Subscription Agreement; (ii) the Compromise Agreement; (iii) the Open offer; (iv) the Whitewash Waiver; and (v) the Creeper Authorisation, the principal factors considered by and the advice of Equitas in relation thereto as set out on pages 40 to 61 of the Circular, we are of the opinion that the terms of (i) the Subscription Agreement; (ii) the Compromise Agreement; (iii) the Open offer; (iv) the Whitewash Waiver; and (v) the Creeper Authorisation are fair and reasonable so far as the Shareholders are concerned. We therefore recommend that you vote in favour of the ordinary resolutions to be proposed at the Special General Meeting to approve the (i) the Subscription Agreement; (ii) the Compromise Agreement; (iii) the Open Offer; (iv) the Whitewash Waiver; and (v) the Creeper Authorisation.

Yours faithfully,

Independent Board Committee

Mr. Wu Wing Kit

Independent non-executive Director

Mr. Wong Kwok Tai

Independent non-executive Director

LETTER OF ADVICE FROM EQUITAS

The following is the text of a letter of advice received from Equitas in relation to the Restructuring Proposal and the Whitewash Waiver which letter has been prepared for the purpose of inclusion in this circular:



EQUITAS CAPITAL LIMITED

盈均財務顧問有限公司

Exempt Dealer • Exempt Investment Adviser

5/F Winning Centre,
46-48 Wyndham Street,
Central,
Hong Kong.

26th April, 2002

The Independent Board Committee
Hung Fung Group Holdings Limited
Room 3A03-06
3/F New Mandarin Plaza
14 Science Museum Road
Tsimshatsui East
Kowloon

Dear Sirs,

**PROPOSED DEBT RESTRUCTURING OF
HUNG FUNG GROUP HOLDINGS LIMITED
INVOLVING
ISSUE OF NEW SHARES AND CONVERTIBLE BONDS,
BANK COMPROMISE,
CREDITOR SETTLEMENTS
AND
OPEN OFFER OF NOT LESS THAN 3,725,905,140 NEW SHARES
AND
APPLICATION FOR WHITEWASH WAIVER**

INTRODUCTION

We, Equitas Capital Limited, refer to our appointment by the Directors of Hung Fung Group Holdings Limited to advise the Independent Board Committee on the terms and conditions of the Restructuring Proposal, which was jointly announced by the Company and the Investor on 22nd February, 2002, and the application by the Investor for the Whitewash Waiver. The Restructuring Proposal involves (inter alia) the Subscription, the Open Offer and

LETTER OF ADVICE FROM EQUITAS

the Bank Compromise. Following the announcement of the Restructuring Proposal, the Company announced on 2nd April, 2002 that it had entered into the Settlements with certain creditors of the Group to settle certain debts owed to such creditors in the total amount of HK\$34.3 million.

Under the Listing Rules, both the Subscription and the Open Offer require the approval of the Independent Shareholders at the Special General Meeting of the Company. In addition, pursuant to the Code, the Whitewash Waiver is required to be approved by a separate vote of the Independent Shareholders voting on a poll. The Settlements do not require the approval of the Independent Shareholders but, pursuant to the various agreements which provide for them, are conditional on the passing of the necessary enabling ordinary resolutions at the Special General Meeting to effect the various transactions contemplated by the Settlements.

Of the four Directors comprising the Board, Messrs. Lo Ming Chi, Charles and Yu Wai Man are both salaried employees of the Group and have been involved in negotiations and discussions in relation to the Restructuring Proposal. Messrs. Lo Ming Chi, Charles and Yu Wai Man are also employed by New Century Group Hong Kong Limited (a company listed on the Stock Exchange and in which the holding company of the Investor has a controlling interest) as an executive director and the financial controller, respectively. Neither of them is, accordingly, considered to be independent under the Code insofar as the Restructuring Proposal and the Whitewash Waiver are concerned. Mr. Wong Kwok Tai is an independent non-executive director of New Century Group Hong Kong Limited but he is otherwise unconnected with the Investor or any of its associates and, accordingly, is considered by the Board to be suitable to give advice to Independent Shareholders on the Restructuring Proposal and the Whitewash Waiver. The Board has therefore constituted the Independent Board Committee, comprising Messrs. Wu Wing Kit and Wong Kwok Tai (both being independent non-executive Directors), to consider the terms of the Restructuring Proposal and the Whitewash Waiver. We, Equitas, as independent financial adviser, agree with the Board's view that it is appropriate to appoint Mr. Wong Kwok Tai to the Independent Board Committee.

The terms defined in the circular dated 26th April, 2002 (the "Circular") to the Shareholders and, for information only, the holders of the Options and of the Existing Convertible Note of which this letter forms part have the same meanings in this letter, unless the context requires otherwise.

Equitas is unconnected with any of the Company; the Investor; Somerley; Kingston; the directors, chief executive and substantial shareholders of the Company, the Investor, Somerley, Kingston or any of their respective subsidiaries and the associates of each of them and, accordingly, is considered suitable to give independent advice to you. Apart from normal professional fees payable to us in connection with this appointment, no arrangement exists whereby we will receive any fees or benefits from any party including the Company; the Investor; Somerley; Kingston; the directors, chief executive and substantial shareholders of the Company, the Investor, Somerley, Kingston or any of their respective subsidiaries or the associates of any of them.

LETTER OF ADVICE FROM EQUITAS

In formulating our opinion and recommendation, we have reviewed the published information on the Group including its annual reports for each of the two years ended 31st March, 2001 and its interim report for the six months ended 30th September, 2001, an independent financial review on the Group prepared by Deloitte Touche Tohmatsu in January 2001, the Compromise Agreement, the Subscription Agreement, the Underwriting Agreement, the valuation report on the property interests owned by the Group prepared by Knight Frank as set out in Appendix II to the Circular, the latest unaudited management accounts of the Group for the five month period from 1st October, 2001 through 28th February, 2002, the Resumption Proposal submitted by the Company to the Stock Exchange, the cash flow projection of the Group for the 14 month period ending 30th April, 2003 as set out in paragraph 7 of Appendix I to the Circular, the agreements for the Settlements and the Company's business plan for the next two years. We have discussed with the Directors and the directors of the Investor regarding their reasons for the Restructuring Proposal and their plans for the future of the Group. We have also paid a visit to the Group's factory at Huang Jiang Zhen, Dongguan City, the PRC.

We consider that the information we have reviewed is sufficient for us to reach the conclusions set out in this letter and have no reason to doubt the truth, accuracy and completeness of the information provided. The Directors and the Investor have confirmed to us that no material factors have been omitted from the information supplied and opinions expressed. We have relied on such information and opinions and have not conducted an independent in-depth investigation and review of the business, operations or financial condition of the Group or the current state or likely prospects of the toy markets in which the Group operates.

THE RESTRUCTURING PROPOSAL

The Restructuring Proposal involves (inter alia) the Subscription, the Open Offer and the Bank Compromise.

1. The Subscription

Under the Subscription Agreement the Investor has conditionally agreed to subscribe for 3,000,000,000 Subscription Shares at the price of HK\$0.01 per Share. The Subscription Shares represent 120.8% of the Company's existing issued share capital of 2,483,936,760 Shares and 54.7% of the Company's issued share capital as enlarged by the Subscription.

The Subscription Shares will upon issue rank *pari passu* in all respects with the then issued Shares. As the Subscription Agreement is scheduled to be completed after the Record Date for the Open Offer, the Subscription Shares will not carry rights to participate in the Open Offer.

LETTER OF ADVICE FROM EQUITAS

Completion of the Subscription Agreement is conditional on the fulfillment of all the conditions to which the Compromise Agreement is subject and on the completion of the Compromise Agreement. Such conditions are contained in the paragraph headed **“III. Conditions to the Compromise Agreement”** under the section headed **“THE BANK COMPROMISE”** in the letter from the Board set out in the Circular.

2. The Open Offer

The Company proposes to raise an additional amount of between approximately HK\$37.3 million and HK\$40.5 million before expenses by issuing a minimum of 3,725,905,140 Offer Shares and a maximum of 4,046,455,140 Offer Shares (depending on whether any of the Company’s outstanding Options are exercised and/or whether any part of the Existing Convertible Note issued by the Company is converted before the Record Date) at a price of HK\$0.01 per Offer Share by way of the Open Offer.

Under the Open Offer, only Qualifying Shareholders will be entitled to receive assured allotments for the Offer Shares on the basis of three Offer Shares for every two existing Shares held on the Record Date.

The Offer Shares, when fully paid and allotted, will rank *pari passu* in all respects with all the then issued Shares. Holders of the Offer Shares will be entitled to receive all future dividends and distributions which are or may be declared, made or paid on the Shares on or after the date of allotment of the Offer Shares.

The expected timetable of events in respect of the Open Offer is set out on page 1 of the Circular. Further terms and conditions of the Open Offer are contained in the section headed **“THE OPEN OFFER”** in the letter from the Board.

As at the Latest Practicable Date, there were an aggregate of 13,700,000 Options outstanding under the Share Option Scheme, which are exercisable into an aggregate of 13,700,000 Shares at a subscription price of HK\$0.046 per Share (subject to adjustment) during the period up to 16th February, 2008. The exercise price of any Options which remain outstanding after the Record Date will be adjusted, where appropriate, as a result of the Open Offer in accordance with the terms of the Share Option Scheme.

In addition, as at the Latest Practicable Date, the Company had outstanding the Existing Convertible Note in the principal amount of HK\$3 million. On the basis of the existing conversion price of HK\$0.015 per Share, full conversion of the Existing Convertible Note would result in the issue of a total of 200,000,000 Shares. The conversion price of any part of the Existing Convertible Note which has not been converted before, and remain outstanding after, the Record Date will be adjusted, where appropriate, as a result of the Open Offer in accordance with its terms of issue.

LETTER OF ADVICE FROM EQUITAS

3. The Open Offer Underwriting Arrangement

Pursuant to the Underwriting Agreement, the Investor has conditionally agreed to underwrite the entire Open Offer of a maximum of 4,046,455,140 Offer Shares for a commission of 3.5% on the aggregate subscription price. The Underwriting Agreement is not subject to any rights of termination.

The Investor has entered into two sub-underwriting agreements with each of Somerley and Kingston whereby they have agreed to sub-underwrite 1 billion Offer Shares in the case of Somerley and 400 million Offer Shares in the case of Kingston for a sub-underwriting commission of 3.5% on the relevant aggregate subscription price. The sub-underwriting agreements are subject to rights of termination principally relating to the occurrence of certain events, including force majeure. In the event that the rights of termination are exercised by the sub-underwriters, the Investor will pursuant to the Underwriting Agreement take up all Offer Shares not applied for and taken up under the Open Offer.

The conditions to which the Underwriting Agreement is subject are contained in the sub-paragraph headed “**IV. Conditions of the Underwriting Agreement**” under the paragraph headed “**The Underwriting Agreement**” under the section headed “**THE OPEN OFFER**” in the letter from the Board.

4. The Bank Compromise

As at 17th December, 2001, the Total Compromised Debt owed by the Group to the Bank Group amounted to approximately HK\$99.7 million. Pursuant to the Compromise Agreement, the Bank Group has conditionally agreed to release and discharge all of the Group’s obligation and liabilities to repay the Total Compromised Debt outstanding as at Completion and to release the Guarantees given by the Group in favour of the Bank Group. In consideration therefor, the Bank Group will receive (1) the payment in cash of HK\$20,038,795 by the Company; and (2) the issue by the Company of the Convertible Bonds in the aggregate principal amount of HK\$6.5 million.

The principal terms of the Convertible Bonds to be issued to the Bank Group are contained in the sub-paragraph headed “*2. Convertible Bonds*” under the section headed “**THE BANK COMPROMISE**” in the letter from the Board.

The conditions to which the Compromise Agreement is subject are contained in the paragraph headed “**III. Conditions to the Compromise Agreement**” under the section headed “**THE BANK COMPROMISE**” in the letter from the Board.

Completion of the Compromise Agreement will be effected concurrently with the Subscription Agreement. Assuming that all the conditions to which the Compromise Agreement is subject are fulfilled, the Compromise Agreement and the Subscription Agreement are currently scheduled to be completed on or about 16th May, 2002.

LETTER OF ADVICE FROM EQUITAS

5. Use of Proceeds

It is estimated that the aggregate net proceeds raised by the Company from the Subscription and the Open Offer will be approximately HK\$60.3 million (on the basis of 3,725,905,140 Offer Shares being issued). The Company intends to apply the net proceeds as to approximately HK\$20.0 million to repay the Bank Group pursuant to the Compromise Agreement; and as to the balance of approximately HK\$40.3 million as working capital and/or to repay outstanding liabilities of the Group (including the HK\$2.1 million payable under the Settlements).

6. Resumption of trading in the Shares

Completion of the Restructuring Proposal is conditional upon, among other things, resumption of trading in the Shares on the Stock Exchange. To this end, the Company has submitted the Resumption Proposal to the Stock Exchange.

INFORMATION ON THE INVESTOR

The Investor is an investment holding company incorporated in the British Virgin Islands, having its registered office at P.O. Box 957, Offshore Incorporations Centre, Road Town, Tortola, British Virgin Islands, and is wholly and beneficially owned by Huang Group. Huang Group is in turn wholly and beneficially owned by a discretionary trust (the “Huang family trust”), the trustee of which for the time being is Mr. Kan Ka Chong, Frederick. The discretionary objects of the Huang family trust are Mr. Huang, his family members and certain unspecified charities. Mr. Huang is engaged in the tour business, cruise liner management, hotel and property investment in Southeast Asia. Huang Group has a controlling interest in New Century Group Hong Kong Limited, a company listed on the Stock Exchange.

Pursuant to the Compromise Agreement, the due performance of all the Investor’s obligations under the Compromise Agreement, the Subscription Agreement and the Underwriting Agreement has been guaranteed by Mr. Huang as guarantor to the Investor.

Further information on the Investor is contained in the section headed “**THE INVESTOR**” in the letter from the Board.

THE WHITEWASH WAIVER

Set out in the paragraph headed “**1. Shareholding structure**” under the section headed “**EFFECTS OF THE RESTRUCTURING PROPOSAL AND THE SETTLEMENTS**” in the letter from the Board are two tables showing, respectively, the shareholding structures of the Company prior to and immediately following completion of the Restructuring Proposal under 4 scenarios(a) taking into account only the Restructuring Proposal and (b) taking into account both the Restructuring Proposal and the effects of the Settlements.

LETTER OF ADVICE FROM EQUITAS

Depending on the level of application by the Qualifying Shareholders for the Offer Shares under the Open Offer, the Investor will, upon completion of the Restructuring Proposal (but before taking into account the sub-underwriting arrangement for the Open Offer and the effects of the Settlements), acquire a shareholding of between approximately 30.4% and 73.0% of the Company's issued share capital as enlarged by the Subscription and the Open Offer (taking no account of the exercise of any Options and before conversion of the Existing Convertible Note). Accordingly, the Investor will in the absence of the Whitewash Waiver be required under Rule 26 of the Code to make a general offer for the Shares, the Options and the Existing Convertible Note other than those held by the Investor and parties acting in concert with it.

An application has been made to the Executive for the grant of the Whitewash Waiver and the Executive has indicated that, subject to the approval of the Independent Shareholders, the Whitewash Waiver will be granted.

THE SETTLEMENTS

The various agreements entered into by the Company which provides for the Settlements comprise the CN Settlement Agreement and the Share Settlement Agreements. Pursuant to the Settlements, the Company has conditionally agreed to settle certain debts owed to creditors of the Group in the total amount of approximately HK\$34.3 million by way of (i) the payment of approximately HK\$2.1 million in cash; (ii) the issue of 1,070,280,000 New Shares at prices ranging from HK\$0.01 to HK\$0.015 per New Share; and (iii) the issue of the New Convertible Note in the principal amount of HK\$16 million.

A description of the terms and conditions of the CN Settlement Agreement and the Share Settlement Agreements, including the respective terms of issue of the New Convertible Note and the New Shares, is contained in the sub-paragraphs headed **"CN Settlement Agreement"** and **"Share Settlement Agreements"**, respectively, under the section headed **"THE SETTLEMENTS"** in the letter from the Board.

The CN Settlement Agreement and the Share Settlement Agreements are not inter-conditional and none of these agreements is conditional on the completion of the Restructuring Proposal.

Completion of the Settlements, subject to the fulfillment of all the relevant conditions, is intended to take place on or before 10th June, 2002.

LETTER OF ADVICE FROM EQUITAS

PRINCIPAL FACTORS AND REASONS CONSIDERED

The transactions contemplated under the Restructuring Proposal, namely the Subscription, the Open Offer and the Bank Compromise, are inter-conditional. Whilst we will attempt to assess the terms of each element of the Restructuring Proposal individually, Independent Shareholders are reminded that these transactions form integral parts of the Restructuring Proposal and should be considered as a whole and not separately.

In arriving at our opinion and advice, we have considered the following principal factors and reasons:

1. As regards the Restructuring Proposal

1.1 background to, and reasons for, the Restructuring Proposal

1.1.1 background

The Company was listed on the main board of the Stock Exchange in March 1998. The business activities of the Group are the design, manufacture and sale of toys, principally ride-on cars, bicycles, tricycles and pre-school toys, and certain other plastic moulded products including plastic utensils.

The business of the Group was founded by Mr. Chan Chun Hung (“Mr. Chan”), the controlling shareholder and former chairman of the Company, who had been heavily involved in the management of the Group. In October 2000, it was widely reported in the Hong Kong press that Mr. Chan had been arrested by the Independent Commission Against Corruption. He was subsequently released on bail but resigned from the Company together with his then wife and the management accountant (who were the only other executive directors of the Company at the time).

Since October 2000, there had been several appointments to, and resignations from, the Board with the effect that none of the current Directors has been in office before December 2000. Following the conclusion of the last annual general meeting of the Company, the composition of the Board has now stabilised.

LETTER OF ADVICE FROM EQUITAS

We understand that since around August 2000, there had been a very serious deterioration in the Group's business operations and financial condition which was caused by a significant breakdown in the internal accounting and financial controls and a credit squeeze brought on by the suspension or withdrawal of credit facilities by the Group's bankers and suppliers. At the same time, the Group experienced a serious decline in its profit margin which was attributed by the then Directors to keen competition in the toys industry and provisions made for trade receivables and inventories caused by over-expansion of trading in the first half of 2000.

We have been informed that Mr. Chan continues to be involved with the Group's business as a consultant in order to maintain the smoothness of liaison with the local authority in the PRC for the settlement of “結匯分成” (Foreign Exchange Conversion Charges) and to ensure the compliance with local regulations for the factory's operations in the PRC. However, we understand that Mr. Chan does not participate in the management of the Group. We have also been informed that the Directors, shortly after their appointments to the Board, have implemented a set of procedures to strengthen the Group's internal accounting and financial controls to rectify the significant breakdown therein referred to above and to prevent such breakdown from happening in the future.

We believe that, subject to the strengthening of financial controls on the Group's operations, Mr. Chan's continued involvement is probably necessary to prevent further damaging disruptions which have so adversely affected the Group's operating and financial performance in recent months.

1.1.2 current financial condition of the Group

Financial information on the Group, including its audited consolidated financial statements for the year ended 31st March, 2001 and the interim financial report for the six months ended 30th September, 2001, is set out in Appendix I to the Circular.

We note that both the auditors' report on the audited consolidated financial statements of the Group for the year ended 31st March, 2001 and the independent review report issued by the Company's auditors on the interim financial report of the Group for the six months ended 30th September, 2001 contain extensive qualifications. The financial information contained in such financial statements and report should therefore be read and considered accordingly.

LETTER OF ADVICE FROM EQUITAS

According to the interim financial report of the Group for the six months ended 30th September, 2001 (the text of which is set out in paragraph 2 of Appendix I of the Circular), the Group incurred an unaudited consolidated net loss from ordinary activities attributable to Shareholders of approximately HK\$25.1 million and reported an unaudited net cash outflow from operating activities of approximately HK\$7.0 million for the six months under review. As at 30th September, 2001, the Group had unaudited net current liabilities of approximately HK\$207.2 million and unaudited net deficit in assets of approximately HK\$94.7 million. The Group continues to experience financial difficulties and currently has no unutilised banking facilities available to support its normal operating requirements. The Group has defaulted in the repayment of the Total Compromised Debts due to the Bank Group amounting to approximately HK\$99.7 million in aggregate as at 17th December, 2001. As disclosed in paragraph 5 of Appendix IV to the Circular, certain suppliers and bankers of the Group have filed writs of summons seeking repayment of the outstanding amounts due by the Group as well as winding-up petitions against the Company and one of its subsidiaries.

1.1.3 listing status of the Company

Trading in the Shares of the Company on the Stock Exchange has been suspended since 22nd January, 2001.

The closing price of the Shares on the Stock Exchange on 19th January, 2001, being the last trading day before trading in the shares were suspended, was HK\$0.013 per Share.

The Stock Exchange is concerned as to whether the Company currently complies with paragraph 38 of the listing agreement made between the Company and the Stock Exchange, which requires the Group to carry out a sufficient level of operations or has tangible or intangible assets of sufficient value to warrant the continued listing of the Company's securities on the Stock Exchange.

Pursuant to Rule 6.04 of the Listing Rules which provides that "the continuation of a suspension for a prolonged period without the issuer taking adequate action to obtain restoration of listing may lead to the Stock Exchange canceling the listing", the Company has been informed by the Stock Exchange on 15th January, 2002 that it had been placed in the second stage of the delisting procedures as set out in paragraph 3.1 of Practice Note 17 to the Listing Rules. The Company is required to submit resumption proposals on or before 15th July, 2002 and to provide monthly progress reports from the Directors to the Stock Exchange. The Stock Exchange is

LETTER OF ADVICE FROM EQUITAS

currently monitoring the developments of the Company during this six month period and, if by the end of this period the Company is unable to implement an acceptable resumption proposal, the Stock Exchange will determine whether to proceed to the third stage of the delisting procedures.

Under Practice Note 17 of the Listing Rules, where the Stock Exchange determines to proceed to the third stage, it will publish an announcement naming the Company, indicating that it does not have sufficient assets or operations for listing and imposing a deadline (generally six months) for the submission of resumption proposals. During the third stage, the Company would again be required to provide monthly progress reports to the Stock Exchange. At the end of the third stage, where no proposals have been received for resumption, the listing will be cancelled. This would be announced by both the Stock Exchange and the Company.

As referred to in the sub-paragraph headed **“6. Resumption of trading in the Shares”** under the section headed **“THE RESTRUCTURING PROPOSAL”** above, the Company has submitted the Resumption Proposal to the Stock Exchange.

1.1.4 reasons for the Restructuring Proposal

The Directors have considered various proposals to address the Company’s financial difficulties and to strengthen the Company’s capital base through negotiations with the Company’s bankers and creditors on stand still and rescheduling arrangements as well as fund-raising exercises, including, but not limited to, loans from Directors, external borrowings and private placements. Prior to the announcement of the Restructuring Proposal, a total of approximately HK\$25.4 million had been raised, comprising short term unsecured loans in aggregate of HK\$21.4 million from an independent third party and an unsecured loan of HK\$4.0 million from Mr. Lo Ming Chi, Charles, the Chairman.

The Directors believe that further borrowings will not provide the solution to the Group’s financial difficulties but that the Group badly needs an infusion of new equity. In this regard, the Company has held negotiations with various potential new equity investors including the Investor and has also explored the possibility of a self-rescue scheme. However, difficulties were encountered in such negotiations, including the need for potential investors to perform due diligence investigations particularly as regards the financial position of the Group’s PRC subsidiaries. The Investor is prepared to proceed without making its Restructuring Proposal subject to formal due diligence investigations. Consequently, the Directors consider that it is in the best interests of the Company to effect the Restructuring Proposal in

LETTER OF ADVICE FROM EQUITAS

order to restore the Group to positive net assets and to open up possibilities for future diversification.

We believe that the fact that the Group's financial statements are extensively qualified will effectively limit the number of investors willing to mount a rescue operation for the Company because of the additional risks involved. We concur with the Directors' opinion that the Restructuring Proposal is in the interests of the Company and the Shareholders as a whole since it is not conditional on the findings of any due diligence investigation or audit. In view that the Company has already been placed by the Stock Exchange in the second stage of the delisting procedures as mentioned in paragraph 1.1.3 above, it is of paramount importance that the Company should take immediate steps to implement a resumption proposal acceptable to the Stock Exchange, failing which the listing status of the Company may be jeopardised.

1.2 terms of the Subscription

The Directors have confirmed to us that the terms of the Subscription have been agreed after arm's length negotiations with the Investor and the Subscription constitutes an important element of the Restructuring Proposal taking into account the requirements of the Bank Group.

The price at which the Subscription Shares will be issued of HK\$0.01 per Share represents:

- a discount of approximately 23.1% to the closing price of the Shares on the Stock Exchange of HK\$0.013 per Share on 19th January, 2001, being the last trading day before trading in the Shares were suspended on 22nd January, 2001;
- a premium of HK\$0.048 over the unaudited consolidated net deficit in assets prior to completion of the Restructuring Proposal of HK\$0.038 per share (*Note*);
- a premium of approximately 213% over the pro forma unaudited adjusted consolidated net tangible assets per Share upon completion of the Restructuring Proposal (but before taking into account the effects of the Settlements) of HK\$0.0032 per Share (*Note*); and
- a premium of approximately 127% over the pro forma unaudited adjusted consolidated net tangible assets per Share upon completion of the Restructuring Proposal and the Settlements of HK\$0.0044 per Share (*Note*).

LETTER OF ADVICE FROM EQUITAS

Note:

Please refer to the statement of the pro forma unaudited adjusted consolidated tangible assets of the Group upon completion of the Restructuring Proposal and the Settlements set out in the sub-paragraph headed “a) Net asset position” under the section headed “EFFECTS OF THE RESTRUCTURING PROPOSAL AND THE SETTLEMENTS” in the letter from the board and to paragraph 1.5.3 below.

On the basis of the above analysis and taking into account particularly the current financial difficulties facing the Group, we consider that the issue price of the Subscription Shares is fair and reasonable.

We note that the Subscription Agreement contains a minimum of warranties principally relating to the legal status of the Company and its current capital structure. In particular, no warranties have been given by any Director or the Company regarding the current financial condition of the Group. Whilst this is slightly unusual, we consider that the absence of such warranties is in the interests of the Company as it would increase the probability of completion of the Subscription Agreement.

We note further that the Subscription Agreement is not conditional on the result of any due diligence review or investigation and that there is no provision for a post completion audit or adjustment of terms subject to such audit. We consider that the absence of such provisions is in the interest of the Company and the Independent Shareholders.

1.3 terms of the Open Offer

1.3.1 basis of the Open Offer

Under the Open Offer, the Company is proposing to issue a minimum of 3,725,905,140 Offer Shares and a maximum of 4,046,455,140 Offer Shares and Qualifying Shareholders will be entitled to receive assured allotments for the Offer Shares on the basis of three Offer Shares for every two existing Shares held on the Record Date.

This is a relatively heavy call on Shareholders as the holder of each board lot of Shares (20,000 Shares) will need to pay HK\$300 if he/she intends to participate in the Open Offer to the full extent of his/her assured allotment, which amount represents approximately 115% of the market value of a board lot of Shares before trading was suspended in January, 2001 (based on the last closing price of the Shares on the Stock Exchange of HK\$0.013 per Share). We believe it is unlikely that the Open Offer will receive full support from Qualifying Shareholders and, accordingly, the pricing of the Offer Shares becomes a material consideration.

LETTER OF ADVICE FROM EQUITAS

1.3.2 pricing of the Offer Shares

Under the Open Offer, the Offer Shares will be issued at HK\$0.01 per Share, which is the same price at which the Subscription Shares will be issued.

On this basis, we would consider that the subscription price of the Offer Shares is fair.

1.3.3 the underwriting arrangement

The Underwriting Agreement, similar to the Subscription Agreement, contains a minimum of warranties which are given only by the Company.

We note that the Investor, as the sole underwriter of the Open Offer, does not have any right of termination under the Underwriting Agreement in the event of the occurrence of force majeure events. Such right is, however, reserved by the sub-underwriters under the sub-underwriting agreements.

The underwriting commission payable by the Company under the Underwriting Agreement is agreed at 3.5% of the aggregate subscription price which is significantly higher than the usual level of 2%. We note, however, that the commission being offered by the Investor to the sub-underwriters is the same 3.5%, which suggests that such rate is not uncommercial and, accordingly, we would regard such commission rate as fair and reasonable, particularly taking into account the current financial condition of the Company.

1.3.4 listing of assured allotments on a nil paid basis

We note that there will be no listing of the assured allotments which Qualifying Shareholders will receive under the Open Offer on a nil paid basis, which would facilitate any intended dealing by Qualifying Shareholders in such allotments. However, bearing in mind the current financial condition of the Group, we believe that the value of such allotments on a nil paid basis is probably limited and we do not regard such a factor as a material consideration in assessing the terms of the Restructuring Proposal.

LETTER OF ADVICE FROM EQUITAS

1.3.5 our view on the Open Offer

We consider that the Open Offer is a fair arrangement which makes Independent Shareholders to participate in the Restructuring Proposal and thereby minimise the dilution of their interests in the Company should they wish to do so whilst ensuring at the same time that the Company obtains the necessary equity funding.

1.4 *terms of the Bank Compromise*

Under the Compromise Agreement, the Bank Group will upon completion thereof receive approximately HK\$20.0 million in cash, equivalent to approximately 20.1% of the Total Compromised Debt outstanding as at 17th December, 2001 of approximately HK\$99.7 million, together with the Convertible Bonds in the aggregate principal amount of HK\$6.5 million.

On the basis that the Convertible Bonds are valued at their principal amount, the Bank Group will effectively have waived HK\$73.2 million of the Total Compromised Debt owed by the Group, equivalent to 73.4% of such amount.

We consider that the terms of the Compromise Agreement are in the interests of the Company.

1.5 *effects of the Restructuring Proposal*

1.5.1 Group liabilities

As stated in the paragraph headed “**II. Financial position**” under the section headed “**EFFECTS OF THE RESTRUCTURING PROPOSAL AND THE SETTLEMENTS**” in the letter from the Board, the principal financial effects of the Restructuring Proposal will be to reduce the Group’s indebtedness and strengthen the Company’s capital base through the issue of the Subscription Shares and the Offer Shares. The expected decrease in interest cost arising from the reduction in indebtedness will have a positive impact on the Group’s future earnings and cash flow.

Upon completion of the Restructuring Proposal, the total liabilities of the Group will be reduced by approximately HK\$93.2 million (being the amount of the Total Compromised Debt as at 17th December, 2001 less the principal amount of the Convertible Bonds of HK\$6.5 million).

LETTER OF ADVICE FROM EQUITAS

In addition to the Total Compromised Debt, the Group had other liabilities (the “Other Liabilities”) amounting to approximately HK\$134.1 million as at 30th September, 2001. The Other Liabilities comprised (i) financial indebtedness due mainly to PRC banks and the holder of the Existing Convertible Note totaling approximately HK\$70.4 million; and (ii) liabilities due mainly to trade creditors of approximately HK\$63.7 million.

Independent Shareholders will note that, pursuant to the Settlements, the Group’s Other Liabilities will be reduced by approximately HK\$16.2 million (being HK\$34.3 million less the cash payment of HK\$2.1 million and the principal amount of the New Convertible Note of HK\$16 million).

As stated in the letter from the Board under the section headed “**THE SETTLEMENTS**”, the Directors are continuing their negotiations with a number of other creditors of the Group with a view to securing further settlement arrangements with such creditors in respect of the Group’s outstanding liabilities which remained outstanding after the completion of the Settlements.

1.5.2 working capital

Set out in paragraph 7 of Appendix I to the Circular is the cash flow projection of the Group for the 14 month period ending 30th April, 2003 together with the bases and assumptions on which the Directors have prepared such projection. In particular, the Directors have prepared such projection on the basis of the Group’s unaudited management accounts for the 11 month period ended 28th February, 2002 and a projection of the Group’s working capital requirement for the 14 month period ending 30th April, 2003 assuming completion of the Restructuring Proposal and the Settlements (the “Projection Period”). As disclosed in paragraph 7 of Appendix I, the Group has also undertaken a number of other measures in order further to relieve its current liquidity pressures.

We note that the Directors have stated that they are of the opinion that in the absence of unforeseen circumstances and subject to the completion of the Restructuring Proposal and the Settlements, taking into account the undertaking given by the holding company of the Investor and, the successful rescheduling and extending of the repayment period for the PRC bank borrowings, the Group, which includes the Company and its subsidiaries other than Hung Cheong Toys International Limited, will have sufficient working capital for the Projection Period.

LETTER OF ADVICE FROM EQUITAS

We have discussed with the Directors the bases and assumptions made by them in preparing the cash flow projection. We have also considered the Directors' working capital statement and the letters dated 26th April, 2002 issued by each of Ernst & Young, the auditors of the Company, and Somerley relating to such working capital statement. On the basis of the assumptions made by the Directors and taking into account the review of the cash flow projection for the Projection Period by Ernst & Young and the opinion of Somerley regarding such cash flow projection, we are of the view that the Directors' statement in relation to the sufficiency of the Group's working capital for the Projection Period (for which the Directors are solely responsible) has been made after due care.

Independent Shareholders are requested to note that whilst the Restructuring Proposal provides the Group with a better basis to carry on its existing business operations, there is no assurance that it will return to profitability immediately and that, as the Group is projected to have a relatively low reserve of working capital at the end of the Projection Period, it may require additional funding support, particularly if the cash flow projection is not met. Such funding support may have to be raised by way of equity issues which may require the support of Independent Shareholders.

1.5.3 net assets

A statement of the pro forma unaudited adjusted consolidated net tangible assets of the Group upon completion of the Restructuring Proposal and the Settlements is set out in the sub-paragraph headed "*a) Net asset position*" under the section headed **"EFFECTS OF THE RESTRUCTURING PROPOSAL AND THE SETTLEMENTS"** in the letter from the Board. As shown in the statement, upon completion of the Restructuring Proposal, the Group will be restored to a positive net asset position with pro forma unaudited consolidated net tangible assets of approximately HK\$29.4 million (before taking account of the conversion of any of the Convertible Bonds to be issued to the Bank Group and the effects of the Settlements).

On this basis, the pro forma unaudited adjusted consolidated net tangible assets per Share upon completion of the Restructuring Proposal will be HK\$0.0032 per Share (based on the minimum total number of Shares then in issue of 9,209,841,900 Shares before taking account of the conversion of any of the Convertible Bonds to be issued to the Bank Group and the effects of the Settlements).

Independent Shareholders may note that, following completion of the Settlements, the pro forma unaudited adjusted consolidated net tangible assets of the Group will improve further to HK\$45.6 million, equivalent to HK\$0.0044 per Share (based on the minimum total number of Shares then

LETTER OF ADVICE FROM EQUITAS

in issue of 10,280,121,900 Shares before taking account of the conversion of any of the Convertible Bonds and the New Convertible Note to be issued to the Bank Group and HZIC respectively).

1.5.4 Gearing

As noted in paragraph 1.5.1 above, upon completion of the Restructuring Proposal but before taking into account the effects of the Settlements, the total liabilities of the Group of approximately HK\$233.8 million (based on the Total Compromised Debt of approximately HK\$99.7 million and the Group's Other Liabilities as at 30th September, 2001 of approximately HK\$134.1 million) will be reduced by approximately HK\$93.2 million and the Company's Shareholders' equity will be restored from a position of net deficit in assets in the amount of approximately HK\$101.3 million before completion of the Restructuring Proposal to a pro forma unaudited adjusted consolidated net tangible assets of approximately HK\$29.4 million (as referred to in paragraph 1.5.3 above).

On this basis, the Group's debt to equity ratio would improve from a net deficit in assets position to approximately 4.78 times.

Independent Shareholders should note that, following completion of the Settlements, the Group's debt to equity ratio will further improve.

1.5.5 shareholding structure

Two tables showing, respectively, the shareholding structures of the Company prior to and immediately following Completion under 4 scenarios (principally relating to the level of applications by Qualifying Shareholders for the Offer Shares) (a) taking into account only the Restructuring Proposal and (b) taking into account the Restructuring Proposal and the effects of the Settlements are set out in the paragraph headed **"I. Shareholding Structure"** under the section headed **"EFFECTS OF THE RESTRUCTURING PROPOSAL AND THE SETTLEMENTS"** in the letter from the Board. The tables of shareholding structures have been prepared on the basis of the existing issued Shares as enlarged by the Subscription Shares and the Offer Shares and/or the conversion of the Convertible Bonds to be issued to the Bank Group and takes into account, where relevant, the effects of the Settlements but not any additional Shares and Offer Shares which may be issued upon conversion of the outstanding Options and the Existing Convertible Note.

1.5.6 dilutive effect on the interests of Independent Shareholders

The attention of Independent Shareholders is drawn to the dilutive effect of the Restructuring Proposal on their percentage shareholdings in the Company. As shown in the table of shareholding structure (table (a))

LETTER OF ADVICE FROM EQUITAS

referred to in paragraph 1.5.5 above, the combined shareholding of Independent Shareholders will be diluted from the present approximately 35.8% to approximately 24.1% (based on scenario 1) immediately following completion of the Restructuring Proposal, assuming applications by Independent Shareholders for all of the Offer Shares pro rata to their existing shareholdings and before taking account of the conversion of any of the Convertible Bonds to be issued to the Bank Group, representing a dilution of approximately 32.6%. However, if Independent Shareholders do not apply for any of the Offer Shares to which they are entitled, then their combined shareholding in the Company will be diluted to approximately 9.0% (based on scenario 4), representing a dilution of 74.9%.

In analysing the dilutive effect of the Restructuring Proposal on the interest of Independent Shareholders, we believe that it is more appropriate to consider scenario 1 as Independent Shareholders are entitled to receive assured allotment under the Open Offer pro rata to their shareholdings. The Investor and its sub-underwriters, Somerley and Kingston, will only be able to pick up any Offer Shares to the extent that such Offer Shares are not applied for and taken up by Independent Shareholders.

Independent Shareholders should note that the dilutive effect of approximately 32.6% on their interest in the Company also represents the percentage shareholding of the Investor under scenario 1, which shareholding, in our view, must be close to the minimum percentage holding which would be demanded by an external investor intending to acquire control (being 30%).

Independent Shareholders should further note that while their aggregate shareholding of approximately 35.8% in the Company represents a share of the unaudited adjusted consolidated deficit in assets (prior to completion of the Restructuring Proposal) of approximately HK\$36.3 million (based on the Group's adjusted consolidated deficit in assets before the Restructuring Proposal and the Settlements of HK\$101.3 million as shown in the net assets statement referred to in paragraph 1.5.3 above), their aggregate shareholding of approximately 9.0% in the Company (based on scenario 4, which is the worst case scenario) upon completion of the Restructuring Proposal will represent attributable net tangible assets of approximately HK\$3.2 million (after taking into account the conversion of the Convertible Bonds to be issued to the Bank Group but not the effects of the Settlements).

Mindful that a certain level of dilution is inevitable in a rescue operation funded by an external party, we consider that the dilutive effect of the Restructuring Proposal on the shareholding of the Independent Shareholders is acceptable.

LETTER OF ADVICE FROM EQUITAS

1.6 future intention of the Investor regarding the Group

1.6.1 business

We note that the Investor intends as stated in the section headed **“FUTURE INTENTION OF THE INVESTOR REGARDING THE GROUP”** in the letter from the Board, the Investor intends that the Group will continue its existing toy manufacturing and distribution businesses. The Company will endeavour to develop and strengthen the core business of the Group if suitable opportunities arise. However, no specific targets have been identified and **the Investor has confirmed that there is no plan in the future for the Investor to transfer any of its existing assets or businesses into the Group and there is no plan for any redeployment or sale of any of the businesses or operations of the Group.**

After completion of the Restructuring Proposal, the Group will continue to restructure its liabilities.

1.6.2 management

The current Board consists of Mr. Lo Ming Chi, Charles, the executive Chairman, Mr. Yu Wai Man, the other executive Director, and the two independent non-executive Directors comprising the Independent Board Committee, Messrs. Wu Wing Kit and Wong Kwok Tai.

We note that it is the intention of the Investor that all the current Directors will be invited to remain on the Board and the Investor has no intention to appoint further Directors to the Board. The Investor intends that all existing senior management and employees will remain with the Group in order to ensure a smooth continuation of the Group's business following Completion.

1.7 continued listing of the Company

It is the intention of the Directors and the Investor to maintain the listing of the Shares on the Stock Exchange after completion of the Restructuring Proposal. Accordingly, the Directors, the Investor and the Company have jointly and severally undertaken to the Stock Exchange to use their respective best endeavours to ensure that a sufficient public float exists for the Shares following completion of the Restructuring Proposal and, in due course, the Settlements.

LETTER OF ADVICE FROM EQUITAS

1.8 alternative proposals

We have been advised by the Directors that the Restructuring Proposal is the only viable proposal which has resulted from their discussions with various new equity investors referred to in paragraph 1.1.4 above. No other proposals, including self-rescue schemes, are currently available to the Group.

Given the current financial difficulties facing the Group, its poor recent trading performance and the fact that the Group's financial statements are extensively qualified, we would concur with the Directors' view that alternative proposals are unlikely.

2. As regards the application for Whitewash Waiver

As disclosed in paragraph 2 of Appendix III to the Circular, as at the Latest Practicable Date, none of the Investor, the directors of the Investor and any party acting in concert with them had any interest in Shares. In addition, during the period from 1st October, 2000 through the Latest Practicable Date, none of the Investor, the directors of the Investor and any party acting in concert with them had dealt for value in any Shares.

Immediately upon completion of the Restructuring Proposal but before taking into account the sub-underwriting arrangement for the Open Offer and the effects of the Settlements, as shown in the table of shareholding structure (table(a)) referred to in paragraph 1.5.5 above, the Investor will hold between approximately 30.4% and 73.0% of the enlarged issued share capital of the Company (depending on the level of applications by Qualifying Shareholders for the Offer Shares). Accordingly, the Restructuring Proposal will result in the Investor and parties acting in concert with it incurring a general offer obligation for the Shares pursuant to Rule 26 of the Code. An application has been made to the Executive for a Whitewash Waiver under Note 1 of the Notes on dispensations from Rule 26.1 of the Code. The approval of the Whitewash Waiver is a condition of the Compromise Agreement and the Subscription Agreement, which condition may be waived by the Investor. However, the Investor has undertaken that it will not waive such condition. In the event that the Whitewash Waiver is not approved by Independent Shareholders on or before 1st June, 2002, being the date four months from the date of the Compromise Agreement (or such later date as may be agreed by the parties), the Compromise Agreement will lapse and the Restructuring Proposal will fail.

The Executive has indicated that the Whitewash Waiver will be granted, subject to approval of the Independent Shareholders which will be sought at the Special General Meeting.

Upon completion of the Restructuring Proposal but before taking into account the effects of the Settlements and depending on the level of application for the Offer Shares by Qualifying Shareholders, the Investor and its concert parties may hold more than 50% of the Shares then in issue. In such event, the Investor may purchase additional Shares without triggering any further obligation for a general offer under the Code. On the other hand, if the aggregate holding of Shares of the Investor and its concert parties

LETTER OF ADVICE FROM EQUITAS

immediately upon completion of the Restructuring Proposal is between 30% and 50%, they will be allowed to acquire a further 2% of the Shares then in issue in the 12 months immediately following completion of the Restructuring Proposal.

In the event that the Whitewash Waiver is not approved by Independent Shareholders, the Restructuring Proposal will fail. Given the fact that the Group is in financial difficulties, the failure of the Restructuring Proposal will result in a further deterioration of the Group's financial situation and the Company may well go into liquidation unless an alternative viable rescue operation is mounted by another party. If the Company were to go into liquidation, it would be unlikely that Independent Shareholders would be able to recover any of their investment in the Company from a distribution of the Group's assets under liquidation in view of its deficiency in net assets. On the basis of the information currently available to us and as discussed in paragraph 1.8 above, we would consider that alternative rescue proposals are unlikely and in any case we believe that such proposals would not likely be made on terms that represent a material improvement on the terms of the Restructuring Proposal. Accordingly, we are of the view that it is in the interests of the Independent Shareholders to approve the Whitewash Waiver.

OUR OPINION AND ADVICE

as regards the Restructuring Proposal

In view of the Group's financial difficulties which necessitate the implementation of a financial restructuring in order to continue as a going concern, we are of the opinion that the Restructuring Proposal is in the interests of the Company and that the terms thereof are fair and reasonable so far as the Independent Shareholders are concerned, notwithstanding its dilutive effects on the shareholdings of the Independent Shareholders. In the absence of the Restructuring Proposal, the future of the Company, including its listing status on the Stock Exchange, may be in jeopardy.

as regards the Whitewash Waiver

In view of our above opinion on the Restructuring Proposal, we consider that the approval of the Whitewash Waiver by Independent Shareholders is fair and reasonable as without such approval, the Restructuring Proposal will fail.

recommendation

Accordingly, we advise the Independent Board Committee to recommend to Independent Shareholders that they should vote in favour of the ordinary resolutions as set out in the Notice of the Special General Meeting to approve the Restructuring Proposal (and the transactions contemplated thereunder) and the Whitewash Waiver.

Yours faithfully,
For and on behalf of
Equitas Capital Limited
Ng Ming Wah, Charles
Managing Director

1. SHARE CAPITAL

The authorised and issued ordinary share capital of the Company as at the Latest Practicable Date were, and immediately following completion of the Restructuring Proposal and the Settlements are expected to be, as follows:

<i>Authorised:</i>		<i>HK\$</i>
10,000,000,000	Shares as at the Latest Practicable Date	100,000,000.00
20,000,000,000	new Shares to be created	200,000,000.00
<u>30,000,000,000</u>		<u>300,000,000.00</u>
<i>Issued and fully paid:</i>		
2,483,936,760	Shares in issue as at the Latest Practicable Date	24,839,367.60
3,000,000,000	Subscription Shares to be issued upon completion of the Subscription Agreement	30,000,000.00
650,000,000	Conversion Shares to be issued upon conversion of Convertible Bonds	6,500,000.00
3,725,905,140	minimum number of Offer Shares to be issued pursuant to the Open Offer	37,259,051.40
1,070,280,000	New Shares to be issued upon completion of Share Settlement Agreements	10,702,800.00
1,600,000,000	Conversion Shares (HZIC) to be issued upon conversion of New Convertible Note	16,000,000.00
<u>12,530,121,900</u>	Shares in issue upon completion of the Restructuring Proposal and the Settlements	<u>125,301,219.00</u>

All the Shares rank pari passu in all respects including as to dividends, voting rights and capital. All the Shares in issue immediately following completion of the Restructuring Proposal and Settlements will rank pari passu in all respects with each other including as to dividends, voting rights and capital. There have been no changes to the authorised and issued share capital of the Company since 31st March, 2001 (being the end of the last financial year of the Company) up to the Latest Practicable Date.

Under the Share Option Scheme adopted by the Company, the Directors may at their discretion, invite employees of the Group, including Directors, to take up options to subscribe for Shares, subject to the terms and conditions stipulated therein, which in aggregate may not exceed, in nominal amount, 10% of the issued share capital of the Company from time to time which have been duly allotted and issued, excluding for this purpose, Shares issued pursuant

to exercise of options granted under the Share Option Scheme. The independent non-executive Directors are not eligible for participation in the Share Option Scheme.

As at the Latest Practicable Date, the Company had outstanding 13,700,000 Options. The holders of which are entitled to subscribe for Shares at an exercise price of HK\$0.046 per Share at any time until 16th February, 2008. Exercise in full of such options would, under the present capital structure of the Company, result in the issue of 13,700,000 additional Shares. The Company also had outstanding at the Latest Practicable Date the Existing Convertible Note in the principal amount of HK\$3,000,000, which was issued at 100% of its principal amount and bears interest at the rate of 5% per annum with maturity on 16th November, 2002. On the basis of the existing conversion price of HK\$0.015 per Share, full conversion of the Existing Convertible Note would result in the issue of a total of 200,000,000 Shares. The figures above take no account of Shares that may be issued under these Options or the Existing Convertible Note.

Save for the Conversion Shares, Conversion Shares (HZIC) and Shares to be issued upon exercise of Options and conversion of Existing Convertible Note, no other share or loan capital of the Company is under option or has been agreed conditionally or unconditionally to be put under option and no warrant or conversion right affecting the Shares or other derivatives in respect of securities which are being offered for or which carry voting rights has been issued or granted or agreed conditionally, or unconditionally to be issued or granted.

Save for the Existing Convertible Note, Options, Convertible Bonds and New Convertible Note, the Company has no options, warrants and conversion rights convertible into Shares. Save for the Subscription Shares, Offer Shares and the New Shares, no share or loan capital of the Company has been issued or is proposed to be issued for cash or otherwise and no commissions, discounts, brokerages or other special terms have been granted in connection with the issue or sale of any such capital.

The Shares are listed on the Stock Exchange. No securities of the Company are listed or dealt in, nor is listing or permission to deal in the securities of the Company being or proposed to be sought, on any other stock exchange.

2. UNAUDITED INTERIM RESULTS

The Group's unaudited interim report for the six months ended 30th September, 2001 is reproduced below.

The Board of Directors (the "Board") of Hung Fung Group Holdings Limited (the "Company") is pleased to announce the unaudited consolidated interim results of the Company and its subsidiaries (the "Group") for the six months ended 30 September 2001 together with the unaudited comparative figures for the corresponding period in 2000. The condensed consolidated interim financial statements have not been audited, but have been reviewed by the Company's auditors, Ernst & Young, in accordance with the Hong Kong Statements of Auditing Standards 700 "Engagements to Review Interim Financial Reports" and by the Company's Audit Committee.

Condensed Consolidated Profit And Loss Account

For the six months ended 30 September 2001

		Six months ended 30 September	
		2001	2000
		(Unaudited)	(Unaudited)
	Notes	HK\$'000	HK\$'000
TURNOVER	3	29,008	188,571
Cost of sales		(34,254)	(189,172)
Gross loss		(5,246)	(601)
Other income		1,194	481
Selling and distribution costs		(1,251)	(938)
Administrative expenses		(10,842)	(15,486)
Other operating expenses		(2,274)	(203,579)
LOSS FROM OPERATING ACTIVITIES	4	(18,419)	(220,123)
Finance costs		(6,660)	(5,584)
LOSS BEFORE TAX		(25,079)	(225,707)
Tax	5	–	1,500
Minority interests		–	–
NET LOSS FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS		(25,079)	(224,207)
DIVIDEND	6	–	–
LOSS PER SHARE	7		
Basic		(HK cents 1.01)	(HK cents 9.03)
Diluted		N/A	N/A

Other than the net loss from ordinary activities attributable to shareholders for the period, the Group had no recognised gains or losses. Accordingly, a consolidated statement of recognised gains and losses is not presented in the interim financial report.

Condensed Consolidated Balance Sheet

30 September 2001

		30 September 2001 (Unaudited) HK\$'000	31 March 2001 (Audited) HK\$'000
	<i>Notes</i>		
NON-CURRENT ASSETS			
Fixed assets	8	115,541	122,802
CURRENT ASSETS			
Inventories		7,953	11,569
Accounts receivable	9	8,317	4,107
Prepayments, deposits and other receivables		2,734	1,744
Cash and bank balances		1,794	782
		<u>20,798</u>	<u>18,202</u>
CURRENT LIABILITIES			
Interest-bearing bank loans and other borrowings	10	62,673	38,968
Trust receipt loans, unsecured		72,578	72,896
Finance lease payables		5,427	6,614
Accounts payable	11	27,997	26,224
Other payables and accruals		55,310	47,327
Tax payable		5	5
Loan from a director	12	4,000	9,000
		<u>227,990</u>	<u>201,034</u>
NET CURRENT LIABILITIES		<u>(207,192)</u>	<u>(182,832)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		(91,651)	(60,030)
NON-CURRENT LIABILITIES			
Interest-bearing bank loans		–	6,542
Convertible note	13	3,000	3,000
		<u>3,000</u>	<u>9,542</u>
		<u>(94,651)</u>	<u>(69,572)</u>
CAPITAL AND RESERVES			
Issued share capital		24,839	24,839
Reserves	14	(119,490)	(94,411)
		<u>(94,651)</u>	<u>(69,572)</u>

Condensed Consolidated Cash Flow Statement*For the six months ended 30 September 2001*

	Six months ended	
	30 September	
	2001	2000
	(Unaudited)	(Unaudited)
	<i>HK\$'000</i>	<i>HK\$'000</i>
Net cash outflow from operating activities	(6,971)	(46,644)
Net cash outflow from returns on investments and servicing of finance	(2,398)	(5,526)
Total tax paid	–	(19)
Net cash outflow from investing activities	(277)	(11,304)
Net cash inflow/(outflow) from financing activities	9,813	(2,711)
Increase/(decrease) in cash and cash equivalents	167	(66,204)
Cash and cash equivalents at beginning of period	(78,385)	18,225
Cash and cash equivalents at end of period	(78,218)	(47,979)
Analysis of the balances of cash and cash equivalents		
Cash and bank balances	1,794	30,924
Bank overdrafts	(7,434)	(2,643)
Trust receipt loans with original maturity within three months	(72,578)	(76,260)
	(78,218)	(47,979)

Notes:

1. Accounting Policies

The unaudited condensed consolidated interim financial report has been prepared in accordance with the applicable disclosure requirements of Appendix 16 to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited and with the Statements of Standard Accounting Practice No. 25 “Interim Financial Reporting” issued by the Hong Kong Society of Accountants.

The accounting policies and basis of presentation used in the preparation of the unaudited condensed consolidated interim financial report are consistent with those adopted in the financial statements of the Group for the year ended 31 March 2001.

2. Basis of Presentation

The Group’s interim financial report for the six months ended 30 September 2001 has been prepared on a going concern basis.

As at 30 September 2001, the Group had net current liabilities of approximately HK\$207,192,000. The Group also incurred a net loss from ordinary activities attributable to shareholders of approximately HK\$25,079,000 and reported a net cash outflow from operating activities of approximately HK\$6,971,000 for the six months ended 30 September 2001.

Although the directors have been undertaking a number of measures with a view to improve the Group’s liquidity and restore its operations to profitability, the Group continued to experience financial difficulties and currently has no unutilised banking facilities available to support its normal operational requirements. The Group also has difficulty in repaying short term bank loans on time. As at the date of this report, certain suppliers and bankers of the Group have filed writs of summons to demand for the repayment of the amounts due by the Group. The directors are currently negotiating with certain parties issuing the writs with a view to restructuring the Group’s overall indebtedness. Except for those disclosed in note 17 to the interim financial report, no other legal actions have been taken against the Group. In view of the above, the amounts due to banks and other financial institutions have been classified as current liabilities.

Having regard to this background, in order to strengthen the capital base of the Group and to improve the Group’s financial position, immediate liquidity, cash flows and profitability and otherwise sustain the Group as a going concern, the directors have adopted the following measures:

- (a) the directors are considering various alternatives to strengthen the capital base of the Company through various fund-raising exercises, including, but not limited to, loans from directors, external borrowings and private placements. In this regard, the directors have been in active negotiations with potential investors for the purpose of seeking capital injections into the Group. Up to the date of this report, a short term loan of HK\$19.4 million has been raised from an independent third party and HK\$4 million from Mr. Lo Ming Chi, Charles, the Chairman of the Company;
- (b) the directors are in active negotiations with the Group’s bankers, the parties which have provided the Group with the loans, and other creditors, especially with those parties who have filed writs against the Group, with a view to entering into a formal standstill arrangement, to rescheduling the repayment terms of certain of the Group’s outstanding borrowings and to seeking their ongoing support; the possibility of entering into a debt hair cut agreement is also under active discussion;
- (c) the directors have taken actions to tighten cost controls over factory overheads and various administrative expenses; and
- (d) the directors have taken measures to scale down the production activities in view of the shrinkage of the Group’s turnover.

In the opinion of the directors, in light of the measures taken to date, together with the expected results, the Group will have sufficient working capital for its current operational requirements and it is expected that the Group will ultimately return to a commercially viable concern notwithstanding the Group's financial position and tight cash flows as at 30 September 2001 and the date this interim report was approved. However, the directors anticipate that it may take some considerable time to successfully implement their plans.

Should the Group be unable to continue as a going concern, adjustments would have to be made to restate the values of assets to their recoverable amounts, to provide for any further liabilities which might arise and to reclassify non-current assets and liabilities as current assets and liabilities, respectively. The effects of these adjustments have not been reflected in the interim financial report.

3. Turnover and Segmental Information

Turnover represents the invoiced value of goods sold, net of discounts and returns.

An analysis of the Group's turnover and contribution to loss from operating activities by principal activity and geographical area of operations for the period is as follows:

	Turnover		Contribution to loss	
	Six months ended		from operating activities	
	30 September		Six months ended	
	2001	2000	2001	2000
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
By principal activity:				
Manufacture and sale of				
Ride-on cars	9,211	48,342	(4,283)	(28,784)
Bicycles and tricycles	9,326	54,540	(5,778)	(31,149)
Stuffed toys	–	9,415	–	(8,282)
Pre-school toys	9,247	9,322	(6,090)	(7,632)
Scooters	–	66,952	–	(81,501)
Plastic utensils	1,224	–	(249)	–
Others*	–	–	(2,019)	(62,775)
	<u>29,008</u>	<u>188,571</u>	<u>(18,419)</u>	<u>(220,123)</u>

* Others represented a contribution to loss from operating activities attributable to provisions, which are not directly arising from different segments of the Group's principal activities, including certain provisions for other receivables, provisions for impairment of fixed assets, provisions against advances to a company, provisions against deposits made to certain suppliers, provisions for potential claim as detailed in note 4 below.

	Turnover		Contribution to loss from operating activities	
	Six months ended		Six months ended	
	30 September		30 September	
	2001	2000	2001	2000
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
By geographical area:				
North America – United States of America	6,442	50,356	(4,885)	(29,412)
Europe	8,267	31,430	(4,001)	(11,511)
Central & South America	9,017	22,883	(4,837)	(16,913)
The Asia Pacific Region	3,782	75,017	(3,922)	(154,442)
The Middle East	1,260	8,233	(628)	(7,129)
Others	240	652	(146)	(716)
	<u>29,008</u>	<u>188,571</u>	<u>(18,419)</u>	<u>(220,123)</u>

4. Loss from Operating Activities

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

	Six months ended	
	30 September	
	2001	2000
	(Unaudited)	(Unaudited)
	HK\$'000	HK\$'000
Depreciation:		
Owned fixed assets	6,647	8,532
Leased fixed assets	891	1,099
Provision for bad and doubtful debts	255	121,072
Provision for impairment of fixed assets	–	38,935
Provision for advances to a company	–	3,515
Provision for deposits made to certain suppliers	–	4,635
Provision for unrecoverable inventories held by a company	–	11,791
Provision for potential claim	2,019	18,000
Provision for inventories	–	3,733
Loss on disposals of fixed assets	<u>–</u>	<u>1,898</u>

5. Tax

Hong Kong profits tax has not been provided because there were no assessable profits arising in Hong Kong during the period. No taxes on profits assessable elsewhere have arisen.

	Six months ended	
	30 September	
	2001	2000
	(Unaudited)	(Unaudited)
	<i>HK\$'000</i>	<i>HK\$'000</i>
Current period provision	–	–
Deferred tax	–	(1,500)
Tax credit for the period	–	(1,500)

6. Dividend

The Board does not recommend to pay any interim dividend in respect of the six months ended 30 September 2001 (2000: Nil).

7. Loss per Share

The calculation of basic loss per share is based on the unaudited consolidated net loss from ordinary activities attributable to shareholders for the six months ended 30 September 2001 of HK\$25,079,000 (2000: HK\$224,207,000) and the weighted average of 2,483,936,760 (2000: 2,482,786,862) ordinary shares of the Company in issue during the period.

The diluted loss per share for the period ended 30 September 2001 has not been calculated as no diluting events existed during the period. The diluted loss per share for the period ended 30 September 2000 has not been presented because any potential ordinary shares of the Company outstanding during that period had an anti-dilutive effect on the basic loss per share.

8. Fixed Assets

As at 30 September 2001, the following fixed assets of the Group were pledged to secure the Group's bank borrowings:

- (i) certain leasehold land and buildings in the PRC with an aggregate carrying value of approximately HK\$39,842,000 (31 March 2001: HK\$40,724,000); and
- (ii) certain plant and machinery and equipment with an aggregate carrying value of approximately HK\$758,000 (31 March 2001: HK\$1,326,000).

As further disclosed in note 17 to the interim financial report, as at the date of this report, writs of summon were issued by certain banks in respect of overdue borrowings.

As at 30 September 2001, the Group was in the process of obtaining the land use rights certificate for leasehold land in the People's Republic of China (the "PRC") with carrying value amounting to approximately HK\$24,230,000 (31 March 2001: HK\$28,851,000). The directors are of the opinion that, subject to the payment of a land premium of approximately HK\$4.2 million, the relevant procedures for obtaining the land use rights certificate will be duly completed without any obstacle.

9. Accounts Receivable

	30 September 2001 (Unaudited) HK\$'000	31 March 2001 (Audited) HK\$'000
The ages of the accounts receivable are analysed as follows:		
Outstanding balances with ages:		
Within 30 days	5,519	3,010
Between 31 to 60 days	1,438	154
Between 61 to 90 days	493	71
Between 91 to 180 days	867	48,923
Over 180 days	–	69,730
	<u>8,317</u>	<u>121,888</u>
Less: Provision for bad and doubtful debts	–	(117,781)
	<u><u>8,317</u></u>	<u><u>4,107</u></u>

10. Interest Bearing Bank Loans and Other Borrowings

Included in the interest-bearing bank loans and other borrowings is an amount of HK\$16,000,000 due to Speed Up Developments Limited (“Speed Up”), an independent third party not connected with the Group. The amount due to Speed Up is unsecured, bears interest at the prime lending rate in Hong Kong plus 3% per annum and is repayable on demand.

11. Accounts Payable

	30 September 2001 (Unaudited) HK\$'000	31 March 2001 (Audited) HK\$'000
The ages of the accounts payable are analysed as follows:		
Outstanding balances with ages:		
Within 30 days	1,925	1,455
Between 31 to 60 days	2,390	305
Between 61 to 90 days	1,684	299
Between 91 to 180 days	1,726	9,152
Over 180 days	20,272	15,013
	<u>27,997</u>	<u>26,224</u>

12. Loan from a Director

Loan from a director is unsecured, bears interest at the prime lending rate in Hong Kong plus 3% per annum and is repayable on demand.

13. Convertible Note

On 30 October 2000, the Company entered into a conditional subscription agreement (the “Agreement”) with Join Asia Enterprises Limited (“Join Asia”). Join Asia is beneficially owned by Speed Up and is an independent third party not connected with the Group. Pursuant to the Agreement, the Company issued a HK\$3 million convertible note (the “Convertible Note”) to Join Asia. The Convertible Note was issued at 100% of its principal amount and bears interest at the rate of 5% per annum payable on 16 November 2002 (the “Maturity Date”).

Pursuant to the Agreement, Join Asia has the right to convert the whole or any part of the principal amount of the Convertible Note into fully paid ordinary shares of HK\$0.01 each of the Company at a conversion price of HK\$0.015 per share (the “Conversion Price”) at anytime before the Maturity Date. A total of 200,000,000 shares will be issued, representing approximately 8.05% and 7.45% of the existing and enlarged issued share capital of the Company, respectively. If not converted by the Maturity Date, the Company will repay such principal monies outstanding under the Convertible Note to Join Asia together with all interest accrued thereon up to and including the Maturity Date.

14. Reserves

	Share premium (unaudited) HK\$'000	Contributed surplus (unaudited) HK\$'000	Asset revaluation reserve (unaudited) HK\$'000	Accumulated losses (unaudited) HK\$'000	Total (unaudited) HK\$'000
At 1 April 2000	44,397	10	36,978	122,493	203,878
Issued of shares	22	–	–	–	22
Share issue expenses	(22)	–	–	–	(22)
Net loss for the year	–	–	–	(279,335)	(279,335)
Revaluation deficit	–	–	(18,954)	–	(18,954)
At 31 March and 1 April 2001	44,397	10	18,024	(156,842)	(94,411)
Net loss for the period	–	–	–	(25,079)	(25,079)
At 30 September 2001	<u>44,397</u>	<u>10</u>	<u>18,024</u>	<u>(181,921)</u>	<u>(119,490)</u>

15. Commitments

At the balance sheet date, the Group had the following commitments:

	30 September 2001 (Unaudited) HK\$'000	31 March 2001 (Audited) HK\$'000
Capital commitments:		
Authorised, but not contracted for	3,150	3,150
Contracted, but not provided for	6,251	6,251
	<u>9,401</u>	<u>9,401</u>
 The total of future minimum lease payments under non-cancellable operating leases in respect of land and buildings for each of the following periods:		
Within one year	353	345
In the second to fifth year, inclusive	442	–
	<u>795</u>	<u>345</u>

16. Contingent Liabilities

In December 2000, the Group received a claim from its processing agent for an amount of approximately HK\$18.7 million. Since the documents in support of the aforesaid claim have not been properly approved by the board of the Company, the directors are seeking legal opinion on the said claim. For prudence, the directors made a provision against the claim of HK\$18 million as at 31 March 2001. During the six months ended 30 September 2001, the Group continued to provide for the contingency which might arise with reference to the basis of the claim and an additional provision of approximately HK\$2,019,000 was further accrued for accordingly. As at 30 September 2001, accumulated provisions made in respect of the potential claim amounted to approximately HK\$20 million.

17. Pending Litigation

During the period under review, certain banks which had previously filed writs of summons against the Group to demand for the repayment of overdue borrowings aggregating to approximately HK\$16.6 million had joined an informal standstill agreement together with other principal bankers of the Group in Hong Kong. As at the date of this report, there are writs of summons issued by miscellaneous creditors of the Group aggregating approximately HK\$4.3 million, together with claims for interest thereon in respect of overdue borrowings, rentals, purchases of goods and the provision of services (the “Indebtedness”).

The directors are currently negotiating with the parties issuing the writs with a view to restructuring the Group’s overall indebtedness. Full provision has been made in the interim financial report for all the Indebtedness, however, no provision has been made for any interest, penalties, damages and legal costs the Group may incur if it is unsuccessful either in defending the writs or in persuading the issuers to withdraw such pursuant to a debt restructuring .

The winding up petitions filed by Sin Hua Bank Limited, Hong Kong Branch against the Company and one of its subsidiaries, Hung Cheong Toys International Limited, were withdrawn on 18 September 2001 and 6 September 2001 respectively.

**INDEPENDENT REVIEW REPORT TO THE BOARD OF DIRECTORS OF
HUNG FUNG GROUP HOLDINGS LIMITED**

(Incorporated in Bermuda with limited liability)

Introduction

We have been instructed by the company to review the interim financial report set out on pages 64 to 73.

Directors' responsibilities

The Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited require the preparation of an interim financial report to be in compliance with SSAP 25 "Interim Financial Reporting" issued by the Hong Kong Society of Accountants. The interim financial report is the responsibility of, and has been approved by, the directors.

Review work performed

We conducted our review in accordance with SAS 700 "Engagements to Review Interim Financial Reports" issued by the Hong Kong Society of Accountants, except that the scope of our review was limited as explained below.

A review consists principally of making enquiries of the management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly, we do not express an audit opinion on the interim financial report.

The information and explanations available to us was limited as follows:

Scope limitations arising from the prior year's audit scope limitations affecting opening balances

1. Our audit opinion on the financial statements of the Group for the year ended 31 March 2001 was disclaimed for reasons which included the significance of the possible effects of several limitations on the scope of our audit which are further detailed in our report dated 26 July 2001.

In summary those scope limitations included:

- (i) Incomplete books and records and a breakdown in the internal controls of the Group; and

- (ii) Matters which prevented us from satisfying ourselves concerning accounts receivable at 31 March 2001 aggregating HK\$117,781,000, inventories of HK\$11,791,000, deposits of HK\$4,635,000, an advance made to a company of HK\$5,177,000, a provision for impairment in the value of the Group's fixed assets of HK\$54,981,000 and a provision for a claim of HK\$18,000,000.

Accordingly, we were then unable to form an opinion as to whether the 2001 financial statements gave a true and fair view of the state of affairs of the Group as at 31 March 2001 and of the loss and cash flows of the Group for the year then ended. Any adjustment found to be necessary to the opening net liabilities of the Group would have a consequential effect on the loss of the Group for the six months ended 30 September 2001.

Scope limitations arising from current period review

2. Fundamental uncertainty – going concern of the Group

In performing our review, we have considered the adequacy of the disclosures made in note 2 to the interim financial report which explains the circumstances giving rise to fundamental uncertainties relating to the Group's ability to continue as a going concern. Such disclosures also include details of the proposed standstill arrangement and debt restructuring between the financial creditors of the Group and the Group, the Group's funding plans and various measures being undertaken or proposed to be undertaken by the directors to relieve the Group from its current profitability and liquidity problems. The interim financial report has been prepared on a going concern basis, the validity of which depends upon the successful outcome of the proposed standstill arrangement, debt restructuring and the funding plans and the attainment of profitable and positive cash flow operations of the Group to meet its future working capital and financial requirements. The interim financial report does not include any adjustments that would result from the failure of such measures. However, because of the complexity of the Group's financial position and the inconclusive state of the Group's discussions and negotiations with its financial creditors, the directors have as yet been unable to provide us with a detailed plan or projection with supporting documents as to how the Group might remain a going concern thereby supporting the basis on which they have prepared the interim financial report. Although we are aware that a significant amount of effort has been put into this aspect of the Group's affairs, we have been unable to determine that the directors have a reasonable basis for their assessment.

Because the inherent uncertainties surrounding the circumstances under which the Group might successfully continue to adopt the going concern basis are so extreme, we are unable to reach a review conclusion.

3. Scope limitation – valuation of fixed assets

In view of the liquidity problems currently faced by the Group, the construction in progress being undertaken in the Mainland of the People's Republic of China (the "PRC") with a carrying value of approximately HK\$ 32,288,000 was put on hold and a full provision has been made against the cost incurred up to 30 September 2001. We concur with this provision on the basis that the Group neither has any plans to complete the construction, nor does it currently have any business plans for such assets even if they were completed. However in the current period, the Group has significantly scaled down its production operations in the PRC. Having regard to the gross operating loss incurred by the Group for the six months ended 30 September 2001, and the uncertainties involved in the Group having sufficient working capital to restore operations in the foreseeable future to a commercially viable level, as explained more fully in note 2 to the interim financial report, there is also an uncertainty as to the carrying value of the Group's existing completed fixed assets and an impairment assessment needs to be performed to determine that recoverable amount either from utilisation in future profitable operations, or from their disposal. Apart from the leasehold land and buildings with carrying value of approximately HK\$77,732,000, the valuation of which was performed by an independent firm of professional valuers on a depreciated replacement cost basis at approximately HK\$95,260,000 as at 31 March 2001, the net book value of the fixed assets held by the Group was stated at cost less accumulated depreciation and impairments. In the absence of any information from the directors as to their assessment of the carrying value of the fixed assets as a result of the scaling down in production operations and in the absence of any valuation on an open market value basis, we are unable to assess whether the provision for impairment in the value of the fixed assets as at 30 September 2001 currently provided by the Group amounted to HK\$54,981,000 in aggregate is adequate but not excessive. Any adjustments that might have been found necessary would have a consequential impact on the net liabilities of the Group as at 30 September 2001 and its net loss attributable to shareholders for the six months ended 30 September 2001.

4. Scope limitation – potential claim

As further explained in note 16 to the interim financial report, the Group received a claim for an amount of approximately HK\$18,729,000 in December 2000. Although the ultimate settlement is still in the process of negotiation, the directors have made a provision for the claim of HK\$18,000,000 as at 31 March 2001. During the six months ended 30 September 2001, the Group continued to provide for the contingency which might arise with reference to the basis of the claim and an additional provision of approximately HK\$2,019,000 was further accrued for accordingly. As we have not been provided with sufficient information or

explanations to satisfy ourselves if the basis of provision is appropriate, we are unable to assess whether the provisions made by the Group is adequate, but not excessive. Any adjustments found to be necessary in respect of the matter set out in the above would have a consequential impact on the Group's net loss attributable to shareholders for the six months ended 30 September 2001 and the Group's net liabilities position as at 30 September 2001.

5. Fundamental uncertainty – legal proceedings against the Group

As further detailed in note 17 to the interim financial report, there are legal proceedings against the Group, principally initiated by various bankers and vendors, the future outcome of which could not be assessed with reasonable certainty at the date of these interim financial report. Other than the amounts claimed as summarized in note 17 to the interim financial report, no reasonable estimation could be made with regard to any possible additional costs to the Group should the various defending companies be unsuccessful in defending the cases. Such additional costs might include interest, legal costs and consequential damages which the Group may sustain. Although we consider the disclosures made in respect of these matters is adequate, we consider them to be so significant that we are unable to reach a review conclusion in this respect.

Inability to reach a review conclusion

Because of the significance of each of (i) the fundamental uncertainty relating to the appropriateness of the going concern basis; and (ii) the possible effects of the limitations in evidence available to us as set out in the review work performed section of this report, we are unable to reach a review conclusion as to whether material modifications should be made to the interim financial report for the six months ended 30 September 2001.

Without modifying our inability to reach a review conclusion above, we draw attention to the fact that because our audit opinion dated 26 July 2001 on the financial statements in respect of the Group for the year ended 31 March 2001 was disclaimed for the scope limitation reasons summarized in paragraph 1 above, and our review report dated 26 July 2001 on the interim financial report in respect of the Group for the six months ended 30 September 2000 was unable to reach a review conclusion for similar scope limitation reasons, the comparative amounts shown in the comparative condensed consolidated profit and loss account and condensed consolidated cash flow statement for the six months ended 30 September 2000 and the comparative condensed consolidated balance sheet as at 31 March 2001 may not be comparable with the amounts for the current period.

Ernst & Young

Certified Public Accountants

Hong Kong

21 December 2001

Business Review and Prospects*Results*

The first half year of the financial year 2001/2002 continued to be difficult for the Group. Net loss from ordinary activities attributable to shareholders for the period was HK\$25,079,000. The loss was mainly due to the shrinkage of the Group's turnover from which the overall contribution of toys products was unable to cover its fixed operating cost.

Business Overview

During the period, the Group devoted all its effort towards the designing, manufacturing and selling of toys. Turnover was dropped by 85% to HK\$29,008,000 as compared with the same period last year. The decrease in turnover was mainly resulted from the imposition of stringent control by the Group on credit sales. Simultaneously, in order to enhance the competitiveness of toys products and to speed up its turnover, the Group established a R&D department in Shenzhen, PRC and strived to adopt several measures in achieving its goals. These measures included modifying the product features to lengthen their life cycles, developing new products, diversifying the product range and widening market penetration into new regions over the world.

The introduction of battery-operated tricycles and ride-on cars has gained widespread support from our clients. In addition to toys, the Group has been diversifying its product range to house-ware products. Acting as a new side production line from the toys products, introduction of the house-ware products was to smoothen out the seasonality of toys sale, which is not unusual in the toys industry.

Taking advantage of experience and the strong capabilities in developing moulds for different varieties of products, the Group is now in the course of enhancing the development of OEM business, as it is now becoming one of the major sources of revenue for the Group.

In view of the keen competition of the developed markets faced by the Group together with the occurrence of the 911 incident, the Group starts to develop its business in other new markets which are perceived as having higher potential growth, including Korea, Singapore, Indonesia, Philippines & etc.

The Group also imposed strict cost control on its production process. These cost reduction measures included sourcing suppliers with lower cost, enhancing its production efficiency and exporting goods directly from PRC port rather than through Hong Kong.

Contingent Liabilities

In December 2000, the Group received a claim from its processing agent for an amount of approximately HK\$18.7 million. Since the documents in support of the aforesaid claim have not been properly approved by the board of the Company, the directors are seeking legal opinion on the said claim. For prudence, the directors made a provision against the claim of HK\$18 million as at 31 March 2001. During the six months ended 30 September 2001 under review, the Group continued to provide for the contingency which might arise with reference to the basis of the claim and an additional provision of approximately HK\$2,019,000 was further accrued for accordingly. As at 30 September 2001, accumulated provisions made in respect of the potential claim amounted to approximately HK\$20 million.

Pending Litigation

During the period under review, certain banks which had previously filed writs of summons against the Group to demand for the repayment of overdue borrowings aggregating approximately HK\$16.6 million had joined an informal standstill agreement together with other principal bankers of the Group in Hong Kong. As at the date of this report, there were writs of summons issued by miscellaneous creditors of the Group aggregating approximately HK\$4.3 million, together with claims for interest thereon in respect of overdue borrowings, rentals, purchases of goods and the provision of services (the “Indebtedness”).

The directors are currently negotiating with parties issuing the writs with a view to restructuring the Group’s overall Indebtedness. Full provision has been made in the interim financial report for all the indebtedness, however, no provision has been made for any interest, penalties, damages and legal costs the Group may incur if it is unsuccessful either in defending the writs or in persuading the issuers to withdraw such pursuant to a debt restructuring .

The winding up petitions filed by Sin Hua Bank Limited, Hong Kong Branch against the Company and one of its subsidiaries, Hung Cheong Toys International Limited, were withdrawn on 18 September 2001 and 6 September 2001 respectively.

Liquidity and Financial Position

As at 30 September 2001, the Group had net current liabilities of approximately HK\$207,192,000 and cash on hand was approximately HK\$1,794,000. In order to strengthen the capital base of the Group and to improve the Group’s financial position, the directors have been taking various measures to raise funds through including, but not limited to, loans from directors, external borrowings and private placements. As at 30 September 2001, the Group’s certain banking facilities and accounts payable as well as obligation under finance leases were either secured by (i) certain leasehold land and buildings in the PRC with an aggregate carrying value of approximately HK\$39,842,000; or (ii) certain plant and machinery and equipment with an aggregate carrying value of approximately HK\$758,000; or (iii) corporate

guarantees executed by the Company and its subsidiary; or (iv) personal guarantees of approximately HK\$31,167,000 from Mr. Chan Chun Hung and Ms. Wong Kin Ching, the former directors of the Company. The directors have negotiated with the Group's bankers, trade creditors as well as other creditors to reschedule the repayment terms of certain outstanding debts of the Group. All of the winding-up petitions against the Company and one of its subsidiaries as well as most of the writs of summons demanding repayment of the outstanding debts have been set aside. The draft debt restructuring agreement with the Group's bankers is under review and is proceeded with promising progress.

Human Resources

As at 30 September 2001, the Group's total number of full-time employees was about 1,260. Among of these, about 1,240 staffs were based in the PRC and about 20 staffs in Hong Kong. In addition to competitive remuneration package offered to the employees, share option of the Company may be granted by the Group to attract and retain talented employees. During the six month ended 30 September 2001, no option has yet been granted.

Prospects

The global economic recession will continue to exert downward pressure on retail business in the foreseeable future. However, it is anticipated that there will be an explosive growth in demand within the PRC with the entry of the WTO. To fully exploit these opportunities, the Group is planning to market its products directly in the PRC by way of setting up a foreign enterprise with the right to sell domestically in the Mainland China. The Group will continue to innovate new products to cater for the needs of various customers. Cost control will remain as one of the most important goals for the Group in the coming years and it is believed that successful cost control will bring about significant turnaround in the ensuing years .

Directors' Interest in Share Capital

None of the directors, or their associates, had any personal, family, corporate or other beneficial interest in the issued share capital of the Company or any of its associated corporations as recorded in the register required to be kept under Section 29 of the Securities (Disclosure of Interests) Ordinance (the "SDI Ordinance") or is otherwise notified to the Company and The Stock Exchange of Hong Kong Limited pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

*Share Options and Warrants**Share Options*

On 17 February 1998, under the terms of the Company's share option scheme adopted by the Company conditional upon the listing of the Company's shares on the Stock Exchange, the directors of the Company were authorised, on or before 16 February 2008, at their discretion to invite any employee, including any executive director of the Company or any of its subsidiaries, to take up options to subscribe for shares of the Company.

As at 30 September 2001, the Company had 59,700,000 share options at exercise price of HK\$0.046 each and 50,000,000 share options at exercise price of HK\$0.03472 each remaining outstanding, respectively. The exercise in full of the subscription rights attached to these share options, under the present capital structure of the Company, would result in the issue of 109,700,000 shares of HK\$0.01 each in aggregate, for a total cash consideration, before expenses, of approximately HK\$4,482,000. No share options was exercised during the period under review.

Warrants

At the beginning of the year, the Company had outstanding warrants of HK\$17,642,061 at the adjusted exercise price of HK\$0.05 each. During the period, no warrants were exercised and such warrants were lapsed on 28 September 2001.

Directors' Rights to Acquire Shares

At no time during the period was the Company or any of its subsidiary as a party to any arrangement to enable the Company's directors, their respective spouse, or children under 18 years of age, to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

Substantial Shareholders

As at 30 September 2001, the following interests of 10% or more in the issued share capital of the Company were recorded in the register of interests required to be kept by the Company pursuant to section 16(1) of the SDI Ordinance.

Name	Number of ordinary shares held	Percentage of issued shares
Baxter Resources S.A.	1,595,140,000	64%

Pursuant to a share charge deed dated on 24 November 2000, 1,565,140,000 ordinary shares of HK\$0.01 each in the Company held by Baxter Resources S.A. was pledged to E-Bigger Investments Limited, an independent third party.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

Neither the Company, its holding company, nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the period.

CODE OF BEST PRACTICE

Save as disclosed herein, in the opinion of the Directors, the Company has complied with the Code of Best Practice as set out in Appendix 14 to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited throughout the period under review except that the independent non-executive directors are not appointed for a specific term because all of the directors excluding the executive Chairman, and without limitation to the non-executive directors, are subject to retirement by rotation and re-election at the annual general meeting in accordance with the bye-laws of the Company.

PUBLICATION OF INTERIM RESULTS ON WEBSITE OF THE STOCK EXCHANGE OF HONG KONG LIMITED

The detailed results containing all the information required by paragraphs 45(1) to 45(3) of Appendix 16 to the Listing Rules will be published on the website of The Stock Exchange of Hong Kong Limited in due course.

By order of the Board
Lo Ming Chi, Charles
Chairman

Hong Kong, 21 December 2001

3. SUMMARY OF AUDITED CONSOLIDATED PROFIT AND LOSS ACCOUNTS

The following is a summary of the audited combined/consolidated results of the Group for each of the five years ended 31st March, 2001. The combined results for the year ended 31st March, 1997 has been extracted from the Company's prospectus dated 25th February, 1998 which was prepared from the audited financial statements of the companies now comprising the Group as if the structure of the Group had been in existence throughout the year. The results of the Group for each of four years ended 31st March, 2001 are those extracted from the relevant annual reports.

	Year ended 31st March,				
	1997	1998	1999	2000	2001
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Turnover	133,090	223,713	241,254	290,600	202,682
Profit/(loss) before tax	28,270	52,649	32,029	30,286	(283,689)
Tax	(4,307)	(8,049)	11,328	(4,091)	4,354
Minority interests (Note 1)	—	—	—	—	—
Extraordinary items (Note 1)	—	—	—	—	—
Net profit/(loss) from ordinary activities attributable to Shareholders	23,963	44,600	43,357	26,195	(279,335)
Dividend	50,000	22,000	2,000	—	—
Earnings/(Loss) per share (HK cents)					
– Basic (Note 2)	1.60	2.91	2.17	1.18	(11.25)
– Diluted (Note 3)	N/A	N/A	N/A	1.12	N/A
Dividend per share (HK cents) (Note 4)	N/A	N/A	0.1	—	—

Notes:

- For each of the five years ended 31st March, 2001, the Group had no minority interests and had not incurred any extraordinary items in the profit and loss account.
- The 1997 figure is calculated based on the assumption that 150,000,000 shares were in issue during the year. The basic earnings per share figures in respect of the four years ended 31st March, 2000 have been adjusted for the effect resulted from the shares subdivision in April 2000, in which each of the Company's issued and unissued ordinary shares of HK\$0.10 each was subdivided into ten ordinary shares of HK\$0.01 each.
- Figure of diluted loss per share has not been presented for 2001 because any potential ordinary shares of the Group outstanding during the year had anti-dilutive effect on the basic loss per share for 2001. Figures of diluted earnings per share for 2000 has been adjusted to reflect the shares subdivision in April 2000 mentioned above. Figures of diluted earnings per share have not been presented for 1997, 1998 and 1999 as no diluting events existed during these years.
- The dividend per share figure for 1999 has been adjusted to reflect the shares subdivision in April 2000 mentioned above. Figures of dividend per share have not been presented for 1997 and 1998 as the dividends were paid by certain subsidiaries of the Group to their then shareholders prior to the group reorganisation on 17th February, 1998.

4. AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Set out below is the text of the report of the auditors and the audited accounts of the Group for the year ended 31st March, 2001 as extracted from the Company's 2001 annual report.



To the shareholders
Hung Fung Group Holdings Limited
(Incorporated in Bermuda with limited liability)

We have audited the financial statements on pages 88 to 113 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants, except that the scope of our work was limited as explained below.

An audit includes an examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, consistently applied and adequately disclosed.

We planned our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. However, the evidence available to us was limited as follows:

1. Scope limitation - fundamental uncertainty - going concern of the Group

In forming our opinion, we have considered the adequacy of the disclosures made in note 2(i) to the financial statements which explain the circumstances giving rise to fundamental uncertainties relating to the Group's ability to continue

as a going concern. Such disclosures also include details of the proposed standstill arrangement and debt restructuring between the financial creditors of the Group and the Group, the Group's funding plans and various measures being undertaken or proposed to be undertaken by the directors to relieve the Group from its current profitability and liquidity problems. The financial statements have been prepared on a going concern basis, the validity of which depends upon the successful outcome of the proposed standstill arrangement, debt restructuring and the funding plans and the attainment of profitable and positive cash flow operations of the Group to meet its future working capital and financial requirements. The financial statements do not include any adjustments that would result from the failure of such measures. However, because of the condition of the Group's accounting records, the complexity of the Group's financial position and the inconclusive state of the Group's discussions and negotiations with its financial creditors, the directors have as yet been unable to provide us with a detailed plan or projection as to how the Group might remain a going concern thereby supporting the basis on which they have prepared the financial statements. Although we are aware that a significant amount of effort has been put into this aspect of the Group's affairs, we have been unable to determine that the directors' assessment is correct. Accordingly, we disclaim our opinion on account of this scope limitation alone, notwithstanding the matters noted below.

2. *Scope limitation - completeness of books and records and maintenance of internal controls*

As further explained in note 2 (ii) to the financial statements, there was a significant breakdown in the Group's internal accounting controls. We have not been provided with adequate audit evidence to satisfy ourselves as to the nature, completeness, appropriateness, classification and disclosures in respect of the transactions undertaken by the Group during the year ended 31 March 2001 and the related balances as further detailed in note 2 (ii) to the financial statements, in particular, we have been unable to perform any satisfactory procedures to substantiate the sales transactions as set out in note 2(ii)(b)(ii).

Any adjustments found to be necessary in respect of the matters set out in the above would have a consequential impact on the Group's net loss attributable to shareholders for the year ended 31 March 2001, the Group's net liabilities position as at 31 March 2001 and the classification and related disclosures thereof in the financial statements.

3. *Scope limitation - valuation of fixed assets*

In view of the liquidity problems currently faced by the Group, the construction in progress with a carrying value of approximately HK\$32,288,000 was put on hold and a full provision has been made against the cost incurred as at 31 March 2001. We concur with this provision on the basis that the Group has no plans to complete the construction, nor does it have any business plans for such assets even if they were completed. However, in the current year, the Group has

significantly scaled down its production operations in the People's Republic of China (the "PRC"). Having regard to the gross operating loss incurred by the Group for the year ended 31 March 2001, and the uncertainties involved in the Group having sufficient working capital to restore operations in the foreseeable future to a commercially viable level, as explained more fully in note 2 to the financial statements, there is also an uncertainty as to the carrying value of the Group's existing completed fixed assets and an impairment assessment needs to be performed to determine that recoverable amount either from utilisation in future profitable operations, or from their disposal. Apart from the leasehold land and buildings of approximately HK\$79,214,000, the valuation of which was performed by an independent firm of professional valuers as at 31 March 2001 as further detailed in note 12 to the financial statements, the net book value of the fixed assets held by the Group was stated at cost less accumulated depreciation and impairments which included leasehold improvements of approximately HK\$9,377,000, moulds, plant and machinery of approximately HK\$32,535,000, and furniture, fixtures, equipment and motor vehicles of approximately HK\$1,676,000. In the absence of any information from the directors as to their assessment of the carrying value of the fixed assets as a result of the scaling down in production operations and in the absence of any valuation on an open market value basis, we are unable to assess whether the provision for impairment in the value of the fixed assets as at 31 March 2001 currently provided by the Group as disclosed in note 12 to the financial statements is adequate but not excessive. Any adjustments that might have been found necessary would have a consequential impact on the net liabilities of the Group at 31 March 2001 and its net loss attributable to shareholders for the year then ended.

4. *Scope limitation - potential claim*

As further explained in note 27 to the financial statements, the Group received a claim for an amount of approximately HK\$18.7 million. Although the ultimate settlement is still in the process of negotiation, the directors have made a substantial provision for the claim. As we have not been provided with sufficient information or explanations to satisfy ourselves if the basis of provision is appropriate, we are unable to assess whether the provision made by the Group is adequate, but not excessive. Any adjustments found to be necessary in respect of the matter set out in the above would have a consequential impact on the Group's net loss attributable to shareholders for the year ended 31 March 2001 and the Group's net liabilities position as at 31 March 2001.

5. *Fundamental uncertainty - legal proceedings against the Group*

As further detailed in note 28 to the financial statements, there are legal proceedings against the Group including petitions for the liquidation of certain Group companies, principally initiated by various bankers and vendors, the future outcome of which could not be assessed with reasonable certainty at the date of these financial statements. Other than the amounts claimed as summarised in note 28, no reasonable estimate could be made with regard to any possible additional

costs to the Group should the various defending companies be unsuccessful in defending the cases. Such additional costs might include interest, legal costs and consequential damages which the Group may sustain. Also, it is not possible to determine the outcome of the court proceedings to wind up certain Group companies. Although we consider the disclosures made in respect of these matters is adequate, we consider them to be so significant that we have disclaimed our opinion in this respect.

Disclaimer of opinion

Because of the significance of each of (i) the fundamental uncertainty relating to the going concern basis detailed in paragraph 5 above, and (ii) the possible effects of the limitations in evidence available to us as set out in each of paragraphs 1 to 4 in the basis of opinion section of this report, we are unable to form an opinion as to whether the financial statements give a true and fair view of the state of affairs of the Group and of the Company as at 31 March 2001 and of the loss and cash flows of the Group for the year then ended and as to whether the financial statements have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

In respect alone of the limitations on our work as set out in the basis of opinion section of this report:

- (i) we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and
- (ii) proper books of accounts have not been kept.

Ernst & Young*Certified public accountants*

Hong Kong

26 July 2001

APPENDIX I**FINANCIAL INFORMATION****Consolidated Profit and Loss Account**

		2001	2000
	<i>Notes</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
TURNOVER	4	202,682	290,600
Cost of sales		<u>(209,240)</u>	<u>(226,428)</u>
Gross profit/(loss)		(6,558)	64,172
Other income		772	2,217
Selling and distribution costs		(2,032)	(2,172)
Administrative expenses		(31,158)	(26,347)
Other operating expenses	5	<u>(231,018)</u>	<u>–</u>
PROFIT/(LOSS) FROM OPERATING ACTIVITIES	5	(269,994)	37,870
Finance costs	6	<u>(13,695)</u>	<u>(7,584)</u>
PROFIT/(LOSS) BEFORE TAX		(283,689)	30,286
Tax	8	<u>4,354</u>	<u>(4,091)</u>
NET PROFIT/(LOSS) FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS	9, 24	<u><u>(279,335)</u></u>	<u><u>26,195</u></u>
EARNINGS/(LOSS) PER SHARE	11		
Basic		<u><u>HK(11.25) cents</u></u>	<u><u>HK1.18 cents</u></u>
Diluted		<u><u>–</u></u>	<u><u>HK1.12 cents</u></u>

Consolidated Statement of Recognised Gains and Losses

	2001 <i>HK\$'000</i>	2000 <i>HK\$'000</i>
Surplus/(deficit) on revaluation of medium term leasehold land and buildings – <i>note 24</i>	<u>(18,954)</u>	<u>25,848</u>
Net gains/(losses) not recognised in the profit and loss account	(18,954)	25,848
Net profit/(loss) from ordinary activities for the year attributable to shareholders	<u>(279,335)</u>	<u>26,195</u>
Total recognised gains and losses	<u><u>(298,289)</u></u>	<u><u>52,043</u></u>

APPENDIX I**FINANCIAL INFORMATION****Consolidated Balance Sheet**

		2001	2000
	<i>Notes</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
NON-CURRENT ASSETS			
Fixed assets	12	122,802	204,948
CURRENT ASSETS			
Inventories	14	11,569	24,631
Accounts receivable	15	4,107	95,883
Prepayments, deposits and other receivables		1,744	3,628
Cash and bank balances		782	63,462
		<u>18,202</u>	<u>187,604</u>
CURRENT LIABILITIES			
Interest-bearing bank loans and overdrafts	17	38,968	5,482
Trust receipt loans, unsecured		72,896	50,714
Current portion of finance lease payables	19	6,614	2,823
Accounts payable	16	26,224	47,615
Other payables and accruals		47,327	12,655
Tax payable		5	82
Loan from a director	20	9,000	–
		<u>201,034</u>	<u>119,371</u>
NET CURRENT ASSETS/(LIABILITIES)		<u>(182,832)</u>	<u>68,233</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		(60,030)	273,181
NON-CURRENT LIABILITIES			
Interest-bearing bank loans	17	6,542	37,774
Finance lease payables	19	–	2,396
Deferred tax	21	–	4,300
Convertible note	22	3,000	–
		<u>9,542</u>	<u>44,470</u>
		<u>(69,572)</u>	<u>228,711</u>
CAPITAL AND RESERVES			
Issued share capital	23	24,839	24,833
Reserves	24	(94,411)	203,878
		<u>(69,572)</u>	<u>228,711</u>

Consolidated Cash Flow Statement

		2001	2000
	<i>Notes</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
NET CASH INFLOW/(OUTFLOW)			
FROM OPERATING ACTIVITIES	25(a)	(80,086)	59,775
RETURNS ON INVESTMENTS			
AND SERVICING OF FINANCE			
Interest received		63	542
Interest paid		(13,050)	(6,924)
Interest element of finance			
lease rental payments		(645)	(660)
Net cash outflow from returns on			
investments and servicing of finance		(13,632)	(7,042)
TAX			
Hong Kong profits tax paid		(23)	(6,373)
INVESTING ACTIVITIES			
Purchases of fixed assets		(11,834)	(49,694)
Proceeds from disposals			
of fixed assets		302	4
Net cash outflow from			
investing activities		(11,532)	(49,690)
NET CASH OUTFLOW BEFORE			
FINANCING ACTIVITIES		(105,273)	(3,330)
FINANCING ACTIVITIES	25(b)		
Issue of share capital		28	31,507
Share issue expenses		(22)	(662)
Drawdown of loan from a director		9,000	-
Drawdown/(repayment) of bank loans		(1,204)	11,471
Issue of convertible note		3,000	-
Capital element of finance leases		(2,139)	(3,163)
Net cash inflow from			
financing activities		8,663	39,153
INCREASE/(DECREASE) IN CASH			
AND CASH EQUIVALENTS		(96,610)	35,823
Cash and cash equivalents			
at beginning of year		18,225	(17,598)
CASH AND CASH EQUIVALENTS			
AT END OF YEAR		(78,385)	18,225

	2001 <i>HK\$'000</i>	2000 <i>HK\$'000</i>
ANALYSIS OF BALANCES OF		
CASH AND CASH EQUIVALENTS		
Cash and bank balances	782	63,462
Bank overdrafts	(6,271)	(2,813)
Trust receipt loans with		
original maturity		
within three months	(72,896)	(42,424)
	<u>(78,385)</u>	<u>18,225</u>

APPENDIX I**FINANCIAL INFORMATION****Balance Sheet**

		2001	2000
	<i>Notes</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
NON-CURRENT ASSETS			
Interests in subsidiaries	13	–	136,183
CURRENT ASSETS			
Dividend receivable		–	8,000
Prepayments and other receivables		50	507
Cash and bank balances		6	1,820
		<u>56</u>	<u>10,327</u>
CURRENT LIABILITIES			
Other payables and accruals		94,324	381
Loan from a director	20	9,000	–
		<u>103,324</u>	<u>381</u>
NET CURRENT ASSETS/ (LIABILITIES)			
		<u>(103,268)</u>	<u>9,946</u>
TOTAL ASSETS LESS CURRENT LIABILITIES			
		(103,268)	146,129
NON-CURRENT LIABILITY			
Convertible note	22	3,000	–
		<u>(106,268)</u>	<u>146,129</u>
CAPITAL AND RESERVES			
Issued share capital	23	24,839	24,833
Reserves	24	(131,107)	121,296
		<u>(106,268)</u>	<u>146,129</u>

Notes to financial Statements**1. CORPORATE INFORMATION**

During the year, the Group was involved in the design, manufacture and sale of a wide range of toys.

There were no significant changes in the nature of the Company or the Group's principal activities during the year. The Group has scaled down its operating during the year.

In the opinion of the directors, the ultimate holding company is Baxter Resources S.A., a company incorporated in the British Virgin Islands.

2. BASIS OF PRESENTATION

The Group's financial statements for the year ended 31 March 2001 have been prepared on the following bases:

(i) Going concern

At 31 March 2001, the Group had net current liabilities of approximately HK\$182,832,000. The Group also incurred a net loss from ordinary activities attributable to shareholders of approximately HK\$279,335,000 and reported a significant cash outflow from operating activities of HK\$80,086,000 for the year ended 31 March 2001.

Although the directors have been undertaking a number of measures with a view to improving the Group's liquidity and restore its operations to profitability, the Group continues to experience financial difficulties and currently has no unutilised banking facilities available to support its normal operational requirements. The Group also has had difficulty in repaying short term bank loans on time. As at the date of this report, certain suppliers and bankers of the Group have filed writs of summons to demand for the repayment of the amounts due by the Group and petition for the winding-up of certain of the Group companies (see note 28). Accordingly, the amounts due to banks and other financial institutions have been reclassified as current liabilities.

Having regard to this background, in order to strengthen the capital base of the Group and to improve the Group's financial position, immediate liquidity, cash flows and profitability and otherwise to sustain the Group as a going concern, the directors have adopted the following measures:

- (a) the directors are considering various alternatives to strengthen the capital base of the Company through various fund-raising exercises, including, but not limited to, loans from directors, external borrowings and private placements. In this regard, the directors have been in active negotiations with potential investors for the purpose of seeking capital injections into the Group. On 7 December 2000, Mr. Lo Ming Chi, a then independent third party and potential investor, was appointed as a director and the new chairman of the Group. Up to the date of this report, Mr. Lo Ming Chi had advanced approximately HK\$4,000,000 to the Group;
- (b) the directors are in active negotiations with the Group's bankers, the parties which have provided the Group with the loans, and other creditors with a view to proposing a standstill arrangement and to reschedule the repayment terms of certain of the Group's outstanding borrowings and to seek their ongoing support; the possibility of entering into a debt hair cut agreement is also under active discussions; and
- (c) the directors have taken actions to tighten cost controls over factory overheads and various administrative expenses and the activities of the Group have been significantly scaled down.

In the opinion of the directors, in light of the measures taken to date, together with the expected results, the Group will have sufficient working capital for its current operational requirements and it is expected that the Group will ultimately return to a commercially viable concern notwithstanding the Group's financial position and tight cash flows as at 31 March 2001 and the date on which these financial statements were approved. However, the directors anticipate that it may take some considerable time to successfully implement their plans.

Should the Group be unable to continue as a going concern, adjustments would have to be made to restate the values of assets to their recoverable amounts, to provide for any further liabilities which might arise and to reclassify non-current assets and liabilities as current assets and liabilities, respectively. The effects of these adjustments have not been reflected in the financial statements.

(ii) Available books and records

The financial statements have been prepared based on the books and records maintained by the Company and its subsidiaries. However, due to significant staff and management turnover during the year, especially that in the accounting and finance department, there have been significant breakdowns in internal controls particularly from October 2000 when an investigation of the Independent Commissioner Against Corruption ("ICAC") into the conduct of the then chairman and major shareholder of the Company was revealed in the press. The directors understand that there is still an ongoing investigation into this case. However, due to the relocation of the Group's accounting department from Hong Kong to the People's Republic of China (the "PRC") and a riot in the Group's PRC factory in October 2000, certain underlying books and records of certain of the Company's subsidiaries were either lost, or can no longer be located. In addition, as a result of the breakdown in internal accounting controls and the loss of certain books and records, the effects of certain transactions of the Group as reflected in the financial statements prior to January 2001 cannot be satisfactorily substantiated or otherwise supported, in particular:

- (a) Certain records substantiating a number of transactions via a bank saving account including cash receipts of approximately HK\$28,269,000 received from the Group's customers during the year, which in addition to the balance of the bank saving account brought forward of approximately HK\$60,830,000, were subsequently utilised as to: cash payments to the Group's suppliers and subcontractors of approximately HK\$71,431,000; cash payments of purchase deposits of approximately HK\$4,635,000; cash payments for purchases of fixed assets of approximately HK\$9,116,000; cash advances to a company of approximately HK\$3,189,000; and other expenses settled in cash of approximately HK\$728,000 in total. All documentation of these transactions conducted via the savings account prior to January 2001 were either lost, or could not otherwise be accounted for; and
- (b) Certain records substantiating the following items including the transactions summarised in (a) above were either lost, or could not otherwise be accounted for:
 - (i) purchases of approximately HK\$159,001,000 for the period from 1 April 2000 to 31 December 2000;
 - (ii) turnover of approximately HK\$195,578,000 and the corresponding accounts receivable of approximately HK\$117,781,000;
 - (iii) deposits made to certain suppliers of approximately HK\$4,635,000;
 - (iv) an advance made to a company of approximately HK\$5,177,000 which included a cash payment of approximately HK\$3,189,000 via the saving accounts as noted in (a) above;
 - (v) inventories held in custody by a company of approximately HK\$11,791,000.

As the directors consider that the probability of recovering the receivables and inventories as stated in (ii) to (v) above is remote, a full provision has been made against the respective amounts (see note 5 to the financial statements).

In addition to the above, the books and records in respect of the Group's turnover, costs of sales, certain expenses and related tax charges were incomplete and although the directors consider that based on their knowledge they have made accruals and provision for all liabilities based on such books and records as available, they cannot be certain as to whether all the liabilities of the Group have been recorded.

All the existing directors were appointed in December 2000, except Mr. Chan Chun Hong, Thomas who was appointed in October 2000 and Mr. Yu Wai Man who was appointed in April 2001. The financial statements have been prepared based on the books and records maintained by the Company and its subsidiaries. However, in view of the aforesaid breakdown in internal control of the Group, no representations as to the completeness of the books and records of the Group during the period from 1 April 2000 to 31 December 2000 could be given by the existing Directors although care has been taken in the preparation of the financial statements to mitigate the effects of the incomplete records. The Directors are unable to represent that all transactions entered into in the name of the Company and its subsidiaries during the period from 1 April 2000 to 31 December 2000 have been included in the financial statements. Notwithstanding the foregoing, the Directors have in the assessment of the Group's assets and liabilities taken such steps as they considered practicable to establish these assets and liabilities based on the information of which they were aware and have made provisions and adjustments as they considered appropriate in the preparation of the financial statements.

3. 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 Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for the periodic re-measurement of certain fixed assets as further explained below.

Basis of consolidation

The consolidated financial statements include the audited financial statements of the Company and its subsidiaries for the year ended 31 March 2001. 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 intercompany transactions and balances within the Group are eliminated on consolidation.

Subsidiaries

A subsidiary is a company in which the Company, directly or indirectly, controls more than half of its voting power or issued share capital, or controls the composition of its board of directors.

Interests in subsidiaries are stated at cost unless, in the opinion of the directors, there have been diminutions in values other than those considered to be temporary in nature, when they are written down to values determined by the directors.

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:

- from the sale of goods, 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 sold; and
- interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable.

Fixed assets and depreciation

Fixed assets, other than construction in progress, are stated at cost or valuation less accumulated depreciation and impairment. Construction in progress is stated at cost less impairment.

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 fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account in the year 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 that asset.

Changes in the values of fixed assets are dealt with as movements in the asset revaluation reserve. If the 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 profits as a movement in reserves.

Depreciation is provided on the straight-line basis to write off the cost or valuation of each asset, less any estimated residual value, over the following estimated useful lives:

Medium term leasehold land	– Over the lease terms
Buildings	– 20 years or over the lease terms, whichever is shorter
Leasehold improvements	– 5 years or over the lease terms, whichever is shorter
Moulds, plant and machinery	– 6 ² / ₃ to 8 years
Furniture, fixtures, equipment and motor vehicles	– 5 years

No depreciation is provided on construction in progress until it is completed and put into use. The gain or loss arising on the disposal or retirement of a fixed asset recognised in the profit and loss account is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Credit terms

Trading terms with customers are largely on credit. Invoices are normally payable within 30 days of issuance, except for certain well-established customers, where the terms are extended to 90 days. Overdue balance are regularly reviewed by senior management.

Leased assets

Leases that transfer substantially all the rewards and risks of ownership of assets to the Group, other than legal title, are accounted for as finance leases. At the inception of a finance lease, the cost of the leased asset is capitalised at the present value of the minimum lease payments and recorded together with the obligation, excluding the interest element, to reflect the purchase and financing. Assets held under capitalised finance leases are included in fixed assets and depreciated over the shorter of the lease terms and the estimated useful lives of the assets. The finance costs of such leases are charged to the profit and loss account so as to provide a constant periodic rate of charge over the lease terms.

Assets acquired through hire purchase contracts of a financing nature are accounted for as finance leases, but are depreciated over their estimated useful lives.

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 first-in, first-out basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour and an appropriate proportion of manufacturing overheads. Net realisable value is based on estimated selling prices less any further costs expected to be incurred to completion and disposal.

Deferred tax

Deferred tax is provided, using the liability method, on all significant timing differences in the recognition of revenue and expenses for tax and for financial reporting purposes, to the extent it is probable that the liability will crystallise in the foreseeable future. A deferred tax asset is not recognised unless its realisation is assured beyond reasonable doubt.

Cash equivalents

Cash equivalents represent short term highly liquid investments which are readily convertible into known amounts of cash and which were within three months of maturity when acquired, less advances from banks repayable within three months from the date of the advance.

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 of overseas subsidiaries, their financial statements 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 fluctuation reserve.

4. TURNOVER AND REVENUE

Turnover represents the invoiced value of goods sold, net of discounts and returns.

An analysis of turnover and revenue is as follows:

	2001 <i>HK\$'000</i>	2000 <i>HK\$'000</i>
Turnover – Sale of goods	202,682	290,600
Interest income	63	542
Revenue	<u>202,745</u>	<u>291,142</u>

5. PROFIT/(LOSS) FROM OPERATING ACTIVITIES

The Group's profit/(loss) from operating activities is arrived at after charging/(crediting):

	2001 HK\$'000	2000 HK\$'000
Cost of inventories sold	209,240	226,428
Depreciation:		
Owned fixed assets	15,583	16,785
Leased fixed assets	2,390	1,168
Staff costs (excluding directors' remuneration, <i>note 7</i>)	15,086	20,081
Operating lease rentals in respect of land and buildings	675	1,462
Auditors' remuneration	1,680	843
Exchange gains, net	(147)	(497)
Gain on disposal of fixed assets	—	(4)
	<u> </u>	<u> </u>
Other operating expenses:		
Provision for bad and doubtful debts		
Accounts receivable	117,781	—
Other receivables	6,734	—
	<u> </u>	<u> </u>
	124,515	—
	<u> </u>	<u> </u>
Provisions for impairment of fixed assets (<i>note 12</i>)	54,981	—
Provisions against advances to a company	5,177	—
Provisions against deposits made to certain suppliers	4,635	—
Provisions for unrecoverable inventories held by a company	11,791	—
Revaluation deficit on land and buildings	3,073	—
Provisions for inventories	6,615	—
Provisions for potential claim	18,000	—
Loss on disposal of fixed assets	2,231	—
	<u> </u>	<u> </u>
	231,018	—
	<u> </u>	<u> </u>

The cost of inventories sold includes HK\$20,991,000 (2000: HK\$27,791,000) relating to staff costs and depreciation, which are also included in the respective total amounts disclosed separately above for each of these types of expenses.

6. FINANCE COSTS

	2001 HK\$'000	Group 2000 HK\$'000
Interest on bank loans, overdrafts and other loans wholly repayable within five years	12,987	6,924
Interest on convertible note	63	—
Interest on finance leases	645	660
	<u> </u>	<u> </u>
	13,695	7,584
	<u> </u>	<u> </u>

7. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID INDIVIDUALS

Details of the remuneration of the Company's directors are set out as follows:

	2001 HK\$'000	2000 HK\$'000
Executive directors:		
Fees	–	–
Basic salaries, housing, other allowances and benefits in kind	3,641	3,816
Independent non-executive directors:		
Fees	326	240
	<u>3,967</u>	<u>4,056</u>

The number of directors whose remuneration fell within the bands set out below is as follows:

	2001 Number of directors	2000 Number of directors
Nil – HK\$1,000,000	12	3
HK\$1,000,001 – HK\$1,500,000	1	1
HK\$2,000,001 – HK\$2,500,000	<u>–</u>	<u>1</u>

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

Of the five highest paid individuals, five (2000: Three) were directors of the Company and their remuneration has been included above. The remuneration of the remaining two highest paid individuals for the year ended 31 March 2000 was as follows:

	2001 HK\$'000	2000 HK\$'000
Basic salaries, housing, other allowances and benefits in kind	<u>–</u>	<u>837</u>
	Number of employee	2001
	2001	2000
Nil – HK\$1,000,000	<u>–</u>	<u>2</u>

During the year, no emoluments were paid by the Group to the directors or any of the five highest paid individuals as an inducement to join, or upon joining, the Group, or as compensation for loss of office.

No value is included in the directors' remuneration in respect of share options granted during the year because, in the absence of a readily available market value for the options on the Company's shares, the directors are unable to arrive at an accurate assessment of the value of the options granted. Details of the options granted to the directors during the year are set out in the section "Directors' rights to acquire shares" in the Report of the Directors.

8. TAX

Hong Kong profits tax has not been provided because there were no assessable profits arising in Hong Kong during the year. For the year ended 31 March 2000, Hong Kong profits tax was provided at the rate of 16% on the estimated assessable profits arising in Hong Kong during that year.

	2001 <i>HK\$'000</i>	Group 2000 <i>HK\$'000</i>
Hong Kong		
Current year provision	–	1,791
Overprovision in prior year	(54)	–
Deferred tax (<i>note 21</i>)	(4,300)	2,300
	<u>(4,354)</u>	<u>2,300</u>
Tax charge/(credit) for the year	<u>(4,354)</u>	<u>4,091</u>

9. NET LOSS FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS

The net loss from ordinary activities attributable to shareholders dealt with in the financial statements of the Company is HK\$252,403,000 (2000: Profit of HK\$3,556,000).

10. DIVIDEND

The directors do not recommend the payment of any dividend for the year ended 31 March 2001 (2000: Nil).

11. EARNINGS/(LOSS) PER SHARE

The calculation of basic earnings/(loss) per share is based on the net loss from ordinary activities attributable to shareholders for the year of HK\$279,335,000 (2000 : Profit of HK\$26,195,000) and the weighted average of 2,483,921,285 (2000: 2,212,655,670) ordinary shares in issue during the year, adjusted to reflect the Shares Subdivision (as here in after defined) during the year as detailed in note 23 to the financial statements.

The diluted loss per share for the year has not been presented because any potential ordinary shares of the Group outstanding during the year had anti-dilutive effect on the basic loss per share for the year.

The calculation of diluted earnings per share for the year ended 31 March 2000 was based on the net profit from ordinary activities attributable to shareholders for the year of HK\$26,195,000. The weighted average number of ordinary shares used in the calculation is 2,212,655,670 ordinary shares in issue during the year, as used in the basic earnings per share calculation, and the weighted average of 133,658,529 ordinary shares assumed to have been issued at no consideration on the deemed exercise of all share options and warrants during the year adjusted to reflect the shares subdivision as further detailed in note 24 to the financial statements.

12. FIXED ASSETS

Group

	Medium term leasehold land and buildings HK\$'000	Leasehold improve- ments HK\$'000	Moulds, plant and machinery HK\$'000	Furniture, fixtures, equipment and motor vehicles HK\$'000	Construction in progress HK\$'000	Total HK\$'000
Cost or valuation:						
At beginning of the year	121,387	28,029	76,699	5,392	29,892	261,399
Additions	–	601	11,923	448	2,396	15,368
Disposals	–	(6,278)	–	(700)	–	(6,978)
Revaluation deficit	(26,127)	–	–	–	–	(26,127)
At 31 March 2001	95,260	22,352	88,622	5,140	32,288	243,662
Accumulated depreciation and impairment:						
At beginning of the year	–	12,401	41,186	2,864	–	56,451
Provided during the year	4,100	4,710	8,254	909	–	17,973
Provisions for impairment	16,046	–	6,647	–	32,288	54,981
Disposals	–	(4,136)	–	(309)	–	(4,445)
Reversal of accumulated depreciation upon revaluation	(4,100)	–	–	–	–	(4,100)
At 31 March 2001	16,046	12,975	56,087	3,464	32,288	120,860
Net book value:						
At 31 March 2001	79,214	9,377	32,535	1,676	–	122,802
At 31 March 2000	121,387	15,628	35,513	2,528	29,892	204,948
Analysis of cost and valuation:						
At cost	–	22,352	88,622	5,140	32,288	148,402
At valuation	95,260	–	–	–	–	95,260
	95,260	22,352	88,622	5,140	32,288	243,662

All the medium term leasehold land and buildings are situated outside Hong Kong. As at 31 March 2000, all the leasehold land and buildings were revalued on a depreciated replacement cost basis by Knight Frank, an independent firm of professional valuers, at approximately HK\$95,260,000.

Had the Group's revalued leasehold land and buildings been stated at cost less accumulated depreciation, they would have been included in the financial statements at approximately HK\$81,517,000 (2000: HK\$84,809,000).

Certain leasehold land and buildings, plant and machinery and equipment were pledged to secure banking facilities granted to the Group as set out in note 18.

As at 31 March 2001, the Group was in the process of obtaining the land use rights certificate for leasehold land amounting to approximately HK\$28,851,000 (2000: HK\$44,503,000).

The net book value of fixed assets held under finance leases included in the above at the balance sheet date was HK\$10,390,000 (2000: HK\$8,235,000). The depreciation charge for the year in respect of such assets amounted to HK\$2,390,000 (2000: HK\$1,168,000).

13. INTERESTS IN SUBSIDIARIES

	Company	
	2001	2000
	HK\$'000	HK\$'000
Unlisted shares, at cost	68,709	68,709
Due from subsidiaries	84,064	67,474
	152,773	136,183
Less: Provisions for diminutions in values	152,773	—
	—	136,183

The amounts due from subsidiaries are unsecured, interest-free and repayable on demand.

Particulars of the subsidiaries are as follows:

Name	Place of incorporation/ operations	Nominal value of issued and paid-up share capital	Percentage of equity attributable to the Company	Principal activities
Hung Cheong Holdings Limited ("HCHL")	British Virgin Islands	Ordinary US\$2,004	100%	Investment holding
Hung Cheong Toys International Limited	Hong Kong	Ordinary HK\$1,000 Non-voting deferred HK\$200,000*	100%	Trading of toy products
Hung Cheong Toys Factory Limited	British Virgin Islands/ PRC	Ordinary US\$4	100%	Sub-contracting of manufacture of toy products
Huang Chiang Chen Hung Cheong Plastics Factory Company Limited	Hong Kong	Ordinary HK\$1,000 Non-voting deferred HK\$10,000*	100%	Property holding
Hung Cheong Toys Trading Limited	British Virgin Islands/ Hong Kong	Ordinary US\$4	100%	Dormant
Hung Cheong Toys Manufacturing Limited	British Virgin Islands/ Hong Kong	Ordinary US\$4	100%	Dormant
Sunstar Nominees Limited	Hong Kong	Ordinary HK\$100	100%	Dormant
Asian Ocean Limited	Hong Kong	Ordinary HK\$2	100%	Dormant
Sino New Finance Limited	British Virgin Islands/ Hong Kong	Ordinary US\$1	100%	Dormant

Name	Place of incorporation/ operations	Nominal value of issued and paid-up share capital	Percentage of equity attributable to the Company	Principal activities
Chiu Fung Toys Trading Limited	Hong Kong	Ordinary HK\$100	100%	Dormant
Gainful International Investment Limited	Hong Kong	Ordinary HK\$100	100%	Dormant
Hung Cheong Technology Limited	British Virgin Islands/ Hong Kong	Ordinary US\$1,000	100%	Dormant

Except for HCHL, all the above subsidiaries are indirectly held by the Company.

* The non-voting deferred shares carry no rights to dividends other than a fixed non-cumulative dividend at the rate of 5% per annum on the excess of the net profits over HK\$1,000,000,000,000 that the company may determine to distribute in respect of any financial year. On a winding-up, the holders of the non-voting deferred shares are entitled, out of the surplus assets of the company, to a return of the capital paid up on the non-voting deferred shares held by them respectively, after a total sum of HK\$1,000,000,000,000 has been distributed in such a winding-up in respect of each of the ordinary shares of the company. Save as described above, the holders of the non-voting deferred shares are not entitled to any participation in the profits or surplus assets of the company and shall not be entitled to receive notice of or to attend or vote at any general meeting of the company.

14. INVENTORIES

	Group	
	2001 HK\$'000	2000 HK\$'000
Raw materials	6,195	9,885
Work in progress	1,374	2,276
Finished goods	4,000	12,470
	<u>11,569</u>	<u>24,631</u>

As at 31 March 2001, inventories stated at net realisable value included in the above were approximately HK\$892,000 (2000: Nil).

15. ACCOUNTS RECEIVABLE

	2001	Group	2000
	<i>HK\$'000</i>		<i>HK\$'000</i>
The ages of the accounts receivable are analysed as follows:			
Outstanding balances with ages:			
Within 30 days	3,010		23,672
Between 31 to 60 days	154		17,797
Between 61 to 90 days	71		18,720
Between 91 to 180 days	48,923		27,104
Over 180 days	69,730		8,590
	121,888		95,883
Less: Provision for bad and doubtful debts	(117,781)		–
	4,107		95,883

The Group has a defined credit policy with credit terms ranged from 30 days to 90 days.

16. ACCOUNTS PAYABLE

	2001	Group	2000
	<i>HK\$'000</i>		<i>HK\$'000</i>
The ages of the accounts payable are analysed as follows:			
Outstanding balances with ages:			
Within 30 days	1,455		8,227
Between 31 to 60 days	305		13,532
Between 61 to 90 days	299		399
Between 91 to 180 days	9,152		15,011
Over 180 days	15,013		10,446
	26,224		47,615

17. INTEREST-BEARING BANK LOANS AND OVERDRAFTS

	Group	
	2001 HK\$'000	2000 HK\$'000
Bank overdrafts, unsecured	6,271	2,813
Bank loans, unsecured	8,398	9,135
Bank loans, secured	30,841	31,308
	<u>45,510</u>	<u>43,256</u>
Bank overdrafts repayable within one year or on demand	<u>6,271</u>	<u>2,813</u>
Bank loans repayable:		
Within one year, or on demand	32,697	2,669
In the second year	6,542	26,754
In the third to fifth years, inclusive	–	11,020
	<u>39,239</u>	<u>40,443</u>
	45,510	43,256
Portion classified as current liabilities	<u>(38,968)</u>	<u>(5,482)</u>
Non-current portion	<u>6,542</u>	<u>37,774</u>

18. BANKING FACILITIES

As at 31 March 2001, the Group's banking facilities were secured by the following:

- (i) certain leasehold land and buildings in the PRC with an aggregate carrying value of approximately HK\$40,724,000 (2000: HK\$76,884,000);
- (ii) certain plant and machinery and equipment with an aggregate carrying value of approximately HK\$1,326,000 (2000: NIL);
- (iii) corporate guarantees executed by the Company and its subsidiary; and
- (iv) personal guarantees of approximately HK\$31,167,000 from Mr. Chan Chun Hung and Ms. Wong Kin Ching, former directors of the Company.

As further disclosed in note 28 to the financial statements, as at the date of the report, writs of summon were issued by certain banks in respect of overdue borrowings.

19. FINANCE LEASE PAYABLES

There were commitments under non-cancelable finance leases at the balance sheet date as follows:

	Group	
	2001	2000
	<i>HK\$'000</i>	<i>HK\$'000</i>
Amounts payable:		
Within one year	7,443	3,247
In the second year	–	2,132
In the third to fifth years, inclusive	–	436
Total minimum lease payments	7,443	5,815
Future finance charges	(829)	(596)
Total net finance lease payables	6,614	5,219
Portion classified as current liabilities	(6,614)	(2,823)
Non-current portion of finance lease payables	–	2,396

As further disclosed in note 28 to the financial statements, as at the date of the report, writs of summon were issued by miscellaneous creditors in respect of overdue borrowings.

20. LOAN FROM A DIRECTOR

Loan from a director is unsecured, bears interest at the prime lending rate in Hong Kong plus 3% per annum and is repayable on demand.

21. DEFERRED TAX

	Group	
	2001	2000
	<i>HK\$'000</i>	<i>HK\$'000</i>
At beginning of year	4,300	2,000
Charge/(credit) for the year (<i>note 8</i>)	(4,300)	2,300
At end of year	–	4,300

The provision for deferred tax is made in respect of accelerated depreciation allowances to the extent that a liability is expected to crystallise.

There are no significant potential deferred tax liabilities for which provision has not been made.

The revaluation of the Group's leasehold land and buildings does not constitute a timing difference and, consequently, the amount of potential deferred tax thereon has not been quantified.

Deferred tax has not been provided for the Company because the Company did not have any significant timing differences at the balance sheet date.

22. CONVERTIBLE NOTE

On 30 October 2000, the Company entered into a conditional subscription agreement (the “Agreement”) with Join Asia Enterprises Limited (“Join Asia”). Join Asia is an independent third party not connected with the Group. Pursuant to the Agreement, the Company issued a HK\$3 million convertible note (the “Convertible Note”) to Join Asia. The Convertible Note was issued at 100% of its principal amount and bears interest at the rate of 5% per annum payable on 16 November 2002 (the “Maturity Date”).

Pursuant to the Agreement, Join Asia has the right to convert the whole or any part of the principal amount of the Convertible Note into fully paid ordinary shares of HK\$0.01 each of the Company at a conversion price of HK\$0.015 per share (the “Conversion Price”) at anytime before the Maturity Date. A total of 200,000,000 shares will be issued, representing approximately 8.05% and 7.45% of the existing and enlarged issued share capital of the Company, respectively. If not converted by the Maturity Date, the Company will repay such principal monies outstanding under the Convertible Note to Join Asia together with all interest accrued thereon up to and including the Maturity Date.

23. SHARE CAPITAL**Shares**

	Company	
	2001	2000
	<i>HK\$'000</i>	<i>HK\$'000</i>
<i>Authorised:</i>		
10,000,000,000 (2000: 1,000,000,000) ordinary shares of HK\$0.01 (2000: HK\$0.1) each	100,000	100,000
<i>Issued and fully paid:</i>		
2,483,936,760 (2000: 248,332,900) ordinary shares of HK\$0.01 (2000: HK\$0.1) each	24,839	24,833

Details of the movements in the issued share capital of the Company during the year were as follows:

	<i>Notes</i>	<i>HK\$'000</i>	Number of shares
At 1 April 2000		24,833	248,332,900
Subdivision	(a)	–	2,234,996,100
Warrants exercised	(b)	6	607,760
At 31 March 2001		24,839	2,483,936,760

(a) Pursuant to an ordinary resolution passed on 5 April 2000, each of the Company's issued and unissued ordinary shares on 6 April 2000 of HK\$0.10 each was subdivided into ten ordinary shares HK\$0.01 each (“Subdivided Shares”) (“Shares Subdivision”). As a result of such Share Subdivision, the Company's authorised share capital was changed from 1,000,000,000 ordinary shares of HK\$0.10 each to 10,000,000,000 ordinary shares of HK\$0.01 each and the Company's issued ordinary share capital was changed from 248,332,900 ordinary shares of HK\$0.10 each to 2,483,329,000 ordinary shares of HK\$0.01 each.

(b) During the year, 60,400 shares of HK\$0.10 each and 3,760 Subdivided Shares of HK\$0.01 each were issued for cash at the subscription price of HK\$0.47 per share and HK\$0.05 per Subdivided Share, respectively pursuant to the exercise of the Company's warrants for a total cash consideration, before expenses, of HK\$28,576.

The excess of the proceeds over the par value of the shares issued was credited to the share premium account.

Share options

On 17 February 1998, under the terms of the Company's share option scheme adopted by the Company conditional upon the listing of the Company's shares on the Stock Exchange, the directors of the Company were authorised, on or before 16 February 2008, at their discretion to invite any employee, including any executive director of the Company or any of its subsidiaries, to take up options to subscribe for shares of the Company. The scheme subscription price is the higher of 80% of the average of the closing price of the shares on the Stock Exchange for the five trading days immediately preceding the date of the offer of the option or the nominal value of the shares. The maximum number of shares in respect of which options may be granted under the share option scheme may not exceed, in nominal amount, 10% of the issued shares of the Company from time to time which have been duly allotted and issued. The scheme became effective upon the listing of the Company's shares on 12 March 1998.

During the year, the number of shares options granted and the exercise price of the options have been adjusted for the effect of the Share Subdivision. Accordingly, the subscription price and the number of shares available for subscription in respect of share option granted on 20 July 1999 were adjusted from HK\$0.46 per share and 7,070,000 shares to HK\$0.046 per Subdivided Share and 70,700,000 Subdivided Shares, respectively. The share options are exercisable at any time from 21 July 1999 to 16 February 2008.

On 25 October 2000, 65,000,000 share options were granted by the Company, pursuant to the above scheme, to their chairman and certain full-time employees of the Company which entitle them to subscribe for a total number of 65,000,000 ordinary shares. The share options are exercisable at HK\$0.03472 per share, subject to adjustment, at any time from 20 September 2000 to 16 February 2008.

During the year, 11,000,000 share options granted on 20 July 1999 and 15,000,000 share options granted on 18 September 2000 lapsed.

The exercise in full of remaining outstanding subscription rights attached to the 109,700,000 share options would, under the present capital structure of the Company, result in the issue of 109,700,000 shares of HK\$0.01 each for a total cash consideration, before expenses, of approximately HK\$4,482,000.

Warrants

At the beginning of the year, the total number of warrants granted on 28 September 1999 (the "Warrants") and remained outstanding were 37,597,100 Warrants. Each of the Warrants entitled the holder thereof to subscribe for one share at an initial subscription price of HK\$0.47 per share, subject to adjustment, from the date of issue to 28 September 2001 (both dates inclusive).

Pursuant to the Shares Subdivision, the subscription price of the ordinary shares under the Warrants was adjusted from HK\$0.47 per share to HK\$0.05 per Subdivided Share. The exercise in full of such Warrants would, after adjusting to reflect the Shares Subdivision, result in the issue of 353,412,740 Subdivided Shares of HK\$0.01 each. 571,520 Warrants were exercised and 60,400 ordinary shares of HK\$0.10 each and 3,760 ordinary shares of HK\$0.01 each were issued at HK\$0.47 and HK\$0.05 per share, respectively. At the balance sheet date, the Company had 352,841,220 Warrants outstanding.

The exercise in full of the Warrants would result in the issue of 352,841,220 ordinary shares of HK\$0.01 each and the receipt by the Company of approximately HK\$17,642,000, before any related expenses.

24. RESERVES

	Share premium HK\$'000	Contributed surplus HK\$'000	Asset revaluation reserve HK\$'000	Retained profits/ (accumulated losses) HK\$'000	Total HK\$'000
Group					
At 1 April 1999	18,385	10	11,130	96,298	125,823
Issue of shares	26,674	–	–	–	26,674
Share issue expenses	(662)	–	–	–	(662)
Net profit for the year	–	–	–	26,195	26,195
Revaluation surplus	–	–	25,848	–	25,848
At 31 March and 1 April 2000	44,397	10	36,978	122,493	203,878
Issue of shares	22	–	–	–	22
Share issue expenses	(22)	–	–	–	(22)
Net loss for year	–	–	–	(279,335)	(279,335)
Revaluation deficit	–	–	(18,954)	–	(18,954)
At 31 March 2001	<u>44,397</u>	<u>10</u>	<u>18,024</u>	<u>(156,842)</u>	<u>(94,411)</u>
		Share premium HK\$'000	Contributed surplus HK\$'000	Retained profits/ (accumulated losses) HK\$'000	Total HK\$'000
Company					
At 1 April 1999		18,385	68,509	4,834	91,728
Issue of shares		26,674	–	–	26,674
Share issue expenses		(662)	–	–	(662)
Net profit for the year		–	–	3,556	3,556
At 31 March and 1 April 2000		44,397	68,509	8,390	121,296
Issue of shares		22	–	–	22
Share issue expenses		(22)	–	–	(22)
Net loss for the year		–	–	(252,403)	(252,403)
At 31 March 2001		<u>44,397</u>	<u>68,509</u>	<u>(244,013)</u>	<u>(131,107)</u>

The contributed surplus of the Group represents the difference between the nominal value of the share capital of the subsidiaries acquired pursuant to the Group reorganisation on 17 February 1998, over the nominal value of the share capital of the Company issued in exchange therefor.

The contributed surplus of the Company represents the excess of the then combined net asset value of the subsidiaries acquired pursuant to the same reorganisation, over the nominal value of the Company's shares issued in exchange therefor. Under the Companies Act 1981 of Bermuda, the contributed surplus of the Company is distributable to shareholders under certain circumstances, which at present the Company is unable to meet.

25. NOTES TO CONSOLIDATED CASH FLOW STATEMENT

- (a) Reconciliation of profit/(loss) from operating activities to net cash inflow/(outflow) from operating activities

	2001 <i>HK\$'000</i>	2000 <i>HK\$'000</i>
Profit/(loss) from operating activities	(269,994)	37,870
Depreciation	17,973	17,953
Interest income	(63)	(542)
Loss/(gain) on disposal of fixed assets	2,231	(4)
Provision for bad and doubtful debts	124,515	–
Provisions for inventories	6,615	–
Provisions against advances to a company	5,177	–
Provisions against deposits made to certain suppliers	4,635	–
Provisions for unrecoverable inventories held by a company	11,791	–
Provisions for impairment of fixed assets	54,981	–
Revaluation deficit on land and buildings	3,073	–
Increase in accounts receivable	(26,005)	(26,359)
Increase in inventories	(5,344)	(2,275)
Decrease/(increase) in prepayments, deposits and other receivables	(14,662)	3,918
Increase/(decrease) in trust receipt loans with original maturity greater than three months	(8,290)	4,995
Increase/(decrease) in accounts payable	(21,391)	24,621
Increase/(decrease) in other payables and accruals	34,672	(402)
Net cash inflow/(outflow) from operating activities	<u>(80,086)</u>	<u>59,775</u>

(b) Analysis of changes in financing during the year

	Share capital and share premium <i>HK\$'000</i>	Bank loans <i>HK\$'000</i>	Loan from a director <i>HK\$'000</i>	Obligations under finance leases <i>HK\$'000</i>	Convertible note <i>HK\$'000</i>
At 1 April 1999	38,385	28,972	–	3,256	–
Issue of shares	31,507	–	–	–	–
Share issue expenses	(662)	–	–	–	–
Net cash inflow/ (outflow) from financing	–	11,471	–	(3,163)	–
Inception of finance leases (<i>note 25(c)</i>)	–	–	–	5,126	–
At 31 March and 1 April 2000	69,230	40,443	–	5,219	–
Issue of shares	28	–	–	–	–
Share issue expenses	(22)	–	–	–	–
Net cash inflow/ (outflow) from financing	–	(1,204)	9,000	(2,139)	3,000
Inception of finance leases (<i>note 25(c)</i>)	–	–	–	3,534	–
At 31 March 2001	<u>69,236</u>	<u>39,239</u>	<u>9,000</u>	<u>6,614</u>	<u>3,000</u>

(c) Major non-cash transaction

During the year, the Group entered into finance lease arrangements in respect of assets with a total capital value at the inception of the leases of HK\$3,534,000. (2000: HK\$5,126,000).

26. COMMITMENTS

At the balance sheet date, the Group had the following commitments:

	2001 <i>HK\$'000</i>	Group 2000 <i>HK\$'000</i>
Capital commitments:		
Authorised, but not contracted for	3,150	3,150
Contracted, but not provided for	<u>6,251</u>	<u>8,843</u>
	<u>9,401</u>	<u>11,993</u>
Annual commitments payable in the following year under non-cancellable operating leases in respect of land and buildings expiring:		
Within one year	345	102
In the second to fifth years, inclusive	<u>–</u>	<u>2,693</u>
	<u>345</u>	<u>2,795</u>

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

27. CONTINGENT LIABILITIES**(i) Potential claim**

In December 2000, the Group received a claim from its processing agent for an amount of approximately HK\$18.7 million. Since the documents in support of the aforesaid claim has not been properly approved by the board of the Company, the directors are seeking legal opinion on the said claim. For prudence, the directors have made a provision against the claim as at the balance sheet date.

(ii) Others

	Group		Company	
	2001	2000	2001	2000
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Bills discounted with recourse	–	320	–	–
Guarantee of credit purchase facilities granted to a subsidiary	–	–	–	3,000
Guarantee of banking facilities granted to a subsidiary	–	–	–	66,974
	<u>–</u>	<u>320</u>	<u>–</u>	<u>69,974</u>

28. PENDING LITIGATION

As at the date of this report, writs of summons had been issued by several miscellaneous creditors aggregating approximately HK\$5.6 million and banks aggregating approximately HK\$16.6 million, together with claims for interest thereon in respect of overdue borrowings, rentals, purchases of goods and the provision of services (the “Indebtedness”).

The directors are currently negotiating with the parties issuing the writs with a view to restructuring the Group’s overall indebtedness. Full provision has been made in the accounts for all the indebtedness, however, no provision has been made for any interest, penalties, damages and legal costs the Group may incur if it is unsuccessful either in defending the writs, or in persuading the issuers to withdraw such pursuant to a debt restructuring.

On 12 May 2001 and 23 May 2001, winding-up petitions were filed by Sin Hua Bank Limited, Hong Kong Branch (“Sin Hua”) against Hung Cheong Toys International Limited (“Hung Cheong”), a principal operating subsidiary within the Group and the Company, respectively. The hearing of the petition against Hung Cheong in the High Court of the Hong Kong Special Administrative Region was adjourned to 1 August 2001 while the hearing of the petition against the Company was adjourned to 22 August 2001.

29. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved by the board of directors on 26 July 2001.

5. PRO FORMA STATEMENT OF UNAUDITED ADJUSTED CONSOLIDATED NET TANGIBLE ASSETS

Set out below is the pro forma statement of the unaudited adjusted consolidated net tangible assets of the Group based on the audited consolidated deficiency in assets of the Group as at 31st March, 2001 and adjusted as follows:

HK\$' million

Audited consolidated deficiency in assets of the Group as at 31st March, 2001	(69.6)
Unaudited consolidated loss of the Group for the six months ended 30th September, 2001	(25.1)
Unaudited consolidated deficiency in assets of the Group as at 30th September, 2001	(94.7)
Revaluation deficit (<i>Note 2</i>)	(6.6)
Adjusted consolidated deficiency in assets before the Restructuring Proposal and the Settlements	(101.3)
Add: Indebtedness waived pursuant to the Restructuring Proposal (<i>Note 3</i>)	70.4
Proceeds from the Open Offer (<i>Note 5</i>)	37.3
Proceeds from the Subscription	30.0
Reduction of indebtedness pursuant to the Settlements (<i>Note 4</i>)	16.2
Less: Estimated professional fees and expenses in connection with the Restructuring Proposal	(7.0)
Pro forma unaudited adjusted consolidated net tangible assets of the Group after completion of the Restructuring Proposal and the Settlements	45.6

HK\$

Pro forma unaudited adjusted consolidated deficiency in assets
per Share prior to completion of the Restructuring Proposal
and the Settlements (*Note 5*) (0.041)

Pro forma unaudited adjusted consolidated net tangible assets per
Share upon completion of the Restructuring Proposal and the
Settlements (*Note 6*) 0.0044

Notes:

1. The pro forma unaudited adjusted consolidated net tangible assets prepared above does not take into account the effect upon conversion of the outstanding Options, Existing Convertible Note, the Convertible Bonds and the New Convertible Note to be issued.
2. The carrying value of the leasehold land and buildings and the construction in progress of the Group as at 28th February, 2002 amounted to HK\$85.6 million and nil, respectively, and were revalued by Knight Frank, an independent firm of professional valuers, at 28th February, 2002 at approximately HK\$124.0 million in aggregate.

The revalued amounts of the leasehold land and buildings of the Group amounted to HK\$95.0 million as at 28th February, 2002 as set out in Appendix II of this circular. In the opinion of the Directors, certain of these leasehold land and buildings were impaired as they had been left vacant and currently not been used by the Group and provisions for impairment of HK\$16.0 million were made as at 31st March, 2001. The revaluation deficit of HK\$6.6 million as set out in the pro forma statement of unaudited adjusted consolidated net tangible assets, represents the shortfall of the revalued amounts of HK\$95.0 million after deducting the aforesaid provisions for impairment of HK\$16.0 million, under the then carrying values of leasehold land and buildings of HK\$85.6 million as at 28th February, 2002.

The construction in progress with no carrying value as at 28th February, 2002 had been revalued at HK\$29.0 million by Knight Frank as set out in Appendix II of this circular. In the opinion of the Directors, the aforesaid construction in progress were impaired as development of which had been put on hold by the Group. As a result, the corresponding revaluation surplus of approximately HK\$29.0 million has not been incorporated in the pro forma statement of unaudited adjusted consolidated net tangible assets.

3. Being the Total Compromised Debt of HK\$99.7 million after netting off the principal amount of the Convertible Bonds of HK\$6.5 million to be issued, HK\$20.0 million to be repaid to the Bank Group by cash and the interest accrued by the Group in respect of the Total Compromised Debt of HK\$2.8 million for the period from 1st October, 2001 to 17th December, 2001.
4. Being the settlement of debts of HK\$34.3 million due to certain creditors of the Group after netting off the payment of HK\$2.1 million cash and the issue of the New Convertible Note in the amount of HK\$16.0 million.
5. Based on the existing issued share capital of 2,483,936,760 Shares.
6. Based on the enlarged issued share capital of 10,280,121,900 Shares after the Restructuring Proposal and the Settlements.

6. INDEBTEDNESS

At the close of business on 28th February, 2002, being the latest practicable date for the purpose of this indebtedness statement prior to the printing of this circular, the Group had outstanding borrowing of approximately HK\$177.5 million comprising secured bank overdrafts of approximately HK\$7.8 million, secured trust receipt loans of approximately HK\$72.6 million,

secured bank loans of approximately HK\$38.6 million, unsecured other loans of approximately HK\$31.6 million, convertible note payable of approximately HK\$3.0 million, obligation under finance lease contracts of approximately HK\$4.1 million, advance from a director of approximately HK\$4.0 million and accrued interest payable of aforesaid indebtedness of approximately HK\$15.8 million.

As at 28th February, 2002, the Group's borrowing were secured by legal charges on certain of the Group's medium term leasehold land and buildings situated outside Hong Kong with an aggregate net book value of approximately HK\$56.1 million, corporate guarantees executed by the Company and a subsidiary, pledge of certain plant and machinery of the Group with an aggregate net book value of approximately HK\$1.1 million and personal guarantees executed by Mr. Chan Chun Hung and Ms. Wong Kin Ching, both of which were former directors of the Company.

Save as aforesaid and apart from intra-group liabilities, none of the companies comprising the Group had outstanding at the close of business on 28th February, 2002, any mortgage, charges or debentures, loan capital issued and outstanding or agree to be issued, bank overdrafts and loans, debt security or other similar indebtedness, liabilities under acceptances (other than normal trade bills) or acceptance credits or any hire purchase commitments, finance lease commitments, guarantees or other material contingent liabilities.

In addition to the above, as at 28th February, 2002, the Group had outstanding claims in respect of pending litigations as detailed in note 5 of Appendix IV to this circular.

Save as disclosed above and the Restructuring Proposal, the Directors confirmed that there had been no material change in indebtedness and contingent liabilities of the Group since 28th February, 2002.

For the purpose of this indebtedness statement, foreign currency amounts have been translated into Hong Kong dollars at the applicable rates of exchange prevailing at the close of business on 28th February, 2002.

7. WORKING CAPITAL STATEMENT

The Directors have prepared the cash flow projections of the Group for the period from 1st March, 2002 to 30th April, 2003 (the "Projection Period") based on the unaudited management accounts for the eleven months ended 28th February, 2002 and a projection of the Group's working capital requirement for the fourteen months ending 30th April, 2003 (the "Working Capital Projection"). Provided that the Restructuring Proposal becoming effective, the Group will raise net proceeds of approximately HK\$60.3 million by Subscription from Investor and the Open Offer. In addition, subject to Completion, Get Start Holdings Limited, the holding company of the Investor, has undertaken to the Company to provide continuing financial support to the Group so as to enable the Group to continue its day-to-day operation as a viable concern notwithstanding any present or future financial difficulties experienced by the Group during the Projection Period. At present, the Group has undertaken a number of other measures in order to further relieve its current liquidity pressure.

In this regard, the Group has obtained written consent from the Group's bankers in the PRC to reschedule and extend the repayment period, subject to a repayment of HK\$2.3 million, of its bank borrowings at 28th February, 2002 of approximately HK\$30.2 million for another one year upon their original maturity in the second half of 2002.

Speed Up Developments Limited ("Speed Up"), an independent third party not connected with the Group, had advanced loans in aggregate of approximately HK\$22.4 million (the "Loans") to the Group as at 28th February, 2002 and agreed that it will not demand the Group to repay partly or wholly of the Loans before 30th June 2003. As at 30th September, 2001, the loans advanced by Speed Up amounted to HK\$16.0 million and had been included in the Other Liabilities as set out on page 30 of this circular. During 1st March, 2002 to the Latest Practicable Date, Speed Up further advanced HK\$5.0 million to the Group.

The Group has entered into agreements with trade and other creditors of the Group in respect of arrangements for settlement their debts as at 28th February, 2002 of approximately HK\$34.3 million by way of cash settlement of HK\$2.1 million and issuance of the Company's Shares and convertible note as set out on pages 22 to 27 of this circular.

Further, certain Directors had agreed that they will not demand for the Group to repay partly or wholly of a total sum of approximately HK\$6.2 million as at 28th February, 2002 in respect of their loans advanced to the Group and accrued emoluments unless the Group has sufficient working capital for its normal operational requirements.

Hung Cheong Toys International Limited ("HCT"), a wholly-owned subsidiary of the Company, had a deficiency in assets of approximately HK\$168.1 million as at 28th February, 2002 and remained dormant since June 2001. As at 28th February, 2002, HCT had total liabilities of approximately HK\$168.7 million which comprised borrowings owed to the Bank Group of approximately HK\$102.1 million including interest payable, intra group liabilities of approximately HK\$52.9 million, other liabilities of HK\$3.9 million guaranteed by the Company and unsecured liabilities of approximately HK\$9.8 million. Having considered the legal counsels' advice, the Directors intend to dispose of the entire interest in HCT held by the Company and withdraw all the Company's financial support provided to HCT in order to improve the Group's current liquidity which is in the interest of the Shareholders. In this regard, other than borrowings owed to the Bank Group and secured liabilities, the Group has no intention to settle the unsecured liabilities of HCT amounted to approximately HK\$9.8 million during the Projection Period. In connection with the Working Capital Projection, no revenue, operating result and related cash flow of HCT had been budgeted by the Group. In the opinion of the Directors, the future disposal of HCT will not have significant adverse impact to the Group.

The Directors are of the opinion that, in the absence of unforeseen circumstances and subject to the completion of the Restructuring Proposal, taking into account (i) the undertaking given by the holding company of the Investor; (ii) the success in rescheduling and extending

the repayment period for the PRC Bank Borrowings; (iii) the satisfaction of the conditions as set out on pages 24 to 26 of this circular in respect of the arrangement for settlement of Other Settlement Debts by way of cash and issuance of Company's Shares and convertible note; (iv) the intention of the Directors for the disposition of HCT; and (v) the withdrawal of all the Company's financial support to HCT, the Group, which includes the Company and its subsidiaries other than HCT, will have sufficient working capital for the Projection Period. Should the Restructuring Proposal and other measures abovementioned be unsuccessful, the Directors are of the opinion that the Group would not have adequate fund to enable it to operate as a going concern in the foreseeable future.

In assessing the adequacy of working capital of the Group, the Directors have prepared the cash flow projections of the Group for the Projection Period on the basis of a number of assumptions, the principal ones of which are set out below. It should be noted that the assumptions set out below could be materially affected by changes in economic and other circumstances.

As a result, actual cash flows may differ substantially from the prospective financial information contained in the cash flow projections below since actual events frequently do not occur as expected and such variation may be material.

Principal assumptions:

1. that the Restructuring Proposal is successfully implemented;
2. that the Group succeeds in rescheduling and extending the repayment period for the PRC Bank Borrowings;
3. that the successful completion of settlement of Other Settlement Debts by way of cash and issuance of Company's shares and convertible note;
4. that certain Directors will not demand repayment of their loans of HK\$6.2 million as at 28th February, 2002 advanced to the Group on 8th June, 2001 and 9th July, 2001 and accrued emoluments until the Group has sufficient working capital for its normal operation requirements;
5. that the Group will dispose of HCT and withdraw its financial support to HCT and is not required to settle the unsecured liabilities of HCT amounted HK\$9.8 million as at 28th February, 2002 during the Projection Period. The disposal of HCT will not have any adverse effect to the Group;
6. that, without jeopardising the interest of the Group, the Group will not be required to make payment of land premium of approximately HK\$8.6 million accrued to the relevant Land Administration Bureau of the PRC in respect of certain lands held under medium term lease by the Group during the Projection Period;

7. that there will be no material changes in principal activities and operations of the Group for the period from 1st March, 2002 to 30th April, 2003;
8. that there will not be any significant provision for bad debts during the Projection Period;
9. that orders on hand are delivered in full and on time;
10. that there will be no material increases in the operating expenses of the Group;
11. that there will be no material changes in existing political, legal, fiscal or economic conditions in Hong Kong and any other countries in which the Group carries on business;
12. that there will be no material changes in the bases or rates of taxation applicable to the activities of the Group;
13. that prices of raw material will not differ materially from those currently prevailing;
14. that there will be no material changes in interest rates and foreign currency exchange rates from those currently prevailing; and
15. that there will be no major business disruptions through international crisis or financial turmoil, industrial disputes, industrial accidents or severe weather conditions.

The following are the cash flow projections of the Group for the Projection Period. As mentioned above, actual cash flows may differ substantially from the prospective financial information contained below since actual events frequently do not occur as expected and such variation may be material.

APPENDIX I

FINANCIAL INFORMATION

	<i>HK\$' million</i>	<i>HK\$' million</i>
Net cash outflow from operating activities for the Projection Period		(21.5)
Net cash outflow from return on investment and servicing of finance for the Projection Period		(5.9)
Net cash outflow from investing activities for the Projection Period		(3.5)
Financing		
Proceeds from the Open Offer	37.3	
Proceeds from the Subscription	30.0	
Professional fees and expenses in connection with the Restructuring Proposal	(7.0)	
Settlement to Bank Group	(20.0)	
Repayment of Existing Convertible Note	(3.0)	
Drawdown of loans from Speed Up	5.0	
Repayment of PRC Bank Borrowings	(2.3)	
Capital element of finance leases payment	(3.3)	
Net cash inflow from financing		36.7
Increase in cash and cash equivalents		5.8

8. MATERIAL CHANGES SINCE 31ST MARCH, 2001

Save as disclosed in the Company's interim report 2001, the pro forma statement of unaudited adjusted consolidated net tangible assets of the Group on pages 114 to 115 of this circular, and the paragraph headed "Litigation" in Appendix IV of this circular, the Directors are not aware of any material change in the financial or trading position or prospects of the Group since 31st March, 2001, the date to which the latest audited financial statements of the Company were made up.

Set out below are the texts of a letter and valuation certificate received from Knight Frank in connection with its valuation as at 28th February, 2002 of the property interest of the Group, prepared for the purpose of inclusion in this circular:—



32/F., AIA Tower
183 Electric Road
North Point, Hong Kong

26th April, 2002

The Directors
Hung Fung Group Holdings Limited
Room 3A30-06, 3/F
New Mandarin Plaza
14 Science Museum Road
Tsimshatsui East
Hong Kong

Dear Sirs,

**Re: Six parcels of land and various buildings and structures erected thereabove,
Xiong Chang Industrial City,
Hua Qiao Industrial Region,
Chang Ming Road,
Huang Jiang Zhen,
Dongguan City,
Guangdong Province,
the PRC (the “property”)**

In accordance with your instructions for us to value the property in which Hung Fung Group Holdings Limited (the “Company”) and its subsidiaries (together the “Group”) have interests, we confirm that we have carried out inspections, made relevant enquiries and searches and obtained such further information as we consider necessary for the purpose of providing you with our opinion of value of the property as at 28th February, 2002.

As there are no readily identifiable market sales comparables, the buildings and structures cannot be valued on the basis of open market value. They have therefore been valued on the basis of their depreciated replacement cost. The depreciated replacement cost approach considers the cost to reproduce or replace in new condition the property appraised in accordance with

current construction costs for similar property in the locality, with allowance for accrued depreciation as evidenced by observed condition or obsolescence present, whether arising from physical, functional or economic causes. The depreciated replacement cost approach generally furnishes the most reliable indication of value for property in the absence of a known market based on comparable sales.

We have relied to a considerable extent on the information provided by the Group and have accepted advice given to us on such matters as planning approvals or statutory notices, easements, tenure, occupation, identification of properties, and site and floor areas.

We have not carried out detailed site measurements to verify the correctness of the site areas in respect of the relevant property but have assumed that the site areas shown on the documents and official site plans handed to us are correct. Based on our valuation experience of similar properties in the PRC, we consider the assumptions so made to be reasonable. All documents and contracts have been used as reference only and all dimensions, measurements and areas are approximations.

We have inspected the exterior and, where possible, the interior of the property. However, no structural survey, investigation or examinations have been made, but in the course of our inspections we did not note any serious defects. We are not, however, able to report whether the property is free from rot, infestation or any other structural defects. No tests were carried out to any of the services.

We have not carried out investigations on site to determine the suitability of the ground conditions and the services etc. for the developments. Our valuations are prepared on the assumption that those aspects are satisfactory and that no extraordinary expenses or delays will be incurred during the construction period.

No allowance has been made in our report for any charges, mortgages or amounts owing on the property. Unless otherwise stated, it is assumed that the property is free from encumbrances, restrictions, and outgoings of an onerous nature which could affect its value.

In valuing the property which is situated in the PRC, we have relied on the opinion of the Group's PRC legal adviser, Guangdong Sincere Law Office, regarding the title to property. We have assumed that the transferable land use rights in respect of the property for respective specific terms at nominal annual land use fees have been granted and that any premium payable has already been fully paid. We have also assumed that the grantee of the property has free and uninterrupted right to occupy, use and assign the property interest for the whole of the unexpired terms as granted.

We have had no reason to doubt the authenticity and accuracy of the information provided to us by the Group. We have also sought and received confirmation from the Group that no material factors have been omitted from the information supplied. We consider that we have been provided with sufficient information to reach an informed view, and have no reason to suspect that any material information has been withheld.

Unless otherwise stated, all monetary amounts stated are in Hong Kong Dollars. The adopted exchange rate for the valuation of property interest is the prevailing rate as at the date of valuation, being HK\$1 to RMB1.07 and no significant fluctuation in exchange rate has been found between that date and the date of this letter.

We enclose herein our valuation certificate.

Yours faithfully,
For and on behalf of
KNIGHT FRANK

Catherine Cheung
AHKIS MRICS RPS (GP)
Assistant Director

Note : Ms. Catherine Cheung has about 12 years' and 10 years' working experience in valuations of properties in Hong Kong and the PRC respectively.

VALUATION CERTIFICATE

Property	Description and tenure	Particulars of occupancy	Capital value in existing state as at 28th February, 2002
Six parcels of land and various buildings and structures erected thereabove, Xiong Chang Industrial City, Hua Qiao Industrial Region, Chang Ming Road, Huang Jiang Zhen, Dongguan City, Guangdong Province, the PRC	The property comprises 6 parcels of land having a total site area of approximately 124,282 sq.m. and 10 blocks of various buildings erected thereabove. These buildings are of 1 to 6 storeys in height and were completed between 1997 and 2000. The property has a total gross floor area of approximately 29,344 sq.m.. Two other 4-storey industrial blocks having a total gross floor area of approximately 17,500 sq.m., a 2-storey canteen block having a gross floor area of about 1,992 sq.m. and a 3-storey paint spraying building having a gross floor area of about 3,230 sq.m. are being constructed. Superstructure work has been commenced. The property is granted with various land use rights for terms up to 5th January, 2047, 5th November, 2047, 15th April, 2048 and 31st December, 2048 respectively.	The property is currently occupied by the Group for production, storage, ancillary office and staff quarters' purposes.	HK\$123,950,000

Notes:

- (1) Pursuant to a State-owned Land Use Rights Grant Contract – Dong Guo Tu Chu Yang He (1997) No. 121-1 (國有土地使用權出讓合同—東國土出讓合(1997)第121-1號) dated 23rd October, 1997 made between State Land Administrative Bureau of Dongguan City, Guangdong Province (廣東省東莞市土地管理局) and Huang Chiang Chen Hung Cheong Plastics Factory Company Limited (黃江鎮雄昌塑膠廠有限公司 (“HC”)), a wholly-owned subsidiary of the Company, the former party has agreed to grant a parcel of land having a site area of 20,000 sq.m. to the latter party subject to payment of a land premium of RMB400,000. As advised by the Group, the land premium has been fully paid (see note 6).
- (2) Pursuant to a State-owned Land Use Rights Grant Contract – Dong Guo Tu Chu Yang He (1997) No. 033 (國有土地使用權出讓合同—東國土出讓合(1997)第033號) dated 6th November, 1997 made between State Land Administrative Bureau of Dongguan City, Guangdong Province (廣東省東莞市土地管理局) and HC, the former party has agreed to grant a parcel of land having a site area of 20,000 sq.m. to the latter party subject to payment of a land premium of RMB400,000. As advised by the Group, the land premium has been fully paid (see note 7 and note 8).

- (3) Pursuant to a Compensatory Land Use Rights Transfer Contract dated 2nd April, 1998 made between Sheng Wei Trading Company Limited, Dongguan City (東莞市盛威貿易有限公司 (“Sheng Wei”)), an independent third party not connected to the Group, and HC, the former party has agreed to transfer a parcel of land having a site area of 36,600 sq.m. to the latter party for a term commencing from 15th April, 1998 to 15th April, 2048 subject to payment of a land premium of RMB15,006,000 to Sheng Wei. As advised by the Group, the land premium has been fully paid and the State-owned Land Use Rights Certificate (國有土地使用證) is currently under application.
- (4) Pursuant to a Compensatory Land Use Rights Transfer Contract dated 28th December, 1999 made between Sheng Wei and HC, the former party has agreed to transfer a parcel of land having a site area of 15,000 sq.m. to the latter party for a term commencing from 1st January, 2000 to 31st December, 2048 subject to payment of a land premium of RMB5,700,000 to Sheng Wei. As advised by the Group, the land premium has been fully paid.
- (5) Pursuant to a Compensatory Land Use Rights Transfer Contract dated 5th October, 1999 made between Sheng Wei and HC, the former party has agreed to transfer a parcel of land having a site area of 32,670 sq.m. to the latter party for a term commencing from 1st October, 1999 to 15th April, 2048 subject to payment of a land premium of RMB13,394,700 to Sheng Wei. As advised by the Group, the land premium has been fully paid.
- (6) The property is subject to a State-owned Land Use Rights Certificate – Dong Fu Guo Yong (1997) Zi No. Te 124 (國有土地使用證 – 東府國用(1997)字第特124號) dated 23rd October, 1997 issued by the People’s Government of Dongguan City (東莞市人民政府), HC has a right to use the land, having a site area of 20,000 sq.m., for a land use term up to 5th January, 2047 for industrial uses.
- (7) The property is subject to a State-owned Land Use Rights Certificate – Dong Fu Guo Yong (1997) Zi No. Te 326-1 (國有土地使用證 – 東府國用(1997)字第特326之一號) dated 17th November, 1997 issued by the People’s Government of Dongguan City (東莞市人民政府), HC has a right to use the land, having a site area of 14,401 sq.m., for a land use term up to 5th November, 2047 for industrial and ancillary uses.
- (8) The property is subject to a State-owned Land Use Rights Certificate – Dong Fu Guo Yong (1997) Zi No. Te 326-2 (國有土地使用證 – 東府國用(1997)字第特326之二號) dated 17th November, 1997 issued by the People’s Government of Dongguan City (東莞市人民政府), HC has a right to use the land, having a site area of 5,611 sq.m., for a land use term up to 5th November, 2047 for industrial and ancillary uses.
- (9) The factory/office complex of the property is subject to a Realty Title Certificate – Yue Fang Di Zheng Zi No. 0919898 (房地產權證 – 粵房地證字第0919898號) dated 12th December, 1997 issued by the People’s Government of Dongguan City (東莞市人民政府), which is under the name of HC.
- (10) The five dormitory buildings of the property are respectively subject to five Realty Title Certificates – Yue Fang Di Zheng Zi Nos. 1287807, 1287808, 1444382, 1444383 and 1444384 (房地產權證 – 粵房地證字第1287807, 1287808, 1444382, 1444383 及 1444384號) dated 9th January, 1998 and 13th October, 1998 issued by the People’s Government of Dongguan City (東莞市人民政府), which are under the name of HC.
- (11) The current status of the property regarding major approvals, consents or licences required in the PRC as follows:–

Document / Approval

State-owned Land use Rights Grant Contract	Yes (Portion)
State-owned Land Use Rights Certificate	Yes (Portion)
Realty Title Certificate	Yes (Portion)

- (12) The breakdown of the valuation into land, existing buildings and buildings in construction are as follows:–
- | | | |
|------|---|----------------|
| (i) | Valuation of land with State-owned Land Use Rights Certificate together with buildings and structures erected or being erected on it | HK\$68,030,000 |
| (ii) | Valuation of land without State-owned Land Use Rights Certificate together with buildings and structures erected or being erected on it | HK\$55,920,000 |
- (13) The breakdown of the valuation is further analysed as follows:–
- | | | |
|------|-----------------------------|----------------|
| (i) | Land and existing buildings | HK\$94,950,000 |
| (ii) | Buildings in construction | HK\$29,000,000 |
- (14) The opinion of the Group’s legal adviser on PRC laws states that:–
- (i) HC has obtained State-owned Land Use Rights Certificate and Realty Title Certificates for various plots of land and buildings and are well protected by law for its right to occupy, use and dispose of the respective portion of the property.
 - (ii) The 3 Compensatory Land Use Rights Transfer Contracts made between Sheng Wei and HC cannot fully protect HC’s legal interest in the land use rights as according to PRC laws one has to obtain the State-owned Land Use Rights Certificate before one could transfer the land use rights and upon the transfer, a new State-owned Land Use Rights Certificate will be issued to the new transferee. Sheng Wei has not yet obtained proper State-owned Land Use Rights Certificate.
 - (iii) The deficiency in title as mentioned in (ii) above could be remedied by HC by paying necessary land premium and fees to the Land Bureau in order to obtain a proper State-owned Land Use Rights Certificate. As advised by the Group, the estimated costs for remedying the title deficiency is about RMB9,320,000.
- (15) In the course of our valuation, we have relied on the following assumptions:–
- (i) HC is in possession of a proper legal title to the land and the buildings of the property and is entitled to transfer the property for the residual term of its land use rights at no extra land premium or other onerous payment payable to the government.
 - (ii) All land premium and other costs of ancillary utility services have been settled in full.
 - (iii) The design and constructions of the property is in compliance with the local planning regulations and have been approved by the relevant authorities.

1. LETTER FROM ERNST & YOUNG

26th April, 2002

The directors
Hung Fung Group Holdings Limited
Room 3A03-06, 3/F
New Mandarin Plaza
14 Science Museum Road
Tsimshatsui East, Kowloon
Hong Kong

The directors
Somerley Limited
Suite 3108, One Exchange Square
8 Connaught Place
Central
Hong Kong

Dear Sirs,

Re: Adequacy of working capital

Hung Fung Group Holdings Limited (the “Company”) and its subsidiaries (collectively referred to as the “Group”)

For the purpose of the statement made by the directors of the Company regarding the sufficiency of working capital for the present requirements of the Group, as set out on pages 116 to 120 of the circular of the Company dated 26th April, 2002 issued in connection with the proposed debt restructuring involving issue of new shares and convertible bonds, bank compromise, creditor settlements, open offer of not less than 3,725,905,140 new shares, grant of waiver, increase in authorised share capital and general mandate to issue shares (the “Circular”), we have reviewed the cash flow projections of the Group (the “Cash Flow Projections”) for the period from 1st March, 2002 to 30th April, 2003 (the “Projection Period”) for which the directors of the Company are solely responsible.

In respect of the Cash Flow Projections, we would like to draw your attention to the fact that because of the significance of each of (1) the fundamental uncertainty relating to the going concern basis; and (2) the possible effects of the limitations in evidence available to us as set out in the basis of opinion section of our audit report dated 26th July, 2001 on pages 84 to 87 of Appendix I of the Circular (the “2001 Basis of Opinion”), we are unable to form an opinion as to whether the financial statements of the Group for the year ended 31st March, 2001 (the “Financial Statements”) give a true and fair view of the state of affairs of the Group as at that date and of the loss and cash flows of the Group for the year then ended and as to whether the Financial Statements had been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

In respect alone of the limitations on our work as set out in the 2001 Basis of Opinion section:

- (i) we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and
- (ii) proper books of accounts have not been kept.

In addition, because of the significance of each of (1) the fundamental uncertainty relating to the going concern basis; and (2) the possible effects of the limitations in evidence available to us as set out in the review work performed section of our report dated 21st December, 2001 and reproduced on pages 74 to 77 of Appendix I of the Circular, we are unable to reach a review conclusion as to whether material modifications should have been made to the interim financial report of the Group for the six months ended 30th September, 2001.

Accordingly, any adjustments found to be necessary to the net liabilities of the Group as at 31st March, 2001 and 30th September, 2001 may have a consequential effect on the Cash Flow Projections. Subject to any such adjustments and the impacts of the matters described above and subject to the successful completion of the Restructuring Proposal (as defined in the Circular) and after taking into account the undertaking given by Get Start Holdings Limited, the holding company of Vision Century Group Limited (the Investor as defined in the Circular), to provide continuing financial support to the Group so as to enable the Group to continue its day-to-day operation as a viable concern during the Projection Period notwithstanding any present or future financial difficulties experienced by the Group, the success in rescheduling and extending the repayment period of the borrowings owed to the Group’s bankers in the People’s Republic of China, the satisfaction of the conditions as set out on pages 24 to 26 of the Circular in respect of the arrangement for settlement of certain creditors by way of cash and issuance of Company’s shares and convertible note, the intention of the directors of the Company concerning the disposition of the Company’s entire interest in Hung Cheong Toys International Limited (“HCT”), a wholly-owned subsidiary of the Company, and also the withdrawal of all the Company’s financial support to HCT thereof, so far as the accounting policies and calculation are concerned, we are satisfied that the Cash Flow Projections have

been properly compiled on the basis of principal assumptions made by the directors of the Company as set out on pages 118 to 119 in the section headed “Working Capital Statement” of Appendix I of the Circular and we are satisfied that the statement in the Circular as to the adequacy of working capital of the Group, which includes the Company and its subsidiaries other than HCT, has been made by the directors with due care and consideration.

We have discussed the unaudited management accounts for the eleven months ended 28th February, 2002 and the underlying assumption of the Cash Flow Projections with the directors for the purpose of the Cash Flow Projections. However, since the Cash Flow Projections relate to future events and are based on assumptions which may not remain valid for the whole of the relevant period, we are unable to express an opinion as to how closely the actual cash flows achieved will correspond to the Cash Flow Projections.

Yours faithfully,
Ernst & Young
Certified Public Accountants

Hong Kong

2. LETTER FROM SOMERLEY

Somerley Limited
Suite 3108
One Exchange Square
8 Connaught Place
Central
Hong Kong

26th April, 2002

The Directors
Hung Fung Group Holdings Limited
Room 3A03-06, 3/F
New Mandarin Plaza
14 Science Museum Road
Tsimshatsui East
Hong Kong

Dear Sirs,

PROPOSED RESTRUCTURING

We refer to the statement made by the directors (the “Directors”) of Hung Fung Group Holdings Limited (the “Company”, together with its subsidiaries, the “Group”) as set out on pages 116 to 120 of the circular of the Company dated 26th April, 2002 (the “Document”) under the paragraph headed “Working Capital Statement” in Appendix I of the Document.

We have discussed with the Directors on, and been satisfied with, the bases and assumptions based on which the Group’s cash flow projections (the “Projections”) for the period from 1st March, 2002 to 30th April, 2003 have been prepared. We have also considered the letter dated 26th April, 2002 to the Directors and ourselves from Ernst & Young, the auditors of the Company, in relation to their review of the compilation of the Projections. Shareholders’ attention is drawn to the fact that the assumptions on which the Projections are based could be materially affected by changes in economic and market conditions and other circumstances. Actual cash flows are likely to be different from the Projections since actual events frequently do not occur as expected and the variations may be material. Accordingly, we express no opinion on how closely the cash flows eventually achieve will correspond with

the Projections. On the bases of the Projections made by the Directors which have been reviewed by Ernst & Young, we are of the opinion that the statement in the Document as to the sufficiency of working capital for the Group, for which the Directors are solely responsible, has been made with due care and consideration.

Yours faithfully,
For and on behalf of
Somerley Limited
Mei H. Leung
Managing Director

1. RESPONSIBILITY STATEMENT

This circular includes particulars given in compliance with the Code and the Listing Rules for the purpose of giving information with regard to the Company. The Directors jointly and severally accept full responsibility for the accuracy of the information contained in this circular (except for information relating to the Investor), and confirm, having made all reasonable inquiries, that to the best of their knowledge and belief, opinions expressed in this circular (except for information relating to the Investor) have been arrived at after due and careful consideration and there are no other facts not contained in this circular, the omission of which would make any statement in this circular misleading.

The information in this circular relating to the Investor has been supplied by the directors of the Investor. The issue of this circular has been approved by the directors of the Investor who jointly and severally accept full responsibility for the accuracy of information contained in this circular, insofar as it relates to the Investor, and confirm, having made all reasonable inquiries, that to the best of their knowledge and belief, opinions expressed in this circular relating to the Investor have been arrived at after due and careful consideration and there are no other facts not contained in this circular, the omission of which would make any statement in this circular misleading.

2. DISCLOSURE OF INTERESTS**(a) Interests in the Company***(i) Directors' interests in Shares*

As at the Latest Practicable Date, none of the Directors had interests in any equity or debt securities of the Company or any associated corporations (within the meaning of the SDI Ordinance) which were required to be notified to the Company and the Stock Exchange pursuant to Section 28 of the SDI Ordinance (including interests which he was taken or deemed to have under Section 31 of, or Part 1 of the Schedule to, the SDI Ordinance) or which were required, pursuant to Section 29 of the SDI Ordinance, to be entered in the register referred to therein or which were required pursuant to the Model Code for Securities Transactions by Directors of Listed Companies to be notified to the Company and the Stock Exchange, so far as the Directors are aware.

(ii) Directors' rights to acquire Shares

The Company had adopted the Share Option Scheme under which the Directors may, on or before 16th February, 2008, invite any employee or executive director of the Group to take up options to subscribe for Shares.

As at the Latest Practicable Date, none of the Directors held options granted to them under the Share Option Scheme entitling them to subscribe for the Shares:

At no time during the period from 31st March, 2001 to the Latest Practicable Date was the Company, or any of its subsidiaries, party to any arrangements to enable the Directors and their associates to acquire benefits by means of the acquisition of Shares in or debentures of the Company or any other body corporate.

(iii) Substantial Shareholders

As at the Latest Practicable Date, so far as is known to, or can be ascertained after reasonable enquiry by the Directors, the substantial shareholder holding interest of 10% or more of the nominal value of any class of share capital was recorded as follows:-

Name	Number of Shares held	Percentage of issued Shares
Baxter Resources S.A.	1,595,140,000	64%

(iv) The Investor and its directors and parties acting in concert with them

As at the Latest Practicable Date, none of the Investor, nor the directors of the Investor, nor any party acting in concert with them had any interest in Shares.

(v) Others

As at the Latest Practicable Date,

- (aa) none of the subsidiaries or associates of the Company, nor any pension funds of the Company or of any of its subsidiaries, nor Somerley, Kingston, Equitas nor Ernst & Young had any interest in Shares;
- (bb) no person who had any arrangement of the kind referred to in Note 8 to Rule 22 of the Code with the Company, the Investor or with any party acting in concert with any of them had any interest in Shares; and
- (cc) no shareholding in the Company was managed on a discretionary basis by fund managers, connected with the Company as at the Latest Practicable Date.

- (dd) There is no arrangement or indemnity of the kind described in note 8 to Rule 22 of the Code with the Company or with any person who is considered an associate of the Company as defined under the Code.

(b) Dealings in Shares

(i) Directors

None of the Directors had dealt for value in any Shares during the period commenced on 22nd August, 2001 (being the date six months prior to the date of the Announcement) and ended on the Latest Practicable Date (the “Relevant Period”).

(ii) The Investor and its directors and parties acting in concert with them

During the Relevant Period, none of the Investor, nor the directors of the Investor, nor any persons acting in concert with them (including Somerley and Kingston) had dealt for value in any Shares.

(iii) Others

During the Relevant Period,

- (aa) none of the subsidiaries or associates of the Company, nor any pension funds of the Company or any of its subsidiaries, nor Somerley, Equitas or Ernst & Young had dealt for value in Shares;
- (bb) persons who had any arrangement of the kind referred to in Note 8 to Rule 22 of the Code with the Company or the Investor or with any persons acting in concert with any of them had dealt for value in Shares.

(c) Interests and dealings in Investor

None of the Directors nor the Company had any interest in the securities issued by the Investor nor had any of them dealt for value in any such securities during the Relevant Period.

3. MARKET PRICES

Trading in the Shares has been suspended since 22nd January, 2001. Therefore, trading in the Shares was suspended on the last day before the Announcement and on the Latest Practicable Date. The table below shows the closing prices of the Shares on the Stock Exchange at the end of each of the eight calendar months immediately preceding the suspension of trading of Shares on 22nd January, 2001.

	<i>HK\$</i>
<i>2001</i>	
19th January	0.013
<i>2000</i>	
29th December	0.018
30th November	0.018
27th October	0.022
29th September	0.040
31st August	0.047
31st July	0.049
30th June	0.059

The lowest and highest closing market prices of the Shares recorded on the Stock Exchange during the eight calendar months immediately preceding the suspensions of trading of Shares on 22nd January, 2001 were HK\$0.013 on 18th and 19th January, 2001 and HK\$0.06 on 4th, 6th and 17th July, 2000, respectively.

4. MATERIAL CONTRACTS

The following contracts have been entered into by the Company and its subsidiaries not being contracts entered into in the ordinary course of business carried on by the Group after the date two years immediately preceding the date of the Announcement and are or may be material:

- (i) A shareholders agreement dated 20th September, 2000 between On Glory Holdings Limited, Hung Cheong Technology Limited, Robert Technology Limited and Toysmatch.com Limited in respect of the establishment of a joint venture company, Toysmatch.com Limited, to operate a business to business electronic commerce portal;
- (ii) A subscription agreement dated 30th October, 2000 between the Company and Join Asia Enterprises Limited in respect of the subscription by Join Asia Enterprises Limited of a convertible note issued by the Company at a face value of HK\$3,000,000.
- (iii) A sale and purchase agreement dated 3rd October, 2000 as amended by a supplemental agreement dated 24th October, 2000 between Gainful International Investments Limited, a member of the Group, and Pearlhost Limited in respect of a proposed sale of properties located in Hong Kong known at House 3 of Greenery Villas, 2-10 Ma Ying Path, Kau To Shan, Shatin, which transaction was cancelled on 6th March, 2001 pursuant to a cancellation agreement between the same parties;

- (iv) the Subscription Agreement;
- (v) the Compromise Agreement;
- (vi) the Underwriting Agreement;
- (vii) CN Settlement Agreement; and
- (viii) Share Settlement Agreements.

Save as aforesaid, no material contracts (not being contracts entered into in the ordinary course of business carried on by the Group) have been entered into by any member of the Group within the two years preceding the date of this circular.

5. LITIGATION

Save as disclosed below, neither the Company nor any other member of the Group is engaged in any litigation or arbitration of material importance and no litigation or claim of material importance is known to the Directors to be pending or threatened against any member of the Group.

Hong Kong

1. A claim (HCA 9585 of 2000) for HK\$4,413,480.63 plus damages and costs in respect of default under an overdraft facility and a trade facility was brought by DBS Kwong On Bank Limited, a party to the Compromise Agreement, against (1) Hung Cheong Toys International Limited; and (2) Hung Fung Group Holdings Limited. DBS Kwong On Bank Limited has since joined the Bank Group and this claim will be settled as part of the Bank Compromise .
2. A claim (DCCJ 17900 of 2000) for outstanding trade debts was brought by Winco Paper Products Company Limited against Hung Cheong Toys International Limited. Claiming HK\$370,249.19 together with interests, costs and/or other relief. The statement of claim was filed on 21st December, 2000 and a defence was filed on 19th January, 2001. No further action has been taken by the parties.
3. A claim (DCCJ 3872 of 2001) for outstanding trade debts was brought by Ip Hing Chemicals Limited against Hung Cheong Toys International Limited. The amount claimed was HK\$479,681.06, together with interests, costs and/or other relief. The statement of claim was filed on 23rd February, 2001 and an acknowledgement of service was filed on 8th March, 2001. No further action has been taken by the parties.
4. A claim (HCA 9532 of 2000) for HK\$2,994,076.30 being provision of goods plus interests was brought by Wesco China Limited against (1) Hung Cheong Toys International Limited and (2) Hung Fung Group Holdings Limited and an amended judgement was entered in favour of the plaintiff on 29th January, 2001. By a consent order dated 11th April, 2001, there was a stay of execution on judgement on the condition that the Group do pay to the plaintiff the claim together with the interest by 8 instalments.
5. A claim (HCA 561 of 2001) for HK\$3,195,529.06 being provision of printing services to Hung Cheong Toys International Limited plus interest was brought by

Midas Printing Limited against Hung Fung Group Holdings Limited. By a consent order on 1st March 2001, the claim will be settled by monthly instalments. Due to the default in payment, there was a winding up petition (HCCW 67 of 2002) by Midas Printing Limited against the Company. On 22nd March 2002, the Group entered a deed of settlement with the Plaintiff and the petition has been withdrawn on 16th April, 2002.

6. The winding-up petitions (HCCW501 of 2001 and HCCW 438 of 2001) filed by Sin Hua Bank Limited, Hong Kong Branch against the Company and Hung Cheong Toys International Limited respectively, were withdrawn by way of court order on 29th August, 2001 and 5th September, 2001 respectively.
7. A claim (HCA1663 of 2001) for the total sum of HK\$2,348,933.95 being the lease payment plus interest was brought by Wing Hang Finance Company Limited against (1) Hung Cheong Toys International Limited and (2) Hung Fung Group Holdings Limited on 12th April 2001. By way of undertaking and guarantee/indemnity signed between the parties, the claim has been adjourned sine die with no order as to costs at the hearing on 15th October, 2001.

PRC

8. A claim (2001) 東經初字第5437號 for the outstanding trade debts was bought by 廣東省大亞灣 (惠光) 石化貿易公司 against (1) Hung Cheong Industrial Company and (2) HCTF and a judgment was entered in favour of the plaintiff on the 10th day of December, 2001 for an amount in the total sum of RMB\$311,287.65 plus interest and costs in the sum of RMB\$7,646.00.
9. Two claims were filed by Pacific Finance (Hong Kong) Limited against (1) Hung Cheong Toys International Limited; (2) Hung Cheong Industrial Company; and (3) HCTF in the PRC in respect of a dispute regarding hire purchase contracts for certain equipment. The parties have entered into a settlement arrangement on 21st March, 2001 regarding those claims under which the Group is obliged to pay rental and interest by instalment, the last of which will be paid on 15th August, 2002.

6. EXPERTS

- (a) Equitas has no shareholding in any member of the Group nor any right to subscribe for or to nominate persons to subscribe for securities in any member of the Group.
- (b) Somerley, Equitas, Ernst & Young (certified public accountants) and Knight Frank (professional property valuers) have given and have not withdrawn their written consents to the issue of this circular with the inclusion of their respective letters and references to their names, as the case may be, in the form and context in which they respectively appear.
- (c) Equitas does not have any direct or indirect interest in any assets which have been since 31st March, 2001, the date to which the latest published audited accounts of the Group were made up, acquired or disposed of by, or leased to, or which are proposed to be acquired or disposed of by, or leased to, the Company or any of its subsidiaries.

7. ARRANGEMENTS AFFECTING DIRECTORS

- (a) None of the Directors has any service contract with the Company or any of its subsidiaries or associated companies in force which has more than 12 months to run, or which has been entered into or amended within six months before the date of the Announcement.

- (b) No benefit is being given to any Director as compensation for loss of office or otherwise in connection with the Restructuring Proposal.
- (c) Save for the Compromise Agreement, the Underwriting Agreement, and the Subscription Agreement, there is no agreement, arrangement or understanding (including any compensation arrangement) between the Investor or any person acting in concert with it and any Director, recent Director, shareholder or recent shareholder of the Company or any other person having any connection with or which is conditional on or dependent upon the outcome of the Restructuring Proposal or otherwise connected therewith.
- (d) No agreement, arrangement or understanding exists whereby any Shares to be acquired in pursuance of the Restructuring Proposal will be transferred to any other persons. The Investor presently does not intend to transfer the Shares to be acquired pursuant to the Restructuring Proposal to any other persons.
- (e) Save for the Compromise Agreement, there is no material contract entered into by the Investor in which any director of the Company or its subsidiaries has a material personal interest.

8. MISCELLANEOUS

- (a) The secretary of the Company is Mr. Yu Wai Man. *AHKSA*.
- (b) The Hong Kong branch registrars of the Company are Tengis Limited at 4th Floor, Hutchison House, 10 Harcourt Road, Central, Hong Kong.
- (c) The registered office of the Company is at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda and the principal place of business of the Company is at Rm 3A 03-06, 3/F, New Mandarin Plaza, 14 Science Museum Road, Tsim Sha Tsui East, Kowloon,
- (d) The registered office of Vision Century Group Limited is P.O. Box 957, Offshore Incorporations Centre, Road Town, Tortola, British Virgin Islands.

The names and addresses of the principal parties acting in concert with the Investor are as follows:

Name	Address
Ms. Lilian Ng	1 Maritime Square, #12-21 World Trade Centre, Singapore 099253
Ms. Sio Ion Kuan	Room 331, West Tower Shun Tak Centre 168-200 Connaught Road, Central Hong Kong
Mr. Kan Ka Chong, Frederick	Suite 3104-7 31/F Central Plaza 18 Harbour Road Hong Kong
Huang Group	Commence Chambers, Road Town Tortola, British Virgin Islands

- (e) The registered office of Somerley is situated at Room 3108, One Exchange Square, 8 Connaught Place, Central, Hong Kong. The registered office of Equitas is situated at 5/F Winning Centre, 46-48 Wyndham Street, Central, Hong Kong.
- (f) No person has irrevocably committed himself to vote for or against the resolutions in relation to the Restructuring Proposal.
- (g) The English text of this circular and form of proxy shall prevail over the Chinese text in the case of any inconsistency.

9. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents are available for inspection during normal business hours at the principal place of business of the Company at Room 3A03-06, 3/F New Mandarin Plaza, 14 Science Museum Road, Tsimshatsui East, Hong Kong, up to and including 12th May, 2002:

- (a) the memorandum of association and bye-laws of the Company and the Investor;
- (b) the annual reports of the Company for the three financial years ended 31st March, 2001;
- (c) the interim report of the Company for the six months ended 30th September, 2001;
- (d) the material contracts referred to in the section headed “Material contracts” in this Appendix;
- (e) the letters from Equitas and the Independent Board Committee, the texts of which are set out on pages 40 to 61 and 39 respectively of this circular;
- (f) the valuation report and valuation certificates prepared by Knight Frank relating to the property interests of the Group, the texts of which are set out in Appendix II to this circular;
- (g) the letter from Get Start Holdings Limited, the holding company of the Investor to provide continuing financial support to the Group;
- (h) the letters from Ernst & Young and Somerley regarding the working capital statement of the Group as set out in Appendix III to this circular; and
- (i) the written consents referred to in the section headed “Experts” in this Appendix.

NOTICE OF SPECIAL GENERAL MEETING



Hung Fung Group Holdings limited

(incorporated in Bermuda with limited liability)

NOTICE IS HEREBY GIVEN that a special general meeting of Hung Fung Group Holdings Limited (the “Company”) will be held at 9:00 a.m. on Monday, 13th May, 2002 at Conference Room, 30/F, Panda Hotel, 3 Tsuen Wah Street, Tsuen Wan, Hong Kong for the purpose of considering and, if thought fit, passing, with or without modifications, the following resolutions:

ORDINARY RESOLUTIONS

1. “THAT

- (a) (i) the conditional agreement dated 1st February, 2002 between Vision Century Group Limited (the “Investor”) and the Company (the “Subscription Agreement”); and (ii) the conditional agreement dated 1st February, 2002 between the Company, the banks and financial institutions whose names are set out in Schedule 2 thereto (the “Banks”), The Hongkong and Shanghai Banking Corporation Limited as co-ordinating bank and also as agent, the wholly-owned subsidiaries and related companies of the Company set out in Schedule 1 thereto, the Investor, Mr. Huang Cheow Leng and Huang Worldwide Holding Limited (the “Compromise Agreement”) copies of which have been submitted to the meeting marked “A” and “B” respectively and signed for the purpose of identification by the Chairman thereof, pursuant to which, inter alia (i) the Investor has agreed to subscribe for 3,000 million shares of HK\$0.01 each in the Company (“Subscription Shares”) at a subscription price of HK\$0.01 per Subscription Share; (ii) the Company has agreed to pay to the Banks an aggregate of approximately HK\$20 million in cash and to issue the Convertible Bonds (as defined in the Compromise Agreement) to the Banks; and (iii) the creation and issue of the Convertible Bonds be and are hereby ratified and approved; and
- (b) conditional on:
 - (i) the conditions precedent under Clause 8 of the Compromise Agreement all having been satisfied;
 - (ii) the obligations of the Investor under the Underwriting Agreement (defined below) entered into between the Company and the Investor becoming unconditional and not having been terminated in accordance with the terms of that agreement or otherwise; and
 - (iii) the registration and/or filing, as the case may be, of the Company’s prospectus and the application form in relation to the Open Offer with the Registrar of Companies in Hong Kong and the Registrar of Companies in Bermuda respectively,

NOTICE OF SPECIAL GENERAL MEETING

the issue by the Company by way of open offer of not less than 3,725,905,140 new Shares (“Offer Shares”) at a price of HK\$0.01 per Offer Share upon the terms and subject to the conditions set out in the circular dated 26th April, 2002 (a copy of which has been submitted to the meeting marked “C” and signed for identification by the Chairman) despatched to the shareholders of the Company or as those terms and conditions may be amended, varied or modified (which the directors of the Company are hereby authorised to do in their absolute discretion) to the persons whose names appear on the Register of Members of the Company on 13th May, 2002 (“Open Offer”) with assured allotments of three Offer Shares for every two Shares held by shareholders on the Record Date and the related underwriting agreement (the “Underwriting Agreement”) entered into by, the Company and the Investor dated 1st February, 2002, a copy of which has been produced to the meeting marked “D” and signed by the Chairman of the meeting by way of identification be and are hereby approved; and

- (c) the directors of the Company be and are hereby authorised to do all acts, deeds and things that they may, in their absolute discretion, consider necessary or desirable to effect the transactions contemplated in the Compromise Agreement, the Subscription Agreement, the Open Offer and the related Underwriting Agreement.”
- 2. “**THAT** (i) any obligation of the Investor and parties acting in concert with it to make a general offer for all the Shares in the capital of, and options of, the Company not already owned or controlled by them as a result of the issue of the Subscription Shares (as defined in Resolution No. 1(a) set out in the notice of Special General Meeting of the Company dated 26th April, 2002 (“Notice”)) and Rule 26 of the Hong Kong Code on Takeovers and Mergers, be and is hereby waived; and (ii) the acquisition by the Investor and parties acting in concert of additional voting rights of the Company following completion of the Compromise Agreement, the Subscription Agreement and the Open Offer, be and is hereby authorised.”
- 3. “**THAT** the authorised share capital of the Company be and is hereby increased from HK\$100 million to HK\$300 million by the creation of 20 billion shares of HK\$0.01 each in the Company (“Shares”).”
- 4. “**THAT** the settlement agreement dated 27th March 2002 (“CN Settlement Agreement”) entered into between Dongguan Shi Huangjiang Zhen Hung Cheong Toys Factory (“HCTF”) and Dongguan Shi Huangjiang Zhen Importing Company, a copy of which has been produced to the meeting marked “E” and signed by the Chairman of the meeting for identification and the transactions contemplated thereunder be and are hereby approved, confirmed and ratified and the directors

NOTICE OF SPECIAL GENERAL MEETING

of the Company be and are hereby authorised to do all acts, deeds and things that they may, in their absolute discretion, consider necessary or desirable to effect the transactions contemplated under the CN Settlement Agreement, including without limitation, the proposed issue of a convertible note of the Company in the principal amount of HK\$16,000,000 under the terms of the CN Settlement Agreement (“New Convertible Note”) and the issue of shares of HK\$0.01 each in the capital of the Company (“Conversion Shares (HZIC)”) upon any conversion of the New Convertible Note.”

5. “**THAT** the 30 settlement agreements dated 27th March, 2002 (“Share Settlement Agreements”) entered into between HCTF and certain creditors of the Company and its subsidiaries, a copy of each of which has been produced to the meeting marked “F” and signed by the Chairman of the meeting for identification and the transactions contemplated thereunder, be and are hereby approved, confirmed and ratified and the directors of the Company be and are hereby authorised to do all acts, deeds and things that they may, in their absolute discretion, consider necessary or desirable to effect the transactions contemplated under the Share Settlement Agreements, including without limitation the proposed issue of a total of 1,070,280,000 shares of HK\$0.01 each in the capital of the Company (“New Shares”) at prices ranging from HK\$0.01 to HK\$0.015 per share under the terms of the Share Settlement Agreements.”
6. “**THAT** the exercise by the directors of the Company during the Relevant Period (as defined below) of all the powers of the Company to issue, allot and dispose of additional Shares of the Company be and is hereby generally and unconditionally approved, provided that, otherwise than pursuant to a rights issue where shares are offered to shareholders of the Company on a fixed record date in proportion to their then holdings of shares (subject to such exclusions or other arrangements as the directors may deem necessary or expedient in relation to fractional entitlements to having regard to any restrictions or obligations under the laws of, or the requirements of any recognised regulatory body or any stock exchange in any territory outside Hong Kong), the additional shares issued, allotted or disposed of (excluding shares agreed conditionally or unconditionally to be issued allotted or disposed of whether pursuant to an option or otherwise) shall not in total exceed 20% of the nominal amount of the share capital of the Company in issue immediately following (i) the issue and allotment of the Subscription Shares and the Offer Shares (as referred to in Resolution No. 1 set out in the Notice in the event that it is passed by the Shareholders); (ii) the issue and allotment of the Conversion Shares (HZIC) (as referred to in Resolution No. 4 set out in the Notice; and (iii) the issue and allotment of the New Shares (or referred to the Resolution No. 5 set out in the Notice, subject to the passing of each relevant

NOTICE OF SPECIAL GENERAL MEETING

aforementioned resolution at the Special General Meeting or of the nominal amount of the share capital of the Company in issue at the date of this Resolution in the event that Resolution No. 1, No. 4 and No. 5 set out in Notice are not so passed.

For the purpose of this Resolution “Relevant Period” means the period from the passing of this Resolution until whichever is the earliest of:

- (a) the conclusion of the next Annual General Meeting of the Company;
- (b) the revocation or variation of the authority given under this Resolution by ordinary resolution of the shareholders of the Company in general meeting;
or
- (c) the expiration of the period within which the next annual general meeting of the Company is required by the bye-laws of the Company or the Companies Act 1981 of Bermuda or any other applicable laws to be held.”

By Order of the Board
Yu Wai Man
Company Secretary

Hong Kong, 26th April, 2002

Notes :

1. Any member entitled to attend and vote at the special general meeting convened by the above notice is entitled to appoint another person as his proxy to attend and vote instead of him. A proxy need not be a member of the Company.
2. In order to be valid, the form of proxy must be deposited at the Company’s branch registrars in Hong Kong, Tengis Limited at 4th Floor, Hutchison House, 10 Harcourt Road, Central, Hong Kong together with the power of attorney or other authority, (if any), under which it is signed, or a notarially certified copy of such power of attorney or authority, not less than 48 hours before the time appointed for holding the special general meeting.
3. Where there are joint registered holders of any share, any one of the such persons may vote at the special general meeting either personally or by proxy, in respect of such shares as if he were solely entitled thereto, but if more than one of such joint holders be present at the special general meeting personally or by proxy, that one of the said persons so present whose name stands first on the register of members of the Company in respect of such share shall alone be entitled to vote in respect thereof.
4. A form of proxy for use in connection with the special general meeting is enclosed.
5. Resolution No. 2 in this notice will be put to a poll.
6. Baxter Resources S.A., and its associates and parties acting in concert with it are required to abstain from voting at the above meeting in respect of Resolution No. 1 and No. 2.



HUNG FUNG GROUP HOLDINGS LIMITED

FORM OF PROXY FOR USE BY SHAREHOLDERS AT THE SPECIAL GENERAL MEETING CONVENED TO BE HELD ON MONDAY, 13TH MAY, 2002 AT 9:00 A.M.

I/We, (*note 1*)
of
being the registered holder(s) of (*note 2*) shares of HK\$0.01 each in the capital of
Hung Fung Group Holdings Limited (the "Company"), hereby appoint (*note 3*) the Chairman of the Meeting
or
of
as my/our proxy to attend and act for me/us at the Special General Meeting (the "Meeting") of the Company to be held
on Monday, 13th May, 2002 at Conference Room, 30/F, Panda Hotel, 3 Tsuen Wah Street, Tsuen Wan, Hong Kong
and at any adjournment thereof for the purpose of considering and, if thought fit, passing the resolutions set out in the
Notice convening the Meeting and at the Meeting to vote on my/our behalf as indicated below.

Please indicate with a "X" in the boxes provided how you wish the proxy to vote on your behalf (*note 4*).

RESOLUTIONS	FOR	AGAINST
1. Ordinary Resolution		
2. Ordinary Resolution		
3. Ordinary Resolution		
4. Ordinary Resolution		
5. Ordinary Resolution		
6. Ordinary Resolution		

Dated this _____ day of _____ 2002. Shareholder's Signature _____ (*note 5*)

Notes:

1. Full name(s) and address(es) to be inserted in BLOCK CAPITALS.
2. Please insert the number of shares registered in your name(s) and to which this form of proxy relates; if no number is inserted, this form of proxy will be deemed to relate to all the shares in the capital of the Company registered in your name(s).
3. If any proxy other than the person named as Chairman of the Meeting is desired, the appointor must delete the words "the Chairman of the Meeting or" and insert the name and address of the proxy desired in the space provided. A proxy need not be a member of the Company, but must attend the Meeting in person to represent you. ANY ALTERATION MADE TO THIS FORM OF PROXY MUST BE INITIALED BY THE SHAREHOLDER WHO SIGNS IT.
4. If this form returned is duly signed but without a specific indication as to how your proxy should vote, the proxy will vote or abstain at his discretion. The proxy will also be entitled to vote at his discretion on any resolution properly put to the Meeting other than those referred to in the notice convening the Meeting.
5. This form of proxy must be signed by the appointor or his attorney duly authorised in writing, or if such appointor is a corporation, either under its common seal or under the hand of an officer or attorney so authorised.
6. In order to be valid, this form of proxy together with a power of attorney, if any, under which it is signed or a notarially certified copy thereof must be deposited with the Company's branch share registrars in Hong Kong, Tengis Limited at 4th Floor, Hutchison House, 10 Harcourt Road, Central, Hong Kong not less than 48 hours before the time for holding the Meeting or any adjourned Meeting.
7. Completion and return of this form of proxy will not preclude the appointor from attending and voting at the Meeting. In that event this form of proxy will be deemed to have been revoked.
8. In the case of joint holders of a share, any one of such holders may vote at the Meeting either in person or by proxy in respect of such share, but if one of such joint holders is present at the Meeting personally or by proxy, the vote of the senior who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the other joint holder(s) and for this purpose, seniority will be determined by the order in which the names stand in the register of members in respect of the joint holders.