漢寶集團(龍蝦大王)有限公司

# Hon Po Group (Lobster King) Limited

*(incorporated in the Cayman Islands with limited liability)*

## ANNUAL RESULTS FOR THE YEAR ENDED 31 DECEMBER 2002

The Board of Directors of Hon Po Group (Lobster King) Limited (the "Company") herein announce the audited consolidated results of the Company and its subsidiaries (the "Group") for the year ended 31 December 2002 together with comparative figures for the previous year as follows:

| | Notes | Consolidated 2002 HK$'000 | Consolidated 2001 HK$'000 | Pro Forma Combined* 2001 HK$'000 |
|---|---|---|---|---|
| TURNOVER | 3 | **730,466** | 498,758 | 798,644 |
| Other revenue and gain | 3 | **8,982** | 3,393 | 6,103 |
| Cost of inventories consumed | | **(232,744)** | (155,633) | (242,996) |
| Staff costs *(remark 1)* | | **(281,039)** | (168,413) | (282,908) |
| Operating lease rentals | | **(77,372)** | (63,920) | (79,614) |
| Depreciation | | **(18,793)** | (16,267) | (21,570) |
| Fuel costs and utility expenses | | **(75,549)** | (45,933) | (78,570) |
| Other operating expenses *(remark 2)* | | **(126,477)** | (43,120) | (69,451) |
| PROFIT/(LOSS) FROM OPERATING ACTIVITIES | 5 | **(72,526)** | 8,865 | 29,638 |
| Finance costs | | **(4,468)** | (171) | (3,365) |
| PROFIT/(LOSS) BEFORE TAX | | **(76,994)** | 8,694 | 26,273 |
| Tax | 6 | **(86)** | (2,540) | (4,560) |
| PROFIT/(LOSS) BEFORE MINORITY INTERESTS *(remark 3)* | | **(77,080)** | 6,154 | 21,713 |
| Minority interests *(remark 4)* | | **36** | 448 | 440 |
| NET PROFIT/(LOSS) FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS *(remark 5)* | | **(77,044)** | 6,602 | 22,153 |
| SPECIAL DIVIDENDS *(remark 6)* | 7 | **100,114** | – | – |
| EARNINGS/(LOSS) PER SHARE – Basic | 8 | **(HK12.59 cents)** | HK1.45 cents | HK4.87 cents |

* To facilitate comparison and for information purposes only, please refer to note 1 for the basis of presentation of the pro forma combined results for the year ended 31 December 2001

** To facilitate better comparison and consistency, the comparative figures used in the sections of "Business Review" and "Financial Review", are extracted from the pro forma combined accounts of the Group for the year ended 31 December 2001 as stated in the 2001 Annual Report.

*Remark 1:* The staff cost has been increased by approximately HK$9.7 million when compared to the announcement of the Company dated 30 April 2003 because of the subsequent provision made for other staff benefits resulting in respect of certain loss-making restaurants. These restaurants were permanently closed during 2003.

*Remark 2:* The other operating expenses have been increased by approximately HK$23.7 million when compared to the announcement of the Company dated 30 April 2003 because of the subsequent provision of approximately HK$22.6 million made for the impairment of fixed assets and other non-current assets in respect of certain loss-making restaurants. These restaurants were permanently closed during 2003. In addition, provision for the impairment of leasehold land and building of HK$1 million has been made in respect of a property of the Group. This property was disposed of during 2003.

*Remarks 3 to 5:* The differences arose due to the reasons as stated in Remarks 1 and 2 above.

*Remark 6:* The difference arose when compared to the announcement of the Company dated 30 April 2003 since, as further explained in the section of "DIVIDENDS" below, the revised special dividend of HK$92,554,000 is a figure approved by the Board of Directors as an amount which should have been declared as special dividend to the then sole shareholder of the Company prior to its listing based on the then intention of the Directors.

*Notes:*

### 1. Group Reorganisation and Basis of Presentation

*Group reorganisation*

Pursuant to a reorganisation scheme (the "Group Reorganisation") to rationalise the structure of the Company and its subsidiaries (hereinafter collectively referred to as the "Group") in preparation for the listing of the Company's shares on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 18 February 2002, the Company became the holding company of the companies now comprising the Group (the "Subsidiaries") on 17 January 2002. This was accomplished by acquiring the entire issued share capital of Hon Po International Limited ("Hon Po International"), a company incorporated in the British Virgin Islands (the "BVI") and the then holding company of the other subsidiaries, in consideration of and in exchange for the allotment and issue of a total of 99 shares of HK$0.01 each in the share capital of the Company, credited as fully paid, to Hon Po Investment Limited ("Hon Po Investment"), the former shareholder of Hon Po International.

As further detailed in the Company's prospectus dated 31 January 2002 (the "Prospectus"), the ongoing business concerns relating to the sourcing of food and beverage operations (the "Sourcing Business") operated by Hon Po Holdings Limited ("Hon Po Holdings"), the Company's ultimate holding company were transferred to Hon Po Management Limited ("Hon Po Management"), a wholly-owned subsidiary of the Company, effective from 26 October 2001. Since then, Hon Po Holdings discontinued its activities of the Sourcing Business.

The ongoing business concerns relating to the restaurant operations (the "Restaurant Business") operated by certain non-Group companies beneficially held by Hon Po Holdings (the "Non-Group Companies") were transferred to certain subsidiaries of the Company, effective from 15 November 2001 and 11 January 2002. The Restaurant Business includes the leasehold land and buildings and investment properties owned by Chinese King's Development Limited ("Chinese King's"), one of the Non-Group Companies, which were also transferred to the Group. Since the date of the transfer, the Non-Group Companies discontinued their activities of operating restaurants.

Further details of the Group Reorganisation are set out in the Prospectus.

*Basis of presentation*

The Group Reorganisation involved companies under common control. The consolidated financial statements have been prepared using the merger basis of accounting in accordance with Statement of Standard Accounting Practice ("SSAP") 27 "Accounting for group reconstructions", issued by the Hong Kong Society of Accountants, as a result of which the legal structure of the Group Reorganisation was completed on 17 January 2002. Under this basis, the Company has been treated as the holding company of the Subsidiaries for the financial years presented, rather than from the date of its acquisition of the Subsidiaries on 17 January 2002. Accordingly, the consolidated results of the Group for the years ended 31 December 2001 and 2002 include the results of the Company and the Subsidiaries with effect from 1 January 2001 or since their respective dates of incorporation, where this is a shorter period. Pursuant to the Group Reorganisation, the results attributable to the Sourcing Business and the Restaurant Business have been included in the consolidated financial statements with effect from their effective dates of acquisition as aforementioned. The consolidated profit and loss account for the year ended 31 December 2002 has consolidated the results attributable to the Restaurant Business acquired on 11 January 2002 from 1 January 2002 rather than from 11 January 2002 onwards. The directors consider that the financial impact on the consolidation of the financial results of the Restaurant Business for the period from 1 January 2002 to 10 January 2002 did not have a significant impact on the Group's consolidated financial statements as a whole.

In the opinion of the directors, the consolidated financial statements of the Group prepared on the above basis present more fairly the results and the state of affairs of the Group as a whole.

All significant intercompany transactions and balances within the Group have been eliminated in the preparation of the consolidated financial statements.

Minority interests represent the interests of outside shareholders in the results and net assets of the Company's subsidiaries.

For information purposes only, the pro forma combined profit and loss accounts for the two years ended 31 December 2001 and 2002, presented below, include the results of the Company and the Subsidiaries with effect from 1 January 2001 or since their respective dates of incorporation, where this is a shorter period, on a pro forma combined basis as if the current Group structure had been in existence throughout the two years ended 31 December 2001 and 2002. For the purpose of presenting the pro forma combined results of the Group, the results of the Sourcing Business and the Restaurant Business have been included as if they had been transferred to the Group as at the beginning of the earliest period presented. This basis of presentation was adopted for the preparation of the accountants' report (the "Accountants' Report") included in the Prospectus.

For information purposes only, the following are the pro forma combined profit and loss accounts of the Group for the two years ended 31 December 2001 and 2002 prepared on the basis as noted above:

| | 2002 HK$'000 | 2001 HK$'000 |
|---|---|---|
| TURNOVER | **730,466** | 798,644 |
| Other revenue and gain | **5,715** | 6,103 |
| Cost of inventories consumed | **(232,744)** | (242,996) |
| Staff costs | **(281,039)** | (282,908) |
| Operating lease rentals | **(77,372)** | (79,614) |
| Depreciation | **(18,793)** | (21,570) |
| Fuel costs and utility expenses | **(75,549)** | (78,570) |
| Other operating expenses | **(126,477)** | (69,451) |
| PROFIT/(LOSS) FROM OPERATING ACTIVITIES | **(75,793)** | 29,638 |
| Finance costs | **(4,468)** | (3,365) |
| PROFIT/(LOSS) BEFORE TAX | **(80,261)** | 26,273 |
| Tax | **(86)** | (4,560) |
| PROFIT/(LOSS) BEFORE MINORITY INTERESTS | **(80,347)** | 21,713 |
| Minority interests | **36** | 440 |
| NET PROFIT/(LOSS) FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS | **(80,311)** | 22,153 |
| EARNINGS/(LOSS) PER SHARE – Basic | **(HK13.13 cents)** | HK4.87 cents |

At 31 December 2002, the Group had net current liabilities of approximately HK$76,116,000. The Group also incurred a net loss attributable to shareholders of approximately HK$77,044,000 for the year ended 31 December 2002. Subsequent to the balance sheet date, a subsidiary of the Company has been involved in legal proceedings with a landlord in the High Court in Hong Kong, concerning rent payable for a restaurant falling due after the balance sheet date. The amount of the subsequent legal claim outstanding against the Group is approximately HK$0.3 million plus other costs, damages and interest. The Group is in the process of negotiating with the landlord.

The Hong Kong economy has also been adversely affected by certain unforeseen events which in turn seriously affected consumer spending and consequently the Group's turnover, profitability and liquidity during the second half of 2002 and subsequently thereto up to the date the financial statements were approved for issue. These events primarily included the threat of war in Iraq towards the end of 2002 which materialised after the year end, the proposed tax increases announced by the Hong Kong government at the beginning of 2003 and the outbreak of the atypical pneumonia epidemic.

Having regard to this background, in order to improve the Group's financial position, immediate liquidity, cash flows, profitability and operations, the directors have adopted the following measures:

(a) the directors have temporarily and permanently closed down certain loss-making Group restaurant operations so as to relieve the Group's liquidity pressure and to reduce further possible losses to the Group;

(b) the Group entered into written agreements with certain decoration contractors responsible for the decoration of the Group's restaurants to reschedule the payment of outstanding balances for restaurant decoration work, amounting to approximately HK$11 million, until January 2004;

(c) the directors have taken action to tighten cost controls over the restaurants' staff costs, overheads and various general and administrative expenses;

(d) subsequent to the balance sheet date, the Group entered into agreements with an independent third party and a related party for the disposal of two properties for a cash consideration of HK$83 million and HK$55 million, respectively. The net cash proceeds, after the repayment of the corresponding secured bank borrowings and related expenses, of approximately HK$33 million, have been used to provide additional cash resources for the Group's operations; and

(e) pursuant to an announcement made by the Company on 29 September 2003, the directors have completed negotiations with ICEA Financial Services Limited ("ICEA") for a proposed loan facility to be made available to the Company of approximately HK$19 million at an interest rate of prime rate plus 2% per annum (the "Proposed Loan Facility"). As part of the loan facility arrangements, the Company will execute a debenture in favour of ICEA creating a first floating charge over all the properties, assets and undertakings of the Company. The Proposed Loan Facility will also be supported by the personal guarantees of two directors of another company (the "Proposed Purchasing Company") connected with the Proposed Purchasing Company's proposed acquisition (the "Proposed Acquisition") of 348,516,000 issued and fully paid ordinary shares of the Company held by Hon Po Investment. The Proposed Loan Facility will be granted upon the completion of the Proposed Acquisition.

A condensed pro forma adjusted consolidated net assets statement of the Group as at 31 December 2002, which is based on the audited consolidated net assets of the Group as at 31 December 2002 and adjusted as if the measures as set out in (b) and (d) above had taken place on 31 December 2002, is presented below:

| | Audited consolidated net assets as at 31 December 2002 HK$'000 | Pro forma adjustments: Rescheduled repayment terms for the decoration payables HK$'000 (b) | Pro forma adjustments: Disposal of properties HK$'000 (d) | Pro forma adjusted consolidated net assets as at 31 December 2002 HK$'000 |
|---|---|---|---|---|
| Non-current assets | 206,914 | | (138,000) | 68,914 |
| Current assets | 69,800 | | 32,507 | 102,307 |
| Current liabilities | (145,916) | 11,379 | 17,556 | (116,981) |
| Net current liabilities | (76,116) | | | (14,674) |
| Non-current liabilities | (98,852) | (11,379) | 87,937 | (22,294) |
| Minority interests | (1,826) | | | (1,826) |
| Net assets | 30,120 | | | 30,120 |

In addition to the above measures, the Group has not experienced any material withdrawal or reduction either of the banking facilities granted by its bankers, or of the credit terms granted by its suppliers up to the date of approval of the financial statements for issuance. The directors are confident that the Group will continue to receive ongoing financial support from its bankers and suppliers in maintaining the existing level of banking facilities and credit terms, respectively, currently made available to the Group for the Group's continued operations.

In the opinion of the directors, in light of the measures taken to date together with the expected successful outcome of those still in progress, and on the basis of the continued support from the bankers and suppliers, the Group will have sufficient working capital for its current requirements and it is reasonable to expect the Group to return to a commercially viable concern. Accordingly, the directors are satisfied that it is appropriate to prepare the financial statements on a going concern basis, notwithstanding the Group's financial position and tight cash flows as at 31 December 2002 and at the date of approval of the financial statements.

Should the Group be unable to continue its business 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, including those contingent liabilities and to reclassify non-current assets and liabilities as current assets and liabilities, respectively. The effect of these potential adjustments has not been reflected in these financial statements.

### 2. Adoption of New and Revised Statements of Standard Accounting Practice

The following new and revised SSAPs and Interpretation are effective for the first time in the preparation of the current year's consolidated financial statements:

- SSAP 1 (Revised) : "Presentation of financial statements"
- SSAP 11 (Revised) : "Foreign currency translation"
- SSAP 15 (Revised) : "Cash flow statements"
- SSAP 34 : "Employee benefits"
- Interpretation 15 : "Business combinations – "Date of exchange" and fair value of equity instruments"

3. **Turnover, Other Revenue and Gain**

Turnover represents the receipts from restaurant operations. All significant intra-group transactions have been eliminated in the preparation of the consolidated/pro forma combined financial statements. An analysis of the Group's turnover, other revenue and gain is as follows:

| | **Consolidated 2002 *HK$'000*** | Consolidated 2001 *HK$'000* | Pro Forma Combined* 2001 *HK$'000* |
|---|---|---|---|
| **Turnover** | | | |
| Receipts from restaurant operations | **730,466** | 498,758 | 798,644 |
| **Other revenue** | | | |
| Rental income, gross | **3,498** | 1,797 | 3,900 |
| Bank interest income | **31** | – | 59 |
| Handling charges received from fellow subsidiaries | **–** | 458 | – |
| Sundry income | **2,186** | 1,138 | 2,144 |
| | **5,715** | 3,393 | 6,103 |
| **Gain** | | | |
| Negative goodwill recognised | **3,267** | – | – |
| Total revenue and gain | **739,448** | 502,151 | 804,747 |

4. **Segment Information**

No separate analysis of segment information by business or geographical segments is presented as the Group's major business solely comprises the operation of a chain of Chinese restaurants in Hong Kong.

5. **Profit/(loss) from Operating Activities**

Profit/(loss) from operating activities is arrived at after charging:

| | **Consolidated 2002 *HK$'000*** | Consolidated 2001 *HK$'000* | Pro Forma Combined* 2001 *HK$'000* |
|---|---|---|---|
| Cost of inventories consumed | **232,744** | 155,633 | 242,996 |
| Depreciation | **18,793** | 16,267 | 21,570 |
| Provision for impairment of leasehold land and buildings | **5,500** | – | – |
| Provision for impairment of other fixed assets | **28,546** | – | – |
| Provision for impairment of other assets | **1,865** | – | – |
| Revaluation deficit on leasehold land and buildings | **585** | – | – |
| Loss on disposal of fixed assets | **94** | – | – |
| Loss on disposal of other assets | **232** | – | – |

6. **Tax**

Hong Kong profits tax has been provided at the rate of 16% (2001: 16%) on the estimated assessable profits arising in Hong Kong during the year. Deferred tax has been provided for the year under the liability method at the rate of 16% (2001: 16%) on timing differences.

| | **Consolidated 2002 *HK$'000*** | Consolidated 2001 *HK$'000* | Pro Forma Combined* 2001 *HK$'000* |
|---|---|---|---|
| Current year provision | **100** | 1,999 | 4,005 |
| Deferred tax charge/(credit), net | **(14)** | 541 | 555 |
| Tax charge for the year | **86** | 2,540 | 4,560 |

7. **Special Dividends**

| | **Consolidated 2002 *HK$'000*** | Consolidated 2001 *HK$'000* | Pro Forma Combined* 2001 *HK$'000* |
|---|---|---|---|
| Revised special dividend | **92,554** | – | – |
| Special dividend | **7,560** | – | – |
| | **100,114** | – | – |

Revised special dividend was approved by the Board to be paid by the Company to the then sole shareholder prior to the listing, more details of which was set out in the paragraph "Dividends" hereunder.

Special dividend of HK$7,560,000 was proposed on 23 April 2002 and paid to the shareholders of the Company on 28 June 2002.

8. **Earnings/(loss) Per Share**

The calculation of basic earnings/(loss) per share, on a consolidated basis, is based on the net loss from ordinary activities attributable to shareholders for the year ended 31 December 2002 of HK$77,044,000 (2001: net profit of HK$6,602,000) and the weighted average of 611,780,822 (2001: 455,000,000) ordinary shares in issue during the year.

For information purposes only, the calculation of the pro forma basic earnings/(loss) per share, on the pro forma combined basis as set out in note 1 above, is based on the pro forma combined net loss from ordinary activities attributable to shareholders for the year ended 31 December 2002 of HK$80,311,000 (2001: net profit of HK$22,153,000) and the weighted average of 611,780,822 (2001: 455,000,000) ordinary shares in issue during the year.

The weighted average number of shares used to calculate the basic earnings/(loss) per share, on both the consolidated and pro forma combined bases, for the year ended 31 December 2001 includes the pro forma issued share capital of the Company of 455,000,000 shares, comprising the 1 share of the Company allotted and issued, credited as fully paid, to Hon Po Investment on 4 May 2001, and the 99 shares issued as consideration for the acquisition of the entire issued share capital of Hon Po International on 17 January 2002, and the capitalisation issue of 454,999,900 shares. The weighted average number of shares used to calculate the basic earnings/(loss) per share, on both the consolidated and pro forma combined bases, for the year ended 31 December 2002 includes the weighted average of the 156,780,822 shares issued upon the listing of the Company's shares on the Stock Exchange on 18 February 2002 in addition to the aforementioned 455,000,000 ordinary shares.

There were no potential dilutive ordinary shares in existence for the years ended 31 December 2001 and 2002, and accordingly, no diluted earnings/(loss) per share amount, on either the consolidated or pro forma combined bases, have been presented.

## DIVIDENDS

The Directors do not recommend the payment of a final dividend in respect of the year ended 31 December 2002.

Prior to the Group Reorganisation, the Company did not have any distributable reserves.

As disclosed in the unaudited consolidated financial statements for the six months ended 30 June 2002 included in the interim report dated 25 September 2002 of the Company (the "2002 Interim Report") as part of the Group Reorganisation process incidental to the listing of the Company on the Stock Exchange, a special dividend (the "Special Dividend") of HK$224,600,000 was declared and approved by the directors of the Company which was conditional upon the listing of the Company's shares on the Stock Exchange. The Special Dividend was set-off against the account balance due to the Company (the "Account Balance") from Hon Po Investment, the sole shareholder of the Company arising upon the completion of the Group Reorganisation on 17 January 2002 prior to the listing. The Special Dividend did not involve any cash payment. It has since transpired that the pro forma financial statements, and other financial information of the Company on which the Accountants' Report was based, and consequently the Accountants' Report itself, were prepared in a manner inconsistent with the intentions of the directors in relation to the nature of the assets transferred in the course of the Group Reorganisation, with the result that the value of the transferred assets had been overstated.

Based on a report prepared by an independent firm of accountants retained by the Group, the directors agreed that the Special Dividend should be in the amount of approximately HK$92,554,000 to set-off the revised Account Balance as at the date of completion of the Group Reorganisation on 17 January 2002. The directors further agreed that the difference in the amount of HK$132,046,000 between the Special Dividend of HK$224,600,000 and the HK$92,554,000 as aforementioned (the "Difference") should be cancelled and waived. As with the Special Dividend, the cancellation and waiver of the Difference did not involve any cash payment, and the aforementioned HK$92,554,000 was settled by way of set-off against the revised Account Balance. Accordingly, the directors consider that there is no adverse change in the financial position and net tangible asset value of the Group and the Company as disclosed in the corresponding sections of the Prospectus, the 2001 Annual Report and the 2002 Interim Report. After taking into account the opinion of legal counsel, the directors consider that the cancellation and waiver of the Difference (i) does not lead to any loss to the members of the Company; (ii) does not lead to any diminution of the Group's and the Company's assets and no third party obtains any benefit or suffers any loss, and accordingly, no party should be held liable.

The rates of the Special Dividend and the number of shares ranking for the Special Dividend are not presented as the directors consider that such information is not meaningful for the purpose of the financial statements.

On 23 April 2002, an ordinary resolution was passed, pursuant to which the directors of the Company proposed the payment of a special dividend of HK$7,560,000, representing HK1.2 cents per share of the Company, out of the Company's distributable reserves for the year, to the shareholders of the Company whose names appeared on the register of members of the Company on 4 June 2002. On 4 June 2002, the Company's shareholders at the Company's annual general meeting approved the special dividend and it was subsequently paid on 28 June 2002.

## EXTRACT OF REPORT OF THE AUDITORS

**Scope limitation – related party transactions**

The evidence available to us was limited in respect of the Group's transactions with Hon Po Holdings Limited, the ultimate holding company of the Company, and its non-listed subsidiaries (collectively known as the "Non-listed Group") for the year ended 31 December 2002. We have not been able to obtain sufficient supporting documentation and explanations relating to these transactions and therefore we have not been able to satisfy ourselves as to the measurement and related disclosures of these related party transactions as required by the Statement of Standard Accounting Practice No. 2.120 "Related party disclosures" (the "SSAP 20") issued by the Hong Kong Society of Accountants and Section 161B of the Hong Kong Companies Ordinance.

**Fundamental uncertainty relating to the going concern basis**

In forming our opinion, we have considered the adequacy of the disclosures made in note 2 to the financial statements concerning the adoption of the going concern basis on which the financial statements have been prepared. As explained in note 2 to the financial statement, the Group is currently undertaking a number of measures to relieve 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 various measures taken by the Group to return its operations back into profitable concerns and to generate cash flows to maintain the Group as a going concern. The financial statements do not include any adjustments that may be necessary should the implementation of such measures become unsuccessful. We consider that appropriate estimates and disclosures have been made in the financial statements and our opinion is not qualified in this respect.

**Qualified opinion arising from limitation of audit scope**

Except for any adjustments and disclosures that might have been found to be necessary had we been able to obtain sufficient evidence concerning the transactions with the Non-listed Group and the related disclosures as required by SSAP 20 and Section 161B of the Hong Kong Companies Ordinance referred to in the "Scope limitation – related party transactions" paragraph, in our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2002 and of the loss and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

In respect alone of the limitation on our work relating to the matter described above:

– We have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and

– We were unable to determine whether proper books of accounts had been kept.

## BUSINESS REVIEW**

In 2002, the restaurant sector continued to contract as the Hong Kong economy was struggling to recovery. According to the Census and Statistics Department of Hong Kong, the total revenue of the restaurant sector in Hong Kong amounted to HK$53.3 billion, representing a decline of 5.5% from that of 2001. Comparing to the first half of 2002, Hong Kong's total restaurant receipts in the second half of the year dropped by a higher percentage. While the restaurant industry experienced sluggish sales, restaurant operators, particularly among those operating Chinese restaurants, significantly lowered prices to attract customers, which resulted in a cutthroat competition.

**Operating results**

Affected by an adverse operating environment, the Group saw its audited consolidated turnover for the year ended 31 December 2002 erode by 8.5% from 2001's pro forma combined turnover to HK$730,466,000. The Group's audited consolidated net loss attributable to shareholders for 2002 was HK$77,044,000, against a pro forma combined net profit of HK$22,153,000 in 2001.

Factors accounted for the loss in 2002 included:

1. Owing to sluggish consumption sentiment and severe market competition, consolidated turnover decreased by 8.5% and gross profit percentage (defined as difference between turnover and cost of inventories consumed as a percentage of turnover) dropped by 1.5% when compared to the pro forma combined figures in 2001. The consolidated turnover and gross profit percentage for the second half of 2002 were lower than that in the first half of 2002;

2. Provisions for the impairment of leasehold land and buildings and leasehold improvements for certain properties of the Group of approximately HK$13.3 million were made in the annual results of the Group for 2002. The disposal of these properties was completed in June 2003 and August 2003.

3. Provision for the impairment of fixed assets and other non-current assets of the Group in respect of certain loss-making restaurants amounted to approximately HK$22.6 million were made in the annual results of the Group for 2002. The related provision for other staff benefits amounted to approximately HK$9.7 million was made in 2002. These restaurants were permanently closed during 2003.

4. Increase in advertising and promotional expenses as part of the marketing strategy to increase market presence;

5. Despite continued deflation in the overall economy, the rentals of the Group's restaurants remained high.

6. A restaurant of the Group, which commenced business in October 2002, has yet to achieve its full potential and, hence, has not reached the breakeven level in 2002.

**Operation review**

During the year, deteriorating market conditions resulted in intensified competition. High unemployment rate and economic slowdown culminated in lower consumption in the restaurant industry. On the other hand, many restaurant operators made deep discounted offers to boost sales, resulting in significant retreat in profits. In addition, as poor economic climate persisted, low-priced ready-to-serve meals and fast food restaurants, which used to target only the low-end market and customers pursuing quick services and convenience, gained popularity and became new strong competitors to Chinese and non-Chinese restaurants, which emphasise on service quality, product variety, culinary delights and gracious ambience. To the Group, the emergence of these new strong competitors increased the pressure of price reduction.

In the face of the tough market situation, the Group expanded its product variety, improved food quality and adopted strategic marketing plans to attract more customers. Moreover, the Group had also implemented market segmentation to enlarge its market coverage. In July and October 2002, the Group opened two new restaurants, Jing Hua Restaurant and Metropolis Harbour View Chinese Cuisine Restaurant respectively – the former is a specialty restaurant serving Guangdong cuisine and Shanghai and Beijing dim sum while the latter caters for medium to high end market. As the two new restaurants were still in their initial operating stage, substantial start-up costs were incurred, but the potential contribution to turnover and profit from them had not yet been reflected in the Group's results.

During the year, the Group diversified into the production of seasonal food and snacks, with the commencement of operation of its food manufacturing factory. In its initial operation, the plant produced moon cakes and other festive food for the Chinese New Year, which were sold through the Group's restaurant network. Although contribution from the food production business to the Group was yet to be significant, the food operation is intended to be a long-term investment and a revenue stream in the future.

The Group had also streamlined its restaurant network to improve operational efficiency and better resources allocation. While this move brought immediate cost-saving benefits to the Group, it was intended to be a long-term strategy in improving the Group's ability to take advantage of any business opportunities arising from a better economy.

Meanwhile, the Group had also stepped up its cost control measures, such as sourcing from new suppliers offering competitive prices, adopting the central purchasing strategy, cutting wages and negotiating with lessors for rental reduction. These measures had helped mitigate part of the impact from reduced turnover and severe price competition.

During the year, the Group's plan to set up a business venture in the mainland China as stated in the Prospectus was suspended temporarily. After conducting extensive market research on the China's restaurant industry, the Group decided that it was not the appropriate timing to embark on operations in the mainland China.

During the year under review, save as disclosed in the audited financial statement for the year ended 31 December 2002 and the Group's prospectus, the Group did not have any significant investments and material acquisitions and disposals of subsidiaries and associated companies during 2002.

**Staff and compensation policy**

As at the end of 2002, the Group had a total workforce of 2,118 (pro forma combined basis for 2001: 1,919). The salary and wages of our employees are commensurate with their duties and performance.

## FINANCIAL REVIEW**

**Funding policy**

The Group will make its funding decision on a case-by-case basis and according to the following factors:

– the availability of bank loans and the interest rate level

– the availability of and the advantage of using internal resources instead of borrowing loans

– impact on the gearing ratio and interest rate fluctuation

**Capital structure**

As at 31 December 2002, the Group had outstanding bank borrowings and finance lease payables denominated in Hong Kong dollars with an aggregate amount of HK$127,350,000 (pro forma combined basis for 2001: HK$37,936,000). The cash and bank balances of the Group amounted to HK$21,927,000 (pro forma combined basis for 2001: HK$39,793,000). The increase in the outstanding bank borrowings was mainly due to the financing of the purchase of a property during 2002 (as detailed in the circular dated 27 May 2002) and the decoration of two new restaurants, which commenced operation during the second half of 2002.

The short-term borrowings of the Group accounted for 24.8% (pro forma combined basis for 2001: 2.0 %) of the total borrowings.

The consolidated interest expenses for 2002 were HK$4,468,000 (pro forma combined basis for 2001: HK$3,365,000).

As at 31 December 2002, the ratio of total liabilities and minority interests to total assets of the Group was 89.1% (pro forma combined basis for 2001: 28.0%).

To conclude, in the coming year, the Group will adopt various measures to strengthen its financial position, including the disposal of two properties of the Group. In April 2003 and July 2003, the Group entered into two separate agreements, pursuant to which the Group have sold two of its properties for HK$83 million and HK$55 million respectively. The disposals of the aforesaid two properties have helped enhance the working capital position and reduced the outstanding bank borrowings of the Group.

**Pledges of assets**

As at 31 December 2002, leasehold land and buildings and investment properties of the Group with a net book value of HK$141,120,000 (pro forma combined basis for 2001: HK$56,900,000) were pledged as security for bank loans.

**Use of proceeds of New Issue**

The Company placed and issued 175,000,000 new shares on 18 February 2002 at a price of HK$0.2 each.

The net proceeds from share offer, after deduction of related expenses, were approximately HK$19,636,000. HK$5,247,000 had been utilised for the establishment of a food manufacturing factory in Hong Kong. HK$10,388,000 had been utilised for the expansion of the Group's restaurant business in Hong Kong.

The balance of approximately HK$4,001,000 was currently used as general working capital for the Group and will be used for the Group's restaurant business in accordance with the intended usage as stipulated in the Prospectus.

**Exchange exposure**

Since most of our sales, raw materials and bank loans were denominated in Hong Kong dollars during 2002 and 2001, the Group was only exposed to insignificant exchange risks.

**Capital commitment**

As at 31 December 2002, there was no material capital commitment for the Group (pro forma combined basis as at 31 December 2001: Nil).

**Contingent liabilities**

As at 31 December 2002, the Group had contingent liabilities not provided for amounted to HK$24,440,000 (pro forma combined basis for 2001: HK$25,864,000) in respect of possible future payments to eligible employees pursuant to the Employment Ordinance, Chapter 57, of the Laws of Hong Kong.

## PROSPECTS

Looking ahead, 2003 will continue to be a difficult year. In the face of a bleak economic outlook, profits tax increase and drastic decline in restaurant patrons in March and April 2003 following the SARS outbreak, the Group will step up its cost control measures, consolidate its business operations, streamline its restaurant network and implement market segmentation.

To increase cost-effectiveness, the Group will continue to fine-tune its restaurant network, such as relocating restaurants to higher traffic areas. For restaurants at strategic locations, the Group focuses on operation improvement and market segmentation. To cater for different clusters of diners, the Group introduces exotic cuisine and a new image to the appropriate restaurants. Consummating the market segmentation strategy, the Group is considering renaming restaurants with a different presentation under a new brand identity. At present, two restaurants operated under the Group are specialty restaurants, and another one targets the medium to high-end market. Such a marketing strategy is beginning to produce results, with the specialty restaurant, Jing Hua, breaking even after a few months of operation.

Regarding the food production business, the Group will continue its focus on developing marketable festive food.

To lower costs, the Group will continue to adopt its central purchasing strategy and to negotiate with lessors to reduce rentals of its restaurants.

With respect to marketing and sales promotion, the Group has joined hands with AEON Credit Service (Asia) Company Limited ("AEON") to make special offers to AEON's credit card members. In addition, the Group has also issued VIP / member cards to regular patrons to Metropolis Harbour View Chinese Cuisine Restaurant. These VIP members will enjoy special discounts and other promotional offers when they dine at Metropolis Harbour View Chinese Cuisine Restaurant.

## PURCHASE, SALE OR REDEMPTION OF SECURITIES OF THE COMPANY

During the year, other than in connection with the Company's initial public offering and the listing of the Company's shares on the Stock Exchange on 18 February 2002, neither the Company, nor any of its subsidiaries has purchased, redeemed or sold any of the Company's listed securities. The Group did not purchase, sell or redeem any of the Company's listed securities during the year ended 31 December 2002.

## CODE OF BEST PRACTICE

In the opinion of the directors, the Company compiled with the Code of Best Practice (the "Code") as set out in Appendix 14 of the Listing Rules, throughout the accounting period covered by the annual report, except that all independent non-executive directors are not appointed for a specific term as required by paragraph 7 of the Code because they are subject to retirement by rotation and re-election at annual general meetings in accordance with the articles of association of the Company.

## DISCLOSURE OF THE ANNUAL RESULTS ON THE WEBSITE OF THE STOCK EXCHANGE

The details of the annual report of the Group for the year ended 31 December 2002 together with the information required by paragraph 45(1) to 45(3) of Appendix 16 of the Listing Rules of the Stock Exchange will be published on the Stock Exchange's website in due course.

By Order of the Board
**Hon Po Group (Lobster King) Limited**
**Cheung To Sang**
*Chairman and Managing Director*

Hong Kong, 6 November 2003