

*The following is the text of a report, prepared for the purpose of incorporation in this prospectus, from the auditors and reporting accountants of the Company, Ernst & Young, Certified Public Accountants.*



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18th June, 2002

The Directors  
Harbin Brewery Group Limited  
Cazenove Asia Limited  
First Shanghai Capital Limited

Dear Sirs,

We set out below our report on the financial information regarding Harbin Brewery Group Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group") for each of the three years ended 31st December, 2001 (the "Relevant Periods"), prepared on the basis set out in Section 1 below, for inclusion in the prospectus of the Company dated 18th June, 2002 (the "Prospectus").

The Company was incorporated as an exempted company with limited liability in the Cayman Islands on 23rd February, 2001 under the Companies Law (2000 Revision) of the Cayman Islands for the purpose of acting as a holding company of the subsidiaries set out in Section 1 below. The Company has not carried on any business since the date of its incorporation, save for (i) the acquisition on 26th June, 2001 of the entire issued share capital of Harbin Brewery Investments Limited, a company incorporated in the British Virgin Islands, which was satisfied by the issue of the Company's shares; and (ii) the acquisition on 29th June, 2001 of the entire issued share capital of and shareholder's loan to King Victory Investments Inc. ("King Victory"), a company incorporated in the British Virgin Islands, which was satisfied by cash consideration. As at the date of this report, Harbin Brewery Investments Limited and King Victory are the intermediate holding companies of the other subsidiaries set out in Section 1 below.

For the purpose of this report, we have undertaken an independent audit of the financial statements of the Company's subsidiaries established in the mainland of the People's Republic of China (the "PRC") for the Relevant Periods, or from the respective dates of their establishment/acquisition, where this is a shorter period, in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants ("HKSA"), and have carried out such additional procedures as we considered necessary.

We have examined the audited financial statements or, where appropriate, management accounts of all of the companies now comprising the Group for the Relevant Periods, or from the respective dates of their incorporation/establishment/acquisition, where this is a shorter period, in accordance with the Auditing Guideline "Prospectuses and the reporting accountant" issued by the HKSA.

We have acted as auditors of all of the companies now comprising the Group for the Relevant Periods or from the respective dates of their incorporation/establishment/acquisition where this is a shorter period.

The summaries of the combined results, movements in equity and cash flows of the Group for the Relevant Periods and of the combined balance sheets of the Group as at 31st December, 1999, 2000 and 2001 (the "Summaries") set out in this report have been prepared from the audited financial statements and management accounts of the companies now comprising the Group and are presented on the basis set out in Section 1 below.

In our opinion, the Summaries together with the notes thereto give, for the purpose of this report, a true and fair view of the combined results and cash flows of the Group for the Relevant Periods and of the combined balance sheets of the Group as at 31st December, 1999, 2000 and 2001.

## 1. BASIS OF PRESENTATION

The Summaries, which are based on the audited financial statements and management accounts of the companies now comprising the Group, include the combined results, statements of movements in equity, cash flows and balance sheets of the companies now comprising the Group as if the current Group structure had been in existence throughout the Relevant Periods, or from the respective dates of their incorporation/establishment/acquisition where this is a shorter period. All significant intra-group transactions and balances have been eliminated on combination.

Notwithstanding that the Group had net current liabilities of HK\$260,753,000 as at 31st December, 2001, the Summaries have been prepared on the going concern basis as the shareholders of the Company have agreed to provide adequate funds for the Group to meet its liabilities and obligations as and when they fall due and not to demand repayment of the amounts due to them prior to the listing of the Company's shares on The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

At the date of this report, the Company had direct or indirect interests in the following subsidiaries, all of which are private companies (or, if incorporated/established outside Hong Kong, have substantially similar characteristics to a private company incorporated in Hong Kong), the particulars of which are set out below:

<b>Company name</b>	<b>Place and date of incorporation/ establishment and registration</b>	<b>Nominal value of issued and paid-up share/ registered capital</b>	<b>Equity interest attributable to the Company</b>	<b>Principal activities</b>
Harbin Brewery Investments Limited	British Virgin Islands 22nd January, 2001	Ordinary US\$50,000	100%	Investment holding

Company name	Place and date of incorporation/ establishment and registration	Nominal value of issued and paid-up share/ registered capital	Equity interest attributable to the Company	Principal activities
Harbin Brewing Company Limited	PRC 9th October, 1995	RMB250,000,000	100%	Production and distribution of bottled, barrel and canned beer, and investment holding
Harbin Brewing (Songjiang) Company Limited	PRC 25th August, 1994	RMB32,500,000	70% (Note)	Production and distribution of bottled beer
Harbin Brewing (Hegang) Company Limited	PRC 8th August, 1999	RMB10,000,000	95%	Production and distribution of bottled beer
Jilin Harbin Brewing Company Limited	PRC 3rd January, 2000	RMB5,000,000	70%	Production and distribution of bottled beer
Harbin Tianhe Bio-engineering Company Limited	PRC 6th August, 1997	RMB1,750,000	52%	Brewing waste treatment
King Victory Investments Inc.	British Virgin Islands 21st April, 1997	Ordinary US\$10	100%	Investment holding
Guangdong Brewery Northern (Holdings) Limited	Hong Kong 26th November, 1996	Ordinary HK\$2	100%	Investment holding
Extra Lucky Investment Limited	Hong Kong 1st August, 1996	Ordinary HK\$10,000	100%	Investment holding
Fung Heng Investment Limited	Hong Kong 22nd January, 1997	Ordinary HK\$2	100%	Investment holding
Prestige Full Investment Limited	Hong Kong 3rd December, 1997	Ordinary HK\$2	100%	Investment holding
Golden Pacific Line Limited	British Virgin Islands 21st March, 1997	Ordinary US\$1	100%	Investment holding
Union Fortune Limited	British Virgin Islands 14th August, 1996	Ordinary US\$1	100%	Investment holding
Vanta International Investment Limited	British Virgin Islands 14th February, 1997	Ordinary US\$1	100%	Investment holding

Company name	Place and date of incorporation/ establishment and registration	Nominal value of issued and paid-up share/ registered capital	Equity interest attributable to the Company	Principal activities
Jiamusi Yuehai Jiafeng Brewery Company Limited	PRC 18th March, 1996	US\$5,984,000	60%	Production and distribution of bottled beer
Jilin GD-Yinpu Beer Company Limited	PRC 21st March, 1997	RMB68,000,000	55%	Production and distribution of bottled and canned beer
Mudanjiang Jing Po Brewery Company Limited	PRC 28th December, 1995	RMB64,120,000	55%	Production and distribution of bottled beer

Except for Harbin Brewery Investments Limited and King Victory, all the above subsidiaries are indirectly held by the Company.

*Note:* Pursuant to a share transfer agreement dated 8th October, 1998 (the "Songjiang Agreement"), the Group agreed to acquire an aggregate of 70% equity interest in Harbin Brewery (Songjiang) Company Limited ("HB Songjiang") from Asia Brewery (Songjiang) Limited and Asia Brewery (China) Investment Company Limited, independent third parties, for a total consideration of RMB19,000,000 which would be divided into two stages: (1) the Group first acquired a 45% equity interest therein for a consideration of RMB12,200,000, which was completed in November 1998 (the "First Stage Acquisition"); and (2) the Group was to acquire the remaining 25% equity interest therein for a consideration of RMB6,800,000 by 30th September, 2001 (the "Second Stage Acquisition"). On 20th August, 2001, the Group effected the Second Stage Acquisition and HB Songjiang became a 70% owned subsidiary of the Group thereafter. Following the First Stage Acquisition of the 45% equity interest in HB Songjiang, the directors are of the opinion that the Group has control over the majority of votes of the board of directors of HB Songjiang, thereby having control over its financial and operating policies. Accordingly, the directors consider it appropriate to account for HB Songjiang as a subsidiary of the Group after the First Stage Acquisition.

## 2. PRINCIPAL ACCOUNTING POLICIES

This report has been prepared under the historical cost convention. The principal accounting policies adopted by the Group in arriving at the financial information set out in this report, which conform with accounting principles generally accepted in Hong Kong, are as follows:

### (a) Subsidiaries

A subsidiary is a company whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

### (b) Joint venture companies established in the PRC

A joint venture company is a company set up by contractual arrangement, whereby the Group and other parties undertake an economic activity. The joint venture company operates as a separate entity in which the Group and the other parties have an interest.

The joint venture agreement between the venturers stipulates the capital contributions of the joint venture parties, the duration of the joint venture and the basis on which the assets are to be realised upon its dissolution. The profits and losses from the joint venture company's operations and any distributions of surplus assets are shared by the venturers, either in proportion to their respective capital contributions, or in accordance with the terms of the joint venture agreement.

A joint venture company is treated as a subsidiary if the Company has unilateral control over the joint venture company.

(c) **Goodwill**

Goodwill arising on the acquisition of subsidiaries represents the excess of the cost of the acquisition over the Group's share of the fair values of the identifiable assets and liabilities acquired as at the date of acquisition.

Goodwill arising on acquisition is recognised in the balance sheet as an asset and amortised on the straight-line basis over its estimated useful life of twenty years.

On disposal of subsidiaries, the gain or loss on disposal is calculated by reference to the net assets at the date of disposal, including the attributable amount of goodwill which remains unamortised and any relevant reserves, as appropriate.

The carrying amount of goodwill is reviewed annually and written down for impairment when it is considered necessary. A previously recognised impairment loss for goodwill is not reversed unless the impairment loss was caused by a specific external event of an exceptional nature that was not expected to recur, and subsequent external events have occurred which have reversed the effect of that event.

(d) **Negative goodwill**

Negative goodwill arising on the acquisition of subsidiaries represents the excess of the Group's share of the fair values of the identifiable assets and liabilities acquired as at the date of acquisition, over the cost of the acquisition.

To the extent that negative goodwill relates to expectations of future losses and expenses that are identified in the acquisition plan and that can be measured reliably, but which do not represent identifiable liabilities as at the date of acquisition, that portion of negative goodwill is recognised as income in the profit and loss account when the future losses and expenses are recognised.

To the extent that negative goodwill does not relate to identifiable expected future losses and expenses as at the date of acquisition, negative goodwill is recognised in the profit and loss account on a systematic basis over the remaining average useful life of the acquired depreciable/amortisable assets. The amount of any negative goodwill in excess of the fair values of the acquired non-monetary assets is recognised as income immediately.

In prior years, negative goodwill arising on acquisition was credited to the capital reserve in the year of acquisition. The Group has adopted the transitional provision of Statement of Standard Accounting Practice No. 30 "Business Combinations" ("SSAP 30") issued by the HKSA and effective for accounting periods beginning on or after 1st January, 2001, that permits negative goodwill on acquisitions which occurred prior to 1st January, 2001, to remain credited to the capital reserve. Negative goodwill on subsequent acquisitions is treated according to the new accounting policy above.

On disposal of subsidiaries, the gain or loss on disposal is calculated by reference to the net assets at the date of disposal, including the attributable amount of negative goodwill which has not been recognised in the profit and loss account and any relevant reserves as appropriate. Any attributable negative goodwill previously credited to the capital reserve at the time of acquisition is written back and included in the calculation of the gain or loss on disposal.

**(e) Related parties**

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

**(f) Impairment of assets**

An assessment is made at each balance sheet date of whether there is any indication of impairment of any asset, or whether there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use or its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years.

A reversal of an impairment loss is credited to the profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the reversal of the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

**(g) Fixed assets and depreciation**

Fixed assets, other than construction in progress, are stated at cost less accumulated depreciation and any impairment losses. 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 period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of that asset.

Depreciation is calculated on the straight-line basis to write off the cost of each asset over its estimated useful life, after taking into account any estimated residual value. The principal annual rates used for this purpose are as follows:

Land use rights	Over the lease terms
Buildings	2.6%-4.5%
Plant and machinery	2.3%-18%
Furniture, fixtures and equipment	9%-18%
Motor vehicles	15%-18%

The gain or loss on 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.

Construction in progress is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction during the period of construction. Construction in progress is reclassified to the appropriate category of fixed assets when completed and ready for use.

**(h) Intangible assets**

Intangible assets, representing right to use electricity, trademarks and technical know-how acquired, are stated at cost less accumulated amortisation and any impairment losses. Amortisation is calculated on the straight-line basis to write off the cost of each asset over its estimated useful life. The estimated useful lives used for this purpose are as follows:

Trademarks	10-20 years
Right to use electricity	20 years
Technical know-how	10 years

**(i) Deferred expenditure**

Deferred expenditure represents expenses incurred in connection with the raising of long term finance and is amortised on the straight-line basis over the terms of the relevant underlying borrowings.

**(j) Inventories**

Inventories are stated at the lower of cost and net realisable value.

Cost in respect of raw materials, work in progress and finished goods is determined on the weighted average method. In the case of work in progress and finished goods, cost comprises direct materials, direct labour and an attributable proportion of production overheads. Net realisable value is based on estimated selling prices less any further costs to be incurred to completion and disposal.

Packaging materials, comprising reusable bottles and plastic crates currently in use, are stated at cost and are amortised on the straight-line basis over a period of three and five years, respectively.

**(k) Accounts receivable**

Accounts receivable, which generally have credit terms of 30 to 90 days, are recognised and carried at original invoice amount less allowances for any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off as incurred.

**(l) Cash equivalents**

For the purpose of the combined cash flow statements, cash equivalents represent short term highly liquid investments which are readily convertible into known amounts of cash and which were within three months of maturity when acquired, less advances from banks repayable within three months from the date of the advance. For the purpose of the combined balance sheet classification, cash and bank balances represent assets which are not restricted as to use.

**(m) Deferred tax**

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

**(n) 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:

- (i) 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;
- (ii) taxes refund/government subsidies, on a cash receipt basis; and
- (iii) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable.



(o) **Dividends**

Dividends proposed by the directors are classified as a separate allocation of retained earnings within capital and reserves in the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

(p) **Operating leases**

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

(q) **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 combination, the financial statements of overseas subsidiaries denominated in foreign currencies 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.

(r) **Pension costs**

The Group operates a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for all of its employees in Hong Kong. The MPF Scheme has operated since 1st December, 2000. Contributions are made based on a percentage of the employees' basic salaries and are charged to the profit and loss account as they become payable in accordance with the rules of the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in an independently administered fund. The Group's employer contributions vest fully with the employees when contributed into the MPF Scheme.

The employees of the Group's subsidiaries which operate in the PRC are required to participate in a central pension scheme operated by the local municipal government. These PRC subsidiaries are required to contribute 22% - 30% of their payroll costs to the central pension scheme.

## 3. RESULTS

The following is a summary of the combined results of the Group for the Relevant Periods prepared on the basis set out in Section 1 above:

	Notes	Year ended 31st December,		
		1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Turnover	(a)	453,806	581,185	836,704
Cost of sales		<u>(245,751)</u>	<u>(303,797)</u>	<u>(455,567)</u>
Gross profit		208,055	277,388	381,137
Other revenue	(a)	2,518	5,251	8,755
Selling and distribution costs		(78,841)	(86,497)	(133,088)
Administrative expenses		(59,125)	(65,207)	(83,580)
Other operating expenses		<u>(14,482)</u>	<u>(14,718)</u>	<u>(20,963)</u>
Profit from operating activities	(b)	58,125	116,217	152,261
Finance costs	(d)	<u>(17,445)</u>	<u>(17,192)</u>	<u>(33,473)</u>
Profit before tax		40,680	99,025	118,788
Tax	(e)	<u>(7,284)</u>	<u>(14,343)</u>	<u>(33,775)</u>
Profit before minority interests		33,396	84,682	85,013
Minority interests		<u>149</u>	<u>273</u>	<u>(3,578)</u>
Net profit from ordinary activities attributable to shareholders		<u>33,545</u>	<u>84,955</u>	<u>81,435</u>
Transfer to proposed reserve fund		<u>2,051</u>	<u>4,590</u>	<u>5,314</u>
Transfer to proposed enterprise expansion fund		<u>2,051</u>	<u>4,590</u>	<u>5,314</u>
Dividends	(f)	<u>29,443</u>	<u>75,775</u>	<u>—</u>
Earnings per share				
— Basic, HK cents	(g)	<u>5.08</u>	<u>12.87</u>	<u>12.34</u>

Notes:

(a) **Turnover and revenue**

Turnover represents the net invoiced value of goods sold, after allowances for returns and trade discounts, value-added tax and consumption tax. All significant intra-group transactions have been eliminated on combination.

An analysis of the Group's turnover and revenue is as follows:

	<b>Year ended 31st December,</b>		
	<b>1999</b>	<b>2000</b>	<b>2001</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Turnover - sale of beer	<u>453,806</u>	<u>581,185</u>	<u>836,704</u>
Sale of raw materials, packaging materials and by-products	1,501	1,676	3,921
Taxes refund/government subsidies	735	3,399	4,337
Interest income	<u>282</u>	<u>176</u>	<u>497</u>
Other revenue	<u>2,518</u>	<u>5,251</u>	<u>8,755</u>
Total revenue	<u><u>456,324</u></u>	<u><u>586,436</u></u>	<u><u>845,459</u></u>

## (b) Profit from operating activities

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

	Year ended 31st December,		
	1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Depreciation	32,644	45,871	69,769
Amortisation of intangible assets, other than goodwill*	1,434	1,441	1,758
Amortisation of goodwill*	—	—	2,251
Minimum lease payments under operating leases on land and buildings	—	757	1,120
Payment for the use of land	450	452	628
Payment for the use of plant and machinery	10,799	901	2,806
Payment for the use of trademark	—	—	471
Auditors' remuneration	400	650	234
Staff costs (excluding directors' remuneration - note (c))			
Wages and salaries	40,264	42,136	52,954
Pension contributions	6,573	7,551	9,349
Total staff costs	<u>46,837</u>	<u>49,687</u>	<u>62,303</u>
Provision for doubtful debts	822	2,242	24
Loss on disposal of fixed assets	2,513	2,011	617
Exchange gains, net	—	—	(260)
Interest income	<u>(282)</u>	<u>(176)</u>	<u>(497)</u>

\* The amortisation of intangible assets and goodwill are included in "Other operating expenses" on the face of the profit and loss account.

During the Relevant Periods, salaries in respect of the Group's employees and office rentals in Hong Kong with aggregate amounts of approximately HK\$720,000, HK\$1,384,000 and HK\$2,457,000 for the years ended 31st December, 1999, 2000 and 2001, respectively, were absorbed by one of the Company's shareholders. Had these amounts been recorded by the Group during the Relevant Periods, the Group's administrative expenses would have increased and the net profit from ordinary activities attributable to shareholders would have decreased by the corresponding amounts.

## (c) Directors' and senior executives' emoluments

Details of the directors' remuneration for the Relevant Periods are as follows:

	Year ended 31st December,		
	1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Fees	—	—	—
Other emoluments:			
Basic salaries and other allowances	450	530	562
Pension scheme contributions	<u>99</u>	<u>117</u>	<u>124</u>
	<u>549</u>	<u>647</u>	<u>686</u>

All directors' remuneration for the Relevant Periods fell within the range of nil to HK\$1,000,000.

During the Relevant Periods, the directors' remuneration paid to two directors amounted to approximately HK\$2,815,000, HK\$1,900,000 and HK\$1,690,000 for the years ended 31st December, 1999, 2000 and 2001, respectively, was absorbed by one of the Company's shareholders. Had these amounts been recorded by the Group during the Relevant Periods, the Group's administrative expenses would have increased and the net profit from ordinary activities attributable to shareholders would have decreased by the corresponding amounts.

The five highest paid individuals of the Group during the Relevant Periods included three directors for the Relevant Periods, and information relating to their emoluments has been disclosed above. The details of the emoluments of the remaining two non-director, highest paid individuals for the Relevant Periods are as follows:

	Year ended 31st December,		
	1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Basic salaries and other allowances	118	163	248
Pension scheme contributions	<u>26</u>	<u>36</u>	<u>55</u>
	<u>144</u>	<u>199</u>	<u>303</u>

The remuneration of all non-director, highest paid individuals for the Relevant Periods fell within the range of nil to HK\$1,000,000.

During the Relevant Periods, 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 director has waived or agreed to waive any emoluments during the Relevant Periods.

## (d) Finance costs

	Year ended 31st December,		
	1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Interest expense on:			
Bank loans wholly repayable within five years	16,149	16,361	30,398
Other loans wholly repayable within five years	—	—	224
Loan from a former joint venture partner of a subsidiary	1,296	831	84
Amount due to a joint venture partner of a subsidiary	—	—	1,173
Convertible notes	—	—	182
	<u>17,445</u>	<u>17,192</u>	<u>32,061</u>
Other finance cost:			
Amortisation of deferred expenditure	—	—	1,412
	<u>17,445</u>	<u>17,192</u>	<u>33,473</u>

## (e) Tax

No provision for Hong Kong profits tax has been made as the Group had no assessable profits for the Relevant Periods. Taxes on profits assessable elsewhere have been calculated at the applicable rates of tax prevailing in the countries in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

Harbin Brewing Company Limited ("HB Company") and HB Songjiang were established and are operating in the Harbin city, one of the designated provincial capitals in the PRC, and are subject to a 24% statutory corporate income tax rate. HB Company is exempt from the PRC corporate income tax for the first two profitable years of operation starting from 1996 and, thereafter, is eligible for a 50% relief from the PRC corporate income tax for the following three years. Accordingly, for the two years ended 31st December, 2000, PRC corporate income tax has been provided at a reduced rate of 12% on the estimated assessable income generated by HB Company in respect of its fourth and fifth profit-making years. From 2001 onwards, HB Company is subject to a corporate income tax rate of 24%. HB Songjiang is exempt from the PRC corporate income tax for the first two profitable years of operation starting from 2001 and, thereafter, is eligible for a 50% relief from the PRC corporate income tax for the following three years. Accordingly, no provision for PRC corporate income tax of HB Songjiang has been made for the Relevant Periods.

Jilin GD-Yinpu Beer Company Limited ("Yinpu JV") was established and is operating in the Changchun city, one of the designated provincial capitals in the PRC, and is subject to a 24% statutory corporate income tax rate. Yinpu JV is exempt from the PRC corporate income tax for the first two profitable years of operation starting from 1998 and, thereafter, is eligible for a 50% relief from the PRC corporate income tax for the following three years. Accordingly, for the two years ended 31st December, 2001, PRC corporate income tax has been provided at a reduced rate of 12% on the estimated assessable income generated by Yinpu JV in respect of its third and fourth profit-making years.

Jiamusi Yuehai Jiafeng Brewery Company Limited ("Jiamusi JV") and Mudanjiang Jing Po Brewery Company Limited ("Mudanjiang JV"), subsidiaries established and operating in the PRC, are subject to a 33% statutory corporate income tax rate. Jiamusi JV is exempt from the PRC corporate income tax for the first two profitable years of operation starting from 2000 and, thereafter, is eligible for a 50% relief from the PRC corporate income tax for the following three years. Accordingly, no PRC corporate income tax of Jiamusi JV has been provided for in the Relevant Periods. Mudanjiang JV is exempt from the PRC corporate income tax for the first two profitable years of operation starting from 1997 and, thereafter, is eligible for a 50% relief from the PRC corporate income tax for the following three years. Accordingly, for the three years ended 31st December, 2001, PRC corporate income tax has been provided at a reduced rate of 16.5% on the estimated assessable income generated by Mudanjiang JV in respect of its third, fourth and fifth profit-making years.

The Group's other subsidiaries established and operating in the PRC, namely Harbin Brewing (Hegang) Company Limited, Jilin Harbin Brewing Company Limited and Harbin Tianhe Bio-engineering Company Limited, are subject to a 33% statutory corporate income tax rate.

No provision for deferred tax has been made as the Group did not have any significant unprovided deferred tax in respect of the Relevant Periods.

(f) **Dividends**

No dividend has been paid or declared by the Company since its incorporation. The dividends paid by the Company's subsidiary to its then shareholders during the Relevant Periods are as follows:

	Year ended 31st December,		
	1999 <i>HK\$'000</i>	2000 <i>HK\$'000</i>	2001 <i>HK\$'000</i>
Harbin Brewery Holdings Limited (Formerly The New China Hong Kong Brewery (Harbin) Limited)	15,310	39,403	—
Harbin Brewery Factory	14,133	—	—
Harbin Brewery Factory (BVI) Limited	—	36,372	—
	<u>29,443</u>	<u>75,775</u>	<u>—</u>

The dividend rates and the number of shares ranking for dividend are not presented as such information is not meaningful for the purpose of this report.

(g) **Earnings per share**

The calculation of basic earnings per share is based on the net profit from ordinary activities attributable to shareholders for the Relevant Periods and on the assumption that 660,000,000 ordinary shares were in issue and issuable, comprising 1,000,000 shares in issue as at the date of the Prospectus and 659,000,000 shares to be issued pursuant to the capitalisation issue, as more fully described in the paragraph headed "Written resolutions of the shareholders of the Company passed on 3rd June, 2002 and 17th June, 2002" in the section headed "Further information about the Company" in Appendix VI to the Prospectus.

No diluted earnings per share have been presented for the Relevant Periods as the Company did not have any dilutive potential ordinary shares during the Relevant Periods.

(h) **Related party transactions**

In addition to the balances detailed elsewhere in this report, the Group had the following material related party transactions during the Relevant Periods:

Nature of transaction	Notes	Year ended 31st December,		
		1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
<b>Joint venture partners of subsidiaries</b>				
Payment to Harbin Songjiang Electrical and Mechanical Factory for the use of land	(i)	450	452	415
Payment to Jilin Province Guoren Beer Company Limited for the use of plant and machinery	(ii)	—	901	984
Payment to Yinpu Brewery Factory, Jilin Province, for the use of land	(iii)	—	—	151
Payment to Yinpu Brewery Factory, Jilin Province, for the use of trademark	(iv)	—	—	471
Payment to Jiamusi Brewery Factory for the use of plant and machinery	(v)	—	—	1,822
Purchase of plant and machinery from Jiamusi Brewery Factory	(v)	—	—	14,139
Interest to Jiamusi Brewery Factory	(vi)	—	—	1,172
<b>Former joint venture partners of subsidiaries</b>				
Interest to Asia Brewery (China) Investment Co., Ltd. ("Asia Brewery")	(vii)	1,296	831	84
Payment to Harbin Brewery Factory for the use of buildings and plant and machinery	(viii)	10,799	—	—
Purchase of buildings and plant and machinery from Harbin Brewery Factory	(viii)	56,367	—	—
<b>Subsidiaries of a former joint venture partner of a subsidiary</b>				
Purchase of buildings and plant and machinery from Brewery Reprocessing Co., Ltd. ("Brewery Reprocessing")	(ix)	28,410	—	—
Purchase of spare parts from Brewery Reprocessing	(x)	—	1,881	—



*Notes:*

- (i) The payment for the use of land was determined based on RMB5 per square metre and was charged at RMB480,000 per annum commencing from 8th October, 1998.
- (ii) The payment for the use of plant and machinery was charged at 6.5% on the revalued amount of the relevant assets, which was based on a valuation at 31st December, 1999 performed by an independent valuer in the PRC.
- (iii) The payment for the use of land was determined based on RMB8 per square metre with reference to the market price prevailing at the time of entering into the contract and was charged at RMB320,000 per annum commencing from 21st March, 1997.
- (iv) The payment for the use of trademark was charged at RMB1,000,000 per annum.
- (v) The payment for the use of plant and machinery was charged by reference to the prevailing bank lending rate quoted by the People's Bank of China on the revalued amount of the relevant assets, which was based on a valuation at 21st January, 1997 performed by an independent valuer in the PRC. In November 2001, the Group acquired from Jiamusi Brewery Factory the related plant and machinery which were previously leased by the Group. The purchase price was at an agreed consideration of RMB15,000,000, determined with reference to a valuation at 30th November, 2000 performed by an independent valuer in the PRC, as adjusted for a discount of approximately 28%.
- (vi) The interest arose from the amount due to Jiamusi Brewery Factory, of which the details of the terms are disclosed in note 4(f) to this report.
- (vii) The interest arose from the loans from Asia Brewery, of which the details of the terms are disclosed in note 4(k) to this report.
- (viii) The payment for the use of buildings and plant and machinery was charged at 18% on the related loan principal amount borrowed by Harbin Brewery Factory for the construction of the buildings and plant and machinery. In December 1999, the Group acquired from Harbin Brewery Factory the related buildings and plant and machinery which were previously leased to the Group. The purchase price was determined based on the net book values of these assets at the date of disposal by Harbin Brewery Factory.
- (ix) The purchase price of buildings and plant and machinery was determined based on a valuation at 4th May, 1999 performed by an independent valuer in the PRC.
- (x) In the opinion of the directors, the purchase prices were effected on prices and terms similar to those granted by other suppliers.

In the opinion of the directors, the above transactions were carried out in the ordinary course of business of the Group.

The directors have confirmed that, except for those transactions described in notes (ii) and (iv) above, the other related party transactions will not continue after the Company's shares are listed on the Stock Exchange.

As mentioned in notes 3(b) and 3(c) to this report, salaries in respect of the Group's employees and office rentals in Hong Kong and directors' remuneration to certain directors aggregating HK\$3,535,000, HK\$3,284,000 and HK\$4,147,000 for the years ended 31st December, 1999, 2000 and 2001, respectively, were absorbed by one of the Company's shareholders. These expenses will be borne by the Group after the listing of the Company's shares on the Stock Exchange.

## 4. COMBINED BALANCE SHEETS

The following is a summary of the combined balance sheets of the Group as at the end of each of the Relevant Periods, prepared on the basis set out in Section 1 above.

	Notes	At 31st December,		
		1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
<b>NON-CURRENT ASSETS</b>				
Fixed assets	(a)	529,937	531,064	1,166,774
Intangible assets	(b)	22,985	21,640	26,349
Goodwill	(c)	—	—	87,756
Deferred expenditure		—	—	9,882
Deposits paid for purchases of fixed assets		3,525	3,720	22,800
Pledged bank deposits		—	—	7,839
		<u>556,447</u>	<u>556,424</u>	<u>1,321,400</u>
<b>CURRENT ASSETS</b>				
Inventories	(d)	93,830	122,211	238,231
Accounts receivable	(e)	12,824	36,557	115,005
Prepayments, deposits and other receivables		11,969	16,066	40,170
Due from the former joint venture partner of a subsidiary	(f)	17,483	18,312	—
Due from joint venture partners of subsidiaries	(f)	—	366	7,539
Cash and bank balances	(g)	<u>15,865</u>	<u>73,588</u>	<u>52,750</u>
		<u>151,971</u>	<u>267,100</u>	<u>453,695</u>
<b>CURRENT LIABILITIES</b>				
Accounts payable	(h)	49,237	73,849	163,172
Accruals and other liabilities		93,753	128,252	253,083
Convertible notes	(i)	—	—	21,800
Due to joint venture partners of subsidiaries	(f)	9,971	11,456	47,697
Loans from shareholders	(j)	—	—	53,545
Loans from a former joint venture partner of a subsidiary	(k)	10,985	5,261	—
Tax payable		3,795	6,220	7,205
Other loans	(l)	3,382	2,816	23,469
Interest-bearing bank loans	(m)	<u>201,923</u>	<u>180,822</u>	<u>144,477</u>
		<u>373,046</u>	<u>408,676</u>	<u>714,448</u>
<b>NET CURRENT LIABILITIES</b>		<u>(221,075)</u>	<u>(141,576)</u>	<u>(260,753)</u>

	Notes	At 31st December,		
		1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
TOTAL ASSETS LESS CURRENT LIABILITIES		335,372	414,848	1,060,647
NON-CURRENT LIABILITIES				
Interest-bearing bank loans	(m)	(39,245)	(66,189)	(564,162)
Due to joint venture partners of subsidiaries	(f)	—	—	(102,306)
Loans from a former joint venture partner of a subsidiary	(k)	(5,239)	—	—
		<u>(44,484)</u>	<u>(66,189)</u>	<u>(666,468)</u>
MINORITY INTERESTS		<u>(13,298)</u>	<u>(14,495)</u>	<u>(54,609)</u>
		<u>277,590</u>	<u>334,164</u>	<u>339,570</u>
Represented by:				
Combined shareholders' equity	(n)	<u>277,590</u>	<u>334,164</u>	<u>339,570</u>

## Notes:

## (a) Fixed assets

	At 31st December, 1999		
	Cost HK\$'000	Accumulated depreciation HK\$'000	Net book value HK\$'000
Land and buildings	168,064	16,838	151,226
Plant and machinery	410,849	66,910	343,939
Furniture, fixtures and equipment	2,066	620	1,446
Motor vehicles	13,694	3,940	9,754
Construction in progress	<u>23,572</u>	—	<u>23,572</u>
	<u>618,245</u>	<u>88,308</u>	<u>529,937</u>

	At 31st December, 2000		
	Cost	Accumulated	Net
	HK\$'000	depreciation	book value
Land and buildings	175,139	24,285	150,854
Plant and machinery	443,129	102,664	340,465
Furniture, fixtures and equipment	3,593	883	2,710
Motor vehicles	14,475	5,255	9,220
Construction in progress	27,815	—	27,815
	<u>664,151</u>	<u>133,087</u>	<u>531,064</u>

	At 31st December, 2001		
	Cost	Accumulated	Net
	HK\$'000	depreciation	book value
Land and buildings	368,845	37,287	331,558
Plant and machinery	862,509	153,213	709,296
Furniture, fixtures and equipment	11,555	2,097	9,458
Motor vehicles	26,098	8,662	17,436
Construction in progress	99,026	—	99,026
	<u>1,368,033</u>	<u>201,259</u>	<u>1,166,774</u>

The Group's land and buildings are situated in the PRC and are held under medium term leases.

Certain of the Group's land and buildings and plant and machinery, with net book value totalling HK\$617,139,000 at 31st December, 2001, were pledged to secure certain banking facilities and an other loan granted to the Group.

(b) **Intangible assets**

	At 31st December, 1999		
	Cost	Accumulated	Net
	HK\$'000	amortisation	book value
Trademarks	13,595	2,732	10,863
Right to use electricity	15,136	3,014	12,122
	<u>28,731</u>	<u>5,746</u>	<u>22,985</u>

	At 31st December, 2000		
	Cost	Accumulated	Net
	HK\$'000	amortisation	book value
		HK\$'000	HK\$'000
Trademarks	13,653	3,423	10,230
Right to use electricity	15,200	3,790	11,410
	<u>28,853</u>	<u>7,213</u>	<u>21,640</u>

	At 31st December, 2001		
	Cost	Accumulated	Net
	HK\$'000	amortisation	book value
		HK\$'000	HK\$'000
Trademarks	19,559	4,414	15,145
Right to use electricity	15,190	4,551	10,639
Technical know-how	566	1	565
	<u>35,315</u>	<u>8,966</u>	<u>26,349</u>

The trademarks and right to use electricity were contributed by the former PRC joint venture partner of HB Company and the respective PRC joint venture partners of Jiamusi JV and Mudanjiang JV as capital contribution at a value specified in their respective valuation reports issued for the purpose of capital contribution.

(c) **Goodwill and negative goodwill**

	Goodwill
	HK\$'000
Cost:	
Acquisition of subsidiaries (note 6(c)) and balance at 31st December, 2001	90,007
Accumulated amortisation:	
Amortisation provided for 2001 and balance at 31st December, 2001	<u>2,251</u>
Net book value:	
At 31st December, 2001	<u>87,756</u>

As detailed in note 2 to this report, the Group has adopted the transitional provision of SSAP 30 which permits negative goodwill in respect of acquisition which occurred prior to 1st January, 2001, to remain credited to the capital reserve. The amount of negative goodwill remaining in reserve, arising from the previous acquisition of a subsidiary, was HK\$94,000 as at 31st December, 1999, 2000 and 2001.

## (d) Inventories

	At 31st December,		
	1999 <i>HK\$'000</i>	2000 <i>HK\$'000</i>	2001 <i>HK\$'000</i>
Raw materials	14,342	24,698	78,880
Work in progress	9,420	11,422	21,850
Finished goods	3,585	9,717	16,061
Spare parts and consumables	14,823	16,555	29,212
Packaging materials	<u>51,660</u>	<u>59,819</u>	<u>92,228</u>
	<u>93,830</u>	<u>122,211</u>	<u>238,231</u>

As at the end of each of the Relevant Periods, no inventories were stated at net realisable value.

## (e) Accounts receivable

The general credit terms of the Group range from 30 to 90 days.

An aged analysis of accounts receivable is as follows:

	At 31st December,		
	1999 <i>HK\$'000</i>	2000 <i>HK\$'000</i>	2001 <i>HK\$'000</i>
Outstanding balances which age:			
Within 30 days	6,432	23,059	44,950
Between 31 and 60 days	955	1,351	27,479
Between 61 and 180 days	1,970	9,910	37,577
Between 181 and 365 days	<u>3,467</u>	<u>2,237</u>	<u>4,999</u>
	<u>12,824</u>	<u>36,557</u>	<u>115,005</u>

Accounts receivable as at 31st December, 1999 included an amount of HK\$2,396,000 due from Harbin Taijiali Brewery Co. Ltd., a company controlled by the former joint venture partner of a subsidiary, which arose from normal trading activity of the sale of beer in the prior year. The balance was fully settled in 2000.

## (f) Balances with the former joint venture partner/joint venture partners of subsidiaries

The current portion of the balances is unsecured, interest-free and has no fixed terms of repayment.

The non-current portion of the amounts due to joint venture partners of subsidiaries is unsecured and not repayable within one year. Except for an amount of HK\$28,082,000 as at 31st December, 2001 which bears interest at the prevailing lending rate quoted by the People's Bank of China, the remaining balances are interest-free.

Included in the non-current portion of the balances as at 31st December, 2001 was an amount of HK\$56,432,000 representing the excess capital contribution from the PRC joint venture partner of Mudanjiang JV. Subsequent to 31st December, 2001, the Group has made an application to the relevant PRC authorities for capitalisation of such excess capital contribution as paid-up capital of Mudanjiang JV. The amount has been verified by a local PRC firm of certified public accountants on 18th January, 2002 and the application is subject to approval by the relevant PRC authorities.

Had interest been charged on the interest-free portion of the outstanding balances during the Relevant Periods with reference to the Group's average interest rate on bank borrowings, the Group would have paid interest of approximately HK\$624,000, HK\$699,000 and HK\$4,526,000 for the years ended 31st December, 1999, 2000 and 2001, respectively. The joint venture partners of subsidiaries have undertaken that the balances will remain as interest-free after the Company's shares are listed on the Stock Exchange.

(g) **Cash and bank balances**

The cash and bank balances were substantially denominated in Renminbi ("RMB"). RMB is not freely convertible into foreign currencies. Subject to the PRC's Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for foreign currencies through banks authorised to conduct foreign exchange business.

(h) **Accounts payable**

An aged analysis of the accounts payable is as follows:

	<b>At 31st December,</b>		
	<b>1999</b>	<b>2000</b>	<b>2001</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Outstanding balances which age:			
Within 30 days	23,883	28,139	56,684
Between 31 and 60 days	8,100	8,833	30,029
Between 61 and 180 days	15,291	25,178	62,538
Between 181 and 365 days	1,108	7,633	8,790
Between 366 and 540 days	855	4,066	5,131
	<u>49,237</u>	<u>73,849</u>	<u>163,172</u>

(i) **Convertible notes**

On 30th October, 2001, the Company issued a total of HK\$21.8 million convertible notes (the "Notes") to two independent third parties. The Notes bear interest at 5% per annum and will mature on 29th October, 2002. Pursuant to these subscription agreements dated 29th October 2001, if the date of listing of the Company's shares on the Stock Exchange (the "Listing Date") falls within the period from 2nd April, 2002 to 29th October, 2002, the noteholders may, at their sole discretion, extend the maturity date to eight months from the Listing Date. The issue price of the Notes was 100% of their principal amount.

The Notes are, at the option of the noteholders, convertible into fully paid ordinary shares of HK\$0.1 each in the Company at the offer price of HK\$1.485, subject to adjustments. The conversion period for the Notes is from the Listing Date up to the fifth business day prior to the maturity date of the Notes (as may be amended pursuant to these subscription agreements), both dates inclusive. On conversion, the outstanding principal amount of the Notes and the unpaid accrued interest thereon will be converted to the new shares to be issued by the Company.

Unless previously redeemed or converted, the Notes will be redeemed by the Company on the maturity date at their principal amount plus accrued and unpaid interest on the maturity date. In the opinion of the directors of the Company, as the extension of the maturity date is not secured, the Notes have been classified as current liabilities as at the balance sheet date.

(j) **Loans from shareholders**

The amounts are unsecured, interest-free and have no fixed terms of repayment.

Had interest been charged on the outstanding balance with reference to the Group's average interest rate on bank borrowings, the Group would have paid interest of approximately HK\$1,762,000 for the year ended 31st December, 2001. The shareholders have undertaken that the balances will remain as interest-free after the Company's shares are listed on the Stock Exchange.

(k) **Loans from a former joint venture partner of a subsidiary**

The loans as at 31st December, 1999 and 2000 are unsecured. Apart from an amount of HK\$469,000 as at 31st December, 1999, which was interest-free and was repaid in 2000, the remaining amount bears interest at the prevailing lending rate quoted by the People's Bank of China and is repayable by installments on semi-annual basis with final maturity due on 30th March, 2001.

(l) **Other loans**

	Notes	At 31st December,		
		1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Other loans:				
Secured	(i)	3,382	2,816	2,531
Unsecured	(ii)	—	—	20,938
		<u>3,382</u>	<u>2,816</u>	<u>23,469</u>

(i) This other loan is secured by certain of the Group's plant and machinery with net book value of HK\$511,000 as at 31st December, 2001, interest-free and has no fixed terms of repayment.

(ii) Unsecured other loans are repayable on demand or not exceeding one year. These loans as at 31st December, 2001 included (i) an amount of HK\$5,070,000 which bears interest at a fixed rate of 10% per annum; and (ii) an amount of HK\$5,126,000 which bears interest at the prevailing bank lending rate quoted by the People's Bank of China. The remaining balances are interest-free.

Had interest been charged on the interest-free portion of the outstanding balances during the Relevant Periods with reference to the Group's average interest rate on bank borrowings, the Group would have paid interest of approximately HK\$247,000, HK\$200,000 and HK\$493,000 for the years ended 31st December, 1999, 2000 and 2001, respectively.



## (m) Interest-bearing bank loans

	At 31st December,		
	1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Bank loans:			
Secured	219,369	230,794	617,430
Unsecured	<u>21,799</u>	<u>16,217</u>	<u>91,209</u>
	<u>241,168</u>	<u>247,011</u>	<u>708,639</u>
Bank loans repayable:			
Within one year	201,923	180,822	144,477
In the second year	21,406	66,189	468,250
In the third to fifth years, inclusive	<u>17,839</u>	<u>—</u>	<u>95,912</u>
	241,168	247,011	708,639
Portion classified as current liabilities	<u>(201,923)</u>	<u>(180,822)</u>	<u>(144,477)</u>
Non-current portion	<u>39,245</u>	<u>66,189</u>	<u>564,162</u>

Certain of the Group's land and buildings and plant and machinery, with net book value totalling HK\$616,628,000 as at 31st December, 2001, were pledged to secure certain banking facilities granted to the Group.

## (n) Combined shareholders' equity

	Note	At 31st December,		
		1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Share capital		100	100	100
Reserves	(o)	248,047	258,289	339,470
Proposed dividends		<u>29,443</u>	<u>75,775</u>	<u>—</u>
		<u>277,590</u>	<u>334,164</u>	<u>339,570</u>

The Company was incorporated on 23rd February, 2001 and an aggregate 1,000,000 shares of HK\$0.10 each were issued as at 31st December, 2001.

For the purpose of preparation of the combined balance sheets, the share capital at 31st December, 1999, 2000 and 2001, respectively, represents 1,000,000 shares of the Company of HK\$0.10 each in issue at the date of the Prospectus, on the basis that the Company had been in existence at 1st January, 1999.

## (o) Reserves

	At 31st December,		
	1999	2000	2001
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
<b>Retained profits</b>			
At beginning of year	—	—	—
Net profit for the year attributable to shareholders	33,545	84,955	81,435
Transfer to reserves	(4,102)	(9,180)	(10,628)
Dividends	<u>(29,443)</u>	<u>(75,775)</u>	<u>—</u>
At end of year	<u>—</u>	<u>—</u>	<u>70,807</u>
<b>Capital reserve</b>			
At beginning and at end of year	<u>176</u>	<u>176</u>	<u>176</u>
<b>Exchange fluctuation reserve</b>			
At beginning of year	1,813	2,438	3,500
Movements during the year	<u>625</u>	<u>1,062</u>	<u>(254)</u>
At end of year	<u>2,438</u>	<u>3,500</u>	<u>3,246</u>
<b>Reserve fund</b>			
At beginning of year	2,970	4,544	6,595
Transfer from proposed reserve fund	<u>1,574</u>	<u>2,051</u>	<u>4,590</u>
At end of year	<u>4,544</u>	<u>6,595</u>	<u>11,185</u>
<b>Enterprise expansion fund</b>			
At beginning of year	2,970	4,544	6,595
Transfer from proposed enterprise expansion fund	<u>1,574</u>	<u>2,051</u>	<u>4,590</u>
At end of year	<u>4,544</u>	<u>6,595</u>	<u>11,185</u>
<b>Proposed reserve fund</b>			
At beginning of year	1,574	2,051	4,590
Transfer from profit and loss account	2,051	4,590	5,314
Transfer to reserve fund	<u>(1,574)</u>	<u>(2,051)</u>	<u>(4,590)</u>
At end of year	<u>2,051</u>	<u>4,590</u>	<u>5,314</u>
<b>Proposed enterprise expansion fund</b>			
At beginning of year	1,574	2,051	4,590
Transfer from profit and loss account	2,051	4,590	5,314
Transfer to enterprise expansion fund	<u>(1,574)</u>	<u>(2,051)</u>	<u>(4,590)</u>
At end of year	<u>2,051</u>	<u>4,590</u>	<u>5,314</u>
<b>Surplus</b>			
At beginning and at end of year	<u>232,243</u>	<u>232,243</u>	<u>232,243</u>

The reserve fund and the enterprise expansion fund are non-distributable and the transfers to these funds are determined by the board of directors of the PRC subsidiaries in accordance with the relevant laws and regulations of the PRC. The reserve fund and the enterprise expansion fund can be used to make good future losses or to increase the capital of the PRC subsidiaries.

The surplus represents reserve arising from the Group reorganisation on the basis that the Company had become the holding company of the Group on 1st January, 1999 and it represents the difference between the nominal value of the share capital issued by the Company and the combined share capital of the subsidiaries of the Company.

(p) **Contingent liabilities**

At 31st December, 2001, the Group had given guarantees of approximately HK\$3,770,000 to a bank in connection with credit facilities granted to certain employees of a subsidiary for financing the construction of employees' quarters. Upon the issuance of building ownership certificate, the employees' quarters will be mortgaged to secure the credit facilities and replace the guarantees.

(q) **Operating lease arrangements**

As lessee

The Group leases certain of its office properties under operating lease arrangements. Leases for properties are negotiated for terms ranging from 1 to 20 years.

At 31st December, 2001, the Group had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	<i>HK\$'000</i>
Within one year	3,962
In the second to fifth years, inclusive	2,265
After five years	<u>1,382</u>
	<u><u>7,609</u></u>

(r) **Commitments**

In addition to the operating lease commitments detailed in note 4(q) above, the Group had the following commitments at 31st December, 2001:

	<i>HK\$'000</i>
(i) Capital commitments in respect of construction/installation of plant and machinery Contracted for	<u><u>66,021</u></u>
(ii) Other commitment	

At 31st December, 2001, the Group had total committed payment of HK\$4.7 million to Yinpu Brewery Factory, Jilin Province, a joint venture partner of a subsidiary, for the use of trademark.

(s) **Pledge of assets**

In addition to the pledge of assets set out in note 4(a) to this report, the Group borrowed a syndicated bank loan of US\$22 million (HK\$171.6 million) in June 2001, which is secured by the followings:

- (i) Bank deposits of US\$1 million (HK\$7.8 million);
- (ii) Floating charge over the assets of the Company and the assets of all of the Company's subsidiaries. This floating charge will be released following the listing of the Company's shares;
- (iii) Share mortgage/assignment of the ownership rights of the Group's interests in subsidiaries; and
- (iv) Assignment of the Company's shareholders loans.

(t) **Net tangible assets of the Company**

The Company was incorporated on 23rd February, 2001. On the basis set out in Section 1 above, the net tangible assets of the Company as at 31st December, 2001 was HK\$280,793,000, representing mainly its investments in subsidiaries.

(u) **Distributable reserves**

As at 31st December, 2001, the Company's reserves available for distribution to the shareholders of the Company at that date amounted to HK\$290,575,000.

**5. COMBINED STATEMENTS OF MOVEMENTS IN EQUITY**

The movements in the combined shareholders' equity of the Group for each of the Relevant Periods, prepared on the basis set out in Section 1 above, are as follows:

	<b>Year ended 31st December,</b>		
	<b>1999</b>	<b>2000</b>	<b>2001</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
At beginning of year	256,924	277,590	334,164
Net profit from ordinary activities			
attributable to shareholders	33,545	84,955	81,435
Dividends paid	(13,504)	(29,443)	(75,775)
Exchange fluctuation reserve	625	1,062	(254)
	<u>277,590</u>	<u>334,164</u>	<u>339,570</u>
At end of year	<u>277,590</u>	<u>334,164</u>	<u>339,570</u>

## 6. COMBINED CASH FLOW STATEMENTS

The combined cash flow statements of the Group for the Relevant Periods, prepared on the basis set out in Section 1 above, are as follows:

	Notes	Year ended 31st December,		
		1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
NET CASH INFLOW FROM OPERATING ACTIVITIES	(a)	93,264	147,354	175,998
RETURNS ON INVESTMENTS AND SERVICING OF FINANCE				
Interest received		282	176	497
Interest paid		(17,445)	(17,192)	(32,061)
Dividends paid		<u>(13,504)</u>	<u>(29,443)</u>	<u>(75,775)</u>
Net cash outflow from returns on investments and servicing of finance		<u>(30,667)</u>	<u>(46,459)</u>	<u>(107,339)</u>
TAX				
PRC corporate income tax paid		<u>(4,905)</u>	<u>(11,918)</u>	<u>(34,208)</u>
INVESTING ACTIVITIES				
Purchases of/additions to fixed assets		(117,669)	(25,421)	(102,009)
Proceeds from disposal of fixed assets		3,011	1,074	865
Purchase of intangible asset		—	—	(566)
Increase in deposits paid for purchases of fixed assets		(1,835)	(196)	(16,840)
Acquisition of subsidiaries	(c)	—	—	(207,212)
Acquisition of additional interest in a subsidiary		—	—	(6,409)
Increase in pledged bank deposits		<u>—</u>	<u>—</u>	<u>(7,839)</u>
Net cash outflow from investing activities		<u>(116,493)</u>	<u>(24,543)</u>	<u>(340,010)</u>
NET CASH INFLOW/(OUTFLOW) BEFORE FINANCING ACTIVITIES		(58,801)	64,434	(305,559)

	Note	Year ended 31st December,		
		1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
<b>FINANCING ACTIVITIES</b>				
New bank loans	(b)	226,612	183,183	484,514
Repayment of bank loans	(b)	(169,000)	(178,370)	(256,431)
New other loans	(b)	—	—	13,977
Repayment of other loans	(b)	(186)	(579)	(3,770)
New convertible notes	(b)	—	—	21,800
Repayment of loans from a former joint venture partner of a subsidiary	(b)	(5,249)	(11,017)	(5,261)
Repayment of amounts due to joint venture partners of subsidiaries	(b)	—	—	(12,302)
Loans from shareholders	(b)	—	—	53,545
Payment of deferred expenditure		—	—	(11,294)
Net cash inflow/(outflow) from financing activities		<u>52,177</u>	<u>(6,783)</u>	<u>284,778</u>
<b>INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>				
		(6,624)	57,651	(20,781)
Cash and cash equivalents at beginning of year		22,428	15,865	73,588
Effect of foreign exchange rate changes, net		<u>61</u>	<u>72</u>	<u>(57)</u>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>		<u><u>15,865</u></u>	<u><u>73,588</u></u>	<u><u>52,750</u></u>
<b>ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS</b>				
Cash and bank balances		<u><u>15,865</u></u>	<u><u>73,588</u></u>	<u><u>52,750</u></u>

## (a) Reconciliation of profit from operating activities to net cash inflow from operating activities

	Year ended 31st December,		
	1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Profit from operating activities	58,125	116,217	152,261
Interest income	(282)	(176)	(497)
Depreciation	32,644	45,871	69,769
Amortisation of intangible assets	1,434	1,441	1,758
Amortisation of goodwill	—	—	2,251
Loss on disposal of fixed assets	2,513	2,011	617
Provision for doubtful debts	822	2,242	24
Increase in inventories	(4,848)	(28,170)	(33,362)
Increase in accounts receivable	(3,742)	(25,917)	(67,554)
Increase in prepayments, deposits and other receivables	(2,529)	(4,044)	(3,329)
Changes in balances with the former joint venture partners of subsidiaries	(6,095)	(866)	18,312
Changes in balances with joint venture partners of subsidiaries	514	1,087	9,620
Increase in accounts payable	8,584	24,458	38,754
Increase/(decrease) in accruals and other liabilities	6,124	13,200	(12,626)
	<u>93,264</u>	<u>147,354</u>	<u>175,998</u>
Net cash inflow from operating activities	<u>93,264</u>	<u>147,354</u>	<u>175,998</u>

## (b) Analysis of changes in financing activities during the Relevant Periods

	Bank and other loans HK\$'000	Convertible notes HK\$'000	Loans from a former joint venture partner of a subsidiary HK\$'000	Amounts due to joint venture partners of subsidiaries HK\$'000	Loans from shareholders HK\$'000	Minority interests HK\$'000
Balance at 1st January, 1999	186,650	—	21,427	—	—	13,414
Net cash inflow/(outflow) from financing activities	57,426	—	(5,249)	—	—	—
Share of loss for the year	—	—	—	—	—	(149)
Exchange realignment	474	—	46	—	—	33
Balance at 31st December, 1999 and 1st January, 2000	244,550	—	16,224	—	—	13,298
Net cash inflow/(outflow) from financing activities	4,234	—	(11,017)	—	—	—
Capital contribution by a joint venture partner of a subsidiary	—	—	—	—	—	1,413
Share of loss for the year	—	—	—	—	—	(273)
Exchange realignment	1,043	—	54	—	—	57
Balance at 31st December, 2000 and 1st January, 2001	249,827	—	5,261	—	—	14,495
Net cash inflow/(outflow) from financing activities	238,290	21,800	(5,261)	(12,302)	53,545	—
Arising from acquisition of additional interest in a subsidiary	—	—	—	—	—	(6,409)
Arising from acquisition of subsidiaries	244,295	—	—	114,657	—	42,994
Share of profit for the year	—	—	—	—	—	3,578
Exchange realignment	(304)	—	—	(49)	—	(49)
Balance at 31st December, 2001	<u>732,108</u>	<u>21,800</u>	<u>—</u>	<u>102,306</u>	<u>53,545</u>	<u>54,609</u>



## (c) Acquisition of subsidiaries

	Year ended 31st December,		
	1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Net liabilities acquired:			
Fixed assets	—	—	589,034
Intangible assets	—	—	5,918
Deposits paid for purchases of fixed assets	—	—	2,239
Inventories	—	—	82,771
Accounts receivable	—	—	10,762
Prepayments, deposits and other receivables	—	—	20,978
Due from joint venture partners of subsidiaries	—	—	16,775
Cash and bank balances	—	—	22,788
Accounts payable	—	—	(50,645)
Accruals and other liabilities	—	—	(128,984)
Tax payable	—	—	(1,419)
Bank and other loans	—	—	(244,295)
Due to joint venture partners of subsidiaries	—	—	(142,935)
Shareholder's loan	—	—	(229,031)
Minority interests	—	—	(42,994)
	—	—	(89,038)
Shareholder's loan to subsidiaries acquired	—	—	229,031
Goodwill arising from acquisition	—	—	90,007
	—	—	230,000
Satisfied by:			
Cash	—	—	230,000

Analysis of the net cash outflow of cash and cash equivalents in respect of the acquisition of a subsidiary:

	Year ended 31st December,		
	1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Cash consideration paid	—	—	(230,000)
Cash and bank balances acquired	—	—	22,788
Net cash outflow of cash and cash equivalents in respect of the acquisition of a subsidiary	—	—	(207,212)

On 29th June, 2001, the Group acquired the entire issued share capital of and shareholder's loan to King Victory from an independent third party as explained above. The purchase consideration for the acquisition was in the form of cash.

Since its acquisition, King Victory and its subsidiaries (the "King Victory Group") contributed HK\$33,659,000 to the Group's net operating cash flows, paid HK\$8,594,000 in respect of the net returns on investments and servicing of finance, paid HK\$1,966,000 in respect of tax, utilised HK\$31,747,000 in respect of investing activities and received HK\$11,954,000 for financing activities.

The King Victory Group acquired in 2001 contributed HK\$767,656,000 and HK\$571,050,000 to the Group's total assets and total liabilities as at 31st December, 2001, respectively, and contributed HK\$1,729,000 to the Group's net profit before minority interests for the period then ended.

(d) **Major non-cash transaction**

The capital contribution made by the joint venture partner of a subsidiary in 2000 was made in the form of non-current assets valued at HK\$1,413,000.

## 7. SEGMENT INFORMATION

During the Relevant Periods, the Group was principally engaged in the production and distribution of beer in the PRC, and over 90% of the Group's revenue was derived from customers based in the PRC. Accordingly, no business or geographical segment information is presented.

## 8. DIRECTORS' REMUNERATION

Save as disclosed herein, no remuneration has been paid or is payable in respect of any of the Relevant Periods referred to in this report by the Company, or any of the companies now comprising the Group, to the directors of the Company. Under the arrangements currently in force, the estimated amount of directors' fees and other emoluments payable to the directors of the Company for the year ending 31st December, 2002 will be approximately HK\$5 million.

## 9. SUBSEQUENT EVENTS

In addition to the subsequent event detailed in note 4(f) above, the Group had the following subsequent events;

- (a) The Group completed a reorganisation in preparation for the listing of shares of the Company on the Stock Exchange, the details of which are set out in the paragraph headed "Corporate reorganisation" under the section headed "Further information about the Company" of Appendix VI to the Prospectus.
- (b) Resolutions of shareholders of the Company were passed on 3rd June, 2002 and 17th June, 2002 to effect the transactions which are set out in the paragraph headed "Written resolutions of the shareholders of the Company passed on 3rd June, 2002 and 17th June, 2002" under the section headed "Further information about the Company" in Appendix VI to the Prospectus.

Save as aforesaid, no other significant events took place subsequent to 31st December, 2001.

**10. SUBSEQUENT FINANCIAL STATEMENTS**

No audited financial statements have been prepared by the Company, or any of the companies now comprising the Group, in respect of any period subsequent to 31st December, 2001.

Yours faithfully,  
**Ernst & Young**  
*Certified Public Accountants*  
Hong Kong