

This Accountants' Report of the Acquired Breweries is not required under the Listing Rules but is presented for information purposes.



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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 King Victory Investments Inc. ("King Victory") and its subsidiaries listed in Section 1 below (hereinafter collectively referred to as the "King Victory 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 Harbin Brewery Group Limited ("Harbin Brewery") dated 18th June, 2002 (the "Prospectus").

King Victory was incorporated with limited liability in the British Virgin Islands on 21st April, 1997 for the purpose of acting as the holding company of the Excluded Subsidiaries (as defined hereunder) prior to Harbin Brewery's acquisition of the entire interest in King Victory as further explained below and the other subsidiaries as set out in Section 1 below. King Victory has not carried on any business since the date of its incorporation except for the acquisition on 22nd May, 1997 of the entire issued share capital of Guangdong Brewery Northern (Holdings) Limited (formerly China Brewery Northern (Holdings) Limited), a company incorporated in Hong Kong, which is, at the date of this report, the intermediate holding company of the subsidiaries set out in Section 1 below.

On 29th June, 2001, Harbin Brewery acquired the entire issued share capital of and the related shareholder's loan to King Victory from Guangdong Alliance (BVI) No.29 Limited (the "Vendor"), an independent third party to Harbin Brewery, for an aggregate cash consideration of HK\$230,000,000 (the "Acquisition"). Prior to and for the purpose of the Acquisition, on 20th June, 2001, certain subsidiaries held by King Victory namely, Empire Prestige Limited, Link Resources Investment Limited, Sino Truth Resources Limited and Daqing GD Xiaoxue Brewery Company Limited (the "Excluded Subsidiaries") were disposed of to the Vendor at their then investment costs (the "Disposal"). For the purpose of preparing this report, the results of the Disposal, the results and the assets and liabilities of the Excluded Subsidiaries have been excluded from the King Victory Group's combined results for the Relevant Periods and combined balance sheets as at 31st December, 1999, 2000 and 2001, respectively.

As at the date of this report, no audited financial statements have been prepared for Golden Pacific Line Limited, Union Fortune Limited and Vanta International Investments Limited for the Relevant Periods. We have, however, performed our own independent review of all relevant transactions of these companies for the Relevant Periods.

For the purpose of this report, we have undertaken an independent audit of the financial statements of King Victory's subsidiaries established in the mainland of the People's Republic of China (the "PRC") for the Relevant Periods 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 King Victory Group for the Relevant Periods in accordance with the Auditing Guideline "Prospectuses and the reporting accountant" issued by the HKSA.

We have acted as auditors of all the companies now comprising the King Victory Group for the Relevant Periods, except for the following:

Company	Financial period
Guangdong Brewery Northern (Holdings) Limited	Years ended 31st December, 1999 and 2000
Extra Lucky Investment Limited	Years ended 31st December, 1999 and 2000
Fung Heng Investment Limited	Years ended 31st December, 1999 and 2000
Prestige Full Investment Limited	Years ended 31st December, 1999 and 2000

The financial statements relating to the above companies and periods were audited by KPMG, Certified Public Accountants, Hong Kong.

The summaries of the combined results, movements in equity and cash flows of the King Victory Group for the Relevant Periods and of the combined balance sheets of the King Victory 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 King Victory 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 King Victory Group for the Relevant Periods and of the combined balance sheets of the King Victory 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 King Victory Group, include the combined results, statements of movements in equity, cash flows and balance sheets of the companies now comprising the King Victory Group as if the current group structure of the King Victory Group had been in existence throughout the Relevant Periods. All significant intra-group transactions and balances have been eliminated on combination.

Notwithstanding that the King Victory Group had net current liabilities of HK\$76,593,000 and a deficiency in assets of HK\$88,191,000 as at 31st December, 2001, the Summaries have been prepared on the going concern basis as Harbin Brewery, the immediate holding company of King Victory following the completion of the Acquisition on 29th June, 2001 as noted above, has agreed to provide adequate funds for the King Victory Group to meet its liabilities and obligations as and when they fall due and not to demand repayment of the amount due to it until such time when the King Victory Group is in a position to do so.

At the date of this report, King Victory 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:

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
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
Golden Pacific Line Limited	British Virgin Islands 21st March, 1997	Ordinary US\$1	100%	Investment holding
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

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
Mudanjiang Jing Po Brewery Company Limited	PRC 28th December, 1995	RMB64,120,000	55%	Production and distribution of bottled beer
Prestige Full Investment Limited	Hong Kong 3rd December, 1997	Ordinary HK\$2	100%	Investment holding
Union Fortune Limited	British Virgin Islands 14th August, 1996	Ordinary US\$1	100%	Investment holding
Vanta International Investments Limited	British Virgin Islands 14th February, 1997	Ordinary US\$1	100%	Investment holding

2. PRINCIPAL ACCOUNTING POLICIES

This report has been prepared under the historical cost convention. The principal accounting policies adopted by the King Victory 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 King Victory 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 King Victory Group and other parties undertake an economic activity. The joint venture company operates as a separate entity in which the King Victory 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 King Victory has unilateral control over the joint venture company.

(c) 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.

(d) 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.

(e) 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%-15%
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.

(f) Intangible assets

Intangible assets, representing trademarks acquired, are stated at cost less accumulated amortisation and any impairment losses. Amortisation is calculated on the straight-line basis over their estimated useful lives of ten years.

(g) 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.

(h) 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 uncollectable 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.

(i) 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.

(j) **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.

(k) **Revenue recognition**

Revenue is recognised when it is probable that the economic benefits will flow to the King Victory 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 King Victory Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold; and
- (ii) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable.

(l) **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.

(m) **Pension costs**

The King Victory 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 King Victory Group in an independently administered fund. The King Victory Group's employer contributions vest fully with the employees when contributed into the MPF Scheme.

The employees of the King Victory 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 23% - 30% of their payroll costs to the central pension scheme.

3. RESULTS

The following is a summary of the combined results of the King Victory 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)	312,170	294,537	304,977
Cost of sales		<u>(234,606)</u>	<u>(219,477)</u>	<u>(228,599)</u>
Gross profit		77,564	75,060	76,378
Other revenue	(a)	1,120	798	1,121
Selling and distribution costs		(28,872)	(26,118)	(20,463)
Administrative expenses		(30,046)	(33,441)	(35,693)
Other operating expenses		<u>(16,405)</u>	<u>(20,406)</u>	<u>(11,913)</u>
Profit/(loss) from operating activities	(b)	3,361	(4,107)	9,430
Finance costs	(d)	<u>(39,865)</u>	<u>(17,043)</u>	<u>(18,579)</u>
Loss before tax		(36,504)	(21,150)	(9,149)
Tax	(e)	<u>(843)</u>	<u>(1,331)</u>	<u>(1,292)</u>
Loss before minority interests		(37,347)	(22,481)	(10,441)
Minority interests		<u>5,350</u>	<u>10,122</u>	<u>4,406</u>
Net loss from ordinary activities attributable to shareholders		<u><u>(31,997)</u></u>	<u><u>(12,359)</u></u>	<u><u>(6,035)</u></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 King Victory Group's turnover and revenue is as follows:

	Year ended 31st December,		
	1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Turnover - sale of beer	<u>312,170</u>	<u>294,537</u>	<u>304,977</u>
Sale of raw materials, packaging materials and by-products	930	635	1,012
Interest income	<u>190</u>	<u>163</u>	<u>109</u>
Other revenue	<u>1,120</u>	<u>798</u>	<u>1,121</u>
Total revenue	<u><u>313,290</u></u>	<u><u>295,335</u></u>	<u><u>306,098</u></u>

(b) **Profit/(loss) from operating activities**

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

	Year ended 31st December,		
	1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Depreciation	36,303	41,832	47,348
Amortisation of intangible assets*	626	629	630
Payment for the use of land	622	412	412
Payment for the use of plant and machinery	3,831	4,377	4,013
Payment for the use of trademark	937	942	943
Auditors' remuneration	49	87	59
Staff costs:			
Wages and salaries	27,312	26,643	29,102
Pension contributions	<u>4,665</u>	<u>4,272</u>	<u>5,078</u>
Total staff costs	<u>31,977</u>	<u>30,915</u>	<u>34,180</u>
Provision for doubtful debts	1,961	7,435	1,351
Loss/(gain) on disposal of fixed assets	10	332	(623)
Exchange losses/(gains), net	89	227	(255)
Interest income	<u>(190)</u>	<u>(163)</u>	<u>(109)</u>

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

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

During the Relevant Periods, no directors' remuneration was paid by the King Victory Group.

The details of the five non-director, highest paid employees for the Relevant Periods are as follows:

	Year ended 31st December,		
	1999	2000	2001
	HK\$'000	HK\$'000	HK\$'000
Basis salaries and other allowances	396	432	821
Pension scheme contributions	<u>2</u>	<u>20</u>	<u>20</u>
	<u>398</u>	<u>452</u>	<u>841</u>

The remuneration of all non-director, highest paid employees 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 King Victory Group to the directors or any of the five highest paid employees as an inducement to join or upon joining the King Victory 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	2000	2001
	HK\$'000	HK\$'000	HK\$'000
Interest expense on:			
Bank loans wholly repayable within five years	14,285	15,193	15,994
Other loans wholly repayable within five years	46	44	508
Amount due to a joint venture partner of a subsidiary	1,867	1,806	2,077
Loan from a former shareholder (note 4(k))	<u>23,667</u>	<u>—</u>	<u>—</u>
	<u>39,865</u>	<u>17,043</u>	<u>18,579</u>

(e) **Tax**

No provision for Hong Kong profits tax has been made as the King Victory 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 King Victory Group operates, based on existing legislation, interpretations and practices in respect thereof.

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 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.

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

(f) **Dividend**

No dividend has been paid or declared by King Victory since the date of its incorporation. No dividend has been paid or declared by any subsidiaries of King Victory during the Relevant Periods.

(g) **Loss per share**

The loss per share is not presented as the directors of King Victory consider that such information is not meaningful for the purpose of this report.

(h) **Related party transactions**

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

		Year ended 31st December,		
	<i>Notes</i>	1999	2000	2001
		<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Joint venture partners of subsidiaries				
Payment to Yinpu Brewery Factory, Jilin Province, for the use of land	(i)	299	301	302
Payment to Yinpu Brewery Factory, Jilin Province, for the use of trademark	(ii)	937	942	943
Payment to Jiamusi Brewery Factory for the use of plant and machinery	(iii)	3,831	4,377	4,013
Purchase of plant and machinery from Jiamusi Brewery Factory	(iii)	—	—	14,139
Interest to Jiamusi Brewery Factory	(iv)	1,867	1,806	2,077
Fellow subsidiaries				
Purchases of raw materials from Harbin Brewing Company Limited ("HB Company")	(v)	—	—	3,223
Sale of raw materials to HB Company	(vi)	—	—	(2,619)
Sale of beer to HB Company	(vii)	—	—	(1,894)
Sale of beer to Jilin Harbin Brewing Company Limited ("HB Jilin")	(vii)	—	—	(354)
Former shareholder				
Interest to Kingway (International) Industry Development Company Limited ("Kingway")	(viii)	23,667	—	—
Fellow subsidiaries of the former shareholder				
Purchases of raw materials from Ningbo Malting Co., Ltd.	(ix)	21,974	3,531	—
Sale of beer to Daqing Fada Sales Company	(x)	(1,515)	—	—

Notes:

- (i) 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.
- (ii) The payment for the use of trademark was charged at RMB1,000,000 per annum.
- (iii) 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 King Victory Group acquired from Jiamusi Brewery Factory the related plant and machinery which were previously leased by the King Victory 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%.
- (iv) The interest arose from the amount due to Jiamusi Brewery Factory, of which the details of the terms are disclosed in note 4(e) to this report.
- (v) The purchase prices were determined based on the purchase cost of HB Company.
- (vi) The selling prices were determined based on the purchase cost of the King Victory Group.
- (vii) In the opinion of the directors of King Victory, the selling prices were effected on prices and terms similar to those granted to other customers.
- (viii) The interest arose from the loan from Kingway, a former shareholder of King Victory, of which the details of the terms are disclosed in note 4(k) to this report.
- (ix) In the opinion of the directors of King Victory, the purchase prices were effected on prices and terms similar to those granted by other suppliers.
- (x) In the opinion of the directors of King Victory, the selling prices were effected on prices and terms similar to those granted to other customers.

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

The directors of King Victory have confirmed that, except for the transaction described in note (ii) above, the other related party transactions will not continue after the shares of Harbin Brewery, King Victory's immediate holding company, are listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

4. COMBINED BALANCE SHEETS

The following is a summary of the combined balance sheets of the King Victory 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
NON-CURRENT ASSETS				
Fixed assets	(a)	576,336	597,510	604,106
Intangible assets	(b)	6,835	6,234	5,600
Deposits paid for purchases of fixed assets		1,494	2,845	2,093
		<u>584,665</u>	<u>606,589</u>	<u>611,799</u>
CURRENT ASSETS				
Inventories	(c)	68,002	96,111	101,892
Accounts receivable	(d)	18,942	11,155	11,509
Prepayments, deposits and other receivables		14,608	12,678	11,231
Due from joint venture partners of subsidiaries	(e)	20,813	7,430	7,538
Fixed deposits		755	2,053	—
Cash and bank balances	(f)	13,495	6,456	26,084
		<u>136,615</u>	<u>135,883</u>	<u>158,254</u>
CURRENT LIABILITIES				
Accounts payable	(g)	46,881	47,320	45,713
Accruals and other liabilities		83,760	120,174	135,474
Due to joint venture partners of subsidiaries	(e)	12,436	13,663	19,999
Due to a fellow subsidiary	(h)	—	—	14,134
Tax payable		—	1,177	3
Other loans	(i)	4,694	9,146	19,524
Interest-bearing bank loans	(j)	198,573	222,805	—
		<u>346,344</u>	<u>414,285</u>	<u>234,847</u>
NET CURRENT LIABILITIES		<u>(209,729)</u>	<u>(278,402)</u>	<u>(76,593)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		374,936	328,187	535,206

	Notes	At 31st December,		
		1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
NON-CURRENT LIABILITIES				
Interest-bearing bank loans	(j)	(9,858)	(5,186)	(248,902)
Due to joint venture partners of subsidiaries	(e)	(114,194)	(114,679)	(102,306)
Loan from a former shareholder/ immediate holding company	(k)	<u>(263,356)</u>	<u>(242,801)</u>	<u>(229,031)</u>
		<u>(387,408)</u>	<u>(362,666)</u>	<u>(580,239)</u>
MINORITY INTERESTS				
		<u>(57,529)</u>	<u>(47,614)</u>	<u>(43,158)</u>
		<u>(70,001)</u>	<u>(82,093)</u>	<u>(88,191)</u>
Represented by:				
Combined shareholders' equity	(l)	<u>(70,001)</u>	<u>(82,093)</u>	<u>(88,191)</u>

Notes:

(a) **Fixed assets**

	At 31st December, 1999		
	Cost HK\$'000	Accumulated depreciation HK\$'000	Net book value HK\$'000
Land and buildings	159,775	23,814	135,961
Plant and machinery	385,725	50,022	335,703
Furniture, fixtures and equipment	8,436	2,348	6,088
Motor vehicles	13,716	4,054	9,662
Construction in progress	<u>88,922</u>	<u>—</u>	<u>88,922</u>
	<u>656,574</u>	<u>80,238</u>	<u>576,336</u>

	At 31st December, 2000		
	Cost HK\$'000	Accumulated depreciation HK\$'000	Net book value HK\$'000
Land and buildings	182,434	30,522	151,912
Plant and machinery	435,152	80,651	354,501
Furniture, fixtures and equipment	8,780	3,243	5,537
Motor vehicles	14,855	5,806	9,049
Construction in progress	<u>76,511</u>	<u>—</u>	<u>76,511</u>
	<u>717,732</u>	<u>120,222</u>	<u>597,510</u>

	At 31st December, 2001		
	Cost	Accumulated depreciation	Net book value
	HK\$'000	HK\$'000	HK\$'000
Land and buildings	207,535	35,623	171,912
Plant and machinery	490,401	114,509	375,892
Furniture, fixtures and equipment	11,045	4,266	6,779
Motor vehicles	16,021	7,770	8,251
Construction in progress	41,272	—	41,272
	<u>766,274</u>	<u>162,168</u>	<u>604,106</u>

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

Certain of the King Victory Group's land and buildings and plant and machinery, with net book value totalling HK\$330,291,000 as at 31st December, 2001, were pledged to secure certain banking facilities granted to the King Victory Group.

(b) **Intangible assets**

	At 31st December,		
	1999	2000	2001
	HK\$'000	HK\$'000	HK\$'000
<i>Trademarks</i>			
Cost:			
At beginning of year	8,578	8,600	8,636
Exchange realignment	22	36	(5)
At end of year	<u>8,600</u>	<u>8,636</u>	<u>8,631</u>
Accumulated amortisation:			
At beginning of year	1,135	1,765	2,402
Provided during the year	626	629	630
Exchange realignment	4	8	(1)
At end of year	<u>1,765</u>	<u>2,402</u>	<u>3,031</u>
Net book value:			
At end of year	<u>6,835</u>	<u>6,234</u>	<u>5,600</u>

The trademarks were contributed by 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) Inventories

	At 31st December,		
	1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Raw materials	14,872	34,839	42,212
Work in progress	11,555	12,561	10,370
Finished goods	5,742	3,907	7,228
Spare parts and consumables	9,023	10,116	11,119
Packaging materials	26,810	34,688	30,963
	<u>68,002</u>	<u>96,111</u>	<u>101,892</u>

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

(d) Accounts receivable

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

An aged analysis of accounts receivable is as follows:

	At 31st December,		
	1999 HK\$'000	2000 HK\$'000	2001 HK\$'000
Outstanding balances which age:			
Within 30 days	8,493	2,477	5,722
Between 31 and 60 days	2,783	1,782	916
Between 61 and 180 days	5,100	3,510	3,860
Between 181 and 365 days	2,566	3,386	1,011
	<u>18,942</u>	<u>11,155</u>	<u>11,509</u>

Accounts receivable as at 31st December, 2001 included amounts of HK\$2,202,000 and HK\$195,000 due from HB Company and HB Jilin, fellow subsidiaries, which arose from normal trading activities of the sale of beer and raw materials (notes 3(h)(vi) and (vii)).

(e) Balances with 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 amounts of HK\$27,981,000, HK\$28,100,000 and HK\$28,082,000 as at 31st December, 1999, 2000 and 2001, respectively, which bear 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 King Victory Group's average interest rate on bank borrowings, the King Victory Group would have paid interest of approximately HK\$6,758,000, HK\$6,785,000 and HK\$6,505,000 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 shares of Harbin Brewery, King Victory's immediate holding company, are listed on the Stock Exchange.

(f) **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 King Victory Group is permitted to exchange RMB for foreign currencies through banks authorised to conduct foreign exchange business.

(g) **Accounts payable**

An aged analysis of the accounts payable is as follows:

	At 31st December,		
	1999	2000	2001
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Outstanding balances which age:			
Within 30 days	28,911	22,507	18,438
Between 31 and 60 days	3,744	3,038	6,433
Between 61 and 180 days	11,939	11,120	10,879
Between 181 and 365 days	1,186	6,758	6,573
Between 366 and 540 days	1,101	3,897	3,390
	<u>46,881</u>	<u>47,320</u>	<u>45,713</u>

Accounts payable included (i) amounts of HK\$15,135,000 and HK\$7,543,000 as at 31st December, 1999 and 2000, respectively, due to Ningbo Malting Company Limited, a former fellow subsidiary (note 3(h)(ix)); and (ii) an amount of HK\$871,000 as at 31st December, 2001 due to HB Company, a fellow subsidiary (note 3(h)(v)), which arose from normal trading activities of the purchases of raw materials.

(h) **Due to a fellow subsidiary**

The amount is unsecured, interest-free and not repayable before 27th November, 2002.

(i) **Other loans**

Other loans are unsecured and repayable on demand or not exceeding one year.

The other loans included amounts of HK\$939,000, HK\$2,358,000 and HK\$5,126,000 as at 31st December, 1999, 2000 and 2001, respectively, which bear interest at the prevailing bank lending rate quoted by the People's Bank of China.

One of the other loans of HK\$5,070,000 as at 31st December, 2001 bears interest at a fixed rate of 10% per annum.

The remaining other loans are interest-free.

Had interest been charged on the interest-free portion of the outstanding balances during the Relevant Periods with reference to the King Victory Group's average interest rate on bank borrowings, the King Victory Group would have paid interest of approximately HK\$197,000, HK\$369,000 and HK\$545,000 for the years ended 31st December, 1999, 2000 and 2001, respectively.

(j) **Interest-bearing bank loans**

	At 31st December,		
	1999 <i>HK\$'000</i>	2000 <i>HK\$'000</i>	2001 <i>HK\$'000</i>
Bank loans:			
Secured	182,302	197,596	239,480
Unsecured	<u>26,129</u>	<u>30,395</u>	<u>9,422</u>
	<u>208,431</u>	<u>227,991</u>	<u>248,902</u>
Bank loans repayable:			
Within one year	198,573	222,805	—
In the second year	4,694	5,186	228,418
In the third to fifth years, inclusive	<u>5,164</u>	<u>—</u>	<u>20,484</u>
	208,431	227,991	248,902
Portion classified as current liabilities	<u>(198,573)</u>	<u>(222,805)</u>	<u>—</u>
Non-current portion	<u>9,858</u>	<u>5,186</u>	<u>248,902</u>

(k) **Loan from a former shareholder/immediate holding company**

The loan is unsecured and not repayable within one year. Upon the Acquisition, the loan was transferred and assigned from the former shareholder to Harbin Brewery, the immediate holding company of King Victory, with effect from 29th June, 2001. The loan is interest-free except that an amount of HK\$262,742,000 as at 31st December, 1999 bore interest at 10% per annum for the year ended 31st December, 1999.

Had interest been charged on the interest-free portion of the outstanding balance during the Relevant Periods with reference to the King Victory Group's average interest rate on bank borrowings, the King Victory Group would have paid interest of approximately HK\$17,097,000 and HK\$15,868,000 for the years ended 31st December, 2000 and 2001, respectively.

(l) Combined shareholders' equity

	<i>Note</i>	At 31st December,		
		1999	2000	2001
		<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Issued capital *		—	—	—
Reserves	(m)	<u>(70,001)</u>	<u>(82,093)</u>	<u>(88,191)</u>
		<u>(70,001)</u>	<u>(82,093)</u>	<u>(88,191)</u>

* These balances are all less than HK\$1,000.

(m) Reserves

		At 31st December,		
		1999	2000	2001
		<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Accumulated losses				
At beginning of year		(37,843)	(69,840)	(82,199)
Net loss for the year attributable to shareholders		<u>(31,997)</u>	<u>(12,359)</u>	<u>(6,035)</u>
At end of year		<u>(69,840)</u>	<u>(82,199)</u>	<u>(88,234)</u>
Exchange fluctuation reserve				
At beginning of year		(345)	(161)	106
Movements during the year		<u>184</u>	<u>267</u>	<u>(63)</u>
At end of year		<u>(161)</u>	<u>106</u>	<u>43</u>

(n) Contingent liabilities

At 31st December, 2001, the King Victory 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.

(o) **Commitments**

At 31st December, 2001, the King Victory Group had the following commitments:

HK\$'000

- (i) Capital commitments in respect of construction/installation of plant and machinery
Contracted for

27,591

- (ii) Other commitment

At 31st December, 2001, the King Victory 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.

(p) **Net tangible liabilities of King Victory**

On the basis set out in Section 1 above, the net tangible liabilities of King Victory as at 31st December, 2001 was approximately HK\$43,000, representing its interests in subsidiaries, net of loan from the immediate holding company.

(q) **Distributable reserves**

As at 31st December, 2001, King Victory had no reserve available for distribution to the shareholders.

5. COMBINED STATEMENTS OF MOVEMENTS IN EQUITY

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

	Year ended 31st December,		
	1999	2000	2001
	HK\$'000	HK\$'000	HK\$'000
At beginning of year	(38,188)	(70,001)	(82,093)
Net loss from ordinary activities attributable to shareholders	(31,997)	(12,359)	(6,035)
Exchange fluctuation reserve	<u>184</u>	<u>267</u>	<u>(63)</u>
At end of year	<u>(70,001)</u>	<u>(82,093)</u>	<u>(88,191)</u>

6. COMBINED CASH FLOW STATEMENTS

The combined cash flow statements of the King Victory 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)	25,235	33,020	73,693
RETURNS ON INVESTMENTS AND SERVICING OF FINANCE				
Interest received		190	163	109
Interest paid		<u>(16,198)</u>	<u>(17,043)</u>	<u>(18,579)</u>
Net cash outflow from returns on investments and servicing of finance		<u>(16,008)</u>	<u>(16,880)</u>	<u>(18,470)</u>
TAX				
PRC corporate income tax paid		<u>(843)</u>	<u>(155)</u>	<u>(2,467)</u>
INVESTING ACTIVITIES				
Purchases of/additions to fixed assets		(38,429)	(48,629)	(44,896)
Decrease/(increase) in deposits paid for purchases of fixed assets		2,405	(1,351)	752
Proceeds from disposal of fixed assets		2,068	6,718	3,584
Decrease/(increase) in fixed deposits		<u>4,953</u>	<u>(1,298)</u>	<u>2,053</u>
Net cash outflow from investing activities		<u>(29,003)</u>	<u>(44,560)</u>	<u>(38,507)</u>
NET CASH INFLOW/(OUTFLOW) BEFORE FINANCING ACTIVITIES		(20,619)	(28,575)	14,249
FINANCING ACTIVITIES	(b)			
New bank loans		263,296	214,623	208,964
Repayment of bank loans		(235,893)	(195,973)	(187,895)
New other loans		5,437	7,062	31,916
Repayment of other loans		(4,030)	(2,637)	(21,529)
Repayment of amounts due to joint venture partners of subsidiaries		—	—	(12,302)
New loan from a former shareholder		880	—	—
Repayment of loan from a former shareholder		<u>—</u>	<u>(1,594)</u>	<u>(13,770)</u>
Net cash inflow from financing activities		<u>29,690</u>	<u>21,481</u>	<u>5,384</u>

	Year ended 31st December,		
	1999	2000	2001
	HK\$'000	HK\$'000	HK\$'000
INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	9,071	(7,094)	19,633
Cash and cash equivalents at beginning of year	4,354	13,495	6,456
Effect of foreign exchange rate changes, net	<u>70</u>	<u>55</u>	<u>(5)</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>13,495</u>	<u>6,456</u>	<u>26,084</u>
ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS			
Cash and bank balances	<u>13,495</u>	<u>6,456</u>	<u>26,084</u>

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

	Year ended 31st December,		
	1999	2000	2001
	HK\$'000	HK\$'000	HK\$'000
Profit/(loss) from operating activities	3,361	(4,107)	9,430
Interest income	(190)	(163)	(109)
Depreciation	36,303	41,832	47,348
Amortisation of intangible assets	626	629	630
Loss/(gain) on disposal of fixed assets	10	332	(623)
Provision for doubtful debts	1,961	7,435	1,351
Decrease/(increase) in inventories	8,337	(27,837)	(5,841)
Decrease/(increase) in accounts receivable	(10,257)	791	(1,495)
Decrease/(increase) in prepayments, deposits and other receivables	(4,781)	1,624	1,222
Changes in balances with joint venture partners of subsidiaries	(4,885)	(4,544)	(1,706)
Increase/(decrease) in accounts payable	8,635	124	(1,573)
Increase/(decrease) in accruals and other liabilities	(13,885)	16,904	10,925
Increase in amount due to a fellow subsidiary	<u>—</u>	<u>—</u>	<u>14,134</u>
Net cash inflow from operating activities	<u>25,235</u>	<u>33,020</u>	<u>73,693</u>

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

	Bank and other loans <i>HK\$'000</i>	Amounts due to joint venture partners of subsidiaries <i>HK\$'000</i>	Loan from a former shareholder/ immediate holding company <i>HK\$'000</i>	Minority interests <i>HK\$'000</i>
Balance at 1st January, 1999	183,849	113,906	238,696	62,737
Net cash inflow from financing activities	28,810	—	880	—
Accrued interest payable	—	—	23,667	—
Share of loss for the year	—	—	—	(5,350)
Exchange realignment	466	288	113	142
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Balance at 31st December, 1999 and 1st January, 2000	213,125	114,194	263,356	57,529
Net cash inflow/(outflow) from financing activities	23,075	—	(1,594)	—
Reclassification from amount due from joint venture partner of a subsidiary	—	—	(19,153)	—
Share of loss for the year	—	—	—	(10,122)
Exchange realignment	937	485	192	207
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Balance at 31st December, 2000 and 1st January, 2001	237,137	114,679	242,801	47,614
Net cash inflow/(outflow) from financing activities	31,456	(12,302)	(13,770)	—
Share of loss for the year	—	—	—	(4,406)
Exchange realignment	(167)	(71)	—	(50)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Balance at 31st December, 2001	<u>268,426</u>	<u>102,306</u>	<u>229,031</u>	<u>43,158</u>

(c) Major non-cash transaction

On 29th June, 2001, the loan from a former shareholder of King Victory in the amount of HK\$229,031,000 was transferred and assigned to Harbin Brewery, the immediate holding company of King Victory upon the Acquisition (note 4(k)).

7. SEGMENT INFORMATION

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

8. DIRECTORS' REMUNERATION

No remuneration has been paid or is payable in respect of any of the Relevant Periods referred to in this report by King Victory, or any of the companies now comprising the King Victory Group, to the directors of King Victory. Under the arrangements currently in force, the directors' fees and other emoluments payable to the directors of King Victory for the year ending 31st December, 2002 will be absorbed by the immediate holding company, Harbin Brewery.

9. SUBSEQUENT FINANCIAL STATEMENTS

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

Yours faithfully,
Ernst & Young
Certified Public Accountants
Hong Kong