



# Convenience Retail Asia Limited

利亞零售有限公司

(incorporated in the Cayman Islands with limited liability)



A member of the Li & Fung Retailing Group



Annual Report 2002





*The ribbon cutting ceremony in celebration of the Grand Opening of the Circle K chain in Guangzhou was held on 8 January 2003 at 48, Zhong Shan Ba Road, Guangzhou. It was officiated by the Group Chairman Dr. Victor Fung, Chief Executive Officer Mr. Richard Yeung and distinguished guests.*

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## CHARACTERISTICS OF THE GROWTH ENTERPRISE MARKET (“GEM”) OF THE STOCK EXCHANGE OF HONG KONG LIMITED (THE “STOCK EXCHANGE”)

GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on GEM and the business sectors or countries in which the companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

Given the emerging nature of companies listed on GEM, there is a risk that securities traded on GEM may be more susceptible to high market volatility than securities traded on the main board of the Stock Exchange and no assurance is given that there will be a liquid market in the securities traded on GEM.

The principal means of information dissemination on GEM is publication on the Internet website operated by the Stock Exchange. Listed companies are not generally required to issue paid announcements in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website in order to obtain up-to-date information on GEM-listed issuers.

*This annual report (the “Report”), for which the directors of Convenience Retail Asia Limited collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on GEM of The Stock Exchange for the purpose of giving information with regard to Convenience Retail Asia Limited. The directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief: - (1) the information contained in this Report is accurate and complete in all material respects and not misleading; (2) there are no other matters the omission of which would make any statement in this Report misleading; and (3) all opinions expressed in this Report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.*



## Corporate Information

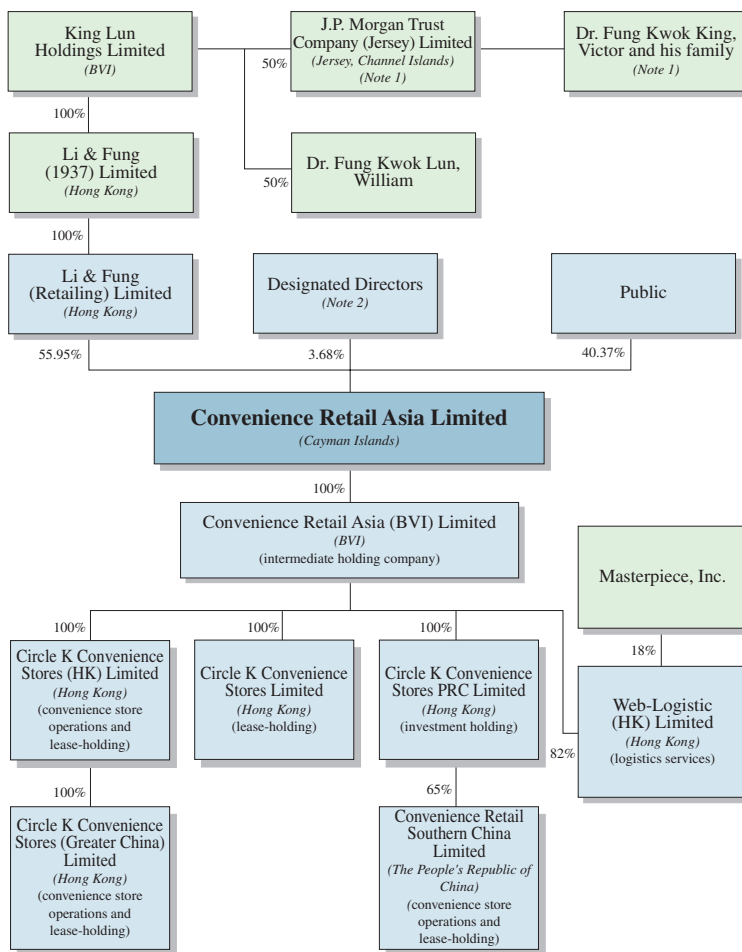
<b>Executive Directors</b>	Yeung Lap Bun, Richard ( <i>Chief Executive Officer</i> ) Li Kwok Ho, Bruno ( <i>Chief Financial Officer</i> )
<b>Non-executive Directors</b>	Dr. Fung Kwok King, Victor ( <i>Chairman</i> ) Dr. Fung Kwok Lun, William Lau Butt Farn Wong Yuk Nor, Louisa
<b>Independent non-executive Directors</b>	Dr. Ch'ien Kuo Fung, Raymond Au Man Chung, Malcolm Godfrey Ernest Scotchbrook
<b>Registered office</b>	Century Yard Cricket Square Hutchins Drive P.O. Box 2681GT George Town Grand Cayman British West Indies
<b>Head office and principal place of business</b>	12th Floor, LiFung Centre 2 On Ping Street Siu Lek Yuen Shatin New Territories Hong Kong
<b>Company's website address</b>	<a href="http://www.cr-asia.com">www.cr-asia.com</a>
<b>Company secretary</b>	Wong Wing Ha (FCIS)
<b>Compliance officer</b>	Li Kwok Ho, Bruno
<b>Qualified accountant</b>	Lam Siu Tak, Jimmy (FHKSA, FCPA)
<b>Audit committee</b>	Dr. Ch'ien Kuo Fung, Raymond Au Man Chung, Malcolm Lau Butt Farn Godfrey Ernest Scotchbrook
<b>Authorised representatives</b>	Li Kwok Ho, Bruno Wong Wing Ha
<b>Authorised person to accept service of process and notices</b>	Li Kwok Ho, Bruno
<b>Sponsor</b>	BNP Paribas Peregrine Capital Limited

Corporate Information (continued)

<b>Legal adviser</b>	Johnson Stokes & Master (as to Hong Kong Law)  Conyers Dill & Pearman, Cayman (as to Cayman Islands Law)
<b>Auditors</b>	PricewaterhouseCoopers <i>Certified Public Accountants</i>
<b>Principal share registrar and transfer office</b>	Bank of Butterfield International (Cayman) Ltd. P.O. Box 705 Butterfield House Fort Street George Town Grand Cayman Cayman Islands
<b>Hong Kong share registrar and transfer office</b>	Abacus Share Registrars Limited G/F, Bank of East Asia Harbour View Centre 56 Gloucester Road Wanchai, Hong Kong
<b>Principal bankers</b>	The Hongkong & Shanghai Banking Corporation Limited
<b>Stock code</b>	8052

## Group Business Structure

As at the date of this Report, the corporate structure of Convenience Retail Asia Limited (the “Company”) and its subsidiaries (the “Group”) is as follows :



### Notes:

1. J.P. Morgan Trust Company (Jersey) Limited (formerly known as Chase Bank & Trust Company (CI) Limited) is the trustee of a discretionary trust established for the benefit of the family members of Dr. Fung Kwok King, Victor.
2. “Designated Directors” refer to Messrs. Yeung Lap Bun, Richard, Li Kwok Ho, Bruno and Lau Butt Farn and Ms. Wong Yuk Nor, Louisa.



## Chairman's Statement



**Dr. Fung Kwok King, Victor**  
*Chairman*

### FINANCIAL OVERVIEW

2002 was an eventful year for the Group and we are pleased to report that the Group was able to maintain satisfactory growth despite a very difficult economic environment in Hong Kong. Sales rose 6.8% to HK\$1.4 billion, compared to 2001. Net profit increased 10.2% to HK\$72.1 million versus the prior year. Basic earnings per share increased 7.9% to 10.9 cents. At the end of 2002, the Group registered a strong balance sheet with a net cash position of HK\$407.5 million, free of any borrowings.

Even though we experienced a strong growth between 1999 and 2001, it was by no means an easy task to achieve the growth last year, in the face of continued deflationary pressure and weak consumer sentiment. In fact, it was further testimony to our robust business model, which seems able to weather market turmoil.

### REVIEW OF HONG KONG RETAIL MARKET

The year in review began with the uncertainty arising from the events of September 11, which cast a shadow over economic recovery around the world.

In Hong Kong, the economy was further affected by a prolonged deflationary cycle, which started in November 1998. At the same time, consumer confidence was affected by continued unemployment, declining wages and the lackluster performance of the equity and property markets. Consumer propensity to spend declined throughout the year and was reflected by a 4.1% drop in value and 2.6% drop in volume of actual retail sales compared to 2001.



## REVIEW OF HONG KONG RETAIL MARKET (continued)

Towards the fourth quarter of 2002, economic indicators suggested that the economy had bottomed out. In addition, with an upsurge of visitor arrivals from the Chinese Mainland, the decline in retail sales value narrowed compared with the same period a year earlier. Another bright spot in the second half of the year was the strong performance of Hong Kong's export trade.

According to the November Shopometer Survey\* conducted by the Hong Kong Retail Management Association, less respondents believed that the Hong Kong economy would further deteriorate (a decline from 51% to 37% among total respondents), reflecting that consumer confidence was recovering. There was also some evidence of increased allocation to investments and savings, with consumer sentiment for future spending showing a slight improvement.

However, the absence of positive news in local and overseas markets meant that the economy would remain vulnerable, even though economic decline appeared to have been temporarily arrested.

## COMPANY INITIATIVES FOR HONG KONG OPERATION

The Group's key challenge for its Hong Kong operation was to sustain profitability and achieve volume growth in a deflationary market environment compounded by uncertainties in the global economy.

Our success in 2002 was largely due to the focus on the Group's core competencies: an integrated marketing programme to promote the Circle K brand and build customer loyalty; intensive customer service training to achieve "speed, tidiness and friendliness"; meeting customer expectations by developing and introducing new product lines; creative promotions to build store traffic; excellence in supply chain management to improve purchase and delivery and reduce cost; shrewd application of information technology to facilitate efficiency and instant communication; and a fine-tuned formula for the selection of appropriate locations for new stores.

We also continued with our network expansion and during 2002, 22 new Circle K stores in strategic locations were opened in Hong Kong.

## MOVING FORWARD IN HONG KONG

We will continue to support and invest in our Hong Kong operation with suitable resources and funding to strengthen Circle K's brand image as the preferred convenience store. Our goal is to widen the gap in service excellence and overall brand attributes versus our competitors.

With a proven business model and a track record of achieving growth and profitability in an adverse retail environment, we will continue to expand prudently. Our aim is to take advantage of future economic recovery by growing market share and maximizing profits.

\* The Shopometer Survey presented by Hong Kong Retail Management Association and Asia Market Intelligence issued on 19 December 2002

## REVIEW OF RETAIL MARKET IN THE CHINESE MAINLAND

In 2002, the Chinese economy recorded a remarkable GDP growth of 8.1%. However, retail sales growth in real terms slowed from 11% in 2001 to 10.3% in 2002. Despite the slight decline, retail sales were healthy in absolute terms and robust compared to sales in other countries around the world. With the Chinese Mainland's accession to the World Trade Organisation ("WTO") coupled with increased overseas and local private investment, the economy showed signs of entering a new growth cycle.

During 2002, major changes were introduced to retail sales structures in accordance with a WTO timetable set for opening up the retail market to foreign investment. The most significant growth was witnessed in the hypermarket sector, with leading multinational retail operators such as Wal-Mart, Makro, Carrefour etc., all of which have already entered the retail market in the Chinese Mainland.

By comparison, the convenience store sector did not develop as fast. Apart from Circle K, there were only two other multinational retail operators entering into the market so far.

The economies in Guangdong Province and Shenzhen have continued to benefit from increased investment in manufacturing and enhancement of infrastructure. As a result of high employment, local residents tend to be more affluent, have more disposable income and tend to follow the life styles of Hong Kong people who are regular visitors to the area. Consumerism in Guangzhou was given a further boost by the municipal government, which adopted a strategy to modernize retail channels and to provide more shopping convenience to fulfill consumer demand.

## NEW BUSINESS MODEL FOR GUANGZHOU OPERATION

Our strategy for entering into the Chinese Mainland is based on developing a strong presence in Guangzhou, one of the fastest growing consumer markets in the Chinese Mainland, whose proximity to Hong Kong allows us to provide excellent back up and support. In order to meet the new life style requirements of the Guangzhou consumers, a new business model has been specifically designed for Guangzhou, which depicts the "new generation of convenience stores".

The first store was soft-opened at 48 Zhong Shan Ba Road, Guangzhou in November 2002. In addition to carrying core product categories, special emphasis is placed on a new range of proprietary hot-served gourmet food and drinks — in-store bakery products, fresh-brew coffee and freshly ground soya milk. With more space, in-store consumption is made possible to provide consumers a new life style experience. The store also incorporates a host of other consumer benefits, including the world's leading dual touch-monitor electronic point-of-sale system and instant promotional redemptions.

The first day of operation was an overwhelming success and so far the preliminary sales figure is in line with expectation. By the end of 2002, two stores were opened prominent locations in Guangzhou.

## **FUTURE PROSPECTS**

In Hong Kong, for 2003, we are forecasting a somewhat depressed and price sensitive market. We are responding to this environment by introducing new product categories, by offering more creative promotions and by carefully controlling costs and expenses.

During the first six months of operation in Guangzhou, the Group will monitor the performance of each store and fine-tune the business model before embarking on an aggressive expansion plan. We are confident that the economy in Guangzhou will continue to strengthen and that consumers will favourably respond to Circle K's unique product range, store environment and promotions.

Overall, we are confident, that barring any unforeseen circumstances, the Circle K operations in Hong Kong and the Chinese Mainland will be well poised to enter a period of solid volume growth and expansion even though short-term profit growth will be modest, given the uncontrollable factors in the Hong Kong economy.

In closing, I would like to express my gratitude to the management and staff of our operations in Hong Kong and the Chinese Mainland for their commitment to excellence in exceptionally demanding circumstances.

**Fung Kwok King, Victor**

*Chairman*

Hong Kong, 14 March 2003



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## Management Discussion and Analysis

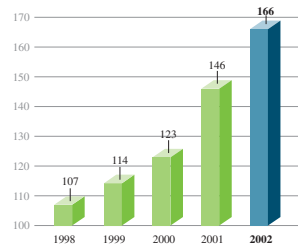


**Mr. Yeung Lap Bun, Richard**  
*Chief Executive Officer*

### FINANCIAL RESULTS

The Board is glad to report the satisfactory financial results of the Group for the year ended 31 December 2002. The Group's sales for the year and the fourth quarter increased to HK\$1.4 billion and HK\$360.8 million respectively, representing a growth of 6.8% and 10.6% when compared to corresponding periods in 2001. Sales of comparable stores (stores that are in existence in 2001 and 2002) showed a decline of 4.3% for the full year and a marginal decline of 0.1% for the fourth quarter. The improvement in the trend of comparable store sales during the fourth quarter is quite encouraging.

In spite of a very difficult environment in 2002, the Group continued to achieve year on year sales growth through opening of new store outlets. The directors of the Company (the "Directors") believe that the Group's continual improvements in core competencies and the building of a strong brand image are the contributing factors.

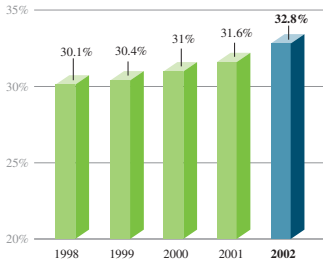


**No. of Circle K Outlets  
in Hong Kong**

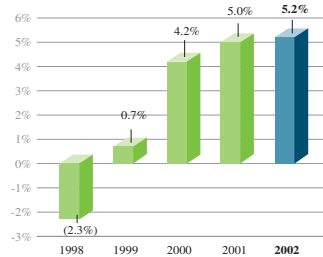
**FINANCIAL RESULTS** (continued)

Continual improvements in category management and supplier trading terms such as advertising income resulted in increase in gross margin and other income (excluding interest income) from 31.6% to 32.8% of sales for the year and from 32.8% to 34.6% of sales for the fourth quarter when compared to 2001.

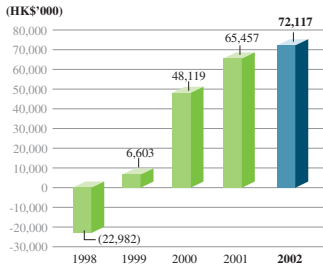
The Group was also very intent on controlling expenses especially during the current deflationary environment in Hong Kong. Despite the drop in comparable store sales, store expenses as a percentage of sales increased only slightly from 22.1% to 22.7% for the year and from 23.1% to 23.5% for the fourth quarter when compared to 2001.



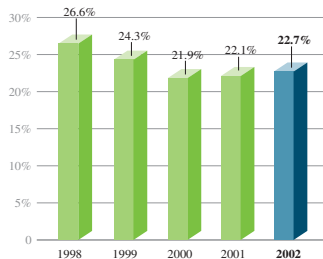
**Gross Margin and Other Income**  
(excluding interest income)



**Net Margin**



**Net Profit**



**Store Operating Expenses**  
as % of Sales

## FINANCIAL RESULTS (continued)

The Group achieved an increase in net margin from 5% to 5.2% of sales and from 4.9% to 5.4% of sales for the year and the fourth quarter respectively when compared to corresponding periods in 2001. The combined effect of an increase in sales and improvement in gross margin accounted for an increase in net margin which, to some extent, was offset by an increase in start up costs in the Chinese Mainland.

The Group was able to achieve a continuous record of growth in sales and net profit quarter on quarter since the Group's GEM listing on 18 January 2001. Net profit attributable to shareholders increased by 10.2% to HK\$72.1 million for the year and by 23% to HK\$19.6 million for the fourth quarter. Basic earnings per share increased by 7.9% to 10.9 cents for the year.

The Group's financial position continued to remain strong. The Hong Kong business generated a free cash flow of approximately HK\$60 million in 2002 and the Group had a total of HK\$407.5 million cash in the bank and without any bank borrowings at 31 December 2002. The Group had a small amount of foreign exchange exposure in RMB after starting up the joint venture operation in the Chinese Mainland. The exposure will be managed to a minimal level by depositing surplus cash in Hong Kong dollars and borrowing in RMB if such need arises in future.

## OPERATION REVIEW



*The new Circle K store located at the lower level entrance of the Citibank Tower, Garden Road became the test site for a range of gourmet hot dogs appealing to a more westernized taste.*



*The Circle K store at the Discovery Bay Pier in Central caters to a small community of commuters who are regular customers.*

Encouraged by the satisfactory results of the mini-store format at Mass Transit Railway (“MTR”) stations, we continued to open more mini-stores at MTR stations to enjoy the high traffic flow and enhance our market presence. The Circle K mini-stores at Lok Fu and Choi Hung on the Kowloon side and Taikoo, North Point, Wanchai and Quarry Bay on the Island side have all helped to increase our brand exposure, in addition to generating healthy turnover.

### Store Operations

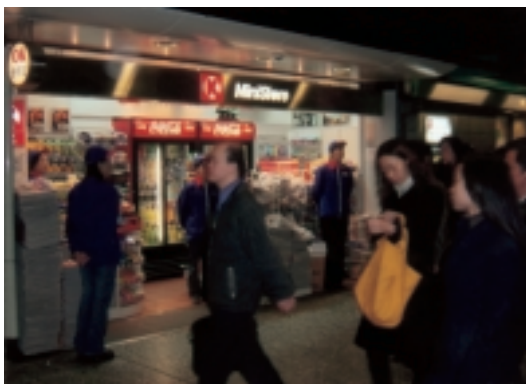
We opened 22 new stores in 2002, giving us a total of 166 outlets by year-end and missing our target of 170 by four stores. This was due to the stringent standards of our sales projection model for new store opening which meant we avoided sites that might not yield the projected traffic and sales required to make the Group’s return on investment. Ten new stores were opened in the fourth quarter of 2002 and one store was closed during the fourth quarter.

Store renovation programme in synchronization with lease renewal was almost completed by end of the fourth quarter. With the exception of a few old stores, almost the entire Circle K chain in Hong Kong featured the bold and contemporary red and white signage at the store front and a tidy, well-organized and bright interior. Renovation for the few remaining stores is expected to be completed by end of first quarter in 2003.

## OPERATION REVIEW (continued)

### Store Operations (continued)

Other site selection experiments, including the Circle K store at the Discovery Bay Pier in Central which caters to the small community of commuters has also proven to be quite successful. The new store located at the lower level entrance of the Citibank Tower, Garden Road, was noteworthy too. Dedicated to serving a specific target segment of office workers, executives and professionals, it was used as a test site for a new range of gourmet hot dogs appealing to a more westernized taste.



*The Circle K mini-stores located at key MTR stations enjoy high traffic flow and greatly enhance the market presence of the Circle K brand.*

Once proven successful, these experiments will open up more potential site opportunities for future expansion with innovative, localized operation models.

### Employees

As of 31 December 2002, the Group had a total of 1,620 employees; of whom 1,500 were based in Hong Kong, 120 were based in Guangzhou. Regular part time staff accounted for 43% of the total headcount.

Human resource development initiatives were implemented through in-house training programmes conducted with the assistance of training consultants. Financial subsidies were provided for staff who enrolled for external courses. The Group's remuneration packages include a performance-related bonus scheme and share options.

In order to provide a safer working environment, Circle K made a commitment to all the staff by signing the "Occupational Safety Charter" formulated by the Labour Department and Occupational Safety and Health Council in August 2002.

Total Quality Culture Awareness was introduced to the Group in December 2002, with the support of the Academy for Productivity, a subsidiary of the Hong Kong Productivity Council. The programme was implemented through a series of training workshops organized by the Total Quality Culture Steering Committee.



## OPERATION REVIEW (continued)

### Marketing and Promotion

In order to counteract the negative market sentiments and conservative spending mood, additional budget was allocated to provide adequate funding for an aggressive and innovative promotional calendar in 2002. Incremental sales and traffic were measured and registered as a result.

Creative promotion themes achieved tangible sales results and created for Circle K such desirable image attributes as “fun” and “in”. These events included the Gundam Crown Top joint-promotion with Coca-Cola in March, the Eason & Friends Pop Concert in celebration of the 150<sup>th</sup> Store Opening in May, the “Qoo in a Can” collectable soft toy promotion in July and the Coca-Cola Christmas Tree Projection Carousel Redemption in December.

Promotions focusing on value offers also proved to be very popular with our customers. Successful case studies include the “Weekend Super Value” offers, which were so well received that they are now a regular promotion feature. “Counter Deals”, suggestive selling of special-priced impulse items displayed at the cashier counter, proved to be another effective promotion mechanism with repeatable results. Another innovative promotion idea, the collectable “stored value cards” as inserts for the Lucky Star tissue pack also received very positive responses and generated considerable incremental sales volume.



*The Eason & Friends Concert on 6 July 2002 was sponsored by Circle K and provided an evening's great entertainment to over 6,000 Circle K customers, staffs and business associates.*

Promotion posters put up at all Circle K stores to communicate the mechanics of each major thematic promotion targeted over 400,000 customers per day.



OPERATION REVIEW (continued)



*The outstanding growth of the telecommunication product category in 2002 demonstrated the great potential of enhanced category management excellence.*

**Category Management Excellence**

The Category Management Excellence Programme took another step forward in 2002. With the appointment of an additional category manager and a category specialist, we were able to re-allocate management resources and re-define category responsibilities, resulting in a sharper focus for all the major product categories and better support for categories with high growth potential.

Overall margin improvement of 1.2% was achieved for the year 2002. This significant progress was made possible with a combination of smart pricing initiatives, satisfactory results of category management, increased volume rebates and maximized promotion support as sources of other incomes.

The cigarette category which accounted for a significant percentage of sales at Circle K stores actually bucked the downtrend in market sales. Improved product mix to broaden the range and the successful Vendor Managed Inventory Programme to centralize the replenishment process and reduce out of stock situations all worked together to outperform other retail channels.

Another major growth category in 2002 was the category of telecommunication products. A 40% increase in sales was recorded for the year, contributed mainly by the increase in sales of SIM cards, IDD calling cards and online game products which tripled in sales for the year. Factors accounting for such phenomenal growth are the enhanced product display, improved communication with customers to provide product information and intensive product knowledge training for the frontline staff.

## OPERATION REVIEW (continued)

### Service Excellences

Customer Service Excellence remained the top priority among our core competencies and was continuously nurtured and improved in 2002. The staff training agenda was further extended and intensified to include store management skills, specific product knowledge training, computer skill and language ability including English and Putonghu courses. Overall time hours devoted to staff training increased by 56.8%. Average training time per staff also went up 68.4%.

Ms. Irene Dai, our Senior Store Manager of the Siu Hong Court Commercial Centre Circle K store, won the 2002 Service & Courtesy Award for the Supervisory Level, Supermarket / Convenience Stores Category from the Hong Kong Retail Management Association. It was a timely recognition of our consistent focus on customer service excellence.



*Ms Irene Dai, Senior Store Manager of Siu Hong Court Commercial Centre Circle K store, was the winner of the 2002 Service & Courtesy Award for the Supervisory Level, Supermarket / Convenience Stores Category from the Hong Kong Retail Management Association.*

### Supply Chain Management and Logistics

To ensure all Circle K stores enjoyed immediate response to their stock replenishment requests, a “Fair Share Allocation System” was introduced in 2002. The mechanism was to fairly allocate merchandises with limited stock to all stores requesting stock replenishment, based on previous sales performance. Stores were classified into grades, relating to their sales volume, and are entitled to an appropriate order quantity allocation during the stock replenishment process. This ensured that no store would be overlooked which can occur with a “first come, first serve” mechanism.

Implementation of the “Fair Share Allocation System” has effectively minimized stock out situations with the whole process being stream-lined. A simple, efficient and fair-to-all stock allocation and replenishment was achieved.

Among other supply chain management initiatives in 2002, a call centre was established early in the year to provide quick response support to the frontline and facilitate internal communication.

In the fourth quarter, preparation work was underway to get ready for the launch of centralized chilled delivery service to all stores in the first quarter of 2003.

## OPERATION REVIEW (continued)

### Cost Saving Initiative

Taking advantage of the deflationary environment, the Group launched a cost saving scheme in 2002 to implement cost cutting measures in every aspect of store operations. For example, in the site development area, contractors were asked to review and reduce the store renovation and equipment maintenance costs significantly. In Business Systems Development, continuous price reduction from suppliers of computer hardware was negotiated. In the Distribution Centre, monthly fees for cleaning contracts were reduced by 20%.

Other smart savings were achieved with innovative solutions such as combining telephone lines per store, purchasing instead of renting telephone sets in stores and slashing POS maintenance costs by handling it in-house.

Process re-engineering also contributed to major cost savings. With communication short cut and standardized procedures, running cost was greatly reduced due to less trial and error, wasted efforts and product shrinkage.

### A Progress Update on the Guangzhou Operation



*The first Circle K store in Guangzhou was opened at 48 Zhong Shan Ba Road on 22 November 2002.*

Currently, three generations of convenience store operation modes co-exist in the market. The traditional “mum-and-pa” family stores, “micro-supermarket” type neighbourhood stores by local chain operators and multinational convenience store chains which are faithful transplants of their overseas operation models.

After conducting extensive market research and focus group studies, a new business model was tailor-made for the Southern China market which is unlike any convenience store in the market so far. Hence, this is the birth of a fourth generation of convenience store, or what we would like to describe as “the new generation of convenience stores”.

In the morning of 22 November 2002 at 48 Zhong Shan Ba Road, an enthusiastic crowd gathered before the first Circle K store in Guangzhou in great anticipation to see and experience “the new generation of convenience stores”.

**OPERATION REVIEW** (continued)



*The “Hot & In” counter in the Guangzhou Circle K store served fresh-from-the-oven breads to be enjoyed with freshly ground soya-milk or fresh-brew gourmet coffee over the counter.*



*Circle K Guangzhou is the first convenience store chain worldwide to adopt the dual monitor interactive touch-screen electronic point-of-sale system.*

**A Progress Update on the Guangzhou Operation**  
(continued)

With a total store area of over 112 square meters, the new store included a food service area branded “Hot & In”. Key product offerings under the “Hot & In” brand are a range of in-store-baked designer breads which are superior in quality, appearance and flavour to what the market currently offers. Served while still fresh from the oven, each bread design has an interesting name and a meaningful story that made the bread unique, interesting and memorable. Customer feedback after product trials has been unanimously positive. We have every indication that the “Hot & In” bread line will achieve its intended strategic objectives i.e. to generate repeat purchases and become the destination category for the neighbourhood.

Another potential star product in the “Hot & In” range is the freshly ground soya milk. Prepared with an innovative recipe, the “Hot & In” soya milk has a taste, consistency and smoothness superior to mass-produced soya milk drinks.

A range of gourmet coffees are also included to cater to the growing number of coffee drinkers in the market. Made from an exclusive blend of coffee beans, three fresh-brew options were offered: gourmet coffee, creamy cappuccino and mocha coffee. The consumer proposition is five-star hotel coffee quality at affordable mass market pricing.

An unique feature of “The New Generation of Convenience Stores” is a full range of fresh-from-the-oven designer breads, fresh-brew gourmet coffee and freshly ground soyamilk under the “Hot & In” brand.

These storefront posters promoted the different “Hot & In” products ideal for consumption at different times of the day.



**OPERATION REVIEW** (continued)

**A Progress Update on the Guangzhou Operation** (continued)

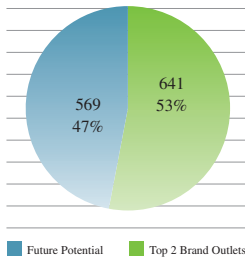
A comprehensive store opening promotion package was created involving the extensive distribution of product tasting coupons for the “Hot & In” range at a very special price. Redemption rate for the coupons was most encouraging. We have high hopes for the “Hot & In” products to become not only a major contributor to sales but gross margin as well.

Among other store opening promotional offers, an interactive electronic lucky draw was designed to be played instantly on the touchscreen monitor of the EPOS, to reward customers fulfilling a minimum purchase amount. This innovative mechanism undoubtedly scored a first among retailers in Guangzhou and greatly enriched the shopping experience by injecting an element of fun and excitement.

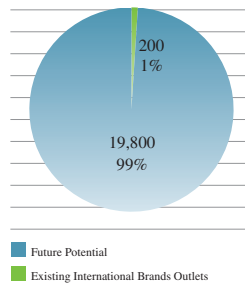
With its innovative product range, the Circle K stores in Guangzhou are positioned to be the best outlets for “grab and go” customers with an enticing selection of freshly baked bread, superior quality soya milk and fresh-brew gourmet coffees. It is also the convenience outlet to purchase packaged drinks, snacks, cigarettes or media anytime of the day or night, with a comprehensive range of popular brands at value pricing and guaranteed authenticity. For customers shopping for household groceries, the Circle K edge is: “location convenience at hypermarket pricing”.



*Presentation of a plaque in commemoration of the Grand Opening of Circle K Guangzhou by Mr. John Patton, Vice President of Circle K International to Dr. Victor Fung, Chairman of the Group.*



**Convenience Store Market in Hong Kong**



**Convenience Store Market in the Chinese Mainland**



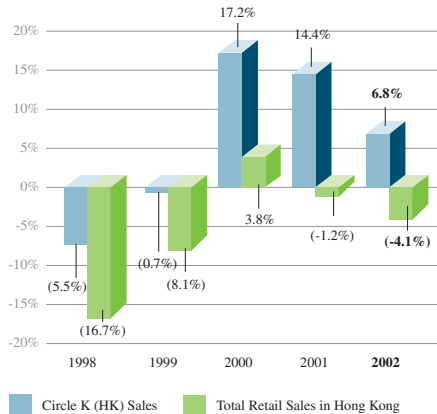
**PROSPECTS**

The outlook for 2003 is not a particularly optimistic one for Hong Kong. Deflation and high unemployment will continue to deter economic recovery. Cross-the-border consumption trend will persist and grow in popularity. The U.S. economy, which has a direct impact on the economy in Hong Kong and the Chinese Mainland, will continue to be unpredictable.

We anticipate a slight decrease in the value of the overall retail market sales in Hong Kong compared with 2002, which will be more or less in line with the continual deflation trend. Competition will become more fierce and there will be a survival match of business model versus business model, supply chain versus supply chain.

Our key objectives for 2003 will be to maintain comparable store sales value, to reduce the cost of goods sold, to generate new source of income with the introduction of new growth categories and to exercise strict cost control.

It will be important for the Group to adhere to the quality growth strategy with tactics to add value to the Circle K shopping experience; such as increasing the number of outlets to provide more location convenience and further enhancing our core competencies. The ultimate goal is to achieve and exceed our target volume and profitability growth for both Hong Kong and Guangzhou operations.



**A Comparison of Sales % Change: Circle K (HK) vs Total Retail Sales**



## Review of Business Objectives

For the six months ended 31 December 2002

### 1. HONG KONG OPERATIONS

#### Initiatives

#### Progress Update

##### Marketing & Brand Building

- Continue Brand Imagery Campaign 2
  - Commence 4th wave of promotional programmes
- Due to the unfavourable retail environment, decision was made to postpone this campaign to 2003 and to divert the advertising fund to promotional programmes to drive sales.
  - A total of 9 promotional campaigns were successfully carried out:
    - ☒ Jul - Octopus Promotion & Qoo Promotion
    - ☒ Aug - New Trendy & Fun Promotion
    - ☒ Sep - Lucky Star Loyalty Program Promotion & Snack Promotion
    - ☒ Oct - Phone Card Promotion
    - ☒ Nov - Bonus Scratch Card Promotion
    - ☒ Dec - Christmas Tree Promotion & Sharing Promotion

##### Store Expansion

- Own & operate 156 - 170 Circle K stores
- Total number of stores increased to 166 as at end of 2002.

##### Service Excellence

- Launch managerial excellence training programme for Circle K store managers
- 5 sessions of managerial and leadership skill training were successfully completed for store managers.
- Our Senior Store Manager, Ms. Irene Dai, won the Hong Kong Retail Management Association's 2002 Service & Courtesy Award for the Supermarket/ convenience store category.

## 1. HONG KONG OPERATIONS (continued)

### Initiatives

#### Category Management Excellence

- Major review of product classification to meet customers' needs

#### Supply Chain Management & Logistics

- Continue supply chain management initiatives with selected partner suppliers on replenishment

### Progress Update

- Category management teams started the "Mass Customization" initiative to match product offerings and pricing to the customer profile of each store.

- The Vendor Managed Inventory (VMI) initiative with British American Tobacco was successfully rolled out to all stores, resulted in reduction of 0.31% out of stock incidences. Stock turnover days reduced from 14 days to 9.7 days for the tobacco category. Category partnership programmes with Heineken and Coca-Cola were also launched.

## 2. START-UP OPERATIONS IN CHINA

### Initiatives

#### Business Model Adaptation

- Review business model for implementation in Phase 2 expansion

#### Establishment of Joint Ventures

- Establish legal entity in the Eastern part of The People's Republic of China ("PRC")

#### Training Centre

- Develop & train management team for Phase 2 expansion

### Progress Update

- This will be done in mid 2003 when the number of stores in Guangzhou reaches 10 - 15 stores.

- This initiative will be delayed due to the focus on building stores in Pearl River Delta area. Will become a 2004 initiative.

- Postpone to 2004.

Review of Business objectives (continued)

For the six months ended 31 December 2002

2. START-UP OPERATIONS IN CHINA (continued)

**Initiatives**

**Progress Update**

Category Management

- Refine category classification
- The Hong Kong and Southern China Category Management Teams worked closely together to set up the initial category classification and opened the first 3 stores. The team is now focusing on localizing the categories according to local consumer preference.

Store Openings

- Operate 50 - 70 Circle K stores in Guangzhou and the Pearl River Delta Area
- Due to delay in obtaining business license, we opened the first Circle K stores in November 2002 and finished 2002 with 2 stores. The revised plan is to have 30 stores in the Pearl River Delta by end of 2003.

Supply Chain Management

- Conduct distribution centre capacity study
- Existing distribution center in Pang Yu has capacity for supporting 50 - 70 stores.

Business System

- Fully implement Decision Support System (“DSS”)
- The system in Southern China was developed based on expertise gained in Hong Kong and most of the DSS features for data analysis and decision support are available to the Southern China management team.

### 3. e-BUSINESS DEVELOPMENT

#### Initiatives

#### Progress Update

##### *Development of new customer accounts*

- Review and plan marketing strategies for 2003
- Due to latest e-commerce developments, it was decided that a prudent approach would be to wind down the e-business development and to trim down operating expenses. The revised business focus is to provide quick response delivery to Circle K stores. Hence, there will be no need to implement any marketing plan.

##### *Brand Building*

- Review and plan brand building strategies for 2003
- There is no need to initiate the programme due to the change of business focus to serving internal customers i.e. Circle K's quick response fulfillment of time-critical products.



## Use of Proceeds

The Group raised approximately HK\$188 million through the placing and public offer of shares upon the listing of the Company. After deducting expenses related to listing, net proceeds were approximately HK\$163 million.

During the period from 18 January 2001 (date of listing) to 31 December 2002, the Group's use of proceeds was substantially in accordance with the intended use stated in the prospectus of the Company dated 9 January 2001 ("Prospectus") and the comparison is set out below:

	Intended amount to be used	Actual amount used		Remaining amount
		For the year ended 31 December 2002	For the period from 18 January 2001 (date of listing) to 31 December 2002	
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Establishment of a convenience store chain comprising up to 100 new Circle K stores in Guangzhou and the Pearl River Delta area	94,300	6,525	9,892	84,408
Establishment of the infrastructure of a distribution centre and an administrative office in the Pearl River Delta area	5,200	1,950	2,726	2,474
Acquisition and development of a computer system for the Group's operation in the PRC	4,200	988	1,126	3,074
Opening of additional Circle K stores in the Eastern PRC and/or the Northern PRC	55,900	—	—	55,900
	-----	-----	-----	-----
Total:	<u>159,600</u>	<u>9,463</u>	<u>13,744</u>	<u>145,856</u>

The actual use of proceeds for the year ended 31 December 2002 of HK\$9,463,000 was lower than the intended amount for the period stated in the Prospectus of HK\$24,813,000. The main reason for the difference was due to the delay in opening Circle K stores in Guangzhou and the Pearl River Delta area which was caused by the delay in obtaining business licence. The first batch of stores has been opened in the fourth quarter of 2002.

The remaining net proceeds from listing are deposited in licensed banks in Hong Kong and the Chinese Mainland of the PRC.

The remaining proceeds will be applied in future years to achieve the business objectives as set out in the Prospectus.



## Directors and Senior Management Profile

### EXECUTIVE DIRECTORS

#### **Yeung Lap Bun, Richard** – *Chief Executive Officer*

Mr. Yeung, aged 46, has over 20 years' experience in general management, food distribution and supply chain management. He is responsible for overseeing the Group's operations, marketing, logistics and supply chain management and he is actively involved in new business development in the Chinese Mainland. Prior to joining the Group in October 1998, he spent about 10 years in senior positions at HAVI Food Services Group, managing the supply chain of McDonald's Restaurants in various countries in Asia. Mr. Yeung graduated from the University of Hawaii with a Bachelor of Business Administration degree. Mr. Yeung also holds an MBA degree from the California State University of Los Angeles and is a Certified Public Accountant. Mr. Yeung is an Executive Committee member of the Hong Kong Retail Management Association.

#### **Li Kwok Ho, Bruno** – *Chief Financial Officer*

Mr. Li, aged 53, joined Li & Fung Group in January 1991 as the Chief Financial Officer. Since February 1993, he has been appointed as the Retail Services Director and takes charge of all the centralised supporting services of Li & Fung Retailing Group which comprises the businesses of Circle K and Toys "R" Us. His areas of responsibilities include Finance and Accounting, Human Resource and Administration, Business Systems Development and Real Estate. Mr. Li graduated from the Chinese University of Hong Kong with a Bachelor of Science degree and is a member of the Institute of Chartered Accountants of Scotland. He has more than 20 years of professional experience in finance and accounting.

### NON-EXECUTIVE DIRECTORS

#### **Dr. Fung Kwok King, Victor** – *Chairman*

Dr. Fung, aged 57, is the Group Chairman of the Li & Fung group of companies, which includes the major subsidiaries, Li & Fung (Distribution) Limited, Li & Fung (Retailing) Limited, and the publicly listed Li & Fung Limited and Convenience Retail Asia Limited. Dr. Fung holds a Bachelors and a Masters Degree in Electrical Engineering from the Massachusetts Institute of Technology, and a Doctorate in Business Economics from Harvard University. Dr. Fung is currently Chairman of the Hong Kong Airport Authority and the Hong Kong University Council. He was appointed by Government to serve as the Hong Kong Representative on the APEC Business Advisory Council (ABAC) in 1996. From 1991 to 2000, he was Chairman of the Hong Kong Trade Development Council. Dr. Fung is also active on a number of Government advisory boards including the Judicial Officers Recommendation Commission.

**NON-EXECUTIVE DIRECTORS** (continued)

**Dr. Fung Kwok Lun, William**

Dr. Fung, OBE, JP, aged 54, brother of Dr. Fung Kwok King, Victor, is the Managing Director of Li & Fung Limited and Li & Fung (Retailing) Limited. He is also a director of Li & Fung (Distribution) Limited. Dr. Fung graduated from Princeton University with a Bachelor of Science degree in engineering and holds an MBA degree from the Harvard Graduate School of Business. He was awarded the degree of Doctor of Business Administration, honoris causa by the Hong Kong University of Science & Technology. Dr. Fung is a non-executive director of HSBC Holdings plc, CLP Holdings Limited, chinadotcom corporation and VTech Holdings Limited. He is past Chairman of the Hong Kong General Chamber of Commerce, the Hong Kong Exporters' Association and the Pacific Economic Cooperation Committee.

**Lau Butt Farn**

Mr. Lau, aged 55, joined Li & Fung Group in 1981 as the Financial Controller. Between 1985 and 1998, he was the Operations Director for the Li & Fung Retailing Group. Since 1999, Mr. Lau is the Chief Financial Officer of Li & Fung (Distribution) Limited, an unlisted company in the supply chain management business. Mr. Lau graduated from the University of London with a Bachelor of Science degree in Physics and is a Fellow of the Institute of Chartered Accountants in England and Wales.

**Wong Yuk Nor, Louisa**

Ms. Wong, aged 53, joined Li & Fung (Retailing) Limited in April 1998 as a director responsible for strategic planning, marketing and communication for the Li & Fung Retailing Group. Ms. Wong graduated from the University of Hong Kong with a Bachelor of Arts degree and has more than 20 years' professional experience in Marketing and Advertising. Prior to joining Li & Fung (Retailing) Limited, Ms. Wong was the Managing Director of a leading 4A advertising agency Foote, Cone and Belding Limited for many years.



## INDEPENDENT NON-EXECUTIVE DIRECTORS

### **Dr. Ch'ien Kuo Fung, Raymond**

Dr. Ch'ien, aged 51, is Executive Chairman of chinadotcom corporation as well as Chairman of its subsidiary, hongkong.com corporation. He is also non-executive Chairman of HSBC Private Equity (Asia) Limited and serves on the boards of HSBC Holdings plc; the Hongkong and Shanghai Banking Corporation Limited; MTR Corporation Limited; Inmarsat Ventures plc, Inchcape plc, VTech Holdings Limited and The Wharf (Holdings) Limited. In public service, Dr. Ch'ien is Chairman of the Hong Kong/Japan Business Cooperation Committee; and Chairman of the Advisory Committee on Corruption of the Independent Commission Against Corruption. Dr. Ch'ien is an honorary President and past Chairman of the Federation of Hong Kong Industries. From 1992 to 1997, Dr. Ch'ien was a member of the Executive Council of Hong Kong, then under British Administration. He was appointed a member of the Executive Council of the Hong Kong Special Administrative Region on 1 July 1997 and served until 2002. Dr. Ch'ien was previously Chairman of the Industry and Technology Development Council and the Hong Kong Industrial Technology Centre Corporation Ltd. Dr. Ch'ien received a doctoral degree in Economics from the University of Pennsylvania, U.S.A. in 1978. He was appointed a Justice of the Peace in 1993 and a Commander in the Most Excellent Order of the British Empire in 1994 and awarded the Gold Bauhinia Star Medal in 1999.

### **Au Man Chung, Malcolm**

Mr. Au, aged 53, is currently the managing director of Artal Food Industries Limited. Mr. Au holds a Bachelor of Science degree in Chemical Engineering and a Master of Science degree in Food Science both from the University of Wisconsin, USA and a Master of Business Administration degree from the University of Toronto, Canada. Mr. Au is also a non-executive director of China-Hongkong Photo Products Holdings Ltd.

### **Godfrey Ernest Scotchbrook**

Mr. Scotchbrook, aged 57, presently serves as an independent director of Del Monte Pacific Limited (a company engaged in the production, marketing and distribution of premium branded food and beverage products) and a non-executive director of Boustead Singapore Limited (a company engaged in engineering, information technology and investments) in Singapore. Mr. Scotchbrook was a founder of Scotchbrook Communications Ltd., a firm specializing in investor relations, issues management, corporate positioning and public affairs; and a veteran in corporate governance.

## SENIOR MANAGEMENT

### **Kan Wing Chuen, Raphael** – *General Manager – Southern China*

Mr. Kan, aged 51, has over 20 years' experience in manufacturing and logistics management with multinationals and local companies in Hong Kong and Southern China. Prior to joining the Group in February 2000, he was the General Manager of HAVI Food Services Group and IDS Logistics (HK) Limited, and was responsible for providing supply chain management services to multinational clients of the companies. After joining the Group he was appointed as General Manager for Southern China and responsible for the Group's expansion into the PRC market. He graduated from the McGill University of Canada with a Bachelor degree in Mechanical Engineering. He also holds a Master degree in Business Administration from the University of East Asia, Macau.

### **Pak Chi Kin** – *General Manager – Operations*

Mr. Pak, aged 44, has over 10 years' experience in the food distribution industry. With an excellent performance as Divisional Manager of Supply Chain Management and Logistics, Mr. Pak was promoted to the new position of General Manager - Operations of Circle K, Hong Kong in January 2003. The position was created to head up Store Operations, Store Development, Supply Chain Management and Logistics functions while taking the lead in coordinating the centralized support services and Total Quality Culture initiatives. Prior to joining the Group in May 1999, Mr. Pak spent 7 years in senior position at HAVI Food Services Group and he was in charge of the distribution of food products and logistics services to McDonald's Restaurants. He graduated from the University of Hong Kong with a Bachelor degree of Science in Engineering. He also holds a Master degree of Science in Engineering from the University of Hong Kong. Mr. Pak is a member of the ECR Hong Kong (previously known as the Hong Kong Supply Chain Management Advisory Board) facilitated by the Hong Kong Article Numbering Association.

### **Ko Kam Cheong** – *Business & Store Development Manager – Business Development*

Mr. Ko, aged 62, has been with the Circle K stores since 1991. He has over 41 years of solid experience in the retailing industry. Prior to joining the Group, he spent 18 years as Operations Manager in PARKnSHOP and he was in charge of all matters related to Store Operations. With his extensive experience, Mr. Ko successfully led a very strong and effective operations team in Hong Kong as the Operations Manager before he assumed the new role as Business & Store Development Manager.

**SENIOR MANAGEMENT** (continued)

**Tsui Yin Ming, Benjamin** – *Divisional Manager – Business Development*

Mr. Tsui, aged 45, has solid experience in conducting the Group's Sales Forecasting Model and location analysis of new stores. He is currently responsible for expediting the Group's new store growth in Hong Kong and the Group's business expansion into the PRC market. He has over 15 years of experience gained in trade finance, marketing and business development area. He graduated from the University of Hong Kong with a Bachelor degree in Geography/Economics.

**Li Kam Hung, Mody** – *Divisional Manager – Site Development*

Mr. Li, aged 50, has been with the Li & Fung Retailing Group since 1985. He has over 27 years of experience in the construction industry. He is responsible for the Company's store construction, renovation, project planning and maintenance. He has been awarded the Associateship in Building Technology and Management from the Hong Kong Polytechnic University and a Diploma in Legal Studies from the University of Hong Kong. He is also a member of The Chartered Institute of Building, a member of The Hong Kong Institution of Engineers, a member of the Architecture & Surveying Institute, a member of the Royal Institution of Chartered Surveyors and the Associate of The Chartered Institute of Arbitrators.

**Tse Yiu Hon, Wallace** – *Divisional Manager – Buying and Marketing*

Mr. Tse, aged 42, is responsible for overseeing the buying, merchandising and marketing strategies of the Company. He has 20 years' experience in the retailing industry gained from his experience in PARKnSHOP, Uncle A and 7-Eleven. He holds a diploma in Management Studies from The Hong Kong Polytechnic University as well as a Master degree in Marketing Management from the Macquarie University of Australia.

**SENIOR MANAGEMENT** (continued)

**Lee Hon Choi** – *Divisional Manager – Operations, Southern China*

Mr. Lee, aged 40, has been with Circle K stores since 1985. He has over 16 years' solid operation experience in the retailing industry. Prior to his appointment to the present position, he spent 10 years as District Manager in Circle K, Hong Kong and has acquired valuable first hand experience and knowledge in the management of our store operations. He is currently responsible for store operations in the PRC market.

**Lai Chun Pang** – *Divisional Manager – Sales and Operations*

Mr. Lai, aged 41, has over 20 years' experience in retail operations management. He is responsible for overseeing the daily operations of the entire Circle K store chain in Hong Kong. Prior to joining the Group in 1987, he spent over 6 years in retail operations and local distribution of imported sportswear. He continued his career in store operations after joining the Group and was promoted to the position of Divisional Manager, Sales and Operations in January 2002. He graduated from the City University of Hong Kong with a Bachelor degree of Arts with honors in Business Studies. He also holds a Master degree of Arts in International Business Management from the City University of Hong Kong.

**Law Ping Lun, Alan** – *Divisional Manager – Supply Chain Management and Logistics*

Mr. Law, aged 43, has over 15 years' solid operation experience in food distribution industry and inventory control. He was recently appointed to be the Divisional Manager, Supply Chain Management and Logistics. Mr. Law is currently responsible for overseeing the Group's logistics and supply chain management system and process. Prior to joining the Group in April 2000, he spent 10 years in a managerial position at HAVI Food Services Group. He has acquired extensive distribution experiences and professional knowledge over the years while providing logistics and supply chain management services to McDonald's Restaurants.

**SENIOR MANAGEMENT** (continued)

**Lam Siu Tak, Jimmy** – *Divisional Manager – Finance & Accounting*

Mr. Lam, aged 44, has over 20 years' experience in finance and accounting in various companies including Shell Australia and Wellcome Supermarket in Hong Kong. Mr. Lam graduated from the University of Melbourne with a Bachelor degree of Commerce. He also holds a Master degree of Business Administration from the University of South Australia. He is a Fellow member of the Hong Kong Society of Accountants. He is also a Fellow member of the CPA Australia.

**Wu Tsz Kin, Chris** – *Divisional Manager – Human Resource & Administration*

Mr. Wu, aged 41, is responsible for overseeing all Human Resources functions of the Group including manpower planning, compensation and benefits, training and development, insurance and administration as well as staff management and relations. He has over 16 years of Human Resources management experience gained in various companies including Watson's the Chemist Ltd. and Asia Television Limited. He holds a Master degree of Business Administration from the Queen's University of Belfast as well as a Master degree of Arts in Human Resources from Macquarie University of Australia.

**Yiu Chi Chung, Joseph** – *Divisional Manager – Real Estate*

Mr. Yiu, aged 43, has over 18 years' solid experience in real estate management gained from various companies including Chinese Estates, Ltd., Emperor Investment Ltd. and Hang Lung Development Co., Ltd. He has an in-depth knowledge on the real estate market of Hong Kong and he is responsible for management of rental leases and for securing new sites for the Company's expansion. He holds a Certificate in Estate Management from The Hong Kong Management Association.

**Fung Chiu Ming, Danny** – *Divisional Manager – Business Systems Development*

Mr. Fung, aged 42, has over 15 years' experience in information technology gained from various companies including ABN AMRO Bank, Theme International Holdings Ltd., PolyU Technology Ltd. and U-Campus.com. He is responsible for the overall management of the MIS function and project implementation in support of business strategies and operations. He graduated from the Brigham Young University of U.S.A. with a Bachelor of Science degree in Finance and a Master of Science degree in Information/Administrative Management with Computer Science emphasis.



## Directors' Report

The directors submit their report together with the audited accounts for the year ended 31 December 2002.

### PRINCIPAL ACTIVITIES AND GEOGRAPHICAL ANALYSIS OF OPERATIONS

The principal activity of the Company is investment holding. Its subsidiaries are principally engaged in the operation of a chain of convenience stores under the tradename of Circle K in Hong Kong and the Chinese Mainland. The Circle K tradename is licenced from The Circle K Stores Inc. of the United States of America.

No activity analysis and geographical analysis is presented as substantially all the Group's turnover and contribution to results were derived from the operation of a chain of convenience stores in Hong Kong.

### RESULTS AND APPROPRIATIONS

The results of the Group for the year are set out in the consolidated profit and loss account on page 55.

The directors do not recommend payment of a dividend.

### RESERVES

Movements in the reserves of the Group and the Company during the year are set out in note 16 to the accounts.

### DONATIONS

Charitable and other donations made by the Group during the year amounted to HK\$299,000.

### FIXED ASSETS

Details of the movements in fixed assets of the Group during the year are set out in note 10 to the accounts.

### SHARE CAPITAL

Details of the movements in share capital of the Company are set out in note 15 to the accounts.

### DISTRIBUTABLE RESERVES

Distributable reserves of the Company at 31 December 2002 calculated under the Companies Law (2000 Revision) of the Cayman Islands, amounted to HK\$134,357,000 (2001: HK\$121,757,000).

### PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's by-laws and there was no restriction against such rights under the laws of the Cayman Islands.

## SUBSIDIARIES

Details of the Company's subsidiaries as at 31 December 2002 are set out in note 11 to the accounts.

## FIVE YEAR FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group for the five financial years ended 31 December 2002 is set out on page 80.

## PURCHASE, SALE OR REDEMPTION OF SHARES

The Company has not redeemed any of its shares during the year. Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's shares during the year.

## SHARE OPTIONS

### (a) Pre-IPO Share Option Plan

On 27 December 2000, a Pre-IPO Share Option Plan (the "Pre-IPO Share Option Plan") was approved by a written resolution of the shareholders of the Company under which the board of Directors may, at its discretion, grant options to full time or part time employees of the Group entitling them to subscribe for shares of HK\$0.10 each (the "Shares") representing up to maximum 19,930,000 Shares. On 30 December 2000, options to subscribe 19,930,000 Shares were granted to 228 employees.

Details of the share options granted under the Pre-IPO Share Option Plan and remain outstanding as at 31 December 2002 are as follows:

	Options held at 1 January 2002	Options exercised during the year (Note 1)	Options lapsed during the year (Note 2)	Options held at 31 December 2002	Exercise price HK\$	Grant date	Exercisable from	Exercisable until
Continuous contract employees	15,490,000	(11,620,000)	(80,000)	3,790,000	0.92	30 December 2000	10 January 2002	9 January 2006
	3,810,000	—	(200,000)	3,610,000	0.92	30 December 2000	10 January 2003	9 January 2006

#### Notes:

- 11,620,000 share options were exercised at an exercise price of HK\$0.92 per Share and the weighted average closing price of the Shares immediately before the date on which the options were exercised is HK\$2.59.
- 280,000 share options were lapsed following the cessation of employment of certain grantees.

## SHARE OPTIONS (continued)

### (b) Share Option Scheme

On 6 January 2001, a Share Option Scheme (the "Scheme") was approved by a written resolution of the shareholders of the Company. On 24 April 2002, the Scheme was amended to comply with the changes to Chapter 23 of the GEM Listing Rules which came into effect on 1 October 2001 in relation to the share option schemes of listed issuers on the Stock Exchange. Details of the Scheme are as follows:

#### (i) Purpose of the Scheme

The purpose of the Scheme is to attract and retain the best quality employees for the development of the Company's businesses and to provide additional incentives or rewards to selected qualifying participants of the Scheme for their contribution to the creation of the Company's shareholders value.

#### (ii) Qualifying participants

Any employee (whether full time or part time employee including any executive or non-executive Directors of the Company or any Affiliate (the "Affiliate") as defined in the Scheme) or any consultant, agent, advisor, business alliance, joint venture partner of or supplier of goods or services to the Group or any Affiliate or any employee of the business alliance, joint venture partner of or supplier of goods or services to the Group or any Affiliate.

#### (iii) Maximum number of shares

The total number of Shares which may be issued upon exercise of all options to be granted under the Scheme and any other schemes (including the Pre-IPO Share Option Plan in (a) above) must not in aggregate exceed 10% of the Shares in issue as at 6 January 2001 being 65,560,000 Shares, which represent approximately 9.81% of the issued share capital of the Company as at the date of this Report.

The total number of Shares issued and to be issued upon exercise of the options (whether exercised or outstanding) in any 12-month period granted to each qualifying participant must not exceed 1% of the Shares in issue, unless specially approved by the independent shareholders of the Company.



**SHARE OPTIONS** (continued)

**(b) Share Option Scheme** (continued)

(iv) Option period

In respect of any particular option, such period as the Board may in its absolute discretion determine, save that such period shall not expire less than three years nor more than 10 years from the commencement date ("the Commencement Date"). The Commencement Date is deemed to have taken effect from the date on which that option was offered to the qualifying participants.

(v) Amount payable on application or acceptance

An offer of the grant of an option shall remain open for acceptance for a period of 28 days from the Commencement Date. An offer of the grant of the option shall be deemed to have been accepted when the duplicate letter comprising acceptance of the relevant option duly signed by the grantee, together with a remittance in favour of the Company of HK\$1.00 by way of consideration of the grant thereof is received by the Company.

(vi) Subscription price

The subscription price in respect of any particular option shall be such price as the Board may in its absolute discretion determine at the time of grant of the relevant option but it shall not be less than whichever is the highest of (i) the closing price of the Shares as stated in the Stock Exchange's daily quotations sheet on the Commencement Date (ii) the average closing price of the Shares for the five business days immediately preceding the Commencement Date on which there were dealings in Shares on the Stock Exchange and (iii) the nominal value of a Share.

**SHARE OPTIONS** (continued)

**(b) Share Option Scheme** (continued)

(vii) The remaining life of the Scheme

The Board shall be entitled at any time within 10 years commencing on 6 January 2001 to offer the grant of an option to any qualifying participants.

Details of the share options granted and remain outstanding as at 31 December 2002 are as follows:

	Options held at 1 January 2002	Options granted during the year (Note 1)	Options lapsed during the year (Note 3)	Options held at 31 December 2002	Exercise price HK\$	Grant date	Exercisable from	Exercisable until
(A) Continuous contract employees								
	242,000	—	—	242,000	2.42	21 September 2001	21 September 2002	20 September 2006
	472,000	—	—	472,000	2.42	21 September 2001	21 September 2003	20 September 2006
	—	2,436,000	—	2,436,000	2.785	24 May 2002	24 May 2003	23 May 2007
	—	660,000	(40,000)	620,000	2.785	24 May 2002	24 May 2004	23 May 2007
	—	94,000	—	94,000	2.15	23 September 2002	23 September 2003	22 September 2007
	—	66,000	—	66,000	2.15	23 September 2002	23 September 2004	22 September 2007

## SHARE OPTIONS (continued)

## (b) Share Option Scheme (continued)

Options held at 1 January 2002	Options granted during the year (Note 1)	Options lapsed during the year (Note 3)	Options held at 31 December 2002	Exercise price HK\$	Grant date	Exercisable from	Exercisable until
(B) Directors							
—	1,800,000 (Note 2)	—	1,800,000	2.785	24 May 2002	24 May 2003	23 May 2007

*Notes:*

- (1) During the year, options were respectively granted on 24 May 2002 and 23 September 2002. The closing price of the Shares immediately before the date on which the options were granted was HK\$2.63 on 23 May 2002 and HK\$2.00 on 20 September 2002 respectively.
- (2) 1,300,000, 250,000 and 250,000 options were respectively granted to the Directors, Messrs. Yeung Lap Bun, Richard and Li Kwok Ho, Bruno and Ms. Wong Yuk Nor, Louisa. Please refer to the section headed "Directors' interests in equity or debt securities in the Company and certain major associated corporations" for details.
- (3) 40,000 options were lapsed following the cessation of employment of certain grantees.
- (4) Rule 23.08 of the GEM Listing Rules stipulates that listed issuers are encouraged to disclose in its annual report the value of options granted to participants set out in (i) to (v) of Rule 23.07 during the financial year. The Directors consider it inappropriate to value the options as there are serious limitations in the application of the Black & Scholes Model and Binomial Model in the valuation of employee share options, especially in the case of the Company of which liquidity of its share trading is relatively low. Detailed explanations are given below on certain assumptions of the models which cannot be followed in the valuation of employee share options of the Company.

a. Options are freely tradeable in the market

In the case of employee share option, it is not freely tradeable and transferable and a vesting period also applies.

**SHARE OPTIONS** (continued)

**(b) Share Option Scheme** (continued)

b. European exercise terms are used

European exercise terms dictate that the option can only be exercised on expiration date. Employee share option follows the American exercise term which allows the option to be exercised at any time during the option exercisable period. It is impossible to predict when the option will be exercised as it depends on the financial and tax considerations of the option holder concerned.

c. Returns are lognormally distributed

The models are based on a normal distribution of underlying asset returns. In practice underlying asset price distributions often depart significantly from the lognormal.

d. Estimating volatility

The models are making the assumption that the volatility in the past is a good indicator of the volatility in the future. This may not be a valid assumption especially in the case of the Company of which liquidity of its share trading is relatively low. Since the option is not tradeable in the market, it is not possible to calculate the "implied volatility" based on market quotes.

e. Value of underlying share

As the liquidity of the share trading of the Company is relatively low, the current market price may not be an accurate reflection of the value of the underlying Shares.

f. The share pays no dividends during the option's life

Although adjustments can be made to the models by making assumptions on dividend yield, it is not possible at this stage to predict the dividend yield of the Company. It is highly likely that there will be dividend payments during the option life but the Board has not determined a dividend policy yet. Historically, no dividend has been paid by the Company.

## SHARE OPTIONS (continued)

### (b) Share Option Scheme (continued)

- g. No tax and commissions are charged

This is not a valid assumption in the case of the Company.

- h. Interest rates remain constant and known during the option's life

In reality interest rates are expected to fluctuate especially during periods of rapidly changing interest rates. The longer the time to maturity of the option, the more the effect of the interest rate will be important.

Save as disclosed above, as at 31 December 2002, none of the Directors, chief executives, management shareholders or substantial shareholders of the Company or their respective associates have been granted options under the Pre-IPO Share Option Plan and the Scheme.

## DIRECTORS

The Directors during the year and up to the date of this Report were:

Dr. FUNG Kwok King, Victor<sup>+</sup>

Dr. FUNG Kwok Lun, William<sup>+</sup>

Mr. LAU Butt Farn<sup>+</sup>

Mr. LI Kwok Ho, Bruno

Mr. YEUNG Lap Bun, Richard

Ms. WONG Yuk Nor, Louisa<sup>+</sup>

Dr. CH' IEN Kuo Fung, Raymond\*

Mr. AU Man Chung, Malcolm\*

Mr. Godfrey Ernest SCOTCHBROOK\* (appointed on 1 November 2002)

<sup>+</sup> Non-executive directors

\* Independent non-executive directors

**DIRECTORS** (continued)

In accordance with Article 86 of the Company's Articles of Association, Mr. Godfrey Ernest Scotchbrook retires and being eligible, offers himself for re-election.

In accordance with Article 87 of the Company's Articles of Association, Dr. Fung Kwok Lun, William and Mr. Lau Butt Farn retire and being eligible, offer themselves for re-election.

The non-executive Directors have no set term of office but are subject to retirement by rotation at annual general meeting of the Company in accordance with the Company's Articles of Association.

**DIRECTORS' SERVICE CONTRACTS**

Each of the executive Directors has entered into a service contract with the Company for an initial term of three years commencing on 1 January 2001 and will continue thereafter subject at all times (including the initial three years period) to termination by not less than three months' prior notice in writing by either party on the other.

Save as disclosed, none of the Directors has entered into any service contracts with any of its subsidiaries which is not determinable by the Group within one year without payment of compensation, other than statutory compensation.

**DIRECTORS' INTERESTS IN CONTRACTS**

No contracts of significance in relation to the Company's business to which the Company, its subsidiaries, its fellow subsidiaries or its holding companies was a party and in which a Director had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

## DIRECTORS' INTERESTS IN EQUITY OR DEBT SECURITIES IN THE COMPANY AND CERTAIN MAJOR ASSOCIATED CORPORATIONS

As at 31 December 2002, the interests of each of the Directors, chief executives and their associates in the equity or debt securities of the Company and certain of its major associated corporations\* (within the meaning of the Securities (Disclosure of Interests) Ordinance (“SDI Ordinance”)) as required to be recorded in the register maintained by the Company pursuant to section 29 of the SDI Ordinance are as follows:

Name of the Company	Name of Director	Personal Interests	Family Interests	Corporate Interests	Other Interests	Total
Company	Dr. Fung Kwok King, Victor	—	—	467,114,000 <i>(Note 1)</i>	—	467,114,000
Company	Dr. Fung Kwok Lun, William	—	—	467,114,000 <i>(Note 1)</i>	—	467,114,000
Company	Yeung Lap Bun, Richard	17,896,000 1,300,000 <i>(Note 2)</i>	—	—	—	19,196,000
Company	Li Kwok Ho, Bruno	2,676,000 250,000 <i>(Note 3)</i>	—	—	—	2,926,000
Company	Lau Butt Farn	2,676,000	—	—	—	2,676,000
Company	Wong Yuk Nor, Louisa	1,338,000 250,000 <i>(Note 4)</i>	—	—	—	1,588,000
Company	Dr. Ch'ien Kuo Fung, Raymond	1,000,000	—	—	—	1,000,000
Li & Fung (Gemini) Limited	Dr. Fung Kwok King, Victor	—	—	10,263,158 <i>(Note 5)</i>	1,184,210 <i>(Note 7)</i>	11,447,368
Li & Fung (Gemini) Limited	Dr. Fung Kwok Lun, William	—	—	10,263,158 <i>(Note 5)</i>	—	10,263,158

**DIRECTORS' INTERESTS IN EQUITY OR DEBT SECURITIES IN THE COMPANY AND CERTAIN MAJOR ASSOCIATED CORPORATIONS** (continued)

Name of the Company	Name of Director	Personal Interests	Family Interests	Corporate Interests	Other Interests	Total
Li & Fung (Distribution) Limited	Dr. Fung Kwok King,	(i)	—	(i)	—	7,090,000
	Victor	130,000 (Note 8)		6,800,000 (full voting ordinary shares) (Note 6)		(full voting ordinary shares)
		(ii)		(ii)		6,630,000
		160,000 (Note 9)		6,630,000 (redeemable participating preferred shares) (Note 6)		(redeemable participating preferred shares)
Li & Fung (Distribution) Limited	Dr. Fung Kwok Lun,	—	—	(i)	—	6,800,000
	William			6,800,000 (full voting ordinary shares) (Note 6)		(full voting ordinary shares)
				(ii)		6,630,000
				6,630,000 (redeemable participating preferred shares) (Note 6)		(redeemable participating preferred shares)
Li & Fung (Distribution) Limited	Lau Butt Farn	32,500 (Note 8)	—	—	—	65,000
		32,500 (Note 10)				



**DIRECTORS' INTERESTS IN EQUITY OR DEBT SECURITIES IN THE COMPANY AND CERTAIN MAJOR ASSOCIATED CORPORATIONS** (continued)

Name of the Company	Name of Director	Personal Interests	Family Interests	Corporate Interests	Other Interests	Total
Li & Fung Limited	Dr. Fung Kwok King, Victor	—	—	1,180,500,000 (Note 11)	50,750,000 (Note 12)	1,231,250,000
Li & Fung Limited	Dr. Fung Kwok Lun, William	68,502,300	4,000 (Note 13)	1,180,500,000 (Note 11)	—	1,250,446,300
		480,000 (Note 14)				
		480,000 (Note 15)				
		480,000 (Note 16)				
Li & Fung Limited	Lau Butt Farn	2,200,000	—	—	—	2,200,000

\* Dr. Fung Kwok King, Victor and Dr. Fung Kwok Lun, William, by virtue of their interests in King Lun and the Company are deemed to be interested in the equity securities of certain associated corporations of the Company under the SDI Ordinance. A waiver from full compliance from Rule 18.15 of the GEM Listing Rules for the disclosure of directors' interest in the equity or debt securities of the associated corporations has been granted by the Stock Exchange on 27 January 2003. Accordingly, the companies under the section headed "Directors' interests in equity or debt securities in the Company and certain major associated corporations" are only the major associated corporations of the Company and are not intended to be exhaustive.

*Notes:*

- King Lun Holdings Limited ("King Lun") through its indirect wholly owned subsidiary, Li & Fung (Retailing) Limited ("LFR") (a wholly owned subsidiary of Li & Fung (1937) Limited ("LF (1937)")) held 467,114,000 Shares in the Company. 1,332,840 shares in King Lun, representing 50% of its issued share capital, are owned by J.P. Morgan Trust Company (Jersey) Limited (formerly known as Chase Bank & Trust Company (CI) Limited), the trustee of a trust established for the benefit of the family members of Dr. Fung Kwok King, Victor. The remaining 50% of King Lun is owned by Dr. Fung Kwok Lun, William.
- In May 2002, Mr. Yeung Lap Bun, Richard was granted share options to subscribe for 1,300,000 Shares. The options are exercisable at a subscription price of HK\$2.785 per Share during the period from 24 May 2003 to 23 May 2007.
- In May 2002, Mr. Li Kwok Ho, Bruno was granted share options to subscribe for 250,000 Shares. The options are exercisable at a subscription price of HK\$2.785 per Share during the period from 24 May 2003 to 23 May 2007.
- In May 2002, Ms. Wong Yuk Nor, Louisa was granted share options to subscribe for 250,000 Shares. The options are exercisable at a subscription price of HK\$2.785 per Share during the period from 24 May 2003 to 23 May 2007.

**DIRECTORS' INTERESTS IN EQUITY OR DEBT SECURITIES IN THE COMPANY AND CERTAIN MAJOR ASSOCIATED CORPORATIONS** (continued)

5. King Lun through its wholly owned subsidiary, LF (1937) held 10,263,158 shares in Li & Fung (Gemini) Limited ("LFG"). Dr. Fung Kwok King, Victor and Dr. Fung Kwok Lun, William are deemed to have interests in these shares through their respective interests in King Lun and LF (1937) as set out in note (1) above.
6. LFG holds 6,800,000 full voting ordinary shares and 6,630,000 redeemable participating preferred shares in Li & Fung (Distribution) Limited ("LFD"). Dr Fung Kwok King, Victor and Dr. Fung Kwok Lun, William are deemed to have interests in these shares through their respective interests in King Lun and LF (1937) and indirect interests in LFG as set out in notes (1) and (5) above.
7. 1,184,210 shares in LFG are owned by a company which is held by J.P. Morgan Trust Company (Jersey) Limited (formerly known as Chase Bank & Trust Company (CI) Limited).
8. In 1999, Dr. Fung Kwok King, Victor and Mr. Lau Butt Farn were granted share options to subscribe for 130,000 and 32,500 full voting ordinary shares of US\$0.01 each in LFD ("LFD Shares") respectively. Of these, options in respect of 105,500 and 26,000 LFD Shares are fully vested in Dr. Fung Kwok King, Victor and Mr. Lau Butt Farn respectively. The remaining share options are to be vested in Dr. Fung Kwok King, Victor and Mr. Lau Butt Farn on 31 December 2003. The share options are exercisable at US\$1 per LFD Share within 21 business days after the earliest of (a) the date of issuance of a notice for an initial public offering of LFD Shares, (b) the date of issuance of a notice of the sale of all or substantially all of the business or shares of LFD and (c) 31 December 2006.
9. In 1999, Dr. Fung Kwok King, Victor was granted share options to subscribe for 16,000 LFD Shares for each full percentage point by which certain LFD investors' fully diluted aggregate estimated internal rate of return on a public share offer by LFD, or on a sale of all or substantially all of its business or shares, exceeds 30% per annum, subject to a maximum of 160,000 LFD Shares. The share options are exercisable at US\$1 per LFD Share within 21 business days after the date of issuance of a notice of public offer or sale (whichever is earlier) as described in note (8) above.
10. In 2002, Mr. Lau Butt Farn was granted share options to subscribe for 3,250 LFD Shares for each full percentage point by which certain LFD investors' fully diluted aggregate estimated internal rate of return on a public share offer by LFD, or on a sale of all or substantially all of its business or shares, exceeds 30% per annum, subject to a maximum of 32,500 LFD Shares. The share options are exercisable at US\$1 per LFD Share within 21 business days after the date of issuance of a notice of public offer or sale (whichever is earlier) as described in note (8) above.
11. Out of the 1,180,500,000 shares of HK\$0.025 each in Li & Fung Limited ("LF Shares"), holdings of 49,950,800 LF Shares, 996,000,000 LF Shares and 134,549,200 LF Shares are respectively held by King Lun, LF (1937) and Orient Ocean Holdings Limited ("Orient Ocean"). Orient Ocean is a private company incorporated in the British Virgin Islands. LF (1937) held 50% of the voting rights, but no beneficial interests, in Orient Ocean. Dr. Fung Kwok King, Victor and Dr. Fung Kwok Lun, William are deemed to have interests in these shares through their respective interests in King Lun and LF (1937) as set out in notes (1) and (5) above.

## **DIRECTORS' INTERESTS IN EQUITY OR DEBT SECURITIES IN THE COMPANY AND CERTAIN MAJOR ASSOCIATED CORPORATIONS** (continued)

12. 50,750,000 LF Shares are held by J.P. Morgan Trust Company (Jersey) Limited (formerly known as Chase Bank & Trust Company (CI) Limited).
13. 4,000 LF Shares are owned by the wife of Dr. Fung Kwok Lun, William.
14. In 2000, Dr. Fung Kwok Lun, William was granted share options to subscribe for 480,000 LF Shares. The options are exercisable at a subscription price of HK\$15.26 per LF Shares during the period from 7 July 2001 to 6 July 2003.
15. In July 2001, Dr. Fung Kwok Lun, William was granted share options to subscribe for 480,000 LF Shares. The options are exercisable at a subscription price of HK\$10.50 per LF Shares during the period from 18 July 2002 to 17 July 2004.
16. In August 2001, Dr. Fung Kwok Lun, William was granted share options to subscribe for 480,000 LF Shares. The options are exercisable at a subscription price of HK\$7.98 per LF Shares during the period from 28 August 2003 to 27 August 2005.

Save as disclosed above, as at 31 December 2002, none of the Directors or any of their associates had any interests in any equity or debt securities of the Company or any of its associated corporations.

## **DIRECTORS' BENEFITS FROM RIGHTS TO ACQUIRE SHARES OR DEBENTURES**

Save as disclosed in the section headed "Share Options" above, at no time during the year was the Company, its holding companies or its subsidiaries a party to any arrangements to enable the Directors of the Company (including their spouses and children under 18 years of age), to acquire benefits by means of acquisition of Shares in, or debentures of, the Company or any other body corporate.

## **SUBSTANTIAL SHAREHOLDERS**

As at 31 December 2002, the register of substantial shareholders maintained by the Company under section 16(1) of the SDI Ordinance showed that Li & Fung (Retailing) Limited held 467,114,000 Shares in the Company. Other than such interests and those as disclosed in the section headed "Directors' interests in equity or debt securities in the Company and certain major associated corporations" above, the Company has not been notified of any substantial shareholders' interests, being 10% or more of the Company's issued share capital.

## SPONSOR'S INTEREST

None of the Company's sponsor BNP Paribas Peregrine Capital Limited (the "Sponsor"), its directors, employees or associates (as referred to in Note 3 to Rule 6.35 of the GEM Listing Rules) had any interests in the securities of the Company or any member of the Group or any rights to subscribe for or to nominate persons to subscribe for the securities of the Company or any member of the Group as at 31 December 2002.

Pursuant to the agreement dated 9 January 2001 entered into between the Company and the Sponsor, the Sponsor will receive usual sponsorship fees for acting as the Company's retained sponsor for the period from 18 January 2001 to 31 December 2003.

## CONNECTED TRANSACTIONS

During the year, the Group had various transactions with related parties (details are set out in note 22 to the accounts on page 79). Some of these transactions, as set out below, are expected to continue on an on-going basis and will constitute non-exempt connected transactions of the Company:

	<i>HK\$'000</i>
1. Provision of services by LFR ( <i>Note 1</i> )	8,890
2. Net purchases of products from JDH (Hong Kong) Limited ( <i>Note 2</i> )	7,914
3. The Circle K Convenience Stores (HK) Limited ("Circle K (HK)") lease ( <i>Note 3</i> )	1,395
4. The Web-Logistic (HK) Limited ("Web-Logistic (HK)") lease ( <i>Note 4</i> )	856

### *Notes:*

1. This refers to the provision by LFR to Circle K (HK) for services relating to finance and accounting, management information systems, human resources, real estate and other administrative support pursuant to the agreement dated 20 March 2002 (the "New Services Agreement"), which replaced the Services Agreement dated 6 January 2001 (the "Expired Services Agreement") (details of which were disclosed in the circular to the shareholders of the Company dated 28 March 2002 (the "Circular")). Apart from the payment of the service fee, Circle K (HK) has also reimbursed LFR for utility expenses, insurance premiums and other office or administrative expenses which were paid by LFR on behalf of Circle K (HK).
2. This refers to the net purchases of various products (being food and non-food products) by Circle K (HK) from JDH (Hong Kong) Limited, an indirect subsidiary of LF (1937) which has an effective interest in it of 51.44%, on its standard terms of business pursuant to the agreement dated 20 March 2002 (the "New Purchase Agreement"), which replaced the Purchase Agreement dated 14 December 2000 (the "Expired Purchase Agreement") (details of which were disclosed in the Circular).
3. This refers to the lease payment from Circle K (HK) to Bomaron Limited, an indirect subsidiary of LF (1937), for a portion of 5th Floor, LiFung Centre, 2 On Ping Street, Siu Lek Yuen, Shatin, New Territories, Hong Kong with a gross floor area of 20,723 sq.ft.. Such premises are used as an office-cum-workshop.

## CONNECTED TRANSACTIONS (continued)

4. This refers to the lease payment from Web-Logistic (HK) to Bomaron Limited, an indirect subsidiary of LF (1937), for a portion of 5th Floor, LiFung Centre, 2 On Ping Street, Siu Lek Yuen, Shatin, New Territories, Hong Kong with a gross floor area of 12,667 sq.ft.. Such premises are used as an office-cum-workshop.
5. Upon listing, a waiver from full compliance with the announcement and shareholders' approval requirements of the GEM Listing Rules was granted by the Stock Exchange on 17 January 2001 in respect of the Expired Services Agreement, the Expired Purchase Agreement and the transactions in items (3) & (4) above (the "Waiver"). Details of the Waiver were set out in the Prospectus.

The Waiver to the extent relating to the Expired Services Agreement and the Expired Purchase Agreement ceased to apply with effect from 24 April 2002 when the New Services Agreement and the New Purchase Agreement became unconditional.

The Waiver to the extent relating to the transactions in items (3) & (4) ceased to apply on 31 December 2002 in accordance with the terms of the Waiver.

The independent non-executive Directors confirmed that the transaction in relation to the provision of services by LFR has been entered into in accordance with the terms of the New Services Agreement, the purchase of products from JDH (Hong Kong) Limited pursuant to the New Purchase Agreement has been entered into on terms no less favourable to the Group than terms available from independent third parties, and the remaining transactions in items (3) & (4) above have been entered into on normal commercial terms, and each of these four transactions has been entered into in the ordinary course of business of the Group, and is fair and reasonable to the Company and in the interests of the shareholders of the Company as a whole.

Pursuant to the approval of the shareholders at the annual general meeting of the Company held on 24 April 2002, approval will be sought for from the independent shareholders for the New Services Agreement and the purchase of products pursuant to the New Purchase Agreement and the maximum cap at which these two transactions may be conducted for the year ending 31 December 2003 at the forthcoming annual general meeting of the Company. In this respect, LFR and its associates (as defined in the GEM Listing Rules) will abstain from voting at the annual general meeting in respect of the resolutions relating to these two transactions. Mr. Lau Butt Farn and his associates (as defined in the GEM Listing Rules) will abstain from voting at the annual general meeting in respect of the resolution relating to the transaction with JDH (Hong Kong) Limited. The independent non-executive Directors have confirmed that they are of the opinion that the Group should continue with the New Services Agreement and the purchase of products pursuant to the New Purchase Agreement in the year ending 31 December 2003.

## MANAGEMENT CONTRACTS

Save as disclosed above, no contracts of significance for the provision of services to the Group by a controlling shareholder or its subsidiaries were entered into or existed during the year.

## COMPETING INTERESTS

During the year, none of the directors or the management shareholders (as defined in the GEM Listing Rules) of the Company had an interest in a business which competed or might compete with the business of the Group.

## MAJOR CUSTOMERS AND SUPPLIERS

The percentage of purchases for the year attributable to the Group's major suppliers is as follows:

### Purchases

— the largest supplier	18%
— five largest suppliers combined	49%

None of the Directors, their associates or any shareholders of the Company which to the knowledge of the Directors own more than 5% of the issued share capital of the Company had an interest in the five largest suppliers noted above.

During the year, the Group sold less than 30% of its goods and services to its five largest customers.

## BOARD PRACTICES AND PROCEDURES

The Company was in compliance with the Board Practices and Procedures as set out in Rules 5.28 to 5.39 of the GEM Listing Rules.

## AUDIT COMMITTEE

The Company established an audit committee on 6 January 2001 with written terms of reference in compliance with Rules 5.23 to 5.25 of the GEM Listing Rules. The primary duties of the audit committee are to review and supervise the financial reporting process and internal control system of the Group. On 1 November 2002, Mr. Godfrey Ernest Scotchbrook was appointed as a member of the audit committee. The present members of the audit committee are Dr. Ch'ien Kuo Fung, Raymond, Mr. Au Man Chung, Malcolm, Mr. Godfrey Ernest Scotchbrook (being the independent non-executive Directors) and Mr. Lau Butt Farn (being a non-executive Director). The chairman of the audit committee is Dr. Ch'ien Kuo Fung, Raymond.

**AUDIT COMMITTEE** (continued)

During the year, the audit committee met four times to review the internal control, the quarterly, half-year and full year financial reports of the Group prior to recommending them to the Board for approval.

**AUDITORS**

The accounts have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment.

On behalf of the Board  
**Fung Kwok King, Victor**  
*Chairman*

Hong Kong, 14 March 2003



## Auditors' Report

### AUDITORS' REPORT TO THE SHAREHOLDERS OF CONVENIENCE RETAIL ASIA LIMITED

*(incorporated in Cayman Islands with limited liability)*

We have audited the accounts set out on pages 55 to 79 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

#### **Respective responsibilities of directors and auditors**

The directors are responsible for the preparation of accounts which give a true and fair view. In preparing accounts which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion to you.

#### **Basis of opinion**

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the accounts are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts. We believe that our audit provides a reasonable basis for our opinion.

#### **Opinion**

In our opinion the accounts give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2002 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

#### **PricewaterhouseCoopers**

*Certified Public Accountants*

Hong Kong, 14 March 2003



## Consolidated Profit and Loss Account

For the year ended 31 December 2002

	<i>Note</i>	<b>2002</b> <b>HK\$'000</b>	2001 HK\$'000
Turnover	2	<b>1,393,542</b>	1,305,124
Cost of sales		<b>(1,044,124)</b>	(981,395)
Gross profit		<b>349,418</b>	323,729
Other revenues	2	<b>114,575</b>	98,200
Store expenses		<b>(316,550)</b>	(288,602)
Distribution costs		<b>(21,509)</b>	(18,037)
Administrative expenses		<b>(48,237)</b>	(46,878)
Start-up costs for China operations		<b>(8,339)</b>	(3,367)
Profit for the year	3	<b>69,358</b>	65,045
Minority interests		<b>2,759</b>	412
Profit attributable to shareholders	5 & 16	<b>72,117</b>	65,457
Basic earnings per share	6	<b>10.9 cents</b>	10.1 cents
Diluted earnings per share	6	<b>10.7 cents</b>	9.9 cents



## Consolidated Balance Sheet

As at 31 December 2002

	<i>Note</i>	<b>2002</b> <b>HK\$'000</b>	2001 HK\$'000
Intangible assets	9	175	253
Fixed assets	10	77,382	58,979
Current assets			
Inventories		50,556	35,521
Rental deposits		24,833	24,104
Trade receivable	12	15,687	8,121
Other receivables, deposits and prepayments		28,766	30,357
Bank balances and cash		407,489	354,567
		<u>527,331</u>	<u>452,670</u>
Current liabilities			
Amount due to immediate holding company	13	1,014	721
Trade payable	14	214,118	204,000
Other payables and accruals		39,039	37,991
		<u>254,171</u>	<u>242,712</u>
Net current assets		<u>273,160</u>	<u>209,958</u>
Total assets less current liabilities		<u>350,717</u>	<u>269,190</u>
Financed by:			
Share capital	15	66,722	65,560
Reserves	16	283,691	202,045
Shareholders' funds		350,413	267,605
Minority interests		304	1,585
		<u>350,717</u>	<u>269,190</u>
On behalf of the Board			

**Fung Kwok King, Victor**  
*Director*

**Yeung Lap Bun, Richard**  
*Director*



## Balance Sheet

As at 31 December 2002

	<i>Note</i>	<b>2002</b> <b>HK\$'000</b>	2001 HK\$'000
Investment in subsidiaries	<i>11</i>	<b>59,395</b>	20,314
Current assets			
Other receivables, deposits and prepayments		<b>4,903</b>	6,166
Bank balances and cash		<b>347,897</b>	321,371
		<u><b>352,800</b></u>	<u>327,537</u>
Current liabilities			
Other payables and accruals		<u><b>1,116</b></u>	<u>1,034</u>
Net current assets		<u><b>351,684</b></u>	<u>326,503</u>
Total assets less current liabilities		<u><b>411,079</b></u>	<u>346,817</u>
Financed by:			
Share capital	<i>15</i>	<b>66,722</b>	65,560
Reserves	<i>16</i>	<b>134,357</b>	121,757
Shareholders' funds		<u><b>201,079</b></u>	<u>187,317</u>
Loans from a subsidiary	<i>17</i>	<u><b>210,000</b></u>	<u>159,500</u>
		<u><b>411,079</b></u>	<u>346,817</u>

On behalf of the Board

**Fung Kwok King, Victor**

*Director*

**Yeung Lap Bun, Richard**

*Director*



## Consolidated Cash Flow Statement

For the year ended 31 December 2002

	<i>Note</i>	<b>2002</b> <b>HK\$'000</b>	2001 HK\$'000
Net cash inflow from operating activities	<i>19(a)</i>	<b>78,584</b>	99,026
Investing activities			
Purchase of fixed assets		<b>(43,491)</b>	(31,544)
Proceeds from disposal of fixed assets		<b>12</b>	378
Interest received		<b>7,126</b>	9,955
Net cash outflow from investing activities		<b>(36,353)</b>	(21,211)
Net cash inflow before financing		<b>42,231</b>	77,815
Financing activities	<i>19(b)</i>		
Net proceeds from issuance of ordinary shares		<b>10,691</b>	162,706
Repayment of other loans		<b>—</b>	(850)
Net cash inflow from financing activities		<b>10,691</b>	161,856
Increase in cash and cash equivalents		<b>52,922</b>	239,671
Cash and cash equivalents at 1 January		<b>354,567</b>	114,896
Cash and cash equivalents at 31 December		<b>407,489</b>	354,567
Analysis of the balances of cash and cash equivalents			
Bank balances and cash		<b>407,489</b>	354,567

*Note:*

As at 31 December 2002, the Group's cash and bank balances of HK\$32,560,000 (2001: HK\$200,000) were kept in the People's Republic of China ("PRC"). The remittance of funds out of this country is subject to rules and regulations of foreign exchange control promulgated by the PRC government.



## Consolidated Statement of Changes in Equity

For the year ended 31 December 2002

	Share capital	Share premium	Merger reserve	Capital reserve	Accumulated losses	Total shareholders' equity
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January 2001	6,769	—	177,087	13,433	(157,847)	39,442
Issuance of shares	16,390	172,095	—	—	—	188,485
Capitalisation issues	42,401	(42,401)	—	—	—	—
Expenses incurred in connection with the issuance of shares	—	(25,779)	—	—	—	(25,779)
Profit for the year attributable to shareholders	—	—	—	—	65,457	65,457
At 31 December 2001	<u>65,560</u>	<u>103,915</u>	<u>177,087</u>	<u>13,433</u>	<u>(92,390)</u>	<u>267,605</u>
At 1 January 2002	65,560	103,915	177,087	13,433	(92,390)	267,605
Issuance of shares	1,162	9,529	—	—	—	10,691
Profit for the year attributable to shareholders	—	—	—	—	72,117	72,117
At 31 December 2002	<u>66,722</u>	<u>113,444</u>	<u>177,087</u>	<u>13,433</u>	<u>(20,273)</u>	<u>350,413</u>



## Notes to the Accounts

### 1. PRINCIPAL ACCOUNTING POLICIES

#### (a) Basis of preparation

The accounts have been prepared in accordance with accounting principles generally accepted in Hong Kong and comply with accounting standards issued by the Hong Kong Society of Accountants (“HKSA”). They have been prepared under the historical cost convention.

In the current year, the Group adopted the following Statements of Standard Accounting Practice (“SSAP”) issued by the HKSA which are effective for accounting periods commencing on or after 1 January 2002:

SSAP 1 (revised)	:	Presentation of financial statements
SSAP 11 (revised)	:	Foreign currency translation
SSAP 15 (revised)	:	Cash flow statements
SSAP 34 (revised)	:	Employee benefits

The adoption of these new SSAPs has no significant impact on the Group’s accounts.

#### (b) Consolidation

The consolidated accounts include the accounts of the company and its subsidiaries made up to 31st December.

Subsidiaries are those entities in which the company, directly or indirectly, controls more than one half of the voting power; has the power to govern the financial and operating policies; to appoint or remove the majority of the members of the board of directors; or to cast majority of votes at the meetings of the board of directors.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from the effective date of acquisition or up to the effective date of disposal, as appropriate.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

The gain or loss on the disposal of a subsidiary represents the difference between the proceeds of the sale and the Group’s share of its net assets together with any unamortised goodwill or negative goodwill or goodwill/negative goodwill taken to reserves and which was not previously charged or recognised in the consolidated profit and loss account.

Minority interests represent the interests of outside shareholders in the operating results and net assets of subsidiaries.

In the company’s balance sheet the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted for by the company on the basis of dividends received and receivable.



**1. PRINCIPAL ACCOUNTING POLICIES (continued)**

**(c) Revenue recognition**

- (i) Revenue from the sale of goods is recognised on the transfer of risks and rewards of ownership, which generally coincides with the time when goods are delivered to customers and the title has passed.
- (ii) Promotion and support fund are recognised in accordance with the terms of agreements with the vendors.
- (iii) Interest income is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rates applicable.
- (iv) Revenue from provisions of services is recognised when the services are rendered.

**(d) Intangible assets**

Intangible assets representing the franchise licence to operate convenience stores are stated at cost less accumulated amortisation. Amortisation is charged on a straight line basis over the licence period of 20 years.

Where an indication of impairment exists, the carrying amount of any intangible asset is assessed and written down immediately to its recoverable amount.

**(e) Fixed assets**

Fixed assets are stated at cost less accumulated depreciation and accumulated impairment losses.

Properties and leasehold improvements are depreciated over the periods of the leases or their expected useful lives to the Group whichever is shorter. Other fixed assets are depreciated at rates sufficient to write off their costs over their expected useful lives on a straight-line basis. The principal annual rates are as follows:

Equipment, furniture and fixtures	10% to 33 $\frac{1}{3}$ %
Motor vehicles	16 $\frac{2}{3}$ % to 25%

Major costs incurred in restoring fixed assets to their normal working conditions are charged to the profit and loss account.

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that fixed assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such impairment losses are recognised in the profit and loss account.

The gain or loss on disposal of a fixed asset is the difference between the net sales proceed and the carrying amount of the relevant asset, and is recognised in the profit and loss account.

**1. PRINCIPAL ACCOUNTING POLICIES (continued)**

**(f) Operating leases**

Leases where substantially all the rewards and risks of ownership of assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases net of any incentives received from the leasing company are charged to the profit and loss account on a straight-line basis over the lease periods.

**(g) Inventories**

Inventories comprising merchandises are stated at the lower of cost and net realisable value. The cost of inventories is calculated on the weighted average basis including all costs of purchase, costs of conversion, and other costs incurred in bringing the inventories to their present location and condition. Net realisable value is determined on the basis of anticipated sales proceeds less estimated selling expenses.

**(h) Accounts receivable**

Provision is made against accounts receivable to the extent which they are considered to be doubtful. Accounts receivable in the balance sheet is stated net of such provision.

**(i) Translation of foreign currencies**

Transactions in foreign currencies are translated at exchange rates ruling at the transaction dates. Monetary assets and liabilities expressed in foreign currencies at the balance sheet date are translated at rates of exchange ruling at the balance sheet date. Exchange differences arising in these cases are dealt with in the profit and loss account.

The balance sheet of subsidiary expressed in foreign currencies is translated at the rates of exchange ruling at the balance sheet date whilst the profit and loss account is translated at an average rate. Exchange differences are dealt with as a movement in reserves.

**(j) Deferred taxation**

Deferred taxation is accounted for at the current taxation rate in respect of timing differences between profit as computed for taxation purposes and profit as stated in the accounts to the extent that a liability or an asset is expected to be payable or receivable in the foreseeable future.

**(k) Cash and cash equivalents**

Cash and cash equivalents are carried in the balance sheet at cost. For the purpose of the cash flow statement, cash and cash equivalents comprise cash on hand and deposits held at call with banks.



**1. PRINCIPAL ACCOUNTING POLICIES (continued)**

**(l) Provisions**

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

**(m) Employee benefits**

**(i) Employee leave entitlements**

Employee entitlements to annual leave and long-service leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave and long-service leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity or paternity leave are not recognised until the time of leave.

**(ii) Profit sharing and bonus plans**

Provisions for profit sharing and bonus plans due wholly within twelve months after balance sheet date are recognised when the Group has a present legal or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made.

**(iii) Pension obligations**

The Group contributes to a defined contribution retirement scheme which is available to all employees are expensed as incurred and are not reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions. Contributions to the scheme by the Group and employees are calculated as a percentage of employees' salaries. The retirement benefit scheme cost charged to the profit and loss account represents contributions payable by the Group to the fund.

The assets of the scheme are held separately from those of the Group in an independently administered fund.

## 2. TURNOVER AND OTHER REVENUES

The Group is principally engaged in the operation of a chain of convenience stores. Revenues recognised during the year are as follows:

	Group	
	2002	2001
	HK\$'000	HK\$'000
Turnover		
Merchandise sales revenue	1,358,685	1,265,632
Bakery sales revenue	34,759	38,491
E-fulfillment service income	98	1,001
	<u>1,393,542</u>	<u>1,305,124</u>
Other revenues		
Promotion and support fund	92,865	80,315
Interest income	7,126	9,955
Service items income	14,584	7,930
	<u>114,575</u>	<u>98,200</u>
Total revenues	<u><u>1,508,117</u></u>	<u><u>1,403,324</u></u>

No activity analysis and geographical analysis are presented for the years ended 31 December 2002 and 2001 as substantially all the Group's turnover and contribution to results were derived from the operation of a chain of convenience stores in Hong Kong.

## 3. PROFIT FOR THE YEAR

Profit for the year is stated after charging the following:

	Group	
	2002	2001
	HK\$'000	HK\$'000
Amortisation of franchise licence	78	78
Auditors' remuneration		
Charge for the current year	689	556
Over provision in prior year	—	(190)
Cost of the inventories sold	1,031,368	966,050
Depreciation of owned fixed assets	25,763	22,055
Loss on disposal of fixed assets	791	230
Operating leases rental for land and buildings	93,243	86,855
Provision for doubtful debts	441	1,301
Provision for inventories	283	300
	<u><u>283</u></u>	<u><u>300</u></u>

#### 4. TAXATION

No Hong Kong profits tax has been provided for the years ended 31 December 2002 and 2001 as the Group has been able to utilise available tax losses brought forward from previous years to offset the assessable profit for the years.

#### 5. PROFIT ATTRIBUTABLE TO SHAREHOLDERS

The profit attributable to shareholders is dealt with in the accounts of the Company to the extent of HK\$3,071,000 (2001: HK\$5,079,000).

#### 6. EARNINGS PER SHARE

The calculation of the Group's basic and diluted earnings per share is based on the consolidated profit attributable to shareholders of HK\$72,117,000 (2001: HK\$65,457,000).

The basic earnings per share is based on the weighted average of 664,448,164 (2001: 647,966,301) ordinary shares in issue during the year.

The diluted earnings per share is based on the weighted average number of 664,448,164 (2001: 647,966,301) ordinary shares in issue during the year plus the weighted average of 6,501,518 (2001: 11,095,146) ordinary shares deemed to be issued at no consideration if all outstanding options had been exercised.

#### 7. STAFF COSTS

	Group	
	2002 HK\$'000	2001 HK\$'000
Wages and salaries	162,948	150,987
Pension costs	7,436	2,763
	170,384	153,750
	170,384	153,750

*Note:*

The staff costs include directors' emoluments.

## 8. DIRECTORS' AND SENIOR MANAGEMENT'S EMOLUMENTS

### (a) Directors' emoluments

The aggregate amounts of emoluments payable to directors of the Company during the year are as follows:

	2002 HK\$'000	2001 HK\$'000
Fees	270	240
Basic salaries, housing allowances, other allowances and benefits in kind	2,906	2,861
Discretionary bonuses	3,005	2,737
Pensions	24	24
	<u>6,205</u>	<u>5,862</u>

In addition to the directors' emoluments disclosed above, certain directors of the Company had emoluments receivable from the immediate holding company, which totals HK\$4,838,000 (2001: HK\$3,377,000), part of which is in respect of their services to the Company and its subsidiaries. No apportionment has been made as the directors consider that it is impracticable to apportion this amount between their services to the Group and their services to the Company's immediate holding company.

Directors' fees disclosed above include HK\$90,000 (2001: HK\$60,000) payable to independent non-executive directors.

During the year, 1,800,000 (2001: Nil) options were granted to the directors under the Share Option Scheme approved by a written resolution of the shareholders on 6 January 2001. The market value per share at the date before the options were granted is HK\$2.625 (2001: Nil). Refer to note 15 to the accounts, for details of options granted during the year.

The emoluments of the directors fell within the following bands:

	Number of directors	
	2002	2001
HK\$ Nil-HK\$1,000,000	8	7
HK\$4,500,001-HK\$5,500,000	1	1
	<u>9</u>	<u>8</u>

The individual emoluments of the executive directors for the year ended 31 December 2002 were approximately HK\$5,303,000 (2001: HK\$4,990,000) and HK\$692,000 (2001: HK\$692,000) respectively.

No director waived or agreed to waive any of their emoluments in respect of the years ended 31 December 2002 and 2001.

**8. DIRECTORS' AND SENIOR MANAGEMENT'S EMOLUMENTS** (continued)**(b) Five highest paid individuals**

The five individuals whose emoluments were the highest in the Group for the year include one (2001: one) director whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining four (2001: four) individuals during the year are as follows:

	<b>2002</b>	2001
	<b>HK\$'000</b>	HK\$'000
Basic salaries, housing allowances, other allowances and benefits in kind	<b>4,228</b>	4,196
Bonuses	<b>896</b>	793
Pensions	<b>48</b>	48
	<u><b>5,172</b></u>	<u>5,037</u>

The emoluments of the employees fell within the following bands:

	<b>Number of individuals</b>	
	<b>2002</b>	2001
HK\$ Nil-HK\$1,000,000	—	1
HK\$1,000,001-HK\$1,500,000	<b>4</b>	3
	<u><b>4</b></u>	<u>4</u>

- (c) During the year, no emoluments have been paid by the Group to directors or the five highest paid individuals as an inducement to join the Group, or as a compensation for loss of office.

**9. INTANGIBLE ASSETS**

	<b>Group</b>	
	<b>2002</b>	2001
	<b>HK\$'000</b>	HK\$'000
Franchise licence, at cost	<b>1,559</b>	1,559
Less: accumulated amortisation	<b>(1,384)</b>	(1,306)
	<u><b>175</b></u>	<u>253</u>

Franchise licence represents the exclusive territorial rights owned by the Group to operate convenience stores utilising the tradename, trademarks and Circle K System of The Circle K Stores Inc. of the United States of America.

## 10. FIXED ASSETS

	Group				
	Property improvements <i>HK\$'000</i>	Leasehold improvements <i>HK\$'000</i>	Equipment, furniture and fixtures <i>HK\$'000</i>	Motor vehicles <i>HK\$'000</i>	Total <i>HK\$'000</i>
Costs					
At 1 January 2002	—	56,035	147,700	3,204	206,939
Additions	1,478	16,770	25,794	927	44,969
Disposals	—	(12,637)	(16,647)	(164)	(29,448)
At 31 December 2002	<u>1,478</u>	<u>60,168</u>	<u>156,847</u>	<u>3,967</u>	<u>222,460</u>
Accumulated depreciation					
At 1 January 2002	—	46,520	99,021	2,419	147,960
Charge for the year	5	7,532	17,955	271	25,763
Disposals	—	(12,637)	(15,845)	(163)	(28,645)
At 31 December 2002	<u>5</u>	<u>41,415</u>	<u>101,131</u>	<u>2,527</u>	<u>145,078</u>
Net book value					
At 31 December 2002	<u>1,473</u>	<u>18,753</u>	<u>55,716</u>	<u>1,440</u>	<u>77,382</u>
At 31 December 2001	<u>—</u>	<u>9,515</u>	<u>48,679</u>	<u>785</u>	<u>58,979</u>

The Group's interest in a property at its net book value is analysed as follows:

	Group	
	2002 HK\$'000	2001 HK\$'000
Outside Hong Kong, held on:		
Lease of 10 to 50 years	<u>1,473</u>	<u>—</u>

## 11. INVESTMENT IN SUBSIDIARIES

	Company	
	2002 HK\$'000	2001 HK\$'000
Investment at cost:		
Unlisted shares	6,769	6,769
Loans to subsidiaries	49,550	12,792
Amounts due from subsidiaries	8,911	788
Amount due to a subsidiary	(5,835)	(35)
	<u>59,395</u>	<u>20,314</u>

The loans to and amounts due from/to subsidiaries are unsecured, interest free and have no fixed terms of repayment.

The following is a list of the subsidiaries of the Company as at 31 December 2002:

Name	Place of incorporation and kind of legal entity	Principal activities and place of operation	Particulars of issued share capital	Interest held
<i>Directly held:</i>				
Convenience Retail Asia (BVI) Limited	British Virgin Islands, limited liability company	Investment holding in Hong Kong	10,000 ordinary shares of US\$1 each	100%
<i>Indirectly held:</i>				
Circle K Convenience Stores (HK) Limited	Hong Kong, limited liability company	Convenience stores operator and lease-holder in Hong Kong	183,756 ordinary shares of HK\$1,000 each	100%
Circle K Convenience Stores Limited	Hong Kong, limited liability company	Inactive	10,000 ordinary shares of HK\$10 each	100%
Circle K Convenience Stores PRC (BVI) Limited	British Virgin Islands, limited liability company	Inactive	1 ordinary share of US\$1 each	100%
Circle K Convenience Stores PRC Limited	Hong Kong, limited liability company	Investment holding in Hong Kong	2 ordinary shares of HK\$1 each	100%
Circle K PRC Properties Limited	Hong Kong, limited liability company	Inactive	2 ordinary shares of HK\$1 each	100%

**11. INVESTMENT IN SUBSIDIARIES (continued)**

Name	Place of incorporation and kind of legal entity	Principal activities and place of operation	Particulars of issued share capital	Interest held
Convenience Retail Southern China Limited 利亞華南便利店有限公司*	PRC, limited liability company	Convenience stores operator and lease-holder in PRC	Registered capital RMB60,000,000#	65%
Ming Yu Superstore Limited †	Hong Kong, limited liability company	Convenience stores operator and lease-holder in Hong Kong	10,000 ordinary shares of HK\$100 each	100%
Web-Logistic (HK) Limited	Hong Kong, limited liability company	Logistic service provider in Hong Kong	15,600,000 ordinary shares of HK\$1 each	82%

# At 31 December 2002, the paid-up capital amounted to RMB40,548,000.

\* The legal name of the Company is in Chinese.

† Name changed to Circle K Convenience Stores (Greater China) Limited on 3 January 2003.

**12. TRADE RECEIVABLE**

Majority of the Group's turnover are cash sales. The Group's credit terms on trade receivable from other revenues mainly range from 30 days to 60 days. At 31 December 2002, the ageing analysis of trade receivable was as follows:

	Group	
	2002 HK\$'000	2001 HK\$'000
0-30 days	12,428	6,189
31-60 days	2,591	997
61-90 days	514	383
Over 90 days	154	552
	<b>15,687</b>	<b>8,121</b>

**13. AMOUNT DUE TO IMMEDIATE HOLDING COMPANY**

The amount due to immediate holding company is unsecured, interest free and has no fixed terms of repayment.



**14. TRADE PAYABLE**

At 31 December 2002, the ageing analysis of the trade payable was as follows:

	<b>Group</b>	
	<b>2002</b>	2001
	<b>HK\$'000</b>	HK\$'000
0-30 days	<b>104,313</b>	106,871
31-60 days	<b>65,435</b>	57,594
61-90 days	<b>30,709</b>	28,049
Over 90 days	<b>13,661</b>	11,486
	<b>214,118</b>	204,000

**15. SHARE CAPITAL**

	2002		2001	
	Ordinary shares of HK\$0.1 each		Ordinary shares of HK\$0.1 each	
	No. of shares	HK\$'000	No. of shares	HK\$'000
Authorised:				
At 31 December	<b>2,000,000,000</b>	<b>200,000</b>	2,000,000,000	200,000
Issued and fully paid:				
At 1 January	<b>655,600,000</b>	<b>65,560</b>	67,690,000	6,769
Issuance of shares	<b>11,620,000</b>	<b>1,162</b>	163,900,000	16,390
	<i>(Note a)</i>		<i>(Note b)</i>	
Capitalisation issues	—	—	424,010,000	42,401
			<i>(Note c)</i>	
At 31 December	<b>667,220,000</b>	<b>66,722</b>	655,600,000	65,560

Notes:

- (a) During the year, 11,620,000 ordinary shares were allotted and issued pursuant to the exercise of share options by the employees of the Company in accordance with terms of the Pre-IPO Share Option Plan.
- (b) On 18 January 2001, 163,900,000 ordinary shares of HK\$0.10 each were issued to the public at a premium of HK\$1.05 per share for cash totalling HK\$188,485,000 (the "New Issue"). The excess of the issue price over the par value of the shares issued was credited to the share premium account of the Company.
- (c) Immediately after the New Issue, 424,010,000 shares of HK\$0.10 each were issued, allotted at par and fully paid to LFR and the Designated Directors by way of the capitalisation of a sum of HK\$42,401,000 out of the credit of the share premium account of the Company created as a result of the New Issue.

## 15. SHARE CAPITAL (continued)

## Share options

## (i) Pre-IPO Share Option Plan

On 27 December 2000, a Pre-IPO Share Option Plan (the "Pre-IPO Share Option Plan") was approved by a written resolution of the shareholders of the Company under which the board of Directors may, at its discretion, grant options to full time or part time employees of the Group entitling them to subscribe for shares representing up to maximum 19,930,000 shares of HK\$0.10 each (the "Shares"). On 30 December 2000, options to subscribe 19,930,000 Shares were granted to 228 employees.

Details of the share options outstanding as at 31 December 2002 which have been granted under the Pre-IPO Share Option Plan are as follows:

Grant date	Options held at 1 January 2002	Options exercised during the year	Options lapsed during the year	Options held at 31 December 2002	Exercise price HK\$	Exercisable from	Exercisable until
30 December 2000	15,490,000	(11,620,000)	(80,000)	3,790,000	0.92	10 January 2002	9 January 2006
30 December 2000	3,810,000	—	(200,000)	3,610,000	0.92	10 January 2003	9 January 2006

Subsequent to the year end, options in respect of a total of 670,000 Shares were exercised in accordance with the terms of the Pre-IPO Share Option Plan.

## 15. SHARE CAPITAL (continued)

### (ii) Share Option Scheme

Pursuant to the Share Option Scheme (the “Scheme”) adopted by the Company on 6 January 2001, and as amended on 24 April 2002, the board of Directors may, at its discretion, grant options to any qualifying participants (including but not limited to any employee, whether full time or part time employees including any executive or non-executive Directors, of the Company or any affiliate as defined in the Scheme) entitling to subscribe for Shares representing up to a maximum of 10% of the Shares in issue as at 6 January 2001 being 65,560,000.

Details of the share options granted and outstanding as at 31 December 2002 are as follows:

Grant date	Options	Options	Options	Options	Exercise price HK\$	Exercisable from	Exercisable until
	held at 1 January 2002	granted during the year	lapsed during the year	held at 31 December 2002			
21 September 2001	242,000	—	—	242,000	2.42	21 September 2002	20 September 2006
21 September 2001	472,000	—	—	472,000	2.42	21 September 2003	20 September 2006
24 May 2002	—	4,236,000	—	4,236,000	2.785	24 May 2003	23 May 2007
24 May 2002	—	660,000	(40,000)	620,000	2.785	24 May 2004	23 May 2007
23 September 2002	—	94,000	—	94,000	2.15	23 September 2003	22 September 2007
23 September 2002	—	66,000	—	66,000	2.15	23 September 2004	22 September 2007

Subsequent to the year end, no options were exercised and granted in accordance with the terms of the Scheme.

## 16. RESERVES

## (a) Group

	Share premium <i>HK\$'000</i>	Merger reserve <i>HK\$'000</i>	Capital reserve <i>HK\$'000</i>	Accumulated losses <i>HK\$'000</i>	Total <i>HK\$'000</i>
At 1 January 2001	—	177,087	13,433	(157,847)	32,673
Premium arising from issuance of shares	172,095	—	—	—	172,095
Capitalisation issues	(42,401)	—	—	—	(42,401)
Expenses incurred in connection with the issuance of shares	(25,779)	—	—	—	(25,779)
Profit for the year attributable to shareholders	—	—	—	65,457	65,457
At 31 December 2001	<u>103,915</u>	<u>177,087</u>	<u>13,433</u>	<u>(92,390)</u>	<u>202,045</u>
At 1 January 2002	103,915	177,087	13,433	(92,390)	202,045
Premium arising from issuance of shares	9,529	—	—	—	9,529
Profit for the year attributable to shareholders	—	—	—	72,117	72,117
At 31 December 2002	<u>113,444</u>	<u>177,087</u>	<u>13,433</u>	<u>(20,273)</u>	<u>283,691</u>

**16. RESERVES** (continued)(b) **Company**

	<b>Share premium</b> <i>HK\$'000</i>	<b>Capital reserve</b> <i>HK\$'000</i>	<b>Retained earnings/ (accumulated losses)</b> <i>HK\$'000</i>	<b>Total</b> <i>HK\$'000</i>
At 1 January 2001	—	12,792	(29)	12,763
Premium arising from issuance of shares	172,095	—	—	172,095
Capitalisation issues	(42,401)	—	—	(42,401)
Expenses incurred in connection with the issuance of shares	(25,779)	—	—	(25,779)
Profit for the year attributable to shareholders	—	—	5,079	5,079
At 31 December 2001	<u>103,915</u>	<u>12,792</u>	<u>5,050</u>	<u>121,757</u>
At 1 January 2002	103,915	12,792	5,050	121,757
Premium arising from issuance of shares	9,529	—	—	9,529
Profit for the year attributable to shareholders	—	—	3,071	3,071
At 31 December 2002	<u>113,444</u>	<u>12,792</u>	<u>8,121</u>	<u>134,357</u>

**17. LOANS FROM A SUBSIDIARY**

The loans from a subsidiary are unsecured, interest free and have no fixed terms of repayment.

**18. DEFERRED TAXATION**

The potential deferred taxation liabilities/(assets) which have not been provided for/(recognised) in the accounts are as follows:

	Group	
	2002 HK\$'000	2001 HK\$'000
Accelerated depreciation allowances	7,255	5,805
Tax losses	(5,423)	(15,398)
	<b>1,832</b>	<b>(9,593)</b>
	<b>1,832</b>	<b>(9,593)</b>

**19. NOTE TO THE CASH FLOW STATEMENT****(a) Reconciliation of profit for the year to net cash inflow from operating activities**

	2002 HK\$'000	2001 HK\$'000
Profit for the year	69,358	65,045
Interest income	(7,126)	(9,955)
Depreciation of owned fixed assets	25,763	22,055
Loss on disposal of fixed assets	791	230
Amortisation of franchise licence	78	78
	<b>88,864</b>	77,453
Operating profit before working capital changes	<b>88,864</b>	77,453
(Increase)/decrease in inventories	(15,035)	33
Increase in trade receivable, rental deposits, other receivables, deposits and prepayments	(6,704)	(1,892)
Increase/(decrease) in amount due to immediate holding company	293	(546)
Increase in trade payable, other payables and accruals	11,166	23,978
	<b>11,166</b>	23,978
Net cash inflow from operating activities	<b>78,584</b>	99,026

## 19. NOTE TO THE CASH FLOW STATEMENT (continued)

## (b) Analysis of changes in financing during the year

	Share capital including premium		Minority interest		Other loans	
	2002	2001	2002	2001	2002	2001
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Balance at 1 January	169,475	6,769	1,585	1,997	—	850
Net proceeds from issuance of ordinary shares	10,691	162,706	—	—	—	—
Repayment of other loans	—	—	—	—	—	(850)
Non-cash movements						
Capital contribution from a minority shareholder (note)	—	—	1,478	—	—	—
Minority interest's share of loss for the year	—	—	(2,759)	(412)	—	—
Balance at 31 December	<u>180,166</u>	<u>169,475</u>	<u>304</u>	<u>1,585</u>	<u>—</u>	<u>—</u>

*Note:*

Capital contribution from a minority shareholder represents injection of a property into a subsidiary in PRC in accordance with the Co-operative Agreement dated 20 December 2001.



Notes to the Accounts (continued)

**20. COMMITMENTS**

**(a) Capital commitments**

	<b>Group</b>	
	<b>2002</b>	2001
	<b>HK\$'000</b>	HK\$'000
Contracted but not provided for		
- in respect of acquisition of fixed assets	<b>4,346</b>	3,925
- in respect of investment in a subsidiary in PRC	<b>—</b>	33,000
	<b>4,346</b>	36,925
Authorised but not contracted for		
- in respect of acquisition of fixed assets	<b>4,951</b>	3,033
	<b>9,297</b>	39,958

**(b) Commitments under operating leases**

At 31 December 2002, the Group had future aggregate minimum lease payments under non-cancellable operating leases in respect of land and buildings as follows:

	<b>Group</b>	
	<b>2002</b>	2001
	<b>HK\$'000</b>	HK\$'000
Not later than one year	<b>82,464</b>	77,928
Later than one year and not later than five years	<b>73,378</b>	56,309
	<b>155,842</b>	134,237

**21. CONTINGENT LIABILITIES**

	<b>Company</b>	
	<b>2002</b>	2001
	<b>HK\$'000</b>	HK\$'000
Guarantees for bank loans and overdrafts of subsidiaries	<b>50,888</b>	50,888



## 22. RELATED PARTY TRANSACTIONS

The following is a summary of significant related party transactions carried out in the normal course of the Group's business during the year:

	Note	Group	
		2002 HK\$'000	2001 HK\$'000
Net purchases from related companies	<i>a</i>	<b>8,468</b>	8,784
Management fee and reimbursement of office and administrative expenses to LFR	<i>b</i>	<b>9,396</b>	8,444
Rental payable to group companies	<i>c</i>	<b>2,969</b>	3,045

Notes:

- Purchases from an associated company of an intermediate holding company and a fellow subsidiary were carried out on normal commercial terms in ordinary course of business and on terms mutually agreed between the Group and the related companies.
- Management fee and reimbursements payable to the immediate holding company in respect of office and administrative expenses incurred are charged on an actual cost recovery basis.
- Rentals are payable to the immediate holding company and fellow subsidiaries in accordance with the terms of agreements.

In the opinion of the Directors, the above transactions were carried out on normal commercial terms in the ordinary course of business. They are expected to continue on an on-going basis, and will be conducted based on the terms of the relevant agreements governing these transactions.

## 23. ULTIMATE HOLDING COMPANY

The directors regard King Lun Holdings Limited, a company incorporated in the British Virgin Islands, as being the ultimate holding company.

## 24. APPROVAL OF ACCOUNTS

The accounts were approved by the board of Directors on 14 March 2003.



## Five Year Financial Summary

The following table summarises the results, assets and liabilities of the Group for the five years ended 31 December 2002.

	<b>2002</b>	2001	2000	1999	1998
	<b>HK\$'000</b>	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Turnover	<b><u>1,393,542</u></b>	<u>1,305,124</u>	<u>1,140,671</u>	<u>972,921</u>	<u>980,209</u>
Profit/(loss) attributable to shareholders	<b><u>72,117</u></b>	<u>65,457</u>	<u>48,119</u>	<u>6,603</u>	<u>(22,982)</u>
Total assets	<b>604,888</b>	511,902	261,569	139,843	117,588
Total liabilities	<b>(254,171)</b>	(242,712)	(220,130)	(339,312)	(323,660)
Minority interests	<b>(304)</b>	(1,585)	(1,997)	—	—
Surplus/(deficit) on shareholders' funds	<b><u>350,413</u></b>	<u>267,605</u>	<u>39,442</u>	<u>(199,469)</u>	<u>(206,072)</u>

*Note:* The results, total assets and total liabilities of the Group for each of the three years ended 31 December 2000 have been prepared on a combined basis as if the Company had been the holding company of the Group throughout the years.