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CORPORATE INFORMATION

BOARD OF DIRECTORS

Executive Directors

Wang Xuan (Chairman)
Cheung Shuen Lung (President)
Cheung Yuk Fung
Zhang Zhao Dong
Zhao Wei
Xiao Jian Guo
Zhou Ning
Jiang Bi Jin

Non-executive Directors

Wu Shu Qing
Ren Yan Shen

Independent non-executive Directors

Hu Hung Lick, Henry
Li Fat Chung

COMPANY SECRETARY

Chan Yiu Kwong ACCA, AHKSA

REGISTERED OFFICE

Unit 1408, 14th Floor,
Cable TV Tower,
No. 9 Hoi Shing Road,
Tsuen Wan,
New Territories.

PRINCIPAL BANKERS

The China & South Sea Bank, Ltd.
The Hongkong and Shanghai Banking
Corporation Limited

LEGAL ADVISER

Herbert Smith

AUDITORS

Ernst & Young
Certified Public Accountants

SHARE REGISTRAR AND TRANSFER OFFICE

Central Registration Hong Kong Limited
Suite 1712-1716,
17th Floor,
Hopewell Centre,
183 Queen's Road East,
Hong Kong.

CORPORATE STRUCTURE

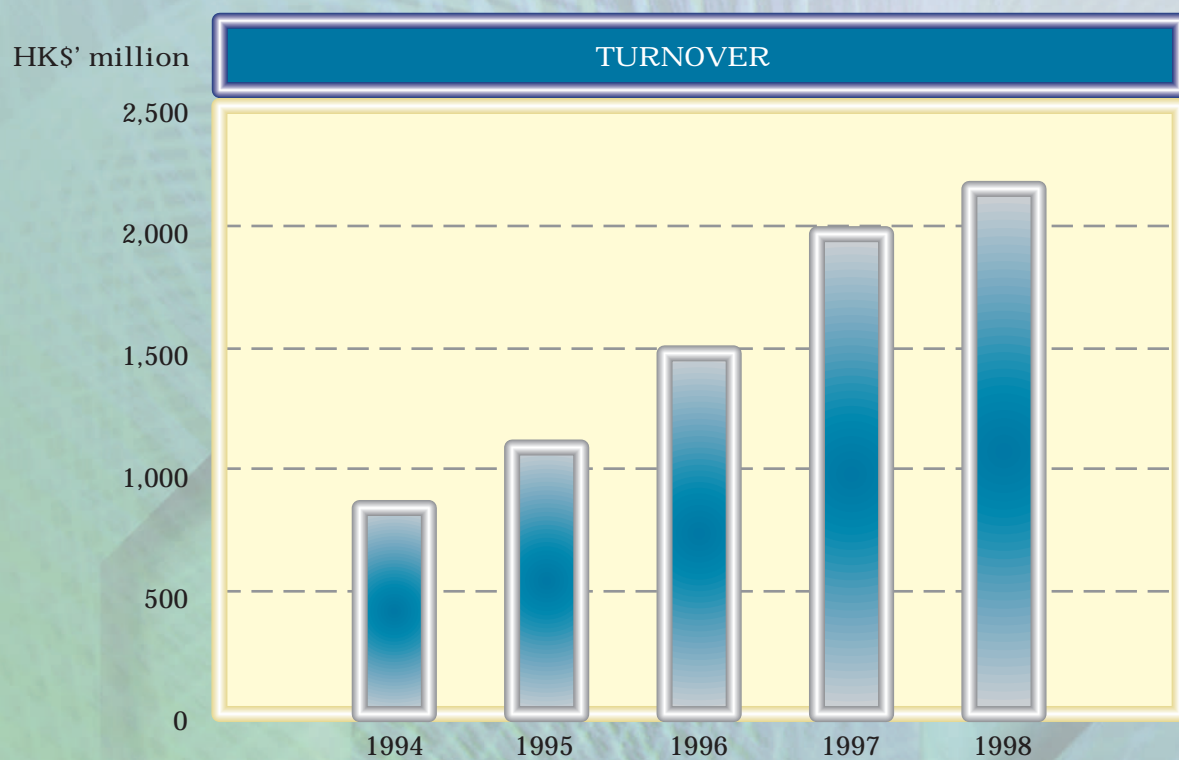
(Major Companies of the Group)



FINANCIAL HIGHLIGHTS

FINANCIAL AND OPERATIONAL SUMMARIES

| Year | 1998 | 1997 | 1996 | 1995 |
|---|-------|-------|-------|-------|
| Turnover (HK\$' million) | 2,160 | 1,973 | 1,483 | 1,096 |
| Total assets (HK\$' million) | 1,163 | 1,363 | 1,242 | 1,030 |
| Total liabilities (HK\$' million) | 491 | 552 | 528 | 535 |
| Net Assets (HK\$' million) | 672 | 811 | 714 | 495 |
| Net assets per share book value (HK\$) | 0.84 | 1.23 | 1.30 | 0.99 |
| Working capital ratio | 2.02 | 2.16 | 2.08 | 1.68 |
| Long term debt to equity ratio | 0.011 | 0.014 | 0.013 | 0.022 |
| Total number of staff (As at the end of the year) | 2,900 | 2,800 | 2,000 | 1,255 |



EVENTS OF THE YEAR

- March 1998** **ISO9001 certificate for Founder R&D Center**
The Group has started the application for the quality assurance of its R&D Center (approved in 1999).
- June 1998** **Establish a Network Systems Integration Consulting Joint Venture**
A 50-50 joint venture company, Founder Dicheng Information Technology Co., Ltd., was established for the expansion in the PRC's systems integration market. Founder Dicheng will be focusing on providing network services and systems integration solutions to government offices, enterprises, postal and telecommunication companies, banks and financial institutions etc. The Joint Venture Company will fully utilize Founder's strength in the sales channel in the PRC, and its technical support, along with Compaq/Digital's management experience and service support to aim at becoming the top systems integration provider in the PRC.
- August 1998** **Disposal of hardware manufacturing business**
The Company has disposed its hardware manufacturing plants in the PRC in order to focus more on its software and systems integration businesses which areas are believed to offer greater performance potential and which the Group has created its own market niches. Upon completion of the disposal, the Group will not be required to provide any further financing support to the plants' operation.
- November 1998** **Cooperation agreement with MapInfo**
A cooperation agreement has been signed between the Group and MapInfo Corporation, the American's leading software developer in geographical information systems. Founder becomes the exclusive distributor for the products of MapInfo Corporation in Greater China regions.

CHAIRMAN'S STATEMENT

I herein present the 1998 annual report for Founder (Hong Kong) Limited and its subsidiaries (the "Group").

RESULTS

For the year ended 31 December 1998, the Group recorded turnover of HK\$2.1 billion and a net loss of HK\$165 million.

REVIEW OF OPERATIONS

The operating loss for the year ended 31 December 1998 was HK\$162 million (for the year ended 31 December 1997, operating profit of HK\$142 million) which can be analysed into: the decrease in the gross profit and the increase in the net operating expense/income. The turnover, gross profit recorded for each of the Group's business units are as follows:

| Business unit | 1998 Turnover (HK\$'m) | 1997 Turnover (HK\$'m) | % Changes |
|-------------------------------|------------------------------|------------------------------|-----------|
| Electronic Publishing Systems | 798 | 730 | 9% |
| Systems Integration | 210 | 247 | (15%) |
| Hardware Business | 1,063 | 889 | 19% |
| Others | 89 | 107 | (17%) |
| TOTAL | 2,160 | 1,973 | 9% |

| Business unit | 1998 Gross Profit (HK\$'m) | 1997 Gross Profit (HK\$'m) | % Changes |
|-------------------------------|-------------------------------------|-------------------------------------|-----------|
| Electronic Publishing Systems | 209 | 257 | (19%) |
| Systems Integration | 26 | 65 | (60%) |
| Hardware Business | 24 | 71 | (66%) |
| Others | 4 | 12 | (67%) |
| TOTAL | 263 | 405 | (35%) |

During the period under review, the contribution from the Group's publishing business in China has been flat. Turnover of this segment for the year ended 31 December 1998 was HK\$798 million, increased 9% compared with the same period of last year. Technology

enhancement in this business segment was insignificant during the year and the delay in the delivery of new products to the market has negatively affected the gross profit of the business. The gross profit percentage decreased from 35% to 26%. In addition, as the Group's overseas markets were adversely affected by the Asian economic crisis, overall publishing operations experienced a drop in profit as compared with the year ended 1997. Nevertheless, the publishing business remains the principal source of profit for the Group, contributing 79% of profit out of total gross profit.

For the systems integration operation, as the market competition becomes stiffer, it resulted in reduction in the selling price. Sales of this business segment for the year ended 31 December 1998 were HK\$210 million, declined 15% compared with last year. The gross profit percentage decreased from 26% to 12%. The Group considers that it is necessary to reposition its business development direction and to strengthen its management. Accordingly, the Group has undergone a major restructuring in this business during the year. On 2 June 1998, the Group and the US Compaq/Digital Corporation had established a 50:50 joint venture, Founder Dicheng Information Technology Co., Ltd. which major range of business includes providing network services and systems integration solutions to government offices, enterprises, postal and telecommunication companies, banks and financial institutions etc.

For the hardware business, the Group has restructured its operations. During the year under review, the Group disposed its hardware manufacturing operations in order to concentrate more on software business. The Group's hardware distribution business has been adversely affected by the significant drop in price of one of the principal brands distributed by the Group. In addition, overall price cut in the market for the hardware products also resulted in low gross profit. Turnover for this segment of business rose 19% which is significantly lower than that of the market growth rate. The gross profit percentage decreased from 8% to 2%.

The net operating income/expense increased from HK\$262 million to HK\$425 million, representing a 62% increase. During the year under review, the Group has increased the scale of operation, expanded the size of the branches and increased the number of employees and their corresponding compensation and benefits. Due to the rapid downturn in market condition and the delay in the delivery of new products, the sales growth rate of the Group was far from satisfactory as originally planned. As a result, provision for doubtful debts and write-off of R&D costs were made. The raise in the employee's compensation and benefits and the corresponding increase in other expenses resulted from the increase in the scale of operation and corporate activities further adversely affected the Group's profitability. The depreciation, operating lease rentals, research & development expenses, amortisation & write-off of deferred development costs, interest expenses, revaluation deficit, and provision for doubtful debts, have been disclosed in the notes to financial statements. As the remedial measure, the Group has taken steps to restructure its management and organisation structure with a view to improve its management control and enhance its profitability.

REFORMS & PROSPECTS

In order to resolve the Group's operational difficulties, the Board has undertaken an in-depth review of the business strategy in each operating unit and has established new directions for business development. Since the first quarter of 1999, the Group has initiated a series of management changes including a major restructuring of the Board of Directors of the Company and the management of the R&D Center in order to accelerate the pace in upgrading products as well as launching new products that will satisfy the demand of the market. As Founder R&D Center has already obtained the ISO9001 certification, it is expected that there will be improvements in the areas of software development as well as products quality control. In relation to operational management, the Group will implement a new regional branch management structure to replace its existing local branch management system in the PRC. Such changes will help to reduce costs and enable the management to have a better control over the local branch operations. In overseas, the Group will concentrate on markets that demonstrate high growth potential but are currently unsaturated. These markets include Japan, Taiwan, and Korea. In the coming year, the Group will focus on its core businesses and continue to invest in the publishing operation. In order for the Group to enhance and broaden its profitability, preparation is underway for the Group when the publishing industry has turnaround and has a steady growth. During the period under review, the Group entered into a cooperation agreement with MapInfo Corporation, a well regarded American software company that specialises in developing geographic information software. In 1999, the Group will continue to establish more strategic partnership with international corporations.

It is expected that the above measures will enhance the Group's competitive edge. However, the Board is aware that time is needed before the effects of the above measures will achieve significant economic returns. Nonetheless, the Board is confident that the results of the measures to be undertaken in 1999 will be beneficial to the Group's long term development.

YEAR 2000 COMPLIANCE

The Group's offices in China have adopted the Year 2000 ("Y2K") conformity requirements issued by the People's Republic of China; overseas branches also took the relative references offered in the regions as its definition of Y2K compliance.

The Group is well aware that certain computer programs and hardware, which use only two digits to identify the year, will not be able to distinguish between the year 1900 and year 2000. Such programs might not function effectively in year 2000 for date related processing and information recording. Failure might occur earlier if forward date calculations involved.

Thus, the Group has established a committee led by Vice President to cope with the problems including systems analysis, solutions proposing, and systems replacement. Risk analysis, planning and testing on fixing the problem are in progress. Contingency plans will be prepared and final testing is expected to be completed at the end of June, 1999.

The committee has reviewed its computer applications and hardware to assess its ability in processing transactions accurately with dates extending beyond year 2000. The Group has also tested the data exchange and transactions for Y2K compliance. Such review and testing showed no serious issue on Y2K compliance for the Group's internal computer applications and hardware. The products provided by the Group to its clients are also Y2K compliant. In addition, all newly purchased equipments would be Y2K compliant. It is expected that the Group to be Y2K compliant by the end of June 1999.

For the Y2K compliance project, the Board has authorised a budget of HK\$5 million. The critical items of the Y2K project is now 60% completed and is expected to be completed by the end of June 1999 on schedule. Currently, approximately HK\$1.5 million has been incurred for employing technical engineers and upgrading related products and services for the project. The costs have been accounted for either as capital expenditures or operation expenses according to their nature.

As at 31 December 1998, there was no significant commitments undertaken by the directors in respect of Year 2000 modification costs.

AUDIT COMMITTEE

The Stock Exchange of Hong Kong Limited (the "Stock Exchange") has revised the Code of Best Practice as set out in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules") to require listed companies to establish an audit committee with written terms of reference which deal with its authority and duties. Amongst the committee's principal duties will be to review and supervise the Company's financial reporting process and internal control. The Company has set up an audit committee in March 1999 with written terms of reference in accordance with the requirements of the Stock Exchange. The committee comprises Dr. Hu Hung Lick Henry and Mr. Li Fat Chung, the two independent non-executive directors of the Company.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 1998, the Group had total assets of approximately HK\$1,163 million which were financed by liabilities of approximately HK\$491 million and equity of approximately HK\$672 million.

The total liabilities comprised HK\$8 million mortgage loan, HK\$131 million trust receipt loans, HK\$9 million of working capital loans, and other liabilities of HK\$343 million.

CHAIRMAN'S STATEMENT *(Continued)*

The mortgage loans are instalment loans. The trust receipt loans are generally for terms of 90 to 120 days. The working capital loans are revolving facilities.

As at 31 December 1998, the Group had a working capital ratio of 2.02, a long term debt to equity ratio of 0.011 and total unutilised banking facilities of HK\$241 million. The Directors believe that the Group had good liquidity and healthy capital structure.

EMPLOYEES

The total number of staff as at 31 December 1998 was approximately 2,900, representing an increase of 3.6% when compared to 1997. There are approximately 2,750 employees in the PRC.

In addition to the contributory provident fund and full medical insurance, the Group has adopted a share option scheme for certain employees. Details of options granted are set out in note 20 to the financial statements.

The Group has maintained a good relationship with its staff and has not experienced any labour disputes since its establishment.

Wang Xuan

Chairman

Hong Kong, 15 April 1999

DIRECTORS AND MANAGEMENT PROFILE

DIRECTORS

Executive Directors

Prof Wang Xuan, aged 62, Chairman, is a professor of Peking University and one of the founders of the Group. Prof Wang is a member of the Academia Science, the China Engineering Academy and the Third World Science Academy. He is also a member of the Standing Committee of the Ninth National People's Congress (NPC) and the Vice-chairman of NPC Education, Science, Culture and Public Health Committee. He graduated from the Faculty of Mathematics of Peking University in 1958, and lectured and carried out research work at Peking University thereafter. He is currently the director of the Research Institute of Computer Science and Technology at Peking University ("Research Institute") and the Founder Technical Research Academy ("Research Academy").

Prof Cheung Yuk Fung, aged 53, graduated from the Faculty of Radio Electronics at Peking University and worked as a professor for the Department of Physics thereafter, and is one of the founders of Founder Group. Prof Cheung was honored many awards, including being selected as the young entrepreneur with outstanding contribution to China, and won the first prize of national golden award for enterprise initiators in the 4th National Technology Industrialist Award and others. Prof Cheung is currently the Chairman of the parent company, Peking University Founder Group Corporation and is responsible for international trade, finance, assets management and the strategic planning of the Group. He was appointed as executive director of the Company in April, 1999.

Mr Cheung Shuen Lung, aged 42, is an Executive Director and the President of the Company. He is a research fellow of the Enterprise Research Institute at Peking University and one of the founders of the Company. Mr Cheung has 18 years of experience in the computer industry.

Mr Zhang Zhao Dong, aged 49, senior engineer, is an Executive Director and the Senior Vice President of the Company. He graduated from the Faculty of Geophysics at Peking University in 1977, and lectured and carried out research work at Peking University thereafter. Mr Zhang is currently responsible for the overall management of the Group's operation in the PRC.

Mr Zhao Wei, aged 32, is a senior engineer and an Executive Director of the Company. He graduated from the Faculty of Mechanics at Peking University in 1988 and joined the Group immediately thereafter. Mr Zhao is currently responsible for the Group's PRC operation and management.

Prof Xiao Jian Guo, aged 42, is a professor of Peking University and an Executive Director of the Company. He graduated from the Faculty of Computer Science at the Dalian Ocean Transport Institute in 1982, and obtained a master's degree in Computer Science at Peking University. Prof Xiao joined the Group in 1987 and is currently the deputy director of the Research Academy responsible for the Group's research and development operations.

Prof Zhou Ning, aged 46, is a professor of Peking University and an Executive Director of the Company. He obtained a master's degree from Peking University in 1982. He taught and carried on research work at Peking University from 1982 to 1988. He joined the Group in 1988 and is now responsible for the Group's systems integration and financial computerization in the PRC.

Mr Jiang Bi Jin, aged 35, is an engineer and joined the Group right after he graduated from the Faculty of Mathematics at Peking University in 1987. Mr Jiang is responsible for the sales and service of the Group's electronic publishing systems in the PRC.

Non-executive Directors

Prof Wu Shu Qing, aged 67, is a professor of the Peking University. Prof Wu graduated in Economics from the People's University of China in 1955 and taught and carried on research work there from 1955 to 1989. He has been the Vice Chancellor of the People's University of China and was the Chancellor of Peking University from 1989 to 1996. Prof Wu has also been a member of the Standing Committee of both the Eighth and Ninth National People's Congress as well as a member of the Financial Committee of the National People's Congress.

Prof Ren Yan Shen, aged 53, is a professor of Peking University. Prof Ren graduated from the Faculty of Dynamics at Qinghua University in 1970. From 1970 to 1991, he held management positions in Qinghua University and the Beijing Municipal Government. He has been the Vice Chancellor of Peking University and a member of the National Committee of the Chinese Peoples's Political Consultative Conference since 1991.

Independent non-executive Directors

Dr Hu Hung Lick, Henry, G.B.S. OBE, PhD, JP, aged 79, has been practising as a barrister for over 44 years and is currently the President of Shue Yan College, and a member of the Standing Committee of the Chinese People's Political Consultative Conference and the China International Economic and Trade Arbitration Commission. Dr Hu is also an adviser to the China Research Committee of Juvenile Delinquency.

Mr Li Fat Chung, aged 38, is a Partner of Chan, Li, Law & Co., Certified Public Accountants. He is a fellow member of both the Chartered Association of Certified Accountants in the United Kingdom and the Hong Kong Society of Accountants. Mr Li is also a fellow member of the Taxation Institute of Hong Kong. Mr Li received a Master's degree in Business Administration from the University of Warwick, United Kingdom.

MANAGEMENT (BELOW ORDERING IS REFERRED TO CHINESE VERSION)

Mr Wang Hui Min, aged 33, obtained a master's degree in Computer Science and Technology of Peking University in 1988. Then, Mr Wang joined the Group and is responsible for the management of the research and development for the Group.

Mr Wang Xiao Qing, aged 33, graduated from the Faculty of Law at Peking University in 1988. He joined the Group in 1992 and is now responsible for the legal affairs, investment management of the Group's PRC branches.

Mr See Chiu Yeung, aged 32, graduated from the Faculty of Electrical Engineering at the Morrison Hill Technical Institute in 1989. He has over 12 years experience in computer and electronic publishing. He is currently responsible for the promotion of electronic media market for the Group in South East Asia.

Mr Xu Chang Jun, aged 32, obtained a master's degree in International Economics of Peking University in 1991. Mr Xu joined the Group in 1994 and is now responsible for the finance and capital management for the Group's PRC branches.

Mr Chan Yiu Kwong, aged 34, has been the financial controller and company secretary since June 1996. Before joining the Company, he was a manager of an international public accountants firm. Mr Chan holds a bachelor degree in Social Science from the University of Hong Kong. He is an associate member of both the Hong Kong Society of Accountants and the Association of Chartered Certified Accountants in the United Kingdom.

Mr Zou Wei, aged 36, graduated from the Faculty of Computer Science at Nanjing University in 1985, and obtained his master's degree in computer software engineering of the China Engineering Academy in 1988. He worked in the China Engineering Academy for software development before joining the Group and is now the Vice President of the Group's R&D Center and the President of the Group's Digital Media Institute.

Mr Irwan Yap, aged 46, member of Professional of Engineer of Ontario, is the President of Founder Technology (Canada) Corporation and Founder Systems (USA) Inc. He graduated from Faculty of Electrical Engineering, McMaster University, Ontario, Canada. Prior to joining the Group in 1992, Mr Yap has gained over 19 years of experience in technical as well as management skills from various major Canadian corporations including the largest electrical power generation company in Canada. He is responsible for the promotion of the Group's profile and products to North American market.

Mr Guan Xianghong (Kan Shoukou in Japanese), aged 32, certified senior engineer by the Ministry of International Trade and Industry of Japan, is the President of Founder Inc. He graduated from the Electrical Engineering Department of Peking University and has 10 years of experience in the factory automation and electronic publishing industry in Japan.

Mr Teh Hon Seng, aged 35, General Manager of PUC Founder (M) Sdn. Bhd., Mr Teh graduated with an honour degree in Applied Science from the University of Science, Malaysia in 1988. He has 10 years of experience in the computer and electronic publishing industry.

NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN that the Annual General Meeting of the Company will be held at Unit 1408, 14th Floor, Cable TV Tower, No. 9 Hoi Shing Road, Tsuen Wan, New Territories, Hong Kong on Wednesday, 30 June 1999 at 10:00 a.m. for the following purposes:

1. To receive and consider the audited financial statements for the year ended 31 December 1998 and the reports of the Directors and Auditors thereon.
2. To re-elect retiring Directors and fix their remuneration.
3. To re-appoint Auditors and authorise the Board of Directors to fix their remuneration.
4. As special businesses, to consider and, if thought fit, pass the following resolutions, as Ordinary Resolutions:

(A) **“THAT**

- (a) subject to paragraph (b) of this resolution, the exercise by the Directors of the Company during the relevant period (as defined herein) of all the powers of the Company to purchase shares of HK\$0.10 each in the capital of the Company (“Shares”), subject to and in accordance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and all applicable laws, be and is hereby generally and unconditionally approved;
- (b) the aggregate nominal amount of Shares which may be purchased by the Company pursuant to paragraph (a) of this resolution shall be no more than 10% of the aggregate nominal amount of the issued share capital of the Company at the date of this resolution; and
- (c) for the purpose of this resolution, “relevant period” means the period from the passing of this resolution until whichever is the earlier of:
 - (i) the conclusion of the next annual general meeting of the Company;
 - (ii) the expiration of the period within which the next annual general meeting of the Company is required by law or the Company’s Articles of Association to be held; and
 - (iii) the revocation or variation of this resolution by an ordinary resolution in general meeting of the Company.”

(B) “THAT

- (a) subject to paragraph (c) of this resolution, the exercise by the Directors of the Company during the relevant period (as defined herein) of all the powers of the Company to allot, issue and deal with additional shares in the capital of the Company and to make or grant offers, agreements and options (including warrants, bonds and debentures convertible into Shares of the Company) which would or might require the exercise of such power be and is hereby generally and unconditionally approved;
- (b) the approval in paragraph (a) of this resolution shall authorise the Directors of the Company during the relevant period to make or grant offers, agreements and options (including warrants, bonds and debentures convertible into Shares of the Company) which would or might require the exercise of such power after the end of the relevant period;
- (c) the aggregate nominal amount of share capital allotted or agreed conditionally or unconditionally to be allotted (whether pursuant to an option or otherwise) by the Directors of the Company pursuant to the approval in paragraph (a) of this resolution, otherwise than pursuant to (i) the exercise of the conversion rights attaching to any convertible securities issued by the Company; (ii) the exercise of warrants to subscribe for shares of the Company or the exercise of options granted under any share option scheme adopted by the Company; (iii) an issue of shares of the Company in lieu of the whole or part of a dividend on shares of the Company or a bonus issue of shares of the Company in accordance with the Company’s Articles of Association; or (iv) any offer of any class of securities of the Company made pro rata (apart from fractional entitlements) by the Company to holders of such class of securities (excluding for that purpose any holder who is resident in a place where such offer is not permitted under the laws of that place), shall not exceed 20% of the aggregate nominal amount of the share capital of the Company in issue as at the date of the passing of this resolution and the said approval shall be limited accordingly; and
- (d) for the purpose of this resolution, “relevant period” means the period from the passing of this resolution until whichever is the earlier of:
 - (i) the conclusion of the next annual general meeting of the Company;
 - (ii) the expiration of the period within which the next annual general meeting of the Company is required by law or the Company’s Articles of Association to be held; and
 - (iii) the revocation or variation of this resolution by an ordinary resolution in general meeting of the Company.”

NOTICE OF ANNUAL GENERAL MEETING *(Continued)*

- (C) “**THAT** the general mandate granted to the Directors of the Company to exercise the powers of the Company to allot, issue and deal with shares of the Company pursuant to Ordinary Resolution 4(B) set out in the notice of annual general meeting of the Company of which this resolution forms part (the “Notice”) be and is hereby extended by the addition thereto of an amount representing the aggregate nominal amount of the share capital of the Company repurchased by the Company under the authority granted pursuant to Ordinary Resolution 4(A) set out in the Notice, provided that such amount shall not exceed 10% of the aggregate nominal amount of the share capital of the Company in issue as at the date of this resolution.”

By Order of the Board
Chan Yiu Kwong
Company Secretary

Hong Kong, 25 May 1999

Notes:

1. A member entitled to attend and vote at the Meeting is entitled to appoint one or more proxies to attend and, on a poll, vote instead of him. A proxy need not be a member of the Company. Completion and returning of an instrument appointing a proxy will not preclude a member from attending and voting in person at the Meeting.
2. In order to be valid, the proxy form and any power of attorney (if any) or other authority (if any) under which it is signed, or a copy of such authority certified notarially or in some other way approved by the Board, must be deposited with the Company's Registered Office, Unit 1408, 14th Floor, Cable TV Tower, No. 9 Hoi Shing Road, Tsuen Wan, New Territories, Hong Kong not less than 48 hours before the time of the holding of the Meeting (or any adjourned meeting).
3. An explanatory statement containing the information necessary to enable the shareholders to make an informed decision on whether to vote for or against the Ordinary Resolution 4(A) above to approve the general mandate for the repurchase by the Company of its own Shares, as required by the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, will be sent to shareholders of the Company together with the 1998 Annual Report.

REPORT OF THE DIRECTORS

Board of Directors and Company Secretary of Founder (Hong Kong) Limited



Prof. Wang Xuan

Chairman

Prof. Cheung Yuk Fung

Executive Director



Mr. Cheung Shuen Lung

Executive Director
and President

Prof. Wu Shu Qing

Non-executive Director



Prof. Ren Yan Shen

Non-executive Director

Dr. Hu Hung Lick, Henry

Independent
Non-executive Director



Mr. Li Fat Chung

Independent
Non-executive Director

Mr. Chan Yiu Kwong

Company Secretary



REPORT OF THE DIRECTORS *(Continued)*

The directors herein present their report and the audited financial statements of the Company and the Group for the year ended 31 December 1998.

PRINCIPAL ACTIVITIES

The principal activities of the Company are investment holding, systems integration and the trading of computer products. The principal activities of the subsidiaries and jointly controlled entities are detailed in notes 14 and 15, respectively, to the financial statements. There were no changes in the nature of the Group's principal activities during the year.

SEGMENTED INFORMATION

An analysis of Group turnover and contribution to operating loss by principal activity and geographical area of operations for the year ended 31 December 1998 is as follows:

| | Turnover HK\$'000 | Contribution HK\$'000 |
|--|------------------------------|----------------------------------|
| <hr/> | | |
| By principal activity: | | |
| Software development and systems integration | 1,096,929 | 239,757 |
| Sales of computers and related products | 1,062,745 | 23,706 |
| | <hr/> | |
| | <u>2,159,674</u> | 263,463 |
| General, administrative and financial expenses | | 425,848 |
| | | <hr/> |
| | | (162,385) |
| <hr/> | | |
| By geographical area: | | |
| The People's Republic of China (the "PRC"): | | |
| Hong Kong | 207,580 | 23,253 |
| Elsewhere | 1,918,081 | 217,359 |
| Others | 34,013 | 22,851 |
| | <hr/> | |
| | <u>2,159,674</u> | 263,463 |
| General, administrative and financial expenses | | 425,848 |
| | | <hr/> |
| | | (162,385) |
| <hr/> | | |

RESULTS AND DIVIDENDS

The Group's loss for the year ended 31 December 1998 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 27 to 57.

The directors do not recommend the payment of any dividends in respect of the year.

SUMMARY OF FINANCIAL INFORMATION

A summary of the published results of the Group for the last five financial years, and of its assets and liabilities as at 30 June 1995 and 31 December 1995, 1996, 1997 and 1998 is set out below.

RESULTS

| | Year ended 31 December | | | | |
|--|------------------------|-----------|-----------|-----------|----------|
| | 1998 | 1997 | 1996 | 1995 | 1994 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| TURNOVER | 2,159,674 | 1,973,409 | 1,483,351 | 1,096,233 | 847,531 |
| OPERATING PROFIT/(LOSS) | (162,385) | 142,534 | 126,934 | 113,090 | 63,627 |
| Share of losses of jointly controlled entities | (3,265) | — | — | — | — |
| PROFIT/(LOSS) BEFORE TAXATION | (165,650) | 142,534 | 126,934 | 113,090 | 63,627 |
| Taxation | (46) | 757 | (131) | (3,819) | (3,707) |
| NET PROFIT/(LOSS) ATTRIBUTABLE TO SHAREHOLDERS | (165,696) | 143,291 | 126,803 | 109,271 | 59,920 |

ASSETS AND LIABILITIES

| | 31 December 1998 | 31 December 1997 | 31 December 1996 | 31 December 1995 | 30 June 1995 |
|-------------------|------------------|------------------|------------------|------------------|--------------|
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| TOTAL ASSETS | 1,163,392 | 1,362,704 | 1,241,511 | 1,030,461 | 609,967 |
| TOTAL LIABILITIES | 490,736 | 551,953 | 527,889 | 535,545 | 427,256 |
| NET ASSETS | 672,656 | 810,751 | 713,622 | 494,916 | 182,711 |

SUMMARY OF FINANCIAL INFORMATION (Continued)

Notes:

- (1) The combined results for the year ended 31 December 1994 have been extracted from the accountants' report included in the Company's prospectus dated 12 December 1995. The combined results for the year ended 31 December 1995 were prepared based on the Group's combined results for the six months ended 30 June 1995 as extracted from the same accountants' report, and the consolidated results for the six months ended 31 December 1995 as extracted from the Company's 1995 annual report. The combined results were prepared on a pro forma basis to reflect the Group reorganisation as set out in the accountants' report included in the Company's prospectus dated 12 December 1995.
- (2) The combined assets and liabilities of the Group at 30 June 1995 as stated above were prepared on a pro forma basis to reflect the Group reorganisation as set out in the accountants' report included in the Company's prospectus dated 12 December 1995.

ACCOUNTING POLICIES

The significant accounting policies of the Company and the Group are set out in note 1 to the financial statements.

FIXED ASSETS AND INVESTMENT PROPERTIES

Details of movements in the fixed assets and investment properties of the Company and the Group are set out in notes 11 and 12 to the financial statements, respectively.

SUBSIDIARIES

Particulars of the Company's subsidiaries are set out in note 14 to the financial statements.

JOINTLY CONTROLLED ENTITIES

Particulars of the Group's jointly controlled entities are set out in note 15 to the financial statements.

BORROWINGS

Details of the Company's and the Group's borrowings at 31 December 1998 are set out in notes 18 and 19 to the financial statements.

SHARE CAPITAL AND SHARE OPTIONS

Details of movements in the Company's share capital and share options during the year and the reasons for the issues are set out in note 20 to the financial statements.

RESERVES

Details of movements in the reserves of the Company and the Group during the year are set out in note 21 to the financial statements.

DIRECTORS

The directors of the Company during the year were:

Executive directors:

Wang Xuan

Cheung Shuen Lung

Zhang Zhao Dong

Zhao Wei

Xiao Jian Guo

Zhou Ning

Jiang Bi Jin (appointed on 25 May 1998)

Non-executive directors:

Wu Shu Qing

Ren Yan Shen

Hu Hung Lick, Henry*

Li Fat Chung*

** Independent non-executive directors*

Subsequent to the balance sheet date, on 15 April 1999, Zhang Zhao Dong, Zhao Wei, Xiao Jian Guo, Zhou Ning and Jiang Bi Jin resigned as directors of the Company. On the same date, Cheung Yuk Fung was appointed as a director of the Company.

In accordance with the Company's articles of association, Ren Yan Shen and Cheung Yuk Fung will retire and, being eligible, will offer themselves for re-election at the forthcoming annual general meeting.

DIRECTORS' SERVICE CONTRACTS

Each of the executive directors of the Company has entered into a service contract with the Company for an initial term of five years and thereafter, subject to re-election by the shareholders of the Company. The service contract can be terminated by either the director concerned or the Company giving to the other not less than one year's notice.

The service contracts with Zhang Zhao Dong, Zhao Wei, Xiao Jian Guo, Zhou Ning and Jiang Bi Jin were terminated as a consequence of the resignation as directors of the Company on 15 April 1999.

Save as disclosed above, no director proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable by the Company within one year without payment other than statutory compensation.

DIRECTORS' INTERESTS IN CONTRACTS

No director had a beneficial interest in any material contract to which the Company or any of its subsidiaries was a party during the year.

DIRECTORS' RIGHTS TO ACQUIRE SHARES

Pursuant to the Company's share option scheme, as further detailed in note 20 to the financial statements, in prior years the Company granted options in favour of the following directors:

| Name of director | Number of share options at 31 December 1998 |
|-------------------------|--|
| Wang Xuan | 10,800,000 |
| Cheung Shuen Lung | 9,360,000 |
| Zhang Zhao Dong | 9,360,000 |
| Zhao Wei | 9,360,000 |
| Xiao Jian Guo | 9,360,000 |
| Zhou Ning | 9,360,000 |
| | 57,600,000 |

All the above share options are exercisable from 21 December 1998 to 6 December 2005 at an exercise price of HK\$1.397 per ordinary share. The exercise price is adjustable in accordance with the provisions of the share option scheme.

Apart from the foregoing, at no time during the year was the Company or any of its subsidiaries a party to any arrangement to enable the Company's directors, their respective spouse or children under 18 years of age of any such director or chief executive to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other related body corporate.

DIRECTORS' INTERESTS IN SHARES

At 31 December 1998, Mr Cheung Shuen Lung and his wife each had a 50% interest in the share capital of Swan-City International Group Limited which in turn held 25,346,058 shares of the Company. As defined by the Securities (Disclosure of Interests) Ordinance ("SDI Ordinance"), Mr Cheung Shuen Lung had corporate interests in these 25,346,058 shares of the Company.

DIRECTORS' INTERESTS IN SHARES (Continued)

In addition to the above, Mr Cheung Shuen Lung has non-beneficial personal equity interests in certain subsidiaries held for the benefit of the Company solely for the purpose of compliance with the minimum company membership requirements.

Save as disclosed above and as disclosed under the heading "Directors' rights to acquire shares", none of the directors or their associates had any personal, family, corporate or other interests in the securities of the Company or any of its associated corporations as defined in the SDI Ordinance and recorded in the register required to be maintained pursuant to Section 29 thereof.

SUBSTANTIAL SHAREHOLDERS

At 31 December 1998, the following interests of 10% or more of the share capital of the Company were recorded in the register of interests required to be kept by the Company pursuant to Section 16(1) of the SDI Ordinance:

| Name of shareholder | Number of shares held |
|--|------------------------------|
| Peking University | 369,527,609 |
| Peking University Founder Group Corporation ("Peking Founder") | 369,527,609 |

Note: Peking Founder is wholly-owned by Peking University. The interests disclosed under Peking University represent its deemed interests in the shares of the Company by virtue of its interest in Peking Founder.

DISTRIBUTABLE RESERVES

At 31 December 1998, the Company's reserves available for cash distribution calculated in accordance with the provisions of Section 79B of the Companies Ordinance amounted to HK\$26,853,000. The share premium of HK\$506,153,000 may be distributed in the form of fully paid bonus shares.

MAJOR SUPPLIERS AND CUSTOMERS

In the year under review, sales to the five largest customers accounted for less than 30% of total sales for the year.

Purchases from the five largest suppliers accounted for 36% (1997: 36%) of the total purchases for the year and purchases from the largest supplier included therein amounted to 15% (1997: 15%).

As far as the directors are aware, neither the directors, their associates, nor those shareholders which to the knowledge of the directors own more than 5% of the Company's share capital had any interest in the five largest customers and suppliers.

PENSION SCHEME

The Group has established defined contribution pension schemes for certain of its qualified employees. The assets of the schemes are held and managed by independent professional fund managers.

RELATED PARTY TRANSACTIONS

The related party transactions undertaken by the Group during the year are set out in note 10 to the financial statements.

The independent non-executive directors of the Company have reviewed and confirmed to the board of directors their opinion about the related party transactions as disclosed in note 10 to the financial statements were conducted in the ordinary and usual course of the Group's business and are fair and reasonable so far as the shareholders of the Company are concerned.

PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES

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

COMPLIANCE WITH THE CODE OF BEST PRACTICE

In the opinion of the directors, the Company has complied with the Code of Best Practice as set out in Appendix 14 of the Listing Rules of The Stock Exchange of Hong Kong Limited throughout the accounting year covered by the annual report. Independent non-executive directors are not appointed for a specific term but are subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the Company's articles of association.

REPORT OF THE DIRECTORS *(Continued)*

AUDITORS

Ernst & Young retire and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting.

ON BEHALF OF THE BOARD

Wang Xuan
Chairman

Hong Kong 15 April 1999

REPORT OF THE AUDITORS



To the members
Founder (Hong Kong) Limited
(Incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages 27 to 57 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

BASIS OF OPINION

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

We planned 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 financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion, the financial statements give a true and fair view, in all material respects, of the state of affairs of the Company and the Group as at 31 December 1998 and of the loss and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

Ernst & Young
Certified Public Accountants

Hong Kong, 15 April 1999

CONSOLIDATED PROFIT AND LOSS ACCOUNT

For the year ended 31 December 1998

| | Notes | 1998 HK\$'000 | 1997 HK\$'000 |
|---|----------|---------------------|------------------|
| TURNOVER | 2 | 2,159,674 | 1,973,409 |
| OPERATING PROFIT/(LOSS) | 3 | (162,385) | 142,534 |
| Share of losses of jointly controlled entities | | (3,265) | — |
| PROFIT/(LOSS) BEFORE TAXATION | | (165,650) | 142,534 |
| Taxation | 6 | (46) | 757 |
| NET PROFIT/(LOSS) ATTRIBUTABLE TO SHAREHOLDERS | 7 | (165,696) | 143,291 |
| Dividends | 8 | — | 52,911 |
| EARNINGS/(LOSS) PER SHARE | 9 | | |
| Basic | | (20.8 cents) | 18.1 cents |
| Diluted | | N/A | 17.2 cents |

CONSOLIDATED BALANCE SHEET 31 December 1998

| | Notes | 1998 HK\$'000 | 1997 HK\$'000 |
|--|-------|------------------|------------------|
| FIXED ASSETS | 11 | 139,451 | 154,990 |
| INVESTMENT PROPERTIES | 12 | 21,320 | 21,830 |
| DEFERRED DEVELOPMENT COSTS | 13 | 5,487 | 14,922 |
| DEFERRED VAT RECOVERABLE | | — | 3,508 |
| INTERESTS IN JOINTLY CONTROLLED ENTITIES | 15 | 21,849 | — |
| CURRENT ASSETS | 16 | 975,285 | 1,167,454 |
| CURRENT LIABILITIES | 18 | 483,645 | 540,847 |
| NET CURRENT ASSETS | | 491,640 | 626,607 |
| TOTAL ASSETS LESS CURRENT LIABILITIES | | 679,747 | 821,857 |
| LONG TERM BANK LOANS, SECURED | 19 | 7,091 | 11,106 |
| | | 672,656 | 810,751 |
| SHARE CAPITAL | 20 | 79,987 | 66,139 |
| RESERVES | 21 | 592,669 | 744,612 |
| | | 672,656 | 810,751 |

Wang Xuan
Director

Cheung Shuen Lung
Director

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 1998

| | Notes | 1998 HK\$'000 | 1997 HK\$'000 |
|---|-------|------------------|------------------|
| NET CASH INFLOW FROM OPERATING ACTIVITIES | 22(a) | 10,378 | 30,121 |
| RETURNS ON INVESTMENTS AND SERVICING OF FINANCE | | | |
| Interest received | | 3,611 | 4,209 |
| Interest paid | | (12,893) | (7,946) |
| Interest element of finance lease rental payments | | — | (75) |
| Dividends paid | | (20,655) | (42,522) |
| Net cash outflow from returns on investments and servicing of finance | | (29,937) | (46,334) |
| TAXATION | | | |
| Taxes paid in Hong Kong | | — | (1,022) |
| Taxes paid outside Hong Kong | | (1,385) | — |
| | | (1,385) | (1,022) |
| INVESTING ACTIVITIES | | | |
| Purchases of fixed assets | | (44,432) | (51,716) |
| Proceeds from disposal of fixed assets | | 11,915 | 750 |
| Increase in deferred development costs | | (1,229) | (7,987) |
| Investment in jointly controlled entities | | (25,114) | — |
| Proceeds from disposal of branch operations | 22(c) | 19,449 | — |
| Net cash outflow from investing activities | | (39,411) | (58,953) |
| NET CASH OUTFLOW BEFORE FINANCING ACTIVITIES | | (60,355) | (76,188) |
| FINANCING ACTIVITIES | 22(b) | | |
| New bank loans | | 17,552 | 28,587 |
| Repayment of bank loans | | (38,906) | (9,239) |
| Net cash inflow/(outflow) from financing activities | | (21,354) | 19,348 |
| DECREASE IN CASH AND CASH EQUIVALENTS | | (81,709) | (56,840) |
| Cash and cash equivalents at beginning of year | | 358,419 | 415,822 |
| Effect of foreign exchange rate changes, net | | 575 | (563) |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | | 277,285 | 358,419 |
| ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS | | | |
| Cash and bank balances | | 281,863 | 358,563 |
| Bank overdrafts | | (4,578) | (144) |
| | | 277,285 | 358,419 |

BALANCE SHEET
31 December 1998

| | Notes | 1998 HK\$'000 | 1997 HK\$'000 |
|---------------------------------------|-------|------------------|------------------|
| FIXED ASSETS | 11 | 36,546 | 47,059 |
| INVESTMENT PROPERTIES | 12 | 15,500 | 19,631 |
| INTERESTS IN SUBSIDIARIES | 14 | 375,377 | 381,321 |
| CURRENT ASSETS | 16 | 456,550 | 416,531 |
| CURRENT LIABILITIES | 18 | 265,611 | 277,880 |
| NET CURRENT ASSETS | | 190,939 | 138,651 |
| TOTAL ASSETS LESS CURRENT LIABILITIES | | 618,362 | 586,662 |
| LONG TERM BANK LOANS, SECURED | 19 | 5,369 | 5,926 |
| | | 612,993 | 580,736 |
| SHARE CAPITAL | 20 | 79,987 | 66,139 |
| RESERVES | 21 | 533,006 | 514,597 |
| | | 612,993 | 580,736 |

Wang Xuan
Director

Cheung Shuen Lung
Director

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year. The results of subsidiaries established, acquired or disposed of during the year are consolidated from or to their effective dates of establishment, acquisition or disposal, respectively. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Subsidiaries

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

Interests in subsidiaries are stated at cost unless, in the opinion of the directors, there have been permanent diminutions in value, when they are written down to values determined by the directors.

Jointly controlled entities

A jointly controlled entity is an entity formed by the Group and other parties under a contractual arrangement to undertake an economic activity which is subject to joint control and none of the participating parties has unilateral control over the economic activity.

The Group's interests in jointly controlled entities are initially recorded at cost and adjusted thereafter for the post-acquisition change in the Group's share of the net assets of the jointly controlled entities. The Group's share of post-acquisition results and reserves of jointly controlled entities are included in the consolidated profit and loss account and consolidated reserves respectively.

Fixed assets and depreciation

Fixed assets, other than investment properties, are stated at cost or valuation less accumulated depreciation.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fixed assets and depreciation (Continued)

The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after the fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of the fixed asset. The gain or loss on disposal or retirement of a fixed asset recognised in the profit and loss account is the difference between the sales proceeds and the carrying amount of the relevant asset.

Changes in the values of fixed assets are dealt with as movements in the fixed asset revaluation reserve. If the total of this reserve is insufficient to cover a deficit, on an individual asset basis, the excess of the deficit is charged to the profit and loss account. A subsequent revaluation increase is recognised as income to the extent that it reverses a revaluation deficit of the same asset previously charged to the profit and loss account.

Upon the disposal of revalued fixed assets, the relevant portion of the fixed asset revaluation reserve realised in respect of previous valuations is credited directly from the fixed asset revaluation reserve to retained profits.

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

| | |
|-----------------------------------|---|
| Land and buildings | Over the terms of the leases |
| Leasehold improvements | 20% or over the terms of the leases, if shorter |
| Furniture, fixtures and equipment | 10% – 33 $\frac{1}{3}$ % |
| Motor vehicles | 20% – 30% |

Investment properties

Investment properties are interests in land and buildings in respect of which construction work and development have been completed and which are intended to be held on a long term basis for their investment potential. Such properties are not depreciated and are stated at their open market values on the basis of annual professional valuations. Changes in the values of investment properties are dealt with as movements in the investment property revaluation reserve. If the total of this reserve is insufficient to cover a deficit, on a portfolio basis, the excess of the deficit is charged to the profit and loss account.

Upon the disposal of an investment property, the relevant portion of the investment property revaluation reserve realised in respect of previous valuations is released to the profit and loss account.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Leased assets

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

Deferred development costs

Research and development costs are charged to the profit and loss account as incurred, except for product development costs which relate to a clearly defined project, the future economic benefits of which are reasonably assured. Such development costs are deferred and amortised on a straight-line basis over three years commencing from the start of sales of the new products.

The unamortised balance of deferred development costs is reviewed at the end of each period and is written off to the extent that the unamortised balance, taken together with further development and directly related costs, is no longer likely to be recovered.

Cash equivalents

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

Inventories

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

Deferred taxation

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Foreign currencies

Foreign currency transactions are recorded at the applicable rates of exchange ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable rates of exchange ruling at that date. Exchange differences are dealt with in the profit and loss account.

On consolidation, the financial statements of overseas subsidiaries and jointly controlled entities, are translated to Hong Kong dollars at the applicable rates of exchange ruling at the balance sheet date. The resulting translation differences are included in the exchange fluctuation reserve.

Pension costs

The Group operates defined contribution pension schemes for certain of its qualified employees, the assets of which are held separately from those of the Group. Contributions made are based on a percentage of the eligible employees' salaries, which are charged to the profit and loss account as they become payable, in accordance with the rules of the scheme. Forfeited contributions in respect of unvested benefits of those employees who leave the scheme are used to reduce the Group's ongoing contributions.

For those employees that have not joined the pension schemes, the Group has accrued for pension costs for them based on a percentage of their salaries. However, the related assets have not been separated from those of the Group.

Related company

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

Revenue

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

- (a) on the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue (Continued)

- (b) on the rendering of services, when the transactions have been completed in accordance with the terms of contracts or based on the stage of completion of transactions. The stage of completion of a transaction associated with the rendering of services is established by reference to contract terms;
- (c) on disposal of fixed assets, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group has no further substantial acts and/or continuing involvement to complete under the contracts;
- (d) interest, on a time proportion basis, taking into account the principal outstanding and the effective interest rate applicable;
- (e) rental, on an accruals basis; and
- (f) dividends, when the rights to receive the payment are established.

2. TURNOVER AND REVENUE

Turnover represents the invoiced value of goods sold and services rendered, net of business tax, discounts and returns.

The Group's revenue as included in turnover for the year arose from the following activities:

| | 1998 HK\$'000 | 1997 HK\$'000 |
|--|------------------|------------------|
| Software development and systems integration | 1,096,929 | 1,083,819 |
| Sales of computers and related products | 1,062,745 | 889,590 |
| | 2,159,674 | 1,973,409 |

Revenue arising from rental income and interest income are disclosed in note 3 to the financial statements. Proceeds from the disposal of fixed assets are disclosed on the face of the cash flow statement.

3. OPERATING PROFIT/(LOSS)

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

| | 1998 HK\$'000 | 1997 HK\$'000 |
|--|------------------|------------------|
| Depreciation: | | |
| Owned fixed assets | 27,413 | 23,902 |
| Leased fixed assets | — | 84 |
| Less: amount capitalised as deferred development costs | — | (1,035) |
| | 27,413 | 22,951 |
| Operating lease rentals on land and buildings | 34,089 | 24,167 |
| Less: amount capitalised as deferred development costs | — | (3,074) |
| | 34,089 | 21,093 |
| Cost of inventories sold | 1,896,211 | 1,599,979 |
| Research and development expenses | 22,391 | 15,197 |
| Amortisation and write off of deferred development costs | 10,689 | 2,950 |
| Interest on: | | |
| Bank loans and overdrafts | 12,893 | 7,946 |
| Obligations under finance leases | — | 75 |
| Auditors' remuneration | 2,000 | 2,080 |
| Pension contributions (note) | 387 | 587 |
| Revaluation deficit — land and buildings | 2,916 | 1,031 |
| Revaluation deficit — investment properties | 4,210 | — |
| Loss on disposal of fixed assets | 2,858 | 1,363 |
| Provision for doubtful debts | 33,071 | 4,860 |
| Exchange loss/(gains) — net | 1,550 | (206) |
| Interest income | (3,611) | (4,209) |
| Rental income — gross and net | (1,781) | (1,516) |
| Gain on disposal of branch operations | (1,501) | — |

Note: The Group's total contribution to the Hong Kong pension scheme charged to the profit and loss account during the year ended 31 December 1998 has been reduced by forfeited contributions of HK\$126,000 (1997: HK\$33,000). The amount of unutilised forfeited contributions at the balance sheet date was not material.

4. DIRECTORS' REMUNERATION

Directors' remuneration disclosed pursuant to the Listing Rules and Section 161 of the Companies Ordinance is as follows:

| | 1998 HK\$'000 | 1997 HK\$'000 |
|--|------------------|------------------|
| Fees: | | |
| Executive directors | 790 | 720 |
| Non-executive directors | 253 | 240 |
| Independent non-executive directors | 254 | 240 |
| | 1,297 | 1,200 |
| Other executive directors' emoluments: | | |
| Salaries | 1,977 | 2,212 |
| Discretionary bonus | — | 7,000 |
| Pension contributions | 40 | 38 |
| | 3,314 | 10,450 |

The remuneration of the above directors for the year fell within the following bands:

| | 1998 Number of directors | 1997 Number of directors |
|-------------------------------|--------------------------------|--------------------------------|
| HK\$Nil – HK\$1,000,000 | 11 | 4 |
| HK\$1,500,001 – HK\$2,000,000 | — | 5 |
| HK\$2,000,001 – HK\$2,500,000 | — | 1 |

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

5. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included 1 director (1997: all), details of whose remuneration are set out in note 4 above.

The details of the remuneration of the remaining 4 (1997: Nil) non-directors, highest paid employees are set out below:

| | 1998 HK\$'000 | 1997 HK\$'000 |
|-------------------------------|------------------|------------------|
| Salaries and other emoluments | 2,984 | — |
| Pension scheme contributions | 50 | — |
| | 3,034 | — |

The remuneration of the above non-director, highest paid employees for the year fell within the following bands:

| | 1998 Number of employees | 1997 Number of employees |
|-------------------------------|--------------------------------|--------------------------------|
| HK\$Nil – HK\$1,000,000 | 3 | — |
| HK\$1,000,001 – HK\$1,500,000 | 1 | — |

6. TAXATION

| | 1998 HK\$'000 | 1997 HK\$'000 |
|---------------------------------------|------------------|------------------|
| Hong Kong: | | |
| Overprovision in prior year | — | 768 |
| Elsewhere: | | |
| Provision for the year | (46) | (11) |
| Taxation credit/(charge) for the year | (46) | 757 |

6. TAXATION (Continued)

No provision for Hong Kong profits tax has been made as there were no assessable profits for the year.

The Company's subsidiary in the PRC, other than those in Hong Kong, has been subject to PRC profits tax at 50% of its standard tax rate for the three fiscal years which commenced in 1998 and ending on 31 December 2000. At present, the standard tax rate applicable to the PRC subsidiary is 15%. No provision for PRC profits tax has been made as there were no assessable profits for the year.

Taxes on profits assessable elsewhere have been calculated at the applicable rates of taxation on the estimated assessable profits for the year based on existing taxation legislation, interpretations and practices in respect thereof.

The revaluation of the Company's and the Group's fixed assets and investment properties does not constitute a timing difference and, consequently, the amount of potential deferred tax thereon has not been quantified.

The Group did not have any significant unprovided deferred taxation during the year or at the balance sheet date.

7. NET PROFIT ATTRIBUTABLE TO SHAREHOLDERS

The net profit attributable to shareholders dealt with in the financial statements of the Company is HK\$5,374,000 (1997: HK\$55,237,000).

8. DIVIDENDS

| | 1998 HK\$'000 | 1997 HK\$'000 |
|---|------------------|------------------|
| Proposed final — Nil (1997: 8 cents per ordinary share) | — | 52,911 |

9. EARNINGS/(LOSS) PER SHARE

The calculation of basic earnings/(loss) per share is based on the net loss attributable to shareholders for the year of HK\$165,696,000 (1997: profit of HK\$143,291,000) and the weighted average number of 797,152,000 (1997: 792,857,000) ordinary shares in issue, adjusted to reflect the bonus issues during the year. The basic earnings per share for 1997 have been adjusted accordingly.

9. EARNINGS/(LOSS) PER SHARE (Continued)

The diluted loss per share for the year is not shown as the impact of the outstanding share options was anti-dilutive during the year.

The calculation of diluted earnings per share for 1997 is based on the net profit attributable to shareholders for the year of HK\$143,291,000 and the weighted average number of 792,857,000 ordinary shares in issue during the year, as used in the basic earnings per share calculation, and the weighted average of 38,944,000 ordinary shares assumed to have been issued at no consideration on the deemed exercise of all options outstanding during the year.

The adoption of the revised Statement of Standard Accounting Practice No. 5 “Earnings per share” issued by the Hong Kong Society of Accountants (“SSAP 5”) has resulted in some modification to the basis of calculation of earnings per share amounts and the disclosures presented for earnings per share. Amounts presented for the prior year have been restated to reflect the requirements of the revised SSAP 5.

10. RELATED PARTY TRANSACTIONS

During the year, the Group carried out the following material transactions with related parties:

- (i) Pursuant to a rental agreement dated 7 December 1995, the Group paid rental expenses of RMB15 million (HK\$14 million) (1997: RMB13 million (HK\$12 million)) to Peking University Founder Group Corporation (“Peking Founder”) for the year ended 31 December 1998.
- (ii) Pursuant to a technology co-operation agreement dated 7 December 1995, the Group paid a research and development fee of RMB4,300,000 (HK\$4,026,000) (1997: RMB4,300,000 (HK\$4,019,000)) to Peking University Research Institute of Computer Science and Technology for the year ended 31 December 1998.
- (iii) Trading stocks at cost of HK\$10,637,000 (1997: Nil) were sold to a jointly controlled entity.

11. FIXED ASSETS

| Group | Land and buildings in Hong Kong HK\$'000 | Land and buildings in the PRC HK\$'000 | Leasehold improvements HK\$'000 | Furniture, fixtures and equipment HK\$'000 | Motor vehicles HK\$'000 | Total HK\$'000 |
|--------------------------------------|---|---|--|---|--|---------------------------|
| Cost or valuation: | | | | | | |
| At 1 January 1998 | 53,000 | 2,913 | 8,817 | 115,677 | 22,723 | 203,130 |
| Additions | — | 13,703 | 22 | 24,163 | 6,544 | 44,432 |
| Disposals | — | (2,178) | (1,131) | (22,718) | (4,123) | (30,150) |
| Transfer to investment properties | (3,700) | — | — | — | — | (3,700) |
| Revaluation deficit | (9,400) | — | — | — | — | (9,400) |
| Exchange adjustments | — | 5 | 4 | 318 | 39 | 366 |
| At 31 December 1998 | 39,900 | 14,443 | 7,712 | 117,440 | 25,183 | 204,678 |
| Accumulated depreciation: | | | | | | |
| At 1 January 1998 | — | — | 4,690 | 36,628 | 6,822 | 48,140 |
| Provided during the year | 1,008 | 119 | 1,437 | 21,765 | 3,084 | 27,413 |
| Disposals | — | (22) | (482) | (8,147) | (757) | (9,408) |
| Written back on revaluation | (1,008) | — | — | — | — | (1,008) |
| Exchange adjustments | — | — | 1 | 78 | 11 | 90 |
| At 31 December 1998 | — | 97 | 5,646 | 50,324 | 9,160 | 65,227 |
| Net book value: | | | | | | |
| At 31 December 1998 | 39,900 | 14,346 | 2,066 | 67,116 | 16,023 | 139,451 |
| At 31 December 1997 | 53,000 | 2,913 | 4,127 | 79,049 | 15,901 | 154,990 |
| Analysis of cost and valuation: | | | | | | |
| Cost | — | 14,443 | 7,712 | 117,440 | 25,183 | 164,778 |
| Valuation at 31 December 1998 | 39,900 | — | — | — | — | 39,900 |
| | 39,900 | 14,443 | 7,712 | 117,440 | 25,183 | 204,678 |

11. FIXED ASSETS (Continued)

Company

| | Land and buildings in Hong Kong HK\$'000 | Leasehold improvements HK\$'000 | Furniture, fixtures and equipment HK\$'000 | Motor vehicles HK\$'000 | Total HK\$'000 |
|--|---|---------------------------------------|---|-------------------------------|-------------------|
| Cost or valuation: | | | | | |
| At 1 January 1998 | 44,000 | 5,833 | 6,836 | 887 | 57,556 |
| Additions | — | — | 649 | — | 649 |
| Disposals | — | — | (2,106) | — | (2,106) |
| Revaluation deficit | (9,000) | — | — | — | (9,000) |
| At 31 December 1998 | 35,000 | 5,833 | 5,379 | 887 | 47,099 |
| Accumulated depreciation: | | | | | |
| At 1 January 1998 | — | 3,917 | 5,839 | 741 | 10,497 |
| Provided during the year | 976 | 1,166 | 693 | 53 | 2,888 |
| Disposals | — | — | (1,856) | — | (1,856) |
| Written back on revaluation | (976) | — | — | — | (976) |
| At 31 December 1998 | — | 5,083 | 4,676 | 794 | 10,553 |
| Net book value: | | | | | |
| At 31 December 1998 | 35,000 | 750 | 703 | 93 | 36,546 |
| At 31 December 1997 | 44,000 | 1,916 | 997 | 146 | 47,059 |
| Analysis of cost and valuation: | | | | | |
| Cost | — | 5,833 | 5,379 | 887 | 12,099 |
| Valuation at 31 December 1998 | 35,000 | — | — | — | 35,000 |
| | 35,000 | 5,833 | 5,379 | 887 | 47,099 |

At 31 December 1998, the land and buildings in Hong Kong of the Company and the Group were revalued on an open market, existing use basis by Centaline Property Consultants Ltd., independent surveyors.

11. FIXED ASSETS (Continued)

Had the land and buildings in Hong Kong of the Company and the Group been carried at cost less accumulated depreciation, the carrying value of the land and buildings would have been included in the financial statements at HK\$38,056,000 (1997: HK\$38,896,000) and HK\$44,578,000 (1997: HK\$48,614,000), respectively.

All the properties held by the Company and certain of the properties held by the Group were pledged to banks to secure banking facilities (note 19).

At the balance sheet date, certificates of ownership in respect of certain Group's land and buildings in the PRC with an aggregate net book value of HK\$13,703,000 had not been issued by the relevant PRC authorities. The directors anticipate that these certificates will be issued in the near future.

The land and buildings at cost or valuation included above are held under the following lease terms:

| | Hong Kong HK\$'000 | PRC HK\$'000 | Total HK\$'000 |
|-------------------|------------------------------|------------------------|--------------------------|
| Long term lease | 39,900 | — | 39,900 |
| Medium term lease | — | 14,443 | 14,443 |
| | 39,900 | 14,443 | 54,343 |

12. INVESTMENT PROPERTIES

| | Group | | Company | |
|-------------------------------|-----------------|-----------------|-----------------|-----------------|
| | 1998 | 1997 | 1998 | 1997 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| At beginning of year | 21,830 | 21,830 | 19,631 | 19,631 |
| Transferred from fixed assets | 3,700 | — | — | — |
| Revaluation deficit | (4,210) | — | (4,131) | — |
| | 21,320 | 21,830 | 15,500 | 19,631 |

The investment properties of the Company and the Group are situated in Hong Kong and held on long term leases.

12. INVESTMENT PROPERTIES (Continued)

At 31 December 1998, the investment properties of the Company and the Group were revalued on an open market, existing use basis by Centaline Property Consultants Ltd., independent surveyors.

All the Group's investment properties are pledged to banks to secure banking facilities (note 19).

Particulars of the Group's investment properties are as follows:

| Location | Use |
|---|--|
| Unit Nos.1, 2a, 2b, 3a, 3b, 4a and 4b on 14th Floor, Cable TV Tower, 9 Hoi Shing Road, Tsuen Wan, New Territories | Office premises/warehouse for rental |
| Residential car parking space No.324 on Podium Level 2, Rhine Garden, 38 Castle Peak Road, Sham Tseng, New Territories | Car parking space for rental |
| Flat B on 29th Floor, Block 3, Locwood Court, Kingswood Villas, 1 Tin Wu Road, Tin Shui Wai, Yuen Long, New Territories | Residential premises for rental |
| Flat B on 8th Floor, Block 2 and Car parking space No. 60 on level 1, Dragon Inn Court, 9 Tsing Ha Lane, Tuen Mun, New Territories | Residential premises and car parking space for rental |

13. DEFERRED DEVELOPMENT COSTS

| | Group | |
|----------------------|-----------------|-----------------|
| | 1998 | 1997 |
| | HK\$'000 | HK\$'000 |
| At 1 January | 14,922 | 8,850 |
| Additions | 1,229 | 9,022 |
| Amortisation | (5,526) | (2,950) |
| Write off | (5,163) | — |
| Exchange adjustments | 25 | — |
| At 31 December | 5,487 | 14,922 |

14. INTERESTS IN SUBSIDIARIES

| | Company | |
|---|-----------------|-----------------|
| | 1998 | 1997 |
| | HK\$'000 | HK\$'000 |
| Unlisted shares, at cost | 136,690 | 136,690 |
| Due from subsidiaries | 247,884 | 248,315 |
| Due to a subsidiary | (3,359) | — |
| | 381,215 | 385,005 |
| Provisions for permanent diminutions in value | (2,519) | (3,433) |
| Provisions against amount due from subsidiaries | (3,319) | (251) |
| | 375,377 | 381,321 |

14. INTERESTS IN SUBSIDIARIES (Continued)

Particulars of the subsidiaries at the balance sheet date are as follows:

| Name | Place of incorporation/ registration/ operations | Issued and paid- up capital | Equity interest attributable to the Company | | Principal activities |
|---------------------------------------|--|-----------------------------------|---|------|--|
| | | | 1998 | 1997 | |
| Beijing Founder Electronics Co., Ltd. | The People's Republic of China | Registered HK\$130 million | 100% | 100% | Development of computer software, systems integration and trading of computer products |
| Founder Technology (Canada) Corp. | Canada | Ordinary CAN\$100 | 100% | 100% | Systems integration and trading of computer products |
| Founder Systems (USA), Inc. | United States of America | Common US\$30,000 | 100% | 100% | Systems integration and trading of computer products |
| Founder Inc. | Japan | Ordinary JPY 50 million | 100% | 100% | Systems integration and trading of computer products |

14. INTERESTS IN SUBSIDIARIES (Continued)

| Name | Place of incorporation/ registration/ operations | Issued and paid- up capital | Equity interest attributable to the Company | | Principal activities |
|--|--|-----------------------------------|---|-------|---|
| | | | 1998 | 1997 | |
| PUC Founder (M) Sdn. Bhd. | Malaysia | Ordinary RM500,000 | 100% | 100% | Systems integration and trading of computer products |
| PUC Founder (MSC) Sdn. Bhd. | Malaysia | Ordinary RM2 | 100%* | 100%* | Dormant |
| PUC Founder (S) Pte. Ltd. | The Republic of Singapore | Ordinary S\$200,000 | 100%* | 100%* | Systems integration and trading of computer products |
| Jets Technology Limited | Hong Kong | Ordinary HK\$2 | 100% | 100% | Production of films and provision of computer training course |
| Hill Glory Limited | Hong Kong | Ordinary HK\$2 | 100% | 100% | Dormant |
| Founder Systems (B.V.I.) Limited | British Virgin Islands | Ordinary US\$1 | 100% | — | Dormant |
| Founder Systems (H.K.) Limited | Hong Kong | Ordinary HK\$2 | 100% | — | Dormant |

14. INTERESTS IN SUBSIDIARIES (Continued)

| Name | Place of incorporation/ registration/ operations | Issued and paid- up capital | Equity interest attributable to the Company | | Principal activities |
|-----------------------|--|-----------------------------------|---|------|-------------------------|
| | | | 1998 | 1997 | |
| Royal Bright Limited | Hong Kong | Ordinary HK\$2 | 100% | — | Property holding |
| Royal Leader Limited | Hong Kong | Ordinary HK\$2 | 100% | — | Property holding |
| Royal Power Limited | Hong Kong | Ordinary HK\$2 | 100% | — | Property holding |
| Sharp Century Limited | Hong Kong | Ordinary HK\$2 | 100% | — | Property holding |

* held indirectly through a subsidiary

15. INTERESTS IN JOINTLY CONTROLLED ENTITIES

| | Group | |
|---------------------|------------------|------------------|
| | 1998 HK\$'000 | 1997 HK\$'000 |
| Share of net assets | 21,849 | — |

15. INTERESTS IN JOINTLY CONTROLLED ENTITIES (Continued)

Particulars of the jointly controlled entities, which are all unlisted, at the balance sheet date are as follows:

| Name | Business structure | Place of incorporation and operation | Equity interest and profit attributable to the Group | | Principal activities |
|--|--------------------|--------------------------------------|--|------|---|
| | | | 1998 | 1997 | |
| Beijing Founder Dicheng Information Technology Co., Ltd. | Corporate | The People's Republic of China | 50% | — | Provision of consultancy services and systems integration |
| Beijing PeCan Information System Inc. | Corporate | The People's Republic of China | 30% | — | Development of software and trading of computer products |

16. CURRENT ASSETS

| | Note | Group | | Company | |
|---|------|------------------|------------------|------------------|------------------|
| | | 1998 HK\$'000 | 1997 HK\$'000 | 1998 HK\$'000 | 1997 HK\$'000 |
| Cash and bank balances | | 281,863 | 358,563 | 22,051 | 22,166 |
| Accounts receivable | | 324,155 | 340,716 | 386,987 | 371,105 |
| Inventories | 17 | 262,963 | 393,359 | 36,426 | 18,692 |
| Prepayments, deposits and other receivables | | 104,790 | 74,816 | 11,086 | 4,568 |
| Tax recoverable | | 1,514 | — | — | — |
| | | 975,285 | 1,167,454 | 456,550 | 416,531 |

17. INVENTORIES

| | Group | | Company | |
|----------------------------------|-----------------|----------|-----------------|----------|
| | 1998 | 1997 | 1998 | 1997 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Raw materials | — | 59,906 | — | — |
| Work in progress | — | 4,774 | — | — |
| Finished goods and trading stock | 262,963 | 328,679 | 36,426 | 18,692 |
| | 262,963 | 393,359 | 36,426 | 18,692 |

18. CURRENT LIABILITIES

| | | Group | | Company | |
|---|-------|-----------------|----------|-----------------|----------|
| | | 1998 | 1997 | 1998 | 1997 |
| | Notes | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Bank loans and overdrafts | 19 | 141,974 | 150,279 | 136,068 | 127,512 |
| Accounts payable and accrued liabilities | | 341,671 | 337,646 | 129,543 | 97,457 |
| Taxation | | — | 11 | — | — |
| Proposed final dividends | 8 | — | 52,911 | — | 52,911 |
| | | 483,645 | 540,847 | 265,611 | 277,880 |

19. BANK LOANS

| | Group | | Company | |
|---|-----------------|-----------------|-----------------|-----------------|
| | 1998 | 1997 | 1998 | 1997 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Balances due: | | | | |
| Within one year | 141,974 | 150,279 | 136,068 | 127,512 |
| In the second year | 1,436 | 1,553 | 632 | 556 |
| In the third to fifth years, inclusive | 3,289 | 4,529 | 2,371 | 2,106 |
| After five years | 2,366 | 5,024 | 2,366 | 3,264 |
| | 149,065 | 161,385 | 141,437 | 133,438 |
| Portion classified as current liabilities | 141,974 | 150,279 | 136,068 | 127,512 |
| Long term portion | 7,091 | 11,106 | 5,369 | 5,926 |
| Secured: | | | | |
| Bank overdrafts | 4,578 | 144 | 4,350 | 38 |
| Bank loans | 8,461 | 12,581 | 5,936 | 6,422 |
| Trust receipt loans | 71,791 | 97,244 | 71,791 | 97,244 |
| | 84,830 | 109,969 | 82,077 | 103,704 |
| Unsecured: | | | | |
| Bank loans | 4,875 | 21,682 | — | — |
| Trust receipt loans | 59,360 | 29,734 | 59,360 | 29,734 |
| | 149,065 | 161,385 | 141,437 | 133,438 |

The Company's and the Group's secured bank loans are secured by all of the Company's and certain of the Group's land and buildings and all of the Group's investment properties in Hong Kong.

20. SHARE CAPITAL

| | Group and Company | |
|--|--------------------------|-----------------|
| | 1998 | 1997 |
| | HK\$'000 | HK\$'000 |
| <hr/> | | |
| Authorised: | | |
| 1,100,000,000 (1997: 900,000,000) ordinary shares of HK\$0.10 each | 110,000 | 90,000 |
| <hr/> | | |
| Issued and fully paid: | | |
| 799,873,893 (1997: 661,387,287) ordinary shares of HK\$0.10 each | 79,987 | 66,139 |
| <hr/> | | |

On 13 May 1998, the authorised share capital of the Company was increased from HK\$90,000,000 to HK\$110,000,000 by the creation of an additional 200,000,000 ordinary shares of HK\$0.10 each.

On 20 May 1998, the Company issued 132,277,457 bonus shares of HK\$0.10 each to shareholders, credited as fully paid by way of capitalisation of part of the Company's share premium account, on the basis of one bonus share for every five ordinary shares.

On 10 June 1998, 6,209,149 ordinary shares of HK\$0.10 each were issued at par, to shareholders who elected to receive new shares in lieu of cash dividends for the year ended 31 December 1997 under the scrip dividend alternative. Shareholders' entitlements to new shares were calculated by reference to the average closing price per share on The Stock Exchange of Hong Kong Limited for the five consecutive trading days ended 13 May 1998 of HK\$5.195 per ordinary share.

Share options

On 7 December 1995, the Company adopted a share option scheme ("Scheme") under which the directors may, at their discretion, make an offer to any employee or director of the Group to take up options to subscribe for shares of the Company. The maximum number of shares in respect of which share options may be granted under the Scheme may not exceed 10% of the issued share capital of the Company, excluding any shares issued on exercise of options granted under this Scheme. The Scheme will remain in force for a period of 10 years from the date of its adoption.

At the balance sheet date, the Company had 57,600,000 outstanding options, entitling the registered holders to subscribe in cash for shares of the Company at a price of HK\$1.397 per share. The exercise in full of such share options would, under the present capital structure of the Company, result in the issue of 57,600,000 additional ordinary shares. No share options were granted or exercised during the year ended 31 December 1998.

21. RESERVES

| | Share premium account HK\$'000 | Land and buildings revaluation reserve HK\$'000 | Exchange fluctuation reserve HK\$'000 | General reserve HK\$'000 | Retained profits/ (accumulated losses) HK\$'000 | Total HK\$'000 |
|--|---|---|--|--------------------------------|---|-------------------|
| Group | | | | | | |
| At 1 January 1998 | 487,745 | 6,202 | 12 | 38,838 | 211,815 | 744,612 |
| Issue of bonus shares | (13,228) | — | — | — | — | (13,228) |
| Arising on issue of ordinary shares | 31,636 | — | — | — | — | 31,636 |
| Net loss for the year | — | — | — | — | (165,696) | (165,696) |
| Revaluation deficit | — | (5,476) | — | — | — | (5,476) |
| Realised on disposal | — | (125) | — | — | 125 | — |
| Exchange adjustments | — | — | 821 | — | — | 821 |
| At 31 December 1998 | 506,153 | 601 | 833 | 38,838 | 46,244 | 592,669 |
| Reserves retained by: | | | | | | |
| Company and subsidiaries | 506,153 | 601 | 833 | 38,838 | 49,509 | 595,934 |
| Jointly controlled entities | — | — | — | — | (3,265) | (3,265) |
| | 506,153 | 601 | 833 | 38,838 | 46,244 | 592,669 |
| Company | | | | | | |
| At 1 January 1998 | 487,745 | 5,373 | — | — | 21,479 | 514,597 |
| Issue of bonus shares | (13,228) | — | — | — | — | (13,228) |
| Arising on issue of ordinary shares | 31,636 | — | — | — | — | 31,636 |
| Net profit for the year | — | — | — | — | 5,374 | 5,374 |
| Revaluation deficit | — | (5,373) | — | — | — | (5,373) |
| At 31 December 1998 | 506,153 | — | — | — | 26,853 | 533,006 |

21. RESERVES (Continued)

In accordance with the relevant PRC regulations, each of the Group's PRC subsidiary and jointly controlled entities is required to transfer not less than 10% of its profits after taxation, as determined in accordance with PRC accounting standards and regulations, to a general reserve until such reserve reaches 50% of its registered capital. The quantum of the annual transfer is subject to the approval of the board of directors of the subsidiary and jointly controlled entities in accordance with their articles of association.

No such transfers were made during the year as the Group's PRC subsidiary and jointly controlled entities incurred losses for the year.

22. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

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

| | 1998 HK\$'000 | 1997 HK\$'000 |
|---|------------------|------------------|
| Operating profit/(loss) | (162,385) | 142,534 |
| Interest income | (3,611) | (4,209) |
| Interest expense | 12,893 | 7,946 |
| Interest on obligations under finance leases | — | 75 |
| Depreciation | 27,413 | 22,951 |
| Revaluation deficit | 7,126 | 1,031 |
| Loss on disposal of fixed assets | 2,858 | 1,363 |
| Gain on disposal of branch operations | (1,501) | — |
| Amortisation and write off of deferred development costs | 10,689 | 2,950 |
| Decrease in deferred VAT recoverable | 3,508 | 2,530 |
| Decrease/(increase) in accounts receivable | 1,501 | (59,611) |
| Decrease/(increase) in inventories | 20,372 | (80,585) |
| Increase in prepayments, deposits and other receivables | (41,640) | (18,337) |
| Increase/(decrease) in accounts payable and accrued liabilities | 128,610 | (56,513) |
| Increase in trust receipt loans | 4,173 | 67,058 |
| Exchange differences | 372 | 938 |
| Net cash inflow from operating activities | 10,378 | 30,121 |

22. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (Continued)

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

| | Share capital and share premium HK\$'000 | Bank loans (with maturity of over 3 months) HK\$'000 |
|--|---|---|
| Balance as at 1 January 1997 | 546,906 | 15,090 |
| Net cash inflow from financing | — | 19,348 |
| Issue of scrip dividends | 6,978 | — |
| Exchange differences | — | (175) |
| Balance as at 31 December 1997 and 1 January 1998 | 553,884 | 34,263 |
| Net cash outflow from financing | — | (21,354) |
| Issue of scrip dividends | 32,256 | — |
| Exchange differences | — | 427 |
| Balance as at 31 December 1998 | 586,140 | 13,336 |

(c) Disposal of branch operations

| | 1998 HK\$'000 |
|---|------------------|
| Net assets disposed of: | |
| Fixed assets | 5,969 |
| Cash and bank balances | 36,723 |
| Accounts receivable | 15,060 |
| Inventories | 110,024 |
| Prepayments, deposits and other receivables | 11,666 |
| Accounts payable and accrued liabilities | (124,585) |
| Tax payable | (186) |
| | 54,671 |
| Gain on disposal | 1,501 |
| Consideration | 56,172 |
| Satisfied by | |
| Cash | 56,172 |

22. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (Continued)

(c) Disposal of branch operations (Continued)

Analysis of the net inflow of cash and cash equivalents in respect of the disposal of branch operations:

| | 1998 HK\$'000 |
|---|------------------|
| Cash consideration | 56,172 |
| Cash and bank balances disposed of | (36,723) |
| Net inflow of cash and cash equivalents in respect of the disposal of branch operations | 19,449 |

The branch operations disposed of during the year contributed approximately HK\$12,459,000 to the Group's net operating cash flows, contributed approximately HK\$4,000 in respect of net returns on investments and servicing of finance, paid approximately HK\$44,000 in respect of taxation and utilised approximately HK\$421,000 for investing activities.

23. COMMITMENTS

| | Group | | Company | |
|--|------------------|------------------|------------------|------------------|
| | 1998 HK\$'000 | 1997 HK\$'000 | 1998 HK\$'000 | 1997 HK\$'000 |
| Annual commitments payable in the following year under non-cancellable operating leases in respect of land and buildings expiring: | | | | |
| Within one year | 1,267 | 3,317 | — | 135 |
| In the second to fifth years, inclusive | 9,622 | 7,151 | — | 178 |
| After five years | 15,496 | 12,676 | — | — |
| | 26,385 | 23,144 | — | 313 |

As at 31 December 1998, neither the Group, nor the Company had any other significant capital commitments.

24. CONTINGENT LIABILITIES

As at 31 December 1998, the Company had guarantees amounting to HK\$6,313,000 (1997: HK\$6,990,000) to banks for facilities granted to its subsidiaries. The Group had no significant contingent liabilities.

25. COMPARATIVE AMOUNTS

Certain comparative amounts have been reclassified to conform with the current year's presentation.

26. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved by the board of directors on 15 April 1999.