



**Since 1956**

**Pegasus International Holdings Limited**

**創信國際控股有限公司**

*(Incorporated in Bermuda with limited liability)*

*(於百慕達註冊成立之有限公司)*

*(Stock Code 股份代號：676)*

**ANNUAL REPORT 2006 年報**

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# PEGASUS INTERNATIONAL

## Pegasus Manufacturing Group

Pegasus Group is one of the largest footwear OEM suppliers in China, founded in 1956 in Taiwan. In 1990, the Group relocated its whole production base from Taiwan to Panyu, Guangdong. In 1996, Pegasus Group successfully listed in Hong Kong. For now, the Group owns a factory area of around 500,000 sq.m. and 42 production lines. It has around 16,000 employees and its production capacity reaches 20,000,000 pair of shoes per year. Pegasus has its products exported to areas around the world, among them North America is the biggest export market. Pegasus has established long-term close cooperation relationship with a number of OEM customers, namely Nike, L.L.Bean, Timberland, Bite, Lands' End, 5.11, Dick's Sports and etc. Pegasus has a variety of product range, including fashionable leisure shoes, out-door leisure shoes, hiking boots, snow boots, army boots, skateboard shoes, aquatic sports shoes, sports shoes, sports sandals, golf shoes, baseball shoes, work boots, formal leather shoes, leisure leather shoes and so forth.

## Pegasus Marketing Group

廣州創信鞋品服飾有限公司 ("Guangzhou Pegasus") is a subsidiary of Pegasus Group, incorporated in January 1998 to explore the domestic sales market in the PRC. Up to now, it has set up self-operated exclusive counters in more than 100 band-one shopping-malls, covering more than ten tier 1 and 2 cities, namely Beijing, Shanghai, Guangzhou, Chengdu, Chongqing, Dalian, Wuhan and so on. Guangzhou Pegasus has unceasingly developed different channels to license for internationally renowned brand-names and self-owned brand-names, in order to pioneer the market in China. These brand-names include children footwear brand-names like Magic House, 3H aerobic health shoes, Bowie, Disney (comprising Mickey and Minnie Series, the Princess Series, Winnie the Pooh Series and Toy Story Series), Doraemon and adult footwear brand-names like Speedwell, Slazenger, IF, Projekt4. Besides, the company is equipped with channels targeting on different markets: Speedwell, Slazenger, Magic House, Kid's E-look. etc.

The group upholds the operation objective of "Professionalism, Quality and Services", and is committed to providing fashionable, comfortable and healthy footwear and accessories to the consumers.



Speedwell Specialty Stores



Magic House Specialty Stores

Brand-name	Feature	Positioning	Concept	Personality	Pursuit	Channels	In-shop Product Structure	Age Group	Product Price Range
Speedwell	Product Brand-name Channel Brand-name	Fashionable Leisure Sportive	Leads the trend of fashion and leisure sports; Embodies an easy, natural and relaxed way of life.	Self-confident Natural and Good-looking	This is me	Exclusive Counters Shop-in-shops Specialty Stores	On the halves of accessories and shoes, and so are the proportion of products for men and products for women.	20-28	500-1000
Slazenger	Product Brand-name Channel Brand-name	Sportive Fashionable Professional	Characterized by sportive style and tradition, stresses on interior and exterior, incorporating fashionable elements to become the advocate for uniqueness	A release of vitality, embodying an English style	A release of vitality, embodying English style	Exclusive Counters Shop-in-shops Specialty Stores	On the halves of products for men and for women, displaying accessories and shoes, rackets and so on	13-25	300-500
IF	Product Brand-name Channel Brand-name	Comfortable Elegant Fashionable	Uniquely features a brand-new sensitivity to conciseness, elegance, ease and functionality, tailor-made for a modern life	Demonstrates, with a distant color of noble, the charisma of successful men in the city	A delicate and elegant Italian Style	Exclusive Counters Shop-in-shops Specialty Stores	Male formal leather shoes	30-40	800-1800
Projekt4	Product Brand-name Channel Brand-name	Vitality Passion Personality	Originating from a sense of pop music in Europe and US, has fashionable, pliable and light and portable characteristics	Vitality Passion	Free will, heart at Home	Exclusive Counters Shop-in-shops Specialty Stores	Men's leather shoes, leisure shoes, women's leather shoes, leisure shoes	20-30	600-1000
Magic House	Product Brand-name Channel Brand-name	Vivacious Fashionable Sportive	Healthy, personalized product with elegant and vivacious design concept; Embodies the care and love for the youngsters	Sportive, brave, sanguine and obliging	Healthy, Environmental Friendly, Cosy and Natural	Exclusive Counters Shop-in-shops Specialty Stores	70% of the products are under characters brand-names (Magic House, Winnie the Pooh, Mickey, Minnie, Princess, Toy Story, Doraemon); 30% are under international brand-names	0-14	200-400
Kid's E-look	Channel Brand-name	Fashionable Diversification	Diversified, personalized products with fashionable and playful design concept	Sportive, lively, healthy and upwardly mobile	Healthy and fashionable, displaying vitality	Exclusive counters	International Brand-names	3-15	400-1000

# PEGASUS INTERNATIONAL

## Events:

1. SPEEDWELL sponsorship of the 11th International Miss Tourism Competition 2006 (Guangdong, the PRC)
2. ZIC as competition promoter of FIAGT 2007 PRC Station and competition owner and promoter of Pan-Zhujiang Delta Super Car Racing Festival 2007 and is entitled to seek sponsorship and to organize promoting activities for the event.
3. The only officially appointed footwear and apparel cooperative partner of Pan-Zhujiang Delta Super Car Racing Festival 2007
  - a) summer competition (23-24 June 2007)
  - b) autumn competition (15-16 September 2007)
4. The only officially appointed footwear and apparel cooperative partner of FIAGT 2007 PRC Station (24-25 March 2007)

**SPEEDWELL**  
Sponsorship & Marketing Solutions

## Official footwear and apparel for the 11th International Miss Tourism Competition 2006 (Guangdong, the PRC)







# CORPORATE INFORMATION

**DIRECTORS**  
Executive Directors  
Wu Chen San, Thomas, Chairman  
Wu Jenn Chang, Michael, Deputy Chairman  
Wu Jenn Tzong, Jackson  
Ho Chin Fa, Steven

Non-Executive Directors  
Fang Yen Ling  
Liu Chung Kang, Helios  
Lai Jenn Yang, Jeffrey

**COMPANY SECRETARY**  
Lee Yiu Ming

**AUDIT COMMITTEE**  
Fang Yen Ling, Chairman  
Liu Chung Kang, Helios  
Lai Jenn Yang, Jeffrey

**REMUNERATION COMMITTEE**  
Lai Jenn Yang, Jeffrey, Chairman  
Fang Yen Ling  
Liu Chung Kang, Helios

**NOMINATION COMMITTEE**  
Liu Chung Kang, Helios, Chairman  
Lai Jenn Yang, Jeffrey  
Fang Yen Ling

**REGISTERED OFFICE**  
Clarendon House, 2 Church Street, Hamilton HM11, Bermuda

**HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS**  
Room 1517, Tower 3, China Hong Kong City, 33 Canton Road  
Tsimshatsui, Kowloon, Hong Kong

**AUDITORS**  
Deloitte Touche Tohmatsu  
35th Floor, One Pacific Place, 88 Queensway, Hong Kong

**PRINCIPAL SHARE REGISTRARS**  
Butterfield Corporate Services Limited  
Rosebank Centre, 11 Bermudiana Road, Pembroke  
Bermuda

**HONG KONG BRANCH SHARE REGISTRARS**  
Secretaries Limited  
26/F, Tesbury Centre, 28 Queen's Road East, Hong Kong

**Stock Code**  
676

**PRINCIPAL BANKERS**  
Bank of Tokyo-Mitsubishi UFJ  
BNP Paribas  
China Construction Bank  
Chinatrust Commercial Bank, Ltd  
DBS Bank (Hong Kong) Limited  
Hang Seng Bank Limited  
Natexis Banques Populaires  
Rabobank International  
Standard Chartered Bank (Hong Kong) Limited  
The Bank of East Asia, Limited  
The Hong Kong and Shanghai Banking Corporation Limited

# NOTICE OF ANNUAL GENERAL MEETING

**NOTICE IS HEREBY GIVEN** that the Annual General Meeting of the Company will be held at Imperial Room III, Towers Wing, Mezzanine Floor, The Royal Pacific Hotel & Towers, China Hong Kong City, 33 Canton Road, Tsimshatsui, Kowloon, Hong Kong on Thursday, 17th May, 2007 at 9:30 a.m. for the following purposes:

1. To receive and consider the audited financial statements and the directors' report and auditors' report for the year ended 31st December, 2006.
2. To approve and declare a final dividend for the year ended 31st December, 2006.
3. To re-elect retiring Directors and authorise the Remuneration Committee to fix their remuneration.
4. To re-appoint the Auditors and authorise the Board of Directors to fix their remuneration.

## As special business

5. To consider and, if thought fit, to pass, with or without modifications, the following Resolutions as ordinary resolutions:

(A) **"THAT:**

- (a) subject to paragraph (b) below, the exercise by the Directors of the Company during the Relevant Period (as hereinafter defined) of all the powers of the Company to purchase shares in the capital of the Company, subject to and in accordance with all applicable laws and the requirements of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited as amended from time to time, be and is hereby generally and unconditionally approved;
- (b) the aggregate nominal amount of shares of the Company which may be purchased by the Company pursuant to the approval in paragraph (a) above shall not exceed 10 per cent. of the aggregate nominal amount of the share capital of the Company in issue as at the date of passing of this Resolution, and the said approval shall be limited accordingly; 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 the Bye-laws of the Company or any applicable law to be held; and
  - (iii) the revocation or variation of authority given under this Resolution by an ordinary resolution of the shareholders of the Company in general meeting."

(B) **"THAT:**

- (a) subject to paragraph (c) below, the exercise by the Directors of the Company during the Relevant Period (as hereinafter defined) 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 which would or might require the exercise of such powers, be and is hereby generally and unconditionally approved;
- (b) the approval in paragraph (a) above shall authorise the Directors of the Company during the Relevant Period to make or grant offers, agreements and options which would or might require the exercise of such powers after the end of the Relevant Period;
- (c) the aggregate nominal amount of the 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) above, otherwise than pursuant to (1) a Rights Issue (as hereinafter defined); (2) an issue of shares as scrip dividends pursuant to the Bye-laws of the Company; (3) an issue of shares by the exercise of options granted under the share option scheme of the Company, shall



# NOTICE OF ANNUAL GENERAL MEETING

not exceed 20 per cent. of the aggregate nominal amount of the share capital of the Company in issue as at the date of 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 the Bye-laws of the Company or any applicable law to be held; and
- (iii) the revocation or variation of authority given under this Resolution by an ordinary resolution of the shareholders of the Company in general meeting; and

“Rights Issue” means an offer of shares open for a period fixed by the Directors of the Company to the holders of shares of the Company on the register on a fixed record date in proportion to their then holdings of such shares (subject to such exclusion or other arrangements as the Directors of the Company may deem necessary or expedient in relation to fractional entitlements or having regard to any restrictions or obligations under the laws of, or the requirements of any recognised regulatory body or any stock exchange, in any territory outside Hong Kong applicable to the Company).”

- (C) “**THAT** conditional upon the Resolutions numbered 5A and 5B set out in the notice convening this meeting being passed, the aggregate nominal amount of shares in the capital of the Company which is purchased by the Company under the authority granted to the Directors of the Company by Resolution numbered 5A (up to a maximum of 10 per cent. of the aggregate nominal amount of the share capital of the Company in issue as at the date of passing of such Resolution) shall be added to the aggregate nominal amount of shares in the capital of the Company that may be allotted or agreed conditionally or unconditionally to be allotted by the Directors of the Company pursuant to Resolution numbered 5B set out in the notice convening this meeting.”

By Order of the Board

**Lee Yiu Ming**

*Company Secretary*

Hong Kong, 25th April, 2007

Notes:

- (1) Any member entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and, on a poll, vote in his stead. A proxy need not be a member of the Company.
- (2) In order to be valid, a form of proxy together with the power of attorney or other authority (if any) under which it is signed or a notarially certified copy thereof must be deposited at the head office and principal place of business of the Company at Room 1517, Tower 3, China Hong Kong City, 33 Canton Road, Tsimshatsui, Kowloon, Hong Kong not less than 48 hours before the time appointed for holding the meeting or any adjournment thereof.
- (3) The register of members of the Company will be closed from Tuesday, 15th May, 2007 to Thursday 17th May, 2007, both days inclusive, during which no transfer of shares will be registered.

In order to qualify for the proposed final dividend, all transfer documents accompanied by the relevant share certificates must be lodged with the Company's Hong Kong Branch Share Registrar, Secretaries Limited at 26/F., Tesbury Centre, 28 Queen's Road East, Hong Kong not later than 4:30 p.m. on Monday 14th May, 2007.

- (4) An explanatory statement containing further details regarding the Resolutions set out in item 5 will be sent to the shareholders of the Company together with the annual report of the Company for the year ended 31st December, 2006.

## RESULTS

The Group's performance for 2006 is highlighted as follows:

- Turnover was US\$141,465,000 (2005: US\$141,242,000)
- Profit for the year was US\$3,120,000 (2005: US\$2,467,000)

During the year, the Group continued its lean management system and readjusted its business focus. As a result, turnover for 2006 has slightly improved as compared with that of 2005, however, profit for the year increased by 27%.

## BUSINESS REVIEW

### Product Mix

In 2006, the Group's product mix comprised sports sandals (12%), casual shoes (26%), athletic shoes (56%) and others (6%).

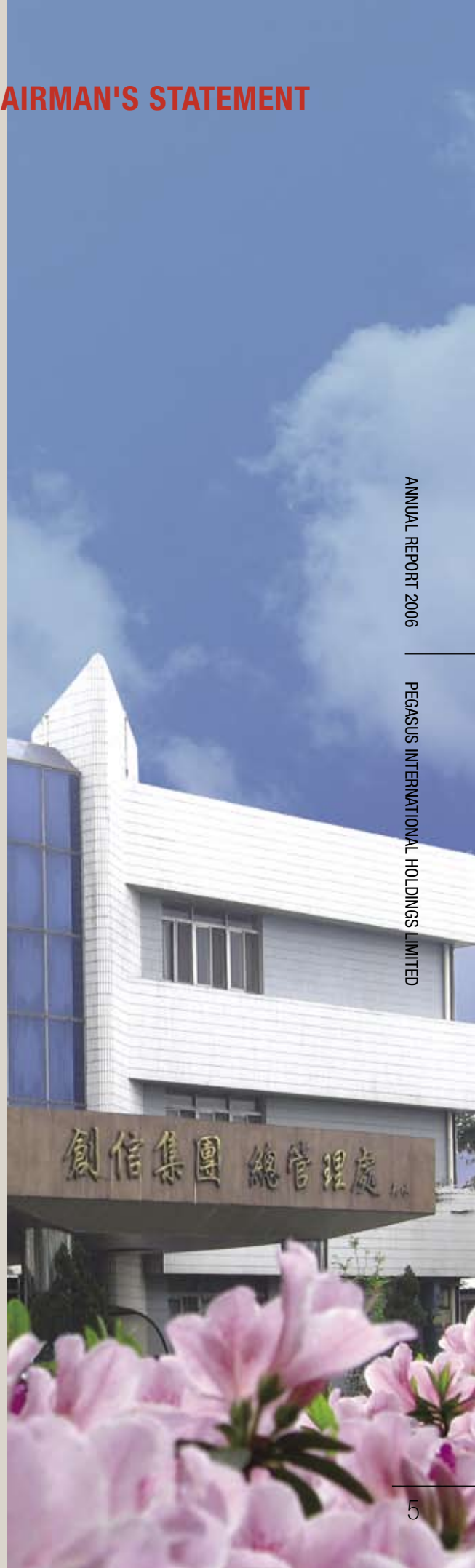


### Geographical Market Segments

North America remained the largest export market of the Group, accounting for 53% of its turnover for 2006. Turnover contribution from the European and Asian markets were 27% and 15% respectively.

### Domestic Sales Market in the PRC

Domestic sales of shoes are vast and important. Therefore, the Group has been seeking golden opportunities to tap the domestic market of the PRC since it relocated its production base to the Mainland in 1991. Starting from 1998, the Group initiated its domestic sales business, which recorded steady growth year by year through integration of resources, segmentation of markets, and the establishment of multi-brands, product diversification and multi-channel operation model, as well as a market-oriented management system. In early 2006, the merchandizing group was initially set



# CHAIRMAN'S STATEMENT

up. By the end of 2006, the Group has established the following structure in respect of sales channels, brand-name and product range:

Channels	Brand-name	Product Range
Speedwell Counter/ Shop-in-shop/ Specialty Store	Speedwell	Fashionable Leisure Shoes, accessories, hand-bags
魔術屋(Magic House) Counter/Shop-in- shop/Specialty Store	Disney	Shoes for Children
	多啦A夢 (Doraemon)	Shoes and school-bags for Children
	魔術屋(Magic House)	Shoes and school-bags for Children

By then there are 51 agents, 30 franchisees and 728 points of sales.

## BUSINESS DEVELOPMENT FOCUSES

### A. Manufacturing Business

We specialize in strengthening process management, applying new technology and new management concepts to improve production efficiency and product quality, reduce wastage and achieve timely delivery for the purpose of further enhancement of corporate competitiveness. Meanwhile, we also make closer cooperation with customers, maintain and expand our business relationship with our major customers to increase revenue. Our continued effort has won high recognition from our customers, as reflected in our high ranking on the integrated grading table of Nike in terms of product quality, lead-time, human resources and social responsibility. Encouragingly, we were the only factory to be granted the



Special Recognition Award by Nike for our outstanding performance product quality and manufacturing excellence.

### B. Domestic Sales Market

Considering the high potential for our business growth, the construction of the domestic sales market has become another operation focus of the Group. The Group intensifies its input to the building-up of brand-name, marketing and sales channels construction by means of all-round integration of resources and, directed against features of brand-name and products, the establishment of effective sales market channels and creative practicing lean management system. While refreshing results of our self-owned points of sales, we also take the initiative to expand regional agency and franchising business, resulting in rapid increase in the number of agents and franchisees.

## LEAN PRODUCTION MANAGEMENT SYSTEM

To further promote the concept of lean management for enhancement of overall operation efficiency, the Group has, from 2003 to the end of 2006, invested US\$6 million to transform all 40 traditional production lines to lean production lines, and have witnessed a leaner management and a leap in efficiency and quality. For the latest three years, the total number of staff has decreased from 21,000 to 16,000, with the turnover



# CHAIRMAN'S STATEMENT

remained at a similar level. Meanwhile, the enhancement in productivity has offset the increase in labor costs recent years. As a result of the implementation of lean production management, the Group's productivity has increase by 25%, which, has provided room for improvement of our revenue without addition of production equipment.

## SOCIAL RESPONSIBILITY

The Group regards the performance of corporate social responsibility as its unshirkable task, and is committed to be an outstanding corporate citizen since its inception.

The Group continues to push forward and reinforce corporate governance. We have established a transparent management system for the shareholders and the staff, fortified construction of corporate culture, and created a harmonic work environment. The Group takes the lead in the shoe-making industry to implement 5-working day/week system, and boosts unit working time income by continuous upgrading of management efficacy. We are also devoted to talent cultivation, retaining and recruiting talents through comprehensive examination, training and promotion mechanism. As for contribution to the community, the Group has not only offered employment opportunities for the disabled, but also made donations to those in flooded areas, primary schools in poverty-stricken areas and to charity hospitals.

Starting from November 2006, the Group has been embarking on the preparation work for ISO14001 and OHSAS18001 certification, with an aim to set up a more effective environment, and a better vocational health and safety management system.

## FUTURE PROSPECTS

### A. Manufacturing Business

The Group expects that turnover from export sales to North American market will grow steadily. However, the shoe-making industry is still confronting the challenges of rising labor costs, lack of labor force and price fluctuation of raw materials.

The Group will carry through the business focus of growing with its customers; continue implementation of lean management system; strengthen internal governance; exploring new sources and economize on consumption; and maintain reasonable growth of profits.

### B. Domestic Sales Market

In light of the huge potential of the domestic sales market, the merchandizing group is, after proper marketing preparation, expecting a real leap and bounce in 2007.

- a. At the end of 2006, the Group entered into a contract with Slazenger in respect of the exclusive agency right for production and sales in the PRC. In fourth quarter 2007, a number of sales counters, shop-in-shops and specialty stores specialized in selling shoes, accessories and sports equipment under the brand-name of Slazenger will commence trial operation, and the operation will be officially launched from 2008.
- b. At the beginning of 2007, the Group entered into children's shoes distribution agreements with internationally renowned brand-names like Nike, Adidas, New Balance and Ecco, pursuant to which, exclusive counters "Kid's E-look" will be launched in high-class department stores in China from fourth quarter in 2007. Sales will be commenced in 2008.
- c. Starting from fourth quarter of 2007, sales counters, shop-in-shops and specialty stores selling "IF" men's formal leather shoes and Projekt4 men's leisure leather shoes will be launched.

The above mentioned three sales targets will enrich the Group's brand-name series and product lines, and will facilitate establishment of sales channel, expansion of market share and increase of revenue.

# CHAIRMAN'S STATEMENT

The Group will sure to establish its leading position in wholesale and retail of shoes and accessories with leaner integration of resources, more accurate segmentation of market, as well as a merchandizing strategy emphasizing multi-brands, product diversification and multi-channel.

## CONCLUSION

The Group will continue to gain confidence from our business partners in long-term cooperation with its faith and pioneering spirit, and will strive to enhance the Group's competitiveness with its lean operation and resources integration, with a view to realizing its objective of long-term development.

On behalf of the Board, I would like to express my deepest gratitude to the staff for their dedication and diligence, and our business partners for their continued support.

By Order of the Board  
**Wu Chen San, Thomas**  
*CHAIRMAN*

Hong Kong, 17th April, 2007



# MANAGEMENT DISCUSSION AND ANALYSIS

## FINANCIAL REVIEW

During the year ended 31st December, 2006, the Group continued to concentrate on the manufacture and sales of footwear products. It was an encouraging year for the Group. For the year ended 31st December, 2006, the Group achieved a turnover of US\$141,465,000 (2005: US\$141,242,000) despite the tough operating environment. Compared with 2005, the turnover maintained at a similar level.

Profit of the Group for the year ended 31st December, 2006 grew by 26.5% to US\$3,120,000. Basic earnings per share for the year ended 31st December, 2006 was 0.43 US cents (2005: 0.34 US cents). Due to the continued surge of labor cost which is reflected by the slight decrease in gross profit margin from 16.49% in 2005 to 16.35% in 2006. Despite the fact, the Group had exercised very tight cost control over the selling and distribution costs and administrative expenses.

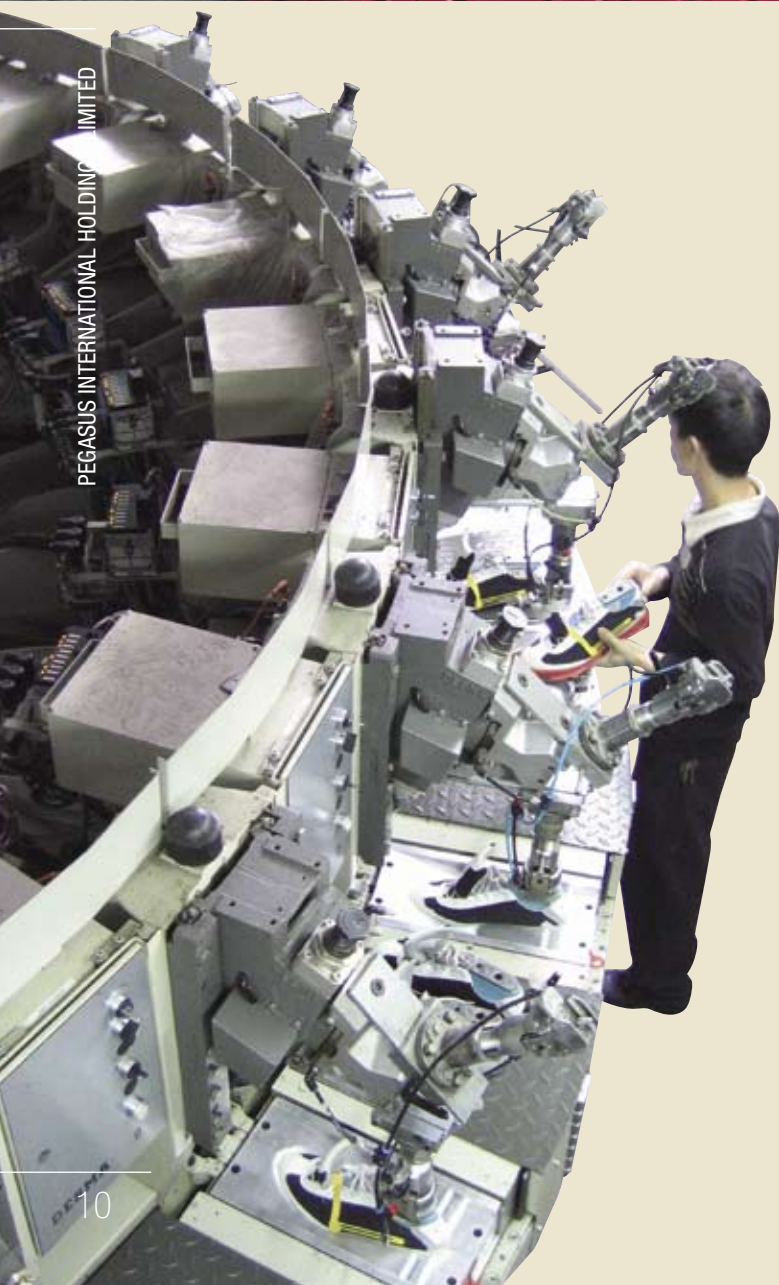
The mild growth of the economy in the United States and Western European countries, coupled with protectionism measures as adopted by some of these countries towards China, did not lead to a strong market



# MANAGEMENT DISCUSSION AND ANALYSIS



ANNUAL REPORT 2006



PEGASUS INTERNATIONAL HOLDING LIMITED

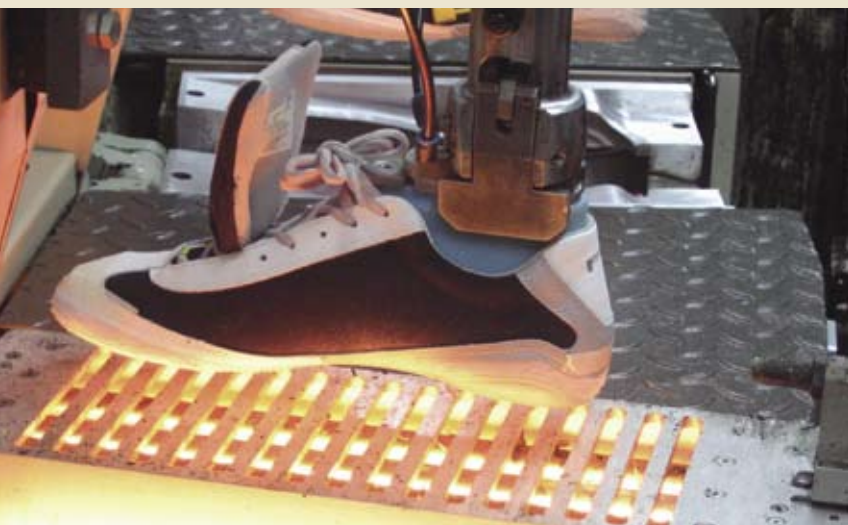
demand. The appreciation of Renminbi, rising labor costs, strict environmental regulations and trade dispute all are the challenges facing by the Group. The Group recognized these challenges and took steps to mitigate their impact.

Labor cost was gradually increased year by year and this trend is expected to continue in 2007. The Group implemented measures to improve staff productivity and to streamline manual working procedures on production lines in order to improve the efficiency of the labor.

## LIQUIDITY AND FINANCIAL RESOURCES

The Group generally finances its business needs with internal cash flows. The Group maintained a stable finance position. As at 31st December, 2006, the Group had cash and cash equivalent of US\$7,129,000 (2005: US\$12,525,000) and total borrowings of US\$25,751,000 (2005: US\$29,813,000). The ratio of net bank borrowing to total equity remained at a healthy level of approximately 17.9% (2005: 16.9%). As at 31st December, 2006, the Group had a strong financial liquidity position as revealed by a current ratio of 2.8 (2005: 2.6) times.





## **CAPITAL EXPENDITURE**

For the year ended 31st December, 2006, the Group incurred US\$4,471,000 in capital expenditure, of which 67% was used in acquisition and replacement of plant and machinery.

## **DIVIDEND**

A final dividend of Hong Kong 1.5 cent (2005: 1 HK cent) per ordinary share has been recommended, making the full-year dividend of Hong Kong 2.5 cents per ordinary share.

## **EMPLOYEES AND REMUNERATION POLICIES**

As at 31st December, 2006, the Group employed a total of approximately 16,000 employees in China. The Group adopts a competitive remuneration package for its employees. Promotion and salary increments are assessed based on performance related basis. There are incentives in the form of discretionary performance bonus and offers equal opportunities to all staff.

# CORPORATE GOVERNANCE REPORT

The Company is committed to adopting the high standards of corporate governance. The board of directors of the Company (the “Board”) believes that good governance is essential to achieving the Group’s objectives of maximizing shareholders’ value and safeguarding the interests of the shareholders.

The Code on Corporate Governance Practices (the “Code”) provides the code provisions and recommended best practices for corporate governance.

During the financial year ended 31st December, 2006, the Company complied with all requirements set out in the Code contained in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Listing Rules”), with deviation from Code provision A.4.1, A.4.2 and B.1.1 in respect of the independent non-executive directors should be appointed under a specific terms, the rotation of directors and setting up of a Remuneration Committee with specific terms, respectively. Relevant amendment to the Bye-Laws of the Company to comply with Code provision A.4.2 was approved by shareholders of the Company at the annual general meeting of the Company held in May 2006. A service contract was signed with each of the independent non-executive directors with specific terms in April 2006. Remuneration Committee was set up in April 2006 with specific written terms of reference.

## A. DIRECTORS

### A.1 The Board

The Board has the collective responsibility for leadership and control of, and for promoting the success of, the Company by directing and supervising the Company’s affairs. The Board sets strategies for the Company and monitors the performance of the management.

During the financial year ended 31st December, 2006, the Board held four regular meetings at approximately quarterly intervals according to the Code. The attendance of each director is set out as follows:–

<b>Name of Director</b>	<b>Number of attendance</b>
Mr. Wu Chen San, Thomas	4/4
Mr. Wu Jenn Chang, Michael	4/4
Mr. Wu Jenn Tzong, Jackson	4/4
Mr. Ho Chin Fa, Steven	4/4
Ms. Fang Yen Ling	2/4
Mr. Lai Jenn Yang, Jeffrey	2/4
Mr. Liu Chung Kang, Helios	2/4

## A.2 Chairman and Managing Director

The Company segregates the role of Chairman from the Managing Director. Mr. Wu Chen San, Thomas is the Chairman of the Company and Mr. Wu Jenn Chang, Michael is the Managing Director of the Company. They are brothers. The Chairman provides leadership to the Board and is responsible for the overall strategic planning and corporate development, whereas the Managing Director is responsible for policy making and corporate management in order to implement the strategies approved by the Board.

## A.3 Board composition

The Board consists of four executive directors and three independent non-executive directors:-

### **Executive directors**

Mr. Wu Chen San, Thomas

Mr. Wu Jenn Chang, Michael

Mr. Wu Jenn Tzong, Jackson

Mr. Ho Chin Fa, Steven

### **Independent non-executive directors**

Ms. Fang Yen Ling

Mr. Lai Jenn Yang, Jeffrey

Mr. Liu Chung Kang, Helios

The Board has met the recommended best practice under the Code that the number of independent non-executive directors is at least three. One independent non-executive director possesses recognized professional qualifications in accounting. The independent non-executive directors bring independent judgement, knowledge and experience to the Board.

The Company has received, from each of the independent non-executive directors, an annual confirmation of his independence pursuant to Rule 3.13 of the Listing Rules. The Company considered all of the independent non-executive directors are independent within the definition of the Listing Rules.



# CORPORATE GOVERNANCE REPORT

## A.4 Appointment, re-election and removal

The code provision A.4.1 provides that non-executive directors should be appointed for a specific terms, subject to re-election. A service contract was signed with each of the independent non-executive director with specific terms in April 2006. During the financial year ended 31st December, 2006, the non-executive directors are subject to retirement by rotation in accordance with the Bye-Law of the Company.

Each of the non-executive directors has entered into a service contract with the Company for a term of one year and continuing thereafter until terminated by either party giving to the other party a period of advance notice in writing one month.

The code provision A.4.2 provides that every director, including those appointed for a specific term, should be subject to retirement by rotation at least once every three years. According to the Bye-Laws of the Company, before the relevant amendment was approved in the annual general meeting of the Company held in May 2006, at each annual general meeting, one-third of the Directors for the time being (or, if their number is not a multiple of three (3), the number nearest to but not greater than one-third) shall retire from the office by rotation provided that notwithstanding anything herein, the Chairman of the Board and/or the Managing Director of the Company shall not, whilst holding such office, be subject to retirement by rotation or be taken into account in determining the number of Directors to retire in each year. As the Chairman of the Board and the Managing Director of the Company are not subject to retirement by rotation under the Bye-Laws of the Company, this constitutes a deviation from code provision A.4.2 of the Code.

To comply with the code provision A.4.2 of the Code, the relevant amendment to the Bye-Laws of the Company was approved by shareholders at the annual general meeting of the Company held on 17th May, 2006. Accordingly, the Chairman of the Board and the Managing Director are subject to retirement by rotation as with other directors.

## A.5 Responsibilities of directors

The directors are continually updated with the regulatory requirements, business activities and development of the Group to facilitate the discharge of their responsibilities.

The independent non-executive directors participate actively in the board meetings. They bring an independent judgement on issues of strategy, policy, performance, accountability, resources, key appointments and standards of conduct. They will lead where potential conflicts of interests arise in connected transaction. They are also members of Audit Committee.

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") as set out in Appendix 10 to the Listing Rules as its own code of conduct regarding securities transactions by the directors. Having made specific enquiry of all directors, all directors declared that they have complied with the Model Code throughout the year.

## A.6 Supply of and access to information

In respect of regular board meetings, an agenda and accompanying board papers of the meeting are sent in full to all directors at least 3 days before the intended date of a meeting.

The management has the obligation to supply the Board and the various Committees with adequate information in a timely manner to enable the members to make informed decisions. Each director has separate and independent access to the Group's senior management to acquire more information than is volunteered by management and to make further enquiries if necessary.

## A.7 Nomination Committee

The Company set up a Nomination Committee in April 2006. The Nomination Committee comprises the three independent non-executive directors. Mr. Liu Chung Kang, Helios is the chairman of the Nomination Committee.

The primary function of the Nomination Committee is to review the structure, size and composition (including the skills, knowledge and experience) of the Board on a regular basis and make recommendations to the Board regarding any proposed changes.

The chairman of the Nomination Committee will report the findings and recommendations of the Nomination Committee to the Board after each meeting. The minutes of all meetings of Nomination Committee will be circulated to the Board for information.

For the financial year ended 31st December, 2006, the Nomination Committee considered its structure, size and composition (including the skills, knowledge and experience) possesses of a diversity of skills, expertise, experience and qualifications and believed that Board would perform its duties competently.

## B. REMUNERATION OF DIRECTORS AND SENIOR MANAGEMENT

### B.1 The level and make-up of remuneration and disclosure

The code provision B.1.1 provides that the Company should establish a remuneration committee with specific written terms of reference which deal clearly with its authority and duties. A majority of the members of the remuneration committee should be independent non-executive directors.

The Company set up a remuneration committee in April 2006. The Remuneration Committee comprises the three independent non-executive directors. Mr. Lai Jenn Yang, Jeffrey is the chairman of the Remuneration Committee.

For the financial year ended 31st December, 2006, the emolument of the directors of the Company are decided by the remuneration committee, having regard to the Company's operation results, individual performance and comparable market statistics.

# CORPORATE GOVERNANCE REPORT

The Group adopts a competitive remuneration package for its employees. Promotion and salary increments are assessed based on a performance related basis.

## C. ACCOUNTABILITY AND AUDIT

### C.1 Financial reporting

The management provides such explanation and information to the Board so as to enable the Board to make an informed assessment of the financial and other information put before the Board for approval.

The directors acknowledge their responsibility to prepare the financial statements that give a true and fair view of the state of affairs of the Group. The Board was not aware of any material uncertainties relating to events or conditions that might cast significant doubt upon the Group's ability to continue as a going concern, the Board has prepared the accounts on a going concern basis.

The Company has announced its annual and interim results in a timely manner within approximately four months and three months, respectively, after the end of the relevant periods in order to enhance high level of corporate transparency.

### C.2 Internal controls

The Board is responsible for the Group's internal control system and for reviewing its effectiveness. The review should cover all moderial controls, including financial, operational and compliance controls and risk management functions. Through the Audit Committee, the Board has reviewed the effectiveness of the system. No material deficiencies have been identified so far. The Audit Committee and the Board considered the Group's internal control system effective and that there were no significant areas of concern, which might affect the shareholders of the Company. However, there is room for improvement.

The Group shall use its best endeavor to implement changes in order to further improve Company's internal control system.

### C.3 Audit Committee

An Audit Committee was established by the Company in 1999. The Audit Committee comprises the three independent non-executive directors, one of them possess recognized professional qualifications in accounting and has wide experience in audit and accounting. Ms. Fang Yin Ling is the chairman of the Audit Committee.

The primary function of the Audit Committee is to review and supervise the Group's financial reporting process and internal controls and compliance procedures, and to make recommendations to the Board on the re-appointment of the external auditors.

# CORPORATE GOVERNANCE REPORT

Two Audit Committee meetings were held during the financial year ended 31st December, 2006. The attendance of each member is set out as follows:-

<b>Name of Member</b>	<b>Number of attendance</b>
Ms. Fang Yen Ling	2/2
Mr. Lai Jenn Yang, Jeffrey	2/2
Mr. Liu Chung Kang, Helios	2/2

The chairman of the Audit Committee will report the findings and recommendations of the Audit Committee to the Board after each meeting. The minutes of all meetings of Audit Committee are circulated to the Board for information.

A summary of the work performed by the Audit Committee for the financial year ended 31st December, 2006 is set out in "Audit Committee Report" on page 19.

## **C.4 Fee paid/payable to Group's auditors**

For the financial year ended 31st December, 2006, the fee paid/payable to the Group's auditors, Messrs. Deloitte Touche Tohmatsu, is set out as follows:-

<b>Services rendered</b>	<b>Fee paid/payable</b>
	HK\$'000
Audit services	830
Non-audit services	650
Taxation services	30

## **D. DELEGATION BY THE BOARD**

### **D.1 Management functions**

The Board is responsible for determining the overall strategy and corporate development and ensuring the business operations are properly monitored. The Board reserves the right to decide all policy matters of the Group and material transactions.

The Board delegates the day-to-day operations to general managers and department heads who are responsible for different aspects of the operations of the Group.

# CORPORATE GOVERNANCE REPORT

## **D.2 Board committees**

The Company has maintained the Audit Committee throughout the year to oversee particular aspects of the Group's affairs. The Audit Committee, Remuneration Committee and Nomination Committee have specific written terms of reference which deal clearly with their authority and duties. The chairman of the Committees will report the findings and recommendations to the Board after each meeting. The minutes of all meetings of the committee are circulated to the Board for information.

## **E. COMMUNICATION WITH SHAREHOLDERS**

### **E.1 Effective communication**

The annual general meeting enables the shareholders of the Company to exchange views with the Board. The chairman of the Board and the Managing Director have attended at the annual general meeting to be available to answer the questions of the shareholders of the Company.

Separate resolutions are proposed at the annual general meeting on each substantially separate issue, including the election of individual director.

### **E.2 Voting by poll**

The right to demand a poll was set out in the circular to shareholders of the Company dispatched together with the annual report of the Company for the year ended 31st December, 2006.



# AUDIT COMMITTEE REPORT

The Audit Committee (the "Committee") has three members; three of them are independent non-executive directors.

The Committee oversees the financial reporting process. In this process, management is responsible for the preparation of the Group financial statements including the selection of suitable accounting policies. External auditors are responsible for auditing and attesting to Group financial statements and evaluating Group system of Internal controls. The Committee oversees the respective work of management and external auditors to endorse the processes and safeguards employed by them. The Committee presents a report to the Board on its findings after each Committee meeting.

The Committee reviewed and discussed with management and external auditors the consolidated financial statements for the year ended 31st December 2006 included in 2006 Annual Report. In the regard, the Committee had discussions with management with regard to new or changes in accounting policies as applied, and significant judgments affecting the Group financial statements. The Committee also received reports and met with the external auditors to discuss the general scope of their audit work (including the impact of new or changes in accounting policies as applied), their assessment of Group internal controls.

Based of these review and discussion, and the report of the external auditors, the Committee recommended to the Board approval of the consolidated financial statements for the year ended 31st December, 2006, with the Independent Auditors' Report thereon.

The Committee also reviewed and recommended to the Board approval of the unaudited financial statements for the six months ended 30th June, 2006, prior to public announcement and filing.

The Committee recommended to the Board that the shareholders be asked to re-appointed Deloitte Touche Tohmatsu as the Group's external auditors for 2007.

## MEMBERS OF THE AUDIT COMMITTEE

Ms. Fang Yen Ling  
Mr. Lai Jenn Yang, Jeffrey  
Mr. Liu Chung Kang, Helios

Hong Kong, 17th April, 2007

## BIOGRAPHICAL DATA OF DIRECTORS AND SENIOR MANAGEMENT

### EXECUTIVE DIRECTORS

Mr. Wu Chen San, Thomas, aged 56, is the Chairman of the Group and is responsible for the Group's sales, marketing and strategic planning. Mr. Wu joined the footwear business founded by his father, Mr. Wu Suei, in the early 1970's and has 37 years' experience in the footwear manufacturing business.

Mr. Wu Jenn Chang, Michael, aged 49, is the Deputy Chairman of the Group and is responsible for the Group's finance, production and purchasing. Mr. Wu is the honor Chairman of Taiwanese-invested Enterprises Association of Guangzhou and honor citizen of Guangzhou city. Mr. Wu joined the footwear business founded by his father, Mr. Wu Suei, in 1983 and has 24 years' experience in the footwear manufacturing business.

Mr. Wu Jenn Tzong, Jackson, aged 51, is responsible for the Group's sourcing functions conducted in Taiwan through the Group's subsidiary, Tospstair International (Taiwan) Ltd. Mr. Wu joined the footwear business founded by his father, Mr. Wu Suei, in 1977 and has 30 years' experience in the footwear manufacturing business.

Mr. Ho Chin Fa, Steven, age 54, is a Deputy General Manager of the Group. He is responsible for production management and staff training. Mr. Ho joined the Group in 1990 and has 24 years' experience in the footwear manufacturing business.

### NON-EXECUTIVE DIRECTORS

Ms. Fang Yen Ling, aged 48, is a partner of KPMG Peat Marwick, Certified Public Accountants, Taipei, Taiwan. She has 25 years of accounting and auditing experience. She is currently a member of the Taiwan Provincial CPA Association.

Mr. Liu Chung Kang, Helios, aged 56, is currently a director of Emo Technology Inc. and Shanghai Netup Management Software Co., Ltd. He graduated from Chiao Tung University in Taiwan. He obtained a bachelor degree in Electricity Engineering and a master degree in Management Science. Prior to joining the Company, he had more than 20 years of experience in managing software development.

Mr. Lai Jenn Yang, Jeffrey, aged 49, is currently an Executive Director of Nicematch International Co., Ltd, which is incorporated in Taiwan. Mr. Lai graduated from Tamkang University in Taiwan and obtained a bachelor degree in Civil Engineering. He also obtained a master degree in Engineering from Ohio State University, USA. Prior to joining to the Company, he had more than 20 years of experience in operation and engineering management.

# BIOGRAPHICAL DATA OF DIRECTORS AND SENIOR MANAGEMENT

## SENIOR MANAGEMENT

Mr. Lee Yiu Ming, aged 42, graduated from Hong Kong Polytechnic University and holds a Master's degree in business administration from the Queen's University of Belfast, Northern Ireland. He is an associate member of the Hong Kong Institute of Certified Public Accountants and a fellow member of the Association of Chartered Certified Accountants. Mr. Lee is a Deputy General Manager of the Group and the company secretary of the Company. He is responsible for the financial, accounting and company secretarial functions of the Group. Prior to joining the Group in May 1996, he worked for an international accounting firm for over seven years.

Mr. Yeh Ming Chieh, aged 50, is a manager of the chemical plant of Panyu Pegasus Footwear Co. Ltd. ("Panyu Pegasus"). He has 37 years' experience in footwear manufacturing and sole unit production. Prior to joining the Group in 1994, Mr. Yeh worked as a technical consultant in Taiwan, Indonesia and the PRC. He is responsible for the production management and research and development.

Ms. Lin Hui Fan, aged 56, is a senior quality assurance inspector and oversees the quality of uppers. Ms. Lin joined the Group in 1991 and has over 30 years' experience in footwear manufacturing. Ms. Lin is responsible for quality control of the Group's footwear products and has extensive experience in training quality control staff.

Mr. Hsieh Hsin Lee, aged 46, is a manager of Panyu Pegasus. Mr. Hsieh joined the Group in 1991 and has over 27 years' experience in footwear manufacturing. He is responsible for the Group's production management and quality control process. He is also responsible for staff training.

Mr. Chang Ho Hsi, aged 52, is a senior manager of administration in Panyu Pegasus. He studied Japanese in Tamkang University, and obtained a bachelor degree in literature. Mr. Chang is also a member of Taiwan Footwear Manufacturers Association in the Republic of China.

Mr. Choi Jae Deng, aged 49, is a quality assurance manager of Panyu Pegasus. Mr. Choi joined the Group in 2004 and has over 25 years' experience in footwear manufacturing and product development.

Mr. Yu Hung Hing, aged 42, is a production manager of Panyu Pegasus. Mr. Yu joined the Group in 2004 and has over 22 years' experience in footwear manufacturing and quality control.

Mr. Sun Jong Wook, aged 56, graduated from Busan National University. He is a Deputy General Manager of Chemical Division of Panyu Pegasus. Mr. Sun joined the Group in November 2003. He has 29 years' experience in sole development and manufacture.

Mr. Lee Kuo Hwa, aged 50, is a Deputy General Manager of Panyu Pegasus. Mr. Lee graduated from East Texas State University, Texas, the US and holds a Master's degree in computer science. He is responsible for production management of the Group. Mr. Lee has 13 years' experience in footwear manufacturing business.

## DIRECTORS' REPORT

The directors present their annual report and the audited consolidated financial statements for the year ended 31st December, 2006.

### PRINCIPAL ACTIVITIES

The Company is an investment holding company. The Group is engaged principally in the manufacture and sale of footwear products. The activities of its associates, jointly controlled entities and principal subsidiaries are set out in notes 15, 16 and 32, respectively, to the consolidated financial statements.

### RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31st December, 2006 are set out in the consolidated income statement on page 30.

An interim dividend of Hong Kong 1 cent per ordinary share, amounting to US\$943,000 was paid to the shareholders during the year. The directors now recommend the payment of a final dividend of HK1.5 cent per ordinary share to the shareholders on the register of members on 17th May, 2007, amounting to US\$1,414,000.

### PROPERTY, PLANT AND EQUIPMENT

The buildings of the Group were revalued at 31st December, 2006. The revaluation resulted in a surplus over book values amounting to US\$1,192,000, which has been credited directly to the revaluation reserve.

The Group continued its plant replacement policy spent US\$2,979,000 on new plant and machinery during the year.

Details of these and other movements during the year in the property, plant and equipment of the Group are set out in note 13 to the consolidated financial statements.

### SHARE CAPITAL

Details of the share capital of the Company are set out in note 24 to the consolidated financial statements.

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

## DISTRIBUTABLE RESERVES OF THE COMPANY

As at 31st December, 2006, the Company's reserves available for distribution to shareholders consisted of accumulated profits, dividend reserve and contributed surplus, totalling approximately US\$20,912,000 (2005: US\$22,683,000).

Under the Companies Act 1981 of Bermuda (as amended), the contributed surplus account of the Company is available for distribution. However, a Company cannot declare or pay a dividend, or make a distribution out of contributed surplus if:

- (a) the Company is, or would after the payment be, unable to pay its liabilities as they become due; or
- (b) the realisable value of the Company's assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts.

## DIRECTORS

The directors of the Company during the year and up to the date of this report were:

Executive directors:

Mr. Wu Chen San, Thomas                      *(Chairman)*  
Mr. Wu Jenn Chang, Michael                *(Deputy Chairman)*  
Mr. Wu Jenn Tzong, Jackson  
Mr. Ho Chin Fa, Steven  
Mr. Yang Chih Chieh, Arthur                (resigned on 20th October, 2006)

Independent non-executive directors:

Ms. Fang Yen Ling  
Mr. Lai Jenn Yang, Jeffrey  
Mr. Liu Chung Kang, Helios

In accordance with Clause 87(1) of the Company's Bye-laws, Messrs. Wu Chen San, Thomas, Wu Jenn Chang, Michael and Ho Chin Fa, Steven, retire by rotation and, being eligible, offer themselves for re-election at the forthcoming annual general meeting.

The terms of office of independent non-executive directors are subject to retirement by rotation in accordance with the provisions of the Company's Bye-laws.

The Company has received, from each of the independent non-executive directors, an annual confirmation of his independence pursuant to Rule 3.13 of the Rules Governing the Listing Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). The Company considers all of the independent non-executive directors are independent.



# DIRECTORS' REPORT

## DIRECTORS' SERVICE CONTRACTS

Each of the executive directors has entered into a service contract with the Company for a term of three years commencing 25th September, 1996 and continuing thereafter until terminated by either party giving to the other party a period of advance notice in writing ranging from three to six months.

None of the directors being proposed for re-election at the forthcoming annual general meeting has an unexpired service contract with the Company or 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 SHARES

At 31st December, 2006, the interests of the directors and their associates in the shares, underlying shares or debentures of the Company and its associated corporation, as recorded in the register maintained by the Company pursuant to Section 352 of the Securities and Futures Ordinance (the "SFO"), or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by the Directors of Listed Companies, were as follows:

### Long positions

(a) Ordinary shares of HK\$0.10 each of the Company

Name of director	Capacity	Number of issued ordinary shares held	Percentage of the issued share capital of the Company
Wu Jenn Chang, Michael	Beneficial owner	8,000,000	1.09%
Wu Jenn Tzong, Jackson	Beneficial owner	1,000,000	0.14%
		<u>9,000,000</u>	<u>1.23%</u>

(b) Ordinary shares of the associated corporation of the Company

Pegasus Footgear Management Limited (note 1)

Name of director	Capacity	Number of issued ordinary shares held	Percentage of the issued share capital of the associated corporation
Wu Chen San, Thomas	Beneficial owner (note 2)	3,235	16%
Wu Jenn Chang, Michael	Corporate (note 3)	6,470	32%
Wu Jenn Tzong, Jackson	Corporate (note 4)	6,470	32%
		<u>16,175</u>	<u>80%</u>

(b) **Ordinary shares of the associated corporation of the Company** *(continued)*

Notes:

1. Pegasus Footgear Management Limited is the holding company of the Company.
2. The shares are jointly held by Mr. Wu Chen San, Thomas and Mrs. Peggy Wu, the spouse of Mr. Wu Chen San, Thomas.
3. The shares are entirely held by M. W. Investment Limited, a company owned by Mr. Wu Jenn Chang, Michael.
4. The shares are entirely held by J. W. Investment Limited, a company owned by Mr. Wu Jenn Tzong, Jackson.

Save as disclosed above, at 31st December, 2006, none of the directors nor their associates had any interests or short positions in the shares, underlying shares or debentures of the Company or any associated corporation.

## SHARE OPTIONS

Particulars of the Company's share option scheme are set out in note 25 to the consolidated financial statements.

No share options were granted or exercised during the year ended 31st December, 2006. As at 31st December, 2006, no share options of the Company were outstanding.

## ARRANGEMENTS TO ACQUIRE SHARES OR DEBENTURES

At no time during the year was the Company, its holding company or any of its subsidiaries, a party to any arrangements to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

## DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

Other than as disclosed in note 30 to the consolidated financial statements, no contracts of significance to which the Company, its holding company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

# DIRECTORS' REPORT

## SUBSTANTIAL SHAREHOLDERS

As at 31st December, 2006, the register of substantial shareholders maintained by the Company pursuant to Section 336 of the SFO shows that, other than the interests disclosed in "Directors' Interest in Shares", the following shareholder had notified the Company of relevant interest in the issued share capital of the Company.

### Long position

Ordinary shares of HK\$0.10 each of the Company

Name of shareholder	Capacity	Number of issued ordinary shares held	Percentage of the issued share capital of the Company
			%
Pegasus Footgear Management Limited (note)	Beneficial owner	468,743,940	64

Note: Details of the directors' interests in Pegasus Footgear Management Limited are disclosed under the section headed "Directors' Interests in Shares".

Save as disclosed above, the Company has not been notified of any other relevant interests or short position in the issued share capital of the Company as at 31st December, 2006.

## MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31st December, 2006, the largest customer of the Group accounted for approximately 65% of the Group's turnover. The five largest customers accounted for approximately 88% of the Group's turnover. For the year ended 31st December, 2006, the aggregate purchases attributable to the Group's five largest suppliers were less than 30% of total purchases.

None of the directors, their associates or any shareholder of the Company which, to the knowledge of the directors, owned more than 5% of the Company's issued share capital had any interest in any of the five largest customers of the Group.

## EMOLUMENTS POLICY

The emoluments policy of the employees of the Group is set up by the board of directors on the basis of their merit, qualifications and competence.

The emoluments of the directors of the Company are decided by the remuneration committee, as authorised by shareholders at the annual general meeting, having regard to the Group's operating results, individual performance and comparable market statistics.

The Company has adopted a share option scheme as an incentive to directors and eligible employees. Details of the scheme are set out in note 25 to the consolidated financial statements.

## SUFFICIENCY OF PUBLIC FLOAT

The Company has maintained a sufficient public float throughout the year ended 31st December, 2006.

## PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's Bye-laws or the laws of Bermuda which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

## AUDITORS

A resolution will be submitted to the annual general meeting to re-appoint Messrs. Deloitte Touche Tohmatsu as auditors of the Company.

On behalf of the Board

**Wu Chen San, Thomas**

*CHAIRMAN*

Hong Kong, 17th April, 2007

# Deloitte.

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### TO THE MEMBERS OF PEGASUS INTERNATIONAL HOLDINGS LIMITED

*(incorporated in Bermuda with limited liability)*

We have audited the consolidated financial statements of Pegasus International Holdings Limited (the "Company") and its subsidiaries (collectively referred to as the "Group") set out on pages 30 to 67, which comprise the consolidated balance sheet as at 31st December, 2006, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

#### **Directors' responsibility for the financial statements**

The directors of the Company are responsible for the preparation and the true and fair presentation of these consolidated financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

#### **Auditor's responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to report our opinion solely to you, as a body, in accordance with Section 90 of the Bermuda Companies Act, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the consolidated financial statements are free from material misstatement.

# INDEPENDENT AUDITOR'S REPORT

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and true and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **Opinion**

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Group as at 31st December, 2006 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

## **Deloitte Touche Tohmatsu**

*Certified Public Accountants*

Hong Kong

17th April, 2007



# CONSOLIDATED INCOME STATEMENT

For the year ended 31st December, 2006

	NOTES	2006 US\$'000	2005 US\$'000
Revenue	6	141,465	141,242
Cost of sales		(118,331)	(117,946)
Gross profit		23,134	23,296
Other income		1,162	859
Selling and distribution costs		(7,971)	(8,506)
Administrative expenses		(11,554)	(11,798)
Share of results of associates		52	181
Share of results of jointly controlled entities		127	(76)
Interest on bank borrowings wholly repayable within five years		(1,400)	(1,199)
Profit before taxation	7	3,550	2,757
Taxation	10	(430)	(290)
Profit for the year		3,120	2,467
Dividends paid	11	1,886	–
Earnings per share	12		
Basic		0.43 US cents	0.34 US cents

# CONSOLIDATED BALANCE SHEET

At 31st December, 2006

	NOTES	2006 US\$'000	2005 US\$'000
<b>Non-current assets</b>			
Property, plant and equipment	13	62,208	65,136
Prepaid lease payments	14	5,256	5,396
Interests in associates	15	944	1,012
Interests in jointly controlled entities	16	2,550	2,423
		<b>70,958</b>	<b>73,967</b>
<b>Current assets</b>			
Inventories	17	50,296	45,819
Trade and other receivables	18	14,584	13,634
Prepaid lease payments	14	137	136
Amount due from an associate	15	12	8
Held for trading investments	19	361	–
Bank balances and cash	20	7,129	12,525
		<b>72,519</b>	<b>72,122</b>
<b>Current liabilities</b>			
Trade and other payables	21	10,468	11,664
Tax payable		666	446
Unsecured bank borrowings – due within one year	22	14,701	15,858
		<b>25,835</b>	<b>27,968</b>
<b>Net current assets</b>			
		<b>46,684</b>	<b>44,154</b>
		<b>117,642</b>	<b>118,121</b>
<b>Capital and reserves</b>			
Share capital	24	9,428	9,428
Reserves		94,762	92,658
<b>Total equity</b>			
		<b>104,190</b>	<b>102,086</b>
<b>Non-current liabilities</b>			
Unsecured bank borrowings – due after one year	22	11,050	13,955
Deferred tax liabilities	26	2,402	2,080
		<b>13,452</b>	<b>16,035</b>
		<b>117,642</b>	<b>118,121</b>

The consolidated financial statements on pages 30 to 67 were approved and authorised for issue by the Board of Directors on 17th April, 2007 and are signed on its behalf by:

**Wu Chen San, Thomas**  
DIRECTOR

**Mu Jenn Chang, Michael**  
DIRECTOR

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31st December, 2006

	Attributable to equity holders of the Company						Total US\$'000
	Share capital	Share premium	Revaluation reserve	Merger reserve	Dividend reserve	Accumulated profits	
	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	
At 1st January, 2005	9,428	21,644	2,504	(4,512)	–	69,365	98,429
Revaluation increase on buildings	–	–	1,630	–	–	–	1,630
Deferred tax liability arising on revaluation of buildings (note 26)	–	–	(440)	–	–	–	(440)
Net income recognised directly in equity	–	–	1,190	–	–	–	1,190
Profit for the year	–	–	–	–	–	2,467	2,467
Total recognised income for the year	–	–	1,190	–	–	2,467	3,657
Final dividends proposed for 2005	–	–	–	–	943	(943)	–
At 31st December, 2005	9,428	21,644	3,694	(4,512)	943	70,889	102,086
Revaluation increase on buildings	–	–	1,192	–	–	–	1,192
Deferred tax liability arising on revaluation of buildings (note 26)	–	–	(322)	–	–	–	(322)
Net income recognised directly in equity	–	–	870	–	–	–	870
Profit for the year	–	–	–	–	–	3,120	3,120
Total recognised income for the year	–	–	870	–	–	3,120	3,990
Final dividends paid for 2005	–	–	–	–	(943)	–	(943)
Interim dividends paid for 2006	–	–	–	–	–	(943)	(943)
Final dividends proposed for 2006	–	–	–	–	1,414	(1,414)	–
<b>At 31st December, 2006</b>	<b>9,428</b>	<b>21,644</b>	<b>4,564</b>	<b>(4,512)</b>	<b>1,414</b>	<b>71,652</b>	<b>104,190</b>

The merger reserve of the Group represents the difference between the nominal amount of the share capital of the subsidiaries acquired and the nominal value of the share capital of the acquiring companies issued in exchange pursuant to a corporate reorganisation prior to the listing of the Company's shares in 1996.

# CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31st December, 2006

	2006 US\$'000	2005 US\$'000
<b>OPERATING ACTIVITIES</b>		
Profit before taxation	3,550	2,757
Adjustments for:		
Interest income	(235)	(107)
Share of results of associates	(52)	(181)
Share of results of jointly controlled entities	(127)	76
Depreciation of property, plant and equipment	8,583	8,162
Release of prepaid lease payments	139	136
Impairment loss on trade receivables	284	364
Gain on fair value changes of held for trading investments	(98)	–
Loss on disposal of property, plant and equipment	8	101
Interest paid	1,400	1,199
Operating cash flows before movements in working capital	13,452	12,507
Increase in inventories	(4,477)	(774)
(Increase) decrease in trade and other receivables	(1,234)	1,076
(Increase) decrease in amount due from an associate	(4)	6
Increase in held for trading investments	(263)	–
Decrease in trade and other payables	(1,196)	(41)
Cash generated from operations	6,278	12,774
Hong Kong Profits Tax refunded (paid)	8	(7)
Taxation in other jurisdictions (paid) refunded	(218)	134
<b>NET CASH FROM OPERATING ACTIVITIES</b>	<b>6,068</b>	<b>12,901</b>
<b>INVESTING ACTIVITIES</b>		
Purchase of property, plant and equipment	(4,471)	(4,346)
Interest received	235	107
Dividend received from associates	120	–
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(4,116)</b>	<b>(4,239)</b>
<b>FINANCING ACTIVITIES</b>		
Repayment of bank loans	(15,522)	(14,590)
Repayment of trust receipt loans	(2,764)	(9,053)
Dividends paid	(1,886)	–
Interest paid	(1,400)	(1,199)
Bank loans raised	11,000	15,319
Trust receipt loans raised	3,224	7,694
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(7,348)</b>	<b>(1,829)</b>
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(5,396)</b>	<b>6,833</b>
<b>CASH AND CASH EQUIVALENTS AT 1ST JANUARY</b>	<b>12,525</b>	<b>5,692</b>
<b>CASH AND CASH EQUIVALENTS AT 31ST DECEMBER,</b> represented by bank balances and cash	<b>7,129</b>	<b>12,525</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 1. GENERAL

The Company is a public limited company incorporated in Bermuda as an exempted company with limited liability and its shares are listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). The directors consider Pegasus Footgear Management Limited, a company incorporated in the British Virgin Islands, to be the ultimate and immediate holding company of the Company. The addresses of the registered office and principal place of business of the Company are disclosed in the corporate information.

The consolidated financial statements are presented in United States dollars, which is the same as the functional currency of the Company.

The principal activities of the Company and its subsidiaries (the "Group") are manufacture and sale of footwear products.

## 2. APPLICATION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

In the current year, the Group has applied, for the first time, a number of new standard, amendments and interpretations ("new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which are either effective for accounting periods beginning on or after 1st December, 2005 or 1st January, 2006. The adoption of the new HKFRSs had no material effect on how the results and financial position for the current or prior accounting years have been prepared and presented. Accordingly, no prior year adjustment has been required.

The Group has not early applied the following new standards, amendment or interpretations that have been issued but are not yet effective. The directors of the Company anticipate that the application of these standards, amendment or interpretations will have no material impact on the results and the financial position of the Group.

HKAS 1 (Amendment)	Capital disclosures <sup>1</sup>
HKFRS 7	Financial instruments: Disclosures <sup>1</sup>
HKFRS 8	Operating Segments <sup>2</sup>
HK(IFRIC) – INT 7	Applying the restatement approach under HKAS 29 Financial Reporting in Hyperinflationary Economies <sup>3</sup>
HK(IFRIC) – INT 8	Scope of HKFRS 2 <sup>4</sup>
HK(IFRIC) – INT 9	Reassessment of embedded derivatives <sup>5</sup>
HK(IFRIC) – INT 10	Interim financial reporting and impairment <sup>6</sup>
HK(IFRIC) – INT 11	HKFRS 2 – Group and Treasury Share Transactions <sup>7</sup>
HK(IFRIC) – INT 12	Service Concession Arrangements <sup>8</sup>

<sup>1</sup> Effective for annual periods beginning on or after 1st January, 2007.

<sup>2</sup> Effective for annual periods beginning on or after 1st January 2009.

<sup>3</sup> Effective for annual periods beginning on or after 1st March, 2006.

<sup>4</sup> Effective for annual periods beginning on or after 1st May, 2006.

<sup>5</sup> Effective for annual periods beginning on or after 1st June, 2006.

<sup>6</sup> Effective for annual periods beginning on or after 1st November, 2006.

<sup>7</sup> Effective for annual periods beginning on or after 1st March, 2007.

<sup>8</sup> Effective for annual periods beginning on or after 1st January, 2008.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis except for certain properties and financial instruments, which are measured at revalued amounts or fair values, as explained in the accounting policies set out below.

The consolidated financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards issued by the HKICPA. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on the Stock Exchange and by the Hong Kong Companies Ordinance.

### **Basis of consolidation**

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

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

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

### **Revenue recognition**

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts and sales related taxes.

Sales of goods are recognised when goods are delivered and title has passed.

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

### **Property, plant and equipment**

Property, plant and equipment, other than construction in progress, are stated at cost or fair value less subsequent accumulated depreciation and accumulated impairment losses.

Buildings held for use in the production or supply of goods or services, or for administrative purposes, are stated in the consolidated balance sheet at their revalued amount, being the fair value at the date of revaluation less any subsequent accumulated depreciation and any subsequent accumulated impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### **Property, plant and equipment** *(continued)*

Any revaluation increase arising on revaluation of buildings is credited to the revaluation reserve, except to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense, in which case the increase is credited to the consolidated income statement to the extent of the decrease previously charged. A decrease in net carrying amount arising on revaluation of an asset is dealt with as an expense to the extent that it exceeds the balance, if any, on the revaluation reserve relating to a previous revaluation of that asset. On the subsequent sale or retirement of a revalued asset, the attributable revaluation surplus is transferred to accumulated profits.

Depreciation is provided to write off the cost or fair value of items of property, plant and equipment, other than construction in progress, over their estimated useful lives and after taking into account their estimated residual value, using the straight-line method.

Construction in progress represents property, plant and equipment in the course of construction for production or for its own use purpose. Construction in progress is carried at cost less any recognised impairment loss. Construction in progress is classified to the appropriate category of property, plant and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the consolidated income statement in the year in which the item is derecognised.

### **Investments in associates**

An associate is an entity over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

The results and assets and liabilities of associates are incorporated in the consolidated financial statements using the equity method of accounting. Under the equity method, investments in associates are carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of the net assets of the associate, less any identified impairment loss. When the Group's share of losses of an associate equals or exceeds its interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognising its share of further losses. An additional share of losses is provided for and a liability is recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that associate.

Where a group entity transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant associate.



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### Joint ventures

#### Jointly controlled entities

Joint venture arrangements that involve the establishment of a separate entity in which venturers have joint control over the economic activity of the entity are referred to as jointly controlled entities.

The results and assets and liabilities of jointly controlled entities are incorporated in the consolidated financial statements using the equity method of accounting. Under the equity method, investments in jointly controlled entities are carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of net assets of the jointly controlled entities, less any identified impairment loss. When the Group's share of losses of a jointly controlled entity equals or exceeds its interest in that jointly controlled entity (which includes any long-term interests that, in substance, form part of the Group's net investment in the jointly controlled entity), the Group discontinues recognising its share of further losses. An additional share of losses is provided for and a liability is recognised only to the extent that the Group has incurred legal constructive obligations or made payments on behalf of that jointly controlled entity.

When a group entity transacts with a jointly controlled entity of the Group, unrealised profits or losses are eliminated to the extent of the Group's interest in the jointly controlled entity, except to the extent that unrealised losses provide evidence of an impairment of the asset transferred, in which case, the full amount of losses is recognised.

#### Impairment

At each balance sheet date, the Group reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

#### Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the first-in, first-out method. Cost comprises direct materials and, when applicable, direct labour costs and those overhead that have been incurred in bringing the inventories to their present location and condition. Net realisable value represents the estimated selling price less any estimated costs of completion and costs to be incurred in marketing, selling and distribution.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight-line basis.

The land and building elements of a lease of land and building are considered separately for the purpose of lease classification, leasehold land which is not expected to pass to the lessee by the end of the lease term is classified as an operating lease unless the lease payment cannot be associated reliably between the land and building elements, in which case, the entire lease is classified as a finance lease.

### Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in the respective functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognised in profit or loss in the period in which they arise. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity, in which cases, the exchange differences are also recognised directly in equity.

For the purposes of presenting the consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into the presentation currency of the Group (i.e. United States dollars) at the rate of exchange prevailing at the balance sheet date, and their income and expenses are translated at the average exchange rates for the year, unless exchange rates fluctuate significantly during the period, in which case, the exchange rates prevailing at the dates of transactions are used. Exchange differences arising, if any, are recognised as a separate component of equity (the translation reserve). Such exchange differences are recognised in profit or loss in the period in which the foreign operation is disposed of.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### **Taxation**

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax base used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised. Deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

### **Retirement benefits schemes**

Payments to state-managed retirement benefit schemes and the Mandatory Provident Fund Scheme, which are defined contribution schemes, are charged as an expense when employees have rendered service entitling them to the contributions.

### **Financial instruments**

Financial assets and financial liabilities are recognised on the balance sheet when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### **Financial instruments** *(continued)*

#### **Financial assets**

The Group's financial assets are classified into held for trading investments and loans and receivables. All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace. The accounting policies adopted in respect of financial assets are set out below.

#### *Held for trading investments*

At each balance sheet date subsequent to initial recognition, held for trading investments are measured at fair value, with changes in fair value recognised directly in profit or loss in the period in which they arise.

#### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables (including trade and other receivables, bank balances and amount due from an associate) are carried at amortised cost using the effective interest method, less any identified impairment losses. An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

#### **Financial liabilities and equity**

Financial liabilities and equity instruments issued by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument.

An equity instrument is any contract that evidences a residual interest in the assets of the group entity after deducting all of its liabilities. The Group's financial liabilities are generally classified into financial liabilities at fair value through profit or loss and other financial liabilities. The accounting policies adopted in respect of financial liabilities and equity instruments are set out below.

#### *Financial liabilities at fair value through profit or loss*

Financial liabilities at fair value through profit or loss has two subcategories, including financial liabilities held for trading and those designated at fair value through profit or loss on initial recognition. At each balance sheet date subsequent to initial recognition, financial liabilities at fair value through profit or loss are measured at fair value, with changes in fair value recognised directly in profit or loss in the period in which they arise.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### **Financial instruments** *(continued)*

#### **Financial liabilities and equity** *(continued)*

##### *Other financial liabilities*

Other financial liabilities, including bank borrowings and trade and other payables, are subsequently measured at amortised cost, using the effective interest method.

##### *Equity instruments*

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

##### *Derivative financial instruments and hedging*

The Group uses derivative financial instruments (primarily foreign exchange forward contracts) to hedge its exposure against foreign currency risk. Such derivatives are measured at fair value regardless of whether they are designated as effective hedging instruments.

Derivatives of the Group that do not qualify for hedge accounting are deemed as financial assets held for trading or financial liabilities held for trading. Changes in fair values of such derivatives are recognised directly in profit or loss.

### **Derecognition**

Financial assets are derecognised when the rights to receive cash flows from the assets expire or, the financial assets are transferred and the Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised directly in equity is recognised in profit or loss.

Financial liabilities are derecognised when the obligation specified in the relevant contract is discharged, cancelled or expires. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

## 4. KEY SOURCES OF ESTIMATION UNCERTAINTY

In the process of applying the Group's accounting policies which are described in note 3, management has made the following estimation that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities recognised in the financial statements within the next financial year are discussed below.

### **Estimated impairment of trade receivables**

When there is objective evidence of impairment loss, the Group takes into consideration the estimation of future cash flows. The amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). Where the actual future cash flows are less than expected, a material impairment loss may arise.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 4. KEY SOURCES OF ESTIMATION UNCERTAINTY *(continued)*

### Income taxes

At 31st December, 2006, a deferred tax asset of US\$691,000 in relation to deductible temporary difference has been recognised in the Group's balance sheet. No deferred tax asset has been recognised on the tax losses and deductible temporary difference of US\$5,778,000 and US\$14,573,000 respectively due to the unpredictability of future profit streams. The realisability of the deferred tax asset mainly depends on whether sufficient future profits or taxable temporary differences will be available in the future. In cases where the actual future profits generated are less than expected, a material reversal of deferred tax assets may arise, which would be recognised in the consolidated income statement for the period in which such a reversal takes place.

## 5. FINANCIAL INSTRUMENTS

### a. Financial risk management objectives and policies

The Group's major financial instruments include equity instruments, bank balances, borrowings, trade receivables and trade payables. Details of these financial instruments are disclosed in the respective notes. The risks associated with these financial instruments and the policies on how to mitigate these risks are set out below. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

#### Currency risk

Certain trade receivables and trade payables of the Group are denominated in currencies other than functional currency at the relevant group entities. The Group currently does not have a foreign currency hedging policy. However, the management monitors foreign exchange exposure and will enter into foreign currency forward contracts in order to mitigate the foreign currency risk, if necessary.

#### Credit risk

The Group's maximum exposure to credit risk in the event of the counterparties failure to perform their obligations as at 31st December, 2006 in relation to each class of recognised financial assets is the carrying amount of those assets as stated in the consolidated balance sheet.

The Group's concentration of credit risk by geographical locations is mainly concentrated in North America, Europe and Asia, which accounted for approximately 96% of the Group's trade receivables as at 31st December, 2006.

In order to minimise the credit risk, the management of the Group has delegated a team responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews the recoverable amount of each individual trade receivables at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors of the Company consider that the Group's credit risk is significantly reduced.

The credit risk on liquid funds is limited because the counterparties are banks with high credit-rating.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 5. FINANCIAL INSTRUMENTS *(continued)*

### a. Financial risk management objectives and policies *(continued)*

#### Cash flow interest rate risk

All borrowings of the Group are arranged at floating rates. The Group currently does not have a hedging policy on interest rate risk. However, the management monitors interest rate exposure and will consider interest rate swap contracts should the need arise.

### b. Fair value

The fair value of financial assets and financial liabilities are determined as follows:

- the fair value of financial assets with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market bid prices;
- the fair value of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models based on discounted cash flow analysis or using prices from observable current market transactions; and
- the fair value of derivative instruments, are calculated using quoted prices.

The directors consider that the carrying amounts of financial assets and financial liabilities recorded at amortised cost in the consolidated financial statements approximate their fair values.



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 6. SEGMENT INFORMATION

### Geographical segments

For management purposes, the Group is currently organised into three major geographical segments based on the location of its customers. These segments are the bases on which the Group reports its primary segment information.

The following is an analysis of the Group's sales by geographical market, irrespective of the origin of the goods:

2006

	North America US\$'000	Asia US\$'000	Europe US\$'000	Others US\$'000	Consolidated US\$'000
REVENUE					
External sales of goods	75,065	21,702	38,013	6,685	141,465
RESULTS					
Segment results	10,512	2,370	5,324	936	19,142
Other income					1,162
Unallocated corporate expenses					(15,533)
Share of results of associates	-	52	-	-	52
Share of results of jointly controlled entities	-	127	-	-	127
Interest on bank borrowings wholly repayable within five years					(1,400)
Profit before taxation					3,550
Taxation					(430)
Profit for the year					3,120

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 6. SEGMENT INFORMATION *(continued)*

### Geographical segments *(continued)*

2006 *(continued)*

	North America US\$'000	Asia US\$'000	Europe US\$'000	Others US\$'000	Consolidated US\$'000
BALANCE SHEET					
ASSETS					
Interests in associates	-	944	-	-	944
Interests in jointly controlled entities	-	2,550	-	-	2,550
Unallocated corporate assets					139,983
Consolidated total assets					143,477
LIABILITIES					
Unallocated corporate liabilities and consolidated total liabilities					39,287

	North America US\$'000	Asia US\$'000	Europe US\$'000	Others US\$'000	Unallocated US\$'000	Consolidated US\$'000
OTHER INFORMATION						
Impairment loss on trade receivables	284	-	-	-	-	284
Capital additions	-	-	-	-	4,471	4,471
Depreciation	-	-	-	-	8,583	8,583

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 6. SEGMENT INFORMATION *(continued)*

### Geographical segments *(continued)*

2005

	North America US\$'000	Asia US\$'000	Europe US\$'000	Others US\$'000	Consolidated US\$'000
REVENUE					
External sales of goods	87,313	20,550	24,464	8,915	141,242
RESULTS					
Segment results	12,626	2,619	3,538	1,289	20,072
Other income					859
Unallocated corporate expenses					(17,080)
Share of results of associates	-	181	-	-	181
Share of results of jointly controlled entities	-	(76)	-	-	(76)
Interest on bank borrowings wholly repayable within five years					(1,199)
Profit before taxation					2,757
Taxation					(290)
Profit for the year					2,467

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 6. SEGMENT INFORMATION *(continued)*

### Geographical segments *(continued)*

2005 *(continued)*

	North				Consolidated
	America	Asia	Europe	Others	US\$'000
	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000
BALANCE SHEET					
ASSETS					
Interests in associates	-	1,012	-	-	1,012
Interests in jointly controlled entities	-	2,423	-	-	2,423
Unallocated corporate assets					142,654
Consolidated total assets					<u>146,089</u>
LIABILITIES					
Unallocated corporate liabilities and consolidated total liabilities					<u>44,003</u>

	North				Unallocated	Consolidated
	America	Asia	Europe	Others	US\$'000	US\$'000
	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000
OTHER INFORMATION						
Impairment loss on trade receivables	364	-	-	-	-	364
Capital additions	-	-	-	-	4,346	4,346
Depreciation	-	-	-	-	8,162	8,162

The Group's operations are located in Mainland China (the "PRC"), Hong Kong and Taiwan.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 6. SEGMENT INFORMATION *(continued)*

The following is an analysis of the carrying amount of segment assets and additions to property, plant and equipment, as analysed by the geographical area in which the assets are located:

	Carrying amount of segment assets		Additions to property, plant and equipment	
	2006 US\$'000	2005 US\$'000	2006 US\$'000	2005 US\$'000
PRC	107,037	105,204	4,464	4,341
Hong Kong	24,274	24,652	7	5
Taiwan	1,170	265	-	-
	<b>132,481</b>	130,121	<b>4,471</b>	4,346

### Business segments

No analysis of financial information by business segment is presented as all the Group's turnover and trading results are generated from the manufacture and sale of footwear products.

## 7. PROFIT BEFORE TAXATION

	2006 US\$'000	2005 US\$'000
Profit before taxation has been arrived at after charging:		
Directors' emoluments (note 8)	722	802
Other staff costs	34,523	32,985
Retirement benefits scheme contributions (excluding contributions in respect of directors)	1,882	1,462
Total staff costs	<b>37,127</b>	35,249
Auditors' remuneration	101	137
Cost of inventories recognised as an expense	118,331	117,946
Depreciation of property, plant and equipment	8,583	8,162
Impairment loss on trade receivables	284	364
Loss on disposal of property, plant and equipment	8	101
Net foreign exchange losses	404	29
Release of prepaid lease payments	139	136
and after crediting:		
Gain on fair value changes of held for trading investments	98	-
Interest income	235	107

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 8. DIRECTORS' EMOLUMENTS

The emoluments paid or payable to each of the 8 (2005: 9) directors were as follows:

### 2006

	Wu Chen San, Thomas US\$'000	Wu Jenn Chang, Michael US\$'000	Wu Jenn Tzong, Jackson US\$'000	Ho Chin Fa, Steven US\$'000	Yang Chih Chieh, Arthur US\$'000	Fang Yen Ling US\$'000	Lai Jenn Yang, Jeffrey US\$'000	Liu Chung Kang, Helios US\$'000	Total US\$'000
Fees	24	12	12	12	9	8	8	8	93
Other emoluments									
Salaries and other benefits	198	167	71	96	-	-	-	-	532
Bonus	33	28	-	36	-	-	-	-	97
	<b>255</b>	<b>207</b>	<b>83</b>	<b>144</b>	<b>9</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>722</b>

### 2005

	Wu Chen San, Thomas US\$'000	Wu Jenn Chang, Michael US\$'000	Wu Jenn Tzong, Jackson US\$'000	Ho Chin Fa, Steven US\$'000	Yang Chih Chieh, Arthur US\$'000	Fang Yen Ling US\$'000	Lai Jenn Yang, Jeffrey US\$'000	Liu Chung Kang, Helios US\$'000	Chang Ho Hsi US\$'000	Total US\$'000
Fees	24	12	12	12	12	8	4	8	4	96
Other emoluments										
Salaries and other benefits	198	167	71	97	74	-	-	-	-	607
Bonus	33	28	-	38	-	-	-	-	-	99
	<b>255</b>	<b>207</b>	<b>83</b>	<b>147</b>	<b>86</b>	<b>8</b>	<b>4</b>	<b>8</b>	<b>4</b>	<b>802</b>

The performance related incentive payment is determined with reference to the Group's operating results, individual performance and the comparable market statistics.

No directors waived any emoluments in the years ended 31st December, 2006 and 2005.



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 9. EMPLOYEES' EMOLUMENTS

The five highest paid individuals of the Group included three executive directors (2005: 3 executive directors) of the Company, whose emoluments are included in the disclosure in note 8 above. The emoluments of the remaining two (2005: two) highest paid individual were as follows:

	2006 US\$'000	2005 US\$'000
Basic salaries and allowances	271	265
Retirement benefits scheme contributions	2	2
	<b>273</b>	<b>267</b>

The emoluments of these highest paid employees were within the following bands:

	Number of employees	
	2006	2005
Nil to HK\$1,000,000 (equivalent to Nil to US\$129,032)	1	1
HK\$1,000,001 to HK\$1,500,000 (equivalent to US\$129,033 to US\$193,548)	1	1

## 10. TAXATION

	2006 US\$'000	2005 US\$'000
Current taxation:		
Hong Kong	8	9
PRC	393	256
Taiwan	30	27
	<b>431</b>	<b>292</b>
Overprovision in prior years:		
Hong Kong	(1)	(2)
Taxation attributable to the Company and its subsidiaries	<b>430</b>	<b>290</b>

Hong Kong Profits Tax is calculated at 17.5% of the estimated assessable profits for both years.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 10. TAXATION *(continued)*

PRC income tax is charged at 27% or 33% on the assessable profits of the PRC subsidiaries. Pursuant to the relevant laws and regulations in the PRC, certain of the Company's PRC subsidiaries are eligible for certain tax concessions and are exempted from PRC income taxes.

Taxation arising in other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions.

Save as disclosed above, in the opinion of the directors, the Group is not subject to taxation in any other jurisdictions.

Details of the deferred taxation are set out in note 26.

The tax charge for the year can be reconciled to the profit per the consolidated income statement as follows:

	2006 US\$'000	2005 US\$'000
Profit before taxation	<b>3,550</b>	2,757
Tax at the domestic income tax rate of 33%	<b>1,172</b>	910
Tax effect of share of results of associates/ jointly controlled entities	<b>(59)</b>	(35)
Tax effect of expenses not deductible for tax purposes	<b>757</b>	1,145
Tax effect of income not taxable for tax purposes	<b>(2,517)</b>	(2,340)
Overprovision in prior years	<b>(1)</b>	(2)
Tax effect of tax losses/deferred tax assets not recognised	<b>1,225</b>	742
Effect of tax holidays and concessions granted to PRC subsidiaries	<b>(137)</b>	(115)
Effect of different tax rates of subsidiaries operating in other jurisdictions	<b>(10)</b>	(15)
Tax charge for the year	<b>430</b>	290

Note: The domestic tax rate in the jurisdiction where the operations of the Group is substantially based is used.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 11. DIVIDENDS

	2006 US\$'000	2005 US\$'000
Dividends recognised as distribution during the year:		
Final, paid – HK1 cent for 2005 (2004: Nil) per share	943	–
Interim, paid – HK1 cent for 2006 (2005: Nil) per share	943	–
	<b>1,886</b>	–

For the year ended 31st December, 2006, the final dividend of HK1.5 cent per share has been proposed by the directors and is subject to approval by the shareholders in the forthcoming general meeting.

## 12. EARNINGS PER SHARE

The calculation of the basic earnings per share is based on the profit attributable to shareholders of the Company of US\$3,120,000 (2005: US\$2,467,000) and on the weighted average number of 730,700,000 (2005: 730,700,000) ordinary shares in issue during the year.

No diluted earnings per share for the years ended 31st December, 2006 and 2005 have been presented because there are no potential dilutive ordinary shares outstanding.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 13. PROPERTY, PLANT AND EQUIPMENT

	Buildings	Construction in progress	Leasehold improvements	Plant and machinery	Furniture, fixtures and equipment	Motor vehicles	Total
	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000
COST OR VALUATION							
At 1st January, 2005	34,793	1,164	1,467	86,220	14,647	1,014	139,305
Additions	32	1,302	5	2,773	214	20	4,346
Transfers	223	(2,416)	945	-	1,248	-	-
Disposals	-	-	-	(6)	(129)	(54)	(189)
Revaluation	772	-	-	-	-	-	772
At 31st December, 2005	35,820	50	2,417	88,987	15,980	980	144,234
Additions	-	1,361	-	2,979	125	6	4,471
Transfers	-	(1,050)	(950)	-	2,000	-	-
Disposals	-	-	-	-	(156)	-	(156)
Revaluation	300	-	-	-	-	-	300
<b>At 31st December, 2006</b>	<b>36,120</b>	<b>361</b>	<b>1,467</b>	<b>91,966</b>	<b>17,949</b>	<b>986</b>	<b>148,849</b>
Comprising:							
At cost	-	361	1,467	91,966	17,949	986	112,729
At valuation - December 2006	36,120	-	-	-	-	-	36,120
	36,120	361	1,467	91,966	17,949	986	148,849
DEPRECIATION							
At 1st January, 2005	-	-	1,458	58,045	11,546	833	71,882
Provided for the year	858	-	83	6,391	775	55	8,162
Eliminated on disposals	-	-	-	-	(34)	(54)	(88)
Eliminated on revaluation	(858)	-	-	-	-	-	(858)
At 31st December, 2005	-	-	1,541	64,436	12,287	834	79,098
Provided for the year	892	-	128	6,383	1,133	47	8,583
Transfer	-	-	(206)	-	206	-	-
Eliminated on disposals	-	-	-	-	(148)	-	(148)
Eliminated on revaluation	(892)	-	-	-	-	-	(892)
<b>At 31st December, 2006</b>	<b>-</b>	<b>-</b>	<b>1,463</b>	<b>70,819</b>	<b>13,478</b>	<b>881</b>	<b>86,641</b>
CARRYING VALUES							
<b>At 31st December, 2006</b>	<b>36,120</b>	<b>361</b>	<b>4</b>	<b>21,147</b>	<b>4,471</b>	<b>105</b>	<b>62,208</b>
At 31st December, 2005	35,820	50	876	24,551	3,693	146	65,136

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 13. PROPERTY, PLANT AND EQUIPMENT *(continued)*

Property, plant and equipment are depreciated at the following rates per annum:

Buildings	2%
Leasehold improvements	20%
Plant and machinery	10%-20%
Furniture, fixtures and equipment	20%-33 <sup>1</sup> / <sub>3</sub> %
Motor vehicles	20%

The buildings and the construction in progress are situated in the PRC.

The buildings were revalued at 31st December, 2006 by Messrs. RHL Appraisal Limited, on a depreciated replacement cost basis. Messrs. RHL Appraisal Limited are not connected with the Group. Messrs. RHL Appraisal Limited are members of the Institute of Valuers and have appropriate qualifications and recent experience in valuation of similar properties. The valuation, which conforms to International Valuation Standards, was arrived at by reference to market evidence transaction prices of similar transactions.

If the buildings in the PRC had not been revalued, they would have been included in these financial statements at historical cost less accumulated depreciation as follows:

	2006 US\$'000	2005 US\$'000
Cost at the end of the year	36,127	36,127
Accumulated depreciation	(6,751)	(6,002)
Net book value at the end of the year	<b>29,376</b>	30,125

## 14. PREPAID LEASE PAYMENTS

	2006 US\$'000	2005 US\$'000
The Group's prepaid lease payments comprise land use rights in the PRC under medium-term leases	<b>5,393</b>	5,532
Analysed for reporting purpose as:		
Current assets	137	136
Non-current assets	5,256	5,396
	<b>5,393</b>	5,532

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 15. INTERESTS IN ASSOCIATES

	2006 US\$'000	2005 US\$'000
Cost of unlisted investments in associates	400	400
Share of post-acquisition profits	544	612
	<b>944</b>	<b>1,012</b>
Amount due from an associate	12	8

The amount due from an associate is unsecured, interest-free, and repayable on demand.

Particulars of the Group's associates at 31st December, 2006 are as follows:

Name of associate	Form of business structure	Place of incorporation/ establishment	Principal place of operation	Issued and fully paid share capital/ registered capital	Proportion of nominal value of issued share capital/ registered capital indirectly held by the Company	Principal activities
Hi-Tech Pacific Limited	Private limited company	British Virgin Islands	Hong Kong	Ordinary US\$1,000,000	40%	Trading in footwear and investment holding
廣州和仁化學塑料有限公司	Wholly-owned foreign enterprise	PRC	PRC	Registered capital US\$500,000	40%	Manufacturing of footwear materials



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 15. INTERESTS IN ASSOCIATES *(continued)*

The summarised financial information in respect of the Group' associates is set out below:

	2006 US\$'000	2005 US\$'000
Total assets	2,999	2,776
Total liabilities	(638)	(247)
Net assets	2,361	2,529
Group's share of net assets of associates	944	1,012
Turnover	4,495	4,807
Profit for the year	131	452
Group's share of results of associates for the year	52	181

## 16. INTERESTS IN JOINTLY CONTROLLED ENTITIES

	2006 US\$'000	2005 US\$'000
Cost of unlisted investments in jointly controlled entities	2,400	2,400
Share of post-acquisition profits	150	23
	2,550	2,423

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 16. INTERESTS IN JOINTLY CONTROLLED ENTITIES *(continued)*

Particulars of the Group's jointly controlled entities at 31st December, 2006 are as follows:

Name of jointly controlled entities	Form of business structure	Place of incorporation/ establishment	Principal place of operation	Issued and fully paid share capital/ registered capital	Proportion of nominal value of issued share capital/ registered capital indirectly held by the Company	Principal activities
C.P.L. International Company Limited	Private limited company	British Virgin Islands	Hong Kong	Ordinary US\$8,000,000	30%	Investment holding
C.P.L. International (H.K.) Company Limited	Private limited company	Hong Kong	Hong Kong	Ordinary HK\$10,000	30%	Investment holding
C.P.L. Marketing Companies Limited	Private limited company	British Virgin Islands	Hong Kong	Ordinary US\$1	30%	Provision of administrative services
Sunshine Leather Industrial Limited	Wholly-owned foreign enterprise	PRC	PRC	Registered capital US\$1,000,000	30%	Manufacture of leather materials
Rich Pine Investments Limited	Private limited company	British Virgin Islands	Hong Kong	Ordinary US\$50,000	30%	Marketing of leather materials

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 16. INTERESTS IN JOINTLY CONTROLLED ENTITIES *(continued)*

The summarised financial information in respect of the Group' jointly controlled entities is set out below:

	2006 US\$'000	2005 US\$'000
Total assets	18,843	16,354
Total liabilities	(10,343)	(8,277)
Net assets	8,500	8,077
Group's share of net assets of jointly controlled entities	2,550	2,423
Turnover	24,766	20,914
Profit (loss) for the year	423	(253)
Group's share of results of jointly controlled entities for the year	127	(76)

## 17. INVENTORIES

	2006 US\$'000	2005 US\$'000
Raw materials	32,732	33,033
Work in progress	8,243	5,952
Finished goods	9,321	6,834
	50,296	45,819

## 18. TRADE AND OTHER RECEIVABLES

The Group allows an average credit period of 30 to 60 days to its trade customers. The following is an aged analysis of the Group's trade receivables at the balance sheet date:

	2006 US\$'000	2005 US\$'000
0-30 days	9,853	10,529
31-60 days	1,466	1,316
Over 60 days	1,093	516
Total trade receivables	12,412	12,361
Other receivables	2,172	1,273
	14,584	13,634

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 19. HELD FOR TRADING INVESTMENTS

	2006 US\$'000	2005 US\$'000
Equity securities listed in Hong Kong	<b>361</b>	–

## 20. BANK BALANCES AND CASH

Bank balances and cash comprises cash held by the Group and short-term bank deposits that are interest-bearing at market interest rates, ranging from 1.93% to 3.87% (2005: 1.29% to 2.39%) per annum, and have original maturities of three months or less.

Included in the bank balances and cash at 31st December, 2006 was an amount in Renminbi of RMB25,700,000 (2005: RMB11,917,000) that are denominated in currency other than functional currency. Renminbi is not freely convertible into other currencies.

## 21. TRADE AND OTHER PAYABLES

The following is an aged analysis of the Group's trade payables at the balance sheet date:

	2006 US\$'000	2005 US\$'000
0-30 days	<b>3,380</b>	3,991
31-60 days	<b>911</b>	361
Over 60 days	<b>509</b>	574
Total trade payables	<b>4,800</b>	4,926
Other payables	<b>5,668</b>	6,738
	<b>10,468</b>	11,664

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 22. UNSECURED BANK BORROWINGS

	2006 US\$'000	2005 US\$'000
Bank loans	23,955	28,477
Trust receipt loans	1,796	1,336
	<b>25,751</b>	29,813
Carrying amount repayable:		
On demand or within one year	14,701	16,458
More than one year, but not exceeding two years	7,975	9,480
More than two years, but not exceeding three years	3,075	3,875
	<b>25,751</b>	29,813
Less: Amounts due within one year shown under current liabilities	<b>(14,701)</b>	(15,858)
	<b>11,050</b>	13,955

The Group has variable-rate borrowings which carry interest at LIBOR plus a fixed percentage. Interest is repriced every three months.

The ranges of effective interest rates (which are also equal to contracted interest rates) on the Group's borrowings are as follows:

	2006	2005
Effective interest rate:		
Variable-rate borrowings	4.75% to 6.69%	3.17% to 5.43%

## 23. DERIVATIVE FINANCIAL INSTRUMENTS

At 31st December, 2005, the Group had nine outstanding foreign currency forward contracts of which the Group sold United States dollars and purchased Renminbi, each with an exercisable period of one month. The fair value of the currency derivatives at the balance sheet date were insignificant. These contracts expired from January 2006 to October 2006.

No foreign currency forward contracts were entered by the Group in 2006.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 24. SHARE CAPITAL

	Number of shares	Amount US\$'000
Authorised		
<i>Ordinary shares of HK\$0.10 each</i>		
At 1st January, 2005, 31st December, 2005 and 31st December, 2006	<u>1,500,000,000</u>	19,355
<i>Convertible non-voting preference shares of US\$100,000 each (note)</i>		
At 1st January, 2005, 31st December, 2005 and 31st December, 2006	<u>150</u>	15,000
		<u>34,355</u>

	Number of shares		Amount	
	2006 '000	2005 '000	2006 US\$'000	2005 US\$'000
Issued and fully paid				
Ordinary shares of HK\$0.10 each	<u>730,700</u>	730,700	<u>9,428</u>	9,428

Note: Convertible non-voting preference shares, when issued and outstanding, carry fixed cumulative dividend. Under certain circumstances, they are entitled to additional dividend and are convertible into shares of the Company.

## 25. SHARE OPTION SCHEME

The Company's share option scheme (the "Scheme") was adopted pursuant to a resolution passed on 25th September, 1996 for the primary purpose of providing incentives to directors and eligible employees. It expired on 24th September, 2006. Under the Scheme, the board of directors of the Company were able to offer to any director or employee of the Company, or any of its subsidiaries, options to subscribe for shares in the Company.

Without prior approval from the Company's shareholders, the total number of shares in respect of which options may be granted under the Scheme is not permitted to exceed 10% of the shares of the Company in issue at any point in time, and the number of shares in respect of which options may be granted to any individual in any one year is not permitted to exceed 1% of the shares of the Company in issue at any point in time.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 25. SHARE OPTION SCHEME *(continued)*

No consideration is payable on the grant of an option. Options may be exercised at any time for a period of three years commencing on the first anniversary of the date of grant. The exercise price of the option shares would be at a price equal to the higher of the nominal value of the shares and 80% of the average of the closing prices of the shares of the Company on the Stock Exchange on the five trading days immediately preceding the date of the offer to grant an option.

Upon the expiry of the Scheme, no new share option scheme has been launched.

During the years ended 31st December, 2006 and 2005, no share options were granted or exercised.

At 31st December, 2006 and 2005, no share options were outstanding under the Scheme.

## 26. DEFERRED TAXATION

The following are the major deferred tax liabilities (assets) recognised and movements thereon during the current and prior years:

	<b>Revaluation of buildings in the PRC US\$'000</b>	<b>Accelerated accounting depreciation US\$'000</b>	<b>Total US\$'000</b>
At 1st January, 2005	2,331	(691)	1,640
Charge to equity	440	–	440
At 31st December, 2005	2,771	(691)	2,080
Charge to equity	322	–	322
At 31st December, 2006	3,093	(691)	2,402

For the purpose of balance sheet presentation, the above deferred assets and liabilities have been offset.

At 31st December, 2006, the Group had unutilised tax losses of US\$5,778,000 (2005: US\$5,119,000) available for offset against future profits and deductible temporary difference of US\$17,133,000 (2005: US\$14,079,000) in respect of accelerated accounting depreciation. No deferred tax assets have been recognised in respect of unutilised tax losses and deductible temporary difference of US\$14,573,000 (2005: US\$11,519,000) due to the unpredictability of future profit streams. Included in unrecognised tax losses are losses of US\$2,911,000 (2005: US\$2,333,000) that will expire in 2007 to 2012 (2005: 2007 to 2011). Other losses may be carried forward indefinitely.



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 27. OPERATING LEASE COMMITMENTS

### The Group as lessee

	2006 US\$'000	2005 US\$'000
Minimum lease payment paid by the Group under operating leases during the year in respect of:		
Minimum lease payments	507	688
Contingent rent	-	1,153
	<b>507</b>	<b>1,841</b>

At the balance sheet dates, the Group had commitments for future minimum lease payments under non-cancellable operating leases which fall due as follows:

	2006 US\$'000	2005 US\$'000
Within one year	417	336
In the second to fifth year inclusive	215	137
Over five years	934	954
	<b>1,566</b>	<b>1,427</b>

Operating lease payments represent rentals payable by the Group for its factories and office premises. Leases are negotiated and rental are fixed for two to six years.

At 31st December, 2005, the Group had commitments for future minimum lease payments under non-cancellable operating leases in respect of certain outlets which were based on a fixed percentage of the annual gross turnover of the outlets.

## 28. COMMITMENTS

	2006 US\$'000	2005 US\$'000
Contracted for but not provided in the financial statements:		
- acquisition of property, plant and equipment	-	159
- use of copyright licence (note)	<b>2,292</b>	-

Note: During the year ended 31st December, 2006, the Group entered into agreements with licensors to obtain licenses to use certain materials and trademarks in a number of merchandising activities for two to three years. Pursuant to the agreements, the Group agreed to pay royalties to the licensors which are based on certain fixed percentages of the selling prices for items sold. In addition, the Group has guaranteed to pay minimum royalties to the licensors throughout the contract period as stated above.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 29. RETIREMENT BENEFITS SCHEMES

The Group operates a Mandatory Provident Fund Scheme for all qualifying employees in Hong Kong. The assets of the schemes are held separately from those of the Group in funds under the control of trustees. The Group contributes 5% of relevant payroll costs to the scheme, which contribution is matched by employees.

The employees of the Group's subsidiaries in the PRC are members of a state-managed retirement benefits scheme operated by the government of the PRC. These subsidiaries are required to contribute 11% of payroll costs to the retirement benefits scheme to fund the benefits. The only obligation of the Group with respect to the retirement benefits scheme is to make the specified contributions.

## 30. RELATED PARTY DISCLOSURES

### (i) Related party transactions

During the year, the Group had entered into the following transactions with its related parties:

Nature of transactions	2006	2005
	US\$'000	US\$'000
Purchases by the Group from an associate	63	509
Purchases by the Group from a jointly controlled entity	2,987	1,334

### (ii) Remuneration of key management personnel

The remuneration of directors and other members of key management during the year was as follows:

	2006	2005
	US\$'000	US\$'000
Short term benefits	1,385	1,467
Post-employment benefits	2	2
	1,387	1,469

The remuneration of directors and key executives is determined with reference to the Group's operating results, individual performance and comparable market statistics.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 30. RELATED PARTY DISCLOSURES *(continued)*

### (iii) Related party balances

Details of the balances with the associate as at respective balance sheet dates are set out in the consolidated balance sheet and note 15.

### (iv) Banking facilities

At 31st December, 2005, certain banking facilities were secured by the guarantees jointly given by Mr. Jenn Chang, Michael, a director of the Company, and his father Mr. Wu Swei to the extent of approximately US\$788,000. These banking facilities were cancelled on 21st March, 2006.

## 31. BALANCE SHEET OF THE COMPANY

	2006 US\$'000	2005 US\$'000
Non-current asset		
Investment in subsidiaries	26,465	26,465
Current assets		
Other receivables	28	39
Amounts due from subsidiaries	24,031	25,286
Dividend receivable from a subsidiary	1,500	2,000
Bank balances and cash	1	3
	<b>25,560</b>	27,328
Current liability		
Other payables	41	38
Net current assets	<b>25,519</b>	27,290
	<b>51,984</b>	53,755
Capital and reserves		
Share capital	9,428	9,428
Reserves (note)	42,556	44,327
	<b>51,984</b>	53,755

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 31. BALANCE SHEET OF THE COMPANY *(continued)*

Note:

### Reserves

	Share premium US\$'000	Contributed surplus US\$'000	Dividend reserve US\$'000	Accumulated profits US\$'000	Total US\$'000
At 1st January, 2005	21,644	19,486	–	3,602	44,732
Loss for the year	–	–	–	(405)	(405)
Dividends proposed for 2005	–	–	943	(943)	–
At 31st December, 2005	21,644	19,486	943	2,254	44,327
Profit for the year	–	–	–	115	115
Final dividends paid for 2005	–	–	(943)	–	(943)
Interim dividends paid for 2006	–	–	–	(943)	(943)
Final dividends proposed for 2006	–	–	1,414	(1,414)	–
<b>At 31st December, 2006</b>	<b>21,644</b>	<b>19,486</b>	<b>1,414</b>	<b>12</b>	<b>42,556</b>

The contributed surplus of the Company represents the difference between the value of the underlying net assets of the subsidiaries acquired by the Company and the nominal amount of the share capital issued by the Company under a corporate reorganisation undertaken in 1996.

## 32. PRINCIPAL SUBSIDIARIES

Particulars of the Company's principal subsidiaries as at 31st December, 2006 are as follows:

Name of subsidiary	Place of establishment/ operations	Issued and fully paid share capital/ registered capital	Attributable equity interest held by the Company		Principal activities
			Directly	Indirectly	
W.P.T. Development Inc.	British Virgin Islands/Hong Kong	Ordinary US\$8	100%	–	Investment holding
Pacific Footgear Corporation	British Virgin Islands/Hong Kong	Ordinary US\$1	–	100%	Marketing and trading in footwear
Wuco Corporation	British Virgin Islands/Hong Kong	Ordinary US\$8	–	100%	Trading in footwear and investment holding

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December, 2006

## 32. PRINCIPAL SUBSIDIARIES (continued)

Name of subsidiary	Place of establishment/ operations	Issued and fully paid share capital/ registered capital	Attributable equity interest held by the Company		Principal activities
			Directly	Indirectly	
Nagano Management Limited	British Virgin Islands/Hong Kong	Ordinary US\$11	-	100%	Investment holding
Topstair International (H.K.) Company Limited	Hong Kong	Ordinary HK\$10,000	-	100%	Provision of administrative services to group companies
Pan Yu Fang Chun Footwear Co., Ltd.* 番禺豐群鞋業有限公司	PRC	Registered capital US\$10,600,000	-	100%	Manufacture of footwear and footwear materials
Panyu Pegasus Footwear Co. Ltd. * 番禺創信鞋業有限公司	PRC	Registered capital US\$38,000,000	-	100%	Manufacture of footwear and footwear materials
台灣松鄰國際有限公司	Taiwan	Registered capital NT\$5,000,000	-	100%	Trading in raw materials of footwear
廣州創信鞋業品服飾有限公司 *	PRC	Registered capital RMB1,000,000	-	100%	Marketing and trading in footwear in the PRC

\* These subsidiaries are established in the PRC as wholly-owned foreign enterprises.

The above table lists the subsidiaries of the Company which, in the opinion of the directors, principally affected the results or assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

None of the subsidiaries had issued any debt securities at the end of the year.

# FINANCIAL SUMMARY

## RESULTS

	Year ended 31st December,				
	2002 US\$'000	2003 US\$'000	2004 US\$'000	2005 US\$'000	2006 US\$'000
Turnover	115,405	129,552	143,704	141,242	<b>141,465</b>
Profit (loss) before taxation	5,715	4,389	(1,321)	2,757	<b>3,550</b>
Taxation	(223)	(172)	421	(290)	<b>(430)</b>
Profit (loss) for the year	5,492	4,217	(900)	2,467	<b>3,120</b>

## ASSETS AND LIABILITIES

	At 31st December,				
	2002 US\$'000	2003 US\$'000	2004 US\$'000	2005 US\$'000	2006 US\$'000
Total assets	162,864	161,701	142,246	146,089	<b>143,477</b>
Total liabilities	59,652	55,358	43,817	44,003	<b>39,287</b>
	103,212	106,343	98,429	102,086	<b>104,190</b>
Minority interests	1	1	-	-	-
Total equity	103,213	106,344	98,429	102,086	<b>104,190</b>

