ESPRIT

annual report 1997/98

contents

esprit today unified and still building

So we're unified and global, with turnover exceeding HK$5 billion, more than 6,500 sales outlets, over 3,700 wholesale customers, 650,000 sq ft of controlled retail area and a strong presence in over 40 countries. ■ Our Esprit brand is not just men's wear, women's wear and children's wear. Well received and well embraced, Esprit today also offers the same branded attitude with core fashion and accessories; timewear and eyewear products; bed and bath products; precious, semi-precious fashion and costume jewelry; and fragrances and cosmetics. ■ And we now also control Red Earth, a younger color cosmetic brand with potential that stretches from New Zealand to Scandinavia. Red Earth will be a new benchmark for contemporary, simple-line cosmetics. ■ Yes, we're unified, but we're still building.

over 3,7

around 650,000 sq ft controlled retail area

red earth distribution channels

as of June 30, 1998

	corporate stores	floor area (sq ft)	esprit free-standing units	franchised stores
australia	45	38,051	0	15
hong kong	10	5,016	15	0
taiwan	5	1,228	5	0
singapore	0	0	13	0
new zealand	5	3,679	0	5
china	1	398	5	0
canada	0	0	24	0
germany	2	876	0	0
netherlands	0	0	0	5
indonesia	0	0	0	9
japan	0	0	0	13
macau	0	0	0	2
malaysia	0	0	0	4
philippines	0	0	0	2
thailand	0	0	0	16

00 wholesale customers

over 40 countries

over 6,500 sales outlets

esprit distribution channels in asia/pacific as of June 30, 1998

	corporate stores	floor area (sq ft)	franchised stores
hong kong	25	67,869	0
australia	88	116,687	0
taiwan	73	63,597	0
singapore	16	52,250	0
south korea	32	17,430	0
malaysia	8	16,130	0
china*	35	41,357	87
japan*	16	16,615	2
other asian countries	0	0	109
israel	0	0	11
canada	26	60,810	0

esprit distribution channels in europe as of June 30, 1998

	corporate stores	floor area (sq ft)	franchised stores
germany	41	143,461	396
the netherlands	18	34,140	0
belgium	20	59,687	0
denmark	10	17,676	32
sweden	3	4,800	2
france	5	10,876	23
austria	0	0	24

* corporate stores are directly managed by joint venture partners

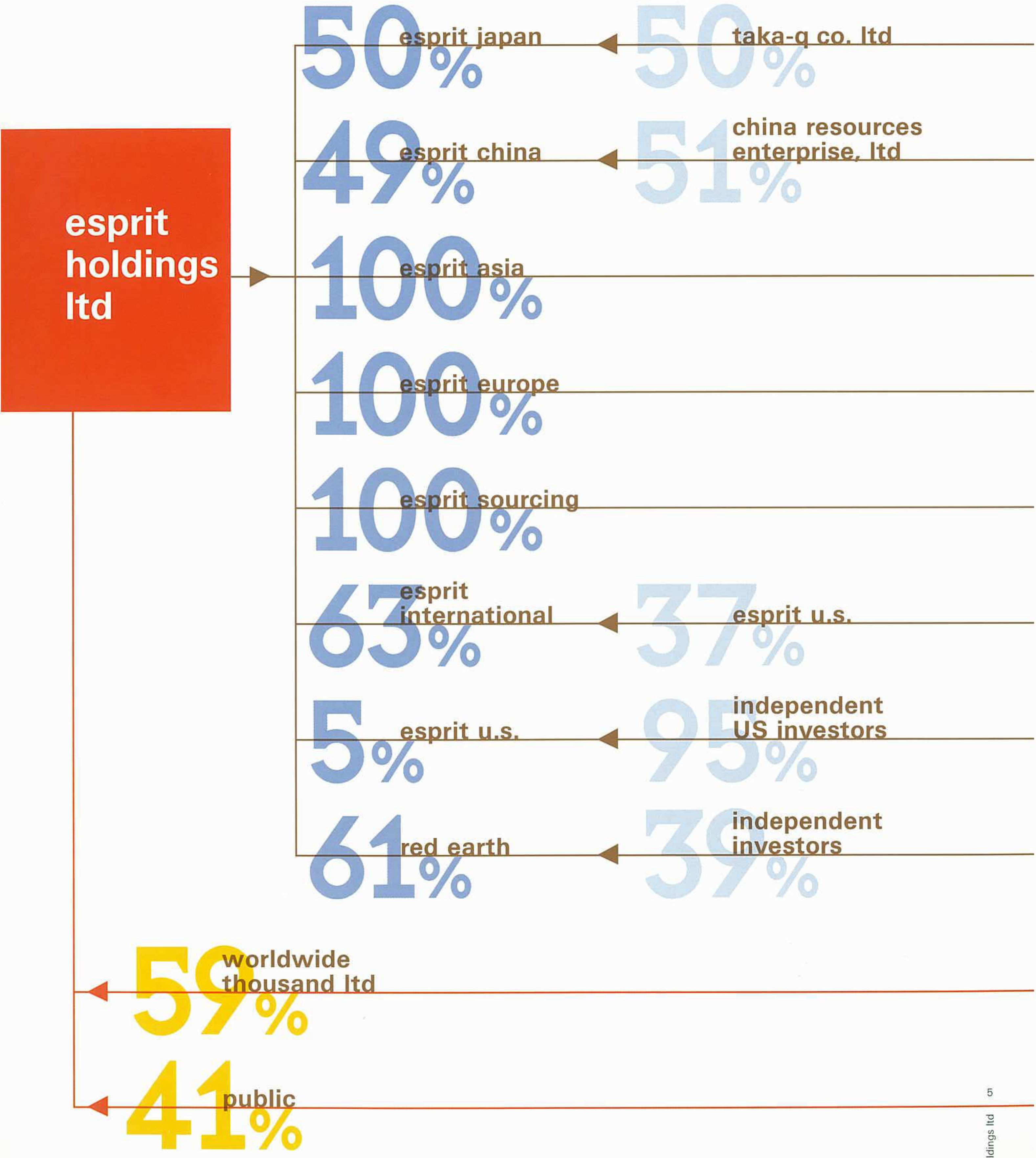
a shared attitude

the first 30 years with Esprit

Esprit celebrates attitude and sharing. As we complete our first 30 years, we are more than mindful that we will have much more to offer and to share. Ours is a powerful relationship that goes beyond the ordinary. Above all, Esprit is an attitude that has been shared and celebrated by millions around the world. ■ We believe in you. We are with you. We have done so for 30 years.

corporate structure

as of October 16, 1998



corporate information

executive directors
Michael Ying Lee Yuen *Chairman*
Alva Chan Wai Mo
Heinz Jürgen Krognar-Kornalik
Surinder Chhibber
Connie Wong Chin Tzi

non-executive directors
Alexander Reid Hamilton
Joyce Elena Ma
Jürgen Alfred Rudolf Friedrich
Raymond Or Ching Fai

company secretary
Alva Chan Wai Mo, FHKSA

authorized representatives
Michael Ying Lee Yuen
Alva Chan Wai Mo

principal banker
The Hongkong and Shanghai Banking Corporation Limited
1 Queen's Road Central, Hong Kong

auditors
Price Waterhouse *Certified Public Accountants*
22/F, Prince's Building, Central, Hong Kong

hong kong share registrar
Secretaries Limited
5/F, Wing On Centre, 111 Connaught Road, Central, Hong Kong

registered office
Clarendon House
Church Street, Hamilton HK 11 Bermuda

head office and principal place of business
10/F, 11 Yuk Yat Street, Tokwawan, Kowloon, Hong Kong

financial highlights

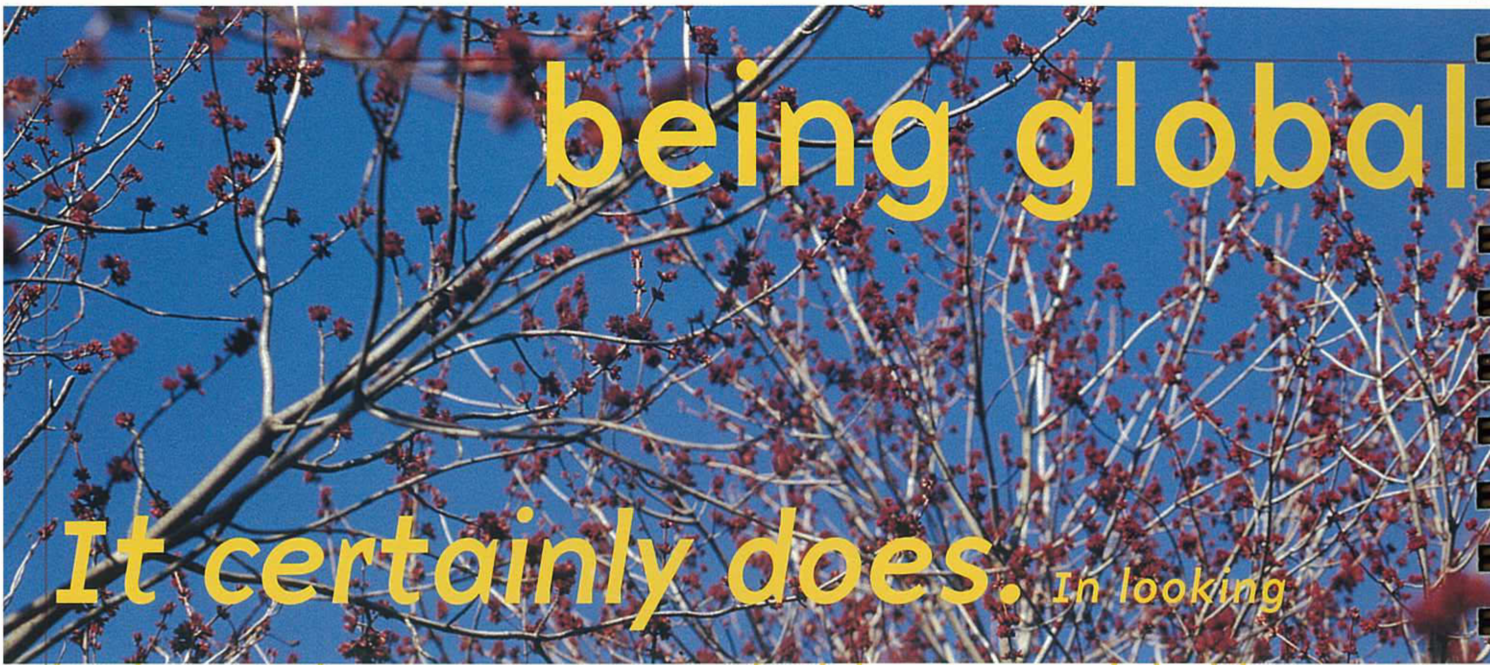
for the year ended June 30

		1998	1997	1996	1995	1994
turnover (hk$m)		**5,087.2**	3,351.7	1,785.3	1,473.2	1,144.9
operation mix (%)						
	retail	**54.4**	65.2	90.7	90.5	91.0
	wholesale	**44.1**	33.5	9.3	9.5	9.0
	others	**1.5**	1.3	–	–	–
geographical mix (%)						
	germany	**43.3**	29.1	–	–	–
	china *(including hong kong)*	**14.9**	23.5	38.7	46.0	56.3
	the netherlands & belgium	**11.3**	7.9	–	–	–
	australia	**7.7**	10.6	12.9	–	–
	taiwan	**6.7**	8.8	16.9	20.5	16.0
	singapore & malaysia	**3.5**	5.0	11.5	17.0	18.2
	canada	**2.0**	–	–	–	–
	south korea & japan	**1.7**	5.0	13.5	14.5	9.5
	other european countries	**7.8**	6.0	–	–	–
	other countries	**1.1**	4.1	6.5	2.0	–
product mix (%)						
	women's wear	**58.6**	61.5	61.5	57.6	63.4
	footwear & accessories	**19.4**	20.3	21.5	23.7	19.5
	kids' wear	**10.4**	6.9	2.0	0.3	1.9
	men's wear	**8.8**	8.9	11.8	15.0	11.9
	body care	**1.6**	1.3	2.2	2.3	2.0
	bed & bath	**0.3**	0.6	1.0	1.1	1.3
	others	**0.9**	0.5	–	–	–
operating profit (hk$m)		**489.6**	400.9	203.4	183.1	205.8
profit attributable to shareholders (hk$m)		**155.1**	235.5	161.8	141.3	167.4
	shareholders' funds (hk$m)	**1,163.1**	1,120.9	659.6	555.4	467.1
	working capital (hk$m)	**438.7**	419.6	409.7	338.4	397.1
	current ratio (x)	**1.4**	1.4	2.0	2.2	2.6
	total debt to equity ratio (%)	**146.2**	165.8	64.0	53.5	53.1
	bank borrowings to equity ratio (%)	**63.3**	68.7	6.6	12.7	3.3
return on shareholders' equity (%)		**13.3**	21.0	24.5	25.4	35.7

operation highlights

	1998	1997	1996	1995	1994
number of corporate stores*	**365**	364	253	174	121
sales footage (sq ft)*	**665,413**	602,735	299,996	180,105	137,028
sales per sq ft (hk$)*	**387**	470	633	823	798
number of employees*	**4,257**	4,377	2,619	2,345	1,988

* refer to Esprit distribution network



being global

It certainly does. In looking back over the past year, our decision to go global in early 1997 could not have been better timed. It was without doubt the right decision and best strategy for the Group. As Europe prospered and several Asian economies sank this past year, we saw two thirds of our global business enjoy good growth while the remaining one third from Asia produced mixed results. We were definitely cushioned from the Asian economic downturn.

prudent steps for a difficult environment

However, like many others, we were surprised by the severity of the economic deterioration in Asia and we do not know how long it will last or where the bottom is. We believe our response has been prudent and we will continue to be cautious. Customers are buying less and at lower prices. The encouraging news though is that there is still demand for the stronger brands that command a bigger consumer franchise and, consequently, there are opportunities.

among the first to rebound

We believe we are well structured for Asia. We are vertically integrated. We control our brand. We run our own design and sourcing operations and we have a large number of directly managed stores. We have the financial strength and the management expertise. We have the will and the wherewithal. We can tough it out in Asia. By staying focused on what we do best, we will be among the first off the starting block when the turnaround comes.

Europe was a double-digit growth story in FY1997/98 in local currency terms. Both our retail and wholesale businesses thrived and turnover reached a record HK$3.2 billion. So further prudent expansion is on the horizon. We will expand our wholesale and retail businesses in existing markets to increase market share.

We will open more directly managed stores and add franchisees and wholesale customers to our current respectable list. Because of our unified structure, we are also well placed for the new Euro and the opportunities that will come with the new European currency. The key phrase for Europe is 'spirited expansion'.

spirited expansion for europe

There is also one important constant about the Group, and that is the power of the Esprit brand. Across the globe, in our most buoyant markets as well as in those affected by recession, the Esprit brand remains unequivocal and unwavering. Its youthful, upbeat and energetic identity remains clear and of tremendous appeal.

We also now control a second brand: Red Earth. I can safely say that Red Earth will be another story in itself. The brand, with its price appeal and high quality products and image, has already created its own niche. This has to a large extent been supported by our distribution strategy. We will further capitalize on Esprit's established infrastructure and global market knowledge for accelerated growth for Red Earth. In FY1997/98 Red Earth accounted for only 1.6% of Group turnover, so the brand's contribution is likely to become more substantial. Without doubt, the Red Earth brand is another brand to watch.

red earth is another brand to watch

our licensing business will expand rapidly

Globally, our licensing business will expand much more rapidly and will include product lines such as bone china and table linen. We will establish new product licenses through strategic alliances and partnerships.

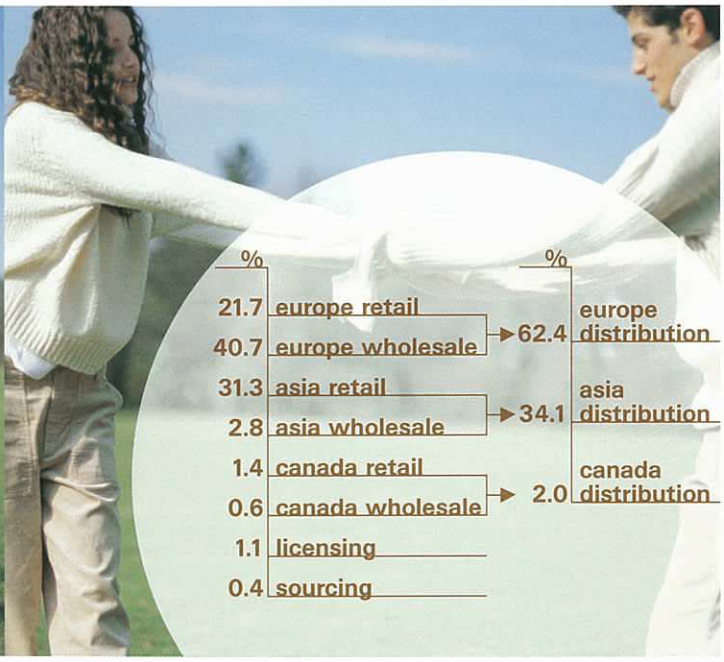
Kids' wear will be given further impetus while women's wear will be similarly strengthened. Accurate brand positioning and targeted pricing strategies for different markets will be our prime focus.

Given the size and growth potential of our European operations – which account for about two thirds of the Group's turnover; our licensing business with revenues that flow largely into our bottom-line; and our strong foothold in Asian markets; I can only view the future of the Group with much enthusiasm. However, as a major shareholder and a member of our management team, I am naturally disappointed at how the Group is currently being valued.

some analysts say our counter is extremely undervalued

When one considers our Group's valuation closely, as some investment analysts have, there appears to be a mismatch and our counter appears extremely undervalued. Our European operations account for approximately two thirds of our Group turnover. At HK$3.2 billion, that is a sizeable business in its own right. Our licensing business is another very strong business that can stand on its own. However, Esprit's stock has been valued like other Hong Kong fashion retail stocks caught in the turmoil of Asia. The Group's stock has been trading on a prospective price/earnings ratio of below 10 times, over the past several months. On the other hand, other fashion retail businesses in Europe that are comparable to our European operation in size have been averaging 16 times and more. If we were to list our operations separately (say, in Europe), we should be able to expect a better valuation and higher multiple, and, consequently, achieve a higher price level. Some analysts have even suggested our breakup value could command a premium of more than 40% over our current price. It seems our well-diversified global business should be better recognized for what it is.

operation mix 12 months to June 30, 1998



product mix 12 months to June 30, 1998

we buy global and we sell global

The fact is, today we own a global Esprit brand that is marketed in over 40 countries around the world and that commands a huge consumer franchise. Our core apparel products are sold through 300+ directly managed stores, 700+ franchised stores and 3,700+ wholesale customers. Our licensed products are moved through another few thousand stores. In short, we buy global and we sell global.

And we know being global has its advantages.

Michael Ying Lee Yuen *Chairman*
October 16, 1998

group results and financial management

In our first full year (FY1997/98) as a global company, we have:

- grown revenue from approximately HK$3,352 million in FY1996/97 to HK$5,087 million in FY1997/98
- achieved operating profit of HK$489.6 million, up 22% from HK$400.9 million
- recorded a profit before exceptional item of HK$ 280.4 million. The exceptional item of HK$125.3 million represents the provision for diminution in the value of listed investments held for the long-term. Profit attributable to shareholders amounted to HK$155.1 million
- earnings per share (with an enlarged shareholder base but on a weighted average basis) were HK14.20 cents compared with HK26.11 cents last year

Maximizing and increasing shareholder value tops management's agenda. As of June 30 1998, shareholders' equity had increased to HK$1,163 million.

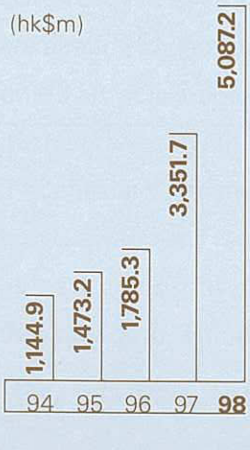
We believe in prudent cash management and conserving our financial strength for business consolidation and expansion in strategic markets, so we are not recommending a final dividend for FY1997/98 – even though our balance sheet and cash position remain strong. Our debt-to-equity ratio is at 146.2%, down from 165.8% in June 1997.

Europe accounted for 62.4% of Group turnover while Asia and Canada generated 36.1%. Our licensing and sourcing businesses represented 1.5% of turnover.

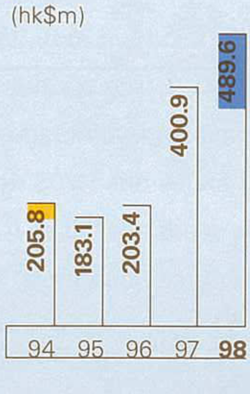
centralized corporate treasury functions to manage forex and hedging needs

In view of heightened volatility in international markets, we enhanced our risk management efforts last year, including the establishment of centralized corporate treasury functions in May 1997 to actively and effectively manage our overall foreign exchange and hedging needs, as well as our funding and liquidity issues. We see our treasury operations as taking on an important anticipatory role as global currency and money markets continue to be volatile.

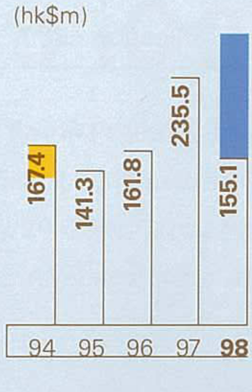
turnover
(hk$m)



operating profit
(hk$m)



profit attributable to shareholders
(hk$m)



exceptional gain of HK$26.9 m   exceptional loss of HK$125.3 m

europe

good growth, more yet

We continued to expand in Europe – we enjoyed double-digit growth in local currency terms in FY1997/98. Our turnover of DM740 million was up from the previous year's DM643 million. Germany accounted for 70% while 18% came from the Netherlands and Belgium. Our European growth flies in the face of the retail industry's average 3% decline over the past couple of years, so we feel gratified.

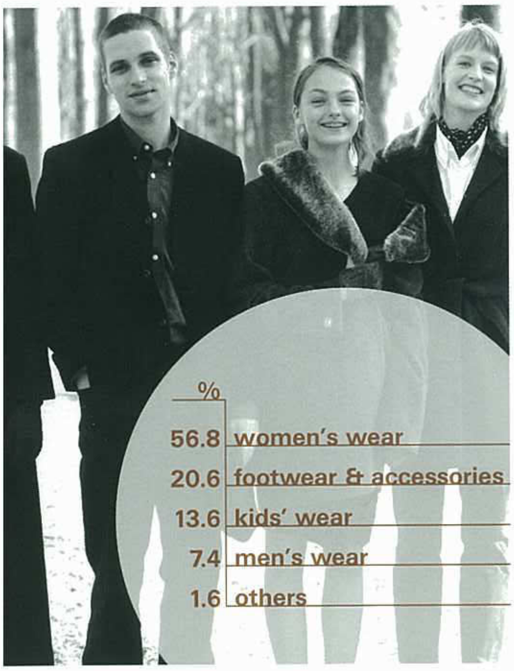
But even that is not the good news. The really good news is that our brand momentum is so strong in Europe that what we need is to be able to get more product to customer. We need more sales footage. We need more strategic alliances. We need more wholesale relationships – even as our wholesale orders are already confirmed till January 1999. Far from it being a mature market, Europe offers attractive potential that, from our point of view, is yet untapped. So we are pushing ahead with our spirited-expansion strategy.

at least 20 other german cities could do with an esprit store each

Consider Germany, where our turnover rose more than 10% in FY1997/98; where brand awareness is more than 80%; and where some 30% of German ladies own at least one Esprit garment. We believe there are easily 20 other German cities that could do with an Esprit store each. At present, our revenues come mainly

product mix in europe

12 months to June 30, 1998



from women's wear, shoes and accessories – which leaves the door wide open for men's wear, kids' wear and other new product lines. It is no surprise therefore that our expectation for this market is a continuing upward curve over the next several years.

So as not to look at our entrenched markets from the wrong end of the telescope, our focus on markets such as Germany and the Benelux region will be that of further growth, while we simultaneously build into markets like France, Austria, Scandinavia and Eastern Europe.

Our first Esprit mega-store in Paris, France has been very well received. A second mega-store is planned for October 1998 and we are confident that our re-launched medium-priced volume brand will do well.

In Britain, where rentals remain prohibitive, we have re-visited our priorities and business strategies. We have started a mail order service (based out of Germany) for this market. We are still looking for an appropriate local partner as we intend to set up a wholesale business. We closed our retail stores but we intend to open one or two mega-stores in due course.

Our Scandinavia business requires some growth impetus and we have adjusted our pricing strategy to suit market conditions and to build volume. Getting the mix right is our priority.

In terms of new markets, we have taken initial steps and laid the groundwork for the future with new franchisees in Croatia, Hungary, Ireland, Slovenia and Turkey. We do not expect any near-term contribution from these markets but we believe it is opportune for us to start up now.

new teenage line scores in several markets

FY1997/98 was also marked by our product extension strategy. We launched a wholesale-driven teenage line called "esprit de corps" for those between 15 – 25. The product range has been well received in Germany, the Netherlands and Belgium and we expect similar successes in other markets.

an exciting alliance with triumph to develop esprit body-wear

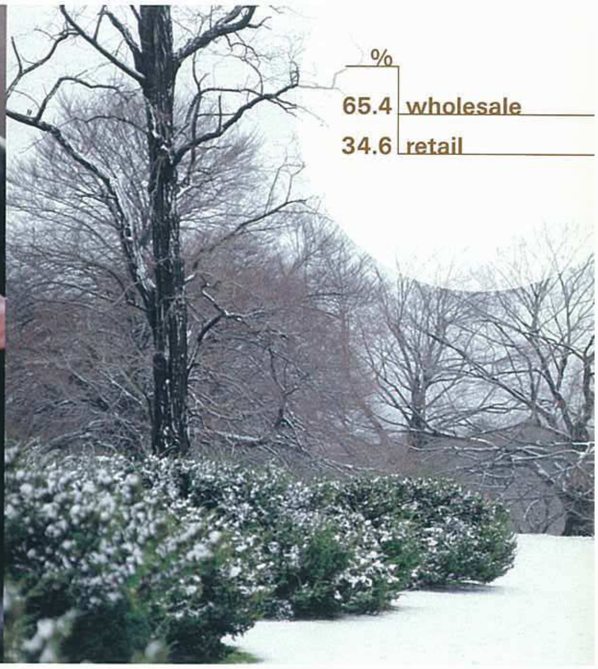
There was another exciting product line development in FY1997/98. We established an alliance with Triumph to develop Esprit body-wear in Europe. Esprit will design and distribute the body-wear products through retail and wholesale channels, while Triumph will handle manufacturing because of its expertise in the

geographical mix in europe

12 months to June 30, 1998

sales mix in europe

12 months to June 30, 1998



business. The potential for this new product line is very clear and we are more than confident that it will add to our top-line. All eyes are on early 1999 when we expect to stage our product launch.

Our Esprit Kids business, as expected, received a boost from our new central sourcing strategy, which allowed for substantial price adjustments of up to 18%. Sales volume has gone up by 20% and Esprit Kids is set to become Europe's leader in casual children's wear.

esprit is ready for the new europe

The European currency in 1999 will mean greater cross-market clarity and will make Europe more transparent in terms of price comparisons, wider choices and manufacturing and distribution options. Esprit is already well on its way to being 'Euronized' and we will be more than ready to capitalize on the new environment. Our product positioning and pricing strategies will be better aligned and our brand value will be much reinforced.

In short, Europe looks good. We expect an annual sales-footage increase of 45,000 to 50,000 sq ft over the next few years. We know we need to be able to get our products to our customers. And the key thing is to secure the right location and the right rental. Such expansion will be financed by Esprit's existing operations in Europe. The wholesale business, which is relatively low cost, will also be expanded.

some growth, some concerns

Asia is a mixed bag. The overall economic scenario has deteriorated considerably from a year ago and recession has hit a number of the region's economies.

asia pacific

right-sizing remains the strategy for asia

Asia's contribution to Group turnover is around a third but we have moved decisively on some issues. Not surprisingly, South Korea, which contributes only 1% to Group turnover, is a low priority market right now because of the prevalent economic and social concerns. We have scaled back our operations and reduced our cost base so as to break even or at least minimize our losses.

aggressive reviews of our operations in south korea and japan

The same low-cost, loss-minimization strategy applies to Japan, where our 50-50 joint venture with Taka-Q Co., Ltd. has not progressed as expected. We also ran into a stagnant economy, with consumer spending languishing rather than accelerating. As a result, we have had to review our relationship with Taka-Q and we are also reviewing our plans for that market. We have also adjusted our growth expectations to a more cautious and conservative level for this market.

The combined turnover of South Korea and Japan accounts for less than 2% of Group turnover.

We have also acted swiftly in our established markets: our aggressive pricing and market-share strategies have been implemented in Hong Kong and Singapore,

hong kong and singapore: expanding market share through reduced margins

where tough conditions demand tough decisions. As the industry goes through the inevitable shakeout, our emphasis is on brand building, expanding market share through reduced margins, effective cost-containment measures and securing greater market penetration.

Taiwan and Australia were two bright spots that offered ready cheer. With a combined turnover that accounts for more than 40% of the region's turnover, the two markets' revenue growth of more than 20% each in local currency terms, was more than welcome news. Their retail sectors are still growing and, consequently, we remain in an expansion mode in those two markets.

ready cheer from taiwan, australia and china

Our total sales footage in Taiwan grew to 63,000 sq ft in FY1997/98. Our mega-store concept has worked especially well in supplementing our network of outlets and more mega-stores are expected for Taichung and Kaohsiung. We will further reinforce our established brand through strong marketing, increased sales footage and effective merchandizing.

Esprit Australia moved purposefully ahead with its wholesale and retail strategies, benefiting from strong demand from the market's major department stores for kids' wear. In FY1997/98, our retail floor space increased by 25%, with total sales footage reaching 116,700 sq ft. Our new range of men's wear will be launched in 1999. We intend to further expand our retail and wholesale businesses and we have plans to open another 20 to 30 specialty retail stores over the next two years.

In China, we effected a comfortable transition and settling-in phase with our new joint venture partner, China Resources Enterprise, Ltd. (CRE). When reviewing the profit contribution from our China operations, we need to take into account the fact that our joint venture with CRE was only incorporated at the beginning of 1998, so the full impact will not be felt until FY1998/99.

We consolidated the number of franchised stores to 87 while the number of corporate stores increased to 35. Our China partnership is now poised to establish a nationwide distribution network that includes Beijing, Shanghai, Tianjin, Dalian and Wuhan.

big enthusiasm for esprit kids

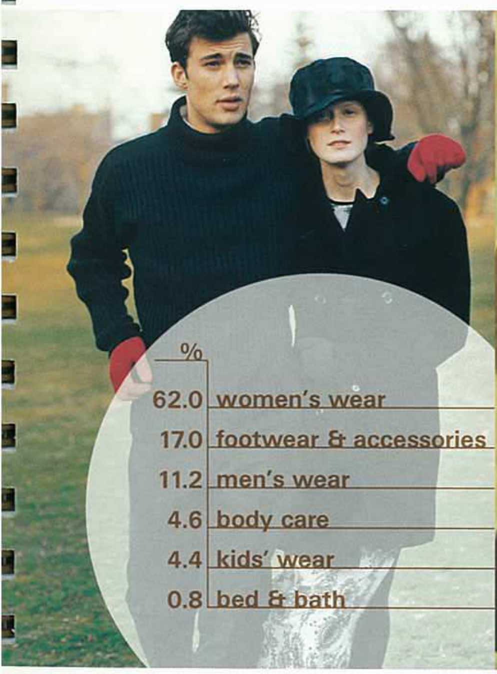
But here is our big enthusiasm story for Asia: Esprit Kids. There is no dominant brand for kids' wear in Asia. We are also talking about a region that adores children.

So it is a big field that is wide open. And we believe we have settled into pole position with our 10 – 15 mega-stores in Taiwan, Hong Kong and Singapore. In Hong Kong alone, we are targeting for five shops. Esprit Kids, with its colorful exuberance, represents excellent value, and that positioning sits nicely in today's economic environment too.

Esprit Canada, in which the Group owns a 75% stake, should make a positive contribution in FY1998/99 from its women's wear and men's wear. But that's only the beginning. Our thoughts and plans stretch beyond that initial foray. We will emphasize retail over wholesale in this market, especially on the West Coast. We have already established a retail management team in Vancouver, while our wholesale team remains in Montreal.

product mix in asia

12 months to June 30, 1998



%	
62.0	women's wear
17.0	footwear & accessories
11.2	men's wear
4.6	body care
4.4	kids' wear
0.8	bed & bath

geographical mix in asia

12 months to June 30, 1998

%	
42.9	china (including hong kong)
22.5	australia
19.6	taiwan
8.3	singapore
4.1	south korea
1.7	malaysia
0.9	japan

sales mix in asia

12 months to June 30, 1998

%	
91.0	retail
7.9	wholesale
1.1	sourcing

red earth

a story in itself

Esprit's sales of Red Earth products in Hong Kong rose 90% in FY1997/98. That was just one market. Granted, the growth came off a base that was relatively small – around HK$58 million. But with effusive customer response to the brand, we are more than encouraged. So we intend to rev up and reach out.

red earth poised to go global

The same success formula has been applied in FY1998/99 to relatively new markets such as Germany, Canada, Taiwan, China and Singapore. Indeed, we have already opened two Red Earth stores in Germany and initial customer response has been very encouraging. More stores are on the drawing board.

The Red Earth story gained momentum when the Esprit Group became the majority shareholder of Red Earth International (REI) with a 60.78% stake in May 1998. REI, in turn, owns Red Earth Holdings Pty. Ltd. (REA), which means that Esprit now effectively controls the distribution network in Australia and New Zealand.

The Red Earth brand is essentially a contemporary, sleek and simple line of color cosmetics that offers quality and value for money. We have notched up our distribution, from a small base in Hong Kong to a network of 18 retail stores and 62 Esprit free-standing units. That's just for starters. Of course, in Australia and New Zealand our 50 stores stand out and they will continue to lead the charge.

Red Earth is poised to go global. It will be the Group's second brand to be marketed across the globe. As they say, watch this space.

esprit international – licensing is good business

The Group owns 63% of Esprit International ("EI"), which covers 10 product licenses with an estimated retail value of HK$2 billion. Royalty income for the Group was HK$56 million for FY 1997/98.

licensing business remains highly profitable; more growth to come

In point of fact, we have barely started with our licensing business. We have made much headway with our core fashion and accessories business and we have licensed timewear and eyewear as well as bed and bath products. That was a good start.

We have since stridden further with precious, semi-precious fashion and costume jewelry, as well as fragrances and cosmetics. And we are now actively looking at athletic wear, tableware, bone china and table linen.

Our second exclusive licensing arrangement with Egana International (Holdings) Ltd., signed in August 1997, enables Egana to use the Esprit trademark in the

design, manufacture, distribution and promotion of precious, semi-precious fashion and costume jewelry. The new line was launched in Europe in spring 1998 and was a sold-out success.

Another global joint licensing agreement was signed in FY1997/98, this time with Coty Inc, for the development and marketing of Esprit fragrances and cosmetics. Plans are underway for the launch of the first fragrance in the Year 2000 in the United States, followed by Europe and Asia.

mis – plans are in place

The use of only two digits to represent the year in certain computer databases to save storage space has created the Year 2000 issue in computers. Computer systems that are not Year 2000 compliant may generate incorrect results for processing or retrieving time-related information when the date turns January 1, 2000. We believe we are ahead of the curve in dealing with this issue. All the computer hardware and software that the Group uses, such as word processing, inventory control, accounting and invoicing systems, will be upgraded to identify the year with four digits and address the problem presented by the year 2000.

Our task force, which includes members of senior management, was set up way back in 1996 because both our front line and back room operations are highly computerized. We expect that the Group's compliance project will be completed in this fiscal year with additional funding of less than HK$5 million.

Our compliance program should be completed by the second quarter of 1999 and the impact and scope of the Y2K project have been properly defined and documented. To date, 80% of the total work has already been completed and tested, and all systems relating to the Group's retail and distribution businesses are in place.

The compliance plan covers all of the Group's domestic and foreign branches as well as subsidiaries; and incorporates all hardware and software needs – including IT, industrial and communication equipment. Priorities have been assigned for operation-critical systems.

Careful planning has resulted in the ability of the Group to handle 95% of the project through the use of in-house programming resources. Outsourcing costs have therefore been immaterial.

Work that is currently in progress covers systems that handle the Group's sourcing business.

image – consistent and integrated

We had a very cohesive and consistent year for our brand image efforts in FY 1997/98 and we succeeded in creating the right brand experience for our customers in all our stores and across the globe. From Paris to Hong Kong to Sydney, one sees and feels the same Esprit brand – there is consistency, impact and the same high-energy creativity. Our billboards stand tall and brighten up our store windows, just as the Esprit up-tempo experience works through our in-store music, merchandize and sales staff. Ours is a truly integrated image system that, simply stated, radiates warmth and well-being.

The Red Earth brand image brims with freshness, fun and cheerfulness – our free-standing stores suggest precisely those qualities. The store environment is very accessible and consumer friendly. Our customers are encouraged to be what they are and to freshen up and enjoy. This brand will go far.

getting ready for the new millennium

Of course the future is hard to predict and recent events in Asia have cast a pall over at least one region of the world. We have a few blips in Asia but we can tough it out and we are doing all that is necessary. Europe, Australia and Taiwan, on the other hand, are almost clamoring with growth opportunities.

our foundation remains strong

In any case, one year after our consolidation and streamlining of the Esprit Group, our foundation remains strong. We see our business as anchored firmly in multiple markets across the world and several of them offer upward curves. We have a second brand, Red Earth, which is going global too. At the heart of it all, we are a HK$5 billion global and vertically integrated company that centrally controls the Esprit brand and the Red Earth brand.

As the final year of the 20th Century rolls in, we see our Group as more than ready for the new millennium.

financial report

The Directors have pleasure in presenting their annual report and the audited financial statements for the year ended June 30, 1998.

Principal Activities

The Company is an investment holding company. The activities of the principal subsidiaries are shown in note 27 to the financial statements. The Group is principally engaged in the design, licensing, sourcing, manufacturing, wholesale and retail distribution of high quality fashion products under the internationally known ESPRIT brand name in Europe, Asia, Canada and Australia, together with Red Earth cosmetics, skin and general body care products.

The turnover and contribution by principal activities and geographical markets are as follows:

	Turnover HK$'000	Contribution HK$'000
Analysis by principal activities		
Retail	2,765,140	156,939
Wholesale	2,245,353	304,464
Others	76,713	28,184
	5,087,206	489,587
Analysis by principal markets		
Germany	2,201,716	270,552
China (including Hong Kong)	756,546	52,405
The Netherlands and Belgium	573,901	102,812
Australia	392,444	30,250
Taiwan	340,842	53,038
United Kingdom and Scandinavia	231,015	(28,934)
Singapore and Malaysia	176,384	12,657
France and Austria	168,019	11,215
Canada	101,365	(5,802)
South Korea and Japan	86,964	(45,632)
Others	58,010	37,026
	5,087,206	489,587

Results and Appropriations

The results of the Group and appropriations of the Company are set out in the consolidated profit and loss account on page 35 and in the accompanying notes to the financial statements.

Interim dividend of 3.80 cents per share, totalling HK$ 41,517,000, was paid on May 4, 1998. Details are set out in note 7 to the financial statements.

The Directors do not recommend the payment of a final dividend.

Reserves

Movements in reserves of the Group and the Company during the year are set out in note 18 to the financial statements.

Financial Summary

A summary of the results of the Group for the five financial years is set out on page 60.

A summary of the balance sheets of the Group for the five financial years is set out on page 60.

Share Capital

Details of movements in share capital of the Company are set out in note 17 to the financial statements.

Details of the share options granted by the Company are set out in note 17 to the financial statements.

Fixed Assets

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

Bank Loans and Overdrafts

Details of bank loans and overdrafts are set out in notes 14 and 20 to the financial statements.

Charitable Donations

During the year, the Group made charitable donations totalling HK$140,407.

Directors and Service Contracts

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

Executive Directors:

Michael Ying Lee Yuen
Alva Chan Wai Mo
Connie Wong Chin Tzi
Surinder Chhibber
Enrique Danilo Arrata Meneses (resigned on March 31, 1998)
Heinz Jürgen Krogner-Kornalik

Non-executive Directors:

Joyce Elena Ma
Alexander Reid Hamilton
Raymond Or Ching Fai
Jürgen Alfred Rudolf Friedrich

In accordance with the Company's Bye-laws, Ms. Connie Wong Chin Tzi and Mr. Alexander Reid Hamilton retire by rotation and, being eligible, offer themselves for re-election.

Heinz Jürgen Krogner-Kornalik has entered into a service agreement which took effect from January 9, 1995 and continues thereafter until terminated by either party giving to the other not less than 12 months' notice of termination, such notice will only take effect from or after December 31, 2000.

Mr. Raymond Or Ching Fai was appointed for a three year term expiring on February 28, 1999.

Save as disclosed above, none of the Directors has a service contract with the Company which is not determinable by the Company within one year without payment of compensation.

Directors and Senior Management Profile

Executive Directors

Michael Ying Lee Yuen, aged 48, is the Chairman and Chief Executive Officer of the Group. Mr. Ying has over 25 years' experience in apparel distribution and manufacturing. He is primarily responsible for the overall direction and formulation of corporate policies of the Group.

Alva Chan Wai Mo, aged 42, is the Chief Financial Officer of the Group. Mr. Chan was initially appointed as Chief Financial Officer of Asia operation in 1992, then General Manager of South Korea operations and currently, he is the Chief Executive Officer of Esprit International and Chairman of Red Earth Group. He received a Master of Business Administration Degree from the State University of New York and is a fellow of the Hong Kong Society of Accountants.

Heinz Jürgen Krogner-Kornalik, aged 57, is the Chief Executive Officer of the Group's Europe operation and has been with the Group since January 1995. He possesses a degree in business administration. He had been a consultant with Kurt Salmon Associates in a variety of areas, including production, organization, marketing, strategy and brand positioning as well as with several textile firms before joining the Group.

Directors and Senior Management Profile *continued*

Executive Directors *continued*

Surinder Chhibber, aged 48, is the Chief Executive Officer of the Group's Asia operation. He joined the Group in 1987 and has over 20 years' experience in the garment industry. He holds a Master of Science Degree in Engineering from the University of Hong Kong and a Master of Science Degree in Operation Research from the University of Delhi.

Connie Wong Chin Tzi, aged 50, is the Director of the Group's Taiwan and South Korea operation. Prior to joining the Group in 1979, she worked for the Asian buying office of a major U.S. department store for over eight years. Ms. Wong received her Bachelor of Arts Degree in Business Administration from the National Taiwan University.

Non-executive Directors

Alexander Reid Hamilton, aged 57, has been an Independent Non-executive Director of the Company since August 1995. He is also a director of CITIC Pacific Limited, COSCO Pacific Limited, COSCO International Holdings Limited and the Swank Shop Limited. He was a partner of Price Waterhouse with which he practised for 16 years.

Joyce Elena Ma, aged 57, was appointed as an Independent Non-executive Director in 1993, is the founder and managing director of Joyce Boutique Holdings Limited and has over 25 years' experience in the fashion industry.

Jürgen Alfred Rudolf Friedrich, aged 60, founded the Esprit Europe operation in 1976 and was appointed as a Non-executive Director in 1997. He has over 30 years of experience in the apparel distribution business and is currently retired in Germany. He is one of the shareholders of Worldwide Thousand Limited, which is a major shareholder of the Company.

Raymond Or Ching Fai, aged 48, was appointed in 1996, is the Head of Corporate and Institutional Banking of The Hongkong and Shanghai Banking Corporation Limited of which he joined in 1972. The Company is a long-standing client of the Hongkong Bank.

Senior Management

Andreas Kromer, aged 40, is the head of retail operations for Esprit Europe. After completing his studies in retailing at the German Polytechnic in Nagold, he worked for six years in the well-known German textile retail company, Boecker. He then assumed the position of managing director for the German department store, Cramer Meermann, until he joined the Group in 1992.

Derong Yang, aged 33, is the image director of the Group. He joined the Group in September 1994 as the creative director. His current role is to create and ensure the smooth implementation of an integrated image system throughout the operating regions of the Group. Prior to joining Esprit, he had worked with a renown French designer "Jean Charles de Castelbajac" as design director. He has received awards for excellence in his creative endeavors and is an activist in the local arts and culture scene.

Eddie Wan Tat Wah, aged 44, is the Chief Operation Officer of China and Hong Kong business. He has over 20 years of experience in garment trading and retail business. Eddie first joined the Group in 1984 and was extensively involved in store operations and merchandizing/buying in Hong Kong. He left the Group in the year 1993 to establish his own business and rejoined the Group in mid-1997.

Günter Wartenberg, aged 45, is the Chief Financial Officer of Esprit Europe Group. He joined Esprit Europe in 1991. Mr. Wartenberg studied taxation and auditing before receiving his doctorate degree from the University of Cologne. He has 16 years of experience in finance and accounting and had worked with Bertelsmann AG, Henkel KgaA and Facit GmbH before joining Esprit Europe.

Joris Leeman, aged 34, is the Chief Operating Officer of Esprit Europe Group. He holds a Master degree and a Master of Business Administration degree in International Business from the European campus of Webster University, St. Louis. Before joining the Group in September 1998, he worked for 11 years for MEXX and Johnson & Johnson on Pan-European consolidation in Logistics Operations, Quality Management and European Marketing.

Morris Wagenheim, aged 45, is the Managing Director of Australian operation. He joined Esprit in 1994, after having spent the previous four years as General Manager of the 150-store Sportsgirl chain in Australia. Mr. Wagenheim has spent most of his working career with the Wooltru Group in South Africa, the largest retailing conglomerate in that country. His career has spanned all aspects of fashion retailing. He has been instrumental in building Esprit Australia into a profitable, fully integrated retail operation with store throughout all states in Australia.

Senior Management *continued*

Shirley Chik Yee Wan, aged 38, is the Corporate Controller of the Group. She graduated from Hong Kong Polytechnic in 1983 and became associate members of The Chartered Institute of Management Accountants and the Hong Kong Society of Accountants since 1987. Before joining Esprit in 1987, she has worked for the Hong Kong Telecom Group and Astec International Group. In Esprit, she has experience for various positions in the Finance and Accounting Department and she assumed her current position in 1996.

Stephen Ip Sing Sing, aged 45, is the General Manager who directs the group's management information function and is also responsible for the Group's financial and accounting activities in Asia. Prior to joining the Group, he had assumed key positions in information technology area for a number of multinational companies. He graduated with a Master of Business Administration degree in finance from the University of California, Berkeley.

Steven Ko Soon How, aged 37, is the Chief Executive Officer of Red Earth International, he is responsible for the overall direction of Red Earth Group. After his university education from Canada, he joined Citibank in Australia for 4 years before he co-founded Red Earth brand in 1990, since then, he was heading the sourcing and licensing office before being appointed as Chief Executive Officer in 1997.

Susan Wong Ping, aged 51, joined the Group in 1976 and is the General Manager responsible for the Group's sourcing and production activities for apparel, shoes & accessories including product and fabric development. She has over 25 years of experience in the garment production field. Prior to joining the Group, she held various positions in the garment manufacturing for a local apparel group.

Theresa Tsang Sui Fong, aged 42, joined the Group in 1977 and has been in charge of the human resources division since 1983. She is responsible for formulating and administrating human resources policies, training programs, recruitment, and employee compensations and benefits. She is a member of the Hong Kong Institute of Human Resource Management.

Thomas Grote, aged 35, is the head of wholesale operation in Europe. He completed business college in 1983 and thereafter worked at a German textile printing company for six years. He joined Esprit in 1990 as key account manager for the accessories division and was later promoted to sales manager. In 1992, he left the Group to work for In-Wear in Germany as sales manager of the men's division and was subsequently promoted to managing director. He returned to the Group in June 1996.

Directors' Interests in Shares

As at June 30, 1998, the interests of the Directors in shares of the Company as recorded in the register maintained under Section 29 of the Hong Kong Securities (Disclosure of Interests) Ordinance ("SDI Ordinance") were as follows:

	Number of shares			
Name of Director	**Personal interests**	**Corporate interests**	**Family interests**	**Other interests**
Michael Ying Lee Yuen	–	649,531,579*	–	–
Alva Chan Wai Mo	1,016,000	–	–	–
Connie Wong Chin Tzi	1,440,000	–	–	–
Surinder Chhibber	2,112,000	–	–	–
Jürgen Alfred Rudolf Friedrich	–	649,531,579*	–	–

* *These shares are held by Worldwide Thousand Limited in which Mr. Michael Ying Lee Yuen and Mr. Jürgen Alfred Rudolf Friedrich have 77% and 23% interest respectively.*

Save as disclosed above, none of the Directors, chief executives or their associates had any interest in the listed securities of the Company or any of its associated corporations as defined in the SDI Ordinance.

Directors' Interests in Contracts

Esprit de Corp. (1980) Ltd. ("Esprit Canada"), a company incorporated in Canada, is a licensee of Esprit International distributing Esprit's product in Canada. Prior to October 17, 1997, 51% of Esprit Canada was owned by Tompkins & Associates (a partnership of Mr. Michael Ying Lee Yuen, Douglas Tompkins and Suzie Tompkins), and 49% by 100930 Canada Limited ("LFCO"). Under the "Facility Agreement" and "Limited Recourse Pledge Agreement" entered between Esprit Canada, its shareholders and the Group, Tompkins & Associates and LFCO agreed to pledge their shares in Esprit Canada to the Group as collateral for the amounts due by Esprit Canada to the Group. On October 17, 1997, as a result of Esprit Canada's failure to repay its debt, the two shareholders of Esprit Canada surrendered all their shares to the Group.

On October 31, 1997, Red Earth International Holdings Limited ("Red Earth"), in which Mr. Michael Ying Lee Yuen has one-third interest, exercised the option contained in the stock option agreement dated September 7, 1992 between Red Earth Limited, an indirect wholly owned subsidiary of the Company, and Red Earth. According to the stock option agreement, Red Earth acquired 20% of the total issued share capital of Red Earth Limited at a consideration of 150% of its net asset value as at June 30, 1997 which amounting to HK$54,159.

On May 7, 1998, the Group acquired 654,100 shares which represented approximately 50% interest in Red Earth from Mr. Michael Ying Lee Yuen (the "Acquisition") at the price of US$1 per share, total approximately HK$5.1 million. Simultaneously with the Acquisition, the Group subscribed for 359,700 new shares in Red Earth at the subscription price of US$1 per share (the "Subscription"). Upon completion of the Acquisition and Subscription, the Group holds about 60.78% of Red Earth.

Prior to the acquisition of Esprit Canada and Red Earth, during the year, the Group entered into transactions with these related companies all of which have been reviewed and confirmed by Directors of the Company, not connected with any member of Esprit Canada, Red Earth and its subsidiaries ("Red Earth Group"), to have been conducted on normal commercial terms and in the ordinary course of business. Details relating to these connected transactions are set out in note 26 to the financial statements.

Save as disclosed above, no contract of significance in relation to the Group's business to which the 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.

Arrangement to Purchase Shares and Debentures

A Share Option Scheme ("the Scheme") was adopted by the Company on November 17, 1993 under which eligible employees of the Group, including Executive Directors of the Company, may be granted options to subscribe for shares in the Company ranging from HK$2.640 to HK$3.096 per share. Details of outstanding share options as at June 30, 1998 granted to the Executive Directors and accepted by Executive Directors under the Scheme are as follows:

Name	**As at 6.30.1998**
Michael Ying Lee Yuen	**15,000,000**
Alva Chan Wai Mo	**6,000,000**
Connie Wong Chin Tzi	**4,000,000**
Surinder Chhibber	**8,000,000**
Heinz Jürgen Krogner-Kornalik	**8,000,000**
Enrique Danilo Arrata Meneses	**6,000,000***

* *These options granted to Enrique Danilo Arrata Meneses, who resigned on March 31, 1998, were expired on July 1, 1998.*

These options were divided into eight equal fractional instalments. The first date of exercise between each instalment shall occur at intervals of six calendar months and expiring on the fifth anniversary of the first date of exercisable of each instalment or ten years from date of adoption of this Scheme, whichever is the earlier. The earliest exercisable date for the first instalment shall occur six months after the date of grant.

Save as disclosed above, at no time during the year was the Company, its subsidiaries, its fellow subsidiaries or its ultimate holding company 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.

Substantial Shareholders

At June 30, 1998, the register of substantial shareholders required to be maintained under Section 16(1) of the SDI Ordinance showed that, other than the interests disclosed above in respect of the Directors, the Company was not notified of any interest which represents 10% or more of the Company's issued share capital.

Purchase, Sale or Redemption of the Company's Shares

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

Pre-emptive Rights

There are no provision for pre-emptive rights under the Company's Bye-laws although there are no restrictions against such rights under the laws of Bermuda.

Major Customers and Suppliers

During the year, less than 30% of the Group's sales were attributable to the five largest customers and less than 30% of the Group's purchases were attributable to the five largest suppliers.

Management Contracts

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

Corporate Governance

During the year, the Company was in compliance with the Code of Best Practice as set out in the Listing Rules of The Stock Exchange of Hong Kong Limited, except that three non-executive directors are not appointed for a specific term but are subject to retirement for rotation at annual general meeting in accordance with the Company's Bye-laws.

Auditors

Our auditors, Price Waterhouse, have merged with Coopers & Lybrand and a resolution to appoint the new firm, PricewaterhouseCoopers, as auditors to the Company will be proposed at the annual general meeting.

On behalf of the board

Alva Chan Wai Mo
Director

Hong Kong, October 16, 1998

AUDITORS' REPORT TO THE SHAREHOLDERS OF ESPRIT HOLDINGS LIMITED

(incorporated in Bermuda with limited liability)

We have audited the financial statements on pages 35 to 59 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

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

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

Basis of opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view, in all material respects, of the state of affairs of the Company and the Group as at June 30, 1998 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Price Waterhouse

Price Waterhouse
Certified Public Accountants

Hong Kong, October 16, 1998

consolidated profit and loss account

for the year ended June 30, 1998

	Notes	1998 HK$'000	1997 HK$'000
Turnover		**5,087,206**	3,351,742
Operating Profit	2	**489,587**	400,889
Exceptional Item	4	**(125,300)**	–
		364,287	400,889
Share of Results of Associated Companies		**(17,616)**	1,053
Profit before Taxation		**346,671**	401,942
Taxation	5	**(153,916)**	(144,000)
Profit after Taxation		**192,755**	257,942
Minority Interests		**(37,656)**	(22,411)
Profit Attributable to Shareholders	6	**155,099**	235,531
Dividends	7	**(41,517)**	(125,309)
Retained Profit for the Year		**113,582**	110,222
Earnings Per Share	8	**14.20 cents**	26.11 cents

consolidated balance sheet

at June 30, 1998

	Notes	1998 HK$'000	1997 HK$'000
Trademarks	9	**783,133**	803,474
Fixed Assets	10	**403,099**	463,098
Other Investments	11	**93,158**	214,263
Associated Companies	13	**43,200**	12,828
Net Current Assets	14	**438,669**	419,635
		1,761,259	1,913,298
Financed by:			
Share Capital	17	**109,255**	108,806
Reserves	18	**1,053,810**	1,012,137
Shareholders' Funds		**1,163,065**	1,120,943
Minority Interests		**2,244**	14,989
Obligations under Finance Leases	19	**8,773**	320
Long Term Loans	20	**537,811**	722,879
Deferred Taxation	21	**49,366**	54,167
		1,761,259	1,913,298

Michael Ying Lee Yuen
Director

Alva Chan Wai Mo
Director

balance sheet

at June 30, 1998

	Notes	1998 HK$'000	1997 HK$'000
Subsidiaries	12	**2,280,264**	2,242,096
Net Current Assets	14	**4,333**	47,532
		2,284,597	2,289,628
Financed by:			
Share Capital	17	**109,255**	108,806
Reserves	18	**1,642,805**	1,483,412
Shareholders' Funds		**1,752,060**	1,592,218
Long Term Loans	20	**532,537**	697,410
		2,284,597	2,289,628

Michael Ying Lee Yuen
Director

Alva Chan Wai Mo
Director

consolidated cash flow statement

for the year ended June 30, 1998

	Notes	1998 HK$'000	1997 HK$'000
Net Cash Inflow from Operating Activities	22(a)	**401,552**	410,346
Returns on Investments and Servicing of Finance			
Interest received		**19,764**	26,008
Interest paid		**(49,238)**	(53,048)
Finance charges on finance leases		**(144)**	(215)
Income from long term listed investments		**6,594**	–
Income from short term listed investments		–	13,008
Dividends paid		**(127,282)**	(92,996)
Dividends paid to a minority shareholder of a subsidiary		**(42,517)**	(23,178)
Net Cash Outflow from Returns on Investments and Servicing of Finance		**(192,823)**	(130,421)
Taxation			
Hong Kong profits tax paid		**(27,237)**	(23,174)
Overseas tax paid		**(128,123)**	(52,670)
Tax Paid		**(155,360)**	(75,844)
Investing Activities			
Purchase of subsidiaries	22(d)	**(35,825)**	(950,800)
Settlement of deferred payment for a subsidiary acquired		–	(114,044)
Investment in an associated company		–	(6,845)
Loan to an associated company		**(49,000)**	–
Purchase of other investments		**(28,731)**	(193,463)
Purchase of fixed assets		**(180,829)**	(79,303)
Proceeds from disposal of fixed assets		**124,477**	12,070
Proceeds from disposal of other investments		**39,216**	–
Proceeds from partial disposal of interests in a subsidiary		**1,363**	–
Net Cash Outflow from Investing Activities		**(129,329)**	(1,332,385)
Net Cash Outflow before Financing		**(75,960)**	(1,128,304)
Financing			
Net proceeds on issue of shares for cash		**11,862**	631,497
Loans from banks		–	1,315,800
Repayment of obligations under finance leases		**(3,222)**	(2,214)
Repayment of bank loans		**(60,488)**	(633,826)
Net Cash (Outflow)/Inflow from Financing	22(b)	**(51,848)**	1,311,257
(Decrease)/Increase in Cash and Cash Equivalents		**(127,808)**	182,953
Cash and Cash Equivalents at Beginning of Year	22(e)	**530,212**	346,555
Effect of Change in Exchange Rates		**(20,067)**	704
Cash and Cash Equivalents at end of Year	22(e)	**382,337**	530,212

notes to the financial statements

for the year ended June 30, 1998

1. Principal Accounting Policies

The principal accounting policies adopted in the preparation of the financial statements, which conform with Hong Kong Statements of Standard Accounting Practices and accounting principles generally accepted in Hong Kong, are as follows:

(a) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to June 30.

All significant inter-company transactions and balances within the Group are eliminated on consolidation.

The Group accounts also include the Group's share of post acquisition profits less losses, and reserves, of its associated companies.

(b) Turnover

Turnover represents the invoiced sales to, royalties and commission income from outside customers.

(c) Revenue recognition

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

Royalty income is recognised on an accrual basis in accordance with the substance of the licensing agreement.

Commission income is recognised upon service rendered.

Interest income is recognised on time proportion basis on the principals outstanding and the rates applicable.

Income from short term investments, including gains and losses on sales of investments and interest and dividend income, are recognised on an accrual basis.

(d) Trademarks

Trademarks are stated at cost and amortized by equal annual installments over their estimated economic life of 40 years. The cost of acquisition is the fair market value at the time of acquisition determined by an independent valuer.

(e) Goodwill and reserve on acquisition

Goodwill/reserve arising on acquisition represents the excess/shortfall of purchase consideration over the fair values ascribed to the net assets of subsidiaries acquired and is taken directly to reserves in the year of acquisition.

(f) Subsidiaries

A company is a subsidiary if more than 50% of the issued voting capital is held for the long term.

(g) Associated companies

An associated company is a company, other than a subsidiary, in which the Group has a long term equity investment, and over which the Group is in a position to exercise significant influence in management, including participation in commercial and financial policy decisions.

The consolidated profit and loss account includes the Group's share of the results of associated companies for the year, and the consolidated balance sheet includes the Group's share of the net assets of the associated companies.

(h) Depreciation and amortization

Fixed assets are stated at cost less accumulated depreciation.

Freehold land is not amortized. Leasehold land is amortized over the remaining period of the lease.

Improvements to leasehold properties occupied by the Group under operating leases are amortized over a period of the shorter of five years and the estimated useful life on a straight-line basis.

1. Principal Accounting Policies *continued*

(h) Depreciation and amortization *continued*

Depreciation on other fixed assets is provided to write off the cost of fixed assets over their estimated useful lives, using the straight-line method after taking into account their estimated residual values, at the following annual rates:

Buildings	$3^1/_3$ – 5%
Plant and machinery	30%
Furniture and office equipment	10 – $33^1/_3$%
Motor vehicles and launch	30%

Assets held under finance leases are depreciated over their estimated useful lives on the same basis as owned assets.

Gain or losses arising from the retirement or disposal of fixed assets are determined as the difference between the estimated net disposal proceeds and the carrying amount of the assets and are recognised as income or expense in the profit and loss account.

(i) Leased assets

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the Group. Assets held under finance leases are capitalized at their fair value at the date of acquisition. The principal portions of the corresponding lease commitments are shown as obligations to the lessor. Finance charges are debited to the profit and loss account in proportion to the capital balances outstanding.

All other leases are classified as operating leases and the annual rentals payable under operating leases are charged to the profit and loss account on a straight line basis over the terms of the respective leases.

(j) Other investments

Investments held for the long term are stated at cost less provision for permanent diminution in value.

(k) Stocks and work in progress

Stocks are stated at the lower of cost and net realizable value. Cost, which comprises the direct cost of materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the stocks to their present location and condition, is calculated using the weighted average cost method. Net realizable value is determined on the basis of anticipated sales proceeds less estimated selling expenses.

(l) Foreign currencies

Each operating entity records its transactions in the currency of the jurisdiction in which it operates, termed its "functional currency". Transactions in foreign currencies are translated into the respective functional currencies at the approximate rates ruling on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into the respective functional currencies at the approximate rates ruling on the balance sheet date. Profits or losses arising on exchange are dealt with in the profit and loss account.

On consolidation, the balance sheets of subsidiaries and associated companies expressed in foreign currencies are translated into Hong Kong dollars at the rates of exchange ruling at the balance sheet date and the result of subsidiaries and associated companies at the average rates of exchange prevailing during the year. Exchange differences arising are dealt with as movements in reserves.

(m) Foreign exchange contracts

Foreign exchange contracts and options are entered into to protect the Group from the impact of foreign currency fluctuation. According to Group policy, within a predetermined risk limit, the Group may over or under hedge certain percentage of anticipated foreign exchange exposure. Transactions designated as hedges are valued on an equivalent basis to the assets, liabilities or net positions that they are hedging. Any gain or loss is recognised in the profit and loss account on the same basis as that arising from the related assets, liabilities or positions. All over hedge transactions are marked to market and the gains or losses are recognised in the profit and loss account. No gain or loss is recognised in relation to foreign exchange contracts which are entered into to hedge future commitments until the transaction occurs. Premium on options is amortized over the option period.

1. Principal Accounting Policies *continued*

(n) Deferred taxation

Deferred taxation is provided, using the liability method, on all significant timing differences, other than those which are not expected to crystallize in the foreseeable future. Deferred tax assets are not recognized unless the related benefits are expected to crystallize in the foreseeable future.

(o) Related parties

Related parties are individuals and companies, including associated companies, where the individual, Company or Group has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions.

(p) Cash and cash equivalents

Cash represents cash in hand and deposits repayable on demand with any bank or other financial institution. Cash includes cash in hand and deposits denominated in foreign currencies.

Cash equivalents represent short-term, highly liquid investments which are readily convertible into known amounts of cash without notice and which were within three months of maturity when acquired, less advances from banks repayable within three months from the date of the advance.

2. Operating Profit

	1998 HK$'000	1997 HK$'000
Operating profit is stated after crediting and charging the following:		
Crediting		
Commission income	15,434	8,123
Exchange gain	46,837	4,738
Income from long term listed investments	13,543	–
Income from short term listed investments	–	13,008
Interest income		
– from listed investment	1,537	1,400
– on bank deposits	18,205	23,088
Profit on disposal of fixed assets	14,609	–
Provision for unlisted investment written back	7,749	–
Provision for doubtful debts written back	–	4,251
Royalty income	58,008	32,477
Charging		
Auditors' remuneration	7,512	4,183
Depreciation and amortization		
– Owned assets	133,490	109,911
– Assets held under finance leases	1,468	805
– Trademarks	20,341	10,171
Finance lease charges	144	215
Interest on short term bank loans, overdrafts and other loans wholly repayable within five years	56,860	44,458
Interest on long term bank loans not wholly repayable within five years	–	1,052
Interest paid to a related company *(note 26)*	–	2,608
Loss on disposal of fixed assets	–	1,531
Operating lease rental expenses		
– Land and buildings	540,064	488,370
– Others	13,527	7,094
Provision for doubtful debts	10,741	–
Provision for estimated loss for terminating overseas operations	16,108	–
Royalties paid to a related company *(note 26)*	–	25,797

3. Directors' Emoluments

	1998 HK$'000	1997 HK$'000
Fees		
– Non-executive Directors	**620**	562
Salaries, housing and other allowances, benefits in kind		
– Executive Directors	**20,136**	16,351
Bonuses		
– Executive Directors	**10,709**	6,880
Compensation for loss of office		
– Executive Directors	**2,809**	–
	34,274	23,793

The emoluments were paid to the Directors as follows:

Emoluments Band	Number of Directors 1998	1997
Nil – HK$1,000,000	**4**	6
HK$1,500,001 – HK$2,000,000	–	1
HK$2,000,001 – HK$2,500,000	–	2
HK$2,500,001 – HK$3,000,000	**1**	1
HK$3,000,001 – HK$3,500,000	–	1
HK$4,000,001 – HK$4,500,000	**1**	–
HK$4,500,001 – HK$5,000,000	–	1
HK$5,500,001 – HK$6,000,000	**1**	–
HK$6,000,001 – HK$6,500,000	**2**	1
HK$7,500,001 – HK$8,000,000	**1**	–
	10	13

The Directors' emoluments presented above include the emoluments of the four *(1997: three)* highest paid individuals in the Group.

Details of emoluments paid to the other one individual *(1997: two)* who is not a director but whose emoluments were among the five highest paid individuals in the Group are as follows:

	1998 HK$'000	1997 HK$'000
Salaries, housing and other allowances, benefits in kind	**959**	8,202
Bonuses	**1,075**	2,451
Compensation for loss of office	**6,528**	–
	8,562	10,653

Emoluments Band	Number of Individuals 1998	1997
HK$5,000,001 – HK$5,500,000	–	2
HK$8,500,001 – HK$9,000,000	**1**	–
	1	2

4. Exceptional Item

It represents the provision for diminution in value of listed investment held for the long term *(note 11)*.

5. Taxation

	1998 HK$'000	1997 HK$'000
Company and its subsidiaries:		
Hong Kong profits tax	**25,136**	23,566
Overseas taxation net of overprovision in prior years of HK$55,619,000 *(1997: HK$8,073,000)*	**131,127**	103,118
Deferred taxation *(note 21)*	**(2,266)**	17,000
	153,997	143,684
Associated companies – overseas taxation	**(81)**	316
	153,916	144,000

Hong Kong profits tax has been provided at the rate of 16.0% *(1997: 16.5%)* on the estimated assessable profit for the year.

Taxation on overseas profits has been calculated on the estimated assessable profits for the year at the rates of taxation prevailing in the countries in which the Group operates.

	Group 1998 HK$'000	1997 HK$'000
Deferred taxation (credit)/charge for the year has not been provided in respect of the following:		
Accelerated depreciation allowances	**1,014**	137
Tax losses	**(5,605)**	9,081
Other timing differences	**409**	3,538
	(4,182)	12,756

6. Profit Attributable to Shareholders

The profit attributable to shareholders is dealt with in the financial statements of the Company to the extent of HK$ 189,497,000 *(1997: HK$133,291,000)*.

7. Dividends

	1998 HK$'000	1997 HK$'000
Interim dividend paid of 3.80 cents *(1997: 3.65 cents)* per share	**41,517**	32,959
Proposed final dividend of nil cent *(1997: 7.85 cents)* per share	–	85,765
	41,517	118,724
Alignment of 1997 interim dividend on 180,410,00 new shares issued	–	6,585
	41,517	125,309

8. Earnings Per Share

The calculation of earnings per share is based on the profit attributable to shareholders of HK$155,099,000 *(1997: HK$235,531,000)* and on the weighted average number of shares in issue during the year of 1,092,379,912 *(1997: 902,005,456)*.

Fully diluted earnings per share is not presented as the exercise of the outstanding share options of the Company would not have a material diluting effect on the 1998 earnings per share.

9. Trademarks

	Group 1998 HK$'000	1997 HK$'000
At July 1	**803,474**	–
Acquisition of subsidiaries	–	813,645
Less: Amortization	**(20,341)**	(10,171)
At June 30	**783,133**	803,474

10. Fixed Assets

Group

	Freehold land outside Hong Kong HK$'000	Long term leasehold land in Hong Kong HK$'000	Buildings HK$'000	Leasehold improvements and fixtures HK$'000	Plant and machinery HK$'000	Furniture and office equipment HK$'000	Motor vehicles and launch HK$'000	Total HK$'000
Cost								
At July 1, 1997	43,500	25,931	120,400	751,123	14,239	380,263	10,472	1,345,928
Exchange translation	(4,960)	–	(6,720)	(56,026)	(565)	(25,895)	(837)	(95,003)
Reclassification	3,418	–	(9,373)	5,955	359	(359)	–	–
Acquisition of Subsidiaries	219	–	–	51,452	1,029	73,003	1,687	127,390
Additions	–	–	10,760	124,816	483	41,143	4,821	182,023
Disposals	(18,897)	–	(49,063)	(177,889)	(178)	(45,954)	(3,639)	(295,620)
At June 30, 1998	**23,280**	**25,931**	**66,004**	**699,431**	**15,367**	**422,201**	**12,504**	**1,264,718**
Depreciation								
At July 1, 1997	–	997	24,755	525,919	12,590	311,094	7,475	882,830
Exchange translation	–	–	(1,456)	(36,929)	(528)	(20,370)	(638)	(59,921)
Reclassification	–	–	(4,398)	4,398	215	(215)	–	–
Acquisition of Subsidiaries	–	–	–	35,112	888	52,804	700	89,504
Charge for the year	–	499	3,571	86,602	1,030	40,741	2,515	134,958
Disposals	–	–	(11,181)	(135,491)	(177)	(35,914)	(2,989)	(185,752)
At June 30, 1998	**–**	**1,496**	**11,291**	**479,611**	**14,018**	**348,140**	**7,063**	**861,619**
Net book values								
At June 30, 1998	**23,280**	**24,435**	**54,713**	**219,820**	**1,349**	**74,061**	**5,441**	**403,099**
At June 30, 1997	43,500	24,934	95,645	225,204	1,649	69,169	2,997	463,098

At June 30, 1998, the net book value of furniture and office equipment includes an amount of HK$12,417,000 *(1997: HK$911,000)* in respect of assets held under finance leases.

At June 30, 1997, freehold land outside Hong Kong and buildings with net book value of HK$50,308,000 had been pledged to secure bank loans of the Group. The bank loans have been fully repaid in 1998.

11. Other Investments

	Group 1998 HK$'000	Group 1997 HK$'000
Investments listed in Hong Kong, at cost	**208,397**	211,908
Provision *(note 4)*	**(125,300)**	–
	83,097	211,908
Unlisted investments, at cost	**10,061**	10,104
Provision	**–**	(7,749)
	10,061	2,355
	93,158	214,263
Market value of listed investments	**79,690**	229,397

12. Subsidiaries

	Company 1998 HK$'000	Company 1997 HK$'000
Unlisted shares, at Directors' valuation	**216,677**	216,677
Loans to subsidiaries	**1,621,930**	1,621,930
Amounts due from subsidiaries	**501,571**	503, 219
	2,340,178	2,341,826
Amounts due to subsidiaries	**(59,914)**	(99,730)
	2,280,264	2,242,096

The Directors' valuation of the investment in subsidiaries is based on the underlying net assets of the subsidiaries acquired by the Company under the Group's reorganization which became effective on November 17, 1993.

Except for a loan to a subsidiary of US$170 million (approximately HK$1,314.1 million) which carries interest at 2% over London Interbank Offer Rate and is wholly repayable on January 10, 2002, the remaining loan balance is interest free and has no fixed terms of repayment.

Details of the Company's principal subsidiaries at June 30, 1998 are set out in note 27 to the financial statements.

13. Associated Companies

	Group 1998 HK$'000	Group 1997 HK$'000
Share of net (liabilities)/assets	**(5,800)**	12,828
Loan to an associated company	**49,000**	–
	43,200	12,828
Unlisted shares, at cost	**8,252**	8,252

The loan to an associated company is unsecured, non-interest bearing and has no fixed terms of repayment.

13. Associated Companies *continued*

The following is a list of associated companies:

Name	Place of incorporation	Principal activities	Group equity interest
Esmido Fashions Limited	Thailand	Retail distribution of fashion products	24%
Esprit Japan Company Limited	Japan	Retail distribution of fashion products	50%
Tactical Solutions Incorporated ("Esprit China")	British Virgin Islands	Investment holding	49%

14. Net Current Assets

	Group		Company	
	1998 HK$'000	1997 HK$'000	**1998 HK$'000**	1997 HK$'000
Current Assets				
Stocks and work in progress *(note 15)*	**517,416**	469,574	–	–
Debtors, deposits and prepayments	**526,292**	444,911	–	–
Amounts due from associated companies	**35,180**	2,429	–	–
Amounts due from related companies *(note 16)*	–	11,831	–	–
Dividend receivable	–	–	**166,539**	131,750
Short-term bank deposits	**191,826**	337,789	–	–
Bank balances and cash	**272,887**	234,489	**480**	4,225
	1,543,601	1,501,023	**167,019**	135,975
Current Liabilities				
Creditors and accrued charges	**618,746**	656,552	**33,128**	2,678
Obligations under finance leases				
– due within one year *(note 19)*	**7,082**	1,397	–	–
Long term loans				
– due within one year *(note 20)*	**121,238**	5,323	**121,238**	–
Short-term bank loans	**45,206**	38,659	–	–
Bank overdrafts	**37,170**	3,407	–	–
Taxation	**275,490**	290,285	**8,320**	–
Proposed dividend	–	85,765	–	85,765
	1,104,932	1,081,388	**162,686**	88,443
	438,669	419,635	**4,333**	47,532

15. Stocks and Work in Progress

	Group	
	1998 HK$'000	1997 HK$'000
Raw materials	**12,096**	27,029
Work in progress	**5,694**	10,923
Finished goods	**486,515**	418,953
Consumables	**13,111**	12,669
	517,416	469,574

16. Amounts Due from Related Companies

Particulars of the amounts due from the related companies are as follows:

Name of borrower	**Balance as at 6.30.1998 HK$'000**	Balance as at 7.1.1997 HK$'000	Maximum amount during the year HK$'000
Red Earth International Holdings Limited and its subsidiaries ("Red Earth group")	–	342	1,762
Esprit de Corp. (1980) Ltd.	–	11,489	14,471
	–	11,831	

Red Earth group and Esprit de Corp. (1980) Ltd. became subsidiaries of the Group during the year.

17. Share Capital

	1998 HK$'000	1997 HK$'000
Authorised:		
2,000,000,000 shares of HK$0.10 each *(note (a))*	**200,000**	130,000

	Number of shares of HK$0.10 each '000	**Nominal value HK$'000**
Issued and fully paid:		
Balance at July 1, 1997	1,088,056	108,806
Exercise of share options *(note (b))*	4,490	449
Balance at June 30, 1998	**1,092,546**	**109,255**

(a) By an ordinary resolution passed on December 12, 1997, the authorised share capital of the Company was increased from HK$130,000,000 to HK$200,000,000 by the creation of 700,000,000 shares of HK$0.10 each.

(b) During the year, 3,990,000 and 500,000 ordinary shares of HK$0.10 were issued at a premium of HK$2.540 and HK$2.556 each respectively in relation to share options exercised by employees under the Company's Share Option Scheme.

(c) On November 17, 1993, the Company adopted a Share Option Scheme (the "Scheme") pursuant to which the Directors may grant options to eligible employees, including Executive Directors of the Company, to subscribe for shares in the Company. In accordance with the terms of the Share Option Scheme, the number of shares in respect of which options may be granted under the Share Option Scheme shall not exceed 20% of the issued share capital of the Company from time to time.

Each Share Option entitles the holder to subscribe for one share of HK$0.10 each at a predetermined price. Options granted were divided into eight equal fractional installments. The first date of exercise between each installment shall occur at interval of six calendar months and expiring on the fifth anniversary of the first date of exercise of each installment or 10 years from the date of adoption of this Scheme, whichever is the earlier. The exercisable date for the first installment shall occur six months after the date of grant. At June 30, 1998 there were 84,563,500 options outstanding which allow the eligible employees to subscribe for shares in the Company at the price from HK$2.640 to HK$3.096 per share. Details of outstanding share options as of June 30, 1998 are as follows:

17. Share Capital *continued*

Date of share options granted	Number of outstanding share options granted as at June 30, 1998	Subscription price per share
January 20, 1994	11,626,000	HK$2.640
December 13, 1995	3,000,000	HK$2.640
July 5, 1996	5,000,000	HK$2.640
July 10, 1996	187,500	HK$2.640
July 30, 1996	1,000,000	HK$2.640
January 23, 1997	2,750,000	HK$2.656
January 27, 1997	2,000,000	HK$2.656
January 28, 1997	23,000,000	HK$2.656
February 16, 1997	2,000,000	HK$2.656
February 17, 1997	2,000,000	HK$2.656
February 26, 1997	1,000,000	HK$2.656
March 5, 1997	1,000,000	HK$2.940
March 13, 1997	1,500,000	HK$2.940
April 12, 1997	1,000,000	HK$2.940
April 17, 1997	1,000,000	HK$2.940
April 28, 1997	1,000,000	HK$2.940
May 2, 1997	3,000,000	HK$2.656
May 15, 1997	4,000,000	HK$2.944
May 26, 1997	15,000,000	HK$3.096
May 27, 1997	2,000,000	HK$2.852
June 17, 1997	1,500,000	HK$2.940
	84,563,500	

18. Reserves

Group

	Share premium HK$'000	Contributed surplus HK$'000	Translation reserve HK$'000	Retained profit HK$'000	Total HK$'000
Balance at July 1, 1997	925,369	6,602	(10,853)	91,019	1,012,137
Premium arising from issues of shares *(notes 17(b))*	11,413	–	–	–	11,413
Goodwill on acquisition of subsidiaries	–	–	–	(22,604)	(22,604)
Exchange translation	–	–	(60,718)	–	(60,718)
Profit for the year retained by:					
Company and its subsidiaries	–	–	–	131,117	131,117
Associated companies	–	–	–	(17,535)	(17,535)
Balance at June 30, 1998	**936,782**	**6,602**	**(71,571)**	**181,997**	**1,053,810**
Attributable to:					
Company and its subsidiaries	936,782	6,602	(69,372)	193,849	1,067,861
Associated companies	–	–	(2,199)	(11,852)	(14,051)
	936,782	6,602	(71,571)	181,997	1,053,810

18. Reserves *continued*

Company

	Share premium HK$'000	Contributed surplus HK$'000	Retained profit HK$'000	Total HK$'000
Balance at July 1, 1997	925,369	473,968	84,075	1,483,412
Premium arising from issues of shares *(notes 17(b))*	11,413	–	–	11,413
Profit for the year	–	–	189,497	189,497
Dividends *(note 7)*	–	–	(41,517)	(41,517)
Balance at June 30, 1998	**936,782**	**473,968**	**232,055**	**1,642,805**

The contributed surplus of the Company represents the difference between the underlying net tangible assets of the subsidiaries acquired by the Company and the nominal amount of the share capital issued by the Company arising from the group reorganization which became effective on November 17, 1993 and the excess of the value of the shares acquired over the nominal value of the shares issued for the acquisition of Esprit Far East Limited and its subsidiaries on January 10, 1997. Contributed surplus is available for distribution to shareholders under the laws in Bermuda.

Distributable reserve of the Company at June 30, 1998 amounted to HK$ 706,023,000 *(1997: HK$558,043,000)*.

19. Obligations under Finance Leases

	Group 1998 HK$'000	Group 1997 HK$'000
The maturity of the obligations is as follows:		
Within one year	**7,082**	1,397
In the second year	**5,639**	320
In the third to fifth years inclusive	**3,134**	–
	15,855	1,717
Amount due within one year included under current liabilities *(note 14)*	**(7,082)**	(1,397)
	8,773	320

20. Long Term Loans

	Group 1998 HK$'000	Group 1997 HK$'000	Company 1998 HK$'000	Company 1997 HK$'000
Secured bank loans				
– wholly repayable within 5 years	**653,775**	701,102	**653,775**	697,410
– not wholly repayable within 5 years	–	27,100	–	–
	653,775	728,202	**653,775**	697,410
Unsecured other loan				
– wholly repayable within 5 years	**5,274**	–	–	–
	659,049	728,202	**653,775**	697,410
Amount due within one year included under current liabilities *(note 14)*	**(121,238)**	(5,323)	**(121,238)**	–
	537,811	722,879	**532,537**	697,410

20. Long Term Loans *continued*

	Group 1998 HK$'000	Group 1997 HK$'000	Company 1998 HK$'000	Company 1997 HK$'000
The maturity of the long term loans is as follows:				
Bank loans *(note (a))*				
– within one year	**121,238**	5,323	**121,238**	–
– in the second year	**152,984**	218,604	**152,984**	216,972
– in the third to fifth years inclusive	**379,553**	485,334	**379,553**	480,438
– in more than five years	–	18,941	–	–
	653,775	728,202	**653,775**	697,410
Other loan *(note (b))*				
– in the third to fifth years inclusive	**5,274**	–	–	–
	659,049	728,202	**653,775**	697,410

(a) The bank loan of HK$ 653,775,000 *(1997: HK$697,410,000)* is secured by the share capital of certain subsidiaries of the Company. In addition, there are unconditional and irrevocable continuing joint and several guarantees of these subsidiaries for the outstanding loan amount which are supported by charges over their respective assets, revenues and undertakings.

(b) Other loan is made by a minority shareholder of a subsidiary and it is unsecured, non-interest bearing and repayable in full on March 19, 2003.

21. Deferred Taxation

	Group 1998 HK$'000	Group 1997 HK$'000
At July 1	**54,167**	–
Transfer (to)/from profit and loss account *(note 5)*	**(2,266)**	17,000
Acquisition of subsidiaries	–	41,603
Exchange translation	**(2,535)**	(4,436)
At June 30	**49,366**	54,167
Provided in the accounts in respect of:		
Accelerated depreciation allowances	**84**	56
Other timing differences	**49,282**	54,111
	49,366	54,167

The potential assets for deferred taxation for which no provision has been made in the financial statements amounts to:

	Group 1998 HK$'000	Group 1997 HK$'000
Accelerated depreciation allowances	**19,035**	6,603
Tax losses	**23,982**	–
Other timing differences	**2,750**	2,376
	45,767	8,979

22. Notes to Consolidated Cash Flow Statement

(a) Reconciliation of profit before taxation and exceptional item to net cash inflow from operating activities

	1998 HK$'000	1997 HK$'000
Profit before taxation and exceptional item	**471,971**	401,942
Interest income	**(19,742)**	(24,488)
Interest expense	**56,860**	48,118
Finance charges on obligations under finance leases	**144**	215
Amortization of trademarks	**20,341**	10,171
Depreciation	**134,958**	110,716
(Profit)/loss on disposal of fixed assets	**(14,609)**	1,531
Profit on partial disposal of interests in a subsidiary	**(363)**	–
Income from short term listed investments	–	(13,008)
Income from long term listed investments	**(13,543)**	–
Provision for estimated loss for terminating overseas operations	**16,108**	–
Share of results of associated companies	**17,616**	(1,053)
Provision for unlisted investment written back	**(7,749)**	–
(Increase)/decrease in stocks and work in progress	**(7,393)**	46,800
(Increase)/decrease in debtors, deposits and prepayments	**(37,475)**	19,623
Increase in amounts due from associated companies	**(32,751)**	–
Increase in amounts due from related companies	**(8,527)**	(21,472)
Decrease in creditors and accrued charges	**(135,677)**	(142,118)
Decrease in amounts due to related companies	–	(11,736)
Effect of foreign exchange rate changes	**(38,617)**	(14,895)
	401,552	410,346

(b) Analysis of changes in financing during the year

	Share capital (including share premium) HK$'000	Minority interests HK$'000	Long term loans HK$'000	Obligations under finance leases HK$'000
Balance at July 1, 1997	1,034,175	14,989	728,202	1,717
Cash inflow/(outflow) from financing	11,862	–	(60,488)	(3,222)
Share of goodwill on acquisition of subsidiaries	–	(7,261)	–	–
Share of exchange reserve	–	238	–	–
Partial disposal of interests in a subsidiary	–	1,015	–	–
Subsidiaries acquired during the year	–	(2,329)	5,485	16,227
Inception of new finance leases	–	–	–	1,194
Share of net profit attributable to minority shareholders	–	37,656	–	–
Dividend paid	–	(42,517)	–	–
Exchange difference	–	453	(14,150)	(61)
Balance at June 30, 1998	**1,046,037**	**2,244**	**659,049**	**15,855**

22. Notes to Consolidated Cash Flow Statement *continued*

(c) Purchase of subsidiaries

	1998 HK$'000
Net assets acquired	
Fixed assets	37,886
Investments	(3,503)
Stocks	40,449
Debtors, deposits and prepayments	41,437
Bank balances and cash	16,382
Creditors and accrued charges	(74,141)
Taxation	(82)
Bank overdrafts and short term bank loans	(42,584)
Finance leases	(16,227)
Amounts due to related companies	(20,358)
Loan from a minority shareholder	(5,485)
Deferred taxation	(627)
Minority shareholders' interests	2,329
	(24,524)
Less: interest in associated companies	4,282
	(20,242)
Goodwill	29,865
	9,623
Satisfied by:	
Cash paid	9,623

The subsidiaries acquired during the year utilised HK$9,511,000 of the Group's net operating cash flows and paid HK$722,000 in respect of the net returns on investments and servicing of finance and utilised HK$16,410,000 for investing activities.

(d) Analysis of net outflow of cash and cash equivalents in respect of the purchase of subsidiaries

	HK$'000
Cash paid	9,623
Bank balances and cash acquired	(16,382)
Bank overdrafts and short-term bank loans of acquired subsidiaries	42,584
Net outflow of cash and cash equivalents in respect of the purchase of subsidiaries	35,825

(e) Analysis of the balance of cash and cash equivalents

	1998 HK$'000	1997 HK$'000
Short-term bank deposits	191,826	337,789
Bank balances and cash	272,887	234,489
Short-term bank loans	(45,206)	(38,659)
Bank overdrafts	(37,170)	(3,407)
	382,337	530,212

23. Contingent Liabilities

	Company 1998 HK$'000	1997 HK$'000
Guarantees given to banks in respect of banking facilities granted to subsidiaries	**1,233,693**	372,040

24. Operating Lease Commitments

	Group 1998 HK$'000	1997 HK$'000
Operating lease commitments at June 30 payable in the next twelve months, analysed according to the period in which the lease expires, are as follows:		
Land and buildings		
– expiring in the first year	**39,855**	45,777
– expiring in the second to fifth years inclusive	**288,953**	249,335
– expiring beyond five years	**102,813**	62,376
	431,621	357,488
Other equipment		
– expiring in the first year	**4,474**	1,679
– expiring in the second to fifth years inclusive	**7,483**	10,334
– expiring beyond five years	**317**	–
	443,895	369,501

The operating lease rentals of certain retail outlets are based on the higher of a minimum guaranteed rental and a sales level based rental. The minimum guaranteed rental has been used to arrive at the above commitments.

The Company did not have any operating lease commitments at June 30, 1998 *(1997: Nil)*.

25. Commitments

(a) Capital Commitments

	Group 1998 HK$'000	1997 HK$'000
Contracted but not provided for	**3,212**	–
Authorised but not contracted for	**18,934**	12,134
	22,146	12,134

The Company did not have any significant capital commitments at June 30, 1998 *(1997: Nil)*.

25. Commitments *continued*

(b) Foreign Exchange Contracts

At June 30, the notional amounts of the Group's foreign exchange contracts are as follows:

	Group 1998 HK$'000	1997 HK$'000
Forward contracts	**2,905,571**	363,387
Option contracts	**464,760**	196,613
	3,370,331	560,000

Foreign exchange contracts, which include forward and options, are entered into primarily to protect the Group from the impact of currency fluctuation during the normal course of business, like the fact that the Group buys and sells the finished goods in different markets, using various currencies.

26. Connected Transactions

Esprit de Corp (1980) Ltd. ("Esprit Canada") is a company incorporated in Canada and a licensee of Esprit International distributing Esprit products in Canada. Prior to October 17, 1997, 51% of Esprit Canada was owned by Tompkins & Associates (a partnership of Mr. Michael Ying Lee Yuen ("MY"), Douglas Tompkins and Suzie Tompkins) and 49% by 100930 Canada Ltd. ("LFCO") (a Canadian company controlled by Mr. Lawrence Firestone). Under the "Facility Agreement" and "Limited Recourse Pledge Agreement" entered into between Esprit Canada, its shareholders and the Group, Tompkins & Associates and LFCO agreed to pledge their shares in Esprit Canada to the Group as collateral for the amounts due by Esprit Canada to the Group. On October 17, 1997, Esprit Canada's shares were surrendered to the Group as a result of Esprit Canada's failure to repay its debt.

On March 19, 1998, the Group disposed 25% interest in Esprit Canada to LFCO for a consideration of CAD250,000. Mr. Lawrence Firestone is the president and a director of Esprit Canada.

On October 31, 1997, Red Earth International Holdings Limited ("Red Earth"), a company equally owned by MY, Mr. Nicholas Everard Chadwick ("NC") and Mr. Stephen Ko ("SK"), exercised the option contained in the stock option agreement dated September 7, 1992 between Red Earth Limited, an indirect wholly owned subsidiary of the Company, and Red Earth. According to the stock option agreement, Red Earth acquired 20% of the total issued share capital of Red Earth Limited at a consideration of 150% of its net asset value as at June 30, 1997 which amounting to HK$54,159.

On May 7, 1998, the Group acquired 50% interest in Red Earth from MY for a consideration of US$654,100 (approximately HK$5.1 million). Simultaneously, the shareholding of the Group in Red Earth was increased to 60.78% as a result of a subscription for 359,700 new shares in Red Earth at the subscription price of US$1 per share.

On May 27, 1998, Red Earth, originally held 20% interest in Red Earth Holdings Pty Ltd. ("Red Earth Australia"), increased its shareholding in Red Earth Australia to 51% by subscribing 400,000 new shares issued by Red Earth Australia at A$1.5 each with a total consideration of A$600,000 (approximately HK$3 million). On June 26, 1998, Red Earth further increased its shareholding in Red Earth Australia to 95% by subscribing 10.2 million new shares issued by Red Earth Australia at A$0.10 each with a total consideration of A$1,020,000 (approximately HK$4.8 million).

The subscription of the 10.2 million shares as described above was funded by drawing down an approximately HK$4.8 million temporary loan facility made available to Red Earth by the Group. In addition, the Group has also granted to Red Earth in March 98 a working capital facility in the principal sum of HK$5 million. The total facilities (HK$9.8 million) granted were unsecured, repayable on demand, fully drawn down and interest is charged at prime rate for lending in Hong Kong.

26. Connected Transactions *continued*

In the ordinary course of business and on normal commercial terms the Group entered into transactions with the related companies during the year. Details relating to these related party transactions are as follows:

	1998 HK$'000	1997 HK$'000
Transaction with Red Earth Group		
Purchase of finished goods	**27,862**	14,429
Transactions with Red Earth Australia		
Sale of finished goods	**1,530**	–
Royalty received	**224**	–
Transactions with Esprit Canada		
Royalty received	**2,944**	3,978
Buying commission received	**776**	1,023
Material handling fee and storage received	**17**	48
Interest received	**210**	730
Sale of finished goods	**61**	224
Transactions with Associated Companies		
Sale of finished goods	**68,719**	30,816

Prior to the acquisition of Esprit Far East Limited ("EFE") on January 10, 1997, MY held a 50% interest in EFE, the former ultimate holding company of the Group. For the period from July 1, 1996 to January 10, 1997, in the ordinary course of business and on normal commercial terms, the Group entered into transactions with EFE and its subsidiaries ("EFE Group"). Details relating to these related party transactions are as follows:

	1997 HK$'000
Buying commission received	1,970
Handling fees paid	6,585
Interest expense	2,608
Interest income	162
Purchase of finished goods	17,346
Receipt from transfer of fabrics	3,848
Royalty paid	25,797
Share of management expenses	4,180

In addition to the above, the Group also paid a consultancy fee of HK$2,908,000 for the period from January 10, 1997 to June 30, 1997 to New Focus Limited which is wholly owned by a Director of the Company.

27. Principal Subsidiaries

The following are the principal subsidiaries which, in the opinion of the Directors, principally affect the results and net operating assets of the Group. To give details of other subsidiaries would in the opinion of the Directors result in particulars of excessive length.

Name of subsidiary	Place of incorporation/ registration/ operation	Attributable equity interest to the Group	Issued and fully paid share capital/ registered capital *(note a)*	Principal activities
Aromatic Beauty Products Pty Limited	Australia	57.8%	A$2	Wholesale distribution of cosmetics and skin and general body care products
Esprit Asia (Distribution) Ltd.	Hong Kong	100%	HK$9,000	Investment holding
Esprit A/S	Norway	100%	NOR5,705,000	Distribution of apparel and accessories
Esprit Belgie Retail N.V.	Belgium	100%	BEF47,500,000	Retail distribution of apparel and accessories
Esprit Belgie Wholesales N.V.	Belgium	100%	BEF2,500,000	Wholesales agent
Esprit Benelux B.V.	Netherlands	100%	DFL300,000	Distribution of apparel and accessories
Esprit China Distribution Limited (formerly Esprit Asia Management Services Limited)	British Virgin Islands	100%	US$100	Investment holding
Esprit de Corp (1980) Ltd.	Canada	75%	CAD1,000,100	Distribution of apparel and accessories
Esprit de Corp Denmark A/S	Denmark	100%	DKK1,000,000	Distribution of apparel and accessories
Esprit de Corp (Far East) Limited	Hong Kong	100%	HK$1,200,000	Sourcing of apparel
Esprit de Corp France S.A.	France	100%	FRF10,000,000	Distribution of apparel and accessories
Esprit de Corp GmbH	Germany	100%	DM32,000,000	Design and wholesale distribution of apparel and accessories
Esprit de Corp (Malaysia) Sdn Bhd.	Malaysia	100%	MYR500,000	Retail distribution of apparel and accessories
Esprit de Corp (Singapore) Pte Limited	Singapore	100%	S$100,000	Sourcing of apparel
Esprit de Corp (Worldwide) Limited	Hong Kong	100%	HK$1,000	Sourcing of apparel

27. Principal Subsidiaries *continued*

Name of subsidiary	Place of incorporation/ registration/ operation	Attributable equity interest to the Group	Issued and fully paid share capital/ registered capital *(note a)*	Principal activities
Esprit Distribution Ltd.	Hong Kong	100%	HK$10,000	Wholesale distribution of apparel and accessories
Esprit Far East Ltd.	British Virgin Islands	100%	US$7,708	Investment holding
Esprit Handelsgesellschart MbH	Austria	100%	ATS500,000	Wholesale distribution of apparel and accessories
Esprit Holdings GmbH	Germany	100%	DM10,000,000	Investment holding
Esprit Image & Product Development Limited (formerly Esprit Image Limited)	United Kingdom	100%	GBP2	Group image direction Wholesale distribution of apparel and accessories
Esprit International	California, U.S.A. (limited partnership)	63%	–	Licensing of trademark
Esprit Japan (Distribution) Limited	British Virgin Islands	100%	US$500	Investment holding
Esprit Manufacturing Pte Limited	Singapore	100%	S$100,000	Manufacturing of apparel
Esprit Retail GmbH	Germany	100%	DM9,000,000	Retail distribution of apparel and accessories
Esprit Retail (Hong Kong) Limited	Hong Kong	100%	HK$10,000	Retail distribution of apparel, accessories and bed and bath products
Esprit Retail (Japan) Limted	Japan	100%	JPY200,000,000	Retail distribution of apparel and accessories
Esprit Retail Pte Ltd.	Singapore	100%	S$3,000,000	Retail distribution of apparel and accessories
Esprit Retail Pty Ltd.	Australia	100%	A$200,000	Retail distribution of apparel and accessories
Esprit Retail (Taiwan) Limited	Hong Kong	100%	HK$9,000	Retail distribution of apparel and accessories

27. Principal Subsidiaries *continued*

Name of subsidiary	Place of incorporation/ registration/ operation	Attributable equity interest to the Group	Issued and fully paid share capital/ registered capital *(note a)*	Principal activities
Esprit Shoes & Accessories Limited	British Virgin Islands	100%	US$100	Sourcing of accessories
Esprit Sweden AB	Sweden	100%	SEK200,000	Distribution of apparel and accessories
Esprit Thailand Distribution Limited	British Virgin Islands	100%	US$100	Investment holding
Esprit (U.K.) Limited	United Kingdom	100%	GBP10,100,000	Retail distribution of apparel and accessories
Index Fashion Company Limited	Hong Kong	100%	HK$10,000	Sourcing of apparel
Red Earth (Hong Kong) Limited	Hong Kong	92%	HK$10,000	Retail distribution of cosmetics and skin and general body care products
Red Earth International Holdings Ltd.	British Virgin Islands	60.8%	US$1,668,000	Investment holding
Red Earth (Korea) Limited	Republic of Korea	100%	Won 5,300,000,000	Retail distribution of apparel and accessories
Red Earth Licensing Limited	British Virgin Islands	60.8%	US$100	Licensing of trademark
Red Earth New Zealand Limited	New Zealand	57.8%	NZ$100	Retail distribution of cosmetics and skin and general body care products
Red Earth Production Limited	Hong Kong	60.8%	HK$10,000	Wholesale distribution of cosmetics and skin and general body care products
Red Earth Pty Limited	Australia	57.8%	A$100	Retail distribution of cosmetics and skin and general body care products
Red Earth (Taiwan) Limited	Hong Kong	100%	HK$2	Garment buying agent
Red Earth Trading Pty Limited	Australia	57.8%	A$2	Wholesale distribution of cosmetics and skin and general body care products

27. Principal Subsidiaries *continued*

Name of subsidiary	Place of incorporation/ registration/ operation	Attributable equity interest to the Group	Issued and fully paid share capital/ registered capital *(note a)*	Principal activities
Shanghai Shile Trading Limited	The People's Republic of China	90%	RMB600,000 registered capital	Distribution of apparel and accessories
Shenzhen Shihe Dress Co. Ltd.	The People's Republic of China	100%	US$1 million registered capital	Manufacturing of apparel
Sijun Fashion Design (Shenzhen) Company Limited	The People's Republic of China	100%	US$700,000 registered capital	Design services

Notes:

(a) All are ordinary share capital unless otherwise stated.

(b) None of the subsidiaries had any loan capital subsisting at June 30, 1988 or at any time during the year.

(c) Except for Red Earth (Taiwan) Limited and Esprit Retail (Taiwan) Limited which operate principally in Taiwan, all subsidiaries operate principally in their place of incorporation.

financial summary

Results

	1998 HK$'000	1997 HK$'000	1996 HK$'000	1995 HK$'000	1994 HK$'000
Turnover	**5,087,206**	3,351,742	1,785,330	1,473,251	1,144,919
Operating Profit	**489,587**	400,889	203,399	183,142	178,932
Exceptional Item	**(125,300)**	–	–	–	26,892
	364,287	400,889	203,399	183,142	205,824
Share of Results of Associated Companies	**(17,616)**	1,053	1,339	1,708	858
Profit before Taxation	**346,671**	401,942	204,738	184,850	206,682
Taxation	**(153,916)**	(144,000)	(44,244)	(43,608)	(39,322)
Profit after Taxation	**192,755**	257,942	160,494	141,242	167,360
Minority Interests	**(37,656)**	(22,411)	1,310	33	–
Profit Attributable to Shareholders	**155,099**	235,531	161,804	141,275	167,360
Dividends	**41,517**	125,309	82,637	67,792	63,750

Balance Sheets

	1998 HK$'000	1997 HK$'000	1996 HK$'000	1995 HK$'000	1994 HK$'000
Trademarks	**783,133**	803,474	–	–	–
Fixed assets	**403,099**	463,098	226,549	217,627	68,484
Other investments	**93,158**	214,263	20,000	20,000	–
Associated companies	**43,200**	12,828	5,246	4,442	3,381
Net current assets	**438,669**	419,635	409,735	338,394	397,114
	1,761,259	1,913,298	661,530	580,463	468,979
Financed by:					
Share capital	**109,255**	108,806	80,987	75,087	75,000
Reserves	**1,053,810**	1,012,137	578,605	480,304	392,086
Shareholders' funds	**1,163,065**	1,120,943	659,592	555,391	467,086
Minority interests	**2,244**	14,989	1,329	2,717	53
Obligations under finance leases	**8,773**	320	609	2,436	1,840
Long term loans	**537,811**	722,879	–	19,919	–
Deferred taxation	**49,366**	54,167	–	–	–
	1,761,259	1,913,298	661,530	580,463	468,979

NOTICE IS HEREBY GIVEN that the Annual General Meeting of Esprit Holdings Limited ("the Company") will be held at the Annapurna Room, Pacific Place Conference Centre, One Pacific Place, 88 Queensway, Hong Kong on Friday, December 18, 1998 at 4:30 p.m. for the following purposes:-

1. To receive and consider the audited Financial Statements and the Report of the Directors and of the Auditors of the Group for the year ended June 30, 1998.

2. To elect Directors and to authorise the Board of Directors to fix their remuneration.

3. To consider the following resolution, special notice having been received of the intention to propose the resolution as an ordinary resolution:
"**THAT** PricewaterhouseCoopers be appointed auditors of the Company in place of the retiring auditors, to hold office until the conclusion of the next general meeting at which accounts are laid before the Company and that their remuneration be fixed by the directors."

4. As special business, to consider and, if thought fit, pass the following resolution as an Ordinary Resolution:
"**THAT:**
(a) subject to paragraph (c), the exercise by the Directors of the Company during the Relevant Period 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 might require the exercise of such powers be and it is generally and unconditionally approved;
(b) the approval in paragraph (a) shall authorize the Directors of the Company during the Relevant Period to make or grant offers, agreements and options which might require the exercise of such power after the end of the Relevant Period;
(c) the aggregate nominal amount of share capital allotted or agreed conditionally or unconditionally to be allotted (whether pursuant to an option or otherwise) by the Directors of the Company pursuant to the approval in paragraph (a), otherwise than pursuant to (i) a Rights Issue; (ii) the exercise of options granted under any share option scheme adopted by the Company or (iii) any scrip dividend or similar arrangement providing for the allotment of shares in lieu of the whole or part of a dividend on shares of the Company in accordance with the Bye-laws of the Company, shall not exceed the aggregate of (aa) 20 per cent. of the aggregate nominal amount of the share capital of the Company in issue on the date of this Resolution and (bb) (if Directors of the Company are so authorized by a separate Ordinary Resolution of the shareholders of the Company) the nominal amount of share capital of the Company repurchased by the Company subsequent to the passing of resolution 5 as set out below (up to a maximum equivalent to 10 per cent. of the aggregate nominal amount of the share capital of the Company in issue on the date 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 Companies Act 1981 of Bermuda (as amended) to be held; and
(iii) the revocation or variation of the authority given under this Resolution by Ordinary Resolution of the shareholders in general meeting.
"Rights Issue" means an offer of shares open for a period fixed by the Directors of the Company to holders of ordinary shares 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 recognized regulatory body or any stock exchange in any territory outside Hong Kong)."

5. As special business, to consider and, if thought fit, passing the following resolution as an Ordinary Resolution:

   "THAT:

   (a) subject to paragraph (b) below, the exercise by the Directors of the Company during the Relevant Period of all the powers of the Company to purchase shares of the Company be generally and unconditionally approved;

   (b) the aggregate nominal amount of shares which may be purchased on The Stock Exchange of Hong Kong Limited or any other stock exchange be recognized for this purpose by the Securities and Futures Commission of Hong Kong and The Stock Exchange of Hong Kong Limited under the Hong Kong Code on Share Repurchases 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 on the date 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:

   (aa) the conclusion of the next Annual General Meeting of the Company;

   (ab) the expiration of the period within which the next Annual General Meeting of the Company is required by the Companies Act 1981 of Bermuda (as amended) to be held; and

   (ac) the revocation or variation of the authority given under this Resolution by Ordinary Resolution of the shareholders in general meeting."

6. As special business, to consider and, if thought fit, pass the following resolution as an Ordinary Resolution:

   "**THAT** conditional upon resolution numbered 5 in the notice convening this meeting being passed, the aggregate nominal amount of shares in the issued share capital of the Company which are repurchased by the Company under the authority granted to the Directors as mentioned in the said resolution numbered 5 above shall be added to the aggregate nominal amount of share capital that may be allotted or agreed conditionally or unconditionally to be allotted and issued by the Directors of the Company pursuant to the resolution numbered 4 in the notice convening this meeting."

7. To transact any other ordinary business.

By Order of the Board

Alva Chan Wai Mo
Director

Hong Kong, October 16, 1998

Notes:

1. *Any member entitled to attend and vote at the meeting is entitled to appoint one proxy to attend, and in the event of a poll, vote in his stead. A proxy need not be a member of the Company.*
2. *In order to be valid, a proxy form, together with the power of attorney (if any) or other authority (if any) under which it is signed or a notarially certified copy of such power or authority, must be lodged with the head office of the Company at 10th Floor, 11 Yuk Yat Street, Tokwawan, Kowloon, Hong Kong not less than 48 hours before the time fixed for holding the Meeting.*