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**THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. PLEASE READ IT CAREFULLY.**

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If you are in any doubt as to the course of action you should take, you should consult your stockbroker, bank manager, solicitor, accountant or other professional adviser immediately.

If you have sold or transferred all your shares in the capital of Daka Designs Limited (the “Company”), you should immediately forward this Circular, the Notice of Special General Meeting and the attached Proxy Forms to the purchaser or the transferee or to the bank, stockbroker or agent through whom the sale or the transfer was effected for onward transmission to the purchaser or transferee.

The Singapore Exchange Securities Trading Limited assumes no responsibility for the accuracy of any of the statements made, reports contained or opinions expressed in this Circular.

The attention of Shareholders is drawn to the statements on the second page of this Circular. You are strongly encouraged to attend the Special General Meeting as the matters in consideration will have a direct impact on your investment.

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## **CIRCULAR TO SHAREHOLDERS**

**in relation to**

- (1) THE PROPOSED SALE OF THE ENTIRE ISSUED SHARE CAPITAL OF DAKA INVESTMENT INTERNATIONAL LIMITED AND DAKA CHINA LIMITED TO DAKA DIRECT INC.;**
- (2) THE PROPOSED CAPITAL REDUCTION RESULTING IN THE CANCELLATION OF 194,883,432 SHARES IN THE CAPITAL OF THE COMPANY AS PART CONSIDERATION TO THE COMPANY FOR THE ABOVE-MENTIONED SALE;**
- (3) THE PROPOSED CHANGE OF THE NAME OF THE COMPANY;**
- (4) THE PROPOSED CHANGE OF AUDITORS FROM RSM NELSON WHEELER TO RSM CHIO LIM; AND**
- (5) THE PROPOSED DISTRIBUTION OF THE NET CASH PROCEEDS FROM THE SALE**

**Independent Financial Adviser to the Independent Directors (as defined herein)**



**Interim Managers to the Company**



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14 March 2007



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## IMPORTANT DATES AND TIMES

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Last date and time for lodgement of Proxy Form. . . . . 3 April 2007 at 10.00 a.m.

Date and time of Special General Meeting. . . . . 5 April 2007 at 10.00 a.m.

Place of Special General Meeting . . . . . 18 Cross Street  
#08-01  
Marsh & McLennan Centre  
Singapore 048423

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## IMPORTANT NOTIFICATION

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*The statements and information set out in this notification are a summary and/or explanation of certain portions of this Circular. Whilst this notification is important, it is qualified in its entirety by, and subject to, the information and explanations in this Circular.*

Shareholders should note that it is proposed that the business operations of the Daka Group (as defined herein) will be sold to Daka Direct Inc., a company effectively controlled by Pat Y. Mah, Raymond Yiu Man Chow and Rose Chow, the persons named in the KPMG Report (as defined herein). 64.42%, or HK\$27,378,500, of the purchase consideration for the Sale (as defined herein) of HK\$42.5 million will be in form of the cancellation of Shares (as defined herein) held by Pat Y. Mah, Raymond Yiu Man Chow and Rose Chow collectively, who as a result of the completion of the Sale, will no longer be Shareholders (as defined herein) of the Company.

35.58%, or HK\$15,121,500 of the purchase consideration of HK\$42.5 million will be in form of cash, of which a significant proportion (this being up to HK\$3,000,000) will be used for the payment of administrative and professional fees.

The Directors believe that it is in the better interest of Shareholders after the Sale and the Share Cancellation (as defined herein) for the Company as a cash company to pursue reverse takeover opportunities. However, the Directors need to remind Shareholders that there is no assurance that such a reverse takeover can be successfully completed.

Accordingly, the Directors wish to present an immediate alternative to Shareholders, i.e., to immediately after completion of the Sale and Share Cancellation voluntarily wind-up the Company to distribute whatever net cash is left to the Shareholders.

Shareholders are advised to read and consider carefully all information which is set out in this Circular prior to the Special General Meeting of the Company to be convened and to attend such Special General Meeting.

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## DEFINITIONS

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*In this Circular, the following definitions apply throughout unless otherwise stated:*

<b>“A&amp;M”</b>	Alvarez & Marsal Asia Limited.
<b>“Agreement”</b>	The sale and purchase agreement dated 8 December 2006 entered into between the Company, the Purchaser and the Guarantors.
<b>“Assets”</b>	Shall have the meaning ascribed to it in Paragraph 4.1 of this Circular.
<b>“Associates”</b>	<p>(a) In relation to any director, chief executive officer, substantial shareholder or Controlling Shareholder (being an individual) means:</p> <p>(i) his immediate family;</p> <p>(ii) the trustees of any trust of which he or his immediate family is a beneficiary or, in the case of a discretionary trust, is a discretionary object; and</p> <p>(iii) any company in which he and his immediate family together (directly or indirectly) have an interest of 30% or more.</p> <p>(b) In relation to a substantial shareholder or a Controlling Shareholder (being a company) means any other company which is its subsidiary or holding company or is a subsidiary of such holding company or one in the equity of which it and/or such other company or companies taken together (directly or indirectly) have an interest of 30% or more.</p>
<b>“Bermuda Companies Act”</b>	The Companies Act 1981 of Bermuda, as amended from time to time.
<b>“Bermuda Registrar”</b>	Registrar of Companies in Bermuda.
<b>“Board”</b>	The board of Directors of the Company.
<b>“Business Day”</b>	A day (other than a Saturday or Sunday) on which commercial banks are open for business in Hong Kong.

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## DEFINITIONS

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<b>“Cash Consideration”</b>	The amount of HK\$15,121,500, representing 35.58% of the Purchase Consideration which is to be satisfied by the Purchaser in cash.
<b>“CDP”</b>	The Central Depository (Pte) Limited.
<b>“Circular”</b>	This circular dated 14 March 2007.
<b>“Code”</b>	Singapore Code on Take-overs and Mergers, 2001.
<b>“Company”</b>	Daka Designs Limited.
<b>“Completion Date”</b>	The day falling five (5) Business Days after the first date as of which all conditions precedent in the Agreement (other than conditions that by their nature are to be satisfied as at completion of the Sale, but subject to the satisfaction or waiver of those conditions at such time) have been fulfilled or waived or such other date as the parties to the Agreement may agree in writing. The Completion Date is currently expected to be on or about 13 April 2007.
<b>“Completion Notice”</b>	Shall have the meaning ascribed to it in Paragraph 3 of this Circular.
<b>“Controlling Shareholder”</b>	<p>A person who:</p> <p>(a) holds directly or indirectly 15% or more of the nominal amount of all the voting shares in a company. The SGX-ST may determine that a person who satisfies this definition is not a Controlling Shareholder; or</p> <p>(b) in fact exercises control over a company.</p>
<b>“Daka China”</b>	Daka China Limited, a wholly-owned subsidiary of the Company.
<b>“Daka Development”</b>	Daka Development Ltd, a wholly-owned subsidiary of the Company.
<b>“Daka Group”</b>	The Company and its subsidiaries collectively.

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## DEFINITIONS

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<b>“Daka Investment”</b>	Daka Investment International Limited, a wholly-owned subsidiary of the Company.
<b>“DIL”</b>	Daka Industrial Ltd, a company in which the Company indirectly owns an 18% equity interest.
<b>“Directors”</b>	The directors of the Company as at the date of this Circular.
<b>“DML”</b>	Daka Manufacturing Limited, a wholly-owned subsidiary of DIL.
<b>“EPS”</b>	Earnings per Share.
<b>“Escrow Amount”</b>	Shall have the meaning ascribed to it in Paragraph 3 of this Circular.
<b>“FY”</b>	Financial year ended or ending, as the case may be, 31 March.
<b>“Group Companies”</b>	Shall refer to Daka Investment, Daka China and the companies in which Daka Investment has an equity interest, whether directly or indirectly, as at the date of the Agreement, and <b>“Group Company”</b> means any one of them.
<b>“Guarantors”</b>	Refers to Pat Y. Mah and Raymond Yiu Man Chow collectively.
<b>“Hong Kong”</b>	The Hong Kong Special Administrative Region of the People’s Republic of China.
<b>“IFA”</b>	Ernst & Young Corporate Finance Pte Ltd, being the independent financial adviser to the Independent Directors in relation to the Sale.
<b>“Independent Directors”</b>	The Directors of the Company who are deemed independent for the purpose of the Sale and the Share Cancellation.
<b>“Initial Deposit”</b>	Refers to the deposit of HK\$1,000,000 paid by the Purchaser to the Company, upon and on the date of execution of the Agreement.



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## DEFINITIONS

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<b>“Inter-co Debts”</b>	Shall have the meaning ascribed to it in Paragraph 4.1(b) of this Circular.
<b>“Interest on Escrow”</b>	Shall have the meaning ascribed to it in Paragraph 3 of this Circular.
<b>“Intra-group Agreements”</b>	Shall have the meaning ascribed to it in Paragraph 4.3 of this Circular.
<b>“Latest Practicable Date”</b>	7 March 2007, being the latest practicable date prior to the printing of this Circular.
<b>“Liabilities”</b>	Shall have the meaning ascribed to it in Paragraph 4.2 of this Circular.
<b>“Listing Manual”</b>	The listing manual of the SGX-ST.
<b>“Long Stop Date”</b>	Means the earlier of the following dates: (a) the date falling two months after the date on which the approval of the Shareholders has been obtained for the Sale and the Share Cancellation; and (b) 30 June 2007.
<b>“LPS”</b>	Loss per Share.
<b>“NTA”</b>	Net tangible assets.
<b>“Parent Guarantees”</b>	Shall have the meaning ascribed to it in Paragraph 4.5(e) of this Circular.
<b>“Proceedings”</b>	Shall have the meaning ascribed to it in Paragraph 4.2 of this Circular.
<b>“Purchase Consideration”</b>	The total amount of HK\$42,500,000 payable by the Purchaser to the Company, in the manner set out in Paragraph 3 of this Circular, for the Sale.
<b>“Purchaser”</b>	Daka Direct Inc., which is wholly-owned by Amrich Investments Limited, a company controlled by the Guarantors.
<b>“Sale”</b>	Means the sale of the Sale Shares by the Company to the Purchaser on the terms and subject to the conditions in the Agreement.

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## DEFINITIONS

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<b>“Sale Shares”</b>	Collectively, 30,309 shares representing 100% of the issued and paid-up capital of Daka Investment as at the date of the Agreement and one share representing 100% of the issued and paid-up capital of Daka China as at the date of the Agreement.
<b>“Securities Accounts”</b>	Securities accounts maintained by Depositors with CDP but not including securities sub-accounts maintained with a Depository Agent.
<b>“SGM”</b>	The special general meeting of the Company to consider the Sale, the Share Cancellation, the change of the name of the Company, the change of auditors and the distribution to the Shareholders of the net cash proceeds from the Sale, notice of which is given on page 87 of this Circular.
<b>“SGX-ST”</b>	Singapore Exchange Securities Trading Limited.
<b>“Share Cancellation”</b>	The cancellation of 194,883,432 Shares held by the Guarantors and Rose Chow via a capital reduction exercise, more details of which are set out in Paragraph 3 of this Circular and Paragraph 5 of this Circular.
<b>“Shareholders”</b>	Registered holders of the Shares.
<b>“Shares”</b>	Ordinary shares of HK\$0.15 each in the capital of the Company.
<b>“Singapore Companies Act”</b>	The Companies Act, Chapter 50 of Singapore.
<b>“USA”</b>	The United States of America.
<b>“Voluntary Winding Up”</b>	The voluntary winding-up of the Company for the proposed distribution of the net cash proceeds from the Sale.
<b>“HK\$”</b>	Hong Kong dollar.
<b>“S\$” or “cents”</b>	Singapore dollars and cents respectively.
<b>“US\$”</b>	United States dollar.
<b>“%” or the “per cent.”</b>	Per centum or percentage.

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## DEFINITIONS

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The terms “**Depositor**”, “**Depository Agent**” and “**Depository Register**” shall have the meanings ascribed to them respectively in Section 130A of the Singapore Companies Act.

Words importing the singular shall, where applicable, include the plural and vice versa. Words importing the masculine gender shall, where applicable, include the feminine and neuter genders. References to persons shall include corporations.

Any reference in this Circular to any statute or enactment is a reference to any statute or enactment as for the time being amended or re-enacted. Any word defined under the Bermuda Companies Act, the Singapore Companies Act or any statutory modification thereof and not otherwise defined in this Circular shall have the same meaning assigned to it under the Bermuda Companies Act, the Singapore Companies Act or any statutory modification thereof, as the case may be.

Any reference to a time of day in this Circular is made by reference to Singapore time unless otherwise stated.

The total of figures listed in certain tables included in this Circular may not be the same as the arithmetic addition of the figures. Any discrepancies therefore are due to rounding.

The following exchange rates were used for the purpose of this Circular:

S\$1 = HK\$5.0273;

S\$1 = US\$0.6468; and

S\$1 = 0.3309 Sterling Pound.

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## LETTER TO SHAREHOLDERS

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PASSION FOR  
INNOVATION

### DAKA DESIGNS LIMITED

*(Incorporated in Bermuda with limited liability)*

(Company Registration No. 34932)

*Directors:*

Pat Y. Mah *(on leave of absence)*  
Raymond Yiu Man Chow *(on leave of absence)*  
Rose Chow *(on leave of absence)*  
Sir Clive Marles Sinclair  
Michael Yue Kwong Chan  
William Chin Shing Tong  
Dr. Roy Chi Ping Chung  
David Tian Bin Chia  
Geoffrey Seng Huat Yeoh

*Registered Office:*

Clarendon House  
2 Church Street  
Hamilton HM 11  
Bermuda

14 March 2007

*To: Shareholders of Daka Designs Limited*

Dear Sir/Madam,

- (1) **THE PROPOSED SALE OF THE ENTIRE ISSUED SHARE CAPITAL OF DAKA INVESTMENT INTERNATIONAL LIMITED AND DAKA CHINA LIMITED TO DAKA DIRECT INC.;**
- (2) **THE PROPOSED CAPITAL REDUCTION RESULTING IN THE CANCELLATION OF 194,883,432 SHARES IN THE CAPITAL OF THE COMPANY AS PART CONSIDERATION TO THE COMPANY FOR THE ABOVE-MENTIONED SALE;**
- (3) **THE PROPOSED CHANGE OF THE NAME OF THE COMPANY;**
- (4) **THE PROPOSED CHANGE OF AUDITORS FROM RSM NELSON WHEELER TO RSM CHIO LIM; AND**
- (5) **THE PROPOSED DISTRIBUTION OF THE NET CASH PROCEEDS FROM THE SALE**

#### **1. INTRODUCTION – THE SALE**

On 8 December 2006, the Board announced that the Company has entered into the Agreement with the Purchaser and the Guarantors, pursuant to which the Company shall sell to the Purchaser, and the Purchaser shall purchase from the Company, the Sale Shares at the Purchase Consideration on the terms and subject to the conditions in the Agreement.

Prior to this, the Company has encountered a series of material and key developments since the fourth quarter of 2005. Please refer to Paragraph 6 of this Circular for a summary of the relevant details.

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## LETTER TO SHAREHOLDERS

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### Chapter 9 of the Listing Manual

The Purchaser is wholly-owned by Amrich Investments Limited, a company controlled by the Guarantors, who are Directors and Controlling Shareholders of the Company as at the date of the Agreement. The Shares which are the subject of the Share Cancellation are owned by the Guarantors and Rose Chow (who is also a Director as well as the spouse of Raymond Yiu Man Chow).

The Purchase Consideration also represents more than 5% of the Daka Group's latest audited NTA as at 31 March 2006. Therefore, the Sale will constitute an interested person transaction which requires the approval of the Shareholders under Chapter 9 of the Listing Manual.

### Chapter 10 of the Listing Manual

In relation to the Sale, the relative figures computed pursuant to Rule 1006 of the Listing Manual are as follows:

#### *Rule 1006(a)*

The unaudited net asset value of the Group Companies of approximately HK\$34,422,000 as at 30 September 2006 compared with the Daka Group's unaudited net asset value of approximately HK\$30,858,000 as at 30 September 2006 is approximately 112%.

#### *Rule 1006(b)*

In the ordinary course of events, the unaudited net profits before tax, minority interests and extraordinary items attributable to the Group Companies of approximately HK\$4.09 million for the half year when compared to the Daka Group's unaudited net profits before tax, minority interests and extraordinary items should be approximately 100% because the Daka Group is disposing of all of its businesses.

As the Company is the holding company, and has additional costs and expenses to bear during the recent difficult period, the consolidation results of the HK\$4.09 million with approximately HK\$6.2 million of such expenses (of which HK\$3.1 million pertains to A&M's fees paid and accrued in relation to its interim management role in the Daka Group, including the day-to-day operational management of the Group Companies) causes the Daka Group's half year results to be a loss of approximately HK\$2.1 million.

Although a strict comparison of the HK\$4.09 million unaudited net profits to the loss of HK\$2.1 million is mathematically meaningless, the substance of the comparison can be taken as approximating 100% since the consolidated Daka Group and the business being sold are in effect one and the same, save for the additional expenses of the holding company.

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## LETTER TO SHAREHOLDERS

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### *Rule 1006(c)*

The Purchase Consideration compared to the Company's market capitalisation of approximately S\$12,102,000 (based on the weighted average price of the Shares on the SGX-ST of S\$0.04 on 13 June 2006, being the market day prior to the date of suspension of the trading of the Shares on the SGX-ST), is approximately 70%.

### *Rule 1006(d)*

Not applicable.

Therefore, the Sale will constitute a major transaction which requires the approval of the Shareholders under Chapter 10 of the Listing Manual.

### **Shareholders' Approval Required**

As set out above, the Sale requires the approval of the Shareholders pursuant to both Chapters 9 and 10 of the Listing Manual. Moreover, the bye-laws of the Company (and, in the case of the change of the name of the Company, the Share Cancellation and the change of auditors, Sections 10, 46 and 89 of the Bermuda Companies Act respectively) require that the approval of the Shareholders be sought for the Share Cancellation, the change of the name of the Company and the change of auditors.

The purpose of this Circular is to provide Shareholders with relevant information pertaining to, and to seek Shareholders' approval for, the Sale, the Share Cancellation, the change of the name of the Company and the change of the Company's auditors from RSM Nelson Wheeler to RSM Chio Lim at the proposed SGM to be convened. This Circular also sets out information pertaining to the distribution of the net cash proceeds from the Sale via the Voluntary Winding Up for Shareholders' consideration.

The SGX-ST assumes no responsibility for the accuracy of any of the statements made, reports contained or opinions expressed in this Circular.

## **2. INFORMATION ON DAKA INVESTMENT AND DAKA CHINA**

### **2.1 Information on Daka Investment**

Daka Investment is a company incorporated in the British Virgin Islands and has at the date of the Agreement an authorised share capital of US\$50,000 consisting of 50,000 ordinary shares of par value US\$1.00 each, of which 30,309 of the said shares have been issued and are fully paid-up. It is presently a wholly-owned subsidiary of the Company. Daka Investment is a principal subsidiary of the Company as it is the intermediate holding company that holds and owns all of the other member companies in the existing Daka group of companies (except for Daka China, which is owned directly by the Company).

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## LETTER TO SHAREHOLDERS

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### 2.2 Information on Daka China

Daka China is a company incorporated in Hong Kong and has at the date of the Agreement an authorised share capital of HK\$10,000 consisting of 10,000 ordinary shares of par value HK\$1.00 each, of which one of the said shares has been issued and is fully paid-up. It is presently a wholly-owned subsidiary of the Company. Daka China is currently dormant and steps have already been taken to deregister it.

### 3. PURCHASE CONSIDERATION AND ESCROW ARRANGEMENT

The net book value and NTA of the Group Companies as at 30 September 2006 were approximately HK\$34,422,000 and HK\$30,584,000 respectively. For further information on how the net book value and NTA of the Group Companies were arrived at, the proforma balance sheet of the Group Companies is set out as follows:

	<b>Group Companies 30 September 2006 (deconsolidated basis)<sup>(1)</sup> unaudited HK\$'000</b>	<b>Group Companies 31 March 2006 (deconsolidated basis)<sup>(1)</sup> unaudited HK\$'000</b>	<b>Daka Group 31 March 2006 (consolidated basis) audited HK\$'000</b>
<b>Assets</b>			
<b>Intangible</b>			
Goodwill	110	—	—
Deferred development costs	3,728	4,978	4,978
<b>Tangible</b>			
Property, plant and equipment	16,033	20,632	20,632
Unquoted club memberships	732	732	732
Inventories	23,215	30,653	30,653
Available-for-sale investments	3,567	10,534	10,534
Interest in an associate	—	27	27
Trade receivables	30,010	21,228	21,228
Other receivables, prepayment and deposits	7,212	9,683	9,741
Bills receivable	1,830	672	672
Pledged bank balances	11,843	13,812	13,812
Bank and cash balances	18,322	6,496	6,553
	116,602	119,447	119,562

## LETTER TO SHAREHOLDERS

	<b>Group Companies 30 September 2006 (deconsolidated basis)<sup>(1)</sup> unaudited HK\$'000</b>	<b>Group Companies 31 March 2006 (deconsolidated basis)<sup>(1)</sup> unaudited HK\$'000</b>	<b>Daka Group 31 March 2006 (consolidated basis) audited HK\$'000</b>
<b>Liabilities</b>			
Trade payables	37,744	31,590	31,590
Deposits received and other payables	27,779	25,256	27,884
Bills payable	10,433	16,619	16,619
Short term bank loans	–	1,296	1,296
Discounted bills receivable	2,760	–	–
Amount due to directors	617	612	612
Provision for income tax	965	965	965
Deferred income tax	1,882	1,882	1,882
	<u>82,180</u>	<u>78,220</u>	<u>80,848</u>
 Net assets	 <u>34,422</u>	 <u>41,227</u>	 <u>38,714</u>
 Share capital	 236	 236	 45,384
Share premium	–	–	48,167
Merger reserve	–	–	(33,085)
Investment revaluation reserve	–	5,735	5,735
Contributed surplus	513	513	–
General reserve	48	48	49
Minority interests	–	6	6
Retained profits/(accumulated losses)	<u>33,625</u>	<u>34,689</u>	<u>(27,542)</u>
	<u>34,422</u>	<u>41,227</u>	<u>38,714</u>

*Note:*

- (1) “Deconsolidated basis” means the consolidated balance sheet of the Group Companies, excluding that of Daka Designs Limited (the ultimate holding company of Daka Group) as at the respective dates.



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## LETTER TO SHAREHOLDERS

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The decrease in net book value of the Group Companies from 31 March 2006 to 30 September 2006 was mainly due to the following reasons:

- (a) deficit on revaluation of available for sale investments (i.e. shares of ZAP (a company incorporated under the laws of the state of California, the USA), which are listed on the over the counter market in the USA and were previously classified as available-for-sale investments in the financial statements of the Daka Group) of about HK\$5.7 million; and
- (b) net loss on waiver of liabilities of Daka Development of about HK\$1 million.

The excess of the Purchase Consideration of HK\$42,500,000 over the book value of the Group Companies as at 30 September 2006 is approximately HK\$8,078,000. After deducting the estimated costs in conjunction with the Sale of approximately HK\$3,000,000<sup>(1)</sup> comprising mainly printing, legal, and financial advisory fees, the Company will book in an accounting loss of approximately HK\$28,007,000 in the consolidated accounts. After the Company was successfully listed on the SGX-ST in 2004, as a result of a restructuring exercise in preparation for the listing of the Company's shares on the SGX-ST, a merger reserve of approximately HK\$33,085,000 was created in the Daka Group's consolidated accounts. Upon completion of the disposal of the Sale Shares, Daka Investment and Daka China will be deconsolidated from the Daka Group. This will result in a reversal of the merger reserve account and cause the equity reserve accounts of the Daka Group to increase correspondingly by approximately HK\$33,085,000. As a result of the reversal to the profit and loss account from the merger reserve account of approximately HK\$33,085,000, the Daka Group will book in an accounting loss of approximately HK\$28,007,000 although the Purchase Consideration exceeds the book value of the Sale Shares as at 30 September 2006. Please refer to Paragraph 7(A) of this Circular for more details on the effect of the Sale on the Shareholders' equity of the Company.

*Note:*

- (1) The estimated costs mainly comprise Hong Kong, Bermuda, and Singapore legal advisory fees of about HK\$1,000,000, A&M fees of HK\$1,300,000, escrow agent and auditor fees of about HK\$250,000, printing and other miscellaneous charges of about HK\$100,000, and IFA fees of HK\$350,000.

The open market value of the Sale Shares is not available as both Daka Investment and Daka China are not listed companies. No independent valuation on the Sale Shares has been carried out. The Purchase Consideration was arrived at following arm's length negotiations and on a willing-buyer willing-seller basis having reference to the net asset value of the Sale Shares.

The Purchase Consideration shall be satisfied in the following manner:

- (a) 64.42% or HK\$27,378,500 to be satisfied via the cancellation of all 194,883,432 Shares<sup>(1)</sup> held by the Guarantors and Rose Chow (the spouse of Raymond Yiu Man Chow) collectively as at the date of the Agreement (the "**Share Cancellation**")<sup>(2)</sup>. The Share Cancellation will be effected via a capital reduction exercise to be undertaken by the Company. More details of the Share Cancellation are set out in Paragraph 5 of this Circular; and

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## LETTER TO SHAREHOLDERS

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- (b) 35.58% or HK\$15,121,500 to be satisfied in cash (the “**Cash Consideration**”).

*Notes:*

- (1) The total number of issued Shares as at the Latest Practicable Date was 302,560,000 out of which the Guarantors and Rose Chow collectively own 194,883,432 Shares. Please refer to Paragraph 11.1 of this Circular for more details on the direct holders of, and the above persons’ deemed interest in, the 194,883,432 Shares.
- (2) The sum of HK\$27,378,500 out of the aggregate sum of HK\$29,232,515 arising from the cancellation of the 194,883,432 Shares will be fully applied by the Company in satisfaction of part of the Purchase Consideration, in lieu of paying such sum to the Guarantors and Rose Chow for the cancellation of their Shares.

In respect of the Cash Consideration, the Purchaser:

- (a) has paid a deposit of HK\$1,000,000 to the Company (the “**Initial Deposit**”), upon and on the date of execution of the Agreement; and
- (b) shall deposit a further sum of HK\$14,121,500 (the “**Escrow Amount**”), at least 5 Business Days before the date of the SGM to be convened by the Company to consider the Sale and the Share Cancellation, with an escrow agent by wire transfer into a bank account of the escrow agent.

The Escrow Amount will be placed in an interest bearing account with an established bank or financial institution in Singapore. The Escrow Amount and any interest accruing on the Escrow Amount (the “**Interest on Escrow**”) shall be paid over by the escrow agent as follows:

- (a) If completion does not occur by the Long Stop Date, the escrow agent shall, if it does not receive a notice of completion (“**Completion Notice**”) from the Purchaser on or before the Long Stop Date, pay the Escrow Amount and the Interest on Escrow in full to the Purchaser or as the Purchaser may in writing direct as soon as reasonably practicable after the Long Stop Date and in any event, no later than 10 Business Days from the Long Stop Date; and
- (b) If completion occurs on or before the Long Stop Date, the Purchaser shall, on the Completion Date, give a Completion Notice to the escrow agent and shall in writing instruct the escrow agent to pay: (i) the Escrow Amount to the Company by wire transfer into a bank account of the Company (the details of which shall be provided by the Company in writing to the Purchaser no later than 3 Business Days before the Completion Date); and (ii) the Interest on Escrow to the Purchaser or as the Purchaser may direct.

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The Initial Deposit shall be refunded to the Purchaser upon occurrence of any of the following events:

- (a) in the event that completion does not occur by the Long Stop Date for any reason whatsoever (other than by reason of the failure by the Purchaser to pay the Escrow Amount in accordance with the Agreement or to comply with its obligations under Paragraph 4.8 below); or
- (b) in the event that the Company shall default in completing the sale and purchase of the Sale Shares in accordance with the terms and conditions of the Agreement by virtue of its failure to deliver certain specified documents on Completion to the Purchaser in accordance with the Agreement.

For the avoidance of doubt, if the Purchaser shall default in completing the sale and purchase of the Sale Shares in accordance with the terms and conditions of the Agreement by virtue of its failure to pay the Escrow Amount in accordance with the Agreement or to comply with its obligations under Paragraph 4.8 below, the Company shall be entitled to forfeit the Initial Deposit.

### 4. SALIENT TERMS OF THE AGREEMENT

#### 4.1 Sale and Purchase

Subject to the terms and conditions of the Agreement, the Company shall sell, transfer and assign the subject matter set out below (hereinafter to be known as the “**Assets**”) as legal and beneficial owner, to the Purchaser:

- (a) the Sale Shares, with all rights and advantages attaching thereto as at 1 October 2006<sup>(1)</sup> and thereafter, free from encumbrances;
- (b) subject to Paragraph 4.2 below, the inter-company debts<sup>(2)</sup> (the “**Inter-co Debts**”) outstanding as at the Completion Date;
- (c) all legal and beneficial rights, title or interests in any Group Company’s intellectual property as at the Completion Date; and
- (d) the exclusive right of the Purchaser to represent and hold itself out after acquiring the Group Companies that it and the Group Companies are carrying on the business in succession to the Company.

Subject to completion of the Sale occurring, beneficial interest and title to the Sale Shares being transferred shall pass to the Purchaser with effect from and on 1 October 2006 and legal title and interest to the Sale Shares will pass with effect from and on completion and the accounting records of the Company and the Purchaser shall reflect the aforesaid accordingly. Notwithstanding the above, the Liabilities, if not already discharged by then from the Inter-co Debts, shall be assumed fully by the Purchaser upon and from and on completion. See Paragraph 4.2 below for further details.

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*Notes:*

- (1) Irrespective of which date was to be fixed as the effective date for the transfer, there was no intention to pay out any dividend once the Agreement was signed. Moreover, the Company recorded a loss for the half year 30 September 2006. The Board chose 1 October 2006 to be the effective date as a matter of practical convenience. In the event that the transaction was completed successfully, the Company as a clean shell would not have to be put to major efforts to prepare and audit the performance of the business that would have been sold after 30 September 2006. Moreover, the performance and results on an unaudited basis to 30 September 2006 had already been made known. It is envisaged that in the annual report and accounts of the Company for the year ending 31 March 2007, the balance sheet would show a cash shell with no business and the financial performance and balance sheet of the disposed business would be shown as a discontinued operation for the first half period ending 30 September 2006.
- (2) These Inter-co Debts were incurred in the past as the Company loaned the proceeds from its initial public offering to fund the operations of these subsidiaries. As at 30 September 2006, Inter-co Debts amounted to HK\$51.134 million.

### **4.2 Assumption of Liabilities by the Purchaser and Set-off of Liabilities from Inter-co Debts**

Subject to the terms and conditions of the Agreement, all liabilities of the Company (including but not limited to payables and other payables and any amounts owing to any Group Companies) whether current, long term or contingent arising and existing on or before the Completion Date (the “**Liabilities**”) shall, on completion of the Sale, be assumed by the Purchaser but only to the extent that such Liabilities have not been discharged on the Completion Date out of the proceeds of repayment from the Inter-co Debts as set out below.

Prior to completion of the Sale, the Company is authorised to require any or all the Group Companies to repay the Inter-co Debts or such part thereof up to an amount equal to the amount of the Liabilities. For this purpose, the Company’s nominees on the boards of the Group Companies are authorised to instruct that the aforesaid repayments be made by the Group Companies to the Company. In the event that the Company and/or the Company’s nominees instruct the Group Companies to effect repayment of the Inter-co Debts or such part thereof to the Company prior to completion, the amounts repaid in respect of such Inter-co Debts must be applied by the Company to discharge the Liabilities on the Completion Date. The balance of the Inter-co Debts outstanding as at completion shall be assigned to the Purchaser at completion.

Current management of the Company is fairly confident based on the operations and the projections that there will be incoming cash flow for the Group Companies such that they will be able, in the period prior to completion of the Sale, to pay down their Inter-co Debts owed to the Company. As at the date of the Agreement, the Inter-co Debts were larger than the Liabilities.

The Liabilities include:

- (a) all of the fees and expenses for A&M (as defined in A&M’s mandate letters of 22 May 2006, 27 July 2006 and 22 November 2006), except for 35.58%<sup>(1)</sup> (amounting to HK\$1,290,137) of the success fees charged or chargeable by A&M upon completion of the Sale, and 50% of the fees, costs and expenses of the escrow agent payable by the Company pursuant to the Agreement; and

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## LETTER TO SHAREHOLDERS

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- (b) expenses incurred by the Company in appointing financial, legal and accounting advisers and other related expenses in connection with the Sale, completion and the Share Cancellation, including without limitation the costs of the IFA, but

shall not include any expenses incurred by the Company in appointing financial, legal and accounting advisers and other related expenses in connection with the acquisition of any new business by the Company or any issue of new shares in the Company, whether or not such transactions are consummated after or simultaneously with completion under the Agreement.

*Note:*

- (1) This Paragraph contains the definition of the Liabilities to be assumed by the Purchaser. One of the key Liabilities is the success fees payable to A&M. The Purchaser and the Company have commercially agreed that the Purchaser would not bear 100% of the success fees charged or chargeable by A&M upon completion of the Sale; but rather the Purchaser would only bear their portion, i.e. 64.42% of the success fees charged or chargeable by A&M upon completion of the Sale. Therefore, the definition of Liabilities to be assumed by the Purchaser shall be all of the A&M expenses, all of the success fees in total less the 35.58% balance that is attributable to all the other Shareholders, and 50% of the escrow agent's fees.

Conditional upon completion, the Purchaser shall indemnify the Company against any claims, litigation, arbitration or administrative proceedings relating to or in connection with the business, Assets and/or the Liabilities (the **"Proceedings"**) commenced or made against the Company from any customers, suppliers, distributors, agents, employees, business partners, taxation agencies or any third parties. The Purchaser may request the Company to take all legitimate steps to contest such Proceedings and to lend its name to such Proceedings and to provide reasonable assistance to the Purchaser and the Company will only do so subject to the Purchaser giving it sufficient security in respect of all costs damages and expenses that the Company may incur in lending its name to such Proceedings and/or providing reasonable assistance to the Purchaser including any award of costs against it.

### **4.3 Termination of agreements between the Company and the Group Companies**

The parties agree that upon completion, any agreement (including without limitation, management fees agreement) entered into between the Company and any Group Company (**"Intra-group Agreements"**) shall be deemed terminated with effect from and on completion and none of the parties to the Intra-group Agreements shall have any rights, claims or courses of action on or against one another in respect of such agreements and if there are any such rights, claims or courses of action existing as at the Completion Date, the parties agree that the same shall be deemed irrevocably and unconditionally waived immediately upon completion.

### **4.4 No warranties on the Assets, Sale Shares or the Group Companies**

The sale and purchase of the Assets shall be on an "as is, where is" basis, and all warranties on conditions whether express or implied, statutory or otherwise as to the state of Daka Investment, Daka China, or any Group Company or as to the state of their assets, property or financial conditions and prospects are excluded save for the Company's warranty as to title to the Sale Shares and as to freedom from encumbrance to the extent as set out in the Agreement. For the avoidance of doubt, save as expressly provided in the Agreement, the Company gives no representations or warranties of any sort whatsoever to the Purchaser or the Guarantors.

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### 4.5 Conditions Precedent

Completion under the Agreement is conditional upon:

- (a) the approval of the SGX-ST for the Sale and the Share Cancellation being obtained on terms acceptable to the parties and not being withdrawn or revoked prior to completion;
- (b) the approval of the Shareholders being obtained for the Sale and the Share Cancellation;
- (c) all necessary regulatory or governmental approvals or consents required under any applicable laws (including but not limited to the laws of Bermuda, the British Virgin Islands, Hong Kong and Singapore) for the Sale and the Share Cancellation being obtained on terms acceptable to the parties and not being withdrawn or revoked prior to completion;
- (d) all necessary third party approvals or consents being obtained on terms acceptable to the parties and not being withdrawn or revoked prior to completion;
- (e) the provision of evidence satisfactory to the Company of the release of any liability, contingent or otherwise, undertaken by the Company, to secure any indebtedness, liability or obligations of the Group Companies to financial institutions (the “**Parent Guarantees**”)<sup>(1)</sup>;
- (f) the disclosure letter, if delivered, being in form and substance satisfactory to the Purchaser in its sole and absolute discretion; and
- (g) in respect of completion of the sale and purchase of the shares in Daka China, Daka China not having been deregistered by the Companies Registry of Hong Kong under section 291AA of the Companies Ordinance of Hong Kong prior to completion. For the avoidance of doubt, in the event where Daka China is deregistered prior to completion, completion in respect of the sale and purchase of the shares in Daka Investment and the other terms of the Agreement shall not be affected in any way and the Agreement shall continue in full force and effect as if the definition of the “Sale Shares” refers to the shares in Daka Investment only.

With regards to condition precedent (b) above, the approval of the Shareholders for the Sale will be sought at the SGM via an ordinary resolution and the approval of the Shareholders for the Share Cancellation will be sought at the SGM via a special resolution.

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With regards to condition precedent (f) above, no disclosure letter was delivered by the Company to the Purchaser. The Agreement contemplates a disclosure letter (if any) being delivered by the Company within 10 Business Days after the date of the Agreement, setting out exceptions to its representations and warranties contained in the Agreement. On a review of the Agreement and the limited representations and warranties therein, as the Sale is on an “as is, where is” basis, the Company came to the conclusion that no exceptions were required and therefore, no disclosure letter was furnished by the Company to the Purchaser.

With regards to condition precedent (g) above, Daka China has not been deregistered by the Companies Registry of Hong Kong as at the Latest Practicable Date.

*Note:*

- (1) Management has discussed the release of the Parent Guarantees with all its financial institutions who had been given corporate guarantees by the Company. As all the financial institutions with the benefit of the Company’s corporate guarantees have been repaid, they have indicated their willingness to release the said corporate guarantees.

However, due to the 6-month claw back period under the bankruptcy laws, these banks have generally indicated that if any repayment to them was recovered from them during these 6 months as a result of bankruptcy laws, they reserve the right to come back against the Company. The repayment of these banks with the benefit of the corporate guarantees was made by the Daka Group under the supervision of A&M in the recent weeks from careful realization of cash flow. The incoming cash flow was used to repay the banks and the bulk of the final repayments to the banks were made by the Group Companies for the period between November 2006 to December 2006. Based on the last repayment to the banks made in December 2006, it is envisaged that the 6-month claw back period will lapse after June 2007. There was no reason to believe that any preference of the banks was made or that the Group Companies have been made insolvent as a result of such repayments. Accordingly, it was a reasonable commercial judgment by the Company and the Board that the risk of claw back is remote in the next 6 months.

It must be noted that although the financial institutions have been repaid, it is within their legal rights and is a reflection of their caution that they would insist on such a legal position of holding the Company to its guarantee for another 6 months. There is nothing that the Company or the Purchaser could commercially do to change the mindset of the banks.

### 4.6 Corporate Guarantee from Daka Development

The Purchaser shall, within 20 Business Days from the Completion Date, deliver a corporate guarantee, in such form as may be acceptable to the Company in its discretion, from Daka Development, in favor of the Company guaranteeing the performance of the Purchaser’s undertakings as set out under Paragraph 4.2 above (the “**Daka Development Guarantee**”), together with copies of all ancillary documents necessary under the Companies Ordinance of Hong Kong to enable Daka Development to provide the Daka Development Guarantee.

Daka Development is a subsidiary of Daka Investment. On completion of the Sale, Daka Investment will become, and consequently Daka Development will also become, a subsidiary of the Purchaser.

The Daka Development Guarantee is the only security furnished to secure the performance of the Purchaser’s undertakings as set out under Paragraph 4.2 above. The Guarantors, will not be furnishing any personal guarantee to secure the performance of the Purchaser’s undertakings described.



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The Purchaser shall have no obligation whatsoever to deliver the Daka Development Guarantee to the Company if either of the following events occurs:

- (i) if any claims are made against the Company during the period commencing from the date of the Agreement up to and including the Completion Date and the aggregate amount of all such claims exceed the distributable profits of Daka Development determined as at the time of the giving of the Daka Development Guarantee; or
- (ii) if Daka Development is insolvent at the time of the giving of the Daka Development Guarantee and/or will become insolvent as a result of the giving of the Daka Development Guarantee.

Provided that if the Purchaser is not under an obligation to deliver the Daka Development Guarantee by reason of the occurrence of the event specified in sub-paragraph (ii) above, the Purchaser shall, at its own cost, within 30 Business Days from the Completion Date, deliver to the Company a report from an auditing firm based in Hong Kong as to the insolvent status of Daka Development. For the avoidance of doubt, the Daka Development Guarantee will be provided by Daka Development, and delivered by the Purchaser to the Company pursuant to the terms and subject to the conditions above, only after completion of the Sale has taken place.

### **4.7 Purchaser's Warranties and Undertaking**

The Purchaser represents and warrants to and for the benefit of the Company as follows:

- (a) the Purchaser has full power and authority to enter into, exercise its rights and perform and comply with its obligations under the Agreement;
- (b) all actions, conditions and things required to be taken, fulfilled and done (including the obtaining of any necessary consents) in order to:
  - (i) enable the Purchaser to lawfully enter into, exercise its rights and perform and comply with its obligations under the Agreement; and
  - (ii) ensure that those obligations are valid, legally binding and enforceable, have been taken, fulfilled and done;
- (c) upon execution of the Agreement, the obligations of the Purchaser hereunder shall be legally valid, binding and enforceable on and against the Purchaser in accordance with the terms thereof; and
- (d) conditional upon and with effect from and on completion, the Company shall be released and discharged from any and all liabilities, contingent or otherwise, under the Parent Guarantees.



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### 4.8 Resignation of directorships in the Company

On the Completion Date, the Purchaser shall deliver the Guarantors' and Rose Chow's letters of resignation from all their directorships in the Company and pay the Escrow Amount to the Company. No later than 10 Business Days before the Completion Date, the Purchaser shall provide the names of at least two nominees to be appointed as directors of each Group Company (other than Daka Research (UK) Ltd, Daka Designs (China) Ltd and Daka Europe Ltd).

### 4.9 Guarantors' undertaking with regards to voting in respect of, and transfers of, Shares

The Guarantors jointly and severally:

- (a) undertake to and for the benefit of the Company that they will abstain from voting in respect of their Shares at the SGM to be convened by the Company to consider, *inter alia*, the Sale and the Share Cancellation; and
- (b) undertake to and for the benefit of the Company that from the date hereof until the completion of the Share Cancellation, there will be no transfers or change in legal or beneficial interest in the 194,883,432 Shares which they have as at the date of the Agreement.

Each Guarantor represents and warrants, with respect to himself only, to and for the benefit of the Company that he has full legal capacity to enter into, exercise his rights and perform and comply with his obligations under the Agreement.

Raymond Yiu Man Chow has further undertaken to and for the benefit of the Company that he will reasonably procure Rose Chow to agree, and Rose Chow has agreed:

- (a) to the Share Cancellation in respect of the 97,441,716 Shares in which she has an interest as at the date hereof;
- (b) to abstain from voting in respect of her Shares at the SGM to be convened by the Company to consider the Sale and the Share Cancellation; and
- (c) from the date hereof until the completion of the Share Cancellation, not to transfer or allow any change in legal or beneficial interest in the 97,441,716 Shares which she has as at the date hereof.

### 4.10 Guarantors' obligations

The Guarantors jointly and severally warrant and undertake to and with the Company that:

- (a) the issued and paid-up capital of the Purchaser would be at least HK\$28 million as at completion of the Sale and for a period of 6 years thereafter, no steps which will

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result in a reduction or decrease in such issued and paid-up capital shall be taken by the Purchaser without the written consent of the Company; and

- (b) in the event that the Purchaser undergoes an amalgamation or merger with a third party within a period of 6 years from the Completion Date, the Guarantors shall jointly and severally procure, in the event that the Purchaser is not the surviving entity after the amalgamation or merger is effected, that the surviving entity be legally bound by the obligations of the Purchaser under the Agreement.

### 4.11 Company's warranties

The Company represents, warrants and undertakes to and for the benefit of the Purchaser as follows:

- (a) that the Company has full power and authority to enter into, exercise its rights and perform and comply with its obligations under the Agreement;
- (b) all actions, conditions and things required to be taken, fulfilled and done (including the obtaining of any necessary consents) in order to:
  - (i) enable the Company to lawfully enter into, exercise its rights and perform and comply with its obligations under the Agreement; and
  - (ii) ensure that those obligations are valid, legally binding and enforceable, have been taken, fulfilled and done;
- (c) upon execution of the Agreement, the obligations of the Company under the Agreement shall be legally valid, binding and enforceable on and against the Company in accordance with the terms thereof;
- (d) the Company in the period from 22 May 2006 to the date of the Agreement (the “**Interim Period**”) has not taken, and will not up to completion take, any action to affect or change or create any encumbrance over any of the Company's rights, title and interests in the Sale Shares existing as of the date falling immediately before the commencement of the Interim Period;
- (e) upon completion, the Company will change its name to remove the word “Daka” from its name within 90 Business Days after completion and shall not use any other word which is confusingly similar to the word “Daka” in its name;
- (f) upon completion, if the Company shall still have any legal or beneficial rights, title or interests in any group company intellectual property, the Company shall transfer all its respective legal and/or beneficial rights, title or interests in such group company intellectual property to the Company promptly and in any event, no later than 90 Business Days after completion; and

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- (g) the Company shall notify the Purchaser in writing of any claims made against the Company during the period commencing from the date of the Agreement up to and including the Completion Date and the respective amount of such claims, within 5 Business Days from the time of receipt of such claims by the Company. If requested by the Purchaser, the Company shall provide the Purchaser with a copy of the relevant documents containing such claims.

### 4.12 No waiver

The Shareholders' attention is drawn to clause 3.3.5 of the Agreement, which states the following (references to the "Vendor" being references to the Company):

*"For the avoidance of doubt, the entering by the Vendor into this Agreement and the provisions herein shall not be, or deemed to be, a waiver, composition or settlement of any sort by the Vendor for any rights or courses of action, whether accrued or accruing hereafter, which the Vendor has or may have, against the Guarantors or any parties related or associated with them, arising from any action or omission which took place during the time when these persons were sitting on the board of directors of the Vendor or involved in the management of the Group and the Vendor."*

## 5. THE SHARE CANCELLATION VIA A CAPITAL REDUCTION EXERCISE

The Share Cancellation involves the cancellation of all 194,883,432 Shares held by (or on behalf of) the Guarantors and Rose Chow (the spouse of Raymond Yiu Man Chow) collectively (the "**Relevant Persons**") as at the date of the Agreement. The Share Cancellation will be effected via a capital reduction exercise to be undertaken by the Company.

The capital reduction exercise (which will (subject to approval of the Shareholders at the SGM) take effect on 5 April 2007 (or such later date as the Directors may decide, being no later than 30 June 2007)) will result in the issued and paid-up share capital of the Company being reduced by HK\$29,232,515, from HK\$45,384,000 comprising 302,560,000 Shares to HK\$16,151,485 comprising 107,676,568 Shares each fully paid as illustrated in table form below:

Immediately before the completion of the Sale		Immediately after the Share Cancellation		Immediately after the Share Cancellation
<i>No of issued Shares</i>	<i>Share capital (HK\$)</i>	<i>No of issued Shares</i>	<i>Share capital (HK\$)</i>	<i>Percentage change (%)</i>
302,560,000	45,384,000	107,676,568	16,151,485	64.4

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Upon such reduction of issued and paid-up share capital taking effect, the amount of HK\$29,232,515 arising from the reduction of issued and paid-up share capital and the cancellation of the Shares held by (or on behalf of) the Relevant Persons shall be applied by the Company as follows:

- (a) in lieu of returning to the Relevant Persons the amount of HK\$27,378,500 as payment for the cancellation of their Shares, the Company shall fully apply the same in satisfaction of the sum of HK\$27,378,500, being part of the Purchase Consideration payable by the Purchaser to the Company in relation to the Sale; and
- (b) the balance of HK\$1,854,015 arising from such reduction shall be credited by the Company to a reserve account of the Company known as the "Other Reserve" account.

The capital reduction exercise will not affect the authorised share capital of the Company which shall be maintained at its current level of HK\$900,000,000 comprising 6,000,000,000 Shares.

The Share Cancellation has been approved by the Directors and is subject to, *inter alia*, the approval of the Shareholders at the SGM via a special resolution. Under the Bermuda Companies Act, there is no requirement for the confirmation by the Supreme Court of Bermuda of the capital reduction to be undertaken in connection with the Share Cancellation. Such capital reduction is also conditional on the publication of a notice of reduction in Bermuda in accordance with section 46 of the Bermuda Companies Act.

### 6. RATIONALE FOR THE SALE

#### Summary of recent key developments in the Company

The Company has encountered a series of material and key developments since the fourth quarter of 2005. These developments were duly reported and announced in the past months and for ease of reference, they are summarised below:

- (i) On 11 October 2005, the Company released a profit warning announcement regarding a material provision in respect of the amounts owing from DML, a major supplier of the Daka Group.
- (ii) On 20 November 2005, the audit committee of the Company duly appointed the accounting firm KPMG to conduct an independent review of the transactions between the Daka Group and DML.
- (iii) On 16 January 2006, the SGX-ST halted trading of the Shares.
- (iv) On 22 May 2006, the Company appointed the consultancy firm of A&M to act as interim managers for the Daka Group. Accordingly, Mr Kelvin Flynn and Mr Eric Thompson of A&M were appointed Executive Director and CEO

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respectively. (Mr Flynn resigned as Executive Director in October 2006 as a consequence of his leaving the service of A&M.) Under the terms of their appointment, A&M would receive a monthly retainer of HK\$300,000 and an issue of new Shares comprising 5% of the enlarged share capital of the Company upon the fulfillment of certain performance milestones, including *inter-alia*, the resumption of the listing and quotation of the Shares on the SGX-ST and/or successful completion of the Sale. The Company and A&M entered into a supplementary agreement on 22 November 2006 whereby the issue of new Shares to A&M has been revoked and A&M will instead, receive cash payment upon the fulfillment of certain performance milestones, including *inter-alia*, the resumption of the listing and quotation of the Shares on the SGX-ST and/or successful completion of the Sale.

- (v) On 25 May 2006, Raymond Yiu Man Chow (the Chief Executive Officer), Pat Y. Mah (the Chairman) and Kevin Leung (the Chief Financial Officer) voluntarily agreed to step down from their management positions to allow the Board to do what is best in the interests of the Daka Group. Raymond Yiu Man Chow and Pat Y. Mah are Executive Directors and majority Shareholders of the Company. They, together with Rose Chow, as Executive Directors, had also voluntarily agreed to take leave of absence from the Board to avoid any erosion in confidence in the management and corporate governance of the Daka Group.
- (vi) On 8 June 2006, a report on the review by KPMG was completed and delivered to the Company (the “**KPMG Report**”)<sup>(1)</sup>. The KPMG Report highlighted certain irregularities in the financial management of the Daka Group. Details are set out in the Company’s announcements via the SGXNET dated 14 June 2006, a copy of which is reproduced as Appendix 3 of this Circular.
- (vii) On 6 October 2006, the Company held its AGM for FY2006. The Daka Group made a loss of approximately HK\$27.7 million for FY2006. As at 31 March 2006, the Daka Group had a consolidated NTA of HK\$33.7 million.

*Note:*

- (1) The Directors wish to highlight that the Purchaser is effectively controlled by Pat Y. Mah and Raymond Yiu Man Chow, who are the Executive Directors and the majority Shareholders against whom allegations were made in the KPMG Report. Raymond Yiu Man Chow is also the spouse of Rose Chow, another Executive Director named in the KPMG Report.

### **Recent developments with DML**

In the prospectus of 2 July 2004 for the listing of the Company, it was disclosed that the Daka Group was relying on the sub-contract manufacturing services of DML.

DML has a manufacturing facility at Dongguan, the People’s Republic of China. DML is wholly-owned by DIL. It was disclosed that the Company holds an indirect interest of 18% in DIL with the remaining 82% held by Mr Lawrence Chan.

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When A&M, as the interim manager, took over control of the operations of the Daka Group in June 2006, the Daka Group then had relied almost exclusively on the sub-contract manufacturing services of DML. In connection therewith, the Daka Group had provided advances to fund the operations of DML and accordingly, DML had owed the Daka Group approximately HK\$48.1 million and HK\$77.8 million as at 31 March 2006 and 30 June 2006 respectively. On the other hand, the Daka Group also owed approximately HK\$13.5 million and HK\$19.9 million to DML (being monies owed for products manufactured by DML and delivered to the Daka Group) as at 31 March 2006 and 30 June 2006 respectively. Hence the net amount owed by DML to the Daka Group was approximately HK\$34.6 million and HK\$57.9 million as at 31 March 2006 and 30 June 2006 respectively.

It must be noted that the financial accounts of DML were consolidated into the financial statements of the Daka Group for the financial year ended 31 March 2006. This was pursuant to the outcome of the KPMG Report that the Company had effective control of DML. As at 31 March 2006, on consolidation, the monies owed by DML of HK\$48.1 million, a corresponding provision for doubtful debt of HK\$30 million on this amount, and the monies owed to DML of HK\$13.5 million were eliminated as they were regarded as intra-group owings and provisions.

At the time of appointment of A&M, the ongoing ability of DML to repay the monies owed was in some doubt because DML was in a poor financial position. The Company has earlier demanded and received the personal guarantee of Mr Lawrence Chan for any shortfall of repayment of such monies owed by DML.

Shortly after A&M took over control, Mr Lawrence Chan had proposed to be released from his personal guarantee by way of a compromise through which DML would settle all monies owed for the sum of HK\$10 million payable by cash instalments over 18 months. At that time, the Board and A&M were not agreeable to this compromise because the ongoing ability of DML to repay the HK\$10 million was very dependent on the Daka Group continuing to utilize a significant part of DML's manufacturing capacity. In other words, the ongoing ability of DML to honour the HK\$10 million repayment was predicated on the Daka Group depending exclusively on DML as its manufacturing arm. The Board and A&M had in fact decided to diversify its manufacturing requirement to other suppliers, and other than DML, the Daka Group has begun to source from two other suppliers since July 2006. The Board and A&M decided to continue to hold Mr Lawrence Chan to his guarantee and to maintain ongoing pressure on DML to cooperate as over the next six months to the end of December 2006, the Daka Group would continue to be heavily dependent on the manufacturing capacity of DML. To agree to the compromised payments would be to release the pressure of Mr Lawrence Chan and DML prematurely whilst still taking the ongoing risks that DML would be unable to honour the repayment instalments.

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A&M, immediately upon their appointment as the interim manager, had put in efforts to assuage the anxieties of suppliers, customers and bankers in light of recent developments and the suspension of trading of the Shares on the SGX-ST. With a degree of stability achieved, A&M has also worked with Pat Y. Mah and Raymond Yiu Man Chow to increase the sales of the automated can openers. This new innovative product enjoyed brisk and robust sales in the second half of 2006. The outsourcing of the manufacture of this product to DML together with close monitoring of the operations of DML has enabled A&M to reduce the amount owed by DML from HK\$77.8 million as at 30 June 2006 to approximately HK\$67.3 million as at 30 September 2006 and HK\$66.9 million as at 31 December 2006. As long as the automated can openers can enjoy robust sales into 2007, then further recovery of the sum owed by DML can be expected; provided that the Daka Group continues to rely on DML for outsource manufacturing. As at 30 September 2006 and 31 December 2006, the Daka Group also owed DML the sums of HK\$21.6 million and HK\$22.0 million respectively. Therefore, the net amount (before taking into account the provision made in FY2006 of HK\$30 million) owed by DML to the Daka Group was HK\$45.7 million and HK\$44.9 million as at 30 September 2006 and 31 December 2006 respectively.

However, the Directors and A&M wish to caution that in the competitive area of innovative consumer products, there is no assurance that the automated can opener while performing well in 2006 would continue to do just as well or better in 2007. There is the prevailing risk of low cost “piracy” products that enter the market to erode sales and the temporal nature of products with innovative appeal.

Shareholders must note that the terms of the Sale as negotiated are to sell the Group Companies as going concerns to the Purchaser. Accordingly, the future recovery, or the future inability to recover the monies owed by DML to the Group Companies would become the respective right or the respective burden of the Group Companies when they are owned by the Purchaser on the completion of the Sale. Hence, it would become a matter between the Purchaser, after it owns the Group Companies, with DML and Mr Lawrence Chan.

In the event that for any reason whatsoever, that the Sale is not completed, and the Company continues to own the Group Companies, then the matter of the recovery of monies from DML and from Mr Lawrence Chan would be preserved intact and remain the prerogative of the Company.

### **A strategic decision**

The Company as an investment holding company owning the underlying business of designing, manufacturing and supplying innovative consumer products faces a critical decision as to its future.



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## LETTER TO SHAREHOLDERS

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The Company can attempt to move forward with its current businesses even though the Executive Directors who are the majority Shareholders (namely Pat Y. Mah, Raymond Yiu Man Chow and Rose Chow) have not been cast in a favourable light in terms of compliance issues and in terms of the alleged financial irregularities as set out in the KPMG Report.

Alternatively, the Company could consider disposing of the current businesses in order to use the sale proceeds for various options including to acquire other viable businesses which may lead to a change in control of the Company via a reverse takeover. After the Sale is successfully completed, the Directors will actively consider proposals for such acquisition targets. The Directors would be inviting the investment banking community to put up proposals which may include appointing one or more of such investment banks with mandate(s) to seek out such acquisition or reverse takeover opportunities. The Singapore independent Directors, being familiar with the Singapore requirements and based in Singapore, would take the lead in such efforts. Given the Company's current adverse financial circumstances, there are no third parties who are prepared to enter into specific discussions at this point in time. Accordingly, the Company is in no position to provide specific details.

Over the past months, the Board, with the help of A&M, has been carefully managing the financial position and operations of the Daka Group and assuring bankers, suppliers and customers of its commitment to restore stability and confidence and to protect their business interests.

The Board recognises that an interim manager is not an ideal solution and it has been evaluating the prospects of a longer-term solution involving the sale of the current businesses with the overall eventual aim of achieving a lifting of the trading suspension of the Shares on the SGX-ST. Accordingly, the current term of engagement of A&M expires upon the completion of the Sale.

In deciding that the proposed Sale and the subsequent pursuit of reverse takeover opportunities is in the best interest of the Company and Shareholders, the Directors have taken into account the following factors.

### **Evaluation of factors and rationale for the Sale**

The Directors set out below their considerations for supporting the proposed Sale:

- (i) The business of the Daka Group is in the design and development of innovative best seller products for the consumer market. Recent examples of best sellers are the sea scooters and automated can openers. Such products are innovative in design and have a finite and often short life cycle. They need to be continuously replaced by subsequent generations of innovative products or applications. The Directors are conscious of the heavy reliance of the Daka Group on Pat Y. Mah and Raymond Yiu Man Chow for their business acumen, design flair and their ability to identify trends and needs of customers.



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## LETTER TO SHAREHOLDERS

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- (ii) In the competitive area of innovative consumer products, there is the continuous challenge and competition from numerous low cost “pirates” who are copycat producers. This shortens the product life cycle of the Daka Group’s best seller products. Therefore, the commercial reality is that the Daka Group has to be fast in terms of design, manufacture and the time to market. Again, the Directors are conscious of the heavy reliance of the Daka Group on Pat Y. Mah and Raymond Yiu Man Chow.
- (iii) Due to the KPMG Report, the continued service of Pat Y. Mah and Raymond Yiu Man Chow to the Daka Group is uncertain. Should they, for any reason, be unable or unwilling to resume their services to the Daka Group, the viability of the Daka Group’s existing business may be adversely affected.
- (iv) The Board has looked at the possibility of recruiting experienced and qualified management as replacement. However, given the relatively unique requirements of innovative design and manufacture coupled with the need for a good understanding of the possible market trends and demands in this consumer products segment, the Board is not optimistic about recruiting or retaining suitable talents.
- (v) With the help of A&M, some degree of financial stability in operations has been achieved for the Daka Group’s businesses. The present success of the current best seller which is an innovative can opener has also helped to some extent. However, this stability can be transient if another innovative product best seller is not identified, designed and manufactured to take over when sales of the automated tin can opener slow down. Pat Y. Mah and Raymond Yiu Man Chow are working on another product. However, the concerns in paragraphs (ii) and (iii) above continue to be present.
- (vi) The Company has sounded out suitable third parties with a view to selling the entire business of the Daka Group to them. To some extent, the same concerns that the Board has set out above were similarly voiced or held by such third parties as negative factors, and therefore, they had been less willing to pay a premium for the business of the Daka Group. The indications of possible purchase price by such third parties were relatively poor.
- (vii) The Directors also took into account the possibility that the findings in the KPMG Report may arguably cast doubts as to the acceptability to the SGX-ST of the Company reinstating Pat Y. Mah and Raymond Yiu Man Chow as Executive Directors of the Company. In addition, it remains uncertain, given the financial position and the business prospects of the Daka Group’s current businesses – which were founded and managed by Pat Y. Mah and Raymond Yiu Man Chow – whether the Company has realistic prospects of having the suspension of the trading of its Shares lifted. A solution which involves the disposal of the Daka Group’s entire current businesses so that the Company

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## LETTER TO SHAREHOLDERS

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becomes a listed shell company, thereby positioning it to pursue subsequent reverse takeovers opportunities, acquire new viable businesses and leading to the resumption of trading of its Shares, may be a better strategy and viable exit opportunity for the public Shareholders.

(viii) The Purchase Consideration for the proposed Sale of HK\$42.5 million represents a premium of approximately HK\$8.1 million over the net book value of the Group Companies of approximately HK\$34.4 million as at 30 September 2006.

### **Caution and upside**

The aim of the Directors in pursuing the proposed Sale is as follows:

- The proposed Sale and the terms offered are the best possible under the circumstances given that third parties which were approached did not make an offer or offered less.
- There is a need to act quickly as the value of the Daka Group's business without conscious long-term leadership would erode over time.
- The Sale to the Purchaser, an entity that is principally owned by the Controlling Shareholders of the Company, namely Pat Y. Mah, Raymond Yiu Man Chow and Rose Chow, should not be construed as an exoneration of these Controlling Shareholders or any other parties nor that the relevant authorities have waived any enforcement action or penalties against the Controlling Shareholders. Once the Company sells off its existing business, it will be a listed shell company, and therefore will be in a better position to acquire a new viable business and apply for the trading of the Shares to resume. This Sale should be viewed as a commercial solution to provide a possible liquidity and exit route for public Shareholders in the longer term and it should be noted that the completion of the Sale will not preclude any enforcement actions by relevant authorities in Singapore or elsewhere against the said Controlling Shareholders or any other parties.
- To facilitate the acquisition of a new viable business and apply for the trading of the Shares to resume, the Directors were mindful that it was necessary for Pat Y. Mah, Raymond Yiu Man Chow and Rose Chow (the spouse of Raymond Yiu Man Chow) not to remain as majority Shareholders of the Company. Accordingly, the cancellation of all of their Shares has been proposed as a term of the proposed Sale.

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## LETTER TO SHAREHOLDERS

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The Directors would like to caution Shareholders on the following:

After completion of the proposed Sale, the Company will be a listed shell company with approximately HK\$12 million in cash, with no core business and only 107,676,568 issued Shares (after the cancellation of 194,883,432 Shares belonging to Raymond Yiu Man Chow, Pat Y. Mah and Rose Chow).

It is contemplated that the next step for the Company would be to actively identify and seek out viable new businesses to acquire through a reverse takeover, in the process of which the vendor(s) of such viable businesses would become the new Controlling Shareholder(s) of the Company. The Directors are optimistic that, barring unforeseen circumstances and conditional upon the approval of the SGX-ST, when such a reverse takeover occurs, Shareholders would possibly have the opportunity to hold shares in a viable business. The Directors must caution that such upside chance is subject to, *inter alia*, the continued positive sentiments in the capital markets; a successful conclusion of a future reverse takeover opportunity; and the approval of the SGX-ST for such acquisition. **At this stage, there is no assurance that such an acquisition can be successfully completed.** Moreover, depending on relative bargaining position, a reverse takeover can result in significant dilution for the present public Shareholders.

The Directors also wish to caution that (i) the current suspension in trading of the Shares is likely to continue until such time as a successful takeover transaction is consummated; and (ii) the SGX-ST may remove the Company from the official list of the SGX-ST (thereby de-listing the quotation of the Shares) if the Company is unable to meet the requirements for a new listing within 12 months from the SGM.

As a firm reverse takeover opportunity has yet to be identified, it is not possible at this point in time for the Directors to determine the market valuation of the Company as a listed shell company for the purposes of a reverse takeover.

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## LETTER TO SHAREHOLDERS

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### 7. FINANCIAL EFFECTS OF THE SALE AND THE SHARE CANCELLATION

The proforma financial effects of the Sale and the Share Cancellation are purely for illustrative purposes only and do not reflect the future actual financial position of the Daka Group after the completion of the Sale and the Share Cancellation.

#### (A) On equity

The proforma financial effect of the Sale and the Share Cancellation on the Shareholders' equity (on a consolidated basis and before deducting any incidental costs in relation to the disposal) as at the end of FY2006, assuming that the Sale and the Share Cancellation had been effected as at 31 March 2006, would have been as follows:

Description (HK\$'000)	As at 31 March 2006	After completion of the Sale and the Share Cancellation
Share Capital	45,384	16,151
Share Premium	48,167	48,167
Other Reserve Account	–	1,854
Merger Reserve	(33,085)	–
Revaluation Reserve	5,735	–
General Reserve	49	–
Accumulated Losses	(27,542)	(53,563)
Minority Interests	6	–
	<hr/>	<hr/>
Total Equity	<u>38,714</u>	<u>12,609</u>

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## LETTER TO SHAREHOLDERS

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### (B) On NTA

The proforma financial effect of the Sale and the Share Cancellation on the NTA per Share (on a consolidated basis) as at the end of FY2006, assuming that the Sale and the Share Cancellation had been effected as at 31 March 2006, would have been as follows:

Description	As at 31 March 2006	After completion of the Sale and the Share Cancellation
NTA ( <i>HK\$'000</i> )	33,736	12,609 <sup>(2)</sup>
Number of issued Shares ( <i>'000</i> )	302,560	107,677
NTA per Share ( <i>HK cents</i> )	11.15 <sup>(1)</sup>	11.71 <sup>(3)</sup>

*Notes:*

- (1) Based on the Company's issued share capital of 302,560,000 Shares as at 31 March 2006.
- (2) Inclusive of the Cash Consideration.
- (3) Based on the illustration that the Company's issued share capital as at 31 March 2006 is 107,677,000 Shares and assuming that the Sale and the Share Cancellation had been effected as at 31 March 2006.

### (C) On LPS

The proforma financial effect of the Sale and the Share Cancellation on the LPS of the Company (on a consolidated basis) for FY2006, assuming that the Sale and the Share Cancellation had been effected as at 1 April 2005, would have been as follows:

Description	Before the completion of the Sale and the Share Cancellation	After the completion of the Sale and the Share Cancellation
Net loss after tax ( <i>HK\$'000</i> )	27,676	54,043 <sup>(2)</sup>
Number of Shares ( <i>'000</i> )	302,560	107,677
LPS ( <i>HK cents</i> )	9.15 <sup>(1)</sup>	50.19 <sup>(3)</sup>

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## LETTER TO SHAREHOLDERS

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*Notes:*

- (1) Based on 302,560,000 Shares in issue for the whole of FY2006.
- (2) Not taking into consideration the loss on disposal of the Sale Shares of approximately HK\$28,007,000. This loss was mainly due to provision for doubtful debt from subsidiaries of approximately HK\$21 million, provision for impairment loss in investments of approximately HK\$29 million, legal and professional fees incurred by the Company for the year ended 31 March 2006.
- (3) Based on the illustration that there are 107,677,000 Shares in issue for the whole of FY2006 and assuming that the Sale and the Share Cancellation had been effected as at 1 April 2005.

### (D) On Gearing

The proforma financial effect of the Sale and the Share Cancellation on the gearing of the Company (on a consolidated basis) as at the end of FY2006, assuming that the Sale and the Share Cancellation had been effected as at 31 March 2006, would have been as follows:

Description	As at 31 March 2006	After the Sale and the Share Cancellation
Debts (interest-bearing loans) ( <i>HK\$'000</i> )	1,296	–
Equity ( <i>HK\$'000</i> )	38,714	12,609
Gearing ( <i>ratio</i> )	0.03	0.00

## 8. USE OF NET PROCEEDS

The gross and net (after deducting estimated costs in conjunction with the Sale of approximately HK\$3,000,000) cash proceeds of the Sale will be approximately HK\$15,121,500 and HK\$12,121,500 respectively. Such net cash proceeds will be used for the settlement of professional fees and other payables which may be incurred for any other future acquisitions or corporate exercises undertaken by the Company, and for the Company's future general administrative costs.

On completion of the Sale, it is contemplated that the next step for the Company would be to actively identify and seek out viable new businesses to acquire through a reverse takeover, in the process of which the vendor(s) of such viable businesses would become the new Controlling Shareholder(s) of the Company. In this context, the Directors are of the view that as a prudent measure, the cash should remain with the Company in order to maintain the Company as a viable vehicle for its future activities. Moreover, after the completion of the Sale, the only Shareholders left in the Company are the (present) minority Shareholders and the intention of the Directors is to maximize value for such Shareholders. Pending the completion of such reverse takeovers or corporate transactions, the Company will disclose, on a quarterly basis, the use of the cash proceeds of the Sale.

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## LETTER TO SHAREHOLDERS

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In pursuing any future reverse takeovers or other corporate transactions, the intention is to try and obtain a premium above the then cash reserves of the Company. In the event that the incoming party is unwilling to take into account the then cash reserves in their premium, the Directors would consider distributing all or part of the then cash reserves to all its Shareholders before or simultaneous with the completion of the reverse takeover or other corporate transaction.

The Directors are optimistic that, barring unforeseen circumstances and conditional upon the approval of the SGX-ST, when such a reverse takeover occurs, Shareholders would possibly have the opportunity to hold shares in a viable business. The Directors must caution that such upside chance is subject to, *inter alia*, the continued positive sentiments in the capital markets; a successful conclusion of a future reverse takeover opportunity; and the approval of the SGX-ST for such acquisition. **At this stage, there is no assurance that such an acquisition can be successfully completed.** Moreover, depending on relative bargaining position, a reverse takeover can result in significant dilution for the present public Shareholders.

Please also carefully read and consider Section 15A of this Circular, which describes the proposed distribution to the Shareholders of the net cash proceeds from the Sale and the winding-up of the Company following completion of the sale as an alternative to pursuing reverse takeover opportunities.

### 9. CHANGE OF THE NAME OF THE COMPANY

In accordance with the provisions of the Agreement, conditional upon completion of the Sale taking place, the Company has agreed to change its name to remove the word “Daka” within 90 Business Days after completion of the Sale and not to use any other word which is confusingly similar to the word “Daka” in its name. Therefore, the approval of the Shareholders, by way of a special resolution, will be sought at the SGM that, subject to completion of the Sale taking place, the name of the Company be changed to “Carats Limited” (or such other name as the Directors of the Company may select).

#### Approvals

The proposed name, “Carats Limited”, has been reserved by the Company until 23 May 2007. The proposed change of the Company’s name to “Carats Limited” (or such other name as the Directors of the Company may select) is subject to the approval of the Shareholders by way of a special resolution, and to the approval of the Bermuda Registrar.

On the basis that these approvals are obtained, the change of the Company’s name will take effect from the date on which the new name is entered upon the register maintained by the Bermuda Registrar, who will issue a “Certificate of Incorporation on Change of Name” to the Company. The change of the Company’s name will not affect any rights or obligations of the Company, or render defective any legal proceedings by or against it.

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## LETTER TO SHAREHOLDERS

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### Existing share certificates

Shareholders should note that notwithstanding the change of the Company's name, the Company will not recall existing share certificates bearing the current name of the Company which will continue to be prima facie evidence of legal title to the Shares. No further action would be required on the part of the Shareholders.

### 10. CHANGE OF AUDITORS FROM RSM NELSON WHEELER TO RSM CHIO LIM

The Company's existing auditors, RSM Nelson Wheeler, are based in Hong Kong, where the Daka Group's headquarters and key management presently reside. After the completion of the Sale, the Company would have disposed of all its subsidiaries and present operations.

As part of the Company's continuing efforts to be more cost-efficient, RSM Nelson Wheeler will resign as the Daka Group's auditors with effect from the close of the SGM, and RSM Chio Lim, who are based in Singapore, have been nominated as the Company's auditors in place of RSM Nelson Wheeler. RSM Nelson Wheeler is the Hong Kong member firm, and RSM Chio Lim is the Singapore member firm, of RSM International, which is the sixth largest network of independent accounting and consulting firms in the world.

A copy of the notice of nomination of the proposed new auditors, RSM Chio Lim, from Mr William Chin Shing Tong, the Chairman of the audit committee of the Company, is reproduced in Appendix 2 of this Circular.

In this regard, RSM Nelson Wheeler have, on 8 March 2007, given notice to the Company of their resignation as auditors of the Daka Group, and have, at the request of RSM Chio Lim and in accordance with the Bermuda Companies Act, on 8 March 2007, informed RSM Chio Lim there are no circumstances or reasons, in their opinion, for their replacement save for the above. Accordingly, RSM Chio Lim have, on 9 March 2007, given their consent to act as auditors of the Company, with effect from the close of the SGM, subject to the approval of the Shareholders at the SGM.

The Directors have confirmed that there are no circumstances connected with the proposed change of auditors that need to be brought to the attention of the Shareholders or creditors of the Company and its subsidiaries.

The appointment of RSM Chio Lim is subject to the approval of the Shareholders at the SGM by way of an ordinary resolution.



## LETTER TO SHAREHOLDERS

### 11. CONTROLLING SHAREHOLDERS' AND DIRECTORS' INTERESTS

#### 11.1 Interests in the Company

The interests of Directors and substantial Shareholders of the Company as at the Latest Practicable Date, as recorded in the Company's Register of Directors' Shareholdings and the Register of Substantial Shareholders respectively, and immediately after completion of the Sale, are as follows:

##### *Interests of Directors as at the Latest Practicable Date*

Name of Director	Direct Interests		Deemed Interests		Total Interests	
	No. of Shares	%	No. of Shares	%	No. of Shares	%
Pat Y. Mah <sup>(1)</sup>	100,000	0.03	97,341,716	32.17	97,441,716	32.21
Raymond Yiu Man Chow <sup>(2)(6)</sup>	100,000	0.03	97,341,716	32.17	97,441,716	32.21
Rose Chow <sup>(3)(6)</sup>	–	–	97,441,716	32.21	97,441,716	32.21
Michael Yue Kwong Chan <sup>(4)</sup>	–	–	11,503,560	3.80	11,503,560	3.80
Sir Clive Marles Sinclair <sup>(5)</sup>	–	–	6,766,800	2.24	6,766,800	2.24
William Chin Shing Tong	–	–	–	–	–	–
Dr. Roy Chi Ping Chung	–	–	–	–	–	–
David Tian Bin Chia	–	–	–	–	–	–
Geoffrey Seng Huat Yeoh	–	–	–	–	–	–

##### *Interests of Directors immediately after completion of the Sale*

Name of Director	Direct Interests		Deemed Interests		Total Interests	
	No. of Shares	%	No. of Shares	%	No. of Shares	%
Pat Y. Mah	–	–	–	–	–	–
Raymond Yiu Man Chow	–	–	–	–	–	–
Rose Chow	–	–	–	–	–	–
Michael Yue Kwong Chan <sup>(4)</sup>	–	–	11,503,560	10.68	11,503,560	10.68
Sir Clive Marles Sinclair <sup>(5)</sup>	–	–	6,766,800	6.28	6,766,800	6.28
William Chin Shing Tong	–	–	–	–	–	–
Dr. Roy Chi Ping Chung	–	–	–	–	–	–
David Tian Bin Chia	–	–	–	–	–	–
Geoffrey Seng Huat Yeoh	–	–	–	–	–	–

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## LETTER TO SHAREHOLDERS

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### *Interests of substantial Shareholders as at the Latest Practicable Date*

Name of substantial Shareholder	Direct Interests		Deemed Interests		Total Interests	
	<i>No. of</i>		<i>No. of</i>		<i>No. of</i>	
	<i>Shares</i>	<i>%</i>	<i>Shares</i>	<i>%</i>	<i>Shares</i>	<i>%</i>
Chariot Technology Limited <sup>(1)</sup>	97,341,716	32.17	–	–	97,341,716	32.17
New Wharton International Ltd. <sup>(2)</sup>	86,402,056	28.56	–	–	86,402,056	28.56

### *Interests of substantial Shareholders immediately after completion of the Sale*

Name of substantial Shareholder	Direct Interests		Deemed Interests		Total Interests	
	<i>No. of</i>		<i>No. of</i>		<i>No. of</i>	
	<i>Shares</i>	<i>%</i>	<i>Shares</i>	<i>%</i>	<i>Shares</i>	<i>%</i>
Chariot Technology Limited	–	–	–	–	–	–
New Wharton International Ltd.	–	–	–	–	–	–
Green Global Limited <sup>(4)</sup>	11,503,560	10.68	–	–	11,503,560	10.68
Sinclair Research Limited <sup>(5)</sup>	6,766,800	6.28	–	–	6,766,800	6.28

#### *Notes:*

- (1) As Pat Y. Mah is the sole shareholder of Chariot Technology Limited (a British Virgin Islands limited liability corporation incorporated on 8 December 2003), he is deemed to be interested in the 97,341,716 Shares representing 32.17% of the issued and paid-up capital of the Company held directly by Chariot Technology Limited as at the Latest Practicable Date in accordance with Section 7 of the Singapore Companies Act.
- (2) As Raymond Yiu Man Chow is the sole shareholder of New Wharton International Ltd. (a British Virgin Islands limited liability corporation incorporated on 12 December 2003), he is deemed to be interested in the 86,402,056 Shares representing 28.56% of the issued and paid-up capital of the Company held directly by New Wharton International Ltd. as at the Latest Practicable Date in accordance with Section 7 of the Singapore Companies Act.
- (3) As Rose Chow is the sole shareholder of Microage Investments Limited (a British Virgin Islands limited liability corporation incorporated on 8 December 2003), she is deemed to be interested in the 10,939,660 Shares representing 3.62% of the issued and paid-up capital of the Company held directly by Microage Investments Limited as at the Latest Practicable Date in accordance with Section 7 of the Singapore Companies Act.
- (4) As Michael Yue Kwong Chan directly controls Green Global Limited (a company incorporated in Hong Kong), he is deemed to be interested in the 11,503,560 Shares representing 3.80% and 10.68% of the issued and paid-up capital of the Company held directly by Green Global Limited as at the Latest Practicable Date and immediately after completion of the Sale respectively in accordance with Section 7 of the Singapore Companies Act.
- (5) As Sir Clive Marles Sinclair is a director and controlling shareholder of Sinclair Research Limited and owns approximately 60.8% (including deemed interests) of Sinclair Research Limited, he is deemed to be interested in the 6,766,800 Shares representing 2.24% and 6.28% of the issued and paid-up capital of the Company held directly by Sinclair Research Limited as at the Latest Practicable Date and immediately after completion of the Sale respectively in accordance with Section 7 of the Singapore Companies Act.

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## LETTER TO SHAREHOLDERS

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- (6) As Raymond Yiu Man Chow and Rose Chow are husband and wife, and they are deemed to have an interest in each other's Shares in accordance with Section 7 of the Singapore Companies Act.

### 11.2 Interests in the Sale

Save for Pat Y. Mah, Raymond Yiu Man Chow and Rose Chow, no Director or Controlling Shareholder of the Company has any interest direct or indirect in the Sale or the Share Cancellation (save as through their shareholding in the Company). Sir Clive Marles Sinclair and Mr Michael Yue Kwong Chan, who own Shares, have also indicated that they will vote, in respect of the Shares which they own as at the date of the SGM, in favour of the Sale and all ancillary transactions.

### 12. CAUTIONARY NOTE ON THE CODE AND NOTIFICATION OF SUBSTANTIAL SHAREHOLDING INTERESTS

Shareholders and investors should note that after the Share Cancellation comes into effect, the percentage shareholding in the Company of each holder of Shares immediately before the Share Cancellation (the “**Existing Shareholders**”) will increase.

No waiver for the obligation of such Existing Shareholders to comply with their obligations under the Code as a result of the Share Cancellation, especially the obligation under Rule 14 of the Code to make a mandatory general offer for Shares which they and parties acting in concert with them do not already own, has been sought. For reference only, Rule 14 of the Code states that where:

- (a) any person acquires whether by a series of transactions over a period of time or not, shares which (taken together with shares held or acquired by persons acting in concert with him) carry 30% or more of the voting rights of a company; or
- (b) any person who, together with persons acting in concert with him, holds not less than 30% but not more than 50% of the voting rights and such person, or any person acting in concert with him, acquires in any period of 6 months additional shares carrying more than 1% of the voting rights,

such person (and potentially his concert parties) must make a general offer for those shares with voting rights in the company not already owned by him and his concert parties.

In addition, Shareholders should note that under bye-law 167(2) of the bye-laws of the Company, they are required to notify the Company Secretary if they end up holding 5% or more of the total votes attached to all the voting shares in the Company as a result of the completion of the Share Cancellation.

Therefore, Shareholders and investors are advised to exercise caution when dealing in the Shares and where necessary, to seek separate professional advice on the same.

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## LETTER TO SHAREHOLDERS

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### 13. OPINION OF THE IFA AND AUDIT COMMITTEE'S STATEMENT

#### 13.1 The IFA's opinion

Pursuant to Chapter 9 of the Listing Manual, Ernst & Young Corporate Finance Pte Ltd has been appointed as the IFA to the Independent Directors to advise them on whether the Sale is on normal commercial terms and whether it is prejudicial to the interests of the Company and its minority Shareholders. A copy of its opinion letter to the Independent Directors dated 14 March 2007 is reproduced in Appendix 1 of this Circular. **Shareholders are advised to read the IFA's opinion letter carefully.**

Taking into consideration the factors set out in its letter, the IFA is of the view that the financial terms of the Sale are on normal commercial terms and are not prejudicial to the interests of the Company and its minority Shareholders.

#### 13.2 Audit committee's statement

The audit committee of the Company comprises Messrs William Chin Shing Tong, David Tian Bin Chia, Geoffrey Seng Huat Yeoh and Michael Yue Kwong Chan. The audit committee has reviewed the terms, rationale and benefit of the Sale and the opinion of the IFA and is of the view that the terms of the Sale are on normal commercial terms and are not prejudicial to the interests of the Company and its minority Shareholders.

### 14. THE OPINION AND RECOMMENDATION OF A&M

A&M, the interim managers of the Daka Group's business, support the Sale and are of the view that the Sale is in the best interests of the Company. A&M therefore recommend that Shareholders vote in favour of the resolutions relating to the Sale, the Share Cancellation, the change of the name of the Company and the change of auditors set out in the notice of SGM on page 87 of this Circular.

### 15. DIRECTORS' RECOMMENDATION

Shareholders should read and consider carefully this Circular in its entirety before giving their approval to the Sale, the Share Cancellation, the change of the name of the Company, the change of auditors and the proposed distribution of the net cash proceeds from the Sale via the Voluntary Winding Up. Shareholders are also urged to read carefully the terms of the Sale and the Share Cancellation, the information on Daka Investment and Daka China, the evaluation of factors and rationale for the Sale and the Share Cancellation, the Directors' caution, the financial effects of the Sale and the Share Cancellation, the cautionary note on the Code and notification of substantial shareholding interests, the opinion of the IFA, the audit committee's statement and the IFA's letter as set out in this Circular.

All the Directors (save for Pat Y. Mah, Raymond Yiu Man Chow and Rose Chow, who have an interest direct or indirect in the Sale and the Share Cancellation and who will abstain from making any recommendation in respect of the Sale and the Share Cancellation),

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## LETTER TO SHAREHOLDERS

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recommend that Shareholders vote in favour of the resolutions relating to the Sale, the Share Cancellation, the change of the name of the Company and the change of auditors set out in the notice of SGM on page 87 of this Circular. The Directors further recommend that any Shareholder who may require specific advice should consult his stockbroker, bank manager, accountant or other professional adviser.

### **15A. WINDING-UP OF THE COMPANY AS AN ALTERNATIVE TO PURSUING REVERSE TAKEOVER OPPORTUNITIES**

The Directors believe that it is in the better interest of Shareholders after the Sale and the Share Cancellation for the Company as a cash company to pursue reverse takeover opportunities. In the event that a reverse takeover acquisition is to be considered, the Directors would have to lay the proposal for Shareholders' approval in general meeting. However, the Directors need to remind Shareholders that there is no assurance that such a reverse takeover can be successfully completed. Moreover there is a time limit to how long the SGX-ST would allow the Company to pursue such an acquisition before delisting the Company.

The Directors will use reasonable efforts to manage the cash reserves carefully and minimise expenses and to arrange payment for professional expenses for the reverse takeover acquisition in the form of new Shares rather than in cash. However, there remains the risk that if, after a reasonable time, the Company is unable to successfully complete a reverse takeover acquisition, the Company is de-listed from the SGX-ST. At such time, it would become necessary to wind-up the Company and as the cash reserves of the Company may by such time become depleted, Shareholders would run the risk that there would be hardly any cash to be distributed through such winding-up.

In light of the foregoing, the Directors wish to present an immediate alternative to Shareholders, i.e., to immediately after completion of the Sale and Share Cancellation voluntarily wind-up the Company, such winding-up to take effect as soon as practicable thereafter and to distribute to the Shareholders whatever net cash is left instead of the Company attempting to pursue reverse takeover opportunities. If Shareholders approve Resolution 5 set out in the Notice of the SGM, the Directors will take such steps as may be expedient to implement the Voluntary Winding Up (including convening a further special general meeting of the Company).

The distribution of the net cash proceeds from the Sale to Shareholders via a voluntary winding-up is put forward by the Directors for Shareholders' consideration over the payment of dividends or a capital reduction because (i) this approach would take into account the interests of the Shareholders as well as the creditors of the Company, in view of the cash proceeds being the only meaningful asset to the Company at that time; and (ii) there is not enough profits to support the declaration of a dividend of the net cash proceeds. Liquidation is the only certain way of distributing the only asset of the Company without any creditor objection. The fees and expenses for the Voluntary Winding-Up are estimated at HK\$350,000.

Accordingly, Shareholders who are not in favour of the Company attempting possible reverse takeover acquisitions or who are not hopeful of a successful outcome for such reverse takeover acquisitions may wish to consider whether they wish to vote in favour of Resolution 5 set out in the Notice of the SGM.

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## LETTER TO SHAREHOLDERS

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However, pursuant to the bye-laws of the Company, a voluntary winding-up resolution would require a special resolution – which would mean that not less than three-fourths of the votes cast by Shareholders being entitled to do so would need to be in favour of such voluntary winding-up. In the event that the voluntary winding-up resolution is not approved by Shareholders at the subsequent special general meeting of the Company to be convened in the event Resolution 5 is approved by the Shareholders, the Directors would continue to use their best efforts to cause for the Company in the immediate future to diligently pursue reverse takeover opportunities, subject to the risk that there is no assurance that such a reverse takeover can be successfully completed.

A voluntary winding-up of the Company will be conducted in accordance with the Bermuda Companies Act. Under the Bermuda Companies Act, a meeting of the creditors of the Company must be convened on the same day as, or the day after, a special general meeting of the Company convened to approve the voluntary winding-up.

### **16. SHAREHOLDERS WHO WILL ABSTAIN FROM VOTING AND ACTING AS PROXIES**

The Guarantors and Rose Chow (also a Director and the spouse of Raymond Yiu Man Chow) will abstain from voting in respect of their Shares on all resolutions to be proposed at the SGM to be convened by the Company to consider the Sale, the Share Cancellation, the change of the name of the Company, the change of auditors and Resolution 5 set out in the notice of the SGM set out on page 87 of this Circular and from acting as proxies to vote on behalf of any Shareholder at the SGM.

### **17. SPECIAL GENERAL MEETING**

The SGM, notice of which is set out on page 87 of this Circular, is being convened to be held at 18 Cross Street #08-01 Marsh & McLennan Centre Singapore 048423, on 5 April 2007 at 10.00 a.m. for the purpose of considering and, if thought fit, passing the resolutions set out in the Notice of the SGM.

### **18. ACTION TO BE TAKEN BY SHAREHOLDERS**

Shareholders who are unable to attend the SGM may appoint a proxy/proxies to attend and vote on their behalf by completing, signing and returning a proxy form (Member Proxy Form) attached to this Circular, in accordance with the instructions printed thereon as soon as possible and in any event so as to arrive at the office of the Company's Singapore share transfer agent, Lim Associates (Pte) Ltd, at 3 Church Street, #08-01 Samsung Hub, Singapore 049483, at least 48 hours before the time fixed for the SGM. The completion and return of a proxy form by a Shareholder does not preclude him from attending and voting in person at the SGM in place of his proxy if he wishes to do so.

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## LETTER TO SHAREHOLDERS

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Depositors who wish to attend and vote at the SGM, and whose names are shown in the records of CDP as at a time not earlier than forty-eight (48) hours prior to the time of the SGM supplied by CDP to the Company, may attend as CDP's proxies. Depositors who are individuals and who wish to attend the SGM in person need not take any further action and can attend and vote at the SGM without the lodgement of any proxy form. Individual Depositors who are unable to attend the SGM personally and wish to appoint their nominee(s) to attend, and Depositors who are not individuals, will find attached to this Circular a Depositor Proxy Form which they are requested to complete, sign and return in accordance with the instructions printed thereon as soon as possible and in any event so as to arrive at the office of the Company's Share Transfer Agent, Lim Associates (Pte) Ltd, at 3 Church Street, #08-01 Samsung Hub, Singapore 049483, at least 48 hours before the time fixed for the SGM. The completion and return of a Depositor Proxy Form by an individual Depositor does not preclude him from attending and voting in person at the SGM in place of his nominee if he wishes to do so.

A Depositor shall not be entitled to attend the SGM and to speak and vote thereat unless he is shown to have Shares entered against his name in the Depository Register, as certified by CDP, as at 48 hours before the SGM.

### 19. CONSENTS

A&M has given and has not withdrawn its written consent to the issue of this Circular with the inclusion herein of its name and all references thereto in the form and context in which they appear in this Circular.

Ernst & Young Corporate Finance Pte Ltd has given and has not withdrawn its written consent to the issue of this Circular with the inclusion herein of its name and its letter reproduced in Appendix 1 and all references thereto in the form and context in which they appear in this Circular.

### 20. INSPECTION OF DOCUMENTS

The following documents are available for inspection at the offices of Alvarez & Marsal (SE Asia) Pte. Ltd., 30 Robinson Road, #04-01, Robinson Towers 4th Floor, Singapore 048546, during normal business hours from the date of this Circular up to the date of the SGM:

- (a) the Memorandum of Association and Bye-laws of the Company;
- (b) the Annual Report of the Company for FY2006;
- (c) the Agreement;
- (d) the IFA's letter dated 14 March 2007; and
- (e) the consent letters referred to in Paragraph 19 of this Circular.

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## LETTER TO SHAREHOLDERS

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### 21. RESPONSIBILITY STATEMENT

A&M and the Directors collectively and individually accept full responsibility for the accuracy of the information given in this Circular and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief, the facts stated and opinions expressed in this Circular are fair and accurate and that there are no material facts the omission of which would make any statement in this Circular misleading.

Where information has been extracted from published or otherwise publicly available sources, the sole responsibility of A&M and the Directors has been to ensure that such information has been accurately and correctly extracted from these sources.

Yours faithfully,  
For and on behalf of  
the Board of Directors of  
**DAKA DESIGNS LIMITED**  
**William Chin Shing Tong**  
**Director**



14 March 2007

**The Independent Directors of Daka Designs Limited**

Dear Sirs:

**THE PROPOSED SALE BY DAKA DESIGNS LIMITED (“DAKA DESIGNS” OR THE “COMPANY”) OF THE ENTIRE ISSUED SHARE CAPITAL OF DAKA INVESTMENT INTERNATIONAL LIMITED (“DAKA INVESTMENT”) AND DAKA CHINA LIMITED (“DAKA CHINA”) TO DAKA DIRECT INC. (THE “PROPOSED SALE”)**

**1. INTRODUCTION**

This letter has been prepared for the use of the independent directors of the Company (the **“Independent Directors”**), to be incorporated into the circular to Shareholders of the Company dated 14 March 2007 (the **“Circular”**) which provides, *inter alia*, the details, purchase consideration, methods of payment, and other terms and conditions of the Proposed Sale, and the recommendation of the Independent Directors thereon. Unless otherwise defined, all terms in the Circular have the same meaning in this letter.

On 8 December 2006, the board of Directors of the Company (the **“Board”**) announced that the Company had entered into a sale and purchase agreement (the **“Agreement”**) with Daka Direct Inc (**“Daka Direct”** or the **“Purchaser”**), which is wholly-owned by a company controlled by Mr Pat Y Mah and Mr Raymond Yiu Man Chow (together, the **“Guarantors”**), and the Guarantors.

Under the Agreement, the Company has agreed to sell, and the Purchaser has agreed to purchase, 30,309 shares representing 100% of the issued and paid-up capital of Daka Investment and one share representing 100% of the issued and paid-up capital of Daka China (collectively, the **“Sale Shares”**) for an aggregate consideration of HK\$42.5 million (about S\$8.5 million) (the **“Purchase Consideration”**). The Proposed Sale will also include the companies in which Daka Investment has equity interest, whether directly or indirectly, as at the date of the Agreement (together with Daka Investment and Daka China, the **“Group Companies”**).

The Purchase Consideration shall be satisfied in the following ways: (a) 64.42% or approximately HK\$27.4 million (about S\$5.4 million) to be satisfied via the cancellation of all 194,883,432 Shares held by the Guarantors and Ms Rose Chow (the spouse of Mr Raymond Yiu Man Chow) collectively as at the date of the Agreement (the **“Share Cancellation”**), and (b) 35.58% or approximately HK\$15.1 million (about S\$3.0 million) to be satisfied in cash (the **“Cash Consideration”**).

The Purchaser is wholly-owned by Amrich Investments Limited, a company controlled by the Guarantors, who are Directors and are considered as controlling shareholders (as defined

in the SGX-ST Listing Manual) of the Company. The Shares which are the subject of the Share Cancellation are collectively owned by the Guarantors and Ms Rose Chow (who is also a Director and the spouse of Mr Raymond Yiu Man Chow). Accordingly, the Proposed Sale constitutes an interested person transaction under Chapter 9 of the SGX-ST Listing Manual.

In addition, as the Purchase Consideration represents more than 5.00% of the audited consolidated NTA of the Company and its subsidiaries (the “**Daka Group**”) as at 31 March 2006, the Proposed Sale is subject to the approval of the Shareholders pursuant to Rule 906(1)(a) of the SGX-ST Listing Manual.

Ernst & Young Corporate Finance Pte Ltd (“**EYCF**”) has been appointed to advise the Independent Directors on whether the financial terms of the Proposed Sale are on normal commercial terms and are not prejudicial to the interests of the Company and its minority Shareholders.

## **2. TERMS OF REFERENCE**

The objective of this letter is to provide an independent opinion on whether the financial terms of the Proposed Sale are on normal commercial terms and are not prejudicial to the interests of the Company and its minority Shareholders. In our opinion, we have taken normal commercial terms to mean fair and reasonable from a financial point of view, and our opinion does not include an assessment of the commercial merits and/or risks of the Proposed Sale.

EYCF’s views as set forth in this letter are based on the prevailing market conditions, economic conditions, and financial conditions, and our analysis of the information provided in the Circular as well as information provided to us by the Company, as of the Latest Practicable Date. Accordingly, this opinion shall not take into account any event or condition which occur after the Latest Practicable Date. Shareholders should take note of any announcement and/or event relevant to their consideration of the Proposed Sale which may be released by the Company after the Latest Practicable Date.

EYCF does not have any financial connections and business dealings with the Purchaser (being Daka Direct Inc), the Guarantors (being Mr Pat Y Mah and Mr Raymond Yiu Man Chow), and with Ms Rose Chow.

EYCF is not and was not involved in any aspect of the discussions and negotiations pertaining to the Proposed Sale, nor were we involved in the deliberations leading up to the decision by the Board to agree with the Purchaser and the Guarantors on the terms and conditions of the Proposed Sale. We have confined our evaluation and analysis of the Proposed Sale to the financial terms thereof. It is not within our terms of reference to evaluate or comment on the rationale for, strategic or commercial merits and/or risks of, the Proposed Sale, and to comment on the financial merits and/or risks of the Proposed Sale where the assessment of such financial merits and/or risks involves our reviewing of non-publicly available

information of the companies involved to which we have no access and with which we have not been furnished. It is also not within our terms of reference to compare the relative merits of the Proposed Sale vis-à-vis any alternative transactions that the Company may consider in the future, and as such, we do not express an opinion thereon. The assessment of the commercial and financial merits and/or risks of the Proposed Sale are solely the responsibility of the Board, although we may draw upon their views in arriving at our opinion.

The scope of our appointment does not require us to express, and we do not express, a view on the future prospects of the Company. We are, therefore, not expressing any view herein as to the prices at which the shares of the Company may trade or on the future financial performance of the Company upon completion of the Proposed Sale. No financial or profit forecasts, business plans or management accounts of the Company have been specifically prepared for the purpose of evaluating the Proposed Sale. Accordingly, we will not be able to comment on the expected future performance or prospects of the Company.

In the course of our evaluation of the Proposed Sale, we have held discussions with the Directors and senior management of the Company. We have also examined and relied on publicly available information in respect of the Company collated by us as well as information provided to us by the Company, including information in the Circular. We have not independently verified such information furnished by the senior management of the Company or any representation or assurance made by them, whether written or verbal, and accordingly cannot and do not warrant or accept responsibility for the accuracy or completeness of such information, representation or assurance. Nevertheless, the Directors have confirmed to us that to the best of their knowledge and belief, the information contained herein and in the Circular constitutes a full and true disclosure, in all material respects, of all material facts relating to the Proposed Sale, and there is no material information the omission of which would make any of the information contained herein or in the Circular inaccurate, incomplete or misleading in any material respect.

We have also made reasonable enquiries and used our judgement in assessing such information and have found no reason to doubt the reliability of such information. We have further assumed that all statements of fact, belief, opinion and intention made by the Directors in the Circular have been reasonably made after due and careful enquiry. We have not made an independent valuation or appraisal of the assets and liabilities of either the Company and we have not been furnished with any such evaluation or appraisal. We have not conducted a comprehensive review of the business, operations and financial condition of the Company, or the transactions described in the Circular.

**Our opinion is addressed solely for the use and benefit of the Independent Directors in connection with and for the purpose of their consideration of the Proposed Sale, and the recommendations made by them to the Shareholders shall remain the responsibility of the Independent Directors.**

**Our opinion should be considered in the context of the entirety of this letter and the Circular.**

In preparing this letter, we have not had regard to the specific investment objectives, financial situation, tax position or unique needs and constraints of any Shareholder. As different Shareholders would have different investment objectives, we would advise the Independent Directors to recommend that any individual Shareholder who may require specific advice in relation to his Shares should consult his stockbroker, bank manager, solicitor, accountant or other professional advisers.

### **3. SALIENT INFORMATION ON THE PROPOSED SALE**

Salient information on the Proposed Sale, including the terms and conditions thereon, is set out in the Circular. Summarised extracts are presented in this letter.

#### **3.1 Information on Daka Investment and Daka China**

The information on Daka Investment and Daka China is set out in section 2 of the Circular. We note that:

- (a) Daka Investment, a wholly-owned subsidiary of the Company, is incorporated in the British Virgin Islands and has, at the date of the Agreement, an authorised share capital of US\$50,000 consisting of 50,000 ordinary shares of par value US\$1.00 each, of which 30,309 shares are issued and fully paid-up. It is a principal subsidiary of the Company as it is the intermediate holding company that holds and owns all of the other member companies in the existing Daka group of companies (except for Daka China, which is owned directly by the Company); and
- (b) Daka China, a wholly-owned subsidiary of the Company, is incorporated in Hong Kong and has, at the date of the Agreement, an authorised share capital of HK\$10,000 consisting of 10,000 ordinary shares of par value HK\$1.00 each, of which one share is issued and fully paid-up. It is currently dormant and we note that steps have already been taken by the Company to deregister it.

#### **3.2 Purchase Consideration for the Proposed Sale**

The Purchase Consideration for the Proposed Sale under the Agreement is HK\$42.5 million (about S\$8.5 million), which will be satisfied as follows:

- (a) 64.42% or approximately HK\$27.4 million (about S\$5.4 million) to be satisfied via the Share Cancellation. The Share Cancellation will be effected via a capital reduction exercise to be undertaken by the Company; and

- (b) 35.58% or approximately HK\$15.1 million (about S\$3.0 million) as the Cash Consideration. The Purchaser shall (i) pay a deposit of HK\$1.0 million (about S\$199,000) to the Company upon and on the date of execution of the Agreement (the “**Initial Deposit**”), and (ii) deposit the remaining sum of approximately HK\$14.1 million (about S\$2.8 million) (the “**Escrow Amount**”) with the escrow agent at least five (5) Business Days before the date of the SGM to be convened by the Company. Additional activities and terms in connection with the Cash Consideration, Initial Deposit, and Escrow Amount are detailed in section 3 of the Circular.

We note that the Purchase Consideration was arrived at following arm’s length negotiations and was on a willing-buyer willing-seller basis. In arriving at the Purchase Consideration, we also note that the Company took into account the net asset value of the Sale Shares as there is no open market value of the Sale Shares available as they are not listed and no independent valuation on the Sale Shares had been carried out.

We also note that the Purchase Consideration of HK\$42.5 million represents an excess of approximately HK\$8.1 million (about S\$1.6 million) over the net book value of the Group Companies of HK\$34.4 million (about S\$6.8 million) as at 30 September 2006 and an excess of approximately HK\$11.9 million (about S\$2.4 million) over the NTA of the Group Companies of HK\$30.6 million (about S\$6.1 million) as at 30 September 2006.

Further, we note that after deducting the estimated costs in conjunction with the Proposed Sale of approximately HK\$3.0 million (about S\$600,000) and with the deconsolidation of Daka Investment and Daka China from the Company and the consequent reversal of the merger reserve account of the Company (which was created following the listing of the Company on the SGX-ST), the Company will book an accounting loss of approximately HK\$28.0 million (about S\$5.6 million).

### **3.3 Assumption of Liabilities by the Purchaser and Set-off of Liabilities from Inter-company Debts**

The details on the assumptions of liabilities by the Purchaser and the setting-off of liabilities from inter-company debts are set out in section 4.2 of the Circular. A summarised extract is as follows:

Subject to the terms and conditions of the Agreement, all liabilities of the Company (including, but not limited to, payables and other payables and any amounts owing to the Group Companies), whether current, long term or contingent, arising and existing on or before the Completion Date (the “**Liabilities**”) shall, on completion of the Proposed Sale, be assumed by the Purchaser but only to the extent that such Liabilities have not been discharged on the Completion Date out of the proceeds of repayment from inter-company debts.

Prior to completion of the Proposed Sale, the Company is authorised to require any or all the Group Companies to repay the inter-company debts or such part thereof up to an amount equal to the amount of the Liabilities. For this purpose, the Company's nominees on the boards of the Group Companies are authorised to instruct that the aforesaid repayments be made by the Group Companies to the Company. In the event that the Company and/or the Company's nominees instruct the Group Companies to effect repayment of the inter-company debts or such part thereof to the Company prior to completion, the amounts repaid in respect of such inter-company debts shall be applied by the Company to discharge the Liabilities on the Completion Date. The balance of the inter-company debts outstanding as at completion shall be assigned to the Purchaser at completion.

Current management is fairly confident that, based on the operations and projections, there will be incoming cash flow for the Group Companies such that they will be able, in the period prior to the completion of the Proposed Sale, to pay down their inter-company debts owed to the Company.

Conditional upon completion, the Purchaser shall indemnify the Company against any claims, litigation, arbitration or administrative proceedings relating to or in connection with the business, the assets and/or the Liabilities commenced or made against the Company from any customers, suppliers, distributors, agents, employees, business partners, taxation agencies or any third parties.

### **3.4 Termination of Agreements between the Company and the Group Companies**

We note that the parties agree that upon completion, any agreement (including without limitation, management fees agreement) entered into between the Company and any Group Company ("**Intra-group Agreements**") shall be deemed terminated with effect from and on completion and none of the parties to the Intra-group Agreements shall have any rights, claims or courses of action on or against one another in respect of such agreements and if there are any such rights, claims or courses of action existing as at the Completion Date, the parties agree that the same shall be deemed irrevocably and unconditionally waived immediately upon completion.

### **3.5 No Warranties on the Assets, Sale Shares or the Group Companies**

We note that the sale and purchase of the assets shall be on an "as is, where is" basis, and all warranties on conditions whether express or implied, statutory or otherwise as to the state of Daka Investment, Daka China, or any Group Company or as to the state of their assets, property or financial conditions and prospects are hereby excluded save for the Company's warranty as to title to the Sale Shares and as to freedom from encumbrance to the extent as set out in the Agreement. For the avoidance of doubt, we further note that save as expressly provided in the Agreement, the Company gives no representations or warranties of any sort whatsoever to the Purchaser or the Guarantors.

### **3.6 Conditions Precedent**

The Proposed Sale is conditional upon the fulfilment of all conditions precedent set out in section 4.5 of the Circular.

### **3.7 Corporate Guarantee from Daka Development Limited**

We note that the Purchaser shall, within 20 Business Days from the Completion Date, deliver a corporate guarantee, in such form as may be acceptable to the Company in its discretion, from Daka Development Limited (“**Daka Development**”), in favour of the Company guaranteeing the performance of the Purchaser’s undertakings as set out in section 4.2 of the Circular (the “**Daka Development Guarantee**”), together with copies of all ancillary documents necessary under the Companies Ordinance of Hong Kong to enable Daka Development to provide the Daka Development Guarantee.

Additional details on the corporate guarantee from Daka Development are set out in section 4.6 of the Circular.

### **3.8 Purchaser’s Warranties and Undertakings**

The Purchaser’s representations, warranties and undertakings are set out in section 4.7 of the Circular.

### **3.9 Resignation of Directorships in the Company**

We note that on the Completion Date, the Purchaser shall deliver the Guarantors’ and Ms Rose Chow’s letters of resignation from all their directorships in the Company and pay the Escrow Amount to the Company.

### **3.10 Guarantors’ Undertakings**

The Guarantors’ undertakings with regard to voting in respect of, and transfers of, the Shares in the Company are set out in section 4.9 of the Circular.

### **3.11 Guarantors’ Obligations**

We note that the Guarantors’ jointly and severally warrant and undertake to and with the Company that:

- (a) the issued and paid up capital of the Purchaser would be at least HK\$28.0 million (about S\$5.6 million) as at completion of the Proposed Sale and for a period of six (6) years thereafter, no steps which will result in a reduction or decrease in such issued and paid-up capital shall be taken by the Purchaser without the written consent of the Company; and



- (b) in the event that the Purchaser undergoes an amalgamation or merger with a third party within a period of six (6) years from the Completion Date, the Guarantors shall jointly and severally procure, in the event that the Purchaser is not the surviving entity after the amalgamation or merger is effected, that surviving entity be legally bound by the obligations of the Purchaser under the Agreement.

### **3.12 Company's Warranties**

The Company's representations, warranties and undertakings to, and for the benefit of, the Purchaser are set out in section 4.11 of the Circular.

### **3.13 No Waiver**

We note that, as set out in section 4.12 of the Circular, the Shareholders' attention is drawn to clause 3.3.5 of the Agreement which states the following (references to the "Vendor" being references to the Company):

*"For the avoidance of doubt, the entering of the Vendor into this Agreement and the provisions herein shall not be, or deemed to be, a waiver, composition or settlement of any sort by the Vendor for any rights or courses of action, whether accrued or accruing hereafter, which the Vendor has or may have, against the Guarantors or any parties related or associated with them, arising from any action or omission which took place during the time when these persons were sitting on the board of directors of the Vendor or involved in the management of the Group and the Vendor."*

## **4. EVALUATION OF THE PROPOSED SALE**

In our analysis and evaluation of the Proposed Sale, and our recommendation thereon, we have taken into consideration the following factors:

- (a) recent key developments in the Company;
- (b) rationale for the Proposed Sale;
- (c) evaluation of the financial terms of the Proposed Sale;
- (d) financial effects of the Proposed Sale and the Share Cancellation on the Company;  
and
- (e) other relevant factors for consideration.



**4.1 Summary of Recent Key Developments in the Company**

Since the fourth quarter of 2005, the Company has encountered a series of material and key developments. A summary of said developments are set out in section 6 of the Circular, and we have included the following extracts:

- (a) On 11 October 2005, the Company released a profit warning announcement regarding a material provision in respect of the amounts owing from Daka Manufacturing Limited (“**DML**”).
- (b) On 20 November 2005, the audit committee of the Company duly appointed the accounting firm KPMG to conduct an independent review of the transactions between the Daka Group and DML.
- (c) On 16 January 2006, the SGX-ST halted trading of the Shares.
- (d) On 22 May 2006, the Company appointed Alvarez & Marsal Asia Limited (“**A&M**”) to act as interim managers for the Daka Group.
- (e) On 25 May 2006, Mr Raymond Yiu Man Chow (as Chief Executive Officer), Mr Pat Y Mah (as Chairman), and Mr Kevin Leung (as Chief Financial Officer) voluntarily agreed to step down from their management positions. Mr Raymond Yiu Man Chow and Mr Pat Y Mah were Executive Directors and majority shareholders of the Company. They, together with Ms Rose Chow (as Executive Director), had also voluntarily agreed to take leaves of absence from the Board to avoid any erosion in confidence in the management and corporate governance of the Daka Group.
- (f) On 8 June 2006, a report on the review by KPMG (the “**KPMG Report**”) was completed and delivered to the Company. The KPMG Report highlighted certain irregularities in the financial management of the Daka Group.
- (g) On 6 October 2006, the Company held its annual general meeting for the FY2006. The Daka Group made a loss of approximately HK\$27.7 million (about S\$5.5 million) for FY2006. As at 31 March 2006, the Daka Group had a consolidated NTA of HK\$33.7 million (about S\$6.7 million).

**4.2 Rationale for the Proposed Sale**

We note the following rationale by the Directors in relation to the Proposed Sale, as stated in section 6 of the Circular:

- (a) The business of the Daka Group is in the design and development of innovative best seller products for the consumer market. Recent examples of best sellers are the sea scooters and automated can openers. Such products are innovative in design and

have a finite and often short life cycle. They need to be continuously replaced by subsequent generations of innovative products or applications. The Directors are conscious of the heavy reliance of the Daka Group on Mr Pat Y Mah and Mr Raymond Yiu Man Chow for their business acumen, design flair and their ability to identify trends and needs of customers.

- (b) In the competitive area of innovative consumer products, there is the continuous challenge and competition from numerous low cost “pirates” who are copycat producers. This shortens the product life cycle of the Daka Group’s best seller products. Therefore, the commercial reality is that the Daka Group has to be fast in terms of design, manufacture and the time to market. Again, the Directors are conscious of the heavy reliance of the Daka Group on Mr Pat Y Mah and Mr Raymond Yiu Man Chow.
- (c) Due to the KPMG Report, the continued service of Mr Pat Y Mah and Mr Raymond Yiu Man Chow to the Daka Group is uncertain. Should they, for any reason, be unable or unwilling to resume their services to the Daka Group, the viability of the Daka Group’s existing business may be adversely affected.
- (d) The Board has looked at the possibility of recruiting experienced and qualified management as replacement. However, given the relatively unique requirements of design and manufacture coupled with the need for a good understanding of the possible market trends and demands in this consumer products segment, the Board is not optimistic about recruiting or retaining suitable talents.
- (e) With the help of A&M, some degree of financial stability in operations has been achieved for the Daka Group’s businesses. The present success of the current best seller which is an innovative can opener has also helped to some extent. However, the stability can be transient if another innovative product best seller is not identified, designed and manufactured to take over when sales of the automated tin can opener slow down. Mr Pat Y Mah and Mr Raymond Yiu Man Chow are working on another product. However, the concerns in paragraphs (b) and (c) above continue to be present.
- (f) The Company has sounded out suitable third parties with a view to selling the entire business of the Daka Group to them. To some extent, the same concerns that the Board has set out above were similarly voiced or held by such third parties as negative factors, and therefore, they had been less willing to pay a premium for the business of the Daka Group. The indications of possible purchase price by such third parties were relatively poor.
- (g) The Directors also took into account the possibility that the findings in the KPMG Report may arguably cast doubts as to the acceptability to the SGX-ST of the Company reinstating Mr Pat Y Mah and Mr Raymond Yiu Man Chow as Executive

Directors of the Company. In addition, it remains uncertain, given the financial position and the business prospects of the Daka Group's current businesses – which were founded and managed by Mr Pat Y Mah and Mr Raymond Yiu Man Chow – whether the Company has realistic prospects of having the suspension of the trading of its Shares lifted. A solution which involves the disposal of the Daka Group's entire current businesses so that the Company becomes a listed shell company, thereby positioning it to pursue subsequent reverse takeover opportunities, acquire new viable businesses and leading to the resumption of trading of its Shares, may be a better strategy and viable exit opportunity for the public Shareholders.

- (h) The Purchase Consideration for the Proposed Sale of HK\$42.5 million represents a premium of approximately HK\$8.1 million over the net book value of the Group Companies of approximately HK\$34.4 million as at 30 September 2006.

Further, we note the following aims of the Directors in pursuing the Proposed Sale as set out in section 6 of the Circular:

- (a) The Proposed Sale and the terms offered by the Purchaser are the best possible option under the circumstances, given that third parties which were approached did not make an offer or offered less.
- (b) There is a need to act quickly as the value of the Daka Group's business, without conscious long-term leadership, would erode over time.
- (c) The Proposed Sale to the Purchaser, an entity that is principally owned by the controlling shareholders of the Company, namely Mr Pat Y Mah and Mr Raymond Yiu Man Chow and Ms Rose Chow, should not be construed as an exoneration of these controlling shareholders or any other parties nor that the relevant authorities have waived any enforcement action or penalties against the controlling shareholders. Once the Company sells off its existing business, it will be a listed shell company, and therefore will be in a better position to acquire a new viable business and apply for the trading of the Shares to resume. The Proposed Sale should be viewed as a commercial solution to provide a possible liquidity and exit route for public Shareholders in the longer term and it should be noted that the completion of the Proposed Sale will not preclude any enforcement actions by relevant authorities in Singapore or elsewhere against Mr Pat Y Mah, Mr Raymond Yiu Man Chow, Ms Rose Chow or any other parties.
- (d) To facilitate the acquisition of a new viable business and apply for the trading of the Shares to resume, the Directors were mindful that it was necessary for Mr Pat Y Mah, Mr Raymond Yiu Man Chow and Ms Rose Chow not to remain as majority shareholders of the Company. Accordingly, the cancellation of all their Shares has been proposed as a term of the Proposed Sale.

### 4.3 Evaluation of the Financial Terms of the Proposed Sale

#### *(a) Purchase Consideration*

Pursuant to the Agreement, the Purchase Consideration for the Sale Shares is HK\$42.5 million. The Purchase Consideration is proposed to be satisfied partially by the Cash Consideration in the amount of approximately HK\$15.1 million and partially through the Share Cancellation of 194,883,432 Shares collectively held by the Guarantors and Ms Rose Chow as at the date of the Agreement in satisfaction of the amount of HK\$27.4 million.

We note that the Purchase Consideration represents a premium of approximately 23.55% over the net book value of the Group Companies of HK\$34.4 million as at 30 September 2006.

#### *(b) Comparable Companies*

Based on our discussions with the management of the Company and a search for comparable listed companies on Bloomberg, we recognise that there is no particular listed company that we may consider to be directly comparable to the Group Companies in terms of the composition of the business activities, company size, scale of operations, product range, customer base, risk profile, geographical spread of activities, accounting standards and policies used, and such other relevant criteria. However, after discussions with the management of the Company, we have selected companies which we believe are broadly comparable to the core businesses of the Group Companies of designing, developing and marketing specialised and innovative consumer products (the “Comparable Companies”).

*The Independent Directors and Shareholders should note that any comparisons made with respect to the Comparable Companies are for illustrative purposes only as there is no one company with the exact scope of business and using the exact accounting policies and standards as those of the Group Companies. The conclusions drawn from such comparisons, therefore, may not necessarily reflect the perceived or implied market valuation of the Group Companies as at the Latest Practicable Date. In addition, we wish to highlight that the list of Comparable Companies is by no means exhaustive.*

Accordingly, for the purposes of our evaluation, we have considered the following Comparable Companies whose activities, in our view (and as explained above), are broadly comparable to those of the Group Companies:

<b>Comparable Company</b>	<b>Business Activity</b>	<b>Country of Listing</b>
Arctic Cat Inc ("Arctic Cat")	Designs, engineers, manufactures and markets snowmobiles and all-terrain vehicles. Also sells personal watercraft products, related parts, garments and accessories.	USA (NASDAQ)
Aztech Systems Limited ("Aztech")	Designs, manufactures, and distributes multimedia products and computer peripherals. Also sells Internet-related products and provides research and development services.	Singapore
IDT International Limited ("IDT Intl")	Designs, develops, manufactures, sells, and markets various consumer electronic products, including electronic personal information products, electronic learning products, and telecommunications products.	Hong Kong
Johnson Outdoors Inc ("Johnson")	Designs, manufactures, and markets branded outdoor recreation products in diving, watercraft, outdoor equipment and motors.	USA (NASDAQ)

*Source: Bloomberg*

The following valuation indicators of the Comparable Companies are based on their respective volume weighted average price as at the Latest Practicable Date or, in case there was no trade on the Latest Practicable Date, the volume weighted average price on the last traded market day prior to the Latest Practicable Date. The Price/NTA ratios of the Comparable Companies are based on the information on their respective latest financial year results.

**Valuation Indicators of the Comparable Companies  
in Comparison with the Valuation Indicators of the Group Companies**

Comparable Companies	Market Capitalisation <sup>(1)</sup> as at the Latest Practicable Date (in S\$'m)	Share Price as at the Latest Practicable Date (in S\$)	Price/Earnings Ratio <sup>(2)</sup> (times)	Price/Book Ratio <sup>(3)</sup> (times)	Price/Sales Ratio <sup>(4)</sup> (times)
Arctic Cat	357.30	29.15	15.71	1.93	0.32
Aztech	151.48	0.37	7.48	1.85	0.63
IDT Intl	215.02	0.09	<i>n.a.</i>	1.17	0.46
Johnson	222.60	28.16	17.51	0.91	0.36
<b>High</b>			<b>17.51</b>	<b>1.93</b>	<b>0.63</b>
<b>Low</b>			<b>7.48</b>	<b>0.91</b>	<b>0.32</b>
<b>Average</b>			<b>13.57</b>	<b>1.47</b>	<b>0.44</b>
<b>Group Companies</b>			<b><i>n.a.</i><sup>(5)</sup></b>	<b>1.23<sup>(6)</sup></b>	<b>0.20<sup>(6)</sup></b>

*Sources: Bloomberg and the Company*

*Notes:*

- (1) Market capitalisation for the Comparable Companies is based on the outstanding number of shares and the market price as at the Latest Practicable Date as obtained from Bloomberg.
- (2) Price/Earnings Ratio is the ratio of the share price as at the Latest Practicable Date divided by the historical earnings per share. Earnings per share of the Comparable Companies is obtained from Bloomberg and based on their financial year results (being 31 March 2006 for Arctic Cat Inc and IDT International Limited; 31 December 2006 for Aztech Systems Limited; and 30 September 2006 for Johnson Outdoors Inc). There is no Price/Earnings Ratio for IDT International Limited due to its net loss position for the last financial year.
- (3) Price/Book Ratio is the ratio of the share price as at the Latest Practicable Date divided by the historical book value per share. Book value per share of the Comparable Companies is obtained from Bloomberg and based on their financial year results (being 31 March 2006 for Arctic Cat Inc and IDT International Limited; 31 December 2006 for Aztech Systems Limited; and 30 September 2006 for Johnson Outdoors Inc).

- (4) Price/Sales Ratio is the ratio of the share price as at the Latest Practicable Date divided by the historical sales per share. Sales per share of the Comparable Companies is obtained from Bloomberg and based on their financial year results (being 31 March 2006 for Arctic Cat Inc and IDT International Limited; 31 December 2006 for Aztech Systems Limited; and 30 September 2006 for Johnson Outdoors Inc).
- (5) There is no Price/Earnings Ratio for the Group Companies due to its net loss position.
- (6) Price/Book ratio of the Group Companies is computed as the Purchase Consideration of HK\$42.5 million, or approximately S\$8.5 million, divided by the net book value of the Group Companies as at 30 September 2006. Price/Sales ratio of the Group Companies is computed as the Purchase Consideration divided by the sales of the Group Companies as at 31 March 2006.

The earnings approach (price-earnings valuation methodology) is normally the valuation methodology used for entities with on-going operations and an identifiable earnings trend, which is the case for the Group Companies and the Comparable Companies. However, due to the losses incurred by the Group Companies, we have looked at Price/Book and Price/Sales ratios instead.

The Price/Book approach is an asset-based relative valuation methodology which takes into consideration the book value or NTA backing of a company. The use of this method is generally considered appropriate where a company carries on a business which incurs losses or generates insufficient return on the assets employed, which is the case of the Daka Group and the Group Companies. As at 30 September 2006, the net book value of the Group Companies was HK\$34.4 million.

We note that, as at the Latest Practicable Date, the range of Price/Book ratios among the Comparable Companies is between 0.91 times to 1.93 times. We also note that the average Price/Book ratio of the Comparable Companies as at the Latest Practicable Date is 1.47 times.

Based on our evaluation, we note that the Price/Book ratio of the Group Companies in respect of the Purchase Consideration is below the average ratio of the Comparable Companies' valuation indicator, but falls within the range of the said valuation indicator.

As earlier mentioned, we have not used an earnings-based approach (price-earnings valuation methodology) in our evaluation as the Group Companies was in net loss position. As an alternative, we have used the Price/Sales approach to provide a comparison with the Comparable Companies. For the financial year ended 31 March 2006, the Group Companies' total turnover was HK\$210.6 million (about S\$41.9 million).

We note that, as at the Latest Practicable Date, the range of Price/Sales ratios among the Comparable Companies is between 0.32 times to 0.63 times. We also note that the average Price/Sales ratio of the Comparable Companies as at the Latest Practicable Date is 0.44 times.

Based on our evaluation, we note that the Price/Sales ratio of the Group Companies in respect of the Purchase Consideration is below the range of the Comparable Companies' valuation indicators.



*(c) The Share Cancellation via a Capital Reduction Exercise*

Under the Agreement, the Company shall undertake a capital reduction exercise to cancel all of the 194,883,432 Shares collectively held by the Guarantors and Ms Rose Chow as at the date of the Agreement, representing approximately 64.41% of the Company's total number of issued Shares. We note that the capital reduction exercise will result in a reduction in the Company's issued share capital from HK\$45.4 million (about S\$9.0 million) as at 31 March 2006 to approximately HK\$16.2 million (about S\$3.2 million), and the total number of issued Shares will also be reduced from 302,560,000 Shares to 107,676,568 Shares.

Upon such reduction of issued and paid up share capital taking effect, the amount of HK\$29.2 million arising from the reduction of issued and paid-up share capital and the cancellation of the Shares collectively by (or on behalf of) the Guarantors and Ms Rose Chow shall be applied by the Company as follows:

- (a) in lieu of returning to the Guarantors and Ms Rose Chow the amount of approximately HK\$27.4 million as payment for the cancellation of their Shares, the Company shall fully apply the same in satisfaction of the sum of approximately HK\$27.4 million, being part of the Purchase Consideration payable by the Purchaser to the Company in relation to the Proposed Sale; and
- (b) the balance of approximately HK\$1.9 million arising from such reduction shall be credited by the Company to a reserve account known as the "Other Reserve" account.

Given that the Purchase Consideration will partially be satisfied by the Share Cancellation for the sum of approximately HK\$27.4 million, we have evaluated the reasonableness of the effective price per Share of HK\$0.1405 (about S\$0.0279) (the "Effective Price").

We note that the last traded volume weighted average share price of the Company prior to the SGX-ST suspension the trading of Shares on 16 January 2006 was S\$0.04 (about HK\$0.2011). The Effective Price in the capital reduction exercise represents a discount of approximately 30.14% to the last traded volume weighted average share price.

*We wish to highlight that given that the trading of Shares has been suspended since 16 January 2006, we are unable to place conclusive reliance on the last traded market price of the Shares as an efficient benchmark of the value of the Company and the Group Companies. The Independent Directors and Shareholders should note that the evaluation on the last traded volume weighted average share price of the Company is for illustrative purposes only.*



We also note that after completion of the Proposed Sale, the Company's NTA will be approximately HK\$13.0 million (about S\$2.5 million). With the remaining issued shares of 107,676,568 Shares, the NTA per share will be approximately HK\$0.1171 (about S\$0.0233). The Effective Price represents a premium of approximately 19.98% over the resulting net book value per share after completion of the Proposed Sale.

#### 4.4 Financial Effects of the Proposed Sale and the Share Cancellation on the Company

The detailed information on the financial effects of the Proposed Sale and the Share Cancellation on the Daka Group are set out in section 7 of the Circular. We note that the proforma financial effects are for illustrative purposes only, assuming the Proposed Sale and the Share Cancellation had occurred at an earlier date. We further note that the financial effects do not reflect the future actual financial position and/or results of the Daka Group after the completion of the Proposed Sale and the Share Cancellation (and before deducting any incidental costs in relation to the disposal).

The financial effects of the Proposed Sale and the Share Cancellation on the Daka Group are as follows:

##### (a) Financial effects on equity

The proforma financial effects of the Proposed Sale and the Share Cancellation on the shareholders' equity (on a consolidated basis) as at the end of FY2006, assuming the Proposed Sale and the Share Cancellation had been effected as at 31 March 2006, are as follows:

Description (in HK\$'000)	As at 31 March 2006	After the Completion of the Proposed Sale and the Share Cancellation
Share capital	45,384	16,151
Share premium	48,167	48,167
Other reserve account	–	1,854
Merger reserve	(33,085)	–
Revaluation reserve	5,735	–
General reserve	49	–
Accumulated losses	(27,542)	(53,563)
Minority interests	6	–
<b>Total shareholders' equity</b>	<b>38,714</b>	<b>12,609</b>

Source: Company

*(b) Financial effects on NTA*

The proforma financial effects of the Proposed Sale and the Share Cancellation on the NTA per Share (on a consolidated basis) as at the end of FY2006, assuming the Proposed Sale and the Share Cancellation had been effected as at 31 March 2006, are as follows:

Description	As at 31 March 2006	After the Completion of the Proposed Sale and the Share Cancellation
NTA (HK\$'000)	33,736	12,609
Number of issued Shares ('000)	302,560	107,677
NTA per Share (HK cents)	11.15	11.71

*Source: Company*

As shown above, the Proposed Sale and the Share Cancellation increases the NTA per share by HK\$0.006, or by approximately 5.02%.

*(c) Financial effects on Loss per Share*

The proforma financial effects of the Proposed Sale and the Share Cancellation on the loss per Share (on a consolidated basis) for FY2006, assuming the Proposed Sale and the Share Cancellation had been effected as at 1 April 2005, are as follows:

Description	Before the Completion of the Proposed Sale and the Share Cancellation	After the Completion of the Proposed Sale and the Share Cancellation
Net loss after tax (HK\$'000)	27,676	54,043
Number of issued Shares ('000)	302,560	107,677
Loss per Share (HK cents)	9.15	50.19

*Source: Company*

As shown above, the Proposed Sale and the Share Cancellation increases the loss per share by HK\$0.41.

*(d) Financial effects on Gearing*

The proforma financial effects of the Proposed Sale and the Share Cancellation on the gearing of the Company (on a consolidated basis) as at the end of FY2006, assuming the Proposed Sale and the Share Cancellation had been effected as at 31 March 2006, would have been as follows:

Description	As at 31 March 2006	After the Completion of the Proposed Sale and the Share Cancellation
Debts (Interest-bearing loans) (HK\$'000)	1,296	–
Equity (HK\$'000)	38,714	12,609
Gearing (ratio)	0.03	0.00

*Source: Company*

As shown above, the Company will not have any debts after the Proposed Sale and the Share Cancellation.

#### 4.5 Other Relevant Factors for Consideration

##### *(a) Positive Effect on the Company's Cash Flow*

The Purchase Consideration for the Proposed Sale will partially be satisfied by the Cash Consideration. The information on the use of the cash proceeds from the Proposed Sale is set out in section 8 of the Circular.

##### *(b) Likely Continuation of the Suspension of Trading of the Company's Shares*

Shareholders should note that after completion of the Proposed Sale, the Company will be a listed shell company with no core business, and whose assets would comprise primarily of about HK\$12.0 million in cash.

Under Rule 1018 of the SGX-ST Listing Manual, if the assets of an issuer consist wholly or substantially of cash or short-dated securities, its securities will normally be suspended, and such suspension will remain in force until the issuer has a business which is able to satisfy the SGX-ST's requirements for a new listing and all relevant information has been announced. The SGX-ST may remove an issuer from the SGX-ST's Official List if it is unable to meet the requirements for a new listing within 12 months of the suspension of its securities. The issuer may apply to the SGX-ST for an extension to the 12-month period and the SGX-ST may, if the circumstances warrant it, grant an extension.

We note that the Company's next step is contemplated to be the active identification and search for viable new businesses to acquire through a reverse takeover. We further note that, at this stage, there is no assurance that such an acquisition can be successfully completed. As such, Shareholders should also note that the current suspension in trading of the Company's Shares will likely continue upon the completion of the Proposed Sale and until such time as a successful takeover transaction is consummated. In addition, the SGX-ST may remove the Company from the official list of the SGX-ST (thereby de-listing the quotation of the Shares) if the Company is unable to meet the requirements for a new listing.

*(c) Winding-Up of the Company as an Alternative to Pursuing Reverse Takeover Opportunities*

We note that as set out in section 15A of the Circular, the Directors believe that it is in the better interest of the Shareholders after the Proposed Sale and the Share Cancellation for the Company, as a cash company, to pursue reverse takeover opportunities. In the event that a reverse takeover acquisition is to be considered, the Directors would have to lay the proposal for Shareholders' approval in a general meeting.

We further note that there is a risk that if, after a reasonable time, the Company is unable to successfully complete a reverse takeover acquisition, the Company may be de-listed from the SGX-ST. At such time, it would become necessary to wind-up the Company and as the cash reserves of the Company may, by such time become depleted, Shareholders would run the risk that there would hardly be any cash to be distributed through such winding-up.

Given the above, the Directors have presented an immediate alternative to Shareholders, which is to voluntarily wind-up the Company immediately after the completion of the Proposed Sale and Share Cancellation and to return to Shareholders whatever cash is left, net of the estimated fees and expenses for the voluntary winding-up of HK\$350,000.

*(d) No Alternative to the Proposed Sale*

We understand that while the Company sounded out suitable third parties with a view of selling the entire business of the Daka Group to them, such third parties had been less willing to pay a premium for the business of the Daka Group and indications from such third parties were relatively poor. As such, it is the Directors' view that there are no viable alternative that can be considered by the Company vis-à-vis the Proposed Sale.

We also note that from the date of the Announcement, being the date on which Board first disclosed the Proposed Sale, to the Latest Practicable Date, the Board did not receive any indication of interest or proposal from any other party for the acquisition of the Daka Group's businesses.

**5. CONCLUSION**

In arriving at our opinion on the Proposed Sale, we have deliberated on the factors which we consider to be pertinent and to have a significant bearing on our assessment of the Proposed Sale. The factors we have considered in our evaluation, which are based on representations made by the Company, its Directors and its senior management and which we have relied upon, are as follows:

- (a) The key developments in the Company which started in fourth quarter 2005;
- (b) The rationale by the Directors in relation to, and their aims in pursuing, the Proposed Sale;
- (c) The Purchase Consideration for the Group Companies representing a premium 23.55% over the net book value of the Group Companies as at 30 September 2006;
- (d) The assumption of the Liabilities by the Purchaser and the setting-off of inter-company debts with the Purchaser on Completion Date, and the sale of the assets on an “as is, where is” basis;
- (e) The Price/Book ratio of the Group Companies in respect of the Purchase Consideration falling within the range of the Price/Book ratios of the Comparable Companies;
- (f) The Price/Sales ratio of the Group Companies in respect of the Purchase Consideration falling below the range of the Price/Sales ratios of the Comparable Companies;
- (g) The Effective Price of the Shares under the Share Cancellation via the capital reduction exercise representing a discount to the last traded volume weighted average share price prior to the suspension of the trading of Shares on 16 January 2006;
- (h) The Effective Price of the Shares under the Share Cancellation representing a premium over the resulting net book value per Share after completion of the Proposed Sale;
- (i) The financial effects of the Proposed Sale and the capital reduction exercise for the Share Cancellation on the Daka Group;
- (j) The positive effect of the Cash Consideration on the Company’s cash flow; and
- (k) The absence of viable alternatives which the Company can consider vis-à-vis the Proposed Sale.

Based on the analysis undertaken and subject to the qualifications and assumptions made herein, EYCF is of the opinion that the financial terms of the Proposed Sale are on normal commercial terms and are not prejudicial to the interests of the Company and its minority Shareholders. Accordingly, we advise the Independent Directors of the Company to recommend to the holders of ordinary shares in the Company to vote in favour of the Proposed Sale and the ordinary resolution relating to the Proposed Sale to be proposed at the SGM convened by the Company.

We have prepared this letter for the use of the Independent Directors of the Company in connection with and for the purposes of their consideration of the Proposed Sale. A copy of this letter may be reproduced in the Circular.

Whilst a copy of this letter may be reproduced in the Circular, no other person may reproduce, disseminate or quote this letter (or any part thereof) for any other purpose at any time and in any manner without the prior written consent of EYCF in each specific case. This opinion is governed by, and construed in accordance with, the laws of Singapore, and is strictly limited to the matters stated herein and does not apply by implication to any other matter.

Yours faithfully  
For and on behalf of  
**Ernst & Young Corporate Finance Pte Ltd**

**Eric Wong**  
*Director*



PASSION FOR  
INNOVATION

**DAKA DESIGNS LIMITED**

*(Incorporated in Bermuda with limited liability)*

(Company Registration No. 34932)

*Directors:*

Pat Y. Mah *(on leave of absence)*  
Raymond Yiu Man Chow *(on leave of absence)*  
Rose Chow *(on leave of absence)*  
Sir Clive Marles Sinclair  
Michael Yue Kwong Chan  
William Chin Shing Tong  
Dr. Roy Chi Ping Chung  
David Tian Bin Chia  
Geoffrey Seng Huat Yeoh

*Registered Office:*

Clarendon House  
2 Church Street  
Hamilton HM 11  
Bermuda

14 March 2007

*To: Shareholders of Daka Designs Limited*

Dear Sir/Madam,

**NOTICE OF NOMINATION OF THE PROPOSED NEW AUDITORS**

RSM Nelson Wheeler have, on 8 March 2007, given notice to the Company of their resignation as auditors of the Company and its subsidiaries, with effect from the close of the Special General Meeting of the Company to be held at 10.00 a.m. on 5 April 2007. The Directors wish to express their appreciation for the services rendered by RSM Nelson Wheeler.

The Company has received notice of the nomination of RSM Chio Lim for appointment as auditors of the Company at the forthcoming Special General Meeting and, in accordance with Section 89(3) of the Companies Act 1981 of Bermuda, a copy of that notice is set out below:

“8 March 2007

The Board of Directors  
Daka Designs Limited  
Clarendon House  
2 Church Street  
Hamilton HM 11  
Bermuda

Dear Sirs,

**NOTICE OF NOMINATION**

Pursuant to Section 89(3) of the Companies Act 1981 of Bermuda, I, William Chin Shing Tong of 29/F, Paul Y Centre 51 Hung To Road Kwun Tong Kowloon, being a director of Daka Designs Limited (the “Company”), hereby nominate RSM Chio Lim of 18 Cross Street, #08-01, Marsh & McLennan Centre, Singapore 048423 for appointment as auditors of the Company in place of RSM Nelson Wheeler, at the forthcoming Special General Meeting of the Company to be held at the offices of RSM Chio Lim at 18 Cross Street, #08-01, Marsh & McLennan Centre, Singapore 048423 on 5 April 2007 at 10.00 a.m..

Yours Sincerely,

**William Chin Shing Tong”**

Yours faithfully,  
For and on behalf of  
the Board of Directors of  
**Daka Designs Limited**  
**William Chin Shing Tong**  
**Director**



The board of directors (the “**Board**”) of the Company refers to:

1. the announcement made by the Singapore Exchange Securities Trading Limited (“**SGX-ST**”) on 15 January 2006 announcing, *inter alia*, the trading halt on the shares of the Company;
2. the Audit Committee’s announcement dated 16 January 2006; and
3. the Company’s announcement dated 20 January 2006.

The Board would like to announce that KPMG, the Special Auditors appointed by the Company’s Audit Committee, have completed their review and have issued a report based on their findings to the Audit Committee (the “**Special Report**”). KPMG was initially engaged by the Audit Committee to carry out a review of the transactions between the Company and its subsidiaries (the “**Daka Group**”) and its investee companies (the “**Investment**”), Daka Manufacturing Limited (“**DML**”) and its parent, Daka Industrial Limited. The scope of KPMG’s engagement was subsequently enlarged to assess whether the Investment is a controlled subsidiary or an associate of the Daka Group for accounting purposes, to assess the accuracy of the Daka Group’s accounting records in relation to certain sales, to report the utilisation of the proceeds from the initial public offering of the Company, and other related matters.

The Special Report was finally completed by KPMG after the management of the Daka Group had provided KPMG reasonable cooperation and access, and had presented to KPMG their responses, reasons and context underlying the circumstances leading to the findings arising from the review. As and when management desires to summarize such responses in a form appropriate for public dissemination, the Board would take due advice and act appropriately.

KPMG’s findings highlighted “serious irregularities in the financial management of the Daka Group”. The Board would like to point out that while the Audit Committee has received the Special Report, the Board is not in the position to make any findings of fact or to form a view as to the potential liability or culpability on the part of any party named in the Special Report. The Board accepts that there are sufficient and serious circumstances and allegations set out in the Special Report which on a weighing of the balance of probabilities would be of serious concern to the Board and the Board has accordingly made arrangements to effect management changes as described below. The Executive Summary of the Special Report is appended to this announcement.

**KEY ACTIONS IMPLEMENTED BY THE BOARD**

The Board is aware that the underlying thrust of the Special Report may undermine the business confidence of shareholders, customers, suppliers and bankers in the Daka Group. The Audit Committee has recommended, and the Board has accepted, certain key actions needed to restore stability in the Company's senior management. The executive directors and the chief financial officer have voluntarily agreed to step down from their management positions in support of the Board to do what is in the best interests of the Daka Group, and the Board notes and appreciates this support. The executive directors have also voluntarily agreed to take a leave of absence from the Board to provide the market with confidence in the governance and decision making structure of the Daka Group and to assist in stabilising the Daka Group.

The Board has engaged the services of Alvarez & Marsal Asia Limited ("**A&M Asia**") to provide an interim management team (the "**Interim Management Team**"), to be led by Mr Kelvin Flynn, managing director of A&M Asia, who has been appointed as a new executive director of the Company. Mr Eric Thompson, a director of A&M Asia has been appointed chief executive officer of the Daka Group to provide day-to-day leadership and have overall responsibility for the operations of the Daka Group. In addition to ensuring that the operations of the Daka Group are minimally disrupted, A&M Asia is also responsible for working with the Board to provide strategies and solutions to maintain and maximise shareholder value. A&M Asia is the Asian arm of the Alvarez & Marsal Group, a global professional services firm providing specialised operational and financial services to underperforming, troubled or over-leveraged companies.

A Special Committee, comprising all non-executive directors based in Hong Kong and Singapore, is being formed to (a) supervise the Interim Management Team; (b) address the issue of the trading halt; (c) review and implement any issues or recommendations raised or made by KPMG or the SGX-ST; and (d) address such other matters as the Special Committee may deem necessary or relevant to the foregoing.

The Interim Management Team will also work to address any concerns of the Company's auditors and bankers and also to work with the Daka Group's auditors, under the supervision of the Special Committee, to review the Daka Group's financial state of affairs, to make adjustments, if necessary, to the Daka Group's financial statements, and to report such findings. The former senior management and chief financial officer will be retained as advisors to the Daka Group with such roles and responsibilities as required of them by the Interim Management Team.

With the support of customers, suppliers and bankers alike, the Interim Management Team and the Board reasonably expects that the Daka Group would be in a position to continue with its business commitments in its usual and ordinary course.

The Board will release updates on major developments in relation to the foregoing.

**DELAY IN ANNOUNCEMENT OF FINANCIAL RESULTS FOR THE YEAR ENDED  
31 MARCH 2006**

In view of the findings in the Special Report, the Company was unable to finalise its financial results for the year ended 31 March 2006 within the requisite 60 days period. Accordingly, the Company has sought and received an extension from the SGX-ST till 21 July 2006. All parties will use their best endeavours to finalise and announce the Company's financial results by then.

**TRADING CAUTION**

NOTWITHSTANDING THE TRADING HALT IMPOSED ON THE COMPANY'S SHARES, INVESTORS OR SHAREHOLDERS ARE ADVISED TO EXERCISE CAUTION WHEN DEALING WITH THE COMPANY'S SHARES, WHETHER IN OFF-MARKET TRANSACTIONS OR OTHERWISE.

**Approved for Release by the Board**

14 June 2006

## Appendix

*Executive Summary to the Special Report***Executive Summary**

This version of the executive summary has been modified by the deletion of the identities of certain third parties referred to in the Report, and in other cases by the use of assigned code names, in accordance with legal advice obtained by Daka.

Assigned names	Description
Company C	A company incorporated in Canada
Company D	A Canadian company offering currency exchange and transfers services
Customer K	A major customer of the Daka Group
Customer L	A major customer of the Daka Group
Mr M	A director and shareholder of Company K

1. On 20 November 2005, we were engaged by the Audit Committee of Daka Designs Limited<sup>1</sup> ("Daka") to carry out a review of the transactions between the Daka group of companies (the "Daka Group" or the "Group")<sup>2</sup> on the one part and Daka Manufacturing Limited ("DML") and its parent, Daka Industrial Limited ("DIL") on the other part (collectively the "Investment"). The purpose of our engagement is to provide the Audit Committee and the Singapore Exchange Securities Trading Limited (the "Exchange") with a report of our findings arising from our review of certain matters relating to the Investment. Our scope of work<sup>3</sup>, as agreed with the Audit Committee and the Exchange, comprised a review focusing on the following matters:
  - i. The history of the Daka Group's investment in the Investment and the circumstances leading to the losses suffered by the Daka Group on the Investment;
  - ii. The commercial arrangement, internal controls and corporate governance structure insofar as it relates to the Investment and the identification and monitoring of losses relating to the Investment;

<sup>1</sup> A company incorporated in Bermuda on 5 March 2004 and admitted to the main board of the Exchange on 16 July 2004.

<sup>2</sup> For a list of companies within the Daka Group, see page 6 of the Prospectus of Daka dated 2 July 2004.

<sup>3</sup> The terms of our engagement are set out in our engagement letter dated 20 November 2005 as amended on 12 January 2006 and the addendum dated 13 January 2006, read with our letter dated 18 January 2006 to the Audit Committee copied to the Exchange.

- iii. The financial impact and the accounting treatment of the Daka Group's investment in and loans to the Investment and losses relating thereto;
  - iv. Disclosures made by the Daka Group of its relationship with the Investment, including compliance with the requirements of the Listing Manual of the Exchange;
  - v. Whether the Investment is a controlled subsidiary or an associate of the Group for accounting purposes under the provisions of the International Financial Reporting Standards;
  - vi. Accuracy, reliability and consistency of the Daka Group's accounting records and entries in relation to sales to Customer K and Customer L recognised by Briga Group (Macao Commercial Offshore) Company Limited ("Briga") and Daka Development Limited ("DDL") during the financial year ended 31 March 2004 and 31 March 2005;
  - vii. Utilisation of the proceeds from the initial public offering of Daka ("IPO"); and
  - viii. Other matters as presented to the Audit Committee on 13 January 2006.
2. Our review was initially conducted to the extent possible, through enquiries of certain personnel<sup>4</sup> and considering the records of the Daka Group made available to us over a period of four weeks, from 24 November 2005 to 23 December 2005 (the "First Review"). The impediments we faced during this period and the lack of access to records and the Daka Group's staff were obstructions which prevented us from carrying out our work. For instance:
- We were requested not to make photocopies of the documents provided to us and any request to make photocopies required prior approval;
  - We were requested to confine our enquiries and clarifications on matters arising from our review to three specified Daka Group staff<sup>5</sup>;
  - We were constantly questioned on our reasons for requesting certain documents or why we asked certain questions;
  - We were requested to restrict our movements in the office premises of the Daka Group, particularly to stay away from the area of the finance department;
  - We were requested to provide a list of DML's documents we required for our review in Chinese when we had given a similar list in English much earlier; and
  - Our fieldworks at the premises of DML and Briga were delayed.

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<sup>4</sup> Principally Mr Chow Yiu Man Raymond, Executive Director and Chief Executive Officer; Mr Leung Kwok Wah Kevin, Chief Financial Officer and Ms Wong Yuet Ying Judy, the then Finance and Administrative Manager, now Internal Audit Manager.

<sup>5</sup> Being Mr Chow Yiu Man Raymond, Mr Leung Kwok Wah Kevin and Ms Wong Yuet Ying Judy.

3. We had asked for access to all accounting records of the Daka Group and the Investment at the onset of our review, but were unable to obtain full access. The records that were provided to us generally came with a significant delay, and were not complete. Although we were provided with various explanations about such delays and missing information, we were unable to verify the legitimacy of those explanations. As such, we were initially unable to carry out the review in the manner which we considered necessary to be satisfied that the matters set out in the scope of work were comprehensively dealt with.
4. On 13 January 2006, at a meeting with Daka's Audit Committee and the Exchange, it was agreed that we were to carry out further work, and be given full access to the Daka Group's information and staff. On 14 January 2004, we flew to Hong Kong, and commenced the further work on the same day. Our review was again impeded, this time by Mr Chow Yiu Man Raymond, the Executive Director and Chief Executive Officer of the Daka Group. We were instructed to stop work about an hour after we commenced our work. Our review in Hong Kong and Macau did not resume till 19 January 2006 and continued to 26 January 2006, during which period we were provided the required access to information and staff of the Daka Group. After we returned to Singapore on 26 January 2006, we continued our review of the documents provided by the Daka Group and commenced the analysis of the forensic images obtained<sup>6</sup>.
5. We assembled and reviewed a substantial number of physical and electronic documents numbering in excess of tens of thousands of pages. The documents we reviewed included but were not limited to (i) email messages obtained from the forensic images of the hard disks of the computers used by Daka Group staff; and (ii) primary documents of the Daka Group and the Investment including accounting records, contracts, human resources records, and electronic files.
6. We noted from our review subsequently that there had been coordinated efforts intended to prevent us from obtaining relevant information and to provide us with incorrect information.
7. On 31 March 2006 and 1 April 2006, we interviewed five directors and staff of the Data Group<sup>7</sup>. These interviews were carried out at the Group's premises in Hong Kong, as we were informed that the interviewees were unable to travel to Singapore for the interviews.

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<sup>6</sup> During the review, we obtained the forensic images of the hard disks of 16 computers used by Daka Group staff; two Briga staff and 14 DDL staff.

<sup>7</sup> Being Mr Pat Y Mah, Executive Chairman; Mr Chow Yiu Man Raymond, Executive Director and Chief Executive Officer; Ms Rose Chow, Executive Director; Mr Leung Kwok Wah Kevin, Chief Financial Officer and Ms Wong Yuet Ying Judy, the then Finance and Administrative Manager, now Internal Audit Manager.

8. On 3 May 2006, we sent relevant extracts of the Report to three executive directors<sup>8</sup> of the Daka Group and invited them to comment on the extracts by making written responses. We received the responses from the executive directors in parts from 11 May 2006 to 15 May 2006 ("Management Responses"). We have considered the written responses in finalising our Report.
9. We set out below a brief summary of our findings, based on our review in accordance with the terms of our engagement.

**A. Matters in relation to the Investment**

10. According to the proforma financial statements contained in Daka's prospectus dated 2 July 2004 ("Prospectus") issued in connection with its IPO on the Exchange, the amounts owing by the Investment to the Daka Group stood at HK\$0.323 million as at 31 March 2003. This amount increased to HK\$30.6 million as at 31 March 2004 and further increased to HK\$42.6 million as at 30 September 2005. The Group as at 30 September 2005 has made a provision of HK\$30 million against the amounts owing by DML.
11. The Prospectus states that DIL (which in turn owned 100% of the stake in DML) was incorporated in Hong Kong on 15 July 1998 as a 50-50 joint venture equally held between DDL and Mr Chan Kam Tong Lawrence<sup>9</sup>. DIL provided the manufacturing facilities for the Daka Group<sup>10</sup> before DML took over the role when it commenced operation in August 2003. DML has dedicated its manufacturing capacity at its plant in Dongguan exclusively for the manufacturing of products designed and developed by the Daka Group<sup>11</sup>. On 1 April 2003<sup>12</sup>, DDL divested 32% of its interest in DIL (reducing DDL's interest in DIL from 50% to 18%) to Mr Chan Kam Tong Lawrence and ceased equity-accounting for its share of the results of the Investment. According to the Prospectus, the divestment resulted from the change in the Daka Group's focus from manufacturing to concentrating on the design and development of products.

<sup>8</sup> Being Mr Pat Y Mah, Mr Chow Yiu Man Raymond and Ms Rose Chow.

<sup>9</sup> Mr Chan Kam Tong Lawrence is also the majority shareholder of T&K Industrial Company Limited ("T&K"), a supplier of moulds and plastics to the Daka Group. T&K had been a long-standing supplier to a company owned by Mr Pat Y Mah. T&K was thereafter introduced to the Daka Group and in 1998, DDL and Mr Chan Kam Tong Lawrence formed DIL as a joint venture. We also understand from Mr Chow Yiu Man Raymond and Mr Leung Kwok Wah Kevin that this shareholding was in place since the incorporation of DIL.

<sup>10</sup> We understand from the Prospectus and from our discussions with Mr Chow Yiu Man Raymond that Daka Group has always outsourced its manufacturing activities. It originally used subcontractors, purchasing raw materials directly with labour added by subcontractors. In January 1999, Daka Group started using DIL as one such subcontractor. This continued until 1 August 2003, when DML took over the manufacturing operations of DIL, and DIL became a dormant holding company.

<sup>11</sup> DDL and Daka Research Inc. ("DRI") had entered into a Business Collaboration Agreement and a Master Outsourcing Agreement, both dated 19 May 2004 with the Investment, whereby DML agreed to provide the services requested by Daka Group on an exclusive basis for an initial period of three years and thereafter until the Agreements are terminated by either parties giving six month's written notice, or in accordance with its terms or at law.

<sup>12</sup> DIL's annual return filed on 20 August 2003 with Hong Kong Registrar of Companies recorded the divestment as having taken place at 1 April 2003.



12. The Prospectus, however, did not disclose the Group's plan in 2001 to acquire 100% of DIL, as part of its IPO plan. The Daka Group did in fact acquire a 100% stake in DIL in 2002, by acquiring Mr Chan Kam Tong Lawrence's 50% stake in DIL. The Group would have consolidated the Investment (and any loss incurred) if it controlled the operations through a 100% equity stake. Management's responses was that *"the IPO professionals are aware that the transfer of shares was annulled (voided) and never happened" and that "Daka had relied on professionals to do the necessary checks (due diligence) and advise on the necessary disclosures prior to the IPO"*.
13. We have reasonable grounds to believe that the Investment is a controlled subsidiary that should be consolidated by the Daka Group for accounting purposes and that the Group's investment in the equity of the Investment is likely to be more than the 18% that is recorded. The legitimacy of the subsequent annulment appears questionable and the further divestment which reduced the Group's stake in the Investment to 18% appears to have been entered into with the intention of reducing the impact to the financial statements of the Daka Group of the losses incurred by the Investment and thereby improving the performance of the Group in anticipation of the IPO. As put by Mr Chow Yiu Man Raymond, the Daka Group *"may be better to divest our DML interest to 18% (less than 20%) so that Daka would only record the investment and not to accrues any profit and loss of this operation. Of course, there are many cash concerns and paper work that we need to do in order to "balance" this book and also place a lot of reliance to Lawrence who will be the majority shareholder."*<sup>13</sup>
14. The involvement of Daka Group staff and the level of control over the affairs of the Investment by the Group even after the divestment were substantiated and were subsequently corroborated in the Management Responses<sup>14</sup>:
- The Group's involvement in the planning, funding, construction and outfitting of DML's factory in PRC was both thorough and detailed<sup>15</sup>.

<sup>13</sup> Email dated 9 July 2003 titled "IPO" from Mr Chow Yiu Man Raymond to Mr Pat Y Mah.

<sup>14</sup> It was stated in the Management Responses that "Directors [executive directors] and Mr Chan [Mr Chan Kam Tong Lawrence] had agreed that the operations should remain status quo in order to avoid disruption to operations and ensure an intact supply chain to the Daka Group. The objective of both the Daka Group and DML was to maintain a stable and quality delivery of products to Daka. To this end, Mr Chan [Mr Chan Kam Tong Lawrence] requested the Daka Group to give assistance and advice in the running of certain aspects of the day-to-day operations of DML, including when requested, recruitment of staff of senior level, during the transitional period until DML's staff had acquired sufficient knowledge to operate independently. Mr Chan [Mr Chan Kam Tong Lawrence] was to be consulted, and had to approve all significant decisions". Further, it was also stated that "It should be noted that both Daka and DML staff are in the same premise and the factory is operating as one facility, therefore operationally, resources and systems are shared."

<sup>15</sup> According to the Management Responses "All final decisions of the new factory rest with Chan [Mr Chan Kam Tong Lawrence]. Daka has loan to DML including the new factory construction hence Daka needs to monitor this carefully and protect our investment."



- Daka Group staff were involved in the day-to-day administration of DML's operations and were seen making executive decisions not only on behalf of the Group but also for DML. Daka Group staff also considered registering its patent under DIL in order to qualify for a one-time government patent grant.
- The attendees of meetings, where detailed operational matters of DML were discussed, were principally Daka Group staff.
- DIL's authorised signatories for bank accounts have been Daka Group staff but have excluded Mr Chan Kam Tong Lawrence<sup>16</sup>.
- The Daka Group financed DML's day-to-day operating expenses, such as salaries, rental, utilities and procurement of plant and equipment. Funds were disbursed after Daka Group staff were satisfied with the expenditure i.e. expenses supported with relevant documents.
- Daka Group staff were in a position to establish policies and detailed operational procedures for DML. Particularly, we noted that DML's payment authorisation structure was established by Daka Group staff and significant payments to be made by DML required authorisation from Daka Group staff<sup>17</sup>.
- Daka Group staff oversaw the finance function of the Investment and maintained the accounting system of DML<sup>18</sup>.

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<sup>16</sup> It was stated in the Management Responses that "this is to ensure funds from DIL will transfer to DML" and that there were "no substantial fund movements except investment funds from Mr Chan [Mr Chan Kam Tong Lawrence] and Daka".

<sup>17</sup> It was stated in the Management Responses that "Under the BCA [Business Collaboration Agreement], Daka was to maintain its R&D department and staff at DML – including policies; procedures and benefits for staff eg. meals, dorms, rooms etc. The transitional period and business plan of Daka have been disclosed in the Prospectus (in particular, p.76 to 78). In the transitional period, Daka has been assisting DML in various aspect of DML in accordance with the instructions of Mr Chan [Mr Chan Kam Tong Lawrence], including (a) Suggesting guidance on the authorisation guidance (b) Assisting in the training and teaching the account staff of DML (c) Keeping registers of members of DIL and doing the filings to HKCR (d) Helping in upgrading the accounts reporting standard of DML (e) Assisting in the recruitment of staff of senior level". The scope of the Business Collaboration Agreement is to enable the Daka Group to establish a research and development centre for its employees to carry out research projects at location where products for the Group are being manufactured by DML pursuant to the Master Outsourcing Agreement. We note that it was not stipulated in the Business Collaboration Agreement that Daka Group was to establish policies, procedures and benefits for DML and its staff. It was also not stipulated in the Prospectus that there would be such a transitional period and that Daka Group would be assisting in the day-to-day operation of DML.

<sup>18</sup> Both Daka Group and DML were using ATL system as their accounting software.

- Daka Group staff had access to detailed operational and financial reports of DML<sup>19</sup>.
15. Further, Mr Chan Kam Tong Lawrence's role in DML did not appear to be that of one in control of the operations of the Investment, even after he purportedly increased his stake in DIL to 82%. As described by Mr Chan Kam Tong Lawrence:<sup>20</sup> *"I am a Legal representative of the factory and also the Director of DIL but never get any salary or benefit from the company"*. We noted instances where:
- He assisted DML on specific areas at the request of Daka Group staff;
  - He negotiated on behalf of T&K with Daka Group staff negotiating on behalf of DML;
  - He appears to have assisted Daka Group staff in the backdating of letters to show us during our review that the Group had taken efforts to secure repayment of the debt owed by DML; and
  - He appears to have assisted Daka Group staff in plans to *"convince"* the Group's Board of Directors that it was in the Group's best interest to acquire Mr Chan Kam Tong Lawrence's majority stake in the Investment and to accept terms, *inter alia*, to release Mr Chan Kam Tong Lawrence's personal guarantee and to indemnify him against any future claims or liabilities.
16. Efforts were undertaken by Daka Group staff during our review to ensure that DML's documents shown to us were signed by DML staff; this include efforts to generate altered documents, replacing documents originally signed by Daka Group staff with new versions bearing names of DML staff. We also noted email correspondence<sup>21</sup> amongst senior Daka management pointing to efforts to down-play the relationship between the Daka Group and the Investment during the course of our review, including making changes to DDL's accounting records and producing DML records to match the Daka Group's documents. The extent to which

<sup>19</sup> It was stated in the Management Responses that "Mr Chan [Mr Chan Kam Tong Lawrence] asked Daka to assist him and give him advice on the operations of DML. As a listed company, we need to ensure that the information from DML is of the right standard for our reporting purposes. We also need such information to protect our investment and our loans. Further, as a supplier and customer relationship, we need to have regular knowledge of DML's financial status from him from time to time to ensure that DML is capable of performing its obligations of a major supplier to Daka". It is not common for a company to have such extensive access to information of its investment if the investment is neither regarded as an associate company nor a subsidiary. Such extensive access may in fact, serve as an indicator that the company has significant influence over the investment at the minimum. Further, it was not stipulated in the Master Outsourcing Agreement that Daka Group would have such extensive access to information of the Investment.

<sup>20</sup> Email dated 31 August 2005 titled "Charging to T&K for Labour loaned & OT due to late delivery" from Mr Chan Kam Tong Lawrence to Mr Leung Kwok Wah Kevin and copied to Mr Chow Yiu Man Raymond, Ms Rose Chow, Ms Wong and other staff of Daka Group and the Investment.

<sup>21</sup> These emails were not corresponded through Daka email facilities but through their non-Daka web email accounts.

efforts were put in to prepare for our review is illustrated in the following two email messages sent by Daka Group staff relating to DML matters (extract):

*"Kevin: pls. arrange Judy to go up to dml on Tues. to start producing records and reports for auditors to sync with Daka records/reports. Rose will go on Tues. to dml as well to see if any assistance is necessary. Pls. plan on putting through all major entries on Saturday nd [and] Monday with me."*<sup>22</sup>

*"Judy needs to ensure the G/L listing of DML from the date of incorporation to 30 October 05 were accurately and completely updated. Also, she needs to ensure major purchases and expenses were approved either by Lawrence or Rainbow."*<sup>23</sup>

17. Daka is required to consolidate the financial performance of the Investment in its consolidated financial statements if it had control over the Investment<sup>24</sup>. DIL's audited financial statements for the year ended 31 March 2002 and 31 March 2003, show that the company incurred a loss of approximately HK\$1.1 million and HK\$4.7 million respectively. DML's audited financial statements for the period from 13 August 2002 (date of its establishment)<sup>25</sup> to 31 March 2004, and from 1 April 2004 to 30 September 2005, show that DML recorded a loss of HK\$19.2 million and HK\$20.2 million respectively.<sup>26</sup> Daka's annual report for the year ended 31 March 2004 shows that the financial performance of the Investment was neither equity accounted nor consolidated in Daka's proforma consolidated income statement for the financial year ended 31 March 2004. The substantial losses of HK\$19.2 million incurred by DML for the period ended 31 March 2004, had it been taken up by the Daka Group, would have affected the Group's results negatively and can reasonably be expected to have negatively impacted the Daka share price for its IPO (if the IPO was to take place with such results reflected in its Prospectus).

## **B. Certain significant sale transactions**

18. We have good grounds to believe that Daka, through its wholly owned subsidiaries, entered into spurious sale transactions with two major customers of the Daka Group, namely Customer K and Customer L, to help the Daka Group improve financial results in anticipation of the intended IPO.

<sup>22</sup> Email dated 25 November 2005 titled "next Monday and Tues./Japan & Singapore sales trip" from Mr Chow Yiu Man Raymond to Mr Pat Y Mah, Ms Rose Chow and Mr Leung Kwok Wah Kevin.

<sup>23</sup> Email dated 9 December 2005 titled "plan (again)" from Mr Leung Kwok Wah Kevin to Mr Chow Yiu Man Raymond, Ms Rose Chow and Mr Pat Y Mah.

<sup>24</sup> While we have concluded that the Investment is a controlled subsidiary, in the absence of full co-operation from management, it was not possible for us to determine if the investment was always a controlled subsidiary or if this took place subsequently as a result of developments over time, and when such change took place.

<sup>25</sup> DML took over the manufacturing activities from DIL when the former commenced operation in August 2003.

<sup>26</sup> We have not been able to conclusively establish the reasons for the losses suffered by DML.

19. The Daka Group recorded four significant sale transactions of approximately HK\$15 million in the last ten days of the financial year ended 31 March 2004 ("Briga Sales") and one significant sale transaction of approximately HK\$1 million in May 2004 ("DDL Sales"). The Briga Sales accounted for approximately 10% of the revenue of the Daka Group for that financial year.
20. Email correspondence amongst Daka Group staff suggest that the Daka Group had entered into spurious sale transactions with Customer K and Customer L to improve financial results in anticipation of the intended IPO.
21. There was no delivery of goods under the Briga Sales in the financial year ended 31 March 2004 and most of the goods under the DDL Sales were in fact not delivered in the financial year ended 31 March 2005<sup>27</sup>. Further, the Briga Sales and the DDL Sales did not fulfil the conditions of a "bill and hold" sale for them to have been recognised for accounting purposes as sales before the actual delivery of the goods. The usual payment terms applicable to Customer K and Customer L were not applicable to these significant sales. The payment terms were more lenient and were negotiable with no fixed terms, thereby allowing Customer K and Customer L to pay at a later date<sup>28</sup>.
22. Further as noted, (i) a substantial quantity of the goods was never shipped to the customers, (ii) the production of certain goods<sup>29</sup> had not even been completed as at 31 March 2004 (iii) payments, if any, for the partial shipments (on a piecemeal basis), were generally received by the Daka Group as and when the goods were shipped, (iv) significant levels of returns were subsequently made, some more than one year after the purported sales were recognised, and (v) the selling prices for certain goods on the commercial invoices were substantially higher than the prices eventually paid by the customers.
23. Even though Customer K and Customer L had confirmed on the Good Receipt Acknowledgement forms that the goods were received on 31 March 2004 for the Briga Sales and on 3 May 2004 for the DDL Sales, they have accepted the quality and condition of the goods received, and that risk and ownership of the goods had accordingly passed to them, we have reasonable grounds to believe that the Good Receipt Acknowledgement forms were obtained for the sole purpose of satisfying the Daka Group's auditors as to the validity of the transactions.

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<sup>27</sup> There was no delivery of goods under the DDL Sales before the half year ended 30 September 2004.

<sup>28</sup> It was corroborated in the Management Responses that "In context, there was a long business relationship, and Customer L initially committed to take 1,700 units, but on concessionary terms as to payment, delivery and storage, it agreed to take another 4,300 units. Daka would house the units to help Customer L save UK VAT, freight and warehouse charges". It was also stated in the Management Responses that as the sales transactions to Customer K were large "Daka therefore made various concessions – long payment periods, payable when goods are on sold, Customer K to sign goods receipt acknowledge on 31/3/04, and to take goods ex factory, Daka to house the goods in the meantime at Customer K's risk."

<sup>29</sup> Goods under the Briga Sales.

24. By recognising the Briga Sales and the DDL Sales, the Daka Group had overstated its revenue for the respective financial years. Had Daka consolidated the financial results of the Investment as a wholly-owned subsidiary and excluded the Briga Sales, Daka would have reported a loss for the financial year ended 31 March 2004 instead of the reported profit after tax of approximately HK\$20 million.
25. The negative impact on Daka's financial performance for the financial year ended 31 March 2004 arising from the reversal of the Briga Sales and the consolidation of the Investment would also have impacted the Share Sale Agreement ("the Avia agreement") entered into between Avia Growth Opportunities Ltd ("Avia Growth")<sup>30</sup> and both Mr Pat Y Mah and Mr Chow Yiu Man Raymond on 4 December 2003. Under the Avia agreement, Mr Pat Y Mah and Mr Chow Yiu Man Raymond sold to Avia Growth, Daka shares constituting 1.93% of its post-listing share capital<sup>31</sup> for a consideration of S\$1 million. A significantly lower profit would have required Mr Pat Y Mah and Mr Chow Yiu Man Raymond to refund a correspondingly larger portion of the consideration to Avia Growth under a price adjustment mechanism tied to the achievement of targeted profits<sup>32</sup>.

### C. Other disclosure issues

#### *Nominee shareholding not disclosed*

26. 883,000 shares in Daka issued during the IPO were held by Mr M (a director and shareholder of Customer K) as nominee for Mr Pat Y Mah and Mr Chow Yiu Man Raymond, who funded the purchase prior to the IPO. This information was not disclosed in the Prospectus<sup>33</sup>.
27. On 17 August 2004, after the IPO, Mr Pat Y Mah and Mr Chow Yiu Man Raymond entered into transactions with Mr M, by which tranches of the nominally held shares were purchased by Mr Pat Y Mah and Mr Chow Yin Man Raymond through open market transactions. An announcement was made on 18 August 2004 that Mr Pat Y Mah and Mr Chow Yiu Man Raymond had acquired 100,000 Daka shares each,

<sup>30</sup> Avia Growth is a company incorporated under the laws of the British Virgin Islands. According to the Prospectus, Avia Growth's investment manager, Avia Capital Partners Limited ("Avia Capital"), is a related company of SBI E2-Capital Holdings Ltd ("SBI"). SBI, in turn, was the holding company of the Manager and the Underwriter and Placement Agent of the IPO.

<sup>31</sup> Accordingly, we noted from the Prospectus that Avia Growth indeed owned 1.93% direct interest in Daka post-listing share capital.

<sup>32</sup> The sales consideration of S\$1 million was subjected to change based on an agreed adjustment mechanism if Daka's proforma profit after tax for the financial year ended 31 March 2004 deviated more than 5% from the amount of HK\$25 million.

<sup>33</sup> Daka's Prospectus disclosed that Mr Chow Yiu Man Raymond together with Ms Rose Chow, and Mr Pat Y Mah each had 32.17% deemed interest (97,341,716 shares) in Daka after its public offer invitation.

describing the reason for the open market purchase of 200,000 shares as personal investment decisions driven by the prospects of the business and the growth of the Daka Group<sup>34</sup>.

28. According to the Management Responses *"This was overlooked as they were many things on our minds such as other regulatory steps and pre launch matters that needed our attention, and that there was reliance on professional advisers that were involved in the listing procedures."* It was also stated in the Management Responses that the shares were not acquired from open market transactions and that the announcements thereof were an *"inadvertent error"*.

***Disclosures on loans to executive directors***

29. Several instances of material cash drawings were made by Mr Pat Y Mah and Mr Chow Yiu Man Raymond from DDL during the period from May 2003 to July 2004<sup>35</sup>. Apart from the amounts outstanding from the directors as at 31 March 2003 and 30 September 2003 which were described in the financial statements of the Daka Group as *"non-trade in nature, unsecured, interest-free and repayable within the next twelve months"*, no further details on the directors' drawings were disclosed in the Prospectus.<sup>36</sup>
30. The non-disclosures, according to the Management Responses, *"were at worst inadvertent omissions on the part of the directors who did not have any previous experience as public company directors and who had placed an extremely huge amount of reliance on the guidance and expertise of the professional advisers whom they had provided all the relevant material to."*
31. These drawings<sup>37</sup> appear to have been made out of funds which either originated from bank loans or funds drawn down on DDL's bank overdraft facilities. The bank borrowings were subsequently settled by various means, including repayments using

<sup>34</sup> Notice of Changes in Director's/Substantial Shareholder's Interest submitted to the Exchange on 17 August 2004 by Mr Mah and Mr Chow disclosing the purchase of 100,000 shares each at S\$0.12 per share and that the additional shares were purchased from the open market.

<sup>35</sup> It was stated in the Management Responses that "the 21 Jul 04 drawing by one of the directors, it must be noted that this was just 5 days after the listing date on 16 July 2004 (a Friday). It was so soon after the transition from a private to a public company (i.e. 2-3 working days) that the director concerned inadvertently omitted to adjust to the new public status of the firm and did [not] make the necessary disclosures upon obtaining the drawings."

<sup>36</sup> The Securities and Futures Regulations require disclosure to be made in the Prospectus of all transactions or loans entered into during the previous three completed financial years and up to the latest practicable date, between the entity at risk (the lender) and an interested person (including a director) of the relevant corporation, which is material in the context of the IPO.

<sup>37</sup> It appears from our review that the drawings made by Mr Mah and Mr Chow on 29 August 2003, 18 November 2003 and 14 May 2004 were largely funded from a HK\$7.7 million loan, a HK\$3 million loan and a HK\$2.3 million factor loan respectively. Drawings made by Mr Mah and Mr Chow on 29 May 2003 were largely funded out of DDL's overdraft facilities. Drawings made by Mr Mah on 21 July 2004 were largely funded out of a packing loan of HK\$6.3 million.



IPO proceeds. The outstanding amounts due from the respective directors as a result of the drawings were subsequently reduced substantially as a result of dividends declared by DDL.

*The repayment of outstanding loan owing by DIL to the Daka Group*

32. It was disclosed in the Prospectus<sup>38</sup> that DIL had an outstanding loan of approximately HK\$9.2 million owing to the Daka Group as at February 2004, and that DIL would repay the outstanding loan amount over 12 monthly instalments commencing March 2004. The loan was provided by the Daka Group to DIL for the upgrading of DML's production facilities.
33. It was subsequently disclosed in Daka's annual report for the financial year ended 31 March 2005 that the outstanding loan had been fully settled. We have reasonable grounds to believe that the outstanding loan was largely settled by way of accounting adjustments and funds originating from the Daka Group, including the IPO proceeds.

*Newly incorporated subsidiary*

34. 4283252 Canada Inc. is a wholly-owned subsidiary of Daka Health & Wellness (USA) Limited, which is in turn a subsidiary of DDL. 4283252 Canada Inc. was set up on 11 February 2005 in Canada.
35. The Listing Manual<sup>39</sup> requires Daka to announce the acquisition of new subsidiaries. To date, Daka has not announced<sup>40</sup> the acquisition of 4283252 Canada Inc.

**D. Use of IPO proceeds**

36. A substantial portion of the funds Daka raised through its IPO were not employed for the purposes stated in the Prospectus. Of the IPO proceeds raised, 43% were utilised to repay trust receipts, 37% to repay bank loans (obtained prior to IPO) and overdrafts and 5% to pay Company C purportedly for IPO consultancy services. These expenditure or payments do not appear to be either directly or indirectly used for the purposes specified in the Prospectus. None of these diversions of funds were disclosed to the shareholders<sup>41</sup>. An amount of US\$384,872 or approximately HK\$3

<sup>38</sup> The matter was similarly disclosed in Daka Annual Report 2004, Daka Annual Report 2005, Daka's interim announcement of the half-year results for the six-month period ended 30 September 2004 and the Business Collaboration Agreement dated 19 May 2004.

<sup>39</sup> Chapter 704(15)(c) of the Listing Manual

<sup>40</sup> According to the Management Responses the "Non-disclosure inadvertent".

<sup>41</sup> It was further explained in the Management Responses that "Daka has a 3-5 year plan for the utilization of the IPO proceeds for the earmarked purposes." However, the plan was also not disclosed to the shareholders.

million was remitted to Company C<sup>42</sup> on 23 July 2004. The related email messages indicate that the payment to Company C neither relates to the services described in the agreement between Company C and DDL dated 1 December 2003 nor the corporate finance services described by Mr Chow Yiu Man Raymond during the interview. Instead, it appears that the HK\$3 million was paid to an individual associated with Company C in the first instance and were subsequently re-channelled to Customer K and DIL via Mr Chan Kam Tong Lawrence<sup>43</sup>.

#### E. The irregular financing arrangements

37. There were irregularities in the manner that DDL obtained some of its bank financing through its use of trust receipts from several banks to settle what appear to be spurious or “*not actual*” commercial invoices issued by DIL<sup>44</sup>. It appears from our review that the application of trust receipt loans on the strength of the commercial invoices issued by DIL was in fact a scheme to obtain general financing by the Daka Group<sup>45</sup> rather than to finance specific purchases of stocks.
38. From December 2003 to March 2005, DDL drew down a total of approximately HK\$27.6 million in such trust receipt loans, of which approximately HK\$26.4 million of the proceeds was transferred back to DDL from DIL. We also observed the following from the trust receipt loans:
- The majority of the proceeds arising from the trust receipt loans were transferred to the Daka Group almost immediately after the loan proceeds were disbursed by the bank to DIL.
  - Mr Pat Y Mah, Mr Chow Yiu Man Raymond and Ms Rose Chow were the only authorised bank signatories of DIL's bank accounts then<sup>46</sup>, and they authorised the transfers of the loan proceeds from DIL's bank accounts to the Daka Group.

<sup>42</sup> Notably, Company D which offers currency exchange and transfers services listed the same address as Company C. It was also noted from the bank advice on the HK\$3 million payment to Company C that its contact number was identical to Company D's contact number.

<sup>43</sup> It was explained in the Management Responses that “(d) Mr Chan came to Daka requesting for a loan and given the good relationship with Mr Chan, Daka referred Company C as a creditor to Mr Chan (c) Company C lent HK\$3 million to Mr Chan who in turn used the HK\$3 million to pay for installment due to DDL (HK\$2.88 million)”.

<sup>44</sup> There was one instance where a trust receipt loan of approximately HK\$1 million was drawn down by DDL on the strength of a DML commercial invoice. Nonetheless, the loan proceeds were directly disbursed by the bank to DIL.

<sup>45</sup> A legal advice on legality and validity of the trust receipt arrangement of the Daka Group was enclosed with the Management Responses. The legal advice suggested that the trust receipt arrangement put forth to the legal counsel is both legal and valid. It appears from the legal advice that the legal counsel's understanding of the trust receipt arrangement might not have considered the entirety of the scheme set out in this Report.

<sup>46</sup> Mr Leung Kwok Wah Kevin was included as a bank signatory in 2005.



- The trust receipt loan application documents and the supporting documents for the applications such as the commercial invoices of DIL and DML and the cargo receipts for DIL and DML (certifying that goods were received by DDL in good order) were either authorised or acknowledged by Mr Pat Y Mah, Mr Chow Yiu Man Raymond or Ms Rose Chow. Notably, the documents of DIL and DML were not signed by Mr Chan Kam Tong Lawrence.
  - Proceeds from the trust receipts transferred to DDL were used, *inter alia*, to reduce overdrafts in DDL's bank accounts, to settle DDL's loan obligations and to finance the Investment.
  - The commercial invoices from DIL were neither recorded in DIL's accounting records as sales nor in DDL's accounting records as purchases.
  - The loan proceeds disbursed from the banks to DIL were recorded in DIL's accounting records as amounts owing by DIL to DDL, and the liabilities were eliminated when the proceeds were transferred to DDL.
  - Similarly, the loan proceeds disbursed to DIL were recorded in DDL's accounting records as amounts owing by DIL to DDL, with these balances eliminated when the proceeds were transferred from DIL to DDL. The trust receipt loans drawn down by DDL were recorded as bank loans.
39. There was no reasonable basis or explanation for DDL to pay DIL using trust receipts because the latter had no transactions with DDL<sup>47</sup>. Further, DDL should not have been paying for the finished goods purchased from DML. As announced by Daka<sup>48</sup>, the substantial amounts owing by DML to DDL would be repaid through purchases of finished goods by the Daka Group from DML.
40. We noted another instance where an import loan of approximately HK\$1.4 million was drawn down by DDL on 8 October 2003 to settle a T&K invoice<sup>49</sup>. Besides the T&K invoice for "*1 set of Tooling and housing mould*", we also sighted the cargo receipt note acknowledging receipt of "*1 set of Tooling and housing mould*" by DDL. We however noted from DDL's accounting records that the "*1 set of Tooling and housing mould*", purportedly received by DDL, was not accounted for as fixed assets of DDL. The proceeds paid to T&K were instead recorded as a loan to DML for payments to T&K, on DML's behalf, for plastic supplies in August 2003.

<sup>47</sup> DIL has been dormant and is a mere investment holding company since August 2003 after DML started operations. Since August 2003, Daka Group purchased its finished products from DML.

<sup>48</sup> It was disclosed in the Prospectus, Daka Annual Report 2004 and Daka's interim announcement of the half-year results for the six-month period ended 30 September 2005 dated 14 November 2005 that the substantial amount owing by DML to DDL arose because the latter had been financing DML (making payments on behalf of DML mainly for the purchase of raw materials for the manufacture of products for Daka Group and advances for working capital purposes) and that the amount owing by DML would be netted off the cost of finished goods purchased by Daka from DML.

<sup>49</sup> T&K invoice number TK0306/03 dated 8 October 2003.

41. These inconsistencies raise questions as to whether the “*1 set of Tooling and housing mould*” actually exists. It was subsequently explained in the Management Responses that the “*Accounts staff had been using the term ‘tooling and mould’ instead of plastic parts to arrange Trust Receipt loan, the underlying accounting records of DML in fact showed the purchase of plastic parts, not tooling and mould. The inconsistent description is due to careless handling of Accounts staff.*”

### **Conclusion**

42. Our review has revealed serious irregularities in the financial management of the Daka Group. From the financial year ended 31 March 2002, and at times with the objective of building a profit track record for an IPO, efforts were undertaken to boost revenue and profits prior to each financial year-end and this involved the recording of sales prior to goods being delivered to customers. Certain of the Daka Group's customers were requested to place orders ahead of their needs, at each subsequent financial year-end, with assurances in some cases of their right to return the goods to the Group without penalty. In March 2004, the year-end profit was lifted from an estimated HK\$8 million at the eleven month mark to a reported profit of HK\$20 million for the full year. Steps were also taken for undelivered goods to be removed from the factory premises prior to the stocktake exercise, to be stored at a nearby location, and for separate stocktake instructions to be used by the Group and to be sent to the auditors.
43. The Daka Group's plans for its manufacturing facilities (the Investment) were similarly focused on the consequences of such plans to the profit track record. Originally set up as a 50-50 joint venture, the Group bought over the remaining 50% in 2002. With the factory operations making losses, this was ostensibly reversed in 2003. Subsequently, the equity stake was ostensibly further reduced to 18%. However, the Daka Group's true interest is certainly much higher, as the operations have been funded mainly through loans from the Group. In addition, Daka's role in the factory operations appears to be that of a controlling shareholder, although senior Daka management took steps to avoid appearing to be so, including producing false documents to us to avoid showing their involvement. While we have concluded that the Investment is a controlled subsidiary, in the absence of full co-operation of management, we were unable to determine if the Investment was always a controlled subsidiary or had become one more recently as a result of developments over time.
44. By not consolidating or equity-accounting the factory operations, the accounting treatment of recording all loans at cost, without provisions, had the effect of removing the factory losses from Daka's consolidated results. With the weight of these accumulated losses growing, a provision of HK\$30 million was made in September 2005. If it eventually proves to be that the Investment was always a controlled subsidiary for accounting purposes, the provision would represent the losses that had been shielded from Daka's consolidated profit and loss account over the years.

45. Apart from recording sales ahead of delivery, the irregularities included the recording of sale prices above actual selling prices. Arrangements to settle consequently inflated customer debtor balances included funds being made available by the Daka Group itself to settle its own debtor balances through circuitous transactions. Payments made by the Group purportedly for professional fees, advances and payments for supplies, and directors' drawings were re-channelled back to the Group and recorded as payment for such sales or in some cases as repayments of loans from the Investment. In addition, senior Daka management developed a plan in December 2005 to "*convince*" the Daka's Board of Directors that it was in the Group's best interest to acquire the entire stake of the Investment and to accept terms, *inter alia*, to release the personal guarantee of and to indemnify any future claims or liabilities against the purported majority shareholder.
46. Funds raised in the IPO amounting to HK\$64.8 million were used substantially for the repayment of bank borrowings, with HK\$54.2 million so used. The repayment of bank borrowings started immediately after the IPO. Nevertheless, the Prospectus described a variety of intended uses of IPO proceeds, with no mention of such intention to repay bank borrowings.
47. We have also found a practice, now no longer in use, to obtain trust receipt financing by submitting sale invoices issued by a seemingly non-controlled company, DIL, which did not involve the sale of any goods by DIL. The funds disbursed by the lending banks to DIL (as the vendor of goods) were invariably transferred immediately to the Daka Group.
48. Drawings by executive directors were among the transactions between the Daka Group and interested persons that were not disclosed – such transactions were required to be disclosed in the Prospectus during the IPO. The Group also formed a new subsidiary without making disclosures required under the Listing Manual.
49. During the IPO, certain executive directors' shareholdings in Daka were registered in the name of an undisclosed nominee. Subsequent sales by this nominee to the directors, which would have, involved no change in beneficial ownership, were planned to be effected in weekly instalments and disclosed in shareholder announcements as open market purchases.
50. Our review was obstructed by senior Daka at various stage, with efforts made to prevent us from obtaining relevant information and to provide us with incorrect information.
51. The range of irregularities effected over several years, as well as the obstruction to our review involving the participation of several senior Daka management and staff, shows serious shortcomings in the financial management of the Daka Group.

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## NOTICE OF SPECIAL GENERAL MEETING

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PASSION FOR  
INNOVATION

### DAKA DESIGNS LIMITED

*(Incorporated in Bermuda with limited liability)*

(Company Registration No. 34932)

#### NOTICE OF SPECIAL GENERAL MEETING

**NOTICE IS HEREBY GIVEN** that a Special General Meeting (the “SGM”) of shareholders (the “Shareholders”) of Daka Designs Limited (the “Company”) will be held at 18 Cross Street #08-01 Marsh & McLennan Centre Singapore 048423, on 5 April 2007 at 10.00 a.m. for the purpose of considering and, if thought fit, approving, the following resolutions of the Company:

#### RESOLUTION 1: ORDINARY RESOLUTION

##### **SALE OF THE ENTIRE ISSUED SHARE CAPITAL OF DAKA INVESTMENT INTERNATIONAL LIMITED AND DAKA CHINA LIMITED TO DAKA DIRECT INC.**

**THAT** approval be and is hereby given for the sale by the Company of 30,309 shares representing 100% of the issued and paid-up capital of Daka Investment International Limited and one share representing 100% of the issued and paid-up capital of Daka China Limited (the “Sale”) to Daka Direct Inc. on the terms and conditions of the Agreement (as defined in the Company’s Circular to Shareholders dated 14 March 2007), and the Directors of the Company be and are hereby authorised to do any and all such acts and things as they may consider necessary, expedient, or incidental with regards to the Sale.

#### RESOLUTION 2: SPECIAL RESOLUTION

##### **SHARE CANCELLATION VIA A CAPITAL REDUCTION EXERCISE**

**THAT**, contingent upon the passing of Resolution 1 above, pursuant to Bye-law 6 of the Bye-laws of the Company:

- (a) (i) the issued and paid-up share capital of the Company be reduced with effect from 5 April 2007 (or such later date as the Directors may decide, being no later than 30 June 2007) by HK\$29,232,515, from HK\$45,384,000 comprising 302,560,000 shares of HK\$0.15 each in the capital of the Company (the “Shares”) to HK\$16,151,485 comprising 107,676,568 Shares each fully paid, (ii) such reduction be effected by cancelling 194,883,432 Shares, being all the Shares held by (or on behalf of) Pat Y. Mah, Raymond Yiu Man Chow and Rose Chow (being Directors of the Company and controlling shareholders of Daka Direct Inc. and together, the

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## NOTICE OF SPECIAL GENERAL MEETING

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“**Relevant Persons**”) as at the date of this Resolution, and (iii) forthwith upon such reduction of issued and paid-up share capital taking effect, the sum of (1) HK\$27,378,500 arising from such reduction be applied by the Company in the manner set out in paragraph (b) below; and (2) HK\$1,854,015 arising from such reduction be credited by the Company to a reserve account of the Company known as the “Other Reserve” account;

- (b) subject to and forthwith upon the preceding paragraph (a) taking effect and in lieu of returning to the Relevant Persons the amount of HK\$27,378,500 arising from the reduction of issued and paid-up share capital and the cancellation of the Shares held by (or on behalf of) the Relevant Persons in accordance with paragraph (a) above, the Company be and is hereby authorised to fully apply the same in satisfaction of the sum of HK\$27,378,500, being part of the purchase consideration payable by Daka Direct Inc. to the Company in relation to the Sale (as defined in Resolution 1 above);
- (c) the authorised share capital of the Company be maintained at its current level of HK\$900,000,000 comprising 6,000,000,000 shares of HK\$0.15 each; and
- (d) the Directors and each of them be and are hereby authorised to do any and all such acts and things and to execute all such documents as they or he may consider necessary, expedient or incidental to give effect to the preceding paragraphs (a) to (c).

### RESOLUTION 3: SPECIAL RESOLUTION

#### CHANGE OF THE NAME OF THE COMPANY

**THAT**, contingent upon completion of the Sale (as defined in Resolution 1 above), the name of the Company be changed from “Daka Designs Limited” to “Carats Limited” (or such other name as the Directors of the Company may select) and that the name “Carats Limited” (or such other name as the Directors of the Company may select) be substituted for “Daka Designs Limited” wherever the latter name appears in the Memorandum of Association and Bye-laws of the Company, and the Directors of the Company be and are hereby authorised to do any and all such acts and things as they may consider necessary, expedient, or incidental with regards to the change of the name of the Company.

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## NOTICE OF SPECIAL GENERAL MEETING

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### RESOLUTION 4: ORDINARY RESOLUTION

#### CHANGE OF AUDITORS

**THAT** the resignation of RSM Nelson Wheeler as auditors of the Company and its subsidiaries with effect from the close of this Special General Meeting of the Company be and is hereby accepted and RSM Chio Lim be and are hereby appointed auditors of the Company and its subsidiaries in place of RSM Nelson Wheeler with immediate effect thereafter, and to hold office until the conclusion of the next Annual General Meeting of the Company, at a fee to be agreed between the Directors and RSM Chio Lim, and the Directors of the Company be and are hereby authorised to do any and all such acts and things as they may consider necessary, expedient, or incidental with regards to the change of auditors.

### RESOLUTION 5: ORDINARY RESOLUTION

#### THE PROPOSED DISTRIBUTION OF THE NET CASH PROCEEDS FROM THE SALE

**THAT**, contingent upon the passing of Resolution 1 above and the completion of the Sale (as defined in Resolution 1 above), approval be and is hereby given for the distribution to the Shareholders of the Company of the net cash proceeds from the Sale, forthwith upon completion of the Sale, by way of a voluntary winding up in accordance with the bye-laws of the Company and applicable laws, and that the Directors and each of them be and are hereby authorised and directed to do any and all such acts and things and to execute all such documents as they or he may consider necessary, expedient or incidental to give effect to the foregoing.

By Order of the Board  
**Lotus Lee**  
*Company Secretary*

Singapore

Date: 14 March 2007

#### *Notes:*

1. A Shareholder entitled to attend and vote at the SGM is entitled to appoint a proxy to attend and vote in his/her/its stead. With the exception of The Central Depository (Pte) Limited ("CDP"), who may appoint more than two proxies, any Shareholder who is the holder of two or more shares may appoint not more than two proxies. A proxy need not be a Shareholder.
2. If a Shareholder is unable to attend the SGM and wishes to appoint a proxy to attend and vote at the SGM in his/her/its stead, then he/she/it should complete and sign the relevant Member Proxy Form and deposit the duly completed Member Proxy Form at the office of the Company's Singapore Share Transfer Agent, Lim Associates (Pte) Ltd, at 3 Church Street, #08-01 Samsung Hub, Singapore 049483, not less than 48 hours before the time appointed for the SGM.

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## NOTICE OF SPECIAL GENERAL MEETING

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3. A Depositor (as defined in Section 130A of the Companies Act, Cap. 50 of Singapore) registered and holding Shares through CDP who/which is (i) an individual but is unable to attend the SGM personally and wishes to appoint a nominee to attend and vote; or (ii) a corporation, must complete, sign and return the Depositor Proxy Form and deposit the duly completed Depositor Proxy Form at the office of the Company's Singapore Share Transfer Agent, Lim Associates (Pte) Ltd, at 3 Church Street, #08-01 Samsung Hub, Singapore 049483, not less than 48 hours before the time appointed for the SGM.
4. A Depositor who is an individual and who wishes to attend the SGM in person need not take any further action and can attend and vote at the SGM as CDP's proxy without the lodgement of any proxy form.
5. If a Shareholder who has Shares entered against his name in the Depository Register and Shares registered in his name in the Register of Members is unable to attend the SGM and wishes to appoint a proxy, he should use the Depositor Proxy Form and the Member Proxy Form.

