

HONG KONG / JUDGMENT

RE ADVANCED WIRELESS GROUP LTD

COURT

Court of First Instance

DECIDED

24 April 2007

CASE / FILE NUMBER

HCCW441/2006

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bjbj HCCW 441/2006 IN THE HIGH COURT OF THE HONG KONG SPECIAL ADMINISTRATIVE
REGION COURT OF FIRST INSTANCE COMPANIES (WINDING-UP) NO. 441 OF 2006

IN THE MATTER of Advanced Wireless Group Limited and IN THE MATTER of the Companies
Ordinance, Chapter 32 of the Laws of Hong Kong

Before: Hon Kwan J in Court Date of Hearing: 24 April 2007 Date of Judgment: 24 April 2007

J U D G M E N T

This is a creditor s petition to wind up Advanced Wireless Group Limited (the Company). The petition was presented by Somacis Korea Company Limited on 17 August 2006. It was founded on a debt of US\$1,687,416.30 with interest, being the outstanding payments due on purchase orders placed by the Company with the petitioner. The petitioner sent a demand on 25 May 2006 for US\$1,817,416.30. Only US\$30,000.00 was settled. A demand under section 178 of the Companies Ordinance, Cap. 32 was then served on 4 July 2006. On 4 August 2006, the Company paid a further US\$100,000.00, leaving outstanding US\$1,687,416.30. This petition was served on the Company on 21 August 2006. On 18 October 2006, a master adjourned the petition to this court on 23 October 2006. The Company filed evidence on 20 October 2006 disputing US\$333,680.00, which related to goods that the petitioner had not delivered to the Company, and US\$15,165.98, which represented the value of defective goods. So US\$1.2 million of the petitioning debt is not in dispute. It was also stated in the Company s affirmation that its parent company, ACE River Investments Limited (ACE River), had engaged Ferrier Hodgson on 10 October 2006 to perform a liquidation analysis to assist the Company in a debt restructuring. A letter from a Malaysian, Dato Teng Poh Foh, dated 18 October 2006 was produced, stating that he represented a consortium of high net worth individuals in Asia in making investments and was engaged in negotiations with the Company

and ACE River on a proposed restructuring. The Company sought a 6 weeks adjournment to enable it to continue negotiations with the investor, for Ferrier Hodgson to carry out their terms of engagement, and for the Company to put a restructuring proposal to its creditors for consideration. On 23 October 2006, I adjourned the petition for 4 weeks to 20 November 2006. The Company filed further evidence on 14 and November 2006. It exhibited a list of unsecured creditors as at 31 July 2006 with a total indebtedness of HK\$349,870,732.61, a report of Ferrier Hodgson dated 13 November 2006 on the rate of return to creditors in a liquidation scenario, a recovery plan of the Company dated 8 November 2006, and a letter of the Company to its creditors dated 16 November 2006 seeking in-principle support to the proposed restructuring. The Company sought a further adjournment to ascertain the views of its creditors. On 20 November 2006, I adjourned the petition for 3 weeks to 11 December 2006. On 8 December 2006, the Company filed evidence on the response received from creditors to the proposed restructuring. 76.28% in value of the creditors were in support of restructuring; in terms of numbers, that was 59 (28.92%) out of a total of 204 creditors. Only 2 creditors (0.98% in value) replied that they did not support restructuring. Creditors who did not respond at all amounted to 23.66% in value and they are 143 in number (70.1%). Of those who had responded, those in support came up to 99.92% in value and 59 in number (96.72%, out of 61 creditors), those not in support came up to 0.08% in value and 2 in number (3.28%). If related parties and those who are prepared to waive their rights to dividends under the proposed scheme are excluded, the extent of creditors support was 99.81% in value and 57 in number (96.61%), and those who were not in support were 0.19% in value and 2 in number (3.39%). I should point out that the above figures have not been updated. The petitioner who has not supported the proposed restructuring was included in those who did not respond. The petitioner informed the court at the adjourned hearing on 11 December 2006 that it had not received the letter from the Company canvassing support for the scheme. The Company also exhibited a draft explanatory statement and a scheme of arrangement. It sought 2 months adjournment to complete the draft scheme documents and to issue an application to convene a creditors meeting to vote on the scheme. On 11 December 2006, I adjourned the petition for 6 weeks to 22 January 2007. The Company filed evidence on 18 January 2007 deposing to the preparatory steps taken regarding its recovery plan and exhibited a revised draft of the scheme documents with waivers signed by 2 related parties and a guarantee executed by the investor, Seachoice Investments Limited (Seachoice), a company formed in the British Virgin Island, for the purpose of financing the restructuring of the Company. The Company envisaged that an originating summons to convene a court meeting for creditors would be issued by 25 January 2007. It sought an adjournment of 7 days. At the hearing on 22 January 2007, detailed submissions were made by the petitioner s counsel in his skeleton submission served only on the day of the hearing on perceived flaws in the report of Ferrier Hodgson. I adjourned the petition for argument to a date to be fixed and gave directions for the Company to respond on affidavit to the matters raised in the skeleton submission of the petitioner s counsel. On 2 February 2007, the adjourned hearing of the petition was fixed to today. The originating summons to convene a creditors meeting was issued only on 12 April 2007, to be heard on 8 May 2007. The Company explained that it was not able to issue its application earlier because it had to undertake significant work on the proposed scheme mechanics and documentation. I have read

the draft scheme document exhibited to the originating summons in HCMP No. 683 of 2007 and compared the latest draft to the draft exhibited to the Company's affirmation in January 2007. I am somewhat sceptical if significant work had indeed been undertaken. The petitioner's complaint that the Company appeared to be adopting delaying tactics does not appear to be without foundation. Be that as it may, what is more important for present purpose whether I should grant a further adjournment to enable the Company to proceed with the proposed scheme of arrangement - is whether the Company can establish there is in-principle support from the requisite majority of creditors, and if there are reasonable prospects of obtaining sanction for the proposed scheme. The Company and the proposed scheme of arrangement The background of the Company and the essential features of the scheme may be stated as follows. The Company was incorporated in October 2001 with an authorized share capital of HK\$10,000.00. Its authorized and issued share capital was increased to HK\$16 million in 2003. The sole shareholder is ACE River. The principal activities of the Company are the design, manufacturing and trading of communication equipment. In the latest audited accounts for the year ended 31 December 2005, the auditor expressed fundamental uncertainty in view of the deficiency of net assets and that the financial statements were prepared on a going concern basis, the validity of which would depend on future funding available from the shareholder. Net liabilities of the Company stood at HK\$48.4 million as at that date. According to the management accounts as at 31 July 2006, total liabilities of the Company stood at HK\$349 million odd. The court has been provided with a list of creditors as at 11 April 2007. There are 206 creditors with a total claim of HK\$356 million odd. There is no doubt that the Company is insolvent. A professional valuer, JR West (Hong Kong) Limited, gave an estimated realisable value of assets as between HK\$7,219,200.00 (on a low case scenario) and HK\$11,961,119.00 (on a high case scenario). Ferrier Hodgson gave an estimated rate of return to unsecured creditors in liquidation of 1.68% (on a low case scenario) to 3.01% (on a high case scenario). In October 2006, Seachoice entered into an agreement with ACE River. In exchange for a non-controlling shareholding in ACE River, Seachoice agreed to inject through ACE River HK\$20 million to finance the restructuring of the Company's debts by a scheme of arrangement between the Company and the unsecured creditors. HK\$20 million was injected to the Company's solicitors between 19 October 2006 and 15 November 2006. Since November 2006, HK\$15 million of the HK\$20 million injected by Seachoice has been allocated for the purpose of implementing the proposed scheme in this way. HK\$6.8 million has been set aside for injection into the scheme funds for distribution to the scheme creditors within 10 business days from the effective date of the scheme. HK\$8.2 million has been spent on the recovery plan comprising stock realisation implementation of the printed circuit board assembly business (PCBA business), and funding the Company's office closure and staff termination in Korea and Hong Kong. The balance of HK\$5 million has been allocated to assist in paying the scheme costs. Under the recovery plan, it is anticipated that the stock realisation business and the PCBA business to be carried out could yield projected profits of HK\$25.7 million. In respect of the stock realisation business, the Company would endeavour to generate total profits of HK\$18.1 million over 11 to 14 months. For the PCBA business, it is expected that total net profits of HK\$7.6 million would be generated over 12 months. The profits generated under the recovery plan will be the net profits before taxation of the Company generated from 1 November 2006 to 31 December 2007. The

profits of HK\$25.7 million generated from the recovery plan would also be applied towards paying the scheme creditors, so the total funds available for distribution to the scheme creditors would be in the region of HK\$32.5 million (HK\$25.7million + HK\$6.8 million). If the profit targets were not met, there is recourse to a guarantee secured by ACE River from Seachoice dated 16 January 2007. In the event that the amount of profits generated by the recovery plan is less than 50% of the amount projected (i.e. HK\$12.85 million), Seachoice will immediately pay the scheme administrator the shortfall up to HK\$12.85 million. On that basis, and taking into account the voluntary waivers by ACE River and another related company, Always Good Investment Limited, of total claims against the Company of HK\$153 million, it is estimated that the rate of return to unsecured creditors under the proposed scheme is 9.99% (on a low case scenario) to 16.52% (on a high case scenario). If there is majority support One other creditor has filed a notice of intention to appear and to support the petition on 30 November 2006. This notice was withdrawn on 7 March 2007. I have set out earlier the percentages in value of those who were in support of the proposed scheme, those who had not responded, and those who would not support the scheme and the numbers of the three categories of creditors. The Company has not filed further evidence on any additional support or opposition since December 2006, or any withdrawal of support previously given. This is clearly unsatisfactory. But even taken into account the petitioner's opposition to the scheme, there would still appear to be a substantial majority of those who have given in-principle support to restructuring. The Company has made out a case of requisite support from a substantial portion of unsecured creditors. If there is a viable scheme Mr Thomson for the petitioner submitted that there are serious deficiencies in the proposed scheme for these reasons : there are serious questions over the valuation of the inventory; there are serious questions over the viability of the stock realisation business; vital information regarding the interests of directors in the scheme has not been provided; and there is no evidence of the ability of Seachoice to meet its obligations under its guarantee. The present hearing is not a dry-run of the petition for sanction of the proposed scheme. The threshold that the Company would need to surmount at this stage is not a high one. If it is reasonably arguable that sanction would be obtained, I should decline to wind up the Company immediately and adjourn the petition for the Company to continue with restructuring (Re APP (Hong Kong) Limited [2005] 1 HKLRD 272 at 280A to 281H, paras 21 to 26). Valuation of inventory The argument regarding the valuation of inventory was as follows. Mr Thomson submitted there are serious flaws in estimating the worth of the Company's assets upon liquidation in that JR West and Ferrier Hodgson have substantially underestimated the value of the Company's inventory. According to the audited accounts of the Company as at 31 December 2005, the Company had inventory to the value of HK\$159 million odd. According to its management accounts as at 31 July 2006, inventory had increased to a net book value of HK\$241 million. Ferrier Hodgson explained in their letter in February 2007 that of the inventory in July 2006, HK\$153 million worth of materials were kept at the factories of the Company's sub-contractors in Baoan and Dongguan, China and the remaining materials of HK\$88.47 million were kept in a warehouse in Hong Kong. Based on the valuation of JR West, of this inventory with a net book value of HK\$241 million, Ferrier Hodgson gave an estimated restricted realisation price of HK\$2.3 million and a fair market value of HK\$6,010,000.00. For the materials kept by the sub-contractors in China, Ferrier Hodgson have assigned a zero value in the

low case analysis, as, in their experience, in the majority of liquidations involving assets in China, inventories are likely to be frozen by the court if legal proceedings are brought by local suppliers in the event the company is placed into liquidation, and local suppliers who have applied for freezing orders would have priority over the sale proceeds generated from the auction arranged by the Mainland court. This would usually end up with a nil return to the company. However, even on the basis of fair market value, there is a huge gap between the figure of HK\$6,010,000.00 and the net book value of HK\$241 million. Ferrier Hodgson stated that they were not appointed to perform a review or an audit on the financial information of the Company, and the scope of their appointment was merely to prepare an analysis of the estimated return to unsecured creditors on a liquidation scenario. No other explanation was provided in the evidence filed by the Company. That to me is not a satisfactory response from the Company. It was submitted by Mr Thomson that the minimal value assigned to the inventory raises concern. He further pointed out that in an earlier draft of the explanatory statement exhibited in January 2007, it was stated that as at 29 December 2006, the total stock value was estimated at HK\$140,583,000.00. This sentence has been removed in the latest draft of the explanatory statement in April 2007. No explanation regarding this has been given. This valuation in December 2006 was substantially different from the net book value in July 2006 and the valuation according to JR West and Ferrier Hodgson. I note that in the explanatory statement, it was stated that if the inventory was liquidated by selling the components on open market, the Company would only expect to receive 5% to 15% of the stock value in cash. Hence, the proposal for the stock realisation business was made in the recovery plan. Even so, there is no adequate explanation why the valuation of the inventory should be so low. Further, there is no or no proper explanation why there were such considerable fluctuations in the valuation of the inventory in December 2005, July 2006 and December 2006. Stock realisation business The petitioner has queried why the stock realisation business would involve the expenditure of cash rather than the receipt of cash. Of the HK\$15 million injected by Seachoice, HK\$2.5 million was spent by ACE River in stock realisation and HK\$0.9 million was spent in research and development expenses in the PCBA business. As I understand the Company's proposal for the stock realisation business, it is to manufacture handsets using the existing inventory, from which it could be expected to recover about 30% to 70% of the stock value, depending on the particular model and parts. The Company would need to purchase such components lacking from the existing inventory for such production to be carried out, it would also need to pay production charges to the contractor responsible for the manufacturing and assembly. According to the Company's affirmation in January 2007, expenses incurred in November and December 2006 generated an initial HK\$1 million in net proceeds which had been re-invested in the second phase of the stock realisation business. Over the next 2 months, the Company expected the products sold to generate gross proceeds of approximately HK\$3.65 million and estimated net proceeds of about HK\$1.2 million. Mr. Thomson has criticised this business plan and queried what would be the point in such a risk-bearing exercise to produce a low return of 20%, so far. Interest of directors Another criticism of the proposed scheme was that no mention was made of the interests of the directors in the plan, particularly in the period from January 2008 when creditors would have been paid off under the scheme. No detail was given of the interests of the investors behind Seachoice. The only

information provided so far is that of the current directors of the Company, none of them are scheme creditors. Financial standing of the investor Nothing is known of Seachoice save that it is managed by Dato Teng Poh Foh, whose profile was given in an appendix to the explanatory statement. The Company is unable to provide information as to the means of Seachoice to honour its guarantee given in January 2007, in the event that the profit targets under the recovery plan are not met.

Conclusion

There are a number of unsatisfactory features about the Company's case. There is unexplained delay in proceeding with restructuring and the Company has not provided full and proper explanation to the court on a number of matters as pointed out earlier. Nevertheless, the matters raised by the petitioner on the viability of the scheme are not sufficiently grave to indicate that it is not reasonably arguable that sanction to the scheme would not be given. As mentioned earlier, a large number of creditors who had responded had given their in-principle support to restructuring. With some reluctance, I accede to the submission not to wind up the Company immediately and grant an adjournment. I emphasise this is likely to be the last opportunity. From now on I expect the Company to proceed with the restructuring in an expeditious manner. I adjourn the petition for 3 months to 30 July 2007 9:30 a.m. The Company is to file and serve evidence on the progress of its restructuring by Thursday 26 July 2007. I give leave to restore the petition to an earlier date on 7 days notice. I should mention that some if not all of the matters raised by the petitioner at this hearing should fairly be brought to the attention of other creditors and they should be suitably emphasized in the explanatory statement of the scheme documents. I expect these matters to be attended to before the hearing on 8 May 2007 of the application for leave to convene a creditors meeting and a new draft explanatory statement should be placed before the court not less than 3 days before that hearing. For the costs of this hearing, the Company should pay the petitioner's costs in any event. (S Kwan) Judge of the Court of First Instance High Court Mr Neil Thomson, instructed by Messrs Oldham, Li & Nie, for the Petitioner Mr William Wong, instructed by Messrs Hammonds, for the Company The Official Receiver, attendance excused PAGE - A B C D E F G H I J K L M N O P Q R S T U V A B C D E F G H 1udk 1udk O P Q R S T U V i\$&` r*pa 5<>| w[{}t0 w[{}t HCCW.dot setup Microsoft Word 9.0 Judiciary Hong Kong Title Microsoft Word Document MSWordDoc Word.Document.8

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