Grandy Applied Environmental Technology Corporation

(incorporated in the Cayman Islands with limited liability)

First Quarterly Report 2002

CHARACTERISTICS OF THE GROWTH ENTERPRISE MARKET ("GEM") OF THE STOCK EXCHANGE OF HONG KONG LIMITED (THE "EXCHANGE")

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This report for which the directors of Grandy Applied Environmental Technology Corporation collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited for the purpose of giving information with regard to Grandy Applied Environmental Technology Corporation. The directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief:— 1. the information contained in this report is accurate and complete in all material respects and not misleading; 2. there are no other matters the omission of which would make any statement in this report misleading; and 3. all opinions expressed in this report have been arrived at after due and careful consideration on the basis and assumptions of fairness and reasonableness.

MANAGING DIRECTOR'S STATEMENT

BUSINESS REVIEW

Results of the Group in the first quarter to 30 June 2002 have shown a marked growth in business performance in comparison with results for the corresponding quarter in 2001. In the period under review, the Group commenced using the funds raised from the listing of the Company's shares on the Growth Enterprise Market ("GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 10 May 2002 for financing its business development and expansion plans. Turnover of the Group in the period under review was approximately HK$8.39 million, representing an increase of 279% in comparison with approximately HK$2.21 million in the corresponding quarter last year. Profit before tax for the quarter under review was approximately HK$136,000, representing a turnaround when compared to a loss before tax of HK$562,000 for the same period in 2001. The Group's robust performance in the face of an overall weakening of the domestic economy reflects: (i) improvements introduced by management designed to enhance the Group's operational efficiency; (ii) economies of scale due to growth of the Group's businesses; and (iii) the introduction of new product lines such as *Light.Eco* in August 2001, for which there has been an exceptionally strong and growing demand. Meanwhile, there has been a steady growth in demand for the Group's broad range of enzyme-based water quality and air quality improvement products and services.

Relocation to new office

The Group relocated its headquarters in Hong Kong to more spacious and more conveniently located premises in the Luk Kwok Centre, 72 Gloucester Road, Wanchai. As well as allowing for planned further increases in head count, the new office houses a custom-designed showroom for the purpose of demonstrating to potential clients the Group's comprehensive range of environmental protection and energy-saving technology.

Promotional and brand-building activities

The Group has participated in a number of high level promotional activities such as joint attendance with Ilum-a-lite (manufacturer of *Light.Eco*) of the Sustainable Energy Development Authority trade delegation to Beijing that was directed at promoting environmental protection products and services to the Beijing authorities in preparation for Beijing's *Green Olympics* in 2008. The Group also participated with Ilum-a-lite in Australian Trade Exhibition, in which *Light.Eco* was promoted to a number of high profile clients in Hong Kong. In addition, the Group has designed and prepared a suite of promotional leaflets, literature and posters for each of its products and services. Work has also begun on upgrading the Group's website.

Waste water treatment projects

Since the beginning of the year, the Group has developed and tested process and equipment solutions for the treatment of waste water arising from a range of industries including textiles, cloth dying, printed circuit boards, electroplating and food manufacturing. To this end, a mobile demonstration-scale waste water treatment plant has been designed, constructed and combined with a demonstration-scale membrane filter. Such plant can be taken from one client's site to another for direct and quantifiable proof of efficacy of the solution, which is in accord with the Group's *'seeing is believing'* approach. The primary market for such waste water treatment processes and supply of equipment is in Mainland China where there is virtually unlimited potential for measures and solutions that are aimed at halting and eventually reversing the trend of pollution of China's already scarce water resources. In order to provide turnkey solutions, the Group has developed close working relationships with a number of contractors who have a solid track record of design and building of conventional waste water treatment plant. Currently, negotiations are in progress for waste water treatment projects with clients in, for example, Hong Kong, Zhongshan, Shandong, Shunde, Dongguan and Shenzhen.

Extension of range of energy-saving products

Commencing from 10 May 2002, the Group was granted the exclusive rights by SavaWatt (UK) Limited for the distribution of *SavaControls* in the territories of Hong Kong and Macau. *SavaControls* are applicable to most fixed speed AC induction motors such as, for example, those used in refrigeration, air condition and air handling units. They work by reducing the amount of energy that is wasted by the motor whilst neither affecting the performance of the motor nor the performance of the refrigeration or air conditioning system. Award of the distributorship significantly broadens the Group's range of energy-saving products. Together, lighting and air conditioning in commercial buildings in Hong Kong consume in the region of HK$12 billion's worth of electricity (2001). At an average energy-saving of 25%, the extended product range affords the Group a total market potential that is worth HK$3 billion in Hong Kong alone. Target customers for the Group's range of energy-saving products include commercial buildings, schools, hospitals, supermarkets, restaurants, hotels, convenience stores and industrial sectors where refrigeration and/or air conditioning are a significant overhead. Owing to the synergy between its energy-saving and air/water quality improvement services, the Group believes it is set to capture a significant share of commercial property in Hong Kong as its *Green Building* clientele.

Food waste recycling system

A high profile product, for which the Group is assessing its feasibility in Hong Kong, is a food waste digestion system that incorporates highly active but harmless microorganisms. The system enables 90% of the food waste to be converted within a matter of 10-20 hours into a soil conditioner that has commercial value. Designed and patented by Guangzhou Tainwei Bio-Tech Co. Ltd, the system has been tested extensively by an independent authority in Hong Kong and is already in operation at seventeen different sites in Hong Kong. Further clients that are being targeted for the food waste recycling system are in sectors that include hospitals, universities, schools, hotels and the catering industry in Hong Kong and large cities in Mainland China.

Evaluation of new technology

State-of-the-art forms of technology that are currently under evaluation and application analysis include: new sources of enzymes; membrane filtration systems from European and Mainland Chinese suppliers; advanced oxidation technology; photo-catalytic oxidation reactors; and bio-farms for water quality improvement. The Group is also evaluating the possibility of a joint venture agreement for the distribution in Hong Kong and Mainland China of an electrostatic precipitator that is capable of recovering 90% of oil from the ventilation exhaust of extractors that are widely used in kitchens of restaurants, hotels and other catering sectors.

Refreshment of the Group's technology base

In order to maintain its competitive edge within the Environmental Protection industry, the Group continually seeks to refresh its technology base through carrying out strategic developmental projects. Accordingly, in June 2002 the Group signed letters of support for two applications that were submitted by The Hong Kong University of Science and Technology for part-funding from the Hong Kong SAR Government's Innovation Technology Fund. Should such applications be approved, the Company will commit to spend HK$550,000 in three years on the following projects. One of the projects is directed at the development of bio-sensors for the real-time monitoring of the level of pollutants in wastewater. This project is co-supported by a manufacturer of electronic equipment that is based in Hong Kong, which will provide the manufacturing facility for the Group's future commercial exploitation of the sensing equipment that the Group expects will be developed. The second project is related to the development of novel nano-catalysts for the treatment of waste water and improvement of indoor air quality.

Geographical expansion

In the period under review the Group initiated the process of registering a subsidiary office in Malaysia, which is anticipated to be operational in August 2002.

FUTURE PROSPECTS

Market demand

Demand for the Group's Environmental Protection ("EP") Solutions, especially in Mainland PRC and other parts of Asia, is predicted to grow markedly over the next five years.

In Mainland China, for example, the Group considers that the principal market drivers for its EP Solutions include:

- China's accession to WTO membership
- Holding of the 2008 *'Green Olympics'* in Beijing
- Projected population growth from current 1.3 billion to 1.6 billion by 2050
- Impending crisis of water shortage, which for the year 2000 the Chinese Government estimates cost industry and agriculture more than RMB120 billion in lost production
- Impact of water pollution on human health, which has been valued at approximately RMB41.7 billion
- Drive towards Cleaner Production and GMP standards in the chemical and related process industries such as fine chemicals and pharmaceuticals

In 2000, the Mainland China's total investment in the environment amounted to approximately RMB106.1 billion (1.1% of GDP), representing an increase of 28.8% on the previous year *(Report on State of the Environment in China 2000).* According to State Environmental Protection Agency ("SEPA"), this figure is set to grow by 15% per annum in the coming years.

Furthermore, according to China's 10th Five Year Plan (2001-2005) for the environment, investment totaling RMB700 billion (1.3% of projected GDP) is required for meeting the plan's objectives, 11% of which is likely to come from central government. Out of the total investment, RMB250 billion is considered by SEPA to be required for control of water pollution. In order to meet the projected demand, the Group has been developing its expertise in waste water treatment solutions and Cleaner Production, the exploitation of which is commencing with the wastewater treatment projects under negotiation in Hong Kong, Zhongshan, Shandong, Shunde, Dongguan and Shenzhen.

Positioning of the Group to capture the Asian market

The Group is well positioned to penetrate further into the Chinese market by capitalizing on its sustained marketing efforts to date and by forming strategic alliances with partners such as Shandong Teachers University and Tianjin University. Moreover, establishment of offices in Beijing and Dongguan are planned for the coming year. Projects that are already being negotiated in Mainland China include the aforementioned waste water treatment projects in Shandong, Dongguan, Zhongshan and Shenzhen; air quality improvement projects for a high profile leisure complex in Guangdong; supply of *Light.Eco* to factories in Dongguan, Shunde, Shenzhen and Beijing.

Cleaner production

Cleaner Production ("CP") is a strategy that aims to eliminate pollution throughout an entire production process. For the chemical and related process industries, CP is a way of reducing discharge of pollutants into the environment by minimising or eliminating their production at source. As such, CP is consistent with the goals of the 10th Five Year Plan for prevention and control of water pollution. Since 1993, all regions and government departments in Mainland China initiated raising awareness of CP through policy research and demonstration projects.

Outlook

During the remainder of 2002 and beyond, the Group will be devoting considerable resources to marketing and brand building. Planned promotional activities include attendance of high profile trade exhibitions as well as holding the Group's own seminars and workshops in both Hong Kong and Southern China.

The Group considers that the planned geographical expansion together with the widening of its range of products and services that are currently in the pipeline provide good prospects for robust, managed growth.

Tsui Tai Hoi Raymond
Managing Director

9 August 2002, Hong Kong

FIRST QUARTERLY RESULTS (UNAUDITED)

The Directors of the Company announce the unaudited consolidated profit and loss account of the Company and its subsidiaries (collectively the "Group") for the three months ended 30 June 2002, together with the comparative unaudited figures for the corresponding period in 2001, prepared in accordance with generally accepted accounting principles in Hong Kong, as follows:

		Three months ended 30 June	
		2002	2001
	Notes	***HK$'000***	*HK$'000*
TURNOVER	*2*	**8,390**	2,214
Cost of Sales		**(3,966)**	(1,543)
Gross profit		**4,424**	671
Interest income		**252**	—
Selling and distribution costs		**(615)**	(179)
Administrative expenses		**(3,410)**	(1,028)
PROFIT/(LOSS) FROM OPERATING ACTIVITIES		**651**	(536)
Finance costs		**(515)**	(26)
PROFIT/(LOSS) BEFORE TAX		**136**	(562)
Tax	*3*	**—**	—
NET PROFIT/(LOSS) FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS		**136**	(562)
Earnings/(Loss) per share	*4*		
— Basic (HK cents)		**0.018**	(0.088)
— Diluted (HK cents)		**0.017**	N/A

Notes:

1. Group Reorganisation and Basis of Presentation

Group reorganisation

The Company was incorporated in the Cayman Islands on 28 May 2001 as an exempted company with limited liability under the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. Pursuant to a group reorganisation (the "Reorganisation") to rationalise the structure of the Group in preparation for the listing of the Company's shares on GEM, the Company became the holding company of the companies now comprising the Group on 17 July 2001. The Company's shares have been listed on GEM since 10 May 2002.

Basis of presentation

The unaudited consolidated profit and loss account includes the results of the Company and its subsidiaries for the three months ended 30 June 2002.

The Reorganisation involved companies under common control. The unaudited consolidated profit and loss account has been prepared on the basis of merger accounting in accordance with SSAP 27 "Accounting for Group Reconstructions". On this basis, the Company has been treated as the holding company of its subsidiaries for the three months ended 30 June 2001 rather than from the date of its acquisition of the subsidiary pursuant to the Reorganisation. Accordingly, the unaudited consolidated profit and loss account of the Group for the three months ended 30 June 2001 includes the results of the Company and its subsidiaries with effect from 1 April 2001 or since their respective dates of incorporation, where this is a shorter period.

Although the Reorganisation had not been completed and the Group did not legally exist until 17 July 2001, in the opinion of the directors, the unaudited consolidated profit and loss account prepared on the above basis presents more fairly the results of the Group as a whole.

All significant intercompany transactions within the Group have been eliminated on consolidation.

2. Turnover and revenue

Turnover represents the net invoiced value of the goods sold, after allowances for returns and trade discounts. Revenue arising from interest income is disclosed on the face of the consolidated profit and loss account.

3. Tax

No provision for Hong Kong profits tax has been made as the Group did not have any assessable profits arising in Hong Kong during the period (2001: NIL).

4. Earnings/(loss) per share

The calculation of basic earnings/(loss) per share is based on the unaudited net profit attributable to shareholders for the three months ended 30 June 2002 of HK$136,000 (2001: unaudited net loss of HK$562,000) and the weighted average of 754,835,000 (2001: 640,000,000) ordinary shares deemed to be in issue on the assumption that the Reorganisation and the capitalisation issue of 631,333,000 ordinary shares of the Company have been effective on 1 April 2001.

The calculations of diluted earnings per share for the three months ended 30 June 2002 is based on the unaudited net profit attributable to shareholders of HK$136,000 and 782,592,000 ordinary shares, being 754,835,000 ordinary shares as used in the calculation of basic earnings per share and the weighted average of 27,757,000 ordinary shares assumed to have been in issue at no consideration on the deemed exercise of the Pre-Initial Public Offering ("Pre-IPO") share options.

A diluted loss per share for the three months ended 30 June 2001 has not been disclosed as no diluting events existed during that period.

5. Dividend

The directors do not recommend the payment of any dividend for the three months ended 30 June 2002 (2001: NIL).

6. Reserves

	Share premium	Contributed surplus	Capital reserve	Accumulated losses	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
At 1 April 2001	—	2,935	—	(3,478)	(543)
Net loss for the period	—	—	—	(562)	(562)
At 30 June 2001	—	2,935	—	(4,040)	(1,105)
At 1 April 2002	3,589	2,935	300	(1,071)	5,753
Issue of new shares	51,300	—	—	—	51,300
Capitalisation issue	(6,313)	—	—	—	(6,313)
Share issuance expenses	(9,430)	—	—	—	(9,430)
Net profit for the period	—	—	—	136	136
At 30 June 2002	39,146	2,935	300	(935)	41,446

Notes:

(a) The Group's contributed surplus represents the difference between the nominal value of the shares of the subsidiary acquired pursuant to the Reorganisation over the nominal value of the Company's shares issued in exchange therefor.

(b) The capital reserve of the Group represents certain professional services fees payable by the Company settled in the form of share options of the Company granted to two professional services providers in lieu of cash considerations.

DIRECTORS' INTERESTS IN EQUITY SECURITIES

As at 30 June 2002, the interests of the Directors in the shares and share options of the Company and its associated corporations (within the meaning of the Securities (Disclosure of Interests) Ordinance (the "SDI Ordinance"), as recorded in the register maintained by the Company under Section 29 of the SDI Ordinance or as notified to the Company were as follows:

1. The Company

Name of director	Number of shares held Corporate Interests	Number of options held *(Note c)*
Mr Tsui Tai Hoi Raymond	416,769,983 *(Note a)*	8,000,000
Mr Yeung Kam Yan	416,769,983 *(Note a)*	8,000,000
Mr Leung Chi Kin	416,769,983 *(Note a)*	8,000,000
Mr Hoang Tan Van George	416,769,983 *(Note a)*	8,000,000
Mr Chan Hon Chiu	416,769,983 *(Note a)*	8,000,000
Mr To Hang Ming	416,769,983 *(Note a)*	8,000,000
Mr Kong Li Szu	119,229,995 *(Note b)*	—
Prof Yu Chai Mei	—	2,400,000

Notes:

a. The six references to 416,769,983 shares in the Company relate to the same block of shares held by Achieve Century Limited, a company incorporated in the British Virgin Islands. Approximately 53.87% and approximately 46.13% of the issued share capital of Achieve Century Limited are respectively owned by Tipmax Limited and Star Wave Limited, companies incorporated in the British Virgin Islands.

Tipmax Limited is 100% owned by Mr Tsui Tai Hoi Raymond, whereas Star Wave Limited is owned as to approximately 13.51% by each of Messrs Yeung Kam Yan and Leung Chi Kin, approximately 40.55% by Mr Hoang Tan Van George, and approximately 10.81% by each of Messrs To Hang Ming, Chan Hon Chiu and a non-director related person.

b. The corporate interest of Mr Kong Li Szu in the shares of the Company was held by Count Wealth Investments Limited, a company incorporated in the British Virgin Islands and beneficially owned as to 100% by Kong Sun Holdings Limited. Kong Sun Holdings Limited is a company incorporated in Hong Kong and whose shares are listed on the main board of The Stock Exchange of Hong Kong Limited. Approximately 41.35% of the issued share capital of Kong Sun Holdings Limited is beneficially owned by Kong Fa Holding Limited, in which Mr Kong Li Szu has beneficial interests.

c. These Pre-IPO share options were granted on 26 April 2002, at an exercise price per share of HK$0.14, representing 50% of the offer price of HK$0.28 per share in respect of the Company's initial public offering. The Pre-IPO share options may be exercised in three equal portions. The three portions are exercisable at any time commencing on 10 November 2002, 10 May 2003 and 10 May 2004, respectively. These share options, if not otherwise exercised, will lapse on 9 May 2012.

2. Associated corporation-Kong Sun Holdings Limited

As at 30 June 2002, Mr Kong Li Szu had the following interests in Kong Sun Holdings Limited, a company listed on The Stock Exchange of Hong Kong Limited:

Number of ordinary shares and nature of interest	Number of share options and nature of interest
997,058,042 Corporate interest *(Note a)*	22,760,695 Personal interest *(Note b)*

Notes:

a. Mr Kong is deemed to be interested in 997,058,042 shares in Kong Sun Holdings Limited held by Kong Fa Holding Limited, of which Mr Kong Li Szu is a director and shareholder.

b. Mr Kong was granted 22,760,695 share options at a consideration of HK$1 to subscribe for shares in Kong Sun Holdings Limited on 7 July 2001. As at 30 June 2002, these share options remained outstanding and exercisable during the period from 9 January 2002 to 31 May 2006 at an exercise price of HK$0.17984 per share.

As the Company has not issued any debt securities, therefore save as disclosed in sub-sections 1 and 2 above, none of the directors had any interests in the equity and debt securities of the Company or any of its associated corporations as at 30 June 2002 as recorded in the register maintained under Section 29 of the SDI Ordinance or which are required, pursuant to Rules 5.40 to 5.49 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange.

SUBSTANTIAL SHAREHOLDERS

The register of substantial shareholders maintained under section 16(1) of the SDI Ordinance shows that as at 30 June 2002, the Company had been notified of the following substantial shareholders' interests, being 10% or more of the Company's issued share capital.

Name of shareholders	Number of shares held
Achieve Century Limited	416,769,983
Tipmax Limited *(Note a)*	416,769,983
Star Wave Limited *(Note a)*	416,769,983
Count Wealth Investments Limited	119,229,995
Kong Sun Holdings Limited *(Note b)*	119,229,995
Kong Fa Holding Limited *(Note b)*	119,229,995
Mr Kong Look Sen *(Note b)*	119,229,995

Notes:

(a) These companies were deemed to have interests in 416,769,983 shares of the Company by virtue of their equity interests in Achieve Century Limited.

(b) These parties were deemed to have interests in 119,229,995 shares of the Company by virtue of their equity interests in Count Wealth Investments Limited.

Save as disclosed above, no person, other than the directors of the Company, whose interests are set out in the section "DIRECTORS' INTERESTS IN EQUITY SECURITIES" above, had registered an interest in the share capital of the Company that was required to be recorded pursuant to Section 16(1) of the SDI Ordinance as at 30 June 2002.

COMPETING INTERESTS

None of the Directors or management shareholders of the Company (as defined in the GEM Listing Rules) has any interest in a business which competes or may compete with the business of the Group.

SPONSOR'S INTERESTS

As updated and notified by the Company's sponsor, Hantec Capital Limited (the "Sponsor"), as at 30 June 2002, neither the Sponsor nor its directors or employees or associates (as referred to in Note 3 to Rule 6.35 of the GEM Listing Rules) had any interest in the securities of the Company or any member of the Group, or any right to subscribe for or to nominate persons to subscribe for the securities of the Company or any member of the Group.

Pursuant to the sponsorship agreement dated 20 August 2001 between the Company and the Sponsor, the Sponsor has been retained for a fee, as the continuing sponsor of the Company until 31 March 2005.

AUDIT COMMITTEE

The written terms of reference which describe the authority and duties of the Company's audit committee (the "Audit Committee") were prepared and adopted with reference to Rules 5.23 to 5.25 of the GEM Listing Rules.

The primary duties of the Audit Committee are (i) to review the annual reports and accounts, half-year reports and quarterly reports and give advice and comments thereon to the directors; and (ii) to review and supervise the financial reporting process and internal controls. The Audit Committee comprises the two independent non-executive directors of the Company.

The Audit Committee had a meeting, during which the Group's results for the three months ended 30 June 2002 have been reviewed.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S SHARES

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's shares during the three months ended 30 June 2002.