



Kanstar Environmental Technology Holdings Limited
建星環保科技控股有限公司

(Incorporated in the Cayman Islands with limited liability)



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This report, for which the directors of Kanstar Environmental Technology Holdings Limited (the “Company”) collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the GEM of the Stock Exchange (“GEM Listing Rules”) for the purpose of giving information with regard to the Company. The directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief: (i) the information contained in this report is accurate and complete in all material respects and not misleading; (ii) there are no other matters the omission of which would make any statement in this report misleading; and (iii) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

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Executive Directors

CHIM Kim Kiu, Jacky
(Chairman and Managing Director)
IP Kai Cheong
LI Gang
SUN Tak Keung

Independent Non-Executive Directors

LAU Kwok Wing (Chairman)
CHAN Chi Hung, Anthony

Company Secretary

Cheung Ka Fai AHKSA, ACCA

Authorised Representatives

IP Kai Cheong
SUN Tak Keung

Members of the Audit Committee

LAU Kwok Wing (Chairman)
CHAN Chi Hung, Anthony

Registered Office

Century Yard
Cricket Square
Hutchins Drive
P.O. Box 2681 GT
George Town
Grand Cayman
British West Indies

Sponsor

South China Capital Limited
28th Floor, Bank of China Tower
1 Garden Road
Hong Kong

Legal Adviser

As to Hong Kong law:
Chiu & Partners
41st Floor, Jardine House
1 Connaught Place
Hong Kong

As to PRC law:
GFE Law Office
15th Floor, Chengyue Plaza
448 Dongfeng Zhong Road
Guangzhou
PRC

As to Cayman Islands law:
Conyers Dill & Pearman, Cayman
2901 One Exchange Square
8 Connaught Place
Hong Kong

Principal Place of Business in Hong Kong

Room 605, Seaview Commercial Building
21-24 Connaught Road West
Hong Kong

Principal Share Registrar and Transfer Office in Cayman Islands

Bank of Butterfield International (Cayman) Limited
Butterfield House
68 Fort Street
P.O. Box 75
George Town
Grand Cayman
Cayman Islands

Hong Kong Branch Share Registrar and Transfer Office

Standard Registrars Limited
G/F, Bank of East Asia Harbour View Centre
56 Gloucester Road
Wanchai
Hong Kong

Auditors

Deloitte Touche Tohmatsu
Certified Public Accountants
26th Floor, Wing On Centre
111 Connaught Road Central
Hong Kong

Principal Bankers

Liu Chong Hing Bank
24 Des Voeux Road Central
Hong Kong

China Construction Bank
Changning Branch
Xing Yu Jie
Changning County
Baoshan City
Yunnan Province
PRC

Huaxia Bank
Kunming Branch
708 Xi Chang Road
Kunming
Yunnan Province
PRC

Kanstar Environmental Technology Holdings Limited (the "Company", and together with its subsidiaries, the "Group") was successfully listed on the Growth Enterprise Market (GEM) of The Stock Exchange of Hong Kong Limited on 12 July 2002. On behalf of the Board of Directors of the Company, I am pleased to present the audited consolidated results of the Group for the year ended 31 December 2002.

During the year under review, the Group expanded rapidly in the production of both paper filling material and pulp and paper products.

Paper Filling Material

The Group invested RMB1.5 million for the installation of a new production line which increased the annual production capacity from 1,000 tonnes to 5,000 tonnes. The trial production was completed in November 2002 and up to 31 December 2002, all the paper filling material produced was used for the Group's own paper production.

Pulp and Paper Products

With the proceeds from listing, the Group has upgraded its existing pulp production facilities in Changning. The Group's production of pulp and paper as at 31 December 2002 has reached the expectation stated in the business objectives in the prospectus dated 5 July 2002.

To cater for production expansion, the Group also installed additional equipment in 2002. Upon completion of such installation in the first half of 2003, the Group's pulp and paper production capacity is expected to increase from 10,000 tonnes to 20,000 tonnes per year.

To improve market share, lower costs and strengthen competitive edge, the Group has focused on research and production of higher quality paper products. As at 31 December 2002, the pulp and paper products produced by the Group already reached the required standard and are well received by the customers.

In December 2002, the Group has signed an agreement with an independent third party, a customer in Sichuan. From February 2003 onwards, the customer has agreed to purchase 8,000 tonnes copying paper from the Group per year at the prevailing market price.

In order to further promote the Group's products, the Group had established offices in both Baoshan and Kunming.

Although the Group was still in the development stage of production in 2002, the Directors believe that the expansion in business will facilitate the reduction in costs in the future and will improve the quality of our products.

Finally, I, on behalf of the Directors, would like to take this opportunity to express our gratitude to the management and staff for their commitment and dedication to the Group. I would like to extend my sincere appreciation to our shareholders, business partners, customers, and suppliers for their continuous support.

Chim Kim Kiu, Jacky

Chairman

Hong Kong, 26 March 2003

Business Overview

For the year ended 31 December 2002, the Group recorded a turnover of about HK\$14,058,000 representing a 4.8 times increase as compared to that of 2001. The Group's turnover was wholly derived from the sales of paper products. The Group had utilised all the produced paper filling material for internal production.

The directors of the Company do not recommend the payment of a final dividend in respect of the year 2002 (2001: nil).

The loss for the year after interest, taxation and depreciation has decreased by about 7% to HK\$5,091,000. In April 2002, the Group had engaged an international valuer to revalue the Group's machinery and equipment and a revaluation surplus of HK\$31,660,000 arised. With the substantial increase in the carrying value of the machinery and equipment, the depreciation charged had increased by approximately HK\$740,000 in 2002. If this additional depreciation charged were stripped out, loss for the year would become HK\$4,351,000, a 20% decrease compared to that of last year.

There were many factors which lead to the loss for the current financial year. In the second half of 2002, there were accidents in some coal fields in China. The PRC government has suspended the operations of many fields for safety control and has lead to the drop in the supply of coals. The price of coal therefore increased substantially. As coal is the main source of power to the production line, such increase in price greatly increased the Group's production cost. The Directors of the Group believe that after this transitional period, the price of coal will decrease to the original level and thus reduce the production cost.

Before listing of the Group, the Group was mainly financed by the funding from the directors, and the Group reserved woods adequate for two months production. However, due to the seasonal fluctuation in the price of the woods, the Group has to bear a higher purchase cost of woods in the second half of 2002 and leads to the increase in production cost in order to guarantee the supply of woods and the production.

To resolve this problem, the management of the Group had entered into agreements with some local fields for the continuous supply of woods at a pre-determined price. Also, the Group used part of the listing proceeds to reserve more woods. At 31 December 2002, the woods reserve reached a level that was sufficient for production for three months. Such arrangement has guaranteed the continuous production and will stabilise the costs for raw materials for the Group in 2003.

The Group's administrative expenses reduced by around 39% during the year. The administrative expenses for the year mainly made up of management's salaries and the professional fees incurred after listing. In 2001, production of the Group only started in the second half of the year and all the pre-operating expenses were charged as administrative expenses for the year.

Prospects

The Group focuses on the expansion of production scale during the year. With the proceeds from listing, the Group upgrades its existing pulp production facilities in Changning. The Group's production of paper products as at 31 December 2002 has met the target stated in the business objectives stated in the prospectus dated 5 July 2002. In early 2003, the Group plans to reach the production capacity to 10,000 tonnes per year.

In the second half of 2002, the Group spend RMB4,400,000 for the purchase and the installation of the new pulp production facilities. With the installation of the new production line in June 2003, there are totally three separate production lines in the Changning factory. Each production line will be specialised in the production of pulps, writing papers and copying papers respectively. This specialisation improves both the efficiency and stability of the machines and reduces the cost incurred for the change of production.

In order to further reduce the cost of production of pulp and paper products, the Group has spent approximately RMB800,000 to acquire four spherical evaporators. These four evaporators helps to minimise the risk of fluctuation in the prices of woods and to reduce the production costs as with the installation of these evaporators, the Group can use bagasse as another substitution of woods. The installation work will properly be completed in the first quarter of 2003. After that, the Group can use a mixture of woods, bamboos, bagasse and paper filling material for the production of paper products.

The rapid increase in the production capacity surely needs the promotion of the products to the market. In the fourth quarter of 2002, the Group has successfully signed a sales agreement with an independent third party, a customer in Sichuan, who agrees to purchase 8,000 tonnes copying paper from the Group per year at the prevailing market price.

For those pulps manufactured from the new production line, the Group is negotiating with some customers. Up to the date of this report, the negotiation was still in progress.

For the manufacturing of paper filling material, the Group invested RMB1,500,000 in 2002 for the installation of a production line which increased the annual production capacity from 1,000 tonnes to 5,000 tonnes. Up to 31 December 2002, the manufactured paper filling material is used as a substitution for wood for internal production of paper products.

In 2003, the Group will investigate the market demand for the paper filling material and invest around RMB4,000,000 in a new production line accordingly. On the completion of this line, the production capacity will increase from 5,000 tonnes to 15,000 tonnes per year. Promotion for paper filling material will probably be one of the main task in the second half of 2003.

As a first step in promoting the Group's products, the Group set up offices in both Kunming and Baoshan in December 2002. Both offices will first focus on the promotion of paper products and in the second half of 2003, will focus on paper filling material.

With the continuous expansion, improvement of the products and the penetration in the market, the management has confidence in the future prospects of the Group and the financial results in 2003 will probably be improved.

Liquidity and Financial Resources

As at 31 December 2002, the Group had a healthy financial position with net assets amounted to approximately HK64,114,000. Net current assets increased to approximately HK\$17,863,000 with current ratio of approximately 2.9 (2001: 0.45). The gearing ratio of the Group, based on the total borrowings to shareholders' equity, was 4.8% (31 December 2001: total borrowings were 3.8 times over the net liabilities). The change in current ratio and gearing is mainly attributable to the capitalisation of shareholder's loan and amount due to a related company during the period.

During the period under review, the funding of operations was mainly derived from the internal resources of the Group. After the Group's listing on GEM on 12 July 2002, the Group utilised the net proceeds of approximately HK\$25,300,000 as detailed in the section headed "Use of Proceeds" in the Prospectus. The Group will continued to adopt its treasury policy of placing the cash and cash equivalents in interest bearing deposits.

As at 31 December 2002, the Group had no contingent liabilities (2001: nil), did not have any charges on its assets (2001: nil), and did not have any committed banking facilities (2001: nil).

As most of the Group's monetary assets and liabilities are denominated in Renminbi, the exchange rate risks of the Group is considered to be minimal.

The Group did not have any material acquisition or disposal of subsidiary and of affiliated company during the year 2002 and 2001. Other than those disclosed in the Prospectus under the section headed "Business Objectives and Strategies", the Group did not have any plan for material investments and acquisition of material capital assets as at 31 December 2002.

Employee Information

The Group had a total staff of approximately 330 employees (2001: approximately 200). Remuneration packages are maintained at a competitive level and reviewed on a periodical basis. Bonus are awarded to employees according to the assessment of individual performance. Besides, a share option scheme was adopted by the Company, pursuant to which the Directors may offer to any eligible employees (including executive directors and independent non-executive directors) of the Company and any of its subsidiaries options to subscribe for shares in the Company in accordance with the terms of the share option scheme. However, save for the share option granted prior to the listing, no other options have been granted up to 31 December 2002. Staff cost was approximately HK\$2,559,000 for the year (2001: HK\$1,536,000). The increase in salary resulted from the increase in employees involved in production, sales and marketing of pulp and paper products during the year.

Comparison of Business Objectives with Actual Business Progress

For the year ended 31 December 2002

The comparison of the Group's business objectives as set out in the Prospectus dated 5 July 2002 to actual business progress for the year ended 31 December 2002 is as follows:

Business objectives as stated in the prospectus dated 5 July 2002

Actual business progress in respect of the year ended 31 December 2002

Paper filling material

- | | |
|---|--|
| <ol style="list-style-type: none">1. Acquire and install new production line in Changning for the expansion of production of paper filling material from 1,000 tonnes to 5,000 tonnes per year.2. Commence trial production run using new production line.3. Recruit an additional 3 staff in the sales and marketing team to promote the Group's paper products and paper filling material.4. Set up offices in Chengdu, Kunming and Baoshan and hiring of sales staff. | <p>Uses RMB1,500,000 to acquire and install a new production line with production capacity of 5,000 tonnes per year.</p> <p>Trial production for the new paper filling material completed in November 2002.</p> <p>Additional 9 staffs have been employed to promote the Group's paper products and paper filling material.</p> <p>Has spend about RMB40,000 to set up offices in both Kunming and Baoshan to promote its paper products. As the Group has already entered into a sales agreement with a customer in Sichuan and the customer agreed to purchase 8,000 tonnes copying paper per year, there is no need to set up an office in Chengdu, Sichuan Province in the near future in order to save the administrative expenses.</p> |
|---|--|

Wood pulp and paper

- | | |
|--|--|
| <ol style="list-style-type: none">1. Commence expansion works in relation to water and power supply and waste water treatment in preparation for the installation of new wood pulp and paper manufacturing facilities, enabling the Group to double its production capacity to 20,000 tonnes per year at Changning factory.2. Acquisition of production equipment for the new pulp and paper production line, expected to cost RMB10,500,000.3. Negotiate and complete the acquisition of the land use right of the Changning paper factory, expected to cost RMB2,000,000.4. Focus on research and production of higher quality writing paper with the aim to increase competitiveness and profit margins.5. Recruit an additional 4 staff in the sales and marketing team to promote the Group's paper products and paper filling material.6. Explore the possibility of commencing retail sales of the Group's paper products in Chengdu, Kunming and Baoshan. | <p>Has spend about RMB1,350,000 for the installation works of the new wood pulp and paper manufacturing facilities and trial production will probably be started in the first half of 2003.</p> <p>Has spend about RMB3,100,000 to purchase production equipment for the new pulp and paper production line and trial production will probably be started in the first half of 2003.</p> <p>As the Group is trying to bargain with the Government for more favourable terms, the acquisition for the land use right of the Changning paper factory is still under negotiation, and the negotiation will probably be completed by the middle of 2003.</p> <p>Successfully produces higher quality writing papers which increases the selling price by more than 10% in December 2002 when compared to that of last year's.</p> <p>Additional 9 staffs have been employed to promote the Group's paper products and paper filling material.</p> <p>Has spend about RMB40,000 to set up offices in both Kunming and Baoshan to promote its paper products. As the Group has already entered into a sales agreement with a customer in Sichuan and the customer agreed to purchase 8,000 tonnes copying paper per year, there is no need to set up an office in Chengdu, Sichuan Province in the near future in order to save the administrative expenses.</p> |
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Comparison of Business Objectives with Actual Business Progress

For the year ended 31 December 2002

Use of Proceeds from the Initial Public Offering

From the date of listing on 12 July 2002, the Group invested approximately HK\$15,200,000 in the following areas:

	Notes	From 12 July 2002 (Date of Listing) to 31 December 2002	
		Proposed HK\$ million	Actual HK\$ million
Establishment of an additional pulp and paper production line	1	9.9	4.9
Establishment of a new paper filling material production line	2	1.9	1.4
Purchase of the land use right of the site in Changning	3	1.9	—
Repayment of Changning county Government loan		3.8	3.8
Set up sales offices in Baoshan, Chengdu and Kunming	4	0.19	0.04
Working capital	5	2.01	5.06
	6	<u>19.7</u>	<u>15.2</u>

Notes:

1. Around HK\$3,800,000 installation cost of the new purchased production line has not been paid, as the installation work was still in progress. Among which around HK\$2,273,000 has been stated in the financial statement under the heading "Capital Commitment".
2. The Group reduced the costs for acquisition and installation of the new production line by approximately 20% during the year due to better control of cost.
3. As the Group is trying to bargain with the Government for more favourable terms, the acquisition for the land use right of the Changning paper factory is still under negotiation and the negotiation will probably be completed by the middle of 2003.
4. As the Group has already entered into a sales agreement with a customer in Sichuan and the customer agreed to purchase 8,000 tonnes copying paper per year, there is no need to set up an office in Chengdu, Sichuan Province in the near future in order to save the administrative expenses.
5. The amount spent as working capital during the year was about HK\$5,060,000, which is HK\$3,050,000 more than the amount stated in the prospectus. The reason for such increase was due to the operating loss. (which has already explained in the Management Discussion and Analysis stated in page 4 - 6 of this annual report) For the future use of proceeds, more than 80% will still be financed by the proceeds received listing and the remaining of about 20% will be financed by the Group's internal generated resources.
6. For the unused proceeds, the Group has deposited it in a registered bank.

Executive Directors

Mr. Chim Kim Kiu, Jacky, (詹劍嶠), aged 30, is the founder, Chairman and the managing director of the Company. He was one of the founders of Leewood, the Group's proprietary paper filling material, Mr. Chim is responsible for the Group's strategic development and day-to-day management. Prior to the establishment of the Group's businesses in Yunnan Province, he was a director of Kunming Vintin Property Development Limited, a company primarily engaged in property development and investment in the PRC. He was educated in Canada.

Mr. Ip Kai Cheong, (葉啟昌), aged 43, is responsible for the Group's general management and financial control. Prior to joining the Group in May 1999, Mr. Ip held managerial positions with Chintex Oil and Gas Company Limited, a listed company in Hong Kong, now renamed Grandfield Group Holdings Limited, and with Rightearth Development Limited, which is engaged in property development, and has experience in corporate management and business development. Mr. Ip studied bachelor of business administration course under the Open University of Hong Kong.

Mr. Li Gang, (李剛), aged 49, is responsible for the Group's management and manufacturing operation as well as sales and marketing activities. He is also the general manager of Changning Kanstar. Prior to joining the Group in October 2000, he was the general manager of Deyang Chemical and Construction Material Factory in Sichuan Province, PRC and worked for the PRC Government as an officer representing Deyang City of Sichuan Province in Kunming, Yunnan Province. He has an industrial economics degree from the Sichuan Financial University, PRC.

Mr. Sun Tak Keung, (辛德強), aged 39, is responsible for the Group's paper filling material and paper products marketing activities. Prior to joining the Group in March 2002, he was a manager in Trigold & Co. and had over ten years of marketing and trading experiences in the garment industry and in daily consumable goods in Hong Kong and overseas.

Independent non-executive Directors

Mr. Lau Kwok Wing, Chris, (劉國榮), aged 38, is a director of Brilliant United Limited, a Hong Kong based company engaged in garment trading. Prior to setting his company in 2001, he was employed as a project engineer of the Hong Kong Productivity Council and had over 10 years of trading and manufacturing experiences in the textile and garment sector as well as in logistics and transportation. He has a bachelor degree in business administration from the Open University of Hong Kong. He was appointed as a Director in June 2002.

Mr. Chan Chi Hung, Anthony, (陳志雄), aged 36, is a currently serving as a dealer representative for Berich Brokerage Limited, a securities broking firm in Hong Kong. He was appointed as a Director in June 2002. Prior to joining Berich Brokerage Limited in early 2001, he was a partner of Sun Yeung Food (Direct Marketing) Company and engaged in foodstuff trading for 2½ years. He was also a manager of Trigold & Co. and was engaged in the sales and marketing of garment products for the overseas market for 3 years to December 1997.

Senior Management

Professor Liu Sin Chai, (劉新才), aged 69, is chief engineer of Kunming Ksnstar responsible for the research and development of paper filling material. Prior to joining the Group in May 1999, Mr. Liu was involved in the research of industrial application of limestone in Sichuan De Yang Nan Di Limited (四川德陽南迪有限公司) as a senior engineer from September 1996 to April 1999. Professor Liu was one of the founders of Leewood, the Group's proprietary paper filling material, who founded a research and development team of the Group with Mr. Chim and other members in 1999. Prior to that, he taught at the Chengdu Geology Institute in Sichuan Province for 30 years and was involved in geological survey as well as economic assessment relating to exploration and mining of minerals. He graduated from the Chengdu Geology Institute in Sichuan Province and the Sichuan University with a Chemistry degree.

Mr. Luo Hung Lim, (駱洪林), aged 46, is assistant general manager of Changning Kanstar responsible for the Group's pulp and paper manufacturing operations as well as sales and marketing activities. Prior to joining the Group in February 2002, he was a production manager of Sichuan Dujiang Paper Factory (四川都江造紙廠) a pulp and paper factory, in Sichuan province and had over 20 years of experience in the production of pulp and paper as well as new paper products development. He graduated from the Sichuan Industrial College in pulp and paper manufacturing.

Mr. Li Gui Sheng (李貴生), aged 50, is manager responsible for pulp and paper production. Prior to joining the Group in January 2001, he was manager at Ching Cheng Paper Factory in Sichuan province. He studied Pulp and paper manufacturing at the Sichuan Light Industry Institute in Sichuan province, PRC.

Madam Li Ling (李玲), aged 51, is the head of finance department at Changning Kanstar and Kunming Kanstar. Prior to joining the Group in October 2000, she was a division head at Deyang Audit Bureau in Sichuan province. She graduated from Southwest Financial University with an accountancy degree. She is a registered accountant in the PRC.

Mr. Cheung Ka Fai, (張家輝), aged 28, is the qualified accountant and company secretary of the Group. Prior to joining the Group in September 2002, he served as an auditor with Deloitte Touche Tohmatsu for 5 years. He has a bachelor of arts degree in accountancy from the Hong Kong Polytechnic University and is both an associate member of the Association of Chartered Certified Accountants and the Hong Kong Society of Accountants.

The directors have pleasure in presenting their first report and the audited financial statements of the Company for the period from 6 March 2002, (date of incorporation) to 31 December 2002.

Group Reorganisation and Listing of the Company's Shares on the Growth Enterprise Market ("GEM") of the Stock Exchange of Hong Kong Limited (the "Stock Exchange")

The Company was incorporated on 6 March 2002 with limited liability in Cayman Islands.

On 26 June 2002, the Company and its subsidiaries (hereinafter collectively referred to as the "Group") underwent a group reorganisation (the "Group Reorganisation") to rationalise the group structure in preparation for the listing of the Company's shares on the GEM of the Stock Exchange.

Details of the Group Reorganisation are set out in the paragraph headed "Group Reorganisation" in Appendix IV of the prospectus dated 5 July 2002 issued by the Company.

The shares of the Company were listed on the GEM of the Stock Exchange with effect from 12 July 2002.

Principal Activities

The Company is an investment holding company. The principal activities of its subsidiaries are set out in note 27 to the financial statements.

Major Customers and Suppliers

For the year ended 31 December 2002, the top five suppliers of the Group together accounted for approximately 30.18% of the Group's total purchases of materials, and the largest supplier accounted for approximately 17.01% of the Group's total purchases of materials.

The Group's five largest customers together accounted for approximately 52.14% of the total sales of the Group, and the largest customer accounted for approximately 21.26% of the Group's total sales for the year ended 31 December 2002.

None of the directors, their respective associates or any shareholders of the Company (which to the knowledge of the directors owns more than 5% of the issued share capital of the Company) had any interests in the Group's five largest suppliers or customers.

Results

The results of the Group for the year ended 31 December 2002 are set out in the consolidated income statement on page 19.

The loss for the year after taxation, amounting to HK\$5,091,212 has been added to the accumulated losses brought forward of HK\$7,208,591, resulting in accumulated losses carried forward of HK\$12,299,803.

The directors do not recommend the payment of a dividend.

Financial Summary

A summary of the results of the Group for the past three financial years ended 31 December 2002 is set out on page 41 of the annual report.

Property, Plant and Equipment

Certain of the Group's machinery and equipment were revalued on 30 April 2002. The revaluation resulted in a surplus over book values amounting to HK\$31,660,286, which has been credited directly to the revaluation reserve.

During the year, the Group acquired additional property, plant and equipment at a cost of approximately HK\$7,044,000 for business expansion.

Details of these and other movements in the property, plant and equipment of the Group are set out in note 12 to the financial statements.

Subsidiaries

Particulars of the Company's subsidiaries are set out in note 27 to the financial statements.

Share Capital

Details of the share capital of the Company are set out in note 21 to the financial statements.

Directors

The directors of the Company during the period and up to the date of this report are:

Executive directors:

Mr. Chim Kim Kiu, Jacky (<i>Chairman</i>)	(appointed on 14 March 2002)
Mr. Ip Kai Cheong	(appointed on 14 March 2002)
Mr. Li Gang	(appointed on 14 March 2002)
Mr. Sun Tak Keung	(appointed on 14 March 2002)

Independent non-executive directors:

Mr. Lau Kwok Wing, Chris	(appointed on 18 June 2002)
Mr. Chan Chi Hung, Anthony	(appointed on 18 June 2002)

In accordance with Clause 108 of the Company's Articles of Association, Mr. Ip Kai Cheong and Mr. Sun Tak Keung retires and, being eligible, offers themselves for re-election at the forthcoming annual general meeting of the Company. All other remaining directors continue in office.

Directors' Service Contracts

Each of the executive directors has entered into a service contract with the Company for an initial term of three years commencing from 1 June 2002.

The independent non-executive directors have been appointed for a term of two years expiring on 17 June 2004.

None of the directors being proposed for re-election at the forthcoming annual general meeting has a service contract with the Company or any of its subsidiaries which is not determinable by the Group within one year without payment of compensation, other than statutory compensation.

Directors' Interests in Shares

At 31 December 2002, the interests of the directors and their associates in the share capital of the Company as recorded in the register maintained by the Company pursuant to Section 29 of Hong Kong Securities (Disclosure of interests) Ordinance (the "SDI Ordinance") were as follows:

Director	Corporate interests	Personal interests	Family interests	Other interests	Total interests
Mr. Chim Kim Kiu, Jacky	600,000,000 (Note)	—	—	—	600,000,000

Note: These shares are beneficially owned by and registered in the name of Siko Venture Limited ("Siko Venture"). Mr. Chim Kim Kiu, Jacky beneficially owns the entire issued share capital of Siko Venture.

Apart from the above, none of the directors or their associates had any personal, family, corporate or other interests in the equity of the Company or any of its associated corporations as at 31 December 2002.

Share Options

Particulars of the Company's share option schemes are set out in note 22 to the financial statements.

Details of share options granted to certain directors and employees to subscribe for shares in the Company prior to the listing of the Company's shares on GEM of the Stock Exchange are as follows:

Name of grantees	Date of grant	Exercisable period (both dates inclusive)	Exercise price HK\$	Number of options granted during the period and balance at
				31 December 2002
Mr. Li Gang	26.6.2002	5 years commencing from and including the date falling 12 months from the Listing Date	0.01	3,800,000
Mr. Ip Kai Cheong	26.6.2002	(i) options to subscribe up to 13,000,000 Shares exercisable within a period of 5 years commencing from the Listing Date (note 1) (ii) options to subscribe up to 8,670,000 Shares exercisable within a period of 5 years commencing from and including the date following 6 months from the Listing Date	0.01	21,670,000
Mr. Sun Tak Keung	26.6.2002	(i) options to subscribe up to 9,000,000 Shares exercisable within a period of 5 years commencing from the Listing Date (note 1) (ii) options to subscribe up to 6,000,000 Shares exercisable within a period of 5 years commencing from and including the date following 6 months from the Listing Date	0.01	15,000,000
Other employees	26.6.2002	5 years commencing from and including the date falling 12 months from the Listing Date	0.01	9,750,000
				50,220,000

Notes:

Each of Mr. Ip Kai Cheong and Mr. Sun Tak Keung have undertaken to the Stock Exchange that, upon the exercise of the options at any time within a period of 12 months after the Listing Date:

- (i) he will place such Shares in escrow with an escrow agent acceptable to the Stock Exchange on such terms as are acceptable to the Stock Exchange for a moratorium period as may be applicable to him in accordance with Rule 13.16 of the GEM Listing Rules;
- (ii) for the period specified in Rule 13.16 of the GEM Listing Rules, he will not (save as provided under the GEM Listing Rules) dispose of (or enter into any agreement to dispose of) or permit the registered holder to dispose of (or to enter into any agreement to dispose of) any of his direct or indirect interest in such Shares; and
- (iii) in the event that he pledges or charges any direct or indirect interest in such Shares under Rule 13.18(1) of the GEM Listing Rules or pursuant to any right or waiver granted by the Stock Exchange pursuant to Rule 13.18(4) of the GEM Listing Rules, at any time during the periods as specified in Rule 13.16 of the GEM Listing Rules, he must inform the Company immediately thereafter and disclose the details of such pledge or charge, including the number and class of securities being pledged or charged and any other relevant details as specified in Rule 17.43(1) to (4) of the GEM Listing Rules; and he must inform the Company immediately in the event that he has pledged or charged any interest in such Shares and he receives indications, either verbal or written, from any pledgee or chargee that any such Shares pledged or charged by him will be disposed of. Upon the Company being informed of any matter as aforesaid, the Company must forthwith notify the Stock Exchange and publish an announcement giving details of the same in accordance with Rule 17.43 of the GEM Listing Rules.

The Company has also undertaken to the Stock Exchange to maintain the minimum prescribed percentage of the Shares in the hands of the public in compliance with Rule 11.23 of the GEM Listing Rules in the event that any options granted to Mr. Ip Kai Cheong and Mr. Sun Tak Keung are exercised.

No share option was cancelled, lapsed or exercised by the directors and employees during the period.

As at 31 December 2002, the number of shares in respect of which options had been granted under the Company's share option schemes, represents 6.28% of the shares of the Company in issue at that date.

No fair value of the options granted is disclosed as in the opinion of the directors, certain assumptions need to derive the fair values using the Black-Scholes option pricing model cannot be reasonably determined for such pre-listing share options.

Arrangements to Acquire Shares or Debentures

Other than the share option schemes disclosed above, at no time during the year was the Company or any of its subsidiaries a party to any arrangement to enable the directors of the Company to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate, and none of the directors, or their spouses or children under the age of 18, had any right to subscribe for the securities of the Company, or had exercised any such right during the year.

Substantial Shareholders

As at 31 December 2002, the register of substantial shareholders maintained by the Company pursuant to Section 16(1) of the SDI Ordinance shows that the following shareholders had interests representing 10% or more of the issued share capital of the Company:

Name	Number of shares	Approximate percentage of issued shares held
Mr. Chim Kim Kiu, Jacky	600,000,000 (Note)	75
Siko Venture	600,000,000 (Note)	75

Note: The entire issued share capital of Siko Venture is beneficially owned by Mr. Chim Kim Kiu, Jacky.

Other than as disclosed above, the Company has not been notified of any other interests representing 10% or more of the Company's issued share capital as at 31 December 2002.

Directors' Interests in Contracts

There was no transaction during the period from 12 July 2002 to 31 December 2002 which need to be disclosed as a connected transaction in accordance with the requirements of the Rules Governing the Listing of Securities on the GEM of the Stock Exchange (the "GEM Listing Rules"); and

No contract of significance, to which the Company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Convertible Securities, Options, Warrants or Similar Rights

Other than the share options as set out in note 22 to the financial statements, the Company had no other outstanding convertible securities, options, warrants or other similar rights as at 31 December 2002.

Pre-emptive Rights

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

Sponsors' Interest

At 31 December 2002, none of the Company's sponsor, South China Capital Limited ("SCCL"), its directors, employees or associates 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 agreement dated 4 July 2002 entered into between the Company and SCCL, SCCL has received and will receive a fee for acting as the Company's retained sponsor for the period from 12 July 2002 to 31 December 2004.

Audit Committee

During the Period, the Audit Committee comprised the two independent non-executive directors of the Company, namely, Messrs. Lau Kwok Wing, Chris and Chan Chi Hung, Anthony.

Up to the date of approval of these financial statements, the Audit Committee has held three meetings and have reviewed and commented on the Company's draft quarterly, half year and annual financial reports.

Corporate Governance

The Company has complied throughout the period from 12 July 2002 to 31 December 2002 with the board practices and procedures as set out in Rules 5.28 to 5.39 of the GEM Listing Rules.

Competing Interest

During the year, none of the directors on the management shareholders of the Company (as defined in the GEM Listing Rules) had any interest in a business which competes or may compete with the business of the Group.

Purchase, Sale or Redemption of Listed Securities

During the period from 12 July 2002 to 31 December 2002, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

Auditors

Messrs. Deloitte Touche Tohmatsu have acted as auditors of the Company since its incorporation.

A resolution will be submitted to the forthcoming annual general meeting of the Company to re-appoint them.

On behalf of the Board

Chim Kim Kiu, Jacky

Chairman

Hong Kong, 26 March 2003

德勤 · 關黃陳方會計師行

Certified Public Accountants
26/F, Wing On Centre
111 Connaught Road Central
Hong Kong

執業會計師
香港中環干諾道中111號
永安中心26樓

**Deloitte
Touche
Tohmatsu**

TO THE SHAREHOLDERS OF **KANSTAR ENVIRONMENTAL TECHNOLOGY HOLDINGS LIMITED**

建星環保科技控股有限公司

(Incorporated in the Cayman Islands with limited liability)

We have audited the financial statements on pages 19 to 40 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective Responsibilities of Directors and Auditors

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

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

Basis of Opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2002 and of the loss and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Deloitte Touche Tohmatsu

Hong Kong, 26 March 2003

Consolidated Income Statement

For the year ended 31 December 2002

	Notes	2002 HK\$	2001 HK\$ (Note 1)
Turnover	4	14,058,190	2,909,965
Cost of sales		<u>(16,872,043)</u>	<u>(4,902,490)</u>
Gross loss		(2,813,853)	(1,992,525)
Other operating income	6	160,014	55,631
Selling and distribution expenses		(363,159)	(102,643)
Administrative expenses		<u>(2,074,214)</u>	<u>(3,405,004)</u>
Loss from operations	7	(5,091,212)	(5,444,541)
Interest expense		<u>—</u>	<u>(18,462)</u>
Loss before taxation		(5,091,212)	(5,463,003)
Taxation	9	<u>—</u>	<u>—</u>
Loss for the year		<u><u>(5,091,212)</u></u>	<u><u>(5,463,003)</u></u>
Dividend	10	<u><u>—</u></u>	<u><u>—</u></u>
Loss per share			
— basic	11	<u>0.71 cent</u>	<u>0.85 cent</u>
— diluted		<u><u>N/A</u></u>	<u><u>N/A</u></u>

Consolidated Balance Sheet

At 31 December 2002

	Notes	2002 HK\$	2001 HK\$ (Note 1)
Non-current assets			
Property, plant and equipment	12	<u>46,250,953</u>	<u>8,671,589</u>
Current assets			
Inventories	14	11,730,540	6,801,474
Trade and other receivables	15	5,544,970	3,176,795
Bank balances and cash	16	<u>9,908,345</u>	<u>2,393,599</u>
		<u>27,183,855</u>	<u>12,371,868</u>
Current liabilities			
Trade and other payables	17	6,230,880	3,594,720
Amounts due to directors	18	3,086,792	18,467,247
Amount due to a related company	18	—	1,415,094
Amount due to ultimate holding company	19	3,550	—
Government loan	20	<u>—</u>	<u>3,773,585</u>
		<u>9,321,222</u>	<u>27,250,646</u>
Net current assets (liabilities)		<u>17,862,633</u>	<u>(14,878,778)</u>
		<u>64,113,586</u>	<u>(6,207,189)</u>
Capital and reserves			
Share capital	21	8,000,000	1,000,000
Reserves		<u>56,113,586</u>	<u>(7,207,189)</u>
		<u>64,113,586</u>	<u>(6,207,189)</u>

The financial statements on pages 19 to 40 were approved and authorised for issue by the Board of Directors on 26 March 2003 and are signed on its behalf by:

Sun Tak Keung
Director

Ip Kai Cheong
Director

Balance Sheet

At 31 December 2002

	Notes	2002 HK\$
Non-current asset		
Interests in subsidiaries	13	<u>60,601,317</u>
Current assets		
Other receivables		189,552
Bank balances and cash		<u>7,295,260</u>
		<u>7,484,812</u>
Current liabilities		
Other payable		240,000
Amount due to ultimate holding company	19	<u>3,550</u>
		<u>243,550</u>
Net current assets		<u>7,241,262</u>
		<u>67,842,579</u>
Capital and reserves		
Share capital	21	8,000,000
Reserves	23	<u>59,842,579</u>
		<u>67,842,579</u>

Sun Tak Keung
Director

Ip Kai Cheong
Director

Consolidated Statement of Changes in Equity

For the year ended 31 December 2002

	Share capital HK\$	Share premium HK\$	Special reserve HK\$	Revaluation reserve HK\$	Exchange reserve HK\$	Accumulated losses HK\$	Total HK\$
At 1 January 2001	10,000	—	—	—	1,274	(1,745,588)	(1,734,314)
Exchange differences on translation of overseas operations not recognised in the income statement	—	—	—	—	128	—	128
Shares issued by Kanstar Hong Kong Limited	990,000	—	—	—	—	—	990,000
Loss for the year	—	—	—	—	—	(5,463,003)	(5,463,003)
At 1 January 2002 (Note 21)	<u>1,000,000</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,402</u>	<u>(7,208,591)</u>	<u>(6,207,189)</u>
Surplus on revaluation of machinery and equipment	—	—	—	31,660,286	—	—	31,660,286
Exchange differences on translation of overseas operations	—	—	—	—	(3,498)	—	(3,498)
Net gains (losses) not recognised in the income statement	<u>—</u>	<u>—</u>	<u>—</u>	<u>31,660,286</u>	<u>(3,498)</u>	<u>—</u>	<u>31,656,788</u>
Special reserve arising on group reorganisation	(985,000)	—	985,000	—	—	—	—
Shares issued at premium on placing	1,600,000	30,400,000	—	—	—	—	32,000,000
Share issue expenses	—	(6,584,689)	—	—	—	—	(6,584,689)
Capitalisation of advances from a director	5,000	18,334,888	—	—	—	—	18,339,888
Issue of shares arising from capitalisation of share premium	6,380,000	(6,380,000)	—	—	—	—	—
Loss for the year	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(5,091,212)</u>	<u>(5,091,212)</u>
At 31 December 2002	<u><u>8,000,000</u></u>	<u><u>35,770,199</u></u>	<u><u>985,000</u></u>	<u><u>31,660,286</u></u>	<u><u>(2,096)</u></u>	<u><u>(12,299,803)</u></u>	<u><u>64,113,586</u></u>

Special reserve represents the difference between the paid up capital of the previous holding company of the Group acquired and the nominal value of the Company's shares issued for the acquisition at the time of the Group Reorganisation as set out in note 1.

Consolidated Cash Flow Statement

For the year ended 31 December 2002

	2002 HK\$	2001 HK\$ (Note 1)
OPERATING ACTIVITIES		
Loss from operations	(5,091,212)	(5,444,541)
Interest income	(52,440)	(52,623)
Depreciation	<u>1,124,467</u>	<u>361,288</u>
Operating cash flows before movements in working capital	(4,019,185)	(5,135,876)
Increase in inventories	(4,929,066)	(4,369,805)
Increase in trade and other receivables	(2,368,175)	(1,907,892)
Increase in trade and other payables	<u>2,632,662</u>	<u>2,534,981</u>
Cash used in operations	(8,683,764)	(8,878,592)
Interest paid	<u>—</u>	<u>(18,462)</u>
NET CASH USED IN OPERATING ACTIVITIES	<u>(8,683,764)</u>	<u>(8,897,054)</u>
INVESTING ACTIVITIES		
Interest received from bank deposits	52,440	52,623
Purchase of property, plant and equipment	<u>(7,043,545)</u>	<u>(1,390,853)</u>
NET CASH USED IN INVESTING ACTIVITIES	<u>(6,991,105)</u>	<u>(1,338,230)</u>
FINANCING ACTIVITIES		
Proceeds from issue of shares	32,000,000	990,000
Shares issue expenses	(6,584,689)	—
New loans raised	—	9,576,661
Repayment of loans	(3,773,585)	(7,547,170)
Advance from director	3,086,792	—
Repayment of amount due to a director	(1,542,453)	—
Advance from ultimate holding company	<u>3,550</u>	<u>—</u>
NET CASH FROM FINANCING ACTIVITIES	<u>23,189,615</u>	<u>3,019,491</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	7,514,746	(7,215,793)
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR	<u>2,393,599</u>	<u>9,609,392</u>
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	<u><u>9,908,345</u></u>	<u><u>2,393,599</u></u>
ANALYSIS OF THE BALANCES OF CASH AND CASH EQUIVALENTS		
Bank balances and cash	<u><u>9,908,345</u></u>	<u><u>2,393,599</u></u>

Notes to the Financial Statements

For the year ended 31 December 2002

1. Group Restructuring and Basis of Presentation of Financial Statements

The Company was incorporated in the Cayman Islands on 6 March 2002 as an exempted company under the Companies Law and its shares have been listed on the Growth Enterprise Market (“GEM”) of The Stock Exchange of Hong Kong Limited since 12 July 2002. Its ultimate holding company is Siko Venture Limited (“Siko Venture”), a limited company incorporate in the British Virgin Islands.

The Company is an investment holding company. Details of the principal activities of the subsidiaries are set out in note 27.

Under a group reorganisation scheme to rationalise the structure of the Group in preparation for the listing of the Company’s shares on GEM (the “Group Reorganisation”), the Company became the holding company of the other companies comprising the Group on 26 June 2002. Details of the reorganisation are set out in the prospectus dated 5 July 2002 issued by the Company.

The principal steps of the reorganisation, which involved the exchange of shares, were as follows:

- (a) the shares of Kanstar Environmental Technology Group Limited (“KETG”) were issued and allotted to the then shareholders of Kanstar Hong Kong Limited (“KHK”), the previous holding company of the Group, in exchange for the shares in KHK; and
- (b) the shares of the Company were then issued and allotted to the then shareholders of KETG in exchange for the shares in KETG.

The Group resulting from the Group Reorganisation is regarded as a continuing entity. Accordingly, the financial statements of the Group have been prepared using the principles of merger accounting in accordance with Statement of Standard Accounting Practice (“SSAP”) 27 “Accounting for Group Reconstructions” issued by the Hong Kong Society of Accountants.

2. Adoption of Statements of Standard Accounting Practice

In the current year, the Group has adopted for the first time a number of new and revised SSAPs issued by the Hong Kong Society of Accountants. Adoption of these SSAPs has led to a number of changes in the Group’s accounting policies. The revised accounting policies are set out in note 3. In addition, the adoption of these SSAPs has resulted in a change in the format of presentation of the cash flow statement and the statement of changes in equity. Comparative amounts for the prior year have been restated in order to achieve a consistent presentation.

Foreign currencies

The revisions to SSAP 11 “Foreign Currency Translation” have eliminated the choice of translating the income statements of overseas subsidiaries at the closing rate for the period, the policy previously followed by the Group. They are now required to be translated at an average rate. This change in accounting policy has not had any significant effect on the results for the current or prior accounting periods.

Cash flow statements

Under SSAP 15 (Revised), “Cash Flow Statements”, cash flows are classified under three headings – operating, investing and financing, rather than the previous five headings. Interests received and paid, which were previously presented under a separate heading, are classified as investing and operating cash flows respectively. Cash flows of overseas subsidiaries have been re-translated at the rates prevailing at the dates of the cash flows rather than the rate of exchange ruling on the balance sheet date.

Notes to the Financial Statements

For the year ended 31 December 2002

2. Adoption of Statements of Standard Accounting Practice *(Continued)* **Employee benefits**

SSAP 34 "Employee Benefits" introduces measurement rules for employee benefits, including retirement benefit plans. Because the Group participates only in defined contribution retirement benefit schemes, the adoption of SSAP 34 has not had any significant impact on the financial statements.

3. Significant Accounting Policies

The financial statements have been prepared under the historical cost convention, as modified for the revaluation of machinery and equipment under property, plant and equipment.

The financial statements have been prepared in accordance with accounting principles generally accepted in Hong Kong. The principal accounting policies adopted are as follows:

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31 December each year.

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

Investments in subsidiaries

Investments in subsidiaries are included in the Company's balance sheet at cost less any identified impairment loss.

Revenue recognition

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

Interest income from bank deposits is accrued on a time basis by reference to the principal outstanding and at the interest rate applicable.

Property, plant and equipment

Property, plant and equipment other than machinery and equipment are stated at cost less depreciation and accumulated impairment losses.

Machinery and equipment are stated in the balance sheet at their revalued amounts, being the fair value at the date of revaluation less any subsequent accumulated depreciation and any subsequent impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date.

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

Notes to the Financial Statements

For the year ended 31 December 2002

3. Significant Accounting Policies *(Continued)*

Property, plant and equipment *(Continued)*

Depreciation is provided to write off the cost or valuation of property, plant and equipment, over their estimated useful lives, and after taking into account their estimated residual value, using the straight-line method, at the following rates per annum:

Buildings	Over the shorter of the operation period of the relevant company, or 30 years
Machinery and equipment	3 $\frac{1}{3}$ %
Furniture and fixtures	20%
Motor vehicles	20%

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in the income statement.

Research and development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from development expenditure is recognised only if it is anticipated that the development costs incurred on a clearly-defined project will be recovered through future commercial activity. The resultant asset is amortised on a straight-line basis over its useful life.

Where no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

Impairment

At each balance sheet date, the Group reviews the carrying amounts of its tangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the assets is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

If the recoverable amount of an asset or cash-generating unit is estimated to be less than its carrying amount, the carrying amount of the asset or cash-generating unit is reduced to its recoverable amount. Impairment losses are recognised as an expense immediately, unless the relevant asset is carried a revalued amount under another accounting standard, in which case the impairment loss is treated as revaluation decrease under that accounting standard.

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

Notes to the Financial Statements

For the year ended 31 December 2002

3. Significant Accounting Policies *(Continued)*

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost, which comprises all costs of purchase and, where applicable, costs of conversion and other costs that have been incurred in bringing the inventories to their present location and condition, is calculated using the weighted average method. Net realisable value represents the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Foreign currencies

Transactions in currencies other than Hong Kong dollars are initially recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities denominated in currencies other than Hong Kong dollars are re-translated at the rates prevailing on the balance sheet date. Gains and losses arising on exchange are included in profit or loss for the year.

On consolidation, the assets and liabilities of the Group's subsidiaries in the People's Republic of China (the "PRC") are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or expense in the period in which the subsidiary is disposed of.

Taxation

The charge for taxation is based on the results for the year as adjusted for items which are non-assessable or disallowed. Timing differences arise from the recognition for tax purposes of certain items of income and expense in a different accounting period from that in which they are recognised in the income statement. The tax effect of timing differences, computed using the liability method, is recognised as deferred taxation in the financial statements to the extent that it is probable that a liability or an asset will crystallise in the foreseeable future.

Operating leases

Leases where substantially all the risks and rewards of ownership remains with the lessor are accounted for as operating leases.

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the relevant lease term.

Retirement benefit costs

Payments to the defined contribution retirement benefit scheme are charged as an expense as they fall due.

4. Turnover

Turnover represents revenue from the sales of pulps, papers and paper filling materials, net of discounts and returns during the year.

5. Segment Information

Business segments

For management purposes, the Group is currently organised into two operating divisions — manufacture and distribution of pulps and papers and of paper filling materials. These divisions are the basis on which the Group reports its primary segment information.

Notes to the Financial Statements

For the year ended 31 December 2002

5. Segment Information (Continued)

Business segments (Continued)

Principal activities are as follows:

Pulps and papers – manufacture and distribution of pulps and papers

Paper filling materials – manufacture and distribution of paper filling materials

Segment information about these businesses is presented below:

	For the year ended 31 December 2002			
	Pulps and papers HK\$	Paper filling materials HK\$	Elimination HK\$	Consolidated HK\$
REVENUE				
External sales	14,058,190	–	–	14,058,190
Inter-segment sales	–	503,022	(503,022)	–
Total revenue	<u>14,058,190</u>	<u>503,022</u>	<u>(503,022)</u>	<u>14,058,190</u>
Inter-segment sales are charged at prevailing market prices.				
RESULT				
Segment loss	<u>(3,822,967)</u>	<u>(355,494)</u>	–	<u>(4,178,461)</u>
Unallocated other operating income				52,439
Unallocated corporate and finance expenses				<u>(965,190)</u>
Loss before taxation				<u>(5,091,212)</u>
Taxation				<u>–</u>
Loss for the year				<u><u>(5,091,212)</u></u>
BALANCE SHEET				
	At 31 December 2002			
	Pulps and papers HK\$	Paper filling materials HK\$		Consolidated HK\$
ASSETS				
Segment assets	<u>63,106,848</u>	<u>2,219,682</u>		65,326,530
Unallocated corporate assets				<u>8,108,278</u>
Total assets				<u><u>73,434,808</u></u>
LIABILITIES				
Segment liabilities	<u>5,980,466</u>	<u>10,414</u>		5,990,880
Unallocated corporate liabilities				<u>3,330,342</u>
Total liabilities				<u><u>9,321,222</u></u>

Notes to the Financial Statements

For the year ended 31 December 2002

5. Segment Information (Continued)

Business segments (Continued)

	Pulps and papers HK\$	Paper filling materials HK\$	Others HK\$	Consolidated HK\$
OTHER INFORMATION				
Capital expenditure	5,464,315	1,454,097	125,133	7,043,545
Depreciation	<u>1,065,120</u>	<u>50,979</u>	<u>8,368</u>	<u>1,124,467</u>

For the year ended 31 December 2001 (Note 1)

	Pulps and papers HK\$	Paper filling materials HK\$	Consolidated HK\$
REVENUE			
External sales	<u>2,817,076</u>	<u>92,889</u>	<u>2,909,965</u>
RESULT			
Segment loss	<u>(5,018,067)</u>	<u>(451,511)</u>	<u>(5,469,578)</u>
Unallocated other operating income			55,631
Unallocated corporate and finance expenses			<u>(49,056)</u>
Loss before taxation			(5,463,003)
Taxation			—
Loss for the year			<u>(5,463,003)</u>

BALANCE SHEET

At 31 December 2001 (Note 1)

	Pulps and papers HK\$	Paper filling materials HK\$	Consolidated HK\$
ASSETS			
Segment assets	<u>18,283,331</u>	<u>2,614,513</u>	20,897,844
Unallocated corporate assets			<u>145,613</u>
Total assets			<u>21,043,457</u>
LIABILITIES			
Segment liabilities	<u>7,367,700</u>	<u>1,510,038</u>	8,877,738
Unallocated corporate liabilities			<u>18,372,908</u>
Total liabilities			<u>27,250,646</u>
OTHER INFORMATION			
Capital expenditure	1,390,853	—	1,390,853
Depreciation	<u>323,418</u>	<u>37,870</u>	<u>361,288</u>

Notes to the Financial Statements

For the year ended 31 December 2002

5. Segment Information *(Continued)*

Geographical segment

All of the Group's business were derived from activities in the PRC in both years and more than 90% of the Group's total assets are located in the PRC as at the balance sheet date.

6. Other Operating Income

Included in other operating income is interest income from bank deposits of HK\$52,440 (2001: HK\$52,623).

7. Loss from Operations

	2002 HK\$	2001 HK\$ <i>(Note 1)</i>
Loss from operations has been arrived at after charging:		
Auditors' remuneration	404,717	80,000
Directors' remuneration		
— fees	—	—
— other emoluments	57,642	113,208
Other staff costs	<u>2,501,357</u>	<u>1,423,274</u>
Total staff costs	<u>2,558,999</u>	<u>1,536,482</u>
Depreciation	1,124,467	361,288
Operating lease payment in respect of rented premises	90,481	158,169
Allowance for inventories included in cost of sales	1,203,799	943,396
Research and development costs	<u>23,793</u>	<u>165,691</u>

Contributions to defined contribution retirement benefit scheme included in other staff costs amounted to HK\$6,968 (2001: nil)

8. Directors' Remuneration and Five Highest Paid Employees' Emoluments

Directors

	2002 HK\$	2001 HK\$ <i>(Note 1)</i>
Fees	—	—
Salaries and other benefits	57,642	113,208
Bonus	—	—
Contributions to retirement benefit scheme	<u>—</u>	<u>—</u>
	<u>57,642</u>	<u>113,208</u>
Analysed into:		
Director A	57,642	67,925
Director B	<u>—</u>	<u>45,283</u>
	<u>57,642</u>	<u>113,208</u>

Notes to the Financial Statements

For the year ended 31 December 2002

8. Directors' Remuneration and Five Highest Paid Employees' Emoluments (Continued)

Directors (Continued)

During the year, three directors waived their emoluments of an aggregate HK\$245,000. (2000: nil). No emoluments were paid by the Group to the directors as an inducement to join or upon joining the Group or as compensation for loss of office

Employees

Of the five highest paid individuals of the Group, three (2001: two) were directors of the Company but two of them waived their emoluments as included in the amount set out above. The remuneration of the remaining two (2001: three) individuals were as follows:

	2002 HK\$	2001 HK\$ (Note 1)
Salaries and other benefits	191,417	96,266
Contributions to retirement benefits scheme	<u>6,968</u>	<u>—</u>
	<u>198,385</u>	<u>96,226</u>

9. Taxation

No provision for Hong Kong Profits tax has been made as the Group had no assessable profit in Hong Kong.

Pursuant to the relevant laws and regulations in the PRC, the PRC subsidiaries are exempted from PRC income tax for two years starting from their first profit-making year, followed by a 50% reduction for the next three years. No provision for PRC income tax has been made in the financial statements as these subsidiaries had no assessable profit during the year.

The Group did not have any significant unprovided deferred taxation in either year nor at the balance sheet date.

Notes to the Financial Statements

For the year ended 31 December 2002

10. Dividend

No dividend has been paid or proposed during 2002, nor has any dividend been proposed since the balance sheet date (2001: nil).

11. Loss per Share

The calculation of basic loss per share is based on the loss for the year of HK\$5,091,212 (2001:HK\$5,463,003) and on the weighted average number of 717,150,685 (2001:640,000,000) ordinary shares in issue during the year

No diluted loss per share is calculated because the effect of assumed exercise of share options outstanding during the year ended 31 December 2002 would result in reduction in loss per share.

The number of shares for the year ended 31 December 2001 of 640,000,000 are deemed to be issued throughout the year, assuming that the Group Reorganisation had been effective on 1 January 2001.

Notes to the Financial Statements

For the year ended 31 December 2002

12. Property, Plant and Equipment

	Buildings HK\$	Machinery and equipment HK\$	Furniture and fixtures HK\$	Motor vehicles HK\$	Construction in progress HK\$	Total HK\$
COST/VALUATION						
At 1 January 2002	4,051,745	4,489,746	220,426	356,358	—	9,118,275
Additions	9,434	648,921	75,752	324,279	5,985,159	7,043,545
Surplus on revaluation	—	31,660,286	—	—	—	31,660,286
At 31 December 2002	<u>4,061,179</u>	<u>36,798,953</u>	<u>296,178</u>	<u>680,637</u>	<u>5,985,159</u>	<u>47,822,106</u>
Comprising:						
At cost	4,061,179	648,921	296,178	680,637	5,985,159	11,672,074
At valuation	—	36,150,032	—	—	—	36,150,032
	<u>4,061,179</u>	<u>36,798,953</u>	<u>296,178</u>	<u>680,637</u>	<u>5,985,159</u>	<u>47,822,106</u>
DEPRECIATION						
At 1 January 2002	157,970	169,925	39,998	78,793	—	446,686
Provided for the year	121,694	893,315	48,490	60,968	—	1,124,467
At 31 December 2002	<u>279,664</u>	<u>1,063,240</u>	<u>88,488</u>	<u>139,761</u>	<u>—</u>	<u>1,571,153</u>
NET BOOK VALUES						
At 31 December 2002	<u><u>3,781,515</u></u>	<u><u>35,735,713</u></u>	<u><u>207,690</u></u>	<u><u>540,876</u></u>	<u><u>5,985,159</u></u>	<u><u>46,250,953</u></u>
At 31 December 2001	<u><u>3,893,775</u></u>	<u><u>4,319,821</u></u>	<u><u>180,428</u></u>	<u><u>277,565</u></u>	<u><u>—</u></u>	<u><u>8,671,589</u></u>

The buildings are situated in the PRC.

In preparing the listing of the Company's shares on GEM, the Group revalued all of the machinery and equipment as at 30 April 2002, resulting in a revaluation surplus of HK\$31,660,286 which has been credited to the revaluation reserve. The valuation was carried out by Messrs. Sallmanns (Far East) Limited, a firm of professional valuers, on an open market value basis.

The carrying value of these revalued machinery and equipment amounted to approximately HK\$34,979,000 at 31 December 2002. If they had not been revalued, they would have been included in the financial statements at historical cost less accumulated depreciation of approximately HK\$4,059,000.

The directors consider the carrying value of machinery and equipment as at 31 December 2002 was not significantly different from its fair value at that date.

Notes to the Financial Statements

For the year ended 31 December 2002

13. Interests in Subsidiaries

	The Company 2002 HK\$
Unlisted shares, at cost	24,894,410
Amounts due from subsidiaries	<u>35,706,907</u>
	<u><u>60,601,317</u></u>

The carrying amount of the unlisted shares is based on the book values of the underlying net assets of the subsidiaries attributable to the Group as at the date on which the Company became the ultimate holding company of the Group under the Group Reorganisation.

The amounts due from subsidiaries are unsecured and interest free, The Company will not demand the subsidiaries for repayment within the next twelve months from the balance sheet date.

Particulars of the Company's subsidiaries at 31 December 2002 are set out in note 27.

14. Inventories

	2002 HK\$	2001 HK\$ (Note 1)
Raw materials and consumables	6,894,410	4,178,140
Work in progress	83,227	32,435
Finished goods	<u>4,752,903</u>	<u>2,590,899</u>
	<u><u>11,730,540</u></u>	<u><u>6,801,474</u></u>

Finished goods are carried at net realisable value as at 31 December 2002 and 2001.

15. Trade and Other Receivables

The Group has a policy of allowing average credit period ranging from 2 weeks to one month to its trade customers. In additions, for certain customers with long-established relationship and good past repayment histories, a longer credit period may be granted.

An aged analysis of trade receivables is as follows:

	2002 HK\$	2001 HK\$ (Note 1)
0-30 days	1,153,357	1,564,035
31-60 days	94,008	3,774
61-90 days	309,442	—
91-120 days	—	—
Over 120 days	<u>1,857,853</u>	<u>—</u>
	3,414,660	1,567,809
Other debtors, deposits and prepayments	<u>2,130,310</u>	<u>1,608,986</u>
	<u><u>5,544,970</u></u>	<u><u>3,176,795</u></u>

Notes to the Financial Statements

For the year ended 31 December 2002

16. Bank Balances and Cash

Included in bank balances and cash as at 31 December 2002 was an aggregate amount of approximately HK\$2,140,000 (2001: HK\$2,391,000) in Renminbi. Renminbi is generally regarded as a currency that cannot be fully converted to other currencies.

17. Trade and Other Payables

An aged analysis of the trade payable is as follows:

	2002 HK\$	2001 HK\$ (Note 1)
0-30 days	3,177,170	1,525,402
31-60 days	98,209	92,956
61-90 days	31,639	27,360
91-120 days	312,285	113,627
Over 120 days	<u>722,993</u>	<u>1,118,866</u>
	4,342,296	2,878,211
Other creditors and accrued charges	<u>1,888,584</u>	<u>716,509</u>
	<u><u>6,230,880</u></u>	<u><u>3,594,720</u></u>

18. Amounts due to Directors/a Related Company

The amount due to a related company as at 31 December 2001 represented an advance from a wholly-foreign owned enterprise established in the PRC and controlled by a director of the Company. During the year ended 31 December 2002, such advance was assigned to a director and then, as part of the Group Reorganisation, the amount was capitalised.

The amount due to a director as at 31 December 2001 had also been capitalised during the year upon the Group Reorganisation.

All the amounts due to these related parties are unsecured, interest-free and have no fixed term of repayment.

19. Amount due to Ultimate Holding Company

The amount is unsecured, interest-free and has no fixed term of repayment.

20. Government Loan

The amount was unsecured, interest-free and fully repaid during the year.

Notes to the Financial Statements

For the year ended 31 December 2002

21. Share Capital

Details of the share capital of the Company are as follows:

	Number of shares	HK\$
Ordinary shares of HK\$0.01 each:		
<i>Authorised</i>		
On incorporation	1,000,000	10,000
Increase during the period	<u>1,999,000,000</u>	<u>19,990,000</u>
At 31 December 2002	<u><u>2,000,000,000</u></u>	<u><u>20,000,000</u></u>
<i>Issued and fully paid</i>		
Allotted and issued nil paid on incorporation	1,000,000	10,000
Issue of shares to acquire KETG	500,000	5,000
Capitalisation of advances from a director	500,000	5,000
Issue of shares on placing in initial public offer	160,000,000	1,600,000
Issue of shares arising from capitalisation of share premium	<u>638,000,000</u>	<u>6,380,000</u>
At 31 December 2002	<u><u>800,000,000</u></u>	<u><u>8,000,000</u></u>

The Company was incorporated on 6 March 2002 with an authorised share capital of HK\$10,000 divided into 1,000,000 ordinary shares of HK\$0.01 each. On 14 March 2002, one share was allotted and issued nil paid to the initial subscriber and on the same date the share was then transferred to Siko Venture. On the same date, 996,999 and 3,000 shares were allotted and issued nil paid to Siko Venture and Mr. Wong Koon Hung, Jimmy, respectively.

Pursuant to a written resolution of the sole shareholder of the Company passed on 26 June 2002:

- (i) the authorised share capital of the Company was increased from HK\$10,000 to HK\$20,000 by the creation of an additional 1,000,000 ordinary shares of HK\$0.01 each. The new shares rank pari passu in all respects with the existing shares;
- (ii) the Company allotted and issued 500,000 shares of HK\$0.01 each in acquisition of the entire issued share capital of KETG; and
- (iii) the Company allotted and issue an aggregate of 500,000 ordinary shares to Siko Venture as directed by Mr. Chim Kim Kiu, Jacky ("Mr. Chim") in full satisfaction of the aggregate amount of HK\$18,339,888 payable to Mr. Chim under a deed of loan assignment dated 26 June 2002.

Pursuant to another written resolution of all the shareholders of the Company passed on 26 June 2002, the authorised share capital of the Company was increased from HK\$20,000 to HK\$20,000,000 by the creation of a further 1,998,000,000 ordinary shares of HK\$0.01 each. The new shares rank pari passu in all respects with the existing shares.

Notes to the Financial Statements

For the year ended 31 December 2002

21. Share Capital *(Continued)*

On 9 July 2002, 160,000,000 ordinary shares of the Company of HK\$0.01 each were issued at HK\$0.2 per share for cash through an initial public offering by way of placing.

On 9 July 2002, 638,000,000 ordinary shares of HK\$0.01 were allotted and issued, credited as fully paid at par, to the holders of shares of the Company on the register of members at the close of business on 26 June 2002 in proportion to their then existing holding by way of capitalisation of the sum of HK\$6,380,000 standing to the credit of the share premium account of the Company following the placing of shares mentioned above.

The share capital of HK\$1,000,000 at 31 December 2001 as shown in the consolidated balance sheet represented the nominal value of the issued share capital of KHK, the then holding company of the subsidiaries, acquired by the Company pursuant to the Group Reorganisation.

22. Share Option Schemes

The Company adopted two share option schemes (hereinafter refer to the “Pre-IPO” share scheme and the “Share Option Scheme”) on 26 June 2002 for the purpose of providing incentives to the directors and eligible participants, the Company may grant options to the executive directors and employees of the Group and also other eligible participants to subscribe for shares of the Company.

The total number of shares in respect of which options may be granted under the Share Option Scheme is not permitted to exceed 30% of the shares of the Company in issue from time to time, without prior approval from the Company’s shareholders. The number of shares in respect of which options may be granted to any individual in any one year is not permitted to exceed 1% of the shares of the Company in issue from time to time, without prior approval from the Company’s shareholders. Options granted to substantial shareholders or independent non-executive directors or their associates in excess of 0.1% of the Company’s share capital or with a value in excess of HK\$5 million must be approved in advance by the Company’s shareholders.

A nominal consideration of HK\$1 is payable on acceptance of each grant. Options may be exercised at any time during a period which may commence on a day after the date of grant of the share options but share end at any event not later than ten years from the date of grant of the options. The exercised price is determined by the directors of the Company, and will be at least the highest of (i) the closing price of the Company’s shares on the date of grant, (ii) the average closing price of the shares for the five trading days immediately preceding the date of grant, and (iii) the nominal value of the shares.

On 26 June 2002, prior to its listing, the Company granted options to certain executive directors and employees of the Group to subscribe for an aggregate of 50,220,000 shares in the Company under the Pre-IPO share option scheme. The terms of the Pre-IPO Share Option Scheme different to the terms of the Share Option Scheme as described above except that:

- (i) the eligible participants are confined to certain directors, senior management, employees, consultants and advisers of the Group;
- (ii) there is no minimum subscription price;
- (iii) the general scheme limit, the individual limit applicable to each proposed grantee and the restrictions on grant of options to a connected person do not apply;
- (iv) the directors may only grant options under the Pre-IPO Share Option Scheme at any time within a period from 26 June 2002 to 12 July 2002.

Notes to the Financial Statements

For the year ended 31 December 2002

22. Share Option Schemes (Continued)

Details of share options granted under the Pre-IPO Share Option Scheme to certain directors and employees to subscribe for shares in the Company are as follows:

	No. of options	Exercisable period
Directors	22,000,000	12 July 2002 – 11 July 2007
	14,670,000	12 January 2003 – 11 January 2008
	3,800,000	12 July 2003 – 11 July 2008
Employees	<u>9,750,000</u>	12 July 2003 – 11 July 2008
	<u><u>50,220,000</u></u>	

No options have been exercised or cancelled since the date of grant.

The financial impact of share options granted is not recorded in the Company's or the Group's balance sheet until such time as the options are exercised, and no charge is recognised in the income statement in respect of the value of options granted in the year. Upon the exercise of the share options, the resulting shares issued are recorded by the Company as additional share capital at the nominal value of the shares, and the excess of the exercise price per share over the nominal value of the shares is recorded by the Company in the share premium account. Options which lapse or are cancelled prior to their exercise date are deleted from the register of outstanding options.

23. Reserves

	Share premium HK\$	Accumulated loss HK\$	Total HK\$
The Company			
Premium arising on			
Group Reorganisation	24,879,410	—	24,879,410
Premium arising on initial			
public offering	30,400,000	—	30,400,000
Shares issue expenses	(6,584,689)	—	(6,584,689)
Capitalisation of advances			
from a director	18,334,888	—	18,334,888
Issue of shares arising from			
capitalisation of share premium	(6,380,000)	—	(6,380,000)
Loss for the year	—	(807,030)	(807,030)
	<u>60,649,609</u>	<u>(807,030)</u>	<u>59,842,579</u>
At 31 December 2002	<u><u>60,649,609</u></u>	<u><u>(807,030)</u></u>	<u><u>59,842,579</u></u>

Notes to the Financial Statements

For the year ended 31 December 2002

23. Reserves (Continued)

Under the Companies Law (Revised) Chapter 22 of the Cayman Islands, the share premium of the Company is available for paying distributions or dividends to shareholders subject to the provisions of its Memorandum or Articles of Association and provided that immediately following the distribution or dividend the Company is able to pay its debts as they fall due in the ordinary course of business. At the balance sheet date, in the opinion of the directors, the Company's reserves available for distribution to shareholders amounted to HK\$59,842,579.

24. Retirement Benefit Schemes

All the staff in Hong Kong of the Group are required to join the Mandatory Provident Fund Scheme. The Group is required to contribute 5%, while the employees are required to contribute 5% of their salaries to the scheme.

According to the relevant laws and regulations in the PRC, the PRC subsidiaries are required to contribute 10% of the stipulated salary set by the Yunnan provincial government to the retirement benefits schemes to fund the retirement benefits of their employees. The only obligation of the Group with respect to the retirement benefits schemes is to make the required contributions under the scheme. No such contribution was made in either year as the Group's employees have not yet entered into formal employment contracts with the Group.

25. Operating Lease Commitments

At the balance sheet date, the Group had the total future minimum lease payments under non-cancellable operating leases in respect of rented premises which fall due as follows:

	2002 HK\$	2001 HK\$
Within one year	158,654	182,535
In the second to fifth year	<u>274,106</u>	<u>381,817</u>
	<u><u>432,760</u></u>	<u><u>564,352</u></u>

Leases are negotiated for an average term of two to five years and rentals are fixed throughout the lease period. On 4 June 2002, an undertaking was given by the Land Bureau of Changning in the PRC (the "Land Bureau") for extending the lease of the land on which the paper plant situated and operated by a subsidiary of the Company to 21 September 2030. Pursuant to the undertaking, the rent will be subject to adjustment every five years, provided that the adjusted rental would not exceed 120% of the rental payable prior to such adjustment.

On 14 November 2002, the Land Bureau has agreed to waive the rental payable by the subsidiary for the period from 1 January 2002 to 30 September 2002 amounted to approximately HK\$104,000.

26. Capital Commitments

At 31 December 2002, the Group had capital commitments amounting to HK\$2,273,696 (2001: nil) in respect of the acquisition of property, plant and equipment contracted but not provided for in the financial statements.

Notes to the Financial Statements

For the year ended 31 December 2002

27. Particulars of Subsidiaries

Particulars of the Company's subsidiaries at 31 December 2002 were as follows:

Name of subsidiary	Place of incorporation/ establishment	Forms of legal entity	Issued and fully paid share capital/ registered capital*	Proportion of nominal value of issued capital/ registered capital held by the Company		Principal activities
				Directly	Indirectly	
Kanstar Environmental Technology Group Limited	The British Virgin Island	Limited liability Company	US\$1,000	100%	—	Investment holding
Kanstar Hong Kong Limited	Hong Kong	Limited liability Company	HK\$1,000,000	—	100%	Investment holding
Addata Development Limited	Hong Kong	Limited liability Company	HK\$10,000	—	100%	Holding and administration of intellectual property rights for paper filling materials and "Kanstar" brandname
昆明建星新技術產品開發有限公司 Kunming Kanstar High Tech Products Development Company Limited	The PRC	Foreign owned enterprise	US\$420,000*	—	100%	Research, development, manufacture and sale of paper filling materials
雲南昌寧建星紙業有限公司 Yunnan Changning Kanstar Paper Co., Ltd.	The PRC	Foreign owned enterprise	RMB13,357,659*	—	100%	Development, manufacture and sale of pulp and paper products

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

Financial Summary

Result

	Year ended 31 December		
	2000 HK\$	2001 HK\$	2002 HK\$
Turnover	—	2,909,965	14,058,190
Cost of sales	—	(4,902,490)	(16,872,043)
Gross loss	—	(1,992,525)	(2,813,853)
Other operating income	10,425	55,631	160,014
Selling and distribution expenses	—	(102,643)	(363,159)
Administrative expenses	(1,678,183)	(3,405,004)	(2,074,214)
Loss from operations	(1,667,758)	(5,444,541)	(5,091,212)
Interest expense	(47,377)	(18,462)	—
Loss before taxation	(1,715,135)	(5,463,003)	(5,091,212)
Taxation	—	—	—
Loss for the year	<u>(1,715,135)</u>	<u>(5,463,003)</u>	<u>(5,091,212)</u>

Assets and Liabilities

	As at 31 December		
	2000 HK\$	2001 HK\$	2002 HK\$
Total assets	20,951,988	21,043,457	73,434,808
Total liabilities	<u>(22,686,302)</u>	<u>(27,250,646)</u>	<u>(9,321,222)</u>
(Deficiency of) shareholders' funds	<u>(1,734,314)</u>	<u>(6,207,189)</u>	<u>64,113,586</u>

Notes:

- The Company was incorporated in Cayman Islands on 6 March 2002 and became the holding company of the Group with effect from 26 June 2002 upon completion of the Group Reorganisation as set out in the Company's prospectus dated 5 July 2002.
- The results of the Group for the two years ended 31 December 2001 and the balance sheet of the Group as at 31 December 2000 and 2001 have been prepared on a merger basis and are extracted from the Company's prospectus dated 5 July 2002.

Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN that the Annual General Meeting of Kanstar Environmental Technology Holdings Limited (the “Company”) will be held at 20/F., Winsome House, 73 Wyndham Street, Central, Hong Kong on 23 April 2003 at 11:00 a.m. for the following purposes:

1. To receive and consider the audited financial statements and the reports of the directors and auditors of the Company for the year ended 31 December 2002.
2. To re-elect directors and authorize the board of directors to fix their remuneration.
3. To re-appoint auditors and authorize the directors of the Company to fix their remuneration.
4. By way of special business, to consider and, if thought fit, pass with or without modifications, the following resolutions as ordinary resolutions:

(1) **THAT:**

- (a) subject to paragraph (c) below, pursuant to the Rules Governing the Listing of Securities on The Growth Enterprise Market of the Stock Exchange of Hong Kong Limited, the exercise by the directors of the Company during the Relevant Period of all the powers of the Company to allot, issue and deal with unissued shares in the capital of the Company or securities convertible into such shares in the capital of the Company and to make or grant offers, agreements and options which might require the exercise of such power be and is hereby generally and unconditionally approved;
- (b) the approval in paragraph (a) above shall authorize the directors of the Company during the Relevant Period to make or grant offers, agreements and options which might require the exercise of such powers after the end of the Relevant Period;
- (c) the aggregate nominal amount of share capital allotted, issued or dealt with or agreed conditionally or unconditionally to be allotted, issued or dealt with (whether pursuant to options or otherwise) by the directors of the Company pursuant to the approval of paragraph (a) of this resolution, otherwise than pursuant to (i) a Rights Issue (as hereinafter defined); or (ii) the exercise of any share option scheme or similar arrangement for the time being adopted for the grant or issue to officers and/or employees of the Company and/or any of the subsidiaries of shares or rights to acquire shares of the Company; shall not exceed 20% of the aggregate nominal amount of the share capital of the Company in issue on the date of the passing of this Resolution; and

Notice of Annual General Meeting

(d) for the purpose of this Resolution:

“Relevant Period” means the period from the date of the passing of this Resolution until whichever is the earliest of:

- (i) the conclusion of the next annual general meeting of the Company;
- (ii) the expiration of the period within which the next annual general meeting of the Company is required by the bye-laws of the Company, the Companies Law (Revised) of the Cayman Islands or any other applicable laws to be held; and
- (iii) the passing of an ordinary resolution by the shareholders of the Company in general meeting revoking or varying the authority given to the directors of the Company by this resolution.

“Right Issue” means an offer of shares in the Company, or offer or issue of warrants, options or other securities giving rights to subscribe for shares open for a period fixed by the directors of the Company to holders of shares on the register on a fixed record date in proportion to the holdings of shares (subject to such exclusion or other arrangements as the directors of the Company may deem necessary or expedient in relation to fractional entitlements, or having regard to any restrictions or obligations under the laws of, or the requirements of, any recognized regulatory body or any stock exchange outside Hong Kong).

(2) **THAT:**

- (a) subject to paragraph (b) below, the exercise of the directors of the Company during the Relevant Period of all powers of the Company to purchase its own shares in accordance with all applicable laws and the listing rules, be and is hereby generally and unconditionally approved;
- (b) the aggregate nominal amount of shares which may be purchased by the company pursuant to the approval in paragraph (a) during the Relevant Period shall not exceed 10% of the aggregate nominal amount of the issued share capital of the Company as at the date of the passing of this Resolution and the authority pursuant to paragraph (a) of this Resolution shall be limited accordingly; and
- (c) for the purpose of this Resolution, “Relevant Period” means the period from the date of the passing of this Resolution until whichever is the earliest of:
 - (i) the conclusion of the next annual general meeting of the Company;

Notice of Annual General Meeting

- (ii) the expiration of the period within which the next annual general meeting of the Company is required by the bye-laws of the Company, the Companies Law (Revised) of the Cayman Islands or any other applicable laws; and
 - (iii) the passing of an ordinary resolution by the shareholders of the Company in general meeting revoking or varying the authority given to the directors of the Company by this Resolution.
- (3) **THAT** the number of shares of the Company in respect of which options may be granted under the share option scheme or any other option scheme or similar arrangement for the time being adopted for the grant or issue to officers and/or employees of the Company and/or any of its subsidiaries of shares or rights to acquire shares of the Company be renewed to an aggregate of 10% of the entire share capital of the Company in issue on the date of passing of this Resolution.

By Order of the Board

Cheung Ka Fai

Company Secretary

Hong Kong, 28 March 2003

Registered office:

Century Yard

Cricket Square

Hutchins Drive

P.O. Box 2681 GT

George Town

Grand Cayman

British West Indies

Head office and principal place of business

in Hong Kong:

Room 605, Seaview Commercial Building

21-24 Connaught Road West

Hong Kong

Notice of Annual General Meeting

Notes:

1. A shareholder entitled to attend and vote at the meeting, is entitled to appoint a person or persons as his proxy or proxies to attend and vote instead of him. A proxy need not be a shareholder of the Company.
2. To be valid, a form of proxy, together with the power of attorney or other authority (if any) under which it is signed or a notarially certified copy of that power of attorney or authority must be deposited with the Company's principal share registrar and transfer office, Standard Registrars Limited, 28/F, Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong not less than 48 hours before the time appointed for holding the meeting and in default thereof the form of proxy shall not be treated as valid. No instrument appointing a proxy shall be valid after the expiry of 12 months from the date of its execution.
3. Delivery of an instrument for appointing a proxy shall not preclude a shareholder from attending and voting in person at the meeting and in such event, the instrument appointing a proxy shall be deemed to be revoked.