



Kanstar

2003
Third Quarterly Report

Kanstar



Kanstar Environmental Paper Products Holdings Limited
建星環保紙品控股有限公司*
(formerly known as 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)

*For identification only

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

GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on GEM and the business sectors or countries in which the companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

Given the emerging nature of companies listed on GEM, there is a risk that securities traded on GEM may be more susceptible to high market volatility than securities traded on the Main Board and no assurance is given that there will be a liquid market in the securities traded on GEM.

The principal means of information dissemination on GEM is publication on the internet website operated by the Stock Exchange. Listed companies are not generally required to issue paid announcements in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website in order to obtain up-to-date information on GEM-listed issuers.

The Stock Exchange takes no responsibility for the contents of this report, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this report.

This report, for which the directors of Kanstar Environmental Paper Products Holdings Limited (formerly known as 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.

HIGHLIGHTS

- On 7 October 2003 the Company's name was changed from Kanstar Environmental Technology Holdings Limited to Kanstar Environmental Paper Products Holdings Limited and on 8 October 2003, the existing issued and unissued Shares having a par value of HK\$0.01 be subdivided into five Subdivided Shares having a par value of HK\$0.002 each.
- Turnover increased by approximately 84% over the corresponding period in the previous year to approximately HK\$18.4 million for the nine months ended 30 September 2003.
- Loss attributable to shareholders decreased by approximately 0.4% compared to the corresponding period in the previous year to approximately HK\$1.7 million for the nine months ended 30 September 2003.
- The Directors do not declare any dividend for the nine months ended 30 September 2003.

QUARTERLY RESULTS

The board of directors (the "Board") of Kanstar Environmental Paper Products Holdings Limited, formerly known as Kanstar Environmental Technology Holdings Limited, (the "Company") is pleased to announce the unaudited consolidated results of the Company and its subsidiaries (collectively the "Group") for the three months and nine months ended 30 September 2003, together with the comparative unaudited figures for the corresponding periods in 2002, as set out below:

UNAUDITED CONSOLIDATED RESULTS

	Notes	Three months ended 30 September		Nine months ended 30 September	
		2003 HK\$	2002 HK\$	2003 HK\$	2002 HK\$
Turnover	2	3,866,799	3,073,181	18,396,142	10,007,753
Cost of sales		(4,088,906)	(3,435,806)	(18,551,029)	(10,037,119)
Gross loss		(222,107)	(362,625)	(154,887)	(29,366)
Other revenue		5,486	21,846	23,514	33,337
Selling and distribution expenses		(209,605)	(180,303)	(375,557)	(324,253)
Administrative expenses		(199,582)	(587,923)	(1,205,650)	(1,398,797)
Loss from operations		(625,808)	(1,109,005)	(1,712,580)	(1,719,079)
Finance costs		—	—	—	—
Loss before taxation	3	(625,808)	(1,109,005)	(1,712,580)	(1,719,079)
Taxation	4	—	—	—	—
Loss for the period		(625,808)	(1,109,005)	(1,712,580)	(1,719,079)
Dividend	5	—	—	—	—
Loss per share					
— basic (cent)	6	(0.078)	(0.173)	(0.214)	(0.269)

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (UNAUDITED)

	Share capital HK\$	Share premium HK\$	Special reserve HK\$	Revaluation reserve HK\$	Exchange reserve HK\$	Accumulated losses HK\$	Total HK\$
At 1 January 2002	1,000,000	—	—	—	1,402	(7,208,591)	(6,207,189)
Capitalisation of advances from a director	5,000	18,334,888	—	—	—	—	18,339,888
Shares issued at premium on placing	1,600,000	30,400,000	—	—	—	—	32,000,000
Share issue expenses	—	(6,584,689)	—	—	—	—	(6,584,689)
Issue of shares arising from capitalisation of share premium	6,380,000	(6,380,000)	—	—	—	—	—
Special reserve arising on group reorganisation	(985,000)	—	985,000	—	—	—	—
Surplus on revaluation of machinery and equipment	—	—	—	31,660,286	—	—	31,660,286
Exchange differences on translation of overseas operations	—	—	—	—	(6,045)	—	(6,045)
Loss for the period	—	—	—	—	—	(1,719,079)	(1,719,079)
Effects of adopting SSAP 12	—	—	—	(10,241,016)	—	—	(10,241,016)
At 30 September 2002	8,000,000	35,770,199	985,000	21,419,270	(4,643)	(8,927,670)	57,242,156
At 1 January 2003							
As previously stated	8,000,000	35,770,199	985,000	31,660,286	(2,096)	(12,299,803)	64,113,586
Effects of adopting SSAP 12	—	—	—	(10,241,016)	—	—	(10,241,016)
Loss for the period	—	—	—	—	—	(1,712,580)	(1,712,580)
At 30 September 2003	8,000,000	35,770,199	985,000	21,419,270	(2,096)	(14,012,383)	52,159,990

Notes:

1. Basis of preparation and principal accounting policies

The condensed consolidated financial statements of the Group have been prepared in accordance with the applicable disclosure requirements of Chapter 18 of the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited (the "GEM Listing Rules") and have been prepared under the historical cost convention. The accounting policies adopted are consistent with those followed in preparation of the Group's annual financial statements for the year ended 31 December, 2002, except as described below.

In the current period, the Group has adopted SSAP 12 (Revised) "Income Taxes". The principal effect of the implementation of SSAP 12 (Revised) is in relation to deferred tax. In previous years, partial provision was made for deferred tax using the income statement liability method, i.e. a liability was recognised in respect of timing differences arising, except where whose timing differences were not expected to reverse in the foreseeable future.

SSAP 12 (Revised) requires the adoption of a balance sheet liability method, whereby deferred tax is recognised in respect of all temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, with limited exceptions. In the absence of any specific transitional requirements in SSAP 12 (Revised), the new accounting policy has been applied retrospectively. Comparative amounts for 2002 have been restated accordingly. The balance on the Group's revaluation reserve at 30 September 2002 has been reduced by approximately HK\$10 million, representing the deferred tax liability recognised in respect of the revaluation surplus on the Group's machinery and equipment.

2. Turnover

Turnover represents revenue from the sales of pulps and papers, net of discounts and returns during the period.

3. Loss before taxation

Loss before taxation has been arrived at after charging (crediting):

	For the three months ended 30 September		For the nine months ended 30 September	
	2003	2002	2003	2002
	HK\$	HK\$	HK\$	HK\$
Depreciation of property, plant and equipment	394,681	328,256	1,172,524	703,977
Bank interest income	(5,486)	(22,255)	(23,514)	(23,745)

4. 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, Kunming Kanstar and Changning Kanstar (wholly-owned subsidiaries of the Group) are exempted from the PRC income tax for two years starting from their first profit-marking year, followed by a 50% reduction for the next three years. No provision for the PRC income tax has been made in the consolidated accounts as these two companies had no assessable profit during the periods.

Deferred taxation has been provided on the revaluation surplus on the revaluation of machinery and equipment at 30 April 2002 and has been charged directly to equity.

5. Dividend

The Board does not recommend the payment of a dividend for the nine months ended 30 September 2003 (2002: Nil).

6. Loss per share

The calculation of basic loss per share is based on the loss attributable to shareholders for the three months and nine months ended 30 September 2003 of approximately HK\$626,000 and HK\$1,713,000 (2002: HK\$1,109,000 and HK\$1,719,000) respectively and on the weighted average number of 800,000,000 (2002: 640,000,000) ordinary shares in issue during the period.

No diluted loss per share for the three months and nine months ended 30 September 2003 has been presented because the effect of exercising the Company's outstanding share options is anti-dilutive.

The number of shares for the three months and nine months ended 30 September 2002 are deemed to be issued throughout the year, assuming that the Group Reorganisation had been effective on 1 January 2001.

MANAGEMENT DISCUSSION AND ANALYSIS

Business and financial review

In October 2003, the Company's name was changed from "Kanstar Environmental Technology Holdings Limited" and 「建星環保科技控股有限公司」 to "Kanstar Environmental Paper Products Holdings Limited" and 「建星環保紙品控股有限公司」 and the issued and unissued shares having a par value of HK\$0.01 each were subdivided into five subdivided shares having a par value of HK\$0.002 each. For the details and reasons of such changes, please refer to the circular dated 11 September 2003.

For the nine months ended 30 September 2003, the Group reported an unaudited turnover of approximately HK\$18 million, increased by approximately 84% over the corresponding period in last year and an unaudited gross loss of approximately HK\$155,000, compared with an unaudited gross loss of around HK\$29,000 in last corresponding period. With the management's effective cost controls, the administrative expenses had been reduced by about 14% when compared with that of last corresponding period.

In current period, the amount of loss from operations was about HK\$626,000 which was 44% less than that of last year. The loss was mainly due to the suspension of production in current period as stated below.

The directors of the Company do not recommend the payment of any dividend for the nine months ended 30 September 2003 (2002: nil).

During this review period, the Group was focusing on the expansion works of the production facilities and production has suspended for more than one month which led to a decrease in sales and the record of operating loss in current period. The installation

works of the new pulp and paper production line were completed in this period. Commission began in late September and trial production started in October 2003. With the success of this new production line, the full production capacity of the Group will be doubled from 10,000 tonnes to 20,000 tonnes per annum.

A new recovery boiler had been successfully installed and was successfully linked up with the four spherical evaporators which were installed in the second quarter and the Group can now use a mixture of woods, bamboos, bagasse and paper filling material for the production of paper products. This wide range of raw materials combination can stabilize the production cost of paper products and improve the quality of Kanstar's products.

In order to further reduce the production costs, the Group also increased the production capacity of the Lime Recovery Plant in current period. This can help to reduce the consumption of lime (a main chemical added in the production) and is more environmental friendly.

Prospects

With the success in the construction of the new production line, the Group will focus on the promotion of sales in the fourth quarter of 2003. In order to diversify its customer base, the Group is now trying to seek customers in Shanghai, Guangdong and Guizhou. It had first set up a sales office in Guangzhou in September 2003.

In order to further improve the Group's profitability, the Group tries to promote its retailed services in this review period. It had purchased additional paper cutting machines and packaging machines for the production of different sizes products under Kanstar's brandname. Kunming, Baoshan and Guangzhou offices will try to promote these new packaging products.

With the expansion of production capacity, the diversification of raw materials combination and the improvement of the quality of the products, the managements of the Group are confidence for the prospect of the Group.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

Up to 30 September 2003, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

DIRECTORS' AND CHIEF EXECUTIVES' INTEREST AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 30 September 2003, the interests or short positions of the Directors and chief executive of the Company in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) which were notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions

which they were taken or deemed to have under such provisions of the SFO), or which were recorded in the register required to be kept by the Company under Section 352 of the SFO, or which were required, pursuant to Rules 5.40 to 5.58 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange, were as follows:

Long positions in the shares of the Company

Name of Director	Capacity	Personal Interests	Family Interests	Number of Ordinary Shares		Total	Percentage of Shareholding
				Corporate Interests	Other Interests		
Mr. Chim Kim Kiu	Interest of a controlled corporation	—	—	600,000,000 (Note 1)	—	600,000,000	75%

Note:

- These shares are beneficially owned and registered in the name of Siko Venture Limited, the entire issued share capital of which is held by Mr. Chim Kim Kiu.

Long positions in underlying shares of the Company

Name of Grantees (Relations with the Group)	Capacity	Description of equity derivatives (number of underlying shares)
Mr. Li Gang (Executive Director)	Beneficial owner	share options to subscribe for shares (3,800,000 shares) (Note)
Mr. Ip Kai Cheong (Executive Director)	Beneficial owner	share options to subscribe for shares (21,670,000 shares) (Note)
Mr. Sun Tak Keung (Executive Director)	Beneficial owner	share options to subscribe for shares (15,000,000 shares) (Note)
Ms. Li Ling (Employee of the Group)	Beneficial owner	share options to subscribe for shares (6,500,000 shares) (Note)

Note: For details of the share options granted, please refer to the section headed "Share Option Scheme" below.

Save as disclosed above, none of the Directors or chief executive of the Company had, as at 30 September 2003, any interests or short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which would have to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they were taken or deemed to have under such provisions of the SFO), or which were recorded in the register required to be kept by the Company under Section 352 of the SFO, or which were required to be notified to the Company and the Stock Exchange pursuant to Rules 5.40 to 5.58 of the GEM Listing Rules.

SUBSTANTIAL SHAREHOLDERS

As at 30 September 2003, so far is known to the Directors, the following persons (not being a Director or a chief executive of the Company) had an interest and/or a short position in the shares and/or underlying shares of the Company which would fall to be disclosed to the Company and the Exchange pursuant to the provisions of Divisions 2 and 3 of Part XV of the SFO and/or required to be entered in the register maintained by the Company pursuant to Section 336 of the SFO and/or were directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any members of the Group.

Name	Number of shares held	Approximate percentage of issued shares
Siko Venture Limited	600,000,000 (Note 1)	75.00%
Mr. Chim Pui Chung	44,000,000 (Note 2)	5.50%

Notes:

1. The entire issued share capital of Siko Venture Limited is beneficially owned by Mr. Chim Kim Kiu, Jacky.
2. Total interests of Mr. Chim Pui Chung in 44,000,000 ordinary shares of the Company referred above include 34,000,000 ordinary shares held by Golden Mount Ltd. and 10,000,000 ordinary shares held by Gallery Land Ltd. The entire issued share capital of both Golden Mount Ltd. and Gallery Land Ltd. are beneficially owned by Mr. Chim Pui Chung.

Save as disclosed above, as at 30 September 2003, there was no person who had an interest and/or a short position in the shares and/or underlying shares of the Company which would fall to be disclosed to the Company and the Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO and/or required to be entered in the register maintained by the Company pursuant to Section 336 of the SFO and/or was directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any members of the Group, or any options in respect of such capital.

SHARE OPTION SCHEMES

Pursuant to the pre-IPO share option scheme (the “Pre-IPO Share Option Scheme”) adopted by the Company on 26 June 2002, certain Directors and participants have been granted options to subscribe for shares at an exercise price of HK\$0.01 per share, details of which are set out as follows:

Name of grantee	Date of grant	Exercise period	Granted	Number of shares options		Outstanding as at 30 September 2003
				Outstanding as at 1 January 2003	Lapsed during the period under review	
<i>Executive directors</i>						
Mr. Li Gang	26 June 2002	12 July 2003 - 11 July 2008	3,800,000	3,800,000	—	3,800,000
Mr. Ip Kai Cheong	26 June 2002	12 July 2002 - 11 July 2007	13,000,000	13,000,000	—	13,000,000
		12 January 2003 - 11 January 2008	8,670,000	8,670,000	—	8,670,000
Mr. Sun Tak Keung	26 June 2002	12 July 2002 - 11 July 2007	9,000,000	9,000,000	—	9,000,000
		12 January 2003 - 11 January 2008	6,000,000	6,000,000	—	6,000,000
<i>Other participants</i>						
Employees in aggregate	26 June 2002	12 July 2003 - 11 July 2008	9,750,000	9,750,000	3,150,000	6,600,000
Total				50,220,000	3,150,000	47,070,000

No share options under the share option scheme (the “Share Option Scheme”) adopted by the Company on 26 September 2002 were granted during the nine months ended 30 September 2003.

Details of the Pre-IPO Share Option Scheme and the Share Option Scheme are set out in the Prospectus.

DIRECTORS’ AND CHIEF EXECUTIVE’S RIGHTS TO ACQUIRE SHARES

Save as disclosed above, at no time during the periods from 1 January 2003 to 30 September 2003 was the Company, its subsidiaries or holding company a party to any arrangements to enable the directors or chief executives (including their spouses or children under 18 years of age) of the Company to acquire benefits by means of acquisition of shares in the Company or any other body corporate.

COMPETING INTERESTS

Up to 30 September 2003, none of the directors or 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.

INTEREST OF SPONSORS

As updated and notified by the Company's sponsor, South China Capital Limited ("SCCL"), as at 30 September 2003, neither SCCL nor its directors, employees and their associates had any interest in the shares of the Company or any subsidiaries of the Group, or any right to subscribe for or to nominate persons to subscribe for the shares of the Company or any member of the Group.

SCCL and the Company have mutually agreed to terminate their sponsorship agreement dated 4 July 2002 with effect from 31 October 2003 and Kingston Corporate Finance Limited has been appointed as the new sponsor to the Company from 31 October 2003. Pursuant to the new sponsor's agreement, Kingston Corporate Finance Limited will receive fee for acting as the Company's sponsor for the period up to 31 December 2004 subject to terms and conditions agreed between the parties thereto.

COMPLIANCE WITH RULE 5.28 TO 5.39 OF THE GEM LISTING RULES

Up to 30 September 2003, the Company has complied with the standards of good practice concerning the general management responsibilities of the Board as set out in Rules 5.28 to 5.39 of the GEM Listing Rules.

AUDIT COMMITTEE

The Company has established an audit committee, comprising Mr. Lau Kwok Wing, Chris and Mr. Chan Chi Hung, Anthony, both of whom are independent non-executive Directors, with written terms of reference in compliance with Rules 5.23, 5.24, and 5.25 of the GEM Listing Rules. Mr. Lau Kwok Wing, Chris has been appointed as the chairman of the audit committee. The primary responsibilities of the audit committee are (i) to review the annual report and accounts, half-yearly report and quarterly reports and provide advice and comments thereon to the Board and (ii) to review and supervise the financial reporting process and internal control system of the Group.

On behalf of the Board
Chim Kim Kiu, Jacky
Chairman

Hong Kong, 13 November 2003