



Kanstar Environmental Paper Products Holdings Limited

建星環保紙品控股有限公司\*

(Incorporated in the Cayman Islands with limited liability)

ANNUAL REPORT 2003

KANSTAR

KANSTAR

\* for identification purpose 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 obligations 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.**

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*This report, for which the directors of Kanstar Environmental Paper Products 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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## CORPORATE INFORMATION

### 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

Kingston Corporate Finance Limited  
Suite 2801, 28th Floor  
One International Finance Centre  
1 Harbour View Street  
Central, 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 604, 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

Louis Leung & Partners CPA Limited  
Certified Public Accountants  
13th Floor, Sun House  
181 Des Voeux 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 Country  
Baoshan City  
Yunnan Province  
PRC

## CHAIRMAN'S STATEMENT

On behalf of the board of directors (the "Board") of Kanstar Environmental Paper Products Holdings Limited and, its subsidiaries (hereinafter collectively referred to as the "Group"), I hereby present the annual report and the audited financial statements for the year ended 31 December 2003.

2003 is a challenging year for the Group. In the first half of 2003, there was the outbreak of severe acute respiratory syndromes (SARS) which increased both the costs and time for the transportation of the Group's products and delayed the construction works of the Group's new pulp and paper production line as the incoming of construction workers in other provinces are restricted.

However, with the great efforts of the managements, the Group still expanded greatly in this challenging year. Turnover in 2003 was approximately HK\$31 million which was around 2.2 times compared to that of 2002 and the loss before taxation decreased greatly by 61%.

In the first half of 2003, the Group first increased the annual production capacity of the initial pulp and paper production line from 7,000 tonnes to 10,000 tonnes. By the end of 2003, the new pulp and paper production line was commissioned and the annual production capacity was further increased to 20,000 tonnes.

With the success of the new pulp and paper production line, the Group has three separate pulp and paper production lines. Each specializes in the production of pulps, writing papers and copying papers. This specialization improves both the efficiency and stability in production.

In order to strengthen the competitive edge, the Group has focused on research and production of higher quality paper products. Comparing to that of 2002, the qualities of the pulps and papers produced by the Group had been improved and the respective selling prices had been increased.

The Group also tries to diversify its customer bases. By the end of 2003, the Group has customers in Yunnan, Sichuan, Guizhou, Shanghai, Guangxi and Guangdong Provinces.

To further speed up the Group's expansion plan in 2004, the Group will try to find opportunities to acquire small pulp and paper manufacturing plants at bargain prices and then turn them around to unlock their hidden values.

With the expansion in the production scale, specialization of the production lines, continuing improvements in the products' qualities and diversification in customers, the management has confidence in the future prospects of the Group.

## CHAIRMAN'S STATEMENT

Finally, I, on behalf of the Directors, would like to take this opportunity to express our gratitude to the management and staffs 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 2004

## MANAGEMENT DISCUSSION AND ANALYSIS

### BUSINESS OVERVIEW

In order to sharpen the Group's corporate image and its market position, the Company has changed its name from "Kanstar Environmental Technology Holdings Limited" to "Kanstar Environmental Paper Products Holdings Limited" in October 2003.

For the year ended 31 December 2003, the Group recorded a turnover of about HK\$30,782,000 which representing a 119% increase as compared to that of 2002 and the loss for the year after interest, taxation and depreciation has decreased greatly by around 61% to HK\$1,966,000. Around HK\$1,100,000 of such operating loss is contributed from the additional depreciation arising from the revaluation of the Group's production machines. With the continuous improvement in the pulp and paper production lines and the increase in the scale of production, the unit production cost has been reduced, which contributes to the gross profits recorded in current year.

The directors of the Company do not recommend the payment of a final dividend in respect of the year 2003 (2002: nil).

The amount of selling expenses has increased greatly by around 97% to approximately HK\$716,000. During the year, the Group put great efforts in expanding its market. Apart from the continuous supports from the original customers, the Group has successfully signed many sales contracts with customers in different provinces including Guizhou, Guangxi, Guangdong and Shanghai. Such diversification of customers can stabilize the Group's performance and can support the continuous expansion of production.

Administrative expenses increased slightly by about 4.6% when compared to that of last year. With the management's effective cost control policies, the percentage increase in the administrative expenses is much lesser than the percentage increase in the scale of business.

During the year, the Group focuses on the expansion of production scale. It first upgrades its existing pulp and paper production facilities. The annual production capacities had first increased from 7,000 tonnes to 10,000 tonnes. With the proceeds from listing, the Group has purchased and installed a new pulp and paper production line with annual production capacities of 10,000 tonnes. Trial production was completed in late 2003 and the full production capacity for our Changning Factory has further increased to 20,000 tonnes.

Not only the production capacities been increased, the Group also focused on the research and production of higher quality paper products. When compared to that of last year, the quality of Kanstar's paper products has been improved.



## MANAGEMENT DISCUSSION AND ANALYSIS

### PROSPECTS

In 2004, the Group has three separate production lines, each specialises in the production of pulps, writing papers and copying papers. This specialization in production will surely improve both the efficiency and stability of production.

In the coming year, the Group will continue its efforts in upgrading its existing production facilities at Changning paper factory to produce higher quality paper products. It targets to further increase the selling prices of Kanstar's products by 5% to 10%.

The Group is also interested in producing other kinds of paper products such as typing papers, thermal papers and packaging papers which has a higher profit margin.

Unlike other paper manufacturing companies, Kanstar is the most upstream manufacturer in the supply chain of the paper manufacturing industry. It produces pulps, which are raw materials of paper board, corrugated papers, newsprint and commercial papers. With the joining of the World Trade Organization ("WTO") and the signing of Closer Economic Partnership Arrangement ("CEPA"), the demand and prices for both pulps and commercial papers in China will surely increase. Unlike other paper manufacturing companies which will suffer from the increase in the price of pulps, Kanstar will benefit from the increase in the prices of both pulps and papers.

With the valuable experience in turnaround the loss-making paper plant in Changning and in setting up new pulp and paper production line, the Group will try to identify low-efficient or loss-making paper manufacturing plant and acquire them at bargain prices. Based on the Group's past successful experience, we have confidence to turns around them. The management believes it can further speed up the business expansion plan.

### LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2003, the Group had a healthy financial position with net assets amounted to approximately HK\$53,996,330. Net current assets decreased to approximately HK\$6,250,630 with current ratio of approximately 1.5 (2002: 2.9). The gearing ratio of the Group, based on the total borrowings to shareholders' equity, was 7% (31 December 2002: 5.5% (Restated)).

As at 31 December 2003, the Group had contingent liabilities in respect of quality guarantee to a customer amounting to HK\$188,690. (2002: nil). The Group did not have any charges on its assets (2002: nil), and did not have any committed banking facilities (2002: 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 2003 and 2002. As at 31 December 2003, the Group did not have any plan for material investments and acquisition of material capital assets.



## MANAGEMENT DISCUSSION AND ANALYSIS

### EMPLOYEE INFORMATION

The Group had a total staff of approximately 500 employees (2002: approximately 330 employees). Remuneration packages are reviewed on a periodical basis. Bonus is 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 2003. Staff cost was approximately HK\$3,876,000 for the year (2002: HK\$2,559,000). 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 ACTIVE BUSINESS PROGRESS

*For the year ended 31 December 2003*

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 2003 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 2003**

#### **Paper filling material**

- |  |   |
|--|---|
| 1. Acquire and install new production line in Changning for the expansion of production of paper filling material from 1,000 tonnes to 15,000 tonnes.  | Uses RMB1.6 million to acquire and install a new production line with annual production capacity of 5,000 tonnes and uses RMB0.7 million for the infrastructure works of other new production line with 10,000 tonnes annual production capacity. |
| 2. Upon completion of the installation of the new production line, approximately 20% of the paper filling material produced will be used by the Group's own paper production with the remaining 80% to be sold to other paper manufacturers in Guangdong, Sichuan and Henan. | As the construction of the second new production line is still in progress, the paper filling material produced from the first line is used by the Group's own paper production.  |
| 3. Commence sales efforts in other provinces including Guizhou, Henan and Guangxi.   | As all the paper filling material produced are for the Group's internal use, no sales efforts commence.   |

#### **Wood pulp and paper**

- |   |   |
|---|---|
| 1. Complete expansion works in relation to water and power supply and waste water treatment for the new wood pulp and paper manufacturing facilities.                           | The expansion works in relation to water and paper supply and waste water treatment for the new wood pulp and paper manufacturing facilities have been completed during the year.                           |
| 2. Acquire and install a new pulp and paper production line. Upon completion of the new production line, the Group's annual production capacity will increase to 20,000 tonnes. | Acquired and installed a new pulp and paper production line and trial production has been completed in late 2003. The Group's annual production capacity has increased to 20,000 tonnes by the end of 2003. |
| 3. Ensure smooth production of pulp and paper using new production line.  | Commercial production has been started in December 2003.  |

## COMPARISON OF BUSINESS OBJECTIVES WITH ACTIVE BUSINESS PROGRESS

For the year ended 31 December 2003

### Business objectives as stated in the prospectus dated 5 July 2002

### Actual business progress in respect of the year ended 31 December 2003

- |    |   |   |
|----|---|---|
| 4. | Negotiate and complete the acquisition of the land use right of the Changning paper factory, expected to cost RMB2.0 million. | We have formed an agreement with the local government and will pay around HK\$2.2 million for the land use right in 2004.   |
| 5. | Focus on research and production of higher quality writing paper with the aim to increase competitiveness and profit margins. | Successfully produces higher quality paper products which increase the general selling price by around 10% to 15% in December 2003 when compared to that of 2002. |
| 6. | Commence sales efforts in other provinces including Guizhou, Henan and Guangxi.   | Kanstar's paper products have been sold to customers in Guizhou, Guangxi, Guangdong and Shanghai Provinces.   |

### USE OF PROCEEDS FROM THE INITIAL PUBLIC OFFERING

From the date of listing on 12 July 2002, the Group invested approximately HK\$23,500,000 in the following areas:

		<b>From 12 July 2002 (Date of Listing) to 31 December 2003</b>	
		<b>Proposed</b>	<b>Actual</b>
		<i>HK\$ million</i>	<i>HK\$ million</i>
Establishment of an additional pulp and paper production line	1	9.9	12.8
Establishment of a new paper filling material production line	2	5.7	2.3
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	0.2	0.15
Working capital	5	2.0	4.45
		23.5	23.5

## COMPARISON OF BUSINESS OBJECTIVES WITH ACTIVE BUSINESS PROGRESS

*For the year ended 31 December 2003*

*Notes:*

1. The establishment works of the new pulp and paper production line and the trial production have been completed during the year. The amount spent for this new production line is around HK\$12,800,000 which is HK\$2,900,000 more than the proposed amount. With the valuable experience for the improvement of the original pulp and paper production line, the Group has spent more to take up the improvements for the new line in order to improve the quality of the products. Also, due to the outbreak of SARS during the year, the installation costs for the new line have increased.
2. During the year, due to the concentration on the installation of the new pulp and paper production line and the outbreak of SARS, the construction work of the remaining two paper filling material production lines was delayed.
3. Due to the change of management of the local government and the outbreak of SARS during the year, the negotiation of the acquisition of the land use right has been delayed. We have formed an agreement with the local government and will pay around HK\$2.2 million for the purchase of the land use right.
4. The Group has set up representative offices in both Baoshan and Kunming. However, as the Group has customers in many different provinces, including Yunnan, Sichuan, Guizhou, Guangxi, Guangdong and Shanghai, the Group plans to delay the setting up of an office in Chengdu, Sichuan Province in order to save the administrative expenses.
5. The amount spent as working capital was about HK\$4.45 million, which is HK\$2.45 million more than the amount stated in the prospectus. The reason for such increase was due to the operating loss recorded in past years.

## BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

### EXECUTIVE DIRECTORS

**Mr. Chim Kim Kiu, Jacky, (詹劍嶠)**, aged 31, 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 44, 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 50, 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 40, 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 39, 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 37, 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 21/2 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.

## BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

### SENIOR MANAGEMENT

**Mr. Wang Qi Nian (王啟年)**, aged 47, is the 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 March 2003, he was the assistant general manager of Hubei Jingzhou City Paper Factory (湖北荊州市造紙廠) a paper factory, in Hubei province. He graduated from the Hubei Province Light Industry College (湖北省輕工業學院) in pulp and paper manufacturing.

**Mr. Zhao Xian Wan (趙賢萬)**, aged 39, is the manager of Changning Kanstar responsible for pulp and paper production. Prior to joining the Group in July 2001, he was a manager at Sichuan Province Qingcheng Paper Factory (四川省青城造紙廠) in Sichuan province and had over 18 years experience in the production of pulp and papers. He studied pulp and paper manufacturing at the Shensi Xibei Province Light Industry College (陝西省西北輕工業學院) in pulp and paper manufacturing.

**Madam Li Ling (李玲)**, aged 52, 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 29, 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.

## DIRECTORS' REPORT

The directors have pleasure in presenting their annual report and the audited financial statements of the Company for the year ended 31 December 2003.

### CHANGE OF COMPANY NAME

Pursuant to a special resolution passed at an extraordinary general meeting of the Company held on 7 October 2003, the Company's name was changed from "Kanstar Environmental Technology Holdings Limited" to "Kanstar Environmental Paper Products Holdings Limited".

### PRINCIPAL ACTIVITIES

The Company is an investment holding company. The principal activities of its subsidiaries are set out in note 29 to the financial statements.

### MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2003, the top five suppliers of the Group together accounted for approximately 34.88% of the Group's total purchases of materials, and the largest supplier accounted for approximately 14.78% of the Group's total purchases of materials.

The Group's five largest customers together accounted for approximately 54.13% of the total sales of the Group, and the largest customer accounted for approximately 25.31% of the Group's total sales for the year ended 31 December 2003.

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 2003 are set out in the consolidated income statement on page 21.

The directors do not recommend the payment of a dividend.

### FINANCIAL SUMMARY

A summary of the results of the Group for the past four financial years ended 31 December 2003 is set out on page 50 of the annual report.

### PROPERTY, PLANT AND EQUIPMENT

Details of 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 29 to the financial statements.



## DIRECTORS' REPORT

### SHARE CAPITAL

Details of the share capital of the Company are set out in note 20 to the financial statements.

### DIRECTORS

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

*Executive directors:*

Mr. Chim Kim Kiu, Jacky (*Chairman*)

Mr. Ip Kai Cheong

Mr. Li Gang

Mr. Sun Tak Keung

*Independent non-executive directors:*

Mr. Lau Kwok Wing, Chris

Mr. Chan Chi Hung, Anthony

In accordance with Clause 108 of the Company's Articles of Association, Mr. Li Gang and Mr. Chan Chi Hung, Anthony 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' REPORT

### DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN THE SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2003, the interests or short positions of the Directors and chief executives 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	Corporate Interests	Other Interests	Total	Percentage of Shareholding
Mr. Chim Kim Kiu, Jacky	Interest of a controlled corporation	-	-	3,000,000,000	-	3,000,000,000	75%

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

#### 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. Ip Kai Cheong (Executive Director)	Beneficial owner	Share options to subscribe for shares (108,350,000 shares) (Note)
Mr. Sun Tak Keung (Executive Director)	Beneficial owner	Share options to subscribe for shares (75,000,000 shares) (Note)
Ms. Li Ling (Employee of the Group)	Beneficial owner	Share options to subscribe for shares (32,500,000 shares) (Note)

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

## DIRECTORS' REPORT

Save as disclosed above, none of the Directors or chief executives of the Company had, as at 31 December 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 5.4 to 5.58 of the GEM Listing Rules.

### 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 2003, so far as 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	3,000,000,000	75%
Mr. Chim Pui Chung	220,000,000	5.5%

*Note:*

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 220,000,000 ordinary shares of the Company referred above include 170,000,000 ordinary shares held by Golden Mount Ltd. and 50,000,000 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.

## DIRECTORS' REPORT

Save as disclosed above, as at 31 December 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\$0.002 (Note) per share, details of which are set out as follows:

Name of grantee	Date of grant	Exercise period	Granted (Note)	Outstanding as at January 1 2003 (Note)	Cancelled/ Lapsed during the year	Outstanding as at 31 December 2003
<i>Executive directors</i>						
Mr. Li Gang	26 June 2002	12 July 2003- 11 July 2008	19,000,000	19,000,000	19,000,000	–
Mr. Ip Kai Cheong	26 June 2002	12 July 2002- 11 July 2007	65,000,000	65,000,000	–	65,000,000
		12 January 2003- 11 January 2008	43,350,000	43,350,000	–	43,350,000
Mr. Sun Tak Keung	26 June 2002	12 July 2002- 11 July 2007	45,000,000	45,000,000	–	45,000,000
		12 January 2003- 11 January 2008	30,000,000	30,000,000	–	30,000,000
<i>Other participants</i>						
Employees in aggregate	26 June 2002	12 July 2003- 11 July 2008	48,750,000	48,750,000	15,750,000	33,000,000
Total				<u>251,100,000</u>	<u>34,750,000</u>	<u>216,350,000</u>

*Note:* Pursuant to an ordinary resolution passed at an extraordinary general meeting of the Company held on 7 October 2003, each of the initial issued and unissued Shares having a par value of HK\$0.01 were subdivided into five Subdivided Shares having a par value of HK\$0.002 each with effect from 8 October 2003. This share subdivision gave rise to adjustments to both the exercise price and the number of underlying shares granted under the pre-IPO share option scheme, and accordingly every option originally granted was increased to five options.

## DIRECTORS' REPORT

### DIRECTORS' INTERESTS IN CONTRACTS

There was no transaction during the year 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 21 to the financial statements, the Company had no other outstanding convertible securities, options, warrants or other similar rights as at 31 December 2003.

### 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

On 31 October 2003, South China Capital Limited resigned as the sponsor of the Company and Kingston Corporate Finance Limited (the "Kingston") were appointed to fill the vacancy and have remained as the Company's sponsor since then.

At 31 December 2003, none of the Company's sponsor, Kingston, 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 31 October 2003 entered into between the Company and Kingston, Kingston has received and will receive a fee for acting as the Company's retained sponsor for the period from 31 October 2003 to 31 December 2004.

### AUDIT COMMITTEE

During the year, 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 four meetings and has reviewed and commented on the Company's draft quarterly, half year and annual financial reports.

### CORPORATE GOVERNANCE

The Company has complied throughout the year ended 31 December 2003 with the board practices and procedures as set out in Rules 5.28 to 5.39 of the GEM Listing Rules.

## DIRECTORS' REPORT

### COMPETING INTEREST

During the year, none of the directors and 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 year ended 31 December 2003, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

### AUDITORS

In the preceding three years, Messrs. Deloitte Touche Tohmatsu has been the auditors of the Company up to the financial year ended 31 December 2002. On 11 December 2003, Messrs. Deloitte Touche Tohmatsu resigned as the auditors of the Company and Louis Leung & Partners CPA Limited were appointed to fill the vacancy and have remained as the Company's auditors since then.

A resolution will be submitted to the forthcoming annual general meeting of the Company to re-appoint Louis Leung & Partners CPA Limited as auditors of the Company.

On behalf of the Board

**Chim Kim Kiu, Jacky**

*Chairman*

Hong Kong, 26 March 2004

## AUDITORS' REPORT

TO THE SHAREHOLDERS OF

**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)*

*(Incorporated in the Cayman Islands with limited liability)*

We have audited the financial statements on pages 21 to 49 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 the 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 solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

### 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 of the Group as at 31 December 2003 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.

### LOUIS LEUNG & PARTNERS CPA LIMITED

AU YANG SUNG FAT, CPA

Practising Certificate Number: P2433

Hong Kong, 26 March 2004



## CONSOLIDATED INCOME STATEMENT (For the year ended 31 December 2003)

	Notes	2003 HK\$	2002 HK\$
Turnover	4	30,782,461	14,058,190
Cost of sales		<u>(29,979,122)</u>	<u>(16,872,043)</u>
Gross profit/(loss)		803,339	(2,813,853)
Other operating income	6	117,264	160,014
Selling and distribution expenses		(716,127)	(363,159)
Administrative expenses		<u>(2,170,616)</u>	<u>(2,074,214)</u>
Loss from operations	7	<u>(1,966,140)</u>	<u>(5,091,212)</u>
Finance costs		–	–
Loss before taxation		<u>(1,966,140)</u>	<u>(5,091,212)</u>
Taxation	9	–	–
Loss for the year		<u><u>(1,966,140)</u></u>	<u><u>(5,091,212)</u></u>
Dividend	10	–	–
Loss per share			(Restated)
– basic	11	<u><u>0.05 cents</u></u>	<u><u>0.14 cents</u></u>
– diluted		<u><u>N/A</u></u>	<u><u>N/A</u></u>

## CONSOLIDATED BALANCE SHEET (As at 31 December 2003)

	Notes	2003 HK\$	2002 HK\$ <i>(Restated)</i>
<b>NON-CURRENT ASSETS</b>			
Property, plant and equipment	12	<u>55,896,816</u>	<u>46,250,953</u>
<b>CURRENT ASSETS</b>			
Inventories	14	12,340,546	11,730,540
Trade and other receivables	15	4,550,913	5,544,970
Bank balances and cash	16	<u>1,511,204</u>	<u>9,908,345</u>
		<u>18,402,663</u>	<u>27,183,855</u>
<b>CURRENT LIABILITIES</b>			
Trade and other payables	17	8,374,940	6,230,880
Amounts due to directors	18	3,777,093	3,086,792
Amount due to ultimate holding company	19	—	3,550
		<u>12,152,033</u>	<u>9,321,222</u>
<b>NET CURRENT ASSETS</b>			
		<u>6,250,630</u>	<u>17,862,633</u>
<b>NON-CURRENT LIABILITIES</b>			
Deferred tax liabilities		<u>(8,151,116)</u>	<u>(8,151,116)</u>
		<u>53,996,330</u>	<u>55,962,470</u>
<b>CAPITAL AND RESERVES</b>			
Share Capital	20	8,000,000	8,000,000
Reserves		<u>45,996,330</u>	<u>47,962,470</u>
		<u>53,996,330</u>	<u>55,962,470</u>

The financial statements on pages 21 to 49 were approved and authorized for issue by the Board of Directors on 26 March 2004 and are signed on its behalf by:

**Ip Kai Cheong**  
Director

**Sun Tak Keung**  
Director

**BALANCE SHEET** (As at 31 December 2003)

	Notes	2003 HK\$	2002 HK\$
<b>NON-CURRENT ASSETS</b>			
Property, plant and equipment	12	26,928	–
Interests in subsidiaries	13	67,046,608	60,601,317
		<u>67,073,536</u>	<u>60,601,317</u>
<b>CURRENT ASSETS</b>			
Other receivables		18,690	189,552
Bank balances and cash		520,285	7,295,260
		<u>538,975</u>	<u>7,484,812</u>
<b>CURRENT LIABILITIES</b>			
Amount due to a director		558,051	–
Other payables		248,971	240,000
Amount due to ultimate holding company	19	–	3,550
		<u>807,022</u>	<u>243,550</u>
<b>NET CURRENT (LIABILITIES)/ASSETS</b>		<u>(268,047)</u>	<u>7,241,262</u>
		<u>66,805,489</u>	<u>67,842,579</u>
<b>CAPITAL AND RESERVES</b>			
Share Capital	20	8,000,000	8,000,000
Reserves	22	58,805,489	59,842,579
		<u>66,805,489</u>	<u>67,842,579</u>

**Ip Kai Cheong**  
Director

**Sun Tak Keung**  
Director

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (For the year ended 31 December 2003)

	Share capital HK\$	Share premium HK\$	Special reserve HK\$	Revaluation reserve HK\$	Exchange reserve HK\$	Accumulated loss 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	-	-	-	-	(3,498)	-	(3,498)
Deferred tax adjustment on revaluation of machinery and equipment arising from adoption of HKSSAP 12	-	-	-	(8,151,116)	-	-	(8,151,116)
Loss for the year	-	-	-	-	-	(5,091,212)	(5,091,212)
At 31 December 2002	<u>8,000,000</u>	<u>35,770,199</u>	<u>985,000</u>	<u>23,509,170</u>	<u>(2,096)</u>	<u>(12,299,803)</u>	<u>55,962,470</u>
At 1 January 2003							
As previously reported	8,000,000	35,770,199	985,000	31,660,286	(2,096)	(12,299,803)	64,113,586
Deferred tax adjustment on revaluation of machinery and equipment arising from adoption of HKSSAP12	-	-	-	(8,151,116)	-	-	(8,151,116)
As restated	<u>8,000,000</u>	<u>35,770,199</u>	<u>985,000</u>	<u>23,509,170</u>	<u>(2,096)</u>	<u>(12,299,803)</u>	<u>55,962,470</u>
Loss for the year	-	-	-	-	-	(1,966,140)	(1,966,140)
<b>At 31 December 2003</b>	<b><u>8,000,000</u></b>	<b><u>35,770,199</u></b>	<b><u>985,000</u></b>	<b><u>23,509,170</u></b>	<b><u>(2,096)</u></b>	<b><u>(14,265,943)</u></b>	<b><u>53,996,330</u></b>

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 for the listing of the Company's shares on the Growth Enterprise Market in 2002.

## CONSOLIDATED CASH FLOW STATEMENT (For the year ended 31 December 2003)

	2003 HK\$	2002 HK\$
<b>OPERATING ACTIVITIES</b>		
Loss before taxation	(1,966,140)	(5,091,212)
Interest income	(20,674)	(52,440)
Depreciation	1,646,527	1,124,467
Operating loss before movements in working capital	(340,287)	(4,019,185)
Increase in inventories	(610,006)	(4,929,066)
Decrease/(increase) in trade and other receivables	994,057	(2,368,175)
Increase in trade and other payables	2,144,060	2,632,662
<b>NET CASH FROM/(USED IN) OPERATING ACTIVITIES</b>	<b>2,187,824</b>	<b>(8,683,764)</b>
<b>INVESTING ACTIVITIES</b>		
Interests received from bank deposits	20,674	52,440
Purchase of property, plant and equipment	(11,292,390)	(7,043,545)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(11,271,716)</b>	<b>(6,991,105)</b>
<b>FINANCING ACTIVITIES</b>		
Proceeds from issue of shares	–	32,000,000
Shares issue expenses	–	(6,584,689)
Repayment of loans	–	(3,773,585)
Advance from directors	690,301	3,086,792
Repayment of amount due to a director	–	(1,542,453)
(Repayment to)/advance from ultimate holding company	(3,550)	3,550
<b>NET CASH FROM FINANCING ACTIVITIES</b>	<b>686,751</b>	<b>23,189,615</b>
<b>NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(8,397,141)</b>	<b>7,514,746</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR</b>	<b>9,908,345</b>	<b>2,393,599</b>
<b>CASH AND CASH EQUIVALENTS AT END OF THE YEAR</b>	<b>1,511,204</b>	<b>9,908,345</b>
<b>ANALYSIS OF THE BALANCES OF CASH AND CASH EQUIVALENTS</b>		
Bank balances and cash	1,511,204	9,908,345

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 1. CORPORATE INFORMATION

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 incorporated 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 29.

### 2. ADOPTION OF REVISED STATEMENT OF STANDARD ACCOUNTING PRACTICE

In prior years, deferred tax liabilities were provided for using the liability method in respect of the taxation effect arising from all material timing differences between the accounting and tax treatment of income and expenditure, which were expected with reasonable probability to crystallise in the foreseeable future. Deferred tax assets were not recognized unless their realization was assured beyond reasonable doubt. With effect from 1 January 2003, the Group has changed its policy for deferred tax in order to comply with Hong Kong Statement of Standard Accounting Practice 12 (revised) ("HKSSAP 12") on "Income Taxes" issued by the Hong Kong Society of Accountants. Details of the new policy are set out in note 3 "Income tax".

The balance on the Group's revaluation reserve at 31 December 2003 and 31 December 2002 was reduced by HK\$8,151,116 in both years, representing the deferred tax liabilities recognized in respect of the revaluation surplus on the Group's machinery and equipment.

The adoption of HKSSAP 12 represents a change in accounting policy which has been applied retrospectively. The change in accounting policy has been reflected by way of a prior year adjustment and the comparative figures for 2002 have been restated to conform with the current year's presentation accordingly.

### 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 all applicable Hong Kong Financial Reporting Standards (which includes all applicable Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Society of Accountants, accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. 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.

## NOTES TO THE FINANCIAL STATEMENTS *(For the year ended 31 December 2003)*

### 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

#### **Basis of consolidation** *(Continued)*

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

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 losses.

#### **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 2003)

### 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.

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### **Impairment** (Continued)

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.

#### **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 income statement 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.

#### **Income tax**

- (i) Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the income statement except to the extent that they relate to items recognised directly in reserves, in which case they are recognised in reserves.
- (ii) Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Income tax (Continued)

- (iii) Deferred tax assets and liabilities arise from deductible and taxable temporary differences between the carrying amounts of assets and liabilities for financial reporting purpose and the tax bases respectively. Deferred tax assets also arise from unused tax losses and unused tax credits.

Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available, against which deductible temporary differences can be utilised.

Deferred tax is calculated at the tax rates that are expected to apply in the year when the liability is settled or the asset is realised. Deferred tax assets and liabilities are not discounted. The carrying amount of deferred tax assets/liabilities is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised.

- (iv) Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if, and only if, the Company and the Group has the legally enforceable right to set off current tax assets against current tax liabilities. The principle of offsetting usually applies to income tax levied by the same tax authority on same taxable entity.

#### 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.

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 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.

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 2003			
	Pulps and papers HK\$	Paper filling materials HK\$	Elimination HK\$	Consolidated HK\$
<b>REVENUE</b>				
External sales	30,782,461	–	–	30,782,461
Inter-segment sales	–	602,185	(602,185)	–
Total revenue	<u>30,782,461</u>	<u>602,185</u>	<u>(602,185)</u>	<u>30,782,461</u>
<b>RESULT</b>				
Segment loss	<u>(590,902)</u>	<u>(31,580)</u>	–	(622,482)
Unallocated other operating income				112,811
Unallocated corporate expenses				<u>(1,456,469)</u>
Loss before taxation				(1,966,140)
Taxation				–
Loss for the year				<u><u>(1,966,140)</u></u>

Inter-segment sales are charged at prevailing market prices.

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 5. SEGMENT INFORMATION (Continued)

#### Business segments (Continued)

#### BALANCE SHEET

	At 31 December 2003			Consolidated HK\$
	Pulps and papers HK\$	Paper filling materials HK\$		
<b>ASSETS</b>				
Segment assets	63,924,364	2,847,720		66,772,084
Unallocated corporate assets				7,527,395
Total assets				<u>74,299,479</u>
<b>LIABILITIES</b>				
Segment liabilities	13,001,837	110,491		13,112,328
Unallocated corporate liabilities				7,190,821
Total liabilities				<u>20,303,149</u>
	Pulps and papers HK\$	Paper filling materials HK\$	Others HK\$	Consolidated HK\$
<b>OTHER INFORMATION</b>				
Capital expenditure	10,001,937	913,675	376,778	11,292,390
Depreciation	1,273,047	99,786	273,694	1,646,527

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 5. SEGMENT INFORMATION (Continued)

#### Business segments (Continued)

	For the year ended 31 December 2002			
	Pulps and papers	Paper filling materials	Elimination	Consolidated
	HK\$	HK\$	HK\$	HK\$
<b>REVENUE</b>				
External sales	14,058,190	–	–	14,058,190
Inter-segment sales	–	503,022	(503,022)	–
	<u>14,058,190</u>	<u>503,022</u>	<u>(503,022)</u>	<u>14,058,190</u>
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.				
<b>RESULT</b>				
Segment loss	<u>(3,822,967)</u>	<u>(355,494)</u>	–	(4,178,461)
Unallocated other operating income				52,439
Unallocated corporate expenses				<u>(965,190)</u>
Loss before taxation				(5,091,212)
Taxation				<u>–</u>
Loss for the year				<u><u>(5,091,212)</u></u>

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 5. SEGMENT INFORMATION (Continued)

#### Business segments (Continued)

#### BALANCE SHEET

	At 31 December 2002			Consolidated <i>HK\$</i> (Restated)
	Pulps and papers <i>HK\$</i> (Restated)	Paper filling materials <i>HK\$</i>		
<b>ASSETS</b>				
Segment assets	63,106,848	2,219,682		65,326,530
Unallocated corporate assets				8,108,278
Total assets				<u>73,434,808</u>
<b>LIABILITIES</b>				
Segment liabilities	14,131,582	10,414		14,141,996
Unallocated corporate liabilities				3,330,342
Total liabilities				<u>17,472,338</u>
<b>OTHER INFORMATION</b>				
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>

#### 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.

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 6. OTHER OPERATING INCOME

Included in other operating income is interest income from bank deposits of HK\$20,674 (2002: HK\$52,440).

### 7. LOSS FROM OPERATIONS

Loss from operations has been arrived at after charging:

	<b>2003</b>	2002
	<i>HK\$</i>	<i>HK\$</i>
Auditors' remuneration		
– provided for in current year	<b>107,547</b>	404,717
– over-provided for in previous year	<b>(90,000)</b>	–
	<u><b>17,547</b></u>	<u>404,717</u>
Directors' remuneration		
– fees	–	–
– other emoluments	<b>80,661</b>	57,642
Other staff costs	<b>3,795,639</b>	2,501,357
	<u><b>3,876,300</b></u>	<u>2,558,999</u>
Depreciation	<b>1,646,527</b>	1,124,467
Operating lease payment in respect of rented premises	<b>32,604</b>	90,481
Allowance for inventories included in cost of sales	–	1,203,799
Research and development costs	<b>3,445</b>	23,793
	<u><b>3,445</b></u>	<u>23,793</u>

Contributions to defined contribution retirement benefit scheme included in other staff costs amounted to HK\$41,599 (2002: HK\$6,968).



## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 8. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID EMPLOYEES' EMOLUMENTS

#### A director

	2003 HK\$	2002 HK\$
Fees	–	–
Salaries and other benefits	80,661	57,642
Bonus	–	–
Contributions to retirement benefit scheme	–	–
	<u>80,661</u>	<u>57,642</u>

For the year ended 31 December 2002, three directors waived their emoluments of an aggregate HK\$245,000. 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, one (2002: three, two of them waived their emoluments as included in the amount set out above) was director of the Company. The remuneration of the remaining four (2002: two) individuals were as follows:–

	2003 HK\$	2002 HK\$
Salaries and other benefits	248,058	191,417
Contributions to retirement benefits scheme	10,863	6,968
	<u>258,921</u>	<u>198,385</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, one of the PRC subsidiaries is 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 other PRC subsidiary was in loss making position for the current and the previous years and accordingly did not have any assessable profit.

**NOTES TO THE FINANCIAL STATEMENTS** *(For the year ended 31 December 2003)***9. TAXATION** *(Continued)*

The balance on the Group's revaluation reserve at 31 December 2003 and 31 December 2002 was reduced by HK\$8,151,116 in both years, representing the deferred tax liabilities recognized in respect of the revaluation surplus on the Group's machinery and equipment.

**10. DIVIDEND**

No dividend has been paid or proposed during 2003, nor has any dividend been proposed since the balance sheet date (2002: Nil).

**11. LOSS PER SHARE**

The calculation of basic loss per share is based on the loss for the year of HK\$1,966,140 (2002: HK\$5,091,212) and on the weighted average number of 4,000,000,000 (2002: 3,585,753,425 (Restated)) 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 2003 would result in reduction in loss per share.

Pursuant to an ordinary resolution passed at an extraordinary general meeting of the Company held on 7 October 2003, each of the initial issued and unissued shares having a par value of HK\$0.01 were subdivided into five subdivided shares having a par value of HK\$0.002 each with effect from 8 October 2003. Upon the share subdivision becoming effective on 8 October 2003, the authorised share capital of the Company became HK\$20 million divided into 10,000 million subdivided shares, of which 4,000 million subdivided shares are in issue and fully paid. The subdivided shares rank *pari passu* in all respects with each other and the rights attaching to the subdivided shares are not affected by the share subdivision. The weighted average number of ordinary shares in 2002 for the purposes of calculating the basic loss per share have been retrospectively adjusted for the one-to-five share subdivision which took place in October 2003.

NOTES TO THE FINANCIAL STATEMENTS *(For the year ended 31 December 2003)***12. PROPERTY, PLANT AND EQUIPMENT  
THE GROUP**

	Buildings <i>HK\$</i>	Machinery & equipment <i>HK\$</i>	Furniture & fixtures <i>HK\$</i>	Motor vehicles <i>HK\$</i>	Construction in progress <i>HK\$</i>	Total <i>HK\$</i>
<b>Cost/valuation</b>						
At 1 January 2003	4,061,179	36,798,953	296,178	680,637	5,985,159	47,822,106
Additions	–	655,197	45,312	–	10,591,881	11,292,390
Reallocation	–	16,510,911	–	–	(16,510,911)	–
<b>At 31 December 2003</b>	<b><u>4,061,179</u></b>	<b><u>53,965,061</u></b>	<b><u>341,490</u></b>	<b><u>680,637</u></b>	<b><u>66,129</u></b>	<b><u>59,114,496</u></b>
<b>Comprising:</b>						
At cost	4,061,179	17,815,029	341,490	680,637	66,129	22,964,464
At valuation	–	36,150,032	–	–	–	36,150,032
<b>At 31 December 2003</b>	<b><u>4,061,179</u></b>	<b><u>53,965,061</u></b>	<b><u>341,490</u></b>	<b><u>680,637</u></b>	<b><u>66,129</u></b>	<b><u>59,114,496</u></b>
<b>Depreciation</b>						
At 1 January 2003	279,664	1,063,240	88,488	139,761	–	1,571,153
Provided for the year	121,835	1,372,833	34,871	116,988	–	1,646,527
<b>At 31 December 2003</b>	<b><u>401,499</u></b>	<b><u>2,436,073</u></b>	<b><u>123,359</u></b>	<b><u>256,749</u></b>	<b><u>–</u></b>	<b><u>3,217,680</u></b>
<b>Net book values</b>						
<b>At 31 December 2003</b>	<b><u>3,659,680</u></b>	<b><u>51,528,988</u></b>	<b><u>218,131</u></b>	<b><u>423,888</u></b>	<b><u>66,129</u></b>	<b><u>55,896,816</u></b>
At 31 December 2002	<u>3,781,515</u>	<u>35,735,713</u>	<u>207,690</u>	<u>540,876</u>	<u>5,985,159</u>	<u>46,250,953</u>

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 12. PROPERTY, PLANT AND EQUIPMENT (Continued) THE COMPANY

	<b>Furniture &amp; fixtures</b> <i>HK\$</i>
<b>Cost</b>	
Additions and at 31 December 2003	<u>28,010</u>
<b>Depreciation</b>	
Provided for the year and at 31 December 2003	<u>1,082</u>
<b>Net book values</b>	
At 31 December 2003	<u><u>26,928</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\$33,718,000 at 31 December 2003 (2002: HK\$34,979,000). If they had not been revalued, they would have been included in the financial statements at historical cost less accumulated depreciation of approximately HK\$3,929,000 (2002: HK\$4,059,000).

The directors consider the carrying value of machinery and equipment as at 31 December 2003 was not significantly different from its fair value at that date.

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 13. INTERESTS IN SUBSIDIARIES

	<b>2003</b>	2002
	<i>HK\$</i>	<i>HK\$</i>
Unlisted shares, at cost	<b>24,894,410</b>	24,894,410
Amounts due from subsidiaries	<b>42,152,198</b>	35,706,907
	<b><u>67,046,608</u></b>	<u>60,601,317</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 2003 are set out in note 29.

### 14. INVENTORIES

	<b>2003</b>	2002
	<i>HK\$</i>	<i>HK\$</i>
Raw materials and consumables	<b>5,970,671</b>	6,894,410
Work in progress	<b>72,065</b>	83,227
Finished goods	<b>6,297,810</b>	4,752,903
	<b><u>12,340,546</u></b>	<u>11,730,540</u>

Finished goods are carried at cost and net realisable value as at 31 December 2003 and 31 December 2002 respectively.

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 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:–

	<b>2003</b>	2002
	<i>HK\$</i>	<i>HK\$</i>
0 – 30 days	<b>1,067,417</b>	1,153,357
31 – 60 days	<b>12,848</b>	94,008
61 – 90 days	<b>201,302</b>	309,442
91 – 120 days	<b>93,023</b>	–
Over 120 days	<b>715,460</b>	1,857,853
	<hr/>	<hr/>
	<b>2,090,050</b>	3,414,660
Other debtors, deposits and prepayments	<b>2,460,863</b>	2,130,310
	<hr/>	<hr/>
	<b>4,550,913</b>	5,544,970
	<hr/> <hr/>	<hr/> <hr/>

### 16. BANK BALANCES AND CASH

Included in bank balances and cash as at 31 December 2003 was an aggregate amount of approximately HK\$840,000 (2002: HK\$2,140,000) 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 payables is as follows:–

	<b>2003</b>	2002
	<i>HK\$</i>	<i>HK\$</i>
0 – 30 days	<b>1,622,612</b>	3,177,170
31 – 60 days	<b>539,474</b>	98,209
61 – 90 days	<b>205,181</b>	31,639
91 – 120 days	<b>81,477</b>	312,285
Over 120 days	<b>2,497,096</b>	722,993
	<hr/>	<hr/>
	<b>4,945,840</b>	4,342,296
Other creditors and accrued charges	<b>3,429,100</b>	1,888,584
	<hr/>	<hr/>
	<b>8,374,940</b>	6,230,880
	<hr/> <hr/>	<hr/> <hr/>

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 18. AMOUNTS DUE TO DIRECTORS

All the amounts due to directors 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. SHARE CAPITAL

Details of share capital were as follows:

	Number of shares	HK\$
<i>Authorised:</i>		
On incorporation	1,000,000	10,000
Increase during the period	1,999,000,000	19,990,000
	<hr/>	<hr/>
At 31 December 2002, ordinary shares of HK\$0.01 each	2,000,000,000	20,000,000
Increase in share subdivision	8,000,000,000	–
	<hr/>	<hr/>
At 31 December 2003, ordinary shares of HK\$0.002 each	<u>10,000,000,000</u>	<u>20,000,000</u>
<i>Issued &amp; 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	638,000,000	6,380,000
	<hr/>	<hr/>
At 31 December 2002, ordinary shares of HK\$0.01 each	800,000,000	8,000,000
Increase in share subdivision	3,200,000,000	–
	<hr/>	<hr/>
At 31 December 2003, ordinary shares of HK\$0.002 each	<u>4,000,000,000</u>	<u>8,000,000</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.

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 20. SHARE CAPITAL *(Continued)*

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 Kanstar Environmental Technology Group Limited ("KETG"); and
- (iii) the Company allotted and issued 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.

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.

Pursuant to an ordinary resolution passed at an extraordinary general meeting of the Company held on 7 October 2003, each of the initial issued and unissued shares having a par value of HK\$0.01 were subdivided into five subdivided shares having a par value of HK\$0.002 each with effect from 8 October 2003. Upon the share subdivision becoming effective on 8 October 2003, the authorised share capital of the Company became HK\$20 million divided into 10,000 million subdivided shares, of which 4,000 million subdivided shares are in issue and fully paid. The subdivided shares rank *pari passu* in all respects with each other and the rights attaching to the subdivided shares are not affected by the share subdivision.



## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 21. SHARE OPTION SCHEMES

The Company adopted two share option schemes (hereinafter refer to the "Pre-IPO Share Option 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 shall 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 2003)

### 21. 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:–

	Exercisable period	No of options as at 1 January 2003 <small>(Note)</small>	Cancelled/ Lapsed during the year <small>(Note)</small>	No of options as at 31 December 2003
Directors	12 July 2002 – 11 July 2007	110,000,000	–	110,000,000
	12 January 2003 – 11 January 2008	73,350,000	–	73,350,000
	12 July 2003 – 11 July 2008	19,000,000	19,000,000	–
Employees	12 July 2003 – 11 July 2008	<u>48,750,000</u>	<u>15,750,000</u>	<u>33,000,000</u>
		<u>251,100,000</u>	<u>34,750,000</u>	<u>216,350,000</u>

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 recognized 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.

*Note:* Pursuant to an ordinary resolution passed at an extraordinary general meeting of the Company held on 7 October 2003, each of the initial issued and unissued shares having a par value of HK\$0.01 were subdivided into five subdivided shares having a par value of HK\$0.002 each with effect from 8 October 2003. This share subdivision gave rise to adjustments to both the exercise price and the number of underlying shares granted under the Pre-IPO Share Option Scheme, and accordingly every option originally granted was increased to five options.

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 22. RESERVES

	Share premium <i>HK\$</i>	Accumulated loss <i>HK\$</i>	Total <i>HK\$</i>
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)
	<hr/>	<hr/>	<hr/>
At 31 December 2002	60,649,609	(807,030)	59,842,579
Loss for the year	–	(1,037,090)	(1,037,090)
	<hr/>	<hr/>	<hr/>
At 31 December 2003	<u>60,649,609</u>	<u>(1,844,120)</u>	<u>58,805,489</u>

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\$58,805,489 (2002: HK\$59,842,579).

### 23. 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 25% of the stipulated salary set by the Yunnan provincial government to the retirement benefits schemes to fund the retirement benefits of certain of the Group's employees. The only obligation of the Group with respect to the retirement benefits schemes is to make the required contributions under the scheme. Such contribution was made in current year as the Group's employees have entered into formal employment contracts with the Group starting from October 2003.

During the year, the Group has contributed HK\$41,599 (2002: HK\$6,968).

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 24. 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:–

	<b>2003</b>	2002
	<b>HK\$</b>	HK\$
Within one year	<b>172,805</b>	158,654
In the second to fifth year	<b>104,128</b>	274,106
	<b>276,933</b>	432,760

For rented premises, leases are negotiated for an average term of two to five years and rentals are fixed throughout the lease period.

On 22 September 2000, a land use right in PRC was granted by the Land Bureau of Changning in the PRC (the "Land Bureau") to a subsidiary for the period from 1 October 2000 to 1 October 2005 at an annual rental of approximately HK\$139,000 with a rental free period from 1 October 2000 to 30 September 2001.

On 4 June 2002, an undertaking was given by the Land Bureau for extending the said land use right to 21 September 2030 at an annual rental of approximately HK\$139,000 on which the paper plant situated and operated by a subsidiary of the Company. Pursuant to the undertaking, the rent will be subject to adjustment every five years, provided that the adjusted increment would not exceed 20%.

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. As the acquisition of the said land use right is under negotiation between the subsidiary and the Land Bureau, both parties have intended and considered the rental would further be waived up to 31 December 2003, and accordingly, no such rental was provided for in the financial statements.

### 25. RELATED PARTIES TRANSACTION

On 20 September 2003, the Company's ultimate holding company, Siko Venture, charged 10,000,000 ordinary shares of the Company as security for a three year term loan granted by a lender. The term loan granted would be on-lent to Kanstar Hong Kong Limited under a shareholder's loan agreement dated 20 September 2003.

On 2 October 2003, Kanstar Hong Kong Limited and Siko Venture entered into a cancellation agreement to cancel the shareholder's loan agreement.

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 26. CAPITAL COMMITMENTS

At 31 December 2003, the Group had capital commitments amounting to HK\$3,856,708 (2002: HK\$2,273,696) in respect of the acquisition of land use right in PRC and the acquisition of property, plant and equipment contracted but not provided for in the financial statements.

### 27. CONTINGENT LIABILITIES

At 31 December 2003, there were contingent liabilities in respect of quality guarantee to a customer amounting to HK\$188,680 (2002: Nil).

### 28. CHANGE OF COMPANY NAME

Pursuant to a special resolution passed at an extraordinary general meeting of the Company held on 7 October 2003, the Company's name was changed from "Kanstar Environmental Technology Holdings Limited" to "Kanstar Environmental Paper Products Holdings Limited".

### 29. PARTICULARS OF SUBSIDIARIES

Particulars of the Company's subsidiaries at 31 December 2003 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

## NOTES TO THE FINANCIAL STATEMENTS (For the year ended 31 December 2003)

### 29. PARTICULARS OF SUBSIDIARIES (Continued)

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	
雲南建星新技術產品開發有限公司 (前稱昆明建星新技術產品開發有限公司) Yunnan Kanstar High Tech Products Development Company Limited (formerly known as 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
Modern Lucky International Limited	Hong Kong	Limited liability Company	HK\$2	-	100%	Dormant

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

### 30. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with current year's presentation.

## FINANCIAL SUMMARY (For the year ended 31 December 2003)

### RESULT

	For the years ended 31 December			
	2000 HK\$	2001 HK\$	2002 HK\$	2003 HK\$
Turnover	–	2,909,965	14,058,190	<b>30,782,461</b>
Cost of sales	–	(4,902,490)	(16,872,043)	<b>(29,979,122)</b>
Gross profit/(loss)	–	(1,992,525)	(2,813,853)	<b>803,339</b>
Other operating income	10,425	55,631	160,014	<b>117,264</b>
Selling and distribution expenses	–	(102,643)	(363,159)	<b>(716,127)</b>
Administrative expenses	(1,678,183)	(3,405,004)	(2,074,214)	<b>(2,170,616)</b>
Loss from operations	(1,667,758)	(5,444,541)	(5,091,212)	<b>(1,966,140)</b>
Finance costs	(47,377)	(18,462)	–	<b>–</b>
Loss before taxation	(1,715,135)	(5,463,003)	(5,091,212)	<b>(1,966,140)</b>
Taxation	–	–	–	<b>–</b>
Loss for the year	<u>(1,715,135)</u>	<u>(5,463,003)</u>	<u>(5,091,212)</u>	<b><u>(1,966,140)</u></b>

### ASSETS AND LIABILITIES

	At 31 December			
	2000 HK\$	2001 HK\$	2002 HK\$ (Restated)	2003 HK\$
Total assets	20,951,988	21,043,457	73,434,808	<b>74,299,479</b>
Total liabilities	(22,686,302)	(27,250,646)	(17,472,338)	<b>(20,303,149)</b>
(Deficiency of) shareholders' funds	<u>(1,734,314)</u>	<u>(6,207,189)</u>	<u>55,962,470</u>	<b><u>53,996,330</u></b>

#### 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.