



**Lai Fai International Holdings Limited**  
(Incorporated in the Cayman Islands with limited liability)

# LAI FAI



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

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## CORPORATE INFORMATION

### BOARD OF DIRECTORS

#### Executive Directors

LI Shui (*Executive Chairman*)

LEE You

#### Non-executive Directors

Yoshitaka KITAO (*Honorary Non-executive Chairman*)

YU Kam Kee, Lawrence, *M.B.E. J.P.*

#### Independent Non-executive Directors

MAK Tak Cheong, Edmund

CHE King Lun, Frankly

### COMPLIANCE OFFICER

LI Shui

LAM King Pui, *CPA, FCCA, AHKSA, ACIS, ACS*

### COMPANY SECRETARY

LAM King Pui, *CPA, FCCA, AHKSA, ACIS, ACS*

### QUALIFIED ACCOUNTANT

LAM King Pui, *CPA, FCCA, AHKSA, ACIS, ACS*

### AUDIT COMMITTEE

MAK Tak Cheong, Edmund (*Chairman of Audit Committee*)

CHE King Lung, Frankly

LI Shui

### SPONSOR

Celestial Capital Limited

### GEM STOCK CODE

8183

### AUDITORS

Ernst & Young

*Certified Public Accountants*

### PRINCIPAL PLACE OF BUSINESS

Rear Portion of G/F

Grandview Garden

71-77 Pau Chung Street

Tokwawan

Kowloon

Hong Kong

### REGISTERED OFFICE

Century Yard

Cricket Square

Hutchins Drive

P.O. Box 2681 GT

George Town

Grand Cayman

British West Indies

### HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Tengis Limited

Ground Floor

Bank of East Asia Harbour View Centre

56 Gloucester Road

Wanchai

Hong Kong

### PRINCIPAL BANKERS

The Hongkong and Shanghai Banking Corporation Limited

Hang Seng Bank Limited

### WEBSITE ADDRESS

[www.laifai.com.hk](http://www.laifai.com.hk)

## CHAIRMAN'S STATEMENT

I would like to present the 2nd annual report of Lai Fai International Holdings Limited (the "Company") and its subsidiaries (collectively referred to as the "Group") for the year ended 31 December 2003 to shareholders.

It has been a challenging year for the Group. Following the listing of the Company's shares on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited on 26 February 2003 which marked the milestone of the Group's business establishment, Hong Kong has entered into an unprecedented difficult time from late March 2003 to July 2003. During the said period, the outbreak of the Severe Acute Respiratory Syndrome ("SARS") has not only led to the collapse of Hong Kong tourism but also a global slack in economic activities due to the wide spreading and high communicable SARS disease affecting a wide spectrum of activities.

### RESULTS

The Group's principal activities are manufacturing and retailing of jewellery products and its major source of revenue comes from Japanese tourists visiting Hong Kong by tours. Number of Japanese visitors visiting Hong Kong has dropped drastically in the 2 quarter of 2003 as a result of the outbreak of SARS by 86% when compared with the same quarter in last year. In this regard, the Group made a profit warning announcement at the GEM website on 25 April 2003 in alerting the shareholders of the Company and investors to exercise caution when dealing the Company's shares.

The aftermaths of SARS have led to a significant decrease in annual turnover and gross profit by 52% and 59% from last year respectively. Net loss from ordinary activities attributable to shareholders was approximately HK\$5 million whereas in last year there was a net profit from ordinary activities attributable to shareholders of approximately HK\$10.4 million.

For a more detailed analysis of the Group's results, please refer to the section of Management Discussion and Analysis.

**Chairman's Statement (cont'd)**

**LOOKING AHEAD**

With the whole-hearted efforts from the Hong Kong government in rebuilding the tourism after SARS, total number of visitors traveling to Hong Kong has reached record-high in the recent months.

Being at the heart of Asia, Hong Kong has won numerous awards for its cultural, scenic and cuisine attractions. Just to name a few, Hong Kong was accredited as "the Best Asia/Pacific Destination" by a Los Angeles Magazine "Travel Weekly" and selected as one of the 50 must go places for life by BBC Holiday and etc..

In hygiene aspect, Hong Kong has the highest standard in medical care as most of the advanced countries in the World. Hong Kong's medical workers were praised as anti-SARS heroes by the Time Asia Magazine. The government's adherence in upholding of medical precautions with zero recurrence cases for SARS or bird flu infections hitherto makes Hong Kong the safest place for travel.

In addition, the spectacular events as organized by the Hong Kong Tourism Board ("HKTB") from month to month make Hong Kong an entertaining and lively city for both new comers as well as re-visitors.

As per HKTB data, visitors from Mainland China has outperformed the figures for all other countries since the adoption of Individual Visa Scheme by the PRC government from July 2003 onwards, however, with so many attractions as organised by the Hong Kong government, we have seen a stable and constant growth in number of Japanese visitors since the last quarter of 2003. We are optimistic about restoration of the return of Japanese tourists and believe the visitors from Japan will sooner be restored to the pre-SARS level in the coming year.

On the wholesaling aspect of our jewellery products, the Group has successfully explored the Japanese market by entering into a supply agreement on 15 October 2003 with HOMEOSTYLE Inc. ("HOS"), which has 39 outlets in all major cities of Japan for its fashion, cosmetic, health care and jewellery products, the initial orders from HOS were quite satisfactory.

**Chairman's Statement (cont'd)****LOOKING AHEAD** *(continued)*

Besides Japan, the Group has accelerated its pace of market expansion in Mainland China as a result of the Closer Economic Partnership Arrangement ("CEPA"). From 1 January 2004, 273 items of products as per CEPA appendix meeting the requirements of place of origin in Hong Kong will enjoy zero tariff when trading into China. Jewellery products, being one of the 273 products on the CEPA appendix list that were previously imposed tariffs at rate of 26% to 35%, will now be tariff free. Since all the Group's establishment are all based in Hong Kong and met the requirements of CEPA for place of origin, it will leverage on its competitive edge and speed up its expansion for distribution of its products to the Mainland China as stated in the Prospectus.

**ACKNOWLEDGEMENT**

I wish to take this opportunity to thank all my fellow directors and consultant for their valuable contributions. On behalf of the Board of Directors, I would also like to express my sincere gratitude to our shareholders, customers and business partners, as well as our staff for their ongoing supports and dedication.

**Li Shui**

*Executive Chairman*

Hong Kong, 29 March 2004



Photo taken in the signing ceremony for the Supply Agreement entered into between Lai Fai Group and HOMEOSTYLE Inc. in Japan on 15 October 2003

- Left 1 Hideaki Shimane (Representative from Softbank Finance Corporation)
- Left 2 Yu Kam Kee, Lawrence, M.B.E. (Chairman of SIIS)
- Middle Li Shui (Executive chairman of Lai Fai Group)
- Right 2 Kazumori Morita (Director of HOMEOSTYLE Inc.)
- Right 1 Yoshitaka Kitao (CEO of Softbank Finance Corporation)



The product line "Bloo" from the co-branding shop of Lai Fai and HOMEOSTYLE in Harajuku



The co-branding shop of Lai Fai and HOMEOSTYLE situated in Harajuku of Japan opened on 23 December 2003





The co-branding shop of Lai Fai and HOMEOSTYLE situated in Harajuku of Japan opened on 23 December 2003



The outlook of one of HOMEOSTYLE's branches in Harajuku of Japan



The reverse side of the Lai Fai membership card illustrating the birthday stones for 12 months

## MANAGEMENT DISCUSSION AND ANALYSIS

### OPERATION REVIEW

As mentioned earlier, the outbreak of SARS had led to the collapse of Hong Kong tourism in the second quarter of 2003 and the Group's operation was seriously affected as a result of SARS. Number of Japanese visitors arrived Hong Kong as tabled below showed a drastic decrease of 86% in the second quarter of 2003 and significant decrease of 38% for the whole year.

#### Number of Japanese Visitors travel to Hong Kong as published by HKTB

	Year 2003	(% decrease)	Year 2002
First Quarter	325,431	(2%)	332,848
Second Quarter	47,552	(86%)	330,972
Third Quarter	232,277	(36%)	362,200
Fourth Quarter	261,900	(29%)	369,000
<b>Total</b>	<b>867,160</b>	<b>(38%)</b>	<b>1,395,020</b>

Signs of recovery were seen in the third quarter of 2003 demonstrating a tremendous growth of 388% from the second quarter and a continual growth of 13% in the fourth quarter for the visitors from Japan as a result of the efforts by the Hong Kong government and the Hong Kong Tourism Board.

### Turnover

The Group is principally engaged in the manufacture, retail and wholesale of jewellery products. The Group's retail business appeals to Japanese tourists who are substantially referred to the Group by inbound Japanese tour operators in Hong Kong with whom the Group has entered into Business Cooperation Agreements for an initial term of 3 years and then renewable annually thereafter.

The aftermaths of SARS has led to the decrease in turnover in the current year by approximately 52% to HK\$22.6 million (2002: HK\$47 million).

**Management Discussion and Analysis (cont'd)****OPERATION REVIEW (continued)****Gross Profit**

Greater magnitude of decrement in gross profit than turnover in the current year by approximately 59% to HK\$14.4 million (2002: HK\$35.6 million) was mainly attributed to the HK\$1 million slow moving inventory provision as proposed by management for prudence sake for the first time. If the slow moving inventory provision of HK\$1 million was excluded from the cost of sales for assessing the magnitude of decrement in gross profit, a more comparable decrement of 57% would be shown.

Gross profit margin in the current year was approximately 64%. By the same token, if the slow moving inventory provision of HK\$1 million was excluded from the cost of sales for assessing the gross profit margin, gross profit margin of approximately 68% would be demonstrated. This is more comparable to the gross profit margin in last year of approximately 76%, leaving a magnitude gap of 8% being the results of more price discounts were given to customers to stimulate their spending after the SARS period.

**Net Loss from Ordinary Activities Attributable to Shareholders**

Despite of the fact that the Group has adopted stringent measures in cost controls, including salary and wages, the low level gross profit was not enough in sustaining the operating expenses of the Group. Net loss from ordinary activities attributable to shareholders of approximately HK\$5 million was resulted (2002: net profit of HK\$10.4 million).

**BUSINESS OUTLOOK AND PROSPECT**

A bleak year had been passed and most of the unfavorable conditions in Hong Kong were fading out. We saw a strong revival momentum for various kinds of economic activities in the last quarter of 2003 and a tremendous improvement in consumption and spending pattern of the public in general.

2004 is a year with good start for both the record-breaking number in visitors traveled to Hong Kong and an obvious sign of cessation of deflation that has been distracting Hong Kong for more than 5 years.

**Management Discussion and Analysis (cont'd)**

**BUSINESS OUTLOOK AND PROSPECT** *(continued)*

Looking ahead, Hong Kong will have excellent conditions for both infrastructural and outbound connections in facilitation of tourism. The opening of Disneyland in 2005, the hosting of Olympic Games by Beijing in 2008, the hosting of East Asian Games by Hong Kong in 2009 together with the prolific attractions as organised by the Hong Kong Tourism Board from month to month in enriching Hong Kong's cultural, scenic and cuisine attractions will definitely make Hong Kong be chosen as one of the 50 "must go" places for life every year. The projects for building the Hongkong-Zhuhai-Macau Bridge, the Tung Chung cable car to the Big Buddha and various rapid connection railways between New Territories, Hong Kong and Kowloon will not only attract re-visitors to town for enjoyment of easy travel but also new comers taking Hong Kong as a convenient gateway for travel to the Mainland China. In addition, Hong Kong has the best medical workers in prevention of highly communicable disease, the excellent police force in fighting against crime and a committed government in promoting tourism which all made Hong Kong as one of the safest cities in the World for pleasure. Management of the Group is optimistic about the retail aspect of the Group's operation and expects the turnover will sooner be recovered to the pre-SARS level.

For the manufacturing and wholesaling aspects of the Group's jewellery products, the Group has entered into a supply agreement on 15 October 2003 with HOMEOSTYLE Inc. ("HOS") with an annual cap of HK\$6 million for each of the financial years ending 31 December 2005. HOS is a retailer and distributor of fashion, cosmetic, health care and jewellery products and has 39 outlets in all major cities of Japan. The initial orders from HOS were quite satisfactory and the Group will continue to explore every market potential in the Japan market.

Upon the signing of CEPA, the Group has also accelerated its pace of distribution of its jewellery products to the Mainland China market. CEPA covers 3 broad areas of preferential terms to Hong Kong enterprises for trading with China, namely, (i) trade in goods; (ii) trade in services and (iii) trade and investment facilitation.

For (i) trade in goods, the Group has spent for approximately HK\$116,000 in improving the workshop facilities as required by the Trade and Industry Department and rendered itself a qualified Hong Kong enterprise meeting the CEPA requirements for place of origin.

**Management Discussion and Analysis (cont'd)****BUSINESS OUTLOOK AND PROSPECT** *(continued)*

The Group will leverage on its competitive advantage under CEPA and zero tariff rate for the jewellery products trade into the Mainland China market and launch an active plan for its market expansion into the huge China market as stated in the Prospectus.

**LIQUIDITY AND FINANCIAL RESOURCES**

As at 31 December 2003, shareholders' funds amounted to approximately HK\$40.4 million. The Group had no non-current liabilities and its current liabilities amounted to approximately HK\$4.2 million comprising mainly accruals, accounts payable, other payables and bank borrowing. The Group's bank borrowing amounted to approximately HK\$1.1 million as at 31 December 2003.

In addition to the bank borrowing, the Group has an unsecured banking facility of HK\$3 million as at 31 December 2003 which are all unutilised at that date. The Group financed its operations primarily with internally generated cash flows, bank borrowings and partly from net proceeds for listing of the Company's shares on the GEM of the Stock Exchange on 26 February 2003.

Except for a time deposit of HK\$84,000 pledged to a bank to secure a banking facility in respect of utility deposit granted to the Group, there were no other charges on the Group's assets as at 31 December 2003.

As at 31 December 2003, the gearing ratio was approximately 2.7% (2002: 0.9%) on the basis of bank borrowings divided by shareholders' fund. The Group had cash and cash equivalents of approximately HK\$11.4 million at as 31 December 2003 of which HK\$5.1 million was placed with Hang Seng Bank Limited as Hong Kong dollars time deposits.

**EMPLOYEE INFORMATION**

Number of staff (excluding 2 executive directors) as at the year ended date 31 December 2003 was 53 (2002: 55), who are all working in Hong Kong.

Total staff costs (excluding directors' remuneration), including retirement benefits scheme contributions for the year ended 31 December 2003 amounted to approximately HK\$5.6 million (2002: HK\$6.4 million). The Group pays its employees based on their performance, experience and the prevailing industry practice.

**Management Discussion and Analysis (cont'd)**

**EMPLOYEE INFORMATION** *(continued)*

Each of the two executive directors has, on 5 February 2003, entered into a service agreement with the Company and is entitled to an annual performance related discretionary bonus (the "Bonus"). The Bonus will be determined by the Board of Directors provided that all bonus payments to be made to the executive directors of the Company in each relevant financial year of the Company shall not exceed 10% of the Group's audited consolidated profits after tax as indicated in the Group's annual audited consolidated financial statements for the relevant financial year.

(i) To continue to stay ahead of its competitors, (ii) to attract, retain and motivate talented employees, officers, advisers and business consultants striving towards the success of the Group, (iii) to recognise the contribution of certain directors, employees and shareholders of any member of the Group to the growth of the Group and/or to the listing of Shares on GEM, the Company has adopted a pre-IPO share option plan (the "Pre-IPO Share Option Plan") and a Share Option Scheme (collectively the "Schemes") by written resolutions passed by the Shareholders on 5 February 2003, further details of the Schemes can be referred to the Report of the Directors and note 23 to the financial statements.

**CAPITAL STRUCTURE**

The Company was listed on the GEM of the Stock Exchange on 26 February 2003 through a placement of 32,000,000 shares comprising 25,600,000 new shares and 6,400,000 sale shares. The net proceeds from this placement, after deduction for relevant expenses, is approximately HK\$16.5 million.

Since the listing of the Company's shares on the GEM of the Stock Exchange on 26 February 2003, there has been no change in the capital structure of the Company. The share capital of the Company comprises only ordinary shares.

**FUNDING AND TREASURY POLICY**

The Group adopts a prudent funding and treasury policy with regard to its overall business operations and foreign currencies receipts are converted into Hong Kong dollars and banked in at the next banking day to minimise foreign exchange risks.

**Management Discussion and Analysis (cont'd)****SIGNIFICANT INVESTMENTS**

There was no significant investment during the year.

**MATERIAL ACQUISITIONS AND DISPOSALS/FUTURE PLANS FOR MATERIAL INVESTMENTS**

Except for those set out in the Prospectus and note 1 to the financial statements, the Company and the Group had no material acquisitions or disposals nor plans for material investments or capital assets.

**EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES**

For the year ended 31 December 2003, approximately 74% of the Group's income was denominated in Hong Kong dollars or US dollars, with the remaining denominated in Japanese Yen. For the same period, over 95% of the Group's expenditure was denominated in Hong Kong dollars, with the remaining denominated in Japanese Yen and Australian dollars. The Group received cash in Japanese Yen, Hong Kong dollars and US dollars from its retail operations in the approximate proportion of 68%, 27% and 5%, respectively for the year ended 31 December 2003. The Group generally charges a small premium over the market exchange rate if the customer pays in Japanese Yen, and converts the Japanese Yen receipts to Hong Kong dollars on the next banking day. As such, the Group faces minimal foreign exchange risks.

## COMPARISON OF BUSINESS OBJECTIVES WITH ACTUAL BUSINESS PROGRESS

The following is a summary of the actual business progress of the Group compared with the business objectives set out in the prospectus of the Company dated 11 February 2003 (the "Prospectus"):

	<b>Business Objectives</b>	<b>Actual Progress</b>
	<i>Expansion of Geographical Coverage to Japan</i>	
Period from 26 February 2003 to 30 June 2003	1. conduct market research and feasibility studies on the Japanese local market to gather information in regard to the locality, population, purchasing power, social and economical factors for management decision.	There were numerous infection cases for SARS inside the flight cabinet and HK citizens were required to be quarantined for 14 days in Japan after arrival. As a result, the directors could not pay visit to Japan until late June 2003, after HK was removed from the list of SARS infected areas as promulgated by the WHO, to study the Japan local market.
Period from 1 July 2003 to 31 December 2003	2. set up a representative office in Tokyo for handling the preparation work for the Group's expansion in Japan.	From late June to October 2003, the director and senior management of the Group had paid frequent visits to Japan for studying the local market environment. After thorough discussions and negotiations, the Group has identified HOS as our trading partner for distribution of the Group's jewellery products in Japan.
	3. open a sales outlet in Tokyo	The Group has entered into a supply agreement with HOS on 15 October 2003. A co-branding shop bearing the Group's name "Lai Fai" was opened with HOS in Harujuku on 23 December 2003. The shop has highly enhanced the Group's corporate image and market acceptance of the Group's jewellery products in Japan.



**Comparison of Business Objectives with Actual Business Progress (cont'd)**

	<b>Business Objectives</b>	<b>Actual Progress</b>
<p>Period from 26 February 2003 to 31 December 2003</p>	<p style="text-align: center;"><b><i>Extension of business into e-commerce</i></b></p> <p>In order to better serve the Group's customers and enhance its after-sales customer services, the existing website <b>www.laifai.com.hk</b> will be enriched by including members' section, products update, news and profile of the Group.</p>	<p>Investments were made in upgrading the Group's hardware and software for improvement of the systems networking in order to cope with the future e-commerce platform. In the meantime, the content of the Group's domain was enriched with news, profile and updates for the customers' information.</p>
<p>Period from 1 January 2004 to 30 June 2004</p>	<p style="text-align: center;"><b><i>Expansion of Geographical Coverage to the PRC</i></b></p> <p>Conduct market research and feasibility studies on PRC cities to gather information in regard to the locality, population, purchasing power, social and economical factors for management decision.</p>	<p>Upon signing of CEPA on 29 June 2003, the Mainland China government has granted 3 broad areas of preferential terms to HK enterprises with effective on 1 January 2004 for trading with China. Under CEPA, import tariffs for certain products were removed and some business opportunities which were previously not opened to Hong Kong enterprises were now granted.</p> <p>The Group's plan for expanding its distribution of jewellery products to the Mainland China can now be speeded up because of CEPA. In order to enjoy the zero import tariff and make the Group's jewellery products more price competitive when trading with China, certain workshop facilities of the Group has been improved to meet the requirement as specified by the Trade and Industry Department.</p>

## Comparison of Business Objectives with Actual Business Progress (cont'd)

## USE OF PROCEEDS

	Budgeted Use as per Prospectus <i>HK\$'000</i>	Actual Use as at year ended 31 December 2003 <i>HK\$'000</i>	Future cash requirement for business objectives <i>HK\$'000</i>	Notes
<b>Details:</b>				
<i>Expansion of Geographical Coverage to Japan</i>				
1. Market research and feasibility studies on the Japan local market	100	85	0	(2)
2. Investment in hardware and software for development of e-commerce	25	27	0	
<b>Sub-total for Period ended 30 June 2003</b>	<b>125</b>	<b>112</b>	<b>0</b>	
1. Set up a representative office in Tokyo	100	0	0	(3)
2. Set up a sales outlet in Tokyo				
• Leasehold improvement and promotional expenses	1,300	0	298	(4)
• Inventory and daily working capital requirements	3,000	1,478	1,522	(5)
3. Investment in hardware and software for development of e-commerce	25	35	0	
<b>Sub-total for Period ended 31 December 2003</b>	<b>4,425</b>	<b>1,513</b>	<b>1,820</b>	

## Comparison of Business Objectives with Actual Business Progress (cont'd)

	Budgeted Use as per Prospectus <i>HK\$'000</i>	Actual Use as at year ended 31 December 2003 <i>HK\$'000</i>	Future cash requirement for business objectives <i>HK\$'000</i>	Notes
<b>Details:</b>				
<b>Expansion of Geographical Coverage to the PRC</b>				
1. Conduct market research and feasibility studies on PRC cities	100	97	0	(6)
2. Leasehold improvement for the Group's workshop in order to meet the CEPA requirement for place of origin	100	116	0	(7)
3. Remaining listing proceeds that will be used in the 6 months period ended 30 June 2004	3,025	0	3,025	
<b>Sub-total for Period ended 30 June 2004</b>	<b>3,225</b>	<b>213</b>	<b>3,025</b>	
Remaining Listing Proceeds that will be used in the 6 months period ended 31 December 2004	4,525	0	4,525	
Remaining Listing Proceeds that will be used in the 6 months period ended 30 June 2005	4,162	0	4,162	
Net Proceeds from listing to be used for business objectives	16,462			(1)
Daily Working Capital Requirement (non-budget) (see note)		3,114		(8)
Total use of listing proceeds as at year ended 31 December 2003		4,952		
Total cash requirement for future business expansion			13,532	(9)
Time deposit, cash and bank balances as at year ended 31 December 2003			11,510	(9)

**Comparison of Business Objectives with Actual Business Progress (cont'd)**

*Notes:*

1. Due to the prolonged duration for the preparation of listing of the Company's shares on the GEM, additional profession fees were incurred and paid from the proceeds for placing the Company's shares. The Company got net proceeds of approximately HK\$16.5 million from placing of the Company's shares.
2. The studies were originally scheduled to conduct from April to June 2003 by paying visits to Japan, however, it was delayed due to the outbreak of SARS. The under utilization of listing proceeds was the results of reduction in airfares after SARS.
3. Spending in setting up a representative office in Tokyo was saved as a result of the good progress and smooth discussions with HOS. A supply agreement was signed by the Group and HOS on 15 October 2003 and a co-branding shop with HOS was opened in Harajuku on 23 December 2003.
4. The actual spending for the co-branding shop was paid in 2004 and HK\$298,000 is already the full amount that the Group needed to contribute. The under utilization of the listing proceeds was due to the fact that HOS also needed to make contribution for the co-branding shop.
5. As the co-branding shop in Harajuku was opened on 23 December 2003, the initial fund that will be tied up in inventory would not be the full sum as stated in the Prospectus.
6. Without hindsight for knowing the signing of CEPA on 29 June 2003, some research and studies expenses that were scheduled to be used in 2004 was now spent in 2003 in order to cope with the preference terms that will be granted to Hong Kong enterprises on 1 January 2004 onwards.
7. To meet the requirements under the CEPA for place of origin and enjoy the zero import tariff rate, HK\$116,000 was spent in improving the Group's workshop facilities as required under the specifications of the Trade and Industry Department.
8. As SARS was an unforeseen natural disaster which had seriously affected most of the business in Hong Kong especially the retailing sectors whose major customers are arrival tourists, the Group's turnover had decreased for about 85% in the 2nd quarter of 2003. In this regard, the Group issued a profit warning announcement on 25 April 2003 and the then temporary usage of the net proceeds from listing announcement on 12 August 2003 (the "Temporary Usage"). The announcement for the Temporary Usage disclosed the fact that HK\$2,211,000 was used in meeting the daily working capital requirement of the Group as at 30 June 2003. The Temporary Usage is expected to be recovered from normal operation when the Group's turnover could be restored to the pre-SARS level. Unfortunately, the aftermaths of SARS had affected the rate of recovery of the Group's turnover and a further sum of approximately HK\$903,000 of the net proceeds from listing of the Company's share was used to meet the daily working capital requirements of the Group as at the balance sheet date.

**Comparison of Business Objectives with Actual Business Progress (cont'd)**

9. The directors do not have any present intention in curtailing the spending of the business development plan as disclosed in the Prospectus. Together with the unused banking facilities of HK\$3 million as at the balance sheet date, it was believed that such shortfall can be met by the time deposit, cash in hand and at bank plus the banking facilities when such spending for the business development falls due.

## REPORT OF THE DIRECTORS

The directors herein present their report and the audited financial statements of the Company and the Group for the year ended 31 December 2003.

### GROUP REORGANISATION AND BASIS OF PRESENTATION

The Company was incorporated in the Cayman Islands as an exempted company with limited liability under the Companies Law of the Cayman Islands on 6 September 2002.

Pursuant to a reorganisation scheme (the "Group Reorganisation") to rationalise the Group structure in preparation for the listing of the Company's shares on the Growth Enterprise Market (the "GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), on 5 February 2003, the Company acquired the entire issued share capital of Lai Fai International (BVI) Limited ("LFBVI"), the then holding company of the other subsidiaries set out in note 26 to the financial statements, and became the holding company of the companies now comprising the Group. Further details of the Group Reorganisation are set out in note 1 to the financial statements and in the Company's prospectus dated 11 February 2003 (the "Prospectus").

### PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. Details of the principal activities of the subsidiaries are set out in note 26 to the financial statements. There were no changes in the nature of the Group's principal activities during the year.

### RESULTS AND DIVIDENDS

The Group's loss for the year ended 31 December 2003 and the state of affairs of the Company and the Group at that date are set out in the accompanying financial statements on pages 38 to 72.

Other than a special dividend proposed by the Board at a meeting on 27 March 2003 and approved by the Company's shareholders at the annual general meeting on 30 April 2003 for which the payment was made on 12 May 2003 of HK\$3.67 cents per share, paid out of the Company's distributable reserves at the time of declaration, for the year ended 31 December 2003 amounting in aggregate to approximately HK\$4,698,000 to the Company's shareholders whose names appeared on the register of members of the Company on 30 April 2003, the Board does not recommend the payment of any final dividend for the year ended 31 December 2003.

## Report of the Directors (cont'd)

**SUMMARY FINANCIAL INFORMATION**

The Company was incorporated in the Cayman Islands on 6 September 2002 and became the holding company of the companies now comprising the Group as a result of the Group Reorganisation, which became effective on 5 February 2003.

To ensure consistency of presentation and for comparison purposes, the consolidated results for the four years ended 31 December 2003 and the consolidated assets and liabilities of the Group as at 31 December 2003, 2002, 2001 and 2000 are presented below on the basis that the current Group structure had been in existence throughout the said period. The summary financial information as at 31 December 2002 and 2001 and for the two years then ended and the summary financial information as at 31 December 2000 and for the year then ended have been extracted from the Company's first annual report dated 27 March 2003 and the Prospectus, respectively.

**Consolidated results**

	Year ended 31 December			
	2003	2002	2001	2000
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Turnover	22,633	46,975	41,950	37,857
Profit/(Loss) before tax	(5,082)	12,335	4,325	3,225
Tax	33	(1,904)	(650)	—
Net profit/(loss) from ordinary activities				
attributable to shareholders	(5,049)	10,431	3,675	3,225

**Consolidated assets and liabilities**

	31 December			
	2003	2002	2001	2000
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Non-current assets	2,081	2,327	1,340	1,469
Current assets	42,539	35,383	26,432	20,477
Current liabilities	(4,212)	(4,018)	(18,689)	(16,538)
Net current assets	38,327	31,365	7,743	3,939
Net assets	40,408	33,692	9,083	5,408

**Report of the Directors (cont'd)**

**FIXED ASSETS**

Details of movements in the fixed assets of the Group are set out in note 14 to the financial statements.

**SHARE CAPITAL AND SHARE OPTIONS**

Details of the Company's share capital and share options are set out in notes 22 and 23, respectively, to the financial statements.

**RESERVES**

Details of movements in the reserves of the Company and the Group during the year are set out in note 24 to the financial statements and in the consolidated summary statement of changes in equity.

**PRE-EMPTIVE RIGHTS**

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

**PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES**

Other than in connection with the Company's initial public offering on the GEM of the Stock Exchange on 26 February 2003, neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year and up to the date of this report.

**DISTRIBUTABLE RESERVES**

At 31 December 2003, the Company's reserves available for distribution, calculated in accordance with the provisions of the Companies Law of the Cayman Islands, amounted to HK\$31,747,000.

**CHARITABLE CONTRIBUTIONS**

During the year, the Group made charitable contributions of HK\$350,000.



**Report of the Directors (cont'd)****MAJOR CUSTOMERS AND SUPPLIERS**

The Group's five largest customers accounted for less than 30% of the total consolidated turnover for the year.

Purchases from the Group's five largest suppliers accounted for 35.1% of the total consolidated purchases for the year and purchases from the largest supplier included therein accounted for 9.6%.

As at 31 December 2003, Mr. Yoshitaka Kitao, who is a director of the Company, is also a director of and has indirect beneficial interest in the Group's largest customer, HOMEOSTYLE Inc. ("HOS"), which accounted for approximately 4.5% of the total turnover of the Group for the year ended 31 December 2003. Saved as aforesaid, none of the directors of the Company or any of their associates or shareholders which, to the best knowledge of the directors, own more than 5% of the Company's issued share capital, had any beneficial interests in the Group's five largest customers or five largest suppliers.

**CONTINGENT LIABILITIES**

As at 31 December 2003, the directors of the Company were not aware of any material contingent liabilities.

**DIRECTORS**

The directors of the Company during the year were as follows:

**Executive directors:**

Mr. Li Shui (*Executive chairman*)

Mr. Lee You

**Non-executive directors:**

Mr. Yoshitaka Kitao (*Honorary non-executive chairman*)

Mr. Yu Kam Kee, Lawrence

Mr. Ty Siao Kian, George

**Independent non-executive directors:**

Mr. Mak Tak Cheong, Edmund (appointed on 5 February 2003)

Mr. Che King Lun, Frankly

Mr. Ho Hou Chiu, William (resigned on 4 February 2003)

**Report of the Directors (cont'd)**

**DIRECTORS** *(continued)*

Subsequent to the balance sheet date, Mr. Ty Siao Kian, George resigned as a non-executive director of the Company on 15 March 2004.

In accordance with article 87 of the Company's articles of association, Mr. Yoshitaka Kitao, Mr. Yu Kam Kee, Lawrence and Mr. Mak Tak Cheong, Edmund will retire and, being eligible, will offer themselves for re-election at the forthcoming annual general meeting.

The independent non-executive directors of the Company are not appointed for specific terms but are subject to retirement by rotation in accordance with the Company's articles of association.

**DIRECTORS AND SENIOR MANAGEMENT BIOGRAPHIES**

Biographical details of the directors of the Company and the senior management of the Group are set out as follows:

**Executive Directors**

Mr. LI Shui (李胥), aged 49, is the founder of the Group, executive chairman, chief executive officer, compliance officer and audit committee member of the Company. Mr. Li founded the Group in 1990 and has over 12 years of experience in the jewellery industry. Mr. Li has been a committee member of the Beijing Committee of the People's Political Consultative Conference (中國人民政治協商會議北京市委員會委員) since 1994, and is a committee member of Yun Fu City of the People's Political Consultative Conference (中國人民政治協商會廣東省雲浮市委員會委員). Mr. Li is also a director of Beijing Chinese Overseas Friendship Association (北京海外聯誼會理事). Mr. Li was a former director of Po Leung Kuk Board of Directors in 1995-1996. Mr. Li was appointed an independent non-executive director of Softbank Investment International (Strategic) Limited ("SIIS") in May 2001 and became non-executive director of SIIS, a substantial shareholder of the Company in March 2002 as a result of the SIIS's investment in the Group, Mr Li resigned as a non-executive director of SIIS on 3 October 2003 and has never been involved in the day-to-day management of SIIS. Mr. Li is fluent in Mandarin, Japanese and Cantonese. Mr. Li is the youngest brother of Mr. Lee.

**Report of the Directors (cont'd)****DIRECTORS AND SENIOR MANAGEMENT BIOGRAPHIES (continued)****Executive Directors (continued)**

**Mr. LEE You (李鈞)**, aged 51, is the chief operating officer of the Company responsible for marketing and business development. Mr. Lee was engaged in general trading business in Japan before he joined the Group in 1990. He has over 12 years of experience in the jewellery industry. Mr. Lee had lived and studied in Japan for 7 years and has in-depth understanding of the Japanese culture and language. Mr. Lee is the eldest brother of Mr. Li.

**Non-executive Directors**

**Mr. Yoshitaka KITAO (北尾吉孝)**, aged 53, is the honorary non-executive chairman of the Company. Mr. Kitao is a director of Softbank Corp., a company listed on the First Section of the Tokyo Stock Exchange Limited. He is also a director of other Softbank Group companies including Softbank Investment Corporation and Softbank Finance Corporation. He was appointed as one of the Company's non-executive directors on 14 September 2002.

**Mr. YU Kam Kee, Lawrence (余錦基)**, M.B.E., J.P., aged 58, is the chairman of SIIS. He has been with the SIIS group for 36 years. He is also currently the Co-Chairman of the Campaign Committee of The Community Chest of Hong Kong and Director of the Hong Kong Football Association. He also serves on many charitable and social organisations. He was appointed as one of the Company's non-executive directors on 14 September 2002.

**Mr. TY Siao Kian, George**, aged 71, is the chairman of Metropolitan Bank & Trust Company (ranking the first among Philippine private commercial banks in terms of assets, loans and deposits for the quarter ending March 2001), Metrobank Foundation, Toyota Motor Philippines Corporation and Toyota Autoparts Philippines Corporation. He is also a member of the board of trustees of the Metrobank Foundation. He was appointed as one of the Company's non-executive directors on 14 September 2002 and resigned on 15 March 2004.

**Report of the Directors (cont'd)**

**DIRECTORS AND SENIOR MANAGEMENT BIOGRAPHIES (continued)**

**Independent Non-Executive Directors**

**Mr. MAK Tak Cheong, Edmund (麥德昌)**, aged 39, is the chairman of the audit committee of the Company. Mr. Mak served as the financial controller of Chinadotcom Corporation, a NASDAQ listed company, as the financial controller and company secretary of hongkong.com Corporation, a GEM listed company, and a financial consultant to Linklaters. Mr. Mak is currently the chief financial officer of Wumart Stores, Inc., a GEM listed company. Mr. Mak is a Certified Public Accountant and a member of the Illinois Certified Public Accountants Society, a member of the American Institute of Certified Public Accountants and an associate member of the Hong Kong Society of Accountants. Mr. Mak holds a Bachelor of Computer Science degree and a Bachelor of Commerce degree from the University of Windsor. Mr. Mak was appointed as one of the Company's independent non-executive directors on the 5 February 2003.

**Mr. CHE King Lun, Frankly (朱經綸)**, aged 41, is an audit committee member of the Company. He is one of the founding partners of TrioArt Company, a Chinese antiques and artworks trading company in Hong Kong. Mr. Che has over 13 years of experience in the auction business of real estate and Chinese antiques and artworks. He obtained a higher certificate in valuation and property management from the Hong Kong Polytechnic in 1990. He was appointed as one of the Company's independent non-executive directors on 14 September 2002.

**Consultant**

**Mr. CHUA Lam (蔡瀾)**, aged 62, was appointed as a consultant to the Company on 5 February 2002 in respect of business development. Mr. Chua has extensive experience in movie industry and the media. Mr. Chua is famous for his entertaining, travel and food books and appears in various local television programmes.

**Report of the Directors (cont'd)****DIRECTORS AND SENIOR MANAGEMENT BIOGRAPHIES (continued)****Senior Management**

**Mr. LAM King Pui (林景沛)**, aged 38, is the Group's chief financial officer, the Company's compliance officer and company secretary. He obtained a Bachelor of Arts degree in Accountancy from the Hong Kong Polytechnic University in 1995 and is a fellow member of the Association of Chartered Certified Accountants, a Certified Public Accountant, an associate member of the Hong Kong Society of Accountants, an associate member of the Institute of Chartered Secretaries and Administrators and the Hong Kong Institute of Company Secretaries. Before Mr. Lam joined the Group in June 2002, he had worked in Ernst & Young, an international accounting firm, for approximately eight years, in Mei Ah Entertainment Group Limited whose shares are listed on the Main Board (stock code: 0391) as group financial controller for approximately five years, and in M21 Technology Limited whose shares are listed on GEM (stock code: 8153) as company secretary for approximately one year.

**Ms. YIP Kwai Lin (葉桂蓮)**, aged 55, is the general manager of Lai Fai Jewellery Trading Limited, a wholly-owned subsidiary of the Company. She is responsible for the daily sales and marketing management of the Group. Ms. Yip is fluent in Japanese, English and Mandarin. Ms. Yip first joined the Group in September 1990 but resigned in May 2000 due to personal reasons. In August 2000, she rejoined the Group.

**Ms. KONG Yuk Ching (江玉清)**, aged 39, is the general manager of Champion Force Industrial Limited, a wholly-owned subsidiary of the Company. She is responsible for product design, purchasing of raw gemstones, production, export and quality control of the Group. Ms. Kong has over 16 years of experience in jewellery industry and is fluent in Japanese, English and Mandarin. Ms. Kong has taken several courses in School of Continuing Education of the Hong Kong Baptist University for jadeite identification, diamond grading, gem knowledge and jewellery production, appraisal and grading. Before joining the Group in August 1992, she had worked with a jewellery production company.

**Ms. WONG Lai Chu (黃麗珠)**, aged 44, is the assistant general manager of Lai Fai Jewellery Trading Limited, a wholly-owned subsidiary of the Company. She is responsible for the daily sales management of the Group. Ms. Wong has 28 years of experience in the jewellery retail industry and is fluent in Japanese and Mandarin. Prior to joining the Group in September 2002, she had been a general manager of and worked in a jewellery retail outlet for 15 years.

**Report of the Directors (cont'd)**

**DIRECTORS AND SENIOR MANAGEMENT BIOGRAPHIES** *(continued)*

**Senior Management** *(continued)*

**Ms. LEE Mei Ling** (李媚玲), aged 48, is the assistant general manager of Lai Fai Jewellery Trading Limited, a wholly-owned subsidiary of the Company. She is responsible for the daily sales management of the Group. Ms. Lee has about 28 years of experience in the jewellery retail industry and is fluent in Japanese, English and Mandarin. Before Ms. Lee joined the Group in September 1990, she had worked in the sales department of a duty free shop in Hong Kong.

**Mr. CHU Ka Loi** (朱家來), aged 46, is the assistant general manager of the Company. He is responsible for the sales and administrative duties of the Group and has about 15 years of experience in the jewellery retail industry and general administration. Mr. Chu is fluent in Japanese and English and had taken a number of courses in personnel management and labour law. Before joining the Group in September 1990, he had worked in two household electrical appliance companies.

**Ms. CHAN Yuk Ping** (陳玉屏), aged 46, is the group accountant responsible for daily accounting and working capital management of the Group. Ms. Chan has about 13 years of experience in accounting and had taken a number of courses in the areas of computer application and accounting. Ms. Chan joined the Group in April 1993 and has since been responsible for the accounting function of the Group.

**DIRECTORS' SERVICE CONTRACTS**

Mr. Li Shui and Mr. Lee You entered into service contracts with the Company for an initial term of three years commencing on 26 February 2003 which are subject to termination by either party giving not less than three months' written notice to the other.

Save as disclosed above, no director proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable by the Company within one year without payment, other than statutory compensation.

**Report of the Directors (cont'd)****DIRECTORS' INTERESTS IN CONTRACTS**

Except for those disclosed in the paragraph headed "CONNECTED TRANSACTIONS" in this report, none of the directors had any material beneficial interests, either direct or indirect, in any contract of significance to the business of the Group to which the Company, or any of its subsidiaries was a party during the year.

**DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN THE SHARES AND UNDERLYING SHARES**

As at 31 December 2003, the interests of the directors and the chief executives of the Company in the shares and underlying shares 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 are taken or deemed to have under such provisions of the SFO) and required to be entered in the register maintained by the Company pursuant to Section 352 of the SFO or which were notified to the Company and the Stock Exchange pursuant to Rules 5.40 to 5.58 of the GEM Listing Rules relating to securities transactions by directors, were as follows:

**Long positions in shares of the Company**

Name of director	Number of ordinary shares held, capacity and nature of interest			Total	Percentage of the Company's issued share capital as at 31 December 2003
	Directly beneficially owned	Through spouse or minor children	Through controlled corporation		
Mr. Li Shui ( <i>Note</i> )	—	—	51,456,000	51,456,000	40.20

*Note:* The 51,456,000 shares are registered in the name of Best Perfect International Limited ("Best Perfect") whose issued share capital is held by Mr. Li Shui as to 91.2% and Mr. Lee You as to 8.8%. Both Mr. Li Shui and Mr. Lee You are executive directors of the Company and directors of Best Perfect.

## Report of the Directors (cont'd)

## DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN THE SHARES AND UNDERLYING SHARES (continued)

## Long positions in underlying shares of the Company

Pursuant to the Pre-IPO Share Option Plan of the Company adopted on 5 February 2003, certain directors and chief executives were granted share options to subscribe for shares of the Company, details of which as at 31 December 2003 were as follows:

	Date of grant	Exercise price per share	Exercisable period	Number of share options outstanding as at 31 December 2003	Percentage of the Company's issued share capital as at 31 December 2003
Mr. Li Shui ( <i>Note 1</i> )	26 February 2003	HK\$0.10	<i>Note 2</i>	4,010,000	3.13
Mr. Yoshitaka Kitao	26 February 2003	HK\$0.10	<i>Note 2</i>	1,300,000	1.02
Mr. Yu Kam Kee, Lawrence	26 February 2003	HK\$0.10	<i>Note 2</i>	500,000	0.39
Mr. Ty Siao Kian, George	26 February 2003	HK\$0.10	<i>Note 2</i>	500,000	0.39
Mr. Che King Lun, Frankly	26 February 2003	HK\$0.10	<i>Note 2</i>	400,000	0.31
Mr. Mak Tak Cheong, Edmund	26 February 2003	HK\$0.10	<i>Note 2</i>	200,000	0.16
Mr. Lam King Pui	26 February 2003	HK\$0.10	<i>Note 3</i>	330,000	0.26
Ms. Yip Kwai Lin	26 February 2003	HK\$0.10	<i>Note 3</i>	200,000	0.16
Ms. Kong Yuk Ching	26 February 2003	HK\$0.10	<i>Note 3</i>	200,000	0.16
Ms. Wong Lai Chu	26 February 2003	HK\$0.10	<i>Note 3</i>	80,000	0.06
Ms. Lee Mei Ling	26 February 2003	HK\$0.10	<i>Note 3</i>	100,000	0.08
Ms. Chu Ka Loi	26 February 2003	HK\$0.10	<i>Note 3</i>	100,000	0.08
Ms. Chan Yuk Ping	26 February 2003	HK\$0.10	<i>Note 3</i>	80,000	0.06

## Notes:

- The options were granted to Best Perfect which is beneficially owned by Mr. Li Shui and Mr. Lee You, directors of the Company as to 91.2% and 8.8% respectively. Accordingly, Mr. Li Shui was deemed to be interested in the options to subscribe for shares in the Company held by Best Perfect under the SFO.
- (i) a maximum of 50% of the total number of options granted at any time during the first year after the date falling 12 months after 26 February 2003 (the "First Exercise Period") and (ii) the remainder 50% of the total number of options granted at any time during the period of one year after the end of the First Exercise Period.



**Report of the Directors (cont'd)****DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN THE SHARES AND UNDERLYING SHARES (continued)****Long positions in underlying shares of the Company (continued)***Notes: (continued)*

3. (i) a maximum of 50% of the total number of options granted at any time during the first year after the date falling 6 months after 26 February 2003 (the "Employees' First Exercise Period") and (ii) the remainder 50% of the total number of options granted at any time during the period of one year after the end of the Employees' First Exercise Period.

Save as disclosed above, as at 31 December 2003, none of the directors and the chief executives of the Company or their associates had any interests or short positions in the shares or underlying shares of the Company or its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be kept under Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to Rules 5.40 to 5.58 of the GEM Listing Rules relating to securities transactions by directors.

**SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSONS' INTERESTS IN SHARES AND UNDERLYING SHARES**

So far as the directors or chief executive of the Company are aware, as at 31 December 2003, the persons (not being directors and the chief executives of the Company) who had interests or short positions in the shares and underlying shares of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which were notified to the Company and the Stock Exchange pursuant Divisions 2 and 3 of Part XV of the SFO and required to be entered in the register maintained by the Company pursuant to Section 336 of the SFO, 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 the Company, were as follows:

## Report of the Directors (cont'd)

## SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSONS' INTERESTS IN SHARES AND UNDERLYING SHARES (continued)

## Long position in shares of the Company

Name of shareholders	Notes	Capacity and nature of interest	Number of ordinary shares held	Percentage of the Company's issued share capital as at 31 December 2003
Best Perfect	1	Directly beneficially owned	51,456,000	40.20
Mr. Li Shui	1	Through a controlled corporation	51,456,000	40.20
Ms. Li So Kuen	2	Through a spouse	51,456,000	40.20
Artfolio Corporation ("Artfolio")	3	Directly beneficially owned	27,955,200	21.84
Softbank Investment International (Strategic) Limited ("SIIS")		Directly beneficially owned	14,028,800	10.96
Softbank Finance Corporation ("Softbank Finance")	3	Through a controlled corporation	27,955,200	21.84

## Notes:

- Best Perfect is beneficially owned by Mr. Li Shui and Mr. Lee You, Directors of the Company, as to 91.2% and 8.8%, respectively. Accordingly, Mr. Li Shui is deemed to be interested in the same block of shares held by Best Perfect under the SFO.
- Ms. Li So Kuen is deemed to be interested in the 51,456,000 shares in which Mr. Li Shui, her spouse who is a director of the Company, is interested.
- Artfolio is beneficially owned as to 84.02% by Softbank Finance. Accordingly, Softbank Finance shall be deemed to be interested in the same block of shares held by Artfolio under the SFO.

**Report of the Directors (cont'd)****SUBSTANTIAL SHAREHOLDERS AND OTHER PERSON'S INTERESTS IN SHARES AND UNDERLYING SHARES** *(continued)***Long positions in underlying shares of the Company**

Pursuant to the Pre-IPO Share Option Plan of the Company adopted on 5 February 2003, share options in respect of 4,010,000 underlying shares of the Company were granted to Best Perfect, details of which were disclosed in the paragraph headed "DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN THE SHARES AND UNDERLYING SHARES". As at 31 December 2003, Best Perfect was beneficially owned as to 91.2% and 8.8% by Mr. Li Shui and Mr. Lee You, respectively.

Further, by virtue of Mr. Li Shui's interests in Best Perfect and therefore deemed interest in the Company, Ms. Li So Kuen, his spouse, was also taken to be interested in the above-mentioned share options in respect of 4,010,000 underlying shares of the Company granted to Best Perfect under the SFO.

Save as disclosed above, as at 31 December 2003, the Company had not been notified of any other person (other than a director or chief executive of the Company) who had any interests or short positions in the shares and underlying shares of the Company as recorded in the register required to be kept under Section 336 of the SFO, 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 the Company.

**DIRECTORS' RIGHTS TO ACQUIRE SHARES**

Save as those disclosed under the heading "Long positions in underlying shares of the Company" of "DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN THE SHARES AND UNDERLYING SHARES" above, at no time during the year were rights to acquire benefits by means of the acquisition of shares in or debentures of the Company granted to any directors or their respective spouse or children under 18 years of age, or were any such rights exercised by them; or was the Company, or any of its subsidiaries a party to any arrangement to enable the Company's directors to acquire such rights in any other body corporate.

**Report of the Directors (cont'd)**

**CONNECTED TRANSACTIONS**

1. On 5 February 2003, the Group entered into a distribution and processing agreement and a purchasing agreement with Reiki Funaya K. K. ("Reiki Funaya"), pursuant to which the Group would sell jewellery products to and purchase certain raw materials from Reiki Funaya. Reiki Funaya is wholly-owned by Mr. Etsuro Funaya, who is regarded as an initial management shareholder by the Stock Exchange. Such transactions constitute continuing connected transactions for the purpose of the Rules Governing the Listing of Securities on the GEM of the Stock Exchange (the "GEM Listing Rules"). During the year, the amount of sales to Reiki Funaya was HK\$912,000 and no purchase was made from Reiki Funaya.
2. On 15 October 2003, the Group entered into a supply agreement with HOS, pursuant to which the Group would sell jewellery products to HOS. On 27 October 2003, HOS was held as to approximately 66% by Softbank Funds, which were managed by Softbank Investment Corporation, and which in turn was owned as to 52.51% by Softbank Finance. HOS was also directly owned as to approximately 6.6% by Softbank Finance. Artfolio, a substantial shareholder of the Company under the GEM Listing Rules, was owned as to approximately 84.02% by Softbank Finance. Softbank Finance and/or its group company directly or indirectly exercises or controls an aggregate of 30% or more of the voting power at general meetings of the composition of a majority of board of directors of HOS. Each HOS and the Company is, therefore, a connected person as defined in the GEM Listing Rule of the other. During the year, the amount of sales to HOS was HK\$1,023,000.

With respect to the above continuing connected transactions entered into by the Group, the Stock Exchange, on application by the Company, granted the Company waivers from strict compliance with the connected transaction requirements as set out in the GEM Listing Rules.

The independent non-executive directors are of the opinion that (i) the transactions were approved by the board of directors; (ii) the terms of the above transactions were fair and reasonable so far as the shareholders of the Company were concerned; (iii) the transactions were entered into by the Group on normal commercial terms, in the usual and ordinary course of business and were carried out in accordance with the terms of the agreements governing such transactions; and (iv) the transactions were within the relevant annual cap amounts agreed by the Stock Exchange.

**Report of the Directors (cont'd)****CONNECTED TRANSACTIONS** *(continued)*

Save as the transactions disclosed above, there were no other transactions required to be disclosed as connected transactions in accordance with the GEM Listing Rules.

**SPONSORS' INTERESTS**

As notified by the Company's sponsors, SBI E2-Capital (HK) Limited ("SBI E2-Capital") whose service was terminated on 4 March 2004 and Celestial Capital Limited ("CASH") (collectively the "Sponsors"), none of the Sponsors or any of its directors or employees or associates (as referred to in note 3 to Rule 6.35 of the GEM Listing Rules) had any interest in the shares of the Company or any members of the Group or any rights to subscribe for or to nominate persons to subscribe for the shares of the Company or any members of the Group as at 31 December 2003 and the date of this report respectively other than the following in relation to SBI E2-Capital:

- (i) the shareholding interests of Artfolio and SIIS in the Company;
- (ii) shareholdings and/or interests in companies or joint ventures which Softbank Finance and its subsidiaries may co-invest with the Group under the Softbank Memorandum of Understanding dated 9 September 2002 or which Softbank Finance, Softbank Investment and their respective subsidiaries may co-invest with the Group under the agreement dated 5 February 2003; and
- (iii) the options granted by the Company to Mr. Yu Kam Kee, Lawrence, an executive director of SIIS and Mr. Yoshitaka Kitao, resigned as executive director of SIIS with effect from 3 October 2003, under the Pre-IPO Share Option Plan to subscribe for shares of the Company as disclosed in this report.

Pursuant to the agreement dated 10 February 2003 entered with the Company, CASH received and will receive, fees for acting as the Company's retained sponsor until 31 December 2005 or until such agreement is terminated upon the terms and conditions set out therein whereas SBI E2-Capital received fees for acting as the Company's retained sponsor up to their service termination date of 4 March 2004.

**Report of the Directors (cont'd)**

**COMPETING INTEREST**

Saved as those disclosed in the Prospectus and this report, as at 31 December 2003, none of the directors or the management shareholders (as defined in the GEM Listing Rules) of the Company had an interest in a business which competes or may compete with the business of the Group and any other conflicts of interest which any such person has or may have with the Group.

**AUDIT COMMITTEE**

The Company set up an audit committee on 5 February 2003 with written terms of reference in compliance with the requirements as set out in Rules 5.23 and 5.24 of the GEM Listing Rules. The primary duties of the audit committee are to review and provide supervision over the financial reporting process and internal controls of the Group. The audit committee comprises two independent non-executive directors, namely Mr. Mak Tak Cheong, Edmund and Mr. Che King Lun, Frankly and one executive director, namely, Mr. Li Shui. Mr. Mak Tak Cheong, Edmund is the chairman of the audit committee. The Group's financial statements for the year ended 31 December 2003 have been reviewed by the audit committee, who are of the opinion that such statements complied with the applicable accounting standards, the Stock Exchange and legal requirements, and that adequate disclosures have been made.

Since its establishment, the audit committee met five times, reviewing the Company's and the Group's reports, announcements, and accounts, and providing advice and recommendations to the directors of the Company.

**BOARD PRACTICES AND PROCEDURES**

The Company has complied with the Board Practices and Procedures as set out in Rules 5.28 to 5.39 of the GEM Listing Rules since the listing of the Company's shares on the GEM on 26 February 2003.

**AUDITORS**

Ernst & Young retire and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting.

On behalf of the Board

**Li Shui**

*Chairman*

Hong Kong, 29 March 2004

## REPORT OF THE AUDITORS

 **ERNST & YOUNG**

安永會計師事務所

To the members

**Lai Fai International Holdings Limited**

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

We have audited the financial statements on pages 38 to 72 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

### RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently. It is our responsibility to form an independent opinion, based on our audit, on those financial 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 an 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 judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, 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.

**Ernst & Young**

*Certified Public Accountants*

Hong Kong, 29 March 2004

## CONSOLIDATED PROFIT AND LOSS ACCOUNT

Year ended 31 December 2003

	<i>Notes</i>	2003 <i>HK\$'000</i>	2002 <i>HK\$'000</i>
<b>TURNOVER</b>	<i>6</i>	22,633	46,975
Cost of sales		(8,216)	(11,397)
Gross profit		14,417	35,578
Other revenue and gains		73	45
Selling and distribution costs		(8,153)	(13,401)
General and administrative expenses		(11,402)	(9,870)
<b>PROFIT/(LOSS) FROM OPERATING ACTIVITIES</b>	<i>7</i>	(5,065)	12,352
Finance cost	<i>10</i>	(17)	(17)
<b>PROFIT/(LOSS) BEFORE TAX</b>		(5,082)	12,335
Tax	<i>11</i>	33	(1,904)
<b>NET PROFIT/(LOSS) FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS</b>		(5,049)	10,431
<b>DIVIDENDS</b>	<i>12</i>	4,698	2,300
<b>EARNINGS/(LOSS) PER SHARE</b>	<i>13</i>		
— Basic, HK cents		(4.07)	10.2
— Diluted, HK cents		N/A	N/A



## CONSOLIDATED BALANCE SHEET

31 December 2003

	<i>Notes</i>	2003 <i>HK\$'000</i>	2002 <i>HK\$'000</i>
<b>NON-CURRENT ASSETS</b>			
Fixed assets	<i>14</i>	1,742	2,024
Other assets	<i>15</i>	339	303
		2,081	2,327
<b>CURRENT ASSETS</b>			
Inventories	<i>16</i>	27,424	27,323
Accounts receivable	<i>17</i>	1,480	296
Prepayments, deposits and other receivables		2,119	6,540
Tax recoverable		6	—
Pledged time deposit		84	83
Cash and bank balances		11,426	1,141
		42,539	35,383
<b>CURRENT LIABILITIES</b>			
Accounts payable	<i>18</i>	492	591
Accruals and other payables		1,818	1,305
Trade deposit received	<i>19</i>	819	712
Tax payable		—	1,110
Finance lease payable	<i>20</i>	—	300
Interest-bearing bank loan, unsecured	<i>21</i>	1,083	—
		4,212	4,018
<b>NET CURRENT ASSETS</b>		<b>38,327</b>	<b>31,365</b>
		40,408	33,692
<b>CAPITAL AND RESERVES</b>			
Issued capital	<i>22</i>	12,800	1
Reserves	<i>24</i>	27,608	33,691
		40,408	33,692

Li Shui  
Director

Lee You  
Director

## CONSOLIDATED SUMMARY STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2003

	<i>Notes</i>	2003 <i>HK\$'000</i>	2002 <i>HK\$'000</i>
Total equity at beginning of year		33,692	9,083
Issue of shares, including share premium	<i>22, 24</i>	25,600	—
Share issue expenses	<i>24</i>	(9,137)	—
Contributed surplus arising from the group reorganisation	<i>24</i>	—	18,178
Net profit/(loss) from ordinary activities attributable to shareholders	<i>24</i>	(5,049)	10,431
Interim dividends proposed in respect of the financial year ended:	<i>12, 24</i>		
— 31 December 2001		—	(1,700)
— 31 December 2002		—	(2,300)
Special dividend in respect of the year ended 31 December 2003	<i>12, 24</i>	(4,698)	—
<b>Total equity at end of year</b>		<b>40,408</b>	<b>33,692</b>

## CONSOLIDATED CASH FLOW STATEMENT

Year ended 31 December 2003

	2003 HK\$'000	2002 HK\$'000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Profit/(Loss) before tax	(5,082)	12,335
Adjustments for:		
Depreciation	641	564
Amortisation of other assets	14	15
Interest income	(71)	(6)
Interest expense	17	17
Gain on disposal of fixed assets	—	(30)
Provision for inventories	1,000	—
Operating profit/(loss) before working capital changes	(3,481)	12,895
Increase in inventories	(1,101)	(6,171)
Decrease/(Increase) in accounts receivable	(1,184)	10
Decrease/(Increase) in prepayments, deposits and other receivables	1,429	(677)
Increase/(Decrease) in accounts payable	(99)	97
Increase in accruals and other payables	513	530
Increase/(Decrease) in trade deposit received	107	(550)
Cash generated from/(used in) operations	(3,816)	6,134
Hong Kong profits tax paid	(1,083)	(985)
Dividends paid	(4,698)	(4,000)
Net cash inflow/(outflow) from operating activities	(9,597)	1,149
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of fixed assets	(359)	(966)
Proceeds from disposal of fixed assets	—	30
Interest received	71	6
Increase in other assets	(50)	—
Increase in pledged time deposit	(1)	(3)
Net cash outflow from investing activities	(339)	(933)

**Consolidated Cash Flow Statement (cont'd)**

	2003 <i>HK\$'000</i>	2002 <i>HK\$'000</i>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Interest paid	(17)	(17)
Net advance from a director	—	2,400
New bank loan	1,083	—
Capital element of finance lease payments	(300)	(300)
Proceeds from issue of share capital	25,600	—
Share issue expenses	(6,145)	(2,992)
	<hr/>	<hr/>
Net cash inflow/(outflow) from financing activities	20,221	(909)
<b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>		
	10,285	(693)
Cash and cash equivalents at beginning of year	1,141	1,834
	<hr/>	<hr/>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b>11,426</b>	<b>1,141</b>
<hr/>		
<b>ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS</b>		
Cash and bank balances	11,426	1,141
	<hr/>	<hr/>

## BALANCE SHEET

31 December 2003

	<i>Notes</i>	2003 <i>HK\$'000</i>	2002 <i>HK\$'000</i>
<b>NON-CURRENT ASSETS</b>			
Investment in a subsidiary	<i>26</i>	28,501	—
<b>CURRENT ASSETS</b>			
Due from subsidiaries	<i>26</i>	16,395	—
<b>CURRENT LIABILITIES</b>			
Accruals		349	—
<b>NET CURRENT ASSETS</b>		16,046	—
		44,547	—
<b>CAPITAL AND RESERVES</b>			
Issued capital	<i>22</i>	12,800	—
Reserves	<i>24</i>	31,747	—
		44,547	—

Li Shui  
*Director*

Lee You  
*Director*

## NOTES TO FINANCIAL STATEMENTS

31 December 2003

### 1. GROUP REORGANISATION AND BASIS OF PRESENTATION

The Company was incorporated as an exempted company with limited liability in the Cayman Islands on 6 September 2002 under the Companies Law of the Cayman Islands.

Pursuant to a group reorganisation (the “Group Reorganisation”) to rationalise the structure of the Group in preparation for the listing of the Company’s shares on the Growth Enterprise Market (“GEM”) of The Stock Exchange of Hong Kong Limited (the “Stock Exchange”), on 5 February 2003, the Company became the holding company of the companies now comprising the Group. This was accomplished by acquiring the entire issued share capital of Lai Fai International (BVI) Limited (“LFBVI”), which is the then immediate holding company of the other subsidiaries as set out in note 26 to the financial statements, in consideration of and in exchange for the allotment and issue of 9,999 shares of HK\$0.10 each in the share capital of the Company credited as fully paid. Further details of the Group Reorganisation are set out in the prospectus of the Company dated 11 February 2003 (the “Prospectus”).

The shares of the Company were listed on the GEM of the Stock Exchange on 26 February 2003 (the “Listing Date”).

The Group Reorganisation involved companies under common control, and for accounting purposes, the Company and its acquired subsidiaries (as further detailed in note 26 to the financial statements) are regarded and accounted for as a continuing group. Accordingly, the consolidated financial statements have been prepared using the merger basis of accounting as if the Company had always been the holding company of the Group. On this basis, the Company has been treated as the holding company of its subsidiaries for the financial years presented or since their dates of incorporation if these are shorter periods, rather than from the subsequent date of acquisition of the subsidiaries. The consolidated results and cash flows of the Group for the years ended 31 December 2002 and 2003 include the results and cash flows of the Company and its subsidiaries with effect from 1 January 2002 or since their respective dates of incorporation, where these are shorter periods. The comparative consolidated balance sheet as at 31 December 2002 has been prepared on the basis that the Group had been in existence at that date.

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

In the opinion of the directors, the consolidated financial statements prepared on this basis present more fairly the comparative results, cash flows and financial position of the Group as a whole.

**Notes to Financial Statements (cont'd)****2. CORPORATE INFORMATION**

During the year, the Group was principally engaged in the manufacture, retail and wholesale of jewellery products.

**3. IMPACT OF A REVISED HONG KONG STATEMENT OF STANDARD ACCOUNTING PRACTICE (“SSAP”)**

The revised SSAP12 “Income Taxes” is effective for the first time for the current year’s financial statements and its effects are summarised as follows:

SSAP 12 (revised) prescribes the accounting for income taxes payable or recoverable, arising from the taxable profit or loss for the current period (current tax); and income taxes payable or recoverable in future periods, principally arising from taxable and deductible temporary differences and the carryforward of unused tax losses (deferred tax).

The SSAP has had no significant impact for these financial statements on the amounts recorded for income taxes. However, the related note disclosures are now more extensive than previously required. These are detailed in note 11 to the financial statements and include a reconciliation between the accounting loss and the tax income for the year.

**4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****Basis of preparation**

These financial statements have been prepared in accordance with Hong Kong Statements of Standard Accounting Practice, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention.

**Subsidiaries**

A subsidiary is a company whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company’s profit and loss account to the extent of dividends received and receivable. The Company’s investment in a subsidiary is stated at cost less any impairment losses.

Notes to Financial Statements (cont'd)

4. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** *(continued)*

**Impairment of assets**

An assessment is made at each balance sheet date of whether there is any indication of impairment of any asset, or whether there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use or its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the profit and loss account in the period in which it arises.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years.

A reversal of an impairment loss is credited to the profit and loss account in the period in which it arises.

**Fixed assets and depreciation**

Fixed assets are stated at cost less accumulated depreciation and any impairment losses. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of that asset.

Depreciation is calculated on the straight-line basis to write off the cost of each asset over its estimated useful life. The annual rate used for this purpose for all fixed assets is 20% per annum.

The gain or loss on disposal or retirement of a fixed asset recognised in the profit and loss account is the difference between the net sales proceeds and the carrying amount of the relevant asset.



**Notes to Financial Statements (cont'd)****4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****Other assets**

Other assets, representing the costs of memberships in a golf club and a recreational club, are stated at cost less any impairment losses and/or accumulated amortisation, where applicable. Amortisation is calculated on the straight-line basis to write off the cost over the term of membership.

**Inventories**

Inventories are stated at the lower of cost and net realisable value, after making due allowances for any obsolete or slow-moving items.

Cost in respect of raw materials and finished goods purchased is determined on the unit cost basis. In the case of finished goods manufactured, cost mainly comprises direct materials, direct labour costs and direct overheads. Net realisable value is based on estimated selling prices less any further costs to be incurred to completion and disposal.

**Cash and cash equivalents**

Cash and cash equivalents comprise of cash on hand and demand deposits, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management.

**Provisions**

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the profit and loss account.

Notes to Financial Statements (cont'd)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

**Income tax**

Income tax comprises current and deferred tax. Income tax is recognised in the profit and loss account or in equity if it relates to items that are recognised in the same or a different period, directly in equity.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences in respect of taxable temporary differences associated with investments in subsidiaries, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax assets and unused tax losses can be utilised in respect of deductible temporary differences associated with investments in subsidiaries, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

**Revenue recognition**

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

## Notes to Financial Statements (cont'd)

## 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

**Revenue recognition (continued)**

- (i) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold; and
- (ii) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable.

**Employee benefits*****Paid leave carried forward***

The Group provides paid annual leave to its employees under their employment contracts on a calendar year basis. Under certain circumstances, such leave which remains untaken as at the balance sheet date is permitted to be carried forward and utilised by the respective employees in the following year. An accrual is made at the balance sheet date for the expected future cost of such paid leave earned during the year by the employees and carried forward.

***Retirement benefits scheme***

The Group operates a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for all of its employees in Hong Kong. Contributions are made based on a percentage of the employees' basic salaries and are charged to the profit and loss account as they become payable in accordance with the rules of the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in an independently administered fund. The Group's employer contributions vest fully with the employees when contributed into the MPF Scheme.

***Share option scheme***

The Company operates a share option scheme for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. The financial impact of share options granted under the share option scheme 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 recorded in the profit and loss account or balance sheet for their cost. Upon the exercise of 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 are cancelled prior to their exercise date, or which lapse, are deleted from the register of outstanding options.

**Notes to Financial Statements (cont'd)**

**4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Foreign currency transactions**

Foreign currency transactions are recorded at the applicable exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable exchange rates ruling at that date. Exchange differences are dealt with in the profit and loss account.

**Dividends**

Final dividends proposed by the directors are classified as a separate allocation of retained profits within capital and reserves in the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim dividends are simultaneously proposed and declared, because the Company's memorandum and articles of association grant the directors the authority to declare interim dividends. Consequently, interim dividends are recognised immediately as a liability when they are proposed and declared.

**Leased assets/Operating lease**

Leases that transfer substantially all the rewards and risks of ownership of assets to the Group, other than legal title, are accounted for as finance leases. At the inception of a finance lease, the cost of the leased asset is capitalised at the present value of the minimum lease payments and recorded together with the obligation, excluding the interest element, to reflect the purchase and financing. Assets held under capitalised finance leases are included in fixed assets and depreciated over the shorter of the lease terms and the estimated useful lives of the assets. The finance costs of such leases are charged to the profit and loss account so as to provide a constant periodic rate of charge over the lease terms.

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Rentals payable under the operating leases are charged to the profit and loss account on the straight-line basis over the lease terms.

**Related parties**

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

## Notes to Financial Statements (cont'd)

## 5. SEGMENT INFORMATION

During the year, the Group was principally engaged in the manufacture, retail and wholesale of jewellery products in Hong Kong, and over 90% of the Group's revenue, results, assets and liabilities were derived from Hong Kong. Accordingly, no business or geographical segment information is presented.

## 6. TURNOVER

Turnover represents the net invoiced value of goods sold, after allowances for returns and trade discounts. All significant intra-group transactions have been eliminated on consolidation.

## 7. PROFIT/(LOSS) FROM OPERATING ACTIVITIES

The Group's profit/(loss) from operating activities is arrived at after charging/(crediting):

	Group	
	2003	2002
	HK\$'000	HK\$'000
Cost of inventories sold	6,577	11,397
Staff costs (excluding directors' remuneration — <i>note 8</i> ):		
Wages and salaries	5,354	6,158
Retirement benefits scheme contributions	241	278
<b>Total staff costs</b>	<b>5,595</b>	<b>6,436</b>
Auditors' remuneration	360	500
Depreciation	641	564
Amortisation of other assets*	14	15
Provision for inventories	1,000	—
Write-off of bad debts	56	—
Minimum lease payments under operating lease in respect of land and building	1,560	1,902
Interest income	(71)	(6)
Gain on disposal of fixed assets	—	(30)
Exchange gains, net	(2)	(9)

\* The amortisation of other assets for the year is included in "General and administrative expenses" on the face of the consolidated profit and loss account.

## Notes to Financial Statements (cont'd)

## 8. DIRECTORS' REMUNERATION

Directors' remuneration for the year, disclosed pursuant to the Rules Governing the Listing of Securities on the GEM of the Stock Exchange and Section 161 of the Companies Ordinance is as follows:

	Group	
	2003	2002
	<i>HK\$'000</i>	<i>HK\$'000</i>
Fees:		
Executive directors	—	—
Non-executive directors	—	—
Independent non-executive directors	80	—
	<hr/>	<hr/>
	80	—
Other emoluments:		
Executive directors:		
Basic salaries and other allowances	2,132	2,275
Retirement benefits scheme contributions	24	24
Non-executive directors	—	—
Independent non-executive directors	—	—
	<hr/>	<hr/>
	2,156	2,299
	<hr/>	<hr/>
	2,236	2,299
	<hr/>	<hr/>

During the year, share options were granted to the directors in respect of their services to the Group, further details of which are set out in note 23 to the financial statements.

## Notes to Financial Statements (cont'd)

## 8. DIRECTORS' REMUNERATION (continued)

The number of directors whose remuneration fell within the following bands is as follows:

	Number of directors	
	2003	2002
Nil to HK\$1,000,000	7	6
HK\$1,000,001 to HK\$1,500,000	1	1
	<b>8</b>	<b>7</b>
	2003	2002
	HK\$'000	HK\$'000
Executive director A	1,230	1,312
Executive director B	926	987
Non-executive director A*	—	—
Non-executive director B	—	—
Non-executive director C	—	—
Independent non-executive director A**	50	—
Independent non-executive director B	30	—
Independent non-executive director C***	—	—
	<b>2,236</b>	<b>2,299</b>

\* resigned subsequent to the balance sheet date

\*\* newly appointed during the year

\*\*\* resigned during the year

There were no arrangements under which a director waived or agreed to waive any emoluments during the year.

During the year, 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.

## Notes to Financial Statements (cont'd)

## 9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included two (2002: two) directors, details of whose emoluments are set out in note 8 above. The details of remuneration paid to the remaining three (2002: three) non-director, highest paid employees are as follows:

	Group	
	2003 HK\$'000	2002 HK\$'000
Basic salaries and other allowances	1,037	839
Retirement benefits scheme contributions	32	27
	1,069	866

The remuneration of the non-director, highest paid employees fell within the range of nil to HK\$1,000,000 for the years ended 31 December 2003 and 2002.

During the year, 330,000 share options were granted to a non-director, highest paid employee in respect of his services to the Group, further details of which are set out in note 23 to the financial statements.

During the year, no emoluments were paid by the Group to any of the five highest paid employees as an inducement to join, or upon joining the Group, or as compensation for loss of office.

## 10. FINANCE COST

Finance cost represents interest on finance lease (*note 20*).

## 11. TAX

	Group	
	2003 HK\$'000	2002 HK\$'000
Current — Hong Kong		
Charge for the year	—	1,904
Overprovision in the prior year	(33)	—
	(33)	1,904
Total tax charge/(credit) for the year	(33)	1,904



## Notes to Financial Statements (cont'd)

## 11. TAX (continued)

No provision for Hong Kong profits tax has been made for the year as the Group had no assessable profits arising in Hong Kong during the year. Hong Kong profits tax in the prior year was provided at the rate of 16% on the estimated assessable profits arising in Hong Kong during that year.

A reconciliation of the tax expense/(income) applicable to profit/(loss) before tax using the statutory rates for the countries in which the Company and its subsidiaries are domiciled to the tax expense/(income) at the effective tax rates, and a reconciliation of the applicable rates (i.e., the statutory tax rates) to the effective tax rates, are as follows:

	2003		Group		2002	
	HK\$'000	%	HK\$'000	%	HK\$'000	%
Profit/(Loss) before tax	(5,082)		12,335			
Tax at Hong Kong profits tax rate of 17.5% (2002: 16%)	(889)	(17.5)	1,974	16.0		
Adjustments in respect of current tax of previous years	(33)	(0.6)	—	—		
Income not subject to tax	(13)	(0.2)	(6)	(0.1)		
Expenses not deductible for tax	16	0.3	19	0.2		
Increase/(Decrease) in deferred tax assets not recognised during the year	968	19.0	(99)	(0.8)		
Others	(82)	(1.6)	16	0.1		
Tax expense/(income) and effective tax rate for the year	(33)	(0.6)	1,904	15.4		

## Notes to Financial Statements (cont'd)

## 11. TAX (continued)

At the balance sheet date, deferred tax assets in respect of tax losses and other deductible temporary differences not recognised in the financial statements were as follows:

	Group	
	2003 HK\$'000	2002 HK\$'000
Depreciation and capital allowance on fixed assets	229	233
General provision for inventories	175	—
Tax losses	819	—
	1,223	233

No deferred tax asset has been recognised in respect of the above items due to unpredictability of future profit streams. The tax losses of the Group arising in Hong Kong amounting to HK\$4,678,000 (2002: Nil) are available indefinitely for offsetting against future taxable profits of the companies in which the losses arose.

## 12. DIVIDENDS

	Notes	2003	2002
		HK\$'000	HK\$'000
Special dividend	(i)	4,698	—
Interim dividend	(ii)	—	2,300
		4,698	2,300

## Notes:

- (i) On 12 May 2003, a special dividend of HK\$4,698,000, representing HK3.67 cents per share of the Company, in respect of the year ended 31 December 2003 was paid by the Company, out of the Company's distributable reserves, to the shareholders whose names appear on the register of members of the Company on 30 April 2003.
- (ii) On 2 August 2002, an interim dividend of HK\$2,300,000 in respect of the year ended 31 December 2002 was paid by a subsidiary of the Company, LFBVI, to its then shareholders before the Group Reorganisation as detailed in note 1 to the financial statements. The rates of dividends and the number of shares ranking for the dividends are not presented as such information, in the opinion of directors, is not meaningful for the purpose of these financial statements.

**Notes to Financial Statements (cont'd)****13. EARNINGS/(LOSS) PER SHARE****(a) Basic earnings/(loss) per share**

The calculation of basic earnings/(loss) per share is based on the net loss from ordinary activities attributable to shareholders for the year of HK\$5,049,000 (2002: net profit of HK\$10,431,000) and the weighted average of 124,072,000 (2002: 102,400,000) shares of the Company, calculated based on the assumption that the Group Reorganisation as further detailed in note 1 to the financial statements had been completed on 1 January 2002.

**(b) Diluted earnings/(loss) per share**

No diluted loss per share has been presented for the year ended 31 December 2003 as the outstanding share options had an anti-dilutive effect on the basic loss per share for the year. No diluted earnings per share has been presented for the year ended 31 December 2002 as no diluting event existed for that year.

## Notes to Financial Statements (cont'd)

## 14. FIXED ASSETS

## Group

	Furniture and fixtures <i>HK\$'000</i>	Office equipment <i>HK\$'000</i>	Motor vehicle <i>HK\$'000</i>	Total <i>HK\$'000</i>
Cost:				
At 1 January 2003	5,947	963	1,106	8,016
Additions	168	191	—	359
	<hr/>			
At 31 December 2003	6,115	1,154	1,106	8,375
	<hr/>			
Accumulated depreciation:				
At 1 January 2003	4,972	715	305	5,992
Provided during the year	341	95	205	641
	<hr/>			
At 31 December 2003	5,313	810	510	6,633
	<hr/>			
Net book value:				
At 31 December 2003	802	344	596	1,742
	<hr/>			
At 31 December 2002	975	248	801	2,024
	<hr/>			

The net book value of a motor vehicle held under finance lease included in the total amount of fixed assets at 31 December 2002 amounted to HK\$801,000. As at 31 December 2003, none of the fixed assets were held under finance lease as a result of the full settlement of the finance lease payable (*note 20*).

## Notes to Financial Statements (cont'd)

## 15. OTHER ASSETS

	Group	
	2003 <i>HK\$'000</i>	2002 <i>HK\$'000</i>
Cost	440	390
Accumulated amortisation	(101)	(87)
Net book value	<u>339</u>	<u>303</u>

## 16. INVENTORIES

	Group	
	2003 <i>HK\$'000</i>	2002 <i>HK\$'000</i>
Raw materials	14,737	12,578
Finished goods	12,687	14,745
	<u>27,424</u>	<u>27,323</u>

The carrying amount of inventories has been carried at after charging a general provision of HK\$1,000,000 (2002: Nil) as at the balance sheet date.

## 17. ACCOUNTS RECEIVABLE

Accounts receivable represent (i) receivables from financial institutions in respect of credit card receivables for retail sales and are aged within one week. No credit term was granted to the Group's retail customers as the Group's retail sales were made by cash, travellers' cheques or credit cards; and (ii) receivables in respect of wholesale sales to HOMEOSTYLE Inc. (*note 28 (a)*). The credit period is granted for a period of 45 days for 30% of the invoiced amount and 120 days for the remaining amount for each transaction.

An aged analysis of the accounts receivable as at the balance sheet date is as follows:

	Group	
	2003 <i>HK\$'000</i>	2002 <i>HK\$'000</i>
Outstanding balances with ages:		
Within 30 days	1,239	296
Between 31 and 60 days	241	—
	<u>1,480</u>	<u>296</u>

## Notes to Financial Statements (cont'd)

**18. ACCOUNTS PAYABLE**

An aged analysis of the accounts payable as at the balance sheet date is as follows:

	Group	
	2003	2002
	<i>HK\$'000</i>	<i>HK\$'000</i>
Outstanding balances with ages:		
Within 30 days	156	134
Between 31 and 60 days	299	320
Between 61 and 180 days	37	56
Over 365 days	—	81
	<hr/>	<hr/>
	492	591

**19. TRADE DEPOSIT RECEIVED**

The amount represents a purchase deposit received from Reiki Funaya K.K. ("Funaya") which is unsecured, interest-free and has no fixed terms of repayment.

Mr. Etsuro Funaya, a former director of Lai Fai Jewellery Trading Limited ("LFJ"), a subsidiary of the Company, is the controlling shareholder of Funaya. Mr. Etsuro Funaya resigned as the director of LFJ on 27 February 2002 and, accordingly, is not regarded as a related party thereafter.

## Notes to Financial Statements (cont'd)

## 20. FINANCE LEASE PAYABLE

The Group leased a motor vehicle in the prior year and the lease was classified as a finance lease which was fully settled during the year.

At the balance sheet date, the total future minimum lease payments under finance lease and its present value, were as follows:

## Group

	Minimum lease payments 2003 HK\$'000	Minimum lease payments 2002 HK\$'000	Present value of minimum lease payments 2003 HK\$'000	Present value of minimum lease payments 2002 HK\$'000
Amounts payable within one year and total minimum lease payments	—	317	—	300
Future finance charges	—	(17)		
Total net finance lease payables	—	300		
Portion classified as current liabilities	—	(300)		
Non-current portion	—	—		

The above finance lease was secured by the personal guarantee given by Mr. Li Shui, a director of the Company. Such guarantee was released upon the full settlement of the finance lease payable in the current year.

## 21. INTEREST-BEARING BANK LOAN, UNSECURED

	Group	
	2003 HK\$'000	2002 HK\$'000
Bank loan repayable within one year classified as current liability	1,083	—

## Notes to Financial Statements (cont'd)

## 22. SHARE CAPITAL

	Company	
	2003 HK\$'000	2002 HK\$'000
Authorised:		
300,000,000 (2002: 500,000) shares of HK\$0.10 each	30,000	50
Issued and fully paid:		
128,000,000 (2002: 1) shares of HK\$0.10 each	12,800	—

The comparative amount of the share capital as at 31 December 2002 as shown on the consolidated balance sheet represents the pro forma share capital of the Company, being 10,000 shares of the Company of HK\$0.10 each in issue upon completion of the Company's acquisition of LFBVI, as if the Group had been in existence at 1 January 2002.

The following changes in the Company's authorised and issued share capital took place during the period from 6 September 2002 (date of incorporation) to 31 December 2003:

- (a) On incorporation, the Company had authorised share capital of HK\$50,000 divided into 5,000,000 shares of HK\$0.01 each, one share of which was issued and fully paid.
- (b) On 11 October 2002, additional 9 shares of HK\$0.01 each were issued at par to the then shareholder.
- (c) Pursuant to an ordinary resolution passed on 11 October 2002, the Company consolidated its authorised share capital of 5,000,000 shares of HK\$0.01 each into 500,000 shares of HK\$0.10 each and its issued share capital of 10 shares of HK\$0.01 each into 1 share of HK\$0.10 each.
- (d) On 5 February 2003, as part of the Group Reorganisation, the Company issued an aggregate of 9,999 new shares of HK\$0.10 each credited as fully paid in consideration for the acquisition of the entire issued share capital of LFBVI. The excess of the fair value of the shares of this subsidiary acquired, as determined on the basis of the consolidated net assets at that date over the nominal value of the Company's shares issued in exchange therefor, amounting to HK\$28,500,000, was credited to the Company's share premium account.



## Notes to Financial Statements (cont'd)

## 22. SHARE CAPITAL (continued)

- (e) On 5 February 2003, the authorised share capital of the Company was increased from HK\$50,000 to HK\$30,000,000 by the creation of further 299,500,000 shares of HK\$0.10 each. On the same date, a total of 102,390,000 shares of HK\$0.10 each were allotted as fully paid at par to the holders of the shares on the register of members of the Company in proportion to their respective shareholdings at the close of business on that day by way of capitalisation of the sum of HK\$10,239,000 standing to the credit of the share premium account, which was arising from the Group Reorganisation mentioned in note (d) above, of the Company.
- (f) On 26 February 2003, 25,600,000 new shares of HK\$0.10 each were issued to the public at HK\$1.00 each for a total cash consideration, before expenses, of HK\$25,600,000.

The following is a summary of the above movements in the issued share capital of the Company:

	<i>Notes</i>	Number of shares issued	Par value HK\$'000
Share allotted and issued at par			
for cash on incorporation	<i>(a)</i>	1	—
Issue of shares	<i>(b)</i>	9	—
Consolidation of shares	<i>(c)</i>	(9)	—
Shares issued as consideration for the acquisition of the entire issued share capital of LFBVI pursuant to the Group Reorganisation	<i>(d)</i>	9,999	1
Capitalisation of the Company's share premium account arising from the Group Reorganisation	<i>(e)</i>	102,390,000	—
<hr/>			
Pro forma share capital as at 31 December 2002		102,400,000	1
New issue on public listing	<i>(f)</i>	25,600,000	2,560
Capitalisation of the share premium account as set out above	<i>(e)</i>	—	10,239
<hr/>			
<b>Share capital as at 31 December 2003</b>		<b>128,000,000</b>	<b>12,800</b>

Details of the Company's share option schemes and the share options granted under the schemes are included in note 23 to the financial statements.

## Notes to Financial Statements (cont'd)

## 23. SHARE OPTION SCHEMES

## Pre-IPO share option plan

In recognising the contribution of certain directors, employees and shareholders of any member of the Group to the growth of the Group and/or the listing of the shares of the Company on the GEM of the Stock Exchange, the Company adopted a pre-IPO share option plan (the "Pre-IPO Plan") on 5 February 2003. Pursuant to the terms of the Pre-IPO Plan, options to subscribe for an aggregate of 8,000,000 shares of the Company were granted to a shareholder and five directors of the Company and seven employees of the Group on 26 February 2003, at an exercise price of HK\$0.10, as detailed below:

Name or category of grantee	Number of share options granted during the year and as at 31 December 2003	Exercise period
<b>Shareholder</b>		
Best Perfect International Limited ("Best Perfect")*	4,010,000	<i>Note (a)</i>
<b>Directors</b>		
Mr. Yoshitaka Kitao	1,300,000	<i>Note (a)</i>
Mr. Yu Kam Kee, Lawrence	500,000	<i>Note (a)</i>
Mr. Ty Siao Kian, George	500,000	<i>Note (a)</i>
Mr. Che King Lun, Frankly	400,000	<i>Note (a)</i>
Mr. Mak Tak Cheong, Edmund	200,000	<i>Note (a)</i>
<b>Other employees</b>		
In aggregate	1,090,000	<i>Note (b)</i>
	<b>8,000,000</b>	

\* Best Perfect is beneficially owned by Mr. Li Shui and Mr. Lee You, directors of the Company, as to 91.2% and 8.8%, respectively.

## Notes to Financial Statements (cont'd)

23. SHARE OPTION SCHEMES *(continued)*Pre-IPO share option plan *(continued)*

## Notes:

- (a) The directors and the shareholder are entitled to exercise (i) a maximum of 50% of the total number of options granted at any time during the first year after the date falling twelve months after the Listing Date (the "First Exercise Period"); and (ii) the remainder 50% of the total number of options granted at any time during the period of one year after the end of the First Exercise Period, provided that such exercise of options would not render the percentage of the Company's shares in public hands to fall below the minimum prescribed percentage of 25% as required by Rule 11.23 of the GEM Listing Rules.
- (b) The employees are entitled to exercise (i) a maximum of 50% of the total number of options granted at any time during the first year after the date falling six months after the Listing Date (the "First Employees' Exercise Period"); and (ii) the remainder 50% of the total number of options granted at any time during the period of one year after the end of the First Employees' Exercise Period.

No share options were exercised under the Pre-IPO Plan up to the date of approval of these financial statements.

The exercise in full of all the outstanding share options would, under the present capital structure of the Company, result in the issue of 8,000,000 additional shares of the Company and additional share capital of HK\$800,000, before the related issue expenses.

**Share option scheme**

Under the terms of the share option scheme (the "Scheme") adopted by the Company on 5 February 2003, the board of directors (the "Board") or a duly authorised committee (the "Committee") of the Company is authorised, at their absolute discretion, to invite any employees, directors, advisors, consultants, distributors, suppliers, agents, customers, joint venture partners and service providers to or of any member of the Group, shareholders (including their directors and employees) of any member of the Group and such other persons whom the Board or the Committee considers to have contributed or will contribute to the Group to take up options to subscribe for shares of the Company. The purpose of the Scheme is to encourage its participants to contribute to the success of the Group.

The Scheme became effective on 26 February 2003 and, unless otherwise cancelled or amended, remains in force for ten years from that date.

Notes to Financial Statements (cont'd)

23. SHARE OPTION SCHEMES *(continued)*

Share option scheme *(continued)*

The maximum number of shares in respect of which options may be granted under the Scheme and any other share option scheme of the Company may not exceed 10% of the issued share capital of the Company or to a maximum of 30% should the shareholders renew the 10% limit, from time to time which have been duly allotted and issued. The maximum number of shares issuable under share options to each eligible participant in the Scheme within twelve-month period is limited to 1% of the shares of the Company in issue at any time. Any further grant of share options in excess of this limit is subject to shareholders' approval in a general meeting.

Share options granted to a director, chief executive or substantial shareholder of the Company, or to any of their associates, are subject to approval in advance by the independent non-executive directors. In addition, any share options granted to a substantial shareholder or an independent non-executive director of the Company, or to any of their associates, in excess of 0.1% of the shares of the Company in issue at any time or with an aggregate value (based on the price of the Company's shares at the date of the grant) in excess of HK\$5,000,000, within any twelve-month period, are subject to shareholders' approval in advance in a general meeting.

An option may be exercised in accordance with the terms of the Scheme at any time during the option period after the option has been granted by the Board. The option period, during which an option may be exercised, is determined by the Board or the Committee, but may not be later than ten years after the date of the grant of the option. According to the Scheme, there is no provision requiring a minimum holding period before an option may be exercised. A nominal consideration of HK\$1 is payable on acceptance of the grant of an option under the Scheme.

The exercise price will be determined by the Board or the Committee, but may not be less than the higher of (i) the closing price of the shares on the GEM of the Stock Exchange on the date of the options granted; (ii) the average of the closing price of the shares on the GEM of the Stock Exchange for the five trading days immediately preceding the date of the options granted; and (iii) the nominal value of the shares.

No share options were granted under the Scheme as at 31 December 2003 and up to the date of approval of these financial statements. As at the date of approval of these financial statements, 12,800,000 shares are available for issue under the Scheme, representing 10% of the issued share capital of the Company at that date.

Share options do not confer rights on the holders to dividends or to vote at shareholders' meetings.

## Notes to Financial Statements (cont'd)

## 24. RESERVES

	<i>Notes</i>	Share premium <i>HK\$'000</i>	Contributed surplus <i>HK\$'000</i>	Retained profits <i>HK\$'000</i>	Total <i>HK\$'000</i>
<b>Group</b>					
At 1 January 2002		—	2,999	4,383	7,382
Contributed surplus arising from the Group					
Reorganisation		—	18,178	—	18,178
Net profit from ordinary activities attributable to shareholders		—	—	10,431	10,431
Interim dividend	12	—	—	(2,300)	(2,300)
<hr/>					
At 31 December 2002 and 1 January 2003		—	21,177	12,514	33,691
Issue of shares	22(f)	23,040	—	—	23,040
Capitalisation issue of shares	22(e)	(10,239)	—	—	(10,239)
Share issue expenses		(9,137)	—	—	(9,137)
Net loss from ordinary activities attributable to shareholders		—	—	(5,049)	(5,049)
Special 2003 dividend	12	—	—	(4,698)	(4,698)
<hr/>					
<b>At 31 December 2003</b>		<b>3,664</b>	<b>21,177</b>	<b>2,767</b>	<b>27,608</b>

## Notes to Financial Statements (cont'd)

## 24. RESERVES (continued)

	<i>Notes</i>	Share premium <i>HK\$'000</i>	Accumulated losses <i>HK\$'000</i>	Total <i>HK\$'000</i>
<b>Company</b>				
Arising from acquisition				
of LFBVI	<i>22(d)</i>	28,500	—	28,500
Issue of shares	<i>22(f)</i>	23,040	—	23,040
Capitalisation issue of shares	<i>22(e)</i>	(10,239)	—	(10,239)
Share issue expenses		(9,137)	—	(9,137)
Net profit for the year		—	4,281	4,281
Special 2003 dividend	<i>12</i>	—	(4,698)	(4,698)
<b>At 31 December 2003</b>		<b>32,164</b>	<b>(417)</b>	<b>31,747</b>

The contributed surplus of the Group represents reserve arising from the Group Reorganisation, comprising (i) the difference between the nominal value of the share capital of the subsidiaries acquired pursuant to the Group Reorganisation set out in note 1 to the financial statements over the nominal value of the share capital of the Company issued in exchange therefor; and (ii) the assignment of amount due to a director, Mr. Li Shui, to LFBVI.

The share premium account of the Company includes reserve arising from the Group Reorganisation amounting to HK\$28,500,000, representing the excess of the then combined net assets of the subsidiaries acquired over the nominal value of the share capital of the Company issued in exchange therefor.

According to the Companies Law of the Cayman Islands, the share premium account is distributable to the shareholders of the Company provided that immediately following the date on which the dividend is proposed to be distributed, the Company will be in a position to pay off its debts as and when they fall due in the ordinary course of business.

## Notes to Financial Statements (cont'd)

## 25. NOTES TO CONSOLIDATED CASH FLOW STATEMENT

## (a) Major non-cash transactions

In the prior year, there were the following major non-cash transactions:

- (i) The Group entered into a finance lease arrangement in respect of a motor vehicle with a total capital value at the inception of the lease of HK\$600,000.
- (ii) On 25 March 2002, an outstanding balance of the amount due to a director, Mr. Li Shui, of HK\$18,178,000 was assigned by Mr. Li Shui to LFBVI pursuant to the deed of assignments entered into, among others, between Mr. Li Shui and LFBVI.

## (b) Restricted cash and cash equivalent balances

A time deposit of the Group is pledged to a bank to secure banking facility in respect of a utility deposit granted to the Group.

## 26. INTERESTS IN SUBSIDIARIES

	Company	
	2003 HK\$'000	2002 HK\$'000
Unlisted shares, at cost	28,501	—
Due from subsidiaries	16,395	—
	44,896	—

The amounts due from subsidiaries included in the Company's current assets are unsecured, interest-free and have no fixed terms of repayment.

## Notes to Financial Statements (cont'd)

## 26. INTERESTS IN SUBSIDIARIES (continued)

Particulars of the subsidiaries are as follows:

Company name	Place of incorporation/ operations	Issued and paid-up share capital	Percentage of equity attributable to the Company		Principal activities
			Direct	Indirect	
Lai Fai International (BVI) Limited	British Virgin Islands/ Hong Kong	US\$1,000	100	—	Investment holding
Lai Fai Jewellery Trading Limited	Hong Kong	HK\$3,000,000	—	100	Retail and wholesale of jewellery products
Champion Force Industrial Limited	Hong Kong	HK\$2	—	100	Sourcing, manufacture and wholesale of jewellery products

## 27. OPERATING LEASE ARRANGEMENT

The Group leases its office property and retail shop under an operating lease arrangement which is negotiated for a term of three years.

The Group had total future minimum lease payments under a non-cancellable operating lease falling due as follows:

	Group	
	2003 HK\$'000	2002 HK\$'000
Within one year	1,715	1,560
In the second to fifth years, inclusive	—	1,715
	<b>1,715</b>	<b>3,275</b>



## Notes to Financial Statements (cont'd)

## 28. RELATED PARTY TRANSACTIONS

In addition to the transactions and balances set out elsewhere in these financial statements, the Group had the following material related party transactions during the year:

(a)	Group	
	2003 HK\$'000	2002 HK\$'000
Sale of goods	1,023	—
Promotion and marketing fees	298	—

The sale of goods and payment of promotion and marketing fees were made to HOMEOSTYLE Inc. ("HOMEOSTYLE"), a Japanese retail company held by the discretionary investment funds managed by a fellow subsidiary of Artfolio Corporation, a substantial shareholder of the Company, pursuant to a supply agreement entered into between the Group and HOMEOSTYLE on 15 October 2003.

Sale of goods were made based on the cost of the Group plus a mark up agreed between the Group and HOMEOSTYLE. Promotion and marketing fees were charged on the actual cost reimbursement basis.

As at 31 December 2003, there were outstanding balances of HK\$1,023,000 (2002: Nil) due from HOMEOSTYLE in respect of the sale of goods included in the Group's accounts receivable, and HK\$298,000 (2002: Nil) due to HOMEOSTYLE in respect of the promotion and marketing fee included in the Group's accruals and other payables.

- (b) During the year, pre-listing public relation service fees of HK\$135,000 (2002: HK\$88,000) and advisory service fees of HK\$511,000 (2002: HK\$405,000) were paid to Ebizal Marketing (Hong Kong) Limited ("Ebizal") and SBI E2-Capital Securities Limited ("SBI"), respectively. Ebizal and SBI are subsidiaries of Softbank Investment International (Strategic) Limited ("SIIS"), a strategic investor of the Company. These amounts were previously included in the Group's prepayments, deposits and other receivables and were deducted against the Company's share premium account in the current year.

**Notes to Financial Statements (cont'd)**

**28. RELATED PARTY TRANSACTIONS** *(continued)*

(b) *(continued)*

In addition to the above, during the year, post-listing public relation service fees of HK\$162,000 (2002: Nil) and advisory service fees of HK\$86,000 (2002: Nil) were also charged by Ebizal and SBI, respectively, at a respective monthly amount of HK\$18,000 and HK\$8,000.

As at 31 December 2003, the outstanding balances due to Ebizal and SBI amounted to HK\$18,000 (2002: Nil) and HK\$25,000 (2002: Nil), respectively, were included in the Group's accruals and other payables.

(c) Mr. Li Shui provided a personal guarantee to Artfolio Corporation and SIIS that the net profit after tax of the Group for the twelve months ended 31 March 2003 would not be less than HK\$10 million, which was satisfactorily fulfilled. The guarantee was discharged upon the receipt of a discharge letter issued by Artfolio Corporation and SIIS on 31 May 2003.

(d) In the year ended 31 December 2002, sale of goods amounted to HK\$812,000 were made to Funaya. Mr. Etsuro Funaya, a former director of LFJ, is the controlling shareholder of Funaya. Mr. Etsuro Funaya resigned as the director of LFJ on 27 February 2002 and, according, is not regarded as a related party thereafter.

In the opinion of the directors, the above transactions were carried out in the ordinary course of business of the Group.

**29. APPROVAL OF THE FINANCIAL STATEMENTS**

The financial statements were approved and authorised for issue by the board of directors on 29 March 2004.

## NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN that the Annual General Meeting of the shareholders of Lai Fai International Holdings Limited (the "Company") will be held at the Company's meeting room of Rear Portion G/F., Grandview Garden, 71-77 Pau Chung Street, Tokwawan, Kowloon, Hong Kong on Friday, 30 April 2004 at 4:30 p.m. for the following purposes:

1. To receive and consider the Audited Financial Statements together with the Reports of the Directors and Auditors thereon for the year ended 31 December 2003;
2. To re-elect the retiring Directors and to authorise the Board of Directors to fix their remuneration;
3. To re-appoint Auditors of the Company and to authorise the Board of Directors to fix their remuneration; and
4. To consider and, if thought fit, pass with or without amendments, the following resolutions as an ordinary resolution:

"THAT:

- (a) subject to paragraph (c) of this Resolution, and pursuant to the Rules Governing the Listing of Securities on the Growth Enterprise Market ("GEM Listing Rules") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), the exercise by the Directors of the Company during the Relevant Period (as hereinafter defined) of all powers of the Company to allot, issue or otherwise deal with additional shares in the share capital of the Company and to make or grant offers, agreements and options which would or might require the exercise of such powers, be and the same is hereby generally and unconditionally approved;
- (b) the approval in paragraph (a) of this Resolution shall authorise the Directors of the Company during the Relevant Period to make or grant offers, agreements and options which would or might require the exercise of such powers after the end of the Relevant Period;

**Notice of Annual General Meeting (cont'd)**

- (c) the aggregate nominal amount of share capital allotted or agreed conditionally or unconditionally to be allotted (whether pursuant to an option or otherwise) and issued by the Directors of the Company pursuant to the approval in paragraph (a) of this Resolution, otherwise than by way of (i) a Rights Issue (as hereinafter defined); or (ii) the exercise of or the grant of any option under any share option scheme of the Company or similar arrangement for the time being adopted for the issue or grant to officers and/or employees of the Company and/or any of its subsidiaries of shares or options to subscribe for or rights to acquire shares of the Company; or (iii) any scrip dividend or similar arrangement providing for the allotment of shares in lieu of the whole or part of a dividend on shares in accordance with the Articles of Association of the Company in force from time to time, shall not exceed 20% of the aggregate nominal amount of the share capital of the Company in issue as at the date of passing of this Resolution and the said approval be limited accordingly; and
  
- (d) for the purpose of this Resolution:
  - (aa) "Relevant Period" means the period from the passing of this Resolution until whichever is the earliest of:
    - (i) the conclusion of the next annual general meeting of the Company;
    - (ii) the expiration of the period within which the next annual general meeting of the Company is required by the Articles of Association of the Company or any applicable laws to be held; or
    - (iii) the revocation or variation of the authority given under this Resolution by an ordinary resolution of the shareholders in general meeting.

**Notice of Annual General Meeting (cont'd)**

(bb) "Rights Issue" means an offer of shares in the share capital of the Company or an offer or issue of warrants or options or similar instruments to subscribe for shares in the share capital of the Company open for a period fixed by the Directors of the Company to holders of shares whose names appear on the register of members of the Company on a fixed record date in proportion to their then holdings of such shares in the Company (subject to such exclusions or other arrangements as the Directors of the Company may deem necessary or expedient in relation to fractional entitlements, or having regard to any restrictions or obligations under the laws of, or the requirements of, or the expense or delay which may be involved in determining the existence or extent of any restrictions or obligations under the laws of, or the requirements of, any jurisdiction applicable to the Company, or any recognised regulatory body or any stock exchange applicable to the Company)."

5. To consider and, if thought fit, pass with or without amendments, the following resolutions as an ordinary resolution:

**"THAT:**

- (a) subject to paragraph (b) of this Resolution, the exercise by the Directors of the Company during the Relevant Period as defined in Resolution 4(d)(aa) of all powers of the Company to repurchase issued shares in the share capital of the Company on the Growth Enterprise Market of the Stock Exchange or any other stock exchange on which the shares of the Company may be listed and recognised by the Securities and Futures Commission of Hong Kong and the Stock Exchange for such purpose, and otherwise in accordance with the rules and regulations of the Securities and Futures Commission of Hong Kong, the Stock Exchange or of any other stock exchange as amended from time to time and all applicable laws in this regard, be and the same is hereby generally and unconditionally approved;
- (b) the aggregate nominal amount of issued shares of the Company which may be repurchased by the Company pursuant to the approval in paragraph (a) of this Resolution during the Relevant Period shall not exceed 10% of the aggregate nominal amount of the share capital of the Company in issue as at the date of passing of this Resolution and the said approval shall be limited accordingly; and

**Notice of Annual General Meeting (cont'd)**

(c) for the purpose of this Resolution, "Relevant Period" shall have the same meaning as in Resolution 4(d)(aa)."

6. As special business, to consider and, if thought fit, pass with or without amendments, the following resolution as an ordinary resolution:

**"THAT:**

conditional upon Resolutions No. 4 and 5 above being passed, the general mandate granted to the Directors of the Company to allot, issue or otherwise deal with additional shares pursuant to Resolution No. 4 be and is hereby extended by the addition thereto of an amount representing the aggregate nominal amount of shares repurchased by the Company under the authority granted pursuant to Resolution No. 5."

By Order of the Board

**Li Shui**

*Chairman*

Hong Kong, 29 March 2004

*Notes:*

1. Any member entitled to attend and vote at the Annual General Meeting is entitled to appoint one or more proxies to attend and vote on his behalf. A proxy need not be a member of the Company. If more than one proxy is so appointed, the appointment shall specify the number and class of shares in respect of which each such proxy is so appointed.
2. The Register of Members will be closed from Friday, 23 April 2004 to Friday, 30 April 2003, both days inclusive, during which period no transfer of shares can be registered.
3. An explanatory statement containing further details regarding the proposed Resolutions nos. 4 to 6 set out in the above notice will be dispatched to shareholders together with the 2003 Annual Report of the Company.