



Kanstar Environmental Paper Products Holdings Limited

建星環保紙品控股有限公司*

(incorporated in the Cayman Islands with limited liability)

Stock code : 8011

Third Quarterly Report 2004

** For identification only*

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

HIGHLIGHTS

- Turnover increased by approximately 93% over the corresponding period in the previous year to approximately HK\$35.5 million for the nine months ended 30 September 2004.
- Net profit attributable to shareholders for the nine months ended 30 September 2004 amounted to approximately HK\$843,000 whereas the net loss to shareholders of approximately HK\$1,713,000 was recorded in previous period.
- The Directors do not declare any dividend for the nine months ended 30 September 2004.

QUARTERLY RESULTS

The board of directors (the "Board") of Kanstar Environmental Paper Products Holdings Limited (the "Company") is pleased to announce the unaudited consolidated results of the Company and its subsidiaries (collectively the "Group") for the three months and nine months ended 30 September 2004, together with the comparative unaudited figures for the corresponding periods in 2003, as set out below:

UNAUDITED CONSOLIDATED RESULTS

	Notes	Three months ended 30 September		Nine months ended 30 September	
		2004 HK\$	2003 HK\$	2004 HK\$	2003 HK\$
Turnover	2	12,532,022	3,866,799	35,520,887	18,396,142
Cost of sales		(11,948,443)	(4,088,906)	(32,463,866)	(18,551,029)
Gross profit (loss)		583,579	(222,107)	3,057,021	(154,887)
Other revenue		12,114	5,486	39,585	23,514
Selling and distribution expenses		(143,707)	(209,605)	(836,086)	(375,557)
Administrative expenses		(374,480)	(199,582)	(1,277,103)	(1,205,650)
Profit (loss) from operations		77,506	(625,808)	983,417	(1,712,580)
Finance costs		(57,174)	—	(139,937)	—
Profit (loss) before taxation	3	20,332	(625,808)	843,480	(1,712,580)
Taxation	4	—	—	—	—
Profit (loss) for the period		20,332	(625,808)	843,480	(1,712,580)
Dividend	5	—	—	—	—
Earnings (loss) per share (cent)	6				
— basic		0.001	(0.016) (Restated)	0.021	(0.043) (Restated)
— diluted		0.001	N/A	0.020	N/A

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (UNAUDITED)

	Share capital HK\$	Share premium HK\$	Special reserve HK\$	Revaluation reserve HK\$	Exchange reserve HK\$	Accumulated losses HK\$	Total HK\$
At 1 January 2003	8,000,000	35,770,199	985,000	23,509,170	(2,096)	(12,299,803)	55,962,470
Loss for the period	—	—	—	—	—	(1,712,580)	(1,712,580)
At 30 September 2003	8,000,000	35,770,199	985,000	23,509,170	(2,096)	(14,012,383)	54,249,890
At 1 January 2004	8,000,000	35,770,199	985,000	23,509,170	(2,096)	(14,265,943)	53,996,330
Profit for the period	—	—	—	—	—	843,480	843,480
At 30 September 2004	8,000,000	35,770,199	985,000	23,509,170	(2,096)	(13,422,463)	54,839,810

Notes:

1. Basis of presentation and principal accounting policies

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

The Group's unaudited consolidated results have been prepared in accordance with Statements of Standard Accounting Practices issued by the Hong Kong Institute of Certified Public Accountants and generally accepted accounting principles in Hong Kong.

The accounting policies and basis of preparation of the unaudited consolidated results are consistent with those used in the annual financial statements for the year ended 31 December 2003.

2. Turnover

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

3. Profit (loss) before taxation

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

	For the three months ended 30 September		For the nine months ended 30 September	
	2004	2003	2004	2003
	HK\$	HK\$	HK\$	HK\$
Depreciation of property, plant and equipment	412,687	394,681	1,259,017	1,172,524
Bank interest income	(4,598)	(5,486)	(6,224)	(23,514)
Interest on bank borrowings wholly repayable within 5 years	57,174	—	139,937	—

4. Taxation

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

Pursuant to the relevant laws and regulations in the PRC, one of the PRC subsidiary of the Company is exempted from the PRC income tax for two years starting from their first profit-making year, followed by a 50% reduction for the next three years. No provision for the PRC income tax has been made in the consolidated accounts as this company had no assessable profit during the periods. The other PRC subsidiary was in loss making position for the current and the previous years and accordingly did not have any assessable profit.

There was no unprovided deferred tax in respect of the three months and nine months ended 30 September 2004 (three months and nine months ended 30 September 2003: Nil).

5. Dividend

The Board does not recommend the payment of an interim dividend for the nine months ended 30 September 2004 (nine months ended 30 September 2003: Nil).

6. Earnings (loss) per share

The calculations of the basic and diluted earnings (loss) per share are based on the following data:

	For the three months ended 30 September		For the nine months ended 30 September	
	2004	2003	2004	2003
	<i>HK\$</i>	<i>HK\$</i>	<i>HK\$</i>	<i>HK\$</i>
Profit (loss) for the period				
Profit (loss) for calculating basic and diluted earnings (loss) per share	20,332	(625,808)	843,480	(1,712,580)
Number of shares				
Weighted average number of ordinary shares used in the calculation of basic earnings (loss) per share	4,000,000,000	4,000,000,000	4,000,000,000	4,000,000,000
Effect of dilutive potential ordinary share	182,900,042	N/A	183,769,184	N/A
Weighted average number of ordinary shares used in the calculation of diluted earnings per share	4,182,900,042	N/A	4,183,769,184	N/A

No diluted loss per share is calculated for the three months and nine months ended 30 September 2003 because the effect of assumed exercise of share options outstanding during the period would result in reduction in loss per share.

Pursuant to an ordinary resolution passed at an extraordinary general meeting of the Company held on 7 October 2003, each of the initial issued and unissued shares having a par value of HK\$0.01 were subdivided into five subdivided shares having a par value of HK\$0.002 each with effect from 8 October 2003. Upon the share subdivision becoming effective on 8 October 2003, the authorised share capital of the Company became HK\$20 million divided into 10,000 million subdivided shares, of which 4,000 million subdivided shares are in issue and fully paid. The subdivided shares rank *pari passu* in all respects with each other and the rights attaching to the subdivided shares are not affected by the share subdivision. The weighted average number of ordinary shares for the three months and nine months ended 30 September 2003 for the purposes of calculating the basic loss per share have been retrospectively adjusted for the one-to-five share subdivision which took place in October 2003.

MANAGEMENT DISCUSSION AND ANALYSIS

Business and financial review

For the nine months ended 30 September 2004, the Group recorded an unaudited turnover of approximately HK\$36 million, increased sharply by approximately 93% over the corresponding period in last year and an unaudited gross profit of approximately HK\$3.1 million, compared with an unaudited gross loss of HK\$155,000 in last corresponding period. With the sharp increase in turnover and the production scale, the amount of selling and distribution expenses increased greatly by 123% compared to that of last corresponding period.

The directors of the Company do not recommend the payment of an interim dividend for the nine months ended 30 September 2004. (30 September 2003: nil)

Due to the lengthy rainy season in Yunnan District this year, the Group used up lots of the reserved raw materials, such as bamboos and woods, for the production in the second quarter of the year. In the third quarter, in order to maintain good business relationships with customers and to stabilize production, the Group needed to use high purchase cost to purchase raw materials in other regions. Comparing to that of the first quarter, the purchase costs of the Group increased greatly by approximately 70%.

Started from this review period, the transportation costs in the Yunnan regions have sharply increased due to the implementation of the new transportation rules and the continuous increase in the price of oil. Comparing to that of the first half of 2004, the transportation costs for the purchase of raw materials in this rainy season have increased by more than 30%. Also, there was instable electricity supply in Yunnan Regions which increased the by-products in the production process and thus the production costs in current period. The sharp increase in purchase and transportation costs and the instable electricity supply decrease the profit margin from 10% in the first half of the year to 4.7% in this review period.

In order to minimize the effect from the increase in the transportation cost, the Group tries to increase the proportion of sales in Yunnan Province and to negotiate with the customers to share part of the transportation costs. In this review period, some of the customers agreed to share part of the costs. Thus the selling and distribution costs in this quarter slightly decreased.

Prospects

In the fourth quarter of 2004, after the rainy season, the Group will intensify its reserve in raw materials such as bamboos and woods in order to stabilize and reduce the production costs in the coming year. It is expected that the purchase costs of raw materials will reduce to normal level and thus improve the profits margin of the Group's products. In order to reserve more raw materials for the rainy season of 2005, the Group has successfully obtained a banking facility for the reservation of raw materials and plans to reserve raw materials adequate for half years' productions before the coming Chinese New Years. The Group will try to negotiate with the suppliers to undertake its products in order to get a lower purchase cost in the coming quarter.

Also, in order to further eliminate the effects from the increase in the transportation costs of Kanstar's products, the Group will intensify its sales efforts in Yunnan regions and it targets to sell around 70% of Kanstar's products within the Yunnan Province in 2005. The Board of Directors believes that the promotion of sales in Yunnan Province will improve the overall gross profit margins of Kanstar's products.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

Up to 30 September 2004, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

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

As at 30 September 2004, the interests or short positions of the Directors and chief executive of the Company in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) which were notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they were taken or deemed to have under such provisions of the SFO), or which were recorded in the register required to be kept by the Company under Section 352 of the SFO, or which were required, pursuant to Rules 5.46 of the GEM Listing Rules, relating to the required standard of dealings by directors of listed issuers, to be notified to the Company and the Stock Exchange, were as follows:

Long positions in the shares of the Company

Name of Director	Capacity	Personal Interests	Family Interests	Number of Ordinary Shares		Total	Percentage of Shareholding
				Corporate Interests	Other Interests		
Mr. Chim Kim Kiu, Jacky	Interest of a controlled corporation	—	—	3,000,000,000 (Note 1)	—	3,000,000,000	75%

Note:

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

Long positions in underlying shares of the Company

Name of Grantees (Relations with the Group)	Capacity	Description of equity derivatives (number of underlying shares)
Mr. Ip Kai Cheong <i>(Executive Director)</i>	Beneficial owner	share options to subscribe for shares (108,350,000 shares) <i>(Note)</i>
Mr. Sun Tak Keung <i>(Executive Director)</i>	Beneficial owner	share options to subscribe for shares (75,000,000 shares) <i>(Note)</i>

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

Save as disclosed above, none of the Directors or chief executive of the Company had, as at 30 September 2004, any interests or short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which would have to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they were taken or deemed to have under such provisions of the SFO), or which were recorded in the register required to be kept by the Company under Section 352 of the SFO, or which were required to be notified to the Company and the Stock Exchange pursuant to Rules 5.46 of the GEM Listing Rules.

SUBSTANTIAL SHAREHOLDERS

As at 30 September 2004, so far is known to the Directors, the following persons (not being a Director or a chief executive of the Company) had an interest and/or a short position in the shares and/or underlying shares of the Company as recorded in the register required to be kept under Section 336 of the SFO or had otherwise notified to the Company were as follows:

Name	Number of shares held	Approximate percentage of issued shares
Siko Venture Limited	3,000,000,000 <i>(Note 1)</i>	75.00%
Mr. Chim Pui Chung	220,000,000 <i>(Note 2)</i>	5.50%

Notes:

1. The entire issued share capital of Siko Venture Limited is beneficially owned by Mr. Chim Kim Kiu, Jacky.
2. Total interests of Mr. Chim Pui Chung in 220,000,000 ordinary shares of the Company referred above include 170,000,000 ordinary shares held by Golden Mount Ltd. and 50,000,000 ordinary shares held by Gallery Land Ltd. The entire issued share capital of both Golden Mount Ltd. and Gallery Land Ltd. are beneficially owned by Mr. Chim Pui Chung.

Save as disclosed above, as at 30 September 2004, the Directors are not aware of any other person or corporation having an interest or short position in the shares and underlying shares of the Company representing 5% or more of the issued share capital of the Company.

SHARE OPTION SCHEMES

Pursuant to the pre-IPO share option scheme (the "Pre-IPO Share Option Scheme") adopted by the Company on 26 June 2002, certain Directors and participants have been granted options to subscribe for shares at an exercise price of HK\$0.002 per share, details of which are set out as follows:

Name of grantee	Date of grant	Exercise period	Granted	Number of shares options		
				Outstanding as at 1 January 2004	Lapsed during the period under review	Outstanding as at 30 June 2004
<i>Executive directors</i>						
Mr. Li Gang	26 June 2002	12 July 2003 - 11 July 2008	19,000,000	—	—	—
Mr. Ip Kai Cheong	26 June 2002	12 July 2002 - 11 July 2007	65,000,000	65,000,000	—	65,000,000
		12 January 2003 - 11 January 2008	43,350,000	43,350,000	—	43,350,000
Mr. Sun Tak Keung	26 June 2002	12 July 2002 - 11 July 2007	45,000,000	45,000,000	—	45,000,000
		12 January 2003 - 11 January 2008	30,000,000	30,000,000	—	30,000,000
<i>Other participants</i>						
Employees in aggregate	26 June 2002	12 July 2003 - 11 July 2008	48,750,000	33,000,000	32,500,000	500,000
Total				216,350,000	32,500,000	183,850,000

No share options under the share option scheme (the "Share Option Scheme") adopted by the Company on 26 June 2002 were granted during the nine months ended 30 September 2004.

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

DIRECTORS' AND CHIEF EXECUTIVE'S RIGHTS TO ACQUIRE SHARES

Save as disclosed above, at no time during the periods from 1 January 2004 to 30 September 2004 was the Company, its subsidiaries or holding company a party to any arrangements to enable the directors or chief executives (including their spouses or children under 18 years of age) of the Company to acquire benefits by means of acquisition of shares in the Company or any other body corporate.

POTENTIAL COMPETING INTERESTS

Mr. Chim Kim Kiu, Jacky and Mr. Ip Kai Cheong, the executive directors of the Company, are directors of Riches Good Limited ("Riches Good"), the entire issued share capital of which is held by Mr. Chim Kim Kiu, Jacky, the Chairman and Management Shareholder of the Company. In October 2004, Riches Good has purchased the assets and production machines from a bankrupted paper manufacturing plant and plans to use one year to restore production. It expects to produce cardboard, corrugating papers and packaging papers after the restoration period. Up to the date of this report, there is no production made by Riches Good.

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

REQUIRED STANDARD OF SECURITIES DEALINGS BY DIRECTORS

During the nine months ended 30 September 2004, the Company had complied with the required standard of dealings set out in Rules 5.48 to 5.67 of the GEM Listing Rules. Having made specific enquiry with all the directors, the directors of the Company had complied with the required standard of dealings and the code of conduct for the directors' securities transactions during the nine months ended 30 September 2004.

INTEREST OF SPONSORS

As updated and notified by the Company's sponsor, Kingston Corporate Finance Limited ("Kingston"), as at 30 September 2004, neither Kingston nor its directors, employees and their associates had any interest in the shares of the Company or any subsidiaries of the Group, or any right to subscribe for or to nominate persons to subscribe for the shares of the Company or any member of the Group.

Kingston and the Company have entered into a sponsor's agreement, pursuant to which, Kingston will receive fee for acting as the Company's sponsor for the period up to 31 December 2004 subject to terms and conditions agreed between the parties thereto.

COMPLIANCE WITH RULE 5.34 TO 5.45 OF THE GEM LISTING RULES

Up to 30 September 2004, the Company has complied with the standards of good practice concerning the general management responsibilities of the Board as set out in Rules 5.34 to 5.45 of the GEM Listing Rules.

AUDIT COMMITTEE

The Company has established an audit committee, comprising Mr. Lau Ka Ho, Mr. Wang Ai Guo and Mr. Chan Chi Hung, Anthony, all of whom are independent non-executive Directors, with written terms of reference in compliance with the GEM Listing Rules. Mr. Lau Ka Ho has been appointed as the chairman of the audit committee. The primary responsibilities of the audit committee are (i) to review the annual report and accounts, half-yearly report and quarterly reports and provide advice and comments thereon to the Board and (ii) to review and supervise the financial reporting process and internal control system of the Group. The audit committee has reviewed the quarterly report for the nine months ended 30 September 2004.

On behalf of the Board

Sun Tak Keung
Executive Director

Hong Kong, 12 November 2004

At the date of this report, the Board is comprised of Mr. Chim Kim Kiu, Jacky, Mr. Ip Kai Cheong, Mr. Li Gang and Mr. Sun Tak Keung as executive directors, Mr. Chan Chi Hung, Anthony, Mr. Lau Ka Ho and Mr. Wong Ai Guo as independent non-executive directors.