

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

Lai Fai



Annual Report
2004

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

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

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

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

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

This report, for which the directors of Lai Fai International 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.

Contents

Corporate Information	2
Chairman's Statement	3
Management Discussion and Analysis	5
Comparison of Business Objectives with Actual Business Progress	11
Report of the Directors	14
Report of the Auditors	30
Consolidated Profit and Loss Account	31
Consolidated Balance Sheet	32
Consolidated Summary Statement of Changes in Equity	33
Consolidated Cash Flow Statement	34
Balance Sheet	36
Notes to Financial Statements	37
Notice of Annual General Meeting	61

Corporate Information

BOARD OF DIRECTORS

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, *M.B.E. J.P.*

Independent Non-executive Directors

Mr. Mak Tak Cheong, Edmund

Mr. Che King Lun, Frankly

Mr. Ho Hou Chiu, William

COMPLIANCE OFFICER

Mr. Li Shui

Mr. Lam King Pui, *CPA, FCCA, ACIS, ACS*

COMPANY SECRETARY

Mr. Lam King Pui, *CPA, FCCA, ACIS, ACS*

QUALIFIED ACCOUNTANT

Mr. Lam King Pui, *CPA, FCCA, ACIS, ACS*

AUDIT COMMITTEE

Mr. Mak Tak Cheong, Edmund

(*Chairman of Audit Committee*)

Mr. Che King Lung, Frankly

Mr. Li Shui

COMPLIANCE ADVISER

Celestial Capital Limited

GEM STOCK CODE

8183

AUDITORS

Albert Lam & Co.

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

Chairman's Statement

I would like to present the 3rd 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 2004 to shareholders.

Hong Kong has demonstrated a fast pick up in economy amid 2004 after a tough year from the outbreak of Severe Acute Respiratory Syndrome ("SARS") in 2003. The adoption of the Individual Visa Scheme ("IVS") by the Mainland China Government in July 2003 has not only led to a boost in number of tourists visiting Hong Kong but also an improvement in investment sentiment and growth in gross domestic product as a whole.

The Group's turnover is mostly tourism driven. It has been outlined by the Hong Kong government (the "Government") in its agenda that tourism, logistics, financial services and property development are the 4 core industries of Hong Kong and it will ensure these core industries to have the infrastructure, capabilities and regulatory environment that they need to continue to expand and develop.

The Group has leveraged on these cutting edges with significant improvement in turnover in the current year and return to a profit position as well.

RESULTS

The Group's principal activities are manufacturing and retailing of jewellery products. The major source of revenue of the Group uses to be the Japanese tourists visiting Hong Kong and has been widened to cover arrival tourists from the Mainland China in the current year.

Turnover has increased significantly by approximately 77% in the current year and there was a turnaround from net loss in last year to the current year net profit attribute to shareholders of HK\$576,000.

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

LOOKING AHEAD

Tourism has been an important hub for driving the growth of Hong Kong economy in last year. We believe this driving force will be intensified with multiplier effects in 2005 when Disneyland and the Tung Chung cable car connecting to the Big Buddha open in the 4th quarter of 2005.

Chairman's Statement

LOOKING AHEAD *(Continued)*

Moreover, in addition to the 32 Mainland China cities with an approximately 150 million citizens eligible for more convenient travel to Hong Kong under the IVS which will cast a huge number of visitors travelling to Hong Kong in the near future, the Mainland China government plans to open further cities under the IVS in 2005. Accordingly, tourism and the related industries will definitely enter into a high growth phase in the coming year and the Group is optimistic about the future results.

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, 25 February 2005

Management Discussion and Analysis

OPERATION REVIEW

The Group is principally engaged in the manufacturing and retailing of jewellery products appealing 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 three years and then renewable annually thereafter.

During the year, the Group obtained the approvals from the Company's shareholders in an extraordinary general meeting ("EGM") held on 8 June 2004, the circular setting out the details of the resolutions were despatched to the shareholders on 11 May 2004 (the "Circular"), for diverting part of net proceeds raised from listing of the Company's shares in February 2003, to extend the retail business to cover arrival tourists from the Mainland China.

After renovation of certain sections of the existing retail outlet, additions of inventory, recruitment and training of new staffs, the Group has commenced retailing of jewellery products to tourists from the Mainland China from July 2004 onwards.

Number of arrival visitors to Hong Kong as extracted from the Hong Kong Tourism Board ("HKTB") publications:

Year 2004	From Japan	From China	Total
First Quarter	220,047	2,919,108	4,935,200
Second Quarter	256,814	2,749,023	5,077,418
Third Quarter	317,836	3,311,344	5,745,474
Fourth Quarter	331,553	3,266,387	6,052,538
Total	1,126,250	12,245,862	21,810,630
Year 2003	867,160	8,467,211	15,536,839
% increment	↑ 30%	↑ 45%	↑ 40%

Although the total number of arrival visitors to Hong Kong showed a swiftly increase of 40% in 2004 over the last year, the operating environment in the first quarter of 2004 was in fact tough. The aftermaths of SARS in 2003 together with the recurrence of bird flu and SARS infection cases in the nearby countries of Hong Kong in the first quarter of 2004 had undermined the visitors' confidence in traveling to Hong Kong.

Management Discussion and Analysis

OPERATION REVIEW *(Continued)*

Nevertheless, the visitors' confidences were sooner recovered in the second quarter of 2004 when it was evidenced that Hong Kong has a high standard of public health and safety precautions as maintained by the Hong Kong medical workers and there were no recurrence of bird flu or SARS infection case in Hong Kong in 2004. Together with the Government's whole-hearted efforts in promoting Hong Kong for travel, shopping and pleasure through a series of prolific events in attracting tourists, the number of arrival visitors went into take-off stage again from the second quarter of 2004 onwards.

Turnover

Turnover was HK\$40,098,000 in the current year (2003: HK\$22,633,000) which represented an increment of 77%. The significant improvement in turnover was partly attributed to the fact that turnover in last year was slack amid the outbreak of the SARS and partly attributed to the active effort in the current year by the Group in widening its customers base to cover arrival tourists from the Mainland China since July 2004.

Gross profit

Gross profit for the year was HK\$27,512,000 (2003: HK\$14,417,000) which represented a 91% increment from last year. The greater magnitude of increment in gross profit than turnover was mainly attributed to the improvement in the gross profit margin from 64% in last year to 69% in the current year.

Net profit/(loss) from ordinary activities attributable to shareholders

There was a turnaround from net loss from ordinary activities attributable to shareholders of HK\$5,049,000 in last year to the current year net profit from ordinary activities attributable to shareholders of HK\$576,000.

It was the tough operating environment in the first quarter of 2004 that led to a net loss from ordinary activities attribute to shareholders in that quarter as certain administrative expenses and staff costs were fixed and unavoidable.

Whilst in the middle of the year, initial setup cost in the areas of recruitment, training and renovation for the retailing business to the arrival tourists from Mainland China had also undermined of the Group's profitability as that section was not operating in the economy of scale at the start-up stages.

Although turnover as contributed by the customers from the Mainland China tourists has accounted for 9.5% of the Group's total turnover, operating expenses of that section were comparatively high in term of the turnover of that section could be generated.

Management Discussion and Analysis

OPERATION REVIEW *(Continued)*

Net profit/(loss) from ordinary activities attributable to shareholders *(Continued)*

As a result of the above compensating effects, net profit from ordinary activities attributable to shareholders was not as well performed as those of the turnover and gross profit.

BUSINESS OUTLOOK AND PROSPECTS

Hong Kong has been internationally renowned for its stylish and high quality jewellery and is the third largest jewellery exporter in the world. Hong Kong is also a shopping paradise that tourists all over the world would visit for shopping fine products and especially be fond of by jewellery lovers. According to a recent survey by the Hong Kong Tourism Board ("HKTB"), jewellery and watches are always amongst the top 3 spending items by the arrival visitors by shopping categories.

Since the adoption of IVS in July 2003, the number of arrival visitors from the Mainland China has always been reaching record high with around 1 million per month especially in the high seasons. Compared with visitors from other countries, Mainland China visitors to Hong Kong tend to be (1) younger, (2) more predominantly female, and (3) junior white-collar workers. It was also indicated that the top three most often purchased items by the Mainland China tourists are (1) fine jewellery (2) cosmetics, and (3) cameras and other home electronics. Moreover, the average spending by Mainland China visitors are equally strong as those from Japan and Taiwan.

The Group has extended its retail business to cover tourists from Mainland China since July 2004 and the proportion of turnover from the Mainland China tourists was about 9.5% of the total turnover. If we annualized the amount for analysis purpose, it would be around 19% of the Group's total turnover. It is expected that there will be further up in turnover proportion from Mainland China tourists when the Tung Chung cable car connecting to the Big Buddha and Disneyland open in 2005.

Looking ahead, Hong Kong will have excellent conditions for both infrastructural and outbound connections in facilitation of tourism. HKTB will continue to fill a number of prolific entertainment events in enriching Hong Kong's cultural, scenic and cuisine attractions from month to month for attracting tourists all over the world to Hong Kong. In addition to the attractions mentioned above, the adjacent cities of Hong Kong that will be hosting certain international events like the East Asian Games by Macau in 2005 and the Olympic Games by Beijing in 2008 will also increase the overall volume of visitors to Asia and benefiting Hong Kong and the Group's sales growth as well. 2005 will definitely be a year of tourism prosperity and the Group is optimistic about its future results.

Management Discussion and Analysis

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2004, the Group had total assets of approximately HK\$45.5 million, including cash and bank balances of approximately HK\$9.1 million. The Group will continue to finance its operations from its sales operations.

With its net current assets of approximately HK\$38.1 million, current ratio of 9.7 and quick ratio of 3.2, the Group remained in a financially liquid position as at 31 December 2004. Taking into consideration of the potential financial resources that may be available to the Group from financial institutions, it is anticipated that the Group will have adequate financial resources to meet its ongoing operations and development requirements in the coming year.

GEARING RATIO

The Group did not have any bank borrowing or bank overdrafts as at 31 December 2004.

The Group's gearing ratio defined as total interest-bearing debt to shareholders' fund was 0% as at 31 December 2004 (2003: 2.7%).

OTHER RATIOS

Based on the information presented in the "SUMMARY FINANCIAL INFORMATION" section, the following ratios were further presented for reviewing the Group's performance:

	2004	2003	2002	2001	2000
Return on Capital Employed*	1.4%	(12.6%)	36.6%	47.6%	59.6%
Current Ratio**	9.7	10.1	8.8	1.4	1.2

* Net profit before tax divided by Shareholders' equity.

** Current assets divided by current liabilities.

Historically, the Group maintained a strong net current assets position with current ratios keeping at the high size.

After a tough year of negative return on capital employed in 2003 as resulted from of the outbreak of SARS, the Group reverted to positive return on capital employed again in the current year.

Management Discussion and Analysis

EMPLOYEE INFORMATION

Number of staff (excluding 2 executive directors) as at the year ended date 31 December 2004 was 77 (2003: 53), who are all working in Hong Kong.

Total staff costs (excluding directors' remuneration), including retirement benefits scheme contributions for the year ended 31 December 2004 amounted to approximately HK\$7,421,000 (2003: HK\$5,595,000). The Group pays its employees based on their performance, experience and the prevailing industry practice.

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 had 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 21 to the financial statements.

CAPITAL STRUCTURE

Since the listing of the Company's shares on the GEM of the Stock Exchange on 26 February 2003, except for the exercise of share options by the eligible persons pursuant to the Pre-IPO Share Share Option Plan as detailed in note 21 to the financial statements during the year, 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

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 2004, approximately 74% of the Group's income was denominated in Hong Kong dollars or US dollars, approximately 21% in denominated in Japanese Yen and approximately 5% denominated in Renminbi. 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, Reminbi and US dollars from its retail operations in the approximate proportion of 56%, 32%, 10% and 2%, respectively for the year ended 31 December 2004. 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.

RULE 17.15 TO 17.21 OF THE GEM LISTING RULES

The directors of the Company have confirmed that the Group was not aware of any circumstances which would give rise to a disclosure requirement under Rules 17.15 to 17.21 of the GEM Listing Rules.

Comparison of Business Objectives with Actual Business Progress

BUSINESS OBJECTIVES FOR THE ACTUAL BUSINESS PROGRESS 6 MONTHS ENDED 30 JUNE 2004

Expansion of geographical coverage of sales to the PRC:

1. Conduct market research and feasibility studies on the PRC local market to gather information in regard to the locality, population, purchasing power, social and economical factors for management decision.

Without hindsight in the course of preparing to list the Company's share in February 2003 that there would be signing of the Close Economic Partnership Arrangement ("CEPA") between the Mainland China Government and Hong Kong SAR Government on 29 June 2003, the Group can now make use of its competitive advantage that it meets the CEPA rules of origin by trading in goods to China for zero import tariff from 1 January 2004 onwards for some 273 Mainland product codes which include jewellery that was previously subject to import tariff of 26.7% to 35% in China.
2. Set up a representative office in Beijing for handling the preparation work for the Group's expansion in the PRC.
3. Procure inventory of jewellery products to be sold at Beijing Antique Corp's retail outlets as planned under the PRC memorandum of understanding.

Pilot batch of jewellery products have been shipped to Beijing Antique to test the market acceptance of the Group's jewellery products in China during the year after the CEPA arrangement was being effective on 1 January 2004.
4. Commencing from early 2004, seek cooperation with strategic partners to distribute the Group's products in Beijing, the PRC.

In Beijing:

 - fixtures & leasehold improvement.
 - marketing, promotion and advertising.
 - inventory and daily working capital purpose.

To grasp the rapid market changes, the Group has prioritized its efforts in the expansion of retail sales to cover arrival tourists from the Mainland China in the second quarter of 2004 and months after in order to cope with the 32 Mainland China cities now under the IVS with approximately 150 million Mainland China citizens that are eligible for more convenient travel to Hong Kong.

Accordingly, this business objective had been delayed to the first quarter of 2005 for launching.

Comparision of Business Objectives with Actual Business Progress

BUSINESS OBJECTIVES FOR THE 6 MONTHS ENDED 31 DECEMBER 2004

ACTUAL BUSINESS PROGRESS

Extension of business into e-commerce:

1. In order to better serve the Group's customers and enhance its after-sales customer services, the existing website www.laifai.com.hk will be enriched by including members' section products update, news and profile of the Group.

Continual improvements of the Group's hardware infrastructure are made as scheduled.

- Setting up IT department, investment in computer hardware and software and maintaining the website.

System planning and development had been started as scheduled.

2. Develop an e-commerce platform for the promotion and sales of the Group's products on the Internet.

System planning had been started.

- Setting up logistic support and delivery channels for Internet sales.
- Investment in software and manpower for enhancing internet security, payment gateway, firewall, anti-hacking, etc.
- Investment in hardware for processing internet sales, data management data security, backup, etc.

Expansion of business to cover Mainland China tourists under the IVS Scheme:

- Fixtures and leasehold improvement.
- Employment and training of new staff.
- Inventory and daily working capital.

On approval by the Company's shareholders in an EGM held on 8 June 2004, the Group had started renovation, recruitment, training and addition of inventories for the retail section to the Mainland China tourists. Retail sales operation was commercially launched from July 2004 onwards.

Comparison of Business Objectives with Actual Business Progress

COMPARISON OF PROPOSED USE OF THE INITIAL PUBLIC OFFERING (“IPO”) PROCEEDS WITH THE ACTUAL USE OF THE IPO PROCEEDS

The Group raised net proceeds from the new listing of the Company’s shares by way of new issue and offer for sale on the GEM in February 2003 of approximately HK\$16.4 million.

The table below sets out the details of the application of the net proceeds:

	Proposed use of the IPO Proceeds as approved in the EGM on 8 June 2004 <i>HK\$'000</i>	IPO Proceeds utilized up to 31 December 2004 <i>HK\$'000</i>
Expansion of geographical coverage of sales operation		
— Japan	4,100	2,683
— Mainland China	2,600	1,067
Extension of business into e-commerce	1,400	181
Expansion of business to cover Mainland China tourists under the IVS	3,300	2,968
Additional working capital	5,000	4,114
Total	16,400	11,013

Note: The cash and bank balances of the Group as at 31 December 2004 were HK\$9.1 million which can sufficiently cover the planned usage of net proceeds for the development of the Group’s business objectives as set out in the Prospectus and the Circular. As the Hong Kong Dollars one month time deposit rate was the same as the Hong Kong Dollars saving account interest rate in the past several months, the net IPO proceeds remain unutilized at 31 December 2004 was all retained in the Group’s Hong Kong Dollars saving account.

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 2004.

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 24 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").

14

PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. Details of the principal activities of the subsidiaries are set out in note 24 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 profit for the year ended 31 December 2004 and the state of affairs of the Company and the Group at that date are set out in the accompanying financial statements on pages 31 to 60.

The Board does not recommend the payment of any dividend for the year ended 31 December 2004.

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.

Report of the Directors

SUMMARY FINANCIAL INFORMATION *(Continued)*

To ensure consistency of presentation and for comparison purposes, the consolidated results for the five years ended 31 December 2004 and the consolidated assets and liabilities of the Group as at 31 December 2004, 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				
	2004 HK\$'000	2003 HK\$'000	2002 HK\$'000	2001 HK\$'000	2000 HK\$'000
Turnover	40,098	22,633	46,975	41,950	37,857
Profit/(Loss) before tax	576	(5,082)	12,335	4,325	3,225
Tax	—	33	(1,904)	(650)	—
Net profit/(loss) from ordinary activities attributable to shareholders	576	(5,049)	10,431	3,675	3,225

Consolidated assets and liabilities

	31 December				
	2004 HK\$'000	2003 HK\$'000	2002 HK\$'000	2001 HK\$'000	2000 HK\$'000
Non-current assets	2,936	2,081	2,327	1,340	1,469
Current assets	42,547	42,539	35,383	26,432	20,477
Current liabilities	(4,405)	(4,212)	(4,018)	(18,689)	(16,538)
Net current assets	38,142	38,327	31,365	7,743	3,939
Net assets	41,078	40,408	33,692	9,083	5,408

FIXED ASSETS

Details of movements in the fixed assets of the Group during the year are set out in note 13 to the financial statements.

Report of the Directors

SHARE CAPITAL AND SHARE OPTIONS

Details of movements in the Company's share capital and share options during the year are set out in notes 20 and 21, 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 22 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 2004, the Company's reserves available for distribution, calculated in accordance with the provisions of the Companies Law of the Cayman Islands, amounted to HK\$31,572,000.

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 32.8% of the total consolidated purchases for the year and purchases from the largest supplier included therein accounted for 10.5%.

As at 31 December 2004, 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 2.6% of the total turnover of the Group for the year ended 31 December 2004. 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.

Report of the Directors

CONTINGENT LIABILITIES

As at 31 December 2004, the directors of the Company were not aware of any material contingent liabilities.

DIRECTORS

The directors of the Company during the year and up to the date of this report 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 (resigned on 15 March 2004)

Independent non-executive directors:

Mr. Mak Tak Cheong, Edmund

Mr. Che King Lun, Frankly

Mr. Ho Hou Chiu, William (appointed on 1 September 2004)

In accordance with article 87 of the Company's articles of association, Mr. Lee You, Mr. Che King Lun, Frankly and Mr. Ho Hou Chiu, William 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.

Report of the Directors

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 13 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 is fluent in Mandarin, Japanese and Cantonese. Mr. Li is the youngest brother of Mr. Lee.

Mr. LEE You (李鈞), aged 52, 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 13 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 54, 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 59, 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.

DIRECTORS AND SENIOR MANAGEMENT BIOGRAPHIES *(Continued)*

Independent Non-Executive Directors

Mr. MAK Tak Cheong, Edmund (麥德昌), aged 40, is the chairman of the audit committee of the Company. Mr. Mak has served as the chief financial officer of Wumart Stores, Inc., a GEM listed company, as the financial controller of Chinadotcom Corporation, a NASDAQ listed company and as the financial controller and company secretary of hongkong.com Corporation, a GEM listed company. Mr. Mak is currently the Finance Director of CB Richard Ellis. 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 Institute of Certified Public 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 42, 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 14 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.

Mr. HO Hou Chiu, William (何厚焯), aged 53, is a director of Tai Fung Bank Ltd., one of the major commercial banks in Macau SAR. Mr. Ho is also a managing director of Jing Yang Co. Ltd., Marcco Co. Ltd., Mascargo (Macau) Co. Ltd., P&W Money Changer Ltd., and Tai Ming Oil Co. Ltd. Mr. Ho is a member of the Beijing Committee of the Chinese People's Political Consultative Conference (中國人民政治協商會議北京市委員會委員) and vice chairman of Beijing Chinese Overseas Friendship Association (北京海外聯誼會). Mr. Ho is also a committee member of Macau Chamber of Commerce and Macau Kiang Wu Charitable Association, Mr. Ho holds a university degree in business administration from Universidade Nova de Lisboa. He was appointed as one of the Company's independent non-executive directors on 14 September 2002, resigned on 4 February 2003 and re-appointed on 1 September 2004.

Consultant

Mr. CHUA Lam (蔡瀾), aged 63, 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

DIRECTORS AND SENIOR MANAGEMENT BIOGRAPHIES *(Continued)*

Senior Management

Mr. LAM King Pui (林景沛), aged 39, 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 Institute of Certified Public 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 56, 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 40, 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 17 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 45, 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 29 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.

DIRECTORS AND SENIOR MANAGEMENT BIOGRAPHIES *(Continued)*

Senior Management *(Continued)*

Ms. LEE Mei Ling (李媚玲), aged 49, 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 29 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 47, is the assistant general manager of the Company. He is responsible for the sales and administrative duties of the Group and has about 16 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 47, is the group accountant responsible for daily accounting and working capital management of the Group. Ms. Chan has about 14 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.

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 directly or indirectly, 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.

Report of the Directors

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

As at 31 December 2004, 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 2004
	Directly beneficially owned	Through spouse or minor children	Through controlled corporation		
Mr. Li Shui (<i>Note</i>)	2,560,000	—	51,456,000	54,016,000	41.89

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

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, ex-directors, chief executive and employees were granted share options to subscribe for shares of the Company, details of which as at 31 December 2004 were as follows:

	Date of grant	Exercise price per share	Exercisable period	Total number of share options granted	Number of share options exercised during the year	Number of share options outstanding as at 31 December 2004	Percentage of the Company's issued share capital as at 31 December 2004
Directors/Ex-director							
Mr. Li Shui (Note 2)	26 February 2003	HK\$0.1	Note 3	4,010,000	—	4,010,000	3.11
Mr. Yoshitaka Kitao	26 February 2003	HK\$0.1	Note 3	1,300,000	400,000	900,000	0.70
Mr. Yu Kam Kee, Lawrence	26 February 2003	HK\$0.1	Note 3	500,000	—	500,000	0.39
Mr. Ty Siao Kian, George *	26 February 2003	HK\$0.1	Note 3	500,000	—	500,000	0.39
Mr. Che King Lun, Frankly	26 February 2003	HK\$0.1	Note 3	400,000	—	400,000	0.31
Mr. Mak Tak Cheong, Edmund	26 February 2003	HK\$0.1	Note 3	200,000	—	200,000	0.16
Employees (Note 1)							
Mr. Lam King Pui	26 February 2003	HK\$0.1	Note 4	330,000	165,000	165,000	0.13
Ms. Yip Kwai Lin	26 February 2003	HK\$0.1	Note 4	200,000	100,000	100,000	0.08
Ms. Kong Yuk Ching	26 February 2003	HK\$0.1	Note 4	200,000	100,000	100,000	0.08
Ms. Wong Lai Chu	26 February 2003	HK\$0.1	Note 4	80,000	40,000	40,000	0.03
Ms. Lee Mei Ling	26 February 2003	HK\$0.1	Note 4	100,000	50,000	50,000	0.04
Mr. Chu Ka Loi	26 February 2003	HK\$0.1	Note 4	100,000	50,000	50,000	0.04
Ms. Chan Yuk Ping	26 February 2003	HK\$0.1	Note 4	80,000	40,000	40,000	0.03

* resigned on 15 March 2004

Report of the Directors

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN THE SHARES AND UNDERLYING SHARES *(Continued)*

Long positions in underlying shares of the Company *(Continued)*

Notes:

1. Employees are those working under employment contracts regarded as "continuous contracts" under Employment Ordinance (Chapter 57 of the laws of Hong Kong).
2. 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.
3. (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.
4. (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 2004, none of the directors and the chief executive 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.

Report of the 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 2004, the persons (not being directors and the chief executive 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:

Long position in shares of the Company

Name of shareholders	Notes	Capacity and nature of interest shares	Number of ordinary shares held	Percentage of the Company's issued share capital as at 31 December 2004
Best Perfect	1	Directly beneficially owned	51,456,000	39.90
Mr. Li Shui	1	Through a controlled corporation	51,456,000	39.90
		Directly beneficially owned	2,560,000	1.99
Ms. Li So Kuen	2	Through a spouse	54,016,000	41.89
Artfolio Corporation ("Artfolio")	3	Directly beneficially owned	27,955,200	21.68
Softbank Finance Corporation ("SBF")	3	Through a controlled corporation	27,955,200	21.68
		Directly beneficially owned	10,316,800	8.00

Report of the Directors

SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSONS' INTERESTS IN SHARES AND UNDERLYING SHARES *(Continued)*

Long position in shares of the Company *(Continued)*

Notes:

1. 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.
2. Ms. Li So Kuen is deemed to be interested in the 54,016,000 shares in which Mr. Li Shui, her spouse who is a director of the Company, is interested.
3. Artfolio is beneficially owned as to 84.02% by SBF. Accordingly, SBF shall be deemed to be interested in the same block of shares held by Artfolio under the SFO.

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 Executive's Interests in the Shares and Underlying Shares". As at 31 December 2004, 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 2004, 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 Executive's Interests in the Shares and Underlying Shares" above, at no time during the period under review were rights to acquire benefits by means of the acquisition of shares in 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.

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\$1,183,000 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\$1,026,000.

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.

Report of the Directors

CONNECTED TRANSACTIONS *(Continued)*

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.

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.

SPONSOR'S/COMPLIANCE ADVISER'S INTERESTS

As notified by the Company's sponsor, SBI E2-Capital (HK) Limited ("SBI E2-Capital") whose service was terminated on 4 March 2004 and the Company's sponsor and compliance adviser, Celestial Capital Limited ("CASH"), none of them or any of their 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 2004 and the date of this report respectively.

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 and compliance adviser 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.

COMPETING INTEREST

Saved as those disclosed in the Prospectus and this report, as at 31 December 2004, 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.

Report of the Directors

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 5.28 and 5.29 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 2004 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 9 times, reviewing the Company's and the Group's reports, announcements, and financial statements, 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 5.34 to 5.45 of the GEM Listing Rules since the listing of the Company's shares on the GEM on 26 February 2003.

AUDITORS

Albert Lam & Co. 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, 25 February 2005

Report of the Auditors

To the members

Lai Fai International Holdings Limited

(Incorporated in the Cayman Islands with limited liability)

We have audited the financial statements on pages 31 to 60 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion 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 Institute of Certified Public 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 2004 and of the profit 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.

Albert Lam & Co.

Certified Public Accountants

Hong Kong, 25 February 2005

Consolidated Profit and Loss Account

Year ended 31 December 2004

	Notes	2004 HK\$'000	2003 HK\$'000
TURNOVER	5	40,098	22,633
Cost of sales		(12,586)	(8,216)
Gross profit		27,512	14,417
Other revenue and gains		914	73
Selling and distribution costs		(16,018)	(8,153)
General and administrative expenses		(11,784)	(11,402)
PROFIT/(LOSS) FROM OPERATING ACTIVITIES	6	624	(5,065)
Finance cost	9	(48)	(17)
PROFIT/(LOSS) BEFORE TAX		576	(5,082)
Tax	10	—	33
NET PROFIT/(LOSS) FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS		576	(5,049)
DIVIDENDS	11	—	4,698
EARNINGS/(LOSS) PER SHARE	12		
— Basic, HK cents		0.45	(4.07)
— Diluted, HK cents		0.43	N/A

Consolidated Balance Sheet

31 December 2004

	Notes	2004 HK\$'000	2003 HK\$'000
NON-CURRENT ASSETS			
Fixed assets	13	2,612	1,742
Other assets	14	324	339
		2,936	2,081
CURRENT ASSETS			
Inventories	15	28,464	27,424
Trade receivables	16	1,053	1,480
Prepayments, deposits and other receivables		3,826	2,119
Tax recoverable		—	6
Pledged time deposit		84	84
Cash and bank balances		9,120	11,426
		42,547	42,539
CURRENT LIABILITIES			
Trade payables	17	1,971	492
Accruals and other payables		1,634	1,818
Trade deposit received	18	800	819
Interest-bearing bank loan, unsecured	19	—	1,083
		4,405	4,212
NET CURRENT ASSETS			
		38,142	38,327
		41,078	40,408
CAPITAL AND RESERVES			
Issued capital	20	12,894	12,800
Reserves	22	28,184	27,608
		41,078	40,408

Li Shui
Director

Lee You
Director

Consolidated Summary Statement of Changes in Equity

Year ended 31 December 2004

	Notes	2004 HK\$'000	2003 HK\$'000
Total equity at beginning of year		40,408	33,692
Issue of shares, including share premium	20	94	25,600
Share issue expenses	22	—	(9,137)
Net profit/(loss) from ordinary activities attributable to shareholders	22	576	(5,049)
Special dividend in respect of the year ended 31 December 2003	11, 22	—	(4,698)
Total equity at end of year		41,078	40,408

Consolidated Cash Flow Statement

Year ended 31 December 2004

	2004	2003
	HK\$'000	HK\$'000
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit/(Loss) before tax	576	(5,082)
Adjustments for:		
Depreciation	789	641
Amortisation of other assets	15	14
Interest income	(1)	(71)
Interest expense	48	17
Loss on fixed assets written off	2	—
Provision for inventories	—	1,000
Operating profit/(loss) before working capital changes	1,429	(3,481)
Increase in inventories	(1,040)	(1,101)
Decrease/(Increase) in trade receivables	427	(1,184)
(Increase)/Decrease in prepayments, deposits and other receivables	(1,707)	1,429
Increase/(Decrease) in trade payables	1,479	(99)
(Decrease)/Increase in accruals and other payables	(184)	513
(Decrease)/Increase in trade deposit received	(19)	107
Cash generated from/(used in) operations	385	(3,816)
Hong Kong profits tax refund/(paid)	6	(1,083)
Dividends paid	—	(4,698)
Net cash inflow/(outflow) from operating activities	391	(9,597)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of fixed assets	(1,661)	(359)
Interest received	1	71
Increase in other assets	—	(50)
Increase in pledged time deposit	—	(1)
Net cash outflow from investing activities	(1,660)	(339)

Consolidated Cash Flow Statement

Year ended 31 December 2004

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
CASH FLOWS FROM FINANCING ACTIVITIES		
Interest paid	(48)	(17)
(Repayment)/Inception of bank loan	(1,083)	1,083
Capital element of finance lease payments	—	(300)
Proceeds from issue of share capital	94	25,600
Share issue expenses	—	(6,145)
Net cash (outflow)/inflow from financing activities	(1,037)	20,221
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS		
	(2,306)	10,285
Cash and cash equivalents at beginning of year	11,426	1,141
CASH AND CASH EQUIVALENTS AT END OF YEAR	9,120	11,426
ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS		
Cash and bank balances	9,120	11,426

Balance Sheet

31 December 2004

	Notes	2004 HK\$'000	2003 HK\$'000
NON-CURRENT ASSETS			
Investment in a subsidiary	24	28,501	28,501
CURRENT ASSETS			
Due from subsidiaries	24	16,085	16,395
Prepayments, deposits and other receivables		142	—
Cash and bank balances		78	—
		16,305	16,395
CURRENT LIABILITIES			
Accruals		340	349
NET CURRENT ASSETS			
		15,965	16,046
		44,466	44,547
CAPITAL AND RESERVES			
Issued capital	20	12,894	12,800
Reserves	22	31,572	31,747
		44,466	44,547

Li Shui
Director

Lee You
Director

Notes to Financial Statements

31 December 2004

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 24 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 24 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 year ended 31 December 2003 include the results and cash flows of the Company and its subsidiaries with effect from 1 January 2003 or since their respective dates of incorporation, where these are shorter periods.

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

31 December 2004

2. CORPORATE INFORMATION

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

3. 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.

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.

Notes to Financial Statements

31 December 2004

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

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.

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.

Notes to Financial Statements

31 December 2004

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Cash and cash equivalents

For the purpose of consolidated cash flow statement, 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.

For the purpose of balance sheet, cash and cash equivalents comprise of cash on hand and cash at banks, including term deposit, which are not restricted as to use.

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.

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.

Notes to Financial Statements

31 December 2004

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Income tax *(Continued)*

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:

- (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.

Notes to Financial Statements

31 December 2004

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

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.

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.

Notes to Financial Statements

31 December 2004

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

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.

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.

Operating leases

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.

4. 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.

5. 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.

Notes to Financial Statements

31 December 2004

6. PROFIT/(LOSS) FROM OPERATING ACTIVITIES

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

	Group	
	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Cost of inventories sold	12,586	6,577
Staff costs (excluding directors' remuneration — note 7):		
Wages and salaries	7,097	5,354
Retirement benefits scheme contributions	324	241
Total staff costs	7,421	5,595
Auditors' remuneration	188	360
Depreciation	789	641
Amortisation of other assets*	15	14
Provision/(overprovision) for inventories	(850)	1,000
Write-off of bad debts	0	56
Minimum lease payments under operating lease in respect of land and building	1,573	1,560
Loss on fixed assets written off	2	—
Interest income	(1)	(71)
Exchange gains, net	(1)	(2)

* 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

31 December 2004

7. 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:

	2004	2003
	<i>HK\$'000</i>	<i>HK\$'000</i>
Fees:		
Executive directors	—	—
Non-executive directors	—	—
Independent non-executive directors	97	80
	97	80
Other emoluments:		
Executives directors:		
Basic salaries and other allowances	2,275	2,132
Retirement benefits scheme contributions	24	24
Non-executive directors	—	—
Independent non-executive directors	—	—
	2,299	2,156
	2,396	2,236

Pre-IPO share options were granted to the directors of the Company upon the listing of the Group on 26 February 2003 in respect of their services to the Group, further details of which are set out in note 21 to the financial statements.

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

	2004	2003
Nil to HK\$1,000,000	7	7
HK\$1,000,001 to HK\$1,500,000	1	1
	8	8

Notes to Financial Statements

31 December 2004

7. DIRECTORS' REMUNERATION (Continued)

	2004	2003
	<i>HK\$'000</i>	<i>HK\$'000</i>
Executive director A	1,312	1,230
Executive director B	987	926
Non-executive director A*	—	—
Non-executive director B	—	—
Non-executive director C	—	—
Independent non-executive director A	50	50
Independent non-executive director B	30	30
Independent non-executive director C**	17	—
	2,396	2,236

* resigned during the year

** newly appointed 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.

8. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included two (2003: two) directors, details of whose emoluments are set out in note 7 above. The details of remuneration paid to the remaining three (2003: three) non-director, highest paid employees are as follows:

	Group	
	2004	2003
	<i>HK\$'000</i>	<i>HK\$'000</i>
Basic salaries and other allowances	1,173	1,037
Retirement benefits scheme contributions	32	32
	1,205	1,069

Notes to Financial Statements

31 December 2004

8. FIVE HIGHEST PAID EMPLOYEES *(Continued)*

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 2004 and 2003.

330,000 pre-IPO share options were granted to a non-director, highest paid employee upon the listing of the Group on 26 February 2003 in respect of his services to the Group, further details of which are set out in note 21 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.

9. FINANCE COST

Finance cost represents interest on a bank loan (2003: interest on a finance lease).

10. TAX

	Group	
	2004 HK\$'000	2003 HK\$'000
Current — Hong Kong		
Charge for the year	—	—
Overprovision in the prior year	—	(33)
Total tax credit for the year	—	(33)

No provision for Hong Kong profits tax has been made for the year as companies within the Group have no assessable profits or have accumulated tax losses brought forward which exceed the estimated assessable profits for the year.

Notes to Financial Statements

31 December 2004

10. TAX (Continued)

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:

	Group			
	2004		2003	
	<i>HK\$'000</i>	%	<i>HK\$'000</i>	%
Profit/(Loss) before tax	576		(5,082)	
Tax at Hong Kong profits tax rate of 17.5% (2003: 17.5%)	101	17.5	(889)	(17.5)
Adjustments in respect of current tax of previous years	—	—	(33)	(0.6)
Income not subject to tax	(1)	(0.2)	(13)	(0.2)
Expenses not deductible for tax	2	0.4	16	0.3
(Decrease)/Increase in deferred tax assets not recognised during the year	(116)	(20.1)	968	19.0
Others	14	2.4	(82)	(1.6)
Tax expense/(income) and effective tax rate for the year	—	—	(33)	(0.6)

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	
	2004	2003
	<i>HK\$'000</i>	<i>HK\$'000</i>
Depreciation and capital allowance on fixed assets	255	229
General provision for inventories	26	175
Tax losses	826	819
	1,107	1,223

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\$4,717,000 (2003: HK\$4,678,000) are available indefinitely for offsetting against future taxable profits of the companies in which the losses arose.

Notes to Financial Statements

31 December 2004

11. DIVIDENDS

	Notes	2004 HK\$'000	2003 HK\$'000
Special dividend	(i)	—	4,698

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.

No dividend was proposed or paid by the Company during the year ended 31 December 2004.

12. EARNINGS/(LOSS) PER SHARE

(a) Basic earnings/(loss) per share

The calculation of basic earnings/(loss) per share is based on the net profit from ordinary activities attributable to shareholders for the year of HK\$576,000 (2003: net loss of HK\$5,049,000) and the weighted average of 128,421,000 shares of the Company (2003: 124,072,000 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 2003).

(b) Diluted earnings/(loss) per share

The calculation of diluted basic earnings/(loss) per share is based on the net profit from ordinary activities attributable to shareholders for the year of HK\$576,000 and the weighted average number of ordinary shares used in the calculation is 128,421,000 ordinary shares in issue during the year and the weighted average of 6,122,000 ordinary shares assumed to have been issued at no consideration on the deemed exercise of all share options during the year.

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.

Notes to Financial Statements

31 December 2004

13. FIXED ASSETS

	Group			
	Furniture and fixtures	Office equipment	Motor vehicle	Total
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Cost:				
At 1 January 2004	6,115	1,154	1,106	8,375
Additions	1,503	158	—	1,661
Write-off	—	(143)	—	(143)
At 31 December 2004	7,618	1,169	1,106	9,893
Accumulated depreciation:				
At 1 January 2004	5,313	810	510	6,633
Provided during the year	472	129	188	789
Write-off	—	(141)	—	(141)
At 31 December 2004	5,785	798	698	7,281
Net book value:				
At 31 December 2004	1,833	371	408	2,612
At 31 December 2003	802	344	596	1,742

14. OTHER ASSETS

	Group	
	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Cost	440	440
Accumulated amortisation	(116)	(101)
Net book value	324	339

15. INVENTORIES

	Group	
	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Raw materials	19,369	14,737
Finished goods	9,095	12,687
	28,464	27,424

The carrying amount of inventories has been carried at after charging a general provision of HK\$150,000 (2003: HK\$1,000,000) as at the balance sheet date.

Notes to Financial Statements

31 December 2004

16. TRADE RECEIVABLES

Trade receivables 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 26 (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 aging analysis of the trade receivables as at the balance sheet date is as follows:

	Group	
	2004 HK\$'000	2003 HK\$'000
Outstanding balances with ages:		
Within 30 days	371	1,239
Between 31 and 60 days	—	241
Between 61 and 180 days	211	—
Over 180 days	471	—
	1,053	1,480

17. TRADE PAYABLES

An aging analysis of the trade payables as at the balance sheet date is as follows:

	Group	
	2004 HK\$'000	2003 HK\$'000
Outstanding balances with ages:		
Within 30 days	346	156
Between 31 and 60 days	180	299
Between 61 and 180 days	1,264	37
Over 180 days	181	—
	1,971	492

Notes to Financial Statements

31 December 2004

18. 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.

19. INTEREST-BEARING BANK LOAN, UNSECURED

	Group	
	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Bank loan repayable within one year classified as current liability	—	1,083

20. SHARE CAPITAL

	Company	
	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Authorised:		
300,000,000 (2003: 300,000,000) shares of HK\$0.10 each	30,000	30,000
Issued and fully paid:		
128,945,000 (2003: 128,000,000) shares of HK\$0.10 each	12,894	12,800

945,000 pre-IPO share options were exercised by the eligible persons during the year and thus increased the issued and fully paid share capital of the Company by HK\$94,500. Details of the Company's pre-IPO share option scheme and the movement of the share options granted under the scheme are included in note 21 to the financial statements.

Notes to Financial Statements

31 December 2004

21. 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. The detailed movements of the share options granted under the Pre-IPO Plan were set out below:

	Date of grant	Exercise price per share	Exercisable period	Total number of share options granted	Number of share options exercised during the year	Number of share options outstanding as at 31 December 2004	Percentage of the Company's issued share capital as at 31 December 2004
Directors/Ex-director:							
Best Perfect International Limited (Note 2)	26 February 2003	HK\$0.1	Note 3	4,010,000	—	4,010,000	3.11
Mr. Yoshitaka Kitao	26 February 2003	HK\$0.1	Note 3	1,300,000	(400,000)	900,000	0.70
Mr. Yu Kam Kee, Lawrence	26 February 2003	HK\$0.1	Note 3	500,000	—	500,000	0.39
Mr. Ty Siao Kian, George*	26 February 2003	HK\$0.1	Note 3	500,000	—	500,000	0.39
Mr. Che King Lun, Frankly	26 February 2003	HK\$0.1	Note 3	400,000	—	400,000	0.31
Mr. Mak Tak Cheong, Edmund	26 February 2003	HK\$0.1	Note 3	200,000	—	200,000	0.16
Others:							
Employees (Note 1)			Note 4	1,090,000	(545,000)	545,000	0.42
				8,000,000		7,055,000	

* resigned on 15 March 2004

Notes to Financial Statements

31 December 2004

21. SHARE OPTION SCHEMES *(Continued)*

Notes:

1. Employees are those working under employment contracts regarded as "continuous contracts" under Employment Ordinance (Chapter 57 of the laws of Hong Kong).
2. The options were granted to Best Perfect International Limited 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.
3. 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 12 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.
4. 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 6 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.

945,000 share options were exercised under the Pre-IPO Plan during the year and 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 7,055,000 additional shares of the Company and additional share capital of HK\$705,500, 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.

Notes to Financial Statements

31 December 2004

21. SHARE OPTION SCHEMES *(Continued)*

Share option scheme *(Continued)*

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

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.

Notes to Financial Statements

31 December 2004

21. SHARE OPTION SCHEMES *(Continued)*

Share option scheme *(Continued)*

No share options were granted under the Scheme as at 31 December 2004 and up to the date of approval of these financial statements. As at the date of approval of these financial statements, 12,894,500 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.

22. RESERVES

		Share premium	Contributed surplus	Retained profits	Total
	Notes	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Group					
At 1 January 2003		—	21,177	12,514	33,691
Issue of shares		23,040	—	—	23,040
Capitalisation issue of shares		(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	11	—	—	(4,698)	(4,698)
At 31 December 2003 and 1 January 2004		3,664	21,177	2,767	27,608
Net profit from ordinary activities					
attributable to shareholders		—	—	576	576
At 31 December 2004		3,664	21,177	3,343	28,184

Notes to Financial Statements

31 December 2004

22. RESERVES (Continued)

	<i>Notes</i>	Share premium <i>HK\$'000</i>	Accumulated losses <i>HK\$'000</i>	Total <i>HK\$'000</i>
Company				
Arising from acquisition				
of LFBVI		28,500	—	28,500
Issue of shares		23,040	—	23,040
Capitalisation issue of shares		(10,239)	—	(10,239)
Share issue expenses		(9,137)	—	(9,137)
Net profit for the year		—	4,281	4,281
Special 2003 dividend	<i>11</i>	—	(4,698)	(4,698)
At 31 December 2003 and				
1 January 2004		32,164	(417)	31,747
Net loss for the year		—	(175)	(175)
At 31 December 2004		32,164	(592)	31,572

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

31 December 2004

23. NOTES TO CONSOLIDATED CASH FLOW STATEMENT

(a) 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.

24. INTERESTS IN SUBSIDIARIES

	Company	
	2004 HK\$'000	2003 HK\$'000
Unlisted shares, at cost	28,501	28,501
Due from subsidiaries	16,085	16,395
	44,586	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.

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

Notes to Financial Statements

31 December 2004

24. INTERESTS IN SUBSIDIARIES *(Continued)*

Company name	Place of incorporation/ operations	Issued and paid-up share capital	Percentage of equity attributable to the Company		Principal activities
			Direct	Indirect	
Champion Force Industrial Limited	Hong Kong	HK\$2	—	100	Sourcing and manufacture of jewellery products
Lai Fai Jewellery (China) Limited	Hong Kong	HK\$1	—	100	Retail and wholesale of jewellery products

25. OPERATING LEASE ARRANGEMENT

At the balance sheet date, the Group leases its office property and retail shop under an operating lease arrangement which is negotiated for a term of two years (2003: three years).

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

	Group	
	2004 HK\$'000	2003 HK\$'000
Within one year	—	1,715
In the second to fifth years, inclusive	6,036	—
	6,036	1,715

Notes to Financial Statements

31 December 2004

26. 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	
	2004 HK\$'000	2003 HK\$'000
Sale of goods	1,026	1,023
Promotion and marketing fees paid	—	298

The sale of goods and prior year 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.

As at 31 December 2004, there were no outstanding balances (2003: outstanding balance of HK\$1,023,000) due from HOMEOSTYLE in respect of the sale of goods included in the Group's trade receivables, and no outstanding balance (2003: outstanding balance of HK\$298,000) due to HOMEOSTYLE in respect of the promotion and marketing fee included in the Group's accruals and other payables.

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

27. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 25 February 2005.

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 Thursday, 24 March 2005 at 4:00 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 2004;
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

(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.

(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

Notice of Annual General Meeting

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

Notice of Annual General Meeting

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

Lai Fai International Holdings Limited

Li Shui

Chairman

Hong Kong, 25 February 2005

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 Thursday, 17 March 2005 to Thursday, 24 March 2005, 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 despatched to shareholders together with the 2004 Annual Report of the Company.