Kanstar Environmental Paper Products Holdings Limited

建星環保紙品控股有限公司*

(incorporated in the Cayman Islands with limited liability)

Stock code: 8011

Annual Report 2006

* For identification only

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

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Corporate Information

Executive Directors

CHIM Kim Kiu, Jacky *(Chairman)*
CHENG Kwok Hing, Andy
KWOK Ching Chung
SUN Tak Keung

Independent Non-Executive Directors

WAN Hon Keung *CPA, FCCA*
CHAN Chi Hung, Anthony
WANG Ai Guo

Compliance Officer

CHENG Kwok Hing, Andy

Company Secretary and Qualified Accountant

KWONG Ping Man *MPA, CPA (Aust), CPA, ATIHK, ACS, ACIS*

Authorised Representatives

CHENG Kwok Hing, Andy
SUN Tak Keung

Members of the Audit Committee

WAN Hon Keung *(Chairman)*
CHAN Chi Hung, Anthony
WANG Ai Guo

Registered Office

Cricket Square
Hutchins Drive
P.O. Box 2681
Grand Cayman KY1-1111
Cayman Islands

Legal Advisers

Chiu & Partners
41st Floor, Jardine House
1 Connaught Place
Hong Kong

Principal Place of Business in Hong Kong

Room 604, Seaview Commercial Building
21-24 Connaught Road West
Hong Kong

Principal Share Registrar and Transfer Office in Cayman Islands

Bank of Butterfield International (Cayman) Limited
Butterfield House
68 Fort Street
P.O. Box 75
George Town
Grand Cayman
Cayman Islands

Hong Kong Branch Share Registrar and Transfer Office

Standard Registrars Limited
26th Floor, Tesbury Centre
28 Queen's Road East
Wanchai
Hong Kong

Auditors

Patrick Ng & Company
Certified Public Accountants
20/F, Hong Kong Trade Centre
161-167 Des Voeux Road Central
Hong Kong

Principal Bankers

Bangkok Bank Public Company Limited
28 Des Voeux Road Central
Hong Kong

Liu Chong Hing Bank Limited
Ground Floor, New World Tower II
16-18 Queen's Road Central
Hong Kong

China Construction Bank
Changning Branch
Xing Yu Jie
Changning County
Baoshan City
Yunnan Province
PRC

Chairman's Statement

I am pleased to present to shareholders the annual report of Kanstar Environmental Paper Products Holdings Limited and its subsidiaries (hereinafter collectively referred to as the "Group") for the year ended 31 December 2006.

2006 was a tough year for the Group. The decrease in turnover was mainly attributable to the shortage of raw materials and the rotation of suspension of production lines and environmental facilities for periodic repair and maintenance in the fourth quarter to ensure that they are in proper working order. The Group recorded loss for the year amid the increasingly competitive environment in the pulp and paper products industry.

In order to ensure sustainable development, the Group is fully aware of the importance of improving the efficiency of its operations as well as its competitiveness in the market. Continuous effort will be dedicated in improving the speed and efficiency in production, reduction in production cost and expansion of customers base. We look forward to achieving strong growth in sales and improving profit margin in the near future.

As the Company is actively looking for new opportunities to increase the value for its shareholders, we believe that the further acquisition of 30% of the equity interest in Polyard Petroleum International Co., Ltd. will be an exciting opportunity. The management team is looking forward to completing the deal in the near future.

On behalf of the Board, I would like to express my gratitude to our shareholders, suppliers and customers for their continuous support and I would also like to take this opportunity to express my sincere thanks to employees for their support and contribution.

CHIM Kim Kiu, Jacky
Chairman

Management Discussion and Analysis

Business Overview

For the year ended 31 December 2006, the Group's turnover decreased by 19.3% to HK$43,295,000 as compared with HK$53,671,000 in 2005. The decrease in turnover was mainly attributable to (i) the short supply of raw materials (ii) the rotation of suspension of production lines and environmental facilities for periodic repair and maintenance in the fourth quarter to ensure that they are in proper working order and (iii) intense competition during the year. The Group recorded an audited net loss of approximately HK$18.4 million whereas, the Group has recorded an audited profit of approximately HK$103,000 last year.

The directors of the Company do not recommend the payment of a final dividend for the year 2006 (2005: nil).

Administrative and other operating expenses for the year ended 31 December 2006 amounted to approximately HK$20,097,000 representing an increase of approximately HK$17,016,000 comparing with year 2005. The increases were mainly resulted from the revaluation of the plant & equipment and a provision for impairment on trade and other receivables of the Group during 2006.

On 10 June 2006, Modern Lucky International Limited ("Modern Lucky"), a wholly-owned subsidiary of the Company, entered into an acquisition agreement with Mr. Lam Nam ("Mr. Lam"), a then independent third party of the Company, to acquire 20% interests in Polyard Petroleum International Co., Ltd. ("Polyard") ("Previous Acquisition"). Subsequent to the completion of the Previous Acquisition on 12 September 2006, Polyard became an associate company of the Group. For the year ended 31 December 2006, the Group's share of losses of associates from the date of acquisition amounted to approximately HK$1,284,000.

Finance costs for the year ended 31 December 2006 amounted to approximately HK$1,032,000 (2005: HK$595,000). The increase was mainly come from increase in the outstanding balance of the bank loan to finance the Group's development.

Prospects

In view of the intense competition and weak operational performance in the pulp and paper products industry, the Company considers it necessary to streamline the Group's business and redeploy its resources in a more productive manner. On 8 January 2007, Modern Lucky and Mr. Lam further entered into the Acquisition Agreement, pursuant to which Modern Lucky has conditionally agreed to further acquire from the Mr. Lam 30% of the equity interest in Polyard. Upon completion of the Acquisition, Modern Lucky will, after taking into account the 20% of the capital acquired in the Previous Acquisition, be beneficially interested in 50% of the Polyard and Polyard will become a subsidiary of the Company. The completion of the Acquisition is expected to take place on or about 31 May 2007 (or such later date as may be agreed between parties). The Company intends to focus its corporate resources on oil business, while retaining the sale of pulp and paper products to maintain the income stream of the Group from such business in the coming years. The Company intends to set up a management team responsible for the oil business, comprising members to be recruited who possess expertise in oil project.

In view of the intense competition and weak operational performance, the Company has decided to streamline the Group's business and redeploy its corporate resources in a more productive manner. On 8 January 2007, Kanstar Hong Kong Limited ("Kanstar HK"), a wholly owned subsidiary of the Company, and Sure Carl Limited, a wholly owned by Mr. Chim Kim Kiu, Jacky, the chairman of the Company, entered into the Disposal Agreement, pursuant to which Kanstar HK has conditionally agreed to dispose of and the Sure Carl Ltd has conditionally agreed to acquire the entire registered capital of Yunnan Changning and related shareholder's loan at a total consideration of HK$26 million in cash and the undertaking given by Sure Carl in favour of Kanstar HK to pay to

Kanstar HK (or as it may direct) the amount due and payable by the Group under the Banking Facilities as at the date of completion of the Disposal Agreement. The Board intends to use the net proceeds from the Disposal to facilitate the Acquisition and strengthen the Company's liquidity (including the funding for exploration of oil and nature gas business).

On 26 January 2007, Yunnan Changning Kanstar Paper Co. Ltd ("Yunnan Changning") as supplier and Yunnan Kanstar High Tech Products Development Company Limited ("Kanstar High Tech") as customer entered into the Supply Agreement to ensure consistent supply of pulp and paper products to the Group after the Disposal. Pursuant to Supply Agreement, Kanstar High Tech has agreed to purchase from Yunnan Changning pulp and paper products for the Group's daily operation of the sale of such products. The Supply Agreement is for a term commencing on the date of completion of the Disposal Agreement and expiring on 31 December 2009. In this connection, the Board is of the view that there will be no material impact on the business operations of the Group as a result of the Disposal.

The Board proposes to change the Company's English name of "Kanstar Environmental Paper Products Holdings Limited" to Polyard Petroleum International Group Limited" and its Chinese name from "建星環保紙品控股有限公司" to "百田石油國際集團有限公司" in order to better reflect the Group's emphasis on oil project.

Liquidity and financial resources

As at 31 December 2006, the Group has a healthy financial position with net assets amounted to approximately HK$253 million. There is a net current liability of around HK$8.4 million with current ratio of approximately 0.75 (2005: 0.96). The gearing ratio of the Group, based on the total borrowings to shareholders' equity, was around 7.5% (2005: 20%).

As at 31 December 2006, guarantee was given by the Company to bank to secure banking facilities made available to a subsidiary amounted to HK$15 million (2005: HK$10 million). The Group had total outstanding borrowings of approximately HK$18.9 million (2005: HK$11 million), comprising (i) loan of approximately HK$2 million from a 信用合作社 in PRC, which is secured by Yunnan Changning's leasehold land and buildings in PRC; and (ii) loans of approximately HK$16.9 million from banks in Hong Kong, which are guaranteed by the Company and Director.

As most of the Group's monetary assets and liabilities are denominated in Renminbi, the exchange rate risks of the Group is considered to be minimal.

Employee information

The Group had a total staff of approximately 520 (2005: approximately 500 employees). Remuneration packages are reviewed on a periodical basis. Bonus is awarded to employees according to the assessment of individual performance. Besides, a share option scheme was adopted by the Company, pursuant to which the Directors may offer to any eligible employees (including executive directors and independent non-executive directors) of the Company and any of its subsidiaries options to subscribe for shares in the Company in accordance with the terms of the share option scheme. However, save for the share option granted prior to the listing, no other options have been granted up to 31 December 2006. Staff cost was approximately HK$4 million for the year as compared with that of approximately HK$3.85 million in 2005.

Introduction

The Company has applied the principles and complied with all the code provisions and, where applicable, the recommended best practices of the Code on Corporate Governance Practices as set out in Appendix 15 to the GEM Listing Rules throughout the year ended 31 December 2006, by establishing formal and transparent procedures to protect and maximize the interests of shareholders.

Directors' securities transactions

The Group adopted the required standard of dealings set out in rules 5.48 to 5.67 of the GEM Listing Rules as the code of conduct regarding directors' securities transactions in securities of the Company. Upon the Group's specific enquiry, each director had confirmed that during the year ended 31 December 2006, he had fully complied with the required standard of dealings and there was no event of non-compliance.

The Board of Directors

Composition

The Board of directors, which currently comprises 7 directors, is responsible for supervising the management of the Group. Details of the Chairman and the other directors of the Group are set in the section "Biographical Details of Directors and Senior Management" of this report. All directors give sufficient time and attention to the affairs of the Group.

In compliance with rule 5.05(1) and (2) of the GEM Listing Rules, the Company had three independent non-executive directors throughout the year ended 12 December 2006, at least one of whom has appropriate professional qualifications or accounting or related financial management expertise.

The Company has received from each independent non-executive director an annual confirmation of his independence, and the Company considers such directors to be independent in accordance with each and the various guidelines set out in rule 5.09 of the GEM Listing Rules.

With the various experience of both the executive directors and the non-executive directors and the nature of the Group's business, the Board considered that the directors have a balance of skills and experience for the business of the Group.

Board meetings

The full Board regularly meets in person or through other means of electronic communication at least four times every year. At least 14 days' notice of all board meetings were given to all directors, who were all given an opportunity to include matters in the agenda for discussion. The Company Secretary assists the Chairman in preparing the agenda for the meeting, and ensures that all applicable rules and regulations regarding the meetings are observed. The finalized agenda and accompanying board papers are then sent to all directors at least five days prior to the meeting.

In the financial year ended 31 December 2006, eleven board meetings were held and the following is an attendance record of the meetings by each director:

Attendants		Number of meetings attended/total	Attendance percentage
Executive Directors			
CHIM Kim Kiu, Jacky		11/11	100%
CHENG Kwok Hing, Andy	(appointed on 27 July 2006)	6/6	100%
KWOK Ching Chung	(appointed on 17 October 2006)	2/4	50%
SUN Tak Keung		11/11	100%
Independent Non-Executive Directors			
CHAN Chi Hung, Anthony		11/11	100%
WANG Ai Guo		9/11	82%
WAN Hon Keung	(appointed on 12 April 2006)	8/8	100%

During regular meetings of the Board, the directors discuss and formulate the overall strategies of the Group, monitor financial performances and discuss the annual and interim and quarterly results, as well as discuss and decide on other significant matters. Execution of daily operational matters is delegated to management.

The Company Secretary records the proceedings of each board meeting in detail by keeping detailed minutes, including all decisions by the board together with concerns raised and dissenting views expressed (if any). Drafts of board minutes are circulated to all directors for comment and approval as soon as practicable after the meeting. All minutes are open for inspection at any reasonable time on request by any director.

All directors have access to relevant and timely information at all times as the Chairman ensures that management will supply the Board and its committees with all relevant information in a timely manner. They may make further enquiries if in their opinion it is necessary or appropriate to request for further information. They also have unrestricted access to the advice and services of the Company Secretary, who is responsible to the Board of directors for providing directors with board papers and related materials, and ensuring that all proper Board procedures are followed and that all applicable laws and regulations are complied with. If considered to be necessary and appropriate by the directors, they may retain independent professional advisors at the Group's expense.

In case where a conflict of interest may arise involving a substantial shareholder or a director, such matter will be discussed through an actual meeting and will not be dealt with by written resolutions. Independent non-executive directors with no conflict of interest will be present at meetings dealing with such conflict issues.

The board committees, including the audit committee, the remuneration committee and the nomination committee, have all adopted the applicable practices and procedures used in board meetings for all committee meetings.

Chairman of the Group

The Chairman of the Group is Mr. CHIM Kim Kiu, Jacky and the Chief Executive Officer of the Group is Mr. SUN Tak Keung. The roles of Chairman and Chief Executive Officer are separate and not performed by the same individual to avoid power being concentrated in any one individual. The Chairman of the Group is primarily responsible for the leadership and effective running of the Board, and ensuring that all key and appropriate issues are discussed by the Board in a timely and constructive manner, whereas the Chief Executive Officer is primarily responsible for the running of the Group's business and implementation of the Group's strategy in achieving the overall commercial objectives.

The Chairman also encourages all directors, including the independent non-executive directors, to actively participate in all board and committee meetings.

Term of appointment of non-executive directors

Each of the independent non-executive directors is appointed for a specific term as follows:

Name	Term
Mr. CHAN Chi Hung, Anthony	2 years commencing on 1 January 2006
Mr. WANG Ai Guo	2 years commencing on 1 January 2006
Mr. WAN Hon Keung	2 years commencing on 12 April 2006

Remuneration of Directors

The remuneration committee was established in 2005. The chairman of the committee is Mr. WAN Hon Keung, an independent non-executive Director, and other members include Mr. SUN Tak Keung and Mr. WANG Ai Guo, the majority being independent non-executive Directors.

The role and function of the remuneration committee included the determination of the specific remuneration packages of all executive Directors, including benefits in kind, pension rights and compensation payments, including any compensation payable for loss or termination of their office or appointment, and make recommendations to the board of the remuneration of non-executive Directors. The remuneration committee should consider factors such as salaries paid by comparable companies, time commitment and responsibilities of the Directors, employment conditions elsewhere in the Group and desirability of performance-based remuneration.

During the year, a meeting of the remuneration committee was held on 15 November 2006. Details of the attendance of the remuneration committee meeting are as follows:

Members	**Attendance**
Mr. WAN Hon Keung	1/1
Mr. SUN Tak Keung	1/1
Mr. WANG Ai Guo	1/1

The remuneration committee of the Company has considered and reviewed the existing terms of employment contracts of the executive Directors and appointment letters of the independent non-executive Directors. The remuneration committee of the Company considers that the existing terms of employment contracts of the executive Directors and appointment letters of the independent non-executive Directors are fair and reasonable.

Nomination of Directors

The nomination committee was established in 2005. The chairman of the committee is Mr. SUN Tak Keung, and other members include Mr. CHAN Chi Hung, Anthony and Mr. WANG Ai Guo, both are independent non-executive Directors.

The role and function of the nomination committee included the appointment and removal of Directors.

The nomination committee considers the past performance, qualification, general market conditions and the Company's articles of association in selecting and recommending candidates of directorship during the year.

During the year 2006, three meetings of the nomination committee were held on 15 November 2006 for nomination of Directors. Details of the attendance of the meeting are as follows:

Members	**Attendance**
Mr. SUN Tak Keung	3/3
Mr. CHAN Chi Hung	3/3
Mr. WANG Ai Guo	3/3

During the meeting, the board of Directors considered and resolved that all the existing Directors shall be recommended to be retained by the Company.

In accordance with the Company's articles of association, Mr. CHAN Chi Hung and Mr. WANG Ai Guo will retire, and being eligible, will offer themselves for re-election at the forthcoming annual general meeting of the Company.

Further, according to the Company's articles of association, the office of directorship of each of Mr. CHENG Kwok Hing, Andy, Mr. KWOK Ching Chung and Mr. WAN Hon Keung, who was appointed a Director by the Directors during the year, will end at the forthcoming annual general meeting of the Company. Each of Mr. CHENG Kwok Hing, Andy, Mr. KWOK Ching Chung and Mr. WAN Hon Keung, being eligible, will offer himself for re-election at the forthcoming annual general meeting of the Company.

Auditors' remuneration

During the year, the nature of the audit and non-audit services provided by Patrick Ng & Company, the auditors of the Company, and the relevant fee paid by the Company for such services are as follows:

Audit services for the Group including the preparation of accountants' reports	HK$350,000

Directors' and auditors' responsibilities for financial statements

The Directors are responsible for the preparation of financial statements for each financial period which give a true and fair view of the state of affairs of the Group. In preparing the financial statements for the year ended 31 December 2006, the Directors have selected appropriate accounting policies and applied them consistently, and have prepared the financial statements on a going concern basis.

The responsibilities of the external auditors are set out in the Auditors' Report to the shareholders of the Company on pages 22 to 23 of the annual report of the Company.

Audit Committee

The Company has established an audit committee ("Audit Committee") with written terms of reference based upon the guidelines recommended by the Hong Kong Institute of Certified Public Accountants. The duties of the Audit Committee include reviewing the Company's annual reports and quarterly financial reports and providing advice and comments thereon to the Board. The Audit Committee is also responsible for reviewing and supervising the Company's financial reporting and internal control procedures. The Audit Committee comprises the three independent non-executive Directors, namely Mr. CHAN Chi Hung, Anthony, Mr. WAN Hon Keung and Mr. WANG Ai Guo.

The audit committee held 4 meetings during the year under review. Details of the attendance of the audit committee meetings are as follows:

Members	**Attendance**
Mr. CHAN Chi Hung, Anthony	4/4
Mr. WANG Ai Guo	4/4
Mr. WAN Hon Keung	4/4

The Group's unaudited quarterly and interim results and audited annual results during the year ended 31 December 2006 have been reviewed by the audit committee, which was of the opinion that the preparation of such results complied with the applicable accounting standards and requirements and that adequate disclosure have been made.

Internal control

The Company has conducted a review of its system of internal control periodically to ensure the effective and adequate internal control system. The Company convened meeting periodically to discuss financial, operational and risk management control.

Biographical Details of Directors and Senior Management

Executive Directors

Mr. CHIM Kim Kiu, Jacky, (詹劍嶠) aged 34, is the founder chairman and the managing director of the Company. He was one of the founders of Leewood, the Group's proprietary paper filling material, Mr. Chim is responsible for the Group's strategic development and day-to-day management. Prior to the establishment of the Group's businesses in Yunnan Province, he was a director of Kunming Vintin Property Development Limited, a company primarily engaged in property development and investment in the PRC. He was educated in Canada.

Mr. SUN Tak Keung, (辛德強) aged 43, is responsible for the Group's paper filling material and paper products marketing activities. Prior to joining the Group in March 2002, he was a manager in Trigold & Co. and goods in Hong Kong and overseas.

Mr. CHENG Kwok Hing, Andy, (鄭國興) aged 35, has over 15 years of experience in accounting and administration fields, of which five years were with a public company listed on the Stock Exchange. Mr. Cheng is currently a director of a Hong Kong private company which is principally engaged in the manufacturing and sale of Chinese medical herbs in Hong Kong and the PRC. Mr. Cheng is also an independent non-executive director of Northern International Holdings Limited, a company whose ordinary shares are listed on the Main Board of the Stock Exchange (stock code: 736).

Mr. KWOK Ching Chung, (郭青松) aged 36, joined the Group as an executive Director on 17 October 2006 and is responsible for general management of the Group. Mr. Kwok does not hold any other position with the Group. Mr. Kwok obtained his Bachelor of Economics degree majoring in International Finance from the Jinan University in Guangzhou in 1993. He further obtained a Master of Business Administration degree from the La Trobe University in Melbourne of Australia in 1997. Mr. Kwok is a holder of a Specialist Certificate — Corporate Finance issued by the Hong Kong Securities Institute ("HKSI"). Being a HKSI specialist in Corporate Finance, Mr. Kwok has in-depth knowledge and over ten years practical experience specialising in corporate finance and direct investments in the international capital markets. Before joining the Group, he was the Assistant Vice President of BOC International from year 1998 to 2001, the Director and Vice President of China Eagle International Holdings Ltd from year 2001 to 2003 and subsequently the executive director of Chinalion International Holdings Co., Ltd until year 2004.

Independent non-executive Directors

Mr. CHAN Chi Hung, Anthony,（陳志雄）aged 40, is currently serving as a dealer representative for Berich Brokerage Limited, a securities broking firm in Hong Kong. Prior to joining Berich Brokerage Limited in early 2001, he was a partner of Sun Yeung Food (Direct Marketing) Company and engaged in foodstuff trading for $2^1/_2$ years. He was also a manager of Trigold & Co. and was engaged in the sales and marketing of garment products for the overseas market for 3 years to December 1997. He was appointed as an independent non-executive Director in June 2002.

Mr. WAN Hon Keung,（溫漢強）aged 45, has over 20 years of experience in accounting and administration fields. Mr. Wan is a fellow member of the Association of Chartered Certified Accountants (FCCA) and associate member of Hong Kong Institute of Certified Public Accountants (CPA).

Mr. WAN Ai Guo,（王愛國）aged 37, is a qualified PRC lawyer. He is currently a lawyer of Hu Bei Jia He Law Firm. He was appointed as an independent non-executive Director in July 2004.

Senior Management

Mr. ZHAO Xian Wan,（趙賢萬）aged 42, is manager responsible for pulp and paper production. Prior to joining the Group in July 2001, he was a manager at Sichuan Province Qingcheng Paper Factory（四川省青城造紙廠）in Sichuan province and had over 18 years experience in the production of pulp and papers. He studied pulp and paper manufacturing at the Shensi Xibei Province Light Industry College（陝西省西北輕工業學院）in pulp and paper manufacturing.

Mr. KWONG Ping Man,（鄺炳文）aged 42, is the qualified accountant and company secretary of the Group. Prior to joining the Group in March 2006, he was the managing director of Fortitude Consulting Limited, engaging corporate advisory services. He was graduated from Curtin University of Technology in Australia with a bachelor's degree in Commerce Accounting. He obtained a master's degree in Professional Accounting from the Hong Kong Polytechnic University in October 2003. He is a Certified Practicing Accountant of the CPA Australia and an associate member of the Hong Kong Institute of Certified Public Accountants. He is also an associate member of the Institute of Chartered Secretaries and Administrators and an associate member of the Hong Kong Institute of Company Secretaries.

Directors' Report

The directors have pleasure in presenting their annual report and the audited financial statements of the Company and the Group for the year ended 31 December 2006.

Principal activities

The Company is an investment holding company. The principal activities of its subsidiaries are set out in note 35 to the financial statements. There were no changes in the nature of the Group's principal activities during the year.

Major customers and suppliers

For the year ended 31 December 2006, the top five suppliers of the Group together accounted for approximately 61% of the Group's total purchases of materials, and the largest supplier accounted for approximately 16% of the Group's total purchases of materials.

For the year ended 31 December 2006, the Group's five largest customers together accounted for approximately 33% of the total sales of the Group, and the largest customer accounted for approximately 15% of the Group's total sales.

None of the directors, their respective associates or any shareholders of the Company (which to the knowledge of the directors owns more than 5% of the issued share capital of the Company) had any interests in the Group's five largest suppliers or customers.

Results

The results of the Group for the year ended 31 December 2006 are set out in the consolidated income statement on page 24.

The directors do not recommend the payment of any dividend for the year ended 31 December 2006.

Financial summary

A summary of the results of the Group for the past five financial years ended 31 December 2006 is set out on page 84 of the annual report.

Property, plant and equipment

Details of movements in the property, plant and equipment of the Group are set out in note 13 to the financial statements.

Subsidiaries

Particulars of the Company's subsidiaries are set out in note 35 to the financial statements.

Share Capital and Share options

Details of the share capital and share options of the Company are set out in notes 25 and 27 to the financial statements.

Directors

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

Executive directors:

Mr. CHIM Kim Kiu, Jacky *(Chairman)*	
Mr. IP Kai Cheong	(resigned on 22 September 2006)
Mr. LI Gang	(resigned on 23 October 2006)
Mr. SUN Tak Keung	
Mr. CHENG Kwok Hing, Andy	(appointed on 27 July 2006)
Mr. KWOK Ching Chung	(appointed on 17 October 2006)

Independent non-executive directors:

Mr. CHAN Chi Hung, Anthony	
Mr. WANG Ai Guo	
Mr. WAN Hon Keung	(appointed on 12 April 2006)

In accordance with article 108(A) of the Company's articles of association, subject to the proposed amendments at the forthcoming annual general meeting, each of Mr. CHAN Chi Hung, Anthony and Mr. WANG Ai Guo will retire and, being eligible, offers himself for re-election as director at the forthcoming annual general meeting of the Company.

Further, according to article 112 of the Company's articles of association, any director appointed by the board of directors of the Company to fill a casual vacancy or as an additional director shall hold office only until the following general meeting of the Company (in the case of the filling of casual vacancy) or the next following annual general meeting of the Company (in the case of an additional director) and shall then be eligible for re-election at the meeting.

By virtue of article 112 of the Company's articles of association, the office of directorship of each of Mr. CHENG Kwok Hing, Andy and Mr. KWOK Ching Chung, who were appointed as executive directors with effect from 27 July 2006 and 17 October 2006 respectively, and Mr. WAN Hon Keung, who was appointed as independent non-executive director with effect from 12 April 2006, will end at the forthcoming annual general meeting of the Company. Each of Mr. CHENG Kwok Hing, Andy, Mr. KWOK Ching Chung and Mr. WAN Hon Keung, being eligible, offers himself for re-election at the meeting.

Directors' service contracts

Each of Mr. CHIM Kim Kiu, Jacky and Mr. SUN Tak Keung has entered into a service contract with the Company for an initial term of three years commencing from 1 June 2002. After three years, the contract will renew automatically in every year.

None of the directors being proposed for re-election at the forthcoming annual general meeting has a service contract with the Company or any of its subsidiaries which is not determinable by the Group within one year without payment of compensation, other than statutory compensation.

The Group's remuneration package is reviewed annually and appropriate adjustments are made with reference to prevailing conditions of the human resource market and the general economy. In addition, the Group's employees are rewarded with reference to their performance and experience of the individual employees. The Group has also allocated more resources to improve the welfare, living standard and quality of the employees to attract and retain quality staff to support the future growth of the Group.

The Group has adopted a provident fund scheme, as required under the Mandatory Provident Fund Schemes Ordinance, for its employees in Hong Kong. It also participates in a government pension scheme for its employees in the PRC pursuant to the relevant rules and regulations of the PRC.

The Group also operates two share option schemes as incentives and rewards to eligible participants who contribute to the success of the Group's operation. Details of the schemes are set out in the section headed "Share Option Schemes" of the Directors' Report.

Directors' and Chief Executives' interests and short positions in the Shares, underlying Shares and debentures

As at 31 December 2006, the interests or short positions of the Directors and the chief executive of the Company in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) which were notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they were taken or deemed to have under such provisions of the SFO), or which were recorded in the register required to be kept by the Company under Section 352 of the SFO, or which were required, pursuant to Rule 5.46 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange, were as follows:

Long positions in the shares of the Company

Name of Director	Capacity	Personal Interests	Family Interests	Corporate Interests	Other Interests	Total	Percentage of Shareholding
Mr. CHIM Kim Kiu, Jacky	Interest of a controlled corporation	—	—	2,743,350,000	—	2,743,350,000	57.15%

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

Long positions in underlying shares of the Company

Name of Grantees (Relationship with the Group)	Capacity	Description of equity derivatives (number of underlying shares)
Mr. SUN Tak Keung *(Executive Director)*	Beneficial owner	Share options to subscribe for shares (75,000,000 shares) *(Note)*

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

Save as disclosed above, none of the Directors or chief executive of the Company had, as at 31 December 2006, any interests or short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which would have to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they were taken or deemed to have under such provisions of the SFO), or which were recorded in the register required to be kept by the Company under Section 352 of the SFO, or which were required to be notified to the Company and the Stock Exchange pursuant to Rule 5.46 of the GEM Listing Rules.

Arrangements to Acquire Shares or Debentures

Other than the share option schemes disclosed above, at no time during the year was the Company or any of its subsidiaries a party to any arrangement to enable the directors of the Company to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate, and none of the directors, or their spouses or children under the age of 18, had any right to subscribe for the securities of the Company, or had exercised any such right during the year.

Substantial Shareholders

As at 31 December 2006, so far is known to the Directors, the following persons (not being a Director or a chief executive of the Company) had an interest and/or a short position in the shares and/or underlying shares of the Company as recorded in the register required to be kept under Section 336 of the SFO or had otherwise notified to the Company were as follows:

Name of person	Number of shares held	Capacity	Approximate percentage of interest
	(Note 1)		
Siko Venture Limited	2,743,350,000 *(Note 2)*	Beneficial owner	57.15%
Lam Nam	800,000,000 (L) *(Note 3)*	Interest of a controlled corporation	16.67%
Silver Star Enterprises Holdings Inc. *(Note 3)*	800,000,000 (L)	Beneficial owner	16.67%

Notes:

1. The letter "L" represents the person's interests in shares of the Company.

2. The entire issued share capital of Siko Venture Limited is beneficially owned by Mr. Chim Kim Kiu, Jacky, the chairman and a director of the Company.

3. The entire issued share capital of Silver Star Enterprises Holdings Inc. is beneficially owned by Mr. Lam Nam.

Save as disclosed above, as at 31 December 2006, the Directors are not aware of any other person or corporation having an interest or short position in the shares and underlying shares of the Company representing 5% or more of the issued share capital of the Company.

Share Option Schemes

The Company adopted two share option schemes (hereinafter referred to as the "Pre-IPO Share Option Scheme" and the "Share Option Scheme") on 26 June 2002 for the purpose of providing incentives to the directors and eligible participants, under which the Company may grant options to the directors and employees of the Group and also other eligible participants to subscribe for shares of the Company. Certain Directors and participants have been granted options under the Pre-IPO share Option Scheme to subscribe for shares at an exercise price of HK$0.002 *(Note)* per share, details of which are set out as follows:

Name of grantee	Date of grant	Exercise period	Granted	Outstanding as at 1 January 2006	Cancelled/ Lapsed during the year	Outstanding as at 31 December 2006
Executive directors						
Mr. IP Kai Cheong	26 June 2002	12 July 2002 — 11 July 2007	65,000,000 *(Note)*	65,000,000	(65,000,000)	0
		12 January 2003 — 11 January 2008	43,350,000 *(Note)*	43,350,000	(43,350,000)	0
Mr. SUN Tak Keung	26 June 2002	12 July 2002 — 11 July 2007	45,000,000 *(Note)*	45,000,000	—	45,000,000
		12 January 2003 — 11 January 2008	30,000,000 *(Note)*	30,000,000	—	30,000,000
Other participants						
Employees in aggregate	26 June 2002	12 July 2003 — 11 July 2008	48,750,000 *(Note)*	500,000	—	500,000
Total				183,850,000 *(Note)*	(108,350,000)	75,500,000

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

No option has been granted by the Company under the Share Option Scheme.

Directors' interests in contracts

Other than the personal guarantees given by Mr. Chim Kim Kiu, Jacky and a close family member of Mr. SUN Tak Keung to the Group stated in note 29 to the financial statements, no contract of significance, to which the Company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year. The personal guarantees disclosed in note 29 to the financial statements constituted exempted continuing connected transactions under Chapter 20 of the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (the "GEM Listing Rules").

Convertible securities, options, warrants or similar rights

Other than the share options as set out in note 27 to the financial statements, no other outstanding convertible securities, options, warrants or other similar rights were issued or granted by the Company as at 31 December 2006.

Pre-emptive rights

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

Audit committee

The Company has an audit committee which was established with written terms of reference based upon the guidelines recommended by the Hong Kong Institute of Certified Public Accountants in compliance with Rules 5.28, 5.29 and 5.33 of the GEM Listing Rules. The primary duties of the audit committee are to review the Company's annual report and financial statements, half-year reports and quarterly reports and to provide advice and comments thereon to the directors. The audit committee is also responsible for reviewing and supervising the Company's financial reporting and internal control procedures. The audit committee comprises the independent non-executive directors and met four times during the year ended 31 December 2006. At the date of this report, Mr. WAN Hon Keung has been appointed as the chairman of the audit committee.

Competing interests

Mr. CHIM Kim Kiu, Jacky, the chairman and a director of the Company, is a director of Riches Good Limited ("Riches Good"), the entire issued share capital of which is held by Mr. CHIM Kim Kiu, Jacky. In October 2004, Riches Good purchased the assets and production machines from a bankrupted paper manufacturing plant. As the products produced by Riches Good are different from those of the Group, the Directors consider the impact of such similar business on the Group is minimal.

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

Purchase, sale or redemption of listed securities

During the year ended 31 December 2006, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

Auditors

The accounts for the year ended 31 December 2006 have been audited by Messrs. Patrick Ng & Company who retire and, being eligible, offer themselves for re-appointment; while the accounts for the year ended 31 December 2005 were audited by Louis Leung & Partners CPA Limited.

On behalf of the Board
CHIM Kim Kiu, Jacky
Chairman

Hong Kong, 23 March 2007

Independent Auditor's Report

TO THE SHAREHOLDERS OF
KANSTAR ENVIRONMENTAL PAPER PRODUCTS HOLDINGS LIMITED
(Incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of Kanstar Environmental Paper Products Holdings Limited set out on pages 24 to 83, which comprise the consolidated and company balance sheets as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors of the Company are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made 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 the report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2006 and of the Group's loss and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

PATRICK NG & COMPANY
Certified Public Accountants

20/F., Hong Kong Trade Centre,
161-167 Des Voeux Road,
Central, Hong Kong,
Hong Kong S.A.R., China

23 March 2007

Consolidated Income Statement

For the year ended 31 December 2006

	Notes	2006 HK$'000	2005 HK$'000
Turnover	5(a)	**43,295**	53,671
Cost of sales		**(38,321)**	(49,546)
Gross profit		**4,974**	4,125
Other income	5(b)	**818**	974
Selling and distribution expenses		**(1,807)**	(1,320)
Administrative and other operating expenses		**(20,097)**	(3,081)
Profit/(loss) from operations		**(16,112)**	698
Finance costs	6	**(1,032)**	(595)
Share of results of associates		**(1,284)**	—
Profit/(loss) before tax	7	**(18,428)**	103
Income tax	8	**—**	—
PROFIT/(LOSS) FOR THE YEAR		**(18,428)**	103
Profit/(loss) attributable to shareholders		**(18,428)**	103
Dividend	10	**—**	—
Earnings/(loss) per share	11		
— basic		**(0.4343 cent)**	0.0026 cent
— diluted		**N/A**	0.0025 cent

Consolidated Balance Sheet

As at 31 December 2006

	Notes	2006 HK$'000	2005 HK$'000 (Restated)
NON-CURRENT ASSETS			
Property, plant and equipment	13	**35,111**	62,040
Prepaid lease payments	14	**2,245**	2,206
Interests in associate	16	**224,316**	—
		261,672	64,246
CURRENT ASSETS			
Inventories	18	**11,087**	9,612
Trade and other receivables	19	**11,520**	10,516
Cash and bank deposits	20	**3,809**	863
		26,416	20,991
CURRENT LIABILITIES			
Bank and other loans	21	**(18,901)**	(11,000)
Trade and other payables	22	**(12,672)**	(10,270)
Amount due to directors	23	**(3,284)**	(638)
		(34,857)	(21,908)
NET CURRENT LIABILITIES		**(8,441)**	(917)
TOTAL ASSETS LESS CURRENT LIABILITIES		**253,231**	63,329
NON-CURRENT LIABILITIES			
Deferred tax liabilities	24	**—**	(8,151)
NET ASSETS		**253,231**	55,178
CAPITAL AND RESERVES			
Share capital	25	**9,600**	8,000
Reserves	26	**243,631**	47,178
TOTAL EQUITY		**253,231**	55,178

Approved and authorised for issue by the board of directors on 23 March 2007.

CHENG Kwok Hing, Andy
Director

SUN Tak Keung
Director

Balance Sheet

As at 31 December 2006

	Notes	2006 HK$'000	2005 HK$'000
NON-CURRENT ASSETS			
Property, plant and equipment	13	**53**	68
Investments in subsidiaries	15	**24,895**	24,895
Amount due from subsidiaries	17	**267,862**	42,674
		292,810	67,637
CURRENT ASSETS			
Trade and other receivables	19	**209**	20
Cash and bank deposits	20	**1,142**	338
		1,351	358
CURRENT LIABILITIES			
Bank and other loans	21	**(3,201)**	(3,100)
Trade and other payables	22	**(206)**	(150)
Amount due to a director	23	**(2,302)**	(157)
		(5,709)	(3,407)
NET CURRENT LIABILITIES		**(4,358)**	(3,049)
NET ASSETS		**288,452**	64,588
CAPITAL AND RESERVES			
Share capital	25	**9,600**	8,000
Reserves	26	**278,852**	56,588
TOTAL EQUITY		**288,452**	64,588

Approved and authorised for issue by the board of directors on 23 March 2007.

CHENG Kwok Hing, Andy
Director

SUN Tak Keung
Director

Consolidated Statement of Changes in Equity

For the year ended 31 December 2006

	Share capital *HK$'000*	**Share premium** *HK$'000*	**Special reserve** *HK$'000*	**Revaluation reserve** *HK$'000*	**Exchange reserve** *HK$'000* (Restated)	**Accumulated losses** *HK$'000* (Restated)	**Total** *HK$'000*
At 1 January 2005							
— as previously reported	8,000	35,770	985	23,509	(2)	(13,257)	55,005
— prior period adjustment *(note 14)*	—	—	—	—	—	(92)	(92)
— as restated	8,000	35,770	985	23,509	(2)	(13,349)	54,913
Exchange differences arising on translation of foreign operations	—	—	—	—	162	—	162
Profit for the year	—	—	—	—	—	103	103
At 31 December 2005	8,000	35,770	985	23,509	160	(13,246)	55,178
At 1 January 2006	8,000	35,770	985	23,509	160	(13,246)	55,178
Exchange differences arising on translation of foreign operations	—	—	—	—	(118)	—	(118)
Issue of ordinary shares for acquisition of interests in associates	1,600	224,000	—	—	—	—	225,600
Reversal of deferred tax liabilities on revaluation of plant and equipment	—	—	—	8,151	—	—	8,151
Reversal of surplus on revaluation of plant and equipment	—	—	—	(31,660)	—	—	(31,660)
Surplus on revaluation of buildings	—	—	—	14,508	—	—	14,508
Loss for the year	—	—	—	—	—	(18,428)	(18,428)
At 31 December 2006	**9,600**	**259,770**	**985**	**14,508**	**42**	**(31,674)**	**253,231**

Special reserve represents the difference between the paid up capital of the previous holding company of the Group acquired and the nominal value of the Company's shares issued for the acquisition at the time of the group reorganisation for the listing of the Company's shares on the Growth Enterprise Market in 2002.

Consolidated Cash Flow Statement

For the year ended 31 December 2006

	2006 HK$'000	2005 HK$'000 (Restated)
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit/(loss) before taxation	**(18,428)**	103
Adjustments for:		
Interest income	**(5)**	(10)
Interest expenses	**1,032**	595
Amortisation of prepaid lease payments	**47**	47
Depreciation	**1,776**	1,738
Loss on disposal of property, plant and equipment	**—**	14
Revaluation decrease of plant and equipment	**10,771**	—
Impairment loss on trade and other receivables	**4,556**	—
Impairment loss on inventories	**239**	—
Share of results of associates	**1,284**	—
Operating profit before movements in working capital	**1,272**	2,487
Increase in inventories	**(1,714)**	(2,559)
Increase in trade and other receivables	**(5,560)**	(3,164)
Increase in trade and other payables	**2,402**	2,027
NET CASH USED IN OPERATING ACTIVITIES	**(3,600)**	(1,209)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received on bank deposits	**5**	10
Purchase of property, plant and equipment	**(1,419)**	(3,324)
NET CASH USED IN INVESTING ACTIVITIES	**(1,414)**	(3,314)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from bank and other loans	**7,901**	3,500
Interest paid	**(1,032)**	(595)
Net proceeds from advances from directors	**2,646**	427
NET CASH GENERATED FROM FINANCING ACTIVITIES	**9,515**	3,332

Consolidated Cash Flow Statement *(Cont'd)*

For the year ended 31 December 2006

	2006 HK$'000	2005 HK$'000 (Restated)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	**4,501**	(1,191)
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR	**863**	2,484
EFFECT OF FOREIGN EXCHANGE RATE CHANGES	**(1,555)**	(430)
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	**3,809**	863
ANALYSIS OF CASH AND CASH EQUIVALENTS		
Cash and bank deposits	**3,809**	863

1. General information

The Company was incorporated in the Cayman Islands as an exempted company with limited liability and its shares are listed on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited. The addresses of the registered office and principal place of business of the Company are disclosed in the corporate information section of the annual report.

The financial statements are presented in Hong Kong dollars, which is the same as the functional currency of the Company.

The principal activities of the Company and its subsidiaries (the "Group") are the development, manufacture and sale of pulp and paper products.

2. Application of New and Revised Hong Kong Financial Reporting Standards ("HKFRSs")

In the current year, the Group has applied a number of new and revised standards, amendments and interpretations (the "new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA"), which are relevant to its operations and either effective for accounting periods beginning on or after 1 January 2005 or 1 January 2006. The adoption of the new HKFRSs has no significant effect on the Group's accounting policies and amounts reported for the current and prior accounting periods in these financial statements.

The Group has not early applied the following new standard, amendment or interpretations that have been issued but are not yet effective. The directors anticipate that the application of these new standard, amendment or interpretations will have no material impact on the results and the financial position of the Group.

HKAS 1 (Amendment)	Capital Disclosures(1)
HKFRS 7	Financial Instruments: Disclosures(1)
HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies(2)
HK(IFRIC)-Int 8	Scope of HKFRS 2(3)
HK(IFRIC)-Int 9	Reassessment of Embedded Derivatives(4)
HK(IFRIC)-Int 10	Interim Financial Reporting and Impairment(5)

(1) Effective for annual periods beginning on or after 1 January 2007
(2) Effective for annual periods beginning on or after 1 March 2006
(3) Effective for annual periods beginning on or after 1 May 2006
(4) Effective for annual periods beginning on or after 1 June 2006
(5) Effective for annual periods beginning on or after 1 November 2006

3. Significant accounting policies

The financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (the "HKFRSs"), which includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA"), accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. The financial statements also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

The measurement basis used in the preparation of the financial statements is the historical cost basis except for certain property, plant and equipment and financial instruments, which are measured at revalued amounts or fair values.

A summary of the significant accounting policies adopted by the Group is set out below.

(a) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries (entities controlled by the Company).

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. Minority interests in the net assets consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

3. Significant accounting policies *(Continued)*

(b) Business combinations

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under HKFRS 3 *Business Combinations* are recognised at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations,* which are recognised and measured at fair value less costs to sell.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in profit or loss.

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

(c) Goodwill

Goodwill arising on an acquisition of a subsidiary represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of the relevant subsidiary at the date of acquisition. Goodwill arising on an acquisition of an associate or a jointly controlled entity represents the excess of the cost of the acquisition over the Group's share of the relevant associate's or jointly controlled entity's net assets at the date of acquisition.

Capitalised goodwill is presented separately in the consolidated balance sheet and is carried at cost less any accumulated impairment losses.

3. Significant accounting policies *(Continued)*

(c) Goodwill *(Continued)*

For the purposes of impairment testing, goodwill arising from an acquisition is allocated to each of the relevant cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the acquisition. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, and whenever there is an indication that the unit may be impaired. For goodwill arising on an acquisition in a financial year, the cash-generating unit to which goodwill has been allocated is tested for impairment before the end of that financial year. When the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated to reduce the carrying amount of any goodwill allocated to the unit first, and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in the consolidated income statement. An impairment loss for goodwill is not reversed in subsequent periods.

On subsequent disposal of a subsidiary, an associate or a jointly controlled entity, the attributable amount of goodwill capitalised is included in the determination of the amount of profit or loss on disposal.

(d) Investments in subsidiaries

A subsidiary is an entity controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

In the Company's balance sheet, investments in subsidiaries are stated at cost less any impairment losses, unless it is classified as held for sale.

(e) Investments in associates and jointly controlled entities

An associate is an entity in which the Group has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

A jointly controlled entity is an entity which operates under a contractual arrangement between the Group and other parties, where the contractual arrangement establishes that the Group and one or more of the other parties share joint control over the economic activity of the entity.

3. Significant accounting policies *(Continued)*

(e) Investments in associates and jointly controlled entities *(Continued)*

An investment in an associate or a jointly controlled entity is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the post-acquisition change in the Group's share of the associate's or the jointly controlled entity's net assets, unless it is classified as held for sale. The consolidated income statement includes the Group's share of the post-acquisition, post-tax results of the associates and jointly controlled entities for the year, including any impairment loss on goodwill relating to the investment in associates and jointly controlled entities recognised for the year.

When the Group's share of losses exceeds its interest in the associate or the jointly controlled entity, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate or the jointly controlled entity. For this purpose, the Group's interest in the associate or the jointly controlled entity is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associate or the jointly controlled entity.

Unrealised profits and losses resulting from transactions between the Group and its associates and jointly controlled entities are eliminated to the extent of the Group's interest in the associate or jointly controlled entity, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

In the Company's balance sheet, investments in associates and jointly controlled entities are stated at cost less impairment losses, unless it is classified as held for sale.

(f) Non-current assets held for sale

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition.

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of the assets' (disposal groups') previous carrying amount and fair value less costs to sell.

3. Significant accounting policies *(Continued)*

(g) Revenue recognition

Sales of goods are recognised when goods are delivered and title has passed.

Service income is recognised when services are provided.

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

(h) Property, plant and equipment

Property, plant and equipment are stated at cost or valuation less subsequent depreciation and impairment losses.

Buildings held for use in the production or supply of goods or services, or for administrative purposes, are stated in the consolidated balance sheet at their revalued amounts, being the fair value at the date of revaluation less any subsequent accumulated depreciation and any subsequent accumulated impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date.

Any revaluation increase arising on revaluation of buildings is credited to the properties revaluation reserve, except to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense, in which case the increase is credited to the consolidated income statement to the extent of the decrease previously charged. A decrease in net carrying amount arising on revaluation of an asset is dealt with as an expense to the extent that it exceeds the balance, if any, on the properties revaluation reserve relating to a previous revaluation of that asset. On the subsequent sale or retirement of a revalued asset, the attributable revaluation surplus is transferred to retained profits.

3. Significant accounting policies *(Continued)*

(h) Property, plant and equipment *(Continued)*

Depreciation is provided to write off the cost or fair value of items of property, plant and equipment, after taking into account of their estimated residual value, if any, using the straight-line method over their estimated useful lives commencing on the date of completion of construction for the intended use, at the following rates:

Property	
— buildings situated on leasehold land	Over the shorter of the unexpired term of lease or 30 years
Plant and equipment	$3^1/_3$% to 20% per annum

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, the term of the relevant lease.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the consolidated income statement in the year in which the item is derecognised.

(i) Intangible assets (other than goodwill)

Expenditure on research activities is recognised as an expense in the period in which it is incurred. Expenditure on development activities is capitalised if the product or process is technically and commercially feasible and the Group has sufficient resources and the intention to complete development. The expenditure capitalised includes the costs of materials, direct labour, and an appropriate proportion of overheads and borrowing costs, where applicable. Capitalised development costs are stated at cost less accumulated amortisation and any accumulated impairment losses. Other development expenditure is recognised as an expense in the period in which it is incurred.

Other intangible assets that are acquired by the Group are stated in the balance sheet at cost less accumulated amortisation, where the estimated useful life is finite, and any accumulated impairment losses. Expenditure on internally generated goodwill and brands is recognised as an expense in the period in which it is incurred.

3. Significant accounting policies *(Continued)*

(i) Intangible assets (other than goodwill) *(Continued)*

Amortisation of intangible assets with finite useful lives is charged to profit or loss on a straight-line basis over the assets' estimated useful lives. The following intangible assets with finite useful lives are amortised from the date when they are available for use and their estimated useful lives are as follows:

Capitalised development costs	5 years
Patents and trademarks	5 to 10 years

Both the period and method of amortisation are reviewed annually.

Intangible assets are not amortised while their useful lives are assessed to be indefinite. Any conclusion that the useful life of an intangible asset is indefinite is reviewed annually to determine whether events and circumstances continue to support the indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite is accounted for prospectively from the date of change and in accordance with the policy for amortisation of intangible assets with finite lives as set out above.

(j) Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are recognised as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to profit or loss, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the Group's general policy on borrowing costs.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight-line basis.

Interest in leasehold land is amortised over the lease term on a straight-line basis.

3. Significant accounting policies *(Continued)*

(k) Foreign currencies

The individual financial statements of each group entity are presented in the currency of the primary economic environment in which the entity operates (its functional currency). For the purpose of the consolidated financial statements, the results and financial position of each entity are expressed in Hong Kong dollars, which is the functional currency of the Company and the presentation currency for the consolidated financial statements.

In preparing the financial statements of the individual entities, transactions in currencies other than the entity's functional currency (foreign currencies) are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in profit or loss for the period in which they arise, except for exchange differences arising on a monetary item forms part of the Company's net investment in a foreign operation, in which case, such exchange differences are recognised in equity in the consolidated financial statements. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity, in which cases, the exchange differences are also recognised directly in equity.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are expressed in Hong Kong dollars using exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuated significantly during that period, in which case, the exchange rates at the dates of the transactions are used. Exchange differences arising, if any, are included in the exchange reserve as a separate component of equity. Such exchange differences are recognised in profit or loss in the period in which the foreign operation is disposed of.

Goodwill and fair value adjustments on identifiable assets acquired arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the rate prevailing on the balance sheet date. Exchange differences arising are included in the exchange reserve.

3. Significant accounting policies *(Continued)*

(l) Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which necessarily take a substantial period of time to get ready for their intended use or sale, are capitalised as part of the cost of those assets, until the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

(m) Employee benefits

(i) Short term employee benefits and contributions to defined contribution retirement plans

Salaries, annual bonuses, paid annual leave, contributions to defined contribution retirement plans and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

(ii) Share-based payments

The fair value of share options granted to employees is recognised as an employee cost with a corresponding increase in a capital reserve within equity. The fair value is measured at grant date, taking into account the terms and conditions upon which the options were granted. Where the employees have to meet vesting conditions before becoming unconditionally entitled to the options, the total estimated fair value of the options is spread over the vesting period, taking into account the probability that the options will vest.

3. Significant accounting policies *(Continued)*

(m) Employee benefits *(Continued)*

(ii) Share-based payments *(Continued)*

During the vesting period, the number of share options that is expected to vest is reviewed. Any adjustment to the cumulative fair value recognised in prior years is included in profit or loss for the year of the review, unless the original employee expenses qualify for recognition as an asset, with a corresponding adjustment to the capital reserve. On vesting date, the amount recognised as an expense is adjusted to reflect the actual number of options that vest (with a corresponding adjustment to the capital reserve) except where forfeiture is only due to not achieving vesting conditions that relate to the market price of the Company's shares. The equity amount is recognised in the capital reserve until either the option is exercised (when it is transferred to the share premium account) or the option expires (when it is released directly to retained profits).

(iii) Termination benefits

Termination benefits are recognised when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

(n) Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

3. Significant accounting policies *(Continued)*

(n) Taxation *(Continued)*

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

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 profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based on tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

(o) Impairment of tangible and intangible assets other than goodwill

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

3. Significant accounting policies *(Continued)*

(o) Impairment of tangible and intangible assets other than goodwill *(Continued)*

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

(p) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method. Net realisable value represents the estimated selling price in the ordinary course of business less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

(q) Financial instruments

Financial assets and financial liabilities are recognised in the consolidated balance sheet when the Group becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

3. Significant accounting policies *(Continued)*

(q) Financial instruments *(Continued)*

(i) Trade and other receivables

Trade receivables are subsequently measured at amortised cost, using the effective interest rate method, less any impairment losses for bad and doubtful debts except where the receivables are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less any impairment losses for bad and doubtful debts.

(ii) Investments

Investments are recognised and derecognised on a trade date basis where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned.

Investments which are non-derivatives with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity are classified as held-to-maturity investments and are measured at subsequent reporting dates at amortised cost, using the effective interest rate method, less any impairment losses recognised to reflect irrecoverable amounts.

Investments held for trading are classified as investments at fair value through profit and loss and are measured at subsequent reporting dates at fair value with changes in fair value recognised in profit or loss in the period in which they arise.

Investments which are non-derivatives and classified neither as held-to-maturity investments nor investments at fair value through profit and loss are classified as available-for-sale investments and are measured at subsequent reporting dates at fair value. Changes in fair value are recognised directly in equity, until the investment is disposed of or is determined to be impaired, at which time, the cumulative gain or loss previously recognised in equity is removed from equity and recognised in profit or loss. Impairment losses are recognised in profit or loss. For available-for-sale equity investments, impairment losses will not reverse in profit and loss in subsequent periods.

3. Significant accounting policies *(Continued)*

(q) Financial instruments *(Continued)*

(iii) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits, and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

(iv) Bank borrowings

Interest-bearing bank loans and overdrafts are subsequently measured at amortised cost, using the effective interest rate method. Any difference between the proceeds (net of transaction costs) and the settlement or redemption of borrowings is recognised over the term of the borrowings in accordance with the Group's accounting policy for borrowing costs.

(v) Convertible loan notes

Convertible loan notes issued by the Company that contain both the liability and conversion option components are classified separately into respective items on initial recognition. Conversion option will be settled by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company's own equity instruments is an equity instrument.

On initial recognition, the fair value of the liability component is determined using the prevailing market interest rate of similar non-convertible debts. The difference between the proceeds of the issue of the convertible loan notes and the fair value assigned to the liability component, representing the conversion option for the holder to convert the loan notes into equity, is included in the convertible loan notes equity reserve as a separate component of equity.

In subsequent periods, the liability component of the convertible loan notes is carried at amortised cost using the effective interest method. The equity component, represented by the option to convert the liability component into ordinary shares of the Company, will remain in convertible loan notes equity reserve until the conversion option is exercised (in which case the balance stated in convertible loan notes equity reserve will be transferred to share premium). Where the option remains unexercised at the expiry date, the balance stated in convertible loan notes equity reserve will be released to the retained profits. No gain or loss is recognised in profit or loss upon conversion or expiration of the option.

3. Significant accounting policies *(Continued)*

(q) Financial instruments *(Continued)*

(v) Convertible loan notes (Continued)

Transaction costs that relate to the issue of the convertible loan notes are allocated to the liability and equity components in proportion to the allocation of the proceeds. Transaction costs relating to the equity component are charged directly to equity. Transaction costs relating to the liability component are included in the carrying amount of the liability component and amortised over the period of the convertible loan notes using the effective interest method.

(vi) Trade and other payables

Trade payables are subsequently measured at amortised cost, using the effective interest rate method, unless the effect of discounting would be immaterial, in which case they are stated at cost.

(vii) Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

Consideration paid to reacquire the Company's own equity instruments are deducted from equity. No gain or loss is recognised in profit or loss.

(r) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

3. Significant accounting policies *(Continued)*

(s) Related parties

A party is considered to be related to the Group if:

(i) The party, directly or indirectly through one or more intermediaries, (1) controls, is controlled by, or is under common control with, the Group; (2) has an interest in the Group that gives it significant influence over the Group; or (3) has joint control over the Group;

(ii) The party is an associate;

(iii) The party is a jointly controlled entity;

(iv) The party is a member of the key management personnel of the Group or its parent;

(v) The party is a close member of the family of any individual referred to in (i) or (iv);

(vi) The party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides, with directly or indirectly, any individual referred to in (iv) or (v); or

(vii) The party is a post-employment benefit plan which is for the benefit of employees of the Group or of any entity that is a related party of the Group.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

(t) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

In accordance with the Group's internal financial reporting system, the Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format for the purposes of these financial statements.

3. Significant accounting policies *(Continued)*

(t) Segment reporting *(Continued)*

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. For example, segment assets may include inventories, trade receivables and property, plant and equipment. Segment revenue, expenses, assets, and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between group entities within a single segment. Inter-segment pricing is based on similar terms as those available to other external parties.

Segment capital expenditure is the total cost incurred during the period to acquire segment assets (both tangible and intangible) that are expected to be used for more than one period.

Unallocated items mainly comprise financial and corporate assets, interest-bearing loans, borrowings, tax balances, corporate and financing expenses.

4. Critical accounting judgments and estimates

(a) Judgments

In the process of applying the Group's accounting policies, management has made the following judgements, apart from those involving estimations as discussed below, which have the most significant effect on the amounts recognised in the financial statements.

(i) Impairment of assets

In determining whether an asset is impaired or the event previously causing the impairment no longer exists, the Group has to exercise judgment in the area of asset impairment, particularly in assessing: (1) whether an event has occurred that may effect the asset value or such event affecting the asset value has not been in existence; (2) whether the carrying value of an asset can be supported by net present value of future cash flows which are estimated based upon the continued use of the asset or derecognition; and (3) the appropriate key assumptions to be applied in preparing cash flow projections including whether these cash flow projections are discounted using an appropriate rate. Changing the assumptions selected by management to determine the level of impairment, including the discount rates or the growth rate assumptions in the cash flow projections, could materially affect the net present value used in the impairment test.

4. Critical accounting judgments and estimates *(Continued)*

(a) Judgments *(Continued)*

(ii) Income taxes

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 assets are recognised for unused tax losses carried forward to the extent that it is probable that future taxable profits will be available against which the unused tax losses can be utilised, based on all available evidence. Recognition primarily involves judgement regarding the future performance of the particular legal entity or tax group in which the deferred tax asset has been recognised. A variety of other factors are also evaluated in considering whether there is convincing evidence that it is probable that some portion or all or the deferred tax assets will ultimately be realised, such as the existence of taxable temporary differences, tax planning strategies and the periods in which estimated tax losses can be utilised. The carrying amount of deferred tax assets and related financial models and budgets are reviewed at each balance sheet date and to the extent that there is insufficient convincing evidence that sufficient taxable profits will be available within the utilisation periods to allow utilisation of the carry forward tax losses, the asset balance will be reduced and charged to the income statement.

(b) Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of the Group's assets and liabilities within the next financial year are discussed below.

(i) Impairment test of assets

The Group determines whether an asset is impaired at least on an annual basis or where an indication of impairment exists. This requires an estimation of the value in use of the asset. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the assets and also to choose a suitable discount rate in order to calculate the present value of those cash flows.

4. Critical accounting judgments and estimates *(Continued)*

(b) Estimation uncertainty *(Continued)*

(ii) Income taxes

The Group reviews the carrying amount of deferred tax assets at each balance sheet date and reduces the amount 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. This requires an estimation of the future taxable profits. Estimating the future taxable profits requires the Group to make an estimate of the expected future earnings from the Group and also to choose a suitable discount rate in order to calculate the present value of the earnings.

(iii) Depreciation of property, plant and equipment

Property, plant and equipment are depreciated on a straight-line basis over their estimated useful lives, after taking into account of their estimated residual value. The determination of the useful lives and residual values involve management's estimation. The Group assesses annually the residual value and the useful life of the property, plant and equipment and if the expectation differs from the original estimate, such a difference may impact the depreciation in the year the estimate is changed and the future period.

5. Revenue

(a) An analysis of the Group's turnover for the year is as follows:

	2006 ***HK$'000***	2005 *HK$'000*
Sales of pulp and paper products	**43,295**	53,671

5. Revenue *(Continued)*

(b) An analysis of the Group's other income for the year is as follows:

	2006 HK$'000	2005 HK$'000
Bank interest income	5	10
Net foreign exchange gain	569	792
Sundry income	244	172
	818	974

6. Finance costs

	2006 HK$'000	2005 HK$'000
Interest and charges on bank loans and advances	1,023	572
Interest on other loans and advances	9	23
	1,032	595

7. Profit/(loss) before tax

Profit/(loss) before tax has been arrived at after charging:

	2006 HK$'000	2005 HK$'000
Staff costs (including directors' remuneration)		
— Salaries and other benefits	**3,859**	3,847
— Retirement scheme contributions	**178**	157
	4,037	4,004
Auditors' remuneration	**200**	119
Amortisation of lease payments for land	**47**	47
Depreciation	**1,776**	1,738
Loss on disposal of property, plant and equipment	**—**	14
Revaluation decrease of plant and equipment	**10,771**	—
Impairment loss on trade and other receivables	**4,556**	—
Impairment loss on inventories	**239**	—

8. Income tax

	2006 HK$'000	2005 HK$'000
Current tax:		
Hong Kong	**—**	—
Other jurisdictions	**—**	—
Deferred tax	**—**	—
Income tax expense for the year	**—**	—

Hong Kong profits tax is calculated at 17.5% (2005: 17.5%) of the estimated assessable profit for the year. Taxation for other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions.

8. Income tax *(Continued)*

The total charge for the year can be reconciled to the accounting profit/(loss) as follows:

	2006	2005
	HK$'000	*HK$'000*
Profit/(loss) before tax	**(18,428)**	103
Notional tax on profit/(loss) before tax, calculated at the tax rates applicable to profit in the jurisdictions concerned	**(5,483)**	206
Tax effect on share of results of associates	**225**	—
Tax effect of non-deductible expenses	**5,231**	171
Tax effect of non-taxable income	**(13)**	(6)
Tax effect of losses not deductible	**510**	266
Tax effect of utilisation of tax losses not previously recognised	**(470)**	(637)
Income tax expense for the year	**—**	—

9. Directors' and employees' emoluments

(i) Directors' emoluments

The emoluments paid or payable to each of the 9 (2005: 7) directors were as follows:

2006

	Fees	Salaries and other benefits	Retirement scheme contributions	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Executive directors:				
CHIM Kim Kiu, Jacky	—	—	—	—
LI Gang	—	145	—	145
IP Kai Cheung	—	—	—	—
SUN Tak Keung	—	—	—	—
CHENG Kwok Hing, Andy	—	—	—	—
KWOK Ching Chung	—	—	—	—
Independent non-executive directors:				
CHAN Chi Hung, Anthony	—	—	—	—
WANG Ai Guo	—	—	—	—
WAN Hon Keung	—	—	—	—
	—	145	—	145

9. Directors' and employees' emoluments *(Continued)*

(i) Directors' emoluments *(Continued)*

2005

	Fees *HK$'000*	Salaries and other benefits *HK$'000*	Retirement scheme contributions *HK$'000*	Total *HK$'000*
Executive directors:				
CHIM Kim Kiu, Jacky	—	—	—	—
LI Gang	—	77	—	77
IP Kai Cheung	—	—	—	—
SUN Tak Keung	—	—	—	—
Independent non-executive directors:				
CHAN Chi Hung, Anthony	—	—	—	—
WANG Ai Guo	—	—	—	—
LAU Ka Ho	—	—	—	—
	—	77	—	77

(ii) Of the 5 individuals with the highest emoluments in the Group, 1 (2005: 1) was a director of the Company whose emoluments are set out above. The emoluments of the remaining 4 (2005: 4) individuals were as follows:

	2006 ***HK$'000***	2005 *HK$'000*
Salaries and other benefits	**278**	312
Retirement scheme contributions	**11**	30
	289	342

9. Directors' and employees' emoluments *(Continued)*

(ii) *(Continued)*

The emoluments of the 4 (2005: 4) individuals with the highest emoluments are within the following bands:

	Number of individuals	
	2006	2005
HK$0 to HK$1,000,000	**4**	4

10. Dividend

No dividend has been paid or proposed for the year (2005: Nil).

11. Earnings/(loss) per share

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

	2006	2005
	HK$'000	*HK$'000*
Profit/(loss) for the year	**(18,428)**	103
Number of ordinary shares:	***'000***	*'000*
Issued ordinary shares at 1 January	**4,000,000**	4,000,000
Effect of shares issued for acquisition of interests in associates *(note 16(c))*	**243,288**	—
Weighted average number of ordinary shares at 31 December used in the calculation of basic earnings/(loss) per share	**4,243,288**	4,000,000
Effect of dilutive potential ordinary shares	**153,023**	182,655
Weighted average number of ordinary shares at 31 December used in the calculation of diluted earnings/(loss) per share	**4,396,311**	4,182,655

The diluted loss per share for the year ended 31 December 2006 has not been disclosed as the potential shares arising from the exercise and conversion of the Company's share options would decrease the loss per share of the Group for the year and is regarded as anti-dilutive.

12. Business and geographical segments

(a) Business segments

The following continuing operations are the basis on which the Group reports its primary segment information. There are no sales or other transactions between the business segments.

2006

Income statement

	Sales of pulp and paper products HK$'000
Revenue	43,295
Segment results	(14,221)
Unallocated corporate income	576
Unallocated corporate expenses	(2,467)
Finance costs	(1,032)
Share of results of associates	(1,284)
Loss for the year	(18,428)

Other information

	Sales of pulp and paper products HK$'000	Others HK$'000	Total HK$'000
Capital expenditure	1,413	6	1,419
Depreciation	1,684	92	1,776

12. Business and geographical segments *(Continued)*

(a) Business segments *(Continued)*

Balance sheet

	Sales of pulp and paper products HK$'000
Assets:	
Segment assets	60,925
Unallocated corporate assets	227,163
Total assets	288,088
Liabilities:	
Segment liabilities	16,057
Unallocated corporate liabilities	18,800
Total liabilities	34,857

12. Business and geographical segments *(Continued)*

(a) Business segments *(Continued)*

2005

Income statement

	Sales of pulp and paper products HK$'000
Revenue	53,671
Segment results	1,435
Unallocated corporate income	796
Unallocated corporate expenses	(1,533)
Finance costs	(595)
Profit for the year	103

Other information

	Sales of pulp and Paper products HK$'000	Others HK$'000	Total HK$'000
Capital expenditure	3,308	16	3,324
Depreciation	1,632	106	1,738

12. Business and geographical segments *(Continued)*

(a) Business segments *(Continued)*

Balance sheet

	Sales of pulp and paper products HK$'000
Assets:	
Segment assets	84,142
Unallocated corporate assets	1,095
Total assets	85,237
Liabilities:	
Segment liabilities	9,628
Unallocated corporate liabilities	20,431
Total liabilities	30,059

(b) Geographical segments

No analysis of the Group's revenue, carrying amount of segment assets and additions to property, plant and equipment and intangible assets by geographical segments is presented as the Group's turnover was wholly derived from the sales of pulp and paper products in the People's Republic of China in both years.

13. Property, plant and equipment

The Group

	Buildings HK$'000	Plant and equipment HK$'000	Construction in progress HK$'000	Total HK$'000
Cost or valuation:				
At 1 January 2005	4,061	56,982	3,969	65,012
Additions	—	1,402	1,922	3,324
Disposals	—	(18)	—	(18)
Transfer	—	4,299	(4,299)	—
Exchange adjustments	78	479	76	633
At 31 December 2005 and 1 January 2006	4,139	63,144	1,668	68,951
Additions	—	665	754	1,419
Transfer	—	2,489	(2,489)	—
Revaluation adjustments	13,695	(50,429)	—	(36,734)
Exchange adjustments	166	1,242	67	1,475
At 31 December 2006	18,000	17,111	—	35,111
Comprising:				
At 31 December 2005				
— cost	4,139	26,994	1,668	32,801
— valuation	—	36,150	—	36,150
	4,139	63,144	1,668	68,951
At 31 December 2006				
— cost	—	—	—	—
— valuation	18,000	17,111	—	35,111
	18,000	17,111	—	35,111

13. Property, plant and equipment *(Continued)*

The Group *(Continued)*

	Buildings	Plant and equipment	Construction in progress	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Depreciation and impairment:				
At 1 January 2005	524	4,614	—	5,138
Provided for the year	124	1,614	—	1,738
Disposals	—	(4)	—	(4)
Exchange adjustments	10	29	—	39
At 31 December 2005 and 1 January 2006	658	6,253	—	6,911
Provided for the year	125	1,651	—	1,776
Revaluation adjustments	(813)	(7,998)	—	(8,811)
Exchange adjustments	30	94	—	124
At 31 December 2006	—	—	—	—
Carrying amounts:				
At 31 December 2006	18,000	17,111	—	35,111
At 31 December 2005	3,481	56,891	1,668	62,040

Revalued amounts at 31 December 2006 were determined as follows:

	Buildings	Plant and equipment
	HK$'000	*HK$'000*
Valuation made by B.I. Appraisals Limited, a firm of professional valuers, on an open market value for continued existing use basis as at 31 December 2006	18,000	17,000
Valuation made by the directors of the Company on a continued existing use basis as at 31 December 2006	—	111
	18,000	17,111

13. Property, plant and equipment *(Continued)*

The Group *(Continued)*

The revaluation increase of buildings, after adjustment for accumulated depreciation, amounted to HK$14.508 million was credited to revaluation reserve as stated in note 26 while the revaluation decrease of plant and equipment, after adjustment for accumulated depreciation and surplus on previous revaluation, amounted to HK$10.771 million was recognised as an expense as stated in note 7.

The Company

	Plant and equipment *HK$'000*
Cost or valuation:	
At 1 January 2005	89
Additions	16
At 31 December 2005 and 1 January 2006	105
Additions	6
Revaluation adjustment	(58)
At 31 December 2006	53
Comprising:	
At 31 December 2005	
— cost	105
At 31 December 2006	
— valuation	53
Depreciation and impairment:	
At 1 January 2005	17
Provided for the year	20
At 31 December 2005 and 1 January 2006	37
Provided for the year	21
Revaluation adjustment	(58)
At 31 December 2006	—
Carrying amount:	
At 31 December 2006	53
At 31 December 2005	68

The valuation was made by the directors of the Company on a continued existing use basis as at 31 December 2006.

14. Prepaid lease payments

Prepaid lease payments comprise:

	The Group	
	2006	2005
	HK$'000	*HK$'000*
		(Restated)
Land held under medium-term lease outside Hong Kong in the People's Republic of China:		
At beginning of the year		
— as previously reported	**2,300**	—
— prior period adjustments *(note)*	**(94)**	2,210
— as restated	**2,206**	2,210
Amortised for the year	**(47)**	(47)
Exchange difference on retranslation	**86**	43
At end of the year	**2,245**	2,206

Note:

A wholly-owned subsidiary of the Company, Yunnan Changning Kanstar Paper Company Limited, acquired interest in leasehold land in the People's Republic of China in December 2002 for a term of 30 years at a consideration of RMB2,440,330. The cost of acquisition had not been recognised and amortised until 2005 when the cost was paid although the lease was operating since December 2002. In order to comply with the Group's accounting policies to recognise the cost in the year of commencement of lease and the amortization over the lease term, adjustment is made to restate amortised cost of prepaid lease payments as at 1 January 2005 and 31 December 2005 to HK$2,210,000 and HK$2,206,000 respectively. As a result, the balance of accumulated losses as at 1 January 2005 was increased by HK$92,000 and the change in exchange reserve for 2005 was decreased by HK$2,000.

15. Investments in subsidiaries

	The Company 2006 HK$'000	The Company 2005 HK$'000
Unlisted shares, at cost	**24,895**	24,895

Details of principal subsidiaries as at 31 December 2006, which materially affected the Group's results or net assets, are set out in note 35.

16. Interests in associates

	The Group 2006 HK$'000	The Group 2005 HK$'000
Share of net assets of associates *(note (a))*	**382**	—
Goodwill arising on acquisition of associates *(note (b))*	**223,934**	—
	224,316	—

Name	Place of incorporation/ operation	Registered capital	Attributable equity interest of the Group 2006	Attributable equity interest of the Group 2005	Principal activities
Polyard Petroleum International Company Limited	Macau	MOP10,000,000	**20%**	—	Investment holding
Chinaoil USA (Macau) Company Limited (*)	Macau	MOP10,000,000	**14%**	—	Exploration of oil and gas

(*): Associate indirectly held by the Group

16. Interests in associates *(Continued)*

Notes:

(a) Share of net assets of associates

	HK$'000
At 1 January 2006	—
Acquisition of 20% interests in associates *(note (c))*	1,666
Share of results of associates for the year *(note (e))*	(1,284)
Share of net assets of associates at 31 December 2006	382

(b) Goodwill arising on acquisition of associates

	HK$'000
At 1 January 2006	—
Acquisition of 20% interests in associates *(note (c))*	223,934
At 31 December 2006	223,934

(c) Acquisition of interests in associates

On 10 June 2006, Modern Lucky International Limited, a wholly-owned subsidiary of the Company, entered into an acquisition agreement with Mr. Lam Nam to acquire 20% interests in Polyard International Petroleum Limited ("Polyard") at a consideration of approximately HK$225,600,000 by the issue of 800 million new shares of the Company at an issue price of HK$0.282 per share (the "Acquisition"). Subsequent to the completion of the Acquisition on 12 September 2006, Polyard and its subsidiary (the "Polyard Group") became associates of the Group. The net assets of Polyard Group as at the date of the Acquisition was approximately HK$1,666,000. Accordingly, goodwill arising on the Acquisition was approximately HK$223,934,000.

(d) The directors of the Company assessed the recoverable amount of goodwill arising on the acquisition of associates by reference to the present value of the expected future revenue arising from the business of exploration of oil and gas operated by the associates. In the opinion of the directors of the Company, no impairment losses need to be recognised as at 31 December 2006.

16. Interests in associates *(Continued)*

Notes: (Continued)

(e) The summarized financial information in respect of the Group's interests in associates from the Polyard Group's financial statements for the year ended 31 December 2006 is set out below:

	HK$'000
Turnover	—
Loss for the year	(10,039)
Loss attributable to the Group from the date of acquisition	(1,284)
Total assets	31,747
Total liabilities	(29,782)
Net assets	
— attributable to parent	1,911
— attributable to minority interests	54
Net assets attributable to the Group	382

17. Amount due from subsidiaries

	The Company	
	2006	2005
	HK$'000	*HK$'000*
Amount due from subsidiaries	**267,862**	42,674

The amount is unsecured and non-interest bearing. The Company will not demand repayment within 1 year after the balance sheet date and the amount is therefore classified as a non-current asset.

18. Inventories

	The Group	
	2006	2005
	HK$'000	*HK$'000*
Raw materials	**6,386**	6,869
Work-in-progress	**1,247**	—
Finished goods	**3,454**	2,743
	11,087	9,612

An analysis of the amount of inventories recognised as an expense for the year is as follows:

	The Group	
	2006	2005
	HK$'000	*HK$'000*
Carrying amount of inventories sold	**38,321**	49,546
Write-down in respect of obsolete inventories	**239**	—
	38,560	49,546

19. Trade and other receivables

The Group has a policy of allowing average credit period ranging from 2 weeks to 1 month to its trade customers. In additions, for certain customers with long-established relationship and good past repayment histories, a longer credit period may be granted.

An aged analysis of trade receivables is as follows:

	The Group		The Company	
	2006	2005	**2006**	2005
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*
0 — 30 days	**3,141**	5,321	**—**	—
31 — 60 days	**—**	452	**—**	—
61 — 90 days	**58**	500	**—**	—
91 — 120 days	**—**	—	**—**	—
Over 120 days	**4**	34	**—**	—
	3,203	6,307	**—**	—
Other debtors, deposits and prepayments	**8,317**	4,209	**209**	20
	11,520	10,516	**209**	20

20. Cash and bank deposits

	The Group		The Company	
	2006	2005	**2006**	2005
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*
Deposits with banks and other financial institutions	**3,686**	777	**1,130**	338
Cash in hand	**123**	86	**12**	—
	3,809	863	**1,142**	338

20. Cash and bank deposits *(Continued)*

Included in cash and bank deposits in the balance sheet are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group	
	2006	2005
	'000	*'000*
Renminbi	**RMB1,340**	RMB527

21. Bank and other loans

	The Group		The Company	
	2006	2005	**2006**	2005
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*
Bank loans — secured	**16,901**	11,000	**3,201**	3,100
Other loans — secured	**2,000**	—	**—**	—
	18,901	11,000	**3,201**	3,100

The loans bear interest at prevailing market rates.

The Group's bank loans amounting to HK$16,901,000 (2005: HK$11,000,000) are revolving loans repayable not exceeding 90 days at the time of drawing.

22. Trade and other payables

An aged analysis of trade payables is as follows:

	The Group		The Company	
	2006	2005	**2006**	2005
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*
0 — 30 days	**1,221**	4,319	**—**	—
31 — 60 days	**2,406**	807	**—**	—
61 — 90 days	**352**	517	**—**	—
91 — 120 days	**—**	300	**—**	—
Over 120 days	**3,263**	866	**—**	—
	7,242	6,809	**—**	—
Other creditors and accrued charges	**5,430**	3,461	**206**	150
	12,672	10,270	**206**	150

23. Amount due to directors

The amount due to directors is unsecured, interest-free and has no fixed term of repayment.

24. Deferred taxation

The Group's major deferred tax liabilities/(assets) recognised and movements thereon during the current and prior years are summarized below:

	Revaluation of plant and equipment *HK$'000*
At 1 January 2005	8,151
Charge/(credit) to equity for the year	—
At 31 December 2005 and 1 January 2006	8,151
Charge/(credit) to equity for the year	(8,151)
At 31 December 2006	—

At the balance sheet date, the Group has unused PRC tax losses of HK$6,900,000 (2005: HK$5,266,000) which will expire at various years up to 2008. No deferred tax has been recognised due to the unpredictability of future profit streams.

The Group has no other significant deferred taxation unrecognised at the balance sheet date (2005: Nil).

25. Share capital

	Number of shares		**Amount**	
	2006 ***'000***	2005 *'000*	**2006** ***HK$'000***	2005 *HK$'000*
Authorised:				
Ordinary shares of HK$0.002 each				
— At beginning and end of the year	**10,000,000**	10,000,000	**20,000**	20,000
Issued and fully paid:				
Ordinary shares of HK$0.002 each				
— At beginning of the year	**4,000,000**	4,000,000	**8,000**	8,000
— Shares issued for acquisition of interests in associates *(note 16(c))*	**800,000**	—	**1,600**	—
— At end of the year	**4,800,000**	4,000,000	**9,600**	8,000

26. Reserves

The Group

	Share premium	Special reserve	Revaluation reserve	Exchange reserve (Restated)	Accumulated losses (Restated)	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
At 1 January 2005						
— as previously reported	35,770	985	23,509	(2)	(13,257)	47,005
— prior period adjustment *(note 14)*	—	—	—	—	(92)	(92)
— as restated	35,770	985	23,509	(2)	(13,349)	46,913
Exchange differences arising on translation of foreign operations	—	—	—	162	—	162
Profit for the year	—	—	—	—	103	103
At 31 December 2005	35,770	985	23,509	160	(13,246)	47,178
At 1 January 2006	35,770	985	23,509	160	(13,246)	47,178
Exchange differences arising on translation of foreign operations	—	—	—	(118)	—	(118)
Issue of ordinary shares for acquisition of interests in associates	224,000	—	—	—	—	224,000
Reversal of deferred tax liabilities on revaluation of plant and equipment	—	—	8,151	—	—	8,151
Reversal of surplus on revaluation of plant and equipment	—	—	(31,660)	—	—	(31,660)
Surplus on revaluation of buildings	—	—	14,508	—	—	14,508
Loss for the year	—	—	—	—	(18,428)	(18,428)
At 31 December 2006	259,770	985	14,508	42	(31,674)	243,631

26. Reserves *(Continued)*

The Company

	Share premium *HK$'000*	Accumulated losses *HK$'000*	Total *HK$'000*
At 1 January 2005	60,650	(2,769)	57,881
Loss for the year	—	(1,293)	(1,293)
At 31 December 2005 and 1 January 2006	60,650	(4,062)	56,588
Issue of ordinary shares	224,000	—	224,000
Loss for the year	—	(1,736)	(1,736)
At 31 December 2006	284,650	(5,798)	278,852

Under the Companies Law (Revised) Chapter 22 of the Cayman Islands, the share premium of the Company is available for paying distributions or dividends to shareholders subject to the provisions of its Memorandum or Articles of Association and provided that immediately following the distribution or dividend, the Company is able to pay its debts as they fall due in the ordinary course of business. At the balance sheet date, in the opinion of the directors, the Company's reserves available for distribution to shareholders amounted to HK$278,852,000 (2005: HK$56,588,000).

27. Share option schemes

The Company adopted two share option schemes (hereinafter referred to as the "Pre-IPO Share Option Scheme" and the "Share Option Scheme") on 26 June 2002 for the purpose of providing incentives to the directors and eligible participants, under which the Company may grant options to the directors and employees of the Group and also other eligible participants to subscribe for shares of the Company. The Scheme became effective on 12 July 2002 and, unless otherwise cancelled or amended, will remain in effect for 10 years from that date.

27. Share option schemes *(Continued)*

Eligible participants of the Share Option Scheme include the following:

(i) any employee or proposed employee (whether full time or part time) of the Group or any entity ("Invested Entity") in which any member of the Group holds any equity interest (including any executive director but excluding any non-executive director of the Group or any Invested Entity);

(ii) any non-executive directors (including independent non-executive directors) of the Group or any Invested Entity;

(iii) any supplier of goods or services to any member of the Group or any Invested Entity;

(iv) any customer of the Group or any Invested Entity;

(v) any person or entity that provides research, development or other technological support to the Group or any Invested Entity;

(vi) any shareholder of any member of the Group or any Invested Entity or any holder of any securities issued by any member of the Group or any Invested Entity;

(vii) any adviser (professional or otherwise) or consultant to any area of business or business development of any member of the Group or any Invested Entity; and

(viii) any company wholly owned by one or more of the eligible participants referred to in (i) to (vii) above.

The total number of shares in respect of which options may be granted under the Share Option Scheme is not permitted to exceed 30% of the shares of the Company in issue from time to time, without prior approval from the Company's shareholders. The number of shares in respect of which options may be granted to any individual in any one year is not permitted to exceed 1% of the shares of the Company in issue from time to time, without prior approval from the Company's shareholders. Options granted to substantial shareholders or independent non-executive directors or their associates in excess of 0.1% of the Company's share capital or with a value in excess of HK$5 million must be approved in advance by the Company's shareholders.

27. Share option schemes *(Continued)*

As at the date of this report, the total number of shares of the Company which may be issued upon the exercise of the options which may be granted under the Share Option Scheme is 400,000,000, representing approximately 8.33% of the issued share capital of the Company as at the date of the report.

The offer of a grant of share options may be accepted within 21 days from the date of the offer. A nominal consideration of HK$1 is payable on acceptance of each grant. Options may be exercised at any time during a period which may commence on a day after the date of grant of the share options but shall end at any event not later than ten years from the date of grant of the options. The exercise price is determined by the directors of the Company, and will be at least the highest of (i) the closing price of the Company's shares on the date of grant, (ii) the average closing price of the shares for the five trading days immediately preceding the date of grant, and (iii) the nominal value of the shares.

On 26 June 2002, prior to its listing, the Company granted options to certain executive directors and employees of the Group to subscribe for an aggregate of 251,100,000 shares (note) in the Company under the Pre-IPO Share Option Scheme. The terms of the Pre-IPO Share Option Scheme are different to the terms of the Share Option Scheme as described above except that:

(i) the eligible participants are confined to certain directors, senior management, employees, consultants and advisers of the Group;

(ii) there is no minimum subscription price;

(iii) the general scheme limit, the individual limit applicable to each proposed grantee and the restrictions on grant of options to a connected person do not apply; and

(iv) The directors may only grant options under the Pre-IPO Share Option Scheme at any time within a period from 26 June 2002 to 12 July 2002.

27. Share option schemes *(Continued)*

(iv) *(Continued)*

Details of share options granted under the Pre-IPO Share Option Scheme to certain directors and employees to subscribe for shares in the Company are as follows:

		Number of options			
	Exercisable period	Outstanding as at 1 January 2006 *(Note)*	Exercised during the year *(Note)*	Cancelled during the year *(Note)*	Outstanding as at 31 December 2006 *(Note)*
Directors	12 July 2002 — 11 July 2007	110,000,000	—	(65,000,000)	45,000,000
	12 January 2003 — 11 January 2008	73,350,000	—	(43,350,000)	30,000,000
Employees	12 July 2002 — 11 July 2008	500,000	—	—	500,000
		183,850,000	—	(108,350,000)	75,500,000

The financial impact of share options granted is not recorded in the Company's or the Group's balance sheet until such time as the options are exercised, and no charge is recognised in the income statement in respect of the value of options granted in the year. Upon the exercise of the share options, the resulting shares issued are recorded by the Company as additional share capital at the nominal value of the shares, and the excess of the exercise price per share over the nominal value of the shares is recorded by the Company in the share premium account. Options which lapse or are cancelled prior to their exercise date are deleted from the register of outstanding options.

Note:

Pursuant to an ordinary resolution passed at an extraordinary general meeting of the Company held on 7 October 2004, each of the initial issued and unissued shares having a par value of HK$0.01 were subdivided into five subdivided shares having a par value of HK$0.002 each with effect from 8 October 2004. This share subdivision gave rise to adjustments to both the exercise price and the number of underlying shares granted under the Pre-IPO Share Option Scheme, and accordingly every option originally granted was increased to five options.

28. Retirement benefit schemes

The Group operates a Mandatory Provident Fund Scheme (the "MPF Scheme") for all qualifying employees in Hong Kong. The assets of the MPF Scheme are held separately from those of the Group, in funds under the control of an independent trustee. Under the rules of the MPF Scheme, the employer and its employees are each required to make contributions at HK$1,000 or 5% of the relevant payroll costs, whichever is the lower, to the scheme. The only obligation of the Group with respect to the MPF Scheme is to make the required contributions under the scheme.

The employees of the Group's subsidiaries in the People's Republic of China are members of a state-managed retirement benefit scheme operated by the local government. The subsidiaries are required to contribute a specified percentage of payroll costs to the retirement benefit scheme to fund the benefits. The only obligation of the Group with respect to the retirement benefit scheme is to make the specified contributions.

29. Related party transactions

Transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation and are not disclosed in this note.

Remuneration for key management personnel of the Group, including the Company's directors and certain highest paid employees, is set out in note 9.

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

(a) Mr. Chim Kim Kiu, Jacky, a director of the Company, has given personal guarantees to the extent of HK$19,500,000 (2005: HK$14,500,000) to different banks for granting banking facilities to the Group.

(b) A close member of the family of Mr. Sun Tak Keung, a director of the Company, has given personal guarantees to the extent of HK$15,000,000 (2005: HK$10,000,000) to a bank for granting banking facilities to a subsidiary.

30. Contingent liabilities

At the balance sheet date, the Company had contingent liabilities as follows:

	The Company	
	2006	2005
	HK$'000	*HK$'000*
Guarantees given to a bank in respect of banking facilities utilised by a subsidiary	**13,700**	7,900

31. Commitments

(a) Capital commitments

At the balance sheet date, the capital commitments outstanding contracted for but not provided for in these financial statements are as follows:

	The Group		The Company	
	2006	2005	**2006**	2005
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*
Acquisition of property, plant and equipment	**2,665**	100	**—**	—

(b) Operating lease commitments

At the balance sheet date, the total future minimum lease payments under non-cancelable operating leases are as follows:

	The Group		The Company	
	2006	2005	**2006**	2005
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*
Properties				
— Within 1 year	**—**	15	**—**	—
— After 1 year but within 5 years	**—**	—	**—**	—
	—	15	**—**	—

32. Events after the balance sheet date

On 8 January 2007, the Group entered into different agreements in respect of various transactions, which are subject to the approval by independent shareholders of the Company at an extraordinary general meeting to be convened, as follows:

(a) Acquisition agreement

Acquisition of a further 30% equity interest in Polyard Petroleum International Company Limited by Modern Lucky International Limited, a wholly-owned subsidiary of the Company, from Mr. Lam Nam, the sole owner of Silver Star Enterprises Holding Inc., a substantial shareholder of the Company, at a consideration of HK$505 million to be paid/satisfied in the following manners:—

(i) HK$191.88 million by the issue of shares of the Company at an issue price of HK$0.36 per share;

(ii) HK$287.12 million by the issue of convertible bonds, with a conversion price of HK$0.43 per share of the Company, at an interest rate of 3% per annum for a term of 3 years from the date of issue; and

(iii) HK$26 million in cash.

(b) Disposal agreement

Disposal of a wholly-owned subsidiary, Yunnan Changning Kanstar Paper Company Limited, as to the Group's interest in the registered capital and shareholder's loan in that subsidiary, to Sure Carl Investment Limited ("Sure Carl"), an investment holding company wholly-owned by Mr. Chim Kim Kiu, Jacky, the chairman and a director of the Company, at a consideration consists of HK$26 million in cash and an undertaking given by Sure Carl to repay the total principal of approximately HK$15.6 million under banking facilities due and payable by the Group.

(c) Supply agreement

Supply of pulp and paper products by Yunnan Changning Kanstar Paper Company Limited, after completion of the disposal agreement, to the Group at a price not less favourable than purchase from independent third party for a term to be expired on 31 December 2009.

33. Financial risk management objectives and policies

The Group is exposed to a variety of financial risks which result from both its operating and investing activities. The board of directors and management meet periodically to analyse and formulate strategies to manage and monitor these exposures to ensure appropriate measures are implemented on a timely and effective manner. Generally, the Group introduces conservative strategies on its risk management. As the Group's exposure to these risks is kept to a minimum, the Group has not used any derivatives or other instruments for hedging purposes.

The Group's major financial instruments include cash and bank deposits, trade and other receivables, trade and other payables, loans from and to related parties and short-term borrowings. Details of these financial instruments are disclosed in respective notes. The main risks associated with these financial instruments and the policies on how to mitigate these risks are set out below:

(a) Credit risk

The carrying amounts of trade receivables included in the consolidated balance sheet represent the Group's maximum exposure to credit risk in the event of the counterparties' failure to perform their obligations as at 31 December 2006 in relation to its financial assets. No other financial assets carry a significant exposure to credit risk.

In order to minimize the credit risk, the management of the Group has policies in place to ensure that sales of products are made to customers with an appropriate credit history. The management has also delegated personnel responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews the recoverable amount of each individual trade debt at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors of the Company consider that the Group's credit risk is significantly reduced.

The Group's concentration of credit risk by geographical locations is mainly in the People's Republic of China (the "PRC") with exposure spread over a number of customers.

(b) Currency risk

The Group's main operations are in the PRC and has no significant exposure to any specific foreign currency other than Renminbi. All the Group's cash and cash equivalents are deposits with major banks located in Hong Kong and the PRC.

33. Financial risk management objectives and policies *(Continued)*

(b) Currency risk *(Continued)*

Certain trade and other receivables and borrowings of the Group are denominated in Renminbi. The Group currently does not have a foreign currency hedging policy. However, the management does closely monitor foreign exchange exposure and will consider undertaking foreign exchange hedging activities to neutralize the impact of foreign exchange rate movements on the Group's operating results.

(c) Liquidity risk

The Group will consistently implement a prudent liquidity risk management and ensure that it maintains sufficient cash and cash equivalents to meet its liquidity requirements. Banking facilities have also been arranged with different banks in order to fund the liquidity requirements. The management monitors the utilization of borrowings and ensures compliance with loan covenants.

(d) Fair value and cash flow interest rate risk

Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Group's exposure to fair value and cash flow interest risks is minimal as the Group has no significant long-term financial assets and liabilities, as such its income and operating cash flows are substantially independent of changes in market interest rates.

34. Immediate and ultimate controlling party

The directors consider the immediate parent and ultimate controlling party of the Group at 31 December 2006 to be Siko Venture Limited, which is a limited company incorporated in the British Virgin Islands. This entity does not produce financial statements available for public use.

35. Particulars of subsidiaries

Particulars of the Company's subsidiaries at 31 December 2006 were as follows:

Name of subsidiary	Place of incorporation/ operation	Forms of legal entity	Issued and fully paid share capital/ registered capital*	Proportion of nominal value of issued capital/ registered capital held by the Company Directly	Proportion of nominal value of issued capital/ registered capital held by the Company Indirectly	Principal activities
Kanstar Environmental Technology Group Limited	British Virgin Islands	International Business Company	US$1,000	—	100%	Investment holding
Kanstar Hong Kong Limited	Hong Kong	Limited Liability Company	HK$1,000,000	—	100%	Investment holding and provision of management services
Addata Development Limited	Hong Kong	Limited Liability Company	HK$10,000	—	100%	Holding and administration of intellectual property right for paper filling materials and "Kanstar" brandname
雲南建星新技術產品開發有限公司 Yunnan Kanstar High Tech Products Development Company Limited	People's Republic of China	Wholly Owned Foreign Enterprise	US$420,000*	—	100%	Research, development, manufacture and sale of paper filling materials

35. Particulars of subsidiaries *(Continued)*

Name of subsidiary	Place of incorporation/ operation	Forms of legal entity	Issued and fully paid share capital/ registered capital*	Proportion of nominal value of issued capital/ registered capital held by the Company Directly	Indirectly	Principal activities
雲南昌寧建星紙業有限公司 Yunnan Changning Kanstar Paper Company Limited	People's Republic of China	Wholly Owned Foreign Enterprise	RMB13,357,659*	—	100%	Development, manufacture and sale of pulp and paper products
Modern Lucky International Limited	Hong Kong	Limited Liability Company	HK$2	—	100%	Investment holding

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

Summary of Financial Information

The summarised consolidated results, assets and liabilities of the Group for the last five financial years, as extracted from the audited financial statements of the Group, are set out below:—

Results

	For the year ended 31 December				
	2002	2003	2004	2005	**2006**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	***HK$'000***
		(Restated)	(Restated)	(Restated)	
Turnover	14,058	30,782	50,313	53,671	**43,295**
Profit/(loss) attributable to shareholders	(5,091)	(2,012)	963	103	**(18,428)**

Assets and Liabilities

	At 31 December				
	2002	2003	2004	2005	**2006**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	***HK$'000***
		(Restated)	(Restated)	(Restated)	
Total assets	73,434	76,691	78,277	85,237	**288,088**
Total liabilities	(17,472)	(22,743)	(23,370)	(30,059)	**(34,857)**
Net assets	55,962	53,948	54,907	55,178	**253,231**