

# REPORT OF THE DIRECTORS

The directors of Chitaly Holdings Limited (the "Company") are pleased to present their report together with the audited financial statements of the Company and its subsidiaries (collectively referred to as the "Group") for the year ended 31 December 2002.

## GROUP REORGANISATION

The Company was incorporated in the Cayman Islands on 8 November 2001 as an exempted company with limited liability under the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands.

Pursuant to a reorganisation scheme to rationalise the structure of the Group in preparation for the listing of the Company's shares on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), the Company acquired Chitaly (BVI) Limited, the then holding company of the subsidiaries, and became the holding company of the Group on 15 December 2001 (the "Group Reorganisation"). Further details of the Group Reorganisation, together with details of the subsidiaries acquired pursuant thereto, are set out in notes 1, 21, 22 and 23 to the financial statements and in the Company's prospectus dated 2 May 2002 (the "Prospectus").

The Company completed its initial public offering on 15 May 2002 and the shares of the Company were listed on the Stock Exchange on the same date.

## PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. Details of the principal activities of the subsidiaries are set out in note 21 to the financial statements. There were no significant changes in the nature of the Group's principal activities during the year.

## RESULTS AND DIVIDENDS

The Group's profit for the year ended 31 December 2002 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 21 to 50.

On 2 April 2002, a special dividend of HK\$10 million was declared and subsequently paid by a subsidiary of the Company to the shareholders of the Company whose names appeared on the register of members on 2 April 2002. An interim dividend of HK2.5 cents per ordinary share was proposed by the Company, approved at the annual general meeting in September 2002, and paid on 10 October 2002. The directors recommend the payment of a final dividend of HK8.0 cents per ordinary share in respect of the year, to shareholders on the register of members on 23 May 2003. The recommendation has been incorporated in the financial statements as an allocation of retained profits within the capital and reserves section of the balance sheet.

**USE OF PROCEEDS FROM THE COMPANY'S INITIAL PUBLIC OFFERING**

Upon the listing of the Company's shares on the Stock Exchange on 15 May 2002 (note 22 to the financial statements), the net proceeds were approximately HK\$32 million. As at 31 December 2002, HK\$2 million, HK\$7 million and HK\$5 million were utilised for the construction of a new factory building, for the purchase of machinery and equipment, and for marketing and promotional activities, respectively. The remaining proceeds are deposited in financial institutions and licensed banks in Hong Kong.

**SUMMARY FINANCIAL INFORMATION**

The following is a summary of the consolidated/combined financial results and consolidated/combined assets and liabilities of the Group for the last four financial years, prepared on the basis set out in note 4:

	<b>Year ended 31 December</b>			
	<b>2002</b>	2001	2000	1999
	<b>HK\$'000</b>	HK\$'000	HK\$'000	HK\$'000
<b>RESULTS</b>				
Turnover	<b>207,020</b>	164,758	143,669	102,823
Profit before tax	<b>51,252</b>	37,615	31,326	27,918
Tax	<b>(6,738)</b>	(5,138)	(4,715)	(3,475)
Net profit from ordinary activities attributable to shareholders	<b>44,514</b>	32,477	26,611	24,443

	<b>31 December</b>			
	<b>2002</b>	2001	2000	1999
	<b>HK\$'000</b>	HK\$'000	HK\$'000	HK\$'000
<b>ASSETS AND LIABILITIES</b>				
Non-current assets	<b>75,662</b>	45,319	42,642	20,180
Current assets	<b>118,931</b>	53,536	32,793	33,347
Current liabilities	<b>(61,571)</b>	(53,525)	(40,542)	(30,245)
Non-current liabilities	–	–	(3,440)	(3,440)
Net assets	<b>133,022</b>	45,330	31,453	19,842

Notes:

1. The summary of the published combined results of the Group for each of the three years ended 31 December 1999, 2000 and 2001 was extracted from the Prospectus. Such summary was prepared as if the current Group structure had been in existence throughout these financial years. The consolidated results of the Group for the year ended 31 December 2002 are those set out on page 21 of this annual report of which the basis of presentation is detailed in note 4 to the financial statements.
2. The summary of the combined assets and liabilities as at 31 December 1999, 2000 and 2001 was extracted from the Prospectus. Such summary was prepared on the same basis as detailed in note 1 above. The consolidated assets and liabilities as at 31 December 2002 are those set out on page 22 of this annual report.

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## **FIXED ASSETS**

Details of movements in the fixed assets of the Group for the year ended 31 December 2002 are set out in note 15 to the financial statements.

## **SHARE CAPITAL AND SHARE OPTIONS**

Details of movements in the Company's share capital and share options for the year ended 31 December 2002, together with the reasons therefor, and details of the Company's share option scheme are set out in note 22 to the financial statements.

## **RESERVES**

Details of movement of reserves of the Company and the Group during the year are set out in note 23 to the financial statements.

## **DISTRIBUTABLE RESERVES**

As at 31 December 2002, the Company's reserves available for distribution, calculated in accordance with the Companies Law (2001 Second Revision) of the Cayman Islands, amounted to HK\$52,657,000. The distributable reserves include the Company's share premium and contributed surplus, in total of HK\$54,192,000 at 31 December 2002, which may be distributed provided that immediately following the date on which the dividend is proposed to be distributed, the Company will be in a position to pay off its debts as and when they fall due in the ordinary course of business.

## **PRE-EMPTIVE RIGHTS**

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

## **PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY**

The Company's shares were listed on the Stock Exchange on 15 May 2002. Neither the Company, nor any of its subsidiaries, redeemed or sold any of the Company's listed securities during the year and up to the date of this annual report.

## **MAJOR CUSTOMERS AND SUPPLIERS**

Sales to the Group's five largest customers accounted for approximately 21% of the Group's turnover for the year, and sales to the Group's largest customer included therein amounted to 6% of the Group's turnover for the year. Purchases from the Group's five largest suppliers accounted for approximately 48% of the total purchases for the year, and purchases from the Group's largest supplier included therein amounted to 17% of the Group's purchases for the year.

None of the directors or any shareholders (which, to the best knowledge of the directors, owns more than 5% of the Company's issued share capital) had any beneficial interest in the Group's five largest customers and/or suppliers.

## DIRECTORS

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

### Executive directors:

Tse Kam Pang

Lam Toi

Lam Ning, Joanna

### Independent non-executive directors:

Tsao Kwang Yung, Peter

Ma Gary Ming Fai

All the directors of the Company are subject to retirement by rotation and re-election in accordance with the provision of the Company's articles of association.

## DIRECTORS' AND SENIOR MANAGEMENT'S BIOGRAPHIES

Biographical details of the directors of the Company and the senior management of the Group are set out on pages 10 to 11 of this annual report.

## DIRECTORS' SERVICE CONTRACTS

Each of the executive directors has entered into a service agreement with the Company for an initial term of two years commencing from 1 May 2002, which will continue thereafter until terminated by not less than two months' notice in writing served by either party on the other.

Each of the independent non-executive directors has entered into a service contract with the Company for an initial term of two years commencing from 26 April 2002.

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

## DIRECTORS' INTERESTS IN CONTRACTS

Saved as disclosed in note 8 to the financial statements, no director had a significant beneficial interest, either direct or indirect, in any contracts of significance to the business of the Group to which the Company or any of its subsidiaries was a party during or at the end of the year.

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## DIRECTORS' INTERESTS IN SHARES

The shares of the Company were listed on the Stock Exchange on 15 May 2002. At the date of this report, the beneficial interests (including interests and short positions in the shares of the Company or underlying shares and debentures) of the directors, the chief executive or their associates in the share capital of the Company or its associated corporations (within the meaning of Part XV of Securities and Futures Ordinance (Cap. 571) (the "SFO")), as recorded in the register maintained by the Company pursuant to Section 352 of the SFO, were as follows:

Name	Notes	Nature of interest	Number of issued ordinary shares of HK\$0.1 each held in the Company	Percentage of total issued shares
Tse Kam Pang	(a)	Corporate	81,250,000	34.9%
Lam Toi	(b)	Corporate	81,250,000	34.9%
Lam Ning, Joanna		Personal	2,300,000	1%
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			164,800,000	70.8%

Notes:

- (a) The 81,250,000 shares are held by Crisana International Inc. ("Crisana"), a company incorporated in the British Virgin Islands. As at 31 December 2002, Mr. Tse Kam Pang held 100% of the issued share capital of Crisana.
- (b) The 81,250,000 shares are held by Silver Wave Holdings Limited ("Silver Wave"), a company incorporated in the British Virgin Islands. As at 31 December 2002, Mr. Lam Toi held 100% of the issued share capital of Silver Wave.

Saved as disclosed above, none of the directors or their associates had any personal, family, corporate or other interests in the ordinary shares of the Company or any of its associated corporations, as defined in the SFO.

## DIRECTORS' RIGHTS TO ACQUIRE SHARES

Saved as disclosed under the headings "Directors' interests in shares" above and "Share option scheme" below, at no time during the year were rights to acquire benefits by means of the acquisition of shares in the Company granted to any director or their respective spouse or children under 18 years of age, or were any such rights exercised by them; or was the Company, or any of its subsidiaries a party to any arrangement to enable the directors to acquire such rights in any other body corporate.

## SHARE OPTION SCHEME

The Company operates a share option scheme (the "Scheme") for the purpose of providing incentives and rewards to eligible participants who contribute to the Group's operations. Under the Scheme, the directors may, at their discretion, invite any employees, directors or consultants of any company in the Group to acquire options. The Scheme became effective on 26 April 2002 and, unless otherwise cancelled or amended, will remain in force for 10 years from that date.

**SHARE OPTION SCHEME (Continued)**

The maximum number of shares in respect of which options may be granted under the Scheme and under any other share option scheme of the Company pursuant to which options may from time to time be granted to directors, consultants, and/or employees of any company in the Group, shall initially not exceed 10% of the relevant class of securities of the Company in issue excluding, for this purpose, shares issued on exercise of options under the Scheme and any other share option scheme of the Company. Upon the grant of options for shares up to 10% of the relevant class of securities of the Company and subject to the approval of the shareholders of the Company in general meetings, the maximum number of shares to be issued under this scheme when aggregated with securities to be issued under any other share option scheme of the Group, may be increased by the board of directors, provided that the shares to be issued upon exercise of all outstanding options do not exceed 30% of the relevant class of securities in issue from time to time.

No option may be granted to any one person such that the total number of shares issued and to be issued upon the exercise of options granted and to be granted to such person in any 12-month period up to the date of the latest grant exceeds 1% of the issued share capital of the Company from time to time.

An option may be exercised in accordance with the terms of the Scheme at any time during the option period (and not more than ten years after the date of grant). The option period will be determined by the board of directors and communicated to each grantee. The board of directors may provide restrictions on the time during which the options may be exercised. There are no performance targets which must be achieved before any of the options can be exercised. However, the board of directors retains discretion to accelerate vesting of fixed-term options in the event that certain performance targets are met.

The subscription price for the Company's shares under the Scheme will be a price determined by the board of directors and notified to each grantee. The subscription price will be the highest of: (i) the nominal value of a share; and (ii) the closing price of the shares as stated in the Stock Exchange's daily quotation sheet on the date of grant, which must be a trading day; and (iii) the average closing price of the shares as stated in the Stock Exchange's daily quotations sheets for the five trading days immediately preceding the date of grant. An option shall be deemed to have been granted and accepted by an eligible participant (as defined in the Scheme) and to have taken effect when the acceptance form as described in the share option scheme is completed, signed and returned by the grantee with a remittance in favour of the Company of HK\$1.00 by way of consideration for the grant.

As at 31 December 2002, the number of shares issuable under share options granted under the Scheme was 7,300,000, which represented 3% of the Company's shares in issue as at that date. The maximum number of shares issuable under share options may be granted to each eligible participant in the Scheme within any 12-month period up to the date of latest grant, is limited to 1% of the shares of the Company in issue at any time. Any further grant of share options in excess of this limit is subject to the shareholders' approval in a general meeting.

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### SHARE OPTION SCHEME (Continued)

The following share options granted under the Scheme during the year for a consideration of HK\$1.00 per grant are set out below:

Name of directors	At the beginning of the year	Granted during the year	At the end of the year	Date of grant of share options	Exercise price per share (HK\$)	Exercisable period	Price of Company's shares at grant date of options (HK\$)
Tse Kam Pang	-	2,300,000	2,300,000	17/9/2002	HK\$0.73	1/1/2003 to 31/12/2005	HK\$0.72
Lam Toi	-	2,300,000	2,300,000	17/9/2002	HK\$0.73	1/1/2003 to 31/12/2005	HK\$0.72
Lam Ning, Joanna	-	2,300,000	2,300,000	17/9/2002	HK\$0.73	1/1/2003 to 31/12/2005	HK\$0.72
One member of senior management and an employee	-	400,000	400,000	17/9/2002	HK\$0.73	1/1/2003 to 31/12/2005	HK\$0.72
In aggregate	-	7,300,000	7,300,000				

The financial impact of the 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 recorded in the profit and loss account or balance sheet for their cost. 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 are cancelled prior to their exercise date are deleted from the register of outstanding options.

The directors do not consider it appropriate to disclose a theoretical value of the share options granted during the year to the directors, and one member of senior management and an employee of the Group, because in the absence of a readily available market value of the share options on the ordinary shares of the Company, the directors were unable to arrive at an accurate assessment of the value of these share options.

Apart from the foregoing, at no time during the year ended 31 December 2002 was the Company, or any of its subsidiaries, a party to any arrangement to enable the directors or any of their spouses or children under 18 years of age to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

### SUBSTANTIAL SHAREHOLDERS

As at 31 December 2002, the following interests or short position in the shares of the Company or underlying shares of 5% or more in the issued share capital of the Company were recorded in the register of interests required to be kept by the Company pursuant to Section 336 of the SFO:

Name	Number of shares held	Percentage of holding
Crisana	86,250,000	37.5%
Silver Wave	86,250,000	37.5%

## **SUBSTANTIAL SHAREHOLDERS (Continued)**

Saved as disclosed above, no person or corporation had any interest in the share capital of the Company as recorded in the register required to be kept under Section 336 of the SFO as having an interest or short position in the shares of the Company or underlying shares of 5% or more in the issued share capital of the Company.

## **POST BALANCE SHEET EVENTS**

Details of the significant post balance sheet events of the Group are set out in note 27 to the financial statements.

## **CODE OF BEST PRACTICE**

In the opinion of the directors, following the listing of the Company's shares on the Stock Exchange on 15 May 2002, the Company has complied with the Code of Best Practice (the "Code"), as set out in Appendix 14 of the Listing Rules throughout the accounting period covered by the annual report except that the non-executive directors of the Company are subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the Company's articles of association.

## **AUDIT COMMITTEE**

The Company established an audit committee (the "Committee") on 1 May 2002 with written terms of reference in compliance with the Code, as set out in Appendix 14 of the Listing Rules. The primary duties of the Committee are to review and supervise the financial reporting process and internal controls system of the Group. The Committee comprises two independent non-executive directors. The Group's financial statements for the year ended 31 December 2002 have been reviewed by the members of the Committee, who are of the opinion that such statements comply with applicable accounting standards, the Listing Rules and legal requirements and that adequate disclosures have been made therein.

## **MATERIAL LEGAL PROCEEDINGS**

As at 31 December 2002, the Company was not involved in any material litigation or arbitration and no material litigation or claims was pending or threatened or made against the Company as far as the board of directors was aware of.

## **AUDITORS**

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

ON BEHALF OF THE BOARD

**Tse Kam Pang**

*Chairman and Executive Director*

Hong Kong

28 April 2003