

Notes to the Financial Statements

For The Year Ended 31st December, 2003

1. GROUP RESTRUCTURING

The Company was incorporated in the Cayman Islands on 28th March, 2003 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. Its ultimate holding company is Hop Fung Industries (Holdings) Limited, a company incorporated in the British Virgin Islands.

The Company acts as an investment holding company. The principal activities of its subsidiaries are set out in note 34.

Pursuant to a group reorganisation scheme (the “Group Reorganisation”) to rationalise the structure of the Company and its subsidiaries (hereinafter collectively referred to as the “Group”) in preparation for the listing of the Company’s shares on the Main Board of The Stock Exchange of Hong Kong Limited (the “Stock Exchange”), on 25th August, 2003, the Company issued shares in exchange for the entire issued share capital of Hop Fung Group Company Limited, the former holding company of the Company’s subsidiaries, and thereby becoming the holding company of the Group. Details of the Group Reorganisation and the public offer and placing of shares in the Company are set out in the prospectus dated 15th September, 2003 issued by the Company (the “Prospectus”).

The shares of the Company have been listed on the Stock Exchange with effect from 24th September, 2003.

The Group resulting from the Group Reorganisation is regarded as a continuing entity. Accordingly, the financial statements of the Group have been prepared using the principles of merger accounting in accordance with Statement of Standard Accounting Practice 27 “Accounting for Group Reconstructions” issued by the Hong Kong Society of Accountants.

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention as modified for the revaluation of certain investments in securities.

The financial statements have been prepared in accordance with accounting principles generally accepted in Hong Kong. The principal accounting policies adopted are as follows:

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31st December each year.

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.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue recognition

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

Service income is recognised when services are rendered.

Interest income from bank deposits is accrued on a time basis by reference to the principal outstanding and at the interest rate applicable.

Property, plant and equipment

Property, plant and equipment are stated at cost less depreciation and amortisation and accumulated impairment losses, if any.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in the consolidated income statement.

Depreciation and amortisation are provided to write off the cost of items of property, plant and equipment over their estimated useful lives, using the straight line method, at the following rates per annum:

Land use rights in the People's Republic of China (the "PRC")	Over the term of the leases
Factory premises in the PRC	4%
Leasehold land	Over the terms of the leases
Buildings	4%
Leasehold improvements	20%
Furniture, fixtures and office equipment	10%
Plant, machinery and equipment	10% – 33 ¹ / ₃ %
Motor vehicles	20%

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 leases.

Investments in securities

Investments in securities are recognised on a trade-date basis and are initially measured at cost.

Investments other than held-to-maturity debt securities are classified as investment securities and other investments.

Notes to the Financial Statements

For The Year Ended 31st December, 2003

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments in securities (Continued)

Investment securities, which are securities held for an identified long-term strategic purpose, are measured at subsequent reporting dates at cost, as reduced by any impairment loss that is other than temporary.

Other investments are measured at fair value, with unrealised gains and losses included in net profit or loss for the year.

Investment in equity-linked deposit

Investment in equity-linked deposit is stated at cost, less any impairment loss that is other than temporary.

Investment in subsidiaries

Investment in subsidiaries are included in the Company's balance sheet at cost less any identified impairment loss.

Impairment

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 the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment losses are recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset 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 in prior years. A reversal of an impairment loss is recognised as income immediately.

Inventories

Inventories are stated at the lower of cost and net realisable value and is calculated using the first-in, first-out method. Net realisable value represents the estimated selling price less all estimated costs to completion and costs to be incurred in marketing, selling and distribution.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Leases

Leases are classified as finance leases whenever the terms of the leases transfer substantially all the risks and rewards of ownership of the assets concerned to the Group. Assets which are held under finance leases are capitalised at their fair values at the date of acquisition. The corresponding principal portions of the leasing commitments are shown as obligations of the Group. Finance costs, which represent the difference between the total leasing commitments and the original principal at the inception of the respective leases, are charged to the income statements over the period of the relevant leases so as to produce a constant periodic rate of charge on the remaining balance of the obligations for each accounting period.

All other leases are classified as operating leases and the rentals payable under operating leases are charged to the income statements on a straight line basis over the lease terms.

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 net profit as reported in the income statement because it excludes items of income and expense that are taxable or deductible in other years, and it further excludes income statement items that are never taxable and deductible.

Deferred tax is the tax expected to be payable or recoverable 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 negative goodwill) or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries 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.

Notes to the Financial Statements

For The Year Ended 31st December, 2003

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Taxation (Continued)

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. Deferred tax is charged or credited in the consolidated income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Foreign currencies

Transactions in currencies other than Hong Kong dollars are initially recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities denominated in currencies other than Hong Kong dollars are re-translated into Hong Kong dollars at the rates prevailing on the balance sheet date. Gains and losses arising on exchange are included in the net profit or loss for the period.

On consolidation, the assets and liabilities of the Group's operations outside Hong Kong are translated into Hong Kong dollars at exchange rates prevailing on the balance sheet date. Income and expense items are translated into Hong Kong dollars at the average exchange rates for the year. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed of.

Retirement benefit scheme

The retirement benefit costs charged in the consolidation income statement represent the contributions payable in respect of the current year to the Group's retirement benefit scheme.

3. TURNOVER AND SEGMENT INFORMATION

Turnover

Turnover represents the net amount received and receivable for goods sold during the year.

Segment information

All of the Group's turnover and contribution to operating profit are attributable to the manufacturing and sales of paper-ware products and over 90% of the Group's turnover and contribution to operating profit is attributable to customers who have their manufacturing base in the PRC. Accordingly, no analysis of segment is presented.

As at 31st December, 2002 and 2003, all the Group's assets and liabilities are located in the PRC, including Hong Kong.

Notes to the Financial Statements

For The Year Ended 31st December, 2003

4. OTHER OPERATING INCOME

	2003 HK\$'000	2002 HK\$'000
Service income from customers	1,249	545
Claims received from suppliers	1,052	609
Exchange gain, net	531	193
Unrealised gain on investment in securities	451	–
Interest income	439	552
Scrap sales	3,654	2,801
Sundry income	2,737	1,908
	10,113	6,608

5. PROFIT FROM OPERATIONS

	2003 HK\$'000	2002 HK\$'000
Profit from operations has been arrived at after charging (crediting):		
Allowance for (write back of) doubtful debts	1,400	(690)
Auditors' remuneration	529	273
Cost of inventories recognised as expenses	430,923	273,949
Depreciation and amortisation	12,239	11,679
Loss on disposal of property, plant and equipment	165	–
Operating lease rental for warehouse and office premises	158	192
Staff costs		
Directors' emoluments (<i>note 6</i>)	6,356	4,804
Other staff		
– salaries and other allowances	6,054	4,905
– retirement benefit scheme contribution	207	128
	12,617	9,837
Unrealised loss on investments in securities	–	112

Notes to the Financial Statements

For The Year Ended 31st December, 2003

6. DIRECTORS' EMOLUMENTS AND FIVE HIGHEST PAID EMPLOYEES

Directors

The directors' emoluments for the year are analysed as follows:

	2003 HK\$'000	2002 HK\$'000
Fees to independent non-executive directors	49	–
Other emoluments to executive directors		
– salaries and other allowances	3,183	2,350
– discretionary bonuses	3,052	2,394
– retirement benefit scheme contribution	72	60
	6,307	4,804
	6,356	4,804

The emoluments of the directors were within the following bands:

	2003 Number of directors	2002 Number of directors
Nil to HK\$1,000,000	4	3
HK\$1,000,000 to HK\$1,500,000	4	3

Employees

The five highest paid individuals of the Group were all directors for each of the two years ended 31st December, 2003, details of whose emoluments are set out above.

Notes to the Financial Statements

For The Year Ended 31st December, 2003

7. FINANCE COSTS

	2003 HK\$'000	2002 HK\$'000
Interest on bank borrowings wholly repayable within five years	2,916	4,157
Interest on discounted bills	182	223
	3,098	4,380
Finance charges on obligations under finance leases	384	301
Bank charges	691	680
	4,173	5,361

8. TAXATION

	2003 HK\$'000	2002 HK\$'000
The charge comprises:		
Current taxation		
– Hong Kong Profits Tax	4,383	3,206
Deferred taxation (<i>note 25</i>)	1,380	210
	5,763	3,416

Hong Kong Profits Tax is calculated at 17.5% (2002: 16%) on the estimated assessable profit for the year. In June 2003, the Hong Kong Profits Tax rate was increased from 16% to 17.5% with effect from the year of assessment 2003/2004. The effect of this increase has been reflected in the calculation of current and deferred tax balances at 31st December, 2003.

A portion of the Group's profits neither arises in, nor is derived from, Hong Kong. Accordingly, that portion of the Group's profit is not subject to Hong Kong Profits Tax. Further, in the opinion of the directors, that portion of the Group's profit is not at present subject to taxation in any other jurisdiction in which the Group operates.

Notes to the Financial Statements

For The Year Ended 31st December, 2003

8. TAXATION (Continued)

The tax charge for the year can be reconciled to the profit before taxation per the consolidated income statement as follows:

	2003 HK\$'000	2002 HK\$'000
Profit before taxation	61,450	40,876
Tax at Hong Kong Profits Tax rate of 17.5% (2002: 16%)	10,754	6,540
Tax effect of income not taxable for tax purpose	(5,486)	(3,336)
Tax effect of expenses not deductible for tax purpose	37	270
Increase in opening deferred tax liabilities resulting from an increase in Hong Kong Profits Tax rate	198	–
Others	260	(58)
Tax expense for the year	5,763	3,416

9. DIVIDENDS

	2003 HK\$'000	2002 HK\$'000
Dividends paid by certain subsidiaries to their then shareholders prior to the Group Reorganisation becoming effective	30,000	30,000

The final dividend in respect of 2003 of 1.26 HK cents per share has been proposed by the directors and is subject to approval by the shareholders in the forthcoming annual general meeting.

10. EARNINGS PER SHARE

The calculation of the basic and diluted earnings per share is based on the following data:

	THE GROUP	
	2003 HK\$'000	2002 HK\$'000
Earnings		
Profit for the year	55,687	37,460
Number of shares	2003	2002
Weighted average number of shares for the purpose of basic earnings per share	295,735,003	270,000,000
Effect of dilutive potential shares in respect of share options	170,995	
Weighted average number of shares for the purpose of diluted earnings per share	295,905,998	

Both the weighted average number of shares for 2003 and the number of shares for 2002 have been arrived at on the assumption that the 2,000,000 shares issued upon the Group Reorganisation and the 268,000,000 shares issued pursuant to the capitalisation issue, as described more fully in notes 24(c) and 24(d), had been completed prior to 1st January, 2002.

Notes to the Financial Statements

For The Year Ended 31st December, 2003

11. PROPERTY, PLANT AND EQUIPMENT

	Land use rights in the PRC HK\$'000	Factory premises in the PRC HK\$'000	Leasehold land and buildings HK\$'000	Leasehold improve- ments HK\$'000	Furniture, fixtures and office equipment HK\$'000	Plant, machinery and equipment HK\$'000	Motor vehicles HK\$'000	Total HK\$'000
THE GROUP								
COST								
At 1st January, 2003	8,202	22,043	425	1,941	2,714	86,420	4,248	125,993
Additions	507	-	1,463	5,852	1,481	9,815	599	19,717
Disposals	-	-	-	-	(9)	(589)	-	(598)
At 31st December, 2003	8,709	22,043	1,888	7,793	4,186	95,646	4,847	145,112
DEPRECIATION AND AMORTISATION								
At 1st January, 2003	634	3,838	4	753	647	28,132	3,091	37,099
Provided for the year	195	906	41	912	358	9,371	456	12,239
Eliminated on disposals	-	-	-	-	(1)	(241)	-	(242)
At 31st December, 2003	829	4,744	45	1,665	1,004	37,262	3,547	49,096
NET BOOK VALUES								
At 31st December, 2003	7,880	17,299	1,843	6,128	3,182	58,384	1,300	96,016
At 31st December, 2002	7,568	18,205	421	1,188	2,067	58,288	1,157	88,894

The land use rights in the PRC are held under medium term leases.

The leasehold land and buildings are situated in Hong Kong and are held under medium term leases.

11. PROPERTY, PLANT AND EQUIPMENT (Continued)

Net book value of property, plant and equipment held under finance leases are as follows:

	THE GROUP	
	2003	2002
	HK\$'000	HK\$'000
Plant, machinery and equipment	12,925	25,719

12. PREPAYMENTS UNDER PROCESSING ARRANGEMENT

The amount of prepayments under processing arrangement disclosed in the consolidated balance sheet represents the unutilised balance of prepayments made by Fung Kong Hop Fung Paper Ware Factory Limited to 東莞鳳崗塘瀝合豐紙品廠 (the "FG Processing Factory") for the construction of the factory premises and other ancillary facilities of the FG Processing Factory as set out in the processing agreement and confirmation (the "FG Processing Arrangement").

Pursuant to the FG Processing Arrangement, a portion of the future processing fees and other processing expenses payable by the Group can be settled by way of setting off against the balance of prepayments over the expected remaining contract period of the FG Processing Arrangement. Accordingly, the prepayments are charged to the consolidated income statement of the Group over the expected remaining contract period of the FG Processing Arrangement.

13. INVESTMENTS IN SECURITIES

	THE GROUP	
	2003	2002
	HK\$'000	HK\$'000
Unlisted investments in mutual funds, at fair value	7,328	6,877

The Group has pledged the investments in securities to a bank to secure the banking facilities granted to the Group.

Notes to the Financial Statements

For The Year Ended 31st December, 2003

14. INVESTMENT IN SUBSIDIARIES

THE COMPANY
2003
HK\$'000

Unlisted shares

113,455

The carrying value of the unlisted shares is based on the book values of the underlying net assets of the subsidiaries attributable to the Group at the date on which the Company became the holding company of the Group pursuant to the Group Reorganisation as set out in note 1.

Particulars of the subsidiaries at 31st December, 2003 are set out in note 34.

15. INVENTORIES

THE GROUP

2003 2002
HK\$'000 HK\$'000

At cost:

Raw materials

39,805

27,728

Work in progress

654

308

Finished goods

2,118

780

42,577

28,816

16. TRADE AND OTHER RECEIVABLES

The Group has a policy of allowing average credit period of 5-120 days to its trade customers and may be extended to selected customers depending on their trade volume and settlement with the Group.

An aged analysis of trade receivables is as follows:

	2003 HK\$'000	2002 HK\$'000
Current	71,500	47,856
Overdue 1 to 30 days	11,120	5,112
Overdue 31 to 60 days	–	88
	82,620	53,056
Other receivables	646	1,252
	83,266	54,308

17. AMOUNTS DUE FROM RELATED COMPANIES

THE GROUP

Particulars of the amounts due from related companies are as follows:

Name of related company	Balance at 31.12.2003 HK\$'000	Balance at 31.12.2002 HK\$'000	Maximum amount outstanding during the year HK\$'000
Fung Kong Wing Lung Paper Ware Factory Limited	652	619	1,425
Hop Fung Group (HK) Limited	–	4,810	8,421
Nga Tat Paper Products Factory	–	375	375
Wing Lung Paper Ware Factory	–	557	557
	652	6,361	

Notes to the Financial Statements

For The Year Ended 31st December, 2003

17. AMOUNTS DUE FROM RELATED COMPANIES (Continued)

THE GROUP (Continued)

The amounts due from related companies are unsecured, interest free and are repayable on demand. Except for the amount due from Fung Kong Wing Lung Paper Ware Factory Limited which is a trade balance, all other outstanding balances with related companies have been fully settled before the listing of the Company's shares on the Stock Exchange.

Fung Kong Wing Lung Paper Ware Factory Limited and Wing Lung Paper Ware Factory are beneficially owned by Ms. Hui Yuk Ling, sister of Messrs. Hui Sum Kwok, Hui Sum Ping and Hui Sum Tai, executive directors of the Company.

Messrs. Hui Sum Kwok, Hui Sum Ping and Wong Wing Por, all being executive directors of the Company, have beneficial interests in Hop Fung Group (HK) Limited.

Mr. Shum Lit Ki, an indirect shareholder of the Company, has beneficial interest in Nga Tat Paper Products Factory which was sold to third party on 1st January, 2003 and therefore ceased to be a related company thereafter.

18. AMOUNTS DUE FROM SUBSIDIARIES

THE COMPANY

The amounts are unsecured and repayable on demand. Other than an amount of HK\$32,601,000 which bears interest at prevailing market rates, all remaining balances are interest-free.

19. PLEDGED BANK DEPOSITS

THE GROUP

The amounts represent deposits pledged to banks to secure the banking facilities granted to the Group.

20. TRADE AND OTHER PAYABLES

THE GROUP

An aged analysis of the trade payables is as follows:

	2003 HK\$'000	2002 HK\$'000
Current	29,238	17,925
Overdue 1 to 30 days	4,462	195
Overdue 31 to 60 days	26	3
Overdue for more than 60 days	315	89
	34,041	18,212
Other payables and accrued charges	29,328	14,988
	63,369	33,200

21. OBLIGATIONS UNDER FINANCE LEASES

THE GROUP

	Minimum lease payments		Present value of minimum lease payments	
	2003 HK\$'000	2002 HK\$'000	2003 HK\$'000	2002 HK\$'000
Within one year	3,859	4,976	3,694	4,506
More than one year, but not exceeding two years	3,859	4,226	3,765	3,926
More than two years, but not exceeding five years	3,035	7,049	3,008	6,832
	10,753	16,251	10,467	15,264
Less: Future finance charges	(286)	(987)	-	-
Present value of lease obligations	10,467	15,264	10,467	15,264
Less: Amount due within one year shown under current liabilities			(3,694)	(4,506)
Amount due after one year			6,773	10,758

The Group's obligations under finance leases are secured by the lessor's charge over the leased assets.

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22. BANK BORROWINGS – SECURED

	THE GROUP	
	2003 HK\$'000	2002 HK\$'000
Secured bank borrowings comprise:		
Bank loans	48,439	17,025
Bank overdraft	648	–
	<u>49,087</u>	<u>17,025</u>

The maturity profile of the above loans and overdraft is as follows:

	2003 HK\$'000	2002 HK\$'000
On demand or within one year	14,145	8,643
More than one year, but not exceeding two years	15,517	3,382
More than two years, but not exceeding five years	19,425	5,000
	<u>49,087</u>	<u>17,025</u>
Less: Amount due within one year shown under current liabilities	(14,145)	(8,643)
Amount due after one year	<u>34,942</u>	<u>8,382</u>

At the balance sheet date, the above bank borrowings are secured by the followings:

- pledged bank deposits of approximately HK\$16,519,000 (2002: HK\$13,515,000);
- machinery with net book value of approximately HK\$2,946,000 (2002: HK\$3,438,000);
- investments in securities of approximately HK\$7,328,000 (2002: HK\$6,877,000); and
- investment in equity-linked deposit of approximately HK\$2,002,000 (2002: nil).

In addition, the bank borrowings at 31st December, 2002 were also secured by certain guarantees and properties provided by related parties as set out in notes 33(b), (c), (d) and (e).

23. AMOUNTS DUE TO SUBSIDIARIES

THE COMPANY

The amounts are unsecured, interest free and are repayable on demand.

24. SHARE CAPITAL

	Number of shares	Nominal value HK\$'000
Shares of HK\$0.10 each		
Authorised:		
On incorporation	1,000,000	100
Increase in authorised share capital (<i>note (b)</i>)	999,000,000	99,900
At 31st December, 2003	1,000,000,000	100,000
Issued and fully paid:		
Allotted and issued on 3rd April, 2003		
and on 25th August, 2003 (<i>notes (a) and (c)</i>)	2,000,000	200
Shares issued at premium on share offer (<i>note (e)</i>)	95,042,000	9,504
Shares issue on capitalisation of share premium account (<i>note (d)</i>)	268,000,000	26,800
At 31st December, 2003	365,042,000	36,504

The following changes in the share capital of the Company took place during the period from 28th March, 2003 (date of incorporation) to 31st December, 2003:

- (a) The Company was incorporated on 28th March, 2003 with an authorised share capital of HK\$100,000 divided into 1,000,000 shares of HK\$0.10 each. On 3rd April, 2003, 1,000,000 shares were allotted and issued at nil paid to the then shareholders of Hop Fung Group Company Limited (the "Then Shareholders").
- (b) On 25th August, 2003, the authorised share capital of the Company was increased from HK\$100,000 to HK\$100,000,000 by the creation of an additional 999,000,000 new shares of HK\$0.10 each. The new shares rank pari passu in all respects with the existing shares.

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24. SHARE CAPITAL (Continued)

- (c) On 25th August, 2003, the Company issued 1,000,000 shares of HK\$0.10 each, credited as fully paid, to the Then Shareholders and credited as fully paid at par the 1,000,000 shares of HK\$0.10 each issued as nil paid on 3rd April, 2003 held by the Then Shareholders as consideration for the acquisition of the entire issued share capital of Hop Fung Group Company Limited.
- (d) 268,000,000 shares of HK\$0.10 each in the Company were allotted and issued as fully paid to the shareholders of the Company whose names appeared on the register of members at the close of business on 3rd September, 2003 in proportion to their respective shareholdings by the capitalisation of an amount of HK\$26,800,000 from the amount standing to the credit of the share premium account of the Company.
- (e) On 23rd September, 2003, 90,000,000 new shares of HK\$0.10 each in the Company were issued at a price of HK\$1.10 per share to the public by way of public offer and placing. On 15th October, 2003, an additional 5,042,000 new shares of HK\$0.10 each in the Company were issued at HK\$1.10 per share to certain investors pursuant to the exercise of the over-allotment option granted by the Company to the underwriters as set out in the Prospectus.

The proceeds from the shares issued above shall be used for financing the Group's expansion of existing manufacturing facilities; setting up of the manufacturing operations mainly for domestic sales in the PRC and for upstream medium paper production; and as general working capital.

The balance of share capital at 31st December, 2002 as shown in the consolidated balance sheet represented the aggregate amount of the nominal value of the share capital of the companies comprising the Group.

25. DEFERRED TAXATION

THE GROUP

The following are the deferred tax liabilities (assets) recognised by the Group and movements thereon during the current and prior reporting period:

	Accelerated tax depreciation	Tax losses	Total
	HK\$'000	HK\$'000	HK\$'000
At 1st January, 2002	4,836	(2,935)	1,901
(Credit) charges to income for the year	(617)	827	210
At 31st December, 2002	4,219	(2,108)	2,111
Charge to income for the year	1,176	204	1,380
At 31st December, 2003	5,395	(1,904)	3,491

26. SHARE PREMIUM AND RESERVE

	Share premium	Retained profits	Total
	HK\$'000	HK\$'000	HK\$'000
THE COMPANY			
Premium arising on Group			
Reorganisation (<i>note below</i>)	113,255	–	113,255
Shares issued at premium on			
share offer (<i>note 24 (e)</i>)	95,042	–	95,042
Shares issue expenses	(13,029)	–	(13,029)
Shares issue on capitalisation of			
share premium account			
(<i>note 24(d)</i>)	(26,800)	–	(26,800)
Profit for the year	–	8,043	8,043
At 31st December, 2003	168,468	8,043	176,511

Note:

The amount represents the difference between the aggregate amount of the underlying net assets of the subsidiaries at the date on which the Group Reorganisation became effective and the nominal amount of share capital issued by the Company pursuant to the Group Reorganisation.

27. SHARE OPTION SCHEME

The Company's share option scheme (the "Scheme") was adopted pursuant to a resolution passed on 4th September, 2003 for the primary purpose of providing incentives or rewards to selected participants for their contribution to the Group. The Scheme will expire on 3rd September, 2013.

Under the Scheme, the Board of Directors of the Company may grant options to eligible employees, including executive or non-executive directors, of the Company, its subsidiaries, or any entity ("Invested Entity") in which any member of the Group holds any equity interest, to subscribe for shares in the Company. Additionally, the Company may, from time to time, grant share options to any supplier of goods or services to any member of the Group or any Invested Entity, any customer of the Group or any Invested Entity, and any consultants, advisers, managers, officers or entities that provides research, development or other technological support to the Group or any Invested Entity.

The total number of shares which may be issued upon exercise of all options to be granted under the Scheme is not permitted to exceed 10% of the shares of the Company in issue which can be refreshed according to the Scheme. The number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised at any time under the Scheme shall not exceed 30% of the issued share capital of the Company from time to time.

The number of shares in respect of which options may be granted to any individual in any 12-month period is not permitted to exceed 1% of the shares of the Company in issue at any point in time, without prior approval from the Company's shareholders in accordance with the Scheme. Where any grant of options to a substantial shareholder or an independent non-executive director or any of their respective associates would result in the shares in the Company issued and to be issued upon exercise of all options to such person in the 12-month period up to and including the date of grant in excess of 0.1% of the shares of the Company in issue and with a value (based on the closing price of the shares of the Company at the offer date of each offer) in excess of HK\$5,000,000, such grant of options must be approved in advance by the Company's shareholders in accordance with the Scheme.

An option may be exercised at any time during the period to be determined and notified by the Directors to the grantee and in the absence of such determination, from the date of acceptance of an offer of the grant of such option to the earlier of the date on which such option lapses according to the Scheme and ten years from the date of offer of that option. A consideration of HK\$1 is payable upon acceptance of the offer.

The exercise price is determined by the directors of the Company, and will not be less than the higher of the nominal value of the share; the closing price of the Company's shares on the date of offer; and the average closing price of the shares for the five business days immediately preceding the date of offer.

27. SHARE OPTION SCHEME (Continued)

The following table discloses details of the Company's share options held by the directors and the employees, and movements in such holdings during the year:

Category	Date of grant	Exercisable period (Note)	Exercise price HK\$	Share options granted during the year and outstanding at end of year
Directors	3.11.2003	3.5.2004 – 3.11.2006	1.13	13,826,000
Other Employees	3.11.2003	3.5.2004 – 3.11.2006	1.13	2,174,000
Total all categories				<u>16,000,000</u>

Note:

Holders of share options granted under the Scheme may only exercise their options as follows:

Exercisable period	Maximum % of share options exercisable
3.5.2004 – 3.11.2004	up to 50%
4.11.2004 – 3.11.2005	up to 75% (to the extent not already exercised)
4.11.2005 – 3.11.2006	up to 100% (to the extent not already exercised)

Total consideration received during the year from directors and employees for taking up the share options granted amounted to HK\$27.

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 consolidated 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.

28. MAJOR NON-CASH TRANSACTIONS

During the year ended 31st December, 2002, the Group entered into finance lease arrangements in respect of property, plant and equipment with a capital value at the inception of the lease of HK\$14,756,000.

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For The Year Ended 31st December, 2003

29. OPERATING LEASE COMMITMENTS

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating lease which fall due as follows:

	THE GROUP	
	2003 HK\$'000	2002 HK\$'000
Within one year	32	–
In the second to fifth years inclusive	5	–
	<u>37</u>	<u>–</u>

Operating lease payments represent rentals payable by the Group for certain of its warehouse, ancillary office properties and car parks.

Lease is negotiated for a term of one year with fixed monthly rentals over the term of the lease.

The Company did not have any operating lease commitments at the balance sheet date.

30. CAPITAL COMMITMENTS

	THE GROUP	
	2003 HK\$'000	2002 HK\$'000
Capital expenditure in respect of the acquisition of plant and equipment contracted for but not provided in the financial statements	<u>1,424</u>	<u>741</u>

The Company did not have any capital commitments at the balance sheet date.

31. RETIREMENT BENEFIT SCHEME

The Group has joined a Mandatory Provident Fund Scheme (the “MPF Scheme”) for its employees in Hong Kong. The MPF Scheme is registered with the Mandatory Provident Fund Scheme Authority under the Mandatory Provident Fund Scheme Ordinance. 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 rule of the MPF Scheme, the employer and its employees are each required to make contributions to the MPF Scheme at rates specified in the rules. The only obligation of the Group with respect to the MPF Scheme is to make the required contributions under the MPF Scheme.

31. RETIREMENT BENEFIT SCHEME (Continued)

The retirement benefit scheme contributions arising from the MPF Scheme charged to the consolidated income statement represent contributions payable to the funds by the Group at rates specified in the rules of the scheme.

32. CONTINGENT LIABILITIES

THE COMPANY

At 31st December, 2003, the Company had contingent liabilities of HK\$68,238,000, representing the extent of banking facilities utilised by the subsidiaries in respect of which corporate guarantees were given by the Company.

33. RELATED PARTY TRANSACTIONS

(a) During the year, the Group had the following transactions with related companies:

Name	Notes	Nature of transactions	2003 HK\$'000	2002 HK\$'000
Hop Fung Properties Limited	(i)	Rental paid to	138	192
Nga Tat Paper Products Factory	(ii)	Sales of goods to	–	2,149
Wing Lung Paper Ware Factory	(ii)	Sales of goods to	–	6,280
Fung Kong Wing Lung Paper Ware Factory Limited	(ii)	Sales of goods to	7,507	564
Hop Fung (Australia) Pty Ltd	(iii)	Agency services	–	–

Notes:

- (i) Rental expenses charged by Hop Fung Properties Limited are calculated in accordance with the terms specified in the rental agreements entered into by both parties. Messrs. Hui Sum Kwok, Hui Sum Ping and Wong Wing Por, all being executive directors of the Company, have beneficial interests in Hop Fung Properties Limited. The rental expenses were ceased upon the acquisition of the relevant property units by the Group from Hop Fung Properties Limited on 22nd August, 2003 (note 33(c)).
- (ii) Sales to related parties were determined on a cost-plus basis with reference to the market condition, and were negotiated on a case by case basis and mutually agreed by both parties.
- (iii) The Group has engaged Hop Fung (Australia) Pty Ltd as the Group's purchase agent in Australia at an annual fee of HK\$1 for the agency services rendered to the Group. The total value of goods purchased under this arrangement from the supplier amounted to HK\$34,137,000 (2002: HK\$26,980,000). Hop Fung (Australia) Pty Ltd is a company in which Mr. Hui Sum Kwok, director of the Company, has beneficial interest.

Notes to the Financial Statements

For The Year Ended 31st December, 2003

33. RELATED PARTY TRANSACTIONS (Continued)

- (b) Certain directors provided unlimited personal guarantees to banks as part of the securities to secure for banking facilities granted to the Group during the year. These personal guarantees were released and replaced by the corporate guarantees executed by the Company or members of the Group subsequent to the listing of the Company's shares on the Stock Exchange.
- (c) A related company in which Messrs. Hui Sum Kwok, Hui Sum Ping and Wong Wing Por, all being executive directors of the Company, have beneficial interests, pledged its properties to a bank as part of the securities to secure for banking facilities granted to the Group. Pursuant to an assignment dated 22nd August, 2003, the Group acquired these properties from the related company for a total consideration of HK\$1,500,000. The consideration paid by the Group was based on the valuation as at 31st July, 2003 of the properties made by DTZ Debenham Tie Leung Limited, an independent property valuer. The security of these properties ceased to be provided by the above related company upon the acquisition of such properties by the Group.
- (d) A subsidiary of the Company had provided corporate guarantees to and cross corporate guarantees with certain related companies, in which certain directors have beneficial interests, for facilities provided by the banks. The guarantees were released subsequent to the listing of the Company's shares on the Stock Exchange.
- (e) Mr. Hui Sum Kwok, a director of the Company, and Ms. Wong Mui, spouse of Mr. Hui Sum Kwok, have pledged their property and assigned the rental income from the property to bank as part of the securities to secure for banking facilities granted to the Group during the year. The security was ceased to be provided by Mr. Hui Sum Kwok and Ms. Wong Mui subsequent to the listing of the Company's shares on the Stock Exchange.
- (f) On 24th May, 2003, the Group entered into a trademark license agreement with Hop Fung Group HK whereby Hop Fung Group HK agreed to grant an irrevocable and exclusive license to the Group to use one of the trademarks currently used by the Group in Hong Kong before it is assigned to the Company as mentioned below, for a nominal consideration of HK\$1. Hop Fung Group HK also agreed and undertook to the Company that, for a nominal consideration of HK\$1, it shall assign and transfer all legal and beneficial rights of the trademark upon request of the Company after the trademark is duly registered with the Register of Trade Marks in Hong Kong.

34. PARTICULARS OF SUBSIDIARIES

Particulars of the subsidiaries which are wholly-owned by the Company as at 31st December, 2003 are as follows:

Name of subsidiary	Place of incorporation/ operation	Issued and fully paid share capital	Principal activities
Fung Kong Hop Fung Paper Ware Factory Limited	Hong Kong	Ordinary shares HK\$100 Non-voting deferred shares HK\$3,000,000 (Note)	Manufacturing and sales of paper-ware products
Fung Kong Shing Fung Paper Ware Factory Limited	Hong Kong	Ordinary shares HK\$2	Investment holding
Gong Ming Hop Fung Paper Ware Factory Limited	Hong Kong	Ordinary shares HK\$100 Non-voting deferred shares HK\$3,000,000 (Note)	Trading of paper-ware products
Hop Fung Group Company Limited	British Virgin Islands/ Hong Kong	Ordinary shares US\$600	Investment holding
Hop Fung (Overseas) Trading Limited	British Virgin Islands/ PRC	Ordinary shares US\$1	Trading of paper-ware products
Hop Fung Paper Ware Development Limited	Hong Kong	Ordinary shares HK\$10,000	Provision of management service
Top Develop Limited	British Virgin Islands	Ordinary shares US\$1	Investment holding
東莞進益紙品有限公司	PRC	HK\$10,000,000	Not yet commenced business

Note: The non-voting deferred shares of HK\$1 each are not held by the Group and practically carrying no right to dividend or to receive notice of or to attend or vote at any annual general meeting of the companies. On winding up, the holders of the deferred shares are entitled to the distribution after the distribution of HK\$100,000,000 million to holders of ordinary shares, as specified in the articles of association.

Other than Hop Fung Group Company Limited, all subsidiaries are indirectly held by the Company.

None of the subsidiaries had any debt securities subsisting at 31st December, 2003 or at any time during the year.