

# Management Discussion and Analysis

## - Report of the Directors

The Directors are pleased to present the annual report together with the audited financial statements of the Group for the Year.

### **GROUP REORGANISATION AND SHARE LISTING**

Pursuant to a group reorganisation (the "Reorganisation") to rationalise the group structure in preparation for the listing of the Company's shares on the Stock Exchange of Hong Kong Limited (the "Stock Exchange"), the Company became the holding company of the companies now comprising the Group formed after the completion of the Reorganisation on 9 June 2003. Details of the Reorganisation are set out in notes 1 and 18 to the financial statements.

On 30 June 2003, the Group was spun off from Ocean Grand Holdings Limited and became a company listed on the Main Board of the Stock Exchange. This move is a key step within the growth strategy of the Group. Not only are funds being raised for growth initiatives such as establishment of a sales and marketing network in the PRC, promotion of our brand name "Kenlap" and the setting up of a comprehensive Research and Development Department in the Zhuhai Plant, the listing also gives the Group a separate listing status which facilitates the formation and implementation of future development plans.

### **PRINCIPAL ACTIVITIES**

The Company is a holding company. Its subsidiaries are principally engaged in the subcontracting, manufacturing and trading of precious metal electroplating chemicals (namely gold salt, silver salt, palladium salt and rodium sulphate) in the PRC and Hong Kong. The production bases are located in Zhuhai City, the PRC, and Hung Hom, Hong Kong.

Segmental information of the Group's turnover and contribution to profit from operations for the year ended 31 March 2004 is set out in note 27 to the financial statements.

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### FINANCIAL REVIEW

#### Liquidity and Financial Resources

As at 31 March 2004, the net current assets of the Group were HK\$276,297,000 (2003: HK\$64,900,000). HK\$83,014,000 (2003: HK\$36,635,000), with 19% (2003: 17%) of the total current assets being free cash and cash equivalent. The current ratio of the Group as at 31 March 2004 was 280% (2003: 144%).

The Group obtained equity financing amounting to approximately HK\$58,000,000 by listing the Company's shares on the Main Board of the Stock Exchange on 30 June 2003. The financing from Ocean Grand Holdings Limited and its subsidiaries to the Group had been fully repaid prior to the listing of the Company's shares on the Stock Exchange on 30 June 2003. The shareholders base of the Company comprised of predominately long-term institutional investors.

During the financial year ended 31 March 2004, the Group generally financed its operations with internally generated resources and banking facilities. As at 31 March 2004, shareholders' fund of the Group was HK\$252,114,000 (2003: HK\$154,828,000), while aggregate composite banking facilities was approximately HK\$357,058,000 (2003: HK\$74,190,000), of which approximately HK\$216,030,000 (2003: HK\$30,534,000) had been utilised. This gave rise to a gross debt gearing (i.e. total bank borrowings/net assets) of 85.7% (2003: 19.7%).

In February 2004, the Group obtained a HK\$120 million term loan facility from a syndicate of banks to finance the establishment of two new production lines, namely the silver nitrate production line and the electroplating fluid recovery line, and to provide additional working capital.

#### Foreign Exchange Risk and Interest Rate Risk

The majority of the transactions of the Group is denominated in either HK\$ and RMB. All bank borrowings of the Group are on a floating rate basis. In the opinion of the management, the Group's exposure to foreign exchange risk and interest rate risk are insignificant. Hence, hedging for these risks by means of derivative instruments is considered unnecessary.

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### CAPITAL EXPENDITURE PLAN

In the coming year, the Group is planning to invest around HK\$80,000,000 in the setting up of two new production lines, namely the silver nitrate production line and the electroplating fluid recovery line, which are scheduled to commence operation by the end of 2004 or early 2005. The Group has arranged a HK\$120 million syndicated loan to finance such capital expenditure.

The management is confident that the new production facilities will provide momentum to the expansion of our product and service range, which will enable the Group to consolidate its leading position in the industry.

### CUSTOMERS AND SUPPLIERS

For the financial year ended 31 March 2004, the five largest customers of the Group accounted for approximately 63% of the Group's turnover, while the five largest suppliers accounted for approximately 96% of the Group's total purchases. In addition, the largest customer of the Group accounted for approximately 25% of the Group's sales revenue and the largest supplier of the Group accounted for approximately 55% of the Group's purchases.

None of the Directors, their associates, or any shareholders (which to the knowledge of the Directors owned more than 5% of the Company's share capital) had a beneficial interest in the Group's five largest customers and five largest suppliers.

### RESULTS AND APPROPRIATIONS

Details of the Company's and the Group's results for the year ended 31 March 2004 are set out on pages 27 to 66 to this 2004 annual report.

The Directors recommend the payment of a final dividend of HK\$0.04 cents per share (*2003: HK\$0.04 per share*) totalling HK\$19,000,000 to the shareholders registered in the Company's register of members as at the close of business on 7 September 2004. An interim dividend of HK\$0.02 per share was declared by the Company during the year (*2003: Nil*), the total dividend per share for the financial year ended 31 March 2004 is HK\$0.06 (*2003: HK\$0.04*). Subject to the approval of shareholders at the forthcoming Annual General Meeting (the "AGM") of the Company, the dividend warrants are expected to be despatched on or before 5 October 2004 to shareholders whose names appear on the Register of Members of the Company on 7 September 2004.

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### CLOSURE OF REGISTER OF MEMBERS

The Register of Members of the Company will be closed from 2 September 2004 to 7 September 2004, both days inclusive in order to determine those shareholders entitled to the proposed final dividend, during which period no transfer of shares shall be effected. In order to qualify for the final dividend, all transfers, accompanied by the relevant share certificates, must be lodged with the Hong Kong branch registrar of the Company, Tengis Limited of G/F., BEA Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong not later than 4:30 pm on 1 September 2004.

### CAPITAL STRUCTURE

The Company's shares were listed on the Main Board of the Stock Exchange on 30 June 2003. In order to prepare for the listing, the following transactions which affect the capital structure of the Company were effected.

On 9 June 2003, the authorised share capital of the Company was increased from HK\$100,000 divided into 1,000,000 shares of HK\$0.10 each to HK\$100,000,000 divided into 1,000,000,000 shares of HK\$0.10 each, such shares carrying the rights and being subject to the restrictions as set out in the bye-laws of the Company.

The companies comprising the Group underwent a reorganisation ("Reorganisation") and as a result Ocean Grand Chemicals (BVI) Limited ("OGCBVI") became the intermediate holding company and the Company became the holding company of the Group. The Reorganisation involved the following:

1. OGCBVI was incorporated in the British Virgin Islands on 24 July 2002.
2. On 9 August 2002, one ordinary share in the capital of OGCBVI was allotted and issued for cash at par to Successful Gold Profits Limited ("Successful Gold"), the immediate holding company of the Company.
3. On 6 June 2003, two ordinary shares in the capital of Kenlap P.G.C. Manufacturer Company Limited ("Kenlap PGC") were allotted and issued for cash at par to OGCBVI and its nominee.
4. On 6 June 2003, in consideration of the allotment and issuance of 1,006,476 shares of US\$0.01 each in the capital of OGCBVI to Successful Gold, 1,006,477 shares of HK\$1.00 each in the issued share capital of Kenlap PGC held by Successful Gold and its nominee were converted into 1,006,477 non-voting deferred shares of HK\$1.00 each.
5. On 6 June 2003, in consideration of the allotment and issuance of 106,875 shares of US\$0.01 each in the capital of OGCBVI to twelve independent investors in accordance with their respective proportion in the shareholding in Kenlap PGC, 106,875 shares of HK\$1.00 each in the issued share capital of Kenlap PGC held by the twelve independent investors were converted into 106,875 non-voting deferred shares of HK\$1.00 each.

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### **CAPITAL STRUCTURE (continued)**

6. On 9 June 2003, the Company acquired 1,113,352 shares of US\$0.01 each of OGCBVI from Successful Gold and the twelve independent investors, and issued 1,012,915 shares, credited as fully paid, to Successful Gold and 213,761 shares, credited as fully paid, to the twelve independent investors.

On 26 June 2003, 394,273,324 new shares were allotted to the persons whose names appeared on the register of members of the Company in proportion to their then existing shareholdings in the Company. These shares rank pari passu with the then existing shares, and are credited as fully paid up at par by way of capitalisation of an amount of HK\$39,427,332 from the share premium account.

On 26 June 2003, 78,500,000 new shares were issued by the Company at HK\$0.88 each under the initial public offering of the Company's shares. These new shares rank pari passu with the then existing shares, and are credited as fully paid up.

### **SHARE CAPITAL AND SHARE OPTIONS**

Movements in share capital of the Company and details of share option schemes of the Company are set out in notes 18 and 19 to the financial statements.

### **RESERVES**

Movements in reserves of the Group and the Company during the Year are set out in note 20 to the financial statements.

### **USE OF PLACING AND PUBLIC OFFER PROCEEDS**

The Group uses the placing and public offer proceeds to conduct advertising and marketing campaign, set up branches and representative offices in Asia, fund its research and development projects. The rest of the proceeds will be applied as general working capital. During the Year, four representative offices were set up and road shows were launched from time to time to expand the sales network, which amount to HK\$10 million.

### **FIVE YEAR FINANCIAL SUMMARY**

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 4 to this 2004 annual report.

### **PURCHASE, SALE OR REDEMPTION OF SHARES**

Neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of the Company's shares on the Stock Exchange during the year ended 31 March 2004 (2003: Nil).

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### PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's bye-laws and the laws of Bermuda.

### SUBSIDIARIES

Particulars of the Company's subsidiaries are set out in note 13 to the financial statements.

### FIXED ASSETS

Movements of fixed assets during the Year are set out in notes 10 and 11 to the financial statements.

### BANK LOANS AND BORROWING COSTS CAPITALISED

Particulars of bank loans as at 31 March 2004 are set out in note 17 to the financial statements. Borrowing costs capitalised by the Group during the Year in respect of construction-in-progress amounted to HK\$Nil (2003: HK\$6,080,000).

### PLEDGE OF ASSETS

Details of pledge of assets are disclosed in note 26 to the financial statements.

### CONTINGENT LIABILITIES

Details of the contingent liabilities are set out on note 25 to the financial statements.

### PENSION SCHEMES

Details of the pension schemes are set out in note 22 to the financial statements.

### STAFF POLICY

Staff costs are disclosed in note 4 to this 2004 annual report.

The management firmly believes that an organisation's most precious asset is its staff. The Group offers competitive remuneration packages at market level to staff members who render satisfactory performance. Top performers might receive further incentives at the absolute discretion of the management. Adequate and in-depth on-the-job training is provided to all employees to facilitate the performance of their duties. As at 31 March 2004, the Group had approximately 100 (2003: approximately 80) full-time employees.

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### RELATED PARTY TRANSACTIONS

Details of related party transactions of the Group are set out in note 23 to the financial statements.

### INFORMATION ON SHARE OPTION SCHEME

At the Annual General Meeting of the Company held on 4 September 2003, an ordinary resolution was passed approving the adoption of a share option scheme (the "Share Option Scheme") which complied with Chapter 17 of the Rules Governing the Listing of Securities (the "Listing Rules") of the Stock Exchange.

Summary of the terms and particulars of outstanding options of the Share Option Scheme is set below pursuant to the requirements as contained in Chapter 17 of the Listing Rules.

#### (a) Purpose

To enable the Group to grant options to selected eligible participants as incentives or rewards for their contribution to the Group.

#### (b) Eligible Participants

(i) any Director, employee or any business associates including but not limited to the customer, distributor, supplier, agent, consultant, business partner or advisor of or contractor to the Group or a company in which the Group holds an interest or a subsidiary of such company ("Affiliate"); or (ii) the trustee of any trust the beneficiary of which or any discretionary trust the discretionary objects of which include any Director, employee or any business associates including but not limited to the customer, distributor, supplier, agent, consultant, business partner, or advisor of or contractor to the Group or an Affiliate; or (iii) a company beneficially owned by any Director, employee or any business associates including but not limited to the customer, distributor, supplier, agent, consultant, business partner or advisor of or contractor to the Group or an Affiliate.

#### (c) Total number of shares available for issuance

47,000,000 shares (approximately 9.89% of the issued share capital as at the date of the 2004 annual report).

The limit on the number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Share Option Scheme and any other schemes of the Company and/or its subsidiary must not exceed 30% of the shares in issue from time to time. No options may be granted under any schemes of the Company or its subsidiary if this would result in the 30% limit being exceeded.

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### INFORMATION ON SHARE OPTION SCHEME (continued)

#### (d) Maximum entitlement of each eligible participant

The total number of shares issued and to be issued upon exercise of the options granted to each eligible participant (including exercised, cancelled and outstanding options) within any twelve-month period under the Share Option Scheme) and any other share option scheme(s) of the Company and/or any subsidiary must not exceed 1% of the number of shares in issue.

#### (e) Time of exercise of option

An option may be exercised in accordance with the terms of the Share Option Scheme at any time during a period to be notified by the Board to each eligible participant at the time of offer of the grant of the option, which must not be more than 10 years from the date of offer of grant of the option.

#### (f) Payment on acceptance of option

HK\$1.00 in cash is payable by the eligible participant of the option to the Company on acceptance of the offer.

#### (g) The basis of determining the exercise price

The subscription price for the shares in relation to the options to be granted under the Share Option Scheme will be a price determined by the Board and notified to each eligible participant at the time of offer of grant of the option and will be at least the highest of (i) the closing price of the shares as stated in the Stock Exchange's daily quotation sheets on the date of offer of the grant of the option, which must be a business day; (ii) the average closing price of the shares as stated in the Stock Exchange's daily quotation sheets for the five business days immediately preceding the date of offer of the grant of the option; and (iii) the nominal value of the shares.

#### (h) Remaining life of scheme

The Share Option Scheme shall be valid and effective for a period of ten years commencing on the adoption date (i.e. 4 September 2003).



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### INFORMATION ON SHARE OPTIONS

Movement of share options during the year ended 31 March 2004:

| Eligible Participant | Date of grant   | Number of share options to subscribe for shares |              |           |                   |            | Outstanding at 31 March 2004 | Subscription price per share       | Exercise period* |
|----------------------|-----------------|---|--------------|-----------|-------------------|------------|------------------------------|------------------------------------|------------------|
|                      |                 | Outstanding at 1 April 2003                     | Granted      | Exercised | Cancelled/ Lapsed |            |                              |                                    |                  |
| Employees            | 9 February 2004 | -   | 37,600,000** | -         | -                 | 37,600,000 | HK\$1.38                     | 9 February 2004 – 3 September 2013 |                  |
| Business Associates  | 9 February 2004 | -   | 9,400,000**  | -         | -                 | 9,400,000  | HK\$1.38                     | 9 February 2004 – 3 September 2013 |                  |
|                      |                 |   |              |           |                   | Total:     | 47,000,000                   |                                    |                  |

Notes:

\* *Share options are vested from date of issue.*

\*\* *The closing price per share of the Company immediately before 9 February 2004 on which the options were granted was HK\$1.40.*

Options were granted for a consideration of HK\$1.00 per grant during the year ended 31 March 2004. No options were cancelled during the year ended 31 March 2004.

The Directors do not consider it appropriate to disclose a theoretical value of the share options granted during the year ended 31 March 2004 because the Directors are of the opinion that the values of share options calculated using theoretical models are subject to certain fundamental limitations, due to the subjective nature of and uncertainty relating to a number of the assumptions of expected future performance input to the model, and certain inherent limitations of the model itself.

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### REFRESHMENT OF GENERAL LIMIT ON GRANT OF OPTIONS

A resolution proposing the refreshment of the general limit on the grant of options under the Share Option Scheme will be proposed at the forthcoming AGM to be held on 7 September 2004. Details are set out in the circular sent together with the 2004 annual report.

### DIRECTORS AND DIRECTORS' SERVICE CONTRACTS

The Directors who held office during the Year and up to the date of this 2004 annual report were:

Mr Yip Kim Po, Chairman  
Mr Hui Ho Ming, Herbert, JP, Deputy Chairman  
Mr Lau Ping  
Mr Lin Jianping#  
Dr Lo Wing Yan, William, JP\*  
Mr Yao Zongren (Passed away on 24 May 2004)  
Mr Yeh V-nee\*

# Formerly, a Non-Executive Director. Appointed as an Executive Director wef 7 October 2003.

\* Independent Non-Executive Director

In accordance with the bye-law nos. 87(1) and 87(2) of the Company, Mr Lau Ping will retire at the forthcoming Annual General Meeting and, being eligible, offer himself for re-election. Mr Lau, who is being proposed for re-election at the forthcoming Annual General Meeting, does not have a service contract which is not terminable by the Company within one year without payment of compensation (other than statutory compensation) with the Company.

Dr Lo Wing Yan, William and Mr Yeh V-nee, both Independent Non-Executive Directors, were appointed for a term of one year, subject to rotation as stipulated in the Company's bye-laws.

### DETAILS OF DIRECTORS

Brief details of Directors are set out on pages 24 and 25 to this 2004 annual report.

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

As at 31 March 2004, the interests and short positions of the Directors and the chief executives of the Company in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")) as recorded in the register required to be kept under Section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies were as follows:

#### Long positions

| Name                    | Type of interest | Attributable interest to the Director | Number of shares | Number of options | Aggregate interest | Approximate % of the Company's issued share capital |
|-------------------------|------------------|---------------------------------------|------------------|-------------------|--------------------|---|
| Mr Yip Kim Po           | Others           | Note                                  | Note             | -                 | Note               | Note  |
| Mr Hui Ho Ming, Herbert | Others           | Note                                  | Note             | -                 | Note               | Note  |
| Mr Lau Ping             | -                | -                                     | -                | -                 | -                  | -   |
| Mr Lin Jianping         | -                | -                                     | -                | -                 | -                  | -   |
| Dr Lo Wing Yan, William | -                | -                                     | -                | -                 | -                  | -   |
| Mr Yao Zongren          | Beneficial owner | 100%                                  | 1,000,000        | -                 | 1,000,000          | 0.21%   |
|                         | Others           | Note                                  | Note             | -                 | Note               | Note  |
| Mr Yeh V-nee            | -                | -                                     | -                | -                 | -                  | -   |

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### **DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES (continued)**

#### Long positions (continued)

Note:

*Successful Gold Profits Limited is a holder of 355,196,000 shares in the Company. Successful Gold Profits Limited is a wholly-owned subsidiary of Ocean Grand Holdings Limited. Ocean Grand Holdings Limited, by virtue of the SFO, is deemed to be interested in all the shares in which Successful Gold Profits Limited is interested.*

*The securities of Ocean Grand Holdings Limited are listed on the Main Board of the Stock Exchange. As at 31 March 2004, Mr Yip Kim Po, Mr Hui Ho Ming, Herbert and Mr Yao Zongren directly and indirectly held 128,225,444 shares, 5,800,000 shares and 50,000 shares respectively (approximately 30.81%, 1.39% and 0.01% respectively) of the issued share capital of Ocean Grand Holdings Limited.*

*As at the date of this 2004 annual report, Mr Yip Kim Po and Mr Hui Ho Ming, Herbert directly and indirectly held 130,000,000 shares and 7,050,000 shares respectively (approximately 30.67% and 1.66% respectively) of the issued share capital of Ocean Grand Holdings Limited.*

Save as disclosed above, no other interests or short positions in the shares, underlying shares or debentures of the Company or any associated corporations (within the meaning of Part XV of the SFO) as at 31 March 2004 were recorded in the register required to be kept under Section 352 of the SFO or which was otherwise required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies and the Company had no notice of any interest required to be recorded under Section 352 of the SFO as at 31 March 2004.

### **DIRECTORS' RIGHTS TO SUBSCRIBE FOR EQUITY OR DEBT SECURITIES**

Save as disclosed under the headings "Directors' and Chief Executives' Interests and Short Positions in Shares, Underlying Shares and Debentures" above, none of the Directors or chief executive or their spouses or children under 18 years of age were granted or exercised any right to subscribe for equity or debt securities of the Company.

### **DIRECTORS' INTERESTS IN CONTRACTS**

Save as disclosed in the preceding paragraphs and note 23 to the financial statements, no contract of significance in relation to the Group's business to which the Company or any of its subsidiaries or holding companies in which any of the Company's Directors or members of its management had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

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### INTERESTS AND SHORT POSITIONS OF SHAREHOLDERS DISCLOSABLE UNDER THE SFO

As at 31 March 2004, the interests or short positions of the substantial shareholder and other person (other than those Directors or chief executives of the Company disclosed above) in the shares and underlying shares of the Company as recorded in the register required to be kept under Section 336 of the SFO were as follows:

#### Long position – Substantial Shareholder

| Name                            | Type of interest | Number of shares | Approximate<br>% of the Company's<br>issued share capital |
|---------------------------------|------------------|------------------|---|
| Successful Gold Profits Limited | Directly         | 355,196,000      | 74.78%  |

#### Long position – Other Person

| Name                                   | Type of interest | Number of shares | Approximate<br>% of the Company's<br>issued share capital |
|--|------------------|------------------|---|
| Martin Currie China Hedge Fund Limited | Directly         | 24,217,000       | 5.10%   |

On 2 December 2003, UBS AG has a security interest of 26,897,000 shares in the Company (approximately 5.66% of the Company's issued shares). The Company was informed by UBS AG about their said interest on 5 July 2004. On 2 July 2004, UBS AG disposed 25,569,000 shares in the Company (approximately 5.38% of the Company's issued shares) and their interest was reduced to 1,000,000 shares in the Company (approximately 0.21% of the Company's issued shares).

Save as disclosed above, as at 31 March 2004, there was no person (other than the Directors or chief executives of the Company) who had an interest or short position in the shares and underlying shares of the Company as recorded in the register required to be kept under Section 336 of the SFO.

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### CODE OF BEST PRACTICE

The Company was listed on the Main Board of the Stock Exchange on 30 June 2003. Thus, during the period from 1 April 2003 to 29 June 2003, the Group was not subject to compliance with the Code of Best Practice as set out in Appendix 14 of the Listing Rules of the Stock Exchange. Nevertheless, the Group has complied with the Code of Best Practice since the listing of the Company on the Stock Exchange.

### AUDIT COMMITTEE

The terms of reference based on "A Guide for Effective Audit Committees" published by the Hong Kong Society of Accountants in February 2002 was adopted by the Board to deal clearly with the authority and duties of the Audit Committee (the "Committee").

The Committee's principal duties is to review and supervise the Group's financial reporting process and internal controls. Initially, the Committee comprised Mr Yeh V-nee (the chairman), Mr Lin Jianping and Dr Lo Wing Yan, William. Mr Lin was appointed an Executive Director of the Company with effect from 7 October 2003 and he ceased to serve on the Committee accordingly.

The Committee has reviewed with management the accounting principles and practices adopted by the Group and discussed internal control and financial reporting matters including the review of the audited financial statements for the year ended 31 March 2004.

### AUDITORS

The Auditors of the Company Messrs Moores Rowland merged with Messrs Mazars on 1 October 2003 and are now practising under the name of Moores Rowland Mazars.

The financial statements were audited by Messrs Moores Rowland Mazars, *Chartered Accountants, Certified Public Accountants*. A resolution for their reappointment as auditors of the Company will be proposed at the forthcoming Annual General Meeting.

On behalf of the Board

**Yip Kim Po**

Chairman

Hong Kong, 20 July 2004