

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

1. GENERAL

The Company is an exempted company with limited liability incorporated in the Cayman Islands under the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands and its shares are listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). 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 33.

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, 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 Group resulting from the Group Reorganisation is regarded as a continuing entity. Accordingly, the financial statements of the Group for the year ended 31st December, 2003 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 Institute of Certified Public Accountants (the "HKICPA").

2. POTENTIAL IMPACT ARISING FROM THE RECENTLY ISSUED ACCOUNTING STANDARDS

In 2004, the HKICPA issued a number of new or revised Hong Kong Accounting Standards and Hong Kong Financial Reporting Standards (hereinafter collectively referred to as "new HKFRSs") which are effective for accounting periods beginning on or after 1st January, 2005. The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31st December, 2004.

The Group has commenced considering the potential impact of these new HKFRSs but is not yet in a position to determine whether these new HKFRSs would have a significant impact on how its results of operations and financial position are prepared and presented. These new HKFRSs may result in changes in the future as to how the results and financial position are prepared and presented.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

3. 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.

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.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Property, plant and equipment *(Continued)*

Depreciation and amortisation are provided to write off the cost of items of property, plant and equipment, other than construction in progress, 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 terms 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 $\frac{1}{3}$ %
Motor vehicles	20%

No depreciation is provided on construction in progress until such time when construction work is completed and the costs of construction are transferred to the appropriate category of property, plant and equipment.

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.

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.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

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 loss is 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.

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.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

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.

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.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Foreign currencies *(Continued)*

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.

4. 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, 2003 and 31st December, 2004, 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, 2004

5. OTHER OPERATING INCOME

	2004 HK\$'000	2003 HK\$'000
Service income from customers	1,951	1,249
Claims received from suppliers	785	1,052
Exchange gain, net	603	531
Realised/unrealised gain on investment in securities	7	451
Interest income	309	439
Scrap sales	5,039	3,654
Sundry income	2,860	2,737
	11,554	10,113

6. PROFIT FROM OPERATIONS

	2004 HK\$'000	2003 HK\$'000
Profit from operations has been arrived at after charging (crediting):		
Allowance for doubtful debts	1,264	1,400
Auditors' remuneration	708	529
Cost of inventories recognised as expenses	560,479	430,923
Depreciation and amortisation	16,220	12,239
Loss on disposal of property, plant and equipment	176	165
Operating lease rental for warehouse and office premises	341	158
Staff costs		
Directors' emoluments (<i>note 7</i>)	9,722	6,356
Other staff		
– salaries and other allowances	9,758	6,054
– retirement benefit scheme contribution	260	207
	19,740	12,617

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

7. DIRECTORS' EMOLUMENTS AND FIVE HIGHEST PAID EMPLOYEES

Directors

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

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Fees to independent non-executive directors	209	49
Other emoluments to executive directors		
– salaries and other allowances	3,355	3,183
– discretionary bonuses	6,088	3,052
– retirement benefit scheme contribution	70	72
	9,513	6,307
	9,722	6,356

The emoluments of the directors were within the following bands:

	2004 Number of directors	2003 Number of directors
Nil to HK\$1,000,000	5	4
HK\$1,000,001 to HK\$1,500,000	–	4
HK\$1,500,001 to HK\$2,000,000	1	–
HK\$2,000,001 to HK\$2,500,000	3	–

The five highest paid individuals of the Group were all directors for each of the two years ended 31st December, 2004, details of whose emoluments are set out above.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

8. FINANCE COSTS

	2004 HK\$'000	2003 HK\$'000
Interest on bank borrowings wholly repayable within five years	1,523	2,916
Interest on discounted bills	253	182
	1,776	3,098
Finance charges on obligations under finance leases	95	384
Bank charges	681	691
	2,552	4,173

9. TAXATION

	2004 HK\$'000	2003 HK\$'000
The charge comprises:		
Current taxation		
– Hong Kong Profits Tax	2,719	4,383
Deferred taxation (<i>note 27</i>)	5,000	1,380
	7,719	5,763

Hong Kong Profits Tax is calculated at 17.5% (2003: 17.5%) on the estimated assessable profit for the year.

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.

Pursuant to the relevant laws and regulations in the PRC, a PRC subsidiary of the Group is exempted from PRC income tax for two years starting from the first profit-making year, followed by a 50% reduction in the income tax rate in the following three years. No provision for PRC income tax has been made in the financial statements as the PRC subsidiary was exempted from PRC income tax during the year.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

9. TAXATION (Continued)

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

	2004 HK\$'000	2003 HK\$'000
Profit before taxation	74,871	61,450
Tax at Hong Kong Profits Tax rate of 17.5%	13,102	10,754
Tax effect of income not taxable for tax purpose	(1,559)	(5,486)
Tax effect of expenses not deductible for tax purpose	106	37
Tax effect of tax losses not recognised	50	–
Tax effect of deferred tax assets not recognised	753	–
Effect of tax exemption/different tax rate of a PRC subsidiary	(6,181)	–
Increase in opening deferred tax liabilities resulting from an increase in Hong Kong Profits Tax rate	–	198
Others	1,448	260
Tax expense for the year	7,719	5,763

Contingent liabilities relating to taxation of the Group are set out in note 31.

10. DIVIDENDS

	2004 HK\$'000	2003 HK\$'000
Dividends paid by certain subsidiaries to their then shareholders prior to the Group Reorganisation becoming effective	–	30,000
Final dividend paid in respect of 2003 of 1.26 HK cents per share	4,600	–
Interim dividend paid in respect of 2004 of 1.26 HK cents per share	4,635	–
	9,235	30,000

The final dividend in respect of 2004 of 4.22 HK cents per share has been proposed by the directors and is subject to approval by the shareholders in the forthcoming annual general meeting.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

11. EARNINGS PER SHARE

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

	THE GROUP	
	2004	2003
	HK\$'000	HK\$'000
<hr/>		
Earnings		
Profit for the year	67,152	55,687
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	2004	2003
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Number of shares		
Weighted average number of shares for the purpose of basic earnings per share	366,362,661	295,735,003
Effect of dilutive potential shares in respect of share options	2,567,132	170,995
Weighted average number of shares for the purpose of diluted earnings per share	368,929,793	295,905,998

The weighted average number of shares for 2003 has 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, 2003.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

12. PROPERTY, PLANT AND EQUIPMENT

	Construction in progress <i>HK\$'000</i>	Land use rights in the PRC <i>HK\$'000</i>	Factory premises in the PRC <i>HK\$'000</i>	Leasehold land and buildings <i>HK\$'000</i>	Leasehold improve- ments <i>HK\$'000</i>	Furniture, fixtures and office equipment <i>HK\$'000</i>	Plant, machinery and equipment <i>HK\$'000</i>	Motor vehicles <i>HK\$'000</i>	Total <i>HK\$'000</i>
THE GROUP									
COST									
At 1st January, 2004	-	8,709	22,043	1,888	7,793	4,186	95,646	4,847	145,112
Additions	38,428	-	-	-	1,351	1,619	29,595	1,057	72,050
Disposals	-	-	-	-	-	-	(323)	(86)	(409)
At 31st December, 2004	38,428	8,709	22,043	1,888	9,144	5,805	124,918	5,818	216,753
DEPRECIATION AND AMORTISATION									
At 1st January, 2004	-	829	4,744	45	1,665	1,004	37,262	3,547	49,096
Provided for the year	-	200	906	76	1,638	556	12,184	660	16,220
Eliminated on disposals	-	-	-	-	-	-	(40)	(86)	(126)
At 31st December, 2004	-	1,029	5,650	121	3,303	1,560	49,406	4,121	65,190
NET BOOK VALUES									
At 31st December, 2004	38,428	7,680	16,393	1,767	5,841	4,245	75,512	1,697	151,563
At 31st December, 2003	-	7,880	17,299	1,843	6,128	3,182	58,384	1,300	96,016

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.

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

	THE GROUP	
	2004	2003
	<i>HK\$'000</i>	<i>HK\$'000</i>
Plant, machinery and equipment	-	12,925

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

13. 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 statements of the Group over the expected remaining contract period of the FG Processing Arrangement.

14. INVESTMENTS IN SECURITIES

	THE GROUP	
	2004 HK\$'000	2003 HK\$'000
Unlisted investments in mutual funds, at fair value	–	7,328

15. INVESTMENT IN SUBSIDIARIES

	THE COMPANY	
	2004 HK\$'000	2003 HK\$'000
Unlisted shares	113,455	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 principal subsidiaries at 31st December, 2004 are set out in note 33.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

16. INVENTORIES

	THE GROUP	
	2004 HK\$'000	2003 HK\$'000
At cost:		
Raw materials	57,035	39,805
Work in progress	614	654
Finished goods	1,384	2,118
	<u>59,033</u>	<u>42,577</u>

17. TRADE AND OTHER RECEIVABLES

The Group has a policy of allowing a 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:

	2004	2003
	HK\$'000	HK\$'000
Current	83,101	71,500
Overdue 1 to 30 days	4,133	11,120
	<u>87,234</u>	<u>82,620</u>
Other receivables	1,301	646
	<u>88,535</u>	<u>83,266</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

18. AMOUNT DUE FROM A RELATED COMPANY

THE GROUP

Particulars of the amount due from a related company are as follows:

Name of related company	Balance at 31.12.2004 HK\$'000	Balance at 31.12.2003 HK\$'000	Maximum amount outstanding during the year HK\$'000
Fung Kong Wing Lung Paper Ware Factory Limited	<u>—</u>	<u>652</u>	<u>652</u>

The amount due from Fung Kong Wing Lung Paper Ware Factory Limited represented a trade debt which was fully settled during the year.

Fung Kong Wing Lung Paper Ware Factory Limited is 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.

19. AMOUNTS DUE FROM SUBSIDIARIES

THE COMPANY

The amounts are unsecured and repayable on demand. Other than an amount of HK\$72,589,000 (2003: HK\$32,601,000) which bears interest at prevailing market rates, all remaining balances are interest-free.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

20. TRADE AND OTHER PAYABLES

THE GROUP

An aged analysis of the trade payables is as follows:

	2004	2003
	<i>HK\$'000</i>	<i>HK\$'000</i>
Current	46,597	29,238
Overdue 1 to 30 days	5,745	4,462
Overdue 31 to 60 days	43	26
Overdue for more than 60 days	1,032	315
	53,417	34,041
Other payables and accrued charges	34,990	29,328
	88,407	63,369

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

21. OBLIGATIONS UNDER FINANCE LEASES

THE GROUP

	Minimum lease payments		Present value of minimum lease payments	
	2004 HK\$'000	2003 HK\$'000	2004 HK\$'000	2003 HK\$'000
Within one year	–	3,859	–	3,694
More than one year, but not exceeding two years	–	3,859	–	3,765
More than two years, but not exceeding five years	–	3,035	–	3,008
	–	10,753	–	10,467
Less: Future finance charges	–	(286)	–	–
Present value of lease obligations	–	10,467	–	10,467
Less: Amount due within one year shown under current liabilities			–	(3,694)
Amount due after one year			–	6,773

At 31st December, 2003, the Group's obligations under finance leases were secured by the lessor's charge over the leased assets.

The obligations under finance leases were fully repaid during the year.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

22. BANK BORROWINGS

	THE GROUP	
	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Bank borrowings comprises:		
Trust receipt loans	24,336	8,684
Bank loans	61,495	48,439
Bank overdraft	328	648
	<u>86,159</u>	<u>57,771</u>
Secured	–	57,771
Unsecured	<u>86,159</u>	–
	<u>86,159</u>	<u>57,771</u>

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

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
On demand or within one year	50,504	22,829
More than one year, but not exceeding two years	24,138	15,517
More than two years, but not exceeding five years	<u>11,517</u>	<u>19,425</u>
	<u>86,159</u>	57,771
Less: Amount due within one year shown under current liabilities	<u>(50,504)</u>	<u>(22,829)</u>
Amount due after one year	<u>35,655</u>	<u>34,942</u>

At 31st December, 2003, the above bank borrowings are secured by the followings:

- (a) machinery with net book value of HK\$2,946,000;
- (b) investment in equity-linked deposits of HK\$2,002,000;
- (c) investment in securities of HK\$7,328,000; and
- (d) bank deposits of HK\$16,519,000.

No asset has been pledged to banks for banking facilities granted to the Group at 31st December, 2004.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

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 <i>HK\$'000</i>
Shares of HK\$0.10 each		
Authorised:		
On incorporation	1,000,000	100
Increase in authorised share capital (<i>note (b)</i>)	<u>999,000,000</u>	<u>99,900</u>
At 31st December, 2004 and 31st December, 2003	<u>1,000,000,000</u>	<u>100,000</u>
Issue 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 issued on capitalisation of share premium account (<i>note (d)</i>)	<u>268,000,000</u>	<u>26,800</u>
At 31st December, 2003	365,042,000	36,504
Exercise of share options	<u>2,794,000</u>	<u>279</u>
At 31st December, 2004	<u>367,836,000</u>	<u>36,783</u>

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, 2004:

- (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.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

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 dated 15th September, 2003 issued by the Company.

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.

- (f) On 12th July, 2004, 2,794,000 shares of HK\$0.10 each in the Company were allotted and issued at a price of HK\$1.13 per share upon exercise of the share options by the option holders.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

25. SHARE PREMIUM AND RESERVES

	Share premium <i>HK\$'000</i>	Retained profits <i>HK\$'000</i>	Total <i>HK\$'000</i>
THE COMPANY			
Premium arising on Group Reorganisation (note below)	113,255	–	113,255
Shares issued at premium on share offer (note 24(e))	95,042	–	95,042
Shares issue expenses	(13,029)	–	(13,029)
Shares issued on capitalisation of share premium account (note 24(d))	(26,800)	–	(26,800)
Profit for the year	–	8,043	8,043
At 31st December, 2003	168,468	8,043	176,511
Exercise of share options	2,878	–	2,878
Profit for the year	–	53,410	53,410
Final dividend paid in respect of 2003	–	(4,600)	(4,600)
Interim dividend paid in respect of 2004	–	(4,635)	(4,635)
At 31st December, 2004	171,346	52,218	223,564

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.

The Company's reserves available for distribution to shareholders as at 31st December, 2004 comprised the share premium and retained profits of HK\$223,564,000 (2003: HK\$176,511,000).

26. 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 (including independent 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.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

26. SHARE OPTION SCHEME *(Continued)*

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 36,000,000 shares, being 10% of the shares of the Company in issue on which the shares of the Company are listed on the Stock Exchange, 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 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.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

26. 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:

Option type	Date of grant	Exercise price HK\$	Share options	Granted during 2004	Exercised during 2004	Cancelled during 2004	Outstanding at 31.12.2004
			granted during 2003 and outstanding at 31.12.2003				
Directors:							
A	3.11.2003	1.130	13,826,000	–	(2,748,000)	(288,000)	10,790,000
B	29.7.2004	1.330	–	5,610,000	–	–	5,610,000
C	4.11.2004	1.104	–	9,000,000	–	–	9,000,000
			<u>13,826,000</u>	<u>14,610,000</u>	<u>(2,748,000)</u>	<u>(288,000)</u>	<u>25,400,000</u>
Other Employees:							
A	3.11.2003	1.130	2,174,000	–	(46,000)	(196,000)	1,932,000
B	29.7.2004	1.330	–	5,390,000	–	–	5,390,000
			<u>2,174,000</u>	<u>5,390,000</u>	<u>(46,000)</u>	<u>(196,000)</u>	<u>7,322,000</u>
Total all categories			<u>16,000,000</u>	<u>20,000,000</u>	<u>(2,794,000)</u>	<u>(484,000)</u>	<u>32,722,000</u>

Note: The vesting period of the share options granted is determined by directors at each time when the options are granted. Holders of share options granted under the Scheme may only exercise their options during the exercisable periods as follows:

Option type A	Option type B	Option type C	Maximum % of share options exercisable
3.5.2004 – 3.11.2004	1.1.2005-31.12.2005	1.3.2005-28.2.2006	up to 50%
4.11.2004 – 3.11.2005	1.1.2006-31.12.2006	1.3.2006-28.2.2007	up to 75% (to the extent not already exercised)
4.11.2005 – 3.11.2006	1.1.2007-31.12.2007	1.3.2007-29.2.2008	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\$17 (2003: HK\$27).

The fair value of the Company's shares at the date on which the share options were exercised was HK\$1.38.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

26. SHARE OPTION SCHEME (Continued)

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.

27. 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
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
At 1st January, 2003	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
Charge to income for the year	3,096	1,904	5,000
At 31st December, 2004	8,491	-	8,491

At the balance sheet date, the Group has unused tax losses of HK\$284,000 (2003: HK\$10,877,000) available to offset against future profits. A deferred tax asset has been recognised in respect of the tax losses amounting to HK\$10,877,000 at 31st December, 2003. No deferred tax asset has been recognised in respect of the tax losses at 31st December, 2004 due to the unpredictability of future profit streams. The losses may be carried forward indefinitely.

At the balance sheet date, the Group also has other deductible temporary differences of HK\$4,305,000 (2003: Nil). No deferred tax asset has been recognised in relation to such deductible temporary differences as it is not probable that taxable profit will be available against which the deductible temporary differences can be utilised.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

28. 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	
	2004	2003
	HK\$'000	HK\$'000
Within one year	466	32
In the second to fifth years inclusive	1,095	5
	<u>1,561</u>	<u>37</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 two years with fixed monthly rentals over the term of the lease.

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

29. CAPITAL COMMITMENTS

	THE GROUP	
	2004	2003
	HK\$'000	HK\$'000
Capital expenditure in respect of the acquisition of plant and equipment contracted for but not provided in the financial statements	<u>40,392</u>	<u>1,424</u>

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

30. RETIREMENT BENEFIT SCHEME

Hong Kong

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.

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.

PRC

The employees of the Group's subsidiaries in the PRC are members of a state-managed retirement benefit scheme operated by the government of the PRC. The subsidiaries are required to contribute 10% of payroll costs to the retirement benefit scheme to fund the benefits. The only obligation of the Group with respect to the retirement benefit scheme is to make the specified contributions.

31. CONTINGENT LIABILITIES

THE GROUP

On 9th December, 2004, tax audits have been commenced by the Hong Kong Inland Revenue Department (the "IRD") on certain subsidiaries of the Company, namely, Gong Ming Hop Fung Paper Ware Factory Limited, Fung Kong Hop Fung Paper Ware Factory Limited and Hop Fung (Overseas) Trading Limited, in respect of the years of assessment 1998/1999 to 2003/2004. On 26th January, 2005, whilst these cases are still under investigation, the IRD issued protective assessments for the year of assessment 1998/1999 to the above-mentioned subsidiaries in order not to jeopardise the assessment powers of the IRD which will be time-barred after 6 years of assessment. The Group's potential tax liabilities on these assessments amounted to approximately HK\$15,965,000. Objections have been filed against all these assessments and, accordingly, no provision has been made in the financial statements in respect of any potential tax liabilities.

Tax reserve certificates totaling HK\$480,000 in respect of the assessments for Gong Ming Hop Fung Paper Ware Factory Limited and Fung Kong Hop Fung Paper Ware Factory Limited, pending the outcome of the tax audits and the objections, were purchased in March 2005. The remaining amounts of tax demanded by the IRD have been held over unconditionally.

In the opinion of the Company's directors, the potential tax liabilities that may arise as a result of the tax audits, if any, would not have any significant effects on the financial statements of the Group.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

31. CONTINGENT LIABILITIES *(Continued)*

THE COMPANY

At 31st December, 2004, the Company had contingent liabilities of HK\$86,159,000 (2003: 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.

32. RELATED PARTY TRANSACTIONS

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

Name	Notes	Nature of transactions	2004 HK\$'000	2003 HK\$'000
Hop Fung Properties Limited	(i)	Rental paid to	-	138
Fung Kong Wing Lung Paper Ware Factory Limited	(ii)	Sales of goods to	2,219	7,507
Hop Fung (Australia) Pty Ltd	(iii)	Agency services	-	-

Notes:

- (i) Rental expenses charged by Hop Fung Properties Limited were 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 32(c)).
- (ii) Sales to related party 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\$20,202,000 (2003: HK\$34,137,000). Hop Fung (Australia) Pty Ltd is a company in which Mr. Hui Sum Kwok, director of the Company, has beneficial interest.
- (b) During the year ended 31st December, 2003, certain directors provided unlimited personal guarantees to banks as part of the securities to secure for banking facilities granted to the Group. 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.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

32. RELATED PARTY TRANSACTIONS *(Continued)*

- (c) During the year ended 31st December, 2003, 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) During the year ended 31st December, 2003, a subsidiary of the Company 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) During the year ended 31st December, 2003, Mr. Hui Sum Kwok, executive director of the Company, and Ms. Wong Mui, wife of Mr. Hui Sum Kwok, 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. 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) Limited, 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, whereby Hop Fung Group (HK) Limited 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) Limited 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 Registrar of Trade Marks in Hong Kong.

On 6 February, 2004, Hop Fung Group Company Limited, a wholly owned subsidiary of the Company became the registered owner of the trademark. The trademark was then transferred to the Group and accordingly, the trademark license agreement was cancelled.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

33. PARTICULARS OF PRINCIPAL SUBSIDIARIES

Particulars of the subsidiaries which are wholly-owned by the Company as at 31st December, 2004 are as follows:

Name of subsidiary	Place of incorporation or registration/ operation	Issued and fully paid share capital/ contributed capital	Principal activities
Able Achieve Limited	British Virgin Islands	Ordinary share US\$1	Investment holding
Chun Yik (Macao Commercial Offshore) Limited	Macau	Ordinary shares MOP\$100,000	Trading of paper ware products
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
Green Forest (QingXin) Paper Industrial Limited*	PRC	Contributed capital HK\$3,000,000	Not yet commenced business
Hop Fung Group Company Limited	British Virgin Islands/ Hong Kong	Ordinary shares US\$600	Investment holding

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2004

33. PARTICULARS OF SUBSIDIARIES (Continued)

Name of subsidiary	Place of incorporation or registration/ operation	Issued and fully paid share capital/ contributed capital	Principal activities
Hop Fung (Overseas) Trading Limited	British Virgin Islands/ PRC	Ordinary shares US\$1	Inactive
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	Contributed capital HK\$20,000,000	Manufacturing and sales of paper ware products

Note: The non-voting deferred shares, which are not held by the Group and practically carry no right to dividends 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.

The above table lists the subsidiaries of the Company which, in the opinion of the Directors, principally affects the result of the year or constituted a substantial portion of the net assets of the Group. To give details of other subsidiaries would, in the opinion of the Directors, result in particulars of excessive length.

None of the subsidiaries had any debt securities subsisting at 31st December, 2004 or at any time during the year.

* *Green Forest (QingXin) Paper Industrial Limited and 東莞進益紙品有限公司 are wholly foreign owned enterprises.*