# HUABAO INTERNATIONAL HOLDINGS LIMITED

Interim Report 2005

The board of directors of Huabao International Holdings Limited (the "Company") is pleased to announce the unaudited condensed financial statements of the Company and its subsidiaries (collectively referred to as the "Group") for the six months ended 30th September, 2005 together with the comparative figures for the corresponding period in 2004.

## CONDENSED CONSOLIDATED INCOME STATEMENT

*For the six months ended 30th September, 2005*

| | Notes | Six months ended 30th September, 2005 HK$'000 (Unaudited) | 2004 HK$'000 (Unaudited and restated) |
|---|---|---|---|
| Revenue | 4 | **10,456** | 10,644 |
| Other operating income | | **17** | – |
| Purchase of finished goods | | **(9,010)** | (10,356) |
| Staff costs | | **(789)** | (370) |
| Depreciation | | **(18)** | (2) |
| Other operating expenses | | **(1,075)** | (697) |
| Finance costs | 5 | **(2,958)** | (2,722) |
| Loss before taxation | | **(3,377)** | (3,503) |
| Taxation | 6 | **(94)** | – |
| Loss for the period | | **(3,471)** | (3,503) |
| | | ***HK cents*** | *HK cents* |
| Loss per share | 7 | | |
| Basic | | **(1.40)** | (1.42) |

## CONDENSED CONSOLIDATED BALANCE SHEET

*At 30th September, 2005*

| | Notes | 30th September, 2005 HK$'000 (Unaudited) | 31st March, 2005 HK$'000 (Audited and restated) |
|---|---|---|---|
| **Non-current assets** | | | |
| Property, plant and equipment | 8 | 421 | 24 |
| **Current assets** | | | |
| Inventories | | 693 | – |
| Trade and other receivables | 9 | 5,705 | 945 |
| Bank balances and cash | | 5,849 | 9,234 |
| | | 12,247 | 10,179 |
| **Current liabilities** | | | |
| Trade and other payables | 10 | 9,057 | 6,433 |
| Amounts due to related companies | 14 | 506 | 280 |
| Tax payable | | 152 | 58 |
| | | 9,715 | 6,771 |
| **Net current assets** | | 2,532 | 3,408 |
| | | 2,953 | 3,432 |
| **Capital and reserves** | | | |
| Share capital | 11 | 24,731 | 24,731 |
| Reserves | | (63,238) | (59,801) |
| | | (38,507) | (35,070) |
| **Non-current liabilities** | | | |
| Preference shares | 12 | 41,460 | 38,502 |
| | | 2,953 | 3,432 |

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

*For the six months ended 30th September, 2005*

| | Ordinary share capital HK$'000 | Preference share capital HK$'000 | Contributed surplus HK$'000 | Share premium account HK$'000 | Capital reserve HK$'000 | Translation reserve HK$'000 | Accumulated losses HK$'000 | Total HK$'000 |
|---|---|---|---|---|---|---|---|---|
| At 1st April, 2004 | | | | | | | | |
| – as originally stated | 24,731 | 52,690 | 51,111 | 244,588 | 1,677 | – | (370,891) | 3,906 |
| – effects of changes in accounting policies | – | (52,690) | – | – | 19,632 | – | – | (33,058) |
| – as restated | 24,731 | – | 51,111 | 244,588 | 21,309 | – | (370,891) | (29,152) |
| Loss for the period representing total recognised income and expense for the period | – | – | – | – | – | – | (3,503) | (3,503) |
| At 30th September, 2004 | 24,731 | – | 51,111 | 244,588 | 21,309 | – | (374,394) | (32,655) |
| Loss for the period representing total recognised income and expense for the period | – | – | – | – | – | – | (2,415) | (2,415) |
| At 31st March, 2005 | **24,731** | **–** | **51,111** | **244,588** | **21,309** | **–** | **(376,809)** | **(35,070)** |
| Loss for the period | **–** | **–** | **–** | **–** | **–** | **–** | **(3,471)** | **(3,471)** |
| Exchange gain arising on retranslation of the financial statements of operations outside Hong Kong recognised directly in equity | **–** | **–** | **–** | **–** | **–** | **34** | **–** | **34** |
| Total recognised income and expense for the period | **–** | **–** | **–** | **–** | **–** | **34** | **(3,471)** | **(3,437)** |
| **At 30th September, 2005** | **24,731** | **–** | **51,111** | **244,588** | **21,309** | **34** | **(380,280)** | **(38,507)** |

*Note:* Capital reserve includes the waiver of an amount due to a former shareholder during the year ended 31st March, 2004 of HK$1,677,000 and the equity component of preference shares of HK$19,632,000.

## CONDENSED CONSOLIDATED CASH FLOW STATEMENT

*For the six months ended 30th September, 2005*

| | Six months ended 30th September, 2005 HK$'000 (Unaudited) | 2004 HK$'000 (Unaudited) |
|---|---|---|
| Net cash used in operating activities | **(2,970)** | (1,899) |
| Net cash used in investing activities | **(415)** | (30) |
| Net cash used in financing activities | **–** | (2,875) |
| Net decrease in cash and cash equivalents | **(3,385)** | (4,804) |
| Cash and cash equivalents at beginning of the period | **9,234** | 10,408 |
| Cash and cash equivalents at end of the period – represented by bank balances and cash | **5,849** | 5,604 |

## NOTES TO THE CONDENSED FINANCIAL STATEMENTS

*For the six months ended 30th September, 2005*

### 1. BASIS OF PREPARATION

The condensed consolidated financial statements have been prepared in accordance with the applicable disclosure requirements of Appendix 16 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") and with Hong Kong Accounting Standard 34 "Interim financial reporting" issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

### 2. PRINCIPAL ACCOUNTING POLICIES

The condensed consolidated financial statements have been prepared on the historical cost basis, except for certain financial assets and liabilities, which are measured at fair values. The accounting policies adopted are consistent with those followed in the preparation of the annual financial statements of Huabao International Holdings Limited (the "Company") and its subsidiaries (collectively known as the "Group") for the year ended 31st March, 2005 except as described below:

In the current period, the Group has applied, for the first time, a number of new Hong Kong Financial Reporting Standards ("HKFRSs"), Hong Kong Accounting Standards ("HKASs") and Interpretations (hereinafter collectively referred to as "new HKFRSs") issued by the HKICPA that are effective for accounting periods beginning on or after 1st January, 2005. The application of the new HKFRSs has resulted in a change in the presentation of income statement, balance sheet and statement of changes in equity. The adoption of the new HKFRSs has resulted in changes to the Group's accounting policies in the following areas that have an effect on how the results for the current or prior accounting periods are prepared and presented:

**Financial instruments**

In the current period, the Group has applied HKAS 32 "Financial instruments: disclosure and presentation" and HKAS 39 "Financial instruments: recognition and measurement". HKAS 32 requires retrospective application. HKAS 39, which is effective for annual periods beginning on or after 1st January, 2005, generally does not permit to recognise, derecognise or measure financial assets and liabilities on a retrospective basis. The Group has applied the relevant transitional provisions in HKAS 39 with respect to classification and measurement of financial assets and financial liabilities that are within the scope of HKAS 39. The principal effects resulting from the implementation of HKAS 32 and HKAS 39 are summarised below:

*Preference shares*

HKAS 32 requires an issuer of a compound financial instrument (that contains both financial liability and equity components) to separate the compound financial instrument into its liability and equity components on its initial recognition and to account for these components separately. In subsequent periods, the liability component is carried at amortised cost using the effective interest method. The principle impact of HKAS 32 on the Group is in relation to convertible cumulative non-voting preference shares issued by the Company that contain both liability and equity components. Previously, the preference shares were classified as equity on the balance sheet. Because HKAS 32 requires retrospective application, comparative figures have been restated. Comparative loss for 2004 has been restated in order to reflect the increase in effective interest on the liability component (see note 3 for the financial impact).

*Financial assets and financial liabilities other than debt and equity securities*

From 1st April, 2005 onwards, the Group classifies and measures its financial assets and financial liabilities other than debt and equity securities (which were previously outside the scope of SSAP 24) in accordance with the requirements of HKAS 39. Financial assets under HKAS 39 are classified as "financial assets at fair value through profit or loss", "available-for-sale financial assets", "loans and receivables" or "held-to-maturity financial assets". Financial liabilities are generally classified as "financial liabilities at fair value through profit or loss" or "financial liabilities other than financial liabilities at fair value through profit or loss (other financial liabilities)". "Other financial liabilities" are carried at amortised cost using the effective interest method. The application of HKAS 39 has had no material effect on the presentation of financial instrument in the Group's condensed consolidated financial statements.

In addition, the Group adopted the following accounting policy during the period.

**Property, plant and equipment**

Property, plant and equipment, other than construction in progress, are stated at cost less accumulated depreciation and impairment losses.

Depreciation is provided to write off the cost of property, plant and equipment, other than construction in progress, over their estimated useful lives on a straight line basis at the following rates per annum and after taking into account their estimated residual value, if applicable:

| | |
|---|---|
| Office equipment | 25% to 33$^1/_3$% |
| Plant and equipment | 25% |
| Leasehold improvements | 25% |

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

Construction in progress is stated at cost, less any recognised impairment loss. Cost comprises construction expenditures and other direct costs. No depreciation is provided on construction in progress until the relevant asset is ready for its intended use, at which time it is transferred to the appropriate categories of property, plant and equipment.

## 3. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES

The effects of the adoption of new HKFRSs on the unaudited results for the six months ended 30th September, 2005 and 2004 are as follows:

| | **Six months ended 30th September,** | |
|---|---|---|
| | **2005** | 2004 |
| | ***HK$'000*** | *HK$'000* |
| Increase in interest on the liability component of the preference shares under finance costs | **2,958** | 2,722 |

The cumulative effects of application of the new HKFRSs as at 31st March, 2005 are summarised below:

| | Originally stated | Applied retrospectively HKAS 32 | Restated |
|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* |
| *Effect on assets and liabilities:* | | | |
| Preference shares | **–** | **(38,502)** | **(38,502)** |
| *Effect on equity:* | | | |
| Share capital | **77,421** | **(52,690)** | **24,731** |
| Capital reserve | **1,677** | **19,632** | **21,309** |
| Accumulated losses | **(371,365)** | **(5,444)** | **(376,809)** |
| | **(292,267)** | **(38,502)** | **(330,769)** |

The financial effects of the application of the new HKFRSs to the Group equity at 1st April, 2004 are summarised below:

| | Originally stated | Adjustment | Restated |
|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* |
| *Effect on equity:* | | | |
| Share capital | 77,421 | (52,690) | 24,731 |
| Capital reserve | 1,677 | 19,632 | 21,309 |
| | 79,098 | (33,058) | 46,040 |

The Group has not early applied the following new standards and interpretations that have been issued but are not yet effective. The directors of the Company anticipate that the application of these Standards or Interpretations will have no material impact on the condensed consolidated financial statements of the Group.

| | |
|---|---|
| HKAS 1 (Amendment) | Capital Disclosures[1] |
| HKAS 19 (Amendment) | Actuarial Gains and Losses, Group Plans and Disclosures[2] |
| HKAS 39 (Amendment) | Cash Flow Hedge Accounting of Forecast Intragroup Transactions[2] |
| HKAS 39 (Amendment) | The Fair Value Option[2] |
| HKAS 39 & HKFRS 4 (Amendments) | Financial Instruments: Recognition and Measurement and Insurance Contracts – Financial Guarantee Contracts[2] |
| HKFRS 6 | Exploration for and Evaluation of Mineral Resources[2] |
| HKFRS 7 | Financial Instruments: Disclosures[1] |
| HKFRS – Int 4 | Determining whether an Arrangement contains a Lease[2] |
| HKFRS – Int 5 | Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds[2] |
| HK(IFRIC) – Int 6 | Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment[3] |

[1] *Effective for annual periods beginning on or after 1st January, 2007.*

[2] *Effective for annual periods beginning on or after 1st January, 2006.*

[3] *Effective for annual periods beginning on or after 1st December, 2005.*

## 4. SEGMENT INFORMATION

The turnover and segment results for the six months ended 30th September, 2005, analysed by business segments which are the primary segments are as follows:

| | Unaudited Six months ended 30th September, 2005 | | |
|---|---|---|---|
| | **Consumer electronic products** *HK$'000* | **Fine chemicals** *HK$'000* | **Consolidated** *HK$'000* |
| Revenue | **3,717** | **6,739** | **10,456** |
| Segment results | **40** | **121** | **161** |
| Unallocated corporate expenses | | | **(3,538)** |
| Loss before taxation | | | **(3,377)** |
| Taxation | | | **(94)** |
| Loss for the period | | | **(3,471)** |

| | Unaudited and restated | | |
|---|---|---|---|
| | Six months ended 30th September, 2004 | | |
| | Consumer electronic products | Fine chemicals | Consolidated |
| | *HK$'000* | *HK$'000* | *HK$'000* |
| Revenue | 8,777 | 1,867 | 10,644 |
| Segment results | 28 | (259) | (231) |
| Unallocated corporate expenses | | | (3,272) |
| Loss before taxation | | | (3,503) |
| Taxation | | | – |
| Loss for the period | | | (3,503) |

## 5. FINANCE COSTS

| | **Six months ended 30th September,** | |
|---|---|---|
| | **2005** | 2004 |
| | ***HK$'000*** | *HK$'000* |
| | **(Unaudited)** | (Unaudited and restated) |
| Imputed interest expenses on preference share liabilities | **2,958** | 2,722 |

## 6. TAXATION

The amount represents Hong Kong Profits Tax calculated at 17.5% of the estimated assessable profit for the period.

In prior period, no provision for Hong Kong Profits Tax had been made in the condensed consolidated financial statements as the Group had no assessable profit for that period.

Taxation arising in other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions. There is no tax charge arising in other jurisdictions during both periods.

At the balance sheet date, the Group had unused tax losses of HK$9,424,000 (31st March, 2005: HK$5,466,000) available for offsetting against future profits. No deferred tax asset has been recognised in respect of tax losses due to the unpredictability of future profit streams.

## 7. LOSS PER SHARE

The calculation of the basic loss per share is based on the Group's loss for the period of HK$3,471,000 (2004: HK$3,503,000) and the number of ordinary shares of 247,309,435 (2004: 247,309,435) in issue during the period.

No diluted loss per share is presented since the exercise of the outstanding convertible cumulative non-voting preference shares and warrants would decrease the loss per share.

The following table summarises the impact on basic loss per share as a result of:

| | Six months ended 30th September, | |
|---|---|---|
| | **2005** | 2004 |
| | ***HK cents*** | *HK cents* |
| Reported figures before adjustments | **(0.21)** | (0.32) |
| Adjustments arising from changes in accounting policies *(see Note 3)* | **(1.19)** | (1.10) |
| Restated | **(1.40)** | (1.42) |

## 8. PROPERTY, PLANT AND EQUIPMENT

For the six months ended 30th September, 2005, the Group has acquired property, plant and equipment of HK$415,000 (2004: HK$30,000).

## 9. TRADE AND OTHER RECEIVABLES

The Group allows a credit period ranging from cash on delivery to 90 days to its trade debtors. The aged analysis of trade debtors is as follows:

| | **30th September, 2005** | 31st March, 2005 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| | **(Unaudited)** | (Audited) |
| Trade debtors: | | |
| 0 – 30 days | **5,177** | 452 |
| 31 – 90 days | **384** | 275 |
| | **5,561** | 727 |
| Other receivables | **144** | 218 |
| | **5,705** | 945 |

## 10. TRADE AND OTHER PAYABLES

The aged analysis of trade creditors is as follows:

| | **30th September, 2005** | 31st March, 2005 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| | **(Unaudited)** | (Audited) |
| Trade creditors: | | |
| 0 – 30 days | **4,552** | 1,799 |
| 31 – 90 days | **705** | 1,400 |
| Over 90 days | **2,995** | 2,217 |
| | **8,252** | 5,416 |
| Other payables | **805** | 1,017 |
| | **9,057** | 6,433 |

## 11. SHARE CAPITAL

| | Ordinary shares of HK$0.10 each | | Convertible cumulative non-voting preference shares of HK$1.00 each | | Convertible cumulative non-voting preference shares of HK$0.10 each | | Convertible cumulative non-voting preference shares of HK$0.10 each | | Total |
|---|---|---|---|---|---|---|---|---|---|
| | *Number of shares* | *HK$'000* | *Number of shares* | *HK$'000* | *Number of shares* | *HK$'000* | *Number of shares* | *HK$'000* | *HK$'000* |
| Authorised: | | | | | | | | | |
| At 1st April, 2005 and at 30th September, 2005 | 2,000,000,000 | 200,000 | 50,000,000 | 50,000 | 350,000,000 | 35,000 | 526,900,000 | 52,690 | 337,690 |
| Issued and fully paid: | | | | | | | | | |
| At 1st April, 2005 as originally stated | 247,309,435 | 24,731 | – | – | – | – | 526,900,000 | 52,690 | 77,421 |
| On adoption of HKAS 32 | – | – | – | – | – | – | – | (52,690) | (52,690) |
| **At 1st April, 2005 as restated and at 30th September, 2005** | **247,309,435** | **24,731** | – | – | – | – | **526,900,000** | – | **24,731** |

## 12. PREFERENCE SHARES

526,900,000 convertible cumulative non-voting preference shares of HK$0.10 each (the “Preference Shares”) were issued by the Company on 22nd March, 2004 with the terms as follows:

(i) the Preference Shares are entitled to a cumulative annual dividend of 5% on the principal amount, payable semi-annually in arrears on the 30th of April and 31st of October but are not entitled to any further dividend distribution.

(ii) the holders of such Preference Shares have the right to request the Company to redeem all or part only of the Preference Shares at par value should the listing of the Company’s shares on the Stock Exchange be cancelled or trading in the Company’s shares on the Stock Exchange be suspended for a period of 20 consecutive trading days or more. On each of the third and fourth anniversary of the date of issue, one-third of the Preference Shares first issued on the date of issue shall become redeemable, at par value, by the Company in cash; and the Company shall redeem all the then outstanding Preference Shares on the fifth anniversary of the date of issue or the earliest date permitted under the Companies Act, whichever is the later.

(iii) the holders of such Preference Shares are entitled to convert their shares, at par value, in multiple of 100,000 into ordinary shares at any time prior to the date upon which such Preference Shares are redeemed.

(iv) the holders of such Preference Shares have the same voting rights as those attaching to the ordinary shares of the Company only if there are any accrued dividends overdue for more than 12 months or where certain resolutions are proposed.

(v) the Preference Shares are attached with warrants which the holders are entitled to subscribe for a maximum number of ordinary shares of 49,000,000 at HK$0.10 each before the fifth anniversary of the date of issue of the warrants.

With the retrospective application of new HKAS 32 on 1st April, 2005, the net proceeds received from the issue of the Preference Shares have been split between the equity element and a liability component, representing the fair value of the contractual obligation to deliver cash to the Preference Shares holders as follows:

| | *HK$'000* |
|---|---|
| Nominal value of the Preference Shares issued | 52,690 |
| Liability component at date of issue | (33,058) |
| Equity component at date of issue and at 30th September, 2005 | 19,632 |
| Liability component at date of issue | 33,058 |
| Interest charged up to 31st March, 2005 | 5,444 |
| Liability component at 31st March, 2005 | 38,502 |
| Interest charged for the six months ended 30th September, 2005 | 2,958 |
| Liability component at 30th September, 2005 | 41,460 |

The interest charged is calculated by applying an effective interest rate of 16.8 per cent to the liability component since the Preference Shares were issued.

The fair value of the liability component of the Preference Shares at 30th September, 2005, determined based on the present value of the estimate future cash outflows discounted at the prevailing market rate for an equivalent non-convertible loan at the balance sheet date, approximates the carrying value.

## 13. CONTINGENT LIABILITIES

The directors noted from an announcement dated 29th April, 2002 made by certain former directors that a verbal demand notice was received from one of the creditors demanding immediate settlement of approximately RMB9,600,000 alleged outstanding debts. However, after the directors have reviewed the records of the Company and conducted internal investigations after appointment, the directors do not have any other information available to verify the existence of or the validity of this claim but will continue to monitor and review the situation from time to time.

Save as disclosed above and based on the information available to the directors, the Group had no contingent liabilities as at 30th September, 2005.

## 14. RELATED PARTY TRANSACTIONS

During the period, the Group has entered into the following transactions with related parties:

| | Six months ended 30th September, | |
|---|---|---|
| | **2005** | 2004 |
| | ***HK$'000*** | *HK$'000* |
| | **(Unaudited)** | (Unaudited) |
| Amount charged by a related company for sharing of administrative expenses *(note a)* | **243** | 158 |
| Repayment to a former shareholder | **–** | (2,875) |
| Payments on behalf of a subsidiary of the Company by related companies *(note b)* | **236** | – |

*Notes:*

(a) The related company is a company in which a director of the Company, Ms. Chu Lam Yiu, has a beneficial interest. The sharing of administrative expenses was charged based on the actual administrative costs incurred, including share of office premises and corporate expenses, and the basis of which was considered appropriate by the directors.

(b) The related companies are companies in which a director of the Company, Ms. Chu Lam Yiu, has beneficial interests. The amounts represent certain pre-operating expenses and leasehold improvements paid by the related companies on behalf of a subsidiary of the Company.

(c) On 22nd March, 2004, the Company, Huabao Investment Company Limited ("Huabao Investment"), a wholly-owned subsidiary of the Company, and the ultimate holding company, Mogul Enterprises Limited, entered into a loan agreement (the "Loan Agreement") which was approved by the shareholders at a special general meeting held on 19th March, 2004. Pursuant to the Loan Agreement, the ultimate holding company agreed to grant a revolving loan facility up to HK$15 million (the "Loan Facility") to the Company and Huabao Investment at an interest rate of 2% over the six-month Hong Kong Inter Bank Offered Rate. Repayment of the loan and the relevant interests are guaranteed by the Company (limited to HK$15 million) and secured by a first legal fixed charge on the Company's entire shareholding interests in Huabao Investment and a first floating charge on all the assets of Huabao Investment. During the six months ended 30th September, 2005, the Group did not make any drawdown under the Loan Facility.

The balances with related parties at balance sheet date are disclosed in the condensed consolidated balance sheet. Ms. Chu Lam Yiu, a director of the Company, has beneficial interest in these companies.

## MANAGEMENT DISCUSSION AND ANALYSIS

The Group recorded a turnover of HK$10,456,000 for the six months ended 30th September, 2005, representing a decrease of 2% as compared with HK$10,644,000 of the corresponding period last year. The loss recorded during the period under review decreased from HK$3,503,000 restated in the same period of last year to HK$3,471,000.

### Trading of Consumer Electronic Products

The performance of the consumer electronic products trading business continued to be weak during the period under review. The turnover decreased by 58% from HK$8,777,000 of the corresponding period last year to HK$3,717,000 of current period. Due to intense competition in the market of consumer electronic products, the profit margin remained meagre. The Group will continue to monitor and assess the market situations and response accordingly.

### Fine Chemicals Trading

The Group's fine chemicals trading business maintained a steady growth pace. The turnover for the six months ended 30th September, 2005 amounted to HK$6,739,000 (2004: HK$1,867,000), representing an increase of 2.6 times compared with that of the corresponding period last year, of which, sales to the Hong Kong market and to the market of the mainland of People's Republic of China (the "Mainland") amounted to HK$4,323,000 and HK$2,416,000 respectively. For seasonal reason, the management believes that the overall sales will see an apparent increase by the end of lunar year. Apart from exploring the Hong Kong market, the Group is also building up more businesses in the Mainland markets. During the period, the Group focused on setting up sales base in Shenzhen and, in the meantime, proactively prepared for the establishment of the R&D and production plant in Shanghai, in the hope that this would further expand its development in the Mainland.

### Prospects

According to the National Bureau of Statistics of China, the nation's GDP in 2004 soared to an amount of RMB13,651.5 billion, representing an increase of 17% from the level of 2003. For the first three quarters of 2005, a growth rate of 9.4% was recorded when comparing with the corresponding period of 2004. With economic growth in the Mainland keeping on, the Chinese people's consuming power and material living standard are continuously improving, and their expectation on the quality of consumer products including food and household necessities has reached a whole new level. Taking food as an example, people now ask for a lot more than they did before on food's color, flavor, taste, nutrition and even package. To meet such a fast-growing expectation, consumer products manufacturers have to put themselves out to improve the appeal and quality of their products in order to secure a share in the market. Among the broad range variety of consumer products, food, drinks, tobacco and household necessities rely largely on the use of fine chemicals to enhance their appeal and quality. In view of that, the fine chemicals market of the Mainland will grow synchronously with the Mainland's economy, the production of consumer products as well as the consuming power of the people. The management has been closely observing and reviewing the operations of the Company and has a great confidence on the prospects of the fine chemicals market. With a hope to start off from the existing fine chemicals trading business and leveraging on our valuable experience and expertise, this business sector can be further expanded, with an aim to create greater returns for our shareholders.

**New Accounting Standards**

During the period, the Group had for the first time adopted certain new Hong Kong Accounting Standard ("New HKAS") issued by the Hong Kong Institute of Certified Public Accountants, and has disclosed separately the equity and liability components of the Company's convertible cumulative non-voting preference shares ("Preference Shares"). Pursuant to the terms of the Preference Shares, the holders of the Preference Shares are entitled to receive cumulative annual dividends of 5% on the principal amount. However, the New HKAS requires the Preference Shares dividends to be calculated by applying the effective interest rate to the liability component, and recognised in the income statement as finance costs. In previous periods, as the Company had no reserve available for distributions to the shareholders since the date of issue of the Preference Shares, no dividends were declared and paid in respect of the Preference Shares, and no accounting records have been made for the dividends. However, in compliance with the New HKAS, as from this period and onwards the Company has to recognise the Preference Shares dividends as finance costs in the income statement, and make retrospective application as required by the New HKAS. As a result, the comparative figures need to be restated accordingly. The dividends to the Preference Shares of the period and that of the corresponding period last year were HK$2,958,000 and HK$2,722,000, respectively, which constitute one of the major reasons of the Group's loss.

## LIQUIDITY AND FINANCIAL RESOURCES

As at 30th September, 2005, the Group had bank balances and cash of HK$5,849,000, of which 20%, 38% and 42% were denominated in Hong Kong dollars, U.S. dollars and Renminbi respectively. Current ratio was 1.26 (31st March, 2005: 1.5).

Due to the application of New HKAS, the liability and equity components of the Preference Shares are separated on its initial recognition and be accounted for separately, resulting in negative shareholders' equity. The Directors consider that it is not meaningful to publish a gearing ratio for the Group until such time as the Group is in a positive shareholders' equity position.

As at 30th September, 2005, the Group had an undrawn revolving loan facility from Mogul Enterprises Limited, the Group's ultimate holding company, of up to HK$15,000,000 ("Loan Facility"). The facility bears interest at 2% over the six-month Hong Kong Interbank Offered Rate on the outstanding amount calculated on a daily basis, and will be secured by a first legal fixed charge made over the equity interest of the Company in Huabao Investment Company Limited ("Huabao Investment"), a wholly-owned subsidiary of the Company, and by a first floating charge made over all of Huabao Investment's assets. Any outstanding loans together with the accrued interest will be due on 22nd March, 2009. During the period, the Group did not make any drawdown under the Loan Facility.

## FOREIGN CURRENCY EXPOSURE

Except for the operations in the Mainland where the transactions are denominated in Renminbi, the sales and purchases of the Group are denominated in U.S. dollars and Hong Kong dollars. In view of the relative stability of the exchange rates between Hong Kong dollars, U.S. dollars and Renminbi, the directors consider that the Group is not exposed to any significant exchange risk.

## CONTINGENT LIABILITIES

The directors noted from an announcement dated 29th April, 2002 made by certain former directors that a verbal demand notice was received from one of the creditors demanding immediate settlement of approximately RMB9,600,000 alleged outstanding debts. However, while the directors have reviewed the records of the Company and conducted internal investigations after their appointment, the directors do not have any other information available to verify the existence of or the validity of this claim but will continue to monitor and review the situation from time to time.

Save as disclosed above and based on the information available to the directors, the Group had no contingent liabilities as at 30th September, 2005.

## MANAGEMENT AND EMPLOYEES

As at 30th September, 2005, the Group had a total of 25 employees. Salaries of employees are primarily based on prevailing market salary levels and year end bonuses are granted at the end of each calendar year. Other employees' benefits include provident fund, medical cover and other insurance.

## DIRECTORS' INTERESTS IN SHARES, UNDERLYING SHARES AND DEBENTURES

At 30th September, 2005, the interests of the directors and their associates 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 maintained by the Company under Section 352 of the SFO, or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") contained in the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"), were as follows:

### Long positions

(a) *Ordinary shares of HK$0.10 each in the Company*

| Name of director | Capacity | Number of issued ordinary shares held | Percentage of the issued ordinary share capital of the Company |
|---|---|---|---|
| Chu Lam Yiu | Held through a controlled corporation *(note)* | 173,219,445 | 70.04% |

*(b) Convertible cumulative non-voting preference shares of HK$0.10 each in the Company*

| Name of director | Capacity | Number of preference shares held | Number of underlying ordinary shares held under equity derivatives | Percentage of the preference share capital of the Company |
|---|---|---|---|---|
| Chu Lam Yiu | Held through a controlled corporation *(note)* | 526,900,000 | 526,900,000 | 100% |

*(c) Warrants*

| Name of director | Capacity | Number of warrants held | Number of underlying ordinary shares held under equity derivatives |
|---|---|---|---|
| Chu Lam Yiu | Held through a controlled corporation *(note)* | 49,000,000 | 49,000,000 |

*Note:* 173,219,445 ordinary shares, 526,900,000 convertible cumulative non-voting preference shares and 49,000,000 warrants in the Company are held by Mogul Enterprises Limited. Ms. Chu Lam Yiu is the sole beneficial owner of Mogul Enterprises Limited.

Save as disclosed above, at 30th September, 2005, none of the directors nor their associates had any interests or short positions in any shares, underlying shares or debentures of the Company or any of its subsidiaries or associated corporations as defined in the SFO.

## SHARE OPTIONS

On 19th March, 2004, the Company has adopted a share option scheme. No options under the share option scheme had been granted to any persons during the period and up to the date of this report.

## DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

Apart from the interests disclosed in the section "Directors' interests in shares, underlying shares and debentures", at no time during the six months ended 30th September, 2005 was the Company, its ultimate holding company or any of its subsidiaries a party to any arrangements to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

## SUBSTANTIAL SHAREHOLDERS

As at 30th September, 2005, the register of substantial shareholders maintained by the Company under Section 336 of the SFO showed that other than the interests disclosed in the section "Directors' interests in shares, underlying shares and debentures", the Company had not been notified of any substantial shareholders' interests and short positions in the issued share capital of the Company.

## PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the six months ended 30th September, 2005.

## CONTINUING DISCLOSURE OBLIGATION

As at 30th September, 2005, trade receivables due to the Group (the "Receivables") from Doassure Limited amounted to approximately HK$3,640,000, representing approximately 28.7% of the total assets of the Group of HK$12,668,000 as at 30th September, 2005.

The Receivables were interest-free, unsecured, due upon presentation of invoices and arose from the sale of ICs products which was part of the Group's ordinary course of business.

To the best of the knowledge and belief of the Directors, Doassure Limited and its respective ultimate beneficial owners are third parties independent of the Company and connected persons (as defined in the Listing Rules) of the Company.

## CORPORATE GOVERNANCE

None of the directors is aware of any information that would reasonably indicate that the Company is not, or was not for any part of the six months ended 30th September, 2005, in compliance with Appendix 14 to the Listing Rules except for the following deviations:

Code provision A.2.1 stipulates that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual. The Company does not have a separate chairman and chief executive officer. Ms. Chu Lam Yiu is the Chairman of the Company and is in charge of the overall management of the Company. The directors meet regularly to consider major matters affecting the operation of the Company. The board of directors considers that existing structure would enable the Company to make and implement decisions promptly and efficiently, and believes that the balance of power and authority can be ensured as half of the board of directors is represented by independent non-executive directors.

Code provision A.4.1 stipulates that non-executive directors should be appointed for a specific term and subject to re-election. The independent non-executive directors of the Company were not appointed for a specific term as they are subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the Company's bye-laws. As such, the Company considers that sufficient measures have been taken to ensure that the Company's corporate governance practices are no less exacting than those set out in the Code on Corporate Governance Practices.

The Company has adopted a code of conduct regarding securities transactions by directors and relevant employees, as defined in Appendix 14 to the Listing Rules, on terms no less exacting than the required standard set out by the Stock Exchange in the Model Code in Appendix 10 to the Listing Rules. Having made specific enquiry of all directors and relevant employees, all directors and relevant employees confirmed they have complied with the required standard as set out in the Model Code.

## AUDIT COMMITTEE

The audit committee comprised three independent non-executive directors, namely Messrs. Mak Kin Kwong, Poon Chiu Kwok and Ms. Ma Yun Yan. The audit committee has reviewed the condensed financial statements for the six months ended 30th September, 2005 with the board of directors.

By Order of the Board

**Chu Lam Yiu**
*Chairman*

Hong Kong, 16th December, 2005