

The following is the text of a report, prepared for the purpose of including in this prospectus, received from the auditors and reporting accountants of the Company, Ernst & Young, Certified Public Accountants, Hong Kong.



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27 November 2001

The Directors
Eco-Tek Holdings Limited
Celestial Capital Limited
SBI E2-Capital (HK) Limited

Dear Sirs,

We set out below our report on the financial information regarding Eco-Tek Holdings Limited (the “Company”) and its subsidiaries (hereinafter collectively referred to as the “Group”) for the period from 27 October 1999 (being the date of incorporation of Eco-Tek Company Limited, the major operating company of the Group, and has been taken as the commencement date of active business pursuits and the date of establishment of the Group) to 31 October 1999, the year ended 31 October 2000 and the nine months ended 31 July 2001 (the “Relevant Periods”). The financial information has been prepared on the basis set out in Section 1 below for inclusion in the prospectus of the Company dated 27 November 2001 (the “Prospectus”).

The Company was incorporated as an exempted company with limited liability in the Cayman Islands on 6 December 2000 under the Companies Law of the Cayman Islands, for the purpose of acting as a holding company of the subsidiaries set out in Section 1 below. The Company has not carried on any business since the date of its incorporation save for the acquisition, through a share exchange, on 21 November 2001 of the entire issued share capital of Eco-Tek (BVI) Investment Holdings Limited, a company incorporated in the British Virgin Islands, which is, at the date of this report, the intermediate holding company of the other subsidiaries set out in Section 1 below.

All of the companies now comprising the Group have adopted 31 October as their financial year end date for statutory reporting purposes.

We have acted as auditors of all the companies now comprising the Group for the Relevant Periods.

As at the date of this report, no audited financial statements have been prepared for the Company, Eco-Tek (BVI) Investment Holdings Limited or Eco-Tek Technology Limited since their respective dates of incorporation, as these companies were either newly incorporated or not subject to any statutory audit requirements in their respective jurisdictions of incorporation. We have, however, performed our own independent review of all relevant transactions of these companies since their respective dates of incorporation.

We have prepared this report in accordance with the Auditing Guideline "Prospectuses and the Reporting Accountant" issued by the Hong Kong Society of Accountants.

The summaries of the combined results of the Group for the Relevant Periods and of the combined net assets of the Group as at 31 July 2001 (the "Summaries") set out in this report have been prepared from the audited financial statements and the unaudited management accounts of the companies now comprising the Group and are presented on the basis set out in Section 1 below.

In our opinion, the Summaries together with the notes thereon give, for the purpose of this report, a true and fair view of the combined results of the Group for the Relevant Periods and of the combined net assets of the Group as at 31 July 2001.

1. BASIS OF PRESENTATION

The Summaries, which are based on the audited financial statements and the unaudited management accounts of the companies now comprising the Group, include the results and net assets of the companies now comprising the Group as if the current Group structure had been in existence throughout the Relevant Periods or from their respective dates of incorporation where this is a shorter period. All material transactions and balances among the companies comprising the Group have been eliminated on combination.

At the date of this report, the Company had direct or indirect interests in the following subsidiaries, all of which are private companies (or if incorporated outside Hong Kong, have substantially similar characteristics to a private company incorporated in Hong Kong), the particulars of which are set out below:

Company name	Place and date of incorporation	Paid-up share capital	Percentage of equity attributable to the Group		Principal activities
			Direct	Indirect	
Eco-Tek (BVI) Investment Holdings Limited (formerly Saramore Co., Ltd)	British Virgin Islands 2 October 2000	US\$30,000 ordinary	100%	–	Investment holding
Eco-Tek Technology Limited (formerly Natural Environmental Ltd.)	British Virgin Islands 9 November 2000	US\$101 ordinary	–	100%	Holding of intellectual properties
Eco-Tek Company Limited	Hong Kong 27 October 1999	HK\$100,000 ordinary	–	100%	Marketing, sales, servicing, research and development of environmental protection related products and services

2. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted by the Group in arriving at the financial information set out in this report, which conform with the accounting principles generally accepted in Hong Kong, are as follows:

(a) Subsidiary

A subsidiary is a company in which the Company controls. Control exists when the Company has the power to govern the financial and operating policies of the subsidiary so as to obtain benefits from its activities.

(b) Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

- sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold; and
- interest income, on a time proportional basis, taking into account the principal outstanding and the effective interest rate applicable.

(c) Fixed assets and depreciation

Fixed assets are stated at cost less accumulated depreciation.

The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after the fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of that asset.

Depreciation is calculated on a straight-line basis to write off the cost of each asset over the following estimated useful lives:

Motor vehicles	2 to 5 years
Office equipment	2 to 5 years
Plant and machinery	2 to 5 years
Furniture and fixtures	2 to 5 years

The gain or loss on disposal or retirement of a fixed asset recognised in the profit and loss account is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Where, in the opinion of the directors, the recoverable amounts of fixed assets have declined below their carrying amounts, provisions are made to write down the carrying amounts of such assets to their recoverable amounts. Recoverable amounts are not determined using discount cash flows.

(d) Research and development costs

All research costs are charged to the profit and loss account as incurred.

Development costs are capitalised and deferred only when the projects are clearly defined, the costs are separately identified and there is reasonable certainty that the projects are technically feasible and the products have commercial value. Development expenditure which does not meet these criteria is expensed when incurred.

Costs so deferred are amortised on the straight-line basis over the expected economic useful lives of the products, subject to a maximum period of five years commencing in the year when the products are put into commercial production.

(e) Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. The rentals applicable to such operating leases are charged to the profit and loss account on the straight-line basis over the lease terms.

(f) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the first-in, first-out basis. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

(g) Provision for warranty costs

Provision for warranty costs is made on an accrual basis by reference to the directors' best estimates of the expenditure required to settle the obligations, and is charged to the profit and loss account in the period in which the related sales are made. Subsequent expenditure on the settlement of such obligations is charged against the provision made, except where the expenditure exceeds the balance of the provision, in which case, it is charged to the profit and loss account as incurred.

(h) Deferred tax

Deferred tax is provided, using the liability method, on all significant timing differences in the recognition of revenue and expenses for tax and for financial reporting purposes, to the extent it is probable that the liability will crystallise in the foreseeable future. A deferred tax asset is not recognised unless its realisation is assured beyond reasonable doubt.

(i) Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party, or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

(j) Foreign currencies

Foreign currency transactions are recorded at the applicable rates of exchange ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the rates of exchange ruling at that date. Exchange differences are dealt with in the profit and loss account.

On combination, the financial statements of overseas subsidiaries are translated into Hong Kong dollars at the applicable rates of exchange ruling at the balance sheet date. The resulting translation differences are included in the exchange fluctuation reserve.

(k) Cash equivalents

For the purpose of balance sheet classification, cash equivalents represent assets similar in nature to cash, which are not restricted as to use.

3. RESULTS

The following is a summary of the combined results of the Group for the Relevant Periods, prepared on the basis set out in Section 1 above:

		Period from 27 October 1999 to 31 October 1999	Year ended 31 October 2000	Nine months ended 31 July 2001
	<i>Notes</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Turnover	<i>(a)</i>	–	1,621	16,906
Cost of sales		–	(421)	(4,254)
Gross profit		–	1,200	12,652
Other income		–	–	387
Selling expenses		–	(51)	(416)
Administrative expenses		–	(1,057)	(4,077)
Profit before tax	<i>(b)</i>	–	92	8,546
Tax	<i>(e)</i>	–	–	(1,366)
Net profit from ordinary activities attributable to shareholders		–	92	7,180
Dividends	<i>(f)</i>	–	–	–
Earnings per share:	<i>(h)</i>			
Basic		–	HK0.02 cents	HK1.73 cents
Diluted		–	HK0.02 cents	HK1.41 cents

Notes:

(a) Turnover

Turnover represents the net invoiced value of goods sold, after allowances for returns and trade discounts.

(b) Profit before tax

The Group's profit before tax is arrived at after charging/(crediting):

	Period from 27 October 1999 to 31 October 1999	Year ended 31 October 2000	Nine months ended 31 July 2001
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Cost of inventories sold	–	421	4,254
Auditors' remuneration	–	100	225
Depreciation	–	9	84
Staff costs, excluding directors' remuneration (<i>note (c)</i>)	–	335	1,526
Research and development costs	–	100	960
Operating lease rentals in respect of land and buildings	–	–	281
Management fee paid to a related company (<i>note (g)</i>)	–	140	100
Interest income	–	–	(196)
	<u>–</u>	<u>–</u>	<u>(196)</u>

The cost of inventories sold for the periods ended 31 October 1999 and 2000, and 31 July 2001 includes nil, HK\$54,000 and HK\$110,000, respectively, relating to direct staff costs and depreciation, which are also included in the respective total amounts disclosed separately above for each of these types of expenses for the Relevant Periods.

The research and development costs for the periods ended 31 October 1999 and 2000, and 31 July 2001 include nil, HK\$100,000 and HK\$960,000, respectively, relating to directors' remuneration, which are also included in the total amounts of directors' remuneration disclosed separately in note (c) below for the Relevant Periods.

(c) Directors' and senior executives' emoluments

Details of directors' remuneration during the Relevant Periods are as follows:

	Period from 27 October 1999 to 31 October 1999	Year ended 31 October 2000	Nine months ended 31 July 2001
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Fees	–	–	–
Other emoluments	–	490	1,590
Bonus	–	–	–
Pension	–	–	24
	<u>–</u>	<u>490</u>	<u>1,614</u>

The remuneration of each of the directors fell within the band of nil to HK\$1,000,000.

None of the executive directors of the Company received any emoluments for the period from 27 October 1999 to 31 October 1999. The three executive directors of the Company received emoluments of approximately HK\$350,000, HK\$140,000 and nil for the year ended 31 October 2000. The three executive directors of the Company received emoluments of approximately HK\$968,000, HK\$458,000 and HK\$188,000 for the nine months ended 31 July 2001.

No emoluments were paid to the non-executive directors of the Company during the Relevant Periods.

The five highest paid individuals in the Group during the year ended 31 October 2000 and the nine months ended 31 July 2001 included 2 and 3 directors, respectively, and information relating to their emoluments has been disclosed above. The emoluments of the remaining highest paid, non-director individuals during the Relevant Periods are as follows:

	Period from 27 October 1999 to 31 October 1999 <i>HK\$'000</i>	Year ended 31 October 2000 <i>HK\$'000</i>	Nine months ended 31 July 2001 <i>HK\$'000</i>
Basic salaries, housing benefits, other allowances and benefits in kind	–	262	417
Bonus	–	–	–
Pension	–	–	13
	<u>–</u>	<u>262</u>	<u>430</u>

The emoluments of each of the remaining highest paid, non-director individuals fell within the band of nil to HK\$1,000,000.

During the Relevant Periods, no emoluments were paid by the Group to the directors or any of the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office. No directors waived or agreed to waive any emoluments during the Relevant Periods.

(d) Pension scheme

For the period from 27 October 1999 to 30 November 2000, the Group did not operate a pension scheme for its employees in Hong Kong.

Commencing from 1 December 2000, the Mandatory Provident Fund Schemes Ordinance took effect and introduced certain new arrangements for the provision of employee benefits. A new Mandatory Provident Fund scheme (the “MPF Scheme”) has been set up by the Group for this purpose and employer’s voluntary contributions are made under the scheme. Contributions are made based on a percentage of the employees’ basic salaries and are charged to the profit and loss account as they became payable in accordance with the rules of the MPF Scheme. The Group’s employer contributions vest fully with the employees when contributed to the scheme except for the Group’s employer voluntary contributions which shall be refunded to the Group when the employees leave employment prior to the employer’s voluntary contributions vesting fully, in accordance with the rules of the MPF Scheme. No forfeited contributions were utilised or available up to 31 July 2001.

For the nine months ended 31 July 2001, the amount of the MPF Scheme contributions dealt with in the profit and loss account of the Group was HK\$76,000.

As at 31 July 2001, the Group had no material liabilities in respect of its obligations for long service payments to its employees pursuant to the requirements under the Employment Ordinance, Chapter 57 of the Laws of Hong Kong.

(e) Tax

Hong Kong profits tax had not been provided as the Group did not generate any estimated assessable profits arising in Hong Kong during the period from 27 October 1999 to 31 October 2000.

Hong Kong profits tax has been provided at the rate of 16% on estimated assessable profits arising in Hong Kong during the nine months ended 31 July 2001.

(f) Dividends

No dividend has been paid or declared by the Company or any of the companies comprising the Group since their respective dates of incorporation.

(g) Related party transactions

The Group had the following material transactions with related parties during the Relevant Periods:

- (i) Prior to 27 March 2001, a banking facility of one of the Company's subsidiaries (note 4(j)) was secured by deposits of HK\$1,000,000 pledged by Dr. Lily Chiang, a director of the Company.

On 27 March 2001, the Group received a consent from the relevant banker to the aforesaid pledged deposits being released and replaced by the Group's pledged bank deposit of HK\$1,000,000.

- (ii) A management fee of HK\$240,000 was paid to E1 Media Technology Limited, a related company of the Company in which Dr. Lily Chiang has a beneficial interest, at HK\$20,000 per month from April 2000 to March 2001 inclusive. The management fee is charged with reference to the costs incurred in respect of, inter alia, the provision of office space and equipment and other overheads. The directors of the Company have confirmed that the charging of such management fees was terminated after March 2001.

In the opinion of the directors, the above related party transactions were entered into by the Group in the ordinary course of business.

(h) Earnings per share

The calculation of basic earnings per share for the Relevant Periods is based on the net profit attributable to shareholders of the Company for the Relevant Periods and on the 414,600,000 shares deemed to have been in issue and issuable, comprising 600,000 shares in issue and 414,000,000 shares to be issued pursuant to the capitalisation issue, as further described in the paragraph headed "Written resolutions of all shareholders of the Company passed on 21 November 2001" in Appendix IV to the Prospectus.

The calculation of diluted earnings per share for the Relevant Periods is based on the net profit attributable to shareholders of the Company for the Relevant Periods and on 508,691,167 shares, being the 414,600,000 shares as used in the calculation of basic earnings per share, and the weighted average of 94,091,167 shares assumed to have been issued at no consideration on the deemed exercise of the Pre-IPO Share Options and the ANT-Options as set out in Appendix IV to the Prospectus.

For the purpose of calculating diluted earnings per share, the fair value of the shares assumed to have been issued upon the deemed exercise of these options was determined as the mid-point of the issue price range of HK\$0.24 per share in respect of the Company's initial public offering of its shares. The difference between the number of shares issued and the number of shares that would have been issued at fair value is treated as an issue of ordinary shares for no consideration.

4. NET ASSETS

The following is a summary of the combined net assets of the Group as at 31 July 2001 prepared on the basis set out in Section 1 above:

	<i>Notes</i>	<i>HK\$'000</i>
NON-CURRENT ASSETS		
Fixed assets	<i>(a)</i>	632
Pledged deposit	<i>(j)</i>	1,000
		<u>1,632</u>
CURRENT ASSETS		
Inventories	<i>(b)</i>	297
Accounts receivable		2,364
Prepayments, deposits and other receivables		1,814
Cash and cash equivalents	<i>(c)</i>	8,264
		<u>12,739</u>
CURRENT LIABILITIES		
Accounts payable		324
Accrued liabilities and other payables		1,293
Tax payable	<i>(d)</i>	1,366
Due to directors	<i>(e)</i>	4,015
		<u>6,998</u>
NET CURRENT ASSETS		<u>5,741</u>
		<u><u>7,373</u></u>

Notes:

(a) Fixed assets

	Cost <i>HK\$'000</i>	Accumulated depreciation <i>HK\$'000</i>	Net book value <i>HK\$'000</i>
Motor vehicles	33	6	27
Office equipment	67	7	60
Plant and equipment	618	79	539
Furniture and fixtures	7	1	6
	<u>725</u>	<u>93</u>	<u>632</u>

(b) Inventories

	<i>HK\$'000</i>
Finished goods	<u>297</u>

As at 31 July 2001, no inventories were stated at net realisable values.

(c) Cash and cash equivalents

	<i>HK\$'000</i>
Cash and bank balances	3,264
Time deposits	5,000
	8,264
	8,264

(d) Deferred tax

As at 31 July 2001, the Group had unprovided deferred tax liabilities of HK\$70,000, which represented accelerated depreciation allowances.

(e) Due to directors

The amounts due to directors were unsecured, interest-free and were fully repaid in November 2001. Should the amounts due to the directors have borne interest at the Hong Kong dollar prime rate, the notional interest charged would have been nil, HK\$67,000 and HK\$122,000 for the period from 27 October 1999 to 31 October 1999, the year ended 31 October 2000 and the nine months ended 31 July 2001, respectively.

(f) Distributable reserves

As at 31 July 2001, the Company had no reserves available for distribution to the shareholders of the Company.

(g) Contingent liabilities

A performance bond facility of HK\$1,000,000 has been granted by a banker in favour of the Group. In the event of a default by the Group in the performance of the services detailed in the tender contract, as further detailed in the paragraph headed "Development and commercialisation of *Eco-Trap*" under the section headed "Business" in the Prospectus, the Government of the Hong Kong Special Administrative Region (the "Government") is entitled to call for payment from the banker to satisfy and discharge any damages, losses or expenses sustained by the Government up to the amount of HK\$1,000,000. The banker has the right of recourse to the Group.

Save as aforesaid, the Group did not have any significant contingent liabilities as at 31 July 2001.

(h) Commitment

At 31 July 2001, the Group had an aggregate commitment of HK\$221,000 payable in the following year under a non-cancellable operating lease on land and buildings expiring within one year.

Save as aforesaid, the Group had no other commitments at 31 July 2001.

(i) Net assets of the Company

The Company was incorporated on 6 December 2000. The net assets of the Company as at 31 July 2001 were HK\$0.10, being the nominal value of its issued share capital on that date. Had the Group reorganisation, as set out in the paragraph headed "Group reorganisation" in Appendix IV to the Prospectus, been completed on 31 July 2001, the fair value of the net assets of the Company as at 31 July 2001 would have been HK\$7,373,000.

(j) Banking facility

Prior to 27 March 2001, the Group's performance bond facility was secured by deposits of HK\$1,000,000 pledged by Dr. Lily Chiang, a director of the Company. On 27 March 2001, the Group received a consent from the relevant banker to the aforesaid pledged deposits being released and replaced by the Group's bank deposit of HK\$1,000,000.

5. DIRECTORS' REMUNERATION

Save as disclosed herein, no remuneration has been paid or is payable in respect of any of the Relevant Periods referred to in this report by the Company or any of the companies now comprising the Group to the directors of the Company. Under the arrangements currently in force, the estimated amount of the directors' fees and other emoluments payable to the directors of the Company for the year ending 31 October 2001 will be approximately HK\$2.3 million, excluding discretionary bonuses payable under the directors' service contracts, the terms of which are set out in the paragraph headed "Disclosure of Interests" in Appendix IV to the Prospectus.

6. ULTIMATE HOLDING COMPANY

The directors consider Team Drive Limited, a company incorporated in the British Virgin Islands, to be the ultimate holding company of the Group.

7. SUBSEQUENT EVENTS

In addition to the matters set out in section 4, the following events took place subsequent to 31 July 2001:

- (a) On 21 November 2001, the Company became the holding company of the Group; and
- (b) The companies now comprising the Group underwent a reorganisation in preparation for the listing of the Company's shares on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited. Further details of the reorganisation are set out in the paragraph headed "Group reorganisation" in Appendix IV to the Prospectus.

Save as aforesaid, no other significant events took place subsequent to 31 July 2001.

8. SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements have been prepared by the Company or any of the companies now comprising the Group in respect of any period subsequent to 31 July 2001.

Yours faithfully,
Ernst & Young
Certified Public Accountants
Hong Kong