

Report of The Directors

The directors present their report and the audited financial statements for the year ended 31st March, 2002.

CORPORATE REORGANISATION

The Company was incorporated as an exempted company with limited liability in Bermuda on 16th November, 2000 under section 14 of the Companies Act (1981). Pursuant to a reorganisation scheme to rationalise the structure of the Group in preparation for the listing of the Company's shares on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") by way of introduction, the Company became the holding company of the companies (principally Honko International Holdings Limited ("Honko") and its subsidiaries (collectively referred to "Honko Group")) now comprising the Group on 14th June, 2001. Further details of the Group reorganisation and the principal subsidiaries pursuant thereto are set out in notes 2 and 16 to the financial statements.

The shares of the Company were listed on the Stock Exchange by way of introduction with effect from 18th June, 2001.

PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. Details of the principal activities of the subsidiaries are set out in note 16 to the financial statements. There were no changes in the nature of the Group's principal activities during the year.

RESULTS

The results of the Group for the year ended 31st March, 2002 are set out in the consolidated income statement on page 23.

The directors do not recommend the payment of a dividend and propose that the profit for the year be retained.

SUMMARY OF FINANCIAL INFORMATION

A summary of the results and of the assets and liabilities of the Group for the each of the last five financial years is set out on pages 67 to 68.

PROPERTY, PLANT AND EQUIPMENT AND INVESTMENT PROPERTIES

Details of movements in the property, plant and equipment and the investment properties of the Group during the year are set out in notes 14 and 15 to the financial statements respectively.

SHARE CAPITAL AND CONVERTIBLE NOTES

Details of movements in the Company's share capital and convertible notes, are set out in note 28 and 30 to the financial statements respectively.

RESERVES

Details of movements in the reserves of the Company and of the Group during the year are set out in note 29 to the financial statements.

DISTRIBUTABLE RESERVES

As at 31st March, 2002, the Company had no reserves available for cash distribution and/or distribution in specie, as calculated in accordance with the Companies Act 1981.

DIRECTORS

The directors of the Company for the year ended 31st March, 2002, and up to date of this report were as follows:

Executive directors

Dr. Li Zhong Yuan	
Mr. Wong Chong Kwong, Derek	
Mr. Chan Chung Yin, Victor	(resigned on 8th February, 2002)
Mr. Lam Yat Keung	(appointed on 14th June, 2001)
Mr. Mok Shau Chuen	(appointed on 14th June, 2001 and resigned on 19th April, 2002)
Mr. Kwong Sang Hun	(appointed on 20th October, 2001)
Mr. Yun Jong Suk	(appointed on 20th October, 2001)

Independent non-executive directors

Mr. Yuen Wai	(appointed on 14th June, 2001)
Mr. Li Xiao Ru	(appointed on 14th June, 2001)

In accordance with the Company's bye-law 87, Messrs, Yuen Wai, Li Xiao Ru and Yun Jong Suk will retire and, being eligible, offer themselves for re-election at the forthcoming annual general meeting.

DIRECTORS *(continued)*

The directors of Honko before the group reorganisation and up to 15th June, 2001 (the date of delisting from the Stock Exchange) were as follows:

Executive directors

Mr. Lam Yat Keung	
Mr. Tam King Ho	(resigned on 14th June, 2001)
Mr. Ho Chi Fai	(resigned on 14th June, 2001)
Ms. Lam Ching Wah	(resigned on 14th June, 2001)
Mrs. Lam Pik Wah	
Mr. Mok Shau Chuen	(resigned on 14th June, 2001)
Dr. Li Zhong Yuan	(appointed on 14th June, 2001)
Mr. Wong Chong Kwong, Derek	(appointed on 14th June, 2001)
Mr. Chan Chung Yin, Victor	(appointed on 14th June, 2001)

Independent non-executive directors

Mr. Chan Hing Kwong, Peter	(resigned on 14th June, 2001)
Mr. Hsu Shiu Foo, William	(resigned on 14th June, 2001)
Mr. Lo Wai Kwok	(resigned on 14th June, 2001)
Mr. Tsumura Tetsuo	(resigned on 14th June, 2001)

DIRECTORS' SERVICE CONTRACTS

Each of the executive directors of the Company has entered into a service contract with the Company for an initial term of five years commencing from the date of appointment with the first two years under a fixed term and the remaining three years being terminable by not less than a six-month notice in writing served by either party.

Independent non-executive directors are not appointed for a specific term.

Save as disclosed above, no director proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable by the Company within one year without payment other than statutory compensation.

DIRECTORS' INTERESTS IN CONTRACTS

On 9th April, 2001, Honko put forward a restructuring proposal, pursuant to which the Company issued shares for cash and restructured all the indebtedness of Honko Group as stipulated in a subscription agreement ("the Subscription Agreement") and two compromise agreements (the "Compromise Agreements") that were entered into on 18th January, 2001. The Subscription Agreement was entered into by Honko, the Company, the Investor, Kingsway SW Securities Limited ("Kingsway") and Mr. Lam Yat Keung, a director of Honko. The Compromise Agreements were entered into by Honko, the Company, the Investor, Kingsway and Honko Group's borrowing banks, finance lease creditors and certain other creditors. Details of them are set out in note 2 to the financial statements.

Save as disclosed above, no director of Honko or the Company had a significant beneficial interest, either directly or indirectly, in any contract of significance to which the Company or any of its subsidiaries was a party during the year.

DIRECTORS' INTERESTS IN SHARE CAPITAL

At 31st March, 2002, the interests of the directors and their associates in the share capital of the Company as recorded in the register maintained by the Company pursuant to Section 29 of the Securities (Disclosure of Interests) Ordinance ("SDI Ordinance") of the Company were as follows:

Name of director	Type of interest	Number of shares held
Dr. Li Zhong Yuan	Corporate (<i>Note (a)</i>)	3,229,400,000
	Personal	195,000,000
Mr. Wong Chong Kwong, Derek	Corporate (<i>Note (a)</i>)	3,229,400,000
	Family (<i>Note (b)</i>)	185,000,000
Mr. Lam Yat Keung	Personal	3,200,000
	Family (<i>Note (c)</i>)	412,500,000

Notes:

- (a) These shares are held by Pacific Annex Capital Limited which is beneficially owned by Dr. Li Zhong Yuan and Mr. Wong Chong Kwong, Derek.
- (b) Included in the family interest of Mr. Wong Chong Kwong, Derek is 90,000,000 shares held by his wife Ms. Wong Kit Wai, Peggy.
- (c) These shares are held by Ms. Lam Pik Wah, the wife of Mr. Lam Yat Keung, personally and a company controlled by her.

Save as disclosed above, as at 31st March, 2002, none of the directors of the Company, or their associates had any personal, family, corporate or other interest in the share capital of the Company or any of its associated corporations, as defined in the SDI Ordinance.

SUBSTANTIAL SHAREHOLDERS

At 31st March, 2002, the following individuals had an interest of 10% or more of the share capital of the Company as recorded in the register of interest in shares required to be kept by the Company pursuant Section 16(1) of the SDI Ordinance.

Name	Number of shares held	Percentage of issued shares
Pacific Annex Capital Limited	3,229,400,000	31.41%

Save as disclosed above, no person, other than the director, Dr. Li Zhong Yuan and Mr. Wong Chong Kwong, Derek, whose interests are set out under the section headed the "Directors' interests in share capital" above, had registered as having an interest of 10% or more of the share capital of the Company that is required to be recorded under Section 16(1) of the SDI Ordinance.

SHARE OPTION SCHEMES

The Company adopted a share option scheme (the "Old Scheme") pursuant to a resolution passed on 16th May, 2001 for the primary purpose of providing incentives to directors and eligible employees, and which will expire ten years after the date of adoption. Under the Old Scheme, the board of directors of the Company may grant options to any directors or full time employees of the Company and its subsidiaries to subscribe for shares in the Company at a price not less than 80% of the average of the closing prices of the Company's shares for the 5 trading days immediately preceding the date on which an option is offered to an employee or the nominal value of the shares, whichever is the higher. The maximum number of shares in respect of which options shall be granted under the Old Scheme may not exceed 10% of the issued share capital of the Company from time to time. No employee shall be granted options which would enable him or her to subscribe for an aggregate of more than 1% of the aggregate number of shares under the Old Scheme.

At 31st March, 2002, the number of shares in respect of which options had been granted under the Old Scheme was 226,000,000, representing 2.2% of the shares of the Company in issue at that date. No charge is recognised in the income statement in respect of the value of options granted in the year.

SHARE OPTION SCHEMES *(continued)*

The consideration of HK\$1.00 is payable on the grant of an option. Options may be exercised at any time from the date of grant of the share option to the 10 anniversary of the date of grant of the option or of the adoption date of the Old Scheme, which is the earlier.

The fair value of the options granted in the current year totalled approximately HK\$40,465,870. The following significant assumptions were used to derive the fair values using the Black-Scholes option pricing model:

1. an expected volatility of 33.9% to 60.8%;
2. No annual dividends;
3. Hong Kong Exchange Fund Notes rates of 6%; and
4. An expected life of 9.3 years to 9.7 years.

For the purposes of the calculation of fair value, no adjustment has been made in respect of options expected to be forfeited, due to lack of historical data.

The Black-Scholes option pricing model requires the input of highly subjective assumptions, including the volatility of share price. Because changes in subjective input assumptions can materially affect the fair value estimate, in the directors' opinion, the existing model does not necessarily provide a reliable single measure of the fair value of the share options.

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SHARE OPTION SCHEMES (continued)

The following table discloses movements in the Company's share options granted during the year:

	Option type	Outstanding at 1.4.2001	Granted	Exercised	Lapsed	Outstanding at 31.3.2002
<i>Directors</i>						
Li Zhong Yuan	A	–	200,000,000	(195,000,000)	–	5,000,000
Wong Chong Kwong, Derek	A	–	190,000,000	(95,000,000)	–	95,000,000
Chan Chung Yin, Victor (resigned on 8 Feb 2002)	A	–	90,000,000	–	(90,000,000)	–
<i>Total Directors</i>		–	480,000,000	(290,000,000)	(90,000,000)	100,000,000
<i>Employees</i>						
	A	–	320,000,000	(200,000,000)	–	120,000,000
	B	–	10,000,000	(4,000,000)	–	6,000,000
	C	–	145,000,000	(145,000,000)	–	–
	D	–	100,000,000	(100,000,000)	–	–
<i>Total Employees</i>		–	575,000,000	(449,000,000)	–	126,000,000
<i>Total</i>			1,055,000,000	(739,000,000)	(90,000,000)	226,000,000

Option Type	Date of grant	Exercisable Period		Exercise Price HK\$	Closing Price immediately before the date of grant HK\$
		From	To		
A	31st August, 2001	31st August, 2001	30th August, 2011	0.043	0.060
B	11th October, 2001	11th October, 2001	10th October, 2011	0.052	0.052
C	11th February, 2002	11th February, 2002	10th February, 2012	0.046	0.041
D	15th February, 2002	15th February, 2002	14th February, 2012	0.046	0.046

SHARE OPTION SCHEMES *(continued)*

The weighted average closing price of the Company's shares immediately before the dates on which the options were exercised was HK\$0.078, HK\$0.068, and HK\$0.053 for options with an exercise price of HK\$0.043, HK\$0.052 and HK\$0.046 respectively.

Pursuant to an ordinary resolution of the Company passed on 8th April, 2002, a new share option scheme (the "New Scheme") was adopted to replace the Old Scheme. The terms of the New Scheme are the same as those of the Old Scheme except that under the New Scheme, the board of the directors may grant option to non-employee to subscribe for shares in the Company at (i) the closing price of the Company's shares on the date on which an option is offered to a participant ("Offer Date"); (ii) the average of the closing price of the Company's shares for the 5 trading days immediately preceding the Offer Date; and (iii) the nominal value of the Company's shares, whichever is the highest.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

Other than as disclosed above, at no time during the year was the Company or any of its subsidiaries a party to any arrangement 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.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's bye-laws or the laws of Bermuda which would oblige the Company to offer new shares on a pro rata basis to existing shareholders of the Company.

POST BALANCE SHEET EVENTS

Details of the post balance sheet events of the Group are set out in note 40 to the financial statements.

MAJOR SUPPLIERS AND CUSTOMERS

The largest supplier and the five largest suppliers of the Group accounted for approximately 30.3% and 70.5%, respectively, of the Group's total purchases during the year.

The largest customer and the five largest customers of the Group accounted for approximately 9.0% and 32.0%, respectively, of the Group's total sales for the year.

None of the directors of Honko or of the Company or any of their associates or any shareholders (which to the knowledge of the directors of Honko or of the Company, own more than 5% of the Company's issued share capital) has any interest in the Group's five largest suppliers or customers.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

Neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed shares.

CODE OF BEST PRACTICE

Pursuant to the Code of Best Practice as set out in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange, Honko, the former holding company of the Group prior to the group reorganization and financial restructuring, had in place an audit committee which comprised two former independent non-executive directors of Honko, up to 14th June, 2001.

On 30th November, 2001, the Company set up its own audit committee, which comprises two existing independent non-executive directors of the Company to perform its duties.

In the opinion of the directors of the Company, other than the non-existence of an audit committee during the period from 18th June, 2001 to 29th November, 2001, the Company has complied throughout the period between its listing date and 31st March, 2002 with the rest of the Code of Best Practice.

DISCLOSURE UNDER PRACTICE NOTE 19 OF THE LISTING RULES

1. At 31st March, 2002, the Group had an advance of US\$2.7 million (equivalent to HK\$21,026,000) made to Multi-line Digital Co. Ltd, an independent third party, which represents approximately 50.6% of the net asset value of the Group. Details of which are disclosed in note 18 to the financial statements.
2. At 31st March, 2002, the Group had an exchangeable loan to a shareholder of Steer Tornado Holdings Ltd of HK\$12.5 million. Details of which are disclosed in note 21 to the financial statements.
3. Up to the date of this report Pacific Annex Capital Limited, Dr. Li Zhong Yuan and Mr. Wong Chong Kwong, Derek pledged an aggregate of 1,666,000,000, 382,000,000, 325,000,000 ordinary shares to independent third parties for short-term financing. The pledged shares represent approximately 14.51%, 3.33% and 2.83% of the total issued share capital of the Company as at date of this report respectively.

AUDITORS

During the year, Messrs. Ernst & Young, resigned and Messrs. Deloitte Touche Tohmatsu were appointed as auditors of the Company. A resolution will be submitted to the annual general meeting to re-appoint the auditors, Messrs. Deloitte Touche Tohmatsu.

ON BEHALF OF THE BOARD

Dr. Li Zhong Yuan

Chairman

Hong Kong
22nd July 2002