

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2003

1. BACKGROUND OF THE COMPANY

Asia Zirconium Limited (the "Company") was incorporated as an exempted company with limited liability in the Cayman Islands under the Companies Law, Cap22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. The Company was listed on The Stock Exchange of Hong Kong Limited on 28 October 2002.

The Company is an investment holding company. The principal activities of its subsidiaries are set out in Note (16) to the financial statements.

2. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below:

(a) Basis of preparation

The financial statements have been prepared under historical cost convention, and in accordance with accounting principles generally accepted in Hong Kong, and comply with accounting standards issued by the Hong Kong Society of Accountants ("HKSA") and the disclosure requirements of the Hong Kong Companies Ordinance.

(b) Changes in accounting policies

In the current year, the Group has adopted, for the first time, the following Hong Kong Financial Reporting Standards (HKFRS) issued by the Hong Kong Society of Accountants (HKSA), the term of HKFRS, is inclusive of Statements of Standard Accounting Practice (SSAPs) and Interpretations approved by the HKSA.

SSAP 12 (Revised) Income Taxes

The Group has adopted SSAP 12 (Revised) Income Taxes ("SSAP 12 (Revised)"). The principal effect of the implementation of SSAP 12 (Revised) is in relation to deferred tax. In previous years, partial provision was made for deferred tax using the income statement liability method, i.e. a liability was recognised in respect of timing differences arising, except where those timing differences were not expected to reverse in the foreseeable future. SSAP 12 (Revised) requires the adoption of a balance sheet liability method, whereby deferred tax is recognised in respect of all temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, with limited exceptions. In the absence of any specific transitional requirements in SSAP 12 (Revised), the new accounting policy has been applied retrospectively, but the adoption of SSAP 12 (Revised) has not had material effect on the results for the years ended 31 December 2002 and 2003.

(c) Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries made up to 31 December 2003.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Notes to the Financial Statements (cont'd)

2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)**(d) Subsidiaries**

Subsidiaries are companies in which the Company directly or indirectly, holds more than half of the issued share/registered capital, or controls more than half of the voting power, or controls the composition of the board of directors.

In the Company's balance sheet, the investments in subsidiaries are stated at cost less provision for impairment losses, if necessary. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable.

(e) Related parties

Parties are considered to be related if one has the ability to control the other, directly or indirectly, or has the ability to exercise significant influence over the financial and operating decisions of the other. Parties are also considered to be related if they are subject to common control or common significant influence.

(f) Revenue recognition**(i) Sales of goods**

Sales of goods are recognised on the transfer of risks and rewards of ownership, which generally coincides with the time when goods are delivered to the customers and the title has passed.

(ii) Interest income

Interest income is recognised on a time proportion basis, taking into account the principal outstanding and at the rates applicable.

(iii) Dividend

Dividend income is recognised when the shareholders' rights to receive payment have been established.

(g) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment loss. 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 property, plant and equipment have been put into operation, such as repairs and maintenance and overhaul costs, are normally charged to the consolidated income statement in the period in which they are incurred. When the expenditure results in increase in the future economic benefits expected to be obtained from the use of the assets, the expenditures are capitalised.

Notes to the Financial Statements (cont'd)

2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)**(g) Property, plant and equipment (Cont'd)**

Depreciation of property, plant and equipment is provided using the straight-line method over their estimated useful lives. The estimated useful lives of property, plant and equipment are as follows:

Land use rights	Over the lease period
Buildings	10-30 years
Machinery and equipment	5-20 years
Office equipment and fixtures	5 years
Motor vehicles	5 years

Gains and losses on disposals of property, plant and equipment are recognised in the consolidated income statement based on the net disposal proceeds less the carrying amount of the assets at the date of disposal.

(h) Construction in progress

Construction in progress represents buildings under construction and plant and machinery pending installation, and is stated at cost. Costs include construction and acquisition costs, and interest charges arising from borrowings used to finance the assets during the period of construction, installation or resting. No provision for depreciation is made on construction in progress until such time as the relevant assets are completed and ready for use.

(i) 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 losses are recognised as an expense immediately, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, such 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, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

(j) Held-to-maturity securities

Held-to-maturity securities are stated in the balance sheet at cost plus/less any discount/premium amortised to date. The discount or premium is amortised over the period to maturity and included as interest income/expense in the consolidated income statement. Provision is made when there is a diminution in value other than temporary.

Notes to the Financial Statements (cont'd)

2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)**(j) Held-to-maturity securities (Cont'd)**

The carrying amounts of individual held-to-maturity securities or holdings of the same securities are reviewed at balance sheet date in order to assess the credit risk and whether the carrying amounts are expected to be recovered.

Provision are made when carrying amounts are not expected to be recovered and are recognised in the consolidated income statement as an expense immediately.

(k) Inventories

Inventories are carried at the lower of cost and net realisation value.

Cost, calculated on the first-in first-out cost basis, comprises all costs of purchase, costs of conversion, including direct labour and an appropriate proportion of production overheads, and other costs incurred in bringing the inventories to their present location and condition.

Net realisable value is determined on the basis of anticipated sales proceeds less estimated selling expenses.

When inventories are sold, the carrying amount of the inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of write-down of inventories, arising from an increase in net realisable value, is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

(l) Trade receivables

Provision is made against trade receivables to the extent that they are considered to be doubtful. Trade receivables in the balance sheet are stated net of such provision.

(m) Foreign currencies

The Group maintains its books and records in Renminbi ("RMB"). Transactions denominated in currencies other than RMB are translated into RMB at exchange rates in effect at the time of the transactions. Monetary assets and liabilities expressed in other currencies are translated into RMB at exchange rate prevailing at the balance sheet date. Exchange differences are dealt with in the consolidated income statement.

The balance sheets of subsidiaries expressed in foreign currencies are translated at the rates of exchange ruling at the balance sheet date whilst the income statement items are translated at average rates. Exchange differences are dealt with as a movement in reserves.

Notes to the Financial Statements (cont'd)

2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)**(n) Taxation**

Income tax expense represented the sum of the tax currently payable and deferred tax.

Income tax is provided on the basis of the results for the year for financial reporting purposes, adjusted for income and expense items which are not assessable or deductible for income tax purposes.

Deferred taxation is provided in full, using the balance sheet liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Taxation rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

(o) Intangible assets**(i) Intangible assets**

Expenditure on acquired technical know-how is capitalised and amortised using the straight line method over the useful lives of five years from the date when the technical know-how is available for use.

(ii) Research and development costs

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally generated intangible asset arising from development expenditure is recognised only if it is anticipated that the development costs incurred on a clearly defined project will be recovered through future commercial activity. The resultant asset is a straight-line basis over its useful life, which is usually no more than five years.

Where no internally generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

There was no development costs capitalised during the financial year.

(p) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

Inter-segment pricing is based on similar terms as those available to other external parties.

Notes to the Financial Statements (cont'd)

2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)**(p) Segment reporting (Cont'd)**

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. Segment revenue, expenses, assets and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidated process, except to the extent that such intra-group balances and transactions are between group enterprises within a single segment.

Segment capital expenditure is the total costs incurred during the period to acquire segment assets that are expected to be used for more than one period.

Unallocated items mainly comprise financial and corporate assets, interest-bearing loans, borrowings, corporate and financing expenses and minority interests.

(q) Operating leases

Leases where substantially all the risks and rewards of ownership of assets remain with the leasing company are accounted for as operating leases. Rentals applicable to such operating leases are charged to the consolidated income statement on a straight-line basis over the lease term.

(r) Cash and cash equivalents

Cash and cash equivalents represent cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of change in value. For the purpose of cash flow, bank overdrafts which are repayable on demand form an integral part of the Group's cash management are also included as a component of cash and cash equivalents.

(s) Employee benefits**(i) Employee leave entitlements**

Employee entitlements to annual leave and long service leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave and long service leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity or paternity leave are not recognised until the time of leave.

(ii) Retirement benefits

The Group contributes to Mandatory Provident Fund scheme ("MPF Scheme") which is available to all employees in Hong Kong. Contributions to the MPF Scheme by the Group and employees are calculated as percentage of employees' basic salaries. Payments made to the MPF Scheme are charged as an expenses to the consolidated income statement as they all due.

Notes to the Financial Statements (cont'd)

2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)**(s) Employee benefits (Cont'd)****(ii) Retirement benefits (Cont'd)**

The assets of the MPF Scheme are held separately from those of the Group in independently administered fund.

The Group is required to contribute to a defined contribution retirement scheme for employees in the PRC based on the applicable basis and rates in accordance with the relevant government regulations.

(t) Provisions and contingent liabilities

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that outflow is probable, it will then be recognised as a provision.

3. TURNOVER, REVENUE AND SEGMENT INFORMATION

The Group is principally engaged in the research, development, manufacturing and sales of zirconium compounds, electronic materials and electronic ceramics. Revenues recognised during the year are as follows:

	2003 RMB'000	2002 RMB'000
Turnover	299,720	267,310
Other revenues — interest income	775	1,162
— others	366	—
	1,141	1,162
	300,861	268,472

Primary reporting format — geographical segments

The Group operates within one geographical segment in the PRC. All segment assets, liabilities and capital expenditures are located in the PRC and therefore no geographical segments are presented, except for the segment revenue and segment result. Segment revenue and segment results are presented base on geographical location of customers.

Notes to the Financial Statements (cont'd)

3. TURNOVER, REVENUE AND SEGMENT INFORMATION (Cont'd)**Secondary reporting format — business segments**

The Group's business is mainly categorised into two business segments:

- Zirconium compounds; and
- electronic materials and electronic ceramics.

(i) Primary reporting format — geographical segments

For the year ended 31 December 2003

	Japan RMB'000	The USA RMB'000	The PRC RMB'000	The Netherlands RMB'000	Others RMB'000	Total RMB'000
Segment revenue	60,281	79,084	107,144	26,870	26,341	299,720
Segment results	12,741	27,809	42,341	7,156	7,823	97,870

For the year ended 31 December 2002

	Japan RMB'000	The USA RMB'000	The PRC RMB'000	The Netherlands RMB'000	Others RMB'000	Total RMB'000
Segment revenue	83,153	81,024	58,906	14,260	29,967	267,310
Segment results	25,015	33,893	22,547	5,148	13,409	100,012

(ii) Secondary reporting format — business segments

For the year ended 31 December 2003

	Turnover RMB'000	Profit from operations RMB'000	Carrying amount of segment assets RMB'000	Capital expenditure RMB'000
Zirconium compounds	289,963	94,904	106,666	19,023
Electronic materials and electronic ceramics	9,757	2,966	64,985	48,503
	299,720	97,870	171,651	67,526
Unallocated assets			166,573	7,884
Interest income		775		
Unallocated costs		(22,132)		
		76,513	338,224	75,410

For the year ended 31 December 2002

The Group conducts its business within one business segment which is research, development, manufacturing and sales of zirconium compounds primarily in the PRC and therefore no business segments are presented.

Notes to the Financial Statements (cont'd)

4. PROFIT FROM OPERATIONS

Profit from operations has been arrived at after charging:

	2003 RMB'000	2002 RMB'000
Auditors' remuneration	542	584
Depreciation	5,311	4,172
Amortisation of intangible assets	500	—
Exchange loss	254	257
Research and development costs	3,434	2,774
Operating lease of land and building	799	720
Provision for inventories obsolescence	—	245
Staff costs (including directors' emoluments) (Note 10)	14,774	19,379

5. FINANCE COSTS

	2003 RMB'000	2002 RMB'000
Interest on:		
Bank borrowings wholly repayable within five years	4	540

6. TAXATION

The amount of taxation charged to the consolidated income statement represents:

	2003 RMB'000	2002 RMB'000
Hong Kong profits tax	—	—
PRC EIT	10,218	—
	10,218	—

- (a) No provision for Hong Kong profits tax has been made in the financial statements as the Group had no assessable profit in Hong Kong for the year (2002: Nil).

Yixing Xinxing Zirconium Co. Ltd ("Yixing Zirconium") is a wholly-owned subsidiary of the Company incorporated in the PRC, and therefore subjects to PRC Enterprise Income Tax ("EIT") at local statutory rate. Pursuant to the relevant income tax laws in the PRC, Yixing Zirconium is entitled to income tax exemption for the first and second profit-making years and a 50% reduction in EIT for the following three years starting from January 2003. The applicable rate of EIT for Yixing Zirconium is 12% for the year ended 31 December 2003 (being 50% of the standard rate for foreign investment enterprises located in coastal open economic regions). As a result, the provision for EIT is calculated at 12% on the assessable profit for the year.

Notes to the Financial Statements (cont'd)

6. TAXATION (Cont'd)**(b) Deferred taxation**

As at 31 December 2002 and 2003 respectively, no provision for deferred tax has been recognised in the financial statements as there have been no material temporary differences for tax purposes.

- (c) As the Group's major operation and income were located in the PRC, the applicable tax rate to the Group was the tax rate of 12% during the year applicable to the PRC subsidiary as stated in (a) above.

Reconciliation between tax expense and accounting profit at applicable tax rate:

	2003		2002	
	RMB'000	%	RMB'000	%
Profit before tax	76,509		72,512	
Tax at the applicable tax rate of 12%	9,181	12.0	8,702	12.0
Tax effect of profit exempted from income tax for the first two profitable years of operation	—	—	(8,974)	(12.4)
Tax effect of expenses/income that are not deductible/taxable in determining taxable profit	808	1.1	272	0.4
Tax effect of unrecognised tax losses	229	0.3	—	—
Tax expense and effective tax rate for the year	10,218	13.4	—	—

7. PROFIT ATTRIBUTABLE TO SHAREHOLDERS

The profit attributable to shareholders includes a loss of approximately RMB2,033,000 (2002: profit of RMB14,010,000) which has been dealt with in the financial statements of the Company.

8. DIVIDENDS

	2003	2002
	RMB'000	RMB'000
Interim, paid	—	7,000
Final, proposed — HK3.7 cents per ordinary share	19,800	12,740
	19,800	19,740

At a meeting of the Board held on 29 March 2004, a final dividend of HK3.7 cents (2002: HK3 cents) per ordinary share has been proposed by the directors and is subject to approval by the shareholders in the forthcoming annual general meeting. This proposed dividend is not reflected as a dividend payable in these financial statements, but will be reflected as an appropriation of reserves for the year ending 31 December 2004.

Notes to the Financial Statements (cont'd)

9. EARNINGS PER SHARE

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

	2003	2002
Earnings		
Earnings for the purposes of basic earnings per share and diluted earnings per share (RMB)	66,291,000	72,512,000
Number of Shares		
Weighted average number of ordinary shares for the purposes of basic earnings per share	400,000,000	317,808,000
Effect of dilutive potential ordinary shares — share options	408,000	—
Weighted average number of ordinary shares for the purpose of diluted earnings per share	400,408,000	317,808,000

10. STAFF COSTS (INCLUDING DIRECTORS' EMOLUMENTS)

	2003 RMB'000	2002 RMB'000
Wages and salaries	11,360	15,689
Retirement benefit scheme	2,161	2,086
Other social welfare costs	1,253	1,604
	14,774	19,379

11. DIRECTORS' EMOLUMENTS

	2003 RMB'000	2002 RMB'000
Directors' fees:		
Executive directors	—	—
Independent non-executive directors	117	117
Other emoluments:		
Salaries, other allowances and benefits in kind		
Executive directors	2,584	7,316
Independent non-executive directors	—	—
Retirement benefit scheme		
Executive directors	122	167
Independent non-executive directors	—	—
	2,823	7,600

Notes to the Financial Statements (cont'd)

11. DIRECTORS' EMOLUMENTS (Cont'd)

Note:

This includes amount of approximately RMB658,000 (2002: RMB880,000) of operating lease rentals and no discretionary bonus (2002: RMB3,800,000) was payable to any executive director.

During the year, no emolument was paid to the directors as inducement to join or upon joining the Group or a compensation for loss of office.

The emoluments of the directors were within the following bands:

	Number of directors	
	2003	2002
Nil — RMB1,000,000	6	5
RMB1,000,001 — RMB1,500,000	—	—
RMB1,500,001 — RMB2,000,000	—	—
RMB2,000,001 — RMB2,500,000	—	—
RMB2,500,001 — RMB3,000,000	1	1
RMB3,000,001 — RMB3,500,000	—	—
RMB3,500,001 — RMB4,000,000	—	—
RMB4,000,001 — RMB4,500,000	—	1
	7	7

12. EMPLOYEES' EMOLUMENTS

Of the five individuals with the highest emoluments in the Group, four (2002: two) were directors of the Company whose emoluments are included in the disclosures in note 11 above. The emoluments of the remaining one (2002: three) individual was as follows:

	2003	2002
	RMB'000	RMB'000
Salaries and other benefits	533	1,630
Retirement benefits schemes	13	289
	546	1,919

The emoluments of the individual was within the following band:

	Number of employees	
	2003	2002
Nil — RMB1,000,000	1	3

Notes to the Financial Statements (cont'd)

13. PROPERTY, PLANT AND EQUIPMENT

	Land use rights RMB'000	Buildings RMB'000	Machinery and equipment RMB'000	The Group Office equipment and fixtures RMB'000	Motor vehicles RMB'000	Construction in progress RMB'000	Total RMB'000
Cost							
At 1 January 2003	16,061	29,582	31,539	754	1,140	989	80,065
Additions	27,163	12,024	28,524	88	1,272	6,339	75,410
Transfers	—	989	—	—	—	(989)	—
At 31 December 2003	43,224	42,595	60,063	842	2,412	6,339	155,475
Accumulated depreciation							
At 1 January 2003	4,202	7,286	13,218	484	228	—	25,418
Charge for the year	432	1,618	2,941	82	238	—	5,311
At 31 December 2003	4,634	8,904	16,159	566	466	—	30,729
Net book value							
At 31 December 2003	38,590	33,691	43,904	276	1,946	6,339	124,746
At 31 December 2002	11,859	22,296	18,321	270	912	989	54,647

All the Group's land and buildings are held in the PRC. The land use rights amounted to approximately RMB11,505,000 and RMB27,085,000 cover a period of 30 years and 50 years expiring in the year 2030 and 2053 respectively.

14. INTANGIBLE ASSETS

	The Group Technical know-how RMB'000
Additions and at 31 December 2003	5,000
Accumulated amortisation	
Charge for the year and at 31 December 2003	500
Net book value:	
At 31 December 2003	4,500
At 31 December 2002	—

Notes to the Financial Statements (cont'd)

15. HELD-TO-MATURITY SECURITY

At 31 December 2003, the Group had a certificate of deposit amounted to HK\$1,000,000 (RMB1,067,000) which carried interest at a fixed rate of 1.8% per annum and with a maturity period of two years. The certificate of deposit will mature in November 2004 and the balance was reclassified as current assets as at 31 December 2003.

The above certificate of deposit was charged to a bank to secure the banking facilities granted to the Company as mentioned in Note (27) below.

16. INVESTMENTS IN SUBSIDIARIES

	The Company	
	2003	2002
	RMB'000	RMB'000
Unlisted shares	31,836	31,836
Amount due from a subsidiary	60,129	61,612
	91,965	93,448

The carrying value of the unlisted shares is based on the underlying net tangible assets of the subsidiary at the time when they became members of the Group at the date of reorganisation.

The amount due from a subsidiary is unsecured, non-interest bearing and the Company will not demand for repayment from the subsidiary within the next twelve months from the balance sheet date.

Details of the Company's principal subsidiaries as at 31 December 2003 are as follows:

Name	Place and date of incorporation/ establishment	Issued and fully paid share capital or registered capital	Proportion of nominal value of issued capital/ registered capital held by the Group		Principal activities and place of operation
			Direct holding	Indirect holding	
Kingweston Technology Limited ("Kingweston")	British Virgin Islands 6 January 2000	US\$2,500,000	100%	—	Investment holding in Hong Kong
Yixing Xinxing Zirconium Company Limited (<i>Note</i>) ("Yixing Zirconium")	The People's Republic of China 7 June 2000	US\$10,500,000	—	100%	Research, development, manufacturing and sales of zirconium compounds, electronic materials and electronic ceramics in the PRC

Notes to the Financial Statements (cont'd)

16. INVESTMENTS IN SUBSIDIARIES (Cont'd)

Name	Place and date of incorporation/ establishment	Issued and fully paid share capital or registered capital	Proportion of nominal value of issued capital/ registered capital held by the Group		Principal activities and place of operation
			Direct holding	Indirect holding	
Century Dragon Investment Limited ("Century Dragon")	Hong Kong 5 June 2000	HK\$100	—	100%	Leasing of the Group's office premises in Hong Kong, provision of administrative services and general trading in Hong Kong

Note: Yixing Zirconium is a foreign investment enterprise with an operating period of 30 years commencing on 7 June 2000.

17. INVENTORIES

	The Group	
	2003 RMB'000	2002 RMB'000
Raw materials	3,874	3,749
Work in progress	973	873
Finished goods	13,691	10,925
	18,538	15,547

All the inventories were carried at cost.

18. TAX RECEIVABLE

	The Group	
	2003 RMB'000	2002 RMB'000
VAT receivable	12,566	18,193
VAT payable	(2,407)	(2,406)
	10,159	15,787

Notes to the Financial Statements (cont'd)

18. TAX RECEIVABLE (Cont'd)

Tax receivable represents PRC value-added tax ("VAT") receivable during the year.

The Group's sales of manufactured products are subject to VAT. The applicable tax rate for domestic sales is 17%. Input VAT on purchases of raw materials and other production materials can be used to set off against output VAT on domestic sales.

19. TRADE AND OTHER RECEIVABLES

	The Group		The Company	
	2003	2002	2003	2002
	RMB'000	RMB'000	RMB'000	RMB'000
Due from a director (<i>Note (20)</i>)	—	—	302	—
Due from a subsidiary (<i>Note (23)</i>)	—	—	4,500	2,502
Trade receivables (<i>Note</i>)	26,089	22,051	—	—
Prepayments and other receivables	13,460	1,853	17	104
Dividend income receivable	—	—	14,917	14,864
	39,549	23,904	19,736	17,470

Note:

Aging analysis of trade receivables after provision for bad and doubtful debts is as follows:

	The Group	
	2003	2002
	RMB'000	RMB'000
0 — 90 days	24,135	21,537
91 — 180 days	1,734	84
181 — 365 days	113	430
More than 1 year	107	—
	26,089	22,051

Normally, 30 to 60 days credit term is granted to local customers in the PRC and 60 to 90 days credit term is granted to overseas customers.

20. AMOUNT DUE FROM A DIRECTOR

	The Company
	RMB'000
Name	
Mr. Yang Xin Min	
Amount outstanding at	
31 December 2003	302
31 December 2002	—

Notes to the Financial Statements (cont'd)

20. AMOUNT DUE FROM A DIRECTOR (Cont'd)

Maximum amount during the year	<i>RMB'000</i>
2003	1,418
2002	—

The amount due from a director is unsecured, interest free and repayable on demand.

21. CASH AND BANK BALANCES

	The Group	
	2003	2002
	<i>RMB'000</i>	<i>RMB'000</i>
Cash on hand	195	261
Cash in banks	139,470	172,727
	139,665	172,988

As at 31 December 2003, bank deposits of approximately RMB125,000 (2002: RMB453,000) were pledged for trade financing facilities granted by banks in the PRC.

As at 31 December 2003, approximately RMB138,212,000 (2002: RMB164,765,000) of the Group's cash and bank balances were denominated in Renminbi and kept in the PRC. The conversion of Renminbi denominated balances into foreign currencies is subject to rules and regulations of foreign exchange control promulgated by the PRC government.

22. TRADE AND OTHER PAYABLES

	The Group		The Company	
	2003	2002	2003	2002
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Due to a subsidiary (<i>Note (23)</i>)	—	—	9,457	346
Due to directors (<i>Note (23)</i>)	8,682	9,715	137	751
Trade payable (<i>Note a</i>)	6,373	6,229	—	—
Notes payable	—	1,466	—	—
Salary and welfare payables	15,287	13,346	—	—
Accruals and other payables	11,160	14,909	459	467
	41,502	45,665	10,053	1,564

Notes to the Financial Statements (cont'd)

22. TRADE AND OTHER PAYABLES (Cont'd)

Note:

(a) Aging analysis of trade payable is as follows:

	The Group	
	2003	2002
	RMB'000	RMB'000
0 — 90 days	4,643	2,021
91 — 180 days	927	418
181 — 365 days	299	695
More than one year	504	3,095
	6,373	6,229

23. AMOUNTS DUE FROM/(TO) A SUBSIDIARY/DIRECTORS

The amounts due are unsecured, non-interest bearing and repayable on demand.

24. SHARE CAPITAL

	Number of shares		Ordinary share capital			
	2003	2002	2003	2002		
			HK\$	RMB	HK\$	RMB
<i>Authorised:</i>						
At beginning of year	1,000,000,000	3,900,000	100,000,000	106,000,000	390,000	413,400
Increase during the year	—	996,100,000	—	—	99,610,000	105,586,600
At end of year	1,000,000,000	1,000,000,000	100,000,000	106,000,000	100,000,000	106,000,000
<i>Issued and fully paid:</i>						
At beginning of year	400,000,000	100	40,000,000	42,449,700	10	10
Shares issued pursuant to Group Reorganisation	—	299,999,900	—	—	29,999,990	31,836,290
Shares issued upon listing	—	100,000,000	—	—	10,000,000	10,613,400
At end of year	400,000,000	400,000,000	40,000,000	42,449,700	40,000,000	42,449,700

Notes to the Financial Statements (cont'd)

25. CAPITAL COMMITMENTS

	2003 <i>RMB'000</i>	2002 <i>RMB'000</i>
Contracted but not provided for		
— purchases of plant and machineries	2,495	989
— construction in progress	4,330	—
Authorised but not contracted for		
— purchases of plant and machineries	—	4,354

26. RELATED PARTY TRANSACTIONS

During the year ended 31 December 2003, the Group had significant related party transactions as summarised below:

		2003 <i>RMB'000</i>	2002 <i>RMB'000</i>
Electricity supply from a related company	(a)	8,209	6,627
Steam supply from a related company	(a)	17,993	15,327
Purchase of coal on behalf of a related company	(b)	—	2,735
Water supply from a related party	(c)	2,705	1,656
Purchase of a new plant from a related company	(f)	5,180	—

- (a) Yixing Zirconium and Jiangsu Xinxing Chemicals Group Corporation (“Xinxing Chemicals Group”), a private owned enterprise wholly owned by Mr. Yang Xin Min who is the substantial shareholder and director of the Company, has entered into an electricity and steam supply agreement dated 1 September 2000 and two supplemental agreements. Pursuant to these agreements, the supply of electricity and steam are conducted on commercial terms in the normal course of the electricity and steam supplying business of the related company.
- (b) Yixing Zirconium entered into a purchasing agreement with a related company, to purchase coal on its behalf at cost on 1 January 2001. The agreement ceased on 30 April 2002.
- (c) Water was supplied by Yixing City Xushe Water Supply Plant (“the Water Plant”), a collectively-owned enterprise in Xushe Town of Yixing City, to Yixing Zirconium, for manufacturing purposes. Purchase of water was conducted in the normal course of business at prices and terms similar to those charged to and contracted with other customers of the Water Plant. The Water Plant is a related party to the extent that Ms. Bao Xi Mei (being the spouse of Mr. Yang Xin Min), is the legal representative of the Water Plant.
- (d) Pursuant to a trademark licensing agreement dated 12 July 2000 entered into between Yixing Zirconium and a related company, the latter has agreed to grant an exclusive license to the former or the Group to use the “Long Jing” trademarks in the PRC, the USA and Japan respectively, during their respectively legally valid periods at nil consideration.

Notes to the Financial Statements (cont'd)

26. RELATED PARTY TRANSACTIONS (Cont'd)

- (e) Certain buildings of Yixing Zirconium were erected on land with the respective land use rights belong to Xinxing Chemicals Group. The land is provided by the related company to Yixing Zirconium rent free from 1 January 2003 to 29 June 2003. Subsequently Yixing Zirconium acquired the respective land use rights from that related company during the year as described in note (f).
- (f) Yixing Zirconium entered into a transfer agreement with Xinxing Chemicals Group on 30 June 2003 to acquire the land use rights of a piece of land and six buildings erected thereon for starting up a new plant at a consideration of RMB5,180,000, based on the valuation of an independent certified valuer.

Pursuant to the Listing Rules, Xinxing Chemicals Group was a connected person of the Group as mentioned in note(a) and the transfer agreement constituted a connected transaction of the Group.

The acquisition was conducted in the ordinary and usual course of business of the Group, and the terms of the transfer agreement were entered on arm's length basis. As the land and buildings acquired were located next to the current zirconium chemicals production plants which can in turn provide the new plant with a continuous production flow, low transportation costs and streamline the production of Yixing Zirconium, the directors and independent non-executive directors considered that the transaction was fair and reasonable and in the interest of the Group, and would benefit the Group's development in the long run.

27. BANKING FACILITIES

At 31 December 2003, the Group pledged a bank deposit of approximately RMB125,000 (2002: RMB453,000) as securities for trade financing facilities granted by banks in the PRC as mentioned in Note (21) above.

At 31 December 2003, the Group had banking facilities including bank overdraft of HK\$1,000,000 and a corporate credit card of HK\$300,000. The facilities are secured by the certificate of deposit amounted to HK\$1,000,000 held by a bank in Hong Kong as mentioned in Note (15) above.

28. OPERATING LEASE COMMITMENTS

At 31 December 2003, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases in respect of land and buildings as follows:

	2003 RMB'000	2002 RMB'000
Within one year	614	1,023
After one year but within five years	1,497	1,956
After five years	8,049	8,423
	10,160	11,402

Notes to the Financial Statements (cont'd)

29. RETIREMENT BENEFITS SCHEME

Prior to 1 December 2000, the Group did not have any pension or retirement benefits scheme for its employees in Hong Kong. With effect from 1 December 2000, the Group has set up a defined contribution retirement scheme, the MPF Scheme under the Mandatory Provident Fund legislation regulated by the Mandatory Provident Fund Scheme Authority in Hong Kong and to make contributions for its eligible employees in Hong Kong at rates specified in the rules.

In addition to the participation in the MPF Scheme, the Group is required to contribute to a defined contribution retirement scheme for its employees in the PRC based on the applicable basis and rates in accordance with the relevant government regulations.

The only obligation of the Group with respect to these retirement benefits schemes is to make the required contributions under the respective schemes.

30. SHARE OPTION SCHEME

Pursuant to a shareholders' resolution passed on 24 September 2002, the Company's share option scheme was approved and adopted. Under the scheme, share options can be granted to eligible persons, including employees, executive and non-executive directors, and any consultants or advisors of the Group. Number of share options granted during the year and outstanding at year end are set out below.

Options held by employees

Outstanding at 1 January 2003	Consideration	Exercise price per share	Number of share options granted during the year	Number of share options exercised during the year	Number of share options lapsed during the year	Outstanding at 31 December 2003
2,000,000	HK\$1.00	HK\$0.87	—	—	—	2,000,000

The options will be vested in five equal trenches on 1 May of five consecutive years starting from 2003 and exercisable up to 30 April 2008.

The consideration for the 2,000,000 share option granted is HK\$1.00.

31. POST BALANCE SHEET DATE EVENT

The following events took place subsequent to 31 December 2003:

- (i) Pursuant to a placing agreement dated 3 February 2004 entered into between Mr. Yang Xin Min ("Mr. Yang"), a substantial shareholder of the Company, and a placing agent, 47,000,000 existing ordinary shares of HK\$0.1 each in the Company were placed to independent investors at a price of HK\$1.17 per share. Upon completion of the placement of shares and pursuant to a subscription agreement entered into between the Company and Mr. Yang, Mr. Yang subscribed for 47,000,000 new ordinary shares of HK\$0.1 each in the Company at a price of HK\$1.17 per share. The net proceeds of the subscription were intended to be used as general working capital for the Group.

Notes to the Financial Statements (cont'd)

31. POST BALANCE SHEET DATE EVENT (Cont'd)

- (ii) On 13 February 2004, Yixing Zirconium, a wholly-owned subsidiary of the Group, entered into an acquisition agreement (the "Agreement") with Jiangsu Xinxing Chemicals Group Corporation ("Xinxing Chemicals Group"), a private-owned enterprise wholly owned by Mr. Yang Xin Min, a substantial shareholder and director of the Company. Pursuant to the Agreement, Yixing Zirconium has agreed to acquire the electricity and steam generating plant and related facilities from Xinxing Chemicals Group at the consideration of approximately RMB77,880,000, which will be satisfied by the issue of the 55,170,946 ordinary shares of the Company to Mr. Yang Xin Min. The directors believe that the acquisition will reduce production cost, ensure stable and continuous electricity and steam supply, thus enhancing the Group's earning capacity in the long run. Details of the acquisition contemplated under the Agreement are set out in the Group's press announcement dated 17 February 2004.

32. COMPARATIVE FIGURES

Comparative figures have been reclassified to conform to the current year's presentation.

33. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the board of directors on 29 March 2004.