



Asia Zirconium Limited

(incorporated in the Cayman Islands with limited liability)

Asia Zirconium • Asia Zirconium •



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Annual Report 2002

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SUMMARY OF THE GROUP

Asia Zirconium Limited (the “Company”) and its subsidiaries (collectively as the “Group”) are the only listed company in Asia specialising in the manufacture and sale of a wide range of zirconium chemicals, which include zirconium oxychloride, zirconium carbonate and zirconium oxides. The Group was accredited by the Nonferrous Metal Society of China as the largest zirconium chemicals manufacturer in the PRC in 2001, which captured 50% of China’s export market. The Group was listed on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) on 28th October, 2002

Started its operation in 1977, based in Yixing, Jiangsu Province, with continuing tremendous reformation commitments, the Group has successfully transformed from a highly labor intensive plant to an internationally renowned manufacturing plant. Current production is approximately 28,000 tonnes of zirconium oxychloride, 4,800 tonnes of zirconium carbonate, 1,800 tonnes of zirconium oxides and 2,300 tonnes of other zirconium chemicals.

The Group’s brandname “Long Jing” was registered in the PRC, Japan, the US & Hong Kong. Recognised by the international market, the Group established markets in Japan, the USA & Europe for 24 years, 12 years and 13 years respectively. Broad applications and new discovery of zirconium chemicals applications from convention usage to fore-front technology materials, such as mobile phone components, electronic and electrical appliances, optical fibres, textiles, plastic materials, ceramic pigments, optical glass, medical and pharmaceutical products, leather goods, paper goods, cosmetic materials, weapon fuel media and nuclear reaction materials, etc, have proven the penetration power and potential of zirconium chemicals.

The Group obtained the ISO9002 Quality System Certification in 1999, this testifies the Group’s philosophy in stringent quality control through the usage of advance equipments and systematical management process. Socially responsible in environment protection, the Group complied with and obtained the ISO14001 Environmental Management System Certification in 2001. The Group is the only China zirconium manufacturer achieving both accomplishments.

A number of the Group’s products were appraised as national and provincial grade, such as the nanometric zirconium oxide which gained the “China Torch Program” award. In March 2003, the Group was further rated as a provincial high-tech enterprise.



FINANCIAL SUMMARY

	1999 RMB'000	2000 RMB'000	2001 RMB'000	2002 RMB'000
Turnover	73,971	166,093	229,263	267,310
Gross profit margin (%)	36.2%	35.9%	35.5%	37.4%
Profit attributable to				
shareholders of ordinary shares	13,167	25,615	55,377	72,512
Dividend — ordinary shares	3,000	10,000	22,000	19,740
Earnings per share — Basic (RMB)	0.044	0.085	0.185	0.228
Debt-equity ratio	0.147	0.011	net cash position	net cash position
Dividend payout ratio (%)	23%	39%	40%	27%
Ordinary shares (shares)	300,000,000	300,000,000	300,000,000	317,808,219
Cash and bank balance	12,523	53,178	85,072	172,988
Cash per share (RMB)	0.04	0.18	0.28	0.54
Total assets	88,091	140,271	205,056	283,936
Net asset value	10,167	46,533	79,910	217,701
Net asset value per share (RMB)	0.03	0.16	0.27	0.69
Inventory turnover days	183 days	47 days	40 days	34 days
Debtors turnover days	30 days	36 days	50 days	30 days
Creditors turnover day	117 days	29 days	32 days	19 days

New Zone (Phase I) of Zirconium Plant in Yixing, China



CHAIRMAN'S STATEMENT

To shareholders,

On behalf of the board (the "Board") of directors ("Directors") of Asia Zirconium Limited, I am pleased to present the Group's results for the year ended 31 December 2002 (the "Year 2002").

During the Year 2002, the Group has continued to explore new markets and enhance its product mix to improve profitability. In spite of the slight decrease in the prices of zirconium chemicals in the international market in the Year 2002, the Group managed to achieve satisfactory results through effective management, product structure adjustment, production scale expansion and diversification into higher margin downstream products.

For the Year 2002, the Group recorded profit attributable to shareholders of RMB72,512,000, representing an increase of 31% as compared to RMB55,377,000 for year ended 31 December 2001 ("Year 2001") and an increase of RMB12,512,000 (approximately 21%) as compared to the estimated profit attributable to shareholders of RMB60,000,000 as set out in the Group's prospectus; whereas turnover was approximately RMB267,310,000 in the Year 2002, representing an increase of 17% as compared to RMB229,263,000 in the Year 2001. Basic earnings per share was RMB0.228 for the Year 2002.

The Board has recommended payment of a final dividend of HK\$0.03 per ordinary share for the Year 2002. An aggregate dividend of RMB19,740,000 was proposed for the Year 2002, including a final dividend of RMB12,740,000 payable and an interim dividend of RMB7,000,000 paid.

Review of the Macroeconomic Market

Despite negative macro factors such as declining product prices, increasing competition from smaller PRC competitors and the slump in the IT industry in Japan, the Group has managed to achieve satisfactory results by stepping up its marketing efforts in overseas markets, notably the USA and Europe. Sales to these two markets have seen substantial increase, thanks to China's accession into the WTO as well as the increased use of zirconium chemicals in the cosmetics industry.

On the domestic front, the Open Door Policy has continued to attract foreign manufactures, particularly hi-tech companies, to set up their production facilities in the PRC. This has in turn led to a substantial increase in the Group's domestic sales within the PRC.

Business Review

During the Year 2002, the Group has significantly increased its production capacity for both upstream (such as zirconium oxychloride) and downstream (such as superfine zirconium oxide) products. The increase in production capacity has resulted in higher turnover and profitability as compared to the Year 2001. Gross margin was maintained through stringent cost control, improved economies of scale and continuing diversification into higher margin upstream products.

Through active participation in international exhibitions, more frequent overseas marketing trips and aggressive marketing through the internet, the Group has managed to increase its sales to the USA and Europe substantially. By taking part in a number of trade fairs in the PRC, such as the Guangzhou Trade Fair, the Eastern Trade Fair and the Harbin Trade Fair, domestic sales within the PRC have also seen substantial increase.

By maintaining close and harmonious relationships with its suppliers, the Group has managed to maintain stable sourcing of raw materials at reasonable prices.

Through continuing improvement in energy conservation and more efficient control of wastage, the Group has managed to improve cost efficiency, resulting in lower cost of production for upstream products such as zirconium oxychloride. Performance was further enhanced by improved economies of scale with average plant utilization rate in excess of 90%.

The Group has continued to place heavy emphases on research and development ("R & D"). For example, the Group's R&D effort in nanometric zirconium oxide, amongst other high-tech projects, was included in the "2002 China Torch Program". The Group's products also received a number of accreditations from the Science and Technology Branch of Jiangsu Province.

Prospects

Looking into 2003, it is expected that the Group will sustain brisk growth. Although competition from the Group's international counterparts in the global market as well as price competition from its China counterparts will inflict comparatively significant bearings and risks on the growth of the Group in 2003 and thereafter, the Group will focus on developing deep-processing products as the means to progressively adjust the product mix and expand the PRC market, in order to generate satisfactory profits and therefore a decent return for its shareholders.

According to the provisions of the PRC tax laws, the Group is allowed a 50% reduction in enterprise income tax in 2003 and the 3 years thereafter. Moreover, since the Group is a Jiangsu Province high-new technology enterprise with a number of its products accredited as State and Provincial high-new technology products, it is entitled to favorable treatment in income tax and export tax refund. It is estimated that the Group will be allowed an income tax reduction of more than fifty percent in 2003, which will be significantly beneficial to the Group's net profit level.

Looking into the future, the Group is fully confident in the prospects of zirconium chemicals, given that zirconium is a novel type of material whose application is growing with time in many different areas, from high-new technology industry and cutting-edge products to common industrial products and everyday life. In conclusion, the use of zirconium chemicals is becoming ever more extensive, encompassing ever more diversified scopes and larger markets. In line with these factors, the Group will continue to concentrate on the downstream and deep-processing operations, in addition to the development of zirconium components.

The Group will effectively use its resources so as to accelerate its development progress and realize its objectives of strengthening and expansion. Should projects with munificent return potential arise, the Group will not exclude the possibility of acquisition or developing zirconium derivative products such as battery materials. However, any acquisition will be subject to the interests of the Company and its shareholders.

In view of these, the Group is confident to reach ever higher grounds and generate better returns for its shareholders and investors in 2003.

On behalf of the Board, I would like to express our sincere gratitude to all our customers, shareholders, investors, and our long-term suppliers and business partners for their continued faith, support and services to the Group over the years. Thanks are also extended to our management team and staff for their dedication, support and understanding.

Yang Xin Min
Chairman

22 April 2003

MANAGEMENT DISCUSSION AND ANALYSIS

Overview of the Group's Performance

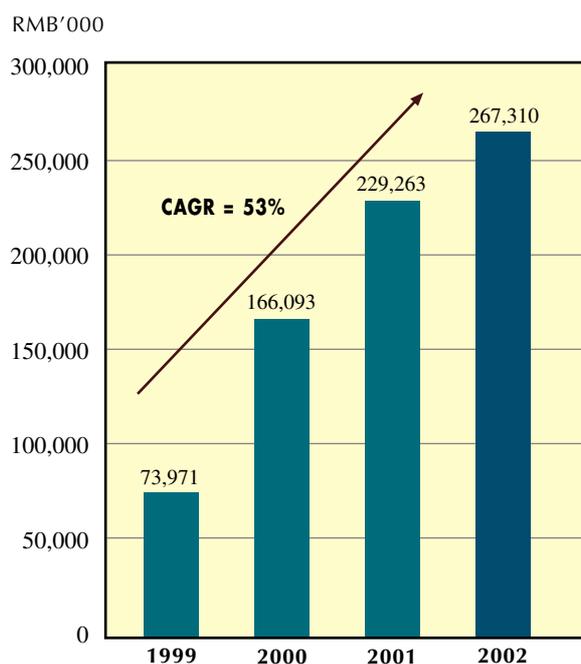
Profits generated by the Group during the track record period were mainly attributable to manufacture and sale of a wide range of zirconium chemicals, which include zirconium oxychloride, zirconium carbonate and zirconium oxides and other zirconium chemicals under the brandname "Long Jing".

Turnover

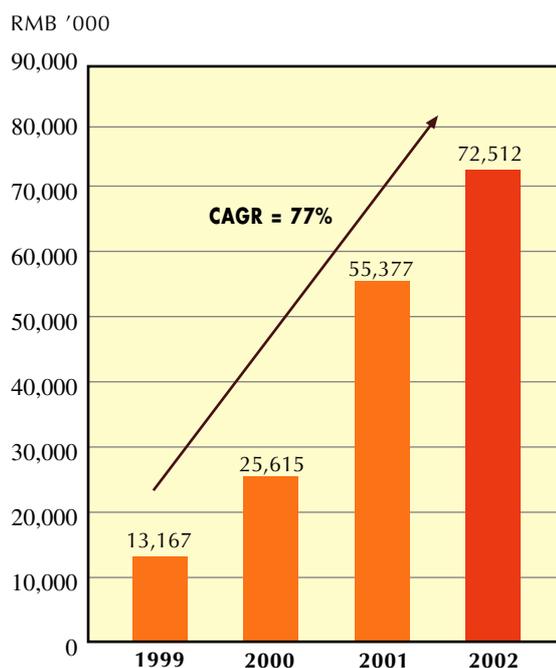
For the year ended 31 December 2002, the Group's turnover was RMB267,310,000, representing an increase of 17% as compared to that of Year 2001. The increase was mainly attributable to the drastic increase in the sales of zirconium oxides in Year 2002. In particular, the sales volume of micrometric zirconium oxides rose from 128 tonnes in Year 2001 to 364 tonnes in Year 2002; whereas the sales volume of stabilized zirconium oxides soared from 2 tonnes in Year 2001 to 128 tonnes in Year 2002; and sales volume of nanometric zirconium oxides accomplished 13 tonnes in year 2002.

For the three years ended 31 December 1999, 2000 and 2001, the Group's turnover reached RMB73,971,000, RMB166,093,000 and RMB229,263,000 respectively. Comparatively, prominent growth in the Company's turnover was sustained during the period from 1999 to 2001. This was mainly attributable to the accreditation of "Qualification Certificate for Wastewater Treatment Facilities in Taihu Lake Basin in Jiangsu Province" by the Company in 1998, and the compliance with the environmental protection regulations under which the Company is allowed to carry out mass production of zirconium compounds, leading to the growth in sales volume which in turn drove up the turnover.

Turnover (1999-2002)



Profit Attributable to Shareholders (1999-2002)



Applications of Zirconium Chemicals

Product	Applications
Zirconium oxychloride	Rubber additives Paint dryer Feedstock for the production of other zirconium chemicals
Zirconium carbonate	Water resistant materials for house building Fiber and paper coating Medical products (anti-fungal and deodorant)
Zirconium oxide	Garment (water-proof clothing) Cosmetics (lipstick, foundations, mascara) Health care products (UV-block lotions) Medical products (man-made bones, denture) Never-worn watch shell Optical fibers Jewellery (Cubic Zirconia) Catalyst in vehicle exhaust system
Zirconium sulphate	Leather tanning Leather degreaser
Zirconium acetate	Paint dryer Fiber and paper coating (flame and smoke suppressant) Water resistant materials for house building
Potassium zirconium hexafluoride	High-grade electronic materials (computer hard discs) Metal alloys Ceramics, enamelware, glasses
Ammonium zirconium hexafluoride	Pesticides
Zirconium silicate	Used for the manufacture of other zirconium chemicals, ceramic glaze and enamels
Zirconium hydroxide	Electronic ceramics (batteries cut-off switch, motor magnetic circuit)

Turnover Analysis by Product Category

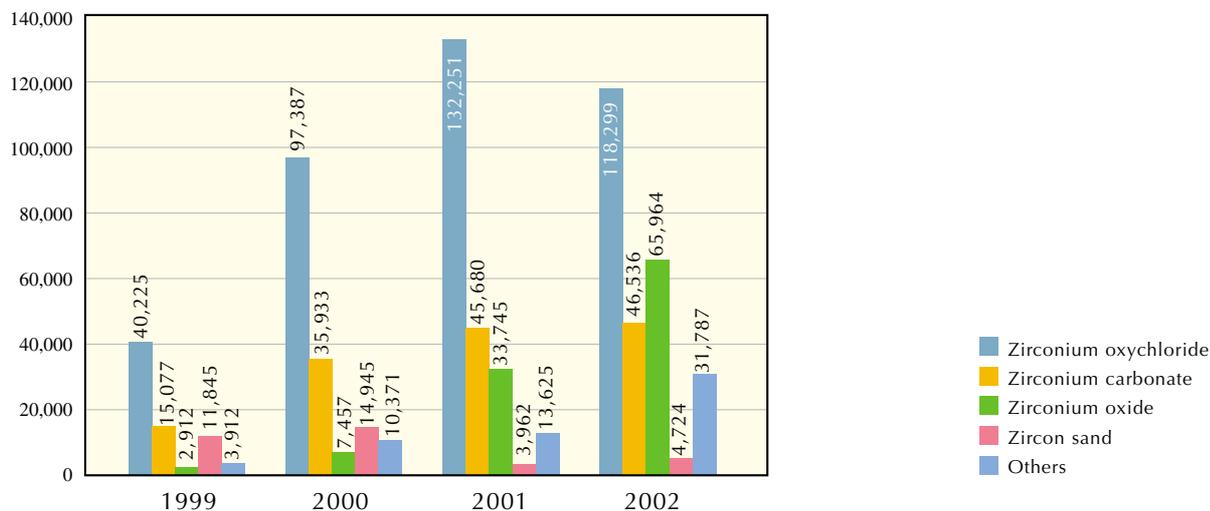
The following table presents the Group's turnover analysis by product category for the four years ended 31 December 2002:

Product Sales	1999		2000		2001		2002	
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%
Zirconium oxychloride	40,225	55	97,387	59	132,251	57	118,299	44
Zirconium carbonate	15,077	20	35,933	22	45,680	20	46,536	17
Zirconium oxides	2,912	4	7,457	4	33,745	15	65,964	25
Zircon sand	11,845	16	14,945	9	3,962	2	4,724	2
Others (Note 1)	3,912	5	10,371	6	13,625	6	31,787	12
	<u>73,971</u>	<u>100</u>	<u>166,093</u>	<u>100</u>	<u>229,263</u>	<u>100</u>	<u>267,310</u>	<u>100</u>

Note 1: Including potassium zirconium hexafluoride, zirconium sulphate, zirconium acetate, zirconium silicate and ammonium zirconium hexafluoride.

Turnover Analysis by Product Category

RMB'000

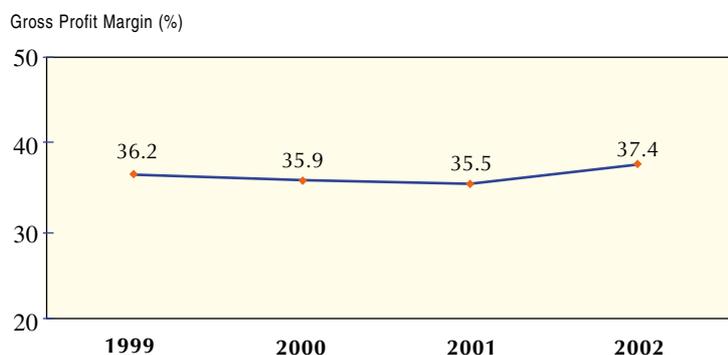


The Group has strategically moved to high-end products, such as zirconium oxides, the sales of zirconium oxides surged up from 4% in 1999 to 25% in 2002, as a result of product structure adjustment. Commitment to move forward to high-end deep-processing products or downstream products (the “High-End” products) were evidenced by the sales of nanometric zirconium oxide started in 2002.

Zirconium Oxides	Sales Volume	
	2001 (Tonnes)	2002 (Tonnes)
Ordinary grade	473	703
Superfine zirconium oxide (stabilized and micrometric grade)	130	492
Nanometric grade	—	13

Gross profit margin of High-End products outperformed the average gross profit margin of the Group. High-End products required further process from upstream products, such as zirconium oxychloride, which include ordinary grade zirconium oxide, stabilized zirconium, micrometric zirconium oxide and nanometric zirconium oxide.

Gross Profit Margin (1999-2002)



Turnover analysis by geographical region

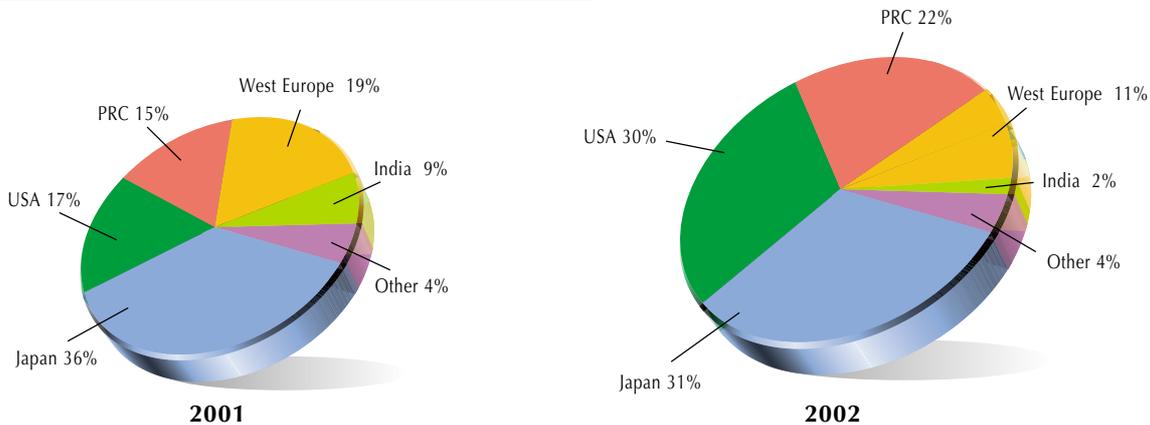
The following table presents turnover analysis by geographical region for the four years ended 31 December 2002 and their respective percentages in total turnover:

Regions	1999		2000		2001		2002	
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%
Japan	20,290	27	67,201	41	82,848	36	83,153	31
USA	15,856	21	34,641	21	39,653	17	81,024	30
PRC	33,763	46	52,241	32	33,371	15	58,906	22
West Europe (Note 2)	2,665	4	6,014	3	42,908	19	28,961	11
India	—	0	12	0	20,509	9	6,072	2
Others (Note 3)	1,397	2	5,984	3	9,974	4	9,194	4
	<u>73,971</u>	<u>100</u>	<u>166,093</u>	<u>100</u>	<u>229,263</u>	<u>100</u>	<u>267,310</u>	<u>100</u>

Note 2: Including UK and the Netherlands

Note 3: Including Korea, Austria and Lithuania

Turnover Analysis by Geographical Region



Capital Expenditure

The capital expenditure of the Group for the four years ended 31 December 2002 is as follows:

	1999 RMB'000	2000 RMB'000	2001 RMB'000	2002 RMB'000
Capital expenditure	2,299	5,105	4,536	12,751

For the year ended 31 December 2002, the Group's capital expenditure was RMB12,751,000, representing an increase of 181% as compared to RMB4,536,000 in Year 2001. This was mainly attributable to expansion of production.

Liquidity and Financial Resources

As at 31 December 2002, the Group's bank and cash balances, including pledged deposits, were approximately RMB172,988,000 (2001: RMB85,072,000). The Group had no long term liabilities as at 31 December 2002 and 2001.

Contingent Liabilities

As at 31 December 2002, the Group had no contingent liabilities.

Pledge of Assets

As at 31 December 2002, the Group pledged a bank deposit of RMB453,000 (2001: RMB415,000) as securities for trade financing facilities granted by banks.

As at 31 December 2002, the Group had banking facilities including bank overdraft of HKD500,000 and a corporate credit card of HKD600,000. The facilities are secured by the certificate of deposit amounted to HKD1,000,000 which carried at fixed rate of 1.8% per annum and with a maturity of two years. The Group had no banking facilities for the year 2001.

Employees

For the year ended 31 December 2002, the Group had approximately 444 employees (2001: 483 employees). In Year 2002, the aggregate employee remuneration (including directors' fees) was approximately RMB19,379,000 (2001: RMB16,711,000). The Group offers competitive salary packages to its employees who will also be given incentives based on their individual performance as well as the Group's overall remuneration and bonus systems.

DIRECTORS' REPORT

Principal Activities

The Group is principally engaged in the manufacture and sale of a wide range of zirconium chemicals under the brandname of "Long Jing".

Results and Appropriations

The results of the Group for the year ended 31 December 2002 are set out in the consolidated income statement on page 27.

The Board has recommended payment of a final dividend of HK\$0.03 per ordinary share for the Year 2002. An aggregate dividend of RMB19,740,000 was proposed for the Year 2002, including a final dividend of RMB12,740,000 payable and an interim dividend of RMB7,000,000 paid.

In the event that the resolution on the proposed payment of the final dividend for ordinary share is passed at the Annual General Meeting to be held on Monday, 26 May 2003, such dividend will be paid on Monday, 2 June 2003 to shareholders whose names appear in the register of members of the Company on Friday, 23 May 2003.

The register of members of the Company will be closed from Thursday 22 May 2003 to Friday, 23 May 2003, both days inclusive, during which period no transfer of shares of the Company will be registered. In order to qualify for the proposed final dividend and to attend and vote at the Company's Annual General Meeting to be held on Monday, 26 May 2003, all transfer documents accompanied by the relevant share certificates must be lodged with the Company's Branch Registrar in Hong Kong, Tengis Limited, at G/F., Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong for registration by no later than 4:30 p.m. on Wednesday 21 May 2003.

Financial Summary

A summary of the results and the assets and liabilities of the Group for the last four financial years is set out on page 3.

Property, Plant and Equipment

Details of movements in the property, plant and equipment of the Group and the Company during the Year 2002 are set out in note 13 to the financial statements.

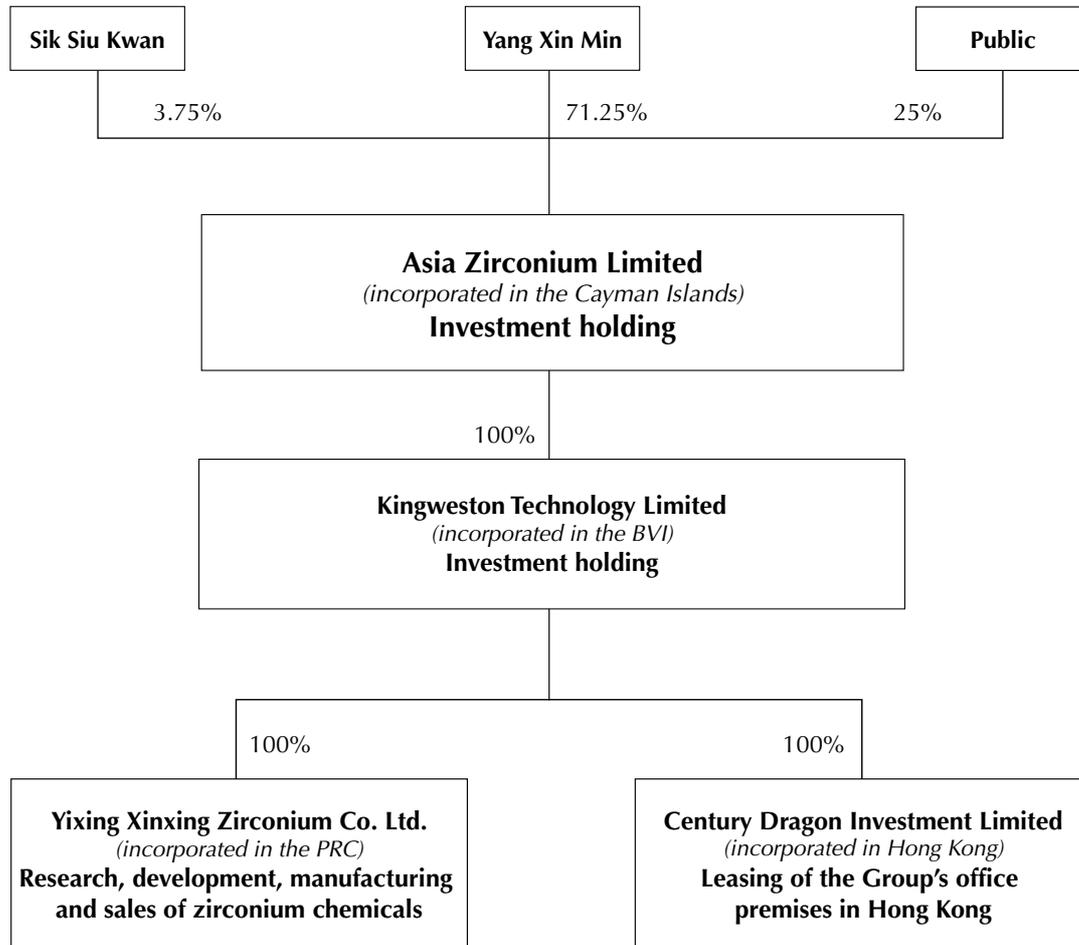
Share Capital

Details of movements in the share capital of the Company during the Year 2002 are set out in note 24 to the financial statements.

Reserves

Details of movements in the reserves of the Group and the Company during the Year 2002 are set out in consolidated statement.

Group Structure



Substantial Shareholder Interests in Securities

As at 31 December 2002, the following interests of the substantial shareholder of 10% or more in the issued share capital of the Company as recorded in the register of substantial shareholders pursuant to Section 16(1) of the SDI Ordinance is as follow:

Name of Substantial Shareholder	Number of Ordinary Shares Personal Interest	Percentage of Issued Share Capital
Yang Xin Min	285,000,000	71.25%

Directors

The Directors of the Company at the date of this report are shown below. Their biographies are set out on pages 22 to 24.

Name	Position	Term of office
Yang Xin Min	Chairman, Managing Director	Since 17 September 2000
Yang Zhen	Vice-Chairman	Since 17 September 2000 (resigned on 15 April 2003)
Huang Yue Qin	Executive Director	Since 17 September 2000
Zhou Quan	Executive Director	Since 1 April 2003
Guo Lu Cun	Executive Director	Since 1 January 2002
Sik Siu Kwan	Non-executive Director	Since 2 March 2002 (resigned on 17 March 2003)
Cheng Faat Ting	Independent Non-executive Director	Since 16 November 2001
Guo Jing Mao	Independent Non-executive Director	Since 26 October 2000

Each of the above directors have entered into a service contract with the Company for an initial term of three years. Each service contract will continue thereafter unless terminated by either party thereto giving to the other at least three months' notice in writing.

Directors' Interests in Securities

As at 31 December 2002, the interests (as defined in the Securities (Disclosure of Interests) Ordinance (the "SDI Ordinance")) of the Directors in the securities of the Company, as recorded in the register maintained by the Company pursuant to Section 29 of the SDI Ordinance or which are required to be notified to the Company and the Stock Exchange pursuant to the Model Code ("Model Code") for Securities Transactions by Directors of Listed Companies of the Rules Governing the Listing of Securities on the Stock Exchange ("Listing Rules") were as follows:

Name of Directors	Number of Ordinary Shares Personal Interests	Percentage of Issued Share Capital
Yang Xin Min	285,000,000	71.25%
Sik Siu Kwan <i>(resigned on 17 March 2003)</i>	15,000,000	3.75%

Save as disclosed above, as at 31 March 2002, none of the Directors and their associates had any interests (as defined in the SDI Ordinance) in the securities of the Company or any of its associates as recorded in the register maintained by the Company pursuant to Section 29 of the SDI Ordinance or which are required to be notified to the Company and the Stock Exchange pursuant to the Model Code.

Directors' Interests in Competing Business

None of the Directors of the Company had any interest, either direct or indirect, in any business, which may compete or constitute a competition with the business of the Group.

Directors' Interests in Contracts

None of the Directors of the Company had a material interest, either direct or indirect, in any significant contract to which the Company or its holding companies or any of its subsidiaries was a party at the year-end of or during the Year 2002.

At no time during the year was the 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 or debentures of the Company or any other body corporate.

Share Option Scheme

Share Option Scheme Adopted on 24 September 2002

Pursuant to the written resolution on Share Option Scheme (the "Scheme") approved by the Directors on 24 September 2002, the Board may, at its discretion, grant options (the "Options") to any Director (whether executive or non-executive and whether independent or not), any employee (whether full-time or part-time), any consultant or adviser of or to the Company or the Group (whether on an employment or contractual or honorary basis and whether paid or unpaid) (the "Eligible Persons"). The purpose of the Scheme is to advance the interests of the Company and its shareholders by enabling the Company to grant Options to attract, retain and reward the Eligible Persons, to provide to the Eligible Persons a performance incentive for continued and improved services with the Company and its subsidiaries, and to enhance such persons' contribution to increase the profits by encouraging capital accumulation and share ownership. The Scheme will expire on 23 September 2012.

Pursuant to the Scheme, the subscription price shall be such price as the Board may in its absolute discretion determine at the time of the grant of the relevant Option but in any case the subscription price must be at least the highest of (i) the closing price of the Shares as stated in the Stock Exchange's daily quotations sheet on the date of grant, which must be a business day; (ii) the average closing price of the Shares as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant; and (iii) the nominal value of a Share. For the purpose of calculating the subscription price where the Company has been listed for less than five business days, the issue price shall be used as the closing price for any business day falling within the period before listing.

Options granted pursuant to the Scheme will be vested in the grantee at a 20%: 20%: 20%: 20%: 20% ratio in five installments during the exercisable period determined by the Board (under no circumstances should the exercisable period exceed five years from six months after the date of acceptance), and shall expire on the last day of the exercisable period.

Maximum Number of Shares Available for Subscription

The maximum aggregate number of Shares which may be issued upon exercise of all outstanding Options granted and yet to be exercised under the Scheme and any other schemes of the Company must not exceed in aggregate 30% of the Shares of the Company in issue from time to time ("Overall Scheme Limit"). No Options may be granted under any schemes of the Company (or its subsidiaries) if such grant will result in the Overall Scheme Limit being exceeded.

The total number of Shares which may be issued upon exercise of all Options to be granted under the Scheme and any other schemes must not in aggregate exceed 10% of the Shares of the Company (or its subsidiaries) in issue as at the date of approval of the Scheme (the "Scheme Mandate Limit"). Options lapsed in accordance with the terms of the Scheme shall not be counted for the purpose of calculating the Scheme Mandate Limit.

Subject to the Overall Scheme Limit, the Company may seek approval from its shareholders in general meeting for "refreshing" the "Scheme Mandate Limit". However, the total number of Shares which may be issued upon exercise of all Options to be granted under all of the schemes of the Company under the limit as "refreshed" must not exceed 10% of the Shares in issue as at the date of approval by the shareholders of the renewed limit (the "Refreshed Scheme Mandate Limit"). Options previously granted under any existing schemes (including those outstanding, cancelled or lapsed in accordance with the Scheme or exercised Options) shall not be counted for the purpose of calculating the Refreshed Scheme Mandate Limit. The Company must send a circular to its shareholders containing the information required under the relevant provisions of Chapter 17 of the Listing Rules.

Subject to the Overall Scheme Limit, the Company may seek separate approval from its shareholders in a general meeting for granting Options to subscribe for Shares beyond the Scheme Mandate Limit or the Refreshed Scheme Mandate Limit (as the case may be) provided that the Options in excess of the Scheme Mandate Limit or the Refreshed Scheme Mandate Limit are granted only to Eligible Persons specifically identified by the Company before such approval is sought. The Company must send a circular to its shareholders containing the information specified in the relevant provisions of the Listing Rules.

Unless approved by shareholders in general meeting at which the relevant Eligible Person and his/her associates abstain from voting in the manner prescribed by the relevant provisions of Chapter 17 of the Listing Rules, the total number of Shares issued and to be issued upon exercise of the Options granted to such Eligible Person (including exercised, cancelled and outstanding Options) in any 12-month period must not exceed 1% of the Shares of the Company in issue (the "Individual Limit") at such time. With respect to any further grant of Options to an Eligible Person exceeding in aggregate the Individual Limit, the Company must send a circular to its shareholders and the circular must disclose the identity of the Eligible Person, the number and terms of the Options to be granted (and Options previously granted to such Eligible Person), and the information required under the relevant provisions of Chapter 17 of the Listing Rules. The number and terms (including the Subscription Price) of Options to be granted to such Eligible Person must be fixed before the general meeting at which the same are approved, and the date of the Board meeting for proposing such further grant should be taken as the date of grant for the purpose of calculating the Subscription Price.

Grant of Options to Connected Persons

Each grant of Option(s) to a connected person (as defined in the Listing Rules) of the Company under the Scheme must be approved by the independent non-executive Directors (excluding any independent non-executive Director who is the grantee of the Option).

Where any Options granted to a substantial shareholder (as defined in the Listing Rules) of the Company or an independent non-executive Director or any of their respective associates would result in the number and value of Shares issued and to be issued upon exercise of all Options already granted and to be granted (including Options exercised, cancelled and outstanding but excluding Options which have lapsed) to such person in the 12-month period up to and including the date of such grant (a) exceeding in aggregate over 0.1% of the Shares in issue; and (b) exceeding an aggregate value, based on the closing price of the Shares on the Stock Exchange at the date of each grant, in excess of HK\$5 million, such further grant of Options must be approved by the shareholders by the taking of a poll in a general meeting. The Company must send a circular to the shareholders. All connected persons (as defined in the Listing Rules) of the Company must abstain from voting (except that any connected person may vote against the relevant resolution at the general meeting provided that his intention to do so has been stated in the circular) at the general meeting. The circular must contain the following:

- (i) details of the number and terms (including the subscription price) of the Options to be granted to each Eligible Person, which must be fixed before the general meeting concerned;
- (ii) a recommendation from the independent non-executive Directors of the Company (excluding any independent non-executive Director of the Company who is the Grantee of the Options) to the independent shareholders as to voting; and
- (iii) the information required under the relevant provisions of Chapter 17 of the Listing Rules.

The Options must be accepted within 28 days from the day of grant, and the grantee must pay a non-remittable amount of HK\$1.00 to the Company.

As at 31 December 2002, a total of 2,000,000 shares of the Company may be issued under the Options granted pursuant to the Scheme, representing 0.5% of the Company's shares in issue as at the date of grant.

Details of the movement of the Company's Options granted during the year were as follows:

Name of Employee	Date of Grant	Exercise Period	Subscription Price per Share	Number of share options			Outstanding as at 31 March 2003
				Outstanding as at 31 December 2002	Granted during the Year	Exercised during the Year	
Wong Hoi Yan, Audrey	1 November 2002	1 May 2003 to 30 April 2008 (Note 4)	HK\$0.87	2,000,000	2,000,000	—	2,000,000

Note 4: The Options will vest in five tranches in the grantee at a 20%: 20%: 20%: 20%: 20% ratio. The first tranche of the Options will vest in the grantee on 1 May 2003. The second, third, fourth and fifth tranches will be vested in the grantee on 1 May 2004, 1 May 2005, 1 May 2006 and 1 May, 2007 respectively.

Connected Transactions

The following connected transactions have been carried out by the Group during Year 2002:

Trademark

Pursuant to the trademark licensing agreement dated 12th July 2000 entered into between Jiangsu Xinxing Chemicals Group Corp. ("Xinxing Chemicals Group") and Yixing Xinxing Zirconium Co. Limited ("Yixing Zirconium"), Xinxing Chemicals Group has agreed to grant an exclusive license to Yixing Zirconium or the Group to use the "Long Jing" trademarks in the PRC, the USA and Japan respectively, during their respective legally valid periods at nil consideration. Xinxing Chemicals Group is beneficially owned by Mr. Yang Xin Min, and Yixing Zirconium is a wholly-owned subsidiary of the Company. Accordingly, the transactions contemplated under the trademark licensing agreement constitutes a connected transaction pursuant to the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules") upon the listing of the shares of the Company on the Stock Exchange.

This transaction falls within the de minimis provision under Rule 14.24(5) of the Listing Rules. Accordingly, upon the listing of the Company's Shares on the Stock Exchange, the trademark licensing agreement will not be subject to disclosure or shareholders' approval requirements.

Supply of power and steam

Xinxing Chemicals Group (as supplier) and Yixing Zirconium (as purchaser) have entered into the supply agreement dated 1 September 2000 and the two supplemental agreements thereto dated 16 September 2000 and 21 March 2002, respectively ("the Agreements"), pursuant to which Xinxing Chemicals Group agreed, inter alia, to provide electricity and steam (which is owned by Xinxing Chemicals Group) to Yixing Zirconium for the normal operation of Yixing Zirconium's production facilities for a term of 15 years commencing from 1st January 2001 to 31st December 2015. The directors expect that the power and steam annual expenses will not exceed 10% of the Group's total turnover in each financial year. The transactions contemplated under the Agreements constitute ongoing connected transactions pursuant to the Listing Rules upon the listing of the shares of the Company on the Stock Exchange.

Save as disclosed above, no other transactions were required to be disclosed as connected transactions pursuant to the Listing Rules. No directors, directly or indirectly, had any material interests in any significant contracts entered into between the Company, the ultimate holding company or any subsidiaries of the ultimate holding company during the year.

Upon the listing of the shares of the Company on the Stock Exchange, the transactions contemplated under the Agreements constitute ongoing connected transactions of the Company pursuant to the Listing Rules. The Company has applied for a waiver from strict compliance of the transactions contemplated under the Agreements with the related provisions of the Listing Rules for the three years ended 31 December 2004, on the basis that the Company undertakes to strictly abide by the following terms and conditions, and the waiver has been granted by the Stock Exchange.

The Company's independent non-executive directors have reviewed the ongoing connected transactions as set out above and confirm that:

- the transactions have been entered into in the ordinary and usual course of the business of the Group;

Connected Transactions *(Cont'd)*

Supply of power and steam *(Cont'd)*

- the transactions have been conducted on normal commercial terms and agree after arm's length negotiations, and in accordance with the terms of the relevant Agreements or on terms no less favourable than terms available to independent third parties;
- the transactions have been conducted in accordance with the relevant agreements on terms that are fair and reasonable so far as the shareholders of the Company are concerned and in the interest of the Company as a whole;
- the transactions entered into during the year do not exceed, in aggregate, 10% of the Company's aggregate turnover in Year 2002 (the "Annual Cap").

The Company's auditors have reviewed the ongoing connected transactions as set out above and confirm that the connected transactions:

- have received the approval of the Board;
- have been entered into in accordance with the pricing policies as stated in the Company's financial statements;
- have been entered into in accordance with the terms of the Agreement governing such transactions or on normal commercial terms in the ordinary and usual course of the Group's business; and
- the values of the ongoing connected transactions do not exceed the Annual Cap mentioned above.

Use of Proceeds

The Group was listed on Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 28 October 2002, and the proceeds was HK\$80,000,000 after charging all the intermediaries fees and costs of HK\$11,900,000 and the net proceeds amounted to HK\$68,100,000. As stated in the prospectus of the Company dated 17 October 2002, the proceeds will be mainly used for the expansion of production lines. The Group will continue to exercise caution in assessing the effectiveness of expanding production lines. During the Year, the proceeds were used for the following purposes:

- approximately HK\$25 million was used to finance the expansion of the production facilities to increase the annual aggregate production capacity of zirconium oxychloride from the original level of approximately 27,600 tonnes to approximately 35,000 tonnes. The project is in progress.
- approximately HK\$20 million was used to finance the expansion of the micrometric zirconium oxide production facilities from an annual production capacity of approximately 100 tonnes to approximately 1,000 tonnes and establish a 20-tonne nanometric zirconium oxide production facility. Currently, the production capacity of the project has reached 600 tonnes and completion is expected at the end of December 2003.
- approximately HK\$10 million was used to finance the expansion of the zirconium carbonate production facilities from the original level of 4,800 tonnes to 6,000 tonnes. Completion of expansion and commencement of production are expected at the end of October 2003.

Use of Proceeds *(Cont'd)*

- approximately HK\$8 million was used for the research and development of new products as well as the import of the relevant inspection and research facilities. The ICP instrument and surface detector imported from the USA have already been installed and put into use. To tie in and speed up the development of new products, the purchase of all the remaining parts of the imported and domestic instruments will also be completed as scheduled by the end of July 2003, and will be put into use accordingly.
- approximately HK\$4 million was used for the expansion of the marketing teams in Hong Kong, the PRC and other countries. The Group has formulated and implemented the plan on participating in international exhibitions and international marketing team in 2003.
- the balances were used for the working capital.

For the year ended 31 December 2002, the balance of the unused net proceeds was approximately HK\$45,000,000 and has been placed on deposits with financial institutions in the PRC for the future expansion of the Group's business and the investments of the relevant business areas. All of the proceeds will be used in accordance with the original plan as stated in the prospectus dated 17 October 2002 and it is expected that all of the proceeds will be utilized by the end of March 2004, progressively exerting decisive effects on the future development of the Company.

Laser Particle Analyzer



US-made
Surface
Detector

US-made ICP Instrument

Atomic Absorption Spectrometer

Major Customers and Suppliers

For the year ended 31 December 2002, the aggregate turnover attributable to the largest customer and the five largest customers of the Group accounted for approximately 28% and 60% of the Group's total turnover for the year respectively; and the aggregate purchases from the largest and the five largest suppliers of the Group accounted for approximately 33% and 74% of the Group's total purchases in the corresponding year respectively.

As far as the directors are aware, none of the directors of the Company, their respective associates (as defined in the Listing Rules of The Stock Exchange of Hong Kong Limited), and the existing shareholders of the Company who own more than 5% of the Company's issued share capital, had any interests in the Group's five largest customers or suppliers at any time during Year 2002.

Responsibility of Directors on Financial Statements

The Companies Ordinance requires the Directors to prepare financial statements for each financial year. Such financial statements should give a true and fair view of the state of affairs of the Company and of the Group as at the balance sheet date of a particular year and on the profit and loss of the Company and the Group for the year then ended. In preparing the financial statements, the Directors should:

- (a) select and apply consistently appropriate accounting policies, make prudent, fair and reasonable judgement and estimation;
- (b) report the reasons for any seriously deviation from accounting practice; and
- (c) prepare the financial statements on going concern basis, unless it is inappropriate to assume the Company and the Group could continue to operate;

The Directors are responsible for the proper keeping of accounting record in order to secure asset of the Company and the Group. The Directors are also responsible for adopting reasonable measures to prevent and check any fraudulences and irregularities.

Corporate Governance

Code of Best Practice

The Code of Best Practice as set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") has been complied with by the Company throughout the Year 2002.

Audit Committee

The Company set up an Audit Committee on 24 September 2002 with its written terms of reference being in compliance with Rules set out in "A Guide for the Formation of An Audit Committee" issued by Hong Kong Society of Accountants.

The primary duties of the Audit Committee are to review and supervise the financial reporting process and internal control systems of the Group. The Audit Committee comprises two independent non-executive directors, namely Mr. Gary Cheng Faat Ting and Mr. Guo Jing Mao, with Mr. Gary Cheng Faat Ting being Chairman of the Audit Committee.

Donations

As at 31 December 2002, the Group did not make any donations.

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 financial year ended 31 December 2002.

Pre-emptive Rights

There is no provision for pre-emptive rights under the Company's articles of association or the laws of the Cayman Islands, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

Post Balance Sheet Date Event

As at 22 April, 2003, the Group had no post Balance Sheet Date Event.

Auditors

A resolution for the re-appointment of RSM Nelson Wheeler as the Company's auditors for 2003 is to be proposed at the forthcoming annual general meeting.

By order of the Board

Huang Yue Qin

Executive Director

22 April 2003

PROFILE OF DIRECTORS AND SENIOR MANAGEMENT



Photos of part of the directors

(from left: Ms. Huang Yue Qin, Executive Director
Mr. Yang Xin Min, Chairman
Mr. Zhou Quan, Executive Director)

Executive Directors

Mr. Yang Xin Min (楊新民), aged 53, is the founding Chairman, Managing Director and controlling shareholder of the Company. Mr. Yang graduated from the Beijing Economics Correspondence College. Since August 1977, Mr. Yang has been the General Manager of all predecessor entities of the Group. Mr. Yang has more than 20 years of experience in the research, production management and international market development of zirconium chemicals. Mr. Yang is responsible for the formulation of the Group's overall business strategies and overseeing the daily operations of the Group. Mr. Yang is the husband of Ms. Bao Xi Mei, the Deputy General Manager of the Group.

Ms. Huang Yue Qin (黃月琴), aged 34, is the manager of the sales, purchasing and marketing departments of the Group. Ms. Huang joined the Group in 1991 and has accumulated more than 10 years of import and export experience in the zirconium chemicals industry. Ms. Huang has frequently visited clients in the USA, Japan and Europe, and maintained very good relationship with the Group's overseas customers.

Mr. Zhou Quan (周全), aged 44, joined the Group in 1993. Mr. Zhou is the assistant to the General Manager of the Group, assisting the Chairman in the overall management of the Group. Mr. Zhou has extensive experience in the production supervision of zirconium products and business administration.

Mr. Guo Lu Cun (郭露村), aged 45, is the Chief Engineer of the Group. Mr. Guo graduated from Nanjing University of Chemistry. He obtained a doctoral degree in zirconium materials engineering after furthering his study and working in Japan for 7 years. Prior to joining the Group in 2000, Mr. Guo was the research director and senior engineer for Jiangsu Ceramics Research Institute. He was also a professor and the director of the research institute for Nanjing University of Chemistry, engaging in the research and development and application of zirconium-based electronic products. After joining the Group, Mr. Guo has been in charge of the development of zirconium products for application in ceramic semiconductors.

Independent non-executive Directors

Mr. Gary Cheng Faat Ting (鄭發丁), aged 34, was appointed as an independent non-executive Director of the Company in November 2001. Mr. Cheng is a professional accountant in both Hong Kong and the USA. Mr. Cheng received his Bachelor's degree in Business Administration (Honours) and Master's degree of Business Administration from Southern Illinois University at Carbondale, the USA, in 1992 and 1994 respectively. Mr. Cheng has worked at the international accounting firm, PricewaterhouseCoopers and has extensive experience in auditing and accounting, in particular, in financial institutions. He is currently a partner of Cheng Pang & Co., C.P.A.

Mr. Guo Jing Mao (郭靖茂), aged 63, was appointed as an independent non-executive Director of the Company in October 2000. Mr. Guo is a retired first-generation expert in zirconium elements. Mr. Guo graduated from Beijing Science and Technology University and specialised in the research on zirconium and other alloy. Mr. Guo has been a senior engineer at the Nonferrous Metals Society of China for 13 years before his retirement in 1999.

Senior Management

Ms. Audrey Wong Hoi Yan (黃凱欣), aged 33, is the Financial Controller and Company Secretary of the Group. Ms. Wong received her Master's degree in Hong Kong. Prior to joining the Group, Ms. Wong worked in an international accounting firm and a securities house for many years. She is a member of the American Institute of Certified Public Accountants and the Hong Kong Society of Accountants.

Mr. He You Gen (何由根), aged 61, is the senior consultant and the head of the production department of the Group. Mr. He stated to work as a freelance consultant of the Group in 1978. Prior to joining the Group, Mr. He was a deputy general manager of the production of one of the first zirconium alloy manufacturers in Shanghai. Mr. He has more than 30 years' experience in the production and management of zirconium chemicals. Mr. He joined the Group as a full-time member of staff in 1991.

Ms. Bao Xi Mei (鮑夕妹), aged 50, is the Deputy General Manager of the Company and is responsible for the administration and investment functions. Ms. Bao graduated from the Jiangsu Television University majoring in accounting and finance. Ms. Bao has over 20 years of experience in financial management and business administration. In particular, Ms. Bao is very familiar with management in the zirconium industry. Ms. Bao joined the Group in August 1977 as the chief accountant. Ms. Bao is the wife of the Chairman of the Group.

Mr. Li Fu Ping (李福平), aged 33, is the assistant to the General Manager of the Group. Mr. Li graduated from the Jiangsu Institution of Chemistry, where he majored in business administration, and was the chairman of the student union of the university. Since joining the Group in 1992, he has engaged in business administration and has been the secretary to the general manager of the Group for 10 years. As such, Mr. Li has accumulated extensive experience in business administration. He is a key member of the Group's internal audit committee for ISO9002 quality assurance accreditation and is in charge of the ISO14001 environmental management systems.

Senior Management *(Cont'd)*

Mr. Shen Hui (沈輝), aged 35, graduated from Nanjing University majoring in chemistry. He was previously involved in zirconium research and development at the Jiangsu Ceramics Research Institute. Mr. Shen joined the Group in 1998 and is currently the director and chief engineer of the nanomaterials research centre of the Group. He is in charge of the Company's project for the research and development of nanometer grade zirconium oxides, one of the projects under Jiangsu Province's "Ninth Five-year Plan". Mr. Shen has extensive experience in the research and development of new products, and has produced significant research results in the application of zirconium in ceramics during his tenure in the Jiangsu Ceramics Research Institute.

Ms. Sun Hong Di (孫紅娣), aged 35, is the head of the technology and quality control department of the Group. Ms. Sun joined the Group in 1990 and has been responsible for quality control, analysis and monitoring of zirconium chemicals. Ms. Sun has been involved in devising the national quality standards for zirconium chemical products with the former Ministry of Chemical Industry of the PRC. Ms. Sun was one of the leaders of the Group's working team for the ISO9002 accreditation.

Ms. Wu Xi Wei (吳夕瑋), aged 34, graduated from Jiangsu Television University majoring in international trade and economics. Since joining the Group in 1991, Ms. Wu has been responsible for the financial function of the Group, and is currently the finance manager of Yixing Zirconium. She has extensive experience in financial management and has maintained good relationships with local and national tax authorities, customs departments, commodity inspection authorities, foreign exchange control authorities and various banks.

Mr. Yuan Jian Rong (袁建榮), aged 48, is the head of the work safety and environmental protection department of the Group. Since joining the Group in 1986, Mr. Yuan has participated in various training functions in respect of environmental protection laws and regulations. For a number of years, he has been engaged in work safety and environmental protection and has helped the Company in maintaining high standards of work safety and environmental protection. The Company was therefore accredited on several occasions by the environmental protection authorities under the central government. He is also the deputy head of the working team responsible for the ISO14001 environmental management systems.

Ms. Jiang Jiao Ping (蔣皎萍), aged 34, is the deputy head of the international business department of the Company. Since joining the Group in 1991, Ms. Jiang has been engaged in the international trading business of the Group. She has extensive experience in international trading and has maintained good relationships with international customers.

Mr. Wu Hai Jun (吳海軍), aged 26, graduated from Nanjing University with a degree in economics and majored in international trading. He joined the Group in 1999 and is currently the secretary of the Chairman of the board of directors.

CORPORATE INFORMATION

Executive Directors

Mr. Yang Xin Min (Chairman)
Mr. Yang Zhen (Resigned on 15th April, 2003)
Ms. Huang Yue Qin
Mr. Zhou Quan (Appointed on 1st April, 2003)
Mr. Guo Lu Cun

Non-executive Director

Mr. Sik Siu Kwan (Resigned on 17th March, 2003)

Independent Non-executive Directors

Mr. Gary Cheng Faat Ting, CPA, AHKSA
Mr. Guo Jing Mao

Financial Controller and Company Secretary

Ms. Audrey Wong Hoi Yan, AICPA, AHKSA

Auditor

RSM Nelson Wheeler
Certified Public Accountants
7th Floor, Allied Kajima Building
138 Gloucester Road
Wanchai
Hong Kong

Principal Bankers

Bank of China, Yixing Sub-branch
No. 106 Taige Xi Road
Yicheng Town
Yixing City
Jiangsu Province
PRC

Bank of China, Xushe representative office
No. 121 Hongxin Road
Xushe Town
Yixing City
Jiangsu Province
PRC

Agricultural Bank of China, Xushe representative office
No. 2 Hongxin Road
Xushe Town,
Yixing City
Jiangsu Province
PRC

Head Office and Principal Place of Business

68 Hong Xin Road
Xushe Town
Yixing City
Jiangsu Province
PRC

Place of Business and Correspondence Address in Hong Kong

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George Town
Grand Cayman
British West Indies

Hong Kong Branch Share Registrar and Transfer Office

Tengis Limited
Ground Floor
Bank of East Asia Harbour View Centre
No. 56 Gloucester Road
Wanchai
Hong Kong

Stock name: ASIA ZIRCONIUM
Stock code: 00395

AUDITORS' REPORT

RSM Nelson Wheeler 羅申美會計師行

Certified Public Accountants

TO THE SHAREHOLDERS OF
ASIA ZIRCONIUM LIMITED

(Incorporated in the Cayman Islands with limited liability)

We have audited the financial statements on pages 27 to 51 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Hong Kong Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December, 2002 and of the Group's results and cash flows for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

RSM Nelson Wheeler

Certified Public Accountants

Hong Kong

22 April 2003

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2002

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	Note	2002 RMB'000	2001 RMB'000 (as restated)
Turnover	3	267,310	229,263
Cost of sales		(167,298)	(147,767)
Gross profit		100,012	81,496
Other revenues	3	1,162	1,224
Distribution costs		(10,348)	(10,139)
Administrative expenses		(17,774)	(15,820)
Profit from operations	4	73,052	56,761
Finance costs	5	(540)	(1,384)
Profit before taxation		72,512	55,377
Taxation	6	—	—
Profit attributable to shareholders	7	72,512	55,377
Dividends	8	19,740	22,000
Basic earnings per share (RMB)	9	0.228	0.185

	Note	2002 RMB'000	2001 <i>RMB'000</i> (as restated)
Non-current assets			
Property, plant and equipment	13	54,647	46,068
Held-to-maturity security	14	1,063	—
		55,710	46,068
Current assets			
Inventories	16	15,547	16,213
Tax receivable	17	15,787	20,288
Trade and other receivables	18	23,904	37,415
Cash and bank balances	19	172,988	85,072
		228,226	158,988
Current liabilities			
Short-term bank borrowings	20	—	14,900
Bank overdraft		—	13
Tax payable	6	20,570	20,570
Trade and other payables	22	45,665	67,663
Dividend payable	8	—	22,000
		66,235	125,146
Net current assets		161,991	33,842
Total assets less current liabilities		217,701	79,910

	<i>Note</i>	2002 RMB'000	2001 RMB'000 (as restated)
Financed by:			
Share capital	24	42,450	31,836
Other reserves		77,636	255
Retained profits		97,615	47,819
Shareholders' funds		217,701	79,910

Approved by the Board of Directors on 22 April 2003

YANG XIN MIN
Director

ZHOU QUAN
Director

	Note	2002 RMB'000	2001 RMB'000
Non-current assets			
Investment in a subsidiary	15	93,448	—
Held-to-maturity security	14	1,063	—
		<u>94,511</u>	<u>—</u>
Current assets			
Other receivables	18	17,470	—
Cash and bank balances		7,751	22
		<u>25,221</u>	<u>22</u>
Current liabilities			
Other payables	22	1,564	23
Net current assets/(liabilities)		<u>23,657</u>	<u>(1)</u>
Total assets less current liabilities		<u>118,168</u>	<u>(1)</u>
Financed by:			
Share capital	24	42,450	—
Reserves		75,718	(1)
Shareholders' funds		<u>118,168</u>	<u>(1)</u>

Approved by the Board of Directors on 22 April 2003

YANG XIN MIN
 Director

ZHOU QUAN
 Director

	The Group Reserves								Total		
	Share capital	Merger reserve <i>(Note a)</i>	Share premium	Reserve fund <i>(Note b)</i>	Enterprise expansion fund <i>(Note b)</i>		Staff Welfare fund <i>(Note b)</i>			Exchange reserve	Retained profits
					RMB'000	RMB'000	RMB'000	RMB'000			
As at 1 January 2001	20,751	—	—	—	—	—	—	—	25,782	46,533	
Effect of the Group Reorganisation	11,085	(11,085)	—	—	—	—	—	—	—	—	
As at 1 January 2001 (as restated)	31,836	(11,085)	—	—	—	—	—	—	25,782	46,533	
Profit for the year	—	—	—	—	—	—	—	—	55,377	55,377	
Transfer to statutory reserves	—	—	—	5,670	2,835	2,835	—	—	(11,340)	—	
Dividend paid	—	—	—	—	—	—	—	—	(22,000)	(22,000)	
As at 31 December 2001	31,836	(11,085)	—	5,670	2,835	2,835	—	—	47,819	79,910	
Issue of shares upon listing	10,614	—	74,293	—	—	—	—	—	—	84,907	
Listing expenses	—	—	(12,608)	—	—	—	—	—	—	(12,608)	
Profit for the year	—	—	—	—	—	—	—	—	72,512	72,512	
Transfer to statutory reserves	—	—	—	7,858	3,929	3,929	—	—	(15,716)	—	
Dividend paid	—	—	—	—	—	—	—	—	(7,000)	(7,000)	
Changes in exchange rates	—	—	—	—	—	—	(20)	—	—	(20)	
As at 31 December 2002	42,450	(11,085)	61,685	13,528	6,764	6,764	(20)	97,615	217,701	217,701	
Representing:											
2002 final dividend proposed									12,740		
Others									84,875		
									<u>97,615</u>		

Notes:

- (a) Merger reserve of the Group represents the difference between the nominal value of shares of approximately RMB31,836,000 issued by the Company and the nominal value of approximately RMB20,751,000 of the share capital Kingweston Technology Limited, a subsidiary acquired through an exchange of shares pursuant to the Group Reorganisation before listing.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2002

- (b) A subsidiary of the Group established in the PRC, being a foreign investment enterprise, is required to appropriate an amount from the net profit reported in the statutory accounts to three statutory reserves, namely reserve fund, enterprise expansion fund and staff welfare fund. All these funds are designated for specific purposes.

The reserve fund can only be utilised, with the approval from the relevant authorities, to offset accumulative losses or to increase capital. All foreign-owned and sino-foreign enterprises are generally required to appropriate not less than 10% of their net profit after taxation to the reserve fund, until the balance of the fund reaches 50% of the registered capital of the subsidiary. The reserve fund cannot be distributed in the form of cash.

The enterprise expansion fund can only be utilised to increase capital, with the approval from the relevant authorities. The board of directors of the subsidiary has resolved to appropriate 5% of its net profit to the enterprise expansion fund.

The staff welfare fund can only be utilised for the benefit of the employees. The board of directors of the subsidiary has resolved to appropriate 5% of its net profits to staff welfare fund.

	The Company Reserves				Total <i>RMB'000</i>
	Share capital <i>RMB'000</i>	Share premium <i>RMB'000</i>	Exchange reserve <i>RMB'000</i>	Retained profits <i>RMB'000</i>	
As at 1 January 2001	—	—	—	—	—
Loss for the year	—	—	—	(1)	(1)
As at 31 December 2001	—	—	—	(1)	(1)
Shares issued pursuant to Group Reorganisation	31,836	—	—	—	31,836
Issue of shares upon listing	10,614	61,685	—	—	72,299
Profit for the year	—	—	—	14,010	14,010
Changes in exchange rates	—	—	24	—	24
As at 31 December 2002	<u>42,450</u>	<u>61,685</u>	<u>24</u>	<u>14,009</u>	<u>118,168</u>

Representing:

2002 final dividend proposed	12,740
Others	<u>1,269</u>
	<u>14,009</u>

	2002 RMB'000	2001 RMB'000 (as restated)
Cash Flows from Operating Activities		
Profit before taxation	72,512	55,377
Adjustments for:		
Depreciation of property, plant and equipment	4,172	3,377
Write off of property, plant and equipment	—	288
Interest expenses	540	1,384
Bank interest income	(1,162)	(1,056)
Operating profit before working capital changes	76,062	59,370
Decrease/(Increase) in inventories	666	(2,572)
Decrease/(Increase) in tax receivable	4,501	(12,807)
Decrease/ (Increase) in trade and other receivables	13,491	(16,641)
(Decrease)/ Increase in trade and other payables	(7,410)	29,227
Cash generated form operations	87,310	56,577
Interest paid	(540)	(1,384)
Interest received	1,162	1,056
	87,932	56,249
Cash Flows from Investing Activities		
Purchases of property, plant and equipment	(12,751)	(4,536)
Investment in held-to-maturity security	(1,063)	—
	(13,814)	(4,536)
Cash Flows from Financing Activities		
Proceeds from issuance of shares upon listing	84,907	—
Listing expenses	(12,608)	—
Repayments of bank loans	(14,900)	(5,270)
Repayment of amount due to a related company	(14,588)	(14,527)
Dividend paid	(29,000)	—
	13,811	(19,797)
Net Increase in Cash and Cash Equivalents	87,929	31,916
Cash and Cash Equivalents at 1 January	85,059	53,143
Cash and Cash Equivalents at 31 December	172,988	85,059
Analysis of Cash and Cash Equivalents		
Bank and cash balances	172,988	85,072
Bank overdraft	—	(13)
Cash and Cash Equivalents at 31 December	172,988	85,059

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, Cap 22 (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.

Pursuant to a group reorganisation (the “Group Reorganisation”), details of which have been set out in the Company’s prospectus dated 17 October 2002 (the “Prospectus”), the Company, in aggregate, allotted and issued 299,999,900 shares credited as fully paid, in exchange and as consideration for the acquisition of the entire issued share capital of Kingweston Technology Limited which is the holding company of Yixing Xinxing Zirconium Company Limited, a wholly foreign-owned enterprise incorporated in the People’s Republic of China (the “PRC”). Upon completion of the Group Reorganisation, the Company became the holding company of Kingweston Technology Limited, Yixing Xinxing Zirconium Company Limited and Century Dragon Investment Limited. The Company and its subsidiaries are collectively referred to as the “Group”.

The Company is an investment holding company. The principal activities of its subsidiaries are set out in Note (15) to the financial statements.

As Mr. Yang Xin Min controlled the aforementioned companies before and after the Group Reorganisation, the Group Reorganisation has been accounted for as a reorganisation of companies under common control and on the basis of merger accounting.

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”), the disclosure requirements of the Hong Kong Companies Ordinance.

(b) Adoption of new and revised statements of standard accounting practice

In the current year, the Group adopted the following new or revised Statements of Standard Accounting Practice (“SSAP”) issued by the HKSA which are effective for accounting periods commencing on or after 1 January 2002:

SSAP 1 (revised):	Presentation of financial statements
SSAP 11 (revised):	Foreign currency translation
SSAP 15 (revised):	Cash flow statements
SSAP 34	Employee benefits

2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)

(c) Basis of consolidation

As described above, the Group Reorganisation was among companies under common control and owned by the same shareholder, therefore, the transaction has been accounted for on the basis of merger accounting in accordance with Statement of Standard Accounting Practice No.27 "Accounting for group reconstructions". Under the merger accounting method, the consolidated financial statements have been prepared as if the Company had been the holding company of the Group throughout the year ended 31 December 2002, rather than from the date on which the Group Reorganisation was completed.

The comparative figures as at and for the year ended 31 December 2001 have been presented on the same basis.

Material intra-group balances and intra-group transactions are eliminated on consolidation.

(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.

(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 on the principal outstanding and at the rates applicable.

iii) Dividend income

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 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.

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 right	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 combined 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 borrowing 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 recognized 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 estimated of its recoverable amount, but so that the increase 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 income statement. Provision is made when there is a diminution in value other than temporary.

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 income statement as an expense immediately.

2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)

(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) 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 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 profit and loss is translated at an average rate. Exchange differences are dealt with as a movement in reserves.

(m) Taxation

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

Deferred taxation is provided using the liability method in respect of significant timing differences between profit as computed for taxation purposes and profit as stated in the financial statements, except when it is considered that no liability will arise in the foreseeable future. Deferred tax assets are not recognized unless its realization is assured beyond reasonable doubt.

(n) 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 depreciated on a straight-line basis over its useful life, which is usually no more than five year.

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 cost capitalised during the financial year.

2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)

(o) 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.

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 transaction are eliminated as part of the combination 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 cost 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 loan, borrowings, corporate and financing expenses and minority interests.

(p) Operation 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 income statement on a straight-line basis over the lease term.

(q) 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 subject to an insignificant risk of change in value. For the purpose of cash flow, bank overdrafts which are repayable on demand and form an integral part of the Group's cash management are also included as a component of cash and cash equivalents.

(r) 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 a percentage of employees' basic salaries. Payments made to the MPF Scheme are charged as an expenses to the income statement as they fall due.

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

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

2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)

(s) Provisions and contingent liabilities

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 accounts. When a change in the probability of an outflow occurs so that outflow is probable, they 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. Revenue recognised during the year are as follows:

	2002 <i>RMB'000</i>	2001 <i>RMB'000</i>
Turnover	267,310	229,263
Other revenues — interest income	1,162	1,056
— others	—	168
Total revenues	<u>268,472</u>	<u>230,487</u>

The Group conducts its business within one business segment which is research, development, manufacturing and sales of zirconium compounds primarily in the PRC, no segment income statement has been prepared by the Group.

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 result are presented base on geographical location of customers.

For the year ended 31 December 2002

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

3. TURNOVER, REVENUE AND SEGMENT INFORMATION *(Cont'd)*

For the year ended 31 December 2001

	Japan RMB'000	The USA RMB'000	The PRC RMB'000	The Netherlands RMB'000	Others RMB'000	Total RMB'000
Segment revenue	<u>82,848</u>	<u>39,653</u>	<u>33,371</u>	<u>26,151</u>	<u>47,240</u>	<u>229,263</u>
Segment result	<u><u>26,734</u></u>	<u><u>12,151</u></u>	<u><u>11,946</u></u>	<u><u>10,347</u></u>	<u><u>20,318</u></u>	<u><u>81,496</u></u>

4. PROFIT FROM OPERATIONS

2002	2001
RMB'000	RMB'000

Profit from operations has been arrived at after charging:

Auditors' remuneration	584	56
Depreciation and amortisation	4,172	3,377
Research and development costs	2,774	488
Property, plant and equipment cost written off	—	288
Provision for bad and doubtful debts	—	1,689
Operating leases of land and building	720	733
Provision for inventories obsolescence	245	—
Staff costs (including directors' emoluments) <i>(Note 10)</i>	<u>19,379</u>	<u>16,711</u>

5. FINANCE COSTS

2002	2001
RMB'000	RMB'000

Interest on:

Bank borrowings wholly repayable within five years	<u>540</u>	<u>1,384</u>
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6. TAXATION

No provision for Hong Kong profit tax has been made in the accounts as the Group had no assessable profit in Hong Kong for the year.

Yixing Xinxing Zirconium Company Limited ("Yixing Zirconium") is a wholly-owned subsidiary of the Company and was incorporated in the PRC, therefore is subject 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. The first profit-making year was year 2001 and therefore there was no EIT tax charge for the year 2002.

Tax payable represents PRC EIT payable prior the initial public offerings, details of which have been disclosed in the Prospectus.

7. PROFIT ATTRIBUTABLE TO SHAREHOLDERS

The profit attributable to shareholders includes a profit of approximately RMB14,010,000 which has been dealt with in the financial statements of the Company.

8. DIVIDENDS

	2002 RMB'000	2001 RMB'000
Interim, paid	7,000	—
Final, proposed — of HK\$0.03 per ordinary share	12,740	22,000
	<u>19,740</u>	<u>22,000</u>

At a meeting of board of directors held on 22 April 2003, a final dividend of HK\$0.03 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 retained profits for the year ended 31 December 2002.

The interim dividend paid for the year 2002 and the final dividend paid for the year 2001 represented profit appropriation paid by Yixing Zirconium to the then shareholder of its immediate holding company, Kingweston, prior to the listing of the Company in the main board of The Stock Exchange of Hong Kong Limited in 2002.

9. EARNINGS PER SHARE

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

	2002	2001
Earnings for the purposes of basic earnings per share (RMB)	72,512,000	55,377,000
Weighted average number of ordinary shares for the purposes of basic earnings per share	<u>317,808,219</u>	<u>300,000,000</u>

Basic earnings per share for the year ended 31 December 2001 was arrived at by dividing the profit attributable to shareholders of that year by the pro-forma number of shares of 300,000,000 shares outstanding immediately prior to the public offerings.

10. STAFF COSTS (INCLUDING DIRECTORS' EMOLUMENTS)

	2002 RMB'000	2001 RMB'000
Wages and salaries	15,689	10,951
Retirement benefit schemes	2,086	2,952
Other social welfare costs	1,604	2,808
	<u>19,379</u>	<u>16,711</u>

11. DIRECTORS' EMOLUMENTS

	2002 RMB'000	2001 RMB'000
Directors' fees:		
Executive directors	—	—
Independent non— executive directors	—	—
Other emoluments:		
Salaries, other allowances and benefits in kind:		
Executive directors (<i>Note</i>)	7,316	1,856
Independent non-executive directors	117	62
Retirement benefit schemes:		
Executive directors	167	441
Independent non-executive directors	—	—
	<u>7,600</u>	<u>2,359</u>

Note:

This includes amount of approximately RMB880,000 (2001: RMB Nil) of operating lease rentals and discretionary bonus based on the Group's performance of RMB 3,800,000 (2001: Nil) payable to executive directors.

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

The emoluments of the directors were within the following bands:

	Number of directors	
	2002	2001
Nil — RMB1,000,000	5	6
RMB1,000,001 — RMB1,500,000	—	1
RMB1,500,001 — RMB2,000,000	—	—
RMB2,000,001 — RMB2,500,000	—	—
RMB2,500,001 — RMB3,000,000	1	—
RMB3,000,001 — RMB3,500,000	—	—
RMB3,500,001 — RMB4,000,000	—	—
RMB4,000,001 — RMB4,500,000	1	—
	<u>7</u>	<u>7</u>

12. EMPLOYEES' EMOLUMENTS

Of the five individuals with the highest emoluments in the Group, two (2001: three) were directors of the Company whose emoluments are included in the disclosures in Note 11 above. The emoluments of the remaining three (2001: two) individuals were as follows:

	2002 RMB'000	2001 RMB'000
Salaries and other benefits	1,630	732
Retirement benefits schemes	289	168
	<u>1,919</u>	<u>900</u>

The emoluments of these individuals were within the following band:

	Number of directors	
	2002	2001
Nil — RMB\$1,000,000	<u>3</u>	<u>2</u>

13. PROPERTY, PLANT AND EQUIPMENT

	THE GROUP						
	Land use right RMB'000	Buildings RMB'000	Machinery and equipment RMB'000	Office equipment and fixtures RMB'000	Motor vehicles RMB'000	Construction in progress RMB'000	Total RMB'000
Cost							
At 31 December 2001	16,061	24,044	25,945	629	—	635	67,314
Additions	—	5,313	5,594	125	1,140	579	12,751
Transfer	—	225	—	—	—	(225)	—
At 31 December 2002	<u>16,061</u>	<u>29,582</u>	<u>31,539</u>	<u>754</u>	<u>1,140</u>	<u>989</u>	<u>80,065</u>
Accumulated depreciation							
At 31 December 2001	3,772	6,375	10,689	410	—	—	21,246
Charge for the year	430	911	2,529	74	228	—	4,172
At 31 December 2002	<u>4,202</u>	<u>7,286</u>	<u>13,218</u>	<u>484</u>	<u>228</u>	<u>—</u>	<u>25,418</u>
Net book value							
At 31 December 2002	<u>11,859</u>	<u>22,296</u>	<u>18,321</u>	<u>270</u>	<u>912</u>	<u>989</u>	<u>54,647</u>
At 31 December 2001	<u>12,289</u>	<u>17,669</u>	<u>15,256</u>	<u>219</u>	<u>—</u>	<u>635</u>	<u>46,068</u>

All of the Group's land and buildings are held in the PRC. The land use right covers a period of 30 years expiring in the year 2030.

As at 31 December 2002, buildings amounted to approximately RMB 2,901,000 (2001: Nil) were erected on a land provided by a related company rent free. (Note 26(e))

14. HELD-TO-MATURITY SECURITY

At 31 December 2002, the Group had a certificate of deposit amounted to HKD1,000,000 (RMB1,063,000) which carried interest at a fixed rate of 1.8% per annum and with a maturity period of two years.

The above certificate of deposit was charged to a bank to secure the banking facilities granted to the Company as mentioned in Note (21) below.

15. INVESTMENT IN A SUBSIDIARY

	THE COMPANY	
	2002	2001
	RMB'000	RMB'000
Unlisted shares, at cost	31,836	—
Amount due from a subsidiary	61,612	—
	93,448	—

The carrying value of the unlisted shares is based on the underlying net tangible assets of the subsidiary at the time when it became a member 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 2002 are as follows:

<u>Name</u>	<u>Place and date of incorporation/ establishment</u>	<u>Issued and fully paid share capital or registered capital</u>	<u>Proportion of nominal value of issued capital/ registered capital held by the Group</u>		<u>Principal activities</u>
			<u>Direct holding</u>	<u>Indirect holding</u>	
Kingweston Technology Limited ("Kingweston")	British Virgin Islands 6 January 2000	US\$2,500,000	100%	—	Investment holding
Yixing Xinxing Zirconium Company Limited (Note) ("Yixing Zirconium")	The People's Republic of China 7 June 2000	US\$10,500,000	—	100%	Research, development, manufacturing and sales of zirconium compounds
Century Dragon Investment Limited ("Century Dragon")	Hong Kong 5 June 2000	HK\$100	—	100%	Leasing of the Group's office premises in Hong Kong and provision of administrative services

15. INVESTMENT IN A SUBSIDIARY (Cont'd)

Note:

Yixing Zirconium is a foreign investment enterprise with an operating period of 30 years commencing on 7 June 2000. Registered capital of US\$2,500,000 was fully paid up on 21 August 2000. The registered capital was increased by US\$8,000,000 and was fully paid up on 6 November 2002.

16. INVENTORIES

	THE GROUP	
	2002	2001
	RMB'000	RMB'000
Raw materials	3,749	1,254
Work in progress	873	827
Finished goods	10,925	14,132
	15,547	16,213

At 31 December 2002, other than certain inventories with cost approximately RMB245,000 had been written down to realisable value of nil, all others were carried at cost. All inventories were carried at cost at 31 December 2001.

17. TAX RECEIVABLE

	THE GROUP	
	2002	2001
	RMB'000	RMB'000
VAT receivable	18,193	22,694
VAT payable	(2,406)	(2,406)
	15,787	20,288

Tax receivable represents PRC value-added tax ("VAT") receivable on export sales.

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.

18. TRADE AND OTHER RECEIVABLES

	THE GROUP		THE COMPANY	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Due from a subsidiary (Note (23))	—	—	2,502	—
Trade receivable (Note)	22,051	31,355	—	—
Prepayments and other receivables	1,853	6,060	104	—
Dividend income receivable	—	—	14,864	—
	<u>23,904</u>	<u>37,415</u>	<u>17,470</u>	<u>—</u>

Note:

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

	THE GROUP	
	2002 RMB'000	2001 RMB'000
0 — 90 days	21,537	29,332
91 — 180 days	84	2,023
181 — 365 days	430	—
More than 1 year	—	—
	<u>22,051</u>	<u>31,355</u>

19. CASH AND BANK BALANCES

	THE GROUP	
	2002 RMB'000	2001 RMB'000
Cash on hand	261	838
Cash in banks	172,727	84,234
	<u>172,988</u>	<u>85,072</u>

As at 31 December 2002, bank deposits of approximately RMB453,000 (2001: RMB415,000) were pledged for trade financing facilities granted by banks.

As at 31 December 2002, approximately RMB164,765,000 (2001: RMB84,148,000) 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.

20. SHORT TERM BANK BORROWINGS

	THE GROUP	
	2002 RMB'000	2001 RMB'000
Wholly repayable within one year	—	14,900

21. BANKING FACILITIES

At 31 December 2002, the Group had banking facilities including bank overdraft of HKD500,000 and a corporate card of HKD600,000. The facilities are secured by the certificate of deposit amounted to HKD1,000,000 held by the bank in Hong Kong as mentioned in Note (14) above. The Group had no banking facilities for the year 2001.

At 31 December 2002, none of the above banking facilities were utilised.

22. TRADE AND OTHER PAYABLES

	THE GROUP		THE COMPANY	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Due to a subsidiary (Note (23))	—	—	346	—
Due to directors (Note (23))	9,715	3,302	751	—
Due to a related company (Note (23), (26e))	—	14,588	—	—
Trade payable (Note a)	6,229	9,401	—	—
Notes payable (Note b)	1,466	14,188	—	—
Salary and welfare payables	13,346	11,679	—	—
Accruals and other payables	14,909	14,505	467	23
	45,665	67,663	1,564	23

Note a:

Aging analysis of trade payable is as follows:

	THE GROUP	
	2002 RMB'000	2001 RMB'000
0 — 90 days	2,021	8,986
91 — 180 days	418	225
181 — 365 days	695	190
More than 1 year	3,095	—
	6,229	9,401

Note b:

Notes payable represents notes issued by the Group counter-signed and guaranteed by the Group's banks to suppliers for presentation after one to three months and are secured by the bank deposits mentioned in Note(19) above.

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

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

24. SHARE CAPITAL

	Number of shares		Ordinary share capital			
	2002	2001	2002		2001	
			HKD	RMB	HKD	RMB
<i>Authorised:</i>						
At beginning of year	3,900,000	3,900,000	390,000	413,400	390,000	413,400
Increased during the year (c)	996,100,000	—	99,610,000	105,586,600	—	—
At end of year	1,000,000,000	3,900,000	100,000,000	106,000,000	390,000	413,400
<i>Issued and fully paid:</i>						
At beginning of year (a)	100	1	10	10	0.1	0.1
Shares issued (b)	—	99	—	—	9.9	9.9
Shares issued pursuant to Group Reorganisation (c)	299,999,900	—	29,999,990	31,836,290	—	—
Shares issued upon listing (d)	100,000,000	—	10,000,000	10,613,400	—	—
At end of year	400,000,000	100	40,000,000	42,449,700	10.0	10.0

- (a) Upon incorporation, the Company issued 1 subscriber's share of HK\$0.1 at par for cash and was fully paid.
- (b) On 25 June 2001, the Company issued 99 shares of HK\$0.1 each at par for cash and were fully paid.
- (c) On 24 September 2002, a written resolution of the shareholders of the Company were passed pursuant to which:

The authorised share capital of the Company was increased from HK\$390,000, divided into 3,900,000 shares of HK\$0.1 each, to HK\$100,000,000 by the creation of 996,100,000 shares of HK\$0.1 each;

The directors were authorised to allot and issue an aggregate of 299,999,900 shares credited as fully paid, as to 284,999,905 of which to a shareholder, and as to 14,999,995 of which to a third party in exchange and as consideration for the acquisition of the entire issued share capital of Kingweston Technology Limited (incorporated in the British Virgin Islands) from Mr. Yang Xin Min.

- (d) On 28 October 2002, the Company was listed on the main board of The Stock Exchange of Hong Kong Limited with 100,000,000 issued share capital by way of a placing for cash of HK\$ 0.8 per share. The excess of the issued price over the par value of the shares issued has been credited to the share premium account of the Company.

25. DEFERRED TAXATION

Neither the Group nor the Company had any material unprovided deferred taxation for the year and at the balance sheet date.

26. RELATED PARTIES TRANSACTIONS

During the year ended 31 December 2002, the Group had significant related party transactions as summarised below:

		2002	2001
		RMB'000	RMB'000
Electricity supply from a related company	(a)	6,627	5,001
Steam supply from a related company	(a)	15,327	10,694
Coal purchase on behalf of a related company	(b)	2,735	7,938
Water supply from a related party	(c)	1,656	1,126

- (a) Yixing Zirconium and a related 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 Deputy General Manager of Yixing Zirconium and the spouse of Mr. Yang Xin Min, an executive director and the shareholder of the Company, 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 respective legally valid periods at nil consideration.
- (e) Certain buildings of Yixing Zirconium were erected on land with the respective land use right title belongs to a related company to the Group. The land is provided by the related company to Yixing Zirconium rent free since 1 November 2002. The land use right certificate granted to the related company covers a period of 50 years and will be expired in the year 2053. It is the intention of the directors of that related company to transfer the respective land use right title to Yixing Zirconium, for as long as the land use right has been originally granted to the related company.

26. RELATED PARTIES TRANSACTIONS (Cont'd)

- (f) The amount due to a related company represented balance due to the Predecessor Entity as defined in the Prospectus. The balance was interest free and repayable on demand.

	2002 RMB'000	2001 <i>RMB'000</i>
Amount due to a related company		
Beginning of year	14,588	29,115
Repayment of amount	(14,588)	(14,527)
At end of year	—	14,588

27. CAPITAL COMMITMENTS

	2002 RMB'000	2001 <i>RMB'000</i>
Contracted but not provided for purchases of plant and machineries	989	2,994
Authorised but not contracted for purchases of plant and machineries	4,354	1,254

28. OPERATING LEASE COMMITMENTS

At 31 December 2002, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases in respect of land and buildings as follows:

	2002 RMB'000	2001 <i>RMB'000</i>
Within 1 year	1,023	643
After 1 year but within 5 years	1,956	1,498
After 5 years	8,423	8,797
	11,402	10,938

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 ("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 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 2002	Consideration	Exercise price	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 2002
—	HK\$1.00	HK\$0.87	2,000,000	—	—	2,000,000

The options will be vested in five equal tranches 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. APPROVAL OF ACCOUNTS

The financial statement were approved by the board of directors on 22 April 2003.

NOTICE IS HEREBY GIVEN that the Annual General Meeting of the Company will be held at Room 9, Floor 35, Tower II Lippo Centre, 89 Queensway, Hong Kong on Monday, 26 May, 2003 at 3:00 p.m. for the following purposes:

1. To receive and adopt the audited financial statements of the Company and the reports of the directors and the auditors for the year ended 31 December 2002.
2. To declare a final dividend.
3. To re-elect retiring directors and to authorize the board of directors to fix the directors' remuneration.
4. To re-appoint auditors and to authorize the board of directors to fix their remuneration.
5. As special business, to consider and, if thought fit, pass with or without amendments the following resolutions as Ordinary Resolutions;

A. "THAT,

- (i) subject to sub-paragraph (iii) of this Resolution, the exercise by the Directors of the Company during the Relevant Period (as defined below) of all the powers of the Company to allot, issue and deal with new shares in the capital of the Company, and to make or grant offers, agreements and options which might require the exercise of such power be and is hereby generally and unconditionally approved;
- (ii) the approval in sub-paragraph (i) of this Resolution shall authorize the Directors of the Company during the Relevant Period to make or grant offers, agreements and options which would or might require the exercise of such power after the end of the Relevant Period;
- (iii) the aggregate nominal amount of share capital allotted or agreed conditionally or unconditionally to be allotted (whether pursuant to an option or otherwise) and issued by the Directors of the Company pursuant to the approval in sub-paragraph (i) of this Resolution, shall not exceed 20% of the aggregate nominal amount of the share capital of the Company in issue as at the date of passing of this Resolution and the said approval shall be limited accordingly, otherwise than pursuant to the following:
 - (a) a Rights Issue (as defined below);
 - (b) any shares issued pursuant to the exercise of rights of subscription or conversion under the terms of any warrants or any debentures, bond warrants, notes issued by the Company or any securities which are convertible into shares of the Company;
 - (c) any share options granted or exercised pursuant to any option scheme or, any option scheme or similar arrangement for the time being adopted for the grant or issue to officers and/or employees of the Company and/or any of its subsidiaries of shares or rights to acquire shares of the Company; and

(d) any scrip dividend or similar arrangement providing for the allotment of shares in lieu of the whole or part of a dividend on shares of the Company in accordance with the articles of association of the Company; and

(iv) for the purposes of this Resolution:

“Relevant Period” means the period from the passing of this Resolution until whichever is the earliest of:

- (a) the conclusion of the next annual general meeting of the Company;
- (b) the expiration of the period within which the next annual general meeting of the Company is required by the articles of association of the Company or any applicable laws to be held; or
- (c) the passing of an ordinary resolution by the shareholders of the Company in general meeting revoking or varying the authority given to the directors of the Company; and

“Rights Issue” means an offer of shares, open for a period fixed by the directors of the Company to shareholders of the Company on the register on a fixed record date in proportion to their then holdings of such new shares (subject to such exclusions or other arrangements as the directors of the Company may deem necessary or expedient in relation to fractional entitlements or having regard to any restrictions or obligations under the laws of, or the requirements of any recognized regulatory body or any stock exchange in any territory outside Hong Kong).”

B. “THAT,

- (i) subject to sub-paragraph (ii) of this Resolution, the exercise by the Directors of the Company during the Relevant Period (as defined below) of all the powers of the Company to repurchase its shares in the capital of the Company, subject to and in accordance with all applicable laws and the requirements of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited as amended from time to time, be and is hereby generally and unconditionally approved;
- (ii) the aggregate nominal amount of shares of the Company which may be repurchased by the Company pursuant to the approval in sub-paragraph (i) of this Resolution, shall not exceed 10% of the aggregate nominal amount of the share capital of the Company in issue on the date of passing of this Resolution and the said approval shall be limited accordingly; and
- (iii) for the purposes of this Resolution:

“Relevant Period” means the period from the passing of this Resolution until whichever is the earliest of:

- (a) the conclusion of the next annual general meeting of the Company;

- (b) the expiration of the period within which the next annual general meeting of the Company is required by the articles of association of the Company or any applicable laws to be held; or
- (c) the passing of an ordinary resolution by the shareholders of the Company in general meeting revoking or varying the authority given to the directors of the Company."

C. "THAT, the general mandate granted to the Directors to issue and dispose of additional shares pursuant to Ordinary Resolution No. 5A set out in the notice convening this meeting be and is hereby extended by the addition thereto of an amount representing the aggregate nominal amount of the share capital of the Company repurchased by the Company under the authority granted pursuant to Ordinary Resolution No. 5B set out in the notice convening this meeting, provided that such amount shall not exceed 10% of the aggregate nominal amount of the issued share capital of the Company at the date of the said Resolution."

6. To deal with other ordinary businesses of the Company.

By Order of the Board

Audrey Wong Hoi Yan

Financial Controller and Company Secretary

Hong Kong, 23 April 2003

Principal Place of Business in Hong Kong:

Room 9, Floor 35,
Tower II Lippo Centre,
89 Queensway,
Hong Kong.

Notes:

1. The register of members of the Company will be closed from Thursday, 22 May 2003 to Friday, 23 May 2003, both days inclusive, during which period no transfer of shares will be registered. In order to qualify for the proposed final dividend and to attend the Annual General Meeting, all transfer documents accompanied by the relevant share certificates must be lodged with the Company's Branch Registrar in Hong Kong, Tengis Limited, at G/F, Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong for registration not later than 4:30 p.m. on Wednesday, 21 May 2003.
2. A member entitled to attend and vote at the meeting convened by the above notice is entitled to appoint one or more proxies to attend and vote instead of him. A proxy need not be a member of the Company.
3. In order to be valid, the instrument appointing a proxy and the power of attorney or other authority (if any) under which it is signed, or a copy of such authority notarially certified, must be deposited at the Company's branch share registrars not less than 48 hours before the time appointed for the holding of the meeting or any adjournment thereof.
4. An explanatory statement containing further information on the above Resolution 5B will be despatched to the shareholders together with 2002 Annual Report.