

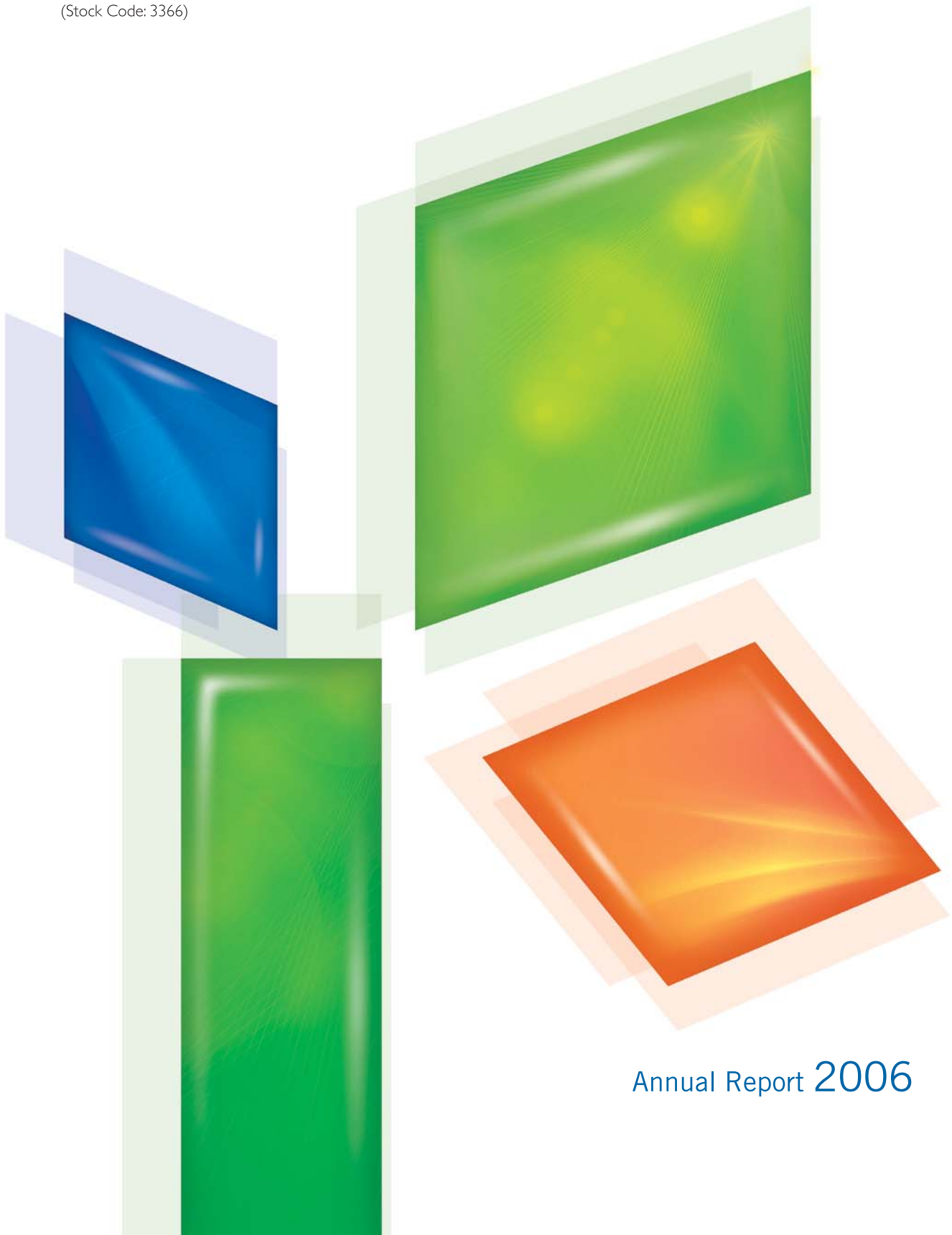


Huali Holdings (Group) Limited

華力控股(集團)有限公司

(incorporated in the Cayman Islands with limited liability)

(Stock Code: 3366)



Annual Report 2006

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Corporate Information

Registered Office	Clifton House 75 Fort Street PO Box 1350 GT George Town Grand Cayman Cayman Islands
Head Office and Principal Place of Business	Suite 3203-3204, Tower 6 The Gateway Harbour City Canton Road Tsim Sha Tsui Kowloon Hong Kong
Company Secretary	Mr. Fong Fuk Wai (<i>FCPA, FCCA</i>)
Qualified Accountant	Mr. Fong Fuk Wai (<i>FCPA, FCCA</i>)
Audit Committee	Mr. Lee Kit Wah (<i>Chairman</i>) Ms. Xie Mei Mr. Xiao Yongping
Remuneration Committee	Mr. Lee Kit Wah (<i>Chairman</i>) Ms. Xie Mei Mr. Xiao Yongping
Authorised Representatives	Mr. Ni Zheng 401, Block K Chunshui'an Portofino Overseas Chinese Town Shenzhen China Mr. Fong Fuk Wai Flat 1710 Choi Ying House, Choi Po Court Sheung Shui Hong Kong
Compliance Adviser	Taifook Capital Limited 25/F New World Tower 16-18 Queen's Road Central Central Hong Kong



Corporate Information

Hong Kong Legal Adviser	Loong & Yeung in association with Rodyk & Davidson Suites 2911-12, 29/F Two International Finance Centre No. 8 Finance Street Central Hong Kong
Auditors	KPMG Certified Public Accountants 8/F Prince's Building 10 Chater Road Central Hong Kong
Principal Bankers	China Merchants Bank Hong Kong Branch 12/F Bank of America Tower 12 Harcourt Road Central Hong Kong Standard Chartered Bank (HK) Ltd. 13/F Standard Chartered Bank Building 4-4A Des Voeux Road Central Hong kong
Principal Share Registrar and Transfer Office	Appleby Corporate Services (Cayman) Limited Clifton House PO Box 1350 GT 75 Fort Street Grand Cayman Cayman Islands
Hong Kong Branch Share Registrar and Transfer Office	Computershare Hong Kong Investor Services Limited Shops 1712-16, 17/F Hopewell Centre 183 Queen's Road East Hong Kong
Stock Information	Stock Code: 3366 Listing Date: 2 November 2005 Total shares issued: 200,000,000 shares Nominal Value: HK\$0.10 per share Stock Short Name: Huali Holdings
Company's Website	http://www.hualiholdings.com



Financial Highlights

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2006

(Expressed in Renminbi)

	2006 RMB'000	2005 (restated) RMB'000
Turnover	695,503	662,243
Cost of sales	(608,381)	(583,646)
Gross profit	87,122	78,597
Other revenue	22,544	21,519
Other net loss	(3,394)	(1,424)
Distribution costs	(32,562)	(30,340)
Administrative expenses	(30,125)	(19,297)
Other operating expenses	(756)	(761)
Profit from operations	42,829	48,294
Finance costs	(3,552)	(2,480)
Profit before taxation	39,277	45,814
Income tax expense	(5,970)	(5,440)
Profit for the year	33,307	40,374
Attributable to:		
Equity shareholders of the Company	32,999	40,089
Minority interests	308	285
Profit for the year	33,307	40,374
Dividends payable to equity shareholders of the Company attributable to the year:		
Final dividend proposed after the balance sheet date	12,675	16,224
Earnings per share (RMB)		
Basic	0.16	0.25
Diluted	0.16	0.25



Chairman's Statement

I am pleased, on behalf of Huali Holdings (Group) Limited ("the Company") and its subsidiaries ("the Group"), to present to all shareholders the operating results and Annual Report of the Group for the year ended 31 December 2006, and would like to express my sincere gratitude to all shareholders and all the staff.

FINANCIAL PERFORMANCE

The Company was successfully listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 2 November 2005. For the year ended 31 December 2006, the Group's turnover was RMB696 million, representing an increase of 5.0% over 2005. Total assets amounted to RMB620 million, and total equity amounted to RMB338 million.

BUSINESS REVIEW

The Group faced many challenges in the year of 2006. Since raw material prices, energy prices, labour costs and interest rates have been rising continuously on different extents, the competition in the industry has been increasingly intensive. Paper packaging companies have been facing the difficulties of higher cost and lower gross profit margin. However, under the joint efforts of the staff, the Group still managed to achieve a business growth through enhancing internal management, building a new factory and expanding the market, which laid a solid foundation for the Group's long term development.

The Group has focused on producing middle to high grade paperboard and cartons and other packaging products, with the clientele being mainly medium and large sized enterprises. In the previous year, the Group offered customers a more comprehensive range of higher quality products and services, through enhancing the quality of products and expanding product range. Meanwhile, the Group puts great efforts on market exploration, and strengthened market sales. During the reporting period, the Group's customer base continued to expand, with a growth in the number of customers to about 650, representing a 9% increase over the same period of last year.

In the past year, the Group implemented a number of measures in order to strengthen internal management, control cost and enhance market competitiveness. To cope with the increase in raw material prices, the Group established a unified purchasing network by capitalising on its branding edge, so as to centralise the purchase of raw materials and major equipment for its subsidiaries. By enlarging the scale of purchase, the Group enhanced its bargaining power in order to control the cost more effectively. In light of the rising electricity price, the Group saved costs by using electricity during off-peak period instead of peak hours, which enjoyed lower charges. Meanwhile, the Group continued to strengthen its management on accounts receivable and inventory in order to lower the capital cost. The Company phased in an Enterprise Resources Planning ("ERP") system at its subsidiaries, in order to provide reference and analysis tools for the management's strategic decision.



Chairman's Statement

The Group completed two acquisitions during the year of 2006 (details of which had been set out in the announcement of the Company dated 27 January 2006), bringing the total number of manufacturing subsidiaries which are wholly-owned or controlled by the Group to six.

Currently, the Group has established its sales network covering the Pearl River Delta, Yangtze River Delta and North-east area in the People's Republic of China (the "PRC"). In 2006, the new factory in Anhui began operation successfully after construction of the plant and purchasing and testing of production equipment, laying a solid foundation for the Group's business expansion in 2007 and enhancing its competitive advantage in the industry.

PROSPECTS

Looking ahead in 2007, we expect the cost of raw materials will still be in an uptrend. As a result, the Group will continue to strengthen internal management and production flow control as well as fully implement the ERP system in all manufacturing subsidiaries, so as to maintain stable production costs.

The Group will put greater effort on market exploration, increasing its market share of high valued-added products such as colour-printed materials and enhancing the capability of new product development. At the end of 2006, the factory in Shanghai has procured a large format offset colour printing press from Germany. The press will be put into operation in April 2007, helping the Group to expand its colour-printing business in Eastern China.

The Company will utilise its new factory to increase its income. With the new factory in Anhui successfully put into operation in 2006, a production line of paperboard in Anhui Huali Packaging Company Limited (安徽華力包裝有限公司) ("Anhui Huali") will commence operation in April 2007.

The Group signed an agreement on 19 March 2007 to acquire the land use right of a piece of land located in Huizhou, Guangdong Province, the PRC, on which a new factory is intended to be built for expanding the production capacity. The Group may also consider relocating the operation in Shenzhen, the PRC to the new production base.

With a steady growth in the economy and increasing consumption power in China, the demand for environment-friendly and light corrugated paper packaging will continue to increase, which will create great potential for the development of the Group. Meanwhile, higher raw material prices and the increasingly intensive market competition have presented challenges to the Group. The management believes that, given the Group's experience of over 20 years in the industry, its high quality products and services, its advantageous strategic planning as well as its expanding customer base, the Group will be in a favourable competitive position and endeavours to bring long-term and steady returns to the shareholders.



Chairman's Statement

APPRECIATION

I, on behalf of the board of directors, hereby express our most sincere thanks to the management team and all the staff for their efforts and contributions made in the development of the Group. I also take this opportunity to thank all shareholders and business partners for their confidence and support to the Group.

Zheng Fan

Chairman

Hong Kong, 27 March 2007



Management Discussion and Analysis

Financial figures for 2005 have been restated. Please refer to note 1(c) of the Notes to the Financial Statements for details.

OPERATING RESULTS

As at 31 December 2006, the Group's total assets amounted to RMB620 million. Total equity amounted to RMB338 million, representing an increase of 3.8% over that as at 31 December 2005. The Group realized sales income of RMB696 million in 2006, representing an increase of 5.0% over the same period in 2005. Profits attributable to equity shareholders were RMB33 million, representing a decrease of 17.7% over 2005. The basic earnings per share for the year were RMB0.16, as compared to RMB0.25 for 2005.

During the period under review, gross profit margin was approximately 12.5% (2005: approximately 11.9%). Net profit margin attributable to shareholders was approximately 4.7% (2005: approximately 6.1%). Profits attributable to equity shareholders decreased by 17.7% over 2005, mainly attributable to the fact that the Group has recognised the fair value of RMB4.56 million of the share options granted to the employees in 2006 as an expense.

DISTRIBUTION COSTS AND ADMINISTRATIVE EXPENSES

Distribution costs for the year ended 31 December 2006 were approximately RMB32.56 million (2005: RMB30.34 million), representing an increase of approximately 7.3% over the same period in 2005, mainly attributable to the increase in transportation costs resulting from the rising of oil prices in mainland China.

The Group's administrative expenses for the year ended 31 December 2006 were approximately RMB30.13 million (2005: approximately RMB19.30 million), representing an increase of approximately 56.1% over the same period in 2005. The fair value of RMB4.56 million of the share options granted to the employees in 2006 was recognised by the Group as expenses in the income statement, and the Group strengthened its corporate governance after listing, resulting in an increase in the administrative expenses.

INTEREST EXPENSES

The interest expenses of the Group were RMB3.55 million for the year ended 31 December 2006, as compared to RMB2.48 million for the year ended 31 December 2005. The increase was mainly attributable to the increase in borrowings for the construction of Anhui Huali's plant and purchase of equipment.

DIVIDENDS

The Board has resolved to recommend the payment of a final dividend of HK\$6.4 cents per share for the year ended 31 December 2006 (2005: HK\$7.8 cents per share).



Management Discussion and Analysis

INVENTORIES, DEBTORS' AND CREDITORS' TURNOVER

Due to the enhancement of internal management, the Group reduced the inventory turnover to 38 days for the year ended 31 December 2006, much lower from 46 days for the year ended 31 December 2005. The Group's debtors' turnover days were 69 days for the year ended 31 December 2006, as compared to 77 days for the year ended 31 December 2005. The above debtors' turnover days are substantially the same as the credit period that normally granted by the Group to its customers. In 2006, the Group enhanced its risks control and the recoverability of its account receivables, resulting in a reduction of the debtor's turnover. The Group's creditors' turnover days were 102 days for the year ended 31 December 2006, as compared to 90 days for the year ended 31 December 2005. The Group settles most of its creditor balances with surplus cash.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

The total equity of the Group as at 31 December 2006 was RMB338 million (31 December 2005: RMB326 million). As at 31 December 2006, the Group had current assets of RMB372 million (31 December 2005: RMB314 million) and current liabilities of RMB256 million (31 December 2005: RMB229 million). The liquidity ratio was 1.45 as at 31 December 2006 as compared to 1.37 as at 31 December 2005. The Group generally finances its operations with internally generated funds and credit facilities provided by banks. As at 31 December 2006, the Group had outstanding bank loans of RMB70.19 million of which RMB15 million were fixed-rate loans (31 December 2005: outstanding bank loans of RMB38.47 million of which RMB15 million were fixed-rate loans). Some of those bank loans were secured by corporate guarantees provided by certain subsidiaries of the Company. The Group's gearing ratio (being the total borrowings including bills payable and bank loans divided by total assets) increased from approximately 22% as at 31 December 2005 to approximately 27% as at 31 December 2006.

The Group's liquidity position remains stable and the Group possesses sufficient cash and available banking facilities to meet its commitments, working capital requirements and future investments for expansion. The Group's transactions and monetary assets are principally denominated in Renminbi, Hong Kong dollars or United States dollars. The Group has not experienced any material difficulties or effects on its operations or liquidity as a result of fluctuations in currency exchange rates during the year ended 31 December 2006. During the year ended 31 December 2006, the Group did not employ any financial instrument for hedging purposes.



Management Discussion and Analysis

ACQUISITION

On 20 January 2006, the Group acquired 100% equity interest in Grand Signal Limited ("Grand Signal") and its wholly-owned subsidiary, Anhui Huali Packaging Company Limited ("Anhui Huali"), located at Chuzhou, Anhui Province. In 2006, Anhui Huali completed its factory construction and purchased manufacturing equipment such as paperboard production lines and printing press. The acquisition helped the Group to increase its production capacity, broaden its sales network geographically, strengthen its market share in Eastern China and enhance the competitiveness of the Group.

On 20 January 2006, the Group acquired 10% equity interest in Shenzhen Huayou Packaging Company Limited ("Shenzhen Huayou"). Shenzhen Huayou became the Group's wholly-owned subsidiary and commenced operation in the second half of the year 2006.

EMPLOYEES AND REMUNERATION POLICY

As at 31 December 2006, the Group employed approximately 1,800 full-time staff members. The basic remunerations of the employees are determined with reference to the industry's remuneration benchmark, the employees' experience and their performance. Salaries of employees are maintained at a competitive level and are reviewed annually, with close reference to the relevant labour market and economic situation. Directors' remuneration is determined based on a variety of factors such as market conditions and responsibilities assumed by each director. Apart from the basic remuneration and statutory benefits required by laws, the Group also provides discretionary bonuses based upon the Group's results and the individual performance of the staff.

The Group has not experienced any significant problems with its employees or disruption to its operations due to labour disputes nor has it experienced any difficulty in the recruitment and retention of experienced staff. The Group maintains a good relationship with its employees. Most members of senior management have been working for the Group for more than 10 years.

The Group adopted a share option scheme at the time of its initial public offering. As at the date of this report, the Company granted a total of 19,300,000 share options under the scheme.

CONTINGENT LIABILITIES

The Company had no contingent liabilities as at 31 December 2006.



Directors and Senior Management

DIRECTORS

Executive Directors

Mr. Zheng Fan, born in 1955, is the Chairman of the Company. He had been a director of Shenzhen Huali Packing & Trading Co., Ltd. ("Shenzhen Huali") from April 2002 to July 2006. Currently, Mr. Zheng is the Chief Cultural Officer of Overseas Chinese Town Group Company ("OCT Group"), the chairman of the board of directors of Shenzhen International Media Co., Ltd. and Overseas Chinese Town (HK) Company Limited ("OCT (HK)"), and a director of Shenzhen Overseas Chinese Town Holding Company. He was the deputy chairman of the board of directors of InterContinental Shenzhen and Shenzhen OCT Happy Valley Tourism Development Co., Ltd, and held various senior positions at OCT Group and its affiliates. Mr. Zheng Fan is also a director of OCT (HK), the intermediate holding company of the Company.

Mr. Ni Zheng, born in 1968, is the Chief Executive Officer of the Company. Mr. Ni has been a director of Shenzhen Huali since 1999. He is also the chairman of the board of directors of Shenzhen Huali, Shanghai Huali Packaging Co., Ltd. ("Shanghai Huali"), Shenzhen Huayou and Huizhou Huali Packaging Co., Ltd ("Huizhou Huali"). He had been the deputy general manager and general manager of investment department of OCT Group from 1995 to 1998. Mr. Ni graduated from the department of Applied Physics of Chongqing University and obtained a bachelor's degree in Science and a master degree in Engineering in 1988 and 1991, respectively. Mr. Ni is also a director of Pacific Climax Limited, the immediate holding company of the Company, and a director of OCT (HK), the intermediate holding company of the Company.

Mr. Liu Danlin, born in 1967, is the director of Shenzhen Huali, Huali Holdings Company Limited ("Hong Kong Huali"), Shenzhen Huayou and Huizhou Huali. Mr. Liu has been the deputy general manager of OCT (HK) since March 2004. From 1994 to 2004, Mr. Liu had been the deputy general manager of Jinli Silk Co., Ltd., the deputy general manager of Investment Department of OCT Group, the deputy general manager of Planning Department of OCT Group and the chief representative of Beijing Representative Office of OCT Group. Mr. Liu graduated from the Computer Science Department of Beijing University of Aeronautics and Astronautics in 1990. Since 2002, Mr. Liu has been an independent director of Beijing Bitech Corp., Ltd., a listed company in the PRC.

Mr. Zhou Guangneng, born in 1951, is the chairman of the board of directors and the general manager of Hong Kong Huali and a director of Mudanjiang Huali Packaging Company Limited ("Mudanjiang Huali"). From 1989 to 2000, Mr. Zhou had been a director of Shenzhen SEG DASHENG Co., Ltd., the assistant to the general manager of the headquarters of the US region of Shenzhen Electronics Group Co., Ltd., the general manager of Seg Pacific International Trading Company Limited, a director of World Wild Electronic Limited and a director of Seg (Hong Kong) Company Limited. Mr. Zhou graduated from the Department of Physics of Nanjing University majoring in semi-conductors in 1978, and obtained a master degree in Science in 1982. Mr. Zhou is also the deputy general manager of OCT (HK) and a director of Pacific Climax Limited, the immediate holding company of the Company.



Directors and Senior Management

Non-Executive Directors

Ms. Xie Mei, born in 1968, joined the Group in December 2004. She has over 10 years of experience in corporate management in Mainland China. Ms. Xie is also a director of a number of affiliates of OCT Group and the deputy chairman of the board of directors of InterContinental Shenzhen. Ms. Xie was/is a vice-supervisor and supervisor of the strategic development department of OCT Group from 2002 to 2004 and from 2004 to present respectively. Ms. Xie graduated from the Department of Electrical Engineering of Xi'an Jiaotong University and obtained a bachelor's degree in Engineering in 1989. She also obtained a master degree in Economics from the People's University of the PRC in 1999. Ms. Xie is also a director of Pacific Climax Limited, the immediate holding company of the Company, and a director of OCT (HK), the intermediate holding company of the Company.

Independent Non-Executive Directors

Mr. Lee Kit Wah, born in 1955, joined the Group in September 2005. Mr. Lee is also an Independent Non-Executive director of the publicly-listed ITC Corporation Limited and SinoCom Software Group Limited in Hong Kong. He has been practicing as a certified public accountant in Hong Kong since 1988. He is the managing director of Katon CPA Limited. He had been a director of Grandton CPA Limited from 1998 to 2004. He had been the audit supervisor and audit manager in F.S. Li & Company Certified Public Accountants from 1985 to 1988, and worked at Price Waterhouse Certified Public Accountants between 1979 and 1984. He is a fellow member of the Taxation Institute of Hong Kong, and a fellow member of the Association of Chartered Certified Accountants and the Hong Kong Institute of Certified Public Accountants ("HKICPA"). He graduated from University of Toronto and obtained a bachelor's degree in Commerce in 1979.

Mr. Chen Xiangdong, born in 1959, joined the Group in September 2005. Mr. Chen is the general manager of China Printing (Group) Corporation. He has over 17 years of experience in the packaging industry. He joined China National Packaging Corporation in 1988 as project manager, and became the deputy general manager of the company in 2001. Mr. Chen graduated from the Department of Automated Control of Northeast China Institute of Heavy Machinery (now known as Yanshan University) and obtained a bachelor's degree in Engineering in 1983. Mr. Chen also obtained a master degree in Engineering majoring in Industrial Management Engineering at Harbin Institute of Technology in 1986.

Mr. Xiao Yongping, born in 1966, joined the Group in September 2005. He is an arbitrator of China International Economic and Trade Arbitration Commission, and the vice chairman of China International Private Law Association. Mr. Xiao obtained a doctoral degree in Law at Wuhan University in 1993. At present, he is the deputy dean of the Law School of Wuhan University and a professor in the Law Faculty at Northwest University of Political Science & Law.



Directors and Senior Management

SENIOR MANAGEMENT

Mr. Yang Daqing, born in 1947, joined Shanghai Huali as general manager in 1998, and is currently the deputy general manager of the Company, the chairman of the board of directors of Zhongshan Huali Packaging Company Limited ("Zhongshan Huali"), Anhui Huali and Mudanjiang Huali, and a director of Shenzhen Huali, Shanghai Huali, Shenzhen Huayou and Huizhou Huali.

Mr. Zhang Xiaojun, born in 1970, has been with the Group since 1993, and is currently the deputy general manager of the Company. Mr. Zhang has supervised the daily operation of Shenzhen Huali since 2002. He is also a director of Shenzhen Huali, Zhongshan Huali, Shenzhen Huayou and Huizhou Huali. Mr. Zhang graduated from Zhuzhou Institute of Technology of Hunan majoring in Printing Technology where he obtained his bachelor's degree in Engineering.

Mr. Fong Fuk Wai, born in 1963, is the chief financial officer, company secretary and qualified accountant of the Company, and also serves as a director of Hong Kong Huali. He joined the Group in January 2005. Prior to joining the Group, between 2003 to 2004, he had been a manager of a group member of a public listed company in Hong Kong, providing group audit and management services. Mr. Fong is a fellow member of the Association of Chartered Certified Accountants and the HKICPA with over 20 years of accounting and auditing experience. Mr. Fong graduated from the Hong Kong Polytechnic University and obtained his bachelor's degree in Accountancy in 1994, and a master degree in business administration at the Chinese University of Hong Kong in 1999.

Mr. Yang Weijian, born in 1965, joined the Group in 1986. Mr. Yang has over 19 years of experience in the packaging industry in Mainland China. Mr. Yang is currently a director and general manager of Shanghai Huali and a director of Anhui Huali. Prior to that, Mr. Yang had been the deputy general manager of Shanghai Huali since 1997.

Mr. Lan Sibing, born in 1960, joined the Group in 1994. Mr. Lan has over 10 years of experience in the packaging industry in Mainland China. He is currently a director and general manager of Zhongshan Huali. He had been an assistant to general manager and deputy general manager of Shenzhen Huali from 1999 to 2004. Mr. Lan graduated from Chengdu Institute of Radio Engineering (now known as University of Electronic Science and Technology of China) majoring in Computer Science and obtained his bachelor's degree in Engineering in 1982.

Mr. Guo Zhenyu, born in 1960, joined the Group in January 2003, and is a director and general manager of Anhui Huali. Mr. Guo has 18 years of experience in corporate management and has served as general manager in a number of subsidiaries of OCT Group.

Mr. Lin Youwen, born in 1970, joined the Group in 1993. Mr. Lin has over 10 years of experience in the packaging industry in Mainland China. Mr. Lin is a director and general manager of Mudanjiang Huali. He graduated from Northwest Institute of Light Industry (now known as Shanxi University of Science & Technology) majoring in packaging engineering and obtained his bachelor's degree in Engineering in 1993.



Corporate Governance Report

The Company believes that good corporate governance can increase long-term share value. Therefore, the Company is committed to implementing a high standard of corporate governance and emphasizes good communication with shareholders and investors with a view to continuously improving the Company's transparency. This includes timely, comprehensive and accurate disclosure of information to safeguard the shareholders' interest and to raise long-term share value.

During the reporting period, the Company has complied with all the code provisions of the Code on Corporate Governance Practice (the "Code") 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").

BOARD OF DIRECTORS

The board (the "Board") of directors (the "Directors") of the Company manages the Company's affairs on behalf of shareholders and is responsible for any corporate governance mechanism deployed. The Board is also responsible for the Company's business, financial performance and preparation of financial statements. The Board formulates the strategy, policy and business plan of the Group, controls corporate risks, monitors the operation and financial performance of the Company. The Board is directly responsible to shareholders and delegates daily management to the management led by the Chief Executive Officer of the Company. The Board comprises eight members, including four Executive Directors, one Non-Executive Director and three Independent Non-Executive Directors.

The Company has a separate Chairman and Chief Executive Officer. The two positions are assumed by different persons, in order to ensure that their independence, accountability and power are clear. Mr. Zheng Fan, the Chairman, is responsible for the operation of the Board and the formulation of the Company's strategies and policies. Mr. Ni Zheng, the Chief Executive Officer, with the assistance of other members of the Board and senior management, is responsible for the management of the Company's business, the implementation of significant policies, the daily operational decisions as well as the coordination of the overall operation.

Independent Non-Executive Directors (with a term of one or two years) comprise experienced professionals and businessmen. They have comprehensive expertise and experience in the legal, accounting, financial, industrial and commercial aspects. They ensure the Board has attained the strict standards in the financial and other statutory reporting areas and they provide sufficient balance to safeguard the interests of the shareholders and the Company as a whole.

In order to assist the Directors to execute their duties, the Board has set out terms of reference, enabling the Directors to seek independent professional advice upon reasonable request under appropriate circumstances and the fees are payable by the Company.



Corporate Governance Report

As at the date of this Report, the Directors of the Company are as follows:

Executive Directors

Mr. Zheng Fan, the Chairman of the Company

Mr. Ni Zheng, the Chief Executive Officer of the Company

Mr. Liu Danlin

Mr. Zhou Guangneng

The above Executive Directors (except Mr. Liu Danlin) have entered into service agreements with the Company with a term of three years starting from the Listing Date, subject to termination provisions therein. Mr. Liu Danlin has entered into a service agreement with the Company for a term of three years commencing from 11 May 2006, subject to termination provisions therein.

Non-Executive Director

Ms. Xie Mei

Ms. Xie Mei has entered into a service agreement with the Company with a term of three years starting from the Listing Date, subject to termination provisions therein.

Independent Non-Executive Directors

Mr. Lee Kit Wah

Mr. Chen Xiangdong

Mr. Xiao Yongping

The above Independent Non-Executive Directors have entered into service agreements with the Company with a term of two years starting from the Listing Date, subject to termination provisions therein. Mr. Lee Kit Wah is a certified public accountant in Hong Kong and has more than 26 years of experience in accounting and finance.

The biographies of all Directors are set out in the Annual Report on pages 11 to 12.

The Company has not established a nomination committee. The Board will evaluate the independence of all Independent Non-Executive Directors each year and make sure that they comply with the independence requirement of the Listing Rules. All members of the Board are not related to one another in all aspects, including finance, family and business.



Corporate Governance Report

THE APPOINTMENT AND RE-ELECTION OF DIRECTORS

The Company has not established a nomination committee. All members of the Board are responsible for formulating the procedures for appointing Directors, nominating suitable candidates for approval at the annual general meeting so as to fill vacancies due to the resignation of Directors or appoint additional Directors.

When selecting candidates for appointment as Directors, the Board will consider the candidates' integrity, achievements and experience in the relevant industry, expertise, educational background and whether they have sufficient time to assume the post of Directors.

The Board held one meeting (which all Directors were present) in 2006 to determine the policy for the nomination of directors, and to propose the appointment of an additional director in the 2005 annual general meeting of the Company.

PROCEDURES OF BOARD MEETINGS

The Board has established meeting procedures and has complied with the code provisions of the Code. The procedures of board meetings provide that the Board shall meet at least four times each year and can convene additional meeting when necessary. Directors can express different opinions at board meetings. Important decisions will be made only after detailed discussions by the Board. Directors who have conflict of interest or material interests in the relevant transactions will not be counted in the quorum of the meeting and shall abstain from voting on the relevant resolutions. Minutes of board meetings and other committee meeting will be drafted by the Company Secretary and will be sent to all members for their comment and record respectively. Directors are entitled to inspect the minutes at any time.

NUMBER OF BOARD MEETINGS HELD AND THE ATTENDANCE OF DIRECTORS

The Board convened six meetings in the year ended 31 December 2006. The attendances of the meetings of the Board, the Audit Committee and the Remuneration Committee are as follows:

Name of Directors	Number of meetings attended		
	The Board	Audit Committee	Remuneration Committee
Zheng Fan	6/6	N/A	N/A
Ni Zheng	5/6	N/A	N/A
Liu Danlin	2/6 (Note 1)	N/A	N/A
Zhou Guangneng	6/6	N/A	N/A
Xie Mei	6/6	3/3	2/2
Lee Kit Wah	6/6	3/3	2/2
Chen Xiangdong	6/6	N/A	N/A
Xiao Yongping	5/6	3/3	2/2

Note 1: Mr. Liu Danlin has been appointed as an Executive Director of the Company starting from 11 May 2006. Thereafter, three Board meetings have been held in 2006 and Mr. Liu has attended two meetings



Corporate Governance Report

SPECIAL COMMITTEES UNDER THE BOARD OF DIRECTORS

The Board has established the following committees and formulated their terms of reference.

AUDIT COMMITTEE

The Audit Committee consists of three members, including two Independent Non-Executive Directors and one Non-Executive Director. They are Mr. Lee Kit Wah, Mr. Xiao Yongping and Ms. Xie Mei, with Mr. Lee Kit Wah as the Chairman of the Audit Committee.

The main areas of responsibilities of the Audit Committee are as follows:

1. To be primarily responsible for making recommendations to the Board on the appointment, re-appointment or removal of the external auditors, and to approve remuneration and terms of engagement of the external auditors;
2. Reviewing of internal control and monitoring the work of internal audit department;
3. Reviewing the financial reporting statements of the Company, the Company's annual reports and accounts, interim reports and quarterly reports (if any);
4. Examining financial statements and reporting to the Board for any significant opinions in relation to financial reporting;
5. Conferring with the auditors on any problems or matters of doubt arising from the audit process, as well as other issues the auditors may like to discuss (if necessary, such discussions could be undertaken in the absence of the management);
6. Reviewing correspondences addressed to the management by the auditors and responses from the management.

The Audit Committee held three meetings during the year ended 31 December 2006, at which the Audit Committee reviewed and discussed the financial results and reports, compliance procedures, the internal audit department's report regarding the reviewing and procedures of the internal control and risk management of the Company, and the re-appointment of the external auditor.

The Audit Committee has reviewed this annual report, and confirms that it is complete and accurate and complies with the Listing Rules.



Corporate Governance Report

REMUNERATION COMMITTEE

The Remuneration Committee consists of three members, including two Independent Non-Executive Directors and one Non-Executive Director. They are Mr. Lee Kit Wah, Mr. Xiao Yongping and Ms. Xie Mei, with Mr. Lee Kit Wah being Chairman of the Remuneration Committee.

The main areas of responsibilities of the Remuneration Committee are as follows:

1. The Committee should consult Chairman of the Board on remuneration recommendations concerning other Executive Directors;
2. The Committee should put forward recommendations to the Board on matters relating to the overall remuneration policy and structure for the Directors and senior managerial staff of the Company, as well as finalizing a formal and transparent remuneration policy;
3. With authority delegated by the Board, the Committee should finalize the compensation packages for all the Executive Directors and senior managerial staff and put forward recommendations to the Board on remuneration for Non-Executive Directors;
4. Reviewing and approving compensations paid to Executive Directors and senior managerial staff, who have their service contracts terminated or whose contracts are not renewed, in order to ensure that the compensations are paid in accordance with relevant contractual terms.

The Remuneration Committee held two meetings during the year ended 31 December 2006, at which the Remuneration Committee reviewed and discussed the remuneration policy and structure of the Company and the remuneration of the Executive Directors in the year under review.

INTERNAL CONTROL

The Company has an internal audit department which is independent of other departments. The internal audit department has the authority to inspect the Company's risk management network, and the control and governance processes in order to assess the relevant situations. Besides, the department also regularly reviews all the businesses, the supporting teams and matters relating to work approach, procedure, expenses and internal control measures of the Company's subsidiaries. The department will also conduct ad hoc reviews and investigations when necessary. The internal audit department reports directly to the Audit Committee.

During the year under review, the Board examined the effectiveness of the internal control system of the Company through the Audit Committee.



Corporate Governance Report

FINANCIAL REPORTING

The Directors are responsible for overseeing the preparation of the financial statements, to ensure the annual report giving a true and fair view of the Group's state of affairs, the results and cash flow for the year. In preparing the financial statements for the year ended 31 December 2006, the Directors have:

- selected suitable accounting policies and applied them consistently; and
- made judgements and estimates that are prudent and reasonable.

The Company recognises that high quality corporate reporting is important in reinforcing the trustworthy relationship with the Company's stakeholders and aims at presenting a balanced, clear and comprehensible assessment of the Company's performance, position and prospects in all corporate communications. The annual results of the Company are announced in a timely manner within the limits of 4 months after the financial year end.

The auditors' responsibilities are set out in the Auditors' Report on page 36.

Through the Audit Committee, the Board has reviewed the internal control system in respect of finance, operations and compliance of the Company and its subsidiaries. The Audit Committee considers that the Company and its subsidiaries have established all necessary mechanisms. The above control mechanism has ensured compliance in respect of the Company's operations. The Board considers that the Company has complied with the code provisions on internal control of the Code.

DIRECTORS' REMUNERATION

The Group paid total Directors' remuneration amounts of approximately RMB819,000, RMB530,000, RMB707,000, RMB122,000, RMB1 and RMB122,000 to Mr. Ni Zheng, Mr. Liu Danlin, Mr. Zhou Guangneng, Mr. Lee Kit Wah, Mr. Chen Xiangdong and Mr. Xiao Yongping respectively for the year ended 31 December 2006. Mr. Zheng Fan and Ms. Xie Mei did not receive any basic remuneration from the Group for the year ended 31 December 2006.

Directors' remuneration is determined based on a variety of factors such as market conditions and responsibilities assumed by each Director. As at 31 December 2006, there was no arrangement in which Directors waived their remuneration.

SECURITIES TRADING BY DIRECTORS

The Board has adopted the Model Code for Securities Transactions by Directors of Listed Companies set out in Appendix 10 of the Listing Rules ("Model Code"). The Board confirms that, having made detailed enquiry of all Directors, the Directors have complied with the required standard set out in the Model Code and its code of conduct regarding directors' securities transactions.



Corporate Governance Report

SECURITIES TRANSACTIONS BY SENIOR MANAGEMENT AND STAFF

Senior management and those staff who are more likely to be in possession of unpublished price-sensitive information or other relevant information in relation to the Group have adopted rules based on the Model Code. These senior management and staff have been individually notified and advised about the Model Code by the Company.

FINANCIAL OFFICER

The Financial Officer of the Company is responsible for preparing interim and annual financial statements based on accounting principles generally accepted in Hong Kong and ensures that the financial statements truly reflect the Group's results and financial position as well as in compliance with the Companies Ordinance, the Listing Rules and other relevant laws and regulations. The Financial Officer reports directly to the Chairman of the Audit Committee and co-ordinates with external auditors on a regular basis. In addition, the Financial Officer will review the control of financial risks of the Group and provide advices thereon to the Board.

COMPANY SECRETARY

The Company Secretary reports directly to the Board. All the Directors have easy access to the Company Secretary and the responsibility of the Company Secretary is to ensure the board meetings are properly held and are in compliance with the relevant laws and regulations. The Company Secretary is also responsible for giving advices with respect to the Directors' obligations on securities interest disclosure, disclosure requirements of discloseable transactions, connected transactions and price-sensitive information. The Company Secretary shall provide advices to the Board with respect to strict compliance with the laws, requirements and the Company's articles of association at appropriate times. As the Company's principal channel of communication with the Stock Exchange, the Company Secretary assists the Board in implementing and strengthening the Company's corporate governance code so as to bring the best long-term value to shareholders. In addition, the Company Secretary also provides relevant information updates and continuous professional development to the Directors with respect to legal, supervisory and other continuous obligations for being a director of a listed company at appropriate times. The Company Secretary is also responsible for supervising and managing the Group's investors relationship.

EXTERNAL AUDITORS

The Group's external auditors are KPMG. The remuneration paid to the external auditors in 2006 comprised fees for audit services of RMB1.77 million and fees for tax compliance work of RMB8,000.

The responsibilities of the auditors to the shareholders are set out on page 36 in this annual report.



Corporate Governance Report

INVESTORS RELATIONSHIP

The Company places great emphasis on its relationship and communication with investors. The Company has numerous communication channels such as seminars with the media, analysts and fund managers. Designated senior management holds regular dialogue with institutional investors and analysts which enables them to keep abreast of the Group's latest developments. In addition, the Group set up a company website (www.hualiholdings.com) in 2006, timely presenting the most updated information and the status of the business development of the Group.

COMMUNICATION WITH SHAREHOLDERS

The Board and senior management recognize the responsibility of safeguarding the interest of shareholders of the Company. The Company reports its financial and operating performance to shareholders through annual reports and interim reports. Shareholders of the Company can also obtain information of the Group in time through annual reports, interim reports, announcements, circulars, press releases and the Group's company website. Shareholders can raise questions directly to the Board in respect of the performance and future development of the Group at annual general meetings.



Directors' Report

The Board has pleasure in submitting the Annual Report together with the audited financial statements for the year ended 31 December 2006.

PRINCIPAL PLACE OF BUSINESS

The Company was incorporated as an exempted company with limited liability in the Cayman Islands on 28 February 2005. Its registered office and principal place of business are at Clifton House, 75 Fort street, PO Box 1350 GT, George Town, Grand Cayman, Cayman Islands and Rooms 3203-3204, Tower 6, The Gateway, Harbour City, Canton Road, Tsimshatsui, Kowloon, Hong Kong respectively.

PRINCIPAL ACTIVITIES

The Company is an investment holding company. The principal activities of the Company's subsidiaries (collectively referred to as "the Group") are design and manufacture of quality paper-based packaging containers and materials, including corrugated paperboard and printed cartons.

RESULTS AND DISTRIBUTIONS

The results of the Group for the year are set out in the consolidated income statement on page 37.

The Directors consider that dividends to be declared during the year or declarable in future by the Group will be decided by the Board in discretion. Their consideration factors include (among others) distributable profits, the Group's profits, financial position, capital requirements and other factors which the Directors may deem relevant at the time. Undistributed profits will be used to provide funds for the Group's continued growth and business expansion. Subject to the above, the Directors propose distribution of a dividend of HK\$6.4 cents per share for the year ended 31 December 2006 (2005: HK\$7.8 cents per share).

ACQUISITION

During the reporting period, the Group acquired 100% equity interest in Grand Signal and its wholly-owned subsidiary, Anhui Huali, located at Chuzhou, Anhui Province, and acquired 10% equity interest in Shenzhen Huayou.

FINANCIAL STATEMENTS

The profit of the Group for the year ended 31 December 2006 and the state of affairs of the Company and the Group as at that date are set out in the financial statements on pages 37 to 94.



Directors' Report

PROPOSED FINAL DIVIDEND

The Board has resolved to recommend the payment of a final dividend of HK\$6.4 cents per share for shareholders whose names appear on the Register of Members of the Company on 24 April 2007. The Register of Member will be closed from 24 April 2007 to 26 April 2007, both days inclusive, and the proposed final dividend will be paid on 7 June 2007. The payment of dividends shall be subject to the approval of the shareholders at the forthcoming Annual General Meeting to be held on 26 April 2007.

CHARITABLE DONATIONS

No charitable donations were made by the Group during the year (2005: HK\$1.00 million).

TRANSFERS TO RESERVES

Profits attributable to shareholders before dividends, of RMB33.00 million (2005: RMB40.09 million) have been transferred to reserves. Other movements in the reserves are set out in note 26 to the financial statements.

PROPERTY, PLANT AND EQUIPMENT

During the year, the Group invested approximately RMB34.56 million for the acquisitions of property, plant and equipment (including construction in progress). Details of the movements of property, plant and equipment, and construction in progress are set out in notes 13 and 14 to the financial statements.

SHARE CAPITAL

Details of the movements in share capital of the Company during the year are set out in note 26(a) to the financial statements.

DISTRIBUTABLE RESERVES

Pursuant to the relevant rules of the Cayman Islands, the Company's distributable reserves as at 31 December 2006 amounted to RMB290 million.

PRE-EMPTIVE RIGHTS

There was no provision in respect of pre-emptive rights in the articles of association of the Company, nor any requirement in the laws of the Cayman Islands requiring the Company to issue new shares to the existing shareholders proportionately.

PURCHASE, SALE OR REDEMPTION OF SHARES

The Company has not purchased its own listed shares during the reporting period. During the period, the Company or any of its subsidiaries has also not purchased or sold any of the listed shares in the Company.



Directors' Report

MATERIAL CONTRACTS

No contract of significance has been entered into during the reporting period between the Company or any of its subsidiaries and the controlling shareholder or its subsidiaries.

SERVICE CONTRACTS

No Director has an unexpired service contract which is not determinable by the Company within one year without payment of compensation other than normal statutory compensation.

DIRECTORS

The Directors of the Company during the year were as follows:

Executive Directors:

Mr. Zheng Fan (*Chairman*)

Mr. Ni Zheng

Mr. Liu Danlin (appointed on 11 May 2006)

Mr. Zhou Guangneng

Non-executive Directors:

Ms. Xie Mei

Independent Non-executive Directors:

Mr. Lee Kit Wah

Mr. Chen Xiangdong

Mr. Xiao Yongping

In accordance with the articles of association of the Company, Mr. Chen Xingdong and Mr. Xiao Yongping shall retire by rotation and, being eligible, will offer themselves for re-election at the forthcoming annual general meeting.

DIRECTORS' INTERESTS IN CONTRACTS

No contract of significance in relation to the Group's business to which the Company, any of its holding companies, subsidiaries or fellow subsidiaries was a party, and in which a director of the Company had a material interest, whether directly or indirectly subsisted at the end of the year or at any time during the year.

PERSONAL BIOGRAPHIES OF DIRECTORS AND SENIOR MANAGEMENT

Personal biographies of Directors and senior management are set out on pages 11 to 13.



Directors' Report

DIRECTORS' INTEREST IN COMPETING BUSINESS

None of the Directors of the Company is or was interested in any business apart from the Group's business, that competes or competed or is or was likely to compete, either directly or indirectly, with the Group's business at any time during the 2006 financial year up to and including the date of this report.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND/OR SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at 31 December 2006, interests and short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) held by the Directors and chief executives of the Company which have been notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which were taken or deemed to have under such provisions of the SFO) or have been entered in the register maintained by the Company pursuant to section 352 of the SFO, or otherwise have been notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") are as follows:

Long position in Ordinary Shares of the Company

Name	Capacity/Nature	No. of shares involved	Approximate shareholding percentage
Ni Zheng (<i>Note 1</i>)	Beneficial owner	2,000,000	1.00%
Liu Danlin (<i>Note 2</i>)	Beneficial owner	1,700,000	0.85%
Zhou Guangneng (<i>Note 3</i>)	Beneficial owner	1,700,000	0.85%

Notes:

1. Ni Zheng is interested as a grantee of options to subscribe for 2,000,000 Shares under the Share Option Scheme of the Company.
2. Liu Danlin is interested as a grantee of options to subscribe for 1,700,000 Shares under the Share Option Scheme of the Company.
3. Zhou Guangneng is interested as a grantee of options to subscribe for 1,700,000 Shares under the Share Option Scheme of the Company.

Save as disclosed above, as at 31 December 2006, none of the Directors or chief executives of the Company had any interests or short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be kept by the Company under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.



Directors' Report

SUBSTANTIAL SHAREHOLDERS' AND OTHER SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at 31 December 2006, as far as is known to the Directors, the following persons (not being a Director or chief executive of the Company) had interests or short positions in the shares or underlying shares of the Company which fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO as recorded in the register required to be kept by the Company pursuant to section 336 of the SFO:

Long Position in Ordinary Shares of the Company

Name	Capacity/Nature	No. of shares held	Approximate shareholding percentage
Substantial Shareholders			
Pacific Climax Limited	Beneficial owner	134,370,000	67.185%
Overseas Chinese Town (HK) Company Limited ("OCT (HK)")	Interest of a controlled corporation (<i>Note 1</i>)	134,370,000	67.185%
Overseas Chinese Town Enterprises Co. ("OCT Group")	Interest of a controlled corporation (<i>Note 2</i>)	134,370,000	67.185%
Others			
Polyfairz Group Limited (formerly known as Polyfair Limited)	Beneficial owner	15,630,000	7.815%
Zhang Zhilin	Interest of a controlled corporation (<i>Note 3</i>)	15,630,000	7.815%
Tang Qinmei	Interest of spouse (<i>Note 4</i>)	15,630,000	7.815%
Noor Financial Investment Company KSC	Beneficial owner	11,778,000	5.89%

Notes:

- (1) OCT (HK) is the beneficial owner of all the issued share capital in Pacific Climax Limited. Therefore, OCT (HK) is deemed, or taken to be interested in these shares which are beneficially owned by Pacific Climax Limited for the purpose of the SFO.
- (2) OCT Group is the beneficial owner of all the issued shares in OCT (HK) (OCT Group holds 454,999,998 shares in OCT (HK) in its own name. Mr. Zheng Fan, an Executive Director, and Mr. Guo Yubin hold one share each in OCT (HK) on trust for OCT Group) and which is in turn the beneficial owner of all the issued share capital in Pacific Climax Limited and therefore OCT Group is deemed, or taken to be, interested in the 134,370,000 shares which are beneficially owned by Pacific Climax Limited for the purpose of the SFO.
- (3) Polyfairz Group Limited (formerly known as Polyfair Limited) is beneficially owned as to 90% by Mr. Zhang Zhilin and thus a controlled corporation of Mr. Zhang Zhilin, and Mr. Zhang Zhilin is deemed, or taken to be, interested in the 15,630,000 shares which are beneficially owned by Polyfairz Group Limited for the purpose of the SFO.
- (4) Ms. Tang Qinmei is the spouse of Mr. Zhang Zhilin. Therefore, Ms. Tang Qinmei is deemed, or taken to be, interested in all the shares in which Mr. Zhang Zhilin is interested for the purpose of the SFO.



Directors' Report

Save as disclosed above, no other interests required to be recorded in the register kept under section 336 of the SFO have been notified to the Company.

As at 31 December 2006, the following parties (other than the Directors or chief executive of the Company) were directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of members of the Group:

Names of shareholders	Name of company	Approximate shareholding percentage
Mudanjiang Nanhua Hesheng Paper Co., Ltd. ("Mudanjiang Nanhua") (Note)	Mudanjiang Huali	15%

Note: Mudanjiang Nanhua is formerly known as Mudanjiang Nanhua Industrial Company Limited.

MANAGEMENT CONTRACTS

No contract concerning the management and administration of the whole or any substantial part of the business of the Group was entered into or existed during the year.

MAJOR CUSTOMERS AND SUPPLIERS

The information in respect of the Group's sales and purchases attributable to the major customers and suppliers respectively during the financial year is as follows:

	Percentage of the Group's total	
	Sales	Purchases
The largest customer	16%	
Five largest customers in aggregate	37%	
The largest supplier		20%
Five largest suppliers in aggregate		53%

Other than OCT Group, the ultimate holding company of the Company, which owns a 8.7% stake in Konka Group Co., Ltd., the largest customer of the Company in 2006, at no time during the year have the Directors, their associates or any shareholder of the Company (which to the knowledge of the Directors owns more than 5% of the Company's share capital) had any interest in the Group's five largest suppliers or customers.



Directors' Report

CONNECTED TRANSACTIONS

During the year, the following continuing connected transactions (the "Connected Transactions") have been entered into by the Group to which the Stock Exchange has granted waiver to the Company from strict compliance with the announcement and/or independent shareholders' approval requirements under Chapter 14A of the Listing Rules.

1. On 26 April 2005, Overseas Chinese Town Real Estate Company Limited (as lessor) ("OCT Properties") entered into a tenancy agreement with Shenzhen Huali (as lessee), a wholly owned subsidiary of the Company, for a term from 26 April 2005 to 31 December 2007.

OCT Group, the ultimate shareholder of OCT (HK) (OCT (HK) owns 100% equity interest in Pacific Climax Limited, which is the immediate holding company of the Company), together with its associated companies, are directly or indirectly interested in 100% equity interest in OCT Properties. OCT Properties is a connected person of the Company within the meaning of the Listing Rules. Accordingly, the arrangements under the above tenancy agreement constitute continuing connected transactions.

2. Mudanjiang Huali, a subsidiary of the Company, purchases paper from Mudanjiang Nanhua. On 9 September 2005, a sale and purchase agreement was entered into between Mudanjiang Huali and Mudanjiang Nanhua for a period commencing from the date of agreement to 31 December 2007.

Mudanjiang Nanhua owns a 15% stake in Mudanjiang Huali. Pursuant to the Listing Rules, the above purchasing arrangement constitutes a continuing connected transaction.

3. Shenzhen Huali purchases printed instruction manuals, brochures or similar publications from Panyu Huali Youde Offset Printing & Packaging Company Limited ("Panyu Huali"). On 9 September 2005, a sale and purchase agreement was entered into between Shenzhen Huali and Panyu Huali for a period commencing from the date of agreement to 31 December 2007.

OCT Group, the ultimate shareholder of OCT (HK), holds 80% equity interest in Shenzhen OCT International Hotel Management Co., Ltd. (formerly known as Shenzhen OCT Xinqiao Industry Development Co., Ltd.), which in turn directly holds 51% equity interest in Panyu Huali and directly holds 90% equity interest in Shenzhen OCT City Inn Company Limited, a company holding 49% equity interest in Panyu Huali. As such, Panyu Huali is a connected person within the meaning of the Listing Rules. Accordingly, the above purchase arrangements constitute continuing connected transactions.



Directors' Report

4. On 25 April 2005, Shenzhen Overseas Chinese Town Water and Electricity Company ("OCT Electricity") and Shenzhen Huali entered into a utilities agreement for a term commencing from the date of agreement to 31 December 2007. Under the agreement, Shenzhen Huali has agreed to pay the water (including sewage charges) and electricity charges incurred for the premises owned or rented by Shenzhen Huali located in Huaqiaocheng, Shenzhen. The calculation of the electricity and water charges are based on meter reading of separate meters installed by Shenzhen Huali. The water, sewage and electricity tariffs charged by OCT Electricity follow the standard charges set by the government authorities.

OCT Electricity is a state-owned enterprise and OCT Group, the ultimate shareholder of OCT (HK), is directly interested in 100% of the registered capital of OCT Electricity. OCT Electricity is a connected person within the meaning of the Listing Rules. Accordingly, the arrangements under the utilities agreement constitute continuing connected transactions.

5. The Group, in particular Shenzhen Huali, sells cartons to OCT Group and a number of its associated companies (being such companies in the equity capital of which OCT Group is directly or indirectly interested so as to exercise or control the exercise of 30% or more of the voting power at general meetings, or to control the composition of a majority of the Board of Directors). A sale and purchase agreement was entered into between Shenzhen Huali and OCT Group on 9 September 2005 for an initial period commencing from the date of the agreement to 31 December 2007.

OCT Group is the ultimate shareholder of OCT (HK), which is the immediate holding company of the Company. Pursuant to the Listing Rules, each of OCT Group and its associated companies is a connected person to the Company. Accordingly, the arrangements under the above sales and purchase agreement constitute continuing connected transactions under the Listing Rules.

6. Shanghai Huali sells cartons to Shanghai Meiling Center Air Conditioner Co., Ltd. ("Meiling Air Conditioner"). A sales and purchase agreement was entered into between Shanghai Huali and Meiling Air Conditioner on 9 September 2005 for an initial period commencing from the date of the agreement to 31 December 2007.

Mr. Zhang Zhi Lin, a director of Shanghai Huali, a subsidiary of the Company, owns 79.08% equity interest in Shanghai Huiyang Industry Co., Ltd., which in turn owns 50% equity interest in Meiling Air Conditioner. Pursuant to the Listing Rules, Meiling Air Conditioner is a connected person to the Company. Accordingly, the sale arrangements stated above constitute continuing connected transactions under the Listing Rules.



Directors' Report

The particulars of the connected transactions are as follows:

Particulars of the connected transactions	Transaction amount for the year ended 31 December 2006 (RMB'000)	Cap amount for the year ended 31 December 2006 (RMB'000)
Tenancy agreement between OCT Properties (as lessor) and Shenzhen Huali (as lessee)	1,711	1,713
Purchase of paper by Mudanjiang Huali from Mudanjiang Nanhua	2,114	4,000
Purchase of booklets by Shenzhen Huali from Panyu Huali	1,002	2,700
Electricity supply arrangement between OCT Electricity and Shenzhen Huali	3,785	5,000
Sales of cartons by the Group to OCT Group and its associated companies	912	1,700
Sales of cartons by Shanghai Huali to Meiling Air Conditioner	7,448	11,000

The Directors confirm that the Company complied with the disclosure requirements in Chapter 14A of the Listing Rules.

The following continuing connected transactions have also been entered into by the Group, each of which involved an aggregate annual consideration of below HK\$1.00 million and hence fall within the de minimis threshold as stipulated under Rule 14A.33(3) of the Listing Rules. Therefore, the following agreements are not subject to any of the reporting, announcement and independent shareholders' approval requirements applicable to continuing connected transactions under Chapter 14A of the Listing Rules.

1. On 18 April 2005, Shanghai Pudong Xiamei Plastics Co., Ltd. (as lessor) and Shanghai Huali (as lessee) entered into a tenancy agreement, pursuant to which Shanghai Huali agreed to lease from Shanghai Pudong Xiamei Plastics Co., Ltd., an office premise for a term effective from 1 April 2005 to 31 December 2008 at an annual rent of RMB180,000 (exclusive of water and electricity charges). Mr. Zhang Zhi Lin, the director of Shanghai Huali, owns 79.08% equity interest in Shanghai Huiyang Industry Co., Ltd. Shanghai Huiyang Industry Co., Ltd. owns 50% equity interest in Shanghai Pudong Xiamei Plastics Co., Ltd. Accordingly, Shanghai Pudong Xiamei Plastics Co., Ltd. is a connected person within the meaning of the Listing Rules, and the arrangements under the above tenancy agreement constitute continuing connected transactions under the Listing Rules.
2. Mudanjiang Huali sells scrap paper to Mudanjiang Nanhua. A sales and purchase agreement was entered into between Mudanjiang Huali and Mudanjiang Nanhua on 9 September 2005 for an initial period commencing from the date of the agreement to 31 December 2007. The actual trading amount for the year 2006 was RMB32,540.



Directors' Report

The Independent Non-Executive Directors of the Company have reviewed the above continuing connected transactions and confirm:

- (1) the above transactions are in the ordinary course of business of the Company;
- (2) the above transactions are on normal commercial terms, or if there are insufficient comparable transactions to judge whether the terms of those transactions are normal commercial terms, as far as the Company is concerned, the terms of the above transactions are no less favourable than that available from or provided by independent third parties (as the case may be); and
- (3) the above transactions are entered into under the terms of the agreement in respect of the relevant transactions and the transaction terms are fair and reasonable and are in the interest of shareholders of the Company as a whole.

In addition, the Company's auditors have confirmed in writing to the Board, the above connected transactions:

- (1) have received the approval of the Board;
- (2) nothing had come to their attention which caused them to believe that:
 - the connected transactions had not been entered into in accordance with the relevant agreements governing the transactions;
 - the connected transactions had not been entered into in accordance with the pricing policies of the Group if the transactions involve provision of goods by the Group; and
 - the transaction amount occurred in 2006 for each of the connected transactions was not within the respective cap amount as disclosed in the Company's prospectus dated 24 October 2005.

The related party transactions are set out in note 29 to the financial statements. Apart from the Connected Transactions disclosed above, all the other related party transactions did not fall under the scope of "Continuing Connected Transaction" under Chapter 14A of the Listing Rules which are required to comply with any of the reporting, announcement or independent shareholders' approval requirements under Chapter 14A of the Listing Rules.

In 2006, the Group had acquired from its connected persons (1) 100% equity interest in Grand Signal and its subsidiary, Anhui Huali; and (2) 10% equity interest in Shenzhen Huayou. Details of the acquisition were stated in the Company's announcement dated 27 January 2006 in compliance with the reporting and announcement requirements under Chapter 14A of the Listing Rules.

BANK LOANS AND OTHER BORROWINGS

Particulars of bank loans and other borrowings of the Company and the Group as at 31 December 2006 are set out in note 22 to the financial statements.



Directors' Report

FIVE YEAR SUMMARY

A summary of the results and the assets and liabilities of the Company for the last five years is set out on pages 95 and 96 of the Annual Report.

RETIREMENT SCHEMES

The Group participates in two defined contribution retirement schemes which cover the Group's full-time employees. Particulars of these retirement schemes are set out in note 23 to the financial statements.

CONFIRMATION OF INDEPENDENCE

The Company has received from each of the Independent Non-Executive Directors an annual confirmation of independence pursuant to Rule 3.13 of the Listing Rules and considers all the Independent Non-Executive Directors to be independent parties.

AUDITORS

KPMG were first appointed as the auditors of the Company in 2005.

KPMG retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as auditors of the Company is to be proposed at the forthcoming annual general meeting of the Company.

PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of the Directors as at the date of this Annual Report, the Company has maintained the prescribed public float under the Listing Rules.

SUBSEQUENT EVENTS

- (a) After the balance sheet date, the Board has resolved to recommend the payment of a final dividend of HK\$6.4 cents per share for the year ended 31 December 2006 (2005: HK\$7.8 cents).
- (b) On 16 March 2007, the Fifth Plenary Session of the Tenth National People's Congress passed the Corporate Income Tax Law of the PRC ("New Tax Law") which will take effect on 1 January 2008. The details of the existing corporate income tax rate and preferential tax policies applicable to the Group are disclosed in note 7 to the financial statements. From 1 January 2008, the income tax rate of the PRC subsidiaries of the Group is expected to gradually increase to the standard rate of 25% over a five-year transition period. However, the New Tax Law has not set out the details as to how the existing preferential tax rate will gradually increase to the standard rate of 25%. Consequently, the Group is not able to make an estimate of the expected financial effect of the New Tax Law on its deferred tax assets and liabilities. The expected financial effect of the New Tax Law, if any, will be reflected in the Group's 2007 financial statements. The enactment of the New Tax Law is not expected to have any financial effect on the amounts accrued in the balance sheet in respect of current tax payable.



Directors' Report

- (c) On 13 March 2007, the Company established an indirectly wholly owned subsidiary, Huizhou Huali Packaging Co., Ltd ("Huizhou Huali") with a registered capital of HK\$90,000,000.

On 19 March 2007, Huizhou Huali entered into a transfer agreement with an independent third party, Guangdong Yonghe Pharmaceuticals Development Limited to acquire the land use rights of a piece of land in Huiyang for the Group's production expansion at a cash consideration of RMB64,460,000 which may be adjusted based on the actual site measurement as approved by the relevant planning bureau of the PRC. The purchase consideration will be satisfied by the net proceeds from the public offer and placing of shares of the Company in 2005 and internally generated funds.

SHARE OPTION SCHEME

The Company has a share option scheme which was adopted on 12 October 2005 whereby the Directors are authorised, at their absolute discretion and on such terms as they may think fit, grant an employee (full-time or part-time), a director, consultant and adviser of the Group, or any substantial shareholder of the Group, options to subscribe for shares of the Company. The purpose of the share option scheme is to attract and retain the best available personnel, to provide additional incentive to the employees (full-time and part-time), directors, consultants and advisers of the Group and to promote the success of the Group. The share option scheme shall be valid and effective for a period of ten years ending on 11 October 2015, unless terminated earlier by shareholders of the Company at general meeting.

An offer for the grant of options must be accepted within seven days inclusive of the day on which such offer was made. The amount payable by the grantee of an option to the Company on acceptance of the offer for the grant of an option is HK\$1.00.

The subscription price of a share in respect of any particular option granted under the share option scheme shall be a price solely determined by the Board and notified to a participant and shall be at least the higher of: (i) the closing price of the shares as stated in the Stock Exchange's daily quotations sheet on the date of grant of the option; (ii) the average of the closing prices of the shares as stated in the Stock Exchange's daily quotations sheets for the 5 business days immediately preceding the date of grant of the option; and (iii) the nominal value of a share on the date of grant of the option.

The Company shall be entitled to issue options, provided that the total number of shares which may be issued upon exercise of all options to be granted under the share option scheme does not exceed 10% of the shares in issue at the date of approval of the share option scheme. The Company may at any time refresh such limit, subject to the shareholders' approval and issue of a circular in compliance with the Listing Rules, provided that the total number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under all the share option schemes of the Company does not exceed 30% of the shares in issue at the time.

The total number of securities available for issue under the share option scheme as at the date of this report was 19,300,000 shares which represented 9.65% of the issued share capital of the Company as at the date of this report. The total number of shares issued and to be issued upon exercise of options granted to any grantee (including both exercised and outstanding options) under the share option scheme, in any 12-month period up to the date of grant shall not exceed 1% of the shares in issue.



Directors' Report

An option may be exercised in accordance with the terms of the share option scheme at any time during a period as the Board may determine which shall not exceed ten years from the date of grant subject to the provisions of early termination thereof.

The status of the share options granted up to 31 December 2006 are as follows:

Name and category of participants	Number of unlisted share options (physically settled equity derivatives)					Date of grant of share options*	Exercise period of share options	Exercise price of share options** HK\$	Share price of the Company as at the date of grant of share options*** HK\$
	As at 1 January 2006	Granted during the period	Exercised during the period	Cancelled/lapsed during the period	As at 31 December 2006				
Directors									
Ni Zheng	–	2,000,000	–	–	2,000,000	7 February 2006	7 February 2006 to 6 February 2016	1.41	1.41
Liu Danlin	–	1,700,000	–	–	1,700,000	7 February 2006	7 February 2006 to 6 February 2016	1.41	1.41
Zhou Guangneng	–	1,700,000	–	–	1,700,000	7 February 2006	7 February 2006 to 6 February 2016	1.41	1.41
	–	5,400,000	–	–	5,400,000				
Other employees	–	13,900,000	–	–	13,900,000	7 February 2006	7 February 2006 to 6 February 2016	1.41	1.41
Total	–	19,300,000	–	–	19,300,000				

* Under the Company's share option scheme, there is no vesting period of the share options.

** The exercise price of the share options was subject to adjustment in the case of rights or bonus issues, or other similar changes in the Company's share capital.

*** The share price of the Company disclosed as at the date of the grant of the share options was the closing price as quoted on the Stock Exchange of the trading day immediately prior to the date of the grant of the share options.



Directors' Report

In accordance with the requirements under Hong Kong Financial Reporting Standards 2 "Share-based Payment", the cost of approximately RMB4.56 million in respect of the share options granted by the Company during the period was recognised in the consolidated income statement of the Group. Upon exercise of the share options, the resulting shares issued are recorded by the Company as additional share capital at the nominal value of the shares, and the excess of the exercise price per share over the nominal value of the shares is recorded by the Company in the share premium account. Share options which lapse or are cancelled prior to the expiration of their exercise dates are deleted from the register of outstanding share options.

The details of the model and significant assumptions used to estimate the fair value of the share options granted by the Company to the eligible participants during the period are set out under Note 24 on the financial statements.

Apart from the foregoing, at no time during the period prior to the date of the Annual Report was the Company, any of its holding company, subsidiaries or fellow subsidiaries a party to any arrangement to enable the directors of the Company to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

By order of the Board

Zheng Fan

Chairman

Hong Kong, 27 March 2007



Independent Auditor's Report



TO THE SHAREHOLDERS OF HUALI HOLDINGS (GROUP) LIMITED

(Incorporated in Cayman Islands with limited liability)

We have audited the consolidated financial statements of Huali Holdings (Group) Limited (the "company") set out on pages 37 to 94, which comprise the consolidated and company balance sheets as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of the report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2006 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

KPMG

Certified Public Accountants

8th Floor, Prince's Building

10 Chater Road

Central, Hong Kong

27 March 2007



Consolidated Income Statement

for the year ended 31 December 2006
(Expressed in Renminbi)

	Note	2006 RMB'000	2005 (restated) (Note 1(c)) RMB'000
Turnover	4	695,503	662,243
Cost of sales		(608,381)	(583,646)
Gross profit		87,122	78,597
Other revenue	5(a)	22,544	21,519
Other net loss	5(b)	(3,394)	(1,424)
Distribution costs		(32,562)	(30,340)
Administrative expenses		(30,125)	(19,297)
Other operating expenses		(756)	(761)
Profit from operations		42,829	48,294
Finance costs	6(a)	(3,552)	(2,480)
Profit before taxation	6	39,277	45,814
Income tax	7	(5,970)	(5,440)
Profit for the year		33,307	40,374
Attributable to:			
Equity shareholders of the Company		32,999	40,089
Minority interests		308	285
Profit for the year		33,307	40,374
Dividends payable to equity shareholders of the Company attributable to the year:	11		
Final dividend proposed after the balance sheet date		12,675	16,224
Earnings per share (RMB)	12		
Basic		0.16	0.25
Diluted		0.16	0.25

The notes on pages 44 to 94 form part of these financial statements.



Consolidated Balance Sheet

at 31 December 2006
(Expressed in Renminbi)

	Note	2006 <i>RMB'000</i>	2005 (restated) (Note 1(c)) <i>RMB'000</i>
Non-current assets			
Property, plant and equipment	13	179,884	183,006
Construction in progress	14	20,438	9,506
Goodwill	15	24,937	24,937
Lease prepayments	16	20,010	20,589
Deferred tax assets	25(b)	2,878	2,360
		<u>248,147</u>	<u>240,398</u>
Current assets			
Inventories	18	63,775	73,181
Trade and other receivables	19	135,858	143,124
Cash and cash equivalents	20	172,160	97,951
		<u>371,793</u>	<u>314,256</u>
Current liabilities			
Trade and other payables	21	207,009	186,562
Bank loans	22	43,664	38,474
Current taxation	25(a)	4,882	3,970
		<u>255,555</u>	<u>229,006</u>
Net current assets		<u>116,238</u>	<u>85,250</u>
Total assets less current liabilities		<u>364,385</u>	<u>325,648</u>
Non-current liabilities			
Bank loans	22	26,524	—
NET ASSETS		<u>337,861</u>	<u>325,648</u>

The notes on pages 44 to 94 form part of these financial statements.



Consolidated Balance Sheet

at 31 December 2006
(Expressed in Renminbi)

	Note	2006 RMB'000	2005 (restated) (Note 1(c)) RMB'000
CAPITAL AND RESERVES			
Share capital	26(a)	20,800	20,800
Reserves		<u>315,362</u>	<u>303,157</u>
Total equity attributable to equity shareholders of the Company	26	336,162	323,957
Minority interests		<u>1,699</u>	<u>1,691</u>
TOTAL EQUITY		<u>337,861</u>	<u>325,648</u>

Approved and authorised for issue by the Board on 27 March 2007.

	)	
Zheng Fan	)	
	)	Directors
Ni Zheng	)	
	)	

The notes on pages 44 to 94 form part of these financial statements.



Balance Sheet

at 31 December 2006
(Expressed in Renminbi)

	Note	2006 RMB'000	2005 RMB'000
Non-current assets			
Investments in subsidiaries	17	248,970	248,970
Property, plant and equipment	13	122	–
		<u>249,092</u>	<u>248,970</u>
Current assets			
Trade and other receivables	19	53,891	14,641
Cash and cash equivalents	20	51,981	41,761
		<u>105,872</u>	<u>56,402</u>
Current liabilities			
Trade and other payables	21	3,754	1,211
Bank loans	22	13,664	–
		<u>17,418</u>	<u>1,211</u>
Net current assets		<u>88,454</u>	<u>55,191</u>
Total assets less current liabilities		<u>337,546</u>	<u>304,161</u>
Non-current liabilities			
Bank loans	22	26,524	–
NET ASSETS		<u>311,022</u>	<u>304,161</u>
CAPITAL AND RESERVES			
Share capital	26(a)	20,800	20,800
Reserves	26(g)	290,222	283,361
TOTAL EQUITY		<u>311,022</u>	<u>304,161</u>

Approved and authorised for issue by the Board on 27 March 2007.

Zheng Fan

Ni Zheng

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Directors

The notes on pages 44 to 94 form part of these financial statements.



Consolidated Statement of Changes in Equity

for the year ended 31 December 2006
(Expressed in Renminbi)

		Attributable to equity shareholders of the Company											
	Note	Registered/ issued capital RMB'000 (note 26(a))	Share premium RMB'000 (note 26(b))	Contributed surplus RMB'000 (note 26(b))	Merger reserve RMB'000 (note 26(c))	Capital reserve RMB'000 (note 26(d))	Exchange reserve RMB'000	General reserve fund RMB'000 (note 26(e))	Enterprise expansion fund RMB'000 (note 26(f))	Retained profits RMB'000	Total RMB'000	Minority Interests RMB'000	Total RMB'000
At 1 January 2005, as previously reported		122,345	–	–	24,757	20,828	–	25,790	5,366	50,057	249,143	1,406	250,549
Adjusted for the Acquisition	1(c)	–	–	9,387	–	–	–	–	–	–	9,387	–	9,387
Issuance of shares	26(a)	1	–	–	–	–	–	–	–	–	1	–	1
Arising from the Reorganisation	26(b)	(122,345)	–	197,991	–	–	–	–	–	(50,057)	25,589	–	25,589
Special dividend declared in respect of the previous year	11(b)	–	–	(50,057)	–	–	–	–	–	–	(50,057)	–	(50,057)
Capitalisation issue	26(a)	15,599	(15,599)	–	–	–	–	–	–	–	–	–	–
Issuance of shares for placing and public offering	26(a)	5,200	62,400	–	–	–	–	–	–	–	67,600	–	67,600
Share issuing costs		–	(16,837)	–	–	–	–	–	–	–	(16,837)	–	(16,837)
Profit for the year		–	–	–	–	–	–	–	–	40,089	40,089	285	40,374
Transfer from retained profits to reserve in respect of the Acquisition		–	–	(814)	–	–	–	–	–	814	–	–	–
Transfer to reserves		–	–	–	–	–	–	2,911	–	(2,911)	–	–	–
Exchange differences on translation of financial statements		–	–	–	–	–	(958)	–	–	–	(958)	–	(958)
At 31 December 2005, as restated		20,800	29,964	156,507	24,757	20,828	(958)	28,701	5,366	37,992	323,957	1,691	325,648
At 1 January 2006, as previously reported		20,800	29,964	147,934	24,757	20,828	(958)	28,701	5,366	37,992	315,384	1,691	317,075
Adjusted for the acquisition	1(c)	–	–	8,573	–	–	–	–	–	–	8,573	–	8,573
At 1 January 2006, as restated		20,800	29,964	156,507	24,757	20,828	(958)	28,701	5,366	37,992	323,957	1,691	325,648
Profit for the year		–	–	–	–	–	–	–	–	32,999	32,999	308	33,307
Transfer to reserves		–	–	–	–	–	–	2,430	–	(2,430)	–	–	–
Equity settled share-based transaction	24	–	–	–	–	4,558	–	–	–	–	4,558	–	4,558
Exchange differences on translation of financial statements		–	–	–	–	–	(332)	–	–	–	(332)	–	(332)
Dividend approved in respect of previous year	11(b)	–	–	–	–	–	–	–	–	(16,224)	(16,224)	–	(16,224)
Acquisition of minority interest of a subsidiary	17(iii)	–	–	–	–	–	–	–	–	–	–	(300)	(300)
Consideration of the acquisition	1(c)	–	–	(8,796)	–	–	–	–	–	–	(8,796)	–	(8,796)
At 31 December 2006		20,800	29,964	147,711	24,757	25,386	(1,290)	31,131	5,366	52,337	336,162	1,699	337,861

The notes on pages 44 to 94 form part of these financial statements.



Consolidated Cash Flow Statement

for the year ended 31 December 2006
(Expressed in Renminbi)

	Note	2006 RMB'000	2005 (restated) (Note 1(c)) RMB'000
Operating activities			
Profit before taxation		39,277	45,814
Adjustments for:			
– Depreciation and amortisation		27,293	26,681
– Interest income		(2,935)	(1,443)
– Loss/(gain) on disposal of property, plant and equipment		6	(122)
– Equity settled share-based payment expenses		4,558	–
– Interest expense		3,552	2,480
Operating profit before changes in working capital		71,751	73,410
Decrease/(increase) in inventories		9,406	(4,242)
Decrease in trade and other receivables		7,603	39,824
Increase/(decrease) in trade and other payables		30,893	(4,954)
Cash generated from operations		119,653	104,038
PRC tax paid		(5,576)	(7,306)
Interest paid		(3,552)	(2,480)
Net cash generated from operating activities		110,525	94,252
Investing activities			
Payment for purchase of property, plant and equipment		(4,909)	(12,302)
Proceeds from disposal of property, plant and equipment		21	276
Payment for construction in progress		(30,970)	(10,969)
Interest received		2,935	1,443
Consideration for the acquisition	1(c)	(8,796)	–
Lease prepayment		(9,118)	–
Acquisition of minority interest of a subsidiary		(300)	–
Decrease in pledged deposits		–	4,091
Net cash used in investing activities		(51,137)	(17,461)

The notes on pages 44 to 94 form part of these financial statements.



Consolidated Cash Flow Statement

for the year ended 31 December 2006
(Expressed in Renminbi)

	Note	2006 RMB'000	2005 (restated) (Note 1(c)) RMB'000
Financing activities			
Net proceeds from issuance of shares by placing and public offering		–	50,764
Proceeds from new bank loans		77,600	98,227
Dividends paid to the equity shareholders of the Company/the then equity holders		(16,224)	(83,983)
Repayment of bank loans		(44,474)	(111,872)
Proceeds from capital injection from intermediate holding company	1(c)	–	9,387
Net cash used in financing activities		16,902	(37,477)
Net increase in cash and cash equivalents		76,290	39,314
Cash and cash equivalents at 1 January		97,951	59,595
Effect of foreign exchange rate changes		(2,081)	(958)
Cash and cash equivalents at 31 December	20	172,160	97,951



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

1 COMPANY BACKGROUND AND BASIS OF PRESENTATION

(a) Reorganisation

The Company was incorporated in the Cayman Islands on 28 February 2005 as an exempted company with limited liability under the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands.

Pursuant to a reorganisation (the "Reorganisation") of the Company and its subsidiaries (the "Group") which was completed on 29 July 2005 to rationalise the Group's structure in preparation for the public listing of its shares on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), the Company became the holding company of the subsidiaries comprising the Group.

The Company's shares were listed on the Stock Exchange on 2 November 2005.

(b) Basis of presentation

The Group is regarded as a continuing entity resulting from the Reorganisation. In accordance with Accounting Guideline 5 ("AG 5") "Merger Accounting for Common Control Combination" issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), the consolidated financial statements have been prepared on the basis that the Company was the holding company of the Group since 1 January 2005, rather than from 29 July 2005. The results of the Group for the year ended 31 December 2005 included the results of the Company and its subsidiaries with effect from their respective dates of incorporation, whichever is a shorter period as if the current group structure had been in existence since 1 January 2005. Pursuant to AG 5, remaining goodwill of RMB24,937,000 arising on the original acquisition of the subsidiaries as recorded in the controlling party's financial statements has been recognised in these financial statements. In the opinion of the directors, the consolidated financial statements prepared on this basis present fairly the results of operations and state of affairs of the Group as a whole.

(c) Acquisition of Grand Signal Limited

On 20 January 2006, the Group acquired 100% interest in Grand Signal Limited ("Grand Signal") from its intermediate holding company, Overseas Chinese Town (HK) Company Limited ("OCT(HK)"), at a cash consideration of HK\$8,457,000 (RMB8,796,000 equivalent) (hereinafter referred to as the "Acquisition"). Grand Signal is an investment holding company and its sole subsidiary, Anhui Huali Packaging Company Limited ("Anhui Huali") (formerly known as Anhui Huali Industrial Products Manufacturing Company Limited), engages in the manufacture and sale of paper boxes and products in the People's Republic of China (the "PRC").



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

1 COMPANY BACKGROUND AND BASIS OF PRESENTATION *(continued)*

(c) Acquisition of Grand Signal Limited *(continued)*

Anhui Huali was established on 9 June 2004 with a capital injection of HK\$9,000,000 (RMB9,387,000 equivalent) from OCT(HK) via Grand Signal on 23 August 2005.

As the Group, Grand Signal and Anhui Huali (the "Acquired Group") have been under the common control of OCT(HK), the Acquisition is reflected in the consolidated financial statements using the principles of merger accounting under AG 5. Accordingly, the assets and liabilities of the Acquired Group have been accounted for at historical amounts and the consolidated financial statements of the Company prior to the Acquisition have been restated to include the result of operations and assets and liabilities of the Acquired Group on a combined basis. The consideration paid by the Group for the Acquisition has been accounted for as an equity transaction in the consolidated statement of changes in equity for the year ended 31 December 2006.

The financial condition and results of operations previously reported by the Group as at 31 December 2005 and for the year ended 31 December 2005 have been restated to include the financial condition and results of the Acquired Group as set out below:

	The Group (without the Acquired Group) RMB'000	The Acquired Group RMB'000	Combined RMB'000
Results of operations for the year ended 31 December 2005:			
Turnover	662,243	–	662,243
Profit/(loss) from operations	49,108	(814)	48,294
Profit/(loss) for the year	41,188	(814)	40,374
Earnings/(loss) per share			
– Basic and diluted (in RMB)	0.26	(0.01)	0.25
Financial condition as at 31 December 2005:			
Current assets	310,983	3,273	314,256
Total assets	538,908	15,746	554,654
Total liabilities	221,833	7,173	229,006
Net assets	317,075	8,573	325,648



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs"), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs") and Interpretations issued by the HKICPA, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. These financial statements also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on the Stock Exchange. A summary of the significant accounting policies adopted by the Group is set out below.

(b) Basis of preparation of the financial statements

The consolidated financial statements for the year ended 31 December 2006 comprise the company and its subsidiaries (together referred to as the "Group").

The measurement basis used in the preparation of the financial statements is the historical cost basis.

The preparation of financial statements in conformity with HKFRSs requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of HKFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 33.

(c) Subsidiaries and minority interests

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(c) Subsidiaries and minority interests *(continued)*

An investment in a subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date control ceases. Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Minority interests represent the portion of the net assets of subsidiaries attributable to interests that are not owned by the Company, whether directly or indirectly through subsidiaries, and in respect of which the Group has not agreed any additional terms with the holders of those interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meets the definition of a financial liability. Minority interests are presented in the consolidated balance sheet within equity, separately from equity attributable to the equity shareholders of the Company. Minority interests in the results of the Group are presented on the face of the consolidated income statement as an allocation of the total profit or loss for the year between minority interests and the equity shareholders of the Company.

Where losses applicable to the minority exceed the minority's interest in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Group's interest is allocated all such profits until the minority's share of losses previously absorbed by the Group has been recovered.

In the Company's balance sheet, an investment in a subsidiary is stated at cost less impairment losses (see note 2(h)).

(d) Goodwill

Goodwill represents the excess of the cost of a business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (see note 2(h)).

Any excess of the Group's interest in the fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of business combination is recognised immediately in profit or loss.

On disposal of a cash generating unit, any attributable amount of purchased goodwill is included in the calculation of profit or loss on disposal.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(e) Property, plant and equipment

- (i) Property, plant and equipment are stated in the balance sheet at cost less accumulated depreciation and impairment losses (see note 2(h)). The cost of an asset comprises its purchase price, any directly attributable costs of bringing the asset to working condition and location for its intended use, the cost of borrowed funds used during the year of construction and, when relevant, the costs of dismantling and removing the items and restoring the site on which they are located, and changes in the measurement of existing liabilities recognised for these costs resulting from changes in the timing or outflow of resources required to settle the obligation or from changes in the discount rate.

- (ii) The Group recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. All other costs are recognised in the income statement as an expense as incurred.

- (iii) Depreciation is calculated to write off the cost of items of property, plant and equipment, less their estimated residual value, if any, using the straight-line method over their estimated useful lives as follows:

Buildings	10 to 40 years
Plant and machinery	5 to 10 years
Motor vehicles	3 years
Other property, plant and equipment	3 to 5 years

- (iv) Gains or losses arising from the retirement or disposal of an item of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in profit or loss on the date of retirement or disposal.

- (v) Construction in progress represents items of property, plant and equipment under construction and pending installation and is stated in the balance sheet at cost less impairment losses (see note 2(h)). Cost comprises all direct and indirect costs, including interest changes (see note 2(s)) related to acquisition and installation of the property, plant and equipment, incurred before the asset is substantially ready for its intended use.

Capitalisation of these costs ceases and the construction in progress is transferred to the property, plant and equipment when the asset is substantially ready for its intended use.

No depreciation is provided in respect of construction in progress.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(f) Operating lease charges

Leases of assets under which the lessor has not transferred all the risks and benefits of ownership to the Group are classified as operating leases.

Where the Group has the use of assets under operating leases, payments made under the leases are charged to profit or loss in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in profit or loss as an integral part of the aggregate net lease payments made. Contingent rentals are charged to profit or loss in the accounting period in which they are incurred.

(g) Lease prepayments

Lease prepayments represent amounts paid for land use rights in the PRC. Land use rights are carried at cost and amortised on a straight-line basis over the respective periods of the rights which range from 30 to 50 years.

(h) Impairment of assets

(i) *Impairment of trade and other receivables*

Trade and other receivables that are stated in the balance sheet at cost or amortised cost are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, any impairment loss is determined and recognised as follows.

- For trade and other receivables carried at cost, the impairment loss is measured as the difference between the carrying amount of the financial asset and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material.
- For trade and other receivables carried at amortised cost, the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows, discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets), where the effect of discounting is material.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through profit and loss. A reversal of an impairment loss shall not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(h) Impairment of assets *(continued)*

(ii) *Impairment of other assets*

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

- property, plant and equipment;
- construction in progress
- lease prepayments;
- investments in subsidiaries; and
- goodwill.

If any such indication exists, the asset's recoverable amount is estimated. In addition, for goodwill, the recoverable amount is estimated annually whether or not there is any indication of impairment.

- Calculation of recoverable amount

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

- Recognition of impairment losses

An impairment loss is recognised in profit or loss whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (group of units) and then, to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less cost to sell, or value in use, if determinable.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(h) Impairment of assets *(continued)*

(ii) *Impairment of other assets (continued)*

- Reversals of impairment losses

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to profit or loss in the year in which the reversals are recognised.

(i) Inventories

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

Cost is calculated using the weighted average cost formula and comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

When the inventories are sold, the carrying amount of those 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 any write-down of inventories is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

(j) Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less impairment loss for bad and doubtful debts (see note 2(h)), except where the receivables are interest-free advances made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less impairment losses for bad and doubtful debts (see note 2(h)).



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(k) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between the amount initially recognised and redemption value being recognised in profit or loss over the period of borrowings, together with any interest and fee payable, using the effective interest method.

(l) Trade and other payables

Trade and other payables are initially recognised at fair value and subsequently stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(m) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

(n) Employee benefits

(i) *Short term employee benefits and contributions to defined contribution retirement plans*

Salaries, annual bonuses, paid annual leave, contributions to defined contribution retirement plans and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

(ii) *Share based payments*

The fair value of share options granted to employees is recognised as an employee cost with a corresponding increase in a capital reserve within equity. The fair value is measured at grant date using the Black-Scholes option pricing model, taking into account the terms and conditions upon which the options were granted. Where the employees have to meet vesting conditions before becoming unconditionally entitled to the options, the total estimated fair value of the options is spread over the vesting period, taking into account the probability that the options will vest.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(n) Employee benefits *(continued)*

(ii) Share based payments *(continued)*

During the vesting period, the number of share options that is expected to vest is reviewed. Any adjustment to the cumulative fair value recognised in prior years is charged/credited to the profit or loss for the year of the review, unless the original employee expenses qualify for recognition as an asset, with a corresponding adjustment to the capital reserve. On vesting date, the amount recognised as an expense is adjusted to reflect the actual number of options that vest (with a corresponding adjustment to the capital reserve) except where forfeiture is only due to not achieving vesting conditions that relate to the market price of the Company's share. The equity amount is recognised in the capital reserve until either the option is exercised (when it is transferred to the share premium account) or the option expires (when it is released directly to retained profits).

(iii) Termination benefits

Termination benefits are recognised when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

(o) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in profit or loss except to the extent that they relate to items recognised directly in equity, in which case they are recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(o) **Income tax** *(continued)*

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary differences or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination), and temporary differences relating to investments in subsidiaries to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed by the Group at each balance sheet date and is reduced to the extent that the Group is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(o) Income tax *(continued)*

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities, if the Company or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Company or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
 - the same taxable entity; or
 - different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

(p) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Company has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditures expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(q) Revenue recognition

Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in profit or loss as follows:

(i) *Sales of goods*

Revenue is recognised when goods are delivered at the customers' premises, which is taken to be the point in time when the customer has accepted the goods and the related risks and rewards of ownership. Revenue excludes value added tax or other sales taxes and is after deduction of any trade discounts.

(ii) *Interest income*

Interest income is recognised as it accrues using the effective interest method.

(iii) *Government grants*

Government grants are recognised in the balance sheet initially when there is reasonable assurance that they will be received and that the Group will comply with the conditions attaching to them. Grants that compensate the Group for expenses incurred are recognised as revenue in profit or loss on a systematic basis in the same period in which the expenses are incurred. Grants that compensate the Group for the cost of an asset are deducted in arriving at the carrying amount of the asset and consequently are recognised in profit or loss over the useful life of the asset.

(r) Translation of foreign currencies

Foreign currency transactions during the year are translated at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rates ruling at the balance sheet date. Exchange gains and losses are recognised in profit or loss.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates.

The results of foreign operations are translated into Renminbi at the exchange rates approximating the foreign exchange rates ruling at the dates of the transactions. Balance sheet items are translated into Renminbi at the foreign exchange rates ruling at the balance sheet date. The resulting exchange differences are recognised directly in a separate component of equity.

On disposal of a foreign operation, the cumulative amount of the exchange differences recognised in equity which relate to that foreign operation is included in the calculation of the profit or loss on disposal.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(s) Borrowing costs

Borrowing costs are expensed in profit or loss in the period in which they are incurred, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

The capitalisation of borrowing costs as part of the cost of a qualifying asset commences when expenditure for the asset is being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalisation of borrowing costs is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are interrupted or complete.

(t) Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if:

- (i) the party has the ability, directly or indirectly through one or more intermediaries, to control the Group or exercise significant influence over the Group in making financial and operating policy decisions, or has joint control over the Group;
- (ii) the Group and the party are subject to common control;
- (iii) the party is an associate of the Group or a joint venture in which the Group is a venturer;
- (iv) the party is a member of key management personnel of the Group or the Group's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;
- (v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or
- (vi) the party is a post-employment benefit plan which is for the benefit of employees of the Group or of any entity that is a related party of the Group.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

(u) Segment reporting

The directors consider the Group operates within a single business and geographical segment. Accordingly, no segment information is provided.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

3 NEW AND REVISED HKFRSs

The HKICPA has issued certain new and revised HKFRSs that are first effective or available for early adoption for the current accounting period of the Group. The adoption of these new and revised HKFRSs did not result in significant changes to the Group's accounting policies applied in these financial statements for the periods presented.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 34).

4 TURNOVER

The principal activity of the Group is the manufacture and sale of paper boxes and products. Turnover represents the sales value of goods supplied to customers, net of value-added tax.

5 OTHER REVENUE AND NET LOSS

(a) Other revenue

	2006 RMB'000	2005 RMB'000
Interest income	2,935	1,443
Sale of scrap paper	17,851	18,615
Sale of materials	1,307	516
Government grants (note i)	—	732
Others	451	213
	<u>22,544</u>	<u>21,519</u>

Note: (i) Subsidies were received from local government on loan interest incurred for purchase of property, plant and equipment in 2005.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

5 OTHER REVENUE AND NET LOSS *(continued)*

(b) Other net loss

	2006 RMB'000	2005 RMB'000
(Loss)/gain on disposal of property, plant and equipment	(6)	122
Exchange loss	(3,400)	(1,576)
Others	12	30
	<u>(3,394)</u>	<u>(1,424)</u>

6 PROFIT BEFORE TAXATION

Profit before taxation is arrived at after charging:

	2006 RMB'000	2005 (restated) RMB'000
(a) Finance costs:		
Interest on bank loans	<u>3,552</u>	<u>2,480</u>
(b) Staff costs:		
Salaries, wages and other benefits	51,847	47,092
Contributions to defined contribution retirement schemes (note 23)	3,579	2,903
Equity-settled share-based payment expenses	<u>4,558</u>	<u>—</u>
	<u>59,984</u>	<u>49,995</u>



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

6 PROFIT BEFORE TAXATION *(continued)*

(c) Other items:

	2006	2005
	RMB'000	(restated) RMB'000
Amortisation of lease prepayments [#]	579	579
Depreciation of property, plant and equipment [#]	26,714	26,102
Impairment losses on trade and other receivables	516	961
Auditors' remuneration		
– audit services	1,770	1,565
– tax services	8	26
Operating lease charges in respect of land and properties [#]	7,749	6,409
Exchange loss	3,400	1,576
Cost of inventories [#]	<u>608,548</u>	<u>583,255</u>

[#] Cost of inventories included RMB68,122,000 (2005: RMB62,510,000) relating to staff costs, depreciation and amortisation expenses and operating lease charges, amount of which is also included in the respective total amounts disclosed separately in notes 6(b) and 6(c) for each of these types of expenses.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

7 INCOME TAX IN THE CONSOLIDATED INCOME STATEMENT

(a) Taxation in the consolidated income statement represents:

	2006 RMB'000	2005 RMB'000
Current tax – Provision for PRC income tax		
Provision for the year	6,488	6,349
Over-provision in respect of prior years	—	(61)
	<u>6,488</u>	<u>6,288</u>
Deferred tax		
Origination and reversal of temporary differences (note 25(b))	<u>(518)</u>	<u>(848)</u>
	<u>5,970</u>	<u>5,440</u>

Pursuant to the income tax rules and regulations of the PRC, taxation for PRC subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant cities in the PRC, which range between 15%-33% (2005: 15%-33%). Certain subsidiaries are entitled to a tax concession period in which it is fully exempted from PRC income tax for 2 years starting from its first profit-making year, followed by a 50% reduction in the PRC income tax for the next 3 years.

Pursuant to the rules and regulations of the Cayman Islands and the British Virgin Islands, the Group is not subject to any income tax in the Cayman Islands and the British Virgin Islands during the year (2005: Nil).

No provision for Hong Kong Profits Tax has been made as the Group did not have any assessable profits subject to Hong Kong Profits Tax during the year (2005: Nil).



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

7 INCOME TAX IN THE CONSOLIDATED INCOME STATEMENT *(continued)*

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2006	2005
	RMB'000	(restated) RMB'000
Profit before taxation	39,277	45,814
Notional tax on profit before taxation, calculated at the rates applicable to profits in the tax jurisdictions concerned	6,436	7,872
Tax effect of non-deductible expenses	451	577
Tax effect of non-taxable income	(443)	(175)
Tax effect of prior year's unrecognised tax losses utilised	–	(1,357)
Tax effect of unused tax losses not recognised	3,042	268
Over-provision in prior years	–	(61)
Effect of tax concessions	(3,516)	(1,684)
Actual tax expense	5,970	5,440



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

8 DIRECTORS' REMUNERATION

Directors' remuneration is as follows:

	Directors' fees	Salaries, allowances and benefits in kind	Discretionary bonuses	Retirement schemes contributions	Sub-total	Share-based payments (note)	2006 Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Executive Directors:							
– Zheng Fan	–	–	–	–	–	–	–
– Ni Zheng	–	329	–	17	346	473	819
– Zhou Guangneng	–	294	–	12	306	401	707
– Liu Danlin	–	117	–	12	129	401	530
Non-Executive Directors:							
– Xie Mei	–	–	–	–	–	–	–
Independent Non-Executive Directors:							
– Lee Kit Wah	122	–	–	–	122	–	122
– Chen Xiangdong	–	–	–	–	–	–	–
– Xiao Yongping	122	–	–	–	122	–	122
	<u>244</u>	<u>740</u>	<u>–</u>	<u>41</u>	<u>1,025</u>	<u>1,275</u>	<u>2,300</u>

	Directors' fees	Salaries, allowances and benefits in kind	Discretionary bonuses	Retirement schemes contributions	2005 Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Executive Directors:					
– Zheng Fan	–	–	–	–	–
– Ni Zheng	–	150	–	15	165
– Zhou Guangneng	–	150	–	12	162
Non-Executive Directors:					
– Xie Mei	–	–	–	–	–
Independent Non-Executive Directors:					
– Lee Kit Wah	21	–	–	–	21
– Chen Xiangdong	–	–	–	–	–
– Xiao Yongping	21	–	–	–	21
	<u>42</u>	<u>300</u>	<u>–</u>	<u>27</u>	<u>369</u>



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

8 DIRECTORS' REMUNERATION *(continued)*

Note: These represent the estimated value of share options granted to the directors under the Company's share option scheme. The value of these share options is measured according to the Group's accounting policies for share-based payment transactions as set out in note 2(n)(ii).

The details of these benefits in kind, including the principal terms and number of options granted, are disclosed under the paragraph "share options scheme" in the directors' report and note 24.

9 INDIVIDUALS WITH HIGHEST EMOLUMENTS

Of the five individuals with the highest emoluments, two (2005: none) are directors whose emoluments are disclosed in note 8. The aggregate of the emoluments in respect of the other three (2005: five) individuals are as follows:

	2006 RMB'000	2005 RMB'000
Salaries and other emoluments	1,051	702
Discretionary bonuses	396	353
Share-based payments	992	—
Retirement schemes contributions	62	129
	<u>2,501</u>	<u>1,184</u>

The emoluments of the three (2005: five) individuals with the highest emoluments are within the band from HK\$Nil to HK\$1,000,000.

10 PROFIT ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY

The consolidated profit attributable to equity shareholders of the Company includes a loss of RMB15,072,000 (2005: profit of RMB4,427,000) which has been dealt with in the financial statements of the Company.

Reconciliation of the above amount to the Company's profit for the year:

	2006 RMB'000	2005 RMB'000
Amount of consolidated profit attributable to equity shareholders dealt with in the company's financial statements	(15,072)	4,427
Final dividends from subsidiaries attributable to the profits of the previous financial year, approved and paid during the year	<u>33,599</u>	<u>—</u>
Company's profit for the year (note 26(g))	<u>18,527</u>	<u>4,427</u>



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

11 DIVIDENDS

(a) Dividends payable to equity shareholders of the Company attributable to the year

	2006 RMB'000	2005 RMB'000
Final dividend proposed after the balance sheet date of HK\$6.40 cents per share (equivalent to RMB6.337 cents per share) (2005: HK\$7.8 cents per share (equivalent to RMB8.112 cents per share))	<u>12,675</u>	<u>16,224</u>

Final dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date.

(b) Dividends payables to equity shareholders of the Company attributable to the previous financial year, approved and paid during the year

	2006 RMB'000	2005 RMB'000
Special dividend in respect of the previous financial year, approved and paid during 2005	–	50,057
Final dividend in respect of the previous financial year, approved and paid during the year, of HK\$7.8 cents per share (equivalent to RMB8.112 cents per share) (2005: Nil)	<u>16,224</u>	<u>–</u>
	<u>16,224</u>	<u>50,057</u>

Special dividend of RMB50,057,000 was declared by the Company on 2 September 2005 to the then shareholders in respect of the profit of the Group generated prior to the Reorganisation. It was distributed from the contributed surplus account of the Company.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

12 EARNINGS PER SHARE

(a) Basic earnings per share

The calculation of basic earnings per share is based on the profit attributable to equity shareholders of the Company of RMB32,999,000 (2005 (restated): RMB40,089,000) and the weighted average of 200,000,000 (2005: 158,219,178) ordinary shares in issue during the year, calculated as follows:

Weighted average number of ordinary shares

	2006 No. of shares	2005 No. of shares
Ordinary shares issued at 1 January (note 26(a))	200,000,000	–
Issuance of new shares (note 26(a)(iii))	–	10,000
Capitalisation issue (note 26(a)(iv))	–	149,990,000
Effect of issuance of shares for placing and public offering (note 26(a)(v))	–	8,219,178
	<u>200,000,000</u>	<u>158,219,178</u>
Weighted average number of shares at 31 December	<u>200,000,000</u>	<u>158,219,178</u>

(b) Diluted earnings per share

The calculation of diluted earnings per share is based on the profit attributable to equity shareholders of the Company of RMB32,999,000 (2005 (restated): RMB40,089,000) and the weighted average of 208,252,699 (2005: 158,219,178) ordinary shares (diluted), calculated as follows:

Weighted average number of ordinary shares (diluted)

	2006
Weighted average number of ordinary shares at 31 December	200,000,000
Effect of deemed issue of shares under the Company's share option scheme for nil consideration (note 24)	8,252,699
	<u>208,252,699</u>
Weighted average number of ordinary shares (diluted) at 31 December	<u>208,252,699</u>

There were no dilutive potential ordinary shares in issue during the year ended 31 December 2005.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

13 PROPERTY, PLANT AND EQUIPMENT

The Group

	Buildings RMB'000	Plant and machinery RMB'000	Motor vehicles RMB'000	Other property, plant and equipment RMB'000	Total RMB'000
Cost:					
At 1 January 2005	71,107	256,164	19,445	17,367	364,083
Additions (restated)	437	591	1,289	1,766	4,083
Transfer from construction in progress (restated) (note 14)	505	3,240	327	621	4,693
Disposals	(301)	—	(984)	(159)	(1,444)
At 31 December 2005 (restated)	<u>71,748</u>	<u>259,995</u>	<u>20,077</u>	<u>19,595</u>	<u>371,415</u>
At 1 January 2006 (restated)	71,748	259,995	20,077	19,595	371,415
Additions	—	3,558	911	2,492	6,961
Transfer from construction in progress (note 14)	11,073	4,428	596	573	16,670
Disposals	—	(111)	(795)	(519)	(1,425)
At 31 December 2006	<u>82,821</u>	<u>267,870</u>	<u>20,789</u>	<u>22,141</u>	<u>393,621</u>
Accumulated depreciation and impairment loss:					
At 1 January 2005	20,542	118,629	14,756	9,670	163,597
Charge for the year (restated)	3,558	18,027	1,572	2,945	26,102
Written back on disposal	(162)	—	(984)	(144)	(1,290)
At 31 December 2005 (restated)	<u>23,938</u>	<u>136,656</u>	<u>15,344</u>	<u>12,471</u>	<u>188,409</u>
At 1 January 2006 (restated)	23,938	136,656	15,344	12,471	188,409
Charge for the year	4,045	18,549	1,594	2,526	26,714
Written back on disposal	—	(111)	(791)	(484)	(1,386)
At 31 December 2006	<u>27,983</u>	<u>155,094</u>	<u>16,147</u>	<u>14,513</u>	<u>213,737</u>
Net book value:					
At 31 December 2006	<u>54,838</u>	<u>112,776</u>	<u>4,642</u>	<u>7,628</u>	<u>179,884</u>
At 31 December 2005 (restated)	<u>47,810</u>	<u>123,339</u>	<u>4,733</u>	<u>7,124</u>	<u>183,006</u>

All of the Group's buildings are located in the PRC.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

13 PROPERTY, PLANT AND EQUIPMENT *(continued)*

The Company

Other property, plant and equipment RMB'000

Cost:

As at 1 January 2006	—
Addition	147
As at 31 December 2006	147

Accumulated depreciation:

As at 1 January 2006	—
Charge for the year	25
As at 31 December 2006	25

Net book value:

As at 31 December 2006	122
As at 1 January 2006	—

14 CONSTRUCTION IN PROGRESS

The Group

2006	2005 (restated)
RMB'000	RMB'000

Cost:

At 1 January	9,506	766
Additions	27,602	13,433
Transfer to property, plant and equipment (note 13)	(16,670)	(4,693)
At 31 December	20,438	9,506

Construction in progress at 31 December 2006 mainly represented the construction and development of production facilities at Anhui Huali.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

15 GOODWILL

The Group

RMB'000

Cost:

At 1 January 2005, 31 December 2005 and
31 December 2006 (note 1)

24,937

Impairment test for cash-generating units containing goodwill

Goodwill is allocated to the Group's cash-generating units ("CGU") identified according to the manufacturing base as follows:

	2006 RMB'000	2005 RMB'000
Shanghai	1,012	1,012
Shenzhen	23,925	23,925
	<u>24,937</u>	<u>24,937</u>

The recoverable amount of the above CGU is determined based on value-in-use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimate rates stated below. The growth rate does not exceed the long-term average growth rate for the business in which the CGU operates.

Key assumptions used for value-in-use calculations:

	2006 %	2005 %
Gross margin	12	12
Growth rate	8	8
Discount rate	5	5

Management determined the budgeted gross margin based on past performance and its expectation for market development. The weighted average growth rates used are consistent with the forecasts included in industry reports. The discount rates used are pre-tax and reflect specific risks relating to the paper packaging industry.

16 LEASE PREPAYMENTS

Leasehold land of the Group is held in the PRC. At 31 December 2006, the remaining lease terms of these pieces of land range from 21 to 47 years.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

17 INVESTMENTS IN SUBSIDIARIES

	The Company	
	2006	2005
	RMB'000	RMB'000
Unlisted shares, at cost	248,970	248,970

Details of the subsidiaries at 31 December 2006 are as follows. The class of shares held is ordinary.

Name of company	Place of incorporation/ establishment	Particular of registered/ issued capital	Proportion of ownership interest			Principal activities
			Group's effective interest	Held by the Company	Held by a subsidiary	
Max Surplus Limited ("Max Surplus")	British Virgin Islands ("BVI")	1 share of US\$1 each	100%	100%	–	Investment holding
Forever Galaxies Limited	BVI	1 share of US\$1 each	100%	–	100%	Investment holding
Fortune Crown International Limited	BVI	1 share of US\$1 each	100%	–	100%	Investment holding
Miracle Stone Development Limited	BVI	1 share of US\$1 each	100%	–	100%	Investment holding
Mission Holdings Services Limited	BVI	1 share of US\$1 each	100%	–	100%	Investment holding
Grand Signal Limited (note1(c))	BVI	1 share of US\$1 each	100%	–	100%	Investment holding
Huali Holdings Company Limited	Hong Kong	1,000,000 share of HK\$1 each	100%	–	100%	Investment holding
Shenzhen Huali Packing & Trading. Co., Ltd ("Shenzhen Huali") (note (i))	PRC	Paid-up capital of HK\$40,000,000	100%	–	100%	Manufacture and sale of paper boxes and products



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

17 INVESTMENTS IN SUBSIDIARIES (continued)

Name of company	Place of incorporation/ establishment	Particular of registered/ issued capital	Proportion of ownership interest			Principal activities
			Group's effective interest	Held by the Company	Held by a subsidiary	
Mudanjiang Huali Packaging Co., Ltd. ("Mudanjiang Huali") (note (ii))	PRC	Paid-up capital of RMB10,000,000	85%	–	85%	Manufacture and sale of paper boxes and products
Shanghai Huali Packaging Co., Ltd. ("Shanghai Huali") (note (i))	PRC	Paid-up capital of RMB55,000,000	100%	–	100%	Manufacture and sale of paper boxes and products
Zhongshan Huali Packaging & Trading Co., Ltd. ("Zhongshan Huali") (note (i))	PRC	Paid-up capital of HK\$40,000,000	100%	–	100%	Manufacture and sale of paper boxes and products
Anhui Huali Packaging Co., Ltd. ("Anhui Huali") (note (i))	PRC	Paid-up capital of HK\$40,000,000	100%	–	100%	Manufacture and sale of paper boxes and products
Shenzhen Huayou Packaging Co., Ltd. ("Shenzhen Huayou") (note (iii))	PRC	Paid-up capital of RMB3,000,000	100%	–	100%	Manufacture and sale of paper boxes and products

Notes:

- (i) These companies are wholly foreign-owned enterprises established in the PRC.
- (ii) This company is an equity joint venture established in the PRC.
- (iii) On 20 January 2006, the Group acquired 10% interest in Shenzhen Huayou at a cash consideration of RMB300,000 from the minority shareholder. After the acquisition, Shenzhen Huayou has become a wholly-owned subsidiary of the Group. Shenzhen Huayou is an equity joint venture established in the PRC.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

18 INVENTORIES

(a) Inventories in the balance sheet comprise:

	The Group	
	2006	2005
	RMB'000	RMB'000
Raw materials	51,156	64,211
Work-in-progress	2,426	2,081
Finished goods	9,623	6,470
Spare parts	570	419
	<u>63,775</u>	<u>73,181</u>

(b) The analysis of the amount of inventories recognised as an expense is as follows:

	The Group	
	2006	2005
	RMB'000	RMB'000
Carrying amount of inventories sold	608,381	583,646
Write down of inventories	385	215
Reversal of write-down inventories	(218)	(606)
	<u>608,548</u>	<u>583,255</u>

The reversal of write-down of inventories made in prior years arose due to an increase in the estimated net realisable value of certain paper cartons as a result of change in customer preference.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

19 TRADE AND OTHER RECEIVABLES

	The Group		The Company	
	2006	2005 (restated)	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000
Amounts due from subsidiaries	—	—	53,861	14,230
Trade receivables	105,467	108,979	—	—
Bills receivable	26,513	30,202	—	—
Prepayment, deposits and other receivables	3,878	3,943	30	411
	135,858	143,124	53,891	14,641

The amounts due from subsidiaries are unsecured, non-interest bearing and have no fixed terms of repayment.

All of the trade and other receivables (including the amounts due from subsidiaries), net of impairment losses for bad and doubtful debts, are expected to be recovered within one year.

Included in trade and other receivables are trade and bills receivables (net of impairment losses for bad and doubtful debts) with the following ageing analysis as of the balance sheet date:

	The Group		The Company	
	2006	2005	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000
Within 3 months	127,807	125,717	—	—
Within 6 months but more than 3 months	4,115	13,224	—	—
Within 12 months but more than 6 months	58	240	—	—
	131,980	139,181	—	—

The Group's credit policy is set out in note 27(a).



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

19 TRADE AND OTHER RECEIVABLES *(continued)*

Included in trade and other receivables are following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group		The Company	
	2006	2005	2006	2005
	'000	'000	'000	'000
Hong Kong Dollars	HKD36,545	HKD 37,900	HKD–	HKD–
United States Dollars	USD 1,835	USD 2,003	USD–	USD–

20 CASH AND CASH EQUIVALENTS

	The Group		The Company	
	2006	2005	2006	2005
		(restated)		
	RMB'000	RMB'000	RMB'000	RMB'000
Cash at bank and in hand	172,160	97,951	51,981	41,761

Included in cash and cash equivalents in the balance sheet are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group		The Company	
	2006	2005	2006	2005
		(restated)		
	'000	'000	'000	'000
Hong Kong Dollars	HKD93,660	HKD59,466	HKD51,154	HKD40,155
United States Dollars	USD 1,418	USD 566	USD 1	USD –



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

21 TRADE AND OTHER PAYABLES

	The Group		The Company	
	2006	2005 (restated)	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000
Trade payables	71,244	58,251	—	—
Bills payable	99,258	85,693	—	—
Other payables	36,415	29,500	3,754	1,211
Amount due to a related party (note 29(b))	92	13,118	—	—
	<u>207,009</u>	<u>186,562</u>	<u>3,754</u>	<u>1,211</u>

All of the trade and other payables are expected to be settled within one year.

Included in trade and other payables are trade creditors and bills payable with the following ageing analysis as of the balance sheet date:

	The Group		The Company	
	2006	2005	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000
Within 3 months or on demand	124,374	142,798	—	—
Over 3 months but less than 1 year	45,934	937	—	—
Over 1 year	194	209	—	—
	<u>170,502</u>	<u>143,944</u>	<u>—</u>	<u>—</u>

Included in trade and other payables are the following amounts denominated in a currency other than the functional currency of the entity to which they related:

	The Group		The Company	
	2006	2005	2006	2005
	'000	'000	'000	'000
Hong Kong Dollars	HKD29,890	HKD10,791	HKD—	HKD—
United States Dollars	USD 1,947	USD 215	USD—	USD—



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

22 BANK LOANS

At 31 December 2006, the bank loans were repayable as follows:

	The Group		The Company	
	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000
Within 1 year or on demand	<u>43,664</u>	<u>38,474</u>	<u>13,664</u>	<u>—</u>
After 1 year but within 2 years	13,664	—	13,664	—
After 2 years but within 5 years	<u>12,860</u>	<u>—</u>	<u>12,860</u>	<u>—</u>
	<u>26,524</u>	<u>—</u>	<u>26,524</u>	<u>—</u>
	<u>70,188</u>	<u>38,474</u>	<u>40,188</u>	<u>—</u>

The Group's short-term bank loans comprise:

		The Group		The Company	
		2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000
Renminbi denominated	Interest rates at 5.3010% to 5.6304% or floating rate at 90% and 95% of PBOC*'s base lending rate per annum with maturities through 24 November 2007	30,000	36,300	—	—
US Dollars denominated	Interest rates at LIBOR** +1.3595% per annum with maturities through 20 March 2006	—	2,174	—	—
		<u>30,000</u>	<u>38,474</u>	<u>—</u>	<u>—</u>
Current portion of long-term bank loan		<u>13,664</u>	<u>—</u>	<u>13,664</u>	<u>—</u>
		<u>43,664</u>	<u>38,474</u>	<u>13,664</u>	<u>—</u>

* People's Bank of China

** London Interbank Offered Rate



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

22 BANK LOANS (continued)

The Group's long-term bank loans comprise:

		The Group		The Company	
		2006	2005	2006	2005
		RMB'000	RMB'000	RMB'000	RMB'000
HK Dollars	Interest rates at HIBOR*	40,188	—	40,188	—
denominated	+1.18% per annum				
	with maturities through				
	2 June 2009				
Less: Current portion of long-term bank loan		(13,664)	—	(13,664)	—
		26,524	—	26,524	—

* Hong Kong Interbank Offered Rate

The bank loans of the Company at 31 December 2006 were guaranteed by its subsidiaries, namely Forever Galaxies Limited, Fortune Crown International Limited and Miracle Stone Development Limited (2005: None). Except for the above, the group and the company did not have secured or guaranteed bank loans at 31 December 2006 (2005: Nil).

All of the Group's banking facilities are subject to the fulfilment of covenants relating to certain of the Group's balance sheet ratios, as are commonly found in lending arrangements with financial institutions. If the Group were to breach the covenants the drawn down facilities would become payable on demand. The Group regularly monitors its compliance with these covenants. Further details of the Group's management of liquidity risk are set out in note 27(b). As at 31 December 2006 none of the covenants relating to drawn down facilities had been breached (2005: RMB Nil).



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

23 EMPLOYEE RETIREMENT BENEFITS

Pursuant to the relevant labour rules and regulations in the PRC, the Group participates in defined contribution retirement benefit schemes (the "Schemes") organised by the relevant local government authorities in Shenzhen, Zhongshan, Shanghai, Anhui and Mudanjiang whereby the Group is required to make contributions to the Schemes at a rate ranging from 8% to 25% of the eligible employees' salaries. The local government authorities are responsible for the entire pension obligations payable to the retired employees.

The Group also operates a Mandatory Provident Fund Scheme ("the MPF scheme") under the Hong Kong Mandatory Provident Fund Schemes Ordinance for employees employed under the jurisdiction of the Hong Kong Employment Ordinance. The MPF scheme is a defined contribution retirement plan administered by independent trustees. Under the MPF scheme, the employer and its employees are each required to make contributions to the plan at 5% of the employees' relevant income, subject to a cap of monthly relevant income of HK\$20,000. Contributions to the plan vest immediately.

The Group has no other material obligation for the payment of pension benefits associated with those schemes beyond the annual contributions described above.

24 EQUITY SETTLED SHARE-BASED TRANSACTION

The Company has a share option scheme which was adopted on 12 October 2005 whereby the directors are authorised, at its absolute discretion and on such terms as it may think fit, grant an employee (full-time or part-time), a director, consultant and adviser of the Group, or any substantial shareholder of the Group, options to subscribe for share of the Company. The share option scheme shall be valid and effective for a period of ten years ending on 11 October 2015, unless terminated earlier by shareholders of the Company in general meetings.

On 7 February 2006, 5,400,000 and 13,900,000 share options were granted to directors and employees of the Company respectively under the Company's share option scheme (no share options were granted for the year ended 31 December 2005). Each option gives the holder the right to subscribe for one ordinary share of HK\$0.1 each of the Company which will be settled by physical delivery of shares. These share options vested immediately from the date of grant, and then be exercisable within a period of ten years. The exercise price is HK\$1.41, as specified in the rules governing the share option scheme, being the higher of (i) the closing price of the shares of the Company on the Stock Exchange on the date of the grant of the options, (ii) the average of the closing prices of the shares on the Stock Exchange for the five business days immediately preceding the date of the grant of the options and (iii) the nominal value of the Company's share of the date of grant of the option. No option was exercised, forfeited or expired during the year. All options granted above were outstanding and exercisable at 31 December 2006 (2005: Nil) with a remaining contractual life of 9 years and 1 month.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

24 EQUITY SETTLED SHARE-BASED TRANSACTION *(continued)*

During the year ended 31 December 2006, the Company recognised RMB4,558,000 in respect of the grant of share options in expenses and equity (2005: Nil).

The fair value of services received in return for share options granted are measured by reference to the fair value of share options granted. The estimate of the fair value of the service received is measured based on Black-Scholes option pricing model.

Fair value of share options and assumptions

Fair value at measurement date (date of grant)	HK\$0.2271
Share price (date of grant)	HK\$1.41
Exercise price	HK\$1.41
Expected volatility	28.30%
Time to maturity	10 years
Expected exercise period by the option holders	2 years
Expected dividends	2.60%
Risk-free interest rate (based on Exchange Fund Notes)	3.89%

The expected volatility is estimated by the annualised standard deviations of the continuously compounded rates of return on return on the comparable listed paper-based packaging companies in Hong Kong. Expected dividends are estimated by the management. There were no market conditions associated with the share option grants. Changes in the subjective input assumptions could materially affect the fair value estimate.

25 INCOME TAX IN THE BALANCE SHEET

(a) Current taxation in the balance sheet represents:

	The Group	
	2006	2005
	RMB'000	RMB'000
Provision for PRC income tax	<u>4,882</u>	<u>3,970</u>



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

25 INCOME TAX IN THE BALANCE SHEET *(continued)*

(b) Deferred tax assets and liabilities recognised:

The Group

The components of deferred tax assets recognised in the consolidated balance sheet and the movements during the year are as follows:

	Accounting depreciation in excess of depreciation allowances RMB'000	Provisions RMB'000	Accrued expenses RMB'000	Pre- operating expenses RMB'000	Total RMB'000
Deferred tax arising from:					
At 1 January 2005	1,158	215	139	–	1,512
Credited to profit or loss	557	65	13	213	848
At 31 December 2005	<u>1,715</u>	<u>280</u>	<u>152</u>	<u>213</u>	<u>2,360</u>
At 1 January 2006	1,715	280	152	213	2,360
Credited/(charged) to profit or loss	560	45	(39)	(48)	518
At 31 December 2006	<u>2,275</u>	<u>325</u>	<u>113</u>	<u>165</u>	<u>2,878</u>



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

26 EQUITY ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY

(a) Share capital

Authorised and issued share capital

	2006		2005	
	No. of shares '000	HK\$'000	No. of shares '000	HK\$'000
Authorised:				
Ordinary shares of HK\$0.1 each (note (ii))	<u>2,000,000</u>	<u>200,000</u>	<u>2,000,000</u>	<u>200,000</u>

Ordinary shares, issued and fully paid:

	No. of shares '000	RMB'000	No. of shares '000	RMB'000
At 1 January	200,000	20,800	–	–
Issuance of shares upon formation and Reorganisation (notes (i) and (iii))	–	–	10	1
Capitalisation issue (note (iv))	–	–	149,990	15,599
Issuance of shares for placing and public offering (note (v))	–	–	50,000	5,200
At 31 December	<u>200,000</u>	<u>20,800</u>	<u>200,000</u>	<u>20,800</u>

Notes:

(i) Issuance of shares upon formation of the Company

The Company was incorporated on 28 February 2005 with an authorised share capital of HK\$390,000 divided into 3,900,000 shares of HK\$0.1 each.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. All ordinary shares rank equally with regard to the Company's residual assets.

On the formation of the Company, 1 nil paid ordinary share was issued to Pacific Climax Limited ("Pacific Climax"), its then sole shareholder.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

26 EQUITY ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY *(continued)*

(a) Share capital *(continued)*

Notes: *(continued)*

(ii) Increase in authorised share capital

At an extraordinary shareholders' meeting held on 12 October 2005, the Company's authorised share capital was increased from HK\$390,000 to HK\$200,000,000 by the creation of an additional 1,996,100,000 ordinary shares of HK\$0.1 each, ranking pari passu with the existing ordinary shares of the Company in all respects.

(iii) Issuance of shares upon Reorganisation

As part of the Reorganisation and as consideration for the acquisition of the entire share capital of Max Surplus, which owns and controls all the operating subsidiaries, the Company (i) allotted and issued, credited as fully paid, a total of 9,999 ordinary shares of HK\$0.1 each to Pacific Climax on 29 July 2005; and (ii) credited as fully paid at par the 1 nil paid share which was held by Pacific Climax.

(iv) Capitalisation issue

On 2 November 2005, an amount of HK\$14,999,000 standing to the credit of the share premium account was applied in paying up in full 149,990,000 ordinary shares of HK\$ 0.1 each. The shares were allotted and distributed as fully paid to the then shareholders in the proportion of 14,999 for every 1 ordinary share held.

(v) Issuance of shares for placing and public offering

On 2 November 2005, an aggregate of 50,000,000 ordinary shares of HK\$0.1 each were issued and offered for subscription at a price of HK\$1.30 per share upon the listing of the Company's shares on the Stock Exchange. The Group raised approximately HK\$48,811,000 net of related expenses from the share offer.

(b) Share premium and contributed surplus

Under the Companies Law of the Cayman Islands, the funds in the contributed surplus account and share premium account of the Company are distributable to the shareholders of the Company provided that immediately following the date on which the dividend is proposed to be distributed, the Company will be in a position to pay off its debts as they fall due in the ordinary course of business.

As part of the Reorganisation, OCT (HK), the then immediate holding company, transferred its equity interests in Shenzhen Huali, Mudanjiang Huali, Shanghai Huali and Zhongshan Huali to Max Surplus Limited, its wholly-owned subsidiary, on 16 February 2005, 28 January 2005, 4 February 2005 and 14 March 2005 respectively. A contributed surplus of RMB 122,345,000 was resulted from these transfers.

As part of the Reorganisation, a shareholder's loan of RMB25,589,000 was waived by Pacific Climax on 30 May 2005. A contributed surplus of an equivalent amount was resulted accordingly.

As part of the Reorganisation, retained profits as at 31 December 2004 amounted to RMB50,057,000 were transferred to the contributed surplus.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

26 EQUITY ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY *(continued)*

(c) Merger reserve

Merger reserve arose from the recognition of the remaining goodwill arising on the original acquisition of the subsidiaries as recorded in the controlling party's financial statements in these financial statements.

(d) Capital reserve

The capital reserve comprises the following:

- difference between the total amount of registered capital and the amount of contributions from the equity holders of a subsidiary; and
- the fair value of the unexercised share options granted to employees of the company recognised in accordance with the accounting policy adopted for share based payments in note 2(n)(ii).

(e) General reserve fund

Transfers from retained earnings to general reserve fund were made in accordance with the relevant PRC rules and regulations and the articles of association of the Company's subsidiaries incorporated in the PRC and were approved by the respective boards of directors.

The subsidiaries in the PRC are required to transfer 10% of their net profits, as determined in accordance with the PRC accounting rules and regulations, to general reserve fund until the reserve balance reaches 50% of the registered capital. The transfer to this fund must be made before distribution of dividends to the equity holders.

General reserve fund can be used to make good previous years' losses, if any, and may be converted into paid up capital provided that the balance of the general reserve fund after such conversion is not less than 25% of the registered capital.

(f) Enterprise expansion fund

The subsidiaries in the PRC are required to transfer a certain percentage of their net profits, as determined in accordance with the PRC accounting rules and regulations, to the enterprise expansion fund. The percentage of this appropriation is decided by the directors of the subsidiaries.

The enterprise expansion fund can be used for the subsidiaries' business development purposes and for working capital purposes. This fund can also be used to increase capital of the subsidiaries, if approved. This fund is non-distributable other than upon liquidation. Transfers to this fund must be made before distribution of dividends to the equity holders.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

26 EQUITY ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY *(continued)*

(g) Reserves of the Company

	Note	Share premium RMB'000	Contributed surplus RMB'000	Capital reserve RMB'000	Retained profits RMB'000	Total RMB'000
Arising from the Reorganisation	(i)	–	299,027	–	–	299,027
Special dividend declared in respect of previous year	11	–	(50,057)	–	–	(50,057)
Capitalisation issue	26(a)(iv)	(15,599)	–	–	–	(15,599)
Issuance of shares for placing and public offering	26(a)(v)	62,400	–	–	–	62,400
Share issuing costs		(16,837)	–	–	–	(16,837)
Profit for the year		–	–	–	4,427	4,427
At 31 December 2005		<u>29,964</u>	<u>248,970</u>	<u>–</u>	<u>4,427</u>	<u>283,361</u>
At 1 January 2006		29,964	248,970	–	4,427	283,361
Profit for the year		–	–	–	18,527	18,527
Dividend approved in respect of the previous year	11	–	–	–	(16,224)	(16,224)
Equity settled share-based transaction	24	–	–	4,558	–	4,558
At 31 December 2006		<u>29,964</u>	<u>248,970</u>	<u>4,558</u>	<u>6,730</u>	<u>290,222</u>

Note:

- (i) The excess of the consolidated net assets represented by the shares acquired over the nominal value of the shares issued by the Company in exchange under the Reorganisation was transferred to contributed surplus in the Company's financial statements.

(h) Distributability of reserves

At 31 December 2006, the aggregate amount of reserves available for distribution to equity shareholders of the Company was RMB290,222,000 (2005: RMB283,361,000).

After the balance sheet date, the directors proposed a final dividend of HK\$6.40 cents per ordinary share (2005: HK\$7.8 cents per share), amounting to RMB12,675,000 (2005: RMB16,224,000). This dividend has not been recognised as a liability at the balance sheet date.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

27 FINANCIAL INSTRUMENTS

Exposure to credit, liquidity, interest rate and currency risks arises in the normal course of the Group's business. These risks are limited by the Group's financial management policies and practices described below.

(a) Credit risk

The Group's credit risk is primarily attributable to trade and other receivables. Management has a credit policy in place and the exposures to these credit risks are monitored on an ongoing basis.

In respect of trade and other receivables, credit evaluations are performed on all customers requiring credit over a certain amount. The credit evaluations are reperformed periodically for the existing customers. The Group chases the customers to settle outstanding balances and monitors the settlement progress on an ongoing basis. Normally, the Group does not obtain collateral from customers. The impairment losses on bad and doubtful accounts are within management's expectation.

(b) Liquidity risk

Individual operating entities within the Group are responsible for their own cash management, including the raising of loans to cover expected cash demands, subject to approval by the Company's board when the borrowings exceed certain predetermined levels of authority. The Group's policy is to regularly monitor current and expected liquidity requirements and its compliance with lending covenants, to ensure that it maintains sufficient reserves of cash and adequate committed lines of funding from major financial institutions to meet its liquidity requirements in the short and longer term.

(c) Interest rate risk

The effective interest rate of cash and cash equivalents is 2.30% per annum (2005: 1.14% per annum). The effective interest rate of bank loans is 5.72% per annum (2005: 5.18% per annum). The interest rates and terms of repayment of the Group's bank loans are disclosed in Note 22.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

27 FINANCIAL INSTRUMENTS *(continued)*

(d) Foreign currency risk

(i) Forecast transactions

The Group is exposed to foreign currency risk primarily through sales and purchases that are denominated in a currency other than the functional currency of the operations to which they relate. The currencies giving rise to this risk are primarily United States dollars and Hong Kong dollars.

(ii) Recognised assets and liabilities

In respect of bank loans, other trade receivables and payables held in currencies other than the functional currency of the operations to which they relate, the Group ensures that the net exposure is kept to an acceptable level.

(e) Fair values

All financial instruments are carried at amounts not materially different from their fair values as at 31 December 2006 and 2005 due to their nature of short-term maturities or floating interest rate for the long-term bank loans.

28 COMMITMENTS

(a) Capital commitments, outstanding at 31 December 2006 not provided for in the financial statements were as follows:

	The Group		The Company	
	2006	2005 (restated)	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000
Contracted for	21,318	3,676	–	–
Authorised but not contracted for	3,158	11,108	–	–
	24,476	14,784	–	–

The capital commitments mainly represented the commitments in connection with the planned capital expenditure for expansion of production facilities.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

28 COMMITMENTS *(continued)*

- (b) At 31 December 2006, the total future minimum lease payments under non-cancellable operating leases in respect of land and properties were payable as follows:

	The Group		The Company	
	2006	2005	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000
Within 1 year	5,357	3,875	—	—
After 1 year but within 5 years	5,668	5,156	—	—
	<u>11,025</u>	<u>9,031</u>	<u>—</u>	<u>—</u>

The Group leases a number of land and properties under operating leases. The leases run for period from one to twenty-six years, certain of the leases are with an option to renew when all terms are renegotiated. None of the leases includes contingent rentals.

29 MATERIAL RELATED PARTY TRANSACTIONS

(a) Transactions with other state-controlled entities

The Company is a state-controlled entity and operates in an economic regime currently dominated by entities directly or indirectly controlled by the PRC government ("state-controlled entities") through its government authorities, agencies, affiliations and other organisations.

Other than those disclosed in 29(b), transactions with other state-controlled entities include but are not limited to the following:

- Utility supplies; and
- Financial services arrangement.

These transactions are conducted in the ordinary course of the Group's business on terms comparable to those with other entities that are not state-controlled. The Group has established its buying, pricing strategy and approval process for purchases and sales of products and services. Such buying, pricing strategy and approval processes do not depend on whether the counterparties are state-controlled entities or not.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

29 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

(a) Transactions with other state-controlled entities *(continued)*

Having considered the potential for transactions to be impacted by related party relationships, the Group's pricing strategy, buying and approval processes and what information would be necessary for an understanding of the potential effect of the relationship on the financial statements, the Directors are of the opinion that the following transactions with other state-controlled entities require disclosure:

(i) Transactions with other state-controlled entities in the PRC

	2006 RMB'000	2005 RMB'000
Interest income	2,007	1,034
Interest expenses	<u>3,552</u>	<u>2,373</u>

(ii) Balances with other state-controlled entities in the PRC

	2006 RMB'000	2005 RMB'000
Cash at bank	152,402	56,553
Bank loans – current	43,664	38,474
Bank loans – non-current	<u>26,524</u>	<u>–</u>



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

29 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

(b) The Group has a related party relationship with the following parties:

Name of party	Relationship with the Group
Overseas Chinese Town Enterprises Corporation ("OCT-EC")	Ultimate holding company
Overseas Chinese Town (HK) Company Limited ("OCTHK")	Intermediate holding company
Konka Group Company Limited, its subsidiaries and associates ("Konka Group") (Note)	Associate of the ultimate holding company (before 28 September 2005)
Shanghai Huiyang Industry Co., Ltd. ("Shanghai Hui Yang")	79% owned by a director of a subsidiary of the Group
Shanghai Mei Ling Central Air Conditioner Company Limited ("Mei Ling Air-Conditioner")	Subsidiary of Shanghai Hui Yang
Shanghai Pudong Xiamei Plastics Co., Ltd. ("Shanghai Xiamei")	Subsidiary of Shanghai Hui Yang
Mudanjiang Nanhua Hesheng Co., Ltd. ("Mudanjiang Nanhua") (Formerly known as Mudanjiang Nanhua Industrial Company Limited)	Minority equity holder of a subsidiary

Note: Due to the change in shareholding of Konka Group Company Limited, Konka Group ceased to be a related party of the Group from 28 September 2005.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

29 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

(b) The Group has a related party relationship with the following parties:
(continued)

Recurring transactions

	2006 RMB'000	2005 RMB'000
Sales of goods to:		
Konka Group (Note)	—	88,432
OCT-EC, its subsidiaries and associates other than Konka Group	912	870
Mei Ling Air-Conditioner	7,448	9,106
Mudanjiang Nanhua	33	168
	<u>8,393</u>	<u>98,576</u>
Purchase of goods from:		
OCT-EC, its subsidiaries and associates other than Konka Group	1,002	1,658
Mudanjiang Nanhua	2,114	1,708
	<u>3,116</u>	<u>3,366</u>
Rental paid to:		
OCT-EC, its subsidiaries and associates other than Konka Group	1,711	1,712
Shanghai Xia Mei	180	180
	<u>1,891</u>	<u>1,892</u>
Utility expenses paid to:		
OCT-EC, its subsidiaries and associates other than Konka Group	3,785	4,335

Note:

The amount for the year ended 31 December 2005 represents transactions occurred before 28 September 2005 when Konka Group was still regarded as a related party of the Group.

The directors of the Company are of the opinion that the above transactions with related parties were conducted in the ordinary course of business, on normal commercial terms and in accordance with the agreements governing such transactions.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

29 MATERIAL RELATED PARTY TRANSACTIONS (continued)

- (b) The Group has a related party relationship with the following parties:
(continued)

Non recurring transactions

	2006 RMB'000	2005 RMB'000
Acquisition of Grand Signal OCT-HK (Note 1 (c))	<u>8,796</u>	<u>—</u>

Balances with related parties

Amounts due from/(to) related parties are as follows:

	2006 RMB'000	2005 RMB'000
Trade receivable	660	2,947
Trade payable	<u>304</u>	<u>475</u>

The trade receivable balances are unsecured, non-interest bearing and is expected to be recovered within six months. These refer to receivables in respect of sales of paper cartons and paper boxes to related parties.

The trade payable balances are unsecured, non-interest bearing and are expected to be settled within three months. These refer to payables in respect of purchases of raw material from related parties.

	2006 RMB'000	2005 (restated) RMB'000
Other receivables	293	294
Other payables (note 21)	<u>92</u>	<u>13,118</u>

Other receivables and payables are unsecured, non-interest bearing, and repayable on demand.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

29 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

(c) The key management personnel remuneration is as follows:

Remuneration for key management personnel, including amounts paid to the Company's directors as disclosed in note 8 and certain of the highest paid employees as disclosed in note 9, is as follows:

	2006 RMB'000	2005 RMB'000
Short-term employee benefits	2,431	1,397
Post employment benefits	103	156
Equity compensation benefits	2,267	—
	<u>4,801</u>	<u>1,553</u>

Total remuneration is included in "staff costs" (see note 6(b)).

(d) Contributions to post-employment benefits plans

The Group participates in various defined contribution post-employment benefit plans for its employees. Further details of these plans are disclosed in note 23.

30 NON-ADJUSTING POST BALANCE SHEET EVENTS

- (a) After the balance sheet date the directors proposed a final dividend. Further details are disclosed in note 11.
- (b) On 16 March 2007, the Fifth Plenary Session of the Tenth National People's Congress passed the Corporate Income Tax Law of the PRC ("new tax law") which will take effect on 1 January 2008. The details of the existing corporate income tax rate and preferential tax policies applicable to the Group are disclosed in note 7. From 1 January 2008, the income tax rate of the PRC subsidiaries of the Group is expected to gradually increase to the standard rate of 25% over a five-year transition period. However, the new tax law has not set out the details as to how the existing preferential tax rate will gradually increase to the standard rate of 25%. Consequently, the Group is not able to make an estimate of the expected financial effect of the new tax law on its deferred tax assets and liabilities. The expected financial effect of the new tax law, if any, will be reflected in the Group's 2007 financial statements. The enactment of the new tax law is not expected to have any financial effect on the amounts accrued in the balance sheet in respect of current tax payable.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

30 NON-ADJUSTING POST BALANCE SHEET EVENTS *(continued)*

- (c) On 13 March 2007, the Company established an indirectly wholly owned subsidiary, Huizhou Huali Packing Co., Ltd ("Huizhou Huali") with a registered capital of HK\$90,000,000.

On 19 March 2007, Huizhou Huali entered into a transfer agreement with an independent third party, Guangdong Yonghe Pharmaceuticals Development Limited to acquire the land use rights of a piece of land in Huiyang for the Group's production expansion at a cash consideration of RMB64,460,000 which may be adjusted based on the actual site measurement as approved by the relevant planning bureau of the PRC. The purchase consideration will be satisfied by the net proceeds from the public offer and placing of shares in 2005 and internally generated funds.

31 COMPARATIVE FIGURES

Certain comparative figures have been adjusted or reclassified as a result of the using of the principles of merger accounting under AG5. Further details are disclosed in note 1(c).

32 PARENT AND ULTIMATE HOLDING COMPANY

At 31 December 2006, the Directors consider the ultimate holding company of the Group to be Overseas Chinese Town Enterprises Corporation, which is incorporated in the PRC. The directors also consider the immediate holding company to be Pacific Climax Limited. These entities do not produce financial statements available for public use.

33 ACCOUNTING ESTIMATES AND JUDGEMENTS

Note 15 contains information about the assumptions relating to goodwill impairment. Other key sources of estimation uncertainty are as follows:

(i) Impairment loss for trade and other receivables

As explained in note 2(j), the Group makes impairment loss for trade and other receivables based on the Group's estimates of the present value of the estimated future cash flow. Given the uncertainties involved in estimating the future cash flow of individual customer, the actual recoverable amount may be higher or lower than that estimated at the balance sheet date.

(ii) Provision for inventories

As explained in notes 2(i), the Group's inventories are stated at the lower of cost and net realisable value. Based on the Group's recent experience and the nature of the inventories, the Group makes estimates of the selling prices, the costs of completion in case for work in progress, and the costs to be incurred in selling the inventories. Uncertainty exists in these estimations.



Notes to the Financial Statements

(Expressed in Renminbi unless otherwise indicated)

34 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED 31 DECEMBER 2006

Up to the date of issue of these financial statements, the HKICPA has issued the following amendments, new standards and interpretations which are not yet effective for the accounting period ended 31 December 2006 and which have not been adopted in these financial statements.

		Effective for accounting periods beginning on or after
Amendments to HKAS 1	Presentation of financial statements: Capital disclosures	1 January 2007
HKFRS 7	Financial instruments: disclosures	1 January 2007
HKFRS 8	Operating segments	1 January 2009
HK(IFRIC) 7	Applying the restatement approach under IAS 29 Financial reporting in hyperinflationary economies	1 March 2006
HK(IFRIC) 8	Scope of HKFRS 2	1 May 2006
HK(IFRIC) 9	Reassessment of embedded derivatives	1 June 2006
HK(IFRIC) 10	Interim financial reporting and impairment	1 November 2006
HK(IFRIC) 11	HKFRS 2 – Group and treasury share transactions	1 March 2007
HK(IFRIC) 12	Service concession arrangements	1 January 2008

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that the adoption of these standards is unlikely to have a significant impact on the Group's results of operations and financial position.



Five-Year Financial Summary

CONSOLIDATED INCOME STATEMENT

	2006	2005 (restated)	2004	2003	2002
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Turnover	695,503	662,243	605,533	504,617	409,688
Cost of sales	(608,381)	(583,646)	(531,817)	(445,252)	(342,508)
Gross profit	87,122	78,597	73,716	59,365	67,180
Other revenue	22,544	21,519	16,493	19,724	8,748
Other net loss	(3,394)	(1,424)	(501)	(226)	(92)
Distribution costs	(32,562)	(30,340)	(31,980)	(29,296)	(22,485)
Administrative expenses	(30,125)	(19,297)	(14,612)	(11,377)	(10,264)
Other operating expenses	(756)	(761)	(1,399)	(2,129)	(6,073)
Profit from operations	42,829	48,294	41,717	36,061	37,014
Finance costs	(3,552)	(2,480)	(3,633)	(637)	(1,739)
Profit before taxation	39,277	45,814	38,084	35,424	35,275
Income tax	(5,970)	(5,440)	(5,942)	(5,145)	(5,318)
Profit for the year	33,307	40,374	32,142	30,279	29,957
Attributable to:					
Equity shareholders of the Company	32,999	40,089	28,651	26,027	25,588
Minority interests	308	285	3,491	4,252	4,369
Profit for the year	33,307	40,374	32,142	30,279	29,957
Earnings per share (RMB)					
Basic	0.16	0.25	0.19	0.17	0.17
Diluted	0.16	0.25	0.19	0.17	0.17



Five-Year Financial Summary

CONSOLIDATED BALANCE SHEET

	2006	2005 (restated)	2004	2003	2002
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Non-current assets					
Property, plant and equipment	179,884	183,006	200,486	162,437	109,578
Construction in progress	20,438	9,506	766	46,304	2,230
Goodwill	24,937	24,937	24,937	–	–
Lease prepayments	20,010	20,589	9,360	9,692	4,029
Deferred tax assets	2,878	2,360	1,512	27	19
	<u>248,147</u>	<u>240,398</u>	<u>237,061</u>	<u>218,460</u>	<u>115,856</u>
Current assets					
Investments	–	–	–	–	200
Inventories	63,775	73,181	68,939	60,103	56,600
Trade and other receivables	135,858	143,124	183,174	171,010	151,407
Pledged bank deposits	–	–	4,091	4,288	2,609
Cash and cash equivalents	172,160	97,951	59,595	45,693	26,491
	<u>371,793</u>	<u>314,256</u>	<u>315,799</u>	<u>281,094</u>	<u>237,307</u>
Current liabilities					
Trade and other payables	207,009	186,562	245,204	187,147	139,323
Bank loans	43,664	38,474	52,119	75,814	7,000
Current taxation	4,882	3,970	4,988	4,007	4,703
	<u>255,555</u>	<u>229,006</u>	<u>302,311</u>	<u>266,968</u>	<u>151,026</u>
Net current assets	<u>116,238</u>	<u>85,250</u>	<u>13,488</u>	<u>14,126</u>	<u>86,281</u>
Total assets less current liabilities	364,385	325,648	250,549	232,586	202,137
Non-current liabilities					
Bank loans	26,524	–	–	–	–
NET ASSETS	<u>337,861</u>	<u>325,648</u>	<u>250,549</u>	<u>232,586</u>	<u>202,137</u>
Total equity attributable to equity shareholders of the Company	336,162	323,957	249,143	194,856	166,459
Minority interests	<u>1,699</u>	<u>1,691</u>	<u>1,406</u>	<u>37,730</u>	<u>35,678</u>
TOTAL EQUITY	<u>337,861</u>	<u>325,648</u>	<u>250,549</u>	<u>232,586</u>	<u>202,137</u>