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CHINA NATURAL RESOURCES INC

Form 20-F

June 10, 2005

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 20-F

(MARK ONE)

[ ] REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES  
EXCHANGE ACT OF 1934

OR

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2004

OR

[ ] TRANSITIONAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission file number: 0-26046

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CHINA NATURAL RESOURCES, INC.

-----  
(Exact name of Registrant as specified in its Charter)

Not Applicable

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(Translation of Registrant's name into English)

British Virgin Islands

-----  
(Jurisdiction of incorporation or organization)

Room 2105, West Tower, Shun Tak Centre,  
200 Connaught Road C., Sheung Wan, Hong Kong

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(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:  
None

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Securities registered or to be registered pursuant to Section 12(g) of the Act:

Common Shares, without par value

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(Title of class)

Securities for which there is a reporting obligation pursuant to Section 15(d)  
of the Act: None

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Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report. 1,247,823 Common Shares  
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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17  Item 18

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### CONVENTIONS

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Unless otherwise specified, all references in this report to "U.S. Dollars," "Dollars," "US\$," or "\$" are to United States dollars; all references to "Hong Kong Dollars" or "HK\$" are to Hong Kong dollars; and all references to "Renminbi" or "RMB" are to Renminbi yuan, which is the lawful currency of the People's Republic of China ("China" or "PRC"). The accounts of the Company and its subsidiaries are maintained in either Hong Kong Dollars or Renminbi. The financial statements of the Company and its subsidiaries are prepared in Renminbi. Translations of amounts from Renminbi to U.S. Dollars and from Hong Kong Dollars to U.S. Dollars are for the convenience of the reader. Unless otherwise indicated, any translations from Renminbi to U.S. Dollars or from U.S. Dollars to Renminbi have been made at the single rate of exchange as quoted by the People's Bank of China (the "PBOC Rate") on December 31, 2004, which was U.S.\$1.00 = Rmb8.28. Translations from Hong Kong Dollars to U.S. Dollars have been made at the single rate of exchange as quoted by the Hongkong and Shanghai Banking Corporation Limited on December 31, 2004, which was US\$1.00 = HK\$7.80. The Renminbi is not freely convertible into foreign currencies and the quotation of exchange rates does not imply convertibility of Renminbi into U.S. Dollars or other currencies. All foreign exchange transactions take place either through the Bank of China or other banks authorized to buy and sell foreign currencies at the exchange rates quoted by the People's Bank of China. No representation is made that the Renminbi or U.S. Dollar amounts referred to herein could have been or could be converted into U.S. Dollars or Renminbi, as the case may be, at the PBOC Rate or at all.

References to "Billion Luck" or "China Natural" are to Billion Luck Company Ltd., a British Virgin Islands company, which was a wholly-owned subsidiary of the Company and became the surviving company after a merger between China Resources and Billion Luck on December 9, 2004 (the "Redomicile Merger"). Following the Redomicile Merger, Billion Luck changed its name to China Natural Resources, Inc.

References to "Central Government" refer to the national government of the PRC and its various ministries, agencies, and commissions.

References to "Common Stock" are to the Common Stock, \$.001 par value, of China Resources. References to "Common Shares" are to the Common Shares, without par value, of China Natural after the Redomicile Merger.

References to "China Resources" are to China Resources Development, Inc., a Nevada company, and the predecessor to China Natural.

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References to "Company" are to China Natural, and include, unless the context requires otherwise, the operations of its predecessor and subsidiaries (all as hereinafter defined).

References to "First Supply" are to First Goods And Materials Supply And Sales Corporation, a company organized in the PRC and a wholly-owned subsidiary of HARC.

References to "GAAP" or "U.S. GAAP" are to generally accepted accounting principles of the United States.

References to "Hainan" are to Hainan Province of the PRC.

References to "HARC" are to Hainan Cihui Industrial Company Limited (formerly known as Hainan Zhongwei Agricultural Resources Company Limited and Hainan Agricultural Resources Company Limited), a Sino-foreign joint stock company organized in the PRC, and a wholly-owned subsidiary of the Company.

References to "iSense" are to iSense Limited, a Hong Kong company whose capital was 100% acquired by the Company on August 29, 2003.

References to "Local Governments" are to governments in the PRC, including governments at all administrative levels below the Central Government, including provincial governments, governments of municipalities directly under the Central Government, municipal governments, county governments, and township governments.

References to "Medi-China" are to Zhongwei Medi-China.com Limited, a Hong Kong company and a wholly-owned subsidiary of Silver Moon.

References to the "PRC" or "China" include all territory claimed by or under the control of the Central Government, except Hong Kong, Macau, and Taiwan.

References to "PRC Government" include the Central Government and Local Governments.

References to "Provinces" include provinces, autonomous regions, and municipalities directly under the Central Government.

References to "Second Supply" are to Second Goods And Materials Supply And Sales Corporation, a company organized in the PRC and a wholly-owned subsidiary of HARC.

References to "Series B Preferred Stock" are to the Series B Preferred Stock, \$.001 par value, of China Resources. References to "Series B Preferred Shares" are to the Series B Preferred Shares, without par value, of China Natural, after the Redomicile Merger, of which 320,000 shares are outstanding.

References to "Silver Moon" are to Silver Moon Technologies Limited, a British Virgin Islands company, whose capital is 80% owned by the Company.

References to "Sunwide" are to Sunwide Capital Ltd., a British Virgin Islands company, which is a wholly-owned subsidiary of Billion Luck.

References to "Xubu" are to Shenzhen Xubu Investment Co. Ltd., a company organized in the PRC and, until its sale in February 2004, a wholly-owned subsidiary of HARC.

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References to "Zhongwei Trading" are to Hainan Zhongwei Trading Company Limited, a company organized in the PRC, whose capital is owned 95% by HARC and 5% by Billion Luck.

References to "Zhuhai Zhongwei" are to Zhuhai Zhongwei Development Company Limited, a company organized in the PRC and, until its sale in April 2003, a wholly-owned subsidiary of HARC.

### FORWARD-LOOKING STATEMENTS

This report contains statements that constitute forward-looking statements. Those statements appear in a number of places in this report and include, without limitation, statements regarding the intent, belief and current expectations of the Company, its directors or its officers with respect to the Company's policies regarding investments, dispositions, financings, conflicts of interest and other matters; and trends affecting the Company's financial condition or results of operations. Any such forward-looking statement is not a guarantee of future performance and involves risks and uncertainties, and actual results may differ materially from those in the forward-looking statement as a result of various factors. The accompanying information contained in this report, including without limitation the information set forth above and the information set forth under the heading, "Operating and Financial Review and Prospects," identifies important factors that could cause such differences. With respect to any such forward-looking statement that includes a statement of its underlying assumptions or bases, the Company cautions that, while it believes such assumptions or bases to be reasonable and has formed them in good faith, assumed facts or bases almost always vary from actual results, and the differences between assumed facts or bases and actual results can be material depending on the circumstances. When, in any forward-looking statement, the Company, or its management, expresses an expectation or belief as to future results, that expectation or belief is expressed in good faith and is believed to have a reasonable basis, but there can be no assurance that the stated expectation or belief will result or be achieved or accomplished.

### PART I

#### [Item 1] IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

#### [Item 2] OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

#### [Item 3] KEY INFORMATION

##### A. SELECTED FINANCIAL INFORMATION

The following selected financial data of the Company and its subsidiaries for the years ended December 31, 2000, 2001, 2002, 2003 and 2004, are derived from the audited consolidated financial statements for the periods indicated and should be read in conjunction therewith.

In thousands, except share amounts

	Year ended December 31,				
	2000	2001	2002	2003	2004

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	Rmb	Rmb	Rmb	Rmb	Rmb
OPERATING STATEMENT DATA					
Net sales	306	4,093	1,948	3,049	3,970
Operating expenses	14,715	9,995	7,267	6,401	8,019
Loss from continuing operations					
before income taxes	13,623	24,628	56,200	29,100	22,429
Loss from continuing operations	16,509	26,206	56,200	29,100	22,440
Loss from discontinued operations	2,057	5,136	4,032	2,637	-
Net loss	23,200	30,144	60,232	31,737	22,440
Basic and diluted loss per share					
Continuing operations	29.56	29.85	67.08	30.20	18.79
Discontinued operations	2.87	6.13	4.81	2.74	-
	-----	-----	-----	-----	-----
	32.43	35.98	71.89	32.94	18.79
	=====	=====	=====	=====	=====
Weighted average number of shares					
Basic and diluted	715,349	837,797	837,797	963,478	1,194,118
BALANCE SHEET DATA					
Total assets	333,184	157,217	89,112	66,684	46,869
Current assets	127,646	35,636	16,520	15,122	13,147
Current liabilities	48,012	17,636	9,656	6,015	3,816
Working capital	79,634	18,000	6,864	9,107	9,331
Long term debt	-	-	-	321	206
Minority interests	115,480	-	-	-	-
Shareholders' equity	169,692	139,581	79,456	60,348	42,847

The Company has not paid any dividends with respect to its Common Shares and has no present plan to pay any dividends in the foreseeable future. The Company intends to retain its earnings to support the development of its business. Any dividends paid in the future by the Company will be paid at the discretion of the Company's Board of Directors and will be dependent upon distributions, if any, made by its subsidiaries. Applicable PRC law requires that, before distributing profits to investors, companies such as the Company must (1) satisfy all taxes; and (2) allocate a specified

percentage of after-tax profits to surplus reserve (10% of after-tax profits) and collective welfare fund (5-10% of after-tax profits). In addition to the foregoing, any future determination to pay a dividend to holders of its Common Shares will depend on the Company's results of operations, its financial condition and other factors deemed relevant by the Board of Directors. Since the acquisition of Billion Luck by the Company in December 1994, the Company has not received any distributions from any of its subsidiaries and has not made any distributions to its shareholders.

EXCHANGE RATES

The Company's reporting currency is Renminbi. Translations of amounts from Renminbi to U.S. Dollars are for the convenience of the reader. The rate of exchange means the quote made by the People's Bank of China (the "PBOC Rate"). The average rate means the average of the exchange rates of the last date of each month during a year.

YEAR	2000	2001	2002	2003	2004
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High	8.2799	8.2786	8.2776	8.2778	8.2775
Low	8.2768	8.2763	8.2760	8.2765	8.2763
Average for period	8.2783	8.2772	8.2770	8.2771	8.2768
End of period	8.2774	8.2765	8.2770	8.2767	8.2765

MONTH	Dec 04	Jan 05	Feb 05	Mar 05	Apr 05	May 05
-----	-----	-----	-----	-----	-----	-----
High	8.2766	8.2765	8.2765	8.2766	8.2766	8.2773
Low	8.2763	8.2763	8.2765	8.2764	8.2764	8.2768

The exchange rate on May 31, 2005 was 8.2767.

**B. CAPITALIZATION AND INDEBTEDNESS**

Not applicable.

**C. REASONS FOR THE OFFER AND USE OF PROCEEDS**

Not applicable.

**D. RISK FACTORS**

**RISKS ASSOCIATED WITH FOREIGN OPERATIONS**

- o Our principal subsidiaries operate in the People's Republic of China, and are, by law, subject to administrative review by various national, provincial and local agencies of the Chinese government - governmental oversight and/or changes to existing rules and regulations could adversely affect our results of operations.
- o Our operations and financial results could be adversely affected by economic, political, legal and social conditions, including changes in the policies of the PRC government, such as changes in laws and regulations (or the interpretation thereof), as well as measures which may be introduced to regulate or stimulate the rate of economic growth. There can be no assurance that these measures will be successful or that they will not adversely affect our ability to operate profitably.
- o The PRC does not have a comprehensive system of laws and enforcement of existing laws may be uncertain and sporadic, and the implementation and interpretation thereof inconsistent. Even where adequate law exists in the PRC, it may be difficult to obtain swift and equitable enforcement of such law, or to obtain enforcement of a judgment by a court of another jurisdiction. Decided legal cases are without binding legal effect, although judges are often guided by prior decisions. The interpretation of PRC laws may be subject to policy changes reflecting domestic political changes, and new laws, changes to existing laws and the pre-emption of local regulations by national laws may adversely affect foreign investors. The activities of our Company's subsidiaries in China are subject to PRC

regulations governing PRC companies. In particular, the realization of our future plans in China will also be subject to PRC government approvals.

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- o Following the merger, we became a British Virgin Islands company and our officers and directors are non-residents of the United States, our assets are located in the PRC and our operations are conducted in the PRC. Therefore, it may not be possible to effect service of process on such persons in the United States, and it may be difficult to enforce any judgments rendered against us or them. Moreover, there is doubt whether courts in the British Virgin Islands or the PRC would enforce (a) judgments of United States courts against us, or our directors or officers based on the civil liability provisions of the securities laws of the United States or any state, or (b) in original actions brought in the British Virgin Islands or the PRC, liabilities against us or any non-residents based upon the securities laws of the United States or any state.
- o Since we are a British Virgin Islands company, the rights of our shareholders may be more limited than those of shareholders of a United States corporation. In this regard, our directors are permitted to take action that, under the laws of most states of the United States require shareholder approval. These actions include authorizing reorganizations, asset sales (of less than 50% of our total assets) and amendments to our Memorandum and Articles of Association (that do not vary the rights of shareholders).
- o Our holding company structure creates restrictions on our payment of dividends. We do not intend to pay dividends for the foreseeable future - we intend to reinvest earnings from operations, if any, back into our operations. The payment of dividends is subject to numerous restrictions imposed under PRC law, including restrictions on the conversion of local currency into United States dollars and other currencies.
- o We are foreign private issuer and are not required to file as much information about us as United States issuers are required to file. In this regard we are not required to file quarterly reports on Form 10-Q or Current Reports on Form 8-K; we are exempt from the provisions of Regulation FD aimed at preventing issuers from making selective disclosures; the SEC proxy statement and information statement rules do not apply; and our officers, directors and principal shareholders are not required to file reports detailing their beneficial ownership of our shares. There is generally greater information available about United States issuers than about foreign private issuers such as us, and the lack of information about us makes it more difficult to make investment decisions about us.

### OTHER RISKS OF OPERATIONS

- o We have discontinued many of our operations and we are currently dependent upon the success of one line of business - our advertising, promotion and public relations operations; and while our advertising business generates operating revenues, those revenues are not sufficient to offset expenses, resulting in continued losses from operations.
- o Unless we are able to reduce expenses, increase our profit margins and/or acquire profitable operations, we will likely continue to incur losses and investors in our shares may be unable to recoup their investment.
- o We intend to investigate and evaluate potential investment opportunities, including acquisition candidates. However, (a) we may be unable to acquire business operations that prove to be profitable and (b) we will continue to incur administrative and professional expenses

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in connection with our evaluation and acquisition of business operations, without corresponding revenues from those operations prior to acquisition.

- o There is no active trading market for our shares and we do not know if an active trading market will develop. An active market will not develop unless broker-dealers develop interest in trading our shares, and we may be unable to generate interest in our shares among broker-dealers until we generate meaningful revenues and profits from operations. Until that time occurs, if it does at all, purchasers of our shares may be unable to sell them publicly. In the absence of an active trading market (a) investors may have difficulty buying and selling our shares or obtaining market quotations, (b) market visibility for our common stock may be limited; and (c) a lack of visibility for our common stock may depress the market price for our shares.
- o As directed by Section 404 of the Sarbanes-Oxley Act of 2002 ("SOX 404"), the SEC has adopted rules requiring

public companies to include a report of management on the company's internal controls over financial reporting in their annual reports, including Form 20-F. In addition, the independent registered public accounting firm auditing a company's financial statements must also attest to and report on management's assessment of the effectiveness of the company's internal controls over financial reporting as well as the operating effectiveness of the company's internal controls. We are not yet subject to these requirements. However, in the event we identify significant deficiencies or material weaknesses in our internal controls that we cannot remediate in a timely manner or we are unable to receive a positive attestation from our independent auditors with respect to our internal controls, investors and others may lose confidence in the reliability of our financial statements and our ability to obtain equity or debt financing could suffer.

### [Item 4] INFORMATION ON THE COMPANY

#### A. HISTORY AND DEVELOPMENT OF THE COMPANY

China Resources was incorporated as Magenta Corp. on January 15, 1986, in the State of Nevada. It was formed to acquire businesses that would provide a profit to the Company. China Resources had no operating business until control of it was acquired in December 1994, by the former shareholders of China Natural, formerly known as Billion Luck, who exchanged all of the issued and outstanding shares of capital stock of China Natural for 108,000 shares of China Resources' Common Stock. As a result of the acquisition, the former shareholders of China Natural acquired 90% of the then issued and outstanding shares of Common Stock of China Resources, and China Resources became the owner of all the outstanding shares of capital stock of China Natural. China Natural was incorporated in the British Virgin Islands on December 14, 1993.

On December 9, 2004, China Resources merged with and into China Natural (the "Redomicile Merger"). The Redomicile Merger was effected by an exchange of shares of China Resources into shares of China Natural on a one-for-one basis. As a result of the Redomicile Merger, the Company became domiciled in the British Virgin Islands and China Natural has succeeded to the rights and obligations of China Resources under its existing agreements and relationships.

The Company's principal place of business is located at Room 2105, West Tower, Shun Tak Centre, 200 Connaught Road C., Sheung Wan, Hong Kong, telephone



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(852) 2810-7205.

### B. BUSINESS OVERVIEW

Since 2000, the Company has been primarily engaged in identifying, acquiring and operating business opportunities and, when management deems it advisable, disposing of acquired businesses. Since the disposition of businesses may, from time-to-time, consist of the sale of assets, the Company maintains ownership over numerous direct and indirect currently inactive wholly owned subsidiaries, organized under the laws of various jurisdictions, that may be used in connection with business opportunities in the future.

As of December 31, 2004, the Company's only active business operations consisted of its advertising, promotion and public relations business. The Company has been engaged in advertising, promotion and public relations services since the third quarter of 2003 through the acquisition of iSense. iSense is an integrated marketing company dedicated to providing creative advertising and promotions services to both local and international customers engaged in various industries, including technology and new media, healthcare products and consumer goods.

The advertising business is not seasonal in nature. Since its incorporation, iSense has serviced over 50 customers. For the period from acquisition to December 31, 2003, one advertising customer accounted for 11% of total sales. For the year ended December 31, 2004, five advertising customers accounted for 84% of total sales. All sales were made in Hong Kong dollars.

The Company commenced operations of its supermarket in the PRC, through Zhuhai Zhongwei, in the fourth quarter of 1999. As the contribution of supermarket operations to the Company's profitability was insignificant since its establishment, the Company disposed of its entire interest in Zhuhai Zhongwei on April 22, 2003 for consideration of RMB6,000,000 (US\$725,000). On August 29, 2003, the Company acquired a 100% equity interest in iSense for total consideration of RMB5,994,000 (US\$724,000) through the issuance of 100,000 shares of the Company's unregistered restricted common stock to the former sole equity owners of iSense. The Company acquired iSense to provide advertising,

promotion and public relations services in Hong Kong and mainland China to both local and international customers. The Company also trades copper occasionally through HARC in the PRC. In light of the foregoing transactions, operating results of prior years should not be viewed as being indicative of operating results that may be expected in future years. The Company is actively seeking other business opportunities to enhance shareholder values.

The Company has not been a party to any bankruptcy, receivership or similar proceedings, trade suspensions or cease trade orders by any regulatory authority.

Prior to the Redomicile Merger, the Company's common stock was traded on the Nasdaq SmallCap market under the symbol "CHRB". Following the Redomicile Merger, the trading symbol was changed to "CHNR".

The following describes activities conducted by the Company's subsidiaries during the year ended December 31, 2004.

#### iSENSE -----

iSense was Incorporated in March 2000 in Hong Kong and is an integrated marketing company. On August 29, 2003, the Company acquired all of the issued

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and outstanding capital stock of iSense for total consideration of RMB5,994,000 (US\$724,000), in exchange for the issuance of 100,000 shares of the Company's unregistered restricted common stock to the former sole equity owners of iSense. The number of shares issued was based upon the US\$7.24 closing price of the Company's common stock (as quoted on the Nasdaq SmallCap Market) on August 22, 2003. The Company acquired iSense to provide advertising, promotion and public relations services in Hong Kong and mainland China to both local and international customers.

HARC

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HARC is a Sino-foreign joint stock company incorporated in the PRC on June 28, 1994 with a registered capital of RMB100 million (US\$12.1 million). HARC owns a 5.3% equity interest in unlisted shares of Hainan Sundiro Motorcycle Co., Ltd., a PRC company listed on the Shenzhen Stock Exchange in the PRC. HARC also trades copper occasionally for its own account.

SUNWIDE

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Sunwide was incorporated in the British Virgin Islands on January 22, 2001. Sunwide is mainly engaged in investing in marketable securities, traded in US markets, as short-term investments.

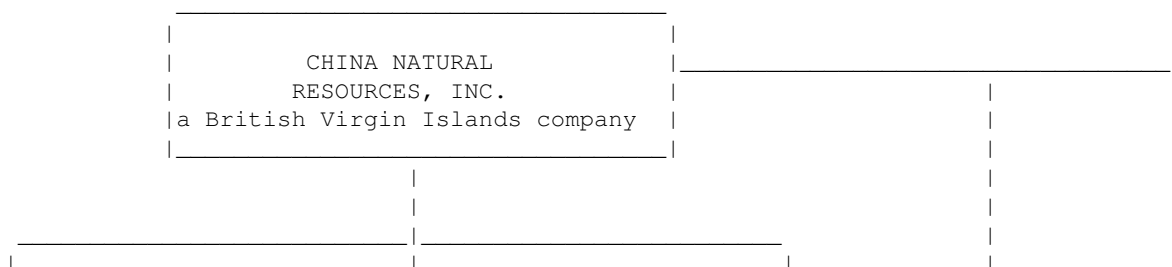
SILVER MOON AND MEDI-CHINA

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Silver Moon is a British Virgin Islands company incorporated on March 24, 2000. The principal business of Silver Moon and its wholly-owned subsidiary, Medi-China (formerly known as Sky Creation Technology Limited), a Hong Kong company incorporated on October 15, 1999, is to provide online Internet healthcare content, through its website, medi-china.com, which offers health-related content in both English and Chinese, with a focus on Chinese herbal medicine and therapies. Neither Silver Moon nor Medi-China is currently engaged in active business operations, however, they are poised to recommence their healthcare-related website to the extent that the e-commerce industry stabilizes and demonstrates signs of revival.

### C. ORGANIZATIONAL STRUCTURE

The following chart illustrates the equity ownership by percentage of each of the Company's subsidiaries as of December 31, 2004:





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From 2002 to 2004 the Company occasionally traded copper. For the year ended December 31, 2002, sales and gross profit amounted to RMB1,948,000 (US\$235,000) and RMB3,000 (US\$362), respectively. For the year ended December 31, 2003, sales and gross profit amounted to RMB1,904,000 (US\$230,000) and nil, respectively. For the year ended December 31, 2004, sales and gross profit amounted to RMB1,842,000 (US\$222,000) and RMB1,000 (US\$121), respectively.

### SALES AND GROSS PROFIT- ADVERTISING AND PROMOTION

The Company has been engaged in advertising, promotion and public relations services since its acquisition of iSense on August 29, 2003. For the year ended December 31, 2003, net sales and gross profit amounted to RMB1,145,000 (US\$138,000) and RMB277,000 (US\$33,000), respectively. For the year ended December 31, 2004, net sales and gross profit amounted to RMB2,128,000 (US\$257,000) and RMB588,000 (US\$71,000), respectively.

### VALUATION ALLOWANCES

For the year ended December 31, 2002, valuation allowances included the impairment loss on the Company's investment in Hainan Sundiro Motorcycle Co. Ltd. ("Sundiro") amounting to RMB46,615,000 (US\$5,630,000), and the write off of VAT receivable of RMB1,563,000 (US\$189,000). For the year ended December 31, 2003, valuation allowances included the impairment loss on the Company's investment in Sundiro amounting to RMB19,000,000 (US\$2,295,000), the write off of VAT receivable of RMB3,126,000 (US\$377,000) and the write off of loan and interest receivables of RMB2,684,000 (US\$324,000). For the year ended December 31, 2004, valuation allowances included the impairment loss on the Company's investment in Sundiro amounting to RMB13,000,000 (US\$1,570,000) and the write off of loan and interest receivables of RMB304,000 (US\$37,000).

### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses decreased by RMB866,000 (US\$105,000) or 11.9% to RMB6,401,000 (US\$773,000) in 2003 from RMB7,267,000 (US\$878,000) in 2002. The decrease was mainly due to reduction of salaries and traveling expenses. Selling, general and administrative expenses increased by RMB1,618,000 (US\$195,000) or 25.3% to RMB8,019,000 (US\$968,000) in 2004 from RMB6,401,000 (US\$773,000) in 2003. The increase was mainly due to increased legal and professional fees in connection with the redomicile.

### INTEREST INCOME, NET

Interest income decreased by 52.1% from RMB654,000 (US\$79,000) in 2002 to RMB313,000 (US\$38,000) in 2003. The decrease was mainly attributable to the default of a short-term loan and related interest receivable of RMB2,684,000 (US\$324,000). Interest income decreased by 93.6% from RMB313,000 (US\$38,000) in 2003 to RMB20,000 (US\$2,000) in 2004. The decrease was mainly attributable to the default of a short-term loan and related interest receivable of RMB304,000 (US\$37,000).

### OTHER INCOME/(EXPENSES), NET

Net other expenses in 2002 mainly represented the net loss on trading of marketable securities of RMB1,622,000 (US\$196,000). Net other income in 2003 mainly consisted of a net gain on trading of marketable securities of RMB1,157,000 (US\$140,000). Net other income in 2004 mainly consisted of a net gain on trading of marketable securities of RMB373,000 (US\$45,000) and the recovery of bad debts and related costs of RMB2,850,000 (US\$344,000).

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### INCOME TAXES

Prior to the Redomicile Merger, it was management's intention to reinvest all income attributable to the Company earned by its operations outside the US. Accordingly, no US federal and state income taxes have been provided in the consolidated financial statements. Following the Redomicile Merger, management believes that the Company is no longer subject to US taxes.

Income taxes in 2002 consisted of PRC federal income tax computed at 15% on assessable income for foreign investment enterprises operating in Zhuhai. Income taxes in 2004 consisted of Hong Kong profits tax computed at 17.5% on assessable income of iSense.

### SALES AND GROSS PROFIT- SUPERMARKET OPERATIONS (DISCONTINUED OPERATIONS)

For the year ended December 31, 2002, net sales and gross profit from supermarket operations amounted to RMB7,222,000 (US\$872,000) and RMB417,000 (US\$50,000), respectively. The Company ceased its supermarket operations following the disposition of its entire interest in Zhuhai Zhongwei on April 22, 2003. Net sales included in discontinued operations totaled RMB1,758,000 (US\$212,000) with gross profit of RMB201,000 (US\$24,000) for the year ended December 31, 2003. Profit from discontinued supermarket operations is reported net of income tax expense, if any.

### B. LIQUIDITY AND CAPITAL RESOURCES

The Company's and its subsidiaries' primary liquidity needs are to fund operating expenses, and to expand business operations.

Net cash (used in)/provided by operating activities was (RMB5,403,000) (US\$653,000), RMB4,540,000 (US\$548,000) and (RMB4,883,000) (US\$590,000) in fiscal 2002, 2003 and 2004, respectively. Net cash flows from the Company's operating activities are attributable to the Company's income and changes in operating assets and liabilities.

The following summarizes the Company's financial condition and liquidity at the dates indicated:

	At December 31,	
	2003	2004
Current ratio	2.5x	3.4x
Working capital	9,107,000	9,331,000
Ratio of long-term debt to total shareholders' equity	.005x	0.005x

Net cash provided by investing activities was RMB11,990,000 (US\$1,448,000), RMB42,000 (US\$5,000) and RMB449,000 (US\$54,000) in fiscal 2002, 2003 and 2004, respectively. Net cash flows from the Company's investing activities in 2002 were attributable to repayment of a short term loan from a third party. Net cash provided by/(used in) financing activities was (RMB11,298,000) (US\$1,364,000), RMB3,665,000 (US\$442,000) and RMB4,773,000 (US\$576,000) in fiscal 2002, 2003 and 2004, respectively. Net cash flows from the Company's financing activities in 2003 and 2004 were attributable to proceeds from issuance of common stocks from the exercise of stock options.

Except as disclosed above, there have been no significant changes in the financial condition and liquidity during the years ended December 31, 2003 and 2004. The Company believes that available funds will be sufficient to

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satisfy its anticipated working capital needs for at least the next 12 months.

### C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES, ETC.

The Company did not spend any significant amounts on company-sponsored research and development activities during each of the last three fiscal years.

### D. TREND INFORMATION

The Company does not believe that there have been recent trends in production, sales and inventory, the state of the order book and costs and selling prices since the latest financial year, nor any known trends, uncertainties, demands, commitments or events that are reasonably likely to have a material effect of the Company's net sales or revenues, income from continuing operations, profitability, liquidity or capital resources, or that would cause reported financial information not necessarily to be indicative of future operating results or financial condition.

### E. OFF BALANCE SHEET ARRANGEMENTS

Under SEC regulations, we are required to disclose our off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors. An off-balance sheet arrangement means a transaction, agreement or contractual arrangement to which any entity that is not consolidated with us is a party, under which we have:

- o Any obligation under certain guarantee contracts;
- o Any retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to that entity for such assets;
- o Any obligation under a contract that would be accounted for as a derivative instrument, except that it is both indexed to our stock and classified in stockholder's equity in our statement of financial position; and
- o Any obligation arising out of a material variable interest held by us in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to us, or engages in leasing, hedging or research and development services with us.

As of the date of this Report, the Company has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

### F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The Company has no contractual obligations and commercial commitments as at December 31, 2004 except the following:

Total