REVIEW OF OPERATIONS

(1) Construction materials

The VSC Group's construction materials businesses comprise distribution of steel and building products primarily to developers and contractors for construction works. Although the local economy continued to depress, the construction materials businesses experienced a moderate growth in both turnover and operating profit. Turnover for the period increased by 24% while operating profit for the period increased by 8% over the same period in 2001.

Turnover of the **steel department** increased by 18% as compared to the corresponding period of last year but the gross profit declined by 12%. Benefiting from various ongoing public and infrastructure works, the piling business recorded a 213% increase in the tonnage delivered. The decrease in gross profit was mainly attributable to several low-price rebars contracts signed during the fierce price war experienced by the VSC Group last year. The VSC Group is encouraged to report that such fierce pricing cutting activities had not continued for an extended period of time.

Under the overall unfavourable market conditions in Hong Kong, the steel department continued its effort in reducing operating cost and expanding revenue base. The steel department focused to streamline the operation to achieve a higher efficiency, optimise stock level to reduce inventory holding cost, diversify product range to enhance revenue and develop new and reliable suppliers to mitigate risk. Cross Functional Teams were set up for supply chain management and accounts receivable management. Vigorous cost saving measures were adopted. As a result to all these efforts, less inventory in warehouse, lower total cost of ownership of holding inventory, shorter days of receivable and reduced operating logistic costs were recorded. The department had also successfully developed reliable and cost effective sources of supply from nearby countries to enhance its competitiveness, provide wider range of products and increase market share.

Redressing a number of problems like high staff turnover, lack of awareness by customers and poor technical support from supplier in last year, the soil nails and couplers business achieved breakeven in the current period after implementing measures like outsourcing to new subcontractor, restructuring of sales force and installation of Oracle Enterprise Resources Planning ("ERP") system. The steel department will continue its effort to improve customer service quality through more efficient processes in both hardwares and softwares, allying with more reliable subcontractors, and deepening market penetration through more marketing effort.

The **building products department** is making progress to recover from its weak performance. Turnover increased by 403% to HK$86 million and operating loss narrowed to HK$0.7 million compared to loss of HK$2.8 million last year. Harvesting from the three major projects, namely Sorrento, Kowloon Station, Coastal Skyline, Tung Chung Station and Bellagio, Sham Tseng, the kitchen cabinet division contributed over 70% to the department's turnover. The three projects are expected to be completed in a few months and will continue to contribute profit to the department.

The sanitary ware division was still adversely hit by the declining market and keen competition which resulted in a 29% decrease in turnover. The division had spent tremendous efforts in reducing inventory level and centralising storage facilities. Inventory was reduced from HK$5.4 million in September 2001 to HK$3.1 million in September 2002 and as a result, storage expense reduced by approximately 51% over the same period last year.

While there is keen competition in the project sales market, the VSC Group during the period had diversified into the retail side of the business to complement its project business. A retail shop/showroom, **Leisure Plus,** was opened in April 2002 in Hong Kong to arouse market awareness, enhance company image and offer a channel for customers to experience the actual products and services. Performance of Leisure Plus was encouraging. Situated in a prime yet cost-efficient location and complemented by a target customers oriented marketing programme, the outlet had attracted enough business to achieve breakeven in its first 6 months' operation. Besides generating profit, the showroom had brought tremendous synergy effect on project sales of kitchen cabinets, sanitary ware and tiles. With the support of the suppliers, the department is planning to systematically establish new retail shops and showrooms to expand its presence in Macau and strategic target cities in Mainland China.

REVIEW OF OPERATIONS (Continued)

(2) Industrial products

The VSC Group's industrial products businesses include processed rolled steel products of its Dongguan coil centre, its Shenzhen factory for manufacturing of enclosure systems, as well as engineering plastic resins and injection moulding machines. For the period under review, turnover and operating profit both increased significantly by 32% and 107%, respectively.

Dongguan coil centre achieved consistently encouraging result for the period by recording 32% and 140% increases in turnover and gross profit, respectively. Through effective supply chain management and continuous production process improvement, Dongguan coil centre had managed to increase its production capacity to address the rising demands from customers. Appearing to be unaffected by the global economic recession, the major customers of Dongguan coil centre whom are engaging in mass production of computers and visual/audio equipments are still continuing to feed large-volume orders to the coil centre. The increases in revenue were further fuelled by the rise of selling price of steel products as a result of the imposition of punitive tariffs by US government in the first quarter of 2002. To further diversify the VSC Group's revenue stream by exploring the market growth potentials, the VSC Group decided in July 2002 to build a new coil centre in Tianjin after careful study of the market. Total capital investments for land, factory construction and machineries were estimated to be approximately HK$25 million. Construction of the factory is in smooth progress and the new coil centre is expected to start production by March 2003, addressing the high growth potential of the northeast China market.

With the continued improvement in production capability and efficiency, **VJY enclosure systems** achieved nearly HK$20 million turnover in the six months ended 30 September 2002 as compared to the turnover of around HK$5.6 million for the first four months of operation in last year. Capitalising on the strategic partnership developed with its major customers such as Huawei, Zhongxing and Emerson, VJY has secured sufficient business volume to attain a breakeven position. The operations will be further streamlined with the use of Total Cycle Time ("TCT") approach to shorten production cycle time and cost control measures will be implemented to improve the profitability.

In the period under review, the **plastics and machinery department** was still adversely affected by the weak US economy. For the plastics division, operating profit was down by 31% mainly due to the loss of distributorship of high profit margin products of GE Plastics. However, the division had been actively developing other brands of plastic resins such as Mitsubishi, UMG and Samsung, resulting in 9% increase in turnover. The division was successful in developing new customers to broaden its customer base. Number of customers from the target industries such as home appliances, electrical and electronics, lightings, and office automation grew steadily in the past six months. The new domestic sales outlet in Mainland China recorded satisfactory results, contributing about 20% to the division's turnover. The division will continue to explore ways to expand in the domestic market in Mainland China. The machinery division's turnover remained similar to last year with more sales of spare parts which had a much lower margin resulting in the decrease in operating profit by 56%. Revenue from commission of new machineries sold was significantly less because many customers held back on capital investment under the poor economy. The machinery division is actively developing new products and will work closely with the plastics division to look for further business opportunities.

(3) Other investments and associated companies

On 14 May 2002, the VSC Group increased its equity interest in its investment, **iSteelAsia.com Limited ("iSA")**, from 17.8% to 19.2% through share swapping and disposing of its entire equity interest in iMerchants Limited. The VSC Group is delighted to note that iSA had achieved a turnaround in financial results. For the 6-month period under review, turnover increased 92% to HK$343 million as compared to last corresponding period and net profit achieved was HK$6.8 million (2001 – net loss of HK$9.6 million). iSA and its subsidiaries (the "iSA Group") successfully gained market share in the vast business opportunities in Mainland China by a well-established distribution steel network with 6 sales offices in major cities, namely Beijing, Shanghai, Guangzhou, Tianjin, Shenzhen and Chongqing. Capitalising on its extensive local market coverage, brandname and strong strategic partnerships established over the past two years, the iSA Group will focus as an aggregator and distributor for the growing markets in Asia, particularly China. The VSC Group is satisfied with the iSA Group's performance and will continue to explore for opportunities to consolidate and rationalise its shareholding in iSA for better business synergy to both groups to solicit business, utilise resources and enhance business efficiency.

REVIEW OF OPERATIONS (Continued)

(3) Other investments and associated companies (Continued)

The **Baosteel Jingchang joint venture** continued to grow satisfactorily. Turnover increased by 33% to RMB104 million. Capitalising on the increase in steel prices as our coil centre, gross profit increased by 184%. Net profit reached RMB1.1 million as compared to net loss of RMB0.5 million last period.

On 5 December 2002, the VSC Group entered into an agreement with Shougang Holding (Hong Kong) Limited in which the VSC Group would acquire a 7.5% beneficial interest in a new joint venture company of the Bejing Shougang Group located in Beijing with a consideration of HK$23.4 million. The joint venture will be engaged in manufacturing and distribution of colour-coated steel plates with an annual capacity of 170,000 tonnes. Demand of colour-coated steel plates in Mainland China has been very high and mostly satisfied by import. With a booming demand from construction projects of the 2008 Olympic Games in Beijing and the hosting of the 2010 World Expo by Shanghai, such investment should not only offer attractive return to the VSC Group but also enable it to participate in distribution of finished goods and sourcing of raw materials for the joint venture.

PROSPECTS

Amid the deflation-battered economic environment in Hong Kong, the VSC Group had successfully recovered from its discouraging performance last year and emerged much stronger than before.

For the construction materials operation, Hong Kong's burgeoning transport infrastructure has provided and will continue to offer demand in rebars, piling, soil nails and couplers. Large-scale projects include Route 5 between Shek Wai Kok and Chai Wan Kok, Route 7 connecting Kennedy Town to Aberdeen, Route 9 from Tsing Yi via Ngong Shuen Chau to Sha Tin Section, Route 10 linking North Lantau and Yuen Long Highway, Central and Wanchai Reclamation, East Kowloon Clean City, East Rail Extension to Tsim Sha Tsui, West Rail, and 2nd Linkage with China invested by the Government and the two railway corporations. The Government has recently announced several new measures with a view to stabilising property market and improving economic climate. While the Government has pledged to minimise its interference on the property market such as the halt of Home Ownership Scheme, the positive impact, if any, on helping the recovery of private property market and hence the related construction activities would still yet to be seen. Some of the VSC Group's major private jobs include Nina Tower in Tsuen Wan and redevelopment of KMB, Lai Chi Kok Depot. With contracts-on-hand of about HK$660 million, the management remains cautiously optimistic about the future prospect of the construction steel business in Hong Kong. On the other hand, the VSC Group is keen to develop new markets in nearby cities. Macau, for example, offers vast opportunity to our construction materials for the construction of new casinos, cultural centre, hotels, theme parks, highways, etc. The VSC Group also plans to set up new retail shops and showrooms to expand its presence in Macau, Shenzhen, Beijing, Shanghai and other major cities in China.

For the industrial products operation, China's exceptionally strong economy characterised by an over 7% Gross Domestic Product (GDP) growth as compared to the global economy provides an exciting platform for the VSC Group to flourish. Our strategy of developing a chain of well-managed coil centres throughout strategic locations of Mainland China would provide a powerful engine to achieve rapid growth in turnover and profitability. The VSC Group will also explore to carry out similar steel or metal processing for other high-growth industries such as automotive parts so as to further develop its niche position in the market. The VJY enclosure systems manufacturing is well equipped to grasp the business growth of telecommunication products and aims to broaden its product scope to cabinet systems for computer and banking industry. Leveraging on the existing set up, VJY will strengthen its role of total solution provider to production of related network support equipment and provision of electronic manufacturing services. The plastics and machinery department will reposition its focus and establish distribution channel to serve the domestic market opened by the entry of China into the World Trade Organisation.

Operationally, the VSC Group will continue to implement the Oracle ERP system and internalise TCT methodology across all departments in the coming year. These efforts could serve to foster the three core values of the VSC Group, namely, teamwork, customer driven and continuous improvement.