BUSINESS REVIEW

It gives me great pleasure to report to our shareholders our business performance for the first half of the financial year ended on 30th September, 2002. During this first half period, turnover grew 23% to HK$735,000,000, while net profit for the period grew by 97% to HK$62,410,000. This net profit figure for the half-year period is 4.0% higher than the profit for the whole of last year. Against the backdrop of global economic downturn and continued declines in Hong Kong's domestic exports, this outstanding performance has been particularly gratifying. Part of the reason for the Group's remarkable performance can be attributable to the sustained growth in China's economy, enabling our domestic sales in China to continue to grow strongly. However, the more important reason for our excellent results is the fact that following completion of the Group's Business Re-engineering Project, all of our five core businesses have become much more focused on the upgrading of our products and services, resulting in greatly enhanced competitiveness in their respective industries. The Group's performance during this first half period can therefore be seen as an initial reflection of the Group's successful Business Re-engineering efforts.

High molecular chemical products and mixed solvents

The Division serves the toys, electronics, paper and woodcraft industries in the Pearl River Delta. During the past six months, the Division's successful efforts in upgrading its products and services have produced record levels of turnover and profit. Turnover and profit from operations were HK$176,346,000 and HK$27,112,000, representing increases of 7.5% and 14% respectively.

However, this Division's products are based on petroleum-derived raw materials, and raw materials prices can be quite sensitive to oil price movements. We anticipate that rising costs of raw materials may impact upon margins in the second half of the year. Coupled with normal seasonal effects, our expectation for the results of the Division in the second half of the year is slightly more cautious, despite our confidence that the business as a whole is still growing steadily.

Progress in the construction works of the new plant in Huiyang has been delayed by two months because of the heavy rain during this past summer. However, we are still confident that the new plant will come on-stream towards early 2004.

Paints

The results of the Paints Division in the first half of the year reflect the initial benefits of last year's management structure reorganization. Turnover and profit from operations increased respectively by 19% and 321%, to HK$239,937,000 and HK$22,501,000 respectively.

With gradual improvements in profit margins and with trade debtors and inventories under effective control, the Division is adopting a more aggressive stance towards new business development, including the recruitment of more high caliber staff to join the Division. We have also established a subsidiary "Bauhinia Paints Manufacturing (Shanghai) Co., Ltd." and will be setting up production facilities in Shanghai to exploit business opportunities in the Yangtse River Delta, targeting the area as a key development region for the paints business.

Raw solvents

In light of China's move to ban or to reduce the use of harmful aromatic solvents from the middle of this year, demand for the more environmentally benign ester-type solvents has increased. As one of China's major producers of esters, this increased demand has benefited the Division. Moreover, with continued capacity expansion during the past few years, the Division's competitiveness has benefited from the improved economy of scale. Turnover and profit from operations, at HK$202,027,000 and HK$15,172,000 respectively, both achieved significant growth during this reporting period, representing increases of 32% and 131% respectively.

Expansion into the adjacent 100,000 sq. ft. site will be completed by early next year, bringing the Division's capacity from 85,000 tons to 120,000 tons.

Lubricants

The Division considers the opening of our new plant in Tianjin to be a major turning point for our lubricants business in this financial year, as it has the potential to fundamentally solve the logistical difficulties of supplying all of China with only one production plant in Zhangjiang, enabling us to reduce operating costs while improving our service to customers. Therefore, we are disappointed at the almost three-month delay in the opening of the plant. While turnover and profit from operations reached HK$52,037,000 and HK$1,914,000 respectively, representing increases of 24% and 101% from the previous period respectively, they were below the Group's expectation.

We expect that the benefits from the improved logistics will gradually flow through the system and will be reflected in the second half year results. With China's WTO entry, we anticipate keener competition. It is likely that some weaker competitors who are uncompetitive in product quality will face possible elimination. We believe that these challenges will also present opportunities, and are confident that we will be able to seize the new business opportunities thus presented.

Inks

The Division invested HK$5 million at the end of last year to re-develop and expand its plant in Zhongshan, resulting in a 60% increase in production capability. However, this increase in plant capacity has been barely able to keep pace with business growth, and the Zhongshan plant is now operating at full capacity again. Accordingly, we will be opening a new production plant in Shanghai in the second half of this year. While relieving part of the demand pressures on the Zhongshan plant and enabling us to consolidate our business in the Pearl River Delta, this new facility will also provide the necessary hardware support for business development in the Yangtse River Delta region, using Shanghai as its operational center. We expect that East China will provide a major impetus for sustained high growth for the Inks business in future.

Turnover and profit from operations grew to HK$73,115,000 and HK$8,589,000 respectively, representing increases of 67% and 104% respectively.