

# Management Discussion and Analysis

## BUSINESS REVIEW

The Group is principally engaged in (i) the manufacture and sale of paints and blended solvents; (ii) the manufacture and sale of plastic colorants; and (iii) the trading of chemical materials. For the year ended 31st March 2003, The Group's turnover reached a record high of HK\$265,789,000, an increase of 34.3% over the previous year. Profit attributable to shareholders was HK\$17,503,000.

### Paints and blended solvents

This division continued to register strong growth, accounting for HK\$235,488,000 or 88.6% of the Group's total turnover. Compared to last year's turnover of HK\$160,401,000, the growth rate was about 46.8%. The increase in turnover was mainly attributable to (i) good market reception of the Group's products including toy paints, cabinet coatings, powder coatings and emulsion paints; (ii) the expansion of our sales workforce from about 50 a year ago to over 80; and (iii) the broadening of customer base from approximately 750 to over 1,100. In addition to maintaining a strong sales network in the Pearl River Delta area, the Group has set up sales offices in the coastal provinces of China. (See Future Prospects)

In pursuing an aggressive sales policy, we succeeded in achieving a record turnover but our gross profit ("GP") was inevitably affected. This was due to a number of reasons. To boost initial sales to new customers and to sustain the competitiveness of more mature products, lower selling prices and larger discounts were offered. Our manufacturing cost went up as our production headcount increased and more customers sought our comprehensive after-sales services. In particular, the volatile situation in the Middle East lingered on throughout the second half of the financial year, resulting in a steep rise of crude oil price. At one time, it rose to US\$34 per barrel, from a previous low of US\$25 in early 2002. This in turn triggered the price hike of many of our petroleum-based raw materials, some of which experienced a price increase of 15% or more. All these factors were responsible for eroding our GP margins.

On the other hand, the Group's net profit was also lower than expected. The primary reason was the increase in headcount which led to an increase in both distribution costs and administrative expenses. Distribution costs were HK\$13,615,000, up 8.9% from last year mainly due to higher commission paid out as an incentive to the Group's sales staff. Administrative expenses were HK\$24,932,000, an increase of 50.8% as compared with that of the previous year. This was mainly attributable to (i) increase in salaries and expenses related to staff quarters such as rental and utilities (ii) provision of bad debts and (iii) expenses incurred by the Company after listing such as listing fee, public relations and share registration.

### Plastic colorants

This division contributed a turnover of HK\$11,344,000, representing a decrease of about 15.5% from previous year's HK\$13,431,000.

The performance was disappointing as a result of personnel turnovers and relocation of manufacturing operations. With the appointment of a new technical director and the deployment of the sales workforce of the Paints and Blended Solvents Division, we hope that this segment will turn around and become a better contributor of revenue and GP to the Group.

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### **Chemical trading**

Turnover derived from the trading of chemical materials decreased by about 21.3%, from HK\$24,101,000 last year to HK\$18,957,000 this year.

The setback was mainly due to the loss of a major customer which had purchased printing ink products from us. On the other hand, it is expected that this division's strengthening in the sales of ink jet products and pigment pastes will more than make up for this loss in the coming year.

### **FUTURE PROSPECTS**

The PRC has successfully entered in the World Trade Organization ("WTO"). It is expected that PRC's accession to the WTO will attract many foreign investors, including manufacturing companies that are also users of industrial paints and related products. In addition, the continuous rise in the disposable income of PRC's consumers will lead to a greater demand for more sophisticated products, such as cooking ware with non-stick coatings. The future bodes well for the Group's diverse variety of products.

Within the next few years, the Yangtze River Delta region is expected to play a much bigger role in the PRC's economic growth. Not only does this region offer many favorable port cities conducive to trade, it is proximate to skilled labor, efficient administration and abundant foreign investments. To capitalize on the business opportunities in this region, the Group has set up a sales office each in Shanghai, Shantou and Quanzhou. Following the Group's success in the Pearl River Delta area, we are confident that we can establish a strong foothold in the coastal provinces of China by offering high quality products and impeccable services to our customers.

While the prospects for sales and higher market share are good, the Group must make a determined effort in the year ahead to reduce expenditure and improve earnings. Some steps are being taken, for example, to reduce rental and sales incentive payments. More significantly, headcount will be trimmed through layoffs and self-attrition to remove marginal performers.

In spite of cost reduction measures, we make no compromise on our technology and product developments. At present, our old staff dormitory is being converted into a technology centre to accommodate the Research and Development department. This, together with some prudent purchases of analytical tools and testing equipment, will amount to a capital expenditure of about HK\$3 million in the year 2003/2004.

With the Group's diverse range of products, broad customer base and well managed production facilities, we look forward to sustaining our business growth and profitability.

### **DIVIDENDS**

The Directors do not recommend the payment of a dividend (2002: Nil)

### **CLOSURE OF REGISTER OF MEMBERS**

Please refer to Note 3 of the Notice of Annual General Meeting at the end.

### LIQUIDITY AND FINANCIAL RESOURCES

As at 31st March 2003, the Group had total outstanding borrowings of approximately HK\$53,177,000, cash and bank balances of approximately HK\$26,504,000 and assets of approximately HK\$167,753,000. Current assets of the Group on the same date amounted to approximately HK\$122,082,000 whilst current liabilities were approximately HK\$77,987,000. The gearing ratio, calculated by dividing the total debts by the total assets, was equalled to 0.32 as at 31st March 2003 (2002 : 0.39).

The Group has minimal currency exposure as the majority of its transactions are denominated in Hong Kong dollars and Renminbi.

The Group generally finances its operations with internally generated cash flow and loan facilities from banks. Through proper management of its treasury functions, the Group will continue to maintain sufficient funds to meet its operational requirements as well as future development needs.

### PLEDGE OF ASSETS

As 31st March 2003, the Group has pledged bank deposits totalling approximately HK\$9,049,000 (2002 : HK\$2,723,000) and certain assets with a net book value of approximately HK\$5,295,000 (2002 : HK\$5,418,000) to secure bank facilities granted to the Group.

### CAPITAL STRUCTURE

As at 31 March 2003, the Group had cash holding of approximately HK\$26,504,000 (2002:HK\$7,233,000) and bank facilities of approximately HK\$117,000,000 (2002: HK\$67,082,000) provided by various banks at prevailing commercial interest rates. The Directors are confident that the Group is able to meet its operational and capital expenditure requirements.

### CONTINGENT LIABILITIES

	<b>Company</b> <b>2003</b> <b>HK\$'000</b>
Guarantees for bank loans and overdrafts of subsidiaries	117,000

As at 31st March 2003, save as disclosed above, the Group had no other material contingent liabilities.

### EMPLOYEES AND REMUNERATION POLICIES

As at 31st March 2003, the Group had over 640 employees of which about 610 operated in the PRC while the rest were based in Hong Kong and Macau. The employees' remuneration package includes salary, bonus and share options. Under the Group's remuneration policy, employees are rewarded on the basis of merit and job market conditions, and in accordance with the statutory requirements of the respective jurisdiction where the employees are engaged.