

MANAGEMENT DISCUSSION AND ANALYSIS

Financial Results

For the six months ended 30 June 2004, the Group recorded a turnover of HK\$336,471,000, representing an increase of 71% compared with HK\$196,549,000 in the corresponding period of 2003. Sales of rare earth products (including fluorescent materials) contributed 47% of the Group's total turnover, amounted to HK\$158,574,000, increased by 63% compared with HK\$97,365,000 in the corresponding period last year; sales of refractory materials (including high temperature ceramics) during the period amounted to HK\$177,897,000, representing an increase of 79% compared with HK\$99,184,000 in the corresponding period last year. Gross profit margin surged to 26% during the period from 20% in the corresponding period last year.

Commencing this period, Wuxi Xinwei Fluorescent Materials Company Limited, a subsidiary of the Group, is required to pay a 50% reduced Enterprise Income Tax in the PRC. The same goes for Wuxi Pan-Asia High Temperature Ceramics Company Limited ("Wuxi Pan-Asia") which the Group recently acquired. Thus, taxation for the period amounted to HK\$8,981,000, significantly higher than that of the corresponding period last year. After deducting taxation and minority interests, net profit for the period reached HK\$59,834,000, representing an increase of 1.7 times when compared with the corresponding period last year. Net profit margin rose to 18%. Earnings per share was HK6.23 cents.

Business Review

Rare Earth Business

In the first half of 2004, as the economy recovered, the demand for rare earth products grew. Furthermore, with the changing of the export tax rebate policy for rare earth products by the Chinese government, prices of some of the rare earth products rose and in turn led to stronger demand for and higher prices of downstream products of rare earth oxides.

During the period under review, the Group sold about 1,950 tonnes of rare earth products. Though the growth in sales volume was slightly below 10%, sales amount increased by over 60%. Selling prices on certain rare earth products such as lanthanum oxide and cerium oxide remained low, while prices of other rare earth products such as terbium oxide and dysprosium oxide surged a fold. Shortage of supply of these products and enormous demand of the application industries were the major reasons for the increase in prices. As for production cost, the prices of both raw and auxiliary materials

rose and fuel price increased by 30% because of shortage of resources. Despite of these, the gross profit margin of the Group's rare earth business in the first half of 2004 still rose to 15% from last year's 10%. In terms of market performance, heeding the impending reduction of export tax rebate on rare earth products by the Chinese government in 2004, several of the Group's major overseas customers ordered in advance at the end of 2003, hence affected the turnover from export in the first quarter of 2004. Though the Group secured several new customers in the first half of 2004, turnover contributed from overseas markets decreased to less than 30% from 40% in 2003. In particular, sales to Japanese market dropped significantly and contributed less than 5% of the turnover. However, with the development of the downstream products of rare earth oxides and broadening of rare earth applications, domestic market demand grew rapidly, hence offset the impact of the decreased export sales on the Group.

Besides, continuous improvement on the production technology of trichromatic phosphor, a rare earth application material, resulted in the betterment of the product in both quantity and quality. With growingly tense electricity supply, the public has been urged to cut electricity consumption. Promotion of using energy-saving rare earth trichromatic lights presents immense opportunities to the Group. During the review period, the Group's sales of fluorescent powder increased by slightly over 50% compared to that of the corresponding period last year. Gross profit margin remained at 20%.

Refractory Materials Business

Refractory materials business of the Group continued its stable growth with domestic market as its major focus. Domestic sales recovered after the drop prompted by the outbreak of Severe Acute Respiratory Syndrome last year, to approximately 26,800 tonnes in the first half of 2004, representing an increase of about 30% compared with the corresponding period last year. Gross profit margin remained at over 30%.

Striving to expand its product portfolio, the Group penetrated into high temperature ceramics business through an acquisition during the review period. High temperature ceramics fall within the category of special refractory materials and are used primarily by the electrical power industry. With the electricity supply constantly falling short of growing domestic demand leading to growth in electricity supply facilities and development of industries such as non-ferrous metals, the Group's high temperature ceramics business is presented with abundant opportunities. As the specification requirements of high temperature ceramics are stricter than conventional refractory materials,



it has a higher gross profit margin of close to 40%. In the first half of 2004, Wuxi Pan-Asia sold about 6,400 tonnes of high temperature ceramics products. The Sialon production line which commenced operation in the first quarter of 2004 served as a new growth driver for the business development.

Prospects

In the first half of 2004, the rise in production cost resulting from price surges of raw and auxiliary materials and shortage of electricity supply was a challenge for the Group. However, through the efforts of different departments in adjusting production, compensating of electricity shortages with self-generated power supply, raising sales price of products and enhancing internal management, it is effectively reduced the unfavorable impact on the operative environment of the Group.

Rare Earth Business

The continuous pursuance of technological excellence and product upgrade are vital for the Group in meeting market demand; and the development of new applications of rare earth products is the way to go. With advantage in rare earth separation, the Group will strive to broaden and deepen the development of value-added products. The additional trichromatic fluorescent powder production facilities and new rare earth polishing powder production project will both commence operation in the near future, promising to bring in better returns to the Group. To satisfy customers' rising requirements, the Group will continue to invest resources to strengthen its production facilities for producing yet better quality products. On the other hand, the Group would continue to devote itself in seeking opportunity to cooperate with rare earth mines.

Refractory Materials Business

As market demand for middle to high-end refractory products increases, the Group will continue to leverage its equipment and technology advantages to improve existing production facilities. New production lines of castable materials, highly densed zircon and highly densed chrome bricks are under construction. To enhance market competitiveness, the Group will adjust the scope and quality of refractory products to satisfy changing market demand and further increase investment in developing new refractory products. Furthermore, the Group will step up co-operation with raw material suppliers of refractory materials with the aim of keeping costs low. While maintaining its share of the metallurgy and construction material market, it will continue to seek to develop markets in the petrochemical and electrical power industries, making sure that the Group's refractory materials business adapts to both technological and marketing requirements.

Merger and Acquisition

Pursuant to the resolutions passed at the extraordinary general meeting held on 29 January 2004, the Group acquired Dynamic Goal Worldwide Inc. and its subsidiary, Wuxi Pan-Asia, which is involved in high temperature ceramics business. The consideration of HK\$207,000,000 was satisfied by allotting and issuing 172,500,000 new shares at a price of HK\$1.20 each. Net asset value of the acquired object amounted to HK\$63,505,000 that led to goodwill at HK\$143,495,000. Goodwill is amortised over 20 years.

The acquisition allowed the Group to extend the reach of its refractory materials business to cover high temperature ceramics and broadened its product category. With a rapidly growing business and relatively high gross profit margin, the business of Wuxi Pan-Asia will generate higher profit for the Group.

Liquidity and Financial Resources

As at 30 June 2004, the Group had cash and bank balances of approximately HK\$249,949,000. From the assets and liabilities of the newly acquired Wuxi Pan-Asia, there was a short-term bank loan of RMB50,000,000 added to the Group. Although there was such a bank loan, the Group still had net current assets of approximately HK\$595,917,000 as at the end of the period. Total liabilities to total assets ratio increased to 10%.

The Group was not exposed to material foreign exchange risk or interest rate risk. There was no charge on assets of the Group.

Authorised Share Capital

Pursuant to the resolutions passed at the extraordinary general meeting held on 29 January 2004, the authorised share capital of the Company was increased from HK\$100,000,000 to HK\$200,000,000 by the creation of 1,000,000,000 additional ordinary shares of HK\$0.10 each in the capital of the Company.

Staff and Remuneration

At 30 June 2004, the Group had a workforce of approximately 1,350 staff. Comprehensive remuneration and welfare packages are offered to them. During the period under review, HK\$9,095,000 was incurred in staff costs including directors' emoluments. The share option scheme has been re-established pursuant to the resolutions passed at the annual general meeting held on 4 June 2004.

