

Report of the Directors

The directors have pleasure in presenting their annual report and the audited financial statements for the year ended 31st December, 2004.

PRINCIPAL ACTIVITIES

The Company acts as an investment holding company.

The Group is principally engaged in the manufacturing of polishing compounds and polishing wheels in Mainland China under its own brand name **Pme** and the trading of various branded industrial abrasive products in Hong Kong and Mainland China.

Details of the activities of the principal subsidiaries of the Company are set out in note 34 to the financial statements.

SEGMENT INFORMATION

An analysis of the Group's turnover, revenue and segment information for the year ended 31st December, 2004 is set out in note 5 to the financial statements.

RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31st December, 2004 are set out in the consolidated income statement on page 20 of the annual report.

During the year, final dividend of HK1.25 cents per share (totalling HK\$12,000,000) for the year ended 31st December, 2003 have been approved and paid to the shareholders of the Company.

An interim dividend of HK0.3 cent per share (totalling HK\$2,880,000) for the year ended 31st December, 2004 was paid to the shareholders during the year.

The directors do not recommend payment of a final dividend for the year ended 31st December, 2004.

FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 52 of the annual report.

FIXED ASSETS

Details of the movements in the fixed assets of the Group for the year ended 31st December, 2004 are set out in note 14 to the financial statements.

SHARE CAPITAL

Details of the movements in the share capital of the Company for the year ended 31st December, 2004 together with the reasons therefore, are set out in note 25 to the financial statements.

SHARE PREMIUM AND RESERVES

Under the Companies Law (Revised) Chapter 22 of the Cayman Islands, the share premium of the Company is available for paying distributions or dividends to shareholders subject to the provisions of its Memorandum or Articles of Association and provided that immediately following the distribution or dividend the Company is able to pay its debts as they fall due in the ordinary course of business.

At the balance sheet date, in the opinion of the directors, the Company's reserves available for distribution to shareholders amounted to HK\$203,294,000.

Movements in the share premium and reserves of the Company for the year ended 31st December, 2004 are set out in note 27 to the financial statements. Movements in the share premium and reserves of the Group for the year ended 31st December, 2004 are set out on page 23 of the annual report.

SHARE OPTION SCHEME

The Company operates a share option scheme for the purposes to enable the directors of the Company to grant options to certain full-time employees (including executive directors, non-executive directors and independent non-executive directors of the Company) of the Group in recognition of their contributions to the Group. Summary of the terms of the share option scheme are set out in note 26 to the financial statements.

No share option has been offered and/or granted to any participants since the adoption of the share option scheme.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's Articles of Association or the laws of the Cayman Islands.

PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

During the year, the Company repurchased its own shares on the Stock Exchange as detailed below:

Month of repurchases	Number of shares repurchased	Highest price paid per share HK\$	Lowest price paid per share HK\$	Aggregate consideration paid HK\$
December 2004	2,000,000	0.150	0.149	299,800

The repurchased shares were subsequently cancelled and accordingly, the share capital of the Company was reduced by the nominal value of shares repurchased amounted to HK\$20,000.

Save as disclosed above, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the year.

Report of the Directors (Continued)

MAJOR CUSTOMERS AND SUPPLIERS

The aggregate sales attributable to the Group's five largest customers taken together accounted for less than 30 per cent of the Group's total turnover for the year.

The aggregate purchases attributable to the Group's largest supplier and the five largest suppliers taken together accounted for approximately 10.4 per cent and 34.6 per cent respectively of the Group's total purchases for the year.

None of the directors, their associates, or any shareholder (which to the knowledge of the directors owns more than 5 per cent of the Company's share capital) has any interest in the Group's five largest suppliers.

USE OF PROCEEDS FROM ISSUE OF NEW SHARES

The proceeds from the issue of new shares of the Company in connection with the listing of the Company's shares on the Stock Exchange on 13th November, 2002, after deduction of related expenses, amounted to approximately HK\$23.6 million. The net proceeds has been applied as follows:

- as to approximately HK\$8 million to improve the production facilities and the technical application center of the Group;
- as to approximately HK\$6 million to expand the Group's sales and marketing network and set up representative office in Mainland China;
- as to approximately HK\$5 million to reduce the Group's bank borrowings; and
- as to approximately HK\$4.6 million as general working capital of the Group.

USE OF PROCEEDS FROM PLACEMENT OF NEW SHARES

On 10th February, 2004, the Company placed 160,000,000 new shares at HK\$0.45 per share. Net proceeds from the placement of new shares, after deducting the professional fees and all related expenses, amounted to approximately HK\$69.7 million. Part of the net proceeds has been applied as follows:

- approximately HK\$9.2 million to improve and expand the production facilities of the Group;
- approximately HK\$3.2 million to support the research and development of the Group's products;
- approximately HK\$0.5 million to explore and develop the market for the Group in the eastern China;
- approximately HK\$5.0 million to reduce the Group's bank borrowings; and
- approximately HK\$36.7 million retained as general working capital and for future investment purposes.

USE OF PROCEEDS FROM PLACEMENT OF NEW SHARES (Continued)

The remaining balance of the net proceeds of approximately HK\$15.1 million is intended to be applied as follows:

- approximately HK\$5.8 million to improve and expand the production facilities of the Group;
- approximately HK\$1.8 million to support the research and development of the Group's products; and
- approximately HK\$7.5 million to explore and develop the market for the Group in the eastern China.

DIRECTORS

The directors of the Company during the year ended 31st December, 2004 and up to the date of this report were:

Executive directors

Mr. Cheng Kwok Woo, *Chairman*

Mr. Cheng Kwong Cheong, *Vice-Chairman and CEO*

Ms. Cheng Wai Ying

Mr. Chow Yin Kwang

Ms. Chan Yim Fan

Mr. Chung Kam Fai Raymond (resigned on 16th January, 2005)

Non-executive directors

Mr. Zheng Jin Hong

Mr. Charles Woo (resigned on 19th April, 2004)

Independent non-executive directors

Mr. Anthony Francis Martin Conway

Mr. Leung Yuen Wing (appointed on 30th September, 2004)

Mr. Lam Hon Ming Edward (appointed on 30th September, 2004)

Mr. Li Kin Kent (resigned on 30th September, 2004)

In accordance with Article 87(1) of the Company's Articles of Association, Messrs. Cheng Kwong Cheong and Zheng Jin Hong shall retire from offices in the forthcoming annual general meeting, and being eligible, offer themselves for re-election.

In accordance with Article 86(3) of the Company's Articles of Association, Messrs. Leung Yuen Wing and Lam Hon Ming Edward shall retire from offices by rotation in the forthcoming annual general meeting, and being eligible, offer themselves for re-election.

The biographic details of the directors are set out on pages 10 and 11 of the annual report.

Report of the Directors (Continued)

DIRECTORS' SERVICES CONTRACTS

Each of the executive directors has entered into a service agreement with the Company for an initial term of three years commencing from 1st October, 2002, and will continue thereafter until terminated by not less than three months' notice in writing served by either party on the other.

Saved as disclosed above, no director proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

DIRECTORS' INTERESTS IN COMPETING BUSINESS

None of the directors have any interest in competing business to the Group.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

At 31st December, 2004, the directors and chief executive of the Company have the following interests and short positions in shares, underlying shares and debentures of the Company or any associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO and the Model Code for Securities Transactions by Directors of Listed Issuers ("Model Code"), were as follows:

Long positions in the ordinary shares of the Company:

Directors	Number of shares held			Percentage of interests
	Personal interests	Corporate interests	Total interests	
Mr. Cheng Kwok Woo	54,400,000	304,498,000 <i>(note)</i>	358,898,000	37.46%
Mr. Cheng Kwong Cheong	54,400,000	304,498,000 <i>(note)</i>	358,898,000	37.46%
Ms. Cheng Wai Ying	54,400,000	304,498,000 <i>(note)</i>	358,898,000	37.46%
Ms. Chan Yim Fan	8,205,333	–	8,205,333	0.86%

Note: These shares are held by PME Investments (BVI) Co., Ltd. ("PME Investments"), a company incorporated in the British Virgin Islands (the "BVI"). The entire issued share capital of PME Investments is beneficially owned as to one-third by each of Mr. Cheng Kwok Woo, Mr. Cheng Kwong Cheong and Ms. Cheng Wai Ying.

Save as disclosed above, none of the directors, chief executive and their associates had any interests or short position in the shares, underlying shares or debentures of the Company or any of its associated corporations, within the meaning of Part XV of the SFO, as recorded in the register kept by the Company under Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO and the Model Code.

DIRECTORS' AND CHIEF EXECUTIVE'S RIGHTS TO ACQUIRE SHARES OR DEBENTURES

Save as disclosed under the heading "Directors' and Chief Executive's Interests and Short Positions in Shares, Underlying Shares and Debentures" above, at no time during the year were rights to acquire benefits by means of acquisition of shares in or debentures of the Company granted to any directors, chief executive, or their respective spouse or minor children, or were any such rights exercised by them; or was the Company or any of its holding company, or subsidiaries a party to any arrangement to enable the directors or chief executive to acquire such rights in any other corporate.

SUBSTANTIAL SHAREHOLDERS AND OTHER PERSONS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at 31st December, 2004, in accordance with the register of the substantial shareholders kept by the Company under Section 336 of the SFO, or to be disclosed under the provisions of Divisions 2 and 3 of Part XV of the SFO and the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"). The following persons were interested (including short positions) in the shares of underlying shares of the Company:

Long positions in the ordinary shares of the Company:

Name	Number of shares held	Percentage of interests
PME Investments (<i>note 1</i>)	304,498,000	31.78%
Mr. Cheng Kwok Woo (<i>note 2</i>)	358,898,000	37.46%
Mr. Cheng Kwong Cheong (<i>note 2</i>)	358,898,000	37.46%
Ms. Cheng Wai Ying (<i>note 2</i>)	358,898,000	37.46%
Ms. Tsang Sui Tuen (<i>note 3</i>)	358,898,000	37.46%
Ms. Wan Kam Ping (<i>note 4</i>)	358,898,000	37.46%
Mr. Cheng Yau Kuen (<i>note 5</i>)	358,898,000	37.46%

Notes:

- PME Investments is an investment holding company incorporated in the BVI and its entire issued share capital is beneficially owned as to one-third by each of Mr. Cheng Kwok Woo, Mr. Cheng Kwong Cheong and Ms. Cheng Wai Ying.
- Each of Mr. Cheng Kwok Woo, Mr. Cheng Kwong Cheong and Ms. Cheng Wai Ying personally holds 54,400,000 shares of the Company, being approximately 5.68% of the entire issued share capital of the Company. Each of them is further beneficially interested in one-third of PME Investments and is accordingly deemed to be interested in the entire interests of PME Investments in the Company.
- Ms. Tsang Sui Tuen is the spouse of Mr. Cheng Kwok Woo and is accordingly deemed to have interest in 358,898,000 shares of the Company that Mr. Cheng Kwok Woo has interest in.
- Ms. Wan Kam Ping is the spouse of Mr. Cheng Kwong Cheong and is accordingly deemed to have interest in 358,898,000 shares of the Company that Mr. Cheng Kwong Cheong has interest in.
- Mr. Cheng Yau Kuen is the spouse of Ms. Cheng Wai Ying and is accordingly deemed to have interest in 358,898,000 shares of the Company that Ms. Cheng Wai Ying has interest in.

Save as disclosed above, no other parties were recorded in the register required to be kept under Section 336 of the SFO as having an interest or a short position in the shares or underlying shares of the Company as at 31st December, 2004.

Report of the Directors (Continued)

CORPORATE GOVERNANCE

In the opinion of the directors, the Company has complied throughout the year with the Code of Best Practice (the "Code") as set out in Appendix 14 to the Listing Rules, except that the independent non-executive directors of the Company are not appointed for specific terms as required by the Code, but are subject to retirement by rotation and re-election in accordance with the Company's Articles of Association.

The Company has adopted the Model Code as the Company's code of conduct for dealings in securities of the Company by the directors. All directors have complied with the required standard set out in the Model Code throughout the accounting period covered by the annual report.

The Company has received from each of the independent non-executive directors an annual confirmation of his independence pursuant to Rule 3.13 of the Listing Rules. The Company considers that all of the independent non-executive directors are independent.

AUDIT COMMITTEE

The Company has an Audit Committee which was established in accordance with the requirements of the Code for the purposes of reviewing and providing supervision over the financial reporting process and internal controls of the Group. The Audit Committee members include three independent non-executive directors of the Company.

REMUNERATION COMMITTEE

The Company has established a Remuneration Committee to advise the Board on the annual remuneration packages of the directors of the Company. The Remuneration Committee members include three independent non-executive directors, the Chairman and the Vice-Chairman of the Company.

PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of its directors, the Company has maintained sufficient public float as required under the Listing Rules as at the date of this report.

AUDITORS

A resolution to reappoint Messrs. Deloitte Touche Tohmatsu as auditors of the Company will be proposed at the forthcoming annual general meeting.

On behalf of the Board
Cheng Kwong Cheong
Vice-Chairman & CEO

Hong Kong, 19th April, 2005