

# Management Discussion and Analysis

## **BUSINESS REVIEW**

The Group is principally engaged in (i) manufacture and sale of paints and blended solvents; (ii) manufacture and sale of plastic colorants; and (iii) trading of chemical materials. For the year ended 31st March 2005, the Group's consolidated turnover amounted to HK\$284,478,000 a trifling decrease of 2.4% compared to that of previous year. Loss attributable to shareholders was HK\$4,737,000.

### **Paints and blended solvents**

The division recorded a turnover of HK\$269,693,000, or a slightly increase of 2% over the previous year. The division contributed a profit for the year under review.

During the period under review, as the international crude oil price and the cost of the petroleum-based raw materials such as solvents, resins and additives were prevailingly high, the operating environment for petroleum-linked industries had remained tough. Since the increase in raw material costs could only be partially passed on to customers after a time lag, the upsurge in the manufacturing costs did erode the gross profit margin of the Group.

In terms of market segment, demands for toy paints and metal paints, which were highly vulnerable to the oil price volatility, had showed less briskly than other products like cabinet and UV cured plastic paints during the year.

### **Plastic colorants**

The division contributed a turnover of HK\$8,523,000, up 1% from last year. Also being adversely affected by the industry-wide increase in direct costs relating to raw materials and labour, the division incurred a loss for the year under review.

### **Chemical trading**

The division accounted for a turnover of HK\$6,262,000, as compared to HK\$18,811,000 of last year. The division also incurred a loss for the year under review.

During the review period, the Group's trading business line has been directly suffering from the fluctuation of international crude oil price on world-wide scale. The sustained increase in prices of petroleum-based raw materials has resulted in the imbalance of supply and demand that had never been experienced before.

### **Implementation of ERP system**

Subsequent to a number of business requirement studies and process reviews conducted last year, deployment of the ERP system will be gathering momentum in the coming year. By means of instant and precise management information flows within the organization, the ERP system will help enhance the Group's capabilities in the areas of costing, pricing and financial management.

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### Commitment to environmental protection

To strive for the accreditation of ISO14000 environmental protection management system, the Group has commissioned the environmental specialists to carry out environmental appraisals on its major production facilities in Dong Guan City of PRC. Furthermore, the Group has invested approximately HK\$3,000,000 for the infrastructure of environmental protection facilities within the existing production plants. The Group will be benefited from such an effective material and energy consumption management, which in turn production costs, cost of waste and pollution will be greatly reduced. The enhancement of corporate image and customer relationship satisfaction will probably help the Group increase competitive edge and market share.

### FUTURE PROSPECTS

In the wake of the sustainable economic growth in the PRC, business outlook for the Group's industrial buyers will be promising and keeping pace with the strong domestic demands in the foreseeable future. As demands for electronic product casing paints and mobile phone coatings are expected to have notable growth, the Group will continue to devote itself to research and development for such products with huge market potential. The proposed acquisition of Zhongshan Wing Shing Ling Feng Chemical Company Limited, a limited liability company established in Zhong Shan City will also lead the Group to diversify its products into coatings for wooden furniture and decoration with steady demands.

The Group has prepared itself for the demands rebound in the foreseeable future by aggressively expanding its production capacity, auxiliary facilities and accessories during last year. In the coming year, it will probably not entail any significant capital expenditure on the Group to cope with the emerging sales demands.

To intensify the market penetration strategy, the Group has added five more sales outlets in the cities, Shantou, Shanghai, Nanning, Changxia, Nanchuan, to the present sales network in Yangtze and Pearl River Deltas. Furthermore, the proposed acquisition of the Dongguan City Changan Xinyimei Paint Company Limited is in line with the Group's business strategy of expansion in both manufacturing capacity and customer base.

Looking forward, with effective and efficient cost control measures, particularly over direct costs and overheads, the Group's gross profit margin will be improving. Under continuous pricing review, sales revenue will also be boosted by expansion in both market and product range.

### DIVIDENDS

No interim dividend was paid or declared in respect of the year ended 31st March 2005 (2004: HK\$0.005 per ordinary share).

The Directors do not recommend the payment of a final dividend in respect of the year ended 31st March 2005 (2004: HK\$0.005 per ordinary share).

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### CLOSURE OF REGISTERS OF MEMBERS AND WARRANTHOLDERS

The registers of members and warrantholders of the Company will be closed from Monday, 22nd August 2005 to Friday, 26th August 2005, both days inclusive, during which period no transfer of shares will be effected and no transfer or exercise of warrants will be effected. In order to determine the identity of members who are entitled to attend and vote at the annual general meeting, all transfer documents accompanied by the relevant share certificates or all completed subscription forms in relation to the exercise of the warrants accompanied by the appropriate subscription monies and the relevant warrant certificates must be lodged with the Company's branch share registrar in Hong Kong, Computershare Hong Kong Investor Services Limited at Rooms 1712-16, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong for registration not later than 4:00 p.m. on Friday, 19th August 2005.

### LIQUIDITY AND FINANCIAL RESOURCES

The Group generally finances its operations with internally generated cash flow and banking facilities from banks. As at 31st March 2005, the Group had bank balances and cash of approximately HK\$17,050,000 (2004: HK\$17,868,000) and total outstanding borrowings of approximately HK\$100,779,000 (2004: HK\$44,549,000). Current assets of the Group amounted to approximately HK\$147,820,000 (2004: HK\$132,939,000) whilst current liabilities were approximately HK\$135,427,000 (2004: HK\$91,124,000).

The gearing ratio, calculated by dividing the total borrowing by the total assets, was equal to 0.41 as at 31st March 2005 (2004: 0.23).

The Group was required to comply certain restrictive financial covenants imposed by a major bank. The financial covenants include, among other things, the maintenance of the following specific financial ratios as at 31st March 2005: (1) the net gearing ratio, defined by the bank as all interest bearing debt less cash balance over consolidated tangible net worth, shall not exceed 0.9:1; (2) minimum interest coverage ratio shall not be less than 6:1; (3) minimum current ratio shall not be less than 1.2:1 and (4) the amount of capital expenditure, as defined by the bank, shall not exceed HK\$25,000,000 for the fiscal year. The Group did not fulfill these four financial covenants as at 31st March 2005, but obtained waivers from the relevant bank in respect of such non-compliance subsequent to 31st March 2005.

As at 31st March 2005, the Group had banking facilities of approximately HK\$206,397,000 (2004: HK\$132,960,000) granted by various banks at prevailing market interest rates. The management is of the view that the Group's incoming cash flow from business operations together with the available banking facilities will provide sufficient funds for the Group to meet the requirements for present operation and further business development in the foreseeable future.

### PLEDGE OF ASSETS

As at 31st March 2005, no assets of the Group were pledged. As at 31st March 2004, certain of the Group's assets with a net book value of approximately HK\$6,512,000 were pledged to secure banking facilities granted to the Group.

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### DISCLOSURE PURSUANT TO RULES 13.13 AND 13.15 OF THE LISTING RULES

Pursuant to Rule 13.13 and 13.15 of the Listing Rules and on the basis of the latest consolidated management accounts of the Company as at 31st March 2005, the Company disclosed in its announcement dated 26th July 2005 the Group's certain accounts/trade receivables due from, or advances made to, three entities, which individually exceeded 8% of the consideration ratio as defined in the Listing Rules. With regard to the trade receivables in the total sum of HK\$12.073 million due from 廣州市荔灣區金寶化工產品經營部 (Guangzhou City Liwan District Jinbao Chemical Products Trading Department, "Jinbao Chemical") as at 31st March 2005, the Directors would like to emphasize that these trade receivables, which arose primarily from the provision of the Group's products to it, were within the relevant credit periods granted to Jinbao Chemical. The relevant credit periods were 120 days for five sums of these trade receivables in the aggregate amount of HK\$4.881 million and 90 days for four sums of these trade receivables in the aggregate amount of HK\$7.192 million respectively. As at 30th June 2005, the balance of these trade receivables was HK\$1.511 million.

### EXPOSURE TO FOREIGN EXCHANGE RISK AND INTEREST RATE RISK

The Group's exposure to foreign exchange risk is minimal as its business transactions are mainly denominated in Hong Kong dollars and Renminbi. All interest bearing bank borrowings of the Group is on floating rate basis. The management is of the view that the Group's exposure to foreign exchange risk and interest rate risk is insignificant, and hence risk hedging by means of derivative instruments is considered unnecessary.

### EMPLOYEES AND REMUNERATION POLICIES

As at 31st March 2005, the Group had an aggregate of 562 (2004: 662) employees of which about 535 (2004: 633) located in mainland China while the rest were based in Hong Kong and Macau. The employee's remuneration package includes salary, bonus and share options. Pursuant to the Group's remuneration policy, employees are rewarded on the basis of merit and market conditions, and in accordance with the statutory requirements of the respective jurisdiction where the employees located.