# MANAGEMENT DISCUSSION AND ANALYSIS

## OPERATING REVIEW

### Trading Division

The principal trading activities of the Group and the contribution of each activity to the Group are summarized as below:

| | Turnover | | Segment Result | |
|---|---|---|---|---|
| **For the Year ended:** | **31.12.2005 HK$' 000** | **31.12.2004 HK$' 000** | **31.12.2005 HK$' 000** | **31.12.2004 HK$' 000** |
| Electroplating Materials and Chemicals | 1,759,158 | 1,586,352 | 52,156 | 38,554 |
| Paint and Coating Chemicals | 124,406 | 113,937 | 6,271 | 5,725 |
| Stainless Steel | 59,930 | 50,757 | 7,436 | 8,146 |
| **Total** | **1,943,494** | **1,751,046** | **65,863** | **52,425** |

**Electroplating Materials and Chemicals**

Strong commodity prices of the metals were the main drivers of the growth in 2005. Total trading turnover gained by 10.9% to HK$1.76 billion. Higher commodities prices also offset impacts of slow sales demand in precious metal products. In geographical points of view, improved economic conditions encouraged sales in Indonesian and Malaysian region. Sales in Korea and Thailand, however, fell substantially because of loss in customers. Direct sales to China also fell as local competitors damaged the market by offering below-market-price strategies. Chinese factories were still suffering from shortage in electricity, skilled labor and high raw material prices. By the end of the year, shortfall of nickel in China pushed up the overall turnover significantly and also improved the full-year profitability.

**Precious Metal Products**

Weakening performance continued in precious metal business although stronger commodity prices contributed higher operating profits when compared with that in previous year. In spite of abolishment of tax rebate in gold products by Chinese government since mid-year, the overall market remained highly competitive. Rising concerns in environmental issues tightened regulations and import permits issuances to Chinese factories when using cyanide products for manufacturing. Sales volume in silver products tumbled as we insisted to sell with profits, not for market shares. Slow demand in palladium also dampened down the overall precious metal business. Sales in rhodium rose but profit margin was trimmed down almost half due to fierce competition among local and Chinese producers. Further squeezing in profit margin is expected in 2006 as many factories may seek for alternatives together with intensified competition.

**Base Metal Products**

Nickel electroplating business experienced a volatile environment in 2005. The pace of de-stocking within China market directed the whole sales turnover and profitability. The growth in turnover in 2005 partly benefited from the rise in commodity price and partly from supply shortage within China close to the end of the year. Such shortage escalated average margin in 2005. Robust economic growth in South East Asian countries also supported the nickel consumption in general as demand from Indonesia, Malaysia, and Taiwan remained strong in the second half year of 2005. Copper electroplating business experienced a flourishing year due to solid demand from printed-circuit board industries. With support of exceptional strong commodity price, sales turnover and gross profit both rose double-digits in the year. Competitions eased close to the end of the year as shortage in supply was also noticeable in the market.

Total inventory level as at 31st December, 2005 posted at HK$ 129.7 million, representing a decrease of 9.7% when compared with HK$ 134.2 million as at 31st December, 2004. The management has shortened the credit extension to customers so as to accelerate the cash flow period for commodity financing and minimize the risk in face of high commodity price.

**Paint and Coating Chemicals**

Total sales volume of 2005 improved by 9.2% over the same in 2004 and gross profit rose by 6.8%. Expanded production from Chinese competitors continued to intensify competition in local and global markets. Since the second half year of 2005, amid international oil price hovering at high level, cost pressure from suppliers as well as stockpiling effect in China market trimmed down part of our competitiveness. Oversupply situation in China has not been eased in early of 2006. Some of our major products experienced a decrease of more than 30-40% in selling price within a year. To cope with the market change, we shifted our focus to promoting high quality paints materials and secured supply channel into foreign-owned chemical companies. In addition, our suppliers also provide continued support to ensure our competitiveness in China market.

**Stainless Steel**

Stainless steel prices went up strongly in the first half year of 2005 because of the increase in raw material prices and the imbalance of supply and demand. With substantial increase in production including China and India, overcapacity started to hit most of coil and flat products in the mid-year, dragging down prices in the world markets. Amid the fall in global stainless steel price since the second half of the year, segment results consequently slightly dropped by 8.7% while sales volume rose by 18.0% over that of last year. Many stainless steel mills in Europe and Japan responded by cutting production since the third quarter till now to reduce global stockpiling and stabilize the world prices. In the early of 2006, worldwide depleted stock level has started to rebuild again as demand expanded in Europe and the U.S. Erosion in base price of stainless steel has also ceased. As at 31st December, 2005, average inventory cost was slightly below the latest purchase cost. Inventory level was reported at HK$ 15.8 million as at 31st December, 2005 (as at 31.12.2004: HK$ 13.4 million).

**Property Investment Division**

Total rental income rose by 9.7% to HK$15.8 million in 2005 when compared with HK$ 14.4 million in 2004. For the whole year, we only sold 4 residential flats in Haihua Garden with average selling price of RMB14, 501.7 per square meter. Gain from properties sales was recorded at HK$1.3 million before tax.

2005 total average occupancy rate for Hong Kong office was 89.3% when compared with 88.0% in 2004. As at 31st December 2005, occupancy rate was 100.0%. With Hong Kong economy trekking up during 2005, robust demand, generated mainly from multinational financials institutions, shrunk the vacancy in prime office spaces and boosted overall rental return in Grade A offices. High expectation of uprising rental from landlords narrowed the tenants' option and demand of spaces in second-tier office buildings located in prime commercial districts was improving starting in the fourth quarter of 2005. Market rent was also picking up close to the year end. Average monthly rental per square foot rose by 10.0%.

Average occupancy rate of Shanghai offices during 2005 was 99.9% compared with 92.4% during 2004. As at 31st December, 2005, office spaces in Shanghai were fully occupied. Supply of Grade A offices was still insufficient to cope with hefty demand from foreign financial institutions which they took opportunities to expand before China opens financial markets to overseas enterprises in 2006. Soaring office rental also drove up property price in Grade A offices. Such trend continued in the 1st quarter of 2006.

Average occupancy rate of Shanghai residential properties during 2005 recorded at 81.3% compared with 90.8% during 2004. As at 31st December, 2005, occupancy rate was at 79.2%. After implemented measure to control Shanghai residential properties market in 2005, the rally immediately cooled down to a stable growth condition. Plentiful supply in investor-owned residential properties pressured down the overall rental market in downtown area. Our rental level was cut down by an average of 30-35% when compared with the rental in 2004. As tenants have much broader option to select, vacancies also rose at the year end. Sales market in the second half year mainly concentrated at low-end properties (selling price marked below RMB 10,000 per square meter) in which it was expected government was taking an active role to help recover the volume transaction. The luxury residential properties showed a rebound at the end of year but a further decrease in average selling price was witnessed. As our properties was priced at mid-level (over RMB 10,000 but less than RMB 18,000 per square meter), transaction remained thin but market prices were resilient.

Following the new accounting standard, a total of HK$ 9.955 million was credited on revaluation of Shanghai and Hong Kong Investment Properties after revalued by appointed surveyor as at 31st December, 2005.

**Securities Investment Division**

After the adoption of the Hong Kong Accounting Standards 32 and 39, the Group's securities portfolio has been re-classified. An analysis of the portfolio, current and non-current, by type of securities as at 31st December, 2005 is as below:

| Market Value as at | 31/12/2005 | 31/12/2004 | Diff % |
|---|---|---|---|
| Investment held for trading (in HKD' 000) | 175,783 | 155,753 | +12.5% |
| Distribution of Securities: | | | |
| Equities – Hong Kong | 33,195 | 37,081 | -10.5% |
| Equities- Overseas | 25,804 | 25,570 | +0.9% |
| Equities - Unlisted | 0 | 1,170 | -100.0% |
| Debt – Quoted/Listed | 49,177 | 47,153 | +4.3% |
| Mutual Funds – Quoted | 67,607 | 45,181 | +49.6% |
| Equity-linked Deposits | 0 | 768 | -100.0% |

In 2005, stock markets in Europe, North and South Asian countries performed outstandingly whereas markets in the U.S. were reported almost no change on a yearly basis. The U.S. Treasuries market showed mixed performance, and inverted yield-curve was observed at the year end. Bond markets in Asian countries were performed badly as depreciation in currencies as well as inflation pressured policymakers to raise their interest rates. US dollar was exceptional strong against major currencies, except Chinese yuan, despite fear of inflation pressure and slow-down economy. Commodities market continued to be a shining star among all as oil was up 48% and gold jumped 14.5% year-on-year basis.

During 2005, we sold under-performed securities and part of bond-related funds and invested into equities-related managed funds totaling HK$41.2 million. Under the new accounting standards, we credited a net gain of HK$ 3.4 million in fair value of investment held for trading and structured bank deposits, together a loss of HK$127k on disposal of investment held for trading. Large corporations continued their high dividend payout scheme during the year. Therefore, dividend income rose to HK$ 2.4 million when compared with HK$ 1.5 million in 2004. Interest income generated from portfolio was reported at HK$ 1.7 million.

Looking towards 2006, it is expected that oil –price volatility remains high and inflation pressure continued to be one of the concerns among all investors. The newly appointed U.S. Federal Reserve Bank Chairman Bernarke has pledged to continue the Fed's fight against inflation, with an aim to preserving the stability of the financial markets and fostering employment. The management will continue to review and monitor the whole portfolio and the global markets as well and re-allocate the securities if necessary to cope with the changing financial markets.

**EMPLOYEES**

Total number of the Group's staff reduced by 2 persons to 85 persons as at 31st December, 2005 comparing with 87 persons as at the year ended 2004. Staff turnover rate remained steadily low.

In accordance with HKAS 19 Employment Benefits, we are required to provide for the cost of benefits determined by actuarial valuation being carried out as at 31st December, 2005. The cost of benefits for employment was determined at HK$ 2.1 million as of 31st December, 2005. Excluding such cost, total staff cost in 2005 only rose by 5.0% over than in 2004. The rise in staff cost was in line with inflation index, staff yearly performance evaluation as well as better payout for improved performance for the whole year of 2005.

In 2006, the management will continue to encourage staff to continue his/her further studies in his/her particular field to enhance and enrich professional knowledge and current practices.

**FINANCIAL RESOURCES AND LIQUIDITY**

For the year of 2005, cash inflow from operation activities was HK$ 59.8 million when compared cash outflow from operation of HK$ 52.3 million for the year of 2004. The rise in cash flow was mainly driven by reduced inventory level and account and bills receivable level. Equity attributable to equity holders of the parent company dropped by 2.8% to HK$ 593.4 million following a total dividend distribution of HK$ 89 million made during the year 2005. Return on equity ratio for the fiscal year of 2005 was 11.4% when compared with 8.4% for the fiscal year of 2004.

Working capital as at 31st December, 2005 dropped by HK$ 8.5 million to HK$ 265.7 million when compared with HK$ 274.2 million as at 31st December, 2004. Inventory as at 31st December, 2005 was posted at HK$ 145.4 million, representing a decrease of 1.3% when compared with HK$147.3 million as at 31st December, 2004. The fall in inventory was partly due to limited supply from our core suppliers and partly due to reduction in goods ordering before Chinese New Year. Trade debtor amounted to HK$ 143.6 million as at 31st December, 2005, representing an increase of HK$ 14.8 million over the same last year, was mainly a reflection of rising metal prices over credit sales. Trading turnover day as at 31st December, 2005 remained the same as that as at 31st December, 2004 at 27 days.

The Group net cash outflow as at 31st December, 2005 amounted to HK$ 63.8 million (As at 31st December, 2004: net cash outflow HK$ 43.3 million). Negative net cash due to dividend payment during the year was main reason of the fall in total short term cash reserve. Capital expenditure during the year amounted to HK$ 2.2 million (2004: HK$ 3.4 million).

**An analysis of cash and short term bank deposits by currencies as at 31st December, 2005 and 31st December, 2004 are set out below:**

| As at | HKD | USD | EUR | SGD | RMB | NTD | Other |
|---|---|---|---|---|---|---|---|
| **31/12/2005** | **29.9%** | **56.2%** | **0.5%** | **4.6%** | **8.2%** | **0.3%** | **0.3%** |
| 31/12/2004 | 14.6% | 77.0% | 3.7% | 0.6% | 0.8% | 2.1% | 1.2% |

**DEBT STRUCTURE**

**An analysis on bank borrowings by currencies as at 31st December, 2005 and 31st December, 2004 are set out below:**

| As at | HK Dollar | US Dollar | Japanese Yen |
|---|---|---|---|
| **31/12/2005** | **83.4%** | **11%** | **5.6%** |
| 31/12/2004 | 90.2% | 4.7% | 5.1% |

All borrowings are in form of Money Market bank loans and Trust Receipt for the year 2005. Average lending tenor for Trust Receipt in financing trading facilities was about 56 days in the fiscal year of 2005, two days shorter than 58 days in 2004. Money-Market bank loans is either used to finance additional safety stocks held or to financed assets purchased in the same foreign currencies. Average interest rate charged to trust receipt borrowings was 3.86% in fiscal year 2005 when compared with 1.53% charged to trust receipt borrowings in 2004. Average total bank borrowing interest rate charged at 3.77% in 2005 whereas 1.52% was charged in 2004. Total finance cost in 2005 accounted HK$ 9.9 million (2004: HK$ 4.1 million).

As at 31st December, 2005, total banking facilities granted by lenders to the Group amounted HK$ 628.2 million. Average banking utilization rate accounted at 43.4% during 2005. Debt to equities ratio declined to 0.46: 1 as at the period ended 31st December, 2005 when compared with 0.49:1 as at the year ended 31st December, 2004. During the year, we employed part of internal funds to finance part of receivables extended to customers.

**FOREIGN CURRENCY RISK**

The Group's transactions were conducted in Hong Kong Dollars, United Stated Dollars, Japanese Yen, Euro, British Sterling, Reminbi, Australian Dollars, Singapore Dollars and New Taiwanese Dollars. In order to reduce the risk, the Group normally used forward exchange contracts to hedge the return currency of such transaction or borrowed the same currency to fund such transaction. As at 31st December, 2005, there was no forward foreign contract outstanding. Short-term borrowings denominated in foreign currencies other than United States Dollars were used to finance assets purchased in the same currencies.