# MANAGEMENT DISCUSSION AND ANALYSIS

## OPERATION 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 | |
|---|---|---|---|---|
| | Six months ended | | Six months ended | |
| | 30.6.2006 HK$' 000 | 30.6.2005 HK$' 000 | 30.6.2006 HK$' 000 | 30.6.2005 HK$' 000 |
| Electroplating Materials and Chemicals | 838,221 | 840,331 | 27,431 | 17,073 |
| Paint and Coating Chemicals | 40,050 | 63,440 | 2,036 | 3,242 |
| Stainless Steel | 31,248 | 29,487 | 3,757 | 4,530 |
| Total | 909,519 | 933,258 | 33,224 | 24,845 |

### Electroplating Materials and Chemicals

With support of strong metal prices, total sales volume only dropped slightly by 0.3% to HK$838.2 million for the first six months of 2006 in spite of about 20% fall in total sales quantities. The rise in profits was primarily due to sharp rise in metal price during the period under review. Market demand was generally weak after Chinese New Year as the astounding metal prices daunted most customers' buying interests. Amid surging metal prices, rising interest costs, stricter Mainland China governmental rules as well as shortage in electricity and skilled labor, many factories either ceased business or scaled down their production. Declining demand has caused cut-throat price war since the second quarter throughout China and other South-east Asian regions.

### Precious Metal Products

Oversupply situation persisted in the market. Intense competition among precious metal producers continued and slashed selling prices. Tighter environmental regulations in China also trimmed down overall demand from electroplating industries. Limited financial resources and high metal prices forced many factories to reduce the size of purchase orders. Some factories also seek for other substitutes to replace high-priced materials.

**Base Metal Products**

Sales fell by 15.2% in the first six months of 2006, partly because of loss in electroplating nickel sales arising from quality problem in the first quarter and partly because of weak demand in China and South-east Asian region. Many factories could neither pass the rise in metal prices to their end customers nor had adequate funds to finance new purchases. Stockpiling situation and de-stocking effect pressured down electroplating nickel's selling prices in China region even lower than international market price. Electroplating copper business held firm and stable, although a slowing sign was shown at the end of second quarter. Unlike previous years, stockpiling situation of electroplating copper in China region eased during the period under review but profitability remained low.

As at 30th June, 2006, total inventory level was HK$ 167.9 million, representing an increase of 29.5% when compared with HK$ 129.7 million as at 31st December, 2005. Beside the rise in metal prices, the increase in inventory at the period end was because slow-turnover in electroplating nickel at the period end created stockpiling in the Group's warehouse. Majority of the accumulated stocks have been sold in July and new purchase orders have been cut in the third quarter. In view of tough business environment, the Group has put effort to regularly review and to monitor purchase strategies and receivables control during the period under review.

**Paint and Coating Chemicals**

Sales turnover in the first six months of 2006 dropped more than one-third primarily due to declining demand from local Chinese chemical factories. Local Chinese chemical factories not only suffered from rising material costs but also tighter requirement from Chinese government on safety and environmental issues. As production capacity of several Chinese local suppliers increased substantially in the past year, oversupply situation has caused prices of various chemical products sold in China dropped lower than international prices. The price war persisted throughout the period under review. Due to the wide price gap between domestic and imported products, the Group focused mainly to foreign customers who concerned more on quality and services. Also, the Group continued to explore new users on high-ended chemical products in the market.

**Stainless Steel**

Demand in stainless steel turned strong during the first six months of 2006 because de-stocking process was completed at the end of last year. Stainless steel base prices have risen sharply since the beginning of this year due to tight supply and scarcity in choices. Supply has been constraint by major suppliers since the second quarter as global demand continues to expand. As at June 30$^{th}$, 2006, inventory was dropped by 34.2% when compared with the figure as at 31st December, 2005. Several varieties of stainless steel materials were in shortage at the end of second quarter because of delayed shipment. Along with current difficult business environment, the Group has taken cautious control measures to monitor inventory level and credits extension to customers during the period.

**Property Investment Division**

Total rental income rose by 9.1% to HK$8.4 million in the first six months of 2006 when compared with HK$ 7.7 million in the same period of 2005.

Average occupancy rate for Hong Kong offices was 100% during the period under review. Hong Kong prime office rents continued to rise in the first six months of 2006 due to little new completed office supply and strong demand mainly from financial sector. Rental demand of second-tier offices in prime location remained firm and so did market rent. A surplus of HK$2.1 million was recognized on revaluation of Hong Kong properties for the 6 months ended June 30th, 2006.

Average occupancy rate of Shanghai offices during the first six months of 2006 was 100%. Supply of office spaces in Shanghai downtown area was still far below demand. Office market rent in prime offices continued to soar. Due to shortage supply of high-ended office spaces, tenants continued to pre-commit office spaces far in advance of the completion of the new office buildings. Demand for Grade A offices continue to rise because of the expansion in office space from financial sector this year. The market value of our Shanghai office properties as at June 30th, 2006 stayed the same as compared with their valuation as at December 31st, 2005.

Average occupancy rate of Shanghai residential properties during the first six months of 2006 was at 90.2% while 85.6% was recorded for the first six months of 2005. As at June 30th, 2006, occupancy rate was at 91.3%. Since June 2006, Shanghai residential property market faced trembling situation. Transaction volume of commercial residential properties dropped continually for several weeks after the implementation of stepping-up new measures by the Chinese central government aiming in cooling down China property market. Market sentiment was weak and pessimistic. Many home buyers deferred their purchase plans. In rental demand side, however, market was fairly satisfactory but market rent stayed unchanged. As at June 30th, 2006, the Group recorded a loss of HK$2.4 million on revaluation of Shanghai residential properties.

**Securities Investment Division**

An analysis of the securities portfolio, current and non-current, by type of securities as at 30th June, 2006 is as below:

| Market Value as at (in HK$ million) | 30/06/2006 | 31/12/2005 | Diff % |
|---|---|---|---|
| Investment Held for Trading: | 173,583 | 175,783 | -1.3% |
| Available-for-Sales Investment: | 0 | 585 | - |
| Structured Bank Deposits: | 27,281 | 28,714 | -5.0% |
| | 200,864 | 205,082 | -2.1% |
| Distribution of Securities in Investment held for trading: | | | |
| Equities – Hong Kong | 30,526 | 33,195 | -8.0% |
| Equities – Overseas | 26,245 | 25,804 | +1.7% |
| Debt – Quoted/ Listed | 44,938 | 67,607 | -33.5% |
| Managed Funds – Quoted | 71,874 | 49,177 | +46.2% |

As at 30th June 2006, the Group used its own fund to finance 92.3% of total investment in securities and the remaining 7.7% was financed by bank borrowings.

An analysis of the portfolio by currency denomination as at 30th June 2006 is listed below:

| US dollar | HK dollar | Euro | JP Yen | SGP Dollar | AUD Dollar |
|---|---|---|---|---|---|
| 70.2% | 15.2% | 2.5% | 8.4% | 1.2% | 2.4% |

During the first six months of 2006, major economies around the world continued to expand and inflation was relatively benign. Global downfall in equity markets during May and June period was considered to be healthy correction rather than a signal of change in economic fundamentals. US dollar showed volatile due to conflicts between concerns in twin deficits and of being world's main reserve currency. Yields on 10-year government bonds rose between 50 and 70 basis points in the U.S., the Eurozone, Japan and the U.K. As market is expected the U.S. will enter into moderating growth period, monetary tightening has been eased in the second half year of 2006.

During the period under review, we disposed part of equity funds and captured a realized gain of HK$1.1 million before the fall in May and June period. However, we still incurred an unrealized loss of HK$ 0.6 million at fair value of investment held for trading as at June 30th, 2006. Also, we disposed of a long term investment in an unlisted Chinese equity with a gain of HK$ 585,000. Dividend income was reported at HK$ 1.4 million for the first six months of 2006 when compared with HK$ 1.5 million for the first six months of 2005. Interest income generated from portfolio was reported at HK$ 0.8 million.

The outlook of global markets will highly depend on market reaction to data on inflation and economic growth in the coming months. Vigorous volatility may still dominate various market segments. Yet, major economic fundamentals around the globe have not changed. In the coming months, we will continually to develop a more conservative position during times of increasing risk aversion.

**EMPLOYEES**

Total number of staff was increased by 1 to 86 as at June 30th, 2006. Staff cost increased by 4.2% in the first six months of 2006 to HK$ 11.6 million when compared to HK$ 11.1 million in the first six months of 2005. The rise in staff cost was in line with cost of inflation and to retain our competitiveness in current labor market. The Group continued to encourage staff continuing his/her further studies in his/her particular field to enhance their professional knowledge and up-to-date practices.

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**FINANCIAL RESOURCES AND LIQUIDITY**

For the first six months of 2006, cash outflow from operation was HK$ 24.9 million when compared cash inflow from operation of HK$ 29.3 million for the first six months of 2005. Additional financing in inventory and receivables were the major reasons of cash outflow during the period under review. Equity attributable to equity holders of the parent company as at June 30th, 2006 dropped by 3.1% to HK$ 574.8 million as the Group distributed HK$ 44.5 million of final dividends in respect of the year 2005 in May 2006. Return on equity for the first six months of 2006 fell to 4.7% when compared with 6.0% for the first six months of 2005.

Due to the fall in cash deposits, working capital as at June 30th, 2006 decreased to HK$ 251.1 million when compared with HK$ 265.7 million as at 31st December, 2005. Inventory as at June 30th, 2006 was posted at HK$ 178.3 million, representing an increase of 22.6% when compared with HK$145.4 million as at 31st December, 2005. The increase in inventory was results of the rise in metal prices as well as accumulated stocks at the period end due to slow sales. Trade debtor amounted to HK$ 165.9 million as at June 30th, 2006, representing a rise of HK$ 22.2 million when compared with HK$143.6 million as at 31st December, 2005. Trade debtor turnover cycle reported at 33 days as at June 30th, 2006 when compared with 27 days as at 31st December, 2005. The rise in trade debtor stemmed from high metal prices as well as longer credit period extended to customers under tough business environment.

The Group negative net cash as at June 30th, 2006 widened to HK$ 246.5 million (as at 31st December, 2005: negative HK$ 172.8 million). The expanded negative net cash was primarily due to cash outflow from accumulated dividend payments in the past two years. Capital expenditure only incurred HK$171,000 during the first six months of 2006.

An analysis of cash and bank deposit by currencies as at 30th June 2006 is set out below:

| **HK Dollar** | **US Dollar** | **Euro** | **SGP Dollar** | **Renminbi** | **NT Dollar** | **Others** |
|---|---|---|---|---|---|---|
| 34.1% | 46.8% | 0.6% | 0.8% | 12.5% | 4.9% | 0.3% |

**DEBT STRUCTURE**

Total bank borrowings as at June 30th, 2006 was HK$ 343.1 million (as at 31st December, 2005: HK$ 272.9 million). As at June 30th, 2006, total banking facilities granted by lenders to the Group amounted to HK$ 718.3 million. Average banking utilization rate accounted at 38.1%. Gearing ratio, which was defined as total bank borrowings divided by equity attributable to equity holders of the parent, rose to 0.60: 1 as at the period ended June 30th, 2006 when compared with 0.46:1 as at the year ended 31st December, 2005. About 96.0% of aggregated sum of inventory and receivables were financed by bank borrowings at the period end.

Currency distribution on Bank Borrowings as at 30th June, 2006:

| | **HK$' 000** | |
|---|---|---|
| Hong Kong Dollars | 294,190 | 85.8% |
| United States Dollars | 32,799 | 9.5% |
| Singaporean Dollars | 578 | 0.2 |
| Japanese Yen | 15,485 | 4.5% |
| | 343,052 | 100.0% |

All borrowings were bearing interests on floating rates and matured within one year. They were in form of money market bank loans, overdraft and trust receipt for the first six months of 2006. Average lending tenor for trust receipt in financing trading facilities was about 52 days during the period under review, 4 days shorter than 56 days in fiscal year of 2005. Money market bank loans were either used to finance additional stocks held or assets purchased in the same foreign currencies. Average interest rate charged to trust receipt borrowings was 5.26% in first six months of 2006 when compared with 1.88% in the same period of 2005. Average interest rate of total bank borrowi ngs was charged at 5.11% in first six months of 2006 whereas 2.94% was charged in the same period of 2005. Total finance cost during the period under review accounted HK$ 6.1 million (the first six months of 2005: HK$ 3.7 million).

## FOREIGN CURRENCY RISK

The Group's transactions were conducted in Hong Kong Dollars, United Stated Dollars, Japanese Yen, Euro, Australia Dollars, British Sterling, Reminbi, Singapore Dollars and New Taiwanese Dollars. In order to reduce the risk, the Group sometimes used forward exchange contracts to hedge the return currency of such transaction or borrowed the same currency to fund such transaction. As at June 30th, 2006, 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. The Group translated overseas profits/loss at average exchange rates as at 30th June, 2006.