Management Discussion and Analysis

BUSINESS REVIEW AND FINANCIAL PERFORMANCE

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. Over 90% of the Group's turnover and profits was contributed from the markets in Hong Kong and the Pearl River Delta in Mainland China.

The Group's turnover for the year 2006 has increased by 22.5% from approximately HK$192.0 million in 2005 to approximately HK$235.2 million. The net profit for the year under review was slightly increased from approximately HK$5.1 million in 2005 to approximately HK$5.5 million.

The increase in turnover is mainly due to increase in sales to wholesale distributors in Mainland China market. During the year, the prices of raw materials increased and had been kept at high level, therefore the gross profit margin was slightly decreased. Due to effective cost control, selling and administrative expenses were kept at the same level as compared with last year. The Group's profit was slightly improved in 2006 as compared with last year.

LIQUIDITY AND FINANCIAL RESOURCES

At 31st December, 2006, the Group had interest-bearing bank borrowings of approximately HK$19.5 million (31st December, 2005: HK$12.2 million), which were of maturity within one year. The directors expect that all the bank borrowings will be repaid by internal generated funds or rolled over upon the maturity and continue to provide funding to the Group's operations. At 31st December, 2006, the Group's leasehold land and buildings with aggregate carrying value of approximately HK$79.1 million (31st December, 2005: HK$84.0 million) have been pledged to banks to secure the banking facilities granted to the Group.

At 31st December, 2006, current assets of the Group amounted to approximately HK$138.7 million (31st December, 2005: HK$129.2 million). The Group's current ratio was approximately 4.49 as at 31st December, 2006 as compared with 5.46 as at 31st December, 2005. At 31st December, 2006, the Group had total assets of approximately HK$275.3 million (31st December, 2005: HK$264.0 million) and total liabilities of approximately HK$34.5 million (31st December, 2005: HK$28.0 million), representing a gearing ratio (measured as total liabilities to total assets) of 12.5% as at 31st December, 2006 as compared with 10.6% as at 31st December, 2005.

FOREIGN EXCHANGE EXPOSURES

The Group's purchases and sales are mainly denominated in US dollars, Hong Kong dollars and Renminbi. The operating expenses of the Group are either in Hong Kong dollars or Renminbi. As Hong Kong dollars have been pledged with US dollars, the directors consider that the Group has no material currency exchange risk exposures, except for the appreciation of Renminbi over Hong Kong dollars.

CONTINGENT LIABILITIES

The Group had no material contingent liabilities as at 31st December, 2006 and 31st December, 2005.

Management Discussion and Analysis (Continued)

CAPITAL COMMITMENTS

At 29th September, 2006, the Group has entered a joint venture agreement with a third party to establish a joint venture in which the Group will invest approximately HK$5,830,000. The Group's commitment for contribution of HK$5,830,000 has not been provided in the consolidated financial statements.

Apart from the above mentioned, there was no (2005: HK$29,000) capital commitment in respect of acquisition of property, plant and equipment contracted for but not provided in the consolidated financial statements.

OUTLOOK

As an enterprise where PRC is its major market, we are filled with hope for the future as the PRC economy continues to grow.

In 2007, we are celebrating the 50th anniversary of the setup of the polishing business. We will bring new elements and environment to create a new future: (1) Shanghai PME-XINHUA Polishing Materials Systems, a joint venture in Shanghai, has been formally established and commenced operations in March 2007. It is expected that the pace of expanding to the Yangtze River Delta market will accelerate; (2) Except for sales of high-end products, we will develop more and more products to suit the market needs. We will capture the market through distribution network as we believe that it is the most effective and economical way to obtain higher market shares. Certainly, cost control remains our top issue this year.

The placement of new shares in April 2007 has increased the capital base of the Company and improved the financial position of the Group. Proceeds from the placement enable the Group to further expand its distribution network in the PRC and also to explore new business opportunity.

EMPLOYEES AND REMUNERATION

At 31st December, 2006, the Group had approximately 240 employees in Hong Kong and Mainland China. The employees are remunerated with basic salary, bonus and other benefits in kind with reference to industry practice and their individual performance. The Group also operates a share option scheme of which the Directors may, at its discretion, grant options to employees of the Group. No option has been granted since the adoption of the share option scheme.