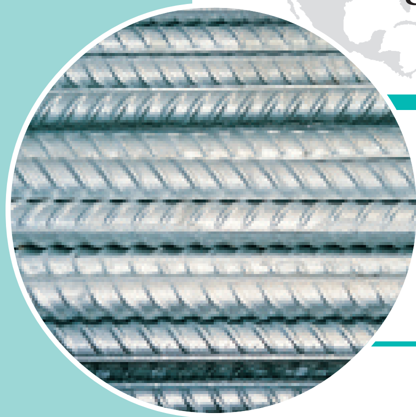
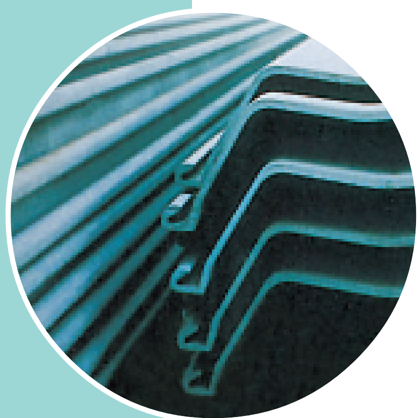
(A) CONSTRUCTION MATERIALS

Market Overview

The VSC Group's construction materials businesses in Hong Kong comprise distribution of steel products and building products to developers and contractors for construction works. During 2001/02, construction activities in Hong Kong continued to plunge as a result of the continued economic depression and a deflationary property market. Both public and private housing sectors experienced weak demand in new construction projects. In public sector, the construction works were mostly generated from the massive infrastructure developments, which were funded by the Government, as well as from the KCRC/ MTRC extension projects. Growth of public housing projects was however affected by the scaling back of Public Housing Programme such as suspension of sale of Home Ownership Scheme. In private sector, the declining property price continued to discourage new development projects. Such shrinkage coupled with the economic recession led to substantial cut in price and volume of construction materials.





STEEL

1. **Steel Department**

Given the adverse construction market in 2001/02, the reinforcement steel bars ("rebars") market in Hong Kong shrunk by 33% from 1.2 million tonnes in previous year to 0.8 million tonnes in current year. Fierce competition in this reduced market had further driven down the price of rebars to an undesirably low level. Our **steel department** had strategically decided not to engage in this "cut-throat" price war during the year so as to maintain the profit margin. Such strategy had cost the VSC Group its market share but had helped the VSC Group to avoid committing to huge amount of low-price unprofitable sales contracts which would have detrimental effect to the coming few years' profitability. Currently, the department's contracts-on-hand amounted to about HK$634 million.

In order to address the loss of market share, the steel department had taken the following initiatives to strengthen its sales and marketing. Firstly, a coordinated effort by the entire team to focus on key account management of selected customers was adopted. Targeted customers were selected through careful assessment of various objective criteria like sales history, payment record and future project potential. Tailor-made action plans with sales target for each individual account was then set up and the progress was being regularly monitored. Premium services were provided to these prestigious customers to strengthen the relationships. The objective was to facilitate provision of total solution and a wider range of construction materials by better servicing these key accounts. Secondly, a structured and centralised database of customers and projects was built internally to capture all relevant information for market trend and customer needs analysis. This computerised database not only enabled the steel department but also the building products department to readily and easily update information of their customers and projects. Potential sales opportunities are identified in a more systematic and organised manner while sharing of data by different departments also facilitated cross selling to each others' customers. Both initiatives were carried out satisfactorily and had laid a solid groundwork for the upcoming Customer Relationship Management module of the Oracle Enterprise Resources Planning ("ERP") system.

Other than rebars, the steel department also made progress in marketing its piling products like H-piles, sheet piles and construction beams. Despite the decline in market price of many steel piling products, the department had successfully developed reliable and cost effective sources of supply from nearby countries to enhance its competitiveness and thus market share.

Operationally, the process improvement programme started since the late 2000 had continued to benefit the supply chain management and sales fulfillment processes. In particular, the emphasis on total costs of ownership for holding inventory had helped the steel department to quantify and evaluate not simply the purchase price of steel but other indirect costs like logistics costs, scrap, rework and write-off costs for sub-standard materials as well. Our global suppliers of steel mills were systematically rated and selected according to their offer prices, on-time delivery, supply lead time and products quality with a view to minimising the total costs of ownership. A collaborative approach was adopted to develop relationship with suppliers to derive and share benefits from streamlining the supply chain process. Substantial efforts were also made to improve the forecast accuracy of customer demand, which involved extensive coordination and communication with the construction sites' personnel to collect and analyse the relevant data. Inventory level was hence minimised without affecting the service level and prompt delivery. As a result, the management is encouraged that a further reduction on the rebars stock level of over 30% was achieved. This optimisation of stock level also allowed the department to undergo vigorous cost saving measures such as reduction of godown space and pier rental as well as other logistics costs of transportation and inventory handling costs. All these operational improvements and cost savings had enabled the VSC Group to become a highly cost competitive operator striving in a difficult market situation.

Meanwhile, the VSC Group continued to establish its role of total solution provider to the construction materials customers by developing the coupler and soil nail businesses. Turnover had been more than double by strategic focusing on target customers and projects. The production flow was continuously streamlined with the adoption of incentive pay to boost workers' output. Part of the process was also outsourced to more effectively utilise in-house resources. The management aims to further improve the profit contribution from this line of business with the objective to develop it as another source of stable revenue.