BUSINESS ENVIRONMENT

Products of the Group

The Group is principally engaged in the manufacture of petroleum refined products in the PRC. Major products comprise lubricating oil and grease ("Lubricants") for industrial usage including petroleum extraction machines and automobiles and anti-corrosive coating ("Anti-corrosive") for drinking water, petroleum, crude oil and natural gas transmission pipes. Lubricants and Anti-corrosive are marketed and sold under the brand name "黑鳥牌" and "H88" respectively in the PRC, Asia, Europe and North America.

Operating environment

During the year, the economy of the PRC, the key market of the Group, has been experiencing continuous growth, and provided the Group with a favourable operating environment. The demand for different kinds of products remained strong.

Despite the gradual price increase in the Group's principal raw material due to the volatility of crude oil costs, the Group succeeded in mitigating the adverse effect by implementing effective operational strategies and adopting a strategy of bulk purchase of raw materials at competitive prices that minimize the effect of price fluctuations on production costs.

Financial performance

During the year under review, the Group reported an encouraging and significant growth in its results. Net profit from ordinary activities attributable to shareholders increased by approximately 92% as compared to the financial year 2001. The Group achieved a basic earnings per share of HK9.1 cents, representing an increase of about 60% from the previous year.

Sales overview

During the year, the PRC remained as the dominant market of the Group which accounted for about 92% of the Group's total sales while 8% were derived from overseas countries, including Asia, North America and Europe.

During the year under review, the sale of Lubricants increased approximately from HK$107.4 million in 2001 to approximately HK$211.6 million in 2002, representing an increase of approximately 97%. The significant increase was mainly attributable to the Group obtained a RMB200 million contract for production of environment friendly ceramic-mental lubricants during the year. In addition, the Group established business relationship with a number of Top Ten automobile manufacturers in the PRC.

The sale of Anti-corrosive increased approximately from HK$36.5 million in 2001 to approximately HK$90.0 million, representing an increase of approximately 147%. Such dramatic increase in sales was mainly due to the Group obtained a RMB30 million contract for the "Shenzhen East Water Supply Project", RMB10 million contract for "West-East Gas Pipeline Projects" for the Lanzhou-Chengdu-Chongqing section and RMB35 million contract for the "Dongjing Water Project" during the year.

BUSINESS ENVIRONMENT *(Continued)*

Financial performance *(Continued)*

Profit growth

In 2002, the Group spent approximately HK$1.9 million (2001: HK$1.1 million) in the research and development, representing an increase of approximately 72.7% from that of last year. The expenditures were classified into new products and technical know-how related to the production of high quality products. Although it is believed that these products will provide the Group with substantial profit in future, product development expenditure is recognized as expenses when incurred.

The operating expenses net of other revenue and other than those for research and development amounted to approximately HK$18.2 million (2001: HK$10.3 million). The increase was primarily due to the higher transportation costs resulted from an increase in sales volume and the expansion of the PRC and overseas markets. Moreover, in order to strengthen its controls over the operations of the Group upon listing in May 2001, the Group had invested further resources for the enhancement of the Group's administration functions.

The Group operates within the high and new technology industrial development zones in Daqing, and is still enjoying a reduced income tax rate of 7.5% up to 2003 and a reduced income tax rate of 15% thereafter. In the absence of significant changes in the bases and rates of profits tax, the effective tax rate on the Group's profit remained at approximately 17% (2001: 16%).

Similarly, in the absence of significant changes in equity holding of all operating companies with the Group, the percentage of profits shared by minority shareholders over profit before minority interests of approximately 4.5% (2001: 4.6%) remained at a similar level of previous year.

Combining the effects of increase in sale, stringent control of operating expenses and stability of rates of taxation and proportion of profits shared by minority shareholders, the Group's net profit from ordinary activities attributable to shareholders improved substantially from approximately HK$39.7 million in 2001 to approximately HK$76.2 million in 2002, representing an increase of 92%.

FINANCIAL RESOURCES AND LIQUIDITY

Funds from IPO and placing

The Company was listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 2 May 2001 through a placing of 80 million shares and a new issue of 40 million shares, pursuant to which the Group raised net proceeds of approximately HK$20 million. Substantial portion of such net proceeds was applied for the enhancement of the Group's production capability, which enabled the Group to take advantage of the market growth in its products and proposed products and to strengthen its competitive edge and market position.

FINANCIAL RESOURCES AND LIQUIDITY *(Continued)*

Funds from IPO and placing *(Continued)*

To help fund rapid expansion of the Group as planned in the upcoming years, the Group placed an aggregate of 60 million shares under a placing (the "Placing"), which was completed in early December 2001, to institutional investors to raise additional capital for the Group's future business development and to broaden the shareholders base and capital base. It is the intention of the Group to apply the net proceeds of approximately HK$20 million from the Placing for acquisition of additional machineries and production facilities for the expansion of the Group's production capacity as well as enhancement of the Group's existing production facilities and for the general working capital of the Group.

Application of net proceeds from the New Issue and Placement

At the date of this report, the Group had utilized a total of approximately HK$32 million of the proceeds. Approximately HK$19 million, HK$2 million, HK$1 million and HK$10 million had been applied towards the establishment of new production facilities and purchasing additional machineries in the PRC, expansion of the Group's distribution and sales network, research and development activities and as general working capital, respectively. The Directors do not intend to change the application of the net proceeds. The remaining proceeds are placed on short term deposits with licensed banks in Hong Kong.

Details of the application of cash for the year ended 30 June 2002 are set out in the "Consolidated Cash Flow Statement" on page 30 of this annual report.

Liquidity and financial ratios

With a strong net cash inflow from operating activities of approximately HK$24 million and aggregate net proceeds of approximately HK$40 million from the IPO and the Placing, the liquidity and financial position of the Group improved substantially.

At 30 June 2002, the Group had total assets of approximately HK$272.3 million (30 June 2001: HK$149.0 million) which were financed by current liabilities of approximately HK$52.3 million (30 June 2001: HK$29.9 million), non-current liabilities of approximately HK$4.6 million (30 June 2001: HK$0.5 million), minority interests of approximately HK$10.1 million (30 June 2001: HK$6.6 million) and shareholders equity of approximately HK$205.3 million (30 June 2001: HK$112.0 million).

Current assets and current liabilities

At 30 June 2002, the current assets of the Group amounted to approximately HK$201.9 million (30 June 2001: HK$89.3 million) comprising inventories of approximately HK$46.6 million (30 June 2001: HK$20.0 million), trade receivables of approximately HK$89.8 million (30 June 2001: HK$37.3 million), other receivables of approximately HK$3.5 million (30 June 2001: HK$2.3 million), cash and bank balances of approximately HK$62.0 million (30 June 2001: HK$29.7 million). Included in the cash and bank balances were the remaining net proceeds from the IPO and Placing amounting to approximately HK$8 million which are placed on short term deposits with licensed banks in Hong Kong.

FINANCIAL RESOURCES AND LIQUIDITY *(Continued)*

Current assets and current liabilities *(Continued)*

The increase in trade receivables was in line with the growth of sales amount while the debtor turnover period at approximately 107 days (30 June 2001: 94 days). The Group normally allows credit terms to established customers ranging from 30 to 120 days. All trade receivables as at 30 June 2002 were aged less than 120 days from the date of recognition of the sale settled approximately 95% as at 30 September 2002 of this report. In order to purchase raw materials at more competitive price, the Group adopted the policy of direct bulk purchases from suppliers, which were mainly conducted on cash basis. As a result, the inventory turnover period increased to approximately 90 days (30 June 2001: 86 days) while the turnover period of trade payables shortened to approximately 32 days (30 June 2001: 41 days).

At 30 June 2002, the Group's current ratio (current assets/current liabilities), quick ratio ((current assets – inventory)/current liabilities)), gearing ratio (total debts/total assets) and debts to equity ratio (total debts/shareholders' equity) of the Group were approximately 3.9 (30 June 2001: 3.0), 3.0 (30 June 2001: 2.3), 20.9% (30 June 2001: 20.4%) and 27.7% (30 June 2001: 27.1%), respectively. These changes reflected an improvement in the Group's structure of assets and liabilities.

Although significant portion of the Group's assets, sales and purchases are primarily denominated in RMB, the Directors consider that the Group has no significant exposure to foreign exchange fluctuations in view of the stability of the RMB. The Directors also consider that there will be sufficient cash resources denominated in Hong Kong dollars for the repayment of its borrowings and for future dividends payable to shareholders. During the year under review, the Group did not use any financial instrument for hedging purposes and the Group did not have any hedging instrument outstanding as at 30 June 2002.

NUMBER AND REMUNERATION OF EMPLOYEES

At 30 June 2002, the Group had 125 full time employees in the PRC and Hong Kong. The Group recognizes the importance of its human resources to its success. Remuneration is maintained at competitive levels with discretionary bonuses payable on a merit basis and in line with industry practice. Other staff benefits provided by the Group include mandatory provident fund, insurance schemes and performances related commissions.

During the year under review, the Company granted share options to certain eligible staff to acquire a total of 80 million ordinary shares of HK$0.01 each in the capital of the Company at exercise price HK$0.2344 per shares. The share options are exercisable from 20 August 2001 to 19 August 2004, both dates inclusive. At the date of this report, a total of 42 million share options remained unexercised.