Management Discussion and Analysis

BUSINESS PROSPECTS AND SEGMENTAL INFORMATION

In 2002 the turnover of the Group increased by 40% from the previous year to HK$1,424 million as a result of the growth in both its aluminium extrusion business and the precious metal electroplating chemical business. The gross profit of the Group has exceeded HK$221 million, representing 28% growth. Net profit was negatively impacted by the one-off HK$35,745,000 loss recognised on the deemed disposal of an associate, Linefan Technology Holdings Limited, as described below.

Riding on the strong performance of the Group's core businesses, the Group's EBITDA has improved by 23% from the previous year to HK$201 million. EBITDA represents earnings before interest income, finance costs, taxation, depreciation, amortisation, gain or loss on disposal of property, plant and equipment, gain or loss on disposal of subsidiary or associate, gain or loss on disposal of investment and minority interests.

A brief discussion of the business prospects of each of the Group's core businesses is as follows:

(i) Aluminium Extrusion Business

Turnover and contributions to operating profits of the aluminium extrusion business segment in 2002 were HK$1,155,373,000 *(2001: HK$866,252,000)* and HK$95,866,000 *(2001: HK$94,910,000)* respectively. The aluminium extrusion business is highly competitive in the PRC. Fortunately, with the accession of the PRC into the WTO, the PRC Government's plan to develop the Northwestern Region, and continued economic growth in the PRC, the demand of aluminium extrusion products is expected to remain strong in the foreseeable future. Total production of aluminium extrusion in 2002 reached 35,000 tonnes, up from 30,000 tonnes in 2001. Furthermore, the new production lines added in 2002, ie. the powder-coating line and the fabrication workshop have significantly enhanced the Group's ability to deliver a whole range of aluminium products of high quality. The Group will continue to invest in its facilities to maintain its competitiveness.

The effort in developing overseas markets has borne fruit in 2002. Management believes that the growing trend of exports will, barring adverse changes in circumstances, continue in 2003.

In 2002, the Group branched out into the manufacturing of aluminium alloy ingots. Part of the unutilised smelting facilities were converted into an aluminium alloy ingot production line with an annual capacity of 20,000 metric tonnes. The aluminium alloy ingots are mainly used for making engines of motor vehicles. If run at full capacity, this line can bring in revenue exceeding HK$200,000,000 per annum. Approximately 12,000 tonnes of aluminium alloy ingot were produced in 2002.

Growth in the aluminium extrusion business in the next few years is expected to remain stable, and the Group is confident of achieving its organic growth target of at least 10% per annum.

BUSINESS PROSPECTS AND SEGMENTAL INFORMATION (continued)

(ii) Precious Metal Electroplating Chemical Business

Significant growth has been sustained in the precious metal electroplating chemical business segment. Turnover and contribution to operating profits for the year ended 31 December 2002 were HK$246,902,000 *(2001: HK$150,625,000)* and HK$39,288,000 *(2001: HK$25,677,000)* respectively. The precious metal electroplating chemical business is expected to be the star of the Group over the next few years. In May 2002, the production capacity of gold salts in Hunghom was increased from 2,000 kg to 7,000 kg per annum and the Zhuhai factory commenced operation in January 2003. High demand for such chemicals from the clock and watch industry, computer hardware industry, jewellery industry, and light and lamp industry has convinced management that the investment in both the Hunghom and Zhuhai factories, which exceeded HK$120,000,000, will result in higher returns. In 2003 the business will focus on the establishment of a marketing network to capture the enormous market in the PRC.

The Group intends to set up a professional Research and Development Department in its Zhuhai Plant to supplement its sales effort. The growth target of this business is 30% per annum in the next 2 years.

(iii) Hot-rolled Stainless-steel coil business

2002 was a good year for the hot-rolled stainless steel coil business. Turnover has increased from HK$607,270,000 in 2001 to HK$668,815,000 in 2002. Net profit for 2002 was HK$88,590,000 *(2001: HK$84,776,000)* and the Group's share in 2002 was HK$34,926,000 *(2001: HK$20,270,000)*. Enjoying the proximity with its suppliers, a very low cost structure, and a high demand for its products, the business has been running at over 90% utilisation in 2002. The enlarged business volume requires a higher amount of working capital to support it and in December 2002 the Group had injected HK$30,000,000 into the business and increased its equity interest in Asia Pacific Holdings (China) Limited from 40% to 49%. The Group is optimistic about the future prospects of this business.

NON-CASH TRANSACTIONS RELATING TO INVESTMENT IN LINEFAN TECHNOLOGY HOLDINGS LIMITED ("LINEFAN")

Linefan was an associate of the Group following its acquisition in 2000. On 5 February 2002, Linefan was listed on the Growth Enterprise Market of the Stock Exchange by way of placement of new shares. As a result, the Group's equity interest in Linefan was diluted from 23.81% to 18.17%.

On 16 October 2002, the Group ceased to have any representation in Linefan's board of directors, and the Group no longer has any significant influence over Linefan. As such, it was no longer considered to be an associate of the Group. From an accounting perspective, the investment in Linefan was reclassified from an investment in an associate to other investment.

NON-CASH TRANSACTIONS RELATING TO INVESTMENT IN LINEFAN TECHNOLOGY HOLDINGS LIMITED ("LINEFAN") (continued)

Although there is no change in the Group's equity interest in Linefan, the General Accepted Accounting Principles of Hong Kong requires the reclassification of the investment in Linefan be accounted for as a deemed disposal of an associate. As a result, two non-cash transactions are recognised in the income statement of the current financial year. First, the investment in Linefan is revalued at its market value as at the balance sheet date, and a gain of HK$18,496,000 is recorded. Secondly, the goodwill arising from the acquisition in Linefan in 2000 amounting to HK$40,519,000, which has already been eliminated against reserves, has to be derecognised and charged against this year's earnings.

Both of these transactions have no effect on the cash flow or operations of the Group, and the derecognition of goodwill amounting to HK$40,519,000 has no effect on the net assets of the Group.

CAPITAL EXPENDITURE PLAN

The Group is committed to maintaining its competitive edge in product quality by investing in equipment. In relation to the aluminium business, the Group is evaluating the addition of a vertical paint-coating line, a homogenising oven, an electro-deposition facility and a 3,600-ton extrusion press. The final decision on whether this equipment is added will depend on its cost and benefits to the Group.

Regarding the hot-rolled stainless steel coil business, the Group is studying various proposals to increase the capacity of the factory to meet the demand for its products.

Overall, the capital expenditure of the Group in 2003 is not expected to be less than HK$100,000,000.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2002, the net current assets of the Group were HK$503,658,000 *(2001: HK$334,850,000)*. Of the current assets, HK$410,868,000 *(2001: HK$317,948,000)* were free cash and cash equivalent. On the same day, the total bank borrowings and obligations under finance leases of the Group were HK$670,660,000 (2001: HK$344,712,000), 48% of which, that is HK$320,093,000 *(2001: HK$104,543,000)*, was due after one year.

The financial health of the Group is reflected by two key financial ratios. First, the Group's current ratio as at 31 December 2002 was 203% *(2001: 208%)*. This means that the Group has twice as many current assets to meet its current liabilities. The second ratio is the net debt gearing (i.e. total borrowings less free cash/net tangible assets) which was only 29% *(2001: 4%)* as at the balance sheet date, which suggests that the Group does not expect to have any problems servicing its debt.

CAPITAL STRUCTURE AND FINANCING

The Company did not issue any new shares during the year. On 29 November 2002, every 10 shares of the Company with a par value of HK$0.10 each were consolidated into one share with a par value of HK$1.00. The share consolidation reduces the number of shares in issue and facilitates future corporate action, but has no effect on the total issued share capital of the Company.

CAPITAL STRUCTURE AND FINANCING (continued)

Since 2001, the Group has been adopting a strategy to obtain financing with a longer tenure to enhance its liquidity and minimise the maturity mismatch between assets and liabilities. As a result, approximately 48% of the Group's bank borrowings and obligations under finance leases was due after one year as at 31 December 2002. This strategy will be maintained in the near future.

FOREIGN EXCHANGE RISK AND INTEREST RATE RISK

The majority of borrowings of the Group are denominated in HK$, RMB and US$ at floating interest rates. Financing in RMB is used only by the Group's factory in Nanhai, which usually receives its revenue in RMB. Management is of the opinion that the Group's exposure to interest rate risk and foreign exchange risk is insignificant.

STAFF POLICY

Management firmly believes that an organisation is only as good as the people who are running it. The Group is confident that with the existing management team, it is in a good position to face the challenges in a competitive business environment and achieve its goal of increasing shareholders' value.

Competitive remuneration packages at market level are offered to staff members who render satisfactory performance. Top performers might receive a bonus and/or an option to subscribe for shares under the Share Option Scheme, which are at the absolute discretion of the management. On-the-job training is provided to all staff members to facilitate the carrying out of their duties. As at 31 December 2002, the Group had approximately 650 full-time employees.

Staff costs and Directors' remuneration for the year ended 31 December 2002 amounted to approximately HK$29,000,000.

CHARGES ON GROUP ASSETS

Details of charge on the Group's assets are set out in note 32 to the financial statements.

CONTINGENT LIABILITIES

(1) Value-added Tax

The Group has been paying PRC value-added tax ("VAT") at a concessionary basis of calculation as agreed with the local State Tax Bureau. Had the standard basis of calculation as stipulated by the PRC tax law been strictly enforced, the VAT liability of the Group would be significantly increased. However, in the opinion of the Directors, such liability is unlikely to crystallise and it is not practicable to estimate the amount.

CONTINGENT LIABILITIES (continued)

(2) Proposed spin-off and separate listing of Ocean Grand Chemicals Holdings Limited

On 17 May 2002, Kenlap P.G.C. Manufacturer Company Limited ("Kenlap"), a former indirect wholly-owned subsidiary of the Company, allotted 113,352 shares (representing 10.2% of the issued share capital of Kenlep as enlarged by the allotment) to 13 subscribers. Kenlap is engaged in the production of chemicals used in the electroplating of precious metal and refining of gold materials.

Each of the subscribers entered into subscription arrangements with the Company, which included a condition that the Company would repurchase the relevant shares at a 20% premium to the relevant subscription consideration if Kenlap is not listed on the Main Board of the Stock Exchange within 12 months from the completion date of the subscription arrangements; and then the Company would compensate the relevant subscriber if the market capitalisation of Kenlap immediately upon its listing is less than an agreed amount.

A formal application was made on 26 November 2002 to the Stock Exchange for the proposed spin-off and the separate listing of, and permission to deal in, the shares of Ocean Grand Chemicals Holdings Limited (including Kenlap as its subsidiary after the proposed corporate reorganisation) in issue and to be issued on the Main Board of the Stock Exchange.

The vetting process has been delayed by issues outside the Company's control, such as the uncertainty which arose from the change in practice of the China Securities Regulatory Commission in no longer issuing "No Comment" letters in respect of listing applications to the Stock Exchange.

Despite the unforeseen circumstances, the Company's application was tabled to the Listing Committee of the Stock Exchange on 17 April 2003. However, the gloomy market sentiment due to the Iraq war and the SARS outbreak has rendered it unlikely that the marketing activities relating to the spin-off can be completed before 17 May 2003.

The Company is in the process of negotiating with the 13 subscribers for an extension of the terms relating to the 12 months under the subscription arrangements. In a worst case scenario, which the management believes is not likely, the Company would have to repurchase the 10.2% equity interest in Kenlap at a consideration of HK$42,000,000. Any amount payable by way of compensation would be dependent on the final terms of the listing, which have not yet been decided, and further negotiation with the 13 subscribers. The amount cannot be quantified as at the date of the 2002 annual report.

The management is of the view that any compensation payable as described above will not have a material adverse effect on the results and financial position of the Group.