Management Discussion and Analysis

BUSINESS ENVIRONMENT

During 2003 and 2004, the crude oil price repeatedly reached a new high. The global political tension was the remote cause of the sustained sharp increase in the crude oil prices which resulted in the cost increases in the Group's raw materials such as base oil, solvents, resin, accessory ingredients. In view of the global demand in crude oil continuously grows in future and the turbulence of certain oil producers such as Iraq and Middle East regions, and the US dollar is anticipated to depreciate, the Directors expects the crude oil price will remain high persistently in short term.

BUSINESS REVIEW

Lubricants

The business was entirely targeted at the domestic market in the PRC. The sustained demand in lubricants was in line with the steady growth of the PRC's economy during the year. However, the turnover increase slightly by 3.0% approximately to HK$236.7 million during the year. Owing to the increase to the prices of raw materials, and it was impossible to shift all the burdens to the customers, the operating profit decreased approximately HK$17.8 million, representing a 27.4% decline as compared to last year. Looking forward, we expect that the economic environment will continue to be extremely challenging. Currently, the Company is conducting a comprehensive review of its products positioning, sales and logistics strategies, with a view to achieve a substantial improvement in the upcoming year.

Anti-Corrosive Coating

During the year, Ningbo new factory was partially put into operation, creating a favourable effect on our business development in East China. Its actual performance was encouraging. Taking the advantage of development momentum of last year, a record high of approximately HK$168.9 million in turnover was achieved in this year, representing an increase of 26.8% as compared with last year. The encouraging increase was mainly attributable to the Group secured a contract amounting to RMB30 million for the "Hangzhou Bay Bridge project" in 2003. However, operating profit only recorded of approximately HK$43.0 million, edging up 1.6% over the past year due to a dramatic rise in the prices of raw materials and the persistence of high prices as well as keen competition within the sector. The Group will strike a balance between increase in market share and improvement of operating effectiveness. When Ningbo factory is put into full production in future, it is expected to further enhance the Group's output and quality of products, and to form a landmark for the development of anti-corrosive coating business.

BUSINESS REVIEW (Cont'd)

Vinyl Acetate

The Group put efforts in ongoing diversification and searched new rooms for innovations in the chemical industry. The Directors have identified vinyl acetate to be the key development project. The Group implemented along the direction in the second quarter of 2004, and entered into a joint venture with Qinglian, a new partnership, in order to access into the potential vinyl acetate market for future development.

Qinglian entered into a joint venture agreement ("Joint Venture Agreement") with Earlsmead Enterprises Limited ("Earlsmead"), the wholly-owned subsidiary of the Group, on 2 April 2004, to set up a subsidiary in Mudanjiang, namely Mudanjiang Dongbei Chemical Engineering Company Limited ("Mudanjiang Subsidiary"), which is mainly engaged in the manufacture and sale of vinyl acetate, for the diversification and expansion of the Group's business.

Pursuant to the Joint Venture Agreement, Qinglian shall inject assets not less than RMB40.91 million, including but not limited to land and production facilities for the entitlement of 45% equity interest of the Mudanjiang Subsidiary. In addition, in accordance with the Joint Venture Agreement, the Company shall inject RMB50 million in cash for a 55% equity interest of the Mudanjiang Subsidiary through Earlsmead.

Mudanjiang vinyl acetate plant is expected to commence mass production in the fourth quarter in 2004 and the annual production capacity is expected to reach 15,000 tonnes. It is expected to contribute profit to the Group in the upcoming year.

PROSPECTS

Looking ahead, the uncertainty in the Middle East affects the crude oil prices remain volatile, resulting in the fluctuation of the Group's operating cost. Moreover, the impact of the macro-economic austerity program implemented by the PRC government is unknown, therefore, the economic development in future is unpredictable. In the long run, a sustained growth is expected in the PRC's economy, and the demand in the PRC will continuously expand. As such, the Group shall be well-positioned for the environment. To enhance the sales and strengthen the production equipments and capacities of every core business are also critical. Besides, management improvement and technical know-how strengthening shall not be in absence. Also, the management shall explore various development opportunities for the Group.

Apart from certain regulatory measures taken by the PRC government to resolve the overheated economy in the PRC, the upcoming rising interest rate and the persistent high prices of various raw materials are expected to constitute a uncertainty which will bring negative impact to the Group for this year.

LIQUIDITY AND FINANCIAL RESOURCES

Liquidity and Financial Ratios

At 30 June 2004, the Group had total assets of approximately HK$465.7 million (30 June 2003: HK$367.0 million) which were financed by current liabilities of approximately HK$65.3 million (30 June 2003: HK$53.0 million), non-current liabilities of approximately HK$3.9 million (30 June 2003: HK$4.4 million), minority interests of approximately HK$28.3 million (30 June 2003: HK$20.4 million) and shareholders equity of approximately HK$368.2 million (30 June 2003: HK$289.2 million).

LIQUIDITY AND FINANCIAL RESOURCES (Cont'd)

Liquidity and Financial Ratios (Cont'd)

At 30 June 2004, the current assets of the Group amounted to approximately HK$303.0 million (30 June 2003: HK$236.0 million) comprising inventories of approximately HK$64.7 million (30 June 2003: HK$59.4 million), trade receivables of approximately HK$129.2 million (30 June 2003: HK$103.8 million), other receivables of approximately HK$25.5 million (30 June 2003: HK$15.4 million), cash and bank balances of approximately HK$83.6 million (30 June 2003: HK$57.4 million).

The increase in trade receivables was in line with the growth of sales amount while the debtor turnover period at approximately 115 days (30 June 2003: 103 days). The Group normally allows credit terms to established customers ranging from 30 to 150 days. Approximate 66.4% of the trade receivables were settled as at 31 August 2004. In order to purchase raw materials at more competitive price, the Group secured to make more direct bulk purchases from suppliers, which were mainly conducted on cash basis. As a result, the inventory turnover period increased to approximately 79 days (30 June 2003: 90 days) while the turnover period of trade payables shortened to approximately 7 days (30 June 2003: 20 days).

At 30 June 2004, 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 4.6 (30 June 2003: 4.4), 3.7 (30 June 2003: 3.3), 14.9% (30 June 2003: 15.6%) and 18.8% (30 June 2003: 19.9%), respectively. These changes reflected an improvement in the Group's structure of assets and liabilities.

Foreign Exchange Exposure

Although most of the operations were carried out in the PRC in which transactions were 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 in recent years. The Directors also consider that there will be sufficient cash resources denominated in Hong Kong dollars for the repayment of borrowings and future dividends. 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 2004.

NUMBER AND REMUNERATION OF EMPLOYEES

At 30 June 2004, the Group had 125 full time employees in the PRC and Hong Kong. The Group recognizes the importance of 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.

At 30 June 2004, a total of 13 million share options are outstanding with exercisable periods up to 6 April 2007 with exercise prices HK$0.47 per share.