# Management Discussion and Analysis

## BUSINESS ENVIRONMENT

During the year under review, the Group faced a formidable operating environment. Global crude oil price escalated through the year and successive record highs were established. This in turn caused the prices of most petrochemical downstream materials to soar. Some of these materials even encountered occasional supply shortages. The Group's core businesses can only pass on cost increases to customers in part, and with a time lag, thus adversely affected the profit margins. Nevertheless, the competitive advantages of the Group accumulated over the years, has stood out even more clearly during this challenging operating environment, which leads to a sharp increase in the Group's turnover and offset the loss in profit margins, laying a sound foundation for steady profit growth.

## BUSINESS REVIEW

### Lubricants

During the year under review, keen competition from rivals has resulted in volatile and high raw material prices, which could only be partially passed on to the market, causing profit margins for the industry to erode and forced a number of competitors out of the market. Some medium or large enterprises continued to use their brand strength and economy of scale to gain additional market shares. Amid such difficult operating environment, the Group took advantages of its effective plant management, superior logistics and good customers relations to achieve its best ever performance. The Group recorded a total turnover of approximately HK$380,529,000 for the year, representing an increase of 60.8% over approximately HK$236,667,000 last year, while the operating profit was approximately HK$62,651,000, representing an increase of 33% over HK$47,116,000 last year.

Following the gradual implementation of a series of measures to optimize profitability, the full effect is starting to materialize, and the Group's ability to pass on increased costs to the market is also enhancing. We anticipate the operating environment for this business will become more stable in the coming year.

### Anti-Corrosive Coating

The rapid growth of the chemical industry in Mainland China provided an excellent opportunity for the development of anti-corrosive coating business. During the year under review, sustained increases in raw materials prices and the imbalance of supply and demand led to highly volatile prices. However, as the price fluctuations could be passed on to the market, and the continued capacity expansion over the years has given the business certain advantages in economy of scale, the business enjoyed even better operating efficiency during the year. The turnover and operating profit for the business during the year were approximately HK$225,669,000 and approximately HK$51,501,000 respectively, representing significant growths of 33.6% and 19.7% from last year respectively.

The Group is planning to improve some of its machineries and equipments, with a view to upgrading its production capacity to international standard. The Group is actively formulating strategies regarding new product development, vertical integration and optimizations of supporting facilities to make the necessary preparation for the long-term competitiveness and continual growth of the business.

### Vinyl acetate

During the financial year, the vinyl acetate division achieved a turnover of approximately HK$83,944,000 and operating profit (net of other revenue) of approximately HK$13,898,000. In view of the potential profit growth, the Group increased its shareholding in the vinyl acetate business in Mudanjiang from 55% to 63.11% in November 2004. The Group's vinyl acetate arm managed to achieve excellent results, being able to commence production and achieve profit in the same year of its expansion.

### Prospects

The Group will further integrate its state-owned assets and businesses acquired from the State units, and improve on the ineffective response to market of traditional state-owned enterprises through modern management strategies. In order to satisfy market demand for quality polyvinyl chloride ("PVC"), the Group has planned to restructure its newly acquired PVC production line to produce high quality PVC materials. Accordingly, its PVC business will be able to ascend to the high technology quality PVC materials market from the common PVC materials market.

The Directors believe that leveraging on its extensive experience in petrochemical materials business, the Group is very optimistic towards exploring coal-related chemical materials business, and the expansion of PVC business will generate fruitful returns to the Group.

## LIQUIDITY AND FINANCIAL RESOURCES

### Liquidity and Financial Ratios

At 30 June 2005, the Group had total assets of approximately HK$770.2 million (30 June 2004: HK$465.7 million) which were financed by current liabilities of approximately HK$84.6 million (30 June 2004: HK$65.3 million), non-current liabilities of approximately HK$nil (30 June 2004: HK$3.9 million), minority interests of approximately HK$86.4 million (30 June 2004: HK$28.3 million) and shareholders equity of approximately HK$599.2 million (30 June 2004: HK$368.2 million).

At 30 June 2005, the current assets of the Group amounted to approximately HK$470.2 million (30 June 2004: HK$303.0 million) comprising inventories of approximately HK$125.9 million (30 June 2004: HK$64.7 million), trade receivables of approximately HK$176.8 million (30 June 2004: HK$129.2 million), prepayments, deposits and other receivables of approximately HK$24.5 million (30 June 2004: HK$25.5 million), cash and cash equivalents of approximately HK$143.0 million (30 June 2004: HK$83.6 million).

The increase in trade receivables was in line with the growth of sales amount while the debtor turnover period at approximately 93 days (30 June 2004: 115 days). The Group normally allows credit terms to established customers ranging from 30 to 150 days. Approximate 99% of the trade receivables were settled as at 31 August 2005. 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 87 days (30 June 2004: 79 days) while the turnover period of trade payables shortened to approximately 6 days (30 June 2004: 7 days).

At 30 June 2005, 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 5.6 (30 June 2004: 4.6), 4.1 (30 June 2004: 3.7), 11.0% (30 June 2004: 14.9%) and 14.1% (30 June 2004: 18.8%), 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 2005.

## NUMBER AND REMUNERATION OF EMPLOYEES

At 30 June 2005, the Group had 345 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 2005, a total of 13 million share options are outstanding with exercisable periods up to 6 April 2007 at the exercise price of HK$0.47 per share.