

Management Discussion and Analysis

BUSINESS ENVIRONMENT

During the year under review, the Group faced an unfavorable operating environment. The crude oil price attained at successive record highs, this in turn caused the prices of most petrochemical downstream materials to rise. Some of these materials, for example base oil, even encountered occasional supply shortages. The Group's lubricants and anti-corrosive coating businesses can only pass on cost increases to customers in part, thus unfavorably affected the profit margins. Nevertheless, the competitive advantages of the Group's coal related chemical businesses (vinyl acetate and PVC), have stood out even more clearly during this high crude oil price period, which leads to an overall increase in the Group's turnover. In addition, these also offset the effect from loss in profit margins of lubricants and anti-corrosive coating businesses. As a result, the Group attained a gentle growth of profit for the year of 13.5% over the corresponding period of the previous year. Disregarding the effect of the share option benefit expenses of approximately HK\$11,463,000 charged to income statement in current year, the growth of profit for the year is 25.0% over the corresponding period of the previous year.

BUSINESS REVIEW

Lubricants

During the year under review, intense competition from rivals has resulted in high and unstable raw material prices, which could only be partially passed on to the customer. Some medium to large enterprises continued to make use of the economy of scale and their brand names to increase their market share. Despite of such difficult operating environment, the Group took special care of its loyal customers and was able to maintain certain extent of its market share. The Group recorded a total turnover of approximately HK\$179,014,000 for the year, representing a decrease of 53.0% over approximately HK\$380,529,000 in last year, while the operating profit was approximately HK\$18,451,000, representing a decrease of 70.6% over approximately HK\$62,671,000 last year. Following the implementation of a series of cost saving measures to optimise profitability, the Group anticipates the lubricant business will be more stable in the coming year.

Anti-Corrosive Coating

During the year under review, continued increases in raw materials prices and the imbalance of supply and demand led to highly unstable prices. Moreover, as the price increment could not be passed on to the customers, and some of the contracted customers did not renew their contracts, the business results were worse than anticipated during the year. The turnover and operating profit for the business during the year were approximately HK\$113,149,000 and HK\$12,902,000 respectively, representing significant drop of 49.9% and 75.0% from last year respectively. The Group has formulated plans on enriching product quality to improve competitiveness of anti-corrosive coating products.

BUSINESS REVIEW (Cont'd)

Vinyl acetate

The Group commenced the development of coal related chemical sector since 2004, with vinyl acetate being its first coal related chemical project. After operating for over 20 months, the production and sales of vinyl acetate has stabilised and generate remarkable profits to the Group. During the financial year, turnover was approximately HK\$226,900,000 representing a significant increase of 80.2% (based on monthly proportional adjustment: eight months in last year and twelve months in this year) over the corresponding period of the previous year. Operating profit was HK\$71,779,000 representing a significant increase of 244.3% (based on monthly proportional adjustment: eight months in last year and twelve months in this year) over the corresponding period of the previous year. The high contribution of vinyl acetate was the mainly result of competitive advantage of coal related production methodology over that of the petroleum related production methodology during high crude oil price period.

PVC

The PVC business is the second investment project in the coal related chemical sector. The PVC manufacturing arm was officially taken over in September 2005. After operating for one year, the suspension PVC raw material production and sales segment is now on track and started to contribute considerable profits to the Group. During the financial period, the PVC segment recorded a turnover of approximately HK\$243,189,000 and an operating profit of approximately HK\$38,571,000 respectively. Within the short period of time after taking over of the PVC Factory, the Group successfully increased the effectiveness of this production line by reducing the consumption proportion of raw materials.

PROSPECTS

The Group will further integrate its assets and businesses acquired from the State units. The Board is confident to improve on the ineffective response to market of traditional state-owned enterprises through modern management techniques. The Group has developed the coal related chemical sector for more than two years. The excellence results from the coal related chemical sector are rewarding. Following the experience in reforming the state-owned assets, the Board is confident in developing the recently acquired glucose and starch business. The Directors believe that the potential of developing agricultural chemical material business is enormous, and the exploration of business opportunities of downstream products which use glucose and starch as raw materials will generate profitable returns to the shareholders.

Management Discussion and Analysis

CAPITAL STRUCTURE, LIQUIDITY AND FINANCIAL RESOURCES

Capital structure

The Group maintained a strong financial position throughout the year under review. The Group financed its operations and business development with internally generated resources and equity funding.

During the year, the Company raised funds from the issuance of 104,330,000 new shares through exercise of share options by option holders with proceeds of approximately HK\$47 million.

The net proceeds raised by the placement of existing shares and subscription of new shares of the Company by a substantial shareholder announced on 24 June 2005 was about HK\$96 million, the whole amount was utilized by the Group at the date of this report. During the financial year, approximately HK\$30 million was injected into Mudanjiang Dongbei Gaoxin (of which approximately HK\$10 million for upgrading and refurbishment of the production facilities of the PVC business and approximately HK\$20 million for working capital of the PVC business); and about HK\$26 million was used as working capital of the Group. On 16 August 2006, approximately HK\$40 million was used to acquire the glucose and starch business.

The net proceeds raised by the placement of existing shares and subscription of new shares of the Company by a substantial shareholder announced on 6 April 2006 was about HK\$118 million, of which approximately HK\$77 million was utilized by the Group at the date of this report. During the financial year, approximately HK\$5 million was used as working capital of the Group. On 16 August 2006, approximately HK\$72 million was used to acquire the glucose and starch business.

The net proceeds raised by the placement of existing shares and subscription of new shares of the Company by a substantial shareholder announced on 3 May 2006 was about HK\$43 million, the whole amount was not yet utilized by the Group at the date of this report.

Liquidity and Financial Ratios

At 30 June 2006, the Group had total assets of approximately HK\$1,200.6 million (30 June 2005: HK\$752.2 million) which were financed by current liabilities of approximately HK\$70.9 million (30 June 2005: HK\$84.6 million), non-current liabilities of approximately HK\$1.6 million (30 June 2005: nil), minority interests of approximately HK\$113.7 million (30 June 2005: HK\$81.6 million) and shareholders' equity of approximately HK\$1,014.4 million (30 June 2005: HK\$586.0 million).

At 30 June 2006, the current assets of the Group amounted to approximately HK\$790.4 million (30 June 2005: HK\$470.2 million) comprising inventories of approximately HK\$85.2 million (30 June 2005: HK\$125.9 million), trade receivables of approximately HK\$124.7 million (30 June 2005: HK\$176.8 million), prepayments, deposits and other receivables of approximately HK\$78.8 million (30 June 2005: HK\$24.5 million), cash and cash equivalents of approximately HK\$501.7 million (30 June 2005: HK\$143.0 million).

CAPITAL STRUCTURE, LIQUIDITY AND FINANCIAL RESOURCES (Cont'd)

Liquidity and Financial Ratios (Cont'd)

At 30 June 2006, 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 11.1 (30 June 2005: 5.6), 9.9 (30 June 2005: 4.1), 6.0% (30 June 2005: 11.3%) and 7.2% (30 June 2005: 14.4%), respectively.

The financial health of the Group has been strong throughout the year as indicated by the above figures.

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 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 2006.

NUMBER AND REMUNERATION OF EMPLOYEES

At 30 June 2006, the Group had 1,004 full time employees in the PRC and Hong Kong. The Group recognises 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 performance related commissions.

At 30 June 2006, a total of 67.77 million share options are outstanding. This comprises 13.77 million with exercisable period up to 9 January 2009 at the exercise price of HK\$0.363 per share and 54.0 million with exercisable period up to 3 May 2009 at the exercise price of HK\$0.552 per share.