RISK FACTORS

Potential investors should carefully consider all of the information set out in this prospectus and, in particular, should consider the following risk factors associated with an investment in the Company before making any investment decision in relation to the Company.

RISKS RELATING TO THE GROUP

Reliance on key personnel

The Group's success is, to a significant extent, attributable to the business strategy and vision of its management, Mr. K W Cheng, Mr. K C Cheng, Ms. Cheng and the current senior management of the Group and their continued service is therefore important to the future prospects of the Group. In view of their experience, knowledge and well-established relationships with the Group's customers and suppliers, there may be a material adverse impact on the Group's business, operating results, financial position and prospects should Mr. K W Cheng, Mr. K C Cheng, Ms. Cheng or other members of the Group's senior management cease to be involved in the Group's business and operations.

Export

The Group's production operation is conducted through Dongguan PME, a wholly foreign owned enterprise established by the Group in the PRC in 1993. Wholly foreign owned enterprises are usually required to satisfy either one of the following requirements of: (1) using advanced technology and equipment, and/or satisfying other requirements relating to products and saving of energy and raw materials; or (2) exporting more than 50% of their output value on an annual basis.

For the year ended 31st December, 2001, the Group exported approximately 96% of its production in the PRC to Hong Kong and overseas markets. If a wholly foreign owned enterprise fails to comply with the export requirements, it may face certain actions taken by the PRC government, which may include imposing fines or requiring the relevant wholly foreign owned enterprise to obtain special approval from SAFE for future purchases of foreign exchange for ordinary transactions and for remittance of foreign exchange as dividend payments to its investors.

Import

As part of the raw materials of the Group used for the Group's production in Dongguan PME are imported into the PRC from Hong Kong and other countries, the importation of these imported raw materials into the PRC is subject to the control of the PRC Customs Bureau. Since the Group exports most of its products from the PRC to Hong Kong and overseas markets, the Group is not subject to customs duty on its import of raw materials. If there is any change in the import policy of the PRC or imposition of any new PRC import tax on the raw materials imported by Group, the Group's profits may be adversely affected.

Reliance on major customers

For the three years ended 31st December, 2001 and the three months ended 31st March, 2002, the Group's five largest customers accounted for approximately 15.6%, 20.1%, 23.9% and 20.0% respectively of the Group's turnover. For the same period, the largest customer of the Group accounted for approximately 3.5%, 9.3%, 15.5% and 10.0% respectively of the Group's turnover. The Group has not entered into any long-term sales agreement with any of its customers. If any of the Group's largest customers ceases its business relationship with the Group or substantially reduces the volume of its business with the Group and the Group is unable to compensate this with the increase of sales to other customers, the Group's profitability and prospects may be adversely affected.

Reliance on major suppliers

The Group's suppliers include suppliers of products for the Group's trading business and suppliers of raw materials for the Group's manufactured products. For the three years ended 31st December, 2001 and the three months ended 31st March, 2002, the Group's five largest suppliers of finished products, raw materials and accessories accounted for approximately 41.5%, 36.8%, 34.2% and 45.2% respectively of the Group's purchases. For the same period, the largest supplier of the Group accounted for approximately 13.8%, 13.3%, 11.1% and 14.6% respectively of the Group's purchases. The Group has not entered into any long-term procurement contract with any of its suppliers. If any of the Group's largest suppliers ceases its business relationship with the Group and the Group is unable to find suitable alternative suppliers at comparable quality and price within a short period of time, the Group may not be able to supply its trading products to its customers on time or may not be able to maintain the quality of its manufactured products. In such circumstances, the profitability and prospects of the Group may be adversely affected.

Reliance on the Asian markets

For the three years ended 31st December, 2001 and the three months ended 31st March, 2002, sales to the Asian markets (including Hong Kong and the PRC) accounted for approximately 94.8%, 93.7%, 95.5% and 97.4% respectively of the Group's turnover. Any significant change in the political, economic or social conditions, foreign trade, or the legal and regulatory requirements or taxation regime in Hong Kong, the PRC and other Asian countries where the products of the Group will be sold, may adversely affect the business and profitability of the Group.

Competition

The Group is principally engaged in the manufacturing of industrial abrasive products in the PRC and the trading of industrial abrasive products in Hong Kong and the PRC. The Directors believe that entry barriers to such business are insignificant in Hong Kong and the PRC as licensing requirements for conducting such business are minimal. Small to medium-sized enterprises may also have the capability to undertake business similar to that of the Group and the Directors are of the opinion that there are numerous manufacturers in the PRC which have such capability. The potentially competitive nature of the industry in which the Group is engaged, if it materialises, may have an adverse effect on the profitability of the Group's business.

Sustainability of profit margin

The gross profit margin of the Group during the three years ended 31st December, 2001 and the three months ended 31st March, 2002 were approximately 40.15%, 43.18%, 48.55% and 52.28% respectively. The net profit margin of the Group during the three years ended 31st December, 2001 and the three months ended 31st March, 2002 were approximately 14.08%, 15.77%, 21.84% and 12.67% respectively. Notwithstanding the steady gross profit margin and net profit margin of the Group during the Track Record Period, the Directors consider that if there is any increase in competition from other manufacturers and/or an increase in the costs of materials which cannot be passed on to the Group's customers, the gross profit margin and operating profit margin of the Group may be adversely affected.

Fluctuation of turnover

The turnover of the Group is subject to fluctuation during the year and thus affects the profit margin of the Group. Turnover for the first half of the year accounts for approximately 35% to 40% of the annual turnover while the turnover of the second half of the year accounts for approximately 60% to 65% of the annual turnover. The lower turnover in the first half year is mainly due to the fact that the end-users of the Group's products are manufacturing companies which usually have about one-month's holiday for the Chinese New Year. The end-users of the Group's products are mainly manufacturing companies of hollowware, cutlery, optical frames, watch cases and watch bands, and jewellery. According to the Directors' knowledge, exports of these industries in the second half of the year is usually higher than that in the first half of the year. Accordingly, the demand of the Group's products by these industries is also higher in the second half of the year. As such, the Group is exposed to the risks associated with seasonal factors and the fluctuation of the demand by other industries, and these may adversely affect the profitability of the Group.

Non-inclusion of a profit forecast for the year ending 31st December, 2002

The Group's turnover is subject to the external economic and industry environment, including demand for other industries' products and consumers goods such as hollowware, cutlery, eyeglasses and watchcases. The Directors are not familiar with the characteristics of the end market of such finished products which may be affected by unforeseeable incidents such as the recent strike of the dockers in the west coast of the US. As the demand of the products of the Group is subject to the demand for a wide range of finished products and each industry itself is subject to numerous factors, the Directors find that it is difficult to predict the turnover of the Group. Furthermore, as the Group's sales are mostly carried out under short-term contracts and the Group has no long-term contracts of firm orders from its customers, it is therefore not possible to predict with certainty the turnover of the Group and thus no profit forecast for the year ending 31st December, 2002 has been included in this prospectus.

Currency conversion and exchange rate risk

During the three years ended 31st December, 2001 and the three months ended 31st March, 2002, the sales and purchases made by the Group were mainly settled in Hong Kong dollars, US dollars or RMB and a small amount of purchases were settled in Japanese Yen and other European currencies. For the year ended 31st December, 2001, approximately 64%, 16%, 8%, 7% and 5% of the Group's purchases were settled in Hong Kong dollars, US dollars, Japanese Yen, RMB and other European currencies respectively, and approximately 90%, 9% and 1% of the Group's revenue were settled in Hong Kong dollars, US dollars and RMB respectively. The Group's profitability could be adversely affected in the event of any fluctuations in the exchange rate of the currencies in which the Group's sales or purchases are settled. The Group has not entered into any foreign forward exchange contracts for the purpose of hedging against foreign exchange risk involved in the Group's operation. As such, the Group is exposed to the risks associated with fluctuations in foreign exchange rates, and this may adversely affect the profitability of the Group.

Credit risk

The Group's sales were mainly made on an open account basis with credit periods ranging from 7 days to 90 days. Cash sales accounted for less than 2% of the Group's turnover for the three years ended 31st December, 2001 and the three months ended 31st March, 2002. The Directors consider that a long credit period inevitably increases the potential credit risk of the Group. There is no assurance that all customers will settle the amounts due to the Group on time. The Group's performance and profitability may be adversely affected if a significant number of its customers fail to settle the amounts due to the Group on time.

Product liability exposure

The Group has not taken out any insurance against liabilities arising from products sold or distributed by it or any indirect losses stemming from termination or disruption of the business (such as loss of profit) as there is no statutory requirement under the current PRC laws and regulations for so doing. The Directors confirm that the Group has never been involved in any material claims made by its customers in relation to product liability. Should any product liability claim be brought against the Group in the future, there is no assurance that it would not have an adverse effect on the reputation and/or the financial position of the Group.

Business concentration

The Group's main focus is in the manufacturing and trading of abrasive products and polishing equipment. Manufacturing and trading of abrasive products and polishing equipment accounted for approximately 98.9%, 98.5%, 98.7% and 98.9% of the Group's total turnover for the three years ended 31st December, 2001 and the three months ended 31st March, 2002 respectively. The Group's turnover may therefore be adversely affected by changes in the demand of such products due to changes in industry demand or the availability of other substitutes at a lower price.

Payment of dividends

For the three years ended 31st December, 2001, the Group paid in aggregate dividends of approximately HK$5,000,000 out of the aggregate net profit attributable to shareholders of the Group for the three years ended 31st December, 2001 of approximately HK$62,706,000 to the then shareholders of the members of the Group. The payments of such dividends were financed by the internal resources of the Group.

On 28th March, 2002, a special dividend of HK$55,000,000 was declared by a subsidiary of the Company and paid to its then shareholders prior to the listing of the Shares on the Stock Exchange in recognition of the contribution of the then shareholders to the Group. The payment of the dividends was financed by the internal resources of the Group.

Since the Directors' priority will be given to retaining earnings for future capital growth and expansion of the Group, the declaration of future payments and amount of dividends will be subject to the discretion of the Directors and will depend on, among others, the Group's earnings, financial condition, cash requirements and availability, and other factors as the Directors may deem relevant. Accordingly, potential investors should note that the above dividend payments should not be regarded as an indication of future payment of dividends.

Reduction in the registered capital of Dongguan PME

Dongguan PME was registered as a wholly foreign owned enterprise in the PRC on 3rd July, 1993 with a registered capital of HK$70 million.

Due to the change of business situation and the needs of Dongguan PME, Dongguan PME applied to have its registered capital reduced from HK$70 million to HK$40 million on 13th December, 1999.

The rules and regulations governing capital reduction by foreign owned enterprises in the PRC require the relevant government authority to issue a written preliminary approval to the company within thirty days upon receiving the application from the company for approval on capital reduction. The company is then required to notify its creditors, within ten days upon receiving the preliminary approval from the relevant government authority, by way of three separate notices, each published at least 30 days apart in the newspapers of its intention to reduce its capital. Subject to due compliance with the requirement of publishing the notices, a formal approval for capital reduction will be granted to the company by the relevant PRC government authority. Non-compliance with the relevant regulations and procedures in relation to capital reduction by wholly foreign owned enterprises will attract a maximum penalty of RMB100,000.

Failing to comply with the regulations, Dongguan PME only announced its intention to reduce its capital in the newspapers once in November, 1999 after it received the preliminary approval from Dongguan City Foreign Trade Cooperative Bureau (東莞市對外貿易經濟合作局). Dongguan PME's omission to publish the required notices was due to inadequate advice given by its then PRC professional advisers. After obtaining subsequent legal advice, Dongguan PME published the required second and third notices regarding its capital reduction in the the newspapers in March and April 2002 respectively. On 30th December, 1999, Dongguan PME had duly registered its reduced capital with the Dongguan City Trade Bureau (東莞市工商行政管理局).

Despite its initial failure to comply with the announcement requirements, Dongguan City Foreign Trade Cooperative Bureau granted a formal approval to Dongguan PME on its capital reduction on 13th December, 1999. The publication of the notices in March and April 2002 was confirmed by Dongguan City Foreign Trade Cooperative Bureau. In view of the above, the Company's PRC legal advisers are of the opinion that the capital reduction of Dongguan PME was effective and would not affect the legal status of Dongguan PME. Furthermore, according to the PRC laws, no penalty will be imposed if the procedural non-compliance is not discovered within two years from the breach of the rules. Based on the legal opinion given by the Company's PRC legal advisers, the Directors consider that the chance of being penalised by the relevant authorities for its past non-compliance is slim and even if such claim is made, the impact on the business of the Group will be minimal and will not have any material adverse effect on the business and financial position of the Group in the future.

As at the Latest Practicable Date, Dongguan PME has not received any notice of warning in relation to its past non-compliance in respect of capital reduction. However, there is no assurance that, due to any change of government policies, the relevant PRC government authorities will not in the future impose a penalty against Dongguan PME for its non-compliance in respect of capital reduction.

Overdue contribution of the registered capital of Dongguan PME

According to the rules and regulations in relation to wholly foreign owned enterprises in the PRC, shareholders of the wholly foreign owned enterprises are required to make contributions to the registered capital of the enterprises within specified periods. If the shareholders fail to make requisite contribution to the capital of the wholly foreign owned enterprises upon the prescribed due dates, the business licence of the wholly foreign owned enterprises will become invalid. Under such rules and regulations, capital contribution need not be fully paid-up upon the establishment of the enterprises, but all contribution has to be fully paid-up within three years from the date of the issue of the business licence of that particular enterprise.

PME International, a wholly-owned subsidiary of the Company and the sole investor of Dongguan PME, was required to pay up all its contribution to the capital of Dongguan PME on or before 2nd July, 1995. However, PME International failed to make its requisite contributions before that date due to tie-up of working capital of the Group in other assets.

Despite the failure to pay up all capital contribution before the due date, the subsequent renewal of Dongguan PME's investment enterprises approval certificate and business license were properly obtained on 26th April 2002 and 30th November, 2001 respectively. Furthermore, Dongguan PME passed the annual business review in 2001 and approvals were granted by Dongguan City Foreign Trade Cooperative Bureau on the changes in the use of the registered capital and capital reduction of Dongguan PME in 1998, 1999 and 2000. In view of the above, the Company's PRC legal advisers are of the opinion that the previous overdue of capital contribution would not affect the legal status of Dongguan PME and its operation has been valid and legal throughout the period since its commencement of business. At present, there are no rules and regulations in relation to the penalty on overdue contribution of capital contribution. Based on the legal opinion given by the Company's PRC legal advisers, the Directors believe that the chance of being penalised by the relevant PRC government authorities is slim and even if such claim is made, the impact on the business of the Group is minimal and will not have material adverse effect on the business and financial position of the Group in the future.

The present required capital of Dongguan PME has now been fully paid-up. As at the Latest Practicable Date, no relevant PRC government authorities have penalised the Group for late contribution of the registered capital. However, there is no assurance that, due to change in government policies, the relevant PRC government authorities will not in the future penalise the Group on its past overdue contributions.

PME Investments, Mr. K W Cheng, Mr. K C Cheng and Ms. Cheng (each an "Indemnifier") have provided an indemnity in favour of the Company and its subsidiaries in respect of overdue contribution of registered capital of Dongguan PME and failure on the part of Dongguan PME to announce the reduction of its registered capital three times in the newspapers in the PRC. Under the deed of indemnity, each of the Indemnifiers jointly and severally covenants to indemnify the Company, PME International and the other members of the Group fully and effectively against all claims, damages, losses, costs, expenses, actions and proceedings whatsoever and howsoever arising at any time whether present or future arising from:

(i) the failure on the part of PME International to contribute or contribute timely to the registered capital of Dongguan PME in compliance with the relevant rules and regulations in the PRC or articles of association of Dongguan PME applicable to Dongguan PME from time to time; or

(ii) failure on the part of Dongguan PME to notify its creditors, within ten days upon receiving the preliminary approval for the reduction of registered capital from the relevant PRC authorities, by way of three separate notices, each published at least 30 days apart in the newspapers of the reduction of Dongguan PME's registered capital, in compliance with the laws, rules and regulations prevailing in the PRC from time to time.

Renewal of the business licence of Dongguan PME

The manufacturing operations of the Group is undertaken by Dongguan PME, a wholly-owned subsidiary of the Company established in the PRC. The establishment of Dongguan PME was approved by Dongguan City Foreign Trade Cooperative Bureau in 1993 and a business licence was granted to Dongguan PME, for a period of 15 years, commencing on 3rd July, 1993 and expiring on 2nd July, 2008. There may be a risk that Dongguan PME may not be able to renew the licence on its expiry and as a result, the manufacturing operations and the financial position of the Group may be adversely affected.

The Group currently has not yet started planning for the renewal of Dongguan PME's business licence as the licence does not expire until 2nd July, 2008, nor does it have any plans to ensure smooth transition of the Group's business if the licence is not renewed.

RISKS RELATING TO THE INDUSTRY

Environmental liability exposure

The current environmental protection laws and regulations promulgated by the PRC government impose various measures to control waste disposal and pollution, including the adoption of a gradual schedule of fees for discharge of waste materials, payment of fines for pollution and regulations for the closure of any facilities which causes serious environmental problems. Except for the production of a certain level of noise and the disposal of a small amount of solid waste, the Group's production plant does not discharge waste water nor does it emit smoke from its production processes.

As at the Latest Practicable Date, the Group has not received any notice or warning in relation to non-compliance with any environmental regulations in respect of its production plants or facilities. However, the Group is required to satisfy testings carried out by the relevant local environmental regulatory authorities for smoke emissions, noise level, solid waste disposal and waste water discharges. Non-compliance with any relevant environmental laws, rules or regulations may, depending on the seriousness of the breach result in either an order for rectification from the relevant authorities, penalties or an order for cessation of production. Furthermore, there is no assurance that the PRC national or local authorities will not impose additional environmental protection requirements which might disrupt the Group's manufacturing process or require the Group to incur additional expenditures in complying with such additional requirements.

Supply of raw materials

The raw materials used by the Group in its production process are aluminum oxide, stearic acid, cotton and sisal fabric. The purchases of the principal raw materials accounted for approximately 83.8% of the Group's total raw material purchases for the year ended 31st December, 2001.

Although the Group has not experienced any shortage in the supply of raw materials, the fluctuation of the price of aluminum oxide could result in the variation of the world demand of aluminum oxide. The price of aluminum oxide on the international market may fluctuate if there is an increase in global demand for aluminum oxide in the future. Should the Group be unable to pass on the increases in the cost of raw materials, especially aluminum oxide, to its customers, the Group's financial performance may be adversely affected.

RISKS RELATING TO THE PRC

Economic, political, legal and social conditions

As a substantial portion of the Group's production is carried out in the PRC, the Group's operation may be affected by the general economic, political and social conditions prevailing in the PRC.

The PRC economy is a planned economy operating under annual, five and ten years' plans. The PRC government has introduced substantial economic reforms in the past 20 years. However, many of the reforms are unprecedented or experimental and are expected to be refined or changed and many laws and regulations governing economic activities implemented by the PRC government are at an early stage of development and their interpretation and enforcement are subject to uncertainties. There can be no assurance that changes in the PRC laws and regulations or the interpretation thereof will not have any adverse effect upon the business and prospects of the Group. In addition, any changes in the economic, political or social conditions prevailing in the PRC may lead to changes in the PRC government's policies which may affect the business and prospects of the Group.

The PRC's accession to the WTO

The WTO is responsible for unifying the regulatory aspects of trade and tariff and seeking to facilitate free trade among its member states. Since the PRC became a member of the WTO in December 2001, it has agreed to eliminate certain trade quotas and other quantitative restrictions over a five-year period and to phase out restrictions on distribution services for a wide range of products within three years. The full impact of the PRC's accession to the WTO is still uncertain at the moment, but it is very likely that the measures to be taken by the PRC government with respect to the lowering or elimination of import barriers would result in an increase in competition in the PRC market from foreign competitors. There is no assurance that the Company's business operation will not be adversely affected by such increase in competition from foreign competitors.

Government control of currency conversion and exchange rate risk

Although the turnover of the Group for the three years ended 31st December, 2001 and the three months ended 31st March, 2002 were mainly received in Hong Kong dollars, the Group's expansion of its market in the PRC may expose the Group's business to the currency risk of RMB. RMB is currently not freely convertible into foreign currencies.

Even though the exchange rate between RMB and Hong Kong dollars has not been subject to any material fluctuation in the past few years, there can be no assurance that exchange rates will not become volatile or that the exchange rate of RMB against Hong Kong dollars will not change in such a way as to adversely affect the financial position and performance of the Group.

Any devaluation of the RMB would increase the effective cost to the Group of satisfying its foreign currency requirements. Any such devaluation may also materially and adversely affect the value, translated or converted into Hong Kong dollars, of the Group's net assets, its earnings and any declared dividends. However, as the revenue of the Group from the PRC is less than 30% of the total revenue for the year ended 31st December, 2001, the Directors expect that the changes to the RMB exchange rate would not have a material impact on the financial position of the Group.

The PRC legal system

Since 1979, many laws and regulations dealing with economic matters in general have been promulgated in the PRC. The PRC is still developing its legal framework to accommodate the needs of investors and to facilitate foreign investment. Since the PRC's economy may be undergoing development at a much faster pace than that of its legal system, a certain degree of uncertainty can possibly be expected until legislation catches up with the economic reforms and activities in the PRC. Since the PRC legal system is based on statutes, decided cases in the PRC have no binding legal effect on the judges, though they are often followed by the judges as a form of guidance. The interpretation of the PRC laws may be subject to policy changes reflecting domestic political changes.

As the PRC legal system develops, the promulgation of new laws, changes of the existing laws and the pre-emption of local regulations by national laws may all affect foreign investors. The trend of legislation over the past 20 years has, however, significantly enhanced the protection afforded to foreign investors in enterprises in the PRC. Foreign parties may resolve disputes through arbitration or litigation. An arrangement concerning mutual enforcement of arbitral awards between the PRC and Hong Kong was reached in June 1999. This arrangement allows reciprocal enforcement of arbitration awards made in the PRC and Hong Kong. In the PRC, the Supreme People's Court will enforce awards made in Hong Kong pursuant to the Arbitration Ordinance (Chapter 341 of the Laws of Hong Kong).

However, there is no assurance that the PRC government will not change its policy in relation to the enforcement of arbitration awards obtained in Hong Kong or the PRC, should the Group fail to enforce its awards obtained in Hong Kong or the PRC due to the change of the policy of the PRC, the Group's interests may be adversely affected.