

BUSINESS

INTRODUCTION

The Group is principally engaged in the manufacturing of different types of industrial abrasive products under its own brand name in the PRC and the trading of different types of industrial abrasive products under various other brand names in Hong Kong and the PRC.

The Group designs and produces polishing compounds and polishing wheels under its own brand name “*Pme*” at its own production plant in Humen Town located in Dongguan City in Guangdong Province of the PRC. The polishing compounds and polishing wheels are used for industrial polishing and shining of different metallic and non-metallic products. The polishing compounds are manufactured under specific in-house designs for the polishing of different metallic or non-metallic finishing to achieve the required colouring and brightness. The polishing wheels are made of selected fabrics in various styles and sizes suitable for different finishing purposes.

The Group also trades different abrasive products including bonded abrasive products, coated abrasive products, non-woven abrasive products and other abrasive products which are supplied to markets in Hong Kong and the PRC. Other abrasive products traded by the Group include dry tumbling materials which mainly consist of grinding paste, polishing paste, shining paste, hard compound impregn and wooden chips. These materials may be applied in the dry tumbling barrel process to most metallic and plastic products to achieve a highly shiny surface finishing particularly suitable for stainless steel parts, jewellery, watch bands, watch cases, spectacle frames, buttons, zinc alloys and die-casting parts.

The Group also provides technical consultancy services to assist its customers in the application of its products. In 2002, the Group has established a technical application centre in Dongguan PME to provide training, testing of new products and various after-sales services to its customers.

The Group’s products are mainly sold in Hong Kong and the PRC. The Group also sells its products to other Asian markets and to the North American and European markets which together accounted for approximately 5% and 2.2% respectively of the Group’s turnover for the year ended 31st December, 2001. Hong Kong is currently the largest market for the Group’s products which alone accounted for about 85.7%, 77.4%, 61.9% and 78.4% of the Group’s turnover for the three years ended 31st December, 2001 and the three months ended 31st March, 2002 respectively.

The Group began manufacturing abrasive products under its own brand name of “*Pme*” in the early 1990’s. The “*Pme*” brand name is an abbreviation of “polishing materials and equipment”. For the three years ended 31st December, 2001 and the three months ended 31st March, 2002, the Group’s products sold under the “*Pme*” brand name accounted for approximately 30.0%, 44.7%, 38.8% and 53.4% of the Group’s turnover respectively. Approximately 68.9%, 53.8%, 59.9% and 45.5% of the Group’s turnover is attributable to the trading of abrasive products under other brand names from overseas for the same period.

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The manufacture of the Group's products involves the use of a variety of raw materials, which are either purchased in Hong Kong, the PRC or imported from overseas. The principal raw materials used in the Group's production are aluminum oxide, stearic acid, cotton and sisal fabric. For each of the three years ended 31st December, 2001 and the three months ended 31st March, 2002, purchases of the four types of principal raw materials mentioned above accounted for about 83.0%, 79.8%, 83.8% and 91.8% of the Group's purchases of raw materials respectively.

The Group's turnover is made up of the manufacturing and trading of industrial abrasive products and the provision of technical consultancy services. For the year ended 31st December, 2001, the manufacturing of polishing compounds and polishing wheels, trading of abrasive products and polishing equipment, and the provision of technical consultancy services accounted for approximately 38.8%, 59.9% and 1.3% respectively of the Group's turnover and about 50.5%, 45.5% and 4.0% respectively of the Group's profit from operations for the same period. Further details of the breakdown of the Group's turnover are set out in the paragraph headed "Sales and marketing" under this section.

The Group's production is carried out at its production plant in Humen Town, Dongguan City, Guangdong Province, the PRC with a total site area of approximately 61,000 sq.m. and a gross floor area of approximately 45,000 sq.m.. As at the Latest Practicable Date, the Group employed approximately 200 full-time employees for its manufacturing operations and approximately 100 full-time employees for general administration, sales, marketing and purchasing, accounting and research.

STRENGTHS

The Directors attribute the Group's successful growth and development to the following principal factors:

Extensive experience in manufacturing of abrasive products

The Group commenced its current business in the 1990's by trading polishing compounds in Hong Kong. The Directors believe that the extensive experience gained in the manufacturing and trading of a large variety of abrasive products serve as a solid foundation for the business development of the Group in the abrasive products industry.

Quality assurance of the Group's products

The Group places a high emphasis on the quality control of its products. The Group implemented a quality assurance system according to the international quality standards ISO9002: 1994 standards in 1999. The whole manufacturing process follows the standard procedures outlined in the ISO9002 procedure manuals and each stage of the production is closely monitored by the Group's quality control staff. The Directors believe that a good quality assurance system provides a guarantee for the quality of the Group's products.

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Long-established relationships with customers

As the Group has a history in trading and manufacturing abrasive products in Hong Kong, the Group has established long-term relationships with its customers since the 1990s which, the Directors believe, is a key to the success of the Group.

Low raw material costs from the PRC

The Group has been and continues to source raw materials from the PRC to reduce the Group's raw material costs. Due to the low cost of raw materials sourced from the PRC, the Group is able to ensure a high profit margin. The Group will continue to source lower cost raw materials from different areas which will further enhance the profitability of the Group and help maintain the price competitiveness of the Group's products.

Established distribution network

The Group has established a team of marketing executives to engage in the provision of sales support services and the development of a marketing network. Since the Group's relationships with its existing customers is long standing, its marketing network with its customers in Hong Kong is relatively well established. The Group has also participated in major PRC trade fairs relating to the polishing industry to promote the Group's products to its existing customer base and to expand its potential customer base in the PRC.

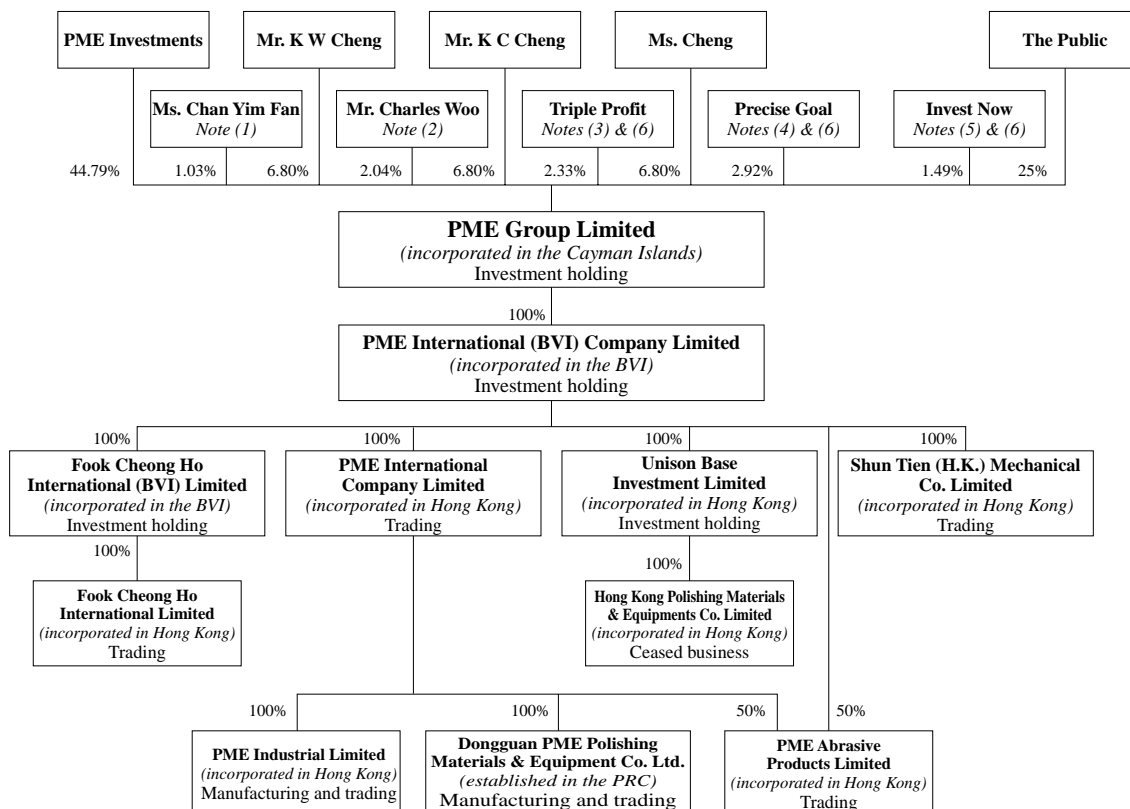
“One-stop” services

The Group provides “one-stop” services to its customers including the production and distribution of a wide range of polishing products, consultancy services on the application of the products and after-sales technical support services for its customers. As the Group produces and distributes a wide range of abrasive products, customers can obtain different abrasive products from the Group without the need to approach other suppliers.

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GROUP STRUCTURE

On 23rd October, 2002, the Group completed the Reorganisation in preparation for the listing of the Shares on the Stock Exchange, as a result of which the Company became the ultimate holding company of the Group. Details of the Reorganisation are set out in the paragraph headed “Group reorganisation” in Appendix IV to this prospectus. The following chart shows the corporate structure of the Group after the Share Offer together with the shareholding and places of incorporation of the various entities within the Group:



Notes:

- (1) Ms. Chan Yim Fan subscribed for a total of 362 shares of PME (BVI) on 2nd January, 1997 and 31st December, 1997.
- (2) Mr. Charles Woo subscribed for a total of 721 shares of PME (BVI) on 2nd January, 1997 and 31st December, 1997.
- (3) Triple Profit acquired 824 shares of PME (BVI) on 3rd December, 2001 from Mr. Hsu Tien Fu, an independent third party to the Group.
- (4) Precise Goal acquired 1,030 shares of PME (BVI) on 19th March, 2002 from Olig Limited, a company incorporated in the US and an independent third party to the Group.
- (5) Invest Now acquired 525 shares of PME (BVI) on 3rd December, 2001 from Mr. Yu Tsung Chen, an independent third party to the Group.
- (6) Triple Profit, Precise Goal, Invest Now and their respective shareholders, namely Ms. Fung Mo Leung, Ms. Tai Kwong Yau, Janet and Ms. Mak Shuk Yin, are independent to each other and are not connected with or acting in concert with any directors, chief executives or substantial shareholders (as defined in the Listing Rules) of the Company or any of its subsidiaries or an associate of any of them.

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HISTORY AND DEVELOPMENT

The Group has over ten years' experience in the trading and manufacturing of polishing materials. In 1990, PME International Company Limited, an indirect wholly-owned subsidiary of the Company, entered into a licence agreement with the Lea Manufacturing Company for a period of ten years to manufacture and distribute products of the Lea Manufacturing Company in Hong Kong, Taiwan and the PRC. The licence agreement was terminated in 2001. The Lea Manufacturing Company is a US company specialising in manufacturing polishing compounds under the brand name "Lea". In 1985, Lea (Hong Kong) International Limited, which at the time was owned as to 30% by Learok Enterprise Limited, a company incorporated in Hong Kong then controlled by Mr. K W Cheng, Mr. K C Cheng and Mr. Charles Woo, entered into a joint venture agreement with Shanghai Jiao Tong University Industrial Group Corporation to establish a joint venture company under the name of "Li Tong Surface Finishing Inc." for the purpose of setting up a plant in Shanghai for the production of various types of cotton and synthetic fabric polishing wheels. The products were supplied to the Northern American markets.

To cope with the continuous expansion of the Group's business and to improve the automation of the manufacturing process, the polishing compound production plant was re-established in Taiwan in 1988. A Taiwan company, 勵諾股份有限公司 (Learok Enterprise Limited), a former subsidiary of the Group, was established to engage in manufacturing in Taiwan. It ceased business in 2000 and thus was not incorporated into the listed group. The Group has no intention to set up manufacturing facilities in Taiwan in the foreseeable future. The after tax results of Learok Enterprise Limited for the three years ended 31st December, 2001 are loss of approximately NT\$4.97 million (approximately HK\$1.11 million), loss of approximately NT\$2.14 million (approximately HK\$0.48 million) and profit of approximately NT\$0.47 million (approximately HK\$0.11 million) respectively. In 1989, the Group set up a joint venture and established a polishing wheels manufacturing facilities in Zhangjiang, Guangdong Province, the PRC for the production of sisal polishing wheels and cotton polishing wheels. The brand name "*Pme*" was registered in Hong Kong, the PRC and Taiwan in 1990, 1993 and 1994 respectively.

In 1991, the Group set up a manufacturing facility in Haikou City in Hainan Province, the PRC for the manufacturing of the other abrasive products.

The Group commenced planning of the construction of the existing production plant in Humen Town, Dongguan City, Guangdong Province, the PRC in 1993 to consolidate the dispersed production facilities of the Group and to facilitate transport and communication. In 1997, the construction of the factory complex in Dongguan was completed and the production facilities located in Taiwan, Zhangjiang and Haikou were all relocated to the existing production plant in Dongguan City. The existing production plant, which has a total site area of approximately 61,000 sq.m, was constructed with the aim to meet the production requirements of the Group for the next 20 years.

Due to the expansion of the business of the Group and labour force related problems, the production flow and the daily management has become more complex. The Directors implemented a new set of internal control guidelines for the planning, management, production and monitoring of many aspects of the business in April 1999 to improve the quality of the management. The Group carried out a series of work flow reorganisations and re-engineering and successfully obtained the ISO9002: 1994 certification in 1999.

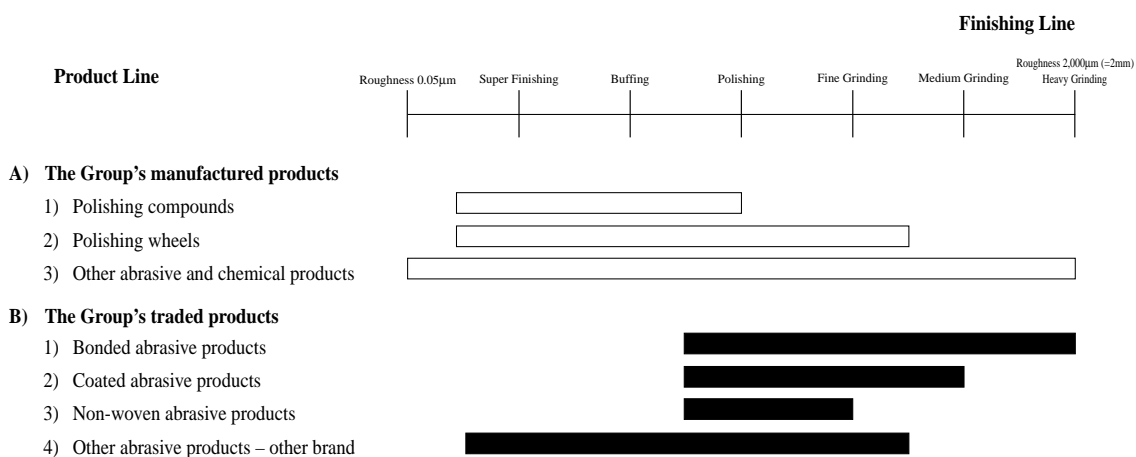
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PRODUCTS

The Group is principally engaged in the manufacturing, sales and trading of various types of polishing compounds and polishing wheels. The following table summarises the breakdown of turnover of products manufactured and traded by the Group for the three years ended 31st December, 2001 and the three months ended 31st March, 2002.

Types of Products	Year ended 31st December,			Three months ended
	1999	2000	2001	31st March, 2002
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<i>The Group's manufactured products</i>				
Polishing compounds	14,736	30,822	27,969	7,591
Polishing wheels	13,551	18,062	12,779	1,642
Other abrasive and chemical products	8,414	6,221	5,420	393
<i>The Group's traded products</i>				
Bonded abrasive products	19,384	14,177	25,777	2,942
Coated abrasive products	6,168	5,951	4,361	487
Non-woven abrasive products	13,168	8,196	5,882	932
Other abrasive products	34,326	30,339	22,611	2,677
Equipment and others	11,298	7,699	12,735	1,161
	<u>121,045</u>	<u>121,467</u>	<u>117,534</u>	<u>17,825</u>

The Group produces different abrasive products designed for the buffing of different roughness of grinding products. The following table shows the application of different product lines of the Group and the respective finishing lines.



THE GROUP'S MANUFACTURED PRODUCTS

The Group produces polishing compounds, polishing wheels and other abrasive products under its own brand name "*Pme*".

Polishing compounds

Since polishing is an important stage in the production process of many industrial products, polishing compounds are widely used in different manufacturing industries, such as the production of watches, watch bands, spectacle frames, jewellery, door locks, stainless steelware and different metal parts. The manufacture of polishing compounds accounted for approximately 12.0%, 25.0%, 23.5% and 42.1% of the total turnover of the Group for the three years ended 31st December, 2001 and three months ended 31st March, 2002 respectively.

The Group produces two principal types of polishing compounds, including compounds made of aluminum oxide and tripoli.

- (1) Aluminum oxide is the abrasive powder most commonly used in the buffing of hard metals. It can be classified into two groups, namely soft aluminas and harder aluminas. Soft aluminas are used to produce luster or a higher reflectivity on all metals, both ferrous and non-ferrous. The harder aluminas will cut and remove more metal from the surface of castings or extrusions of aluminum, brass, and other metals.
- (2) Tripoli is suitable for buffing of aluminum, brass, copper, and zinc die cast or other white metals. It can be used as a cutting abrasive or a "cut-and-color" abrasive for non-ferrous alloys.

Polishing wheels

The Group produces three principal types of polishing wheel series under its "*Pme*" brand name. The major polishing wheels series comprise: (a) cotton wheels; (b) sisal cord wheels; and (c) non-woven wheels, the details of which are described as follows:

- (a) There are different types of cotton wheels, including ventilated cotton and sisal buffing wheels and chemical treated cotton buffing wheels.
- (b) Sisal cord wheels are made of braided sisal cords. Both sisal and cotton cord wheels are usually applied in the production of different products, such as hollowware and cutlery.
- (c) Non-woven wheels are made of non-woven fabric and abrasive materials. They are usually used for surface conditioning.

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Other abrasive products and chemical products

The Group also produces other abrasive products such as non-woven abrasive products and chemical products such as cleaner solutions. Other abrasive products and chemical products contributed to approximately 6.9%, 5.0%, 4.6% and 2.2% of the total turnover of the Group for the three years ended 31st December, 2001 and the three months ended 31st March, 2002 respectively.

Throughout the Track Record Period, the Group has not experienced any major production overhaul.

THE GROUP'S TRADED PRODUCTS

The Group engages in the trading of various abrasive products and polishing equipment imported from the United States, Japan and Taiwan. The trading of abrasive products constituted approximately 68.9%, 53.8%, 59.9% and 45.5% of the total turnover of the Group for the three years ended 31st December, 2001 and the three months ended 31st March, 2002 respectively.

The following table summarises the breakdown of the Group's turnover of traded products for each of the three years ended 31st December, 2001 and the three months ended 31st March, 2002.

Turnover	Year ended 31st December,			Three months ended
	1999	2000	2001	31st March, 2002
Bonded abrasive products	23.0%	21.4%	36.1%	35.9%
Coated abrasive products	7.3%	9.0%	6.1%	5.9%
Non-woven abrasive products	15.6%	12.4%	8.3%	11.4%
Other abrasive products	40.7%	45.6%	31.7%	32.6%
Equipment and others	13.4%	11.6%	17.8%	14.2%
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

Bonded abrasive products

Bonded abrasive products are grinding wheels which are abrasive grains held by bonding material. The bonded abrasive products have different grain sizes, dimensions, structures and bond types which form into a variety of product shapes, such as cylinders, disc cups, bars and mounted products. Bonded abrasive products are used as a major cutting tool for industrial use and it can be applied to produce different degrees of grinding varying from heavy grinding to decorated fine finishing.

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Coated abrasive products

Coated abrasive products come in the form of sheets, belts, discs and wheels. They are used extensively to cut the finished flat or curved surfaces of metallic and non-metallic parts, and for wood work. The coated abrasives are usually made of aluminum oxide, silicon carbide and zirconia alumina which have a more open structure than abrasives on grinding wheels.

Non-woven abrasive products

Non-woven abrasive products are three-dimensional materials which are impregnated in non-woven fabric to provide deburring, cleaning, scrubbing, scouring, blending, polishing, and imparting satin and decorative finishes. Due to the broad range of shapes, types, grit sizes and densities available to non-woven abrasive products, they can be applied for many cleaning and finishing operations.

Other abrasive products

The Group also trades cleaner solutions and other abrasive products, such as materials for dry tumbling process. For instance, polishing compounds, special grinding abrasive and chemicals. These products are also used in light industries such as in the production of watches and hollowware.

Equipment and others

In addition to the abrasive products, the Group trades automatic and semi-automatic polishing machines for use in various industries. Such machines are important in the production stage of cutlery industry.

The Group also provides after sales services such as the provision of machine parts and tooling to satisfy the needs and requirements of its customers. Although the trading of equipment is not a major part of the business of the Group, the Directors believe that such business will continue to grow as a result of the Group's penetration in the PRC market.

INTEGRATION OF MANUFACTURING AND TRADING

The Directors believe that by integrating trading and manufacturing, it can provide the most comprehensive and full range of products for its customers in a cost efficient way. However, not all of the Group's manufactured products may satisfy the requirements of its customers in terms of pricing quality or specific usage purpose and it may not be cost efficient to produce a particular product if the demand for it is too low. In such situations, the Group shall source different products to meet the particular requirement of its clients and will be able to satisfy the needs of any possible demand without manufacturing the entire range of products.

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TECHNICAL CONSULTANCY SERVICES

As the Group has been engaging in the polishing industry for many years, it has gained substantial know-how of industrial polishing. In addition to the manufacturing and trading of abrasive products, the Group also provides technical consultancy services to assist customers in the application of industrial polishing. Such services include advice on choosing between different classes of products, laboratory analyses and research and also tailor-made proposals regarding the application of polishing materials and equipment. These proposals are handled by the product specialists of the Group under the know-how approach and research supported by the technical application centre and the Group's laboratory. The income from the Group's consultancy services represents approximately 1.1%, 1.5%, 1.3% and 1.1% of the total turnover of the Group for the three years ended 31st December, 2001 and the three months ended 31st March, 2002 respectively.

PRODUCTION FACILITIES

The production facilities of the Group are located in Humen Town, Dongguan City, Guangdong Province, the PRC with manufacturing operations undertaken by Dongguan PME.

Dongguan PME is a wholly foreign owned enterprise established in the PRC with a registered capital and total investment of HK\$40,000,000. The establishment of Dongguan PME was approved by Dongguan City Foreign Trade Cooperative Bureau (東莞市對外貿易經濟合作局) in 1993. According to Dongguan PME's business licence, it is entitled to operate until 2008. As the business licence of Dongguan PME will expire in 2008 and as Dongguan PME undertakes the manufacturing operations of the Group, there is a risk that Dongguan PME may not be able to renew the licence upon its expiry and the manufacturing operations of the Group may be adversely affected.

PME Investments, Mr. K W Cheng, Mr. K C Cheng and Ms. Cheng (each an "Indemnifier") have jointly and severally 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 registered capital of Dongguan PME three times in the newspaper 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, regulations in the PRC and articles of association of Dongguan PME applicable to Dongguan PME from time to time; or

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- (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 newspaper 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.

The production complex has a total site area of approximately 61,000 sq.m. and a gross floor area of approximately 45,000 sq.m. which consists of an administration building, a production plant for polishing compounds, a production plant for polishing wheels and a warehouse. The production process of polishing compounds has computerised control of the temperature and the mixture of the raw materials.

At the Latest Practicable Date, the Group employed approximately 200 full-time employees for its manufacturing operations and approximately 100 full-time employees for general administration, sales, marketing and purchasing, accounting and research.

PRODUCTION PROCESS

The following is a summary of the major stages of the production processes for polishing compounds and polishing wheels, the principal products of the Group:

Polishing compounds

There are three stages in the process of polishing compounds manufacture:

Stage 1 – Preparation

- Materials are selected from various suppliers.
- Raw materials are inspected by incoming inspection units.
- The compound's ingredients are prepared to conform to the compound's exclusive formulation.

Stage 2 – Production

- An in-process automatic reacting system is used in formulating the compound and is formed by an automatic moulding machine.
- A special cooling unit is used to achieve an ambient temperature for the compound bars.

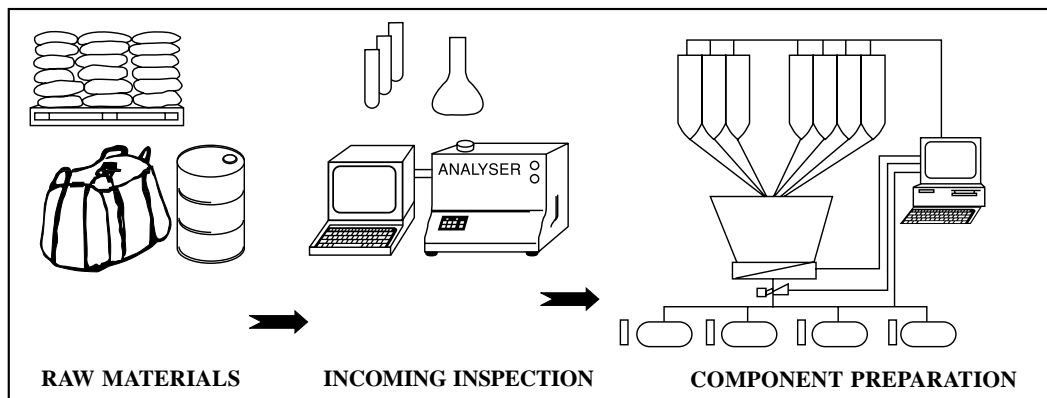
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Stage 3 – Completion

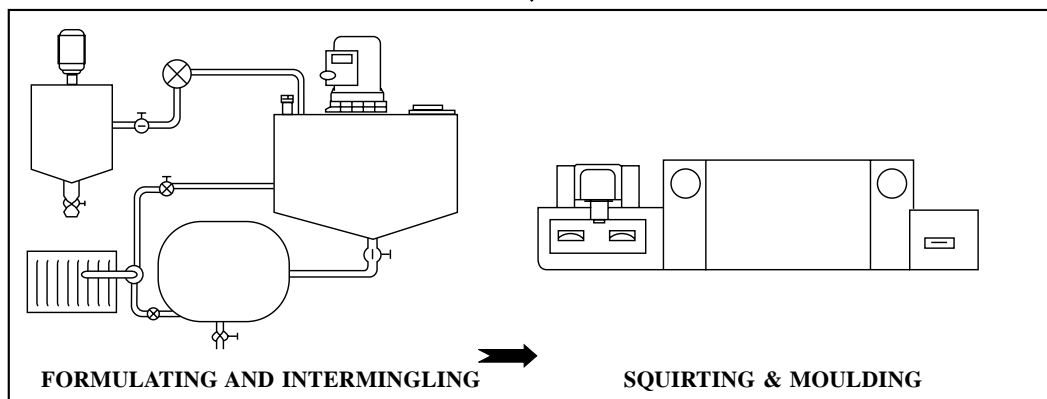
- Special requirements of the compounds are complied with under the supervision of the quality control specialists.
- Products are packaged, labelled and despatched.

Production of polishing compounds

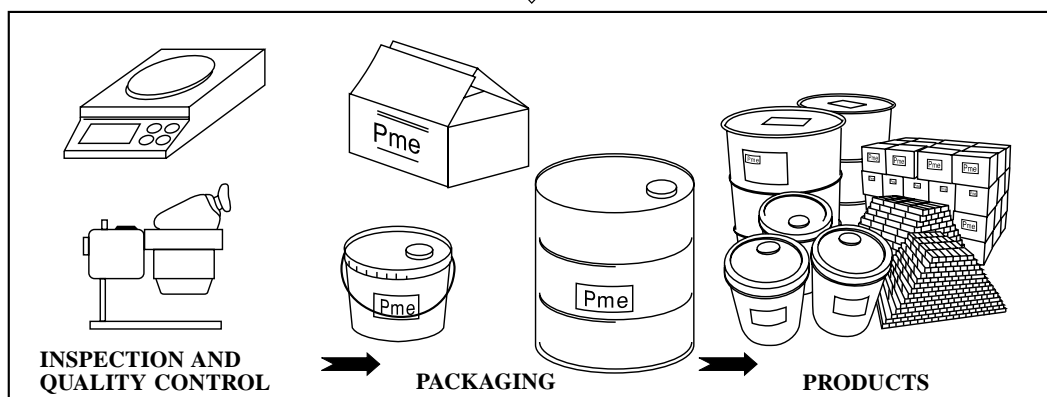
PREPARATION



PRODUCTION



COMPLETION



Polishing wheels

There are three basic stages in the production of polishing wheels including preparation, production and completion.

Stage 1 – Preparation

- Raw materials are acquired from various suppliers.
- Raw materials are inspected by the incoming inspection unit.
- Raw materials are delivered to the relevant staff for stamping and cutting at various parts of the preparation stages.
- In-processing inspection is carried out at the examination station for quality control.

Stage 2 – Production

- The stamped parts are assembled according to the working instructions of different product requirements.
- Raw materials are assembled and compressed by hydraulic pressing.
- Assemblies are stitched together with rolls of sewing.
- The sewed assemblies are then formed into the required shapes and dimensions in accordance with customers' requirements.

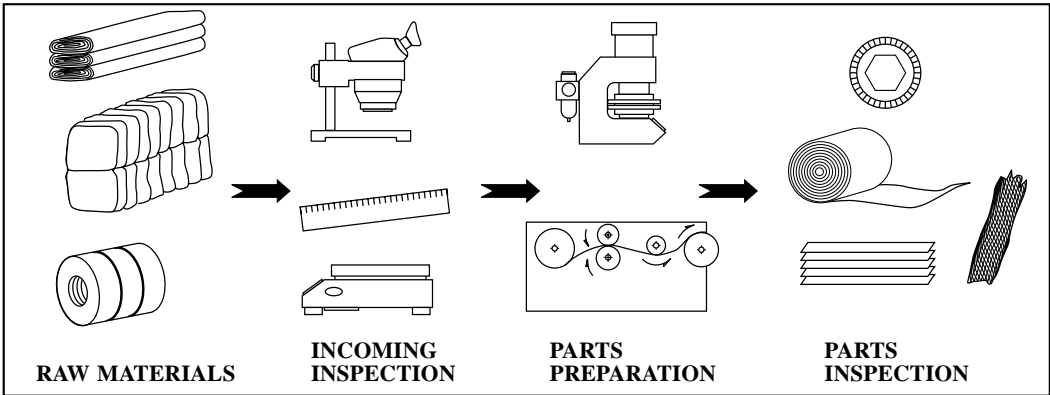
Stage 3 – Completion

- All products are passed to the quality control staff for final inspection to ensure the fulfillment of the different requirements.
- The products which pass the final inspection are packaged, labelled and despatched.

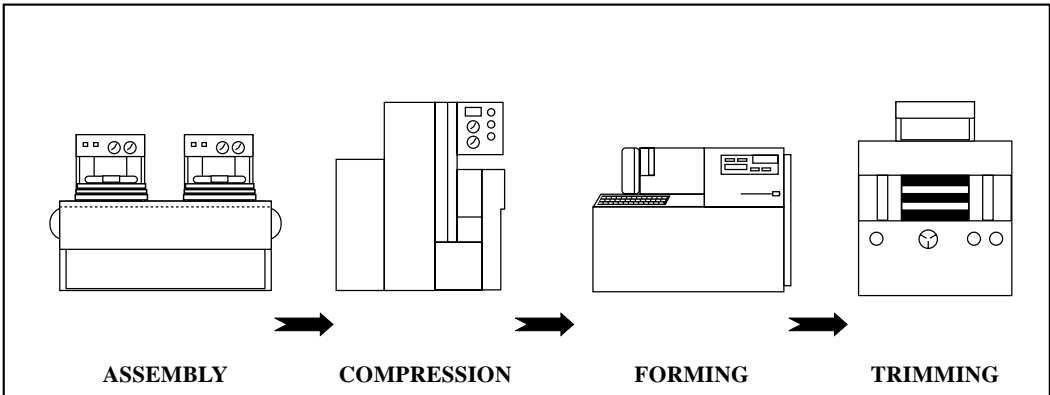
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Production of polishing wheels

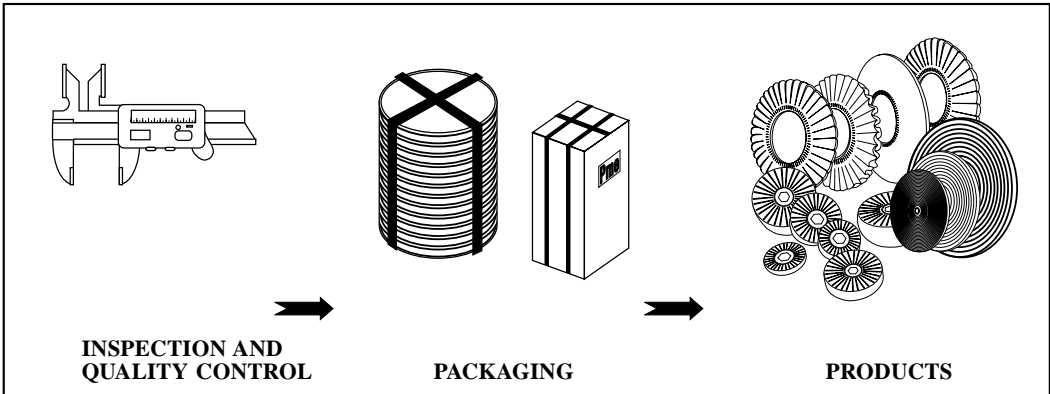
PREPARATION



PRODUCTION



COMPLETION

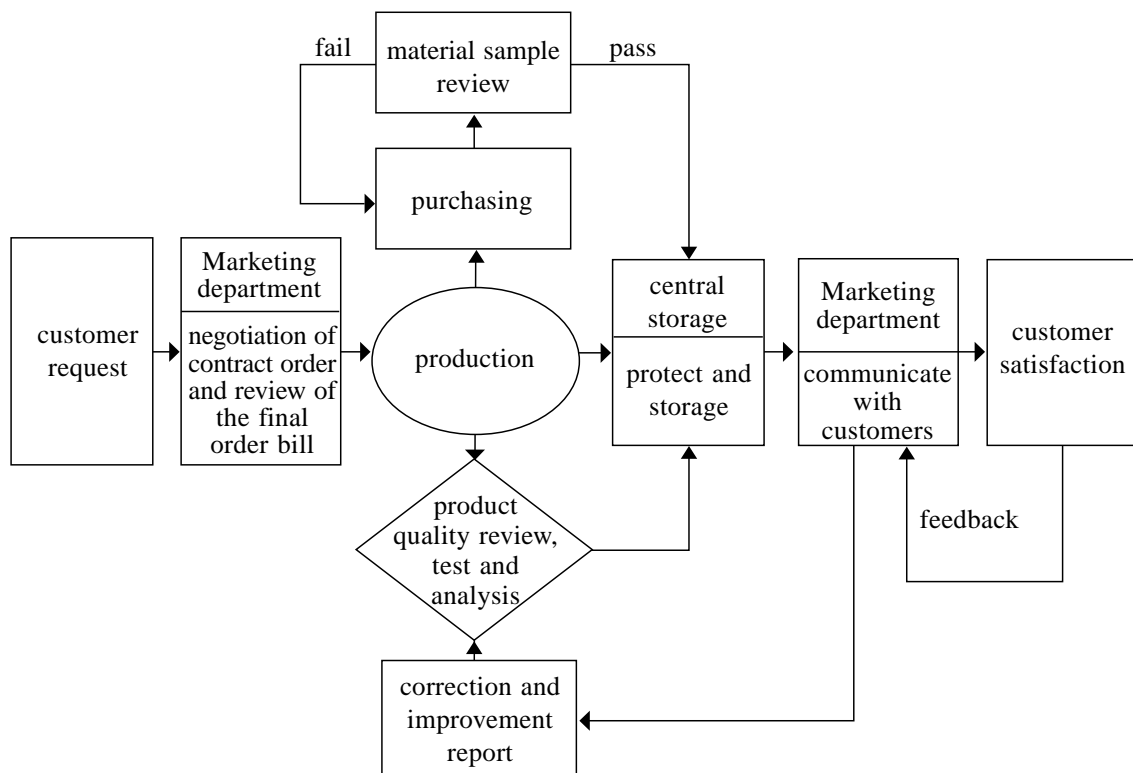


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QUALITY CONTROL

To enhance the competitiveness of the Group's products, the Group has placed much emphasis on the quality control of its production and its supply chain management. Investments have been made as to the purchasing of test equipment, setting up of testing facilities, formulating strict testing procedures and employing qualified personnel to enforce its quality control policies. Raw materials are tested prior to production and end products are again tested to ensure uniform high quality. Every stage of the Group's production and delivery process is closely monitored by the Group's quality control staff. The incoming raw materials and accessories are tested by the Group's research and development staff on a random sampling basis to ensure that the quality of the materials is in compliance with the prescribed quality standards of the Group. Quality checks are also carried out at various stages of production and workers are required to follow an instruction menu to ensure the quality of the Group's products. Samples of finished goods are inspected at the Group's laboratories using various testing equipment to ensure the relevant requirements and standards are complied with before packaging for delivery.

The following flow chart sets out the procedures taken by the Group in relation to quality control at various stages from the purchase of raw materials to the delivery of the products to customers:



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In order to guarantee the proper functioning of the quality control system of the Group, a system procedure document and operating menu are prepared. The Group also prepares its own quality control menu, document control system, record system and internal audit procedure to ensure the production of high quality products and compliance with the quality control system.

It is the Group's policy, through continuous improvement, to dedicate itself to meet the demands and expectations of its customers in terms of quality products and services.

The Directors consider that the quality of the Group's products is a key to its success. For the three years ended 31st December, 2001 and the three months ended 31st March, 2002, the return rate of defective products accounted for less than 1% of total turnover for the Group.

In November 1999, the Group was certified to ISO9002: 1994 standards by BSI Pacific Limited for its production, planning and management. BSI Pacific Limited is the Asia Pacific Office of British Standards Institution. The Group is attempting to satisfy the requirements to improve the output and the customer satisfaction under ISO2000 in 2002.

INVENTORY CONTROL

The Group's raw materials and inventories are stored in its warehouses in Dongguan and Hong Kong. The production department of the Group, headed by an executive Director, performs checks on a monthly basis on the inventory records kept by the Group to ensure that such records are up-to-date and are an accurate reflection of the inventory levels and movements maintained by the Group.

As of 31st December, 2001, the normal inventory level of the Group, including raw materials, work in progress and finished goods amounted to approximately HK\$17.5 million. The Directors carefully monitor the Group's inventory level to cater for the uptrend and downtrend in the Group's sales volume. The Directors closely monitor the overall business environment in which the Group is engaged in and will increase the inventory level as required so as to reduce the impact from any possible interruption of production. The Group has not experienced any significant production interruption during the three years ended 31st December, 2001 and the three months ended 31st March, 2002. The stock turnover of the Group for the three years ended 31st December, 2001 and the three months ended 31st March, 2002 was approximately 57 days, 65 days, 54 days and 79 days respectively.

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SALES AND MARKETING

Sales

Products manufactured by the Group are mainly sold in Hong Kong and the PRC. Asia, especially Hong Kong and the PRC, is the largest market for the Group's products, accounted for approximately 94.8%, 93.7%, 95.5% and 97.4% of the Group's turnover for the three years ended 31st December, 2001 and the three months ended 31st March, 2002 respectively.

Set out below is the breakdown of the Group's turnover by geographical area for the three years ended 31st December, 2001 and the three months ended 31st March, 2002:

	Year ended 31st December,						Three months ended 31st March,	
	1999		2000		2001		2002	
	HK\$'000	%	HK\$'000	%	HK\$'000	%	HK\$'000	%
By geographical area								
Turnover:								
Hong Kong	104,974	85.7	95,493	77.4	73,764	61.9	14,119	78.4
PRC	4,903	4.0	14,655	11.9	34,037	28.6	3,288	18.2
Other Asian countries	6,183	5.1	5,451	4.4	5,918	5.0	139	0.8
North America and Europe	4,146	3.4	3,669	3.0	2,611	2.2	184	1.0
Other countries	2,245	1.8	4,095	3.3	2,734	2.3	285	1.6
	<u>122,451</u>	<u>100.0</u>	<u>123,363</u>	<u>100.0</u>	<u>119,064</u>	<u>100.0</u>	<u>18,015</u>	<u>100.0</u>

The Group's sales are mainly denominated in Hong Kong dollars. The Group may request down payments from customers, which varies from 10% to 30% of the contract value, depending on the credit worthiness of individual customers. The credit period of the Group usually ranges between 7 and 90 days. The Group has not experienced any significant bad debt problems and the percentage of bad debts amounted to approximately 0.40%, 0.18%, 0.01% and nil of the Group's turnover for the three years ended 31st December, 2001 and the three months ended 31st March, 2002 respectively.

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Marketing

The Group has participated in major trade fairs of the polishing industry in the PRC to promote the Group's products to existing and potential customers in the PRC and overseas.

The Group has a team of professional marketing staff who works in conjunction with the management team of the Group to promote the products and services of the Group and to identify customers' needs. Although the Group has not conducted any major advertising campaign to promote its business in Hong Kong, its well-established network and customer base has provided the Group with a steady stream of business.

The Group provides "one-stop" services including the production and distribution of a wide range of polishing products, related consultancy services on the application of the products and after sales technical support services for its customers. The Group has established a technical application centre in Dongguan PME's headquarters with the view to promote and drive the sales of the Group's products. In order to enhance the quality of services of the Group, marketing staff will liaise with customers and the technical application centre to provide general advice to customers and assist them in the application of the Group's products.

The Directors believe that the PRC will be a market of great potential. The Group plans to establish a trade representative office in Shanghai, the PRC to further expand the business of the Group in the PRC market. It is intended that the representative office will be responsible for the co-ordination and promotion of the Group's business and the establishment of the sales network in Shanghai and other major cities in the eastern part of the PRC. The representative office will assist with the business development of the Group and help to build up a network of customers in the eastern part of the PRC.

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% of the Group's turnover respectively. During the same period, the largest customer of the Group accounted for approximately 3.5%, 9.3%, 15.5% and 10.0% of the Group's turnover respectively. The Group has had business relationships with such five largest customers ranging from 1 to 10 years.

The Directors believe that the Group has established good business relationships with its customers and has gained a reputation in the abrasive product industry primarily due to the high quality and competitive prices of its products. As at the Latest Practicable Date, the Group had a customer base of more than 700 active customers.

None of the Directors, their respective associates or any Shareholders owning more than 5% of the issued share capital of the Company has had any interests in any of the five largest customers of the Group during the three years ended 31st December, 2001 and the three months ended 31st March, 2002.

BUSINESS

The Directors are not aware of any material litigation or disputes that have been encountered by any member of the Group during the three years ended 31st December, 2001 and the three months ended 31st March, 2002.

CUSTOMER SERVICES AND AFTER-SALES SERVICES

As part of the Group's objectives to provide high quality products and to establish a good relationship with its customers, the Group established a technical application centre in Dongguan PME's headquarters in 2002 to promote the application of the Group's products and to provide professional advice on the industrial application of abrasive products, introduce new technology and techniques of polishing and provide solutions and technical support to customers. The technical application centre also performs testings on the Group's existing and new products for customers and provides training to its employees. The marketing manager handles the customers' enquiries and liaises with the technical application centre and sales and marketing department to provide the necessary technical support to the customers. The Directors believe that the provision of after sales services and the establishment of the technical application centre can enhance the Group's reputation and the product quality of the Group in the industry.

PRICING POLICIES AND PAYMENT TERMS

The Group takes into consideration a number of factors in determining its pricing policies, which include market supply and demand, prices set by competitors, costs of production and technical specifications of the products. A bulk discount may be given to customers on a discretionary case-by-case basis.

All of the Group's income from sales to customers in Hong Kong are denominated in Hong Kong dollars. Payments are generally required to be made before delivery by way of cash, cheque, letter of credit or interbank transfer. If any customer requests to purchase products on credit, the credit control of the accounts department of the Group will consider the customer's request and, if appropriate, decide the credit limit to be given to the customer.

The bad debts of the Group accounted for less than 1% of the Group's turnover for the three years ended 31st December, 2001 and the three months ended 31st March, 2002. The Directors attribute this to the Group's stringent credit control policy.

BUSINESS

PROCUREMENT

The Group's purchasing department is responsible for the purchase of raw materials and trading products for over 5,000 different items. As at the Latest Practicable Date, the department consisted of 10 full-time employees for the purchase of raw materials and the trading of products which works closely with the Group's sales and marketing department and staff stationed at the Group's warehouses.

The Group currently has approximately 18 major suppliers of raw materials. The Group has established long business relationships with them ranging from two to ten years. The Group's purchases are usually made from the PRC, Hong Kong, Taiwan, the United States, Japan and Spain. The Group will arrange for the delivery of the necessary raw materials and accessories to Dongguan PME for processing into finished products.

For each of the three years ended 31st December, 2001 and the three months ended 31st March, 2002, the five largest suppliers of the Group accounted for approximately 41.5%, 36.8%, 34.2% and 45.2% of the Group's total cost of purchases respectively and the largest supplier of the Group accounted for approximately 13.8%, 13.3%, 11.1% and 14.6% of the Group's total purchases respectively. Save for unforeseen circumstances, the Directors do not anticipate any material difficulties in the sourcing of raw materials, accessories or trading products in the foreseeable future. None of the Directors, their respective associates or any Shareholders owning more than 5% of the issued share capital of the Company has had any interests in any of the Group's five largest suppliers for each of the three years ended 31st December, 2001 and the three months ended 31st March, 2002.

Each of the five largest suppliers of the Group is independent of and not connected with any of the directors, chief executive or substantial shareholders of the Company or any of its subsidiaries and any of their respective associates.

RAW MATERIALS

The raw materials used by the Group are primarily aluminium oxide, stearic acid, cotton and sisal fabric which are sourced from Japan, the PRC, Indonesia, Taiwan and Spain.

The Group has not experienced any difficulties in obtaining supplies of raw materials since the commencement of its business.

During the three years ended 31st December, 2001 and the three months ended 31st March, 2002, purchases of the Group were mainly denominated in Hong Kong dollars, RMB and US dollars. For each of the three years ended 31st December, 2001 and the three months ended 31st March, 2002, approximately 48%, 35%, 64% and 35% of the Group's purchases were settled in Hong Kong dollars respectively while the remaining percentage was settled in RMB, US dollars, Japanese Yen and other European currencies.

BUSINESS

The Group has not encountered any disruption to its production as a result of shortage of supply of raw materials despite the fact that the Group has not entered into any long-term procurement contracts with any of its suppliers. The Group has never experienced any difficulties in obtaining supplies from its existing major suppliers. The Group had not entered into any supplier agreement with the suppliers of trading products either. Given the Group's good relationship with its major suppliers, the Directors do not envisage that the Group will experience any significant difficulties in obtaining supplies from its existing major suppliers in the foreseeable future.

RESEARCH AND DEVELOPMENT

The sales and marketing team of the Group works closely with the research and development team to ensure the quality of the Group's products and to meet the demand of its customers. The Group has a research and development team headed by the Group's technical application centre which, as at the Latest Practicable Date, comprises six full-time employees responsible for the development of new products. The research and development team constantly seeks to formulate new product formula, improve new production methods and develop new product mix. The research and development team uses advanced equipment, such as the laser diffraction of the Particle Size Analyser, to ensure the quality of micron abrasives used in polishing compounds and abrasive products during the quality control process.

ENVIRONMENTAL PROTECTION

The current environmental protection laws and regulations promulgated by the PRC government impose a gradual scale of fees for the discharge of waste materials and require the payment of fines for pollution and the closure of any facility which causes serious environmental problems. Production plants are required to have environmental protection facilities designed to operate simultaneously with the production facilities. 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.

Although the nature of the business of the Group requires the disposal of solid waste during the manufacturing process, the Group has not received any notice or warning of any non-compliance with environmental regulations in respect of its production and facilities. However, as an on-going requirement, the Group is required to satisfy tests carried out from time to time by relevant local environmental regulatory authorities for smoke emissions, noise level, solid waste disposal and waste water discharges. Non-compliance with any environmental laws, rules or regulations may, depending on the seriousness of the breach, result in an order for rectification from the authorities, penalties, or an order for cessation of production. 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. The Directors confirm that up to the Latest Practicable Date, the Group has not been in breach of, warned by or imposed of any fines or penalties by government authorities in the PRC and Hong Kong in relation to environmental protection laws in the PRC and Hong Kong.

BUSINESS

COMPETITION

The Group is principally engaged in the manufacturing of polishing compounds and polishing wheels in the PRC under its own brand name “*Pme*” 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 both Hong Kong and the PRC as licensing requirements for conducting such business are minimal. Small size enterprises and companies may have the capability to undertake such similar business to that of the Group. The Directors are of the opinion that there are numerous manufacturers in the PRC capable of competing in the industry in which the Group is engaged which may have an adverse effect on the profitability of the Group’s business.

The Directors believe that the Group will face increasing competition from an increase in the number of imported goods following the PRC’s accession to WTO in 2001 and a decrease in the prices of imported goods. However, the Directors consider that such competition is favourable to the business of the Group since the decrease in the prices of the imported goods may encourage the PRC manufacturers to use higher quality polishing materials. The Directors believe that the products manufactured and traded by the Group are of high quality and of a relatively competitive price compared to the imported products. The Directors are of the view that the opening up of the PRC markets in this industry will therefore have a positive impact on the business of the Group.

The Directors consider that the Group’s competitive advantage in the market arises from its extensive experience in the manufacturing of polishing materials, its long-established relationship with local customers in Hong Kong and the PRC, few competitors in Hong Kong, lower raw material costs in the PRC, a well-established production plant in the PRC, constant product development of the Group and the existing marketing resources, production and distribution network in Hong Kong. The Directors believe that these advantages will place the Group in an advantageous position in the local market.

INTELLECTUAL PROPERTY RIGHTS

The Group’s trade mark “*Pme*” has been registered in Hong Kong, Taiwan and the PRC. Further details of the Group’s intellectual property rights are set out in the paragraph headed “Intellectual property rights of the Group” under the section headed “Further information about the business” in Appendix IV to this prospectus. The Group did not encounter any trademark infringement problem during the Track Record Period.

BUSINESS

INSURANCE

The Group does not maintain any insurance for product liability or third party liability. The Directors are not aware of any major third party liability claim or material accident compensation claim filed against any member of the Group during the Track Record Period and up to the Latest Practicable Date.

The Directors are of the view that the sums insured by property insurance policies taken out by the Group are sufficient to cover the exposure of the costs of its plant.