

Management Discussion and Analysis – Chairman's Letter to Shareholders

Dear Shareholders,

It is my pleasure to report to you the results of Ocean Grand Holdings Limited (the "Company") and its subsidiaries (collectively "Ocean Grand" or the "Group") for the year ended 31 December 2003 (the "Year") and the management's strategies in leading the Group in this challenging and exciting business environment.

BUSINESS PROSPECTS AND SEGMENTAL INFORMATION

Turnover of the Group during the Year reached HK\$2,067,758,000 (2002: HK\$1,423,934,000), an increase of 45% as compared with 2002. Gross profit has in turn increased by 34% to HK\$296,979,000 (2002: HK\$221,219,000). The robust growth in business has propelled Ocean Grand's net profit attributable to shareholders to a record high of HK\$149,546,000 (2002: HK\$109,963,000), up 36%.

The remarkable performance in 2003 was made possible because of the commitment and dedication of all our staff members. I would like to take this opportunity to extend my heartfelt appreciation for their effort and endeavour.

ALUMINIUM EXTRUSION BUSINESS

2003 has been both a rewarding year and a challenging year in relation to the Group's aluminium extrusion business. On one hand, the effort of the Group in developing overseas markets for high value-added, high margin and fabricated products has come to fruition; on the other hand, the outbreak of SARS in the first half of 2003 had created obstacles to both order negotiation and customer liaison. The Group has made up the difference by putting in extra effort in the second half of the Year in order to meet its anticipated market development targets.

In addition, the price of aluminium had risen by 18% and become much more volatile during the Year. As aluminium cost constitutes a major part of cost of goods sold, volatility in aluminium prices represents a substantial risk which any aluminium extruder must address. Fortunately, the risk management strategies of Ocean Grand have shielded the Group from adverse market volatility. Turnover and contributions to operating profits of the aluminium extrusion business segment in 2003 have reached an encouraging HK\$1,330,708,000 (2002: HK\$1,155,373,000) and HK\$120,189,000 (2002: HK\$95,866,000) respectively, and average gross profit margin for extrusion products for 2003 is maintained at a reasonable level of 25% (2002: 25%).

Striking a balance between risk management and growth when managing an aluminium business is essential.



Anodising line

Re-melting facility



Fabrication workshop

RISK MANAGEMENT

The extrusion industry in The People’s Republic of China (the “PRC” or “China”) is highly fragmented and is undergoing consolidation. At one time there were more than 600 aluminium extruders in China, but there are now only about 300 in operation, the vast majority of which specialising in producing low-end profiles for construction use at a competitive price. Whilst operating in this environment, the Group has to cautiously manage the following risks in order to maintain a solid business foundation and stable growth:

1. Aluminium price risk
2. Pricing risk
3. Bad debt risk

Aluminium price risk

Ocean Grand’s strategy is not to take on any unnecessary aluminium price risk.

It is a well-established industry norm that an aluminium extruder will eliminate its aluminium price risk by quoting the price of its products on a “cost-plus” basis and locking-in the price of raw materials in the open market at the same time when an order is received. Ocean Grand has maintained the “cost-plus” pricing basis and aluminium price lock-in mechanism steadfastly since its commencement of business.

Furthermore, in order to expand turnover in a short period of time and benefit from economies-of-scale, many Chinese aluminium extruders adopt a business model of mass production, i.e. raw materials are bought before receiving any orders; and a large quantity of standard aluminium extrusions for construction use are produced and are then sold via sales offices all over the country or distributors on a consignment basis. Under this model, pricing of the products is directly controlled by market environment. The manufacturer loses his influence on pricing, but still have to maintain a huge inventory and therefore be exposed to a considerable aluminium price risk.

The management of the Group has deliberately steered away from this operating model. All production is order-driven and the Group does not sell its products via distributors on a consignment basis in order to minimise its inventory level and aluminium price risk.

The Group will maintain its strategy of minimising the aluminium price risk. The management currently has no intention of deviating from or modifying the existing practices.

RISK MANAGEMENT (continued)

Pricing risk

Pricing risk is the risk that an aluminium extruder will be forced by market conditions to lower the price of its products and consequently reduce its profit margin. This risk is usually salient in an environment where there are large numbers of players producing similar products and competing on price, a difficult situation which resembles the market for low-end standard aluminium extrusions for construction use.

The management of the Group considers that high value-added, tailor-made fabricated products are much more resistant to pricing risk than low-end standard construction profiles. Since 2001, Ocean Grand has been switching its product range from low-end standard construction profiles to high-end tailor-made extrusions for industrial or household uses. Considerable investment was made to upgrade the factory’s capability to produce high value-added and high margin fabricated products, and armed with enhanced capability, the Group has made inroads to the United States (the “US”), European and Australian markets. During the past two years, the proportion of household and industrial profiles in the Group’s output of extrusion products increased from 20% in 2001 to 42% in 2003.

In addition, the profitability and credit terms, rather than the size of an order, are always the key points of consideration in order acceptance. Ocean Grand has been targeting the market for tailor-made profiles for curtain wall and mid-sized residential projects in China rather than large residential projects. Although large projects can provide the Group with large business volume, the management will not accept such orders unless their credit terms and pricing are favourable to the Group.

At present, the Group has maintained a stable customer base in China of about 70 mid-sized developers and distributors. Most of the customers have had a long term business relationships with the Group, of which none of them individually accounts for more than 5% of its turnover. With careful and prudent management of its PRC customer base, Ocean Grand is in a position to maintain its bargaining power and flexibility in its pricing and credit policies.

Going forward, Ocean Grand will continue its strive to develop its presence in the international market for high value-added, tailor-made fabricated products and will limit its exposure in market sectors considered susceptible to pricing risk.

Bad debt risk

The development of its international market and prudent management of its customer base in China has helped to limit bad debt risk. The Group’s track record in this aspect is considered satisfactory and the management is committed to maintaining vigorous control over the risk of bad debt. Bad debt provision for the Year is only HK\$1,790,000 (2002: HK\$3,114,000).

GROWTH

International market

During the Year, Ocean Grand experienced substantial growth as a result of its business activities within the international market. In August 2003, following a period of eighteen months of negotiation, the Group entered into an exclusive supply contract with The William L Bonnell Company Inc., the fourth largest aluminium extruder in the US for a period of three years. Contractual relations with The William L Bonnell Company Inc., mean that the Group is able to extend its business activities to the North American market, which indicates that the Group’s products are competitive in respect of both pricing and quality. In addition, in October 2003, Ocean Grand became one of the twenty seven (as at 31 December 2003) aluminium extruders in the world to receive the Approval of Manufacturer Certificate issued by Det Norske Veritas AS, a Norwegian company, and become an approved supplier of aluminium extrusions to the maritime industry. Furthermore, the Group has also commenced providing aluminium extrusions to the largest curtain wall manufacturer in the world.

At present, the international client network of Ocean Grand has stretched its reach to the US, Europe, Australia and Japan, with a total of over 20 clients. The management believes that armed with its capability to provide premium products at competitive pricing, Ocean Grand’s business potential within the international market is significant both for the short and the medium term.

Establishing a new factory – capital expenditure plan

With the increase in demand for Ocean Grand’s products, the management believes that the time is right for Ocean Grand to expand its production capacity. The Group will invest HK\$600 million to establish a new plant in Sanshui District, Foshan City, Guangdong Province, the PRC which will have an annual production capacity of 100,000 to 150,000 metric tonnes of aluminium products. As a participant in “The National Torch Programme Foshan Automatic Machinery and Equipment Production Base”, the Sanshui plant will cover over 900 chinese acres (600,000 square meters), ten times the site of the existing plant in Nanhai. The new plant will be easily accessible by various means of transport and is only 30 and 20 minutes away from the New Baiyun International Airport and Guangzhou city respectively.

The new plant is expected to be brought into operation in phases over three years, with the first phase of production to commence at the end of 2004. Apart from simply augmenting capacity by over 100%, it will be equipped with specialised machinery such as reverse extrusion presses, conformed extrusion presses, brite-dip line and other fabrication equipments which allow the Group to further expand its product range of high-end, high-margin and fabricated products. It will also give Ocean Grand the necessary capabilities to improve and expand its business with the automobile, maritime and other industries.

The capital required will be injected in phases over a period of three years, and will be funded by the Group’s internal resources and bank financing. I believe that establishing the Sanshui plant will be a strategic milestone in Ocean Grand’s development, and have every confidence that it will enhance overall productivity, expand product portfolio and further strengthen Ocean Grand’s market position and market share.

GROWTH (continued)

Proposed acquisition

Ocean Grand started to negotiate an acquisition with a state-owned high grade aluminium rolled product manufacturer in China in the second half of 2003. Currently, the negotiation has reached the stage of detailed discussion, but there are still a number of issues, such as consideration, staff housing and welfare compensation, employment terms after the acquisition, to which no consensus has been reached. In the event that Ocean Grand is able to reach an agreement which is favourable to the Group with the local government, the proposed acquisition may be completed within 2004. I shall report to shareholders on the progress in due course.

PRECIOUS METAL ELECTROPLATING CHEMICALS BUSINESS

2003 is a year of growth and development for the Group’s precious metal electroplating chemicals business. Turnover and contributions to operating profits generated by this business for the Year were HK\$663,541,000 (2002: HK\$246,902,000) and HK\$67,472,000 (2002: HK\$39,288,000), representing growth of 168% and 72% respectively. On 30 June 2003, the business was spun-off for listing on the Main Board of The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) as a strategic move to facilitate its expansion. Currently, the Group retains an approximately 75% stake in the business, and the day-to-day management is passed on to the capable hands of the executive management team of Ocean Grand Chemicals Holdings Limited (“Ocean Grand Chemicals”) (stock code: 2882).

During the Year, the performance the Hunghom plant of the Group in the Hong Kong Special Administrative Region (“Hong Kong”) was satisfactory, of which the product capacity utilisation of gold salt increased by 97% compared with the corresponding period last year. The production capacity utilisation of the Zhuhai plant of the Group, which is unique in China, has reached 60% since the commencement of its operations in January 2003, adding a remarkable impetus to the development of the Group.



Product exhibition



Finished goods packaging



Analysis of ingredients of products in laboratory

PRECIOUS METAL ELECTROPLATING CHEMICALS BUSINESS (continued)

As one of the largest precious metal electroplating chemicals manufacturers in the PRC, the Group has (1) enforced the marketing effort and started to set up distribution centres in Shanghai, Beijing, Guangzhou and Shenzhen; and (2) set up a research and development centre in Zhuhai, with a focus on the development of electroplating new chemical products and an emphasis on the improvement of production efficiency and quality of products. New products which have been developed successfully and will be launched include silver cyanide and silver nitrate. Silver cyanide is another type of electroplating chemical, while silver nitrate is principally used in making photo sensitive film. The manufacture and marketing of these two new products will have considerable synergies with the silver salt business of the Group. The Group will also co-operate with the Department of Chemistry of the University of Hong Kong and jointly participate in the Innovation and Technology Fund provided by the Hong Kong government to study the enhancement of recycle technology of electroplating fluid. It is expected that the production lines for silver nitrate and electroplating fluid recovery will be completed by the end of 2004.

The Group will continue its research on new precious metal chemicals such as palladium chloride and palladium tetraammonia chloride. Palladium chloride, which is applied in the pollution control of exhaust gas of automobiles and industries, such as plastic electroplating and chemical catalysis, has great potential in the PRC market. In addition, the Group will explore the specific opportunities brought by the “Closer Economic Partnership Arrangement” towards the factory in Hunghom, Hong Kong, which includes cooperation with foreign manufacturers to process the production of electroplating chemicals or related chemicals so as to obtain an exemption from tariffs imposed on imports to the PRC.

The Group will use its best endeavour to capitalise on the latest opportunity and competitive advantage in the high growth market and be committed to expanding its sales network, strengthening the marketing of the brand “Kenlap”, diversifying products as well as improving its ability to research and development capability and production efficiency, in order to become the best provider of precious metal electroplating chemicals in Hong Kong and the PRC.

STAINLESS STEEL BUSINESS

The Group’s hot-rolled stainless steel coil factory in Panzihua City, Sichuan Province, the PRC, has an annual capacity of 100,000 tonnes and continues to produce different kinds of stainless steel products providing a reasonable return to the Group.

The turnover of the stainless steel business during the Year reached HK\$527,914,000 (2002: HK\$668,815,000). Profit attributable to the Group during the Year amounted to HK\$25,796,000 (2002: HK\$34,926,000). Utilisation of capacity was 80% (2002: 95%). Performance of this business in the Year has dropped because it has been adversely affected by SARS and the need to carry out certain repair and maintenance work of the production line.

STAINLESS STEEL BUSINESS (continued)

The management of the Group has undertaken research on the development plan and strategies in the stainless steel business. Despite the promising prospects in this industry after assessing the economic efficiency of resources allocation, the management believes that it would be more favourable to divest from the stainless steel business and redirect the resources to the expansion of the aluminium business – the core business of the Group. The Group is in the process of contemplating different action plans and I shall report to shareholders on progress in due course.

BUSINESS ENVIRONMENT IN 2004

Looking ahead to 2004, the business environment of Ocean Grand will continue to present its fair share of challenges. Firstly, certain places in China, such as Nanhai District, Guangdong Province, have experienced power shortage as the far-exceeding-expectation economic growth outpaces the development of power generation capacity. Fortunately, the Group’s production has not been affected thanks to the back-up power generators in our Nanhai factory and a re-juggling of our production workflow. The Group is in the process of acquiring additional power generators to prepare for any ascertainment of power shortage.

In addition, the PRC government has begun to let off the steam of its overheated economy, and one of its objectives is to slow down the growth in the aluminium smelting industry. The aluminium smelting industry is in the upstream of Ocean Grand, therefore this policy shall not affect the Group directly. Should credit be tightened in China, we expect the consolidation in our industry will pick up pace and weed out the mismanaged, the small-sized, the inefficient, and the inexperienced within the industry. In the long run, it will be beneficial to the Group.

CORPORATE GOVERNANCE

The management fully appreciates the importance of maintaining good corporate governance to a company like Ocean Grand, especially when it is going to embark on a path of high growth. Ocean Grand is determined and committed to implement an effective corporate governance to facilitate further development of the Group.

MISSION

During the past five years Ocean Grand’s development has not been entirely smooth. However, its achievements since 2001 have convinced me that the simplest strategy in fact is the best strategy, i.e. Ocean Grand should go “back to basics” and focus on its real core business, which is the aluminium business. My colleagues and I are firmly committed to build Ocean Grand as a world-class PRC-based supplier of high quality and high value-added aluminium extrusion products to its clients throughout the world. Leveraging on our experience gained in the industry and our existing solid foundation, we are confident that Ocean Grand will become a leading aluminium products provider in the Asian Pacific region and create continuous and satisfactory returns for shareholders.

Yip Kim Po

Chairman

Hong Kong, 22 April 2004