

BUSINESS REVIEW

The business environment for the Group's financial year 2001/2002 is full of challenges and difficulties. On top of the Group's controversial development blueprint, the market environment was both depressed and uncertain, creating the challenging first quarter for the Group. During the same period last year, both the markets for electronics and high-technology products were booming, stimulating substantial demand for electronic components. For the current year, however, the market situation was totally reversed with the global economic slowdown and the flood of negative news from the world's leading electronics manufacturers. Affected by the downturn in demand for telecommunications, information technology and consumer electronic products, some leading international coil makers suffered more than 30% drop in turnover for the second quarter of 2001, resulting in precipitous plunge in their operating profits. Some even recorded operating losses during the period. The markets were flooded with reports of staff reductions, capital expenditure cuts, closures of factories and business restructuring. Despite the unfavourable market environment, however, for the three months ended 31st July, 2001, the Group recorded a turnover of approximately HK\$79,770,000, showing only a moderate decrease of 12.0% when compared to the same period last year. Even more positively, the Group has sustained its gross profit margin at a satisfactory level of 32.6%. The results have demonstrated the Group's ability to maintain its competitive edge despite the adverse market conditions.

In the past financial year, the Group grasped emerging market opportunities, enjoying relatively low costs in the construction of new factory blocks and investment in the automation of production facilities, with total capital expenditure amounting to more than HK\$200 million. With the support of its major financing banks, the Group continued to finance its capital expenditure by its well-adopted asset-based financing methods, which were proved to be both effective and practical. As such, interest expense was pushed up by 78.1% to approximately HK\$6,769,000. The investments have also led to a 41.2% increase in depreciation of property, plant and equipment to approximately HK\$10,599,000. This has caused the profit attributable to shareholders to decrease from approximately HK\$14,588,000 to approximately HK\$5,747,000.

The Group is, however, fully committed to the above initiatives, which will be implemented according to the original plans. The Group strongly believes that these initiatives are essential and vital to building a more promising future. The Group is therefore expected to gain market share rapidly and will be able to fulfill the market demands better once the market stabilises, further reinforcing its status in the market.

Active Preparation for the Production of Series of Manganese-Zinc Ferrite Core Products

During the previous financial year, the Group began the installation of automated production facilities and the construction of new factory blocks fitted with sophisticated machinery, which have reached the completion stage. During the period under review, the production line for the series of manganese-zinc ferrite core products commenced trial production and has begun operations in the second quarter of this financial year. With the rapid technological advancement, the demand for quality electronic components has been soaring. The Group expects the manganese-zinc series products to fulfill the demands of manufacturers of high-tech products for top quality electronic components. The manganese-zinc series products also enjoy a higher expected gross profit margin of 40%, compared to 30% for usual coil products. With the high demand for manganese-zinc series products, the Group believes that these products will generate satisfactory returns.

Building on its research achievements and production experience, the Group has been continuously developing new formulae and innovative products during the period under review, striving for further breakthroughs in the quality and variety of its products to satisfy the demands of the electronics industry.

Financial Position

As at 31st July, 2001, total borrowings amounted to approximately HK\$294,160,000 (as at 30th April, 2001: HK\$255,558,000). Total cash and bank deposits increased to approximately HK\$56,761,000 (as at 30th April, 2001: HK\$55,714,000). The net gearing ratio, defined as total borrowings less total cash and bank deposits over net tangible assets, was approximately 88.1% (as at 30th April, 2001: 75.9%). With regard to the Group's incompliance as at 30th April, 2001 with one of the financial covenants imposed by its major bank that the net gearing ratio should not exceed 0.6:1, in August 2001, the Group has obtained the bank's approval for its net gearing ratio up to 0.85:1. Together with the net proceeds of approximately HK\$13,800,000 from the subscription for new shares announced on 11th September, 2001 (please see below for details), the Group has every confidence that it will effectively bring the net gearing ratio to below 0.85:1 in the near future.

As most of the Group's capital expenditure was financed by borrowings instead of equity financing, this has resulted in the Group's higher net gearing ratio. Despite this, the Directors considered the Group's overall financial position to be healthy. As at 31st July, 2001, the Group's aggregate banking facilities increased to approximately HK\$308,536,000 (as at 30th April, 2001: HK\$302,624,000), of which approximately HK\$56,944,000 (as at 30th April, 2001: HK\$65,727,000) was not yet utilised.

■ FUTURE PLANS AND PROSPECTS

Entering the 21st century, the world has been transforming into a knowledge-based economy. Global information and communication networks are therefore more important than ever. In spite of the worldwide economic slowdown, the accession of China into the World Trade Organisation ("WTO") will be a key growth-driver for electronic components arising from the information and communication technology revolution. We are therefore cautiously optimistic for the future and are preparing for sustainable development so as to bring better returns to our shareholders. The Group's future plans and prospects are elaborated as follows:

Broadening Customer Base and Diversifying Product Mix

Besides effective cost control, the Group is actively broadening its customer base. The Group has maintained an excellent product portfolio including different types of coils, inductors, transformers, line filters and electrolytic capacitors, etc. These products are widely applied in telecommunication and information technology equipment, data transmission and network products, audio and visual appliances, home electrical and electronic appliances. Together with its top product quality, the Group has won a broad customer base. In response to the climbing demand for product diversity in the markets, the Group launched the vertically integrated production of manganese-zinc series ferrite core products in the second quarter. Because of its intensive and detailed planning for the production, the Group is fully confident that this will create new sphere for turnover growth.

Although electronics manufacturers, especially those in Europe, are focusing more on production cost and product quality, the Group considers this to be an ideal opportunity for business exploitation. Over the years, the Group has been adopting efficient and effective production methods, producing quality products at the lowest possible cost, to capture a higher market share. Meanwhile, the Group is negotiating with a well-known mobile phone manufacturer in Europe to supply high-power major electronic components for its chargers on a long-term basis. The Group expects this move to bring in reasonable returns.

Strengthening Strategic Partnerships

In addition to effective cost management and a broad customer base, a well-established supply chain and widespread distribution network also contributed to the success of the Group.

Currently, the Group has two strategic partners, Nittoku Engineering Co., Ltd. (“Nittoku”), a manufacturer of coil-winding machines, and Toko Inc. (“Toko”), a leading international coils manufacturer. Both are well-known and well-established listed companies in Japan.

Since the Company’s listing in November 1999, Nittoku has been supporting the Group unremittingly, displaying total confidence in the Group’s business with full action and support. On 11th September, 2001, the Company entered into a conditional agreement with Nittoku for the subscription of 20,588,235 new shares in the Company at a subscription price of HK\$0.68 per subscription share. Nittoku’s beneficial interest in the Company’s issued share capital will be increased from approximately 4.78% to approximately 7.77%. The net proceeds from the subscription will be approximately HK\$13,800,000, which is intended to be used as general working capital of the Group.

Adding value to the Group’s operating cycle, Nittoku supplies the latest technology and advanced equipment for the Group’s upstream production, while Toko provides a widespread distribution network for the Group’s downstream sales and marketing. These strategic alliances have effectively enhanced the Group’s competitiveness, forming strong foundations for the Group’s technical, sales and marketing aims. The Group will further strengthen these strategic partnerships to create ongoing win-win solutions and broaden its future development.

Staff Sharing the Group’s Commitment – One Vision, One Heart

In view of the difficult and challenging business environment as well as the depressed and uncertain market, the staff at every level of Coils Electronic Co., Limited initiated an overall reduction in their salaries ranging from 7% to 20%. This move reflects the tremendous support from our staff for the Group’s efforts to streamline operating costs and was followed by similar actions by most of the Directors and other subsidiaries. The Directors strongly believe that, with all staff sharing a common goal with committed hearts, the Group will certainly overcome the difficult and challenging time ahead.

■ PURCHASE, SALE OR REDEMPTION OF THE COMPANY’S LISTED SECURITIES

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company’s listed securities during the three months ended 31st July, 2001.

■ DIRECTORS’ INTERESTS IN SECURITIES

As at 31st July, 2001, the Directors of the Company had the following beneficial interests in the share capital of the Company and its associated corporations (within the meaning of the Securities (Disclosure of Interests) Ordinance (the “SDI Ordinance”)) and in the warrants of the Company as recorded in the register required to be kept by the Company pursuant to Section 29 of the SDI Ordinance or otherwise notified to the Company and The Stock Exchange of Hong Kong Limited pursuant to the Model Code for Securities Transactions by Directors of Listed Companies:

(a) The Company

	Family interests	Number of shares of HK\$0.10 each		Number of warrants
		Personal interests	Corporate interests	Personal interests
Mr. Lam Wai Chun (Note 1)	332,574,381	2,000,000	—	—
Mr. Saito Misao (Note 2)	—	625,411	315,046	—
Ms. Tang Fung Kwan (Note 2)	—	2,918,843	315,046	—
Ms. Hu Yan Huan (Note 2)	—	944,361	315,046	—
Mr. Au Son Yiu	—	—	—	1,000,000

Notes:

- As at 31st July, 2001, Ka Yan China Development (Holding) Company Limited held 332,574,381 shares in the Company. The entire issued share capital of Ka Yan China Development (Holding) Company Limited was ultimately beneficially owned by Ka Yan China Family Trust, the family trust of Mr. Lam Wai Chun. The beneficiaries under this family trust were Mr. Lam Wai Chun's spouse, Ms. Law Ching Yee, and his children who were under the age of 18 years, and accordingly Mr. Lam Wai Chun was deemed under the SDI Ordinance to be interested in all the shares held by Ka Yan China Development (Holding) Company Limited.
- As at 31st July, 2001, CMPP Investment Holdings Limited ("CMPP") held 315,046 shares in the Company. The issued share capital of CMPP was US\$471.49 divided into 47,149 shares of US\$0.01 each, of which Mr. Saito Misao, Ms. Tang Fung Kwan and Ms. Hu Yan Huan, the directors of the Company, respectively held 700 shares, 3,514 shares and 1,230 shares of US\$0.01 each.

(b) Associated corporation

Coils Electronic Co., Limited

	Number of non-voting deferred shares of HK\$1.00 each (Note 5)		
	Personal interests	Family interests	Total
Mr. Lam Wai Chun (Notes 3 and 4)	7,500,000	6,500,000	14,000,000

Notes:

- Mr. Lam Wai Chun held 7,500,000 non-voting deferred shares of HK\$1.00 each in Coils Electronic Co., Limited, a wholly-owned subsidiary of the Company, representing approximately 53.57% of the 14,000,000 non-voting deferred shares of HK\$1.00 each in the share capital of Coils Electronic Co., Limited.
- In respect of the 6,000,000 non-voting deferred shares of HK\$1.00 each held by Ka Yan China Development (Holding) Company Limited and the remaining 500,000 non-voting deferred shares of HK\$1.00 each held by Ms. Law Ching Yee in Coils Electronic Co., Limited, representing approximately 42.86% and approximately 3.57% respectively of the 14,000,000 non-voting deferred shares of HK\$1.00 each in the share capital of Coils Electronic Co., Limited, Mr. Lam Wai Chun was deemed to be interested in all those shares under the SDI Ordinance by virtue of, in the case of Ka Yan China Development (Holding) Company Limited, the reasons set out in Note (a)1 above and, in the case of Ms. Law Ching Yee, the fact that Ms. Law Ching Yee is the spouse of Mr. Lam Wai Chun.
- Holders of the non-voting deferred shares have no voting rights, are not entitled to dividends unless the net profit of Coils Electronic Co., Limited exceeds HK\$100,000,000,000,000, and are not entitled to any distributions upon winding up unless a sum of HK\$100,000,000,000,000 has been distributed to the holders of ordinary shares.

Save as disclosed above, as at 31st July, 2001, none of the Directors of the Company or any of their associates (as defined in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules")) had any interests in the securities of the Company or its associated corporations (within the meaning of the SDI Ordinance) which were required to be notified to the Company and The Stock Exchange of Hong Kong Limited pursuant to Section 28 of the SDI Ordinance, or pursuant to the Model Code for Securities Transactions by Directors of Listed Companies or which were required, pursuant to Section 29 of the SDI Ordinance, to be entered in the register referred to therein.

■ DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

As at 31st July, 2001, the Directors had the following personal interests in share options to subscribe for shares in the Company granted under the share option scheme, as recorded in the register required to be kept under Section 29 of the SDI Ordinance:

Name	Date of grant	Exercisable period	Subscription price per share	Number of shares under options outstanding
Mr. Lam Wai Chun	21st September, 2000	22nd September, 2002 to 21st January, 2005	HK\$1.22	2,948,966
Mr. Saito Misao	21st September, 2000	22nd September, 2002 to 21st January, 2005	HK\$1.22	2,948,966
Ms. Tang Fung Kwan	21st September, 2000	22nd September, 2002 to 21st January, 2005	HK\$1.22	2,948,966
Ms. Hu Yan Huan	21st September, 2000	22nd September, 2002 to 21st January, 2005	HK\$1.22	2,948,966

Save as disclosed above, at no time during the three months ended 31st July, 2001 was the Company or any of its associated corporations (within the meaning of the SDI Ordinance) a party to any arrangement to enable the Directors of the Company or any of their associates (as defined in the Listing Rules) to acquire benefits by means of the acquisition of shares in, or debt securities of, the Company or any other body corporate.

■ SUBSTANTIAL SHAREHOLDERS

As at 31st July, 2001, according to the register kept by the Company under Section 16(1) of the SDI Ordinance, other than the Directors of the Company, the following persons were interested or taken or deemed to be interested in 10% or more of the issued share capital of the Company:

Name	Number of issued shares	Percentage holding
Ka Yan China Development (Holding) Company Limited (Notes 1 and 2)	332,574,381	62.984%
Ka Yan China Investments Limited (Note 2)	332,574,381	62.984%
HSBC Holdings plc (Note 3)	332,574,381	62.984%
HSBC Finance (Netherlands) (Note 3)	332,574,381	62.984%
HSBC Holdings B.V. (Note 3)	332,574,381	62.984%
HSBC Investment Bank Holdings B.V. (Note 3)	332,574,381	62.984%
HSBC International Trustee Limited (Note 3)	332,574,381	62.984%

Notes:

1. The 332,574,381 shares were held by Ka Yan China Development (Holding) Company Limited, a wholly-owned subsidiary of Ka Yan China Investments Limited, the entire issued share capital of which was ultimately beneficially owned by Ka Yan China Family Trust, the family trust of Mr. Lam Wai Chun, a director of the Company.
2. The interests of Ka Yan China Development (Holding) Company Limited and Ka Yan China Investments Limited, the ultimate holding company of the Company, in respect of 332,574,381 shares duplicated with each other.
3. The interests of HSBC Holdings plc, HSBC Finance (Netherlands), HSBC Holdings B.V., HSBC Investment Bank Holdings B.V. and HSBC International Trustee Limited in respect of 332,574,381 shares in the Company duplicated with each other. The 332,574,381 shares in which HSBC International Trustee Limited was interested were the shares referred to in Note 2 above.

Save as disclosed above, the Company had not been notified of any other interests representing 10% or more of the issued share capital of the Company which was required to be recorded under Section 16(1) of the SDI Ordinance as at 31st July, 2001.

■ CODE OF BEST PRACTICE

None of the Directors is aware of any information that would reasonably indicate that the Company is not, or was not for any part of the three months ended 31st July, 2001, in compliance with the Code of Best Practice as set out in Appendix 14 of the Listing Rules, except that the independent non-executive directors have not been appointed for a specific term but are subject to retirement by rotation and re-election at the annual general meetings of the Company in accordance with the Company's Bye-laws.

■ APPOINTMENT OF DIRECTOR

Mr. Lam Wing Kin, Sunny, has been appointed as an Executive Director of the Company with effect from 27th September, 2001.

By Order of the Board
Lam Wai Chun
Chairman

Hong Kong, 27th September, 2001