

### BUSINESS REVIEW

#### Review of operations

2002 was a steady year for Varitronix reflected by encouraging improvements in operating results and solid progress in technology development. Benefiting from significant sales growth in the PRC market, turnover was 4.2% higher than 2001 at HK\$1,086 million. The European market continued to be the Group's largest market, accounting for 50.6% of total turnover. Compared to 2001, turnover contribution from the North American market was lower at 11.3%. This can be partly explained by the growing number of customers who relocated their operations to the PRC, hence the share in the HK/China market increased from 11.7% to 26.0%. The significant rise in the PRC's contribution was also attributable to the valuable support from our joint venture partner Tsinghua University Enterprise Group, who helped to broaden our business connections and provided strategic guidance. In addition, it reflected the thriving conditions in the PRC domestic telecommunications sector.

Sales of our automotive products recorded impressive growth, a direct result of the QS9000 Quality System certification in 2001 and the cumulative efforts in deepening our understanding of customers' requirements. In view of stringent product requirements, the certification will continue to be a crucial asset in securing orders from our automotive customers. In addition, thanks to our highly flexible manufacturing facilities and technological capabilities, we were able to secure significant orders from telecommunication customers especially in the PRC

in the second half of the year. Annual sales in telecommunication products were however comparatively lower than last year. This can partly be explained by the fact that backlog orders from the telecommunication sector had carried forward to the first half of 2001. Notwithstanding this, sales in the telecommunications sector started to gradually improve in the second half of 2002 following a period of consolidation. Performance of our industrial products, which continued to be our most important product category, was steady in spite of the weak economic conditions prevailing in many parts of the world.

The Group's focused strategies in restoring performance have proven to be highly effective in further improving our first-half results. For the full year, the Group achieved profit attributable to shareholders of HK\$111 million, a rebound of 157.3% from the previous year. Amidst the highly competitive market environment, our business margins actually improved. Whilst careful production planning and stringent cost controls were important factors, continual improvements in operational management and process optimization have also contributed greatly. Together, these have helped to deliver a lower level of material content. Staff costs as well as other operating expenses were lower despite the higher level of sales achieved. Our profitability would have been higher if the charge against operating profit of HK\$10 million resulting from the winding up of an investment portfolio in the first-half was excluded. The overall results would have been even better if the Group could have achieved a turnaround at its Penang plant during the year.



Colour STN LCD

In addition to improving results, we have also moved forward in our technology roadmap. The Group's Bistable Cholesteric Display was awarded the 2002 Outstanding Innovation and Technology Silver Award by The Hong Kong Electronic Industries Association in recognition of its creative design, features and technology. Having successfully completed the prototypes of both monochrome and area color OLED displays, the Group pro-actively geared up its technical capacity in the second-half by entering various strategic partnerships. This included the alliance with DuPont Displays to assemble and distribute OLED display modules. In addition to this alliance, the Group had entered into a licensee agreement with Eastman Kodak Company permitting the Group to manufacture and sell passive matrix OLED modules based on Kodak's small molecule technology. The Group was the first Hong Kong company to be licensed by Kodak. The Group also collaborated with the UK based ZBD Displays Limited to develop the manufacturing process for zero-power displays. Prototype orders for our new color STN products were also secured during the year. These strategic moves are instrumental in planting the seeds for future sustainable growth and places the Group in the forefront in seizing emerging opportunities.



*LCoS High Definition rear projection TV*

The Group's balance sheet remained extremely healthy. Supported by robust cash flow from operations, net liquid funds were reported at a higher level of HK\$716 million at the end of the review period. This represents an increase of 16.2% over the level reported at the end of 2001 in spite of the fact that the majority of the payments for the construction, new equipment and facility costs of the new Heyuan plant had been settled during the year. To exercise prudent financial management, the Group was essentially in a debt free position. Inventory level was also lower than last year end.

### **PROSPECTS**

The existing uncertainties besieging the global economy are expected to linger in 2003, creating overall cautious business sentiment. Amongst these concerns, the possible slowdown of the U.S economy will be a key influence. However, the PRC market is expected to sound a positive note, where the growth momentum of its telecommunications sector is anticipated to continue. We expect our sales in the PRC market to continue experiencing dynamic growth, reaching yet further highs in the year to come. As for the LCD industry, growing popularity of full color displays especially for handheld products will lend considerable support, helping the industry to develop steadily in the year ahead. Remaining at the forefront, we will not only deliver color solutions for color STN but also TFT solutions through alliance with TFT manufacturers, enabling us to stand out from our competitors.



*Colour TFT Module*

Faced with this market environment, defined corporate strategies combined with a high degree of production flexibility, are keys to maintaining competitiveness. As we approach our 25th year in business, our focus for 2003 will be to promote top line growth whilst continuing to raise efficiencies to enhance the bottom line. The rapidly expanding PRC economy will continue to create a background conducive to the Group's business. With the strong ability to deliver premier display products, our strength in capturing this market potential is further boosted by the technical support of the Tsinghua University Enterprise Group.

Whilst the Group's short term order growth appears promising, long term visibility remains low in view of the current world situation. However, ongoing efforts to review our technical capabilities have helped to expedite business expansion. The partnership with DuPont Display and licensee agreement from Eastman Kodak have placed the Group in the wings, poised to capture opportunities once the OLED market matures. To enrich our product variety, we are also actively developing full color OLED. Adhering to our commitment to research and development, we will continue to place strong emphasis on increasing the relevance of our production capabilities to match market requirements. In addition to the development of new products, the improvement of existing products, coupled with focused marketing strategies, will also be important elements.



*Black-and-white bistable cholesteric display in electronic book application*

Enhancing our operational leverage will also be a central task. Building construction at our new Heyuan plant has now drawn to a finish. Equipment installation is underway and is expected to be operational in the second half of the year. On the other hand, whilst resources are being allocated to revamp the Penang plant, the management remains conservative to its turnaround in the near term. However, we believe that our continuous commitment to reviewing and streamlining operations will ensure that our efficiencies and utilization rates will be further improved.

With clearly identified expansion plans and prudent production management, the Group is back on track to attaining better performance. Varitronix is committed to leveraging its renowned production excellence and innovation to deliver improved returns to shareholders in the years ahead.

On behalf of the directors, I would like to thank our staff for their dedication and efforts in the past year. I would also like to thank our customers, suppliers and shareholders for their continuous support. I look forward to working more closely with them to deliver even better results in the future.

**Dr C.C. Chang**

*Chairman*

Hong Kong, 3 April 2003

***We Put Our Heart on*** **DISPLAY**