

BUSINESS REVIEW

Sales increased by capitalizing market potential

The growth of EMS industry in the PRC has been escalating, arising from the accession into the WTO of China as well as the global outsourcing trend. Possessing unique market strength, the Group has stood well on its industry in the provision of one-stop services throughout the cycle of PCBs. More sizeable electronics companies are penetrating into the PRC market and looking for quality EMS providers for business cooperation. Hence, the Group has perfectly fit into the gap with its competitive strength of lower labour cost, engineering cost and production cost. In addition, the emerging trend in production outsourcing nowadays has also contributed to the growth of EMS business, which has consequently brought numerous opportunities to the Group.

The Group has positioned itself as a high-mix EMS provider. With the proven track record in these years, the high-mix strategy has been demonstrated to be a no better approach for the Group. The Group offered a wide range of customized solution in a high price but at small volume orders. In conjunction with the capabilities to meet with various and specific customer needs in the planning, designing and manufacturing of PCB, the Group's services are recognized and credited by customers.

As a result, the Group achieved significant sales orders from a numbers of small to medium ODM customers during the year under review. Resulting in further boost of sales in addition to the retaining clients in the domestic market.

Sales guaranteed by cohesive relationship with clients

Stable and long-term client relationship is always recognized by the Group, and also believed to be a key success factor for maintaining leading position in the EMS industry. Sinotronics has established close bonding with clients since its establishment. In view of its committed research and developments, precious client relationship and technology know-how in relation to EMS industry, Sinotronics developed its impeccable foundation and successfully for other EMS providers to enter into the PRC market.

Wide and wise PCB application has been provided to the Group's clients throughout different industries, for instances, consumer electronics, telecommunication, computer ancillary devices and industrial industries. Sinotronics has been maintaining at least three years of relationship with main clients. With interactive approach during the cooperation, the Group built up trust with different clients by providing professional technical intelligence and support. With regard to the growing economy of China as well as the positive external environment factors, the Group made profits together with its clients, and resulted in a win-win situation. Tapping to the sales increase, the Group has invested in the capacity expansion by purchasing advanced production facilities during the year under review, which in turn increased its production capacity by approximately 20%. Currently, the Group remained active in local market research, sales promotion to maintain clients portfolio. As at the date of this announcement, the Group established six additional sales offices in the PRC located at Shanghai, Xiamen, Wuhan, Chengdu, Xian and Shenzhen, excluding the product and sales headquarters in Fuzhou.

Sustainable provision of quality service in the scope

The Group recognized the sustainable top quality service is the requisite for capturing continuing opportunities in the market. During the year under review, service scope has been enlarged together with value added services including design of sub-systems and assembly outsourcing services. In order to attain constant production of faultless PCBs, the Group implemented latest production facilities imported from Germany, in addition to strictly following the international ISO/TS16949 standards in the entire work process. During the year under review, the Group has purchased an advanced tester, named PROBE TESTER, which can further shorten the cycle of prototyping and improve its overall quality and efficiency.

Proved by the incremental sales order, the quality productions of thick copper large power supply PCB, diffraction PCB and steel diffraction composite PCB were demonstrated. In respect of the acquisition of a 49% equity in an associate, named Floret Industries Limited, which indirectly holds a 83% equity interest in Fuzhou Tin Fong, the Group thereby actively explored into the rapidly growing industry of electricity supply systems. The professions and specific technology of Fuzhou Tin Fong have enabled the Group to maintain product and service quality in the realm.

FUTURE PROSPECTS

Looking ahead, the Group is well prepared to tap growth potential in the electronics industry in the PRC by continuously providing one-stop EMS service with high quality. In view of the promising future prospects of EMS industry, it is becoming fairly crucial to expand production capacity and shorten production cycle in order to meet the sales opportunities. Therefore, Sinotronics will devote itself to incrementing overall production capacities. With the surpassing vision, the Group is confident in the domestic output of flexible PCB, which can be widely applied to the most trendy mobile phones and digital cameras. In the coming future, apart from adopting high-mix strategy, the Group will further polish its design capability and production technology in order to provide seamless and market-oriented EMS to our valuable customers.

MAKING CAPACITY TO THE SALES

Currently, the utilization rate of the production facilities is revealed over 90%. Hence, the Group intends to further increase the PCB fabrication capacity for both the core products such as single-sided, double-sided and multiplayer PCBs as well as newly launched products, for instances, thick copper large power supply PCB and flexible PCB. This will be most likely actualized by direct investment of advanced production equipment or, if beneficial and feasible, the Group may fascinate different means to better enhance its organic growth and capacity expansion.

Sinotronics is not only the first multilayer PCB designer, engineer and manufacturer in Fujian, but also the first EMS provider in PCB industry. Leveraging on its well-established and in-depth cooperation with clients, the Group is confident that it can attain further sales boost in its target markets as long as higher overall capacity is achieved.



EXCELLING IN R&D CAPABILITY

The superlative R&D capability is always the key competitive strength of Sinotronics, as in the industry competing for the newest design and quickest response to various customers' needs. The Group will continue to focusing on the niche market of EMS of brand new product prototyping to maintain its high level profit margin. Adopting high-mix strategy, Sinotronics will unceasingly upgrade R&D capabilities and maintain itself in the EMS market of edge of new electronic products.

To further enhance the design skills and market sense of upcoming trend, the staff of Sinotronics will keep working closely with other major customers. Evidently, trust and loyalty is established with regard to seamlessly interactive cooperation and research and development of product development. The Group also intends to form strategic alliances with major customers to demonstrate the competitiveness and benefit of close client relationship.

FINANCIAL PERFORMANCE

For the year ended 30th June, 2003, the Group recorded a turnover of approximately RMB241,543,000, representing an increase of approximately 18.3% as compared to the previous year. The gross profit during the year under review was approximately RMB117,426,000, as compared to approximately RMB103,884,000 for the previous year. Despite the fact that expenses relating to the change of its listing from the GEM to the Main Board of approximately RMB7,433,000 was incurred during the year, the Company managed to achieve a profit attributable to shareholders for the year of approximately RMB73,357,000, representing an increase of approximately 13.3% compared with that of last year, and basic earnings per share for the year amounted to approximately RMB18 cents. The increase in turnover during the year under review was mainly due to the active expansion of production capacity, improved technology and advanced PCBs design capability. These operational improvements helped improve economies of scale, diversify the product range, successfully solicit new customers, create new market segments and capture market opportunities.

SEGMENTAL INFORMATION

Segment information is presented in respect of the Group's business and geographical segments. Business segment information is chosen as the primary reporting format because this is more relevant to the Group in making operating and financial decisions.

Throughout the years ended 30th June, 2003 and 2002, the Group has been operating in a single business segment, that is, the manufacturing and sale of printed circuit boards.

Turnover by product categories and their respective contributions to profit from operations are as follows:

	Turnover	Profit from
	<i>RMB'000</i>	<i>operations</i>
		<i>RMB'000</i>
Single and double-sided PCBs	130,353	43,290
Multilayer PCBs	111,190	45,517
	<u>241,543</u>	<u>88,807</u>

The increase in the Group's turnover for the period ended 30th June, 2003 was mainly attributable to the increase in sales of the single and double-sided PCBs and the provision of relevant design and assembly services to customers. During the year ended 30th June, 2003, sales of single and double-sided PCBs and multilayer PCBs amounted to approximately RMB130,353,000 and RMB111,190,000 respectively, representing increases of approximately 50.3% and a decrease of approximately 5.3% respectively over 2002.

Sales within the PRC, excluding Hong Kong, represented approximately 83.6% of the Group's total turnover, posting a growth of approximately 10.5% as compared to that of last year. Sales to Australia accounted for approximately 12.2% of the Group's total turnover, posting an increase in turnover from approximately 69.2% in 2002 to approximately RMB29,510,000 in 2003 as a result of active market presentation. Sales to the US, Germany and other overseas countries accounted for the remaining of approximately 4.2% of the Group's total turnover.

LIQUIDITY AND FINANCIAL RESOURCES AND CAPITAL STRUCTURE

For the year ended 30th June, 2003, the Group's working capital was principally financed by its internal resources and banking facilities.

As at 30th June, 2003, the Group had outstanding loan facilities of approximately RMB41,800,000 (2002: RMB33,000,000) from several banks which were all short term and fully utilized as at the date thereof. The loan facilities were secured by guarantees provided by the Company. The Group's borrowings were mainly denominated in Renminbi. Loan facilities were granted to the Group at the normal market interest rates.

The shareholders' equity of the Group as at 30th June, 2003 increased by approximately 20.5% to approximately RMB354,187,000 (2002: RMB293,889,000). The gearing ratio (calculated as the ratio of current liabilities plus non-current liabilities : shareholders' equity) of the Group as at 30th June, 2003 was approximately 0.24 (2002: 0.21).

The finance costs of the Group for the year ended 30th June, 2003 amounted to approximately RMB2,567,000, representing approximately 1.1% of the Group's turnover and a decrease of approximately RMB1,000,000, or approximately 28% over the last corresponding period. The decrease in finance costs was principally due to the decrease of annual interest rate of the bank loans from approximately 8% in last corresponding period to approximately 6% in current period and loans from related companies were repaid in May 2002.



Subsequent to the balance sheet date, except for the increase in the Company's issued share capital of 8,000,000 shares of HK\$0.1 each due to the exercises of share options for cash totaling HK\$7,960,000, during the year ended 30th June, 2003 and up to the date of this report, there was no change in the Company's share capital.

SIGNIFICANT INVESTMENTS

Saved as the acquisition disclosed elsewhere in Management Discussion and Analysis, the Group had no other significant investment held as at 30th June, 2003 (2002: Nil).

ACQUISITIONS AND DISPOSALS OF SUBSIDIARIES AND ASSOCIATES

On 15th August, 2002 the Group entered into a sale and purchase agreement with an independent third party in relation to the acquisition of 49 shares of Floret Industries Limited ("Floret Industries") held by him, representing 49% of the issued share capital of Floret Industries, at a consideration of RMB47.0 million (equivalent to approximately HK\$44.6 million), which will be wholly satisfied in cash upon completion by the Company out of the net proceeds raised from the placing and subscription of shares announced by the Company on 14th June, 2002.

Floret Industries is an investment holding company whose sole asset comprises the entire equity interest in 福州威美電子有限公司 ("Fuzhou Wei Mei"), which in turn holds a 83% equity interest in 福州天方科技有限公司 ("Fuzhou Tin Fong") as its sole asset. Fuzhou Tin Fong is a company principally engaged in the research, development, manufacture and sale of products as well as the provision of ancillary services in relation to the automation and intellectualisation of electric supply systems. These systems are composed of a variety of data processing hardware which, in general, would utilise PCBs as their components. During the year ended 30th June, 2003, the associate made a profit contribution of approximately RMB793,000 to the Group.

EMPLOYMENT INFORMATION

As at 30th June, 2003, the Group employed a total of 537 employees (2002: 446). It is a policy of the Group to review its employees' pay levels and performance bonus system regularly to ensure that the remuneration policy is competitive within the relevant industry. During the year ended 30th June, 2003, the employment cost (including directors' emoluments) amounted to approximately RMB12,393,000 (2002: RMB10,935,000). The increase in total staff cost of the Group of approximately RMB1,458,000 was resulted from the increases in directors' emoluments and labour costs.

The Company adopted an employee share option scheme ("2001 Scheme") as detailed in the Company's prospectus dated 11th May, 2001, under which it may grant options to employees of the Group (including the executive directors of the Company) to subscribe for shares in the Company. The 2001 Scheme was superseded by a new share option scheme ("2003 Scheme") on 20th January, 2003. As at the date thereof, no option has been granted pursuant to the 2001 Scheme. The 2003 Scheme as detailed in the listing document, under which the Company may grant options to employees of the Group (including executive directors of the Company) and business consultants, agents, legal or financial advisors, etc. to subscribe for shares in the Company, was approved by the shareholders at the extraordinary general meeting of the Company held on 9th January, 2003. As at the date of this report, options to subscribe for an aggregate of 15,000,000 shares in the Company have been granted under the 2003 Scheme.

CHARGE ON ASSETS

As at 30th June, 2003, a fixed deposit of HK\$5,000,000 (equivalent to approximately RMB5,350,000) (2002: RMBNil) has been pledged to a bank for bank loan of RMB4,800,000 (2002: RMBNil) granted to the Group.

FUTURE PLANS FOR MATERIAL INVESTMENTS AND EXPECTED SOURCES OF FUNDING

Save as disclosed elsewhere in Management Discussion and Analysis, as at 30th June, 2003, the Group had no future plans for material investments except that capital assets will be purchased in accordance with the details set out in the section headed “Future plan and prospects” in the listing document of the Company dated 24th December, 2002.

EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES

The Group experienced only immaterial exchange rate fluctuations as most of the Group’s monetary assets and liabilities are denominated in Hong Kong Dollars and Renminbi, and the Group conducted its business transactions principally in Hong Kong Dollars, US Dollars and Renminbi, all of which were relatively stable during the year under review. The Group considered that as the exchange rate risks of the Group are considered to be minimal, the Group did not employ any financial instruments for hedging purposes.

CONTINGENT LIABILITIES

As at 30th June, 2003, the Group had no contingent liabilities (2002: Nil).



USE OF PROCEEDS

The Group raised approximately HK\$47.6 million and approximately HK\$8.7 million upon the listing of the Company's shares on GEM and pursuant to the exercise of an over-allocation option on 17th May, 2001.

Comparison of the use of proceeds as stated in the prospectus of the Company dated 11th May, 2001 (the "Prospectus") with actual applications

The use of proceeds as disclosed in the Prospectus	Notes	Application of proceeds from the initial share offer to 30th June, 2003
<ul style="list-style-type: none"> ● Approximately HK\$30 million for the expansion of the PCB fabrication plant 	1	<ul style="list-style-type: none"> ● Approximately HK\$47.2 million was used for the expansion of the PCB fabrication plant
<ul style="list-style-type: none"> ● Approximately HK\$10 million for the development of EMS business and the purchase of related equipment 	1	<ul style="list-style-type: none"> ● The Company did not apply any proceeds for this purpose. Instead, the proceeds of HK\$10 million were used for the expansion of the PCB fabrication plant
<ul style="list-style-type: none"> ● Approximately HK\$4 million for the construction of a SMT assembly line 	2	<ul style="list-style-type: none"> ● The Company did not apply any proceeds for this purpose. Instead, the proceeds of HK\$4 million were used for the expansion of the PCB fabrication plant
<ul style="list-style-type: none"> ● Approximately HK\$3.3 million for the purchase of advanced testing equipment and software for PCB testing to facilitate the provision of computer-aided testing and assembly of PCBs 	3	<ul style="list-style-type: none"> ● Approximately HK\$0.4 million was used for the purchase of advanced testing equipment and software for PCB testing to facilitate the provision of computer-aided testing and assembly of PCBs. The remaining proceeds of approximately 2.9 million were used for the expansion of the PCB fabrication plant
<ul style="list-style-type: none"> ● Approximately HK\$0.3 million for the establishment of a joint engineering design centre with Electronic Research Institute to undertake future and development projects from ODMs 	4	<ul style="list-style-type: none"> ● The Company did not use any proceeds for this purpose. Instead, the proceeds of HK\$0.3 million were used for the expansion of the PCB fabrication
<ul style="list-style-type: none"> ● The remaining balance of approximately HK\$8.7 million for general working capital 		<ul style="list-style-type: none"> ● The remaining balance of approximately HK\$8.7 million was used as general working capital

Notes:

1. The Board re-allocated the proceeds of approximately HK\$10 million for the expansion of the PCB fabrication plant because the proliferation of orders, which was resulted from the rapid development of the existing major clients and the increase of new clients, exerted pressure on the Company's production. Therefore, enhancing production capacity to fulfill customer's needs became the most urgent project of the Company.
2. The Board re-allocated the proceeds of approximately HK\$4 million for the expansion of the PCB fabrication plant because the SMT production line of the existing major clients could still support their basic operations.
3. The Board re-allocated the proceeds of approximately HK\$2.9 million for the expansion of the PCB fabrication plant because the quality control on principal products of the existing clients was relatively stable. As a result of the advancement of clients' technologies and because of the production of the Company's main products became more and more technologically difficult, testing equipment will gradually be acquired.
4. The Company trained and employed certain engineers that can fundamentally support the needs for design service of the existing clients of the Company.

