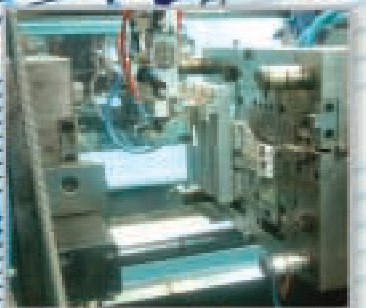
# Management Discussion and Analysis



## OVERVIEW

The financial year under review posed various challenges to the Group. Despite the increasing acute price-sensitivity of market, coupled with the Iraqi War and the SARS outbreak in March 2003, the Group went ahead with its geographical expansion plan. The strategic expansion paid off when the Group's turnover increased by 21.81% to HK$1,136.05 million (2002: HK$932.63 million).

Confronted with such acute market conditions, the Group's effort for better returns on its expansion plan was inevitably hindered. The Group's gross profit ratio narrowed to 11.68% compared to the previous financial year's of 15.57%. This was mainly attributed to the thin profit margin of the plastic parts for household electrical appliances and the low utilisation rate of the production facilities in Qingdao, which accounted for 17.93% of the Group's sales as compared to previous financial year of 5.01%. In addition, the short term escalation in the cost of resin during the Iraqi War has further worsened the Group's profit margin.

Profits attributable to shareholders narrowed from HK$65.79 million in the previous financial year to HK$18.87 million. This mainly resulted from an aggregate loss of HK$17.52 million from the operations in Qingdao and the investments in the newly established subsidiary and joint venture company with Andes Electric Co., Ltd. and Sumitronics Hong Kong Ltd. (collectively, the "VSA Group"), and the significant increase in administrative expenses and finance costs of HK$22.82 million and HK$5.69 million respectively. However, the Directors believe that the situation will improve upon completion of the restructuring of the Qingdao's subsidiaries and commencement of mass production of the VSA Group.

## BUSINESS AND FINANCIAL REVIEW

### BUSINESS HIGHLIGHTS

***Acquisition of minority interest in 海爾威城電子塑膠製品(青島)有限公司 (V.S. Haier Electronics Plastic (Qingdao) Co., Ltd. or VS Haier) (now known as 青島偉勝電子塑膠有限公司(Qingdao GS Electronics Plastic Co., Ltd. or Qingdao GS)***

In the financial year under review, the Group acquired from 青島海爾投資發展有限公司(Qingdao Haier Investment Development Limited or Qingdao Haier) its 20% interest in VS Haier, a then non-wholly owned subsidiary of the Company in Qingdao, at a consideration of RMB14.80 million (equivalent to HK$13.96 million).

This move enables VS Haier to diversify its customer base by seeking other business opportunities without the over-influence of Qingdao Haier and some of its associated companies ("Haier Companies") which have been the major customers of VS Haier since its commencement of operation in March 2002, and to reduce the risk of overreliance on Haier Companies. Further, the operation and management of VS Haier would be wholly controlled by the Group.

The acquisition also allows the Group to streamline the deployment of internal resources of its two subsidiaries based in Qingdao, so that higher operation efficiency and utilisation of production facilities are expected to be achieved in the coming years.

***Establishment of a new production line for plastic parts of mobile phone***

During the financial year under review, the Group invested HK$28.98 million to set up a mobile phone plastic parts production line which included precision injection moulding machine, spraying rotate automatic painting machine in a clean room environment and ancillary equipment of air shower room and UV light drying. Hence, under the initial development stage, the Group had managed to secure sales revenue of HK$16.13 million.

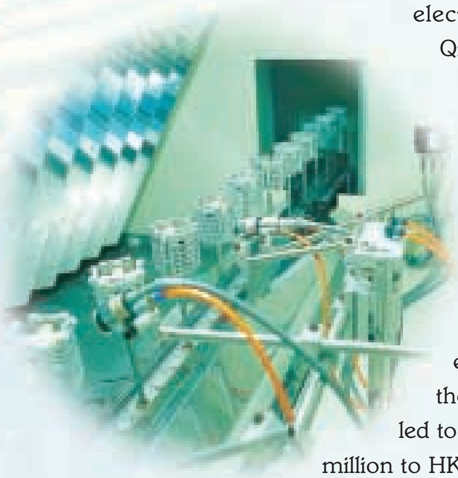
***Establishment of VSA Group***

The Group has set up VSA Group towards the end of year 2002 to collaborate on technological transfer in order to enter into the assembling of high-end electronic market as the Directors envisage vast opportunities in this market. Through this joint venture, the Group has upgraded its technology capability in the manufacture of multi-layered printed circuit board with precision surface mounting technology, and this enhanced the Group's integrated manufacturing solutions capability. The Group is now capable of manufacturing printed circuit board used for high-end electronic products such as digital camera, color screen mobile phone and personal digital assistant.

## TURNOVER AND GROSS PROFIT BY BUSINESS ACTIVITIES OF THE GROUP

***Plastic injection and moulding business***

For the financial year under review, the turnover from the plastic injection and moulding business amounted to HK$600.48 million, representing a substantial increase of 70.52% from the previous year's turnover of HK$352.15 million. The increase was derived from the growth in the sales of plastic parts for household electrical appliances in the Qingdao's operations. Combined turnover of the two Qingdao's operations contributed 33.93% (2002: 13.28%) of the Group's turnover for this segment. However, during the financial year under review, the operations in Qingdao were in a loss making position causing the contribution margin to drop significantly from 21.76% for the year ended 31 July 2002 to 10.82% this financial year. In addition, during the uncertainty period of the Iraqi War, the short term upward fluctuation in the price of resin, the Group's main raw material, could not be shifted to our customers.



Ancillary to that, during year ended 31 July 2003, the Group had actively expanded its production facilities and capacity in Zhuhai and Qingdao to meet the current and future demands of existing and new customers. These new facilities led to an increase in the segment's depreciation charge by 53.00% rising from HK$19.95 million to HK$30.52 million during the financial year under review. Nevertheless, the Directors believe that this investment will boost long-term performance and enhance the vertical integration with the assembling business.

# Management Discussion and Analysis

### *Assembling of electronic products business*

Turnover for assembling of electronic products business amounted to HK$489.97 million (2002: HK$545.21 million), accounting for 43.13% (2002: 58.46%) of the total turnover of the Group. The decrease in the turnover of this segment was mainly due to a shift in the product mix of a major customer, from relatively high-end home audio equipment to semi-finished mechanical audio assembles, which comparably has a lower selling price. In addition to that, it was also partly caused by the outbreak of SARS in March 2003 which caused delays in commercial production of certain products in the financial year under review. However, the segment contribution margin remained comparable with that of the previous financial year as the composite profit margin derived from the major customer was similar.

### *Mould design and fabrication business*

During the year ended 31 July 2003, this segment showed encouraging growth potential. Turnover has improved by 29.28% to HK$45.59 million (net of inter-segment sales) (2002: HK$35.27 million). Despite the increased sales, the contribution declined slightly from HK$8.22 million to HK$8.05 million due to initial start-up and trial run costs of the new production facilities set up in Zhuhai.

This business segment, which is an essential part in forming integrated manufacturing solutions of the Group, can enhance the overall competitiveness of the Group.

### *Distribution costs and administrative expenses*

For the year ended 31 July 2003, the total distribution costs and administrative expenses of the Group recorded an amount of HK$93.59 million (2002: HK$67.77 million). These expenses as a percentage of turnover increased slightly by 0.97%, from about 7.27% in the previous financial year to about 8.24%. The increase of these expenses was contributed by the increase in personnel expenses of HK$14.24 million, which was in line with increase in number of management and staff resulting from the commencement of operations in Zhuhai and Qingdao.

### *Finance costs*

The finance costs of the Group for the financial year under review amounted to HK$21.66 million (2002: HK$15.97 million), representing an increase of 35.64% as compared to that of the previous financial year. The increase was due to the funding requirement of expanded business operations and capital expenditure of the Group in Zhuhai and Qingdao. This represented 1.91% of the turnover of the Group for the year ended 31 July 2003 and was comparable with that of the year ended 31 July 2002.

## FUTURE PROSPECTS

The year 2004 is expected to be a year of consolidation for the Group. The global economy seems to have rebounded after the end of the Iraqi War. Regionally, Hong Kong and the PRC look set to recover from the SARS epidemic. The Directors, however, believe that the Group's business performance in the short-term will continue to reflect the aftermath of the SARS epidemic. Despite the prudent outlook for the short-term, the Directors are optimistic about the medium to long-term business performance of the Group.

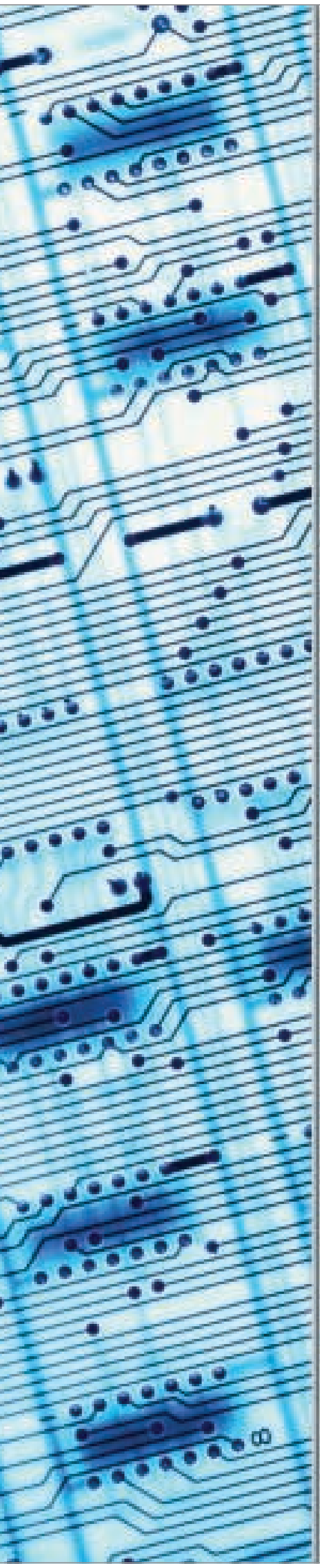
The Group has included in its medium-term business plan an inroad into the mobile phone business in view that the PRC now ranks as the world's largest and fastest growing mobile phone market, with almost 240 million users as of the end of July 2003 *(Source: Ministry of Information Industry of the PRC)*. As the PRC has a population of around 1.45 billion, given the present low penetration rate of 16.55%, the PRC market will continue to experience enormous growth in the near future. Hence, the resultant and sustainable demand for mobile phones in this country can never be neglected. In the long run, the Group intends to go into full assembling of mobile phone with the existing production facilities in the VSA Group and the Directors believe that the Group's investment in mobile phone manufacturing provides reasonable growth potential for the Group.

Despite the slowdown in the global economy, the PRC remains a market with enormous potential. Over the years it has been one of the fastest-growing regions in the world and will continue to be promising for investment. The recently announced CEPA between the PRC and Hong Kong as well as the plan to construct the Hong Kong-Zhuhai-Macau Bridge and its related infrastructure would spur further economic growth of the Pearl River Delta and strengthen its position as the world's manufacturing centre. The Group's production base in Zhuhai is set to be benefited from this development.

With these limitless opportunities looming before us, the Group's performance is poised to culminate as its plans come into stream.

## LIQUIDITY AND FINANCIAL RESOURCES

The Group continued to maintain a healthy financial position and benefit from the significant improvement in cash inflow from operations, which generated net operating cash inflow of HK$49.45 million (2002: HK$27.08 million) during the financial year under review. As at 31 July 2003, the Group had cash and bank deposits of HK$285.82 million (2002: HK$194.62 million) of which HK$86.47 million (2002: HK$83.71 million) were pledged to the banks for banking facilities granted to the Group. About 66.84% and 28.63% of the total cash and bank deposits were denominated in US dollars and Renminbi ("RMB") respectively with the remainder in Hong Kong dollars.

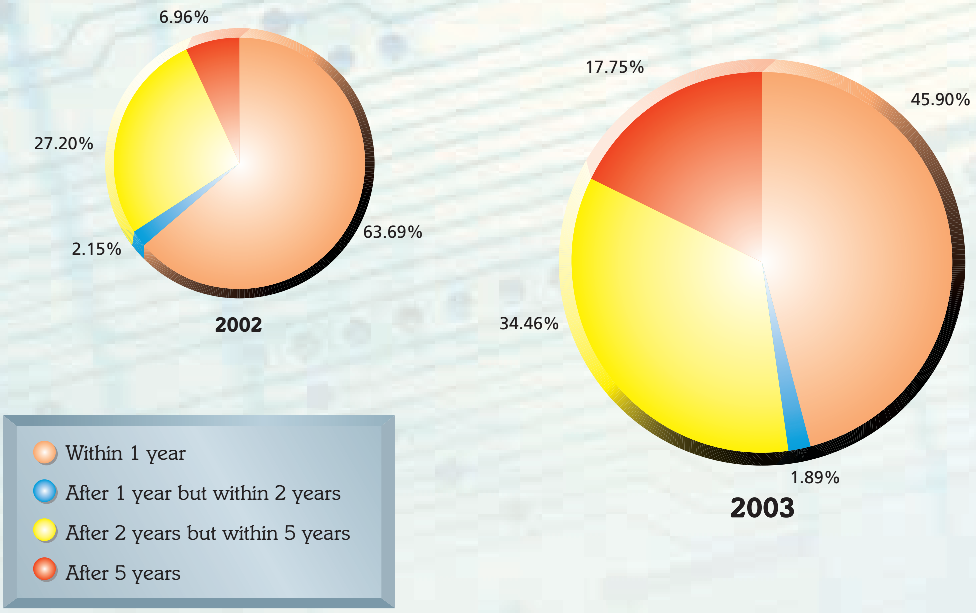


## CAPITAL STRUCTURE

During the financial year under review, the Group has taken steps to refinance the Group's existing short-term debts with medium to long-term borrowings which led to the substantial improvement of the Group's working capital (defined as current assets less current liabilities). The Group's working capital was HK$45.18 million as at 31 July 2003 compared to previous year's negative working capital of HK$1.55 million.

As at 31 July 2003, the total borrowings of the Group were HK$641.77 million (2002: HK$351.23 million). Net debt, after deducting cash and bank deposits was HK$355.95 million (2002: HK$156.61 million). The Group's borrowings maturity profile is set out as follows:

| | **2003** | 2002 |
|---|---|---|
| | ***HK$ million*** | *HK$ million* |
| Repayable | | |
| Within 1 year | **294.57** | 223.69 |
| After 1 year but within 2 years | **12.15** | 7.55 |
| After 2 years but within 5 years | **221.15** | 95.53 |
| After 5 years | **113.90** | 24.46 |
| Total borrowings | **641.77** | 351.23 |
| Cash and bank deposits | **(285.82)** | (194.62) |
| Net debt | **355.95** | 156.61 |



Included in these borrowings is a shareholder's loan amounting to HK$44.02 million (2002: HK$48.92 million). The remaining balance of borrowings was for business expansion, capital expenditure and working capital purpose with an interest rate ranging from 1.59% per annum to 7.13% per annum. Among these borrowings about 50.78%, 40.87% and 8.35% were denominated in US dollars, RMB and Hong Kong dollars respectively.

The Group's gearing ratio, represented by the interest bearing borrowings over the Group's total assets as at 31 July 2003 was 45.82% (2002: 35.27%). The increase in the gearing ratio was principally due to construction of phase III and phase IV of Zhuhai Industrial Park and new capital investments in VSA Group's production facility. The Directors will continue to monitor the borrowing level and will maintain the gearing ratio at a reasonable level.

As at 31 July 2003, apart from refinancing short-term debt with long-term borrowings, the Group has also secured substantial undrawn facilities on committed basis from its relationship banks, amounting to HK$295.40 million of which about HK$121.49 million and HK$28.61 million were committed long-term loans and finance leases respectively. The remaining balance represented short-term loan and trade finance.

The Directors believe that with the Group's available facilities, cash and bank deposits on hand and the recurrent cash flow from operations, the Group is in a strong liquidity position and has ample financial resources to satisfy its capital commitments and ongoing working capital requirements.

## CHARGES ON ASSETS

As at 31 July 2003, certain assets of the Group with an aggregate carrying value of HK$294.22 million (2002: HK$182.76 million) were pledged to secure banking facilities granted to the Group.

## COMMITMENTS AND CONTINGENT LIABILITY

As at 31 July 2003, the Group's capital commitment was HK$68.67 million (2002: HK$49.84 million). This commitment related to the Group's capital investments in the development of Zhuhai Industrial Park. As for the investment commitment of HK$66.87 million (2002: Nil), it related to future contribution of capital to a subsidiary in the PRC by the year 2005.

The Group's contingent liability as at 31 July 2003 was bills discounted with banks on recourse basis amounting to HK$11.41 million (2002: Nil).

## FOREIGN EXCHANGE RISK

The Group's exposure to foreign exchange rate fluctuations during the year ended 31 July 2003 was not significant as most of its transactions, including borrowings, were conducted in US dollars and RMB. During the financial year under review, the exchange rates of these currencies were relatively stable, and hence the Group reported only net exchange loss of HK$0.80 million (2002: HK$0.12 million).

## EMPLOYEES AND REMUNERATION POLICY

As at 31 July 2003, the Group had a total of 7,298 (2002: 5,565) employees of which 2, 361 (2002: 2,772) were employed under processing arrangements. During the year ended 31 July 2003, there was no significant change in the Group's remuneration policies for its employees.

Employees' costs of the Group (excluding Directors' emoluments but including wages paid to employees employed under the processing arrangements) for the financial year under review amounted to approximately HK$91.11 million (2002: HK$57.74 million). During the financial year under review, the Group had put more resources to recruit and retain quality staff as the Directors view that human capital is the most important asset and the vital gear for future growth of the Group. Remuneration packages are maintained at competitive level and the Group's employees are rewarded on a performance basis.

The Company conditionally adopted a share options scheme (the "Scheme") on 20 January 2002 for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operation. The Board, may at their absolute discretion, grant options to employees and Directors and directors of the Company's subsidiaries and any qualified persons as set forth in the terms of the Scheme, to subscribe for shares. The subscription price, exercisable period and the maximum number of options to be granted are determined in accordance with the terms of the Scheme. During the year ended 31 July 2003, no options were granted under the Scheme.

The Group has adopted a provident fund scheme, as required under the Mandatory Provident Fund Schemes Ordinance, for its employees in Hong Kong. It also participates in a government pension scheme for its employees in the PRC pursuant to the relevant rules and regulations of the PRC.