Financial Review

Summary of Results

HK$'000	2003	2002 (Restated)	Change in %
Turnover			
- Continuing operations	1,664,638	472,615	252%
- Discontinued operations	—	27,262	N/A
	1,664,638	499,877	233%
Gross profit	9,482	55,387	(83%)
Net loss attributable to shareholders	(856,364)	(66,262)	1,192%

Following the acquisition of the 64.5% interest in Pegasus Qingdao in 2002, the Group has now reformed into a mobile handset manufacturer.

Turnover of HK$1,664.6 million from the continuing operations in 2003 was derived from Pegasus Qingdao, the Group's principal subsidiary engaged in the mobile handset business acquired in 2002, which represented a full-year contribution from Pegasus Qingdao, while turnover of the Group of HK$472.6 million in 2002 only included a three-month contribution from Pegasus Qingdao. The turnover in 2003 of Pegasus Qingdao witnessed a remarkable increase of approximately 49% over that of 2002. Such increase was due to reasons including the Group's successful penetration of the mobile handset market, the ongoing technological improvement and advancement of the Group's products, the expansion of production scale, the extension of our sales network overseas and the increasing recognition of "Haier" brand name in the mobile handset industry. New models of mobile handsets with innovative features will be introduced in 2004 and it is expected that sales will continue to grow in the years ahead.

The turnover from the discontinued operations in 2002 was derived from the baby care products business which was sold to CCT Telecom in March 2002.

Gross profit during the year amounted to HK$9.5 million, represented a decrease of 83% as compared with that of 2002. The decrease was mainly attributable to a provision for slow-moving stock amounted to HK$55.5 million made during the year. The stock provision was made due to poor market in year 2003 as a result of the outbreak of atypical pneumonia and a general price reduction trend in the mobile handset market. The change in consumer trends, such as from black-and-white screen handsets to colour-screen handsets, also led to some of the Group's inventory becoming obsolete. The decrease in gross profit ratio was also caused by general price competition and the increase in research and development expenses for new products in 2003.

No selling expenses have been incurred in 2003, as compared to selling expenses of HK$9.1 million in 2002. This was due to the new sales arrangement with Haier Telecom in late 2002. Pursuant to a products distribution agreement effective on 2 October 2002, Pegasus Qingdao sold most of its products to Haier Telecom at costs of raw materials (at market price) plus a processing fee, while Haier Telecom was responsible for all the selling and marketing charges. The arrangement reduced the cost of Pegasus Qingdao and also reduced the business risks of Pegasus Qingdao as it will not be responsible for the inventory ordered by Haier Telecom.

Net loss attributable to shareholders for the year amounted to HK$856.4 million (2002 (restated): HK$66.3 million). The increase in loss during the year was mainly due to the stock provision mentioned above, the amortisation of goodwill amounting to approximately HK$82.9 million and an impairment of goodwill of approximately HK$732.2 million.

Summary of Results (cont'd)

Due to the continuous price reduction and the intensifying mobile handset market competition both between domestic manufacturers and with foreign players, the Board has reviewed the carrying amount of the goodwill attributable to the Group"s acquired interest in the mobile handset business. Though the Board has confidence over the long-term growth of the mobile handset industry, the Board decided to write-down the carrying amount of goodwill attributable to the Group's acquired interest in the mobile handset business to reflect the impact of such intensifying market competition. The impairment of goodwill of approximately HK$732.2 million mentioned above was assessed by the Board and was written off to the consolidated profit and loss account for the year ended 31 December 2003. After the impairment of such goodwill attributable to the Group's acquired interest in the mobile handset business, the annual amortisation of goodwill will be decreased thereafter.

Management anticipates that the business environment will be improving in the coming years when market demand increases for technology advancement and that measures have been taken by the Group to control risk of excessive inventories.

Analysis by Business Segment

	2003		2002		% change
HK$'000	Turnover	Results	Turnover	Results	in turnover
Telecom Products	1,664,638	(25,666)	472,615	4,725	252%
Baby care products	—	—	27,262	1,245	N/A
Corporate and others	—	(8,309)	—	(5,398)	N/A
Total	1,664,638	(33,975)	499,877	572	233%

During the year ended 31 December 2003, the entire revenue of the Group was derived from the telecom products business engaged in the manufacture of mobile handsets. Loss before interest income, amortisation and impairment of goodwill, finance costs, tax and minority interests was amounted to HK$34.0 million, which was mainly caused by the provision for stocks mentioned above.

Analysis of Turnover by Geographical Segment

HK$'000	2003		2002		% change
The Mainland, PRC	1,361,655	82%	382,117	76%	256%
Hong Kong	1,005	—	54,092	11%	(98%)
European Union	299,695	18%	35,066	7%	755%
United States of America	—	—	27,708	5%	N/A
Unallocated	2,283	—	894	1%	155%
Total	1,664,638	100%	499,877	100%	233%

The Mainland of the People"s Republic of China ("PRC") represents the major market of the Group and accounted for 82% of the Group's turnover for the year (2002: 76%). There was an increase in the proportion of turnover for the European Union market from 7% in 2002 to 18% in 2003. Such increase was mainly due to (i) the Group's expansion into the EMS business during 2003 which also include the export of its products manufactured under EMS arrangement for international telecom companies and (ii) the increase of export of the Group's ODM products under "Haier" brand name.

Liquidity and Financial Resources

The financial position and liquidity of the Group remain healthy with a current ratio (current assets over current liabilities) of 117% at 31 December 2003 (31 December 2002: 190%). At 31 December 2003, the Group had a cash balance of HK$268 million (31 December 2002: HK$375 million) and total banking facilities of approximately HK$443.2 million (31 December 2002: HK$787 million), all of which were utilised (31 December 2002: HK$140.2 million were utilised). All of the bank borrowings of the Group were arranged on a short term basis for the ordinary business of the Group and are repayable within one year. The large pool of cash, together with cash flow generated from the operations, provides the Group with sufficient resources for its operations and business growth.

There is no material effect of seasonality on the Group's borrowing requirements.

The Group had authorised capital commitments amounting to approximately HK$17.6 million at 31 December 2003, representing the balance of the cost for the building of the new mobile factory in Qingdao.

Capital Structure and Gearing Ratio

	As at 31 Dec 2003		As at 31 Dec 2002 (restated)	
	HK$'000	Relative %	HK$'000	Relative %
Bank and other loans	548,928	31%	140,187	6%
Equity	1,245,654	69%	2,101,711	94%
Total capital employed	1,794,582	100%	2,241,898	100%

At 31 December 2003, the Group maintained a gearing ratio (total borrowings over total capital employed) of 31% (31 December 2002: 6%).

The loans of HK$548.9 million as at 31 December 2003 were borrowed by a subsidiary of the Company for working capital purposes and most of which are denominated in Renminbi, repayable within one year, and bear interest at floating rates.

Change in Use of Proceeds

In December 2001, the Company made two placements of shares in order to restore the public float, raising total net proceeds of HK$430 million in December 2001 and January 2002. The proposed use of proceeds was detailed in an announcement by the Company dated 19 December 2001, which has subsequently been revised as announced on 18 November 2002.

On 21 May 2003, the Board announced that it has approved further change of application of the proceeds. The following table sets out the use of proceeds as previously announced and the proposed revised use of proceeds as announced on 21 May 2003.

	As announced on 21 May 2003 (current revised use) HK$'000	As announced on 18 November 2002 (1st revised use) HK$'000	As announced on 19 December 2001 (original use) HK$'000
Research and development for mobile handset and telecom products operation	40,000	40,000	50,000
Potential acquisition of distribution network in the PRC and overseas	—	80,000	160,000
Capital expenditure for mobile handset operations	250,000	170,000	50,000
Development of the Group's distribution of corded and domestic cordless phone operations	—	—	50,000
Marketing and advertising	10,000	10,000	40,000
Working capital	130,000	130,000	80,000
Total	430,000	430,000	430,000

The capital expenditure of HK$250 million above has been set aside for the building of a new mobile handset factory in Qingdao, out of which approximately HK$186 million was used as at 31 December 2003. Out of the total proceeds of HK$430 million, an amount of approximately HK$159 million was unused and was carried forward.

Treasury Management

The Group employs a conservative approach to cash management and risk controls. Most of the Group's receipts and payments are made in Renminbi and Hong Kong dollars. Cash is generally placed in short term deposits denominated either in Renminbi or Hong Kong dollars. At 31 December 2003, most of the Group's outstanding borrowings were denominated in Renminbi and were principally made on a floating rate basis. Foreign currency risk is not significant as liabilities in Renminbi will be matched by the Group's earnings, most of which are also denominated in Renminbi. The Group does not have any significant interest rate risk, as the current interest rate in China stay at a lower level and is stable.

Employees and Remuneration Policy

The total number of employees of the Group as at 31 December 2003 was 961. Remuneration packages are normally reviewed on an annual basis. Apart from salary payments, there are other staff benefits including provident fund, medical insurance and performance related bonus. Share options may also be granted to eligible employees and persons of the Group. At 31 December 2003, there were outstanding share options of approximately 883.5 million.

Significant Investment

The Group did not hold any significant investment at 31 December 2003.

Acquisition and Disposal of Material Subsidiaries and Associates

The Group did not acquire or dispose any material subsidiaries and associates during the year ended 31 December 2003.

Pledge of Assets

At 31 December 2003, bank deposits of approximately HK$1.1 million were pledged to secure general banking facilities granted to a subsidiary of the Group.

Contingent Liabilities

The Group did not have any significant contingent liabilities as at 31 December 2003.