

## MANAGEMENT DISCUSSION AND ANALYSIS

### Results

For the financial year ended 30th June 2004, the Group continued to achieve impressive results in an environment where the electronics industry is on the recovery road with increasing demands for consumer electronics goods such as PCs, mobile phones, digital cameras, MP3 players and other multi-media products. The Group, as a one-stop Electronics Manufacturing Services (EMS) provider in the PRC, benefited from these favourable market conditions and the well-planned expansion of its production capacity through technological innovation of its existing production lines and introduction of advanced production equipment, and reported a solid growth of 24.7% in turnover to RMB301,255,000 (2003: RMB241,543,000) with net profit attributable to shareholders lifted by 10.7% to RMB81,212,000 (2003: RMB73,357,000). The gross profit margin, however, was slightly decreased due to the increase in raw materials prices.

### Business Review

During the financial year of 2004, the Group has been focusing on developing its EMS and PCB businesses. With the picking up of demand in the electronics industry worldwide, in particular the consumer electronics sector, the Group was able to take advantage of this favourable trend and received increasing orders from its customers.

Sinotronics is in a strong market position as a one-stop EMS solution provider in the PRC. With its extensive knowledge and experience in the EMS and PCB markets, the Group has the capability and flexibility to deliver high-mix, low volume and customized complex products to its customers at low lead times. This unique business model allowed the Group to capture the immense opportunities arising from the global outsourcing trend, especially in the niche market of producing low volume products such as prototype samples.

### Segment 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 2004 and 2003, the Group has been operating in a single business segment, i.e. the manufacturing and sale of circuit printed boards.

Geographically, sales within the PRC (excluding Hong Kong) remained the largest segment in which 83.2% (2003: 83.6%) of the Group's turnover was generated, while 10.5% (2003: 12.2%) was attributable to the sales to Australia for the year under review. The balance of 6.3% of the Group's turnover (2003: 4.2%) was taken up by the US, Germany and other countries.

## *Single and Double-sided PCBs*

During the year under review, the sales of single and double-sided PCBs amounted to RMB120,984,000 (2003: RMB130,353,000), representing approximately 40.2% of the Group's total turnover. The operating profit was RMB43,258,000 (2003: RMB43,290,000).

## *Multilayer PCBs*

Total sales of multilayer PCBs amounted to RMB180,271,000 for the financial year of 2004 (2003: RMB111,190,000), which contributed approximately 59.8% to the Group's total turnover. The operating profit was RMB64,456,000 (2003: RMB45,517,000), a surge of 41.6% as compared with that of the preceding year.

## *Thick Copper PCBs and Flexible PCBs*

Committed to expanding its existing product mix, the Group has dedicated to develop a new range of PCB products, namely thick copper PCBs and flexible PCBs, in the past two years. The thick copper PCBs are widely used in the manufacturing of automobiles, while the flexible PCBs with its uniqueness in mechanical flexure and 3-Dimensional shape are applicable to various portable electronic devices such as automobiles, aerospace application, trendy mobile phone and digital cameras. Due to the complexity in design and production, these two new products enjoy higher profit margins than the conventional single-sided, double-sided and multilayer PCBs, which will in turn boost the Group's net profit.

As the thick copper PCBs and flexible PCBs has just kicked off its production on a small scale, these two new products did not make a significant contribution to the Group for the year ended 30th June 2004. As a result, the breakdown of turnover and operating profit of this division was not provided for the year under review.

## **Manufacturing Facilities**

Strategically located in Fuqing, Fujian Province, the Group's existing manufacturing facilities have a total built-up area of 17,246 square metres and employ numerous advanced manufacturing techniques and systems, including CAD/CAM workstation, dry-film imaging, multi-purpose metal plating, dual-access electrical testing and automated optical inspection. As of 30th June 2004, the Fuqing plant had a total production capacity of 33,000 square metres of PCBs per month and was running at a utilization level of over 90%.

In view of this high utilization level, the Group has been stepping up efforts to expand the production capacity of the Fuqing plant for further growth. Technological innovation of existing production lines and introduction of advanced production equipment are now underway, in order to bring the Group's monthly production capacity to 40,000 square metres by the end of 2004.

In line with the Group's expansion plan and in order to cope with the increasing demand for the Group's products, the Group entered into the purchase agreement with an independent third party in relation to the acquisition of land and buildings in Danshui, Huizhou City, Guangdong

Province, the PRC in February 2004. The premises acquired by the Group had a site area and an aggregate gross floor area of approximately 49,775 square metres and 27,727 square metres respectively for a term of 50 years commencing in 2001. The consideration of the acquisition amounted to approximately RMB36.0 million, which the Group expected to be satisfied by internal resources. This Huizhou plant will specialize in the manufacturing of thick copper PCBs and flexible PCBs, and is scheduled to commence operation in early 2005. With this new plant, the Group's total production capacity will be doubled to almost 80,000 to 90,000 square metres per month.

## **Research and Development**

Sinotronics believes that strong R&D capability is crucial for its continued success and retention of its leading edge in the EMS and PCB markets. Supported by 10 product development engineers and designers in the Shanghai and Shenzhen offices, they work closely with the Group's customers before, during and after the whole production process in order to better address the customers' needs. Such move will help to reduce the lead time of production, lower the production costs as well as increase the reliance of their customers on the Group's services.

## **Quality Certification**

In September 2003, the Group was awarded the ISO/TS16949:2002 Certification in recognition of its Quality Management System applicable to the manufacturing of printed circuit boards (PCBs) for automobiles. The Group is one of the first EMS providers in the PRC to obtain this worldwide qualification. This certification clearly demonstrates the Group's success in raising the level of its quality management and its commitment in providing world-class quality standards to its customers.

## **Strategic Investment in Floret Industries Limited**

As of 30th June 2004, the Group held a 49% shareholding in Floret Industries Limited ("Floret"). Floret had an effective 83% interest in Fuzhou Tin Fong, which is principally engaged in the R&D of computer hardware, software and systems as well as the provision of ancillary services in relation to power supply systems. During the year under review, the associates made a profit contribution of approximately RMB2,732,000 to the Group. In view of the positive growth in the computer market and the increasing power demand in the power industry in the PRC, the management decided to keep Floret as the strategic investment of the Group in the medium term.

## **NEW DIRECTORSHIP**

The Group is very pleased to welcome on board Mr. Chen Yan Shun as an executive Director and vice-chairman of the Company on 17th September 2004. Mr. Chen is responsible for overseeing the Group's overall strategic planning and financial management. Prior to joining the Company, Mr. Chen was an executive Director and a senior vice president of BOE Technology Group Co. Ltd. ("BOE"), a company listed on the Shenzhen Stock Exchange. Presently, he is the

non-executive Director of BOE as well as the non-executive Director of TPV Technology Limited, a company listed on The Stock Exchange of Hong Kong Limited. Leveraging on Mr. Chen's extensive experience in corporate restructuring and financing, securities-related matters and mergers and acquisitions, he will bring to the Group invaluable skills and professionalism.

## **FUTURE PROSPECT**

Riding on the fast recovery of the electronics industry and increasing demands for consumer electronics goods such as PCs, mobile phones, digital cameras, MP3 players and other multimedia products, the market for EMS solution and PCB products is growing at a rapid pace. In view of the rising demand of PCB products globally, the Group is now on track to expand its production capacity through the enhancement of the existing manufacturing facilities in the Fuqing plant and installation of new and advanced machinery in the new Huizhou plant. Apart from organic growth, the Group will also seek other mergers and acquisitions opportunities to spearhead its business growth.

To further consolidate its market position as a one-stop EMS solution provider, the Group has recently developed its self-owned PCB assembly facilities, offering a series of ancillary solution including the design of sub-system, production of prototype samples, low-volume production and testing services to its customers. These new PCB assembly facilities, which are installed under the Group's leased plant spreading over 5,000 square metres at Fuzhou Mawei Economic and Technical Development Zone, commenced operations in September 2004. This new investment will not only allow the Group to enjoy economies of scale from vertical integration, but also further expansion of its market share in the worldwide PCB industry.

The Group strongly believes that its unique business model, high-quality PCB products and extensive experience in the EMS market will continue to differentiate itself from its industry peers. On the other hand, the Group will leverage on Mr. Chen's strong business networks in the consumer electronics industry to further expand its footprint in the global EMS and PCB markets. With its solid foundation laid in the PCB market over the years and its well-established position in the EMS industry, the Group is well-positioned to benefit from the strong global demand of PCBs and global outsourcing trend of production, and is set to achieve another fruitful result in the coming financial year of 2005.

## **Liquidity and Financial Resources and Capital Structure**

For the year ended 30th June 2004, the Group's working capital requirement was principally financed by its internal resources and banking facilities.

As at 30th June 2004, the Group had outstanding loan facilities of approximately RMB128,176,000 (as at 30th June 2003: RMB41,800,000) from several banks, of which approximately RMB70,300,000 for short term and the remainder of approximately RMB57,876,000 for long term, and all were fully utilized as at the date thereof. Included in these short term loans of approximately RMB4,500,000 was secured by bank deposit. The remaining balance of the short term loan of approximately RMB65,800,000 and the long term

loan of approximately RMB57,876,000 were unsecured. The total borrowings was mainly for business expansion, capital expenditure and working capital purposes. The Group's short term and long term borrowings were mainly denominated in Renminbi and US Dollars respectively. Loan facilities were granted to the Group at the normal market interest rates.

The shareholders' equity of the Group as at 30th June 2004 increased by approximately RMB153,413,000 to approximately RMB507,600,000 (30th June 2003: RMB354,187,000). The gearing ratio (calculated as the ratio of current liabilities plus non-current liabilities: shareholders' equity) of the Group as at 30th June 2004 was approximately 0.37 (30th June 2003: 0.24).

During the year ended 30th June 2004, the Company increased the issued share capital of 65,000,000 shares of HK\$0.10 each, of which 8,000,000 shares was due to the exercise of share options for cash totaling HK\$7,960,000 and the remainder of 57,000,000 shares was due to arrangements being made for a placement of 57,000,000 shares of HK\$0.10 each in the issued capital of the Company ("Shares") and a subscription for 57,000,000 new Shares by Mr. Lin Wan Qaing both at HK\$1.40 per Share, raising a net proceeds of approximately HK\$77,000,000, of which approximately HK\$75,000,000 for further developing the Group's printed circuit board fabrication capacity and the remainder of approximately HK\$2,000,000 for general working capital of the Group.

Saved as disclosed above, there is no change in the Company's share capital.

## **Significant Investments**

Saved as disclosed elsewhere in the Management Discussion and Analysis, the Group had no other significant investment held.

## **Acquisition and Disposal of Subsidiaries and Associated Companies**

During the year ended 30th June 2004, the Group had no material acquisition and disposals of subsidiaries and affiliated companies, and it is the same as for the comparative year ended 30th June 2003.

## **Employment Information**

As at 30th June 2004, the Group employed a total of 648 (2003: 555) employees. It is the policy of the Group to review its employee's 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 2004, the employment cost (including directors' emoluments) amounted to approximately RMB13,376,000 and no shares options has been granted. The share options granted to directors and consultants for 7,000,000 shares and 8,000,000 shares in 2003 under the Company's share option scheme were lapsed and exercised respectively.

## **Charge on Assets**

As at 30th June 2004, a fixed deposit of HK\$5,000,000 (equivalent to approximately RMB5,329,000) (2003: RMB5,350,000) has been pledged to a bank for bank loan of RMB4,500,000 (2003: RMB4,800,000) granted to the group.

## **Future Plans for Material Investments and Expected Sources of Funding**

Save as disclosed elsewhere in the Management Discussion and Analysis, as at 30th June 2004, 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.

The management will continue to monitor the industry and review its business expansion plans regularly, so as to take necessary measures in the Group's best interests.

## **Exposure to Fluctuations in Exchange Rates**

During the year ended 30th June 2004, the Group experiences only immaterial exchange rate fluctuations as most of the Group's monetary assets and liabilities are denominated in Hong Kong Dollars, Renminbi and US Dollars and the Group also 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's risks of the Group is considered to be minimal, the Group did not employ any financial instruments for hedging purposes.

## **Contingent Liabilities**

As at 30th June 2004, the Group had no contingent liabilities, and it is the same as for the year ended 30th June 2003.

### **Use of Share Issue Proceeds**

For the year ended 30th June 2004, the Group had applied part of placement proceeds from top-up placement in January 2004 as follows:

1. Approximately RMB41.4 million (HK\$39.1 million) had been utilised for further developing the Group's printed circuit board fabrication capacity; and
2. Approximately RMB2.1 million (HK\$2.0 million) has been utilised for general working capital.

The net proceeds which have not yet been utilised of approximately HK\$35.9 million were deposited in licensed banks and would be used for the intended applications as set out in the Company's announcement issued on 16th January 2004 relating to the placing of existing shares and subscription of new shares.