Management Discussion and Analysis

OVERVIEW

Financial year 2004 has proven to be a challenging year for the Group. A slight decline in the Group's turnover was recorded for the first time. For the year ended 31 July 2004, the Group's turnover had decreased by 10.11% to HK$1,021.22 million, compared to HK$1,136.05 million in the previous financial year. The decline had been mainly attributable to changes of the product mix from a major customer in the Shenzhen electronic assembly division that had affected the overall sales performance of the Group. On a positive outlook, turnover from the Group's two core business segments of plastic injection moulding and mould design & fabrication recorded an increase of 22.79% to HK$737.33 million and 29.25% to HK$58.93 million respectively, in line with new programs from existing customers and new business sectors. Turnover from the Group's manufacturing facilities in Zhuhai increased 69.43% to HK$577.63 million. The increase in turnover from Zhuhai operations in the financial year ended 31 July 2004 reflected the positive results from capital expansion carried out in the recent years.

Price hikes of raw materials were experienced during the year ended 31 July 2004 and the impacts were not shifted on time to the customers of the Group. Nevertheless, the Group managed to achieve an increase in gross profit margin to 13.61%. This was due to increased contributions from the plastic injection moulding and mould design & fabrication businesses that generally produced higher profit margins than assembling business. Furthermore, the two subsidiaries in Qingdao and VSA Group (comprising VSA Holding Hong Kong Co., Limited ("VSA(HK)") and VSA Electronics Technology (Zhuhai) Co., Ltd. ("VSA(ZH)")), which incurred an aggregate loss of HK$2.57 million in the previous financial year, had turned-around in this financial year and contributed an aggregate gross profit of HK$36.25 million.

During the year ended 31 July 2004, the Group recorded a marginal profit attributable to Shareholders of HK$0.42 million, representing a 97.78% decrease comparing with the previous financial year. The decline was largely due to several factors. The Group implemented streamlining measures by consolidating the manufacturing facilities of two subsidiaries in Qingdao. Consequently, the Group incurred restructuring costs which amounted to HK$4.45 million for the year under review. Additionally, the Group had also been expanding manufacturing facilities in Zhuhai to broaden the Group's scope of services and solutions in order to capitalise on future business opportunities, which had resulted in increased depreciation charges and finance costs by HK$24.52 million and HK$14.87 million respectively. Such increase had become a temporary drag on the profitability of the Group since the facilities had not been fully utilised. Nevertheless, the Directors believe that with the Directors' initiative to steer business growth, the facilities will be better utilised in the years to come to increase the profitability of the Group.

Business and Financial Review

Establishment of V.S. Industry (Zhuhai) Co., Ltd.

During the financial year under review, the Group set up a wholly-owned subsidiary, V.S. Industry (Zhuhai) Co., Ltd. ("VSI"), with the strategic objective of capturing the increasing business opportunities in both the PRC domestic market and the global outsourcing trend, particularly from American and European Original Equipment Manufacturers. VSI is located at the Zhuhai Industrial Park and is well equipped with advanced manufacturing facilities and good infrastructure to excel in operational efficiency to meet customer's growing high expectations. Since its inception, VSI's performance had been commendable. VSI started mass production within a short lead time and generated operating profits during the first 6 months of operation.

Turnover and gross profit by business activities of the Group

– Plastic injection and moulding business

For the financial year under review, the plastic injection moulding business achieved a positive growth of 22.79% in turnover to HK$737.33 million, as compared to the previous financial year of HK$600.48 million. Its contribution to the Group's turnover as a whole leapt from 52.86% to 72.20% and the increase was derived largely from the business expansion in Zhuhai.

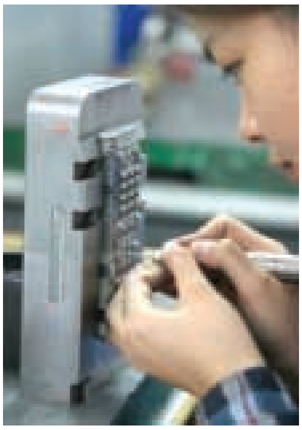
Looking at segment result performance, the plastic injection moulding division also registered impressive improvement from HK$64.94 million for the previous financial year to HK$87.50 million for the year under review. Contribution margin improved by 9.70% against the previous financial year. The improvement was also attributed by the management's initiative taken to conduct the restructuring efforts in Qingdao. By merging the operations of the two subsidiaries in Qingdao into one production base, the effectiveness in deploying internal resources was enhanced and resulted in significant reduction in operating costs. With this effort, the combined results of the two subsidiaries in Qingdao had shown marked improvement in the financial year under review.

– Assembling of electronic products business

Turnover for assembling of electronic products business shrunk by 54.09% against the previous financial year. The decrease was mainly due to a major customer of the Group changing its product mix from full assembly to semi-assembly that carried lower selling prices. In order to cushion the negative impact from the substantial reduction in sales, the Group aggressively developed new customer base and new customers were acquired particularly in the PRC for the assembling of remote control units. The Group will continue its efforts in identifying more potential customers to leverage the risks of over-reliance on a few major customers.

The newly established VSA Group which commenced operations in April 2003 had also performed strongly and generated a turnover of HK$30.23 million, compared to only HK$1.42 million in the previous financial year.

In spite of the reduced sales, this segment's contribution to profit remains comparable with the previous year. This was mainly attributable to better profit margins derived from VSA Group, as compared to those of the Group engaged in electronic product assembling, due to its processing nature. However, as a result of the reduced sales, result from this segment dropped in absolute terms from HK$29.19 million in the previous financial year to HK$11.76 million in this financial year.



– Mould design and fabrication business

During the year ended 31 July 2004, revenue generated from the mould design and fabrication business showed a positive growth of 29.25% to reach HK$58.93 million (2003: HK$45.59 million). Operations have now been largely consolidated in Zhuhai and internal resources were positioned to be optimally deployed within the Group. Accordingly, segment results climbed from HK$8.05 million to HK$10.30 million.

This business segment supplements the integrated manufacturing solutions provided to the customers of the Group, and is well positioned to enhance the overall competitiveness of the Group in the coming financial year.

DISTRIBUTION COSTS AND ADMINISTRATIVE EXPENSES

For the year ended 31 July 2004, total distribution costs and administrative expenses of the Group of HK$93.35 million had been fairly consistent with the previous financial year of HK$93.59 million. The expenses as a percentage of turnover went up by 10.92% from 8.24% in the previous financial year to 9.14%. The increase was mainly attributable to the moderate increase in personnel expenses (including directors' remuneration) from HK$35.23 million for that of the previous financial year to HK$41.82 million in this financial year.

FINANCE COSTS

The finance costs of the Group for the financial year under review amounted to HK$39.96 million (2003: HK$21.66 million), representing an increase of 84.49% over the previous financial year. This was principally attributable to the increased use of banking facilities for capital spending, particularly for the expansion in Zhuhai Industrial Park.

In addition, the Group also incurred a net exchange loss of HK$3.37 million for the year ended 31 July 2004, compared to a meagre net exchange loss of HK$0.80 million in the previous financial year. The net exchange loss for the current financial year was largely resulted from the acquisition of machinery and equipment that were denominated in Japanese Yen which had appreciated against Hong Kong dollars.

Future Prospects

Barring unforeseen circumstances, the Directors are cautiously optimistic that the sales and profitability of the Group would improve in the next financial year. The initiatives taken to steer business growth and improve operational efficiency are expected to bear fruits. Zhuhai Industrial Park has successfully been transformed into a fully integrated manufacturing site, capable of handling high volume production activities. This is well supported by modern manufacturing facilities and complete range of machinery and equipment for the plastic injection division to achieve greater sales network and capturing new markets, particularly from foreign multinational corporations in Europe and America.

The consolidation and streamlining programs carried out in the Qingdao operations during the financial year ended 31 July 2004 would stimulate better operation efficiency and improve cost performance. Preliminary results were reflected in the financial performance of the Qingdao operations, which showed positive turnaround for the year ended 31 July 2004.

At the beginning of the financial year, the tooling and assembly operations at Shenzhen operation were relocated in phases to Zhuhai operation. This has created a synergistic effect, resulting in stronger pool of engineering resources and capabilities for Zhuhai operation. At the same time, Shenzhen operation is now more focused on its core business and competencies in growing the plastic injection moulding activities and reducing operating costs.

In order to further strengthen its competitive advantage by expanding its scope of services, the Group entered into a joint venture with Wako on 8 September 2004. Wako is the subsidiary of a Japanese company with reputable technology and technical expertise in surface enhancement through spray painting technology. Through this joint venture, two companies, Wako VS Nano Technologies (Hong Kong) Co., Ltd. and Wako VS Nano Technologies (Zhuhai) Co., Ltd. were established in which the Group has effective equity interests of 18.90% and 47.21% respectively. The Directors believe that the advanced technology transfer from Wako would add breadth to the Group's integrated manufacturing solutions provided to its customers and contribute positively to the Group.

The Directors would continue monitoring closely the Group's capital spending and reduce the cost of financing and gearing to enhance the profitability of the Group. The Group would also manage its operating costs, further enhance its operating efficiency. This would yield increasing gross margins which would enhance the shareholders' value in the coming years.

The Directors are fully aware of the challenges ahead, particularly from the uncertainty in business environment. Nevertheless, with the diverse range of experience of the Directors and its management team, the Directors are optimistic that the results of the Group would improve in the coming years.

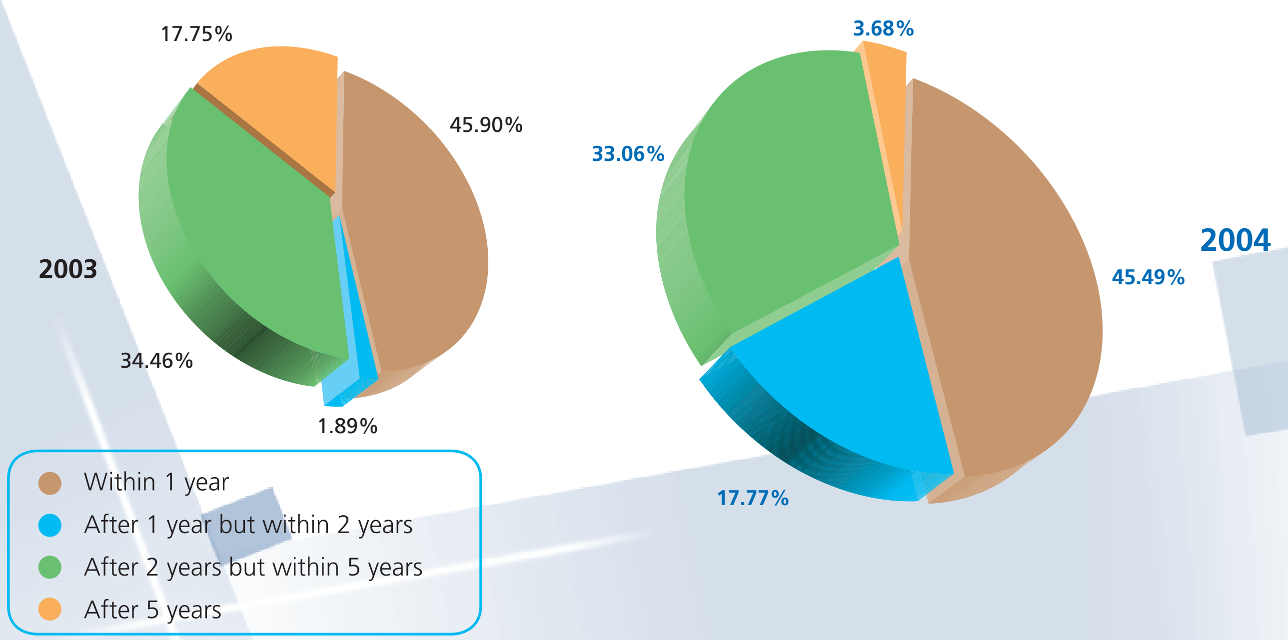
Liquidity and Financial Resources

The Group generally finances its operations with internally generated cash flows and banking facilities from banks in Hong Kong and the PRC. During the financial year under review, the Group's net cash inflows from operating activities improved significantly to record at HK$71.89 million (2003: HK$49.45 million).

As at 31 July 2004, the Group had cash and bank deposits of HK$240.02 million (2003: HK$285.82 million) of which HK$77.12 million (2003: HK$86.47 million) were pledged to the banks for banking facilities granted to the Group. About 52.10% and 39.36% of the total cash and bank deposits were denominated in United States ("US") dollars and Renminbi ("RMB") respectively with the remainder in Hong Kong dollars.

As at 31 July 2004, total borrowings of the Group were HK$789.91 million (2003: HK$641.77 million), inclusive of a loan from a shareholder of HK$39.13 million (2003: HK$44.02 million). The Group's borrowings maturity profile is set out as follows:

	2004	2003
	HK$ million	HK$ million
Repayable		
Within 1 year	**359.30**	294.57
After 1 year but within 2 years	**140.36**	12.15
After 2 years but within 5 years	**261.16**	221.15
After 5 years	**29.09**	113.90
Total borrowings	**789.91**	641.77
Cash and bank deposits	**(240.02)**	(285.82)
Net borrowings	**549.89**	355.95



The Group's gearing ratio, represented by the interest bearing borrowings over the Group's total assets as at 31 July 2004 was 51.18% (2003: 45.82%). The increased borrowings were mainly used for financing the Group's capital spending particularly for the Zhuhai Industrial Park and trade financing. Interest rates were ranging from 2.71% per annum to 7.60% per annum. Among these borrowings, about 45.52%, 45.45% and 9.03% were denominated in US dollars, RMB and Hong Kong dollars respectively.

The Directors are confident that there would have adequate financing being continuously available to the Group in the next 12 months. Therefore, the Directors believe that the Group's available facilities, combined with cash and deposit on hand and the Group's recurrent cash flow generated from operations, will provide sufficient financial resources to satisfy its current commitment and ongoing working capital requirements.

Capital Structure

As at 31 July 2004, the Group's shareholders' funds were HK$388.23 million (2003: HK$385.39 million). Total assets of the Group, which comprised mainly fixed assets, strengthened by HK$142.76 million, to stand at HK$1,543.33 million.

Charges on Assets

As at 31 July 2004, certain assets of the Group with an aggregate carrying value of HK$301.30 million (2003: HK$294.22 million) were pledged to secure loan facilities utilised by the Group.

Commitments and Contingent Liabilities

As at 31 July 2004, the Group's capital commitment was HK$20.70 million (2003: HK$68.67 million). This commitment related mainly to the construction and acquisition of machineries for Zhuhai Industrial Park. There was an investment commitment of HK$66.73 million (2003: HK$66.87 million) 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 2004 was bills discounted with banks on recourse basis which amounted to HK$14.71 million (2003: HK$11.41 million).

During the year ended 31 July 2004, a PRC custom authority carried out an examination of value-added tax and custom duties paid by one of the Group's subsidiary in Zhuhai for the period from April 2001 to September 2003. According to the result of examination, the subsidiary was requested to pay further value-added tax and custom duties, totalling to HK$1.50 million and HK$0.92 million respectively. These amounts have been recognised in the financial statements as at 31 July 2004. The Directors have performed an assessment as to whether any further liability may be incurred by this subsidiary in this regard. Based on this assessment, the Directors are of the opinion that there is no further liability that would have significant financial impact on the Group.

Foreign Exchange Risk

The Group's exposure to foreign exchange rate fluctuations during the year under review, other than acquisitions of machinery and equipment in Japanese Yen, was not significant as most of its transactions, including borrowings, were denominated in US Dollars and RMB, which have a narrow exchange rate fluctuation band against Hong Kong dollars.

The Group reported a net exchange loss of HK$3.37 million during the year under review as a result of fluctuations in Japanese Yen, against a net exchange loss of HK$0.80 million in last corresponding period.

Employees and Remuneration Policy

As at 31 July 2004, the Group had a total of 7,227 (2003: 7,298) employees of which 1,381 (2003: 2,361) were employed under processing arrangements. During the year ended 31 July 2004, 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 with certain independent third parties) for the financial year under review amounted to approximately HK$98.72 million (2003: HK$91.11million). The Group's remuneration packages are in line with the prevailing market practices and the Group's employees are rewarded on the basis of performance and experience of individual employees. The Group has continuously put efforts in improving its remuneration policies to attract 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.

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.

The Company conditionally adopted a share option scheme ("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. As at 31 July 2004, no options had been granted under the Scheme.