MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW

Overview

The Group's turnover for the six months ended 31st October 2004 was HK$293,388,000 (2003: HK$235,550,000), up 24.6% as compared with the corresponding period last year. During the period, coils manufacturing segment recorded a rise of 30.4% in turnover. In addition, ferrite powder manufacturing segment, which started sales in December 2003, also reported turnover of HK$15,900,000 in the period. As for the electronic components trading segment and information technology segment, the turnover of these segments decreased by 86.7% and 73.9% respectively as compared with the same period last year. These reflected that the Group has been strictly implementing the step-by-step restructuring policy for its coils business.

During the period under review, the Group's overall gross profit was HK$65,022,000 (2003: HK$58,463,000), with an increase of 11.2% as compared with the corresponding period last year. Gross profit margin decreased to 22.2% (2003: 24.8%), which was attributable to the sustaining high prices of raw materials, as well as the increase in energy charges and wages incurred by its plant in Mainland China.

During the period, operating profit and profit attributable to shareholders were HK$22,760,000 (2003: HK$18,382,000) and HK$12,966,000 (2003: HK$8,543,000), up 23.8% and 51.8%, respectively as compared with the same period last year. Earnings before interest, tax, depreciation and amortisation ("EBITDA") was HK$54,869,000 (2003: HK$47,886,000) for the period.

Manufacturing Segment

The turnover of the coils manufacturing segment, the Group's core business, recorded a rise of 30.4% to HK$269,860,000 (2003: HK$206,871,000) for the six months ended 31st October 2004 and accounted for 92.0% (2003:87.8%) of the Group's turnover. The increase in turnover was mainly attributable to the growth in sales volume of SMD chip inductor, power inductor, toroid coil and transformer.

Moreover, as at 31st October 2004, the Group's inventory was HK$53,676,000 (as at 30th April 2004: HK$83,973,000). The decrease in inventory was mainly resulted from the active consumption of raw materials inventory in the warehouse during the period by virtue of the sustaining high prices of raw materials, such as plastics, copper and metallic oxides, some of which surged to a new ten-year highs. In view of no dealings on commodity futures contract for hedging, the Group has been actively consuming the backlog of raw materials inventory in the warehouse since May of this year. This helped to alleviate the negative impact of the increasing production cost on profit and to reduce working capital locked up in inventory. Meanwhile, the Group has been striving to improve the logistics and control system to maintain inventory turnover days to the existing level . However, the policy regarding the active consumption of inventory could only ease pressure on the rising production cost in the short-term, and the directors recognize that it is not a long-term policy. If the aforesaid raw materials prices still stay pinned virtually to the highs in the future, it will inevitably put a squeeze on the Group's profit margin. As such, the Group is actively studying any possible long-term solutions to address this issue.

Under the maturing business environment and system in Mainland China, the Group also has grasped such opportunity for business development. The turnover in Mainland China reached HK$91,877,000 for the six months ended 31st October 2004 (2003: HK$31,959,000), with a growth of more than two-fold as compared with the same period last year, and accounted for 31.3% (2003: 13.6%) of the Group's turnover. Moreover, with the achievement in exploring active foreign markets, the turnover in America more than doubled to HK$10,185,000 (2003: HK$3,747,000) as compared with the corresponding period last year and accounted for 3.5% (2003: 1.6%) of the Group's turnover.

MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL REVIEW

Funds Surplus and Liabilities

As at 31st October 2004, cash and bank deposits (denominated mainly in Hong Kong dollar, United States dollar, Renminbi, etc) was HK$50,449,000 (as at 30th April 2004: HK$49,564,000). The banking facilities were secured by mortgages on the Group's certain land and buildings, pledges of the Group's bank deposits, investment, machinery, and corporate guarantees provided by the Company and its certain subsidiaries. In addition, the Group is required to meet certain restrictive financial covenants with the major banks. As at 31st October 2004, the Group could comply with such financial ratios, which indicates that the Group's financial position was satisfactory.

As at 31st October 2004, the Group's total borrowings granted from banks and financial institutions was HK$249,915,000 (as at 30th April 2004: HK$280,273,000), of which HK$204,274,000 (as at 30th April 2004: HK$204,376,000) was current and HK$45,641,000 (as at 30th April 2004: HK$75,897,000) was non-current and will be repayable within a period of more than one year but not exceeding five years. Furthermore, with a continuous decline in the total borrowings, interest expenses of the Group reduced by 19% to HK$7,335,000 (2003: HK$9,055,000) as compared with the corresponding period last year.

As at 31st October 2004, contingent liabilities amounted to HK$32,976,000 (as at 30th April 2004: HK$38,052,000), of which HK$32,976,000 (as at 30th April 2004: HK$35,568,000) was factoring of trade receivables with recourse.

Financial Resources and Capital Structure

The Group's net cash flow for the six months ended 31st October 2004 amounted to minus HK$3,051,000 (2003: HK$24,430,000). Net cash flow from operating activities was HK$67,741,000 (2003: HK$44,164,000). Net cash flow from financing activities was minus HK$45,382,000 (2003: HK$11,270,000). During the period, the Group obtained banking facilities which were used for the acquisition of new equipment and as working capital. Taking into account the corporate development and the market condition, the Group will gradually improve its capital structure. During the period under review, the Group continued to repay certain balances of bank loans for reducing the Group's net gearing ratio. As at 31st October 2004, the Group's net gearing ratio* was 0.74 (as at 30th April 2004: 0.88).

(* *The ratio of (total borrowings plus bills payable and contingent liabilities less total cash and bank deposits) over (net tangible assets less proposed dividend))*

Net cash flow from investing activities for the six months ended 31st October 2004 was minus HK$25,204,000 (2003: minus HK$31,273,000), the capital expenditure of which was mainly used in purchasing equipment and expanding manufacturing plant, thereby increasing the production capacity.

Cash Flow Summary

	Six months ended 31st October	
	2004	2003
	HK$'000	HK$'000
Net cash inflow from operating activities	**67,741**	44,164
Net cash outflow from investing activities	**(25,204)**	(31,273)
Net cash (outflow)/inflow from financing activities	**(45,382)**	11,270
Exchange adjustment	**(206)**	269
(Decrease)/increase in cash and cash equivalents	**(3,051)**	24,430

MANAGEMENT DISCUSSION AND ANALYSIS

Charges on Assets

As at 31st October 2004, certain assets of the Group with an aggregate carrying value of HK$48,363,000 (as at 30th April 2004: HK$69,671,000) were pledged to secure banking facilities and finance lease.

Exchange Risks

The Group's business is mainly conducted in Mainland China and Hong Kong and the major revenue generating currencies and major currencies in purchase commitments primarily denominated in Hong Kong dollar, Renminbi and United States dollar. As such, the management is of the view that it is not necessary for the Group to purchase any foreign exchange futures or options contract to hedge against exchange risks.

The Group's borrowings are mainly settled in Hong Kong dollars, Renminbi and United States dollars. The management believes that there is no substantial exchange risk.

FUTURE PLAN AND PROSPECTS

With regard to plant and production facilities, the Group reached an agreement with the local government in Mainland China for purchasing a land parcel of 35,000 square meters nearby its main plant at Zhongshan. During the period under review, the infrastructure construction for the land and plant started off. The new plant will be utilized to expand production lines for power inductor and transformer. Besides, the Group continues to pursue more business opportunities, including plans to set up production lines in Gaozhou and Dongguan, Guangdong Province of Mainland China, as well as Brazil in South America in order to meet the increasing demand from its customers. It is expected that these development projects will come into production in the second half of this financial year.

CORPORATE DEVELOPMENT POLICY

The Group's Hong Kong head office will still be responsible for formulating its overall management policy, while the management in accounting, finance, capital and risk is strictly implemented according to the policies approved by the Board. As to the financing aspect, the Group will continue to make use of the credit facilities provided by financial institutions in Hong Kong as the major financing method. The Group recognizes that fund-raising from the capital market is an important financing method. As such, the Group will further reinforce corporate governance and transparency in information disclosure, and strengthen its coils business development.

Apart from the local business which is involved with Hong Kong customers to be continuously run by Coils Electronic Co., Limited, a wholly-owned subsidiary of the Group, the Group will continue to adhere to the "Re-organization to the China-focused Operating Model" as laid down in the last financial year with all the functional departments, including manufacturing business, research and development, logistics management, sales and customer service, to be re-located to its main plant in Zhongshan. On the other hand, the Group will also fully make use of the relationship network and human resources of its subsidiaries in different locations for less resources overlapped so as to enhance the overall operating efficiency of the Group. The Board expects that the said re-organization can be completed before the end of 2005.

The Group will make all its employees attain the requisite professional standards in line with their job duties, especially in the areas of sales and marketing, production, research and development, environmental system, quality assurance, financial management as well as human resources and administration. The Group will devote to upgrading the senior management to professional standards. It is expected that all the senior management will be qualified in their respective professions before the end of 2005. All the middle management must have the requisite qualification in their specialized studies or attained tertiary level. Moreover, the Group's "Executive Trainee Program" will continue to provide the relevant training courses to the employees under the program in order to let them attain the requisite professional standards in their respective positions.

MANAGEMENT DISCUSSION AND ANALYSIS

CORPORATE DEVELOPMENT POLICY *(continued)*

The Group as a coils manufacturer fully realizes that product development and research and development must be major for component products, instead of depending on assembly business, to continuously provide electronic component products of high quality at competitive prices to its customers when facing the rapidly changing demand in electronic products. Accordingly, the Group will continue to implement this policy for achieving a steady business development.

DIVIDEND POLICY

The Board has adopted a stable dividend policy to distribute dividend income to the Company's shareholders that is in line with the Group's profit performance. The dividend payout ratio will not exceed 25% of the profit attributable to shareholders for the relevant financial year. The recommendation or declaration of dividends to be considered by the Board will be subject to a minimum dividend per share of HK0.5 cent. No declaration of dividend will be made in the first quarter and third quarter of each financial year. The Company will consider the following factors to review the dividend policy:

– the level of the Group's cash position in comparison to its current and projected operating and capital requirements;
– rewarding shareholders for their continued support;
– improving return on investment; and
– sustaining the Group's stability, growth and maintaining prudent risk management.

EMPLOYEES AND REMUNERATION POLICY

The Group had approximately 6,700 employees as at 31st October 2004. The remuneration of the employees is determined by reference to market benchmark, individual performance and work experience, subject to review, while bonus entitlement depends on the Group's results and employees' individual performance.