Management Discussion and Analysis

FINANCIAL REVIEW

Turnover for the year ended 31 December 2004 amounted to HK$170 million, which represented an increased of 77% as compared to the same period last year. The increased was mainly due to an increased in sales from the manufacturing business unit noted as compared to 2003.

The consolidated results of the Group for the financial year ended 31 December 2004, which amounted to a loss of HK$21.4 million (2003: HK$89.2 million). This represented an improvement of 76% as compared to the previous financial year. The improvement noted mainly due to the following:

(i) The manufacturing business unit recorded an operating profit of HK$7.0 million in 2004 as compared to a loss of HK$0.5 million in 2003.

(ii) In 2003, HK$44.9 million provision was made for a quality deposits receivable for the Information Technology business unit. No such provision was required in 2004.

(iii) Operating loss before provision for the Information Technology business unit was HK$1 million in 2004 as compared to HK$21 million in 2003.

(iv) The increase in share of losses attributable from an associated company by HK$4.4 million (2004: HK$8.0 million and 2003: HK$3.6 million).

At the balance sheet date, the Group's net liabilities were HK$4 million (2003: Net assets of HK$16 million). The dropped in net assets of approximately HK$20 million as compared to last year is mainly due to the losses incurred for the year.

FINAL DIVIDEND

The directors do not recommend the payment of a final dividend for the year ended 31 December 2004 (2003: HK$ Nil).

THE GROUP'S LIQUIDITY AND FINANCIAL RESOURCES

At the balance sheet date, the Group has cash and bank deposits of HK$1.6 million (2003: HK$0.4 million) which includes foreign currency deposits of RMB0.5 million (2003: RMB 61,000).

The Group's consolidated net borrowings increased from last year's figure of HK$19 million to HK$22 million. The Group's gearing ratio, which is expressed as a percentage of the Group's net borrowings over total assets value of HK$80 million as at 31 December 2004 (2003: HK$86 million), has increased from 22% to 28%. The increase is attributable to the dropped in the Group's total assets value and increase in borrowings as compared to last year.

The amount of debt due within one year at the balance sheet date amounted to HK$22.5 million (2003: HK$18.9 million). The table below shows the type, maturity, currency and interest rate profiles of the Group's bank and other borrowings at the balance sheet date.

	2004	2003
	HK$'000	*HK$'000*
DEBT MATURITY PROFILE		
Within one year	**22,471**	18,931
Within two to five years	**–**	–
Total	**22,471**	18,931
INTEREST RATE PROFILE		
Unhedged floating	**7,386**	3,375
Fixed	**15,085**	15,556
Total	**22,471**	18,931
NATURE OF DEBT		
Secured loans	**8,585**	9,056
Unsecured loans	**13,886**	9,875
	22,471	18,931
CURRENCY PROFILE		
Hong Kong Dollars	**13,886**	9,874
Reminbi	**8,585**	9,057
	22,471	18,931

At the balance sheet date, the Group's secured borrowings amounting to HK$8.6 million (2003: HK$9.0 million) which were secured by a legal charge on certain leasehold land and buildings of the Group situated in the PRC with carrying value of approximately HK$17 million at the balance sheet date.

Despite that the Group sustained recurrent losses and had net current liabilities of HK$52 million at 31 December 2004, the directors of the Company are of the opinion that the Company and the Group will be able to meet their obligations as and when fall due after taking into account the following:

(i) the Group is able to attain profitable and cash positive operation in the longer term;

(ii) loan facilities totaling HK$30 million made available to the Company from a financial institution; and

(iii) continual financial support received from a substantial shareholder.

The directors believe that the Group will have sufficient cash resources to satisfy its future working capital and other financing requirements.

EXPOSURE TO FLUCTUATION IN EXCHANGE RATES, INTEREST RATES AND RELATED HEDGES

To manage the risk associated with an uncertain market environment, the Group pursues a funding strategy, using equity as far as possible to finance long-term investments.

The Group's borrowings and cash and cash equivalents are primarily denominated in Hong Kong dollars, Renminbi and US dollars. The Group does not hedged against foreign exchange risk, as the management believe Hong Kong dollars will remain pegged to US dollars in the foreseeable future and the exchange risk associated with Renminbi is expected to be minimal.

The interest rates profile of the Group's borrowings comprises a mixture of fixed and floating rates. The Group does not hedged against interest rates risks as the management does not expect the impact of any fluctuation in interest rates to be material to the Group.

MATERIAL ACQUISITIONS AND DISPOSAL OF SUBSIDIARIES

In 2004, the Group had neither any material acquisition nor disposal.

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW

The Group's business is slowly gathering momentum as the global economic climate continues to improve. The Group's turnover was HK$170 million in 2004, an increase of HK$74 million or 77% as compared to HK$96 million in 2003. The Group incurred a net loss of HK$21.4 million in 2004 as compared to a net loss of HK$93.7 million in 2003.

The Group's significant investments are investments in subsidiaries of which their performance during the year under review have been grouped according to their respective segments and discussed below.

Manufacturing Business

As the Group's core business, the manufacturing unit has maintained a healthy growth and recorded an increase of 81% in turnover from HK$94 million in 2003 to HK$170 million in 2004. This was a result of the management's consistent effort in improving quality control and securing new orders from customers. Gross margin was improved to 22% as compared to 17% in 2003 despite raw materials prices hike during 2004. Increased competition had also reduced the average selling price. In an effort to maintain the gross margin, management had focused on production rationalization and implemented various cost-reducing measures. The unit recorded an operating profit of HK$7.0 million in 2004 as compared to a loss of HK$0.5 million in 2003.

Information Technology Business

In an effort to reduce its losses, the group had started divesting its loss-making IT businesses since the year 2003 and the restructuring had concluded during the period under review. As a result, no turnover was recorded for this unit in 2004 as compared to HK$2.4 million in 2003. Operating loss was HK$1 million in 2004 as compared to HK$66 million in 2003.

However, the Group's share of losses of associates included an amount of HK$6.0 million, being the share of losses incurred by the Group's associated company, Chinese 2 Linux (Holdings) Limited ("C2L") and the amortization of goodwill arising from the acquisition of C2L in 2003 amounted to HK$1.8 million. The directors have considered the impact of these losses on the Group's carrying value of C2L of HK$15.9 million as at 31 December 2004 and no provision was made as these losses incurred by C2L were in line with the forecast performed by the management of C2L in the year C2L was acquired. Nevertheless, the directors will continue to monitor the performance of C2L and will make necessary adjustments upon being able to quantify any impairment loss on the value in the accounts of the Group.

Outlook

We expect challenging business conditions to persist in the coming year as materials and labor costs will be remained at a high level and do not foresee an imminent upturn in the Group's business. However we are optimistic about our manufacturing business where we have the scale and competitive edge. Capitalizing on our effort in R&D, we will be able to offer a wider range of quality products to our customers. At the same time we will continue to pursue a policy of cost containment and production rationalization.

MATERIAL CONTINGENT LIABILITIES

At 31 December 2004, the Group had provided a guarantee on a joint and several basis with a third party in respect of payment obligations of service fees payable by an associated company of approximately HK$11.8 million.

EMPLOYEES AND REMUNERATION POLICY

At the balance sheet date, the Group employed approximately 39 staff (2003: 45) in Hong Kong and approximately 1214 employees (2003: 760) in Mainland China. Employee remuneration are given and reviewed based on market norms, individual performance and experience. Awards and bonuses are considered based on the Group's business results and employees' individual merit.

The Group also granted share options to certain employees of the Group on 10 July 2000, entitling them to subscribe for shares of the Company. These options are exercisable in stages commencing twelve months from the date of grant. The expiry date of the options is ten years from the date of grant. During the year under review, no option was exercised.