Management Discussion and Analysis

Operating Review

Operating results for the year

Sandmartin Group, founded in Taipei in 1987, engages in design and manufacture of digital television ("TV") reception equipment, connectors and cables, and other communication related products. The Company was successfully listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on May 12, 2005. The listing is a new milestone in the Group's development, laying the foundation for our further growth in the industry.

The following is an analysis of the Group's turnover by business segment:

	For the year ended June 30,			
	2005		2004	
	HK$'000	***%***	*HK$'000*	*%*
Satellite television reception products	**828,343**	**63**	771,516	61
Connectors and cables	**246,194**	**19**	231,185	18
Communication related products	**233,585**	**18**	262,656	21
Total	**1,308,122**	**100**	1,265,357	100

Sales from satellite TV reception products still represented the majority of the Group's turnover, including satellite receivers (set-top boxes), satellite antennas (low-noise block downconverters, or LNB) and Digital Satellite Equipment Control (DiSEqC) switches. Sales from connectors and cables include various cables: network, speaker, telephone and others. Communication related products include assorted electronic accessories mainly produced on an electronic manufacturing service ("EMS") basis.

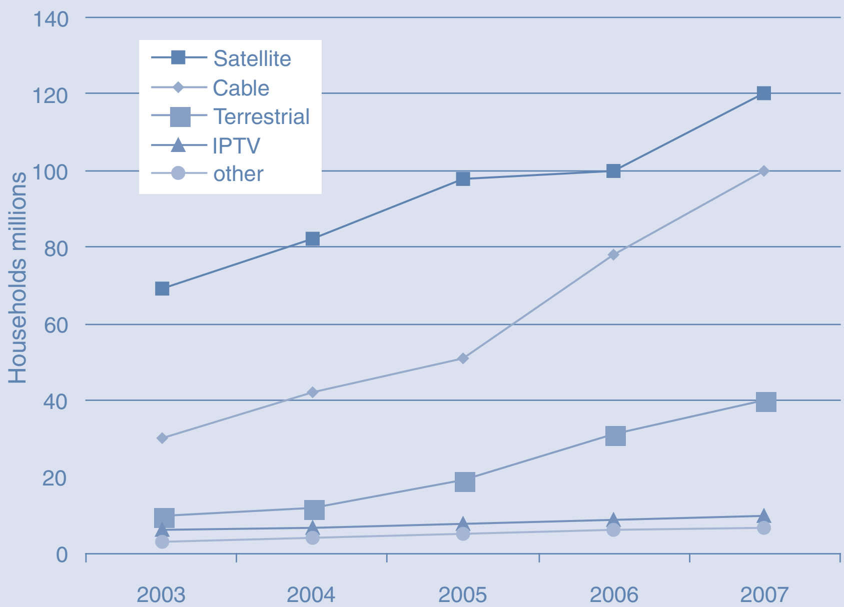
The following table provides an analysis of the Group's sales by geographical market:

	For the year ended June 30,			
	2005		2004	
	HK$'000	***%***	*HK$'000*	*%*
Middle East	**607,326**	**46**	605,528	48
America	**361,927**	**28**	298,979	24
Europe	**246,856**	**19**	298,639	24
Others	**92,013**	**7**	62,211	4
Total	**1,308,122**	**100**	1,265,357	100

Changes in the industry

The TV broadcasting industry is undergoing restructuring stimulated by technological change. The major driver is digitalisation of the TV signal, which is expected to bring major benefits in increased bandwidth (carry more channels), interactivity and improved picture definition. Most media regulators worldwide target switching off analogue TV broadcast over the next decade. Conversion to digital broadcasting is gathering pace, driven by competition from aggressive market entrants that have adopted digital broadcasting as their medium: either Satellite, Cable, Terrestrial, or Internet Protocol TV (IPTV), as well as initiatives from media regulators to increase adoption rates.

Estimated number of digital TV households



Source: Strategy Analytics

Newer digital standards are continually being developed and launched such as the Multimedia Home Platform ("MHP"), which is an open middleware system standard for interactive digital TV designed by the DVB Project, an industry-led consortium committed to designing global standards for the global delivery of digital TV and data services. A digital set-top box is needed for receiving digital TV broadcasts, because the vast majority of TV sets do not yet have such a tuner. It is expected these changes will create a healthy environment for the replacement/upgrade market for digital equipment, such as set-top boxes, over the longer term.

Acquisitions and disposals

The Group had no significant investments held in the year ended June 30, 2005. The Group also did not have any material acquisition of subsidiaries and associates in the year ended June 30, 2005.

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During the year ended June 30, 2005, SMT Electronic Technology Europe GmbH, a wholly owned subsidiary of the Group incorporated in Germany, had applied for voluntary liquidation. The subsidiary was engaged in trading of the Group's products and the turnover for the years ended June 30, 2004 and 2005 were HK$12.2 million and HK$6.6 million, respectively. The Directors believe that future contributions from the subsidiary are limited and from this dissolution, the Group recorded a gain of HK$1.4 million.

In view of strengthening the research and development ("R&D"), and distribution abilities in Europe, as announced on September 12, 2005, the Group entered into a non-binding letter of intent for a proposed acquisition of the entire interest in a company incorporated in Spain, which engages in R&D and distribution of digital TV reception products (the "Proposed Acquisition"). The parties to the letter of intent agreed to use their best endeavours to enter into a formal legally binding but conditional agreement on or before October 31, 2005, or such later date as agreed between the parties. Further announcement will be made by the Company in respect of any further material development on the Proposed Acquisition and action will be taken to comply with the disclosure/approval requirements under The Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"). The Directors are of the view that the Proposed Acquisition, which is in line with the business direction of the Group, is in the interest of the Company and the shareholders.

Employees

At June 30, 2005, the Group employed a total of 4,998 (2004: 5,164) full-time employees. Remuneration for employees, amounted to HK$80.3 million (2004: HK$88.5 million) including training, medical benefits, insurance coverage and staff quarters, is determined based on industry practice, the performance and working experience of the employees and the current market conditions. Discretionary bonuses or share options may be awarded according to individual merits.

On July 30, 2005, 6,520,000 share options were granted under the Company's share option scheme, details of which are set out in note 25 to the financial statements.

Prospects and plans for the future

The Directors believe that the transition to digital TV is a process that follows different paces around the world. Governments see digital TV as a futuristic technology that will push their countries to the forefront of the "digital revolution" and free up existing TV frequencies for resale to telecommunications operators. This would continue to generate strong demand on TV reception and communication related products. The Group's business objective is to become a leading digital communication and electronic product designer and manufacturer offering a complete range of products. In order to achieve this, the Group intends to:

1. further expand the production capacity and productivity by increasing the investment in plant and machinery;

2. broaden product mix through product development and solution innovation, such as digital receivers incorporating video recording function; and

3. expand the Group's distribution network while enhancing its sales and marketing along with customer services.

As at June 30, 2005, the Group was one of twenties worldwide which was granted by the DVB Project, the right to use the MHP logo on their equipment for interactive digital TV. We believe that technological leadership will be important to our ability to introduce products that are competitive on all fronts and also reduce costs for not requiring to buy solutions from outsiders. The Directors also anticipate that the contribution from sizeable orders on an original equipment manufacturer basis will continue to increase in the coming years.

Financial Review

Attributable return to shareholders

Turnover increased from HK$1,265.4 million for the year ended June 30, 2004 to HK$1,308.1 million for the year ended June 30, 2005, representing an increase of approximately 3.4%.

The sales of satellite TV reception products grew from HK$771.5 million for the year ended June 30, 2004 to HK$828.3 million for the year ended June 30, 2005, representing an increase of approximately 7.4%. The increase was mainly driven by an increase to some extent in the average selling price. Pursuing the technology advancement, the Group continuously strives to improve the quality and functionality in the product mix so as to enhance the product values. The Directors also believe that the increase in sales of satellite TV reception products is attributable to the digitalization of TV broadcasts that the consumers need to replace their set-top boxes from analogue to digital.

Sales from connectors and cables increased by approximately 6.5% to HK$246.2 million for the year ended June 30, 2005 (2004: HK$231.2 million), are traditional business of the Group and the Directors believe they will maintain a steady income of the Group.

Sales from communication related products decreased by approximately 11.1% to HK$233.6 million for the year ended June 30, 2005 (2004: HK$262.7 million) was because of the keen competition on the EMS market. Thus, the Directors would like to shift the resources to the revenue driver of the Group, the satellite TV reception products business.

Cost of sales consists principally of direct materials, direct labour, manufacturing overheads, and depreciation. Cost of sales increased by approximately 2.0% to HK$1,074.6 million for the year ended June 30, 2005 (2004: HK$1,053.9 million). The increase was in line with the increase in turnover. The gross profit of the Group was HK$233.5 million for the year ended June 30, 2005, representing an increase of approximately 10.4%. The gross profit margin slightly increased from approximately 16.7% in the previous year to approximately 17.9% for the year ended June 30, 2005. The increase was mainly due to the growth in sales from both of satellite TV reception products, and connectors and cables, which contributed a higher gross margin than that of communication related products.

Other income, which consisted mainly of sales of scrap, foreign exchange gains and interest income, increased in line with the turnover to HK$29.0 million for the year ended June 30, 2005 (2004: HK$28.4 million). The increase also related to gain on disposal of the German subsidiary amounted to HK$1.4 million (2004: nil).

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Distribution costs increased to HK$71.9 million for the year ended June 30, 2005 (2004: HK$53.7 million) primarily owing to the increased payment of commission rebates to customers.

R&D expenses consisted mainly of salaries and related personnel costs for technology development, technology license fees, and maintenance of the equipment used in technology development, increased by approximately 21.0% to HK$9.8 million for the year ended June 30, 2005 (2004: HK$8.1 million). This signifies the Group's effort to increase the R&D capability. The increase in R&D expenses and other administrative expenses offset the decrease in allowance for bad and doubtful debts; therefore, the total administrative expenses slightly increased to HK$78.2 million for the year ended June 30, 2005 (2004: HK$77.2 million). During the year ended June 30, 2005, the Group also recorded a negative bad debt provision of HK$1.6 million due mainly to the over provision made in the previous financial year.

The Group's finance costs for the year ended June 30, 2005 amounted to approximately HK$7.9 million (2004: HK$5.6 million), mainly comprised interest expenses on bank loans and trade facilities. The increase in finance costs was primarily due to the increase in interest rate and usage of trust receipt loans.

The net profit attributable to shareholders for the year ended June 30, 2005 was HK$99.8 million (2004: HK$96.5 million). The net profit margin for the year ended June 30, 2005 was 7.6% (2004: 7.6%). Basic earnings per share for the year ended June 30, 2005 was HK22.9 cent (2004: HK22.7 cent).

Accounting policies

The Group's financial statements have been prepared in accordance with accounting principles generally accepted in Hong Kong. The Hong Kong Institute of Certified Public Accountants has announced, as part of its programme to converge with International Financial Reporting Standards, a number of new Hong Kong Financial Reporting Standards and revised Hong Kong Accounting Standards (collectively "new HKFRSs"). The Group has not early adopted these new HKFRSs in the financial statements for the year ended June 30, 2005. The Group has already commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a significant impact on its results of operations and financial position.

Capital structure and treasury policy

On May 12, 2005, the Company was listed on the Stock Exchange. A total of 133,682,000 shares were offered by way of placing and public offer, comprising (i) a public offer of 12,500,000 new shares, (ii) a placing of 121,182,000 shares including 62,500,000 new shares, 50,000,000 sale shares, and 8,682,000 new shares as a result of the exercise of the over-allotment option as defined in the prospectus dated April 28, 2005 (the "Prospectus"). The net proceeds of the Initial Public Offer ("IPO"), after deduction of underwriting fees and expenses, together with proceeds from the over-allotment option, amounted to approximately HK$78.9 million. As stated in the Prospectus, the Group intends to use these proceeds to partially fund the Group's future expansion plans.

Below is an analysis of secured borrowings of the Group:

	At June 30,	
	2005	2004
	HK$'000	*HK$'000*
Trust receipt loans	**114,685**	86,119
Bank loans	**47,816**	62,452
Amounts payable under finance leases	**5,566**	9,014
	168,067	157,585
Less: Amount due within one year	**(156,683)**	(135,889)
Amount due after one year	**11,384**	21,696

At June 30, 2005, all bank borrowings of the Group were denominated in United States dollars ("US$") or HK$ on either an inter-bank borrowing interest rate basis or prime rate basis. The Directors are of the opinion that the Group is not subject to any significant interest rate risk.

The gearing ratio, representing debts divided by total assets of the Group, was approximately 19.4% at June 30, 2005 (2004: 33.2%). The net debt to equity ratio, representing debts net of pledged bank deposits and bank balances and cash divided by capital and reserves, was approximately 7.7% at June 30, 2005 (2004: 17.3%, including advances from shareholders of HK$80 million in capital and reserves as if adjusted to take effect to capitalisation upon IPO). Interest coverage, representing profit before taxation and finance costs divided by finance costs, for the year ended June 30, 2005 was approximately 14.3 times (2004: 19.2 times).

Dividend policy

We propose to declare a final dividend of 6.9 HK cent per share for the financial year ended June 30, 2005, which is consistent with the dividend policy stated in the Prospectus. The final dividends proposed after the balance sheet date have not been recognised as a liability at the balance sheet date.

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Liquidity and financial resources

At June 30, 2005, the Group had cash and cash equivalents of HK$83.6 million (2004: HK$75.3 million), of which approximately 32.4% (2004: 24.2%) was denominated in Renminbi yuan ("RMB") and others were mainly US$ or HK$.

The following table summaries the Group's cash flow for the years ended June 30, 2005 and 2004:

	For the year ended June 30,	
	2005	2004
	HK$'000	*HK$'000*
Net cash from operating activities	**13,437**	22,801
Net cash used in investing activities	**(56,341)**	(64,003)
Net cash from financing activities	**51,378**	50,270
Net increase in cash and cash equivalents	**8,474**	9,068
Cash and cash equivalent at end of year, representing:		
Total bank balances and cash	**137,199**	118,248
Less: Pledged bank deposits	**(53,582)**	(42,967)
	83,617	75,281

Net cash inflow from operating activities generally arose from operating results of the Group after adjustment in utilization of working capital. The decrease in the year ended June 30, 2005 compared to the previous financial year was mainly attributable to increase in trade and other receivables of HK$105.1 million (2004: HK$130.3 million) was more than the increase in trade and other payables of HK$2.2 million (2004: HK$100.4 million).

The Group's expenditure for investing activities primarily related to purchase of property, plant and equipment, decreased from HK$57.0 million for the year ended June 30, 2004 to HK$45.5 million for the year ended June 30, 2005.

Net cash inflow from financing activities for the year ended June 30, 2005 primarily comprised inflow from bank borrowings of HK$142.5 million (2004: HK$157.0 million) and net proceeds from IPO of HK$78.9 million (2004: nil), and offset by repayment of bank borrowings and finance leases of HK$132.0 million (2004: HK$95.4 million) and previous year's dividend payment of HK$38 million (2004: HK$20 million).

At June 30, 2005, the Group's current ratio, being ratio of current assets to current liabilities, was approximately 1.4 (2004: 1.1) and inventory turnover period, being inventories divided by cost of sales and multiplied by 365 days, was approximately 65 days (2004: 62 days). Debtors' turnover days, being trade receivables divided by total sales and multiplied by 365 days, at June 30, 2005 was approximately 74 days (2004: 47 days), which was in line with the average credit terms of 30 to 90 days granted to the customers. The substantial increase in debtors' turnover days was due to the Group continues to shift its focus to the sizeable customers and longer credit terms are usually granted to these customers.

At June 30, 2005, the Group had aggregate credit facilities of approximately HK$321.3 million (2004: HK$282.8 million), of which HK$168.1 million (2004: HK$157.6 million) was utilized. The credit facilities are subject to annual renewal and restrictive covenants which limit the ability of the Company to, among other things, pay dividends not exceeding 40% of the Group's net profit.

At June 30, 2005, the Group had capital commitments of approximately HK$1.2 million (2004: HK$9.0 million), which has been contracted for but not provided in the financial statements in respect of acquisition of property, plant and equipment.

At June 30, 2005, bank deposits of approximately HK$53.6 million (2004: HK$43.0 million) and land and buildings with a net book value of approximately HK$20.8 million (2004: HK$80.4 million) were pledged to banks to secure general banking facilities granted to the Group.

Foreign exchanges

The Group is exposed to foreign exchange rate risk in the extent that most of the Group's sales are denominated in US$ while a significant portion of the Group's cost of sales is denominated in RMB and HK$. In addition, the Group has borrowings denominated in US$. The value of the HK$ is correlated to that of the US$; therefore, there are currently no fluctuations among these currencies to generate any significant impact on the Group's foreign exchange gain or loss. To protect against the potential fluctuations between the RMB and the US$, the Group engaged in certain foreign exchange hedging activities to manage part of these risks and is planning to enter new forward contracts for hedging purpose on terms considered attractive. The Group has not engaged in foreign exchange transactions for speculative purposes.

Taxation

The Group's effective tax rate was approximately 5.5% (2004: 5.1%). The low effective tax rates were mainly attributable to the offshore trading profits of transactions executed and effected by the Taiwan branch of SMT Electronic Technology Limited, a subsidiary of the Company, which were exempt from the Taiwan business income tax. The Taiwan branch receiving commission income is subject to the Taiwan business income tax charged at a rate of 25%.

Furthermore, pursuant to the relevant laws and regulations in the PRC, Sandmartin (Zhong Shan) Electronic Co., Ltd. ("Sandmartin (Zhong Shan)"), a subsidiary of the Company, was entitled to full exemption from the local income tax and the PRC enterprise income tax (the "EIT") from January 1, 2000 to December 31, 2001 and was entitled to full exemption from the local income tax and a 50% relief from the EIT of 24% (i.e. 12%) from January 1, 2002 to December 31, 2004. After the expiry of the above mentioned preferential tax treatment, Sandmartin (Zhong Shan) can continue to enjoy the full exemption from the local income tax and the reduced EIT rate of 12% if the export sales exceed 70% of its total sales (the "Export Exemption").

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No Hong Kong Profits Tax has been provided, as the Group did not have any assessable profit in Hong Kong for the year.

Contingent liabilities

At June 30, 2005, the Group had contingent liabilities in relation to bills discounted with recourse of approximately HK$2.5 million (2004: HK$4.3 million). At June 30, 2005, the Group had lease commitments of HK$3.8 million (2004: HK$2.6 million) for office premises and machinery, which were all due within five years.