Management Discussion and Analysis

FINANCIAL REVIEW

The Group continued to report remarkable performance for the year ended 31 December 2005 ("FY2005"). Group revenue for the year amounted to HK$1,104,134,000 (2004: HK$870,910,000), representing a year-on-year growth of 26.8% (2004: 39.0%). For the five years ended 31 December 2005, the Group revenue had achieved a cumulative annual growth rate ("CAGR") of 35.2%. This continuous revenue growth has been mainly driven by increase in production capacity and increase in the average unit selling price due to enhancement of product mix.

Gross profit for the year amounted to HK$265,252,000 (2004: HK$190,556,000), representing a growth of 39.2% (2004: 26.0%). Gross margin improved from last year's 21.9% to this year's 24.0%, mainly attributable to shifting of product mix to higher value and higher margin items such as the Low ESR radial leaded series, snap-in series and screw type series. The improvement in gross profit was slightly offset by the rise in certain material costs, labor costs, depreciation charges for plant and machinery and other manufacturing overhead expenditure in the second half of FY2005.

Operating expenses, particularly selling and distribution costs, also increased as a result of expansion of our overseas markets, such as North America and Europe. Interest expenses rose as a result of increase in market interest rates as the Group's bank loan interests were mainly determined on a floating interest rate basis. All in all, the Group's net profit for the year reported a significant jump from last year's HK$61,867,000 to this year's HK$95,696,000. This represented an increase of 54.7% (2004: 67.2%) from last year. For the five years ended 31 December 2005, the CAGR of net profit was 105.2%. Net margin also improved to 8.7% from last year's 7.1%.

Basic earnings per share rose to HK 24.76 cents (2004: HK16.75 cents), representing an improvement of 47.8% from last year.

REVIEW OF OPERATIONS

Over 95.0% (2004: 92.6%) of the Group revenue comes from the sales of E-Caps. In FY2005, the supply of E-Caps in the global market continues to be dominated by a few large global manufacturers, including the Group. Based on a survey conducted by Paumenok Publications Inc. in 2005, approximately 80.3% of the global E-Cap market share (in value terms) was held by the top eight players in the world, and the Group ranked as the seventh largest E-Cap manufacturers in the world. Based on the survey, most top eight players in the world are growing steadily but the group achieved an average annual growth rate of 23% between 2002 and 2004. We have also seen that the top eight players together are occupying incremental market shares between 2002 and 2004.

The Group's rapid revenue growth was primarily driven by increase in demand in the end product market particularly in the sectors of computer and peripherals, digital consumer electronic products such as flat panel TV, DVD and digital cameras, and in the energy sector. The Group grew its revenue by 26.8% in FY2005. This significant growth was mainly contributed by incremental orders from the existing global customer and revenue generated from new global customers. Satisfactory growth was recorded both in the sale of SAMXON brand products as well as our ODM/OEM revenue.

From the geographical perspective, the Group has already made successful penetration in all major markets. In FY2005, sales growth was particularly strong in the Taiwanese, North American, European, Mainland China and Northeast Asian markets.

The Group is one of the few global E-Cap manufacturers that deliver a full range of products to its customers, ranging from miniature to large can. The Group's products are widely applied in various electrical and electronic end-product industries. In FY2005, the sales growth was particularly strong in the market segment of computer and peripherals; power supply equipment including battery charger for mobile phones; digital consumer electronic products including flat panel TV, digital cameras, DVDs and energy saving lamps and audio equipments.

The Group's E-cap products are manufactured by its wholly owned manufacturing facilities in Dongguan, Wuxi and Xiamen. The Dongguan manufacturing facility is the largest in scale. It currently produces up to 520,000,000 pieces of E-Cap per month. The second largest manufacturing facility is located in Wuxi which produces up to 150,000,000 pieces per month. The Xiamen manufacturing facility produces up to 40,000,000 pieces per month. In summary, the Group's total production capacity reaches 710,000,000 pieces of E-caps per month.

The Group has uncompromising demand for high quality products. The Group believes that quality assurance starts from procurement and, as a result, key raw materials such as aluminum foils, electrolytes and electrolytic papers, etc are sourced from the world's best suppliers in Japan. Apart from sourcing the best raw materials, each production process is cautiously monitored by over 1,000 quality assurance personnel. As a result, the quality of our products has received world-wide recognition. The Group has already obtained several world class quality management certificates such as ISO 9001: 2000 and ISO 14001. The Group is also obtaining the quality management systems certificate of TS 16949 for the automobile industry segment. In addition, the Group has won the Productivity and Quality Certificate of Merits in the 2005 Hong Kong Award for Industries as organised by the Hong Kong Productivity Council.

LIQUIDITY AND FINANCIAL RESOURCES

At 31 December 2005, the Group's gross borrowings in terms of bank loans and finance leases amounted to HK$313,000,000 (2004: HK$229,849,000), of which HK$91,011,000 (2004: HK$152,947,000) was repayable within one year, HK$111,073,000 (2004: HK$66,902,000) was repayable between one and two years and HK$110,916,000 (2004: HK$10,000,000) was repayable between three and five years. After deducting cash and cash equivalents of HK$82,395,000 (2004: HK$50,961,000), the Group's net borrowing amounted to HK$230,605,000 (2004: HK$178,888,000). Shareholders' equity at the year end stood at HK$444,441,000 (2004: HK$325,109,000). Accordingly, the Group's net borrowing to shareholders' equity ratio improved from last year's 55.0% to this year's 51.9%.

In FY2005, the Group generated a net cash inflow from operating activities of HK$95,183,000 (2004: HK$61,664,000). In addition, the Group also obtained a net cash inflow from financing activities of HK$88,084,000 (2004: HK$27,646,000) mainly due to the net increase in bank loans of HK$89,339,000 (2004: HK$37,801,000). The above cash inflows were partly consumed in investing activities, mainly the purchase of plant and machinery, construction of new manufacturing facilities, and investment in jointly controlled entities amounted to HK$153,447,000 (2004: HK$79,486,000).

Profit before interest, taxation, depreciation and amortisation ("EBITDA") for FY2005 was HK$155,067,000 (2004: HK$112,083,000, as restated), representing an increase of approximately 38.4% (2004: 51.5%) as compared to that of last year. Interest coverage expressed as a multiple of EBITDA to total interest expenses decreased to 13.4 times (2004: 15.9 times).

Capital expenditure incurred on the purchase of fixed assets for FY2005 amounted to HK$131,393,000 (2004: HK$79,486,000), representing an increase of approximately 65.3% (2004: decrease of 17.4%) as compared to that of last year. This was funded by internally generated cash resources, long term bank loans and finance lease payables.

The Group's reporting currency is in Hong Kong dollars and it conducts its business transactions mainly in Hong Kong dollars, Renminbi, United States dollars and Japanese yens. Revenue is mainly received in United States dollars, Hong Kong dollars and Renminbi whereas purchases are mainly settled in Japanese yen, Hong Kong dollars and Renminbi. As Hong Kong dollars are more or less pegged to the United States dollar, there is no major currency exposure in this area. In addition, the Group's receipts in Renminbi roughly matches with its payments in Renminbi, so the currency risks in Renminbi are, to a large extent, naturally hedged. Forward foreign currency contracts were used by the Group to hedge against its anticipated cash flows and currency exposures arising from Japanese yen. The Group also entered into interest rate swap contracts to partially hedge the interest payable in the bank loans stated above. Credit risk was hedged through export credit insurance coverage.

CAPITAL COMMITMENTS AND CONTINGENT LIABILITIES

As at 31 December 2005, the Group had capital commitments, which were contracted but not provided for, in respect of construction in progress of HK$9,296,000 (2004: HK$11,343,000) and plant and machinery of HK$9,696,000 (2004: HK$7,025,000). As at 31 December 2005, the Company had issued guarantees amounting to HK$687,900,000 (2004: HK$483,857,000) in respect of banking facilities and finance lease contracts granted to its subsidiaries.

EMPLOYMENT AND REMUNERATION POLICY

At 31 December 2005, the Group had 103 employees (2004: 93) located in Hong Kong and employed a total work force of approximately 5,445 (2004: 3,676) inclusive of its operations in Mainland China and overseas offices. Total headcount increased mainly due to the expansion of existing production facilities, both in Dongguan and Wuxi, to meet increasing sales order demands. Salaries, bonuses and benefits to employees were determined with reference to market terms and the performance, qualification and experience of individual employees.

PROSPECTS

The Group is confident of sustaining satisfactory sales growth in the near future. Revenue growth will generally be driven by the expansion in its existing board and solid customer base; launching of new innovative products; penetrating into new industry segments; and further expansion of production capacity.

The development of phase 1 of the new manufacturing facility in Dongguan will be completed by mid 2006. Upon completion of this phase, the Group will relocate its Dongguan manufacturing operations to the new centralized state-of-the-art manufacturing facility, which will progressively deliver up to 650,000,000 pieces of output per month by the end of 2006. This represents an increase of approximately 130,000,000 pieces of the existing Dongguan operation. Our production capacity in the new Wuxi manufacturing facility will be further increased by 50,000,000 pieces to deliver up to 200,000,000 pieces of output per month by the end of 2006. The Xiamen plant will continue to operate at its existing scale of up to 40,000,000 pieces per month.

Besides the expansion of production capacity, the Group has started to integrate its business operations upstream. In this regard, a new aluminum foil factory has commenced operation in January 2006. This integration process will allow the Group to further secure the supply of high quality aluminum foils in the market and improve the overall cost efficiency.

Research and development capability is a key to the success in product innovation and diversification. In this regard, the Group is benefiting from its cooperation with The Research Institute of the Tsinghua University in Shenzhen. Several new products and technological innovations are being registered for patent in several market territories. By mid 2006, the Group will launch a brand new product series known as "polymer based solid capacitor". The launching of this new product further demonstrates the Group's ability to stay competitive in the keen competitive industry environment.

All in all, the coming years will be very exciting for the Group. We are expecting to reach new heights in revenue, market shares and profitability. We are integrating certain manufacturing processes upstream to enhance cost efficiency. We are launching new products to capture untapped future market segments.