Management Discussion and Analysis

Industry Review

Due to the escalating price of raw materials in the PRC and the skyrocketing transportation cost as a result of the macroeconomic austerity measures implemented by the State, the production cost and cost of sales of the manufacturing industries in general increased substantially in 2005. After the adoption of the floating exchange rate system for Renminbi in July 2005, the value of Renminbi has been rising while Euro keeps depreciating, thereby exerting pressure on the prices of exports and resulting in shrinking income for the Group. Some of the enterprises even suffered losses due to the increasing operating cost.

During the year under review, the German government imposed more stringent regulations on imported power tools products, leading to a decrease of export from the PRC manufacturers. The further enhancement of the standards on innovative technology within the power tools and air tools industry reflected the market's more stringent requirements on product quality and the higher quality requirement imposed voluntarily by importers. In August 2005, the European Union introduced the "Directive on waste electrical and electronic equipment" ("WEEE"), requiring manufacturers to shoulder the responsibility of recovering the waste products exported to the European Union. The market expects that the "Directive on the Restriction of the use of certain Hazardous Substances in electrical and electronic equipment" ("RoHS") will come into force in July 2006. Since the directive restricts the use of six hazardous substances including lead, mercury and cadmium in electrical and electronic equipment, buyers of power tools adopted a wait-and-see attitude last year, which led to a slowdown of the export of the power tools.

Although the operating environment of the power tools and the air tools market becomes increasingly challenging, the recovery of the global economy, as well as the improvement of the living standard of the general public and the increasing popularity of DIY practice have enabled the power tools and air tools market to achieve substantial growth and gradually develop into a major tool market. With the DIY markets in Europe and US maturing and the DIY market in the PRC beginning to develop, we see a strong performance in the global sales of power tools and air tools, which provided a significant impetus for the growth of power tools and air tools business. In addition, due to the rapid expansion of the power tools and air tools chain stores in Europe and the US, it is expected that the development prospect of such markets will be promising.

Users of professional tools accounted for more than 60% of the overall power tools market in 2005. Since professional power tools are higher end and higher value-added products, it is expected that they will account for 70% of the market share of the tools market in the coming years. As a result of the enhancement of the technology for professional tools and the launch of innovative products, the market demand keeps increasing. A smooth development and a huge room for growth are expected for the brands of professional power tools and air tools in 2006.

Dividends

The Board of Directors does not recommend any final dividend for the year ended 31 December 2005.

Business review

Wang Sing International is principally engaged in the production and sales of middle-priced and high quality AC and DC power tools and air tools products. During the period under review, the persistent surge in domestic prices and raw material prices and the macroeconomic austerity measures adopted by the State resulted in the continuous rise in the cost of production. In addition, with Europe being its major market, the Group's profit was affected by the depreciation of Euro and the rise of Renminbi in 2005, and the business performance of SBW, the renowned German distributor under the Group was impacted accordingly. For the year ended 31 December 2005, the Group recorded a turnover and loss attributable to shareholders of approximately HKD263,406,000 and HKD9,538,000 respectively, representing a decrease of 17% and 152% from 2004 respectively.

With the view to reducing production cost and adjusting production strategy, the Group reduced its self-production proportion to 63% while increasing the proportion of outsource production to 37% in 2005. Meanwhile, the Group maintained a stable inventory level and requested its suppliers to share the risk while strengthening its cost control measures. By implementing effective strategies, the Group succeeded in partly offsetting the increase in production cost. The Group's overall profit margin decreased to 10% from 15% of the corresponding period last year. During the year, orders from most of the Group's existing clients increased steadily. However, the overall business performance of the Group was not as good as that of the corresponding period last year, mainly attributable to the shrinking business of the Group's German associated company due to the depreciation of Euro.

In 2005, power tools business remained the Group's major source of revenue, but the proportion of power tools and other products in total turnover increased. Power tools accounted for approximately 84% of the total turnover while air tools and other products accounted for 16%. (2004: power tools: 91%, air tools: 9%).

As regards air tools, since air tools and power tools are highly complementary and share similar clientele, making it possible for the Group to create synergy. Witnessing steady growth and showing promising potential during the year under review, the emerging professional tools chain stores are set to become the new focus of the market. In 2005, besides entering into cooperative agreements with US renowned tool brands, the Group succeeded in concluding cooperative agreements with numerous new clients in Europe, such as Bosch, Carrefour and Skil. It is expected that this may lead to a further increase in the Group's production and enhance the Group's positive corporate image while creating a stable income source and help exploring markets for the Group's new business.

While proactively consolidating its business foundation in existing markets in 2005, the Group also stepped up its efforts in market exploration. The Group's clientele continued to grow and its major clients includes Praktiker, Leroy Merlin, Campbell Hausfeld and TIP, all being world renowned chain stores operators and major power and air tools distributors in Europe and US. The Group further explored the European market in 2005 and gradually achieved a more balanced market development, which helped mitigating the Company's risk in its business development. As regards the European market, being the Group's operating enterprise in Europe, SBW further consolidated its market position during the period and succeeded in establishing cooperative relationship with its clients.

As regards new product development in 2005, the Group successfully launched 15 new power tools products and 7 new air tools products which were well received by the market. As at the end of 2005, the Group produced 32 different categories under its 10 series of power tools and air tools products. The Group produces 278 models in total, it has 56 patents and 8 registered trademarks from all over the world.

In order to strengthen its research and development capability, the Group established a research and development centre in Taiwan in 2005. The centre has commenced full operation last year and its projects are progressing smoothly as scheduled. In the third quarter of 2005, the Group established a research and development centre in Suzhou, with the view to further enhancing its research and development capabilities and enabling it to respond promptly to consumer's ever-changing demands. The Group now employs approximately 120 professional engineers. Meanwhile, in order to improve product quality, the Group increased its investment on professional laboratories. The Group has been collaborating closely with "TUV" of Germany, a renowned European certification company and the Group's laboratories have already obtained all the qualifications necessary for certification examinations by "TUV", which helped enhancing the Group's market competitiveness.

Financial Review

Turnover and Profit Analysis

For the year ended 31 December 2005, the Group recorded an audited turnover of approximately HK$263,406,000, an decrease of 17.1% as compared to 2004. Loss attributable to shareholders was approximately HK$9,538,000 in 2005 while profit attributable to shareholders was approximately HK$18,608,000 in 2004.

The decrease in turnover and profit was mainly due to decrease in sales in an associate, SBW, HK$58,852,000 while other customers other than SBW increased sales by HK$4,689,000. The decrease in profit was mainly due to decrease in turnover, increase in raw material prices, devaluation in Euro dollars and revaluation in RMB.

Turnover Breakdown by Products and Geographical Locations

In term of products, power tools were still the major income source for the Group. The Group's air tools business also ran smoothly and steadily during the year. In 2005, the sales of power tools, power tools and hand tools and other products represented 83%, 7% and 10% (2004: power tools 92%, power tools 5% and hand tools and other products 3%) respectively.

Geographically, Europe was still the major market of the Group. In addition, the Group succeeded in exploring American markets. In 2005, the turnover proportion for the Group in Europe, Australia, North America and other markets was 81:11:8 (2004: 81:14:5).

During the year under review, the European markets grew steadily except the German markets. It was due to the decrease of sales in an associate, SBW. In addition, the Group also explored new markets including the US and Eastern Europe. It also established offices and representative agents to expand its business in Latin America so as to strengthen the market intensity in America.

Gross Profit and Profit Margin Analysis

For the year ended 31 December 2005, the Group's gross profit decreased from approximately HK$47,191,000 to approximately HK$26,758,000. The decrease in gross profit was mainly due to the increase in materials price. The price of main materials are copper, aluminium, and plastics have been increased by 30.7%, 18.8% and 28% on average respectively during 2005.

During the year under review, the Group's gross profit margin decreased as compared to last year to 10%. (15% in the corresponding period last year). The profit margin of power tools was approximately 8.6% while it was approximately 14.7% as for power tools and other tool products. (2004: power tools: power tools and other tool products: 14.2%:21.8%). The decrease in gross profit margin was mainly due to the increase in raw materials cost which were still the major portion of production cost.

Structure of Costs

For the year ended 31 December 2005, raw materials, salary, power and manufacturing overheads amounted to 96.36%:1.49%:0.07%:2.09% respectively. (2004: raw materials: salary: power: manufacturing overhead: 91.25%:4.33%:1%:3.42%). Raw materials were still the major portion of production costs.

Cashflow Analysis

For the year ended 31 December 2005, the Group's net operating cash inflow was approximately HK$818,000, representing a balance of cash inflow and cash outflow.

Cash on Hand

For the year ended 31 December 2005, the cash on hand for the Group was HK$61,140,000 (2004: HK$60,823,000). It was sufficient to be general working capital.

Debts Analysis and Gearing ratio

For the year ended 31 December 2005, the long term and short term debts of the Group were HK$138,001,000 (2004: HK$53,381,000) in aggregate. The increase in debts is partly due to the change of accounting policy amounted to HK$19,813,000 because the facilities granted by bank such as accounts receivables factoring, invoices financing, invoices discounting and bills receivables with full recourse with bank should be treated as bank borrowings under HKAS 39.

The debts are used for the purchase of fixed assets amounted to HK$27,781,000, the purchase of intangible assets amounted to HK$9,814,000 and general operations fund.

For the year ended 31 December 2005, the net debt to equity ratio (bank loans – cash/equity) of the Group was 39% (2004: net cash). Before the effect of change of accounting policy, the net debt to equity ratio is 26%

Capital Expenditure

The Group's capital expenditure in 2005 was approximately HK$36 million (2004: HK$15 million), of which development of mould expenses amounted to HK$10.7 million (2004: HK$4.0 million) and R&D expenses and licenses fee amounted to HK$9.8 million (2004: HK$2.2 million)

The major infrastructure of the Group's PRC production base was completed. There is no need to inject a great deal of capital for the construction of production plants in the short term. The expected capital expenditure of the Group in 2006 will be approximately HK$30 million, of which development of mould expenses amounted to HK$15 million and R&D expenses and licences fee amounted to HK$10 million. The above estimates include the cost of equipments which are necessary for the horizontal expansion of our power tools business to produce the accessories of power tools.

Trade Receivables Analysis

For the year ended 31 December 2005, the trade receivables (including an associate) of the Group were HK$73,789,000. (2004: HK$61,351,000). The Group's debtors' turnover days is 94 days (2004: 59 days). The increase in Group's debtors' turnover days is due to the change of accounting policy as mentioned in the section of "Debt Analysis and Gearing Ratio", the account receivables increased by HK$19,813,000 due to derecognized under HKAS 39. Before the effect of change of accounting policy, the Group's debtors' turnover days is 80 days.

Account Payables Analysis

For the year ended 31 December 2005, the account payables of the Group were HK$85,994,000 (2004: HK$104,119,000).

Inventories Analysis

For the year ended 31 December 2005, the inventories of the Group were HK$37,253,000 (2004: HK$38,054,000) while the inventory turnover days were 57 days (2004: 51 days). The increase in the inventory turnover days as compared to 2004 was due to increase in safety stock for the expectation of the price increase in raw materials.

Dividend

The Board of Directors do not recommend any payment of a final dividend. An interim dividend of HK0.8 cent per share amounting to HK$2,997,000 was paid to the shareholders on 11 November 2005. The company will maintain a steady dividend policy and try to distribute the cash dividend each year.

Shareholding Structure

The Group continued to have large shareholder base. For the year ended 31 December 2005, the shareholding of the major shareholder remains 55.61% (2004: 55.61%), while the second largest shareholder, Arisaig Greater China Fund Limited held 10.47% (2004: 10.47%).

Pledge of Assets

For the year ended 31 December 2005, the Group pledged bank deposits amounting to HK$2,491,000 (2004: HK$16,318,000) and trade receivables of HK$19,813,000.

Exposure to Foreign Exchange Risks

The Group's income and expenses are mainly denominated in US dollars and RMB and partly in Euro. During the year under review, the devaluation in Euro and revaluation in RMB lead to the Group having exchange loss approximately in HK$26 million, of which reflected in the financial statement for the decrease in turnover and increase in cost of sales figures.

Employee Benefits and Training

For the year ended 31 December 2005, the Group had approximately 1,122 employees, of which, 269 employees were management staff and 120 employees were engineers.

The Group has focused on the enhancement of the quality of staff and training. During the year under review, the Group engaged the famous training firm, Genesis Education Group, to organize an outdoor and indoor three-days training camp for the outward development and business simulator of the management staffs in July 2005. The group also organized courses at least once a week for the internal training of different level of staffs including moral, ethic, languages, technical and management skill trainings. For the Group's production plant at Golden Harbour, there were hundreds of on-the-job training programs held there.

Prospect

In 2006, the Group will continue to strive for further development and focus on diversifying its market, expediting the exploration of new markets, strengthening its research and development capability and shifting to the production of higher end products.

With respect to market expansion, the Group will continue to explore the North American market and pursue a balanced development in the European markets, with a plan to establish a sales office in North America in 2006. In addition, the Group plans to proactively seek further opportunities for cooperation with world renowned brand enterprises and chain stores. Meanwhile, the Group is negotiating with several world renowned brand enterprises or chain stores on the opportunities and intention for further cooperation on certain projects.

In 2006, the Group will launch professional tools that can meet higher technical requirements. In view of the robust global demand for professional tools, the Group will continue to explore opportunities for cooperation with professional brands or chain stores in the joint development of innovative new professional tools in future, so as to broaden its clientele and create new sources of income. With the view to expediting the research, development and production of such products, the Group's plants have set up specialized teams to follow up and conduct specific researches, which will bring new impetus for the future development of the Group's professional tools business.

As regards research and development, the Group plans to further increase its research and development investment. In addition to further strengthening the coordination between research and development and production, the Group will focus on the establishment of the Suzhou Nanjing research and development centre and step up the research and development of new products for the North American market. Moreover, the Group will strengthen its cooperation with domestic universities in the joint development of new products, gradually upgrade the facilities of its existing laboratories, strengthen experimental examination and quality control, continue to enhance the qualities of new products, expedite product research and development and shift to the production of higher end products.

Looking forward, the Group will stay abreast of market changes. While boosting the sales performance of power tools and air tools, the Group will proactively shift to the production of higher end products, develop more high quality and medium to higher end power tools, air tools and professional tools so as to enhance economic benefits. In order to comply with the new product quality standards laid down by the European Union, the Group has purchased new equipment from abroad for conducting specific tests on RoHS while strengthening staff training in such aspect. In future, the Group will strengthen corporate governance and implement stringent cost control while consolidating its market position. Leveraging on its diversified product portfolio, strong research and development capabilities, worldwide brand reputation and extensive sales network, Wang Sing International is set to become a leading power tools and air tools manufacturer in the PRC.