

# Management Discussion and Analysis



## OVERVIEW

We are one of the leading manufacturers focusing on the design and production of miniature acoustic components, which are used in mobile phone handsets, MP3 players and other consumer handheld devices. We believe our research, product development and engineering capabilities, combined with our vertical integration model, have continued to enable us to work with our customers on advanced miniature acoustic components that can meet their requirements for performance, quality and cost.

For the year ended 31st December, 2005, the Group recorded sales of RMB1,073.7 million, representing a 71.3% growth over the same period in 2004, and recorded net profit of RMB332.9 million, representing a 68.4% growth over the same period in 2004.

## MARKET REVIEW

The year of 2005 saw another year of growth for most of our key end markets, especially the global handset industry. Due to the increased popularity of MP3 players among consumers, leading handset OEMs have increasingly incorporated digital music capability in their handsets. Moreover, leading handset OEMs have introduced more models of smaller and thinner phones to the market, and increasingly adopted SMD in their production. As a leading acoustic manufacturer for the global handset industry, the Group was benefiting not only from the unit growth in the global handset industry but also from the above trends towards smaller and thinner phones and SMD.

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For the year of 2005, our customers primarily consisted of various participants in the mobile phone handset industry value chain (such as module suppliers, design houses, EMS providers, ODMs and OEMs), as well as OEMs in the consumer electronics and other industries. We were able to increase our sales to most of our key handset customers, especially for racetrack speakers and receivers as well as our newly introduced speaker modules.

## FINANCIAL REVIEW

Turnover of the Group for the year ended 31st December, 2005 was RMB1,073.7 million, representing an increase of 71.3% from RMB626.8 million for the previous year. Gross profit was RMB527.7 million, representing an increase of 69.6% from RMB311.1 million for the previous year. Net profit was RMB332.9 million, representing an increase of 68.4% from RMB197.7 million for the previous year. Basic earnings per share was RMB31.05 cents, representing an increase of 50.1% from RMB20.68 cents for the previous year.

## GEARING RATIO

The gearing ratio of the Group, computed by dividing the aggregate of short-term bank loans, dividends payable and non-current liabilities by the total assets, as at 31st December, 2005 was 0.8% compared to 49.2% as at 31st December, 2004.

## INDEBTEDNESS

As at 31st December, 2005, the Group had RMB15.0 million short-term bank loans. Redeemable convertible preferred shares in the value of RMB219.8 million as at 31st December, 2004 were fully converted into ordinary shares of the Company during the year of 2005.

## CONTINGENT LIABILITIES

As at 31st December, 2005, the Group had no material contingent liabilities.

## LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

As at 31st December, 2005, the Group had RMB939.0 million in cash and cash equivalents. In addition, the Group had restricted short-term bank deposits of RMB18.8 million. The Group had no long-term debt as at 31st December, 2005. The management believes the Group's current cash and cash equivalents, together with available credit facilities and expected cash flow from operations, will be sufficient to satisfy the current need of the Group for capital.

## FOREIGN EXCHANGE

Majority of the Group's sales, purchases and operating expenses were denominated in RMB, U.S. dollars, Japanese yen, Hong Kong dollars and Euros. The Board believes that the Group has been and will continue to be exposed to foreign currency exchange risk but they do not expect future currency

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fluctuations to have a material impact on the Group's operations. The Group does not have a formal hedging policy and no instrument has been applied for hedging purposes during the year ended 31st December, 2005.

## **CHARGES ON GROUP ASSETS**

As at 31st December, 2005, none of the Group's assets was charged to any financial institution.

## **MATERIAL ACQUISITIONS OR DISPOSALS OF SUBSIDIARIES AND ASSOCIATED COMPANIES**

Other than the Group Reorganisation as described in the prospectus of the Company dated 28th July, 2005 (the "Prospectus"), the Group had no material acquisitions and disposals during the year ended 31st December, 2005.

## **FUTURE PLANS FOR MATERIAL INVESTMENTS**

During the year ended 31st December, 2005, the Group has not made any material investments other than those set out in Appendix V of the Prospectus. The future plan for investments of the Group has been disclosed in the Prospectus.

## **EMPLOYEE INFORMATION**

As at 31st December, 2005, the Group employed 7,675 permanent employees. Employees of the Group are remunerated based on their individual performance, professional qualifications, experience in the industry and relevant market trends. The management regularly reviews the Group's remuneration policy and appraises the work performance of its staff.

Employee remuneration includes salaries, allowances, social insurance or mandatory pension fund. As required by the relevant regulations in the People's Republic of China ("PRC" or "China"), the Group participated in the social insurance schemes operated by the relevant local government authorities. The Group also participated in the mandatory pension fund and social insurance schemes for its employees in Hong Kong, the United States of America ("USA") and Europe.

## **PROSPECTS**

With the increased demand for miniaturation and digital music capability in mobile phone handsets and portable consumer electronic products, more and more new handset models are expected to be introduced incorporating more value added acoustic features, which will drive the growth of our products. In addition to handset OEMs, handset ODMs are expected to increasingly use our racetrack speakers and receivers, which will further increase the sales of our racetrack speakers and receivers. Moreover, we will introduce more acoustic products to the market to meet the demand of our customers, which will include SMD and MEMS microphones, SMD receivers, linear and SMD vibrators, stereo headsets and speaker modules with more integrated functions.

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## DIVIDENDS

The form, frequency and amount of future dividends on the shares of the Company will depend on the Group’s earnings and financial position, results of operations, capital needs, plans for expansion and other factors as the Board may deem appropriate. The Board may recommend the amount of dividends to be declared and the declaration and payments of dividends will be determined by the shareholders in general meeting. The amount of dividends to be declared shall not be in excess of the amount recommended by the Board.

## DEFINITIONS

“EMS”	Electronic Manufacturing Services
“MEMS microphone”	Micro Electro Mechanical Systems (“MEMS”) microphones are compact, light weight and based on MEMS technology. MEMS is based on semiconductor technology which uses silicon to create pathways for electricity within components
“ODM”	Original Design Manufacturer, a company that both designs and manufactures a product for its customers
“OEM”	Original Equipment Manufacturer, the original manufacturer and their designated contract manufacturers
“SMD”	Surface Mount Device which is readily fed into a SMT production line
“SMT”	Surface Mount Technology