

Management Discussion and Analysis

*New technologies, new products and new
sales and marketing strategies*



Management Discussion and Analysis

FINANCIAL REVIEW

OVERALL FINANCIAL RESULT

For the year ended 31 December 2005, the Group recorded a significant growth in turnover of approximately 72% and reached a historically high amount of HK\$1,066.2 million comparing with HK\$618.4 million in 2004. The gross profit increased substantially from HK\$61.9 million in 2004 to HK\$95.6 million in 2005 while the overall gross profit margin dropped from 10.0% to 9.0%. The net profit attributable to equity holders of the parent company increased by 78% from HK\$8.6 million in 2004 to HK\$15.2 million in 2005. Earnings per share increased to HK3.80 cents from HK2.47 cents in 2004.

TURNOVER

The significant growth in turnover during the Year was mainly due to the fact that the Group has successfully launched the traditional cathode ray tube ("CRT") chassis into the new market in South America and the good performance obtained in the original markets such as Mainland China, Asia (other than Mainland China), and Europe. Additionally, the Group commenced the sales of LCD chassis upon the maturity of our LCD technologies in 2005 and it represents a milestone in the business history of our Group. The Group's LCD products were firstly introduced into the European markets such as Italy and Germany and obtained satisfactory responses from those two markets. Approximately 5% of total sales of the Group were generated by the sales of LCD chassis. Owing to the success of our LCD products in the European

markets, we are going to launch the LCD products in all existing markets in the coming year.



(From the left) Kazunori Watanabe (Executive Director and Chief Operating Officer), Zhang Shuyang (Chairman) and Tung Chi Wai, Terrence (Executive Director and Chief Marketing Officer).

GROSS PROFIT MARGIN

The gross profit margin decreased to 9.0% in 2005 from 10.0% in 2004. During the Year, the average unit selling price of CRT chassis decreased by approximately 6% due to general price pressure in the home appliance electronics market. However, the Group has successfully offset most of the aforesaid impact by obtaining better purchase costs with our increased sales scale and with the great support of our suppliers globally. As the result, the overall gross profit margin dropped by 1%.



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In the coming years, the Group expects to maintain a growth of CRT business with a stable gross profit margin and to expand the LCD business considering our success in Europe. With the scale of the Group's CRT business globally, the Group can maintain a strong negotiation power, strong global sourcing for electronic components and good purchase terms with vendors. With the competitive advantages, the Group can supply our LCD products at very competitive prices while maintaining much higher gross profit margin than traditional CRT products. The Group is going to change the sales strategy with more focus on high margin products such as LCD TV so as to increase the overall gross profit margin in the coming years.

EXPENSES

The Group's selling and distribution costs increased from HK\$7.8 million in 2004 to HK\$12.9 million in 2005. Such increase is in line with the increase in turnover. The administrative costs increased from HK\$32.3 million in 2004 to HK\$49.5 million in 2005 mainly because of the increase in staff costs and the depreciation expense on property, plant and equipment.

In 2005, more professional and experienced staff and executives joined the Group in order to improve the management quality and facilitate the Group's business development. Management of the Group believes that investment in human resources will be beneficial to the Group in the long term. At the same time, the Group is trying to strengthen the cost control by conducting monthly cost review for various business units of the Group. As most of the administrative expenses of the Group are fixed in nature, the cost efficiency is going to improve while the sales volume of the Group increased.

Moreover, in order to prepare for the growth in LCD business, the Group has acquired more plant and machinery and completed a new logistic center in Shanghai at the second half of 2005. The acquisition has increased the overall depreciation of the Group in 2005 by approximately HK\$3.2 million when compared with 2004.

In 2005, other operating expenses of the Group decreased to HK\$8.8 million from HK\$12.8 million incurred in 2004 mainly due to the decrease in the legal expenses incurred for the litigation involving East Kit Industries Limited and East Kit Electronic Manufacturing Co. Ltd.

The finance costs increased generally in line with the increase of bank borrowings in 2005.



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FINANCIAL CONDITION AND LIQUIDITY

As at 31 December 2005, the shareholders' interests were HK\$201.3 million (2004: HK\$183.9 million). The current assets amounted to HK\$760.7 million (2004: HK\$463.5 million), of which the Group's cash and cash equivalents were HK\$136.3 million (2004: HK\$53.3 million). The current ratio was 1.04 (2004: 1.18).

As at 31 December 2005, the Group's bank borrowings amounted to HK\$116.9 million (2004: HK\$65.0 million), and the gearing ratio increased to 12.5% from 11.3% when compared with 2004.

Trade receivables increased from HK\$214.8 million as at 31 December 2004 to HK\$412.8 million as at 31 December 2005. Provision of HK\$2.2 million has been made against those doubtful debts during the Year.

The core business of the Group is transacted in RMB and US dollars, which also are the currencies in which it holds most of its cash and bank balances. As at 31 December 2005, the Group did not use any derivative instruments to hedge against any foreign exchange risk, which the Group did not consider to be material.

CAPITAL EXPENDITURE

The Group's total capital expenditure on property, plant and equipment during the year amounted to HK\$52.2 million (2004: HK\$40.6 million). Additionally, the Group paid a deposit of HK\$15.4 million for the acquisition of an equity investment in Mainland China.

BUSINESS REVIEW

INDUSTRY OVERVIEW

The global CTV market continues to grow, and demands for CTV throughout the world are on an upward trend, in particular, the growth in demand for LCD TV. Being affected by LCD products, the demand for CRT TV of developed countries and regions is reducing. However, with its own competitive cost advantage, as well as under gradual downward adjustment of its price, demand for CRT TV products remains strong in markets such as Central America, South America and Middle East.

In recent years, TV models were developing in the direction of high definition, large screen, flat and slim. The high-end CTV market was growing rapidly, and LCD TV and Plasma TV were becoming popular among consumers. Demands in overseas markets came from affluent consumer base of developed countries, including Europe, the United States and Japan, and developing countries. Due to intense price-wars of high-end CTV, the price of LCD plummeted, which resulted in an increasing demand for LCD TV. In response, LCD manufacturers also accelerated their pace to increase their output in order to meet market demands. According to the statistical data of DisplayBank, a renowned consultancy firm, in 2005, the output of flat TV was 31.70 million sets, of which 20.70 million sets were LCD TV. It is estimated that the output of flat TV by 2008 will reach 97.30 million sets, of which 72.80 million sets will be LCD TV. LCD TV will be growing at an annual growth rate of 35%, and it is expected that the output of LCD TV will reach 92.80 million sets by 2010. International well-known CTV producers are optimistic about the prospects and are continuing to invest significantly in the research, development and production of such business. Such environment will encourage the TV microelectronics industry and the development of all TV products. Consequently, they will bring tremendous development potentials to the Company.



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In the previous year, the CTV industry experienced hard times, which was attributable to the factors including a significant cost increase of raw materials such as copper, aluminum and plastic, appreciation of RMB, a price reduction of panel and the downward trend of prices in the end markets. At the same time, CTV enterprises in the PRC faced increasing difficulties in export due to the continuing control of standards by the European and American countries with respect to the CTV products made in the PRC. Fortunately, by leveraging in the strength of "No Brand Solution" and its sharp industrial insights in the market, the Group is positioned to keep informed of the various policies and take initiatives to meet future challenges.

Furthermore, pursuant to the directive of RoHS enacted by the European Union, with effect from 1 July 2006, the European Community restricts the use of six types of hazardous substances in electronic and electrical equipments in its member states. For this purpose, the Group set up an environmental components working team in June 2005, and has implemented the process flow of environmental components, set up conditions for qualified environmental suppliers, ascertained the limitation on using the six hazardous substances, requested the signing of papers in relation to commitment on environmental components by suppliers, etc. Currently, the Group has the capability to accept orders placed by customers for environmental CRT and LCD products, and is standing in the leading position amongst players in this industry. The working team will continue to keep abreast of the latest developments relating to environmental protection requirements in all the regions and countries throughout the world. The Group will develop and cultivate new environmental suppliers and continue to enhance its understanding of the relevant regulations and make constructive recommendations to each department for improvement. This will help the Group prepare itself for breaking all the barriers so that its products can be introduced into the markets successfully.

CRT PRODUCTS

The CRT TV products provided by the Group can be divided, in terms of category, into standard analogue CTV and progress scanning HDTV. The screen size of standard analogue CTV has 14", 15", 21", 25", 28"(16:9), 29", 32"(16:9) and 34", whereas the screen size of HDTV is larger than 28". The system and functions of all products meet the requirements of the countries and regions throughout the world.

LCD PRODUCTS

To cater for market demands, the Group has successfully developed and produced diversified LCD TV products during the year. Currently, the Group provides 8 models of LCD TV products with mini screens of 15" and 17", 3 systems and 3 function options; 9 models of 20" mini screen, 5 systems and 2 DVD function options; 12 models of 26" or above large screen, 4 systems, 3 chassises and 4 function options, for exports to Europe, North America, South America, Australia and the PRC, etc. The Group will continue to strive to develop new models of LCD TV, and actively expand its share in LCD TV market.



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OUTLOOK

Based on the present development trend of global video products market and the rapid growth in the number of flat products, it is possible that the number of CRT products will be exceeded by that products in years. However, demands for CRT products in the Central and South America and Middle East markets remain strong. Accordingly, the Group will strengthen and expand its sales of CRT products and enhance its turnover and maintain the profitability of CRT products by increasing sales volume. In respect of its LCD products, its markets are mainly located in the developed countries and regions such as Europe, the United States and Japan. The Group will rapidly expand its sales coverage to achieve a growth in turnover for LCD products and make them a new growing point of profits. In the future, the Group will invest more resources in digital and flat products, and develop standard and modular design of flat products, so as to adapt to different panels and cases. In the future, sales of CRT products will be mainly in the form of CKD and complemented by SKD/CBU format. In respect of LCD products, supplies will be mainly in the form of SKD, and complemented by CBU format.

In the meantime, the Group will reinforce its sales and marketing strategies. At the end of 2005, a marketing department was established to focus on new customers, new markets and new products. The marketing department will be mainly dedicated to exploring for new customers and entering into partnership with domestic and overseas leading brand manufacturers, exploring domestic and overseas markets, trying new cooperation models, understanding market needs, identifying the requirements of customers in respect of products, design and price, providing feedback to the research and development department on a timely basis, and launching new products catering customers' needs under the coordination with the research and development department. Additionally, the marketing department is responsible for the sales and marketing of products other than TV such as automotive electronics. With a view to enhancing the Group's market position and the competitiveness of the Group and exploring potential markets, the Group will continue to work on the planning and organising of and participating in world-renowned international electronics expositions.

The Group remains cautiously optimistic about the prospects of markets and operations for the coming year, and it is also well-prepared for any possible challenges. The Group will continue to be dedicated to business expansion by capitalising on its own advantages and pursuing its "No Brand Solution" approach through proactive attitude and to achieving its goal of maximising profitability.