# Management Discussion and Analysis

## BUSINESS REVIEW

After riding the difficult operating period in last year, the Group experienced a fast-growing stage in current year. Thanks to the huge customers' demand for High Density Inter-connect ("HDI") printed circuit board ("PCB") and the Group's timely investment in a series of sophisticated machines to cope with the foreseeable increase in sales orders for HDI PCB, the Group's revenue, net profit and earnings per share for the current year together with the net assets at current year end were all at record high.

The Group's revenue for the current year exceeded last year by about HK$365 million or 141%. It was a great leap forward resulting mainly from the fact that the Group has become an approved vendor in the provision of HDI PCB to its world-renowned telecommunication products customers from December 2004 onwards after passing through these customers' lengthy and stringent approval process. The sales value of HDI PCB for the current year and the last year were about HK$405 million and HK$96 million respectively, which represented about 65% and 37% respectively on the Group's revenue.

HDI PCB has become the main stream of PCB used for mobile phones nowadays. It normally means those PCB with hole diameter less than 0.15mm, hole circumference less than 0.25mm, connecting density over 130 connecting points per square inch or line density over 117 inches per square inch. Due to the requirement for heavy investment in sophisticated machines and the various technical difficulties confronted during production, there are not many PCB manufacturers who are capable of manufacturing high quality HDI PCB with large volume and short delivery time. Accordingly, the selling price and the profit margin for HDI PCB are generally higher than those for normal multi-layer PCB. The Group has a competitive edge in the manufacturing of HDI PCB partly because it can directly obtain strong technical support from Daisho Denshi Co., Ltd. who is not only one of the Company's substantial shareholders but also one of the top manufacturers of highly delicate PCB in Japan.

The Group's gross profit percentage has improved significantly from about 13% for the last year to about 45% for the current year. The poor profit margin for the last year was primarily attributable to the sharp increase in the purchase prices of certain major raw material items such as copper foil and laminate etc. together with the Group's strategic postponement of selling price increase. On the contrary, the appealing profit margin for the current year was mainly due to more sales of HDI PCB with higher profit margin as mentioned above together with the benefits derived from economy of scale such as volume discount on bulk purchase of raw materials and lower average fixed costs per unit.

Apart from the provision of routine sales support services to the customers, the Group's European sales offices are also responsible for gathering relevant customer and market information regularly together with providing constructive advice to the Board for strategic planning. In fact, the Group's overseas sales offices help generating 82% and 62% of the Group's revenue for the current year and the last year respectively. Although the selling and distribution costs (mainly related to the Group's overseas sales offices) increased substantially from about 9% on the Group's revenue for the last year to about 18% on the Group's revenue for the current year, they were fully justified because the Group's overseas sales offices were indispensable to the record results of the Group for the current year.

## FINANCIAL REVIEW

In order to ensure the timely availability of the necessary machines to cope with the huge customers' demand for HDI PCB, the Group ordered the purchase of plant and equipment amounting to about HK$228 million during the current year. Up to the current year end, the amounts of the machines received which were financed out of the Group's internal resources and the external finance lease facilities were about HK$87 million and HK$44 million respectively. Out of about HK$79 million worth of machines which were received after the current year end, the Group had paid deposits of about HK$19 million during the current year. Shortly after the current year end, the Group was granted further external finance lease facilities and bank loan facility amounting to about HK$51 million and HK$30 million respectively, which were used mainly for settling the capital commitments at the current year end on the purchase of plant and equipment.

As at 31 March 2006, the Group's interest-bearing bank and other borrowings amounting to HK$66,425,000 (31 March 2005: HK$52,238,000) out of which HK$32,208,000 (31 March 2005: HK$36,604,000) were repayable within the next 12 months. These borrowings were all denominated in either Hong Kong dollars ("HK$") or United States dollars ("US$"), originally repayable monthly over 3 years (except for the bank borrowings totaling HK$4,501,000 (31 March 2005: HK$24,414,000) which were originally repayable within 3 months) and subjected to floating interest rates for about 79% (31 March 2005: 86%) of them. The Group has not adopted any interest rate hedging tool for these borrowings. Certain machinery and equipment of the Group with a net book value at 31 March 2006 of HK$70,089,000 (31 March 2005: HK$28,484,000) were pledged to secure these borrowings.

The Group's gearing ratios (defined as the ratio of interest-bearing bank and other borrowings to total equity) at 31 March 2006 and 31 March 2005 were 0.28 times and 0.42 times respectively while the Group's current ratios at 31 March 2006 and 31 March 2005 were 1.05 times and 1.04 times respectively. Although the Group's PCB operations generated net cash inflow of about HK$177 million during the current year, these financial ratios had not improved substantially mainly because of the payment for the purchase of machines during the current year as mentioned above.

The Group's assets or liabilities were mostly denominated in either HK$, US$ or Renminbi ("RMB"). Because the exchange rate for US$ against HK$ is relatively stable in Hong Kong for the moment, the Group does not expect any significant exchange difference relating to its assets or liabilities denominated in US$. Since the Group's subsidiary in Mainland China has net assets and RMB is likely to appreciate in the future, there is only remote possibility that the Group will suffer exchange loss on translation of these net assets. Hence, the Group's negative exposure to fluctuation in exchange rates for US$ and RMB is insignificant and therefore the Group has not adopted any foreign currency hedging tool.

## EMPLOYEE BENEFITS

As at 31 March 2006, the Group had 2,001 (31 March 2005: 1,169) employees, including directors, working mainly in Mainland China. For the year ended 31 March 2006, the Group's total staff costs including directors' remuneration were HK$39,197,000 (2005: HK$24,667,000).

According to the Group's staff remuneration policy, the remuneration of an employee and the Company's director is determined by the Board and the Company's Remuneration Committee respectively from time to time with reference to his performance and duties, the performance and profitability of his employer and the prevailing market conditions.

The Company operates a share option scheme (the "Scheme") for the purpose of encouraging the eligible participants to perform their best in achieving the goals of the Company and at the same time allowing the eligible participants to enjoy the results of the Company attained through their effort and contribution. Eligible participants of the Scheme include (i) any full-time employees of the Company or any of its subsidiaries or associated companies; (ii) any directors (whether executive directors, non-executive directors or independent non-executive directors) of the Company or any of its subsidiaries or associated companies; and (iii) any consultants, technical, financial, legal or other professional advisers engaged by the Company or any of its subsidiaries or associated companies, provided that the Company's board of directors or a duly authorised committee may have absolute discretion to determine whether one falls within the categories. The Scheme became effective on 28 August 2003 and, unless otherwise cancelled or amended, will remain in force for 10 years from that date.

## OUTLOOK

Dr. Hayao Nakahara (a world-renowned expert in PCB industry) in his article – "Worldwide PCB output for 2005" as published in the July 2006 issue of "Printed Circuit Design & Manufacture" magazine estimated that the global PCB output for 2005 was US$42.5 billion of which more than 80% was manufactured in Asia Pacific countries. In 2005, Japan ranked number 1 with PCB output of US$10.45 billion and Mainland China ranked number 2 with PCB output of US$10.06 billion. He further estimated that the PCB capacity growth rate in Mainland China with about 20% per annum in the next few years would be the highest in the world and Mainland China would become the top PCB output country from 2006 onwards.

Undoubtedly, Mainland China has become a major PCB production base in the world and gradual shifting of PCB orders from other countries to the PCB manufacturers in Mainland China is expected. Besides, Mainland China has also become the top mobile phone users country. It is expected that the third generation ("3G") telecommunication service providers will soon obtain the licence to operate in Mainland China and there will be a huge demand for 3G mobile phones, which in turn will stimulate the demand for HDI PCB.

## OUTLOOK *(Continued)*

The Group can definitely benefit when the above expectations come up because the Group enjoys certain competitive advantages at present. Firstly, the Group's PCB factories in Mainland China are equipped with sophisticated machines well suited for the manufacture of HDI PCB. Secondly, the Group has a strong technical support in the production of delicate PCB through the alliance with Daisho Denshi Co., Ltd. who is one of the top manufacturers of highly delicate PCB in Japan. Thirdly, the Group has a strong customer base with many world-renowned customers who are willing to pay a premium for high quality PCB and with whom the Group has long term business relationship.

Although the Group's PCB production capacity fell short of the customers' demand during the first quarter of the financial year ending 31 March 2007, the growth momentum for the Group's revenue persists in the same period with a growth rate of about 30% as compared to the fourth quarter of current year. In light of the huge customers' demand for HDI PCB and other valid reasons, the Board is currently exploring various scenarios in enhancing the Group's PCB production capacity and capability. However attractive a scenario seems, the Board will be extremely cautious not to under-estimate any business risks and financial risks involved.

Although the year ahead looks promising, the Board is wary of the challenging factors that could adversely affect the Group.

First of all, the Group could exert no influence to any mismatch in the worldwide demand and supply of non-ferrous metals used in the manufacture of major raw material items for PCB production. It is noteworthy that the purchase prices of gold and copper etc. have once reached their record high during the year 2005 due to their huge demand in excess of their supply. If there is any such mismatch which will drive up the purchase prices of major raw material items steeply and the Group cannot shift the burden wholly to the customers, the Group will suffer because the cost of raw material is still a significant component of the Group's cost of sales.

Besides, the Group is currently quite heavily relying on its telecommunication products customers from whom about 74% of the Group's revenue for the current year was generated. Although the business of these customers is still quite robust for the moment, there is no guarantee that the same will apply in next year. In light of this, the Board intends to broaden the customer base of the Group gradually so as to alleviate the impact which may result from relying too much on a particular type of customer.

The PCB manufacturing technology is ever changing and the PCB manufacturers must continuously invest in modern machinery and equipment in order to meet the customers' ever changing requirement. The Group ordered for the purchase of plant and equipment amounting to about HK$228 million during the current year. If the machinery and equipment bought by the Group become obsolete due to the customers' new requirements, the Group will be required to dispose of them or write them off.

## OUTLOOK *(Continued)*

The petroleum price has remained at a fairly high level during the year 2006. The interest rates for US$ and HK$ are expected to maintain at a high level for the year 2006. The RMB is likely to appreciate in the near future. Although these economic events may not increase the operating costs of the Group to a great extent, they may hinder the growth of the world economy and the business of the Group may be adversely affected accordingly.

In spite of the above concern, the Board is optimistic about the results of the Group in the year ahead barring any unforeseen circumstance.