

FINANCIAL REVIEW

The Company was listed on the Stock Exchange on 15 December 2006, achieving a remarkable milestone in the Group's development. The response to its global offering was encouraging. The international offering was significantly oversubscribed whilst the Hong Kong public offering was oversubscribed more than 47 times.

The Group reported impressive results for the 2006 financial year. Turnover grew moderately while net profit grew significantly. For the year ended 31 December 2006, the turnover of the Group reached HK\$1.26 billion, an increase of 29.6%. Net profit increased remarkably by 81.7% to a record HK\$260.7 million. Basic earnings per share was HK\$0.43, representing an increase of 79.2% as compared with HK\$0.24 in 2005.

These encouraging results in 2006 were mainly attributable to continued favourable sales of the Group's LED decorative lighting products and entertainment lighting products. Effective cost and operational expense control also contributed to the rise in profit.

TURNOVER

Incandescent-based decorative lighting products

The sales revenue of incandescent-based decorative lighting products decreased from HK\$538.9 million to HK\$482.8 million. The era of the replacement of incandescent-based decorative lighting products by LED-based decorative lighting products has begun. We expect this trend will carry on in the next few years.

LED-based decorative lighting products

The sales revenue of LED-based decorative lighting products grew significantly from HK\$230.5 million in 2005 to HK\$497.0 million, an increase of 115.6%. The revenue of one of our patented products, the LEDNEON-FLEX, increased by 182.5% from 2005 to 2006. After more than three years of application, recently, an invention patent has been granted by the PRC government for the LEDNEON-FLEX in which we had already obtained patent approval in US and several Asian and European countries in prior years.

Entertainment lighting products

The sales revenue of entertainment lighting products increased from HK\$169.2 million in 2005 to HK\$232.2 million, an increase of 37.2%. The growth of the entertainment lighting business is in line with our expectation.

COST OF SALES

The Group's total cost of sales increased from HK\$632.2 million in 2005 to HK\$758.7 million in 2006. The increase was in line with the increase in sales revenue. Cost of sales represented 60.3% of the Group's total turnover in 2006, which decreased 4.8% compared to 65.1% in 2005. In 2006, the cost of copper increased dramatically which to certain extent affected our sales performance. The cost of LED chips declined in 2006 which is a general phenomenon in the industry. We expect this cost decreasing trend for the LED chips will continue in the next few years.

GROSS PROFIT AND GROSS PROFIT MARGIN

The Group's gross profit increased by 47.5% from HK\$339.1 million in 2005 to HK\$500.1 million in 2006 as a result of the increase in sales during the year.

The Group's overall gross profit margin increased 13.8% from 34.9% in 2005 to 39.7% in 2006. This was mainly due to the reason that the LED-based decorative lighting products, which carry a relatively higher gross profit margin than other lighting products, increased 115.6% from 2005 to 2006. However, increases in sales revenue of the entertainment products, which have a lower gross profit margin during the year, partly offset the increase in the overall margin.

OPERATING EXPENSES

Operating expenses include distribution expenses and administrative expenses. For the year ended 31 December 2006, the Group's operating expenses were HK\$290.4 million, an increase of 47.6%, compared to HK\$196.7 million in 2005. The increase was mainly attributable to the growth in production volumes, the administrative costs associated with the listing exercise, and an increase in professional costs. Operating expenses accounted for 23.1% of the Group's turnover for the year, up 2.8 percentage points as compared with 20.3% in 2005. The change was mainly due to the one-off listing expenses and professional fees in 2006.

NET FINANCING COST

For the year ended 31 December 2006, the Group's net financing cost was HK\$8.9 million, an increase of 50.8% compared with HK\$5.9 million in 2005, which was mainly attributable to the increase of interest expense as a result of more amount of bank loans drawn during the year.

NET PROFIT

For the year ended 31 December 2006, the Group's net profit was HK\$260.7 million, an increase of 81.7% compared with HK\$143.5 million in 2005. The increase was mainly attributable to the substantial increase in sales and the Group's success in controlling costs and overhead expenses. The net profit margin was 20.7%, an increase of 39.9% compared with 14.8% in 2005.

FINANCIAL RESOURCES AND LIQUIDITY

The Company listed on the Stock Exchange on 15 December 2006. A total of 160,000,000 shares of nominal value of HK\$0.1 each were issued at a price of HK\$6.90. The net proceeds from the initial public offering ("IPO") were HK\$1.06 billion.

The Group's major liquidity and capital resources are the cash inflow from operating activities and the proceeds from the IPO. Net cash from operating activities during the year was HK\$15.7 million, a decrease of HK\$175.3 million compared to HK\$191.0 million in 2005. Cash and cash equivalents as of 31 December 2006 was HK\$1,158.2 million.

ASSETS AND LIABILITIES

As of 31 December 2006, the Group's total assets were HK\$2,443.4 million, an increase of HK\$1,299.8 million compared with HK\$1,143.6 million as of 31 December 2005. The main reason for the increase was due to the net proceeds from the IPO of HK\$1.06 billion.

The Group's total liabilities as of 31 December 2006 were HK\$419.4 million, an increase of HK\$87.6 million compared to that as of 31 December 2005. The main reason for the increase in total liabilities was due to increased bank borrowings in 2006.

As of 31 December 2006, the Group's outstanding bank loans amounted to HK\$177.9 million, an increase of HK\$53.7 million compared with HK\$124.2 million as of 31 December 2005.

The Group's shareholders' equity as of 31 December 2006 was HK\$2,024.0 million, an increase of HK\$1,212.2 million compared with HK\$811.8 million as of 31 December 2005. The increase was mainly due to the net proceeds from the IPO and the net profit for the year.

As of 31 December 2006, the Group's cash and cash equivalents amounted to HK\$1,158.2 million, an increase of HK\$864.4 million compared with HK\$293.8 million as of 31 December 2005. The increase mainly represents the net proceeds from the IPO and the cash generated from operations during the year.

The Group's gearing ratio decreased substantially to 8.8% as of 31 December 2006 compared with 15.3% as of 31 December 2005 as a result of the increase in capital after the listing.

TAXATION

Taxation of the Group for the year ended 31 December 2006 was HK\$5.03 million. The effective tax rate was 1.9% which was lower than 5.8% rate in 2005. Our LED-based decorative and entertainment lighting products required the input and contribution from research and development as well as distribution and marketing functions. The Group's (i) research and development and (ii) distribution and marketing functions, among other things, have contributed to our success. To enhance the efficiency of these functions and preserve the value and contribution of these functions to the Group, it was desirable that they together with the related risks and uncertainties of the markets be undertaken by companies in the Group, which are separated from the manufacturing operations. As it is not mandatory for relevant companies in the Group undertaking such activities to be incorporated in the PRC or Hong Kong, they were legally set up in overseas jurisdictions. While operating in the PRC/Macau as non-resident enterprises, they have been taxed according to the relevant regulation of these jurisdictions, where appropriate. The relevant intra-group transactions were carried out on the above-mentioned basis.

FOREIGN EXCHANGE RISK

The Group's sales were mainly denominated in United States Dollars, no significant currency risk exposure was expected in this respect. The Group currently does not have a foreign currency hedging policy in respect of foreign currency debt. However, management monitors the related foreign currency exposure closely and will consider hedging significant foreign currency exposure should the need arise.

PLEDGE OF ASSETS

As of 31 December 2006, the Group pledged its bank deposits of HK\$2.0 million (2005: HK\$16.1 million), investment properties of HK\$17.4 million (2005: HK\$17.4 million) and building of HK\$27.1 million (2005: HK\$25.8 million) to secure credit facilities granted by certain banks to the Group.

CONTINGENT LIABILITIES

The Group had no contingent liabilities as of 31 December 2006.

BUSINESS REVIEW**Production Facilities and Production Capacity**

In 2006, the Group's LED light bulbs capacity expansion progressed smoothly: Monthly capacity reached 100 million LED light bulbs at the end of the year compared with 30 million LED light bulbs at the end of 2005.

The production capacity of our incandescent light bulb will continue to maintain a moderate utilization rate. The Group will not invest new resources in the incandescent lighting products business in the near future.

The new LED production plant with a gross floor area of 60,000 sq.m. will commence production in early April 2007. We expect that as a result of our expansion plan, by the end of the third quarter of 2007, our production capacity of LED-based light bulbs will increase to 200 million per month.

In 2006, the Group continued to expand the LED-based decorative lighting products market and the entertainment lighting market of which impressive results were achieved during the year.

Quality Control

Product quality has always been the most important objective for the Group since its establishment. The Group implemented strict quality controls throughout the entire processes of procurement, production, sales and logistics. Our standards and compliance department is responsible for obtaining certifications for our products with certification agencies, some of which are country specific. Our products have to comply with the standards of the country in which our customers conduct business. We ensure full compliance with the required standards in the manufacturing and sales process for our products.

Sales and Distribution

As of 31 December 2006, the Group had a sales team of 390 staff. We believe that the demand for LED-based decorative lighting products will continue to increase and that the LED-based decorative lighting market has already surpassed the incandescent-based decorative lighting market in 2006. Our sales effort in 2006 was aimed to strengthen our current market position in LED-based decorative lighting to capture the growth opportunities.

RESEARCH & DEVELOPMENT

Our research and development capabilities are important in maintaining our position as one of the world's leading manufacturers in the decorative lighting industry. Our research and development efforts focus on product design, new product development and improving production efficiency of our products to reduce overall manufacturing costs. In 2006, we allocated significant resources in the research and development of LED-based illumination lighting application technology and products. We believe there is a huge market potential in the LED-based illumination lighting market and that LED-based lighting will replace traditional lighting such as incandescent lighting and fluorescent lighting in the future.

HUMAN RESOURCES

The basic remunerations of the employees are determined with reference to the industry remuneration benchmark, the employees' experience and their performance. Salaries of employees are maintained at a competitive level and are reviewed annually, with close reference to the relevant labour market and economic situation. Directors' remuneration is determined based on a variety of factors such as market conditions and responsibilities assumed by each director. Apart from the basic remuneration and statutory benefits required by laws, the Group also provides discretionary bonuses based upon the Group's results and the individual performance of the staff.

The Group has not experienced any significant problems with its employees or disruption to its operations due to labour disputes nor has it experienced any difficulty in the recruitment and retention of experienced staff. The Group maintains a good relationship with its employees. Most members of senior management have been working for the Group for more than 10 years.

The Group also adopts an employee share option scheme at the time of IPO.

FUTURE PLANS AND PROSPECTS

The global rising concerns about energy savings will create more business opportunities for the Group. The EU established “Rainbow project” to propel the use of LED. Recently, both Australia and EU government announced plans to ban the use of incandescent lights, which will benefit our business in the long run.

With respect to our patented products, the Group will optimize product structure, focusing on product innovation and sales of high-margin products to maximize economies of scale and lower production cost in order to further raise overall profitability.

In view of promising sales prospects and growing market demand, Neo-Neon plans to rapidly expand its production capacity, especially the production of LED light bulbs in order to satisfy the market demands.

As we plan to penetrate the illumination lighting market in 2007, the Group intends to build an international brand for our lighting products in the long run.

Attracting and retaining top management and executive talent is the key for sustaining Neo-Neon's future growth. The Group's existing performance based incentive scheme and employee share option scheme help to achieve this goal. It will also improve overall management quality and business professionalism through on-the-job training and formal training programs. This will help develop team spirit and reinforce a sense of unity and belonging for both management and staff.

Neo-Neon will continue to pursue new business opportunities in the lighting industry. We will carefully look for acquisition opportunities to enhance our technology in order to maintain our leadership in the industry and maximise returns to our shareholders.