

# Management Discussion and Analysis

## OVERVIEW

We are one of the leading manufacturers focusing on the design and production of miniaturize acoustic components, which are used in mobile phone handsets and other consumer handheld devices. We provide a wide range of miniaturize acoustic products, including miniature receivers, polyphonic speakers, multi-function devices, speaker modules, transducers, ECM microphones, headsets and vibrators. We believe that our strong research, product development and engineering capabilities, combined with our vertically-integrated and semi-automated production processes, have continued to enable us to produce advanced miniature acoustic components that can meet our customers' strict requirements for performance, quality and cost.

## MARKET REVIEW

In 2006, we continued to benefit from the increasing demand for advanced miniature acoustic products from our key customers, including leading global handset OEMs. Handset OEMs tend to implant more than one acoustic component into one handset; hence, we were able to grow faster than the overall handset industry in terms of shipment volume. Handset OEMs have also continued to introduce smaller and thinner handsets to the market. We believe that we are well-positioned to continue to benefit from this trend given that our competitive advantage lies in our ability to develop acoustic products that are increasingly smaller in size, but at the same time, of increasingly superior acoustic performance.

Our end customers included various participants within 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 further penetrate into most of our key end customers by increasing shipment of traditional products and obtaining qualification for newer products such as vibrators and stereo headsets. In 2006, shipment for nearly all of our products increased.

## FINANCIAL REVIEW

We experienced our fourth year of double-digit growth in annual revenue and net income. We maintained a strong financial position and generated RMB461.7 million in net cash flows from operations in the year 2006. Turnover of the Company and its subsidiaries (the "Group") for the year ended 31st December, 2006 was RMB1,773.4 million, representing an increase of 65.2% from RMB1,073.7 million for the previous year. Gross profit was RMB871.3 million, representing an increase of 65.1% from RMB527.7 million for the previous year. Profit attributable to equity holders of the Company was RMB570.3 million, representing an increase of 71.3% from RMB332.9 million for the previous year. Basic earnings per share was RMB45.70 cents, representing an increase of 47.2% from RMB31.05 cents for the previous year.

## GEARING RATIO

The gearing ratio of the Group, computed by dividing the short-term bank loans by the total assets, as at 31st December, 2006 was 0.4% compared to 0.8% as at 31st December, 2005.

## INDEBTEDNESS

As at 31st December, 2006, the Group had RMB10.0 million short-term bank loans compared with RMB15.0 million as at 31st December, 2005.

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## **CONTINGENT LIABILITIES**

During the year, the Company and a subsidiary has been named as a defendant in a United States District Court action in respect of an alleged claim of trade secret misappropriation under the Illinois Trade Secrets Act (the “Complaint”). The Complaint seeks injunctive relief and damages in an amount in excess of US\$1,000,000. The Group believes that it has meritorious defenses to the Complaint and thus no provision for any potential liability has been made in the consolidated financial statement.

## **LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE**

As at 31st December, 2006, the Group had RMB989.0 million in cash and cash equivalents. In addition, the Group has restricted short-term bank deposits of RMB27.0 million. The Group had no long-term debt as at 31st December, 2006. 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 Euro. The Board believes that the Group has been and will continue to be exposed to foreign currency exchange risk. The Group does not have a formal hedging policy. Management closely monitors such risks and will consider hedging significant foreign currency exposure should the need arise. During the year, the Group has entered into foreign exchange linked contracts to minimise the effect of exchange rate fluctuations between the RMB and the U.S. dollars.

## **CHARGES ON GROUP ASSETS**

As at 31st December, 2006, none of the Group’s assets was charged to any financial institution.

## **MATERIAL ACQUISITIONS OR DISPOSALS OF SUBSIDIARIES**

The Group had no material acquisitions or disposals of subsidiaries during the year ended 31st December, 2006.

## **FUTURE PLANS FOR MATERIAL INVESTMENTS**

The future plan for investments of the Group will focus on SMD microphones, MEMS microphones, linear vibrators and SMD vibrators.

## **EMPLOYEE INFORMATION**

As at 31st December, 2006, the Group employed 9,921 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 Mainland 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 our employees in Hong Kong, Taiwan, the United States of America (“USA”) and Europe.

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## **PROSPECTS**

The Company went through another year of strong growth. We have further penetrated into existing customers and we will continue to target new customers as well as explore the possibility of applying our products into other consumer electronics devices. We believe that our strong research, product development and engineering expertise is critical to our sustained growth and competitiveness. We have successfully developed new and more advanced acoustic products, and we intend to continue to produce innovative products that can cater to our customers' need for smaller and better quality acoustic products. We strive to maintain our strong revenue growth and at the same time, reduce costs and enhance production efficiency, so that we can generate stable operating margins. We are also committed to enhancing shareholder's returns.

## **DIVIDENDS**

From time to time, the Company will consider its financial position, results of operations, debt repayment ability, capital expenditures, Group's earnings and other factors as the Board may deem appropriate. The Board of Directors ("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. No dividends have been paid or declared by the Company for the year ended 31st December, 2006.

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## DEFINITIONS

“ECM”	Electret Condenser Microphone
“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