Management Discussion and Analysis

FINANCIAL REVIEW

Turnover

During the year ended 31 December 2006, the turnover of the Group has increased significantly by 86.9% to HK$592 million, as compared to HK$317 million for the year 2005. The table below shows the turnover analysis by electronic products, components for electronic products and plastic moulds and plastic components for the two years ended 31 December 2006 and 2005 respectively:

	2006	2005
	HK$'000	*HK$'000*
Sales of electronic products	**465,921**	267,880
Sales of components for electronic products	**75,265**	49,023
Sales of plastic moulds and plastic components	**51,132**	–
	592,318	316,903

The turnover for electronic products has increased by HK$198 million to HK$466 million whereas the turnover for components for electronic products has increased by HK$26 million to HK$75 million. The increases were mainly due to the continued strong growth in demand from customers and the expansion of the customer base. The year 2006 is the first year whereby the results of the Group's 51% owned subsidiary, Southchina Engineering and Manufacturing Limited ("Southchina"), were reflected in the consolidated financial statements as a subsidiary. Southchina is principally engaged in the manufacture of plastic moulds and plastic components. Total sales of plastic moulds and plastic components during the year amounted to HK$51 million.

During the year 2006, the sales of the Group's single major product, irrigation controllers, regained its growth momentum due to the launch of new models and continued increase in demand from the key customer. Sales of irrigation controllers have increased from HK$127 million to HK$245 million. Sales of carbon monoxide detectors and audio equipment have also increased significantly during the year by 58.0% and 53.9% to HK$32 million and HK$32 million respectively. Management expects that the demand for these products will remain strong in the year ahead.

The increase in turnover for the Group's components for electronic products was mainly due to the continued expansion in the customer base as well as the increase in business volume with individual customers. The relocation of the factory to new premises with larger facilities in November 2005 has enabled the Group to expand its production capacity for components for electronic products to cope with increasing demand.

The acquisition of Southchina as a 51% owned subsidiary in December 2005 has enabled the Group to broaden its sales and customer base. The acquisition has also ensured that the Group has a reliable supply of quality plastic moulds and plastic components for its electronic products.

Gross Profit

Despite the growth in turnover, the gross profit margin decreased by approximately 3% during the year 2006. The drop was mainly due to the inclusion of Southchina's results in the consolidated financial statements as a subsidiary, as the mould and plastic business has a lower profit margin than other traditional products of the Group. In addition, the increase in general wage level in PRC together with the continuing appreciation in the value of the Renminbi during the year, also resulted in an increase in the overall labour and material costs and overheads.

Operating Expenses

During the year ended 31 December 2006, distribution costs were approximately at 1.0% of turnover. This is comparable to 1.4% in the year ended 31 December 2005. The surge of turnover has resulted in an increase in the utilisation of trade facilities granted by our bankers. Together with the general increases in interest rates during the year, total finance costs have increased by HK$6 million. On the other hand, bank interest income for the year has also increased by HK$2 million, as a result of the increase in average bank deposit balances and increases in interest rates during the year. The total finance costs and interest income of Southchina for the year amounted to HK$3 million and HK$136,000 respectively.

Administrative expenses for the year 2006 have increased by 59.1% or HK$23 million. The increase was due to a number of reasons, including the increase in staff costs as a result of the annual salary review in January 2006; the provision for impairment on trade receivables of HK$6 million and other bad debts written off of HK$1 million. The administrative expenses of Southchina alone for the year amounted to HK$10 million, which were included in the consolidated income statement.

Net Profit

The net profit margin for the year has dropped from the 8.5% achieved for the year 2005, to 7.6% for the year 2006. The reduction in net profit margin was due to the decrease in average gross profit margin and the increase in administrative expenses, as explained above.

PRODUCTION FACILITIES

During the year 2005, the Group leased additional factory premises for the production of electronic products and also relocated its factory for production of components for electronic products to new premises with an enlarged production capacity to cater for future growth. During the year 2006, the Group spent HK$9 million to acquire new plant and machinery and HK$5 million on leasehold improvements to expand the production capacity to cope with increasing demand from customers.

Management Discussion and Analysis

LIQUIDITY AND FINANCIAL RESOURCES AND CAPITAL STRUCTURE

The financial position of the Group remains strong and healthy. At 31 December 2006, total cash and cash equivalents, net of current bank overdrafts, amounted to HK$45 million. The net funds are available to finance the Group's working capital and capital expenditure plans.

At 31 December 2006, the total borrowings of the Group amounted to HK$78 million, comprising bank overdrafts of HK$11 million, bank loans of HK$31 million, bills payable of HK$30 million and obligations under finance leases of HK$6 million, all of which are denominated in Hong Kong dollars. The average effective interest rates for each of these borrowings at 31 December 2006 ranged from 7.1% to 8.6%.

The Group's trade receivable turnover, inventory turnover and trade payable turnover were 52 days, 70 days and 61 days respectively for the year 2006. The turnover periods are consistent with the respective policies of the Group on credit terms granted to customers and obtained from suppliers.

At 31 December 2006, the Company had in issue a total of 300,000,000 ordinary shares of HK$0.01 each.

CASH FLOWS

Total balance of cash and cash equivalents at 31 December 2006 was HK$45 million, which decreased by HK$9 million compared to the balance at 31 December 2005.

Given continued strong sales growth in 2006, there was a net cash inflow from operating activities of HK$10 million. The net cash outflow from investing activities in 2006 amounting to HK$14 million, which was mainly due to the HK$16 million spent on the addition of property, plant and equipment.

There was a net cash outflow of HK$6 million from financing activities in 2006. This was mainly the net effect of payment of dividends of HK$14 million, repayment of borrowings of HK$45 million and new bank loans of HK$54 million obtained.

PLEDGE OF ASSETS

At 31 December 2006, the Group had total bank borrowings of HK$72 million, out of which HK$33 million were secured by short-term bank deposits of HK$2 million and available-for-sale financial assets of HK$3 million.

GEARING RATIO

At 31 December 2006, total borrowings, excluding trade related debts, were HK$47 million and the shareholders' equity was HK$164 million. The gearing ratio of the Group, calculated as total borrowings mentioned above over shareholders' equity, was therefore 28.7%, which improved significantly from the 46.7% recorded at 31 December 2005.

CONTINGENT LIABILITIES

At both 31 December 2005 and 31 December 2006, the Group did not have any material contingent liabilities.

EMPLOYEES

At 31 December 2006, the Group had 3,214 employees, of which 78 are employed in Hong Kong and 3,136 are employed in the PRC. Salaries of employees are maintained at competitive levels. The Group operates a defined contribution Mandatory Provident Fund retirement benefits scheme for all its employees in Hong Kong, and provides its PRC employees with welfare schemes as required by the applicable laws and regulation in the PRC. The Group also offers discretionary bonuses to its employees by reference to the performance of individual employees and the overall performance of the Group. Total staff costs, excluding Directors' emoluments, incurred by the Group for 2006 amounted to HK$84 million.

The Company has also adopted a share option scheme on 22 June 2005. During the year, a total of 13,500,000 share options were granted to three executive Directors and other staff of the Company. These share options do not have any vesting period and are exercisable within a period of two years to 26 September 2008 at an exercise price of HK$1.11 per share. Details of the principal terms and conditions of the scheme are set out in the Report of the Directors on page 23.

The Group did not experience any significant labour disputes or substantial changes in the number of its employees that led to any disruption of its normal business operations. The Board believes that the Group's management and employees are the most valuable asset of the Group and have contributed to the success of the Group.

FOREIGN EXCHANGE EXPOSURE

Most of the Group's sales are denominated in United States dollars and Hong Kong dollars and most of the purchases of raw materials are denominated in United States dollars, Hong Kong dollars and Renminbi. Furthermore, as most of the Group's monetary assets are denominated in Hong Kong dollars, United States dollars and Renminbi, the exchange rate risk of the Group for the time being is considered to be minimal.

In view of the current financial position and diverse operations of the Group, the management considered that it was not necessary for the Group to have any kind of sophisticated financial instruments for hedging purposes or to adopt any formal hedging policy.

Management Discussion and Analysis

OUTLOOK

The Group's primary objective is to become a leading and internationally recognised manufacturer and "total solution provider" of its electronic products and electronic products components. The Group has been focusing on developing new designs to meet customers' needs and continuously expanding its service to its increasing range of international customers.

The Group will pursue a more cost effective operational structure and will continue to tighten its controls over production costs and overheads so as to maximize gross profit margins. In terms of product range, the Group will focus some of its resources in the development of medical health care products; environmental protection products; and energy savings products. The Group believes that there will be a consistently future high demand for these products.

In terms of markets, the United States continue to be the major market for the Group's products, and accounted for 69% of the Group's total turnover for the years 2005 and 2006. However, the Group will continue to devote significant effort to explore other markets in Europe, Japan and other Asian countries, so that the turnover by geographic locations can be spread more evenly in future periods.

Management still foresees there are tremendous opportunities in the year 2007 and has strong confidence in maintaining future growth momentum. The Group is very clear about its responsibility towards shareholders and their expectations. Although there are challenges ahead in terms of competition and rising production costs, management is confident that it will meet these challenges because it has a well distributed worldwide customer base; consistently high quality products; and timely delivery, strong engineering and development support to its customers allied with an experienced and dedicated management team and a highly skilled, efficient workforce.

DIVIDENDS

In appreciation of the support from our shareholders, the Board proposes the payment of a final dividend of HK3.8 cents per share. Together with the interim dividend of HK3.2 cents per share paid in November 2006, the total dividends paid for the year 2006 will be HK7.0 cents per share, representing a dividend payout of 48.0% of the profit attributable to equity holders for the year 2006. All dividends are paid in cash from funds generated from the Group's operations. The Group has sufficient funds to meet its future expansion after the payment of dividends.

The proposed final dividend of HK3.8 cents per share will be payable to shareholders whose names appear on the Register of Members of the Company on Wednesday, 23 May 2007. The Register of Members will be closed from Friday, 18 May 2007 to Wednesday, 23 May 2007, both days inclusive, and the proposed final dividend will be paid on or about Wednesday, 6 June 2007. The payment of dividend shall be subject to the approval of the shareholders at the forthcoming Annual General Meeting.