

Management Discussion and Analysis

MARKET REVIEW

The demand for high quality electro-acoustic peripheral products continue to be high, the direct result of consumers' insatiable desire for the latest communication, entertainment and multimedia products, i.e. compressed music players, personal computers, gaming consoles, LCD TVs and mobile phones. The ongoing permeation of the Internet and Wi-Fi into people's daily lives has also meant a need for products that encompass a wide range of features, providing fresh impetus for multifunctional devices and the cross application of multimedia electronics. Though the demand for state-of-the-art digital technology remains robust, mainstream electro-acoustic peripherals such as Bluetooth headsets are enjoying renewed favor as well, the direct result of growing legislation to curb motorists from using mobile phones. As a result of these factors, the electro-acoustic peripheral segment expanded across various vectors and this evolution looks set to continue unabated.

BUSINESS REVIEW

During the past year, Shinhint continued to affirm its status as a premier manufacturer of electro acoustic peripheral products, strengthening ties with some of the world's leading consumer electronic brands while at the same time forging new alliances with established companies from the United States, Europe and Asia. Such associations are indicative of the Group's solid reputation for developing and producing a full breadth of lifestyle oriented electronic components that are of the highest caliber in terms of quality and performance.

To continue nurturing such bonds and further the Group's reputation, Shinhint expanded its management team, enlisting those most capable of providing new insights, perspectives and methodologies. The ultimate purpose of enlarging this important nucleus has been to ensure that Shinhint is operated with utmost professionalism and efficiency from the top down.

Consistent with Shinhint's status as both an original design and original equipment manufacturer with electronic, acoustic and mechanical engineering expertise, the Group continued to strengthen its R&D capabilities through the hiring of skilled technicians while at the same time seeking to ally with those companies that can enrich its product offerings be it in technically, aesthetical or in other key aspects. A good example of such allegiances is its strategic partnership with New Transducers Ltd ("NXT"), a leader in flat-panel loudspeaker technology, which was secured in mid-2006. In addition to capitalizing on NXT's technical prowess, the two parties will cooperate in the creation of a new business that mainly targets the flat-panel acoustic sector. A new factory will be established in Dongguan which, in addition to catering to developing and manufacturing speakers for the LCD and Plasma TV industry, will also seek to tap other segments including the automotive sector.

Accordingly, for the year under review, Shinhint achieved a turnover growth of 15.5% to HK\$1,174,157,000 (2005: HK\$1,016,198,000).

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In terms of production, the Group was able to raise capacity by approximately 20% due to the introduction of enhancement initiatives as well as investing in more advanced equipments which were integrated into the production lines. The former had the benefit of meeting evermore stringent quality standards while the latter enabled the Group to mitigate negative pressures arising from rising labor costs and scarcity of skilled workers, and just as important, be equipped to produce the most advanced products where intricate production processes are requisite. Moreover, with vertically integrated manufacturing facilities in place, Shinhint is thus able to better accommodate increase sales orders and expansion of sales channels as they arise.

Communication Peripheral Business

A key facet of the Group's makeup, the communication peripheral business comprises of complementary products used in combination with mobile phones, line phones and Internet phones, among others. During the review period, a turnover of HK\$169,420,000 was achieved, representing a rise of 4.4% or HK\$7,173,000 in dollar terms year on year. Furthermore, segment result continued to be buoyant, recorded at 8.3% (2005: 7.0%).

Management expects mobile phones and Internet phony will have further scope for expansion and this in turn will help propel demand for supporting peripherals, specifically, digital wireless application products. Furthermore, with stricter legislation requiring motorists to adopt hands free communication devices (wireless technology/headsets), still greater business growth from this area is projected. In view of such developments, the Group will allocate more resources toward R&D, seeking to capture the available opportunities ahead.

Entertainment Peripheral Business

With consumer outlook remaining positive on the European and American fronts, the leisure segment of the consumer electronics industry was duly upbeat. This had an expectedly favorable impact on the entertainment peripheral business as more consumers opted for high-performance electro-acoustic accessories, driving sales up by 23.8% to HK\$357,877,000 – accounting for 30.5% of total turnover of the Group. In turn, segment result rose to HK\$19,498,000 from HK\$18,882,000. As this sector continues to rapidly develop, the Group will seek to consolidate relations with leaders in the consumer electronics industry, capitalizing on their understanding of business trends and constantly upgrading itself with the necessary skill sets for tapping this lucrative market.

Multimedia Peripheral Business

Continuing to represent the key revenue driver of the Group, the multimedia peripheral business comprises of accessories that are used in conjunction with popular digital consumer electronics. Spurred by the public's obsession for digital music and reliance on the Internet, the Group's multimedia peripheral products enjoyed positive consumer sentiment and achieved solid sales growth, consequently realizing turnover of HK\$515,588,000, a rise of 17.0%. Accordingly, the segment result of this business increased to HK\$27,979,000 from HK\$24,464,000 and accounted for 43.9% of the Group's total revenue. This segment will continue to be among the growth drivers for the Group in the future.



Audio Peripheral Business and Other Accessories

The nature of the audio peripheral and accessories business is characterized as intensely competitive, the Group's sales in these segment increased fractionally and recording turnover of HK\$131,272,000, an increase of 5.8%, compare to last corresponding year. Having disposed of interests in an associate during the year, this segment will remain as supplementary to the Group's business.

Customers

The Group's key focus continues to be in providing comprehensive product creation services both on OEM as well as ODM basic to leading players of the multimedia product industry. Working in concert with these customers, the Group has been able to keep abreast of the latest trends, identifying potential market opportunities from which new products are developed.

FINANCIAL REVIEW

Results Performance

For the year ended 31st December, 2006, the Group's turnover increased by 15.5% from that of the previous year, reaching HK\$1,174,157,000 (2005: HK\$1,016,198,000). This increase was mainly attributed to the sales increase in North America and Europe. Net profit likewise increased by 10.8% to HK\$50,329,000 from HK\$45,432,000.

During the year, basic earnings per share approximately maintained at HK cents 17. The board of directors recommended the payment of a final dividend of HK cents 3.8 per share for the year ended 31st December, 2006. Together with the interim dividend of HK cents 1.5 per share, total dividends for the year amounted to HK cents 5.3.

Liquidity and Financial Resources

As at 31st December, 2006, the Group maintained a healthy cash level with cash and cash equivalents of HK\$117,013,000 (2005: HK\$71,736,000) and unutilized banking facilities of HK\$52,553,000 (2005: HK\$9,043,000). The Group's current ratio, being the proportion of total current assets against total current liabilities, was 1.52 compared with 1.39 in 2005.

Meanwhile, the gearing ratio of the Group decreased to 16.6% from 20.4% as at 31st December, 2006. The ratio was calculated by dividing total borrowings of HK\$43,447,000 (2005: HK\$45,957,000) by shareholders' equity of HK\$262,387,000 (2005: HK\$224,809,000).

As at 31st December, 2006, the Group's inventories decreased to HK\$135,363,000 (2005: HK\$173,492,000). The inventory decrease was the result of the Group's achievements in enhancing inventory management.

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Treasury Policies

The Group does not engage in any highly leveraged or speculative derivative products. Since the Group's sales and raw material purchases are conducted in US dollars and Hong Kong dollars, the Board believes that the Group will have sufficient foreign exchange reserves to match necessary requirements. Although part of manufacturing overhead is denominated in Renminbi, the Group's exposure to risk associated with its exchange is not significant. Still, the Group will closely monitor the movement of the Renminbi exchange rate. During the year, the Group did not use any financial instruments for the purpose of hedging.

Contingent Liabilities

As at 31st December, 2006, the Group had no contingent liabilities.

Pledge on the Group's Assets

As at 31st December, 2006, bank deposits of HK\$4,452,000 (2005: HK\$9,877,000) had been pledged to secure the Group's banking facilities.

PROSPECTS

As the electro-acoustic peripheral industry advances on various fronts, the ability to remain pliant to change will be paramount – such is the aim of the Group.

The Group has shown that it is fully committed to the electro-acoustic peripheral industry, and in particular, the four segments that it is engaged in. New investments in infrastructure, including a factory in ChangAn Town, Dongguan, which is dedicated to the production of speakers for the flat-panel TV and automotive sectors amongst other audio products, will be fully operational by mid-2007. To expedite product development and quickly address the latest consumer trends, the Group has continued to strengthen its research and development capabilities by maintaining its practice of recruiting talented engineers and working closely with industry leaders. Moreover, to fortify relations with core clients, the Group has sought to strengthen its presence in China with the goal of serving as an ambassador on their behalf. Towards this objective, Shinhint has promptly fulfilled industry standards set out by the China Quality Center. With the vast potential of the PRC market yet to be realized, Shinhint's early compliance will stand it in good stead as opportunities develop.

The Group is committed to maintaining mutually fruitful ties with industry leaders and harnessing the synergies created to enhance growth. Consequently, Shinhint will continue to utilize its Shenzhen research center to drive the product creation process, and will consider the possibility of forming partnerships with other enterprises to access necessary technologies towards this end. Moreover, opportunities for acquisitions which can further strengthen Shinhint's position in the industry, and ultimately, improve long term returns for shareholders will be explored.



EMPLOYEES

As at 31st December, 2006, the Group's work force totaled approximately 4,300 (2005: approximately 4,300) in Hong Kong and the PRC collectively. Staff costs (excluding directors' emoluments) amounted to approximately HK\$79,670,000 (2005: HK\$65,942,000). The Group ensures that the pay levels of its employees are competitive and according to market trends. Its employees are rewarded on a performance related basis and within the general framework of the Group's salary and bonus system.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S SECURITIES

During the year under review, there was no purchase, sale or redemption of shares of the Company by the Company or any of its subsidiaries. However, after the year end date, on 10th April, 2007, a net proceed of HK\$19.99 million was raised from a top-up shares subscription of the Company, which was intended to be used as general working capital of the Company. The shareholders base of the Group has been widened with the addition of China Development Capital Partnership Master Fund LP and General Motors Investment Management Corporation who each holds 6.29% stake in the Group's enlarged share capital.