

CHAIRMAN'S Statement



Electrochromic Mirrors in Production

PDA Module with Gray Scale



Overview

2000 was a tough year for Varitronix, especially during the second half. The Group had to deal with both on time delivery problems caused by worldwide components shortage and a drop in production yields during the learning period of newly recruited staff. However we are greatly encouraged that the Group was able to achieve a substantial growth in sales.

During 2000 and especially from May to November, the demand on LCD was extremely strong particularly in the MNC telecommunication sector. For example, worldwide mobile phone sales in 2000 were 413 million sets compared with 284 million sets in 1999. To meet such demand, a new Nanling plant was built within a few months in early 2000. There was also a substantial increase in human resources, with manpower growing by 88% in order to cope with the orders and the demanding quantity within a short time.

The fast growth during the second half was not without costs. A large number of staff was recruited. The newcomers were inexperienced in the operations of the Group and could not work to the optimum efficiency. Production yield were adversely affected. Quality of product suffered also, resulting in some returns.

In addition, there were continued shortages of components during the year throughout the electronic industry. At Varitronix, we faced serious shortage mainly of polarizers and ICs. As a result, there were substantial increases in component prices which significantly affected the Group's profits.

Our material cost content was significantly higher in 2000 than in 1999. Orders with higher material content were largely found on the MNC orders that came in second half of the year. The higher consumption rate was also caused by higher component prices as well as production inefficiencies. The Group could not achieve desired results in some large volume orders.

In response to the shortages of components and long lead times for component delivery, we committed to more forward purchases in order to meet the on-time deliveries to customers, resulting in increases in mainly raw material and to some extent in finished goods inventory at year end. However, the market situation changed swiftly in December and with the sudden downturn, the Group had excess inventory at the year end. In view of this the Group has written off and made provisions against inventory and return products, resulting in a charge against profits of HK\$32.5 million.

Chairman's Statement *(continued)*

At the year end, the Group held a liquid portfolio of HK\$509 million (1999: HK\$901 million) of which HK\$192 million (1999: HK\$544 million) was in cash and cash equivalents and HK\$317 million (1999: HK\$357 million) in securities. The Group received less interest income in 2000 than in 1999 because of the decreasing market interest rates and the lower cash level partly due to the payout of special dividend during 2000. Besides, part of the securities in the portfolio was generally classified as "trading" and was recorded on the balance sheet at fair value with unrealized gains and losses reported in the profit and loss account. As a result of market price volatility, the Group experienced an unrealized loss of HK\$6 million during 2000 while an unrealized gain of HK\$4 million in 1999 on the trading securities.

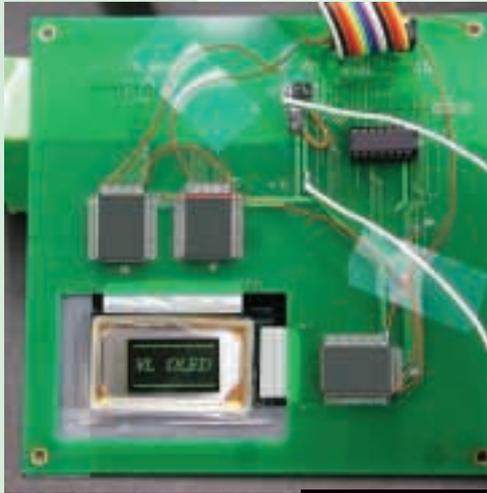
During the year the Group acquired the minority interests in our overseas offices in Canada, UK, France and US. This was to overcome internal conflict of interest and to offer the Group greater flexibility in operating and financing these subsidiaries and in utilizing any cashflows generated.

It is a general trend that more companies are moving their production bases into China. In order to strengthen our presence in China, we formed a joint venture with Tsinghua University Enterprise Group. This new operation, Varitronix Pengyuan Limited is 51% owned by Varitronix and will serve as a marketing base of Varitronix to penetrate into the up-surgng China LCD market.

Way Forward:

The present slowdown in the electronics industry and global economy in general makes forecasting difficult. Excess inventory in the industry needs to be digested. Nevertheless, the component shortage started to ease off towards the end of 2000. Component prices are expected to resume to a reasonable level in the coming months. The lower purchase price will help to improve the Group's margin after most of excessive raw materials are consumed first. Also, the management will strike for measures to train the new staff and workers to be more efficient and will take a more careful focus on purchasing and inventory issues to reduce cost. Barring unforeseeable circumstances, the management is confident that the Group will achieve better results with measures and administrative structural changes that were instigated last year. In particular, the new organization is more streamlined and focused, the new ERP system facilitates better production control, a modern production plant has been added and additional managerial and technical talents are in place. All these would position us for growth in the future.

Ultra Thin COG Display*COG Production**Microdisplays Production*



Development of Driving Scheme for Organic Light Emitting Diodes (OLED)



Ultra Thin COG Module

A new site in Heyuan was purchased and we have planned to build facilities there to consolidate operations and improve logistics and hence reduce duplicated cost of running few plants at different locations.

In an intense information era, applications evolve to be more demanding. They require displays with higher information content, higher resolution, faster response time, wider viewing angle and colour capability, lower power rating and other properties. In each aspect, the Group has been committing R&D effort for improvements and successfully launched new products such as microdisplays. Also small volume production for these product has started. Apart from introducing the microdisplays, the Group is currently working on, and will in due course launch, other display technologies such as colour STN and Organic Light Emitting Displays (OLED) etc.

To be competitive in the display industry, it is even more important for the Group to enhance its competence through technology development. The Group will therefore put more effort on R&D and launch new products and technology services to customers to achieve higher margins in the longer term.

The Group will continue to focus on the highly customized market in future but at the same time maintaining its share in the multinational sectors . The Group will continue this strategy to take advantage of the established business connections and to look for further growth across different geographic markets in the world.

I would like to take this opportunity to express my appreciation for the continued support of my fellow directors and the dedication of our staff during the year.

Dr. C. C. Chang

Chairman

Hong Kong, 11 April 2001

We Put Our Heart on **DISPLAY** 