Management Discussion and Analysis

RESULTS

During the year under review, Matrix Holdings Limited (the "Company") and its subsidiaries (collectively, the "Group") achieved a remarkable growth in both turnover and net profit. The audited consolidated turnover of the Group for the year was HK$500,357,000 (2002: HK$395,644,000), an increase of 26.5% from that of the preceding year. Net profit attributable to shareholders for the year increased by 28.7% to HK$131,166,000 (2002: HK$101,939,000). These encouraging results were attributable mainly to the synergic contribution from the Zhongshan and Vietnam plants, of which the production capacities had been expanded by over 30%, helping to increase the customers' confidence in the Group. The commencement of operation of a new production plant in Vietnam in July 2003 also made a significant contribution to the Group's outstanding performance.

DIVIDEND AND DIVIDEND POLICY

The board of directors of the Company recommended a final dividend of HK9 cents per share (2002: HK9 cents) to its shareholders whose names appear on the Register of Members of the Company on 20 April 2004. Together with the interim dividend of HK8 cents per share and the special dividend of HK3 cents per share paid or to be payable during the year, this makes a total dividend paid or to be payable for the financial year of HK20 cents (2002: HK17 cents) per share.

The Group intends to maintain a long-term dividend payout policy and distribute dividend income to the shareholders in accordance with the Group's earnings growth. The Group will also continue to actively and regularly review and manage its capital structure to ensure optimal capital structure and shareholder returns, considering:

– The level of the Group's cash position in comparison to its current and projected operating and capital requirements;
– To reward shareholders for their support;
– To improve returns on investment;
– To be in line with the prevailing market dividend yield; and
– To assess the Group's stability, growth and maintain prudent risk management.

BUSINESS REVIEW

2003 was a challenging year for all, in particular the outbreak of SARS had threatened almost everyone in the Asia Pacific region. Starting from that period, the Group immediately reinforced its environmental and health policy in the workplaces and required all employees to remain prepared for another SARS outbreak. Moreover, the war in Iraq also resulted in the escalation in the price of crude oil and other related chemicals. Despite these extraordinary challenges, with stringent cost control measures in place, Matrix still managed to achieve a remarkable net profit of HK$131,166,000 in 2003 (2002: HK$101,939,000).

With the groundwork being laid on our core toy manufacturing business and the Group's sound financial position, we are optimistic that our production capability can be further improved, and we will be able to maintain a steady growth both in turnover and market share.

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TOY MANUFACTURING OPERATION

China

We are very encouraged by the improvement in our production capacity by approximately 50% in 2003. Our production in Zhongshan plant contributed over 60% of our output in 2003 supported by its well-developed manufacturing facilities and production lines. With continuous innovation in our products, the Group had expanded our engineering team responsible for all the product design and mechanisms in order to enhance our customer appeal and satisfaction.

Zhongshan, China

Vietnam

To cope with the rapidly changing development of the Group and the need for an increase in production capacity, our second production plant for the assembly of the plush toys production line in Danang City, Vietnam, commenced operation in July 2003. The production area of the second plant is approximately 40,000 sq.m., and the factory space is well equipped with about 3,000 sewing machines. To tap on the labour cost advantage, the Group had allocated its labour intensive plush toys production to its second plant in Vietnam. The production volume in the plush toys division had recorded an increase of 30% over the previous year.

Danang City, Vietnam – First plant

Danang City, Vietnam – Second plant

Production Line

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PRINTING OPERATION

To continue to strengthen our market position as one of the leading premium toy manufacturers, we invested an amount of approximately HK$13,000,000 in developing a new promotional materials and inserts printing business during the year. This new business is a long-term strategic investment of the Group since we believe that vertical integration can ensure a smoother production process and a reduction in production cost. Besides, we can also have better quality and time control over our production process and reduce the reliance on external service suppliers. At present, this operation can fully support internal consumption and we are confident that this business will grow exponentially in the near future.

PRODUCTION CODE OF CONDUCT

We pay critical attention to our production code of conduct. With some of our major customers being renowned multinational companies, highly stringent requirements on human rights conditions, safety standards, terms of employment and working environment had been imposed in our production plants in China and Vietnam. Our Group works closely with our customers, supervising every stage of production to ensure that the product quality met their standards and fulfilled all the requirements. In return, there is also a direct stimulation on the Group's sales orders and the development of a fruitful relationship with each of our customers.

FINANCIAL REVIEW

Borrowing and Gearing

During the year under review, the Group was granted two banking facilities in a total of HK$42,000,000 secured by fixed deposit and pledged by certain land and property from one of its subsidiaries. The Group's gearing ratio was 4.90% (2002: 13.80%), representing the total debt divided by total shareholders' fund and convertible loan stock. As at 31 December 2003, the Group had cash and bank balances of HK$83,243,000 (2002: HK$50,327,000).

Capital Expenditure

The total capital expenditure during the year amounted to HK$30,564,000 (2002: HK$30,034,000) including the establishment of the second production plant in Vietnam and the printing business. These capital expenditures were funded mainly by internal resources.

Management Discussion and Analysis

Shareholders' Funds and Share Capital

Shareholders' funds as at 31 December 2003 increased 44.8% to approximately HK$237,298,000 (2002: HK$163,817,000). There had been an increase in the issued share capital from HK$32,272,000 to HK$46,272,000 as at the year end date due to the conversion of HK$14,000,000 convertible loan stock during the year.

In February 2004, Suncorp Investments Group Limited converted the remaining HK$12,200,000 convertible loan stock into 122,000,000 ordinary shares of HK$0.10 each in the Company.

Liquidity

The Group maintained a strong financial position for this year. Net cash provided by operating activities amounted to approximately HK$117,000,000 (2002: HK$102,000,000).

Assets and Liabilities

At 31 December 2003, the Group had total assets of HK$363,748,000 (2002: HK$265,992,000), total liabilities of HK$126,450,000 (2002: HK$102,175,000) and shareholders' equity of HK$237,298,000 (2002: 163,817,000). The net assets of the Group increased 44.8% to HK$237,298,000 as at 31 December 2003 (2002: HK$163,817,000).

Contingent Liabilities

The Company had given guarantee to a bank in respect of general facilities granted to its subsidiary which had not been utilized at the balance sheet date.

Exchange Rate Risk

The assets and liabilities of the Group are mainly denominated either in Hong Kong dollars, United States dollars, Renminbi or Vietnamese Dong.

A majority of the Group's inventory purchases were made in Hong Kong dollars and Vietnamese Dong whereas majority of sales were denominated in United States dollar. Theoretically, the Group was subject to foreign exchange risk exposure in Hong Kong dollar against United States dollar for trust receipts loan borrowing plus any uncovered inventory position to fulfill sales contracts. With the strong support from the government to maintain the peg system in Hong Kong, the exchange rate for the United States dollar should be relatively stable and the Group's potential risk exposure in United States dollar should thus be minimal in the foreseeable future. The Group will continue to monitor closely the exchange risks by requesting United States dollar settlement from customers and hedging the exposure with the appropriate use of forward contracts and applicable derivatives where necessary.

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HUMAN RESOURCES

As at 31 December 2003, the Group had a total of approximately 12,000 (2002: 8,800) employees in Hong Kong, China and Vietnam. The operation of the new Vietnam plant contributed to the increase in workforce. The Group provides its employees with competitive remuneration packages commensurate to the level of pay and market trend in comparable businesses. A mandatory provident fund scheme and share option scheme are in place.

CORPORATE GOVERNANCE

Matrix strives for enhancing its disclosure of corporate information to its shareholders and the investment community. The Company had published its first quarterly results to the public during the year.

With the increase in international corporate governance standard, the Group has planned to adopt series of arrangements, including enhancement of board structure and setting up of guidelines and codes for employees and directors in the coming year to improve its corporate governance in line with the development in Hong Kong.

INVESTOR RELATIONS

The Company's corporate website, www.matrix.hk.com, which is updated on a regular basis, allows the effective dissemination of information. In addition to the latest interim and annual reports, the Group also posted the archives on all announcements and press releases on its website, which gives the investment community easy access to the most up-to-date information of the Groups' business activities.

To further increase its transparency, the Company had carried out a new strategy in engaging professional investor relation services in January 2004 so as to cultivate high standards of investor relations to cement its cordial relationship with the financial community and as a whole, maximize shareholder value.

PROSPECTS

As we look to the future, we will continue to focus on our core competency of manufacturing toy items. In 2004, we will further consolidate the business operation of the new production plant in Vietnam to ensure the Group's long-term success. This new production plant has not only enhanced the Group's capabilities for producing plush toys, but also helped to maintain its cost-efficiency with the lower labour costs in Vietnam.

In addition, the new promotional materials and inserts printing business has provided us with a platform for vertical integration, with an aim of offering a one-stop solution to our customers. Apart from internal consumption, we are preparing to explore the opportunity in providing printing services to other companies in this coming financial year.