

BUSINESS REVIEW

Review of operations

The year under review was a special year for Varitronix as we celebrated our 25th anniversary in business. It was also a rewarding year with the advance in both our business performance and research and development capabilities.

For the 12 months under review, turnover was recorded at HK\$1,275 million, 17% higher than 2002. A major reason behind this growth was the robust sales generated from our telecommunications and automotive products. I am also pleased to report that we achieved a satisfactory increase of 28% in profit attributable to shareholders to HK\$151 million, despite keen competition in the industry and the underlying tight components supply. Basic earnings per share rose to 49 cents.

Profit grew in line with our revenue. The profit level was maintained as a result of stringent cost control measures from the procurement stage through to production and logistic controls. As a result, our material content was kept at a reasonable level.

We continued to adhere to our established strategy of maintaining balanced exposure both in terms of products and markets, which we regard as an important element in achieving stability in our business. As a result of this strategy, turnover from Europe, our largest market remained steady at 46% of total turnover. Turnover from Asia as a whole climbed significantly. For the year, turnover contribution from Hong Kong and the PRC was higher at 33%. This was mainly due to strong sales from our PRC telecommunications sector, even though production relocation by some of our European and US customers to the PRC also contributed to this growth. For the rest of Asia, mounting orders especially in the second half of the year from customers in the Korean region boosted sales. Therefore, turnover contribution from the rest of Asia was higher at 13%. The US market accounted for the remaining 7%.

Whilst demand for mono-color handset displays from our PRC customers remained steady, order momentum for color STN and TFT solutions gained pace in the second half of the year. In this respect, our solid relationship with a major PRC handset design house together with the support from our joint venture partner Tsinghua University Enterprise Group continued to be vital factors. The thriving PRC telecommunications market has also helped to fuel this growth. Industrial and automotive products continued to be important pillars in our business. In addition, the Group also started to see a gradual increase in automotive orders from the US towards the end of the year.

The Group's inventory level at the end of the review period largely reflected the order growth and supply conditions, where the latter began to show signs of mild tension during the second half of the year. However, the supply situation is expected to remain steady, and the Group will continue to be responsive to market conditions, implementing flexible inventory policies accordingly.

Our new Heyuan production complex formally came into operation in the second half of last year. Housing some of our finest equipment and machinery including a new automated production line, the complex is expected to raise our operational efficiencies as well as our cost competitiveness due to process optimization.

On the technology side, we remained on track with our established roadmap. We continue to commit ourselves in readiness for product commercialization. Further to our partnership with DuPont Displays, we entered into a license agreement with Eastman Kodak Company for OLED at the beginning of last year. In addition to completing the prototype for bi-stable cholesteric display, I am also pleased to report that we successfully launched the "Zero Power" display sample last year. Commercial production incorporating this versatile technology has already started with deliveries scheduled for later this year. Satisfactory progress was made during 2003 in the prototyping of micro-displays, allowing us to further advance in this important technology.

Despite the capital expenditure required during the year at our new Heyuan complex, strong cash flow from operations has kept our financial position solid.

PROSPECTS

Into 2004, management maintains a positive business view. The recent pick up in Europe and the US will lend support to our growth, and especially in our automotive and industrial products. In addition much of our growth is expected to originate in Asia, especially in the PRC and Korea.



Order momentum from the PRC telecommunications market continues to be promising. Together with the rising penetration of handsets in the PRC, this business is expected to remain an important growth driver



this year. Given the increasing trend for color handset displays, the volume of color STN and TFT orders is expected to expand further. Efforts are also underway to further our market presence in Korea, which is an important production base in Asia for hand-held electronic goods.

We will continue to focus on our research and development, which represent an important asset in ensuring our future growth. Particular efforts will be made towards prototyping of color -"Zero Power" displays, micro-displays and full color OLED to ensure multiple solutions that fulfill different quality attributes.

Chairman's Statement *(Continued)*

Adhering to our strategy to develop high-end LCD technologies, we have, subsequent to the review period, instituted a series of restructuring moves in our Malaysia business. These include the possible merger of Varitronix (Malaysia) Sdn. Bhd. with Crystal Clear Technology Sdn. Bhd. to enhance efficiency and profitability and achieve economies of scale at the two operations. Listing the shares of the merged entity on the Malaysian Exchange for Securities and Automatic Quotation is part of the plan. In addition, we also divested our electro-chromic mirror business to focus on our core strengths in delivering high-end LCD product solutions. These moves are designed to improve the Group's overall performance whilst enabling us to better utilize our resources.

Based on the current order situation and barring unforeseen circumstances, it is expected that the Group will continue this encouraging performance in 2004.

On behalf of the directors, I would like to thank our staff for their dedication and efforts in the past year. I would also like to thank our customers, suppliers and shareholders for their continuous support.

Dr C.C. Chang

Chairman

Hong Kong, 19 April 2004