

Management

Discussion & Analysis

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BUSINESS REVIEW

The financial year ended 31 March 2004 was a rewarding year for the Group. The Group recorded a remarkable 902% increase in net profit from ordinary activities attributable to shareholders to HK\$126m and a 45% increase in shareholder funds to HK\$307m. Below are the highlights of the Group's performance for the year under review:

- Turnover increased 5% to HK\$1,771m
- Profit attributable to shareholders increased 902% to HK\$126m
- Shareholder funds increased 45% to HK\$307m
- Earnings per share increased 825% to HK 33.3 cents
- Proposed final dividend per share increased 700% to HK 8 cents

The remarkable increase in profit is derived from the 300% increase in recurring net profit from ordinary activities attributable to shareholders to HK\$50m and a net gain on the partial disposal of investment in Reigncom Limited of HK\$76m. Reigncom Limited ("Reigncom"), is a company incorporated in the Republic of Korea ("Korea") and listed on the KOSDAQ Stock Exchange, Inc., (the "KOSDAQ").

The significant growth in profit demonstrated the Group's successful business direction. Thanks to the persistent effort for quality product design, engineering and development, the Group's design and manufacture business successfully turnaround during the year under review and is expected to continue to flourish in the coming years.

As well as being a leading semiconductors distributor in Asia, AV Concept strives to become one of the world's leading manufacturers of digital electronic products.

Marketing and Distribution

During the year under review, the marketing and distribution business remained as the Group's core business with turnover of HK\$1,484m, a rise of 11% compared with last year's figure. The profit from this segment, amounted to HK\$40m, grew 7% from last year.

During the year, demand for semiconductors from manufacturers operating in the Pearl River Delta region was strong. With the support from the Group's principals, Samsung Electronics and Fairchild Semiconductors, the Group was able to build and increase its market presence.

AV Concept has become one of the largest distributors for Samsung Electronics flash memory in Hong Kong and the PRC. Samsung Electronics is the largest flash memory manufacturer worldwide. For the year ended 31 March 2004, the Group more than doubled its sales in flash memory. Increased application in digital electronic consumer products, like MP3 players; USB discs and digital cameras, and the demand for higher memory capacity have significantly increased demand for flash memory products. AV Concept flash memory customers are predominately manufacturers and the Group does not engage in any speculative trading of flash memory products.

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During the year under review, the Group recorded steady increase in sales of Samsung micro controller units and LCD display driver IC's. Both business segments require in-depth product knowledge and engineering knowhow to select the best products to suit customers' requirement. In addition to the Group's in-house engineering team, it is able to leverage from the strong and reliable technical backup from Samsung and its expert design house partners to provide robust engineering support for the Group's products. The Group is also able to provide a complete design solution to our customers. These value added services have differentiated the Group from the ordinary semiconductors suppliers and made the Group a preferred one-stop supplier to many customers.

The Pearl River Delta region has been the traditional customer base of the Group's semiconductors distribution business. The continuous growth of the region to become one of the world's prominent manufacturing centre for electronic products presents a flourishing and favorable market environment. To capture the growing demand, the Group has further expanded its sales team and application engineers to contend with both the increased business volume with existing customers and the rising number of new customers. For the year ending 31 March 2005, the Group has planned to double the headcount in its PRC representative offices.



Design and Manufacture

The design and manufacture business of the Group covers two major operations: electronic manufacturing services ("EMS") and original design manufacture ("ODM").

Turnover of the design and manufacture business for the year was HK\$287m, as compared with the previous year's HK\$357m. The segment achieved a turnaround from a loss of HK\$5m to profit of HK\$25m for the year ended 31 March 2004.

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The drop in turnover of the design and manufacturing business segment was attributable to the adoption of a new business model in the provision of EMS to Reigncom.

In April 2003, the Group entered into a new EMS agreement with Reigncom. Under the new agreement, the Group's sales to Reigncom are based only on the EMS fees chargeable on the products manufactured. Principal raw materials used in the manufacture of the products are consigned by Reigncom.

Prior to the new arrangement, the Group is responsible for the purchase of all raw materials. Accordingly, sales to Reigncom are based on the price of the completed products which included the costs of the raw materials and the EMS fees chargeable.

The change in business model caused an apparent drop in sales to Reigncom to HK\$36m (2003: HK\$327m). If the same basis of the new EMS agreement was applied in 2003, the pro-forma sales to Reigncom would have been HK\$29m, a growth in the Reigncom EMS services sales of 24% over the previous period.



In March 2003, the Group won its first major Japanese EMS customer to provide SMT printed circuit board assembly services. The output of the product rose rapidly from the initial 30,000 units per month in April 2003 to an average of over 100,000 units per month in the second half of the year. The Group's consistent product quality is well recognised by our customers and further Japanese EMS orders are expected.

The ODM business performed exceptionally well during the year under review. The Group's own-designed ODM products, namely MP3 players, achieved great success during the year ended 31 March 2004. The quality and good reputation of the Group's range of MP3 players not only brought in repeat orders from existing customers, but also attracted new customers from around the world. The substantial increase in the number of orders during the year enabled the Group to benefit from economies of scale, successfully reducing product costs, and in turn improve the profit margin of the business.

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The management believes that the knowledge, experience and expertise gained from the different functions of the Group have allowed it to build a solid foundation for developing its future growth drivers. Expertise on selecting quality electronic components learnt from the distribution business, as well as knowledge on manufacturing techniques observed from the EMS operation have both contributed significantly to the success of today's ODM operation. In view of the vast demand for quality MP3 players around the world, the design and manufacturing business will continue to be the Group's major growth driver in the coming years.

Investment in Reigncom

On 19 December 2003, the shares of Reigncom was listed on the KOSDAQ and was accepted as one of the constituent stock of the Star Index of the KOSDAQ.

On 28 January 2004, the Group made a partial disposal of its investment in Reigncom and resulted in a net gain of HK\$76m. A special dividend of HK10 cents per share was declared and paid to shareholders. Subsequent to the partial disposal, the Group's interest in Reigncom is reduced to 12.4%. As at the balance sheet date, the market value of the remaining 12.4% equity interest in Reigncom amounted to approximately HK\$535,788,000.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 March 2004, the Group has cash and bank balances of HK\$153m (2003: HK\$64m).

The gearing ratio as at 31 March 2004 was reduced to 0.35 (2003: 0.81). This is calculated based on the Group's total bank borrowings, net of cash and bank balances, of HK\$106m (2003: HK\$169m), and the Group's net tangible assets of HK\$304m (2003: HK\$208m).

The management is confident that the Group has adequate financial resources for its business growth and forecast requirement for the coming year.

EMPLOYEES

As at 31 March 2004, the Group employed a total of approximately 1,883 employees (2003: approximately 948 employees). Continued emphasis is put on staff training and enhancement of their skills.

The Group recruits and promotes individuals based on merit and their development potentials for the positions offered. Remuneration package is determined with reference to their performance and the prevailing salary levels in the market. In addition, the Group operates a share option scheme for eligible employees to provide incentive to the participants for their contribution, and continuing efforts to promote the interests of the Group.

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PROSPECTS

Looking ahead, while seeking to strengthen its distribution business, AV Concept will also strive to accelerate development of its high-growth design and manufacture business.

The Group's distribution product portfolio is constantly expanding through new products from existing principals and expert design house partners. For the coming year, new products introduced by Samsung included TFT/LCD displays, CMOS image sensors and new micro controller units. This is expected to further increase the Group's revenue as well as cementing the Group's position as one of the leading semiconductors distributor in Asia.

After the year end, the Group has secured distribution arrangements with Cornice Inc. and Ness Display Co., Ltd. for the distribution of micro hard discs and organic light emitting diode products, respectively. The new range of products are complimentary to the Group's existing product portfolio and have already generated much interests from existing customer base. As the Group's product portfolio widens, it will be capable of delivering a wider selection of related components, thus providing a 'one-stop' service platform for customers.

The design and manufacture business will continue to be the Group's major growth driver in the years ahead. Capitalizing on its established quality standards, the Group is ready to further expand its EMS customer base to cover a wider range of digital electronics products. Apart from refining production techniques and maintaining product quality, in



response to the increasing market demand for more sophisticated products, more attention will be placed on enhancing product designs and brand building.

On top of satisfying the increasing EMS and ODM orders, the Group is planning to further develop its original brand manufacture ("OBM") operation, with Asia and Europe as the new target markets. With the Group's MP3 players recording persistently impressive sales in the US market and around the world, AV Concept has full confidence in its OBM business ahead. In the long run, the OBM operation will augment the profit margin of the design and manufacturing business, further enhancing the Group's overall profitability. With the above development plans in place, the management is optimistic towards the Group's future.