

Chairman's Statement

The Board of Directors is pleased to report the results for Kin Yat Holdings Limited (the "Company") and its subsidiaries (collectively the "Group") for the year ended 31 March 2004.

GROUP RESULTS

The past financial year continued to be a very difficult one for the toys industry. In addition to unforeseen environmental factors such as the Iraq situation and the outbreak of the Severe Acute Respiratory Syndrome ("SARS") in Hong Kong and China that affected customer confidence and business development activities, the Group's business was also under strains of fierce price competition, price increases in raw materials, and shortages of labour and electricity which made efficient operation of our manufacturing facilities in China a sustained challenge.

The Group recorded a net profit of HK\$24,832,000 from ordinary activities attributable to shareholders, compared with an attributable profit of HK\$71,443,000 in the previous year. Turnover fell 21% to approximately HK\$624,665,000 for the year ended 31 March 2004, from HK\$794,209,000 the previous year.

The toys and motors divisions contributed 62% and 29% respectively in turnover to the Group during the year in review. Performance of the CDR operation was encouraging.

In view of very difficult market environment, the Group will continue to capitalize on its product research and development capabilities for a market breakthrough and also to improve production efficiency.

MANAGEMENT DISCUSSION AND ANALYSIS

Toys

The year in review was a very difficult time for the toys industry as unexpected events plagued consumer sentiments worldwide. Buyers and retailers were therefore very conservative when it came to placing orders. The Iraq situation towards the end of 2003 and in the beginning of 2004, traditionally the peak order placement period, further suppressed the already subdued market sentiment and put a dampener on subsequent manufacturing activities.

The Iraq situation in the second half of the financial year, coupled with the SARS outbreak in Hong Kong and certain parts of China from March to June in 2003 that deterred many overseas buyers from fulfilling their procurement trips to this part of the world, had led to a drop in the Group's turnover for the year.

Meanwhile, our customers continued to minimize their risk exposure through active product diversification – more model variety and lower volume for each model – and this diminished our benefits derived from economy of scale, further eroding our profit margin.

The Group also faced significant price reduction pressure during the year under review. Retailers continued to target merchandising effort on low to mid-priced items and transfer part of margin squeeze on the manufacturers. There was also cut throat price competition among manufacturers, especially from Mainland Chinese manufacturers with much cheaper cost structure.

Another adverse factor came from the soaring oil prices during the year, resulting in significant surges in the costs of plastics and other petrochemicals, all key materials for toys making. Faced with intensifying competition, the Group had to absorb price hikes in materials such as plastics, especially in the second half of the financial year. Overheads also mounted in pace with tightened labour laws in China and customer demands in code of conduct.



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Given the poor market situation and unanticipated negative environmental factors, some of the Group's clients decided to strategically drop or defer projects that had been developed and were ready for implementation in the second half of the financial year to contain their investments. Such client moves had caused some loss of sales for the Group.

The toys division reported a segment loss of HK\$12,729,000 on a 32% decrease in turnover to HK\$388,600,000 compared with the previous year.

Looking ahead, the 2004-05 financial year continues to be a very tough one for all manufacturers, in view of the sustained increases in materials cost and shortage of electricity and labor in China. Although the Group is able to generate its own electricity supply to support the operation of its manufacturing activities in Shenzhen, the cost is nevertheless much higher than it would be from public utilities. Toys manufacturing is a very labour-intensive industry and a shortage presents a greater challenge to the Group to produce and deliver products on time.

Despite the very difficult market environment, the Group firmly believes in its unique competitive strength in adding values to products with innovative and specialized technologies. The Group pledges its commitment to research and development, the recognized foundation of continued success in product and business development. One such initiative was the development of materials, both for toys production and a wide scope of application, in order to extend the Group's vertical integration competence and add value to its products.

Motors

The Group's motors division continued to focus its business activities in the toys sector during the year under review as efforts by the Group to expand into other sectors were stalled by the SARS outbreak in the beginning of 2003. Plans to visit potential overseas customers were cancelled as a result.

Given the poor market conditions in the toys sector, the motors division managed to achieve a slight increase in turnover to HK\$189,924,000, compared with HK\$183,065,000 the previous year. Segment profit was HK\$43,946,000 with profit margin maintaining stable as a result of a constant enhancement of the product mix through inclusion of more high value-adding items, to offset unfavourable industry factors.

In addition, the availability of stock raw materials had buffered the division's profit margin from substantial price increases in copper and steel towards the end of 2003, and the fourth financial quarter (January-March 2004) was traditionally a slow production period. Nevertheless, the impact of higher material costs will be reflected in the performance of the first quarter of 2004-05 financial year.

Fierce market competition does not allow the division to transfer all or at least a significant portion of the price increases to the customers. Should the prices remain high for the entire financial year, the profit margin of this division will be further squeezed.

Similar to the toys division, shortages in labour and electricity are potential threats to the motor division. Meanwhile, efforts to identify niche products and expand the range of motor-powered devices for future momentum growth will continue.

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CDRs

The performance of the Group's 50%-owned CDR manufacturing arm was within target as its six production lines were in 24-hour-a-day commercial operation during the entire financial year. The low-cost production base enhanced the division's competitive power, however, unstable supply of electricity in China was a constant threat to the business. In fact, the performance of the division could have been even better if not for this factor.

As new competitors entered the marketplace with more up-to-date production lines and higher output, competition began to mount in China and this led to the emergence of a price war in the second quarter. This cut throat situation is expected to last for quite some time until the weaker competitors are phased out. Therefore, the immediate prospect of this division is going to be challenging, but given its manufacturing prowess and technical expertise, the outlook for a longer term is optimistic.

In June 2004, six additional production lines were installed, increasing the production capacity to approximately 11 million pieces per month. The enhanced economy of scale has further reduced the production cost for each CDR disc, thus strengthening the division's competitiveness.

PROSPECTS

The 2004-05 financial year is going to be very challenging for all manufacturers – certain environmental factors affecting consumer confidence are likely to persist for some time and shortages of labour and electricity in China are not something that can be resolved in the very near future. Volatility in oil price is a constant threat to price increases in raw materials such as plastics. Metal prices such as copper and steel have been on the rise as well.

While the operating environment is not favourable, the Group's competitive strengths in manufacturing prowess and technological innovation should enable the Group to face up to the many challenges. The management will also take the opportunity to spruce up the Company's operating mechanism and business infrastructure with a more refined strategic direction to build market share and improve profit-making capabilities.

On the topline, the Group will dedicate increased marketing resources to regenerate sales momentum on the toys and motors business fronts. The CDR operations will be expanded to attain cost advantages from economies of scale. To defend its bottomline amidst industry challenges, management will also continue to advance its cost structure and operating efficiency. By upholding our core strengths, we are confident of our Group's long-term resilience.



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LIQUIDITY AND FINANCIAL POSITION

The Group primarily used its internally generated cash flow and banking facilities to finance its operations and business development during the year. The Group adopts a prudent and conservative policy in its financial management. At the end of the financial year, the Group's aggregated time deposits and cash and bank balances amounted to HK\$63 million (2003: HK\$85 million). In addition, the Group currently maintains aggregate composite banking facilities of approximately HK\$147 million (2003: HK\$128 million) with various banks, of which HK\$32 million (2003: HK\$6 million) has been utilized as at 31 March 2004.

The Group continues to enjoy healthy financial position. As at 31 March 2004, the current ratio (current assets divided by current liabilities) was 2.3 times (2003: 2.8 times) and the gearing ratio (long term liabilities divided by shareholder funds) was 5.5% (2003: 3.3%).

EMPLOYEES AND REMUNERATION POLICIES

As at 31 March 2004, the Group employed over 9,000 full time employees, of which approximately 60 were based in Hong Kong with the remainder in China.

The Group remunerates its employees largely in accordance with prevailing industry standards. In Hong Kong, the Group's employee benefits include staff retirement scheme, medical scheme and performance bonus. In China, the Group provides its employees staff welfare and allowances in accordance with prevailing labour law. The Group has also put in place a share option scheme to motivate and reward performing staff. At the discretion of the Board of Directors, the Group's employees will be granted options, the amount of which is determined by performance and rank of individual employees.

APPRECIATION

We take this opportunity to thank our staff, shareholders, customers and all business partners, who have been a major part of our business and corporate advancements.

Cheng Chor Kit

Chairman

Hong Kong
23 July 2004