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## Buji Plants

Gross Floor Area: 520,000 sq.ft.

Products: Consumer Electronic

Telecommunication

Digital AV



# Production Facility

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## Xi Xiang Plants

Gross Floor Area: 120,000 sq.ft.

Products: Networking



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## Huizhou Plants

Gross Floor Area: 110,000 sq.ft.

Products: Moulds and Plastic Parts





# Systematic

Management

**SUGA**





## CHAIRMAN'S STATEMENT

### *To our Shareholders*

On behalf of the Board, I present the annual results of Suga International Holdings Limited (the "Company") and its subsidiaries ("SUGA" or the "Group") for the fiscal year ended 31 March 2005 ("fiscal year 2005") as well as our vision for the future.

Although fiscal year 2005 fell short of our expectations in both sales turnover and profits, we managed to broaden our customer base and diversify our product portfolio. As part of our long-term business strategy and taking the competitive environment into consideration, we increased our research and development and sales and marketing expenditures to put SUGA in a better position to capture future opportunities. As a result, our net profit for the year was depressed. However, we are highly confident that SUGA will benefit from this strategic decision in the form of increased sales and profits in the future.

### **FINANCIAL PERFORMANCE**

The Group recorded sales turnover of approximately HK\$591 million for fiscal year 2005, a decrease of 1.6% compared with the previous year. This slight decrease in annual turnover was the net result of the drop in telecommunication products sales offset almost entirely by sales growth of consumer electronic appliances and new sales from digital A/V products.

During fiscal year 2005, the Group's gross profit decreased by 12.7% to HK\$79.7 million while gross profit margin decreased to 13.5% from 15.2% in fiscal year 2004. A temporary slowdown in sales of networking products created idle production capacity during the year, which added to overhead costs. In addition, rising raw material costs and pricing pressure on digital A/V products weighed down overall product profitability.

In response to lower than expected sales turnover and rising costs of materials, SUGA tightened considerably certain variable overhead expenses during fiscal year 2005. However, in order to enhance competitiveness and build a diversified product portfolio, SUGA continued to expand research and development and marketing operations for its new digital A/V products business. Research and development expenses were increased to HK\$4.6 million from HK\$1.0 million last year, while distribution and selling expenses rose to HK\$16.7 million from HK\$11.3 million.

Net profit for the year was HK\$19.2 million, as compared to HK\$42.8 million in fiscal year 2004. This change was mainly attributable to (i) a HK\$11.6 million reduction in gross profits, (ii) a HK\$3.5 million increase in product research and development expenditure, and (iii) a HK\$5.4 million increase in marketing expenditure. Although our investments in new product development and marketing for digital A/V products had negatively impacted profitability in the last fiscal year, we believe this investment will drive future growth for the Group and create long-term shareholder value.



## CHAIRMAN'S STATEMENT

### DIVIDENDS

The Directors recommend the payment of a final dividend of HK0.35 cent per share (fiscal year 2004: HK3.0 cents per share) to shareholders whose names appear on the register of members of the Company on 26 August 2005. Together with the interim dividend of HK3.0 cents per share (fiscal year 2004: HK2.5 cents per share), the total dividend for the year will amount to HK3.35 cents per share (fiscal year 2004: HK5.5 cents per share). The final dividend will be payable on or before 8 September 2005.

### BUSINESS OVERVIEW

#### Telecommunication Products

The sales turnover from telecommunication products business fell 24.5% from that in the prior year to HK\$272 million, accounting for 46.0% of the Group's total turnover. The decline was mainly due to one of our largest networking customers changing its product distribution strategy, which led to a temporary reduction of production in the second half of the fiscal year. Shipments for this customer have now returned to normal. In the first quarter of fiscal year 2006, orders for these networking products increased significantly, with sales growing by 25.0% over the last quarter of fiscal year 2005, and we expect them to continue to grow steadily.

During the past year our telecommunication products business captured new orders from NEC of Japan for both key telephone systems and voice-over-internet-protocol ("VoIP") phones. Orders from NEC had grown since the first shipment in July 2004. We are confident of achieving further growth for the telecommunication products business segment in the coming year.

#### Consumer Electronic Appliances

Sales from the consumer electronic appliances business recorded growth of 30.7% over the previous year to reach HK\$283 million, accounting for 47.9% of the Group's total sales.

Sales of pet training devices maintained steady organic growth and satisfactory gross margins during the year. With over 10 years of experience in developing and manufacturing pet training devices, SUGA is the only Hong Kong-based Electronic Manufacturing Services ("EMS") provider with extensive experience in producing such unique products. Building on our long-standing relationship with our US partner, who is the largest supplier in the US pet training device market, SUGA is confident of maintaining its position as the leading EMS provider in the pet training device industry.

In fiscal year 2005, we also secured a US customer who designs high definition video security products. With security a growing concern among different industries, the Group's video security products have great development potential. This video security product is complex in both its features and manufacturing processes and requires advanced design and manufacturing capabilities. SUGA was selected as the manufacturing partner because of its capabilities in designing and manufacturing high-precision and affordable products.

## **BUSINESS OVERVIEW** *(Continued)*

### **Digital Audio-Visual ("A/V") Products**

In operation for less than a year, this segment generated sales turnover of HK\$19 million and accounted for 3.2% of the Group's turnover. This segment mainly comprises products developed by the Group as well as trading products sourced for resale. Digital A/V products faced intense competition and rising raw materials costs during the year, pushing down product prices and margins.

We launched a SUGA designed and developed portable MPEG-4 player to overseas markets during the year, but the market growth was lower than expected. Market analysts believe MPEG-4 players will gain popularity as more online digital entertainment content becomes legally available for download. Apart from MPEG-4, we also launched our smallest color MP3 in Hong Kong, which was pretty well received by retailers.

We introduced the "Nachus" brand with a sales and distribution network spanning Hong Kong, Singapore and during the first half of fiscal year 2006, China. Supported by major retail channels, the Nachus brand enjoyed widened distribution and gained gradual market recognition. Greater market recognition of the brand and our effective distribution and marketing strategy in the ODM market are expected to generate more business at a better profit margin for the Group in the future. SUGA will continue its commitment to developing more innovative digital A/V products to overcome challenges and capitalize on opportunities in this fast changing market.

### **ACQUISITION**

In September 2004, the Group acquired Precise Computer Tooling Company Limited ("Precise") in Huizhou, Guangdong, at a consideration of HK\$8.5 million. Precise specializes in the production of moulds and plastic components. The acquisition provides SUGA with the opportunity to vertically integrate its manufacturing processes. Apart from ensuring the stable supply of plastic parts for production and better control of production cost and quality, vertical integration of its production also allows the Group to maximize overall profitability and operational efficiency. Plastic parts produced for internal use accounted for approximately 27% of Precise's total production. Furthermore, Precise also has an established customer base, which is now contributing to the Group sales turnover. In five months since it joined the Group, Precise contributed additional revenue of HK\$19 million to the Group, or 3.2% of the Group's total turnover for fiscal year 2005. Its contribution to the Group is expected to increase significantly in fiscal year 2006.

### **SYNDICATED LOAN AND REVOLVING CREDIT FACILITY**

To finance SUGA's capital expenditure and working capital requirements for future growth as well as to lower funding costs, the Group signed a three-year HK\$120 million syndicated loan and revolving credit facility in September 2004 with DBS Bank Limited as the arranger. This loan facility is more than adequate to finance our continued growth, and we have ample cash and loan facilities available to finance future growth.



## CHAIRMAN'S STATEMENT

### LOOKING AHEAD

We are positive about the Group's performance for the coming year. SUGA will continue to leverage its well-developed manufacturing capabilities, research and development expertise, logistic planning, and distribution network to offer top quality products to our customers.

In the telecommunication products business, networking products have resumed growth and will be one of the Group's major revenue contributors in the coming year. Through efforts to improve production efficiency, we expect the gross profit margin of the segment to improve. In addition, the VoIP phone is gaining worldwide popularity and, based on orders already received, we see steady growth in sales.

The consumer electronic appliances business is expected to continue to provide stable sales and profits to the Group. We are launching a series of deluxe model of pet training devices to our US partners in the first half of fiscal year 2006. In addition we are studying an exciting opportunity of possibly working with our US partner to expand their marketing footprint into the Asian pet training devices market. We can leverage our extensive experience in the China market to assist our US partner in growing sales and production.

In addition, orders for the Group's high definition video security product show good growth potential. The wide applications of this advanced security product are expected to draw a wide variety of major customers, such as banks and casinos. We are confident such business will not only boost our profits, but also our reputation for product innovation and manufacturing excellence.

The Group's digital A/V products business will launch a new product, a digital photo album, in August 2005 for a leading US electronics retailer. In addition to manufacturing the product, the Group was also in responsible for the product development. This strategy has allowed the Group to capture higher margins and further strengthen its relationship with this new customer. The Group's hard drive MP3 player, with an attractive appearance, advanced functions, and large memory, will hit the market in the first half of fiscal year 2006. As the digital A/V products business is still in its initial investment stage, we intend to inject more resources into research and development to establish a stronger foundation for future business growth. Nevertheless, the research and development expense will be less than 1.5% of the Group's total sales in a fiscal year.

The Precise acquisition completed last year enhanced the Group's vertical production capability and brought SUGA a new and stable revenue and profit source. The Group will capture a full year contribution from Precise in fiscal year 2006, and benefit from the diversified customer and revenue base it brings. Prior to the Precise acquisition, we increased our interest in Suga Networks Hong Kong Limited by 15% in November 2003, making it a wholly-owned subsidiary of the Group. This acquisition enabled us to capture the entire profit contribution from the networking product business. Both acquisitions generated handsome returns to the Group and demonstrated the management's capabilities and vision in acquiring new businesses. The Group will remain open to future merger and acquisition opportunities to accelerate growth.

### **LOOKING AHEAD** *(Continued)*

As a value-added EMS provider, the Group is committed to ensuring that our production processes are environmentally friendly, thereby protecting both our workers and customers. The consumer electronic manufacturing processes are lead-free and comply with all relevant environmental standards as per respective customer's request. Our strict adherence to environment safety codes improved our competitiveness and demonstrated our commitment to employing the best manufacturing practices. Since many European customers see green manufacturing as a prerequisite in selecting their manufacturers, SUGA stands favourably in serving the needs of potential European customers.

### **APPOINTMENT OF INDEPENDENT NON-EXECUTIVE DIRECTOR**

Mr. Leung Yu Ming, Steven was appointed as the Group's Independent Non-executive Director effective from 27 September 2004. Mr. Leung is a certified practicing public accountant of CPA Australia and a fellow of the Association of Chartered Certified Accountants in the UK, the Hong Kong Institute of Certified Public Accountants and the Taxation Institute of Hong Kong. Mr. Leung is also a practicing certified public accountant in Hong Kong.

### **APPRECIATION**

On behalf of SUGA, I would like to extend my sincere gratitude to our business associates, customers and shareholders for their support throughout the year. I would also like to thank our dedicated management team and committed staff for their hard work and continuous efforts over the years. While our results in the past year did not meet our expectations, we are confident that the efforts we made the past year had strengthened our foundation for future business growth. SUGA's management and staff are committed to growing sales turnover and profits to ensure rewarding future returns to all our shareholders.

**NG Chi Ho**

*Chairman*

Hong Kong, 25 July 2005