

Management Discussion and Analysis

Market Review

The electro-acoustic peripheral industry experienced healthy growth in 2005 driven by the boom of multi-media, communication, and entertainment products worldwide. Technological advancements in internet and digital technologies have enabled consumers to enjoy their contemporary life with greater mobility and instant access anytime, anywhere. Consumer demand for digital multi-media, communication, and entertainment products namely portable compressed music players, personal computers, gaming consoles, mobile phones in particular Bluetooth-enabled models, has been rocketing and is expected to continue to grow as those products become yet more user-friendly and affordable. The digital lifestyle is expected to spread among different age groups and cross-application of different multi-media products. That will in turn translate into derived demand for electro-acoustic peripherals that can complement or realize fully the performance and applications of the new and more powerful multi-media products. Electro-acoustic peripherals which are personal, portable, wearable, stylish, and can fit a diverse range of devices will undoubtedly be preferred over traditional products.

Business Review

Company Overview

Listed on 14th July 2005, Shinhint is one of the prominent manufacturing services providers of electro acoustic peripherals for leading consumer electronics brands. Armed with vertically integrated manufacturing facilities and expertise in electronic, acoustic, and mechanical engineering, the Group develops and produces a broad range of contemporary and life style enriching electro acoustic peripherals. These products including communication, entertainment, multi-media, audio peripherals, and other accessories for various consumer electronic devices such as personal computers, gaming consoles, mobile phones, compressed music players, as well as automobile and home theatres.

The Group achieved encouraging growth in turnover and profit for the fiscal year 2005, despite having to face adverse cost factors including pressure from the Renminbi appreciation, and increase in material, electricity and labour costs. The Group posted a turnover of HK\$1,016,198,000, up from HK\$529,946,000 last year, representing an increase of 91.8%. While the Group's profit attributable to shareholders increased by 12.7% to HK\$45,432,000 (2004: HK\$40,315,000). Basic earnings per share were HK cents 17 (2004: HK cents 18).

The Group's production facilities operated at 82.0% of their total capacity during the year. The net proceeds raised from the Group's share offering in July 2005 were used as planned and on schedule to enhance product research and development, manufacturing capabilities to cater for the expected increase of sales order in 2006 as well as sales channel expansion.

To better reflect the market dynamics under the rising popularity of digital applications, the Group has realigned its sales segments by product categories to enable formulation of business strategies for each specific segment. During the year under review, the Group focused on broadening its product range and facilitating cross-device application of its products. All the business segments registered significant growth during the year, re-affirming both the strong market demand for the products concerned, as well as consumers' acceptance of the products manufactured by the Group.

06 Management Discussion and Analysis

Communication Peripheral Business

Turnover of the Group's peripherals for communication devices such as mobile phones, line phones and internet phones recorded a 93.5% growth in 2005 to HK\$162,247,000. Segment result went up 194.5% to HK\$11,385,000, with the margin of this business segment surged from 4.6% last year to 7.0% this year. It has emerged to be a growth driver for the Group.

Both the accelerating penetration of mobile phones and internet phony have been fuelling demand for communication peripherals, especially those for supporting digital wireless applications. The Bluetooth digital wireless technology is expected to gain further market acceptance in the coming years. In addition, the management also sees tremendous potential in internet phony applications in the market and expects demand for its related products to take off in the near future and emerge as another growth driver for the Group. As a result, the Group will continue to devote dedicated resources to support the R&D activities in this business segment.

Entertainment Peripheral Business

The bullish economy in the USA and Europe in the passed year has boosted consumer demand for high quality personal consumer electronic products to enrich their leisure lives, which in turn derived a strong demand for high performance electro-acoustic peripherals. Sales of entertainment peripherals rose 102.2% to HK\$289,150,000. Segment result increased from HK\$9,707,000 to HK\$18,882,000 and its margin was generally maintained at 6.5%. Close collaboration with key customers in the consumer electronic market has equipped the Group with in-depth understanding of market trends, as well as the technical know-how to satisfy the consumers' demand, and thus the confidence of capturing the vast potential in this market segment.

Multi-media Peripheral Business

The multi-media peripheral business segment includes highly adaptable electro-acoustic peripheral for use with digital consumer electronic products. The growing popularity of digital music and increasing internet penetration supported sales growth of the Group's peripherals for multi-media products. This business segment was the largest revenue contributor of the Group and achieved turnover of HK\$440,769,000, a 116.0% surge, and a significant increase of 35.5% in segment result to HK\$24,464,000 as compared with the previous year. Although the margin of this business segment dropped from 8.8% to 5.6% as a result of increased in shipment of more functionally sophisticated models which requires the use of more expensive material, the segment is expected to continue generating substantial contribution to the profits of the group as the sales of multi-media products will continue to grow and so will the demand for peripherals covered in this segment.

Audio Peripheral Business and Other Accessories

During the year under review, the Group's audio peripheral segment reported a substantial improvement of 339.0% in turnover from HK\$10,604,000 last year to HK\$46,548,000 this year. The growth was mainly attributable to secure of high volume orders from major customers. Although segmental profit soared from last year's HK\$706,000 to HK\$1,215,000 this year, its margin was reduced to 2.6% from 6.7% due to increase in material cost. Competitive pressure is expected to remain tough in this particular segment, and the Group will focus on enhancing operational efficiency to ensure the segment to continue generate positive impact at the bottom lines.

Management Discussion and Analysis

Customers

The Group continued to focus on providing manufacturing services to leaders in the multi-media product industry. To facilitate the development of new products, the Group's key customers, including leading international consumer electronics brand owners, collaborate closely with the Group to identify and analyse potential market opportunities and changing consumer needs. During the year under review, the Group strategically forged partnerships with a new customer who is a prominent player in the consumer electronic market engaged in the design, marketing and distribution of digital wireless communication products. The Group will continue to strengthen strategic relationships with existing customers, and at the same time seek to broaden its customer base by stepping up sales and marketing efforts.

FINANCIAL REVIEW

Results Performance

For the year ended 31st December, 2005, the Group's turnover increased by 91.8% from that of the previous year to reach HK\$1,016,198,000 (2004: HK\$529,946,000). This increase was driven by further expansion of sales to European market, where sales grew by 181.5% over the comparable period last year to HK\$416,827,000. Gross profit amounted to HK\$140,342,000 (2004: HK\$90,481,000), representing an increase of 55.1% as compared with last year while profit attributable to shareholders amounted to HK\$45,432,000 (2004: HK\$40,315,000), representing an increase of 12.7%. Net profit margin dropped to 4.5% from 7.6% last year, reflecting the impact from a lower gross margin as well as change of accounting standard including expensing share-based compensation of HK\$1,919,000 and charging of one-off expense of HK\$5,570,000 due to issuance of new Shares on Listing of shares on Stock Exchange, as well as increase in headcount and expenditure due to the establishment of research centre in Shenzhen. In addition, a loss of HK\$2,900,000 was posted due to the share of results of an associate.

During the year, basic earnings per share of the Group approximated at HK cents 17. The board of directors recommended the payment of a final dividend of HK cents 2.8 per share for the year ended 31st December, 2005. Together with the interim dividend of HK cents 2.5 per share already paid, total dividends for the year amounted to HK cents 5.3.

Liquidity and Financial Resources

As at 31st December 2005, the Group maintained a healthy cash level with cash and cash equivalents of HK\$71,736,000 (2004: HK\$50,099,000) and unutilised banking facilities of HK\$9,043,000 (2004: HK\$14,695,000). The Group's current ratio, being the proportion of total current assets against total current liabilities, was maintained at a stable level of 1.39 in 2005 compared to 1.33 in 2004.

Reflecting continuous improvement in the quality of the Group's assets, the gearing ratio of the Group decreased from 29.0% to 20.4% as at 31st December, 2005. The ratio was calculated by dividing total borrowings of HK\$45,957,000 (2004: HK\$31,205,000) by shareholders' equity of HK\$224,809,000 (2004: HK\$107,697,000).

As at 31st December, 2005, the Group's inventories increased to HK\$173,492,000 (2004: HK\$45,173,000). Inventories increase reflected primarily a significant increase of customer purchase order received on hand over the corresponding period. New ERP system is going to be implemented to enhance inventory and receivable management.

08 Management Discussion and Analysis

The cash outflow from operating activities amounted to HK\$12,407,000, it was mainly due to significant increase in turnover in the last quarter of the year, and the trade receivables were received on schedule subsequently.

Treasury Policies

It is the Group's treasury management policy not to engage in any highly leveraged or speculative derivative products. Continuing this conservative approach to financial risk management, the Group worked during the year towards decreasing its gearing position. Since the Group's sales and raw material purchases are denominated in US dollars and Hong Kong dollars, the Board believes the Group will have sufficient foreign exchange to match foreign exchange requirements. Although part of its manufacturing overhead is denominated in Renminbi, the Group's exposure to Renminbi exchange risk is nominal. The Group will closely monitor the movement of the Renminbi exchange rate. During the year, the Group did not use any financial instrument for hedging purpose.

Contingent Liabilities

As at 31st December, 2005, the Group had no contingent liabilities.

Pledge on the Group's assets

As at 31st December, 2005, bank deposits of HK\$9,877,000 (2004: HK\$2,053,000) had been pledged to secure the Group's banking facilities.

Significant Capital Investments

During the year, the Group invested approximately HK\$19,552,000 in acquiring the latest technological equipment, product design and development software and integrated management information system. The expenditures were mainly funded by proceeds from IPO.

PROSPECTS

Going forward, the Group sees surging market demand for personal, portable, wearable, compact and stylish, and highly adapted electro acoustic products that can bring quality acoustic experience to the consumers. For communication, multi-media, and entertainment devices to realise their sophisticated functional performance, they require the support of high quality electro acoustic peripherals. Heeding this need, the Group has mapped out certain strategic directions that will enable it to capture new market opportunities.

To strengthen its research and development supports to answer the ever-changing end-user demand for quality electro-acoustic peripherals and to facilitate the development of trend setting products, the Group will continue to foster the capability of its research centre in Shenzhen, the PRC and will recruit more experts with strong product development and design experiences to hasten the product development processes.

To maintain and enhance collaborative relationship with worldwide industry leaders and deepen penetration of the international market, the Group will set up three overseas offices in the short to medium term. Work in relation to the setting up of the Japan office is in its advanced stage and that of the US office is progressing according to plan. Both offices are scheduled to be operational within 2006. The Group also has plans for setting up an office in Europe.

Management Discussion and Analysis

Anticipating rapidly growing demand from the consumer market, the Group sees a significant portion of its future growth to be contributed by organic growth of its business with existing clients. Nevertheless, the Group will also endeavour to enlarge its customer base. It will employ focused marketing strategy to foster collaboration with industry leaders who will bring growth potential to the Group. Moreover, aiming to enhance return to shareholders, the Group will continue to explore opportunities for acquisition, or forming strategic partnerships with enterprises with advanced technological know-how in related fields that can bring values and synergies to the Group .

With all the above strategies in place, the Group will continue to strengthen its prominence in the industry and develop premium products that meet customers' demand, thereby assure its future success as well as better returns for its shareholders.

EMPLOYEES

As at 31st December, 2005, the Group had a total of about 4,300 employees in Hong Kong and in the PRC. Employees' cost (excluding directors' emoluments) amounted to approximately HK\$65,942,000 (2004: HK\$46,249,000). The Group ensures that the pay levels of its employees are competitive according to market trend and its employees are rewarded on a performance related basis within the general framework of the Group's salary and bonus system.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S SECURITIES

There was no purchase, sale or redemption of shares of the Company by the Company or any of its subsidiaries during the year.