Understanding
Customers' requirements

Management Discussion and Analysis

FINANCIAL REVIEW

Fiscal year 2006 was a challenging year to SUGA. The economic environment remained unfavourable to electronic industry. The continued rise in raw materials price, manufacturing costs and labour costs, the severe pricing pressure on digital audio-visual ("A/V") products caused by fierce competition and the interest rate hike all posed huge pressure on our gross profit margin and net profit for the year.

Turnover

The Group's turnover for the year was HK$772 million, representing an increase of 30.5% from last year. The growth was mainly attributable to the significant increase in sales of pet training products, digital A/V products and the full year operation of our plastic division, which was acquired by the Group in the second half of fiscal year 2005.

Consumer electronic appliances achieved sales growth of 48.7% to reach HK$421 million. This segment accounted for 54.5% of the Group's turnover. Pet training products sales accounted for 60.0% of this segment's total sales for this year.

The sales of telecommunication products amounted to HK$293 million for the year, representing an increase of 7.7% as compared to last year. This segment accounted for 38.0% of Group's turnover, down from 46.0% last year. The increase in turnover was mainly attributable to the significant increase in sales of key telephones and voice-over-internet-protocol ("VoIP") phones offsetting the drop in networking products sales. The networking products sales this year dropped by 16.6% as compared with last year.

Digital A/V products recorded sales of HK$49 million for the year, representing 6.3% of the Group's turnover. Sales under the Group's owned brand, "Nachus", accounted for 62.1% of this segment's total sales while ODM sales of the Group's self-developed products accounted for 37.9%.

Geographically, United States became the major market of the Group. Sales to United States increased by 62.8% to HK$296 million, representing 38.3% of the Group's turnover, up from 30.7% last year. Sales to Mainland China decreased slightly by 3.7% to HK$234 million, representing 30.3% of the Group's turnover, down from 41.0% last year.

Profit Attributable to Shareholders

The Group's gross profit increased by 7.9% to HK$86 million from HK$80 million last year while gross profit margin decreased from 13.5% to 11.1%. The decrease in gross profit margin was mainly attributable to the increase in production costs, the drop in sales of networking products and the substantial pricing pressure of the digital A/V products due to keen market competition. During the year, digital A/V products sales increased by HK$30 million, a raise of 158.5% from last year. As the selling price of digital A/V products drop rapidly and significantly, this segment recorded an operating loss of HK$18 million for this year.

Profit from operations was HK$14.8 million, compared with HK$26.3 million last year. Total operating expenses increased by 33.7% to HK$72.5 million from HK$54.2 million last year, representing 9.4% of the Group's total sales.

Selling and distribution expenses moved up to HK$18.5 million this year from HK$16.7 million. The increase is mainly due to increase in resources to cope with the boost in sales volume and to enlarge our customer base of the consumer electronic appliances and digital A/V products business.

Research and development expenses increased from HK$4.6 million to HK$6.8 million, approximately 0.9% of Group's sales. The increase in research and development expenses was mainly due to the fact that more staff was employed to our research and development team plus the written off of HK$1.2 million capitalised development expenditures for discontinued projects during the year.

General and administrative expenses for the year amounted to HK$54.0 million, representing an increase of 43.8% as compared to that of last year. The increase is mainly due to increase in depreciation charge and staff costs and also the full year operation of the plastic division. In addition, the Group has made provisions for doubtful debts of HK$4.4 million for trade receivables of the trading business.

Finance costs increased to HK$9.1 million from HK$3.7 million last year as a result of the increase in bank borrowings and the continued rise in interest rate during the year.

Management Discussion and Analysis

FINANCIAL REVIEW *(Continued)*

Profit Attributable to Shareholders *(Continued)*

In October 2004, the Group acquired a 29.27% interest in Modern Tech Limited ("Modern Tech") for HK$3 million. The principal activities of Modern Tech are development and sale of electronic educational products. The key feature of these products is the application of "Advance Speech Technology enhancing language learning" technology. The first product was launched to the market in July 2005 but the response from the market was far below our expectation. As a result Modern Tech suffered loss for the fiscal year 2006. The share of loss of the associated company and the impairment on investment cost made by the Group amounted to HK$2.3 million for the year.

As a result of the above reasons, net profit attributable to shareholders decreased to HK$1.3 million from HK$19.2 million last year, representing a decrease of 93.0%.

LIQUIDITY AND FINANCIAL RESOURCES

The Group generally finances its operations by internally generated resources and banking facilities provided by its principal bankers in Hong Kong. Banking facilities used by the Group include revolving loans, trust receipt loans, overdrafts, leasing and term loans, which are primarily on floating interest rates basis.

As at 31 March 2006, the Group's cash and bank balances amounted to HK$63 million while net current assets were HK$120 million. The current ratio as at 31 March 2006 was 1.43, down from 2.23 last year. The significant drop in current ratio is mainly due to most of the Group's term loans will be matured within the next twelve months and are classified as current liabilities at the balance sheet date. The Group is now negotiating with banks to refinance some of the short term loans by long term banking facilities. The Group's net bank borrowings as at balance sheet date were HK$94 million compared to HK$67 million last year. Net gearing ratio, based on net borrowings to equity, was 42.7% (2005: 32.2%). Increase in bank borrowings was primarily a result of the increase in inventories held and the investment in capital expenditure of HK$37.3 million during the year.

As at 31 March 2006, the Group had aggregate banking facilities of approximately HK$405 million (2005: HK$370 million) from its principal bankers for overdrafts, loans and trade financing, with unused facilities of HK$194 million (2005: HK$202 million).

Compared with last year, the Group's inventories increase by 17.3% whereas trade and other receivables and trade and other payables balances decreased by 3.1% and 0.3% respectively. The substantial increase in inventories held at year-end was mainly due to increase in sale orders on hand. The decrease in trade and other receivables was due to the tightening of credit control to our customers during the year. The Group also factored some of the trade receivables to bank on a without recourse basis in order to limit the credit exposure to individual customer.

CAPITAL EXPENDITURES

The Group's total capital expenditures for the year was HK$37.3 million which mainly comprised investment in land use rights and property, plant and equipment in Huizhou factory for plastic business of HK$15.9 million and purchase of machineries and equipment for the expansion in consumer electronics business of HK$20.4 million. The investment in Huizhou factory included the acquisition of land use rights and buildings situated at District 8-6, LG East Road, Zhongkai Hi-Tech Development Zone, Huizhou at a consideration of RMB10.3 million. The land use rights and building acquired are currently used by the Group's subsidiary engaged in plastic and mold manufacturing as its production plant.

FOREIGN EXCHANGE EXPOSURE

Most of the Group's business transactions are denominated either in Hong Kong Dollars ("HKD"), United States Dollars ("USD") or Renminbi ("RMB"). As USD is pegged to HKD, the Group does not expect any significant movements in the USD/HKD exchange rate.

FOREIGN EXCHANGE EXPOSURE *(Continued)*

As all of the Group's production plants are based in the People's Republic of China, most wages and salaries and manufacturing overheads are mainly denominated in RMB. The continued appreciation of RMB since July 2005 inevitably increase our production costs. However, the fluctuation in RMB is still mild for the time being and also about 30% of the Group's income are denominated in RMB, which can be considered as a natural hedge against the RMB expenditures, the directors are of the view that it is not necessary for the Group to purchase any foreign exchange futures to hedge against the RMB exchange risk at this moment.

CAPITAL COMMITMENTS AND CONTINGENT LIABILITIES

As at 31 March 2006, the Group had an outstanding capital commitment of approximately HK$8.1 million in respect of capital injection in Precise Plastic Injection (Shenzhen) Co., Limited, a wholly owned subsidiary of the Group. Corporate guarantees given to banks to secure the borrowings granted to subsidiaries as at 31 March 2006 amounted to HK$165.2 million and the Group did not have any significant contingent liability.

HUMAN RESOURCES

As at 31 March 2006 the Group had approximately 2,466 employees, of which 105 were based in Hong Kong, Macau and Singapore while the rest were mainly in the Mainland China. Competitive remuneration packages are structured to commensurate employees with reference to their individual job duties, qualification, performance and years of experience. In addition to salaries and other usual benefits like annual leave, medical insurance and provident fund, the Group also provides educational sponsorship subsidies, discretionary performance bonus and share options. A share option scheme was adopted on 17 September 2002 which is valid and effective for a period of 10 years from the adoption date, detailed of which are specified in the Section "Share Option Scheme" on page 26.