MANAGEMENT

Discussion and Analysis

The following sets out the financial highlights for the year ended 31 March 2006, with the comparative figures for the corresponding financial year of 2005.

	2006	2005
	HK$'million	*HK$'million*
Revenue		
– Marketing and distribution	**2,178.9**	1,878.2
– Design and manufacture	**273.3**	409.1
	2,452.2	2,287.3
Earnings before interest, tax, depreciation, amortisation and non-cash items		
– Corporate	**4.2**	0.9
– Marketing and distribution	**47.4**	37.5
– Design and manufacture	**(54.9)**	47.2
Gain on disposal of a subsidiary	**39.6**	–
Gain on disposal of an available-for-sale equity investment/ a long term listed investment	**37.5**	197.7
	73.8	283.3
Depreciation, amortisation and other non-cash items		
– Marketing and distribution	**(4.7)**	(2.3)
– Design and manufacture	**(33.9)**	(27.2)
	(38.6)	(29.5)
Earnings before interest and tax	**35.2**	253.8
Interest expenses	**(19.0)**	(11.4)
Profit before tax	**16.2**	242.4
Tax	**(7.9)**	(32.3)
Profit for the year	**8.3**	210.1

Management Discussion and Analysis

BUSINESS REVIEW

FY2005/06 was of strategic importance to AV Concept. The management has observed cautiously changing consumer behaviors in the markets in the past few years and made timely decisions accordingly to address different market situations. During the year under review, the Group made several crucial moves to restructure its business model.

Major Restructuring

The global MP3 market has recently transformed into a heavily monopolised marketplace dominated by a few major players. Apart from low profitability and margins, the business required continuous investment in research and development and the tying up of working capital of the Group. Taking into account the unfavorable market environment, the management has decided that the Group should exit from the market at an early stage and free resources for higher margin businesses.

Discontinuation of the MP3 business led to command our exit from the Japan market, the closing down of the Group's Shenzhen manufacturing plant for the China market, as well as the MP3 sales offices in Germany. Going forward, AV Concept plans to direct its research and development resources towards developing its new line of business – design and manufacturing of niche special-care products. Since 2003, the Group has been developing special-care electronics products for one of the world's largest special-care products provider. Although turnover contribution from the business segment was insignificant in the past, the Group sees vast potential in this market as the worldwide population ages. Characterised by relatively longer product cycles, higher profit margins and entry barriers, the management has full confidence in this new business direction of the Group.

Furthermore, the Group will also be engaging in a new line of distribution business distributing niche medical equipments in Asia and the PRC. Taking advantage of its experience in electronics distribution in the Greater China region and in dealing with Korean suppliers, AV Concept is well equipped with the necessary qualities to succeed in this niche distribution market. Currently engaged distribution arrangements include the state-of-the-art balanceback™ equipment for the treatment of balance disorders to be distributed in Asia, and a range of quality Korean medical equipments targeted at hospitals and clinics in the PRC. The Group believes the restructuring will enable it step into a new era of development.

BUSINESS REVIEW *(continued)*

Financial Results

For the financial year ended 31 March 2006, the Group recorded turnover of approximately HK$2,452.2 million, representing a growth of 7% over last year's. This was attributable to the healthy growth of the distribution business. Profit for the year amounted to HK$8.3 million (FY2004/05: HK$210.1 million). The reasons for the significant change in profit are as follows:

- During the year, the Group disposed of all the remaining investment in Reigncom Limited ("Reigncom"), resulting in a net pre-tax gain of HK$37.5 million on disposal of investment (FY2004/05: net pre-tax gain of HK$197.7 million).

- The negative EBITDA (i.e. earnings before interest, tax, depreciation, amortisation and non-cash items) of HK$54.9 million was incurred by the design and manufacturing business which saw operations (i.e. MP3 business) discontinued and the HK$33.9 million non-cash losses such as depreciation, amortisation, stock and bad debts provisions, and fixed assets write-offs in relation to the MP3 business.

In the current year, another disposal gain of HK$39.6 million was recorded from the disposal of our 50% equity interests in AV BreconRidge Limited (previously known as "AV Chaseway Limited") to the Group's long-term business partner BreconRidge Manufacturing Solutions Corporation ("BreconRidge"), a Canadian EMS manufacturer.

Excluding the above non-recurring items and the gain from Reigncom share disposal of about HK$197.7 million in the previous financial year, the EBITDA of our core business (i.e. marketing and distribution business) for FY2005/06 increased about 26% to HK$47.4 million. Thanks to the stabilised prices and increased volume of the semiconductors distributed by the Group, as well as the increasing contribution from the high-margin special-care electronics business segment.

Marketing and Distribution Business

During the year under review, the marketing and distribution business remained as the Group's core revenue contributor accounting for 89% of the total turnover. The segmental turnover grew 16% to reach HK$2,178.9 million. Although the market was competitive, backed by the long term and stable relationships the Group has with Samsung Electronics, Fairchild and other suppliers, an extensive distribution network and experienced marketing and sales workforce, the Group was able to exploit the continuously growing demand for semiconductors coming from the increasing export of PRC manufactured digital products.

EBITDA for the segment amounted to HK$47.4 million, 26% higher than that of last year, while segmental profit was HK$42.8 million (FY 2004/05: segmental profit of HK$29.7 million).

BUSINESS REVIEW *(continued)*

AV Concept remains as one of the largest distributors of Samsung Electronics semiconductor products in Hong Kong and the PRC. With in-depth product knowledge and engineering know-how, the Group's in-house engineering team is capable of offering technical design and engineering support to customers, and that distinguish the Group from its competitors. Being able to offer one-stop service has been crucial in helping the Group to maintain long-term relationships with major suppliers and customers.

In coming years, the marketing and distribution business will remain as the Group's cash cow business and will continue to provide stable and substantial income for Group's future developments.

Design and Manufacturing Business

The design and manufacturing segment's turnover for the year decreased by 33% to HK$273.3 million due to severe market competition.

EBITDA for the segment was loss of HK$54.9 million, while segmental loss was HK$85.2 million. The difference was largely due to the HK$33.9 million non-cash losses such as depreciation, amortisation, stock and debt provisions, and fixed assets write-offs in relation to the MP3 business.

Due to the market challenges mentioned earlier, the management decided to exit the MP3 business and switch focus on to the niche special-care electronics market. The Group's existing customers in this market segment are mainly from North America, with its key client being the largest supplier of low-vision-aid products worldwide. Eyeing on the encouraging performance of this business segment as orders from existing customers continue to increase, the management has decided to dedicate more efforts in developing this line of business, targeting at achieving overall margin enhancement and long term profitability.

Joint Venture with BreconRidge

On 1 August 2005, the Group completed the first phase of the cooperative arrangement with BreconRidge, transferring its 50% equity interests in AV BreconRidge Limited in exchange for a warrant issued by BreconRidge. The warrant was valued at HK$60.7 million as at 31 March 2006. With BreconRidge's world-class engineering expertise and prominent client base as leverage, the management believes the Group will be able to streamline its manufacturing business and more efficiently allocate its resources. Furthermore, having direct interest in a world-class EMS solutions provider will allow the Group to generate more significant returns for its shareholders.

BUSINESS REVIEW *(continued)*

Establishment of AVC Medical

In May 2005, the founding of a new wholly-owned subsidiary AVC Medical Technology Limited ("AVC Medical") marked the Group's diversification into the niche medical products industry. AVC Medical engages in the development, manufacture and distribution of quality patented medical equipments targeting the elderly and those with special needs. AVC Medical has made its first strategic move, which is to cooperate with US-based Fall Prevention Technologies LLC in developing the balanceback™ equipments for the treatment of balance disorders. AVC Medical will be the exclusive manufacturer and sole distributor of these equipments in Asia. The Group believes an aging global population will drive demand for such products in the coming years.

PROSPECTS

Looking ahead, the Group will continue to strengthen its existing business and dedicate extra efforts in developing its new business. On top of that, the management will also continue to explore other profitable business opportunities with lucrative margins and growth potentials.

Electronics Distribution Business

The electronic distribution business will continue to be the Group's main revenue contributor continuing its proven track record. The Group will strive to expand market share of the business and maintain its position as a leading semiconductors distributor in Asia for Samsung Electronics and Fairchild products. The Group is confident that the segment will be able to consistently improve its financial performance as the market potential of the PRC manufacturing industry continues to expand. As for new products, the Group entered into a sole distribution arrangement with SiTime Corporation in April 2006 to distribute the world's first commercially viable MEMS ("micro-electro-mechanical systems") silicon resonators. Going forward, the Group will continue to expand its distribution portfolio, grasping suitable opportunities in the fast-changing electronics market.

Design and Manufacturing for Special-care Electronics Products

The Group's current strategy for the design and manufacturing business is to focus on high margin products with longer product life cycles targeting niche markets such as the special-care product market. Though turnover may be lowered at the early stages, segmental results will be compensated by higher profits margins, allowing the Group to maintain overall profitability in the long run.

The management believes market demand for such products will surge as governments worldwide become increasingly aware of their responsibility to provide financial aid to the needy for purchasing these products.

PROSPECTS *(continued)*

Medical Equipment Distribution Business

On top of manufacturing niche special-care products, the Group will also diversify into the distribution of quality medical equipments to hospitals and clinics in the PRC and Asia.

The Group has already secured exclusive distributorships for the balanceback™ equipments in Asia and a range of quality Korean medical equipments in the PRC. The management anticipates high demand for quality medical equipments from PRC cities as medical services improve at the push of provincial governments. The comparative advantages of these products being that when compared with those produced locally, Korean medical equipments stand out in quality; and price-wise, they are more affordable than those made in Japan, USA and Europe. Backed by a sales and marketing team with experienced members, some of whom having over 20 years' experience in medical equipment distribution in the PRC, together with AV Concept's experience in working with Korean business partners, the management is optimistic about the development of the new business segment.

Adhering to the new business focus, the management is confident of achieving sustainable growth for the Group in the long run. With the electronics distribution business continuing to contribute stable income, and the new niche market businesses driving future growth, the Group is committed to bringing satisfactory returns to its shareholders.

LIQUIDITY AND FINANCIAL RESOURCES

The net debt position as at 31 March 2006 and 2005 and the corresponding gearing ratio are shown as follows:

	2006	2005
	HK$'million	*HK$'million*
Bank debts	**394.2**	353.5
Cash and cash equivalents	**164.9**	219.0
Equity investments under current assets	**138.3**	89.7
Cash and cash equivalents and equity investments	**303.2**	308.7
Net debt	**91.0**	44.8
Total equity	**417.1**	473.9
Net debt to total equity	**22%**	9%

LIQUIDITY AND FINANCIAL RESOURCES *(continued)*

The reconciliation of profit before taxation to the change in net debt for the financial year of 2006 and 2005 are shown as follows:

	2006	2005
	HK$'million	*HK$'million*
Profit before taxation	**16.2**	242.4
Depreciation, amortisation and other non-cash items	**38.6**	29.5
Net proceeds from disposal of equity investment	**44.9**	218.1
Change in working capital	**47.8**	(83.7)
Gain on disposal of an equity investment	**(37.5)**	(197.7)
Gain on disposal of a subsidiary	**(39.6)**	–
Net capital expenditure investment	**(26.6)**	(42.5)
Interest paid	**(17.7)**	(11.4)
Change in fair value of equity investments	**(8.0)**	6.1
Tax paid	**(1.4)**	(7.5)
Others	**1.9**	(9.8)
Net cash inflow before dividends	**18.6**	143.5
Dividends paid	**(64.8)**	(84.3)
Net cash (outflow)/inflow for the year (i.e. change in net debt)	**(46.2)**	59.2
Analysis of change in net debt		
Net debt at beginning of year	**44.8**	104.0
Change in net debt	**46.2**	(59.2)
Net debt at end of year	**91.0**	44.8

LIQUIDITY AND FINANCIAL RESOURCES *(continued)*

As at 31 March 2006, the Group had a balance of cash and cash equivalents (i.e. cash and bank balances and time deposits) of HK$164.9 million (2005: HK$219.0 million), while the Group's equity investments at fair value through profit or loss amounted to HK$138.3 million (2005: HK$89.7 million). The equity investments included a balanced mix of fixed income, equity and alternative investments and such amount represented the cash reserves held for the Group's medium to long term business development and would form an integral part of the Group's treasury.

The Net debt to total equity ratio as at 31 March 2006 was 22% (2005: 9%), while the Group's total equity as at 31 March 2006 was HK$ 417.1 million (2005: HK$473.9 million), with the total balance of cash and cash eqivalents and equity investments as at 31 March 2006 of HK$303.2 million (2005: HK$308.7 million).

The working capital position of the Group remains healthy. As at 31 March 2006, the liquidity ratio was 150% (2005: 168%).

	2006	2005
	HK$'million	*HK$'million*
Current assets	**805.1**	935.4
Current liabilities	**(536.7)**	(556.2)
Net current assets	**268.4**	379.2
Current assets to current liabilities	**150%**	168%

The management is confident that the Group follows a policy of prudence in managing its treasury position, and maintains a high level of liquidity to ensure that the Group is well placed to take advantage of growth opportunities for the business.

EMPLOYEES

As at 31 March 2006, the Group employed a total of approximately 1,500 (2005: approximately 2,400) full-time employees.

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.