

Management Discussion and Analysis

BUSINESS REVIEW

“Jolimark” Brand Business

Having received many awards, “Jolimark” is a widely recognized brand in the PRC. It is the biggest domestic dot matrix printer brand. “Jolimark” boasts a great variety of products of wide applications. They include dot matrix printers, tax control ECRs, external tax control devices, tax control printers, mini printers and projectors, etc. Among them all, dot matrix printers bring in the most income for the Group.

To fully exploit opportunities arising from the third phase of the “Golden Tax Project”, the Group reassigned most of its sales force to promote tax control devices. However, as a result of the government’s delay in kick-off of the third phase of the project, together with the postponement of delivery of certain government purchases that the Group won in the bidding, sales for the year was affected. With the third phase of the project now underway, shipment in relation to the purchase order will gradually deliver and the kick-off of the “Golden Finance Project”, the Group expects its Jolimark brand business to make a robust return on to the growth track and tax control devices to become its major growth driver in the next few years. The “non-tax income” system in the “Golden Finance Project”



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requires government departments responsible for fee collection to install dot matrix printers, which will allow uniform fee collection management. This points to tremendous demand for dot matrix printers in 2006 and the few years beyond.

Of excellent quality and supported by an outstanding sales and after-sales service channel infrastructure, Jolimark's dot matrix printer received "The Most Powerful in Professional Training" award in the "2005 China IT channels — Champion Survey Election" organized by the Computer Partner World. In addition, Jolimark was also honoured with three top awards including the "2005—2006 China IT Market — Brand with the Highest Growing Potential (Jolimark)", "2005—2006 China IT Market — The Most Competitive Product (Jolimark FP-5800KII)" and "2005—2006 China IT Market — Product with the Highest Growing Potential (Jolimark LQ-300KII)" in 6th China IT Channel Forum hosted by CBI. It won the most awards among local receipt printer manufacturers.



Apart from supplying the dot matrix printer market, computer projector market is the Group's another target market. In the year under review, the Group launched the first projector series under the brand of "Phenix", targeting small and medium size enterprises and educational institutions that have a strong demand for products with high quality and competitive price.

EMS Business

As an EMS provider, the Group is capable of producing high quality optical, mechanical and electrical products. Armed with cost advantage, quality products and the ability to promptly respond to customers' demand, Jolimark has built itself into a choice EMS partner of a number of international corporations. At present, among the Group's prominent EMS clientele are many leading Japanese and European business equipment brands including EPSON, OKI, Seiko Precision, ABB and Neopost, etc. Benefited from customers developing more new product models, the Group saw steady growth in orders. During the year under review, the Group won a new client, namely Shinko, in Japan in manufacturing bankbook record printers. Riding on its solid customer base and the low labour cost in Mainland China, the management is confident that its EMS business will grow steadily in 2006.



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Distribution Business

With regard to its distribution business, the Group primarily distributes printers for Epson, and has been actively seeking new clients. During the year, the Group secured a new client, INFOCUS, and started to distribute the entire product line of ASK projectors for them.

Furthermore, the Group also actively extended its sales and after-sales service network. It set up branches in mid-size and large cities such as Hangzhou, Jinan, Zhengzhou, Kunming, Nanning, Fuzhou, Nanjing, Changsha and Lanzhou, and, during the year bringing its total number of branches from 7 to 16. The expanded network has helped the Group improve its distribution capability and foster its brand image. The Group also operates 146 after-sales service centers in about 20 provinces, 4 autonomous regions and 4 municipalities in the PRC to provide customers with the most comprehensive services.

Riding on the extended sales and after-sales service network, the Group has gained deeper understanding of the needs of its partners as well as the ultimate users of the products. Such knowledge allows the Group to adjust its sales strategy and tactics in a timely manner, thus boosts the Group's edges in assuming a better position in the competitive market.

FUTURE PROSPECTS

The third phase of "Golden Tax Project" has officially commenced, targeting income taxpayers in the service and retail industries such as food and beverage, entertainment and transport. The project requires sizeable retailers and service providers with fixed outlets to purchase and use tax control ECRs, and the IC card to report sales figure to the PRC Tax Bureau. This will allow the authority to effectively monitor business operation of taxpayers and provide important reference for tax bureaus for tax assessment and review. This policy is expected to be fully implemented



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in 3-5 years and will see a boom in demand for the Group's tax control equipment including tax control ECRs, external tax control devices, tax control printers, mini printers and ordinary invoice printers.

There are around 30 provinces in the PRC, and they have gradually begun to invite tender for tax control equipment. Most of the provinces are expected to close tender within 2006 and they would select generally 5 to 10 providers. Guangdong is the first province to close state related tenders and Jolimark is one of the five tax control ECR providers selected.

Guangdong contributes the highest tax revenue among all Chinese provinces.

According to a report on Xinhua Net on 3rd January 2006, the tax payment received by the Office of State Administration of Taxation and the Tax Bureau of Local Taxation from Guangdong in 2005 was RMB420.261 billion, an increase of 17.2%, or RMB61.54 billion, more than that in 2004, topping all provinces for the 14th consecutive year. The tax control ECRs market in Guangdong is the biggest and most competitive province in tender bidding over the country. The fact that Jolimark was selected in Guangdong shows that it has the strengths and advantages to compete more than that in other provinces.

In addition, Jolimark is capable of producing mini printer movement which is the core element of tax control ECRs accounting for one-fifth of the production cost of a tax control ECR. Adopting one-stop production, the Group can effectively control cost and widen gross profit margin.

Having snatched more than 25% market share during the second phase of "Golden Tax Project" and extensive experience in related product development, the Group will bid for contracts in most provinces in the brand name of "Jolimark" and is confident of achieving excellent results in the third phase of the "Golden Tax Project".

As far as dot matrix printers are concerned, with the "non-tax income" system in the "Golden Finance Project" taking effect and remote education programmes gain popularity, market demand for the printer will rise. At the launch of more new products and through acquisition and organic growth, the management expects yet better satisfactory development for the business segment. The Group will continue to step up promotion of its brand products, especially the mini printers, to enhance the profit contribution of its brand business and craft "Jolimark" into the top brand for business and tax control equipment in China.

Projectors are another strong growth driver of the Group. According to a CCID report, the CAGR of unit sales and sales volume of projectors in the PRC market is expected to be 36.9% and 13.2%, respectively between 2005 and 2008, to 868,000 units and RMB7.8 billion at the end of the period. The Group has already mastered the core technology for producing projectors and has been offering high quality and competitively priced products to customers under the "Phenix" brand. The Group believes it is poised to grasp every opportunity in the market. Besides producing projectors carrying the "Phenix" brand, the Group also distributes projectors to different overseas brands including 3M and INFOCUS, which is expected to generate notable income.



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Looking ahead, Jolimark will continue to heed and meet the demands of customers, step up channel development. Besides striving for economies of scale in production and maintaining its cost management advantage, the Group will also increase investment in R&D. By introducing the new printing solutions and extending its product lines, the Group pledges to offer better products to customers, thereby raise the overall value and competitiveness of the Group. With factors affecting the Group's performance in 2005 eliminated, the third phase of the "Golden Tax Project" steaming ahead and production of new products such as projectors and mini-printers commencing, we have great confidence in the financial performance of the Group in 2006.

FINANCIAL REVIEW

Summary of results

For the year ended 31 December 2005, the Group recorded a turnover of RMB981,650,000, representing an increase of 1.6% over the previous year. Although the cost of goods sold increased by 1.8% to approximately RMB825,541,000 (2004: approximately RMB810,959,000), the gross profit margin remained at approximately 16%. During the year, the Group recorded an operating profit of RMB80,127,000, and the profit attributable to shareholders was RMB78,603,000, representing a decrease of 8.8% from the previous year, which was mainly attributable to the increase in brand promotion cost and management fee. The basic earnings per share was RMB0.181.

Information by business activities

Set out below is a comparison of the Group's turnover, gross profit and gross profit margin in terms of business line for the year ended 31 December 2005 and 2004:

	For the year ended 31 December 2005			For the year ended 31 December 2004		
	Turnover (RMB'000)	Gross Profit (RMB'000)	Gross Profit Margin	Turnover (RMB'000)	Gross Profit (RMB'000)	Gross Profit Margin
Jolimark brand business	195,139	74,211	38.0%	277,963	86,066	31.0%
Distribution business	328,975	21,484	6.5%	242,576	17,474	7.2%
EMS/ODM/OEM businesses	457,536	60,414	13.2%	445,433	51,473	11.6%
Total	981,650	156,109	15.9%	965,972	155,013	16.1%

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ANALYSIS ON SALES AND GROSS PROFIT

During the year under review, the EMS business was still the largest contributor to the turnover of the Group, which accounted for approximately 47% and amounted to RMB457,536,000 representing an increase of 3% over the previous year. The increase was mainly due to increases in purchase orders for projectors and envelope machines.

The government's delay in kick-off of the third phase of the project, together with the postponement of delivery of certain government purchases that the Group won in the bidding caused Jolimark brand business's turnover down to RMB195,139,000, which represented 20% of the turnover of the Group. However, the third phase of the Golden Tax Project has formally commenced now and those orders under the government projects successfully tendered are to be delivered in succession. Turnover of the distribution business increased by 36% to RMB328,975,000 from RMB242,576,000 of the previous year, representing 34% of the turnover of the Group.

With regard to gross profit, the Jolimark brand business was the largest contributor which accounted for approximately 47% of the total gross profit of the Group for the year of 2005. The gross profit margin of the Jolimark brand business, by virtue of effective cost control measures and the launch of new products, increased to 38%, compared with 31% for the previous year. The EMS business and the distribution business constituted approximately 39% and 14% of the Group's total gross profit respectively. The gross profit margin of the EMS business increased to 13.2%, compared with 11.6% for the previous year, whereas the gross profit margin of the distribution business was 6.5%.

CAPITAL EXPENDITURE

For the year ended 31 December 2005, capital expenditure amounted to RMB13,443,000, of which, approximately RMB8,800,000 was used for the purchase of moulds for production, and the balance was used for the purchase of fixed assets for production and management purposes.

USE OF NET PROCEEDS FROM IPO

The Company issued 125 million shares of HK\$1.14 per share by way of Share Offer (as defined in the prospectus of Company dated 20 June 2005 "Prospectus") in June 2005. The net proceeds after deducting the relevant expenses was approximately HK\$120.8 million.

During the year 2005, the Group utilised the above proceeds in accordance with that disclosed in the Prospectus, namely, (i) HK\$11.47 million for the Group's marketing and promotional activities in the PRC and overseas markets and enhancing brand recognition of the Group's own brand products in the PRC; (ii) HK\$6.88 million for strengthening the Group's capacity in research and development; (iii) HK\$3.55 million for the expanding of sales and distribution network in the PRC; (iv) HK\$1.35 million for the development of overseas EMS business and (v) HK\$2.23 million related to the acquisition of new machinery and equipment for the development and production of new products and for the enhancement and expansion of the Group's production capacity.

The remaining balances of the proceeds were placed in banks as bank deposits as at 31 December 2005.

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FOREIGN EXCHANGE RISK MANAGEMENT

The Group's business are principally conducted in RMB, except for import of some of the direct materials and machinery used for production that are mainly conducted in USD, Japanese Yen, Euro and HKD. Therefore, the directors consider the risk to foreign exchange rate fluctuations is low.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2005, the total assets of the Group amounted to RMB622,865,000 (2004: RMB461,461,000), comprising shareholders' fund of RMB396,708,000 (2004: RMB194,282,000), minority interests of RMB11,895,000 (2004: RMB10,371,000) and long term and current liabilities of RMB214,262,000 (2004: RMB256,808,000). The current ratio of the Group was 2.6 (2004: 1.5).

The financial conditions of the Group were sound, as at 31 December 2005, the cash and cash equivalents of the Group amounted to RMB112,841,000 (2004: RMB38,951,000).

As at 31 December 2005, the bank loans of the Group amounted to RMB96,160,000 (2004: RMB100,000,000), and the gearing ratio was 15.4% (2004: 21.6%). The Group had no assets held under finance leases for the year.

CONTINGENT LIABILITIES

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

STAFF

As at 31 December 2005, the Group employed a total staff of 1,173, in which 1,155 were employed in Mainland China, while 18 were employed in Hong Kong and overseas. The Group implemented its remuneration policy, bonus and share option schemes based on the results and the performance of individual staff. In addition, fringe benefits such as insurance, medical allowance and pension were provided to ensure the competitiveness of the Group.

DIVIDEND

The Board recommended to declare a final dividend for 2005 of HK2.85 cents per share to shareholders whose names appear on the register of members on Monday, 24 April 2006. The final dividend will be paid on Wednesday, 31 May 2006.

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PURCHASE, DISPOSAL OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

During the year ended 31 December 2005, there was no purchase, redemption or disposal by the Group and any of its subsidiaries and their jointly controlled entities, of the Group's listed securities during the year.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") contained in Appendix 10 to the Rules Governing the Listing of Securities ("Listing Rules") on the Stock Exchange. The Company has made specific enquiry of all Directors regarding any non-compliance with the Code during the year ended 31 December 2005 and all Directors confirmed that they have fully complied with the required standard set out in the Model Code during the year.

AUDIT COMMITTEE

The Audit Committee of the Company was established on 13 June 2005 in accordance with Appendix 14 to the Listing Rules. The existing Committee comprises Mr. Lai Ming, Joseph as the chairman, Mr. Meng Yan and Mr. Xu Guangmao. All of the committee members are Independent Non-Executive Directors. During the year ended 31 December 2005, the audit committee held two meetings to review the accounting standards and practices adopted by the Group and to discuss on matters regarding the internal control and financial reporting (including the interim results before proposing them to the Board for approval) with the management, external auditors and internal auditing staff. The Audit Committee has reviewed the results announcement of the Company for the year ended 31 December 2005.

COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICES

Since the listing of its shares on the Stock Exchange, the Company has complied with the Code on Corporate Governance Practices as set out in Appendix 14 to the Listing Rules.