

BUSINESS REVIEW

The business environment for the Group's financial year 2001/2002 is full of challenges and difficulties. On top of the Group's controversial development blueprint, the market environment was both depressed and uncertain, creating the challenging first quarter for the Group. During the same period last year, both the markets for electronics and high-technology products were booming, stimulating substantial demand for electronic components. For the current year, however, the market situation was totally reversed with the global economic slowdown and the flood of negative news from the world's leading electronics manufacturers. Despite the unfavourable market environment, however, for the three months ended 31st July, 2001, the Group recorded a turnover of approximately HK\$79,770,000, showing only a moderate decrease of 12.0% when compared to the same period last year. Even more positively, the Group has sustained its gross profit margin at a satisfactory level of 32.6%. The results have demonstrated the Group's ability to maintain its competitive edge despite the adverse market conditions.

In the past financial year, the Group grasped emerging market opportunities, enjoying relatively low costs in the construction of new factory blocks and investment in the automation of production facilities, with total capital expenditure amounting to more than HK\$200 million. With the support of its major financing banks, the Group continued to finance its capital expenditure by its well-adopted asset-based financing methods, which were proved to be both effective and practical. As such, interest expense was pushed up by 78.1% to approximately HK\$6,769,000. The investments have also led to a 41.2% increase in depreciation of property, plant and equipment to approximately HK\$10,599,000. This has caused the profit attributable to shareholders to decrease from approximately HK\$14,588,000 to approximately HK\$5,747,000.

The Group is, however, fully committed to the above initiatives, which will be implemented according to the original plans. The Group strongly believes that these initiatives are essential and vital to building a more promising future. The Group is therefore expected to gain market share rapidly and will be able to fulfill the market demands better once the market stabilises, further reinforcing its status in the market.

Active Preparation for the Production of Series of Manganese-Zinc Ferrite Core Products

During the previous financial year, the Group began the installation of automated production facilities and the construction of new factory blocks fitted with sophisticated machinery, which have reached the completion stage. During the period under review, the production line for the series of manganese-zinc ferrite core products commenced trial production and has begun operations in the second quarter of this financial year. With the rapid technological advancement, the demand for quality electronic components has been soaring. The Group expects the manganese-zinc series products to fulfill the demands of manufacturers of high-tech products for top quality electronic components. The manganese-zinc series products also enjoy a higher expected gross profit margin of 40%, compared to 30% for usual coil products. With the high demand for manganese-zinc series products, the Group believes that these products will generate satisfactory returns.

Building on its research achievements and production experience, the Group has been continuously developing new formulae and innovative products during the period under review, striving for further breakthroughs in the quality and variety of its products to satisfy the demands of the electronics industry.

Financial Position

As at 31st July, 2001, total borrowings amounted to approximately HK\$294,160,000 (as at 30th April, 2001: HK\$255,558,000). Total cash and bank deposits increased to approximately HK\$56,761,000 (as at 30th April, 2001: HK\$55,714,000). The net gearing ratio, defined as total borrowings less total cash and bank deposits over net tangible assets, was approximately 88.1% (as at 30th April, 2001: 75.9%). With regard to the Group's incompliance as at 30th April, 2001 with one of the financial covenants imposed by its major bank that the net gearing ratio should not exceed 0.6:1, in August 2001, the Group has obtained the bank's approval for its net gearing ratio up to 0.85:1. Together with the net proceeds of approximately HK\$13,800,000 from the subscription for new shares announced on 11th September, 2001 (please see below for details), the Group has every confidence that it will effectively bring the net gearing ratio to below 0.85:1 in the near future.

As most of the Group's capital expenditure was financed by borrowings instead of equity financing, this has resulted in the Group's higher net gearing ratio. Despite this, the Directors considered the Group's overall financial position to be healthy. As at 31st July, 2001, the Group's aggregate banking facilities increased to approximately HK\$308,536,000 (as at 30th April, 2001: HK\$302,624,000), of which approximately HK\$56,944,000 (as at 30th April, 2001: HK\$65,727,000) was not yet utilised.

FUTURE PLANS AND PROSPECTS

Entering the 21st century, the world has been transforming into a knowledge-based economy. Global information and communication networks are therefore more important than ever. In spite of the worldwide economic slowdown, the accession of China into the World Trade Organisation ("WTO") will be a key growth-driver for electronic components arising from the information and communication technology revolution. We are therefore cautiously optimistic for the future and are preparing for sustainable development so as to bring better returns to our shareholders. The Group's future plans and prospects are elaborated as follows:

Broadening Customer Base and Diversifying Product Mix

Besides effective cost control, the Group is actively broadening its customer base. The Group has maintained an excellent product portfolio including different types of coils, inductors, transformers, line filters and electrolytic capacitors, etc. These products are widely applied in telecommunication and information technology equipment, data transmission and network products, audio and visual appliances, home electrical and electronic appliances. Together with its top product quality, the Group has won a broad customer base.

Although electronics manufacturers, especially those in Europe, are focusing more on production cost and product quality, the Group considers this to be an ideal opportunity for business exploitation. Over the years, the Group has been adopting efficient and effective production methods, producing quality products at the lowest possible cost, to capture a higher market share. Meanwhile, the Group is negotiating with a well-known mobile phone manufacturer in Europe to supply high-power major electronic components for its chargers on a long-term basis. The Group expects this move to bring in reasonable returns.

Strengthening Strategic Partnerships

In addition to effective cost management and a broad customer base, a well-established supply chain and widespread distribution network also contributed to the success of the Group.

Currently, the Group has two strategic partners, Nittoku Engineering Co., Ltd. ("Nittoku"), a manufacturer of coil-winding machines, and Toko Inc. ("Toko"), a leading international coils manufacturer. Both are well-known and well-established listed companies in Japan.

Since the Company's listing in November 1999, Nittoku has been supporting the Group unremittingly, displaying total confidence in the Group's business with full action and support. On 11th September, 2001, the Company entered into a conditional agreement with Nittoku for the subscription of 20,588,235 new shares in the Company at a subscription price of HK\$0.68 per subscription share. Nittoku's beneficial interest in the Company's issued share capital will be increased from approximately 4.78% to approximately 7.77%. The net proceeds from the subscription will be approximately HK\$13,800,000, which is intended to be used as general working capital of the Group.

Adding value to the Group's operating cycle, Nittoku supplies the latest technology and advanced equipment for the Group's upstream production, while Toko provides a widespread distribution network for the Group's downstream sales and marketing. These strategic alliances have effectively enhanced the Group's competitiveness, forming strong foundations for the Group's technical, sales and marketing arms. The Group will further strengthen these strategic partnerships to create ongoing win-win solutions and broaden its future development.

Staff Sharing the Group's Commitment – One Vision, One Heart

In view of the difficult and challenging business environment as well as the depressed and uncertain market, the staff at every level of Coils Electronic Co., Limited initiated an overall reduction in their salaries ranging from 7% to 20%. This move reflects the tremendous support from our staff for the Group's efforts to streamline operating costs and was followed by similar actions by most of the Directors and other subsidiaries. The Directors strongly believe that, with all staff sharing a common goal with committed hearts, the Group will certainly overcome the difficult and challenging time ahead.

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

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the three months ended 31st July, 2001.

CODE OF BEST PRACTICE

None of the Directors is aware of any information that would reasonably indicate that the Company is not, or was not for any part of the three months ended 31st July, 2001, in compliance with the Code of Best Practice as set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, except that the independent non-executive directors have not been appointed for a specific term but are subject to retirement by rotation and re-election at the annual general meetings of the Company in accordance with the Company's Bye-laws.

APPOINTMENT OF DIRECTOR

Mr. Lam Wing Kin, Sunny, has been appointed as an Executive Director of the Company with effect from 27th September, 2001.

By Order of the Board
Lam Wai Chun
Chairman