

RISK FACTORS

In evaluating an investment in the Offer Shares, potential investors should consider carefully all of the information set out in this prospectus and, in particular, the following risk factors relating to the business of our Group.

RISKS RELATING TO OUR BUSINESS

Reliance on the success of our key product

Our revenue is principally derived from the sale of 12kV VCBs, which accounted for approximately 74.2%, 72.3% and 73.3% of our total turnover for each of the three years ended 31 December 2004 respectively. If the market demand for 12kV VCBs declines, our turnover and profit could be adversely affected.

Sustainability of growth in turnover and profit

For the year ended 31 December 2003, our turnover was approximately RMB243.9 million, representing a growth rate of approximately 35.0% from that of the previous year and our net profit attributable to the Shareholders was approximately RMB32.0 million, representing a growth rate of approximately 51.6% from that of the previous year. Our turnover and net profit further increased by approximately 22.6% and 31.7% in 2004 respectively.

The improvement in our turnover and profitability was largely due to the increase in sales of 12kV VCBs, our key product. This increase was mainly attributable to the surge in demand for electricity distribution equipment in the PRC.

The growth in demand for our products in the PRC may or may not be sustained because the industry is largely affected by electricity demand in the PRC. As such, there is no assurance that we will be able to sustain or further improve the growth rate in turnover or profitability in the future.

Gross profit margin of our products may not maintain or increase

We price our products, among other things, competitive to other similar products. Due to intense competition in the PRC market, the average selling price of our VCBs decreased by approximately 12.2% in 2003. However, the average cost of raw materials and component parts decreased by a larger rate. As a result, our gross profit margin increased from 23.8% in 2002 to 26.9% in 2003. Our gross profit margin slightly decreased to 25.4% in 2004.

The changes in selling price and/or cost of sales of our products will affect our gross profit margin. There is no assurance that the gross profit margin of our products will maintain or increase in the future. Our Group's profitability and financial condition may be adversely affected if our profit margin decreases significantly.

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Reliance on key management and experienced technical staff

The continued success of our Group depends, to a significant extent, on the continued services of our key management who set out strategic direction and manage our businesses. Both of Mr. Tsang and Mr. Zhou, who are the chairman of the Board and the chief executive officer of our Company respectively, are responsible for formulating the overall business development strategies, setting mid-term and long-term objectives and defining the direction of growth for our Group. In addition, our success also depends upon our ability to attract and retain a group of experienced technical staff. The departure of our senior management and experienced technical staff and our inability to recruit the appropriate personnel may adversely affect our business and operations, which in turn affect our profitability.

We could become involved in intellectual property disputes

The design of our products involves the use of various intellectual property rights. We seek to protect our intellectual property rights by relying on laws and regulations such as Patent Law and Trademark Law of the PRC and confidentiality contracts with our employees, customers and other relevant parties.

Despite our efforts to protect our proprietary rights, it may be possible for third parties to use our intellectual property without authorisation. Since we operate in a legal regime that is still developing, the protection and enforcement of our intellectual property rights may not be as effective as in countries with more mature legal systems. The steps we have taken may be inadequate to prevent the misappropriation of our proprietary technology and design. Any unauthorised use or infringement of our Group's intellectual property rights may have an adverse impact on our business, financial condition and results of operations. From time to time, we may have to resort to litigation to enforce our intellectual property rights, which may involve significant costs.

On the other hand, there is no assurance that infringement claim from third parties will not occur. Should any infringement claim from third parties occur, we may incur significant legal expenditure to defend our rights and interests or be required to pay substantial damages and be forced to develop non-infringing technology or obtain licences for such technology. Our Group may not be able to develop non-infringing technology or obtain licences acceptable to our Group and as a result the business of our Group may be adversely affected.

We have applied for the registration of the trademark "senyuan" in the PRC and Hong Kong. However, there is no assurance that the registrations for the aforesaid trademark can be completed or should they be completed, there is no assurance that such registrations can absolutely protect us against any infringement claim conducted by third parties nor can such registrations protect our Group from any challenge made by third parties. In the event that such disputes occur, the legal proceedings may be costly and/or if we are unable to succeed in the legal proceedings, our financial condition may be adversely affected.

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Although we have not been involved in or subject to any legal action in relation to infringement claims of any intellectual property rights owned by us or third parties to date, there is no assurance that we will not be involved in intellectual property disputes in the future.

As for particulars of our intellectual property rights, such as date(s) of registration/application and/or duration of validity of the trademarks and patents, please refer to the section headed “Further information about our business – Intellectual property rights” in appendix V to this prospectus.

Product liability exposure

On 17 September 2004, 淄博天通電器有限公司 (Zibo Tian Tong Electrical Company Limited) brought a claim against Changzhou Senyuan for damages of RMB590,000 resulting from defective products together with the incidental litigation costs. For details of the claims between Changzhou Senyuan and 淄博天通電器有限公司 (Zibo Tian Tong Electrical Company Limited), please refer to the section headed “Business – Legal proceedings and others” in this prospectus. We may be subject to other product liability claims, suits and complaints incidental to our business, both in the PRC and other jurisdictions. Under current laws of the PRC, we are not required to maintain any insurance policy in relation to the quality of our products sold or distributed. We have thus maintained no insurance coverage for product liability or third party liability. Should our products be found defective and/or should any claim against us in respect of any defective product be successful, we may have to devote significant resources to defend any such claims or to provide compensation. This may adversely affect the relationship with our customers leading to negative publicity and thus affecting the profitability of our Group.

Specific credit terms

In line with the industry practice, we grant specific credit terms to some of our customers. We currently offer three types of credit terms to our customers, namely 滾動付款 (rolling payment), pre-agreed credit limit and proportionate payment. The arrangement of 滾動付款 (rolling payment) represented approximately 65.8%, 69.0% and 71.0% of our total sales for each of the three years ended 31 December 2004 respectively. The arrangement of pre-agreed credit limit represented approximately 5.0%, 2.3% and 1.0% of our total sales for each of the three years ended 31 December 2004 respectively. The arrangement of proportionate payment represented approximately 29.2%, 28.7% and 28.0% of our total sales for each of the three years ended 31 December 2004 respectively.

For the majority of our customers, the contractual credit term generally ranges from 30 days to 90 days. In practice, we allow a customer to settle the outstanding balance in full upon delivery of our products under its next purchase order. This payment arrangement is known as 滾動付款 (rolling payment). Under 滾動付款 (rolling payment) arrangement, if a customer does not place a second order within a period of approximately three months, it is bound to settle the outstanding balance pursuant to the credit term stipulated under the sales contract.

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We offer a pre-agreed credit limit to a limited number of major customers. Depending on the usual sizes of its purchase orders, a pre-agreed credit limit of up to approximately RMB4 million may be offered to a customer. So long as the amount of the accumulated purchases fall within such credit limit, no payment is due. However, the customer is required to settle the amount exceeding such limit within the stipulated credit period. Pursuant to the sales contract, we can adjust the credit term and/or credit limit granted to the customer unilaterally at any time.

For other customers, we normally require a deposit ranging from 10% to 30% of the contract value from our customers in advance. Upon delivery of our products, they will pay a second installment. The amount of which is determined based on credit assessment of the respective customers. The balance will be payable within 30 days to 90 days thereafter.

Due to the specific credit terms granted to some of our customers, namely 滾動付款 (rolling payment) and pre-agreed credit limit, we are subject to the specific risk of late payment by these customers as well as the risk of bad debts. If we are unable to collect a material amount of trade receivables, our cash flow position may be adversely affected.

Awaiting building ownership certificate(s) in connection with certain buildings erected on our production site excluding factory blocks

We own a production site located in Changzhou, Jiangsu Province, the PRC, with a gross site area of approximately 65,100 square meters. The production complex consists of two factory blocks comprising eight production workshops, an office building, a canteen, an auxiliary plant, a boiler room and a power room, with a gross floor area of approximately 32,825 square meters. As at the Latest Practicable Date, the outstanding construction work involved the interior renovation of the office building and installation of lighting system in the complex.

The building ownership certificate in respect of two factory blocks has been obtained. As advised by our PRC legal advisers, there will be no legal impediment to obtaining building ownership certificate(s) for other buildings erected on the site. Nonetheless, if any disputes arise in connection with the legal title of these buildings, we may not be able to continue to use them. As a result, additional cost would be incurred, including relocation cost, and our operations may be disrupted in the event that we are evicted from the buildings.

Part of the net proceeds from the Share Offer will be applied towards the repayment of some of our existing bank loans

Potential investors should be aware that approximately HK\$12.0 million, representing 16.0% of the net proceeds obtained from the Share Offer, will be used to repay a portion of our existing bank loans. Such amount will therefore not be available to fund our Group's future expansion.

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We had net current liabilities as at 30 April 2005

Our Group had net current liabilities of approximately RMB0.9 million as at 30 April 2005. This was principally due to the utilisation of short term bank loans to finance our capital expenditures, which were classified as non-current assets.

We have not experienced any defaults in repayment of bank loans and difficulties in raising funds by short term loans from various banks in the PRC. However, there is no assurance that we can obtain bank loans in the future. If we are unable to obtain the adequate funding, our business and financial position may be adversely affected.

RISKS RELATING TO OUR INDUSTRY

Demand for circuit breakers may decrease

The demand for circuit breakers in the PRC has experienced substantial growth in the recent years. The growth of our industry is affected by the growth of electricity consumption in the PRC. If the growth of electricity consumption slows down, the demand for circuit breakers might decline. This may result in reduced demand for our products which could adversely affect our profitability.

Technological development in our industry may affect our performance

Our continued success depends, to a large extent, on the enhancement of our existing products and the development of new products to meet the changes in market demand which gives us a competitive edge over our competitors. In the event that we fail to enhance the quality of our existing products or develop new products or to keep up with the technical advancement of our competitors, there may be significant reduction in the market share and the profit margin of our products. Hence, our Group's operating results and financial condition may be adversely affected.

Prices of raw materials or components may substantially increase

We use raw materials such as steel plates and copper in manufacturing our products. While we generally transfer the increase in cost of raw materials to our customers, there can be no assurance that any future significant price increase of raw materials could be successfully transferred to our customers and if this occurs, our Group's profitability will be adversely affected.

The principal components we purchase are vacuum interrupters. Although we have not experienced any substantial price increment in vacuum interrupters, there is no assurance that we will not experience such fluctuations in the future. Therefore, substantial increases in prices of these components could adversely affect our gross profit margin and operating results.

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Our results could be harmed if we violate any environmental regulations

Currently, certain PRC environmental protection laws and regulations impose fines on discharge of waste materials and empower certain environmental authorities to close any facility which causes serious environmental problems.

Although it has not been alleged that we have violated any current environmental protection laws and regulations in the PRC and no claim has been made against us on this issue to date, there is no assurance that the PRC government will not impose stricter environmental protection laws and regulations in the future. The imposition of additional or more stringent environmental protection laws and regulations in the PRC may increase our operational costs, which may adversely affect our profitability.

RISKS RELATING TO THE PRC

Changes in political and economic policies in the PRC may affect our businesses

All of our businesses, assets and operations are located in the PRC. In addition, all of our Group's sales for the three years ended 31 December 2004 were derived in the PRC. As a result, our businesses, operations and financial condition are subject to the political, economic and social conditions or the relevant policies in the PRC.

The PRC has been undergoing a series of economic reforms since late 1970s. Such reforms have resulted in significant economic growth and social progress. Any adverse changes in political, economic and social conditions or the relevant policies in the PRC would have a material adverse effect on the economic growth of the PRC. Any future downturns in the PRC economy could lead to a reduction in demand for our products which may adversely affect the results of our operations and financial condition.

Changes in the PRC legislation or the interpretation thereof may affect our businesses

Since 1979, numerous laws and regulations which govern economic matters in general have been promulgated in the PRC. As the PRC government is still in the process of developing a legal system to better accommodate the needs of investors and to facilitate foreign investments, the interpretation and enforcement of such laws and regulations are still at a developmental stage. The PRC legal system is based on written statutes and therefore, decisions made by the courts are not binding precedents, although judges may use them as guidance. In addition, the interpretation of the PRC laws may be subject to changes in policies and political environment.

As the PRC legal system develops, foreign investors may be adversely affected by new laws and regulations, changes to existing laws and regulations, new interpretations of current laws and regulations and the pre-emption of local regulations by national laws. Considerable progress has been made in the enactment of laws and regulations concerning economic matters such as foreign investment, corporate organisation and governance, commerce, taxation and trade, which have significantly enhanced the legal protection afforded to foreign investors. As some of these laws and regulations are still in the course

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of development, they may be subject to changes and modifications. Since the PRC economy is developing at a faster pace than the PRC legal system, some degree of uncertainty may result and, until the development of the legal system is able to keep up with economic reforms in the PRC, such uncertainty is likely to remain. However, there can be no assurance that changes in the PRC laws and regulations or interpretation thereof will not have any adverse effect upon our businesses.

Our tax benefits in the PRC may not continue in the future

According to the prevailing tax law of the PRC, Changzhou Senyuan, an enterprise with foreign investment which conducts manufacturing business operation, is entitled to full exemption from national income tax liability for a period of two years commencing from the first profitable year of operation and a 50% relief on the applicable tax rate for the national income tax for the succeeding three years.

Changzhou Senyuan was granted 50% relief from national income tax for each of the two years ended 31 December 2003 and accordingly, the applicable national income tax rate for 2002 and 2003 was 12%.

Being granted as 兩個密集型企業 (double-intensity enterprise) and approved by the State Administration of Tax, Changzhou Senyuan has been entitled to an applicable tax rate of 15% since 2004. In addition, Changzhou Senyuan, as an advanced-technology enterprise with foreign investment, is also entitled to a 50% reduction (with a minimum tax rate of 10%) of the national income tax for an additional three years after the initial five-year tax holiday as stated above. Accordingly, pursuant to the approval by the State Administration of Tax of Changzhou City, Jiangsu Province, Changzhou Senyuan is subject to an applicable income tax rate of 10% from 2004 to 2006.

Without the above tax exemption, we could be subject to the PRC income tax of 24% generally applicable to enterprises with foreign investment which are located and operate in the coastal economic opening zone of the PRC, such as Changzhou. Any decision by the relevant PRC authorities to reduce or revoke such tax preferential treatment would adversely affect our profitability.

Future movements in exchange rates may adversely affect our financial condition and results of operation

All of our revenues are denominated in Renminbi whereas dividends to the Shareholders are to be paid in Hong Kong dollars. Any future exchange rate volatility relating to Renminbi may give rise to uncertainties in our financial condition and results of operations. There has been, in the past, fluctuation of Renminbi against foreign currencies. There can be no assurance that Renminbi will not be subject to substantial fluctuation. Any devaluation of Renminbi may have an adverse impact on the value of our net assets, earnings and declared dividends in foreign currency terms and any appreciation of Renminbi may subject us to increased competition from imported goods.

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Currency conversion may limit our ability to remit dividends

Renminbi currently is not a freely convertible currency. Existing restrictions on the conversion of Renminbi into foreign currencies may affect the ability of our Group to convert Renminbi into foreign currencies (and thus restrict the subsequent repatriation of those funds), and any tightening of such restrictions may have an adverse effect on our Group.

RISKS RELATING TO THE SHARES

No prior public market for the Shares

Prior to the Share Offer, no public trading market for the Shares existed and there is no assurance that there will be an active trading market for the Shares after the Share Offer. If an active public market for the Shares does not develop after the Share Offer, the market price and liquidity of the Shares may be adversely affected.

Market prices of the Shares may be volatile

The trading price of the Shares could be subject to significant volatility in response to, among other factors:

- investor perceptions of our Group and our futures plans;
- variations in our Group's operating results;
- changes in pricing made by us or our competitors;
- technological innovations;
- changes to senior management;
- the depth and liquidity of the market for the Shares; and
- general economic and other factors.

Any material changes in the above factors could cause the market price of the Shares to change substantially.

No assurance on the future dividends

Changzhou Senyuan declared dividends of RMB45.0 million in 2004, which represented the distribution of the retained profits of Changzhou Senyuan to one of its then shareholders, Tai Ah HK, prior to the Reorganisation. The amount of dividends that we declared historically are not indicative of the dividends that we may pay in the future.

No dividends were declared by Changzhou Senyuan in 2002 and 2003.

As disclosed in the section headed "Financial information – Dividends and dividend policy – Dividend policy", it is our current intention to recommend annually the dividend to the Shareholders of approximately 30% of our Group's annual distributable profits as dividends in the foreseeable future. It should be noted that the ability to distribute dividends depends on, among other things, the availability of our Company's cash and

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distributable reserves, our Group's investment requirement, the cash flow and working capital requirements of our Group. Therefore, the actual percentage of net profits to be distributed (if any) to the Shareholders may differ from our current estimation.

OTHER RISK

Forward-looking statements contained in this prospectus may not materialise

Included in this prospectus are various forward-looking statements which can be identified by the use of forward-looking technology such as "may", "will", "expect", "believe" and other similar words. We have made forward-looking statements with respect to, among other things, our Group's future business strategies and the environment in which our Group will operate in the future. The actual performance of our Group may be materially different from the future performance expressed or implied by such forward-looking statements.