MANAGEMENT DISCUSSION AND ANALYSIS

CAPITAL STRUCTURE, LIQUIDITY AND FINANCIAL RESOURCES

For the year ended 31 December 2008, the Group financed its liquidity requirements by cash generated from operations and bank borrowings.

At 31 December 2008, the Group's consolidated current assets increased to approximately HK$2,700 million (2007: HK$2,558 million) whereas the Group's consolidated current liabilities maintained at approximately HK$2,543 million (2007: HK$2,595 million). Current ratio improved to 1.06 (2007: 0.99).

At 31 December 2008, total bank borrowings increased to approximately HK$3,636 million (2007: HK$2,699 million) whereas total cash and bank balances increased to approximately HK$890 million (2007: HK$418 million). The increase in bank borrowings was mainly used to finance the purchase of property, plant and equipment totalling approximately HK$1,409 million for ongoing expansion and upgrading of the production facilities of the Group. Total equity increased to approximately HK$3,204 million (2007: HK$2,823 million). Gearing ratio (expressed as total net borrowings over total equity) increased to 0.86 (2007: 0.81).

As highlighted in the Chairman's Statement, the Group entered into a facility agreement with a syndicate of banks to secure this facility at an aggregate of US$170 million for a period of four years. This facility is for the purpose of financing the Group's future capacity expansion and general corporate funding requirements, including replacement of certain shorter-term facilities. With this facility, the Group's liquidity position will be enhanced as less than 27% of this facility will be due by 2011 while the balance will be due in 2012. The Group was able to obtain an interest rate of LIBOR plus 0.9% per annum for this facility. As at 31 December 2008, the Group had total banking facilities, comprising primarily bank loans and bilaterals, amounting to approximately HK$6,616 million of which approximately HK$2,278 million was not yet utilised.

The Group has adopted prudent financial management policy. In the last quarter of 2008, the Group entered into certain simple interest rate swap contracts to hedge certain of the Group's bank loans amounting to US$100 million with fixed interest rates. The fair value of these interest rate swap contracts, amounting to approximately HK$25 million, was recognised as derivative financial instruments under liabilities at 31 December 2008.

In view of the slow-down of the global economy, the Group anticipates that it is unlikely that India plant investment will start in the near term, say in 2009 or 2010. The Group has decided to revise down the projections of the India and Suzhou operations for the next four years, allowing Meadville to reduce the financial liabilities pertaining to the fair value of the put option of this acquisition by about HK$129 million in 2008. For the same reason, the Group's goodwill pertaining to this acquisition has also been reduced by the same amount while the credit difference arisen after set off against the Group's relevant goodwill available at 31 December 2008 was dealt with in the Group's profit and loss account for the year.

In order to enhance shareholders' value of the Group, the Company repurchased approximately 36 million shares which accounted for about 1.8% of the Company's total issued shares in the second half of 2008. Total amounts incurred for the share repurchases were approximately HK$70 million.

In view of the Group's current level of cash and bank balances, funds generated internally from operations and the unutilised banking facilities available, the Board is confident that the Group will have sufficient resources to meet its foreseeable capital expenditures and debt repayment requirements.

CHARGES ON GROUP ASSETS

The Group's assets were free from charge at 31 December 2008.

CAPITAL COMMITMENT AND CONTINGENT LIABILITIES

At 31 December 2008, the Group had outstanding capital commitments in respect of purchases of property, plant and equipment of approximately HK$358 million (2007: HK$782 million). In addition, the Group had commitments in respect of injection of additional capital into certain subsidiaries established in mainland China totalling approximately HK$655 million (2007: HK$809 million), of which approximately HK$469 million will be due within 2009. Such injection of capital will be mainly used to pay for the purchase of property, plant and equipment and operating expenses. These capital commitments will be financed by the Group's internal resources.

The Group had no material contingent liabilities as at 31 December 2008.

STAFF AND REMUNERATION POLICY

At 31 December 2008, the Group had a total of 10,202 employees (2007: 11,653). The number of employees has dropped from a peak of 13,349 in September 2008. This was primarily due to the retrenchment actions as a result of the temporary shut down of the GME and MAS plants following the sudden global economic slow down after Lehman Brothers' bankruptcy. These actions allowed the Group to lower its variable and fixed overhead and to retain a higher level of production capacity utilisation for the remaining plants of the Group.

The Group's staff costs, excluding the non-cash share award expenses, increased by 28.2% to approximately HK$787 million for the year ended 31 December 2008 (2007: HK$614 million), out of which approximately HK$18 million was redundancy costs attributed by various retrenchment actions. Effective from November 2008, the staff costs were slightly lowered by salary cuts of 10%, 5% and 2.5% for directors, indirect staff and direct employees respectively for all high cost regions such as Hong Kong and overseas regions, but excluding mainland China.

The Group remunerates its employees based on their performance, work experience and the prevailing market compensation packages. Salaries of employees are maintained at competitive level while bonuses are granted by reference to the performance of the Group, individual plant operations and individual employees.

The Company approved and adopted a share option scheme on 12 January 2007 for the purposes of providing a longer term incentive and reward to eligible participants who have contributed to the success of the Group. In view that a total of 134.8 million shares in the capital of the Company were granted to the employees by a substantial shareholder during the initial public offering in 2007, the Group considers there is no need to grant any share options to employees under this share option scheme in the foreseeable future.

FOREIGN EXCHANGE FLUCTUATION EXPOSURES AND HEDGES

The Group operates principally in Hong Kong and mainland China, and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to U.S. dollar and Renminbi. Foreign exchange risk arises from future commercial transactions, recognised assets and liabilities and net investments in foreign operations. The Group attempts to minimise its foreign exchange risk exposure through matching its operating costs and borrowings against its receivables on sales. Nevertheless, the Group is still exposed to relevant foreign exchange risk in respect of Renminbi and U.S. dollar exchange rate fluctuations such that the Group's profit margin might be impacted accordingly. In addition, the conversion of Renminbi into foreign currencies is subject to the rules and regulations of the foreign exchange controls promulgated by the Chinese government.

MATERIAL ACQUISITION AND DISPOSAL OF SUBSIDIARY AND ASSOCIATED COMPANY

The Group had no material acquisition or disposal of subsidiaries and associated companies during the year ended 31 December 2008.

SEGMENT INFORMATION

Details of segment information are set out in note 5 to the financial statements.

REVIEW OF OPERATING RESULTS – YEAR ENDED 31 DECEMBER 2008 COMPARED TO YEAR ENDED 31 DECEMBER 2007

Revenue and gross profit

The Group's revenue grew by 25.3% to approximately HK$5,626 million in 2008 (2007: HK$4,490 million) with details as highlighted in the Chairman's Statement. The Group's gross profit increased to approximately HK$1,080 million (2007: HK$1,060 million). The Group's gross profit margin declined to 19.2% (2007: 23.6%). The decline in the Group's gross profit margin was mainly due to the initial start-up operating losses (excluding redundancy costs) of the two new plants in Guangzhou (i.e. GME and MAGL), totalling approximately HK$99 million (2007: HK$28 million) as a result of their relatively low output. Out of these initial start-up losses, approximately HK$45 million (2007: nil) was attributable to cost of sales. Other factors attributable to the Group's gross profit margin decline included the surge in raw material costs, Renminbi appreciation, as well as higher energy and labour costs resulting from the general high inflation during the first nine months of 2008.

Other income

The Group's other income sustained at approximately HK$172 million in 2008 (2007: HK$177 million) comprising mainly of sales of scrap amounting to HK$168 million (2007: HK$130 million). The Group's other income as a percentage of revenue decreased to 3.1% in 2008 (2007: 3.9%) primarily attributable to the investment tax credits as a result of re-investment of dividend income from subsidiaries and associated companies in mainland China, amounting to approximately HK$34 million recorded in 2007. There was no such tax credits in 2008 due to the change in tax incentive policies in mainland China.

Operating profit

The Group's operating profit for 2008 grew by 36.6% to approximately HK$679 million (2007: HK$497 million) and operating profit margin sustained at 12.1% (2007: 11.1%). The Group's non-cash share award expenses for 2008 were approximately HK$12 million (2007: HK$255 million) which were approximately HK$5 million less than the amount of HK$17 million as disclosed in previous annual reports due to the return of approximately 4.8 million shares (which were subject to return condition) to Total Glory as a result of employee turnover during 2008, and the relevant non-cash share award expenses of approximately HK$5 million (2007: nil) were credited to the Group's profit and loss account for the year. The non-cash share award expenses had no impact on the Group's cash flow and net assets value as the corresponding amounts were credited to the Group's employee share-based compensation reserve account.

Excluding share award expenses, the Group's operating performance in 2008 was negatively impacted by the lower gross profit margin as explained above, the higher selling and distribution expenses, and the higher general and administrative expenses as a result of the start up losses (excluding redundancy costs) incurred for the two new plants in Guangzhou (i.e. MAGL and GME), totalling approximately HK$59 million (2007: HK$27 million) as well as various retrenchment costs of approximately HK$22 million due to the sudden change in global economic conditions. By excluding the non-cash share award expenses, the Group's operating profit would have been approximately HK$691 million in 2008 (2007: HK$752 million), and the Group's operating profit margin would have been 12.3% in 2008 (2007: 16.7%).

Despite the higher selling and distribution expenses, and the higher general and administrative costs incurred by the two new plants at the initial start-up stage together with the retrenchment costs, the Group's selling and distribution expenses as a percentage of the Group's revenue sustained at 5.0% in 2008 (2007: 5.3%) whereas the general and administrative expenses as a percentage of the Group's revenue decreased to 5.0% (2007: 5.5%) which was primarily due to the exchange gain for the year as a result of the appreciation of Renminbi in 2008.

Interest income and finance costs

The Group's interest income decreased to approximately HK$5 million in 2008 (2007: HK$27 million). In 2007, the Group's interest income was mainly earned from the subscription funds during the Group's listing period and higher bank balances after taking in the net listing proceeds in February 2007. The Group's finance costs, after capitalisation of about HK$25 million to qualifying assets, increased to approximately HK$132 million in 2008 (2007: HK$110 million). The increase in finance costs was primarily due to higher level of the Group's bank borrowings as explained before.

Share of net profit of associated companies

The Group's share of net profit of associated companies decreased significantly to approximately HK$34 million in 2008 (2007: HK$108 million). This was due to substantial drop in operational performance of the Group's associates, GSST and SSST as explained in the Chairman's Statement.

Income tax expense

The Group's income tax expense increased to approximately HK$77 million in 2008 (2007: HK$72 million). The Group's income tax expense as a percentage of the Group's taxable profit (profit before income tax less share of profit of associated companies plus non-cash share award expenses) increased to 13.7% in 2008 (2007: 10.8%) which was mainly due to overall increase in corporate income tax rates pursuant to the new Corporate Income Tax Law in mainland China which has become effective since 1 January 2008, and the expiration of certain tax incentives enjoyed by one of our major PCB manufacturing plants in mainland China.

Profit for the year

The Group's profit for the year increased to approximately HK$509 million in 2008 (2007: HK$451 million). The Group's profit margin declined to 9.0% (2007: 10.0%). By excluding the non-cash share award expenses, the Group's profit for the year would have been approximately HK$520 million (2007: HK$705 million), and the Group's profit margin would have been 9.2% in 2008 (2007: 15.7%).

By excluding the non-operating expenses such as (i) non-cash share award expenses, (ii) the first year operation losses of the two new plants in Guangzhou, (iii) the one-time charges in relation to the rationalisation in operations, (iv) the interest income from the proceeds of the Company's initial public offering, (v) the share of net profit of associated companies and (vi) the investment tax credit as explained above, the Group's revenue and profit would have been approximately HK$5,484 million and HK$608 million respectively in 2008 (2007: HK$4,490 million and HK$577 million respectively) while the profit margin would have been 11.1% in 2008 (2007: 12.8%).