
RISK FACTORS

RISKS RELATING TO THE GROUP

Reliance on major customers

A significant portion of the Group's revenue has been, or may continue to be, derived from a limited number of customers. For each of the two years ended 30 June 1999 and 2000, sales to the Group's largest customer accounted for approximately 94.8 per cent. and 64.8 per cent. respectively of the Group's turnover. For each of the two years ended 30 June 1999 and 2000, the Group had less than five customers who together accounted for 100 per cent. of the Group's turnover. Should the Group be unable to secure new contracts from its existing customers or find new customers to replace them, the Group's operations and financial conditions may be adversely affected.

Funding requirements of the Company

Without taking into account the estimated cashflow generated from the internal operations of the Group, the Directors believe that the net proceeds from the Placing of the New Shares, which is estimated to be approximately HK\$40 million based on an Offer Price of HK\$0.77 per Placing Share, will not be sufficient to meet all the funding requirements of the Company's business plans for the Forward Looking Period, which is estimated to require a total implementation cost of approximately HK\$175 million if all material aspects of the business objectives and the business plans of the Company materialise and progress according to the implementation plans as described in the section headed "Business objectives and future prospects" in this prospectus. The Directors consider that the net proceeds from the Placing of approximately HK\$40 million will be sufficient to sustain the Company's business plans regarding its research and development and geographical expansion up to 31 December 2001 and the net proceeds will be able to sustain its sales and marketing up to 30 June 2001.

To achieve the Company's business objectives and materialise all the implementation plans, the Group has to be able to generate sufficient funds internally from operating cashflow or to seek additional funds by means of other external financing to meet the Company's funding requirements. Should the Company be unable to obtain additional funds from internal and/or external sources in the future, the implementation of the Group's business plans will be adversely affected.

Reliance on key personnel

The success of the Group, to a large extent, depends on the continued services of its key senior executives and skilled professionals. Should any of these key executives cease to be involved in the management and operations of the Group or should their full-time services be interrupted, there may be an adverse impact on the Group's financial and operating performance. There can be no assurance that the Group will be able to retain their services in the future.

The Group believes that its future success will, to a large extent, depend on its ability to attract, retain and motivate highly skilled and experienced professionals. In addition, the Group's future expansion will require an increase in the number of technical staff. However, competition for these highly skilled and experienced professionals is intensive and there can be no assurance that the Group will be able to attract or retain such professionals in the future. Should the Group experience an inadequate supply of skilled professionals, the Group's operations and business growth may be adversely affected.

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Sustainability of profit

All of the Group's revenue is generated primarily on a project-by-project basis and the Group's revenue may vary over time. Therefore, the future growth of the Group's profits depends on its ability to secure new contracts and the scope, duration, and profitability of those contracts secured. There can be no assurance that the revenue and/or profits achieved during a particular period will be sustained in any subsequent periods. There can also be no assurance that the level of revenue derived from a particular project or client during a particular period will recur in any subsequent periods. If the Group cannot secure adequate number of contracts in the future, the Group's financial performance and profit growth may be adversely affected.

Limited operating history

The Group operates within a highly competitive environment. Many of the Group's potential competitors have longer operating histories and/or significantly greater financial, sales, marketing and other resources. To compete with these established brand names and automation companies, the Group must establish its own record and reputation as a reliable producer of quality goods with a niche to provide unique products and services so as to gain market share among the large industrial enterprises in the PRC. In this respect, as compared with its potential competitors, the Group's ability to convince the market of its role as a quality automation and control system company is uncertain, which may in turn erode the competitive edge of the Group.

Fixed-price contracts

Most of the Group's completed and existing contracts in progress are on a fixed-price basis rather than on a time-and-materials basis. It is also the intention of the Group's management to continue to charge its clients on a fixed-price basis, the financial risk associated with which may be greater than that associated with charging on a "time-and-materials" basis. If the total costs of a fixed-price contract is under-estimated or if unexpected delays or difficulties are encountered in the course of carrying out the contract which result in an increase in costs, the Group's profitability and financial conditions may be adversely affected.

Dependence on large system contracts

The Group derives a substantial portion of its revenues from large systems contracts, which make the Group's operating results more difficult to predict. The attainment of such large orders, which are limited in number and do not necessarily occur at regular intervals, is dependent on a variety of factors and, many of which are beyond the Group's control. The revenues of the Group would decline in the near term if the Company were unable to offset the impact on its results of operations resulting from the expiration of existing contracts with new bookings of the same magnitude and profitability. There can be no assurance that the Group will be able to obtain such large contracts in the future. A substantial portion of the Group's business is awarded through competitive bidding processes in which the Group agrees to install a large, complex system on a fixed-price basis. As a result of the nature of the competitive bidding process for large system contracts, the Group's business is potentially subject to lower profit margin from time to time. In addition, it is estimated that the time required to complete a project under normal circumstances from the signing of contract to product acceptance ranges from two to four months, depending on the complexity of the project. The profit derived from large system contracts may be adversely affected if there is any delay in project completion.

RISK FACTORS

Dependence on the performance of certain industries in the PRC

Many of the industries in the PRC served by the Group, such as the metal refining, oil drilling and power generating industries, have been subject to substantial cyclicalities in the past and are likely to suffer the same in the future. This cyclicalities may in turn materially impact the Company's bookings and results of operations, particularly as customers in these industries reduce capital expenditures, and delay ordering the Company's products, in anticipation of potential economic downturns or reductions in demand, or in response to economic uncertainty.

RISKS RELATING TO THE INDUSTRY

Competition

The markets for automation and control systems integration and production are highly competitive and are characterised by major existing international competitors that have introduced or developed products and services similar to those offered by the Group. The Group competes with PRC and international automation and control system integrators and manufacturers, and as the Group expands its geographical coverage outside the PRC, it will also have to compete with other local and international automation and control system integrators and manufacturers. Competitors of the Group may have substantially greater resources, larger customer bases, greater brand name recognition and more established relationships than the Group. As a result, these competitors may be able to adapt to new or emerging technologies and changes in customer requirements more quickly, take advantage of business opportunities more readily, devote greater resources to the marketing and sale of their products and services and adopt more aggressive pricing policies than the Group. This intense competition may limit the profitability of the Group or result in a loss in the Group's market share.

Rapid technological changes

The automation and control industry is characterised by rapid technological changes. Existing products subject to improved and enhanced standards as new industry standards are being introduced regularly. The Group's prospect may adversely be affected if it is unable to keep pace with the technological advances in a timely and cost-efficient manner by improving and enhancing its existing products and services and by introducing new products and services embodying the latest technologies required by the Group's customers from various industries in the PRC. The development of new technologies or new products and the enhancement of existing products entail substantial investments in research and development. There is no assurance that such research and development efforts will result in the successful introduction of new products or the enhancement of existing products, and there is no assurance that any of such new or enhanced products will be accepted by the market. If the Group cannot continue to develop new products acceptable by the market, the Group's future growth and profitability may be adversely affected.

Intellectual property rights

Piracy of software applications and hardware developed by the Group and the infringement of its intellectual property rights may adversely affect the Group's revenue and financial performance. At present, the Group has applied for certain patents and copyrights for its software and hardware products in the PRC. Nevertheless, there can be no assurance that the piracy or infringement of its technology can be kept under control at all times. In addition, the Group may incur additional expenses and its management's time and efforts may be required in any proceedings for enforcing its intellectual property rights in future. Such diversion of resources may adversely affect the existing business and future growth of the Group.

RISK FACTORS

Potential product liability

The products developed and distributed by the Group are important to the operations of its customers. As the Company does not maintain any product liability insurance and if the Group's products contain defects or errors which adversely affect the operations of its customers, the Group may have to incur additional costs to correct the defects and/or devote significant resources to defend any claims which may be brought by its clients. This may also adversely affect the Group's relationship with such client, and result in negative publicity which may adversely affect the reputation of the Group. However, the Group has not experienced any third party claims in respect of its products during the two years ended 30 June 1999 and 2000.

RISKS RELATING TO THE PRC

Political and economic environment

The PRC is in the process of transforming its economy from a planned economy into a more market-oriented economy. Political, economic and social factors may result in the PRC government making further changes to its laws or regulations, introducing additional tax measures, imposing restrictions on currency exchange and remittance, and changing tax rates or customs duties. Such factors may also adversely affect the Group's operations in the PRC.

Foreign exchange control and currency conversion risks

The Group is operating significantly in the PRC and thus generating revenues, expenses and liabilities in RMB and is thereby subject to the effect of RMB exchange rate fluctuations. The Group has not currently entered into agreements or purchased instruments to hedge such exchange rate risks.

RMB is not a freely convertible currency in the international currency market and its exchange rate system is a managed-floating-rate system. Upon the execution of the unitary managed-floating-rate system in 1994, the RMB was devaluated by 50 per cent. against the US dollar. Since then, the exchange rate between the RMB and US dollar has been generally stable. However, there can be no assurance that the RMB will not become volatile against other currencies. In the event of a major devaluation of the RMB, the Group may incur capital depreciation on its investments in the PRC as well as a material adverse effect on the Group's operations and financial condition, in view of the Group's significant PRC presence at the moment.

Although new policies were introduced by the PRC government in 1996 to allow greater convertibility of the RMB, significant restrictions still remain. In accordance with "Foreign Exchange Control Regulations" and the "Regulations on the Administration on Settlement, Sale and Payment of Foreign Exchange", foreign exchange required for the payment of dividends that are payable in foreign currencies can be purchased from designated foreign exchange banks upon presentation of the relevant documents including, but not limited to board resolutions authorising the distribution of profits or dividends of the company concerned. Although the Group currently is able to convert its RMB earnings into foreign currency for the purpose of dividend distribution, there is no guarantee that the PRC government will not introduce more restrictive foreign exchange measures that could adversely affect the Group's ability to convert its RMB earnings into foreign currencies.

RISK FACTORS

Import restrictions on computer hardware and software

Under the current rules and regulations in the PRC, computer equipment and software are restricted items and permits are required for proper clearance into the PRC. The Group has in the past engaged certain importing/exporting companies to handle the import and customs clearance matters and the Directors believe that such arrangement will be continued in the future. Should the PRC strengthen the controls on the import of the computer equipment or should the Group have difficulty in engaging the importing/exporting companies, the Group's operations and profits in the PRC may be adversely affected.

RISKS RELATING TO THE PLACING

Price volatility and liquidity of the Shares

Prior to the Placing, there has been no public market for any of the Shares and there can be no guarantee that an active trading market will develop, or if it does develop, there can be no guarantee that the market will be sustained following the completion of the Placing. In addition, the Offer Price for the Placing Shares has been determined by negotiation between the Company and the Underwriters. This price may not be indicative of the price at which Shares will trade following completion of the Placing and the trading price of Shares may fluctuate significantly. There can be no guarantee that the market price of the Shares will not decline below the Offer Price.

Statistics from unofficial publications

Certain statistics in this prospectus such as statistics relating to the industry, are derived from various public and private publications. Such information has not been independently verified by the Group and may not be accurate, complete and/or up-to-date. The Group makes no representation as to the correctness or accuracy of such statements and, accordingly, such information should not be unduly relied upon.

Forward looking statements

Forward-looking statements relating to the Group's plans, objectives, expectations and intentions contained in this prospectus may be materially different from the actual results, performance and achievements of the Group or the industry in the future. There are various forward-looking statements in this prospectus which can be identified by the use of forward-looking terminologies such as "may", "will", "believe", "expect", "anticipate", "estimate" and other similar words. These forward-looking statements reflect the expectations of the Directors as at the Latest Practicable Date and are based on numerous assumptions regarding the Group's implementation plans, business strategies and the industry environment in which the Group operates or will operate. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results or performance of the Group to be materially different from any future results or performance expressed or implied by those statements. Potential investors of the Placing Shares should keep in mind that there can be no assurance that the forward-looking statements described in this prospectus will materialise.