

NAM TAI ELECTRONICS INC

Form F-3/A

April 22, 2003

As Filed with the Securities and Exchange Commission on April 22, 2003

Registration No. 333-103547

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**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**Amendment No. 1 to**

**Form F-3**

**REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933**

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**Nam Tai Electronics, Inc.**

*(Exact Name of Registrant as Specified in its Charter)*

**British Virgin Islands**

*(State or other jurisdiction of  
incorporation or organization)*

**None**

*(I.R.S. Employer  
Identification Number)*

**116 Main Street  
2nd Floor  
Road Town, Tortola  
British Virgin Islands  
(284) 494-7752**

*(Address and telephone number of Registrant's principal executive offices)*

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**Stephen Seung  
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(212) 732-0030  
Fax: (212) 227-5097**

*(Name, address and telephone number of agent for service)  
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**Approximate date of commencement of proposed sale to the public:** As soon as practicable after this Registration Statement becomes effective.

If the only securities being registered on this Form are to be offered pursuant to dividend or interest reinvestment plans, please check the following box. ☐

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. ☐

## Edgar Filing: NAM TAI ELECTRONICS INC - Form F-3/A

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. ☐

### CALCULATION OF REGISTRATION FEE

Title of Each Class of securities to be registered	Amount to be Registered(1)	Proposed Maximum Offering Price per Share(2)	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee
Common Shares, \$.01 par value per share	3,450,000 shares	\$26.05	\$89,872,500	\$7,271*

(1) Includes 450,000 shares that may be issued pursuant to the underwriters' over-allotment option.

(2) Estimated solely for the purpose of computing the amount of the registration fee pursuant to Rule 457(c) based on the average of the high and low prices reported on the New York Stock Exchange on February 24, 2003.

\* Previously paid.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall hereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to such Section 8(a), may determine.

**The information in this prospectus is not complete and may be changed. We may not sell these securities until the Securities and Exchange Commission declares our registration statement effective. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

**(Subject to Completion, dated April 22, 2003)**

**PROSPECTUS**

**3,000,000 shares**

**Common Shares**

This is a public offering of 3,000,000 common shares of Nam Tai Electronics, Inc. We are selling 2,000,000 of the common shares offered under this prospectus and certain of our shareholders, referred to in this prospectus as the selling shareholders, are selling the remaining 1,000,000 shares.

Our common shares are listed on the New York Stock Exchange under the symbol NTE. The last reported sale price of our common shares on April 21, 2003, was \$24.41 per share.

**See Risk Factors beginning on page 8 to read about certain risks you should consider before buying our common shares.**

	<b>Per Share</b>	<b>Total</b>
Public Offering Price	\$	\$
Underwriting Discount	\$	\$
Proceeds, Before expenses to us	\$	\$
Proceeds, Before expenses to the selling shareholders	\$	\$

We have granted the underwriters a 30-day option to purchase up to 450,000 additional common shares to cover any over-allotments.

Delivery of shares will be made on or about , 2003.

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.**

**Bear, Stearns & Co. Inc.**

**The date of this Prospectus is , 2003**

**Our Advanced Manufacturing Facilities and Equipment**

**Below: Ultra Sonic Cleaning Machines for LCD Panels**

[Picture of worker standing in front of Ultra Sonic Cleaning Machines for LCD Panels.]

**Below: Testing of Graphic Calculators**

[Close-up picture of gloved hands testing of Graphic Calculator.]

**Below: Fully Automatic Assembly Machines for STN LCD Panels**

[Picture of factory workers in front of Fully Automated Assembly Machines for STN LCD Panels.]

**Below: Semi-automated Fine Pitch Heat Seal Machine**

[Close-up picture of Semi-automated Fine Pitch Heat Seal Machine.]

**Below: Factory Workers in Clean Room Environment**

[Picture of a row of factory workers wearing protective suits and masks in clean room environment working in front of factory machines.]

**Below: Semi-automated Chip on Glass Machine**

[Close-up picture of work being done on Semi-automated Chip on Glass Machine.]

**Below: Semi-automated Chip on Board Assembly Line**

[Picture of several rows of factory workers sitting in front of Semi-automatic Chip on Board Assembly Line wearing protective suits.]

**Below: Tape Automated Bonding with Anisotropic Conductive Film Machine**

[Picture of Tape Automated Bonding with Anisotropic Conductive Film Machine.]

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## PROSPECTUS SUMMARY

*This summary highlights information more fully described elsewhere in this prospectus. This summary is not complete and does not contain all the information you should consider before buying our common shares in this offering. You should read this entire prospectus carefully, including Risk Factors and our consolidated financial statements and the related notes included in this prospectus, before deciding to invest in our common shares.*

### Nam Tai Electronics, Inc.

#### Our Business

We are an electronics manufacturing and design services provider to a select group of the world's leading original equipment manufacturers, or OEMs, of telecommunications and consumer electronic products. Our largest customers include Epson Precision (HK) Ltd., Sony Ericsson Mobile Communications AB and Texas Instruments Incorporated. We were founded in 1975 as an electronic products trading company based in Hong Kong and shifted our focus to manufacturing of electronic products in 1978. We moved our manufacturing facilities to China in 1980 to take advantage of lower overhead costs, lower material costs and competitive labor rates.

Through our electronics manufacturing services, or EMS, operations, we manufacture electronic components and subassemblies, including liquid crystal display, or LCD, panels, transformers, LCD modules and radio frequency, or RF, modules. These components are used in numerous electronic products, including cellular phones, laptop computers, digital cameras, copiers, fax machines, electronic toys, handheld video game devices and microwave ovens. We also manufacture finished products, including cordless phones, palm-sized PC's, personal digital assistants, electronic dictionaries, calculators and digital camera accessories for use with cellular phones.

We assist our OEM customers in the design and development of their products and furnish full turnkey manufacturing services that utilize advanced manufacturing processes and production technologies. Our services include hardware and software design, component purchasing, assembly into finished products or electronic subassemblies and post-assembly testing. These services are value-added and assist us in obtaining new business but do not represent a material component of our revenue. We also provide original design manufacturing, or ODM, services, in which we design and develop proprietary products that are sold by our OEM customers using their brand name.

#### Our Strategy

We are focused on expanding our position as a China-based provider of electronic manufacturing services to major OEMs. To achieve this objective, we intend to continue to pursue the following strategies.

*Maintain low-cost manufacturing in China.* Our manufacturing facilities are all in China and have been there since 1980. We believe that our history and experience in China well position us to take advantage of the trend of shifting production of electronic products to China.

*Focus on Asian OEMs.* We have strong relationships with OEMs throughout Asia, particularly those in Japan and China. These OEMs produce a large portion of the electronic products used worldwide and, we believe, represent a significant opportunity for future outsourcing growth.

*Manufacture small form factor consumer products.* We focus on providing OEMs with services for small form factor electronic products. These products and their key components and subassemblies are easy to ship globally, thereby negating the need for regional manufacturing and sophisticated logistics support.

*Produce high value-added electronic components and subassemblies.* We produce components and subassemblies, like LCD modules and RF modules, which are central to several types of electronic

products. As a result, we are able to maintain relatively high gross profit margins in comparison with those of other EMS providers of electronic products.

*Apply advanced manufacturing technologies.* Our manufacturing and assembly processes apply advanced bonding and other sophisticated technologies, including using a clean room manufacturing environment. We believe that relatively few of our competitors possess our level of clean room manufacturing capability in their China-based facilities.

*Develop improved production techniques.* We focus on collaborating with our customers to refine and improve the production methods employed for complex, yet proven production technologies. These relationships allow us to focus our research and development efforts on process improvement and help limit our risks associated with new product introductions.

*Produce high quality products at low cost.* We seek to manufacture the highest-quality products at a low cost to our customers. Our location in China allows us to access one of the lowest cost engineering and production work forces in the world.

*Invest strategically in key technology partners.* We have made and will continue to make strategic investments in targeted and existing customers and providers of critical component technologies. We believe that such investments foster new or enhance existing customer and supplier relationships.

### **Our Risks**

Our business is subject to risk and uncertainty. We are dependent on a few large customers. The electronics industry in which we participate is highly competitive, and we are subject to continuing pressure on our margins. Our operating results fluctuate and lack predictability. Because our operations are primarily located in China and Hong Kong, we are subject to risks arising from governmental policies, taxation, trade regulation, and currency exchange. As a foreign private issuer, we are not subject to the same regulation that applies to issuers domiciled in the U.S. We also are currently subject to pending litigation that may adversely affect us.

### **Our Headquarters And Website**

We were incorporated as an International Business Company in the British Virgin Islands in 1987. Our principal executive offices are located in the British Virgin Islands at 116 Main Street, 2nd Floor, Road Town, Tortola, British Virgin Islands and our telephone and fax numbers are (284) 494-7752 and (284) 494-4957, respectively. We maintain the following toll-free telephone number for United States investor relations: (800) 661-8831, and our Internet website address is [www.namtai.com](http://www.namtai.com). The information found on our website is not part of this prospectus.

### **References to Dollars**

All dollar amounts in this prospectus are expressed in United States dollars, except where we state otherwise. In this prospectus, unless we state otherwise, all references to "U.S.\$" or "\$" are to U.S. dollars.

### **References to China**

The People's Republic of China resumed sovereignty over Hong Kong effective July 1, 1997 and politically Hong Kong is an integral part of China. However, for the purposes of this prospectus and as a matter of definition only, our references to China or the PRC in this prospectus means the People's Republic of China and all of its territories excluding Hong Kong.

### The Offering

Common shares offered:

by us	2,000,000 shares
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by the selling shareholders	1,000,000 shares
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Common shares to be outstanding after this offering	14,130,668 shares
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New York Stock Exchange Symbol	NTE
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Use of Proceeds	We are raising funds in this offering primarily to increase our production capacity by using approximately \$40.0 million to construct and equip a new factory adjacent to our principal manufacturing facilities in Shenzhen, China. We intend to use the balance of the net proceeds for working capital and other general corporate purposes. We will not receive any proceeds from the sale of common shares by the selling shareholders.
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Risk Factors	Investing in our common shares involves certain risks, which are described under the heading "Risk Factors", beginning on page 8 of this prospectus.
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The number of shares of our common stock that will be outstanding after this offering is based on our shares outstanding as of January 31, 2003. The number of shares that will be outstanding after this offering excludes:

372,000 common shares issuable upon exercise of stock options outstanding as of January 31, 2003;

602,233 common shares available as of January 31, 2003 for future issuance under our stock option plans; and

450,000 common shares that we may issue upon exercise of the underwriters' over-allotment option.



**Summary Consolidated Financial Information**

We derived the statements of income data presented below for the years ended December 31, 2000, 2001 and 2002 and the balance sheet data as of December 31, 2001 and 2002 presented below from our audited consolidated financial statements. You should read this summary consolidated financial information with the Management's Discussion and Analysis of Financial Condition and Results of Operations, which is included elsewhere in this prospectus. The as adjusted balance sheet data gives effect to the proceeds to be received by us from our sale of 2,000,000 common shares in this offering at an assumed offering price of \$24.41 per share, after payment of estimated underwriting discounts and commissions and other estimated offering expenses payable by us, and the application of such proceeds to our cash and cash equivalents, working capital, total assets and shareholders' equity.

	Year ended December 31,		
	2000	2001	2002
(in thousands except per share data)			
<b>Consolidated statements of income data:</b>			
Net sales - third parties	\$ 207,456	\$ 212,934	\$ 228,167
Net sales - related party	6,232	21,072	7,849
Total net sales	213,688	234,006	236,016
Cost of sales	182,096	203,974	197,956
Gross profit	31,592	30,032	38,060
Operating costs and expenses:			
Selling, general and administrative	17,646	21,974	17,983
Research and development	3,489	2,954	2,686
Impairment of goodwill			339
Income from operations	10,457	5,104	17,052
Equity in (loss) income of affiliated companies	(189)	1,867	10,741
Other income (expense) - net	13,853	2,709	(6,043)
Interest expense	(165)	(178)	(790)
Income before income taxes and minority interests	23,956	9,502	20,960
Income taxes benefit (expense)	33	(227)	(773)
Income before minority interests	23,989	9,275	20,187
Minority interests	12	(230)	(164)
Net income	\$ 24,001	\$ 9,045	\$ 20,023
Earnings per share:			
Basic	\$ 2.63	\$ 0.88	\$ 1.89
Diluted	\$ 2.56	\$ 0.87	\$ 1.86
Weighted average shares:			
Basic	9,114	10,274	10,571
Diluted	9,375	10,393	10,736

	At December 31,		
	2001	2002	
		Actual	As adjusted
<b>Consolidated balance sheet data:</b>			
Cash and cash equivalents	\$ 58,676	\$ 82,477	\$ 127,476
Working capital	83,982	87,408	132,407
Property, plant and equipment net	70,414	75,914	75,914
Total assets	224,573	275,086	320,085
Total debt	16,547	17,782	17,782
Shareholders' equity	169,351	202,128	247,127

**SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS**

This prospectus and the documents and information incorporated by reference in this prospectus, such as from Management's Discussion and Analysis of Financial Condition and Results of Operations and Business in this prospectus and Item 4 Information on the Company and Item 5 Operating and Financial Review and Prospects in our Annual Report on Form 20-F for the year ended December 31, 2002, include forward-looking statements within the meaning of section 27A of the Securities Act of 1933, as amended and section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements include the information concerning our possible or assumed future operating results, business strategies, financing plans, competitive position, industry environment, the anticipated impact on our business and financial results of recent and future acquisitions, the effects of competition, our ability to produce new products in a cost-effective manner and projections relating to our and our industry's market share. Forward-looking statements may be identified by the use of words like believes, considers, intends, expects, may, will, should, forecast, or anticipates, or the negative equivalents of those words or comparable terms by discussions of strategies that involve risks and uncertainties.

Actual results may differ materially from those expressed or implied by forward-looking statements for a number of reasons, including those appearing elsewhere in this prospectus under the heading Risk Factors. In addition, we base forward-looking statements on assumptions about future events, which may not prove to be accurate. In light of these risks, uncertainties and assumptions, you should be aware that the forward-looking events described in this prospectus and the documents incorporated by reference in this prospectus may not occur.

## RISK FACTORS

*An investment in our common shares involves a substantial risk of loss. You should carefully consider the risks described below and the other information in this prospectus, including our financial statements and the related notes, before you purchase any of our common shares. If any such risks actually occur, our business and operating results could be materially and adversely affected. In such case, the trading price of our common shares could decline and you may lose all or part of your investment.*

### Risks Related to Our Business

**We are dependent on a few large customers, the loss of any of which could substantially harm our business and operating results.**

Historically, a substantial percentage of our sales have been to a small number of customers. During the years ended December 31, 2000, 2001 and 2002, sales to our customers accounting for 10% or more of our net sales aggregated approximately 72.4%, 44.1% and 60.2% respectively, of our net sales. The loss of Epson Precision (HK) Ltd., Sony Ericsson Mobile Communications AB or Texas Instruments Incorporated, each of which accounted for more than 10% of our net sales during 2002, or a substantial reduction in orders from any of them would materially and adversely impact our business and operating results.

**Our quarterly and annual operating results are subject to significant fluctuations from a wide variety of factors.**

Our quarterly and annual operating results are affected by a wide variety of factors that could materially and adversely affect our business and operating results during any period. This could result from any one or a combination of factors, such as:

the timing, cancellation or postponement of orders,

the type of product and related margins,

our customers' announcement and introduction of new products or new generations of products,

the life cycles of our customers' products,

our timing of expenditures in anticipation of future orders,

our effectiveness in managing manufacturing processes, including, interruptions or slowdowns in production and changes in cost and availability of components, and

the mix of orders filled.

The volume and timing of orders received during a quarter are difficult to forecast. From time to time, our customers encounter uncertain and changing demand for their products. Customers generally order based on their forecasts. If demand falls below such forecasts or if customers do not control inventories effectively, they may reduce, cancel or postpone shipments of orders.

As a consequence of any of the above factors, results of operations in any period should not be considered indicative of results to be expected in any future period, and fluctuations in operating results may also result in fluctuations in the market price of our common shares. Our results of operations in future periods may fall below the expectations of public market analysts and investors. This failure to meet expectations could cause the trading price of our common shares to decline substantially.

**Cancellations or delays in orders could materially and adversely affect our gross margins and operating income.**

Sales to our OEM customers are primarily based on purchase orders we receive from time to time rather than firm, long-term purchase commitments. Although it is our general practice to purchase raw



materials only upon receiving a purchase order, for certain customers we will occasionally purchase raw materials based on such customers rolling forecasts. Further, during times of potential component shortages we have purchased, and may continue to purchase, raw materials and component parts in the expectation of receiving purchase orders for products that use these components. In the event actual purchase orders are delayed, are not received or are cancelled, we would experience increased inventory levels or possible write-downs of raw material inventory that could materially and adversely affect our business and operating results. In 2001, we made an inventory provision of \$3.8 million for slow-moving raw materials relating to cancelled, reduced or delayed orders. Subsequently, we were able to use some of these raw materials in production or we received compensation for the unused raw materials from certain of our customers, resulting in a partial reversal of \$2.0 million of the provision in 2002. Of the remaining \$1.8 million of slow-moving inventory, \$1.2 million was scrapped and \$600,000 will be scrapped in the next six months.

**If we are unable to produce our new products in a high quality and cost-effective manner, our gross margins and business and operating results could be materially and adversely affected.**

We have experienced increased costs associated with developing advanced manufacturing techniques to produce our complex products on a mass scale and at a low cost. This has negatively impacted our gross margins. For example, our initial production runs of liquid crystal display, or LCD, modules experienced low production yields and other inefficiencies. We have currently commenced production of radio frequency, or RF, modules, thin film transistor, or TFT, modules and color LCD modules, in relation to which we have limited manufacturing experience. We expect that a substantial portion of our growth will come from our manufacture of these products. While we expect and plan for such increased costs in our new product manufacturing cycle, we cannot precisely predict the time and expense required to overcome initial problems and to ensure reliability and high quality at an acceptable cost. The increased costs and other difficulties associated with manufacturing RF modules, TFT modules and color LCD modules and other new products could have a negative impact on our future gross margins. In addition, even if we develop capabilities to manufacture new products, there can be no guarantee that a market will exist for such products or that such products will adequately respond to market trends. If we invest resources to develop capabilities to manufacture new products, like the investment in our new factory, for which a market does not develop, our business and operating results would be seriously harmed. Even if the market for our services grows, it may not grow at an adequate pace.

**Our inability to utilize capacity at our new factory could materially and adversely affect our business and operating results.**

In order to expand production capacity, we intend to use approximately \$40 million of our net proceeds to construct and equip a new factory consisting of approximately 250,000 square feet on land adjacent to our principal manufacturing facilities in Shenzhen, China. Once our new factory is complete, we will have committed substantial expenditures and resources to constructing and equipping this factory, but cannot guarantee that we will fully utilize such additional capacity. Our factory utilization is dependent on our success in providing manufacturing services for new or other products that we intend to produce at that factory, including RF modules, TFT and color LCD modules, and handset assemblies for cellular phones, at a price and volume sufficient to absorb our increased overhead expenses. Demand for contract manufacturing of these products may not be as high as we expect, and we may fail to realize the expected benefit from our investment in our new factory.

**We face increasing competition, which has had an adverse effect on our margins.**

Competition in the EMS industry is intense and is characterized by price erosion, rapid technological change, and competition from major international companies. This intense competition has resulted in pricing pressures, lower sales and reduced margins. Over the last several years our margins have declined substantially, from 24.3% in 1998 to approximately 15.3% in 2002, as adjusted to take into account a

\$2.0 million partial reversal of a provision we made in 2001. Continuing competitive pressures could materially and adversely affect our business and operating results.

**We may not be able to compete successfully with our competitors, many of which have substantially greater resources than we do.**

The electronics manufacturing services we provide are available from many independent sources as well as from our current and potential customers with in-house manufacturing capabilities. Our EMS competitors include Celestica, Inc., Flextronics International Ltd., Hon Hai Precision Industry Co., Ltd., Jabil Circuit, Inc., Sanmina-SCI Corporation and Solecron Corporation. Our principal competitors in the manufacture of our traditional product lines of calculators, personal organizers and linguistic products include Kinpo Electronics, Inc. and Inventec Co. Ltd. We have numerous competitors in the telecommunication, subassemblies and components product lines, including Philips, Samsung and Varitronix. Many of our competitors have greater financial, technical, marketing, manufacturing, regional shipping capabilities and logistics support and personnel resources than we do. As a result, we may be unable to compete successfully with these organizations in the future.

**We must spend substantial amounts to maintain and develop advanced manufacturing processes and engage additional engineering personnel in order to attract new customers and business.**

We operate in rapidly changing industries. Technological advances, the introduction of new products, and new manufacturing and design techniques could materially and adversely affect our business unless we are able to adapt to those changing conditions. As a result, we are continually required to commit substantial funds for, and significant resources to, engage additional engineering and other technical personnel and to purchase advanced design, production and test equipment.

Our future operating results will depend to a significant extent on our ability to continue to provide new manufacturing solutions that compare favorably on the basis of time to introduction, cost, and performance with the manufacturing capabilities of OEMs and competitive third-party suppliers. Our success in attracting new customers and developing new business depends on various factors, including:

utilization of advances in technology;

development of new or improved manufacturing processes for our customer's products;

delivery of efficient and cost-effective services; and

timely completion of the manufacture of new products.

**We generally have no written agreements with suppliers to obtain components and our margins and operating results could suffer from increases in component prices.**

We are typically responsible for purchasing components used in manufacturing products for our customers. We generally do not have written agreements with our suppliers of components. This typically results in our bearing the risk of component price increases because we may be unable to procure the required materials at a price level necessary to generate anticipated margins from the orders of our customers. Accordingly, increases in component prices could materially and adversely affect our gross margins and operating results.

**Our business and operating results would be materially and adversely affected if our suppliers of needed components fail to meet our needs.**

At various times, we have and continue to experience shortages of some of the electronic components that we use, and suppliers of some components lack sufficient capacity to meet the demand for these components. In some cases, supply shortages and delays in deliveries of particular components have resulted in curtailed production, or delays in production, of assemblies using that component, which contributed to an increase in our inventory levels and reduction in our gross margins. We expect that shortages and delays in deliveries of some components will continue. If we are unable to obtain sufficient

components on a timely basis, we may experience manufacturing delays, which could harm our relationships with current or prospective customers and reduce our sales. We also depend on a small number of suppliers for certain of the components that we use in our business. For example, we purchase most of our integrated circuits from Toshiba Corporation and Sharp Corporation and certain of their affiliates. If we were unable to continue to purchase components from these limited source suppliers, our business and operating results would be materially and adversely affected.

**Factors affecting the electronics industry in general and our customers in particular could harm our operations.**

Most of our sales are to customers in the electronics industry, which is subject to rapid technological change, product obsolescence and short product life cycles and has suffered from an industry-wide slowdown since 2000. The factors affecting the electronics industry in general, or any of our major customers or competitors in particular, could have a material adverse effect on our business and operating results. Our success will depend to a significant extent on the success achieved by our customers in developing and marketing their products, including their products that use RF modules and color STN modules and TFT modules, some of which may be new and untested. If our customers' products become obsolete, fail to gain widespread commercial acceptance or become the subject of intellectual property disputes, this could harm our business and operating results.

**Future acquisitions or strategic investments may not be successful and may harm our operating results.**

An important element of our strategy is to review prospects for acquisition or strategic investments that would complement our existing companies and products, augment our market coverage and distribution ability or enhance our technological capabilities.

Future acquisitions or strategic investments could have a material adverse effect on our business and operating results because of:

possible charges to operating results for purchased technology, restructuring or impairment charges related to goodwill or amortization expenses associated with intangible assets,

potential increase in our expenses and working capital requirements and the incurrence of debt and contingent liabilities,

difficulties in successfully integrating any acquired operations, technologies, customers products and businesses with our operations,

diversion of our capital and management's attention to other business concerns,

risks of entering markets or geographic areas in which we have limited prior experience, or

potential loss of key employees of acquired organizations or inability to hire key employees necessary for expansion.

For example, in 1998, we made a provision for, and subsequently wrote-off, our entire \$10.0 million investment in Albatronics.

**Our customers are dependent on shipping companies for delivery of our products and interruptions to shipping could materially and adversely affect our business and operating results.**

Typically, we sell our products F.O.B. Hong Kong and our customers are responsible for the transportation of products from Hong Kong to their final destinations. Our customers rely on a variety of carriers for product transportation through various world ports. A work stoppage, strike or shutdown of one or more major ports or airports could result in shipping delays materially and adversely affecting our customers, which in turn could have a material adverse effect on our business and operating results. Similarly, an increase in freight surcharges due to rising fuel costs or general price increases could materially and adversely affect our business and operating results.



**Because our operations are international, we are subject to significant worldwide political, economic, legal and other uncertainties.**

We are incorporated in the British Virgin Islands and have subsidiaries incorporated in the British Virgin Islands, the Cayman Islands, Hong Kong and China. Our executive and administrative offices are located in Hong Kong. We manufacture all of our products in China. As of December 31, 2002, approximately 72% of the net book value of our total fixed assets is located in China. We sell our products to customers in Hong Kong, North America, Europe, Japan, China and Southeast Asia. Our international operations may be subject to significant political and economic risks and legal uncertainties, including:

changes in economic and political conditions and in governmental policies,

changes in international and domestic customs regulations,

wars, civil unrest, acts of terrorism and other conflicts,

changes in tariffs, trade restrictions, trade agreements and taxation,

difficulties in managing or overseeing foreign operations, and

limitations on the repatriation of funds because of foreign exchange controls.

The occurrence or consequences of any of these factors may restrict our ability to operate in the affected region and decrease the profitability of our operations in that region.

**Our operating results could be negatively impacted by seasonality.**

Historically, our sales and operating results have been affected by seasonality. Sales of calculators, personal organizers and linguistic products are typically higher during the second and third quarters in anticipation of the start of the school year and the Christmas buying season. Similarly, our consumer services for electronics products have historically been lower in the first quarter from both the closing of our factories in China for the Chinese New Year holidays and the general reduction in sales following the holiday season. These sales patterns may not be indicative of future sales performance.

**Our results could be harmed if we have to comply with new environmental regulations.**

Our operations create some environmentally sensitive waste that may increase in the future depending on the nature of our manufacturing operations. The general issue of the disposal of hazardous waste has received increasing attention from the PRC national and local governments and foreign governments and agencies and has been subject to increasing regulation. Our business and operating results could be materially and adversely affected if we were to increase expenditures to comply with environmental regulations affecting our operations.

**If there is an adverse outcome in class action litigation that has been filed against us, our business could be seriously harmed.**

On March 11, 2003, we were served with a complaint in an action captioned Michael Rocco v. Nam Tai, et al., 03 Civ. 1148 (S.D.N.Y.) (the Rocco Action ). Plaintiff in the Rocco Action purports to represent a putative class of persons who purchased the common stock of Nam Tai from July 29, 2002 through February 14, 2003. In addition to Nam Tai, certain directors are named as defendants. On or about April 9, 2003, a second complaint was filed in an action captioned A.J. & Celine Steigler v. Nam Tai, et al., 03 Civ. 2462 (S.D.N.Y.) (the Steigler Action ) (together with the Rocco Action, the Actions ). We have not yet been served in the Steigler Action. Plaintiff in the Steigler Action purports to represent a putative class of persons who purchased Nam Tai's common stock during the period December 13, 2002 through February 14, 2003. One director is also named as a defendant in the Steigler Action. Plaintiffs in the Actions assert claims under Section 10(b) of the Securities Exchange Act of 1934 and allege that misrepresentations and/or omissions were made during the alleged class periods concerning an accounting charge related to Nam Tai's JIC unit. The plaintiff in the Rocco Action also appears to

allege that Nam Tai failed to make timely disclosures concerning certain pending litigation related to a British Virgin Islands company known as Tele-Art. The Actions are in their preliminary stages, Nam Tai believes it has meritorious defenses and it intends to defend vigorously. Nam Tai is aware of no other actions that have been filed which relate to these matters. The ultimate outcome of this litigation cannot be presently determined. However, this litigation could be very costly and divert our management's attention and resources. In addition, we have no insurance covering our liability, if any, or that of our officers and directors, and we will have to pay the costs of defense. Any adverse determination in this litigation could also subject us to significant liabilities, any or all of which could materially and adversely affect our business and operating results.

**We are dependent on certain members of our senior management.**

We are substantially dependent upon the services of Mr. Tadao Murakami, our Chairman of the Board of Directors, Mr. Joseph Li, our Chief Executive Officer, and, Mr. M. K. Koo, our Chief Financial Officer. We have employment agreements with each of Mr. Murakami and Mr. Koo, which may be terminated immediately and upon short notice, respectively. We also have entered into a Services Agreement with Mr. Li, which expires in October 2003. We maintain no key person insurance on these individuals. The loss of the services of any of these officers could have a material adverse effect on our business and operating results.

**We may be unable to succeed in recovering on our judgment debts against Tele-Art.**

We have two judgments in our favor against Tele-Art, Inc. awarded by The High Court of Justice in the British Virgin Islands for approximately \$35.0 million plus interests and costs. Because Tele-Art, Inc. is in liquidation, we may not realize the entire amount of our judgments, and the actual amount of the recovery, if any, is uncertain and dependent on a number of factors. We may incur substantial additional costs in pursuing our recovery, and such costs may not be recoverable.

**We could become involved in intellectual property disputes.**

We do not have any patents, licenses, or trademarks material to our business. Instead, we rely on trade secrets, industry expertise and our customers sharing of intellectual property with us. We may be notified that we are infringing patents, copyrights or other intellectual property rights owned by other parties. In the event of an infringement claim, we may be required to spend a significant amount of money to develop a non-infringing alternative or to obtain licenses. We may not be successful in developing such an alternative or obtaining a license on reasonable terms, if at all. Any litigation, even without merit, could result in substantial costs and diversion of resources and could materially and adversely affect our business and operating results.

**We may not pay dividends in the future.**

Although we have declared dividends during each of the last 10 years, we may not be able to declare them or may decide not to declare them in the future. Our China subsidiaries are required to reserve 10% of profits for future development, which may effect our ability to declare dividends. We will determine the amounts of the dividends when they are declared and even if dividends are declared in the future, we may not continue them in any future period.

**Risks Related to Our Operations in China and Hong Kong**

Our manufacturing facilities are located in China and our principal subsidiaries and several of our customers and suppliers are located in Hong Kong and China. As a result, our operations and assets are subject to significant political, economic, legal and other uncertainties associated with doing business in China and Hong Kong, which are discussed in more detail below.

**The Chinese government could change its policies toward, or even nationalize, private enterprise, which could harm our business and operating results.**

Over the past several years, the Chinese government has pursued economic reform policies including the encouragement of private economic activities and decentralization of economic deregulation. The Chinese government may not continue to pursue these policies or may significantly alter them to our detriment from time to time without notice. Changes in policies by the Chinese government resulting in changes in laws, regulations, or their interpretation, or the imposition of confiscatory taxation, restrictions on currency conversion or imports and sources of supply could materially and adversely affect our business and operating results. The nationalization or other expropriation of private enterprises by the Chinese government could result in the total loss of our investment in China.

**The Chinese legal system has inherent uncertainties that could materially and adversely impact our ability to enforce the agreements governing our factories and to do business.**

We do not own the land on which our factories in China are located. We occupy our principal manufacturing facilities under land use agreements with agencies of the Chinese government and we occupy other facilities under lease agreements with peasant collectives or other companies. The performance of these agreements and the operations of our factories are dependent on our relationship with the local government. Our operations and prospects would be materially and adversely affected by the failure of the local government to honor these agreements or an adverse change in the law governing them. In the event of a dispute, enforcement of these agreements could be difficult in China. Unlike the United States, China has a civil law system based on written statutes in which judicial decisions have limited precedential value. The Chinese government has enacted laws and regulations dealing with economic matters such as corporate organization and governance, foreign investment, commerce, taxation and trade. However, its experience in implementing, interpreting and enforcing these laws and regulations is limited, and our ability to enforce commercial claims or to resolve commercial disputes in China is unpredictable. These matters may be subject to the exercise of considerable discretion by agencies of the Chinese government, and forces and factors unrelated to the legal merits of a particular matter or dispute may influence their determination.

**Fire, severe weather, flood or earthquake could cause significant damage to our facilities in China and disrupt our business operations.**

Our products are manufactured exclusively at our factories located in China. Fire fighting and disaster relief or assistance in China is not well developed. Material damage to, or the loss of, our factories due to fire, severe weather, flood, earthquake or other acts of God or cause may not be adequately covered by proceeds of our insurance coverage and could materially and adversely affect our business and operating results. In addition, any interruptions to our business caused by such disasters could harm our business and operating results.

**Controversies affecting China's trade with the United States could harm our results of operations or depress our stock price.**

While China has been granted permanent most favored nation trade status in the United States through its entry into the World Trade Organization, controversies between the United States and China may arise that threaten the status quo involving trade between the United States and China. These controversies could materially and adversely affect our business by, among other things, causing our products in the United States to become more expensive resulting in a reduction in the demand for our products by customers in the United States. Political or trade friction between the United States and China, whether or not actually affecting our business, could also materially and adversely affect the prevailing market price of our common shares.

**Changes to Chinese tax laws and heightened efforts by the Chinese tax authorities to increase revenues could subject us to greater taxes.**

Under applicable Chinese law, we have been afforded a number of tax concessions by, and tax refunds from, the Chinese tax authorities on a substantial portion of our operations in China by reinvesting all or part of the profits attributable to our Chinese manufacturing operations. However, the Chinese tax system is subject to substantial uncertainties with respect to its interpretation and enforcement. Following the Chinese government's program of privatizing many state owned enterprises, the Chinese government has attempted to augment its revenues through heightened tax collection efforts. Continued efforts by the Chinese government to increase tax revenues could result in decisions or interpretations of the tax laws by the Chinese tax authorities that would increase our future tax liabilities or deny us expected concessions or refunds.

**Our results have been affected by changes in currency exchange rates. Changes in currency rates involving the Japanese yen, Hong Kong dollar or Chinese renminbi could increase our expenses.**

Our financial results have been affected by currency fluctuations, resulting in total foreign exchange losses of \$345,000 during the year ended December 31, 2002 and total foreign exchange gains of \$530,000 and \$51,000 during the years ended December 31, 2001 and 2000, respectively. We sell most of our products in United States dollars and pay our expenses in United States dollars, Japanese yen, Hong Kong dollars, and Chinese renminbi. While we face a variety of risks associated with changes among the relative value of these currencies, we believe the most significant exchange risk presently results from material purchases we make in Japanese yen. Approximately 14%, 16% and 8% of our material costs have been in yen during the years ended December 31, 2000, 2001 and 2002, respectively, but sales made in yen accounted for less than 7% of sales for each of the last three years. An appreciation of yen against the U.S. dollar would increase our expenses when translated into U.S. dollars and would materially and adversely affect our margins unless we made sufficient sales in yen to offset against material purchases made in yen.

Approximately 4% and 10% of our revenues and 18% and 15% of our expenses were in Chinese renminbi and Hong Kong dollars, respectively, during the year ended December 31, 2002. Approximately 5% and 11% of our revenues and 15% and 19% of our expenses were in Chinese renminbi and Hong Kong dollars, respectively, in 2001. An appreciation of the renminbi or Hong Kong dollar against the U.S. dollar would increase our expenses when translated into U.S. dollars and could materially and adversely affect our margins. In addition, a significant devaluation in the renminbi or Hong Kong dollar could harm our business if it destabilizes the economy of China or Hong Kong, creates serious domestic problems or increases our borrowing costs.

**We have suffered losses from hedging against our currency exchange risk.**

From time to time, we have attempted to hedge our currency exchange risk. We recorded charges of \$304,000 in 2000 and \$566,000 in 1999 on the write-off of option premiums purchased as a hedge against the appreciation of the Japanese yen and the decline of the Hong Kong dollar, respectively. We did not engage in currency hedging transactions for fiscal year 2002. We have experienced in the past and may experience in the future losses as a result of currency hedging.

**Political and economic instability in Hong Kong could harm our operations.**

Some of our principal subsidiaries' offices and several of our customers and suppliers are located in Hong Kong, formerly a British Crown Colony. Sovereignty over Hong Kong was resumed by China effective July 1, 1997. Since then, Hong Kong has become a Special Administrative Region of China, enjoying a high degree of autonomy except for foreign and defense affairs. Moreover, China's political system and policies are not practiced in Hong Kong. Under the principle of "one country, two systems," Hong Kong maintains a legal system that is based on the common law and is different from that of China. It is generally acknowledged as an open question whether Hong Kong's future prosperity in its role as a

hub and gateway to China after China's recent accession to the World Trade Organization (introducing a market liberalization in China) will be diminished. The continued stability of political, economic or commercial conditions in Hong Kong remains uncertain, and any instability could materially and adversely impact our business and operating results.

**The spread of severe acute respiratory syndrome may have a negative impact on our business and operating results.**

There has been a recent outbreak of severe acute respiratory syndrome, or SARS, in Hong Kong and southern China, where our operations are located. This outbreak is being investigated by the World Health Organization, among other health agencies. To date, we are not aware of any of our employees having contracted this illness and have had no plant shutdowns due to workers being suspected of infection with SARS. For the personal safety of our employees, we have directed our employees to minimize business travel and we have distributed respiratory masks to our employees. We are continuing to monitor the possible implications of the SARS outbreak but at this time it is difficult to quantify the future impact on our business. For example, the SARS outbreak could result in quarantines or closures to some of our factories if our employees are infected with SARS and ongoing concerns regarding SARS, particularly its effect on travel, could negatively impact our China-based customers and suppliers and our business and operating results.

**Risks Related to Our Industry**

**We are exposed to general economic conditions. The current slowdown in the technology products industry has affected and we expect it to continue to affect our business and operating results adversely.**

As a result of recent unfavorable economic conditions and reduced capital spending, sales to OEMs in the electronics industry declined during 2002 and 2001. Lower consumer demand and high customer inventory levels have resulted in the delay and cancellation of orders for nearly all types of electronic products. As a result of order cancellations in 2001 we were required to make a provision for slow-moving inventory, which materially and adversely impacted our net income in 2001. If the economic conditions in the United States or Asia worsen generally or in the electronics and contract manufacturing businesses particularly, or if a wider or global economic slowdown occurs, this could materially and adversely impact our business and operating results.

**The current economic downturn in the electronics manufacturing services industry could continue to have a material adverse effect on our business and operating results.**

The EMS industry is currently in an economic slowdown with an uncertain outlook. Some of the major contract manufacturers and OEMs worldwide have announced job reductions and plant closures aimed at reducing costs. Industry analysts have reduced their projections of the future growth of the EMS segment. Furthermore, Wall Street analysts have reduced earnings and revenue estimates across the entire EMS sector and have reported that the EMS industry has excess capacity. For example, the EMS industry in which we operate experienced a decrease in demand in 2001 and 2002. Softening demand for our products and services caused by the ongoing economic downturn was responsible in part for a decline in our operating income in 2001, as well as our provision for slow-moving inventory.

The global economy may remain weak and market conditions continue to be challenging in the EMS industry. As a result, individuals and companies may continue delaying or reducing expenditures, including those for electronic products. Further delays or reductions in spending in our industry in particular, and economic weakness generally, could materially and adversely affect our business and operating results.

**Risks Related to the Offering**

**The market price of our shares will likely be subject to substantial price and volume fluctuations.**

The markets for equity securities have been volatile and the price of our common shares has been and could continue to be subject to wide fluctuations in response to variations in operating results, news announcements, trading volume, sales of common shares by our officers, directors and our principal

shareholders, customers, suppliers or other publicly traded companies, general market trends both domestically and internationally, currency movements and interest rate fluctuations. Certain events, such as the issuance of common shares upon the exercise of our outstanding stock options could also materially and adversely affect the prevailing market price of our common shares.

Further, the stock markets have recently experienced extreme price and volume fluctuations that have affected the market prices of equity securities of many companies and that have been unrelated or disproportionate to the operating performance of such companies. These fluctuations may materially and adversely affect the market price of our common shares and your ability to resell your shares at or above the price you paid, or at any price.

**The concentration of share ownership in our senior management allows them to control or substantially influence the outcome of matters requiring shareholder approval.**

At January 31, 2003, members of our management and board of directors as a group beneficially owned approximately 46% of our common shares and will beneficially own approximately 33% immediately upon completion of this offering (assuming the underwriters' over-allotment option is not exercised). As a result, acting together they may be able to control and substantially influence the outcome of all matters requiring approval by our shareholders, including the election of directors and approval of significant corporate transactions. This ability may have the effect of delaying or preventing a change in control of Nam Tai, or causing a change in control of Nam Tai that may not be favored by our other shareholders. We have agreed, subject to limited exceptions, not to sell or offer to sell or otherwise dispose of any common shares or securities convertible into or exercisable or exchangeable for our common shares, for a period of 90 days after the date of this prospectus, without the prior written consent of Bear, Stearns & Co. Inc., on behalf of the underwriters. Our executive officers, directors and selling shareholders have entered into similar agreements. Bear, Stearns & Co. Inc. may release some or all of these shares, or us, from these agreements at any time without public notice.

**Risks Related to Our Foreign Private Issuer Status**

**It may be difficult to serve us with legal process or enforce judgments against our management or us.**

We are a British Virgin Islands holding corporation having our principal subsidiaries in Hong Kong. We have appointed Stephen Seung, 2 Mott St., Suite 601, New York, New York 10013 as our agent upon whom process may be served in any action brought against us under the securities laws of the United States. However, outside the United States, it may be difficult for investors to enforce judgments against us obtained in the United States in any of these actions, including actions based upon civil liability provisions of the Federal securities laws. In addition, all of our officers and most of our directors reside outside the United States and all of our assets, and the assets of those persons who reside outside of the United States, are located outside of the United States. As a result, it may not be possible for investors to effect service of process within the United States upon those persons, or to enforce against those persons or us judgments obtained in United States courts grounded upon the liability provisions of the United States securities laws. There is substantial doubt as to the enforceability against us or any of our directors and officers located outside of the United States in original actions or in actions for enforcement of judgments of United States courts of liabilities based solely on the civil liability provisions of the securities laws of the United States.

No treaty exists between Hong Kong or the British Virgin Islands and the United States providing for the reciprocal enforcement of foreign judgments. However, the courts of Hong Kong and the British Virgin Islands are generally prepared to accept a foreign judgment as evidence of a debt due. An action may then be commenced in Hong Kong or the British Virgin Islands for recovery of this debt. A Hong Kong or British Virgin Islands court will only accept a foreign judgment as evidence of a debt due if:

the judgment is for a liquidated amount in a civil matter;

the judgment is final and conclusive and has not been stayed or satisfied in full;

the judgment is not, directly or indirectly, for the payment of foreign taxes, penalties, fines or charges of a like nature (in this regard, a Hong Kong or British Virgin Islands court is unlikely to accept a judgment for an amount obtained by doubling, trebling or otherwise multiplying a sum assessed as compensation for the loss or damage sustained by the person in whose favor the judgment was given);

the judgment was not obtained by actual or constructive fraud or duress;

the foreign court has taken jurisdiction on grounds that are recognized by the common law rules as to conflict of laws in Hong Kong or the British Virgin Islands;

the proceedings in which the judgment was obtained were not contrary to natural justice (i.e., the concept of fair adjudication);

the proceedings in which the judgment was obtained, the judgment itself and the enforcement of the judgment are not contrary to the public policy of Hong Kong or the British Virgin Islands;

the person against whom the judgment is given is subject to the jurisdiction of the Hong Kong or the British Virgin Islands court; and

the judgment is not on a claim for contribution in respect of damages awarded by a judgment, which does not satisfy the criteria stated previously.

Enforcement of a foreign judgment in Hong Kong or the British Virgin Islands may also be limited or affected by applicable bankruptcy, insolvency, liquidation, arrangement, and moratorium or similar laws relating to or affecting creditors' rights generally, and will be subject to a statutory limitation of time within which proceedings may be brought.

**Future issuances of preference shares could materially and adversely affect the holders of our common shares or delay or prevent a change of control.**

Our board of directors may amend our Memorandum and Articles of Association without shareholder approval to create from time to time and issue one or more classes of preference shares (which are analogous to preferred stock of corporations organized in the United States). While currently no preference shares are issued or outstanding, we may issue preference shares in the future. Future issuance of preference shares could materially and adversely affect the rights of the holders of our common shares or delay or prevent a change of control.

**Our status as a foreign private issuer exempts us from certain of the reporting requirements under the Exchange Act and corporate governance standards of the New York Stock Exchange, limiting the protections and information afforded to investors.**

We are a foreign private issuer within the meaning of rules promulgated under the Securities Exchange Act of 1934. As such, we are exempt from certain provisions applicable to United States public companies including:

the rules under the Exchange Act requiring the filing with the Commission of quarterly reports on Form 10-Q, current reports on Form 8-K or annual reports on Form 10-K;

the sections of the Exchange Act regulating the solicitation of proxies, consents or authorizations in respect of a security registered under the Exchange Act;

the provisions of Regulation FD aimed at preventing issuers from making selective disclosures of material information; and

the sections of the Exchange Act requiring insiders to file public reports of their stock ownership and trading activities and establishing insider liability for profits realized from any short-swing trading transaction (i.e., a purchase and sale, or sale and purchase, of the issuer's equity securities within less than six months).

In addition, because the Company is a foreign private issuer, certain of the corporate governance standards of the New York Stock Exchange that are applied to domestic companies listed on that exchange may not be applied to us.

Because of these exemptions, investors are not afforded the same protections or information generally available to investors holding shares in public companies organized in the United States or traded on the New York Stock Exchange.



**USE OF PROCEEDS**

We estimate that net proceeds from our sale of 2,000,000 common shares will be approximately \$45.0 million, based on assumed public offering price of \$24.41 and after payment of estimated underwriting discounts and commissions and other estimated offering expenses payable by us. If the underwriter's over-allotment option is exercised in full, we estimate that net proceeds will be approximately \$55.3 million. We will not receive any of the proceeds from the sale of common shares by the selling shareholders.

We intend to use approximately \$40.0 million of the net proceeds to construct and equip a new factory of approximately 250,000 square feet and associated offices and facilities adjacent to our principal manufacturing facilities in Shenzhen, China. We currently expect to use this new facility, among other things, to manufacture RF modules, TFT and color LCD modules and handset assemblies for cellular phones. We intend to use the balance of the net proceeds for working capital and other general corporate purposes, which may include additional capital expenditures and possible acquisitions of, or strategic investments in, businesses, products or technologies that are complementary to our business. From time to time, we evaluate potential acquisitions of, or strategic investments in, such businesses, products or technologies; however, we have no current understandings, agreements or commitments with respect to any such transaction. Pending such uses, we intend to invest the net proceeds in short-term interest bearing obligations.

**DIVIDEND POLICY**

We have paid an annual dividend for the last 10 consecutive years. On February 14, 2003, we announced that we were increasing our regular annual dividend to \$0.60 per share to be declared and paid quarterly commencing with the first quarter 2003 dividend of \$0.15 per share. The following table sets forth the total cash dividends and dividends per share we have declared for each of the five years in the period ended December 31, 2002:

	Year ended December 31,				
	1998	1999	2000	2001	2002
Total dividends declared (in thousands)	\$ 2,829	\$ 2,942	\$ 12,190	\$ 4,134	\$ 17,056
Regular dividends per share	\$ 0.28	\$ 0.32	\$ 0.36	\$ 0.40	\$ 0.48
Special dividends			1.00		1.00
Total dividends per share	\$ 0.28	\$ 0.32	\$ 1.36	\$ 0.40	\$ 1.48

It is our general policy to determine the actual annual amount of future dividends, if any, based upon our growth during the preceding year. Future dividends, if any, will be in the form of cash or stock or a combination of both. We may not be able to pay dividends in the future or may decide not to declare them in any event. We will determine the amounts of the dividends when they are declared and even if dividends are declared in the future we may not continue them in any future period.

We declared special dividends in 2000 and 2002 for the reasons described below:

In 2000, as a result of a realized gain we made from our sale of our investment in Group Sense (International) Ltd.; and

In 2002, primarily as a result of a realized gain we made from our sale of approximately one-third of our indirect investment in Huizhou TCL Mobile Communication Company Ltd.

We do no business in the United States that subjects us to United States income taxes on our income and we do not expect to receive dividends from any United States company or any foreign company that has income effectively connected with a United States trade or business. Accordingly, we expect that any cash dividends we pay to our shareholders who are subject to United States income tax will remain taxable if the recent tax proposal relating to exempting dividends from United States income tax is enacted as proposed.

### PRICE RANGE OF COMMON SHARES

Our common shares are traded exclusively in the United States. On January 23, 2003, our common shares were listed on the New York Stock Exchange under the symbol NTE. Prior to that, our common shares were quoted on the Nasdaq National Market under the symbol NTAI.

The following table sets forth the high and low closing sale prices for our common shares for the quarters indicated through March 31, 2003:

	2001			2002			2003		
	High	Low	Average Daily Trading Volume(1)	High	Low	Average Daily Trading Volume(1)	High	Low	Average Daily Trading Volume(1)
First Quarter	\$19.13	\$12.13	18,517	\$19.04	\$15.45	101,055	\$33.68	\$23.61	121,090
Second Quarter	\$15.01	\$12.25	21,319	\$23.18	\$18.30	18,768			
Third Quarter	\$15.31	\$11.30	24,724	\$20.59	\$16.00	47,936			
Fourth Quarter	\$17.91	\$12.50	44,555	\$27.20	\$18.50	51,105			

(1) Determined by dividing the sum of the reported daily volume for the quarter by the number of trading days in the quarter.

The following table sets forth the high and low closing sale prices for each of the last five years ended December 31:

Year ended	High	Low	Daily Trading Volume(1)
December 31, 2002	\$27.20	\$15.45	55,051
December 31, 2001	\$19.125	\$11.30	27,305
December 31, 2000	\$20.625	\$12.938	37,881
December 31, 1999	\$19.00	\$8.00	57,253
December 31, 1998	\$17.625	\$9.375	73,906

(1) Determined by dividing the sum of the reported daily volume for the year by the number of trading days in the year.

The following table sets forth the high and low closing sale prices during each of the most recent six months through March 31, 2003:

Month ended	High	Low	Daily Trading Volume(1)
March 31, 2003	\$25.16	\$23.61	44,848
February 28, 2003	\$33.91	\$24.18	152,342
January 31, 2003	\$33.68	\$25.50	169,057
December 31, 2002	\$27.20	\$22.45	134,719
November 30, 2002	\$22.33	\$20.25	148,740
October 31, 2002	\$20.55	\$18.50	28,852

(1) Determined by dividing the sum of the reported daily volume for the month by the number of trading days in the month.

On April 21, 2003, the last reported sale price of our common shares on the New York Stock Exchange was \$24.41 per share. As of January 31, 2003, there were 856 holders of record of our common shares.



**CAPITALIZATION**

The following table sets forth our cash and cash equivalents, short-term indebtedness and capitalization:

as of December 31, 2002 on an actual basis; and

as adjusted to reflect the sale of 2,000,000 common shares offered by us at an assumed public offering price of \$24.41 per share, less estimated underwriting discounts and estimated offering expenses and the application of such proceeds to our cash and cash equivalents, shareholders' equity and total capitalization.

You should read this table in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and the accompanying notes included elsewhere in this prospectus.

	<b>At December 31, 2002</b>	
	<b>Actual</b>	<b>As adjusted</b>
	<b>(in thousands)</b>	
Cash and cash equivalents	\$ 82,477	\$ 127,476
Notes payable	\$ 985	\$ 985
Current portion of long-term debt	13,985	13,985
Total short-term debt	\$ 14,970	\$ 14,970
Long-term debt, excluding current portion	\$ 2,812	\$ 2,812
Minority Interests	2,099	2,099
Shareholders' equity:		
Common shares, \$0.01 par value (20,000,000 shares authorized, 12,019,668 shares issued and outstanding actual and 14,019,668 shares issued and outstanding as adjusted)	120	140
Additional paid-in capital	147,828	192,807
Retained earnings	54,182	54,182
Accumulated other comprehensive loss	(2)	(2)
Total shareholders' equity	202,128	247,127
Total capitalization	\$ 207,039	\$ 252,038

The preceding table does not give effect to the issuance of:

483,000 common shares issuable upon exercise of stock options outstanding as of December 31, 2002;

602,233 common shares available as of December 31, 2002 for future issuance under our stock option plans; and

450,000 common shares that we may issue upon exercise of the underwriters' over-allotment option.

At December 31, 2002, our short-term debt included \$12.9 million of the current portion of long-term debt that was secured. On January 3, 2003, this debt was repaid. The table above does not reflect this repayment. Our remaining debt at December 31, 2002, including the current portion of \$1.1 million and notes payable of \$985,000, was not secured. None of our debt at December 31, 2002 was guaranteed by a third party.

## SELECTED CONSOLIDATED FINANCIAL DATA

Our historical consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States and are presented in U.S. dollars. The following selected statements of income data for each of the three years in the period ended December 31, 2002 and the balance sheet data as of December 31, 2001 and 2002 are derived from our consolidated financial statements and notes thereto included later in this prospectus. The selected statements of income data for each of the two years in the period ended December 31, 1999 and the balance sheet data as of December 31, 1998, 1999 and 2000 were derived from our audited financial statements, which are not included in this prospectus. The following data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements including the related footnotes.

		Year ended December 31,				
		1998	1999	2000	2001	2002
		(in thousands except per share data)				
<b>Consolidated statements of income data:</b>						
Net sales	third parties	\$ 101,649	\$ 145,054	\$ 207,456	\$ 212,934	\$ 228,167
Net sales	related party			6,232	21,072	7,849
Total net sales		101,649	145,054	213,688	234,006	236,016
Cost of sales		76,939	120,074	182,096	203,974	197,956
Gross profit		24,710	24,980	31,592	30,032	38,060
Operating costs and expenses:						
	Selling, general and administrative	13,246	14,913	17,646	21,974	17,983
	Research and development	1,691	2,624	3,489	2,954	2,686
	Impairment of goodwill					339
	Non-recurring expense (income)	1,445	(848)			
Total operating expenses		16,382	16,689	21,135	24,928	21,008
Income from operations		8,328	8,291	10,457	5,104	17,052
Equity in income (loss) of affiliated companies		534	1,146	(189)	1,867	10,741
Equity in loss of an unconsolidated subsidiary		(1,708)				
Other income (expense) net		5,687	2,494	13,853	2,709	(6,043)
Interest expense		(1)	(192)	(165)	(178)	(790)
Provision for/write off of investment in an unconsolidated subsidiary		(8,271)	(1)			
Income before income taxes and minority interests		4,569	11,738	23,956	9,502	20,960
Income taxes (expense) benefit		(1,040)	60	33	(227)	(773)
Income before minority interests		3,529	11,798	23,989	9,275	20,187
Minority interests				12	(230)	(164)
Net income		\$ 3,529	\$ 11,798	\$ 24,001	\$ 9,045	\$ 20,023
Earnings per share:						
	Basic	\$ 0.34	\$ 1.26	\$ 2.63	\$ 0.88	\$ 1.89
	Diluted	\$ 0.34	\$ 1.25	\$ 2.56	\$ 0.87	\$ 1.86

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Weighted average shares:					
Basic	10,317	9,328	9,114	10,274	10,571
Diluted	10,351	9,417	9,375	10,393	10,736

At December 31,					
	1998	1999	2000	2001	2002
(in thousands)					
<b>Consolidated balance sheet data:</b>					
Cash and cash equivalents	\$ 71,215	\$ 54,215	\$ 58,896	\$ 58,676	\$ 82,477
Working capital	77,539	61,265	89,568	83,982	87,408
Property, plant and equipment net	32,445	44,717	44,599	70,414	75,914
Total assets	147,228	158,747	208,370	224,573	275,086
Short-term debt, including current portion of long-term debt	329	6,949	1,523	3,687	14,970
Long-term debt, less current portion				12,860	2,812
Total debt	329	6,949	1,523	16,547	17,782
Shareholders equity	127,696	125,568	162,364	169,351	202,128

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Except for statements of historical facts, this section contains forward-looking statements involving risks and uncertainties. You can identify these statements by forward-looking words including believes, considers, intends, expects, may, will, should, forecast, or anticipate, and the negative equivalents of those words or comparable terminology, and by discussions of strategies that involve risks and uncertainties. Forward-looking statements are not guarantees of our future performance or results and our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under Risk Factors. This section should be read in conjunction with our consolidated financial statements.

**Overview**

We are an electronics manufacturing and design services provider to a select group of the world's leading original equipment manufacturers, or OEMs, of telecommunication and consumer electronic products. Our largest customers include Epson Precision (HK) Ltd., Sony Ericsson Mobile Communications AB and Texas Instruments Incorporated. Through our electronics manufacturing services, or EMS, operations, we manufacture electronic components and subassemblies, including liquid crystal display, or LCD, panels, transformers, LCD modules and radio frequency, or RF modules. These components are used in various electronic products, including cellular phones, laptop computers, digital cameras, copiers, fax machines, electronic toys, handheld video game devices and microwave ovens. We also manufacture finished products, including cordless phones, palm-sized PCs, personal digital assistants, electronic dictionaries, calculators and digital camera accessories for use with cellular phones.

We assist our OEM customers in the design and development of their products and furnish full turnkey manufacturing services that utilize advanced manufacturing processes and production technologies. Our services include hardware and software design, component purchasing, assembly into finished products or electronic subassemblies and post-assembly testing. These services are value-added and assist us in obtaining new business but do not represent a material component of our revenue. We also provide original design manufacturing, or ODM, services, in which we design and develop proprietary products that are sold by our OEM customers using their brand name.

*Net Sales and Cost of Sales*

We derive our net sales principally from manufacturing services that we provide to OEMs of telecommunications and consumer electronic products. The market for the products we manufacture is generally characterized by declining unit prices and short product life cycles. Sales to our OEM customers are primarily based on purchase orders we receive from time to time rather than firm, long-term purchase commitments from our customers. We recognize sales, net of product returns and warranty costs, typically at the time of product shipment or, in some cases, as services are rendered.

A substantial percentage of our net sales are to a small number of customers. During the years ended December 31, 2000, 2001 and 2002, sales to our ten largest customers were 90.2%, 83.7% and 84.8% of our net sales, respectively. Furthermore, our customers accounting for 10% or more of our net sales aggregated approximately 72.4%, 44.1% and 60.2% of our total sales, respectively, for the same three-year period. The loss of any of our largest customers or a substantial reduction in orders from any of them would materially and adversely affect our business and operating results.

Our production is typically based on purchase orders received from OEM customers. However, for certain customers we will occasionally purchase raw materials based on such customers' rolling forecasts. Purchase orders are often supported by letters of credit or written confirmation from our OEM customer. We generally do not obtain firm, long-term commitments from our customers. Uncertain economic conditions and our general lack of long-term purchase commitments with our customers make it difficult for us to accurately predict our revenue over the longer term. Even in those cases where customers are contractually obligated to purchase products from us or to repurchase unused inventory from us, we may



elect not to immediately enforce our contractual rights because of the long-term nature of our customer relationships and for other business reasons, and instead may negotiate accommodations with customers regarding particular situations.

We did not suffer a material loss resulting from the cancellation of OEM customer orders in 2000 or 2002. In 2001 however, we made an inventory provision of \$3.8 million to cost of sales for slow-moving raw materials relating to cancelled, reduced or delayed orders. Subsequently, we were able to use some of these raw materials in production or we received compensation for the unused raw materials from certain of our customers, resulting in a partial reversal of \$2.0 million of the provision in 2002. Of the remaining \$1.8 million of slow-moving inventory, \$1.2 million was scrapped and \$600,000 will be scrapped in the next six months.

#### *Gross Margins*

Our gross margins and operating income generally improve during periods of high-volume and high-capacity utilization in our manufacturing facilities and decline during periods of low-volume and low-capacity utilization. Over the last several years our gross profit margins have declined substantially, from 24.3% in 1998, to 17.2% for 1999, to 14.8% for 2000, to 12.8% in 2001 and increasing to 16.1% in 2002. Before the \$3.8 million inventory provision in 2001 and our subsequent partial reversal of \$2.0 million of this provision in 2002 discussed above, our gross margin was 14.5% in 2001 and 15.3% in 2002.

An increased mix of more complex products that generally have relatively high material costs as a percentage of total unit costs has historically been a factor that has adversely affected our gross margins. This is the primary reason for the decline in our gross margins between 1998 and 2001. During this period, we diversified our product mix from predominantly low complexity electronic products, including, calculators and electronic dictionaries, to include more complex components and subassemblies, like LCD modules. We believe our gross margin improved in 2002 as a result of the experience we acquired in manufacturing these more complex products as we changed our strategic focus. Despite the lower gross margin on more complex products, we believe that the opportunity for growth in the demand for these complex products justifies the shift in our strategic focus. Furthermore, we believe that the manufacturing processes and know-how that we have developed from producing more complex products are a competitive advantage for us relative to many of our competitors.

The increased costs associated with developing advanced manufacturing techniques to produce complex products on a mass scale and at a low cost has also negatively impacted our gross margins. For example, in our initial production runs of LCD modules we experienced low production yields and other inefficiencies that caused our gross margin to decrease. Although we believe we have improved the efficiency and quality of our manufacturing processes relating to LCD modules, we may not be able to improve or maintain our gross margin for these products. Furthermore, in December 2002 we began to produce RF modules, and, in January 2003, we began to produce color and thin film transistor, or TFT, LCD modules, each a complex component used in a variety of devices. The increased costs associated with manufacturing these products and other new complex products could have a negative impact on our future gross margins. The complex manufacturing processes involved in the production of complex products is also capital intensive thereby increasing our fixed overhead costs.

#### *Selling, General and Administrative Expenses*

Our selling, general and administrative, or SG&A, expenses, consist primarily of salary and benefits, depreciation and amortization of our non-manufacturing fixed and intangible assets, office expenses, and professional fees.

#### *Research and Development*

We invest in research and development for manufacturing and assembly technology that provide us with the potential to offer better and more technologically advanced services to our OEM customers or assist us in the design and development of future products for them. We plan to continue acquiring

advanced design equipment and to enhance our technological expertise through continued training of our engineers and further hiring of qualified system engineers. These investments are intended to improve the speed, efficiency and quality of our manufacturing processes.

### *Operating Realignment*

In 2001, we restructured certain of our operations to better align our manufacturing, engineering and administrative resources. Related to this restructuring, we incurred approximately \$300,000 of costs related to employee severance charges that were included in cost of sales. We also incurred severance charges of approximately \$700,000 related to the elimination of certain administrative positions that were included in selling, general and administrative expenses in that year.

Due to the termination of the aforementioned employees, we anticipate that we will have yearly savings of approximately \$1.7 million, although the benefit of these savings will be mitigated by the hiring of additional employees since the realignment and any future employees hired from time to time.

### *Income Taxes*

Our principal operations, which are conducted through subsidiaries, are in Hong Kong and China. We calculate the provision for current income taxes of our subsidiaries operating in Hong Kong for the years ended December 31, 2000, 2001, and 2002 by applying the current rate of taxation of 16% to the estimated taxable income earned in or derived from Hong Kong during the period.

The basic corporate tax rate for Foreign Investment Enterprises in China, such as our China subsidiaries, is currently 33% (30% state tax and 3% local tax). However, because all of our China subsidiaries are located in Shenzhen and are involved in production operations, they qualify for a special reduced state tax rate of 15%. In addition, the local tax authorities in the regions in which our subsidiaries operate in Shenzhen are not currently assessing any local tax. Moreover, several of our China subsidiaries are entitled to certain tax benefits and certain of our China subsidiaries have qualified for tax refunds as a result of reinvesting their profits earned in previous years in China for a minimum period of five years.

Efforts by the Chinese government to increase tax revenues could result in decisions or interpretations of the tax laws by the Chinese tax authorities, which are unfavorable to us and which increase our future tax liabilities, or deny us expected refunds. Changes in Chinese tax laws or their interpretation or application may subject us to additional Chinese taxation in the future.

Our effective tax rates were 0%, 2%, and 4% for 2000, 2001, and 2002, respectively. The significant factors that cause our effective tax rates to differ from the applicable statutory rates of 15% were as follows:

	2000	2001	2002
Applicable statutory tax rates	15%	15%	15%
Effect of (income) loss for which no income tax benefit/ expense is receivable/ payable	(11%)	0%	(4%)
Tax holidays and incentives	(2%)	(8%)	(3%)
Effect of PRC tax concessions, giving rise to no PRC tax liability	(2%)	(6%)	(10%)
Others	0%	1%	6%
Effective tax rates	0%	2%	4%

### **Strategic Investments**

An important element of our strategy is to make investments in companies that provide the potential to complement our existing products and services, become new customers, augment our market coverage and sales ability, enhance our technological capabilities and expand our service offerings. We account for



investments of less than 20% under the cost method and we account for investments between 20% and 50% under the equity method. Our material investments over the last five years include:

*Alpha Star/ JCT Wireless.* In January 2003 we invested \$10.0 million for a 25% equity interest in Alpha Star Investments Ltd., the ultimate parent of Hong Kong based JCT Wireless Technology Company Limited, or JCT. JCT is engaged in the design, development and marketing of wireless communication terminals and wireless application software and is using us to manufacture wireless communication terminals and their related RF modules.

*TCL Group.* Over the period from September 2000 through November 2002, we made three investments in the TCL Group of companies and disposed of a portion of one investment. The TCL Group of companies is a leading OEM for numerous consumer electronic and telecommunications products in the domestic Chinese market.

In September 2000, we made a strategic investment of \$2.0 million to acquire a 5% indirect equity interest (through a 25% direct equity interest in Mate Fair Group Limited) in both TCL Mobile Communication (HK) Co., Ltd. and Huizhou TCL Mobile Communication Co., Ltd., or together known as TCL Mobile. TCL Mobile is engaged in manufacturing, distributing and trading of digital mobile phones and accessories in China and overseas markets. In October 2002, we began to provide TCL Mobile with LCD modules used in its mobile phones. However, sales to TCL Mobile were not material for 2002.

In January 2002, we acquired a 6% equity interest in TCL Corporation (formerly known as TCL Holdings Corporation Ltd.), the parent of the TCL Group of companies, for approximately \$12.0 million.

In November 2002, Mate Fair Group Limited sold a portion of its equity interest in Huizhou TCL Mobile Communication Co. Ltd. for which we received proceeds of approximately \$10.4 million, reducing our indirect equity interest (held through Mate Fair Group Limited) in TCL Mobile to approximately 3%.

In November 2002, we invested \$5.1 million in 3% convertible notes of TCL International Holdings Limited that are due in November 2005. TCL International Holdings Limited is another company in the TCL Group and is publicly listed on the Hong Kong Stock Exchange.

*Deswell Industries.* In September 2000, we purchased 500,000 common shares in Deswell Industries Inc., a Nasdaq-listed company, representing approximately 9% of the outstanding shares of Deswell at the time of the purchase for an aggregate of \$7.5 million. Deswell is a manufacturer of injection-molded plastic parts and components, electronic products and subassemblies and metallic molds and accessory parts for OEMs and contract manufacturers. During the first quarter of 2002, we sold our Deswell shares in the open market for aggregate proceeds of \$10.1 million.

*Group Sense.* In May 1998, we acquired 20% of the outstanding shares of Group Sense (International) Limited, a Hong Kong public listed company, for cash of \$16.3 million, which was reduced by a pre-acquisition dividend of \$460,000. Group Sense and its subsidiaries manufacture consumer electronics products. During the period from February to November 2000, we disposed of our Group Sense shares for cash aggregating \$28.1 million.

*Albatronics.* In December 1998, we acquired slightly over 50% of the outstanding shares of Albatronics (Far East) Company Limited, a Hong Kong public listed company, for cash of approximately \$10.0 million. Albatronics and its subsidiaries were engaged in the trading of electronic components and manufacturing of consumer electronics products. Despite our direct cash investment, Albatronics' financial position weakened dramatically and it became unable to pay its liabilities as they came due. As a result, we wrote off our entire investment in Albatronics.

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The following details the impact of our strategic investments on our income statements for each of the years ended 2000, 2001, and 2002:

		<u>2000</u>	<u>2001</u>	<u>2002</u>
(in thousands)				
<b>Cost Investments</b>				
<b>Included in other income:</b>				
Group Sense	Realized gain on disposal of investment, net	\$ 9,435	\$	\$
Deswell	Realized gain on disposal of marketable securities			642
Deswell	Unrealized gain on marketable securities	433	1,568	
Deswell	Dividend income received from marketable securities	165	525	114
Group Sense	Dividend income received from investment	23		
TCL Corporation	Dividend income received from investment			803
		<u>          </u>	<u>          </u>	<u>          </u>
		\$ 10,056	\$ 2,093	\$ 1,559
		<u>          </u>	<u>          </u>	<u>          </u>
<b>Equity Investments</b>				
<b>Included in equity in (loss) income of affiliated companies:</b>				
Shanghai Q&T Tech Co., Ltd				
Share of results		\$ (93)	\$	\$
Amortization of goodwill		(28)		
Provision for unamortized balance of goodwill		(86)		
		<u>          </u>	<u>          </u>	<u>          </u>
		\$ (207)	\$	\$
		<u>          </u>	<u>          </u>	<u>          </u>
Mate Fair Group Ltd.				
Share of results		\$ 69	\$ 2,020	\$ 10,741
Amortization of goodwill		(51)	(153)	
		<u>          </u>	<u>          </u>	<u>          </u>
		18	1,867	10,741
		<u>          </u>	<u>          </u>	<u>          </u>
Equity in (loss) income of affiliated companies		\$ (189)	\$ 1,867	\$ 10,741
		<u>          </u>	<u>          </u>	<u>          </u>
<b>Included in other income:</b>				
Group Sense	Gain on disposal of investment in an affiliated company	\$ 1,346	\$	\$
Mate Fair	Release of unamortized goodwill of affiliated companies			(520)
		<u>          </u>	<u>          </u>	<u>          </u>
		1,346		(520)
		<u>          </u>	<u>          </u>	<u>          </u>
		\$ 1,157	\$ 1,867	\$ 10,221
		<u>          </u>	<u>          </u>	<u>          </u>

## Toshiba Joint Venture

In March 2000, we formed a joint venture with Toshiba Battery Company Ltd. called BPC (Shenzhen) Co., Ltd., or BPC, to manufacture rechargeable lithium ion battery packs at our manufacturing complex in Shenzhen, China. Toshiba Battery Company Ltd. owned a 13% interest in BPC and we owned the balance of BPC for a cash investment of \$1.3 million. During 2000 and 2001 and from January 1 to April 30, 2002, we recognized net sales of \$6.2 million, \$21.1 million, and \$7.8 million, respectively, from Toshiba and its related companies. In 2002, we sold our 87% joint venture interest in BPC and a related manufacturing license to a Toshiba related company for an aggregate of \$2.9 million, resulting in a gain of \$77,000.



Based on the 2001 full year results of BPC, we estimate that the sale of BPC will result in a reduction of annual revenues of approximately \$21.1 million and a reduction in profits of \$1.3 million. We further estimate that the BPC sale will result in a reduction of annual operating expenses of approximately \$600,000. Future cash flows from operations will decline by approximately \$1.7 million a year.

### **JIC Group Acquisition**

We acquired J.I.C. Group (BVI) Limited, or the JIC Group, in October 2000 for \$32.8 million. We paid a portion of the purchase price to the seller by issuing approximately 1.16 million of our common shares and paid \$11.0 million in cash. The JIC Group is engaged in the manufacture and marketing of transformers and LCD panels, a key component for a variety of consumer electronic products. We accounted for the acquisition of the JIC Group under the purchase method of accounting and the results of the JIC Group's operations have been consolidated with our results since the date of its acquisition.

### **JIC Group Minority Interest**

In June 2002, through a restructuring of our interest in the JIC Group, we arranged for the listing of the JIC Group on The Stock Exchange of Hong Kong Limited. As a result, our effective interest in the JIC Group reduced from 100% to 92.9%. However, our interest in the JIC Group became publicly tradable shares on the Hong Kong Stock Exchange. In the second quarter of 2002, we accounted for the restructuring by the creation of a minority interest and a comparable reduction in the value of the net assets of JIC. We discussed the accounting treatment of the JIC restructuring in our consolidated financial statements for the six months ended June 30, 2002 with HLB Hodgson Impey Cheng, our auditor at the time. We believed, and HLB concurred, at the time we released our consolidated financial statements for the six months ended June 30, 2002 that our accounting treatment complied, where applicable, with the relevant generally accepted accounting principles of Hong Kong and the United States.

During the third quarter, in connection with this transaction we were then considering, we were requested to engage Deloitte Touche Tohmatsu to review our interim operations for the six months ended June 30, 2002. On October 23, 2002, Deloitte Touche Tohmatsu communicated that, based on its review, the financial results for the six months ended June 30, 2002 may be materially misstated as a result of a departure from generally accepted accounting principles with respect to the absence of a \$1.5 million goodwill charge relating to the creation of the 7.1% minority interest in our subsidiary, JIC. As a result, management and our Board of Directors again discussed the accounting treatment with HLB. Shortly thereafter, HLB resigned as our auditors for unrelated reasons described in "Change in Public Accountants". In doing so, HLB provided us with no additional information as to the appropriate accounting treatment for the \$1.5 million goodwill in question and suggested that the issue would most appropriately be addressed by the independent auditors that succeeded them.

We brought the issue to the attention of Grant Thornton, whom we had retained as our independent auditors in December 2002. Based on the advice of HLB, our auditor at the time, we believed that our original accounting was accurate. However, upon consultation with Grant Thornton, we determined to include a charge of \$1.5 million in other income/(expense), net in 2002. We then decided to revise our previously issued financial information issued in the second quarter of 2002 in order to reflect the charge for the 7.1% JIC minority interest, which we announced in a press release issued before the market opened on February 18, 2003.

### **Operating Segments**

Our operations are generally organized in two segments, Consumer Electronics Products, or CEP, and LCD panels and transformers, or LPT. The activities of our LPT segment relate primarily to our JIC subsidiary that we acquired in October 2000. Prior to our acquisition of JIC, we operated as a single segment; therefore, our comparison of operating results for the years ended December 31, 2001 and 2000 presented below is not described on a segment basis.

*Consumer Electronics Products.* Our CEP segment is primarily engaged in the manufacture and assembly of electronic components, subassemblies and finished products for OEMs of electronic and telecommunications products. The electronic components and subassemblies that our CEP segment produces are primarily LCD modules used in a wide variety of consumer electronic products including cellular phones, personal digital assistants, or PDAs, digital cameras, handheld video game devices and microwave ovens. In December 2002, our CEP segment also began producing RF modules, used in cellular phones and other electronic devices with wireless features. The finished products that our CEP segment assembles include digital camera accessories for cellular phones, handheld electronic calculators, dictionaries and linguistic products. Within our CEP segment, we also provide software development services to our OEM customers.

*LCD Panels and Transformers.* Our LPT segment manufactures LCD panels for use in numerous electronic products, including watches, clocks, calculators, pocket games, PDAs and cellular and wireless telephones. The transformers produced by our LPT segment are used in home appliances, telecommunications equipment, computers and computer peripherals.

### **Seasonality**

Historically, our sales and operating results are often affected by seasonality. Sales of calculators, personal organizers and linguistic products are often higher during the second and third quarters in anticipation of the start of the school year and the Christmas buying season. Similarly, our consumer services for electronics products have historically been lower in the first quarter resulting from both the closing of our factories in China for the Chinese New Year holidays and the general reduction in sales following the holiday season. As we have diversified our services for complex components, we expect that seasonality may be less of a factor affecting our business.

### **Application of Critical Accounting Policies**

The preparation of our financial statements and related disclosures in conformity with generally accepted accounting principles in the United States requires management to make estimates and judgments that affect our reported amounts of assets and liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. On an on-going basis, we evaluate our estimates and assumptions based upon historical experience and various other factors and circumstances. Management believes that our estimates and assumptions are reasonable under the circumstances; however, actual results may vary from these estimates and assumptions under different future circumstances. We have identified the following critical accounting policies that affect the more significant judgments and estimates used in the preparation of our consolidated financial statements.

#### *Revenue Recognition*

We recognize revenue from product sales in accordance with Staff Accounting Bulletin (SAB) No. 101 *Revenue Recognition in Financial Statements*. SAB No. 101 requires that revenue be recognized when all of the following conditions are met:

*Persuasive evidence of an arrangement exists,*

*Delivery has occurred or services have been rendered,*

*Price to the customer is fixed or determinable, and*

*Collectibility is reasonably assured.*

Revenue from sales of products is recognized when the title is passed to customers upon shipment and when collectibility is assured. Generally, we do not provide our customers with the right of return (except for quality), price protection, rebates or discounts. There are no customer acceptance provisions associated with our products, other than for quality. All sales are based on firm customer orders with fixed terms and conditions, which generally cannot be modified.



#### *Inventory Reserves*

Our inventories are stated at the lower of cost or market value. We determine cost on the first-in, first-out basis. Our industry is characterized by rapid technological change, short-term customer commitments and rapid changes in demand, as well as many other lower of cost or market considerations. We make provisions for estimated excess and obsolete inventory based on our regular reviews of inventory quantities on hand and the latest forecasts of product demand and production requirements from our customers. Specifically, we provide for all inventories, other than electronic parts and LCDs, that remain unused for six months. We do not generally provide for electronic parts and LCDs as these customers are held to their purchase commitments. If actual market conditions or our customers' product demands are less favorable than those projected, additional provisions may be required. Our current reserve for slow-moving or obsolete raw materials is \$1.5 million. We did not make any material provisions relating to inventory for 2002.

We derive information concerning our customers' inventory levels through constant communications with our significant customers. Customers that see indications of high inventory levels will communicate this fact to us and we will attempt to delay our production if we are able to reduce our own order commitments. Our ability to reduce orders from suppliers depends on the terms, conditions and timing of the request.

In 2001, we made an inventory provision of \$3.8 million for slow-moving raw materials relating to cancelled, reduced or delayed orders. However, subsequently, we were able to use some of these raw materials in production in 2002 or we received compensation for the unused raw materials from certain of our customers, resulting in a partial reversal of \$2.0 million of the provision in 2002. Of the remaining \$1.8 million of slow-moving inventory, \$1.2 million was scrapped and \$600,000 will be scrapped in the next six months.

#### *Impairment or disposal of long-lived assets*

In August 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, that was applicable to financial statements issued for fiscal years beginning after December 15, 2001. The FASB's new rules on asset impairment supersede SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, and portions of Accounting Principles Board Opinion No. 30, *Reporting the Results for Operations*. The statement requires a single accounting model for long-lived assets to be disposed of and significantly changes the criteria that would have to be met to classify an asset as held-for-sale. Classification as held-for-sale is an important distinction since such assets are not depreciated and are stated at the lower of fair value or carrying amount. The statement also requires expected future operating losses from discontinued operations to be recorded in the period(s) in which the losses are incurred, rather than as of the measurement date as previously required. On January 1, 2002, we adopted SFAS No. 144. The adoption of SFAS No. 144 did not have any significant impact on our financial position and results of operations. We continually review our long-lived assets for impairment. In 2002, we determined that long-lived assets were not impaired.

#### *Goodwill*

The excess of the purchase price over the fair value of net assets acquired is recorded on our consolidated balance sheet as goodwill. As of December 31, 2002, we had goodwill of \$21.3 million, the majority of which was from our acquisition of JIC in 2000. Prior to January 1, 2002, we amortized goodwill to expense on a straight-line basis over various periods ranging from 4 to 15 years.

In June 2001, the Financial Accounting Standard Board (the FASB) issued Statement of Financial Accounting Standard (SFAS) No. 142, *Goodwill and Other Intangible Assets*. This statement provides that goodwill and other intangible assets with indefinite lives will not be amortized, but will be tested for impairment at the reporting unit level on an annual basis. A reporting unit is an operating segment or one level below an operating segment (i.e. a component) as defined in SFAS No. 131

*Disclosures about Segments of an Enterprise and Related Information* . A component of an operating segment is a reporting unit if the component constitutes a business for which discrete financial information is available and segment management regularly reviews the operating results of that component. Through May 2002, we operated in two reporting units, which were the operating segments of CEP and LPT . Beginning in June 2002 we segregated our LPT segment into two reporting units: LCD panels and transformers.

The evaluation of goodwill for impairment involves two steps: (1) the identification of potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill and (2) the measurement of the amount of goodwill loss by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill and recognizing a loss by the excess of the latter over the former.

SFAS No. 142 was effective for fiscal years beginning after December 15, 2001. We adopted SFAS No. 142 on January 1, 2002. Upon adoption of SFAS No. 142, we evaluated goodwill for impairment at the reporting unit level and determined that there was no impairment at January 1, 2002. Later in 2002, we determined that goodwill was impaired by \$339,000 related to Micro Business Systems Industries Company Limited ( MBS ). All remaining and future acquired goodwill will be subject to an annual impairment test on December 31st of each year or earlier if indications of a potential impairment exist. As of December 31, 2002, we completed our annual impairment evaluation and determined that there was no impairment.

#### *Income Taxes*

We provide for all taxes based on profits whether due at year end or estimated to become due in future periods but based on profits earned to date. However, under the current tax legislation in the PRC, we have reasonable grounds to believe that income taxes paid by Namtai Electronic (Shenzhen) Co., Ltd., Zastron Electronic (Shenzhen) Co., Ltd. (formerly known as Zastron Plastic & Metal Products (Shenzhen) Ltd.), Shenzhen Namtek Company Limited, Jieyao Electronics (Shenzhen) Co., Ltd. and Jetup Electronic (Shenzhen) Co., Ltd. in respect of any year would be refunded after the profits earned in that year are reinvested in the business by way of capital injection. Accordingly, any PRC tax paid by these subsidiaries during the year is recorded as an amount recoverable at the balance sheet date when an application for reinvestment of profits has been filed and a refund is expected unless there is an indication from the PRC tax authority that the refund will be refused. Deferred income taxes are provided to recognize the effect of the difference between the financial statement and income tax bases of measuring assets and liabilities.

#### *Investments*

We apply the equity method of accounting for investments in affiliates when we have a 20% to 50% interest in those entities. Under the equity method, original investments are recorded at cost and adjusted by our share of undistributed earnings or losses of these entities which results in our recording corresponding earnings or losses in our income statement. Nonmarketable investments in which we have a less than 20% interest and in which we do not have the ability to exercise significant influence over the investee are accounted for using the cost method and are initially recorded at cost and periodically reviewed for impairment. Income from these investments are recognized to the extent of dividends received and gains or losses are recognized upon disposition or impairment of the investments.

#### **Operating Results**

The following table presents selected consolidated financial information stated as a percentage of net sales for the years ended December 31, 2000, 2001, and 2002 (certain amounts may not calculate due to rounding and amounts may not add due to rounding).

	2000	2001			2002		
	Total	CEP	LPT	Total	CEP	LPT	Total
Net sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of sales	(85.2)	(88.3)	(81.0)	(87.2)	(83.4)	(86.5)	(83.9)
Gross profit	14.8	11.7	19.0	12.8	16.6	13.5	16.1
Selling, general and administrative expenses	(8.3)	(8.3)	(15.2)	(9.4)	(7.4)	(8.6)	(7.6)
Research and development expenses	(1.6)	(1.4)	(0.6)	(1.2)	(1.1)	(1.5)	(1.1)
Impairment of goodwill					(0.2)		(0.2)
Income from operations	4.9	2.0	3.2	2.2	7.9	3.4	7.2
Equity in (loss) income of affiliated companies	(0.1)	0.9		0.8	5.4		4.6
Other income (expense)	6.5	0.5	5.1	1.2	(2.4)	(3.4)	(2.6)
Interest expense	(0.1)	(0.1)	(0.0)	(0.1)	(0.4)	(0.2)	(0.3)
Income (loss) before income taxes and minority interests	11.2	3.3	8.3	4.1	10.5	(0.2)	8.9
Income taxes benefit (expense)	0.0	(0.1)	(0.2)	(0.1)	(0.4)	(0.2)	(0.3)
Income (loss) before minority interests	11.2	3.2	8.1	4.0	10.1	(0.4)	8.6
Minority interests	0.0	(0.1)		(0.1)		(0.1)	(0.1)
Net income (loss)	11.2%	3.1%	8.1%	3.9%	10.1%	(0.5)%	8.5%

*Year ended December 31, 2002 Compared to Year ended December 31, 2001*

**Net Sales.** Our net sales remained flat, increasing by 0.9%, to \$236.0 million for 2002 compared to \$234.0 million for 2001. Sales in the CEP segment increased by 1.4% to \$200.8 million for 2002 compared to \$198.0 million for 2001. The primary reason for the increase was sales of digital camera accessories for cellular phones that we first produced in 2001 of approximately \$39.8 million in 2002 compared to only \$3.2 million in 2001, an increase of \$36.6 million. This increase was partially offset by the sale of our joint venture interest in BPC (Shenzhen) Co., Ltd. to a Toshiba related company on April 30, 2002 resulting in a decrease of our sales of approximately \$13.2 million in 2002 as compared to sales in 2001. We also experienced decreased sales in 2002 of calculators, personal digital assistants and linguistics products and LCD modules of \$9.6 million, \$6.7 million and \$3.5 million, respectively, as compared to levels in 2001. We believe that these decreases resulted from pricing pressures and the completion of the lifecycle or obsolescence of certain of these products that were not replaced by comparable devices.

Sales in the LPT segment decreased by 1.9% to \$35.3 million for 2002 compared to \$36.0 million for 2001. The primary reason for the decrease in sales was the reduction in LCD panel selling price caused by market competition partially offset by an increase in the number of LCD panels sold.

**Gross Profit.** Our gross profit increased by 26.7%, to \$38.1 million for 2002 from \$30.0 million for 2001. Our gross profit margin also increased in 2002 to 16.1% from 12.8% in 2001. Before the inventory provision of \$3.8 million in 2001 for slow-moving raw materials relating to cancelled, returned or delayed orders and our subsequent reversal of \$2.0 million of this provision in 2002 discussed below, our consolidated gross margin was 14.5% in 2001 and 15.3% in 2002.

Gross profit in the CEP segment increased 43.7% to \$33.3 million, or 16.6% of net sales, for 2002 compared to \$23.2 million, or 11.7% of net sales, for 2001. The primary reason for this increase was our inventory provision in 2001 of \$3.8 million for slow-moving raw materials relating to cancelled, reduced or delayed orders within the CEP segment that was recorded in our cost of sales. In 2002, we were able to use some of these raw materials in production or we received compensation for the unused raw materials from certain of our customers, resulting in our partial reversal of \$2.0 million of the provision to cost of sales in 2002. For the inventory that we were able to use, we sold the related

products to customers at our normal prices. We did not establish a new cost basis for the inventory as it was not written-off, but rather reserved for. Before the inventory provision of \$3.8 million in 2001 and our subsequent reversal of \$2.0 million of this provision in 2002, our gross margin for the CEP segment was 13.6% in 2001 and 15.6%

in 2002. Also contributing to the increase in gross profit in 2002 is a \$300,000 non-recurring charge to our cost of sales in 2001 related to employee severance charges for direct labor in the CEP segment. In addition to these specific factors, our gross profit increased in 2002 due to our ability to negotiate advantageous price terms with certain of our suppliers and our focus on reducing overhead costs.

Gross profit in the LPT segment decreased 30.7% to \$4.8 million, or 13.5% of net sales, for 2002 compared to \$6.8 million, or 19.0% of net sales, for 2001 as a result of lower selling prices for LCD panels driven by increased competition as well as increased depreciation charges in relation to a new STN LCD panel line that commenced operations in June 2002.

*Selling, general and administrative expenses.* SG&A expenses for 2002 decreased approximately \$4.0 million to \$18.0 million, or 7.6% of net sales, from \$22.0 million, or 9.4% of net sales, in 2001.

SG&A expenses in the CEP segment decreased 9.6% to \$14.9 million, or 7.4% of net sales, for 2002 compared to \$16.5 million, or 8.3% of net sales, for 2001. This decrease was driven primarily by our cost realignment and tightened cost controls that reduced salaries and benefits to \$6.0 million from \$8.1 million in 2001. Our salaries and benefits expense in 2001 included \$700,000 of restructuring expenses primarily related to severance for certain administrative positions that we eliminated. The decreases in our CEP segment were partially offset by increases in selling expenses of \$600,000 due to implementation of a new commission incentive program in January 2002.

SG&A expenses in our LPT segment also decreased in 2002 to \$3.0 million, or 8.6% of net sales, from \$5.5 million, or 15.2% of net sales, in 2001. The decrease in SG&A expenses in our LPT segment in 2002 is primarily related to terminating the amortization of goodwill as a result of our adoption of the new accounting rule, SFAS No. 142, effective January 1, 2002. During the year ended December 31, 2001 our amortization of goodwill in the LPT segment was approximately \$1.6 million. SG&A expenses in our LPT segment were also lower in 2002 due to the decrease in stock option compensation expense of \$839,000 in 2002 compared to 2001.

Our SG&A expenses include provisions for bad debt expenses, which provision increased from \$86,000 in 2001 to \$138,000 in 2002. On a segment basis, the provision for bad debt expenses increased in the CEP segment from \$55,000 in 2001 to \$89,000 in 2002 and increased in the LPT segment from \$31,000 in 2001 to \$49,000 in 2002. Our allowance for doubtful accounts increased from \$31,000 in 2000 to \$122,000 in 2002. On a segment basis, our allowance increased in the CEP segment from zero in 2001 to \$35,000 in 2002 and increased in the LPT segment from \$31,000 in 2001 to \$87,000 in 2002. Our policy for the allowance for doubtful amounts is to provide for all invoices that are 30 days overdue from their original credit terms and for which settlement is not assured. The increase in the allowance was due to the increase in accounts receivable and a resulting increase in our general provision and a delay in payment from some customers.

*Research and development expenses.* Research and development expenses for 2002 decreased to \$2.7 million, or 1.1% of net sales, from \$3.0 million, or 1.2% of net sales, in 2001. On a segment basis, research and development expenses decreased in the CEP segment by \$584,000, or 21.3%, due to a reduction in related staff, which was partially offset by an increase in the LPT segment of \$316,000 in relation to the addition of a new STN LCD line for the development of new products, including LCD panels for TCL Mobile.

*Goodwill impairment.* In 2002, we determined that \$339,000 of unamortized goodwill related to our 1999 acquisition of a telecommunications company was impaired as the technology of the acquired company had become obsolete.

*Income from Operations.* Income from operations increased by approximately \$11.9 million to \$17.1 million, or 7.2% of sales, for 2002 compared to \$5.1 million, or 2.2% of sales, for 2001. On a segment basis, the operating income of our CEP segment increased \$12.0 million to \$15.9 million, or 7.9% of net sales, in 2002 compared to \$3.9 million, or 2.0% of net sales, in 2001. This increase in operating income is attributable to the increase in gross profit and decrease in SG&A expenses and R&D expenses

described above. The operating income of our LPT segment remained constant at \$1.2 million in both 2002 and 2001.

*Equity in Income of Affiliated Companies.* Equity in income of affiliated companies was \$10.7 million in 2002 compared to \$1.9 million in 2001. The income in 2002 includes \$8.6 million, which represents our share of the gain from the sale by Mate Fair of a portion of its interest in TCL Mobile, and \$2.1 million for our proportional share of the net earnings of our 25% investment in Mate Fair for the five months ended May 31, 2002.

*Other Income/(Expense), net.* Other expense, net, during the year ended December 31, 2002 was \$6.0 million. This amount included expenses of \$5.2 million for our provision of legal contingencies related to the liquidation of Tele-Art Inc., \$2.7 million of loss related to the creation of a minority interest in our JIC Group subsidiary, including the release of unamortized goodwill, \$1.4 million of legal and professional fees related to the JIC minority interest transaction, \$610,000 of finance charges related to the early repayment of a \$12.9 million fixed term loan, \$520,000 for release of unamortized goodwill of affiliated companies - Mate Fair, \$307,000 of finance charges and \$771,000 of miscellaneous expenses primarily related to non-operating legal fees. These expenses were partially off set by gains of \$3.3 million related to the partial recovery of a judgment debt in the Tele-Art case, net of expenses, \$917,000 of dividend income primarily from our indirect investment in TCL Corporation, \$799,000 of interest income and \$642,000 of realized gain from the disposal of marketable securities. The costs of defending the recently announced securities class action litigation could substantially increase our expenses in future periods and any adverse determination could be significant.

*Interest Expense.* Interest expenses increased to \$790,000 for 2002 compared to \$178,000 for 2001. The increase in interest charges is the result of \$15 million in long-term debt that we obtained in the fourth quarter of 2001 and \$4.5 million obtained in the second quarter of 2002.

*Income Taxes.* Income tax expenses of \$773,000 for 2002 compares to \$227,000 for the prior year. The increase is primarily the result of our not receiving tax refunds for two of our PRC entities for taxes paid in previous years that we have normally been eligible to receive in the past.

*Minority Interest.* Minority interest decreased \$66,000 or 28.7%, to \$164,000 in 2002 from \$230,000 in 2001. Minority interest in 2002 included \$107,000 from the minority shareholders' share of profits of BPC from January 1, 2002 through April 30, 2002, the date we sold BPC and \$57,000 from the minority shareholders' share of profits of the JIC Group from June 4, 2002, the date of listing on the Hong Kong Stock Exchange, through December 31, 2002. Minority interest in 2001 represented an entire year of the minority shareholder's share of BPC's profit.

*Net Income.* Net income increased by \$11.0 million, or 121.4%, to \$20.0 million or 8.5% of net sales, for 2002 compared to \$9.0 million, or 3.9% of net sales, for 2001. This resulted in diluted earnings per share for 2002 of \$1.86 (\$1.89 basic) compared to \$0.87 (\$0.88 basic) for 2001. Net income for the CEP segment increased 230% to \$20.2 million for 2002 compared to \$6.1 million for 2001. The increase in CEP's net income is the result of a higher gross profit margin, the increase in equity in income from affiliated companies, and decreased general and administrative expenses described above. Net Income for the LPT segment decreased by \$3.1 million or 106.6% to a loss of \$191,000 compared to net income of \$2.9 million for 2001. The net loss position in year 2002 for LPT was the result of lower gross profit margin, and the release of unamortized goodwill as described above.

#### *Year ended December 31, 2001 Compared to Year ended December 31, 2000*

*Net Sales.* Our net sales increased by 9.5% to \$234.0 million for 2001 compared to \$213.7 million for 2000. We attribute this growth in sales to our acquisition of the JIC Group, full year results from our battery pack joint venture and our focus on manufacturing key components for telecommunication products and other complex components and subassemblies resulting from our investment in high-technology manufacturing equipment. The acquisition of the JIC Group in October 2000 contributed \$36.0 million in sales for 2001 compared to \$10.3 million in 2000. The startup of our battery pack joint

venture with a Toshiba-related company in June of 2000 contributed \$21.1 million to our net sales in 2001 compared to \$6.2 million for 2000. Sales of subassemblies and components, particularly LCD modules for mobile phones, increased by approximately \$14.7 million in 2001 compared to 2000. Sales increases in these categories were partially offset by sales of calculators, telecommunication products, and PDAs and linguistic products, which decreased by \$23.4 million, \$9.3 million and \$4.3 million, respectively, compared to the prior year period.

*Gross Profit.* Our gross profit decreased 4.9% to \$30.0 million for 2001 from \$31.6 million for 2000. Our gross margin also decreased in 2001 to 12.8% from 14.8% in 2000. Our inventory provision of \$3.8 million for slow-moving raw materials relating to cancelled, reduced or delayed orders by our customers is the primary reason for the decline in our gross profit and gross margin. Before this charge, our gross margin in 2001 was 14.5%. Our shift in product mix towards more complex and capital intensive subassemblies and components, combined with a reduction in sales of higher margin finished goods such as calculators, also contributed to the decline in our gross profit in 2001. Pricing pressure caused by the increasingly competitive environment for electronic products was another factor in our gross profit decline. Our cost of sales for 2001 also included \$300,000 related to severance payments for direct labor employees who were terminated as part of our restructuring activities in that period.

*Selling, General and Administrative Expenses.* For 2001, SG&A increased 24.5% to \$22.0 million from \$17.6 million in 2000. As a percentage of net sales, SG&A expense increased to 9.4% in 2001 from 8.3% in 2000. This increase reflected amortization charges related to the acquisition of JIC Group of \$1.6 million in 2001 compared to \$406,000 in 2000, the addition of JIC Group's SG&A expenses, excluding goodwill amortization, of \$3.0 million for an entire year in 2001 compared to \$2.0 million for the fourth quarter of 2000, stock option compensation expense of \$839,000 in 2001 compared to nil in 2000 and various realignment charges, including employee severance charges, of \$700,000 in 2001.

*Research and Development Expenses.* Research and development expenses for 2001 decreased 15.3% to \$3.0 million, or 1.2% of net sales, from \$3.5 million, or 1.6% of net sales, in 2000. The decrease was related to a reduction of some R&D related staff in 2001 as well as the closure of our Korean research and development office in the latter part of 2000.

*Income from Operations.* Income from operations decreased by approximately \$5.4 million to \$5.1 million, or 2.2% of sales, for 2001 compared to \$10.5 million, or 4.9% of sales, for 2000. This decrease in operating income is attributable to the decrease in gross profit and our increase in SG&A expenses, as described above.

*Equity in Income of Affiliated Companies.* Equity in income of affiliated companies was \$1.9 million for 2001 compared to a loss of \$189,000 for 2000. The gain in 2001 was primarily related to our indirect investment in TCL Mobile. Equity in loss of affiliated companies in 2000 was related to \$18,000 gain from our indirect investment in TCL Mobile, that was made in September 2000, offset by the \$207,000 loss on the write off of our investment in Shanghai Q&T Tech. Co., Ltd.

*Other Income (Expense), net.* Other income, net decreased to \$2.7 million for 2001 compared to \$13.9 million for 2000. Other income in 2001 included unrealized gains on marketable securities of \$1.6 million, interest income of \$1.2 million, foreign exchange gains of \$530,000, and dividend income received from marketable securities of \$525,000 offset by the write-off of a non-trade receivable of \$500,000, bank charges of \$333,000 and miscellaneous expenses of \$294,000. In 2000, other income was comprised primarily of gains related to sales of investments of \$10.8 million and interest income of \$3.3 million. The decrease in interest income from 2000 to 2001 was the result of lower cash balances and lower interest rates in 2001 compared to 2000.

*Interest Expense.* Interest expenses rose to \$178,000 for 2001 compared to \$165,000 for 2000. The increase in interest charges is the result of \$15.0 million in long-term debt that we obtained in the fourth quarter of 2001 offset by a reduction in interest rates.

*Income Taxes.* The income tax expense of \$227,000 for 2001 compares to a benefit of \$33,000 for 2000. The primary reason for the increase in 2001 was an increase in our taxable income compared to 2000.

*Minority Interest.* Minority interest changed \$242,000 from a loss of \$12,000 in 2000 to a profit of \$230,000 in 2001. Minority interest in 2001 represented the minority shareholder's share of BPC's profit. The minority interest in 2000 represented the minority shareholder's share of the loss of BPC.

*Net Income.* Net income decreased by \$15.0 million, or 62.3%; to \$9.0 million or 3.9% of net sales, for 2001 compared to \$24.0 million, or 11.2% of net sales for 2000. This resulted in diluted earnings per share for 2001 of \$0.87 (\$0.88 basic) compared to \$2.56 (\$2.63 basic) for 2000. The decrease in net income and earnings per share is the result of the decrease in gross profit, the increase in SG&A expense and the decrease in other income, as described above.

## **Liquidity and Capital Resources**

### *Liquidity*

We have financed our growth and cash needs to date primarily from internally generated funds, proceeds from the sale of our strategic investments, sales of our stock and bank debt. We do not use off-balance sheet financing arrangements, such as securitization of receivables or obtaining access to assets through special purpose entities, as sources of liquidity. Our primary uses of cash have been to fund expansions and upgrades of our manufacturing facilities, to make strategic investments in potential customers and suppliers and to fund increases in inventory and accounts receivable resulting from increased sales.

We had positive net working capital of \$87.4 million at December 31, 2002 compared to positive net working capital of \$84.0 million at December 31, 2001. We believe that our cash flows from operations, our current cash balance and funds available under our working capital and credit facilities will be sufficient to meet our working capital needs and planned capital expenditures for the next 12 months.

Net cash provided by operating activities was \$39.5 million in 2002. Cash provided by operating activities in 2002 was primarily attributable to net income of \$20.0 million, plus depreciation and amortization expense of \$10.6 million, dividend income from affiliated companies of \$10.5 million and the non-cash loss on restructuring of our JIC Group of \$2.7 million, non-cash equity in income of affiliated companies of \$10.7 million, release of unamortized goodwill of affiliated companies of \$520,000, realized gain on marketable securities of \$642,000 and non-cash gain on share redemption of \$3.5 million. Our working capital related to operating activities also decreased driven by an increase of \$17.0 million in accounts payable and accrued expenses and \$10.1 million of proceeds from marketable securities offset by increases in accounts receivable of \$8.5 million and inventory of \$7.6 million.

Our inventory increased in 2002 as a result of our anticipation of increase in sales. Accounts receivable increased due to increased sales in the fourth quarter relative to sales in the prior year period. The increase in accrued expenses is primarily related to a \$5.2 million provision for legal contingencies. Accounts payable increased due to support for higher inventory levels. The proceeds from marketable securities relates to the disposal of our holdings in Deswell Industries, Inc. during 2002.

Net cash provided by operating activities in 2001 was \$23.2 million. Cash provided by operating activities in 2001 was primarily attributable to net income of \$9.0 million, plus depreciation of \$9.1 million, amortization of intangible assets of \$2.0 million and stock option costs of \$839,000 offset by non-cash equity in income of affiliates of \$1.9 million and unrealized gain on marketable securities of \$1.6 million. Our decrease in working capital related to operating activities was driven by a decrease in inventory of \$15.3 million offset by a decrease in accounts payable and accrued expenses of \$6.1 million and an increase in accounts receivable of \$4.4 million.

Our inventory decreased in 2001 due to our increased focus on inventory management and our increased use of domestic China suppliers with shorter delivery lead times. Inventory also decreased due to



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our \$3.8 million provision for slow-moving raw materials relating to cancelled, reduced or delayed orders. The increase in our accounts receivable was primarily related to the increase in our net sales while the decrease in our accounts payable and accrued expenses related to the decrease in inventory levels.

Net cash used in investing activities was \$33.8 million in 2002. Cash used in investing activities was primarily related to our \$12.0 million strategic investment in TCL Holdings Corporation and \$5.1 million in convertible notes of TCL International Holdings Ltd. as well as capital expenditures of \$18.5 million offset by proceeds of \$1.7 million related to the disposal of our joint venture interest in BPC. Our capital expenditures in 2002 included a \$12.3 million new STN LCD panel production line and \$4.0 million for completion of the new factory expansion.

Net cash used in investing activities was \$35.4 million in 2001. Cash used in investing activities was primarily related to capital expenditures of \$36.0 million offset by proceeds from the disposal of property plant and equipment of \$698,000. Our major capital expenditures in 2001 included:

\$13.0 million for the purchase and interior improvements on 23,000 square feet of contiguous prime office space at Shun Tak Centre in the Central district of Hong Kong,

\$6.4 million for the purchase of new staff residences in Hong Kong,

\$5.5 million for the construction and machinery for a new 138,000 square foot five-story factory building within our principal manufacturing facilities,

\$5.5 million for the purchase of new chip on glass production lines, and

\$2.0 million for the expansion of the front end process for producing LCD panels.

In the past three years we have invested significant amounts of cash to expand our manufacturing capacity and to upgrade our equipment to produce increasingly complex products. We plan to use a significant portion of the proceeds of this offering to construct additional manufacturing facilities. We believe that we will continue to make significant cash investments in the future to broaden our manufacturing capabilities and increase our capacity. In this regard, we intend to use approximately \$40.0 million of our net proceeds to construct and equip another factory consisting of approximately 250,000 square feet on land adjacent to our principal manufacturing facilities in Shenzhen, China.

Net cash provided by financing activities was \$18.1 million for 2002. Cash provided by financing activities for 2002 primarily resulted from net proceeds of \$36.5 million received from the exercise of options and warrants and \$4.5 million received from a four-year variable rate term loan offset by \$16.7 million paid to shareholders as dividends, \$2.7 million for the repayment of bank loans and \$3.5 million for the repurchase of our common shares pursuant to our share buy-back program.

Net cash provided by financing activities was \$12.0 million for 2001 which primarily resulted from \$15.0 million of proceeds from a bank loan and \$4.3 million of proceeds received from the exercise of options and warrants offset by \$3.9 million of cash dividends and \$3.4 million for the repurchase of the our shares.

Except as discussed above there are no material transactions, arrangements and relationships with unconsolidated affiliated entities that are reasonably likely to affect liquidity.

### *Capital Resources*

As of December 31, 2002, we had \$82.5 million in cash and cash equivalents, consisting of cash and short-term deposits compared to \$58.7 million at December 31, 2001. Our short-term debt was \$15.0 million and \$3.7 million at December 31, 2002 and at December 31, 2001, respectively.

At December 31, 2002, we had in place general banking facilities with two financial institutions aggregating \$58.2 million. The maturity of these facilities is generally up to 90 days. These banking facilities are guaranteed by us and there is an undertaking not to pledge any assets to any other banks without the prior consent of our bankers. Interest rates are generally based on the banks' reference lending



rates. Our facilities permit us to obtain overdrafts, lines of credit for forward exchange contracts, letters of credit, import facilities, trust receipt financing, shipping guarantees and working capital. These facilities are subject to annual review and approval. As at December 31, 2002, we had utilized approximately \$8.9 million under such general credit facilities and had available unused credit facilities of \$66.1 million.

As at December 31, 2002, we had debt of \$16.8 million, including the current portion of \$14.0 million, compared to debt of \$15.0 million, including the current portion of \$2.1 million at December 31, 2001. A portion of this debt was obtained in the fourth quarter of 2001, had a seven-year term and carried a fixed rate of interest of 5.05% for the first four years, changing to a floating rate of 1% over the Singapore Interbank Money Market Offer Rate, or SIBOR, for the final three years. The loan was secured by a property with net book value of \$11.4 million. Principal repayments of \$535,000 were made on a quarterly basis for the term of the loan. At December 31, 2002, the outstanding balance of the loan was \$12.9 million. On January 3, 2003, we repaid the entire outstanding balance of this loan.

Our debt as of December 31, 2002 also included unsecured long-term debt of \$4.5 million that we obtained in May 2002. This debt has a term of four years and bears interest of 1.5% over 3 month LIBOR (with a cap at 7.5%), with principal repayments of \$281,250 due on a quarterly basis. At December 31, 2002, the outstanding balance of the loan was \$3.9 million, including the current portion of \$1.1 million.

A summary of our contractual obligations and commercial commitments as of December 31, 2002 is as follows:

Contractual obligation	Payments due by period						
	Total	2003	2004	2005	2006	2007	2008 and thereafter
Long-term debt	\$ 16,797,000	\$ 13,985,000	\$ 1,125,000	\$ 1,125,000	\$ 562,000	\$	\$
Operating leases	3,935,000	779,000	727,000	745,000	731,000	565,000	388,000
Capital expenditures	20,856,000	20,856,000					
Total	\$ 41,588,000	\$ 35,620,000	\$ 1,852,000	\$ 1,870,000	\$ 1,293,000	\$ 565,000	\$ 388,000

There are no material restrictions (including foreign exchange controls) on the ability of our non-China subsidiaries to transfer funds to us in the form of cash dividends, loans, advances or product or material purchases. With respect to our China subsidiaries, with the exception of a requirement that 10% of profits be reserved for future developments, there are no restrictions on the payment of dividends and the removal of dividends from China once all taxes are paid and assessed and losses, if any, from previous years have been made good. In the event that dividends are paid by our China subsidiaries, such dividends will reduce the amount of reinvested profits and accordingly the refund of taxes paid will be reduced to the extent of tax applicable to profits not reinvested.

### Capital Expenditures

Our principal capital expenditures and divestitures over the last three years include the following:

	2000	2001	2002
Property, plant and equipment (net)	\$ 3,579,000	\$ 36,013,000	18,485,000

Our capital expenditures in 2002 included a \$12.3 million new STN LCD panel production line and \$4.0 million for completion of the new factory expansion.

Our major capital expenditures in 2001 included:

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\$13.0 million for the purchase and interior improvements on 23,000 square feet of contiguous prime office space at Shun Tak Centre in the Central district of Hong Kong,

\$6.4 million for the purchase of new staff residences in Hong Kong,

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\$5.5 million for the construction and machinery for a new 138,000 square foot five-story factory building within the Company's existing manufacturing complex,

\$5.5 million for the purchase of new chip on glass production lines, and

\$2.0 million for the expansion of the front end process for producing LCD panels.

In order to expand production capacity, we also plan to build a new factory consisting of approximately 250,000 square feet adjacent to our principal manufacturing facilities in Shenzhen, China. Planning for the project began in January 2003 and we expect construction to be completed by the end of September in 2004. We have budgeted \$40.0 million to cover the cost of construction and fixtures and equipment for the new factory. We plan to finance these improvements to our manufacturing facilities from a portion of the proceeds of this offering.

Other capital expenditures we have planned for 2003 include:

\$12.0 million for machinery for manufacturing RF modules,

\$8.9 million for other capital equipment, and

\$10.0 million for investment in a 25% interest in Alpha Star Investments Ltd., which we made in January 2003.

Our plans for capital expenditures are subject to change from time to time and could result from, among other things, our consummation of any significant amount of additional acquisition or strategic investment opportunities, which we regularly explore.

#### **Impact of Inflation**

Inflation and deflation in China and Hong Kong has not had a material effect on our past business. During times of inflation, we have generally been able to increase the price of its products in order to keep pace with inflation.

#### **Exchange Controls**

There are no exchange control restrictions on payments of dividends, interest, or other payments to nonresident holders of our securities or on the conduct of our operations in Hong Kong, where our principal executive offices are located, or in the British Virgin Islands, where we are incorporated. Other jurisdictions in which we conduct operations may have various exchange controls. With respect to our China subsidiaries, with the exception of a requirement that 10% of profits be reserved for future developments, there are no restrictions on the payment of dividends and the removal of dividends from China once all taxes are paid and assessed and losses, if any, from previous years have been made good. We believe such restrictions will not have a material effect on our liquidity or cash flows.

#### **Recent changes in accounting standards**

In August 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. This Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 143 requires a company to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of a tangible long-lived asset. SFAS No. 143 also requires a company to record the contra to the initial obligation as an increase to the carrying amount of the related long-lived asset (i.e. the associated asset retirement costs) and to depreciate that cost over the remaining useful life of the asset. The liability is adjusted at the end of each period to reflect the passage of time (i.e. accretion expense) and changes in the estimated future cash flows underlying the initial fair value measurement. Companies are required to adopt SFAS No. 143 for fiscal years beginning after June 15, 2002. We adopted SFAS No. 143 on January 1, 2003. We do not believe that its adoption will have a material effect on our financial position, results of operations, or cash flows.

In April 2002, the FASB issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. SFAS 145 eliminates extraordinary accounting treatment for reporting gain or loss on debt extinguishment, and amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The provisions of SFAS No. 145 related to the rescission of SFAS No. 4 are applicable in fiscal years beginning after May 15, 2002, the provisions related to SFAS No. 13 are effective for transactions occurring after May 15, 2002, and all other provisions are effective for financial statements issued on or after May 15, 2002; however, early application is encouraged. Debt extinguishments reported as extraordinary items prior to scheduled or early adoption of SFAS No. 145 would be reclassified in most cases following adoption. In the current year, we adopted the provisions of SFAS No. 145 related to the accounting treatment for the gain or loss on debt extinguishment. The result of this adoption is that a \$610,000 finance charge incurred for the early extinguishment of our long term debt that would have been recorded as an extraordinary item under the previous accounting rules has been included as an expense from continuing operations. We do not expect the adoption of the remaining provisions of SFAS No. 145 to have a material effect on our financial position, results of operations, or cash flows.

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 requires recording costs associated with exit or disposal activities at their fair values when a liability has been incurred. Under previous guidance, certain exit costs were accrued upon management's commitment to an exit plan, which is generally before an actual liability has been incurred. The requirements of SFAS No. 146 are effective prospectively for exit or disposal activities initiated after December 31, 2002; however, early application is encouraged. We do not expect the adoption of SFAS No. 146 to have a material effect on our financial position, results of operations, or cash flows.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). FIN 45 requires that upon issuance of a guarantee, a guarantor must recognize a liability for the fair value of an obligation assumed under a guarantee. FIN 45 also requires additional disclosures by a guarantor in its annual financial statements about the obligations associated with guarantees issued. The recognition provisions of FIN 45 are effective for any guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. We are currently evaluating the effects of FIN 45; however, we do not expect that the adoption of FIN 45 will have a material effect on our financial position, results of operations, or cash flows.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure*. SFAS No. 148 amends SFAS No. 123, *Accounting for Stock-Based Compensation*, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 is effective for fiscal years beginning after December 15, 2002. The expanded annual disclosure requirements and the transition provisions are effective for fiscal years ending after December 15, 2002. We do not expect the adoption of SFAS 148 to have a material effect on our financial position, results of operations, or cash flows.

## QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

### Currency Fluctuations

We sell a majority of our products in U.S. dollars and pay for our material components in Japanese yen, U.S. dollars, Hong Kong dollars, and Chinese renminbi. We pay labor costs and overhead expenses in renminbi, the currency of China (the basic unit of which is the yuan), Hong Kong dollars, and Japanese yen. The exchange rate of the Hong Kong dollar to the U.S. dollar has been fixed by the Hong Kong government since 1983 at approximately HK\$7.80 to US\$1.00 through the currency issuing banks in Hong Kong and accordingly has not in the past presented a currency exchange risk. This could change in the future if those in Hong Kong arguing for a floating currency system prevail in the ongoing debate over whether to continue to peg the Hong Kong dollar to the US dollar.

We believe our most significant foreign exchange risk results from material purchases made in Japanese yen. Approximately 14%, 16%, and 8% of our material costs have been in Japanese yen during the years ended December 31, 2000, 2001, and 2002. Sales made in yen account for less than 7% of sales for the years ended December 31, 2000, 2001 and 2002. Our business and operating results could be materially and adversely affected in the event of a severe increase in the value of the yen to the US dollar at a time when our sales made in yen are insufficient to cover our material purchases in yen.

Effective January 1, 1994, China adopted a floating currency system whereby the official exchange rate equaled the market rate. Since the market and official renminbi rates were unified, the value of the renminbi against the dollar has been stable. We believe any devaluation of the renminbi would benefit us by reducing our costs in China, provided that devaluation or other economic pressures do not lead to fundamental changes in the present economic climate in China.

Foreign exchange transactions involving the renminbi take place through the Bank of China or other institutions authorized to buy and sell foreign exchange or at an approved foreign exchange adjustment center (known as a swap center). In the past, when exchanging Hong Kong dollars for Chinese renminbi, we used a swap center to obtain the best possible rate. When translating the Chinese company accounts into U.S. dollars, we use the same exchange rate as quoted by the People's Bank of China. Since January 1, 1994, when China adopted a floating currency system (whereby the official rate is equal to the market rate), swap centers and banks in China offer essentially the same market rates, facilitating the exchange of Hong Kong dollars for renminbi. The adoption of a floating currency system has had no material impact on us.

Beginning on December 1, 1996, the Chinese renminbi became fully convertible under the current accounts. There are no restrictions on trade-related foreign exchange receipts and disbursements in China. Capital account foreign exchange receipts and disbursements are subject to control, and organizations in China are restricted in foreign currency transactions that must take place through designated banks.

We may elect to hedge our currency exchange risk when we judge such action may be required. In an attempt to lower the costs of expenditures in foreign currencies, we will periodically enter into forward contracts or option contracts to buy or sell foreign currency(ies) against the U.S. dollar through one of our banks. As a result, we may suffer losses resulting from the fluctuation between the buy forward exchange rate and the sell forward exchange rate, or from the price of the option premium.

At December 31, 2002 we held no option or future contracts and during the year we did not purchase or sell any commodity or currency options. We are continuing to review our hedging strategy and there can be no assurance that we will not suffer losses in the future as a result of hedging activities.

### Foreign Currency Risk

As at December 31, 2002 we had no open forward contracts or option contracts to purchase or sell foreign currencies.

Cash on hand at December 31, 2002 of \$82,477,000 was held in the following currencies.

	Equivalent U.S. Dollar Holdings
	December 31, 2002
Japanese yen	438,000
United States dollars	78,408,000
Hong Kong dollar	3,293,000
Chinese renminbi	338,000

## Interest Rate Risk

### *Short-term interest rate risk*

Our interest expenses and income are sensitive to changes in interest rates. All of our cash reserves and short-term borrowings are subject to interest rate changes. Cash on hand of \$82.5 million as of December 31, 2002 was invested in short-term interest bearing investments having a maturity of three months or less. As such, interest income will fluctuate with changes in short term interest rates. In November 2002, we purchased a \$5.1 million in principal amount of a 3% convertible note due in November 2005. As the interest rate on the convertible note is fixed, we do not expect fluctuations in interest rates to materially effect our cash flows and net income.

As of December 31, 2002 we had \$8.9 million outstanding on our credit facilities, including \$985,000 in short-term notes payable, resulting in minimal interest rate risk.

### *Long-term interest rate risk*

As of December 31, 2002, we had \$16.8 million in long-term debt including the current portion of \$14.0 million.

We obtained a seven-year \$15.0 million term loan in the fourth quarter of 2001 with a fixed rate of interest of 5.05% for the first four years and 1% over the SIBOR rate for the last three years. The term loan had an outstanding balance of \$12.9 million as of December 31, 2002. We repaid this term loan on January 3, 2003.

We also obtained a four-year term loan with borrowings in May 2002 totalling \$4.5 million at a rate of 1.5% over three months LIBOR repayable in 16 quarterly installments of approximately \$281,000 beginning August 2002. The term loan had an outstanding balance of \$3.9 million as of December 31, 2002.

The potential effect of a hypothetical 1% increase in interest rates for 2002 indebtedness would be insignificant to our cash flows and net income.



## BUSINESS

### Overview

We are an electronics manufacturing and design services provider to a select group of the world's leading original equipment manufacturers, or OEMs, of telecommunication and consumer electronic products. Our largest customers include Epson Precision (HK) Ltd., Sony Ericsson Mobile Communications AB and Texas Instruments Incorporated. Through our electronics manufacturing services, or EMS, operations, we manufacture electronic components and subassemblies, including liquid crystal display, or LCD, panels, transformers, LCD modules and radio frequency, or RF, modules. These components are used in various electronic products, including cellular phones, laptop computers, digital cameras, copiers, fax machines, electronic toys, handheld video game devices and microwave ovens. We also manufacture finished products, including cordless phones, palm-sized PCs, personal digital assistants, electronic dictionaries, calculators and digital camera accessories for use with cellular phones.

We assist our OEM customers in the design and development of their products and furnish full turnkey manufacturing services that utilize advanced manufacturing processes and production technologies. Our services include hardware and software design, component purchasing, assembly into finished products or electronic subassemblies and post-assembly testing. These services are value-added and assist us in obtaining new business but do not represent a material component of our revenue. We also provide original design manufacturing, or ODM, services, in which we design and develop proprietary products that are sold by our OEM customers using their brand name.

We were founded in 1975 as an electronic products trading company based in Hong Kong and shifted our focus to manufacturing of electronic products in 1978. We moved our manufacturing facilities to China in 1980 to take advantage of lower overhead costs, lower material costs and competitive labor rates available and subsequently relocated to Shenzhen, China in order to capitalize on opportunities offered in Southern China. We were reincorporated as a limited liability International Business Company under the laws of the British Virgin Islands in August 1987. Our principal manufacturing and design operations are based in Shenzhen, China, approximately 30 miles from Hong Kong. Our principal executive offices are located in Hong Kong, which provides us access to Hong Kong's infrastructure of communication and banking and facilitates management of our China operations and transportation of our products out of China through the port of Hong Kong.

### Our Industry

#### *Electronic Products*

Electronics products are made from numerous components and subassemblies. Progressive miniaturization and persistent advances in performance have increased the complexity of these products. This increased complexity has resulted in companies that specialize in the manufacture of these products. Continual reduction in product lifecycles has generated increased demand for enhanced manufacturing and design technologies. There is also continuous demand to reduce the cost of technology products, which, in turn, will permit the product or component to be mass-produced on a cost-effective basis.

#### *Outsourced Production of Electronic Products*

As more sophisticated technologies become broadly accepted and prices decline, the demand for advanced yet cost-effective manufacturing capabilities and related services has grown. Historically, OEMs were fully integrated, performing the product design, new product introduction, assembly and manufacturing, testing, order fulfillment and distribution and after-market support functions for their products. In recent years, we believe that OEMs throughout the world have increasingly accepted and relied upon the outsourcing of these functions to EMS providers to meet their customers' demands and to remain competitive. This enables OEMs to concentrate on their core competencies, such as product development, marketing and sales.

As a result of this outsourcing strategy, some OEMs have divested a significant portion of their manufacturing facilities and newer OEMs are choosing to outsource rather than build an internal manufacturing infrastructure. In some cases, the outsourced functions include the original design of products. This process, called Original Design Manufacturing, or ODM, refers to companies that both design and manufacture products that are marketed and sold by OEMs using the OEM's brand name.

We believe that the factors driving OEMs to continue to favor an outsourcing strategy include:

***Reduce total production cost.*** OEMs continually need to reduce costs to remain competitive. EMS providers manufacture products at a reduced total cost to OEMs because of higher utilization of manufacturing capacity, access to leading-edge procurement and inventory management capabilities, proficiency in purchasing materials and components and a continual focus on improving the entire supply chain from product design to after-market support. Contract manufacturing also enables some OEMs to take advantage of producing in low-cost geographical regions.

***Access to leading technologies.*** OEMs continually seek access to engineering expertise and manufacturing technologies necessary to build their increasingly complex products. OEMs are motivated to work with EMS companies to gain access to their expertise in product design, assembly, manufacturing and testing technologies, as well as their expertise in materials procurement and management.

***Accelerate time-to-market.*** Due to intense competitive pressures in the electronics industry, OEMs face increasingly shorter product life-cycles and therefore have a growing need to reduce the time required to bring new products to market. OEMs can significantly improve product development cycles and shorten time-to-market by utilizing the expertise and manufacturing infrastructure of EMS companies, including capabilities relating to design and development.

***Reduce capital investment and shift fixed costs to variable costs.*** As electronics products have become more technologically advanced, the manufacturing process is requiring greater levels of investment in capital equipment. Outsourcing to EMS companies allows OEMs to lower their investment in inventory and manufacturing assets and shift more of their fixed costs to variable costs, thereby increasing their return on assets. As a result, OEMs can react more quickly to changing market conditions and allocate capital to other core activities such as sales and marketing and research and development.

#### ***Market Size***

Contract manufacturers of electronic products are expected to experience growth driven by continued outsourcing by OEMs as well as overall expansion of the electronics industry. Technology Forecasters, Inc. reported on December 6, 2002, in its Fourth Quarter 2002 Electronics Manufacturing Outsourcing Report that it expects that the EMS industry will grow from \$92.0 billion in 2002 to \$170.0 billion in 2006, and that the worldwide ODM market will grow from \$36.4 billion in 2002 to \$72.4 billion in 2006. These figures represent a compound annual growth rate of 16.6% and 18.8% for the EMS Industry and Worldwide ODM market, respectively. Our operations are primarily characterized as EMS-related and a relatively small portion of our business is presently characterized as ODM related.

Aggregate OEM cost of goods sold of electronic products is used within our industry to define the total available market size for EMS and ODM services. Aggregate revenue of EMS and ODM providers as a percentage of cost of goods sold of OEMs is generally used to measure the penetration of contract manufacturing in the electronic products industry. In its Fourth Quarter 2002 Electronics Manufacturing Outsourcing Report, Technology Forecasters forecasted that combined EMS and ODM revenue, as a percentage of cost of goods sold of OEMs, will increase from 19.1% in 2001 to 28.0% in 2006 as OEMs continue to outsource their manufacturing and supply chain services. Moreover, Technology Forecasters forecasted that EMS and ODM penetration in the Consumer Electronics segment will grow from 5.1% in 2001 to 16.2% in 2006 and that the EMS and ODM penetration in the Wireless Telecom segment will

grow from 22.4% in 2001 to and 34.1% in 2006. Our contract manufacturing services are primarily focused on these two OEM segments.

A further segmentation of growth in the contract EMS industry is by geographic region. The low labor and facility costs in geographic areas such as China, Southeast Asia and India have resulted in a trend toward increased manufacturing in these locations. Technology Forecasters predicts in its Fourth Quarter 2002 Electronics Manufacturing Outsourcing Report that the percentage of EMS services provided in Asia as a percentage of the worldwide supply will increase from 29% in 2001 to 42% in 2006. Technology Forecasters defines Asia in its report as China, Hong Kong, Taiwan, Singapore, Philippines, Malaysia, Thailand, Korea, Vietnam and India.

## **Our Strategy**

We are focused on expanding our position as a China-based provider of electronic manufacturing services to major OEMs. To achieve this objective, we intend to continue to pursue the following strategies.

***Maintain low-cost manufacturing in China.*** Our manufacturing facilities are all in China and have been there since 1980. Our location allows us to access one of the lowest cost engineering and production work forces in the world. We believe that our history and experience in China well position us to take advantage of the trend of shifting production of electronic products to China.

***Focus on Asian OEMs.*** We have strong relationships with OEMs throughout Asia, in particular those in Japan. These Japanese OEMs produce a large portion of the electronic products used worldwide and, we believe, represent a significant opportunity for future outsourcing growth. More recently, we have developed relationships with OEMs in China including the TCL group of companies, widely acknowledged as one of the leading domestic consumer electronics OEMs in China. According to the Third Quarter 2002 Report, Everyone Wants to Go to China, by Technology Forecasters, China is the largest mobile phone market in the world but is only 11% penetrated. Consequently, we believe that we are well positioned to capitalize on the growth in consumer electronic products in China.

***Manufacture of small form factor consumer products and hand-held electronic device.*** We focus on providing OEMs with services for handheld electronic products known in our industry as anywhere/anytime devices. These products are easy to ship globally, thereby negating the need for our OEM customers to require regional manufacturing and sophisticated logistics support. These products are generally consumer focused and not closely tied to corporate technology spending patterns.

***Produce high value-added electronic components and subassemblies.*** We produce components and subassemblies, like LCD modules and RF modules that are central to several types of electronic products. These components and subassemblies also constitute a high percentage of the cost of materials of our OEM customers' products. For example, RF modules may be used in cellular phones and PDAs. Similarly, LCD modules are used in cellular phones, laptop computers, digital cameras, copiers, fax machines, electronic toys, handheld video game devices and microwave ovens. As a result of our focus on high value-added components that are integrated into complex products, we are able to maintain relatively high gross profit margins in comparison with those of other EMS providers of consumer electronic products.

***Apply advanced manufacturing technologies.*** Our manufacturing and assembly processes apply advanced bonding and other sophisticated technologies, including chip on glass, chip on film and chip on board that are essential to the production of complex components. Production of high-quality products using these technologies typically require Class one thousand clean rooms, including a special area inside the clean room called a Class one hundred clean bench. We believe that relatively few of our competitors possess our level of clean room manufacturing capability in their China-based facilities. We consider our ability to employ these advanced

production technologies provides us with a competitive advantage over other EMS companies offering contract manufacturing of electronic products.

**Develop improved production techniques.** We focus on collaborating with our customers to refine and improve the production methods employed for complex, yet proven production technologies rather than on the initial development of components or assemblies for which there is not an established market. By doing this, we help our OEM customers enhance their product design, lower costs and improve yields. This strategy allows us to strengthen our relationships with our OEM customers. As a result, our customers allow us to use their proprietary production technologies in our assembly operations. These relationships allow us to focus our research and development efforts on process improvement and help limit our risks associated with new product introductions.

**Produce high quality products at a low cost.** Our goal is to manufacture the highest-quality products at a low cost to our customers. We believe that the quality of our manufacturing services is central to maintaining customer trust and loyalty, and therefore we strive to ensure that our design and production processes are of world-class standards. We have consistently met the stringent quality demands of our OEM customers. Our factories are certified under either ISO 9001 or ISO 9002 quality standards, the International Organization for Standardization's highest standards. Our principal manufacturing facilities located in Shenzhen are also certified under an ISO 14001 quality standard, which was published in 1996 by the International Organization for Standardization that provides a structured basis for environmental management control. Given that the electronics industry overall and the EMS sector in particular are intensely price sensitive, we leverage our low cost structure and operational efficiency to provide high-quality manufacturing services at competitive pricing.

**Invest Strategically in key technology partners.** We have made and will continue to make strategic investments in targeted and existing customers and providers of critical component technologies. We believe that such investments foster new, or enhance existing, customer and supplier relationships. We have found that these investments promote business opportunities with our partners. These investments include our ownership interest in the TCL group of companies and our investment in Alpha Star Investments, Ltd. These investments have expanded our offerings for cellular telephones and other wireless communication products and components.

## Our Customers

Historically, we have had substantial recurring sales from existing customers. About 96.2% of our 2002 net sales came from customers that also used our services in 2001. While we seek to diversify our customer base, a small number of customers currently generate a significant portion of our sales. Sales to our 10 largest customers accounted for 90.2%, 83.7% and 84.8% of our net sales during the years ended December 31, 2000, 2001 and 2002, respectively. Sales to customers accounting for 10% or more of our net sales in the year ended December 31, 2000, 2001 or 2002 were as follows:

	Year ended December 31,		
	2000	2001	2002
Epson Precision (HK) Ltd.	23.8%	29.9%	32.2%
Sony Ericsson Mobile Communications AB	N/A	*	16.9
Texas Instruments Incorporated	23.9	14.2	11.1
Sharp Corporation	14.7	*	*
Seiko Instruments Inc.	10.0	*	*

\* Less than 10% of our total net sales.

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Our largest OEM customers based on net sales during 2002 include the following (listed alphabetically):

Customer	Product
Advance Watch Co. (Far East) Ltd.	LCD panels for watches
Canon Electronic Business Machines (H.K.) Co. Ltd.	Electronic dictionaries and calculators
Casine Electronics Ind. Co.	LCD panels for calculators and clocks
Epson Precision (H.K.) Ltd	LCD modules for cellular phones
Hitachi Ferrite Electronics Ltd.	Transformers
Hitachi Media Electronics Co. Ltd.	Transformers
Kanda Tsushin Kogyo Co Ltd (affiliate of Fujitsu)	Caller ID function phones
Maeda Global Net (HK) Co Ltd	PCB modules for cellular phones
Nanox Ltd	LCD panels for cordless phones and household appliances
Nishimura Musen Denki Co. Ltd	Transformers
Optrex Corporation	Assemblies for LCD modules
Seiko Instruments Inc.	Electronic dictionaries
Sharp Corporation	Calculators, pocket computers and control panel modules
Sony Corporation	Electronic dictionaries.
Sony Ericsson Mobile Communications AB	Mobile phone digital camera accessories
Stanley Electric (Asia Pacific) Ltd.	LCD panels for car audio devices
Texas Instruments Incorporated	Calculators
Toshiba Battery Company Ltd*	Rechargeable battery packs for cellular phones
Vtech Telecommunications Ltd.	LCD panels for phones
Zexus Technology Ltd.	LCD panels for watches

\* We sold rechargeable battery packs to Toshiba Battery Company Ltd., through a joint venture we had with this customer. We sold our interest in the joint venture to a Toshiba related company and ceased manufacturing rechargeable battery packs as of April 30, 2002.

At any given time, different customers account for a significant portion of our business. Percentages of net sales to customers vary from quarter to quarter and year to year and fluctuate depending on the timing of production cycles for particular products.

Sales to our OEM customers are primarily based on purchase orders we receive from time to time rather than firm, long-term purchase commitments from our customers. Although it is our general practice to purchase raw materials only upon receiving a purchase order, for certain customers we will occasionally purchase raw materials based on such customers' rolling forecasts. Uncertain economic conditions and our general lack of long-term purchase commitments with our customers make it difficult for us to accurately predict revenue over the longer term. Even in those cases where customers are contractually obligated to purchase products from us or repurchase unused inventory from us, we may elect not to immediately enforce our contractual rights because of the long-term nature of our customer relationships and for other business reasons, and instead may negotiate accommodations with customers regarding particular situations.

## Our Products

The dollar amount (in thousands) and percentage of our net sales by business segment and product category for the years ended December 31, 2000, 2001 and 2002 were as follows:

	Year ended December 31,					
	2000		2001		2002	
	Dollars	Percent	Dollars	Percent	Dollars	Percent
Consumer Electronic Products:						
Component assembly(1)	\$ 103,288	48%	\$ 121,751	52%	\$ 103,625	44%
LCD consumer products	98,043	46	73,596	32	94,207	40
Software development services	2,073	1	2,701	1	2,923	1
LCD Panels and Transformers(2)						
LCD panels	6,606	3	24,977	11	23,937	10
Transformers	3,678	2	10,981	4	11,324	5
	<u>\$ 213,688</u>					