HIGHWAY HOLDINGS LTD
Form 20-F
June 30, 2016

United States
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

¨ REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) or (g) OF THE SECURITIES EXCHANGE ACT OF 1934
or

x ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended March 31, 2016.

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________ to ____________.

¨ SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 0-28990

HIGHWAY HOLDINGS LIMITED

(Exact name of Registrant as specified in its charter)

British Virgin Islands

(Jurisdiction of incorporation or organization)

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Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Shares, $0.01 par value per share	NASDAQ Capital Market

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report 3,801,874 Common Shares were outstanding as of March 31, 2016.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

Indicate by check mark which basis of accounting the registration has used to prepare the financial statements included in this filing:

U.S. GAAP x

International Financial Reporting Standards as issued by the International Accounting Standards Board ¨

Other ¨

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow: Item 17 ¨ Item 18 x

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

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FORWARD - LOOKING STATEMENTS

This Annual Report on Form 20-F contains forward-looking statements. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in the section entitled “Risk Factors” under “Item 3. Key Information.” Forward-looking statements include, but are not limited to, statements relating to:

- the Company’s goals, strategies and expansion plans;
- the Company’s business development, financial condition and results of operations;
- changes in the original equipment manufacturing (“OEM”) market;
- the demand for, and market acceptance of, the Company’s products and services;
- changes in the Company’s relationships with its major customers;
- political or economic changes in Hong Kong, Shenzhen, China, and Myanmar that affect the Company, including inflation, labor laws and worker relations, changing governmental rules and regulations, and structural factors affected manufacturing operators in general; and
- general economic and business conditions affecting the Company’s major customers.

Readers should not place undue reliance on forward-looking statements, which reflect management’s view only as of the date of this Annual Report. The Company undertakes no duty to update any forward-looking statement to conform the statement to actual results or changes in management’s expectations except as required by applicable law. Readers should also carefully review the risk factors described in other documents the Company files from time to time with the U.S. Securities and Exchange Commission, which we refer to in this Annual Report as the “SEC.”

CONVENTIONS

Highway Holdings Limited is a British Virgin Islands holding company that operates through various controlled subsidiaries. Unless the context indicates otherwise, all references herein to "the Company" refer collectively to Highway Holdings Limited and its subsidiaries. References to "China" or "PRC" are to the People's Republic of China (excluding Hong Kong), whereas references to "Hong Kong" are to the Hong Kong Special Administrative Region of the People's Republic of China. References to Myanmar are to the Republic of the Union of Myanmar ("Myanmar"). Unless otherwise stated, all references to "dollars" or $ are to United States dollars. "RMB," "Renminbi" or "yuan" are references to the legal currency of China.

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PART I

Item 1. Identity of Directors, Senior Management and Advisers

Not Applicable

Item 2. Offer Statistics and Expected Timetable

Not Applicable

Item 3. Key Information

The Company's historical consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP") and presented in United States dollars. The following selected statements of operations data for each of the three years in the period ended March 31, 2016 and the balance sheet data as of March 31, 2015 and 2016 are derived from the Company's consolidated financial statements and notes thereto included in this Annual Report. The selected statements of operations data for each of the years ended March 31, 2012 and 2013 and the balance sheet data as of March 31, 2012, 2013 and 2014 were derived from the Company's consolidated financial statements, which are not included in this Annual Report. The selected information is qualified in its entirety by reference to, and should be read in conjunction with, such consolidated financial statements, related notes and "Operating and Financial Review and Prospects" included as Item 5 in this report.

Selected Consolidated Financial Information

(In thousands, except for per share data):

	2012	2013	2014	2015	2016
Statement of Operations					
Net sales	$25,370	$21,933	$22,936	$22,373	$22,935
Gross profit	5,121	4,904	5,452	5,717	5,928
Operating income	230	355	793	1,271	1,516
Net income attributable to Highway Holdings Limited shareholders	184	448	596	1,150	1,251
Per share amounts					

Net income-basic	$0.05	$0.12	$0.16	$0.30	$0.33
Net income-diluted	0.05	0.12	0.16	0.30	0.33
Dividend declared[1]	0.20	0.12	0.12	0.30	0.40
Weighted average number of shares:					
Basic	3,778	3,779	3,779	3,787	3,802
Diluted	3,788	3,781	3,789	3,795	3,802
Dividend declared[1]	$756	$454	$454	$1,138	$1,521

(1) Represents dividends declared during the fiscal year and not necessarily the payment date (dividends declared in one fiscal year may have been be paid to shareholders in the subsequent fiscal year).

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Balance Sheet Data

Property, plant and equipment, net	$2,027	$1,769	$1,213	$1,094	$1,121
Working capital	10,221	10,131	10,374	11,016	10,657
Total assets	16,579	15,352	15,776	16,987	17,039
Long term debt	377	112	-	-	-
Common shares	38	38	38	38	38
Total equity	11,998	12,008	12,146	12,233	11,934
Common shares issued and outstanding	3,784	3,784	3,784	3,802	3,802

RISK FACTORS

The Company's business and operations involve numerous risks, some of which are beyond the Company's control, which may affect future results and the market price of the Company's Common Shares. The following discussion highlights all the material risks the Company faces.

The Company is now Required to Conduct its Manufacturing Operations Under the Rules and Regulations Applicable to Domestic Chinese Companies That Previously Did Not Affect the Company. Since the Company commenced its manufacturing operations in China in 1991, the Company has conducted its operations in Long Hua, Shenzhen, China, pursuant to various agreements entered into, primarily, between two of the Company's subsidiaries and the Shenzhen City Baoan District Foreign Economic Development Head Company and its designees (collectively, the "BFDC") (the agreements, collectively the "BFDC Agreements"). Under the BFDC Agreements, the BFDC was the party responsible for providing manufacturing facilities for the Company and for supplying workers to the Company. The Company paid the BFDC a management fee and certain other charges for the use of the facilities and the services of the workers. Because the Company's manufacturing operations in Long Hua, Shenzhen, were conducted under the BFDC Agreements, its operations were not subject to many of the rules and regulations that would be imposed on entities that are considered under China law to be doing business in China (either as joint venture or as a wholly owned subsidiary organized in China). For example, the Company did not have to apply for permits or licenses in China or to register to do business in China and received beneficial treatment with respect to import/export taxes and duties.

In 2010, the Company received official governmental notice that the foregoing BFDC license structure of operations would no longer be permitted and that, accordingly, all foreign companies operating under that structure, including the Company's two subsidiaries that operated in Shenzhen, would have to reorganize their operations and register in China as a local company. As a result of the foregoing governmental decree, the Company formed Nissin Metal and Plastic (Shenzhen) Company Limited (herein referred to as "Nissin PRC"), a new wholly-owned subsidiary that is now a registered company in the PRC, and discontinued Nissin's operations under the BFDC Agreements. All of Nissin's assets, equipment, employees and manufacturing operations were transferred from Nissin Precision Metal Manufacturing Limited (herein referred to as "Nissin HK"), one of its Hong Kong subsidiaries, to Nissin PRC in 2011. While Nissin HK was forced to transfer its assets and operations to Nissin PRC, the Company's other operating entity in Shenzhen, China, Hi-Lite Camera Company Limited ("Hi-Lite"), was temporarily allowed to continue to operate in Shenzhen under the BFDC Agreements. However, as of March 31, 2016, Hi-Lite also has transferred all of its assets and operations to Nissin PRC and has officially ceased operating under the BFDC Agreement. Hi-Lite is currently being dissolved. The dissolution process normally takes several years and involves several governmental agencies. While the Company believes that it has made all necessary payments to dissolve Hi-Lite, no assurance can be given that these governmental agencies will not during the dissolution process determine that the Company has to make additional payments to complete the dissolution. As a result of the termination of the operations of both Nissin HK and Hi-Lite, all of the Company's future operations in China are now conducted through Nissin PRC. A foreign owned subsidiary, such as Nissin PRC, that is registered in China is commonly known as a "foreign invested enterprise" (a "FIE"), or as a "Wholly Foreign Owned Enterprise" (a "WFOE"). As a new PRC registered WFOE, Nissin PRC is now permitted to hire its own employees, lease its own facilities, and distribute its products in China. However, unlike the Company's prior arrangements under the BFDC Agreements, Nissin PRC now has to obtain and maintain its own permits and licenses, is subject to China's income and business taxes, and is subject to the rules and regulations applicable to other PRC registered companies. Most of these new rules, permits and taxes previously did not apply to its operations in China under the BFDC Agreements. These new rules, regulations and taxes have made the operations of Nissin PRC more cumbersome and expensive. To date, the Company has managed to restructure the operations of its new PRC subsidiary in a manner that has enabled it to comply with the additional rules and regulations. However, no assurance can be given that the Company will be able to continue to operate profitably through Nissin PRC and will be able to comply with future regulations and restrictions.

Terminating the BFDC Agreements and Conducting its Operations Through a Wholly Foreign Owned Enterprise Has Increased the Company's Cost of Operations in Shenzhen, China, and Could Result in Additional Unexpected Costs. As part of the governmentally required transfer of the operations of the Company from the BFDC Agreements to a WFOE, the Company's Nissin PRC wholly-owned limited liability company is now a registered PRC company and is governed by the PRC's company laws and regulations. The cost of conducting operations through Nissin PRC is substantially higher than the operating under the BFDC Agreements. The regulations imposed on Nissin PRC have resulted in increased taxes and increased regulatory and accounting burdens. For example, Nissin PRC has to charge value added tax ("VAT") on all of the products that its sells locally, and has to pay VAT on materials it purchases locally. Depending on the classification of products and/or materials not all of the VAT tax is refunded to Nissin PRC when it exports these products. As a result, the VAT increases the overall cost of those products. The Company, therefore, must either pass these increased costs on to its customers (which hurts the Company's price competitiveness and its customer relations), or absorb the cost increases through smaller profit margins (which reduces the benefits of such sales to the Company). No assurance can be given that the cost of operating Nissin PRC as a WFOE will not continue to increase and will not further negatively affect the Company and its operations.

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The Company's Operations At Its Long Hua, Shenzhen, Facilities May Be Disrupted By Changes Made By The Landlord To The Leased Buildings. The Company's current manufacturing facilities in Long Hua, Shenzhen, China, consist of approximately 261,000 square feet of space that are used for manufacturing and as dormitory facilities. These facilities are currently leased pursuant to several leases that permit the Company to operate in various buildings until February 28, 2017. The Company and its landlord recently agreed to enter into new leases (the "Premises Leases") that will allow the Company to continue its operations at the current location through February 2020. However, the Company's total annual cost under the Premises Leases is expected to increase by approximately 13%. The new leases are currently under review by the required governmental agencies and have not yet been executed. Accordingly, the terms of the lease agreements may vary from the terms agreed to by the parties. The landlord of the Company's facilities recently completed a new building that the Company will hereafter use primarily for its metal stamping operations. Accordingly, the Company will have to move its entire metal stamping operations from the existing temporary facilities to the new building that the landlord built. Although the Company last year relocated this part of its operations without significant expense and without materially impacting its operations, no assurance can be given that the upcoming relocation of the Company's metal stamping operations will not negatively impact its metal stamping operations, disrupt the Company's other operations, and otherwise affect its ability to attract new customers or business. In addition, moving the plant and equipment could also be costly and may require the Company to incur additional expenses in refurbishing the new facilities and returning the old facilities. The cost and negative impact on the Company's operations of this move cannot currently be accurately estimated, but the impact on the Company's operations and financial results could be material.

Changes in Labor Laws, Environmental Regulation, Safety Regulation and Business Practices, and Operating Costs in China, and in Shenzhen, China, in Particular, Have Significantly Increased the Costs and Risks of Doing Business. As described elsewhere in this Annual Report, the Chinese government has during the past few years significantly changed and/or increased the enforcement of a number of laws affecting employees (including regulations regarding their salaries and benefits, labor unions, working conditions and overtime restrictions, and contract duration—in particular, requirements leading to lifelong employment). These regulations now require companies to make payments to up to six different employee benefit funds for each employee, which has significantly increased the Company's cost of employment. In addition, the Chinese government has also changed or increased the enforcement of certain environment protection laws, which have restricted some common practices and/or increased the Company's cost of operations. Employees also now have the right to enforce labor laws relating to their termination and the right to strike. For example, as a result of the winding down of Hi-Lite's operations, the Company intended to transfer Hi-Lite's workers to Nissin PRC. The employees claimed that they had been terminated, went on strike, and demanded the required employment termination severance payments. While the Company was able to resolve this issue without much expense, other such labor actions can occur at any time, which actions could be more costly to the Company. The foregoing factors have increased the risks of doing business in China and have caused many companies to terminate their operations in Southern China and have caused many of the remaining companies operating in Shenzhen, China to restructure their operations. The foregoing changes in labor and other rules and regulations have adversely affected the Company's recent financial results. No assurance can be given that other business changes will not be implemented that will further negatively affect the Company and that the Company will, in fact, be able to continue to operate and/or prosper under any new business or regulatory conditions.

Changing Internal Fiscal, Regulatory and Political Changes Continue to Negatively Affect The Company's Operations in China. The Company's main manufacturing facilities are located in China. As a result, the Company's operations and assets are subject to all of the political, economic, legal and other uncertainties associated with doing business in China. Changes in policies by the Chinese government to its laws, regulations, or the interpretation thereof, the imposition of confiscatory taxation, restrictions on imports and sources of supply, currency re-valuations, or the expropriation of private enterprises, could materially adversely affect the Company. For example, the Chinese government has recently been imposing burdensome import regulations on companies, such as the Company, that heavily rely on imports of raw materials. While the Company has, to date, been able to continue its operations in China despite these changes, no assurance can be given that the increasing regulations and the more restrictive government policies will not, in the future, cause the Company's operations to become financially untenable or otherwise materially affect its business, operations and financial condition.

Increased Wages And The Other Costs Of Labor Have a Material Negative Affect The Company's Operations And Continue to Increase Its Operating Costs. Minimum wages in in general, and in Shenzhen in particular, have significantly increased during the past few years. While the Company pays its employees more than the minimum wage, the increase in the minimum wage has required the Company and other local manufacturers to increase their salaries by approximately the same percentage. Increases in wages also result in increases in our and other employer's contributions for various mandatory social welfare benefits for Chinese employees that are based on percentages of their salaries. These continuing material increases in our cost of labor will continue to increase our operating costs and will adversely affect our financial results unless we pass on such increases to our customers by increasing the prices of our products and services. In response to the increased cost of labor (as well as the other increases in doing business in Shenzhen), we have increased the prices that we charge our customers. The effect of these increases in the prices of our products and services has resulted, and may continue to result in the loss of customers, who may seek, and are able to obtain, products and services comparable to those we offer in lower-cost regions of the world or from certain local Chinese companies that receive governmental support of subsidies. During the past few fiscal years, several of our larger customers were unwilling to pay the higher prices that we had to charge in response to our higher cost of operations. Future increases in our costs and in the prices that we charge our customers may result in future loss of revenues, which could affect our financial results.

In response to these material, continuing increases in wages and labor related costs, the Company has, during the past few years, been increasing the amount of automation and its use of robotics in its operations and has been attempting to move most of the Company's labor intensive work to lower labor cost countries. As a result of the increased automation and its ability to shift labor intensive operations to Myanmar (formerly Burma), the Company has been able to reduce the number of employees that it employs in Shenzhen from almost two thousand a few years ago, to approximately 290 currently. However, the cost of acquiring and manufacturing its own automation equipment has been high, and the increases in productivity and the decreases in the cost of production that result from automation have not fully offset the increased labor costs. As a result, during the past year the Company been shifting part of its labor intensive assembly operations to Myanmar, a country where labor costs are substantially lower than in Shenzhen, China. The Company now owns a 75% interest of a Myanmar company that operates an assembly facility in Yangon, Myanmar, and the Company intends to increasingly shift much of its labor intensive operations to that new facility. See, "*The Company Faces Numerous Risks In Its Operations In Myanmar*," below.

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Uncertain Legal System and Application of Laws. The legal systems of China and Myanmar are often unclear and are continually evolving, and there can be no certainty as to the application of laws and regulations in particular instances. While China has an increasingly comprehensive system of laws, the application of these laws by the existing regional and local authorities is often in conflict and subject to inconsistent interpretation, implementation and enforcement. New laws and changes to existing laws occur quickly and sometimes unpredictably. As is the case with all businesses operating in both China and Myanmar, the Company often is also required to comply with informal laws and trade practices imposed by local and regional administrators. Local taxes and other charges are levied depending on the local needs for tax revenues and may not be predictable or evenly applied. These local and regional taxes/charges and governmentally imposed business practices often affect the Company's cost of doing business and require the Company to constantly modify its business methods to both comply with these local rules and to lessen the financial impact and operational interference of such policies. While the Company has, to date, been able to increase its compliance with the regulations and operate within the newly enforced rules and business practices in China, no assurance can be given that it will continue to be able to do so in the future. Should the local or regional governments or administrators impose new practices or levies that the Company cannot effectively respond to, or should the administrators continue to enforce more of those rules that they have not previously enforced, the Company's operations and financial condition could be materially and adversely impacted. The Company's ability to appeal many of the local and regionally imposed laws and regulations is limited, and the Company may not be able to seek adequate redress for laws that materially damage its business. The Chinese judiciary is relatively inexperienced in enforcing the laws that exist, leading to a higher than usual degree of uncertainty as to the outcome of any litigation. Even where adequate laws do exist in China, it may not be possible to obtain swift and equitable enforcement of that law.

Transactions Between The Company And Its Subsidiaries May Be Subject To Scrutiny By Various Tax Authorities And Could Expose The Company To Additional Taxes. The Company operates through various subsidiaries in various countries. These subsidiaries make inter-company purchases at various prices. Under China's enterprise income tax law, all such inter-company transactions have to be made on an arm's-length basis and are subject to scrutiny as transfer pricing transactions between related parties. Transactions between the various subsidiaries located inside and outside of China must also meet China's transfer pricing documentation requirements that include the basis for determining pricing between the related entities, as well as the computation methodology. The Company could face material and adverse consequences if the Chinese tax authorities determine that transactions between the Company's various subsidiaries do not represent arm's-length pricing regulations and, therefore, that such transactions are deemed to be structured to avoid taxes. Such a determination could result in increased tax liabilities of the affected subsidiaries and potentially subject the Company to late payment interest and other penalties.

The Company Faces Numerous Risks In Its New Operations In Myanmar. In March 2015, the Company completed its acquisition of 75% of Kayser Myanmar Manufacturing Company Ltd. ("Kayser Myanmar"), a foreign company registered to operate in Myanmar. During the past fiscal year, the Company has transferred various equipment to the Myanmar company in order to enable the Myanmar company to assemble the Company's products. To date, the Company has shifted the assembly of two of its product lines to Kayser Myanmar as part of the Company's plan to shift much of its labor intensive assembly operations to Myanmar. In addition to the assembly services currently performed in Myanmar, in order to further avoid the high cost of operating in Shenzhen, China, the Company plans to move some of its component manufacturing operations to Myanmar. As a result, more of the Company's overall operations may reside in Myanmar. Operating in an underdeveloped country such as Myanmar is subject to numerous risks and uncertainties. These risks include the lack of infrastructure, excessively high rent for suitable facilities and land (which rates appear to be continuing to increase), uncertain rules and regulations, unpredictable access to utilities (including electricity), cultural and political issues with local governmental authorities, and the lack of international financing expertise. The lease of the Myanmar subsidiary expires in January 2017. The Company intends to relocate the Myanmar subsidiaries' facilities to a larger facility. To date, the Company has not identified an alternate site for its Myanmar operations, and no assurance can be given that the Company will locate a suitable facility at an acceptable price. Furthermore, the Company currently anticipates that the leasing costs of any alternate site will be significantly higher than the costs under the existing lease. The operations in Myanmar also are subject to the currency risks associated with the Myanmar Kyat (MMK), the official currency of that country. Myanmar recently permitted the exchange rate of the Kyat into the U.S. dollar to fluctuate. Such currency fluctuations could affect the operations in Myanmar, which would impact the Company's plan to relocate some of its assembly functions to the Yangon, Myanmar facility. No assurance can be given that unfavorable currency fluctuations will not occur in the future.

The Company's Customers May Not Permit Their Products To Be Manufactured In Myanmar, Which Would Negatively Affect The Company's Plans To Move Much Of Its Assembly and Manufacturing Operations To Myanmar. Following decades of authoritarian rule, Myanmar recently enacted various political and economic reforms that have made it possible for foreign businesses to own an interest in a Myanmar company. In addition, the U.S. and European Union recently lifted many trade sanctions with Myanmar. As a result, a number of international and other enterprises have started acquiring interests in businesses in Myanmar. In March 2015, the Company completed its acquisition of a controlling interest in Kayser Myanmar, which the Company intends to increasingly use as a low cost product assembly and manufacturing facility. Shifting part of its assembly and manufacturing operations from the higher cost facilities in China to the lower cost facility in Myanmar is part of the Company's business plan to retain its existing customers and to increase its competitiveness in the OEM marketplace. However, the Company will not be able to shift its assembly and/or manufacturing operations from Shenzhen, China, to Yangon, Myanmar, without the prior approval of its customers. To date, a few of the Company's customers have permitted some of the assembly work on their products to be subcontracted to the Myanmar facility. However, other customers have been reluctant to permit the Company to outsource the manufacture of their products to the Myanmar assembly facility because of concerns related to the quality and delivery of the assembled products and because of political and public relations issues. Unless more of the Company's customers allow the Company to shift the assembly and/or manufacture of products to Myanmar, the Company's goal of offsetting its high costs of assembly in China may not be fully realized. While the Myanmar operations have, to date, met the expectations of the Company and its customers, no assurance can be given that enough assembly and manufacturing work can be subcontracted to Myanmar to materially lower the Company's overall costs and to improve its price competitiveness.

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Political Or Trade Controversies Between China And The United States Could Harm The Company's Operating Results Or Depress The Company's Stock Price. Relations between the U.S. and China have during the past few years been strained as a result of numerous events that have threatened the business relations between the countries. These strains on U.S./China relations could affect the ability of foreign companies listed on U.S. stock markets, such as the Company, from operating in China. Also, strains between the U.S. and China could interfere with the ability of the Company's manufacturing in China from engaging in business with, or selling to the U.S. or U.S. companies. Any disruption of the current trade relations with the U.S. could have a material adverse effect on the Company's business. No assurance can be given that these and any other future controversies will not change the status quo involving peaceful trade relations between the U.S. and China, or that the Company's business and operations in China will not be materially and adversely affected. Even if trade relations between the U.S. and China are not affected by political difficulties between the two countries, such political friction could adversely affect the prevailing market price for the Company's Common Shares.

China's Political Issues With Japan Could Harm The Company's Operations. As a result of the dispute between Japan and China (such as the on-going dispute over the Senkaku/Diaoyu island chain), the business environment has deteriorated for companies in China that do business with Japan or otherwise appear to be connected to Japan. Since the name of the Company's subsidiary in China is a Japanese name ("Nissin"), and possibly because that subsidiary produces products for Japanese customers, the Company believes that its subsidiary has been subject to heightened scrutiny by Chinese authorities that may impact its operations. Accordingly, political strains between China and Japan may negatively impact the Company on-going operations in China.

Labor Shortages and Turnover. One of the principal economic advantages of locating the Company's operations in China and Myanmar has been the availability of low cost labor. Due to the enormous growth in manufacturing in China, workers' higher salary expectations, and the aftereffects of China's one-child policy, the Company has recently experienced difficulty in filling its lower cost labor needs. In addition to the recently developing tight labor market, the Company has also been affected by cyclical trends and other shortages in labor supply. The Company regularly faces severe labor shortages in Shenzhen as a result of the Chinese New Year during which time the Company follows the customary practice at its factory complex to grant its employees home leave and to, therefore, temporarily discontinuing operations. Any material or prolonged shortage of labor would have a material adverse effect on the Company's results of operations. As a result of the high cost of labor, the changing nature of the labor market, and the departure of employees that typically occurs during the Chinese New Year, many of the Company's assembly workers have to be replaced every year. The cost of hiring and training new employees adds to the Company's overall cost of operations. Myanmar also observes a 12-day new year's celebration during which all workers leave.

The Recently Imposed Import Duty Deposits May Negatively Affect The Company's Liquidity. The local authorities in China in 2012 imposed a "Customs License Deposit" on the Company for the import of raw materials, including sheet metal. These customs deposits serve as a guarantee to make sure that the Company re-exports all imported materials within a one-year period. As a result, the Company has had to deposit refundable payments with the Chinese Customs Department based on its import contracts for raw materials. These deposits are refundable, and the Chinese Customs Department periodically releases some of these funds. The Company will continually have to deposit funds with the Chinese Customs Department, which deposits will decrease the amount of cash available to the Company to fund its liquidity needs. Should the Chinese Customs Department delay the release of the remaining deposits, or should new, larger deposits be required, the Company's liquidity could be negatively affected while its cash is held by the Chinese Customs Department.

The Global Economic Uncertainty and Weakness Has In the Past Adversely Affected The Company's Business And Do So Again In the Future. Most of the Company's customers are international companies that operate globally or serve global markets. The Company's largest customers serve the European market. As a result, the Company's customers have in the recent past been affected by the unstable financial and credit markets generally, and in Europe in particular, and by the recent downturn in many European economies. Although the Company's principal customers have gradually been increasing the amount of purchases from the Company, a new round of instability of the markets and weakness of the global (and European) economy could adversely affect the future demand for the Company's customers' products and the amount and timing of their orders. Fluctuating economic uncertainties are expected to continue to affect the Company's operations, earnings and financial condition. The instability also affects the prices at which the Company can sell its products, which in turn adversely affects the Company's earnings and financial condition and its relations with its customers.

The Company Is Financially Dependent On A Few Major Customers. During the years ended March 31, 2016 and 2015 the Company's aggregate sales to its three largest customers accounted for approximately 70.3% and 60.7% of net sales respectively. While the Company believes that there are material benefits to limiting its customer base to a few, large, well-established and financially strong customers, having fewer customers also has significant risks. The Company's success will depend to a significant extent on maintaining its major customers and on the success achieved by its major customers. The Company could be materially adversely affected if it loses one or more of its major customers or if the business and operations of its existing major customers declines. While the Company has in the past either been able to replace major customers or to increase the amount of orders it receives from its remaining customers, no assurance can be given that the Company will be able to do so in the future. In addition, with few, larger customers, the Company's operations are more significantly impacted by a delay or reduction of any anticipated purchase orders or by the loss of any one or more of its major customers.

In addition to its increasing dependence on generating revenues from fewer, larger customers, the Company's risk exposure to the collection of its accounts receivable likewise is increasing as the size of receivables from individual clients increases. A substantial portion of the Company's sales to its major customers are made on credit, which exposes the Company to the risk of significant revenue loss if a major customer is unable to honor its credit obligations to the Company. Any material delay in being paid by its larger customers, or any default by a major customer on its obligations to the Company would significantly and adversely affect the Company's liquidity. During

the fiscal years ended March 31, 2016 and 2015, accounts receivable from the three customers with the largest receivable balances at year-end represented, in the aggregate, 69.2% and 66.6% of the total outstanding receivables, respectively.

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The Company Is Highly Dependent Upon Its Executive Officers And Its Other Managers. The Company is highly dependent upon Roland Kohl, the Company's Chief Executive Officer, and its other officers and managers. Although the Company has signed employment contracts with Mr. Kohl and many of its other key officers/managers, no assurance can be given that those employees will remain with the Company during the terms of their employment agreements. The loss of the services of any of the foregoing persons would have a material adverse effect on the Company's business and operations. Mr. Kohl's new employment agreement expires in March 2019. The Company owns a $2,000,000 life insurance policy issued to insure the Company's in the event of Mr. Kohl's death. In addition, the Myanmar operations are highly dependent upon that facilities' Managing Director (who also is its co-founder). Should the Myanmar co-founder leave, the Myanmar operations could be materially affected, and the Company could have difficulty in finding a replacement.

The Company Must Continuously Adapt Its Operations To Suit Its Customers Needs, Or Else It Will Lose Customers. The Company's customers are continuously changing the mix of their products. Accordingly, the Company must continuously adapt its manufacturing abilities to suit the needs of its customers. No assurance can be given that the Company will be able to detect and correctly react to future changes in the needs of its principal customers, or that its investments in equipment and machinery made in anticipation of such changes will result in a positive return. Should the Company fail to react, or to incorrectly react to changes in the needs of its current or future customers, its business, operations and financial condition could be adversely affected.

The Company Faces Significant Competition From Numerous Larger, Better Capitalized, and International Competitors. The Company competes against numerous manufacturers for all of its current products. Such competition arises from both third party manufacturers and from the in–house manufacturing capabilities of existing customers. To a large extent, the Company competes in its Original Equipment Manufacturing ("OEM") business on the basis of quality, price, service, and the ability to deliver products on a reliable basis. Due to significant competition and the availability of alternate OEM suppliers for the Company's customers, the Company has, at times, been reluctant, or even unable to pass through significant materials cost increases. This has led to lower gross margins and even to net losses in some product lines. During the past few years, the Company has also lost manufacturing contracts because of its price increases, which losses have resulted in lower net sales. As a result of these factors, the Company will have to continue to operate at narrow gross profit margins, which could jeopardize the Company's financial position.

Since locating its facilities in Shenzhen, China, in 1991, the Company has been able to compete with other manufacturers based on its cost of operations in Shenzhen, the availability of a large labor pool, its favorable tax status, and its convenient access to Hong Kong's shipping port and business/banking facilities. However, since the Company first moved to Shenzhen as one of the first manufacturers in that locality, many other manufacturers have re-located or established new facilities in Shenzhen, and the Company's competitive advantage has been significantly diminished. In addition, many of the larger, international companies that have established competing facilities in Shenzhen have also established manufacturing facilities in other low-cost manufacturing locations, many located at sites outside of China, which have given those competitors the ability to shift their manufacturing to those locations whenever costs at those other locations are cheaper than in Shenzhen. Accordingly, the Company has indirectly been competing against both the competitors in Shenzhen as well as the other facilities outside of China. The significantly increases in the cost of operating in China, including changes in labor laws, changes in environmental regulations and in the enforcement of such regulations, increases in safety regulations, and a general increase in the cost of doing business have all collectively significantly eroded the advantages of operating in China. No assurance can be given that the Company will continue to be able to compete effectively against companies based in China or those operating outside of China.

Dependence on the Long Hua, Shenzhen, China, Factory Complex. The Company currently operates its sole manufacturing facility in Long Hua, Shenzhen. Although the Company has acquired a 75% interest in a Myanmar company, which company it currently uses for the assembly of some of its products, the Company currently is, and will continue to be heavily dependent upon its Long Hua, Shenzhen facility. The loss of this facility, or any material disruption of its operations at the Shenzhen facility, would be costly, would materially disrupt the Company's overall operations, and would have a material and adverse impact on the Company's operations and financial condition. The Company currently maintains fire, casualty and theft insurance aggregating approximately $10 million, covering its stock in trade goods and merchandize, furniture and equipment in China. The scope of the insurance coverage, and the amount of financial coverage provided by this insurance may not be sufficient to cover material damage to, or, the loss of, all or material portions of the factory complex due to fire, severe weather, flood, or other act of God or cause, and such damage or loss would have a material adverse effect on the Company's financial condition, business and prospects. The Company may not be able to move its principal facilities from its current location in Long Hua without significant cost and expense. For example, if the Company were to permanently re-locate its manufacturing facilities (because it cannot extend its leases or for other reasons) outside of the current locality, under local law the Company would have to terminate all of its employees and pay substantial termination fees and severance. The amount of such employment termination fees could substantially impact the Company's financial condition.

Fluctuation in Foreign Currency Exchange Rates Will Continue to Affect the Company's Operations and Profitability. Because the Company engages in international trade, the Company is subject to the risks of foreign currency exchange rate fluctuations. The Company's operations are based in the PRC and Hong Kong and, recently, in Myanmar. However, because most the Company's customers are located outside of these markets (primarily in Europe), the Company makes and/or receives payments in various currencies (including U.S. dollars, Hong Kong dollars, RMB and Euros). As a result, the Company is exposed to the risks associated with possible foreign currency controls, currency exchange rate fluctuations or devaluations. For example, the Company realized currency exchange losses of $21,000 and $125,000 in the fiscal years ended March 31, 2016 and 2015, respectively. However, these currency fluctuations have in the past been more significant and have, in those prior years, materially affected the Company's financial results. Notwithstanding these currency conversion rate fluctuations, the Company does not attempt to hedge

its currency exchange risks and, therefore, will continue to experience certain gains or losses due to changes in foreign currency exchange rates. The Company does attempt to limit its currency exchange rate exposure in certain of its OEM contracts through contractual provisions, which may limit, though not eliminate, these currency risks. In addition, the Company has an understanding with many of its larger European customers that the Company's quoted prices will be periodically adjusted to reflect currency exchange rate fluctuations. The Company is also attempting to limit its exposure to currency fluctuations with its non-U.S. based customers by increasingly asking for payment in U.S. dollars. Nevertheless, no assurance can be given that the Company will not suffer future currency exchange rate losses that will materially impact the Company's financial results and condition.

Significant Worldwide Political, Economic, Legal And Other Risks Related To International Operations. The Company is incorporated in the British Virgin Islands, has administrative offices for its subsidiaries in Hong Kong, and has all of its manufacturing facilities in China and Myanmar. The Company sells its products to customers in Hong Kong, North America, Asia and Europe. As a result, its operations are subject to significant political and economic risks and legal uncertainties, including changes in international and domestic customs regulations, changes in tariffs, trade restrictions, trade agreements and taxation, changes in economic and political conditions and in governmental policies, difficulties in managing or overseeing foreign operations, and wars, civil unrest, acts of terrorism and other conflicts. The occurrence or consequences of any of these factors may restrict the Company's ability to operate in the affected region and decrease the profitability of the Company's operations in that region.

Acquisitions Or Strategic Investments, Including The Recent Expansion Into Myanmar (Burma), May Not Be Successful And May Harm The Company's Operating Results. The Company has in the past, and may in the future, acquire, invest in, or enter into strategic arrangements with other companies in China and elsewhere (including elsewhere in Asia, Europe or even in North or Central America). For example, as part of its strategy to reduce some of its operating expenses, the Company recently acquired a 75% interest in a Myanmar company. In addition, in the fiscal year ended March 31, 2014, the Company acquired a 51% interest in a venture that it co-owns with ACI Group GmbH, a company based in Zimmern, Germany, to manufacture a series of lower cost, proprietary CO_2 cleaning systems for industrial and commercial cleaning applications. Such acquisitions or strategic investments could have a material adverse effect on the Company's business and operating results because of:

- The assumption of unknown liabilities, including employee obligations. Although the Company normally conducts extensive legal and accounting due diligence in connection with its acquisitions, there are many liabilities that cannot be discovered, and which liabilities could be material.

- The Company could incur significant expenses related to bringing the financial, accounting and internal control procedures of the acquired business into compliance with U.S. GAAP financial accounting standards and the Sarbanes Oxley Act of 2002.

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- The Company's operating results could be impaired as a result of restructuring or impairment charges related to amortization expenses associated with intangible assets.

- The Company could experience significant difficulties in successfully integrating any acquired operations, technologies, customers' products and businesses with its operations.

- Future acquisitions could divert the Company's capital and management's attention to other business concerns.

- The Company may not be able to hire the key employees necessary to manage or staff the acquired enterprise operations.

Risk of Cybersecurity Breaches. Security breaches and other disruptions could compromise the Company's information and expose the Company to liability, which would cause the Company's business and reputation to suffer. In the ordinary course of the Company's business, the Company stores sensitive data, including business information and regarding its customers, suppliers and business partners, in the Company's networks. The secure maintenance and transmission of this information is critical to the Company's operations. Despite the Company's security measures, its information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. Any such breach could compromise the Company's networks and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such access, disclosure or other loss of information could result in legal claims or proceedings, regulatory penalties, disrupt the Company's operations, and damage our reputation, which could adversely affect its business, revenues and competitive position.

Certain Legal Consequences of Incorporation in the British Virgin Islands. The Company is incorporated under the laws of the British Virgin Islands, and its corporate affairs are governed by its Memorandum of Association and Articles of Association and by the BVI Business Companies Act of the British Virgin Islands. Principles of law relating to such matters as the validity of corporate procedures, the fiduciary duties of the Company's management, directors and controlling shareholders and the rights of the Company's shareholders differ from those that would apply if the Company were incorporated in a jurisdiction within the U.S. Further, the rights of shareholders under British Virgin Islands law are not as clearly established as the rights of shareholders under legislation or judicial precedent in existence in most U.S. jurisdictions. Thus, the public shareholders of the Company may have more difficulty in protecting their interests in the face of actions of the management, directors or controlling shareholders than they might have as shareholders of a corporation incorporated in a U.S. jurisdiction. In addition, there is doubt that the courts of the British Virgin Islands would enforce, either in an original action or in an action for enforcement of judgments of U.S. courts, liabilities that are predicated upon the securities laws of the U.S.

Anti-Takeover Provisions Of The Company's Amended Articles Of Association Could Delay Or Prevent A Change Of Control That The Shareholders May Favor. Article 61 of the Company's Articles of Association was amended in June 2013 to divide the Board of Directors into three classes, with the directors of each class to be elected for staggered three-year terms. In August 2015, the Company's Articles of Association were amended (i) to increase to 25% the number of shares required to call a special meeting of shareholders, (ii) to provide that shareholders can only act at a meeting (and not by written consent), and (iii) to provide that directors can only be nominated by the current/existing Board, or by shareholders who comply with certain procedures normally applicable to U.S. pubic companies. These changes may have the effect of discouraging, delaying or preventing a merger or other change of control that the shareholders may consider favorable, or may impede the ability of the holders of our common shares to change the Company's management. In