FINANCIAL REVIEW

Turnover and Gross Profit

Televisions

Market competition and price war continue to be the Group's major challenge this year. Despite a 12% increase in sales volume, actual sales income only increased by 3.3%. Fortunately, part of the effect of the price reduction was offset by the decrease in material cost, in particular, CRTs. Overall gross margin only reduced by 1–2%. The Group is able to maintain its leading position in the industry and is the best performer in the industry in terms of profitability.

White goods

The Group's other home appliances also faced severe competition during the period under review. Higher profit margin of the air conditioners business has enticed more home appliance manufacturers to the market. Despite growth, both in terms of volume and turnover, sales were far from expectation. It was nice to note that price pressure has been alleviated by the decline in component cost and gross margin remained stable.

The Group's product strategy of shifting refrigerators and washing machines to higher end products has resulted in the delay in product rollout. Sales volume was severely affected. Gross margin decreased by 1–2%. With this product repositioning, TCL's white goods products would be better received by the consumers in the second half of the year.

Computers

The overall performance of the Group's newly acquired PC business was below expectation. The burst of the internet bubble has led to a less-than-expected demand in PCs in the PRC. As a result of the continuous price cuts by market players, margin was eroded by 2–3%. The restructuring of operation flow and the upgrading of the ERP system have further aggravated the situation as salespeople, distributors and front-end managers needed time to familiarize with the system and their sales performance was affected.

Expenses

Selling expenses accounted for 10.1% (2000: 11.6%) of the consolidated turnover of the Group, most of which represented sales commission paid to TCL Electrical Appliances Sales Co., Ltd ("Sales Co.") for all sales transacted through the Sales Co. in the PRC. Pursuant to a distribution agreement signed between the Group and the Sales Co., the Group's electrical appliance products are distributed through the sales network of the Sales Co..

Administrative expenses accounted for 3.3% of the consolidated turnover of the Group, comparing to approximately 2.1% of the consolidated turnover over the same period last year. The main reasons for such substantial increase were:

— included in the expenses was HK$9 million amortization of goodwill on the acquisition of the Group's PC business in February this year.

— certain new investments, in particular, the information technology division were still at their initial development stage. As compared to the well-matured home appliance division, relatively higher administrative cost was incurred for their development.

Finance costs reduced by almost 50% as compared to same period last year. With the Group's prudent management of its working capital, the cash generated from the Group's operation was more than enough to reduce the Group's borrowings. Average outstanding debt balance decreased, resulting in the reduction of the Group's finance costs.

Associated Company and Jointly Controlled Entities

The performance of the Group's 20% stake in the mobile phone business was encouraging. Unit sales have increased to over 300,000 sets comparing to 56,000 sets the same period last year. Share of profits before tax attributed to the Group amounted to HK$10 million.

The demand for televisions in India slowed down in the wake of the earthquake in January this year. In the traditionally low season of the first half of the year, market players cut prices in order to maintain their market shares. Margins were squeezed and the performance of the Group's joint venture in India was less than expected with loss of HK$4.7 million shared by the Group. Demand in India will prosper in festive months in the second half of the year. Besides, the joint venture company has started importing CKD kits for assembly to take advantage of the lower customs duty. Better sales and margin are therefore anticipated.

The Group's another major joint venture — Henan TCL Melody Electronics Co., Ltd was able to turn around from its loss-making position in 2001. With the production of the more profitable 29 inches TVs, gross margin as well as overall results was improved.

Other newly invested joint ventures such as the distance learning projects, the compressors manufacturing factory were still at their initial development stage with no profit contributions to the Group.

BUSINESS REVIEW AND PROSPECTS

Television

Albeit relentless market competition in the PRC, the Group's television business outperformed the industry average growth rate of 6.5% in the period under review. The Group's sales of televisions amounted to 2.71 million sets, 12% hiked over the corresponding period in 2000. The Group's market share rose to 19%, which was higher than 2000's market share of 17%.

The Group launched numerous new products during the first half of 2001. Most of them were well received in the market. By closely monitoring market demand and fastly introducing new products, the Group fended off price erosion. This not only expanded the Group's market share but uplifted the corporate image of TCL.

In the second half of the year, the Group's business strategies are to buttress R&D; facilitate sales with new innovative products; rationalize production resources and costs to extend the Group's competitive advantage.

White Goods

The Group's air-conditioning business reported growth despite ongoing fierce competition and price reduction in the market. Sales were up by 7.9% over the corresponding period last year. "Trendy-Technology-People" is the motto behind the design philosophy. Having a grip on the market standards and demand, the Group's air-conditioning business is poised to prosper.

During the period under review, the Group sold 92,000 refrigerators and 169,000 washing machines. In the wake of intensified market competition and the transitional period of shifting product strategy to focus on high-end market, sales of refrigerators and washing machines showed a decline compared to the corresponding period last year. To catapult sales and improve profitability, the white goods division will further improve product mix and speed up new products introduction in the second half of the year.

AV Products

In the period under review, sales of DVD players doubled that of previous year but sales of other products declined. This resulted in sales downturn over the corresponding period last year.

DVD becomes more popular as a result of the reducing price on DVD players, affordable DVDs and the high-resolution television. The Group will capitalize on burgeoning business opportunities in the DVD market and promote sales of its home theatres as well.

PCs

The growth of the industry during the period under review was generally below market anticipation. It was mainly due to the Internet boom last year projecting a picture of rosy demand this year. However, demand failed to live up with the expectation and was aggravated by delay in consumers' desire to buy due to continuous information on price cuts. Other than that, the installation of the ERP system and internal operation restructuring also affected the performance. The Group reported a 3% drop in sales of its PCs compared with the corresponding period in 2000. According to IDC report, the Group's market share in the consumer PC market was 6.1%, ranking third among domestic manufacturers in the second quarter of 2001.

The Group launched two new models during the first half of 2001, namely 988 and P4 series. These products incorporated the latest Intel Pentium 4 processors. Through which, the Group was successful in enhancing its brand recognition and establishing a leading position in Pentium 4 products.

In the second half of 2001, Pentium 4 is to replace Pentium 3 as the mainstream high end product. The Group has been overhauling its sales channels and buoying the sales capability of the 500 Pentium 4 sales specialty centres. Leveraging the market dominance of the TCL brand name and the efficient management, growth will prevail in 2001.

Internet Business

In the highly competitive information technology industry, the Group is currently capitalizing on its resources superiority. Apart from providing quality portal to its customers, the Group has achieved substantial progress in network devices and distance learning programmes.

In the second half of the year, the internet business will operate the portal and network for the distance learning education programmes, market its education platform for classes at the Central Television Broadcasting University, boost Internet business development and define a standard in the long-distance education industry and market.

Under the corporate "information technology" theme of "Heavenly Families on the Earth connecting an inter-lifestyle world", the Group continues to attain synergy in its businesses, contain costs and endeavor in the information technology application and services in the second half of 2001.

Overseas Markets

In the first half of 2001, the Group's overseas reported sales of 360,000 sets of television, representing a growth of 7% over the corresponding period last year. The Group's newly established businesses in overseas countries have successfully penetrated their respective markets. Not only did they capture considerable market share, most of them also brought profits.

To capitalize fully on its competitive advantages in the Group's product research and development, technical know-how, mass manufacturing and product quality, the management will actively exploit new markets in the Middle East and Europe. At the same time, the Group will keep enriching its product lines and expand into AV business and white goods business. The Group's overseas operations see flamboyant growth this year.

Mobile Phones

The mobile phone business, in which the Group holds 20% stake, achieved phenomenal growth. Sales quintupled from 56,000 sets in the corresponding period last year to over 300,000 sets during the first half of 2001, capturing a market share of approximately 1.5%.

Sources indicate that the mobile phone market is approaching maturity. The industry in general has been enduring a decline in profits. The handset manufacturing is to move to Asia and China. This shift will undoubtedly benefit the Chinese enterprises like TCL and therefore the Group predicts accelerated growth in its mobile phone business in the future.