

Management Discussion and Analysis

— Operations Review

— Financial Review



Operations Review

Television Business

In 2001, the PRC television market grew modestly by 2% over the previous year. Despite ferocious competition within the market, the Group's television business registered a 6% growth in turnover, with a 20% market share. TCL became the hottest television brand name in the PRC and outranked all its competitors.

Prices of television sets continued to decline in 2001, due not only to the continual price reductions of parts and components, but also to the pressures of competition. However, TCL was left relatively unscathed by such price adjustments and succeeded in sustaining the Group's competitive price advantage by reducing and accelerating turnover in inventory, upgrading overall operating efficiencies, judging the market situation accurately, and devoting itself to technological innovations and complementary product rollouts. In 2001, the Group launched seven series of television sets, featuring over 50 different models, in order to cater to various market and consumer tastes. In the prevailing economic environment, the success of the Group's television business in achieving better results than its peers hinged on its relentless devotion to developing a high-end market, actively driving product innovation, being instinctively aggressive, introducing international-standard advanced technology, and buttressing research and development capabilities to reap reasonable profitability and returns with new high-end models.

Currently, TCL has the most diverse product range in the PRC, created by a lightning pace in new product rollouts. The Group's products are well received by consumers for their outstanding image, as well as the accurate market

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positioning designed to satisfy the needs of different consumers.

TCL places particular emphasis on technological innovation. It responds to individual market needs by catering to different consumers with different product features. Characteristic designs make it possible for consumers to fully enjoy the fruits of advanced technologies.

White Goods Business

Amidst fierce competition in the air-conditioner market in 2001, the decline in overall prices was higher than expected. Although the Group's air-conditioning business recorded a 14% increase in turnover to HK\$440 million, the deviations in pricing policies as a result of misinterpreting market changes led to an unsatisfactory performance in profitability. Nevertheless, TCL's air-conditioner business, adhering to the motto of "Trendy, Technology, People", with revamped organisational structure, established nationwide distribution channels, and enhanced quality and cost awareness, looks poised for better results this year .

Last year, the Group's sales of 176,000 refrigerators and 402,000 washing machines slipped in view of mismatched timing of new product rollouts and market demand. In order to address this situation, TCL has boosted its research and development capability and established a sales department solely for white goods. With professional sales teams, a gradual





improvement in the distribution network and the implementation of related management measures, the sales figures for 2002 are expected to rise considerably.

TCL's washing machines and refrigerators were the first batches of "quality inspection exempted" home appliances in the PRC last year, being accredited by the State Bureau of Quality and Technical Supervision, which recognised the quality of TCL's products, as well as provided a reference and proof of confidence for consumers when they purchase our home appliances. The Group believes that the white goods business has ample room for growth next year.

AV Business

In 2001, the Group's domestic sales decreased by 39% while its sales in overseas markets doubled. The constant emergence of new technologies led to downward price adjustments, as well as ferocious competition in the DVD market, affecting domestic sales to a certain extent.

In view of this and to facilitate growth, the Group has set a new direction for its AV products by concentrating on individual features and establishing a direct and swift network of distribution channels. As far as future product lines are concerned, the Group has plans to improve interconnectivity with loudspeakers and televisions as well as overall appearance consistency. The Group has also strengthened scientific research and quality control associated with its AV products, upgraded market monitoring and forecasts, as well as repositioned its AV products from a more professional perspective. Management believes that there is room for development in the domestic market for AV products, and also considerably better sales prospects in overseas markets. In conclusion, TCL's AV products have tremendous potential for development.

PC Business

Affected by the global market environment, the PRC's home PC market grounded to a halt, with occasional phases of negative growth, in 2001. Monopoly within the industry and price wars among manufacturers also led to a massive price cuts.

Influenced by the overall environment, TCL Computer failed to meet pre-determined objectives for sales, profit and growth. However, TCL Computer managed to maintain a good market position, with a market share of approximately 6.8% in home PCs and approximately 3.5% in desktop PCs, ranking third and fourth in the respective domestic markets.

TCL Computer launched two new product series targetted at the household market in 2001, namely Rui Xiang (锐翔) and Rui Li (锐麗) series. Rui Xiang was designed and produced in June 2001 to complement the Group's Pentium 4 strategy. Rui Li, a mid-market model based on the P4 and Windows XP platforms, was rolled out in December to tie in with digital consumption.

In August 2001, TCL Computer started to implement ERP information management system. This system helps to optimise overall operations and sales flow, and lay a solid foundation for its business expansions.

Currently, the Group has entered into strategic alliances with internationally recognised suppliers and manufacturers, including Microsoft and Intel. These alliances will not only affirm TCL's leading position within the industry, but also bestow competitive advantages for the Group in the home PC market, thereby leading to growth in market share and sales.

The Group currently has 27 representative offices and over 800 distributors in the PRC. TCL has adopted the sales network model of “wholesaler system plus core distributors” by deploying wholesalers in second- and third-tier regions and cities to develop appointed dealers. It also employs P4 and ejiajia (億家家) sales specialty centres under core distributors. With its effective sales policies, the Group sales performance has enhanced and has boosted overall operational efficiency.

Looking ahead, the Group’s strategy is to “establish a strong and effective avenue for consumer digital products”. TCL Computer’s strategy in the future is to solidify its competitive advantages in the home PC sector, proactively establish its market position in business PCs and create a new TCL consumer digital brand name in the personal consumer digital product sector.

Internet Business

In 2001, the growth of the IT industry was static due to the global economic slowdown, in particular the United States. The Group’s Internet business leverages on the advantageous resources of TCL to actively provide customers with a quality portal, network devices and distance learning services.

Last year, the Group successfully marketed its network devices, which won a number of awards, including the “Best in Functions and Price” award from the “China Computer Newspaper”. It also secured a 4% market share in the network device market and established a quality brand image within the industry.

Operation of the Group’s portal for distance learning education programmes and marketing of its education platform for classes at the

Central Television Broadcasting University has been underway. The Group believes that it will benefit from the establishment of a unified distance education market system and a commercialised operation.

The Group’s Internet business is still in its investment stage and, has yet to contribute to profit. In 2002, the Group will centralise its resources in developing network devices and distance education projects, strengthen management and operation, and contain costs in order to lay a solid foundation for the development of electronic digitalisation in the PRC.

Research and Development

In 2001, the Group was successful in developing an extensive series of new products, such as the “Picturesque” Television, the “One Key” Set-Top Box, the DVB-S Digital Television Satellite Receiver, the LCD Display Monitor, the PDA and the 16 X 9 HDTV Ready HiD. TCL also set up a research and development team for specialised display devices that is responsible for the development of the PDP, the LCD Rear Projection Television and the LCOS Television. These products are expected to be placed in the market in 2002.

During the year under review, the Group also actively explored technologies related to digital circuit designs and software development. IT technology, such as the 32-bit CPU application and embedded operating system, was also incorporated into the Group’s consumer electronic products.

Overseas Business

To become a world-class PRC enterprise has always been TCL’s stated objective. To achieve





this goal, the Group has been active in exploring all kinds of opportunities in overseas business. During the year under review, TCL exported over 740,000 television sets, representing a 5% increase previous year. Sales of AV products reached over 84,000. In 2001, total sales, comprising TCL and OEM brands amounted to HK\$645 million.

The TCL brand name has successfully made its way into the top five or six on lists of the best-selling television brand names in individual markets. Despite last year's quiet operating environment, the Group did not match the significant price cuts prevailing in the market to boost sales, but actively optimised its products to secure orders. The Group is in the process of reorganising the operational structure of its joint venture company in India and rationalising its local operating strategies.

As the overseas markets were generally weak last year, the Group did not make any large-scale overseas investments but maintained its interests in Vietnam, the Philippines, Hong Kong, Singapore, Indonesia, India, Russia and the United States. In addition to actively driving local sales, TCL also reviewed its operating models, and strengthened management and financial controls in order to further consolidate the status of the TCL brand name in these markets, and also enhanced operational efficiency.

Subsequent to China's accession to the WTO, the gradual dismantling of the trade barriers between China and other member states will attract an influx of overseas investors and large international customers to the PRC. The ensuing prevalence of unprecedented business opportunities and favourable circumstances will be highly beneficial to the development of the Group's overseas business. With the gradual recovery of the global economy anticipated in

2002, the Group is very optimistic about its overseas business for the coming year. Looking ahead, TCL will capitalise on its current competitive advantages by introducing new products and models, upgrading after-sales services and increasing modestly its overseas advertising promotion and marketing. In markets with potential, such as Vietnam, the Philippines, Hong Kong and Indonesia, the Group will capitalise on its mature sales network and competitive advantages by expanding product lines to include AV, air-conditioning, white goods and mobile phones, as well as lifting the economies of scale in sales.

Regarding market development, the Group has completed its market research in Russia, established primary contacts with local customers and adopted respective sales model. TCL is expecting Russia to begin profit contribution in 2002. In South America, the Group will rely on its US subsidiary to drive sales and establish a local distribution network. Elsewhere, the Group is actively studying the feasibility of developing TCL brand business in the Middle East, South Africa and Malaysia. The Group believes that the overseas markets for home appliances have tremendous growth potential and could offer significant returns for the Group.

Mobile Phone Business

Encouraged by a swiftly growing market, TCL Mobile owed its excellent performance since establishment to its well-experienced management team and its buoyant research and development capability. In order to enhance the Group's future profitability and value to shareholders', the Group obtained the shareholders' approval in the Extraordinary General Meeting in January 2002, to acquire an additional 10% of its mobile phone business for approximately HK\$280 million (with an implied price earnings ratio of 10 based on the

guaranteed profit), bringing its total investment to 30%. The transaction is expected to be completed at the end of March 2002.

Despite several foreign brands' leading positions in the PRC market, headed by Nokia and Motorola, the PRC Ministry of Information Industry revealed that some of these large enterprises suffered losses last year. Other well-known enterprises, such as Ericsson and Phillips, have announced that they will gradually withdraw from the mobile phone manufacturing sector. This demonstrates clearly that mobile phone manufacturing is shifting towards Asian and Chinese enterprises, most notably by TCL.

In 2001, the mobile phone business was instinctively aggressive and innovative. Some 1.25 million sets were sold during the year, a surge of 4.6 times over the 0.22 million sets sold in 2000, and realising a market share close to 3%. Total sales revenue last year was HK\$2.0 billion, 7 times over the previous year's HK\$254

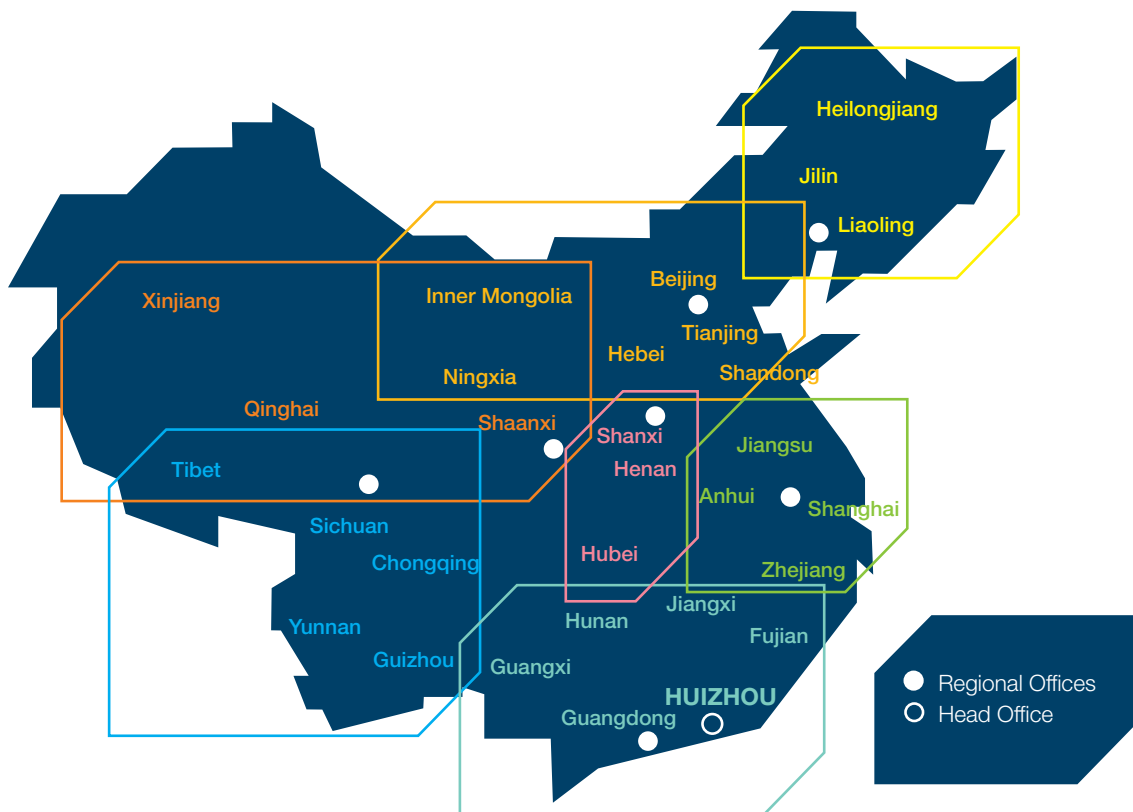
million. Net profit also exceeded the guaranteed profit set in January 2002.

The Company will consistently apply its operating strategy of "horizontal and vertical integration, and in-depth distribution", and create new core competitiveness with value-added services. In 2002, it also plans to introduce a number of highly competitive mobile phones to capture a higher market share.

Distribution Network

In June 2001, the Group announced the acquisition of a 51% equity interest in Huizhou TCL Electrical Appliances Sales Co., Ltd. from its parent company for the sum of HK\$26 million. The transaction was completed in September 2001.

TCL Electrical Appliances Sales Co., Ltd., established in 1996, currently controls and operates a distribution and after-sales service network. The network comprises 27 branch



companies, 174 sales offices, 80 representative offices, over 10,000 agents, 3,950 service centres, and over 20,000 distributors and retailers. It is also regarded as the most comprehensive and efficient distribution network for electronic consumer goods.

The Group believes that the acquisition of the distribution network will greatly enhance its competitive advantages and bring it much closer to the market than the contractual interest derived from the distribution agreement. It will help the Group to obtain more opportunities and information, secure greater coverage and room for development, reduce costs further, to enhance service standards, quicken product flows and upgrade operational efficiencies, and eventually boost the overall competitiveness and profitability of the Group considerably.

Financial Review

Performance indicators

	2001	2000
Gross Margin	17.9%	19.8%
Net Margin	3%	5%
Return on equity	9.95%	16.67%
Current ratio	1.56 times	1.65 times
Interest cover	17.44 times	13.74 times
Debt/Equity ratio	0.01	0.10
Inventory turnover	94 days	135 days
Trade receivable collection period	36 days	35 days

Television — Market competition and price war among the industry players become less ferocious in the second half of the year. Sales volume increased by 9% with sales revenue increased by 6% to HK\$7,476 million. In order to allow the Group to react swiftly to this highly dynamic market, the Group allocated more

resources on ameliorating operations efficiency and reducing its stock level. At the end of the year, more than 30% of decrease in stocks was recorded. Coupled with the Group's emphasis on higher end models which entailed higher margin, gross margin of the TV division could be maintained at 19%. It is encouraging to note that TCL is able to maintain its leading position in the industry and is the best performer, both in terms of profitability and market share.

White Goods — The overall performance of other home appliances businesses was far from expectation. Established since 1999, the white goods division has still been at its initial stage of development. Over-optimistic pricing policy and the delay in product rollout largely contributed to the lower-than-expected sales. In the air-conditioner subdivision, higher profit margin of the industry has enticed more players to enter the market. Low level of sales made it difficult for the Group to take advantage of the economies of scale, in particular, when the newly acquired manufacturing facility in Zhongshan went into operation in early 2001. Gross margin of white goods decreased by 5%.

Computer related products — The burst of the internet bubble has led to a worldwide reduction in PC demands. Continuous price cuts caused delay in consumption and sales target was unable to attain. Together with the provision of certain obsolete stock, gross margin was eroded by 5% and the division has made a loss of 17.5 million in 2001. The management believes that the situation is only temporary. We are confident that with the gradual pick-up of the worldwide economy and gradual streamlined flow of sales and operation resulting from a full-scale restructuring of the ERP system and distribution network, the performance of the division will soon have a turnaround in the near future.



Associated Company and Jointly Controlled Entities

- The mobile phone business in which the Group had a 20% stake in 2001 has experienced encouraging results. Unit sales have increased from 220,000 sets in 2000 to 1,250,000 sets in 2001. Share of profits before tax attributed to the Group amounted to HK\$61 million. Subsequent to the year end in January 2002, the Group acquired an additional 10% interest in the mobile phone business. It is believed that the mobile phone business will become the Group's major profit contributor in the future.

Performance of mobile phone business:

	2001	2000
Unit sales (units)	1,250,000	220,000
Turnover (HK\$m)	1,990	254
Gross Margin	34%	16%
Net Margin	15%	2%
Net Profit (HK\$m)	307	5
Net Asset Value (HK\$m)	388	78

- The economy of India and not to mention the television market was badly hit by the disastrous earthquake in January 2001. The performance of our JV in India was further aggravated by the financial difficulties of our JV partner there, which was handling the assembly and distribution and therefore has tremendous impact on the ultimate profitability of the JV. The future of this JV is still under consideration and for prudence sake, a full provision for investment in the amount of HK\$8 million is made. In addition, trade receivable from the JV partner in the amount of HK\$38 million is fully provided and included in other operating expenses.

- The Group's another major joint venture — Henan TCL Melody Electronics Co., Ltd was able to turn around from its previous loss-making position recorded as in 2000. With the production of the more-profitable 29 inches TVs, gross margin as well as overall results were improved.
- Other newly invested joint ventures such as the distance learning projects, the compressors manufacturing factory were still at their initial stage of development with no profit contributions to the Group.

Liquidity, Financial Resources and Borrowings

With the Group's efficient management of resources, financial position of the Group remains healthy. Cash on hand amounted to HK\$1 billion of which HK\$63 million was pledged as security for trade finance facilities in the PRC. Bank loans reduced by HK\$100 million to HK\$30 million.

During the year, a total of 105,619,289 shares were issued at a price of HK\$1.78 per share as partial consideration for the acquisition of the Group's PC business from our holding company. Apart from the above, there was no major equity financing during the year.





production

quality

Through an ongoing process of diversification, TCL has established its wide range of home appliances with advanced digital functions. As the leading home appliance manufacturer in China, TCL's products bring every Chinese consumer in contact with digital information conveniently and in the comfort of their homes.

