



Management

Discussion and Analysis

Operating Review

Double-digit growth in turnover; significant profit improvement

The year 2001/2002 marked the beginning of the Group's harvest from its strategic business restructure in 2000. Securing a leadership in display technology, the Group reported a record increase of 26 per cent in turnover to HK\$5.6 billion and returned to black for the year, posting a net profit of HK\$62 million against a net loss of HK\$61 million in the previous year.

Management Discussion and Analysis

During the year, the Group successfully managed the adverse economic conditions and hostile competition in the television (“TV”) market in particular during the first half of the year. The Group has explored the business opportunities by diversifying its businesses into the manufacture and sale of multimedia and IT-related products through the restructuring of its operations into six major subsidiaries, which specialise respectively in TVs, multimedia products, display products, computer and network products, broadband technology products and IT-related solution. Each business unit has its distinctive focus and is able to implement tailor-made development plans and marketing strategies to cater for the specific needs of different target markets.

Strong research and development (“R&D”) capabilities and efficient cost management also contributed to the Group’s significant profit improvement. Over 180 new products were introduced by the Group during 2001/2002 year. In addition, continued product improvement succeeded in bringing down the cost of goods. As sales went up due to improved market conditions and seasonal adjustments in the second half of the year, the Group succeeded in increasing its gross profit for the entire year by 17 per cent to HK\$782 million.

For the year, the Group reduced its selling and distribution expenses by 8 per cent to HK\$549 million, largely due to enhanced efficiency after a sales operation restructure and the Group’s decisive mix of domestic and overseas sales. Although China remained the Group’s largest market, accounting for 81 per cent during the year under review, overseas sales contribution increased by 64 per cent to 19 per cent of the Group’s total turnover. As the majority of the Group’s overseas business is involved in original equipment manufacturing (“OEM”), original design manufacturing (“ODM”) and private label production, distribution expenses, excluding logistics cost, and overheads could remain rather low. However, the change in the mix of sales contributed to a decline in Group gross profit margin by $\frac{1}{4}$ percentage points for 2001/2002 year, as the Group’s OEM activities have comparatively lower margins than the sale of its brand-name products.

General and administrative expenses for the year rose by 10 per cent to HK\$188 million. The increase was largely due to a provision of HK\$9 million to write off the technical know-how with respect to the computer business operation that the Group had decided to close down due to intensified competition and unfavourable market conditions.





China Business

TV

Turnover of the Group's TV operation in China was HK\$4.3 billion, representing an increase of 12% per cent from that of the previous year and accounting for 78% per cent of the Group's total turnover. Sales volume for the year also increased by 34 per cent to 3.6 million units. In fact, Skyworth's growth rates in sales volume and turnover ranked the first in China's TV industry by the end of 2001, according to the Ministry of Information Industry of the PRC. Against such an astounding growth performance, the Group became the third largest TV manufacturer in China.

The astounding operating results of the TV operation were the result of the Group's successful market segmentation strategy and an outstanding sales team, which enabled the Group to expand its market coverage. The Group's higher end TV and bigger size model is targeting the urban cities, whereas the lower end to mid range TV is for the rural cities. On

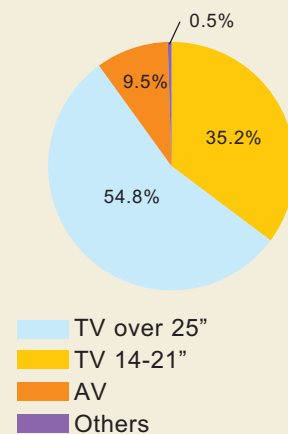
the other hand, the high end and larger size TV such as rear projection ("RP") TV is mainly focusing on the trade and educational markets.

In the first half of the year, sales volume and turnover from the Group's China TV operation were 1 million units and HK\$1.3 billion. During the interim period, the Group has to lower its price owing to the occurrence of price war in the TV industry. The management has also taken actions against the

substantial portion of older inventories by reworking some of the models, which may only appeal to specific Group of customers; offering deep discounts on unpopular models and outright disposal of some of the obsolete electronic parts, which had significantly improved inventory level. Subsequent to price reduction and an inventory write-off provision, the gross margin from the TV operation in China was 14 per cent. As the market became consolidated in the second half of

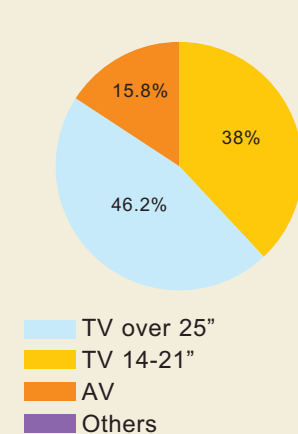
Product Mix in mainland China Market

2002 product Mix



Product Mix in mainland China Market

2001 Product Mix



the year, prices began to stabilise. The traditional peak season for TV sales, which usually takes place before the Chinese New Year and the advent of the World Cup also contributed to a favourable market environment in the last six months of the year. Capitalising on these improved market conditions, the Group's strategic launch of new products and effective distribution network succeeded in substantially raising sales volume and turnover to 2.5 million units and HK\$2.9 billion, respectively, in the second half of the year.

After the Group reorganised its businesses, the TV unit began to fine-tune its sales operation and strengthen R&D capabilities to meet its priorities. During the year, the Group launched 36 new TV products through its TV unit and display products unit. In particular, the Group was the first to mass launch the pure flat TV series, progressive scan TVs, LCD TVs in



• China Business Sales & Distribution network

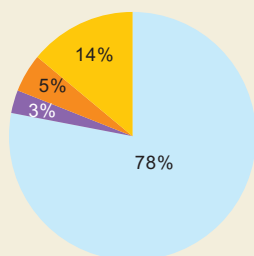
China. Pure flat TV now becomes the best seller of the Group. Turnover from this product accounted for 25 per cent of the Group's overall TV sales in China during the year, and increased by 14 times as at the end of 2001 from its debut in late 2000.

Sales and distribution network

The Group's sales and distribution network comprises 144 sales offices with over 4,000 sales staff, more than 2000 distributors and 10,000 retail outlets. Every sales member receives formal training of marketing as well as technical knowledge. Because of their deep market insights and good relationship with distributors, they enable the Group to make timely response and strategic positioning decision to sweeping market changes. In addition, the continued implementation of sales target and incentive scheme had also significantly propelled sales members and distributors to increase sales.

Sales Revenue Breakdown

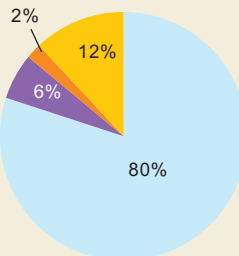
2002 Revenue



- TV - Domestic
- TV - Oversea
- AV - Oversea
- AV - Domestic

Sales Revenue Breakdown

2001 Revenue



- TV - Domestic
- TV - Oversea
- AV - Oversea
- AV - Domestic

AV products

Sales of AV products in the China market were HK\$160 million, representing decreases of 28 per cent from those of the previous year. The sales decline was largely due to severe price competition, which was partly offset by the introduction of 100 new items of five product lines. During the year, the Group's AV products sold in China represented 33 per cent of its total AV product sales, down from 76 per cent in the previous year.

TV

TV sales volume in overseas markets rose by 74 per cent to 1.1 million units, enabling the Group to remain as the largest TV exporter in China for the eighth consecutive year. According to the PRC's Ministry of Information Industry, the Group now enjoys a market share of 11 per cent share in China's TV export sector. Turnover also increased by 33 per cent to HK\$700 million and accounted for 14 per cent of the Group's total TV sales. During the year, 25 new TV models were introduced.

models to its overseas clients, a provision of variety choice of models is one of the main reasons for a high sales growth of the Group.

Other Business

IT-related products

Broadband Business

This business line focuses on the development of integrated services digital network ("ISDN") products, asymmetric digital subscriber line ("ADSL") products, and digital



Overseas Business

Following the Group's business restructuring, a multi-media product unit was set up for the operation of the Group's overseas activities and all AV product sales. Since we have over 10 years of overseas business experience, in addition we have provided variety of model choice with quality sales service, the multi-media product team succeeded in expanding the Group's overseas clientele by 25 new clients and increasing orders by 20 per cent, when compared with those of the previous year.

The Group signed 9 clients and expanded new markets to Japan, Korea and Western Europe in the first quarter of 2002/2003.

AV

Overseas sales of digital AV products increased thrice over HK\$300 million, with those of DVD players achieving the highest growth of 400 per cent. The multi-media product team succeeded in seizing the opportunities for timely launch of DVD players in new emerging markets. During the year, the Group introduced 20 new AV

information and video broadcasting ("DVB") set-top boxes ("STB") for the household market.

The Group had developed five new digital information and video broadcasting set-top boxes with leading technology for its project clients in China and other overseas market, including Indonesia, Vietnam and Australia. The Group's major clients for set-top boxes are mainly cable TV operators and TV stations.



• Exchange R&D ideas between staff



• Fully automatically digital products production in progress

To increase the competitiveness of broadband business, the Group had decided to merge it with the TV operation. The consolidation is expected to produce synergetic effect on both businesses.

Information Technology

Pursuant to the collaboration projects with Jiangsu provincial Administrations for Industry and Commerce (“AIC”), the Group had completed the IT infrastructure, including the set-up of an internal information system for the AICs. The systems will be ready for commercial launch by the end of 2002.

Personal Computer (“PC”) Business

Facing weak market sentiment in the PC sector, a market research spanning over nine months had been conducted. The findings suggested a persistent unfavourable market environment, under which the Group could only operate on low margins. After due consideration, the Group

believed it would be in the best interest of the shareholders to close its PC operation and focus its resources on the higher-margin TV business. As at the end of the year under review, the PC business had ceased operation.

R&D

R&D has been playing an instrumental role in the Group’s ability to achieve quick response to market change and to tighten cost control. The research teams of all business units together introduced a total of over 180 new products during the year. In addition, through continued effort in research and upgrading existing products, the research team from TV operation succeeded in developing a lower-cost chasis – an integral component for making a TV set, which had greatly reduced the cost of TV production.

To further strengthen its overall R&D capabilities, the Group spent up to date HK\$76 million to build the Shenzhen Research

and Development Centre at the Shenzhen High Technology Park. Construction work had been completed and the Group intended to move its research teams to the centre by the third quarter of 2002. The new location will allow the Group’s R&D force to exchange latest technological and product information with researchers from other resident institutions and companies.

Financial Position

The Group’s financial position remained sound and healthy. Its cash and bank balances as at 31 March 2002 were HK\$1,172 million, compared with HK\$1,516 million as at 31 March 2001. Inventory turnover for the year stood at 58 days, improved from 74 days of the previous year. Accounts Receivables turnover were 61 days for the year under review, compared with 52 days of the year 2000/2001. The quick ratio of the Group stood at 1.9 as at 31 March 2002, against 2.3 as at the end of the previous year.



• Factory in Gongming, Shenzhen

As at 31 March 2002, the Group's bank borrowings amounted to HK\$73 million, significantly increased from HK\$20 million as at 31 March 2001. This was mainly due to the Group's healthy cash position as well as its effort in keeping low-level of borrowings to avoid high interest payments. The Group's shareholders' fund stood at HK\$2,152 million, against HK\$2,184 million as at 31 March 2001; its gearing ratio stood at 3.4 per cent as at 31 March 2002, compared with 0.9 per cent as at 31 March 2001.

Most of the Group's business transactions are made in Renminbi and in US dollars, and all assets and liabilities are denominated either in Renminbi, Hong Kong dollars or US dollars. The Group, therefore, believes it is not subject to substantial foreign exchange risk.

Future Prospects

The Group's success has been the result of its business restructuring and R&D

capabilities, which have earned the Group the leading position in display technology. In the new fiscal year, the Group will continue to enhance its R&D competency and will move its research teams to the new research centre, which it hopes will facilitate technological exchanges between its research force and other resident research institutions and high-tech companies.

With the dedicated efforts of its R&D teams, the Group plans to roll out more new products in the coming year. Fifty TV products, 360 AV products and nine digital set-top boxes are in the pipeline. The Group intends to introduce more new digital products and high-end TVs like RP TV, HDT Ready TV, Plasma TV and LCD TV in the China market in August 2002. It will become the first to mass launch such products in China. As a standardization in digital broadcasting in China is expected by 2008, a demand for digital display product and set-top box will therefore be

increased. Another focus of the R&D force will be on lowering production cost through new technology and product development.

To accommodate rapid sales growth, the Group has constructed a new factory for the production and export of Plasma TV, TFT TV and AV products in Gongming city of Shenzhen in the PRC. To further enhance its production capacity, the Group has acquired a piece of land with an area of 350,000 square metres in Shi Yan of Shenzhen for the establishment of an additional plant. Phase one construction work of the Shi Yan factory will commence in the fourth quarter of 2002.

Cost management and sales incentive schemes will continue to be implemented in 2002/2003 year. As each of the business units is operating as a profit centre, they are in a better position to fully utilise their resources to achieve its business and sales objectives. Moreover, the Group expects to

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enjoy improved operation efficiency and inventory control brought forth by the enterprise resources planning (“ERP”) system it is going to establish in the fourth quarter of 2002. In the new year, the Group will continue to expand and solidify its sales network in China, as well as to tap into new overseas markets.

The Group is expected to explore more business opportunities and cooperation with both international and domestic mainland China enterprises in the future. Recently, the Group has signed the cooperation agreement with leading Japanese and Korean multi-national corporations. The partnership is expected to create synergetic effect on both businesses.

Capitalising on its strong financial position and competencies, the Group is looking ahead with enormous room for expansion. In China, market conditions for TVs have improved after a period of consolidation. Currently, the four leading TV manufacturers in China account for 67 per cent market share. The Group believes its R&D strengths, efficient sales and distribution network and stringent cost control will enable it to leap from the third largest to even higher position. Moreover, demand for digital display products and set-top boxes are expected to continue to rise as digital broadcasting may eventually prevail in China.

The Group is expected to reap profits from the growth potential of each target market via its market segmentation strategy. According to the PRC’s Ministry of Information Industry, the cities in general are projected to experience 5 per cent annual growth, and 15-20 per cent in the rural areas. As the second consumption revolution in China is underway (the first one occurred in 1990), demand for TVs is expected to rise tremendously. The trade and educational markets, on the other, are up-and-coming markets for RP TVs. Being the pioneer in this market, the Group has the advantage of establishing a firm foothold that will allow it to capture a critical market share.

Outside China, the Group has the advantage of being an export veteran and quality OEM and ODM services. The Group was awarded the Japanese Quality Assurance Approval by Ministry of Economy, Trade and Industry “METI” for three export production lines. These, together with launch of new products such as RP TVs, digital set-top boxes, will help the Group secure more orders, from its new clients from Japan, Europe and Korea.

