

MANAGEMENT DISCUSSION & ANALYSIS



2002 REVIEW OF OPERATIONS

During the year under review, the Group was deeply committed to developing the 3Cs core businesses — Consumer Electronics, Communications and Computers. All the three businesses, especially TVs and mobile phones, the two major revenue and profit contributors, achieved encouraging results, further consolidating the Group's leading position in the PRC market.

Television Business

According to the statistics compiled by the Ministry of Information Industry¹, TCL was the best selling TV brand in the PRC. The Group adopted a strategy of reaching out comprehensively to all corners of the market and strengthening its position in the high-

end market while maintaining its foothold in the mid-end market. The Group also expanded its market share, predominantly by leading the low-end market through competitive pricing. A total of 6.75 million television sets were sold in the PRC in 2002, attaining growth of 22% compared to the same period last year. As a result of our continuous inventory control efforts, coupled with the downward price adjustment of components, the gross profit margin increased to 21%.

Product research and development has always been one of the Group's core focuses. The Group met market demand in 2002 by rolling out a diverse range of 50 new products. These included PDPs (2 models), HiD rear projection TVs (8 models), HiD TVs (12 models), Audio TVs (15 models) and Games TVs (5 models).

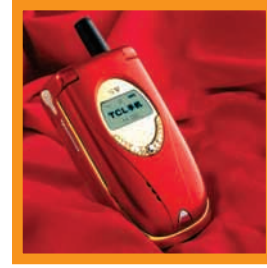
In general, domestic brands made further international inroads in 2002, accelerating the pace of overseas expansion. The strong growth in TV exports drove the PRC TV industry towards a gradual recovery. Price competition eased, and inventories of the entire industry were also reduced to a reasonable level. As well, the domestic TV market consolidated as small players retreated from competition. On the other hand, domestic brands are facing increasing challenges from overseas brands. Market competition shifted towards the high-end products. While the price of standard TV models remained stable with a minor downward adjustment, pure flat and TV models with progressive scanning features experienced rapid growth and captured an increasing proportion of market share.

Devoting additional resources to high-end products will be our key focus in 2003. The Group will also maintain its competitive edge in mid-range products and retreat from selective lower priced products. We will also cater to the needs of different market segments, such as home and commercial users. By increasing the pace of product rollout, a total of 50 new products, which included high-end models such as PDPs, rear projection, and LCD TVs, the Group aims to capture an even larger share of the market.

Unit Sales Comparison

	2002 (in'000)	2001 (in'000)	Growth	2002 preset sales target (in'000)	Completion rate
TVs — PRC	6,753	5,552	+22%	6,000	113%
TVs — Overseas	1,299	740	+75%	1,000	130%
Mobile Handsets	6,236	1,247	+400%	5,000	125%
PCs	376	201	+87%	300	125%

¹ For the first eleven months in 2002.



PC Business

Despite the gradual recovery of the PC market, market-demand was far from strong. According to the market figures announced by IDC¹, the desktop PC market recorded a growth of only 12%, and the average unit price declined further during the year.

Under the shadow of such an operating environment where the market had yet to recover, TCL with a proper product position in place successfully expanded its market share in the educational PC sector. Total sales reached 376,000 sets in 2002, representing an increase of 87%. The gross profit margin has also remained relatively stable. With sales exceeding the preset targets, the PC business turned around during the year.

TCL's ranking in the PC market was also relatively stable. It is now the third best selling consumer desktop PC brand and ranked fourth among all domestic players in the PRC. The rapid growth in 2002 narrowed the gap between TCL and other leading players, while increasing the distance between those competitors lagging behind.

The Group launched six new series of PCs. Among the new products rolled out during the year, the high-end home PC series that offer TV functions, such as the "Rui Xiang 7000", as well as the digital PC series, such

as the "Rui Li 500", have emerged as the dominating products. In the commercial PC market, the Group introduced "精鼎"、"精致"、"税通" series which were targeted at education, e-commerce and medium enterprise sectors. These series recorded solid sales.

Moving into 2003, the operating environment is expected to improve gradually, but it will be a difficult time for small and medium regional brands as they will face increasingly tough challenges in the marketplace. Meeting these new challenges, the Group has integrated its new strategies in the upcoming operations plans. We will expand our distribution channels for educational and industrial applications and increase resources utilisation to ensure the accomplishments of our growth targets by streamlining the processes of marketing, distribution, point of sales as well as supply chains. Our target customers are mid-income group families and families in the third or fourth tier cities. Under the marketing theme of "fitting customers' needs", TCL aims to provide quality and competitive products and services to achieve even better sales results.

Mobile Phone Business

The growth of the mobile phone business was extremely encouraging in 2002. A total of 6.24 million handsets were sold during the year, representing fourfold growth, truly

exponential. According to the latest monthly report² CCID, TCL handset achieved a market share of 13% and an average of 10% market share for the whole year, outperforming other players amid keen competition.

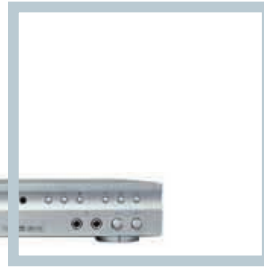
The Group continued to enrich its products lines from medium to high-end products to lower priced mid-range products to attract customers in different market segments. Although the gross profit margin decreased from 34% to 27%, the overall profitability increased satisfactorily as a result of stringent cost controls and encouraging sales of the "3" series, among which sales of model "3188" were particularly impressive. Inventory was maintained at a healthy level.

In view of the positive outlook of the mobile phone business, the Group acquired additional equity stake in TCL Mobile twice in 2002, increasing its interest from 20% to 40.8%. The acquisition has broadened the Group's earnings base, enabling shareholders to enjoy better returns.

The Group continued to increase R&D investment during the year. Possessing a highly competent R&D team, the Group's product design capabilities were greatly enhanced, resulting in a shorter product development cycle. As fast growing as the market was, the Group seized the opportunities and launched 20 new models during the year under review.

1. *Figures up to the third quarter of 2002.*
2. *Statistics for December 2002.*

MANAGEMENT DISCUSSION & ANALYSIS



We anticipate that the market will continue to enjoy further growth in 2003. Market competition will intensify as foreign brands increase investment in the market and as an increasing number of domestic handset manufacturers enter the market. To cope with the keen competition, the Group plans to further increase R&D investments, while controlling costs to maintain its competitiveness. We will continue to differentiate ourselves from other players by the pioneering gem stone design concept. Enriching products lines and speeding up the pace of new product roll-outs, the Group also plans to capitalise on market opportunities to enlarge its market share through the introduction of colour screen handsets and mobile phones with trendy designs and camera features.

AV Business

Competition in the AV industry was still fierce. Although the AV business has not yet contributed to profits, product competitiveness increased in the second half of 2002 following a full year of internal adjustments. As a result, the product outlook, functions and qualities were adjusted to suit the needs of the mainstream market.

The Group sold a total of more than 550,000 DVD/VCD players in 2002, representing an increase of 59% compared to 2001. Our market share was slightly increased. TCL performed particularly well in certain regions such as Guangzhou, Beijing, Shenzhen,

Jinnang, etc. with satisfactory sales performance. Four new products series, totalling 11 models, were launched in 2002, including "TD-C2P", "FP" series, "F6" series, "F6P" series. Amongst these products, the first vertical stand DVD player brought the greatest impact to the market. In addition, the "F6" series, our key product, accounted for more than 50% of the revenue from this business.

Looking forward to 2003, market competition will shift from primary price reduction to brand differentiation. Consumers will pursue high-end products that are typically thinner and smaller in size and incorporated with personalized features. As such, the Group will introduce 15 new DVD models, some of which include DVD ultra thin players, touch screen DVD players, DVD recorders, audio DVD players, PS-DVD players (capable of reading 32-digit games, with PSI disc) etc. Additionally, the Group will foster a closer alliance with its back-end sales outlets and offer effective support to transform the sales mode of DVD players, speed up the development of professional channels, and implement focused, well-planned promotion strategies for individual regional market. In leveraging our existing sales platform and customer resources, TCL will continue to introduce products appealing to customers to increase the penetration and scale of operations of AV products. Our aim is to develop a professional image for the AV business and increase the market share of DVD players.

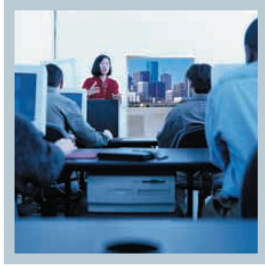
Information Technology Business

With regard to the network devices business, the Group devoted its efforts to the development and marketing of mid-to low-range exchange switches. Total sales increased 1.15 times in 2002, with share of 3.5% in the China market. Performance indicators such as the cash conversion cycle and operating efficiency improved considerably compared to the previous year.

Stepping up R&D efforts, the Group launched a total of six new models. Internally developed products accounted for 35% of the total products launched in 2002.

The distance-learning education business also turned around during the year under review. The number of students for the programme jointly run by the Group and the China Central Radio and Television University ("CCRTU") reached 160,000. The network covered primary and secondary cities throughout the nation. Meanwhile, the Group also developed the "Digital Campus" programme which is part of the IT project of the western part of China sponsored by the Ministry of Education of the PRC.

The Group expects that China's overall investment in information technology will continue to increase. The network devices market will also grow steadily. In pooling its resources, the Group is on the lookout for opportunities with promising growth. We will



emphasize the practical usage of mid and low-range products and enrich mid to high-end product lines to establish an all-around capability in the construction of large-scale regional networks, especially for tertiary institute campus networks. We also intend to increase the proportion of in-house developed products. Our goal is to launch 12 new products in 2003.

Overseas Business

The Group refined the organisational structure of the overseas division in 2002. A preliminary integrated support platform covering sales, procurement and production management was set up to cater to market and customer needs. Operational efficiency was further increased.

In 2002, TCL Overseas achieved sales of 1.3 million TV sets and 220,000 DVD players, representing growth of 75% and 87% respectively compared to the previous year.

TCL brand products were still targeted at Southeast Asia. Sales in Vietnam, the Philippines and Hong Kong grew more than 30%. TCL was the top-five best selling TV brands in Vietnam and the Philippines. We also increased our efforts to explore new emerging markets in 2002, with sales in Russia and Korea for example recording good performance.

Not only is 2002 a year of rapid growth for our overseas business, it also provided solid

ground for 2003. We anticipate that in 2003, growth will come primarily from Europe and South America.

The acquisition of major assets of Schneider in 2002 has paved the way for our future expansion in Europe. We have also established a new office in the city of Miami, the US, to tap the South American market. Our goal is to establish our presence and acquire a stable market share for TCL brand products in South America within two years. As to Russia, we are actively exploring opportunities for different forms of co-operation. We will further strengthen our position established in 2002, and seek partners with whom we can develop long term cooperation to jointly boost sales of TCL brand products in the Russian market.

White Goods Business

As affected by the clearance of stocks and severe market competition in 2002, the performance of the white goods business was not satisfactory. A loss of HK\$71 million was recorded for the year under review. In 2002, a total of 243,000 sets of refrigerators were sold, representing growth of 38%; sales of washing machine amounted to 485,000 sets, growth of 21%; and sales of air conditioner reached 341,000 sets, a growth of 109%. The gross profit margin of the division slipped 7% to 12% in 2002.

In line with the Group's strategy of developing 3C businesses, the Group sold

its white goods manufacturing business to TCL Corporation, its parent company, in December 2002, resulting in a profit on disposal of HK\$8 million.

Research and Development

The Group is dedicated to bettering its products through research and development in enhancing its competitiveness. During the year under review, the Group achieved fruitful results in R&D. The TV business focused on the development of high-end products and optimisation of low-end products, to attract different customers.

Regarding the high-end TV market, the Group placed its emphasis on three main directions, namely the Plasma Display Panel TV, (PDP TV), Liquid Crystal Display TV (TFT-LCD TV), and Rear Projection TV (RPTV). The results of these developments were satisfactory.

In the development of PDPTV, TCL is the first player in the PRC to acquire PDP core technology. The Group successfully developed its own PDP driving circuitry, separate power supply for plasma display panel and digital video interface. All these innovations effectively lowered the cost of production. Dr. Yan Xiaolin of TCL Group is appointed as the program leader of PDP Testing Program of the International Engineering Consortium. He is the only Chinese expert participant to define international standards of PDP technology.

MANAGEMENT DISCUSSION & ANALYSIS

In 2002, TCL Group put more effort in the development of Rear Projection TV, which significantly increased the Group's market share in this product category, making TCL the number two brand in the PRC. TCL developed the internationally advanced state-of-the-art HiD435B.r HiD Rear Projection TV high, equipped with advanced technology such as progressive scanning, high clarity, compatibility and Internet access. The Group also launched the first HiD Rear Projection TV equipped with 85 Hz progressive scanning with full brightness control in the PRC and internationally advanced LCOS Rear Projection TV.

In addition, the Group has developed products such as LCD TV, combined LCD TV/DVD product and LCD monitor, as a preparation of exploration of the future LCD TV market.

Looking at the low-end TV market, the Group will improve product outlook, optimise circuit designs, minimise manufacturing cost, and effectively boost its low-end market share.

FINANCIAL REVIEW

Results and Performance

Performance Indicators

	2002	2001
Gross Margin	18%	18%
Net Margin	5%	3%
Return on Equity	16%	10%
Current Ratio	1.5	1.6
Interest Cover	45	17
Debt/Equity Ratio	0.21	0.01
Inventory Turnover	94 days	94 days
Account Receivable Turnover	31 days	36 days

Overall Performance

The year 2002 was one of exciting financial results. The Group benefited from strong economic growth in the PRC. The formulation of effective business strategies led the Group to make further inroads in overseas markets. With its efficient manufacturing system, nationwide distribution and service network throughout the PRC, the Group is on the road to success.

The Group's consolidated turnover in 2002 exceeded HK\$10 billion for the first time, reaching HK\$12.2 billion, which represented an increase of 27% over the previous year. While TV remains the major revenue source, the Group has successfully reduced its reliance on the PRC market. Turnover derived from overseas exports increased 82% to HK\$1.2 billion, representing 10% of the Group's consolidated turnover (2001: 7%).

In addition, the Group brought in a new profit driver through the investment in its joint venture company, TCL Mobile. TCL Mobile's contribution accounted for 50% of the Group's net profit in 2002 (2001: 21%). In achieving a remarkable growth in revenue during the past three financial years, TCL Mobile is the fastest growing technology company according to the first of its kind compilation, the "Asia Pacific Technology Fast 500" programme hosted by Deloitte Touche Tohmatsu.

The financial performance of the principal businesses of the Group are discussed in details as below:

Gross Profit Margin Comparison

	2002	2001	Change
TVs – PRC	22%	19%	+3%
TVs – Overseas	11%	11%	–
Mobile Handsets	27%	34%	-7%
PCs	9%	7%	+2%

Televisions

TCL maintained its leading position in the PRC TV industry. Sales increased 28% to 8.1 million units in 2002, of which 6.8 million units (2001: 5.6 million units) were sold in the PRC, while the remaining 1.3 million units (2001: 0.7 million units) were exported overseas under the TCL brand or on an OEM basis.

The operating environment of the TV industry in the PRC improved as a result of the increasing demand from export markets. As local manufacturers utilised their spare capacity to manufacture TV sets for export, the supply-demand position in the PRC moved closer to equilibrium. This greatly eased domestic competition among major players.

Benefiting from this favourable market change, coupled with reduction of CRT costs, the overall gross margin of the TV business increased from 19% in 2001 to 21% in 2002. Export sales will be a major growth driver in 2003, on the back of acquisition of major assets of Schneider and certain newly secured strategic OEM alliances. Overall prices and margins are expected to remain stable.

PCs

The Group's PC business experienced a turnaround in the third quarter of 2002 and made a profit. During the year under review, in addition to targeting home PC users, the Group took active steps to promote TCL brand PCs to the consumer sector as well as to educational institutions. Additional resources and attention were allocated to promotions in second-tier cities in China. This strategy has proven to be highly successful, with shipments increasing 87% to 376,000 units. Despite a decrease in average sales prices, both gross profit and operating profit did not drop due to better economies of scale, effective ERP system, mature supply chain management and improvements made in the manufacturing and distribution process. The business therefore turned profitable.

White Goods

The Group entered into a disposal agreement with its parent company for the disposal of the loss-making White Goods Division. Disposal was completed in December 2002. On completion, a gain on disposal in the amount of HK\$8 million was recognised.

Stock provisions were made to write down the goods to its net realisable value. The gross margin, therefore, decreased from 19% in 2001 to 12% in 2002.

Mobile Phones

2002 has been a year of excitement for the Group's mobile phone business. While television remained the Group's backbone product, mobile handset business was the key growth driver in 2002. Sales surged by 400% to 6.24 million units. The contribution from the mobile phone business represented approximately 50% of the Group's total net profit.

This exciting business is run by the Group's 40.8% owned joint venture company TCL Mobile. More than 90% of the Group's contribution from jointly-controlled entities was derived from TCL Mobile and its subsidiaries ("TCL Mobile Group"). A summary of the performance of TCL Mobile Group for year 2002 is listed out as follows:

Performance Indicator — TCL Mobile

	2002	2001
Gross Margin	27%	34%
Net Margin	15%	15%
Return on Equity	75%	80%
Current Ratio	1.5	1.3
Interest Cover	76	51
Debt/Equity Ratio	0.04	0.02
Inventory turnover	90 days	91 days
Trade receivable turnover	4 days	12 days
Unit Sales	6,236,000	1,247,000

MANAGEMENT DISCUSSION & ANALYSIS

To further expand the market share, the Group actively broadened its product lines from high-end products to mid-range products. As expected, the gross margin for mobile phones decreased from 34% in 2001 to 27% this year. With proper corporate strategies in place, however, adverse effects of the gross margin reduction were mitigated by improved economies of scale. In addition, as a pioneering mobile handset manufacturer, TCL successfully developed chip-set based manufacture. In command of a higher technology level, the Group effectively lowered production cost as the cost of chipsets is lower than that of modules.

Despite the increasingly competitive environment, the Board is confident that this business will continue to stay ahead of the competition through various measures. Continuous improvements in the product mix will secure further market share and economies of scale should continue to improve. Further, the increased internal production of key components will have the benefit of both cutting production and logistics costs, and enhancing the components' quality control and availability.

Significant Investments and Acquisitions/Disposals

Taking proactive steps to enhance its earnings potential, the Group made a series of investments and acquisitions/disposals during the year under review. The major moves made during the year are summarised as follows:

(a) In January 2002, the Group increased its equity interest in TCL Mobile from 20% to 30% through an acquisition of an additional 10% equity interest in TCL Mobile at a consideration of approximately HK\$282.7 million.

In May 2002, the registered capital of TCL Mobile was increased from US\$10 million to US\$29.8 million, of which US\$2.98 million was contributed by Cheerful Asset Investment Limited, a company controlled by the management of TCL Mobile, in return for a 10% equity interest in TCL Mobile. The remaining amount was contributed by the existing shareholders of TCL Mobile through the capitalisation of dividends from TCL Mobile. As a result of the transaction, the Group's interest in TCL Mobile was diluted from 30% to 27%.

In November 2002, the Group acquired a further 13.8% interest in TCL Mobile for a cash consideration of HK\$764.9 million, increasing its stake in TCL Mobile to 40.8%. The consideration was funded partly by the net proceeds from the issue of convertible notes in the amount of approximately HK\$350 million, and partly from bank borrowing of HK\$400 million. The nominal remaining balance was financed by internal resources.

(b) In view of the highly competitive nature of the white goods business, and the fact that this business did not fit into the Group's 3C strategy and its long-term goal of becoming a leader of infotainment/multi-media device provider, the Directors consider that it is in the interest of the Company to terminate the white goods manufacturing business.

In December 2002, the Company sold its interest in a number of companies engaging in the white goods manufacturing business to TCL Corporation, the Company's ultimate controlling shareholder, at a total consideration of approximately HK\$54 million.

- (c) In September 2002, the Group formed a joint venture company, "Team Way Limited", with Great Wall Cybertech Limited ("Great Wall") to take over the entire export business of TV and other audio-visual products of Great Wall. The Group owns 70% of the joint venture and Great Wall owns the remaining 30%. The Group's total investment in the venture amounted to HK\$7 million. Subsequent to the year end, the Group further acquired a 30% equity interest in Team Way from Great Wall at a cash consideration of HK\$3 million.
- (d) To accelerate access into the European market, in October 2002, the Group acquired assets, mainly production facilities, inventories, and trademark for a series of brands including SCHNEIDER, from the Insolvency Administrator of Schneider Electronics AG at a consideration of EURO 8.2 million.

All these strategic moves have been made for the long-term benefit of the Group, aimed at broadening its revenue base, enhancing its earnings and increasing shareholder value.

Liquidity and Financial Resources

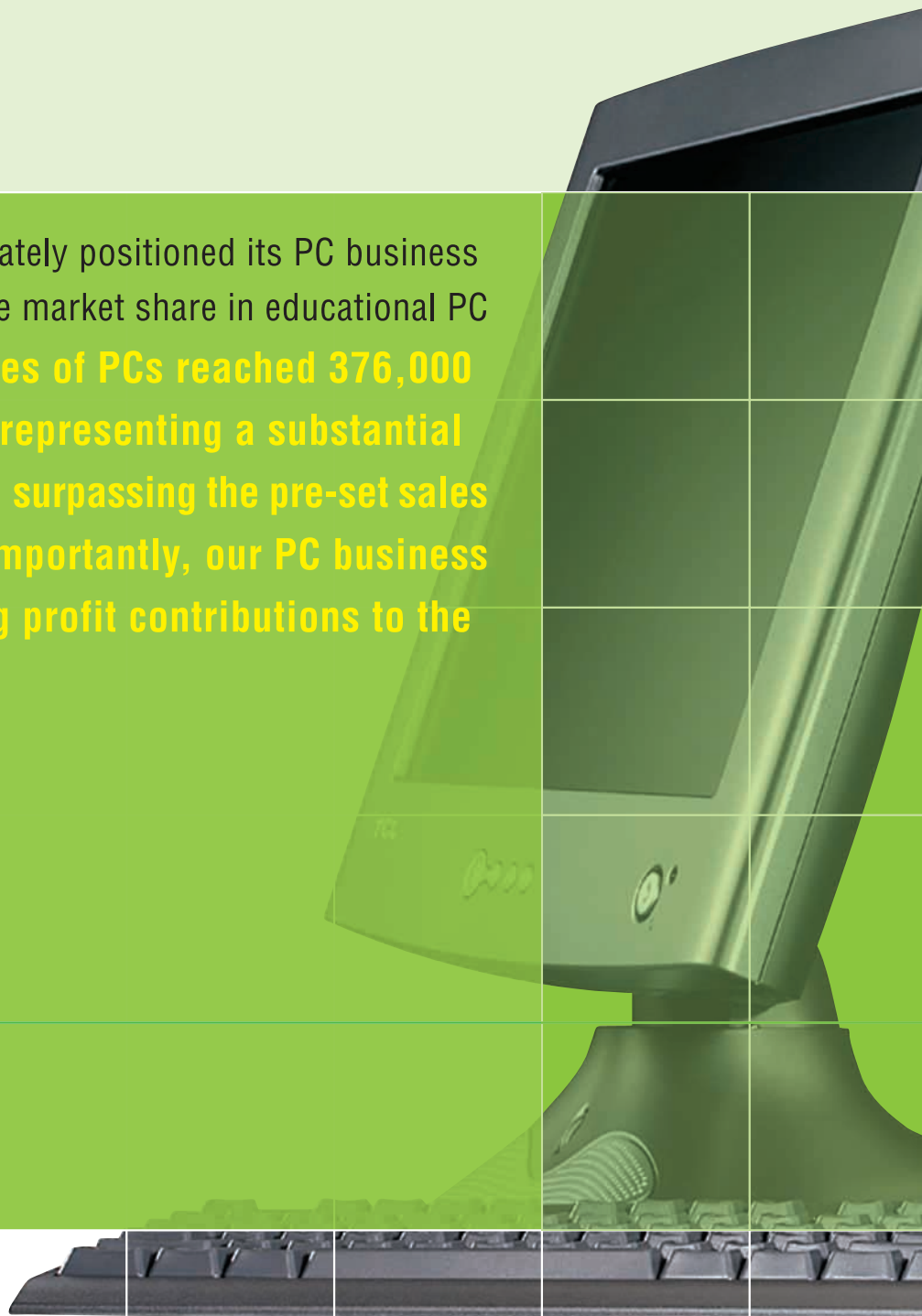
The Group's efficient management of resources has ensured that its financial and liquidity positions remain healthy. The cash and bank balance at year end amounted to HK\$1,183 million of which 21% was in Hong Kong Dollars, 53% was in RMB and 25% was in US dollars.

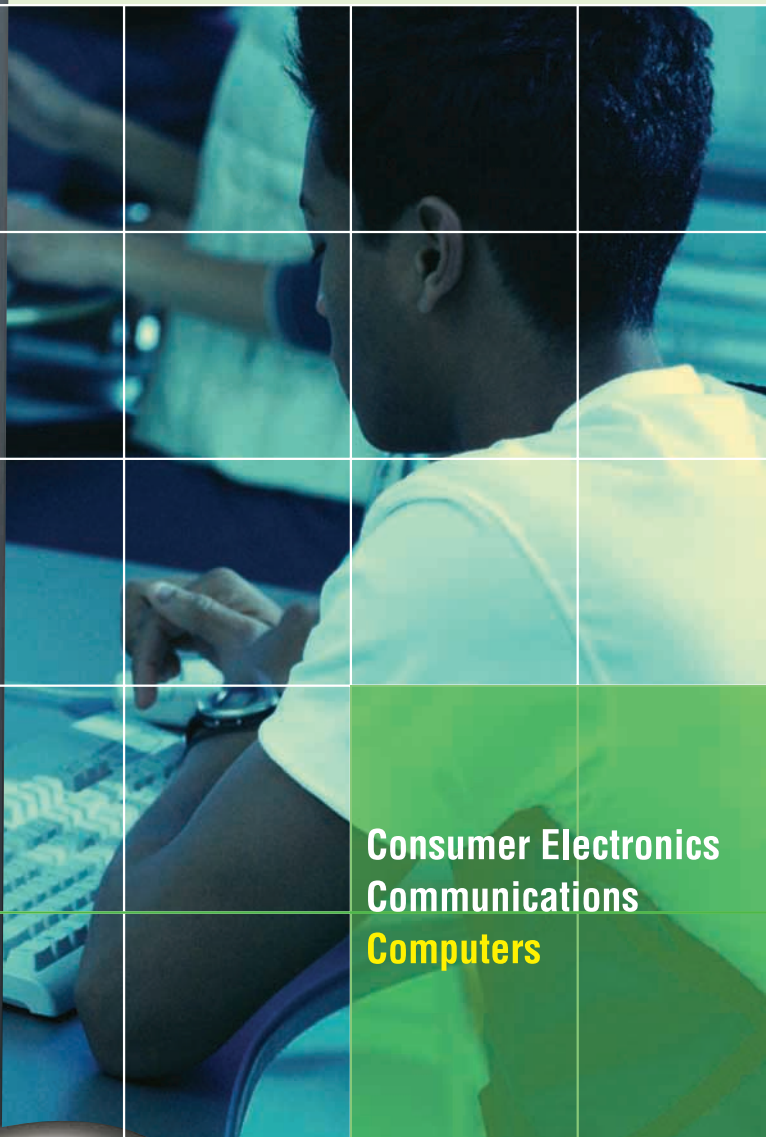
To finance the acquisition of additional interest in TCL Mobile, HK\$400 million long-term bank loan was raised and HK\$350 million convertible notes (the "Notes") were issued. None of the Notes were redeemed or converted during the year. Despite the increase in long-term debt, the debt-equity ratio still remains at a healthy level of 21%. The current ratio of the Group at the year end was 1.5.

There was no major equity financing during the year. A total of 119,779,563 shares were issued pursuant to the exercise of employee share options.

PC BUSINESS

The Group accurately positioned its PC business and expanded the market share in educational PC market. **The sales of PCs reached 376,000 sets in 2002, representing a substantial growth of 87%, surpassing the pre-set sales target. More importantly, our PC business started making profit contributions to the Group.**





Consumer Electronics
Communications
Computers