

REPORT OF THE DIRECTORS

The directors present their report and the audited financial statements of the Company and the Group for the year ended 31 December 2003.

Principal activities

The principal activity of the Company is investment holding. Details of the principal activities of the principal subsidiaries are set out in note 17 to the financial statements. There were no significant changes in the nature of the Group's principal activities during the year.

Results and dividends

The Group's profit for the year ended 31 December 2003 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 48 to 111.

The directors recommend the payment of a final dividend of 10 HK cents per share in respect of the year to shareholders on the register of members on 18 May 2004. This recommendation has been incorporated in the financial statements as an allocation of retained profits within the capital and reserves section of the balance sheet.

Five years financial summary

A summary of the published results and assets, liabilities and minority interests of the Group for the last five financial years, as extracted from the audited financial statements and adjusted as appropriate, is set out on page 112. This summary does not form part of the audited financial statements.

Fixed assets

Details of movements in the fixed assets of the Group during the year are set out in note 14 to the financial statements.

Share capital and share options

Details of movements in the Company's share capital and share options during the year, together with the reasons therefor, are set out in note 29 to the financial statements.

Pre-emptive rights

There are no provisions for pre-emptive rights under the Company's articles of association or the laws of the Cayman Islands which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

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Purchase, redemption or sale of listed securities of the Company

Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year.

Reserves

Details of movements in the reserves of the Company and the Group during the year are set out in note 30 to the financial statements.

Distributable reserves

At 31 December 2003, the Company's reserves, including the share premium account, available for cash distribution and/or distribution in specie, calculated in accordance with the provisions of the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands, amounted to HK\$2,458,464,000, of which HK\$272,000,000 has been proposed as a final dividend for the year. Under the laws of the Cayman Islands, a company may make distributions to its members out of the share premium account under certain circumstances.

Major customers and suppliers

The percentages of purchases and sales for the year attributable to the Group's major suppliers and customers are as follows:

Purchases	
— the largest supplier	8%
— the five largest suppliers combined	32%
Sales	
— the largest customer	6%
— the five largest customers combined	9%

None of the directors of the Company or any of their associates or any shareholders (which, to the best knowledge of the directors, own more than 5% of the Company's issued share capital) had any beneficial interest in the Group's five largest customers or five largest suppliers.

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Directors

The directors of the Company during the year and up to the date of this report were:

Executive directors:

Li Dong Sheng, Tomson (Chairman)

Yuan Xin Cheng (Vice-chairman)

Lu Zhong Li

Hu Qiu Sheng

Yan Yong (designated as Managing Director on 2 March 2004)

Suen Hay Wai (appointed on 10 January 2003)

Non-executive directors:

Wong Toe Yeung (resigned on 19 July 2003)

Hon Fong Ming*

Albert Thomas da Rosa, Junior*

* Independent non-executive directors

In accordance with article 116 of the Company's articles of association, Madam Lu Zhong Li and Mr. Yan Yong will retire by rotation and, being eligible, will offer themselves for re-election at the forthcoming annual general meeting.

All non-executive directors will cease to hold such office at the conclusion of the forthcoming annual general meeting and, being eligible, will offer themselves for re-election at the forthcoming annual general meeting.

Directors' and senior management's biographies

Biographical details of the directors of the Company and the senior management of the Group are set out on pages 28 to 31 of the annual report.

Directors' service contracts

No director proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

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Directors' interests in contracts

None of the directors or their associates had a material interest, either directly or indirectly, in any contract of significance to the business of the Group to which the Company, or any of its subsidiaries, holding companies or fellow subsidiaries was a party during the year.

Directors' and chief executive's interests and short positions in shares, underlying shares and debentures

At 31 December 2003, the interests and short positions of the directors and chief executive in the share capital, underlying shares and debentures of the Company or its associated corporations (within the meaning of part XV of the Securities and Futures Ordinance (the "SFO")), as recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO, or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies, were as follows:

(i) Long positions in ordinary shares of the Company

Name of directors	Capacity and nature of interest	Number of shares held	Percentage of the Company's issued share capital
Li Dong Sheng, Tomson	Directly beneficially owned	21,206,000	0.8

(ii) Long positions in underlying shares of the Company — share options

Name of directors	Capacity and nature of interest	Number of underlying shares held
Li Dong Sheng, Tomson	Directly beneficially owned	6,950,000
Yan Yong	Directly beneficially owned	134,000
Suen Hay Wai	Directly beneficially owned	700,000

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Directors' and chief executive's interests and short positions in shares, underlying shares and debentures (continued)

(iii) Long positions in ordinary shares of associated corporations of the Company

Name of directors	Name of associated corporation	Relationship with the Company	Number of shares held	Capacity and nature of interest	Percentage of the associated corporation's issued share capital
	(Note)				
Li Dong Sheng, Tomson	TCL Corporation	Controlling shareholder of the Company	144,547,698	Directly beneficially owned	9.08
Yuan Xin Cheng	TCL Corporation	Controlling shareholder of the Company	24,834,186	Directly beneficially owned	1.56
Lu Zhong Li	TCL Corporation	Controlling shareholder of the Company	23,560,638	Directly beneficially owned	1.48
Hu Qiu Sheng	TCL Corporation	Controlling shareholder of the Company	18,944,027	Directly beneficially owned	1.19

Note: TCL Corporation held 1,461,685,289 shares in the Company through its wholly-owned subsidiary, T.C.L. Industries Holdings (H.K.) Ltd. ("TCL Industries"). TCL Corporation is an associated corporation by virtue of its being a controlling shareholder of the Company.

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Directors' and chief executive's interests and short positions in shares, underlying shares and debentures (continued)

In addition to the above, a director has non-beneficial personal equity interest in a subsidiary held for the benefit of the Company solely for the purpose of complying with the minimum company membership requirements.

Save as disclosed above, as at 31 December 2003, none of the directors and chief executive and their associates had registered an interest or short position in the shares, underlying shares or debentures of the Company or any of its associated corporations that was required to be recorded pursuant to Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of the Listed Companies.

Directors' rights to acquire shares or debentures

Apart from as disclosed under the heading "Directors' and chief executive's interests and short positions in shares, underlying shares and debentures" above and notes 27 and 29 to the financial statements, at no time during the year were rights to acquire benefits by means of the acquisition of shares in or debentures of the Company granted to any director or his/her spouse or children under 18 years of age, or were any such rights exercised by them; or was the Company, or any of its subsidiaries, holding companies or fellow subsidiaries a party to any arrangement to enable the directors to acquire such rights in any other body corporate.

Share option schemes

Concerning the share options granted during the year, as detailed in note 29 to the financial statements, the directors do not consider it appropriate to disclose a theoretical value of the options granted because a number of factors crucial for the valuation cannot be determined. Such factors include the exercise period and the conditions that an option is subject to. Accordingly, any valuation of the options based on various speculative assumptions would not be meaningful.

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Substantial shareholders' interests and short positions in shares and underlying shares

At 31 December 2003, the following interests and short positions of 5% or more of the issued share capital and share options of the Company were recorded in the register of interests required to be kept by the Company pursuant to Section 336 of the SFO:

Long positions in ordinary shares of the Company:

Name	Capacity and nature of interest	Number of shares held	Percentage of the Company's issued share capital
TCL Industries	Directly beneficially owned	1,461,685,289 (Note 1)	54.51
TCL Corporation	Through a controlled corporation	1,461,685,289 (Note 1)	54.51
Huizhou Investment Holdings Limited	Through a controlled corporation	1,461,685,289 (Note 2)	54.51
J.P. Morgan Chase & Co.	Directly beneficially owned	217,463,900	8.11
Templeton Asset Management Limited	Directly beneficially owned	160,446,000	5.98

Note 1: TCL Industries is a direct wholly-owned subsidiary of TCL Corporation and accordingly, the shares in which TCL Industries is shown to be interested are also the shares in which TCL Corporation is interested.

Note 2: Huizhou Investment Holdings Limited held a 40.97% interest in TCL Corporation and accordingly, the shares in which TCL Corporation is shown to be interested are also the shares in which Huizhou Investment Holdings Limited is interested.

Save as disclosed above, as at 31 December 2003, no person, other than the directors and chief executive of the Company whose interests are set out in the section "Directors' and chief executive's interests and short positions in shares, underlying shares and debentures" above, had registered an interest or short position in the share or underlying shares of the Company that was required to be recorded pursuant to Section 336 of the SFO.

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Connected transactions

The connected transactions undertaken by the Group with companies controlled by the ultimate holding company during the year are as follows:

	HK\$
Contract fee paid to:	
TCL Digital Science and Technology (Wuxi) Co., Ltd.	16,218,000
Inner-Mongolia TCL Electrical Appliance Company Limited	13,337,000
Purchases of raw materials from:	
Chinaway Paper Production (Huizhou) Co., Ltd.	38,926,000
Chinaway Polyfoam Plastics (Huizhou) Co., Ltd.	45,680,000
Huizhou TCL-Sumisho Electronics Co., Ltd.	6,850,000
Shenzhen Axic Micro-electronics Ltd.	5,557,000
Huizhou Shenghua Industry Co., Ltd.	67,193,000
Huizhou TCL King High Frequency Electronics Co., Ltd.	15,557,000
Purchases of finished goods from:	
Huizhou TCL Mobile Communication Co., Ltd. and its subsidiaries	533,000
TCL Air Conditioner (Zhongzhan) Co., Ltd.	25,434,000
Sales of raw materials to:	
Huizhou TCL King High Frequency Electronics Co., Ltd.	6,315,000
Subcontracting fee paid to:	
Huizhou TTK Household Electrical Appliances Company Limited	4,301,000
Sales handling fee income from:	
TCL Household Appliances (Huizhou) Co., Ltd.	8,247,000
TCL Electric Appliances (Shaanxi) Co., Ltd.	281,000
TCL Air Conditioner (Zhongzhan) Co., Ltd.	842,000

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Connected transactions (continued)

Further details of the terms of the above connected transactions are set out in note 35 to the financial statements.

The independent non-executive directors of the Company have reviewed and confirmed that the above connected transactions were: (i) entered into in the ordinary and usual course of the Group's business; (ii) entered into on terms that were fair and reasonable so far as the shareholders of the Company are concerned; (iii) either carried out in accordance with the terms of the respective agreements governing such transactions, or where there were no such agreements, on terms no less favourable than those available to or from independent third parties; and (iv) within the maximum expected extent or amounts as stated in the Company's announcements.

The Group also entered into other connected transactions during the year as follows:

- (a) On 4 March 2003, TCL Holdings (BVI) Limited, a wholly-owned subsidiary of the Company, acquired from Great Wall Cybertech Limited the remaining 30% interest in Team Way Limited (subsequently renamed as TCL Overseas Consumer Electronics Limited), a 70% owned subsidiary of the Company, at a total consideration of HK\$3,000,000, which was determined by reference to the vendor's share of the total paid-up capital of Team Way Limited.
- (b) On 18 June 2003, TCL Information Technology Industrial (Group) Company Limited, a wholly-owned subsidiary of the Company, entered into a sale and purchase agreement to dispose of its 100% interest in TCL 網絡設備深圳有限公司 ("TCL Network") to TCL Communication Equipment Share Company Limited ("TCL Communication") and a wholly-owned subsidiary of TCL Communication at a cash consideration of RMB13,231,500 (equivalent to approximately HK\$12,483,000), which was determined by reference to the net asset value of TCL Network as at 30 April 2003. TCL Communication is a non-wholly-owned subsidiary of TCL Corporation, the ultimate holding company of the Company. The transaction was completed on 29 September 2003.
- (c) On 22 August 2003, the parties to the subscription agreement for the issue of the 3% convertible notes due 2005 in the aggregated principal amount of HK\$350,000,000 (the "Notes") dated 26 September 2002, namely the Company, United Asset Investments Limited, Nam Tai Electronics, Inc. and Go-Win Limited, entered into an amendment agreement (the "Amendment Agreement") to amend the terms and conditions of the Notes. The Amendment Agreement created global notes (the "Global Notes") representing the Notes, which are admitted to the global electronic clearing and settlement systems of Euroclear and Clearstream. As a result of the Amendment Agreement, the Global Notes became more freely tradable. However, the basic economic terms of the Notes, including interest, maturity and currency of payment as well as the conversion features of the Notes are unaffected by the Amendment Agreement.

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Post balance sheet event

Details of the significant post balance sheet event of the Group are set out in note 36 to the financial statements.

Code of Best Practice

In the opinion of the directors, the Company complied with the Code of Best Practice as set out in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange, throughout the accounting period covered by the annual report.

Audit committee

The Company has an audit committee which was established in accordance with the requirements of the Code of Best Practice, for the purposes of reviewing and providing supervision over the Group's financial reporting process and internal controls. The audit committee comprises the two independent non-executive directors of the Company.

Auditors

Ernst & Young retire and, being eligible, offer themselves for reappointment as auditors of the Company.

ON BEHALF OF THE BOARD

Li Dong Sheng, Tomson

Chairman

Hong Kong

2 March 2004