MANAGEMENT DISCUSSION AND ANALYSIS

Operation review

Group review

Following the acquisition of 65% interest of the electrical appliances retail business in the PRC under the trading name, "GOME", in July this year at a total consideration of around HK$8.3 billion by issuing of share capital of HK$243.5 million and mandatory convertible notes of approximately HK$8.1 billion, the Group has successfully transformed into the largest retail chain operator of electrical appliances and consumer electronic products in the PRC with 96 outlets by that time. Currently, there are 56 outlets which are not under the Group's control but they are operating in different locations and not in competition with the Group. Given the relevant statistics indicating an encouraging trend of improving living standards and increasing household consumption in the PRC over the past few years, the management of the Group believes that there is enormous growth potential in the retail market of electrical appliances in the PRC. The acquisition put the Group in a premium position to participate in the retail market in the PRC. Accordingly, the name of the Company was changed from "China Eagle Group Company Limited" to "GOME Electrical Appliances Holding Limited" in August to reflect the forward move on operation focus of the Group. To further enhance the operating coordination with the newly acquired business, the financial year end date of the Group will also change from 31 March to 31 December with effect from this year.

This is the first interim results of the Group with the inclusion of the electrical appliances retail business. For comparison purpose, all figures and analysis stated in the sections below will include the performance of this newly acquired business for the corresponding periods in both current and previous year.

In the six months' period ended 30 September 2004, turnover of the Group was HK$6.1 billion, representing an increase of 45% as compared with HK$4.2 billion in the corresponding period last year. The turnover mainly consisted of income generated from the electrical appliances retail business with less than 1% from securities broking and investment. In fact, it is the intention of the Group to focus its management and financial resources on the PRC retail sector with the aim to maximize growth potential and deliver the best return to shareholders. Net profit for the period amounted to HK$246 million, increased by HK$161 million or 190% as compared with last year.

Electrical appliances retail business review

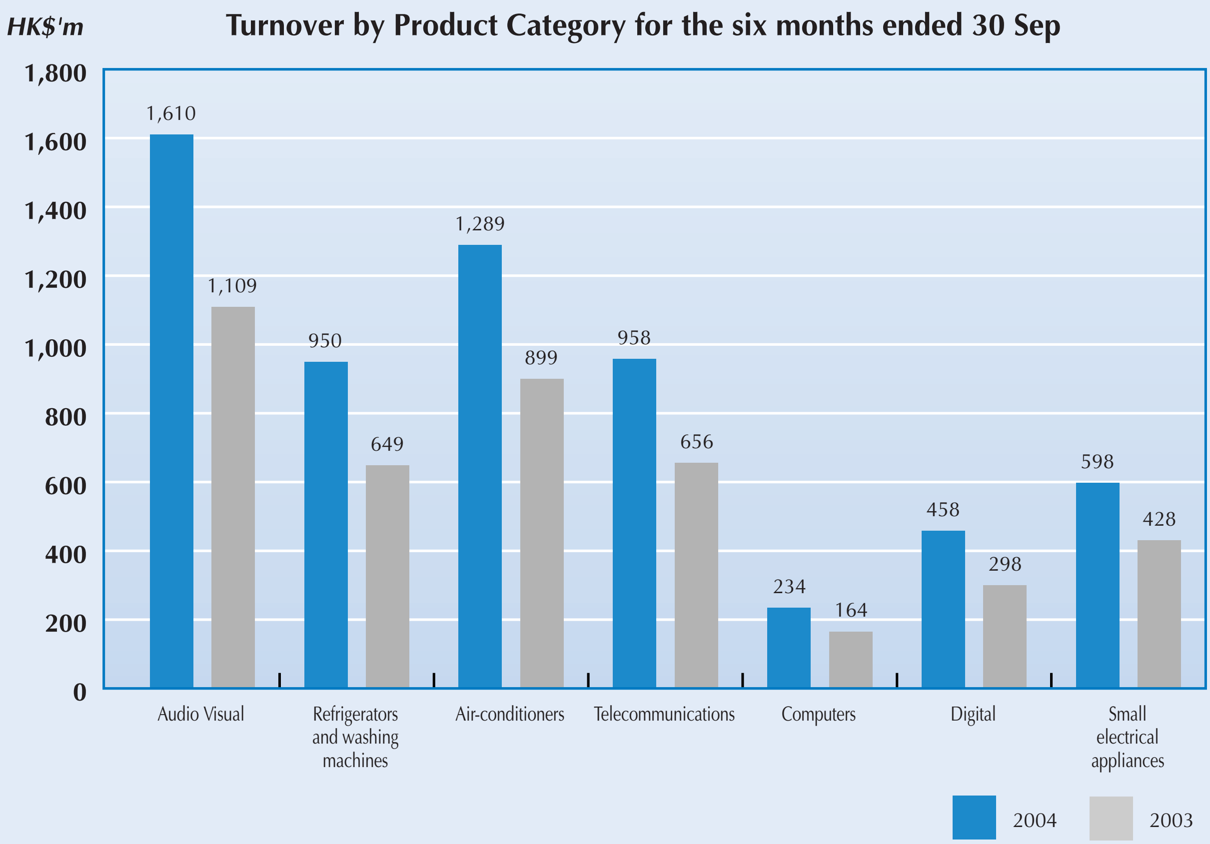
The electrical appliances retail business became the major income stream of the Group subsequent to the acquisition. During the period under review, turnover was HK$6.1 billion, with significant increase of HK$1.9 billion, or 45%, as compared with the corresponding period last year. Gross profit margin improved from 7.2% to 10%. Earnings before interest, taxation, depreciation and amortization ("EBITDA") significantly increased to HK$447 million, a 146% rise as compared with HK$182 million in the corresponding period last year.

The satisfactory performance of the business is attributable to a number of factors.

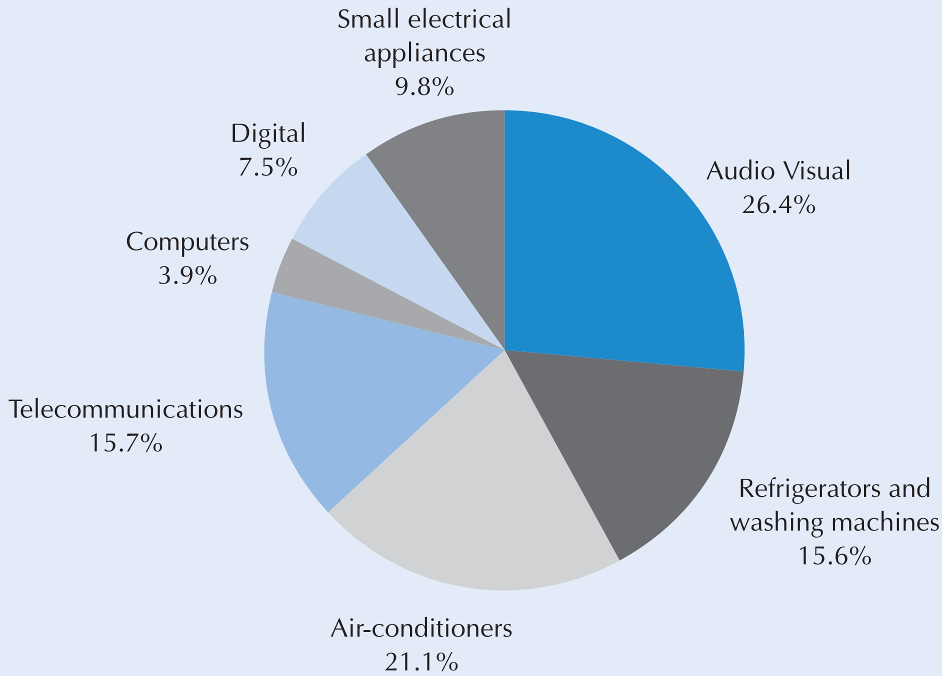
Externally, the continuous development of the PRC economy boosted the consumer consumption, which led to a rapid growth in demand on consumer products including electrical appliances and consumer electronic products. As the largest retail chain operator of electrical appliances and consumer electronic products in the PRC, the Group is well positioned to benefit from such economic growth in the PRC market.

The following chart illustrates the revenue by product category of the Group.

Product category	**Six months ended 30 Sep 04** HK$'m	**Six months ended 30 Sep 04** % of total revenue	Six months ended 30 Sep 03 HK$'m	Six months ended 30 Sep 03 % of total revenue
Audio visual	**1,610**	**26.4**	1,109	26.4
Refrigerators and washing machines	**950**	**15.6**	649	15.4
Air-conditioners	**1,289**	**21.1**	899	21.4
Telecommunications	**958**	**15.7**	656	15.6
Computers	**234**	**3.9**	164	3.9
Small electrical appliances	**598**	**9.8**	428	10.2
Digital	**458**	**7.5**	298	7.1
Total revenue	**6,097**	**100.0**	4,203	100.0



Turnover by Product Category for the six months ended 30 Sep 2004



According to the above table, sales of overall electrical appliances and electronic consumer products were increased and an upward trend is noted in revenue generated from sales of digital and telecommunication products, and the Group has planned to explore the market share for these high end products.

Internally, the management placed strong emphasis on retail chain network expansion so as to leverage benefits of economies of scale and further expand market share. The management believes that telecommunication and digital products will continue to attract significant consumer consumption in the PRC. Thus, the Group has adopted a business plan to establish speciality shop, referred to as "digital shops", to sell such products in districts with heavy pedestrian traffic. During the period under review, the Group established 12 traditional retail outlets and 18 digital shops. This extensive expansion broadened coverage of the Group's existing retail network, and the increase in number of outlets can reduce the spread of overheads of the Group and improve the operating margin.

The table below sets out the expansion of the retail network.

	30.9.04	31.12.03	30.09.03
Number of traditional outlets	**98**	79	71
Number of digital shops	**18**	–	–
Number of cities covered	**22**	19	17

The proactive purchasing strategy also attributed to the strong performance of the Group. With the effective retail network covering major cities of the PRC and broad consumer base, the Group can leverage its significant purchasing volume to establish a direct relationship with major manufacturers and suppliers which allowed the Group for cost savings by enjoying more favourable terms and incentive bonus after achieving guaranteed purchase volume. In addition, the Group was also able to obtain exclusive right to sell certain product models and tailored made products based on the latest market trend.

The Group continues to launch effective marketing and promotional campaigns including but not limited to price bulletin published in newspapers, promotional price reduction, daily specials, free gifts and lucky draws. In addition, the Group also co-operated closely with suppliers in certain promotional campaigns so as to boost sales and foster relationship with suppliers and offered competitive pricing to consumers.

Other operating income increased as a result of the combined impact of network expansion and frequent promotional co-operation with suppliers and the management income from the Parent Group. An analysis of other operating income was stated on the following table.

	30.09.04	30.09.03
	HK$'m	*HK$'m*
Promotion income	**92.7**	63.5
Management fee for promotion	**23.7**	21.1
Air-conditioner installation fee	**28.6**	21.7
Product listing fee	**12.8**	11.5
Display space leasing fee	**17.6**	15.5
Management Income from Parent Group	**36.7**	–
Others	**42.4**	17.5
Total other operating income	**254.5**	150.8

Inventory turnover was 35 days as at 30 September 2004. It is the Group's policy to maintain an optimal inventory level based on the internal guideline on estimated inventory turnover of 16 days. The significant deviation noted was due to the fact that inventory was ordered and accumulated as at the period end to meet the expected uplift in sales volume during the Golden Week holiday of National Day of the PRC commencing on 1 October 2004.

In conclusion, the significant improvement of the Group's results were attributable to its extensive network expansion, close relationship with suppliers and manufacturers, effective marketing strategy and tight internal control.

Securities broking and investment business review

During the period, commission generated from securities broking business amounting to HK$6 million. This business remained as one of the operating activities of the Group throughout the period. The increase in commission income was mainly attributable to the recovery of Hong Kong's economy especially in the capital market. The momentum of the market was greatly affected by the attack of Severe Acute Respiratory Syndrome ("SARS") and the depression of the global market during the same period last year. With the introduction of Closer Economic Partnership Arrangement ("CEPA") and the strong economic growth in the PRC, an upward trend is resulted in the Hong Kong's economy as a whole from which the securities broking business directly benefited.

Property development and investment division
The property development and investment business remained inactive during the period. No significant development was undertaken by the Group in respect of property development.

Prospect and outlook

Electrical appliances retail division
After the acquisition of the Target Group, the Group has expressed a clear intention to focus its management and financial resources on development of the electrical appliances and consumer electronic products retail business. With the retail market manifesting enormous growth potential as the PRC economy continues to develop, the management is optimistic about the prospects of the electrical appliance retail business.

While the potential growth of the market is enormous, so is the competition. Despite the fact that the Group is the number one electrical appliances and consumer electronic product retailer, the management will continue to extensively invest and focus on network expansion and strive to identify any possible and practical solutions to improve the profitability of the business.

By improving and expanding the existing network, the management believes that to enlarge the market share, secure and further improve the gross profit margin and operating income as well as to implement tight cost control measures are crucial to the success of the business.

According to the State Information Centre, the trend of growth in electrical appliances and consumer electronic products is expected to continue and the forecasted annual growth in the retail sales of such products will be 11.4% for 2005. Amongst the growth, management believes that telecommunication and digital products will take the lead and the Group has adopted a proactive expansion plan to capture such rapid growth. As mentioned earlier, the Group is devoted to establishing digital shops in districts with significant pedestrian traffic to sell mainly telecommunication, digital and computer products. The key features of such products are their smaller in sizes and high value as compared with traditional electrical appliances such as refrigerators and air-conditioners, etc. Major products carried in the digital shops include mobile phones and accessories, IT products, digital cameras, digital video recorders, MP3, hand-held computers, various small home appliances and electronic consumer products. The traditional outlets, on the other hand, carry a full range of products including bulky white goods such as refrigerators, washing machines and air-conditioners. Focusing on high value products in location with significant consumer flow, the digital shops will attract higher sales volume and improve the operating margin by sharing overheads of the Group. In addition, the establishment of digital shops will enhance the coverage of the existing network and better positioned the Group to serve different consumers. The following table illustrates the expansion plan of the Group.

	By end of 2004	**By end of 2005**
Number of new stores established –		
– traditional outlets	24	35
– digital shops	30	30

For 2004, the Group is confident of achieving the retail network expansion target as planned. Following the PRC's accession to the WTO, tariffs on foreign products will be reduced and import of high value digital products under foreign brand name is expected to grow in term of volume as well as variety. This will greatly facilitate the development of digital shops in the retail market of the PRC.

To drive sales volume, the Group will have established sizable retail outlets, referred to as "mega stores", with larger floor area of over 15,000 square metres as compared to the traditional outlets of around 3,500 square metres on average by 2006. These mega stores will be opened in cities with higher GDP and population exceeding two million.

As part of the expansion plan to improve the coverage of its existing retail network, the Group will also open new stores in second-tier cities around the major locations of which the Group already has presence. The Group believes that this step forward to the second-tier cities can strengthen the bargaining power of the Group with suppliers benefiting from economies of scale, reducing overheads shared among the Group and thus improve the overall profit margin of the Group.

Regarding the expansion plan of the retail network, the management will focus on location selections as it will have a direct impact on the business performance of the outlets. Detailed feasibility study will be carried out for each new store to ensure the Group's resources will be effectively utilized.

The Group will further streamline and improve its efficiency of its logistic function to reduce costs and facilitate better control on inventory management. Purchasing function will be strengthened to enrich the product variety and establish closer relationship with suppliers which allows the Group to offer competitive pricing and attractive promotional activities to consumers.

The management also believes that an efficient ERP system is critical to the success of the retail business which involves high volume of inventory movement and widespread product lines and product ranges. The Group intends to upgrade the ERP system to allow better exchange of information and to implement a centralized management reporting system to enhance the efficiency and effectiveness of the Group and improve the risk management on group level.

To cope with challenging in managing a widespread retail network, the management recognised the importance of real time data sharing and communication. Video and telephone conference facilities had been installed in most of the regional offices and head offices in Beijing to ensure effective management and timely information flow.

In conclusion, ridden with keen competition, the business environment is challenging. With a solid expansion plan, quick response to ever-changing market demands, the wholehearted commitment of the management in streamlining process and improve communication, the Group will continue to attain remarkable growth in business performance this year. Despite severe competition, management remains optimistic about the prospects of the business.

Securities broking and investment division

Despite the upturn movement in the capital market, there is no further expansion of the securities broking business. As mentioned earlier, it is the intention of the management to focus the resources of the Group on the electrical appliances retail market in the PRC. Accordingly, the scale of operation of the securities broking business will remain unchanged.

Property development and investment division

The property development business is inactive and the Group has no further capital commitment in respect of the property held located in Beijing. The management of the Group has determined not to engage in any property development subsequent to acquisition of the retail network in the PRC. In the meantime, the management is committed to seeking opportunities to maximize the returns to shareholders.

Liquidity and financial resources

Net cash amounted to HK$1.4 billion, which is 28% higher than that of six months ago. Except for short-term bills payables, which increased by HK$880 million to HK$3.2 billion during the six months period, the Group has no other bank borrowings. The increase in bills payables are in line with the increase in revenue which in turn lead to higher purchase volume of the Group.

Very substantial acquisition and connected transactions

In July this year, the Group acquired the entire interest of Ocean Town International Inc. ("Ocean Town"), a company incorporated in the British Virgin Islands which holds 65% of the shareholding of Gome Appliance Company Limited ("Gome Appliance"), a Sino-foreign equity joint venture established under the laws of the PRC, which in turn holds the entire interest of 96 electrical appliances retail outlets in 22 cities in the PRC. The consideration for the acquisition of Ocean Town is RMB8.8 billion (approximately HK$8.3 billion), satisfied as follows:

1. as to HK$243.5 million by the allotment and issue of approximately 44.1 million new shares after the capital reorganization consolidating 40 shares into 1 new share;

2. as to approximately HK$7,031.4 million by the issue of First Convertible Note; and

3. as to approximately HK$1,026.9 million by the issue of the Second Convertible Note.

The electrical appliances retail network under the brand name "GOME" operated a total of 135 outlets in 37 cities in the PRC as at the acquisition date. However, only 96 outlets in 22 cities (the "Target Group") were identified by the management of the Group for acquisition while the remaining 39 outlets in 15 cities (the "Parent Group") remained as they were for the following reasons:

1. the Target Group has a more established track record and hence a stable base for future development; and

2. as compared with the Target Group, the business in the remaining cities is less developed and hence entails higher business risks.

The Target Group and the Parent Group are operated in different locations and thus no direct competition will be imposed. To maximize the competitive advantages in the network operations, the Target Group and the Parent Group are under the same senior management team and have entered in agreements for the following connected transactions:

1. *Transitional Purchasing Service Agreement*
   Prior to the acquisition, the Parent Group had entered into purchasing contracts with various suppliers and purchased electrical appliances for both retail outlets under the Parent Group and the Target Group. As a transitional arrangement, the Parent Group and the Target Group has entered into agreement pursuant to which the Parent Group will continue to purchase from those suppliers for the Target Group.

2. *Purchasing Service Agreement*
   The Target Group and the Parent Group have entered into agreement pursuant to which the Target Group will provide purchasing services to the Parent Group for a service fee at a rate of 0.9% of the revenue generated from the sales of electrical appliances and consumer electronic products of the Parent Group for a term of 36 months commencing upon completion of the acquisition.

3. *Management Agreement*
   The Target Group and the Parent Group have entered into agreement pursuant to which the Target Group will provide management services for the Parent Group for an annual management fee at a rate of 0.75% of the total revenue generated from sales of electrical appliances and consumer electronic products of the Parent Group if such revenue is equal or less than RMB5 billion (approximately HK$4.7 billion) or at a rate of 0.6% if such revenue exceeds RMB5 billion.

As at the acquisition date, an amount of RMB1.1 billion was owed by the Parent Group to the Target Group. As at 30 September 2004, the amount was included in the amount due from related companies under current assets in the consolidated balance sheet of the Group. The amount was subsequently repaid in full in October this year. Please refer to the section under "Post Balance Sheet Events" below for details.

Charges on assets

As at 30 September 2004, the Group had pledged deposits amounting to HK$971 million to secure the general banking facilities granted to the Group.

Contingent liabilities and commitment

There were no material contingent liabilities and commitments as at 30 September 2004.

Foreign currencies and treasury policy

The Group has little exposure to foreign currencies fluctuations as most of the Group's business transactions, assets and liabilities are principally denominated in either China Renminbi, Hong Kong dollar or United States dollar. It's the Group's treasury policy to manage its foreign currency exposure whenever its financial impact is material to the Group. The Group will continue to monitor its foreign exchange position and, if necessary, will hedge its foreign currency exposure by forward foreign exchange contracts.

Human resources

As at 30 September 2004, the total numbers of employees of the Group were 8,814, including 8,785 in the PRC and 29 in Hong Kong. The Group values its human resources and recognizes the important of attracting and retaining qualified staff for its continuing success. Remuneration packages are generally structured by reference to market terms and individual qualifications.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS IN SECURITIES

At 30 September 2004, the interests of the directors and the chief executive of the Company and their associates in the securities of the Company and its associated corporations as recorded in the register maintained by the Company pursuant to Section 352 of the Securities and Futures Ordinance (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 in the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing rules") were as follows:

	Number of ordinary shares held			
Name of director	**Personal interests**	**Corporate interests**	**Total**	**Percentage of Shareholding**
Mr. Wong Kwong Yu	900,087	135,867,754 *(note 1)*	136,767,841	74.90%

note:

(1) The Shares are held in name of Shinning Crown Holdings Inc., which is 100% beneficially owned by Mr. Wong Kwong Yu.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

At no time during the period was the Company, its subsidiaries or its holding company a party to any arrangements to enable the directors of the Company to acquire shares in or debentures of the Company or any other body corporate.