Management Discussion and Analysis

Operations Review

Overall Business Performance

TCL's global business development strategy continued to make progress in 2004, following the establishment of TTE, the TCL-Thomson joint venture, which commenced operations in August 2004.

Since the establishment of TTE, management has been focusing their attention on streamlining operations and realizing synergies. A series of business restructuring plans were implemented in the period under review. At the manufacturing level, the Group consolidated its operations in the North America and Europe. We started to consolidate manufacturing activities in Mexico in the fourth quarter of 2004. In Europe, the manufacturing activities managed by Schneider started to be shifted to the plant in Poland to enjoy better economies of scale and benefit from our global manufacturing footprint. The manufacturing platform of the Group in China started to support the activities in the North America market. The implementation of these measures is expected to save up to €20 million per annum upon the completion of restructuring plans.

At the sourcing and procurement level, the Group has gradually shifted its operations in different markets to a global platform. The increased procurement volume, the standardizing of components, the selection and consolidation of suppliers are expected to enable the Group to save up to €40 million per annum, which would be our expectation for 2006.

Operating on an enlarged scale, with manufacturing bases and sales network spanning across all major continents, the Group's presence was greatly enhanced through its multi-brand strategy, which laid a solid foundation for future development.

TV Unit Sales ('000 Units)	FY2004*	FY2003	Change
— PRC	8,877	7,826	+13%
— Europe	1,488	108	Not comparable
— North America	1,603	—	Not comparable
— Emerging Markets	3,054	2,329	+31%
— Strategic OEM	1,697	1,390	+22%

* *Thomson's TV shipment in January–July 2004 is not part of TTE, and therefore not included in the above TV shipment numbers.*

TV Business

The Group is pleased to announce that its total TV sales achieved robust growth of 43% to 16.7 million sets in 2004, while sales revenue reached HK$21.8 billion, representing a surge of 75% and accounting for 85% of the Group's total turnover. The strong growth was partly contributed by the establishment of TTE and partly by the organic growth of TCL's TV business. The total TV sales of TCL's original TV business was 13.9 million units, while sales revenue reached HK$14.1 billion, representing a surge of 19% and 14% respectively. This was particularly impressive given the competitive landscape of the global consumer electronics market.

The PRC

The Group achieved notable progress in the PRC market in 2004. Unit sales grew by 13% during the year under review, reaching 8.88 million sets. Sales revenue from TV sales in the PRC market amounted to HK$10.5 billion, accounting for 48% of the turnover from the TV business.

Keen competition in the PRC market led to intensified price competition across all product ranges. This was particularly apparent in the high-end segment. Continual price reductions were seen in models such as high definition digital TVs and LCD TVs. To fully embrace market opportunities, the Group adopted a dual-brand strategy in the PRC market, using the “TCL” and “Rowa” brands to target different market segments with a comprehensive product offering from high-end new models to competitively priced core value TVs. Of the total 8.88 million TV sets sold, approximately 90% were “TCL” brand models and 10% were “Rowa” brand models. The Group was pleased to see that leveraging on TCL’s distribution channel and marketing expertise, sales of its “Rowa” brand TVs picked up rapidly and formed one of the driving forces for the Group’s domestic sales.

Already a market leader in the PRC, TCL further strengthened its leadership through the dual-brand strategy. According to statistics from the MII together with our company data, the two brands in aggregate are estimated to capture a 20% share of the PRC market in the year under review, up from a 19% share in 2003.

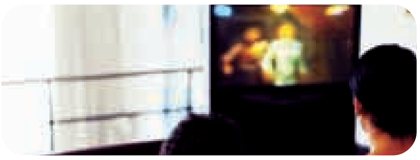
Sales of high-end models, mostly of the TCL brand, accounted for 12% of the revenue from domestic TV sales. In the projection TV segment, the Group was one of the two leading domestic players in terms of market share, according to MII. In the LCD TV segment, the Group implemented two promotional campaigns to establish its presence. The enhanced product mix has contributed to a relatively stable average selling price despite industry wide unit price decreases. This together with the implementation of a series of cost control measures, decreases in upstream component prices and good supply chain management contributed to an increase of gross margin by 2% to 22%.

A total of over 50 models were launched in 2004, of which over 30 were CRT models with enhanced features, 14 projection TVs, 3 LCD models and 3 plasma models. The launch of the TCL 61" Slim DLP model, only one-third of the depth of a conventional DLP projection model, marked a major breakthrough in the PRC market and was highly praised by customers for its innovation.

The Group also placed strong emphasis on new generation digital TVs, which offer 3C convergence features for online interactive infotainment. Its R&D efforts were driven towards higher definition, more powerful features, and enhanced digital audio systems. The exclusive “digital and high-definition 2 in 1” technology was employed to upgrade display qualities.

In addition, the Group joined hands with Genesis, a US-based global leader in IC chip manufacturing, to co-develop the first world-class DDHD IC chip for digital high definition TVs. The DDHD IC chip is embedded in all TCL digital high definition TVs, offering unparalleled visual enjoyment.

Going forward, the PRC TV market will be driven by super large, ultra-thin, high definition, intelligent TVs with digital 3C functional products in the future. Flat panel TVs will be a key R&D area for future product development. TCL will continue to stay ahead of its peers with new breakthroughs in three aspects — distinguished high definition, outstanding 3C functions and prominent audio systems.



Europe

The TV market in Europe was highly competitive in 2004. Taking advantage of the LCD boom, private labels and small players in the market adopted low pricing strategies with the aim of capturing market shares quickly. Product prices were pushed down rapidly. Competition further intensified, especially focusing on 20" and 27" LCD TVs and approaching the end of the year also on 30" LCD TVs. Other high-end models such as plasma and DLP TVs were also under pressure, while sales of CRT TVs were gradually replaced by the sales of such high-end models.

In Europe, the Group distributes its products under "Thomson" and "Schneider" brands. For the five months ended 31 December 2004, a total of 1.5 million units of TVs were sold in Europe, of which Thomson and Schneider accounted for 85% and 15% respectively. Total revenue in Europe was HK$4.6 billion, accounting for 21% of the TV business turnover.

As for "Thomson" brand, the Group strived for profit margins and profitability, as compared to sheer volume growth, and chose not to participate in most of the aggressive price reductions initiated by private labels and small players. As a result, unit sales recorded a yearly decline and 1.3 million units were sold in the five months ending 31 December 2004. According to statistics from the GFK Panel, Thomson's market share in Europe declined marginally to 6% in 2004. Nevertheless, gross margin improved to 18% during the period under review, as a result of the enhanced product mix, with increased flat-screen display TV sales, and good supply chain management.

One of the Group's key tasks for the European market in 2004 was to enhance its profitability. To the Group's satisfaction, "Thomson" brand business improved its profitability and posted an operating profit of HK$49 million, meeting the Group's target set out at the time of JV establishment. Continual product mix enhancement contributed to a moderate increase in overall average selling prices. Sales value of LCD, plasma and projection TVs accounted for 33% of the total "Thomson" brand sales.

The Group's business strategy in Europe was to move rapidly towards new technology TVs. Amongst the 142 new models launched in 2004, there were 24 LCD TVs, 4 plasma TVs, 6 projection TVs and 8 DLP TVs. The launch of the DLP Slim 61" model was supported by a TV advertising campaign in France, Spain, Sweden, Russia and Germany, which boosted its DLP product awareness and enhanced the brand image of Thomson.

On a relatively small business scale, Schneider recorded a 108% growth in unit sales in 2004, amounting to 225,000 sets, and generated a sales revenue of HK$465 million. The oversupply of LCD TVs in Germany and the rapid decline in LCD panel prices since the second quarter of 2004, however, led to product price reductions and significant decreases in gross margin. And as the sales volume of the Group's LCD TVs had yet to achieve economies of scale, Schneider's financial performance was adversely affected. In addition, Schneider recorded a write-off of HK$31 million for its inventory. The Schneider operation, as a result, incurred an operating loss of HK$132 million for the year ended 31 December 2004.

Nevertheless, the Board is optimistic of the long-term prospect of Schneider. Following the establishment of TTE, the Group expects that synergies, in terms of procurement, R&D and economies of scale, will be created in the European markets. The plan of moving the manufacture of Schneider brand TVs to the Poland plant was kicked off in the fourth quarter of 2004. In the future, Schneider's activity in Germany will be confined to a pure sales and marketing office. Benefiting from the global platform of TTE, the Group expects the Schneider operation to deliver substantial improvement in the coming year.

Going forward, for the European market, high-end TVs and large-sized LCD TVs in particular will be the high-growth areas. The Group will continue to deploy R&D resources to the development of LCD, projection and plasma TVs and introduce a wide range of LCD and plasma TVs in the first half of 2005.

North America

There was no lessening of competitive pressures in the North American market in 2004, much of which impacted pricing. There was an increasing trend for retailers to showcase Microdisplay Projection TVs, LCD TVs and plasma models. As in other developed countries, competition was driven towards high-end TV models, while sales of analog TVs declined.

In the North America, the Group sells products under "RCA" brand. For the five months ended 31 December 2004, TV unit sales from the North America amounted to 1.6 million units. Sales revenue for the same period amounted to HK$3.6 billion, accounting for 16% of the turnover from the TV business. According to Synovate, "RCA" brand enjoyed a market share of 8% for the first 11 months of 2004.

The Group began several important initiatives aimed at improving profitability in the North American market during the fourth quarter of 2004. As a first step to realize the synergies of this global venture, the Group began using TCL-designed chassis for TV models sold in the North America, and started selling TV models built in TCL's manufacturing bases in China. These moves, together with a series of cost control measures and decreases in component costs, lifted the gross margin to 16%, which is encouraging.

A total of 30 new models have been introduced since TTE commenced operations, including 11 DLP models and 8 projection digital models. The highlight amongst the new DLP models, as in the PRC and the European market, was the award winning 61" RCA Scenium model, the industry's first microdisplay TV capable of being wall-mounted.

The R&D labs located in Indianapolis continued to focus on developing microdisplay technologies targeted towards the mass market and establishing global leadership in the category. Current projects in the pipeline include new low-cost design concepts encompassing leading edge technology for applications in 2005 and beyond.

Demand for LCD TVs, plasma, Microdisplay and Digital TV products is expected to remain strong in 2005. To enhance the future competitiveness of "RCA" brand, a revitalization programme for the brand with the theme "Making Technology Affordable" will be launched via a coordinated effort encompassing the Internet, product packaging, retail support and advertising. Efforts will also be undertaken to strengthen the Group's relations with key distribution channels and customers.

Emerging Markets

One of the growth engines for the Group's TV business is undoubtedly the emerging markets. During the year under review, unit sales from Emerging Markets exceeded 3 million units, representing an impressive growth of 31% as compared to 2003. Sales revenue amounted to HK$2.2 billion, accounting for 10% of total TV sales.

The Group rapidly extended its presence from the Southeast Asian markets to global emerging markets. Branch offices were established in India, Thailand, Australia and Mexico, and the formation of subsidiaries in the Middle East, South Africa and Latin America is also in the pipeline.

TCL TVs have developed leadership in certain markets and rank among the top three TV brands with double-digit market shares in Vietnam and the Philippines.

The Group strategically catered to the needs of different geographical markets with different product offerings. Conventional CRT products were the mainstream products sold in the Emerging Market division. Yet, high-end models such as LCD, plasma and projection TVs were introduced to some selected markets such as Australia and Latin America in order to test the market.

Strategic OEM Business

One of the Group's core competitive edges lies in its capability for manufacturing quality products at highly competitive prices. Riding on this strength, its Strategic OEM business recorded an encouraging volume growth of 22% in 2004, with unit sales reaching 1.7 million sets. Sales revenues amounted to HK$1.0 billion, representing 5% of the total revenue from the TV business.

The Group is optimistic about its Strategic OEM business. Following TTE's formation, the Group is well positioned to benefit from enhanced economies of scale and R&D capabilities, to emerge as the global leader in the TV manufacturing industry.

PC Business

The PRC PC market underwent consolidation in 2004. Dominated by international and leading domestic players, waves of price wars were initiated. Drastic price reductions were seen in desktop PCs and notebook computers.

The Group's PC business continued to focus on three areas, home PCs, commercial PCs and notebook computers. The PC business reported satisfactory results during the year under review. Total unit sales for the year amounted to 620,000 units, representing a growth of 17%. Desktop PCs and notebook computers accounted for 95% and 5% of total unit sales respectively. Sales revenue from the PC business for the year under review amounted to HK$2.0 billion, representing a growth of 11% and accounting for 8% of the total turnover. With an enhanced product mix, the gross margin posted a mild growth of 1% to 9%. Effective cost control measures as well as economies of scale resulted in improvements in operating margin.

With regard to home PCs, the Group launched three new product series, namely large display panel PCs (Ruixiang WK series "銳翔WK系列"), entertainment PCs and "Ladies' PCs" (Ruixiang A series "銳翔A系列"). Entertainment PCs mainly offer electronic game features and "Ladies' PCs" are specifically designed for ladies. Riding on TCL's core strength of TV manufacturing, the Group launched the first LCD TV PC model combining a wide viewing LCD display with multimedia 3C features, setting the highest standards for home PCs.

The Group also launched two new commercial PCs series, further enriching the list of products offered. The newly launched Jingding C series ("精鼎C系列") and Jingding E series ("精鼎E系列") were specifically designed to meet the needs of SMEs, offering multi-layered security functions and personalized applications for maximizing work efficiency.

Looking ahead, competition in the PRC PC market is expected to remain ferocious. Innovative products with 3C convergence functions offering online entertainment and TV functions with

LCD displays will be key attractions in the market. The Group will continue to leverage on its strong 3C convergence experiences to launch new products for meeting market needs.

Audio-Visual Business

Year 2004 marked an important milestone in the Group's AV business with remarkable performances. The Group achieved a sales turnover of HK$1.3 billion, in which the PRC and overseas sales accounted for 10% and 90% respectively, representing in aggregate an impressive year-on-year growth of 248%.

The growth in sales volume brought forth benefits of economies of scale, and together with enhanced operating efficiencies, turned around the AV business. Its operating margin was 2% during the year under review.

The AV business is an integral part of the Group's multimedia consumer electronics business. Core products include DVD players, VCD players and other audio-visual products.

In the PRC, the Group launched a total of 11 new models including high definition DVD players, mobile DVD players and DVD recorders. Competitively priced, these new products were well received by consumers.

In addition to the PRC market, the Group also manufactures for its overseas OEM customers. During the year under review, to keep up with market changes, the Group developed some new products for its export market, including DVD recorders, and DVD PMPs embedded with a USB connector and hard disk. These new products were well received by customers and are expected to form revenue streams in the upcoming quarters.

Handset Business

TCL Communication, the handset business arm owned 40.8% by the Group, was successfully listed on the mainboard of the Hong Kong Stock Exchange on 27 September 2004. The Group divested its stake in TCL Communication in the form of distribution of species. This strategic move enabled the Group and TCL Communication to focus on the development of their respective businesses.

2004 was a challenging year for handset manufacturers in China. International players continually introduced new models with innovative features to capture the high-margin market segment on the one hand and triggered price reductions for mid to low-end models to regain market share on the other. Caught up with such daunting challenges, TCL's performance in the domestic market was adversely affected. Outside China, the newly formed TCL-Alcatel joint venture commenced operations in September 2004 and has yet to achieve profitability.

Financial Review

Turnover Analysis

The TV business continued to be the major revenue source, accounting for 85% of the Group's total turnover, up from 82% in 2003 when the Group operated predominantly in the PRC and had limited exposure to global markets.

Geographically, the PRC, where the Group's headquarters are located, remained the major revenue stream for the year ended 31 December 2004. It accounted for 51% of the total turnover. This was followed by Europe and the North America which accounted for 19% and 14% of the total turnover respectively, The remaining revenue came from the rest of the world.

The relatively high turnover contribution from the PRC was partly due to encouraging sales growth from the market, and partly because contribution from other profit centres were not fully reflected as TTE only operated for 5 months in 2004. The Board anticipates that in 2005, the European and North American markets will take up an even larger proportion of TV sales under a full year operation. It is expected that sales outside the PRC will account for more than one half of the total TV sales of TTE, in 2005 and beyond.

Gross Margin

The Group's overall gross margin increased from 16.4% in 2003 to 17.1% in 2004. The improvement was attributable to decreases in component prices, continual improvements in product mix and higher economies of scale. All these contributed to effective cost savings.

The Group's strong roots in China contributed to a relatively high gross margin as compared to that of its overseas operations.

Operating Profit

For the year ended 31 December 2004, the Group recorded an operating profit of HK$497 million. As a result of the loss brought forth by TTE, particularly arising from the North American market and Schneider operations, the Group's operating margin declined from 3.4% to 1.9% despite substantial increases in turnover and gross profit. The decrease was partly compensated by operating profit from the Group's PC and AV business which in aggregate contributed an operating profit of HK$92 million.

The performance is broadly in line with the expectations of the Board of Directors.

Gross Margin	FY2004	FY2003
TVs-Domestic	**22.2%**	19.6%
TVs-Overseas	**15.2%**	12.0%
PCs	**9.0%**	8.0%

Operating Margin	FY2004	FY2003
TVs-Domestic	**5.2%**	5.1%
TVs-Overseas	**-0.3%**	2.9%
PCs	**3.1%**	1.8%

Finance Charges

The Group's operations in Europe and the North America were mainly funded by the following means:

- A medium term loan up to a maximum of €100 million from Thomson. Interest was based on Thomson's financing costs, which amounted to approximately 2.32%.
- A long term syndication loan of US$180 million, at a rate of LIBOR plus 60 basis points

As a result, the Group's finance charges in 2004 increased by 100% to HK$66 million.

Working capital

The Group manages its working capital efficiently. Various inventory and accounts receivable measures were employed in accordance with different business models in different profit centres. For the year ended 31 December 2004, inventory turnover further decreased to 36 days (2003: 51 days), as the Group exercised tighter inventory controls in Europe and North America as majority of the sales went to mega chain stores instead of distributors.

As the Group sells most of the products directly to mega chain stores in Europe and North America markets, longer credit terms were offered as a general practice. During the year under review, accounts receivable turnover increased to 55 days (2003: 36 days).

Jointly Controlled Entities

As a result of the Company's plan to restructure its business portfolio to focus primarily on multi-media electronic products, TCL Communication, the holding company of TCL Mobile, separately listed on the Stock Exchange of Hong Kong on 27 September 2004. The Group successfully divested its 40.8% interest in TCL Communication by means of a special dividend to the shareholders which was satisfied by a distribution in specie of its entire interest in TCL Communication. Share premium of the Group was utilized to fund the distribution.

Significant Investment and Acquisitions

Year 2004 represents a new era for the Group's internationalization process. Pursuant to the Combination Agreement signed at the beginning of 2004 between the Group and Thomson, TTE was formally established to combine the TV businesses of TCL and Thomson. TTE was held by the Group and Thomson as to 67% and 33% respectively.

It formally started its operations in early August last year. The initial net asset value of TTE was approximately HK$3,872 million, of which HK$1,910 million and HK$1,962 million was contributed by the Group and Thomson, respectively. A negative goodwill of approximately HK$598 million arose and is amortised on a straight line basis over the average remaining useful life of the acquired depreciable or amortizable assets.

In July 2004, the Company acquired from TCL Corporation 100% and 70% interest in Inner-Mongolia TCL Electrical Appliance Company Limited and TCL Digital Science and Technology (Wuxi) Company Limited, respectively ("Wuxi and Inner Mongolia Assets") at a total consideration of RMB231.5 million. The Wuxi and Inner Mongolia Assets were part of the Group's contribution into TTE as detailed above.

Liquidity and Financial Resources

The Group's principal financial instruments comprise of bank loans, factorings, convertible notes, cash and short-term deposits. The main objective for the use of these financial instruments is to maintain continuity in funding and flexibility at the Group's lowest cost. The cash and bank balances as at the year end amounted to HK$1.8 billion, of which 16% was maintained in Hong Kong dollars, 24% in US dollars, 23% in Renminbi, 27% in Euro and 10% held in other currencies for the overseas operations.

On 16 November 2004, the Company entered into an agreement ("Syndicated Loan Agreement") with a group of banks in relation to a dual currency term and revolving loan facility (the "Facility") of up to US$180 million. The term loan under the Syndicated Loan Agreement has a tenor of five years and is repayable in five equal semi-annual installments, commencing 36 months from the date of the Syndicated Loan Agreement with margin of 0.6% per annum above the inter-bank offer rate. The purpose of the Facility is to fund the operations of TTE. As at the year end, the Facility was fully drawn down.

Pursuant to a receivable purchase and sales agreement, to ensure the smooth running of TTE, Thomson agreed to purchase, on a rolling basis, up to a maximum outstanding amount of €100 million of the trade accounts receivables of TTE and its relevant subsidiaries. Such outstanding amount shall, from the first anniversary of commencement of operation of TTE, be reduced by 1/12 at the end of each month. The facility has been fully utilized and the balance at the year end amounted to HK$1.0 billion.

Save as disclosed above, there was no material change in available credit facilities when compared with the year ended 31 December 2003 and there was no asset held under finance lease at the year end. Convertible notes were subject to a fixed interest rate of 3% per annum.

As the distribution in specie of shares of TCL Communication was defined as capital distribution, in accordance with the terms of the convertible notes, the conversion price of the convertible notes was adjusted from HK$2.556 per share to HK$2.06 per share. At year end, a total of HK$256 million worth of convertible notes remained outstanding which entitled the holders to convert into 124,271,844 shares at the new conversion price of HK$2.06 per share.

At the year end, the Group's gearing ratio was 0.65 which is calculated based on the Group's net borrowing of HK$1,896 million (calculated as total interest-bearing borrowings less cash and bank balances) and the shareholders funds of HK$2,931 million.

Financial Risk Management

The Group enters into hedging transactions, principal interest rate swaps and forward currency contracts with the purpose of managing the interest rate and currency risks arising from TTE's operations and its sources of finance.

Interest rate risk

The Group's exposure to market risk for changes in interest rates relates primarily to the Group's long-term debt obligations.

The Group manages all bank debt at a corporate level and acquires appropriate external financing to meet the borrowing needs of all subsidiaries. The subsidiaries either borrow funds from the head office of TTE at a short-term floating rate basis, or borrow from local banks at short term basis under the close monitoring and supervision of the head office. Long-term and fix rate bank debts are done at a corporate level and the exposure thereof shall be hedged by TTE case by case in a cost-efficient manner. The Group's policy is to manage its interest exposure using a mix of fixed and variable rate debt.

Foreign currency risk

Due to its international presence and operations, the Group is facing foreign exchange exposure including transactional exposure and translational exposure.

It is the Group's policy to centralize foreign currency management to be able to monitor the Company's total foreign currency exposure, to net offsetting affiliate positions and consolidate hedging transactions with banks. The Group emphasizes the importance of trading, investing and borrowing in functional currency to achieve natural hedging.

FOCUS ON

Advanced

Technology